Impacts of the United States and Canada Free Trade Agreement on the United States Economy

Won W. Koo

Canada is the largest trading partner of the United States. In 1985, United States merchandise exports to Canada were $53 billion, while Canada's exports to the United States were $69 billion. Trade of agricultural products between the two counties has been relatively small compared to that of manufactured products. In 1985, United States exports of agricultural products were $1.7 billion while imports from Canada were $1.9 billion (Table 1).

About 70 percent of goods traded between Canada and the United States now enters the other's market duty free. On the remaining 30 percent, Canada applies duties nearly twices as high as the United States. United States tariffs apply mostly to Canada's high value-added exports. The current average tariff rate imposed on United States commodities by the Canadian government is about 10.4 percent of the values of the products while that imposed on Canadian commodities by the United States government is about 6 percent.

The United States and Canada agreed on the elements of a new bilateral Free Trade Agreement (FTA) on December 10, 1987. Under the agreement all tariffs and nontariff barriers imposed on commodities traded between the United States and Canada will be phased out. The objective of this agreement is to stimulate both countries' economies.

HOW THE AGREEMENT AFFECTS TARIFFS

Commencing January 1, 1989, the United States and Canada will begin to phase out all tariffs which each country applies to the other's trade. Under the FTA, this process will be completed by January 1, 1998.

Some tariffs will be removed immediately when the FTA comes into effect January 1, 1989. The commodities affected are cattle, fish, most forms of leather, fur and fur coats, and computers and related products.

Other tariffs will be removed in five equal steps over the period to January 1, 1993. Included in this group are various meat and fish products; chemicals; hardwood, plywood, and other wood products; a range of machinery and equipment; telecommunications equipment; and some petroleum products.

The other tariffs will disappear in 10 annual cuts to January 1, 1998. These include tariffs on most agricultural products, textiles, apparel, steel and steel products, transportation equipment, appliances, and most finished goods.

Koo is professor, Department of Agricultural Economics.

Table 1. The Values of Agricultural and Nonagricultural Commodities Traded.

Year	U.S. Exports to Canada		U.S. Exports from Canada	
	Ag	Non-Ag	Ag	Non-Ag
	(U.S. $ Million)			
1972	843.9	11,237.6	353.8	14,555.2
1973	1,034.5	13.771.2	529.5	16,913.4
1974	1,279.5	18,284.0	529.6	21,394.8
1975	1,305.4	20,053.0	491.4	21,678.4
1976	1,492.9	22,105.6	603.3	26,223.5
1977	1,550.4	23,473.1	688.9	28,666.8
1978	1,634.7	25,984.6	779.8	33,865.6
1979	1,650.0	30,511.5	960.5	37,138.7
1980	1,851.7	32,250.4	1,070.9	40,384.5
1981	1,988.9	36,308.6	1,167.1	45,246.6
1982	1,805.0	30,697.0	1,385.6	45,091.3
1983	1,830.3	35,087.1	1,501.5	50,628.3
1984	1,983.0	52,101.0	1,736.0	65,894.0
1985	1,727.0	52,152.0	1,908.0	70,265.0

Rules of origin are necessary to ensure that the benefits of the FTA are limited to the United States and Canada. To qualify for duty-free crossing of the United States-Canada border, material or goods must be produced or processed in either country. In certain cases, there will also be a requirement that 50 percent of the total direct manufacturing cost be United States and/or Canadian.

The new FTA sets up a United States-Canada trade commission to govern the whole agreement and resolve trade problems as they arise. The countries agreed on a unique new way to settle disputes. The commission may refer trade disputes to special panels for binding decisions.

Either country can also request a panel to examine future changes to dumping and countervail laws. Dumping involves selling goods in another country at lower than the fair market price in your own country. Countries impose countervailing duties when they judge that imports have been subsidized unfairly. Under the FTA, neither country will pay subsidies on exports to the other.

WINNERS AND LOSERS

Both countries will get benefits from the FTA. There will be increases in trade volume between the two counties as a result of the FTA. The prices of commodities traded will decline because of the elimination of tariffs. This implies that consumers in both countries will benefit. The elimination of tariffs will also lower the prices of production factors in the manufacturing industry. Business sectors in both countries, therefore, will be more efficient and competitive in the world market. This indicates that the FTA will not only increase trade volume between two countries but also increase exports to third countries.

Each industry has its own unique characteristics in terms of factor intensity and endowments, indicating that impacts of the FTA on one industry could be different from those on another industry. Impacts of the FTA, therefore, are analyzed in more detail for agriculture, energy, and forest industries.

Agricultural Industry

United States farmers, food processors, and consumers will all get benefits from the FTA. However, the benefits given to food processors and consumers will be generally greater than those given to producers. The United States' agricultural exports to Canada include fruits and vegetables, oil seeds, vegetable oil, and protein meal, while the United States' imports from Canada are grain (mainly wheat), meat, fruits and vegetables, sugar, and wine and malt beverages (Tables 2 and 3). Under the FTA, there will be increases in trade volume of these agricultural products between the United States and Canada, resulting in more competition in both countries. This means lower prices for these products to consumers in both countries. The United States and Canada will have more secure access to the other countries' markets. This implies that producers must improve production efficiency to maintain and/or expand their market shares under the FTA. If producers in a region in the United States have a comparative advantage over those in Canada in producing a particular commodity, these producers can expand their market shares in Canada. Meanwhile, if Canadian producers have a comparative advantage over producers in the United States in producing other commodities, these Canadian producers should be able to expand their market share in the United States under the FTA.

Food tariffs will be removed over a 10-year period, indicating that food produced in the United States will be more competitive in the Canadian market. There will be a substantial increase in United States exports of food products after the removal of the tariffs.

Fresh fruit and vegetables grown in the United States will have more secure access to the Canadian market. The FTA allows a 20-year adjustment period in which tariffs can be reimposed on temporarily under-deprssed price conditions. United States future exports of fruits and vegetables, however, will be larger under the FTA.

United States exports of poultry and dairy products will be increased after the removal of tariffs under the FTA, although Canada will maintain its global import quotas on poultry and eggs.

Trade of beef, veal, and hogs will not be impeded by the United States Meat Import Act because both countries have agreed to exempt each other from meat import laws. However, Canada may not be able to increase its exports of beef, veal, and hogs to the United States markets without the export subsidies which the Canadian government frequently provided to its exporters. Under the FTA, neither country will pay subsidies on exports to the other.

The United States and Canada are the largest and second largest wheat exporting countries in the Western World. Canada produces hard red spring and durum wheat. Saskatchewan, Alberta, and Manitoba are major wheat-producing provinces in Canada (Figure 1). The Northern

Table 2. Values of United States Exports of Agricultural Products to Canada.

	1982/83	1983/84	1984/85	1985/86
	(1,000 dollars)			
Total	1,869,709	1,936,092	1,727,397	1,466,003
Rice	43,231	43,974	42,779	31,789
Coarse grains	43,847	40,786	53,284	28,472
Feeds and fodders	52,573	48,509	46,351	47,617
Fruits, vegetables, and nuts	720,048	714,260	583,177	546,388
Oilseeds	94,090	100,431	55,148	45,379
Protein meal	94,114	111,612	100,221	123,438
Vegetable oils	30,762	39,067	41,524	22,472
Cotton	77,934	77,436	63,032	20,468
Tobacco	14,305	7,348	5,262	2,077
Animal fats and oils	8,543	12,626	11,736	7,205
Dairy products	14,628	10,106	10,687	9,034
Poultry meat	27,160	40,790	34,157	31,460
Meat	67,864	84,276	74,375	53,545

SOURCE: Foreign Agricultural Trade of the United States, U.S. Department of Agriculture.

Table 3. Values of Unites States Imports of Agricultural Products from Canada.

	(1,000 dollars)			
Total	1,511,852	1,736,063	1,907,939	1,971,267
Meat and products (ex poultry)	358,848	357,787	445,835	513,088
Dairy products	31,436	45,119	63,159	61,920
Grains and feeds	237,483	256,207	255,273	285,254
Fruits, nuts, and vegetables	116,838	148,494	141,612	152,743
Sugar and related products	69,856	88,334	103,807	122,980
Tobacco	17,287	23,781	19,880	38,635
Wine and malt beverages	125,955	138,415	138,813	142,690
Oilseeds and products	50,250	81,046	87,228	70,146
Bananas and plantains	26	42	334	55
Coffee and products	2,145	757	7,178	43,514
Cocoa and products	27,728	53,636	53,970	59,807
Rubber and gums	49	290	36	137
Tea	7,324	8,708	2,753	6,935
Spices	1,499	1,218	1,186	1,376

SOURCE: Foreign Agricultural Trade of the United States, U.S. Department of Agriculture.

Plains including Montana and Minnesota produce hard red spring and durum wheat (Figure 2). A very limited amount of wheat has been traded between the two countries mainly because these two countries produce more than they need, and transportation costs from domestic producing regions of one country to domestic consuming regions are lower than those from producing regiosn of one country to consuming regions in other country. For example, transportation costs of shipping wheat from the Dakotas and Minnesota to the northeastern states of United States, where about 40 percent of flour milling capacity is located, are lower than those from Saskatchewan to the same consumign regions unless the Canadian government subsidizes the wheat shipments. Variable production costs are almost the same in the two countries. Average yield per acre in the northern plains, however, is higher than that in Canada. Therefore, wheat producers in Canada may have a comparative disadvantage in terms of production costs per bushel and transportation

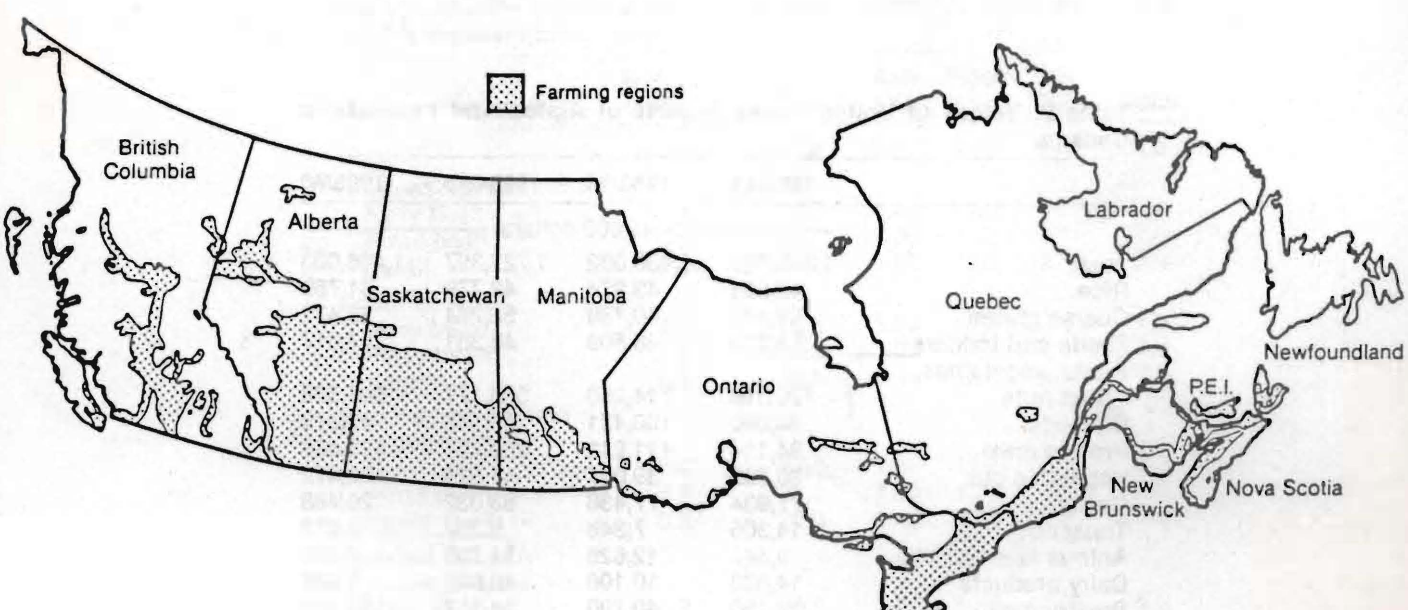

Figure 1. Canadian Farming Regions.

costs over producers in the United States in shipping wheat to the northeastern states. This implies that wheat producers in the northern plains including Minnesota and Montana will not lose their market share to Canadian wheat producers in the U.S. market as long as U.S. producers maintain their production and marketing efficiency.

Under the FTA, the United States still maintains the right to exercise Section 22 of the Agricultural Adjustment Act (AAA) of 1933, which authorizes the imposition of import restrictions on price-supported commodities if it is found that the imports substantially interefere with operation of the price support program. As long as the United States maintains the AAA of 1933, Canada may not be able to increase wheat exports to the United States under the FTA even if the price of wheat in the United States is higher than the world market prices.

Again, it is important to know that neither country will pay subsidies on exports to the other under the FTA. In addition, the United States and Canada are both members of GATT, the body that governs international trade. They have agreed to continue their work through GATT to remove subsidies that distort world agricultural trade.

Energy Industry

In 1987, the United States imported $10 billion worth of energy, while exporting $2 billion in return. The United States and Canada have in place a complex system to transfer this energy between two countries. Powerlines and oil and gas piplines criss-cross the border, moving supplies efficiently to market. The agreement will help preserve this system.

There will be increases in energy imports from Canada under the FTA. It is important to know that Canada also imports a sizeable amount of coal and refined petroleum products from the United States. The United States can increase exports of these products, especially petroleum products to Canada.

In addition, the FTA will lower energy prices, which will make United States industrial products more competitive in the world market.

Forest Industry

The United States imported about $12 billion worth of forest products from Canada. Canada is the world's largest exporter of softwood lumber, and ships 80 percent of its exported softwood lumber to the United States.

The United States also imports shingles, shakes, pulp and paper from Canada. Almost 85 percent of Canadian forestry exports currently enter the United States duty-free. The United States and Canada agreed to phase out tariffs on all forest products over a five-year period. This will clearly increase competition between two countries. The five-year phase-out of tariffs will protect workers on both sides of the border. The FTA will eventually lead to lower prices of forestry products in the United States.

CONCLUDING REMARKS

The United States and Canada agreed to drop tariffs completely over a 10-year period under the FTA. Since each country is the largest trading partner of the other, the FTA will stimulate both countries' economies on the basis of optimal trade patterns which will be established on the basis of

Continued on page 24

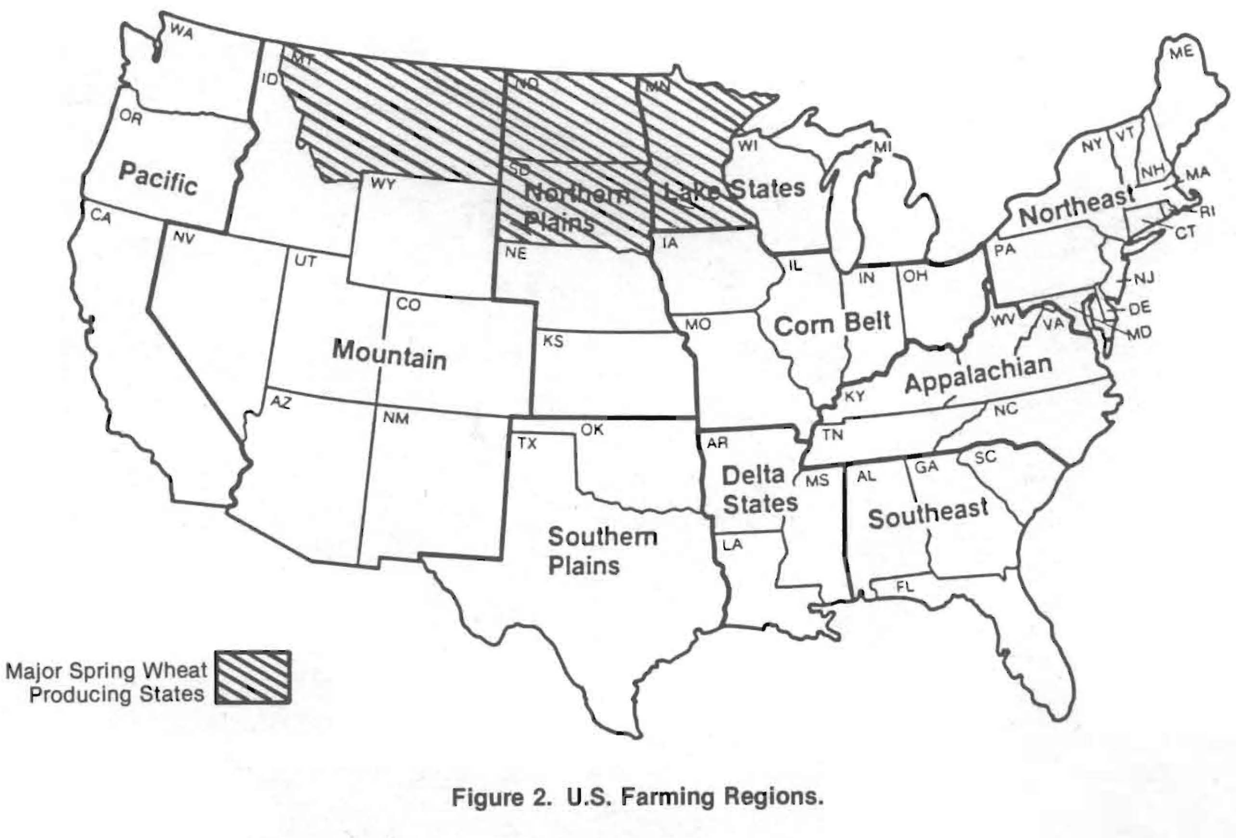

Figure 2. U.S. Farming Regions.

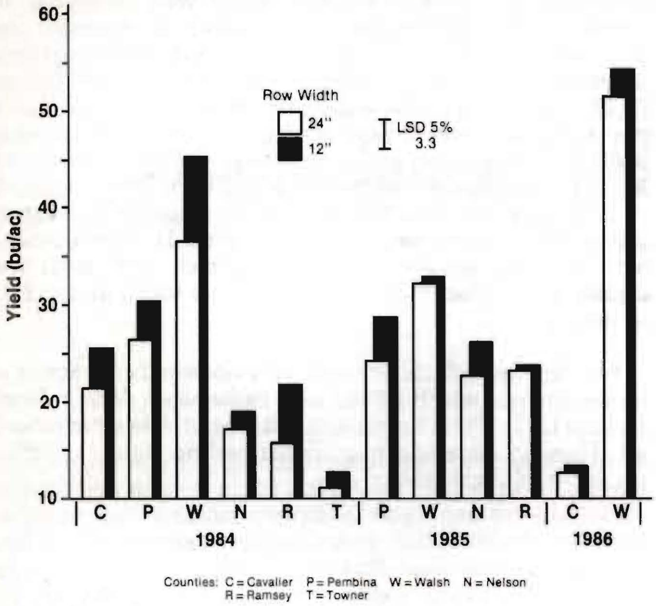

Figure 1. Effect of Two Row Widths Averaged over Planting Rates on 'McCall' Soybean Yields across Northeast North Dakota.

Summary

Results from this study were similar to other studies conducted in North Dakota. Twelve-inch row widths had a 3.2 bushel per acre or 13 percent yield advantage over 24-inch row widths. The 12-inch row width always outyielded the 24-inch row width with the differences between the two ranging from 0.3 to 8.9 bushels per acre across environments. No significant differences occurred between planting rates for the three-year study.

Acknowledgements

The authors wish to thank Dr. Jim Hammond for assistance in analyzing the data.

References

1. Johnson, R.R., D.E. Green, and C.W. Jordan. 1982. What is the best soybean row width? Crops and Soils. 34(4). pp. 10-13.
2. Muhamadali, S.M. 1983. Cultivar planting rate and row spacing influence on yield and other characteristics of soybeans at Fargo. MS thesis. North Dakota State University, Fargo, North Dakota. 46 p.
3. North Dakota Agricultural Statistics Service. North Dakota Agricultural Statistics 1986. Ag. Stat. No. 55. Fargo: USDA Stat. Rpt. Serv. and Agr. Exp. Sta., NDSU cooperating, 1986.
4. North Dakota Agricultural Statistics Service. North Dakota Agricultural Statistics 1987. Ag. Stat. No. 56. Fargo: USDA Stat. Rpt. Serv. and Agr. Exp. Sta., NDSU cooperating, 1987.
5. Sletteland, R.L. 1974. Variety, planting date, and row width effects of irrigated soybeans at Oakes, North Dakota. MS thesis, North Dakota State University, Fargo, North Dakota. 67 p.
6. Spilde, L.A., D.A. Whited, and R.L. Sletteland. 1980. The effect of row spacing on soybean yields. North Dakota Farm Research. North Dakota Agr. Exp. Sta. 37(5):15-18.
7. Swallers, C.M. 1957. The effect of dates and rates of planting and row widths upon certain characters of four soybean varieties. MS thesis. North Dakota State University, Fargo, North Dakota. 59 p.

Continued from page 35

the principle of comparative advantage. In the long run, the United States could have a comparative advantage over Canada in high-technology and service industries and Canada could have a comparative advantage in energy and forest industries.

Impacts of the FTA on the United States agricultural sector will be much smaller than those on the manufacturing and service sectors. There will be increases in United States exports of fresh fruits and vegetables, oilseeds (soybeans), vegetable oil, poultry products, and feed grains to Canada. On the other hand, Canada may be able to increase its exports of meat and grain, mainly oilseed, to the United States. Wheat producers in both countries will be neither winners nor losers form the FTA.