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Liberalized trade between Canada and the United States is a subject of great debate. The proposal which has been put forward by politicians on both sides of the border is that freer trade between Canada and the United States should occur and that large economic benefits will result. This paper focuses on Canadian/U.S. trade relations in agriculture and it identifies important issues that will surface during free trade negotiations.

As this paper shows, it may be extremely difficult to achieve more liberalized trade in agricultural products because of the nature of Canadian institutions. For example, many segments of Canadian agriculture are governed by supply managed marketing boards. These boards control both output in Canada and the volume of imports from the United States. These boards have not only curtailed the volume of trade but have also distorted resource use within Canada. There are many cases in which comparative advantage within the domestic economy is not realized because several provinces are striving for self-sufficiency in specific commodities. If interprovincial trade barriers were removed in Canada, one would have a much greater degree of regional specialization and trade than what currently exists. Freer trade among provinces may generate as much economic gain as more liberalized trade between the U.S. and Canada.

Agricultural products are an important component of Canadian/U.S. trade. Canada ranks as one of the top five customers for U.S.

agricultural products. More important for Canada, however, is the fact that the U.S. ranks as the largest market for Canadian agricultural products, receiving shipments valued at $1.5 billion ($ U.S.) in 1984 (Table 1). Canada experiences a large agricultural trade imbalance with the U.S. The Canadian trade deficit was an average of $1.4 billion per year in the 1975-79 period, increasing to $2.0 billion in 1981 and then declining to $1.4 billion in 1984.

1. The Regulation of Interprovincial Trade

In discussing the costs and benefits of freer agricultural trade with the United States, it is important to recognize the extent to which agricultural trade is currently restricted among the various provinces in Canada. As an illustration of the extent of government involvement in Canadian agriculture, Table 2 gives a breakdown of Agriculture Canada expenditures for 1981-82.

The dairy program receives the greatest expenditure because this industry is highly subsidized. However, expenditures by Agriculture Canada do not account for all federal spending on agriculture. There are large federal outlays made by Transport Canada, the Department of Regional Economic Expansion, Industry Trade and Commerce and External Affairs. The regulated rates in rail shipment constitute an appreciable subsidy to prairie grain since the federal government now pays what is called the Crow gap and which amounts to an annual payment of $650 million.

In contrast to dairy and grains, federal expenditures on beef and hogs are relatively minor. Perhaps this explains why there are a variety of provincial government programs for these sectors. The

number of provincial programs supporting the red meat sector has grown significantly. Most provinces have at least some form of a Red Meat Stabilization Plan in place. In addition, other factors influencing red meat production and trade include tax credits for feeding cattle and livestock feeder associations through which low interest loans can be obtained (Rosaasen and Schmitz).

Government expenditures on agriculture give only a partial indication of income transfers to agriculture. Producer transfers via supply managed commodities are affected by restrictions on imports and domestic production. Though these transfers do not show up in government expenditures, they are real transfers which affect consumers directly via higher prices. These are, in essence, hidden subsidies. Studies which have estimated the general order of magnitude of these transfers have found them to be substantial. For example, for the dairy industry, it has been estimated that in the mid to late 1970s, the consumer costs associated with such transfers were two to three times the size of the government expenditures reported for the sector in Table 1 (Josling). For poultry products, the consumer costs of egg regulation have been estimated to range between $39 to $100 million for 1979 and these can be compared with farm cash receipts for eggs of $340 million in that year (Veeman, 1982; Schmitz, 1983b).

Regional patterns of trade have also been directly affected by government intervention in the case of poultry and dairy products. The national supply control programs for these products involve the determination of national quotas and the division of these quotas

among provinces. Although a number of economic features are listed as guides to the allocation of quotas among provinces for the poultry marketing plans, reallocations reflect provincial negotiating power rather than economic criteria. These features have likely impeded the transfer of quota toward low cost producing areas.

> "The tendency for political pressure towards self-sufficiency on a provincial level may be expected to lead to higher cost levels of the producing sector with consequent loss of the benefits of regional specialization in trade. The result has been a general tendency for supply deficient provinces to become more self-sufficient since the supply controlling programs for poultry products have been introduced. There is evident pressure also for reallocation of quota to provinces where there has been more rapid population and income growth and consequently more rapid increase in consumption levels. These pressures are in the interests of local producers but are not necessarily consistent with comparative advantage." (Veeman, 1983, p. 66).

These observations indicate that the regional nature of Canadian domestic farm policy is potentially a major constraint to the establishment of freer trade between Canada and the United States. Not only is the Canadian government perceived as favouring agricultural development in central Canada and the Maritimes, but several provincial governments are subsidizing agricultural production in order to achieve self-sufficiency. Provinces freely construct nontariff barriers to protect their own industries and the net effect is the balkanization of Canadian agriculture. The swine industry perhaps best illustrates this problem. Largely due to government programs, western Canada's share of national hog production declined from 46 percent in 1971 to 30 percent in 1984. During the same

period, eastern Canada's share increased from 54 percent to 70 percent (Carter, et al.).

2. Institutions and Government Policy

Canada has a somewhat unique set of institutions which impact significantly on the Canada - U.S. free trade initiative in agricultural products. A major institution governing international trade in grains is the Canadian Wheat Board. The major agricultural commodity exported from Canada is grain and the Canadian Wheat Board is the sole exporter of wheat and feed grains. The Canadian Wheat Board also, through its import licensing system, restricts the importation of grains. The free movement of grain between the United States and Canada would seriously bring into question the future role of the Canadian Wheat Board and thus the entire grain marketing system in Canada. With a free trade zone, the Canadian Wheat Board would have extreme difficulties in carrying out its current marketing programs where one of the key items involves the use of producer marketing quotas. In addition, under a free trade arrangement in grains, it could well be that a portion of Canadian grain would be shipped to export markets via the U.S. rail and barge system. This would certainly cause concern to the Canadian National and Canadian Pacific railroads in Canada and it would also result in a lower volume of traffic on the St. Lawrence Seaway. There is very little movement of grains between the United States and Canada under the current system. This is partly due to the low number of import licenses granted by the Canadian Wheat Board. However, there is a sizable export trade of malt barley from Canada to the United States. Corn is

allowed into Canada under a small tariff but most of the corn has been imported into eastern Canada.

In dealing with international trade between the United States and Canada, one cannot underestimate the role and political strength of institutions, some of which have been mentioned above. It is not merely a matter of removing or reducing tariffs on imported goods into Canada in order to achieve more liberalized trade. Many of the commodities imported into Canada are regulated through the above institutions via quotas. If these quotas are substantially reduced then the entire institutional structure comes under serious challenge. For example, with zero quotas on eggs, broilers, dairy products, etc., it would be extremely difficult for marketing boards to operate since they achieve part of their strength through their control of imports. They also regulate interprovincial trade. Therefore, if these bodies were removed, not only would the pattern of trade change between the United States and Canada, but there would likely be a significant change in the pattern of international trade and regional specialization within Canada.

In addition, if freer trade in grains between the United States and Canada necessitated the elimination of the Canadian Wheat Board, one is reasonably sure that freer trade in grains would not happen. Regardless of its strengths and weaknesses, the Canadian Wheat Board is a very popular institution among the majority of grain farmers in Canada. This is not to say an arrangement could not be worked out which modified the Canada Wheat Board's authority. For example, the

Canadian Wheat Board could possibly become the marketing agency for both U.S. and Canadian grown spring wheat.

Provincial red meat stabilization policies also involve producer subsidies in Canada. In the case of hogs, the United States levied, in 1985, countervailing duties on the importation of live hogs from Canada into the United States. After a complaint was filed by the Iowa Hog Producers and other groups in the United States, the U.S. Commerce Department investigated the extent to which the Canadian hog industry was being subsidized in Canada via red meat stabilization programs. The Commerce Department ruled that there were significant production subsidies in Canada. The International Trade Commission heard the case to determine whether or not these subsidies were creating significant economic hardship to the United States hog producers. The Commission ruled that injury was being done and, therefore, a countervailing duty of five cents per pound on live hog shipments into the United States was imposed (Schmitz and Sigurdson). In this regard there has been concern expressed by the Canadian cattle industry that further stabilization programs for beef in Canada could well lead to countervailing action on the part of the United States.

Most of the above discussion has focused on Canadian policies. The U.S. government also has numerous subsidy programs and trade restrictions in force in agriculture. The most obvious examples of where the U.S. regulates imports to support its domestic industry are in sugar, tobacco and dairy products. Transportation subsidies are less direct than the Canadian freight assistance programs but there are significant federal subsidies involved in the construction and

maintenance of internal waterways in the U.S. Heavily subsidized irrigation programs are used in the U.S. to expand agricultural production of grains, livestock, fruits and vegetables that compete with Canadian production. Another major issue is the size of the deficiency payments U.S. wheat, corn, soybean and cotton farmers receive from the USDA when market prices are low.

3. Market Size, Economies of Scale and Costs of Production

The U.S. market is significantly larger than Canada's and this fact has important implications for freer trade between the two countries. As an illustration, a major product shipped from Canada to the United States is red meat. Until recently, pork and live hogs entered the United States essentially duty free, however, nontariff barriers existed. For beef, there are no restrictions on the exportation of live animals from Canada except for nontariff barriers. However, there is a quota on the amount Canada can export in terms of processed beef to the U.S. market. Recently this quota has not been binding because Canada's exports of beef products have not reached the quota limit (Schmitz, 1984).

In terms of the North American beef and pork industry, Canada is essentially a price taker in that it can increase output without significantly affecting the North American price. This is because U.S. imports of pork and beef from Canada represent a very small percentage of their domestic production. Thus, under freer trade in these products it is unlikely that the U.S. producers would suffer greatly from Canada's greater access to their markets.

On the other hand, consider those products which could potentially be exported from the United States to Canada in a freer trade regime and a different picture emerges. For example, it is likely that the egg and broiler industry in Canada would come under significant short-term pressure. Unless Canadian producers become more efficient through larger scale operations, the size of the Canadian industry would probably be reduced significantly. This would have a significant impact on the Canadian producers since a small increase in U.S. production and hence a large increase in exports from the U.S. to Canada represents a large percentage of total Canadian production. As with beef and pork, in a truly free trade arena, Canada would be a price taker with respect to the major import goods, including eggs and broilers. In other words, in a truly free trade arrangement between the U.S. and Canada, the U.S. would have market power (because of its relative size), whereas Canada really has no market power and, therefore, ends up as a price taker.

It is interesting that at the present time Canada does not fill its export quotas on beef shipments into the U.S. market. This implies that under present prices, beef is not a highly profitable industry. Otherwise, expansion in Canada clearly would take place in order to increase its exports into the U.S. market. The profitability of the North American red meat industry has been under serious pressure for the last several years. This has very little to do with United States - Canada trade relations, however. It has more to do with Japanese import quotas and European Economic Community subsidies

along with decreasing per capita consumption of red meats (Kerr and Ulmer).

In the large U.S. markets there are opportunities to exploit economies of scale. For example, in the egg industry there are now several producers in California which have over two million laying hens. It is easy for these organizations to increase output in order to meet the Canadian demand. Part of the costs of production are influenced by economies of scale and, therefore, for the Canadian industry to compete it would have to increase the size of operations significantly. However, if it does so in order to meet U.S. competition it will end up with fewer producers.

In dairying, in the U.S., there is a significant difference between the structure of the dairy industry in California and Arizona and that in the Mid-west. Many of the herds in California are 20 times the size of those in the Mid-west. This can partly be explained by geography and other factors including the highly regulated milk trade in the U.S. Because of marketing orders, the interstate flow of milk is as highly regulated in the U.S. as it is in Canada.

Why is there such a difference in the structure of the dairy industry, by state, in the United States? Secondly, what would happen to the industry if U.S. - Canadian barriers to milk trade and related products would be removed? If at the same time interprovincial and interstate barriers were removed, a significant structural change would occur. It is our hypothesis that unless the Mid-west drastically changed its structure and thus lowered its cost of production, that production would shift to the western United States

in spite of the increased transportation charges which would accompany such a restructuring. Also, if interprovincial barriers were removed in Canada, along with freer trade between Canada and the United States, the Canadian dairy industry would become more concentrated and more efficient that currently is the case. It is doubtful that the average size of dairying in Canada could survive against competition from California. Many of the California dairies are at least 10 times the size of those in Canada. However, as in the case with eggs and broilers, once rationalization occurs and the average size of a firm increases, relatively few dairy producers are needed to satisfy the Canadian milk market.

Barichello and Warley indicate that Canadian farmers would suffer under a freer trade arrangement with the U.S. in the areas of eggs, broilers and dairy. However, whether this is the case in the long-run is not clear. They would certainly incur economic losses in the short-run but restructuring might well occur to meet the competition from the U.S. This is an area that needs further work to determine if there are economies of scale of production in Canada, and if economies of scale do exist, why haven't they been achieved in the past. In addition, using the "X inefficiency argument," one could perhaps make the case that Canada could meet the competition from the United States in products such as eggs, broilers and dairy.

4. Canada's Comparative Advantage

When discussing free trade between the United States and Canada in agricultural products, the question has to be asked as to what Canada has a comparative advantage in. This is extremely difficult to

determine, especially if one is going to give serious consideration to the institutions and other factors already mentioned. Unless Canada has some advantage over the U.S. in producing agricultural products, there will not be significant expansion of exports to the United States under a free trade initiative. To examine this in detail is beyond the scope of this paper. However, a few examples will suffice to illustrate the complexity of this issue. Several studies have concluded that there is a significant potential for increased beef exports into the California market (e.g., Dawson, Dau and Associates). As already indicated, if this is true, why hasn't the current U.S. quota been filled? In addition, even though California has over 25 million people, it has a vast area suitable for livestock production. Therefore, one asks the question as to where does Canada obtain an advantage in the production of beef over California production or Californian imports of beef from other parts of the United States. One factor has to be the existing exchange rate which has enhanced Canadian agricultural exports to the U.S. market. However, if the exchange rate should once again approach par, this would have a serious negative impact on beef exports in the United States. Currently, some of the largest feedlots in the world operate in the U.S., including California. Therefore, given the relatively small feeding operations in Canada, the question arises as to whether or not Canada can expand its trade into the U.S. market. In the U.S., if red meat prices were to increase significantly, a major improvement would take place in pasture management of public lands in the U.S. The

reason this is not occurring is because of the low profitability of the North American beef industry.

In this regard, one can hypothesize that Canada may have a good future in expanding exports to the U.S. because of opportunity costs. Given the opportunities that exist for off-farm exployment in California, the level of profitability in beef production will have to be relatively high in the future otherwise producers will seek off-farm employment and de-emphasize the livestock industry. In many regions in Canada, off-farm employment does not offer as great an opportunity as in the United States and, therefore, in terms of costs of production Canadian production costs may well be lower than in the United States.

In terms of the current trade pattern, much of the trade between the United States and Canada, excluding red meats, is in commodities which, because of climate, Canada cannot produce. Fresh fruits and vegetables enter Canada from the U.S. in large volumes and this trade will continue in future years regardless of trade barriers.

5. Gains From Liberalized U.S. - Canadian Agriculture Trade

Deloitte, Haskins, Sells and Associates have estimated the direction of effect and various implications for greater liberalized agricultural trade between the U.S. and Canada. This information is provided in Table 3. As the table indicates: the beef and pork sectors of Canada will gain; the sheep industry will not be affected; the chicken and turkey industry will be negatively impacted; there will be no effect on the wheat economy; the feed grain sector will

lose; canola, flax and rye, along with mustard, pulses and specialty crops will gain. The net gain from trade approximates $60 million per annum. This is an underestimate of the true gains, however, as consumer welfare changes were not calculated by Deloitte, Haskins and Sells.

In evaluating these results, questions on the grain trade arise. As pointed out earlier, wheat will be unaffected if controls remain on the importation of wheat from the United States and grain is not allowed to be shipped to foreign countries through the United States. In addition, if the Canadian Wheat Board remains intact, in its present form, wheat would be unaffected. However, it the free flow of wheat was allowed to occur between the United States and Canada, along with the free flow of shipping activities, then the wheat sector would certainly be affected. The direction of the gains in wheat are uncertain, however, it is our belief that there would be gains in the trade of feed grains. This is contrary to the result reported in Table 3. In addition, it is still open to question, for example, whether or not the poultry industry would be negatively affected. It certainly would be in the short-run, but in the long-run, because of economies of scale in production, the Canadian industry may well become rationalized to the point that producers in Canada could compete with U.S. producers. However, this would require increased concentration and regional specialization within Canada.

6. The U.S. Agricultural Economy

Currently, as a result of the 1985 Farm Bill, the U.S. grain sector receives substantially greater subsidies than does the grain

sector in Canada. Canada has to compete in the world market against countries such as the U.S. and since the U.S. lowered the loan rate as part of the 1985 Farm Bill, Canadian wheat prices will drop in accordance with the U.S. loan rate. This raises the important question as to what role subsidies in the U.S. play in a U.S.-Canadian free trade arrangement. For example, if subsidies remain or are increased, Canadian grain producers are in a disadvantageous situation because of the relative sizes of the treasuries in the two countries. The situation could arise whereby millers in Canada could purchase relatively cheap wheat from the U.S. where production is highly subsidized. The current two-price system for Canadian wheat could not function under a free U.S. - Canadian trade agreement.

In the example referred to earlier concerning the hog countervail duty, the issue was not the extent to which American hog production was being subsidized but rather the extent to which Canadian hog production was being subsidized. Clearly, in a free trade arrangement the question then has to become one of not only subsidies through stabilization schemes in Canada but also subsidies in the United States via, for example, the relatively cheap feed grains brought about by the U.S. farm policy.

Not only do subsidies exist for grain producers in the U.S., the dairy industry, like Canada, is also highly subsidized. Livestock production in the U.S. is also subsidized since a large percentage of ranching is done on public lands where grazing fees are extremely low. However, in the U.S. the egg and broiler industries subsidies are relatively small.

7. Summary and Conclusions

Currently, the major trade in agricultural products between Canada and the U.S. is in red meats, followed by fresh fruits and vegetables. Very little trade occurs in eggs, broilers and dairy products. There is essentially no trade in wheat but there are exports of malt barley to the United States. Corn and oilseeds are imported into Canada. In the red meat trade, quotas exist on Canadian shipments of beef products into the United States but at the present time this quota is not being filled. Recently, in the hog trade, countervailing duties were imposed by the U.S. Canada imports fresh fruits and vegetables from the United States because, in many instances, she cannot produce these on a continuous basis. Therefore, in considering freer trade with the United States and the gains from trade, it might be difficult to imagine that the gains from liberalized trade would be substantial. If gains are to be made, they are likely to come about in expanded livestock trade and perhaps in eggs, poultry and dairy products. Gains in the grains and oilseeds area would be relatively small. The Canadian Wheat Board will remain the key marketing institution in Canada for the exportation of wheat and barley and, therefore, freer trade negotiations with the Americans have to take this into account. In addition, unless freer trade in supply managed commodities is realized within Canada, the possibility of more liberalized trade with the U.S. is not likely to happen.

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Table 1

U.S. - Canada Agricultural Trade
1984

Commodity	U.S.		Canada Share		Canada		U.S. Share	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
	---million $---		----percent-----		---million $---		----percent-----	
Animal Products	4,228	4,076	8.0	23.7	1,548	778	47.7	56.2
Beef and Cattle	526	1,514	9.9	21.9	356	242	88.7	46.3
Meat	470	1,228	9.6	11.6	147	214	93.2	39.4
Live Animals	56	286	12.5	65.7	208	28	85.6	100.0
Pork and Hogs	121	911	13.3	45.9	493	23	79.5	67.7
Meat	113	755	13.3	34.7	337	23	70.0	67.7
Live Animals	8	156	0	100.0	156	0	100.0	0
Poultry and Eggs	415	118	17.6	22.9	38	85	53.1	98.2
Dairy Products	373	773	2.7	7.4	186	87	5.8	12.4
Grains and Feeds	17,162	566	1.3	46.3	4,666	346	5.4	84.8
Oilseeds and Products	8,392	87	3.1	52.9	908	436	8.4	84.1
Horticultural Products	2,849	3,129	28.1	5.0	318	1,686	49.0	65.2
Sugar and Products	136	1,442	24.3	6.4	51	176	91.0	14.0
Wine and Malt Beverages	64	1,557	23.5	9.2	375	NA	37.6	NA
Cotton	2,441	5	3.3	0	0	94	0	95.3
Tobacco	1,511	558	0.4	3.4	86	8	24.3	80.0
Other	1,042	7,904[a]	26.5	1.2	435	1,289	80.7	43.4
Total	37,825	19,324	5.2	9.6	8,387	4,719	24.0	59.1

[a]Mostly noncompetitive agricultural products. NA is not available.

Source: USDA. World Agriculture Outlook and Situation Report (Washington, D.C.: Economic Research Service), WAS-42, December 1985.

Table 2

Agriculture Canada Expenditures, 1981-82
Canada, by Province

Type of Expenditure	Nfld.	P.E.I.	N.S.	N.B.	Que.	Ont.	Man.	Sask.	Alta.	B.C.	National Capital Region[a]	Canada
	(million dollars)											
Administration	-	-	-	0.62	0.63	0.74	0.55	0.42	0.45	0.23	36.54	40.18
Research	1.62	4.49	6.52	6.47	15.18	34.32	10.30	16.44	23.65	8.04	32.50	159.58
Crop Insurance	0.01	1.11	0.20	0.51	[b]	15.99	11.23	52.86	31.92	2.13	-	115.86
Advance Crop Payments	-	0.45	0.19	0.47	2.20	2.54	0.31	-	0.13	1.46	-	7.75
Stabilization[c]	0.27	5.16	2.55	4.51	44.90	42.33	10.03	6.13	13.18	8.68	-	137.74
Dairy Program	-	5.38	3.94	3.22	141.22	91.94	10.63	7.18	17.98	9.64	10.38	301.51
Food Inspection	1.70	3.29	3.50	6.05	34.51	38.43	10.44	8.94	19.30	13.04	30.81	169.51
Grain Inspection	-	-	-	-	2.47	11.23	9.70	0.82	0.98	5.78	-	30.98
Grain Embargo	-	0.01	0.02	0.02	0.94	7.13	9.92	39.16	20.88	0.63	0.53	79.24
Feed Freight Assistance	-	-	-	-	8.79	0.13	-	-	-	0.30	-	9.22
Livestock Feed Board[d]	1.23	2.53	1.73	0.57	4.97	0.65	0.03	-	0.01	5.78	-	17.50
Other Expenditures	0.09	0.39	0.64	0.24	4.76	5.34	8.58[e]	1.04	1.31	3.82	29.31	55.52
Total Expenditures	4.92	22.81	19.29	22.68	260.57	250.77	81.72	132.99	129.69	59.53	139.57	1,124.54

[a]Includes expenditure outside Canada and program storage, interest and other expenditures not allocatable by province.
[b]No payment pending signing a federal-provincial agreement.
[c]Agricultural Stabilization Act payments, excluding dairy payments.
[d]Mainly contributions to feed transport costs.
[e]Includes a 6.4 million grant to Canadian Cooperative Investments Ltd.

Source: Agriculture Canada. Selected Agricultural Statistics, Canada and the Provinces (Ottawa: Supply and Services Canada), Regional Development Branch, 1983, p. 81.

Table 3

Estimated Effects of Free Trade Between Canada and the U.S.A. in 1995, Selected Agricultural Commodities Prairie Provinces[a]

Commodity	Direction of Effect	% Change in Production in 1995	1983 Prairie Farm Cash Receipts[b]	Change In Farm Cash Receipts[c]
			-$ million--	$ million
Beef[d]	+	12	1,690	200
Pork[d]	+	2	433	9
Sheep	0	0	9	0
Chicken and Turkey	-	-80	150	-120
Wheat	0	0	4,118	0
Feed Grains	-	-6	906	-53
Canola[d]	+	3	712	21
Flax	+	1	151	1
Rye	+	1	60	1
Mustard, Pulses and Specialty Crops	+	1	99	1
Total	+	1	8,328	60

[a]Excludes impact on input and value added (processing and distribution) industries.

[b]From Canada Grains Council, Statistical Handbook 84, and Alberta Agriculture.

[c]Impact after an adjustment period (1995), values are constant (1983) dollars. See commodity sections for details.

[d]Includes anticipated increase in sales in the current trade environment (Option B, Status Quo), of 5% for beef, 2% for pork and 2% for canola. The incremental impact of free trade is therefore 7% for beef, no change for pork and 1% for canola.

Source: Deloitte, Haskins, Sells and Associates. Canadian Agricultural Trade Issues, July 1985.