Canada – EU Dairy Trade and CETA: Impacts and Significance

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Introduction

- Canada and the EU signed and recently have approved the Canada-EU trade agreement (CETA)
- Despite some glowing claims about the agreement by government and other proponents, it was controversial in terms of its effects on each country's dairy sector
- In this presentation, I review the key details of the dairy component of the agreement, beginning with Canada's negotiating position and how the resulting agreement was predictable (including for TPP-11 and perhaps for NAFTA)
- Second, we evaluate what the CETA agreement (and TPP) will mean to Canada's dairy farmers
- Finally I will also note the effects on the EU, basically by considering CETA's likely effects on EU cheese exporters

Canada's High P Dairy Industry

- Canada's dairy sector is unique in world dairy mkt because its domestic prices are relatively high
  - These are seen most readily by comparing farm milk prices
  - Farm milk prices, USD/liter (2018 data; 2017 Canada)

U.S.	EU	Canada
0.48	0.50	0.62

  - These numbers obviously affected by exchange rates; Canadian dollar is now relatively low at USD 0.75 (compared to PPP estimate of USD 0.84)
  - Consequently, the price differences have narrowed when compared to previous estimates
  - These price differences are above transport costs

Difficult access to CDN dairy product mkt

- Price differential of 25-30% rarely observed for comparable products without some barriers to trade
- CDN dairy products have highly restrictive import quotas (TRQs) and associated very high ‘over-TRQ’ tariffs
  - The dairy TRQs typically admit less than 5% of domestic consumption, and
  - The over-TRQ tariffs are roughly 200% for the main dairy products
- Trade negotiations between Canada and its trade partners often incorporate much attention and controversy over these restrictive measures

Contentious area in trade negotiations

- Most milk producing countries/regions (e.g., EU, US, New Zealand) are attracted to export to Canada; they want fewer and lower trade barriers (lower tariffs, larger TRQs) to allow them to export more
- Two examples are recent trade negotiations that resulted in the Canada-EU Trade Agreement (CETA), and Trans-Pacific Partnership (TPP-11) agreement that was recently concluded and signed.
- NAFTA renegotiations are ongoing

Policy change options for CETA, TPP?

- Basically two instruments that can be changed as part of dairy product trade negotiations:
  - Reduce over-TRQ (Tariff Rate Quota) tariffs
    - Those tariffs currently 200-250%
    - Could be lowered; *in theory* could make some imports competitive with domestic products, leading to possibility of increased imports *and* lower domestic prices
  - Increase TRQs themselves
    - Would certainly increase imports; effect on domestic prices is unclear, depending on response of domestic industry in terms of domestic production quotas

The latter dominates

- On basis of history of Canada's trade negotiating positions over 25 yrs, the only concession Canada offers is to expand TRQs
  - Canada has strenuously avoided reducing over-TRQ tariff levels; supported strongly by industry
  - URAA result: setting of TRQs with high over-quota tariffs
  - Doha Rd negotiations converged on only TRQ increase
  - CETA + TPP negotiations had the same result
- Canada's over-TRQ tariffs have much water (i.e., excess protection where tariffs are higher than needed to keep out imports)
  - Moderate tariff reductions could occur with no change in imports for most years and world prices

Canada’s TRQ as % of Consumption

- One metric: measure TRQs as percentage of total consumption of that product, pre-CETA, TPP
- Here is what we find by main dairy product TRQ category (WTO) using 2011 consumption data

Butter	3.5%
Cheese	4.2%
Yogurt	0.1%
Creams	0.1%
Ice Cream	0.5%
Fluid Milk	2.4%

What is the CETA result?

- Of most interest is the dairy policy change from the 2017 CETA
- As anticipated, it resulted in an increase in the cheese TRQ to the EU with no change in over-TRQ tariffs
- The new quota is 17,700 tons of cheese, representing net increase of 16,900 tons

Different measures of TRQ increase

- 16,900 tons, the *increased* cheese imports, equals
  - 83% of the prior cheese TRQ
  - The old TRQ represented 4.2% of total cheese consumption in Canada
  - The new TRQ becomes 8% of total cheese consumption
  - More importantly for milk producers, the increased TRQ is roughly equivalent to 1.9% of total *industrial milk* production, or 1.6% of total milk production, including both fluid and industrial milk
  - The industry response can be predicted to cut production (domestic quotas) by this one-time increase in imports

How much of a production cut

- First, the 1.9% (of industrial milk production) cut will be phased in, specified in the agreement to be over 5 years (i.e., 0.38%/yr)
- Such cuts appear modest, but must be compared with normal fluctuations in industrial milk quota holdings
- Those fluctuations occur annually, with changes in demand; recall quotas are adjusted so that supply = expected demand
- Over past 20 years, from dairy years 1997/98 to 2016/2017, the average change in aggregate Canada-wide MSQ was +2.2 percent (i.e., demand for butterfat has been growing)
- In past 10 years, that growth was even larger, +3%/yr
- If you subtract the 0.4% cut for each of the first five years of introducing CETA, and use the 10 year average increase, the net increase in quota is a still-handsome +2.6%/yr for 5 yrs

How serious is this risk?

- Conclusion: due to the impressive **growth** in farm quotas, the quota ‘cuts’ arising from CETA are not visible
- The cuts will not only be very small in the bigger picture but they will be brief
- So for Canadian dairy, this agreement will have a modest effect, not noticed at the farm level

What about adding TPP?

- In case of TPP, the same result occurred: Canada gave up an increase in TRQs equivalent to 3.25% of domestic consumption
- If phased in over 5 years, the result is a cut of 0.65% in producer quotas per year for 5 years
- This is equivalent to a net increase in quota holdings of 2.25%/year taking TPP alone
- If one adds CETA to TPP cuts, still net quota growth of a healthy 1.85%/yr; then return to full market increase in quotas of ~3%/yr (i.e., still no net cuts)

Prospects for EU cheese exporters?

- Will the CETA offer significant gains to EU cheese exporters?
  - The % increase in market access (compared to previous cheese quota levels) looks very attractive
  - Similarly, the price difference for cheese between EU prices or world wholesale prices and Canadian cheese prices must look very attractive to EU cheese exporters
- But the increased access is small in absolute tons
- Even more sobering for EU exporters, who will have the property rights to the increased TRQ?
  - Past practice for Canada's WTO cheese quota is that all cheese quota is allocated to Canadian cheese importers, large and small private firms; This will be continued

Cheese Import rents will go to Canada

- Allocations will be given to Canadian companies who are already allocation holders of Canada's WTO cheese TRQ,
  - It is broken into two groups, cheese manufacturers and distributors/retailers
- But at least 30% will be available to new entrants each year from 2017-2022, and subsequently at least 10%/yr
- Canadian importers who hold the TRQ will buy EU cheese on the open market, with EU exporters competing (bidding) for these sales, at prices likely following existing world export prices
  - i.e., Canadian cheese importers will enjoy the large quota rents
- EU exporters will *not* have access to the large price difference between the high Canadian cheese prices and their own low costs
- They will simply enjoy increased export sales to Canada

Extension to NAFTA

- To the extent the NAFTA negotiations can be predicted at all, the terms will likely follow the CETA and TPP
- If so, adding this increased import access means additional reductions in domestic milk quota
- Still there will be no actual reduction at the farm level within an assumed 5 yr phase-in, due to strong growth in domestic demand for butterfat
- Specifically, dom quota holdings would still increase by 1.2% per year for the 5 year phase in, then back to 3%/yr

Conclusions

- The result of CETA, combined with the likely TPP result, will be an increased dairy TRQ of about 5% of total consumption in total, or in annual phased-in terms, about 1%/yr
- This should be compared to exogenous annual market growth in CDN farmer quota holdings of about 3%/year
  - Net effect of CETA+TPP TRQ increases is still positive 2%/yr growth in farmer quota holdings
    - And that is for only 5 years, after which quota growth reverts to 3%/yr
    - No net fall in quota holdings from CETA or even combined CETA+TPP
- Similarly, EU exporters will be unlikely to achieve market rents from the protected Canadian cheese market
- They will get more sales but at world prices; CDN cheese mkt rents will go to the recipients of the new TRQ, Canadian importers
- *CETA = Small effects all round, to Canadian dairy farmers and EU cheese exporters*