Montreal Economic Institute
Ideas for a More Prosperous Nation

ECONOMIC NOTE

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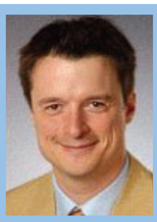
SUPPLY MANAGEMENT OF FARM PRODUCTS: A COSTLY SYSTEM FOR CONSUMERS

Despite a worldwide trend toward market liberalization and competition, most politicians and people involved in Quebec agriculture maintain a vigorous defence of supply management of certain farm products.[1] Supply management is the mechanism by which milk, poultry and egg producers in Canada (most of them located in Quebec and Ontario) adjust production to protect their incomes. To this end, domestic demand is evaluated arbitrarily, and efforts are made to match this with production of the goods covered by the scheme.

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As is often the case in farming, these mechanisms for bringing goods to market were created at a time of crisis. The Great Depression of the 1930s was devastating for western producers, so much so that the need to create a lever for development of the farming industry seemed obvious. The same applied to the establishment of "joint plans" in the 1950s for marketing Quebec farm products.

Supply management, a system motivated by protectionism, operates largely as a cartel and can no longer be justified in today's setting. Things have changed enormously in the last 50 years, and consumers deserve better than the status quo. We need to devise mechanisms for transforming, restructuring and adapting the food and agriculture sector rather than striving to maintain an obsolete, costly and unfair system like supply management.

Canada's isolation on the international scene

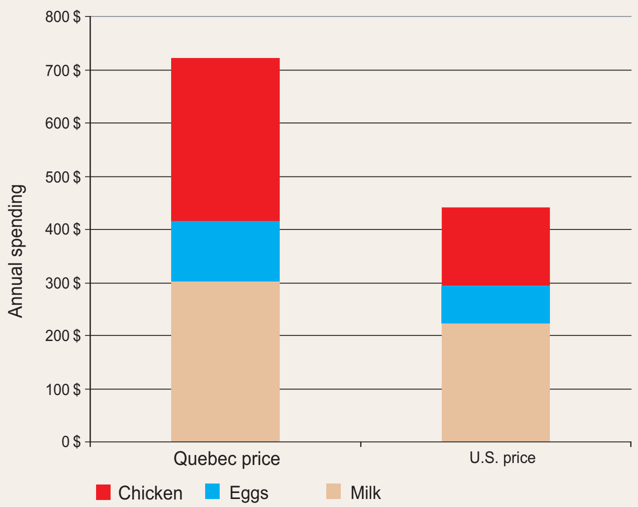
Canada's farm marketing programs have come under aggressive attack from a number of countries around the world.[2] Even though Canada has won many of the disputes brought against it under trade agreements, it simply no longer has any allies on the international scene. The world community often regards these marketing bodies, quite accurately, as interventionist government agencies that go against market forces. In recent years, several countries have eliminated supply management and opted for greater openness to world trade.

At the World Trade Organization (WTO), tentative efforts have been made to advance the liberalization of international trade through the Doha round of negotiations, but the intransigence of some participants, including the United States and the European Union, remains a major obstacle to success. The Doha round, begun in November 2001, deals in particular with agriculture and with improving access for farm products from developing countries to markets in wealthy countries. In other words, the ultimate goal is to enable destitute countries to emerge from misery by developing their agricultural sectors without unfair competition from the industrialized countries that subsidize their farmers. Despite good intentions at the start, any likelihood of a reduction in direct or

1. Presse Canadienne, "La fin de la gestion de l'offre nuirait aux productions agricoles québécoises", *Le Devoir*, June 20, 2007, p. A3.
2. Jean-Philippe Gervais and Bruno Larue, "La crème est-elle en train de surir? Les relations canado-américaines dans le secteur agroalimentaire", *Policy Options*, Vol. 26, No. 9, 2005, pp. 41-45.

Figure 1

Estimate of annual spending by a Quebec family of four based on average Canadian consumption



indirect government assistance to farmers creates a corporatist outcry in developed countries such as Canada and more particularly in France, the United States, Switzerland, Japan and South Korea. The deadlock in negotiations is due primarily to the fact that a majority of member countries, including Canada, are relentless in defending the special interests of their own farming sectors, thereby going against the aim of the talks and against the general interests of their respective populations.

In this respect, Canada is often accused of double-talk and of spreading ambiguity within the international community.[3] On the one hand, the Canadian economy as a whole relies heavily on exports. In fact, 40% of Canada's GDP is exported, which means that a similar proportion of jobs depends on foreign trade. In Quebec, nearly 60% of GDP goes to outside markets, two-thirds of this to other countries. In brief, our economy is very open to the world. But on the other hand, in ministerial meetings at the WTO, Canada fervently defends key features of its protectionist farm policies. It does so at the insistence of agricultural pressure groups and provincial governments, those of Quebec and Ontario in particular. Supply management, which governs sectors such as dairy products, poultry and eggs, is heavily criticized due to the astronomical customs duties and price-fixing practices that are involved. Canada has been denounced many times by WTO member states. This policy of economic isolationism risks harming the country's reputation and jeopardizing other markets. Sooner or later, Canada must recognize that free trade makes sense, and it will have to reform its restrictive policies on the importing and production of agricultural goods. The longer it waits to adapt, the harder and costlier the process will be.

Consumers shoved aside

Under the supply management system, it is obvious that consumers' interests are secondary. The dairy industry alone represents 80% of revenues from products governed by supply management. Between 1980 and 2005, Canadian consumption has declined 18% for milk, 30% for butter and 24% for ice cream. Consumption of milk is expected to fall by a further 12% by 2020. Meanwhile, the price of milk is 53% higher than 12 years ago, double the rate of inflation. At the same time, production costs have fallen by 3.8%.[4]

As a point of reference, there is a growing gap between retail prices for milk in Quebec and prices observed in the United States.[5] Price differences are significant in comparisons with the average in big U.S. cities.[6] For example, the minimum price

Supply management of farm products is heavily criticized on the international scene due to the astronomical customs duties and price-fixing practices that are involved.

3. Michael Hart, *Great Wine, Better Cheese: How Canada Can Escape the Trap of Agricultural Supply Management*, C.D. Howe Institute, April 2005, http://www.cdhowe.org/pdf/backgrounder_90.pdf.
4. Canadian Restaurant and Foodservices Association (www.dairyplanet.ca) based on data from Statistics Canada, the Canadian Dairy Commission and Agriculture and Agri-Food Canada.
5. Although it is true that agriculture in the United States is subsidized, the experience of other countries that have greatly reduce assistance to dairy farmers (such as Australia and New Zealand), as an example, tends to show that the productivity gains that are obtained, along with increased competition, help reduce prices rather than raise them. See Valentin Petkantchin, *Dairy production: the costs of supply management in Canada*, Montreal Economic Institute, February 2005, http://www.iedm.org/main/show_publications_en.php?publications_id=86, and *Reforming dairy supply management in Canada: the Australian example*, January 2006, http://www.iedm.org/main/show_publications_en.php?publications_id=126.
6. The cities in question were selected by the U.S. Department of Agriculture (http://www.ams.usda.gov/dyfmos/mib/rtl_mon_rdft_07.pdf). The period of comparison was the second quarter of 2007. The U.S. liquid gallon (3.78 litres) was converted to a four-litre container, and prices were converted to Canadian dollars at an exchange rate of $0.94.

for a four-litre container of milk (2% fat) is currently $5.13 in Quebec,[7] 37% higher than in the U.S. The maximum price is $5.73, but this ceiling applies only to regular milk (the price of UHT, biological or value-added milk may be significantly higher). The U.S. price is an average price rather than a minimum, meaning that in reality the gap between U.S. and Quebec prices is even wider.

For the average consumer, the operation of the Canadian milk marketing system may seem highly complex. Each autumn, representatives of the industrial milk and fluid milk industries are invited to present their positions to the Canadian Dairy Commission, which is involved in setting market quotas, and the Régie des marchés agricoles et alimentaires du Québec, which sets retail prices for milk. Quebec is the only province that still regulates the retail price of milk. This tends to favour upward manipulation of prices.

On one side we have the powerful lobby working for producers, who seek to maximize their revenues, and retailers, who want a high floor price to avoid competition. On the other side are the comparatively ineffectual associations that are supposed to represent consumers' interests. The result is predictable, and 2007 has been no exception. Quebec consumers have had to bear another increase in the milk price since last January.[8] With an apprehended rise in the prices of inputs, Quebec consumers are likely to see another price rise for 2008.

The supposedly "fair" supply management mechanisms set up in Canada amount to nothing less than a highly regressive tax, which hits hard at the poorest households.

An empirical study of the Canadian supply management system found that 81% of Canadians are not even aware of the existence of the Canadian Dairy Commission. Although the primary mission of this government body is to serve the Canadian public, it appears to be indulgent with the dairy industry. Of greater concern in this study is that more than half the respondents who said they were aware of this body's existence were not even able to indicate its main function.[9]

The situation is similar for eggs and poultry, the two other commodities governed by supply management across the country. For eggs, the difference between prices in Montreal and prices in the United States for Grade A large eggs is 55%.[10] Poultry does not escape, either. A kilogram of fresh whole chicken has a retail price twice as high in Quebec than in the United States.[11]

If we take account of average Canadian consumption of milk, eggs and poultry and compare our retail prices with those listed in the United States,[12] we can conclude that supply management costs each person in Quebec an average of about $75 a year. This comes to $300 a year for a family of four (see Figure 1) and more than $575 million for the entire province. These costs hit hard at the poorest households, which appear to have been abandoned in this matter by the usual groups which defend low-income citizens. The supposedly "fair" supply management mechanisms set up in Canada amount to nothing less than a highly regressive tax that has escaped the attention tax measures normally get. The system's supporters, along with pressure groups in the food and agriculture sectors directly concerned, pride themselves in receiving no subsidies and go so far as to demand the elimination of subsidies to farmers in the United States and Europe. However, supply management resembles in practice a taxation power granted by the state. Rather than subsidize farmers directly with money collected in taxes from citizens, the government lets producers raise prices by giving them monopoly privileges. This amounts to the same thing, except that the government does not face the ire of consumers, who are totally unaware of the situation.

A costly deadlock

What is most disturbing is that the industry still insists on limiting supply rather than responding to increasingly

7. For Region I, encompassing the great majority of people in Quebec. The minimum price for the other regions is higher. Régie des marchés agricoles et alimentaires, http://www.rmaaq.gouv.qc.ca/_private/document/sources/Secteur_lait/Tableau_prix_lait_extrait_decision_8743.pdf.
8. Régie des marchés agricoles et alimentaires, *Demande de modification du Règlement sur les prix du lait aux consommateurs*, decision no. 8743, December 21, 2006, http://www.rmaaq.gouv.qc.ca/decision/decision_2006/768-03-01_prix_lait_8743.pdf.
9. Sylvain Charlebois, Wolfgang Langenbacher and Robert Tamilia, "The Canadian Dairy Commission: an empirical survey on its relevance in today's civil society", *International Food and Agribusiness Management Review*, Vol. 10, No. 1, 2007, pp. 81-99.
10. For a dozen eggs in the second quarter 2007; U.S. prices were converted to Canadian dollars at an exchange rate of $0.94. Sources: U.S. Department of Agriculture (http://www.ers.usda.gov/data/meatpricespreads/Data/cuts.xls); Agriculture and Agrifood Canada (http://www.agr.gc.ca/volaille/pri_e_f.htm).
11. For Canada, the Quebec price is not available on Statistics Canada's website. The U.S. weights were converted to kilograms (2.2 lbs.), and prices (June 2007) were converted to Canadian dollars at an exchange rate of $0.94. Sources: Statistics Canada, *Food and other selected items, average retail prices*; U.S. Department of Agriculture (http://www.ers.usda.gov/data/meatpricespreads/Data/cuts.xls).
12. Statistics Canada, *Highlights – Food available for consumption in Canada* http://www.statcan.ca/english/ads/23F0001XCB/highlight.htm. Results may vary based on exchange rates and other factors. Only the products mentioned are taken into account and not derivative products (e.g. cheese or butter). These comparisons are given only as a rough guide.

diversified demand. International trade rules are no longer the same as they were when the supply management system was established. We are on the cusp of an upheaval as profound as that which gave birth to modern industry, and Canadian agriculture faces a struggle in preparing itself. These changes will be related to the environment, genetics, production methods and, above all, innovation and information. Only the creation of international distribution channels will provide the Canadian agricultural industry with access to indispensable strategic information and enable it to compete with other economies by offering innovative products.[13] Otherwise, an inability to foresee trends and to act in timely fashion will be very costly. Brazil, Australia, China, India and other emerging countries already have a considerable lead in this regard. Compared to Canada, these countries benefit from relatively open and competitive agricultural economies.

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Conclusion

Farmers are well aware that supply management will eventually be dismantled. It should be understood that Canada is a major player in agriculture. It is the world's fourth largest exporter and fifth large importer of farm products. Canada can potentially play a leadership role in resolving the impasse at the WTO, but its current trade practices hurt its credibility. Instead of relying on arguments aimed solely at protecting our so-called "food sovereignty", a concept that is as fallacious as it is dangerous, Canada must be consistent and promote the liberalization of markets among WTO member states, and this includes markets in food and agriculture. Canada's current position on supply management could ricochet and harm not only talks on opening other food and agriculture markets, to the great disadvantage of the Canadian agrifood industry as a whole, but also talks on market access for non-agricultural products. Items falling into this latter category account for nearly 90% of world merchandise trade and include all products from manufacturing industries as well as fuels and forest products, along with other key industries in our economy.

Adequate transition mechanisms will certainly be needed, but the federal and provincial governments must show a keen willingness to rationalize our food and agriculture industry based on competitive processes. We can get there by looking to the experiences of countries that have had the courage to act in this regard. Unless we change direction, we will simply be protecting an inefficient and incoherent food and agriculture industry with much of it isolated from the world, to the great disadvantage of consumers and, in the long run, even of farmers.

13. Mike Gifford, "Canada's dairy industry: can supply management survive an open trade environment?", *Policy Options* Vol. 26, No. 10, 2005, pp. 57-63, http://www.irpp.org/po/archive/nov05/gifford.pdf.

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