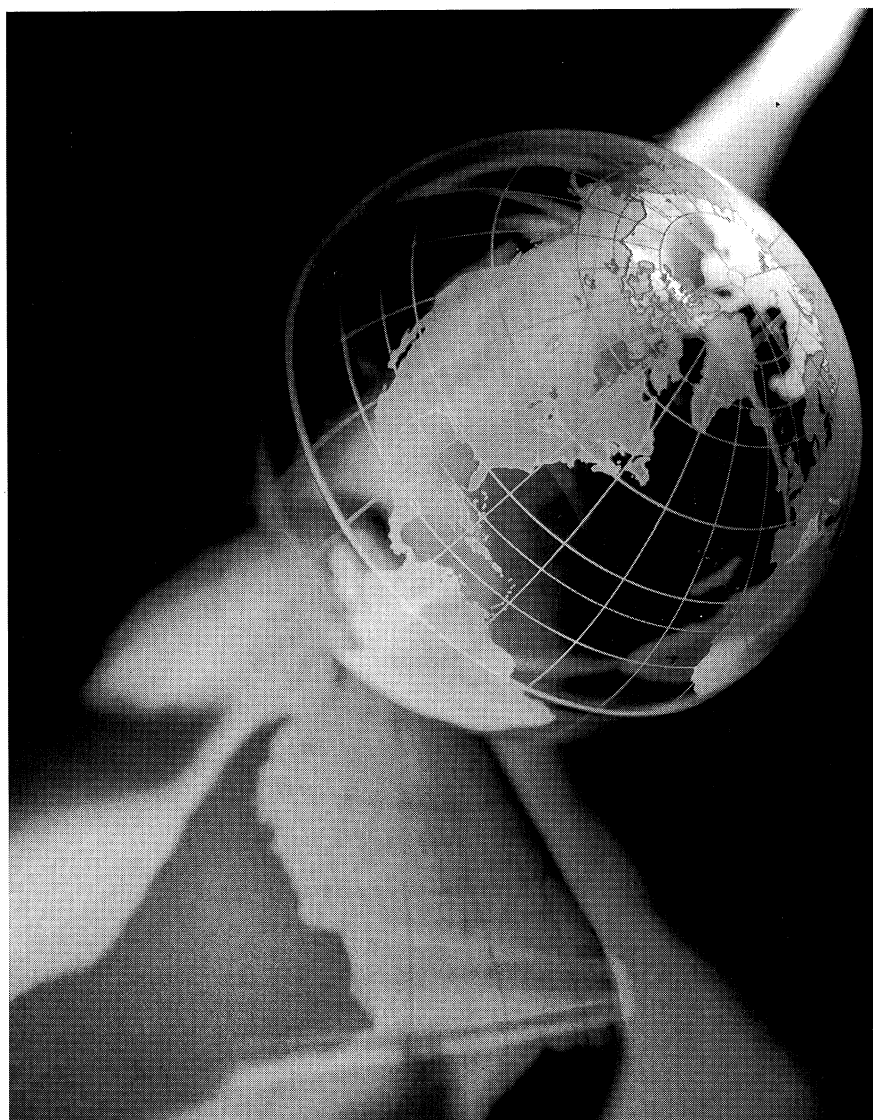


# **ECONOMIC INTEGRATION IN THE WESTERN HEMISPHERE**

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**Emerging Policy Issues and Research Priorities on  
Western Hemisphere Integration**  
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**Introduction**

This paper outlines some directions and priorities for research related to trade and domestic policies for the agriculture and agri-food industries in the wake of the Uruguay Round of GATT negotiations, the extension of NAFTA to Mexico, and the further extension of NAFTA to Chile now underway. The perspective necessarily builds on where we are today, with the initiation of implementation in domestic and trade policies in a number of countries in response to those agreements. As well, other pressures, fiscal in particular, are shaping policies in trade and domestic economies. These changes indicate a substantial change in the information and analytical requirements in the years ahead. Yogi Berra summed it up nicely with the comment, "The future ain't what it used to be".

The paper begins with a stylized view of three stages of the trade liberalization process, along with the changing information and analytical needs in each of these stages. The three stages described are preparation and negotiation, liberalization and implementation, and finally market integration. By relating these needs to each stage, it is possible to identify more readily the range of effort and priorities we can expect. The second section explores the dynamics of each of these stages since for many countries, all three stages are being pursued simultaneously. The final section of the paper uses examples from Canada-USA trade relations to examine the range of issues for both domestic and trade policy and the nature of the information and analytical information required in the years ahead.

**The Trade Liberalization Process**

From the late 1970s to the signing of the GATT/WTO agreement in Marrakesh, Morocco in April 1994, global trade liberalization in agriculture essentially stood still. Even though Canada and the USA established the FTA, agriculture for the most part was set aside, pending the outcome of the GATT/WTO Round. The single minded focus was whether or not to initiate trade liberalization for agriculture. The trade research throughout this period, both conducted and stimulated by the IATRC, was directed to defining and measuring the nature and size of domestic and international impacts of lowering specific trade barriers. Along with this work was the creative efforts exploring alternative measures, both for the longer term and for transition, to employ in domestic and trade policies to replace the trade distorting ways that governments over the years had erected.

The efforts are characterised by the work of many members and friends of the IATRC around the world. The basic messages from this effort were:

- domestic policies had to be addressed as part of the trade liberalization negotiations in agriculture
- full trade liberalization offered overall economic gains to developed and developing countries
- partial trade liberalization offered gains as well

-both full and partial trade liberalization offered gains in market stability; recall that instability in markets was a major reason for erecting trade and domestic policies in agriculture

-unilateral liberalization offered mixed results

-gains from liberalization of agricultural trade occurred not only within the industry, but also in the overall economy

-for most countries, there were both winners and losers in the agricultural sector, an issue that needed to be addressed through domestic policies following the GATT/WTO Round.

Certainly other messages emerged from the years of work. However, the continued flow of results which confirmed and built on earlier results made a major contribution to reaching conclusions in the negotiations.

Added to this work were the efforts to seek new and different policies and tools for agricultural trade, such as decoupling, the PEG concept, the PSE and CSE measures that led to the AMS used in the negotiations and commitments in the Uruguay Round results. A new area of research began during this period as well. It was the work on the sanitary and phytosanitary policies and programs which resulted in new rules to prevent different ways of restricting trade.

All of this work was directed to preparation and support for the negotiations, convincing reluctant governments that trade liberalisation was necessary and possible. Since the GATT/WTO agreement represents a partial liberalization of trade in agriculture, this work will have to continue, in a steadily more refined way as the bilateral and regional trade liberalization efforts become the focus of attention in the years ahead. We are involved, for example, in the extension of the OECD's AGLINK model to Mexico and Chile, with work also getting underway on other countries in Latin America.

Let me stress that this basic work on gains from trade liberalization continues to be needed. The risk is that, without maintaining these messages, policy makers are going to return to skepticism and reluctance in continuing with trade liberalization.

A second aspect of the research needed in trade is the efforts began in the late years of the Uruguay Round, and the early years of the Canada-USA agreement, on the redefinition and re-engineering of domestic policies, based on the emergence of a more liberal trade regime. This is the implementation phase of the GATT and NAFTA agreements. To a great extent, this research is country specific, carried out by universities, research institutions and governments. In Canada, for example, a great deal of attention was given to how to design domestic policies in grain transportation in light of the expected GATT/WTO agreement. Clearly, it was not enough to agree on trade liberalizing measures in the GATT or NAFTA. The additional step of recalibrating domestic policies to meet international obligations as well as to utilize fully the access won in the agreements, was also needed.

This research was different than the earlier work on preparation and support for the negotiations themselves. It required a great deal more detail on specific country policies, but also required integration across countries because of the deepening interaction that trade liberalization brought among countries. Not only is there the task of reshaping domestic policies to fit the new agreements, there is also the task of finding the right mix of national and regional adjustment policies. Again, this work will need to continue as new agreements are negotiated. A worry I note is that while the first stage of work in preparing for

negotiations is well underway, the adjustment problems and policies, particularly regarding small farmers, is not moving forward as rapidly.

A third stage of the research in trade liberalization is just getting under way. After convincing the world that trade liberalization is a preferred state, and working through the processes of re-design in domestic policies to respond to trade liberalization, the markets are telling us about two additional aspects of trade liberalization. The first is the horizontal market integration for products across national boundaries. The second is the integration at all levels in the food chain across national boundaries.

With trade restraints in place, individual firms, particularly in value added products, treated each country as a separable market. Plants were established to fulfil national and subnational market needs with little thought to exporting. Firms designed themselves to work in these separable markets. With trade liberalization, the increased integration of markets is changing substantially the behaviour of firms, the location of plants, the investment decisions for expansion or contraction, and the mandate of individual plants to produce for local as well as export markets. This integration of markets has received little attention by trade economists and their research. We have little evidence, for example, if the market integration occurring in North America will also apply to the Pacific Rim as barriers are reduced, or whether it is restricted to nearby or adjacent market areas. As well, we have very little consistent evidence about the behaviour of firms in the face of market integration. The explosion of value added products in international trade in the past ten years appears to have had little impact on the nature of research in international trade.

Market integration suggests that instead of trade equilibrating prices at only one level in the market, say live hogs, all levels in the market place must equilibrate. The result is that margins between different levels in the food chain must remain similar between two countries, or at least bounded by transportation cost differences. The example from the hog industry would be that input prices, particularly feed grains and protein meals, must equate across boundaries, just as live hogs, dressed carcasses, primal cuts, and retail ready packs must equate across boundaries.

This integration forces recognition that not only raw product prices are relevant, but also a host of other policies, many of them not specific to agriculture, are also at play. Examples include taxation policy, labour regulation, depreciation schedules, research and education policies, investment treatment in taxation, payroll and income tax levels, environmental policies, labelling and packaging requirements, and how social policy is treated within national policies. The difficulty lies in simple comparisons of specific policies, such as taxation of income. A direct comparison of income tax rates between Canada and the USA would reveal that Canadian income tax rates are substantially higher than in the USA, giving USA an advantage in trade. However, taking a wider mix of policies including income tax, payroll taxes and health care, for example, gives an entirely different view. Yet, this mix of policies is a substantial component in the choices of plant location, trade in value added products, firm behaviour, about which we know very little. An added component of this research includes the need for redesign of marketing structures and institutions, both those created by governments as well as those generated in the private sector and condoned by government. Complicating all of these issues is that technological change in products and processes for food and agricultural industries is also changing many aspects of location, production investment and marketing arrangement. Differentiating between trade liberalization and technologically driven change needs to be sorted out.

A final aspect of research on market integration I want to mention is the need to creatively explore a new policy set with respect to countervail, anti-dumping and anti-trust or competition policy. Where market integration is largely complete between two countries, the usual measures of concentration ratios in competition policy become meaningless. A firm, for example, may have a large share of a national market, but also face substantial competition from abroad, so long as open trade is possible. The question is whether this competition or the potential of competition from abroad replaces the need for policy worries by governments about excess concentration or unfair competition. On the international side, countervail and anti-dumping have been the historical tools for dealing with unfair competition. With integrated markets, a common competition or anti-trust policy may offer greater opportunity to discipline firms or industries and hold trade open, than continuing reliance on CVD, which by its nature reintroduces trade restraints.

In general, the theory, methodologies, practice and results of trade research in preparation for and support of negotiations is well advanced. The focus of attention will continue to change as negotiations centre on different issues and country participants, although models and approaches will remain similar. For liberalization and implementation, the approaches are also reasonably well known and well advanced in most instances. However, for the market integration stage, very little work has been done. The issues go beyond traditional trade theory and practice, with little integrating work between trade and other aspects of economic research on the horizon.

### **The Dynamics of the Three Stages**

The three stages of negotiation, liberalization/implementation and integration set out above are described with the simplistic notion that each is separate and distinct. Very briefly, this section argues that all three stages are occurring simultaneously in many countries, and will continue to occur for a long period of time.

While countries around the world are examining ways to implement the GATT/WTO agreement through changes in domestic policies, many countries of the western hemisphere are also involved in preparation for the expansion of regional trade liberalisation, involving NAFTA, MERCOSUR, Andean Pact and others. Additionally, discussions are beginning regarding a Pacific Rim trade agreement sometime early in the next century. I note also that there appears to be some interest in greater trade liberalization between Europe and the western hemisphere. Finally, where trade liberalization was well advanced prior to the current agreements, market integration is occurring very swiftly, and demanding increased attention in research and policy.

In looking ahead, there is every likelihood that all three stages will continue to occur simultaneously. We should expect some form of negotiations to occur continuously for at least one to two decades, not only in multilateral fora, but also in bilateral and regional fora. The implementation stage will also be continuous as regional agreements come on line. And market integration will continue to occur as trade restraint becomes increasingly limited. We do not appear to have the luxury of the single focus available to us in the 1980s, with the GATT negotiations as the single largest issue we faced.

### **The Spectrum of Issues**

In this section, I want to use examples across the commodity spectrum in relation to Canada-USA trade to examine the change in the nature of issues as trade liberalization occurs. If one arrays the major commodities in Canada-USA trade on a continuum from the greatest integration to the least integrated, one

starts with beef and oilseeds. For both these commodities, few restraints are in place. Following these are hogs and horticultural products, then grains, and finally dairy and poultry, sugar and peanuts. The issues at play in trade discussions between Canada and the USA on beef and oilseeds have to do with sanitary and phytosanitary regulations, grading, labelling and packaging. Even though the two markets are largely integrated, these trade issues persist. Moving on to hogs and horticulture, fair competition, domestic subsidies, seasonal trade and trade remedy measures, container sizes and packaging are at issue. In both of these products, trade integration is occurring over time, and domestic policies in the two countries are not central.

In the case of grains, dairy, poultry, sugar and peanuts, the basic issues of access remain the central debate. In effect, domestic policies in both countries are the issue, which must be addressed before substantial progress on trade liberalization is going to take place.

On the spectrum from least to most integration of markets between Canada and the USA, one can find all stages from negotiation through implementation to integration. The issues across the spectrum differ substantially, and offer a glimpse of the changing nature of research needed as trade liberalization occurs over time.

## **Conclusions**

This paper argues that the theory, methodology, practice and results from research in support of trade liberalizing negotiations is reasonably well developed. The focus will change as the negotiations shift from fully multilateral to bilateral and regional and back to multilateral by the end of the decade. As well, the research in support of bringing domestic policies into line with trade agreements is well underway in most countries. However, there is little research on the impacts of market integration across the entire food chain. Yet this phenomenon is occurring swiftly in many cases, and appears to be at least partially responsible for the rapid growth in value added trade.

Our research agenda for trade liberalization is substantially more complex today than it was a decade ago, when the central issue was devoted to convincing policy makers of the gains from liberalization and offering them ideas on how best to achieve agreement. All three stages from negotiation to implementation and integration are occurring simultaneously for many countries on a multilateral and bilateral basis. Even in the case of Canada and the USA with trade agreements in place, the full range of these stages remain on the table.

With respect to market integration, future research will have to become substantially broader, involving not only several levels in the food chain, but also an increasing array of non-sectoral policy that impacts on firm behaviour and trade.

Finally, the pace of change will depend on the clarity and consistency of the research results in providing messages for policy makers, and the compatibility with technological change and industrial restructuring. Added to this is the creativity we need for a new tool kit of policies, measurements, and programs to solve the domestic and international issues which will surface as trade liberalization continues to occur over the next several years.