

—DISCUSSION—  
**A PRODUCER PERSPECTIVE ON  
THE FUTURE OF DOMESTIC AND TRADE DAIRY POLICY IN CANADA**

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In the context of market globalization and trade liberalization it is more and more common to read research documents and analytical papers that attempt to predict what would happen to the Canadian dairy sector if free trade in dairy products between Canada and the United States were allowed in the short run. Many of these studies predict a significant shrinkage of the dairy sector in Canada, a major decrease in producers and processors' income and some, but minor gains for consumers.

More open markets may well be the direction in which we are headed. However, free trade is not a realistic scenario for the immediate future. To allow this to happen suddenly and rapidly would not be a sound policy option for Canada. A number of prerequisites are required before we can even consider this option. If we can take the time to design a gradual and intelligent process of adjustment towards more open markets, the future of the industry may be much brighter than many studies predict.

**FREE TRADE IS NOT A REALISTIC SHORT TERM SCENARIO**

Free trade in dairy products is not a realistic short term scenario for a number of reasons. The first is that it would be in contradiction with what was agreed upon in all of the trade agreements that have been concluded over the last decade: the first Canada/U.S. free trade agreement, the North American Free Trade Agreement and the World Trade Organization (WTO) Agreement that came into effect at the beginning of last year. In the first two agreements it was agreed that the question of border protection and trade in dairy and poultry products would be solved in the WTO negotiation. In this last negotiation it was further agreed to proceed with a slow and gradual reduction of border protection and towards a modest market opening.

Canada has complied with these commitments and dairy producers in Canada expect that the Canadian government will live with them and only them. Canadian dairy producers expect that at the next round of the WTO negotiations, Canada will take a position similar to the one taken the last time: to fight for a much more disciplined trade environment and, if that can be achieved, to agree on the continuation of a gradual and limited process of market opening.

Second, dairy producers in Canada are not prepared to give up on the system of supply management that they have developed and are in the process of fine tuning. To accept free trade between Canada and the United States is equivalent to discarding that system.

It may be useful to recall that the essence of this system is to provide primary producers with market power to counterbalance the market power of other players in the system in order to stabilize and improve their income while providing the consumers with an adequate and stable supply of high quality dairy products at reasonable prices. There is no doubt that this system has met its objectives and producers feel that it remains well suited to the dairy sector, which is one of the most highly protected industries in the world.

Also, producers are not prepared to give up this system because they know that to do so is equivalent to shifting the power they have gained to other players in the system who will use them to their own advantage, and specifically to the disadvantage of producers. Producers hold the position that real gains to consumers and to the overall economy would be small.

## **PREREQUISITES ARE REQUIRED**

There are a few important changes that have to be made outside Canada before we can consider moving more rapidly in the direction of free trade in dairy. The first one is a process of gradual reduction and elimination of other, more trade disruptive types of behaviour in world dairy production and trade. In the background document for this workshop, I noted a table in which the various forms of protection, support and export enhancement measures used by the major world dairy countries are described. Canada protects its producers but I noted that no other country has an effective supply management scheme to adjust production to market needs. The result is that the global market is characterized by overproduction, the piling up of stocks and disposal of stocks on the world market at whatever price may result. The result is an unstable, unpredictable and totally unattractive price structure for world dairy products.

Before we are prepared to give up the system of discipline that we have built, substantial moves towards greater discipline will have to be achieved elsewhere. One of these moves is the reduction and elimination of export enhancement programs that most other countries use. None of these are financed by producers, but they are in Canada.

The last WTO negotiation resulted in an agreement to reduce tariffs by 36 percent. The next negotiation should follow in this direction with an equal reduction. This is an absolute prerequisite to more open markets. Why would producers accept opening the markets if it is only to see these markets occupied by foreign producers with the assistance of their public treasury? That would be nonsense.

To consider moving towards a more open dairy market in Canada, substantial improvements have to be made so that the world dairy market becomes more stable, predictable and attractive.

A second prerequisite is that countries exhibit a greater willingness to comply with the rules agreed upon in trade negotiations. At the last WTO negotiation, it was almost agreed that countries would open their markets to a minimum level of 3 percent of consumption moving to 5 percent at the end of the implementation period (the Dunkel guideline). In the process of negotiation this obligation became less constraining and, finally, when the countries tabled their offers, it was much less than that. In fact the European Union and the United States offered next to nothing in terms of new access in the dairy sector. Canada had prepared a totally consistent position but followed the U.S. example and reduced it. Nevertheless Canada has a more open dairy sector than many other countries, especially the United States. Canadian imports represent 4.27 percent of consumption. They are approximately 1.8 percent in the United States. Why would Canada open its borders further if others do not?

A third prerequisite is that some behavioural change is required. U.S. producers and their lobbies will have to be more flexible and accept the reality that with free trade sometimes there are gainers and sometimes there are losers. That is a rule of the game.

Most if not all of the studies conducted which analyse free trade between Canada and the United States in dairy products predict that Canada would be a big loser in terms of producer prices, revenues and the size of the industry. There is little doubt in my mind that Canadian producers would have to live at least in the short run, with lower incomes. It may well happen that exports (without public subsidy) will develop from certain Canadian producing areas in certain U.S. markets. What will be the reaction of dairy producers of these areas and their lobbies, and U.S. senators, and even Mr. Kantor, if this happens? Their reaction is easy to predict if we base our expectation on past experience. There are a number of examples which indicate that U.S. producers may not like it very much:

- the hog and pork cases over the last a decade;
- the wheat case with Western Canada last year;
- the softwood and lumber case with British Columbia and Quebec, very recently;
- the potato cases with New Brunswick producers;
- the tomato case with Mexican producers this year.

If there are important exports of dairy products from Canada to the United States after free trade, will we be under heavy pressure to conclude an agreement to restrict these exports? If so, what is the purpose of this kind of free trade?

Before we can accept the acceleration of free trade talks with the United States, U.S. producers and lobbyists will have to exhibit more willingness to comply with the rules of the game. This may even require a change in that part of U.S. trade law which appears to require that the United States should always “win”.

There is a fourth type of change in the environment that might facilitate a move towards more open markets. This one does not depend on a public policy decision in either of our countries. It is the question of the equilibrium between world food demand and supply.

According to a number of analysts we are entering a new era in which food demand may outpace the capacity to respond to it. Given population growth in the world (in China and some Latin American countries) and the growth in disposable income, we will face a major crisis. If the overcapacity era is over, then we may move faster. Supply management is an instrument to curb overcapacity. If this really disappears, the need for supply management may decrease. We will need to wait and see if that is a lasting trend.

## **THE FUTURE: A REASONABLY GRADUAL PROCESS OF CHANGE**

Ten years ago the system of supply management was severely criticised for its unwillingness and inability to adapt or to adjust to changing circumstances. The history of this last decade has demonstrated that this is no longer the case. A number of important changes and adjustments have taken place. For most of these changes, total agreement was reached among the provinces. These include:

- the adjustment to the decline in the consumption of butterfat;
- the greater integration of fluid and industrial milk;
- the adjustment of the revenue pooling system;
- the multiple component pricing system;
- the butterfat utilization program;
- the rebate system for further processors;
- the changes from the system of levies and rebates to processors to the formula of differentiated prices to adjust to the new trade rules.

All these changes are significant. They have been made gradually, not always without difficulties and conflicts among the players, but they have taken place. This process continues. For example, it is likely that in the near future we will have a Canadian market for production quota allowing some, gradual interprovincial adjustments that will permit the sector to grow where it should and allow for economies of size and capacity utilization at both the farm and processing levels.

Another change which is about to be implemented is the optional export quota. Again this is likely to be introduced gradually beginning at a low level, but that may be

increased over time, especially if the world market becomes more stable and predictable, or if the United States and European Union markets were to become more open.

This is an important move. It will offer those producers who want to expand their operation an option other than purchasing quota at a relatively high price. Those producers who want to expand are those who will supply the market in 10 and 15 years. This possibility to expand the size of their operation may be the only factor that separates them from their U.S. competitors on the cost side.

This move is going to have another important and necessary impact: inducement of a decline in the value of quota. This would be highly desirable. Another move which is going on and will continue is the research and extension work to improve the management skills and lower the cost structure of the larger producers.

## **CONCLUSION**

Dairy producers in Canada do not favour sudden and drastic changes in policy directions. They do not oppose changes, they have exhibited their capacity to accept and induce changes in the system and this will continue and may be at a faster rate than many think they are capable of. This might be the case if the changes they hope to see happen elsewhere do in fact happen: elimination of export subsidies, a more disciplined and predictable world market, and reduction of trade harassment by competitors.

If that gradual adjustment process goes as expected, Canadian producers are going to be fully ready to face the competition, to maintain or increase the industry size and contribute to growth in revenue and income for the whole economy. This may also be an incommensurably larger benefit to the whole of Canadian society than the very marginal gain consumers might obtain from a sudden move towards free trade.