Straight Talk

Professor Ian Lee on Supply Management

2011, Issue #4

Canadian agriculture is among the most protected parts of our economy via government-sponsored cartels, referred to as "supply management". They cover a host of key staples such as milk, eggs, and chicken. Intended to guarantee stable income for farmers and food supply for the nation, it actually limits output, fixes prices well above competitive levels, and slows productivity growth. In addition, it is becoming increasingly contentious to our trading partners in Europe and Asia.

In this fourth instalment of our *Straight Talk* series, MLI talks to Ian Lee about why Canada has marketing boards, why we shouldn't, and the fairest way to help consumers and farmers out of their straitjacket.

Ian Lee is an Assistant Professor at Carleton University's Sprott School of Business where he teaches strategic management and international business. Professor Lee earned his Ph.D. in Public Policy from Carleton University. He has taught courses at Carnegie Mellon, University of Washington, University of Pittsburgh, SUNY Buffalo, University of Calgary, Dalhousie, Carleton, UQAM, and the University of Ottawa, and for MBA programs in China, Cuba, Iran, Poland, Romania, Ukraine, Latvia, Slovenia, Croatia, and Mexico. Professor Lee has also done consulting work for the World Bank, CIDA, Coca Cola, and France Telecom.

MLI: What is the basic idea behind supply management and why is it wrong?

Professor Lee: Supply management benefits producers at the expense of consumers. The idea, say the Canadian Dairy Commission and the National Farm Council, is to 'stabilize producers' incomes and stabilize the dramatic fluctuations in supply and demand'. They argue that ensuring farmers a 'fair income' and a stable one will allow them to generate a stable supply of food. But to set up such a system government must first give producers the power to act like a cartel and limit production through permits called 'quotas'. The price must be set not by market forces but a government sponsored agency, higher than it would be in a competitive market. And they must be able to limit both domestic farmers and foreign imports from undercutting the price. Or, to put it more colloquially, supply management allows a small number of producers to exploit a large number of consumers.

MLI: The Canadian Wheat Board has received a lot of attention of late. Is the Canadian Wheat Board considered part of supply management?

Professor Lee: The Canadian Wheat Board (CWB) was established in the Depression as a precursor to supply management and marketing boards. As the CWB is mostly selling wheat internationally, they are unable to assign quotas and fix prices, as wheat is an international commodity with an international price. Rather, the CWB requires farmers to sell their wheat through the CWB, which tries to maximize sales while negotiating transportation costs on behalf of the farmers and then “price pools”, sharing the different prices earned by the market share of each farmer.

MLI: How about the other commodities covered by supply management?

Professor Lee: In Canada, supply management covers dairy, eggs, turkeys, chickens, and broiler hatching eggs. The 2010 figures from Statistics Canada indicated that supply-managed commodities accounted for 19 percent of total farm income in Canada, or $8.6 billion of a total $44.4 billion in farm income.

MLI: Is supply management a recent development?

Professor Lee: No, supply management has been around since the 1960s. It started under the Pearson Liberal Government with the establishment of the Canadian Dairy Commission in 1966 and was expanded to cover other areas during the Trudeau and Mulroney years.

MLI: Raising the price of basic staples would adversely affect the poor the most, correct?

Professor Lee: Yes, any changes that raise the cost of basic food hurts low income people much more for the simple reason that they spend a much higher percentage of their income on basic food than higher income people. The OECD estimates that Canadians are paying double the market cost for milk while the Conference Board of Canada estimates that Canadians pay 60 cents more per litre of milk due to this system. There is no question that phasing out supply management brings benefits to almost all members of society, excluding the producers, through lower prices and especially to low-income people.

MLI: Normally when policies are designed to help producers they hurt consumers. But they don’t always help producers. How does agricultural supply management affect Canada’s producing sector?

Professor Lee: The clearest way supply management affects producers is by limiting entry. The license quotas become more valuable over time because the number of quotas is restricted in order to limit production. This allows them to fix the price of the underlying commodity, so as income grows the value of each license quota increases. New farmers covered by quotas must purchase a license to enter, driving up the cost of entry. For example, it now costs roughly $25,000 to buy a quota for one cow and about $140 for the quota for one hen. Multiplying these rough per unit costs results in fairly high values for the right to farm in these protected areas.

MLI: Supply management creates problems in a completely different area too, namely trade policy. When Canada goes to the WTO (World Trade Organization) or attempts to negotiate new trade deals with the EU and Trans-Pacific Partnership we’re criticized for our protectionism in these areas, aren’t we?

Professor Lee: Yes, definitely. Supply management was legal under the old GATT (General Agreement on Tariff and Trade) rules. But it started to cause problems for Canada when the GATT was transformed into the WTO (World Trade Organization). The WTO started to go after these kinds of protectionist practices because it wanted to restrict, even prohibit the use of protective quotas and tariffs. Such policies have been

a major sticking point in negotiations with the European Union. It is also a real barrier for negotiations with the Australians and New Zealanders, who are both important members in the Trans-Pacific Partnership.

Anecdotally, I was at a reception recently and was pressed on this very subject. Comments like, “When is Canada going to end supply management?” were common. The WTO (World Trade Organization) also issued a blistering attack on supply management because we are blocking foreign imports coming into Canada from Australia, New Zealand, the U.S. and elsewhere. It is not only a black eye, but it is causing more and more grief in our international relations with other countries that we trade with.

MLI**:** Okay. If the current government were to realize it did not like hurting consumers, did not like stagnant productivity, and did not like messing up our trade initiatives, and said we need to wrap this up in a way that is fair to producers how would they do it? What is the template for getting rid of these things?

Professor Lee**:** The solution is essentially to buy them out. Supply management has only two functions: set prices and set production quotas. If these two powers are removed, they no longer have a raison d’être. You cannot partially close down these systems. You either have them or you don’t. So you have to shut down the system and compensate the producers. This is a very tricky proposition though, since some farmers, those who were around in the beginning didn’t really incur any costs to purchase the quotas but have benefited from monopoly rents. At the same time though, more recent entries have spent considerable monies to purchase the quotas.

In any industry where government has created licences, quotas, medallions, or permits, like a taxi licence, they acquire market value and people pay high prices for them. And you have to pay off people who make that kind of investment because you are changing the rules of the game. In Australia they did it over an eight year period and paid out each individual producer for the loss of the value of the asset.

MLI: How did producers in Australia respond?

Professor Lee**:** Their dairy farmers responded to new opportunities by becoming more efficient, they invested in new technology and ramped up production to a more efficient scale. The result was that farms got bigger and the number of farms declined--not the output, but the number of farmers. So by design there was a period in which the quotas were being purchased and efficient producers bought out less efficient producers and gained economies of scale.

And it’s not complicated to put a fair price on these quotas because the market values are already out there. The quotas or licences trade now based on how many eggs or chickens they let you sell and at what price.

MLI**:** Can you more fully describe the Australian model?

Professor Lee**:** The Australians removed all controls on production and pricing of milk and put a temporary surcharge of 11 cents per litre on dairy beverages that ended in 2009 and used the money to compensate dairy farmers through 32 payments made quarterly for eight years for the loss of their protected market (or, in some cases, to assist them to exit the industry).

And the total cost – granted the Australian economy is about a third smaller than ours – was $1.92 billion Australian. It’s not a trivial amount, but it’s a one-off expenditure to shift from a rigid, overpriced, non-

market system to one driven by supply and demand. There's a huge benefit to consumers through lower prices.

In addition, it would be good for the farm sector itself since they would finally be able to access export markets as their Australian and New Zealand counterparts have done that have been denied to them until now due to protectionism.

MLI**:** Was this approach taken with the dissolution of the Canadian Wheat Board?

Professor Lee**:** No, in ending the Wheat Board monopoly, the government did not have to compensate farmers since there are no quota licenses. The government simply ended the monopoly requiring farmers to sell their wheat through the CWB. Now farmers can sell through the CWB or on their own. I would recommend following the Australian model because it was widely studied and was considered by people in the industry and consumer groups to be very fair.

Conclusions:

1. Phase out all supply management in Canada that fix production and prices in dairy, eggs, chicken, turkey, and broiler hatching eggs in Canada.

2. Impose a temporary levy on the sale of those products sufficient, in each industry, to pay fair compensation to all holders of quotas or licences over a period of time. Statistics Canada currently values these licenses at roughly $31 billion. In compensating farmers who hold quota licenses, the government should use a sliding scale. Farmers who purchased the licenses more recently should receive close to or even full compensation. Farmers who existed when the system was created, and therefore incurred no cost in purchasing the licences should receive little, if any compensation. In between the two extremes adjustments to the total compensation should be made based on the fact that the farmers enjoyed monopoly rents, or prices above market, based on the quotas. These rents have already to some extent compensated farmers for the cost of the licences.

3. The removal of supply management will allow Canada to aggressively negotiate new trade deals and thus secure access to new markets for our agricultural produce.

THE MACDONALD-LAURIER INSTITUTE

True North in Canadian Public Policy

The Macdonald-Laurier Insitute for Public Policy exists
to make poor-quality public policy in Ottawa unacceptable
to Canadians and their political and opinion leaders,
by proposing thoughtful alternatives through non-partisan
and independent research and commentary.

The Macdonald-Laurier Insitute is an independent, non-partisan registered charity for educational purposes in both Canada and the United States. We are grateful for support from a variety of foundations, corporations and individual donors. The Institute would not be able to continue making a diffrence for Canadians without the support of people across Canada and the United States for our publications on policy issues from aboriginal affairs to democratic institutions; support for our events featuring thought and opinion leaders; and support for our other activities .

For information on supporting the work of the Macdonald-Laurier Insitute by making a charitable donation, please visit our website at www.macdonaldlaurier.ca/supportMLI

The notion that a new think-tank in Ottawa is unnecessary because it would duplicate existing institutions is completely mistaken. The truth is there is a deep dearth of independent think-tanks in our nation's capital.
- Allan Gotlieb, former Deput Minister of External Affairs and Ambassador to Washington

To surmount the enormous challenges of getting Canada's place in the world right and taking advantage of changing opportunities, we need more ideas, input, discussion and debate in Ottawa - that is where the crucial decisions about our future are made. That's why MLI is so vital to Canada today.
- Hon. James S. Peterson, former Minister of International Trade and Member of Parliament for 23 years

MLI is a registered charity for educational purposes with the IRS and CRA

Winner, Sir Antony Fisher International Memorial Award

Best Think Tank Book in 2011

as awarded by the Atlas Economic Research Foundation

"Top 20 New Think Tank" in the world for 2010

as rated by the University of Pennsylvania

What people are saying about MLI:

Very much enjoyed your presentation this morning. It was first-rate and an excellent way of presenting the options which Canada faces during this period of "choice." ... Best regards, and keep up the good work.

Preston Manning, President and CEO, Manning Centre for Building Democracy

Congratulations all for the well deserved recognition. You've come a long way in a very short period of time.

Marc Patrone, Commissioner, CRTC

The reports and studies coming out of MLI are making a difference, and the Institute is quickly emerging as a premier Canadian think tank.

Jock Finlayson, Executive Vice President of Policy, Business Council of BC

In the global think-tank world, MLI has emerged quite suddenly as the "disruptive" innovator, achieving a well-deserved profile in mere months that most of the established players in the field can only envy. In a medium where timely, relevant, and provocative commentary defines value, MLI has already set the bar for think-tanks in Canada."

Peter Nicholson, former senior policy advisor to Prime Minister Paul Martin

---

Where you've seen us:

and in other major Canadian and international media

www.macdonaldlaurier.ca