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Implications of the U.S. Farm Act on Canadian Agriculture*

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This paper addresses the implications of the U.S. Farm Security and Rural Investment Act of 2002 or "Farm Act" for Canadian agriculture. The Farm Act, which is expected to add at least US $45 billion in new price supports over its six-year timeframe, is expected to harm the position of less-subsidized and non-subsidized producers in Canada and other countries. Canadian farm products will be less competitive not only domestically, but also in the U.S. and in third-country markets. Canada will be most affected by subsidies for corn, soybeans, wheat, and pulse crops. New country-of-origin labeling rules under the Farm Act are also expected to be disruptive to Canadian livestock exports. In addressing these issues the paper also explores potential Canadian responses – including filing WTO or NAFTA complaints – as well as the broader implications for U.S.-Canada trade and international cooperation.

Keywords: U.S. Farm Bill; U.S.-Canada trade.

Introduction

In May 2002 the U.S. Congress passed, and President Bush approved, the Farm Security and Rural Investment Act of 2002, better known as the Farm Act. The act constitutes a reversal from the 1996 Freedom to Farm Act, which sought to gradually phase out the longstanding practice of providing billions of dollars in subsidies to U.S. farmers. Subsequent to the passage of Freedom to Farm, falling worldwide commodity prices led to huge political pressure on U.S. legislators to halt the phase-out of farm subsidies. This pressure culminated in the passage of the 2002 Farm Act.

The Farm Act is expected to add at least US $45 billion in new spending over its six-year timeframe, for a total of $111.5 billion for U.S. agricultural programs. Some estimates are higher. According to the Congressional Budget Office, the act could add as much as $57 billion in new price supports.[1] Annual spending under the Farm Act will be approximately $17 billion, up from $10 billion.[2] Naturally, this is expected to harm the position of less-subsidized and non-subsidized producers in Canada and other countries. Canadian farm products will be less competitive not only domestically, but also in the United States and in third-country markets. Canada will be most affected by subsidies for corn, soybeans, wheat, and pulse crops (the latter include dry peas, lentils and chickpeas). New country-of-origin labeling (COL) rules under the Farm Act are expected to be very disruptive to Canadian livestock exports.

Worldwide prices of grains, oilseeds, and other commodities have been relatively high this year due to drought conditions in North America and other parts of the globe. This is considered a mitigating factor regarding the negative effects of the Farm Act. Because of these weather-related forces, the act is not expected to result in plummeting commodity prices, at least initially. What it may do is cause prices to be lower than they otherwise would be.

The Farm Act comes at a difficult time for Canadian farmers because their profits have been dampened due in large part to high operating expenses. Net farm income was about $2.5 billion annually from 1997 to 2000 (adjusted for inflation), much lower than the high of $11.1 billion set in 1975.[3]

On a per-farm basis, the United States far outspends Canada on agricultural support programs. Subsidies and other programs amount to 34 percent of the value of farm production in the United States and more than 40 percent in the European Union, versus 11 percent for Canada, according to the Canadian Federation of Agriculture. On a per-tonne basis, U.S. agricultural subsidies for wheat were C $108 in 2001, compared with C $31 for Canada. [4] That difference will widen under the new Farm

Act. Canada's subsidies have fallen substantially in recent years, from 33 percent of total farm receipts in 1986-88 to just under 20 percent now (see figure 1). During that time, U.S. subsidies fell as well, from 25 per cent of total farm receipts to just over 20 percent. Of course, the Farm Act will produce a reversal in that U.S. trend. Meanwhile, European Union subsidies account for nearly 40 percent of total farm receipts.[5]

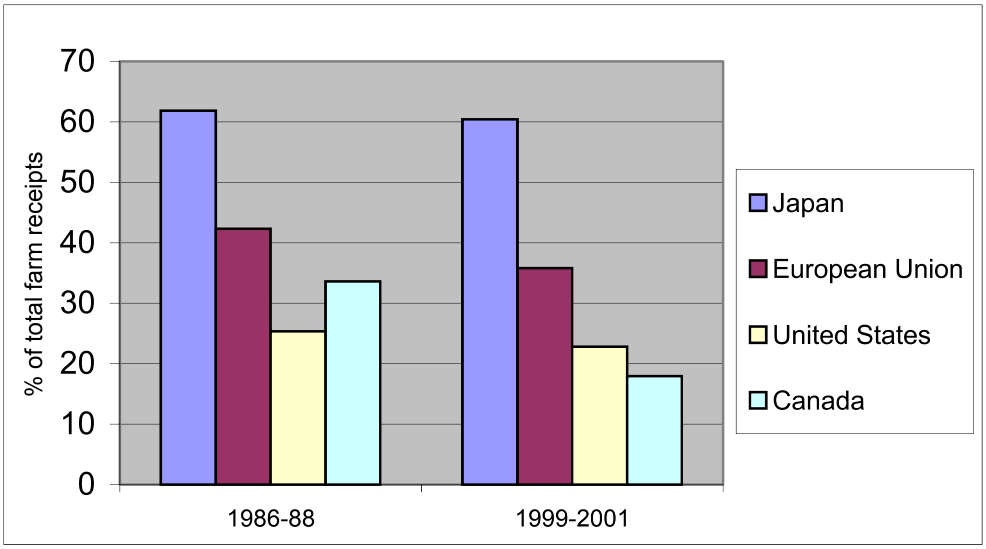

Figure 1 Agricultural producer support
Source: OECD, 2002.

When the U.S. institutes a new farm policy, virtually all countries feel the effects. The size of the U.S. economy allows it to set world prices for key commodities. Subsidies and trade distortions thus keenly impact Canada, particularly because it is the United States' largest trading partner and vice versa.

In 2001, two-way trade totaled US $380.7 billion, according to the U.S. Department of Commerce. Canada accounts for 22.7 percent of American exports and 18.9 percent of U.S. imports. The United States accounts for 85 percent of Canadian exports. According to a recent report by the Conference Board of Canada, of the major industrialized countries, Canada is the most trade dependent. Exports generate about 45 percent of its gross domestic product, and one out of three jobs depends on exports. Lower export prices as a result of the Farm Act, both in the U.S. market and in third-country markets, will therefore significantly negatively impact Canadian jobs and incomes.[6]

The Farm Act is also expected to significantly hamper trade liberalization efforts as well, particularly in the context of the World Trade Organization. One country's introduction of subsidies is a large irritant in trade relations, as it often prompts other countries to enact countervailing tariffs in order to offset the impact of the subsidies on imports. This is particularly the case in the context of the Farm Act, due to the U.S. economy's huge impact on the rest of the world. Disputes over agriculture, moreover, are the largest stumbling block in the current Doha round of WTO negotiations. The Farm Act's subsidies will not necessarily violate WTO statutes, but they will introduce credibility problems. The United States traditionally has taken a leadership role in the push for trade liberalization, often admonishing countries to reduce subsidies. The Farm Act, however, will weaken the United States' "moral authority" in this area. Moreover, the COL provisions in the Farm Act may indeed violate WTO statutes.

Provisions of the Farm Act

The Farm Act consists of ten titles: Commodity Programs, Conservation, Trade, Nutrition Programs, Credit, Rural Development, Research and Related Matters, Forestry, Energy, and Miscellaneous.[7] Of the titles, Commodity Programs, Trade, and Miscellaneous – the last includes COL – will have the most impact on Canada.

Commodity Programs

The Farm Act's commodity programs are essentially subsidies taking various forms. They include direct payments to farmers, counter-cyclical payments, and commodity loan programs including marketing assistance loans and loan deficiency payments.

Direct Payments

The annual direct payments under the Farm Act replace production flexibility contract payments under the previous 1996 act. They apply to farmers (and eligible landowners) of wheat, corn, barley, grain sorghum, oats, upland cotton, rice, soybeans, other oilseeds, and peanuts. The amount of the payment is based on a complicated formula involving the payment rate of the applicable base crop, the payment acres, and the payment yield for the farm. Direct payments for the 2002 crop are being made immediately following enactment of the Farm Act. The payment limit on direct payments is $40,000 per person, per crop year.

The Economic Research Service (ERS) of the U.S. Department of Agriculture predicts that these payments will likely lead to slightly higher crop production. The ERS also states "farmers may have an incentive to continue producing crops and/or to expand production in order to maintain a production history in anticipation of future opportunities to expand payment acres."[8]

Counter-Cyclical Payments

Counter-cyclical income support payments, a new program, replace most ad hoc market loss assistance payments that were provided to farmers during the period from 1998 to 2001. The payments aim to provide an improved counter-cyclical income safety net by compensating for drops in crop prices, and are based on historical production rather than current production. Under the program, counter-cyclical payments are available for covered commodities whenever the effective price is less than the target price. The payment amount is equal to the product of the payment rate, the payment acres (85 percent of base acres), and the payment yield. The payments go into effect as soon as possible after the end of the crop year for the covered commodity. The payment limit is $65,000 per person, per crop year.

The ERS admits that these support payments reduce economic efficiency, because producers would not be responding strictly to signals from the marketplace but instead to market signals augmented by expected benefits of future programs and future program changes.[9]

Commodity Loan Program

Like direct payments and counter-cyclical payments, the commodity loan programs are essentially subsidies, since they result in below-market interest rates. They enable a farmer to receive a government loan at a commodity-specific loan rate per unit of production by pledging production as loan collateral. The program essentially protects farmers from low prices, while still allowing them to take advantage of high prices. The loans may be repaid in three ways: at the loan rate plus interest costs; by forfeiting the pledged crop to the government at loan maturity; or at the alternative loan repayment rate. When market prices are below the loan rate, farmers are allowed to repay the commodity loans at a lower loan repayment rate.

Alternatively, eligible farmers may receive direct loan deficiency payments when market prices are lower than commodity loan rates. This allows producers to receive the benefits of the marketing loan program without having to take out a commodity loan and subsequently repay it. The payment limit on marketing loan gains and loan deficiency payments is $75,000 per person, per crop year.

The Farm Act increases loan rates for wheat and feed grains and lowers the rates for soybeans and other oilseeds from their caps. For the first time, the program covers small chickpeas, lentils and dry peas. According to the Economic Research Service, these loan rate changes would shift plantings toward wheat and feed grains when commodity prices are low, compared with leaving loan rates at their caps under the 1996 Farm Act.[10]

Trade Provisions

The trade provisions of the Farm Act aim to develop and expand commercial outlets for U.S. commodities and to provide international food assistance. New programs include the Biotechnology and Agricultural Trade Program, which addresses nontariff barriers to U.S. exports, and the Technical Assistance for Specialty Crops Program, which addresses barriers to exports of specialty crops. The Export Credit Guarantee Program is extended through 2007. It extends terms of repayment for the Supplier Credit Program from 180 to 360 days. It continues the requirement that not less than 35 percent of export credit guarantees issued be used to promote exports of processed or high-value agricultural products. Other trade programs include the Market Access Program, Foreign Market Development Program, Emerging Markets Program, and the food aid program known as P.L. 480. The Export Enhancement Program provides a subsidy to U.S. exporters with the stated aim of helping them compete against subsidized prices in specific export markets.[11]

Miscellaneous Provisions (Country-of-Origin Labeling)

Based on “consumers’ right to know”, agricultural products in the United States must carry a country-of-origin label at the retail level. The COL provision amends the Agricultural Marketing Act of 1946, requiring retailers to inform consumers of the country of origin for covered commodities. It applies to fresh fruits and vegetables, as well as to cuts of beef, lamb, and pork; ground beef, ground lamb, and ground pork; farm-raised fish and shellfish; wild fish and shellfish; perishable agricultural commodities; and peanuts.

The 2002 act states that retailers may use a “United States country-of-origin” label if the product is from an animal that was exclusively born, raised, and slaughtered in the United States. Food-service establishments such as restaurants are exempt. Guidelines for voluntary labeling are to be issued by September 30, 2002 and mandatory labeling is to take effect September 30, 2004. Those who prepare, store, handle, or distribute a covered commodity for retail sale may be required to maintain a verifiable record-keeping audit trail.[12]

Implications for Canadian Farmers

Ken Ritter, chair of the Canadian Wheat Board's farmer-controlled Board of Directors, observes that "the increased government support will influence input application decisions, cropping decisions and farm investment decisions by changing farmers' perception of risk, their ability to obtain credit and their ability to invest in new technology." He states all of these factors will push productivity to levels beyond what the market would normally dictate. Surpluses will grow larger, resulting in depressed prices in Canada.[13]

Grain producers are expected to be hit hardest. The European Commission forecasts that, on a worldwide basis, the cereals sector will be most affected by the Farm Act.[14] The marketing loan program, for example, makes it very attractive to move acres into soybeans and corn, which will likely result in downward pressure on soybean and corn prices.[15] This may put upward pressure on wheat prices – or at least slow the rate of price decline. Since corn is the major feed grain in the United States, the shift in acreage also would likely boost U.S. livestock production to the detriment of Canadian livestock producers.[16]

Robert Friesen, president of the Canadian Federation of Agriculture (CFA), notes that some Canadian cattle and hog farmers are already taking advantage of higher American subsidies by moving their animals across the border, where feed prices are lower.[17]

As mentioned above, the Farm Act extends subsidies to pulse crops for the first time, guaranteeing them prices above current levels. Farmers in Saskatchewan and Manitoba, who are growing more and more of these types of crops, will be greatly affected. U.S. lentil and chickpea growers argued that it is difficult to compete with Canadian farmers because of Canada's lower freight rates, better crop insurance, and weaker currency (which makes Canada's exports more affordable). Under the program, if market prices fall below specified levels, the U.S. government will make up the difference with loan deficiency payments.[18]

Canadian farmers, particularly in Manitoba, have diversified into pulse crops in order to avoid competing with subsidized American produce. Jennifer Fellows of the CFA calls this "very demoralizing – whatever you move into gets targeted by the U.S. government."[19] Robert Friesen of the CFA says the Farm Act threatens to substantially undercut their position. A relatively small increase in U.S. supply of these crops would likely cause a very large price drop.[20]

For Canadian farmers, COL is one of the most worrisome features of the Farm Act. In a November 9, 2001 letter to Senate Agriculture, Nutrition and Forestry Committee chairman Senator Tom Harkin, Canadian Ambassador Michael Kergin complained that COL would interfere with the growing integration of the North American cattle/beef and hog/pork industries. U.S. exports of cattle to Canada increased from fewer than 1,000 head in 1998-99 to more than 209,000 in 2000-01, mostly from northern plains states. Iowa and Minnesota hog operations import Canadian piglets to be raised in the United States. Under COL, none of the pork or beef from these integrated producers could be labeled as product of the U.S.A., which could dissuade "buy American"–oriented consumers from purchasing those products, with a potentially devastating impact on Canadian producers.[21] Moreover, the need to individually identify cattle and hogs prior to processing, and to keep detailed records, would impose additional costs.

On the potentially positive side, COL could give Canada an opportunity to differentiate its products from U.S. products and charge a premium. Some U.S. observers have said that for certain niche products the Canadian label could be attractive to U.S. consumers.[22] But this is by no means certain, and it is likely that U.S. consumers looking for the "Made in the U.S.A." label would far outnumber those desiring the "Made in Canada" label.

In another scenario, the costs and complexities of importing from Canada, due to the administrative burdens of COL, could dissuade U.S. packers from doing so. Canadian meat processors are concerned that U.S. stores and distributors may opt not to deal with non-U.S. products because of the likely obligations to maintain a separation between those products and U.S. products.[23]

Dr. Joe Rosario, Executive Director of the Alberta Agriculture Food and Rural Development Policy Secretariat, states that mandatory COL would restrict trade, particularly in livestock and red meats. He contends that mandatory COL does not address a public health or consumer protection concern but rather appears to be intended as a trade-restricting measure. He goes so far as to say that mandatory COL threatens to unravel an integrated North American market that has been highly beneficial to the meat and livestock sectors of both Canada and the United States.[24]

Implementation of COL will be exceedingly complex, based on widespread complaints raised by entities on both sides of the border. Rosario asks, "What label will apply to beef from an animal that was born in Canada but raised and slaughtered in the United States? What label will apply to pork from an animal that was born and raised in Canada but slaughtered in the United States?" He also raises the issue of records and audits of livestock producers to ensure accuracy of labels, as well as the types of records and procedures that would have to be used to follow meat through processing to show that it meets the "born, raised and slaughtered" definition. Additionally, segregation of animals and meat products may be required at the processing and retail levels. Ground beef is particularly challenging. It is often composed of fat trimmings from U.S. beef and lean meat from other nations, which raises the question of how it would be labeled.

Edouard Asnong, president of the Canadian Pork Council, states that the labeling would place the United States in violation of international law, which ensures fair and equitable treatment of imported and domestic products.[25] He also points to an important third-country element to this. The United States exports pork products that are derived in part from Canadian hogs and pork. He states that it is critically important that COL rules prevent Canada from being wrongly blamed as the source of, for example, a food safety problem where the contamination actually may have occurred in the United States.[26]

Even U.S. players are concerned. MartinHaggen, Inc. of Bellingham, Washington is one of many U.S. retailers that urged the United States Department of Agriculture (USDA) to hold suppliers, not just retailers, responsible for accurately determining the country of origin of meat, fish and produce. The company's general manager, Traci Aplin, states that retailers cannot determine where fruits or meats come from by looking at them; only suppliers can determine a product's country of origin accurately. Alpin warns the USDA that her company will not label voluntarily if it has to audit suppliers for the accuracy of country of origin and then be liable for their errors.[27]

Compliance with COL will cost an additional $1 billion for the livestock, red meat and supermarket industries in the United States, and another $60 million in annual oversight costs for the USDA.[28] Of course, consumers will have to pay more due to the reduced competitiveness.

Many U.S. livestock producers and their organizations have been seeking protection from imports of Canadian livestock and meat products for more than 20 years, prompting northern-tier state lawmakers to introduce the COL provision.[29]

The Third-Country Threat

According to various observers, the biggest potential problem for Canada involves U.S. exports to third-country markets where Canada competes. Canada could easily lose these markets as a result of subsidized U.S. products. The Farm Act expands assistance for foreign food aid and international market development. That implies depressed prices from more heavily subsidized trade promotion programs, against which Canadian products will have to compete.[30]

After years of declining export subsidies, the Farm Act keeps such subsidies at the same level as in the past year in order to combat "unfair trade practices". Mayer, Martin and Staciwa (2002) observe, "Implicitly, by defining these unfair trade practices, the U.S. is declaring its intent to use export subsidies in third-party markets to compete with Canada and other countries." A plausible scenario would be the United States using export subsidies targeted at third-country markets where it believes Canada or other countries are dumping their products, or at third-party countries where European regulations on genetically engineered products are perceived to be hurting the United States. In either scenario, Canada is hurt through "sideswiping".[31]

The export credit programs have been reauthorized, and repayment terms have been extended to one year from six months. Such programs enable U.S. exporters to more easily sell their products in countries that otherwise may not be able or willing to purchase them.

In addition to artificially low prices of U.S. export crops, third-country markets may also see new kinds of U.S. crops such as peas and lentils, due to the Farm Act's production incentives for these pulse crops, to the detriment of Canadian exporters.

Effects on International Trade

It appears certain that, when the subsidies take effect, the Farm Act will distort world commodity markets and hinder the ability of Canadian farmers to compete in domestic and world markets. Canada will be most affected by subsidies for corn, soybeans, wheat, and pulse crops.

The increased level of support implies higher production levels than would occur under market prices, creating overproduction, leading to an inefficient allocation of resources, and artificially driving down prices for subsidized products. U.S. farmers are insulated from market signals. The products are often dumped in international markets, often provoking trade retaliation and harming non-U.S. farmers. Moreover, subsidies can lead to vicious circles. By lowering prices, they in turn spawn more subsidies. Farmers worldwide often suffer the consequences: subsidies frequently provoke other countries into enacting tariffs, hurting farmers who produce for export. In Mexico, for example, President Vicente Fox is expected to implement taxpayer subsidies to increase production and add "antidumping" tariffs to keep out subsidized imports from the United States.[32]

A study sponsored by the government of Australia found that cutting global trade barriers and subsidies to agriculture by half would raise global welfare by $89 billion a year, and completely eliminating them would raise global welfare by $150 billion.[33]

Subsidizing agriculture is an indirect form of trade protection; since foreign producers cannot match the subsidized price, they are prevented from exporting to the subsidizing country. "That bill could be the final shot that pushes a world already edgy about increased U.S. protectionism into a trade war," observes Fred McMahon.[34]

During earlier trade negotiations the United States has been particularly vocal about reducing subsidies, tariffs, and nontariff barriers. The Farm Act, however, could damage the credibility of the United States in future negotiations and hinder its leadership position. As a specific example, the United States has been trying to get the EU's genetically modified labeling plans designated as a nontariff trade barrier. However, COL – widely perceived as a nontariff barrier itself – would substantially weaken the impact of the United States' arguments regarding this measure.[35] The Government of Alberta admonished the USDA that adoption of mandatory COL by the United States will weaken the position of both countries and that food labeling regulations must be based on science.[36]

Given the United States' importance in overall world trade and its role in the negotiation process, the entire trade round could break down – affecting not only agricultural trade but non-agricultural trade as well. This is even more alarming given that major progress in the agriculture part of WTO negotiations was planned for 2002.

In addition to jeopardizing negotiating lower tariffs among WTO countries, the Farm Act could harm progress toward a Free Trade Area of the Americas.[37] A stated U.S. objective is to eliminate all export subsidies within an FTAA, yet the Farm Act will likely make it much more difficult to convince other countries to do so. The Farm Act will particularly affect Mexico and Latin America as a whole, since such significant percentages of their populations are in agriculture.

While implementation of the act may manage to avoid technical violations of WTO (or NAFTA) rules, observers insist that the provisions of the act contradict much of what the WTO is attempting to do. These provisions include imposing new trade barriers such as COL, increasing domestic support to farmers and thereby distorting production and trade, aggressively applying export subsidies, and using food aid as a form of dumping.[38]

The Farm Act will likely give other OECD nations an excuse to slow or halt their own reforms, arguing that they need protection from subsidized U.S. exports. Already, the European Union is considering increasing its own agricultural subsidies.[39] Canadian groups are seeking an additional C $1.3 billion in farm support.[40]

Potential Canadian Responses

Canada is one of several countries considering a WTO complaint regarding the Farm Act. The question arises as to whether Canada will be successful in seeking redress with the WTO. It cannot do so until the provisions in question take effect and actual harm to Canadian producers has occurred. Because of the currently high market prices of wheat and oilseeds, it may be several years before this happens. Moreover, once the relevant provisions take effect, there is debate as to where Canada's complaints could be targeted. Some analysts state that the amount of subsidies for American farmers contained in the act is consistent with WTO guidelines; the Farm Act aims to increase subsidies only up to a point, in order to conform to WTO rules. It may not violate WTO guidelines unless "cheating" takes place.[41]

The potential for WTO or NAFTA violations lies more with COL, where Canada could have a possibility of a complaint. For example, COL may require country-of-origin labels on products that cannot be easily labeled.[42] Apart from filing WTO or NAFTA complaints, Canada could respond unilaterally as well. For example, it could consider enacting countervailing duties on imports of U.S. agricultural products for its marketing loan program. However, as Mayer et al. posit, that cure may be worse than the disease. A countervailing duty on grain would harm Canadian livestock producers, who are large consumers of feed grains. COL would exacerbate their situation.[43]

Canada also could provide direct compensation to farmers. The risks of this include provoking retaliation by the United States. However, if such a measure were taken, it would likely end up capitalized in Canadian land values.[44]

Coordinated multilateral retaliation is another possible measure, in which Canada would be a part of a coordinated retaliation with other countries, in order to prompt a change in U.S. policy. Risks of this include provoking no change in U.S. policies, thus making everyone worse off than before the retaliation. It could also provoke counter-retaliation, further exacerbating the situation. Alexandra Lamont of the Canadian

Wheat Board says Canadian officials "are keeping their cards close to their chest" regarding what action the Canadian government may or may not take. As stated above, no action can be taken until the Farm Act's provisions take effect, and once that occurs, it has to be demonstrated that harm has been done.[45]

Conclusion

Apart from the likely scenario of harming Canadian farmers due to subsidized prices in both domestic and export markets, the U.S. Farm Act is a setback for the free flow of trade as well. While the act imposes no new explicit tariffs on imports into the United States, the subsidies associated with the act will set back the cause of trade liberalization. In the push for free trade, subsidies can be as potent an obstacle as tariffs. Subsidies often have the effect of inducing foreign governments into erecting new trade barriers in order to offset the price of the subsidized imports, or dissuading foreign governments from dismantling existing barriers. The Farm Act appears to be producing this effect in the current round of WTO negotiations.

It is too early to predict whether Canada will countervail imports of subsidized U.S. farm products, but chances are, it will not. As Toronto-based international trade lawyer Jon Johnson says, "The Americans can hurt us a lot more than we can hurt them."[46] The market power of the United States, the size of its economy, and above all, the political clout of the farm lobby make it very unlikely that Canadian countervailing duties or the threat of them would prompt the United States to revisit some of the Farm Act subsidies. For this reason, any retaliatory action on Canada's part would likely result in a lower overall level of trade between the two countries.

However, multilateral action by Canada, the European Union, and other countries could very well prompt the United States to modify some provisions in the Farm Act. While it is doubtful that such action could bring about a rollback in subsidies, some modification of COL provisions is not out of the question.

In the push for greater trade liberalization, international cooperation and smooth working relations among nations are paramount. The Farm Act, unfortunately, introduces myriad irritants in trading relations not only between the United States and Canada, but also among the United States, Canada, and the rest of the world. It could poison the overall atmosphere, with a devastating impact not only on trade in agricultural goods, but on trade in nonagricultural goods as well. The potential effect on trading relations shows that the push for free trade is about much more than dismantling trade barriers. It is about dismantling subsidies as well.

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