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# The U.S.-Canada Free Trade Agreement and Agriculture: One Year Later

Carol Goodloe

On January 1, 1989, the much-heralded—or much-maligned, depending on which side of the border you sit—U.S.-Canada Free Trade Agreement (FTA) went into effect. With only a year and a half under its belt, the FTA continues to generate discussion and debate in Canada, as it has ever since Prime Minister Mulroney proposed the idea at the "Shamrock Summit" in 1985. The FTA is actually generating some columns in the U.S. press as well. Agricultural and natural-resource topics remain prominent in U.S.-Canadian trade issues.

With respect to agricultural trade, this paper attempts to summarize what the FTA has done, what it has not done, and what it might do in the future. The direct, measurable effects of the FTA on agricultural trade are small, generating perhaps a 1 percent increase in U.S. agricultural exports in 1989 and an even smaller increase in U.S. agricultural imports from Canada. Although not measurable, more important have been the indirect effects of the FTA on policy and trade in both countries. Because the FTA basically left both countries' agricultural and trade policies intact, numerous trade problems continue, about which the FTA has had little to say. But in a broader perspective, the FTA may be a harbinger of the future if regional trading arrangements and greater economic integration assume greater importance in the world trading environment. If this case proves true, even the limited coverage of agriculture in the FTA may prove to be important.

## What Has the FTA Done?

The agricultural provisions of the FTA are generally limited and narrow, with the exception of the staged tariff removal on all products. The major items include:

- *Article 701*: public entities cannot export agricultural goods to the other country at a price

below the acquisition price, plus storage and handling costs; Canadian goods (eligible grains and oilseeds) shipped to the U.S. through West Coast ports are excluded from receiving transport subsidies.

- *Article 702*: tariff snapback on fresh fruits and vegetables.
- *Article 704*: both countries exclude each other from their respective meat import laws.
- *Article 705*: Canada will take off its import license on wheat, barley, and oats when the U.S. government support level for each grain is equal to or less than Canadian government support. The support methodology is contained in Annex 705.4.
- *Article 706*: Canada enlarges its global import quotas for chicken, turkey, and shell eggs.
- *Article 707*: the U.S. will not place any quantitative import restriction or fee on Canadian imports of products containing 10 percent or less sugar.
- *Article 708*: technical regulations and standards.
- *Chapter 8*: regulations regarding listing, pricing, and distribution policies for wine and distilled spirits, primarily aimed at the Canadian wine industry.

Before examining some of the trade and policy effects of specific provisions of the FTA, one can boldly state that the FTA—or at least the process of negotiation—turned the U.S. from a net agricultural importer from Canada into a net agricultural exporter. This curious shift results from a deficiency in U.S. export data that became increasingly evident during the FTA negotiations.

## *Change in the Bilateral Trade Balance*

If one looks at U.S. agricultural exports to and imports from Canada, using official U.S. data from the Census Bureau of the Department of Commerce, the U.S. became a net agricultural importer from Canada in 1985. However, using Canadian import data in lieu of U.S. export data shows the

U.S. had an agricultural trade surplus of over \$620 million in 1985.

Discrepancies often exist between two countries' export and import data (that is, what a country reports as exports rarely matches what the receiving country says it imported from that same country) because of differences in reporting requirements, shipping periods, and other administrative factors. The census data, however, substantially understate U.S. exports to Canada because of undocumented shipments. The magnitude of the discrepancy appears unique to Canada and likely results from the long, relatively unguarded border between the two countries. A comparison of U.S. export data with Canadian import data reveals that the underreporting problem worsened in the 1980s (Table 1). As of January 1990, the Census Bureau is reporting Canadian import data in lieu of U.S. export data to represent U.S. exports to Canada (Davis, Good-loe, and Gill).

### *Direct Effects of the FTA*

The agricultural provisions, despite being targeted at specific bilateral trade irritants rather than designed to bring about policy reform or harmonization, have produced a variety of effects, both

direct and indirect. Most of the measurable trade effects stem from tariff reduction and changes in Canada's poultry quotas (Table 2).

*Tariff reduction.* On January 1, 1990, tariffs on most agricultural products came down 10 percent as part of the general tariff reduction provisions. Tariffs on some items were completely removed and on others were dropped 20 percent. In addition, Article 401.5 of the FTA provides for accelerated tariff reduction, subject to agreement by both sides. On April 1, 1990, tariffs on about twenty agricultural items (including animal carcasses, honey, various cereal products, oilmeals, lard and other animal fats, and pet food) fell to zero.

Because agricultural tariffs are generally low and not significant barriers to trade, tariff removal was not a contentious issue. Using three simplifying assumptions of complete pass-through to consumers of tariff reductions, import demand elasticities of 1.0 for both countries, and an average tariff rate for food products (3.8% for the U.S. and 5.4% for Canada), one can estimate the one-year impact of tariff removal on U.S. agricultural exports to and imports from Canada. About 8 percent of the \$382 million increase in U.S. agricultural exports to Canada in 1989 can be attributed to Canadian tariff reduction. Similarly, about 5 percent of the \$473 million increase in U.S. agricultural imports from Canada can be attributed to U.S. tariff reduction.

*Tariff snapback.* Tariffs on fresh produce are scheduled to come down 10 percent annually, but the special tariff provision in Article 702 allows the tariff to revert back to its previous higher level for up to 180 days if certain price and acreage conditions are met. On May 4, 1990, the special tariff provisions for fresh fruits and vegetables were exercised for the first time. Canada "snapbacked" its tariff on U.S. fresh asparagus imports from 12 percent to 15 percent. Estimating the impact of this slightly higher tariff is not possible at this point, although the U.S. asparagus industry noted that the bulk of fresh exports come from California, whose season is almost over (U.S. Department of Agriculture/Economic Research Service).

**Table 1. Comparison of U.S. Export Data and Canadian Import Data**

Year	U.S. Exports	Canadian Imports <sup>3</sup>	Difference	Percentage Difference <sup>b</sup>
	----- Million U.S. Dollars -----		-----	Percent
1968	596	528	68	11
1969	712	600	112	16
1970	826	639	187	23
1971	760	698	62	8
1972	843	822	21	2
1973	1,034	1,221	-187	-18
1974	1,281	1,614	-333	-26
1975	1,304	1,566	-262	-20
1976	1,484	1,858	-374	-25
1977	,534	1,924	-390	-25
1978	,621	2,018	-397	-24
1979	,647	2,286	-639	-39
1980	,852	2,494	-642	-35
1981	,988	2,722	-734	-37
1982	1,820	2,481	-661	-36
1983	1,844	2,531	-687	-37
1984	1,963	2,787	-824	-42
1985	1,622	2,514	-892	-55
1986	1,542	2,617	-1,075	-70
1987	1,808	2,934	-1,126	-62
1988	2,019	3,218	-1,181	-58
1989	2,228	3,600	-1,372	-62

<sup>a</sup> Canadian data converted to U.S. dollars using an annual average exchange rate. <sup>b</sup> Difference divided by U.S. export data.

**Table 2. Direct Trade Effects of the FTA**

Policy	U.S. Exports	U.S. Imports
	Million U.S.	. Dollars
Tariff reduction	32.0	24.0
Poultry quotas	13.6	NA
Chicken	9.2	NA
Turkey	2.4	NA
Shell eggs	3.0	NA
Oats	0.3	NA
Total change	45.9	24.0
1989 trade	3,600.0	2,915.6

Since this provision was included in the FTA mainly at the insistence of Canada, given the vulnerability of its horticultural industry to low-priced imports, it is not surprising that Canada was the first to invoke it. From the U.S. perspective, although the possibility exists that the snapback could be used against Canadian exports of certain storage vegetables (potatoes, carrots, onions), the cost of developing and maintaining a price and acreage database for over fifty fruits and vegetables will likely outweigh any U.S. benefits received from higher tariffs.

On the other hand, this provision will be in effect for twenty years. Any price impacts will be much greater the further out into the twenty-year period the snapback is used. After ten years, tariffs will be zero. At that time, the price effect of reverting to the most favored nation (MFN) rates, which currently range from 10 to 15 percent on most fruits and vegetables, will be substantial.

*Support calculations for wheat, barley, and oats.* The support calculations represent the first and novel use of an "aggregate measure of support," a concept that has been talked about and used in academic circles for several years. The FTA may be the first official government-to-government agreement to contain algebra. The provision is structured such that if the U.S. lowers its subsidies, it is rewarded with increased market access.

Support calculations are based on a two-year average level of support and have been done for two years. The 1989 calculations showed U.S. support levels higher for wheat and barley, but lower for oats. Canada was obligated to remove its import licensing requirement for oats. Since the U.S. is a large oat importer from Canada, removal of the licensing requirement was not expected to have much effect. U.S. oat exports rose marginally in 1989. However, even if one assumes all of the increase in U.S. oat exports in 1989 (\$284,000) was a result of the license removal, this value is only slightly more than the cost of paying lots of

bureaucrats and lawyers to wrangle over the calculations!

The 1990 calculations showed U.S. support levels for wheat and barley were still above Canadian levels. The wheat calculations were very close—45.80 percent for the U.S. versus 44.83 percent for Canada. The U.S. starts out next year with a strong advantage: U.S. wheat support for 1988-89 (one-half of next year's support level) is 30.36 percent compared to 43.10 percent for Canada.

The direct effect of the grain-support calculations—including the removal of Canada's oat license requirement—has been straightforward and relatively insignificant. But there have been several indirect effects, of relevance mostly to Canada, which will be discussed below.

*Changes in poultry import quotas.* Canada enlarged its global poultry import quotas to equal actual imports over the previous five years. The new global quota is now equal to the old global quota plus any supplemental quotas, which Canada often issued in addition to the global quota. Canadian chicken, turkey, and shell egg imports grew substantially in 1989 over 1988 (Table 3).

As with other aspects of the FTA, to ascribe changes in trade to specific FTA provisions is difficult. For chicken and shell eggs, since actual 1989 imports exceeded both the old and the new quotas, some of the increase would likely have occurred even without the new, larger quota. Assuming the difference between the old and new quotas represents additional U.S. exports, U.S. chicken exports increased \$9.2 million and turkey exports \$2.4 million. For shell eggs, the difference between the old and new quotas was greater than the increase in U.S. exports. However, if one attributes all of the increase in exports to the new quota, U.S. shell egg exports increased \$3 million.

*Changes in Canadian wine policies.* For many years, the U.S. and the European Community (EC) complained about discriminatory Canadian practices on wine imports. U.S. wine producers felt

**Table 3. Canadian Poultry Quotas and Imports**

Item	Old	New	1988 Imports	1989 Imports		
	Quota	Quota		Old	New	Actual
	Level <sup>3</sup>	Level <sup>3</sup>		Quota	Quota	
	----- - Percent -----	-----	-----	-----	Metric Tons-----	-----
Chicken	6.3	7.5	41,000	34,000	40,500	47,000
Turkey	2.0	3.5	2,000	2,400	4,105	4,000
Shell eggs <sup>b</sup>	.675	1.647	293	186	454	496

Sources: Agriculture Canada, ERS, Foreign Agricultural Service. <sup>a</sup>

Expressed as a percentage of production. <sup>b</sup> 1,000 boxes of 15 dozen.

they could export more wine to Canada if these wine policies were altered. Chapter 8 of the FTA provides for equal treatment of domestic and imported wine, with a few exceptions. Although implementation of Chapter 8 has been slow, especially in Ontario, 1989 data indicate the wine provisions appear to have had an impact on U.S. exports (Table 4). The quantity of U.S. wine exports increased sharply, but the value only slightly, meaning the export unit value fell dramatically.

Shortly after the FTA went into effect, one researcher asked, with the advantages eroding for Canadian domestic wine, whether demand for wines for blending would increase (Lindsey). Based on one year of data, the answer may be yes, assuming the lower-value wine is bulk rather than bottled wine. Whether this situation of bulk versus bottled wine continues will be interesting to monitor. U.S. producers would no doubt prefer to tap into the more profitable bottled-wine market, but whether and how fast this occurs depends on how quickly provinces implement the FTA provisions.

### *Indirect Effects of the FTA*

The indirect effects of the FTA, while not measurable, are more significant in terms of policy changes and potential trade effects than the direct effects described above. The indirect effects point out that the FTA provisions affecting agriculture, while seemingly limited in intent, are having repercussions on the agricultural policy process in both countries. Although many of the potential changes would fall hardest on Canada, the U.S. has a major interest in the effect of the changes.

*Canadian quotas on dairy products.* Within two months after the FTA was initialed and a year before it came into force, Canada put various dairy products on its Import Control List, meaning a license was required to import these products. The U.S. protested the action before the General Agreement on Tariffs and Trade (GATT). Thus began the saga that illustrates Canada's basic farm policy dilemma, both in the FTA and in the current Multilateral Trade Negotiations (MTN): how to support

producers, by raising farm prices above import levels, without jeopardizing the competitiveness of the food-processing sector, which is forced to buy higher-priced domestic raw products.

The problem came to a head when the FTA was signed. Tariffs on processed dairy and poultry products are relatively high to protect domestic processors. (Canadian processors of fruit, vegetables, malting barley, and, until recently, wheat face a similar situation; horticultural products are not regulated by supply-management systems but are usually subject to some marketing board requirements.) Even though the FTA leaves both countries' dairy policies untouched, tariffs will still come down on all dairy products. In Canada, most dairy products are subject to quotas or licensing requirements as part of the supply-management system that regulates production, prices, and trade. Yogurt, ice cream, and some other products, however, were not covered by the import quotas. Canadian producers were afraid as tariffs fell, they would face stiff competition from lower-priced U.S. imports. The dairy industry successfully petitioned the government to restrict imports of these products.

Even though Canada's supply-management systems for dairy and poultry are "legal" under GATT Article XI, which allows import restrictions in conjunction with domestic production controls, the GATT ruled in September 1989 that yogurt and ice cream could not be placed under quotas because they were not "like products" to milk. Canada refused to make any policy changes (*The Economist*) until after the MTN is over in December (citing a U.S. delay in changing its patent-infringement procedures) and is now working to "strengthen" GATT Article XI, meaning change the article so more products can be brought under its sway.

The U.S. is watching these developments closely from both a bilateral and multilateral perspective. The U.S. will no doubt continue to push Canada to open its import market for U.S. products under the aegis of the FTA. Canada's stance in the GATT is also key; the two countries have generally agreed on the objective of eliminating trade-distorting agricultural subsidies. However, Canada's Article XI proposal runs counter to that objective and could lead to tensions between the two countries. Canada may ultimately be faced with either dismantling its supply-management systems or becoming more protectionist by sealing its border to imports to maintain the systems.

*Changes in the Canadian Wheat Board.* The combination of Article 705 and one part of Article 701 is leading to some interesting developments

**Table 4. U.S. Wine Exports to Canada**

Item	1988	1989
Quantity (HL <sup>a</sup> )	15,082	197,150
Value (thousand \$U.S.)	13.078	17.861
Unit value (\$US/HL)	867	91

Source: U.S. Department of Agriculture, Economic Research Service.

<sup>a</sup> Hectoliter.

concerning the Canadian Wheat Board (CWB), arguably the most important institution in Canadian agriculture, and one the U.S. watches closely. To protect the integrity of its export monopoly on wheat, barley, and oats, the CWB required import licenses, which were rarely issued. This system allowed Canada to maintain a two-price situation for wheat (and a de facto one for malting barley). After the passage of the 1985 U.S. Farm Bill, as world prices began to fall, Canadian domestic wheat prices greatly exceeded Canadian export prices.

Even before the FTA went into effect, the CWB announced changes in the two-price wheat policy for the 1988-89 marketing year. Prices would be adjusted every two months, rather than being fixed, based on conditions prevailing in the North American market. Although the gap between domestic and export prices had become politically untenable, the prospect of the import license being removed as a result of Article 705 was likely a consideration as well. The CWB has announced that it will move to daily wheat pricing for the 1990-91 marketing year.

Several developments have also surrounded oats marketing. Even before the 1989 support calculations were completed, there was widespread feeling that Canadian support levels for oats would be above U.S. levels. In early 1989, the CWB announced that oats would no longer be under its jurisdiction beginning in August 1989. The announcement aroused much domestic opposition from farm groups who said they had not been adequately consulted about the change. Although officially unconnected, the timing of the announcement was curious.

In January 1990, the CWB announced the final payments for the 1988-89 marketing year, the last year the CWB marketed oats. The feed-oats pool was in deficit by CDN \$32 million. Because of record CWB oat exports to the U.S., the question whether Canada violated Article 701.3 (exporting goods below acquisition cost) has been raised. The deficit highlights U.S. concerns about CWB price transparency; that is, that the CWB does not reveal sales prices.

The U.S. government for some time has felt that the monopoly pricing and export authority of the CWB gives it an unfair advantage in the highly competitive world wheat market. CWB pricing has also been an issue in the debate over large durum wheat exports to the U.S. the past few years. By not revealing its sales prices, the CWB is probably better able to extract that last dollar per ton out of a customer. The U.S. implementing legislation for the FTA specifies review of CWB pricing policies to ensure compliance with Article 701.3. The U.S. government will continue to press Canada and the

CWB to make clear at what prices goods are sold to the U.S.

Opening the border to grain, especially wheat, poses considerable difficulties for the CWB. Would U.S. wheat interfere with Canada's complex grading and transportation systems? Would U.S. wheat end up comingled with Canadian wheat and receive the subsidized freight rates? Opening the border means opening Pandora's box for the CWB. Perhaps the CWB chose to remove oats from its jurisdiction because it was not sure how to resolve these questions, if even for a small quantity of oats imports.

These changes and events, seemingly trivial in isolation, add up to considerable pressure on how the CWB operates, not just in respect of U.S. trade but in its overall operations. Couple an open border with more transparent pricing and the CWB loses a tremendous advantage in marketing wheat. Assuming the calculations show U.S. wheat support levels to be lower next year, the CWB has a year to figure out how to deal with an open border. The FTA may prove to have resounding implications for one of Canada's foremost institutions, possibly to the U.S.'s advantage in world grain trade.

*Changing nature of beef trade.* Under Article 704, both countries are excluded from each other's meat import laws. Even though pre-FTA beef trade was relatively free, the expected result of this provision, as indeed with the entire FTA, is to shift trade from an east-west flow, especially in Canada, to a north-south (cross-border) flow. Although other factors besides the FTA are at work (the opening of the Japanese and Korean beef markets is influencing the entire Pacific Rim beef trade), this shift seems to be occurring. More beef is being exported to the U.S. from western Canada, while U.S. exports into Ontario and Quebec are growing. The trade patterns mirror changes in the Canadian cattle sector, where herds are increasing in the West but declining in the East. The FTA may have been a factor in the opening of a large, modern beef packing plant in Calgary in 1989. The plant is expected to reduce Canadian feeder cattle imports from the U.S. and increase Canadian fed beef exports to the U.S. (Dyck).

*Changes in meat inspections.* On February 26, 1990, the U.S. and Canada announced they had agreed to a one-year test that would allow meat products to move freely across the border without routine reinspections. Each country would accept each other's meat inspection procedures (USDA/Foreign Agricultural Service). This decision follows in the wake of a growing controversy about U.S. inspection procedures after the FTA went into effect. Shortly before the FTA was initialed, the

U.S. Department of Agriculture (USDA) gave the green light to private U.S. companies to build inspection stations on the border. This decision reflected an earlier U.S. decision to inspect meat at border points rather than at destinations (Keller). But with the passing of the FTA, Article 708.3 called for harmonization or acceptance of each other's inspections systems. Just when the FTA was calling for peace and harmony on the border, the U.S. stepped up the intensity of its inspections, about which the Canadians claimed harassment and increased expense due to a high rate of rejections. The announcement has met with opposition from the U.S. Congress and has not yet been implemented. The proposed changes have raised questions about the legal authority under the FTA to change U.S. inspection procedures as well as USDA procedures to determine whether Canadian inspection procedures are equivalent to U.S. procedures. This issue will be an interesting test case to see how provisions under Article 708 (technical regulations) are implemented.

### **What Has the FTA Not Done?**

The FTA has not automatically ushered in a harmonious trading environment and solved all the bilateral trade issues. In fact, as described above, the FTA has managed to create some new headaches and intensify some old problems. The disputes have ranged from apples to wool, with bees, beer, and just about everything else in between.

#### *Trade Issues Abound*

In addition to placing dairy products under quotas, in 1989 Canada also put antidumping duties on U.S. red delicious apples and sour cherries. In May 1989, Canada imposed an import quota on broiler hatching eggs and day-old chicks under the auspices of the newly created Canadian Broiler Hatching Egg Marketing Agency. The U.S. requested GAIT consultations to investigate whether the quota was consistent with GATT requirements, but the issue is still not resolved.

There is another long-standing issue that concerns the Canadian marketing board for eggs, the Canadian Egg Marketing Agency (CEMA). CEMA purchases all eggs; eggs in excess of domestic demand are sold at a discount to processors which make them into egg products. U.S. producers claim that exports of these egg products are sometimes dumped into the U.S., depressing U.S. prices. A U.S. producer group maintains that CEMA is a public entity and is violating Article 701.3. The

issue has not yet been resolved (USDA/Foreign Agricultural Service).

The U.S. is also protesting new grade-labeling regulations for fresh produce implemented by Canada on January 1, 1990. The regulations require grade labeling on all fresh produce shipped in consumer-size packages. Since the rules do not apply to produce grown and traded in the same province (about 70 percent), the U.S. feels imports are unduly affected. The U.S. is considering several options to resolve the issue (USDA/Foreign Agricultural Service).

#### *Durum Wheat and Pork Imports Trouble U.S.*

From the U.S. perspective, two major trade problems have loomed large since the FTA went into effect—imports of durum wheat and pork from Canada. U.S. durum wheat imports began increasing in 1986-87, much to the consternation of U.S. durum growers. The U.S. International Trade Commission was asked to conduct a study on the competitiveness of the U.S. and Canadian durum sectors, to be released June 22, 1990. This issue raises again the question of CWB price transparency, since some U.S. producers claim Canadian durum has been dumped in violation of Article 701.3.

The issue of Canadian hog and pork imports has been around since Canadian imports of live hogs began accelerating in 1984. A U.S. countervailing duty (CVD) was placed on hog imports in 1985 and on pork imports in 1989. Canada protested the CVD and called for a panel under the FTA dispute settlement mechanism. A ruling will be issued in the fall to determine whether the U.S. CVD was issued consistent with U.S. law.

#### *U.S. Sugar Policy Gets Even Stickier*

Sugar has been a sticky issue between the U.S. and Canada ever since the U.S. put quotas on sugar in 1982. As U.S. and world sugar prices began to diverge, U.S. importers found it profitable to import sugar-containing products, made with lower-priced world sugar, from Canada and other countries to extract the sugar. The U.S. responded by putting quotas on some sugar-containing products. Canada pressed this issue in the FTA negotiations and was granted a concession in the form of Article 707.

When the U.S. converted to the Harmonized System of tariff codes, effective January 1, 1989, significant exports of Canadian sugar blends were reclassified as quota sugar. Canada protested the change, claiming that CDN \$30 million worth of

sugar blends were affected (USDA/Foreign Agricultural Service). Canada has threatened to retaliate by withdrawing concessions on U.S. products. The issue remains unresolved.

A GATT ruling in June 1989, on a complaint by Australia, found U.S. sugar import quotas violated Article XI. The U.S. accepted the GATT ruling and is now exploring options to bring the U.S. sugar program into compliance. Several proposals have been put forth as part of the 1990 farm bill process. Any proposal will have to balance the preferential treatment now accorded Canada under the FTA with limits on Canadian access so as not to disrupt any new U.S. sugar regime (McNair).

### *Can Trade Issues Be Solved?*

To summarize the nature of the trade disputes that remain impervious to easy solution despite the FTA reveals the conflict between agricultural policies that support producers and freer trade in agricultural products, the selfsame issue with which the MTN is grappling. Trade issues have revolved around (1) highly protected, politically sensitive sectors—for example, dairy, sugar, and horticulture (in Canada); (2) institutions that isolate producers from world market signals and are not transparent in their actions (Canada's marketing boards); or (3) alleged unfair, inconsistent use of trade protection laws (U.S. countervailing and antidumping laws). That these issues have not yet been successfully resolved in the bilateral context between two relatively friendly, peaceful traders does not bode well for a successful MTN conclusion.

### **What Might the FTA Do in the Future?**

After grinding through the minutiae of agricultural trade effects and disputes, is it possible to sit back and put the FTA in a broader perspective? As two authors put it, is the FTA a "special case or the wave of the future?" (Lipsey and Smith).

#### *The Rise of Preferential Trading Arrangements*

The recently concluded FTA, the greater economic integration envisioned under the European Community's (EC) 1992 program, and the slow progress in the current MTN have focused attention on preferential trading arrangements (PTAs) as alternatives to the multilateral system codified under GATT. The increase in preferential arrangements has raised concerns that their proliferation will have adverse effects for the world trading system. (The

following material is taken from Goodloe and Normile.)

*Shortcomings of the GATT.* By most assessments, the GATT has been instrumental in fostering a favorable climate for international trade since its creation in 1948. However, changes in the structure of international trade and the major players have strained the multilateral system and revealed GATT's shortcomings. The task of dealing with nontariff barriers (NTBs) and extending GATT disciplines to new areas, such as services, agriculture, and intellectual property rights, will make it harder to achieve the same success as in the past. The increasingly slow and complex multilateral process has led frustrated but like-minded countries to pursue alternative trade arrangements outside the GAIT to achieve greater, more rapid liberalization, such as the 1988 U.S. beef and citrus agreement with Japan and the U.S.-Canada FTA. In addition, U.S. frustration with large trade deficits with the East Asian countries has led to increasing use of unilateral trade legislation, import relief measures, and so-called "grey area" measures (such as voluntary export restraints) to deal with the deficits.

*Why enter into PTAs?* Economic forces may compel countries to enter into formal preferential trading arrangements or result in informal trading blocs as trade becomes more concentrated within a region. One rationale for concluding a PTA is that the expected gains from bilateral or regional liberalization would be greater than from multilateral liberalization. An example is Canada's desire to conclude a free-trade agreement with the U.S. With Canada's trade dependence on the U.S. market already high—in 1988, 73 percent of Canada's exports went to and 66 percent of imports came from the U.S.—and a perception of growing U.S. protectionism, Canada concluded there were greater economic benefits to be gained from a bilateral FTA than from waiting on the uncertain outcome of the MTN.

Additionally, a country may be willing to make bilateral concessions that it would never make unilateral<sup>^</sup>. Canada gained some concessions—for example, in the areas of services and dispute settlement—which the U.S. would not likely concede in a multilateral agreement.

Another economic rationale is to improve domestic economic efficiency. The expected gains that would come from unilateral liberalization, as increased competition forces domestic producers to become more efficient, may lead a country to seek a formal agreement to provide the impetus and discipline for liberalization. This economic motive has been ascribed to Canada in its pursuit of a U.S. FTA. Many Canadians were concerned that Canada



was losing its international competitiveness, and a way to force change was to open the border to the full impact of the more efficient U.S. economy.

Political and strategic motives may also play a role in forming PTAs. Countries may enter into PTAs as part of a strategy to signal their intentions to seek alternatives to the multilateral system, a U.S. motive underlying the agreements with both Israel and Canada.

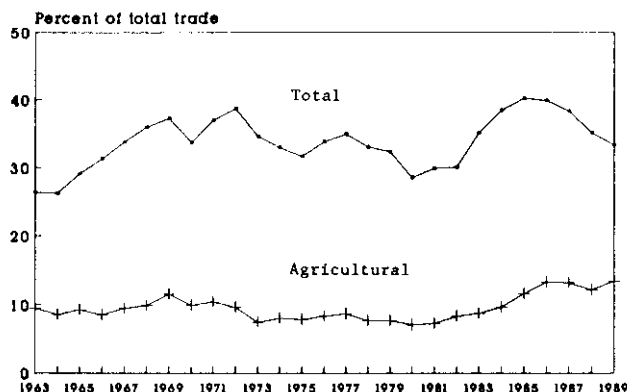
*Agriculture and PTAs.* Nearly all existing PTAs encountered difficulty in incorporating agricultural products into the initial agreement. Agriculture has proven difficult to liberalize within PTAs for the same reasons that it has proved to be a sticking point in the GATT. In most PTAs, the agricultural sector has usually benefited less from across-the-board reductions in tariffs or nontariff barriers. In some cases, agricultural products are excluded from trade concessions altogether. The agricultural provisions in the U.S.-Canada FTA were not comprehensive, except for tariff reduction, and left each country's agricultural policies basically intact. Special treatment, or a general exclusion from treatment for agriculture, was also the case in the formation of the EC, the European Free Trade Area, the New Zealand-Australia Closer Economics Relations Agreement, the U.S.-Israel Free Trade Agreement, and the Association of Southeast Asian Nations.

*PTAs and changes in trade patterns.* An assessment of the various PTAs' effects on trade is complicated by many factors, including the diverse nature and objectives of an agreement and the time period for which it has been in force. A formal PTA may grow out of an already highly concentrated trade relationship, such as Canada's with the U.S. In this case, a formal trade agreement may have limited effects on intratrade because many of the opportunities have already been exploited.

PTAs can be assessed according to whether they stimulate internal trade relative to external trade. Two general indicators—intraregional exports as a share of total exports (trade concentration) and growth in intraexports relative to growth in total exports (intragrowth)—can indicate whether internal trade has increased relative to external trade.

The U.S.-Canada FTA has only been in effect since January 1, 1989, so it is not yet possible to assess its effects on total trade. Trade concentration data show two cycles (Figure 1). Concentration rose until the early 1970s, then fell until 1980 when it rose again. Intragrowth tells a similar story; intra-exports grew faster than total exports in 1963-71, slower in 1972-81, and then exceeded total export growth again in 1982-88 (Table 5). As intratrade became more concentrated in the 1980s—and par-

U.S.-Canada intra-regional trade  
as share of total trade



**Figure 1. U.S.-Canada Intraregional Trade as Share of Total Trade**

ticularly as Canada's trade became more dependent on the U.S. market—, Canada sought out formal confirmation of its bilateral trade relationship.

Interestingly, in 1989, the first year the FTA was in effect, bilateral trade, especially agricultural trade, generally grew faster than total trade (Table 6). U.S. agricultural exports to Canada increased twice as fast as total U.S. agricultural exports. The story was even more dramatic for Canada; total and agricultural exports to the world actually fell in 1989, while rising to the U.S. If the logical outcome of a PTA, in this case a free-trade agreement, is to increase internal trade relative to external trade, sketchy evidence for one year indicates the FTA is having such an effect.

### *The Outlook for PTAs*

What is the outlook for the world trading environment—a tighter, more comprehensive GATT

**Table 5. U.S. and Canada: Growth in Total and Intraregional Trade**

Item	1963-71	1972-81	1982-88
	<i>Percent</i>		
U.S. -Canada			
Exports to world	8.6	15.7	5.5
Exports to region	12.8	12.8	7.7
Agricultural exports to world	4.1	16.3	0
Agricultural exports to region	5.2	13.0	4.8
World exports*			
Total exports	9.6	17.0	7.0
Agricultural exports	5.4	13.6	2.9

Sources: U.N. trade data; Agriculture Canada; ERS.<sup>a</sup> 1962-71.

**Table 6. U.S. and Canadian Exports, 1987-89**

Item	1987	1988	1989	Change from 1987 to 1988	Change from 1988 to 1989
	-----	-- Mil, \$U.S. --	-----	-----	Percent -----
U.S. exports	243.7	308.0	349.6	26	8
U.S. agricultural exports	30.9	37.1	40.0	20	8
U.S. exports to Canada	56.9	70.3	73.9	18	5
U.S. agricultural exports to Canada	2.9	3.2	3.6	10	12
Canadian exports	92.9	117.7	115.4	21	- 1
Canadian agricultural exports	7.2	8.3	7.4	15	11
Canadian exports to the U.S.	70.4	81.8	84.7	16	4
Canadian agricultural exports to the U.S.	2.2	2.4	2.9	10	13

system or an even more fragmented, managed trade system characterized by PTAs? In the near term, the expansion of PTAs will likely continue. Forces already in motion will lead to greater integration among existing PTAs, will expand some PTAs to include more countries, and may formalize ties among regional trading partners with new agreements.

Much depends on the outcome of the Uruguay Round, where resolution of agricultural issues is key. If the most contentious issues can be resolved in a satisfactory manner that results in a strengthened GATT system, some of the impetus to forge PTAs will be removed. A failed MTN suggests the opposite course will be followed. A third possible outcome is a continuation of the current system where a kind of dual trading system exists in which countries rely both on the GATT and PTAs to achieve their trade objectives (such as the U.S. and Canada are now following).

## Conclusions

Two themes already emerge from the FTA. Although more apparent for the nonagricultural sectors, these themes apply to agriculture as well. Despite many ongoing trade disputes, the FTA has constrained agricultural policy actions and influenced policy decisions, which ultimately limit national sovereignty. An example is the contemplated changes in U.S. sugar policy, where U.S. policy-makers have to make sure a new policy does not violate the FTA, and in U.S. meat inspection procedures, when the U.S. would change an established system as a result of the FTA. Canada has made several policy changes, either directly or indirectly, as a result of the FTA—transition payments to grape growers, changes in the two-price wheat system, and removal of the oats import license.

A related theme is that as the FTA constrains policy options, even in a limited way for agriculture, it expands economic opportunities. One reporter, in examining growing economic activity on the U.S.-Canadian border, concluded that the FTA "is blurring the border between the world's two biggest trading partners, encouraging both companies and consumers to base their decisions on market forces rather than political frontiers" (Simon). This emphasis on economics rather than politics, also evident in the EC 1992 process and the developments in Eastern Europe, is rendering national boundaries obsolete with respect to economic activity. In a future world where political boundaries become less important than economic prowess, perhaps the FTA will be seen as an early step in an inevitable process of world economic integration.

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