

# Canadian Farm Milk Quota System Yields Rewards to Producers, Rural Dairy Communities by John Bunting

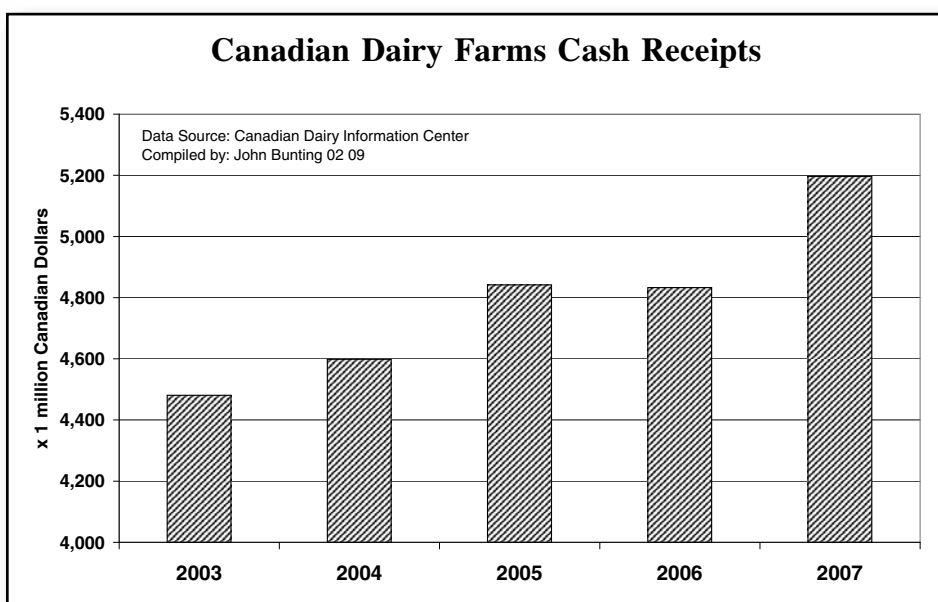
**“Markets can remain irrational longer than you can remain solvent.”** — John Maynard Keynes

Dairy farmers have a large investment in their operations compared to many businesses. Presently in the U.S., most of the dairy farm investment is at complete risk. No matter where you look in this nation, dairy farms are under severe financial stress. Regardless of size, the financial condition of many dairy operations is in danger.

Risk of total loss for dairy farmers — if U.S. milk prices stay ruinously low for very long — has nothing to do with a farm’s size, location, or any measures of so-called “efficiency.” The risk of total loss in the U.S. is almost entirely attributable to one thing — the U.S. milk pricing system. Our milk pricing system is crooked, corrupt ... and now threatens indiscriminate ruin for dairy farming.

Few in a position to affect dairy policy are voicing any intelligent alternatives to the obviously failing U.S. milk pricing system. Land grant university dairy economists tell farmers, “You should have contracted prices in advance last summer.” Others naively mumble that (maybe) lower dairy commodity prices will filter through to lower retail dairy prices in the supermarkets and thus boost overall sales.

What are intelligent alternatives to our dairy pricing mess? Just across our northern border is Canada, with a dairy pricing system which has sustained dairy farmers’ standard of living. Canadian dairy policies have also sustained and nourished nearby rural communities.



As can be seen in the above graph, annual volatility is not a factor in Canadian farm milk prices. In three of the recent five years represented in the graph, U.S. farmers experienced downturns in farm milk prices. And here we go again, in early 2009, as USDA economists project that 2009’s farm milk prices will average their lowest levels since 1978 — when Jimmy Carter was president.

Farm milk prices are determined individually in each Canadian province. Although the geographical size is different, a Canadian province is the political equivalent to a U.S. state. **Farm milk price in the province of Ontario, is Canadian \$70.10 per hectoliter, which translates into just over \$ US 25 per hundredweight.**

According to Dairy Farmers of Canada, “About 81% of Canadian dairy farms are located in Ontario and Quebec, 13.7% in the western provinces and 5.5% in the Atlantic Provinces.” This roughly conforms to the distribution of population in the provinces.

Canada uses a pricing system set by a formula, which has varied slightly from province to province. Ontario uses a weighted formula for class 1 (beverage milk) comprising of 30% consumer price index, 40% producer (farm) cash costs and 30% personal disposable income. Other provinces have adopted Ontario’s formula, which has then become, in effect, the national formula through 2009, subject to renewal.

Prices in class 2 to 4 (industrial milk) are changed by provincial milk marketing boards and agencies which use support prices as a reference to determine the price paid to dairy farmers. The Commission annually reviews (mainly based on cost of production data) and establishes support prices for butter and skim milk powder for the year to come.

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According to Dairy Farmers of Canada, “About 81% of Canadian dairy farms are located in Ontario and Quebec, 13.7% in the western provinces and 5.5% in the Atlantic Provinces.” This roughly conforms to the distribution of population in the provinces. Imagine! Dairy policies that sustain local production!

Canada uses a pricing system set by formulas, which have varied slightly from province to province. Ontario uses a weighted formula comprising of 30% consumer price index, 40% producer (farm) cash costs and 30% personal dis-

posable income. Other provinces are adopting Ontario’s formula, which will then become, in effect, the national formula. Interestingly, Class V products — for which use less than 10% of the milk is priced — are based on the U.S. Class III (cheese) milk price adjusted, for currency exchange rates.

More importantly, Canadian dairy policies have all but eliminated farm milk price volatility. Financial planning achieves real meaning, with steady milk prices. On our side of the border, financial planning is too often reduced to expansion, just to keep the cash-flow wolf away from the door. In the final analysis, growth of dairies here is a short-term, cash-flow panic.

## Producing milk for the consumer market

The glue which holds the Ontario provincial milk pricing system together is milk supply management by farm milk quota allocation. Quota is held by individuals and is bought and sold on an exchange. In other words, Canada producers market milk for which there is a market, that’s certainly “not the American way”.

Many dairy farmers in the U.S. feel that the Canadian system of producing for what the market can handle is some form of “socialism.” Alternatively, in our “free-market, dog-eat-dog” environment, U.S. dairy farmers are free to expand production at any time. When a U.S. farmer expands production for milk which has no home, that farmer places the costs of finding a market for the additional milk on all the other farmers who have chosen to not expand by reducing the blend price. That is, the expanded milk production will not go into Class I (fluid) milk utilization which has the highest value. The expanded milk production generally goes to milk powder, which then reduces the blend price for all dairy farmers. Here in the U.S. we have socialism for some (the biggest interests) and an unnecessary, desperate struggle to survive financially for most others.

Be that as it may, the very factors which drove Canadian dairy farmers, back in the mid-1960s, to approve supply management sound remarkably similar to the present conditions in the U.S. Canada formulated its milk pricing system in 1965 because dairy was attempting to produce for an uncertain export market. That drive for production led to ruinous, volatile prices and costly surpluses.

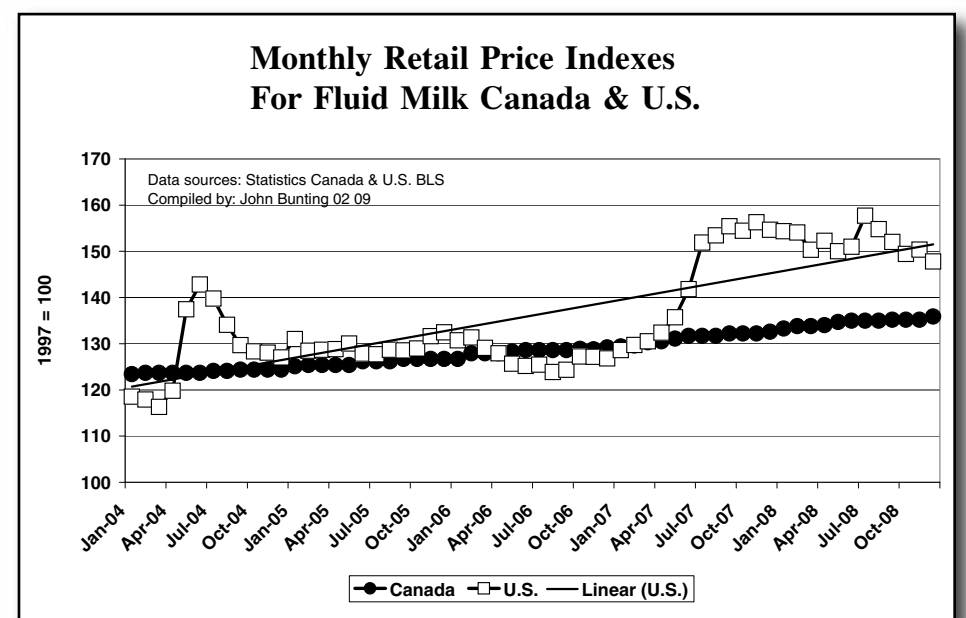
Back in 1965, both the U.S. and Canadian dairy farming communities would have looked very similar. Rural communities were still viable in the dairy sections of both countries. Move ahead to 2009 and the traditional dairy communities in the U.S. of 45 years ago, appear to be part of some undeclared war zone.

U.S. milk production/pricing in 1965 provided numerous benefits. Along with the production of milk came a long list of what economists call external benefits. One example of an external benefit would be the dairy farm landscape. An external benefit is truly an economic benefit which is enjoyed by all. The benefit has a value, although not a market value. There is no price discovery for scenic rural landscapes.

The casual American visitor to Canada is often struck by the overall prosperous appearance of Canadian dairy farms, compared to those in the U.S. Pick-up trucks tend to be fairly new on Canadian dairy farms. The average age of tractors on Canadian dairy farms are somewhere in the region of 20 years newer than the counterpart south of the border. The typical Canadian dairy farm counts a total of 67 head. In Ontario, there are 4,800 dairy farms averaging 54 cows per farm. Each farm produces an annual average of 1,087,483 pounds of milk. Canadian dairy cows are not pushed to produce. Dairy animal values are stable. Cows from Canada regularly win at important U.S. dairy cattle shows, so Canadians obviously enjoy a solid knowledge of dairy cattle.

## Financially stable, rural dairy economies yield public benefits

Canadian dairy farmers did not have sufficient political power of their own to achieve a new pricing system. The general public has been onboard from the beginning, largely to maintain the vitality of rural communities.



Consider the data in the above graph. Canadians experience rather steady retail milk prices. Although, there is a steady increase in the price Canadians there are no massive jumps. Each time, in the U.S. retail milk price jumps, consumption falls. U.S. consumers are probably as confused about milk pricing as are dairy farmers.

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In Canada there is a broad sense of public responsibility which far exceeds any such thinking in the U.S. By all measures, there is less economic inequality in Canada than in the U.S. Everyone has access to health care. The cost of post-secondary education for Canadian citizens and residents is about one-third the cost of a college education in the U.S. Again, many in the U.S. consider many government programs in Canada to be “socialism.” But most of those folks do not consider public highways, bridges and airports in the U.S. to be “government meddling in the market place.” The fact is, the difference is a matter of degree and not of kind.

Beyond the value of external benefits, there appear to be some very tangible public benefits from Canada’s dairy pricing system.

Additionally, if the U.S. price is leveled off to a trend line, the U.S. retail price is rising far more rapidly than the Canadian retail price despite the fact that Canadian dairy farmers are so “highly paid.” That’s an interesting measure on the economic powers of our few, large dairy processors and the also powerful supermarket chains.

## Provincial oversight: local control

Each province exercises considerable regulatory oversight. For instance, in Ontario, Dairy Farmers of Ontario (DFO) is authorized under the Milk Act to oversee marketing, including the promotion and pricing of farm milk. DFO is entirely financed and controlled by Ontario dairy farmers. DFO oversees supply management for the province. The prime objective of supply management is a stable system. With supply management the government has no costly purchases of overproduction.

Supply management has three aspects. First: a system of high tariffs, which limits dairy imports. Second: dairy farm milk sales are limited through quotas. Third: a pricing system based on the cost of production.

DFO has the legal authority to set the farm price of most milk within Ontario. Industrial milk prices are set under a nationally-managed supply system. In both uses of milk, farm cost of production is the lead pricing factor. To determine the cost of production within Ontario, DFO uses actual data from just under 100 herds. DFO supplies milk to all dairy plants and bills the plants according to components, volumes used, and in which class those components were utilized.

The provincial government of Ontario conducts all milk quality testing, audits, licensing of graders and operates an appeals tribunal for dispute resolution. Dairy farmers are paid based on test for butterfat, protein, and other solids. DFO also arranges milk hauling. Milk truck drivers are licensed graders and can reject milk at farm for odor or appearance.

Here is a list of current marketing charges assessed to producers by DFO. (The amounts have been converted from Canadian currency into U.S. dollars, and the from the metric system’s liters into U.S.-style hundredweights.) In Ontario, DFA charges farmers \$.1675 per hundredweight for administration, \$.14 for research, \$.02 for Ontario DHI, \$.937 for transportation, and \$.46 for promotion for a total deduction of US\$ 1.60 per hundredweight. For farmers the benefits of the system are: price stability which provides producers with adequate, stable incomes; fair returns on labor and investment; and the opportunity to invest in their businesses with confidence.

## Processors benefit from stability, equal costs

One notable aspect of Canada’s provincial milk oversight is the benefits for processors. In the U.S. distribution of milk to processors is the result of power based dealing. Those with the most power get the best deals. For example: In the U.S., Dairy Marketing Services, a subset of Dairy Farmers of America, has

a full supply agreement with Dean Foods ... and dramatically reduces competition among raw milk sellers.

In Canada, the supply management system provides all processors with an adequate supply of raw milk to meet Canadian demand. Of course, the milk provided to plants is at a stable price, which, in fact, increases plant economic activity.

Processors operate on a level playing field, with comparable prices and similar terms from the raw milk seller. Canada’s system can’t be all that unfair to dairy processors’ profitability. Canadian firms like Saputo Cheese and Agropur have come across the border in recent years and paid handsomely for U.S. dairy processing/marketing businesses. They must be making money in Canada!

## Quota makes the Canadian dairy system function

All producers selling farm milk must hold quota issued by provincial milk marketing boards. Individuals hold quota, which is similar to contracting for specific amounts of milk. Quota is not cheap. Quota prices vary by province with Ontario currently the highest at \$11,247 per pound of butter fat to Quebec at \$8,818 per pound of butter fat. The value of quota is established on an open, quota-exchange market. Quota represents 365 days of production and each unit is roughly equal to the milk produced by one cow.

Quota is essentially a capital cost. As such, on a per-cow basis, the capital requirements in Canada are about double that found in the Northeast U.S. Consequently, quota is sometimes depicted as an impediment to entering dairy farming in Canada. The data does not support this conclusion as dairy farmers continue to enter dairying in Canada when quota is available.

Some farms also buy additional quota for expansion, which indicates quota is a reasonable investment. As a capital cost, quota will hold value better than any facility or equipment in the U.S. And, most Canadian farmers who choose to sell their quota are millionaires.

## Conclusion

While there are many in the U.S. who question the Canadian system, keep in mind that if the dairy farmers in Canada were unhappy with the system, they could vote it out in a heartbeat.

The Canadian system also answers an important but, rarely asked, question – under what conditions should the government intervene, in the public interest, on behalf of the financial stability of the industry. Surely, in recent months, we know what the U.S. government’s answer to that question has been for some major banks and brokerages! Yet another question: Under what conditions should milk for public consumption be produced?

In Canada, most dairy farmers are prosperous without undue stress. In the U.S., except perhaps for those with millions of dollars of real estate money in their pockets, dairy farming is not the desirable lifestyle choice it once was. As a matter of fact, much of dairying has become a version of the sweatshop, with the difference that both labor and management are controlled by sweatshop mentality: always produce more for less.

Obviously, there are differences between the U.S. and Canada. Certainly, the Canadian system cannot be adopted, lock stock and barrel, in the U.S. However, the Canadian model suggests there are alternatives to the U.S. slash-and-burn thinking. We really do not have viable dairy markets in the U.S., we have divisions of monopoly power with the dairy farmer taking the greatest risk and having the least rewards to show for it all.

“Business as usual” for U.S. milk pricing is leading most dairy farmers down one-way, dead-end path to ruin. “Business as usual” will not sustain rural communities, nor will such practices feed this nation.

## Classification of Milk Use in Canada

Canada uses a pricing system set by a formula, which has varied slightly from province to province. Ontario uses a weighted formula for class 1 (beverage milk) comprising of 30% consumer price index, 40% producer (farm) cash

Description	Class
Fluid milks	1a
Fluid creams	1b
Yogurt, ice cream, sour cream	2
Fresh Cheeses, specialty cheeses	3a
Cheddar	3b
Butter, powders	4a
Condensed and evaporated milk for retail	4b
New products	4c
Inventory, animal feed	4d
Domestic surplus	4m
Cheese for further processing	5a
Non cheese dairy products for further processing	5b
Confectionery products	5c
Planned exports	5d

costs and 30% personal disposable income. Other provinces have adopted Ontario’s formula, which has then become, in effect, the national formula through 2009, subject to renewal.

Prices in class 2 to 4 (industrial milk) are changed by provincial milk marketing boards and agencies which use support prices as a reference to determine the price paid to dairy farmers. The Commission annually reviews (mainly based on cost of production data) and establishes support prices for butter and skim milk powder for the year to come.

Class 5 is tied to U.S. Class III adjusted for the currency exchange rate.

Average net milk check from December 2007 through November 2008 was \$70.10 (Canadian \$) per hectoliter, which is just over \$25 (U.S. \$) per hundred-weight.

## History of Canadian & U.S. Farm Milk Prices August 2003 - July 2008

Milk Pricing Year	Canada 10 Provinces Canadian \$/hl	Canada 10 Provinces Canadian \$/hl	U.S. All Milk U.S. \$/cwt
Aug 2003 - July 2004	\$61.45	\$27.04	\$16.05
Aug 2004 - July 2005	\$64.63	\$28.44	\$15.13
Aug 2005 - July 2006	\$67.67	\$29.77	\$12.88
Aug 2006 - July 2007	\$69.35	\$30.51	\$19.13
Aug 2007 - July 2008	\$71.23	\$31.34	\$18.52