Groupe de recherche en économie et politique agricoles, Département d'économie agroalimentaire et des sciences de la consommation, Université Laval
(Department of Agri-Food Economics and Consumer Sciences, Laval University)

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SUMMARY

Supply Management in the Dairy Sector, Still an Appropriate Regulation Method

Daniel-Mercier GOUIN

FOREWORD

Daniel-Mercier Gouin is Director of the Groupe de recherche en économie et politique agricoles (GREPA) and a professor in the Department of the Agri-Food Economics and Consumer Sciences at Université Laval. The study was written when the author was a visiting researcher at the Farmers, Territories, Environment, Markets and Public Policy Unit (MONA), of the Department of Rural Economics and Sociology at the Institut national de la recherche agronomique (INRA) in Paris.

The objective of the study is to compare the dairy supply management system in Canada with systems regulating the dairy economies of the United States, the European Union, Australia and New Zealand.

INTRODUCTION

The structured application of supply management in the dairy sector across Canada began in the late 1960s. Its implementation terms evolved into what became known as the national dairy policy, whose key features were in place by 1975. Since then, even though the national dairy policy's terms have evolved with the economic and regulatory environment, there has been very little change in its major guiding principles. In fact, of the four guiding principles implemented at the start, three are still in force – adjustment of milk supply to domestic market requirements expressed in terms of butterfat, dairy producers' financial accountability with regard to surplus, and adjustment of producer support prices according to production costs. Over the years, only a government subsidy, designed to keep the consumer price of dairy products low, has been abolished (2002). Some of the support provided to the dairy sector, previously borne by Canadian taxpayers, was thus transferred to dairy product consumers, who now cover all the expenses related to their individual consumption.

In a context of market openness and a reconsideration of the tools of government intervention in agriculture, regulation of the dairy sector by supply management, as applied in Canada, is being called into question. In fact, the import barriers required to maintain an effective dairy supply management system appear to be totally inconsistent with the avowed objective of liberalizing farm product trade. However, while supply management as a tool of regulation of the dairy sector or other agricultural commodity sectors merits debate, the free market as the sole potential regulator of the dairy sector, and more broadly of the agricultural sector, also merits just as vigorous a debate.

SUMMARY

The summary begins with the main findings of the simulation analysis developed throughout the study. Questions are then raised about the purpose of reconsidering the current system of dairy regulation in Canada.

MAIN FINDINGS OF THE STUDY

The purpose of this study was to evaluate the performance of supply management as a regulation system in the dairy sector, as it is applied in Canada, based on a comparative analysis of the principal dairy economies of other developed countries, specifically the United States, the European Union, Australia and New Zealand. For this purpose, the debate is situated within the broader context of the economic justification of agricultural support, an analytical framework which is not specific to the dairy sector. We demonstrated that this analytical framework began to emerge in the 1930s.

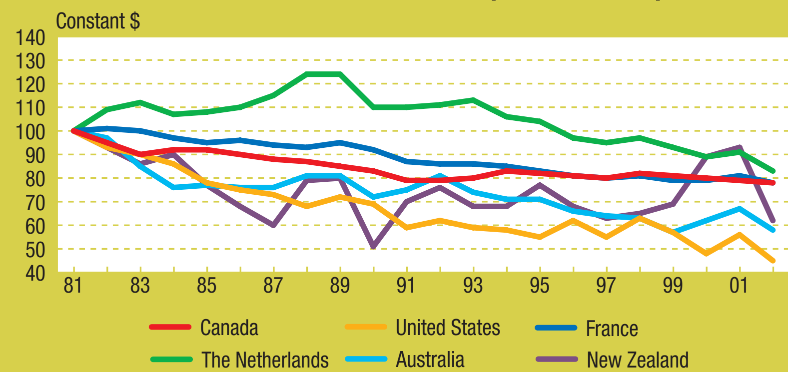
Government intervention in agriculture in the developed countries has historically been explained by the economic specificity of the agricultural sector, particularly with regard to its imperfect response to market signals for both supply and demand. This economic justification for government support to agriculture is still relevant, especially in the dairy sector. The emergence of a spontaneous balance that could come about on a deregulated dairy market, and especially on a completely liberalized international market, is far from proven. Nor is it proven that such a spontaneous balance would be sustainable and provide dairy producers with an adequate and stable return in relation to the social choices made in each country. Consequently, it is not surprising that governments continue to support dairy production.

Government intervention in agriculture in the developed countries has historically been based on the fact that it is a special economic sector that cannot be regulated by the rules of the free market alone.

While regulation of national dairy economies appears to be the norm rather than the exception, the systems put in place are very different from one country to another.

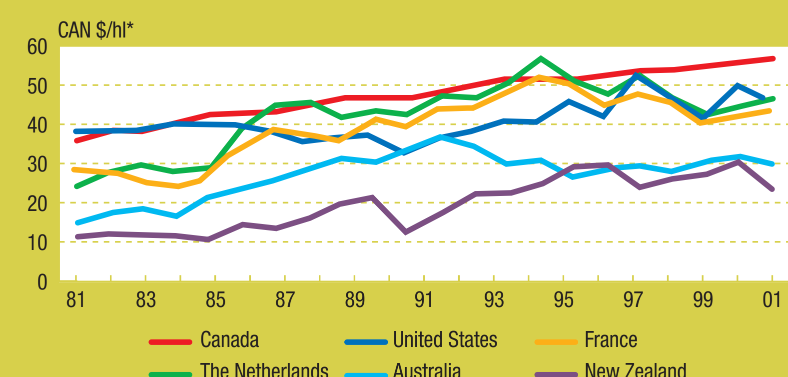
In the current situation, however, regulatory systems are very different from one country to another. Supply management is practised in Canada and Europe, but with different backgrounds and specific implementation frameworks. In Canada, it is a social compromise guaranteeing farmgate prices based on production costs, in exchange for production strictly adjusted to domestic market needs. In the European Union, supply management was basically implemented with a view to controlling the budgetary costs of dairy regulation. In the United States and Australia, regulatory systems are evolving toward different outcomes. Australia is currently in a transitional phase, which ultimately should lead to total deregulation of its dairy economy. For the United States, deregulation is not complete – quite the contrary. Even though the government authorities have applied a policy of reducing domestic price supports, leading to a drop in farmgate prices, dairy producers have been compensated since 2002 by a program of direct production subsidies. In New Zealand, a virtually total liberalization of the dairy economy was implemented many years ago, but nonetheless with a concern for maintaining market power on the international market, formerly through a government-owned enterprise, now through a cooperative which has essentially retained the same prerogatives. Regulation of national dairy economies appears to be the norm rather than the exception.

FIGURE 1.1
Farmgate milk price trends, by country, 1981 to 2002, in constant national currencies (Index 100 =1981)



Sources: USDA, Agricultural Statistics; Statistics Canada, CANSIM data bank, Cat. 23-001; Dairy Board; INSEE France, comptes de l'agriculture; AF New Zealand; Dairy Australia; and our calculations.

FIGURE 1.2
Farmgate milk price trends, by country, 1981 to 2002, in CAN$/hl



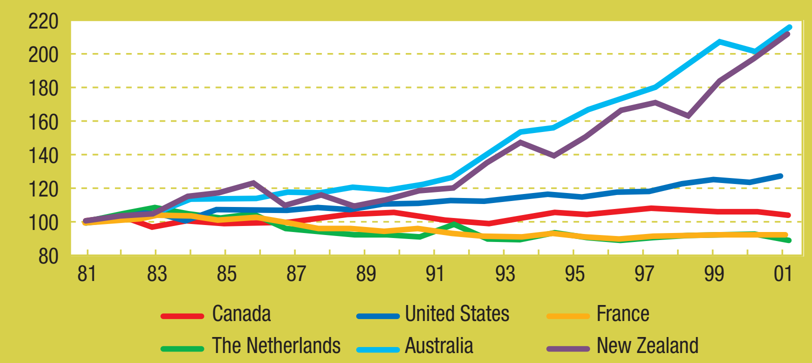
** Non-deflated data.*
Sources: Groupe AGÉCO (2003), Annuaire statistique laitier du Québec, Effective price of milk.

In Canada, where a supply management system is applied in the dairy sector, the farmgate price of milk is more stable and generally higher than in the other countries studied.

A comparative analysis of the performance of these various regulatory systems has revealed that the farmgate price in Canada is more stable and generally higher than in the other countries studied. In the United States, France and the Netherlands, domestic dairy market intervention measures are maintained to support prices, but at a declining price support level. Recently, both in the European Union and in the United States, direct subsidy programs have been instituted to compensate for this decline in support prices and the resulting drop in farmgate prices. New Zealand dairy producers are totally subject to the world market price, while those of Australia are in transition to such a regulatory system or, more precisely, to an absence of regulation. However even at such price levels, producers in these countries seem to be able to obtain a return on resources used in milk production, as the continuous growth of production in these countries shows.

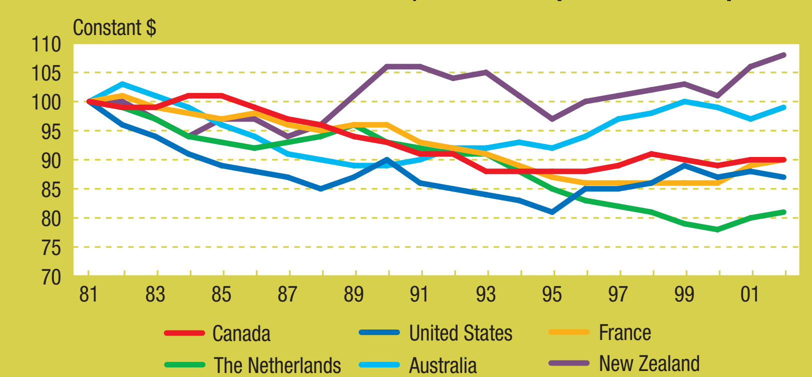
Paradoxically, Canada's more favourable and stable farmgate prices do not mean unfavourable price trends for Canadian consumers. On the contrary, the oft-repeated argument that supply management means price increases and higher costs for consumers does not stand up to analysis. It is in the three countries with supply management - Canada, France and the Netherlands - where consumer prices increased the least during the period under review, to the benefit of their dairy consumers.

FIGURE 1.3
Trends in milk production volume, by country, 1981 to 2002 (Index 100 =1981)



Sources: FAOSTAT 2004, Agricultural production, Primary livestock, consulted on-line, April 2004; and our calculations.

FIGURE 1.4
Trends in the Consumer Price Index of dairy products[1], by country, in constant national currencies, 1981 to 2002 (Index 100 = 1981)



1 For the Netherlands and New Zealand, Consumer Price Index for dairy products and eggs.

Source: Statistics Canada, NASS-USDA; Agreste Chiffres et Données Agroalimentaire – Milk and Dairy Products (Table 7.10) various issues; Annuaire statistique de la France, various years; Dutch Dairy Board, EC Dairy Facts and Figures, Statistics Netherlands, Australian Bureau of Statistics – special issue; MAF New Zealand; New Zealand Statistics - special issue; and our calculations.

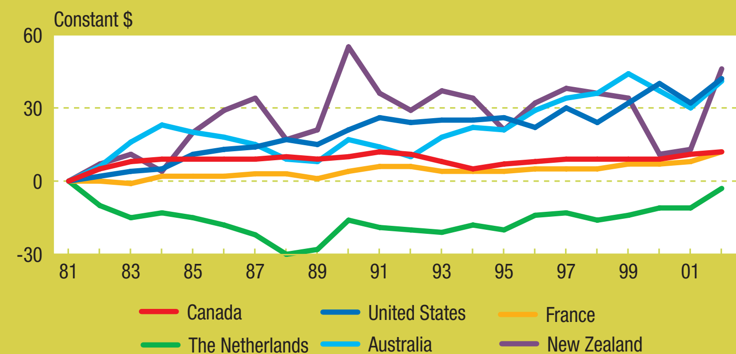
It is in the three countries with supply management – Canada, France, Netherlands – where consumer prices increased the least during the period under review.

In the countries evolving toward deregulation, processors and distributors are increasing their margin, while producers and consumers do not appear to be benefiting from the deregulation.

Consequently, it is also in these three countries that the aggregate margin of dairy processing and distribution increased the least during the period studied. Given such a context, one might be inclined to think that processing activities should be more profitable in countries where the margin increased during the period under review. Although we didn't have much information to produce such an analysis, the data we did have indicate that we should refrain from drawing conclusions too hastily. The few available studies we consulted on the subject tend to indicate that dairy processing in Canada is doing well. For example, dairy processing enterprises in Canada seem to perform better than those in the United States.

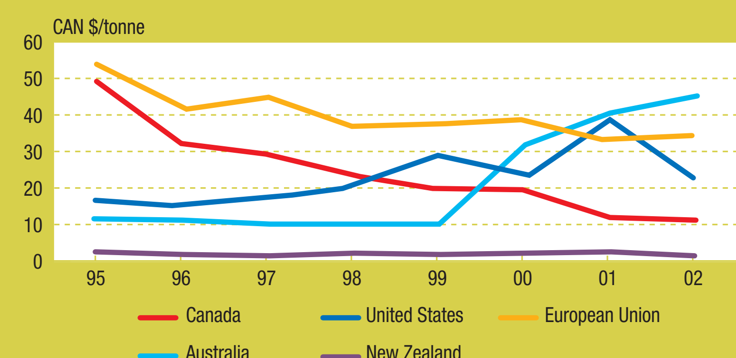
Conversely, the two countries converging toward total deregulation of their dairy economy, New Zealand and Australia, were those where consumer prices increased the most, as did the aggregate margin of dairy processing and distribution. Deregulation in these countries does not seem to have benefited either consumers or dairy producers.

FIGURE 1.5
Trends in the aggregate margin of dairy processors and retailers based on the difference between the Consumer Price Index and the Producer Price Index, by country, 1981 to 2002 (Index 100 =1981)



Sources: Data from Figures 1.1 and 1.4

FIGURE 1.6
Trends in direct payments to dairy producers and export subsidies in CAN$ per tonne of milk produced, by country, 1995 to 2002



Sources: OECD data base on PSE (2004); European Union: EAGGF Guarantee, restitutions, http://europa.eu.int/comm/agriculture/fin/finrep02/tab_fr/a12.pdf, consulted on-line May 2004; United States: DEIP, expenditures per fiscal year, USDA - ESR, special release, May 2004; Canada, New Zealand and Australia: USDA - ESR, Data WTO export subsidy notifications, consulted on-line May 2004; and our calculations.

Not only is the income of dairy producers best protected in Canada, the financial contribution of the Canadian government to its dairy sector is among the lowest as well.

Budget costs per tonne of milk produced are perfectly controlled and very low in New Zealand. Even though Canada is the country where dairy producers' income is the best protected, without high relative costs for consumers, budget costs have declined sharply with abolition of the direct production subsidy, and have now stabilized at a level clearly lower than in the United States, the European Union and Australia. In the case of Australia, however, it must be noted that the increase in budget costs is recent, paid by a consumption tax, and should only be a transitional program pending deregulation. In the United States and the European Union, a new trend is emerging: the introduction of direct payments to offset declining support prices or market prices, which are related. This said, there has been an appreciable drop in budget costs for the European Union since 1984 if we consider only export subsidies, which decreased following implementation of dairy production quotas (however, reform of the CAP will substantially increase the amounts paid to dairy producers through direct payments). In the United States, budget costs, including export subsidies, have generally grown since 1996.

Finally, the findings of an analysis of alternative regulation scenarios in Canada's dairy sector are unconvincing with regard to their capacity to replace the current dairy policy. A direct income support program, which would consist of abolishing price supports while protecting dairy producers' income, would lead to a budget cost out of proportion with the total support budgets dedicated to agriculture by the federal government. As for applying income support programs that exist in other commodities in Quebec or across Canada to the dairy sector, dairy producers' income would deteriorate despite budget costs that again would be very high.

Without supply management, the dairy industry would have to be supported by massive outlays of public funds.

Deregulating the Canadian dairy sector would not guarantee any benefits whatsoever for consumers.

WHY RECONSIDER THE SUPPLY MANAGEMENT SYSTEM IN CANADA?

Following our analysis, one might rightfully question the purpose of reconsidering supply management in the Canadian dairy sector. It appears obvious that deregulation of the Canadian dairy sector would not offer any guarantee of benefits for Canadian consumers. It is just as obvious that any such deregulation, on the contrary, would have a very adverse impact both on the levels and stability of farmgate milk prices, as well as on farm income in Canada. As for the budget costs of the dairy regulation system, which are already relatively low, we do not see how deregulation could reduce them further. On the contrary, the eventual dismantling of the supply management system risks significantly increasing the cost of dairy regulation and thus the burden supported by the taxpayer. Finally, the dairy supply management system, as applied in Canada, makes only a very marginal contribution to the supply of dairy products on the international market and certainly does not contribute to imbalance or disorder on this market, which is caused, in particular, by export subsidies applied in other dairy economies.

Consequently, supply management in the dairy sector appears to be a method of regulation that is still appropriate, at least in the Canadian context, and in the way it is applied. If abolishing supply management does not benefit producers, taxpayers, or consumers, then one might rightfully ask just who would benefit from it.

This summary report contains the main findings of Daniel-Mercier Gouin's study. The full report, which runs to over 100 pages, can be obtained at the following location:

http://www.go5quebec.ca/en/documents.php

Abolishing this system risks significantly increasing the government's financial contribution and thus the burden supported by taxpayers.