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Pork Barrel Protectionism

US Anti-Dumping Duties on Canadian Hogs

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By Rolf Penner

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About the Author

Rolf Penner is the Frontier Centre for Public Policy's Agriculture Policy Fellow. He is a grain, oilseeds, and hog farmer from southern Manitoba. He graduated with a diploma in agriculture from the University of Manitoba in 1988. Rolf has a keen interest in science, economics, philosophy, politics as well as animal and environmental activism in regards to agriculture.

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The Rural Renaissance Project (RRP) explores solutions to the issues facing our rural communities. Many of the challenges can be traced to old public policy models which may no longer be appropriate in today's wide-open, fast moving trading environment. In addition, the psychological malaise within the agricultural sector, exacerbated by downward trending commodity prices, threatens to overshadow the best ideas, projects and opportunities that abound in rural areas. The RRP, however, takes the view that there are opportunities in the midst of adversity that call for a new focus on the advantages of living and working in rural communities. These advantages are waiting to be discovered, both from within and without. Lost in the negative public discussion are many success stories of local people whose stubborn perseverance has just "made it happen". The RRP will examine these bright spots so that we can learn what works

Suite 25 Lombard Concourse, One Lombard Place
Winnipeg, Manitoba CANADA R3B 0X3

Tel: 204 957-1567 Fax: 204 957-1570
www.fcpp.org

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FRONTIER CENTRE
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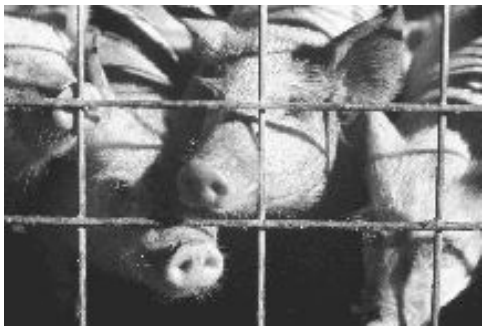

Executive Summary

- In response to a trade complaint from the National Pork Production Council in the United States, the American government has slapped duties on the import of live hogs and piglets from Canada.
- The Pork Council's motives for the complaint are suspect.
- The group alleges that Canadian producers are dumping into the American market below the cost of production, and that the dumping is enabled by existing farm insurance programs.
- The data used to justify the complaint are highly speculative, and ignore other market-based reasons for the increase in Canadian exports.
- Given the size of the Canadian share of the American market, the complaint is more likely based on protectionist motives.
- Besides its creation of winners and losers, the duty will have a number of unintended effects.
- Canada should aggressively pursue the case under free trade rules, and work to eliminate the possibility of such nuisance actions in all export commodities.

Introduction

On October 15′ 2004, the United States Department of Commerce announced preliminary anti-dumping duties averaging 14.06 % on live hogs and weanlings (piglets) from Canada. The duty does not apply to breeding stock.

The duties are the second of two trade actions launched by the U.S. in March, 2004, to investigate subsidies and dumping. A preliminary decision, announced in August, found that Canadian subsidies were not countervailable. The new decision reverses that, an action which surprised a Canadian hog industry wondering about the justification for any further trade action.

Since the BSE-inspired closure of the border to live beef in May, 2003, record and near-record beef prices have raised pork prices significantly. It is especially ironic that the American pork lobby would pick this period of prosperity to advance a trade action that claims economic injury.

Dumping

Dumping is defined as foreign companies (in this case Canadian hog exporters) selling a product into an export market at below the cost of production or below the price that it would receive domestically at the time. An antidumping investigation looks at whether or not the foreign producers are unloading goods into the domestic American market below a ”fair” market price, calculated as either the market price in the foreign country or in a third country market, or as the cost of production.

The purpose of the anti-dumping legislation is to penalize importers who may be selling below that “fair market price” because they receive subsidies and to encourage them to take a more ”free-market” approach. The root complaint in any dumping claim is that those accused have been selling goods too cheaply to allow fair competition.

The Instigators

On March 5, 2004, the National Pork Producers Council (NPPC), 20 state pork associations and 101 individual pork producers filed a petition with the U.S. International Trade Commission (ITC). It claimed that imports of live swine from Canada are being subsidized and sold at less than fair value (“dumped”) in the United States, and that this was causing injury to the U.S. hog-producing industry. The petitioners claimed dumping margins as high as 66.48 percent. Their goal was to force U.S. farmers to pay a tax (duty) on all live swine imports from Canada, traffic which was valued at $400 million in 2003.

Jon Caspers, a pork producer from Swaledale, Iowa, and a past president of the (NPPC), stated, "The Commerce Department's determination is compelled by the economic reality of the situation. Canadian hog producers unfairly benefit from huge subsidies that cause overproduction in Canada and allow Canadian producers to sell their hogs in the United States at artificially low prices. The flood of low-priced hogs from Canada has pushed down U.S. hog prices and inflicted severe financial on U.S. hog producers."

One of the nation's largest livestock commodity organizations, the NPPC (at www.nppc.org) has producer members in 44 affiliated state associations and provides a unified voice for America's pork producers on a wide range of industry and public policy issues.

Motivations

Many theories are circulating as to why NPPC may have started this trade action.

1) Market Signal Response

While the U.S. hog industry has moved to reduce sow herd inventories in response to years of low prices, the Canadian sow herd continued to grow. Since U.S. producers were barely able to get by during the 2002-2003 downturn in prices, they are asking how Canadian producers can go against these market signals and expand.

If the Canadian industry is subsidized to the disadvantage of U.S. producers, they believe, the trade challenge will send us a message to cease and desist and to once again respond to market signals. Supporters of this theory allege that illegally subsidized Canadian producers are unfairly adding to the total North American pork supply. They claim to support the notion of free trade and do not want to close the border. Some have even pronounced willingness to end the trade challenge if the subsidy allegations were proven to be unfounded.

An Iowa State University economist, Dermot Hayes, has analyzed both the data from the public record of the countervailing duty case and other available Canadian agricultural data. He estimated that Canadian hog farmers receive benefits ranging from $4 to $6 per pig from federal subsidy programs and that Quebec producers receive as much as $15 per pig from a provincial program.

2) Fighting for Survival

Observers on both sides of the border have noted that the NPPC's very existence has being questioned and threatened by a segment of its own membership. One way to

survive in a hostile climate may be for the organization to prove one's worth. Because the flow of pigs south, especially market hogs, has been an ongoing irritant to U.S. producers, a trade action has become a means for NPPC to justify its usefulness.

3) Market Share Takeover

Some have speculated in the direction of a "corporate conspiracy" theory. This dour view emphasizes the role of major U.S. pork integrators seeking to increase concentration in the industry. It is suggested that integrators would like to put the last vestiges of the U.S. independent family farmer out of business by cutting off the supply of imported weanlings. Once that happened, integrators would control all U.S. hog production. They have therefore pressured the NPPC to challenge Canadian pork production.

4) *Revenue Generator*

Revenues from this tax would go into the pockets of the petitioners. In 2000, the U.S. Congress passed a new law called the Byrd Amendment, which mandates that countervailing duties be paid directly to affected producers. The World Trade Organization (WTO) recently ruled that the Byrd Amendment is in violation of U.S. international trade obligations, but to date the Americans have ignored this verdict.

The Justification

The NPPC attributes much of its complaint to the current version of the Canadian farm support program, called the Canadian Agricultural Income Stabilization Program (CAIS, see http://www.agr.gc.ca/caisprogram/docs/html/2004/cais04hb.html#1.2). Under this program, farmers can purchase a subsidized, "whole farm income guarantee."

The organization sees it in this way. The government calculates historical margins for each covered farm enterprise in Canada. Then it calculates the Olympic average of the margin in that enterprise over the past five years. This Olympic average then becomes the basis for an income guarantee and a farmer chooses an income protection level. The lowest available is 70%, and the highest is 100%. The government shares the premium cost of this program with the producer according to a set formula, with the government assuming 80% of the cost up to the 70% coverage level, 70% of the cost of additional coverage up to 85% and 50% of the additional cost between 85% and 100%.

The NPPC acknowledges that the CAIS program is fairly new, and that the average annual cost of the program has not stabilized. But they try to prove the extent of the subsidy by projecting how the program would have performed over an historic period,

specifically as it might have affected hog returns in Iowa 1974 to 2003. They attempt to calculate what additional revenue Iowa farmer would have received it they had operated under a program identical to CAIS. Their data is hedged with so many assumptions that its validity is in serious question, yet the numbers that result form the basis of the complaint.

The NPPC also targets a program specific to the Province of Québec, the Agricultural Revenue Stabilization Program. It guarantees that a hog producer above a certain size will earn an income of 70 percent to 90 percent of that calculated for a skilled worker. The NPPC claims that whenever market-level prices fall below the amount needed to provide the target income, the program distributes payments (on a per hog basis) to producers to make up the difference.

The NPPC calculates the value of the CAIS subsidy at $8.83 a hog, except in Québec, where it is alleged to amount to approximately $15 per animal. They further claim that the original DOC ruling, which said that these farm income programs were not distortions of trade, was incorrect. They cite the data for increased Canadian production (see below for values) as proof of the trade-distorting consequences.

The Investigation

The Byzantine way in which U.S. trade law is written provokes heavy-handed remedies for such real or imagined trade violations. It takes almost no evidence from an American industry that may or may not be being hurt to trigger countervailing action by the Department of Commerce (DOC). It is typically a case of shoot first, then ask questions and sort out the evidence later.

In reponse to the complaint from the NPPC, the task fell to the DOC to make the determination whether Canadian live hog imports were being illegally subsidized and/or dumped and if so, to determine the amount of the subsidy and dumping margins. In a preliminary ruling on August 17, 2004, the Commerce Department announced that it had found that after looking at 22 government programs there were no illegal subsidies in this case, determining that Canadian swine industry farm support payments are fully in compliance with both U.S. law and international trade rules.

Following that, the DOC investigation divided Canadian exporters into two groups. One small group of exporters, called ”mandatory respondents,” was required to supply the DOC with specific and detailed information on sales and costs. The rest, called ”all others,” did not have to supply information. The DOC then calculated dumping margins for each of the mandatory respondents.

The Commerce Department chose and thoroughly investigated the activities of four Canadian exporters, Hytek, Excel, Premium Pork and Ontario Pork, in the year 2003.

They found grounds for complaint. Hytek was found to be below the 2% minimum requirement for subsidy allegations, coming in at .38% which put it in the ”de minimus” category. Ontario Pork’s subsidy level was found to be 13.25% while Premium Pork received a 15.01% rate.

At the eleventh hour, before the levels were to be announced, the investigation into Excel was for some reason stopped. That company was lumped in with the rest of the country, which received a level of 14.06%. Excel officials suspect that the level that would have been handed down, had the investigation concluded, would have been in the range of 2.3%. It has been widely speculated that Excel was dropped from the investigation because including this rate would have lowered the overall average down to 10%.

Notably, in a U.S. anti-dumping case when any company receives a ”de minumus” rating is automatically removed from the final calculation of the amount of dumping that is said to have occurred. *In other words, the strongest evidence available to contradict the allegation is purposefully removed*. Had the DOC used *all* of the available data to make an honest calculation the average duty would have come in at 7.74%.

The duty that is being applied to all Canadian exporters (other than Hytek) is therefore based on the data gathered from only two respondents. Hytek has been found innocent by the DOC and can carry on business as usual.

Analysis

The justice of the DOC imposition of duties, based on the reasoning of the NPPC complaint, is difficult to fathom. This case is based on a very specific time frame in what is a very dynamic and ever-changing marketplace, and the law it triggers does not take market conditions into account. A higher than normal amount of Canadian exports to the US in the fall of 2003 was due, in part, to the aftermath of the close of the US border to Canadian beef, which increased the value of *all* meat products. The rapid increase in the value of the Canadian dollar against the US dollar in 2003 and 2004 also contributed to the lower returns available to Canadian producers, as did the high cost of feed following back-to-back droughts in western Canada.

The market conditions that resulted in Canadian exporters selling under the cost of production turned around almost immediately after the time frame cited in the complaint. If found guilty at the final DOC determination, scheduled for April 2005, Canadian hog producers will have to endure the duty for five years, long after the situation has righted itself. Yet a law that is supposed to encourage free market principles is being used to punish Canadian hog producers, who have embraced and live by them.

The task of the DOC now is to determine if the Canadian imports had any negative impact on the American marketplace. That seems unlikely, since American producers were experiencing similar conditions to Canadians and, more importantly, since the amount of Canadian hogs in the U.S. runs at only about 3% of the total. That share of the market is hardly large enough to precipitate any meaningful impact, even if the charges of subsidy are correct, especially after the 14.06% average dumping rate assigned to Canadian hogs is factored in. Besides, a persuasive case can be made that larger amounts of Canadian hogs entering the American market are actually having a positive impact.

Victims, Losses, and Costs

Early estimates on the cost of the new duty put it at about $24 per market hog and $7 per piglet. That puts losses to Canadian farmers at $60 million a year, plus $10 to $15 million in legal fees to fight the action. Manitoba will be most affected by this duty as it generates 53 percent of the live exports that leave Canada. In terms of total numbers of hogs, Canada ships about eight million a year south while approximately three million weanlings (piglets) and one million slaughter hogs come from Manitoba. Close to 33% of farm gate receipts generated by hogs in Manitoba are at risk to this tariff, 14% for all of Canada combined.

The increased cost of moving Canadian pigs into the US will harm not only Canadian producers but U.S. ones as well. These pigs are a critical element of many U.S. farmers' operations. They allow them to remain competitive in a U.S. industry in which large, integrated packers own a significant portion of the hog supply. These farmers cannot otherwise obtain the quality or quantity of pigs needed from U.S. sources.

Once raised to market weight, the pigs imported from Canada enable US packers to run more efficiently by filling their plants to full capacity. Much of the remaining imports, full-size slaughter hogs, help smaller, independent U.S. packers fill their capacity and meet the combined demand for pork in the U.S. and in the export markets that the U.S. has developed. Because there is more capacity to slaughter and process hogs than the total supply of U.S.-born hogs, Canadian imports allow more hogs to be slaughtered, therefore increasing the efficiency of the packers' production lines.

A 2003 Country of Origin Labeling study completed by the George Morris Centre and VirginiaTech Department of Agricultural and Applied Economics identified ways U.S. interests could be harmed by the stoppage of pig imports into the U.S. Here are the problems the study identified:

If the free flow of weaners (piglets) and feeders into the U.S. stopped, approximately 1,300 independent mid-west farms will be placed in jeopardy. This could mean a loss

of $420 million in gross incomes in the states of Iowa, Minnesota, Nebraska and South Dakota. Using U.S. multiplier rates, a further $1.3 billion would be lost to the U.S. economy. If 1,300 farm families are put at risk, a further 1,045 related farm supply jobs are also put on the chopping block. Up to five hog processing plants hit with a reduced flow in supply will be forced to close, jeopardizing 4,500 jobs. Plants in Iowa are seen to be particularly vulnerable. Closures could represent a loss of $1.2 billion, which translates into $4.386 billion for the U.S economy, along with an additional 8,000 jobs once multipliers are factored in.

Allies

Because of adverse consequences discussed above, a number of American interests are also fighting this action.

One is the Pork Trade Action Coalition (PTAC), a recently formed association of U.S. and Canadian farmers, finishers and others who have joined together to fight the anti-dumping trade petition. PTAC members represent hundreds of family-owned farms in the Midwest who have built business plans based on the availability of high quality Canadian pigs to raise in the U.S. with heavily subsidized, cheap American grain. PTAC states that the preliminary dumping duties on live swine from Canada are an "unjustified and unfair tax on American farmers." PTAC has vowed to continue to fight against the duties on behalf of hundreds of American farmers who rely on the imports for their livelihoods.

"The government tax on Canadian pigs will make these pigs unaffordable to American family farmers," said Larry McAllister, Founder and President of Iowa-based Prairie States Management Company, a family owned and operated business founded in 1986. "We are particularly disappointed that the National Pork Producers Council has pursued this matter which penalizes its own members whose business practice is to buy pigs from Canada. I was assured that the NPPC had no desire to close the border to Canadian pigs."

Another ally is a consumers group called Consumers for World Trade (CWT), who rightfully argues that it is consumers who pay the final price for this type of "leveling of the playing field." The group has also pointed out that American tax dollars are continually being "flushed down the toilet" with these kinds of actions, because in addition to the legal costs the U.S. government has to pay interest on the refunded money when it is found out in the final determination stage that the actions were wrong. They claim the action is thinly disguised protectionism, to reduce competition for American producers.

The CWT asserts that the anti-dumping duty on imports of live Canadian swine contradicts the spirit of free markets and American capitalism. It feels that: Congress

should support free trade principles and urges the ITC to reject these new tariffs on Canadian swine imports.

Canadian Hog Stats

In 2003, U.S. imports of Canadian live swine, by weight, totaled only 3.3% of the U.S. market by. Two-thirds of the live swine imports from Canada are baby pigs raised to market weight by U.S. farmers. By number, the piglets amount to between five and six million out of the approximately 100 million marketed in the U.S. Canadian hog exports to the U.S. were nearly 6.6 million in the first nine months of 2004, up more than 20% from the same time a year earlier. About 40,000 a week are currently slaughter hogs and twice that number are weanlings and feeder pigs.

Value of Canadian Market Hog Exports to the United States

PROVINCES/YEAR	2003
Quebec	$516,145
Ontario	$89,816,490
Manitoba	$139,835,575
Saskatchewan	$18,043,240
Alberta	$38,473,251
British Columbia	$2,946,889
CANADIAN TOTAL	**$289,631,590**

Value of Canadian Weanling Exports to the United States

PROVINCES/YEAR	2003
PEI	$80,446
Quebec	$1,155,285
Ontario	$78,849,666
Manitoba	$117,305,794
Saskatchewan	$1,881,347
Alberta	$8,550,227
British Columbia	$1,382,425
CANADIAN TOTAL	**$209,124,744**

Canadian Farm Cash Receipts for Pigs – 2003
$3.4 billion

Manitoba Farm Cash Receipts for Pigs – 2003
$777 million

Total Value of Manitoba Market Hog and Weanling Exports to the United States – 2003
$257,141,360.00

Possible Repercussions and Consequences of the Duty

It is difficult to predict with certainty all of the ramifications of this trade action. It deals with a large group of highly motivated, creative people whose livelihoods are on the line. For these reasons alone, surprises should be expected. But there are a number of ways in which this predicament *could* play out. The American antidumping duty could actually encourage increased Canadian live hog exports to the U.S. in the short term, and expanded Canadian finishing and processing in the longer term.

As the only Canadian company to be absolved of the dumping charge by the DOC, the Manitoba exporter, Hytek, is well positioned to increase its export of live hogs into the U.S. marketplace. However, the number of hogs Hytek would be able to absorb into its system is negligible when compared to current overall exports.

While the levy will take a bite out of the price Canadian exporters receive in the U.S., they duty may force Canadian packers at some point to cut their prices due to oversupply. It may also end up forcing Canada to become more aggressive in competing with the U.S. on the international market, if and when we become capable of processing the Canadian animals at home. For allied industries such as oilseed processing, a net decline in hog production in the U.S. and Canada combined would result in a reduction in the demand for their inputs.

Another scenario involves the void left by empty independent family farms when faced with higher import costs. The fear is that it would quickly be filled by integrated farming systems. Once this production comes on stream and Canada ramps up to accommodate the extra supply of young hogs that used to go south, North American production will reach an all-time high. The effect of this kind of oversupply of pork on prices could be disastrous.

One way or another, the duty will certainly set off a chain of consequences for the pork industry on both sides of the border. Lower Canadian hog prices will probably not occur immediately, though the market will suffer in the medium to longer terms. U.S. buyers will also probably pay slightly higher prices, especially for weaner pigs, absorbing some of the price difference caused by the tariff. The way the American law is written this is technically not supposed to happen, and stiff penalties (a doubling of the duty) are to be applied to violators.

Lower Canadian prices should improve the bottom line of Canadian packers, who will be able to buy hogs at reduced, duty-applied prices while being able to sell the processed pork in the U.S. for the going price. However, Canadian pork-packing capacity is not presently sufficient to handle all of the extra hogs. Plans are already in the works by Maple Leaf Foods at Brandon and Olymel at Red Deer to expand their capacity by going to two-shift operation, possibly by next summer, but they will not do so before additional markets are found for the processed pork. Packing capacity

will have to *substantially* increase before competition for domestic hogs forces packers to bid prices up noticeably higher.

Prices for U.S. hogs may increase a bit, but any changes that might be ascribed to the duty will most likely be so small that they will be lost in the normal day-to-day fluctuations of the market. American finishers who have been relying on Canadian weaner and feeder pigs will face lower supplies and higher costs, since it will be more attractive to finish these animals in Canada. However, finishing capacity on this side of the border is also insufficient to absorb extra weaners.

There could be a resurgence of finishing barn construction in Canada, partly inspired by reduced prices and greater availability of weanlings, and partly by current hog economics, which are quite favourable. Feed-grain costs are expected to remain low at least for the next year, because of the much-increased supply of feed wheat and barley, especially in the western provinces.

Previous hog expansion has always been based on long-term indicators and the availability of financing. The latter may be tougher to get this time, as bankers are more skittish due to the BSE disaster and the number of cattle farms that are in arrears. The last round of hog farm development ended around 2001, when the market softened. As big an issue as the prevailing economic conditions are overly burdensome regulations and getting *local permission* (municipal approvals) to put up modern, efficient, large-scale operations.

The last time there was a duty on Canadian pigs entering the United States was in the early 1990s. Just as in the present situation, the duty applied only to live hogs, not pork. Live exports declined, though they did not entirely stop. Exports of processed pork increased, as did internal domestic Canadian slaughter and value-added processing. The pork industry was smaller back then but exports were just as important as they are today. Offshore markets were not yet as well developed, so the U.S. was the dominant destination. The duty lasted for five years. After it was over, analysts on both sides of the border noted the utter uselessness and expense of the action, as it did nothing to create any kind of lasting change in either Canadian or American hog industry economics.

The NPPC's Nick Giordano of course disagrees with this assessment, claiming that this time U.S. farmers will benefit from higher prices for finished hogs and that "The majority of adjustments are going to be north of the border." NPPC's current actions will no doubt go into the history books under the banner of "new people making old mistakes."

Recommendations

If Canada were to lose nest spring in the final determination, we should be prepared for the anti-dumping charges to work their way up the supply chain to an evitable dumping investigation on processed pork that is exported into the United States.

The case, if lost, should also be brought before NAFTA and WTO tribunals. This American action should be ruled as contrary to these trade agreements and could be overturned by them.

This should also serve as motivation and an opportunity to target third markets, principally Asia, in which American pork currently outsells Canadian pork. We should aggressively be pursuing free trade agreements with as many other countries as possible.

Regulations should be loosened or at least put under a moratorium for the duration of the tariff, particularly environmental approvals for those affected by the action. And tax incentives should be granted to stimulate the construction or expansion of finishing barns and packing plants across Canada, particularly in Manitoba. Without resorting to subsidies, we need to pursue policies that will lower the cost of hog production in the same amount (14%) as the tariff.

It is also in the interests of the Canadian pork industry that American prices rise. Higher domestic prices in the US will also raise export prices elsewhere, which will make American pork less competitive in the markets that really count, which are offshore.

A key to surviving this hog duty is to disperse the impact. That will happen by itself, through the normal actions of markets. Governments can speed this process up by getting out of the way.

Even if the duty is confirmed, Canadian hog producers are in better shape than a year ago. Hog prices are currently 21% higher than in October 2003 and barley prices are 19% lower. With a 14% duty in effect, and if the entire amount of the duty were reflected across the entire Canadian hog market, prices would still be 7% higher and feed would be 19% cheaper. However we cannot count on market conditions remaining consistently favourable over the medium to long run. Hog and feed markets are highly volatile and can move dramatically over short periods of time.

Perishable commodities like livestock, where long production periods are required and which cannot be held back for any length of time as, say, lumber or grains can, are quite vulnerable to these kind of dumping charges. As such, they have been eliminated in some of our trade agreements such as the bilateral free trade agreement that we have with Chile. Market conditions surrounding the production

and sale of agricultural commodities are far too volatile to be subject to the conventional anti-dumping rules that are applied to manufacturing-type industries. Far too often, as is the case here, anti-dumping cases are based on normal cycle price fluctuations and become barriers to trade, rather than the insurance of open markets they were intended to be. Our trade negotiators need to be keenly aware of this when dealing with other countries.

Negotiators must also work towards shackling overly creative bureaucrats in the countries that we do business with. We must insist on *independent* appeal tribunals, which can rule quickly with final authority and have the sanctioning power to back up their rulings. Justice delayed is justice denied in these cases, because it can lead to the bankruptcy of affected parties.

NAFTA could be reopened and taken to the next level, bringing it much closer to true free trade than the current version. It could also be used to develop a common economic union, like Europe or Great Britain. With Canada, Mexico, and the US forming a United Republic Of The Americas.

We should also move to quickly reduce Canada's own protectionist measures such as milk and dairy products pricing, state trading arrangements for dairy and wheat products, film distribution, taxation of periodicals, textiles, export support for aircraft and the automotive trade regime, with the intention of completely eliminating them in the next five years.

SOURCES

Statistics Canada, Consumers for World Trade, Country of Origin Labeling Study by the George Morris Centre, 2003, the *Manitoba Co-operator*, *Agriweek*, the Pork Trade Action Coalition, "Pork and Protectionism" in the *Wall Street Journal*, October 26, 2004, www.nppc.org, www.gov.mb.ca/agriculture, www.cpc-ccp.com, www.manitobapork.com.