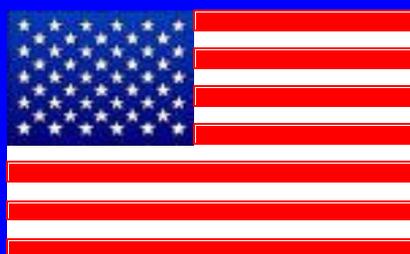


**Policy Disputes Information Consortium
Ninth Agricultural and Food Policy Information Workshop**



**Farm Policy Development and
Policy Tensions under NAFTA**

Executive Summary

Farm Foundation

POLICY DISPUTES INFORMATION CONSORTIUM

Ninth Agricultural and Food Policy Information Workshop
Farm Policy Development and Policy Tensions under NAFTA
May 2003

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The ninth in a series of workshops organized by the Policy Disputes Information Consortium designed to produce timely, relevant economic analyses related to agricultural, food, and trade policy as a means of reducing trade tension and disputes between Canada, United States, and Mexico.

This publication was produced by Farm Foundation in the pursuance of public policy education and understanding.

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May 2003

Farm Policy Developments and Policy Tensions Under NAFTA

Executive Summary

NAFTA has been exceedingly successful in increasing agriculture sector trade among the United States, Canada, and Mexico. The value of agricultural trade among NAFTA countries increased from \$17 billion in 1993 to \$32 billion in 2001. More important, the share of trade among the NAFTA countries has more than doubled compared to trade with the rest of the world. This positive occurred as gains from trade as tariffs have been largely eliminated among the NAFTA partners.

Despite NAFTA's unquestioned record of success, concerns have arisen over the extent of members' commitment to pursue further market integration. These concerns involve issues far more complicated than tariffs or border measures. The questions have been fostered, among other things, by a perceived increase in subsidies under the U.S. 2002 Farm Bill, the initiation of a number of anti-dumping cases and other administered protection actions, and the lack of progress in dealing with some of the trade disputes and associated issues addressed in previous workshops such as state trading enterprises and sugar policy.

On the positive side, proposals tabled in the Doha Round of multilateral trade negotiations at the World Trade Organization (WTO) suggest continued multinational pursuit of freer trade, the outcome of which will directly affect trading relationships under NAFTA. However, there is need for initiatives within the NAFTA region to pursue the harmonization and convergence of policies and programs that are in the interest of the region as a whole. Since the signing of NAFTA, biosecurity and terrorism have been added to the agenda of policy makers and also threatened to increase border tensions.

It was in this setting that the Ninth Policy Disputes Information Consortium Workshop brought together leaders and authorities on NAFTA from academia, industry, and government. The purpose of the ninth workshop was to evaluate the impacts of changes in the domestic policies of member countries on trade and trading relationships under NAFTA. The major conclusions of the Workshop included:

- After positive steps toward freer trade in the 1996 Farm Bill, the 2002 Farm Bill represents a significant step backward. It did this by increasing the level of domestic support (including the value of trade-distorting support), by expanding commodity coverage, and by requiring country-of-origin labeling. In certain respects, the 2002 Bill simply institutionalized the ad hoc supplemental payments that followed the enactment of the 1996 Bill. However, the perception of a major policy change was created by making these subsidies part of a six-year program and by adding new distortions. Subsequently, the United States took a position on trade liberalization in the Doha Round that could, with appropriate negotiated outcomes, put the NAFTA partners back on a path toward increased market access, reduced trade distorting subsidies, and greater transparency.
- Mexico followed the U.S. lead by initiating higher levels of domestic support for its farmers and by initiating (or threatening to initiate) a series of trade-remedy legal actions creating barriers to trade on U.S. products. On the positive side, its new longer-term agricultural agreement provides for improvements in infrastructure, plant and animal protection, and

food safety designed to put Mexican farmers on a more competitive plane with respect to Canada and the United States. The extreme heterogeneity of Mexican farmers, ranging from a large proportion of very small farmers to a much smaller number of highly efficient and competitive commercial operations, makes the job of designing policy to serve both the commercial and small farm segments difficult. This has resulted in the need for the development of separate and differentiated social/rural and domestic farm policies.

- Canada, so far, has resisted farmer pressure to significantly increase its level of domestic support, concentrating instead on longer-run programs designed to strengthen and maintain its comparative advantage in cool-weather crops and livestock production, while meeting market demands. However, Canada is committed to maintaining the high level of border support protecting its dairy and poultry industries and to its use of a state trading enterprise for exporting wheat and barley from Western Canada.
- One of the major impacts of the U.S. Farm Bill has been to capitalize its benefits into increased land prices. The beneficiaries are landowners, while tenants pay higher rental rates. The result, in either case, is increased U.S. costs of production relative to other NAFTA countries and the rest of the world. Therefore, while increased subsidies help to get U.S. farmers through short-run declines in farm income, they create a long-run competitiveness problem.
- Country-of-origin labeling is a barrier to trade that is likely to have serious unintended structural consequences. The effect will be to impose extra labeling, traceback, and handling costs on beef, pork, lamb, fish, and shellfish having a U.S. origin and going to the domestic market. Products of foreign origin will likely be segmented for the away-from-home market and for U.S. consumers desiring lower-cost products. Products of mixed origin (domestic product mixed with foreign product, e.g. hamburger meat) will likely be eliminated from the mainstream retail market. By forcing the premature adoption of a table-to-farm traceback system, the result will be increased pressure toward the development of a vertically integrated food system. These unintended consequences are diametrically opposite to several proposals that are before the U.S. Congress and are designed to foster a more decentralized and competitive structure.

As a general rule, agricultural negotiations are not self-sustaining. In the WTO, tradeoffs among agriculture and industrial goods or services often are necessary to provide added leverage for successful completion of the agriculture negotiations. There has been no such leverage/leadership in NAFTA. The lack of a mechanism within NAFTA that analyzes the impacts of policy changes from the perspective of NAFTA as a whole is a major weakness. As a result, under NAFTA there is no advocate for moving the freer trade agenda forward in the direction of an integrated North American





market. Under these conditions, further harmonization, convergence, and compatibility of policies awaits action in WTO. To remedy this deficiency, it was suggested that each agriculture minister should consider appointing a person who would be solely responsible for pursuing the NAFTA harmonization and convergence agenda. This group would work to foster assessment of progress under NAFTA through institutions such as this workshop and through NAFTA consultative committees to move their agenda forward.

Author's Comments and Discussion in Brief

Policy Developments by Country

Armbruster, Conklin, Keenan, Rosenzweig

United States: The U.S. 2002 Farm Bill reinstates target prices and expands commodity coverage but is not expected to breach the WTO caps. If U.S. domestic support rises above its negotiated cap, circuit breaker provisions allow the Secretary of Agriculture to lower support to meet its WTO obligations. Moreover, the United States has tabled an ambitious trade-negotiating position in WTO that is designed to move the world toward freer trade. The major 2002 Farm Bill provisions include:

- Continuing the coupled marketing loan provision with a rebalancing of the relationship between corn and soybean loan rates. Commodity coverage was expanded to include dry peas and lentils.
- Continuing the decoupled direct payments.
- Reinstating the target price provisions, without previous production adjustment provisions, and with decoupled production. However, producers were given the option of updating their yields and base acreage. These update provisions combined with the coupled price raise amber box questions in WTO.
- New and expanded conservation and environment provisions, mainly designed to aid in adjustment of the livestock industry to increased environmental regulation.
- New country-of-origin labeling requirements for beef, pork, lamb, fish, and shellfish.

Mexico: The most important features of recent Mexican policy developments include the introduction of a multiyear budget appropriation process leading to a longer range planning horizon, increased and targeted domestic support, and increased federal-state support for infrastructure development. These policy initiatives clearly reflect a reaction to the 2002 Farm Bill in that the trade and domestic support provisions are designed to counterbalance the support that the Farm Bill provides to U.S. producers. The following two components have resulted from a producer-government negotiated effort to set in place a National Development Plan for agriculture and the rural economy:

- An Agrifood Armor Program designed to deal with trade disputes, provide multiyear income support for grains and oilseeds, and subsidize energy costs.
- A federal-state Alliance for Agriculture Program designed to develop much needed infrastructure for rural and agricultural development, increase irrigation capacity, develop information systems, encourage technology transfer, increase credit availability, and harmonize plant and animal protection policies with those existing in the United States and Canada.

Canada: In contrast with Mexico and the United States, the new Canadian framework is designed to help its agrifood industry become more profitable through market returns. This is to be accomplished by providing additional federal-provincial support to get ahead of competitive challenges posed by advancing technology, changing consumer demands, increased globalization, and North American market integration. While maintaining existing state trading and supply management programs, specific provisions include:

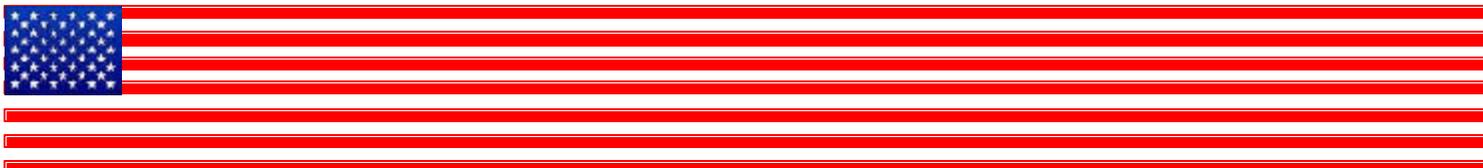
- The development of a five-year integrated whole-farm stabilization and disaster mitigation program to manage risk. This program would be patterned after the current NISA program that is based on total farm income but would change the trigger mechanism in important ways. Producers would continue to be eligible for a revamped crop insurance program.
- Strengthening food safety, quality, and security through a food chain certification program including traceability and on-farm HACCP.
- Supporting planning and providing incentives to reduce environmental risk.
- Investing in science and innovation.
- Implementing an international strategy to develop markets and improve market access.

2002 Farm Bill Impacts

Dixit, Kruse, Dyer, Rude, Westcott

Utilizing the FAPRI analysis of the U.S. 2002 Farm Bill as a basis for discussion, it was concluded that production/supply would increase, and prices would continue to be depressed over the life of the Farm Bill. The reasons for this conclusion included:

- Somewhat higher levels of income support.
- Reductions in income risk.
- Increases in wealth due to higher and more stable incomes and capitalization into land values.
- New countercyclical/target price payments that, while partially decoupled, create incentives to increase yields and base due to the expectation that they will be allowed to be updated in the future.





A concern was expressed that the FAPRI and USDA analyses underestimated the crop supply response to government payments. In addition, the impact could be more directly felt by Mexico and Canada due to their proximity to the United States.

Implications of Domestic Support Changes for Trade Tensions and Disputes

Paddock, Josling, Zahniser, Victor Ochoa, Rosson, Francl, Rutter, Galindo

While each NAFTA country remains within its Uruguay Round Agriculture Agreement limits on domestic support, the challenges posed by current programs and policy changes include:

- **United States:** Spending under the 2002 Farm Bill is close to the domestic support limits agreed to in the URAA, with some potential for exceeding the limit. In its Doha Round submission, the United States proposed reductions in domestic support limits, and Harbinson's Doha draft text would require reduction in U.S. levels of support and hence a modification of programs. Although the provisions of the new dairy direct payment program expire in 2005 with low milk prices, they could cause the United States to exceed its WTO domestic support limits. Even current levels of wheat and barley movements from Canada into the United States are a major political challenge, given Canada's continued reliance on a state trading enterprise to handle these sales. However, if the Canadian Wheat Board were to be eliminated, an unintended consequence could be even higher wheat exports to the United States.
- **Canada:** With an adverse WTO ruling on dairy product export subsidies, Canadian dairy producers will likely withdraw from export markets. In addition, the Canadian Wheat Board (CWB) will continue to be challenged. Changes in either dairy or state trading policies would have enormous implications for the United States and Mexico, including pressure for increased U.S. dairy, wheat, and sugar imports. Such unintended consequences hold substantial potential for fostering future trade disputes. As the major producer and dominant exporter of peas and lentils, the U.S. extension of the marketing loan to these crops could present a major challenge to diversification strategies of Canadian farmers. However, the dry pea and lentil marketing loan levels are below current market prices, and these products may not be competitive with traditional U.S. program crops, such as wheat and barley.
- **Mexico:** Pork imports from the United States are a major challenge to Mexico, as are imports of food corn and dry beans, both staples in the Mexican diet. The basic problem in the Mexican hog sector is substantially higher feed costs, many smaller size producers with traditional production systems, the spillover of cyclically low U.S. pork prices into Mexico, and the

inability to access the U.S. market for specialty pork cuts due to classical swine fever in several southern Mexican states. Dry beans and food corn imports present a different type of challenge because of their tendency to displace markets for small indigenous Mexican farmers having few alternatives.

As a general rule, agriculture negotiations are not self-sustaining. In WTO, an industrial goods or services trade-off often has been needed to jump-start and provide leverage for completion of the agricultural negotiations. There has been no such leverage/leadership in NAFTA. The lack of a mechanism within NAFTA that analyzes the impacts of policy changes from the perspective of NAFTA as a whole is a major weakness. As a result, there is no advocate for moving the freer trade agenda under NAFTA forward in the direction of an integrated North American market. Under these conditions, further harmonization, convergence, and compatibility of policies awaits action in WTO, where the Uruguay Round set a precedent for a single WTO agreement that included agriculture.

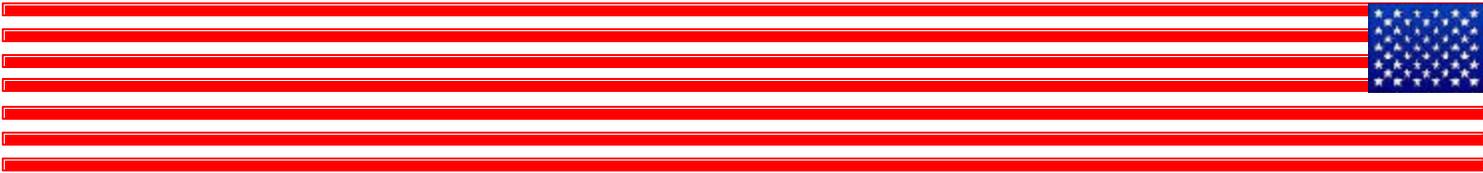
Country of Origin Labeling (COOL) and Traceability

Clayton, Carpenter, Kerr, Hobbs, Hacault, Dominguez

The 2002 Farm Bill contains a provision that requires country-of-origin labeling (COOL) by retailers of beef, pork, lamb, fish, and shellfish—but interestingly not poultry. Food service establishments, butcher shops, fish markets, and exporters are exempt. Listening sessions are being held by USDA to receive input regarding the proposed regulation, some of the most interesting of which relates to labeling requirements for processed products and products of mixed origin. The following conclusions were drawn regarding the COOL Farm Bill provisions and the related ideas present by USDA that could end up influencing COOL regulations, several of which are suspected to involve unforeseen consequences:

- While apparently allowed by WTO information provisions (and explicitly allowed by NAFTA), COOL appears to be a barrier to trade.
- While it is virtually impossible to estimate the costs of this regulation, due in part to the implied structural changes noted subsequently, they are believed to be substantial and will be born by all U.S. industry participants, including producers and consumers. These additional costs will put U.S. meat, fish, and shellfish at a cost disadvantage relative to poultry and similar products from other countries.
- To implement COOL, a traceback system extending from the retail to the farm level will need to be developed. Such systems, however, may eventually be desirable for reasons of supply chain management, food safety, and food security; but COOL has little to do with food safety.
- The labeling requirements for products of mixed (domestic and foreign) origin will likely drive such products from the market. U.S. consumers will then have a retail product choice consist-





ing of lower cost products of foreign origin or higher cost U.S. products.

- Food service establishments, with no COOL requirement, will continue to receive USDA inspected products having their origin outside the United States.
- The result will be major structural changes in order to meet the requirements for establishment of a traceback system, and this will, in turn, change the way meat is handled, the way meat prices are determined, and ultimately consumer choice. The combination of these factors will be increased pressure for backward integration of the supply chain, even though the U.S. Congress has before it proposals to discourage backward integration.

Policy Convergence and Harmonization

Murphy, Knutson, Rene Ochoa, Day, Richardson, Jones, States

NAFTA has been exceedingly successful in increasing trade among the United States, Canada, and Mexico. The value of agricultural trade among NAFTA countries increased from \$17 billion in 1993 to \$32 billion in 2001. More important, the share of trade among the NAFTA countries more than doubled compared to trade with the rest of the world.

Despite this success, trade tensions within the NAFTA region have intensified since the passage of the U.S. 2002 Farm Bill. The 2001 workshop, which evaluated progress under NAFTA, revealed an unlevel playing field leading to areas of significant conflict among the NAFTA members in the areas of infrastructure (largely with Mexico); trade policy (all three countries); food safety, plant and animal protection (largely with Mexico); and market intervention and support programs (all three countries). It is difficult to find examples of harmonization or convergence of programs toward increased market integration since the 2001 workshop.

Since all politics are local, country interests drive country policies. While NAFTA has been successful in many other areas, it has not yet set its goals high enough or established mechanisms to influence the future policy directions of its three member countries. The absence of a mechanism within NAFTA for assessment of country policies from the perspective of comparative advantage and the NAFTA region as a whole is a serious deficiency. While NAFTA consultative committees exist, only a few are active. Opening the formal NAFTA agreement for discussion of this issue, or any of the other areas of conflict discussed in the workshop, would be a serious mistake. Instead, it was suggested that each agriculture minister should consider appointing a person who would be solely responsible for pursuing the NAFTA harmonization and convergence agenda. This group would work to foster assessment of progress under NAFTA, through institutions such as this workshop, and work with the consultative committees to move their agenda, as well as the broader NAFTA agenda, forward to accomplish freer trade for the overall good.

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