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AGRICULTURAL TRADE NEGOTIATIONS IN THE FTA AND NAFTA

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INTRODUCTION

Thank you for the opportunity to provide a Canadian perspective on agricultural trade negotiations in both the FTA and NFTA context.

I will focus on the agricultural aspects of the negotiations which led first to the establishment of the Canadian/USA Free Trade Agreement (FTA) and then a few years later resulted in the formation of the North American Free Trade Agreement (NFTA).

However, in order to put the North American scene into perspective, it is useful to first recall where agriculture was multilaterally when the FTA negotiations started in the summer of 1986.

To be frank, from the outset of the GATT, agriculture had been treated as a special case by the developed countries. Existing import quotas and other non-tariff barriers were grandfathered when countries joined the GATT and the GATT rules were written to allow import quotas in support of supply management. The special treatment for agriculture was continued in the mid-1950s when the GATT decided to eliminate industrial export subsides but not agricultural export subsidies. The proliferation of country-specific exceptions and special rules for agriculture meant that, while industrial trade barriers were progressively reduced over the post-world war period, distortions in agriculture actually increased.

Ineffective multilateral rules, rules which did not apply equally between countries, and the increasing tendency of governments to block GATT panel reports they did not like, formed the background to the agricultural negotiations of the FTA.

It is also worth noting that, in Europe, the Free Trade Agreement between the members of the European Free Trade Area (EFTA) and the original six members of the European Economic Community effectively excluded agriculture. Only in the case of the European Community's Custom Union was agriculture fully included. But as we all know now the price of European integration for world agriculture was very high. The resulting common agriculture policy was based on the lowest common denominator which meant very high commodity-specific price supports, even higher import barriers through the use of variable import levies and, as structural surpluses were created, increasingly aggressive use of direct export subsidies.

By the mid-1980s agriculture had become the 'bad boy' of international trade.

In contrast, prior to the negotiation of the FTA, roughly 50% of Canada/USA agricultural trade was already free. For much of the balance, successive rounds of GATT negotiations had resulted in tariffs which were relatively low, and in many cases matched US tariff rates. Only a few sectors were subject to non-tariff barriers. In the case of the USA, Section 22 import quotas were in place for dairy, sugar, cotton and peanut. In the case of Canada, GATT Article XI import quotas were being applied in support of the Canadian supply management systems for dairy, poultry and eggs.

While the overall level of support for agriculture was broadly comparable between the two countries, there were significant differences between commodity sectors. In the USA direct income support was concentrated in the grain sector whereas non-budgetary support provided through import protection was concentrated in the sugar and dairy sectors.

In Canada, the budgetary support was spread over a wider range of commodities but was particularly concentrated in the grains and red meat sectors. Non-budgetary support was provided to the supply-managed dairy and poultry sectors by restrictive import quotas.

It was against these international and domestic backdrops that many people questioned whether it would be possible for agriculture to be included in the FTA. Contrary to many expectations, substantial progress was made. In particular, it was agreed to phase-out all normal agricultural tariffs.

However, it quickly became apparent that both parties lacked the political will to eliminate import quotas and the USA was not prepared to negotiate either domestic support programmes or US marketing orders. Canada, for its part, was interested in defining what constituted a trade-distorting subsidy in order to avoid having its income support programme potentially vulnerable to US countervailing duties and protecting its marketing boards for dairy and poultry products. In the end, negotiations on internal support and countervailing duties had to be left to the Uruguay Round negotiations which had gotten underway in the fall of 1986.

Both countries agreed it made good sense to eliminate agricultural export subsidies on bilateral trade, but the USA was not willing to accept effective disciplines on export subsidies to third markets. For the USA, a multilateral agreement on export subsidies was the main goal of the Uruguay Round.

There was early recognition in the FTA negotiations that as conventional trade barriers were reduced it was essential to ensure that technical regulations, such as sanitary and phytosanitary measures, were not used as disguised barriers to trade. The FTA negotiations in this area provided a model for the NAFTA and GATT negotiations.

It is important to note that while the FTA ultimately did not address import quotas and internal support, and only dealt with the bilateral use of export subsidies, the negotiators nevertheless recognized the interrelationships between domestic agricultural policies and agricultural trade problems. This recognition reflected the path-breaking work of the OECD and GATT's preparatory committee on agriculture (The de Zeeuw Committee) which in the early 1980s provided the first intergovernmental acknowledgement that agricultural trade problems were directly linked to the level and type of domestic agricultural support.

Consequently, the final results of the FTA negotiations, which were concluded in December 1987, were not as broad as the Uruguay Round nor as deep as the results achieved between Mexico and the USA in the NAFTA negotiations a few years later. However, the FTA results were largely shaped by the perception of the US administration at the time, which did not believe that a bilateral negotiation had the necessary critical mass, i.e. the more sensitive issues could only be sold to Congress as part of a much larger multilateral negotiation.

MEXICO AND NAFTA

An important aspect concerning Canadian involvement in NAFTA, is our changing view of Mexico. Rather than just being a warm country to vacation in during the winter, Canadians have discovered Mexico as a place to do business. Visits by Canadian business people as registered by our embassy in Mexico City have increased dramatically.

When it became clear that Mexico and the United States were intent on concluding an arrangement similar to the FTA, Canada faced two choices. We could watch from the sidelines and let our neighbours to the south work out a bilateral agreement or, we could take advantage of the opportunity to secure ease of access to new markets and to ensure our interests under the FTA were protected. The latter was the option chosen.

A trade agreement between the USA and Mexico alone would have meant that the USA would have free trade with Canada and Mexico, although Canada and Mexico would not have free trade with each other. This so-called 'hub and spoke' arrangement would have disadvantaged Canada as a place for investment.

Canada's participation in the negotiations, ensured development of an integrated market, with trade rules that apply equally to all three countries.

The United States and Mexico have agreed to phase-out without exception, all agricultural tariffs and non-tariff barriers with extended transition periods for sensitive products. At the start of the NAFTA negotiations over 80% of Mexico's agricultural exports to Canada entered duty-free. By contrast most Canadian goods and services faced barriers entering Mexico, primarily import licenses – in effect this was an unbalanced situation in Mexico's favour. NAFTA provides for the elimination of all Mexican and Canadian agricultural tariffs and non-tariff barriers, except the non-tariff barriers affecting Canadian dairy, poultry and egg sectors and the Mexican sugar import regime.

In the case of Canada's supply-managed products (dairy, poultry and eggs) Canada's position from the outset of the NAFTA negotiations was that GATT Article XI import quotas were not negotiable in a NAFTA context and we would only address Article XI in the GATT multilateral negotiations. In the final analysis Canada accepted MTN tarrification of

GATT Article XI. The upshot is that the tariff equivalents for the dairy, poultry and egg sectors introduced consistent with the WTO remain in effect under the NAFTA.

Sugar is somewhat different Here, Mexico wanted Canada to adopt the same import regime against third countries as adopted by the United States and Mexico.

We said no, on the grounds that higher sugar prices in Canada would adversely affect consumers and the competitivity of food processors. In the end it was agreed that Canada would apply against Mexico the same tariffs Mexico applied against Canada on sugar and syrups.

Will Canada be at a disadvantage *vis-à-vis* the USA in the Mexican market? For dairy, poultry, eggs and sugar, the answer is , of course, yes. In these areas, Canada will continue to be treated by Mexico as a GATT trading partner, just like the European Community or New Zealand, and we will not receive the preferential and ultimately duty-free entry that the USA will receive for these products. However, for all other agricultural products Canada will receive the same or equivalent access to Mexico as the USA. Imagine you are an agri-food company in south-west Ontario and a market of 85 million consumers opens up – remembering Laredo, Texas (on the Mexican border) is closer than Edmonton! What an economic opportunity.

Will NAFTA affect Canada/USA agricultural trade? Not really. Agricultural trade between Canada and the United States will continue to be governed by the provisions of the Canada/United States Free Trade Agreement which were legally incorporated into NAFTA. These provisions provide for the phased elimination of all agricultural tariffs, except Canada's Article XI import quotas supporting marketing boards and the US Section 22 import quotas on sugar, dairy and peanut which were tariffied under WTO, remain.

IMPACTS ON CANADIAN AGRICULTURE

While the FTA was not as comprehensive as the USA/Mexico negotiations under NAFTA, which did eliminate import quotas as well as tariffs, both the FTA and NAFTA have had important impacts on Canada.

Firstly, exports to the USA have grown appreciably (more than 130% since the agreement entered into force on 1 January 1989). The same is true for Canada's agricultural exports to Mexico which have quadrupled since 1991. In 1994 Canada's exports to Mexico grew by 42% in the first full year of NAFTA. The more rapid expansion of Canadian agricultural exports to the USA, as compared to the slower growth to third countries, has meant that the importance of the US market for Canadian agriculture has increased significantly.

In 1988 the USA accounted for 31% of total Canadian agricultural exports. In 1994 the USA accounted for 53% of total Canadian agricultural exports.

While both primary and processed products have shared in the growth of exports to the USA, it is becoming increasingly evident that to date the greatest impact of the FTA has been on the food processing sector – both in terms of investment and product specialization decisions. Let me take a moment to explain.

Prior to 1989, the Canadian food manufacturing sector was largely a branch-plant operation. That is to say, transnational as well as Canadian-owned companies were largely content to produce mainly for the domestic market behind fairly high tariffs, typically in the 15–17.5% range. As a consequence, production runs tended to be small and processing and distribution costs fairly high.

However, since 1989 the Canadian food processing sector has undergone a number of important transformations.

Firstly, the management mind-set has changed fundamentally. Companies are increasingly operating as part of a North American and, in some cases, a global market. Product specialization, economies of scale, and north-south as opposed to transnational marketing, are increasingly the watch words of the agri-food business community. Cargill, ADM, Iowa Beef Packers and a number of other major US food processing companies have all increased their investment in Canada, particularly in the beef packing and oilseed crushing industries. Many transnational companies have reduced the number of product lines produced in Canada, but have given the Canadian operation the product mandate to service, say, the North American eastern seaboard or the Pacific north-west.

Although some production lines have been pulled back to the USA, on balance it would appear that Canada has gained more investment than it has lost. There is no doubt that the rationalization which has occurred has helped the Canadian food processing sector to become increasingly competitive and increasingly orientated towards servicing a North American agri-food economy.

At the primary producer level the adjustments have not been as great. The main exception was the grape-producing sector which had to make major adjustments to survive in a less protected wine environment. On the other hand, the cattle, hog, grains and oilseed, and most of the fruit and vegetable sectors were already operating largely within a North American market or on a North American competitive basis.

What the FTA and NAFTA have done is to make access to the USA and Mexico more secure and in most cases free. More fundamentally it has encouraged producers, processors and federal and provincial governments to recognize that in order to prosper Canadian agriculture has to become more regionally and globally competitive.

It is therefore rather ironic that the main sector where Canada has been globally competitive for many decades, the Canadian wheat and barley sector, is currently experiencing difficulties fully accessing the US market.

LESSONS

Let me now turn to some of the lessons we have learned from the FTA and NAFTA trade agreements.

As trade barriers come down it becomes difficult, if not impossible, to continue to ignore the impact of producer support programmes and marketing systems on food processors. As barriers are reduced, it becomes progressively more difficult for one partner to maintain a two-price system. Some examples illustrate this. In Canada, it was recognized that once the FTA was implemented, it would be impossible to continue to have a 'made-in-Canada' price for domestic sales of milling wheat if imports of US bread, biscuits and pasta were to enter duty-free. As a consequence, Canada unilaterally abolished its long-standing two-price wheat system once the FTA negotiations were completed.

Similarly, where protection was maintained in the supply-managed sectors it was immediately evident that Canadian processors of, say, chicken TV dinners would have to have access to inputs at US competitive prices if Canadian companies were to compete with duty-free imports of the finished product. This required the introduction of a supplementary import quota system which favoured further processors.

On the US side the reintroduction of grain export subsides in 1985 after more than a decade of absence has clearly acted to attract increased imports of Canadian wheat. The EEP programme has resulted in US domestic wheat prices being extremely attractive relative to off-shore markets, particularly where the USA and EU are going head-to-head with export subsidy competition. In the case of durum wheat, for example, high EEP subsidies shorted the US market and caused increased imports of durum from Canada as well as increased imports of pasta from off-shore.

Another lesson is that as barriers come down differences in support and marketing systems may begin to be perceived as unfair. Unfortunately, in politics perception is reality. Again the grain sector is a classic example. Even though US support levels for wheat and barley are roughly twice those of Canada, the fact that Canada markets these grains through a single desk selling agency – the Canadian Wheat Board – has acted as a lightening rod. These differences in the grain sector nearly resulted in a full-scale trade war last summer.

Similarly, Canada's insistence on maintaining protection for supply-managed products (i.e. dairy, poultry and egg marketing boards) has precipitated US poultry and dairy producers to argue that, notwithstanding the import quota exceptions negotiated in the FTA, all barriers should now be progressively eliminated. Continuing differences between Canada and the USA as to whether the GATT conversion of import quotas into tariffs should result in agreement to phase-out the ensuing tariff equivalents on bilateral trade of such tariffs, will probably lead to the establishment of a formal NAFTA dispute settlement panel later this year.

The importance of effective dispute settlement provisions cannot be over-emphasized. The capacity to refer intractable trade disputes to an impartial panel for an objective finding of the facts helps to prevent special interest groups from hijacking the agreement and allows governments to diffuse trade disputes which have become too politicized to be resolved through normal bilateral consultations.

All the foregoing suggests that while domestic support and market policies do not have to be harmonized, it becomes increasingly difficult to manage the trade relationship if the policies diverge too widely. It has also become increasingly evident that as investment and trade barriers are reduced governments have to be conscious of the impact of their producer support policies on the production and investment decisions of food processing companies which are increasingly prepared to move resources to regions which offer the best long-term returns. This has particular significance for smaller countries which must offer a hospitable economic environment if they are to attract and maintain scarce investment resources in the agri-food processing sector.

CONCLUSIONS

As someone who has spent most of his career in trade policy, I am very much aware that trade negotiations are a means to an end. Whether these negotiations are bilateral, regional, or multilateral, the key objectives remain the same. We want freer and more secure access which will enable domestic producers and processors to invest and plan with greater confidence.

We want a rules-based agreement where all the parties are subject to the same rules, and the rules are backed-up with an effective dispute settlement system.

We want an agreement which is seen by all parties to be fair and mutually beneficial.

The bottom line is that international economic relations are about enlightened self-interest. In this respect agriculture is no different than any other sector of the economy. However, the politics of agriculture are such that often the outcomes are less than perfect. In this regard Arthur Dunkel, the ex-head of the GATT, often liked to remark: "The best is often the enemy of the good". Sometimes it is possible to move ahead on a revolutionary rather than an evolutionary basis. But sometimes we have to be satisfied that a partial outcome is still very much preferable to the status quo.

With the benefit of hindsight, perhaps the most important lesson to be learned from the trade negotiations in the FTA and NAFTA is that domestic policy-makers in the future will no longer be able to develop domestic agricultural policies in a vacuum. As trade barriers come down countries can no longer respond only to domestic political imperatives. They must begin to frame their agricultural policies in such a way that they are more compatible with freer and less distorted markets.

While I do not believe that free trade agreements have to result in identical agricultural policies, the experience of the FTA and NAFTA agreements for Canada clearly suggest that the parties to such agreements must begin to adjust their policies to make them more compatible if the agreements are not to fracture.

I am reasonably confident that, provided adjustments are not expected to be made overnight, it is well within the realm of the possible to gradually bring differing agricultural support and marketing systems into greater convergence, thereby reducing the potential for friction and maximizing the prospects for a mutually beneficial trading relationship.

In agricultural trade negotiations it has been my experience that the most important negotiation is the one at home. The key to any successful negotiation is to persuade the domestic stakeholders that, given sufficient time, they can adjust to the terms of the agreement. In these domestic negotiations, the trick is to demonstrate that there are opportunities as well as challenges.

The experience of the Canada/USA Free Trade Agreement and the New Zealand/Australia Free Trade Agreement is that it is the smaller partner which is more likely to adjust faster, therefore capturing more of the opportunities associated with a larger, integrated market.

In closing, let me stress that it is all too easy in a talk to over-emphasize the difficulties associated with regional trade agreements. This would not be the main lesson to draw nor the conclusion I want you to take from this meeting today. While there continue to be some problems, the fact remains that in North America the vast bulk of agricultural trade flows without difficulty, to the mutual benefit of producers, processors and consumers in all three North American countries.

Thank you.