The United States' Challenge(s) to Canada's Dairy Import Tariff Rate Quotas: What is All the Fuss About?

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ABSTRACT

At first glance, the U.S.-Canada dispute over Canada's use of tariff rate quotas (TRQs), a special type of trade policy targeted at imports, to protect its dairy management supply system may seem to be a fuss about nothing. The United States argues that Canada's use of TRQs discriminates against U.S. exports of dairy products to Canada, but any remedy would likely result in only modest economic gains to the United States. To conclude that the dispute is "a tempest in a teapot," however, is to miss the larger implications of the dispute.

While economists have shown TRQs to be inefficient trade policy instruments, Canada has been remarkably successful in using them along with other policies to maintain its dairy management system for about 70 years in order to secure high milk prices for its dairy farmers. A combination of bipartisan political support and effective lobbying by the Canadian dairy industry has resulted in a system that offers very robust resistance to trade liberalization pressures, with only modest gains due to recent free trade agreements (FTAs). The Canadian TRQ system vindicates their use as effective instruments of agricultural trade policy.

The other major significance of this dispute is the United States' enthusiastic use of the dispute resolution mechanism of the United States Mexico Canada Trade Agreement (USMCA). In light of the crisis in the World Trade Organization (WTO) due to the paralysis of its dispute settlement system, the United States appears to be indicating that it intends to substitute a parallel dispute settlement system created in the USMCA and other U.S.-led FTAs for that of the WTO. The USMCA dispute resolution mechanism can be used to resolve either WTO or USMCA disputes, a feature shared by other U.S.- led FTAs. This development could signal that the United States is ready to completely abandon dispute settlement

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under the WTO in favor of parallel dispute resolution systems of its own making.

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I. INTRODUCTION

On May 25, 2021, the United States requested establishment of a panel under Article 31.6[1] of the dispute settlement mechanism of the United States-Mexico-Canada Agreement (USMCA)[2] which replaced the North American Free Trade Agreement (NAFTA) on July 1, 2020.[3] This followed a request on December 9, 2020, by the United States for consultations with Canada concerning the measures through which Canada allocates dairy tariff-rate quotas (TRQs) under USMCA.[4] A TRQ is a policy instrument where a tariff is imposed on imports up to a certain quantity (the "in-quota" rate) after which a higher tariff is imposed on imports above that quantity (the "over-quota" rate).[5] This case was the first to be judged under the new dispute resolution process of USMCA, the panel ruling on December 20, 2021 that the TRQ allocation mechanism limited the U.S. dairy industry's access to the Canadian market, thereby violating the provisions contained in Chapter 3.A.2.11(b) of USMCA.[6] Despite the panel ruling in favor of the United States, and an announcement by Canada on May 22, 2022 of changes to its dairy TRQs,[7] the United States has sought to launch a second dispute with Canada, the United States Trade Representative (USTR) Katherine Tai requesting a new panel on January 31, 2023, on the

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[1] *See* CANADA-UNITED STATES-MEXICO AGREEMENT ARIBTRAL PANEL ESTABLISHED PURSUANT TO ARTICLE 31, *CANADA-DAIRY TRQ ALLOCATION MEASURES* (CDA-USA-2021-31-010), 1 (December 20,2021) [hereinafter Final Report]. https://ustr.gov/sites/default/files/enforcement/USMCA/Canada%20Dairy%20TRQ%20Final%20Panel%20Report.pdf

[2] *See* USTR, *Agreement between the United States of America, the United Mexican States, and Canada* (July 1, 2020), [hereinafter USMCA]. (Note, in Canada USMCA is referred to in official and other documents as CUSMA). https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between.

[3] *See North American Free Trade Agreement*, 17 December 1992, 32 I.L.M. 289, 32 I.L.M. (1993) [hereinafter NAFTA].

[4] *See* Final Report *supra* note 1, at 1.

[5] *See* DANIEL C.K. CHOW, THOMAS J. SCHOENBAUM, & GREGORY C. DORRIS, INTERNATIONAL TRADE LAW: PROBLEMS, CASES, AND MATERIALS (5th ed. 2022) (hereinafter, CHOW, SCHOENBAUM, & DORRIS, INTERNATIONAL TRADE LAW).

[6] *Id*. at 50.

[7] *See* Ljiljana Biukovic, *The First Challenge to Canada's Supply Management System under CUSMA: Tweaking the Supply Management System One Dispute at a Time*, 59 CANAD. YRBK. OF INT.LAW 341, 344 (2021).

grounds that Canada's TRQ quota allocation mechanism remains inconsistent with its USMCA obligations.[8]

The U.S. International Trade Commission (USITC) has estimated implementation of USMCA would increase U.S. dairy exports to Canada by $227 million, driven largely by higher exports of cheese and other milk and cream products.[9] Despite these forecasted gains from USMCA, some economists have suggested that any actual gains may be smaller and that the ongoing dispute between the United States and Canada over the latter's dairy TRQs is nothing more than "…A Tempest in a Teapot…."[10]

Yet to dismiss the significance of the U.S.-Canada dairy TRQ dispute is to completely ignore its serious ramifications for agicultural trade policy and dispute resolution. First, the dispute presents a good study of how Canada implemented "tariffication" in the dairy industry. Tarrification is one of the basic requirements of the Agreement on Agriculture (AoA) of the World Trade Organization (WTO).[11] Tariffication requires a nation to convert all of its border measures - such as quotas (or numerical restrictions), variable import levies, and minimum import prices - into tariffs, i.e., a duty or tax imposed on imports at the border.[12] The USMCA, like its predecessor entities, is a free trade agreement (FTA) recognized and sanctioned by the WTO as it further liberalizes trade beyond basic WTO requirements, but its members are still subject to all WTO obligations, including tarrification under the AoA.[13] As further discussed below, tariffication has the advantage of creating transparency and predictability lacking in traditional non-tariff import barriers and should lead to further trade liberalization.[14] Canada chose to transform its border measures affecting agriculture, which were quotas in the main into TRQs. A TRQ is considered to be a tariff under the WTO so the transformation of Canada's dairy quotas to TRQs satisfied its WTO tarrification

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[8] *See U.S. Establishes Second USMCA Dispute Panel on Canada Dairy TRQ Policies*, U.S. DEPT. OF AG. FOR. AG. SERV., News Release (January 31, 2023).
https://www.fas.usda.gov/newsroom/us-establishes-second-usmca-dispute-panel-canada-dairy-trq-policies

[9] *See* USITC, *U.S.-Mexico-Canada Trade Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors*, Publication Number: 4889, 1, 22-23 (April 2019).

[10] *See* Madeline Turland, Rick Barichello, & Colin A. Carter, *Canadian-U.S. Dairy Trade Dispute: A Tempest in a Teapot*, 26 ARE UPDATE, 5, 5 (January/February 2023).
https://s.giannini.ucop.edu/uploads/pub/2023/02/15/v26n3_2.pdf.

[11] *See* WTO Agreement on Agriculture (1995).

[12] AoA, Art. 4.2.

[13] *Id.*

[14] *See* Part II.A *infra*.

obligations.[15] However, as further discussed in this article, Canada's TRQs did not lead to liberalization of the dairy industry due to several reasons.[16] One reason is how effectively Canada was able to use TRQs to protect its dairy management system.[17] While economists have shown that TRQs are typically inefficient trade policy instruments, Canada has been able to effectively use TRQs, a topic further discussed in Part II below. This discussion indicates how TRQs can be used to maintain an important domestic industry and as a policy of agricultural trade policy.

Second, another reason why Canadian dairy TRQs have not led to freer trade is due to the political acumen and skill demonstrated by the Canadian dairy industry in resisting the pressures of trade liberalization and increased import competition from the United States and other countries.[18] Although subject to liberalization pressures since the end of the Second World War, the Canadian dairy industry has been able to successfully resist all attempts to make significant inroads into its industrial position and importance to Canada's economy.[19] Small and insular, the Canada dairy industry nevertheless displayed a rare combination of industrial strategy and political savvy.[20] The Canadian dairy industry has portrayed itself as important for the preservation of Canada's cultural heritage – an argument that has repeatedly hit a national nerve in Canada.[21] A study of the Canadian dairy industry's efforts is an examination of how a small, insular industry can successfully resist trade liberalization pressures in the modern global economy.

Third, although the financial stakes seem to be minimal, the United States has pursued this case with a vigor that seems out of proportion to the potential gains in trade. Moreover, the Canadian dairy TRQ case is one of a number of new cases brought by the United States under the dispute resolution mechanism of the USMCA.[22] This development is significant in light of the crisis in the WTO created by the paralysis of the Appellate Body of the WTO dispute settlement mechanism. This crisis has been precipitated by the actions of Presidents Obama, Trump, and Biden from both US political parties.[23] Due to the actions of the United States, the WTO

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[15] *Id*.
[16] *See* Part III *infra*.
[17] *Id*.
[18] *Id*.
[19] *Id*.
[20] *Id*.
[21] *Id*.
[22] *See* Part IV.E *infra*.
[23] *See* Daniel C.K. Chow, *A New and Controversial Dispute Resolution Mechanism under the US-China Trade Agreement of 2020*, 26 HARV.

dispute settlement mechanism has been crippled and is no longer able to decide disputes leading to a final, binding conclusion.[24] All attempts at resuscitating the WTO dispute settlement system have been heretofore unsuccessful because the WTO dispute settlement system cannot be revived without the cooperation of the United States, which does not appear to be forthcoming.[25] The U.S. approach to the U.S.-Canada TRQ dispute and other USMCA cases portends that the future of U.S. trade disputes may lie in the dispute resolution mechanism of the USMCA and other FTAs, not the WTO. The United States could be signaling its intention to permanently substitute the use of dispute resolution mechanisms in FTAs for the use of the WTO dispute settlement system. This substitution is made possible by the provisions in all recent U.S.-led FTAs that disputes under either the WTO agreements or the FTA can be decided by the FTA's dispute resolution mechanism.[26]

The article proceeds as follows. Part II outlines the economics of TRQs, focusing on the institutional background on why they have become a commonly utilized trade policy instrument applied to agricultural products, and laying out their basic economic logic. Importantly, this part concludes by noting that TRQ administration, which has proven a key issue in the current dispute between the United States and Canada, is likely a key reason for many TRQs not filling. Next Part III outlines how the Canadian dairy production management system functions, with import controls through a TRQ system being a crucial part of that system, and how this has influenced previous trade disputes with the United States. The conclusion drawn here is that the Canadian dairy industry has been very effective in utilizing its lobbying power to maintain political support for what appears a highly insulated agricultural sector. Finally, Part IV sets forth how the USMCA dispute resolution mechanism is used and the panel's findings on Canada's dairy TRQ administration. Part IV also discusses how the United States appears ready to substitute dispute resolution under the USMCA and other regional trade agreements for WTO dispute settlement.

II. ECONOMICS OF TARIFF RATE QUOTAS

A. *Institutional Background*

NEG. L. REV. 31, 49-50 (2020) (hereinafter Chow, *A New and Controversial Dispute Resolution Mechanism*).

[24] *Id*. at 50-61.

[25] *See U.S. Rejects EU-Led Interim Appeal Arbitration Arrangement*, TWN NETWORK ON WTO AND TRADE ISSUES (June 9, 2020), https://www.twn.my/title2/wto.info/2020/ti200608.htm/

[26] *See* Part IV.F *infra*.

In the aftermath of the Second World War, the United States led international efforts to establish global economic institutions to prevent a repeat of the disastrous economic policies that contributed to the eruption of a catastrophic world war.[27] One of these institutions was the General Agreement on Tariffs (GATT), established in 1947, which was intended to help nations eliminate or reduce trade barriers and to promote free trade.[28] Trade protectionism had reached a peak in the years preceding the Second World War and immediately after the war, nations, led by the United States, made it a priority to eliminate or reduce protectionist trade barriers through the GATT.[29] A basic goal of the GATT was to discipline and reduce tariffs.[30] A basic rule of the GATT is the "no quotas" rule of GATT Article XI, which, in general, prohibited all quotas or quantitative restrictions at the border.[31] The GATT sought to have nations use tariffs, not quotas, as basic instruments of trade policy.[32] The other basic approach of the GATT was to reduce tariffs through a succession of negotiation rounds, which proved to be extremely successful.[33]

Although the GATT was intended to apply to all trade in goods, agricultural trade was singled out at the very beginnings of GATT for special treatment.[34] The collapse of food prices during the Great Recession of the 1930s and the calamitous effects of the Second World War meant that nations had to focus on resuscitating domestic food production so agriculture received special consideration.[35] GATT rules were ignored in agricultural trade, often without justification.[36]

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[27] *See* CHOW, SCHOENBAUM, & DORRIS, INTERNATIONAL TRADE LAW, *supra* note 5, at 9-10.

[28] *Id*. at 10. After the war, the United States held a conference in Bretton Woods, New Hampshire to create the post war world economic framework. The Bretton Woods Conference envisioned a tripartite structure. In addition to an international trade organization and the GATT, there were the International Monetary Fund to deal with currency exchange issues and the World Bank to lend money for the reconstruction of Europe and to developing countries. *Id*.

[29] *Id*.

[30] *Id*.

[31] *See* General Agreement on Tariffs and Trade Art. XI (1995). (General Elimination of Quantitative Restrictions).

[32] *See* CHOW, SCHOENBAUM, & DORRIS, INTERNATIONAL TRADE LAW, *supra* note 5, at 131-32.

[33] *Id*. at 131-32.

[34] *Id*. at 280.

[35] *Id*.

[36] *Id*.

In 1955 the United States sought and got a GATT waiver under Article XXV for import quotas on products covered under section 22 of its Agricultural Adjustment Act.[37] Under the Act, fees or restrictions were imposed on imported products if the President, based on advice from the Secretary of Agriculture, and an investigation by United States International Trade Commission (USITC), established import levels of those products would negatively affect their domestic production and processing.[38] Prior to 1995, and pursuant to the provisions of section 22, the United States applied import quotas on dairy products, cotton, peanuts, and certain sugar-containing products.[39] As well as its section 22 measures, the United States also applied an absolute quota on imports of raw and refined sugar, based on a provision in the U.S. GATT Schedule of Concessions.[40] However, in 1989 a GATT dispute settlement panel, established at the request of Australia, ruled the U.S. sugar import quota was inconsistent with GATT Article XI:1, and could not be justified as a term, condition or qualification of a tariff concession under Article II.[41] In complying with this ruling, the United States converted the sugar import quota into a TRQ in 1990.[42] Even though Canada had criticized the scope of the GATT waiver granted to the United States,[43] starting in the early-1970s it was also applying import quotas in the supply-managed sectors for dairy, poultry and egg products, and it also required permits for imports of wheat, oats and barley, and banned imports of margarine.[44] The objective of the border policies was to ensure that imports did not disrupt Canadian supply control and pricing objectives.[45]

In September 1986, the United States, Canada and the other member countries of GATT 1947 launched the Uruguay Round of multilateral trade negotiations.[46] The Uruguay Round would eventually lead to the establishment of the WTO and a host of new trade agreements in addition to the GATT, including the Agreement

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[37] *See* Allan Willis & Michael G. Woods, *The NAFTA Panel Decision on Supply Management: Gamble or Bargain*? 35 CANAD. YYRBK. OF INT.LAW 81, 85 (1997). *See* also JOHN H. JACKSON, THE WORLD TRADING SYSTEM 57-58 (1997).

[38] *See* Dale E. McNiel, *The NAFTA Panel Decision on Canadian Tariff-Rate Quotas: Imagine a Tariffying Bargain*. 22 YALE J. INT'L L. 345, 349-50, 351 (1997).

[39] *Id*. at 349-350.

[40] *Id*. at 350.

[41] *Id*. at 350.

[42] *Id*. at 350.

[43] *Id*. at 350.

[44] *Id.* at 349. *See* also Willis & Woods *supra* note 37, at 86.

[45] *Id*. at 349.

[46] *Id*. at 349-350.

on Agriculture.[47] The goal of the AoA was to eliminate special treatment for agriculture, to fully integrate agriculture into the trade in goods, and to eventually subject agriculture to the same rules that applied to all other goods.[48] Agriculture would lose its special status and be subject to the same GATT rules of trade liberalization applicable to all trade in goods.[49]

With respect to agriculture, the Punta del Este Declaration of September 20, 1986[50] sought to bring "…all measures affecting import access…under strengthened and more operationally effective GATT rules and disciplines"[51] by "…improving market access through, *inter alia*, the reduction of import barriers."[52] Import quotas, belong to a class of trade policy instruments economists denote as non-tariff trade barriers (NTBs), which also include policy instruments such as voluntary export restraints (VERs), and standards.[53] Finding a solution to the problem of NTBs in agricultural trade was seen as crucial from the very beginning of the negotiations, the United States putting forward its tariffication proposal forward in July 1989, having formally introduced the idea of tariffication on November 9, 1988.[54]

In its tariffication proposal of July 1989, the United States argued that market access for agricultural products could be improved through, first, converting agricultural NTBs into bound tariffs, and second, establishing a schedule for the phased reduction of and eventual elimination of tariffs.[55] Subsequently, in October 1989 the United States submitted a more comprehensive proposal for reform of agricultural trade, four key areas being identified:[56] (i) import access; (ii) export competition, notably the use of export subsidies; (iii) domestic farm support; and (iv) sanitary and phytosanitary measures. Tariffication was put forward as the main tool for dealing with the issue of market access, but it was also part

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[47] *Id.*

[48] *See* CHOW, SCHOENBAUM, & DORRIS, INTERNATIONAL TRADE LAW, *supra* note 5, at 280.

[49] *Id*.

[50] *See* the Ministerial Declaration on the Uruguay Round of 20 September 1986, GATT B.I.S.D. (33rd Supp.) at 19 (1987) [hereinafter Punta del Este Declaration].

[51] *Id*. at 24.

[52] *Id*. at 40.

[53] *See* Giancarlo Moschini, *Economic Issues in Tariffication: An Overview*, 5 AG. ECON. 101, 103-102 (1991).

[54] *Id*. at 102-103.

[55] *Id*. at 103.

[56] These key areas became the modalities for negotiation and were eventually incorporated into the AOA. For details *see* WTO, *The Uruguay Round Reform Program for Trade in Agriculture*. https://www.wto.org/english/tratop_e/agric_e/ag_intro00_contents_e.htm

of a comprehensive package designed to generate fundamental policy reforms in the other policy areas.[57]

The reason why tariffication was a linchpin of the AoA's effort to fully integrate agriculture into the GATT system of trade liberalization was that many nations had engaged in various complex schemes and artifices at the border to limit agricultural imports.[58] In addition to outright quotas, nations used various other schemes to limit agricultural imports. One common device was the variable import levy - a type of tariff that varied in each case in accordance with some internal non-transparent mechanism.[59] For example, in the *Chile -- Price Band* case, Chile applied a system of import duties based upon a comparison of the import price of an agricultural product with world prices in accordance with a weekly price band mechanism in which the duty imposed would vary with each week; moreover, the price band was an internal mechanism and resulted in tariffs that could not be predicted in advance by traders in agricultural products.[60] These types of duties made trade in agricultural products subject to unpredictable variables so that traders could not accurately calculate final prices and costs in their transactions. These artifices had an adverse impact on trade, which was their intended purpose. In addition to variable import levies, nations devised other types of ingenious and non-transparent artifices to impede agriculture trade such as minimum import prices and non-transparent import licensing requirements.[61]

The basic approach of tariffication was to require the conversion of all of these types of trade barriers into tariffs. All nations use tariffs, which are transparent because they are subject to strict control under the GATT.[62] The conversion of all agricultural trade barriers into tariffs would create both transparency, discipline, and predictability in imports of agricultural products.[63] In addition to the first step of conversion, the second step was systemic negotiation of tariff reductions across the board in all products in successive rounds of negotiations.[64] This two step process - conversion into tariffs and tariff reduction negotiations - would be a

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[57] *See* Moschini, *supra* note 53, at 103.
[58] *See* CHOW, SCHOENBAUM, & DORRIS, INTERNATIONAL TRADE LAW, *supra* note 5, at 279-280.
[59] *See Chile – Price Bank System and Safeguard Measures Relating to Certain Agricultural Products*, Report of the Appellate Body adopted on October 23, 2002, WT/DS207/AB/R, at ¶ 285.
[60] *Id*. at ¶¶ 234, 253, 254, 259. & 262.
[61] AoA, Art. 4.2 n.1.
[62] *See* CHOW, SCHOENBAUM, & DORRIS, INTERNATIONAL TRADE LAW, *supra* note 5, at 281.
[63] *Id*.
[64] *Id*.

critical step in fully integrating trade in agriculture with the general trade in goods under the GATT.

The subsequent path to acceptance of tariffication by Canada is interesting in that it highlights the importance they placed on application of import quotas in support of its various supply management programs. Between the time when tariffication was proposed by the United States in 1989, and tabling in 1991 of the Draft Final Agreement (DFA) as the basis for conclusion of the Uruguay Round, Canada continued to argue for retaining and clarifying the use of import quotas combined with supply management under GATT Article XI:2(c)(i).[65] Parallel to this, at the February 1992 NAFTA Ministerial meeting, the United States and Mexico agreed to tariffication, but Canada refused to abandon the use of import quotas. Subsequently, Canada negotiated a bilateral exception with Mexico allowing it to invoke Article XI:2(c)(i) to restrict dairy, poultry and egg imports, but the United States refused to accept a similar exception for these products.[66] Eventually the two countries sidelined their disagreement over import quotas by incorporating into NAFTA, provisions on their use that were included in the Canada-United States Free Trade Agreement (CUSFTA) signed in 1987, NAFTA being signed in December of 1992.[67] With respect to the Uruguay Round, Canada eventually accepted tariffication in December 1993, submitting its market access schedule on February 24, 1994 which included tariffication of its import quotas.[68] On January 1, 1995, both Canada and the United States implemented revised tariff schedules, which included TRQs on imports originating from the other country. One month later, under the NAFTA dispute resolution mechanism, the United States requested consultations with Canada over its application of over-quota tariffs on dairy, poultry, eggs, barley and margarine imports from the United States.[69] A more detailed discussion of this dispute is reserved for Section III C(2) of this article.

The USMCA and its predecessor entities, NAFTA and the CUSFTA, were formed as FTAs under Article XXIV of the GATT, which both recognizes and sanctions their existence.[70] The GATT/WTO recognizes that FTAs are consistent with the multilateral trading system because FTAs further liberalize trade

[65] *See* McNiel *supra* note 38, at 355-356.
[66] *Id*. at 358.
[67] *Id*. at 359.
[68] *Id*. at 360.
[69] *Id.* at 360.
[70] GATT, Article XXIV.

beyond the minimal requirements of the WTO.[71] For example, while today trade in goods is subject to GATT tariffs, which are historically low, most trade in goods under the USMCA is duty free. FTAs are built on top of the substratum of WTO obligations - as all of its members are also WTO members and subject to WTO obligations - but are considered to be "WTO plus" by going beyond the minimal legal obligations of the WTO. Entering into an FTA does not alter the obligations of each member to comply with its WTO obligations, including tarrification.

B. *Justification for Tariff Rate Quotas*

As a negotiating concept, tariffication has a clear justification in international economics, plus it fits well with the institutional setting of the GATT. First, in achieving a specific protectionist objective, import quotas generate avoidable economic inefficiencies as compared to tariffs.[72] Trade economists have shown that, under a variety of conditions including imperfect competition, price uncertainty, and inefficient quota allocation, contrary to the standard undergraduate textbook comparison of import quotas and tariffs, they are not equivalent to each other in terms of their effects.[73] In terms of the principles underlying GATT, there is a preference for trade policies being achieved through bound tariffs, the extent of protection being both transparent and easier to reduce than NTBs,[74] i.e., multilateral trade negotiations can focus on the phased reduction of bound tariffs by agreed on formulae.

Given that a pillar of the AoA was improved agricultural market access through tariffication, the new tariffs generated by this process were to be bound at levels of protection equivalent to observed barriers to trade over the period 1986-1988, and the bindings were to be reduced over the implementation period agreed on in the AoA, i.e., 1995-2000 for developed countries, and 1995-2004 for developing countries.[75] In addition, countries agreed to allow imports up to a minimum of three rising to five percent of 1986-1988 consumption, or current imports, whichever was the greater. [76]

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[71] *See* CHOW, SCHOENBAUM, & DORRIS, INTERNATIONAL TRADE LAW, *supra* note 5, at 46.
[72] *See* James E. Anderson, *The Relative Inefficiency of Quotas*, 19 J. OF ECON. EDUC. 65, 65-66 (1988).
[73] See Moschini, *supra* note 53, at 106-112.
[74] *Id*. at 104.
[75] *See* Philip C. Abbott, *Tariff-Rate Quotas: Failed Market Access Instruments?* 29 EUR. REV. AG. ECON. 109, 109 (2002).
[76] *See id*. at 109.

World market conditions in the base period 1986-1988 were such that negotiators became concerned that tariff bindings would result in very high tariffs, preventing minimum access requirements being met.[77] As a compromise, and in order to provide a base level of market access, TRQs were established, the idea being countries would permit imports up to their minimum access requirements at low tariffs, with further imports facing higher most favored nation (MFN) tariffs.[78] Essentially TRQs were an effort to satisfy two different views of market access: on the one hand, to trade economists tariffs and NTBs both restrict market access, but turning NTBs into tariffs would allow trade liberalization via the phased reduction of those tariffs; on the other hand, the transparency and predictability of tariffs would benefit commercial interests.[79]

Looking back, trade negotiators who participated in the Uruguay Round saw TRQs as a successful compromise that allowed the eventual completion of AoA. Even if they could lead to high over-quota tariffs, TRQs were expected to allow some imports to enter markets at lower in-quota tariffs, thereby increasing market access which was a key goal of the Uruguay Round negotiations.[80]

Once sanctioned, TRQs were primarily introduced in the 1990s by developed countries that were founding members of the GATT's successor the WTO, but countries joining the WTO after the AoA, have also negotiated TRQs.[81] By 2016, 40 WTO members had 1,125 TRQs in their bound tariff schedules, the number declining from 1,371 in 2000, many having been being consolidated through enlargement of the European Union (EU).[82] The number of TRQs varies across countries, with Norway having the most at 232, through 124 for the EU27, 54 for the United States, 22 for Canada, down to two for Australia.[83] TRQs also cover a wide range of products, but they are dominated by those relating to dairy, sugar and animal products, average in-quota tariffs being 34.5 percent, average over-quota tariffs being 2.3 times higher.[84] In addition, a key characteristic of TRQs is that in the majority of cases, minimum access requirements are not being met, imports being less than the

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[77] *See id*. at 109-110.
[78] *See id*. at 110.
[79] *See id*. at 110-11.
[80] *See* Abbott, *supra* note 75, at 127.
[81] *See* Jayson Beckman, Fred Gale, & Tani Lee, *Agricultural Market Access Under Tariff-Rate Quotas*, U.S. DEPT. OF AG. 1, 5 (January 2021). https://www.ers.usda.gov/webdocs/publications/100158/err-279.pdf?v=6705.
[82] *Id*. at 7.
[83] *Id*. at 8.
[84] *Id*. at 7.

defined quota, i.e., to use the WTO jargon there is "underfill",[85] for the period 2014-2016, average TRQ fill rates were 56 percent.[86]

C. *Economic Logic of Tariff Rate Quotas*

Prior to their introduction in the AoA, TRQs were not a commonly used instrument of trade policy, much of the rigorous economic analysis of them occurring after the fact, although adoption of the Generalized System of Preferences (GSP), did amount to a TRQ system for some countries.[87] TRQs consist of three policy instruments: an in-quota tariff, a quota, and an over-quota tariff, and unless the latter is prohibitive, TRQs are not an absolute restriction on imports.[88] Importantly, for a specific agricultural product covered by a TRQ, the market-clearing domestic and world prices are determined by which of the three policy instruments are effective – or binding to use the economics jargon.[89] The three possible cases are described as follows.

Case 1: Binding In-Quota Tariff

The case where the in-quota tariff t^i is the binding policy instrument is described in Figure 1.[90] The importing country's demand function is D_1, and without a TRQ in place, the exporting country(ies) supply curve is given by the perfectly elastic[91] supply function S_w, i.e., the importing country does not affect the world price of the product, P_w.[92] As discussed later in the paper, this is a reasonable assumption in the case of Canadian imports of dairy products.

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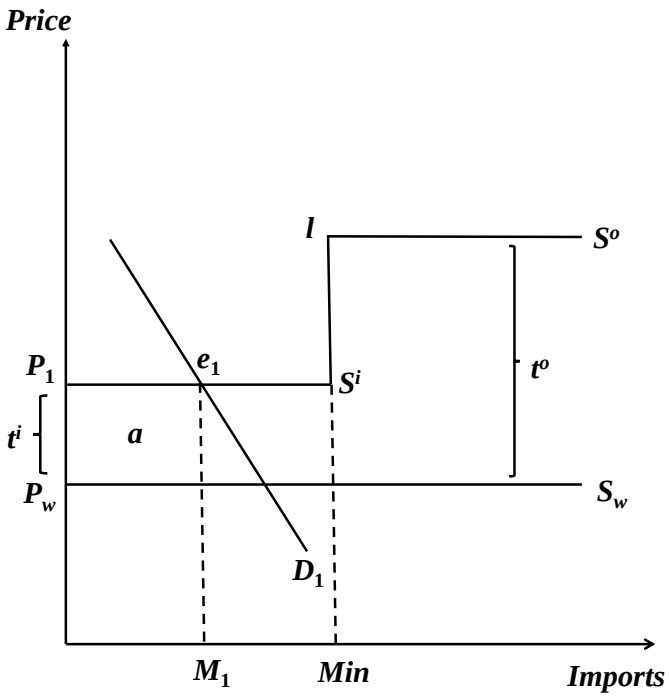
[85] *See* Abbott, *supra* note 875, at 111.
[86] *See* Beckman, Gale & Lee, *supra* note 81, at 7.
[87] *See* MICHAEL ROM, THE ROLE OF TARIFF QUOTAS IN COMMERCIAL POLICY, 155 (1979).
[88] *See* Devry S. Boughner, Harry de Gorter & Ian M. Sheldon, *The Economics of Two-Tier Tariff-Rate Import Quotas in Agriculture*, 29 AG. & RES. ECON. REV. 58, 58 (2000).
[89] *Id*. at 59-60.
[90] See Philip C. Abbott & Philip Paarlberg. *Tariff Rate Quotas: Structural and Stability Impacts in Growing Markets*, 19 AG. ECON. 257, 258-260 (1998).
[91] Price elasticity refers to the responsiveness of supply of a product to a change in the price of that product. *See* RICHARD G. LIPSEY, AN INTRODUCTION TO POSITIVE ECONOMICS, 107 (1972).
[92] See JAMES R. MARKUSEN, JAMES R. MELVIN, WILLIAM H. KAEMPFER, & KEITH E. MASKUS, INTERNATIONAL TRADE: THEORY AND EVIDENCE, 246-249 (1995). To use conventional economics language, a country facing a flat export supply curve is denoted as "small".

Figure 1: Binding In-Quota Tariff



With a TRQ, the export supply function consists of three segments: (i) up to the quota level of *Min*, the supply curve is P_1 to S^i incorporating the in-quota tariff t^i; (ii) at the quota *Min* the supply curve is the vertical segment S^i to l, the height being determined by the difference between the in-quota and over-quota tariffs ($t^o - t^i$); and (iii) beyond *Min*, the supply curve is l to S^o incorporating the over-quota tariff t^o.[93]

When D_1 intersects the TRQ export supply curve at e_1, the effective policy instrument is the in-quota tariff t^i, imports being less than the quota *Min* at M_1, the domestic and world prices being P_1 and P_w respectively, the importing government raising tariff revenue of area *a*. Essentially, with underfill of the import quota (*Min*-M_1), the TRQ operates in the same way as an orthodox import tariff.[94]

[93] *See* Abbott, *supra* note 75, at 113-115.
[94] *Id*. at 113.

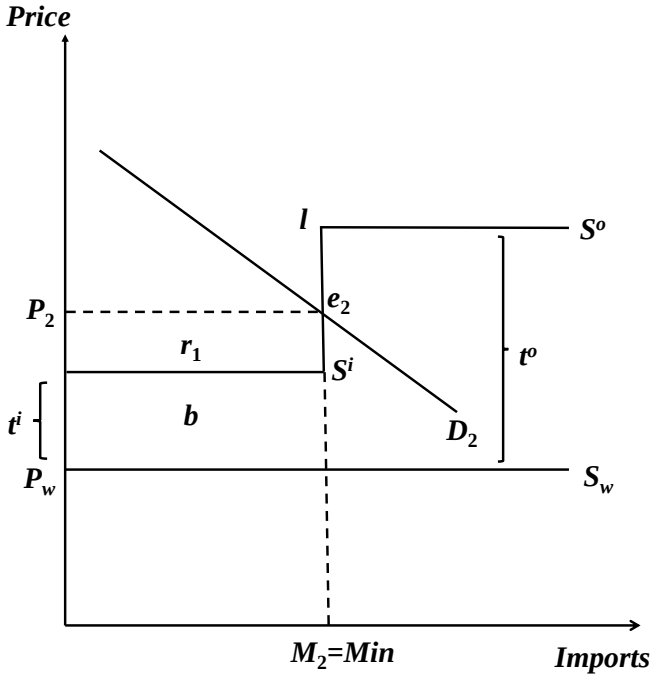
Case 2: Binding Quota

In Figure 2, when D_2 intersects the TRQ export supply curve at e_2, the effective policy instrument is the quota *Min*, with M_2 being imported, and the domestic and world prices being P_2 and P_w respectively.[95] Under an orthodox import quota, the difference between P_2 and P_w measures the per unit quota rent, i.e., owners of import licenses purchase the product at the world price P_w and sell it at the domestic price P_2. However, under a TRQ, owners of import licenses must pay a per unit in-quota tariff of t^i, the importing government raising tariff revenue of area *b*, leaving net quota rents of area r_1.

It should be noted here that, for quota *Min* to be the effective policy instrument, there needs to be an administrative mechanism in place that will limit the level of imports at the in-quota tariff. If such a mechanism is utilized, and there are no transaction costs, the equilibrium will be as described.[96] In contrast, if there are transactions costs, the domestic price consists of the world price, plus the in-quota tariff, and the transaction costs, which will shift down the import demand curve by the amount of the transaction costs, potentially resulting in underfill of the quota.[97] However, if no mechanism is in place to administer the quota, it is possible there will be overfill, the effective instrument operating as an applied tariff equivalent to the in-quota tariff. These two special cases emphasize the importance of TRQ administration mechanisms in determining market equilibrium.[98]

[95] *Id*. at 113-114.
[96] *Id*. at 117.
[97] *Id*. at 117.
[98] *Id*. at 117.

Figure 2: Binding Quota

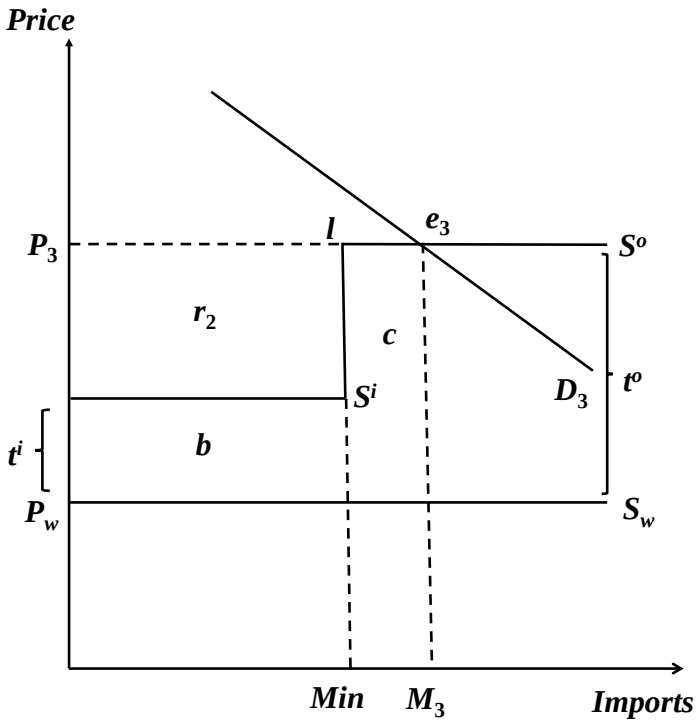


Case 3: Binding Over-Quota Tariff

In Figure 3 when D_3, intersects the TRQ export supply curve at e_3, the effective policy instrument is the over-quota tariff t^o, imports exceeding the quota *Min* at M_3, the domestic and world prices being P_3 and P_w respectively. In this case, the government raises in-quota tariff revenue of area *b* on imports up to the quota *Min* being filled, and over-quota tariff revenue of the area *c* on imports of *Min* to M_3, the net quota rents increasing to the area r_2.[99]

[99] *Id*. at 115.

Figure 3: Binding Over-Quota Tariff



C. *TRQs and Trade Liberalization*

Which policy instrument is effective is not only important in determining equilibrium prices and imports, but also matters in any trade liberalization negotiations. If Case 1 holds, trade liberalization can only occur through reduction of the in-quota tariff t^i, i.e., the domestic price would fall below P_1 and imports would increase beyond M_1, the quota fill rate rising. If Case 2 holds, lowering the in-quota tariff would simply increase the level of available quota rents, in which case the import quota should be increased, the domestic price falling below P_2 and imports increasing beyond M_2. Finally, if Case 3 holds, trade liberalization occurs when the over-quota tariff t^o is reduced, the domestic price would fall below P_3,

imports would increase beyond M_3, with the potential of reducing quota rents. [100]

Necessarily, trade negotiators for the importing country have an incentive to liberalize the policy instrument that is not effective, e.g., offer reductions in the over-quota tariff, especially when there is significant "water" in that tariff, i.e., where t^o is essentially redundant.[101] Not surprisingly, economists have argued that the only way to increase agricultural trade beyond the market access commitments made in the AoA is to steadily reduce MFN tariffs over time, over-quota tariffs being reduced to the point where imports will actually occur at these prices.[102] Empirical analysis of a 35 percent cut in tariffs and a 50 percent expansion in import quotas would support the latter argument. Specifically, reduction in over-quota tariffs would have the largest impact, increasing the value of total TRQ trade by 51.5 percent, most of the increase coming under regime (iii) where over-quota tariffs are effective, with very little coming from regime (ii) where import quotas are effective. By comparison, a 50 percent expansion of quotas would result in a 14.5 percent increase in the value of total TRQ trade.[103]

D. *Tariff-Rate Quotas – Administration*

Under WTO rules, there are several permitted methods for administering TRQs. For example, in 2019: (i) applied tariffs were used for 22 percent of TRQs - unlimited quantities of a product being imported at the in-quota tariff; (ii) first-come-first-served at the border were used for 6 percent of TRQs – imports permitted entry at the in-quota tariff until the quota fills, after which the over-quota tariff is applied; (iii) licenses on demand were used for 7 percent of TRQs – licenses issued to importers based on quantities demanded; (iv) auctioning was used for 4 percent of TRQs – import licenses issued on the basis of an auctioning or competitive bidding system; (v) historical importers were used for 1 percent of TRQs – import licenses issued based on past imports of the product; (vi) state trading entities were used for less than 1 percent of TRQs – import shares allocated to a state trader; (vii) producer groups or associations were used for less than 1 percent of TRQs – import

[100] *See* Boughner, de Gorter & Sheldon *supra* note 88, at 52-24.
[101] *Id.* at 59.
[102] *See* Abbott, *supra* note 75, at 128.
[103] *See* Harry de Gorter & Erika Kliauga. *Reducing Tariffs Versus Expanding Tariff Rate Quotas*, in KYM ANDERSON AND WILL MARTIN (Eds.), AGRICULTURAL TRADE REFORM & THE DOHA DEVELOPMENT AGENDA, 117, 123-128 (2006).

shares allocated to producer groups or associations; and (vii) mixed allocation methods were used for 2 percent of TRQs.[104]

There are potential problems associated with all methods of TRQ administration.[105] Applied tariffs, which operate where there is underfill of the quota, do not involve any means of limiting either imports or allocating quota rents, but as the quota approaches fill, the method may prove an inadequate method of administering the TRQ. The first-come-first-served method can enforce the quota effectively, but there are problems associated with rent allocation. Specifically, license holders may anticipate when the quota will fill, importing early and then storing the product to extract quota rents once the quota fills.[106] Other methods such licenses, state trading and producer group administration are not transparent. The mechanisms for allocating import licenses are not explicit, and are either discriminatory or impose costs on exporters, and failure to reallocate unused licenses may contribute to TRQ underfill. Overall, the complexity of the options for administering TRQs has been identified as one of the reasons for their underfill.[107]

Finally, auctions are considered the most economically efficient method of TRQ administration but have seldom been used.[108] Returning to Figures 2 and 3, under a properly functioning auction of import licenses, the quota rents are captured by the administering government, the marginal bid in an auction being equivalent to the difference between world and domestic prices. For example, under Case 2 the revenue raised in an auction, areas *b* and r_1, would be equivalent to a tariff generating the domestic price of P_2 with imports of M_2. However, if this is the case, why not substitute a simple applied tariff for the TRQ?[109]

It should also be noted that, without an auction there is potential for what has been termed directly unproductive (DUP)

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[104] *See* WTO. *Tariff Quota Administration Methods and Fill Rates 2014-2019*, BACKGROUND PAPER BY SECRETARIAT, G/AG/W/183/Rev.1 (2020). https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=287629,266406,247224&CurrentCatalogueIdIndex=1&FullTextHash=&HasEnglishRecord=True&HasFrenchRecord=True&HasSpanishRecord=True.

[105] *See* Abbott, *supra* note 75, at 122-124.

[106] *See* Abbott & Paarlberg, *supra* note 90, at 262.

[107] *See* de Gorter & Kliauga, *supra* note 103, at 152-155.

[108] *See* David Skully. *Economics of Tariff-Rate Quota Administration*, U.S. DEPT. OF AG. 1, 8 (April 2001). https://www.ers.usda.gov/webdocs/publications/47379/31998_tb1893_002.pdf?v=0.

[109] *See* Abbott, *supra* note 75, at 124.

"rent-seeking" (DUP) activities by holders of import licenses.[110] Essentially, if there are quota rents associated with holding an import license, there is an incentive for license holders to lobby for the quota to be maintained over time, but the act of lobbying, while generating a pecuniary gain, is considered an unproductive activity.[111] Therefore, if lobbying requires real resources such as the services of lawyers, the argument is that some portion of the available quota rents will be "wasted" through DUPs, i.e., there are losses from rent-seeking to be added to the loss consumers incur from domestic prices exceeding world prices.[112]

III. CANADA'S DAIRY SUPPLY MANAGEMENT SYSTEM

A. *Dairy Supply Management System*

Dairy supply management in Canada has evolved over more than a 70-year period,[113] originating at the provincial level and subsequently being instituted at the national level in 1972.[114] The system of supply management began with dairy farmers organizing themselves to stabilize a domestic market subject to production cycles. Initial organization consisted of farmers forming marketing boards that were subsequently given province-wide authority to establish pricing and supply restrictions in the 1930s by provincial governments.[115] For example, *inter alia*, Quebec established the Quebec Dairy Commission in 1933, and Ontario created the Milk Control Board in 1934.[116]

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[110] *See* Jagdish N. Bhagwati, *Directly Unproductive, Profit-Seeking (DUP) Activities*. 90, J. POLIT. ECON., 988, 989-990 (1982). *See* also, Anne O. Krueger, *The Political Economy of the Rent-Seeking Society*, 64, AM. ECON. REV, 291, 291-295. (1976).

[111] *Id*. at 989-990.

[112] *Id*. at 990. At the economy-wide level, with widespread lobbying, it has been shown an economy can approach what has been termed a "black hole", i.e., as resources are wasted on rent-seeking, there is a depressive effect on aggregate output – *see* STEPHEN MAGEE, WILLIAM A. BROCK, & LESLIE YOUNG, BLACK HOLE TARIFFS AND ENDOGENOUS POLICY THEORY: POLITICAL ECONOMY ON GENERAL EQUILIBRIUM, 215, (1989).

[113] *See* Willis & Woods *supra* note 37, at 84.

[114] *See* Biukovic, *supra* note 7, at 358.

[115] *See* Willis & Woods *supra* note 37, at 84.

[116] See Conner Peta, *Canada's Supply Management System and the Dairy Industry in the Era of Trade Liberalization: A Cultural Commodity?* 49 AMER. REV. OF CANAD. STUDS. 547, 551 (2019).

Due to the provincial territorial authority of marketing boards, it was difficult to regulate local supply and prices due to surplus production in other provinces and also imports by Canada.[117] As a consequence, the federal government eventually stepped in to coordinate the supply management system, with the establishment of the Canadian Dairy Commission (CDC) in 1966.[118] The CDC had a mandate of "…coordinating federal and provincial dairy policies and creating a control mechanism for milk production which would help stabilize revenues and avoid costly surpluses…"[119] Subsequently, a federal dairy supply management system was authorized in 1972, focusing on coordination of milk production and implementation of import controls.[120] Following the provisions of the AoA coming into force in 1995, Canada introduced the National Milk Marketing Plan, which created the Canadian Milk and Supply Management Committee (CMSMC) to oversee a new "pooling" system.[121]

The current Canadian supply management system has three key pillars: first, domestic milk supply is restricted; second, there is administered milk pricing; and third, dairy product imports are controlled.[122] The objective of the system is to generate a return to Canadian dairy farmers that is in line with their costs of production. Practically, the system works as follows.[123] The CMSMC sets an annual milk production quota based on expected sales and the wholesale price of milk, the quota being measured in kilograms of butterfat. Based on historic market share, the quota is then allocated to the provinces, their respective marketing boards purchasing milk from farmers and then selling its components to downstream processors, the weighted average of the components determining the price dairy farmers receive. Essentially, the supply management system is operated in three regions of Canada, covering 10 provinces: region 1 – western Canada operating the Western Milk Pool and accounting for 24 percent of production (British Columbia, Alberta, Saskatchewan, and Manitoba); region 2 – Ontario accounting for 33 percent of production; and eastern Canada accounting for 43 percent of production (Quebec, Newfoundland and Labrador, New Brunswick, Novia Scotia, and Prince Edward Island), with Quebec accounting for 37 percent of production, the

[117] *See* Willis & Woods *supra* note 37, at 84.
[118] *See* Peta *supra* note 116, at 552.
[119] *Id*. at at 552.
[120] *See* Willis & Woods *supra* note 37, at 84.
[121] *See* Biukovic, *supra* note 7, at 360.
[122] *Id*. at 358.
[123] *See* Scott Biden, Alan P. Kerr, & Stephen Duff, *Impacts of Trade Liberalization in Canada's Supply Managed Dairy Industry*. 51 AG. ECON. 535, 536 (2020).

four maritime provinces who only account for six percent of production, tend to follow Quebec in their marketing.[124] This system of administered pricing necessarily raises milk prices at the expense of Canadian consumers, with the average retail price of milk in Canada being U.S.$ 4.96/gallon in 2021 compared to U.S.$ 3.74/gallon in 2021.[125]

B. *Dairy Tariff Rate Quotas*

To maintain domestic milk prices, the supply management system applies a set of 14 different dairy product TRQs, which were first introduced in 1995 as part of Canada's AoA commitments.[126,127] The import quota levels are defined through Canada's WTO commitments, as well as market access commitments it has made under recently negotiated free trade agreements (FTAs), the Canada-European Union Comprehensive Economic and Trade Agreement (CETA) signed in 2016,[128] the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) signed in 2018,[129] and USMCA.[130,131]

Prior to the FTAs being signed, Canada applied MFN bound in-quota tariffs ranging from 7.5 percent on fluid milk, through 6.5 percent for butter, ice cream, skim milk powder, and yogurt respectively, to 1 percent for cheddar, mozzarella, and specialty cheeses.[132] A limited number of countries also had preferential

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[124] *See* Biukovic, *supra* note 7, at 356.
[125] *See* Turland, Barichello, & Carter *supra* note 10, at 5.
[126] *Id*. at 5.
[127] *See* USMCA *supra* note 2, Chapter 2 National Treatment and Market Access for Goods, Appendix 2: Tariff Schedule of Canada, Section B: TRQs; the product categories are: milk, cream, skim milk powder, butter and cream powder, industrial cheeses, cheeses of all types, milk powders, concentrated or condensed milk, yogurt and buttermilk, powdered buttermilk, whey powder, products consisting of natural milk constituents, ice cream and ice cream mixes, and other dairy products. https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/02%20National%20Treatment%20and%20Market%20Access.pdf
[128] *See Canada-European Comprehensive Economic and Trade Agreement*, October 30, 2016 [hereinafter CETA]. https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/ceta-aecg/text-texte/08.aspx?lang=eng.
[129] *See Comprehensive and Progressive Agreement for Trans-Pacific Partnership*, March 8, 2018 [hereinafter CPTPP]. https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/text-texte/toc-tdm.aspx?lang=eng.
[130] *See* USMCA, *supra* note 2.
[131] *See* Biden, Kerr, & Duff *supra* note 123, at 536.
[132] *Id*. at 543.

tariff-free access on a limited number of products, e.g., New Zealand, Australia, and the United States.[133] Over-quota tariffs have been and continue to be applied, ranging from 298.5 percent for butter, through 277 percent for ice cream, 270 percent for skim milk powder, 245.5 for cheddar, pizza and specialty cheeses respectively, 241 percent for fluid milk, and 237.5 percent for yogurt.[134]

In terms of trade liberalization, the new FTAs have zeroed out in-quota tariffs for the member countries, while increased market access was offered via changes in specific import quotas. Under CETA, the major concession on dairy imports was increased market access for European cheese, along with reallocation of part of the cheese TRQ to the EU under Canada's WTO obligations.[135] For CPTPP, dairy sector access for member countries will amount to 3.25 percent of the Canadian market, with Australia and New Zealand being reallocated most of the TRQs originally set aside for the United States under the Trans-Pacific Partnership (TPP), Canada being obligated to concede this market access even after the United States chose not to ratify the TPP.[136] Finally, in the case of USMCA, a partial opening of the dairy market was negotiated, Canada conceding 3.59 percent of its market to the United States.[137] In total, market access negotiated under the WTO, CETA, CPTPP, and USMCA account for almost 8 percent of the Canadian market,[138] with the United States, the EU, and New Zealand accounting for most imports, notably cheese, butter, and milk protein isolates.[139] For example, in 2021, cheese, butter, and milk and cream accounted for 19.6, 16.4, and 12.1 percent respectively of the value of U.S. dairy product exports to Canada.[140]

Focusing on USMCA, and returning to Figure 1, the TRQ situation applied to the Canadian dairy sector is such that with zeroing out of in-quota tariffs, S_w is the export supply curve for a specific dairy product, which will be flat (perfectly elastic), due to Canada accounting for a very small share of global imports of dairy products.[141] Therefore, the world (border) price for a specific dairy product will be P_w, and the domestic price will be a function of the level of import demand in combination with administered pricing under the supply management system. Unless product imports exceed the specific quota *Min*, no tariff revenue will be raised by the

[133] *Id*. at 544.
[134] *Id*. at 543.
[135] *Id*. at 536.
[136] *See* Turland, Barichello, & Carter *supra* note 10, at 7.
[137] See Biden, Kerr, & Duff *supra* note 123, 537.
[138] *See* Turland, Barichello, & Carter *supra* note 10, at 8.
[139] *See* Biden, Kerr, & Duff *supra* note 123, 536.
[140] *See* Turland, Barichello, & Carter *supra* note 10, at 5.
[141] *See* Biden, Kerr, & Duff *supra* note 123, at 545.

Canadian government, quota rents being the difference between the world price P_w and the administered domestic price.

Surprisingly, recent empirical analysis indicates implementation of USMCA will result in dairy producer prices rising by 11.8 percent.[142] This is likely the result of lower import prices due to increased market access (movement along the demand curve D_1 in Figure 1 following reduction of the in-quota tariff) being less than higher domestic prices driven by an expected increase in Canadian consumer demand (a rightward shift in the import demand curve).

C. *Previous Trade Disputes and the Dairy Supply Management System*

1. Pre-NAFTA

The current dispute between the United States and Canada is just the latest in a series of trade policy interactions concerning the dairy supply management system. When the national system was first introduced in 1972, it was dependent on it being compliant with the-then GATT rules. Although the United States challenged Canada's egg supply management system in 1975, there was no conclusion by the GATT Working Party in its report as to whether egg import quotas were inconsistent with Article XI:2(c)(i).[143] With conclusion of CUSFTA in 1987, the two countries agreed to phase out import tariffs on products originating in the other's territory, but under Article 710 of CUSFTA,"GATT rights and obligations (including Article XI) are retained for all agricultural trade not specifically dealt with in the Agreement".[144] Essentially, this provision permitted continued use of import quotas consistent with GATT Article XI:2(c)(i), the GATT Protocol of Provisional Application, or the section 22 waiver granted to the United States.[145]

Then in 1989, a GATT panel concluded Canada's restrictions on imports of ice cream yogurt were inconsistent with Article XI:1, and could not be justified under Article XI:2(c)(i).[146]

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[142] *Id*. at 547.

[143] *See Canada – Import Quotas on Eggs (Complaint by the United States)* (1976), GTT L/4279 (Working Party Report). https://www.wto.org/english/tratop_e/dispu_e/gatt_e/75eggquo.pdf.

[144] *See* Chapter 7: Agriculture, Article 710: International Obligations in *Canada-United States Free Trade Agreement*, Can TS 1989 No. 3, 1, 76-78 (1988) [hereinafter CUSFTA]. https://www.international.gc.ca/trade-commerce/assets/pdfs/agreements-accords/cusfta-e.pdf.

[145] *See* McNiel *supra* note 38, at 352-353.

[146] *See Canada-Import Restrictions on Ice Cream and Yoghurt (Complaint by the United States)* (1989), GTT Doc L/6588.

Critically, the panel report questioned the ability of Canada or any other GATT member to restrict imports of dairy products as a means of managing the supply of raw milk.[147] Canada accepted the panel's report, but then proceeded to keep its ice cream and yogurt import quotas in anticipation of the outcome of the Uruguay Round negotiations.[148] Subsequently in 1990, Canada proposed in the Uruguay Round Negotiating Group on Agriculture, reaffirmation of the right to use import quotas to aid in dairy supply management, as well as proposing increasing the range of dairy products that could be subject to import quotas.[149]

2. Post-NAFTA

Probably the most substantive challenge to Canada's dairy supply management system up to that point occurred on July 14, 1995, when the United States sought establishment of a panel under Chapter 20 procedures for resolution of disputes between parties of NAFTA.[150] As noted earlier, the challenge also occurred at the same as the new rules on tariffication were introduced under the AoA. Chapter 7 of NAFTA covers agricultural trade, with separate bilateral agreements being reached between Canada and Mexico, the United States and Mexico, and the United States and Canada. Through Annex 702, the United States and Canada agreed to incorporate into NAFTA the agricultural provisions of Chapter 7 of CUSFTA.[151]

Incorporation of GATT rights under CUSFTA Article 710 and NAFTA Annex 702.1 allowed Canada to maintain its import quotas, drawing on GATT Article XI:2(c)(i), while the United States was allowed to keep its import quotas under the 1955 GATT Section 22 waiver.[152] The dispute arose because Canada imposed tariffs on imports of dairy and other supply managed products, the United States arguing Canada had violated NAFTA Article 302, paragraphs (1) and (2), which prohibited new or increased tariffs.[153] In response Canada argued Article 710 of CUSFTA, incorporated in NAFTA

https://www.wto.org/english/tratop_e/dispu_e/gatt_e/88icecrm.pdf.

[147] *See* McNiel *supra* note 38, at 353.

[148] *See* Biukovic, *supra* note 7, at 359.

[149] *See* McNiel *supra* note 38, at 353-354.

[150] *See* NAFTA *supra* note 3, Chapter 20.

[151] *See* Willis & Woods *supra* note 37, at 87.

[152] *Id.* at 87.

[153] *See* McNiel *supra* note 38 for detailed analysis of this dispute. *See* also Willis & Woods *supra* note 14.

Annex 702.1, authorized the use of tariff equivalents on agricultural imports as per the AoA.[154]

The United States position was as follows: Canadian tariffication of its import quotas involved implementation of new or increased import tariffs, and while Canada was entitled to apply such tariffs to imports from third countries under the AoA, they were incompatible with NAFTA, the latter taking precedence by virtue of Article XXIV of GATT 1994.[155] By contrast, the Canadian position was that the AoA was "an agreement under the GATT", within the meaning of CUSFTA Article 710, the rights and obligations of Canada and the United States under the latter agreement being retained under NAFTA.[156]

Ultimately, the panel accepted Canada's interpretation of the relationship between AoA obligations that came into force in 1995, and NAFTA obligations which came into force in 1994. In making its case, Canada drew on Article 30(3) of the Vienna Convention on the Law of Treaties (VCLT)[157] which posits a conflict between treaties should be resolved by applying the "later-in-time" rule, i.e., the AoA would prevail over NAFTA.[158] Given the panel ruling, Canada was able to retain its system of TRQs, including those applied to imports of dairy products.[159] From a legal perspective, the reliance of the panel on the VCLT suggests that while trade agreements such as CUSFTA, NAFTA and GATT 1994 are in some respects *sui generis*, they were seen as legitimate international treaties, hence, trade law is a part of the body of international law.[160,161]

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[154] *See In the Matter of Tariffs Applied by Canada to Certain U.S.-Origin Agricultural Products*, NAFTA Secretariat File No. CDA-95-2008-01 (December 2, 1996). https://publications.gc.ca/collections/Collection/E100-2-1-95-2008-01E.pdf.

[155] *See* Willis & Woods *supra* note 37, at 88.

[156] *Id*. at 90.

[157] *See Vienna Convention on the Law of Treaties*, 23 May 1969, 1155 UNTS 331, Can TS 1980 No. 37 (entered into force 27 January 1980) [hereinafter VCLT]. https://treaties.un.org/pages/ViewDetailsIII.aspx?src=TREATY&mtdsg_no=XXIII-1&chapter=23&Temp=mtdsg3&clang=_en.

[158] *See* Willis & Woods *supra* note 37, at 98-99, for a discussion of the interpretive framework.

[159] *See* Biukovic, *supra* note 7, at 360.

[160] *See* Willis & Woods *supra* note 37, at 110.

[161] *See* McNiel *supra* note 38, at 377-379 for a detailed criticism of the panel findings in this case.

Not surprisingly, the panel's ruling was welcomed by Canada, but not so much in the United States, one legal observer being particularly critical and noting that the decision:

> "…sided with the interests of protectionism rather than the interests of trade liberalization, casting an ominous shadow over the future of NAFTA…"[162]

The same legal observer also laid out their reasoning as to why the panel ruled incorrectly in favor of Canada.[163] Their argument was that Article 302 of NAFTA prohibited Canada from applying over-quota tariffs on imports from the United States, and that Canada's TRQs could not be justified under CUSFTA Article 710 as a right under GATT, there being no such right under GATT. Their reasoning was based on a view that if the panel had focused on GATT Articles II (Schedules of Concessions) and XXVIII (Tariff Negotiations), and had also noted Canada's pre-AoA tariff bindings, they would have realized Canada had no such right under GATT to implement its over-quota tariffs. Specifically, Canada's actions would have been found inconsistent with Article II:1(b) in terms of their previous tariff bindings, as well as their obligation under Article XXIV to eliminate tariffs within a free trade area, the conclusion being that the panel's decision "...allows Canada to remain a party to the NAFTA without having to pay its price of admission – elimination of all tariffs…."[164] Other legal observers note that this argument was never actually presented by the United States, and therefore it would be unreasonable to criticize the panel for not having considered it. In addition, if the panel had accepted the argument, it would have brought into question the legal basis for tariffication in the AoA.[165]

As previously noted, once the AoA came into force, Canada chose to change its dairy supply management scheme by introducing the CMSMC, a non-governmental organization (NGO), to oversee the milk pooling system.[166] The revision introduced a two-tiered pricing system where domestic milk and dairy product prices

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[162] *Id*. at 379.
[163] *Id*. at 377-379.
[164] *Id*. at 378-379.
[165] *See* Willis & Woods *supra* note 37, at 109. Their argument is that under Article 4.2 of AOA, tariffication was either based on GATT Article XXVIII or Article XXVII was overridden by Article 21 of the AOA.
[166] *See* JACQUELINE D. KRIKORIAN, INTERNATIONAL TRADE LAW AND DOMESTIC POLICY: CANADA, THE UNITED STATES, AND THE WTO, 179-184 (2012), who argues Article 9.1 (c) of the AOA was targeted at the Canadian dairy supply management system.

exceeded dairy product export prices.[167] These changes were challenged at the WTO in 1998 by the United States.[168,169] After New Zealand brought a similar complaint in 1998,[170] both complaints were consolidated into one by the WTO's Dispute Settlement Body (DSB).[171]

The key claim of the United States and New Zealand was that Canada's dairy supply management system meant Canada was exceeding export subsidy limits agreed to in the AoA, and that Canada was in breach of AoA Article 9.1(c), the panel finding in favor of both claimants. [172] Even though Canada appealed, the WTO Appellate Body upheld most of the panel's findings, Canada being found to have violated Articles 3.3 and 8 of the AoA relating to export subsidies listed in Article 9.1(c). At this point, Canada deregulated the pricing of dairy product exports, while maintaining its domestic supply management system.[173] Neither the United States nor New Zealand were satisfied with this outcome, but after two rounds of compliance hearings in 2001, and a DSB ruling against Canada in 2003, all three countries informed the DSB that they had reached an agreement regarding the dispute.[174] Ultimately, Canada's domestic dairy supply management system survived, changes in the regulation of exports accounting for less than two percent of the value of its dairy production.[175]

D. *Why Has the Dairy Supply Management System Survived?*

Since introduction of Canada's dairy supply management system in the early-1970s, it has survived multiple attempts by other countries, notably the United States, to undermine that system through the targeting of its border policies in successive trade disputes. Even though increased access to Canada's dairy sector has been surrendered in the sequence of recently negotiated FTAs, i.e., CETA, CPTPP, and USMCA, its TRQ system remains in place, and

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[167] *See* Biukovic, *supra* note 7, at 361.
[168] *Id*. at 361.
[169] *See Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products (Complaint by the United States)* (1999). WTO Doc WT/DS103 (Appellate Body Report). https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds103_e.htm.
[170] *See Canada – Measures Affecting Dairy Exports (Complaint by New Zealand)* (1999). WTO Doc WT/DS113/AB/RW (Appellate Body Report). https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds113_e.htm.
[171] *See* Biukovic, *supra* note 7, at 361.
[172] *Id.* at 361.
[173] *Id*. at 362.
[174] *Id*. at 361.
[175] *See* KRIKORIAN *supra* note 166, at 183.

as will be argued in part IV of the paper, Canada has really not given up that much following the ruling of the USMCA dispute resolution panel on their dairy product TRQs.[176] This might seem surprising for an industry that accounts for only 0.9 percent of Canadian gross domestic product (GDP).[177] In addition economists and public policy analysts have consistently been recommending dismantling the system due to the costs it imposes and international trade reasons.[178]

So why is defending the system a priority of Canadian trade policy, and why is there so little opposition to maintaining a system that protects dairy farmers? Fundamentally, the Canadian dairy lobby has proven itself to be powerful and very effective in presenting an argument to Canadian politicians and voters that has proven very effective.[179] It is argued Canadian dairy farmers have presented milk as a Canadian cultural commodity that is part of the country's heritage, emphasizing the industry's history and the role of farmers in the founding of Canada.[180] Part of this argument involves Canadian dairy farmers portraying the pressure by other countries such as the United States, EU, and New Zealand to liberalize the dairy products sector as "…an infringement of Canadian sovereignty…"[181] Through their marketing and lobbying campaigns, the Canadian dairy industry has managed to convince both Liberal and Conservative federal governments that maintaining the dairy supply management system is critical.[182]

A feature of Canadian trade liberalization post-NAFTA has been the surrendering of modest amounts of market access for dairy product imports, yet the dairy supply management system remains in place. To make sense of this, it is possible to draw on the political economic analysis of FTAs that takes explicit account of lobbying behavior.[183] Without going into a lengthy discussion of the technical details, the analysis focuses on explaining why specific industries may be excluded from liberalization in the negotiation of an FTA.

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[176] *See* Final Report *supra* note 1.
[177] *See* Biukovic, *supra* note 67, at 364.
[178] *See* Martha Hall Findlay, *Supply Management Problems, Politics – and Possibilities*, 5 SPP. RES. PAPS., 1, 2 University of Calgary, School of Public Policy (2012). *See* also Richard Barichello, John Cranfield, & Karl Meilke, *Options for Reform of Supply Management in Canada with Trade Liberalization* 35 CAN. PUB. POL., 203, 204-205 (2009).
[179] *See* Peta *supra* note 116, at 552.
[180] *Id*. at 547-548.
[181] *Id*. at 548.
[182] *Id*. at 559.
[183] *See* Gene M. Grossman, & Elhanan Helpman, *The Politics of Free Trade Agreements*, 85 AM. ECON. REV., 667-690 (1995).

To simplify, suppose a range of products are produced in Canada with labor and a sector-specific factor of production.[184] In the dairy industry the latter consists of a combination of land, cows, and physical capital, earning a rate of return that depends on the domestic price of milk, which consists of the world price plus a mark-up which captures the impact of the dairy supply management system on the domestic price of milk, i.e., the policy instruments in place in Canada post-AoA and which were then folded into NAFTA.[185] Due to the small number of dairy farmers relative to the Canadian population at large, they are sufficiently well-organized to have overcome the "collective action" problem,[186] i.e., there is no free riding by individual farmers on the lobbying organization, all being fully committed to contributing to the lobbying effort. In other words, Canadian dairy farmers have formed an effective special interest group to maximize their joint economic welfare.[187]

The Canadian government sets trade policy, and it can either negotiate an FTA with another country, or it can terminate those negotiations. Politicians in the incumbent government receive lobbying contributions from interest groups such as dairy farmers to influence the FTA negotiations, politicians valuing the contributions, but also caring about the well-being of the average Canadian voter. The objective of the government is to maximize the sum of lobbying contributions plus the aggregate economic welfare of Canadian voters, where politicians are more-or-less sensitive to the average voter's well-being. Aggregate economic welfare consists of wages from labor, plus the sum of the returns to sector-specific factors of production, plus the sum of consumer surplus, the latter being defined as the utility individuals get from consuming a product, minus their expenditure on that product.[188]

Given the small number of dairy farmers, they only capture a small proportion of the consumer surplus available in the Canadian economy, their key objective being to maximize their profits net of political contributions. Profits of the dairy industry will vary depending on the outcome of the FTA negotiations: (i) when no FTA is agreed; (ii) when the dairy sector is partially excluded from

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[184] *Id.* at 669.

[185] The degree of protection afforded the Canadian dairy sector under the AoA not modeled here, but it could be analyzed using typical political-economic models in the international economics literature. For example, *see* Gene M. Grossman, & Elhanan Helpman, *Protection for Sale*, 84 AM. ECON. REV, 833-850 (1994). *See* also Caroline Freund, & Çağlar Özden, *Trade Policy and Loss Aversion*, 98 AM ECON. REV., 1675-1691 (2008).

[186] *See* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION 5-52 (1965).

[187] *See* Grossman, & Helpman *supra* note 183, at 669.

[188] *Id.* at 670

an FTA; and, (iii) when the dairy sector is included in an FTA.[189] Partial exclusion is defined to be what has been observed in the FTAs recently negotiated by Canada – some concessions on market access, but AOA-consistent TRQs and the dairy supply management system remain in place.

The key idea is that a government, in considering an FTA, has some ability to make the deal acceptable to competing interests through either partial or complete exclusion of some sectors from the agreement, but the countries negotiating an FTA will clash on the issue of exceptions.[190] i.e., they want to protect politically powerful industries, while seeking to gain market access for their exporters. An equilibrium agreement is one that reflects the political pressures on the negotiating governments and the nature of the FTA bargaining process.

A successful FTA negotiation occurs because both governments prefer it on political grounds as compared to maintaining the *status quo*, sector exclusions improving the possibility this is the case, because they can be "sold" to import-competing industries in exchange for their political support.[191] Assuming a bargaining solution,[192] a specific sector such as dairy production will be granted partial exclusion in FTA negotiations because, the weighted sum of the political benefits of increased dairy product market access to the exporting country, and the political cost of more intense competition from dairy product imports by Canada, is very negative. Both political benefits and costs are measured by a weighted sum of the change in sector profits and the change in average welfare from going from the *status quo* to bilateral free trade. The weights on benefits in one country and the costs in the other reflecting the negotiating abilities of the respective governments, and the political welfare accruing to both governments if the FTA is rejected.[193]

Necessarily this is a stylized model, but it does capture the salient characteristics of the Canadian dairy industry and how, through its lobbying activities, it has been able to defend and maintain the supply management system in the face of pressure from other countries to liberalize the sector through successive FTA

[189] *Id*. at 681.
[190] *Id*. at 680-681.
[191] *Id*. at 684.
[192] Specifically, Nash bargaining, where two players are trying to maximize their joint economic surplus, conditional on some disagreement outcome. See John Nash, *Two-Person Cooperative Games*, 21 ECONOMET., 128, 128-129 (1950).
[193] *See* Grossman, & Helpman *supra* note 183, at 687.

negotiations.[194] This forms an important part of the background to understanding the dispute between Canada and the United States over administration of the former's dairy products TRQ system under USMCA.

IV. THE U.S. CHALLENGE TO CANADA'S DAIRY SUPPLY MANAGEMENT

A. *Dispute Settlement under USMCA*

State-to-state dispute settlement under the provisions of USMCA Chapter 31,[195] is a modification of the procedure that operated under the provisions of NAFTA Chapter 20.[196] Without detailing all provisions of USMCA Chapter 31, the key features of the dispute settlement mechanism are as follows:

> (I) Article 31.3: *Choice of Forum*, if a dispute under the Agreement (USMCA) is also covered by the WTO, the complaining Party can select where to settle the dispute, but once selected, that forum will be used to the exclusion of the other forum, i.e., if a panel is established under USMCA, that rules out the complaining Party requesting establishment of a WTO panel.[197]
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> (II) Article 31.4: *Consultations*, a Party can request consultations with another Party, and unless the Parties decide otherwise, consultations will begin 15 days after the request is made in the case of perishable products, the Parties being expected to make every effort to resolve the matter through such consultations.[198]

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[194] *See* Peta, *supra* note 116, at 559.

[195] *See* USMCA, *supra* note 2, at Chapter 31. https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/Text/31%20Dispute%20Settlement.pdf.

[196] *See* Biukovic, *supra* note 7, at 354. Modification allows for both greater transparency of panel hearings and a speedier process. For example, disputing Parties are no longer able to block the process by not nominating panelists.

[197] *See* USMCA, *supra* note 2, at Chapter 31,1-2. See Jennifer Hillman, A Serious Enforcement Mechanism Will Require Major Changes to USMCA's Dispute Settlement Provisions, INT. ECON. LAW. BLOG. https://ielp.worldtradelaw.net/2019/09/usmca-a-serious-enforcement-mechanism-will-require-serious-changes-to-usmcas-dispute-settlement-prov.html.

[198] *Id*. at Chapter 31, 2-3, where perishable goods refer to perishable agricultural and fish goods. For non-perishable products, the time-limit after request for consultations is 75 days.

(III) Article 31.6: *Establishment of a Panel*, if the consulting Parties fail to resolve the matter within 30 days under Article 31.4 in a matter relating to perishable products, a consulting Party can request establishment of a panel by written notice to the other Party. On delivery of the request, the panel is established.[199]

(IV) Article 31.9: *Panel Composition*, with two or more disputing Parties, the panel will consist of five members, unless the Parties agree to one made up of three members, the panel Chair being selected within 15 days of the request for panel establishment.[200]

(V) Article 31.13: *Function of Panels*, a panel makes an assessment of the matter before it, and presents a report containing: (a) findings of fact; (b) a determination of whether: (i) the measure at issue is inconsistent with the Agreement, (ii) a Party has failed to meet their obligations under the Agreement, and (iii) the measure is causing nullification or impairment of a Party's benefits it would expect to accrue under the Agreement; (c) recommendations on resolving the dispute; and (d) reasons for the panel's findings and determinations.[201]

(VI) Article 31.17: *Panel Report*, the panel will present an initial report to the disputing parties no later than 120 days after appointment of a final panelist, the disputing Parties having 15 days to respond to the report. After considering any comments, the panel will present a final report to the disputing Parties no later than 30 days after presentation of the initial report, the final report then being made public no later than 15 days after presentation to the disputing Parties.[202] Note that, unlike the WTO dispute settlement mechanism, there is no provision in Chapter 31 of USMCA for appeal by either Party against a panel's final report.

(VII) Article 31.18: *Implementation of Final Report*, within 45 days of receipt of a final report containing findings covered in Article 31.13, the disputing Parties should seek to agree on resolution, which could consist of: (a) elimination of non-conformity with or the nullification of impairment of

[199] *Id*. at Chapter 31, 3-4.
[200] *Id*. at Chapter 31, 6-7.
[201] *Id*. at Chapter 31, 9-10.
[202] *Id*. at Chapter 31, 11-12.

> benefits under the Agreement; or (b) provision of compensation; or (c) another remedy agreed by the disputing Parties.[203]
>
> (VIII) Article 31.19: *Non-Implementation – Suspension of Benefits*, if the disputing Parties are unable to resolve the dispute, the complaining Party may suspend responding Party benefits equivalent to their own loss of benefits under the Agreement. Suspension of benefits by the complaining Party should occur either in the sector subject to the dispute or in some other sector.[204]

The request by the United States for establishment of a panel under Article 31.6 of the Agreement concerning Canada's dairy TRQ allocation, was the first brought under the new dispute resolution procedures.[205] The United States and Canada as Parties, having been through a consultation process under Articles 31.1 and 31.4 of the Agreement, instigated by the United States on December 9, 2020, agreed on May 25, 2021to establishing a three-member panel in accordance with Article 31.9 of the Agreement. The panel then released its unanimous decision on December 20, 2021, two hundred days elapsing between the date the panel was established and release of its final report.[206]

B. *The Nature of the Dispute*

Under USMCA, Canada is permitted to maintain its TRQ system for 14 categories of dairy product imports.[207] Canada administers all TRQs according to three provisions: (a) administration occurs through an import licensing system; (b) the quota period of a TRQ is for a 12-month period; and (c) each year quota is allocated to eligible applicants, the latter being defined as being active in the Canadian food or agricultural sector, including applicants who have not previously imported a product under a TRQ.[208] Under the allocation system, "pools" or reserved amounts of the TRQs are established for Canadian processors, including further processors, such that they have access to 85 to 100 percent of the quota, based on market share and type of dairy product. Other

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[203] *Id*. at Chapter 31, 12.
[204] *Id*. at Chapter 31, 12.
[205] *See* Biukovic, *supra* note 7, at 346.
[206] *Id*. at 354-355.
[207] *See* USMCA, *supra* note 2, at Chapter 2, Appendix 2, Sections A and B.
[208] *Id*. at Chapter 2, Appendix 2, Section A, 2-B-CANADA-2-1.

eligible TRQ applicants, which includes distributors and secondary processors, get access to up to 15 percent of the quota.[209]

In 2020, Canada published notices to importers regarding its 14 TRQs, after which it allocated 80 percent or more of each TRQ to processors on a market share basis, with an additional 10 percent being allocated to further processors on a market share basis, and another 10 percent was allocated to distributors on an equal share basis.[210] In seeking establishment of a panel, the United States considered Canada had violated USMCA by allocating most of each TRQ to Canadian processors, thereby reducing U.S. access to the Canadian dairy product retail market.[211] Specifically, the United States made four points relating to Canada failing to meet its obligations under Chapter 3 of the Agreement:[212] (a) contrary to Article 3.A.2.11(b), Canada was limiting access to TRQs to processors; (b) contrary to Article 3.A.2.11(c), Canada was not making allocations based on applicant requests; (c) contrary to Articles 3.A.2.4(b) and 3.A.2.11(e), Canada was not providing "fair" and "equitable" procedures for TRQ administration; and (d) contrary to Article 3.A.2.6(a) Canada was introducing new conditions for utilization of a TRQ beyond those set out in Canada's Schedule to Annex 2-B.[213]

At the heart of the dispute were the United States' and Canada's conflicting interpretations of Article 3.A.2.11(b). The United States essentially maintained that by giving most of the allocation of TRQs to Canadian processors, it restricted their access to Canadian retail markets, and claiming the Agreement granted it access in all categories of dairy products covered in TRQs.[214] With a large percentage of TRQs being reserved for Canadian processors, who imported lower-valued dairy products from the United States at zero in-quota tariffs, the allocation system restricted U.S. access to the Canadian markets for high-value added and finished dairy products.[215] It is important to note the United States was concerned about the inflexibility of the TRQ allocation system, and not Canada's right to allocate the TRQs *per se*.

Canada's response to the concerns of the United States was that it had not violated Article 3.A.2.11(b), given some portion of the TRQs was being allocated to distributors.[216] In addition, Canada argued its method for administering dairy TRQs was entirely

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[209] *See* Final Report *supra* note 1, at 5.
[210] *See* Biukovic, *supra* note 7, at 347.
[211] *See* Turland, Barichello, & Carter *supra* note 10, at 6.
[212] *See* USMCA, *supra* note 2, at Chapter 3, Annex 3-A, Article 3.A.2.
[213] *See* Final Report *supra* note 1, at 1.
[214] *See* Biukovic, *supra* note 7, at 348.
[215] *Id*. at 348.
[216] *See* Turland, Barichello, & Carter *supra* note 10, at 6.

consistent with the system it has utilized under various other trade agreements, including CETA and CPTPP, and that the panel should view the provisions of the Agreement in terms of the key role that processors and the dairy supply management system play in supporting its dairy farmers.[217]

C. *Findings of USMCA Dispute Settlement Panel*

The panel applied Articles 31 and 32 of the VCLT[218] relating to treaty interpretation to resolve the United States' and Canada's conflicting interpretation of Article 3.A.2.11(b) of the Agreement, both countries agreeing the Convention was the appropriate guide in this case.[219] The panel noted[220] that the principal rule of the VCLT is Article 31(1) which states:

> "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose." [221]

In this context, the focus of the panel was on establishing the ordinary meaning of several parts of Article 3.A.2.11(b), which states:

> "A Party administering an allocated TRQ shall ensure that:
> (b) unless otherwise agreed by the Parties, it does not allocate any portion of the quota to a producer group, condition access to an *allocation* on the purchase of domestic production, or *limit access to an allocation* to processors;"[222] [emphasis added]

In evaluating Canada's official Notices to Importers for their 14 TRQs, where pools were referred to as "allocations", and which were reserved for Canadian processors, the panel concluded that the notices were, "…compelling evidence of the plain and ordinary meaning of the words used in Article 3.A.2.11(b)",[223] and that, "The Processor Clause unquestionably constrains Canada's ability to deny access to non-processors, in furtherance of a more open trade

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[217] *See* Biukovic, *supra* note 7, at 350.
[218] *See* VCLT, *supra* note 157.
[219] *See* Final Report *supra* note 1, at 14.
[220] *Id*. at 14.
[221] *See* VCLT, *supra* note 157.
[222] *See* USMCA, *supra* note 2, at Chapter 3, Annex 3-A, Article 3.A.2.
[223] *See* Final Report *supra* note 1, at 29-30, para.110.

relationship."[224] In other words, the dispute was about Canada restricting its dairy product imports,[225] the panel concluding:

> "…the Panel finds that Canada's practice of reserving TRQ pools exclusively for the use of processors is inconsistent with Canada's commitment to Article 3.A.2.11(b) of the Treaty not to 'limit access to an allocation to processors,'"[226]

and that:

> "…Canada cannot…ring-fence and limit to processors…a reserved "pool" of TRQ amounts to which only processors have access…"[227]

In terms of evaluating the overall importance of the panel's ruling, it should be noted that it acknowledged the importance to Canada of its dairy supply management system,

> "The Panel takes seriously Canada's statements regarding the importance of processors in the Canadian dairy industry. The Panel does not question Canada's interests in regulating supply and demand within its dairy industry, including by striving to ensure predictability in imports." [228]

Essentially, the dispute and the panel's ruling boiled down to administration of Canada's 14 dairy product import TRQs, and not their application of TRQs, Canada's dairy supply management system once again surviving scrutiny.[229] Having said that, the dispute continues.

D. *Responses to Findings of USMCA Dispute Settlement Panel*

As noted in Part I of the paper, Canada outlined changes to its TRQ allocations in response to the panel's ruling. Its proposal, released on March 1, 2022, outlined several changes to its dairy product TRQ allocations, their objective being to not limit allocation to processors by extending allocation to distributors.[230] For

[224] *Id*. at 32, para. 117.
[225] *See* Biukovic, *supra* note 7, at 351.
[226] *See* Final Report *supra* note 1, at 50, para.167.
[227] *Id*. at 49, para.163.
[228] *Id*. at 48, para.160.
[229] *See* Biukovic, *supra* note 7, at 351-352.
[230] *See* Government of Canada, Public Consultations: CUSMA Dairy Tariff Rate Quotas (TRQs) Panel Report Implementation – Proposed Allocation

example, Canada proposed that 85 percent of milk TRQs would be allocated on a market share basis to both processors and distributors importing milk in bulk not for retail sale, with 15 percent being available to processors and distributors on a market share basis for any milk, with no end-use requirement.[231]

Even though U.S. Trade Representative Katherine Tai initially described the ruling of the USMCA panel as a "historic" win for the United States, that would "ensure that American dairy farmers get the full benefit of the USMCA to market and sell their products in Canada",[232] the subsequent reaction to these announced changes was not favorable,[233] USTR requesting further consultations with Canada on May 25, 2022, under Article 31 of USMCA.[234] The United States followed up with a request for establishment of a second panel on January 31, 2023,[235] filing its first written submission on March 20, 2023.[236] There are four elements to this latest objection by the United States to Canada's allocation of its dairy TRQs.

First, the United States is challenging Canada's exclusion of retailers, food service operators, and other entities from eligibility for TRQ allocation. Specifically, the United States argues Canada is failing to allocate its TRQs to "eligible applicants" that are "active in the Canadian food or agriculture sector",[237] as per Paragraph(c)

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and Administration Policy Changes (March 1, 2022) [hereinafter Canada's Proposal for Panel Report Implementation].
https://www.international.gc.ca/trade-commerce/consultations/TRQ-CT/cusma_dairy_changes-produits_laitiers_aceum_changements.aspx?lang=eng.

[231] *Id*.

[232] *See* Katherine Tai, USMCA Priorities for the United States in 2022, in BROOKINGS INSTITUTE, USMCA FORWARD 2022 (February 28, 2022).
https://www.brookings.edu/blog/up-front/2022/02/28/usmca-priorities-for-the-united-states-in-2022/.

[233] *See* Biukovic, *supra* note 7, at 353.

[234] *See* USMCA, *supra* note 2, at Chapter 31.

[235] *See* USTR, U.S. Request for the Establishment of a Panel, 1 (January 31, 2023).
https://ustr.gov/sites/default/files/enforcement/USMCA/Chapter%2031%20Disputes/USMCA%20Canada%20Dairy%202%20Panel%20Request.for.USTR.website.pdf.

[236] See United States Trade Representative's Office, CANADA-DAIRY TRQ ALLOCATION MEASURES 2023 (CDA-USA-2023-31-01), INITIAL WRITTEN SUBMISSION OF THE UNITED STATES OF AMERICA, (March 20, 2023) [hereinafter USTR].
https://ustr.gov/sites/default/files/enforcement/USMCA/Chapter%2031%20Disputes/US.Sub1.docketed.pdf.

[237] *Id*. at 3.

of Section A of Canada's USMCA TRQ Appendix[238]. In addition, by excluding retailers, food service operators, and other entities, Canada has introduced a new eligibility requirement for TRQ allocation, in violation of its commitment under Article 3.A.2.6(a) of the Agreement.[239]

Second, the United States is challenging Canada's allocation of its dairy TRQs on a market share basis, and its application of different criteria for different types of applicants.[240] Essentially, the United States is claiming the TRQ allocation system still heavily favors processors over distributors and other potential applicants, which is in violation of Article 3.A.2.11(b) of the Agreement, and is neither "fair" nor "equitable", which is inconsistent with Article 3.A.2.4(b).[241] In addition, the United States argues that Canada's market share approach to allocating its dairy TRQs discriminates against new dairy product importers, in violation of Article 3.A.2.10 of the Agreement, and introduction of new conditions, limits, or eligibility requirements on the utilization of the dairy TRQs is inconsistent with Article 3.A.2.6(a).[242]

Third, the United States is challenging Canada's imposition of 12-month trading activity requirements on TRQ applicants which is inconsistent with Section A, Paragraph(c), of Canada's USMCA TRQ Appendix, [243] plus Canada has effectively introduced a new eligibility requirement for TRQ allocation, in violation of its commitment under Article 3.A.2.6(a) of the Agreement, and is discriminating against new dairy product importers, which is inconsistent with Article 3.A.2.10.[244]

Fourth, the United States is challenging the mechanism for the return and reallocation of unused dairy TRQ allocations,[245] arguing they are inconsistent with Article 3.A.2.15 of the Agreement.[246] The United States argument is that the mechanism occurs late in the quota year, leaving a very short period in which other importers can use reallocated TRQ volume, which is in breach of Article 3. A. 2.6.[247]

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[238] *See* USMCA *supra* note 2, Chapter 2 National Treatment and Market Access for Goods, Appendix 2: Tariff Schedule of Canada (Tariff Rate Quotas), Section A: General Provisions.
[239] *See* USMCA, *supra* note 2, at Chapter 3, Annex 3-A, Article 3.A.2.6(a).
[240] *See* USTR, *supra* note 236, at 3-5.
[241] *See* USMCA, *supra* note 2, at Chapter 3, Annex 3-A, Articles 3.A.2.4(b) and 3.A.2.11(b).
[242] *Id*. at Chapter 3, Annex 3-A, Articles 3.A.2.6(a) and 3.A.2.10(a).
[243] *See* USTR, *supra* note 236, at 6.
[244] *See* USMCA, *supra* note 2, at Chapter 3, Annex 3-A, Articles 3.A.2.6(a) and 3.A.2.10.
[245] *See* USTR, *supra* note 236, at 6-7.
[246] *See* USMCA, *supra* note 2, at Chapter 3, Annex 3-A, Article 3.A.2.15.
[247] *See id*. at Chapter 3, Annex 3-A, Article 3.A.2.6.

The United States concludes in its initial submission:

> "The stark reality is that, after losing the first USMCA dispute, Canada modified certain measures but failed to bring its dairy TRQ allocation measures into compliance with the USMCA…the United States estimates that Canada's revised dairy TRQ allocation measures have preserved for processors exclusive access to very large portions of the USMCA dairy TRQs, and it is possible that, for some TRQs, the portion allocated to processors may even have increased…"[248]

Even though this second USMCA panel investigation has not yet been completed, as with the first investigation, and based on the initial submission of the United States, the concern remains with Canada's system for allocating its dairy TRQs, and not *per se* with its dairy supply management system and use of TRQs as a trade policy instrument.

E. *Observations on the USMCA Dairy TRQ Dispute*

Neither the United States nor the panel sought to evaluate the overall economic impact of Canada's dairy supply management system, the focus being entirely on the allocation of quotas under the dairy TRQs. Returning to the economics of TRQs as described in Part II of the paper, what "wiggle room" is there for the United States to bring a complaint against Canada? Even before the negotiation of USMCA and other recent FTAs, Canada's bound MFN in-quota tariffs were on already on average very low, and with USMCA, they have been zeroed out, i.e., that part of the dairy TRQs has been fully liberalized.[249] Second, under USMCA, once the negotiated increase in the quota portion of the TRQs is fully implemented in 2026, this will give the United States an additional 3.6 percent of the Canadian dairy market,[250] more than doubling its access from the AOA.[251] Third, Canada's bound MFN over-quota tariffs are clearly very high on average, and even though President Trump made much of this during the USMCA negotiations, the evidence suggests that as a practical matter, the United States does not typically export dairy products beyond the quota,[252] i.e., the

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[248] *See* USTR, *supra* note 236, at 7.
[249] *See* Biden, Kerr, & Duff *supra* note 123, at 543.
[250] *Id*. at 536.
[251] *See* Turland, Barichello, & Carter *supra* note 10, at 6.
[252] *See* Roger Noll, & Robert E. Litan, *A Trumped-Up Charge Against Canadian Dairy Tariffs*, UP FRONT, Brookings Institute (June 13, 2018).

over-quota tariffs are not even binding, and for that to be the case, there would have to be a significant increase in Canadian dairy product import demand.[253]

If the quota is the binding policy instrument for Canadian dairy TRQs, and given their quota allocation/licensing mechanism, it is perhaps not surprising the United States targeted this aspect of the dairy management supply system, with a view to maximizing U.S. access to the Canadian market through distributors of dairy products. However, the economic gains from the panel ruling in favor of the United States are relatively small. For example, in 2022, there was a 17 percent mark-up between a high-value dairy product such as cheese and fluid milk, so the value of being able to export to Canadian distributors of high-value dairy products has been estimated at U.S. $39 million per year.[254]

Notwithstanding the likely modest benefits from winning the dispute, what is puzzling is that, while the United States continues to push back on the allocation of the lion's share of dairy TRQs to Canadian processors, it has not sought to have part of the dairy TRQs allocated to its own processors/distributors, in other words, it appears to be willing to give up potential quota rents. Returning to Figure 2, if import demand is D_2, the quota being filled at *Min*, the wedge between the world price P_w and the internal Canadian price of P_2 is the per unit rent available to those allocated a portion of the quota, total quota rents being the sum of the areas b and r_1. Therefore, if Canadian dairy product distributors were allocated a higher proportion of dairy TRQs, they would grab some portion of the total quota rents. In other words, it does not matter whether dairy processors or distributors are allocated dairy TRQs, what is key is that it is Canadian not U.S. firms that are earning the quota rents, i.e., the United States appears to be leaving "money on the table".[255]

If the economic benefits to the United States of winning the dispute are relatively small, and conversely Canada would not be giving up very much if it were to accept the panel's finding that it is violating its USMCA commitments on dairy TRQ allocation, what is all the fuss about? Again, an appeal can be made to political-economic arguments by revisiting the USMCA negotiations over Canada's dairy supply management system. Although the United States is expected to double its access to the Canadian dairy product market, this will only have a small economic impact – despite the U.S. Trade Representative making strong claims about the benefits

https://www.brookings.edu/blog/up-front/2018/06/13/a-trumped-up-charge-against-canadian-dairy-tariffs/.

[253] *See* Biden, Kerr, & Duff *supra* note 123, at 547.

[254] *See* Turland, Barichello, & Carter *supra* note 10, at 7.

[255] *Id*. at 7.

to the U.S. dairy industry of USMCA.[256] Therefore, the United States is most likely responding to vocal lobbying from its dairy industry. For example, after Canada responded to the panel's findings by announcing revised allocation of its dairy TRQs, both the National Milk Producers Federation (NMPF) and the U.S. Dairy Export Council responded very critically, after which the United States sought further consultations with Canada, and subsequently initiated a second dispute.[257] In other words, the U.S. government has responded to pressure from its own dairy industry, the focus being on shifting the "blame" to Canada for the very modest gains to the sector from USMCA.[258]

From a Canadian perspective, as the discussion in Part III indicated, through successive trade disputes and FTA negotiations it has ceded some market access in its dairy products sector, but its system of dairy TRQs is fundamentally intact. The effectiveness of the Canadian dairy lobby's argument has been well-documented, Canadian farmers successfully linking continued protection of their market to "preserving Canadian traditions and culture".[259] Even though changes were made to the supply management system in the 1990s, it has not been subject to any fundamental change, the Canadian government seeking to preserve rather than fully liberalize the system.[260] In line with the political-economic argument noted in Part III,[261] the basic structure of the dairy supply management system has been almost totally excluded from the FTA negotiations over CETA, CPTPP, and USMCA, with only modest increases in market access to the dairy sector being offered to members of these FTAs.[262] The incremental liberalization of the Canadian dairy market, which has bi-partisan political support, is well-described in a recent article title as, "…Tweaking the Supply Management System One Dispute at a Time…"[263]

F. *Use of the USMCA Dispute Resolution Mechanism as a Substitute for the WTO Dispute Settlement System*

Perhaps the most important aspect of this dispute is the fact that it was the first to be evaluated under Chapter 31 of the USMCA,[264] in other words, going through the process of

[256] *See* Brookings Institute *supra* note 232.
[257] *See* Biukovic, *supra* note 7, at 353-354.
[258] *See* Turland, Barichello, & Carter *supra* note 10, at 8.
[259] *See* Peta *supra* note 116, at 559.
[260] *Id*. at 558.
[261] *See* Grossman, & Helpman *supra* note 183.
[262] *See* Peta *supra* note 116, at 558.
[263] *See* Biukovic, *supra* note 7, at 341.
[264] *See* USMCA, *supra* note 2, at Chapter 31.

consultation, panel investigation and ruling, was critical in establishing the initial credibility of the revised dispute settlement mechanism. Already, the rate at which Chapter 31 of USMCA is being utilized by its three member countries is more extensive than under NAFTA Chapter 20, where only three panel reports were ever circulated.[265] In addition to the dairy TRQ case, in February 2022, a panel concluded the United States had applied a safeguard measure to crystalline silicon photovoltaic cells (CSPV) imported from Canada that was inconsistent with its obligation under Article 10.2.1 of the Agreement to exclude Canada from application of the safeguard measure, the United States violating its obligations under Article 2.4.2.[266] Then in December 2022, a panel ruled in favor of Mexico, the United States' interpretation and application of the automotive rules of origin being found inconsistent with Article 4.5 of the Agreement.[267] As already discussed in section C of this part of the paper, a second dairy TRQ panel was recently sought by the United States.[268] Most recently, a panel was established to investigate a ban by Mexico on imports of genetically modified (GM) corn used in food products,[269] following a request by the United States for a second set of consultations.[270] The ruling of the dispute panel with respect to this issue, will likely be a major test for Chapter 9 of the Agreement covering sanitary and phytosanitary (SPS) measures.[271] The obvious conclusion to be drawn here is that

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[265] *See* NAFTA Chapter 20 Panel Reports, WORLD TRADE LAW. https://www.worldtradelaw.net/databases/nafta20.php.

[266] *See* CRYSTALLINE SILICON PHOTOVOLTAIC CELLS SAFEGUARD MEASURE (USA-CDA-2021-31-01), FINAL REPORT, 42 (February 1, 2022). https://ustr.gov/sites/default/files/enforcement/USMCA/Chapter%2031%20Disputes/Final%20Report%20USMCA%20solar.pdf.

[267] *See* ARBITRAL PANEL ESTABLISHED PURSUANT TO ARTICLE 31 OF THE AGREEMENT AMONG THE UNITED STATES, MEXICO, CANADA WHICH ENTERED INTO FORCE ON JULY 1, 2020, *UNITED STATES – AUTOMOTIVE RULES OF ORIGIN* (USA-mex-cda-2022-31-01), 1 (December 20,2021), at 37-38. https://ustr.gov/sites/default/files/enforcement/FTA/USMCA%2031/USMCAAutomotive%20ROO.pdf.

[268] *See* USTR, *supra* note 236.

[269] See USTR, *U.S. Establishes USMCA Dispute Panel on Mexico's Agricultural Biotechnology Measures* (August 21, 2023). https://ustr.gov/about-us/policy-offices/press-office/press-releases/2023/august/what-they-are-saying-us-establishes-usmca-dispute-panel-mexicos-agricultural-biotechnology-measures.

[270] See Farm Policy News, *U.S. Requests USMCA Dispute Settlement Consultations on Mexico's Ag Biotech Measures*, farmdoc (June 4, 2023). https://farmpolicynews.illinois.edu/2023/06/u-s-requests-usmca-dispute-settlement-consultations-on-mexicos-ag-biotech-measures/.

[271] *See* USMCA, *supra* note 2, at Chapter 9.

USMCA member countries are confident in the revised dispute resolution mechanism, especially in light of the current non-functioning Appellate Board of the WTO.[272]

The confidence of the U.S., Canada, and Mexico in the USMCA dispute resolution mechanism could portend a future trend by the United States of substituting dispute resolution in the USMCA and other free trade agreements for the WTO dispute settlement system. Currently, the WTO is gripped in a crisis because its dispute settlement system is no longer fully functioning due to the actions of the United States.[273] Beginning with the Obama administration and continuing through the Trump and Biden administrations, the United States has refused to approve new members to the Appellate Body to replace retiring members.[274] The United States objected to the Appellate Body because of what the United States saw as its judicial activism.[275] The United States claims that while the Appellate Body was charged with enforcing the texts of the WTO, the Appellate Body instead has often invented rights and obligations that were not found in any WTO agreements.[276] These acts of judicial activism led the Appellate Body to harm U.S. interests by rejecting or limiting U.S. domestic trade remedies and other U.S. rights.[277] The United States claims that without any justification or authority the Appellate Body anointed itself as the supreme court of international trade, usurping the authority of the members of the WTO.[278]

The result of U.S. intransigence in appointing new Appellate Body members was that on December 10, 2019, the number of active members of the Appellate Body fell below that necessary to convene a forum to hear appeals from WTO panels.[279] No decision by a WTO panel or Appellate Body is legally effective unless it is adopted by the full membership of the WTO sitting as the Dispute Settlement Body.[280] The results of the paralysis of the Appellate Body is that there is no guarantee that any decision under the WTO dispute settlement system will reach a final resolution of the dispute and that all WTO obligations have become, in effect,

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[272] *See* Biukovic, *supra* note 7, at 356.
[273] See Chow, *A New and Controversial Dispute Resolution Mechanism*, *supra* note 23, at 34.
[274] *Id*. at 49-50.
[275] *Id*. at 49.
[276] *Id*. at 48.
[277] *Id*.
[278] *See* DANIEL C.K. CHOW & THOMAS J. SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS 53 (5th ed. 2023).
[279] *See* Chow, *A New and Controversial Dispute Resolution Mechanism*, *supra* note 23, at 50.
[280] *Id*.

unenforceable.[281] Only panel decisions that are not appealed can become final after adoption by the DSB.[282] Any panel decision that is appealed becomes a legal nullity.[283] For example, if a WTO member brings a case before a WTO panel and wins, the losing party can appeal the decision to the now decommissioned Appellate Body. Under Article 16 of the WTO Dispute Settlement Understanding, "[i]f a party has notified its decision to appeal, the report by the panel shall not be considered for adoption by the DSB until after completion of the appeal."[284] Since the now defunct Appellate Body cannot complete the appeal, the DSB can not adopt the panel decision and the decision can never become legally effective. Any appeal of a panel decision launches it into a legal limbo where it is suspended indefinitely. In other words, any losing party can effectively nullify a panel decision by appealing it into a legal abyss. All WTO legal obligations have become effectively unenforceable through the WTO because any member found to be in violation by a panel can simply appeal the decision and annul its effect. For example, when the United States lost in the panel that ruled in favor of China that punitive new U.S. tariffs imposed by the Trump administration were illegal, the United States immediately appealed and nullified the panel decision.[285]

While the WTO appears to be mired in a sustained state of paralysis, the USMCA offers a path out of this legal morass for its members. The USMCA dispute resolution mechanism provides that it can be used to resolve either WTO or USMCA disputes.[286] Recall that the USMCA is built on top of a substratum of existing WTO rules. Many rules in the WTO and the USMCA overlap and are identical. For example, the WTO is based on the cornerstone of two fundamental principles: the most favored nation principle (MFN) set forth in GATT Article I and the national treatment principle (NT) set forth in GATT Article III.[287] The USMCA also sets forth both the MFN principle in Article 2.10 and the NT principle in Article

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[281] *Id*.
[282] *Id*.
[283] *Id*. at 50-51.
[284] WTO Dispute Settlement Understanding, Article 16.4 (1995).
[285] *United States – Tariff Measures on Certain Goods from China Notification of an appeal by the United States under Article 16 of the Understanding on Rules and Procedures governing the Settlement of Disputes*, WT/DS543/10 (Oct. 10, 2020).
[286] USMCA, Art. 31.3.
[287] GATT, Arts. I & III. Under the MFN principle, a WTO member must immediately extend any trade prefence or benefit given to another country (whether a WTO member or not) to all other WTO members. Under the NT principle, WTO members cannot discriminate against imported goods from other WTO members in favor of domestic goods.

2.3.[288] The clauses in the WTO and the USMCA are identical in substance. A dispute between USMCA members concerning MFN or NT can be brought either in the WTO or in the USMCA. A dispute brought in the WTO, however, falls into the legal morass created by the paralysis of the Appellate Body while a dispute in the USMCA can be resolved by a fully functional dispute resolution mechanism. This example can be repeatedly in many different areas because many of the WTO and USMCA obligations overlap.

The enthusiasm of the United States in using the USMCA dispute resolution mechanism may portend how the United States intends to deal with the WTO crisis for the foreseeable future. Although a number of reforms have been proposed, including the use of a substitute Appellate Body under the Multiparty Interim Appeal Arbitration Arrangement (MPIA), such reforms are ultimately unsatisfactory sue to the stubborn refusal of the United States to support such proposals.[289] The United States refuses to join the MPIA so the substitute Appellate Body cannot be used to resolve any WTO disputes involving the United States, leaving a gaping hole in the MPIA's coverage. The standing of the United States as a dominant actor in the WTO means that in practice no effort to salvage the WTO dispute settlement system can be successful with the cooperation of the United States, which does not appear to be forthcoming. Rather, the United States may be signaling that it intends to use parallel dispute settlement mechanisms to replace the WTO. The USMCA provides a good example of how the United States has created a substitute dispute settlement mechanism. In addition to USMCA, the United States also has trade agreements with a total of 15 other countries containing a dispute resolution mechanism that can be used to resolve either WTO disputes or disputes under the particular trade agreement.[290] If the United States

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[288] USMCA, Art. 2.3 & 2.10

[289] *See Japan's Joining the MPIA has Outside Chance to Boost Momentum for WTO Reform*, https://www.eastasiaforum.org/2023/05/14/japans-joining-mpia-an-outside-chance-to-boost-momentum-for-wto-reform/#:~:text=The%20United%20States%2C%20of%20course,States%2C%20deciding%20not%20to%20join (discussing US's refusal to join MPIA "claiming that the undesirable practices of the Appellate Body are embedded in the MPIA").

[290] The treaties and the provision that allows for the resolution of disputes arising under the WTO agreements or the trade agreement through the particular treaty dispute resolution mechanism are as follows: United States-Australia FTA (Art. 21.4); United States-Bahrain FTA (Art. 19.4); US-Chile FTA (Art. 22.3); US-Morrocco FTA (Art. 20.4); US-Columbia Trade Promotion Agreement (Art. 21.3); US-Dominican Republic FTA (with members Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua) (Art. 20.3); US-Korea FTA (Art. 22.6); US-Oman FTA (Art. 20.4); US-Panama Trade Promotion Agreement (Art. 20.3);

decides to revive the negotiations for the Transatlantic Trade and Investment Partnership with the European Union and to join the Transpacific Partnership, both agreements abandoned by the Trump administration, then the availability of a parallel dispute resolution mechanism for WTO disputes could extend to the additional 38 countries in Europe and Asia.[291]

The United States' enthusiastic use of the USMCA dispute resolution mechanism in the U.S.-Canada dairy TRQ disputes could indicate that the many ongoing efforts of those who seek to rescue the WTO from its crisis may be in vain. The United States may have already shown its hand that it does not intend to agree to any reforms that would revive the WTO Appellate Body. Rather, the United States intends to abandon the WTO and to substitute its own dispute resolution mechanism in FTAs that can be used to resolve both WTO and particular FTA disputes.

The United States may also be signaling that it intends to leave the WTO in a permanently diminished state without the ability to resolve its own disputes and to enforce its own rules. Left in such a crippled state, the WTO will then inevitably fade in significance and might already be moribund. Both political partes in the United States could be signaling a retrenchment from the multilateral approach that has characterized the United States approach to trade for the past seventy years. Instead, the United States could be entering a new period of asserting the primacy of U.S. interests and could be retreating from globalization in favor of a bilateral approach to trade that was first shown in the Trump administration and is continuing under the Biden administration.

V. CONCLUSION

This study indicates that the Canada's TRQs introduced as part of the process of tariffication under the AoA yields important insights of importance to the U.S.-Canada agricultural trade relationship and to international trade as a whole. Despite arguments by economists that TRQs are inefficient as trade policy instruments some 40 WTO members currently have 1,125 TRQs in their GATT tariff schedules, including those Canada applies to its imports of 14

US-Peru Trade Promotion Agreement (Art. 21.3). All of these agreements can be found on the website of the United States Trade Representative, https://ustr.gov/trade-agreements/free-trade-agreements.

[291] See The Office of the USTR, *The United States Officially withdraws from the Trans-Pacific Partnership*, https://ustr.gov/about-us/policy-offices/press-office/press-releases/2017/january/US-Withdraws-From-TPP; Philip Blenkinsop, *US Trade Talks in Deep Freeze after Trump Win says EU*, Reuters (Nov. 11, 2016), https://www.reuters.com/article/idUSKBN1361UM/.

dairy products. Even though Canada has reduced its bound in-quota tariffs on dairy product imports to zero and progressively expanded access to the dairy TRQs through negotiation of successive FTAs, including USMCA, the system is for all intents and purposes intact, Canadian consumers continuing to pay higher prices than U.S. consumers for milk and other dairy products, quota rents continuing to be up for grabs by those allocated import licenses. As noted frequently in this article, the Canadian dairy industry has been remarkably successful at lobbying the Canadian government to maintain and minimally liberalize this system. In fulfilling its obligation to convert all of its agricultural trade barriers to TRQs, Canada has been able to use TRQs effectively to maintain a dairy supply management system that has been in placed for about 70 years. This approach by Canada suggests that, while TRQs are economically inefficient, they appear to be effective in the actual implementation of agricultural trade policy.

In the first case to be judged under the new dispute resolution process of USMCA, a panel ruled on December 20, 2021, that Canada's dairy TRQ allocation mechanism limited the U.S. dairy industry's access to the Canadian market, thereby violating the provisions contained in Chapter 3 of USMCA. Despite Canada offering to revise the quota allocation mechanism, the United States continues to push for improved access to the high value-added portion of Canada's dairy product market, seeking a second panel earlier this year, on the grounds that Canadian distributors continue to be discriminated against in gaining access to import licenses. However, even if the United States eventually wins the second dispute, the annual economic gains will likely be small unless Canadian import demand is pushed beyond existing quota levels, plus the United States is not seeking allocation of the quota to its own dairy product exporters, thereby foregoing quota rents. On these grounds, it is reasonable to conclude that the U.S. challenge to Canada's dairy TRQs is a fuss about nothing, and no more than a response to lobbying by the U.S. dairy industry.

To draw this simplistic conclusion, however, is to completely miss the United States' signals about its approach to dispute settlement in international trade generally. The United States' enthusiasm for the use of the USMCA dispute resolution mechanism may be an indication that the United States has completely and irrevocably abandoned the WTO dispute settlement system. The proponents of WTO reforms to revive the Appellate Body may be acting in vain in hopes of securing U.S. support for reform without which no solution for the current impasse in the WTO dispute settlement system is possible. The United States may have moved on permanently from the WTO by creating and using parallel dispute resolution mechanisms in U.S.-led FTAs that can be

used to revolve WTO disputes as well as particular FTA disputes. This development could consign the WTO to a permanently crippled state and to eventual irrelevance. Finally, in a rare area of agreement, both political parties in the United States may be signaling a retrenchment and retreat from multilateralism and globalism. The United States may be returning to a U.S.-centered power-based approach in international trade based on the use of bilateral treaties in the place of multilateral trade agreements that has marked U.S. trade policy for the past seven decades.