Pacific Trade Deal An Opportunity for Canadian Dairy to Expand and Export

Christopher Ragan
The Globe and Mail, June 30 2015

Over the next few months, Canadians will hear a lot about the negotiations of the Trans-Pacific Partnership and about the possibility that our "supply management" of the dairy and poultry industries is on the bargaining table. This might even become a significant issue in the fall federal election. So it seems like the right time for a bit of a primer.

The Trans-Pacific Partnership (TPP) is an ambitious trade agreement, 10 years in the making so far, between 12 countries of the Pacific Rim, including the United States, Mexico, Canada, Australia, New Zealand, and Japan. Canada has become infamous in past trade negotiations for its hypocritical stance on agricultural policy – wagging our fingers at countries that subsidize their grain farmers while insisting that our own systems of supply management are innocent and worth ignoring. For the TPP, however, our trade partners are finally calling us out and pushing for a dismantling of these systems.

"Supply management" is the Canadian term for a system that forcibly restricts output and raises prices, thus enhancing producers' incomes. The output of milk is restricted through the use of "quota"; dairy farmers must possess enough for their entire dairy herd, and cannot sell their milk without it. The total amount of quota is less than the quantity of milk that would otherwise be sold in an unregulated market, and this restriction drives up the market price of dairy products.

You might think this high-price system obviously benefits dairy farmers, but it's actually not so simple. Farmers lucky enough to receive their quota for free, when the system was first created many years ago, are now sitting on assets of tremendous value – and have also been benefitting from years of high milk prices.

Any farmer who entered the industry much later, however, had to purchase the necessary dairy quota at market prices. Today, it costs between $25,000 and $30,000 to purchase the quota to sell one cow's milk; adequate quota for a typical herd of 70 cows would thus cost about $2 million. That's an enormous up-front capital cost, in addition to the cost of the herd, land, structures, equipment, and labour. For these "newer" farmers, the high milk prices are absolutely essential for generating even a normal return on these high capital costs.

Another aspect of supply management is that very high tariffs on imports are needed to prevent cheaper foreign dairy products from flooding the market. Tariffs between 200 and 300 percent are typical. The overall result is that dairy products are ridiculously expensive in Canada, as any reasonably alert Canadian shopper notices while visiting a grocery store in Seattle or New York or London or Paris. These high prices are obviously bad for all

Canadian consumers, but they also harm the competitiveness of Canadian firms producing prepared foods with dairy inputs.

Supply management harms consumers and forces our dairy farmers to incur large capital costs and to serve only the small Canadian market. And we appear to be stuck with the system, because new farmers need the artificially high prices in order to cover their artificially high quota costs. What system would be better?

If Canadians really cared about their dairy farmers, we would change the policy to encourage farmers to expand their operations and export to the rest of the world. This is precisely the opportunity that the TPP offers us if we give up supply management. Given our rich endowment of prime agricultural land, there is no reason we couldn't be as successful as Australia and New Zealand at exporting our dairy products. Only about 5 percent of our dairy output is currently exported; for New Zealand, the number is roughly 95 percent.

Making the transition from today's dairy industry to a larger and export-oriented one is possible, but it requires some assistance from government. Compensation to farmers for some part of their quota value, especially those new to the industry, is only fair since they purchased the quota under a different set of rules and expectations.

Despite its cost, the provision of such government assistance should not be seen as an obstacle to reform. It would be far better for taxpayers to make these transitional payments to some dairy farmers than to miss the opportunity of moving permanently to a world with more Canadian dairy farmers and cheaper dairy products for all Canadians – and also with more Canadian cheddar in grocery stores around the world.

*****

Christopher Ragan is an associate professor of economics at McGill University in Montreal and a research fellow at the C.D. Howe Institute in Toronto.