

—DISCUSSION—
**CONTEMPORARY DAIRY POLICY CHANGES IN CANADA:
A WESTERN CANADA PERSPECTIVE**

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Changing dairy policy in either Canada or the United States is a difficult business. In this industry, we inherit numerous regulations and administrative practises that are very resistant to change. The existing policy nexus also favours sub-groups within the dairy industry. We need to keep these observations in mind as policy change is contemplated.

Canadian dairy policy changes over the past year have not received the public or analytical attention accorded U.S. dairy policy, through the Farm Bill. As a recent example, two February 28th editorials in USA TODAY were dedicated to U.S. dairy policy changes. Both sides of the debate were presented in terms understandable to the average reader. There has been no equivalent public debate in Canada.

Canadian dairy producers historically insisted that Canadian dairy policy be based upon three "pillars".

- Domestic supply management (production quotas by province).
- Import restrictions (import quotas, now tariff rate quotas).
- Cost-of-production (COP) pricing.

Cracks have appeared in these pillars recently. Some provinces are committed to an interprovincial quota exchange, to allow milk production to move to those provinces/regions with a comparative advantage. Export markets have been developed. In 1994, the dairy support price was severed from a formal COP formula, as "benchmarking" was introduced to the system. And further processors using dairy ingredients have negotiated lower prices for dairy ingredients in order to be competitive with imports.

With Canada signing onto the WTO, the Canadian dairy industry was faced with three realities.

- Domestic supply controls to meet GATT Article XI obligations were no longer necessary or required.
- Dairy export assistance, a structural surplus removal program, had to be reduced or, in some instances, eliminated.

- Canadian quantitative import quotas on dairy products were "tariffed", and minimum access commitments for butter and margarine were established.

Although domestic supply controls are no longer necessary, domestic production currently remains fixed in place, without any provincial reallocations of industrial milk quota (MSQ).

Fluid milk production quota is the responsibility of the provincial milk boards, while MSQ is set at the national level, through the Canadian Dairy Commission (CDC). Dairy products move interprovincially, as MSQ is currently not allocated according to market supply/demand. The interprovincial movement of fluid milk is now occurring, suggesting that provincial fluid milk price differentials are creating the opportunity for arbitrage. Even in the instance of industrial milk quota, genuine export market opportunities (as opposed to structural surplus removal) are starting to influence the system.

Dairy export assistance was producer-funded through over-quota levies, and under the new WTO, any such assistance was deemed to be an export subsidy. The FTA and the NAFTA required that Canada and the United States terminate all export subsidies on goods traded between the two countries. Consequently, in August 1995, the CDC eliminated all assistance on dairy exports to the United States, and implemented price pooling to maintain these markets with the same distributional impacts on Canadian dairy producers.

Canadian international trade policy (tariffs and border access commitments) is the purview of the federal government, and tariffication and minimum access commitments (MACs), were put into place as per Canada's WTO obligations.

Given the federal government's implementation of its WTO obligations, the Canadian dairy industry, in particular the provincial milk boards and the Canadian Dairy Commission (CDC), through the Canadian Milk Supply Management Committee (CMSMC), decided to undertake a series of policy changes to retain the existing Canadian dairy system.

Following is a brief review of these changes.

Harmonization of Milk Classes Nationally. All parties to the CMSMC agreed to establish 5 harmonized milk classes. This involved some provinces amending regulations and associated conversion costs.

Pooling Nationally - Special Classes. Nine provinces (P9) have agreed to pool special classes, which collectively fall into Class 5 in the new, harmonized system. Special classes include export classes and ingredient classes to provide competitive dairy inputs to domestic further processors. Returns are pooled nationally, with each province required to contribute a minimum amount of Class 5 milk to this pool, from higher classes if necessary. Pooling was done to ensure all provinces paid for structural surplus exports, whether or not a province was generating any such surplus, or benefiting from the export or import-replacement activities of the CDC.

Pooling Milk Nationally and Regionally. Central Canada, Manitoba, the Maritimes and the CDC have agreed to a national pooling of all milk, fluid, industrial and special classes. Extending this proposal to the West would have a substantive deleterious impact on growing regions such as BC and Alberta, where population growth means growth in the higher-priced fluid sector. The West is presently considering a separate "Western Pool", as a means to capture greater production and allocative efficiencies.

Domestic Structural Surplus Management Programs. The CDC has three domestic surplus management programs.

- Plan A - CDC takes ownership of product and sells it later;
- Plan B - CDC stores butter or powder for a particular processor;
- Plan C - CDC tries to get processors to "share" surplus milk, to reduce the surplus without exporting.

Plans A and B were designed to address seasonality of production and demand. Plan C, a new program, is fraught with problems. Processors are not horizontally integrated and continue to compete for market share. Small butter processors do not want to "sell" their surplus milk; and larger, efficient processors do not want to buy it on a haphazard basis. Plan C is an example of a CDC policy designed by producers which has not been fully implemented by processors.

Optional Export Program. This program allows provinces to produce milk for which there is a unique export market niche. It is not intended to compete in existing export markets serviced by the CDC. This program permits additional provincial milk production, administered centrally, without requiring industrial (MSQ) quota. Government at this time is allowing producers the right to control production for export. However, some provinces may take the opportunity to expand output for export, at the expense of those provinces where producers continue to dominate the policy agenda.

Multiple Component Pricing (MCP). MCP allows for the pricing of fat and protein separately. As indicated in one of the background papers, if component prices are set with market demands in mind, pricing and milk allocation will move the dairy product mix towards a market-sensitive pattern.

However, if component prices are set with an eye to maintaining producer revenues, allocative efficiencies will not be realized. To date, the latter path seems to be the preference.

Quota Policies. Some provinces have a single quota for industrial and fluid milk production. This is an attractive administrative concept - milk is milk is milk - but implementing it will have significant equity impacts on producers who are not at a 50/50 split in fluid/industrial production.

Interprovincial quota transfer/movement is another policy issue. There is resistance to this policy initiative in some provinces. Provinces are jealous of their existing milk

production levels and a quota exchange under supply management creates winners and losers.

Levy Policy. Existing levies support CDC programs and activities. If CDC programs and policies are seen to support specific provinces, the levies may be at risk in those provinces not receiving any CDC program benefits.

Pricing Policy. Attempts by producer boards to retain maximum prices, without reference to market conditions or processor needs, will prove and have proven to be unsustainable.

Fluid milk is now moving interprovincially in response to price differentials. And processors are undertaking mergers, vertical integration, and vertical coordination to protect their interests. Dairyworld, for example, is now a regional cooperative of significant size in the Canadian market.

CONCLUSIONS

Dairy policy in Canada in 1996 continues largely to reflect a producer perspective. However, producers, at least in the West, now realize that they need to support processing and marketing interests, if their industry is to be sustainable and profitable. Indeed, vertical coordination between Canadian and U.S. dairy firms may become more attractive in the future.

Some observers believe that the U.S. dairy industry will walk all over the Canadian industry if high tariffs are removed. However, I believe that if tariffs are lowered substantially or removed, producers, processors and provincial governments will take action; policy will change; and the Canadian industry will be more competitive as a result. As a practical matter, no government will allow an industry to simply disappear, on either side of the border.

Consequently, I agree with the finding of Barichello and Romain, that the Canadian dairy industry will not cease to exist if the United States gains increased access to the Canadian market. There would be an adjustment period and the Canadian industry would use that time to make the necessary changes.

I am much less sanguine about the authors' support for the current set of national dairy policy initiatives: a single national milk pool; an interprovincial quota exchange (MSQ only?); new CDC surplus control programs; and a centralized export program. These are palliatives for the existing system. They are unlikely to provide the basis for a new dairy policy in Canada under conditions of freer trade.

THEME: ANALYSING THE POTENTIAL FOR INCREASED TRADE

OBJECTIVE

To establish the nature and extent of common ground in place, or needed to be put in place, in order to permit unbiased, consistent, and efficient analysis to be developed in both Canada and the United States.

