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# A Review of Tariff Rate Quota Administration in Canadian Agriculture

Richard R. Barichello

To analyze Canada's Tariff Rate Quota (TRQ) administration, a model of efficient quota administration is put forward. After examining the operation of the Canadian TRQ system for its twenty-one TRQs, conclusions are drawn. In general this system has worked well in Canada. The quotas are almost all filled, and the administration is transparent and not costly for quota-holders to use. Among the international lessons from Canada's experience are that few WTO rules may be needed in this area, aside from steps to ensure the TRQ is fully available to users and can be freely transferred among them.

Tariff Rate Quotas (TRQs) emerged as an important element of the trade policy landscape in the Uruguay Round Agreement (URA). However, their operation was largely left to individual countries to determine. This has led to some dissatisfaction with how they are working, particularly as there have been many cases where actual imports have fallen below the TRQ levels. It is the purpose of this paper to review the operation of TRQs in Canada to determine whether the TRQ system has worked efficiently and as intended, and to see if any lessons can be drawn to help in guiding the next round of WTO negotiations.

## *Three Objectives*

Before getting into the details of Canada's TRQ regime, I will start by addressing three broad objectives of TRQ administration. First, and probably most important from an international trade perspective, is the objective of allowing access opportunities up to the full amount of the TRQ level. This is how the URA was intended to deal with the

remaining high tariff and non-tariff barriers that inhibit trade: by making the TRQs as a small tunnel through those barriers. The introduction of TRQs was a step toward achieving greater openness to trade via additional market access, but only if the TRQs were fully utilized. (Of course, this assumes that domestic prices are above world market prices due to the existence of trade barriers. If domestic prices are below world prices, then there are no binding border protection measures and it is not desirable to force inefficient imports through TRQs.)

Second, from a home country perspective of making the most efficient use of domestic resources, there is the objective of having the lowest cost or highest revenue firms do the importing. In other words, we would like to see the TRQs allocated to those firms that can make the best use of them by generating the highest profits from the importing activity. Third, it would be desirable that the system of administration of TRQs is designed to operate efficiently in that it does not unnecessarily waste the country's resources.

## **An Efficient TRQ Administration Model**

Given these objectives, we now describe what would constitute an efficient regime for administering TRQs, by discussing the means for achieving each objective.

### *Full Utilization of TRQ*

To ensure full use of the TRQ, many models and procedures could be followed. The full use of

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TRQs has two aspects: the aggregate TRQ for a country should be fully allocated to importing entities (firms), and the entities receiving TRQs should fully use their allocation. (This assumes that some quota is imposed. Alternative access mechanisms like first-come, first-served (FCFS) with no prior allocation or simply applying a tariff, mechanisms with no quantitative restrictions, are not being considered as true TRQs here.) For the first aspect, the main means of assuring full utilization is for the administering agency to fully distribute import quotas to importers, and to do so relatively early in the quota period. Other rules for operating the TRQ administrative system must be designed to facilitate a full, rapid and transparent distribution of the quota.

For the second aspect, there are many means of ensuring that importers holding the quota make full use of it. In a market economy, one would wish to preserve the profit motive for importers so that they would import the item in question as long as domestic prices are higher than world prices by more than the cost of importation. This can be accomplished by having private firms receive the import quotas. It can also be accomplished by allowing firms to compete to obtain these import rights. The general point here is that the TRQ system should involve many importers and not create a situation where there is a monopoly importer.

Similarly, allowing quotas to be rented out or rented in, or bought and sold openly, will create strong incentives for the firms that obtain the quotas to use them fully. The application of carefully constructed additional regulations can also strengthen the incentives for firms to make full use of their quotas. One example is the widely observed rule for all types of quota systems, for the quota holder to "use it or lose it." Such a regulation removes quota from quota holders if they do not use some high percentage of their quota. Whether such added regulations are necessary is a separate question, but most countries seem to believe so because this type of regulation is almost universal across and within countries.

#### *TRQs Allocated to Firms That Make Best Use of Them*

The second objective is to ensure that those importers receiving the quota are the most efficient importers in terms of net profit (lowest costs, highest revenues). One widely suggested method of achieving this is to use quota auctions to allocate the TRQ. (Although this allocation mechanism is economically efficient, there may be legal WTO

issues that inhibit its use. The fee that is paid in such an auction, although it is bid by the would-be buyer, could be seen as a breach of the tariff binding, the in-quota tariff in this case, and that fee is not related to the cost of import service.) Allocation by auction will result in those firms that make the highest net importing profit acquiring the quota. However, other methods can achieve this same end. One effective but overlooked mechanism is to allow quota resale and transfer. However the quota is initially allocated, if there is a well-developed (and legal!) market in quota for resale and transfer, a firm that is unlikely to utilize its quota fully can sell it and realize the quota profits. In the process the quota passes along to a firm that will necessarily use it to recoup the costs of buying it. The point is often lost, that resale provisions will result in the quota ending up in the same hands (i.e., that it is as economically efficient) as with an auction. This point has practical importance because many jurisdictions find some reason for *not* allowing quota transfer and sale.

#### *Efficient TRQ Operating System*

The third objective is to have efficient quota administration and regulations. This can be accomplished most effectively by following a basic rule in regulating quota use, and that is to keep the regulatory system as simple as possible. All firms (existing ones or newcomers) should be allowed to acquire the quota; there is no reason for limiting the quota validity period (i.e., they should be able to use the quota whenever they wish within the quota period); and buying and renting should be fine for all firms of whatever size or with whatever facilities. Put differently, the rules need only to say which commodity item can be imported (HS number) and that imports must be made by the end of the quota period. The temptation to use the quota regulatory system to meet other objectives should be resisted.

Another way to keep the quota administration system as simple as possible is to minimize the uncertainty and rule changes associated with the regime. Even if there are a number of rules, if these rules are transparent, well publicized and not changed too often, the uncertainty factor facing quota users is substantially reduced. This is particularly an issue in developing countries where quota regimes are often characterized by little information and a complete lack of transparency and openness, usually to facilitate corruption of various types.

One added rule type may be useful, and that

concerns the general question of the distribution of quota rents and whether the recipient should pay for the quota. (Note the possible legal issues surrounding any payment for the quota, beyond the in-quota tariff and a cost of service, as mentioned above.) It may be judged desirable to tax away some of the profits (quota rents) accruing to quota holders. This can be done effectively and completely by an auction, but it can also be done less thoroughly by imposing a charge to acquire the quota. This can have the advantage of generating some public revenue as well as leaving some profits in the hands of the quota recipient (although reducing those profits by the amount taxed by this charge). And the charge can be infinitely varied to achieve any desired split in revenues (quota rents) between the quota recipients and the treasury. One disadvantage of such a charge system is the difficulty in knowing, at least at the outset, what to charge. Observations on the transfer price prevailing in private transactions can be a guide to the total rents and to an appropriate charge to levy on initial allocations.

One advantage of both these payment schemes is that they have the effect of reducing rent seeking or corruption by those wishing to obtain the quotas. Rent seeking induced by a quota allocation scheme can make the system very inefficient in terms of the waste of time and money spent in lobbying, especially when quota values are high. This can be reduced or prevented by making the receipt of quotas less lucrative by auctioning them or charging a fee for them that is close to the auction price. In addition, rent-seeking can be reduced by keeping the quota allocation system rules-based, with clear reallocation criteria and a mechanical reallocation process with no scope for case-by-case adjustments or individual judgments. (Keeping the system rules-based is still consistent with imposing penalties that may result in quota reallocations for behavior by quota holders considered undesirable by quota administrators. The key issue is that these penalties be specified in advance and not discretionary.)

Another way to make the quota system work more efficiently is to define two types of quota—permanent and annual. TRQs are usually valid for only one year. In some cases, it may be more efficient for a firm to own the quota outright, so that the amount of quota the firm will have in future years is known with certainty. This can be accomplished by defining a permanent quota, according to which the firm would receive the annual import rights every year in perpetuity (subject to the possible future demise of the regime, of course, and subject to “use it or lose it” provisions). This is the

type of quota used to limit farm production in most supply management regimes in Canada. Yet to have only such a “permanent” quota is less efficient than giving the permanent quota owner the flexibility of being able to rent out (or in) of some permanent quota from year to year. In other words, an efficient quota system will involve both permanent quota (for acquisition for long-term reasons) and one-year quota or the rental of permanent quota (for short-term reasons of fluctuating markets and general flexibility). Designers and managers of such schemes can draw on the experience of TRQ administration for short-term, one-year rental arrangements and on the experience associated with farm marketing quotas for long-term, permanent quota arrangements.

### Issues Surrounding TRQ Systems

A number of other issues regarding TRQ systems, including Canada's, are worth discussing here. These issues concern the efficiency of the quota administrative system, the profitability (size of quota rents) of the export opportunities opened up or restricted by the TRQ, and the equity of quota allocations. This allocation issue is not so much about which entities within Canada receive import rights, but which countries gain the right to export into Canada through the TRQs.

Five issues are addressed. How aggregated are TRQ commitments, and at what level of commodity aggregation are TRQs administered? Second, should TRQs be targeted partly or completely to specific countries' exports (“country reserves”)? Third, should state trading enterprises (STEs) be handling or be the recipient of TRQs? Fourth, should import allocations be restricted to industry segments, establishments, and product end-uses? And fifth, are there administrative matters concerning handling the TRQs, such as validity periods and unfilled quota provisions, that lead to fewer imports or lower-valued imports that lower the value of the TRQ to the exporting country? Finally, there is some confusion about whether a problem in the eyes of an exporter is due to Canada's TRQ implementation system or to the negotiated access and commitments agreed upon in the UR. One such example would be the debate about tariff peaks, which is not a TRQ issue per se, and will not be discussed here. Another is the actual level of the TRQ, which was also negotiated and is now exogenous and not an issue of TRQ administration.

On the subject of aggregation, to maximize the value of the TRQs one would like to see commitments defined as broad aggregates and adminis-

tered similarly. However, if the TRQ is defined broadly (e.g., "eggs"), yet in terms of administration it can be used only to import processed eggs, not table eggs, the tariff will be valid only for low-valued egg products. This mix of commitment and administration detail effectively reduces the market access of the TRQ. To maximize the value of market access for a given TRQ, the commitment should be made across a broad commodity category, without further administrative constraint, and the trade should determine which products to import within that broad commodity category.

The country reserve or preferential trade issue is really one of equity in distribution of TRQs among different countries' exports. But limiting a TRQ to a specific country's exports lowers the value of the TRQ compared with allowing any country's exports under that quota, as in the previously discussed case. Of the 21 TRQs administered by Canada for agricultural commodities, five have some kind of partial or complete country reserve (cheese to the EU, butter to New Zealand, powdered buttermilk to New Zealand, condensed milk to Australia, and beef and veal to Australia and New Zealand). Certain country allocations existed prior to the URA, and these were continued to ensure that those countries would not lose as a result of Canada's URA commitments under the UR guidelines for establishing current access commitments.

The matter of STEs handling TRQs remains contentious. One argument is that the STE, often less influenced by market considerations, may have no incentive to fill the TRQ. A simple statistical correlation, as done by the WTO Secretariat in June 1998, may show that state trading enterprises fill their TRQs as completely as other recipients of TRQ allocations. Although it may be more likely that STEs do not have the incentive to fill their TRQs, in an actual situation this depends on the specific incentives faced by the firm, agency, or STE. That kind of detail is not available in simple correlations, and so this approach offers an incomplete test of STE behavior in general in filling TRQs.

Another complaint is that the STE, especially if it represents producer interests, will choose to limit the TRQ to lower valued imports within that category or to pay the exporter lower prices for the good in question than would be paid under a private market transaction. Therefore, the argument goes, allocating TRQs to STEs is likely to reduce the market access represented by that quota, either quantitatively or in value terms. Canada has one case of an STE holding a TRQ in which the Canadian Dairy Commission receives the butter TRQ.

New Zealand has complained that this arrangement has reduced the prices it can receive for its butter exports to Canada. This complaint covers two issues, the general potential of an STE to lower the value of its TRQ, and the specific use of a policy directive to import New Zealand butter for processing, not retail, use.

In answer to the fourth question, about restricting import allocations to industry segments, establishments, and product end-uses, this will also reduce the value of the market access represented by the TRQ. In effect, such restrictions reduce the demand for those imports, compared with unrestricted, open-market allocation of those imports. Although this restriction puts allocations into the hands of those who will use it, the recipients are willing to pay less to get the allocation than others would be. If not, the restriction would be unnecessary. Consequently, this type of restriction has the same effects as do country reserves and, arguably, allocating TRQs to state traders. Any restrictions on who can use or receive TRQs will reduce the demand for and lower the implicit value of that TRQ, to the disadvantage of would-be exporters. There are several examples of this kind of TRQ allocation in Canada. It has usually arisen for historical reasons, where pre-URA end-use allocations have been preserved in the current TRQ allocations.

With regard to administrative restrictions in handling of TRQs, such as limited validity periods for the quota and unfilled quota provisions, the tighter those restrictions, the more costly it is to comply and the lower the demand for TRQ imports. This could lead to fewer or lower-valued imports, or simply to a reduction in import quota rents (or in the implicit value to the importing country of the TRQ). This situation will harm the importing country as much as the exporting country and is discussed in the previous section under efficiency of TRQ administrative arrangements.

### **The Canadian TRQ System**

In Canada, jurisdiction for imports, like all elements of international trade, falls to the federal government. The administration of tariff rate quotas since 1995 has been undertaken by the Export and Import Controls Bureau (EICB) of the Department of Foreign Affairs and International Trade (DFAIT), which also was previously responsible for the administration of all import quotas. In keeping with this continuity in jurisdiction, the shift in administration from the previous import quota re-

gime to the current TRQ system has been smooth and largely seamless.

The firms that receive import allocations (or "quota-shares") are mostly private, with the post-1995 exception that a state enterprise, the Canadian Dairy Commission (CDC), is the sole organization that will ordinarily be granted import permits for butter by the EICB. Import allocations are decided upon annually. The property right to this quota, year after year, is weak in strictly legal terms, but there has been a great deal of continuity in allocations over the years. There has also been considerable variation in the number of holders of import permits or allocations across dairy products. In 1991, for example, there were 237 quota holders for cheese, 33 for ice cream, 28 for yogurt, 1 for buttermilk, and 1 for evaporated and condensed milk (Canadian International Trade Tribunal 1992).

TRQs have been handled in much the same way as were the previous import quotas. The number of quota holders by product has not changed appreciably, although now there is a TRQ for butter (held by the CDC) whereas before there was no specific import quota. Many regulations for obtaining and using the quotas are the same as in the pre-1995 period. There are now twenty-one TRQs in Canada.

#### *Current Procedures*

The procedures that are now followed can be summarized across commodities in terms of which firms are likely to be given priority in TRQ allocations and what restrictions must be followed. In general, new entrants are heavily discriminated against in Canada, although there are cases (e.g., chicken) where there is a gradual shift away from historical allocations. For TRQ allocations, some commodities emphasize historical importers and firms with established operations and distribution lines. Sometimes allocations are proportional to production or sales, and sometimes an allocation depends upon specific component needs in the production process. In other cases, TRQs are allocated on a first come, first served basis. Almost always there is an adjustment for any previous quota left unfilled. "Use it or lose it" is the rule almost universally applied, with an allowance for sufficient prior notification to the administering agency. There are some size restrictions per company for the holding allowed, and some Canadian residency conditions.

No financial element is involved in the quota allocation process between quota recipients and the administering agency. In other words, there is no

auctioning and no charge for a quota allocation. Therefore, it is still a policy decision that all quota rents accrue to the recipient of the quota. Some commodity rules still do not allow rentals or inter-firm quota transfers, but in most cases quotas can be rented and sold, a change from the situation in 1991.

#### *Performance of TRQ Regime in Terms of Fill Rates for TRQ*

Another aspect of Canada's TRQ regime is the extent to which TRQ levels have been filled by actual imports. In general, the percentage is close to 100% across all categories. Therefore, the situation in Canada is generally unlike that in many other country jurisdictions where there have been problems of "underfilling" TRQs. This appears in part to be the natural outcome of vesting the TRQs in private hands, outside the farm production side of the industry where there is a commercial incentive to import the products in question. Another observation is that there are available import permits, supplementary to the TRQs (and outside TRQ access), for those processing firms wishing to import dairy raw materials or products, manufacture or further process other dairy products, and export them internationally. Imports for re-export are outside the TRQ system and are not counted as part of Canada's fill.

We have data for 1995 to 1998 for all twenty-one products or product categories (beef, poultry/eggs, dairy products, a close dairy substitute (margarine), and wheat/barley) that fall under the jurisdiction of the Export and Import Controls Bureau on the TRQ levels and actual quantities imported. All categories are reviewed below. Ignoring the open wheat/barley category, for 1997 there are only four cases where TRQs are not virtually 100% filled: yogurt (88% filled), heavy cream (63%), dry whey (83%), and margarine (1.6%). In 1998, there are two such cases: heavy cream (83%), and margarine (6%). There are no data for liquid milk, for which Canada's TRQ is 64,500 tons, due to the unique means of dealing with this TRQ which allows individual cross-border shoppers to import the product subject to the conditions which applied in the base period.

#### **Commodity-Specific Detail for Canada's TRQs**

##### *Margarine*

Canada had a TRQ of 6348.8 tons of margarine in 1998, rising to 7558 tons in the year 2000. In 1998,

actual imports under the TRQ were 404.43 tons, indicating a fill rate of only 6.4%. This might appear to indicate that protective or overly rigid measures are being practiced in the implementation of this TRQ in order to restrict margarine imports, but there are no indications that this is the case. The TRQ is administered on a first-come, first-served basis. Since the establishment of the tariff quota, all requests for imports have been granted. There are no restrictions on access to these permits, other than a 500 ton limit per applicant, and that has been raised from 200 tons per applicant. Further increases in that level have not yet been requested. The only imports are specialty spreads.

It is most likely that domestic margarine production in Canada is highly competitive with imports to the extent that general margarine imports into Canada are not profitable. This is not surprising, given that Canada is an exporter of canola, a major ingredient in margarine production, and hence canola is available relatively cheaply within the country. All oilseeds can also be imported without duty. Furthermore, this low fill rate for the margarine TRQ has persisted over the TRQ period.

#### *Broiler Hatching Eggs and Chicks*

The quota level for broiler hatching eggs and chicks has been arranged in a bilateral agreement between Canada and the U.S. at 21.1% of the current year's estimated domestic production. This level has been split into two separate access commitments for eggs (17.4%) and chicks (3.7%). The TRQ level under the WTO is 7.9 million dozen in egg equivalents (one chick equals 1.27 hatching eggs). The larger of these percentages is applied to arrive at the TRQ each year.

Individual quotas are allocated to federally registered hatcheries on the basis of market share (production), with appropriate downward adjustments for any hatchery's underutilization of the previous year's quota. There is the opportunity to grant supplemental quota to deal with market shortages. However, application for supplementals must be made to the EICB, which consults with the Canadian Broiler Hatching Egg Marketing Agency, the national agency representing all provincial producer marketing boards, to determine whether there is domestic product available and hence whether a market shortage exists. Supplemental imports can also be granted to allow for re-exports.

The fill rate for this TRQ appears to have been in excess of 100% in each of the last four years since the TRQ was established in 1995. In 1998, actual imports were 175% of the WTO TRQ level,

and in 1997 actual imports were 132% of the WTO TRQ level. However, the NAFTA commitment exceeds the WTO quota so the larger level of imports are actually allowed, and the fill rate relative to the (smaller) WTO quota looks to be in excess of 100%. Properly measured, the fill rates are approximately 100%.

#### *Shell Eggs*

Canada's import quota under the FTA and NAFTA for table eggs and egg products was agreed to at 2.988% of the previous year's domestic production, split among shell eggs (1.65%), egg products such as frozen, liquid, and further processed eggs (0.71%), and powdered eggs (0.63%). For 1999 this is equivalent to 13.318 million dozen. The WTO commitment established a TRQ level of 19.66 million dozen for 1999, which was about 5% of the base year. The higher access level between these two quotas is applied, and since 1996 this has been the WTO commitment.

For both shell eggs and egg products, the quota is allocated to historical (pre-1974) importers of shell eggs and egg products who keep their initial allocation minus any adjustments for underuse. The remainder of the quota for these two categories of imports is allocated to registered egg stations (shell eggs) and processors, wholesalers, and distributors (for egg products) on the basis of their market share. The quota for powdered eggs is allocated on a modified first-come, first-served basis to registered processed-egg stations and further processors that use powdered eggs in their manufacturing processes, adjusted for previous underuse. A new allocation for nest-run eggs for breaking purposes (i.e., ungraded shell eggs) was introduced in 1996 for the increase in import access that occurred under Canada's larger WTO access commitment. This is allocated each year to registered processed egg stations on a market share basis, with the usual adjustment for underuse.

This latter allocation has been contentious because all the increased market access agreed to under the WTO goes to egg imports for breaking purposes, with none of the access going to the higher-priced shell-egg market. This is an example of an end-use quota restriction that has denied WTO import access to higher-valued portions of the egg market by preserving that market for domestic producers, but one that Canada has vigorously defended.

A supplementary quota scheme exists for the usual two reasons: to prevent shortages of shell eggs or egg products, and to allow imports of eggs to be reexported in some form. However, to obtain

this quota (for the former reason) involves making application to the EICB, which consults with the Canadian Egg Marketing Agency, the national agency that oversees the activities of the provincial producer marketing boards, to determine whether a shortage exists or whether there is domestic product available.

The fill rate of Canada's egg TRQ has been close to or above 100% since 1995. In the last two years, 1997 and 1998, the fill rates were 120% and 132%, respectively, on an egg-equivalent basis, although these numbers include supplementary permits.

### *Chicken*

The quota level for chicken also differs between the FTA/NAFTA and the WTO. Under NAFTA, the agreed quota level was 7.5% of the previous year's domestic production. The WTO commitment has been 39,844 tons (eviscerated product basis) for both 1997 and 1998. Due to continuing growth in the domestic market, the access level under NAFTA has been higher and consistently applied since 1995.

The method of allocating this quota was revised in 1996, and it has now become quite complex. Three groups receive quota. First, any firms, regardless of their end use, who imported chicken prior to 1979 receive their initial allocation, adjusted for underuse. Second, processors of chicken products that are not on the Import Control List, and who hence must compete with imports that have open access to the Canadian market, receive enough quota ("FTA quota") to cover their "needs" but they must satisfy an "activity" test. Firms in the food services sector receive a share (5.6%, or 2.7 million kgs.) of the TRQ remaining, depending upon the firm's market share. Finally, the remainder of the TRQ is split 70:30 between chicken processors (on the basis of market share) and chicken distributors (on the basis of equal shares). Any firm with a historical share can opt (irreversibly) for a market share or equal share, depending upon whether they are a processor or food services firm, or a distributor, respectively. There are minimum "threshold levels" for firms to qualify for quota in these various categories, with some provision for minimum quota allotments for small operations. Firms with historical quota shares are subject to use-it-or-lose-it provisions.

Supplemental quota is available under four categories: when there are shortages in the Canadian market; for firms who need imports destined for reexport; for firms who wish to test-market new products or processes; and to allow further proces-

sors to compete with imports. Requests for quota for the first category (shortages) must be made to the EICB, which consults with the Chicken Farmers of Canada who determine whether domestic supplies are available for that use. For the other three categories, supplementary permits are issued on request. It should be noted that there are no country reserves within the chicken quotas.

The fill rates for the chicken TRQ have been at 100% since 1995. In 1997 and 1998, the fill rates were calculated as 139% and 146%, respectively, but this was due to the fact that NAFTA quota levels are higher than the WTO quota levels used as the basis for the TRQ fill rate calculations. However, it is also true that the market for chicken, particularly for further processed categories, has been growing quickly, and supplemental quota allocations (above the TRQ) have been common.

### *Turkeys*

The FTA/NAFTA quota level for turkey was equivalent to 3.5% of the current year's estimated production. Under the WTO, the TRQ level negotiated for 1999 was 5.4 million kgs. (on an eviscerated-product basis), and for 1999 the expected WTO access level was slightly larger and therefore dominant. The WTO quota has incorporated a growth factor since it was defined, growing by 20% from 1995 to 1999. As in the cases of the other poultry quotas, there are no country reserves.

These import quotas have been allocated to two groups. First, there are fourteen traditional or historical (pre-1974) importers, and, as in the cases above, they receive their initial allocations, adjusted downward for any underutilization. Second, there are Non-Import Control List or FTA Quota-holders for firms producing products like potpies, soups, and TV dinners. They receive quota "to the extent of their needs," as quoted in the regulations. New entrants can qualify here, based on their production in the previous year. Remaining unallocated quota is allocated in the first six months of the year for special requests. The provisions for supplemental permits are based on the usual four categories: to cover domestic market shortages, imports for reexports, test-marketing of new products, and for "further processors" who need raw turkey imports so that they can compete with further-processed turkey imports. Requests for supplemental quota in the category of "shortages" must be made to the EICB after the producer agency, the Canadian Turkey Marketing Agency, has attempted to find sources of domestic product. After the first six months of the year, remaining



quota is allocated to historical quota holders on a pro-rata basis.

Regarding TRQ fill rates, the turkey TRQ has been filled since its inception in 1995. In 1995 the fill rate was 105%, in 1996 it was marginally below 100%, in 1997 it was 101%, and in 1998 the fill rate was 103.3%.

### *Beef and Veal*

Although there is free trade between Canada and the U.S. under the FTA/NAFTA, Canada has a TRQ commitment under the WTO. It has agreed to a TRQ for non-NAFTA countries (except Chile) in the amount of 76,409 tons for fresh, chilled, and frozen beef and veal. The TRQ does incorporate two country reserves, for New Zealand and Australia, with the New Zealand share of the total quota at 29,600 tons and the Australia share at 35,000 tons. The remaining amount, 11,809 tons, is open to all other countries.

The beef TRQ is allocated to importers in two pools, one for processors and retailer-processors, and one for distributors. The former pool, of 57,307 tons, is allocated based on the amount of beef and veal from countries other than the U.S., Mexico, and Chile processed in these processors' own facilities from November 1 to October 31 of the previous year. The second pool, of 19,102 tons, is allocated to distributors based on sales of beef and veal from countries other than the U.S., Mexico, and Chile, from November 1 to October 31 of the previous year. A system of supplementary quotas has been implemented to deal with market shortages.

The beef and veal TRQ has been filled or virtually so in all years since 1995. In 1995 the fill rate was 113%, in 1996 the rate was 97.4%, in 1997 it was 117%, and in 1998 it was 111%.

### *Fluid Milk*

In the case of fluid milk, Canada has a TRQ of 64,500 tons. This is a global TRQ, accessible by any country supplier, but in practice, due to transportation costs, it is likely to be filled only from the U.S. This TRQ is unique in that Canada does not allocate it to any importer, but leaves its importation to individual residents of Canada who shop in the U.S. and choose to bring fluid milk home. Under General Import Permit #1, "any resident of Canada may import up to \$20 worth of dairy products, including fluid milk and cream, for the personal use of the importer and his household. This General Import Permit may be invoked an unlimited number of times." This method of handling the

fluid milk TRQ has been challenged by the U.S., but a WTO Panel appeal judgment earlier this year accepted the procedure and removed the \$20 limit. Because there is no formal counting of fluid milk imported by individual consumers, no published notifications are made and we cannot verify the fill rate.

### *Heavy Cream*

This is a relatively small TRQ, with Canada's access commitment at only 394 tons. It is a global TRQ, and by its product description applies to cream in excess of 6% fat without added sweetening and not concentrated. The scheduled commitment, and therefore TRQ, is restricted to sterilized cream with a minimum 23% butterfat in cans of volume not exceeding 200 ml. and to "specialty creams."

The allocation of this TRQ is on a modified first-come, first-served basis. Allocations are also made to certain firms and lines of business, with "priority to importers with established distribution lines for specialty creams." Any remaining balance in the TRQ can be allocated, upon application, to other firms that can demonstrate they have in place a distribution line for specialty creams.

In the administration of this TRQ, companies that cannot fill their quotas are not allowed to transfer the unutilized part of their quota to another user. But any such unused quota is allocated to other would-be importers on a first come, first served basis, so the allocation system is still quite open; transfers are effectively made through the EICB. Firms who turn in unused parts of their TRQ retain their TRQ without penalty for the next year's allocation.

This TRQ is quite unique among Canada's agricultural TRQs in that, like margarine, it has not been completely filled in any of its years of operation since 1995. Its fill rates since 1995 have been 77%, 80%, 63%, and in the marketing year 1998/1999, 83%.

### *Concentrated and Condensed Milk/Cream*

The TRQ level for this small category is 11.7 tons, and it has not changed since 1995. However, this TRQ is allocated entirely to one traditional or historical importer, and can be sourced only from Australia. The reason for this situation is that Australia was the sole supplying country when this item was placed on the Import Control List.

This TRQ has been completely filled in each of the four years from 1995 to 1998, at 100%, 100%, 126%, and 121%.

### Yogurt

Canada's WTO commitments for yogurt have resulted in a TRQ of 332 tons, a quota that has stayed constant in size since 1995. It is a global quota, without restriction on country suppliers.

This TRQ has been allocated to historical importers, regardless of their sector of activity. The quota amount is made in proportion to each importer's historical imports. Underutilization penalties do apply, and any quota obtained through these penalties is made available to historical and new importers who make application, without other restriction.

This TRQ has been somewhat underfilled over the period since 1995, although the fill rate has been increasing each year to 100% in the last year. Its pattern of fill has been the following: 1995, 72%; 1996, 86%; 1997, 88%; and 1998, 100%.

### Powdered Buttermilk

Canada's WTO commitment in the case of powdered buttermilk is a TRQ of 980 tons that has stayed constant over the period from 1995 to date. Unlike yogurt, however, it is not a global commitment; rather, the supplying country is New Zealand for the full TRQ allotment. Furthermore, the TRQ is allocated to one historical importer. The reason for this country reserve is the same as for Australia and condensed milk, that when powdered buttermilk was placed on the Import Control List, New Zealand was the traditional and sole supplier, and this arrangement rolled over into the WTO commitments.

The administrative arrangements are standard, including that the importer is subject to a use-it-or-lose-it restriction on the TRQ. However, the importer has completely filled this TRQ in each year since 1995. The fill rates have been 1995, 116%; 1996, 133%; 1997, 101%; and 1998, 120%.

### Dry Whey

This product has a TRQ of 3198 tons. Its level has been constant since 1995 and can be sourced from any country. The allocation of the dry or powdered whey TRQ is on a modified first-come, first-served basis. Allocations are made to specific firms whose use of this product conforms to certain end-use conditions. Priority is given to users of specialty wheys not available from domestic sources who can show that specialty wheys are required in their manufacturing or product formulations. Any remaining TRQ, after the needs of this first group are

met, is allocated to processors and further processors who can show a requirement for whey in their manufacturing process. Again, any unused quota from one firm cannot be transferred directly to another firm, but rather should be turned into the Export and Import Controls Branch who reallocate to other users on a first come, first served basis.

The fill rates on this TRQ have been highly variable. In 1995 the rate was 66%. It increased to full usage in 1996 (101%), fell to 83% in 1997, then rebounded to 160% in 1998/1999.

### Products of Natural Milk Constituents

The TRQ for this category of products is 4345 tons, a level that has been constant since 1995. This TRQ can be sourced from any country and is allocated on a modified first-come, first-served basis. However, its allocation is to firms that have certain manufacturing characteristics, just as in the case for dry whey, discussed above. Priority goes to users of milk protein concentrate who can show they need this product in their manufacturing or product formulations. The remainder of this TRQ is allocated to processors and further processors who can demonstrate a need for these products in their manufacturing and production processes. The usual administrative requirements apply, such as the use-it-or-lose it condition.

This TRQ started out being often unfilled, but each year its usage has increased, to 100% fill rates in the years 1997 and 1998. However, in 1995 the fill rate was only 46%, and in 1996 it was 67%.

### Butter

As one of the most protected of Canada's dairy products, butter had been on the Import Control List for forty years with the Canadian Dairy Commission as the sole importer. In most years prior to 1995, there were no butter imports. When butter was imported, it was only to relieve a temporary market shortage. In 1995, as part of Canada's UR commitments, a TRQ for butter was initiated, with a growth factor built in and with a country reserve for New Zealand. The level of the TRQ for 1995 was 1,964 tons, increasing to 3,274 tons in 2000. Of this, New Zealand's reserve started at 1,200 tons (61%) of the 1,964 tons in 1995, increasing to 2,000 tons (61%) of Canada's total 3,274 tons in the year 2000. This level accounts for less than 3% of Canada's base-period butter consumption.

This TRQ has been fully allocated by the EICB to the Canadian Dairy Commission, the national

agency that oversees dairy policy in Canada and which is a state trading enterprise by virtue of its right as the sole importer of butter. The further allocation of this quota is restricted to use only by processors and further processors. As noted earlier, this allocation of the butter quota to the CDC has been contentious, with New Zealand complaining that it has received lower export prices for its butter than would otherwise be the case.

The TRQ has been filled in each year since 1995 with a fill rate of 100% in the 1995, 1996, 1997, and 1998 dairy marketing years.

### *Cheese*

A cheese import quota was introduced in 1975 at 50 million pounds, which was reduced to 45 million pounds (20,412 tons) in 1978. There was then an agreement between Canada and the European Union for a country reserve. The current EU share (since 1996) is 66%, with the remainder open to imports from all other countries. The TRQ established for cheese under the URA was fixed at this same level of 20,412 tons until 1999 and beyond. In addition, the country reserve to the UE was incorporated into the administration of Canada's cheese TRQ. It is the view of some industry experts that the EU reserve produces a result that is not that different from what the pattern of imports would be with open markets, and therefore would arguably be consistent with GATT 1994 Article 13.

A large number of private cheese importers have been actively involved in the cheese trade for many years and have retained their rights to annual allotments of this TRQ since 1995. Regardless of what sector of activity they are engaged in, these historical importers still receive their traditional allotment, as long as they remain active in the cheese trade and as long as they utilize at least 95% of their import allocation. These TRQs can be bought and sold among cheese-trade participants, including newcomers. In fact, there has been enough trade in these quotas that 72% of current cheese quota holders have entered the cheese trading system since 1985. There is also a provision for supplemental quotas for market shortages and for reexport, but these allocations are rare.

As far as fill rates are concerned, cheese quotas have been filled in each of the four years since 1995, at 100% until 1997, and at 101% in 1998.

### *Other Dairy Products*

This category is for food preparations that contain more than 10% by weight of milk solids, packaged

for the wholesale and industrial trade. The TRQ is set for 70 tons and is open to all countries. The quota is allocated to those who apply, and there is a requirement that quota holders are users of these food preparations and can show a need for these products in their manufacturing and product formulations. This quota has always been filled, usually at a fill rate considerably above 100%. In the four years from 1995 to 1998, the fill rate has been 100%, 310%, 224%, and 197% respectively, reflecting issuance of supplementary permits.

### *Ice Cream*

This product was only named to the Import Control List in 1988, but then placed under a TRQ like all other agricultural products in 1995. The TRQ level was initially 347 tons, rising by 1999 to 456.6 tons. It is open to all countries and has no restrictions on the types of importing firms that receive the quota.

The TRQ is allocated to historical importers, regardless of their sector of activity, in proportion to their historical imports. Underutilization penalties apply if imports fall below 90% of the importer's allocation, and such quota is reallocated periodically to those who apply, new or traditional importers, without restriction.

The fill rate on this quota has been quite high and steadily rising to more than 100%. In 1995 it was 89%, in 1996 it was 99%, in 1997 it was 104%, and in 1998 it was 121%, even though there was a growth factor in the TRQ.

### *Wheat, Barley and Their Products*

There are four TRQs under this category, and they are items not under supply management regimes. The items are wheat, barley, wheat products, and barley products. The TRQ levels for 1998/99 were: wheat, 190,582 tons; barley, 335,160 tons; wheat products, 123,557 tons on a grain-equivalent basis; and barley products, 16,070 tons on a grain-equivalent basis. In addition to these quota levels, under NAFTA provisions Mexican wheat, barley, and their products can still enter at the within-quota tariff rates, even if the TRQ is full. The same applies to the U.S. for wheat and wheat products, and now also for barley products.

TRQs for these grains and products are available to importers from the U.S. and Chile on a first-come, first-served basis. Revenue Canada, Canada's customs and income tax department, keeps track of the volumes, and once the TRQ level is reached, the over-TRQ tariff then applies. Initially, importers need General Import Permit No. 20 and they pay the within-quota tariff. No application for

these GIP permits (both No. 20 and No. 100) is required. After the TRQ is filled, General Import Permit No. 100 is necessary, and this covers unlimited imports, but all such imports pay the higher over-TRQ rates of duty. There is, in addition, a supplementary access regime to cover the situation of market shortages. Importers make application and the Minister of Foreign Affairs considers the availability of "like or directly substitutable" products on the Canadian market in making the decision to grant supplemental permits.

Fill rates are quite variable within these grain categories. The fill rates for the wheat TRQ in the four marketing years from 1995/1996 to 1998/1999 were 18, 74, 27, and 33%, respectively. For barley over the same four years fill rates were 5, 31, 12, and 18%. For wheat products the TRQ was always filled, with fill rates of 114, 100, 110, and 102%. For barley products the fill rates were 75, 70, 59, and 60%. Despite less than complete fill rates, there appears to be no administrative constraint that reduces market access. Permits are free for the asking and no application is required. Further, access to the TRQs is on a first-come, first-served basis. The explanation would appear to be that imports of wheat, barley, and barley products are often not profitable, particularly for wheat and barley grain, given the competitiveness of Canadian grain production and processing.

#### *Lessons Learned from the Canadian TRQ System*

In terms of fill rates, the Canadian record is relatively good. Most categories are filled or nearly so. When categories have low fill rates, it appears most often to be due to the importation being unprofitable. Further, the rules and procedures for these TRQs appear to be transparent and not too difficult to use. In other words, for this criterion, the Canadian TRQ system appears to be working as desired. Explaining why fill rates are so high is a tall order, but some observations can be made. First, the quotas are usually allocated to private firms that are independent and do not profit from domestic production. So there would appear to be strong incentives for these firms to fill their TRQs as long as the underlying economics of importation are attractive. Further, the administration of the regime is quite open, straightforward, and predictable, not burdening importers with large costs.

In terms of quota allocation, the domestic economy and foreign exporters will gain from allocating quotas to those importers who can generate the highest profits from the quotas. One would want to see a minimum of regulations restricting who can gain access to the quota, by enterprise

characteristics or industry sector (e.g., further processors, or end-uses). Also, one would want to allow new entrants to get into importation readily. TRQ allocation in the Canadian system has done little to help accessibility by often relying on allocation to historical importers. Some changes are now beginning to give more access to newcomers.

The most effective means of meeting an objective of open access is to allow quotas to be bought and sold on a permanent basis and for there to be easy short-term rentals (buying and selling the quotas for that import year). The advantage of allowing this kind of transferability is that it makes the initial allocation largely irrelevant for achieving an efficient quota system. On this score, Canada has improved its regime by allowing the quotas to trade in many categories, but further gains are possible by allowing quotas to be bought and sold legally within the year or rented readily in all categories. (This does not apply in those cases where quotas are not constraining, such as when they are allocated on a first-come, first-served basis.) This would be a most effective means of getting quotas into the hands of the most efficient importers. Then the initial allocation can be done simply to transfer income to desired groups (e.g., further processors), and the initial allocations can become irrelevant for keeping the regime operating efficiently. Allocating quotas by auctions becomes less an issue of efficiency for the regime and more a question of how to split up the quota rents.

Regarding the objective of keeping the administration of the quota system efficient, this calls for keeping costs to the importer of accessing quota as low as possible, keeping transparency high, and keeping uncertainty from rule changes, additions, or interpretations as low as possible. Across the twenty-one TRQ categories, Canada's regime appears reasonably successful in meeting this objective. There are still many gains from further simplifying quota administration. Some of the poultry allocations seem particularly good candidates for further simplification. In fact, it would seem unnecessary to have *any* rules governing quota administration other than that the quota or permit is needed to undertake importation, and that the quota must be used within the quota period. Further gains in domestic efficiency can be arrived at by some changes in system design. One example mentioned above is to allow quota rental (within the year) as well as permitting the quota to be held *permanently* (the property right to be granted the annual import permits, as for farm marketing quotas). This allows the flexibility of adjusting your quota holding each year in case of excess demand or your inability that year to completely use your quota, and it provides

the certainty of knowing you will be receiving your import quota each year.

It may be desirable to spread the quota rents more widely than is practiced at present. This could be achieved by having quota auctions, or for the government to levy a charge on quota recipients to receive the quota each year. There are several advantages to such charges, but Canada has not yet gone any distance down this path in its quota administration.

In terms of more international issues, there is the question of targeting TRQ supplier countries with the use of country reserves. Canada does have five of these (one-fourth of all TRQs), but does not appear to consider the existence of such reserves a policy objective. These reserves do not seriously affect the operation of Canada's regime, do not contribute to quota under-fill, and are valuable only to the recipient exporter. Another issue is the role of State Trading Enterprises. Canada has only one case, butter, in which the TRQ is allocated to the Canadian Dairy Commission. One worry about such a role for STEs is that they may have weaker incentives to fill the quota. But the evidence in Canada is that the STE monopoly importer is fully utilizing its butter TRQ.

#### *Implications for the Next Round*

From this review, the primary lesson for dealing with TRQ administration in the next round is to

require that TRQ levels are actually imported where there is a market demand for such imports. Penalties should be imposed on governments (or their implementing agencies) for failure to allocate quotas to importers, allowing them to be guided by private economics as to how much to import. If the importer is not an independent private firm (e.g., an STE), additional penalties may be necessary to induce them to import their TRQ import levels, assuming there is a private demand for those imports.

It is not clear why any additional WTO rules should be adopted in this area, other than to ensure meeting privately profitable TRQ levels as discussed above. From the Canadian experience above, it would not seem necessary to require quota allocation to private firms, to disallow allocations to STEs, or to require the auctioning of quotas. Most of these additional rules could contribute to filling TRQs and reducing the economic cost of quota administration and system operations. But if we can deal directly with the filling of TRQs as suggested above, such other rules are either redundant or are primarily matters for domestic policy.

#### **Reference**

Canadian International Trade Tribunal. 1992. *An Inquiry into the Allocation of Import Quotas*. Ottawa.