SUPPLY MANAGEMENT

A win-win opportunity for reform

CANADA WEST FOUNDATION

JUNE 2017

MARTHA HALL FINDLAY
with **ERIC DALKE**

CANADA WEST FOUNDATION

cwf.ca

The Canada West Foundation focuses on the policies that shape the West, and by extension, Canada. Through our evidence-based research and commentary, we provide practical solutions to tough public policy challenges facing the West, and Canada as a whole, at home and on the global stage.

Any errors or omissions are the sole responsibility of the authors. The opinions expressed in this report are those of the authors and are not necessarily those of the Canada West Foundation's Board of Directors, advisers or funders. Permission to use or reproduce this report is granted for personal or classroom use without fee and without formal request, provided that it is properly cited. Copies are available for download from the Canada West Foundation website at *cwf.ca.*

CANADAWEST FOUNDATION *cwf.ca*

ISBN 978-1-927488-46-1

Canada West Foundation is a registered Canadian charitable organization incorporated under federal charter. (#11882 8698 RR 0001)

For too long, supply management in our dairy, poultry and egg sectors[1] has been seen as a "third rail" in Canadian politics, an untouchable sacred cow.

No longer.

The evidence for reform is staggering. Research and analysis conducted by a variety of experts across Canada have overwhelmingly demonstrated the inequity and inefficiency of the current system. Increasingly persuasive commentary is coming from all sides. And despite the propaganda made possible by the wealth and power of the dairy lobby, more and more politicians are seeing the public opinion tide turning.

It is, after all, a non-partisan issue. Progressives who espouse social justice simply cannot defend the unnecessary costs imposed on consumers – especially low-income families with children in need of affordable essential nutrition – in favour of what is now a small group of millionaire producers. But neither can conservatives defend a regulated cartel which flies in the face of a market-based economy. And *all* politicians in Canada, of *all* stripes, know that Canada's economy is dependent on trade. We can no longer afford to have supply management harm our leverage in our trade negotiations – particularly given what is now happening with our largest trading partner next door.

It is time for our politicians to do what is right. We are past knowing "why" – now is time for "how."

How do we transition forward from supply management in a way that is fair to our dairy, poultry and egg producers, as well as to consumers and taxpayers? We know that we can. We have, after all, done this before, most notably with Canada's wine industry – to great success. And we have other international examples from which to learn – both for what to do and what not to do.

THIS REPORT PROPOSES JUST SUCH A PLAN.

More work is needed to iron out details which will require engagement by all involved. After close to 50 years, the system has become complex. The same numbers won't apply to long-time producers as to new entrants, or to producers in different parts of the country. Some producers are ready to retire, or their farms are too small to compete – they would benefit from an appropriate buyout. For those who want to compete, grow and profit from the incredible international opportunities, additional transition assistance will be needed. The plan must address both.

The only missing piece now is for our politicians to stand up, defy the power of a wealthy lobby and show the leadership Canadians expect. A big opportunity has emerged to do something that not only helps in our looming trade negotiations, but that is actually *right* for Canada.

The future of the dairy industry is bright in Canada. Reforming supply management should not be seen as an obstacle, but rather as an opportunity to redress domestic inequities in a way that is fair to producers, grow our industry, open new markets and, most importantly – compete and win. Because we can.

Martha Hall Findlay
PRESIDENT AND CEO

[1] Note this paper focuses on dairy, but the principles, problems – and ultimately solutions – hold true for poultry and egg production as well.

OPPORTUNITIES FOR CANADA'S DAIRY INDUSTRY

We propose that supply management for dairy, poultry and eggs – the only agricultural sectors that benefit from such protection – be eliminated, but *with appropriate compensation and transition assistance for the producers*, **(i)** to bring fairness to Canadian consumers of essential nutrition; and **(ii)** to support producers so they can benefit from the opportunities that the global economy presents.

EXPORT OPPORTUNITIES

Moving away from supply management system – now – is a huge global opportunity for Canada.

Global markets beckon the Canadian dairy industry, in particular the rapidly growing Asian markets with millions of people now able to afford, and who want, the high-quality food Canadians produce. But Canadian dairy producers are prohibited from exporting because the World Trade Organization (WTO) has ruled that, due to the heavy subsidization our supply management system provides to Canadian producers, trying to sell internationally is against the rules. It is true that our system of price fixing, high tariffs on imports and production-limiting quotas has made our now small number of producers wealthy. But the Canadian dairy industry could be so much larger and profitable if it could export to international markets.

Yet, every time we enter trade talks, protecting this sector puts us in a more difficult negotiating position – our negotiators come to the table with one hand already tied behind their backs. Even when we do sign trade agreements, we've had to sacrifice benefits for other sectors, which is unfair to them. It would be a win-win for them and for dairy producers who want to export to the world.

DOMESTIC UNFAIRNESS

The truth is supply management hurts low income Canadians the most – who have to pay hundreds of dollars more a year than they need to for essential nutrition like milk and cheese.

Simply put, supply management forces consumers to pay two to three times more for basic nutrition. This system now represents a massive transfer of wealth from consumers to what is now a small number of producers who are among the wealthiest Canadians – members of the "one per cent."

TRANSITION A WIN-WIN

A thoughtful, well-planned transition away from supply management can work for producers and ensure not only the sustainability, but the competitiveness and growth of the dairy industry.

No one wants to harm Canada's dairy, poultry and egg producers. On the contrary, we are proposing a compensation and transition plan that would benefit all – including those who choose to exit comfortably and those who choose to compete and grow. Canada helped tobacco producers transition to new crops. Canada helped the wine industry go from protecting pretty awful (let's be honest) product before the Free Trade Agreement (FTA) with the United States to what is now a much larger and thriving industry. With these lessons, and learning from what Australia did 15 years ago to move away from its own system of supply management, we are confident that this can be done well, in a manner that is fair to all.

In this report, we propose the basics of a plan with recommendations on how to move to a fair, market-based system. Detailed calculations are, however, still required. For example, one study suggests that compensation be based on buying-out quota at book value; we, however, believe compensation should recognize the complexity of the situation. There is a big range between book value and market value of quota. Some producers obtained quota at no cost in the early days of the 1970s. Others who bought into the system more recently paid high prices and are carrying heavy debt loads. And there are significant regional differences. Work is needed to determine who obtained their quota when, at what value, where, and what they have used it for. These are all relevant factors for a fair compensation plan, as are the costs of transition assistance to a competitive environment.

To better understand how we got here, the current situation, the problems, and the proposed solutions, this report is organized as follows:

- How does supply management work and how did we get here?
- Where are we now?
- Myths about supply management: The evidence
- Designing a workable transition plan

SUPPLY MANAGEMENT

HOW DOES SUPPLY MANAGEMENT WORK?*

Supply management is based on three pillars. Like three legs of a stool, all three are essential or it falls down. The three legs are **(i)** fixed prices, **(ii)** high tariffs, and **(iii)** production-limiting quotas.

01 Price fixing

Milk prices (for consumers as well as processors of butter, cheese, yogurt, ice cream and other dairy-based products) are set by the dairy producers themselves – based on cost of production plus what *they* determine is the appropriate profit. It is a regulated cartel.

In the Canadian dairy supply managed market, approximately 40% of raw milk, also known as table or fluid milk, goes to consumers. The remaining production goes to processors to be used in cheese, yogurt, ice cream and related products. Pricing is set by the Canadian Dairy Commission and a target price range is established. Provincial boards set their own prices based on the target. The prices are arrived at by taking into account production costs, market demand and input from producers, and a "fair" price is determined.[3] It is the producers, not the market, who decide what "fair" is. To use a construction analogy, this is like a "cost-plus" job. There is no downside to the producers – all risk goes to the buyer.

As a result, Canadian prices are 2-3 times higher than those in the U.S. (see page 6). The average Canadian household with children spends almost $600 *extra* for milk and poultry products than our neighbours to the south.

02 Tariffs

To protect and maintain these high domestic price levels, the federal government limits competition from other countries. For all imports (other than a small exempt amount) the tariffs range from 168% for eggs, 238% for chicken, 246% for cheese, to almost 300% for butter.[4]

The allowable exempt amount is so small that it doesn't affect the domestic market. For example, 1% in the case of yogurt is the equivalent of one rounded teaspoon of yogurt per Canadian per year.[5] The newly ratified Comprehensive Economic and Trade Agreement (CETA) with Europe will open only an additional 3% of the Canadian market to European imports[6] – still, small enough to have a negligible impact on the overall market.

03 Quotas

Having a guaranteed and protected price makes for a no-lose, profitable and thus attractive enterprise. To prevent overproduction, the government established a quota system to limit production that, in 1971, was based on each producer's existing production. That

* **Much of this comes from *"Supply Management: Problems, Politics – and Possibilities,"* June 2012, written for the School of Public Policy, University of Calgary, but with updated statistics and other information where appropriate.**[2]

2 Hall Findlay, M. "Supply Management: Problems, Politics – and Possibilities," *School of Public Policy Research Papers (University of Calgary)* 5(19) (June 2012). Accessed April 28, 2017, https://www.policyschool.ca/wp-content/uploads/2016/03/supply-management-hall-findlay.pdf.

3 See Goldfarb, D. "Setting Milk Prices," *Making Milk: The Practices, Players, and Pressures Behind Dairy Supply Management*. The Conference Board of Canada, November, 2009, 7-16.

4 Hall Findlay, M. 2012. *supra* note 2, 4.

5 Hart, M. "Great Wine, Better Cheese: How Canada Can Escape the Trap of Agricultural Supply Management," *C.D. Howe Institute Backgrounder* (90) (April 2005). Accessed April 28, 2017, https://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed/backgrounder_90.pdf.

6 Sumner, Daniel A., Balagtas, Joseph, and Hall Findlay, M. 2014. "Dairy Policy in Canada and the United States: Protection at Home or International Trade?" *Wilson Center Canada Institute* (July 2014). Accessed May 6, 2017, https://www.wilsoncenter.org/sites/default/files/1i2v%20i17%20Supply%20Management%20-%20FINAL_0.pdf.

quota was allocated to each producer for free. Quota is transferable, and is currently worth, on average, about $30,000 per cow.[7] In B.C., it is now around $42,500 a cow.[8] In Alberta and Saskatchewan, it is $40,000 and $30,000, respectively.[9] In Ontario and Quebec, quota has been capped at $25,000.

This has now created a major economic distortion: As we've seen, with quota now worth, on average, about $30,000 per cow, total market value of dairy quota in Canada is more than $23 billion; for all supply managed sectors, it is about $34 billion.[10] The value of quota has more than tripled just since 1995 (see Figure 3 on page 10)[11] [12] and "soaring quota prices are thought to be prima facie evidence that production costs have been systematically overestimated."[13] (It is important to remember that, in the context of discussing how to transition away, and what the cost would be, the market value of quota is only this high because of the inflated prices for milk, and is not necessarily the "price tag for exit.")

HOW DID WE GET HERE?

Supply management developed through organization and co-operation by producers in collaboration with the federal and provincial governments. The purpose of the system was to stabilize producer incomes. It took place during a time of much greater enthusiasm in governments (in Canada and globally) for intervention in the agricultural economy.

The 1963 Canadian Dairy Conference led to the creation of the Canadian Dairy Advisory Committee the same year. The Canadian Dairy Commission was created under the Pearson government in 1967. Its goals were "to provide milk producers with a fair return for their labour and investment, and consumers with a continuous and stable supply of high-quality dairy products." (Note that there is no mention of consumer prices.)[14]

The National Milk Marketing Plan came into being in 1970, with Ontario, Quebec and the federal government the first to sign on. By the end of 1974, all remaining provinces except Newfoundland entered the plan; Newfoundland eventually signed in 2001. The National Milk Marketing Plan's most important function is to establish the production target for industrial milk in Canada.[15]

Thus, in 1970, the first fully national supply management system in Canada was created, with dairy leading the way. This was followed by eggs (1972), turkey (1974), chicken (1978), and chicken-hatching eggs (1986).[16]

Separate systems for poultry and egg production followed over the years. Over time, more complex federal and provincial industry regulations were developed to ensure the enforceability of the system.

The objectives of supply management suited the context in which the system developed. But times change, and the system needs changing. Indeed, the establishment of supply management pre-dates all of Canada's current free trade agreements, including the North American Free Trade Agreement (NAFTA), and the establishment of the modern World Trade Organization in 1995. The world around us has changed – we are being left behind.

7 Canadian Dairy Information Centre. "Milk Exchange Quota," *Quota*. Accessed May 6, 2017, http://www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil&s2=quota&s3=qe-tq&s4=yr-an&page=2017.

8 *Ibid*.

9 *Ibid*.

10 Statistics Canada. "Table 002-0020 – Balance sheet of the agricultural sector, at December 31, and ratios," *CANSIM (database)*. Accessed April 28, 2017, http://www5.statcan.gc.ca/cansim/a26;jsessionid=B40CA22644DCCE91F0971BDBC875E02D?id=20020&lang=eng&retrLang=eng.

11 Goldfarb, D. 2009. *supra* note 3, 17. See also Statistics Canada. "Table 002-0020". *supra* note 10.

12 Trebilcock, Michael J. "Dealing With Losers: The Political Economy of Policy Transitions." Oxford University Press, p.82.

13 *Ibid*, p.83.

14 Hall Findlay, M. 2012. *supra* note 2.

15 *Ibid*.

16 *Ibid*.

WHERE ARE WE NOW?

Dairy represents less than 0.5% of Canada's economy, ranking third in agriculture behind grains and red meats.[17]

Almost two-thirds of Canadian dairy producers are in Quebec, although they represent less than half of Canada's dairy production. Quebec and Ontario together are responsible for about 70% of Canadian dairy production.[18]

In the 1970s, when supply management was brought in, there were approximately 145,000 dairy producers; according to Statistics Canada, there are now only about 9,000 – a staggering drop of more than 93%.[19]

Since the creation of the supply management system, Canada has produced a relatively constant supply of milk, though with far fewer producers due to productivity gains and increasing economies of scale. In a normal market, this would have resulted in decreased prices; however, in our supply managed system prices have actually risen over the last 30 years by more than the inflation rate.[20] The opposite is true in the U.S., where, with similar rates of consolidation into a smaller number of usually larger farms, the consumer prices of dairy products increased by *less* than the price of all consumer goods.[21]

As for the prices received by the producers, a report done for the International Dairy Foods Association in 2010 showed farm gate prices consistently higher in Canada than in the European Union, New Zealand and the United States between 2001-2010 – with the difference getting increasingly large in the latter years of the study. In January 2010, relative farm gate prices (in U.S. dollars per hundredweight) were approximately $15 in each of New Zealand and the U.S., $17 in the EU, and a whopping $32 in Canada.[22] Recent surveys of farm prices show similar ongoing premium for Canadian product.[23]

---

17 Goldfarb, D. 2009. *supra* note 3.

18 Canadian Dairy Information Centre. "National Market Sharing Quota: Provincial Share of the National Market Sharing Quota (MSQ)." Accessed May 6, 2017, http://www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil&s2=quota&s3=prov. See also Canadian Dairy Information Centre. "Milk production at the farm." Accessed May 6, 2017, http://www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil&s2=farm-ferme&s3=prod.

19 In 2015, there were 9,720 dairy farms in Canada and we have seen yearly consolidation/reduction averaging over 500 farms per year. See Statistics Canada. CANSIM, Table 002-0072 *infra*, note 24. Note that according to dairy industry statistics, there were 11,280 dairy farms in Canada in 2016. This likely includes farms of nominal size with little or no cash receipts. See Canadian Dairy Information Centre. "Overview of the Canadian Dairy Industry at the Farm," *Number of Farms, Dairy Cows and Heifers*. Last modified January 31, 2017, http://www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil&s2=farm-ferme&s3=nb.

20 From January 1981 to January 2012, all consumer prices increased by 157.4%, whereas consumer dairy product prices increased by 175.7%. Statistics Canada. "Table 326-0020 - Consumer Price Index; Canada; All-items," *CANSIM (database)*; and Statistics Canada. "Table 329-0059 – IPI, meat, fish and dairy products, fruits, vegetables and feeds, beverages and tobacco *Archived*; Canada; Dairy products," *CANSIM (database)*. Accessed April 28, 2017, http://www5.statcan.gc.ca/cansim/a26?id=3290059&pattern=&p2=-1&stByVal=1&p1=1&tabMode=dataTable&retrLang=eng&csid=&lang=eng.

21 From January 1981 to January 2012, milk price increased 129.69%, whereas the change in all-items CPI for the same period was 160.53%. Gould, Brian. "Consumer Price Index of Dairy and Related Products: Dairy and Related Products CPI," *Understanding Dairy Markets*. Accessed April 28, 2017, http://future.aae.wisc.edu/data/monthly_values/by_area/312?tab=prices (source U.S. Department of Labor, Bureau of Labor Statistics ftp://ftp.bls.gov/pub/special.requests/cpi/cpiai.txt)

22 *An International Comparison of Milk Supply Control Programs and Their Impacts*. Informa Economics, Inc. September, 2010. Accessed April 28, 2017, http://future.aae.wisc.edu/publications/Informa_Supply_Control_Impacts_0910.pdf.

23 Taverner, C. "What farmers in other countries get paid for milk," Farmer's Weekly, April 8, 2016, accessed April 28, 2017, http://www.fwi.co.uk/business/what-farmers-in-other-countries-get-paid-for-milk.htm.

People are willing to pay a lot of money up front for a Tim Hortons franchise. The numbers are far higher for a dairy farm. More people should be asking why.

In 2015, the average dairy farm's net worth – *net worth* – was almost $4 million; the average poultry/egg farm's net worth was almost $6 million.[24] This is more than virtually all other Canadian producers – and far more than the average Canadian family – those paying a premium for their food. In 2014, the net cash income of the average dairy farm (over and above net worth of assets) was nearly $150,000 – double that of the average Canadian family – and that was *after all family farm salaries were paid.*[25]

FIGURE 1: NET WORTH AND NET FARM CASH INCOME OF SUPPLY-MANAGED FARMS

Farm Type[26]	Net Worth (2015)	Net Farm Cash Income (2015)
Dairy cattle and milk production farms	3,763,575	147,775
Poultry and egg farms	5,819,260	180,350

Source: Statistics Canada. CANSIM, Table 002-0072

Just to participate, it now costs millions of dollars. To buy quota for an average farm of 70 head would be, in B.C. – at $42,500 a cow – just shy of $3 million. In Ontario and Quebec, where quota has been capped at $25,000, it is just shy of $2 million. In all cases, that does not include the actual cows, the land, the barns, or the equipment.

People are willing to pay a lot of money up front for a Tim Hortons franchise. The numbers are far higher for a dairy farm. More people should be asking why. What's more, a now very small (and getting even smaller) number of people benefit from this system, but it hurts far more.

IT HURTS CONSUMERS. There have been several studies done all showing the cost to consumers. A recent study[27] shows that the average Canadian household with children had to spend almost $600 *extra* for their milk and poultry products because of supply management. Worse, it is highly regressive, hurting the poorest households, with the largest burden on low-income households with small children – those who need access to affordable nutrition the most. In 2009, dairy consumption fell to a level not seen since 1975.[28]

[24] Statistics Canada. "Table 002-0072 – Farm financial survey, financial structure by farm type, average per farm (gross farm revenue equal to or greater than $25,000)," *CANSIM (database).* Accessed April 28, 2017, http://www5.statcan.gc.ca/cansim/a26?lang=eng&retrLang=eng&id=0020072&&pattern=&stByVal=1&p1=1&p2=1&tabMode=dataTable&csid=.

[25] Statistics Canada. "Table 002-0044 - Detailed average operating revenues and expenses of farms, by farm type, incorporated and unincorporated sectors, Canada and provinces," *CANSIM (database).* Accessed April 28, 2017, http://www5.statcan.gc.ca/cansim/a26?id=0020044&pattern=&p2=-1&tabMode=dataTable&p1=1&stByVal=1&csid=&retrLang=eng&lang=eng.

[26] Statistics Canada. CANSIM, Table 002-0072, *supra* note 24.

[27] According to data from 2009-2011, the average Canadian household with children spent $585 more on supply-managed products. See Cardwell, R., Lawley, C. and Kiang, D. "Milked and Feathered: The Regressive Welfare Effects of Canada's Supply Management Regime," *Canadian Public Policy* 41(1) (March 2015). Accessed April 28, 2017. http://www.utpjournals.press/doi/abs/10.3138/cpp.2013-062.

[28] Trebilcock, *supra* note 12, p.84.

The average Canadian income is less than $40,000, whereas the average dairy producer is part of the 1 per cent. Why do we still force much poorer consumers to pay extra to make a small number of millionaires even wealthier?

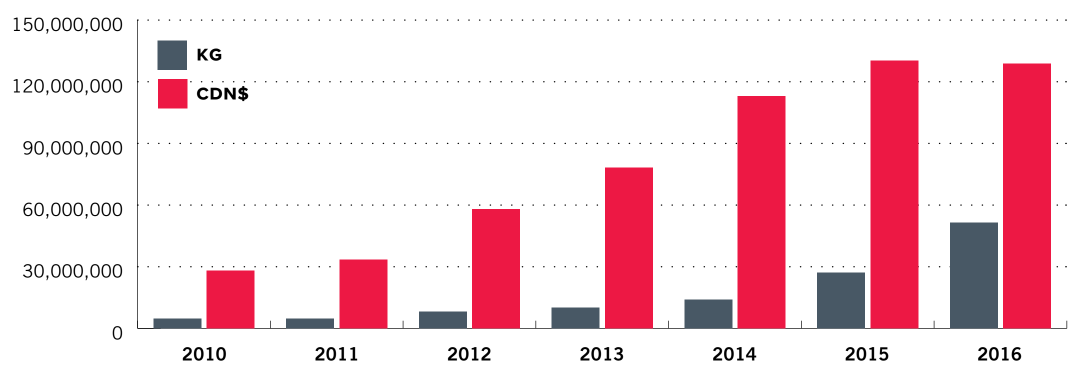
WE LOSE CANADIAN FOOD PROCESSING JOBS. The food processors (the butter, cheese, yogurt and ice cream makers) who want to sell internationally have to locate their plants (and their jobs) outside of Canada, because **i)** our milk is too expensive, and **ii)** we can't trade. Saputo has long had operations in South America and recently acquired a big Australian operation for these very reasons. (The CEO of Saputo recently, and publicly, called for the dismantling of supply management in Canada.[29])

Agropur, which is a co-operative owned by Canadian dairy producers, has in recent years expanded significantly into the United States, where it now processes more milk than it does in Canada. In 2016, Agropur's U.S. operations processed 3.5 billion litres of milk, significantly more than the 2.4 billion in Canada.[30] Agropur's expansion outside of Canada is the only way for Agropur to achieve any significant growth. Because it is owned by Canadian dairy producers, its official policy is to protect supply management at home – but it acquires and builds plants (and creates jobs) outside of Canada for anything else. How ironic that Agropur's own members are unable to increase production to supply this growth. It all goes to benefit U.S. producers and U.S. processing jobs.

Processors here are successful, but their Canadian operations only serve Canada's limited but inflated price market. To do business anywhere else, you need to get out, and take your jobs with you.

IT HURTS CANADIAN TRADE – PARTICULARLY EVERYONE IN CANADA WHO EXPORTS. This includes, ironically, more than 90% of Canadian farmers who are *not* supply managed, all those who produce beef, pork, grains, oilseeds, pulses, etc. But it also hurts most everyone else who relies, either in whole or in part, on trade. This is because Canada's insistence on protecting supply management puts Canada at a disadvantage in every

FIGURE 2: MILK PROTEIN SUBSTANCES IMPORTS FROM UNITED STATES[31]



Source: Canadian Dairy Information Centre. "Imports of Dairy Products by Country of Origin." *AIMIS (database).*

29 van der Linde, Damon. "Saputo Inc CEO says Canada could have been better without dairy supply management system," *Financial Post*, June 2, 2016, accessed April 28, 2017, http://business.financialpost.com/news/agriculture/saputo-navigates-challenging-global-dairy-market-in-q4.

30 Agropur Cooperative, "Annual Report 2016", Accessed May 6, 2017, http://www.agropur.com/pdf/RapportAnnuel_2016_EN.pdf.

31 Canadian Dairy Information Centre. "Imports of Dairy Products by Country of Origin." *AIMIS (database).* Accessed May 6, 2017, http://www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil&s2=imp-exp&s3=imp&menupos=1.1.2.

A thoughtful transition away from supply management will result in growth, opportunity and sustainability of the dairy industry. It is a win-win opportunity.

trade negotiation, hindering access to international markets. Even in those trade deals that Canada has been able to sign, we have had to give up far too much on other things at the negotiating table. This is particularly challenging given that Canada's economy is so dependent on trade.

The recent uproar over the import into Canada of ultra-filtered milk from the U.S. is only one symptom of the distorting effects of the system. This time, dairy producers were angry because processors were importing increasing amounts of highly concentrated milk protein, replacing costly Canadian milk in products such as cheese, yogurt and ice cream. Protein ingredients are not covered by NAFTA rules and thus are able to enter Canada without the substantial tariff that would otherwise be applied on dairy imports. This was creating a glut of our milk which was being diverted into animal feed – or simply being dumped. (This put Agropur, a processor wanting cheaper U.S. imports but owned by Canadian producers, in an awkward spot.)

Figure 2 shows the increase in U.S. exports into Canada of protein ingredients since 2011. To tackle the problem, first the Ontario government then the federal government, pressured by the dairy lobby, developed a new class of skim milk to be priced at the much lower world price, to displace these cheaper U.S. imports. In doing so, demand for U.S. imports decreased. But, Canadian producers now find themselves in two-tier milk pricing system, where they accept world price for skim milk products sold to processors, but an inflated supply managed price for other products. This same approach to selling abroad is what caused the WTO to rule against Canada – it is not acceptable to use an inflated, subsidized price to sell something else at below cost in order to displace competitors. While the legality of this recent move has not been ruled on, there is a possibility that it will expose Canadian producers to another international legal challenge.

In Canada, we have poor families with children who are paying hundreds of dollars extra for essential nutrition while some of our too-expensive milk is dumped down the drain.

IRONICALLY, AND PERHAPS MOST FRUSTRATINGLY, IT HURTS MANY OF THE DAIRY PRODUCERS THEMSELVES – certainly the most efficient ones. Twenty-five per cent of Canada's dairy producers produce fully one half of Canada's milk. These more efficient, growth-oriented producers could be reaping significant profit from exporting to international markets, particularly the rapidly-growing Asian markets. They are denying themselves growth and profit opportunities; the better producers are subsidizing the less-productive ones; and, the whole system costs several hundred million dollars a year in debt servicing costs due to the value of quota – capital that could be better used to fund tangible and productive assets.

Export markets are neither easy nor consistent – there are fluctuations in demand to which suppliers in every business must adapt. But again, more than 90% of Canada's agricultural producers are subject to free market global trade and have been able to compete, expand and thrive. Yet, Canada isn't even at the table for dairy, poultry and eggs.

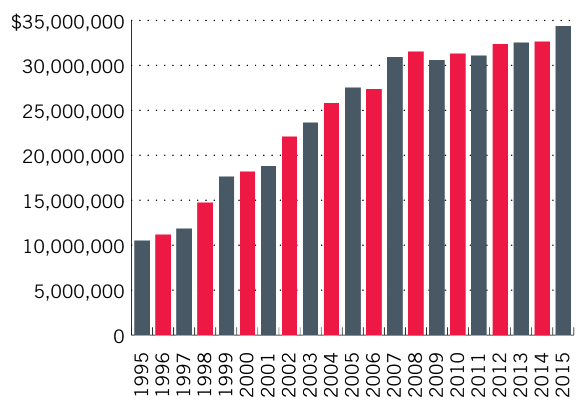
A recent Conference Board of Canada report sets out these lost opportunities in detail.[32] For example, liberalizing Canada's dairy sector to serve global demand would result in a more than doubling of national milk production, an increase in the number of farms by 2.1% and growth in average herd size to 187 cows. Not to mention, 8,500 new Canadian full-time jobs – 5,000 in primary production and 3,000 in processing.[33] More cows, more farmers, more processing jobs – who can argue with that?

Concerns have been raised about the cost of buying out quota. But the cost to consumers of keeping supply management is even higher. And the value of quota has more than tripled since 1995 – how much more will a buy-out cost if we continue to delay the inevitable?

Canadian consumers, our trading partners, other non-supply managed agricultural producers, and all others who rely on exporting their goods from Canada are taking a hard look at supply management. The likelihood that it will survive such increased pressure from key stakeholders is diminishing every day. Producers need to ask themselves not, "How can we hold onto supply management?" but rather, "How can we thrive in a post-supply management world?"

A thoughtful transition away from supply management will result in growth, opportunity and sustainability of the dairy industry. It is a win-win opportunity. We have already proposed a plan that would work (page 14). It is time to engage with the dairy, poultry and egg industries to iron out the details.

FIGURE 3: GROWTH IN QUOTA VALUE* ($)



Source: Statistics Canada Table 002-0020
*Note: this includes quota value for all supply managed industries.

[32] Grant, M., Barichello, R., Liew, M. and Gill, V. *Reforming Dairy Supply Management: The Case for Growth*. Conference Board of Canada. March, 2014.

[33] *Ibid.*

MYTHS ABOUT SUPPLY MANAGEMENT

The evidence

"Canadian prices aren't that high."

Nonsense, of course they are – that's why we have tariffs ranging up to 300%; why a "cheese smuggling ring" was "busted" some time ago coming in from the U.S.; why Canadians all along the border, from East to West, make regular weekend driving trips across the border to stock up on milk, cheese and eggs. And to be clear, these are not loss-leader, cross-border prices – the same lower prices prevail across the U.S. These numbers are not based on anecdotal or selective "shopping" evidence, but rather Statistics Canada and U.S. Bureau of Labor statistics.

"We can't compete with the heavily subsidized U.S. dairy producers without supply management."

(Note that this argument completely contradicts the first one about our prices not really being higher than those in the U.S.) Historically, yes – the U.S. has subsidized dairy, but not nearly as heavily as Canada for a long time. Those making the "argument" continue to use very old statistics – sometimes decades-old. More accurate are the calculations for the OECD producer subsidy equivalent (PSE), which reflect real support given by countries, whether directly or indirectly through regulations such as supply management. In the last couple of years, the PSE for Canada and the U.S. were similar, around 9%. But in Canada, almost all of that is due to dairy poultry and eggs – in the U.S., a majority of its support goes to sugar, not milk. (In Australia, it was near 1%; in New Zealand, less than 1%.)[34]

To be clear, *we don't want to expose Canadian producers unfairly – to the extent there is support in the U.S. for dairy, we should ensure a level playing field.* But right now, the level of U.S. subsidization of dairy is far lower than ours. We must move forward, although it needs to be fair.

"Supply management 'protects' the family farm."

Not only does it not do so, the opposite is true. Consolidation (smaller farms combining into large ones for economies of scale) is a fact of agriculture all around the world, and Canada is no exception. But the statistics show that in Canada, the rate of consolidation has actually been higher – *yes, higher* – in the supply-managed dairy, poultry and egg sectors, than in most other agricultural sectors. In the 1970s, when supply management was brought in, there were approximately 145,000 dairy producers; there are now only about 9,000 – a staggering drop of more than 93%. Between 2011 and 2015 alone, the number went down by more than 2,200 – on average *more than 500 a year.* Supply management can make *no* claim to so-called "protecting the family farm" – indeed, the cost of entry is so high that various economists have blamed the system for making it more difficult.

---

[34] Organization for Economic Cooperation and Development (OECD). "Agricultural Policy Monitoring and Evaluation". Accessed May 6, 2017, http://www.oecd.org/tad/agricultural-policies/monitoring-and-evaluation.htm

Our government is supporting a regulated cartel that in any other economic sector would be illegal.

"Supply management helps 'farmers.'"

Supply management only supports a tiny number of Canadian farmers – 6%. The irony is that supply management actually *hurts* the majority of Canadian farmers – the 90+% who are *not* supply managed, including beef, pork, grain, oilseed and pulse producers, who would *benefit* from more global trade opportunities.

"Supply management protects food safety and security."

Another fallacy. We all want to ensure the quality of all of our food, not just dairy, poultry and eggs. And we do so by regulation, food labelling, food inspection – and, as needed, restrictions on what we allow in. The economic structure of supply management has nothing to do with it. The fearmongers claim that without supply management, we will "let in U.S. milk that is produced with artificial hormones." Some U.S. dairies do use artificial hormones for their herds – just as most Canadian beef producers do. But the control for that – for all of our food – is at the border, or with labelling, not supply management. Note that in the recent CETA trade agreement with Europe, Europe insisted that beef coming from Canada be hormone-free. There is absolutely nothing to prevent Canada from doing the same; either saying that we will not accept milk into Canada that has been produced using hormones – or by requiring thorough labelling so that people can make their own choice and pay whatever price is most appropriate.

"It is not subsidized by the government."

This has to be our 'favourite' argument because it is so false. Technically, the government doesn't make the payments. The subsidy is paid for by all Canadians in their roles as consumers instead of as taxpayers, thanks to the inflated milk prices from a system *supported* by government. The money comes out of the same pockets. And all of the international trade authorities including the WTO have confirmed that, for trade purposes, it is indeed a subsidy, and a very significant one at that. Our government is supporting a regulated cartel that in any other economic sector would be illegal.

"We can't compete with our climate."

This was a big one used by the Canadian wine industry in the lead up to the original free trade negotiations with the United States over 25 years ago. Yet look at the great success the Canadian wine industry has had since the FTA was implemented. It defies logic – and geography – to claim that the climate in southern Quebec is different from the climate immediately across the border in New York or Vermont – or that Wisconsin, a major dairy producing region in the U.S., is better off climate-wise than we are, given that most of Wisconsin is at a more northern latitude than Toronto. Indeed, thanks to our abundant supplies of free fresh water, many U.S. dairies claim that we are the ones with an unfair geographic advantage.

"It doesn't affect Canada's trade negotiations – see how many trade deals we've signed?"

Again, a fallacy. We are losing access to important international markets. Every trade negotiation is exactly that – a negotiation, with gives and with takes. International trade experts at the OECD, the WTO and other organizations all confirm that mandated consumer-paid support distorts trade just as much as direct government subsidies do. Canada thus arrives at every trade negotiation with, in effect, one hand tied behind its back, and is forced to make concessions in other areas. People point to the fact that we signed CETA and the Trans-Pacific Partnership (TPP), and only gave up a few percentage points of dairy market access for each. This is true. But what else did we give up in other aspects of the negotiations? What, for example, did we sacrifice for the auto sector in the TPP negotiations in order to maintain protection for dairy? Or manufacturing? Or beef?

And now, what will Canada be prepared to sacrifice? We are threatened with major U.S. border taxes, "Buy American, Hire American" policies, softwood lumber duties, a major renegotiation of NAFTA. Canadians need to ask ourselves: What will we give up on all of those important trade issues to insist on retaining a system that helps a very small number of Canadians become ever-wealthier – and which we should be dismantling anyway?

DESIGNING A WORKABLE TRANSITION PLAN

Canada has a tremendous opportunity to develop a transition plan that works for producers and consumers and ensures the future sustainability and competitiveness of the industry.[35] By designing a system which can provide appropriate transition compensation to producers based on the value of their quota, while also encouraging producers to "scale-up" and develop economies of scale, the industry can transition to the new market reality with success. Transition must involve all three legs of the stool: pricing, tariffs and quotas. Transition should also be designed to permit, encourage and help the industry to adapt to a competitive market and to export opportunities.

We need to consider this as a win-win solution. Australia successfully dismantled its own supply management system more than a decade ago. At little cost to government, its reforms provided compensation and transition assistance to dairy producers while still benefiting consumers. Canadian winegrowers had help in moving to free trade with the United States to much success; so did tobacco producers in moving to different crops.

The good news is that a transition plan that works for producers, consumers and taxpayers is an achievable goal. We propose a transition plan designed around three main principles:

1. Reform must treat producers fairly with adequate compensation and transition assistance that meets individual producer needs.
2. Transition assistance can be funded over time, using part of the existing system.
3. Transition should remove all three legs of the supply management stool simultaneously – this includes pricing, tariff protection and production-limiting quota allocation.

1 Reform must treat producers fairly with adequate compensation and transition assistance that meets individual producer needs.

Any reform plan should be designed with producers in mind. It must be tailored to differentiate between those who want to exit the industry versus those who wish to continue producing (likely involving expansion) to meet market demand. It should also differentiate between early quota values which were obtained at lower cost versus more expensive quota obtained later. A variety of transition strategies may be employed and can involve a hybrid approach of quota buyout and transition payments.[36]

[35] This discussion is drawn from: Hall Findlay, M. and Mintz, J. "Here's Canada's way forward on supply management," *The Globe and Mail*, June 24, 2015, accessed April 28, 2017, http://www.theglobeandmail.com/report-on-business/rob-commentary/heres-canadas-way-forward-on-supply-management/article24878498/.

[36] See Grant, M, et al. *supra* note 32.

A workable transition plan can benefit producers, encourage the sustainability and expansion of the industry, and benefit consumers with greater choice and lower prices.

For example, some suggest using full market value for quota. Yet many producers were allocated quota for free or at little cost decades ago, whereas new entrants have paid dearly. The Conference Board of Canada has suggested using book value, which it estimates for dairy as being somewhere between $3.6 billion and $4.7 billion.[37] The actual number would likely be somewhere between book value and market value, to address historical differences, interfamily transfers, use of quota as collateral for borrowing and other factors.

2 Transition assistance can be funded over time, by using part of the existing system.

Compensation and transition payments should be funded by maintaining and collecting a small portion of the system's existing price supports for a limited period of time. Although removing the supply management system will drop prices, a small supplement would be maintained on retail sales for a limited transition period (a Transition Price Supplement, or TPS). Governments would be able to borrow against the TPS to be collected over the transition period to fund immediate compensation. To create immediate benefits for consumers, the TPS must be low enough that the retail price during transition is still lower than current supply managed prices. The lower the TPS, the longer the transition period – and the higher the TPS, the shorter the transition period.

In Australia, the milk-price supplement was just 11 cents a litre, kept in place for eight years. Nearly three billion litres of fluid milk are consumed annually in Canada. If the fund totalled $5 billion (for dairy), the TPS would need to be just 17 cents a litre if spread over 10 years. If the fund were $15 billion, the TPS would be 50 cents a litre over 10 years,or 25 cents a litre, if we chose to spread it out over 20 years. (Remember that this supplement would be on the new, lower non-supply-managed milk prices.)

3 Transition should remove all three legs of the supply management stool simultaneously – this includes pricing, tariff protection and production limiting quota allocation.

Tariffs must be removed, all at once, so that Canada can immediately participate in robust, international trade deals. A more gradual approach would delay Canadian producers' ability to begin exporting, and allow competitors from Australia, New Zealand and the United States to secure and consolidate their export-market shares. However, once the tariffs are removed, the price received by our producers will drop to approximately U.S. price levels, and the value of quota will disappear – hence the need for immediate compensation and transition assistance to producers.

[37] *Ibid*, *supra* note 32, 94.

Such a transition assistance plan should both encourage those continuing to produce to compete and provide assistance to do so, and provide those exiting the industry with an appropriate compensation package. Thus, a workable transition plan can benefit producers, encourage the sustainability and expansion of the industry, and benefit consumers with greater choice and lower prices.

Right away, consumers would pay less for essential nutrition. Producers would be immediately and appropriately compensated and, for those who wish to remain, assisted in transition. Some would take advantage and retire comfortably, while the efficient, growth-oriented producers who remained would consolidate, make more efficient use of their capital and expand with exports to what are now rapidly growing markets.

Finally, Canada would be able to go to trade talks with clean hands, unencumbered by supply management and ready to benefit from global opportunities.

BIBLIOGRAPHY

Hall Findlay, M. "Supply Management: Problems, Politics – and Possibilities," *School of Public Policy Research Papers (University of Calgary)* 5(19) (June 2012). Accessed April 28, 2017, https://www.policyschool.ca/wp-content/uploads/2016/03/supply-management-hall-findlay.pdf.

Goldfarb, D. "Setting Milk Prices," *Making Milk: The Practices, Players, and Pressures Behind Dairy Supply Management*. The Conference Board of Canada, November, 2009.

Hart, M. "Great Wine, Better Cheese: How Canada Can Escape the Trap of Agricultural Supply Management," *C.D. Howe Institute Backgrounder* (90) (April 2005). Accessed April 28, 2017, https://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed/backgrounder_90.pdf.

Sumner, Daniel A., Balagtas, Joseph, and Hall Findlay, M. 2014. "Dairy Policy in Canada and the United States: Protection at Home or International Trade?" *Wilson Center Canada Institute* (July 2014). Accessed May 6, 2017, https://www.wilsoncenter.org/sites/default/files/1i2v%20i17%20Supply%20Management%20-%20FINAL_0.pdf.

Canadian Dairy Information Centre. "Milk Exchange Quota," *Quota*. Accessed May 6, 2017, http://www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil&s2=quota&s3=qe-tq&s4=yr-an&page=2017.

Statistics Canada. "Table 002-0020 – Balance sheet of the agricultural sector, at December 31, and ratios," *CANSIM (database)*. Accessed April 28, 2017, http://www5.statcan.gc.ca/cansim/a26?lang=eng&id=20020.

Trebilcock, Michael J. "Dealing With Losers: The Political Economy of Policy Transitions." Oxford University Press, p.82.

Canadian Dairy Information Centre. "National Market Sharing Quota: Provincial Share of the National Market Sharing Quota (MSQ)". Accessed May 6, 2017, http://www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil&s2=quota&s3=prov. See also Canadian Dairy Information Centre. "Milk production at the farm". Accessed May 6, 2017, http://www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil&s2=farm-ferme&s3=prod.

An International Comparison of Milk Supply Control Programs and Their Impacts. Informa Economics, Inc. September, 2010. Accessed April 28, 2017, http://future.aae.wisc.edu/publications/Informa_Supply_Control_Impacts_0910.pdf.

Taverner, C. "What farmers in other countries get paid for milk," Farmer's Weekly, April 8, 2016, accessed April 28, 2017, http://www.fwi.co.uk/business/what-farmers-in-other-countries-get-paid-for-milk.htm.

Statistics Canada. "Table 002-0072 – Farm financial survey, financial structure by farm type, average per farm (gross farm revenue equal to or greater than $25,000)," *CANSIM (database)*. Accessed April 28, 2017, http://www5.statcan.gc.ca/cansim/a26?lang=eng&retrLang=eng&id=0020072&&pattern=&stByVal=1&p1=1&p2=1&tabMode=dataTable&csid=.

Statistics Canada. "Table 002-0044 – Detailed average operating revenues and expenses of farms, by farm type, incorporated and unincorporated sectors, Canada and provinces," *CANSIM (database)*. Accessed April 28, 2017, http://www5.statcan.gc.ca/cansim/a26?lang=eng&retrLang=eng&id=0020044&&pattern=&stByVal=1&p1=1&p2=1&tabMode=dataTable&csid=.

Cardwell, R., Lawley, C. and Xiang, D. "Milked and Feathered: The Regressive Welfare Effects of Canada's Supply Management Regime," *Canadian Public Policy* 41(1) (March 2015). Accessed April 28, 2017. http://www.utpjournals.press/doi/abs/10.3138/cpp.2013-062.

van der Linde, Damon. "Saputo Inc CEO says Canada could have been better without dairy supply management system," *Financial Post*, June 2, 2016, accessed April 28, 2017, http://business.financialpost.com/news/agriculture/saputo-navigates-challenging-global-dairy-market-in-q4.

Agropur Cooperative, "Annual Report 2016", Accessed May 6, 2017, http://www.agropur.com/pdf/RapportAnnuel_2016_EN.pdf.

Grant, M., Barichello, R., Liew, M. and Gill, V. *Reforming Dairy Supply Management: The Case for Growth*. Conference Board of Canada. March, 2014.

Canadian Dairy Information Centre. "Imports of Dairy Products by Country of Origin". *AIMIS (database)*. Accessed May 6, 2017, http://www.dairyinfo.gc.ca/index_e.php?s1=dff-fcil&s2=imp-exp&s3=imp.

Organization for Economic Cooperation and Development (OECD). "Agricultural Policy Monitoring and Evaluation". Accessed May 6, 2017, http://www.oecd.org/tad/agricultural-policies/monitoring-and-evaluation.htm

Hall Findlay, M. and Mintz, J. "Here's Canada's way forward on supply management," *The Globe and Mail*, June 24, 2015, accessed April 28, 2017, http://www.theglobeandmail.com/report-on-business/rob-commentary/heres-canadas-way-forward-on-supply-management/article24878498/.

CANADA WEST FOUNDATION

cwf.ca