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ISSUES IN NEGOTIATING REDUCTIONS
IN SUPPORT FOR CANADIAN AGRICULTURE*

by

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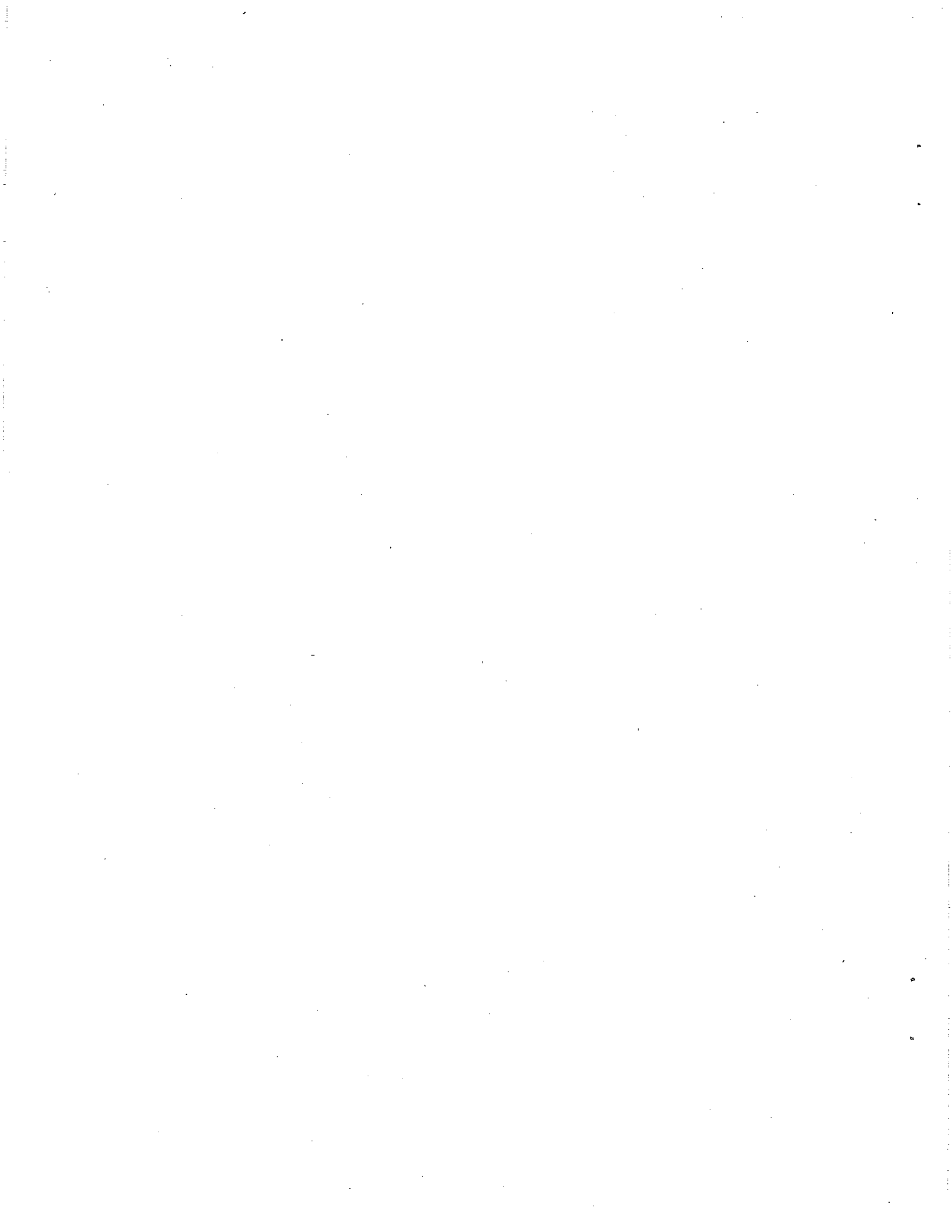
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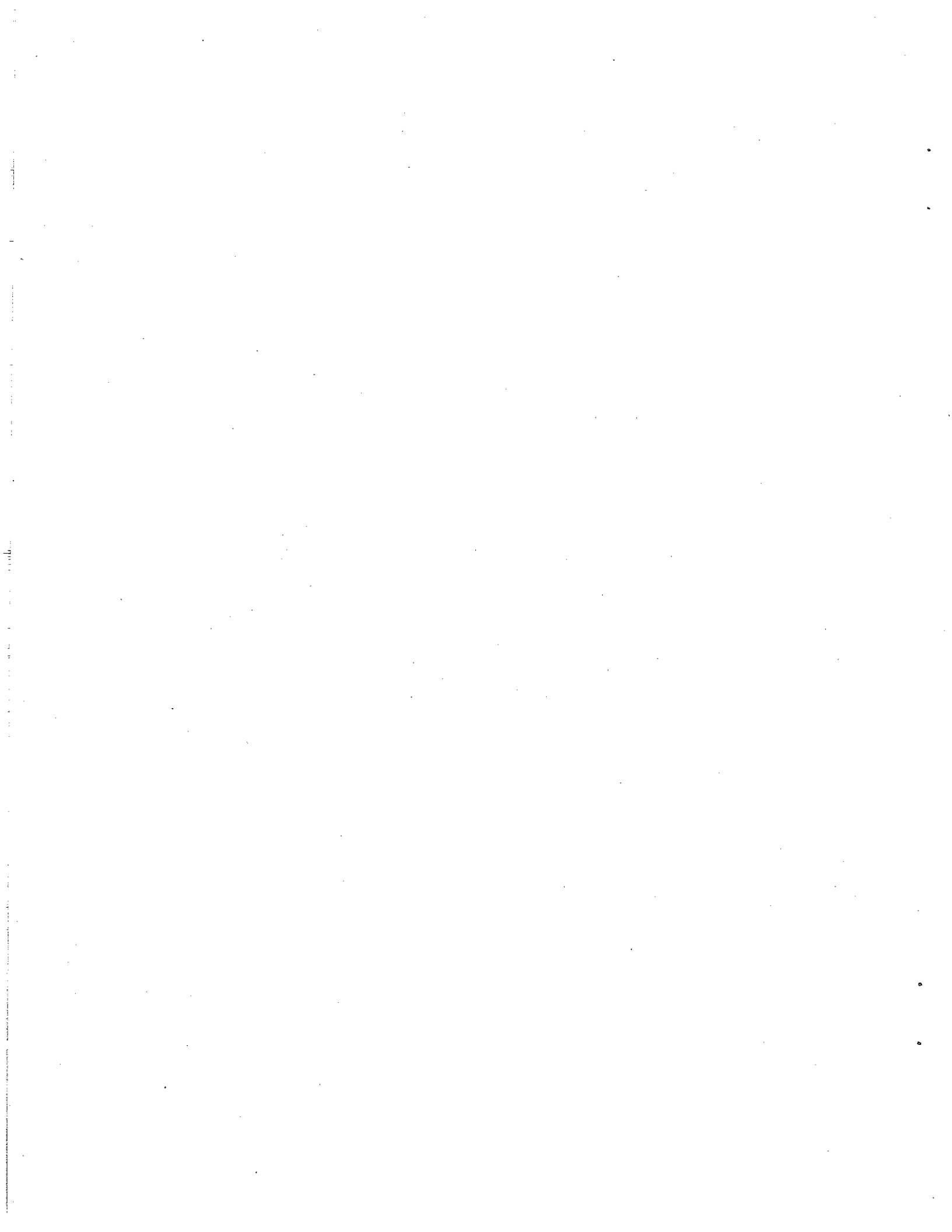


Preface

This report was prepared at the request of the International Agricultural Trade Research Consortium to provide background information for their symposium on "Bringing Agriculture into the GATT", scheduled for Annapolis, Maryland August 19-20, 1988.

In common with other country studies prepared for the symposium, the authors were asked to discuss the economic consequences and technical, conceptual and political difficulties of reducing Canada's aggregate level of support for four agricultural commodities by 50 percent over a five year period.

This discussion of reducing support to Canadian agriculture does not imply endorsement of the use of the PSE, or of a 50 percent over 5 year option, but does serve to initiate the debate on how Canada's agricultural programs might be modified in fulfillment of an internationally binding obligation to reduce their most trade distorting features.



ISSUES IN NEGOTIATING REDUCTIONS
IN SUPPORT FOR CANADIAN AGRICULTURE

1.0 Introduction

In common with the other country studies prepared for the International Agricultural Trade Research Consortium (IATRC) symposium, this paper examines the modalities, the economic consequences and the technical, conceptual and political difficulties of reducing Canada's aggregate level of support for four commodities by 50 percent over a five year period.

The national and provincial commodity compositions of farm cash receipts for 1986 are shown in Table 1. The total policy transfers and percentage producer and consumer subsidy equivalents (PSE and CSE) in that year are given in Table 2. Table 3 gives a further breakdown of the commodity distribution of support for Canadian agriculture, while Table 4 compares Canadian support levels to those in other industrialized nations. It is apparent from this data that while our paper follows the common model accepted by the IATRC study team, of exploring trade liberalization for the four commodity groups grains, sugar, dairy and beef, in the Canadian case only the support given for grains and dairy is of international interest since these two product

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groups attracted 47 percent and 36 percent respectively of all agricultural policy transfers in 1986.

Only changes in Canadian support policies are discussed, albeit that the reduction in the trade distortions that flow from national agricultural policies will permit PSEs to be narrowed "from the bottom" (as well as "from the top") as world market prices strengthen with concerted agricultural and trade policy reform (Roningen et al.). No assumptions have been made about the way that the PSE or alternative measures of support or distortion will be used in the negotiations. Nor has a position been taken on whether compliance with an agreed percentage reduction in support would be measured on a per unit basis or on a percentage basis albeit this matter is of considerable importance to the degree of policy change and adjustment required. For example, suppose the per unit subsidy on a commodity with a market value of \$100 is \$100. In this case the PSE on a percentage basis is 50% ($\$100/(\$100 + \$100)$). A reduction in the per unit PSE by 50% requires a cut in support from \$100/unit to \$50/unit. However, a cut of this magnitude only reduces the percentage PSE from 50% to 33% ($\$50/(\$100 + \$50)$).

Table 1: Distribution of Farm Cash Receipts by Commodity for each Province, 1986, Percent.

Province	Feed									
	Wheat	Grains	Oilseeds	Cattle	Hogs	Dairy	Poultry & Eggs	Other Cash Receipts	Gov't Direct Payments	
B.C.	1.0	0.6	0.3	15.8	5.5	23.1	16.0	32.0	5.7	
Alberta	13.8	9.1	7.3	29.3	7.2	6.0	3.5	6.6	17.2	
Sask.	39.2	6.9	7.9	12.8	2.6	2.2	1.2	5.5	22.3	
Manitoba	25.8	8.1	10.4	14.2	11.7	5.2	4.7	9.5	10.5	
Ontario	2.2	5.9	4.4	21.2	12.5	17.7	9.9	23.8	2.5	
Quebec	0.5	5.3	0.0	9.3	20.9	31.4	11.1	12.6	9.0	
Maritimes	0.3	0.8	0.0	11.5	11.9	24.0	15.4	32.5	3.6	
Canada	13.8	6.4	5.2	17.6	10.4	13.8	7.1	14.4	11.3	

a. Other Cash Receipts includes Canadian Wheat Board advances plus net change in deferred grain receipts which totalled \$250 million.

Source: Statistics Canada, 21-603

Table 2: Support for Canadian Agriculture 1986

Commodity	Producer Value \$M	Policy Transfers \$M	PSE %	CSE %
Wheat	5,162	2,575	50	-20
Barley	1,353	891	66	0
Oats	217	50	23	-
Rye	60	38	64	-
Corn	606	130	21	-2
Canola	1,127	610	54	-
Flaxseed	246	120	49	-
Soybeans	278	71	25	-
Sugar	32	15	49	-4
Total above	9,081	4,500	50	
Beef	3,046	320	11	-1
Pork	1,699	200	12	0
Poultry	948	35	4	2
Dairy	3,441	2,797	81	-42
Total above	9,184	3,352	37	
TOTAL	18,214	7,852	43	-13

Source: USDA, 1988

Table 3: Commodity Distribution of Producer Values and PSEs, Canada, 1986

Commodity	Percent of Total Producer Value	Percentage PSE	Contribution to Total PSE Value	Percent
Wheat	28.3	49.9	14.1	32.7
Coarse Grains	12.3	49.6	6.1	14.2
Oilseeds	9.1	48.4	4.4	10.2
Sugar	0.2	48.7	Neg.	Neg.
Crops	49.9	49.3	24.6	57.1
Dairy	18.9	81.3	15.4	35.7
Beef & Veal	16.7	10.5	1.8	4.2
Pork	9.3	11.8	1.1	2.5
Poultry	5.2	3.7	.2	.5
Livestock	50.1	36.9	18.5	42.9

Source: USDA, 1988

Table 4: Income Transferred to Agriculture, Selected Countries 1982 and 1986*

Country	1982			1986		
	Total (bi.dol.)	As a percentage of Farm Value	\$/Capita	Total (bil.dol.)	As a percentage of Farm Value	\$/Capita
Australia	827	13.3	54	642	13.3	40
Canada	2,776	20.4	113	5,653	43.1	221
EC-10	29,472	29.0	108	54,488	49.8	195
Japan	18,636	66.6	157	34,850	78.6	287
New Zealand	869	35.3	275	237	13.1	73
United States	19,202	17.3	83	36,864	35.8	153

* All amounts are in U.S. dollars

Source: U.S. Department of Agriculture. Estimates of Producer and Consumer Subsidy Equivalents.

2.0 Analysis

Where possible, a standard format has been employed in discussing each of the four commodities. The major policy instruments affecting production, consumption and trade and the proportion of the aggregate policy transfers associated with each are identified first. This is followed by the identification of the ways policies might be changed in order to implement the obligation to cut each PSE by one-half. Where these alternative modalities would have significantly different trade effects this is noted. Thirdly, the economic consequences of changing internal programs and accompanying frontier measures are indicated qualitatively in terms of such variables as output, resource use, farmers' incomes, the value of assets,

assumptions have been made about the extent to which and the methods by which the income losses resulting from changes in commodity policies and trade arrangements might be offset by "decoupled" income transfers (deGorter; Warley). Fourthly, the nature of the resistances to change are identified. Two types of objections are noted; the first are the predictable complaints of groups whose economic interests are harmed, the second are the more interesting cases where it will be claimed that present policies either do not distort trade or that the extent of trade distortion is much exaggerated by the calculated PSE.

2.1 Dairy

Income is transferred to Canadian dairy farmers by a set of measures that include formula pricing, supply control, support purchases, quantitative import controls, a direct subsidy on industrial milk (much of which is held back from producers to cover the loss on exporting a structural surplus of skim milk powder) and discriminatory pricing that yields higher than world market prices for manufacturing milk and a price premium on fluid milk. Neglecting dairy-related expenditures on public goods, policy transfers and the percentage PSE in 1986 were as follows (USDA):

	<u>\$M</u>	<u>Percentage</u>
Producer value	\$3,441	-
Policy transfers	\$2,812	-
of which:		
Price and income support		
Product price support	2,200	85.9
Direct subsidy	300	11.7
Fluid milk premium	312	12.2
Input and marketing subsidies	28	1.1
Less, producer levies	- 280	- 10.9
Net transfers	\$2,560	100.0
Percentage PSE	-	74

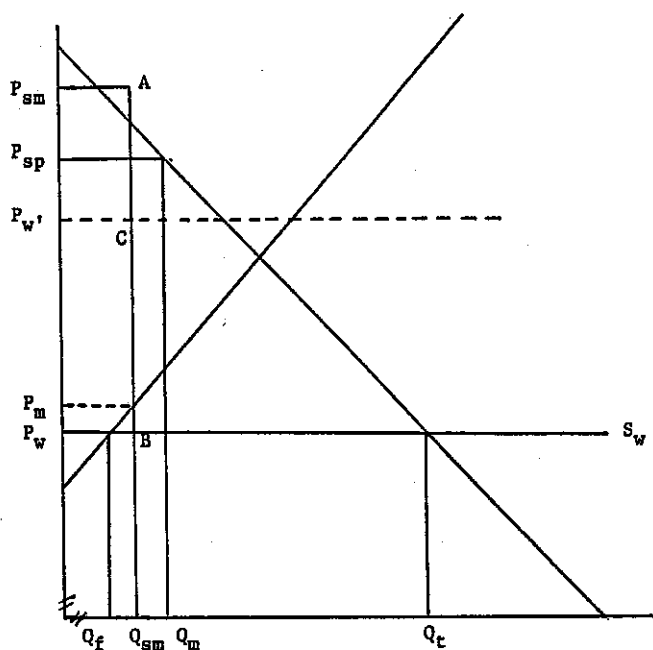
A greatly simplified diagrammatic representation of the Canadian market for milk is given in Figure 1. With a world supply of S_w , open borders and no domestic regulation, price would be P_w , domestic milk output Q_f , consumption Q_t and imports $Q_t - Q_f$. With regulation, the producer price is P_{sm} , output is limited to Q_{sm} , consumption is Q_m at the market price of P_{sp} made up of domestic output Q_{sm} and permitted imports (mainly 20,400 tonnes of cheese) of $Q_m - Q_{sm}$. The total policy transfer is $P_{sm}ABP_w$ made up of a direct subsidy of $P_{sm}ACP_{sp}$ and a transfer of $P_{sp}CBP_w$ made through the increased market prices of fluid milk and manufactured dairy products. The percentage PSE is

$$\frac{P_{sm} - P_w}{P_{sm}} \times 100$$

With a supply price of P_m and a formula price of P_{sm} for the permitted output Q_{sm} , economic rents are substantial. The rental value for one unit of milk for a single time period is $P_{sm} - P_m$ in Figure 1. In Ontario, currently, this translates into quota values of \$300 for the right to ship one litre of milk per year in perpetuity

into the fluid market and \$0.70 for the right to ship one litre per day into the industrial milk market.

Figure 1: The Canadian Milk Market



It is worth noting that historically Canada was a net exporter of dairy products, and that the shadow supply price implied by quota values has led some to speculate that she might become so again if agricultural policy and trade reform entailed the abandonment of domestic supply control and the strengthening of international prices to, say, P_w' . Be that as it may, the demand side distortion represented here is $Q_t - Q_m$, whereas the supply side and trade distortions with supply management are $Q_{sm} - Q_f$ and $(Q_t - Q_f) - (Q_m - Q_{sm})$ respectively. While the relative size of the supply, demand and trade distortions depend on the slope of the supply and demand curves it should be clear that the PSE is an imperfect guide to the trade

distorting effects of enhanced domestic prices when effective supply controls are in effect.

Several alternative routes could be taken in fulfilling an obligation to reduce the PSE by the representative 50 percent in five years. Not all of them would be of equal value to Canada's trading partners.

For instance, removal of the direct subsidy (\$300 million) and elimination of the fluid milk premium (\$312 million) would cut Canada's per unit dairy PSE by 17 percent but provide no increased demand for imports. Alternatively, Canada could cut its unit dairy PSE "from the top" by lowering the formula price for fluid milk and the target price for industrial milk but allow domestic output to expand to fully satisfy the resultant increase in consumption. Again, the GATT obligation on policy reform would have been met without providing any expanded market opportunities for trading partners. Conversely, even without making cuts in milk support price and PSE levels Canada would be materially helpful to dairy product exporters if it ceased to dump its structural surplus of skim milk powder and evaporated milk on world markets thereby allowing international market prices to strengthen. This could be accomplished by diverting surplus products to stock feed or to additional food aid. Furthermore, insofar as world market prices did improve, Canada's dairy PSE would fall.

Finally, there are three main ways in which Canada could both cut its dairy PSE and provide expanded markets for efficient exporters. The first, would be to simply slice the PSE column $P_{SM}ABP_w$ horizon-

tally by lowering target and market prices and giving all the increased consumption to exporters. The second would entail the contraction of output under the supply control programs (cutting the PSE column vertically) and replacing domestic supplies with some imports of fluid milk (from the U.S.), imports of butter and expanded imports of cheese. Going this second (market sharing) route would conform with a change to GATT's Article XI which entailed the acceptance of significant minimum access commitments where GATT-legal quantitative import restrictions are maintained. However, the required cut in output to achieve a 50 percent reduction in the total PSE would also be 50 percent. The third option would be, of course, some combination of support price reductions and expanded market shares for imports.

Depending upon the option chosen, the effects would be economically positive for Canada's consumers, taxpayers and trading partners. All choices entail negative effects for dairy farmers and milk processors and for political stability. Income from dairying would fall under liberalized trade with reduced milk revenue and increased feed costs being offset only partially by increased prices for cull cows. Reduced income prospects would lower the value of land and cows, but the major result would be a reduction in the value of milk quotas which are presently worth about \$5 billion to the industry and represent a large fraction of dairy farmers' equity. Processors presently gain from secure margins and the absence of international competition. They are already short of milk supplies. They too would face severe adjustments if domestic milk supplies were reduced and

imported dairy products were given improved access. In some specific regions dairying would disappear if supplies fell below the level required to support a single plant.

These negative economic effects would be concentrated in Ontario and Quebec (Table 1). In view of the unique role played by Quebec in Canadian politics, it would be very difficult for a federal government of any political persuasion to support radical changes in Canadian dairy policy and trade arrangements of the type sketched above.

The nature of the professional opposition to cutting PSEs as a means of improving world agricultural trade conditions is also well illuminated by the Canadian dairy case. Under supply control, the PSE per unit appears huge (at $P_{sm} - P_w$ in Figure 1) but is not a reliable guide to the production and consumption volume distortions and, more especially, to the trade volume distortions caused by Canada's dairy policies, $((Q_t - Q_f) - (Q_m - Q_{sm}))$ as drawn). Note too that there is sufficient uncertainty about underlying non-distorted supply and demand relationships in national and global markets for milk and dairy products that alternative representations to Figure 1 could readily be devised and defended. Hence, while the qualitative results following trade liberalization are clear the scientific basis for providing exact quantitative estimates of alternative policy actions is weak.

Based on concepts developed by Dr. D. McClatchy in Agriculture Canada, Canadian authorities have suggested a way in which the PSE could be modified to better measure trade effects when supply controls both limit the domestic output response to an incentive price and constrain consumption (Government of Canada 1988a, 1988b).

Essentially, on the supply side, the output effects of policy would be derived from the price distortion indicated by the difference between the world reference price and the shadow supply price. This might be inferred from the annualized value of the capital value of quota rights or more simply, on the basis of estimates of what unconstrained output would be (a) at current support prices and (b) at current world prices. This particular proposal for a method of giving credit for supply restraints has not yet been accepted internationally, but the EEC has put forward a very similar proposal.

Two final points about Canadian dairy policy are worth remarking. First, while policy for industrial milk is notionally a federal responsibility, in practice it is a joint venture of federal and provincial governments, a federal crown corporation and provincial producers' marketing boards. Fluid milk pricing and marketing are entirely the responsibility of the provinces. This imposes real constraints in the ability of the Government of Canada to "deliver" on any commitments it might make on the dairy sector in international negotiations on agriculture. Note, however, that the federal governments control over the size of import quotas of dairy products may allow it to "force" reductions in either support prices or production quotas on the provinces, although this would be politically unpopular. The second point is related, part of Canadian dairy policy consists of restrictions on dairy analogues. For instance, imports of margarine are banned and some provinces impose colour standards on margarine, and ban the use of butter-margarine blends and cheese substitutes. As a practical matter, at some stage these aspects of the Canadian dairy

situation -- including the need to get binding commitments from the provinces -- will have to be factored in to the negotiations.

2.2 Grains and Oilseeds

The major policy instruments that transfer income to producers of grains and oilseeds in Canada are the rail freight subsidies under the Western Grain Transportation Act (WGTA), stabilization payments under the Western Grains Stabilization Act (WGSA) and the Agricultural Stabilization Act (ASA), "compensation" payments under the Special Canada Grains Program (SCGP) (ostensibly to offset the hurt done to Canadian producers in 1986/7 and 1987/8 by the production and export subsidies of other countries), and price premiums to wheat producers under the Two-Price Wheat Plan and to producers of malting barley through the licensing of barley imports. Other subsidy programs that benefit the grains and oilseeds sector are additional transport subsidies, subsidized crop insurance, fuel tax rebates, export credits, and coverage of occasional deficits in the Canadian Wheat Board's pool accounts and, in 1987/8, in the Western Grains Stabilization Fund. The magnitudes of the major policy transfers in 1986 are shown below;

	<u>\$M</u>	<u>Percentage</u>
Producer value	\$9,771	
Policy transfers		
S.C.G.P.	892	20
W.G.S.A. and A.S.A.	1,357	31
Transportation	<u>1,090</u>	<u>25</u>
Sub-Total	3,339	76
Other federal expenditures	848	19
Provincial expenditures	<u>201</u>	<u>5</u>
Total	\$4,388	100
Percentage PSE	-	50

The Two Price Wheat Plan will be terminated on August 1, 1988. However the federal government has said that \$227 million will be provided to producers by some other means (not as yet identified) for 1988/89 to compensate for the loss of this program. Thereafter, it appears that this subsidy will be terminated. In theory, the Special Canada Grains Program provides discretionary, retroactive compensatory payments (\$1.0 billion and \$1.1 billion for the 1986 and 1987 crops respectively) and is not regarded as a continuing program. In practice, it is now viewed by producers as an entitlement and its availability is being factored into current production decisions. Moreover, it may not be as production and trade neutral as is sometimes claimed, for the payment rates are crop specific and the base year for entitlements has been rolled forward. However, as market receipts for grains and oilseeds strengthen due to improved market balances and trade policy reform, the payment is supposed to be phased down and eventually terminated. Similarly, coverage of the deficits in the CWB's pool accounts is not a permanent feature of the support of western grain producers' incomes. Nor is the write down in the

accumulated deficit in the Western Grain Stabilization Fund (\$750 million of the \$1.5 billion deficit will be written off in the 1987/8 fiscal year if current amendments to legislation are passed). Furthermore, the present provisions of the WGSF ensure that payments under this program will fall dramatically in future years from the extraordinary levels reached in the past two years (\$859 million in 1985/6 and \$1.4 billion in 1986/7) either because the guaranteed minimum net cash flow will ratchet downward if grain markets don't improve or because the need for payments will fall if they do.

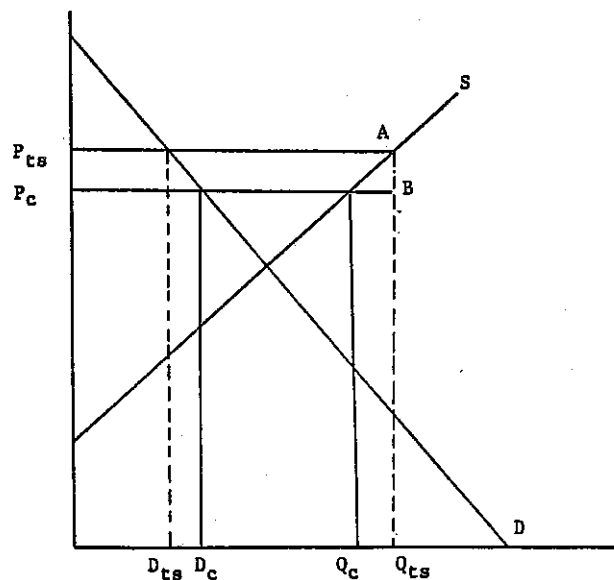
The point to be emphasized is that there is a good deal of fluidity about Canadian grain programs and the income transfers they provide. The SCGP is viewed as transitory, two-priced wheat and the malting barley premium are on their way out under the CAFTA, and the WGSF is obviously destined for early and radical change. In terms of trade negotiations this means that it will be difficult to establish a program and PSE base line for the Canadian grains and oilseeds sector, and there may be some ambiguity about the nature and negotiating value of requests, offers and commitments to make grains policy changes. Indeed, in theory, Canada could meet a substantial part of an obligation to cut its grain and oilseeds PSE by 50 percent by offering to reduce policy transfers under SCGP, WGSF, two-price wheat and CWB deficits knowing full well that transfers under these programs are likely to fall anyway in future years from the levels recently experienced.

Canada's negotiating partners are, of course, going to want a more substantive contribution to the shared task of reducing the level

of subsidization to grain production and export world-wide. And the Canadian program which is universally perceived to act as an incentive to grain production and export is the WGTA. Under the WGTA, Western grain producers pay only about one-fifth of the cost of shipping their grains by rail to export positions. This has the effect of raising the on-farm price of export grains and the export volume. In Figure 2, the farm price is raised from P_C to P_{ts} and export volume increases by $(D_C - D_{ts}) + (Q_{ts} - Q_C)$ (the trade volume distortion) as a result of production rising from Q_C to Q_{ts} and consumption contracting from D_C to D_{ts} . The total PSE is the area $P_{ts}ABP_C$ and the percentage PSE per unit is

$$\frac{P_{ts} - P_C}{P_{ts}} \times 100.$$

Figure 2: Transport Subsidies and the Prairie Grain Market



Eliminating the WGTA (and other transport subsidies) would meet about one-half of the suggested 50 percent cut in the 1986 per unit PSE (the negotiating value of the WGTA depends crucially on the choice of a base year). The rest would have to be found by reducing the subsidies in fuel tax rebates, crop insurance, federal contributions to WGSAs and ASAs, and any successor to two-price wheat.

The on-going debate in Canada on whether the "Crow Benefit" should be paid to the railways (as at present) or directly to farmers would be resolved if the WGTA was eliminated as part of Canada's contribution to agricultural policy and trade reform.

However, it should be noted that, in our view, paying the freight subsidy directly to producers through an output decoupled per acre payment, would remove a considerable portion of the grain trade distortion that is the object of other countries' complaints albeit the PSE would be unchanged. This would occur as on-farm grain prices fell and animal feeding and grain processing increased. In addition, there would be a small decline in aggregate grain output (because of the low opportunity cost of Prairie grain land) and a shift in production away from low valued crops (barley) towards higher valued crops (wheat and canola). This again points up the limitations that attend the use of the PSE as a proxy for the trade distortions caused by national subsidy policies.

Some initial empirical work (MacGregor, et al.) suggests that the degree of world price strengthening predicted by Roningen et al. following global trade liberalization would not be sufficient to offset the complete loss of present subsidies to Prairie producers of

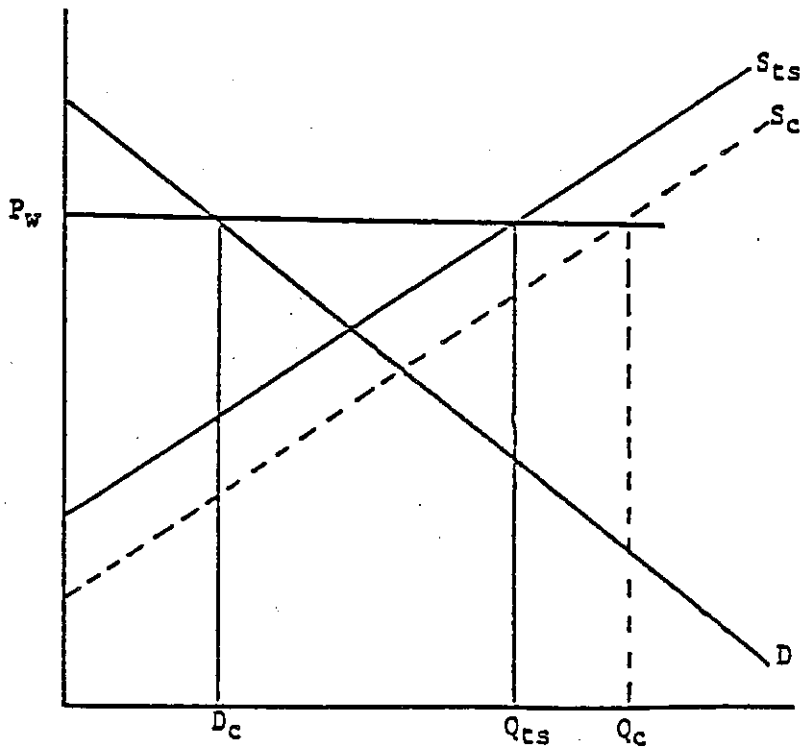
grains and oilseeds. Farm incomes from grain production in Western Canada, and therefore land values, would fall. However, in Western Canada the negative impacts of phasing subsidies down or out would vary quite widely among the different grains and therefore among producers, provinces and localities. By contrast, grain and oilseed producers in Eastern Canada could have a favorable experience under liberalized trade since they do not benefit from the WGTA and the WGSAs, and derive smaller subsidies from SCGP, ASA, fuel tax rebates, crop insurance and two-price wheat.

Proposals to reduce Canada's grain and oilseeds subsidies will obviously be strongly resisted by their beneficiaries in Western Canada, and particularly by Saskatchewan's wheat producers. Politically, it might even be necessary to dust off earlier proposals to buy out the present value of the Crow Benefit by a bond issue (Harvey). However, it can also be anticipated that there will be producer, official, and academic opposition to the termination of non-commodity specific WGSAs type programs. It will be argued that, under normal circumstances such "safety net" programs are, for all practical purposes, not trade distorting. Indeed, it will be suggested that rather than requiring Canada to abandon such programs, the international community should be emulating Canada's example by replacing their trade distorting support programs with similar trade-neutral stabilization schemes.

Finally, examination of the ways in which Canadian grains and oilseeds PSEs might be cut illuminates the importance of identifying cross commodity efforts and raises the question as to whether, in the

case of livestock products, PSEs should be modified to account for the effects of domestic subsidies/taxes on grain prices. In particular, payment of the Crow Benefit to the railways has the effect of raising the market prices of feed grains in the Prairies, thereby suppressing livestock feeding and the production, processing and export of meat and meat products. This is illustrated in Figure 3. S_{ts} is the supply function for livestock in the Prairies with grains priced under WGTA, whereas the supply function would be S_c if grain producers had to pay compensatory rail freight rates for grains. Removal of the WGTA for grains would therefore increase livestock exports by $Q_c - Q_{ts}$, and given the lags in livestock supply response it would take some time for the livestock PSE to decline as a result of increased producer value.

Figure 3: The Prairie Market for Livestock Products



2.3 Beef

Beef production and meat packing are important industries in Canada (17 percent of producer value in 1986 and the country's third largest manufacturing industry) but they are not highly protected, according to present estimates, although these are questioned by some for underestimating the value of provincial support to the livestock sector. Tariffs are at low levels and are due to be eliminated bilaterally with the U.S. under the CAFTA. However, since tariffs are maintained with respect to third country markets, this won't change the measured PSE. The quantitative import restrictions permitted under the Meat Import Act of 1981 have only once been invoked, and their use is constrained by the (rising) minimum access commitment for beef assumed by Canada in the Tokyo Round. The beef industry in Eastern Canada derives some benefit from grain freight subsidies, but this is more than offset by the burden of the Western Grain Transportation Act on the beef industry in the Prairies. Health and sanitary standards that restrict imports are genuinely aimed at excluding cattle diseases; they are not used as concealed protection. This leaves stabilization programs as the major source of benefits to the beef industry from public programs (other than public goods type programs).

Stabilization schemes come in a variety of forms. Payments under the Agricultural Stabilization Act of 1975 have been sporadic and small in total. The tripartite stabilization program does not yet cover all provinces and is not fully operational. Provincial ad hoc payments to beef producers in distressed periods, and payments under

on-going provincial stabilization and assistance schemes that top-, bottom- and side-load the federal ASA are more substantial, but their incidence is not readily determined from provincial expenditure data, and may not be fully reflected in currently available PSE estimates.

Total support for cattle production, including for this commodity expenditures on federal and provincial public goods programs, in 1986 was as follows (USDA):

	<u>\$M</u>	<u>Percentage</u>
Producer value	\$3,146	-
Policy transfers		
ASA	3	1.0
Tariff	46	14.4
Feed freight assistance	5	1.6
Provincial programs	<u>127</u>	<u>39.7</u>
Sub total	181	56.7
Other federal	<u>139</u>	<u>43.3</u>
Total	\$ 320	100.0
Percentage PSE	-	10.5

Abandonment of income transfer programs for the Canadian beef industry would not in itself be traumatic since, overall, the transfers are modest. However, this masks the fact that certain provincial cattle industry assistance programs are quite "rich", and that the producers on whom these programs are focussed would experience significant negative effects from the withdrawal of this support. Furthermore, though Prairie beef producers would benefit from termination or revision of the WGTA, under liberalization the Canadian beef industry as a whole would experience the negative effects of some increase in world feed grain prices. Taking everything together -- stronger cattle prices, increased feed costs, loss

of tariffs and stabilization payments, and the withdrawal of both direct transport subsidies and the indirect transport taxes inherent in the WGTA -- the net effect would probably be some reduction in profitability in the Canadian cattle industry and some contraction in its size (MacGregor et al.). Negative effects would be most marked in the cow-calf sector and in Quebec (where provincial beef assistance programs are particularly generous).

~~Canadian opposition to internationally-prescribed policy changes~~ for the beef industry will focus on the key issue of whether the ASA and tripartite stabilization programs that place low-slung, market-driven, economic safety nets under Canadian cattle producers' prices and margins are trade distorting and hence candidates for abandonment in negotiations on agricultural policy and trade reform. Experience and empirical analysis (Martin and Meilke) lend support to the view that they are essentially trade-neutral and, hence, should be of no concern to Canada's trading partners.

2.4 Sugar

Canada's support for the sugar industry will not be of much consequence in multilateral agricultural trade negotiations. Essentially, Canada's sugar policy is to buy as much sugar as is required from world markets at the cheapest possible price. Imports satisfy about 90 percent of consumption. A one cent per pound tariff on sugar is designed to give preference to Australian suppliers whose shipments enter duty-free. The small domestic industry benefits from this tariff too, but that is an incidental result. Sugar has been

assisted heretofore under the Agricultural Stabilization Act, but starting with the 1987 crop, sugar beet growers are provided with a floor price under a national tripartite stabilization program (\$40.29 per standard tonne in 1987 where a standard tonne is 125 kg. of sugar per tonne of beets).

Because world sugar prices have been so low in recent years, the degree of protection given the Canadian sugar industry through the 1¢/lb tariff and an 11¢/lb ASA floor (and other benefits from subsidies on fuel and insurance) has appeared to be very high. In fact, the percentage PSE averaged approximately 65 percent in the three years 1984 to 1986 (USDA).

Unless there is a strong and sustained increase in world prices as a result of better market balance and global sugar policy reform, removal of the tariff and the abandonment of tripartite stabilization might well put an end to the Canadian sugar beet growing industry. The sugar processors are mainly engaged in refining imported raw cane sugar, but some of their investments in beet processing facilities would have to be written down. The demise of sugar beet growing and processing could cause severe dislocations in local communities. However, the affected communities are few, the numbers of growers involved is less than 1,000, and Ontario's experience in closing down its sugar beet industry in 1970 suggests that adjustment costs are not high. In short, adjustment assistance could readily be provided.

The most important characteristic of Canadian sugar policy is that the Canadian sugar industry is so small that its complete

abandonment in the context of multilateral trade negotiations would be worth next to nothing to Canada's trading partners.

3.0 Conclusions

This exploratory look at how Canada might contribute to global agricultural and trade policy reform points to a number of conclusions of generic interest.

- i) The analysis emphasizes the early limits on the value of using the PSE as a measure of trade distortion. The milk case was particularly illuminating in that it was apparent that the dairy PSE could be cut in ways that conveyed no benefits on trading partners. Conversely, in both milk and grains, it was seen that Canadian policies could be changed in ways that reduced trade distortions even though PSEs were unaffected.
- ii) In all cases, Canadian producers appear to lose under trade liberalization since the improvements in market-derived revenue is insufficient to offset the loss of policy transfers. This emphasizes the urgency of further work on the identification of trade-neutral (decoupled) direct income support programs and/or adjustment assistance and compensation schemes (deGorter).
- iii) Much of the assistance to Canadian agriculture is through the provision of stabilization or safety net programs and through programs in which the production response to incentive prices is restricted by supply control. The analytical community does not yet appear to be able to advise policy makers as to whether such programs distort trade and, if so, by how much, and there are

uncertainties about how programs with these features can be incorporated pragmatically into the analyses that will underpin negotiations.

iv) Cross commodity effects are clearly important and an area where knowledge is particularly patchy. Where sub-national governments -- such as the provinces of Canada or the member states of the European Community -- have a role in agricultural policy, there is obviously going to be a real problem in ensuring that they cooperate in the implementation of commitments made by federal governments or regional authorities. The experience with wine in Canada since the Tokyo Round and in the CAFTA emphasizes the reality of this issue.

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Executive Summary

Introduction

Although this paper deals with the modalities and consequences of reducing the level of subsidization for the four assigned commodity groups -- grains and oilseeds, sugar, dairy and beef -- only Canada's grains and oilseeds and dairy policies are of significance in multilateral trade negotiations. Grains and oilseeds illuminate the case of support for an export product provided, inter alia, by stabilization programs and transport subsidies. ~~Canada's national dairy policy and associated frontier measures are an example of how the adverse trade effects of a high level of support are moderated on the supply side by supply controls. Thus, the Canadian case presents the pivotal issue of how "safety net" and supply control programs are to be handled in the GATT negotiations.~~

Dairy

Milk production is the most regulated and heavily protected segment of Canadian agriculture, and defense of a national price for milk that is high in international terms requires the use of quantitative import restrictions. Import quotas are GATT-legal however since they are accompanied by national production quotas.

The Canadian dairy industry perceives itself as a historic exporter driven out of traditional markets by the subsidy and trade practices of others, and as behaving responsibly in international terms insofar as the output response to a made-in-Canada milk price is limited by an effective supply control program. Accordingly, the strong industry resistance to proposals to reduce support and open the border to imports is animated by considerations of equity as well as by economic interest.

Canada's dairy PSE could be cut substantially in ways that confer no benefits on Canada's trading partners by removing the direct subsidy and the fluid milk premium and by lowering the market price for milk while relaxing supply controls. Alternatively, Canada could contribute to the strengthening of world dairy markets and cut its PSE by ceasing to dump its structural surplus of skim milk powder. These examples point to the conclusion that there need be no automatic linkage between reductions in PSEs and improvements in trade conditions, and vice versa.

More generally, it is shown that under supply controls the PSE is not a reliable guide to the production and consumption effects of national support policies and hence to the trade distortions they produce. Attention is drawn to work that suggests how this problem might be overcome.

Canada could meet a small target cut in its dairy PSE by expanding import quotas while tightening domestic supply controls. This market sharing approach would have the advantage of maintaining the integrity of national production, pricing and marketing arrangements whilst conferring predictable benefits on the suppliers of imports. The alternative of cutting the PSE "from the top" by slashing support prices carries with it the possibility that relaxation of national milk supply controls could negate any expanded trade opportunities that national dairy policy changes and liberalization of import access were intended to produce. However, achieving a 50% cut in Canada's dairy PSE would probably require both a reduction in support prices and an increase in import quotas.

Grains and Oilseeds

Much of the assistance presently being given to Canada's producers of grains and oilseeds is through programs that are intended to be transitory (Special Canada Grains), are ad hoc (the write down of deficits in the Western Grains Stabilization Fund), are being phased out anyway (two-price wheat), or will automatically provide reduced benefits in future years (WGSA). This program fluidity has policy significance in that it will be difficult to establish a program and PSE base-line for the Canadian grains and oilseeds sector, and because there may be some ambiguity about the negotiating value of requests and offers to make policy changes in fulfillment of a quantitative commitment to cut the degree of support.

The freight subsidy to the movement of Prairie grains to export positions is a clear candidate for elimination for there is agreement that it stimulates the production of export grains. However, its removal would not be sufficient to meet a target 50 percent PSE cut and other assistance programs would have to be trimmed too. Interestingly, paying the Crow Benefit to producers, on a per acre basis, rather than to the railways could remove much of the grain trade distortion effect of the transport subsidy without affecting the PSE.

The status of the assistance provided to grain growers under the Western Grains Stabilization Act and the Agricultural Stabilization Act is less clear. Although substantial in recent years -- particularly in 1987/8 with the expected write-down of half the \$1.5 billion deficit in the stabilization fund -- there are features of these schemes which raise

questions about their effect on production and trade. Indeed, many Canadians hold the view that the provision of low-slung, market-driven, economic safety nets in the manner of non-commodity specific programs such as WGSAs is a beneficial and essentially trade-neutral function of agricultural policy, and a model that other countries might well embrace.

Beef

Precisely the same issue would be involved in meeting a requirement that half the modest assistance provided to cattle producers be eliminated since much of the present support is provided through federal and provincial "stabilization" programs. In fact, some of the provincial programs are sufficiently generous as to constitute "support"; these do have effects on production and trade and they would have to go. However, there is empirical evidence to support the view that the tripartite program that will replace the federal ASA and provincial beef stabilization programs will have characteristics that make it, for all practical purposes, trade neutral and therefore internationally acceptable.

The fact that both federal and provincial government provide stabilization and other assistance programs for the beef industry has wider policy significance in that it is an example of the generic problem of the limited ability of federal authorities to prevent junior governments from subverting national commitments made at the multilateral level. It is emphasized in the paper that this is a particularly acute problem for Canada in meeting multilateral obligations for the dairy sector since provincial bodies dominate fluid milk marketing and have operational control over the industrial milk sector.

Sugar

Canadian sugar policy is not of much international interest since Canada already imports 90 percent of the sugar consumed and is, in addition, a small-country importer. Nonetheless, abandonment of the floor price provided under tripartite stabilization, and of the preferential tariff that while favouring Australia shippers provides incidental benefits to the domestic sugar beet growers, could well spell the end of sugar beet growing in Canada. Fortunately, the costs of providing adjustment assistance to such a small industry would not be high.

