FAX FROM THE FRONTIER (FF216)
THE FRONTIER CENTRE FOR PUBLIC POLICY March 13, 2003

REFORMING MILK THE AUSTRALIAN WAY

IN BRIEF: CANADA'S RECENT FEDERAL BUDGET, FEAT A WTO DECISION WILL FORCE CANADA TO REFORM AGRICULTURAL MARKETING BOARDS BY 2005. THE POLICY HAS BEEN COSTLY; UNNECESSARILY RAISING THE COST OF NUTRITIOUS STAPLES, FRAGMENTING THE INDUSTRY AND CREATING AN ARTIFICIAL VALUE FOR QUOTA, THE RIGHT TO PRODUCE A COMMODITY IN A CONTROLLED MARKET. RECENT POLICY REFORMS IN AUSTRALIA'S DAIRY INDUSTRY SHOW HOW TO MANAGE THE TRANSITION OUT OF THE RESTRICTIVE MARKETING BOARD MODEL WHILE PROTECTING DAIRY FARMERS WHO ARE ON THE HOOK FOR MAJOR INVESTMENTS IN "QUOTA." THE GOVERNMENT INTRODUCED A TEMPORARY CONSUMER TAX ON MILK, THE REVENUES FROM WHICH, WILL PARTIALLY BUY OUT QUOTA FROM AFFECTED DAIRY FARMERS. AN INTELLIGENT PHASE OUT WHICH HELPS PRODUCERS TO ADJUST WILL PARTICULARLY BENEFIT WESTERN CANADA WITH ITS GREAT STAKE IN COMPLYING WITH INTERNATIONAL TRADE AGREEMENTS.

Canada's system of supply management – where a food commodity is taken out of the competitive market and subjected to price and production controls – is on its way out. The World Trade Organization has set a deadline of January 1, 2005 for open markets in foodstuffs. Our marketing boards violate the spirit and the letter of trade agreements, and penalties will follow if we don't open our borders.

Supply management took root in the interventionist 1970s. Phasing it out will end a costly policy that has served consumers and the broader industry poorly. The OECD estimates that, since 1980, the milk that Canadians drink has cost us $50 billion more than it would have at world prices. Currently we pay about 25% more than Americans for milk, an extra charge of about 36 cents a litre. Higher prices for this vital food staple affect the poor most of all. Households with children now drink less milk per capita than childless ones. Under supply management, milk consumption and the value of dairy exports are both declining.

Advocates of marketing boards maintain that supply management brings reliability and quality to the production system. But we pay quite a price. Almost three-quarters of Canada's agricultural subsidies are paid to milk producers. Between 1990 and 2000, the aggregate inflation rate stood at 21.7% but milk prices rose 37.7%. High tariffs on imported dairy products seal the deal for the consumer. Cheaper alternatives exist, but we can't access them.

How do we get out of this? Restoring markets is more easily said than done. Insulated for years from effective price competition, Canadian dairy farmers have invested billions of dollars more in land, livestock and infrastructure than they otherwise would have. Opening the milk market in one fell stroke would impose massive losses. Some economists regard that as an abrogation of the producer's property rights, even though the value of that property has been artificially raised by special protection.

Since marketing boards first popped up in Australia, it seems appropriate for that country to lead the way out. A new Frontier Centre study, *Australia's Dairy Reforms – Lessons for Canada* (available at www.fcpp.org), shows how to exit supply management without bankrupting producers. In 2000, that country terminated its program of administered prices and subsidies, and introduced an adjustment program for dairy farmers to adapt or exit the market.

The form of the adjustment sounds contentious. A consumer tax of 11 cents a litre was imposed on July 8, 2000, and will continue until 2008. The money the levy raises is paid out to dairy farmers to compensate for transition losses. It doesn't cover all the burden, but expanded exports are making up some of the difference. Milk prices in Australia – where subsidies and regulated prices exacted about the same toll as in Canada – have fallen in six of eight states and risen only slightly in the others.

Financing an end to privilege may seem unfair, but the sunset clause in the Australian milk tax makes all the difference. Instead of consumers paying more forever, the program allows them to capture the full benefits of price competition within a specified time period. In the meantime, overall prices will still fall, even while the industry is protected from collapse. In New Zealand, where the dairy industry was deregulated twenty years ago, it took only six years to adjust fully to market prices.

In both countries, phasing out dairy supply management meant that farmers who stayed in the business expanded milk production, increased exports and became more efficient by using new technology and methods. The average dairy herd in Canada contains 56 cows, compared to the American average of 82. Dumping this arcane system would bring lower prices, more efficient production and ultimately more value to the Canadian dairy industry.

Although the Australian study restricts itself to milk, author Paul Earl suggests that Canada should also pay attention to the "feather industries", poultry and eggs, similarly regulated commodities that have provoked trade complaints. As with dairy, protected producers have a vested interest in preventing open competition. Economist Richard Posner estimates that up to 30% of the value of annual sales in these protected markets goes into activity designed to maintain the privilege.

That explains the millions of dollars paid out in Canada by marketing boards to convince the public that they are somehow better off with supply management. The dairy producer association in Québec, where farmers benefit the most from controls, spends $40 a year in administration and promotion, a deadweight social cost. They defend the system as "an instrument to protect Canadian identity."

The economic case for phasing out dairy boards is clear and coercive. The Australian model points the way to reforms that would benefit both the public and the industry, without catastrophic consequences for producers. Such changes would also remove a significant irritant in trade discussions and protect the Canadian economy, particularly the West's, from punitive retaliation.

What's most intriguing about the Australian restructuring is the fact that the impetus for it came from the dairy industry itself. Those with the most to lose realized they would ultimately be better off without marketing boards.

That wisdom ought to prevail in Canada, too.

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Upcoming Events - March 13th – Breakfast on the Frontier with **Larry Desjardins, former Mb Minister of Health –**
Topic: More Money is Not the Answer for Better Healthcare
Place: Winnipeg Winter Club, 200 River Avenue, Winnipeg, MB **Time:** 7:30 a.m. **Cost:** $15.00/person **Please RSVP** to 957-1567