

—DISCUSSION—
**EMPHASIS ON TECHNICAL BARRIERS TO TRADE
IN DAIRY UNDER NAFTA**

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The de Gorter/de Valk paper and the Kerr/Hayes paper provided an excellent basis for discussion. My comments reflect:

- Questions concerning what we do not know with regard to competitiveness.
- Issues of vertical integration and supply chain management.
- The need for balance in discussion of the dairy issues.
- What we do not know.

The de Gorter and de Valk paper asserts that “Moreover, within North America, Canada can be a consistent exporter of both dairy and poultry...” Many in U.S. agriculture assert that the United States has an absolute advantage in most commodities. I do not know which is right. Moreover, I do not think that anyone knows where the advantage lies. Economists on both sides of the border have done a very poor job of analysing the comparative costs. While it is sometimes argued by economists that costs are meaningless because they are influenced by policy, it is possible to estimate the impacts of policy. For economists, these arguments are a copout. While the information may not be perfect, comparable data from both sides of the border, given its inadequacy, can be very useful to policy makers.

VERTICAL INTEGRATION

Kerr/Hayes and de Gorter/de Valk make a distinction between the U.S. vertical integration approach and the European supply chain management approach. The U.S. integration approach is characterized as one where the corporate integrator owns and controls production throughout the market channel.

There are very few U.S. cases of this type of integration and primarily involve small firms. The large U.S. poultry and hog integrators utilize a contract system involving growers who own the physical production facilities. The integrator supplies feed, pigs or chicks. Production is according to a set of specifications.

A distinction can be made between investor-owned and producer-owned integrators. Both exist in the United States although investor-owned integration tends to be dominant. While producers have more to say about how an integrated system that they own operates and have a more direct pipeline to benefits, to be competitive their goal still has to be efficiently producing a uniform quality product that consumers want. This requires a high level of control over production. Control may either be accomplished through vertical integration or by a very small number of large producers who, themselves, are integrated.

In discussion, the point was made that U.S. poultry integrators may be reconsidering the number of functions that they perform internally. Surely, during a time of out sourcing, any large integrator has to be evaluating whether there are certain functions that can be performed at a low cost by out sourcing. But, the product or service that is out sourced will still be produced to highly controlled specifications.

On a milk equivalent basis, Mexico produces only about 50 percent of its dairy product consumption. Neither the United States nor Canada have been large net exporters. U.S. and Canadian exports have been limited to commodities that have been subsidized either directly or through technical classified pricing. U.S. dairy trade with Canada has been limited largely to Canadian consumers who cross the border to buy lower priced U.S. dairy products, when they exist.

The purpose of this paper is to explore technological barriers to trade in milk and its products under NAFTA. These barriers to trade appear to revolve largely around the U.S. Pasteurized Milk Ordinance (PMO) whose provisions are set by the National Conference on Interstate Milk Shipments and its equivalents in Mexico and Canada. A central issue is the equivalency of these provisions between the United States and Canada. Since dairy trade with Mexico only moves in one direction, from the United States and Canada to Mexico, the equivalency issue involves the conditions under which Mexican dairy products can enter the United States. The issue of the use of rBST also looms as a potential technical barrier.

Canadian supply management programs and the related tariff rate quota schedule preclude dairy trade between the United States and Canada, except for direct consumer border crossing sales. As a result, it is difficult to determine the extent of dairy technical barriers. It is also important to note that there may be different technical barriers among the Canadian provinces, although it is understood that efforts are being made to identify and eliminate these barriers to inter-provincial trade.

HEALTH AND SANITARY REGULATIONS

Discussion of the U.S. PMO provides a useful point of departure for indicating the nature of potential technical barriers to trade affecting health and sanitary conditions related to dairy. The PMO was adopted in the 1950s to facilitate free movement of Grade A milk from one state to another.

The commerce clause of the U.S. Constitution provides that no state shall take action to impede the movement of products from one state to another. Historically, this clause, which effectively mandates free trade among the states, has been one of our more powerful constitutional provisions. After World War II, the geographic scope of milk markets expanded rapidly with improvements in transportation, refrigeration and packaging. Markets for milk used for bottling expanded rapidly from a local to a regional basis or multi state basis. Efforts to protect local markets on the basis of somatic cell count or inspection requirements were struck down by the U.S. Supreme Court on the grounds that they were a barrier to the interstate movement of milk.

The result of these court decisions was the need for a single national uniform standard which was accomplished by state adoption of the PMO =AF a model law. All states adhere to the PMO which contains requirements which inspectors utilize in certifying farms for Grade A (suitable for use in fluid products) sales. These requirements become relatively detailed such as one indicating that a milk house must contain double wash vats or a penalty of receipts from two days milk for a farmer who contaminates a tanker of milk with antibiotic residues.

Under NAFTA, there logically develops an issue of whether other countries (Mexico and Canada) can participate in the National Conference on Interstate Milk Shipments that sets the rules for PMO. In 1993, delegates to the Conference voted that other countries could participate and receive the benefits of the PMO if the U.S. Food and Drug Administration (FDA) certified that the country follows Conference/PMO procedures. This means that FDA would have the right to review farm inspection and quality programs of Interstate Milk Shippers listed countries.

The elimination of U.S. import quotas on Canadian supply management programs, combined with certification of equivalency would mean free movement of fluid milk and dairy products among the states and provinces of the three NAFTA countries.

CANADIAN TECHNICAL DISPUTES

There is at least one instance where the equivalency issue has been challenged. It involved a Quebec processor who had been shipping UHT milk into Puerto Rico for more than a decade. After becoming a full member of the Conference in 1989, Puerto Rico moved to prohibit imports of milk from the Quebec processor.

In June 1993, a CFTA dispute settlement panel recommended that an equivalency study be undertaken. Subsequently, in October 1993, the United States and Canada agreed to a three-part equivalency study (not including market access):

1. The equivalency of the UHT system of Quebec with that of Puerto Rico (a scheduled 8-10 week study).
2. The equivalency of fluid milk and fluid products (yogurt and sour cream, for example) between Quebec and the United States (a scheduled 2-year study).
3. The equivalency of all provinces and the United States, (a scheduled 6-year study).

It is significant to note that the first of these studies, which took two years to complete and was signed in October 1995, found equivalency in the case of UHT for Quebec and Puerto Rico. It is also significant to note that the total process is scheduled to take eight years. Moreover, it is anticipated that the safety and technical issues will only be taken up toward the end of the eight-year period. Depending on when you start counting, that means between 2001 and 2003.

MEXICAN TECHNICAL DISPUTES

The situation with Mexico is different but equally interesting. The United States exports substantial quantities of fluid milk and products to Mexico. The fluid milk crosses the border in both bulk and packaged form. A few border conflicts have developed over these shipments.

But, since most of the bulk imports are by cooperatives that need milk to offset Fall deficit production, these protests have been limited.

Concern has developed on the U.S. side of the border that a plant located across the border might import U.S. bulk milk, process it and send it back across the border as finished products. The economic incentive for doing this lies in lower Mexican labour costs (which really are not that significant in a milk plant) and questions of whether the price of bulk milk moving into Mexico can legally be administered under NAFTA by Federal Milk Marketing Orders (FMMO). The FMMO issue is made more complex by the fact that New Mexico producers are significantly large to own their own 18-wheeler tankers, and haul and sell their production across the border. This is reminiscent of Canadian wheat farmers running the U.S.-Canadian border to obtain a higher price.

THE CASE OF rBST

When the United States and Canada get into the guts of the equivalency study, it will be interesting to see how they handle the rBST issue. Approval of the use of rBST in Mexico goes back several years. U.S. producers began using it on a commercial basis in 1994. Its approval was the most studied animal drug in U.S. history. While there were initial consumer and producer protests, these died down rapidly. The death blow was a U.S. Supreme Court decision that Vermont could not require the labelling of milk products as being rBST-free =AF a violation of the interstate commerce clause.

The sale of rBST in Canada is prohibited, as it is in the European Union. With production controls, there is little incentive to use rBST because it would mean buying more quota (investment cost about = 2410,000 per cow in Canada) or selling cows which reduces capacity utilization.

PRICING MILK FOR EXPORT

While not a technical barrier to trade, the impact of milk pricing policies on trade has the potential to become quite important and controversial. The 1996 Farm Bill directs the Secretary of Agriculture to get the U.S. dairy industry more involved in exports. While it arguably even includes the authority for the United States to become a state trader in dairy exports, this is an unlikely alternative.

A more likely option involves establishing a separate lower price Class on milk used to make products exported under FMMOs. The proceeds from this Class would go into the Federal Order pool and be reflected in average producer returns. The issue is whether such a pricing scheme is legal under the WTO. Interestingly, the Quebec processor who was shipping UHT milk to Puerto Rico was competing on the basis of a separate price Class for products exported = 21. This is one of the reasons U.S. dairy farmers charge that they are being asked to compete internationally with their arms tied behind their backs.

PROSPECTS

Without breakthroughs in the next round of trade negotiations, it would appear unlikely that the fate of technical barriers to trade between the United States and Canada in dairy will be decided for 8 to 10 years. However, these issues will surface each time there are discussions over the expansion of NAFTA into a Western Hemisphere free trade bloc.

The pressures of global economic forces could be more influential than negotiation in lowering barriers to trade. The 1996 Farm Bill decoupling and milk price support decisions were a product of the reality that the United States could not maintain its protectionist policies in the face of global economic forces. The realities of a global economy could force equivalency in dairy among Canada, Mexico and the United States.