Trump and Agri-food Trade

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In a few short months, President Trump appears to have been able to do what years of negotiation and economics research has been unable to do – unite the political left and right in Canada in defence of regional free trade. After nearly 30 years of deepening economic integration between the U.S. and Canadian economies (and later Mexico), it is difficult to conceive of an alternative arrangement. Still, President Trump has asked to renegotiate the North American Free Trade Agreement (NAFTA) – and Canada and Mexico have agreed to his request. The renegotiations are scheduled to begin on 16 August 2017, and the U.S. has tabled its objectives for the talks as required by their legislation. Canada has no such legislative requirement to make its objectives public and most commentators expect the negotiations to be challenging, taking up to a year to complete. Many of the negotiating objectives specified by the U.S. are vague and largely consistent with Canadian wishes. However, some of the specific objectives will require careful negotiation including those focused on agriculture. I will address the agricultural issues with a particular emphasis on our supply managed commodities.

Given the rhetoric coming from Washington, one could be forgiven for thinking that trade relations between Canada and the U.S. are in a sorry state and badly in need of repair. Given the evidence, nothing could be further from the truth. Since 1995, the U.S. has taken six trade disputes against Canada to the World Trade Organization (WTO). All but one of these cases was settled by 2006 and no new cases were initiated between 2006 and 2016. Between 1995 and 2017, Canada has taken 16 disputes against the U.S. to the WTO. Five of these disputes concerned agricultural products and six dealt with softwood lumber. Since 2006, only three new cases have been initiated. For two countries with a combined annual cross border trade of C$673 billion, trade relations seem to have been – dare I say it – dull for a decade. Given that NAFTA is going to be renegotiated, what are the concerns? First, no one is arguing that jobs are leaving the U.S. for Mexico. In agriculture, wheat, poultry, red meat, wine and dairy trade have been mentioned in media reports as points of concern by the U.S. However, no specific agricultural commodities are mentioned in the U.S. negotiating document. For Canada, our goals will be focused on deepening the integration agreement with better rules and border measures. Although the U.S. does not explicitly mention our supply managed sectors (dairy, poultry and eggs), these were the commodities largely exempted from liberalization in the CUSTA/NAFTA negotiations. Clearly, the U.S. stated objective in agriculture: “to expand competitive market opportunities...” is targeted at our supply managed commodities. For political and economic reasons, the dairy industry will be the most challenging for Canadian negotiators.

**Dairy Trade**

Canadian milk production is strictly regulated through our supply management system that consists of three key “pillars”: 1) producers receive administered prices; 2) output is tightly controlled through production controls; and 3) domestic prices are protected through high import tariffs. Does the renegotiation of NAFTA mean the end of supply management in Canada? Definitely not, but it might further strain the regime. Concerns about Canadian dairy policy have been raised by a small group of milk producers in Wisconsin who claim they lost a $150 million market for ultra-filtered milk in Canada. President Trump won the traditionally democratic state of Wisconsin by just over 20,000 votes in 2016 and Speaker of the House Paul Ryan is from the state – so the voices of a few Wisconsin dairy farmers will certainly be heard.

The issues surrounding dairy trade in a renegotiated NAFTA are a complex mix of market realities, trade rules and politics. **Market Realities** – Fluid milk is processed and sold as it comes from the cow, but the standard 3.6% fat whole milk now sits on the shelf with 2%, 1% and many other variations of fluid milk and milk substitutes. Raw milk is mostly water but contains fat and high protein non-fat components that are mixed in various proportions to make butter, cheese, yogurt, ice cream and skim milk powder. As a result, it is possible to simultaneously have a surplus of one milk component and a shortage of another. An attempt is made to balance the supply and demand for components by charging different prices for raw milk depending on its end use. In recent years, Canada has typically had a shortage of fat and a surplus of non-fat milk components. The excess non-fat is usually exported, using export subsidies, as skim milk powder, or sold domestically as animal feed as a part of our dairy policy.

Enter ultra-filtered milk – a new product consisting of high protein milk components that can be used as ingredients in making cheese and yogurt. Because ultra-filtered milk did not exist when NAFTA
and the most recent WTO agreements were signed, ultra-filtered milk imports are not subject to Canada’s high tariffs on “traditional” dairy products. Canadian dairy processors began importing ultra-filtered milk displacing domestic milk and exacerbating the surplus of non-fat. To combat this problem, Canada created a new milk class (Class 7) allowing domestic processors to buy milk at a much lower price if they made ultra-filtered milk to replace the product being imported from the U.S.6 Processors complied and the market for ultra-filtered milk from the U.S. declined, much to the chagrin of the Wisconsin dairy farmers and processors who lost sales. This provides the setting for the dairy trade negotiations in the renewed NAFTA negotiations.

**Trade Rules** – It is important to understand that the U.S. argument is not with supply management but with its lost sales and limited access to our dairy market. Canada’s trade and domestic policies are currently WTO and NAFTA compliant but challenges lie ahead. In 2020, Canada will no longer be able to subsidize exports are currently WTO and NAFTA compliant but challenges lie ahead. In 2020, Canada will no longer be able to subsidize exports. In either case, the quid pro quo could be an agreement not to challenge Class 7 dairy products at the WTO or in NAFTA – whether sold domestically or exported. However, this type of a managed trade agreement would continue the practice of giving up a part of our domestic dairy market to exporters in exchange for maintaining supply management as was the case in the Canada-EU negotiations. Instead, reform of the supply management system could begin to move it away from a regime so dependent on border measures and, in the case of dairy, a relatively stagnant domestic market.

**Reform.** There are many domestic reasons to begin the reform of our supply management regime and, starting the process now rather than waiting until international pressure makes it mandatory, seems wise. The reasons and options for reform are well documented by Barichello, Cranfield and Meilke as well as in early analysis by the Food Prices Review Board in the 1970s and the Economic Council of Canada in the 1980s. Currently, milk quota transfer rules in Ontario and Quebec make it nearly impossible to enter the industry, expand existing dairy farms or to change the location of milk production. The industry desperately needs the opportunity to consolidate and move milk production from its current location and into the hands of its most efficient producers. In this way, it will be better positioned to meet additional foreign competition.

**Conclusion**

The NAFTA renegotiations provide an opportunity to modify the original agreement in ways that benefit all three signatories. The renegotiations are likely to set the rules that will govern regional trade for the next 15 to 20 years. It is essential that we get them right. This might require difficult changes in our domestic and border policies that will none-the-less serve us well in the future. Now is not the time to be timid and defensive. As has often been said, a good offense is the best defence and a carefully crafted list of “asks” will be essential to success. An efficacious outcome is crucial to our continued economic growth and wellbeing. Is a borderless customs union twenty years hence a goal worth striving for?

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6 There is no definition of Class 7 milk on the Canadian Dairy Commission’s website, but Dairy Farmers of Ontario provide a definition for their Class 6 milk, which is believed to be the same or similar to the federal Class 7. Ontario Class 6 milk is:

“Milk used to process skim milk components or condensed skim milk components, wet or dry, into an ingredient to be used in processed milk products. For example, skim milk powder, milk protein concentrate, or ultra-filtered milk.”

7 Meilke, K. D. 2016. Agricultural Export Subsidies: RIP.


9 Huff, K. M., K. D. Meilke, R. D. Knutson, R. F. Ochoa and J. Rude, eds. 2007. Achieving NAFTA Plus; Meilke, K., J. Rude and S. Zahnisser discuss ways to improve the NAFTA in considerable detail. In the dairy sector, Canada has three intertwined options: 1) hold the fort; 2) give and take; and 3) reform.


14 A customs union is a trade bloc composed of a free trade area with a common external tariff.