

## PROGRESS TOWARD A SINGLE MARKET: THE NEW INSTITUTIONAL ECONOMICS OF THE NAFTA LIVESTOCK SECTORS

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### INTRODUCTION

Even before the initiatives which brought about the Canada-United States Trade Agreement (CUSTA) and, subsequently, the North American Free Trade Agreement (NAFTA), trade in red meat and livestock between the United States and Canada was characterized by low levels of formal trade barriers. Tariff levels were so low as to be considered a nuisance rather than a real barrier to trade (Kerr and Cullen, 1985). Import quotas on beef from Canada could be put in place under the U.S. Meat Import Quota Law and while the imposition of quotas disrupted commercial transactions in the short run, they were imposed so seldom that they were, again, considered more of an annoyance than an important trade barrier (Kerr, et al, 1986). Prior to the CUSTA, the beef and pork sectors were often offered as examples of the kind of *North American Market* that could be achieved with the removal of trade barriers under a Canada-U.S. agreement.

It was recognized in the run up to the CUSTA negotiations that a considerable number of non-tariff barriers existed which limited the potential to create a truly integrated market in beef and pork (Bruce and Kerr, 1986). These non-tariff barriers included: (1) contingent protection; (2) health and sanitary regulations; and (3) consumer regulations. It was agreed that some of these non-tariff barriers would be directly eliminated in the text of the CUSTA. In other cases, it was agreed that ongoing negotiations would take place to eliminate existing non-tariff barriers through harmonization, national treatment, or the granting of equivalence. Consultative mechanisms were to be put in place to prevent new non-tariff barriers from arising (Kerr, 1988). The CUSTA was signed with considerable optimism that a *Single Market* for livestock and red meat products would be achieved relatively quickly.

Prior to the NAFTA being signed, formal trade barriers in livestock, pork and beef between the United States and Mexico were, with a few exceptions, relatively benign. Further, as part of its internal deregulation and restructuring initiatives, Mexico was already eliminating many of its trade restrictions (Gerber and Kerr, 1995). Mexico had removed its

tariffs on cattle and beef and was in the process of eliminating an export tax on feeder cattle (Rosson et al., 1993). Live hogs and pork products, however, faced a 20 percent import tariff. Mexico's extensive import licensing system was largely absent in the livestock and red meat sectors.

Mexican exports faced U.S. tariffs on feeder cattle of approximately 1.5 percent and for finished livestock and meat of approximately six percent *ad valorem*. Mexican beef was also subject to the U.S. Meat Import Quota Law. As in the case of Canada, these formal barriers were not considered significant inhibitors of international trade. Health and sanitary restrictions, however, presented considerable hurdles for many Mexican processors. In the NAFTA, all three countries agreed to eliminate their formal trade barriers and to put mechanisms in place to reduce or eliminate non-tariff barriers.

The new World Trade Organization/General Agreement on Tariffs and Trade (WTO/GATT) added additional weight to the need to cooperate to remove non-tariff barriers to trade through the provisions of the Agreement on Sanitary and Phytosanitary Measures, the Agreement on Technical Barriers to Trade, the Agreement on Implementation of Article VI (Anti-Dumping) and the Agreement on Subsidies and Countervailing Measures.

Once the provisions and mechanisms to reduce non-tariff barriers to trade in livestock and red meat products had been negotiated and agreed in the CUSTA/NAFTA, many of those involved in providing input into the negotiation process — livestock producers, meat packers, academics, government officials — simply sat back with the expectation that what had been agreed to would be carried out. While it is probably too early to know how effective the provisions of the NAFTA and the WTO/GATT will be, the CUSTA has been in operation for seven years and some insights as to how the progress to a *Single Continental Market* in red meat and livestock is evolving should be discernible. The evidence to date is disappointing. This does not mean that no progress has been made, but it is far short of what was expected (except by the most cynical of observers) when the CUSTA was signed.

The disappointing rate of progress on the elimination of non-tariff barriers to the movement of livestock and red meat suggests that the process needs to be re-examined and that a new theoretical approach to the problem may be warranted. This paper suggests (but does not fully develop) a new theoretical framework for examining trade liberalization/trade disputes relating to non-tariff barriers, provides some examples of the difficulties associated with liberalizing non-tariff barriers and indicates how further liberalization might be approached.

## **THE NEW INSTITUTIONAL ECONOMICS OF LIBERALIZING NON-TARIFF BARRIERS TO TRADE**

In moving from trade liberalization based on the removal of formal barriers to trade such as tariffs and import quotas to international market integration based on the removal of non-tariff barriers to trade, the nature of international interaction changes. A sophisticated

set of domestic and international institutions has evolved over a long period of time to facilitate the reduction and elimination of formal trade barriers. Specific and easily identifiable government departments administer import tariffs and import quotas. The Office of the U.S. Trade Representative or the Department of Foreign Affairs in Canada is responsible for trade negotiations in multi-lateral forums such as the WTO or bi-laterally as in the NAFTA. Thus, it is relatively easy for those who have a vested interest in having a formal trade barrier reduced or removed to identify to whom they must make their case. The officials in these departments are professionals whose direct concern is the formulation and administration of trade policy. While it may take considerable lobbying resources to achieve one's goal, once it has been achieved through international agreement, an interested party can have considerable confidence that it will be carried out.

The tariff reductions offered at the GATT or the tariff elimination schedules agreed to in the NAFTA are implemented automatically by the department which is responsible for administering tariffs. If tariffs are not removed on schedule, their continued collection provides a *smoking gun* of evidence which cannot easily be denied. Channels where one can formally complain exist and dispute mechanisms are available if no satisfaction is received from consultation. Similarly, the removal of import quotas is relatively automatic once they have been agreed to. There are seldom complaints that countries fail to live up to their commitments to remove tariffs or import quotas.

On the other hand, commitments relating to the removal of non-tariff barriers often pertain to ongoing consultations and negotiations. The regulations which constitute the non-tariff barriers to trade in livestock and red meat products are scattered among a large number of government departments, agencies and sub-agencies. Trade liberalization and the administration of international trade is not the primary function of these institutions. Their personnel are not experts in international trade law. Simply because the trade negotiation arm of government has agreed to procedures aimed at the eventual liberalization of non-tariff barriers does not mean that the agreed liberalization will be carried out or that a satisfactory resolution to ongoing discussions will be reached. Those who negotiate trade agreements have no direct authority to influence events in other government departments or agencies nor do they have a vested interest in seeing that what has been agreed to is implemented. Hence, to ensure that progress continues to be made, those who have a vested interest in liberalization of the sector must be much more active after a trade agreement is signed than is the case when the removal of formal barriers to trade is the primary objective of liberalization initiatives. While these difficulties might appear to be primarily a principle-agent problem, and certainly they have aspects to which that analytical approach applies, it is only part of the problem. Adapting the transaction cost approach of New Institutional Economics may provide broader insights into the liberalization process pertaining to the removal of non-tariff barriers.

One of the central tenets of New Institutional Economics is that transactions do not occur in the frictionless economic environment assumed in standard neoclassical economic analysis (Hobbs, 1996). This friction means that there are costs associated with organizing economic activity (Coase, 1937). The costs are generally referred to as transaction costs. Although transaction costs can be identified in a broad spectrum of economic activities, one

area where there has been particular interest is the organization of complex transactions. Complex transactions are those that involve production and payment over time, which have complicated quality and/or performance specifications and where the quality of the goods exchanged is not transparent (Kerr, 1996). The transaction costs that arise in complex transactions can be divided into three main classifications: information costs, negotiation costs and monitoring/enforcement costs. According to Hobbs (1996):

Firms and individuals face costs in the search for information about products, prices, inputs, and buyers and sellers. Negotiation costs arise from the physical act of the transaction, such as negotiating and writing contracts (costs in terms of managerial expertise, the hiring of lawyers, etc.) or paying for the services of an intermediary to the transaction (such as an auctioneer or a broker). Monitoring or enforcement costs arise after an exchange has been negotiated. This may involve monitoring the quality of goods from a supplier or monitoring the behaviour of a supplier or buyer to ensure that all the pre-agreed terms of the transaction are met. Also included are the costs of legally enforcing a broken contract, should the need arise (p. 17).

Trade agreements dealing with the removal or reduction of non-tariff barriers to international trade have many elements which are similar to a complex transaction. As a specific non-tariff barrier which is to be reduced or eliminated is seldom directly identified in the trade agreement, it is up to those who have an interest in creating a Single Market to search out information about: (1) trade inhibiting regulations and to quantify the costs they impose on the economies to which they apply; (2) the organizations which administer the regulations and their procedures for changing regulations; (3) the individuals within the organizations who have the power to initiate change; and (4) influential allies which can be enlisted to support an initiative for change. It should be noted that proposals for the reduction/elimination of non-tariff barriers will have to come from those with an interest in liberalization since politicians or government bureaucrats will seldom have a personal interest in liberalization (or for that matter protection). These information gathering activities will require resources and, hence, impose costs — *information costs* — on firms or organizations with an interest in liberalization. Further, in the case of non-tariff barriers, considerable intelligence gathering activities must be ongoing to ensure that new regulations do not arise as a result of activities unrelated to trade undertaken by various regulatory agencies e.g., a new sanitary regulation which is being put in place for purely domestic reasons but which may have considerable trade ramifications that have not occurred to the scientists developing the regulations.

Once the non-tariff barrier has been identified and information has been obtained on the relevant economic actors, there will be costs associated with securing an agreement to reduce or eliminate the trade inhibiting effects of the non-tariff barrier. These costs may include lobbying those responsible for initiating legislative/regulatory changes in the government. Studies may have to be commissioned to evaluate the welfare effects of the change. Research may have to be funded to provide the scientific evidence required to convince those responsible for administering regulatory regimes. Proposals for regulatory changes may have to be drafted. Input to hearings, both public and private may have to be

prepared and effectively delivered. Formal and informal discussions with stakeholders in the other country may be required. These *negotiation costs* will continue to be incurred until an agreement to take action on a non-tariff barrier is secured.

Securing an agreement to take action on a non-tariff barrier, however, does not mean that the agreed undertaking will actually be carried out. In many cases, the branch of government which agrees to the undertaking may not be responsible for implementing the change. The state is not a unified actor (Kwon, 1995). The government consists of the various components within it, which have different preferences, cultures and standard operating procedures, and which play their roles interactively in the decision-making process (Allison, 1969). Hence, even if the bureaucracy is neutral, those with an interest in liberalization will have to monitor the agency responsible for implementation to ensure that acceptable progress is being made. If the changes which have been agreed to lead to job losses, retraining or significant changes to standard operating procedures in the implementing agency, then the agency itself may have a vested interest in sabotaging or delaying the changes and, hence, will not be a neutral actor. This will raise the costs of having the changes implemented for those interested in liberalization.

As those with an interest in securing liberalization may not have *standing* when dealing with the bureaucracy in the other country, they may have to convince their own government to press the matter with the other government. As the officials in the home country's government may have a broad agenda for their dealings with the other country's government, the particular concern may become a *poker chip* in ongoing bi-lateral negotiations. Hence, the actions of the home government officials also need to be monitored. These activities require staff and other resources.

If acceptable rates of progress cannot be discerned, then the party with an interest in liberalization will have to work towards having the dispute mechanism activated to ensure that the agreement is enforced. This will require the preparation of a case, convincing their own government that the case has sufficient merit for it to proceed, etc. In the case of sanitary regulations and some other non-tariff barriers the dispute settlement procedures are less transparent than those relating to, for example, dumping or countervail cases. Taken together, these *monitoring/enforcement costs* may be considerable.

In the case of a trade agreement (as opposed to a complex transaction) these information, negotiation and monitoring/enforcement costs can be designated *fulfillment costs* — those costs associated with ensuring that the benefits expected from a trade agreement are actually realized or fulfilled. While many of these topics are dealt with in the political economy literature, putting them into the *fulfillment cost* framework may be useful for those who must allocate resources to these activities and for identifying where action is needed to reduce fulfillment costs in aid of facilitating the movement to single continental markets for livestock, beef and pork. Table 1 provides an illustrative (but by no means a comprehensive) list of the fulfillment costs associated with trade agreements, as well as a comparison with the transaction costs which are typically associated with complex transactions.

**Table 1. Comparison of Representative Fulfillment Costs and Transaction Costs**

	COMPLEX TRANSACTIONS	TRADE AGREEMENTS
	<b>Transaction Costs</b>	<b>Fulfillment Costs</b>
INFORMATION COSTS	Identifying potential customers/suppliers	Identifying non-tariff barrier
	Acquiring product quality information	Acquiring an understanding of the specific regulations and how they impact trade flows
	Determining the reputation of potential customers/suppliers	Identifying key political and administrative players
	Acquiring and assessing price information	Identifying potential allies in both countries
	Acquiring information on future price and/or product quality trends which may alter the desirability of the transaction	Monitoring legislative and/or regulatory initiatives which may increase the trade inhibiting effects of non-tariff barriers
NEGOTIATION COSTS	Time spent developing and negotiating contract offers	Time spent lobbying and providing input into regulatory hearings
	Legal costs of drawing up formal contracts	Legal and other costs associated with drawing up proposals for regulatory changes
	Formal assessments of contract offers in budget, financial and production models	Formal assessments of the economic (and possibly other) benefits from regulatory reform
	Informing suppliers/customers of any affects of the proposed contract on exiting relationships such as quality or quantity changes involving inputs	Informing and/or lobbying potential allies on either side of the border
MONITORING AND ENFORCEMENT COSTS	Monitoring the activities of the other party to the contract to ensure that provisions of the contract are adhered to - e.g. monitoring deliveries to ensure that they are of the quality specified in the contract	Monitoring the activities of foreign legislatures and bureaucracies to ensure that the agreed changes are taking place and at an acceptable rate - i.e. to ensure the expected benefits from trade are not nullified
	Discussing any problems identified with the other party	Lobbying foreign officials regarding any problems identified, if allowed, and lobbying home government to press for implementation
	Costs of preparing a formal legal case if contract is breached	Cost of preparing a case upon which a dispute mechanism challenge can be mounted
	Court or arbitration costs	Preparing for and responding to dispute settlement activities directly or through officials of the home government

In terms of the NAFTA continental market, one should expect fulfillment costs to rise when different languages are involved. Mexican organizations will have to have staff (or agents) who are fluent in English or French. Canadian and American organizations will require individuals with a similar degree of capability in Spanish. International language capability cannot be expected among the domestic bureaucracies which are responsible for framing and administering the regulations that constitute non-tariff barriers. The professionals who are charged with negotiating the reduction and elimination of formal trade barriers are, in contrast, likely to be multilingual or operate in venues with a high degree of translation capability.

How significant are fulfillment costs? As with transactions costs, measuring fulfillment costs is unlikely to be easy. According to Hobbs (1996):

...unlike production costs, transactions costs - the costs of economic organization are neither easy to separate from other managerial costs nor readily measurable. (The problem is analogous to the difficulty accountants have in assigning costs of jointly used assets to individual enterprises in a multiple enterprise firm). The complex nature of companies and market institutions means that the costs of their operation are not easy to quantify and the data which one might use to measure transaction costs are not usually collected by governments or by the standard accountancy practices of firms. Although one can recognize that there is indeed a cost involved in valuing a good or in monitoring the actions of a buyer or seller, it is difficult to measure these costs in financial terms (p. 20).

Fulfillment costs will, for the most part, have the same *overhead* aspects to them as transaction costs and, hence, will be difficult to measure. Certainly, some fulfillment activities will have directly measurable costs such as legal fees and the hiring of economic consultants to prepare studies. Measuring fulfillment costs, however, may not be particularly important. If they can simply be identified they can provide insights into the problems associated with ensuring that the benefits expected to arise from a trade agreement are not *nullified*. A word of caution, however, the absolute level of fulfillment costs must be more of a concern than transaction costs because competitive forces are expected to move an industry toward the most transaction cost efficient vertical coordination system, *ceteris paribus* (Gaisford, et al 1994). Fulfillment costs relate primarily to ensuring that activity takes place within the political and bureaucratic arena but there will be no competitive pressure to reduce them. As a result, pro-active measures may be required to reduce these costs; otherwise fulfillment costs may, in themselves, remain a significant barrier to the achievement of a single market.

While it may not be easy to measure fulfillment costs, examples may be found to illustrate their importance. If the agreed upon removal of a non-tariff barrier has not taken place and, hence, the expected benefit from liberalization is *nullified*, this would suggest that organizations or firms with an interest in removing the non-tariff barrier did not expend sufficient resources on the activity. Alternatively, the fulfillment costs may have been sufficiently high so as to exceed the potential benefit from liberalization. One suspects that organizations and firms have not yet adjusted to the higher costs associated with ensuring

that liberalization is realized in the case of non-tariff barriers. By explicitly identifying their fulfillment costs, these organizations may begin to allocate more resources to these activities. They may also realize that there may be benefits to attempting, individually or collectively, to reduce these costs. In the next section, a number of examples from the livestock and red meat industries are presented which illustrate the problems associated the failure to accomplish liberalization already agreed to in trade negotiations.

## **NON-TARIFF BARRIERS WHICH HAVE NOT BEEN REMOVED OR REDUCED IN LIVESTOCK AND RED MEATS**

This illustrative discussion will begin with two examples where specific commitments to reduce or eliminate a non-tariff barrier were written directly into the trade agreement but were not acted upon. In these cases, organizations or firms with an interest in the liberalization of the specific provision would only have to incur monitoring and/or enforcement costs to have their expectation realized. Subsequent examples will examine cases where there was an agreement to work toward removal of certain classes of non-tariff barriers. Hence, organizations and firms with an interest in liberalization would be faced with information and negotiation costs as well as monitoring/enforcement costs.

### **Countervailing Duties**

Prior to the signing of the CUSTA, the Canadian pork industry had been subject to countervailing duties imposed by the United States. The industry had complained about the lack of fairness in the U.S. countervailing duties system and the costs involved in preparing cases against both formal countervail proceedings and the threat of countervail actions. Their organizations had lobbied hard for relief from U.S. countervail to be included in the CUSTA Agreement. There was no resolution to the countervail procedures question, or for that matter the equally contentious anti-dumping procedures, at the formal CUSTA negotiations. Instead, a temporary arrangement was negotiated and in Article 1907 of the CUSTA it was agreed that:

The Parties shall establish a Working Group that shall:

- (a) seek to develop more effective rules and disciplines concerning the use of government subsidies;
- (b) seek to develop a substitute system of rules for dealing with unfair pricing and government subsidization

Further, in Article 1906 it was agreed that:

The provisions of this Chapter shall be in effect for five years pending the development of a substitute system of rules in both countries for antidumping and countervailing duties as applied to their bilateral trade. If no such system of rules is agreed and implemented at the end of five years the provisions of



this Chapter shall be extended for a further two years. Failure to agree and implement a new regime at the end of the two year extension shall allow either Party to terminate the Agreement on six months notice.

Hence, the Canadian pork industry should have been able to expect some relief from U.S. contingency protection measures after no longer than seven years. (Presumably the U.S. industry could have expected relief from equally capricious Canadian countervail actions). There was clearly a commitment to find a mutually acceptable countervailing duties system and a very strong sunset clause built in to ensure *bargaining in good faith*. The entire CUSTA was to be put at risk if no resolution was found.

In theory, the Canadian pork industry should have been able to monitor the progress of these discussions, present its views to Canadian negotiators and lobby the appropriate Canadian government officials to ensure that progress was being made. Of course, contingency protection measures were an issue for many industries on both sides of the border and to keep the pressure on would have required the Canadian pork industry to forge alliances with other Canadian groups or firms with an interest in improving the contingent protection system, as well as with allies in the United States. Forging these alliances would have taken considerable resources given the high costs associated with organizing such a diverse group. Admittedly, the resolution of the contingent protection problems was complicated by the ongoing and slower than expected GATT negotiations pertaining to contingent protection but it was apparent that little real progress was being made fairly early on in the five-year mandate. The Canadian and U.S. pork industries and their various formal and informal allies could not exert sufficient pressure on the negotiators to ensure that they received this very important expected benefit from the CUSTA.

Buried in the fine print of the NAFTA is a clause which removes the seven year deadline for arriving at new countervail and dumping definitions and procedures (Gerber and Kerr, 1995). Hence, either the pork industries in the United States and Canada and their allies failed to allocate sufficient resources to ensure fulfillment of the contingency protection provisions of the CUSTA or, alternatively, the expected (collective) benefits could not justify the required (collective) fulfillment costs.

In the synopsis of the CUSTA released by the Government of Canada (1987), Canadians were led to believe that they would be much better protected from the capricious use of countervail than they eventually were:

The combined effect of bilateral review of the existing law and the development of a new set of rules will be to ensure that by the time all tariffs are removed and other aspects of the Agreement phased in, Canadian firms will have not only more open access, but also *more secure and predictable access* (emphasis added) (Government of Canada, 1987, p. 53).

One doubts if the Canadian pork industry currently believes that it has more secure and predictable access to the U.S. market than was the case when the new bilateral review procedures introduced in the CUSTA became fully operational.

## **Border Inspections**

Canadian beef packers had complained of what they perceived as capricious, if not strategic, use of border inspections for meat as a non-tariff barrier to trade prior to the CUSTA negotiations. While rejection of products at the point of export is a trade irritant for many commodities, it does not impose large economic costs. If meat products are monitored at the border they can be delayed and if rejected returned to the exporter. Due to meat's perishability, delays and *turn backs* can lead to deterioration in quality and a subsequent reduction in price.

In addition, border delays or rejections will likely have other economic effects. Given the tight logistics parameters of cold chains for meat, delays may lead to reductions in quality and subsequent doubt about the reliability of the exporter in the mind of the consignee. This is likely to affect future sales orders adversely. Rejection of product at the border can affect the consignee's ability to fill pre-committed orders and, hence, raises concerns pertaining to security of supply. Again, this can adversely affect the ability of the exporter to secure future sales. Rejection of product at the border may also lead to a reduction in returns to processors even if there is no deterioration in product quality. As the meat is destined for export, it is cut to U.S. standards. To the extent that product specifications differ, if the rejected product has to be sold in the Canadian market it will suffer a discount. These losses must be added to the cost of trucking to the border and back and the cost of loading and unloading the vehicle.

All meat leaving Canadian export plants (all of which are approved by USDA) is inspected by Agriculture and AgriFood Canada veterinarians and certified as satisfying U.S. standards prior to leaving the plant. All meat exports are, however, also inspected at the border by officials from the USDA. These inspectors may examine a random sample of the cartons (known as skip-lot) with the help of a computerized selection process. This procedure generally takes about three hours. The officials may also choose to inspect every carton (known as full-lot) and this requires six hours. Obviously, the probability of finding unsatisfactory product or packaging increases with the number of cartons inspected. All, or only part, of a shipment may be refused if the product is not sealed or preserved properly or if the quality is poor or is not as stated. An increase in the number of full-lot rather than skip-lot inspections may imply an attempt to reduce trade flows. This is also true when entire rather than part loads are rejected. Product is often inspected again at the point of delivery.

There was some evidence that border inspections were being used strategically to limit imports with the number of rejections inversely related to the price of beef in the United States (Kerr, et al, 1986). According to Menzie and Prentice (1987):

There are suspicions and some evidence, however, that these regulations have been used to control movements beyond the legitimate levels (p. 947).

While the degree of emphasis placed on this non-tariff barrier may appear excessive to those outside the meat industry, the organizations and firms representing the Canadian beef industry felt that border inspections were sufficiently disruptive to the operation of the North

American beef market to lobby extremely hard to have a special provision to address the problem written into the CUSTA.

Article 708:3 states:

Where, for agriculture, food beverage and certain related goods other than animals:

... (b) the exporting party has, pursuant to such systems, procedures or requirements, determined or certified, as the case may be, that such goods meet the standards or technical regulations of the importing Party, the importing Party may examine such goods imported from the territory of the exporting Party only to ensure that (b) has occurred. This provision shall not preclude spot checks or similar verifying measures necessary to ensure compliance with the importing Party's standards or technical regulations provided that such spot checks or similar verifying measures, including any conducted at the border, are conducted no more frequently than those conducted by the importing Party under similar circumstances with respect to its goods.

The clear intent was to effectively eliminate border inspections and the interpretation of the agreement at the time was to move to a system whereby inspection would take place only at the final destination of the meat. Seven years later little has changed.

Border inspections remain an irritant. Part of the difficulty is that it is not clear where the lines of authority within the U.S. government lie in relation to having USDA comply with the CUSTA. One suspects that the change was resisted within the inspection bureaucracy due to fears of job losses and by those who had invested in private border inspection facilities. In Canada, having the matter pressed with the U.S. government required that the correct officials in the Canadian bureaucracy be identified and then convinced that the rather narrow provision justified a concerted effort on the part of the Canadian government to press the point with the Americans. In other words, was it worth pressing the issue of border inspections of red meat — of interest to only one industry — within the dynamics of the broad spectrum of Canada-U.S. relations? The organizations and firms representing the red meat industry could also have attempted to have the issue brought to the dispute settlement mechanism but, again, it required bringing Canadian officials on side. These lobbying activities carry a considerable cost and, as it was a single industry issue, there were no prospects of finding allies among whom the costs could be shared.

This issue can be couched in the new institutional economics paradigm outlined above. Both nations realized that there were gains to be had from certifying each others plants for safety, and the law was written as such. However, the border inspectors had a very different viewpoint than the trade negotiators even though both work for the same government.

Take the case of a particular — and now very famous — USDA inspector in Montana, Bill Lehman from the Sweetgrass border station. Unlike his colleagues in Washington, this inspector had little contact with parties outside Montana agriculture. Acknowledgment by the United States that Canadian packing plants are safe not only removed the need for his

job, but also invalidated a lifetime's work. This particular inspector refused to implement the new provisions and was asked to relocate. Rather than do this, the inspector quit, and is now a popular celebrity in that part of Montana, and has begun a media campaign to convince consumers that the USDA is allowing unsafe Canadian meat into the United States. Although other inspectors have not gone to this extreme, it is easy to understand why they are imposing as many restrictions as the law allows. The enormous popularity of the inspector who quit is also instructive. Local beef farmers have noticed a constant flow of Canadian cattle into the United States, and given the depressed state of United States cattle prices in general, it is easy to see why they assume a causal relationship between imports and low prices.

Economists and others promoting advantages of free trade have failed in two ways. First, we did not anticipate the reaction of the border inspectors, and second, we did not do a good job convincing those producers along the border that they would benefit from this agreement. To do the latter, we would have had to convince cattle producers in Montana that U.S. cattle exports from midwestern plants increase prices throughout the United States. This concept of a spatially integrated market does not come easily to some cattle producers for whom all business is local.

### **Beef Grade Equivalency**

Grading represents a technical standard rather than a sanitary regulation. Chapter Six of the CUSTA pertains to technical standards. According to Article 604 the Parties agreed:

To the greatest extent possible, and taking into account international standardization activities, each Party shall make compatible its standards-related measures and procedures for product approval with those of the other Party.

where *make compatible*:

means the process by which differing standards, technical regulations or certification systems of the same scope which have been approved by differing standardizing bodies are recognized as being either identical or *technically equivalent* in practice (emphasis added) (Article 609).

Differences in grading standards have been recognized as an impediment to the creation of a single North American market for beef for a number of years (Kerr, 1992). As a result, boxed choice Canadian beef sold into the United States must be sold at a *no-roll* discount. Boxed U.S. Select beef must be sold into Quebec and Ontario as ungraded beef and, hence, does not receive the premiums associated with equivalent quality graded Canadian beef. The net result is lower sales and returns in both markets. A single market does not yet exist. As a result of Canada unilaterally changing some of its grading procedures, as of January 1, 1996, Canada and the United States have been using the exactly the same methods for grading beef quality (Hayes et al., 1995).

Grade equivalency would have to be approved by both governments. It should be noted that there is no mechanism within either government or bilaterally to push for the implementation of Chapter Six of the CUSTA. This means that lobbying must be done by interested parties. Grade equivalency is unlikely to be approved if it is opposed by a major organization on either side of the border. According to Thomas (1996):

The Canadian Cattlemen's Association supports cross-border grades, but the U.S. cattle industry is much more skeptical — in some cases, even hostile (p.56).

The Canadian Cattlemen's Association had to undertake a long process of consultations to bring the National Cattlemen's Beef Association (NCBA) on side in the United States and:

Grade equalization got a kick at the can in 1994 when it made it to the National Cattlemen's Association (NCA) annual meeting. Unfortunately, it was tabled at the meeting in favour of further study (Thomas, 1996, p. 56).

A study was subsequently commissioned to respond to questions raised by a subgroup of the National Cattlemen's Association's U.S.-Canada Grade Equivalency Task Force. The major conclusion of the study was that it would be beneficial to the industry if the market for beef was approached from a Single Market perspective:

The overall effect would be to allow the North American packing industry to operate more efficiently. This effect is equivalent to cutting the packer margin by a small amount. The volume of U.S. beef exports to Canada and of Canadian beef exports to the United States would increase (Hayes et al, 1995).

Despite the results of the study, there is still resistance to the granting of grading equivalence and:

At the moment, grading negotiations with the National Cattlemen's Beef Association have been suspended until a better negotiating climate arises (Thomas, 1996, p. 56).

Meanwhile, the Canadian Cattlemen's Association (CCA) continues to expend resources attempting to gain allies in the United States. For example, in 1996:

Questions about the Canadian industry from U.S. producers frustrated with the market prompted the CCA to invite a delegation to tour Canadian feedlots and packing plants in mid-June. The tour was aimed at helping our major trading partner understand the Canadian industry and recent trade patterns.

... The quality of our genetics and commercial production practices, plus the high safety standards of our packing plants, was demonstrated in detail.

... All in all, the Montana and Idaho cattlemen were impressed with what they saw (Grogen, 1996, p. 32).

This is all part of the expensive process of recruiting allies for the removal of non-tariff barriers and the mental movement to the concept of a single continental market. According to Dennis Laycraft of the CCA:

Right now there are knowledgeable U.S. ranchers willing to stand up at NCBA meetings and promote freer trade with Canada. They are being listened to, and that, for me, is a bright sign for better things to come (Thomas, 1996, p. 56).

This is a case where both consumers and producers would have benefited from removal of a barrier. Yet, the USDA reaction was to defer to the wishes of U.S. beef producers who opposed the chain. The U.S. beef producers were made aware of the benefits but they came out against equivalency. There are two possible reasons for this position. First, the discussions were dominated by producers in border areas who did not want any Canadian imports and beef producers in the U.S. corn belt who stood to gain by accessing central Canadian markets were not as vocal.

The argument that eventually won the day was that the words *US Choice* were a highly valuable U.S. trade mark and should not be shared with the competition. This argument won despite an explicit provision that prohibited the Canadians from using this brand outside the United States.

The current situation is one where both sides have almost identical standards, but where *Choice* Canadian carcasses must cross the United States border as live animals so that they can be graded in the United States. Likewise, *Select* US meat must sell at discounts in Central Canada because it cannot be labeled *A*.

Economists in the United States have failed to convince U.S. beef producers that the North American beef market is now spatially integrated. We have failed to convince producers of the benefits of free trade.

Again, we see schizophrenic behaviour on behalf of the U.S. government. One arm, the trade negotiators, assumed that the other arm would follow its lead. Meanwhile, the group responsible for grading was responding only to the needs of a relatively small group, and it chose to let policy be dictated by that one group.

Clearly, the removal of non-tariff barriers imposes considerable fulfillment costs on the industry organizations in both countries. Once the organizations themselves accept the proposition of grading equivalence, the long process of convincing the governments will begin.

## Rules for Importation of Animals and Animal Products

Under Article 708 of the CUSTA relating to health, sanitary and phytosanitary regulations the Parties agree to:

- © notify and consult with each other during the development or prior to the implementation or change in the application of any technical regulation or technical standard that may affect trade in such goods.

On April 18, 1996, the USDA's Animal and Plant Health Inspection Service (APHIS) published a set of proposed Importation of Animals and Animals Products Rules. While the issues are complex, one intent of the rules is to allow for regional differences in health standards whereas in the existing rules animal health status was determined on a national basis. The new regulations also assign risk levels to regions. The greater the assigned risk levels, the more stringent the animal exporting procedures required. The CCA believes that the levels of risk assigned to Canada have the potential to considerably reduce trade in live animals from current levels. It would appear that the USDA developed these proposals in isolation - which contravenes the spirit, if not the letter of the CUSTA. The CCA and other interested Canadian parties are now restricted to a reactive role rather than having been consulted during the development of the rules. This is in spite of CCA initiatives taken in conjunction with the NCBA in the United States. The two organizations had formed a Cross-Border Animal Health Committee in 1993.

The major problem seems to be that either the USDA did not feel obligated to consult with Canada *ex ante* about the development of the regulations, or if a government body was consulted in Canada, the CCA did not have their ear. While the USDA did subsequently receive responses from interested Canadian organizations, this appears to be far from the active process of consultation envisioned in the CUSTA. The government agencies in each country still approach regulation from a national rather than a single market perspective and, as a result, new non-tariff barriers can still arise. According to Thomas (1997):

One senior trade analyst told *Cattlemen* the USDA proposal is a *scary document*, nothing more than a non-tariff barrier (p. 41).

Presumably, this is what the CUSTA provisions on sanitary non-tariff barriers to trade were intended to prevent.

## United States International Trade Commission 332 Study

Simply keeping informed of potential problems in the non-tariff area may be expensive. In November, 1996 the U.S Congress ordered the International Trade Commission to conduct a 332 study into the effects of new WTO trade rules on U.S. imports of live cattle for slaughter and fresh, chilled and frozen beef. It also called for a review of the steps the United States has taken to prevent trans-shipment of these products through Mexico and Canada. While the study itself cannot trigger a trade action, once the report is

released an official complaint can be launched with the U.S. Department of Commerce based on the information in the report.

While 332 studies are not covered by the WTO or the NAFTA, what is disconcerting is that the Canadian industry was taken by surprise:

This time, the 332 came out of the blue — tossed into an omnibus agricultural marketing bill that passed through Congress just before the politicians headed off to campaign for the November elections. In fact the Canadian Cattlemen's Association first heard about it from their Washington lawyers, not from U.S. cattlemen (Winslow, 1996, p. 6)

Clearly the CCA had not expended sufficient resources to acquire information. With better information, as a best case the Congress could have been lobbied and the study dropped from the Bill. In the worst case, the CCA would have had more time to prepare input into the study and to consult with U.S. beef organizations to reduce the probability of their launching a formal complaint with the Department of Commerce.

## **SUMMARY AND CONCLUSIONS**

From the few examples outlined above, it should be clear that the process of reducing non-tariff barriers and preventing new non-tariff barriers from arising is a resource intensive activity — much more resource intensive than reducing formal trade barriers. These examples are only representative of the hundreds of issues that have arisen since the coming into being of the CUSTA, NAFTA and the WTO. These large costs arise because the responsibility for administering non-tariff barriers is diffused among a large number of government organizations. The lines of responsibility for ensuring the implementation of trade commitments are not clear within the wider machinery of government and by their very nature, non-tariff barriers tend to be industry specific, hence, it is more difficult to build politically effective alliances. In contrast, tariff policy is the responsibility of one government department and the responsibility for tariff reduction is well defined and understood. Further, tariffs are transparent while most non-tariff barriers are not.

New Institutional Economics has had an important role in explaining the workings of economic systems. Transaction costs have provided insights into the success and efficiency of complex transactions. Trade agreements share many characteristics with the contracts which are often used to facilitate complex transactions. Extending the concept of transaction costs to the processes required to ensure the liberalization of non-tariff barriers — fulfillment costs — hopefully provides insights into the difficulties associated with the creation of a single market. By using the information, negotiation and monitoring/enforcement cost framework, organizations can begin to think formally about the resources they need to expend to accomplish the removal of non-tariff barriers. Further, once costs are identified, means to reduce them can be sought individually or collectively. Clearly, high fulfillment costs can themselves act as a non-tariff barrier to trade.



As formal barriers to trade in livestock and red meat have, for the most part, been removed from the continental market as a result of the CUSTA and NAFTA, the discussion of the costs associated with removing non-tariff barriers is particularly relevant to the creation of a single market. Once the major organizations representing livestock and red meat interests begin to approach problems from a single market perspective, negotiation costs will fall and the pace of progress toward the goal will increase. Governments also need to think about how to reduce fulfillment costs. One problem within the NAFTA, and within the three national governments, is that there is no institution with a prime responsibility for the promotion of trade liberalization and ensuring that the agreements are implemented. The Office of the U.S. Trade Representative and its counterparts in Canada and Mexico have responsibilities which are inherently protectionist. One possible means to reduce fulfillment costs would be to create trilaterally, or within the individual countries, a Trade Ombudsman with responsibility for implementing the agreements and through which interested parties could obtain information and provide input as to how the removal of non-tariff barriers could be facilitated. The Ombudsman could be given the power to intervene when a department was seen to be dragging its feet or acting to thwart implementation of the international trade agreement.

The process of removing non-tariff barriers to trade is in its infancy. New and less costly institutions will be required to ensure that progress toward single markets is maintained. Using the fulfillment cost framework outlined in this paper may be a useful first step.

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