

## **NATIONAL DAIRY COUNCIL OF CANADA**

*Kempton Matte*

Canadian dairy processors have participated in three disputes, not necessarily by choice. They were:

- Ice cream and yogourt import prohibition by Canada under the GATT (January 1988 to December 1989).
- NAFTA import tariffs for U.S. dairy products versus tariffication under the new WTO (July 1995 to December 1996).
- the Special Classes for Export Purposes (5D & 5E) Program, and fluid milk import restrictions also under the new WTO (October 1997 to October 1999).

In each case the predominant political interest was to protect the protectionist consensus of dairy farmers, reflected in supply management in the Canadian market.

### **Ice Cream And Yogourt Import Prohibition**

In the first case, so fearful were the dairy farmers of having to face a GATT panel that they indicated a willingness to government to give the United States access to a substantial portion of the Canadian ice cream and yogourt markets in order to reach a settlement. This outraged product manufacturers who were interested in trade liberalization. Manufacturers urged that one of two courses of action be undertaken:

- negotiate a bilateral access agreement whereby both parties would acquire access rights with some relationship to market size; or
- fight the battle at the GATT.

Since the farmers did not wish to see a trade precedent set regarding access, the GATT route was clearly the only politically acceptable course of action. In spite of Canada's best efforts in presenting its case, the GATT panel ruled against Canada's prohibition of imports of ice-cream and yogourt. Canada then chose not to implement the panel ruling pending the outcome of the Uruguay Round.

## **NAFTA (Article 2006) And Tariffs**

This dispute arose because of the expectation that U.S. tariffs would decline relative to GATT tariffs. Canadian tariffs on U.S. dairy products were in fact on a declining path when the Uruguay Round adopted tariffication. Canada then applied the new WTO agreed tariffs to all its trading partners including the United States.

As members of the supply management community, dairy processors found themselves reluctantly drawn into the defence of a tariff structure designed to eliminate any possibility of increasing trade flows. As before, the political imperative was protecting the system inside Canada favoured by the dairy farmers.

Though undertaken reluctantly, there were two main reasons why processors agreed to participate in, and share the high costs of, defending the tariffs. First, under the agreements in force at the time, losing the tariff protection meant lost market because there would have been no opportunity for processors to access additional U.S. market. If tariffs were reduced, the domestic markets would have been opened up to an influx of U.S. product at a time when raw milk prices in the United States were decidedly lower than in Canada.

Second, dairy farmer leadership, being well funded and astute lobbyists, positioned this dispute as an unfettered attack on the family dairy farm in Canada. Politics being what it is, the government, as well as dairy processors, simply had no choice but to step up to the bar.

The NAFTA panel ruled in Canada's favour and the high tariffs continue to protect our domestic system.

## **Outcomes**

As indicated in the Cox and LeRoy (2000) paper, at this stage in the process (December, 1996) Canada had lost one dispute and won one. But did we learn something in the process? And did we make any adjustments?

During the first dispute, dairy processors became convinced that if ice cream and yogurt are not "like products" to milk, and if we experienced a negative outcome (which was confirmed), then we would likely lose other trade

challenges. This would mean that our markets would open up and the domestic supply management system would have to adjust. Processors therefore began to look seriously at their ability to compete in a more price sensitive environment. What they found was a need to rationalize operations, modernize plant base and squeeze costs out of their operations. The mantra became “only those with the sharpest pencils will survive”. A dialogue of similar tone was attempted with the farm leadership but they remained convinced that they needed to make no substantive changes to their current structures and methods.

As a result of this situation, processors began to consolidate facilities and operations. This move was dramatically visible in western Canada but also very active in eastern Canada. These changes included product line rationalizations but more importantly, mergers, amalgamations, and joint ventures on a commodity or product basis, as well as licencing agreements for brand sharing and marketing. All of this occurred in a mature market stilted by low or no growth.

Dairy farmers reacted to these developments with a mixture of bemusement and fear: bemusement because they had always claimed the processor sector was unable to co-operate and, indeed, unable to creatively market product; with fear because now their only customers were growing in scale by buying market share, and were becoming more vocal about their needs, and more critically, the needs of the market and consumers. Resistance to policy driven price increases on the part of processors further exacerbated the growing divide within the industry.

### **Special Classes For Export And Fluid Milk Import Restrictions**

We lost a critical element of the third dispute, which by the way, processors spent hundreds of thousands of dollars defending alongside dairy farmers providing proof there is no escaping the political reality of our domestic supply situation. While we won the right to restrict imports of fluid milk to non commercial purchases, we were obligated to remove the previous ceiling on such imports. It was determined however that our milk classes 5d and 5e were in fact subsidies and a redesign of our export structure is therefore required. Processors, while still supporting supply management for the domestic market, are now clearly pushing for a truly market driven structure for the export busi-

ness including the elimination of the marketing boards monopoly rights on raw milk supply for exports.

## Impacts

**Trade.** The NAFTA impact on dairy cross-border trade was negligible due to the defacto exclusion of dairy by both countries.

**Investments.** There were huge impacts because NAFTA was seen as a precursor of much more open markets and the possible demise of dairy supply management. They showed up as:

- consolidations and plant rationalization;
- adoption of “state of the art,” world-based systems and configurations;
- an influx of management from non-dairy firms;
- an influx of European trained, experienced senior management; and
- significant expansion into the United States by co-operative joint ventures (DFA), and by firms such as Saputo who now do most of their business in the United States.

## Dispute Resolution

**GATT Panel.** This approach has been demonstrated to be cumbersome, have little respect for time lines, and result in enormous slippage from one phase of the process to another. It is very long and drawn out in time, and expensive.

**NAFTA.** There was a major delay initially because of a lack of roster from which to select the five panelists. Overall it is a legalistic, but effective mechanism with little if any ability for political interference once the process begins. However, it is still an expensive process for NGO’s participating directly with the support of trade or legal counsel.

**WTO.** This approach is subject to the same roster considerations as the NAFTA process. Nonetheless, this process functioned as advertized, i.e., the time lines were known and relatively little slippage occurred. There was no evidence of political interference in any way. The WTO dispute Settlement Body preserved its reputation for thoroughness and professionalism. The cost

implications remain very significant and are a major burden for NGO's and certainly would be for developing countries, especially if they did not have "in house" expertise. Most simply do not have that capability.

### **Further Cooperation Between The United States And Canada**

The jury is out - it is taking much too long to resolve the dairy harmonization differences for farm and plant inspections, or equivalency discussions for regulatory and standards issues. Also, there remains the whole, and larger, question of quantitative market access for dairy where each side of the 49th parallel gleefully engages in calling the other protectionist when, truthfully, both are!