

## WHAT WE LEARNED

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Historically, dairy has been one of the most highly protected commodity areas within U.S. and Canadian agriculture. Until recently, any discussion of free trade in dairy products would have been viewed as being purely academic. However, withdrawal of the grain transportation subsidy on the Canadian prairies, and phasing out of dairy price supports in the 1996 Farm Bill demonstrate how fast political and economic realities can change.

This workshop was characterized by spirited discussion which was fostered by the inclusion of industry interests, but was stimulated as well by the significant differences that exist in the institutional aspects of the industry in the two countries. The focal point of discussion related to two central issues:

- The relative competitiveness of the U.S. and Canadian dairy industry.
- The potential for Canada to take bold steps in eliminating its production quota policy.

There is no doubt that past policies have had a major impact on the structure of both the U.S. and Canadian dairy industries. Unimpeded by quotas, U.S. dairy farms have grown to the point where in most regions, industrial farms of 1000 cows or more are present. In some regions, such as the U.S. Southwest and West, large industrial dairies are prevalent. The Canadian size contrasts are striking—attributable largely to quota policies. Efficiency differences were believed to relate more to the farm level than to the processing sector. Farm level differences in efficiency are believed to be largely size related—once the value of the Canadian quota is removed. Provincial barriers to trade have become as much of an obstacle to Canadian adjustment as has border barriers.

The major contemporary thrust of Canadian dairy policy is one of facilitating freer trade among the provinces and removing some of the basic pricing inefficiencies that developed over time. A removal of provincial barriers to trade is a desirable first step toward rationalizing U.S./Canadian trade disputes. The U.S. policy changes brought on by the 1996 Farm Bill may put greater pressure on Canada to reform its dairy policy. Both GATT and NAFTA rulings could play a critical role in dictating the pace of change.

Free trade models suffer from incomplete information on the economic factors that can be expected to affect cross-country movement of dairy products. One of the most critical missing links is the marginal cost of producing milk in Canada, relative to the United States.

Since marginal costs in the two countries will be equal (except for transfer costs) under free trade, these autarky values will largely determine the direction of trade flows. U.S. economists tend to assume that U.S. dairy farms are substantially more efficient, while Canadians expect their farmers to achieve similar levels of efficiency with the removal of output controls. Based on the results of Meilke, et. Al., it appears that there would be no major change in Canadian milk production and only small net trade flows between the two countries under a wide range of economic assumptions. If so, regional trade flow predictions coming from U.S. models, based on the assumption of no change in milk production and demand conditions, take on added significance. In general, these models predict that milk would move South from Quebec to serve large population centres in Northeast United States.

Both U.S. and Canadian government economists emphasized the needs for data and improved modelling. Econometric models based on historical data in the virtual absence of trade have inherent weaknesses. The need for collaboration in filling the data gaps was stressed.

Representatives of Canadian and U.S. dairy interests stressed the importance of these types of interchanges providing insights into the effects of policy changes. While U.S. interests stressed the importance of moving ahead, Canadian interests logically preferred a posture of maintaining the current policy or at least allowing a prolonged adjustment period..

Perhaps one of the most perceptive comments arising from a discussant was Matte's observation on the role and importance of policy harmonization in this sector as a vehicle for trade dispute avoidance. As a Canadian processor representative, he is acutely aware of the importance of trading relations within Canada, and between Canada and the United States. His comments in this area impressed the organizers of the workshop to the extent that the issue of harmonization of policies and programs in the agriculture and food industry is on the agenda for the next workshop in this series. Suggestions for that topic would gladly be received by any of the workshop planners.