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THE NORTH AMERICAN FREE TRADE AGREEMENT AND THE AGRIFOOD SECTOR:  
A CANADIAN PERSPECTIVE

by

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# The North American Free Trade Agreement and the Agrifood Sector: A Canadian Perspective

## INTRODUCTION

Prime Minister Chretien's announcement on December 2, 1993 that Canada would proclaim the North American Free Trade Agreement (NAFTA) on January 1, 1994 marks the completion of a process which began in February 1991 when the governments of the United States, Canada and Mexico announced that they would attempt to negotiate a trilateral free trade agreement. The NAFTA is a comprehensive agreement that covers trade in goods (NAFTA, Chs. 3-8), technical barriers to trade (NAFTA, Ch. 9), government procurement (NAFTA, Ch. 10), investment, services and related matters (NAFTA, Chs. 11-16), intellectual property (NAFTA, Ch. 17) and substantive administrative, institutional and dispute settlement procedures (NAFTA, Chs. 18-22). The highlighted portions of Table 1 indicate which of the NAFTA's chapters contain provisions which affect the agrifood sector.<sup>1</sup>

The NAFTA will create one of the world's largest free trade areas, with a gross national product of nearly C\$ 7 trillion.<sup>2</sup> It also marks the creation of the first comprehensive free trade area to link a developing country (Mexico), with a per capita GDP of less than \$3000 per year, with two of the world's most industrialized nations (Canada and the U.S), which with per capita GDPs of approximately \$25,000 per year have among the best standards of living in the world.<sup>3</sup> Largely for this reason, the NAFTA remains unpopular with the general public in Canada, as well as in the United States, and even its supporters agree that its economic benefits will only materialize in the longer-term. The general pattern of costs and benefits expected from the NAFTA applies equally as well to the agrifood sector as to the overall Canadian economy, but the agrifood sector's treatment in the NAFTA is an interesting case study because of the interrelationships among the multilateral trade negotiations recently completed under the General Agreement on Tariffs and Trade (GATT) and the experience gained from the Canada-United States Free Trade Agreement (FTA).<sup>4</sup> To examine these interrelationships and their implications for Canada's agrifood sector the paper proceeds as follows. The issues that formed the basis of the multilateral, trilateral and bilateral trade negotiations and agreements and their interrelationships are examined first. Subsequently, the implications of the NAFTA for Canada's agrifood sector are assessed.

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<sup>1</sup> We use the term agrifood, instead of agriculture, because agrifood includes the production and processing levels of the sector. Sector refers to the aggregate of the various agrifood industries such as red meat, poultry, dairy, cereals, horticulture etc.

<sup>2</sup> The European Union, which was created very recently through the joining of the European Community and the European Free Trade Association, is approximately the same size.

<sup>3</sup> Some students of trade agreements may argue that Spain's and Portugal's entry into the European Community was the first incidence of developing countries joining with developed countries in a free trade area. However we assert that this is not the case since the ratio of the country with the highest per capita GDP (West Germany) to that of Spain and Portugal is about 4:1 versus 8:1 for Canada and the U.S. versus Mexico.

<sup>4</sup> The NAFTA negotiations were concluded approximately one year prior to the conclusion of the GATT negotiations.

**Table 1: The North American Free Trade Agreement**  
(chapters with most relevance to the agrifood sector are shaded)

PART	Chapter
GENERAL PART	1. Objectives
	2. General Definitions
TRADE IN GOODS	3. National Treatment and Market Access (annexes for automotive and textiles)
	4. Rules of Origin
	5. Customs Procedures
	6. Energy
	7. Agriculture
	8. Emergency Action
TECHNICAL BARRIERS TO TRADE	9. Standard Related Measures to Trade
GOVERNMENT PROCUREMENT	10. Government Procurement
INVESTMENT, SERVICES & RELATED MATTERS	11. Investment
	12. Cross-Border Trade in Services
	13. Telecommunications
	14. Financial Services
	15. Competition Policy, Monopolies & State Enterprises
	16. Temporary Entry for Business Persons
INTELLECTUAL PROPERTY	17. Intellectual Property
ADMINISTRATIVE & INSTITUTIONAL PROVISIONS	18. Publication, Notification and Administration of Laws
	19. Review and Dispute Settlement in Antidumping and Countervailing Duty Matters
	20. Institutional Arrangements and Dispute Settlement Procedures
OTHER PROVISIONS	21. Exceptions
	22. Final Provisions

## AGRIFOOD PROVISIONS IN THE NAFTA

Much of the NAFTA negotiations occurred in parallel with the Uruguay Round of GATT negotiations which were concluded on December 15, 1993. Along with the FTA, the trilateral and multilateral negotiations addressed a similar set of issues with respect to the agrifood sector, namely: market access through tariff and non-tariff barriers (including safeguards), domestic support, export assistance and technical regulations. Dispute settlement is also an important issue in the agrifood sector, as are some miscellaneous trade matters. During the negotiation of the NAFTA, negotiators hoped that the GATT negotiations would be concluded first so that the NAFTA could build on a GATT agreement. Unfortunately, this was not the case. Negotiators also drew heavily on their experience in negotiating the FTA, as well as its content.

The treatment of agrifood issues in the NAFTA is structured similarly to their treatment in the FTA, but because there are three countries involved, the particulars are more complex. Several provisions which will have an effect on the agrifood sector such as tariffs, custom administration and dispute settlement are covered in the chapters dealing with the general provisions for trade in goods (Table 1). The more contentious issues of tariffs in import sensitive industries and non-tariff barriers are covered in chapter seven, which deals specifically with agrifood. Also given the differences among the agricultural policy instruments in the three countries, their status in the GATT and existing bilateral deals, the parts of the NAFTA that deal with the agrifood sector consist of three bilateral agreements.

The agrifood component of the NAFTA is structured partially on the hub-and-spoke model of trade agreements that Canada wanted to avoid going into the negotiations. The United States' agrifood sector gets many of the benefits associated with being in the hub, while Canada's and Mexico's agrifood sectors obtain fewer benefits. In theory, the hub and spoke model offers the hub country the advantage of being the only participant with duty free access to all of the member countries and thereby creates an incentive for firms to locate new investment in the hub to gain tariff free access to all consumers and input suppliers (Wonnacott, Lipsey).

The approach adopted in the NAFTA allowed the incorporation of existing provisions between Canada and the United States under the FTA, primarily for Canada's supply managed industries which retained their GATT legal import quotas. However, the NAFTA contains new provisions for trade between the United States and Mexico. Unfortunately, the accommodation of Canada's supply managed industries' concerns came at a potentially heavy price to parts of our agrifood sector. At the end of 15 years, all agrifood trade between Mexico and the United States will be tariff free, while this is unlikely to be the case between Canada and either Mexico or the United States. Mexico also gained an exemption from Section 22 of the United States Agricultural Adjustment Act (AAA), which allows it to impose import quotas on imports of any product deemed to interfere with its domestic support programs. This exemption now seems less important because the United States will have to give up its Section 22 import quotas as a result of the GATT agreement. With this overview we turn to our analysis.

### Market Access - Tariffs

With the exception of the horticulture industry, tariffs have played a minor role in comparison to various non-tariff barriers in protecting domestic agrifood interests in Canada, especially for raw agricultural products. Nevertheless, tariffs are part of the protective structure for the agrifood sector, and reducing them can negate or change the effectiveness of the remaining policy instruments. As a result of the recently concluded GATT negotiations, average most favoured nation tariff levels will decline over a six year period beginning in 1995. However, most favoured nation tariffs will not be eliminated as they will on trade among the NAFTA countries. However, given the complex format for reducing other components of the protective structure covering parts of the agrifood sector the exact impact of NAFTA's and GATT's tariffs on Canada's agrifood sector is difficult to predict.

Table 2 summarizes the treatment of tariffs under the FTA and the NAFTA. It indicates that the FTA and the NAFTA both contain several broad schedules for phasing out tariff protection, ranging from immediately to 10 or 15 years. Although many product groups span more than one tariff schedule, some generalizations can be made. Several products are already tariff free in all three countries. Canada and the United States eliminate tariffs on most livestock products immediately. Mexico, already allows duty free entry for beef, and will eliminate other tariffs on red meat over 10 years. Canada will eliminate tariffs on grains over 5 years, as it will for several horticultural products. The tariffs on these fresh and processed horticultural products will be phased out starting at the level applicable under the FTA (5 years of which will have passed when the NAFTA comes into effect on Jan. 1, 1994).

The United States, which has a large bilateral trade in horticultural products with Mexico, will phase out tariff protection on most of these products over 10 years, and for some of the more sensitive products, over a period of 15 years. Mexico will remove its tariff protection on many vegetable products, flowers and nuts immediately, but will phase out protection for some tree fruits over five years and allow 10 years for several fruits, cereals and potatoes. Mexico is allowed 15 years to phase out its tariffs on its most import sensitive goods, namely, maize and dried beans.

Generally, Canada has followed the pace set by the FTA in adjusting to tariff free trade with Mexico, while the United States has eliminated more tariffs immediately but allowed longer phase-out periods for sensitive products. However, a major unanswered question flowing from the GATT agreement is what tariff rates will apply to trade between Canada and the United States for those products that are subject to tariffication? Canada's position is that the high tariff equivalent will apply to cross-border trade because Article 710 of the FTA indicates that both countries retain their GATT rights and obligations. Conversely, the United States argues that these tariffs must be phased out as a result of the FTA's provisions to phase-out tariffs on bilateral trade (FTA, Art. 401). This issue is the subject of current bilateral negotiation, and its resolution will have a major influence on the degree and time period over which Canada's supply managed industries are able to operate with significant import protection. At this point our operating assumption is that relatively high tariff rates will continue to apply between Canada and the United States for supply managed products. Only time will tell what price has to be paid for maintaining this protection.



Table 2: Tariff Treatment of Agrifood Products in the FTA and the NAFTA by Country

Description of Tariff Treatment	Canada-United States Trade Agreement				North American Trade Agreement				
	Canada		United States		Canada		United States		Mexico
Currently Tariff Free	most live cattle some pork fruit (inc. grapes) orange juice	offal nuts coffee most fish	most live cattle some pork coffee soybeans	offal apples spices most fish	live cattle pork fruit coffee	offal nuts grapes orange juice	live cattle pork coffee soybeans	offal apples spices	live cattle soybeans beef oilseed products
Eliminated in 1989 (when the FTA came into force)	animal feeds whiskey some pork products some fish	yeast rice	animal feeds whiskey some pork and beef products some fish some oils some tropical fruits a few dried fruits and spices	yeast rice					
Eliminated by 1994 - begin 1994 for NAFTA - during 1989-1994 for the FTA	lamb cuts some coffee products some pork selected livestock	some rice some oils some fish	some nuts some tropical fruits some pork selected livestock	some rice some oils some fish	beef honey	sheepmeat soybeans	beef pork milk nuts wheat eggs oilseeds products	sheepmeat poultry flowers grapes flour beans	honey cocoa nuts onions orange juice most vegetables tomatoes coffee spices garlic flowers
Eliminated by 1998 - during 1994-1998 for NAFTA - during 1989-1998 for the FTA	horticultural products * dairy products some meat cuts and products some spices most grain products selected fish most sugars, syrups, confectionary most alcoholic beverages	some oils	horticultural products * dairy products some meat cuts and products few spices most grain products selected fish most sugars, syrups, confectionary most alcoholic beverages	some oils	potatoes* onions* broccoli* flour fruit maize most fresh vegetables	tomatoes* cucumbers* apples wheat barley cut flowers* processed vegetables			horsemeat apricots plums offal (not of pork & beef)
Eliminated by 2003:(NAFTA)	Not Applicable		Not Applicable				honey tomatoes/TRQ fruit		pork/TRQ potatoes/10/7 wheat barley peaches strawberries oilseed cake apples/TRQ grapes flour rice sheepmeat offal (beef and pork)
Eliminated by 2009	Not Applicable		Not Applicable				onions peanuts orange juice	melons avocados asparagus	maize/15/7 dried beans/15/7
Excluded	non processed dairy and poultry				dairy/CM	poultry/CM			dairy/CM poultry/CM

Notes:

- \* Eligible for special safeguards of the Agriculture Chapter
- TRQ Tariff Rate Quota accompanies the tariff reductions
- 15/7 Uneven reductions over 15 years, with major reduction beginning in the 7th year

CM Applies to Canada-Mexico trade only  
10/7 Uneven reductions over 10 years, with major reductions beginning in the 7th year

Sugar is treated under the tariff provisions for Canada and Mexico. Mexico applies the most favoured nation tariff to sugar from Canada, and Canada applies that same level of tariff to Mexican sugar. Mexico retains its current quota of sugar into the United States market (7,258 tons), but if it produces a surplus, a fixed quantity of sugar (25,000 tons) can enter the United States duty free for the first six years, while in subsequent years 150,000 tons will be eligible. This has been a contentious issue in the United States where the sugar lobby is concerned that Mexico will increase its domestic production and consumption of corn sweeteners and export granulated sugar to the United States. According to the November 5, 1993 issue of Inside United States Trade, the United States has negotiated a side deal with Mexico to address this ambiguity.

All three countries enjoy special safeguard provisions to deal with import surges and severe price effects. These are indicated by asterisks in Table 2. The safeguards allow for the imposition of tariff rate quotas during certain periods of the year. It is difficult to say whether these will provide the same relief as the "snapback" to the most favoured nation tariff rate that is possible, in Canada, under the FTA when specified economic conditions relating to price and area planted are met. However, the NAFTA's provisions appear more protectionist since they are not conditioned on the level of economic variables as is the case with the FTA. The special safeguard provisions for agrifood products in the GATT, which are based on volume or price triggers fall between the structure and protective intent of the safeguard provisions in the FTA and NAFTA.

Under NAFTA, some products are excluded completely from tariff elimination for trade between Canada and Mexico, most notably Canada's supply managed products. However, Mexican-United States trade in these products is subject to tariff elimination, while Canada-United States trade is governed by an FTA provision which excludes supply managed products from tariff elimination with the exception of some highly processed products which are explicitly listed.<sup>5</sup> This asymmetry in NAFTA occurred because Canada's supply managed industries enjoyed market access restrictions through means they hoped could be maintained in the recently concluded GATT negotiations. But since the Canadian argument to maintain import quotas on supply managed products was lost in the GATT, the supply managed and other industries which would have benefitted from further concessions from Mexico paid a price for this negotiating position.

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<sup>5</sup> The list of products which are subject to tariff elimination consists of highly processed poultry products: chicken or turkey cordon bleu (plain and breaded), chicken or turkey Kiev (plain and breaded), boneless chicken or turkey with apples and almond, chicken or turkey Romanoff Regell, chicken or turkey Neptune breast, boneless chicken or turkey panache, chicken or turkey T.V. dinners, old roosters and spent fowl (FTA, Annex 706).

### Market Access - Non Tariff Barriers

The various non-tariff barriers that hinder the free movement of agrifood products were the most contentious issue in the Uruguay Round and were resolved by requiring the conversion of various measures such as quantitative import restrictions, variable import levies, import licensing and others to tariffs. Since NAFTA was negotiated before the GATT negotiations ended, like the FTA, it reflects the lack of progress in GATT during the period from 1986 to near the end of 1993.

Some market access provisions of the NAFTA apply equivalently to all three countries, most notably; the commitment to work together to improve access to each other's markets (NAFTA, Art. 704(1)); to consult with each other when wanting to adopt any measure pursuant to an international agreement that might nullify or impair a concession granted to the other parties (NAFTA, Art. 702(2)), and, to comply with international agreements unless specifically, otherwise stated (NAFTA, Art. 702(1)). The key market access provisions for agrifood in the NAFTA are in its three bilateral components. Those that deal with Canada-United States trade are essentially those in the FTA; in fact, several articles of the FTA are incorporated, as is, into the NAFTA (NAFTA, Arts. 701, 702, 704, 705, 706, 707, 710 and 711). This provided a way to avoid the political problems associated with reopening the FTA, but it also limited the opportunity for improving the agrifood provisions. This means that the key provisions with respect to market access for the agrifood sector contained in the NAFTA are those of the FTA (Warley, 1989). They are:

- \* a prohibition on export subsidies on bilateral trade and an agreement to take account of each other's interests when using export subsidies on sales to third markets (NAFTA, Art. 701);
- \* a commitment to work together to improve access to each other's markets (NAFTA, Art. 703);
- \* mutual exemption from restrictions under each other's meat import laws (NAFTA, Art. 704);
- \* Canada agreed to eliminate its import licenses for wheat, oats and barley when United States levels of support for these products fell below Canadian support levels<sup>6</sup> (NAFTA, Art. 705);
- \* Canada's quantitative restrictions on trade in products covered under Article XI(2)(c) of the GATT (dairy and poultry) remain in place, as do the import restrictions covered by the United States section 22 of the AAA waiver (imports which would interfere with price support programs) ( NAFTA, Art. 706); and,
- \* Canada and the United States retain their rights and obligations with respect to agricultural, food, beverage and certain related goods under the GATT, unless otherwise specifically indicated in the agrifood chapter of the FTA (NAFTA, Art. 710).

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<sup>6</sup> This has happened for oats and wheat while Canada removed them unilaterally for barley.

In the NAFTA, all three countries agree to eliminate all quantitative restrictions on trade, by using tariff rate quotas to provide temporary protection from import surges. Each country agrees to waive their rights under the NAFTA if tariffs and/or tariff rate quotas that are bound in GATT require them to do so (NAFTA, Annex 704-2). However, the Canada-Mexico bilateral component of the NAFTA contains a number of exceptions to these general provisions.

Canada retains its GATT Article 11(2)(c) rights for the dairy and poultry industries (Annex 704-2), while Mexico is also allowed to impose quantitative import restrictions on such products from Canada, including powdered milk which Canada currently exports without facing Mexican barriers (NAFTA, Annex 704-2). In contrast, the U.S-Mexico component of the NAFTA for market access improves substantially on existing GATT and the FTA's provisions. Both countries waive their rights under GATT Article 11(2)(c) (NAFTA, Annex 704). Notably, the United States agrees to not impose fees on imports from Mexico under Section 22 of its AAA or under any successor statute (NAFTA, Annex 704). Canada risked missing an opportunity to get equal access to the Mexican market for its supply managed products, and more importantly risked missing the chance to gain an exemption from Section 22 of the AAA. During the final days leading up to the passage of the NAFTA by the United States' Congress, it was rumoured that President Clinton persuaded several Congressmen to vote for the NAFTA by promising action under Section 22 of the AAA against Canadian exports of durum wheat to the United States. This action will not be possible once GATT's domestic support provisions are in effect, but it could prove to be yet another short-term irritant for Canada's durum wheat exporters.

Mexico's treatment under Canada's meat import law is unaffected by the NAFTA, while live cattle and beef already enter Mexico duty-free. Also, voluntary export restraints on meat products are eliminated (NAFTA, Annex 704).

NAFTA's market access provisions with respect to non-tariff barriers reflect Canada's negotiating position in international trade agreements on supply management (Moschini and Meilke, 1991). Since Canada, was committed to maintaining supply management in the GATT negotiations, it had to behave consistently in the NAFTA negotiations. The GATT agreement eliminates the possibility that Canada will be able to retain its import quotas but because Canada did not want to acknowledge this possibility in the NAFTA negotiations, Canada's supply managed industries are left with less access to the Mexican market than their United States' counterparts.

### **Domestic Support**

As with the FTA and the impetus behind the recently concluded GATT round, in the NAFTA all three countries agree to work towards minimal distortions in trade (NAFTA, Art. 705). The NAFTA recognizes each country's right to change its domestic support instrumentation subject to the GATT (NAFTA, 704). This approach enabled the governments that negotiated the NAFTA to claim that it does not alter domestic policy or affect sovereignty, but that these issues were being negotiated multilaterally. The GATT agreement removes most of the uncertainty left by NAFTA with respect to which domestic programs will not be subject

to countervailing duty action, or considered "green". Although a complete discussion of the reductions in domestic support that countries have committed to in the GATT is beyond the scope of this paper, the general agreement is a 20 percent reduction in each country's total aggregate measure of support (GATT 1994, Art. 6). However, programs that are acceptable under GATT's domestic support provision may still be subject to countervailing duty action, although GATT requires that countries exercise due restraint in initiating such actions (GATT 1994, Art. 13).

Under NAFTA, Canada has apparently won the fight for the establishment of a trilateral working group to address the subsidy issue. Canada may still want to consider using this working group to improve on the GATT agreement for trade among the United States, Mexico and Canada. Although the FTA, the NAFTA and the GATT in their current forms leave countries sovereignty over domestic assistance to industry, increasing international trade flows and their attendant disputes will nevertheless increase pressure to harmonize support measures across the NAFTA countries (Josling and Barichello, 1993).

### Export Assistance

In the NAFTA, the three countries aim for the multilateral elimination of export subsidies. This aim is similar to the FTA's but the actual treatment of the use of export subsidies is less onerous. The FTA bans the use of export subsidies internally, while the NAFTA only states that it is inappropriate for one country to provide export subsidies for the export of an agricultural good to another NAFTA country. Both the FTA and the NAFTA require that each country take into account other's interests when using export subsidies in a third country. In fact, if the exporting and importing countries agree to an export subsidy, the NAFTA expressly allows it (NAFTA, 706(7)). This treatment of export assistance reflects the fact that Mexico benefits substantially from food imports sold with the assistance of export subsidies.

Mexico expected that export subsidies would eventually be reduced or eliminated through GATT negotiations, but currently the subsidized imports help in feeding its poor urban population. Its expectations were confirmed in the GATT agreement, which requires that the budgetary outlays or the quantities of product benefitting from forms of export assistance which were previously allowable for agricultural products be reduced to 64 or 79 percent, respectively, of their base period levels (GATT 1994, Art. 7). So, although GATT requires reductions in export subsidies, NAFTA's allowance of export subsidies by members within a free trade area, will create an arduous situation. Experience with the FTA has shown that the requirement to take into account the interests of the other country in making export sales does not work well, as the United States' recent subsidized sale of wheat to Mexico illustrates. An alternative might have been to limit the quantity of subsidized product that Mexico could buy from non-NAFTA countries to pre-NAFTA levels with a phased reduction, while requiring it to purchase United States and Canadian products at unsubsidized prices. Even if the United States and Canada had made a side payment to Mexico in return for this provision, it would have been better than the current situation which will certainly cause friction among the three countries.

### Technical Regulation<sup>7</sup>

Technical regulation, or sanitary and phytosanitary measures, as they apply to the agrifood sector figure prominently in the agrifood chapter of the NAFTA and are also generally treated in a separate chapter (NAFTA, Ch. 9). The draft GATT provisions formed the basis for the detail that is contained in the NAFTA, but which was missing in the FTA because it had yet to be determined and was being addressed by several industry and topic oriented Working Groups.

Given that the NAFTA was largely derived from the draft GATT agreement, it has four similar substantive thrusts which are essentially the same as those of the final GATT agreement. First, each country retains sovereignty in the formulation and administration of regulations and standards, including the level of protection, for all measures relating to human, animal and plant life or health, the environment and consumers (NAFTA, Art. 754). This includes the right to prohibit imports from another NAFTA country. However, regulations must be legitimate; based on scientific principles and appropriate procedures for risk assessment (NAFTA, Arts. 754, 757). Second, all regulations must be applied in a non-discriminatory manner; NAFTA countries do not receive special treatment (NAFTA, Art. 754). Third, regulations are to be formulated and administered so that they do not cause unnecessary obstacles to trade (NAFTA, Art. 754). Finally, in the formulation and administration of these regulations, international standards should be used whenever possible (NAFTA, Art. 755). However, the goal is equivalency in the effect of regulations (NAFTA, Art. 756), which means that each country can develop appropriate guidelines for risk assessment which include scientific evidence, relevant processes, production methods, inspection, sampling and testing methods, relevant regional, geographic and climatic conditions, relevant treatments, as well as economic and political-legal variables such as loss of production and sales, minimizing trade effects etc. (NAFTA, Art. 757).

The NAFTA contains considerable attention to detail with respect to the subject of technical regulation, an approach which is consistent with the GATT agreement, and a substantial improvement on the FTA. Therefore, it shares the GATT agreement's weakness that the effectiveness of the provisions relies heavily on the countries' governments' political will to carry out their intent. This is likely to be a substantial challenge, since the reduction of tariffs and other barriers will likely induce many industries to exert pressure on their governments to use technical regulations and other trade actions to shelter them.

### Miscellaneous Trade Matters

The NAFTA contains a general prohibition against the use of export taxes with two exceptions: energy and basic "foodstuffs" in Mexico. Mexico may adopt export taxes, on a

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<sup>7</sup> We use the term technical regulation as an umbrella term for technical specifications, technical regulations and standards etc. as defined in the Tokyo Round GATT Agreement.

temporary basis for up to one year, on a list<sup>8</sup> of food products if they are applied on exports to all NAFTA countries, are used to ensure their domestic availability and that program benefits stay with domestic consumers (NAFTA, Art. 315).

The rules of origin contained in the NAFTA are quite detailed and designed to keep the products of third countries from taking advantage of the tariff free access that Mexico has obtained with the United States and Canada. However, it is difficult to see how these rules can be effective, even in the absence of fraud, when dealing with relatively homogenous agricultural products. If the economic incentives are great enough, the imported product could replace the Mexican product in the home market while the Mexican product could be exported. The likelihood of this scenario happening will depend to a large extent on the relationship of Mexico's external tariffs to those in Canada and the United States, as well as the structures and relative efficiencies of their processing sectors.

As with the FTA, each country in the NAFTA agrees not to adopt or maintain any measure requiring that distilled spirits imported from any member countries be blended with domestic products. The provisions in the FTA for the spirits/wines industries are incorporated directly into the NAFTA, and a bilateral component between Canada and Mexico extends many of these provisions, some with modification, to Canadian-Mexican trade. These provisions are generally consistent with GATT law. Specifically, they provide for; non-discriminatory listing and transparency in treatment, only cost of service differentials to be charged for handling, discriminatory mark-ups to be eliminated immediately and members may maintain or introduce measures respecting on-site sales of spirit/wine products. Both Canada and Mexico retain their GATT rights and obligations (NAFTA, Art. 313). Also, as with the FTA, each NAFTA country agrees to comply with certain standards and labelling of distinctive liquor products; whisky, tequila and mescal (NAFTA, Art. 314).

### Dispute Settlement

An equitable and expeditious method for settling trade disputes between Canada and the United States was of paramount concern to Canada in the negotiation of the FTA, and remained a key issue in the NAFTA. Given the nature of U.S-Mexico trade, the nature of state involvement in the Mexican economy and past bilateral trade disputes, the issue was also of great importance to Mexico. Canada had hoped for an improvement on the FTA's provisions for settling countervailing and anti-dumping disputes in the NAFTA, but this did not materialize. Canada's main problem with United States law, its inconsistency with the 1979 GATT Subsidies Code (van Duren), remains unaddressed. NAFTA's substantive provisions for dispute settlement are identical to the FTA's, the differences are in the additional procedural complexities required to deal with three countries. As in the FTA, in the NAFTA, each country retains its own contingency protection laws: both countervailing duty laws (CVD) and anti-dumping laws (AD) (1902). A dispute settlement panel, chosen from a trilateral roster (1901), becomes responsible for reviewing final CVD and AD determinations which are not settled satisfactorily, instead of domestic courts, and its decisions are binding (1904). The

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<sup>8</sup> The list includes staples such as bread, flour, eggs, rice, pasteurized milk, corn flour and products, salt, margarine, sugar etc., but also contains several processed products such as roasted coffee, crackers, low-price cookies, soft drinks, tomato puree, beer, canned sardines and tuna etc (Annex 315).

binational panel can only determine whether the final decision was made in accordance with the relevant domestic law, using a specified standard of review (1904).

The wording of the NAFTA's dispute settlement provisions suggests that the dispute settlement panels are only empowered to judge if decisions are consistent with the relevant national laws. Hence, conflicting decisions are possible and the dispute settlement provisions, that are currently in place, will become increasingly unwieldy if the free trade area is extended to additional countries. The NAFTA negotiations missed the opportunity to engage in institution building. A NAFTA institution to develop its own GATT based trade law and to serve as a binding arbitrator for all trade disputes is a highly desirable approach. Given that the current GATT Agreement on Subsidies and Countervailing Measures fails to address several of Canada's key concerns, such the manner in which injury and causality are determined, NAFTA still offers Canada the potential to pursue improvements in trade law. The NAFTA Trade Commission (Art. 2001) could begin the creation of such a law by forming a working group to examine how disputes with third countries should be handled, as well as disputes among the three NAFTA countries. As internal barriers among the NAFTA countries are reduced, both of these types of trade disputes will become more complicated, and until the issues of domestic subsidies and export subsidies are settled properly, such trade disputes are also likely to become more common.

A common NAFTA contingency protection law, which would settle all intra-NAFTA and external disputes, makes economic and practical sense. But there are powerful forces working against such an approach. One in particular is the desire, especially in the United States, to guard the sovereignty of its domestic trade laws. Therefore, it is encouraging that the dispute settlement panels created under the FTA have not appeared to be unduly restricted in making their decisions, although conflicting opinions have been delivered in the United States' countervailing duty case against Canadian exports of hogs. Hopefully, the same progressive approach will evolve for countervailing duty and anti-dumping cases occurring under the NAFTA. Continuation of such an approach would also make it increasingly obvious that the United States' contingency protection laws are not GATT consistent.

As with the FTA, under the NAFTA, each country reserves the right to amend its own laws, provided it can meet several conditions. First, the amendment applies only to other members if explicitly stated. In other words, if the NAFTA countries are not mentioned in the legislation, they are exempt. Second, when a NAFTA country is amending its contingency protection laws it must inform the other NAFTA countries of the changes in writing. Third, a NAFTA country is also to consult with the other members when making a change in its contingency protection laws. Last, any amendment to a NAFTA country's contingency protection laws must be consistent with the GATT or its relevant codes. In the case of an amendment, another member may request a NAFTA panel to determine whether the amendment is consistent with the provisions of the NAFTA or has the effect of overturning a decision made under the NAFTA's dispute settlement provisions (NAFTA, Art. 1903). This declaratory opinion, which only has force with respect to the NAFTA's dispute settlement amendment provisions, leads to the requirement that the two members find a mutually satisfactory solution within 90 days. Then, if corrective action is not enacted within the next nine months, the other member may take comparable legislative action, or terminate the NAFTA with 60 days notice (NAFTA, Art. 1903). The NAFTA also allows for an extraordinary challenge procedure similar to the FTA's (NAFTA, Art. Annex 1904-13).



## IMPLICATIONS FOR CANADA'S AGRIFOOD SECTOR

The implications of the NAFTA for Canada's agrifood sector can only be assessed in the context of changes already occurring as a result of the FTA, the reform of the Mexican economy initiated in 1986 (Paguaga et. al, 1991), the recent GATT Agreement, as well as myriad other forces affecting the sector. Nevertheless, some generalizations can be made. We do this on an industry basis and then, very briefly, for the whole agrifood sector.

### Red Meat

Much of the trade in red meat among the NAFTA countries already occurs tariff free or subject to low tariffs, and as a result of the GATT Agreement Canadian and United States Meat Import Laws will also be converted to tariffs and reduced over six years beginning in 1995. Therefore, the NAFTA's provisions for tariff reductions will have minimal effect on the industry, although GATT's requirement that Canada's and the United States' Meat Import law's be tariffed and then reduced will allow slight increases in competition from off-shore beef. However, the importance of the bilateral exemptions between Canada and the United States as well as Mexico and the U.S. from each other's meat import laws will continue to be largely determined by ongoing economic phenomena. The beef industry in Canada and the United States has been rationalizing for over a decade. However, because of Mexico's lower per capita income, Mexican beef plants have been more geared to a mixed kill (which includes cows, which produce more low quality beef, not just steers and heifers, which produce mostly high quality beef) than Canadian and United States plants. These plants focus on higher quality, boxed products (from steers and heifers almost exclusively). Therefore, in the short-run, the NAFTA's meat import law provisions will have a minor impact on Canada's cattle and beef industries, although Mexican product could displace the Nicaraguan product that occasionally finds its way into the east and central Canadian retail trade. Mexican beef is already classified as low risk for foot and mouth disease, so this displacement effect could occur without any technical changes in the product.

The FTA's provisions with respect to meat imports will play a more important role for Canada than the NAFTA's. For example, the increase in Canadian cattle exports to the United States has already spawned a United States investigation into the effect of Canada's cattle and beef industries and the nature and level of Canadian assistance programs on the competitive state of the United States industry; its third study in a little over a decade. In January of 1993 the United States International Trade Commission released its findings, which have not led to trade action as was originally feared by the Canadian industry. Partly in response to the United States investigation, Canada's International Trade Tribunal is currently investigating the competitiveness of Canada's cattle and beef industries, which includes examining its North American context and the level of government assistance in all three countries. The CITT's report is expected shortly.

In the longer-run, to the extent that the NAFTA contributes to higher per capita incomes in Mexico, it will stimulate investment in meat packing and processing in Mexico. However, Canadian concerns that the cheaper labour available in Mexico could put Canadian

meat packing plants at a competitive disadvantage are only a longer-run issue. In the short-run, lower technology levels and the less trained labour force available to the Mexican meat processing industry, will enable Canadian and U.S. plants to maintain their current competitive positions. In Mexico, beef plants would be best served to continue a mixed kill since this would fit with the requirements of Mexican consumers. These plants would not be in direct competition with the major United States and Canadian plants, which tend to focus on higher quality and boxed beef. In addition, they may find future export opportunities in the United States South-West, given its substantial Mexican and Latin American population.

Although pork is the preferred meat in Mexico, demand is generally for the less expensive types of utility cuts. As with beef, as per capita incomes increase, demand for these products should also improve. Although, the United States has a geographic advantage in serving the Mexican market, substantial increases in United States exports to Mexico, could result in more Canadian product being exported to the northern United States markets.

Technical regulations are likely to play an important role in this industry; both for beef and pork. Although the NAFTA's technical regulation provisions improve considerably on the FTA's with respect to inspection procedures and standards, the same high hopes existed for the FTA when it was passed. However, it was not long before a dispute erupted, the issue became politicized and Canadian exports to the United States were frustrated (von Massow et. al). This history, combined with the concern of Canadians and Americans with respect to products originating in developing countries, where health, safety and environmental standards are already suspect and enforcement may be less rigorous, makes the use of technical regulation a potentially contentious issue. However, when NAFTA provisions are considered in conjunction with the GATT's technical regulation and market access provisions, additional export opportunities for all NAFTA countries will transpire in markets in the E.U, and Japan among others.

### **Grains and Oilseeds**

Domestic support and export assistance reduction commitments agreed to in the recent GATT agreement will pervade the impacts that provisions of the FTA and NAFTA have on Canada's grains and oilseeds industries. Under NAFTA, Canada will gradually obtain complete access to the Mexican market for cereals. Mexico's restrictions on imports of these products will be replaced with tariffs and tariff rate quotas, and then eliminated over 10 years, with the exception of corn, which will take 15 years. Mexican tariffs on wheat and its products will be phased out over 10 years. This will benefit Canadian grain exporters which have faced quantitative restrictions in the Mexican market. Canadian wheat sales into Mexico have been sporadic, ranging from over 500,000 tonnes in 1991/1992 to none in four of the last ten years.

Although, Canada will also remove its import restrictions on wheat, oats and barley for products imported from Mexico, this provision is not likely to have any effect. Canadian-United States competition for the Mexican grain and oilseeds market will be complicated by both countries' use of export subsidies. Some United States exports to Mexico benefit from

payments under the Export Enhancement Program while some Canadian exports benefit from subsidized transportation rates. North American exporters will also have to compete against subsidized product from off-shore country suppliers in Mexico. However, due to the recent GATT agreement, off-shore country suppliers will be required to reduce the level of assistance they can offer on products destined for export. This should reduce the subsidized competition in the Mexican export market.

Historically, Mexican corn and wheat prices have been well above world market levels. Mexico has recently announced that it is planning to eliminate its deficiency payments for grains and replace them with a per hectare payment covering 90 percent of arable land. This payment would be made to landowners, regardless of the crop grown, or whether any crop was grown. If this approach is successfully implemented, these payments would be totally decoupled from production decisions. However, implementing this scheme is likely to be difficult in Mexico, where property rights are not as firmly established as in Canada or the United States.

The relationship between Mexican wheat and corn prices and price reductions resulting from reductions and re-instrumentation of support will partly determine Canadian and U.S. export opportunities in the Mexican market. While wheat prices will be liberalized more quickly than corn prices, over the long-run corn prices will drop relative to wheat prices, thereby providing greater export opportunities for corn than wheat. The United States and Canada are also concerned that since they face high tariffs on sales above the tariff rate quota, that this may provide an advantage to third country suppliers. This issue is currently being deliberated.

Imports benefitting from export subsidies also reduce the cost of food to Mexico's large poor, urban population. The issue of food security is of major importance to Mexico as indicated by its treatment in NAFTA which included a list of product considered to be basic foodstuffs whose export was exempted from a general prohibition against export taxes.<sup>9</sup> Given that a number of product that have benefitted from export subsidies in recent decades appear on this list, it will be interesting to see whether the GATT's provisions for international food aid become a vehicle for exporting cereals and oilseeds to the Mexican market. Unfortunately, NAFTA and GATT's treatment of export assistance suggest that Canadian, United States' and other countries' use of such assistance in the Mexican market will have to be guided by common sense; a commodity often in short supply in agricultural trade relations.

### **The Supply Managed Industries: Dairy and Poultry**

Given domestic political realities, the import quotas that have traditionally protected Canada's dairy and poultry industries had to be maintained in the NAFTA. This, more than any other single reason, accounts for the bilateral treatment of the agrifood sector in the NAFTA, rather than the trilateral structure of the agreement for other sectors. In return for this exemption Canadian exports of dairy products to Mexico also face quantitative

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<sup>9</sup> Ibid.

restrictions, a barrier not faced by United States dairy firms. Instead, Canadian exports will face the most favoured nation rates decided on under the GATT agreement. Historically, Canadian exports of milk powder to Mexico have been important, although they have declined from 63 percent of the value of Canada's total agrifood shipments to Mexico in 1990 to only 12 percent in 1992. Inauspiciously, the recent GATT Agreement will require Canada to convert its import quotas in the dairy and poultry industries to tariffs. As a result of the above, increased shipments of Canadian milk products to Mexico under the status quo seem unlikely given the supply and demand situation in Canada and the fact that Canadian dairy products are generally considerably more expensive than comparable products in the United States.

As the GATT's tariff reduction provisions are phased into Canada's dairy industry, Canadian dairy products may become more competitively priced. However, at current projections of the initial tariffs and their expected reductions, the declines in Canada's industrial milk and processed dairy product prices are not likely to be sufficient to allow the Canadian industry to make substantial in-roads in the Mexican market. What is certain, is that the asymmetry in the NAFTA gives the United States an advantage in the Mexican market, as does its geographic proximity. The United States will also obtain a first-mover advantage that could be difficult to overcome, even if Canadian-Mexican trade is further liberalized in the future.

Mexico has been pursuing increased self-sufficiency in dairy products through the development of a better genetic base and in productivity by importing semen and breeding stock. However, it is unlikely that Mexico's domestic production of dairy products will keep pace with its growth in consumption. Canada's brightest prospects for export sales in the dairy industry might well be in live animals and semen, and this would have been the case regardless of the NAFTA and GATT Agreements.

Canadian-Mexican trade in poultry is affected by the same provisions as for the dairy industry in the NAFTA and the FTA, as is United States-Mexican trade in poultry. For the chicken segment of the industry, the NAFTA will have little impact on the Canadian industry, since the United States has a scale, scope and geographic advantage vis-a-vis the Mexican market. With the possible exception of processed eggs and products, the same is true for turkey and eggs.

### Horticulture

The impact of the NAFTA on the functioning of the North American industry is likely to be greatest in the horticulture industry. Since most trade in horticultural products occurs on a North American basis, the recent GATT Agreement will have a relatively minor impact although it will improve the price competitiveness of offshore products in Canada, the United States and Mexico. Tariff reductions under NAFTA will affect some vegetable and fruit products to the extent that they will become price competitive in Canada, and this effect will be magnified for the United States' regions that are closer to Mexico. These tariff effects are likely to be most pronounced for fresh fruits and vegetables, but they will also alter the spatial constellation of processing activity over the longer-term, especially as restrictions on bulk imports of horticultural products under Canada's Agricultural Products Act are challenged

under the GATT and the NAFTA's technical regulation provisions.

Even without the bulk import challenge, horticultural processors may find it advantageous to process horticultural products in Mexico, especially as growing practices and processing plant technology and productivity improve. With the NAFTA these concerns are more significant to horticultural firms in the United States southwest, but they are similar to those aired by the Canadian horticulture industry with respect to the FTA. Therefore, the horticulture industry received special safeguards in the FTA and the NAFTA.<sup>10</sup> Under the FTA, these safeguards apply only to non-processed products, while under the NAFTA, some processed products are also included, most notably tomato paste for Canada. Unfortunately, the safeguards in the FTA and the NAFTA are unlikely to be sufficient to inhibit a domestic industry from using various non-tariff barriers and contingency protection laws in an attempt to delay the inevitable adjustments.

### GENERAL EFFECTS ON THE AGRIFOOD SECTOR AND CONCLUDING COMMENTS

The NAFTA, like its predecessor the FTA, contains a multitude of special provisions for the agrifood sectors in Canada, the United States and Mexico that reflect the differences in domestic policies, progress in the GATT negotiations and political sensitivities among industries and countries. Consequently, it is difficult to generalize with respect to the NAFTA's effects, but we do have these comments.

First, provisions of the recently concluded GATT Agreement will have far more significant effects and implications for Canada's agrifood sector than NAFTA, and this balance of effects was pursued by design. Unfortunately, Canada's attempt to preserve the quantitative restrictions on trade used to operate its supply management systems in the GATT negotiations resulted in asymmetry in the treatment of trade among NAFTA countries that puts Canada at an unnecessary disadvantage relative to the U.S. in some agrifood industries.

Second, over the next five years NAFTA offers a better vehicle than GATT for Canada to pursue its aim to improve the dispute settlement mechanism for subsidies that can be treated using countervailing duties. Efforts made under NAFTA in this area can also be tested under the new GATT Agreement.

Third, the interrelationships among the provisions in the Free Trade Agreement between Canada and the United States, the North American Free Trade Agreement and the recent GATT Agreement suggest that the web of trade agreements governing economic activity in the agrifood sector will continue to evolve, and will further open a Pandora's box of challenges which Canadian agrifood businesses must respond to appropriately in order to survive and prosper.

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<sup>10</sup> Products marked by an asterisk in Table 2 are eligible for safeguards

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