

## **POLICY DIVERGENCE — REGULATORY CONVERGENCE IN THE LIVESTOCK AND POULTRY INDUSTRIES**

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One of the stated objectives of this conference is to explore how harmonization, convergence and compatibility (H/C/C) of agriculture policies, programs and regulations could avoid costly trade disputes between NAFTA partners. This paper comments on two very different perspectives within the livestock and poultry industries.

Bill Kerr and Dermot Hayes, in their paper, have used the example of the livestock and red meat sectors to demonstrate how Canada-U.S. trade, which is ostensibly free (all tariffs will be removed by January 1, 1998), can still be peppered by a variety of trade irritants and disputes. In fact, their paper suggests that removal of formal tariffs may in fact engender an increase in the number of trade actions as domestic industries seek protection under any cloak that fits. As conference participants discussed earlier, to the cloaks of technical regulations (grading and inspection), health standards, countervail actions, and Section 332 investigations, may be added the new cloak of environmental regulations. The point to emphasize is that these disputes are occurring in a sector where the domestic agriculture policies in Canada and the United States are compatible, if not harmonized. The incongruity is not in the policy environment, but in the regulatory one.

This is not to say that these sectors have not benefited from free trade. As the authors have shown, however, the high "fulfilment costs" of the "resource intensive activity" of removing non-tariff barriers and preventing new ones from being implemented has restricted the full potential of these benefits from being realized. Along with convergence in tariffs and regulations, there needs to be a change in the mind set of industry. Expectations need to be managed.

Harry de Gorter and Robert de Valk, in their paper, attempt to demonstrate, through the example of Canada-U.S. trade disputes in the dairy and poultry industries, how different agriculture policies make H/C/C difficult and lead to conflict. This paper, however, deals less with H/C/C than it does with one side of a Canadian domestic agriculture policy issue. Their paper also contains many gratuitous comments, factual errors and unsubstantiated conclusions, some of which are addressed below.

These authors indicate that the disputes in these industries go back at least two decades. In fact, the origins go much farther back; back to the original GATT negotiations, at which time Canada opposed U.S. attempts to exempt agriculture from stringent disciplines for trade in industrial products.<sup>1</sup> The compromise result in 1947 was the limited exemption for agriculture contained in GATT Article XI 2(c)(I). It quickly became evident, however, that even this limited discipline was too stringent for the United States, as it was not prepared to bring its *Agricultural Adjustment Act* (1933) programs in line with GATT Article XI. In 1995, therefore, the United States sought and obtained a waiver from GATT disciplines for its Section 22 import quotas.

Notwithstanding the substantial progress in reducing normal agricultural tariffs, Canada and the United States were never able to negotiate the liberalization of quantitative import restrictions which covered the U.S. dairy, sugar, peanut and cotton sectors (throughout virtually all of the post-World War II period) and the import quotas on supply-managed products (which Canada progressively introduced, primarily during the 1970s). The U.S. reliance on its Section 22 import quotas and Canada's reliance on Article XI 2(c)(I) import quotas in support of its supply-managed dairy, poultry and egg sectors were well entrenched by the early-1980s when the first suggestions of a Canada-U.S. Free Trade Agreement began to emerge.

In their history of the dispute, de Gorter and de Valk give significant weight to the 1976 GATT Working Party report on Canadian import quotas on eggs. In their view, the working party was a watershed event in the development of supply management in Canada as the ruling in Canada's favour gave Canadian policy makers confidence that GATT Article XI could be used effectively to block imports. Rather than the egg working party, the watershed point for national supply management in Canada (more for domestic considerations than international ones) was 1970. It was in 1970, after intense federal-provincial discussions, the Canadian federal government proposed legislation to permit the establishment of national supply management systems consistent with the provisions of GATT Article XI 2(c)(I) (remember that this avenue had been open to all GATT members, including Canada, since 1947, and only the United States with its 1955 GATT waiver did not have to meet the GATT's stringent criteria). This strategy of stabilizing prices by controlling production and/or marketing on a national basis led to the implementation of a system of supply management with the *National Milk Marketing Plan* (NMMP) between 1970 and 1974, as each province joined the Plan. Concurrent with the NMMP, the *Farm Products Marketing Agencies Act* of 1972 provided for the establishment of national marketing agencies in the poultry industries with authority to allocate national output among each of the provinces.

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<sup>1</sup> For a detailed historical overview of Canada-U.S. agricultural disputes for these industries, see: Michael Hart, *Damned if you Do and Damned if you Don't: The Trials and Tribulations of Canada-US Agriculture Trade*, Occasional Paper No. 38, Centre for Trade Policy and Law.

Supply management is a unique Canadian marketing system that has been viewed as a kind of "industrial strategy" to maintain agricultural production in all regions of the country, while contributing to the development of rural Canada, and ensuring the survival of the traditional "family farm" structure. Historically, the core objectives of supply management in Canada is to provide efficient producers with the opportunity of obtaining a fair return for their labour and investment, while providing consumers with a continuous and adequate supply of high quality products.

Canada's national supply management systems have their roots in the troubled agricultural conditions of the 1960s: surpluses were accumulating, and prices and incomes were low and unstable. Although producer marketing boards with varying degrees of power had become fairly well-established at the provincial level, they had very little authority to regulate interprovincial trade and none to regulate international trade. Matters changed in the late-1960s, more because of interprovincial than international factors. New production, management and shipping techniques had increased the supply of agricultural products on an interprovincial basis. The limitations of provincial marketing boards had become clearly evident. While provincial regulation was effective in managing the production and marketing of products such as fluid milk which are bulky and perishable, and products such as tobacco that are produced almost exclusively in one province, supply management on a national basis was required to deal with products for which there was interprovincial competition.

In order to operate its national supply management systems effectively, Canada adopted measures to monitor and control imports of supply-managed products. Without these measures, the stability provided by the national policies would be undermined by imports, as it would be impossible for the national agencies to determine domestic demand accurately and allocate domestic quotas accordingly.

The 1988 GATT Panel on Ice Cream and Yogurt ruled that Canada's import quotas on ice cream and yogurt were inconsistent with Canada's GATT obligations under Article XI because they were deemed not to be "like" products with milk. Instead of focusing on that ruling, the authors chose instead to focus on an aspect that the panel chose not to rule on - that of restricting production. The authors muse about how beneficial it would have been, for certain industry sectors in Canada, had the panel ruled on this matter. The fact that there is over-production does not *ipso facto* mean that production is not restricted. All producers attempt to produce to the maximum of their allocation. The vagaries of agriculture production, however, are such that they rarely hit that number exactly, being either slightly under or slightly over. As the integrity of the system depends on production meeting demand, to counterbalance the producers' desire to maximize their production, there are prohibitive over-production penalties in place that provide a real disincentive to over produce and ensure that production remains restricted.

In the Canada-U.S. Free Trade Agreement (FTA) negotiations, not just Canada, but neither country was prepared to negotiate the removal of quantitative import restrictions.

In the first substantive meeting between the Canadian and U.S. negotiating teams, the U.S. negotiators made it clear that they were prepared to work towards the elimination

of all normal agricultural tariffs, but that Section 22 import quotas, export subsidies to third markets and domestic agricultural support could only be negotiated in the GATT where other countries, in particular those of the European Community, could be engaged.<sup>2</sup>

The Canadians will not eliminate their quota program on eggs and egg products. It will continue in effect, just as some of our agriculture programs, dairy for example... We do have an opportunity to remove the quotas in the Uruguay round and we did deliberately leave a lot of these agricultural issues for the Uruguay round because they are global issues, rather than bilateral ones.<sup>3</sup>

Both countries recognized at the time that the rules related to market access under the GATT would probably be modified as a result of the Uruguay Round, which had just gotten underway. However, neither country knew in what manner these modifications might occur. The eventual agreement for dealing with this uncertainty was the wording in FTA Article 710 which stated that both countries retain their GATT rights, including those under Article XI.

Regarding de Gorter's and de Valk's comments on the FTA, they state that the increase in access "granted" to the United States for poultry was an "arbitrarily chosen number". In any trade negotiation, nothing is granted, and nothing is chosen arbitrarily. The level of access is a negotiated one, and the bilateral deal was to provide access at the current level of imports (imports within the existing quota as well as supplemental imports). Regarding the NAFTA Panel and a new anti-dumping and countervail dispute settlement system, the two are unrelated. The NAFTA panel falls under Chapter 20, while anti-dumping and countervail are covered by the dispute settlement provisions of Chapter 19. The Canadian government has stated that it remains committed to pursuing a new dispute settlement system as it was at the time it negotiated the FTA. In fact, the recently concluded Canada-Chile free trade agreement includes a provision to eliminate anti-dumping actions.

An important point raised by the authors is that much has been achieved in the harmonization of the regulatory environment since the signing of the FTA. It is interesting to note that this harmonization is occurring in the poultry industries despite continuing tariff barriers. This is not to say that the Canadian market is closed. There is significant trade. For chicken, Canada is the United States' 7th largest export market by volume and 4th largest by value. In 1996, the United States exported 56 million kilograms of chicken to Canada valued

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<sup>2</sup> *Counter-Submission of Canada, North American Free Trade Agreement Chapter Twenty Panel in the matter of tariffs applied by Canada to certain U.S.-origin agricultural products*, February 19, 1996, p.1.

<sup>3</sup> *United States-Canada Free Trade Agreement: Hearings Before the Subcommittee on Trade of the House Committee on Ways and Means*, 100th Congress, 2d Session 56 (1988) (statement of Hon. Clayton Yeutter, U.S. Trade Representative, February 9, 1988).

at \$141 million.<sup>4</sup> Furthermore, the economic rent of these imports is worth another \$60 million to Canadian import quota holders, which includes retailers, distributors, food service operators, further processors and processors. The difference between bilateral trade in chicken and beef is that the chicken Tariff Rate Quota (TRQ) effectively dictates the terms of trade - the level of imports and who gets them, while trade in beef is driven more by market dynamics. As the terms of trade are well-established, the trade that is permitted flows freely without regulatory impediment, as witnessed by the fact that the TRQ is consistently fully utilized.

The North American Free Trade Agreement (NAFTA) negotiations were conducted at a time when the results of the Uruguay Round negotiations were not known. There was general agreement to phase-out normal tariffs but there was no agreement on how non-tariff barriers were to be handled. Canada refused to prejudice its Uruguay Round negotiating position of clarifying Article XI and indicated that, while it was prepared to phase-out all normal tariffs, it would maintain its import quotas on supply-managed products.

The end result was that Canada and the United States did not engage in any market access negotiations. The United States and Mexico, and Canada and Mexico conducted separate bilateral market access negotiations on agriculture. Canada and the United States agreed to incorporate the key provisions of Chapter Seven of the FTA into the NAFTA. The only trilateral provisions of the agricultural chapter in the NAFTA were those dealing with non-market access issues.

From the beginning of the Uruguay Round negotiations, Canada pressed for clarification of GATT Article XI as a means of improving market access opportunities while still maintaining import restrictions in support of effective supply management programs. In March of 1990, Canada tabled a detailed proposal for strengthening and clarifying Article XI.

The United States was proceeding on a different track in the negotiations, i.e., comprehensive tariffication. The United States circulated a paper on tariffication in Geneva on November 7, 1988, and this proposal was further developed in a discussion paper on tariffication submitted to the GATT by the United States in July, 1989. Eventually the concept of tariffication was incorporated as a central feature of the market access section of the draft agriculture negotiating texts. Canada, however, continued to press for a solution incorporating changes to Article XI until the close of negotiations in December, 1993. The end result of the Uruguay Round was tariffication.

During a number of occasions throughout 1994, Canada and the United States met to discuss the implications of the Uruguay Round results for the agricultural provisions of the

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<sup>4</sup> Under the terms of the FTA, the United States has access equal to 7.5 percent of Canada's domestic production during the previous year. As a result of increased Canadian production, U.S. exports have risen from 34 million kilograms in 1988 to 56 million kilograms in 1996. The value of these exports has increased to \$141 million from \$66 million over the same time frame. The tariff rate applied to these within-quota imports will be reduced to zero as of January 1, 1998.

NAFTA. The United States argued that tariff equivalents could not be applied to bilateral trade. When it became apparent that the legal differences could not be bridged, the two countries attempted to negotiate a pragmatic package which would put the legal differences to one side for five or six years. These discussions failed to reach an agreement and in late-1994 the United States indicated it would pursue its interests through the dispute settlement provisions of the NAFTA.

Regarding the NAFTA Panel itself, the question was not whether the World Trade Organization (WTO) took precedence over the NAFTA, as claimed by de Gorter and de Valk. The United States fully conceded that Canada's tariff equivalents were WTO consistent. What they questioned was whether they also met Canada's independent NAFTA obligations. And what the panel unanimously agreed was that Canada's conversion of its import quotas to tariff equivalents was fully consistent with the NAFTA by virtue of NAFTA Annex 702.1 which incorporated FTA Article 710. WTO tariffication did not increase tariffs or introduce new ones, what it did was convert import quotas to tariff equivalents — a process sold by the United States to GATT Parties as trade liberalizing.

De Valk and de Gorter erroneously imply that the United States can now take this case to the WTO. Nothing is further from the truth. NAFTA Chapter 20 clearly states that a country can choose the NAFTA or the WTO dispute settlement procedure. Furthermore, as mentioned above, the United States conceded in the NAFTA Panel that Canada's tariffication fully met its WTO obligations.

The authors then make the bold assertion that now that tariffication is in place “the need for national supply management agencies to maintain effective control over production is removed.” Just as national supply management was not put in place simply to obtain import controls, the change in the nature of import controls does not obviate the need for domestic supply management. As noted earlier, controls over both domestic and import supply are essential to operate supply management effectively. Just as control over domestic supply was not enough in the 1970s, neither would control over imports alone be enough in the 1990s and beyond.

Leaving aside the arguments on the merits of supply management and the proposition that the Canadian industry should be harmonized to the U.S. model (and not the other way around), I propose to look at an issue that I believe is leading to increased confrontation, and that is the creation of “unrealistic expectations”.

I agree with the authors that unrealistic expectations created in the United States have played a large role in this dispute. But, more than just stiffening the resolve of Canadian industry to force the United States to abide by the agreements it has negotiated, it has convinced U.S. industry of its right to unlimited access to the Canadian market for these products. In order to sell the Uruguay Round to Congress, the U.S. Administration had to demonstrate the benefit of the WTO Agreement on Agriculture to U.S. industry. The U.S. government stated that the United States would gain access to the \$1 billion dairy industry in Canada. This did not happen. No matter — the U.S. government said it would challenge these tariffs as NAFTA inconsistent and there was no way it could lose. But lose it did, and clamour did the industry. In the same vein, the U.S. government has created similar

unrealistic expectations regarding wheat shipments from Canada, i.e., that the United States can legally do something about them. For political expediency purposes, the U.S. government has not been forthright with its industry. This has created increased political pressure in the United States against these decisions as well as the dispute settlement process itself. This is a dangerous game that the government is playing, by insinuating that Canadian policies or trade are actually WTO or NAFTA incompatible.

De Gorter and de Valk make several recommendations to settle the dairy and poultry dispute. First, I would point out that the dispute has been settled by a NAFTA panel. The United States has, and continues to try to obtain through dispute settlement and other means what it was unable to negotiate bilaterally in the FTA, trilaterally in the NAFTA or multilaterally in the WTO. That aside, as for the specific recommendations:

1. It will never be possible to develop a meaningful and representative live poultry price from U.S. integrated processors as there is no live price. Contract growers are not paid for their product, but only for their labour.
2. As demonstrated by the blue ribbon commission on wheat, this is a political process that is not conducive to settling disputes.
3. Canada continues to push for clearer trade remedy and safeguard regimes.
4. Harmonization of regulatory issues should proceed.
5. Interprovincial trade in goods in Canada and milk marketing order reform in the United States are domestic matters and it is not appropriate to deal with them in an international forum. It is sufficient to agree that domestic policies/regulations will be brought into conformance with negotiated international commitments.
6. The best, and only, venue to address these issues is during the next round of WTO agricultural trade negotiations scheduled to begin in 1999.

In conclusion, the two papers have highlighted two telling aspects on how H/C/C implications affect trade disputes:

1. On the one hand, as Bill Kerr and Dermot Hayes highlight, the continuing frictions in wheat, beef and pork trade demonstrate that tariff-free trade does not necessarily negate disputes; regulatory issues continue to be irritants.
2. On the other hand, as de Valk and de Gorter point out, there has been progress made on regulatory issues in the poultry industries, demonstrating that tariff barriers, which effectively determine the terms of trade, can create a non-confrontational environment in which non-tariff issues can be addressed.
3. In general, with the huge change engendered by the Uruguay Round bringing agriculture more fully within international trade disciplines, we may see more trade disputes, in the short term, as agriculture industries around the globe are forced to adapt quickly to new trading environments.

Given these observations, perhaps the solution is for the next round of WTO agriculture negotiations to consider the Mercosur proposal for Free Trade of the Americas Agreement (FTAA) negotiations as an option. Mercosur has proposed a three stage negotiation process. During the first stage, talks would focus on business facilitation issues such as customs documentation measures, certification of origin, and acceptance of SPS certificates. The second stage would encompass norms and disciplines such as administration of customs procedures, investment promotion and protection regimes, technical standards, sanitary and phytosanitary measures, antidumping and countervail measures, transparency in government procurement, professional services and intellectual property rights. Only once these issues are satisfactorily solved would negotiations begin on market access, export subsidies and competition policy.<sup>5</sup>

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<sup>5</sup> *Special Report: Mercosur plan at odds with U.S., Canada on start date for FTAA talks*, in *Inside U.S. Trade*, February 28, 1997.