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# THE NEGATIVE CONSEQUENCES OF AGRICULTURAL MARKETING BOARDS

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Economist

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# The negative consequences of agricultural marketing boards

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September 2012



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## Executive Summary

A marketing board is an organization that holds a monopoly on the marketing of agricultural products, which means that producers must sell their production to the appropriate board or must follow the rules imposed by the board when selling it. Some marketing boards also have the responsibility of supply management, fixing in advance how much of the agricultural commodity under its jurisdiction will be produced, in effect constraining supply and raising prices.



The objectives of the agricultural policies that are widely considered to have given rise to the marketing boards are:

- to create the conditions for farm families to have income levels comparable to those of other families;
- to increase farm income;
- to stabilize farm income;
- to preserve family farms.

Regarding the first objective, the average income for farm families who own non-incorporated farms was \$100,053 in 2009 compared to \$72,400 for all families. But if their incomes are higher, it is because of off-farm income, which represents 77% of their total revenues and not the result of marketing boards.

As for the second objective, to increase farm income, the marketing boards that do not have supply management powers have not managed to raise prices significantly higher than those that prevail in other markets, despite their monopoly. In the case of marketing boards equipped with the responsibility

of managing supply, the objective of raising and stabilizing the prices received by farmers seems at first glance to have been achieved. Yet, high farm prices are not synonymous with high farm incomes. In any new production under supply management, higher income stemming from higher prices can only be obtained through buying production quotas. In practice, there is a *capitalization* of these benefits in the price of quotas, their high prices

reflecting what producers expect to earn as extra profits. Higher farm incomes are therefore misleading since they do not take into account the value of the quotas.

Higher farm incomes have not been achieved, but is it even a relevant objective? The goal of increasing farm income also suffers from a measurement problem. The current profitability of farming activities is not the only relevant factor. Farmers also take into consideration the growth of the value of the assets in their possession. The rising value of assets is a result of either appreciation or reinvestment by farmers. Both asset appreciation and reinvestment have caused the average net worth of agricultural businesses to grow by more than \$635,000 over 16 years, or about \$40,000 per year. In other words, marketing boards didn't achieve their stated objective of increasing farm income, even with supply management. But the objective appears even less relevant in view of the rising value of assets.

With respect to the third objective, stabilizing farm income, marketing boards with supply management powers have succeeded in this regard better than the others, but only by forcing consumers of agricultural products to bear the cost of this stability. Also, when governments themselves take on the responsibility of stabilizing the incomes of agricultural producers, farmers no longer feel

responsible for adopting measures by themselves, such as diversifying their production, purchasing financial derivatives to partially guarantee future market prices, or forming contractual partnerships with processors or suppliers. Moreover, other industries such as newsprint paper, mining or tourism are also risky but do not enjoy comparable policy protection.

As for the fourth and last objective, since the introduction of supply management, 91% of dairy farms have disappeared and so did 93% of poultry farms. The same kind of observation can also be made in sectors with marketing boards that are not responsible for supply management. For example, a reduction of 94% is found in the number of hog farms. The decline in the number of farms is happening in all developed countries.

Measuring “transfers from consumers to producers” created by current agricultural policy in Canada, the OECD calculated an average of \$3.9 billion per year from 2008 to 2010. In addition to this cost for the consumers, other costs are borne by other links in the agricultural sector. Notably, marketing boards generates complexities that hinder adaptation and innovation.

If an agricultural policy does not produce the results it was designed to produce, and furthermore costs taxpayers and consumers billions of dollars, one should expect that it would be abandoned and replaced.

In order to promote a change of agricultural policy, we briefly review the cases of countries that have abolished or are in the process of abolishing quota systems: the buyback and abandonment of milk quotas in Australia, of tobacco and peanut quotas in the United States, the elimination of milk quotas in Switzerland and the beginnings of a process of abandonment of milk quotas in Europe. Canada could follow these examples by abandoning mandatory membership in marketing boards and by imposing a temporary tax to buy back farming quotas. These are necessary conditions to realizing the competitive potential of our agri-food sector, fostering agricultural entrepreneurship and thereby allowing it to contribute to the prosperity of the country.

## Introduction

The Canadian agri-food industry has important strengths. Canada's agricultural acreage per capita is among the highest in the world. As a result, the price of agricultural land is reasonable. Water is abundant, the transportation and communications networks are efficient and the sector's human capital is highly knowledgeable. Moreover, macroeconomic factors generally help make the sector competitive. Canadian agricultural businesses do very well indeed when the rules of the market prevail. The fact that about 45% of our agricultural production is exported shows that Canadian exports do in fact succeed when facing competition from around the world.<sup>1</sup>

The Canadian agri-food industry is also regulated and heavily structured by government-enforced marketing monopolies called marketing boards. The purpose of this research paper is to explain how marketing boards function and examine their concrete effects. In other words,

have the boards achieved the objectives that were assigned to them? Do they help make the agri-food industry more competitive, or do they in fact make it less so?

The first chapter describes what the marketing boards are and what objectives they pursue. The second chapter undertakes an evaluation of their effects on agricultural producers to see if they have fulfilled their objectives. The third chapter considers their impact on the other players in the agri-food industry. This analysis will establish whether or not the results observed correspond to the stated objectives, and therefore whether the marketing boards should be maintained, modified or eliminated.

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1. Agriculture and Agri-Food Canada, *An Overview of the Canadian Agriculture and Agri-Food System 2012*, March 2012, p. 101. This proportion is merely 20% in the United States and 5% in the European Union.



## CHAPTER 1

# Agricultural Marketing Boards

In Canada, a marketing board is an organization that holds a monopoly on the marketing of agricultural products in accordance with federal and provincial laws.<sup>1</sup> The marketing boards are distinguished according to the products they cover and the territories under their jurisdiction. Producers must sell their production to the appropriate board or must follow the rules it imposes when selling it. A board is generally controlled by a group of agricultural producers whose decisions constrain all of the producers of a specific commodity on a regional or national level. But decisions are constrained by each board's marketing plan that is approved by a majority of the producers—often a two-thirds majority.

Moreover, certain marketing boards not only have a marketing monopoly, but also have a responsibility to manage supply and to establish prices or determine the pricing mechanism for producers and buyers. In this case, the board determines in advance how much of the agricultural commodity under its jurisdiction will be produced—what is called the “supply,” as opposed to the demand of consumers. Each producer is authorized to produce a certain quantity over the course of the year. In practice, the board therefore allows producers to form a cartel by collaborating in such a way as to reduce supply and increase their profits instead of

competing with each other. In the dairy and poultry (eggs and chicken) sectors, the marketing boards are responsible for managing supply and their jurisdiction extends all across Canada.

### The history of the marketing boards: the notion of a balance of power

At the start of the 20th century, Edward Alexander Partridge, the founder of United Grain Growers, described independent agricultural producers as pygmies attacking giants. Farmers, who were small and competed with one another, were seen as being at a disadvantage compared to the buyers of their products, who were larger and fewer in number. According to this point of view, giants could compete with giants, and pygmies could compete with pygmies, but pygmies could never compete with giants.<sup>2</sup> To increase farmers' power and allow them to “face the giants,” Mr. Partridge encouraged them to group themselves into cooperatives in order to market their products.

The first agricultural cooperatives were trying to profoundly change the existing commercial relations between farmers and the buyers of their products. However, the creation of the first groups of agricultural producers relied on voluntary membership.

Little by little, the producers realized that forming cooperatives was not enough to change the rules of the game in the grain markets. Producers who did not join the cooperative could easily outcompete it. The cooperative members therefore wanted to force all producers to join their groups. The idea of imposing agricultural monopolies was inspired directly from the creation of marketing boards in New Zealand and Australia in the 1920s.<sup>3</sup>

In Canada, the first marketing boards run by producers were established in British Columbia in the late 1920s. In 1931, however, the Supreme

1. Although there are some marketing boards that deal with the marketing of wood and seafood, the great majority of them are concentrated in the agricultural sector. Christopher Green offers a “quasi-official definition” of a marketing board as a “compulsory horizontal marketing organization for primary and processed natural products operating under government delegated authority,” in “Agricultural Marketing Boards in Canada: An Economic and Legal Analysis,” *University of Toronto Law Journal*, Vol. 33 (1983), No. 4, p. 407. Marketing boards are referred to in this report as monopolies since the principal feature under study is the role of marketing boards as sellers. Obviously, since marketing boards are a compulsory association, they also act as monopsonies, i.e. as the only buyers from the producers' viewpoint. See: Christopher B. Barrett and Emelly Mutambatsere, “Marketing Boards,” *The New Palgrave Dictionary of Economics*, 2<sup>nd</sup> Edition, 2005.

2. Andrew Schmitz, Charles B. Moss, Troy G. Schmitz, Harley W. Frutan, and Helen C. Schmitz, *Agricultural Policy, Agribusiness, and Rent-Seeking Behaviour*, University of Toronto Press, 2010, p. 25.

3. Christopher B. Barrett and Emelly Mutambatsere, *Marketing Boards*, Cornell University, June 2005, p. 3.

Court of Canada ruled that the provincial law under which these first marketing boards had been established encroached on the authority of the federal government in matters of interprovincial trade and that the boards amounted to an indirect tax.<sup>4</sup>

The difficult conditions experienced by farmers, as by all of society, in the 1930s helped the agricultural world apply added pressure behind the push to create such entities. In reaction, a federal law was adopted in 1934, but it too was declared unconstitutional. It was the *Agricultural Products Marketing Act* adopted by the federal government in 1949 that finally put an end to this legal saga. It gave the federal government the power to authorize marketing boards created by provincial laws to regulate interprovincial trade and exports.

In the meantime, the federal government had created the Canadian Wheat Board that since 1943 has exercised a monopoly on the marketing of wheat and barley from the Prairies.<sup>5</sup> This body had been created by a specific law and was originally controlled directly by the federal government. Subsequently, agricultural producers retook control of it and named 10 of the 15 administrators. The Canadian Wheat Board is of particular interest because the federal government has passed a law to abolish its monopoly on the marketing of wheat and barley in Canada, which has come into effect on August 1, 2012.<sup>6</sup>

Today, there are some 80 marketing boards in Canada's agricultural sector. At the federal level,

two organizations were established to oversee the marketing boards, namely the Farm Products Council of Canada and the Canadian Dairy Commission. The marketing boards are created on a provincial or territorial basis, at the request of producers' groups, and are grouped together at the federal level in the case of those that have the responsibility of managing supply. These producers' requests are presented to organizations that authorize the creation of the boards, in accordance with provincial and territorial laws harmonized with the 1949 federal law.<sup>7</sup>

## The prerogatives of an agricultural monopoly in dealing with buyers

The marketing boards have a wide range of prerogatives. The one that best characterizes them, the monopoly over the sale of the agricultural products that are under their jurisdiction, allegedly gives the marketing boards a position of strength with buyers in the negotiation of sale prices and other conditions related to the delivery of the products.

Another prerogative deals with delivery conditions. Some marketing boards have fairly flexible rules in this regard, while others choose to use this lever extensively. For example, a processor in Quebec who wants to produce pork-based foods is obliged to buy and to receive at one of his slaughterhouses the pigs that are delivered to him, without being able to choose one pig over another.<sup>8</sup> This situation is unique, since in other industries, the client can choose which goods to purchase, just like a consumer does in a retail store. And a processor in Alberta would be under no similar obligation. The Ontario Vegetable Growers marketing board negotiates contracts with processors who can

4. Michele Veeman, "Agricultural Marketing Boards", *The Canadian Encyclopedia*, <http://www.thecanadianencyclopedia.com/articles/agricultural-marketing-board>.

5. The Canadian Wheat Board had existed under a different form since 1935 but was granted the marketing monopoly on wheat in 1943. The main responsibilities of the Canadian Wheat Board are: "to market wheat and barley delivered to it, to the best advantage of the grain producers; to provide producers with initial payments established and guaranteed by the federal government; to pool selling prices for the same grains so that all producers get the same basic return for the same grain delivered; to equalize delivery opportunities so that each producer gets his fair share of available markets; and to organize grain shipments to meet sales commitments in order to make the most effective use of the handling and transportation system." Agriculture and Agri-Food Canada, *Acts and Regulations*, <http://www4.agr.gc.ca/AAFC-AAC/display-afficher.do?id=1180107359564&lang=eng#s6>.

6. The end of the Canadian Wheat Board monopoly gives producers the choice of marketing their production with the CWB or by other means. Agriculture and Agri-Food Canada, *Marketing Freedom for Grain Farmers*, <http://www4.agr.gc.ca/AAFC-AAC/display-afficher.do?id=1318619331542&lang=eng>.

7. These organizations are: Farm Industry Review Board (Newfoundland); Nova Scotia Natural Products Marketing Council; Prince Edward Island Marketing Council; New Brunswick Farm Products Marketing Commission; Régie des marchés agricoles et alimentaires du Québec; Ontario Farm Products Marketing Commission; Manitoba Farm Products Marketing Council; Saskatchewan Agri-Food Council; Alberta Agricultural Product Marketing Council; British Columbia Farm Industry Review Board; Northwest Territories Agricultural Products Marketing Council.

8. Fédération des producteurs de porc du Québec, *Hog Marketing Agreement 2009-2013*, s. 6.1.1.

choose whom to deal with among their members.<sup>9</sup> Ultimately, endowing marketing boards with such a prerogative opens the door to potential rigidity.

Monopoly power also allows the marketing boards to determine who will receive what quantities of controlled commodities among their clients, often processors of agricultural products who use those commodities to make consumer products. A marketing board can therefore decide to allocate its commodities not on the basis of the needs of its clients as reflected by market demand, but by taking other factors into account (buying history, for example), especially when a board also manages supply.

So, when a buyer wishes to obtain a product with specific characteristics, he will be dependent on the willingness of the monopoly to follow up on this request. A new slaughterhouse, for example, might not receive any animals because it does not have a delivery history. New needs might not be satisfied for lack of agricultural products, while at the same time surpluses pile up with a competitor. These powers to allocate commodities, to choose clients and to decide whether or not to respond to new demands constitute a regulatory burden.<sup>10</sup> They also represent a risk for businesses looking to innovate, since such businesses have to reach some sort of agreement with the marketing board without the possibility of negotiating with a competing supplier.

In certain sectors, payment for products passes through the board, which can deduct certain amounts to fund its operations. The collection of payments for their products also allows certain boards to carry out generic promotion of those products. It furthermore allows the pooling of total sales revenues and the allocation of identical payments to producers. The boards can also control the transportation of products, negotiate with carriers, pool transportation costs and take care of their payment after having deducted cer-

tain amounts from sales. The boards therefore have the possibility of determining if products are to be paid for by buyers without regard for the costs incurred to transport them from their starting points to the points of delivery. This intervention has the effect of changing the incentives that influence the location of processing plants.

## Supply management by quota

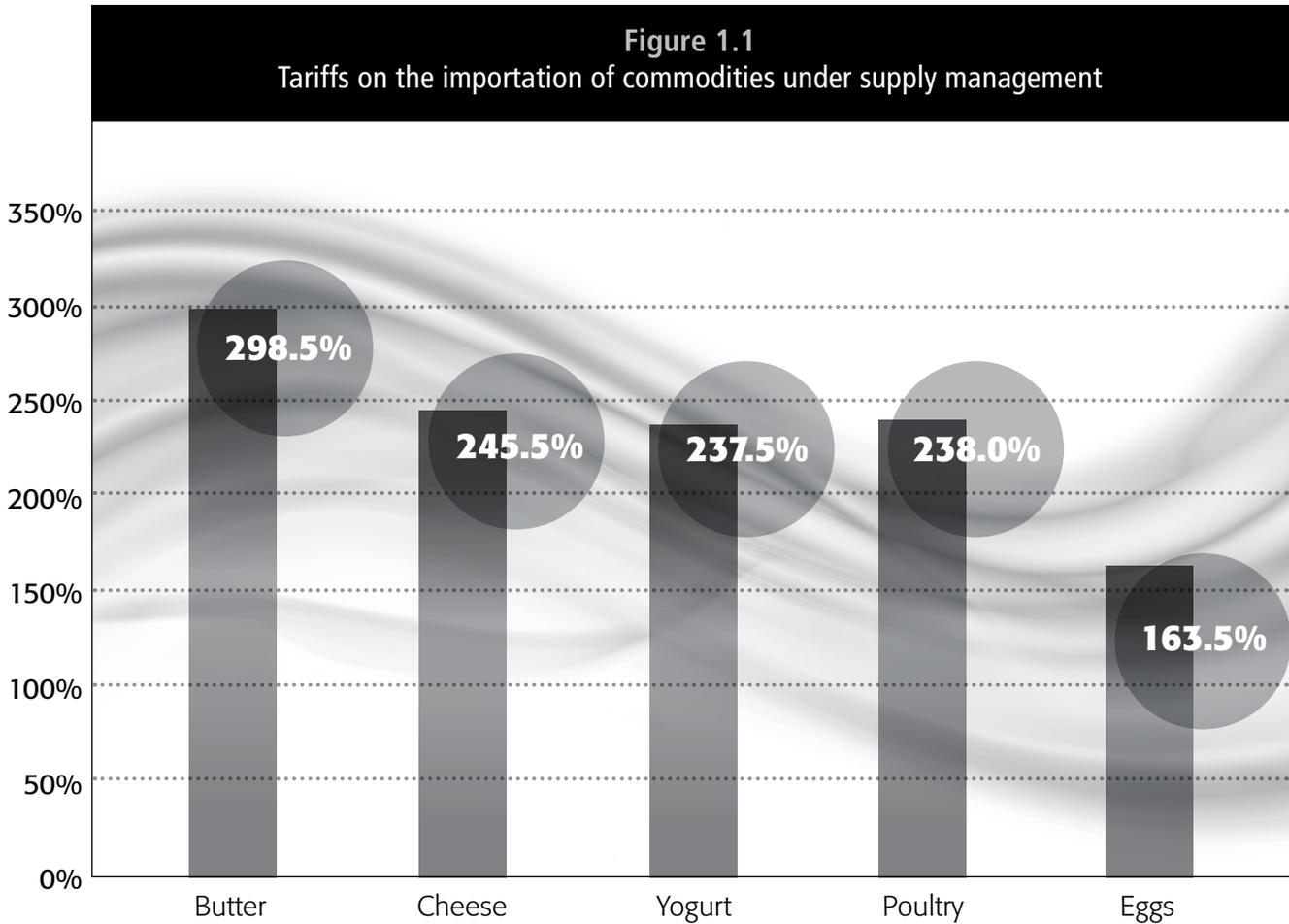
Marketing boards with supply management powers also determine the total volume of production. Such boards regulate production with production permits, or marketing permits, which are called quotas. Originally, these are handed out at no charge. They allow the marketing boards to determine the quantity that will be produced in order to help set prices. Managing the ownership of the quotas also allows the boards to determine if they are transferable, if they can be sold and if so, how this will happen. The need to own quotas in order to produce allows the boards to control entry into the market for production covered by the quotas as well as expansion by individual businesses and the overall volume of production.

For the supply of a product to be effectively controlled, imports must also be controlled. This is done in Canada through import quotas and tariffs. Tariffs are taxes paid to the Canadian government in order to import goods. Import quotas are established within the framework of current World Trade Organization agreements. They allow certain quantities of a product to be imported at a low or zero tariff. For example, the import quota for chicken is 7.5% of the interior market, while the quota for cheese amounts to nearly 5% of the market.<sup>11</sup> Above these fixed quantities that can enter the country tariff-free or with a low tariff, the full tariff applies to the value of the goods, increasing their cost and drastically reducing their competitiveness in the Canadian market. For all practical purposes, these tariffs are so high that they prevent significant levels of imports. Figure 1.1 shows examples of these tariffs.

9. See: Ontario Processing Vegetable Growers, *Regulation No. 1*, February 2012.

10. In Quebec, the Régie des marchés agricoles et alimentaires (Agriculture and Food Marketing Board) indicates that there were 298 regulations to follow as of March 2011. Régie des marchés agricoles et alimentaires du Québec, *Rapport annuel de gestion 2010-2011*, p. 18.

11. Foreign Affairs and International Trade Canada, *Cheeses of all types and Chicken and Chicken Products*, notices no. 781 and no. 792; and data compiled by Agriculture and Agri-Food Canada, Dairy Section.



Source: Canada Border Services Agency, *Customs Tariff: Departmental Consolidation 2012*, July 2012.

The responsibility of managing supply further allows marketing boards to modulate the sale price of products as a function of the use buyers will make of them. Generally, the price of a commodity doesn't change according to the identity of the buyer or the use envisioned. But in the dairy sector, for instance, milk is sold at different prices depending on whether it will be used to make butter, cheese of one kind or another, yogurt, etc., even though the quality of milk and the delivery conditions are the same. Another example of price discrimination is that cheese destined to be incorporated into a frozen pizza sold in grocery stores, which must deal with international competition, is lowered so that the cheese is sold to the pizza maker at an internationally competitive price. However, restaurant pizzas do not enjoy this benefit. The legislator might have presumed that there is no international competition to local restaurants making pizzas. Nevertheless, restaurant pizzas have to compete

with substitute products like grocery store pizzas, to which they lose some business marginally because the prices and competitiveness of their products is affected by these differentiated rules.

### An anti-competitive anomaly

The strong position that the marketing boards enjoy stems directly from the monopoly power they are granted by Canadian law. In this regard, we should not lose sight of the fact that governmental authorities in democratic countries are entrusted with the mission of fighting monopolies and promoting competition. In order to do this, Canada, like other countries, equipped itself with anti-monopoly legislation and created a Competition Bureau to deal with the issue. In virtue of the monopolistic powers granted to them, the marketing boards can compel all producers to join, which constitutes a glaring exception to the principle of competition.

## CHAPTER 2

# Impact on Agricultural Production

Public policies are implemented in order to achieve certain objectives, and it is always possible to debate their relevance. However, even when everyone agrees on the advisability of the objectives pursued, policies must be evaluated on the basis of the results they achieve and the consequences they entail. This chapter will measure the concrete impact of agricultural policies on producers in order to evaluate whether or not they achieve their objectives.

The objectives of the agricultural policies that are widely considered to have given rise to the marketing boards are:

- to create the conditions for farm families to have income levels comparable to those of other families;
- to increase farm income;
- to stabilize farm income;
- to preserve family farms.

The first two objectives were pursued at different times. When governments began to intervene to increase farm income over the course of the last century, the motive invoked was usually formulated in relation to the income levels of farm families. It is less and less common for government to formulate its intentions in these terms since the average income of farm families<sup>1</sup> in Canada today is greater than that of other types of families.

For example, the average income for farm families who own non-incorporated farms<sup>2</sup> was

\$100,053<sup>3</sup> in 2009 compared to \$72,400<sup>4</sup> for all families. Net operating profits of a farm, at \$22,683, represent a fifth of the income of farm families. If their incomes are higher, it is because of off-farm income, which represents 77% of their total revenues. This has to be considered since, for farm families as for any family, there shouldn't be an expectation that all family members will pursue the same professional activity. What's more, the net worth of a Canadian farm is estimated at \$1,522,080 on average in 2010. Although there is no exact equivalence between the net worth of farms and the net worth of farm families, this figure is substantial considering that the average net worth of all households is less than \$400,000.<sup>5</sup> With 38% higher incomes and substantially more acquired wealth, there is no longer any social justification for a redistribution of income from Canadian families in general to farm families.

As a result, the groups lobbying for farmers are now more likely to call for government interventions to increase the incomes of farms instead of the incomes of farm families. How has this second objective fared?

### Increasing farm income?

To appraise the results of marketing boards with regard to the objective of increasing farm income, there are two different situations to consider. Results obtained by marketing boards with or without supply management differ. Each one needs to be examined separately.

### Marketing boards without supply management: no effect

In 2010, Laurent Pellerin, then-president of The Canadian Federation of Agriculture (CFA), stated that a great challenge united farmers from one ocean to the other: namely, the inadequacy of their income levels. According to him, for 25 years, all around the world, farmers have been poorly paid.<sup>6</sup> Also, in a Canadian government report, Wayne

1. The concept of farm family refers to families "involved in a single unincorporated farm with total operating revenues of \$10,000 and over."  
2. Non-incorporated farms have not issued shares. They are either a "sole proprietorship operation" or a "partnership with or without a written agreement."

3. Statistics Canada, CANSIM Table 002-0024 (the data for 2009 are the most recent).  
4. Statistics Canada, CANSIM Table 202-0403.  
5. Statistics Canada, CANSIM Tables 002-0065, 202-0409, and 378-0012.  
6. Hugo Fontaine, "Le nouveau champ de bataille de Laurent Pellerin," *La Presse*, February 20, 2010.

Easter states that the farm income crisis for family farms is not a short-term or cyclical situation. According to him, it is in fact systemic and long-term, and also global. He mentions that the same situation can be observed in Canada, in the United States, in Europe and in Brazil.<sup>7</sup>

Moreover, OECD researchers indicate that “over the last two decades, the majority of government agricultural policies and programs in OECD countries have been highly ineffective in translating support into additional income for farm households.”<sup>8</sup>

It’s a fact that the profitability of farming is still low in general when one considers only current revenues.<sup>9</sup> The marketing boards that do not have supply management powers have not managed to raise prices significantly higher than those that prevail in other markets, despite their monopoly on the sale of particular products. This is mainly the result of the fact that these products are not sold on markets that are sheltered from international competition.

In certain cases, the boards succeeded in equalizing the prices received by producers thanks to revenue sharing. However, this was often accomplished through the introduction of standards that interfere with product differentiation. The bottom line is that government policies and expenditures in agriculture have not achieved this objective that motivated their adoption in the case of marketing boards without supply management powers.

## Marketing boards with supply management powers: an apparent success for farmers’ incomes

In the case of marketing boards equipped with the responsibility of managing supply, the objective of raising and stabilizing the prices received by farmers seems at first glance to have been achieved. The representative example of milk clearly shows that the price paid to dairy producers in Canada really is higher than it is elsewhere, as illustrated by Figure 2.1.

The farm price of milk in Canada in 2010 was \$72.11 for one hundred kilograms compared to \$37.13 in the United States and \$41.66 in the European Union.<sup>10</sup> This higher price is inevitably passed on to buyers.

Moreover, the price paid to milk producers is more stable and is generally rising in Canada, which is not the case in the United States or in Europe, as shown by Figure 2.2. A comparable situation is observed in the poultry sector.

And yet, high farm prices are not synonymous with high farm incomes. In any new production under supply management, higher income stemming from higher prices can only be obtained through buying production quotas. Since the value of quotas appears only in the balance sheet, it isn’t taken into account in current income statistics. Nevertheless, to really understand the economic impact of supply management on income, quotas must be factored in.

## The value of quotas reduces farm income

Just as the researchers who studied supply management had predicted and observed as far back as 1959, the rise and stabilization of product prices come at a cost. The profitability of these sectors would normally encourage established producers to increase their production and attract new producers who also want to produce commodities whose prices are high and stable. However, the whole point of supply management is to reduce supply by granting a limited number of production rights or quotas.

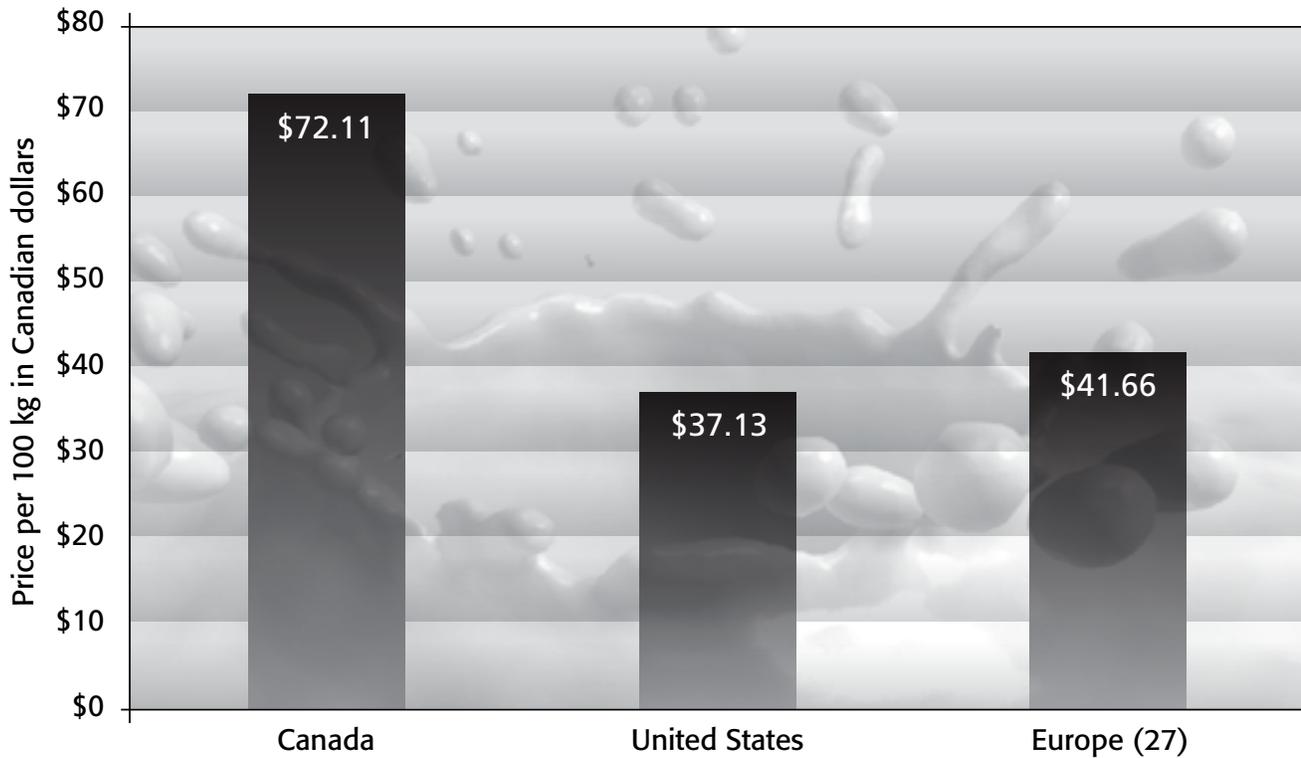
7. Wayne Easter, *Empowering Canadian Farmers in the Marketplace*, July 2005, p. 7.

8. Agriculture and Agri-Food Canada, *Economic Backgrounder: OECD findings on policy performance and design*, November 2006, p. 3.

9. A standard financial indicator, the leverage effect, shows that return on assets has been lower than the interest rate paid on borrowed funds in farming for recent decades in Canada. Hence, interest paid on loans to acquire assets are higher than the profitability of those assets. The leverage effect is therefore negative in agriculture. The low profitability of farming is not a Canadian phenomenon. The same negative leverage effect has been observed in the United States. But this measure also has its shortcomings, not taking into account asset appreciation, as we will see below. USDA, *Farm Financial Ratio Indicating Solvency and Profitability, 1960-2011* and Statistics Canada, *Balance Sheet of the Agricultural Sector*.

10. International Dairy Federation, *The World Dairy Situation 2011*, 2011, p. 217.

**Figure 2.1**  
Price of milk paid to producers in 2010



Sources: International Dairy Federation, *The World Dairy Situation*, 2011, p. 217. Prices in Canadian dollars, according to exchange rate for 2010 by the Bank of Canada.

As a result of the strong demand for these quotas, whose supply is limited, their price increases.<sup>11</sup>

In practice, the high price of quotas reflects what producers expect to earn as extra profits thanks to supply management. In economic terms, the price of the quota corresponds to the discounted value of future profits in excess of normal profits. We therefore speak of the *capitalization* of these benefits in the price of quotas.<sup>12</sup> According to an OECD study, only 24% of the transfers to guarantee the price of farm products actually increase prices while the remaining 76% is capitalized or used to pay for increased input prices.<sup>13</sup>

The increases in farm income are therefore misleading since this income does not take into account the value of the quotas. For those who received the quota when they were first implemented, the rising value of the quota represents an addition to their net worth. But those who must buy quotas in order to increase or begin production will pay an amount equivalent to the extra profitability stemming from the management of supply. Since the quota is really just a piece of paper authorizing the sale of a product, this amount paid for the quota must be taken into account to give an accurate idea of the farm income gained from this production.

In this light, the farm income of any new production represents a return on investment. And this investment includes the capital invested in the form of quotas.<sup>14</sup>

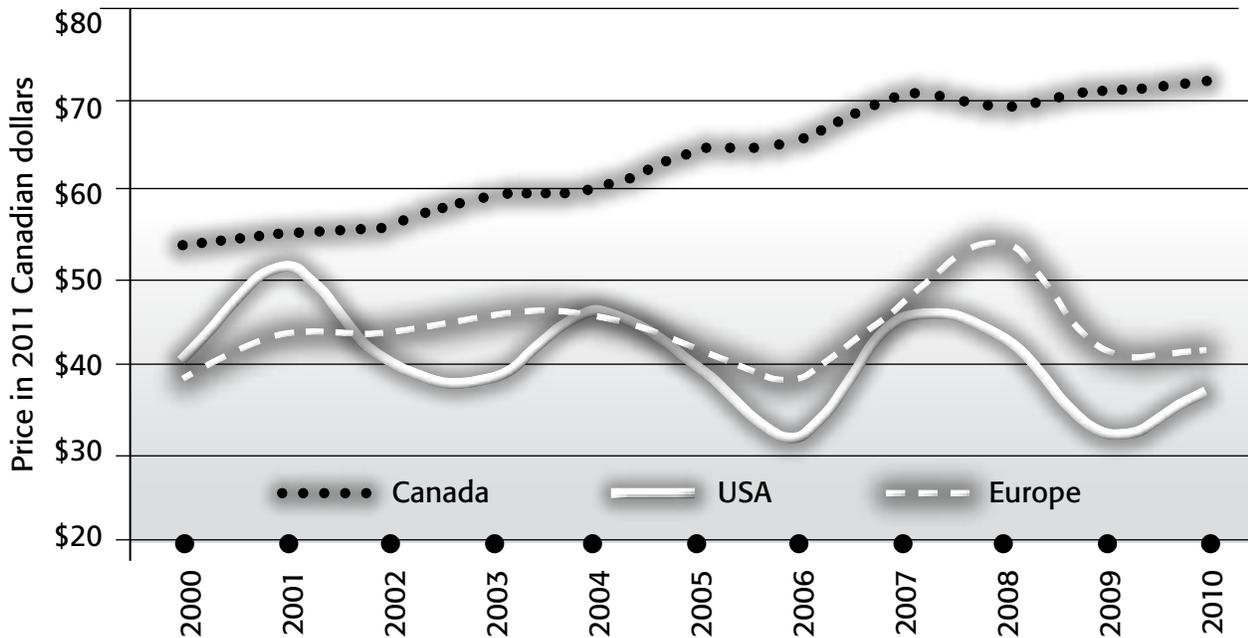
11. Willard W. Cochrane, "Some Further Reflections on Supply Controls," *Journal of Farm Economics*, Vol. 41 (1959), No. 4, p. 700.

12. Excess profits are capitalized in the price of quotas when these are freely negotiable. When this is not the case, and price limits are imposed on traded quotas or quotas are not allowed to be traded at all, the capitalization of excess profits occurs in the prices of assets to which the quotas are linked, which amounts to essentially the same thing from an economic standpoint.

13. OECD, *The Incidence and Income Transfer Efficiency of Farm Support Measures*, July 2002, p. 15.

14. Christopher Green, "Agricultural Marketing Boards in Canada: An Economic and Legal Analysis," *The University of Toronto Law Journal*, Vol. 33 (1983), No. 4, p. 414.

**Figure 2.2**  
Milk prices received by producers (\$CA/hectolitre)



Sources: International Dairy Federation, *The World Dairy Situation*, 2011 and Bank of Canada.

As a case in point, an agricultural economist crunched the numbers for the Quebec dairy industry using the data for 2002. By deducting the cost of dairy quotas from producers' income, he came to the same conclusions. He supposed that this cost was paid with the help of a loan with a hypothetical interest rate of 7%, the rate that was then current for this kind of investment. It is clear that the purchase of quotas represents a cost that a farmer will have to bear for a long time, either by paying interest or by foregoing a return.

His calculations show that a dairy producer in Quebec only received \$12.67 more per hectolitre for his production than the price in the American Northeast while he paid \$19.39 in interest in order to be allowed to produce it. The cost of the quotas was therefore greater than the future profitability of a higher priced and stable production. In this case, the supply management system actually reduces farm income.<sup>15</sup>

In other words, if, according to this example, Quebec dairy producers could have obtained the same price as Northeast American producers in the absence of a supply management system, they would no longer have had to bear the cost of quotas and would have earned higher farm incomes than they currently do.

### Relevance of increasing farm income

Having established that the objective of increasing farm income has not been achieved, an important question remains: is increasing farm income even a relevant objective? After all, Canadian agriculture has not disappeared. If the profitability of agriculture were really so inadequate, why would farmers continue to invest in it?

The explanation of this apparent paradox rests on the fact that the goal of increasing farm income also suffers from a measurement problem. Only current farm income is considered, and it remains low, both without supply management and with supply management when the prohibitive cost of quotas for new production is taken into account.

15. Jean Nolet, *La compétitivité des fermes laitières québécoises : quand on se compare, est-ce qu'on se console?*, Conference presented during the Colloque de l'entrepreneur gestionnaire, Centre de référence en agriculture et agroalimentaire du Québec, November 24, 2005, p. 5.

**Table 2.1**  
Balance sheet per farm in Canada (2009 dollars)

	Assets	Liabilities	Net worth
1993	\$875,008	\$137,909	\$737,100
2009	\$1,695,298	\$323,146	\$1,372,153
Growth in average net worth : \$635,053			

Source: Statistics Canada: *Farm Financial Survey*, March 2011, p. 24.

However, the current profitability of farming activities is not the only relevant factor. Farmers also take into consideration the growth of the value of the assets in their possession. The rising value of assets is a result of either appreciation or reinvestment by farmers.

Asset appreciation does have an impact on profitability. For example, the profitability of an investment in company shares or a rental property is not measured solely on the basis of the income generated, whether in the form of a dividend paid out by the company or of rents generated by the property. Investors also consider the appreciation of the shares or the properties that they hold when evaluating the profitability of their investments. The same should hold true in agriculture, where current revenues and asset appreciation should both be considered by agricultural policies.

As for reinvestment by farmers, it constitutes a clear indication that the profitability of farming is satisfactory enough, even if revenues appear small overall. In fact, many agricultural producers succeed in the marketplace through their efficiency and their ingenuity. There is an exception to this reasoning worth mentioning: a non-negligible fraction of farmers are involved in farming regardless of its current or future profitability. Some, for example, operate what specialists call hobby farms. Others who have reached retirement age choose to scale back their agricultural operations but want to remain on their farms. This can partly explain the low profitability of some farms, and why those farms remain in operation nonetheless, but such practices don't justify taxpayers or consumers subsidizing this type of activity. In any case, it should not be the goal of agricultural policies and marketing boards to increase agricultural income, which is either high enough to

justify reinvesting or just not relevant in the case of hobby farms.

Both asset appreciation and reinvestment have caused the average net worth of agricultural businesses to grow by more than \$635,000 over 16 years, or nearly \$40,000 per year, as shown in Table 2.1.

In other words, marketing boards didn't achieve their stated objective of increasing farm income, even with supply management. But the objective appears even less relevant in view of the fact that, at the end of 2010, farmers held total agricultural assets of \$352 billion.<sup>16</sup>

## Stabilizing farm income?

What about marketing boards' goal of stabilizing agricultural income? It is true that the boards with supply management powers have succeeded in this regard better than the others. Indeed, in order to stabilize *agricultural income*, it is invariably necessary to stabilize *the price of agricultural products*. As we have seen with the example of milk prices, this is what the supply management system allows by forcing buyers of agricultural products to bear the cost of this stability. For those boards with a monopoly on product marketing alone, as have existed for many years in the pork sector, product prices and producer incomes have remained unstable.

Other kinds of interventions can guarantee the prices of agricultural commodities. But those programs are altogether different from collective marketing through a marketing board. A program aiming to stabilize income would pay out support when incomes were low and would be paid back when incomes were high. Indeed, programs known as "agricultural income stabilization" have been implemented by governments even though they are generally agricultural subsidies instead of insurance programs.

## Relevance of stabilizing farm income

Beyond considerations of the effectiveness of

16. Statistics Canada, *Balance Sheet of the Agricultural Sector*, January 2012, p. 6.

measures to stabilize the incomes of agricultural producers, a more fundamental question must be asked: Is it necessary or fair for governments to impose on taxpayers or consumers the price of stabilizing one sector's income?

When governments themselves take on the responsibility of stabilizing the incomes of agricultural producers, by making taxpayers ultimately bear this burden, farmers no longer feel responsible for adopting such measures themselves. Agricultural businesses, however, do of course have options at their disposal for stabilizing their income. For example:

- Diversifying their production;
- Rearing animals while also producing feed for their herds;
- Collaborating among themselves to form businesses, cooperatives or others, in order to market or process their products or for the purchase of inputs;
- Forming contractual partnerships with processors or suppliers of inputs;
- Purchasing financial derivatives to partially guarantee future market prices;
- Etc.

The goal of stabilizing agricultural income is sometimes assigned to government under the pretext that farming is riskier and more uncertain than other sectors of the economy. It would therefore require more government assistance than other sectors. This conventional wisdom is questionable.<sup>17</sup> It is based on the fact that farming must deal with random and unpredictable adversities, such as bad weather, epidemics, and other natural disasters. Due to a relatively inelastic demand for agricultural products in the short term—quantity demanded varies little whether in times of shortage or in times of plenty—these adversities generate high volatility in agricultural prices.

And yet, if the prices of many agricultural com-

modities are relatively unstable, they are not more so than those of products like paper, steel, copper, gold, natural gas, oil, or other metals and minerals that do not enjoy comparable policy protection. Moreover, while farmers must deal with the risks of bad weather and epidemics, other sectors are faced with other risks, for example interruptions in the supply of inputs. Finally, if farming suffers from unstable production and benefits from stable demand, lots of other sectors must deal with the opposite state of affairs, enjoying stable production but suffering from highly variable demand. Demand shocks can be every bit as important as supply shocks and entail very significant consequences.

## Preserving family farms?

Another motive often invoked to justify government interventions in support of agriculture is the desire to preserve an agriculture based on family farms.

It is hard to define exactly what is meant by this concept. We can however examine if marketing boards have managed to check the decline in the number of farms in those sectors where they have the widest prerogatives, namely the dairy and poultry sectors. There were 145,318 dairy farms in 1971,<sup>18</sup> when the supply management system was put in place. There were only 12,965 remaining in 2010, a 91% reduction in the number of farms over 40 years.<sup>19</sup> There were 112,938 farms on which poultry was raised in 1976, and this number had fallen to 7,756 in 2011, a 93% reduction in the number of farms.<sup>20</sup>

The decline in the number of farms in developed countries is a universal phenomenon. This does not mean, however, that the farms are simply abandoned, or that cultivated acreage is shrinking. Rather, certain agricultural enterprises expand their operations by purchasing and integrating other enterprises, which increases their size and their production but reduces the total number of farms. Technological advances in agriculture have made economies of scale significant,

17. Barry K. Goodwin, *We're Not in Kansas Anymore: Is There Any Case for Ag Subsidies?*, American Enterprise Institute, July 2012, p. 2.

18. W.H. Heck, *A Propensity to Protect: Butter, Margarine and the Rise of Urban Culture in Canada*, Wilfrid Laurier University Press, 1991, p. 132.

19. Canadian Dairy Information Center, *Number of Farms, Dairy Cows and Dairy Heifers*, [http://www.infolait.gc.ca/index\\_e.php?s1=dff-fcil&s2=farm-ferme&s3=nb](http://www.infolait.gc.ca/index_e.php?s1=dff-fcil&s2=farm-ferme&s3=nb).

20. Statistics Canada, *Selected Historical Data from the Census of Agriculture*, December 2007; Statistics Canada, *Farm and Farm Operator Data*, May 2012.

**Table 2.2**  
Differences in profitability according to efficiency

<b>Production costs for feeder pigs</b>	
Least efficient group (cost per pig)	\$162.71
Most efficient group (cost per pig)	\$125.56
Difference	\$37.15
Average production per farm (number of pigs)	4,978
Difference in production costs for an average farm between the most and least efficient	\$184,932.70
.....	
<b>Production costs for grain corn</b>	
Least efficient group (cost per tonne)	\$201
Most efficient group (cost per tonne)	\$137
Difference	\$64
Average production per farm (tonnes of corn)	1,610.40
Difference in production costs for an average farm between the most and least efficient	\$103,066

Source: Michel R. Saint-Pierre, *Une nouvelle génération de programmes de soutien financier à l'agriculture*, Ministère du Conseil exécutif, February 2009, p. 13.

and the average production per farm has grown tremendously. As a result, despite the overall growth in production volume around the planet, the number of farms is everywhere in constant and dramatic decline. The change in the number of producers in the dairy and poultry sectors in Canada has not bucked this global trend.

The same kind of observation can also be made in sectors with marketing boards that do not manage supply. For example, hogs were raised on 122,479 farms in Canada in 1971,<sup>21</sup> while this number had fallen to 6,999 in 2011,<sup>22</sup> a 94% reduction. It

is therefore false to claim that marketing boards are able to protect family farms.

### Relevance of preserving family farms

Not only has the objective of preserving family farms not been achieved, but it is worth asking whether or not it was a laudable goal in the first place. Increasing agricultural productivity seems like a much more important objective, and in this regard, large agricultural enterprises are much more successful. When we examine the data on farm size, we can see that the largest 20% account for around 82%<sup>23</sup> of total operating revenues. We also observe that their current profitability is higher, and that the

21. Agriculture and Agri-Food Canada, *Profil statistique de la chaîne d'approvisionnement du porc*, December 2005, p. 11.

22. Canadian Pork Council, *Statistics*, <http://www.cpc-ccp.com/statistics-farms-e.php>.

23. Agriculture and Agri-Food Canada, *An Overview of the Canadian Agriculture and Agri-Food System*, 2011, p. 97.

growth in asset value and net worth of these farms is even more impressive.<sup>24</sup>

Productivity also plays a role in profitability since, within a single production sector, profitability varies greatly according to the efficiency of each business. If we compare the production costs of the most efficient businesses with those of the least efficient in a single sector, the discrepancies are striking.

Table 2.2 illustrates this fact for two production sectors in the province of Quebec, pork and grain corn, for which La Financière agricole du Québec periodically conducts scientific analyses of production costs as a part of its Farm Income Stabilization Insurance program.

These differences are often linked primarily to the sizes of the businesses. Other factors also play a role, like management know-how and the businesses' levels of debt. At any rate, the bottom line is that preserving small farms at all cost has negative consequences on productivity.

## Falling short on every objective

The negligible impact of marketing boards without supply management powers on the profitability of agricultural production—in addition to their inflexibility—has led several provinces to question the advisability of marketing monopoly power in certain sectors. This was the case in British Columbia in the fruit sector and in Ontario in the pork and wheat for human consumption sectors, in which producers are now allowed to market their products freely. The federal government has also abolished the marketing monopoly for wheat and barley held by the Canadian Wheat Board.<sup>25</sup>

Even in the case of marketing boards with supply management powers, the gains in terms of income are offset or even wiped out altogether by the costs of marketing quotas. The goal of increasing

farm income itself seems ill-advised since it does not take into account the increase in value of farm assets which is added to current income.

The goal of stabilizing agricultural income is achieved only by those boards with supply management powers, which can transfer the costs of such stabilization onto buyers of agricultural commodities. Programs unconnected to marketing boards, like the federal Agricultural Risk Management program, also achieve this goal, but only because they foist their costs onto taxpayers.

And yet, many other sectors have to deal with unstable sources of income and neither consumers nor taxpayers are called upon to remedy this situation. Government interventions financed by taxpayers and consumers are hard to justify in light of the risks undertaken by market players in other sectors of the economy on whose behalf governments feel no obligation to intervene. Who has ever recommended, for example, government intervention to smooth over the weather-related risks that confront those who work in the tourist industry? Even if weather is uncontrollable, private investors bear the risks at their own cost. They also make additional profits when conditions are better than average.

Since the number of farms has fallen sharply in recent decades, the goal of preserving family farms has clearly not been achieved either. Given agriculture's economies of scale and increases in agricultural productivity, the preservation of small agricultural farms should not be an objective pursued by the government through subsidies paid by consumers and taxpayers. The largest farms account for the vast majority of production and the most efficient farms are much more profitable than their inefficient counterparts.

The results achieved by organizing agriculture into monopolies through the mechanism of marketing boards clearly fall short of stated objectives, except in certain rare cases and at the cost of a transfer from consumers and taxpayers to agricultural businesses. But the consequences of the existence of marketing boards do not stop there, as the following chapter explains.

24. Michel R. Saint-Pierre, *Une nouvelle génération de programmes de soutien financier à l'agriculture*, Ministère du Conseil exécutif, February 2009, p. 13.

25. The monopoly of the Canadian Wheat Board was abolished in August 2012, giving producers the choice to market their production with the Board or by other means. See: Agriculture and Agri-Food Canada, *Marketing Freedom for Grain Farmers*, <http://www4.agr.gc.ca/AAFC-AAC/display-afficher.do?id=1311891454058&lang=eng>.

## CHAPTER 3

# Consequences for Processors and Other Links in the Agri-Food Chain

Our current business environment requires intense coordination between the industry's various links, collaboration between many actors and constant innovation. The *raison d'être* of the marketing boards, namely the idea that the agricultural sector must establish a balance of power with the buyers of its products, looks more and more anachronistic with each passing year.

How is it possible for processors of agricultural products to play their designated role in the agri-food chain as well as they can if they must face off against their suppliers in an attempt to gain the upper hand instead of establishing a collaborative relationship with them in order to satisfy, in a competitive fashion, the final demand of consumers for their products?

Marketing boards, by their very presence, entail consequences that are felt all along the agri-food chain. This chapter aims to illustrate those consequences for various links in the agri-food chain, including consumers.

### The complexity of the pork sector

To visualize just how important cooperation is to the agri-food industry's ability to satisfy demand, let us examine the complexity of the agri-food chain by taking a single example, that of the pork sector. The starting point for this production, like many others, is the genetic material. For instance, are we dealing with *Yorkshire*, *Landrace*, *Duroc* or *Hampshire* hogs? These pigs can come from foreign suppliers.

From these animals, sows are produced that are then sent to maternity barns. Other centres

produce the sperm destined for the insemination of the sows, a practice that is more and more common in this sector and that has been used for a long time in the dairy sector. Once out of the maternity barns, piglets are directed to nurseries. From the nurseries, they are then sent to finishing sites. When they reach the desired weight, they are transported to slaughterhouses.

During the whole rearing stage, nutrition is provided by businesses that specialize in livestock feed. The products used to feed and care for the animals must be tracked, and so must the manner in which they are housed and treated. Specialized companies are called upon to transport the animals between the various links in the production chain.

After slaughter, the carcasses are processed into pieces of meat and delicatessen. The products of this activity are then sent to centres that handle distribution to the retail network, or to restaurants and cafeterias. It is at this moment that the product comes into contact with consumers.

Consumers are interested in the price of the meat they buy, of course, but also in its quality and safety. Some want to know how the animal was reared, fed, transported and slaughtered. Certain consumers demand meat from animals that were reared without antibiotics or without growth hormones. Product conservation methods are also scrutinized. Some consumers want organic products, while those in the "buy local" camp want products that have not traveled too great a distance. Certain community-supported farming enthusiasts want to buy foods that have not been through the typical food-processing chain.

Not every consumer will exhibit behaviour that combines all of these concerns, and all will have their own preferences. The diversity of needs expressed by consumers is truly impressive. To succeed in such a market, a distributor must take into consideration the concerns of the various segments of its clientele. The current degree of centralization of the distribution networks is considerable, however, which makes adaptation to a multitude of preferences more difficult.

## The need for traceability and the Coopérative fédérée

The clients of a fast food chain may not all be terribly concerned about the wellbeing of the animals and the rearing methods that might affect them. The managers of the chain, however, are aware that certain organizations may scrutinize their rearing methods and the way their animals are treated. As a result, they ask their suppliers to give them an account of such matters.

These kinds of concerns are felt all along the supply chain. It therefore becomes necessary for agri-food sector businesses to implement traceability mechanisms, which is to say mechanisms that keep track of how everything is done at each step of the process. And the implementation of traceability mechanisms requires close collaboration among all of the actors in an industry.

It is these kinds of considerations that brought the Coopérative fédérée and the Quebec Pork Producers' Federation into conflict for a few years between 2000 and 2010.<sup>1</sup>

The Coopérative fédérée, a federation of farming cooperatives from Quebec, Ontario and New Brunswick, has a massive presence in the Canadian pork sector. Along with other affiliated cooperatives, it forms what is known as the coop network. This network is involved in the rearing of sows for maternity barns through its affiliate Sogeporc. Affiliated cooperatives and member producers rear hogs that are fed with feed and ingredients supplied through its network.

The Coopérative fédérée is also the main shareholder of Olymel, one of the most important pork processors in Canada. This company is very much involved in the export of Canadian pork destined for various markets, especially the Japanese market. Now, Japanese buyers are very particular about the methods and procedures used in the slaughter and processing of the products they buy. They even go

to the trouble of visiting and inspecting production sites and examining the methods that are used there.

Consequently, a few years ago in Quebec, the farmer-owned coop network wanted its pork products destined for the Japanese market to be labelled “coop pork.” The network wanted to pay its members a premium for hogs that were to be reared in accordance with certain specifications. Among other characteristics, these products would have come with a waybill that included the genetic origins of the pigs, the rearing method and the manner in which they were fed, as well as the manner in which the animals were slaughtered and processed.

In order to implement this “coop pork” concept, the rearing and slaughter conditions of each pig must be controlled. Unfortunately, the production from the network's herds were not directed to its own slaughterhouses and processing plants, but rather, as required by the system described in the first chapter, were sent to the marketing board. The marketing board could deliver these pigs to a slaughterhouse outside the coop network and deliver to coop slaughterhouses pigs from herds outside the network.

The network finally came to an agreement with the marketing board allowing it to slaughter its own pigs, but only after several years of negotiations and confrontations. During this time, the American pork industry seized the opportunity. While it had been having trouble satisfying the Japanese market's high standards of quality and traceability a few years earlier, it very quickly modified its methods without having to leap over the artificial hurdles of a marketing monopoly. The American pork sector thus carved out a greater share of this market for itself, to the detriment of Quebec pork.<sup>2</sup>

The current organization of the agri-food industry therefore does not take into account the need for greater collaboration between the various links in the production chain. The marketing boards play

1. Fédération des producteurs de porcs du Québec, *L'Indice*, Vol. 18, No. 2 (March 2006); Thierry Larivière, “Guy Coulombe explique son échec,” *La Terre de chez nous*, March 20, 2008, p. 4.

2. Mario Hébert, *Une analyse des grandes filières porcines mondiales*, March 2006, pp. 21-24. Total exports of US pork rose 178% between 2000 and 2005. Mr. Hébert cites evidence that the US pork industry's vertical integration was a key to providing Japanese consumers the quality of pork required and increasing their market shares.

the role of intermediaries between processors and the suppliers of their inputs, namely farmers. The boards are dedicated to creating and maintaining a favourable balance of power for producers over processors, but in the coop network example, the board bizarrely confronted a producer-owned network that it is supposed to benefit. Even where the long-term interests of farmers are concerned, the boards constitute an anachronism in a market that requires its producers and processors to be flexible and adaptable.

The Canadian pork sector, several provincial links of which used to be governed by marketing boards with monopoly power, has in fact been reformed in several provinces in order to put an end to this kind of situation, as was the case in Ontario in 2010. However, a pork marketing board still exists in Quebec. Even if its operating methods are continually changing, this board retains its monopoly power, which absorbs an enormous amount of energy and resources from the sector to the detriment of the flexibility required for it to innovate and compete on the international market.

### Consequences for the final link in the chain: consumers

The examples related to pork production illustrate some of the consequences of the actions of marketing boards that do not have supply management powers. In those sectors where there is supply management—including the dairy and poultry sectors—similar conflicts can occur. In these cases, there is also the fact that farm gate prices are much higher than they are elsewhere in the world, even in other developed countries, as we saw in chapter 2. In sum, these higher prices represent a financial transfer to producers, either from other agri-food companies or from consumers.

The difference is even greater when we consider world prices. The Organisation for Economic Co-operation and Development (OECD) measures the size of agricultural subsidies and designates as a *transfer from consumers to producers* the difference between the managed price for an agricultural commodity that prevails within a country and its

international price. The OECD used this measure to calculate that transfers from consumers to producers reached an average of \$3.9 billion per year from 2008 to 2010 in Canada.<sup>3</sup>

In a market economy that promotes healthy competition, productivity improvements due to innovation normally lead to lower production costs and a reduction in the real prices of goods. In a sector like milk, for example, productivity has increased considerably since supply management was introduced. This can be clearly seen in the data on milk production per cow, for example.

Unfortunately, these improvements are not passed on to the consumer through a drop in real prices because there is no competition between producers. On the contrary, productivity gains are largely capitalized in the value of quotas. In sectors controlled by marketing boards, Canadian governments have abandoned their mission of promoting competition, as opposed to other economic sectors that are subject to the *Competition Act* and watched over by the Competition Bureau. At the end of the day, it is consumers, agri-food businesses and farmers themselves who pay the price.

Marketing boards, especially those equipped with supply management powers, stem from a protectionist vision of farming. To a certain extent, there was a desire to shelter farming from competition and from the risks presented by innovation. The ability of farming to fully explore its potential was therefore somewhat circumscribed. This represents a kind of protection that is more and more outdated in an open world.<sup>4</sup> If Canada wants to maximize its agricultural potential and restore its credibility as an advocate for openness to global trade, it must take the steps required to liberate its agricultural entrepreneurs and liberate us all from the shackles that are the marketing boards.

3. OECD, *Agricultural Policy Monitoring and Evaluation*, 2011, p. 95.

4. Commission sur l'avenir de l'agriculture et de l'agroalimentaire québécois, *Agriculture and Agrifood: Securing and Building the Future*, 2008, p. 15.



## Conclusion: The Need for Change

The marketing boards were created with specific goals in mind, and they have failed to achieve them. If an agricultural policy does not produce the results it was designed to produce, and furthermore costs taxpayers and consumers billions of dollars, one should expect that it would be abandoned and replaced. The Canadian government has indeed just taken a first step in this direction in order to put an end to the Canadian Wheat Board's marketing monopoly over barley and wheat from the Prairies.

This is an important and laudable step. But logically, all farmers should enjoy this freedom to set out on their own and market their products themselves. It is time for governments to put an end to the marketing monopolies held by the marketing boards. In practice, the marketing boards do not need to be dismantled and their expertise need not be lost. Mandatory membership in collective marketing should be abandoned, however, allowing producers the opportunity to take care of their own marketing if they wish to do so. This would involve challenging the *Agricultural Products Marketing Act* adopted by the federal government in 1949, as well as the various federal and provincial measures that allow the existence of the marketing board systems.

### The situation in supply management

The prospect of dismantling supply management is far more delicate and requires a more thorough framework. Questioning the existence of a marketing board like the Canadian Wheat Board has no counterpart in the supply management systems. On the contrary, the federal and provincial governments keep reaffirming their commitment to defending Canada's supply management system tooth and nail in every international forum in which the liberalization of trade is discussed.

Various factors can be blamed for this attitude. First of all, the supply management systems do not

involve direct expenditures on the part of governments. It is rather consumers and processing companies that must bear the burden of monopolistic prices for products under supply management. In practice, though, Canadian consumers generally devote just a small fraction of their disposable incomes to feeding themselves, and the products under supply management in turn represent only a fraction of their grocery bills. Consequently, it is easy to understand why there exists no significant consumer lobby to pressure governments into changing these laws.

On the other hand, the agricultural lobbies for commodities under supply management carry significant political weight thanks to their extraordinary mobilization. Certain of their members have an interest in protecting high and stable prices for their products and in protecting the value of the quotas that they either received free of charge from the government, or at a reduced price from their parents, or that they acquired by purchasing them at a steep price. Those entrepreneurs who might wish to get involved in farming, whom the current system penalizes severely, are not members of these lobbies until and unless they set up their projects.

Finally, processing companies penalized by uncompetitive prices for their inputs are hesitant to denounce the system publicly. After all, they must deal with the marketing monopolies for their supplies. Moreover, the Canadian market for their product is generally protected from foreign competition by import tariffs, which do represent a benefit to them. These businesses also have the option of investing abroad in order to profit from the growth of the global market, as we see happening in the case of the large Canadian dairy businesses.

The result is that the political cost associated with a change of agricultural policy discourages most politicians. If the general public were better informed about the consequences of marketing boards and supply management, it would be a first step in getting our politicians to be open to change. It would also help if farmers became increasingly aware of missed opportunities due to current agricultural policy, opportunities that farmers in other countries have been able to seize.

## A few cases of the abandonment of supply management

In order to promote a change of agricultural policy, it is useful to briefly recall the cases of countries that have abolished or are in the process of abolishing quota systems: the buyback and abandonment of milk quotas in Australia, of tobacco and peanut quotas in the United States, the elimination of milk quotas in Switzerland and the beginnings of a process of abandonment of milk quotas in Europe.

The Australians put an end to the existence of milk quotas and to various other kinds of regulations in the industrial dairy subsector. This deregulation, begun in 1983 through the signature of a free trade agreement with New Zealand, was completed in the year 2000, at which point the sector was entirely governed by the market.<sup>1</sup> In addition to this long adaptation period, the Australian government also decided to set up a transition program for the dairy industry (*Dairy Industry Adjustment Program*) in the amount of almost two billion Australian dollars.<sup>2</sup>

These transitional measures are explained by the fact that a large number of dairy producers and of communities dependent on this activity need to adjust to the new reality. The transition costs were borne by consumers who are, according to the government, the principal benefactors of the deregulation thanks to lower prices for dairy products. An 11 cent per litre sales tax was therefore imposed on milk for direct consumption from July 2000 until February 2009, at which time it was abolished, the transition program having by then been entirely financed by this tax.<sup>3</sup>

The United States lived through the experience of putting an end to agricultural production quotas in its peanut and tobacco sectors. The production of peanuts had historically been governed by quotas in the United States. Free trade agreements like NAFTA

and World Trade Organization rules contributed to a reduction in the strength of measures that restrict imports. In addition to various other measures adopted to allow the sector to adjust to this new reality, the government set up a program that proceeded to buy back quotas from 2002 to 2006.<sup>4</sup>

In the tobaccos sector, a program to stabilize the market had existed since 1938. It included quotas that controlled production. But as the quantity and the quality of foreign tobacco gradually increased, imports slowly began to replace domestic tobacco. In 2004, the American Congress adopted a law that set up a 9.6-billion-dollar program to buy back tobacco production quotas over the following ten years.<sup>5</sup>

In Switzerland, Parliament decided in 2003 to abolish the milk quota system that had been in place since 1977. The goal was to promote a more flexible milk supply formula that was more sensitive to market signals and more competitive. The quota system ended in 2009 after a planned, three-year transition period.<sup>6</sup>

In Europe, the reform of the European agricultural policy adopted in 1999 and baptized Agenda 2000 had mentioned that quotas would not last indefinitely, especially the milk quotas that had been put in place in 1984. The European Commission proposed to increase the production authorized for each quota by 2% in 2008. A new reform of the policy called “Health Check” subsequently stipulated that as of April 1, 2009, there would be a 1% per year increase in the quota for the next five years, plus an administrative correction related to fat content that is equivalent to another 1% increase until the complete elimination of quotas on April 1, 2015.<sup>7</sup>

This tendency for industrialized countries to rethink their agricultural policies is in keeping with

1. Australian Dairy Industry Council, *Submission to European High Level Expert Group on Milk*, January 2010, p. 18.  
 2. Geoff Edwards, “The story of deregulation in the dairy industry,” *The Australian Journal of Agricultural and Resource Economics*, Vol. 47 (2003), No. 1, p. 92.  
 3. Australian Department of Agriculture, Fisheries and Forestry, *Australian Dairy Recent Experiences in a Deregulated Market*, p. 2.

4. Andrew Schmitz, Charles B. Moss, Troy G. Schmitz, Hartley W. Frutan, and Helen C. Schmitz, *Agricultural Policy, Agribusiness, and Rent-Seeking Behaviour*, second edition, University of Toronto Press, 2010, p. 152.  
 5. *Id.*  
 6. Jacques Chavaz, *The Swiss milk market*, Presentation at the Panel of the High Level Experts Group on Milk, January 12, 2010, p. 1.  
 7. Julian Binfield, Trevor Donnellan, and Keven Hanrahan, “An Examination of Milk Quota expansion at EU member State Level with specific emphasis on Ireland”, *107<sup>th</sup> Seminar of the European Association of Agricultural Economists*, 2008; European Commission, *Health Check of the Common Agricultural Policy*, February 2009.

a desire for competitive agricultural sectors, to the benefit of both consumers and producers. Canada could certainly draw some inspiration from these countries' experiences.

## How to proceed

Agricultural quota systems which are central to supply management can also be challenged. The estimated value of quotas in Canada is on the order of \$30 billion.<sup>8</sup> These quotas were distributed free of charge originally. However, their straightforward elimination, overnight and without compensation, has little chance of happening. Indeed, those who received the free quotas originally are generally no longer in production, and many of those who are in production today had to buy some or all of their quotas. These purchases of quotas were carried out under the rules of the game that were put in place by governments. It would therefore be unfair to put an end to the systems without compensating holders of current quotas, which would be the equivalent of expropriating them without compensation.

In this context, what specifically could be done to end quotas? The Australian model offers an interesting avenue, namely liberalizing the market under supply management by temporarily taxing the products sold in order to finance the buyback of quotas.

The liberalization of markets consists in eliminating tariffs and marketing monopolies to bring Canadian prices for products in line with international levels. At the same time, there can be a temporary tax equal to the current subsidy from consumers to producers. Recall that Canadian consumers subsidized producers in restricted sectors to the tune of 3.9 billion dollars a year between 2008 and 2010, according to the OECD. By collecting this amount, the buyback of quotas would be completed in seven or eight years without consumer prices having to be raised any higher than before.

At the end of this transition period, the temporary tax would be eliminated and processors and consumers would save the equivalent of 3.9 billion dollars a year from that point onward.

As for farmers, they would lose no part of what they spent to acquire the quotas and the future profitability of their production would not be compromised given that the additional income procured by the system was capitalized in the value of the quotas for which they would have been compensated. Moreover, the agricultural sector would no longer be subject to rigid, outdated constraints, which would promote producers' entrepreneurial initiatives and, as a result, would lead to more innovation. Finally, the Canadian economy would benefit from the growth potential of its agricultural products on foreign markets, an avenue that is currently under-exploited due to supply management.

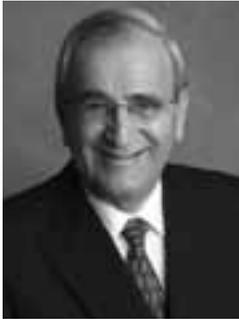
Farming can survive and prosper on the simple basis of agricultural entrepreneurship. This is indeed what has happened in those countries that have encouraged productivity gains and competitiveness in their industries. New Zealand is a compelling case in which subsidies were eliminated and agricultural businesses were exposed to competition. Through this process of competition, New Zealand farmers ended up finding their way and prospering to the point of grabbing a significant part of the global agricultural export market. Today, these farmers are committed to never again relying on government handouts.<sup>9</sup>

The adoption of agricultural policies aiming to promote entrepreneurship and freedom, however, requires informed public opinion and a political class with a long-term vision. These are necessary conditions to realizing the competitive potential of our agri-food sector and thereby allowing it to contribute to the prosperity of the country.

8. Statistics Canada, *Balance Sheet of the Agricultural Sector*, January 2012, p. 39.

9. Federated Farmers of New Zealand, *Life after Subsidies*, August 2002, p. 1.





## About the author

### **Mario Dumais**

Mario Dumais holds a master's degree in economics from the Université de Montréal. He has worked as an economist and as publications director for the Union des producteurs agricoles, as general secretary for the Coopérative fédérée de Québec and in Costa Rica as director of the Center for Integration and Agribusiness Development at the Inter-American Institute for Cooperation on Agriculture. He was a member of the Commission sur l'avenir de l'agriculture et de l'agroalimentaire québécois («Pronovost Commission»), and took part in the Commission sur le développement durable de la production porcine au Québec as a member of the Bureau d'audiences publiques sur l'environnement. Among the defining experiences of his career, he was by turns a member and co-president of the Canadian government's Sectoral Advisory Group on International Trade (SAGIT) for agricultural products, foods and beverages, and he participated, as president of the International Cooperative Agricultural Organization, in the FAO's World Food Summit in Rome in 1996.

