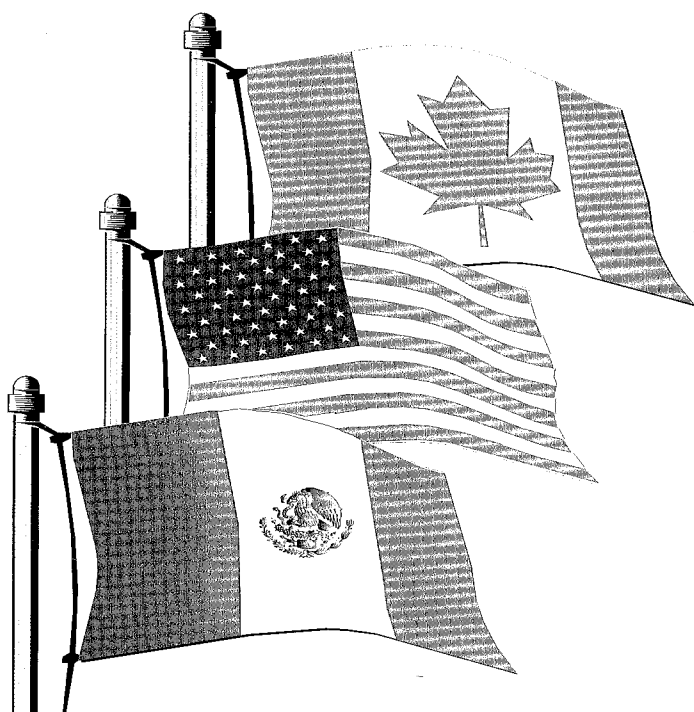


Proceedings of the Seventh
Agricultural and Food Policy Systems Information Workshop

STRUCTURAL CHANGE AS A SOURCE OF TRADE DISPUTES UNDER NAFTA



Edited by

R.M.A. Loyns
Karl Meilke
Ronald D. Knutson
Antonio Yunez-Naude

February 2002

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Food Policy Systems Information Workshop

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UNIVERSITY
of GUELPH



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EXECUTIVE SUMMARY

STRUCTURAL CHANGE AS A SOURCE OF TRADE DISPUTES UNDER NAFTA

The seventh Policy Disputes Information Consortium workshop, held in Tucson, Arizona, in February 2001, addressed the changes in market structure and trade that have occurred since the inception of the NAFTA agreement, and the relationship between those changes and trade disputes. The workshop theme arose out of the realization that risk, fear, and uncertainty associated with structural change in agriculture could be an important contributor to lack of progress in achieving free trade in the NAFTA region.

There have been substantial gains from NAFTA in terms of increased efficiency in production and distribution, and growth in trade. However, there appear to be continuing concerns among farmers, laborers, and some agribusinesses that they will be reorganized or displaced, that production will be relocated, that economic rents that may have existed in a protected market will disappear, and that the nature of agriculture, including its institutions and culture, will be forever changed. There has also been an increase in the level of trade stress and number of trade actions in several areas. On the other hand, there are many farmers and agribusiness managers who view NAFTA as creating opportunities to adjust crop mixes and business operations into more profitable and more efficient configurations.

All of this has occurred in a trading environment governed by the set of agreements among the United States, Mexico and Canada referred to as the North American Free Trade Agreement (NAFTA). Experience has demonstrated that NAFTA is, at most, a limited “free trade” instrument as significant areas of regulation, government support and trade limitations were not dealt with in the NAFTA. In fact, the NAFTA has been described as never being intended to be a “free trade” arrangement, rather one to achieve greater trade among the member countries, and a method of deregulating some sectors. That description is consistent with the trading framework established by the agreement, and with its accomplishments. This situation does, however, raise interesting questions about how structure and trade would evolve if the agriculture and agri-food industries in the three countries were, in fact, subject to full free trade conditions. For purposes of the workshop, full free trade was defined as the absence of government institutions (policy, programs and regulations) which influence or impede trade within and among the three NAFTA countries. Analysis of this situation was one of the objectives of the workshop.

The overall conclusion of the workshop was that NAFTA has made major contributions to farming and, particularly, to agribusiness and consumers in the United States, Canada, and Mexico; full free trade would allow the comparative advantages of agriculture in the three countries to be fully realized. It was often cited that NAFTA has been blamed for many adversities and adjustments that would have happened with or without NAFTA. Illustrative of these situations are reductions in the level of farm prices and incomes, reduced U.S. wheat production, reductions in farm numbers, changes in consumer tastes and preferences, changes in currency values, increased concentration, and increased integration. While NAFTA may contribute to one or more of these trends, they will continue regardless of what happens to trade. Following are more specific conclusions reflected in the papers and discussion.

Structural Change. The greatest structural change attributable to NAFTA has occurred in Canada and Mexico. In Canada, NAFTA (and other significant policy changes) have contributed to increased diversification of farming operations and to the development of a robust cattle feeding and hog industry increasingly located on the prairies of Canada. In Mexico, NAFTA has contributed to the development of the fruit, vegetable, and poultry industries,

with pressure on commercial corn and wheat producers. There has been a smaller impact on the indigenous and subsistence corn production systems than had been anticipated, because these producers are insulated from market forces.

Under genuine free trade within NAFTA, structural changes would be more pervasive because U.S. farm program subsidies (totaling \$32 billion in 2000) would not be present to protect farmers from the forces of change. The major impacts would be in wheat (where Canada likely has a comparative advantage), in corn (where the US has a comparative advantage), and in high-risk production areas (where U.S. farmers receive protection from farm program subsidies on prices, income, insurance, and disaster assistance). In Mexico, the greatest impacts would be on small commercial farms that are forced to compete in a commercial environment. In general, the cattle/beef and hog/pork sectors are evolving toward free trade conditions now. In Canada and the United States, the protected sectors especially dairy would undergo substantial structural change.

There would be distributional impacts from full free trade. Larger farms producing to their comparative advantage would realize the greatest benefits from free trade. Crop farms would become increasingly integrated in some of their activities with agribusiness, as has happened in poultry and is happening in hogs, beef, and dairy. These effects are simply an extension/acceleration of those structural changes otherwise occurring in the agricultural economy.

Policy and Trade Conflict. Most of the major policy and trade conflicts occur in the commodities where regulation (including state trading), support programs and quality and health standards are significant aspects of market structure. Wheat, dairy and supply management generally in Canada; sugar, dairy, wheat, avocado in the United States; and sugar in Mexico are examples. Predictably, the most structural change and trade stress under a free full trade environment would likely occur in these areas as well. Plant and animal health and sanitary procedures, and environmental standards have not much altered market structure so far nor contributed to serious trade stress. However there is cause for concern, particularly that differential environmental standards across the three countries could produce trade stress. The level of subsidization of the grains sector in the United States in absolute terms and relative

to Canada and Mexico has produced an unbalanced playing field in grains and livestock. A major benefit of a full free trade arrangement would be more level terms of trade inside and outside of NAFTA.

Trade remedy laws in each of the three NAFTA countries have been demonstrated to be highly inefficient and disruptive policy instruments for addressing trade disputes and promoting trade harmony. Antidumping duties make no sense in agricultural markets where farm prices are frequently below costs of production, due to market cycles, or due to other-country impacts. Serious consideration is required to develop alternative, more effective means of dispute resolution that reflect the economic characteristics of the agriculture and food industries.

Competition. Trade economists usually assume that open borders help discipline uncompetitive behavior in domestic markets. The argument is that trade expands the geographic reach and commercial volume of markets. Increased market size allows firms to expand to realize available scale economies, thereby lowering costs. At the same time, by combining previously separate markets, expanded market size brings local dominant firms into new competition with one another in the larger market, thereby driving prices closer to costs. The combined effect can lead to sharply reduced prices for products where scale economies are larger relative to the size of the market.

This economic evolution is more likely to occur in Mexican and Canadian markets than in the United States where the large national market means that trade agreements will generally have only incremental effects on market sizes and competition. In addition, expanded trade, by increasing the reach of some markets, will play a role in corporate integration and merger evaluations. There are serious questions of whether antitrust/competition laws in their present form is the best approach for dealing with agricultural issues of concentration, contracting, and pricing. There is also a need to increase data sharing, market analysis, and even policy development across the three countries.

Role of Government in Free Trade. The closing paper and discussion examined policies and programs currently in operation in the three countries, their consistency across countries and their compatibility with genuine

free trade. The evidence indicates reasonable compatibility in some areas but major conflict in some of the regulatory framework and in the protection and public support offered particular groups of producers. Mexico has moved the furthest in deregulation and removal of public support, the United States retains the highest level of public support to agriculture, and Canada has a highly skewed support system (in favour of supply management) and retains significant trade inhibiting regulation in the grains sector. Movement toward full free trade would require major adjustment in public support in the United States, and significant deregulation in Canada.

Because of the sensitivity of subsidies, state trading and supply management programs, the workshop concluded that initial emphasis should be placed on important but less sensitive areas such as differences in grade standards, infrastructure support, plant and animal protection, food safety, and environmental standards. This is not to say that the other issues should be ignored. Indeed the NAFTA Secretariat, properly organized and funded may also serve as an instrument of change and facilitator of reduced policy and trade barriers.

A NAFTA Secretariat. Several of these areas of common interest and conflict could be removed if there were continuing institutional analysis, research and policy development capacity within NAFTA. This strategy could be institutionalized through the implementation of an arms-length Secretariat charged with fostering and monitoring progress toward free trade under NAFTA. Issues of the evolution of market structure and competition might also be productively examined in a joint framework.

ORDERING THE PUBLICATION

This publication is available at a nominal cost (\$15, including shipping and handling) in Canada and the United States. Prices on multiple copies and in Mexico are negotiable. First copies are available to universities, libraries, government departments and associations without charge.

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Several universities, interest group organizations, the private sector, and interested individuals are among our presenters and discussants. We pay a small honorarium for the preparation of main papers but it does not cover the time and effort expended by those researching and writing the papers, let alone resubmitting them after the workshop for publication. These contributions are part of the way this workshop has evolved, and we could not maintain our program without these generous contributions.

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