

# Trade Reforms Increase Likelihood of Challenges to Food Standards

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**T**he Uruguay Round of the General Agreement on Tariffs and Trade (GATT) negotiated a freer international arena for foreign direct investment and trade in the processed food industry. With its signing in April 1994 and implementation on January 1, 1995, the Uruguay Round also transformed the GATT into the World Trade Organization (WTO). Nontariff trade barriers such as quotas were immediately dismantled, and tariffs on many food and agricultural products such as cheese and meats are being reduced over a 6-year period that began in 1995.

Product and process standards for food products are under the spotlight more following the Uruguay Round than in the past. The Uruguay Round Agreement on Agriculture, by removing quantitative barriers to trade and reducing tariffs, creates an incentive for countries desiring to protect domestic industries to resort to improper use of product and process standards. With traditional trade barriers falling, some protection-seeking firms may improperly try to use product and process standards for processed foods as trade barriers, while firms

interested in freer trade may wish their governments to challenge these food standards. To ward off this potential misuse, the Uruguay Round Agreement created a clearer set of obligations regarding product and process standards in the areas of technical regulations and measures established to protect human, animal, or plant life or health. Additionally, the Uruguay Round Agreement established the Dispute Settlement Body, a stronger procedure for determining whether WTO members' food standards serve only to support legitimate objectives.

## Domestic Interests Motivate Product and Process Standards

Product and process standards are requirements that specify characteristics that a product must have or processes that must be followed by product manufacturers (see box on product and process standards).

Most often, the impetus behind product and process standards comes from domestic concerns unrelated to trade. For example, U.S. food standards reflect U.S. consumers' desire for safe, nutritious food. U.S. standards for nutrition labeling and health claims provide consumers with nutrition informa-

tion. Other government standards that prohibit or limit the use of certain pesticides in the production of food protect farmworkers from the deleterious effects of pesticides. The key is to provide standards high enough to keep inferior products out of the market while avoiding unnecessarily burdensome regulations.

However, standards could end up being used as disguised restrictions on trade to protect farmers and processed food manufacturers from international competition. Although the standards may be in the guise of consumer protection or other domestic goals, their true purpose—as in the case of unjustifiably short shelf-life rules, for example—is to prevent imports from harming domestic producers.

## Product and Process Standards Could Hinder Trade...

Because product and process standards impose requirements on food products, they can impede trade, either intentionally or inadvertently. Countries devise standards independently of one another to meet regulatory objectives not directly related to trade. Conflicts arise when the product and process standards pre-

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## Product and Process Standards

Governments and other organizations such as industry associations can be involved in the development of product and process standards, depending on the institutional relationships in a particular country. Product and process standards specify that a product must have certain characteristics or that certain processes must be followed in the manufacture of that product in order to qualify for import and sale. A product or process standard may be covered in labeling laws, packaging laws, standards of identity, certification and inspection rules, and food safety regulations.

A standard of identity is an example of a product standard. Standards of identity require products to be what they claim to be, such as peanut butter having to be made from peanuts. Other examples of standards of identity include the Italian pasta purity laws and the German beer purity law, which strictly regulated the permissible ingredients in these products. Formerly in Germany, beer could have only prescribed ingredients. Any other ingredients, such as preservatives, would make it illegal for import and sale. The beer purity law is now mostly voided as far as trade is concerned,

but it stood as a product standard for more than 450 years.

Examples of process standards would include a ban on goods made with prison labor or a law against the production or trade in goods containing ozone-depleting gases, such as Freon. Environmental standards provide many examples of process standards. A country may decide for reasons of environmental policy that certain production processes be employed when making the product. The regulation may not relate to the character of the product, but instead only allow for sale products that were produced under specified processes.

vent food produced in one country from being traded to another country.

Geographical indications (also known as denomination of origin) illustrate the potential misuse of standards to inhibit trade. Geographical indications require that a product label say where the product originates and not present itself in a misleading manner. Processors regard geographical indications as an indicator of quality. But, they can also inhibit trade by preventing a foreign producer of a similar product from using a familiar name that readily identifies its type for consumers. Perhaps the best known example of geographic indications is that of champagne. France prefers that only sparkling wine produced in the Champagne region of France be labeled as champagne, but has been unsuccessful in gaining agreement from all WTO members. Champagne, according to some other countries, is a type of product produced in many places, but known everywhere as champagne.

## ...And Affect Decisions in Food Markets

Product and process standards can affect a firm's decision to export or invest in foreign production. In a foreign market, information about product and process standards may not be readily available or may change frequently or without notice, making exporting risky. Some firms are quite protective of proprietary technology and formulations that a foreign government may require to be disclosed as part of a product or process standard in order to be eligible for import. As an example of an improper use of a product or process standard, a country may specify a minimum share of local content for a particular food item, which encourages domestic processing and the use of domestic materials in production.

These difficulties in meeting product and process standards for imports can lead a firm to buy manufacturing facilities in the foreign market rather than to attempt to export into the foreign market. In 1994, economists with USDA's Economic Research Service and their counterparts in Agriculture and AgriFoods

Canada surveyed multinational food firms' decisions to export versus producing in the foreign market. Firms most frequently cited the benefits of large-scale production and delivery costs relative to the value of the product as decisive factors in these decisions. However, firms also mentioned inspection and certification requirements, which are part of product and process standards, as influencing their decision to export rather than producing in the foreign country.

Even though most of the burden of complying with product and process standards falls on food manufacturers, farmers also are affected. For example, farmers whose products are exported to many countries may not wish to use pesticides that are beneficial in the farming operation if the pesticide leaves a residue that an importing country regards as harmful to consumers. The farmer would then bear the cost of using an alternative pest control method that may not be as effective or may cost more.

## WTO Principles for Sanitary and Phytosanitary Measures Seek Freer Trade

To prevent the misuse of product and process standards, particularly in the area of health, the Uruguay Round included an Agreement on the Application of Sanitary and Phytosanitary (SPS) Measures. The SPS rules require that all measures with the objective of protecting animal, plant, or human life or health be based on scientific evidence and appropriate risk analysis, that standards be transparent—that is, published, readily available, and understandable—to other countries, and that measures be harmonized through international institutions where possible. Other disciplines exist to minimize any trade-distorting effect of health measures. For example, SPS rules also require that countries' standards, even if different from each other, be considered equivalent if the exporting country can demonstrate that its standards meet the importing country's legitimate objectives. A more objective treatment of product and process standards under WTO rules is likely to decrease risk for exporters and enhance trade.

The Agreement on the Application of Sanitary and Phytosanitary Measures applies to human, animal, and plant health and safety arising from diseases, pests, additives, contaminants, and toxins. A country may have a regulation for processed foods that specifies how foods must be treated in processing, such as time and temperature requirements, to ensure that diseases and microbes are not viable in the food product. The Uruguay Round Agreement allows countries to determine their own standards governing food safety and animal and plant health, but establishes a number of obliga-

tions to discourage their use as barriers to trade.

The SPS principles attempt to balance national interests that are reflected in each country's standards with the promotion of trade. SPS rules allow countries to use measures to protect human, animal, or plant life or health, as long as the measures are not employed in an arbitrary or discriminatory manner. This preserves the sovereignty of nations in establishing standards for legitimate purposes while disallowing standards that might be intentionally devised for protection of domestic industries.

### *Scientific Basis*

Requiring product and process standards to be based on scientific evidence and appropriate risk analysis provides a basis for resolving trade disputes and may dissuade countries from implementing standards for purposes of protection. Shelf-life rules have provided clear examples of standards stricter than required to meet legitimate objectives. For example, Mexico began in November 1994 to update its food-safety standards. The updated standards required that fluid milk could not be offered for sale more than 48 hours after pasteurization. U.S. milk bottlers in California, Arizona, New Mexico, and Texas, who were already selling fluid milk in Mexico, considered the short shelf-life to be protectionist because their commercial experience had taught them that continuously cooled milk has at least a 10-day shelf-life. As a result, U.S. milk shippers objected to the standard under North American Free Trade Agreement (NAFTA) rules similar to WTO rules that require science-based regulations that are no more stringent than necessary to meet legitimate objectives. In this case, the Mexican Government was

dissuaded from implementing the 48-hour shelf-life rule.

In a second example, South Korean shelf-life rules posed a barrier to imports of U.S. chilled beef. In the summer of 1994, the allowed shelf-life for frozen, chilled, and vacuum-packed meat products was shortened from 90 days to 30 days. Following objections from U.S. meat exporters and negotiations between trade officials of the two governments, South Korea agreed in July 1995 to restore the 90-day shelf-life, then allow "use-by" dates established by meat product manufacturers beginning in July 1996. In this case, the clearer WTO obligations guided the two countries to a settlement without resorting to formal dispute settlement.

### *Transparency*

Transparency, another WTO principle, stipulates that a country make available to foreign companies and governments the requirements and changes in requirements for goods to have access into the country. Transparency essentially requires that there be no hidden barriers or changes in import criteria without notice. Transparency improves predictability and steadiness in import requirements. The importance of transparency has grown over time in processed food trade, especially for products with a limited shelf-life. If a shipment of food with a limited shelf-life is rejected by customs agents at the border because a new license or a different label is required, the exporting company may suffer losses due to spoilage or delay.

### *International Harmonization*

Harmonization of process and product standards minimizes disputes over standards by making them identical or recognizing the

equivalency of two standards. Hence, there is no basis for conflicts over trade and no impediments to trade due to product and process standards. International standards for food products also help countries agree on methods for meeting regulatory objectives. Under SPS rules, international harmonization is encouraged but not required. Countries may deviate from an international standard when establishing a measure, but the deviation must be justified by scientific evidence or as a consequence of the country's generally applied, more stringent level of protection.

### **National Treatment**

Another general WTO principle, national treatment, obliges countries to give the same treatment to imported products that have cleared customs as is given to domestic goods. Taxation and regulation are two obvious areas that could be abused. If a country's regulations have different requirements for imported goods than for domestically produced goods, without any scientific basis or legitimate purpose, then the restrictions may be challenged as violations of national treatment.

### **Most-Favored Nation**

Most-favored nation (MFN) treatment, a primary principle of the WTO, prevents, for example, the United States from giving Germany import preferences over the United Kingdom. The idea is to create a liberal trading environment that avoids creating trade distortions. Regional trade agreements are an exception to MFN, allowing trade preferences within an area governed by a specific trade agreement. MFN rules also allow for preferential treatment of developing countries, the best example being the special access granted by the European Union under the Lomé Convention to a

## **Scientific Evidence Under TBT and SPS Agreements**

Scientific evidence and risks get qualitatively similar treatment in both the Technical Barriers to Trade (TBT) and the Sanitary and Phytosanitary Standards (SPS) agreements, but stronger emphasis in the SPS agreement. Following is the language that appears in Article 2, paragraph 2 of each agreement:

### **TBT 2.2**

Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. For this purpose, technical regulations shall not be more trade-restrictive than necessary to fulfill a legitimate objective, taking account of the risks non-fulfillment would create. Such legitimate objectives

are, *inter alia*: national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment. In assessing such risks, relevant elements of consideration are, *inter alia*: available scientific and technical information, related processing technology or intended end-uses of products.

### **SPS 2.2**

Members shall ensure that any sanitary or phytosanitary measure is applied only to the extent necessary to protect human, animal or plant health or life, is based on scientific principles and is not maintained without sufficient scientific evidence, except as provided for in paragraph 7 of Article 5.

designated list of African, Caribbean, and Pacific nations growing out of former colonial status.

## **Dispute Settlement Built In**

Prior to the Uruguay Round Agreement, the GATT trade rules had no binding enforcement mechanism. The new Dispute Settlement Body in the Uruguay Round is a stronger means of settling disputes than had existed. Under the Uruguay Round rules, the defending party can no longer deny the WTO jurisdiction, avoid timely settlement, or block adoption of dispute panel rulings. If the Dispute Settlement Body operates in a way that ensures countries can get claims addressed in a timely, impartial, predictable fashion, then countries will have to live up to their obligations in the Uruguay Round Agreement or else provide compensation or lose concessions won in prior negotiations. For example, a country that a dispute panel ruled had lost \$10 mil-

lion annually due to an improperly used food standard might be allowed by the WTO to block \$10 million in imports from the losing party as compensation if the losing party is unwilling to bring its offending standard into WTO compliance.

## **Trading Rules Strengthened for Processed Foods**

Several other sections of the Uruguay Round Agreement are likely to expand international trade. The Agreement on Technical Barriers to Trade, also known as the Standards Code, was expanded to cover process standards. The original agreement, made in the Tokyo Round (1973-79), dealt only with product standards in such areas as packaging and labeling requirements, inspection, and certification procedures in order to protect the public and avoid deceptive practices. The Standards Code now encourages countries to adhere to in-

ternational product and process standards when such standards already exist, to publish their standards, and to base standards on scientific evidence and appropriate risk assessment.

The Agreement on Trade-Related Intellectual Property issues covers patent and copyright protections for branded products including food products. The agreement establishes minimum standards to which countries must adhere regarding brand protection, geographical indications, and protection of proprietary information such as processing technology and recipes. The agreement protects food brands by protecting trademarks that are renewable indefinitely. A company such as Kellogg's, for instance, does not want another company offering counterfeit Corn Flakes because profits may be lost and because Kellogg's reputation for quality may be injured if the other company's product is inferior.

Many processed foods that are traded in bulk after initial processing—such as soybean meal, corn gluten feed, and wheat flour—are also affected by the Uruguay Round Agreement on Agriculture. The agriculture agreement reduces export subsidies and tariffs on such bulk products, and expands import access through elimination of quantitative import barriers and the progressive reduction of tariffs.

## Standards Are Also Important in Regional Agreements

In addition to participating in multilateral negotiations, the United States has completed complementary regional trade agreements, among which NAFTA is the most

significant. Under NAFTA, trade barriers between the United States, Canada, and Mexico for food and agricultural products are to be reduced and eliminated on a fixed schedule up to 10 years according to the type of product.

A critical provision of NAFTA for processed foods was strict rules of origin, which are process standards that prevent transshipment of non-NAFTA products through one NAFTA country to another NAFTA country. For a food product to qualify for preferential access under NAFTA, a product has to be substantially transformed within a NAFTA country. In other words, a product could not be imported from outside NAFTA, repackaged to show a NAFTA origin, and then exported to another NAFTA country as a NAFTA-origin product.

Environmental and labor standards, which are process standards, figured prominently in the NAFTA ratification debates. Some opponents to NAFTA argued that products from Mexico should not be allowed improved access to the U.S. market because Mexico has less stringent environmental controls or enforcement and lower wages, which could give Mexican products a cost advantage. NAFTA opponents feared that greater integration of markets would lead to migration of manufacturing capacity from regions with relatively high labor costs to regions with relatively low labor costs, resulting in loss of employment and downward pressure on wages and benefits in the high-cost region.

This migration is less likely in the processed foods industries because much food processing occurs close to where the commodity is produced, and land is not a mobile factor of production. Also, many food products are perishable, with final processing located close to the point of consumption, and large population centers are not mobile. Others in the NAFTA debates argued against special environmental and

labor standards as running counter to the national treatment principle, which requires imported products be treated like domestic products. In the end, NAFTA included side agreements on labor and environmental practices that diminish cost advantages which might be gained by maintaining lower standards.

A regional trade pact such as NAFTA or the European Union provides for common standards or mutual recognition within the trading group that may be preferential for members within the group, in which case an advantage is conferred to members and a disadvantage to nonmembers. WTO rules permit regional trade agreements as long as the agreement covers substantially all trade and the standards are not set or applied in a discriminatory or arbitrary way.

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