Mandatory Country-of-Origin Labeling (MCOOL), Its Economic and Trade Policy Implications

William A. Kerr
Van Vliet Professor
University of Saskatchewan, Canada

Senior Associate
Estey Centre for Law and Economics and International Trade
Saskatoon, Canada

and

Shannon L. Hall
Research Assistant
Department of Agricultural Economics
University of Saskatchewan, Canada

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> In the restraints upon the importation of all foreign commodities which can come into competition with those of our own growth or manufacture, the interest of the home-consumer is evidently sacrificed to that of the producer. It is altogether for the benefit of the latter that the former is obliged to pay that enhancement of price which this monopoly almost always occasions.
>
> Adam Smith, 1776[1]

Introduction

Political economists from Adam Smith on have warned us about protectionists attempting to clothe themselves in the raiment of the general good while, in reality they are simply attempting to feather their own nest. The claims of vested interest are seldom, however, checked to see if they are true, either because they do not win the argument and the protection they seek does not materialise or, once the battle over protection is lost, those who opposed the protection have little incentive to revisit the arguments (Kerr and Foregrave, 2002). The result is that protectionists are able to make "wild claims" to support their case with relative impunity. Trade policy professionals should not be surprised by such claims. Protectionists are skilled "spin doctors" and adept at rent seeking or limiting the deleterious effects declining relative competitiveness on their vested interests.

Every once in awhile, however, a trade policy initiative comes along that is so odd that it defies rational analysis and one is forced to search deep into the history of economic thought to find an explanation – in the case of the Mandatory Country of

[1] See Smith (1994), p. 715

Origin Labelling (MCOOL) provisions of the US 2002 Farm Bill, the only answer we can find is from *The Wealth of Nations* (p. 580)[2].

> The laws concerning corn may everywhere be compared to the laws concerning religion. The people feel themselves so much interested in what relates either to their subsistence in this life, or to their happiness in a life to come, that *government must yield to their prejudices*, and, *in order to preserve the public tranquillity*, establish that system which they approve of. It is upon this account, perhaps, that we so *seldom find a reasonable system* established with regard to either of those two capital objects [emphasis added].

The reason why MCOOL is so odd is that while it is understandable that vested interests would ask for a protectionist policy that would be to their benefit, it is much more difficult to understand why a group would ask for a policy that may well be to their own detriment. It is also understandable that a group of farmers lobbying for a protectionist policy might 'get it wrong' and fail to realise the full ramifications of their position; it is harder to understand in a modern market economy with a great deal of sophisticated analytical human capital that such a policy could survive both public and private sector scrutiny and become law[3]. This is a failure in trade policy making. Apologists for trade policy making in the US suggest that the passage of MCOOL arose because of a relatively unique set of circumstances in the US Congress. Be that as it may, a policy has been put in place that, if implemented, will likely be detrimental to the US industry it was designed to protect and will lead to hardship in the short run for industries in Canada and Mexico. It also opens up the US to the use of MCOOL legislation by trading partners where the cost of protectionism will fall far more heavily

[2] See Smith (1994).
[3] All of the public and private analysis of MCOOL done in the US that I have been able to read has given it a negative report.

on US exporters than industries in the foreign markets that have implemented their own MCOOL program. Faced with folly in trade policy making, the best economists can do is to lay out the expected effects and hope the analysis better informs the policy process.

If there was ever any doubt that those in the US administration did not believe or understand that MCOOL represented a trade barrier that would be detrimental to foreign suppliers irrespective of the detrimental effects on the US industries to which MCOOL is to be applied, the following exchange between US and South Korean officials reported in *Inside US Trade* (January 5, 2001) should allay any doubts:

> Korea has stepped back from a new country-of-origin labeling rule for meat that U.S. officials argued would have completely choked off U.S. beef and pork exports to Korea.
>
> Korea last month agreed to delay implementation of the rule by one year, after Secretary of Agriculture Dan Glickman and Deputy U.S. Trade Representative Richard Fisher told Korean officials that the U.S. could not implement the rule as written and so could not export beef and pork to Korea, which is the third largest market for U.S. beef exports.
>
> In a meeting with Korean Ambassador Yang Sung Chui, Fisher hinted that the move by Korea could provoke a challenge in the World Trade Organisation, alleging that the rule was inconsistent with the Agreement on Rules of Origin …
>
> The Korean rule would have introduced mandatory country-of-origin labeling for foreign beef and pork, and defined country-of-origin as the country where the live animal resided for six months prior to slaughter in the case of cows, and for two months prior to slaughter in the case of hogs. The concern from the US meat industry was that there was currently no system for tracking passage of beef and pork from feedlot to slaughterhouse and through the packing process.

The MCOOL legislation is also curious because of the narrow range of products to which is applies. The products to which MCOOL applies include: muscle cuts of beef (including veal) lamb, and pork; ground beef, ground lamb, and ground pork; farm-raised fish and shellfish; wild fish and shellfish, perishable agricultural commodities (fresh and frozen fruits and vegetables), and peanuts. The law *excludes* food items from country of origin labelling when a covered commodity is an "ingredient in a processed food item". The law does not apply to covered products sold in restaurants and other food service outlets.

The most obvious omission from the list of covered commodities is chicken. For some reason consumers of chicken have no need to know the country of origin of their choices. Given the long (and loosing) battle that beef, and to some extent pork, have been fighting with chicken over the share of the consumer's budget spend on meat (Atkins, et. al, 1989), fostering or acquiescing to a law that imposes costs on beef and pork but not chicken will lead to a further deterioration in market share.

It is also curious that restaurant consumers are considered to be less discerning in their consumption choices than those who shop in supermarkets. Given that US producers will have to put labelling mechanisms in place that raise their costs if they wish access to the higher priced home consumption market, it will make competing foreign unlabelled product relatively less expensive for hotel, restaurant and institutional (HRI) supply chains. As HRI-based consumption has been growing faster than the home consumption market, over the long run MCOOL would seem not to be in the interest of producers of covered commodities. Mandatory country of origin labelling also does not apply to processed foods – another fast growing area of consumption. Processed foods substitute processors labour for consumers labour in preparation and, in the process, combine relatively low cost inputs with high cost meat products. This means that a smaller proportion of a consumer's food budget is spent on high value products than when muscle meats are, for example, barbecued or oven roasted. Hence, MCOOL is going to make it easier for unlabelled foreign product to compete with US produced muscle meats for the consumer's food budget.

Is There a Market Failure?

Government intervention in markets can be justified if a market failure exists. Intervention to remove a market failure could be a justification for trade measures. Is there a market failure in the case of the products covered by mandatory country of origin labelling?

Figure 1 can be used to illustrate a possible market failure that could be the basis of mandatory country of origin labelling. To understand the market failure, first assume that the US embargos the import of the good – it is in a situation of autarky. As a result, the market is supplied exclusively by 'United States Country of Origin' product and consumers have perfect knowledge of the country of origin of the product they are consuming. In Figure 1, the demand curve under the embargo is D_A and the supply curve for US product is S. Under the embargo the price would be P_A and the quantity Q_A.

Now assume that the embargo is removed and imports can be obtained from foreign suppliers at P_W.[4] The foreign product is imported without labelling and is indistinguishable from domestically produced product. In other words, country of origin is a 'credence' attribute of the good – meaning that the consumer cannot discern whether they have acquired foreign product prior to purchase or after consumption.[5] If consumers

[4] Assuming a perfectly elastic supply of imports may not be strictly correct in the case of products that have been named in the MCOOL legislation given the relative size of the US market in NAFTA, but an upward sloping supply curve will unduly complicate the graphics and not materially alter the results.
[5] Products that have characteristics that can be differentiated prior to purchase are known as 'search goods' while those that have characteristics that can be discerned during consumption are known as 'experience goods'. An example of a search good is unprocessed fruit whose freshness attribute can often be discerned by visual inspection prior to purchase. A can of pees is an experience good because the taste and other

do not care at all about country of origin then the demand curve would remain at D_A and one would obtain the standard trade result. If, on the other hand, some US consumers do have a preference for US product over foreign products, it means that they value foreign products less than US products. As these consumers cannot determine whether they are consuming domestic or foreign product, their individual demands will decline. Hence, as a result of allowing unlabelled imports, aggregate consumer willingness to pay falls and the demand curve shifts down to the 'pooled' demand curve, D_P as a result in the decline in average perceived quality (Gaisford and Kerr, 2001). Note, the shift in the demand curve will take place as long as at least some consumers value mixed products less than those labelled 'United States Country of Origin'. Domestic output will be Q_S and domestic consumption at Q_D. There are two opposing effects on the welfare of US consumers from opening up the market to unlabelled imports. On the one hand, there is a beneficial price effect of **w** + **y**. There is also an adverse quality effect equal to '**z**'. If the adverse quality effect is perceived to be sufficiently large there may be a justification for a public policy intervention to correct the market failure. Labelling is one way to address the market failure.[6]

The effect of a mandatory country of origin labelling policy can be illustrated using Figure 2 where P_W, Q_S and D_P are the same as those in Figure 1. For simplicity we assume for the moment that MCOOL can be implemented without cost. With MCOOL, consumers can now choose to buy products labelled 'United States Country of Origin' or

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attributes of the peas cannot be discerned until they are eaten. See Hobbs and Kerr (1999) for a further discussion of the three types of goods.

[6] An alternative would be an import embargo. Gaisford and Kerr (2001) show that mandatory labelling of imports is unambiguously superior to an import embargo for the importing country.

a product labelled as being of foreign origin.[7] Thus, the pooled market is no more and there are instead two markets. The demand for the labelled foreign product will be made up of consumers who are indifferent between 'United States Country of Origin' product and those labelled as being of foreign origin. As long as US product is more expensive than foreign product they will be willing to purchase the foreign product. Further, there will be consumers who, while they have a preference for US product over foreign product, will be induced to switch to the foreign product as the relative price of US product rises. Thus, demand for the labelled foreign product, D_{FL} will, in part, be determined by the relative prices of the two products. The protectionist motive for MCOOL can also be discerned. In the market for 'United States Country of Origin' products, those who advocate the policy hope that the demand curve for those who have a preference for their product will lie anywhere to the right of the point where P_W cuts the supply curve S. This case is depicted in Figure 2 by the demand for US labelled product, D_{USL}.[8] In the 'United States Country of Origin' market, price and quantity would be $P_{US}*$ and Q_S*. Producers would gain surplus area '**a**' relative to the unlabelled case.

Figure 2, however, is unrealistic because it does not consider the costs of implementing a labelling system. In Figure 3 the costs of labelling are added. In the 'United States Country of Origin' market adding the cost of labelling shifts the supply

[7] For simplicity it is assumed that all consumers are indifferent among foreign products

[8] Note, there are two opposing forces leading to D_{USL}. If one starts at D_P there is a leftward force on the demand curve due to some consumers switching to the labelled foreign market, while at the same time those with a preference for 'United States Country of Origin' products no longer experience the adverse quality effect from having mixed or pooled products effectively shifting their demand to the right. The net effect will depend on the strength of preferences of all consumers and cannot be discerned ex ante. It could be that D_{USL} intersects P_W to the left of Q_S meaning that the producers asking for protection will be worse off as a result of their asking for protection. We do not consider this case. The best possible result for producers would be that all consumers prefer 'United States Country of Origin' product, at least to the point where the price differential equals P_A minus P_w in Figure 1, and the demand curve shifted to D_A. In other words no consumers switched to the labelled foreign product market.

curve from S to S + L. This market will be in equilibrium where D_{USL} (from Figure 2) intersects S + L yielding P_{US+L} and Q_{SL}. If Q_{SL} is less than Q_S then producers who lobbied for MCOOL will be worse off by **d** + **e**. Of course, the equilibrium in the 'United States Country of Origin' market will depend on the relative labelling costs for the domestic and foreign suppliers – remember that the higher the relative difference in price between 'United States Country of Origin' product and the labelled foreign product, the more consumers will switch to consuming the labelled foreign product. MCOOL clearly leads to a welfare loss for consumers who would choose the labelled foreign product and the larger the cost of labelling in the 'United States Country of Origin' market, the more likely that there will be a welfare loss from the policy as a whole.

Figure 3 may also explain why voluntary country of origin labelling has not been taken up. If the costs of labelling are positive, then voluntarily labelling ones product shifts the supply curve from S to S + L in the 'United States Country of Origin' market. If there are consumers who are indifferent to the country of origin, they will still be able to buy cheaper foreign product, even if it is not labelled, at P_W. As labelling will increase price in the 'United States Country of Origin' market but leave P_W unchanged, the price differential would increase and more consumers would switch to foreign product shifting D_{USL} to the left. Hence, the likelihood of a positive increase in producers' surplus is reduced. Even with MCOOL, the cost of labelling for foreign exporters is likely to be less than that for domestic producers because they will not be required to put the expensive tracing systems in place that are required for domestic producers. It is relatively inexpensive to label final products – much of it is labelled already. As a result, the price differential between US and foreign prices is likely to increase.

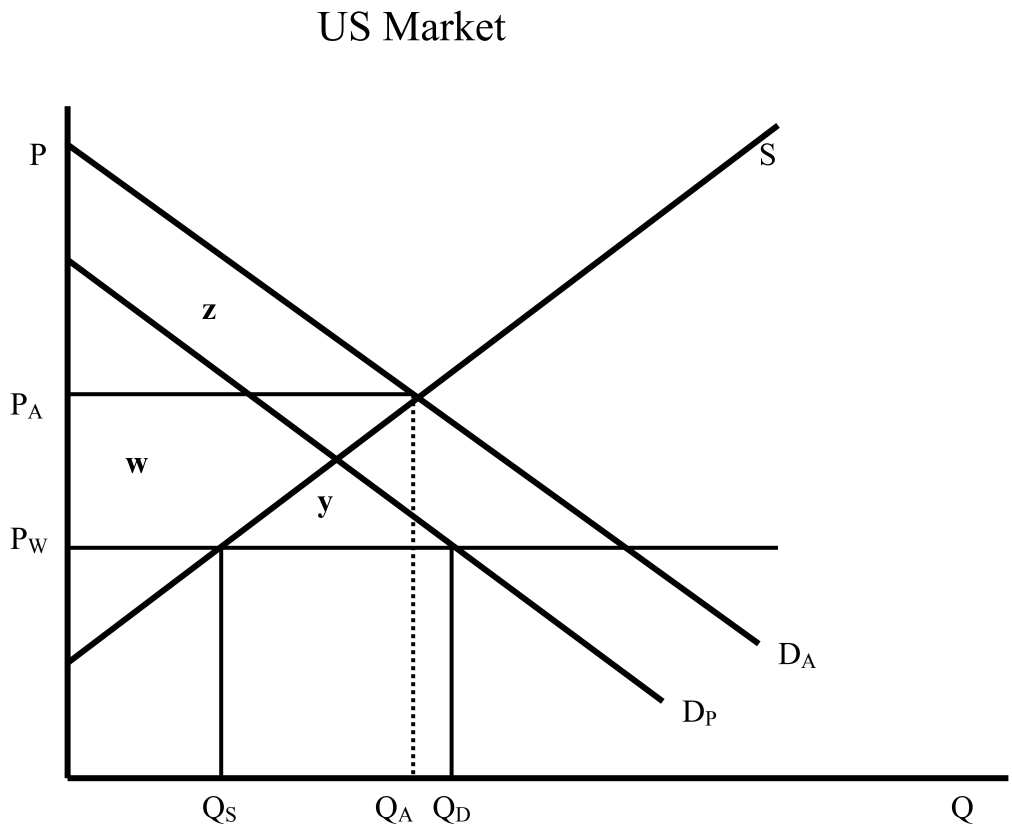

Figure 1 – Market Failure in the US

Market for ‘United States Country of Origin’ Labelled Foreign Product

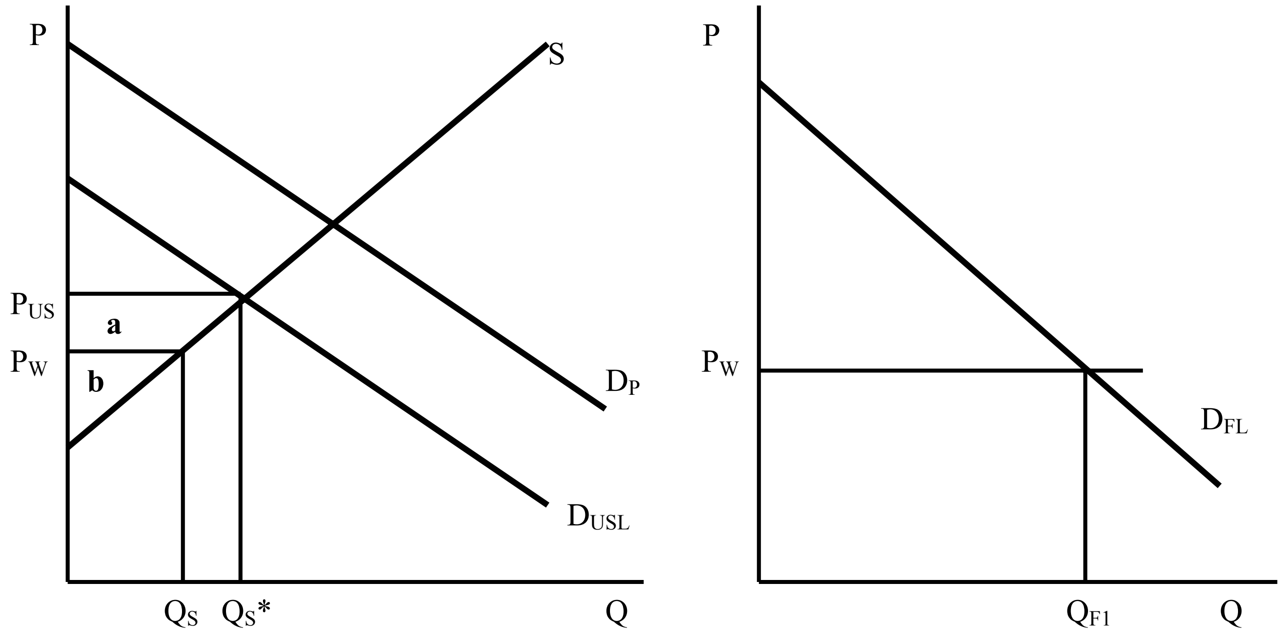

Figure 2 – Country of Origin Labelling Assuming Zero Labelling Cost

Market for ‘United States Country of Origin’ Labelled Foreign Product

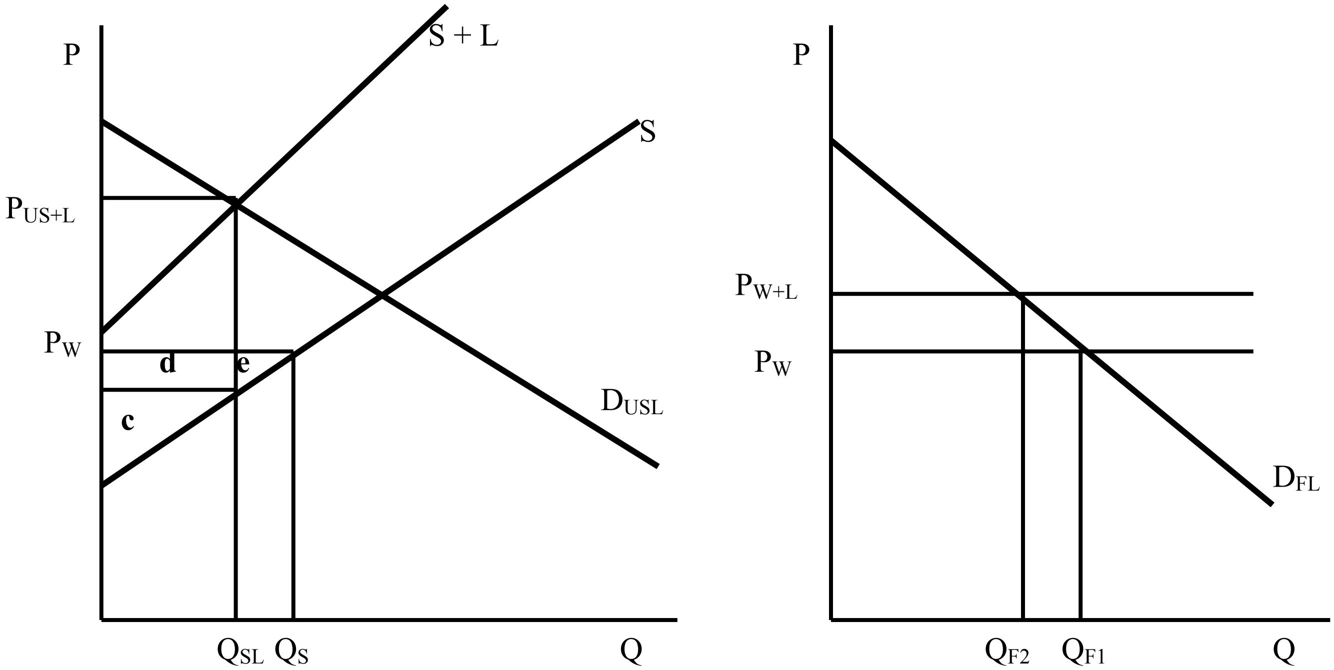

Figure 3 – Country of Origin Labelling with Positive Labelling Costs

Impact on Foreign Suppliers

The analysis in the previous section was undertaken to illustrate the effects of MCOOL on covered product originating in the US. Assuming perfectly elastic supply curves for foreign products effectively obscured any effects on foreign suppliers and focussed attention on the US market. If the US market is large relative to individual foreign suppliers' total production, however, normal upward sloping supply curves will apply. In the case of table ready cuts of beef and pork, the relative cost of MCOOL should be less for Canadian and Mexican products than US products. This is because Canada and Mexico will not have to put the tracing and monitoring systems in place back to the farm of origin that will be required of US producers. Table ready cuts originating from Mexico or Canada will only have to be labelled 'Product of Mexico' or 'Product of Canada' when it leaves processing plants in Mexico and Canada. Its origin does not have to be traced further[9]. The same would be true for all covered products of foreign origin. Products in this form already have to be labelled and the US distribution system has no particular difficulty dealing with such products. The label is on the product for consumers to see and retailers do not have to take any particular actions.

In the case of livestock products, over time final table ready cuts will become the preferred export product from Canada and Mexico. This will mean more stages of production and processing will take place in Mexico and Canada meaning more jobs and investment. Under the current less restrictive trade regime, movements of less than consumer ready products across the US border are more profitable. According to Hobbs and Kerr (1999), competitive pressure will lead to the most efficient supply chains arrangements surviving. In other words, the current efficient supply chain arrangements in North America lead to imports of boxed beef that are further processed into table ready cuts; imports of slaughter cattle and hogs to be processed in the US and the import of feeder cattle and weaner pigs for fattening and eventually processing in the US. It is these mixed country of origin supply chains that will be most negatively impacted if MCOOL is implemented in these industries. The problems will be more difficult in the short run but as time progresses adjustments, particularly through investment in processing capacity, will reduce the overall impact on the Canadian and Mexican industries.

The products of mixed country of origin supply chains will have to be labelled, for example 'born in Mexico, raised and processed in the United States' or 'born and raised in Canada and processed in the United States'. These mixed country of origin products will have to be kept separate throughout the supply chain until they are labelled for sale to final consumers. These products will require separate tracking systems and will create problems in terms of warehousing, transportation and processing line procedures – all of which will increase costs along the supply chain. There may also be shelf-space crowding problems in supermarkets that will add to the cost of marketing mixed country of origin products (Grier, et al., 2002).

The current mixed country of origin supply chains mean that supply chain capacity is located on both sides of the border. Thus, if retailers, for example, refused to put mixed country of origin products on their shelves, effectively eliminating those supply chains from the North American market, there would be a shortage of upstream facilities in the United States and a shortage of downstream facilities in Mexico and Canada. For example, currently Mexico exports feeder cattle to the US. If mixed

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[9] Of course, Canada and Mexico may have tracing systems in red meat for other, health-related reasons.

country of origin beef is no longer to be sold in the US then cattle feeders that have been feeding Mexican steers will have to source them from the US. In the short run there will not be sufficient cow-calf capacity in the US to provide those extra cattle. Similarly, if fed cattle from Canada were excluded from being slaughtered in the US, packing plants in the US may be forced to close because the capacity to provide alternate local supplies of fed cattle do not exist.

In a similar fashion, if weaner pigs from Western Canada were excluded from being finished in the US, there is not sufficient sow barn or farrowing capacity in the US to provide the additional weaner pigs required to ensure the full use of US hog finisher capacity (Grier, et al. 2002). On the other side of the border in Canada, there is not sufficient capacity to finish and process the weaner pigs shut out of the US market. There is not enough cattle feeding capacity in Mexico to finish the current supply of feeder cattle that normally flows into the US. One way or the other, there will be a disruption to mixed country of origin supply chains. In part, this will be manifest in idle capacity and in part through changes in relative prices with prices in Canada and Mexico falling and prices for inputs in short supply rising in the US. If the price wedge becomes sufficiently high to overcome the costs of mandatory labelling, mixed country origin supply chains will survive or be re-established. These disruptions will be, however, short run phenomenon.

The decline in prices of inputs in Canada and Mexico will provide an incentive to expand downstream capacity for finishing animals and processing them. In the long run, Canada and Mexico will simply ship increasing quantities of consumer ready beef and pork products to the US. These products that can be easily labelled when they leave the processing facility. Canadian and Mexican supply chains selling their final product in the US will not be burdened with the cost of MCOOL labelling giving them a competitive advantage in the US market. The exact shape of international trade flows cannot be discerned as lower priced Canadian and Mexican product will also be more competitive with US exports both in their domestic markets and in overseas markets. Once the short-run mismatch of capacity on either side of the border has been rectified through increased investment, the US industry will find itself lumbered with the costs of MCOOL while its NAFTA competitors will not.

The cost of the short run disruption to mixed country of origin supply chains should not be trivialised. Those exporting through mixed country of origin supply chains from Canada and Mexico will suffer from low prices and a lack of markets. There will also be short run opportunities for windfall gains in the US for existing producers of inputs normally supplied by foreign suppliers. Given the relatively competitive nature of these industry segments in the US, the higher prices will be short lived. If the price increases are dramatic, it may set off a wave of 'destructive competition' (Hulleman and Kerr, 1998) that may make the input industry worse off in the long run.

In general, the long run configuration of the North American beef and pork sectors will change – mixed country of origin supply chains are likely to disappear. Supply chains for the US home consumption market will be of two forms; (1) those for products that were produced entirely in the US and labelled as such, and (2) foreign consumer ready products labelled as being from the country where final processing took place. There is also the possibility that new mixed country of origin supply chains will arise that exclusively serve the HRI trade. The latter would be segregated from the supply chains providing meat for the home consumption market.

Given the cost of the short run disruptions for the NAFTA trading partners of the US, the question arises as to whether MCOOL can be challenged in international trade law. Both the World Trade Organisation (WTO) and the NAFTA have country of origin labelling provisions. These are examined in the next section.

Challenging MCOOL in International Trade Law

Country of origin labelling is allowed in the WTO, but there are some constraints on its use. Article IX, Marks of Origin, of the General Agreement on Tariffs and Trade (1994) allows imported products to be labelled with a specific country of origin at the time of import so long as the marking requirement does not seriously damage the imported products, *materially reduce their value*, *or unreasonably increase their cost*. It seems likely that either one or both of the italicised outcomes will be able to be strongly argued at the WTO. Unfortunately, they can only be argued after the fact – after there is evidence that value has been reduced or costs increased.[10] As a result, much of the damage would have already been done as the costs of MCOOL are expected to be much larger for the Canadian and Mexican livestock industries in the short run than in the long run. The *materially reduce value* and *unreasonably increase their cost* criteria have never been tested at the WTO so there are no precedents to assist in determining what the dispute panels would consider as *materially* or *unreasonably*. As a result, while I believe Canada or Mexico would have a strong case, they could well lose the case.

[10] It might have been possible to argue the case ex ante to implementation if better modelling capacity existed in Canada or Mexico.

It is becoming increasingly apparent that for Canada and Mexico, the WTO dispute resolution system better serves their interests than the system provided in the NAFTA (Kerr, 2001a). The NAFTA does have different provisions for Country of Origin Marking. These are laid out in Annex 311; it states:

> Each Party shall, in adopting, maintaining and applying any measure relating to country of origin marking, minimize the difficulties, costs and inconveniences that the measure may cause to the commerce and industries of the other Parties.

There seems to have been little attempt to 'minimize the difficulties, costs and inconveniences' when the MCOOL was passed. In particular, the provision that an animal must born in the US for the final product to be considered as 'United States Country of Origin' seems designed to have just the opposite effect. It is, however, not clear how a NAFTA panel would deal with the key terms *minimise*, *difficulties* and *inconveniences* – again this is uncharted territory.

The major problem with a WTO or NAFTA challenge is that they could only be mounted after MCOOL came into effect. Given that the major disruptions for Canada and Mexico are expected to take place in the short run, a challenge would mean a considerable period of uncertainty while the case was working through the adjudication process. If there was a reasonable prospect of winning, investments designed to mitigate the difficulties caused by MCOOL would be delayed due to the risk that they would be wasted if MCOOL was overturned by a Panel. This will extend the period of short run disruption and increase its cost. If there were to be no challenge, investments in expanding capacity could take place in a climate of relative surety.

The provisions of international trade law, however, are operating in the background to improve the chances that MCOOL will be repealed. One of the basic principles of the WTO is *National Treatment*. This means that foreign goods cannot be treated differently from domestic goods. This is why the MCOOL legislation forces US as well as foreign product to be labelled. If it did not, the MCOOL legislation could impose a higher standard on foreign products. Foreign suppliers could be required to label and certify their products while US firms would not. That would violate the *National Treatment* provisions of the WTO. As a result, MCOOL will impose much larger total costs on the US livestock industries than exporters given the relative sizes of the US domestic industries. Given that even those who lobbied for MCOOL may have realised that they will bear considerable costs without receiving any benefit, the chances that MCOOL will be amended or withdrawn are considerably increased. Of course, at least to this point, this has been accomplished by a failure of Congress to fund the implementation of the program.

Lessons from the BSE Border Closure

Sometimes protectionists' fantasies come true. For those who advocate mandatory country of origin labelling for beef the best case scenario would be that live cattle imports would cease due to the increased cost of tracing and segregating products of foreign origin in mixed supply chains and that all US consumers actually have a strong preference for US beef once it is labelled and would cease buying foreign beef. The net economic effect, however, would be exactly the same as having the border closed to imports. Of course, this is exactly what happened in the wake of Canada having discovered a single cow infected with bovine spongiform encephalopathy (BSE) – mad cow disease – on May 20, 2003. Imports of Canadian beef cattle and beef were prohibited. The US border remains closed to live cattle exports but did open to imports of beef on August 8, 2003. In fact the effect of the BSE border closure should have an even larger impact on the US market than would be the case with MCOOL because imports destined for the HRI trade are also restricted[11]. In other words, the market effects in the US due to the embargo on imports of beef should represent the best case scenario that the protectionists advocating for MCOOL could expect. Until now, it has been difficult to estimate the price effects of MCOOL so that they can be compared to the cost of the program.

Of course, full analysis of the effects on the BSE border closure will have to await the complete opening of the market and the time it needs to return to normal market conditions – the results presented here are, hence, preliminary and incomplete. Figure 1 shows the price of slaughter steers in the US before and after the border closure. Initially, the US price of slaughter steers declined when the border closed suggesting that other forces in the US market are more important than the effect of a border closure. Of course, this is to be expected given the small proportion of the market that are comprised of imports. Figure 4 also shows the long term variability of US slaughter cattle prices which have been far lower than present over the last few years, again suggesting that trade is not an important overall component of US beef prices. Figure 5 presents a shorter time series of the same slaughter cattle prices. The decline in prices and their subsequent rise appear to be within the range of prices that existed prior to the border being closed. In the 13 weeks prior to the closure of the border, US slaughter steer prices averaged

[11] Of course, unlike the case of MCOOL pork imports are not affected. Declining prices of beef in Canada have put downward pressure on pork prices in Canada. This downward pressure on pork prices has led to increased pork exports from Canada to the US which, in turn should decrease US pork prices leading to a moderation in US beef prices.

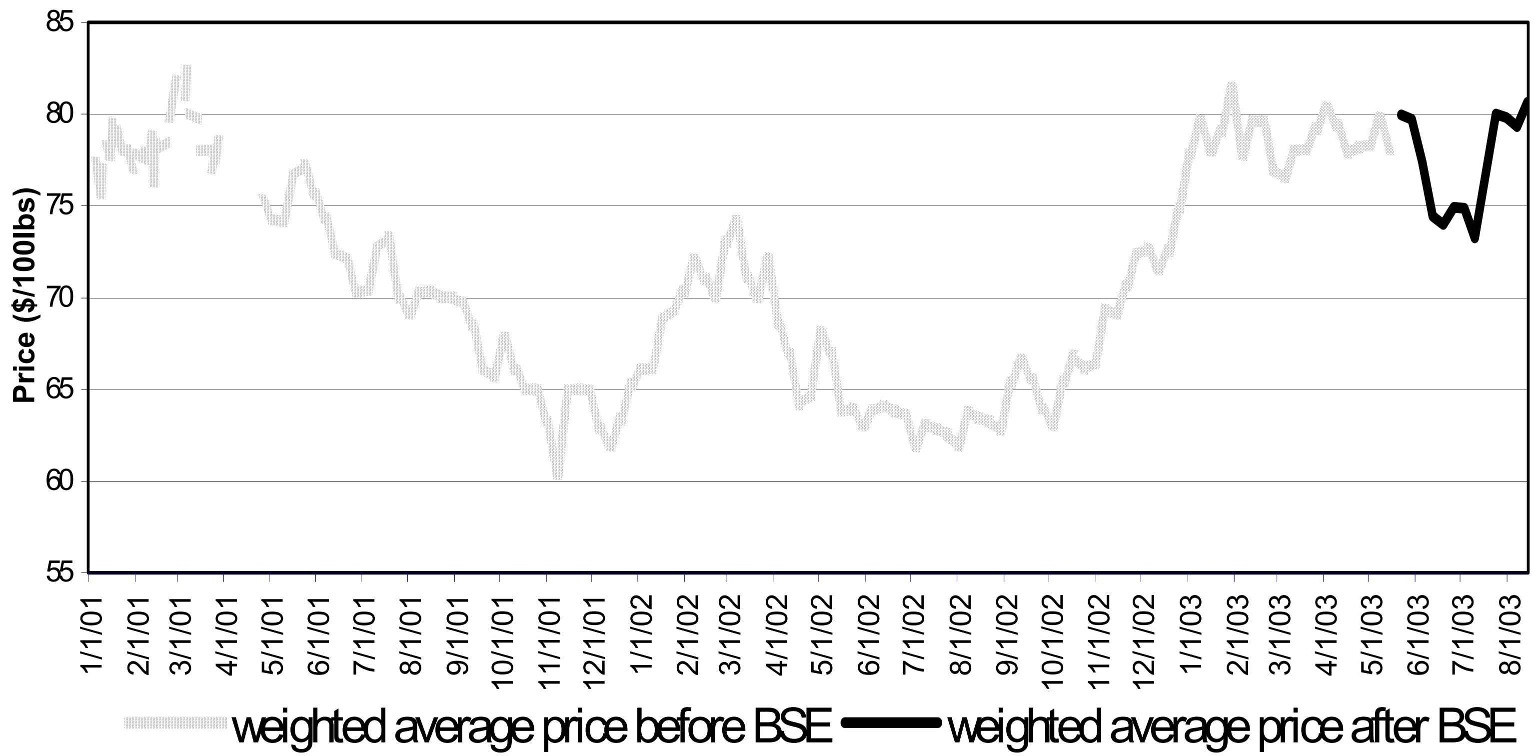
$78.48. In the 13 weeks after the border closure they averaged $77.30. Of course, the border reopened for beef at the end of the period shown. Beef prices could be expected to have the greatest influence on the price of slaughter cattle. In short, even if US consumers had a strong preference for 'United States Country of Origin' product, there would be little benefit to the beef industry from MCOOL, and the costs that will be imposed on the industry need to be closely examined with this conclusion in mind.

Cow-calf producers, at least in some parts of the US, have been the major advocates of MCOOL. The closure of the border effectively removed feeder cattle of Canadian origin as competitors. Figure 6 shows the US price of feeder steers before and after the closure of the border. Prices have clearly increased since the closure of the border, although they were already on a rising trend. In Figure 7, which shows a shorter series of the same prices, there was no sharp break in the upward movement of cattle prices after the border closure. Even if all of the increase in prices could be attributed to the border closure, prices only rose from an average of $77.95 in the sixty-day period prior to the border closure to $87.77 in the sixty-day period after the border closure, an increase of only twelve percent. While in an industry that prides itself on narrow profit margins, this increase could be considered significant, it should be remembered that this is the "best case" best case scenario arising from the MCOOL policy. It is clearly a short-term shock to the market that does not allow any adjustments. Allowing short-run adjustments, the price premium might be cut to eight percent[12]. This would have to be compared to the increased costs of satisfying the requirements of the MCOOL regulations. Of course, given that the cow-calf industry is relatively competitive, any

[12] Again, assuming that all the increase in price after the closure of the border could be attributed to that closure.

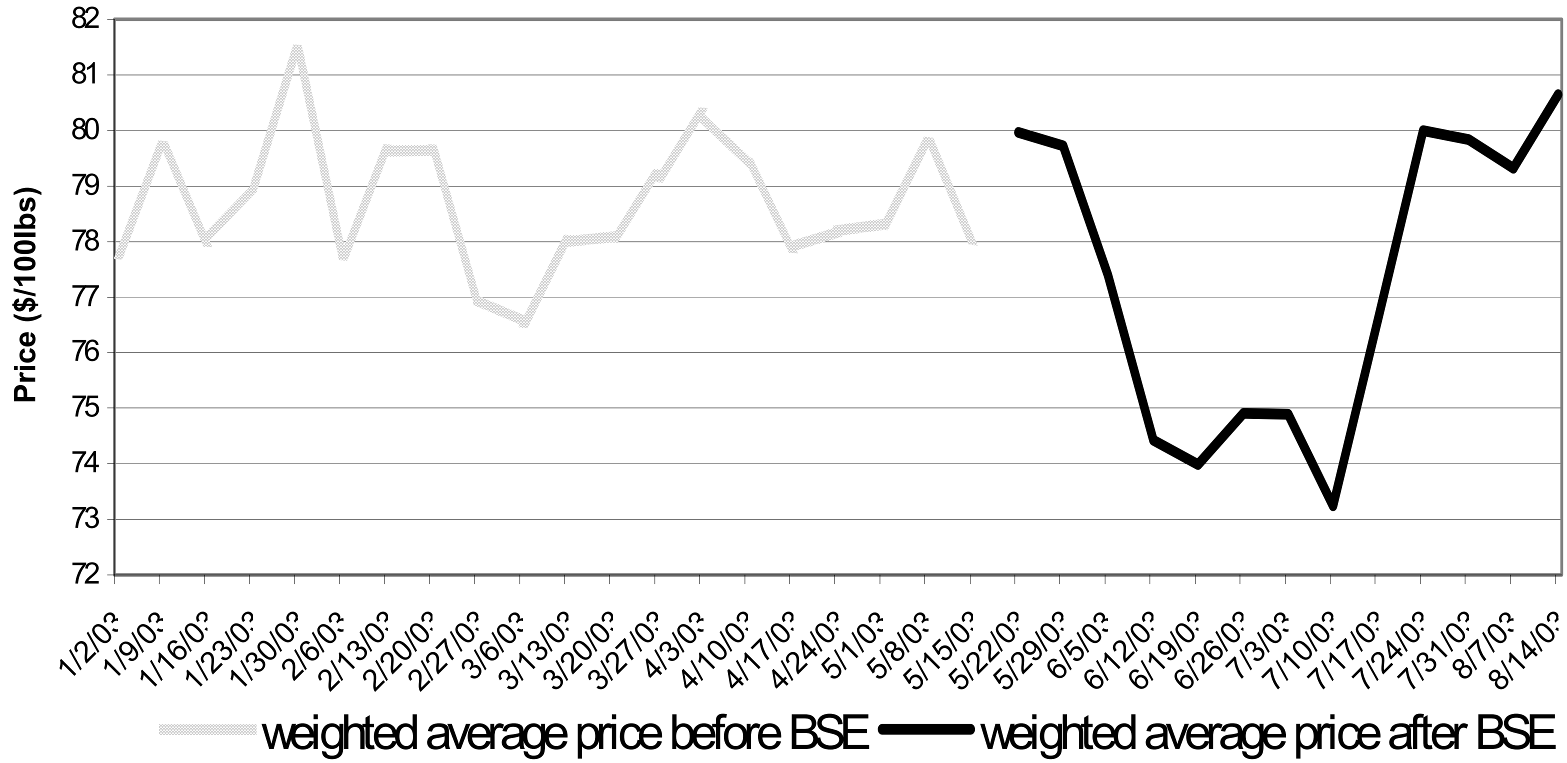
increase in profitability arising from MCOOL will be competed away as a result of entry into the industry in the US. Again, one should use caution when using the information on changes in prices arising from the BSE border closures as a proxy for the effects of implementation of MCOOL due to differences in the market conditions and the preliminary nature of the data.

Figure 4: U.S. 5- Area Weighted Average Price of Slaughter Steers
January 1, 2001 - August 14, 2003



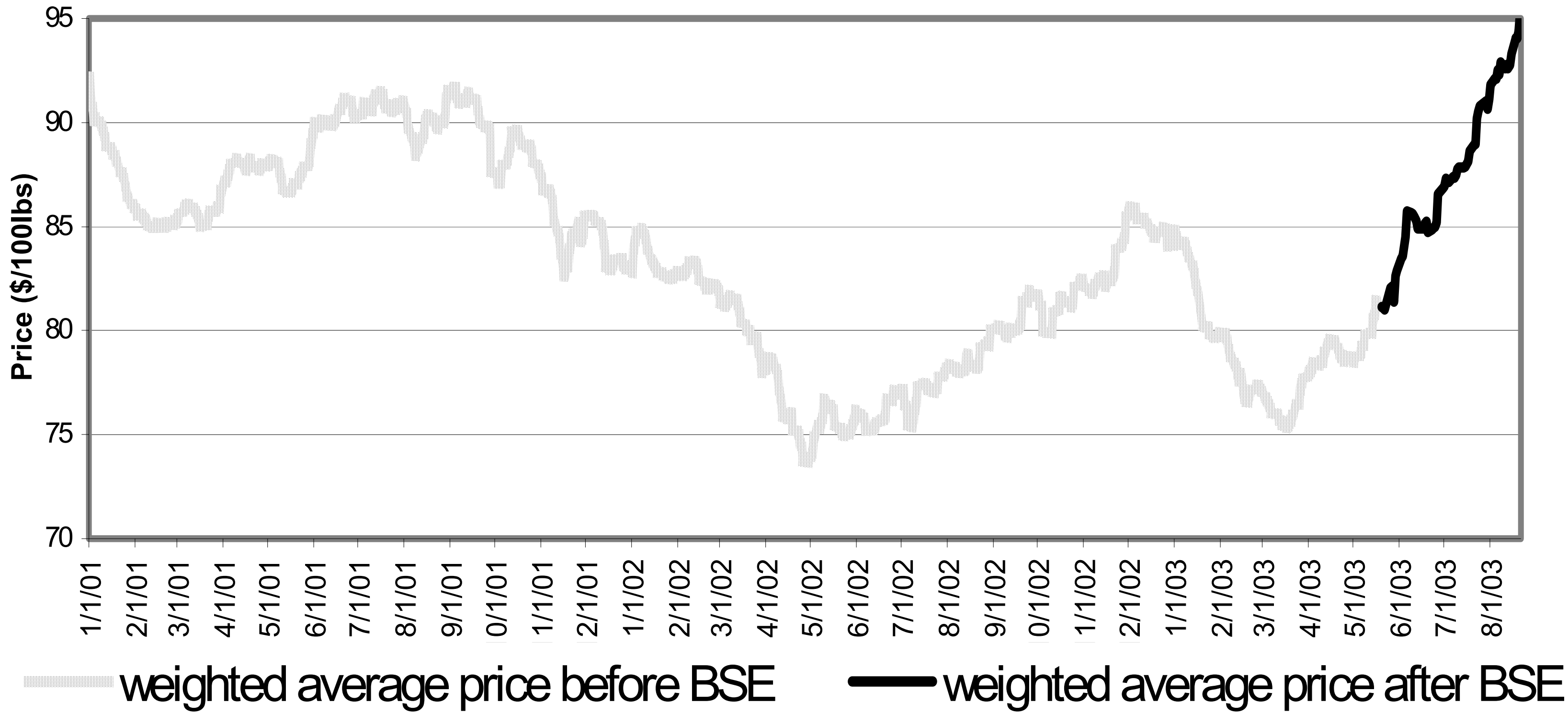
Source: USDA Market News Service- Texas?Oklahoma; Kansas; Nebraska; Colorado: Iowa/Minnesota- www.ams.usda.gov/mnreports/lm_ct100.txt

Figure 5: U.S. 5-Area Weighted Average Price of Slaughter Steers
January 1, 2003 - August 14, 2003



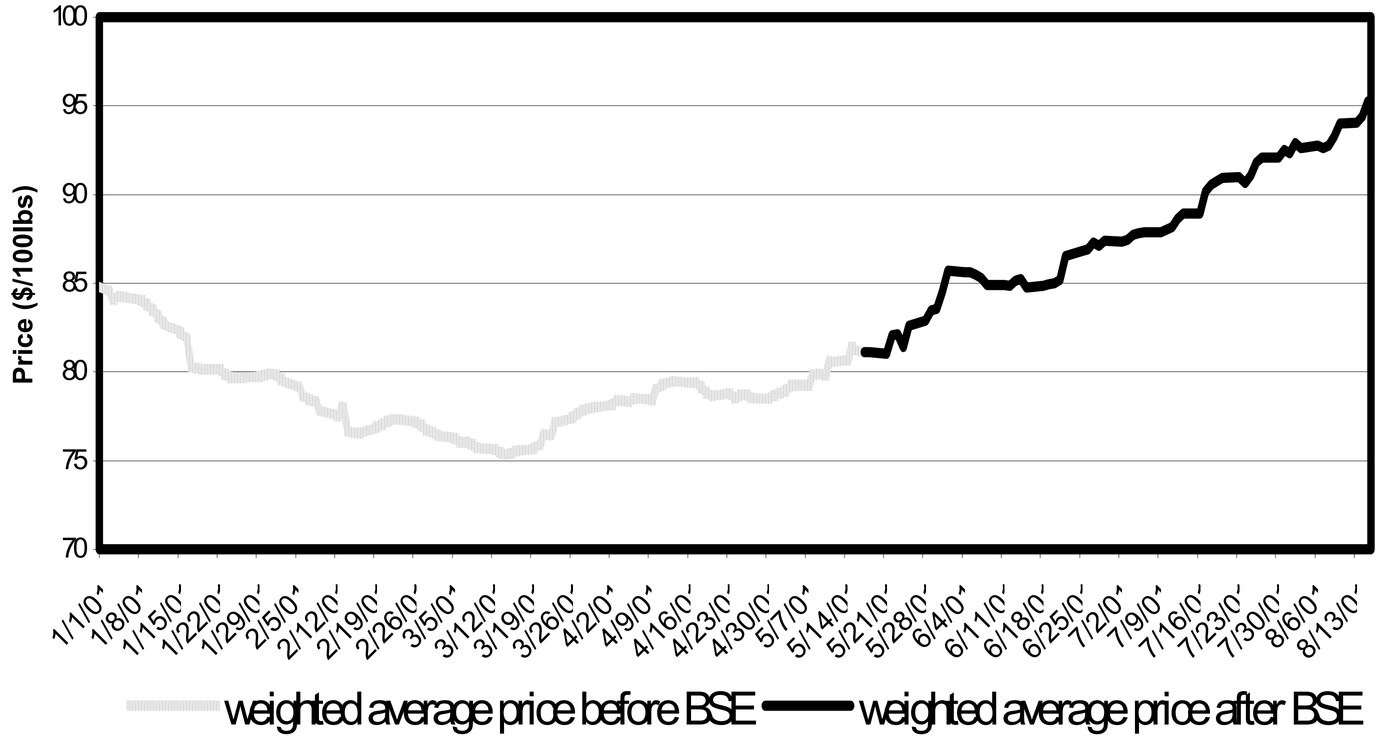
Source: USDA Market News Service Texas/Oklahoma; Kansas; Nebraska; Colorado; Iowa/Minnesota www.ams.usda.gov/mnreports/lm_ct100.txt

Figure 6: U.S. Composite Weighted Average Price of Feeder Steers
January 1, 2001 - August 21, 2003



Source: Chicago Mercantile Exchange amalagamation of US auction market reports
www.cme.com

Figure 7: U.S. Composite Weighted Average Price of Feeder Steers
January 1, 2003 - August 21, 2003



Source: Chicago Mercantile Exchange amalagamation of US auction market reports www.cme.com

Conclusion

If it is implemented, mandatory country of origin labelling for beef and pork in the US will represent the first major set back in the market integration that has been progressing since the signing of the NAFTA. While the deepening of economic integration in the NAFTA has been an incredibly slow, and at times frustrating process (Kerr, 2001b) – e.g. the inability to accomplish something simple such as the harmonisation of beef grading, it has progressed all the same. The development of mixed country of origin supply chains is the proof that NAFTA is working. Given that the share of Canadian pork is approximately four percent of the US market and Mexican and Canadian beef imports a similarly small proportion of the US market, it is hard to see what the protectionists in the US expect to gain. The real anomaly of MCOOL is how the public policy process could have allowed such a counter-productive policy to become law. Of course, at the time of writing, the future of MCOOL, at least as far as livestock products is concerned, is in limbo due to the failure of the US House of Representatives to fund its implementation but with the possibility that the US Senate will vote to fund it, and a reconciliation of the two Bills that would restore funding a possibility.

While it is problematic to draw parallels with the BSE border closure and MCOOL. One does wonder how a NAFTA Panel might treat MCOOL's implementation. Figure 8 shows the effect of the BSE border closure on Canadian cattle prices. Remember, the NAFTA provision pertaining to country of origin labelling is:

> Each Party shall, in adopting, maintaining and applying any measure relating to country of origin marking, *minimize the difficulties, costs and inconveniences that the measure may cause to the commerce and industries of the other Parties*. (NAFTA Annex 311, *emphasis added*).

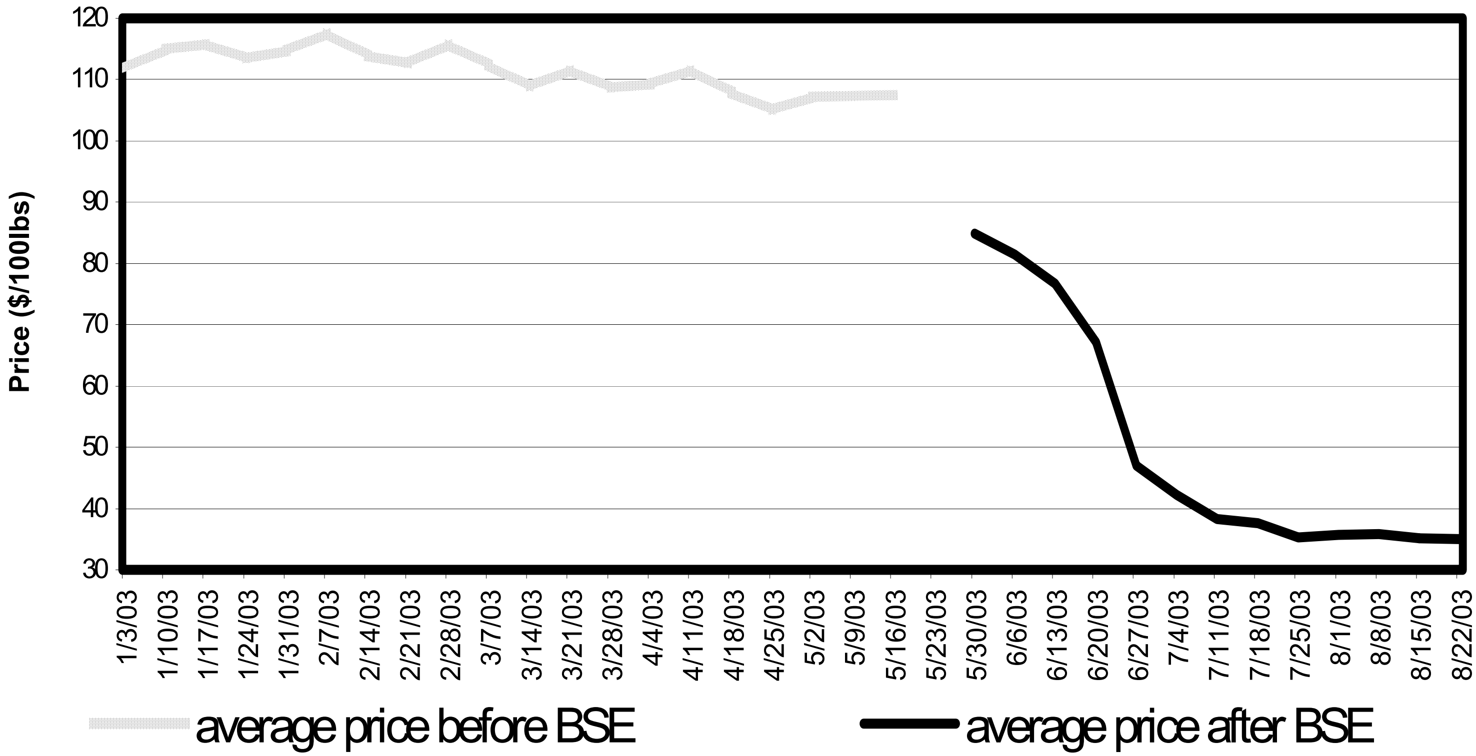
Even if the price decline in Canada arising in Canada as a result of MCOOL was half that arising from the BSE border closure, a strong case could be made by Canada that MCOOL violated NAFTA's provisions

That protectionism is alive and well in the United States (and other countries) is not a surprise. Beyond the strict interpretations of the rules of trade agreements, the NAFTA is supposed to breed a spirit of co-operation among the three countries. It is even institutionalised in the NAFTA section on Country of Origin Marking. In Annex 311 (10) it states:

> Each Party shall cooperate and consult on matters related to this Annex, including additional exemptions from a country of origin marking requirement …

The MCOOL legislation is a major departure from the spirit of co-operation that was embodied in the NAFTA.

Figure 8: Direct Sales Alberta Steer Price
2003



Source: www.canfax.ca

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