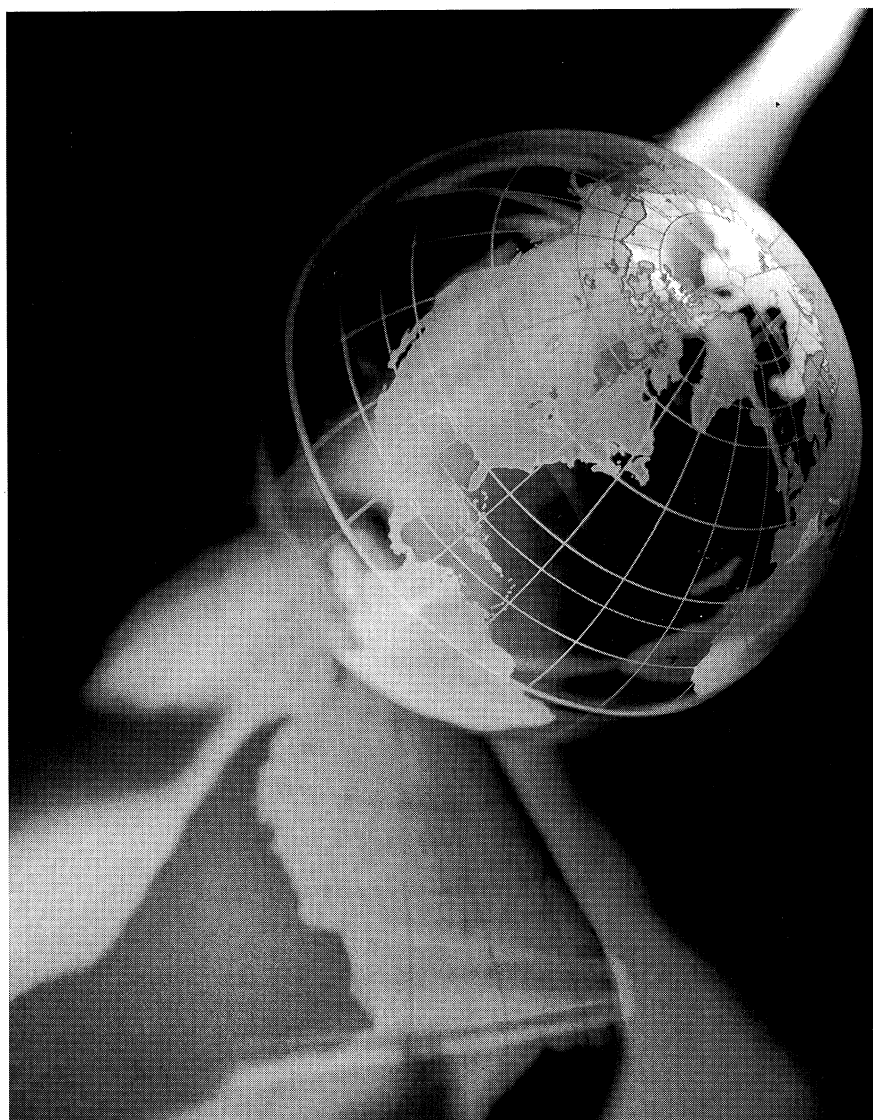


# **ECONOMIC INTEGRATION IN THE WESTERN HEMISPHERE**

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## **SESSION 4. LESSONS FROM TRADE NEGOTIATIONS IN THE WESTERN HEMISPHERE**

### **Lessons Learned From the NAFTA: A U.S. Perspective** *Carol Goodloe, Foreign Agricultural Service, U.S. Department of Agriculture*

The lessons gleaned from the North America Free Trade Agreement, commonly known as NAFTA can best be analyzed if the NAFTA is viewed as a process, which began roughly in 1990 and is still only in the beginning stage of a long transition period. This process can be divided into three phases: negotiation, legislation, and implementation. Regarding the first and third phases, Mexico's and Canada's lessons learned are likely similar to those in the United States. The second phase, more so than the other two, reflects the unique U.S. political system and was quite different in Canada and Mexico, as it would be in other countries in the Western Hemisphere.

At the beginning, I note that my perspective is one of an economist who, in an earlier capacity was charged with attempting to analyze, understand, and forecast agricultural production, trade, and policies, suddenly found herself thrust into the midst of a difficult and contentious agricultural trade negotiation. Since this meeting is a gathering of economists, I will attempt to make my comments and observations relevant to economists and what we do.

#### **Negotiation Phase**

The negotiation phase can be further divided into two categories of problems: substantive and practical. The main substantive issue can be summarized as the process of reaching agreement on the long-term goals and objectives of the negotiations, and then working out a transition path to achieve the objectives with respect to specific commodity concerns and other trade sensitivities. The NAFTA agricultural provisions well illustrate the different objectives of the NAFTA parties.

#### **Substantive Issues**

Going back to the negotiation of the U.S. Canada Free Trade Agreement (CFTA) during 1986-87, both countries agreed to defer addressing the sensitive issues concerning nontariff barriers (NTB's) pending the completion of the Uruguay Round. Thus, the agreement on agriculture was limited in scope and effect. When the NAFTA negotiations began, the Uruguay Round negotiations were languishing. Canada insisted that it still could not address NTB's in the NAFTA context, whereas the United States was willing to put NTB's on the table for discussion. Thus, the issue of the treatment of NTB's between the United States and Canada was still unresolvable in 1992. The United States and Canada maintained their differences with respect to the objectives for the agricultural provisions, and the CFTA was simply rolled over into the NAFTA with no further liberalization specified.

Partly as a result of the limited agreement on agriculture, the United States and Canada continue to have contentious, unresolved agricultural trade issues. Foremost is the question of the consistency between the tariffs created in the Uruguay Round to replace NTB's and the obligations stated in the NAFTA to not impose new tariffs or raise existing ones. Secondly, there has been a long running dispute over grain trade, which reached crisis proportions in 1994 in the United States as a result of a large surge in U. S. imports

of Canadian wheat and barley. Whatever one has to say about the dispute, most can agree that as tariffs and other border measures come down, the trade effects of incompatible domestic policies become more apparent and can have significant economic and political repercussions. The U.S. Canadian agricultural trade disputes illustrate this finding all too well.

In contrast, the United States and Mexico were able to agree on an ultimate goal of complete elimination of tariff and nontariff barriers on agricultural trade at the end of a transition period. Thus, once that objective was agreed upon (about 6 months into the formal negotiations in February 1992), it took another 6 months to work out the transition arrangements to address the key market access problems and other sensitive issues.

Likewise, Canada could not agree to a goal of complete liberalization with Mexico, and worked out yet another set of transition arrangements, with some commodities given more liberal treatment than U.S. commodities and some exempt entirely from liberalization.

Although some NAFTA provisions are trilateral-internal support, export subsidies, and sanitary and phytosanitary measures - because there was no trilateral agreement on the ultimate objective for market access in agriculture, the result was an odd, triangular structure of agricultural provisions on market access. The process of adding Chile to the NAFTA, to which the NAFTA partners agreed at the Miami Summit last December, will have to wrestle with this question of ultimate objectives and structure of the agreement as well.

### Practical Negotiating Problems

Substantive negotiating objectives are ultimately decided by policymakers at the highest levels. Practical negotiating problems are handled by people like you and me. The data and analysis that support a trade negotiation are quite different from what economists might do in universities and government agencies to test a trade theory or evaluate potential impacts of a particular trade agreement. The stuff of negotiations is extremely detailed, commodity specific, and oriented to solving very specific product sensitivities, both on the import and export side.

### *Data Requirements*

For example, going back to the CFTA, we had a major headache with trade data. Beginning in the 1980's, it became apparent that U.S. trade data were significantly undercounting U.S. exports to Canada. One positive outcome of the a CFTA was an agreement to use each other's import data to represent exports. This data difficulty between two large, wealthy countries with a common border should make all trade economists pause to reflect as they load data in their computers to do sophisticated trade analysis!

The practical problems were compounded when negotiations with Mexico began. A major one was addressing differences in each country's tariff schedules and trade data. Simply trying to figure out what each country was exporting to each other, by tariff line, consumed enormous amounts of time. For example, economists may simply analyze production and trade of poultry and eggs as an aggregate quantity, but trade negotiations require closely examining 20 to 30 different tariff lines for poultry and eggs to evaluate what level of trade is occurring at what rate of duty for which type of poultry.

The reliability and accuracy of data was a major problem in constructing the tariff-rate quotas (TRQ's), which are the chief tool to achieve free trade over the transition period. These data problems will likely be compounded if the NAFTA enlarges to include other countries in Latin America, where data and other information may not be readily available or well documented.

Another problem was gathering the necessary data and information on Mexico's policies and programs in order to understand those aspects of Mexican agriculture that would be affected by a free trade agreement. This was complicated by the fact that Mexico was in the midst of changing its entire agricultural policy, and it was not clear what sort of policies would emerge after the transition. Again, such uncertainty is likely to be even more prevalent if the NAFTA is extended to other countries, because the general economic situation in many Latin American countries, as well as post-Uruguay Round agricultural policy, is likely to continue to undergo significant change.

### *Impact of the Uruguay Round*

One Practical negotiating problem may have been solved by the Uruguay Round. Future negotiations on market access will begin at a much different place than did the NAFTA, which was the first trade agreement to use the tariffication concepts and practice. During the NAFTA, once Mexico and the United States agreed on the objective of free trade, a key aspect of the negotiation was establishing the various tariff-rate quotas and tariff equivalents to replace the NTB's. Much time was spent gathering and evaluating data, such as domestic and international prices, consumption, and government support payments. But now, at least in theory, for all GATT/WTO members there are no more NTB's - only tariffs - which should greatly simplify future negotiations. Simple tariffs are fast becoming irrelevant as trade barriers, and NTB's, having been converted to tariffs, are now in a form to be phased out as part of the next round of bilateral or multilateral agreements.

Any new negotiations will begin where the Uruguay Round leaves off. The Uruguay Round allows countries to establish "ceiling bindings." That is, previously unbound tariffs are all now bound, meaning they cannot be exceeded without providing compensation to trading partners. But most Latin American countries have ceiling bindings that greatly exceed the tariffs that are actually applied in daily commerce. This situation existed in Mexico at the beginning of the NAFTA negotiations, but the negotiators agreed that the starting point would be the duty applied on bilateral trade. One question for future negotiations is whether the phaseout of tariffs begins from bound or applied rates.

Just as the Uruguay Round may have helped solve one problem, it may have inadvertently helped to create another. Sanitary and phytosanitary (SPS) measures and technical barriers to trade, such as standards for food labeling, grading, or pesticide tolerances, are fast becoming, if they are not already, the most contentious issue in international trade policy. Both the NAFTA and the WTO have ground-breaking provisions addressing the transparency and use of SPS and standards. But the implementation of these new provisions to address a particular measure or practice is relatively new, and we are on the beginning of the learning curve. Just as the NAFTA and WTO have hopefully made future market access negotiations simpler, addressing technical barriers to trade will become even more important and subject to closer negotiating scrutiny.

### *Other Negotiating Areas*

Another key area of the negotiations was constructing the rules of origin—the rules that determine which goods are eligible for the NAFTA tariff preferences. Many of these rules for agriculture were carefully developed to address economic - and political - sensitivities with respect to Mexico and Canada. How long these rules can remain in place as the NAFTA enlarges is an open question. They were designed for the North American market, but may not be as appropriate in a larger Western Hemisphere context. A free trade area with many countries becomes increasingly difficult to hold together with complicated rules of origin. A common market does not have this difficulty, but requires a different political commitment in terms of integration and harmonization of policies. A common market in the Western Hemisphere is not currently being contemplated, but it may look more attractive from a purely technical and administrative sense if the NAFTA enlarges much beyond its current members.

In addition to SPS and standards, other areas for negotiation may also loom larger in terms of their potential effects on agriculture and trade as traditional market access issues become less significant in affecting trade. For example, intellectual property rights, investment, and transportation are all key areas of interest for agricultural trade. As with technical barriers to trade, these areas will likely become even more important for agricultural trade negotiators.

### **Legislative Phase**

This phase is unique to the United States, because neither Canada nor Mexico had to deal in the same way with a recalcitrant and often unfriendly legislature. The domestic opposition to NAFTA may have been unparalleled in the annals of U.S. trade agreements. After numerous supplemental agreements were struck to help ensure NAFTA's passage, one lesson may have been quickly learned. The passage of the NAFTA implementing legislation helped pave the way for the staffing and passage of the Uruguay Round legislation. The Uruguay Round implementing legislation was much less encumbered with additional provisions that were not, in a strict sense, necessary to implement the agreement. Much more so than the NAFTA, the Uruguay Round legislation changed only those laws that had to be changed to make U.S. legislation consistent with the new agreement.

With respect to future trade negotiations, the key issue for the United States is securing so-called fast track legislation from the Congress. Again, this type of legislation is peculiar to the U.S. because of our political system. Legislation is not necessary to negotiate a trade agreement, but the Congress must authorize tariff changes through legislation. To ensure that the Congress does not substantially change an agreement negotiated by the executive branch, the fast track approach was developed so that the Congress would pass the necessary legislation to implement a trade agreement expeditiously and as negotiated. Such legislation is considered necessary to pursue future free trade agreements, including additions to the NAFTA.

### **Implementation Phase**

We are at the year-and-a-half mark for the NAFTA. Tariffs have begun to be cut, and all NTB's between the U.S. and Mexico are gone. Total and agricultural trade rose significantly in the first year of NAFTA. We also know that the second year, which started off with Mexico's peso devaluation and resulting economic slump, will be significantly different from the first year. For agricultural trade, 1995 will mean more balanced bilateral trade with Mexico.

The road between what is negotiated on paper or laid out in a tariff schedule and what actually happens between trade partners as they attempt to implement an agreement is long and rocky. Implementation issues often occur at the intersection of the official text with domestic legislation and political interests. The first year and a half of the NAFTA has been full of challenges. These challenges have been of two kinds: implementing what is actually in the agreement and addressing what is not in the agreement - the unfinished business that did not get resolved during the negotiation phase. A good example of the latter has been the on-going difficulties between the United States and Canada.

A example of the first kind of implementation issue has been the administration of the TRQ's. The proliferation of TRQ's as a mechanism for removing NTB's, both in the NAFTA and the World Trade Organization (WTO), has spawned a whole set of implementation questions; for example, who has the right to import and under what terms and conditions. Under the NAFTA, the United States has opted for a first come, first-served approach, while Mexico and Canada have chosen to administer closely the right to import under the TRQ's. Dealing with the practical aspects of Mexico's administration of the TRQ's, which were not spelled out in the agreement, has been a significant problem for the U.S. Government and exporters.

Another key area has been the implementation of the SPS provisions - the first of its kind in any trade agreement. As both countries, but especially Mexico, have made changes in domestic procedures and practices, the guidelines and rules in the NAFTA for SPS, as well as standards, have been called upon often. These measures, as well as the dispute settlement provisions, will continue to be tested during the implementation of the NAFTA.

With respect to unfinished business, one very contentious issue during the negotiations was the use of export subsidies among the NAFTA partners. Both Mexico and Canada wanted to bar the use of export subsidies on agricultural products in the North American market. The United States could not agree, both because Mexico could not commit to forego receiving subsidized imports from the European Union, as well as long-standing U.S. concerns about the operation of the Canadian Wheat Board as a state-trading entity in the Mexican and other markets.

Failure to completely resolve the treatment of export subsidies in the NAFTA negotiations has left us with on-going issues on Mexico's countervailing duty (CVD) investigation on U.S. and Canadian wheat exports and Mexico's potential CVD investigation against U.S. exports of vegetable oils. Work on this issue will continue in the NAFTA Working Group on Agricultural Subsidies. This issue will remain an important one in the context of Western Hemisphere free trade as some countries, notably Argentina and Canada will continue to press for a hemisphere free of export subsidies. But other countries in the hemisphere may face an equally difficult choice of not importing subsidized product from outside the hemisphere. U.S. concerns about export practices not currently disciplined by the WTO will continue.

### **What Countries Can Do To Prepare for Trade Negotiations**

Based on the NAFTA experience, coupled with the years spent completing the Uruguay Round with its very detailed negotiations on agriculture, trade negotiators should begin to have an understanding of the basic elements necessary to achieve a successful negotiating outcome. Here, I am not addressing the "big picture" questions of eligibility requirements or preconditions for joining the NAFTA, but rather some of the more practical aspects of a trade negotiation.

Most Western Hemisphere countries were engaged during the Uruguay Round negotiations and are members of the GATT/WTO. But countries should be aware that there are still numerous technical and practical requirements of a NAFTA-type negotiation that must be met to achieve a successful negotiated outcome. Some of these have been mentioned as part of the practical negotiating problems - for example, having reliable, current, detailed tariff schedules and trade data (in an electronic, user-friendly form). Another very useful item would be good, up-to-date, detailed analytical reports on country policies and programs.

Concerning the up and coming trade barriers of the 21st century - SPS measures and technical barriers to trade-it is necessary to understand how a country's regulatory process works. To this end, it would be most useful to have organizational charts and descriptions of which agencies in the government have responsibility for developing and administering SPS measures and standards for food and agricultural products. For example, are regulations done through legislation or through an administrative process? What is the relationship between federal state, and local laws? The whole issue of the transparency in the promulgation or modification of SPS measures or technical standards has been a significant implementation issue, and will only become more important. Countries should be aware of the increased importance of these technical issues and be prepared to address such questions.

### **The Role of Economists**

The role of economists in trade negotiations also varies with the different phases I have described. Generally, economists don't like to think of themselves as "hunters and gatherers" of data or information. Economists often want to test hypotheses with complex methods, but in fact during the NAFTA negotiations what was most needed and useful were good data and practical explanations of the effect of country policies on patterns of production and trade.

At different times during the NAFTA negotiations, we would be asked to assess the implications of different liberalization scenarios. Another question that was often posed by our chief negotiators was whether the two sides had achieved a balance in concessions. It was next to impossible to develop a framework that could encompass the phasing out of hundreds of tariff lines, and the conversion of NTB's to tariffs and their lengthy phaseouts, not to mention the non-agricultural portions of the NAFTA that could have significant impacts on trade. As one more experienced trade negotiator explained it to me, "if you can't tell which side has the best deal you know you've got a good deal." These more practical aspects of evaluating progress and potential impacts during the negotiation phase pose a tough challenge for economists.

During the legislative phase, it was imperative to have credible, valid, and explainable analysis to assess the impact of the agreement on the U.S. agricultural sector. Having good economic analysis that explains the benefits of an agreement may not win any votes in the U.S. Congress, but not having such analysis would leave an Administration naked and open to charges that it did not understand what its own negotiators had done.

During the debate over the NAFTA in the legislative phase, tremendous attention was paid to potential job loss as a result of the NAFTA. The political debate required that economists (supporters) come up with estimates of specific trade benefits and job creation. What was perhaps more important for the United States, but not subject to easy quantification, were the benefits obtained from domestic policy reforms in Mexico, which were undertaken and locked in as a result of the disciplines imposed by the NAFTA. In the

rush to produce large estimates of job creation, the long term benefits of a more open, liberal economic regime in Mexico, prompted and ensured by the NAFTA, may have been overlooked in the analysis.

Now that we are in the implementation phase, it is likewise imperative to maintain on-going analysis of the impacts of the NAFTA on the U.S. economy. This is needed not only to address potential criticism of what the Administration has already negotiated, but to help provide proof of the benefits of trade agreements to the U.S. economy to justify future policy actions such as the creation of the Free Trade Area of the Americas.

### **After NAFTA?**

The Administration is committed to pursuing further hemispheric trade liberalization on two fronts: through the accession of Chile to the NAFTA and through a process of consultation and negotiation with other regional trade groups in the hemisphere to create the Free Trade Area of the Americas by the year 2005. Preliminary discussions with Chile have already begun. In theory, the process of adding Chile to the NAFTA should be easier than the negotiations that created the NAFTA, because the goals and objectives are already contained within the NAFTA. But agriculture is likely to be a difficult area in the negotiations, precisely because of the complicated structure of the NAFTA agricultural provisions. Perhaps in a short time, we will be engaged in another negotiating process, and we will have an opportunity to see whether in fact we have learned any lessons from the NAFTA.