IMPLICATIONS FOR TRADE TENSIONS AND DISPUTES ARISING FROM STRUCTURAL IMPACTS OF NAFTA: A CANADIAN HOG INDUSTRY PERSPECTIVE

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INTRODUCTION

It is almost taken as a given that trade liberalization arrangements such as the North American Free Trade Agreement exert a huge impact on the structure of an industry. The introduction of greater competition arising from the reduction or elimination of import barriers, and the additional sales opportunities provided by improved access for domestic industries to foreign markets, will almost certainly accelerate the pace of modernization, innovation and other behavioural norms that help determine the structural profile of an industry.

As I understand the objectives of this workshop, our purpose is to ponder the implications of these structural developments for the tendencies toward pursuing trade dispute actions by affected economic sectors. My own task is to look at it from a specific agri-food perspective, the hog/pork subsector. The co-speaker on this topic, Steve Meyer from our U.S. counterpart National Pork Producers Council, and I have chosen to look at this question from our own respective economic circumstances. We thought it could be the differences in what we have to say, as much as what we would say in common, that will be of interest to the workshop participants.

The way that the Canadian industry would look at this issue is with the perspective of a country with a relatively smaller domestic market and production, and also greater dependence on trade, particularly export access. Roughly one in every two pigs born in Canada is ultimately exported, as a feeder pig, a slaughter hog, or more often, as pig meat. The U.S. industry is a larger industry, thus providing an advantage in identifying and exploiting economies of scale. Their domestic market is relatively much more important in determining their overall economic health. Our other NAFTA partner, Mexico, has its own unique circumstances, and Enrique Dominguez remarks will be as important as our own comments in considering industries trade dispute behavior under a free trade arrangement like NAFTA. Ed Tyrchniewicz, with academic as well as what one might call public interest reconciliation facilitation experiences, is bound to add some interesting content to the discussion.

NAFTA CONSEQUENCES ON INDUSTRY STRUCTURE

To contemplate what have been the impacts of the North American Free Trade Agreement for our hog/pork industries, one needs to examine the situation prior to the trade deals existence. Was the subsector in a strong or weak position relative to its competitors in the other country? Had it been exposed to, and had it been able to take advantage of internationally competitive input prices?

Prior to NAFTA, both the United States and Canada had zero import tariffs in effect on unprocessed pork as a result of previous GATT rounds, and as major players in the world grains and oilseeds markets, had internationally competitive feed grain prices[1] . Mexico, however, had not been a member of the General Agreement on Tariffs and Trade for very long prior to the creation of NAFTA, and had in place high tariffs on meat as well as significant restrictions on the use and importation of corn for livestock production.

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[1] There was an exception, small grains in western Canada (wheat, barley) where local feed prices were higher due to transportation subsidies on export grain, a situation that was largely corrected by the revocation in the mid-1990s of the Western Grains Transportation Act.

For the Mexican pork industry, adjustment to a free trade environment involved much more significant change than was the case for their northern neighbours. They had to adjust from a situation where prices of inputs and output were largely determined within Mexico, to one of more North American-origin prices subject to a declining tariff. This included having to adapt to the same up-and-down hog price cycle that their northern counterparts were used to. To make matters even more challenging for a protected industry moving to open competition, they were being directly exposed to Canadian and U.S. hog prices which, due to our production and marketing efficiencies, are generally the lowest in the world, at least among open market economies. While modernization was no doubt already taking place within the Mexican hog and pork sector, the new market realities made it more important, and more feasible, to tap into the feeding, genetics and other input strategies being pursued elsewhere.

Another consideration for examining structural impacts of free trade is whether all segments of the supply chain are in similar circumstances, or is one better able to withstand, and even thrive on, increased competition and opportunities arising from the trade agreement? At the time that the North American continental free trade negotiations were conducted, the hog growing segment of the Canadian hog/pork subsector was quite competitive vis-à-vis its U.S. counterparts. Such was not the case for the hog processing segment. There developed in the 1980s and into the 1990s a significant and growing export of Canadian feeder and slaughter pigs to the United States. The smaller and technologically older Canadian slaughter and processing facilities were unable to pay prices for the hogs that would prevent a growing proportion of them from moving to the U.S. buyers that were paying higher prices. For a time, Canadian hog processors were provided something of a cushion against the lower cost U.S. packers when a countervailing duty was applied on live hogs moving from Canada into the United States. However, as Canadian subsidy programs were eliminated, the duty declined and thus that protection was also eroded. By the time the duty was eliminated, it had become quite apparent to Canadian hog processors that they had no choice but to make significant capital expenditures and labour cost-saving measures so they could achieve cost economies that would permit them to bid competitively for hogs against the U.S. companies.

Now, for the first time in probably decades, there actually are some Canadian hog processing facilities which offer an attractive alternative marketing opportunity for U.S. hog producers, particularly in northern states.

What the free trade agreement provides that is of great importance here is the clear signal to all market participants that the barriers that now exist are in support of, not restrictive of, cross-border trade. The elimination of tariffs, the establishment of rules providing imports accorded equal treatment with domestically produced goods, and the availability of binding dispute settlement procedures have provided a solid foundation for market transactions between countries to become essentially like transactions within countries in terms of some assurance of being able to retain that business once the individual buyer and seller considerations have been met. Increased understanding of the rules, and confidence that they will be applied, seems to lead to greater cross-border business collaboration and specialization. In the hog/pork subsector, one example is the long-term contracting of feeder pigs from Canada to growers in the United States. Even with the emergence of more competitive hog purchasers in Canada, the flows of feeder swine remain steady. That channel of commerce has become quite well established in the form of long-term partnerships.

The Canadian hog processing industry was for many years entirely in Canadian hands. Recently, Smithfield has taken an important position in that sector through purchase of all or a majority interest in two of Canadian companies, Schneider[2] and Mitchell's Gourmet Meats.

SOME IMPLICATIONS FOR COMPETITION POLICY

Traditionally, when examining the degree of competition within an industry (numbers of sellers and buyers, etc.) and the implications of consolidation within a sector, the geographical context has been the country itself for which the competition legislation applies. In the Canadian hog/pork subsector, there has been tremendous consolidation. If looked at in a Canadian context alone, there likely would be greater pressure being brought to bear on competi-

[2] Schneider Corp. recently sold its fresh pork business to Maple Leaf Foods.

tion authorities to examine the implications of the emergence of one or two major players in the purchasing of hogs in Canada. While there undoubtedly are some concerns with the increasing concentration of buyers, there also exists an attitude shared by many observers that for there to be any buyer willing to pay as much as U.S. companies do for market pigs, they will need to be large enough to compete in the larger North American context. And for Canada's approximately 25 million hogs produced per year, more than one or two players in the volume end of the spectrum is likely not feasible.

FREE TRADE IMPLICATIONS FOR TRADE RELATIONS

Just as a free trade agreement can lead to more efficient industries within the trade bloc, these industries may be more competitive vis-à-vis the rest of the world. The greater exposure to the intricacies of cross-border trade within the agreement territory may well also increase the appetite of these players for doing business with other nations. It is interesting to note, for example, that all three NAFTA countries have emerged as significant exporters of pork into Japan. Such developments lead to recognition of common interests in third country trade. This helps to broaden the nature of the dialogue among industries and their representatives, to more than simply bilateral issues.

While there are developments that may lessen the interest in, or likelihood of, trade disputes, some of the consequences of the free trade arrangement, and the attendant structural changes which it promotes, may actually increase the probability of a trade action through the greater volumes of commerce that inevitably occur. This is particularly the case during a cyclical downturn when commodity prices fall, and suppliers may see imports as being a large part of their problem. There can remain within the community of sellers, if they are not directly engaged in this new continental market reality, the notion that they should retain a priority with the buyers in their own country whenever total supplies start to become burdensome and prices are depressed.

Each country in the NAFTA has retained its own separate countervail and dumping legislation which may be applied to examine the impact of product coming in from another country, even a free trade partner nation, as if it is derived from a separate world altogether as the domestic supply. In fact, as a result of the integration between the free trade countries economies, there is very little to distinguish between the two supplies in terms of how products are produced and priced. Increasingly, there are contracts in place between sellers and buyers that happen to be located on opposite sides of the political border. These contracts may not differ in any appreciable way from those in place between the buyer and more locally based sellers. Nevertheless, that buyer may come under pressure for continuing to purchase from foreign sources when, for example, hog numbers are high and prices low.

It becomes more complicated to operate separate, country-specific, trade remedy dispute systems as the economies of the countries within a trading bloc become more integrated. In Canada currently, there are provisional countervailing and antidumping duties on grain corn entering western Canada from the United States [editors note: the tariff was in place from November, 2000 to March, 2001]. Given that Canada, as a relatively insignificant importer of corn relative to the world market, has to absorb most of the impact of such tariffs, this new duty renders Canadian users of grain corn less competitive vis-à-vis U.S. counterparts. This, in turn, can lead to an increase in feeder animal exports thus losing value-added in Canada, and potentially becoming a trade irritant for some in the United States who see all of these additional feeder animals contributing to a buildup of total hog supplies relative to slaughter capacity in that country.

The Canadian Pork Council, along with several other Canadian parties, is actively opposing the permanent imposition of these duties. Although sympathetic to the notion that there be a level playing field internationally of government support for agriculture, we are not sympathetic to any means of achieving that objective which places the burden of adjustment on the backs of other segments of the marketing supply chain by imposing countervailing duties on imports. In our view, the costs of the battle to achieve international agri-food subsidy reforms is in the total public interest and the costs of achieving it therefore should also be borne by the general public.

With respect to dumping, the Pork Council urges that cost-of-production, the basis for the Canadian corn antidumping tariffs, only be allowed as the reference for assessing if dumping is taking place where there are no reliable prices by which to determine if the imported products are being priced below the level in the country of origin. It is our view that in a free trade situation, all participants in the marketplace need to be able to get along with the same basic underlying prices[3], both in worse and in better times. It might also be said that generally, the greater is the trade, the greater becomes the awareness of each other business environment. This includes the availability of inputs such as medications, environmental regulations, animal welfare standards, and food safety requirements. Where differences exist, the side which thinks it carries the more onerous requirements can use this to complain about unfair trade. This is not at all limited to the North American context, as the EU continues to press for such non-trade concerns to be incorporated into the WTO. Presumably, countries would be provided certain import tariff and even export subsidy allowances for their alleged higher environmental and welfare standards, not an easy sell outside of the EU!

POTENTIAL FUTURE DEVELOPMENTS

Given some of the structural impacts of free trade that have been observed to date, the following are suggested as what one might expect for the future:

- agricultural support policy regimes existing in each country (e.g., relative levels of domestic support available, and how trade-distorting is this support) will continue to be closely examined, and trade instruments (e.g., countervail) will be used to reinforce a movement toward greater harmonization, and avoidance of trade-distorting practices;
- economies of scale available from larger plants will lead to further consolidation and fewer companies, but with NAFTA and free trade there is more potential for companies to operate in more than one country and/or have vertical or horizontal alliances which cross borders and reduce the incentive to pursue trade actions;
- with increasing economic integration and more political cooperation, there will be less appetite of governments for defending import

[3] This argument applies for inputs as well as output.

sensitive and less competitive industries which often are the cause of bilateral trade disputes;

- converging cross-border interests within many economic sectors make country-specific trade remedy administration problematic. Alternative means of addressing trade disputes with corrective measures that do not penalize innocent bystanders need to be developed;
- more frequent communications and further development of cross-border economic and political relationships can result in common efforts to address marketing challenges and further lower the potential for trade friction;
- the increased scrutiny by producers in one country of the business environment existing for their counterparts in other trading bloc member countries will produce increasing pressure for harmonization in such areas as labeling standards, availability of production inputs such as veterinary medications, and product definitions such as whether hams are derived only from pigs or also from other protein ingredients; and
- pressures for rationalization of marketing flows on a continental basis, such as U.S. pigs moving to nearby Canadian slaughter plants, and Canadian plants selling pork to major U.S. population centers because they are in closer proximity to those markets, will sustain interest in cross-border flows and on occasion, lead to trade disputes[4]

However, other aspects of the developing free-trade-area relationships will cause many of these disputes to be addressed at a much earlier point, before they explode onto the stage of trade action plays. The costs of large-scale trade disputes are usually so great, and there are so many more losers and winners from these actions, that other mechanisms are being developed with still more to be created, to address cross-border trade tensions.

[4] This may include actions taken to distinguish domestic product from imports, such as country-of-origin labelling, that can in turn lead to a cross-border dispute.