

THE CANADA -U.S. TRADE DISPUTES ON DAIRY AND POULTRY: A GOOD EXAMPLE

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INTRODUCTION

The dispute between Canada and the United States on the supply managed commodities of dairy and poultry is a long standing one that goes back at least two decades. The dispute has its roots in each country's agricultural policies which now have structures, investments and stakeholders built around them. The dairy and poultry dispute is a good example of how policy choices can make harmonization, compatibility and consistency (H/C/C) not only difficult to achieve but also can lead to conflict. Yet this dispute also provides insight into how policy harmonization can be achieved, disputes avoided and trading relationships improved.

One of the keys to understanding the dairy and poultry dispute is to take account of the division of powers over agriculture and food matters which has led to supply management in Canada and the Federal Marketing Order system in the United States. To protect these programs, non-tariff barriers were put in place which were subsequently legitimized by use of international dispute settlement mechanisms and, in some cases, the national courts.

The trade environment between Canada and the United States is changing. The United States is becoming more sensitive to the realities of using dispute settlement mechanisms and the wider perception that the United States cannot control the outcome of such efforts¹. Canada is quietly becoming more confident in its role as a food exporter and this brings with it a different approach to trade matters.

By reviewing a number of the international cases arising from the poultry and dairy dispute, we will try to demonstrate how the dispute evolved and also identify some of the

¹ A coalition of 21 lobby groups, the American Coalition for Competitive Trade, has started a legal effort to overturn the authority of the NAFTA (North American Free Trade Agreement) Panel in the U.S. Court of Appeal.

failures and opportunities for harmonization. We also will identify some of the market forces which are currently working toward harmonization in these two sectors.

Our conclusion is that harmonization of the poultry and dairy industries on a NAFTA basis (Canada, United States, Mexico) is well underway and will be achieved by market forces rather than by political leadership. Moreover, within North America, Canada can be a consistent exporter of both dairy and poultry products while maintaining a larger share of the Canadian market than most analysts have projected, providing that the necessary adjustment process in the production and processing sectors is given time to be completed.

Finally, our paper makes no attempt to differentiate between harmonization, compatibility and consistency. Instead, we have taken the broad approach of defining H/C/C as any change which achieves or makes possible freer trade in dairy and poultry products.

HISTORY OF CANADA-U.S. DISPUTE IN DAIRY AND POULTRY: THE CASES AND ISSUES

The General Agreement on Tariffs and Trade (GATT) Working Party on Canadian Import Quotas on Eggs (L/4279) adopted February 17, 1976

Dispute Settlement Mechanism On September 9, 1976, the United States requested a meeting of the GATT Council of Representatives to discuss the establishment of a working party to make an advisory ruling on Canada's import quota for shell eggs and egg products set up under GATT Article XI.

Issues The United States asked for an advisory ruling on the following:

- a) Does the Canadian supply management system on eggs conform to the requirements of GATT Article XI?
- b) Is the basis for determining the import quotas in accord with the requirements of the last paragraph of Article XI?
- c) Irrespective of the findings under (a) and (b) above, does the imposition of the Canadian quotas under Article XI constitute nullification and impairment of a prior binding?

Working Party Terms of Reference "To examine the matters referred to the CONTRACTING PARTIES by the Government of the United States (L/4223) concerning the imposition of import quotas for eggs and egg products by the Government of Canada (L/4207), and to report thereon to the Council."

The Decision All but the United States agreed that Canada's egg supply management program was in conformity with GATT Article XI.² The working party suggested the parties revisit the "representative" period upon which the import quotas were to be calculated.³ On the third question of nullification of prior binding, the working party did not come to a conclusion.

Comments and Observations The United States did not make a similar challenge to the dairy and turkey import quotas also in place at that time or those subsequently set up for chicken and hatching eggs. It would appear that the egg reference was a test case for the United States. The issue of effective control was not raised again until the United States challenged, in the GATT, the addition by Canada of ice cream and yogurt to the import control list. The "pressure" of maintaining effective control did play a key role within Canada and allowed provinces with less production to use the withdrawal threat effectively. Such a strategy for a larger province was not credible because it was argued that effective control would be lost and Canada would no longer be in conformity with GATT Article XI thereby losing its ability to protect the border with import quota. Considering that Ontario joined the Chicken Farmers of Canada (CFC), formerly the Canadian Chicken Marketing Agency, only because this would allow border controls to be put in place, the significance of the United States raising this issue at the working party in the evolution of Canada's supply management program should not be underestimated.⁴

Looking back, the one vote per province arrangement in Canadian supply management marketing plans, combined with the "restrict" provision of GATT Article XI, gave sufficient power to each province to essentially override the intent in the legislation to allocate growth on the basis of comparative advantage. The failure to execute this key aspect of the legislation has prevented production adjustments from taking place in response to a

² The United States did not agree because they stated effective domestic production control has not been achieved and, therefore, domestic production was not restricted. Some industry stakeholders in Canada would have agreed with this view at that time since eggs and not layers were being counted. The problem, however, is in defining "effective" and this term in Canada, over time, has come to mean that at least 90 percent or more of Canadian production is directly participating in the supply management program. The findings of this working party remained until the World Trade Organization (WTO) Agreement replaced GATT Article XI.

³ This was done, resulting in a doubling of access.

⁴ It is still a mystery to some in Canada as to why the United States did not raise the issue of effective control when the third largest chicken producing province, namely British Columbia, withdrew from the CFC. The CFC tried to protect its "effective" control through a separate agreement but B.C. set production levels during this time, independent of the CFC. It could have been debated whether the B.C. agreement is a "governmental measure" as set out in GATT Article XI. If one recalls that GATT Article XI has its origins with the United States, it is ironic that the United States should be challenging its use. The United States has been criticized for choosing a working party format rather than a full panel. Some U.S. trade law experts have cited the egg working party decision as an example of a bad trade law decision.

changing market. The failure to allow such adjustments may yet prove to be more of a threat to the supply management system than external forces.

Successfully resisting the U.S. challenge gave Canadian policy makers confidence that GATT Article XI could be used to "protect" the domestic industry. The long run consequences of eliminating competition among processors, producers and provinces while controlling import competition were either not examined or ignored.⁵ It is speculation, but had the United States not challenged Canada, domestic participants beyond the farm gate, as well as policy analysts, might have been more effective in influencing the way supply management programs evolved. The egg working party decision also shifted the balance of power in food policy matters to the Canadian federal government. Had the United States chosen to challenge Canada by way of a panel of trade experts, it is possible that a more restrictive interpretation of GATT Article XI would have resulted. With less effective border protection available, the advantage of creating new supply management programs would have been reduced.

The GATT Panel on Ice Cream and Yogurt (L/6568, September 27, 1989, Adopted in December 1989)

Dispute Settlement Mechanism The consultative and dispute settlement provisions as set out in the GATT.

Issues. The United States is the main exporter of ice cream and yogurt products to Canada. On January 28, 1988, Canada amended the import control list by adding ice cream products and yogurt. This decision significantly reduced the ability of the United States to export these products. The Panel, therefore, was asked by the United States to restore its access by making a recommendation that Canada eliminate its quotas and import permit system. Canada stated that its actions were consistent with GATT Article XI.

At issue was the scope of coverage provided by GATT Article XI.

GATT Panel Terms of Reference *"To examine, in the light of the relevant GATT provisions, the matter referred to the CONTRACTING PARTIES by the United States in document L/6445 and to make such findings as will assist the CONTRACTING PARTIES in making the recommendations or in giving the rulings provided for in Article XXIII:2."*

⁵ One attempt to examine the issues was the (1976) cost of production formula challenge by the Consumers' Association of Canada (CAC) for eggs. This was lost, in part, because the CAC was overwhelmed by the Canadian Egg Marketing Agency's (CEMA) legal counsel and accountants, but much of what the CAC raised as concerns proved to be valid. Similarly, the Food Prices Review Board and the Economic Council of Canada raised concerns about supply management which were not heard. The failure to listen to other stakeholders was a point also made by Kempton Matte at the dairy session last year.

The Decisions The Panel concluded that ice cream and yogurt did not compete directly with raw milk and would not undermine the milk supply management program if left uncontrolled at the border. Choosing to keep the scope of GATT Article XI narrow, the Panel found ice cream and yogurt not to be "like" milk and, therefore, Canada did not meet the conditions set out in GATT Article XI. The Panel recommended that Canada be requested by the GATT to terminate the restrictions.

Comments and Observations The Panel did not rule on the meaning of "in early stages of processing" or the meaning of "still perishable" or the issue of what it means to "restrict" production or have "effective" control. The United States, this time, had a much stronger case on the failure of Canada to "restrict" milk production which included evidence that overproduction had occurred six years in a row. The Panel, in commenting on its decision not to rule on the meaning of "restrict", did state that the concept of "restricting" production as distinct from regulating production was difficult to apply in practice. It is unfortunate that the Panel chose not to comment further because a finding on this matter could have modified the Canadian perception of an "effective" control which was formed from the shell egg working party. Again, this is speculation, but a finding that overproduction is evidence of a failure to restrict production could have provided Canadian policy analysts with additional means to influence the way supply management programs continued to evolve or at least raised some concerns for the policy makers to consider.

On the finding that ice cream and yogurt did not compete directly with raw milk, the Panel also noted that GATT Article XI was not designed to protect the producer or processing industries from international competition and it was never intended to be used to promote self-sufficiency.⁶ It was feared in Canada that the Panel findings could also encourage the United States to challenge the import control of further processed chicken and turkey products or challenge the entire system if the Panel sided with the United States on the issue of "restricting" production. This challenge never happened primarily, we suspect, because the United States felt it could achieve a more desirable outcome at the GATT. This aspect of the U.S. trade strategy was confirmed by the recent NAFTA Panel in reviewing the intentions of the parties.

The ice cream and yogurt situation is an example of political considerations overriding economic ones. The Canadian government was informed that putting ice cream and yogurt on the import control list would be a high risk effort and if challenged at the GATT, could be lost. However, the government overruled this advice due primarily to the sensitivity of dairy matters to the province of Quebec and the need to show that the federal system was essential for Quebec agriculture.⁷ Whereas Canada was looking at the Uruguay Round to

⁶ A similar ruling was handed down by the Panel on Japanese agricultural quotas - L/6253, November 18, 1987.

⁷ The threat of separation was often a factor influencing the government on dairy policy. Canada was able to put off implementing the Panel findings by suggesting that the GATT negotiations were underway and serious proposals to clarify the working of GATT Article XI were being put forward and considered. From the U.S. perspective, the Panel ruling was the first

justify its restrictions with a strengthening of GATT Article XI, the United States was hoping to use the same Round to eliminate GATT Article XI exceptions. Once again, the dispute settlement mechanism, even though the United States prevailed this time, failed to defuse the dispute.

The Canada-U.S. Trade Agreement (CUSTA) (1989) and NAFTA (1995) Trade Agreements

CUSTA

The next time Canada and the United States faced the issue of supply management was during the agricultural negotiations leading to the CUSTA of 1989. The United States pressed for an agreement on agriculture without exceptions while Canada insisted on the right to protect the supply managed commodities through the use of quantitative import restrictions. To achieve this, Canada did agree to provide the United States with some increased access for chicken, turkey, shell eggs, and egg products (see Article 706 below). Since both parties had domestic dairy programs in place, it was agreed not to make any reference in the CUSTA to dairy.

Article 706: Market Access for Poultry and Eggs

If Canada maintains or introduces quantitative import restrictions on any of the following goods, Canada shall permit the importation of such goods as follows:

- a) *the level of global import quota on chicken and chicken products, as defined in Annex 706, for any given year shall be no less than 7.5 percent of the previous year's domestic production of chicken in Canada;*
- b) *the level of global import quota on turkey and turkey products, as defined in Annex 706, for any given year shall be no less than 3.5 percent of that year's Canadian domestic turkey production quota; and*
- c) *the level of global import quotas on eggs and egg products for any given year shall be no less than the following percentages of the previous year's Canadian domestic shell egg production:*
 - i) *1.647 percent for shell eggs;*
 - ii) *0.714 percent for frozen, liquid and further processed eggs; and*
 - iii) *0.627 percent for powdered eggs.*

In the CUSTA, Canada and the United States also agreed to work towards eliminating technical barriers to trade and setting up working groups to harmonize or achieve equivalency in the following areas:

- i) Animal Health,
- ii) Plant Health, Seeds and Fertilizers,
- iii) Meat and Poultry inspection,
- iv) Dairy, Fruit, Vegetable and Egg Inspection,
- v) Veterinary Drugs and Feeds,
- vi) Food, Beverage and Colour Additives and Unavoidable Contaminants,
- vii) Pesticides, and
- viii) Packaging and Labelling of Agricultural, Food, Beverage and Certain Related Goods for Human Consumption.

In addition, Canada and the United States agreed to work towards developing a new regime to address dumping and subsidization.

"Article 1907 provides that the two governments will work towards establishing a new regime to address problems of dumping and subsidization to come into effect no later than at the end of the seventh year. During the course of the current negotiations, the two sides recognized that developing a new regime was a complex task and would require more time. The goal of any new regime, however, will be to obviate the need for border remedies, as are now sanctioned by the GATT Antidumping and Subsidies Codes, for example, by developing new rules on subsidy practices and relying on domestic competition law. Thus the goal of the two governments remains the establishment of a new regime to replace current trade remedy law well before the end of the transition period."

"Article 1907: Working Group

1. *The Parties shall establish a Working Group that shall:*
 - a) *seek to develop more effective rules and disciplines concerning the use of government subsidies;*
 - b) *seek to develop a substitute system or rules for dealing with unfair pricing and government subsidization; and*
 - c) *consider any problems that may arise with respect to the implementation of this Chapter and recommend solutions, where appropriate.*
2. *The Working Group shall report to the Parties as soon as possible. The Parties shall use their best efforts to develop and implement the substitute system of rules within the time limits established in Article 1908."*

Comments The increase in access granted to the United States for poultry was an arbitrarily chosen number. However, in trying to defend this concession to Canadians, one politician said that the Canadian industry should not be concerned because the increase was "about" equal to the supplementary import permits that had been issued in previous years. This unfortunate justification has stuck and served to alert the chicken, turkey and egg agencies to the "danger" of supplementary imports. As a result, the Agencies have resisted all attempts to allow any imports in addition to the global import access annually available, even if such issuance is a reasonable solution to a problem in the market place created by the regulatory environment. A more liberal import policy would have provided more flexibility to an otherwise rigid system and, as a result, would probably have provided more scope for market forces to influence industry structure (e.g. the average Canadian farm size for both poultry and dairy).

The harmonization committees have quietly gone about their work although the effort was much more energetic in the early years following the agreement. Much has been achieved, more because of industry pressure on both sides of the border and technological developments than because of the CUSTA. Nevertheless, the existence of the committee did provide a mechanism which is being used. However, our view is that the usefulness of these committees has been reduced by failing to involve industry as active participants. The pace and agenda is still in the hands of government and the process of decision-making is far from transparent.

The bold attempt to develop new anti-dumping and countervail procedures which would eliminate the need for border controls has so far failed. Perhaps it was the experience with the bilateral panels that reduced U.S. enthusiasm for the project, but we are well past the seventh year and little has been achieved.⁸ The longer than expected GATT Round was a factor, but we suspect neither country is now anxious to pursue this task. With the NAFTA Panel decision in hand, Canada's incentive to develop a new regime is reduced even further, at least from the agricultural perspective. If policy analysts can convince the policy makers in Canada and the United States that gains from free trade in poultry and dairy exist, the process could be picked up again. However, so far, a win-win outcome for producers in both countries has not been documented by policy analysts.

NAFTA

During the NAFTA negotiations, agricultural issues were raised but did not receive as much attention as non-agricultural ones. This was because both the United States and Canada had expectations regarding agriculture that might result from the then ongoing GATT discussions. As a result, the CUSTA understandings on agriculture were restated in the NAFTA for Canada and the United States and, as well, the parties agreed to again "protect" their GATT rights.

⁸ In the NAFTA, both Canada and the United States agreed to eliminate the timetable set out in the CUSTA on this matter. This clause has received very little public attention.

For poultry products, Mexico and the United States agreed to minimum access levels as well as a ten-year adjustment period before free trade would take effect. To give the Mexican poultry and egg industry time to adjust, the decline in tariffs would not begin until the sixth year and then decline at the rate of 25 percent annually. Similarly, for dairy products, Mexico and the United States agreed to a ten-to-fifteen year adjustment period and tariffication.

Comments It is not known to us how the Canadian and Mexican poultry and egg industries compare competitively, but we suspect that Canada may have the edge. This raises the question, if Mexico can live with a ten year adjustment period, why is this not possible for the Canadian industry? Elements beyond the farm gate in Canada have suggested a ten-year phase-in is worth considering and U.S. poultry and egg industry participants have expressed similar views.⁹

As a footnote, Mexican buyers of MSCM (mechanically separated chicken meat) have made serious efforts to buy from Canada but the high tariffs have made it uncompetitive with the United States. It would appear an opportunity to develop a poultry export market has been missed. This demonstrates how policies can rob the policy maker of the flexibility to make reasonable choices. A similar approach (poultry and eggs left out) was recently taken in the trade agreement with Chile. Forgoing export opportunities to keep Canadian industry protection does not appear to be a policy which is sustainable either internally or externally at the next round of multilateral trade negotiations.

The NAFTA Panel in the Matter of Tariffs Applied by Canada to Certain U.S.-Origin Agricultural Products (Secretariate File No. CDA-95-2008) December 2, 1996

Mechanism Article 2006(4) of NAFTA to pursue consultations and Article 2007 to provide the Free Trade Commission an opportunity to resolve the dispute. Article 2008 to establish an arbitration panel.

Products Covered Dairy,¹⁰ poultry, eggs, barley and margarine, including their respective products.

The Issue The United States alleged that Canada increased tariffs for a range of agricultural products contrary to Canada's NAFTA undertakings. Canada agreed that the duties had been raised but justified its action on the basis that this was tariffication consistent with Canada's obligations as set out in the Marrakesh Agreement establishing the WTO. At issue,

⁹ The U.S. dairy industry's willingness to engage in a ten-year phase out for most dairy tariffs with Mexico suggests the Canadian dairy industry could have done the same and supports our point on poultry.

¹⁰ Dairy includes milk, yogurt, buttermilk, whey, butter and other milk fats and oils, cheese curd, ice cream and other preparations containing milk and milk products.

therefore, is which agreement takes precedence in light of the relevant provision of the NAFTA. The Panel was not asked to make recommendations for resolution of the dispute.

Findings The Panel took particular care to sort out the timing of the various agreements Canada and the United States had reached since negotiations were ongoing both at a multilateral and bilateral level. Of importance is the Panel observation that Canada and the United States agreed that exports in excess of the import quotas for certain agricultural goods would continue to be governed by multilateral agreements. Based on these observations, the intent of the parties, and the wording in the relevant agreements, the Panel concluded that Canada's action to put into effect the tariffication option provided by the WTO conforms with the provisions of the NAFTA.

Comments and Observations A late intervention by the United States suggested that the Panel should consider the special situation of ice cream and yogurt since the non-tariff barriers on these products had been ruled as being outside GATT Article XI by a GATT Panel. The Panel did assess this matter but concluded it had no basis for questioning the tariffication schedules agreed to by the parties as part of the WTO. It would appear that the United States should have questioned the inclusion of ice cream and yogurt in the tariff schedules exchanged among the parties in 1994. The opportunity to put into effect the ice cream and yogurt panel decision, therefore, has been missed by the United States and the tariffication process has made all the GATT Article XI issues irrelevant.

The panel decision means the United States focus will shift to the next WTO round where a case can be made for a rapid decline in tariffication duties. Canada will have to be alert to the possibility of a WTO decision on the poultry and dairy tariffs which could be worse than a transition period negotiated directly with the United States. However, we suspect Canadian governments are more comfortable implementing multilateral trade decisions than bilateral ones.

Some observers commenting on the NAFTA Panel suggested that even if Canada wins, further negotiations with the United States would quickly have to follow. We see no evidence of this nor any compelling need for Canada to do so.

The call for this NAFTA Panel, in part, may lie in the lack of results from the Canada-U.S. bilateral discussions held in Geneva between Mr. Goodale and then U.S. Secretary of Agriculture, Mr. Espy. Perhaps the failure to find any common ground at those discussions provided Canada with further justification that tariffication was the best course of action, while the United States became more convinced of its position. Choosing tariffication as the means of dealing with the U.S. dairy and poultry trade has the disadvantage of leaving U.S. concerns unresolved domestically. It also weakens the Canadian government's position on agricultural matters at a time when a strong federal hand is needed if Canada is to take its place as a major food producer in the world.

Once tariffication duties were put in place, the requirement for national supply management agencies to maintain effective control over production was removed. Removing the "effective" control function takes away one of the key reasons for the existence of national agencies and makes it more difficult to develop a competitive Canadian poultry

industry.¹¹ Already, the CFC has felt the effect of this change and are now operating a "bottom up" allocation approach under which the CFC, in effect, "rubber stamps" the allocation requests of the provinces. This new allocation approach was proposed by Ontario, confident with the knowledge that border protection is firmly in place. Similarly, in turkey, the Ontario Turkey Producers Marketing Board recently filed a withdrawal notice with the Canadian Turkey Marketing Agency (CTMA) over quota and export credit matters, something which likely would not have happened prior to tariffication.¹²

ADDITIONAL CONSIDERATIONS

Harmonization And Equivalency

Canada and the United States have accepted each others' inspection systems as equivalent even though there are differences in detail and in some cases, approach. The key is that officials agree similar results are achieved and, therefore, the objective of the relevant legislation is met. An attempt through the courts by the National Broiler Council in the United States to have equivalency defined as "identical," failed. This action was taken mainly with the Europeans in mind, not Canada. The United States and European Union are currently testing the meaning of equivalency and appear to be heading for a showdown. The WTO Agreement on sanitary and phytosanitary provisions should bring some sense and reason to the equivalency issue because food safety factors are now the accepted justification for import restrictions, not the failure of being equivalent. By eliminating the equivalency issue, the scope for conflict is reduced.

The U.S. Department of Agriculture (USDA) mega-regulation is again testing the equivalency status of Canadian inspection regulations but so far, Canada has met all the conditions. In both Hazard Analysis Critical Control Point (HACCP) system and the new Food Inspection Agency, Canada is ahead of the United States and some industry stakeholders in the United States have indicated (unofficially) their desire to move in a similar direction. In Canada, because a higher level of cooperation exists between industry and government, it has been able to move somewhat quicker on inspection matters and U.S. officials appear to respect this factor rather than turn it into an issue of equivalency. However, this can change quickly because the United States has many more active consumer lobby groups than does Canada and there is always the possibility that someone will take legal action hoping to force the U.S. government to behave differently.

¹¹ Those in Canada wanting a strong competitive Canadian poultry industry might have been wishing for a decision in favour of the United States. Similarly, the business community in general is not happy that uncertainty remains.

¹² At the time of writing, the problems underlying the Withdrawal Notice appear to be resolved.

The U.S. Role in Supporting Canadian Supply Management Programs

Creating Fear As we have already noted, the United States, in its attempts to challenge Canada's trade restrictions put in place under GATT Article XI for dairy and poultry, may actually have served to forge support for this policy and influenced its evolution.

Similarly, repeated and consistently overstated estimates of how big a share the U.S. dairy and poultry exporters could obtain of the Canadian market only served to convince producers and policy makers of the need to keep trade protection in place.¹³ This kind of lobbying information feeds the misconception that the Canadian dairy and poultry sectors are not competitive with their U.S. counterparts. Many Canadian producers in these sectors now fear competition from U.S. producers. Such fears and efforts encourage policy conflict and build the foundation for serious disputes where parties can easily underestimate each others resolve.¹⁴ To better understand supply management issues, U.S. policy analysts should look at Canada as a federation of twelve separate "countries" or more like the EU model rather than like the United States.

Providing a Safety Valve Perhaps the most overlooked factor in the longevity of Canadian supply management systems is the geographic proximity of Canada to one of the world's largest producers of poultry and dairy products. This factor played a much bigger role in poultry than in dairy but, nevertheless, was a key element in the acceptability of supply management to the Canadian public. On behalf of Canadian consumers, the CAC and the Department of Consumers and Corporate Affairs, fought to ensure that Canadian producers of supply managed commodities would not be allowed to control production and raise prices to unreasonable levels.

In the absence of direct competition, unreasonable price levels were quite possible even though the competition of substitutes still existed. One way of ensuring that retail prices would not be unreasonable was the creation of a mechanism which became known as

¹³ Overstated estimates again appeared last year when Canadian supply management groups hired Infometrica Ltd. to do a study of the economic impact if Canada were to lose border protection and 165 U.S. companies pushed the United States to keep up its fight for more access. The Infometrica study estimated losses in market share of 20 to 25 percent, job losses of 138,000 over a five-year period, an economic output loss of \$16 billion, and a tax revenue loss of \$18.1 billion through to the year 2000. The U.S. ad hoc coalition suggested that gains of US\$300 million in chicken and US\$1 billion in dairy were likely. These gains are even greater than the estimated losses by Infometrica.

¹⁴ The United States may have misread Canada's resolve in the last GATT Round because the United States, we understand, offered Canada a ten-year period to phase out dairy and poultry border controls which Canada rejected. On several occasions in Geneva, the United States was taken back by the uncompromising approach Canada took on supply management issues in Geneva. It appears the United States was not well prepared for the new Liberal government and were still basing their perceptions on the Conservative government with which the United States had negotiated the CUSTA.

the supplementary import system.¹⁵ In short, this mechanism allowed the Minister in charge of import permits to issue permits whenever a market shortage existed. The administration of this safety valve proved to be tricky and controversial but it worked and did provide additional chicken at critical times.¹⁶ This safety valve worked only because the United States was ready, at a moments notice, to supply Canada with whatever poultry product was needed. By being a ready supplier whenever the supply management manager made a mistake (and mistakes were made), the United States prevented the Canadian consumer from experiencing the market realities that often resulted from attempts to control production and has happened in other countries that attempted to control production. The United States, therefore, assisted Canadian policy makers by blunting the full market impact of controlling production.¹⁷

It is our view that the United States has never taken the time to fully understand the administrative procedures that make up the import control regime.¹⁸ Similarly, we can generalize and say that on both sides of the border, the way policy is administered is often not as great a concern to analysts as the policy itself. Yet, our experience is that both are equally important and a policy objective can often be undone by administrative procedures

¹⁵ The other way was that supply management producers agreed not to price by the market but rather be guided by the cost of production.

¹⁶ On two occasions the discretion of the Minister to issue permits was challenged all the way to the Supreme Court but in both cases, the courts rejected any attempt to bind or put conditions on the exercise of discretion. Even the condition in the Export and Import Permits Act that the Minister must act to support supply management was interpreted so liberally that the Minister could, if he wished, allow sufficient imports to put pressure on producer prices. Reference Maple Lodge Farms vs the Government of Canada and the Canadian Association of Regulated Importers vs the Attorney General of Canada.

¹⁷ One astute observer at the Department of Finance, in about 1978, suggested the Canadian government give the supply management agencies total control over supplementary permits because they would misuse this power and bring about their own demise. He may have been right but this was not done and to this day, the government still controls the supplementary import system which can be used as a lever to make changes if the government wishes to exercise this option.

¹⁸ This was demonstrated when Carla Hills visited Michael Wilson on one of the regularly scheduled trade talks. KFC and other companies had complained to the U.S. Trade Representatives Office that access was being denied and this was causing problems. Ms. Hills raised the issue and Mr. Wilson suggested that KFC should make use of the supplementary import system. They subsequently did and received about 5 kilotonnes in access for new products, about 10 percent of the existing access. The United States was no doubt surprised by this development but it shows that opportunities may have existed which the United States did not fully exploit and which could have served to reduce the intensity of the poultry conflict.

which frustrate the policy objective. Similarly, it should be clear that the choice of administrative procedures can serve either to promote harmonization or prevent it.¹⁹

Fear of One-Way Trade Other than the perception of some producers that they will never be able to compete, the next biggest obstacle to harmonization is U.S. trade laws and U.S. senators who exploit these laws.²⁰ The perception in Canada is that the United States wants Canada to open its border for all food products but if Canada makes inroads on the U.S. market, even by a small share, questions are raised and often action to reduce the trade flow is the result. For example, at the recent Outlook Conference, the newly appointed representative of the U.S. Trade Representatives Office, Ms. Barshefsky, noted that Canada was exporting subsidized eggs into the United States. Potato exports have been a growth item for Canada recently and it looks like Canada captured about 5 percent of the U.S. market last year. As a result, the U.S. International Trade Commission (ITC) is launching an investigation which could lead to trade action. As the hog and softwood industries have found out, these actions are expensive and disruptive even if the dispute is won.

GENERAL COMMENTS AND OBSERVATIONS

In reviewing the dairy and poultry dispute, it is evident that many factors have made the dispute a difficult one to resolve. It is our view that the dispute will not now be resolved by government initiatives.²¹ The need to do so will come from industry and the economic realities of the marketplace. This dispute demonstrates the case of economics leading the political process.²² The government still dominates but cannot stop the harmonization process that is taking place in trade, inspection, labelling, health claims, food safety,

¹⁹ Canadian supply management has its origins in the simple policy objective that producers should receive a fair return for their labour and investments as announced in a Speech from the Throne in 1971. How this policy was operationalized and administered has given rise to the poultry and dairy disputes, even though for dairy, at least, U.S. policy objectives were similar.

²⁰ The use of U.S. trade laws was noted as a concern in the text of the 1989 CUSTA. The recent decision by the U.S. government to ignore the WTO Panel examining the Helms-Burton Law again fuels the perception that the United States will not abide by international rules if they hurt.

²¹ Indeed, Mayer and Josling suggest that the nature of the U.S. political system makes change in U.S. dairy policy difficult to achieve. See *Agricultural Policy Reform: Politics and Process in the EC and USA*, 1990.

²² For a discussion on how market forces are reshaping corporate America and how the policy makers are failing to keep up, see *Tales of a New America*, by Robert B. Reich, particularly chapter 20.

HACCP, technology, products, and the rationalization of food manufacturing on a NAFTA basis.

One way to speed progress is to remove the fear producers have that they will lose income or be put out of business. This goal can be achieved by policy analysts showing producers that market acceptance of the products they produce is the only way to ensure their future. This point was made at last year's dairy session but as the poultry dispute shows, this means reversing or undoing what has been said many times — not an easy task. Another way to speed up the process is to harmonize Canadian and U.S. trade laws, anti-dumping and countervail ones in particular, and agree on safety mechanisms which can be used once a free trade environment is achieved.

Uncertainty and the inability to obtain competitively priced inputs from the dairy and poultry sectors are forcing changes on the supply management commodities as are changes in the market place and in technology. Change is also being fuelled by the debt loads of governments. Corporations do not like uncertainty or risk. They are always taking steps to create a more certain future with reduced risks. Reduced costs and increased productivity are being achieved by rationalization, adopting new technology, consolidation, entering into strategic alliances, benchmarking, and developing export markets. In Canada, the pace of change is quicker beyond the farm gate than at the producer level for both the dairy and poultry sectors. In the United States, changes at the processing level are also significant. It is an irreversible process which in part has been accelerated by the WTO agreement, particularly for dairy. The production sectors will have to join in and there are signs that supply management producers are realizing they must do more to ensure their future. Some interprovincial production transfers have taken place and some provinces have removed the maximum size restrictions for registered growers.

Several interesting ideas are being pursued by groups of producers, taking them beyond the farm gate. These moves have been made possible in part because after twenty years of supply management, producers and cooperatives have a stronger capital base than do the processor and further processor sectors. It is not surprising that in the dairy sector, several co-ops have recently made strategic moves. (i.e., Agropur purchasing Ault milk business, 1997.)

The NAFTA decision has given many stakeholders in the poultry and dairy producer sector the confidence that there remains at least ten years of protection. As a result, quota value for chicken in Ontario has increased from \$18 a bird to \$23 and complacency is again settling in. The pace of change has slowed down and a new battle appears to be developing over the price of live chicken. We view this as a temporary situation as most stakeholders feel, including individual producers, that the current protection will gradually erode. This position is supported by the realization that border protection is not complete and that "leakage" of products not controlled at the border is increasing. The leakage problem is greater for poultry than for dairy because fowl meat is not covered by tariff rate quotas (TRQs). For example, of the \$88.5 million of further processed poultry products (i.e., chicken dinners, frozen entrees, or fully prepared meals) imported last year from the United States, 70 percent or \$62 million was not covered by TRQs. In 1988, imports for this

category totalled only \$30 million. Similarly, Canada has become a major market for U.S. fowl meat with imports increasing during five out of the last six years.

Harmonization of the poultry and dairy sectors on a NAFTA basis is a real possibility. The technology and inspection systems are very similar already, while the regulatory environment is being harmonized a little bit at a time. When the border restrictions are removed, it is our view that, like beef, Canada, the United States and Mexico will trade poultry and dairy products on a north/south basis. In dairy, the results presented by Meilke et al. at the last workshop was an outcome with which we are comfortable.²³ Often, U.S. analysts have over-estimated the gain that can be made from trade while Canadian analysis has underestimated Canada's ability to be competitive with U.S. producers and processors of dairy and poultry. The food service distribution sector, which uses at least 40 to 50 percent of the poultry produced in North America, is quickly being reorganized on a north/south basis. The feed grain industry is similarly reorganizing on a north/south basis, particularly now that the Crow Rate has been eliminated. Since Canada is already shipping feed grain into the United States and feed grain makes up about 60 percent of the cost of producing poultry, Canada can be a competitive poultry producer.²⁴

Further evidence that two-way trade will be a reality can be found in dairy and poultry export and import performance since 1990. For example, two-way trade in dairy products, despite border measures, has increased from US\$65 million in 1990 to US\$140 million in 1995. Although the United States is the net exporter, Canadian dairy exports to the United States are also increasing. In 1994, Canadian dairy exports totalled about US\$50 million and in 1996 are expected to reach over US\$76 million. Imports of chicken have grown from about 51 kilotonnes in 1990 to over 57 kilotonnes in 1996. Chicken exports have grown from almost nothing to 18.5 kilotonnes in 1996. Canadian chicken exports compete with U.S. chicken exports in offshore markets but further processed chicken products are also being marketed in the United States. A similar pattern can be observed in the trade flows for turkey products.

In the dairy sector on both sides of the border, changes in policy have been made as a result of the WTO and budget pressures in Canada. Subsidies are being phased out over a period of time but we do not see this change bringing about increased trade. It does, however, bring the possibility of freer trade a step closer. Similarly, the shift from producer financed subsidies to an end-use pricing system brings the dairy sector closer to market realities. This particular change in Canadian dairy policy is being informally reviewed by

²³ Similar results are forecast by Langley et al. in their recent article, "Dairy Policies are Limiting U.S.-Canada Trade," published in the January/February 1997 issue of *Agricultural Outlook*, ERS, USDA. This is an excellent, well-balanced article and more work of this nature is needed.

²⁴ A study by De Valk Consulting Inc. comparing the competitiveness of Canada and U.S. poultry processors shows that the difference in processing costs has narrowed significantly since 1991. The January 1996 issue of *Poultry International* contains broiler meat cost of production comparisons. Although Canada is not included, our information on Canada suggests that costs similar to the United States are achievable.

Australia, New Zealand and the United States to determine if WTO conformity has been achieved. If the approach is found wanting, the WTO may yet be the catalyst for some more fundamental changes.²⁵ Interprovincial quota transfers (similar to the EC's country transfers) are becoming a reality and will help rationalize production on a more effective basis, but this is something policy analysts recommended be put in place twenty years ago.

The U.S. dairy policy change to consolidate the current thirty-two milk marketing orders into eleven will expand each region's market and is a necessary interim step to achieve harmonization. Just as in Canada, any remaining interprovincial barriers on dairy products and milk have to be eliminated. The issue of imitation dairy products also has to be dealt with and Quebec's recent suggestion that all provinces harmonize by each adopting the same prohibition on margarine is not a realistic one. Pressure to eliminate provincial restrictions is building.

The NAFTA agreement has the greatest impact on the Mexican dairy industry as a ten-to-fifteen year phase in period to achieve trade without restrictions is in place.

The likelihood of harmonization is made more compelling when consideration is given to the form of ownership that might evolve in the poultry and dairy industries. Currently, there are three approaches being used to achieve vertical coordination: the U.S. vertical integration approach where control is achieved through 100 percent ownership and one-to-one grower contracts; the European supply chain management approach where vertical coordination is achieved through means other than 100 percent ownership or control, including "voluntary" cooperation; and the Canadian supply management approach where vertical cooperation is attempted under the umbrella of national marketing agencies. It is our view that the supply chain management concept will evolve as the preferred approach because it provides the ability to manage food safety issues in a cost effective manner and best responds to changing consumer demands. We see both U.S. vertically integrated firms and Canada's supply management system evolving toward the chain management model. In Canada, this will mean that an independent producer sector coordinated through producer agencies can continue to exist while in the United States, the larger vertically integrated firms will likely spin off units and become more focused on core business.²⁶

The common goal of ensuring production of safe food products will bring the Canadian and U.S. industries closer together. Sharing the same export markets and being a consistent exporter will do likewise.

As these changes take place, governments will follow and, from time to time, may be tempted to stall or reverse the process in response to demands by special interest groups. It is during these actions that analysts will need to ensure that policy makers have a good understanding of the options and the outcome. If, as Kempton Matte suggested at last year's seminar, the analysis available is complete and includes the downstream and trade

²⁵ If it is "approved", it is likely the United States will adopt a similar approach.

²⁶ Alan Barkema and Mark Drabentstott, *The Many Paths of Vertical Coordination: Structural Implications for the U.S. Food Industry*.

implications, the policy makers will at least have the economic consequences of their policy choices clearly set out. This was not the case when dairy and poultry policies were first developed.

CONCLUSIONS AND RECOMMENDATIONS

The following are a number of conclusions we have drawn from the poultry and dairy disputes.

- The use of dispute settlement mechanisms does not always resolve the dispute. It could, and probably has, made resolution more difficult. Policy makers should only use this mechanism when the implications of both winning and losing, both in the short and long run, are considered.
- International trade rules, even in agriculture, are starting to have some impact on modifying "political" rule-making.
- The transparency provided by international trade rules is superior to "political" rule-making and supply management rule-making. Transparency and predictability are good for business because they reduce risk and uncertainty.
- Policy analysts and agricultural economists have a role to play in bringing to bear on agricultural and food disputes, transparent rule-making. Their input can help keep issues from becoming disputes and provide opportunities for harmonization. A greater reliance on international trade rules also achieves this objective.
- Canada's aggressive efforts to increase access and reduce barriers to trade for all agricultural products while keeping in place trade restrictions for poultry and dairy will be difficult to defend and maintain both domestically and internationally. The latter because doing so contradicts the spirit of the trade agreements Canada has signed, as shown by this dispute. Inconsistency in approach, by developing trade policy for sectors, leads to disputes.
- Both Canada and the United States have a comparative advantage in producing poultry and dairy products compared to other producers around the world. This common denominator should provide opportunities for harmonization and freer trade so that both countries can build a strong North American base from which to export and also one which will be of benefit to Mexico.
- The poultry program in Canada, and dairy program in both countries, transfers income to producers. If this factor is addressed, a more harmonized environment can be achieved more quickly.

Although it does not appear to be part of most of the workshop presentations, we will take this opportunity to move beyond conclusions to recommendations. In order to defuse the dairy and poultry dispute, the following suggestions are put forward:

1. The U.S. poultry industry needs to develop meaningful and representative live chicken and turkey prices that can be compared to Canadian live prices by developing a more transparent pricing arrangement with their contract growers.
2. In both dairy and poultry, Blue Ribbon Industry Panels (U.S. and Canadian) should be established to make recommendations to both governments on how and when freer trade can be achieved.
3. The Canadian and U.S. governments should resume their efforts to develop a new regime of trade remedies and safeguards, pushed by industry on both sides of the border.
4. Harmonization of inspection systems, labelling, product definition and other technical areas need to be continued and encouraged.
5. In Canada, interprovincial movement of milk and poultry production quotas should be facilitated and maximum limits on farm size should be removed.
6. Interprovincial trade barriers in the dairy sector and interprovincial differences on imitation dairy products should be eliminated while in the United States, the efforts to reduce the number of milk marketing orders should continue.
7. Policy analysts should be studying the implications of removing border controls on poultry and dairy products based on industry structures and costs which reflect the outcome of structural adjustments made during a suitable adjustment period.

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