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In protecting agriculture, we sacrifice other trade gains

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Exploiting technology and classification loopholes, U.S. exporters are destabilizing Canada's insulated system

Imagine a drafty old house: Patch one hole and the cold soon finds another way in.

Canada's protected dairy, chicken and egg sectors are in a similar predicament. In theory, they are insulated from global trade. Prohibitive tariffs lock out most imports. Trade rules make exports almost impossible. Inside the walls, prices and production are fixed.

But the agrifood industry has become much more complex than it was when supply management was introduced in the 1970s. And it has gone global.

Canada's tariff wall, and the resulting price differential, creates huge financial incentives to get cheaper foreign product into the country. Wholesale dairy prices, for example, are typically 30-per-cent lower outside Canada.

It's a system ripe for arbitrage. Exploiting technology and clever loopholes, Canada's food industry is now importing massive amounts of chicken and dairy products, destabilizing the system and angering farmers.

These imports represent lost sales worth hundreds of millions of dollars a year at the retail level.

The federal government plugged one hole in November – abruptly warning of an imminent reclassification of imported pizza kits containing shredded mozzarella and sliced pepperoni as "cheese" rather than duty-free "food preparation." Canada now hits the kits with the normal 245.5-per-cent tariff on imported cheese, effectively shutting down the trade.

But there are many more gaps. Imports of U.S. ultrafiltered milk soared to as much as $100-million in 2013 from almost nil four years ago. This 85-per-cent protein liquid concentrate is used to make cheese, and it enters Canada duty-free from the United States, unlike pure milk or less-concentrated protein.

Suspicious that not all of these imports are legitimate duty-free concentrates, the Dairy Farmers of Canada have asked the Canadian Food Inspection Agency to test and audit shipments.

Technology has made the job of stopping imports much more difficult. Milk isn't just milk any more. It's filtered, synthesized and broken into its numerous components, including lactose, milk fat, proteins, vitamins, minerals and water. Then it is shipped around the world and reconstituted into cheese, yogurt, energy drinks and countless other products.

Moves by Canada to shore up supply management's protective wall are already sparking tensions with the United States. The office of the U.S. Trade Representative (USTR) recently complained to Canadian officials about the pizza-kit crackdown. J. Cheese Inc., which was selling kits to Pizza Pizza Ltd., is threatening legal

action, warning in a recent letter to the Canada Border Services Agency (CBSA) that the reclassification amounts to an expropriation of its business.

Meanwhile, more than a dozen members of the U.S. Congress from dairy-producing states New York and Wisconsin are calling on the Obama administration to respond to multiple apparent trade violations by Canada.

"It is our hope that USTR will be evaluating the full range of options for how to deal with any negative impacts to these U.S. exports, including examining their legal compliance with Canada's [World Trade Organization] and [North American free-trade agreement] obligations," the members said in a letter this month to U.S. Trade Representative Michael Froman and Agriculture Secretary Thomas Vilsack.

Canadian chicken farmers, meanwhile, are in a nasty fight with the United States about imports of so-called "spent fowl" (former egg-laying chickens). Under current trade rules, such chickens enter Canada duty-free, instead of the normal 238-per-cent tariff. The Chicken Farmers of Canada says spent-fowl imports are up more than 50 per cent in the past three years. Those imports displaced as much as 10 per cent of Canadian production last year, representing about $600-million in lost sales.

Huge volumes of normal broiler chicken are illegally entering Canada from the United States "under the guise" of spent fowl to escape the duty, according to the chicken lobby. Prodded by farmers, the CBSA recently made it more difficult to mix different types of chicken at the border to get in duty-free.

In normal circumstances, such trade tensions might be an after thought. But Canada is in the midst of trade negotiations with 11 countries in the Trans-Pacific Partnership, and agricultural issues are front and centre.

Canadian negotiators could find themselves fighting a rear-guard action to protect supply management in the face of complaints from other major agricultural exporters at the TPP table, including the United States, Australia and New Zealand.

Efforts to shore up the drafty house could put a chill on Ottawa's ability to make vast trade gains for other sectors of the economy.

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