THE
CANADIAN
INTERNATIONAL
TRADE TRIBUNAL

CANADA

# AN INQUIRY INTO THE ALLOCATION OF IMPORT QUOTAS

October 1992

REFERENCE NO. GC-91-001

# AN INQUIRY INTO THE ALLOCATION OF IMPORT QUOTAS

**Canadian International Trade Tribunal**

The Canadian International Trade Tribunal is an independent quasi-judicial body which reports to Parliament through the Minister of Finance. It was established on December 31, 1988, by the *Canadian International Trade Tribunal Act*. The Tribunal hears appeals from rulings by Revenue Canada on customs, excise and sales tax matters. The Tribunal makes findings on whether or not imported goods, which have been found to be dumped or subsidized, are injuring Canadian production of such goods. It also conducts import safeguard inquiries at the request of the government or domestic producers. Finally, the Tribunal acts almost as a standing commission of inquiry with powers to conduct research, hold public hearings and report on a broad range of matters relating to the economic, trade, tariff or commercial interests of Canada.

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## FOREWORD

Import quotas are an important feature of the complex and often charged international environment in which the Canadian dairy and poultry industries operate. Despite the small share of the market typically accounted for by imports in the supply managed sectors, the allocation of import quotas can seriously affect the competitive position and supply relationships of these industries. They can also affect the variety of products available to Canadian consumers.

This inquiry was undertaken as a result of a request by the Governor in Council that the Canadian International Trade Tribunal provide recommendations on optimum methods to allocate import quotas. The government's request arose, in part, from recommendations made by the National Poultry Task Force and the National Dairy Task Force to examine this question.

Import quotas are valuable, and decisions about who should hold them are difficult and divisive. On one side are those whose businesses are based on the ability to import controlled products. On the other side are those who believe that they have been denied advantages that their quota-holding competitors possess. The small number of import quotas available in most cases makes it impossible to satisfy the needs of both. Overshadowing this dilemma is the reality that participants in these industries already face the challenge of operating within a supply managed environment that provides them with limited control over volumes and prices.

We have concluded that, for most of the products which we examined, access to import quotas should be open to all industry participants through auctions. This would avoid entrenching the privilege of importing controlled products to a select few on a long-term basis or the necessity of making frequent decisions on who is best entitled to hold the quota. Auctions can be organized and timed to ensure reasonable market stability and still allow the entry of new participants.

We consider, however, that auctions would not be appropriate in every circumstance. For those imports that represent a substantial share of the Canadian market and serve as an important input to a further processing industry in Canada, which is the case for chicken, turkey and broiler hatching eggs and chicks, we recommend that quotas be allocated to the processors of the imports in proportion to the size of their operation.

We would like to thank the dozens of producers, processors and distributors that showed us their plants, completed our questionnaires, prepared submissions and participated so actively in our public hearings. Through them, we learned how imports are used, how food products are manufactured and how markets operate in the complex industries in which they function. We also benefited greatly from very thorough submissions made by industry associations.

We began this inquiry believing that there would be no easy answers to the questions posed. At the close of our work, this original view remains unshaken. However, this intensive and hard-fought inquiry has allowed us to examine the issues from all angles and develop a good understanding of them. The result, we believe, is a set of recommendations that fully satisfies the requirements of our terms of reference and also acknowledges the complexity of the industries and import quota regimes involved.

We also owe a great deal of thanks to our staff for their dedication and fine work. It was a pleasure for all of us to work on this important and challenging inquiry.

Kathleen E. Macmillan
Presiding Member

Arthur B. Trudeau
Member

Sidney A. Fraleigh
Member

## 1. Introduction

Over the past 20 years, the government has implemented supply management schemes for many agricultural products, beginning with certain dairy products in the late 1960s and ending, in 1988, with production controls on broiler hatching eggs and chicks. Protection of the Canadian market from import competition is critical to the operation of such regimes. There are currently 18 agricultural or food products on the Import Control List (ICL), 10 of which have global quotas established to allow limited volumes of imports. Imports for products on the ICL for which import quotas have been set are restricted either to a certain fixed volume, such as for cheese and buttermilk, or to a set percentage of the Canadian market, such as for chicken and turkey.

Whenever products were placed on the ICL and subjected to quantitative control, the government had to decide who should be allocated a share of the global import quota. Generally, the government allocated quotas to firms that had imported in the years immediately before controls were instituted, in proportion to their involvement in the import market. For a product such as cheese, this continues, many years later, to be the sole basis for allocating import quotas. Consequently, import quotas remain largely in the hands of historical importers or firms that have acquired original quota holding firms.

On balance, the value of import quota holdings has tended to grow over time, reflecting the widening divergence between foreign and Canadian prices for controlled products. An import quota is a highly prized commodity, providing the holder with an opportunity to expand its product line, increase its market share, lower its costs and improve its profits. In all but a few cases, the demand for import quotas greatly exceeds the amount available for distribution. This is reflected in very long waiting lists for available quotas, high acquisition costs for quota holding firms that possess few other assets and a lucrative "rental" market for import quotas.

Seeing the competitive advantages of holding an import quota, some industry participants began to argue for an alternative method of quota allocation that would offer them the possibility of obtaining these benefits. Why, they asked, should these privileges go, at no cost, to the same group year after year? Quota holders, for their part, maintained that they rightfully deserved their holdings in recognition of the growth that they had forfeited because of import controls and of their continuing efforts to develop the market. On a number of occasions, the government has worked with industry groups to develop a consensus on how best to allocate import quotas. These efforts have generally met with limited success. As a result, and following the recommendations made by industry task forces, the government decided to have the issue examined by the Canadian International Trade Tribunal (the Tribunal).

The question is a difficult one indeed since, like any debate about how best to distribute a scarce commodity, the feelings of the "haves" and "have nots" run deep. There is, we quickly discovered, no way to please all participants. Moreover, the issue involves considerably more than simple questions of fairness. Those sectors heavily dependent on supply managed inputs face special problems of competitiveness and market efficiency. Any decisions about import quota allocation would have to recognize the complex interrelationships that have developed to accommodate the domestic production sector.

## 2. Our Terms of Reference

The Tribunal's approach in addressing the question of import quota allocation was dictated entirely by the Governor in Council's terms of reference. On August 13, 1991, the government directed us to:

> *undertake forthwith an inquiry into current methods of import quota allocation for agricultural products and alternatives thereto for the purpose of providing recommendations on the optimum method or methods to allocate import quota on a national basis for agricultural products currently subject to import controls with respect to the factors of equity, predictability, economic efficiency, transparency, entry to the industry, market responsiveness and competitiveness.*

In interpreting the terms of reference, we noted that the Governor in Council's interest was in an "optimum method or methods to allocate import quota." The request was not that the Tribunal assess the current regimes to justify if changes were warranted. The terms of reference set out seven factors against which the current methods and alternatives should be considered. All related to the features of an import quota allocation method in an "up and running" state, not to the possible trade-offs or disruptions that might result from change. In short, the Governor in Council's desire, as expressed in the terms of reference, was for the Tribunal to provide advice on the <u>ideal</u> or <u>best</u> method for allocating import quotas, but one that was also sensible and practicable and that recognized business realities.

This view very much colours our recommendations. Our presumption was that the government would not have framed its request in the way that it did if it were not prepared to accept the possibility of change to existing methods of import quota allocation. In posing the question as it did, the government left for itself decisions about how any changes might be accomplished and how they might be coordinated with other developments, such as those arising from international trade.

Clearly, our determinations were not to be made in a vacuum. We were directed to hold public hearings and receive the views of all interested parties, from the producer through to the consumer. This we did in abundance. A total of 108 groups and individuals registered as participants in this inquiry. We received 151 submissions and witness statements and held 23 days of public hearings. As a result of the enthusiasm, commitment and patience of these participants, we learned about the operation of the Canadian dairy and poultry sectors and the strengths and weaknesses of the existing import quota allocation methods. Their knowledge and advice were reflected in the reports prepared by Tribunal staff, which were extensively reviewed and well received by industry participants. Accordingly, we are confident that our recommendations display a genuine appreciation of the industries at issue in this inquiry.

We were aware in framing our advice that our inquiry was not established for the purpose of arriving at a consensus among industry players on an optimum import quota allocation method. In fact, had we restricted our attention solely to the views of participants at our public hearings, we would have concluded that the overwhelming consensus was that the current import quota allocation methods should not be changed, only fine tuned. The message of importer organizations and processor groups, which were well represented at our hearings, was very clear in that respect. However, we did not view this inquiry as a head-count of the "nays" and "yeas." This kind of weighing of opinions is not in the nature of economic inquiries. Rather, we were cognizant of the government's directive to consider both current and alternative import quota allocation methods against the same set of factors and to recommend "optimum methods."

One important factor that the terms of reference asked us to take into account in making our recommendations was Canada's international rights and obligations. Many counsel and parties argued that we could be truly safe only with the current import quota allocation methods and pointed to the many pitfalls of alternative allocation methods, particularly auctions. In the end, we disagreed, for the reasons set out in Chapter II of this report.

Finally, in considering the possibility of change to existing import quota allocation methods, we kept in mind the supply managed framework within which the affected industries operate. Conscious as we always were of the regulatory environment, we saw nothing in the terms of reference to lead us to conclude that we were constrained to the various existing mechanisms by which federal and provincial supply management agencies allocate marketing or production quotas.

## 3. The Seven Assessment Factors

We spent considerable time during our public hearings discussing the definitions put forward by Tribunal staff and interested parties of the seven factors set out in the terms of reference. We also devoted great attention to parties' views on the relative importance of each of the factors in our assessments of current and alternative import quota allocation methods. We concluded that some factors stand out as especially important, while others are of limited application, and that it would be necessary to make some trade-offs between certain factors (e.g. equity versus competitiveness and economic efficiency) in arriving at an optimum import quota allocation method. Finally, we decided that the exact weighting of the factors depends critically on the import product under consideration.

The first factor identified in the terms of reference is equity. Interested parties had vastly different ideas about the meaning of the term. This suggested to us that equity, like beauty, is very much in the eye of the beholder. In our view, equity means fairness. We saw an equitable import quota allocation method as one in which all participants have equal opportunity to directly acquire an import quota. An equitable method does not discriminate in favour of or against particular trade levels.

The second factor cited in the terms of reference, and the one usually given the most weight by interested parties, is predictability. We viewed a predictable import quota allocation method as one that allows a firm to accurately forecast whether it will be successful in obtaining an import quota through direct allocations and, if so, the cost, amount and terms of the allocation.

We interpreted economic efficiency as referring to the ease with which import quotas find their way to those industry participants that value them the most, thereby minimizing the transaction costs associated with quotas passing through many hands. An economically efficient method is also administratively straightforward, from the point of view of both the quota holder and the government.

In our view, a transparent import quota allocation method has simple, straightforward decision-making criteria and processes that are clearly communicated to all industry participants. A transparent method would also involve little or no discretion on the part of its administrators. Finally, a fully transparent method would include a formal appeal process and would publicize not only the names of import quota holders but also the amounts of the quota that they hold.

In our opinion, the entry to the industry factor overlapped somewhat with equity. We believe that an import quota allocation method that provides for new entrants would significantly enhance both these factors.

We defined market responsiveness as the ability of the import quota allocation method to meet the needs of the marketplace in terms of product size, quality, variety, timing and location. We shared the view of many parties that market responsiveness must be considered in the context of the supply management system and the constraints that it imposes on supply and market behaviour.

Competitiveness, the last factor listed in the terms of reference, relates to the ability of firms to survive and grow while earning a reasonable profit. Within the framework of supply management, an import quota allocation method could enhance the competitiveness of individual recipients by reducing the cost of their material inputs and, in some instances, by providing them with access to additional supply to help absorb fixed processing or distribution costs. In an overall sense, however, we doubted that any method of allocating import quotas would have a significant effect on the competitiveness of the affected industries because of the generally small share of the market accounted for by imports and the large number of industry participants. Nonetheless, we did recognize that producers of non-ICL products which use ICL inputs were at a disadvantage with respect to U.S. competitors and might have their competitiveness improved through a direct allocation of import quotas.

## 4. General Observations

Our understanding of the way that imports are used in different industries led us to different conclusions about the importance of the seven factors in the design of an optimum import quota allocation method. A primary consideration was the stage of processing at which the imports enter Canada and by whom they are further processed.

### a) Controlled Products Imported in Finished Form

In our opinion, import quota auctions are the fairest and most straightforward allocation method for most ICL products that are imported in finished form, such as shell eggs and most dairy products. Import quota auctions leave to the marketplace the difficult if not impossible task of determining which firms among many competitors are best entitled to the scarce and valuable commodity. Another advantage of auctions is that they direct imports to the participants that value them the most, thus satisfying the objective of economic efficiency. Auctions allow for the fact that markets change, and those who most value the imports one year might not be the same participants willing to bid highest for them in the next auction. Thus, auctions avoid permanently entrenching a set of privileges that might not respond to evolving market needs in a responsive and competitive fashion.

In our view, all trade levels should be allowed to bid in auctions of import quotas. We see the risks of powerful interests at any trade level monopolizing import quota holdings as being no greater under auctions than under the current schemes, where import quotas can generally be "rented" on the secondary market. Limitations on maximum quota holdings by any single bidder would further minimize this risk.

We believe that the same group of participants that currently deals in imported products (some are quota holders, others are purchasers on the secondary market) would constitute the core group of importers under an auction system. These firms have the expertise and the contacts to operate efficiently under such a system. Their continued participation would ensure stability in import patterns.

The largest weakness of auctions is their potential for unpredictability. However, we did not view auctions as any less stable than "renting" quotas on the secondary market, a practice in wide existence now. We saw no reason why the laws of supply, demand and profit maximization would not compel quota holders under an auction system to work every bit as hard to satisfy the market in as capable a fashion as historical quota holders have in the past. The fact that any participant intent on disrupting the market or using imports to gain undue advantage could have "rented" quotas on the secondary market for that purpose suggested to us that auctions pose no greater risk in this respect than the existing system, especially with the additional restriction of upper limits on quota holdings.

We felt that auctions could be designed and administered to minimize unpredictability and promote market stability. Import quota holdings should be reasonably long term, but the auctions themselves should be held frequently to provide easy access. We believe that a generalized Dutch- or English-style auction would yield a less surprising outcome for auction participants than a system in which each party placed one sealed bid and then awaited the result. Finally, we recommend full transparency with respect to bid prices and quantities so that all participants have complete information on which to base future bidding decisions.

### b) Controlled Products Used as Inputs

We did not view auctions as an appropriate method of allocating import quotas for ICL products that are inputs to further processing operations or to other supply managed industries in Canada. This is the case for poultry and for broiler hatching eggs and chicks. In these instances, there is some scope, through direct allocations of import quotas, to improve the competitiveness of the domestic industry that uses the ICL inputs. This is particularly true for processors of non-ICL items, such as chicken TV dinners, that will have to compete on an equal footing with products manufactured in the United States using cheaper inputs, as tariffs on the finished products are eliminated under the *Canada-United States Free Trade Agreement*.

In addition to the competitiveness consideration, predictability is a critical concern for downstream industries in the poultry and the broiler hatching egg and chick sectors. Interruptions in imported supply could cause serious disruptions to the capital-intensive poultry processing operations that depend on these inputs. Because of supply management, the plants could not easily replace lost imports with domestic supply on a short-term basis. This could prove costly to these processors and the many workers that they employ.

Moreover, imports represent over one fifth of the domestic market for broiler hatching eggs and chicks and, in turn, are inputs to the supply managed poultry industry. Regional swings in import patterns could leave poultry producers short, creating major difficulties for this sector that would ultimately add to grower costs and consumer prices.

Consequently, in situations where a processing industry is dependent on a predictable supply of imported products, we would recommend that the government give consideration to directly allocating the import quota to that trade level. For reasons of equity, we suggest that the allocation be made in proportion to the size of the operation.

### c) Common Features of Import Quota Allocation Methods

No import quota allocation method can ensure that, in every instance, quotas find their way directly to the participants that value them the most. Although an auction of import quotas offers the best means of achieving this result, market conditions can change from one auction to the next, and participants must revise their original intentions. Therefore, we have no doubt that existing informal secondary markets will continue to operate and act as a complement to any import quota allocation method that we recommend.

The operation of the secondary market hinges upon the ability to transfer import quotas. As a common feature of any import quota allocation method, we believe that there should be no legal impediments to the transfer of import quotas. This would sanction the transactions that are currently taking place in the market and would keep transaction costs to a minimum in the future.

We also recommend that the government disclose both the names of quota holders and the amount of their allocation. To protect the confidentiality of firms that have been allocated an import quota on the basis of the size of their operation, their holdings should be provided within ranges.

Finally, we believe that a formal appeal system should be part of any import quota allocation method.

## 5. Product-Specific Recommendations

### a) Cheese

In our opinion, the cheese import quota is an excellent candidate for auction. We have every confidence that, under a cheese quota auction, the new holders of import quotas will continue to serve the cheese market in the same efficient, effective and market-responsive way as traditional holders have in the past. There is a strong demand for varietal cheese in Canada, and there are sizeable profits to be made in importing products not manufactured in this country. The large quota rents that have emanated from this activity have spurred the development of a Canadian specialty cheese industry now capable of producing Brie, Camembert, Havarti and a number of other varieties. We believe that this same set of incentives would continue to exist under an auction system and that it would yield the same results in terms of diversity of varieties and support for domestic cheese production.

With respect to the design of the auction, we recommend limits on maximum quota holdings to ensure that no single participant has direct access to an import quota in excess of 10 percent of the total. We also suggest that the import quota be auctioned annually for a three-year term. Three-year holdings would provide some time to develop supplier and buyer relationships. Finally, we note that separate auctions would be necessary for European Community (EC) and non-EC import quotas.

We saw little practical or economic rationale for holding separate auctions for individual cheese varieties or varietal groupings. Our observation, based on the descriptions of interested parties, was that, notwithstanding the monitoring of imports by variety conducted by government officials, the market has been deciding for some time on what varieties should be imported. In our view, the market should continue to make these determinations.

We rejected direct allocations for domestic manufacturers using cheese as an input in their processing operations. The Canadian cheese industry currently supplies the bulk of the processor requirements, which is primarily for cheddar and mozzarella. Our concern was that any direct allocation to further processors would come at the expense of Canadian production of the standard varieties used by food manufacturers. Furthermore, the Canadian Dairy Commission (CDC) has recently instituted a rebate program to cover a portion of the higher input costs incurred by processors using ICL dairy inputs. While recognizing that this program is not yet permanent, in our view, it offers a better way of addressing the competitive disadvantages faced by these processors than would direct import quota allocations. Judging from the very few representations made on this point by industrial users of ICL dairy products, we would assume that they agree.

### b) Ice Cream and Yoghurt

We recommend that ice cream and yoghurt import quotas be auctioned on the same basis as cheese, i.e. annual auctions for holdings of a three-year term. Individual quota holdings should be limited to 20 percent of each available quota.

### c) Buttermilk

The import quota for buttermilk has been held by the same importer since the product was placed on the ICL over 20 years ago.

We believe that the import quota for this product should be auctioned. Auctions should be held once a year for import quotas of a one-year term. We recommend that no single bidder be able to hold more than 25 percent of the available quota.

### d) Evaporated/Condensed Milk

Like buttermilk, the entire amount of the import quota for evaporated/condensed milk has been held by the same importer since the late 1960s. We suggest that it be governed by the same annual auction of one-year holdings that we recommend for buttermilk. However, because the import quantity is so small, we recommend that there be no restriction placed on maximum allowable holdings by any one auction participant.

### e) Broiler Hatching Eggs and Chicks

We concluded that the import quotas for broiler hatching eggs and chicks were not good candidates for auction due to the high market share accounted for by imports and the fact that the ICL product is the critical input to the supply managed chicken industry.

Therefore, we recommend that the government maintain the current method of import quota allocation which, by 1993, will distribute all quotas to federally registered hatcheries on the basis of their throughput.

## f) Chicken and Turkey

We recommend that the government continue to directly allocate import quotas to processors of non-ICL products using ICL poultry inputs to the full extent of their requirements.

In our view, the remaining chicken and turkey import quotas should be held by firms in the processing sector in proportion to their size of operations. In this respect, all processors would share in a commensurate way in the benefits of lower-cost imports. We advocate a method of calculating quota entitlement on the basis of the dollar difference between the purchases and sales of chicken or turkey ICL products. This method has the advantage of administrative simplicity since these amounts are easily calculated by firms. It also favours those firms that add more value to chicken and turkey products.

While we see the optimum allocation method for chicken and turkey as being processor holdings in proportion to the size of operation, we acknowledge the many difficulties of getting from here to there. Substantial investments have been made in production facilities, dependent on higher levels of imported throughput than the firms would be entitled to under a proportionate sharing basis. Indeed, some processing facilities depend entirely on imported products. While we recognize that it is open to these players to purchase imported products on the secondary market, many are unable to obtain domestically produced supply at what they consider to be competitive prices. A reallocation of import quotas along proportionate share lines would result in a sizeable reshuffling of production capacity. This would come at a substantial cost to a sector that already faces many competitive pressures.

Accordingly, to ease the anticipated disruption of poultry processors that are currently highly dependent on imported supplies, processors that presently hold an historical import quota would be allocated the greater of their historical base amount or their entitlement under the value-added system. The historical base amount represented some 40 percent of the total import quota for chicken in 1991.

## g) Shell Eggs

Shell eggs, like the ICL dairy products that concerned us in this inquiry, are imported in market-ready form. The importer, even when it is an egg grader, simply acts as a distributor with respect to imported eggs, performing few operations and adding little value. We believe that the efficiency and responsiveness of the market would be best served by an auction of the shell egg import quota, with eligibility open to all industry participants. Because egg graders possess the expertise and contacts to best serve market needs, we fully expect egg graders to be among the successful bidders under an auction. We saw, however, little practical rationale for limiting access to that trade level only.

## h) Egg Products

In light of the relative lack of interest in holding import quotas for egg products and the fact that the current import quota allocation methods appear to adequately respond to market demands, we recommend that the current methods be retained.

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# CHAPTER I

# THE INQUIRY

## 1. Introduction and Purpose of the Inquiry

On August 13, 1991, the Governor in Council, pursuant to section 18 of the *Canadian International Trade Tribunal Act*,[1] directed the Canadian International Trade Tribunal (the Tribunal) to undertake "an inquiry into current methods of import quota allocation for agricultural products and alternatives ... for the purpose of providing recommendations on the optimum method or methods to allocate import quotas on a national basis for agricultural products currently subject to import controls with respect to factors of equity, predictability, economic efficiency, transparency, entry to the industry, market responsiveness and competitiveness."[2] The Tribunal was also directed to "provide recommendations on principles which should generally guide any import quota allocations." The reference was made to the Tribunal on the recommendations of the Minister of Industry, Science and Technology and Minister for International Trade, the Minister of Agriculture and the Minister of Finance.

We were asked to report our findings within 14 months of the date of the Order in Council, that is, by October 13, 1992. In conducting the inquiry, the terms of reference instructed us to hold public hearings to provide an opportunity for oral and written submissions by all interested parties, including, but not limited to, supply management agencies, provincial commodity boards, domestic producers, processors and further processors, importers, wholesalers, retailers and consumers.

As to the background against which the inquiry was established, the preamble to the terms of reference indicated that concerns had been raised respecting the efficiency, equity, transparency and market responsiveness of current methods of import quota allocation, as well as the need to improve the competitiveness of Canadian further processors that use controlled agricultural inputs to manufacture products not subject to import controls and on which tariff protection is decreasing under the *Canada-United States Free Trade Agreement*[3] (FTA). The terms of reference also stated that the National Poultry Task Force and the National Dairy Task Force had recommended, respectively, that the current methods of import quota allocation for poultry and dairy products be reviewed.

We note that the terms of reference asked us to make recommendations on the "optimum" methods of import quota allocation. That is, we were not asked to assess the current methods and to justify if changes were warranted. On the other hand, we did not interpret our mandate as encouraging us to recommend change purely for the sake of change. The Governor in Council clearly intended the inquiry to focus squarely on assessing the best means of allocating import quotas, recognizing that this might mean changes to current allocation methods. Further, the

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1. R.S.C., 1985, c. 47 (4th Supp.).
2. The full text of the Order in Council, P.C. 1991-1512 (13 August 1991), is contained in Appendix I.
3. Canada Treaty Series, 1989, No. 3 (C.T.S.), signed on January 2, 1988.

wording of the terms of reference did not direct us to achieve a consensus among industry participants when formulating our recommendations on optimum import quota allocation methods.

The government asked us to recommend an optimum method to allocate import quotas "on a national basis." We interpreted this requirement to mean that, for a given controlled product, the same method or methods must be used to allocate import quotas on a consistent basis across the country. The requirement for a "national" import quota allocation method was further taken to mean that quotas should not first be earmarked for specific provinces or regions. Rather, applicants for quotas should be on an equal footing throughout Canada.

The Tribunal was asked to consider whether the optimum methods by which global import quotas are allocated should apply to the issuance of supplemental import permits, commonly referred to as supplementary import permits (SUPPs) for poultry and eggs and as special import permits for dairy products. This request in and of itself, as well as the wording of the rest of the terms of reference, made it clear that the focus of our recommendations was to be on methods of allocating global import quotas. We were not asked to undertake a full-scale review of the supplemental import permit system; however, it is recognized that this system adds to the supply of imported products in Canada.

## 2. Organization of the Inquiry

The import quota reference was one of the larger references undertaken by the Tribunal. It placed the interests of firms holding an import quota against those of firms wishing to obtain free access to this valuable commodity. Participants from all levels of the dairy and poultry industries played an active role in the inquiry. This section identifies some of the principal participants to the inquiry; Appendix II provides a comprehensive list of parties that made submissions; Appendix III is a glossary of key terms related to the inquiry; and Appendix IV provides a bibliography of the material used during the inquiry.

The major trade levels within each of the affected industries played an important role in the inquiry. Dairy processors were represented by the National Dairy Council of Canada (NDC), while the Dairy Farmers of Canada (DFC) argued the position of milk producers. On the poultry side, there were the Further Poultry Processors Association of Canada (FFPAC), the Canadian Hatchery Federation (CHF) and the Canadian Poultry and Egg Processors Council (CPEPC).

Importer associations were well represented throughout the inquiry. The International Cheese Council of Canada (ICCC) put forward the views of the cheese importers that it represented, while the Canadian Association of Regulated Importers (CARI) did the same for importers of chicken and turkey.

The Coalition for the Equitable Allocation of Import Quotas (the Coalition) represented retailers that, for the most part, do not currently hold import quotas. Similarly, the Canadian Restaurant and Foodservices Association (CRFA) represented foodservice organizations that were seeking import quotas.

The supply management agencies for each of the controlled products, including the Canadian Dairy Commission (CDC), the Canadian Chicken Marketing Agency (CCMA), the

Canadian Turkey Marketing Agency (CTMA), the Canadian Broiler Hatching Egg Marketing Agency (CBHEMA) and the Canadian Egg Marketing Agency (CEMA), took an active part in the inquiry.

Several large firms also participated in the inquiry, including Maple Lodge Farms Ltd. and Cuddy Food Products, chicken and turkey processors that hold chicken and turkey import quotas. In addition, a number of large distributors took part, including Intersave Buying & Merchandising Services, a holder of chicken and cheese import quotas, and Ronald A. Chisholm Limited, which holds import quotas for cheese, buttermilk and evaporated/condensed milk. Among firms seeking additional import quotas that attended our public hearings were Cara Operations Limited and KFC-Canada. In addition, several smaller firms and associations came forth to express their views. We heard from Mondo Foods Co. Ltd. with regard to cheese and the Affiliated Administration Services (SAA) Inc. with regard to chicken.

Over 800 notices of inquiry were mailed on August 16, 1991. At that time, parties were invited to prepare preliminary submissions to identify the issues arising from the terms of reference that they believed should be addressed by the inquiry. Fifty-nine such submissions were received.

Tribunal staff[4] used these responses to assist them in preparing the Draft Staff Notes on the Conduct of the Inquiry (the Draft Notes), which were distributed on October 2, 1991. The Draft Notes described the proposed inquiry process and research program and provided the staff's initial interpretation of the terms of reference. Some 30 interested parties[5] attended a preliminary hearing in Ottawa on October 10 and 11, 1991, to discuss the issues raised by the Draft Notes. Following the preliminary hearing, Tribunal staff prepared the Final Staff Notes on the Conduct of the Inquiry, dated October 29, 1991, which provided a more detailed research plan and described how we intended to proceed with the remainder of the inquiry.

To update secondary data sources as well as to obtain more detailed information not available from published sources, Tribunal staff mailed questionnaires to approximately 330 firms at various trade levels in the dairy and the poultry and egg industries. Key industry associations and a number of larger firms helped in preparing the questionnaires. Nearly 230 questionnaire responses were received, covering, for example, 93 percent of the cheese import quota, 77 percent of the chicken import quota and 63 percent of the broiler hatching egg and chick import quotas.

In November and December 1991, to better understand how the controlled products are manufactured and used in further processing operations, panel members and Tribunal staff visited more than 20 poultry and dairy facilities in Ontario and Quebec. The first substantive public hearing was held in Ottawa from January 22 to February 6, 1992. In preparation for the hearing, Tribunal staff undertook a wide-ranging program of research for the purposes of understanding the structure, operation and performance of the affected industries, as well as the current methods of import quota allocation.[6] The results of their work are summarized in the Descriptive Staff

4. Appendix V lists Tribunal staff who worked on the inquiry.
5. Appendix VI lists the participants and witnesses to all public hearings.
6. Appendix VII provides a list of studies produced by Tribunal staff.

Report of December 19, 1991. Our final report does not attempt to reproduce the contents of the Descriptive Staff Report, which should be consulted by interested readers for detailed descriptions of the affected industries and the current import quota allocation methods.

Consultants[7] were hired to identify and discuss the strengths and weaknesses of various allocation methods, current as well as alternative, and to develop an economic model to measure the impact of the various import quota allocation methods on the competitive behaviour of participants in the marketplace. The Descriptive Staff Report and the various consultants' reports were circulated to all parties in advance of the hearings.

Some 46 parties provided us with submissions prior to the January-February hearing, with 15 also providing written final remarks at the close of the hearing. More than 3,300 pages of transcript were generated by the 12 days of hearings, during which time we heard from 54 witnesses representing a wide variety of firms, industry associations, governments, supply management agencies and other associations.

With a much greater store of facts in front of us as to how the affected industries operated, the next step was to present specific import quota allocation proposals and assessments thereof to parties for their consideration. It fell to Tribunal staff to develop the details of the alternative import quota allocation methods. In doing so, they were guided by the terms of reference, while also considering the methods that had been proposed by parties, our views and their own on which methods should be examined. In response to our desire to assess the various options directly against the seven factors enumerated in the terms of reference, the staff used a grid approach to rate the allocation options. The results of their work are contained in the Analytic Staff Report, dated May 11, 1992, which should be consulted by readers interested in the details of the alternative import quota allocation methods proposed by the staff and the staff's assessment of the strengths and weaknesses of each allocation option, including the existing methods. That report, as well as further consultant reports, were circulated to all parties prior to the June hearing.

The second public hearing was held in Ottawa from June 8 to 18, 1992. The focus this time was on understanding what the impacts of the current and alternative methods of import quota allocation might be. The Tribunal received 46 pre-hearing submissions and witness statements, as well as 15 written final arguments. The hearing produced a further 2,000 pages of transcript, as we listened to 59 witnesses and heard 4 oral final arguments.

## 3. Domestic Legal Framework

In Canada, the authority to control the import of goods is derived from the *Export and Import Permits Act*[8] (the EIPA) which gives broad authority to the Governor in Council to control the import and export of designated products and technologies.

7. Appendix VIII lists the consultant studies produced during the inquiry.

8. R.S.C., 1985, c. E-19, as amended.

Under subsection 5(1) of the EIPA, the Governor in Council may establish an ICL. Goods may be added to the ICL for any of several purposes enumerated in the EIPA, including the following:

1) to restrict, for the purpose of supporting any action taken under the *Farm Products Marketing Agencies Act*[9] (the FPMA Act), the importation in any form of a like article to one produced or marketed in Canada, the quantities of which are fixed or determined under that act; or

2) to implement any action taken under the *Agricultural Stabilization Act*,[10] the *Fisheries Prices Support Act*,[11] the *Agricultural Products Cooperative Marketing Act*,[12] the *Agricultural Products Board Act*,[13] or the *Canadian Dairy Commission Act*[14] (the CDC Act), with the object or effect of supporting the price of the article.

In the case of poultry products, section 21 of the FPMA Act provides that the object of an agency be "to promote a strong, efficient and competitive production and marketing industry for the regulated product or products ... and to have due regard to the interests of producers and consumers of the regulated product or products." In the case of dairy products, section 8 of the CDC Act states that the objectives of the CDC are "to provide efficient producers of milk and cream with the opportunity of obtaining a fair return for their labour and investment and to provide consumers of dairy products with a continuous and adequate supply of dairy products of high quality."

Control over the import of any goods included in the ICL is effected through the issuance of import permits. Section 14 of the EIPA provides that no person shall import a product included on the ICL "except under the authority of and in accordance with an import permit issued under this Act." Subsection 8(1) of the EIPA gives the Minister the discretion to issue a "permit to import goods included in an Import Control List in such quantity and of such quality, ... from such places ... and subject to such other terms and conditions as are described in the permit or in the regulations." Subsection 10(1) of the EIPA grants the Minister the discretion to amend, suspend, cancel or reinstate any import permit. Section 16 prohibits a person who has been issued a permit to "transfer the permit to, or allow it to be used by, a person who is not so authorized."

It is pursuant to the above provisions of the EIPA that global import quotas for restricted products included in the ICL are allocated among firms in Canada; that is, the EIPA itself does not use the word "quotas" or "import quotas." Despite the absence of any wording in the EIPA regarding import quotas, government and industry practice is to clearly distinguish between import quotas and import permits, with the former being taken to mean the total annual volume that firms can normally import (excluding any supplemental imports), while the latter refers to

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9. R.S.C., 1985, c. F-4, as amended.
10. R.S.C., 1985, c. A-8, repealed by S.C., 1991, c. 22.
11. R.S.C., 1985, c. F-23.
12. R.S.C., 1985, c. A-5.
13. R.S.C., 1985, c. A-4.
14. R.S.C., 1985, c. C-15, as amended.

the documents that allow the quota holder to import a specified amount of product. We have adopted these definitions throughout our report.

There are currently 57 products on the ICL, of which 18 are agricultural or food products, with the following 10 being subject to quantitative control:

1) *Cheese of all types other than imitation cheese* (ICL Item No. 4);
2) *Ice cream, ice milk, ice cream mix, ice milk mix or any product manufactured mainly of ice cream or ice milk* (ICL Item No. 83);
3) *Yoghurt* (ICL Item No. 84);
4) *Buttermilk in dry, liquid or other form* (ICL Item No. 6);
5) *Evaporated and condensed milk* (ICL Item No. 11);
6) *Broiler hatching eggs* (ICL Item No. 87);
7) *Chicks hatched for chicken production from broiler hatching eggs* (ICL Item No. 88);
8) *Chicken and chicken capons, live or eviscerated, chicken parts, whether breaded or battered, and chicken products manufactured wholly thereof, whether breaded or battered* (ICL Item No. 19);
9) *Turkey, live or eviscerated, turkey parts, whether breaded or battered, and turkey products manufactured wholly therefrom, whether breaded or battered* (ICL Item No. 17); and
10) *Eggs and egg products* (ICL Item No. 18).

Table 1.1 summarizes the existing import quota allocation methods for these 10 products.

**Table 1.1**

**OVERVIEW OF CURRENT IMPORT QUOTA ALLOCATION METHODS FOR CONTROLLED AGRICULTURAL PRODUCTS**
**1991**

| Commodity | Controlled Since | Method(s) of Allocation | # of Quota Holders | Quota Volume | Supplemental Imports |
|---|---|---|---|---|---|
| Cheese | 1975 | • Historical importers | 237 | 20,411,986 kg | Minimal |
| Ice Cream | 1988 | • Historical importers | 33 | 352,150 kg; adjusted yearly in accordance with changes in domestic production of industrial milk | Minimal |
| Yoghurt | 1988 | • Historical importers | 28 | 334,267 kg; adjusted yearly in accordance with changes in domestic production of industrial milk | Minimal |
| Buttermilk | 1968 | • Historical importer | 1 | 907,000 kg | Minimal |
| Evaporated/ Condensed Milk | 1970 | • Historical importer | 1 | 11,808 kg | 759,177 kg* |
| Chicken | 1979 | • Traditional importers<br>• Further processors of non-ICL products<br>• Equal share to new entrants, small traditional importers<br>• Pro rata to all traditional importers | 232 | 42,745,015 kg; 7.5% of previous year's domestic production | 877,914 kg* |
| Turkey | 1974 | • Same as for chicken | 100 | 4,406,178 kg; 3.5% of current year's estimated domestic production | 887,937 kg* |
| Broiler Hatching Eggs | 1989 | • Historical importers (claw back by 1993)<br>• Market share to hatcheries only | 94 | 7,022,067 dz.; 17.4% of current year's estimated output | 173,850 |
| Chicks | 1989 | • Historical importers (claw back by 1993)<br>• Market share to hatcheries only | 94 | 14,108,366 chicks; 3.7% of current year's estimated output | 0 |
| Shell Eggs | 1975 | • Historical importers<br>• Market share to grading stations only | 83 | 7,033,581 dz.; 1.647% of previous year's production | 3,600 dz. |
| Egg Products | 1975 | • Historical importers<br>• Market share to grading stations only | 14 | 2,162,372 kg; egg products 0.714% and dried egg 0.627%, respectively, of previous year's shell egg production | 9,354,103 kg* |

* This includes a high volume of supplemental import permits for goods reimported or for imports used in products destined for reexport.

There are eight other dairy products on the ICL for which no import quotas have been established: animal feeds containing more than 50 percent of non-fat milk solids; butter; butterfat in any form; dry casein and caseinates; skimmed milk in dry, liquid or other form; dry whole milk; dry whey; and blends in dry, liquid or other form, containing a minimum of 50 percent of skimmed milk, casein, caseinates, buttermilk or whey. The circumstances in which import permits are issued for these products include instances when the product is not manufactured domestically (e.g. casein), the product is destined for reexport or, much less frequently, when there is a temporary domestic shortage.

The Secretary of State for External Affairs is designated as the Minister for the purposes of the EIPA. Import controls are administered by the Export and Import Permits Bureau (EIPB) of External Affairs and International Trade Canada.

Section 12 of the EIPA provides for the establishment of regulations governing the administration of import permits. In practice, the most important source of information on the legal and administrative policies and practices surrounding the import of controlled goods and the issuance of the necessary import permits is a series of Notices to Importers, which are guidelines issued by the EIPB on a product-specific basis. While the EIPB has publicly disclosed names of import quota holders, it considers the actual amount of an import quota held by individual firms to be confidential.

Permits to import goods on the ICL are issued in three general situations.

1) To allow the holder of an import quota for a particular product to import goods against its import quota allocation.

2) To allow the import of a specified quantity of a particular product <u>in addition</u> to or supplemental to the global import quota for that product. These permits may be issued to holders of import quotas, as well as to firms that do not hold quotas.

3) To allow individuals to import ICL products for their personal use. This is done under the authority of a series of "general import permits," such as General Import Permit No. 1 for dairy products.

The EIPA is silent on the subject of the transfer of <u>import quotas</u>. (As stated previously, the transfer of <u>import permits</u> is prohibited pursuant to section 16 of the EIPA.) In practice, the import quota is "transferred" when a firm that has been allocated an import quota is purchased by another entity. The firm that holds the quota will surrender it to the EIPB and make a request that it be reallocated to the new entity. The EIPB may recommend that the quota be reallocated to the new entity and, on approval by the Minister, will issue a letter confirming the reallocation. In the future, the new entity will apply for import permits.

## 4. International Legal Framework

Articles XI and XIII of the *General Agreement on Tariffs and Trade*[15] (GATT) set out Canada's international obligations regarding the imposition and administration of quantitative restrictions. Article XI:1 is a general rule prohibiting the use of import restrictions, including those made effective through quotas, import licences or other measures.

Article XI:2(*c*)(i) exempts from the general rule "import restrictions on any agricultural or fisheries product ... necessary to the enforcement of governmental measures which operate ... to restrict the quantities of the like domestic product permitted to be marketed or produced, or, if there is no substantial domestic production of the like product, of a domestic product for which the imported product can be directly substituted."

Article XI also requires that any quantitative restriction shall not be applied in a manner such as to reduce the total of imports relative to the total of domestic production, as compared with the proportion which might reasonably be expected to exist in the absence of such restriction.

Quantitative restrictions must be administered in a non-discriminatory manner in accordance with the rules set out in Article XIII of GATT. In cases in which the quota is allocated among supplying countries, Article XIII:2(*d*) provides that "the contracting party applying the restriction may seek agreement with respect to the allocation of shares in the quota with all other contracting parties having a substantial interest in supplying the product concerned." If this is not reasonably practicable, the shares must be allocated based on the proportion of supply by those countries in a previous representative period taking into account any "special factors" affecting trade in the product concerned. No conditions or formalities are to be imposed which would prevent any contracting party from fully utilizing the share of any quota allocated to it.

The requirements of Articles XI and XIII of GATT have been supplemented by the *Agreement on Import Licensing Procedures* (Import Licensing Code). Twenty-eight of the contracting parties to GATT, including Canada, the United States and the European Community (EC), are signatories to the Import Licensing Code. The Import Licensing Code sets forth the procedures to be followed in implementing import licensing systems. Its objectives are to simplify the administrative procedures and practices used in international trade and to ensure their fair and equitable application.

Article 706 of the FTA sets out the Canadian market access requirements for poultry and eggs imported from the United States. Articles 706:a) and 706:b) provide that the level of global import quota on chicken and chicken products shall be not less than 7.5 percent of the previous year's domestic production of chicken in Canada and that the level of global import quota on turkey and turkey products shall be no less than 3.5 percent of that year's estimated Canadian domestic turkey production. The level of global import quotas on shell eggs, egg products and dried egg is prescribed to be no less than 1.647 percent, 0.714 percent and 0.627 percent,

15. Geneva, 1979.

respectively, of Canadian domestic shell egg production, as specified in Article 706:c) of the FTA.

Canada and the United States have a bilateral agreement governing access levels for imports of broiler hatching eggs and chicks into Canada. For broiler hatching eggs and egg-equivalent chicks, the access levels are 17.4 percent and 3.7 percent, respectively, of Canadian domestic broiler hatching egg production.

Canada also has a bilateral arrangement with the EC to have a global import quota, for all cheeses, of not less than 45 million pounds per year. Canada has undertaken to allocate to the EC not less than 60 percent of this global import quota, or 27 million pounds. The EC has undertaken to ensure that the ex-quay, duty-paid prices of cheeses from the EC do not undercut the ex-factory prices of the same or similar cheeses made in Canada.

Bilateral arrangements also exist between Canada and the Nordic countries (Finland, Norway and Sweden), Austria and Switzerland with respect to imports of cheese into Canada. In each of these arrangements, Canada has undertaken to establish a global import quota, for all cheeses, of not less than 45 million pounds per year. Canada has agreed to allocate not less than 40 percent of the global import quota for cheese, or 18 million pounds, to imports from countries other than the EC. In each of these arrangements, the Nordic countries, Austria and Switzerland have made certain undertakings with respect to the ex-quay, duty-paid prices of imported cheeses from these countries.

A country quota of 2 million pounds for imports of buttermilk powder into Canada from New Zealand has existed since 1968. Canada has agreed to consult with the Government of New Zealand if consideration is being given to changing the import regime on cheese or buttermilk powder.[16] A country quota of 25,800 lbs for imports of condensed milk into Canada from Australia also exists.

## 5. Organization of the Report

The report is divided into eight chapters, including this introductory chapter.

Chapter II describes the assessment framework that we used to arrive at our recommendations, including how the seven evaluation factors enumerated in the terms of reference were defined.

Chapter III provides an overview of the dairy industry, focusing on the operation of supply management in the market and the competitive challenges facing participants.

Chapter IV describes the options for the allocation of import quotas for the various dairy products, giving the Tribunal's assessment of the options and its recommendations as to the optimum method of allocation, including a recommendation as to whether the optimum allocation method should also govern the allocation of supplemental import permits.

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16. *Agreement on Trade and Economic Cooperation between the Government of Canada and the Government of New Zealand,* Ottawa, September 25, 1981, Canada Treaty Series, 1982, No. 17 (C.T.S.), Article VII-2(b).

Chapters V and VI contain similar material to that of Chapters III and IV, respectively, for the poultry and egg industries.

In response to the second key element of our mandate, Chapter VII discusses the principles that should generally guide any import quota allocation.

Finally, Chapter VIII lists our recommendations on optimum methods of import quota allocation, by product.

# CHAPTER II

# THE ASSESSMENT FRAMEWORK

## 1. Introduction

In formulating our recommendations on optimum methods of import quota allocation, we wanted to ensure that our work was carried out in a systematic and consistent manner and that we addressed all the elements set out in the terms of reference. This entailed interpreting the seven evaluation factors enumerated in the terms of reference and assessing their relative importance, as well as considering how to take into account the supply management environment of the affected industries and Canada's international rights and obligations. We also considered the value of import quotas.

## 2. Interpreting the Evaluation Factors

Considerable time was spent in the hearings discussing the definitions of the seven evaluation factors as put forward by Tribunal staff and interested parties. In deciding what meaning to attach to the factors, we did not consider ourselves bound to look at them from either a strictly legal or economic perspective. Rather, we sought to define the factors in a manner that would most usefully apply to the industries and import quota allocation methods that were the focus of the inquiry.

### a) Equity

The Tribunal views equity as meaning fairness. Because there are simply not enough import quotas to allocate them to all who desire them or feel that they deserve them, we see an equitable import quota allocation method as one that offers all industry participants an equal opportunity to acquire import quotas. In other words, an equitable method of import quota allocation puts all players on an equal footing and does not discriminate in favour of or against any particular trade level, including importers, wholesalers/distributors, brokers, processors, retailers or foodservice organizations.

### b) Predictability

Predictability is taken by the Tribunal to mean an import quota allocation method that enables individual applicants to reasonably forecast whether they will be successful in obtaining a quota and, if so, at what cost, for what volume and type of products, and over what period of time. For an import quota allocation method to be truly predictable, firms should be able to anticipate that similar allocation criteria will continue to be applied in the medium term, say for the next three to five years. Searching for an allocation method that provides for predictability beyond this time frame was, in our view, unrealistic, given the uncertain nature of the international trading environment.

We consider that the predictability of an import quota allocation method is enhanced when there is an active secondary market in either imported products, or more directly, in import quotas. Even when applicants are completely certain of the outcome of their quota application, indirect access to import quotas or imported products on a secondary market represents an additional source of supply that should, other things being equal, improve predictability.

### c) Economic Efficiency

We interpreted economic efficiency as referring to the ease with which import quotas find their way to the players that value them the most, thereby minimizing the transaction costs associated with import quotas reaching their most valuable use for the Canadian economy as a whole. The administrative costs to government and industry of a particular method of import quota allocation represent a specific component of overall economic efficiency.

### d) Transparency

Transparency refers to a method of import quota allocation in which there are open, simple, well-documented decision-making criteria and processes. A transparent system would also require a minimal degree of administrative discretion. Finally, a fully transparent allocation method would provide a formal appeal process and would make available to the public both the names of quota holders and the size of their holdings.

### e) Entry to the Industry

We found this factor difficult to apply in our assessments. To us, entry to the industry refers to the ease with which new firms can directly access an import quota and use it as a foothold to enter one of the affected industries, at any trade level. However, as noted by several parties, direct access to an import quota is unlikely to influence the decision to start operations at most trade levels because quotas represent such a small percentage of total domestic supply.

The import business is the exception because, in this instance, access to import quotas can influence the decision to enter. Under the current import quota allocation methods, firms wishing to become importers must either purchase a company that holds an import quota or buy imported products on the secondary market. These additional costs might put them at such a disadvantage that entry would be impossible. However, this is also an issue of equity as we have defined it, i.e. do all firms in the import business have an equal opportunity to access import quotas?

Besides looking at entry in terms of the import industry, we also considered whether the method of import quota allocation itself had specific provisions for new entrants at any trade level, for example, as does the current quota regime for chicken and turkey. This is more in keeping with the notion of new entrants as contained in GATT's Import Licensing Code.

### f) Market Responsiveness

Market responsiveness is concerned with the extent to which the method of import quota allocation is able to effectively meet the needs of the marketplace in terms of product size, quality, variety, timing and location. We shared the view of many parties that market responsiveness must be considered in the context of the supply management system and the constraints that it imposes on supply and market behaviour.

### g) Competitiveness

Competitiveness means the ability to survive and grow while earning a reasonable profit. Competitiveness is a relative concept, often expressed in relation to foreign competitors.

We viewed this factor in the context of domestic supply management and its relatively fixed volumes of supply. For an import quota allocation method to promote competitiveness, it would have to confer a financial advantage on recipients by allowing them to use the lower-cost product to improve their profits and/or by providing them with additional product to run through their plants, thereby reducing their fixed costs per unit. Because, in most cases, imports represent a small share of the Canadian market and because of the large number of participants in the various sectors, we doubted that any method of allocating import quotas would have a significant effect on the overall competitiveness of the affected industries. We did, however, recognize that producers of non-ICL products, which contain a significant proportion of ICL input, were at a distinct disadvantage and might have their competitiveness improved through a direct allocation of import quotas.

## 3. Domestic Supply Management

The preamble to the terms of reference makes two references to the existence of supply management in Canada. The first paragraph states that, pursuant to the EIPA, the Governor in Council is authorized to establish an ICL and include therein any article, the import of which he deems necessary to control for any of the purposes in section 5 of the EIPA. The third paragraph states that import quotas have been established for the purpose of administering controls on the import of certain agricultural products which require import permits in support of supply management.

Given these references in the preamble of the terms of reference, we viewed supply management in Canada as an important element of the background against which we would make our recommendations on optimum import quota allocation methods. However, we did not, as many parties did, consider that any import quota allocation method that we recommended had to be "supportive of" or "compatible with" the legislated objectives of supply management, let alone of the particular way in which domestic marketing or production quotas are allocated.

We are of the view that none of the import quota allocation methods that we examined would be clearly disruptive of supply management. For the most part, imports represent only a small share of the domestic market, and any pressures on the system resulting from a different method of allocating import quotas would likely be relatively minor and within the capacity of provincial boards to address.

We should note that, on the issue of the potential impacts of alternative import quota allocation methods on domestic supply management, arguments by parties were sometimes contradictory, with one party claiming that a particular method was supportive of supply management, while another argued with equal conviction that the same method was detrimental to the system.[1] Similarly, several expert witnesses were able to postulate different theoretical scenarios in which the same allocation method either would or would not be disruptive to supply management.

## 4. Canada's International Rights and Obligations

In the terms of reference, we were asked to consider, in conducting our inquiry, "that Canada has international rights and obligations under bilateral and multilateral trade agreements." We have considered this issue, and we are of the view that none of the methods of import quota allocation that we have recommended would be inconsistent with Canada's rights and obligations under GATT, the Import Licensing Code, the FTA or any other bilateral agreements.

Parties have raised questions, in particular, about proposed methods of import quota allocation based on auctions or market share of particular firms. With respect to auctions, the major issue raised by parties is whether an auction premium or any other associated charge is consistent with Article II:1(*b*) of GATT. In our opinion, an auction premium or any associated charge is intrinsically a fee paid as part of the administration of a quantitative import restriction. If that import restriction is consistent with the provisions of Articles XI and XIII of GATT, a fee charged as part of its administration could not nullify or impair benefits under Article II.

With respect to an import quota allocation method based on market share, the major issue raised by parties is whether it is consistent with Article III of GATT. We believe that such an allocation method would not be an "internal regulation or measure" covered by Article III, but would be part of the administration of a quantitative import restriction. Further, we note that, since 1989, economic activity has been one of the bases for allocating import quotas for chicken, turkey, shell eggs and broiler hatching eggs and chicks.

## 5. Import Quota Rents

The issue of the value of import quotas was discussed extensively throughout the inquiry. It is obvious to us that holding import quotas provides recipients with a variety of benefits, beginning with the financial advantages of being able to obtain products at lower-than-domestic costs. Beyond this, depending on the product and the circumstances of the quota holder, import quotas can have many additional benefits; for example, they can be valuable as an alternative source of raw material or because they give access to unique products which have no Canadian equivalent.

To give an approximate sense of the monetary value of import quotas, we had a consultant develop estimates of the quota rents for all products, except cheese, for 1991. Quota rents for cheese were developed by Tribunal staff. The estimates are summarized in the product chapters of this report. At the June hearing, several parties noted that the size of quota rents for any one year may not be indicative of their average value over a longer time horizon.

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1. For example, the CDC, the federal supply management agency responsible for milk, supported an auction (which it would operate and retain the proceeds thereof) whereas the ICCC and the NDC, representing cheese importer and dairy processor interests respectively, did not support an auction, arguing in the process that it would be disruptive to the supply management system for milk.

In the end, we were convinced that significant import quota rents exist for most controlled products. However, our choice of the optimum method of import quota allocation for the various products was not dependent on the exact value of the import quota rent.

## 6. Determining the Optimum Import Quota Allocation Method

We began the inquiry with the objective of being able to quantitatively estimate what the impacts of reallocating import quotas would be on the competitive behaviour of participants in the market in terms of factors such as profits, sales and employment. A consultant with expertise in agricultural economics was hired to develop a model that would measure the likely consequences on the affected industries and individual firms. The consultant's model was presented to parties in advance of the January-February hearing and was widely discussed at that time. It was the strong view of parties, and accepted by the Tribunal, that the necessary data to make such a model operational were simply not available. Further, we recognized that a quantitative model, no matter how carefully developed, would leave many of the really critical questions posed in the terms of reference unanswered, such as issues relating to equity, predictability, market responsiveness and transparency of the allocation alternatives. Therefore, we abandoned the approach of empirically estimating the impacts of various import quota allocation options and accepted the advice of parties to focus our attention, and that of the staff and consultants, on thoroughly understanding the competitive behaviour of the industries and operation of the import quota allocation methods concerned.

Prior to the June hearing, to assist parties and the Tribunal in systematically analysing a range of import quota allocation methods, Tribunal staff developed a grid approach for use in the Analytic Staff Report. Under this approach, they disaggregated the seven evaluation factors enumerated in the terms of reference into specific subcriteria and rated, under each subcriterion, various methods of import quota allocation, including the current regimes, on a 1-to-5 scale. The individual scores were then totalled to arrive at an overall score for each allocation method. The ratings assigned reflected the views of the staff, based on their understanding of the industries and perception of the strengths and weaknesses of each method.

Tribunal staff applied this grid approach to a short list of alternative import quota allocation methods which they developed, taking into account the terms of reference (e.g. auction is specifically mentioned), the submissions and testimony of parties, our views and their own on which methods should be examined. We did not view ourselves as being limited to the details of the proposals discussed at the June hearing in our search for optimum methods of import quota allocation. Rather, the proposals put forth by the staff were seen as a useful means of eliciting input from parties on the strengths and weaknesses of a range of alternatives and not as the only choices open to us. In this final report, we do not describe in detail the various proposals assessed in the Analytic Staff Report. Instead, we offer more generic descriptions of the alternative allocation methods that we considered.

The quantitative approach used by Tribunal staff in their Analytic Staff Report was a very effective way of directing attention during the hearings to the specifics of alternative import quota allocation methods and how they measured up with respect to each of the seven factors. However, we feel that a "scorecard" approach is not an appropriate way of developing final recommendations on optimum methods of import quota allocation. We decided that it would be more meaningful, and ultimately more useful, to present the Governor in Council with a well-reasoned, qualitative analysis, rather than just a series of scores. To attempt to numerically rate methods of import quota allocation in our final report might have detracted from the rationale of why certain methods were being recommended as optimal. Further, as several parties to the inquiry noted, any method of scoring is essentially arbitrary and open to manipulation. As evidence of this, we note that proponents of various allocation methods had no difficulty in developing scenarios, based on different weightings for the evaluation factors and their component subcriteria, in which the approach that they were recommending scored the highest.

Economic inquiries often require the exercise of judgment about what may happen in the future, particularly when conjecturing what might occur if existing systems were changed. While we have more facts at hand about how the current regimes are functioning in the market, we believe that it is nonetheless appropriate, and necessary to the exercise of our mandate, to also assess how alternatives to the existing methods of import quota allocation would be likely to perform.

In sum, we approached the task of formulating our recommendations as to optimum methods of import quota allocation in a qualitative manner, but with no less rigour in our overall thinking than if we had used a "scorecard" approach. Each allocation method that we examined was extensively assessed against the seven evaluation factors in the terms of reference, taking into account both the supply management environment in which these industries operate and Canada's international rights and obligations.

# CHAPTER III

# OVERVIEW OF THE DAIRY INDUSTRY

## 1. Scope of the Dairy Industry

The Canadian dairy industry consists of three principal sectors, i.e. milk producers, dairy processors and further processors. Other trade levels involved in the distribution chain for dairy products, such as importers, brokers, wholesalers/distributors, retailers and foodservice operations are identified in a more general sense as components of the food industry.

### a) Milk Producers

Table 3.1 sets out some general features of the milk production sector.

**Table 3.1**

**OVERVIEW OF THE MILK PRODUCTION SECTOR**
**1990**

| | |
|---|---|
| Total Farm Production of Milk | 73.1 million hectolitres (63% industrial, 37% fluid); (decreased by 3.6% over the last 10 years) |
| Production of Industrial Milk | 46.0 million hectolitres (decreased by 7.5% over the last 10 years) |
| Number of Dairy Farms | 34,620 (decreased by 36% over the last 10 years) |
| Number of Cows (000 head) | 1,429 (decreased by 19% over the last 10 years) |
| Yield per Cow (kg) | 5,528 (increased by 26% over the last 10 years) (yield per cow in the United States is 6,700) |

Source: Canadian International Trade Tribunal, Descriptive Staff Report, December 1991.
Dairy Farmers of Canada, Dairy Facts and Figures at a Glance, 1991.

In 1990, Quebec and Ontario accounted for 78 percent of domestic production of industrial milk.[1] Cash receipts of $3.1 billion placed dairying second only to grain farming in the agriculture sector.

1. Industrial milk is used to manufacture products such as cheese, butter, skim milk powder, ice cream, yoghurt and dry and cultured milk products, while fluid milk is processed into table milk and cream.

## b) Dairy Processors

Dairy processors or manufacturers of dairy products typically do one or more of the following: process fluid milk; manufacture dairy products from industrial milk; use dairy products as ingredients in the production of other dairy products (e.g. cheese in processed cheese, skim milk powder in ice cream); or process and package dairy products for redistribution (e.g. cut and package cheeses, blend milk powders).

Table 3.2 provides an overview of the processing sector of the dairy industry.

**Table 3.2**

**OVERVIEW OF THE DAIRY PROCESSING SECTOR 1990**

| | Cheese | Ice Cream | Yoghurt | Buttermilk (dry) | Evaporated/ Condensed Milk |
|---|---|---|---|---|---|
| No. of Plants[1] | 175 | 103 | 67 | 9 | 23 |
| Domestic Production - (t) | 361,377[2] | 194,879 | 92,061 | 3,381 | 9,352 |
| Domestic Disappearance (t) | 367,257 | 195,399 | 92,125 | 4,394 | 7,880 |
| Import Quota - 1991 (t) | 20,412 | 352 | 334 | 907 | 12 |
| Imports as % of Domestic Disappearance | 5.5 | 0.2 | 0.4 | 20.6 | 0.2 |
| No. of Quota Holders | 235 | 33 | 28 | 1 | 1 |
| Product(s) Imported | specialty cheeses | mix, finished products & novelties | refrigerated products & frozen mixes | buttermilk powder | sweetened condensed milk |

1. There were, in total, 361 plants processing industrial milk in Canada in 1990. A single plant may produce more than one product.
2. Cheddar, specialty cheeses (including cottage) and processed cheese accounted for 31, 47 and 22 percent, respectively, of total cheese production for 1990.

Source: Canadian International Trade Tribunal, Descriptive Staff Report, December 1991.
Agriculture Canada, data from Plant Rating and Inspection System, 1991.

A large number of dairy processors have integrated operations that manufacture both fluid and industrial milk products. In 1990, about half of the 361 dairy processing establishments were owned by farm cooperatives; another 35 percent were controlled by large public corporations, with the remaining 15 percent being run by smaller, private firms. Employment in the dairy processing industry was 24,000, and the value of domestic shipments of dairy products was $7.8 billion.

### c) Further Processors

Further processors use controlled dairy products as inputs into processed food products, virtually all of which are not covered by the ICL. There are 30 such companies in Canada, including such well-known corporate names as Campbell Foods, Kraft General Foods Canada Inc., McCain Foods Ltd., Nestlé Canada Inc., Pillsbury Canada, Sara Lee Canada and The Quaker Oats Company of Canada.

Of the products on the ICL for which import quotas are currently allocated, cheese is by far the most important dairy input to further processing. In 1988, according to the Food Industries - 1986 - Annual Census of Manufactures[2] (Annual Census of Manufactures), 90 plants in the food industry used cheese worth a total of $35 million as an input to further processing. Virtually all of this cheese is purchased from domestic manufacturers. Preliminary data from the CDC rebate program[3] indicate that further processors eligible for rebates use some 4,500 t of cheese annually; a National Dairy Policy Task Force study determined that the manufacture of frozen pizza alone accounts for 2,500 t. Three quarters of all mozzarella cheeses produced in Canada is used in the $1.4 billion fresh pizza business.

In 1986, according to the Annual Census of Manufactures, there were 25 establishments using a total of 2,425 t of buttermilk powder at a cost of some $2.7 million as an input to prepared flour mixes, cereal foods, cereal grain flours and animal feeds. Liquid buttermilk is also used in the manufacture of products such as ice cream and salad dressings.

In 1988, five further processors in the sugar and chocolate confectionery industry used 1,200 hl of sweetened condensed milk as an input at a cost of $1.8 million.

Ice cream and yoghurt are rarely used in further processing.

### d) The Distribution Sector

Wholesalers/distributors play an important role in the Canadian dairy industry by coordinating the distribution of both domestic and imported dairy products.

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2. Statistics Canada, Catalogue 32-250 Annual, Minister of Supply and Services Canada, 1990.
3. The 1991 report of the Task Force on National Dairy Policy recommended the establishment of a rebate program to assist Canadian further processors whose ability to remain competitive in the domestic market was reduced as a result of the cost of dairy ingredients in Canada. The program was implemented through the CDC and offered initially for the period from January 1 to July 31, 1992. Essentially, it was designed to "level the playing field" for Canadian further processors faced with increasing competition from foreign imports as a result of reduced tariff levels under the FTA, by rebating 60 percent of the difference between the prices paid by Canadian firms for dairy ingredients and the corresponding prices paid by their foreign-based competitors. Total funding of the rebate program amounted to $6 million and was provided through a levy on milk producers and dairy processors. On August 27, 1992, the CDC announced that the program would be continued for the 1992-93 dairy year, with a total funding of $8.5 million.

The retail/grocery trade level is made up of two main groups: chains such as supermarkets and convenience stores, which account for approximately 52 percent of gross industry revenues, and independent companies which account for the remainder. In 1991, total food sales at this trade level were approximately $43.8 billion.

The foodservice sector includes hotels, restaurants and taverns. With the exception of ice cream and yoghurt outlets, these establishments use dairy products as ingredients in the preparation of other food products, with the most important product being pizza.

## 2. Supply Management in the Dairy Industry

The CDC is the federal agency principally responsible for implementing dairy policies with regard to industrial milk supply management. The CDC chairs the Canadian Milk Supply Management Committee (CMSMC), which is composed of producer and government representatives from the nine provinces with industrial milk production (Newfoundland produces no industrial milk).

Each year, the CMSMC sets the national production target for industrial milk, known as the market sharing quota (MSQ), by estimating the domestic demand for dairy products, adding a small "sleeve" to cover exports and subtracting the anticipated volume of imports. The objective is to set a quota that will provide for national self-sufficiency and avoid costly overproduction. The National Milk Marketing Plan sets out the provincial shares of the total MSQ. The provincial distribution of the MSQ has remained relatively unchanged in recent years, with Quebec holding the largest proportion of the MSQ with a 47-percent share and Ontario accounting for the second largest share at 31 percent.

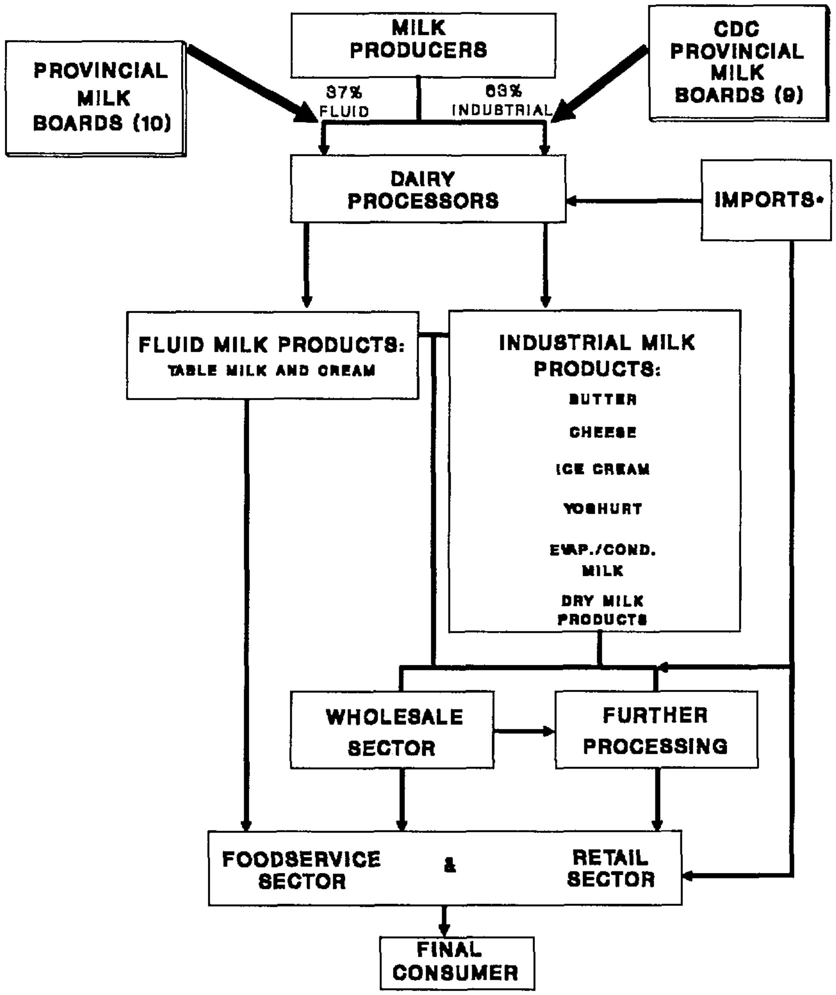
There are milk marketing boards and/or government agencies in each province that license producers and manufacturers of dairy products, set production quotas for fluid milk and distribute both fluid and industrial quotas to individual producers. There is virtually no interprovincial trade in fluid milk.

Figure 3.1 illustrates the product flow through the various trade levels in the Canadian dairy industry and indicates the points at which supply management is applied through the CDC and provincial milk boards.

The CDC sets a target price to be paid to producers for industrial milk; the price is calculated to cover the costs of production and provide a fair return to producers' labour, capital and management. Support prices are also set for butter and skim milk powder. If prices for their usual products are not high enough, industrial milk processors can choose to separate milk into its constituent by-products, namely, cream and skim milk, and just manufacture butter and skim milk powder for sale to the CDC.

Dairy processors must purchase their industrial milk from provincial milk marketing boards and agencies. Each province has a plant-supply system to allocate industrial milk among dairy processors. The milk is designated by class and subclass according to its end use, such as cheese, ice cream or yoghurt, and prices to processors vary for each of these designations (producers are paid a blended price). While the supply of some milk classes or subclasses is

**Figure 3.1**
**DOMESTIC DAIRY INDUSTRY**




* IMPORTS OF CONTROLLED DAIRY PRODUCTS SUBJECT TO QUANTITATIVE RESTRAINTS.

unlimited, others are restricted. In Ontario, for example, there are no limits on milk supply for manufacturing yoghurt, but milk for cheddar cheese is subject to plant-supply quotas. The system for allocating milk supply is therefore a major factor controlling dairy processors' product mix and plant volumes. Also, the target price that is set for producers of industrial milk has the effect of establishing the cost of milk supplies for dairy processors.

## 3. Competitiveness Profile and Challenges

### a) Milk Producers

Direct price competition among milk producers is limited by the supply management system. However, Mr. Rick Phillips of the DFC testified that "there is competition at our level and it is fairly intense. Producers are constantly striving to reduce their costs of production because that is how they maximize their returns."[4] Although the investment required to purchase fluid or industrial milk production quotas is significant, there is still a large number of individuals who are willing to buy these quotas.

## b) Dairy Processors

The dairy processing sector has been characterized by several parties to this inquiry as "the cheese in the sandwich"[5] because it is positioned between powerful suppliers, namely, milk producers and their marketing boards, and equally powerful buyers, including supermarket chains, grocery buying groups, further processors and the foodservice sector. These customers possess significant bargaining power, as they operate in an environment where there is continual pressure to decrease costs and where the costs of switching from one supplier to another are minimal. In the words of Mr. Kempton Matte of the NDC, "this is one of the most competitive of all sectors in the food industry. It is a high-volume, low-margin, business. Wholesale accounts will switch suppliers of butter, for example, for as little as a quarter of a cent per pound, an eighth of a cent per pound."[6]

Demand for industrial milk has declined steadily in recent years, largely due to a consumer shift towards lower-fat dairy choices, including milk, cheese, ice cream and yoghurt products, and the consumer's continued acceptance of non-dairy substitutes, such as polyunsaturated margarine and vegetable oils. To compete in this more health-conscious market, the major dairies have developed new low-fat product lines. Even with a dramatic increase in yoghurt production in the last five years and a less significant increase in cheese production (specialty cheeses accounting for most of the growth), the butterfat available from all industrial milk produced still exceeds the domestic requirements and results in periodic reductions of the MSQ.

The dairy processing industry has undergone continuing rationalization in recent years, resulting in fewer plants and employees, increased concentration of ownership, increased volume of milk processed per plant and increased value of shipments. The small number of large, equally balanced players in the dairy processing sector also contributes to the high level of competition, as evidenced by the consistent but low profits[7] earned by processors. The yoghurt market, for example, was described by Mr. Richard Innes of Ault Foods Limited as "vicious"[8] and by Mr. Rowan Caseley of Farmers Co-operative Dairy Limited as "very competitive."[9] Dairy processors have generally not been successful in competing internationally, in part because of relatively high raw milk costs.

Dairy processors use imports to round out their product lines, to test market new products and assess domestic demand before investing in production capacity, and to increase economies

4. Transcript, June 10, 1992, at 3885.
5. Transcript, June 8, 1992, at 3317.
6. Transcript, June 11, 1992, at 3950-51.
7. According to the 1990-91 Industry Profile for Dairy Products prepared by Industry, Science and Technology Canada, profits after tax for Canadian dairy processors have ranged between 2.1 and 3.0 percent of income since 1983.
8. *Supra*, note 6, at 3994.
9. *Ibid.*, at 4104.

of scale or capacity utilization by using imports as an input to a manufacturing process (e.g. cutting and packaging of cheese).

### c) Further Processors

Further processing firms with access to import quotas can import bulk ingredient cheese in order to lower input costs in the production of processed items. Alternatively, they can use imports to test market new products with a view to producing them in Canada, if successful.

Mr. Nelson Coyle of the CDC remarked "I think you cannot characterize the further processing industry in Canada with one brush. There are sectors of our further processing industries that are extremely competitive. There are others that are small, almost boutique type of plants that are, obviously, not able to compete on the basis of scale."[10]

Revenues from frozen pizza have declined in recent years as a result of the increase in competition from substitutes such as fresh chilled pizza and pizzas prepared in supermarket deli counters. This sector also faces growing competition from U.S. goods as tariffs on frozen pizza are lowered under the FTA.

### d) The Distribution Sector

The largest proportion of import quotas for dairy products is held by firms at the wholesale/distribution level. The competitive benefits of an import quota for these firms stem from the opportunity to acquire higher-margin specialty imports and to offer an enhanced product line to their customers.

Concentration in the retail sector is quite high, as a small number of equally large supermarket chains and buying groups dominate the market. Buyers in the retail sector exert competitive pressure on processors for discounts and rebates on large orders. Their bargaining power is even stronger because of the ease with which they can switch suppliers.

Competition in the retail sector extends beyond simple price competition to include quality, service and adapting to changing consumer habits. The changing nature of non-price competition has resulted in the introduction of a range of value-added products, such as specialty cheeses, new varieties and package sizes in yoghurt, ice cream novelties, and a growing array of freshly prepared meals, such as pizza.

The foodservice sector is less concentrated than the retail and further processing sectors of the industry. With the continual threat of new entrants in this market, the larger chains battle for market share, while independents compete for their very survival. Establishments that serve meals containing significant portions of ICL dairy ingredients, such as pizza, must remain competitive with other operations, such as the hamburger chains that do not rely on controlled product ingredients. Buyers representing pizza chains consider cheese as an item with little differentiation and can switch suppliers at low cost if this provides them any kind of "edge" on the competition.

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10. Transcript, June 10, 1992, at 3830.

Dr. H. Garth Coffin, appearing for Cara Operations Limited, stated, "I think you are familiar with the characteristics of a competitive industry, in economic terms, and that relates to the ease of entry into the business, the number and size of firms, the degree of homogeneity of product, the availability of information. All of those characteristics are fulfilled to a greater degree by the food service industry in total than some of the other sectors."[11]

## 4. Import Quota Rents

A range of import quota rents for cheese was estimated by Tribunal staff based on the difference between retail prices and landed costs, allowing for all appropriate trade margins.[12] At the dairy processing level, in 1991, for both EC and non-EC quotas, the average cheese import quota rent was estimated to be CAN$1.23-2.43 per kg. Confidential evidence adduced throughout the inquiry also suggests that quota rents for cheese are within this range.

Import quota rents for ice cream in 1991 were estimated to be CAN$0.30-0.52 per kg for manufacturers and CAN$0.51-0.74 per kg for wholesalers.[13] It is important to note that ice cream prices vary significantly with quality and that the figures used in the quota rent calculations are averages.

Similarly, import quota rents for frozen yoghurt in 1991 were estimated to be CAN$0.26-0.32 per kg for domestic processors and CAN$0.45-0.52 per kg for wholesalers.[14]

The value of the import quota rent associated with buttermilk powder imports was estimated at CAN$0.57 per kg for 1991.[15] Representatives of Ronald A. Chisholm Limited argued that this estimate was substantially overstated and submitted a detailed cost statement for imported buttermilk powder in support of their position.

The value of the import quota rent associated with evaporated/condensed milk was estimated at CAN$1.21 per litre for 1991.[16]

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11. Transcript, June 15, 1992, at 4526-27.
12. For a more detailed description of the methodology used by Tribunal staff, please refer to Appendix 4.1 of the Canadian International Trade Tribunal's Analytic Staff Report and Tribunal exhibit GC-91-001-79D, Additional Table to the Analytic Staff Report.
13. Deloitte & Touche, Import Quota Rents on Supply Managed Products, March 1992, at 46.
14. *Ibid.*, at 48.
15. *Ibid.*, at 43.
16. *Ibid.*

# CHAPTER IV

# OPTIMUM IMPORT QUOTA ALLOCATION METHODS - DAIRY PRODUCTS

## 1. Cheese

## a) Import Quota Allocation Options: Current Method and Alternatives

### (i) The Current Method

Cheese is the most important of the controlled dairy products, in terms of both volume and absolute value of the import quota. When cheese was added to the ICL on June 6, 1975, the volume of the quota was set at 50 million pounds, based on the average level of total cheese imports in the preceding two years. The level of the quota was reduced to 45 million pounds or 20,411,986 kg in 1978 and has remained unchanged since. The import quota was initially allocated to traditional importers on the basis of their individual volumes of imports in 1973 and 1974, and, in many instances, these allocations are still in effect.

Quota holders must use at least 95 percent of their allocation each year, or it will be reduced to the actual level utilized in the following year. Any unused amounts of import quotas are available for re-allocation to new applicants. However, there has been very little cheese import quotas available for redistribution for many years, and there are currently hundreds of applications on hand at the EIPB.

To give effect to various international arrangements[1] into which Canada has entered with regard to cheese, the import quota is designated as EC or non-EC, and although there is some flexibility to switch between EC and non-EC sources, it is tightly controlled by the EIPB.

The cheese import quota is also designated by some 30 individual varieties; however, holders may shift purchases among varieties up to a maximum of 20 percent of their allocated quota. As long as the volumes involved are not considered large enough to cause disruption in the market, the EIPB does not interfere with this process; in fact, there has been virtually no occasion in recent years where the EIPB has found it necessary to enforce these varietal rules.

Although cheese import quotas are not officially transferable, there appears to be an active secondary market where quotas are traded.[2] In addition, considerable volumes of cheese import quotas have changed hands since 1975, as firms holding cheese import quotas have been purchased by other firms.

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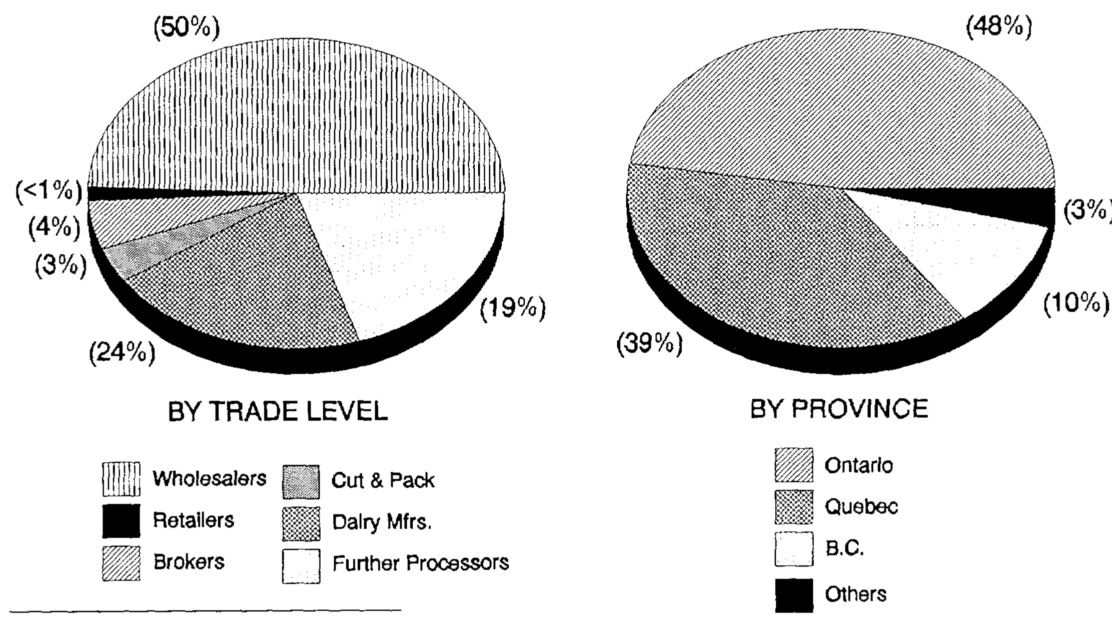
1. For further details, see Chapter I, section 4 of this report entitled "International Legal Framework."
2. Trading is generally effected through quota "rental," whereby the purchaser is able to make arrangements for the foreign sourcing, procurement and delivery of cheese, but the import permit is issued in the name of the original quota holder who remains the importer of record.

In 1991, there were 235 cheese import quota holders. Figure 4.1 provides a breakdown of holdings of the cheese import quota by trade level and province.

Figure 4.1

DISTRIBUTION OF IMPORT QUOTA (1991)
CHEESE




Source: EIPB data.

Over and above the global import quota, special import permits can be issued to quota holders or others in a variety of circumstances, including instances where there is a temporary domestic shortage of a particular product or where a cheese is not manufactured in Canada (e.g. certain kosher varieties). These permits are also routinely issued in situations where the product is destined for reexport, such as provisions for international flights and shipping lines.

### (ii) The Current Method with Modifications

In the Analytic Staff Report, Tribunal staff suggested a number of measures to improve the operation of the current method of allocating the cheese import quota. In fact, these modifications could apply to any quota allocation method. Specifically, they are:

1) transferability, which would allow for the purchase and sale of import quotas, either on a temporary (annual) or longer-term basis;

2) an appeal process, which would provide a formal mechanism by which applicants could have their allocation reviewed;

3) disclosure, which would provide increased transparency by making quota allocations, within ranges, available to the public;

4) the establishment of upper limits, which would prevent any one party from holding more than a prescribed maximum amount of the quotas; and

5) earmarking, which would set aside certain amounts of quotas for allocation to specific groups.[3]

### (iii) Auction

In the Analytic Staff Report, Tribunal staff proposed an open auction of the cheese quota on a quarterly basis, with quotas being sold by place-of-origin and variety designations, and with price being determined by the lowest successful bid. The report recognized, however, that an auction could be structured in many different ways.

Key issues of design that would have to be resolved for a cheese import quota auction are as follows:

1) whether quotas would be designated by variety (in addition to being designated as EC or non-EC) and whether current restrictions on switching would be maintained;

2) what proportion of the quota to auction at any one time and the length of the allocation period (e.g. one month, five years, in perpetuity);

3) the upper limit on individual holdings to prevent monopolization (e.g. in New Zealand, a limit of 20 percent has been put in place);

4) the bidding method (e.g. lowest successful bid, pay what you bid, Dutch auction);

5) eligibility requirements to participate in the auction (e.g. a cheese quota auction could be restricted to only "active" dairy industry participants);

6) regulations regarding security deposits, payments and minimum quota utilization requirements;

7) an appeal mechanism;

8) whether to permit import quotas to be transferred and to which industry participants;

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3. The most prominent case for consideration is that of Canadian further processors using higher-cost dairy inputs to produce non-ICL products, which are subject to decreasing tariff protection under the FTA.

9) who would run the auction (the EIPB, a supply management agency or a public corporation);

10) who would get the proceeds of the auction; and

11) whether it would be appropriate to retain special import permit provisions.

### (iv) Market Share

Under this import quota allocation alternative, the government would distribute cheese import quotas on the basis of some measure of an applicant's share of the domestic cheese market or its throughput of cheese. For example, cheese import quotas could be distributed on the basis of the volume of purchases of cheese from domestic manufacturers. This would restrict eligibility for import quotas to firms actively engaged in the manufacturing, processing and distribution of cheese in the previous year. To operate this type of scheme, the EIPB would need some method to verify firms' purchases of cheese.

A key decision for a market share approach is whether to establish a minimum activity threshold for applications. Without such a threshold, there might be administrative difficulties in handling a large volume of requests for small amounts of cheese import quotas.

As with auction, decisions would have to be made with regard to the transferability of cheese import quotas, upper limits on holdings, variety restrictions, maximum utilization requirements and special import permits.

## b) Assessment and Recommendations

In general, we believe that the current method of allocating the cheese import quota operates efficiently and effectively in providing Canadian consumers with access to a broad range of varietal cheeses. It is also unquestionably efficient to administer, considering the minimal amount of resources and documentation involved.

The relative stability of the method, since its inception in 1975, is considered to be a particular strength in terms of the high level of predictability for participating quota holders. The Tribunal heard much testimony on the importance of predictable access to import quotas in allowing a company to develop realistic business plans and manage its operations competently. The stability of the method has also fostered the development of long-term supplier relationships between quota holders and their offshore suppliers, as well as long-term customer relationships with domestic retailers. This has not only resulted in the evolution of efficient importing and distribution processes, but has also enabled quota holders to develop expertise in anticipating and serving the market for imported product.

The current method provides no official means for transferring import quotas. However, the industry has found ways to move quotas to another importer either on a temporary basis through "quota rental," or on a longer-term basis through acquisition of the quota holder's company. In the former case, the non-transferability aspect forces the buyer and seller to undergo an awkward process to comply with quota rules, while in the latter case, the buyer may have to purchase unwanted assets that come with import quota holdings. We believe that flexibility in the use of import quotas is an important consideration and that the lack of easy transferability constitutes an unnecessary obstacle to an otherwise efficient secondary market. In this same vein, the confidentiality accorded to individual quota allocations is also seen as a hindrance to secondary market activity, since it conceals useful information from prospective purchasers looking for a suitable amount of controlled products.

Several parties offered arguments in favour of transferability. A witness for the ICCC stated that this would simplify entry into the import sector and provide more responsiveness to market demands.[4] Agropur Coopérative agro-alimentaire (Agropur) referred to the elimination of [translation] "bureaucratic hassles."[5] The NDC held that transferability would allow market forces to shift quotas toward their best use, as well as enabling smaller processors to benefit from the system.[6] The CDC felt that it would allow easier exit from the industry and contribute to the overall flexibility of the system.[7] We agree with these views.

Criticism of the current method centres around the issues of equity and entry to the industry. More specifically, the current import quota allocation method is based on a pattern of trading activity that is almost 20 years old, and this continues to provide significant competitive benefits to some 230 quota holders to the exclusion of a large part of the industry. Firms that do not hold import quotas are unable to participate equally in these competitive benefits, even if they obtain quotas through the secondary market, since they must pay a premium for this access. The only other method of obtaining a quota, i.e. via redistribution as a result of under-utilization, is a very unlikely prospect. This situation has created a substantial barrier to entry into the cheese importing business to the detriment of many would-be entrants and future competitors.

With respect to transparency, the Tribunal believes that the disclosure of quota holdings, within ranges, would result in a more efficient secondary market without unreasonably compromising quota holders' sensitive commercial information. Parties generally indicated acceptance, if not enthusiasm, for additional disclosure. Mr. Carl E. Harrison of McCain Refrigerated Foods Inc. testified "Because we are large purchasers of imported cheese, we would find it advantageous to know who has what varieties and how much they have."[8]

A major factor leading to this inquiry was the situation faced by Canadian further processors handicapped by higher-priced dairy ingredients in comparison with import competition in the domestic market. Earmarking of import quotas for further processors was one of four basic options considered by the National Dairy Policy Task Force to address this problem (others were the addition to the ICL of products containing minimum amounts of supply managed ingredients, the creation of additional import quotas for further processors and the implementation of a two-price system for industrial milk). Although very few further processors participated actively in this inquiry, thus denying us of the insights that they might have offered, it is our view that earmarking is not an appropriate method of allocating cheese import quotas since the

4. Public submission of Mr. A. Pelliccione, January 1992, at 15.
5. Transcript, January 22, 1992, at 150.
6. Public submission, January 1992, at 61-62.
7. Transcript, February 6, 1992, at 3017.
8. Public evidence statement of Mr. Carl E. Harrison, June 5, 1992, at 3.

result would be the use of large amounts of the global quota to import low-priced ingredient cheese. Based on figures from the CDC rebate program, the volumes involved could be as much as 20 percent of the current global import quota and would produce a "double-whammy" effect of depriving domestic cheese manufacturers of an important market and reducing the amount of the quota available to satisfy consumer demand for varietal cheeses. We agree with the National Dairy Policy Task Force that a rebate program for further processors is a better approach to "levelling the playing field" for Canadian further processors.

The market share method would equalize the conditions of access to the import quota for all applicants in a relatively predictable fashion; it would also allow for entry to the importing business. Canadian dairy manufacturers and, ultimately, milk producers would benefit through the continuous promotion of domestic cheese sales.

There are, however, critical flaws that undermine the merits of this system. At the outset, two significant groups would be effectively excluded from access to quotas, i.e. most dairy processors as well as firms dealing exclusively in imported products, since neither of these groups purchases domestic cheese. Indeed, many firms in the latter group are the traditional importers that have done an effective job of satisfying consumer demand for imported cheeses and developing markets for new varieties. Furthermore, the administration of such systems can be complicated. Another troublesome prospect of this system is the likelihood of it producing numerous small allocations, which would end up in the secondary market, thus detracting from the economic efficiency of the import quota.

The auction method provides the most equal access to the import quota and entry to the cheese importing business for all industry participants. In our opinion, equity is the predominant criterion for cheese, and auction presents the best alternative to ensure continuing equity of access in an evolving industry context. It also facilitates the distribution of the quota directly to the parties that value it the most, thereby minimizing subsequent transaction costs in the secondary market.

We believe that the allocation of the cheese import quota by auction would be just as responsive to market demands as any other method; indeed, the involvement of additional industry participants through an open auction would afford a broader reading of market signals and emerging trends.

There might be some discontinuity of long-standing importer relationships with suppliers and/or customers, but it is reasonable to expect that the established core of cheese importers would continue to play a dominant role under a quota auction regime and this, in itself, would limit any market disruption that might occur. The potential for newcomers to take advantage of quota auctions and engage in speculative forays into established markets is no greater than under the current system, where quotas could be rented in the secondary market for the same purpose.

The issue of cheese varieties poses some complications in the context of a quota auction. Government officials have monitored cheese imports on a varietal basis since the product was placed on the ICL, ostensibly to ensure some market stability and to protect against wholesale shifts to varieties that are produced in Canada. Nonetheless, cheese imports have shifted to new varieties in response to changes in consumer demand and developments in Canadian production.

Several witnesses testified at the June hearing that varietal stipulations were not necessary to protect Canadian production of standard cheeses.[9] We would tend to agree. In our view, using quotas to import standard cheeses like cheddar and mozzarella would leave unsatisfied Canadian demand for high-value, differentiated cheeses, many of which are simply unavailable from Canadian sources at any price. Having developed this sophisticated and demanding market for foreign varietal cheeses, importers are unlikely to neglect it in favour of imports of, for example, pizza cheese. In our view, this is particularly so since foreign varieties are limited to 20 million kilograms per year which, in 1991, amounted to only 5.5 percent of the Canadian cheese market.

Our observation, based on the descriptions of interested parties, was that notwithstanding the monitoring of imports by variety conducted by government officials, the market has been deciding for some time on what varieties to import. In our view, the market should continue to make these determinations.

With respect to predictability, the Tribunal believes that this aspect of an auction can be maximized by adopting the following procedures.

1) The global import quota would be divided into three equal portions with one third being auctioned every year for a three-year term. For example, if company "A" successfully bids for a cheese quota of 100,000 kg for 1993, it would be entitled to import 100,000 kg of cheese in each of 1994 and 1995 at the original bid-clearing price.

2) EC and non-EC quotas would be auctioned separately.

3) The auction itself should be operated in the generalized English or Dutch style,[10] whereby the bidding takes place in successive rounds and provides participants with the necessary feedback throughout the process to determine how much they must bid to be successful (see Appendix IX for an illustration of a generalized Dutch auction procedure).

4) Eligibility to participate in the auctions would be unrestricted, but no individual party would be permitted to purchase more than 10 percent of the import quota auctioned.

5) Full transparency of purchases and prices would provide useful information to guide bidders in preparing for subsequent auctions.

6) An appeal process would be provided.

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9. For example, see the testimonies of Mr. Smith of MD Foods, Mr. Robert of Agropur Coopérative agro-alimentaire and Mr. Pelley of Ronald A. Chisholm Limited, transcript, June 10, 1992, hearing, at 3972-82.

10. In the generalized English style of auction, the initial offering price is set low and then increased for each successive round of bidding until the market fails to clear. Conversely, in the generalized Dutch style, the initial offering price is set high and reduced for each successive round of bidding until market clearing is achieved. In both cases, all successful bidders pay the <u>same</u> clearing price. The Dutch-style auction usually arrives at a market-clearing price with much less bidding activity than the English style.

Import quotas would be transferable up to the expiry of their term, and full utilization of quotas would be assured by requiring a deposit for all purchases on completion of each auction. Under-utilization penalties would be forfeiture of the deposit and a limit on the amount that the bidder could purchase in the subsequent auctions. The detailed mechanics of operating a quota auction are best left to the administering agency, but it is worth noting that auctions are used currently[11] by a number of organizations, both in government and the private sector, and the expertise and communications technology associated with such operations are easily accessible.

We do not accept the proposal that the CDC operate the auction for two reasons. First, the CDC is associated closely with the producer/processor side of the dairy industry, and we do not consider it appropriate for an organization in this position to control an auction that would involve all segments of the industry, or to benefit from the auction revenues. Second, we are concerned that this might contravene the provisions of the Import Licensing Code. Auctions would more appropriately be handled under the EIPB mandate.

The Tribunal therefore considers that the auction method fulfils the factors specified in the terms of reference in the most comprehensive manner and, in particular, that the method ensures continuing equity of access to quotas for all industry participants.

Special import permits would continue to be issued in instances where there is a temporary domestic shortage of a particular product, where a cheese is not manufactured in Canada or where the product is destined for reexport. For products that are consumed in Canada, however, these permits would be subject to a fee equal to the most recent auction clearing price.

## 2. Ice Cream and Yoghurt

### a) Import Quota Allocation Options: Current Method and Alternatives

In our consideration of the optimal method of allocating import quotas for ice cream and yoghurt, we examined the two industries separately when appropriate. In our opinion, the analysis and recommendations apply equally to ice cream and yoghurt.

#### (i) The Current Method

In January 1988, ice cream and yoghurt were added to the ICL. No import quotas were established at the time because of unsettled trade negotiations with the United States.[12] However, in 1989, import quotas for ice cream and yoghurt were established at 345 t and 330 t, respectively, based on average imports in the preceding three years. For both products, the level of the quotas is adjusted annually in accordance with the domestic production of industrial milk.

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11. For example, the Bank of Canada issues its Treasury Bills through a weekly auction, while the city of Vancouver uses an auction to allocate its taxicab licenses.

12. For further details, see Canadian International Trade Tribunal, Descriptive Staff Report, December 1991, at 42-43.

Figure 4.2 provides a breakdown of holdings of ice cream and yoghurt import quotas by trade level and province.

The import quotas were initially allocated among applicants according to their demonstrated importing history, with some quotas being granted to new importers. Redistribution of under-utilized quotas provided additional allocations to new importers in subsequent years.

Quota holders must utilize 90 percent of their annual quota, or the unused portion of their allocation will be re-distributed. Most ice cream and yoghurt imports come from the United States. Over 80 percent of imported yoghurt is frozen yoghurt, which is sold in specialty shops or grocery stores.

Special import permits for ice cream and yoghurt may be issued in some instances. Such occurrences tend to be for imports of kosher product, test marketing purposes and assisting franchise operations that are in the process of converting to domestic production.

#### (ii) The Current Method with Modifications

Potential modifications to the current import quota allocation methods for ice cream and yoghurt are the same as the first four described for cheese, namely, transferability, disclosure, upper limits on quota holdings and a formal appeal process. Earmarking of import quotas for further processors producing non-ICL products is not considered a desirable modification because there is very little use of ice cream or yoghurt in further processing.

#### (iii) Auction

Most of the same design issues would have to be addressed for an auction of ice cream and yoghurt import quotas as for a cheese quota auction; obvious exceptions would be the place-of-origin designations.

### b) Assessment and Recommendations

Any assessment of the import quota allocation methods for ice cream and yoghurt must take into account that these are relatively new regimes (1988) with a somewhat doubtful future due to recent GATT rulings.[13] These methods have not yet settled into a stable operating pattern.

As in the case of the cheese quota, the current import quota allocation method appears to operate efficiently, with a high level of predictability, and its administration requires few resources. The system responds well to market demands, although the amount of import quotas is very small in proportion to domestic production (0.2 percent of domestic production for ice cream, 0.3 percent for yoghurt).

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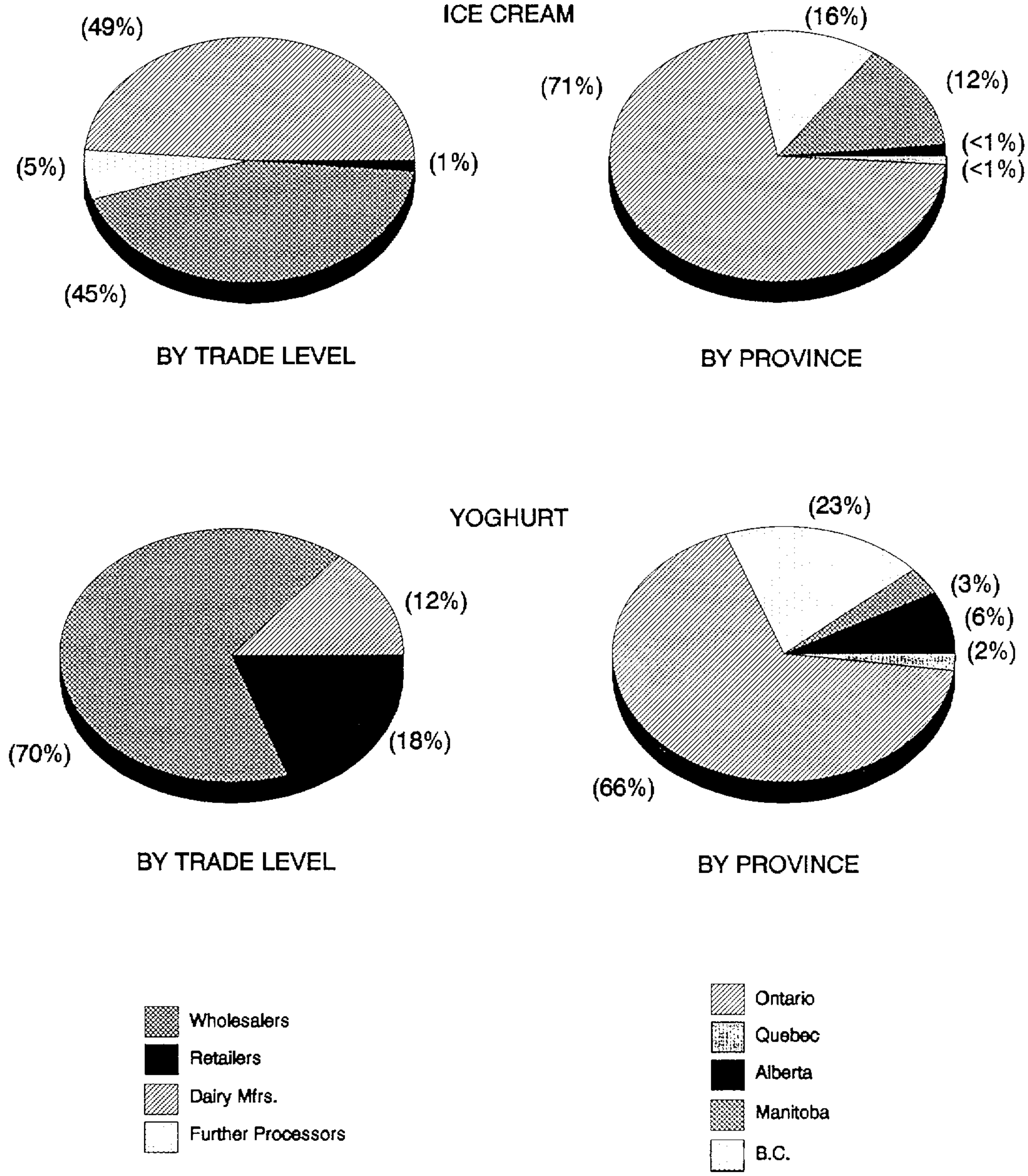
13. In September 1989, in response to a challenge by the United States, a GATT panel found that Canada's restrictions on imports of ice cream and yoghurt were not justifiable under Article XI of GATT. See Panel Reports adopted on December 5, 1989, in GATT, Basic Instruments and Selected Documents, at 68.

Figure 4.2

DISTRIBUTION OF IMPORT QUOTAS (1991)
ICE CREAM AND YOGHURT




Source: EIPB data.

The arguments advanced in the cheese section with respect to transferability of quotas and disclosure also apply to ice cream and yoghurt and need not be repeated here.

Again, the current method of allocation fails to measure up in terms of equity of access to an import quota when viewed in a long-term context. While allocation to recent importers might reflect competitive realities in the early years of a quota regime, the lack of entry to the market underlines the inequity of the method as time progresses and the value of the quota increases. Eventually, there will be a fortunate group of quota holders that enjoy a significant and continuing competitive advantage over the rest of the industry.

The auction method would place all industry participants on the same footing in terms of access to an import quota and would equalize the conditions of entry into the importing business. The administration of the quota auction would be more complex than the current method, but the direct distribution of quotas to those who value them the most would minimize subsequent trading and transaction costs in the secondary market. No particular impacts are anticipated on market responsiveness under this method.

An acceptable level of predictability could be ensured by adopting the same principal features identified for cheese quota auctions, except that there would be no country restrictions and the much smaller amount of total ice cream and yoghurt suggests that limits on individual holdings should be increased to 20 percent.

The Tribunal, therefore, considers that the auction method fulfils the factors specified in the terms of reference in the most comprehensive manner and, in particular, ensures continuing equity of access to the quota for all industry participants.

We recommend that the current criteria for issuing special import permits for ice cream and yoghurt be continued without modifications. The only change to that process would be that successful applicants would pay a fee equal to the most recent auction clearing price in the case of products consumed domestically.

## 3. Buttermilk

### a) Import Quota Allocation Options: Current Method and Alternatives

#### (i) The Current Method

Dry buttermilk was placed on the ICL on May 22, 1968. The product definition was amended in 1988 to include liquid buttermilk, although no liquid buttermilk has ever been imported using the global import quota. Buttermilk differs from the other controlled dairy products currently imported under annual quota in that it is used exclusively as an input to further processing.

The quota level was initially set at 2 million pounds (907 t) and has remained unchanged. The entire quota was allocated to the single historical importer of record. That firm is required to fully utilize the quota each year, which it has always done. The product must be imported from New Zealand.

As with other controlled dairy products, special import permits can be issued in certain circumstances.

### (ii) The Current Method with Modifications

Potential modifications to the current system are the same ones considered in the analysis of cheese, that is, transferability, an appeal process, disclosure, upper limits on quota holdings and earmarking of import quotas for further processors producing non-ICL products.

### (iii) Auction

Under this alternative method of allocation, the buttermilk import quota would be distributed by an annual auction. Again, most of the same design issues would have to be addressed for an auction of the buttermilk quota as for auctions of cheese, ice cream or yoghurt quotas.

### (iv) Market Share

Under this allocation alternative, the quota would be distributed on the basis of applicants' purchases of buttermilk from domestic manufacturers, in the same manner as described previously for the market share option for cheese.

## b) Assessment and Recommendations

The current method of allocating the buttermilk import quota measured up well in virtually all aspects except equity and entry to the industry.

The fact that the total quota has been held by the same firm since the inception of controls in 1968 produces a number of advantages: the method is very predictable, transparent in terms of quota holdings and involves minimal administration. The current method has allowed the quota holder to develop long-term supplier relationships as well as extensive knowledge of the domestic customer base, resulting in efficient importing and market responsiveness.

However, the continued monopoly of the buttermilk quota by a single firm does not, in our opinion, meet an acceptable standard of equity, nor does it allow for entry into the importing business for would-be competitors.

The arguments advanced in the cheese section with respect to transferability of quotas and disclosure have little relevance in the context of the current method, but would apply to any method that distributes quotas among more parties.

With respect to earmarking of import quotas for further processors, we are under the impression that buttermilk powder is only a minor ingredient in many processors' operations. No processor using buttermilk in its operations chose to participate in this inquiry. Neither is there a clear consensus as to the effect that earmarking might have in terms of displacing existing purchases of buttermilk powder from domestic manufacturers. Even if this impact is small, the Tribunal still believes that the CDC rebate program for further processors is a better approach to "levelling the playing field" for Canadian firms handicapped by higher-priced dairy ingredients in comparison with import competition in the domestic market.

The market share method is rejected for buttermilk for two major reasons. Firstly, as noted above, buttermilk powder is only a minor ingredient in many processors' operations, and there is a real possibility that the quota would be divided among a very large number of users. This raises the prospect of numerous small allocations floating around in the secondary market, thereby increasing transaction costs to end users. Secondly, we anticipate that a market share allocation approach would be very complex to administer in the case of the buttermilk import quota.

Again, the same reasoning as for cheese leads us to believe that the auction method fulfils the factors specified in the terms of reference in the most comprehensive manner and, in particular, ensures continuing equity of access to a quota for all industry participants. We recommend that the auction for buttermilk be modeled after the cheese auction, with the following exceptions:

1) the use of New Zealand buttermilk powder as a specialty commercial ingredient and the relatively small amount of the total quota would require that appropriate adjustments be made to raise the upper limits specified for individual purchases to 25 percent;

2) in view of the fact that sourcing requirements for this product are minimal, the term of the buttermilk quota need not be extended as with cheese, but instead, would be limited to one year; and

3) all imports would originate in New Zealand.

Additional imports would continue to be authorized in special cases; however, for products that are consumed in Canada, these permits would be subject to a fee equal to the most recent auction clearing price.

## 4. Evaporated/Condensed Milk

### a) Import Quota Allocation Options: Current Method and Alternatives

#### (i) The Current Method

Evaporated/condensed milk was placed on the ICL on August 14, 1970. The quota was set at 25,800 lbs (approximately 12 t) and allocated to the single Canadian importer of the product. That company, a distributor, has always fully utilized its quota allocation. The product must be imported from Australia.

Special import permits for evaporated/condensed milk have been issued in certain circumstances, albeit in limited volumes, for users such as provisioners for international shipping lines.

### (ii) Auction

Considering the size of the quota, the design of an auction for evaporated/condensed milk would entail decisions only on the frequency and the price settling mechanism of the auction.

## b) Assessment and Recommendations

The assessment of import quota allocation methods for evaporated/condensed milk is guided by a single overriding factor, i.e. that the total amount of the import quota is not sufficient to fill one shipping container.

It makes no sense to attempt to divide such a small benefit among industry participants given the very small amount of product involved. The possibility of concentration of the quota does not pose a concern. The prime consideration in this situation is equity of access.

In our view, this eliminates all methods except auction. The recommended auction would possess all the characteristics of the cheese auction with the following exceptions:

1) it would be held once a year for a one-year term;

2) there would be no restrictions on maximum allowable holdings by any one participant;

3) under-utilization penalties would be forfeiture of deposit and <u>no</u> participation in the following year's auction; and

4) all imports would originate in Australia.

Additional imports would continue to be authorized in special cases; however, for products that are consumed in Canada, these permits would be subject to a fee equal to the most recent auction clearing price.

# CHAPTER V

# OVERVIEW OF THE POULTRY AND EGG INDUSTRIES

## 1. Broiler Hatching Eggs and Chicks

### a) Scope of the Broiler Hatching Egg and Chick Industry

Table 5.1 provides an overview of the broiler hatching egg and chick industry.

**Table 5.1**

**OVERVIEW OF THE BROILER HATCHING EGG AND CHICK INDUSTRY 1991**

| | B.H. Eggs | Chicks |
|---|---|---|
| Number of Signatory Provinces and Regulatory Boards | 5 | N/A |
| Number of Federally Registered Entities | 298 producers | 77 hatcheries |
| Domestic Production | 454 million; (increased by 24% over the last 10 years) | 418 million; (increased by 24% over the last 10 years) |
| Signatory Provinces' Production | 406 million; (increased by 17% over the last 10 years) | 374 million; (increased by 16% over the last 10 years) |
| Share of Domestic Production which is Regulated | 90% of eggs only | Chicks not regulated |
| Setting of Production Quota (estimates) | 9 months in advance (March) | N/A |
| Setting of Final Production Quota | August of current production year | N/A |
| Import Quotas | 17.4% of current year's estimated B.H. egg production | 3.7% of current year's B.H. egg production |
| State in which the Product is Sold | Fertilized egg | Day-old chick |
| Product Imported | Fertilized egg | Day-old chick |
| Growing or Hatching Period | 3 weeks to hatch | 6 to 8 weeks |

N/A: Not applicable.

Source: Tribunal research.

### (i) Broiler Hatching Egg Producers

In 1991, broiler hatching egg producers located in the five supply managed provinces of British Columbia, Alberta, Manitoba, Ontario and Quebec represented 97 percent of all producers and 90 percent of total domestic hatching egg production. Ontario accounted for 30 percent of producers and 32 percent of hatching egg production, while Quebec represented 23 percent of producers and 29 percent of production.

### (ii) Federally Registered Hatcheries

There were 118 federally registered hatcheries[1] operating in Canada in 1991, of which 77 were engaged in the production of broiler hatching chicks. Sixty-nine of these were located in the five regulated provinces, and they produced 374 million of the total 418 million chicks hatched.

## b) Supply Management in the Broiler Hatching Egg and Chick Industry

Figure 5.1 illustrates the basic structure of the chicken and turkey hatching egg industries.

Supply management for broiler hatching eggs is administered by CBHEMA which was first established on November 27, 1986. However, it was not until May 1989, when import controls were first established for broiler hatching eggs and chicks, that CBHEMA attained full status as a supply management agency. The five member provinces of CBHEMA are British Columbia, Alberta, Manitoba, Ontario and Quebec.

CBHEMA establishes the yearly national production quota for hatching eggs and determines the allocation to each province. It sets quotas for intraprovincial, interprovincial and export trade for each member province and enforces a monitoring system to penalize those provinces that sell more than their intraprovincial and interprovincial quotas.

Each member province has a provincial commodity board or commission that is authorized to allocate the production quota to individual producers, license persons who engage in interprovincial or export trade and administer the allocation of the province's interprovincial and export trade quotas.

The provincial boards also set the minimum selling price for broiler hatching eggs sold intraprovincially. The pricing of broiler hatching eggs varies somewhat among the member provinces as does the basis for hatching egg sales. Only Ontario sets minimum selling prices for day-old chicks. In 1992, the Ontario Broiler and Roaster Hatching Egg and Chick Commission introduced an adjustment to the cost-of-production formula for hatcheries to reflect the lower cost of imported hatching eggs in establishing minimum chick prices in Ontario. This resulted in a $0.02 reduction in the minimum price in January 1992. While chick prices are not regulated in

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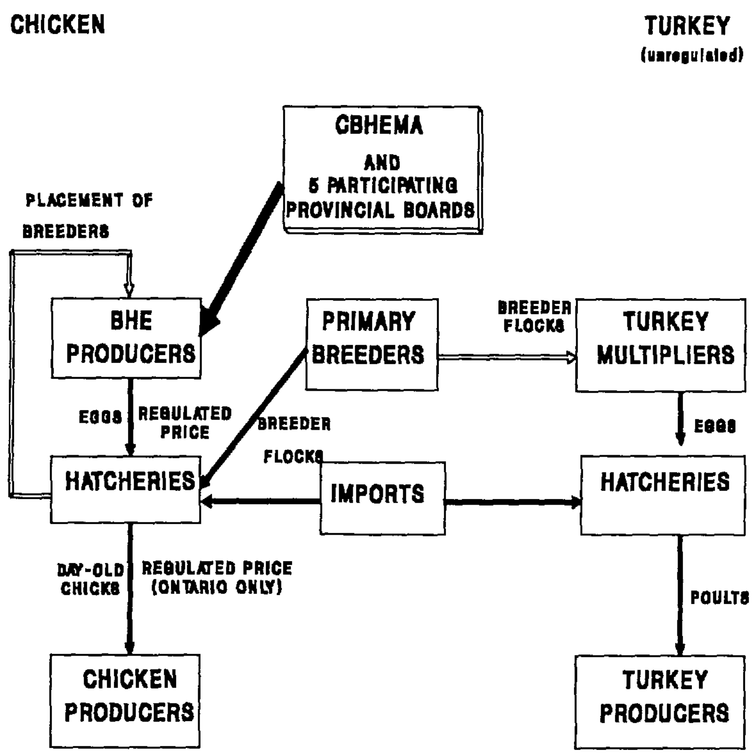
1. Registration of hatcheries is largely for purposes of disease control pursuant to the federal *Health of Animals Act*, S.C., 1990, c. 21. A registered hatchery must be equipped with an incubation capacity of 1,000 or more (broiler hatching) eggs and be used for incubation.

Figure 5.1

CHICKEN AND TURKEY HATCHING EGG INDUSTRIES




other provinces, individual hatcheries take Ontario prices into consideration when establishing their selling prices for day-old chicks.

## c) Competitiveness Profile and Challenges

### (i) Broiler Hatching Egg Producers

The supply management regime limits competitive behaviour among hatching egg producers. Not only are production volumes and selling prices for intraprovincial sales fixed by provincial commodity boards, but also pricing regulations, quotas and licensing for interprovincial trade restrict competition from producers in either regulated or unregulated provinces. Any competitive pressure on producers is therefore internal and likely to arise from the goal of minimizing costs of production.

Hatching egg producers tend to be associated with or under contract to particular hatcheries.

### (ii) Hatcheries

The hatchery trade level is positioned between two supply managed trade levels, namely, broiler hatching egg producers as suppliers and commercial chicken producers as buyers. The price that hatcheries pay for their principal input, broiler hatching eggs, is regulated, and selling prices for their output, day-old chicks, are either directly regulated, as in Ontario, or are strongly influenced by the Ontario price.

Hatcheries compete for contracts to supply commercial chicken producers on the basis of quality and service. This was emphasized in the testimony of Mr. John E. Hoover, Chairman of the CHF, who stated: "It is a very competitive business. There are customers who are won and lost on the basis of the quality of the product and, certainly in my time, quality has been the word upon which we have tried to sell chicks."[2]

Hatchery throughput must adjust to meet changes in chicken demand and supply. The demand for broiler hatching eggs is driven by the annual estimate of the demand for chicken converted into egg equivalents. The import share (egg equivalents) of the total supply of hatching eggs is significant at 21.1 percent of domestic production.

In describing how a hatchery goes about securing additional supply to meet a shortage, Mr. Hoover explained that a hatchery operator would begin by contacting local competitors and proceed to contact hatcheries further afield in other regions until, "like concentric circles,"[3] a suitable source is located. Mr. Brian A. Cram, testifying on behalf of Cuddy Chicks Limited, noted that although commercial relationships do develop among some competitors, approximately 65 percent of the import quotas "rented" by his firm are sourced from out-of-province hatcheries.[4]

In Ontario, three major chicken processors own hatcheries. This, combined with the practice of chicken producer/processor "lock-in" arrangements, has made chicken producers reluctant to change hatcheries when dealing with a processor-owned hatchery. The recent decision by the Ontario Chicken Marketing Board to terminate the chicken producer/processor lock-in is expected to increase competition among hatcheries for producer contracts. Mr. Brian Snyder, President of Jarvis Chicks, testified that his hatchery will be able to gain market share and noted that "In fact, it has started to happen, because we have signed the first contract forms for the first open period already. So, those growers are already talking about switching."[5]

Hatcheries and egg producers enter into supply contracts which are the basis for breeder placements. For example, Mr. Hoover noted that "in ... Ontario, no breeder is put in the field

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2. Transcript, June 17, 1992, at 4948.
3. *Ibid.*, at 4951.
4. *Ibid.*, at 5007.
5. *Ibid.*, at 4987.

unless there is a contract, with a hatchery, to take the production from that flock from 26 weeks of age until it is disposed of as fowl."[6] This assists hatcheries in matching their throughput to changes in demand in their downstream market (i.e. chicken producers) and securing high-quality hatching eggs in a timely fashion, at the lowest possible average price.

Hatcheries control the placement of breeders with the regulated hatching egg producers. Breeder flock suppliers have a long-standing arrangement not to supply flocks directly to hatching egg producers, but to deal through a hatchery. In practice, this means that although a provincial commodity board may allocate a production quota to a registered hatching egg producer, the quota could be underfilled by the hatchery. For example, in 1992, some 13,000 breeders which were allocated to producers in Manitoba were not placed by the hatcheries in that province.

In British Columbia, hatcheries concerned about having to accept domestic hatching eggs over and above their requirements have notified the B.C. Broiler Hatching Egg Commission that they will reduce all future placements by 10 percent.[7] This reduction in placements suggests that imports will displace the higher-priced domestic hatching egg production.

### d) Import Quota Rents[8]

In 1991, the estimated average unit quota rent accruing to importers of broiler hatching eggs was $0.93 per dozen. Total quota rents accruing to importers ranged from an estimated $5.9 million to $7.1 million using a 10-percent range in minimum and maximum quota rents, which reflect price differences over the year.

The average minimum unit quota rent arising from imports of chicks in 1991 ranged from an estimated $0.14 to $0.18 per chick. Total estimated quota rents accruing to importers from imports of chicks ranged from $1.9 million to $2.5 million.

## 2. Chicken and Turkey

### a) Scope of the Chicken and Turkey Industries

Table 5.2 summarizes the primary features of the chicken and turkey industries.

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6. Transcript, June 17, 1992, at 4960.
7. Letter dated April 22, 1992, from the B.C. Hatchery Association to the B.C. Broiler Hatching Egg Commission.
8. Deloitte & Touche, Import Quota Rents On Supply Managed Products, March 1992, at 56.

Table 5.2

OVERVIEW OF THE CHICKEN AND TURKEY INDUSTRIES
1991

| | Chicken | Turkey |
|---|---|---|
| Hatching Period | 3 weeks | 4 weeks |
| Growing Period (estimates) | 6 weeks - broilers<br>8 weeks - roasters | 12 weeks - broilers<br>15 weeks - hens<br>18 weeks - toms |
| Number of Provincial Boards | 10<br>(includes B.C.) | 8<br>(excludes Nfld. & P.E.I.) |
| Number of Producers | 2,516 (increased by 12% over the last 6 years) | 586 (increased by 8% over the last 10 years) |
| Production Year | Jan.1 - Dec. 31 | May 1 - April 31 |
| Setting of Production Quota (estimates) | 3 months in advance | 6 months in advance |
| Domestic Production | 561 million kilograms (increased by 45% over the last 10 years) | 132 million kilograms (increased by 41% over the last 10 years) |
| Import Quotas | 7.5% of previous year's domestic production 42,745,015 kg | 3.5% of current year's estimated production quota 4,406,178 kg |
| Annual Per Capita Consumption | 23.1 kg (increased by 36% over the last 10 years) | 4.7 kg (increased by 12% over the last 10 years) |
| Type of Products Imported (%) | Live - 3.6<br>Eviscerated - 7.5<br>Parts, bone-in - 44.2<br>Parts, boneless - 36.2<br>Processed - 8.5 | Live - 25.9<br>Eviscerated - 5.8<br>Parts, bone-in - 4.2<br>Parts, boneless - 59.7<br>Processed - 3.3<br>Skin - 1.1 |

Source: Tribunal research.

The Canadian poultry industry consists of two principal sectors: producers and processors. Other trade levels involved in the distribution chain for poultry products include wholesalers, retailers and the foodservice sector.

### (i) Commercial Poultry Producers

Commercial poultry producers must have a marketing or "production" quota to raise and sell live chicken or turkey for slaughter. In 1991, there were 2,516 commercial chicken producers and 586 commercial turkey producers in Canada.

In 1991, approximately 34 percent of Canadian chicken production took place in Ontario, 29 percent in Quebec, while the Prairies and British Columbia accounted for 16 percent and 13 percent of domestic output, respectively. The Atlantic provinces produced approximately 8 percent of Canada's chicken.

In 1991, Ontario was the largest turkey producer, producing 43 percent of the total Canadian output. Quebec was second, producing 22 percent, the Prairies ranked third with 20 percent, British Columbia was fourth with 10 percent, and the Atlantic provinces produced 5 percent of Canada's domestic turkey. Ontario prices for turkey at the farm-gate level tend to be one of the leading indicators for farm-gate prices in other provinces.

### (ii) Processors

A primary processor of chicken or turkey is a federally or provincially inspected facility which slaughters and eviscerates live chicken and turkey. The secondary processing function involves cutting up and deboning chicken or turkey.

Further processors of chicken or turkey are federally or provincially inspected facilities. They purchase whole eviscerated birds, bone-in or deboned chicken or turkey from primary, secondary or integrated processors, and transform the chicken and turkey meat into value-added poultry products. The products produced by further processors may be segregated into two groups: ICL poultry products, such as nuggets, fingers, rolls or roasts which are wholly made of chicken or turkey; and non-ICL poultry products, such as Kiev, entrées and TV dinners where a high percentage of the components are not chicken or turkey.

Integrated processors slaughter, eviscerate and cut up chicken or turkey and further process poultry in their own facilities. A processor must both slaughter and further process to be considered an integrated processor. Integrated operations are estimated to represent about 25 to 30 percent of the Canadian industry's processing activities, compared with 85 to 90 percent in the United States.[9]

### (iii) Distribution Sector

Wholesalers purchase whole eviscerated birds, bone-in or deboned chicken and turkey and further processed items for resale to retailers and foodservice firms. Retailers, in turn, cut up, display and sell these products to the final customer. Foodservice firms purchase whole eviscerated birds, bone-in or deboned chicken and turkey and further processed items. They cut up, cook, heat, prepare and serve the product to the final customer.

The foodservice sector includes firms ranging from fast-food outlets to institutions, to fine dining restaurants. These foodservice firms require a variety of poultry products. For example, companies such as KFC-Canada, Swiss Chalet and St-Hubert require eviscerated chicken meeting their different individual specifications. In addition, various further processed poultry products such as nuggets, fingers, Kiev and boneless chicken and turkey may also be used by these firms and other foodservice outlets.

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9. Industry, Science and Technology Canada, 1990-1991 Industry Profile, Poultry and Egg Processing, at 4.

## b) Supply Management in the Chicken and Turkey Industries

Supply management programs for poultry take the form of a series of commodity-specific agreements among federal and provincial governments, federal supervisory boards and provincial commodity boards. The national agencies for both chicken and turkey establish the amount of marketing or "production" quotas for each province. Since the inception of supply management, each province's percentage share of the total production has remained relatively constant despite numerous attempts by some provinces to change their shares in order to redress perceived regional market imbalances.

The provincial boards allocate their respective share of nationally established production quotas to individual producers.

Figure 5.2 illustrates the basic structure of the supply management system for chicken and turkey.

### (i) Chicken

Supply management for chicken comes under the control of the CCMA, which was established in 1978. Since December 31, 1989, the province of British Columbia is no longer a signatory to the national chicken supply management system. As a result of British Columbia's withdrawal from the CCMA, the province is no longer required to conform to that agency's regulations governing the amount of chicken that it can produce for its own consumption. Since the province's withdrawal, British Columbia's growth rate of chicken production has exceeded that in other provinces. British Columbia is, however, still required to adhere to the CCMA regulation respecting the amount of chicken that it moves interprovincially.

The CCMA sets the total quota in interprovincial, export and intraprovincial trade in member provinces; establishes and enforces a quota penalty system for provinces exceeding their annual and periodic allocations; licenses persons engaged in interprovincial and export trade of live chicken; and establishes a cost-of-production formula as a reference used by the provincial commodity boards when negotiating producer prices with processors.

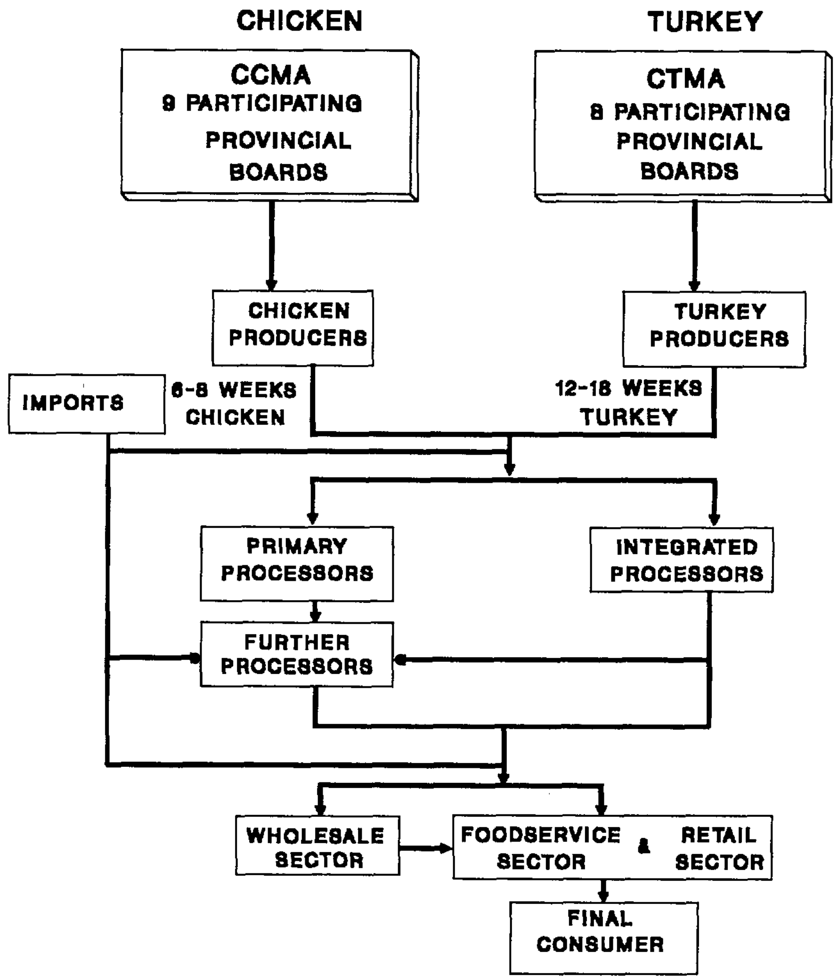
The provincial boards for chicken allocate their respective share of the national quota to individual producers which agree not to market in excess of their allocation. The provincial boards agree to provide the national agencies with a financial guarantee that they will adhere to the national agencies' quota allocations for their respective province.

Determining the price of chicken paid to producers by processors is also a provincial responsibility. In general, the provincial boards and processors use cost-of-production information together with other market factors to determine producer prices. The price set in the province of Ontario tends to be used as a guide by the other provinces. The boards agree to establish a minimum producer price.

On March 18, 1992, the Ontario Minister of Agriculture and Food announced revisions to the pricing and procurement system for chicken in Ontario, which was based on the price-setting authority of the Ontario Chicken Producers' Marketing Board and the allocation of supply

Figure 5.2

DOMESTIC CHICKEN AND TURKEY INDUSTRIES




to primary processors. Beginning on January 1, 1989, and up until September 19, 1992, producers in the province of Ontario were assigned to, and supplied, particular processors. A similar "lock-in" system has been in effect in Quebec since January 15, 1989. In other provinces, producers generally sell to processors of their choice.

The mandate of the Ontario Chicken Producers' Marketing Board has been changed from a price-setting authority to that of a price negotiator. As a result, prices in Ontario are currently negotiated between producers' and primary processors' representatives, with recourse to binding arbitration if required. In addition, chicken producers are able to select the processors to whom they sell through a system of open contracting, i.e. lock-ins are no longer in effect in Ontario. This new system allows primary processors direct input into pricing through a negotiating agency.

The framework for the new system sets out various principles, including negotiated minimum prices. The new pricing system for Ontario came into effect May 2, 1992, and the new agreement on live chicken procurement was introduced in September 1992.

No changes will be made to the pricing and allotment systems in Quebec for the remainder of 1992. However, producers and processors are working together to develop a new method for implementation in 1993.

#### (ii) Turkey

Supply management for the production of turkey comes under the control of the CTMA which was established in 1973. The CTMA regulates the production of turkey in all provinces, except Prince Edward Island and Newfoundland, which have virtually no turkey production.

The CTMA determines the production quota for each province, the specific weight categories required and the period in which the required production is to occur. It licenses the interprovincial movement of live turkey.

The price paid by processors to turkey producers is established by each provincial marketing board and, therefore, differs among provinces. For example, in Ontario, the provincial board establishes a minimum farm-gate price using a cost-of-production formula and prevailing market conditions as a guide. On the other hand, the Quebec producer price is set through negotiations between the processors and the provincial board. Although contracts may exist between producers and processors, producers in most provinces are generally free to sell to the processor of their choice.

### c) Competitiveness Profile and Challenges

#### (i) Commercial Poultry Producers

Currently, there is relatively little competition among chicken and turkey producers. Due to supply management, the percentage share of the marketing quota issued per farm has remained relatively stable. Because of the stability in provincial production, there is little threat of competition from producers in other provinces. Therefore, competitive pressure on producers is internal and likely a result of trying to minimize production costs.

#### (ii) Processors

The primary processing sector of the poultry industry faces a variety of competitive pressures arising from its position in the production/distribution chain. Mr. George Leroux, Vice-President of Cold Springs Farm Limited, characterized its circumstances as follows:

> *This sector, more than any other involved in turkey production, is classically "stuck." On the supply side, which is basically non-competitive ... the processing sector must purchase from grower controlled boards which are essentially monopolistic in their control of production volumes and price setting. On the demand side, the sector sells to either an increasingly concentrated retail sector*

*where individual firms have tremendous market buying power, or a further processed sector which has become increasingly integrated with both primary processing and other meat processing sectors. As a result, primary processing firms compete for restricted supply to sell to powerful buyers.*[10]

Also, Mr. Robert May, Chief Executive Officer of Maple Lodge Farms Ltd., stated that:

*The primary processor is the direct interface between the free market system, and the monopoly that the boards have.... There is, with the rationalization that has taking place today, it is a very competitive and volatile market out there.*[11]

Primary processors are unable to exert any real control on supply other than through participating in advisory committees established by the supply management agencies.

The degree of vertical integration in the chicken and turkey processing industries is increasing as more primary processors become involved in further processing. There has been a steady increase in processing capacity as a result of plant expansions and modernization undertaken to meet the growing demand, largely from the foodservice sector, for value-added products such as nuggets, Kiev and fingers. Buy outs and mergers have resulted from firms competing for domestic market share and sources of raw material.[12]

Testimony at the June hearing indicated that independent further processors have particular concerns. For example, Mr. Fred Williamson, President of Pinty's Premium Foods Inc. and Mr. Lem Janes, President of Janes Family Foods Ltd., noted that independent further processors face additional challenges caused by rationalization, concentration of slaughtering and the additional further processing being done by primary processors.

During the January-February and the June hearings, many parties involved in poultry processing argued that the availability of supply is the most important factor contributing to competitiveness. While imports represent only a small portion of the total domestic supply of chicken and turkey, for some individual processors, imports represent the major, or even the only, source of supply. Supply of chicken and turkey is seen as critical because, in most cases, chicken or turkey is the only input used by poultry processors. In comparison, the supply of chicken and turkey to other players such as importers, distributors and retailers is not viewed as critical to their operation because firms at these trade levels, generally, do not rely solely on the availability of these products.

Processors manufacturing non-ICL products using ICL inputs face a particularly difficult competitive situation. These processors compete with products imported from the United States that are not subject to import controls and that are manufactured primarily using lower-cost poultry inputs. In addition to the input cost disadvantage, the tariff protection afforded these processors is being eliminated under the provisions of the FTA. The problems of these

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10. Public submission of Mr. George Leroux, May 28, 1992, at 3.
11. Transcript, January 30, 1992, at 1830.
12. Industry, Science and Technology Canada, 1990-1991 Industry Profile, Poultry and Egg Processing, at 3.

processors have been recognized by the government and are currently being addressed, in part, through the earmarking of import quotas for the production of non-ICL products.

Poultry processing operations are capital intensive. To respond to the needs of the foodservice and retail sectors, many poultry processors have invested heavily in new plant facilities and equipment. In addition to slaughtering and selling whole birds, processors provide pre-cut poultry parts, special cuts, deboned, breaded and prepackaged items because many of the processors' customers are not normally equipped to cut nor use all parts of a chicken or turkey. The poultry processing industry continues to employ a large work force, notwithstanding the introduction of specialized equipment that has been developed in an effort to keep pace with the proliferation of new products. Most processing operations continue to rely heavily on the human element. Therefore, steady throughput of either domestic or imported product is important to help ensure efficient capacity utilization and keep labour employed.

Further processors have somewhat more bargaining power with their suppliers (primary and secondary processors) than do the primary processors with their suppliers (commercial poultry producers). At present, it appears that processors may experience timing and specification problems with respect to the availability of raw product.

### (iii) The Distribution Sector

Processors are typically suppliers to the wholesale and retail sectors. Many of the large retail chains belong to buying groups. Individual processors do not have a high degree of relative bargaining power since wholesalers and retailers can purchase from alternate suppliers.[13]

On the consumer side, retailers face several pressures, including the growing trend to consume food products away from home, cross-border shopping and the variety of food choices available to consumers, such as beef, pork and fish. Retailers have responded, in some measure, with deli counters and more ready-to-eat foods.

Given the considerable amount of rivalry existing in the retail sector, the slow to negative growth in retail sales and the consumer issues raised above, the retail sector may be described as being competitive.[14]

The foodservice sector is one of the fastest growing areas of chicken consumption. It now accounts for approximately 40 percent of the chicken consumed in Canada. One of the main pressures facing this industry is the availability of poultry, mainly chicken, in sufficient quantity, at the right time and to the right size specification. Testimony at the hearings indicated that cross-border shopping was also a concern for the foodservice industry, particularly those establishments in close proximity to the United States.[15]

Other poultry-specific pressures facing the foodservice sector include the threat of new entrants and competition from other fast-food establishments selling substitute foods such as

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13. Deloitte & Touche, Competitiveness Profile of the Chicken Industry, March 1992, at 34.
14. *Ibid.*, at 35.
15. Canadian Restaurant and Food Services Association, public submission, January 1992, at 7.

pizza, hamburgers or fish fillets. These substitute foods may also compete with poultry products within the same establishment. Two measures of competitiveness in the foodservice sector are the amount of price cutting in an attempt to increase volumes and the trend towards outlets offering a wider range of products.[16]

Overall, there appears to be potential for further growth in the chicken and turkey industries. For example, Canadian annual per capita consumption of chicken was 23.1 kg/person[17] in 1991, compared to 32.9 kg/person[18] in the United States. The increasing trend in the annual Canadian per capita consumption of chicken means that it may soon be expected to compete with pork as the second most popular meat consumed in Canada after beef.[19]

### d) Import Quota Rents

In the Analytic Staff Report, Tribunal staff estimated that the value of import quota rent for the chicken industry in 1991 was between $26.4 million and $40.5 million.[20] Import quota rent for the turkey industry was estimated to be approximately $4.4 million.[21] These estimates take into account the actual volume of each category of chicken and turkey product imported by the various trade levels. As shown earlier in Table 5.2, imports of boneless chicken parts in 1991 accounted for 36.2 percent of total ICL chicken imports, while whole eviscerated chicken represented only 7.5 percent of imports.

The unit import quota rent varies between products and trade levels. The estimated import quota rent for further processors in 1991 was $0.22/kg for whole chicken legs, $0.75/kg for eviscerated chicken and $1.12/kg for boneless chicken parts.[22]

## 3. Shell Eggs and Egg Products

### a) Scope of the Shell Egg and Egg Product Industries

Table 5.3 gives an overview of the shell egg and egg product industries.

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16. Deloitte & Touche, Competitiveness Profile of the Chicken Industry, March 1992, at 36.
17. Statistics Canada, Production of Poultry and Eggs, 1991, at 9.
18. U.S. Department of Agriculture, Livestock and Poultry, Situation and Outlook Report, May 1992, at 42.
19. Industry, Science and Technology Canada, 1990-1991 Industry Profile, Poultry and Egg Processing, at 3.
20. Canadian International Trade Tribunal, Analytic Staff Report, May 1992, at 114.
21. *Ibid.*
22. Deloitte & Touche, Import Quota Rents on Supply Managed Products, March 1992, at 24, 25 and 27.

**Table 5.3**

**OVERVIEW OF THE SHELL EGG AND EGG PRODUCT INDUSTRIES**
**1990**

| | Shell Eggs | Egg Products |
|---|---|---|
| Supply Managed | Yes | No |
| Number of Producers | 1,626 (decreased by 25% over the last 10 years) | 14 (registered stations only) |
| Total Production | 471,787,000 dz. | 39,649 t (67,305,000 dz. shell egg equivalents) |
| Less: Broiler Hatching Eggs | 40,953,000 dz. | N/A |
| Net Production | 430,834,000 dz. | 39,649 t (67,305,000 dz. shell egg equivalents) |
| Number of Federally Registered Egg Grading Stations/Processed Egg Stations | 245 (decreased by 42% over the last 10 years) | 14 (decreased by 18% over the last 10 years) |
| Customers | Retail trade | Further processors, foodservice, wholesalers/distributors |
| Annual Per Capita Consumption | 13.98 dz. | 2.22 dz. shell egg equivalents |
| Import Quota (as a percentage of the previous year's net shell egg production) | 1.647% | Frozen and liquid - 0.714%<br>Dried - 0.627% |

N/A: Not applicable.

Source: Tribunal research.

The shell egg and egg product industries are composed of three principal sectors:

a) shell egg producers;
b) federally registered egg grading stations; and
c) registered processed egg stations.

### (i) Shell Egg Producers

An egg producer is any person or operation engaged in the production of eggs in Canada and includes a producer/vendor, which means a producer who is also an egg grading station operator.

In 1990, the shell egg industry in Canada was comprised of 1,626 egg producers. Between them, Ontario and Quebec accounted for 51 percent of the total number of egg producers in Canada and for 56 percent of total Canadian egg production.

### (ii) Federally Registered Egg Grading Stations

Egg grading stations have one or more rooms where eggs are graded for the commercial market prior to sale.

In 1990, the 245 federally registered egg grading stations in Canada received and graded 400.3 million dozen eggs. Grade A large eggs, which are destined primarily for the table market, accounted for slightly more than 50 percent of total domestic eggs graded. Ontario and Quebec represented 55 percent of all Canadian graders in 1990 and had 58 percent of the total throughput of grading stations. The two largest graders in Ontario and Quebec accounted for approximately 67 percent and 40 percent, respectively, of all eggs graded in those provinces.

### (iii) Registered Processed Egg Stations

Egg processors wash, break open, blend, pasteurize, dry and freeze eggs, mainly for resale and primarily to further processors. Some egg processors themselves may further transform egg products into value-added consumer egg products such as boiled and pickled eggs or enzymes for the pharmaceutical industry.

In 1990, the processed egg industry in Canada was comprised of 14 major registered processed egg stations (breakers) whose total production of egg products was 39.6 million kilograms. Most of those stations were located in Ontario, with one major producer also located in each of British Columbia, Manitoba and Quebec.

## b) Supply Management in the Shell Egg Industry

Figure 5.3 shows the basic structure of the domestic shell egg and egg product industries.

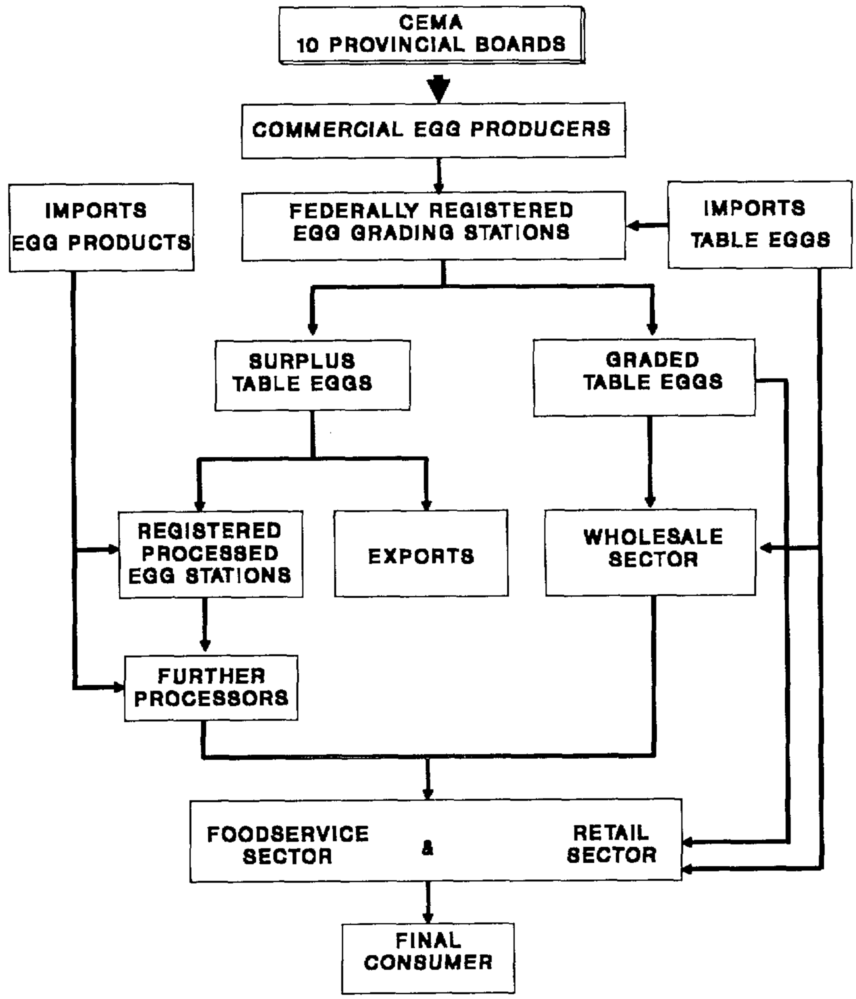
CEMA was created in 1972 and functions as a federation of the 10 provincial marketing boards. It is responsible for setting the national production quota and allocating it to provincial members according to a negotiated provincial share formula. It also administers a central pricing system and a surplus removal program for eggs declared surplus to the table market.

Provincial commodity boards have the responsibility of allocating their production quota among their producers who, in turn, market their eggs to the egg grading stations of their choice. Provincial boards also ensure that provincial production does not exceed the allocation.

Egg producers sell their product to graders at prices determined by CEMA or by provincial commodity boards, based on a cost-of-production formula designed to ensure that efficient producers receive a reasonable return, over time, on their operations.

Figure 5.3

DOMESTIC SHELL EGG AND EGG PRODUCT INDUSTRIES




## c) Competitiveness Profile and Challenges

### (i) Shell Egg Producers

The competitiveness of the egg production industry is limited by the fact that production volumes and prices are controlled by supply management. Any competitive pressure on producers is therefore internal and likely to arise from the goal of minimizing costs of production. It is primarily through reductions in production costs that egg producers are able to maximize their returns, since selling prices are the same to producers within each province.

### (ii) Federally Registered Egg Grading Stations

There is no opportunity for egg grading stations to receive any competitive assistance in the form of lower input prices from their upstream suppliers, due to supply managed price controls. However, egg grading stations have some chance to offer their downstream customers lower prices if they can achieve economies of scale in the processing of shell eggs or purchase imported shell eggs at lower prices.

### (iii) Registered Processed Egg Stations

Egg processing stations purchase their inputs (surplus eggs) from CEMA at preferential prices based on the Urner-Barry price for industrial shell eggs in the United States. This pricing system was adopted because most of Canada's food processors were either owned by, or competed directly with, U.S. manufacturers of similar products. Both CEMA and the domestic processors agreed that the Canadian price for breaker eggs should not exceed the equivalent U.S. price. As a result, CEMA sells eggs to breakers at prices which are often as much as $0.50 a dozen below CEMA's purchase price.

The share of total sales of shell eggs accounted for by sales to processors has been rising in recent years. What started out as a 95:5 ratio between table eggs and processed eggs is now an 85:15 split. In CEMA's view, it is conceivable that, by the year 2000, the share of eggs destined to the processing sector could be as high as 40 percent of domestic disappearance.

Egg processing stations can offer lower prices to their domestic customers only to the extent that economies of scale permit or that they can access imports to blend their selling prices. However, as noted above, domestic selling prices for breaker eggs are based on prices for similar eggs in the U.S. market. To the extent that these input costs are a major determinant of the price of the finished product, domestic egg products should be more or less equivalent in price to imported egg products. This appears to be the case because of the low quota rents associated with imports of egg products.

## d) Import Quota Rents

### (i) Shell Eggs

Import quota rents for shell eggs in 1991 were estimated at between $1.24 million and $1.44 million.[23] To put that figure in context, Agriculture Canada has estimated the 1990 wholesale value of shell eggs in Canada at more than $545 million.

The relative insignificance of the low quota rents associated with shell eggs seems to be borne out by the fact that, although all 245 federally registered egg grading stations are eligible to apply for a share of the post-FTA import quota, only one third of those graders had made such application and received a quota in 1991 and 1992.

23. Deloitte & Touche, Import Quota Rents on Supply Managed Products, March 1992, at 54.

### (ii) Egg Products

Estimated quota rents in 1991 for liquid and frozen egg products ranged from a minimum of $4,000 to a maximum of $166,000. This small value is not surprising, given that domestic prices for industrial eggs, which are used as inputs into the production of egg products, are based on U.S. prices for similar eggs. It is to be expected that domestic egg products would tend to be priced competitively with imported egg products and that no significant economic benefit would accrue from holding import quotas.

There is little, if any, rent associated with the import quota for dried eggs. Even though the import quota is allocated freely to interested parties on a first come first served basis, the quota for dried eggs was only 54 percent utilized in 1991.

# CHAPTER VI

# OPTIMUM IMPORT QUOTA ALLOCATION METHODS - THE POULTRY AND EGG INDUSTRIES

## 1. Broiler Hatching Eggs and Chicks

### a) Import Quota Allocation Options: Current Method and Alternatives

#### (i) The Current Method

Broiler hatching eggs and chicks were placed on the ICL on May 8, 1989. The combined quota was based on the average volume of imports between 1984 and 1988 and amounted to 16.3 percent of domestic production. In 1990, after modifying the calculation of domestic production to include exports and exclude imports, the quota level was increased to 19.07 percent of domestic production. The combined annual import quota was increased to 21.1 percent of domestic production in November 1990, following completion of the Canada/United States agreement concerning imports of broiler hatching eggs and chicks. The combined level was subdivided into separate quotas for broiler hatching eggs and chicks. The import quota for eggs is equivalent to 17.4 percent of domestic production of broiler hatching eggs and, for egg-equivalent chicks, is equivalent to 3.7 percent of domestic broiler hatching egg production. Estimates of the import quota levels are made in November prior to the allocation year and finalized each August, reflecting any change in the actual production level compared to the initial estimate upon which the quota estimates were based.

Initially, import quotas were allocated to applicants on the basis of historical imports. Any remaining quotas not allocated on this basis were allocated to federally registered hatcheries on the basis of their market share. On May 8, 1989, the government announced that, beginning in 1990 and in each of the next three years, 25 percent of the quotas originally allocated on the basis of historical imports would be retrieved and reallocated only to federally registered hatcheries on the basis of their market share. After 1993, only federally registered hatcheries would be eligible for import quotas.

To ensure that both the broiler hatching egg import quota and the chick import quota are fully allocated, each hatchery is allocated a proportional amount of both quotas. The hatcheries must utilize at least 90 percent of their annual import quota allocations for both broiler hatching eggs and chicks or see them reduced in the following year by the percentage of under-utilization. If a quota holder imports hatching eggs, but arranges for them to be delivered for use by another hatchery, the importation would still be recorded as utilization of the holder's import quota. Unused import quota cannot be carried over to the next calendar year.

A broiler hatching egg import quota allocation may be converted into a chick import quota at the conversion rate of 1.27 eggs per chick. A chick import quota allocation may not be converted to a broiler hatching egg quota unless agreed to by the two signing parties to the Canada/United States agreement.

There are two categories of SUPPs for broiler hatching eggs and chicks:

1) to import broiler hatching eggs and chicks to alleviate temporary shortages and strengthen market responsiveness in Canada; and

2) to import broiler hatching eggs for reexport as chicks.

In order to be eligible for SUPPs, applicants must use 30 percent of their import quota allocations for both broiler hatching eggs and chicks by March 31, 60 percent by June 30 and 80 percent by September 30 of the same year. The second test is the lack of availability of domestic eggs or chicks. Firms seeking hatching eggs are not required to accept chicks, which may be offered in place of eggs.

In 1990, SUPPs amounted to 21.5 percent of the import quota while in 1991, they represented just 2.0 percent of the import quota. No SUPPs were issued during the first half of 1992.

In 1992, 80 firms were allocated import quotas for 6,569,912 dz. hatching eggs and 13,873,943 broiler chicks.[1]

Figure 6.1 displays the regional and trade level distribution of import quotas for broiler hatching eggs and chicks in 1989 and 1992. Import quotas have clearly shifted from Ontario and the Atlantic provinces to British Columbia and the Prairies as a result of quotas being clawed back from traditional holders and reallocated to hatcheries. The quadrupling of British Columbia's share of the import quotas from 1989 to 1992 also reflects the fact that the growth rate of chicken production in British Columbia exceeds that of the other regions.

The proportion of import quotas allocated to hatcheries and firms affiliated with hatcheries rose from 1989 to 1992, in accordance with the claw-back procedure initiated in 1990. The figure also shows the increasing integration of hatcheries with other trade levels. The majority of the integrated hatcheries are linked to chicken processing operations.

### (ii) The Current Method with Modifications

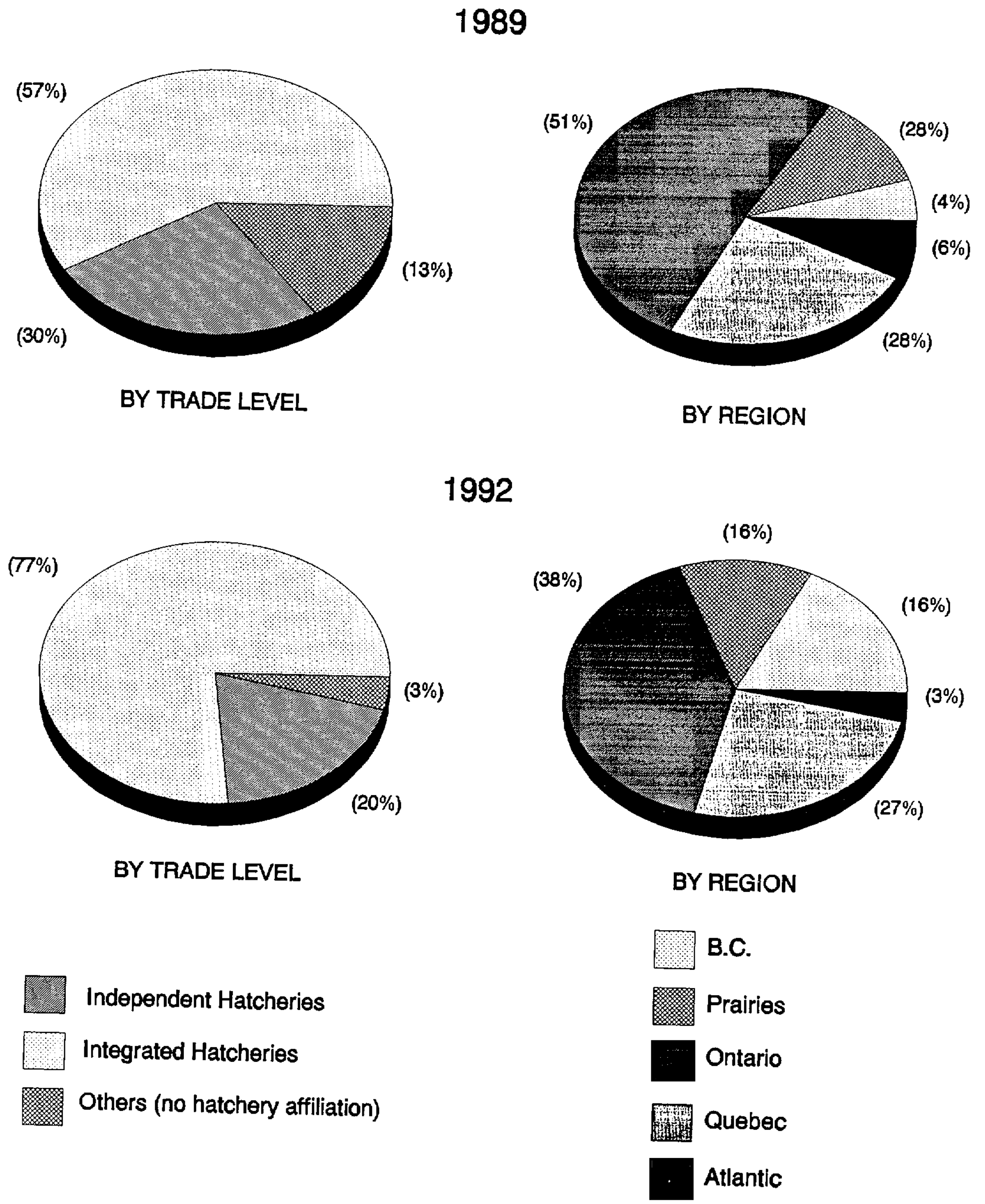
One modification to the current allocation method would be to explicitly allow the transfer of import quotas among federally registered hatcheries. An import quota holder (the transferrer) would authorize the EIPB to issue import permits for broiler hatching eggs or chicks to other hatcheries (the transferee), allowing them to draw down the transferrer's quota allocations. The transferrer would still be responsible for meeting the minimum 90-percent utilization requirement.

Another modification, beyond transferability, would also facilitate the reallocation of import quotas. The market-share-based allocations would be made to each eligible hatchery, but would then be adjusted to reflect unused allocations over the previous two years or purchases in addition to the hatchery's allocations during the period. Unused quotas would be deducted from

1. EIPB data. The 80 firms in question were each allocated both broiler hatching egg and chick import quotas.

Figure 6.1

DISTRIBUTION OF IMPORT QUOTAS (1989 AND 1992)
BROILER HATCHING EGGS AND CHICKS




Source: CBHEMA submission, January 10, 1992, at 6 (1984-88 annual average), Tribunal research, and EIPB data.

the allocations of hatcheries in a surplus position and would be reallocated to hatcheries that had been short and that had been acquiring import quotas on the secondary market.

Either of the above options could include a formal appeal process as well as the publication of allocations to individual quota holders within broad ranges.

### (iii) Auction

A broiler hatching egg and chick import quota auction would need to address many of the same issues raised in the discussion of cheese auctions.

In addition, because of the manner in which the broiler hatching egg and chick import quotas are established, it would likely be useful to conduct two auctions each year. In November, prior to the allocation year, 75 percent of the estimated import quotas for the following year could be auctioned, with a second auction in August distributing the balance of the total import quotas for the year.

One variation would be to limit a broiler hatching egg and chick auction to federally registered broiler hatching egg hatcheries.

### (iv) CBHEMA: Historical Provincial and Market Share

CBHEMA proposed to allocate the import quotas to provincial commodity boards on the basis of historical import levels, specifically the five-year average annual import level in each province during the period 1984-88. Quotas would then be allocated to individual hatcheries within each province on the basis of their percentage share of the province's throughput. In addition, CBHEMA proposed that a "stakeholder corporation" be created to collect the quota rents and to redistribute them to hatcheries and others in the broiler hatching egg industry sector to fund such activities as research programs.

## b) Assessment and Recommendations

As we have already concluded in the preceding chapters, we view auction as an attractive import quota allocation method, particularly from the equity standpoint. However, with respect to broiler hatching eggs and chicks, we were concerned with the possibility that auctions could disrupt regional supply patterns from one year to the next with serious consequences for downstream industries.

In our view, the potentially disruptive impact of an auction for the broiler hatching egg and chick sector differs from that for cheese, for which we have recommended the auction method. First, imports of broiler hatching eggs and chicks represent a significantly greater share of the market than do imports of cheese. Also, virtually all chicks hatched are critical inputs to the downstream market, chicken production, which is another supply managed industry. Unlike cheese, there are no foodservice or consumer markets for either broiler hatching eggs or chicks. Nor is there any viable alternative to hatching eggs for the hatcheries or chicks for the chicken industry if supply is disrupted.

Our conclusion is that auction, whether open or limited to a single trade level, is not an appropriate import quota allocation method for broiler hatching eggs and chicks.

CBHEMA contended that imports displace domestic production in some regions because the current method of allocating import quotas results in regional distributions which differ significantly from historical import patterns. It proposed a return to historical provincial import patterns combined with a market share system for individual allocations within each province.

In our view, an import quota allocation method based on provincial import shares established at some time in the past would not offer sufficient flexibility to respond to future changes in the marketplace. Given the regional inflexibilities on the production side, our preference was for an import quota allocation method that would not entrench provincial shares but would offer the maximum flexibility with respect to regional flows of imported product. The other reason for rejecting CBHEMA's proposal is that, in our view, it does not constitute a nationally based method as required by the terms of reference.

CBHEMA also argued that the current method is not compatible with the supply management scheme for broiler hatching eggs. We have previously stated, in Chapter II of this report, that we do not interpret the terms of reference to mean that the import quota allocation method need be the same as the one for allocating the production quota for broiler hatching eggs. Furthermore, we are not convinced that the current method of import quota allocation is the sole cause of, nor could any revision to it alone resolve, the present difficulties in British Columbia cited by CBHEMA as evidence of the alleged incompatibility of the current method with supply management.

The regional pattern of import quota allocations under the current method results in the gradual transfer of import quotas through the secondary market, from hatcheries in a long position to those that are repeatedly short of supply.[2] Tribunal staff proposed to speed up this corrective feature by reallocating surplus quotas, every two years, to hatcheries that secured additional import product in the secondary market. The proposed modification is driven by a "use it or lose it" requirement.

However, in our view, the economically rational strategy of hatcheries holding import quotas, faced with a "use it or lose it" requirement, would be to fully utilize their lower-cost imported inputs, which would likely involve displacing domestic production through reductions in breeder placements or early kills of producing birds. For these reasons, we do not recommend adopting this modification of the current method.

The current method of import quota allocation for broiler hatching eggs and chicks was the first Canadian import control system for supply managed products to adopt economic activity (specifically throughput) as the basis for allocating the entire quota. The method is evolving and the industry's experience with the method has been relatively short. In 1993, the remaining 25 percent of the historical import quotas will be reallocated to federally registered hatcheries, thereby allocating the global import quotas to one trade level.

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2. Transferred product reduces the throughput reported by the transferrer for purposes of applying for import quotas in the following year, as it is reported as throughput by the recipient of the product.

In our view, allocating the import quotas to one trade level in this industry is preferable for a number of reasons. First, hatcheries are the only trade level that can make commercial use of broiler hatching eggs and add further value to them through the incubation and hatching process. It seems reasonable to allocate the import quotas to the trade level that accounts for 100 percent of the commercial demand for broiler hatching eggs and that supplies virtually 100 percent of the broiler chicks to the chicken production industry.

Second, the egg hatching function is a critical step in the poultry meat chain, and the global import quotas constitute a large portion of the total input supply. Positioning the global import quotas in that single trade level significantly enhances predictability by providing a safeguard against serious disruptions of the market stemming from changes in import patterns.

The significant size of the broiler hatching egg and chick import quotas and their inherent benefit emphasize the need for an import quota allocation method that is highly equitable within the designated trade level and that does not confer an undue economic advantage to any particular hatchery.

We find that the current method is equitable because the market share basis puts participants in the selected trade level (hatcheries) on a similar footing.

The evidence of most parties supports the conclusion that the current method is both predictable and, with its active secondary market, responsive. The CHF and hatchery representatives endorsed maintaining the current method of import quota allocation. In response to a request to describe the system after the completion of its evolution, Mr. Hoover of the CHF characterized the current method as follows:

> *I think it is going to be predictable, from the standpoint of each hatcheryman knowing in advance what he has contracted for, in terms of domestic production; within a few cases of eggs knowing what he is going to be eligible for, in terms of his global import quota. He is going to be able to make his market plans, in terms of estimating what his share, or what his customer base is going to be. He will have the option, depending on what province he is in, of being able to purchase greater than 78.9 percent of his raw supply from local producers. He will then have the option of being able to sell some of the annual allocation that he is going to receive from [the] EIPB.*[3]

The current method does not officially permit the transfer of the import quotas. However, this does not appear to have hindered the operation of an active secondary market in imported product. In our view, it would be useful to eliminate any doubt on the part of industry participants as to their ability to transfer import quotas and to remove any potential impediment to the operation of the secondary market. In addition, transferability would provide the end user with direct access to import quotas and control over their use throughout the year without involving the quota holder in transactions with export suppliers.

3. Transcript, June 17, 1992, at 4976.

Therefore, we recommend that the current method of allocating import quotas for broiler hatching eggs and chicks be retained, but modified to include transfer of import quotas. In addition, we recommend two additional modifications: the introduction of an appeal mechanism and public disclosure of individual import quota allocations, within ranges, so as not to reveal the confidential market shares of quota holders.

We view the SUPP system for broiler hatching eggs and chicks as being designed to alleviate temporary shortages in supply primarily arising from gaps in the flow of product from the supply management system and when, for various reasons, import product of sufficient quantity or quality is not available. By comparison, the global import quota allocation method is an integral part of the total supply base. In our view, because SUPPs are a safety valve, all participants at the hatchery trade level should have equal access to them. For these reasons, we recommend that the current criteria applied to allocate SUPPs continue unchanged in the future.

## 2. Chicken and Turkey

The chicken and turkey industries, while quite different at the producer level, are very similar in nature and operation at the processing and distribution levels. Therefore, our analysis and recommendations apply equally to both the chicken and the turkey industries.

### a) Import Quota Allocation Options: Current Method and Alternatives

#### (i) The Current Method

Import controls were imposed on chicken in 1979. The import quota was initially allocated to firms with a history of importing chicken during the years from 1976 to 1978. The total levels of the import quota for the years 1979, 1980 and 1981 were set through negotiations with the United States. For the years 1982 through 1988, the global chicken import quota was set at 6.3 percent of the previous year's domestic production of chicken, as reported by Statistics Canada.

Import controls for turkey were introduced in 1974. The import quota was initially allocated to firms with a history of importing turkey during the years from 1971 to 1973. The total amount of the import quota was set at 2 percent of the current year's estimated domestic production and continued to be set at that percentage of the estimated domestic production until 1989.

In 1989, as a result of the FTA, the level of the chicken import quota was increased to 7.5 percent of the previous year's domestic production of chicken, while the quota for turkey grew to 3.5 percent of the current year's estimated domestic production of turkey. These increases were allocated, first, to further processors producing non-ICL poultry products using ICL poultry input materials, as described in step (2) below.

Currently, chicken and turkey import quotas are allocated as follows.

1) Traditional importers are allocated an amount equal to their historical allocation for the previous year (their historical base amount, adjusted when applicable, for under-utilization[4] in previous years).

2) Further processors of chicken or turkey products, which manufacture products that are not on the ICL, are allocated an amount of the chicken or turkey import quota up to the volume of chicken or turkey required to produce the same amount of those products that was produced the previous year.

3) The remaining import quota is the "unallocated pool," which is allocated as follows.

   a) Small traditional import quota holders (less than 290,000 kg of the traditional import quota for chicken and less than 100,000 kg of the traditional import quota for turkey) and new entrants (applicants who are not traditional import quota holders) are allocated 60 percent of the unallocated pool on an equal share basis. Applicants for the equal share portion must provide evidence that they are "active"[5] in the poultry industry. Sales at the retail level do not qualify, thereby excluding the retail and foodservice sectors.

   b) Traditional import quota holders are allocated the remaining 40 percent of the unallocated pool on a pro-rata basis.

Chicken and turkey import quotas are allocated, and permits are subsequently issued, for amounts in eviscerated weight equivalent units that use conversion factors to put live poultry and deboned poultry products on a similar weight basis as eviscerated bone-in poultry products.[6]

To ensure a relatively stable utilization of the chicken import quota throughout the year, firms that hold an import quota in excess of 100,000 kg must use no more than 30 percent of their holdings during the first quarter of the year, 60 percent in the first half and 90 percent in the first three quarters of the year. No such provisions exist for the turkey import quota.

In 1991, a global import quota of 42,745,015 kg of chicken was allocated to 232 firms. A global turkey import quota in the amount of 4,406,178 kg was allocated to 100 firms. There were 80 firms holding both chicken and turkey import quotas that year.

Figure 6.2 shows the distribution of chicken and turkey import quotas in 1991, by trade level and by region.

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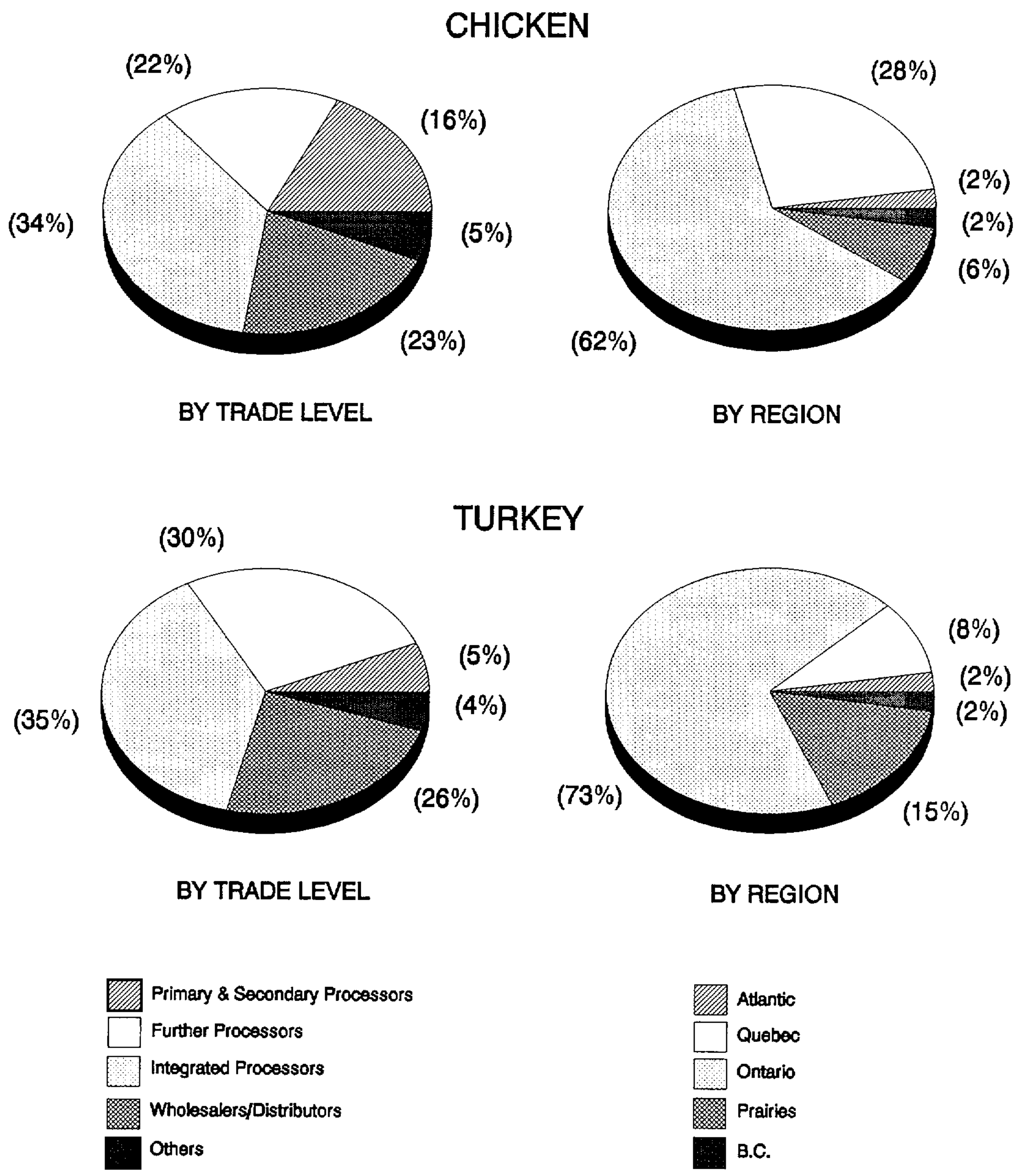
4. Failure to utilize 90 percent or more of a firm's annual import quota allocation will result in the next year's allocation being reduced to the actual level of imports in the preceding year.

5. Active firms are defined as those that have purchased or sold at least 218,000 kg in eviscerated equivalent weight of chicken or turkey, at any trade level, during the previous 12-month period.

6. For example, live chickens and turkeys are converted to an eviscerated weight equivalent by multiplying the live weight by 0.75 or 0.82, respectively, while boneless poultry products are converted to eviscerated weight equivalents by multiplying the product weight by 2. Therefore, it requires 2 kg of import quota to obtain an import permit for 1 kg of boneless poultry products.

Figure 6.2

DISTRIBUTION OF IMPORT QUOTAS (1991)
CHICKEN AND TURKEY




Source: EIPB data.

The processing sectors, including primary, secondary, further and integrated processors, hold roughly 70 percent of both the chicken and turkey import quotas. This share has remained relatively constant over the last four years.

The regional breakdowns of import quota holdings do not necessarily reflect the split of actual imports between the regions. Many firms with head offices in Ontario or Quebec have operations in other regions and may use all or part of their allocations in those other regions.

The utilization of the FTA portion of the import quota for non-ICL chicken products increased from 61 percent in 1989 to 71 percent in 1991, falling to 69 percent in 1992. The share of the global chicken import quota accounted for by allocations to producers of non-ICL chicken products equalled 9.7 percent in 1989 and grew to 11.4 percent in 1991, before decreasing slightly to 11.0 percent in 1992.

The utilization of the FTA portion of the import quota for non-ICL turkey products dropped from 78 percent in 1989 to 63 percent in 1991, but jumped to 84 percent in 1992. As a percentage of the total turkey import quota, the non-ICL product allocation has varied between 7 and 10 percent during the 1989-92 period.

Permits for the importation of chicken or turkey, supplementary to the global import quotas, may be issued if the Minister judges that the importations are required to serve overall Canadian market needs. These SUPPs for chicken and turkey may be issued in four circumstances:

1) when a controlled product is not available from domestic sources due to temporary shortages;

2) for use in the manufacture of non-ICL products over and above the amount of product awarded from the non-ICL earmarked portion;

3) for use in further processing and reexport; and

4) for market testing.

SUPPs to alleviate temporary shortages are the most common. Use of this provision has varied from year to year, and from product to product, depending on the state of the domestic market.

Since 1981, shortage SUPPs for chicken ranged from a low of 375,000 kg in 1991 to a high of 17,675,000 kg in 1984, with the average over the last four years being 2,350,000 kg, or 5.4 percent of average total imports.

During the last 10 years, shortage SUPPs for turkey ranged between 27,216 kg in 1988 and 1989, to 4,222,211 kg in 1986, with an average volume over the last four years of 61,942 kg, or approximately 1.9 percent of total turkey imports.

### (ii) The Current Method with Modifications

Several modifications could be made to the current method. First, import quotas could be allocated only to "active" firms. Second, import quotas could be transferred either on a temporary or longer-term basis, with the latter transfers restricted to active firms. Finally, a "pool" could be created by earmarking import quotas for new product development of both ICL and non-ICL poultry products. The import quotas available for such a pool could come principally from the unallocated portions, as well as from any additional import quotas that might be available from the elimination of allocations to non-active firms. Additional modifications could include a formal appeal process, as well as the publication of allocations to individual quota holders within broad ranges.

### (iii) Auction with Earmarking

An auction of chicken or turkey import quotas would be based on many of the features discussed for cheese in Chapter IV. However, chicken and turkey import quota auctions could also incorporate earmarking provisions for further processors producing non-ICL products.[7] The import quotas available for auction would be the amounts remaining after requests from processors manufacturing non-ICL products had been fulfilled.

Other specific issues to be addressed would include quarterly utilization requirements and appropriate lot size.

### (iv) Market Share Proposals

There are many chicken and turkey import quota allocation alternatives in which the quotas could be allocated on the basis of participants' individual market shares, the purchases of domestic products or value added in Canada. The Analytic Staff Report considered the following two schemes in detail.

1. Market Share - All Participants

The first approach would base individual allocations on the volume of a participant's purchases and sales of all chicken or turkey products, including imports. Tribunal staff suggested a weighting system that would give more emphasis to the amount of value added by each firm in the production and distribution chain.

2. Market Share - Processors Only

The second method would direct import quotas only to the processing sectors of the poultry industry. It would recognize only purchases, both domestic and imported, of live, whole eviscerated and cut-up chicken or turkey made by primary, secondary, further or integrated processors as being eligible to be used in calculating an applicant's market

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7. The principles currently in use for the earmarking of import quotas for the production of non-ICL poultry products would also apply to the earmarking provision under the auction proposal.

share. Again, a weighting system would give more emphasis to the value-added nature of the processing activity undertaken.

Under the market share allocation methods studied by Tribunal staff, the allocation for the production of non-ICL poultry products would remain, and the balance of the import quotas would be allocated on the basis of market share. In addition, for both market share alternatives, the chicken import quota would have quarterly utilization requirements, while the turkey import quota could be used at any time throughout the year. Under-utilization penalties, as they currently exist, would be imposed and temporary transferability would be permitted.

## b) Assessment and Recommendations

A number of individual firms, all of whom now hold import quotas, some industry associations, the CCMA and the CTMA were of the view that the current method best meets the evaluation factors set out in the terms of reference. In addition, they claimed that the current method best achieves the objectives of supply management and is consistent with Canada's international rights and obligations.

Pressure for change to the current method came mainly from parties that currently hold little or no import quotas. These parties raised concerns about the viability of the current method and maintained that it is outdated and unfair. Many of the parties dissatisfied with the current method of import quota allocations for chicken and turkey are members of the retail and foodservice sectors. Most of these parties proposed an alternative allocation method based on economic activity or market share.

The Coalition argued that the *status quo* is inequitable and inefficient, that it distorts price competition by concentrating import quota rents in the hands of a few firms and that it unduly impedes market entry by new firms.[8] Other participants claimed that the current method has resulted in windfall profits for traditional importers,[9] that it does not take into sufficient account the role played by small- and medium-sized firms[10] and that it lacks transparency and could be manipulated through influence.[11]

We acknowledge that the current method possesses certain strengths. It ranks high in terms of predictability, a factor viewed as being very important by most participants. Allocations based on traditional holdings have permitted the development of long-standing relationships between Canadian buyers and U.S. suppliers, thus offering the industry a great deal of certainty as to who will be participating in the market and what quantities will be available. While predictability is important to the operation of the market, we were not prepared to give it the overriding importance that many participants argued that it should have, because total import volumes are predictable, and the proportion of imports to domestic production is relatively small. However, we recognized that the rigidity of the supply managed production system makes planning of import supply especially critical to the overall functioning of the market.

8. The Coalition for the Equitable Allocation of Import Quotas, January submission, at 4 and 9.
9. Cara Operations Limited, January submission, at 13.
10. Affiliated Administration Services (SAA) Inc., January submission, at 5.
11. Cold Springs Farm Limited, January submission, at 5-6.

We also saw the current method as performing well in terms of economic efficiency and market responsiveness. Under the current method, the product generally moves to the parties that value or need it the most, either directly or indirectly, through the means of an active and well-developed secondary market. Many witnesses testified that an active secondary market for poultry products exists under the current method and constitutes an important source of supply.[12] We believe that any import quota allocation method should preserve this flexibility so that imported products can continue to be used to fill voids in supply and to satisfy the specific market needs for certain quality products at different times and in different markets.

Where the current method fails to perform, in our opinion, is principally with regard to competitiveness. One distinguishing aspect of the chicken and turkey industries is that the imported product entering Canada is generally in a form which can be further processed in Canada. This offers some potential for improvement in the competitiveness of the processing sector. If this sector were to hold the entire import quota, it could use the supply and the resulting quota rents, which generally have been positive over the last several years, to the benefit of their value-added operations. This, in our view, would constitute an improvement over the current method that awards import quotas to certain trade sectors that merely resell the product in virtually the same form as purchased, thus generating very little economic activity in Canada.

We also found some potential to improve the equity of allocating import quotas in the current method, which still allocates approximately 60 percent of the total chicken and turkey import quotas on the basis of traditional import patterns of some 15 to 20 years ago. We were also concerned with the unequal distribution of import quotas within industry segments, which was discussed extensively during the hearings.

Given the potential for improvements in the areas of competitiveness and equity, we rule out the current method as our choice for the chicken and turkey sectors.

Many of the parties that favoured the *status quo* suggested or supported modest modifications, which would, in their view, enhance the current allocation method. These parties believed that any problems with the current method of allocation should be solved through an evolutionary process, not with radical changes.

While modifications such as transferability and measures to improve transparency would be worthwhile enhancements to the current method, we believe that such measures do not go far enough in addressing the issues raised in the assessment of the current method. Accordingly, the current method with modifications is not considered to be the optimum method of allocating import quotas for this sector.

No parties expressed support for the alternative of allocating import quotas for chicken and turkey on an auction basis. The CCMA and the CTMA, in a joint submission, argued that an auction would be incompatible with supply management and would be detrimental to the

12. Witness statement of Mr. Cyril Levenstein, on behalf of the Further Poultry Processors Association of Canada, June 1, 1991, at 2; supplementary witness statement of Mr. R. de Valk, on behalf of the Canadian Association of Regulated Importers, January hearing, at 3.

existing stability in these supply managed industries.[13] Other parties strongly opposed an auction system because of the lack of predictability involved in obtaining imported supplies. Security of supply was seen as the most important factor to industry participants, particularly processors.

The consequences of interruptions in supply are greater for the poultry processing industry than for most other industries importing controlled products. Certainty of access to adequate supplies is an important consideration in the evaluation of investment decisions for poultry processing operations.

Although we believe that auction is the optimum approach to address equity issues for dairy products, in considering auction for chicken and turkey, we observed that these industries are different from the dairy industry in some important respects. First, we are dealing with a homogeneous product, i.e. the processors and consumers do not generally distinguish between domestic and imported products. Second, in many instances, chicken and turkey imports are used as an input to produce further processed products. This, in our judgment, means that there is potentially more risk that large changes in import patterns could disrupt the operation of downstream users dependent on the product and, consequently, interfere with the smooth functioning of the market. If, for example, a large portion of a province's import supply was to shift to another province from one auction to the next, serious and sudden regional imbalances could result. Interruptions in imported supply could create problems for chicken and turkey processing plants that often do not have the flexibility to replace such imports with domestically produced product on a short-term basis. Accordingly, we rule out auction as an optimum method for allocating import quotas for this sector.

We believe that, on balance, a market share approach to allocating chicken and turkey import quotas offers the best solution to the weaknesses of the current method. To begin with, such an approach would reward those that support the domestic industry by putting import quotas into the hands of the industry participants that are most "active" in the market. That is, if all purchases and sales of poultry products were to count toward each firm's allocation base, those firms which purchase and sell the greatest amount of poultry, domestic as well as imported, would be allocated a proportional amount of import quotas the following year. As well, the formula used to calculate economic activity or market share could award more import quotas for processing activities carried out by the industry participants, thus encouraging the processing of poultry products in Canada. We also note that the amount allocated to each firm from year to year would be reasonably predictable within a range, based on the firm's knowledge of its market share and its allocations the previous year.

However, the market share approach poses two potential problems. First, if the limited quantities of chicken and turkey import quotas are allocated over too wide a base, as would be the case with the "Market Share - All Participants" proposal, there would be a large number of applicants, each of whom would receive a relatively small amount of the import quotas, thus making the method rather inefficient. Second, as many parties argued, both market share proposals examined by Tribunal staff would be difficult to administer and would impose unnecessary calculations, record keeping and paperwork on the applicants.

13. Canadian Chicken Marketing Agency and Canadian Turkey Marketing Agency, joint June submission, at 2 and 6.

In developing our recommendation for the optimum method of allocating chicken and turkey import quotas, we considered the two major differences between the chicken and turkey industries and the other industries affected by import controls, as noted earlier in our analysis of the auction proposal, i.e. that poultry products are homogeneous and that they can be used as an input to produce further processed products. We propose the following to achieve the benefits inherent in the market share approach, while minimizing the negative elements.

### (i) Earmarking for Non-ICL Products

In keeping with the recommendations of the Advisory Council on Adjustment[14] and the Report of the National Poultry Task Force,[15] we recommend that, as a first step in allocating chicken and turkey import quotas, an allocation be made to the processors that produce non-ICL products using ICL poultry input material. The procedures for this portion of the chicken and turkey import quota allocations should remain the same as the current earmarking of import quotas for non-ICL poultry production.

Some parties have suggested that, in the near future, the amount of import quotas available from the FTA increases will not be adequate to provide chicken and turkey for all non-ICL poultry product production.[16] Therefore, we recommend that this prior earmarking of import quotas not be limited to any level.

### (ii) Processors Only

The remaining chicken and turkey import quotas should be allocated only to firms in the processing sectors. All federally or provincially registered poultry processors, including primary, secondary, further and integrated processors, regardless of size, will be eligible to apply for import quotas under this method. Firms in other trade levels would not be eligible to receive import quotas even if they perform some of the functions that poultry processors perform. For example, a retail grocery or foodservice establishment which cuts up or debones whole chicken would not qualify. We recognize that there may be some pressure to redefine the boundaries of what constitutes poultry processing and that it will be necessary for the administrators of this program to develop strict guidelines to address this matter.

We recognize that awarding import quotas to only one trade level may not be as equitable as the proposal which would allocate import quotas to all industry participants. However, the inherent benefits of allocating import quotas to processors only, in our view, outweigh the broader principle of equity to all. Furthermore, the value-added method constitutes an improvement over the current method, which allocates import quotas on a very uneven basis among and within the industry segments.

The processing sector has a highly capital-intensive infrastructure in place to process poultry products. Processors have substantial investments in plant and equipment, have a large

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14. Advisory Council on Adjustment, Adjusting to Win, March 1989, at 118.
15. National Poultry Task Force, Growing Together Towards the Development of a Second Generation of Poultry Supply Management Systems, March 15, 1991, at 30.
16. Cambridge Canadian Foods, witness statement of Mr. Malcolm Garner, June 4, 1992, at 2.

number of people employed in their plants and have the most potential to add value to imported products in Canada. These processors have largely dedicated operations and are dependent upon supplies of poultry, both domestic and imported. A predictable source of supply is important for this sector to operate efficiently.

The chicken and turkey processing sectors are squeezed between a supply management system that controls the domestic supply of live birds and demanding buyers in the retail and foodservice industries. Any supply problems encountered by the processing sector are, in turn, passed along to the retail and foodservice sectors and, ultimately, to the final consumers of poultry products. As noted by Maple Lodge Farms Ltd., the processing sector "is the most vulnerable sector in the supply management system, standing at the interface between a regulated market for live supply and free enterprise on the wholesale level. This sector cushions producers from the volatility of the marketplace and, in effect, underwrites the returns and price structure necessary to maintain supply management."[17] The availability of poultry products to most other industry participants such as importers, distributors, retailers and foodservice firms is not as critical because firms at these levels, generally, do not tend to have manufacturing infrastructures that rely solely on the availability of chicken and turkey.

### (iii) Allocation on the Basis of Value Added

Each processor's value added would be measured annually as the difference between the processor's sales value of ICL poultry products and its value of purchases of ICL poultry products during a representative 12-month period.[18] Sales and purchases of both domestically produced and imported ICL poultry products would qualify, as most processors' records do not distinguish between imported and domestic supplies. Non-arms-length transactions between affiliated companies would not qualify as purchases and sales to be used in the value-added calculation. Each qualified processor would be allocated a pro-rata share of the available import quotas, based on its relative amount of value added to chicken or turkey products.

Because import quotas for the manufacture of non-ICL products would be "earmarked" prior to the value-added allocations, sales of non-ICL products would not qualify toward a firm's value-added import quota allotments. Therefore, purchases of ICL poultry to be used for non-ICL production would be deducted from the total ICL poultry purchases.

In our opinion, this method would be relatively simple to administer, from the perspective of both government and participants. The purchase and sales figures are readily available from most accounting systems. We believe that there is very little room for administrative discretion with this method. Verification could be accomplished through random audits of applicants' records and by having applications audited and signed by an independent public accountant, as

17. Maple Lodge Farms Ltd., final written argument, June 25, 1992, at 7.

18. The current provisions for earmarking import quota for manufacturing non-ICL products is based on the volume of production of those products during the previous September 1-August 31 period. The same 12-month period could be used to calculate the amount of "value added" by each processor. This time period allows sufficient time for the processors to perform the necessary calculations and complete the application form and for the EIPB to calculate the individual allocations prior to the beginning of the next calendar year.

is currently the practice for the "equal share" and "manufacture of non-ICL products" portions of the current chicken and turkey import quota allocations.

### (iv) Transferability of Import Quotas

Import quotas would be transferable. We do not see any reason to limit the transfer of import quotas to the processing sector. Consequently, once the annual initial allocation is made, import quotas may be transferred to firms at any trade level.

We anticipate that the secondary market will continue to be an important and integral part of the supply system for imported poultry. Allowing the transfer of import quotas will, in our view, facilitate the expedient and efficient use of the secondary market to help smooth out anticipated temporary disruptions.

### (v) Disclosure and Formal Appeal Process

Because this approach entails submitting confidential information for the calculation of each applicant's value-added amount, only the range of each processor's import quota holdings should be made public. This will protect the confidentiality of the application information, while providing greater transparency which will help the secondary market operate more efficiently. The allocation method would also provide for a formal appeal process.

### (vi) Utilization Requirements

Since all of the import quota is being allocated to the processing sector, we do not feel that quarterly utilization requirements for the chicken import quota are necessary under the recommended allocation method. The processing sector needs a regular supply of inputs throughout the year and is in a position to know when this supply is required. However, annual utilization requirements and penalties for under-utilization should remain in effect for both chicken and turkey import quotas.

The Tribunal recognizes that moving to totally different import quota allocation methods could be disruptive for individual firms in the processing industry. These firms have invested substantial amounts of money and employ a large number of people, some of which could become idle if a major shift in the allocation of the imported portion of supply occurred at one time and could not be replaced by domestic supply.

In Ontario and Quebec, a large percentage of each province's production is controlled by a few large integrated processing firms. Certain independent further processors made submissions that these large firms may be unwilling to supply the independent further processing sector.[19] These independent further processors fear that they would not be able to obtain domestic poultry to replace the imports upon which they now depend.

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19. Presentation to the Tribunal by Maxi Poultry Co. Ltd., September 16, 1991, at 12-18; and witness statement of Mr. Jean Lauzon of T. Lauzon Ltée, January 27, 1992, at 18-19.

In light of the above, the Tribunal recommends that all processors that currently hold traditional import quotas be allocated the greater of their historical base amount[20] of import quotas or the amount calculated under the value-added system. Under such a scenario, if the base historical amount is higher than a firm's allocation under a value-added approach, the processor would continue to be allocated the historical base amount and would not participate in any growth in import quotas until the firm's allocation as calculated under the value-added approach exceeds the historical base allocation. We note that this provision will necessitate an iterative process to calculate the final individual allocations. While this process may be somewhat more complicated than a straight value-added approach, in our view, the extra burden can easily be accommodated using computer technology.

To illustrate how much of the chicken import quota would be redistributed under our recommended method, we have divided the current allocation into five categories:

- "Historical-Processors" is the amount of the historical base import quota allocated to all processors.
- "Historical-Others" is the amount of the historical base import quota allocated to trade levels other than processors.
- "Non-ICL Allocation" is the amount of the FTA increase that was allocated to processors producing non-ICL chicken products.
- "Other FTA Growth" is the amount of the FTA increase that was not required to meet the needs of non-ICL chicken product manufacturers.
- "Market Growth" is the increase in the overall import quota that has resulted from increases in the amount of domestic production since import controls were introduced.

Table 6.1 gives, for 1991, the share in volume and percentage terms of the total chicken import quota that was allocated to each of the five categories.

20. The historical base amount of an import quota is that quantity which was allocated at the beginning of import controls to importers of record during the years from 1976 to 1978 for chicken, and from 1971 to 1973 for turkey. The historical base import quota obtained through the acquisition of, or merger with, import quota holding firms is considered part of the total historical base allocation and would continue to be guaranteed to the current recipient.

**Table 6.1**

**CHICKEN IMPORT QUOTA DISTRIBUTION 1991**

| Category | Kilograms | Percentage |
|---|---|---|
| Historical-Processors | 17,122,675 | 40 |
| Historical-Others | 7,423,717 | 17 |
| Non-ICL Allocation | 4,862,611 | 11 |
| Other FTA Growth | 1,976,591 | 5 |
| Market Growth | 11,359,421 | 27 |
| Total | 42,745,015 | 100 |

Source: EIPB data.

Under the recommended import quota allocation method, the "Non-ICL Allocation" category would remain unchanged at 11 percent of the total allocation, while historical processors, collectively, would be eligible to receive at least their current holdings (40 percent of the total allocation). The volumes allocated to the other three categories (49 percent) would be reallocated to the processing sectors. Thus, at least 49 percent of the total 1991 allocation of the chicken import quota would be redistributed using the recommended method.

Many parties expressed the opinion that any change to the *status quo* would result in changes in regional import patterns. However, in our view, the recommended allocation method, with the guarantee that each processor will be allocated at least its historical base allocation amount, should minimize regional import shifts. Furthermore, we note that poultry processing in Canada is concentrated in Ontario and Quebec, as are the current holders of import quotas. Therefore, we do not believe that any significant shifts in the regional distribution of import quotas will result from the implementation of our recommended import quota allocation method.

In summary, the Tribunal recommends that chicken and turkey import quotas be allocated first to processors producing non-ICL poultry products using ICL poultry inputs. The remaining import quotas would be allocated to federally or provincially registered poultry processors, based on the amount of value-added activity performed by each processor. These import quotas would be transferable during the year for which they were issued, and each import quota holder's allocated amount would be disclosed as being within a certain range. To ease the anticipated disruption of poultry processors that are currently highly dependent on imported supplies, processors that currently hold historical import quotas would be allocated the greater of their historical base amount or their entitlement under the value-added system.

In our opinion, the SUPP system for chicken and turkey, as it now exists, performs a different function in the poultry markets than import quotas. The SUPP system acts to alleviate shortages when the domestic supply systems are temporarily short and import quotas are not available, as well as to provide relief to manufacturers of non-ICL poultry products that wish to expand their production of non-ICL products without using higher-priced domestic supplies. SUPPs also allow firms to perform market testing and obtain lower-cost inputs for further processed products destined for export markets.

Therefore, we recommend that the criteria for issuing SUPPs for chicken and turkey products remain different from the method of allocating import quotas for those products. In contrast to our recommendation concerning the eligibility of industry participants to apply for import quotas, SUPPs should be available to any industry trade level that demonstrates a need as defined by the four issuance criteria. This will provide a double "safety valve" in that, if the domestic producers do not adequately supply the Canadian poultry markets, SUPPs will be available to ensure that processors have access to adequate supplies. On the other hand, if the processing sector does not use its control of poultry supplies in a market-responsive manner to adequately supply the Canadian market, other trade levels would have the opportunity to obtain poultry supplies through the SUPP system.

## 3. Shell Eggs

### a) Import Quota Allocation Options: Current Method and Alternatives

#### (i) The Current Method

Shell eggs were placed on the ICL on May 9, 1974, although a global import quota for shell eggs was not established until July 4, 1975. Up to 1989, the quota was set at 0.675 percent of the previous year's shell egg production, as reported by Statistics Canada, and was allocated to importers on the basis of their historical performance in importing shell eggs.

In accordance with provisions in the FTA, the level of the shell egg quota was increased in 1989 to equal the actual average level of imports during the five years prior to the agreement coming into force. This revision incorporated supplementary imports made during that five-year period into the global quota. Under this adjustment, the global shell egg import quota was increased to 1.647 percent of the previous year's domestic egg production (minus broiler hatching eggs). The FTA quota increase was allocated only to federally registered egg grading stations, in proportion to each station's market share as adjusted by surplus declarations.

Shell egg import quota allocations are made on the basis of 10 periods corresponding to the months of the year, with March/April forming the third period and November/December forming the tenth period. These two larger periods are times of peak demand. September and October are also relatively high-demand periods. These four periods are allocated 85 percent of the global import quota, leaving 15 percent for the remaining six months of the year.

The purpose of dividing the quota allocation among a number of periods is to ensure market responsiveness as requirements vary and to prevent market (price) disruption resulting from substantial volumes of lower-priced imports entering the market during a period when large numbers of domestically produced eggs are being declared surplus.

Quota holders must achieve a minimum utilization of 95 percent or their quota will be reduced in the subsequent year to the actual utilization volume.

There are two categories of SUPPs for shell eggs:

1) to import shell eggs for resale when these are not available from domestic sources; and

2) to import eggs for further processing and reexport.

Utilization of SUPPs fell sharply from a high of 8 million dozen eggs in 1985 to zero in 1989 and subsequent years (except for recent small volumes of SUPPs to import eggs for further processing and reexport). One of the major reasons for this decline appears to be the greater volume of the import quota that has been available as a result of the FTA increase.

In 1988, there were only 22 firms holding a shell egg import quota. Of that total, 13 were federally registered egg grading stations, while the remaining 9 were at other trade levels. In 1991, there were 83 firms holding an import quota; 74 were federally registered egg grading stations, while the remaining 9 were at other trade levels. Grading stations held approximately 92 percent of the global quota in that year.

The high level of import quota concentration in Ontario and Quebec (80 percent in 1991) reflects both the historical activity of importers of shell eggs in those provinces and the fact that more than 50 percent of domestic production and grading of shell eggs is also located in Ontario and Quebec.

Figure 6.3 shows the distribution of the shell egg import quota by trade level and by province/region.

### (ii) The Current Method with Modifications

Under this proposal, the current method of import quota allocation would be modified to allow for the full transferability of the import quota allocations on a temporary and/or longer-term basis; a formal appeal process; and disclosure of the amount of import quotas allocated to individual firms, within ranges.

### (iii) Auction

An auction for shell eggs would need to address many of the same issues raised in the discussion of cheese auctions in Chapter IV of this report. The auction could allow all interested parties at all trade levels to bid for the import quota, on an annual basis, or could be restricted to federally registered egg grading stations.

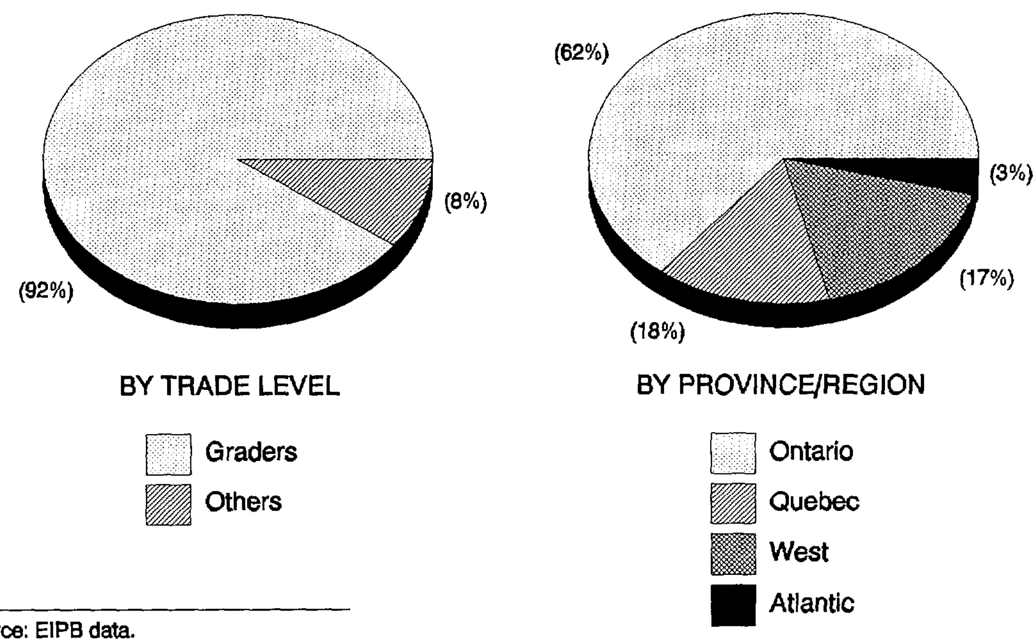
Minimum economical lot sizes for bids would need to be established, as would maximum levels of import quota holdings for individual firms, including affiliates.

## b) Assessment and Recommendations

The CPEPC was strongly in favour of retaining the current method of allocating the import quota for shell eggs. It saw the allocation of the quota to egg grading stations as being

Figure 6.3

DISTRIBUTION OF IMPORT QUOTA (1991)
SHELL EGGS




Source: EIPB data.

both predictable and efficient. However, it acknowledged that minor modifications to the current method, such as the addition of transferability, would be "important because they remove what appear to be regarded as key irritants."[21]

CEMA, on the other hand, opposed continuation of the current method of import quota allocation for shell eggs, on the grounds that it directed imports to regions of the country that were in surplus conditions of supply while other regions were short of product.

The Coalition and the CRFA both made broad recommendations that import quotas for all products should be allocated on the basis of market share. While both those associations then went on to discuss and to elaborate more fully on the desirability of such an allocation method for chicken, turkey and cheese, neither made any specific references to shell eggs.

It is our view that the current method of allocating the import quota for shell eggs responds adequately to the demands and needs of this market sector. At the same time, we recognize that oversupply and undersupply conditions exist in different regions of the country and that CEMA incurs costs in trying to address these anomalies.

21. Transcript, June 12, 1992, at 4220.

However, we do not see these regional supply imbalances as resulting from the current method of allocating the import quota since imports account for such a small fraction of the total Canadian market demand. Rather, the problems are more structural in nature and are related to the allocation of the production quota under the supply management system. Even so, regional supply problems are exacerbated to some extent by the current import quota allocation method, which may encourage direct imports into regions of the country that are already experiencing surplus domestic supply conditions.

The current method of import quota allocation is not equitable, in that, for the most part, only egg grading stations are able to import shell eggs.

The auction method appeals to us as the best means of addressing the weakness in the current system. CEMA proposed an auction that would be open only to federally registered egg grading stations. While we anticipate that egg grading stations will continue to be the principal importers of shell eggs under an auction, we see no reason to exclude other trade levels from bidding.

Egg grading stations are the first receivers of eggs from domestic egg producers. In fact, provincial legislation requires that all eggs sold in retail stores and through wholesalers be graded. Egg grading stations add value when they wash, grade and package domestic eggs in preparing them for ultimate sale to the final consumer. Agriculture Canada's requirements for proper storage and inspection facilities also promote the continued prominence of egg grading stations as major importers of shell eggs. The facilities that grading stations currently have in place for the storage and inspection of domestic eggs give those graders an inherent advantage over other trade levels.

However, there is no processing required of imported shell eggs which have already been graded and, often, even packaged by the exporter for resale to the consumer. Accordingly, egg graders in Canada act simply as distributors of these eggs and play no role other than that played by other importers, which act purely as distributors.

The CPEPC was strongly opposed to an auction.[22] One of the major industry objections to auction was the amount of uncertainty or unpredictability which this allocation method would generate. We found that point of view difficult to accept. Imported shell eggs constitute such a small percentage of total domestic demand for shell eggs (less than 2 percent) that the question of the availability or non-availability of imported shell eggs to egg grading stations could hardly be construed as critical to their operations. This would seem to be borne out by the fact that only one third of the eligible grading stations have bothered to apply for an import quota.

An auction will not directly address the problem of regional supply imbalances; however, it will allow market forces to play a greater role in the allocation of the import quota. Egg grading stations in those regions of the country where surplus product was already being declared to CEMA would be less apt to bid for, and to import, shell eggs into those regions. Even if they were inclined to do so, other grading stations in those provinces experiencing shortages of supply would likely be more aggressive in bidding for an import quota in order to respond to their

22. Transcript, June 12, 1992, at 4222-23.

particular market situation. That is to say, these latter egg grading stations would tend to take into account domestic supply conditions as well, something which importers at other trade levels would be less well situated to do.

We therefore recommend that both the pre- and post-FTA shell egg import quotas be made accessible to importers at all trade levels through the means of an auction. The auction would possess all the features of the cheese auction described in Chapter IV of this report, with the following exceptions.

1) Auctions would be held once a year for a one-year term.

2) Quota allocations would be divided into 10 periods, corresponding to the existing importation periods. September, October and the larger periods of March/April and November/December would continue to be allocated 85 percent of a holder's annual allocation. The remaining 15 percent would be allocated over the other six months of the year (2.5 percent per month).

3) There would be an upper limit of 20 percent on individual quota holdings.

Allocating the import quota among a number of periods throughout the year will ensure that the market continues to be able to respond as demand varies. This approach will also prevent the market from being disrupted by substantial volumes of lower-priced imports entering Canada during periods when large numbers of domestically produced eggs are being declared surplus.

CEMA proposed that it administer the auction and use a portion of the proceeds to moderate the levies charged to egg producers, which would potentially result in lower prices to consumers. We do not consider it appropriate for a supply management agency to administer an import quota auction for the same reasons that we noted in our discussion of the cheese auction.

We recommend that the current criteria for issuing SUPPs for shell eggs be continued without modifications.

In the case of requests for SUPPs to import shell eggs for resale when these are not available from domestic sources, permits should be issued to those applicants meeting the requirements as presently outlined in the relevant EIPB Notice to Importers. The only change to that process would be that successful applicants for SUPPs would have to pay a fee equal to the most recent auction clearing price for shell eggs.

In the case of SUPPs to import shell eggs for further processing and reexport from Canada, permits would be issued without charge to the successful applicants.

## 4. Egg Products

### a) Import Quota Allocation Options: Current Method and Alternatives

#### (i) The Current Method

Egg products were placed on the ICL on May 9, 1974, although import quotas were not established until July 1975. Up to 1989, the liquid and frozen egg product quota was set at 0.415 percent of the previous year's shell egg production, while the egg powder quota was set at 0.615 percent.

Historical importers were granted quota allocations based on the size of their imports in the years before controls were introduced. These quotas were allocated on a quarterly basis, with unused portions of the quarterly amounts being available to other importers in subsequent quarters, on a first come first served basis. Adjustments to individual quotas were made if importers used less than 90 percent of their allocations.

The FTA increased the size of the egg product import quotas to the actual average level of imports during the five years prior to the agreement, thus incorporating supplementary imports into the global levels. The egg product and dried egg import quotas were therefore increased in 1989 to 0.714 percent and 0.627 percent, respectively, of the previous year's shell egg production. Under the liquid and frozen egg product quota, importers have the choice of bringing into Canada not just liquid or frozen eggs, but also ungraded shell eggs, provided that these imports are directed to a federally registered processed egg station for breaking.

The global quota levels which were established before the FTA came into force continue to be distributed among traditional importers at the level of their past allocations, adjusted for under-utilization. The FTA quota increases were allocated only to applicants involved in the industry as registered processed egg stations or as wholesalers/distributors and are proportional to each applicant's market share.

There are two categories of SUPPs for liquid and frozen egg products and egg powder:

1) to import egg products when those products are in short supply in Canada; and

2) to import egg products for further processing and reexport.

Applications for SUPPs for domestic use are sporadic and most commonly requested for liquid egg products. However, special SUPPs are regularly issued for substantial quantities of egg products for reexport from Canada. In 1991, these latter SUPPs amounted to 7.8 million kilograms, almost four times the level of the global quota for liquid and frozen egg products.

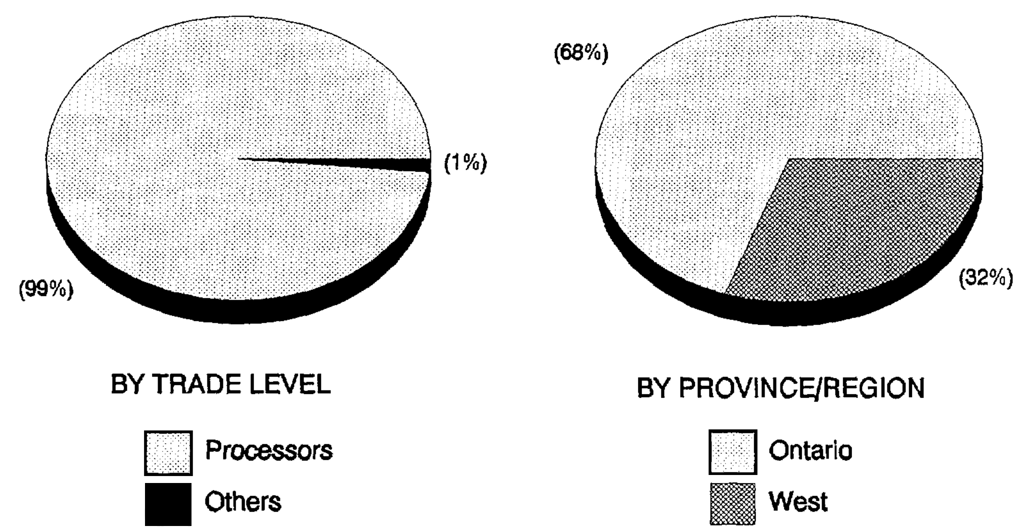
SUPPs are not requested for egg powder since the global quota itself is usually under-utilized, to the point where the quota is no longer allocated to traditional importers. Instead, permits are issued on a first come first served basis.

The total number of quota holders increased from five to fourteen over the period from 1986 to 1991. Three of those firms accounted for 75 percent of the global quotas for egg products in 1991. Approximately 99 percent of the import quotas for egg products were held by processors in that same year. Two thirds of the quotas were held by companies with head offices in Ontario.

Figure 6.4 shows the distribution of egg product import quotas by trade level and by province/region.

Figure 6.4

DISTRIBUTION OF IMPORT QUOTAS (1991)
EGG PRODUCTS




Source: EIPB data.

### (ii) The Current Method with Modifications

Possible modifications to the current allocation method would be the same as those described for shell eggs, i.e. transferability, a formal appeal process and disclosure of quota holdings, within ranges.

## b) Assessment and Recommendations

Direct intervention with respect to egg products during the Tribunal's hearings was almost non-existent. Where comments were made with respect to the allocation of egg products, they were generally favourable to a continuation of the present allocation method. In particular, both the CPEPC and CEMA were disposed to such continuation, as was CARI. However, CEMA was prepared to include egg products in its egg auction proposal at the request of the processor segment or when it was able to segment the egg product market for pricing purposes.

The Coalition and the CRFA both made broad recommendations that import quotas for all products should be allocated on the basis of market share. While both those associations then went on to discuss and to elaborate more fully on the desirability of such an allocation method for chicken, turkey and cheese, neither made any specific reference to egg products.

The lack of any other intervention suggests not only a lack of interest in holding import quotas for these products by other parties, but also that the current allocation method adequately responds to market demands. We find no argument with that conclusion. The lack of any evidence of a secondary market for egg products was also taken as an indication that quotas are reaching those firms that value it most.

Accordingly, we are of the opinion that the existing import quota allocation methods for egg products are satisfactory and recommend that only relatively minor modifications to the current allocation methods for egg products be implemented. Those modifications relate to the transferability of import quotas, the disclosure of quota holdings and provision for a formal appeal process.

We recommend that the current criteria for issuing SUPPs for egg products be continued without modifications.

# CHAPTER VII

# PRINCIPLES TO GUIDE IMPORT QUOTA ALLOCATIONS

## 1. Introduction

The terms of reference of this inquiry direct the Tribunal "to provide recommendations on principles which should generally guide any import quota allocations." In a broad sense, the Tribunal understands a principle to mean a basic rule or code of conduct which produces or determines particular results; it is a fundamental doctrine or assumption which determines how things are done.

Principles can be helpful in making consistent decisions, resolving conflicts or responding to new situations. We discovered, however, that because of the diversity of industries, products and markets that could be involved, it was impossible to develop one set of general principles that would govern every situation involving future import quota allocations. Rather, we focused our attention on overriding objectives, recognizing that, in making decisions about future quota allocations, policy makers will want to take into account the unique circumstances and trade-offs present in the specific sectors being considered.

## 2. An Historical Overview

When import controls were first introduced in the 1970s (for chicken, turkey, shell eggs and cheese), the basic principle governing their allocation was a consideration of historical shares of import volumes. This approach benefited the importers of record and recognized their pivotal role in importing the subject goods.

In the 1980s, the dynamics of the marketplace changed with the addition of new products to the ICL (such as, for example, breaded and battered chicken products), as well as with the changes in international trade relations, of which the most prominent resulted from the conclusion of the FTA. As a result, principles other than historical performance appeared to be taken into consideration by the government.

For example, the increase in import levels for chicken and turkey resulting from the FTA was allocated first to further processors manufacturing products not on the ICL (but using ICL inputs) and only second to new entrants and traditional import quota holders. The FTA increase for shell eggs was allocated only to federally registered egg grading stations on the basis of throughput. Furthermore, when broiler hatching eggs and chicks were placed on the ICL in 1989, the original allocation of quotas was to traditional importers, based on the five-year average volume of reported imports. However, it was immediately announced that, by 1993, the global quota would be entirely reallocated to federally registered hatcheries and distributed according to throughput.

Thus, while in most product-specific industries historical importers continued their dominance of import quota allocations, it was gradually recognized that historical performance may not be the only criterion of allocation. This evolution in the approach to allocations has widened the distribution of quota holdings to include a variety of market players whose access was not based on historical precedence. It also recognized the various difficulties and competitive disadvantages experienced by different industries and trade levels.

## 3. Recommendations on Principles which Should Generally Guide Import Quota Allocations

Before listing our recommendations on principles, it bears emphasizing that we take for granted that any import quota allocation method would be required to meet Canada's rights and obligations under GATT, the FTA and other bilateral agreements. Of particular importance would be that any import quota allocation method be consistent with Canada's obligations under GATT's Import Licensing Code. These obligations imply, for example, that import quota allocation methods should not impose trade restrictive effects on imports, additional to those caused by the imposition of the restriction itself; that the rules for administering an import quota allocation method should be neutral in application and administered in a fair and equitable manner; that the import quota allocation will not discourage full utilization of the quotas; and that the application procedures applied in connection with an import quota allocation method will be kept as simple as possible.

In an ideal world, our first recommendation would be that import quota allocation methods should result in any cost savings being passed on to the final consumers of the controlled products. However, we believe that, for many products, it is unrealistic to expect that any method of import quota allocation could be devised that would have a noticeable impact on consumer prices. This is certainly true in the context of the present inquiry where we were faced with a supply managed environment and the limitation of import volumes to a small share of the total domestic consumption, as well as terms of reference requiring us to recommend optimum national methods of quota allocation. Consequently, our overriding concern became the development of import quota allocation methods that would minimize cost and maximize fairness and predictability for the industries concerned, at no additional cost to the consumer.

We believe that the following principles should generally govern quota allocations.

### 1. Consideration of the product and industry: any method of import quota allocation should take into account the unique circumstances of a product or an industry.

Products imported into Canada are subject to such a variety of factors, influences and conditions that no blanket import quota method, no matter how well conceived or carefully executed, would be suitable for them all. The following are some of the key product and industry factors to be considered.

- **With respect to the product**

- At what stage of processing do the imports enter Canada? Are they in the final form in which they are to be consumed or are they likely to be subject to additional processing in Canada?

- Is the imported product relatively homogeneous or is it differentiated?

- What is the magnitude of the imports allowed, relative to the domestic market of the product?

- **With respect to the industry**

- Is the imported product used directly as an input in a supply managed industry?

- Are there any types of businesses for whom access to imported products at world competitive prices is considered essential to their survival?

- Are there any trade levels that should be allowed priority access to imports subject to a quota because of their position in the chain of production or the particular competitive pressures that they face?

- How easy would it be for purchasers of the imported product to replace any lost supply with a product from domestic sources? Do any production or marketing constraints exist that would deny them access to domestic substitutes on a short-term basis?

## 2. Open access: all industry participants should have equal opportunity to directly access import quotas.

The optimum allocation method is one which responds effectively to market dynamics by allowing wide and open eligibility, including easy entry and exit. Only in rare circumstances, and for very good reasons, should industry participants be excluded from allocations.

One situation justifying excluding certain trade levels would be if changes in import patterns had the potential to seriously disrupt the market for the ICL product. A good example would be if imports accounted for a large portion of the domestic market and if a steady supply of the ICL product was critical to the viability of a downstream user, such as another supply managed industry or a manufacturing industry unable to easily access a product from other sources. In such instances, one could limit import quota holdings to players next in line in the production or distribution chain and allocate import quotas in proportion to the size of the operation.

Another example of a situation where discrimination is warranted would be if the competitive advantages to be gained by directly accessing an import quota are necessary for the survival of a specific trade sector. We concluded that such is the situation of non-ICL processors that must compete with foreign imports made with less expensive chicken or turkey input costs.

Finally, producers of supply managed products should not be eligible to participate in free allocations of import quotas because they already enjoy the benefits of protection. These producers would, of course, be allowed to participate in auctions for controlled products.

### 3. Consideration of the duration: any method of import quota allocation must have regard to the anticipated duration of the proposed regime, i.e. whether it is likely to be temporary and short term or relatively long term.

Methods of import quota allocation which can be quite suitable for a short term might be quite inappropriate if left untouched for a long time. For example, in special situations, such as those arising from a safeguard action pursuant to Article XIX of GATT, allocations could be made temporarily to historical importers on the basis of previous import patterns.

But, if it were necessary to introduce an import quota method for a longer period, a method which is not restricted exclusively to historical importers would be preferable. It would allow all industry participants an equitable opportunity to acquire an import quota and would be more responsive to changing circumstances and market conditions.

We consider that auction is the best, most equitable method of allocating restricted imports in the long run. When new import restrictions are put in place and current importers exist, we suggest that direct access to imports be opened up over a five-year period. In year one, traditional holders would receive an allocation based on their pro-rata share of imports over a recent representative period. Starting in year two, and for each of the following three years, 25 percent of the initial allocation would be clawed back and auctioned off.

In cases where there have been no recent imports, the controlled import regime should begin immediately with an auction.

### 4. Open markets: allocation methods should open import quota holdings to the widest group of participants.

Any import quota allocation method should mitigate against monopolistic concentration in any group or trade level. This should not be a difficult objective to attain for; in a typical industry, there are likely to be several active players eligible to use quotas. However, in some cases, it might be justified to allocate all, or almost all, of the quota to a single enterprise; for example, when the quantities involved are very small and the allocation to a large number of importers would result in the quota being split into uneconomical quantities.

In general, monopolistic allocations should be a justifiable exception and not a rule. A rule of thumb would be that no individual enterprise should hold more than 20 percent of the global quota for any product.

### 5. Transferability allows the method to respond to market fluctuations.

Even the best thought-out allocation method cannot guarantee an efficient allocation because, within the term of the allocation, economic conditions may require interim changes and modifications. For this reason, any import allocation method should provide for the legal transfer of one's import quota, or parts thereof.

### 6. Predictability promotes market stability and minimizes uncertainty to the industry.

Predictability was a concern common to most parties represented at this inquiry. We concur that firms should be able to plan their import activities with as much certainty as possible. Applicants should be able to predict if they will be successful in obtaining an import quota and under what terms and conditions. Further, any import quota allocation method should be structured in a way which promotes market stability in terms of longer-term continuity of procedures and established relationships, as well as in terms of assurance of steady supply of the needed product.

For reasons of predictability, any change in the method of allocation should be preceded by a transition period which would allow industries to make the necessary adjustments. Here, as with the introduction of a new import quota allocation method with traditional importers (see Principle 3 above), we recommend that, generally, transition from an existing to a new method be accomplished over a five-year horizon, with the *status quo* maintained for the first year and a progressive yearly claw back of 25 percent of the total imported product.

### 7. Administrative simplicity and transparency are essential to the smooth functioning of any import quota allocation method.

An optimum method of import quota allocation should be administered in an open and transparent manner, with its rules visible, clear cut and simple. All information and rules concerning procedures for the submission of import quota applications and the methods used to allocate the quota among firms should be disclosed to applicants. The eligibility requirements to apply for an import quota, the deadlines for submitting applications, the period required for processing them and the time frames to be notified of results should be made known to the industry and consistently applied. The import allocation method should be applied to each quota applicant in a fair and objective manner.

The administration of the allocation method should leave little room for the exercise of discretionary powers by officials. If the quota application is not approved, the applicant should be given reasons for the decision and should have a right of appeal or review of the decision. For reasons of administrative efficiency, the organization that controls the import permits should also be responsible for the administration of the quota allocation method (currently, this is the EIPB).

The names of import quota holders and the amount of their allocation should also be easily accessible. To protect the confidentiality of firms that are allocated an import quota on the basis of the size of their operation, their quota holdings should be provided within ranges.

# CHAPTER VIII

# RECOMMENDATIONS

The following summarizes the recommendations that we made in the product-specific chapters.

## 1. Dairy Products

### a) Cheese

- The optimum method for the allocation of the cheese import quota is an auction with the following characteristics.

    1) The global import quota should be divided into three equal portions with one third being auctioned every year for a three-year term.
    2) Eligibility should be unrestricted, but no single party should be permitted to purchase more than 10 percent of the import quota auctioned.
    3) EC and non-EC quotas should be auctioned separately.
    4) There should be no variety restrictions.
    5) Price settlement mechanism should be the generalized English or Dutch style.
    6) A deposit should be required on completion of the auction.
    7) Under-utilization penalties should be forfeiture of deposit and a limit in the holder's participation in the next auction.
    8) Quotas should be transferable up to their expiry.
    9) The auction should be fully transparent.
    10) There should be a formal appeal process.
    11) The EIPB should run the auction.

- Special import permits should continue to be issued under the same rules as the current method. However, for products that are consumed in Canada, these permits should be subject to a fee equal to the most recent auction clearing price.

### b) Ice Cream and Yoghurt

- The optimum method for the allocation of ice cream and yoghurt import quotas is an auction. It should possess all the characteristics of the cheese import quota auction with the following exceptions.

    1) No single party should be permitted to purchase more than 20 percent of the import quota auctioned.
    2) There should be no country restrictions.

- As with cheese, special import permits should continue to be issued under the same rules as the current method. However, for products that are consumed in

Canada, these permits should be subject to a fee equal to the most recent auction clearing price.

### c) Buttermilk

- The optimum method for the allocation of the buttermilk import quota is an auction. It should possess all the characteristics of the cheese import quota auction with the following exceptions.

  1) Auctions should be held once a year for a one-year term.
  2) No single party should be permitted to purchase more than 25 percent of the import quota auctioned.
  3) All imports should originate in New Zealand.

- As with cheese, special import permits should continue to be issued under the same rules as the current method. However, for products that are consumed in Canada, these permits should be subject to a fee equal to the most recent auction clearing price.

### d) Evaporated/Condensed Milk

- The optimum method for the allocation of the evaporated/condensed milk import quota is an auction. It should possess all the characteristics of the cheese import quota auction with the following exceptions.

  1) Auctions should be held once a year for a one-year term.
  2) There should be no restrictions on maximum allowable holdings by any one participant.
  3) Under-utilization penalties should be forfeiture of deposit and <u>no</u> participation in the following year's auction.
  4) All imports should originate in Australia.

- Any special import permits issued for domestic use should be subject to a fee equal to the most recent auction clearing price.

## 2. Poultry and Egg Products

### a) Broiler Hatching Eggs and Chicks

- The optimum method for the allocation of import quotas for broiler hatching eggs and chicks is the current method which, by 1993, will distribute all import quotas to federally registered hatcheries on the basis of their throughput. Three modifications are required.

  1) Import quotas should be transferable.
  2) There should be a formal appeal process.

3) Each import quota holder's allocated amount should be disclosed, within a range.

- The current supplementary import system should be continued without modifications.

## b) Chicken and Turkey

- The optimum method for the allocation of chicken and turkey import quotas is a market share allocation with the following characteristics.

1) Processors producing non-ICL poultry products using ICL poultry inputs should have the first opportunity to access import quotas. Their share of the global quotas should not be capped.
2) The remaining import quotas should be allocated to federally or provincially registered poultry processors based on the amount of value-added activity performed by each processor.
3) Value added should be defined as the difference between the processor's sales value of ICL poultry products and its value of purchases of ICL poultry products during a representative 12-month period.
4) Poultry processors that currently hold historical base import quotas should be allocated the greater of their historical base amount or their entitlement under the value-added system.
5) Annual import quota allocations should be transferable.
6) There should be a formal appeal process.
7) Each import quota holder's allocated amount should be disclosed, within a range.

- The current supplementary import system should be continued without modifications.

## c) Shell Eggs

- The optimum method for the allocation of the import quota for shell eggs is an auction. It should possess all the features of the cheese import quota auction with the following exceptions.

1) Auctions should be held once a year for a one-year term.
2) Quota allocations should be divided into 10 periods, corresponding to the existing importation periods. September, October and the larger periods of March/April and November/December should continue to be allocated 85 percent of a holder's annual allocation. The remaining 15 percent should be allocated over the other six months of the year (2.5 percent per month).
3) There should be an upper limit of 20 percent on individual quota holdings.

- Supplementary import permits should continue to be issued under the same rules as the current method. However, for products that are consumed in Canada, these permits should be subject to a fee equal to the most recent auction clearing price.

## d) Egg Products

- The optimum methods for the allocation of import quotas for egg products are the current methods with the following modifications.

  1) Import quotas should be transferable.
  2) Quota holdings should be disclosed, within a range.
  3) There should be a formal appeal process.

- Special import permits should continue to be issued under the same rules as the current system.

# APPENDIXES

## APPENDIX I

### Order in Council

**P.C. 1991-1512**
**13 August 1991**

WHEREAS, pursuant to the *Export and Import Permits Act*, the Governor in Council is authorized to establish an import control list and to include therein any article the import of which he deems it necessary to control for any of the purposes in section 5 of the said Act;

WHEREAS, under the said Act, the Minister may issue to any resident of Canada a permit to import goods included in an Import Control List;

WHEREAS import quotas and methods of quota allocation, including methods for the issuance of supplementary import permits, have been established for the purpose of administering controls on the import of certain agricultural products which require import permits in support of Canadian supply management;

WHEREAS concerns have been raised respecting, *inter alia*, the efficiency, equity, transparency and market responsiveness of current methods for the allocation of import quotas for agricultural products as well as the need to improve the competitiveness of Canadian further processors who use agricultural products subject to import controls to manufacture products not subject to import controls and on which tariffs are decreasing;

WHEREAS the reports of the National Poultry Task Force and the National Dairy Task Force have recommended that current methods of import quota allocation in respect of poultry and dairy products be reviewed;

WHEREAS it would be desirable to have available a comprehensive review of current and alternative methods for the allocation of import quotas on agricultural products subject to import controls;

AND WHEREAS section 18 of the *Canadian International Trade Tribunal Act* authorizes the Governor in Council to refer to the Canadian International Trade Tribunal for inquiry and report on any matter in relation to the economic, trade or commercial interests of Canada;

THEREFORE, HIS EXCELLENCY THE GOVERNOR GENERAL IN COUNCIL, on the recommendations of the Minister of Industry, Science and Technology and Minister for International Trade, the Minister of Agriculture and the Minister of Finance, pursuant to section 18 of the *Canadian International Trade Tribunal Act*, is pleased hereby to direct the Canadian International Trade Tribunal to undertake forthwith an inquiry into current methods of import quota allocation for agricultural products and alternatives thereto for the purpose of providing recommendations on the optimum method or methods to allocate import quota on a national basis for agricultural products currently subject to import controls with respect to factors of equity, predictability, economic efficiency, transparency, entry to the industry, market responsiveness and competitiveness. The Canadian International Trade Tribunal is also directed to provide recommendations on principles which should generally guide any import quota allocations.

In doing its inquiry, the Canadian International Trade Tribunal should consider, *inter alia*:

(a) the methods by which import quotas have been allocated, for example, on the basis of traditional or historic imports, of market share, of earmarking shares for further processors of products not on the Import Control List, as well as other possible methods by which to allocate import quota, for example, through auction;

(b) the impact different quota allocation methods have had or might have on the market place and on the competitive behaviour of its participants;

(c) whether the method by which import quota is allocated should differ as between the various agricultural products subject to import control;

(d) whether the method by which import quota is allocated should apply to the issuance of supplemental import permits;

(e) that Canada has international rights and obligations under bilateral and multilateral trade agreements.

HIS EXCELLENCY THE GOVERNOR GENERAL IN COUNCIL is further pleased to direct that the Canadian International Trade Tribunal hold public hearings in respect of the inquiry and provide an opportunity for oral and written submissions by all interested parties, including, but not limited to, supply management agencies, provincial commodity boards, domestic producers, processors and further processors, importers, wholesalers, retailers and consumers, in respect of its inquiry and submit its recommendations and report within fourteen months of the date of this Order.

## APPENDIX II

## LIST OF SUBMISSIONS / WITNESS STATEMENTS

### 1. Preliminary Hearing — October 10-11, 1991

ACA Co-operative Limited
Affiliated Administration Services (SAA) Inc.
Alberta Agriculture - Agricultural Products Marketing Council
Alberta Egg Producers Board
Les aliments Krinos Foods Canada Ltée/Ltd.
L'Association des Abattoirs avicoles du Québec Inc.
Association des Classificateurs d'Oeufs du Québec (1990) Enr.
Aurora Importing & Distributing Ltd.
British Columbia Broiler Hatching Egg Producers Association
Canadian Association of Regulated Importers
Canadian Broiler Hatching Egg Marketing Agency
Canadian Chicken Marketing Agency
Canadian Dairy Commission
Canadian Egg Marketing Agency
Canadian Hatchery Federation
Canadian Restaurant and Foodservices Association
Canadian Turkey Marketing Agency
Cara Operations Limited
The Coalition for the Equitable Allocation of Import Quotas
Cold Springs Farm Limited
Colombo Dairy Foods Ltd.
Coopérative fédérée de Québec
Couvoir Jolibec Inc.
Couvoirs, Boire & Frères Inc.
Cuddy International Corporation
D.A. Warring & Sons Foods Ltd.
Dairy Farmers of Canada
Dairyland Foods
Dunn-Rite Food Products Ltd.
Effem Foods Limited
Fahn Products Co. Ltd.
Far-Met Importers Ltd.
Fédération des producteurs de lait du Québec
Fleming Chicks Limited
Further Poultry Processors Association of Canada
Girardi's Enterprises Ltd.
Grocery Products Manufacturers of Canada
Intercity Packers Ltd.
International Cheese Council of Canada
Intersave Buying & Merchandising Services

Jarvis Chicks
KFC-Canada
Kirkland & Rose Ltd.
Maple Lodge Farms Ltd.
Maxi Poultry Co. Ltd.
McCain Foods Ltd.
Morrison Lamothe Inc.
National Cheese Company Ltd.
National Dairy Council of Canada
National Farmers Union
Natural Nectar Canada
Northern Pride Poultry Ltd.
The Ontario Egg Producers' Marketing Board
P & H Foods - A Division of Parrish & Heimbecker Limited
Premiers' Choice Gourmet Entrées Limited
Protein Foods Group Inc.
Saskatchewan Economic Diversification & Trade, Government of Saskatchewan
Scott's Food Services Inc.
T. Lauzon Ltée

## 2. First Public Hearing — January 22-February 6, 1992

Affiliated Administration Services (SAA) Inc.
Agropur Coopérative agro-alimentaire
Alberta Agriculture, Agricultural Products Marketing Council
AMGA Poultry & Meat Co. Ltd.
Association des Classificateurs d'Oeufs du Québec (1990) Enr.
Ault Foods Limited
B.J. Duxbury Enterprises
British High Commission
Canadian Association of Regulated Importers
Canadian Broiler Hatching Egg Marketing Agency
Canadian Chicken Marketing Agency
Canadian Dairy Commission
Canadian Egg Marketing Agency
Canadian Hatchery Federation
Canadian Importers Association Inc.
Canadian Poultry and Egg Processors Council
Canadian Restaurant and Foodservices Association
Cara Operations Limited
Central Alberta Dairy Pool
The Coalition for the Equitable Allocation of Import Quotas
Cold Springs Farm Limited
Consumers' Association of Canada
Les Couvoiriers du Québec Inc.
Cuddy Chicks Limited
Cuddy Food Products

Dairy Farmers of Canada
Fédération des Producteurs d'Oeufs de Consommation du Québec
Further Poultry Processors Association of Canada
Intercity Packers Ltd.
International Cheese Council of Canada
Intersave Buying & Merchandising Services
KFC-Canada
Kofman-Barenholtz Foods Limited
Lucerne Foods Limited
Maple Leaf Foods Inc.
Maple Lodge Farms Ltd.
Maxi Poultry Co. Ltd.
Mondo Foods Co. Ltd.
National Dairy Council of Canada
Northern Alberta Dairy Pool Limited
Pascobel Inc.
Scott's Food Services Inc.
Swissmart of Canada
T. Lauzon Ltée
USA Poultry & Egg Export Council
U.S. Department of Agriculture

### 3. Second Public Hearing — June 8-18, 1992

Affiliated Administration Services (SAA) Inc.
Agropur Coopérative agro-alimentaire
Aliments Delisle Ltée
Ault Foods Limited
Beatrice Foods Inc.
British Columbia Broiler Hatching Egg Producers Association
Canadian Association of Regulated Importers
Canadian Broiler Hatching Egg Marketing Agency
Canadian Chicken Marketing Agency
Canadian Dairy Commission
Canadian Egg Marketing Agency
Canadian Hatchery Federation
Canadian Poultry and Egg Processors Council
Canadian Turkey Marketing Agency
Cara Operations Limited
The Coalition for the Equitable Allocation of Import Quotas
Cold Springs Farm Limited
Cuddy Chicks Limited
Cuddy International Corporation
Dairy Farmers of Canada
Dairyland Foods
Farmers Co-operative Dairy Limited
Les Fromages Saputo Cheese Ltée/Ltd.

Further Poultry Processors Association of Canada
Groupe Lactel
Henning, J., Associate Professor, Department of Agricultural Economics, McGill University
International Cheese Council of Canada
Intersave Buying & Merchandising Services
Jarvis Chicks
KFC-Canada
Kofman-Barenholtz Foods Limited
Kraft General Foods Canada Inc.
Maple Lodge Farms Ltd.
Maxi Poultry Co. Ltd.
McCain Foods Ltd.
McCain Refrigerated Foods Inc.
Ministère de l'Agriculture, des Pêcheries et de l'Alimentation du Québec
Morrison Lamothe Inc.
National Dairy Council of Canada
National Farmers Union
Niagara Regional Importers, Exporters & Distributors Co. Ltd.
National Sea Products Limited
Swissmart of Canada
Syndicat des producteurs d'oeufs d'incubation du Québec
T. Lauzon Ltée
USA Poultry & Egg Export Council

## APPENDIX III

## GLOSSARY

### 1. GENERAL

#### *Canada-United States Free Trade Agreement* (FTA)

An agreement signed by Canada and the United States in 1988 that will see the elimination of most of the remaining tariff and non-tariff trade barriers between the two countries by 1999, with tariffs being phased out at differing rates.

#### Canadian Broiler Hatching Egg Marketing Agency (CBHEMA)

The federal agency responsible for the supply management of broiler hatching eggs and chicks, established in 1986 pursuant to the *Farm Products Marketing Agencies Act*. The member provinces of CBHEMA are British Columbia, Alberta, Manitoba, Ontario and Quebec. CBHEMA sets the national production quotas for hatching eggs and enforces a monitoring system to penalize those provinces that sell more than their allotment.

#### Canadian Chicken Marketing Agency (CCMA)

The federal agency responsible for the supply management of chicken, established in 1978 pursuant to the *Farm Products Marketing Agencies Act*. The CCMA is composed of one representative from each of the nine provincial chicken commodity marketing boards that are signatories to the federal-provincial agreement plus two Governor in Council appointees. The CCMA performs such functions as setting the total production quota for member provinces; establishing and enforcing a quota penalty system for provinces exceeding their allocations; and setting a cost-of-production formula as a reference used by provincial commodity boards when negotiating producer prices.

#### Canadian Dairy Commission (CDC)

The federal agency established in 1966 pursuant to the *Canadian Dairy Commission Act* that is responsible for the implementation of dairy policy in Canada. The CDC chairs the Canadian Milk Supply Management Committee, with representatives from nine provinces (Newfoundland does not produce industrial milk), which sets the national production target for industrial milk; sets the target price to be paid to producers for industrial milk; and establishes support prices for butter and skim milk powder.

#### *Canadian Dairy Commission Act* (CDC Act)

The federal statute enacted in 1966 to establish a national supply management system for industrial milk. Section 8 of the CDC Act states that the objectives of the CDC are to provide efficient producers of milk and cream with the opportunity of obtaining a fair return for their labour and investment and to provide consumers of dairy products with a continuous and adequate supply of dairy products of high quality.

### Canadian Egg Marketing Agency (CEMA)

The federal agency responsible for the supply management of shell eggs established in 1972 pursuant to the *Farm Products Marketing Agencies Act*. CEMA is responsible for setting the national production quota for shell eggs and allocating it to 10 provincial members. It also administers a central pricing system and a surplus removal program for eggs declared surplus to the table market.

### Canadian Turkey Marketing Agency (CTMA)

The federal agency responsible for the supply management of turkey established in 1973 pursuant to the *Farm Products Marketing Agencies Act*. The CTMA is composed of one representative from each of the eight provincial turkey commodity marketing boards that are signatories to the federal-provincial agreement. The CTMA sets the total production quota for member provinces (except Prince Edward Island and Newfoundland which have virtually no turkey production) and establishes and enforces a quota penalty system for provinces exceeding their allocations.

### Cost-of-Production Price or Formula

Used by supply management agencies to develop actual or target prices for primary producers of controlled products. Cost-of-production prices are usually comprised of estimated "average" labour and material costs, with a further amount added to provide a "fair" return to capital investment, usually excluding the value of production quota..

### Dutch Auction

A descending price auction that starts at a high price, which is gradually lowered until a bidder offers to buy at the quoted price. A Dutch auction is usually used to sell one object at a time.

### English Auction

An ascending price auction in which bids are offered at successfully higher prices until no one is willing to raise the bid further. An English auction is usually used to sell one object at a time.

### European Community

An economic union consisting of France, Italy, Belgium, Germany, the Netherlands, Luxembourg, Denmark, the United Kingdom, Ireland, Greece, Spain and Portugal.

### *Export and Import Permits Act* (EIPA)

Enacted in 1947, legislative authority to the Governor in Council to control the import and export of designated products and technologies.

### Export and Import Permits Bureau (EIPB)

The bureau within External Affairs and International Trade Canada responsible for the administration of the EIPA. (Formerly called the Special Trade Relations Bureau.)

### *Farm Products Marketing Agencies Act* (FPMA Act)

An act to establish the National Farm Products Marketing Council and to authorize the establishment of national marketing agencies for farm products (eggs and poultry, and any part of any such products and any other natural product of agriculture and any part of any such product), the marketing of which in interprovincial and export trade is not regulated pursuant to the CDC Act or the *Canadian Wheat Board Act*. Pursuant to section 21, the objectives of a supply management agency established under the FPMA Act are to promote a strong, efficient and competitive production and marketing industry for the regulated products and to have due regard to the interests of producers and consumers of the regulated product or products.

### *General Agreement on Tariffs and Trade* (GATT)

A multilateral treaty subscribed to by 93 countries (Contracting Parties), which together account for more than four fifths of world trade, which sets out rules for international trade. The primary objective of GATT is to liberalize world trade and place it on a secure basis, thereby contributing to global economic growth and development.

### Generalized Dutch Auction

Within the context of this inquiry, a multiple-unit generalization of a single item Dutch auction (descending price).

### Generalized English Auction

Within the context of this inquiry, a multiple-unit generalization of a single item English auction (ascending price).

### Import Control List (ICL)

The list of goods established under the EIPA which cannot be imported into Canada except under the authority of, and in accordance with, an import permit issued under the EIPA.

### Import Permit

A document issued on behalf of the Minister that allows the importation of goods on the Import Control List.

### Import Quota

A quantitative restriction on the amount of a commodity that can be imported into a country during a given period of time. Import quotas represent a non-tariff trade barrier. The restriction can be set in either absolute volume terms or as a percentage of domestic production.

### Non-ICL Product

In the context of this inquiry, non-ICL products are not on the Import Control List, but use goods on the Import Control List as inputs.

### Supplemental Import Permits

Import permits issued to import quota holders or others for specific quantities of products on the Import Control List, supplementary to the global import quota for that particular product. Commonly referred to as SUPPs for poultry and egg products and as special import permits for dairy products.

### Supply Management

In Canada, supply management of agricultural products involves regulating the production or sale of the product, supporting income levels for primary producers and controlling imports of the product.

## 2. Product Specific

## a) Broiler Hatching Eggs and Chicks

### Broiler Hatching Egg

An egg that is suitable for incubation and that is to be hatched as a chick for chicken production.

### Federally Registered Hatchery

Any place, building or premise equipped with an incubation capacity of 1,000 or more eggs.

### Multiplier

The final genetically engineered product of the primary breeding company used to produce the eggs for commercial chicken and turkey meat growers.

### Primary Breeder

Represents the various gene pool lines required in combination to produce a multiplier breeder chicken and turkey.

## b) Chicken and Turkey

### Poultry Processing

Refers to the primary, secondary and further processing of chicken and turkey products.

### Further Processor

A federally or provincially inspected facility that purchases eviscerated bone-in or deboned chicken or turkey from primary and/or secondary processors, and transforms the products into value-added poultry products.

### Integrated Processor

A federally or provincially inspected facility that both slaughters and further processes chicken and turkey on its own premises.

### Primary Processor

A federally or provincially inspected facility that slaughters and eviscerates live chicken and turkey.

### Secondary Processor

A federally or provincially inspected facility whose function involves cutting up and deboning chicken and turkey.

## c) Dairy Products

### Dairy Processor

A dairy processor or manufacturer of dairy products typically does one or more of the following: processes fluid milk; manufactures dairy products from industrial milk; uses dairy products as ingredients in the production of other dairy products; or processes and packages dairy products for redistribution (e.g. cuts and packages imported and specialty cheeses, blends milk powders).

### Fluid Milk

Milk used to manufacture table milk and cream.

### Industrial Milk

Milk used to manufacture dairy products such as cheese, ice cream, yoghurt, dry and condensed milk.

## d) Shell Eggs

### Breaker or Industrial Eggs

Eggs that are surplus to the needs of the table market and that are consumed in processed form.

### Federally Registered Egg Grading Station

An establishment that has one or more rooms where eggs are graded for the commercial market prior to sale.

### Federally Registered Processed Egg Station

A processed egg station that washes, breaks open, blends, pasteurizes, dries and freezes eggs, primarily for resale to further processors. Some egg processors also further process egg products into value-added consumer products.

### Shell Eggs

Eggs produced for human consumption, comprising table and breaker eggs.

### Table Eggs

Eggs that are normally graded and sold to the foodservice and retail sectors for consumption by the public.

## 3. Associations Participating in the Inquiry

### Canadian Association of Regulated Importers (CARI)

A trade association that promotes the interests of firms and individuals having access to import permits for products placed on the Import Control List. CARI is a member of the import advisory committees created to advise External Affairs and International Trade Canada on import matters for chicken, turkey and eggs.

### Canadian Hatchery Federation (CHF)

A national trade organization representing close to 80 hatcheries of broiler hatching eggs.

### Canadian Poultry and Egg Processors Council (CPEPC)

A national organization representing poultry and egg processors in Canada, with 80 corporate members and 29 associate members.

### Canadian Restaurant and Foodservices Association (CRFA)

A national organization of both independent and chain foodservice organizations. For the most part, its members do not currently hold import quotas for any controlled agricultural products.

### The Coalition for the Equitable Allocation of Import Quotas (Coalition)

The Coalition consists of 21 companies that represent over 75 percent of the Canadian food distribution industry. The members of the Coalition currently do not hold import quotas for controlled agricultural products.

### Consumers' Association of Canada (CAC)

A voluntary, non-profit and non-governmental association representing consumers across Canada.

### Dairy Farmers of Canada (DFC)

The national lobby and policy organization representing all dairy farmers in Canada. It is a federation of provincial milk marketing boards, dairy producers' association cooperatives and a national dairy breed organization.

### Further Poultry Processors Association of Canada (FPPAC)

Represents the interests of corporations engaged in the further processing of chicken, turkey, fowl and other poultry products.

### International Cheese Council of Canada (ICCC)

A trade committee within the Canadian Importers Association Inc., whose members account for the majority of Canada's imports of cheese. The membership of the ICCC represents both large and small traditional cheese importers, including trading houses, as well as producers, processors, distributors and exporters of dairy products.

### National Dairy Council of Canada (NDC)

The national trade association of the Canadian dairy processing industry. NDC members process over 90 percent of the fluid milk produced in Canada, manufacturing and marketing a wide range of dairy products.

### Affiliated Administration Services (SAA) Inc.

An association of more than 55 small- and medium-sized Quebec firms involved in processing and distributing food products, including chicken and turkey.

# APPENDIX IV

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#126 — Chicken, October 19, 1979.
#130 — Cheese of all types, October 26, 1979.

#131 — Chicken, November 1, 1979.
#138 — Cheese of all types, March 3, 1980.
#141 — Turkey, March 10, 1980.
#146 — Chicken, August 25, 1980.
#155 — Turkey, March 6, 1981.
#158 — Chicken, May 29, 1981.
#159 — Cheese of all types, September 17, 1981.
#164 — Cheese of all types, March 29, 1982.
#173 — Turkey, July 12, 1982.
#174 — Chicken, July 12, 1982.
#186 — Chicken, January 3, 1983.
#187 — Chicken, January 3, 1983.
#188 — Turkey, January 3, 1983.
#206 — Cheese of all types, June 30, 1983.
#240 — Cheese of all types, April 12, 1984.
#263 — Cheese of all types, May 7, 1985.
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#289 — Turkey, December 19, 1985.
#290 — Eggs and egg products, December 19, 1985.
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#367 — Turkey, January 24, 1989.
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#381 — Chicken and turkey, October 16, 1989.
#382 — Broiler hatching eggs and chicks for chicken production, October 23, 1989.
#383 — Chicken and turkey, October 30, 1989.
#399 — Eggs and egg products, October 22, 1990.
#400 — Broiler hatching eggs and chicks for chicken production, November 2, 1990.
#401 — Chicken and turkey for further processed poultry products, November 8, 1990.
#403 — Chicken and turkey, November 14, 1990.
#407 — Ice cream and yoghurt, January 24, 1991.
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#419 — Chicken and turkey (further processed) August 23, 1991.
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## APPENDIX V

## TRIBUNAL STAFF

### 1. Research Branch

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| Mary Walsh | Project Director |

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| Gillian Bryenton* | Dairy Products, Poultry Products |
| Audrey Chapman | Poultry Products |
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| Francesca Iacurto* | Dairy Products, Poultry Products |
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| Ken Nicholls* | Dairy Products |
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| Benoit Papillon* | Generic Issues |
| Daryl Poirier | Shell Eggs, Egg Products |
| André Renaud | Dairy Products |
| Rose Ritcey | Dairy Products, Generic Issues |
| Nancy Ross* | Dairy Products |
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| Don Shires | Broiler Hatching Eggs and Chicks |

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| Taryn Barone* | |
| Nynon Burroughs | |
| Franco Longo* | |
| Sonia McEachern | |
| Marguerite Turner* | |
| Joe Vincec* | |

#### Administrative Support

Keltie Findlay*
Cathie Richards*

* Term or secondment agreement.

## 2. SECRETARIAT

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| Robert J. Martin | Secretary |

### Registrar

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|---|---|
| Nicole Pelletier | Assistant Secretary and Registrar |

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| Lynne Assad | |
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| Danielle Lefebvre | Chief |
| Françoise Couture | |

## 3. COUNSEL FOR THE TRIBUNAL

| | |
|---|---|
| Debra Steger | General Counsel |
| Brenda Swick-Martin | |

## APPENDIX VI

## LIST OF PARTICIPANTS/WITNESSES*

### 1. Preliminary Hearing — October 10-11, 1991

| Participants | Title |
| --- | --- |
| François Lemieux<br>Timothy McCunn | Counsel for:<br>Dairy Farmers of Canada<br>Canadian Broiler Hatching Egg Marketing Agency<br>Canadian Chicken Marketing Agency<br>Canadian Egg Marketing Agency |
| Donald Kubesh<br>Glenn H. Cranker<br>Martine M.N. Band | Counsel for:<br>International Cheese Council of Canada<br>Natrel Inc.<br>Pascobel Inc.<br>Agropur Coopérative agro-alimentaire |
| Peter Clark | Counsel for:<br>National Dairy Council of Canada<br>Government of Saskatchewan |
| Kempton L. Matte | President<br>National Dairy Council of Canada |
| Pierre Nadeau | Vice-President<br>National Dairy Council of Canada |
| Michael A. Kelen | Counsel for:<br>Cara Operations Limited<br>Effem Foods Limited |
| Paul C. LaBarge | Counsel for:<br>Maple Leaf Foods Inc./Nestlé Enterprises Limited |
| Dalton J. Albrecht | Counsel for:<br>Canadian Association of Regulated Importers |

* Counsel and witnesses were participants at the preliminary hearing of October 10-11, 1991. Only sworn witnesses have been listed for the public hearings of January 22-February 6 and June 8-18, 1992.

| | |
|---|---|
| Paul Stott | Chairperson<br>Canadian Association of Regulated Importers |
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| Don Axford | Director, Policy Research<br>Consumers' Association of Canada |
| Raymond Tremblay<br>Michel Bergevin | Counsel for:<br>Gouvernement du Québec: Direction des affaires juridiques - Agriculture, Pêcheries et Alimentation |
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| Thomas W. Maich | Counsel for:<br>KFC-Canada/Pepsi-Cola Canada Ltd. |
| Ian Johnstone | Purchasing Manager<br>KFC-Canada |
| Luc Martineau | Counsel for:<br>T. Lauzon Ltée |
| Ron. E. Folkes | Counsel for:<br>Maple Lodge Farms Ltd. |
| Robert (Bob) Joseph May | Chief Executive Officer<br>Maple Lodge Farms Ltd. |
| David M. Ivison | Vice-President, Finance and Treasurer<br>Vice-President, Fine Foods Division<br>Morrison Lamothe Inc. |
| Lyne Jacques<br>François Painchaud | Counsel for:<br>Affiliated Administration Services (SAA) Inc. |

## 2. First Public Hearing — January 22-February 6, 1992

| Witness | Title |
|---|---|
| Arthur Pellicione | President<br>Colombo Importing Ltd. |
| Peter J. Couture | President<br>Lovell & Christmas (Canada) Inc. |
| Walter I. Pelley | Vice-President<br>Ronald A. Chisholm Limited |
| Pierre Robert | General Manager, Fine Cheese Division<br>Agropur Coopérative agro-alimentaire |
| Kempton L. Matte | President<br>National Dairy Council of Canada |
| Richard (Dick) Innes | President, Industrial Division<br>Ault Foods Limited |
| Pierre Nadeau | Vice-President<br>National Dairy Council of Canada |
| Ian D. Ferguson | President, Frozen Products Division<br>Ault Foods Limited |
| Lee Sienna | President, Refrigerated Products Division<br>Ault Foods Limited |
| Larry J. Martin | Distinguished Professor of Agricultural Policy<br>University of Guelph |
| Bob Jack | General Manager<br>Kofman-Barenholtz Foods Limited |
| Thomas (Tom) A. De Nardi | Sales Manager<br>Mondo Foods Co. Ltd. |
| Michael C. McCracken | President<br>Informetrica Limited |

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| Michel Côté | Vice-président, Développement corporatif - Fusions et acquisitions<br>Le Groupe Sofati<br>President of The Coalition for the Equitable Allocation of Import Quotas |
| Lawrence E. Ross | Corporate Vice-President, Meat Merchandising<br>The Great Atlantic & Pacific Company of Canada Limited |
| Harold Garth Coffin | Associate Professor, Agricultural Economics<br>McGill University |
| Jean H. Dagenais | President<br>Switzerland Cheese Association of Canada |
| Rick Phillips | Assistant Executive Director<br>Dairy Farmers of Canada |
| Robert G. de Valk | Executive Secretary<br>Canadian Association of Regulated Importers |
| Andrew Schmitz | Chairman, Agricultural Economics<br>University of California, Berkeley |
| Colin Carter | Professor, Agricultural Economics<br>University of California, Davis |
| Cynthia Currie | General Manager<br>Canadian Chicken Marketing Agency |
| Angelo Mardas | President<br>AMGA Poultry & Meat Co. Ltd. |
| George Douglas Leroux | Vice-President, Turkey Division<br>Cold Springs Farm Limited |
| Phil Kudelka | Vice-President, Operations<br>Cuddy Food Products |
| William P. Dover | President<br>General Mills Restaurants, Canada |
| Douglas C. Needham | President<br>Canadian Restaurant and Foodservices Association |

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| Jack Radlo | President<br>Radlo Bros., Inc. |
| James H. Sumner | President<br>USA Poultry & Egg Export Council |
| Ian Johnstone | Purchasing Manager<br>KFC-Canada |
| Robb Chase | Director, Business Development<br>KFC-Canada |
| Allan Warring | General Manager<br>D.A. Warring & Sons Foods Ltd. |
| John Whyte | Vice-President<br>D.A. Warring & Sons Foods Ltd. |
| Robert G. de Valk | General Manager<br>Further Poultry Processors Association of Canada |
| Andrew Friedmann | Vice-President, Administration<br>Maxi Poultry Co. Ltd. |
| Robert (Bob) Joseph May | Chief Executive Officer<br>Maple Lodge Farms Ltd. |
| Grant (Cameron) Robinson | Chief Financial Officer<br>Maple Lodge Farms Ltd. |
| Jean Lauzon | Directeur<br>T. Lauzon Ltée |
| Ron Drohomereski | Chairman<br>Canadian Broiler Hatching Egg Marketing Agency |
| Paul Jelley | General Manager<br>Canadian Broiler Hatching Egg Marketing Agency |
| Bertrand Cloutier | Secrétaire<br>Fédération des Producteurs d'Oeufs de Consommation du Québec |
| David Charles Barlow | Vice-President, Purchasing and Product Development<br>Cara Operations Limited |

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|---|---|
| Louise M. Arthur | Manager, Land Use Evaluation<br>Land Use Policy Branch<br>Province of British Columbia |
| Gerry Gartner | General Manager<br>Canadian Egg Marketing Agency |
| Neil Currie | Operations Manager<br>Canadian Egg Marketing Agency |
| Paul Ouellette | Vice-President, Poultry<br>Canadian Poultry and Egg Processors Council |
| Robert (Bob) M. Anderson | Executive Vice-President<br>Burnbrae Farms Ltd. |
| Dan H. Hara | Principal<br>Hara Associates |
| John R. Groenewegen | Principal<br>Deloitte & Touche |
| Nelson Coyle | Policy and Program Analyst<br>Canadian Dairy Commission |
| Roch Morin | Chairman<br>Canadian Dairy Commission |
| Charles C. Birchard | Senior Policy Advisor<br>Canadian Dairy Commission |
| Jocelyn J. Comtois | Director of International Marketing<br>Canadian Dairy Commission |
| Ross Mitchell | Vice-President, National Brands<br>Intersave Buying & Merchandising Services |

## 3. Second Public Hearing — June 8-18, 1992

| Witness | Title |
|---|---|
| John R. Groenewegen | Principal<br>Deloitte & Touche |
| Nelson Coyle | Policy and Program Analyst<br>Canadian Dairy Commission |

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| Roch Morin | Chairman<br>Canadian Dairy Commission |
| Jocelyn J. Comtois | Director of International Marketing<br>Canadian Dairy Commission |
| Charles C. Birchard | Senior Policy Advisor<br>Canadian Dairy Commission |
| Rick Phillips | Assistant Executive Director<br>Dairy Farmers of Canada |
| Pierre Robert | General Manager, Fine Cheese Division<br>Agropur Coopérative agro-alimentaire |
| Doug C. Smith | Sales & Marketing Manager<br>MD Foods |
| Walter I. Pelley | Vice-President<br>Ronald A. Chisholm Limited |
| Timothy Angus Chisholm | President<br>Ronald A. Chisholm Limited |
| Stephen Ronald Chisholm | Manager, Dairy Division<br>Ronald A. Chisholm Limited |
| Pierre Nadeau | Vice-President<br>National Dairy Council of Canada |
| Kempton L. Matte | President<br>National Dairy Council of Canada |
| Richard (Dick) Innes | President, Industrial Division<br>Ault Foods Limited |
| Lee Sienna | President, Refrigerated Products Division<br>Ault Foods Limited |
| Ian D. Ferguson | President, Frozen Products Division<br>Ault Foods Limited |
| Serge Bragdon | President, Quebec Fluid Division<br>Ault Foods Limited |
| Pierre Claprood | Chief Financial Officer<br>Agropur Coopérative agro-alimentaire |

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|---|---|
| Camillo Lisio | Assistant to the President<br>Les Fromages Saputo Cheese Ltée/Ltd. |
| Randy W. Williamson | Vice-President, Industrial Division<br>Dairyland Foods |
| Rowan B. Caseley | Vice-President, Manufacturing<br>Farmers Co-operative Dairy Limited |
| Gilbert (Bert) C. Lear | President, Food Products Division<br>Beatrice Foods Inc. |
| Michael A. Taylor | General Manager, Beatrice Ice Cream<br>Beatrice Foods Inc. |
| Carl E. Harrison | President<br>McCain Refrigerated Foods Inc. |
| Carl A. Nanni | Vice-President, Marketing Refrigerated Products<br>Kraft General Foods Canada Inc. |
| Peter J. Porteous | Category Manager, Refrigerated Business Unit<br>Kraft General Foods Canada Inc. |
| Ross S. Green | Corporate Director, Quality Assurance & Industry Relations<br>Kraft General Foods Canada Inc. |
| Normand de Montigny | Directeur, Affaires institutionnelles<br>Groupe Lactel |
| Paul Ouellette | Vice-President, Poultry<br>Canadian Poultry and Egg Processors Council |
| Robert (Bob) M. Anderson | Executive Vice-President<br>Burnbrae Farms Ltd. |
| Roy W. McDannold | Executive Director<br>Canadian Poultry and Egg Processors Council |
| Oliver Kent | Partner<br>Price Waterhouse |
| Michael C. McCracken | President<br>Informetrica Limited |
| Donald B. Murray | Agricultural Economist<br>Agriculture Canada |

| | |
|---|---|
| Denis Desrosiers | Economist<br>Canadian Chicken Marketing Agency |
| Cynthia Currie | General Manager<br>Canadian Chicken Marketing Agency |
| Ken E. Crawford | Executive Director<br>Canadian Turkey Marketing Agency |
| George Douglas Leroux | Vice-President, Turkey Division<br>Cold Springs Farm Limited |
| Harold Garth Coffin | Associate Professor, Agricultural Economics<br>McGill University |
| Jim Macartney | President<br>Macartney Poultry Farm |
| Paul Stott | President<br>Reuven International Ltd. |
| Robert G. de Valk | Executive Secretary<br>Canadian Association of Regulated Importers |
| Guy Raymond | President and Managing Director<br>Affiliated Administration Services (SAA) Inc. |
| Lem Janes | President<br>Janes Family Foods Ltd. |
| Fred Williamson | President<br>Pinty's Premium Foods Inc. |
| Cyril Levenstein | President<br>Readyfoods Limited |
| Malcolm Garner | Vice-President, Marketing & Business<br>Development<br>Cambridge Canadian Foods |
| Gabrielle Pop-Lazic Schappert | Economist and Manager of Information Services<br>Canadian Broiler Hatching Egg Marketing Agency |
| Paul Jelley | General Manager<br>Canadian Broiler Hatching Egg Marketing Agency |

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| John C. Durham | Secretary Manager<br>B.C. Broiler Hatching Egg Commission |
| Pierre Belleau | Secrétaire<br>Syndicat des producteurs d'oeufs d'incubation du Québec |
| John E. Hoover | President<br>Curtis Chicks Limited |
| Brian Snyder | President<br>Jarvis Chicks |
| Brian A. Cram | Vice-President, Operations<br>Cuddy Food Products |
| Gerry Gartner | General Manager<br>Canadian Egg Marketing Agency |
| Neil Currie | Chief Operations Officer<br>Canadian Egg Marketing Agency |
| Peter Constable | Vice-President<br>Niagara Regional Importers, Exporters & Distributors Co. Ltd. |
| Robert A. Cuddy | President<br>Cuddy Food Products |
| R. William C. Stevens | Executive Advisor to the Chairman<br>Cuddy International Corporation |

# APPENDIX VII

## STAFF REPORTS

S.1 Draft Staff Notes on The Conduct of The Inquiry, October 2, 1991.

S.2 Final Staff Notes on The Conduct of the Inquiry, October 29, 1991.

S.3 Descriptive Staff Report, December 19, 1991.

S.4 Analytic Staff Report, May 11, 1992.

S.5 Spreadsheet Instructions to Calculate Alternative Import Quota Allocation Method Scores, May 11, 1992.

D.1 Import Quota Data, December 20, 1991.

D.2 Import Quota Data (Revised Cheese Tables), January 17, 1992.

D.3 Import Quota Data (1991-1992), May 11, 1992.

D.4 Poultry Import Permit Data, May 11, 1992.

# APPENDIX VIII

## CONSULTANT REPORTS

C.1 Deloitte & Touche Management Consultants, Economic Framework to Measure Impact of Import Quota Allocations, December 1991.

C.2 Hara Associates, Alternative Methods of Allocating Import Quotas, December 1991.

C.3 Deloitte & Touche Management Consultants, Notes for Using the Spreadsheet Models, January 1992.

C.4 Deloitte & Touche Management Consultants, Potential Effects of Import Quota Alternatives on Supply Management, March 1992.

C.5 Deloitte & Touche Management Consultants, Potential Implications of Tariffication on Existing Border Controls, March 1992.

C.6 Deloitte & Touche Management Consultants, Competitiveness Profile of the Canadian Cheese Industry, March 1992.

C.7 Deloitte & Touche Management Consultants, Competitiveness Profile of the Chicken Industry, March 1992.

C.8 Deloitte & Touche Management Consultants, Import Quota Rents on Supply Managed Products, March 1992.

# APPENDIX IX

## ILLUSTRATIVE METHOD FOR IMPLEMENTING A GENERALIZED DUTCH AUCTION FOR IMPORT QUOTAS

This appendix provides an example of how an auction for import quotas could be run to meet the objectives set out in the main body of the Tribunal's report. It uses cheese as the commodity subject to the auction, but a similar set of arrangements, modified as appropriate, could also be made for other products. Precise administrative details would need to be developed by the EIPB or the administrative body running the auction.

The design of an auction raises a number of practical and theoretical issues regarding, for instance, eligibility and procedures. An attempt has been made in the following list to cover most of these issues, classified into five broad groups: definition of auction lots, frequency of auctions and quantities auctioned, bidding conditions, auction medium and procedure, and obligations and rights of buyers. Some practical ways to address the related issues are proposed. Other options would also be possible. In the end, experience will be the best guide to improve these auction rules and procedures.

### 1. Definition of Auction Lots

The current global quota for cheese is fixed at 20.4 million kilograms per year. This global quota is divided into two groups of countries of origin: 60 percent or 12.24 million kilograms for EC countries, and 40 percent or 8.16 million kilograms for non-EC countries. The global quota is further subdivided into many dozens of varieties. In order to allocate quotas through an auction system, quota lots could be defined as follows.

- Minimum lot size: a quota lot would represent 100 kg per year. Therefore, the global import quota would be broken down into 204,120 lots.

- Variety restriction: the variety restriction would be dropped, which means that a quota lot could be used to import any kind of cheese.

- Country-of-origin restriction: in order to satisfy Canada's international obligations, the distinction between EC and non-EC countries would be maintained. Therefore, 122,472 lots would be EC quotas, and 81,648 lots would be non-EC quotas.

- Date and duration of quota: each quota lot would be auctioned for three years, this quota life being defined by the calendar year. For instance, the holder of an EC quota lot could import 100 kg of any variety cheese, per year, from any EC country over the defined three-year period.

## 2. Frequency of Auctions and Quantities Auctioned

Every year, EC quota lots and non-EC quota lots would be put up for sale in two different auctions. Given the size of the global quota, the three-year duration and the 60 percent/40 percent breakdown between EC and non-EC quotas, 40,824 lots would be put for sale at every EC quota auction, and 27,216 lots would be put for sale at every non-EC quota auction.

## 3. Bidding Conditions

- Eligibility to bid: cheese quota auctions would be open to any person or business (party).

- Deposit requirements: in order to avoid disruption by non-serious bidders, the administrator would have to decide whether a pre-auction deposit is to be required from participants.

- Bidding restrictions: a party would not be allowed to bid for more than 10 percent of the total amount put up for sale at any auction. In the case of the EC quota auction, this would limit individual bids to a maximum of 4,082 lots, while in the case of the non-EC quota auction, it would limit individual bids to a maximum of 2,722 lots. For the purpose of this restriction, a party could be defined to include all the employees (with their family) and all the shareholders (with their family) of a corporation/cooperative and of its affiliated companies or cooperatives.

## 4. Auction Medium and Procedure

The auction procedure would be designed to determine a clearing price and to allocate quota lots among parties willing to buy at this price. In a generalized Dutch auction, the clearing price is arrived at in a stepwise process and parties receive a feedback of information during the auction in order to limit the uncertainty about the quantity that they will ultimately buy and the final price.

- Auction medium: in order to allow parties to place bids successively and to be informed about how fast the successively lower prices converge towards the clearing price, the use of telephone lines or on-line computers is needed. This would avoid the need for all participants to travel to one single location on the day of the auction.

- Opening bid price: based on price information from previous auctions and from the secondary market, the auctioneer would announce an opening price per kilogram expected to be, say, 25 percent higher than the anticipated clearing price.

- First bid amounts: each party interested in purchasing at the opening bid price would communicate to the auctioneer the number of lots for which it bids at this price (it is possible that no quantity would be requested at the opening bid price).

- Total first bid: the auctioneer would compute the total number of lots requested at the opening bid price; parties would be informed of the number of lots for which there were no bids, and all bids would be set aside.

- Second bid price: the auctioneer would then announce a second price lower than the opening bid price by a pre-determined number of cents (for instance, $0.05 per kg).

- Second bid amounts: parties interested in purchasing at the second bid price would communicate to the auctioneer the number of lots for which they bid at this price.

- Total second bid: the auctioneer would compute once again the total number of lots requested at the second bid price; parties would be informed of the number of lots for which there were no bids, and all bids would again be set aside.

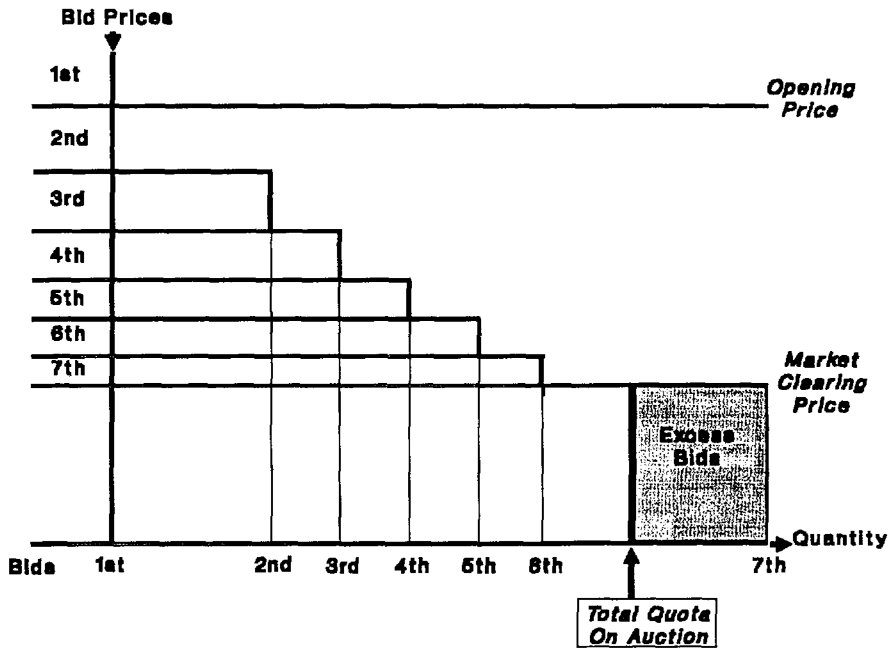
This process would continue at successively lower prices and higher quantities demanded until a price is eventually reached at which time all the lots put up for sale are taken. This price is the auction clearing price.

- Excess quantities bid: the total quantity requested at the last price announced (the clearing price) could be larger than the quantity of lots put up for sale. This excess demand for quota lots must be cut back to match the quantity for sale.

- Prorationing: each bid made at the clearing price would be reduced proportionately in order to arrive at a total which is equal to the quantity of lots put up for sale, with rounding up of individual bids to the next even lot size for administrative and marketing convenience.

Figure 9.1 illustrates the determination of a market clearing price under a generalized Dutch auction system. The quantities 1st, 2nd, etc., on the horizontal axis stand for total quantity bid at the first bid price, total quantity bid at the second bid price, etc., and would likely be of different sizes in practice. The chart illustrates a case where no quantity is bid by parties at the opening bid price.

**Figure 9.1**
**ILLUSTRATIVE GENERALIZED DUTCH AUCTION**




## 5. Obligations and Right of Buyers

- Payment requirements: a partial payment (deposit) of the quota lots bought at the auction must be made within 10 working days after the date of the auction. The import allocations would be recorded in the name of the buyers in the files of the EIPB. Import permits would be issued for the amounts as specified by the permit applicant.

- Penalties for non use: parties in the name of whom the import allocations are recorded at the EIPB are responsible for the full use (95 percent for flexibility) of import quota lots allocated under these permits. The penalty for non-fulfilment of this utilization rule would be forfeiture of the partial payment deposit and a limit on the amount that the bidder could purchase in subsequent auctions.

- Transferability: a quota holder could resell all or part of its allocation for which the auction clearing price has been paid in full.

## 6. Administrative Options

There are several aspects of an import quota auction method on which there are various administrative options. An attempt was made to recommend those options that would enhance the allocation method in terms of the seven evaluation factors enumerated in the terms of reference. However, in practice, experience may suggest that other options would better achieve the objectives of an optimum allocation method.

Use of a single clearing price rather than a "pay-what-you-bid" approach should enhance the equity and predictability of the auction method; that is, all parties pay the same price for an import quota rather than what they are prepared to pay. In order to achieve this result as each successive bid price is proposed, the bids received previously should be set aside and each individual bidder should make a new bid for the quantity desired at the new bid price. A single clearing price approach has the further advantage of encouraging higher initial bids. Bidders would have some confidence that their final settlement price would be lower than their opening bid.

If an opening bid price results in an oversubscribed auction, the auctioneer should reject all bids and start a new auction with a higher opening price.

When an auction clearing price is determined, which results in an auction that is not largely oversubscribed (less than 5 percent), the administrator should prorate the bid quantities to match the amount of the import quota available. In other circumstances (i.e. significant oversubscription), it would be more appropriate to use a combination of a generalized Dutch-type auction and an English auction where the bid price would move back up in small increments until the excess demand disappears. In the latter case, the size of the movements in the bid price could be varied so that smaller increments are used as the bid quantities approach the total quantity available.