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— DISCUSSION —
**IMPACTS OF PAST U.S./CANADIAN DAIRY PROGRAMS
ON STRUCTURE, EFFICIENCY AND TRADING RELATIONSHIPS**

Rick Phillips

Comments made on behalf of the Dairy Farmers of Canada follow by topic.

Supply Management Economists Versus Free Market Economists

At the core of differences in policy formulation is the fact that supply management economists do not believe that "free" markets are necessarily "perfectly competitive" markets.

Free market economists appear to be mainly concerned with where the long run "perfectly competitive" equilibrium lies. Supply management economists on the other hand are more concerned with whether a "perfectly competitive" equilibrium is attainable and, if so, what adjustments are necessary to attain that equilibrium, and who pays the adjustment costs associated with the move to equilibrium.

Supply Management As An Evolving Concept Which Considers The Objectives Of Various Stakeholders

The supply management system that was established in Canada has evolved significantly since its inception in the 1970s and continues to evolve. A basic objective is to allow all producers to share equally in all milk markets and the system is well on its way to solving producer equity concerns.

Policy development is now focused on processor equity issues and processors are deeply involved in the negotiation process. Processor "equity" has been defined to mean that all processors have the "same competitive access to milk".

Supply management economists would argue that consumers would find themselves in a similar situation with or without supply management. The Dairy Price Index (DPI) has tended to rise at a slower rate than the Consumer Price Index. This would suggest that dairy

products have become relatively less expensive. Where consumption has declined this was likely more a function of changing consumer preferences than price.

There is some evidence to suggest that the relative price stability associated with supply management (market equilibrium in a supply management system is achieved mainly through quantity adjustment) is of significant benefit to consumers. Recent experience in the United States would tend to support this conclusion. The DPI in the United States has risen at a faster rate than in Canada even though there were price increases at the producer level in Canada. The U.S. producer price has been trending downward. This is a consequence of higher variability in the producer price in the United States, combined with the exercise of unfettered market power at the retail level as evidenced by the observation that price movements in the United States appear to be asymmetric.

The Canadian industry evolves through negotiation and the establishment of consensus. Market forces may drive the discussion, but the market does not necessarily dictate the speed of the adjustment process nor the distribution of adjustment costs. In Canada the industry tends to buy out, rather than push out, those exiting the business.

Barriers to Trade

The tariff equivalents established as a consequence of the GATT Uruguay Round agreement were *conversions* of import quotas into tariffs. During the negotiations Canada established the level of these tariffs using a methodology utilized by the European Community and accepted by the United States. Canada used the U.S. methodology to establish its access levels. Whatever the differences, the tariff equivalents imposed by the United States and Canada are meant to accomplish the same thing. They are meant to act like import quotas.

Technically there are no barriers to Canadian access to U.S. fluid milk markets. In reality the United States keeps Canadian milk of the same or higher quality out of its market through the use of non-tariff barriers and in particular the combination of the Pasteurized Milk Ordinance (PMO) and the National Conference of Interstate Milk Shippers (NCIMS) which operate to set restrictive standards, Canada has already been exposed to the trade inhibiting potential of these non-tariff barriers in its ultra high temperature (UHT) milk market to Puerto Rico.

The greatest barrier to future trade liberalization is the harassment potential of U.S. trade actions.

Imperfect Competition

The economic analysis presented at the conference tended to be from the analytical framework of the "perfectly competitive market". Much of the analysis considered where long term market equilibrium might lie. Implicit in these models was the assumption that

adjustment costs are zero, and are ignored. Since "perfect competition" is assumed, distribution effects are also ignored. From a policy analyst's perspective, however, the "politics" of policy making is in the adjustment to equilibrium and the distribution of market revenue between producers and others in the marketing chain. If markets are "imperfectly competitive" this policy focus is entirely justifiable.

Economists have to recognize the possibility that food markets at the retail level are not perfectly competitive, nor do they "behave" as though they are perfectly competitive. There is *prima facie* evidence for this market structure in high levels of industry concentration and the asymmetric pricing behaviour observed at that level.

The major implications are that:

- If pricing is asymmetric at the retail level, price stability is an important policy objective at the producer level.
- The benefits of deregulation for consumers tend to be overstated and the costs to producers understated. (i.e., The retail "pie" in the end is the same size. It is the producer share of this pie relative to others in the marketing chain that changes and perhaps this is a function of relative market power as opposed to perfectly competitive behaviour.)
- Border measures are necessary to protect Canadian institutions that correct what producers believe are domestic market distortions (U.S. retailers seem to have the same relative market power). Tariff equivalents should not be reduced until the alternative arrangements required to resolve this issue are developed.

U.S. Negotiating Techniques

There is some peculiar logic in the papers that are presented here. To move surplus milk from a federal milk marketing order (FMMO) in surplus to a FMMO in deficit requires the FMMO price plus transportation plus a "give up" charge. Movement of surplus fluid milk to Canada on the other hand will be at "marginal cost". Something does not quite add up but this is typical of the type of argumentation we often hear from the United States.

The biggest impediment to the expansion of trade between the United States and Canada is the apparent inability of the United States to accept the results of a negotiation. U.S. negotiators may bargain in good faith but the American "system" inherently bargains in "bad faith". The alternative is to believe that Canadian negotiators are totally inept. Our belief is that Canadian negotiators are not inept.

The Level Playing Field

From a producer perspective, the end of high tariffs is not a "sufficient" condition to ensure a level playing field with the United States. The Canadian dairy industry has its own history of the U.S. exercise of non-tariff barriers to limit imports. UHT milk is a good

example. We believe that given the PMO and NCIMS, U.S. specific compositional and labelling standards, and the demonstrated difficulty in determining "equivalency" of health, safety and inspection standards, our fears about the U.S. ability to impede imports are well founded.

It seems that if we wish to access the U.S. market unimpeded, we have to give up our ability to produce "Canadian" policy solutions. We must conform to the U.S. perception about the "right" way to do things. Ultimately it seems that the only way to do this is to give up our sovereignty and "adopt" the "U.S." solution.

Inevitability

There was a time when the United States "had" to convert to metric and Canada would "have to" beat them to it. There is no apparent trade imperative to reduce border measures for supply managed products within the NAFTA context. The WTO context is a more appropriate context to deal with dairy. Access to the European Union, which is critical for the Canadian industry in the longer term, can only be dealt with in this context.

Research Directions

There are several areas on which this structural process can and should be focussed.

Expand the Analytical framework. Economic researchers who wish to develop viable policy proposals must recognize that economics is not divorced from politics. In Canada, no national government would willingly adopt a policy that would require Quebec producers to do their work in Alberta.

The economics of "perfect competition" is nothing more than religion if it does not recognize the political and sociological context in which markets operate. A general criticism of the economic research community is that researchers tend to take the research path of least resistance. They tend to concentrate on areas where there are good data availability and stick to a theoretical framework that a Masters candidate can deal with.

Don't ignore imperfect competition. How have stakeholder shares of market benefits changed over time in markets characterized by increasing size of players, especially concentration at the retail level, when 1) marketing systems at the producer/processor level have not resulted in effective supply/price control at the producer level, 2) marketing systems at the producer/processor level have resulted in effective supply/price control at the producer level?

Don't ignore adjustment costs. Increase emphasis on analysis of the dynamics and costs of adjustment to market equilibrium as opposed to simply determining where market equilibrium lies.

**THEME: WHAT IMPACTS WILL CONTEMPORARY POLICY CHANGES
HAVE ON STRUCTURE, EFFICIENCY AND TRADING RELATIONSHIPS?**

OBJECTIVE

To discuss the nature and extent of the impacts of current policy changes and likely changes on the prices, supply, demand, trade, structure and efficiency on both sides of the border.

