Musings on U.S. Dairy Trade with Canada and Mexico

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May 2017

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Outline

- What is the historical context for GATT and NAFTA as trade agreements?
- What did we expect to be the outcomes or benefits?
- What have been the general outcomes since NAFTA (and Uruguay Round)?
- How do we evaluate the success of a trade agreement?
- What does better look like?

In the beginning

Sometimes policy choices are about what they seem to be on the surface, and sometime not.

Was the cheese tariff about protecting our fledgling dairy industry, or

Was it to poke a stick in England's eye

1598

Juan de Onate brings dairy cattle from Mexico to his fledgling colony in what will become New Mexico

1611

Sir Thomas Dale brings 100 dairy cattle to Jamestown

1789

George Washington is inaugurated

1790

A 4¢/lb. tariff is levied on cheese imports, the U.S. is exporting butter and cheese

Subsidizing Exports is a Big Instinct

- Agriculture was called on to increase production for World War I
- After the war,
  - the farm economy became depressed
  - Cooperative bargaining became less effective as non-cooperative firms learned new ways to bargain with farmers and many coops over reached their grasp.
  - **Packers and Stockyards Act of 1921** protects ranchers from "unscrupulous practices" of meat packers. **Capper-Volstead of 1922** seeks to bolster cooperative marketing
  - McNary-Haugen bills, vetoed twice by President Coolidge in mid to late 1920s, sought to stimulate exports by having a federal agency buy surplus products for export sale at reduced prices
- The stage was set for government regulation but the form it took was problematic and things had to get a bit worse before we were ready to do it. The Great Depression made it "worse" enough
- If you can't increase exports then decrease imports, I guess

The Milk Price Support Program leads to Dairy Import Quotas

- Early experience with DPSP "teaches" us
  - Be careful about sellback
  - We want to enhance prices, not stabilize them
- Dairy import quotas - Strict quotas are implemented via Trade Agreements Extension Act of 1951 with original authority from Section 22 of AAA of 1933. Recognizes we could not risk supporting world prices
- Quotas terminated by the Uruguay Round General Agreement on Tariffs and Trade
- Tariffs: WTO allows for minimum market access and restrictive tariffs on amounts above that level.

- *1930 to 1941 to 1945*
  - *We began using public funds to purchase surplus butter for food relief and school feeding programs*
  - *This ramped up during the War, with a parity based price supporting strategy*
- *1949*
  - *Following the post-WWII slump in exports and rise in costs, Congress made a Milk Price Support Program permanent in 1949*
- *1950*
  - *Support program revenues exceed costs for the first and only time.*
- *1951*
  - *Strict dairy import quotas are established with Secretarial authority to suspend them*

1953-54
  - *USDA net removals hit a record 11.3 billion pounds (milk equivalent), net expenditures soar to $474 million.* Secretary drops support back to 75% of parity (a big cut) and markets adjust fairly quickly over the rest of the decade.

Gains from Trade

- In more popular thought, we seem to assume that the beneficiary of an exchange is the person who ends up with the cash (the seller)
- By this thinking, exports are good, imports are bad, and an economy is best off when it is a net exporter.
- From this, we get policies to protect domestic industries by limiting imports and/or subsidizing exports.
- This is a very "mercantilist" view of trade that denies the gains from trade experienced by consumers who get to buy goods and services at a lower price.

Why Trade – Competitive Advantage

Adam Smith (late 1700s)

- an exchange occurs when the buyer wants a good more than he wants currency and the seller wants currency more than he wants the good. (This is why polite shopkeepers and customers both say "thank you".)
- In the case of trade between countries (I.e., buyers and sellers located in different political divisions), one way to explain trade is simply by looking at price differences.

If the price of milk in WI is $12 per cwt., then any NY processor willing to pay more than $15.50 (the WI price plus the $3.50 it will cost for transportation) will receive milk. If the NY price is less than $15.50 then no trading will take place- those are the barriers that the laws of economics place on trade within or between countries.

Mark Stephenson, 1994

But, why does this situation/opportunity exist?

- Different Factor endowments
  - The amount of labor, capital, or land available in a country (large country vs small country)
  - The relative amounts of each (labor rich vs land rich, etc.)
- Different Technical efficiency
  - Shape of the production possibility frontier or meta-production function
  - Factor intensity
  - Factor productivity

Why Trade – Comparative Advantage

The Theory of Comparative Advantage asserts that:

- every country (producer) has something in which it has a relative or comparative advantage, something it does relatively better – based on factor efficiency and endowments
- The advantage is not necessarily evident or expressed in terms of monetary cost of production, per se

Sellers gain from the sale, but buyers also gain from the purchase. The gains are measured in terms of our collective ability to grow the economic pie.

Origins of WTO – The GATT

- General Agreement on Tariffs and Trade (GATT)
  - Established in 1947 as a forum to reduce trade barriers
  - GATT was more a political decision than an economic decision
- Negotiations take place in "rounds"
  - Revisited about every 7 years
  - Begins with an agreement among members on agenda
  - There have been 9 to date, with each new treaty referred to by a distinguishing name, usually related to location of first meeting
    - Geneva (1948), Annecy (1949), Torquay (1951), Geneva (1956), Dillon (1962), Kennedy (1967), Tokyo (1979), Uruguay (1994), Doha (aborted)
  - Kennedy Round – should we talk about Ag? No! (cf. Canada)
  - Tokyo Round – let's talk about Ag! Ok, just a little, but not dairy
  - Uruguay Round– get over it, we are doing dairy!
- WTO replaced GATT Secretariat in 1995 as legal and institutional foundation of multilateral trade relations
  - Designed to strengthen the trade rules by providing a stronger set of institutions for resolving disputes and enforcing agreements

Preferential Trade Agreements – GATT lite

- FTAs/PTAs are Bilateral or Regional Trade Agreements intended to reduce or eliminate trade barriers among signatories, consistent with but simpler than GATT. Hope to leverage preferential treatment – get to the head of the line – within GATT framework
- PTAs GATT/WTO legal if they eliminate trade barriers completely or move in that direction
- US agreements include:
  - NAFTA and CAFTA
  - Australia, Bahrain, Canada, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Israel, Jordan, Korea, Mexico, Morocco, Nicaragua, Oman, Panama, Peru, Singapore

North America Free Trade Agreement NAFTA

Really 3 Separate Trade Agreements

- Canada – US Trade Agreement (CUSTA) effective in 1989
- Canada – Mexico Trade Agreement effective in 1993
- US – Mexico Trade Agreement effective in 1994
- NAFTA was considered a combined agreement in 1993

NAFTA Challenges
(really all trade agreements)

Overall provision that has caused conflict involves the ability of the three countries to maintain their own domestic subsidies in the setting of freer trade – reductions in tariffs.

- If free trade is to exist there must be harmonization of policies.
  - Farm subsidies
  - Market information
  - Grades and standards
  - Infrastructure
  - Plant and animal protection

NAFTA Dispute Procedures

Basic method for dispute settlement involves the establishment of Panels which act as "judges" of who did what to whom (legal rights and obligations)

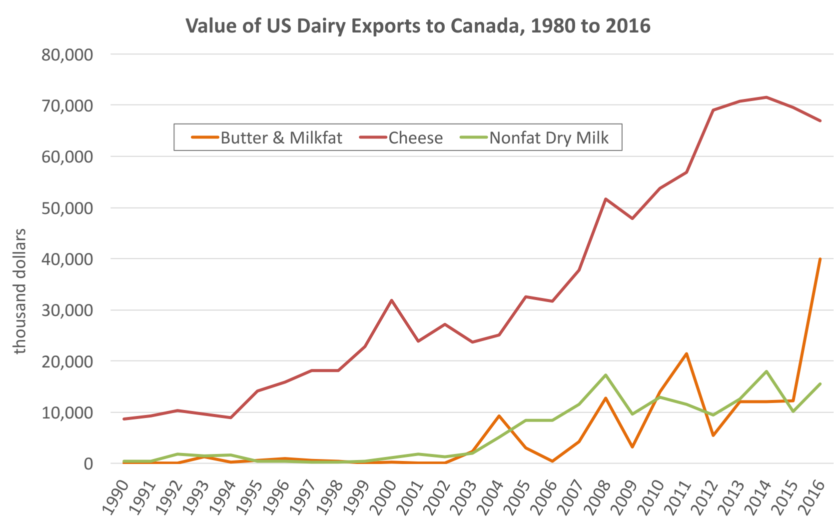
- Members of these panels include:
  - 2 members chosen by one country
  - 2 members chosen by the other country
  - 1 mutually agreed upon chair
- Original agreements had a provision for continuing discussion to eliminate domestic program issues but no Secretariat was established (comparable to EU Commission) to continue to process of negotiation

Canadian Trade Agreement

CUSTA

- Tariffs on most commodities phased out over 5-10 year period with following important exceptions being Tariff Rate Quotas (TRQ) on:
  - Poultry: Canadian Poultry Board
  - Dairy: Canadian Dairy Board and US price supports
  - Sugar: US price supports
- A TRQ allows a certain amount of imports at a lower tariff (sometimes zero) with impacts above the quota assessed a higher tariff. Example the TRQ in Canada for cheese is 245% of the price at 20,412 MT. For the US it is 58% at 134,995 MT.

What Really Happened – Canada
in particular cheese (cf. MPI controversy)



Primary Concern in Canada is Producer Prices

Using the average net milk price at the farm for Quebec and New York in May 1995 and the predicted changes from the base simulation to the two trade scenarios, a price effect can be estimated.

In Quebec, dairy farmers received an average of $16.00 per cwt in May 1995. After simulation I, milk price would have been reduced to $13.25 and further reduced to $12.25 with the implementation of free trade conditions.

New York dairy farmers received an average of $12.75 per cwt in May 1995. Simulation I results in a slight increase to $13.00 and, under free trade conditions, average price in New York for raw milk at the farm would rise to $14.50.

These price effects should be viewed as the first step in a price adjustment process following a shock to the market structure. The final equilibrium should imply a smaller price decrease for Quebec, and a smaller price increase for New York.

Maurice Doyon, 1997

Mexican Trade Agreement

US – Mexico Trade Agreement

- NAFTA provisions affecting the U.S.- Mexico trade in dairy products fall into three major categories: market access, sanitary and phytosanitary standards and rules of origin.
  - Convert all trade barriers to tariffs (Mexico had extensive licensing of imports) and then reduce to zero over 5-15 years.
  - Mexico gets a longer time to open markets

    Last part coming in 2008 (Mexico hoped to delay more)

USDA FAS Ag. Attache Report, Sept. 1993

US exports to Mexico have expanded 28% per year from $1.1 billion in 1987 to $3.7 billion in 1992. The North American Free Trade Agreement (NAFTA), if implemented, will boost them further.

US dairy products have excellent potential in Mexico.

- US exports of all products totaled $160 million in 1992, growing at 30% per year.
- Opportunities are excellent for cheese, yogurt and ice cream. US faces tough competition on NDM.s
- NAFTA would eventually open the market much wider for all dairy products.

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Gains from Trade – Mexico Style

Mexico has a rapidly growing population, and other provisions of the NAFTA are expected to have a positive impact on per capita income levels in Mexico in the long run. There is a tremendous demand for dry milk for beverage purposes in the two-thirds of Mexico's population that is poor and an export opportunity for Mexican style cheeses in the rest of the population. <u>On balance, NAFTA will be a plus for the U.S. dairy industry</u>.

Mark Stephenson, 1993

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Gains from Trade – The MX Perspective

Using a sophisticated model of US and Mexican dairy markets and based on changes due to NAFTA and GATT:

Mexican producer prices are predicted to be as low as 50% of their 1992 levels, whereas retailer prices fall some 10 to 25%. Dairy processing in Mexico is predicted to increase under trade liberalization, due to the greater availability of dairy components.

As expected, trade liberalization is predicted to increase imports of milk powders previously subject to import controls, but imports of final products are less under NAFTA and GATT than under 1992 policies. Thus, Mexican dairy processing companies and consumers appear to benefit from dairy trade liberalization, but Mexican dairy producers will face additional competitive challenges in the future.

Charles Nicholson, 1994

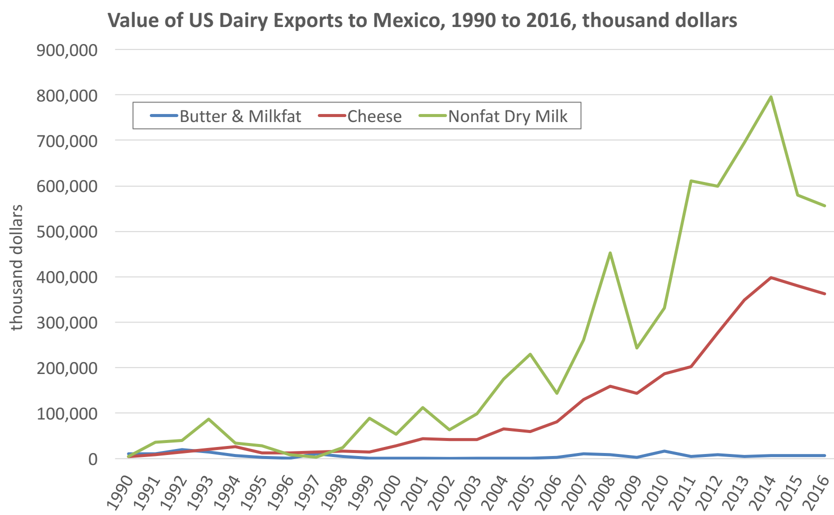
Gains from Trade Deniers/Realists

James Cranney (PSU), 1992: Tough on MX producers, good for MX consumers. "<u>Substantial opportunities</u> exist for U.S. exports of nonfat dry milk, butter and to a limited degree, fresh fluid milk. " But, US will have to be prepared to <u>match low international prices and use export subsidies.</u>

William Dobson (UW), 1994: Mexico will have <u>minimal affect</u> on US dairy sector, with complications arising from difficult transportation, lack of US marketing acumen, tough foreign competition, and better options in the US.

Tom Cox et al. (UW), 1994: the more likeLy NAFTA and STATUS QUO scenarios generate <u>very modest impacts</u> on aggregate and regionaL U.S. dairy markets. This is mainly due to the fact that while the NAFTA may potentially generate large impacts on U.S.-Mexico dairy trade, these changes in U.S. exports are likely to remain a relatively small portion of U.S. total milk supply.

What really happened - Mexico



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More to it than just dairy foods

NAFTA, which came into force in January 1994, also represented a significant break with previous policies. Although it provides US dairy producers and companies with greater access to Mexican markets, it will also allow Mexican dairy producers (especially in the specialized system) to purchase imported inputs more cheaply. Thus, <u>NAFTA will provide both incentives and disincentives to dairy production in Mexico</u>.

Charles Nicholson, 1994

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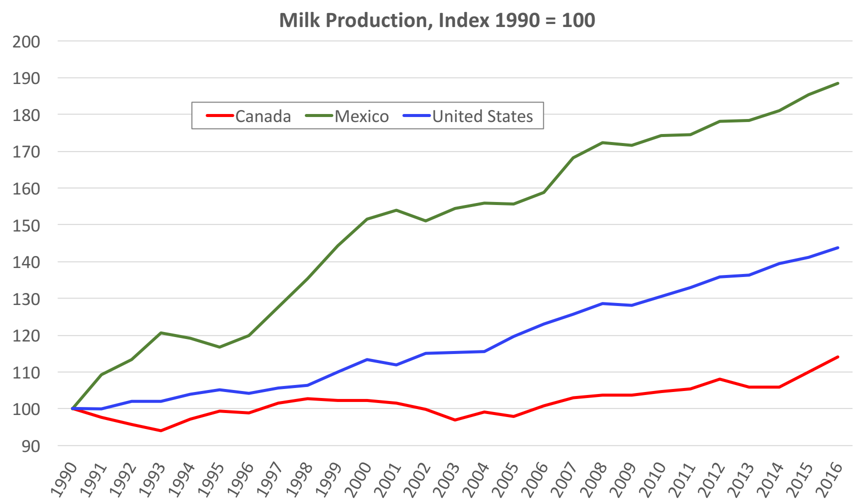
Mexico has grown more than the US, Canada barely at all until recently



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A host of factors that go beyond who has the cheapest powder.

Competition unleashed by trade and investment liberalization under NAFTA will have the greatest impact on Mexico's dairy marketing subsector in the next decade.

Tariff reductions and liberalization of the trucking industry promise greater availability of imported dairy products in Mexico at lower prices.

Reform of investment regulations, and the strapped-for-capital condition of Mexico's dairy cooperatives, portend greater direct investment in dairy processing by foreign firms.

As domestic dairy companies continue to shake off the legacy of price controls, competition based on product quality will take on greater importance.

Post NAFTA, Mexico increased the ”enforcement” of SPS regulations – “quality” as a barrier to trade.

Charles Nicholson, 1994

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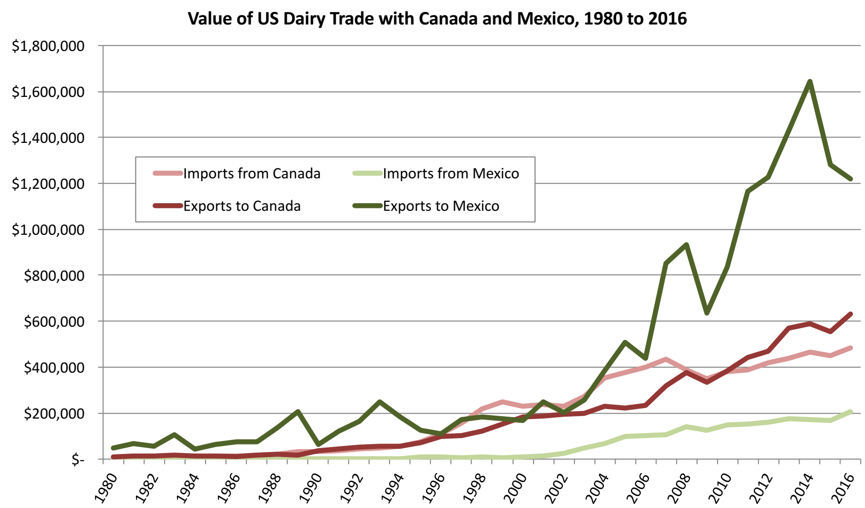
What Really Happened



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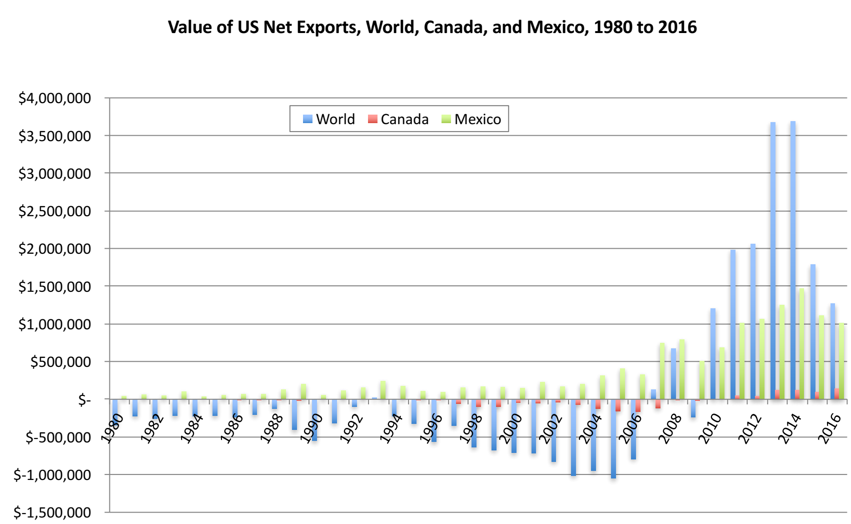
Net Trade in Dairy Products



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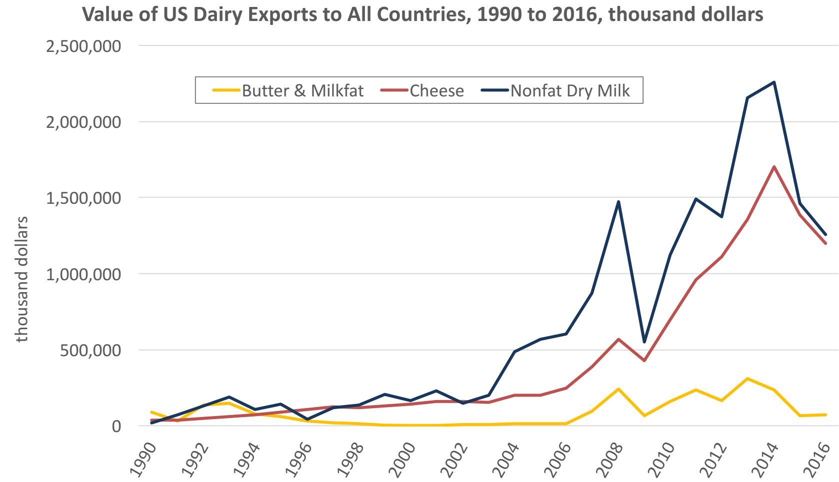
Experience with Mexico, to a lesser degree Canada, mirrors our experience with other countries



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Minimum Classified Pricing

The Federal Milk Marketing Order program may be unable to maintain significant class I prices and producer revenues if free trade in milk and dairy products becomes a reality in North America. Moreover, the adverse affects will be concentrated in specific regions. Both state and federal orders in these regions will be impacted.

As milk is diverted from these areas to fluid processing plants in Canada and Mexico, the disorderly conditions that federal orders sought to, and indeed did, alleviate may well begin to reappear.

Key to this conclusion is the requirement that Canada reform its own pricing system to exploit this potential. If they fail to do so, the tables could be turned.

Phil Bishop, 1997

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Factor Price Equalization

The free trade simulation results suggest average world market farm prices near current U.S. levels,

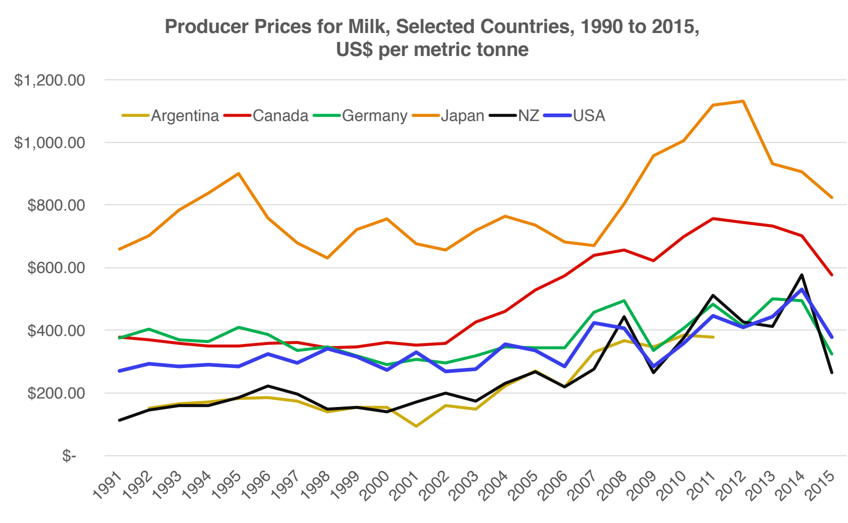
Farm milk prices in Western Europe, Japan, Canada, and South America are simulated to fall l7%, 53%,24% and 10%, respectively.

In contrast, Eastern Europe, Australian and New Zealand farm milk prices are simulated to rise 140%,43% and

105%, respectively.

Cox and Zhu, 1997

Yup, FPE happens



Dairy trade protectionism begins to unravel, and then ravel back up again.

Passage of WTO under Uruguay Round of GATT (1984-94) begins to seriously open US markets to new imports. Opportunities exist for exports, but these remain limited by continuing, albeit reduced, EU subsidies for dairy exports. Trade issues become increasingly troublesome for dairy, but with little sympathy outside the industry.

Doha Round (starting in 2001) hopes for more of the same, but becomes fatally stuck under protests by displaced laborers, environmentalists, and developing countries that want greater ag trade liberalization by US and EU and also less "trade distorting" domestic programs

Trump era ushers in a new protectionist instinct in hopes of rebuilding jobs from the old economy, as opposed to the new economy

Has Trade Liberalization been a success?

- By what criteria?
  - Expansion of the economic pie
  - Growth in low income countries
  - Food security
  - Inspired innovation and entrepreneurship
  - Reduced international tensions
- What needs improving?
  - Alternatives for displaced workers
  - Opportunities for those who seem to have no opportunities

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