

## CHAPTER 5

### TRADE ISSUES

Two major trends have changed the trade environment in recent years:

- New rules governing trade were introduced in the WTO agreement — in particular, the regionalization principle, sanitary and phytosanitary barriers based on scientific considerations, and minimum market access.

- Improvements in transportation technology have reduced travel time for both commodities and passengers, while the volume of trade and number of international travelers have increased.

Meanwhile, the population of California has become more diverse with several ethnic communities originating in FMD-endemic countries, mainly in Asia and Eastern Europe.

This chapter reviews recent changes in regulations governing trade, with particular emphasis in the role of sanitary and phytosanitary barriers, and analyzes the composition and destination of California's livestock exports. In 1995, California exported \$11.7 billion in agricultural products; of this amount, \$1.23 billion was beef and dairy products (CDFA, 1997).

#### **Regulatory changes**

The new regulatory framework was introduced in 1995 at the conclusion of the Uruguay Round (UR) of the GATT. The main changes are (1) creation of the WTO; (2) the principle of regionalization, (3) risk assessment and assessment of the scientific grounds for the imposition of non-tariff barriers, (4) prohibition of the use of sanitary and phytosanitary barriers as barriers to trade, (5) the creation of expert panels to resolve trade disputes, (6) minimum access to domestic markets, and (7) introduction of tariff quotas in the U.S. and Canada, reduction in import tariffs in Japan, increase in minimum access commitments in Korea, and limits to subsidized exports by the EU process (O'Riordan and Jordan, 1995). These changes have increased the importance of the International Office of Epizootics (OIE) in the definition of the scientific standards that can be used to impose sanitary barriers to trade.

A country that has been affected by an outbreak of FMD, or where FMD is in the process of being eliminated, must take certain steps to be certified as FMD-free. According to the International Animal Health Code (Part 2, Sec. 2.1, Article 2.1.1.2), such a country, in order to be listed as FMD-free with vaccination, must send a declaration to the OIE stating that there has been no outbreak of FMD within the previous two years, and must demonstrate the absence of any viral activity. After an

additional 12 months without vaccination, a country may ask to be recognized as FMD-free without vaccination.

Before the UR, any country signatory to the GATT could ask for the formation of a panel to review a trade complaint against other members; however, both the formation of the panel and its conclusions had to be accepted by consensus. As a result, a single party could block or delay a report's adoption. Currently, under the WTO, the power of any one country to prevent the formation of a panel is greatly reduced. Additionally, the adoption of a panel's report is presumed, unless the Dispute Settlement Body decides by consensus not to adopt it or unless it is appealed by one of the parties to the dispute. The new rules also set stricter time limits to the complaint process (O'Riordan and Jordan, 1995).

Another major change to the rules of trade introduced by the WTO is the requirement that non-tariff barriers must be backed by scientific evidence. In the case of FMD, this will mean that countries that do not accept the zoning principle could be subject to a dispute within the framework of the WTO.

The principle of regionalization has been accepted by European and North American authorities since the Italian outbreak in 1993. It allows beef originating in FMD-free zones within FMD-endemic countries into a FMD-free country if the disease is contained within quarantine areas. Conversely, if a FMD-free country suffers an outbreak, it may continue to export to FMD-free countries provided that the outbreak is successfully contained within a quarantined area. This is a substantial change from the previous rule that only recognized FMD-free countries.

These changes will foster a more formal, rule-oriented approach to dispute resolution. As the procedures reflect a more legalistic approach, the entire process becomes more adjudicatory and less diplomatic. However, since the international bodies have no legal or administrative capacity to implement their rulings, the final decisions on sanitary controls still lie with national authorities in importing countries. Even though the new dispute settlement mechanism introduced by the WTO reduces the power of individual states to impose barriers to trade, it is still not known how much control individual states will actually lose in the process (O'Riordan and Jordan, 1995).

This point is reinforced by the fact that, in the case of an outbreak, acceptance by importing countries of the efficiency of the quarantines is not automatic, and must be demonstrated by the infected country to the satisfaction of foreign animal health inspectors. Until now, the attitude towards the regionalization principle of major importing countries (in particular, how demanding they will be on the evidence of quarantine success) has not been tested. Italy exports only within the European Community and Taiwan could not contain the outbreak before the whole country was affected. Until better information is available, the best assumption on the behavior of the major US beef foreign markets is that they would be closed for a substantial length of time. In the simulations, it was assumed that Japan and Korea would respond to a FMD outbreak by banning all imports of American beef for two years after eradication of the last reported case (or cessation of vaccination), regard-

less of whether the beef originated in an affected or clean region.

The most probable scenario in Japan and Korea following a FMD outbreak in the United States is that domestic meat prices would rise as supply would be seriously disrupted. Given the large share of U.S. exports in these markets, the price increase is likely to be substantial. Domestic producers of meat, poultry and fish, and exporters in other countries (i.e., Australia, New Zealand and Canada) would try to capture the share of the meat market abandoned by the U.S. Due to the characteristics of the Japanese and Korean beef markets, it is unlikely that other countries will be able to become exporters on short notice (Ekboir et al., 1996a). The long term impact of the outbreak would be determined by the capability of U.S. beef to regain its lost market share.

### **U.S. meat trade**

Beef is an important export commodity, amounting to about \$2.6 billion in 1995. It is known that California has a large beef deficit, but also that the major slaughterhouses export substantial volumes of beef, mainly to Canada and Asia. Additionally, a large volume of beef originating in other states is exported through California ports. Because there are no reliable figures on the origin of these exports, it is impossible to know how many originated in California. Consequently, we will make no effort to estimate the losses to California derived from disruptions to beef exports; only the losses for the whole U.S. are estimated.

The international market for meats is divided into several segments according to differing qualities. The broadest division is between countries that are free of FMD and countries where the disease is endemic. FMD-free countries allow only imports originating in regions (or countries, according to their import policies) that are FMD-free. For beef of similar quality, prices in the FMD-free market are about twice as high as in the FMD-endemic market (Ekboir et al., 1996a).

U.S. beef exports are heavily concentrated in a few countries (Table 2). Japan is the primary destination with 64% of U.S. exports. Following are Canada with 14%, Korea with 12% , Mexico with 3.2% , and Taiwan with 1.7% (CDEFA, 1997 and F.A.S.,b). The four most important markets are free from FMD.

The imported portion of U.S. beef supply varies from 11% to 18% of the total. Most imports are of manufacture quality (Cothorn, 1991). It is likely that a FMD outbreak would shock the domestic beef market both in the short and medium term, seriously disrupting imports. The most likely scenario is that imports would fall initially as the domestic supply rises due to the depopulation of exposed but non-infected premises. After this initial surge, the domestic supply should fall abruptly until depopulated areas can return to production and herds are rebuilt—a process that could take between six months to five years, depending on the magnitude of the outbreak. During this period, imports should increase. If domestic policies do not change with the emergency, it is likely that imports would fall in the long run, but not to the levels prior to the outbreak. The long disruption of domestic

Table 2: Beef and Dairy Exports - Calendar Year 1995

| Rank | Beef U.S.   |                 | Dairy Products California |                 | US <sup>1</sup> |                 | Pork U.S. |                 |
|------|-------------|-----------------|---------------------------|-----------------|-----------------|-----------------|-----------|-----------------|
|      | Country     | Value (\$1,000) | Country                   | Value (\$1,000) | Country         | Value (\$1,000) | Country   | Value (\$1,000) |
| 1    | Japan       | 1,699,111       | Algeria                   | 71,039          | Mexico          | 123,926         | Japan     | 594,378         |
| 2    | Canada      | 363,466         | Japan                     | 48,869          | Algeria         | 97,758          | Russia    | 71,631          |
| 3    | Korea       | 320,753         | Mexico                    | 32,503          | Japan           | 77,364          | Canada    | 45,604          |
| 4    | Mexico      | 85,778          | Hong Kong                 | 16,265          | Canada          | 53,994          | Mexico    | 37,840          |
| 5    | Taiwan      | 43,487          | Korea                     | 12,331          | Taiwan          | 51,476          | Korea     | 27,436          |
| 6    | Hong Kong   | 23,296          | Taiwan                    | 10,026          | Russia          | 35,873          | Hong Kong | 23,474          |
| 7    | Switzerland | 13,547          | Canada                    | 9,183           | Korea           | 23,310          | Taiwan    | 7,728           |
| 8    | Netherlands | 12,223          | Philippines               | 4,546           | Egypt           | 16,160          | Others    | 72,292          |
| 9    | Russia      | 10,088          | China                     | 3,966           | Hong Kong       | 13,664          | Caribbean | 9,369           |
| 10   | Singapore   | 9,508           | Indonesia                 | 3,219           | Georgia Rep.    | 8,951           | S.E. Asia | 5,064           |
|      | Total       | 2,647,209       | Total                     | 235,661         | Total           | 778,080         | Total     | 846,865         |

<sup>1</sup> Only includes those products in which the country is a major exporter.

Source: CDFA (1997), F.A.S. (b) and ERS (1997).

production would give foreign exporters a chance to develop market channels that would be difficult to close.

### Dairy and other exports

California dairy exports, ranking 12th among the state's agricultural exports, totalled \$128 million in 1995 (CDFA, 1997). In general, importing countries specialize in a few items. For example, 87% of Algeria's imports are dry milk products (whole and non-fat) and 45% of Japanese dairy imports are ice cream. Mexico is the only major importer that has a diversified demand for U.S. dairy products. Fluid and dried milk accounted for 33.4% of U.S. dairy exports in 1995 while 20.6% of the total was composed of cheese, ice cream and yogurt (F.A.S.,b).

Survival of the FMD virus in dairy products depends on several factors, including the type of product, processing method, and storage length and temperature. The virus survives for up to two years in dry milk and more than a month in pasteurized milk. It can also survive in certain types of cheeses but is generally destroyed during the ripening process (APHIS,1991). Since most high value products such as cheese and ice cream are exported to FMD-free countries, it is almost certain that this trade would be disrupted. However, dry milk is exported to both FMD-endemic and FMD-free countries, e.g., Algeria and Mexico. Presently both groups of countries have similar sanitary requirements for dairy imports. It should be expected that all countries would restrict imports of dry milk, at least initially, after an outbreak. If prices fall enough or if the U.S. government presses enough, some markets would open slowly. In any case there would be major losses until at least two years after eradication.

In 1995 the U.S. exported \$1.4 billion worth of cattle hides and calf skins, mainly to Korea (\$615 million), Japan (\$257 million) and Taiwan (\$204 million). Pig and sheepskin exports amounted to \$36 million and \$30 million respectively. In case of an outbreak, these exports would also be subject to a trade ban. Livestock hides are salted in California and exported to tanneries in Japan and Korea. A few tanneries in the east coast could treat raw hides, but it is not known how many additional hides from California they could handle in the case of an emergency, or if it would be worth the additional handling and transportation costs. New export markets would have to be found to treat American hides, almost surely entailing a price reduction.

