

## BRIEFING NOTE

### MEMORANDUM TO THE MINISTER

**ISSUE:** Elimination of Dairy Sector Supply Management System in Canada

#### SUMMARY

- The Federal government recently signed on in principle to the Trans Pacific Partnership (TPP). One of many requirements of the deal is to open up national markets for trade by eliminating tariffs.
- Opening up to more free trade means the government is looking at options to replace Canada's supply management system of the dairy sector. The dairy sector is currently protected from competition through strict domestic regulation of prices and production quota, and is sheltered against external competition with high import tariffs on international dairy products.
- Recommended policy options: 1) gradual lowering of import tariffs to cushion introduction of internal products; 2) offer of support to transition the industry; and 3) gradual dismantling of supply management systems within provinces and transition the mandate of Canadian Dairy Commission to a producer-industry group.

#### BACKGROUND

The Constitution Act, 1867, outlines the responsibilities for the Federal, Provincial and Territorial (PT) Governments regarding taxation powers and what each is responsible for funding. Agriculture is historically a shared jurisdiction. The Federal Department of Agriculture was one of the first government departments, dating to 1867, and each province has its own department of agriculture. Therefore, any changes to the supply management system need to be carried out in consultations with the provinces. However, the federal government is able to make changes to the Canadian Dairy Commission and other federally mandated boards.

#### CURRENT STATUS

Canada's supply management has been called very inefficient. Canada's system of dairy product supply management dates to the 1960s. One consequence of the system is industry exit: in 1969 there were almost 140,000 dairy farms in Canada, and by 2009 there were less than 20,000. The quota system also created very high barriers to entry as new producers are unable to afford purchasing production quotas. Studies have shown that prices for dairy products are often 2-3 times higher than comparable products in the United States. There the industry is supported with subsidies to producers that top \$4 billion dollars in 2015.

Australia dismantled its supply management system in 2000. All dairy support prices and quotas were eliminated, and a transition package worth \$1 billion over 8 years to enable producers to adjust to changes. That was financed by a tax of 11 cents per liter of fluid milk sold at retail locations<sup>1</sup>. The tax was

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<sup>1</sup> National Post, March, 2015: How to phase out supply management.

due to expire in 2010. The United Kingdom and New Zealand have also previously eliminated their dairy supply management structures.

## **CONSIDERATIONS**

Based on the available information recommendations can be made in part from past experience with the dismantling of the Canadian Wheat Board (CWB) in stages. For the elimination of the single desk, legislation was enacted in 2011, with the CWB monopoly on western barley and wheat production stripped in August 2012, and then the CWB itself was restructured with assets sold through 2013. For the CWB no direct compensation and previously with the North American Free Trade Agreement (NAFTA) tariff implementation in the late 1990s. Following ratification of NAFTA in 1994, tariffs were gradually lowered on imported goods in 1997, 1998 and 2002<sup>2</sup>.

## **RECOMMENDATIONS**

Canada's supply management system should be eliminated gradually, specifically in three phases:

1. Gradual lowering of import tariffs to cushion introduction of international products: under the TPP, an allocation of 3.25% of foreign production will be phased in over the next five years, and tariff would be eliminated fully following the initial five years following ratification of the TPP<sup>3</sup>. That is similar to the Australian model that allowed 8 years of transition.
2. Offer of support to transition the industry: based on the average price of the most efficient suppliers. Compensation can be offered accordingly based on historical quota production to ease their transition to other industries. Transition payments could be funded via a tax on all dairy products sold in Canada, similar to the Australian experience.
3. Gradual dismantling of supply management systems within provinces and transition the mandate of Canadian Dairy Commission to a producer-industry group: that ensures there is a consistent group to speak on behalf of dairy producers and ensure the sustainability of the industry in a competitive tariff free environment.

Throughout the process significant consultation would occur with dairy producers, their associations, and the public within each province to determine their needs as well.

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<sup>2</sup> Foreign Affairs, Trade and Development Canada (2015): Tariff elimination.

<sup>3</sup> Financial Post, October 2015: How the TPP deal could signal a 'slow erosion' of dairy supply management system.