POLICY DEVELOPMENTS IN CANADIAN AGRICULTURE: REPORT CARD ON TRADE LIBERALIZATION

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BACKGROUND

The country policy review paper on policy developments in Canadian agriculture gives a concise listing of program changes for agriculture and food that have occurred since the mid-1980s. A major focus of many of the changes, as noted in that paper, is to orient agricultural programs to be consistent with the Uruguay Round Agreement on Agriculture (URA). The related, and even more compelling, focus underlying the reorientation of Canadian agricultural policy in the last half of the 1990s, has been reduction of budget outlays. A further motivation for changes in farm programs has been the high levels of costs associated with trade disputes. However, the need for expenditure reductions reinforced political will for action on a number of the policy changes highlighted in the country policy review paper for Canada.

IMPACTS ON THE CANADIAN FOOD INDUSTRY

The changes in Canadian agri-food policy that are outlined in the country review paper have accompanied considerable transformation of the Canadian food processing and distributing industry. At the start of the period under review, Canadian food processing and distribution were highly concentrated. Food manufacturing, in particular, contained numbers of relatively small-scale, high-cost plants, sheltered behind protective tariff walls. Industrial reorganization has occurred during the period since the mid-1980s and the industry now includes many lower-cost, larger technologically advanced processing units. This underlies increased exports of prepared and semi-prepared food by Canadian food processors. A recent study of Canadian food manufacturing companies, by Agriculture and Agri-Food Canada and Statistics Canada, focuses on advanced technology in food manufacturing. The study included assessment, by managers of the sampled firms, of their technological competitiveness. Of

these, 23% believed they were technologically more advanced than their US competitors, while 26% believed that their firm lagged in competitiveness [Baldwin et al, 1999].

The North American Free Trade Agreement [NAFTA] is often credited with contributions to this transformation, which has not been confined to Canada, but is paralleled in other nations. However, the removal of distorting agricultural programs (such as changes in Mexico's programs for maize and the deletion of Canada's transportation subsidies for grain, among other domestic policy reforms), as well as economy-wide changes in economic policy that are not directly related to NAFTA, are believed to be larger influences on trade within North America [Burfisher and Jones, 1998]. In Canada, corporate restructuring with associated major reorganizations of structure and operations has been evident in virtually all components of the food processing and distribution industries, including meat packing, grain handling and dairy foods.

Within agriculture, the regional integration of North American markets for farm products is most evident for red meats and for livestock. The cross-border markets for live cattle and beef in particular are fairly well integrated and highly interdependent. However, even in this sector, complete mutual recognition of the equivalency of beef grading standards has not occurred. Differences in grade standards have long been recognized to have impeded the evolution to a single market for beef [Hayes and Kerr, 1997]. These differences have contributed to such features as the value of boxed beef imports being heavily discounted in both the United States and Canada [Young and Marsh, 1998]. Proposals to introduce mandatory country-of-origin labeling for meat, which can be viewed to be a non-tariff barrier, raises potential trade concerns [FSIS, 2000]. For grains, market integration is hampered by institutional differences, such as in grain trading institutions and variety licensing practices. Cross-border market integration for the politically sensitive sectors is limited. In Canada, these are the supply managed sectors for dairy, poultry and eggs.

IMPLICATIONS OF CANADIAN AGRI-FOOD POLICY DEVELOPMENTS

The extent of the reform of agricultural and food policy in Canada is encapsulated in the summary figures showing the changes, over time, in OECD

support estimates for Canadian agriculture that are included in the country policy review paper for Canada. The removal of transport subsidies eliminated most of Canada's export subsidies and removed a large component of Canada's aggregate measure of support, with an associated significant reduction in transfers to the farm sector. A very high proportion of agricultural imports now enter Canada duty free. This proportion is higher than for any other OECD country [OECD, 1997]. However, the levels of tariff protection afforded the Canadian supply managed sectors are extremely high. When these are included, the average tariff rate on agricultural imports by Canada is calculated to be about the same as in the United States. This was 21% in 1996, according to WTO Secretariat calculations [WTO, 1997].

The continuing distortions in Canada's supply-managed sectors are reflected in the existence of 22 different tariff rate quotas. Most of these apply to the supply managed commodities. The fact that the supply-managed sectors have escaped meaningful reform can be attributed to the receptivity of regional sensitivities to effective lobbying and the absence of fiscal pressure, as the cost of support for these programs is borne mainly by consumers, whose ability to influence farm policy has been minor. This is the area of Canadian agricultural policy that requires further reform.

THE WTO RULING ON CANADA'S DAIRY POLICY: A SOURCE OF MAJOR CHANGE LEADING TO TRADE LIBERALIZATION OR AN IMPETUS TO MINOR ADJUSTMENT OF SUPPLY MANAGEMENT POLICY?

The recent WTO dispute settlement ruling concerning Canada's dairy trading and pricing practices is of interest as the first post-Uruguay Round WTO dispute settlement case that focuses on agricultural export subsidies. This is also the first occasion of a trade law ruling that an export subsidy has been provided at the cost of domestic consumers through price discrimination between domestic and export markets. In addition, the panel finding suggests that agricultural pricing practices for some other commodities that seem to involve systematic price discrimination between domestic and export markets could potentially also be challenged as export subsidies if this is effected through government action. Also of interest is whether the need to change Canada's

dairy pricing policy in response to the WTO ruling will be a trigger for substantial policy reform of supply management.

The WTO Appellate Body that examined the initial panel findings concerning the complaint against Canada's dairy price pooling practices concluded that the procedures associated with the arrangements for Canada's special milk classes 5 (d) and 5(e) constitute an export subsidy. These procedures make provision for milk that is priced significantly lower than the domestic milk price to be made available to processors/exporters. Access to this milk is only available for sales into export markets. The pricing of special class milk at prices lower than processors/exporters can obtain elsewhere was judged to confer a benefit to processors/exporters since revenue is foregone by its being discounted in price. Since this benefit is associated with the export of dairy products and the actions of governments or their agencies are required to provide for these benefits, the panel and the Appellate Body judged this benefit to represent the direct payment of an export subsidy. Consequently, it was determined that in following price pooling procedures for the two specific special classes, export subsidy reduction commitments arising from the URA had not been met. The export subsidy ruling applies only to the export classes 5(d) and 5(e) which were pooled with higher priced end-uses for domestic use. The dairy pricing challenge did not apply to the other Canadian dairy export category (the "optional dairy export program"), introduced at about the same time as the price pooling arrangements. Revenues from this milk are handled differently in different provinces, but this category of milk is not pooled with higher-priced end-uses for domestic use and thus does not receive a consumer financed export subsidy [WTO Panel, 1999; WTO Appellate Body, 1999].

Another issue in the dairy dispute related to the way in which Canada applied its tariff-rate quota for fluid milk imports. The United States had argued that this did not meet Canada's URA commitments. Fluid milk imports were confined to importation of restricted quantities for personal use by individual cross-border shoppers. (Canadian dairy interests have pointed out that the United States did not actually adopt any provision for fluid milk imports in its URA commitments.) The U.S. challenge on Canada's provision for access of fluid milk, and the initial panel finding on it, were not upheld by the Appel-

late Body, although Canada's restriction limiting cross-border imports to $20 for each individual entry was ruled to be inconsistent with its commitments.

Canada has agreed to reduce subsidized dairy exports (and to remove the milk entry limitation of $20) in compliance with the WTO ruling. Canadian dairy policy and procedures must now be developed that will ensure that this commitment is maintained in the future. One view of the necessary adjustments to Canada's dairy pricing and marketing arrangements, stated by industry spokesmen, is that changes can be made to meet Canada's export subsidy commitments in a way that need not interfere substantially with the supply management program for dairy. This approach to the need for adjustment of dairy policy is to make minimal changes to the current administered procedures, as by running a "tighter" program [DFO, 1999]. This policy reaction is likely the most expedient, politically, despite the expectation that future negotiations on agricultural trade liberalization will emphasize reductions in prohibitive tariff levels associated with tariff rate quotas so that the current isolation from world markets of Canada's supply management programs is unlikely to be sustained in the longer-term.

The need for reform of Canadian dairy policy extends to domestic trade. Provincial-level restrictions have, with some exceptions, limited interprovincial shipment of raw and semi-processed dairy products and there is virtually no ability for adjustments in dairy production and processing between provinces and regions in response to any differences in their economic environments. A challenge of restrictions on the shipment of milk from Nova Scotia to Prince Edward Island has recently occurred under procedures relating to Canada's Agreement on Internal Trade [AIT]. A ruling through the AIT panel process, which follows procedures patterned on international trade dispute procedures, was made in early 2000. This panel found that dairy regulations adopted by Prince Edward Island do contravene the AIT, but no resolution of this issue has occurred to this point.

The limited experiment to allow quota movements between regions through an interprovincial quota exchange, introduced in 1997, concluded in 1998. Ontario withdrew from these arrangements in March 1998, reportedly after more than two percent of provincial dairy quota was sold to producers in

Nova Scotia and Quebec. Later, with a net loss of dairy quota to Quebec and stated concerns about increasing quota price levels, Nova Scotia withdrew from the interprovincial quota exchange program, ending this particular experiment [DFO, 1999]. The alternative to the current rigid system of production/marketing quotas would be a more flexible system based on contractual arrangements between producers and their cooperative processing companies (or with other processors) but there is little indication that this is likely to be advocated by farm organizations.

CHALLENGES FOR CANADIAN AGRI-FOOD POLICY AND OTHER TRADE LIBERALIZATION ISSUES

As noted above, a major challenge for Canada's agricultural policy relates to the continued isolation of the supply managed sectors---the dairy industry in particular---from world trade. Producers' associations have been unwilling to seek the opportunities of competing in the larger North American market by moving to reduce the barriers to cross-border trade within North America. Recent price-tracking reports by ACNielson-Canada of cross-border retail prices for dairy products, commissioned and reported by Dairy Farmers of Ontario [DFO, 1999], show retail dairy prices for a variety of dairy foods to be higher in major U.S. cities than in cities in Canada, despite considerably higher producer-level prices for milk in Canada. Such comparisons are, of course, considerably influenced by the choice of the comparison city locations and retail outlets as well as by the rate of exchange between the Canadian and U.S. dollar. Even so, their focus is reinforced by the change over time in earlier patterns of cross-border shopping involving considerable diminution of this practice. These suggestions and other indications of increased efficiency in the dairy processing and distributing sectors in Canada do not support a hypothesis that the Canadian dairy industry would be at a major disadvantage relative to the US industry with a more open border. In fact, the opposite could be argued.

The increases in the level and concentration of trade between the United States and Canada have contributed to increased tensions over trade flows. As is discussed in other papers in this proceedings, these have resulted in U.S. countervail actions on Canadian exports of pork and live hogs, and a series of U.S. actions and inquiries related to single-desk selling of Canadian wheat and

barley. Challenges and disruptions in the export of beef from Canada to the United States have also occurred periodically. Tension continues between the United States and Canada about trade in softwood lumber, for which Canadian exports to the United States are effectively constrained. There is much concern in the United States (and some other countries) about Canada's trade policy for its supply managed sectors.

Despite periodic but persistent tensions over agricultural trade, in general the dispute settlement procedures of the WTO and NAFTA have streamlined the resolution of cross-national trade disputes and moved the outcome of these away from reliance on market power, in favour of settlement according to agreed rules. Even so, Canadians and others have concerns about the ability of U.S. farm groups to seek protection under national trade remedy legislation. The relative ease with which U.S. procedures for countervail and antidumping can be invoked by regional interest groups and producers' associations have imposed high levels of legal and other costs on some Canadian export sectors.

Existing trade dispute procedures are not well suited to the settlement of tensions arising from policy changes involving specifications of quality or grading that result in limitations of cross-border trade. A current example of this type of activity applies to the U.S. provisions for grading of meat that meets USDA standards. Currently beef and other livestock carcasses may be shipped from Canada to U.S. plants for USDA inspection and grading, but a legislative change that would disallow USDA grading of imported carcasses (and thus encourage U.S. importation of slaughter animals rather than beef carcasses) has recently been proposed.

Through the action of working groups, NAFTA was supposed to aid the harmonization of standards to reduce the potential for disputes that might arise through technical barriers to trade, as from differences in national composition or quality standards for food and associated labeling policies. These types of issues are likely to be of increasing importance in the future. In developing a report card on trade liberalization through NAFTA, a high mark cannot be given for major achievements in standards harmonization to date.

SUMMING UP

The report card that could be given for changes in Canadian agricultural policy relative to trade liberalization since the mid-1980s would note the major reduction in Canada's program expenditures that might distort agricultural production decisions, for the major products of grains and livestock. It would express concern about the relatively low progress on liberalization of trade, domestically and internationally, for Canada's supply managed products, particularly for dairy. The report card could raise concerns that the levels of Canada's investment in publicly funded research on agricultural and food issues is lower than desirable. It could suggest that more public communication and policy attention be directed to issues of food quality and safety and that more emphasis be placed on pursuit of harmonized standards---at the domestic as well as the international level. In looking towards the future, the report card could express concerns that Canada's current budget surpluses not be spent on emergency assistance in agriculture without targeting funding to assess the efficiency and distributional consequences of expenditures; concerns could be expressed that this type of assessment also be applied to other policy initiatives directed at agriculture and rural Canada.

In commenting on both the progress for Canadian policy and the effectiveness of NAFTA as a vehicle to promote trade liberalization, investment, and reduced trade disputes, the report card might sum-up as: "good progress but keep on working for even better achievements."

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