A CANADIAN POLICY ANALYST'S PERSPECTIVE

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The opportunity to provide a Canadian policy analyst's perspective at this conference is a rare privilege as the agricultural economics community does not usually get together to discuss the art and practice of autarchy except in purely theoretical circumstances. In fact, there is a powerful argument to be made that, for this industry, the agricultural economists on both sides of the border have mainly been engaged for the last generation or two in making sure that there was no Canada-U.S. dairy trade. The art and practice of autarchy has been very successful, because the Uruguay Round notwithstanding, there is hardly any trade in milk or dairy products and there has not been much as far back as the 1930s. This is no accident—it is the result of concerted government action and industry desire in both Canada and the United States.

For example, Section 22 of the U.S. Agricultural Adjustment Act of 1933 was added in 1935 and was reinvented many times thereafter. Canada, on the other hand, operated a differential tariff scheme before the Second World War which applied lower tariffs to British Commonwealth supplies but was also a substantial exporter of dairy products.

Most of the U.S. Section 22 quota and import quantity limits that were tariffied in 1995 date from the 1950s and 1960s. By 1970, the United States had quotas in place which were consistent with the U.S. 1955 GATT (temporary) waiver and which limited the quantities of imports of almost all dairy products. The exceptions were fluid milk, casein and soft-ripened cheeses such as camembert and brie.

Canada proceeded more cautiously. Cheddar cheese was first put under import control in 1957. In 1969, the Export and Import Permits Act was amended to allow more dairy products to be subject to import controls consistent with Article XI 2(c) of the GATT. During the 1970s and 1980s, additions were made which brought Canada's import barriers close to the level of coverage which the United States had under Section 22 quotas.

It remains true today that dairy trade between Canada and the United States is extremely small. In aggregate, both countries import only about two percent of their dairy market requirements and almost all of that comes from third countries. Recently the largest seller of U.S. dairy products to Canada was most likely a gas station in Point Roberts, Washington where British Columbia consumers buy low priced gasoline and milk.

This history makes the point that dairy policies and programs in both countries have been developed in isolation for the last sixty years. Of course this phenomenon of isolation in domestic policy development is not unique to North America. Governments have been very sensitive to dairy sectors. It has been observed that Canada's first dairy policy involved providing a new settler with an axe, a cow and a spouse, in that order of importance. Milk markets have been held in isolation from world markets in most northern hemisphere developed countries. The European Community is one example of this process and also a model which other nations have felt bound to copy.

Of course the case of Canada-U.S. dairy trade is an agricultural economist's dream. Two countries with a three thousand plus mile common border succeed in keeping it closed for sixty years or more. They have put in place dairy programs intended to achieve domestic objectives based on the certainty that market penetration by imports will be fixed and very limited. There has been no need to have regard to Canada-U.S. dairy trade because there is none to speak of, by design, on both sides of our border.

The mythological analogy for this that comes to mind is Romulus and Remus, the founders of Rome; they are alleged to have been suckled and raised by a she-wolf, thereby providing a very early case study for students wishing to find out which human behaviour is innate and which is learned! The dairy policies and programs of our two countries have also grown up in isolation. Do not be surprised therefore that they are different, and do not underestimate how different they really are! It is not just the high profile programs and border controls that are different; differences are far deeper than that.

It should be noted that the Uruguay Round outcome made virtually no change to trade. The U.S. final offer on dairy access fell short of the 3 rising to 5 percent Dunkel guideline; Canada mirrored the U.S. offer in aggregate when formulating its own offer. In practice, the increased access in both cases has gone mainly to third countries. Even by the end of the Uruguay Round transition period in the year 2000, each country will have minimal access to the other's market under tariff rate quotas. Both countries will continue to have multilateral over-quota tariffs in place based on their Uruguay Round schedules which will still be prohibitive to trade.

The Crawford-Stillman paper has mentioned the high level of Canadian dairy product tariffs but U.S. dairy import tariffs will be equally effective in preventing Canadian dairy exports to the United States, even in year 2000.

Policy makers in both countries have, for many years, had the luxury of establishing their domestic dairy policies without having to consider trade aspects to any extent. Surplus removal policies which back-stop domestic markets are in place at the Commodity Credit Corporation (CCC) in the United States and at the Canadian Dairy Commission (CDC) in Canada. These programs underpin the industrial dairy products markets and indirectly the market price for industrial milk in each country. Programs such as federal and state milk orders in the states and provincial fluid milk regimes in Canada support regional fluid milk pricing at levels which are administered and exceed industrial milk prices. These government commodity-specific programs are similar in design and objectives. However

a very important difference in approach has been the use of pricing in the United States to limit supply. Canada, on the other hand, has used production quotas to limit supply. Economists who are not working regularly with agricultural systems that include production constraints sometimes forget that the observed price is not necessarily on the supply curve, i.e., prices could probably be significantly lower before a supply response would be observed—in economic terms, the administered supply curve is vertical through a wide range of prices, above and below the current, administered prices.

The Canadian and U.S. markets are isolated from each other not only by tariffs on imports but also by a battery of technical, sanitary and phytosanitary barriers. For anyone who is not familiar with the history of Canadian U.H.T. milk exports to Puerto Rico, there are still plenty of non-tariff barriers in play. Those exports have just resumed after a hiatus of several years following Puerto Rico's adoption of the Pasteurized Milk Order. Our exports were halted while the conformity of the Canadian product with the U.S. Pasteurized Milk Order was verified. That process took several years.

As the trade situation changes, governments are going to need help from policy analysts. This will have to include practical advice on how policies and programs can change incrementally towards a more liberal trade scenario in both directions across the Canada-U.S. Border. Supply-managed systems are a real challenge to modellers, so step one is, as always, to have a firm understanding of what is in place and why.

With regard to the NAFTA Chapter 20 Panel, this Panel is currently dealing with a U.S. complaint about Canadian tariffication as negotiated in the Uruguay Round, included in Canada's schedules in Marrakesh in April 1994, and implemented in 1995 for imports of dairy products into Canada. The U.S. position is that these tariff equivalents should not apply to products originating in the U.S. The United States cites Articles 302(1) and 302(2) of the NAFTA as the basis of their position. These Articles require countries to progressively eliminate and not to increase custom duties except as otherwise provided for elsewhere in the NAFTA.

Canada has now replied in detail to the U.S. case. Given that the Panel deliberations are in progress, Canada's case must not be promoted in detail except to say that it explains that trade in agricultural goods was provided for in Chapter 7 of the NAFTA and that those provisions take precedence over the General Provisions in Chapter 3. Chapter 7 allows for the tariffication of agricultural non-tariff barriers as negotiated multilaterally in the Uruguay Round.

An interesting aspect of the U.S. position is that, if true, it would also apply in reverse and is not specific to dairy, i.e., if the United States were correct, tariffication of U.S. Section 22 regimes for dairy and some other sectors, such as sugar and peanuts, would also be inconsistent with the NAFTA. This might come as a rather unwelcome surprise in some quarters.

Trade access for dairy products has more support now in the United States than at any time in the last sixty years. How broadly based that support is and how far it embraces liberalization of U.S. border measures as well as those of potential importers of U.S. dairy

products is not entirely clear. However, recent U.S. dairy and exporting activities both through the Dairy Export Incentive Program (DEIP) and through unsubsidized exports at world market competitive prices have clearly brought about a change in attitudes within the U.S. dairy industry. Analyses showing Canada as a large potential market for U.S. dairy exports may have played a part. "Access" may be a more important variable in driving opinion than "free trade" in dairy products.

In Canada, the dairy industry made a conscious decision in the 1960s to withdraw largely from export markets that Canada had been supplying. The dairy industry remains to be convinced that dairy exports on a larger scale than at present can contribute to adequate and reasonably stable revenues for the sector in the future. Similar attitudes probably exist in the United States too, judging from dairy industry responses to Congress' recent efforts at dairy program reform. Better the domestic market you know than the peril and uncertainties of international trade seems to be the underlying principle.

North American dairy trade liberalization is probably coming. Probably not soon and probably not fast, but the pressure for change is there. In Jakarta, Miami, Kyoto, and elsewhere, the directions seem to be quite clear. It is driven by export interests in the short term but in the medium term, it is driven by pressures to do multilaterally for agricultural trade what has already been achieved for industrial goods. The World Trade Organization is likely the main vehicle for this but there may be other vehicles too.

The implications of this for dairy trade and policy analysts is that there likely is an emerging market for our services which will continue for several years. Decision-makers in government and in the private sector are going to need our help to navigate a complex policy environment in which barriers to trade are first reduced and perhaps eventually eliminated.

CONCLUSION

A vital first step is to get our facts right. This seminar is an important step in that process. Both the United States and Canadian dairy programs are complex; we have seen examples in the past of analysis based on misconceptions of how the Canadian system works. I know that the mysteries of exactly how your marketing order system works have, at least until now, been unravelled by only a handful of cognoscenti; Canadian supply management in dairy may be a similar case.

If the transition towards freer dairy trade between our two countries will be gradual, then the method by which the transition is handled becomes critical. This transition is not only with respect to trade policies, but also with respect to the domestic policies each country can pursue. How do you best analyse that? Going to the end point and working backwards will not do. It appears that transitional arrangements will shape the eventual outcome.