

US - Canada Dairy Trade Disputes

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The North American Free Trade Agreement (NAFTA) and its impact on the US dairy farmer has been controversial since its passage. Since the 1970's the Canadian dairy sector has been regulated under government supply management involving administered producer milk prices (based on costs of production) and production quotas that restrict milk production to the quantities demanded at the administered prices. In order to protect their domestic dairy programs, Canada (like the US) restricts imports of dairy products using tariff rate quotas as stipulated under the 1995 GATT/WTO accord. Tariff rate quotas allow access to the protected market at a reduced tariff rate up to the quota limit. Imports beyond the quota limits are generally tariffed at very high levels (240%-350% in Canada and roughly half this level in the US) so as to essentially prohibit imports beyond the quota limits.

The brunt of the US-Canada dairy trade dispute is that the US argues the Canadian over quota tariffs are excessive and in violation of the NAFTA which stipulates that tariffs on U.S. products be phased down to zero by the 2003. Canada argues that GATT provisions (which allow for a slower rate of reduction in tariffs and provide increased access to all nations not just the U.S.) supersede the NAFTA. The NAFTA Dispute Settlement Panel recently sided with Canada on this issue.

While both the U.S. and Canada heavily protect their domestic dairy programs via tariff rate quotas, Canada's dairy trade barriers are somewhat higher than those in the US (e.g., about 37% higher on average during 1989-91, 26% higher in 1994). As a result, there is considerable Canadian concern that complete U.S.-Canada dairy trade liberalization would result in Canadian prices falling to U.S. levels due to the dominance (relative size) of the U.S. dairy sector.

The US Dairy Export Council (USDEC) and National Milk Producers Federation (NMPF) estimate that the US dairy industry has a potential \$1 billion market in Canada in the absence of trade barriers. Canadian research estimates that Canadian dairy producer prices and production would fall by 25% and 15% (minimum), respectively, under complete US-Canada dairy trade liberalization. Associated projections are that the US would supply 20% of Canadian domestic dairy consumption generating a cumulative loss to Canadian Agricultural and food processing sectors of \$16 billion over 5 years.

Given the magnitude of these projected impacts, the issue of NAFTA and US-Canadian dairy trade liberalization remains highly politicized. However, accurate analysis of the potential impacts of liberalization in US-Canada dairy trade is difficult for a variety of reasons. Key among these difficulties is predicting impacts of these changes in the Canadian milk supply and dairy processing sectors. There is a lively debate among agricultural policy and trade economists on these issues. There does not appear to be

definitive answers as to these impacts at this point in time. It is clear however, that the impacts of trade liberalization would be felt regionally with considerable north-south bilateral trade replacing the east to west trade in Canada and west to east trade in the US that currently predominates. Quite different predictions as to Canadian milk supply response and dairy prices levels in the absence of the Canadian supply management system generate quite different impacts due to trade liberalization. Economic analyses presented at a recent US/Canada Dairy Policy Trade Tensions Workshop in February 1996 underscore this dilemma.

Collaborative university research by US and Canadian agricultural policy and trade economists could help to provide a more objective basis for evaluating the likely impacts of potential trade liberalization. There is considerable urgency in these matters particularly as the major players in the world dairy sector (US, Canada, European Union, New Zealand, Australia, Brazil) look toward the next round of World Trade Organization (WTO) negotiations due to start in 1999. Any sense that the recent NAFTA ruling on the US-Canada dairy trade disputes is indicative of "backsliding" on commitments to increasingly open up and liberalize trade in heavily protected markets (such as the Europe, Canada and the US) would significantly hamper future progress in this area.