

# The Politics of Milk in Canada

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## 1. Introduction

In terms of logic, fairness, and the size of the possible net increase in the economic well being of Canadians,<sup>1</sup> Owen Lippert (2001) has made a very strong case for extensive changes in Canada's milk policy. The most important would be the ending of the federal-provincial supply management marketing scheme (SMSS) that has existed for three decades.<sup>2</sup>

Lippert has focused on the economics of Canada's milk policy and its relation to our international trade agreements.<sup>3</sup> His is a most useful contribution to the fairly extensive literature on this nation's milk policy, but it refers only briefly to the *politics* of that policy. Yet efforts to reform milk policy have always been frustrated by political factors. The purpose of this paper is to try to explain the politics of milk in Canada. Any change in the policy must be made by politicians, notably by the cabinet of the federal government. To influence these ministers, it is essential to understand the complex web of forces within which they operate.

It is rare for a deeply entrenched public policy to be changed by "brute logic," or by showing that, on average, real per capita income will rise if a policy is changed. Why? The short answer is "politics." This term, however, is mere shorthand for a complex web of incentives (economic and others), institutions, and ideas, some of which are highly questionable, or even false.<sup>4</sup> In general, politics is about who gets what and how they do so in the context of elections and efforts to influence the activities of government between elections.<sup>5</sup> Before I delve into the politics of milk (and dairy policy more generally) in Canada, it is useful to summarize what is to be explained. The key consequences of Canada's milk policy as presented by Lippert (2001, pp. 3-5) are as follows:

- The OECD estimates that the total income transfer from Canadian consumers to dairy farmers in 2000 was Cdn \$2.47 billion (including \$987 million for fluid milk alone). This is measured in terms of the Consumer Support Estimate (CSE).
- OECD figures indicate that between 1980 and 2000, Canadian consumers have transferred Cdn \$50 billion to milk producers, i.e., an average of \$2 billion per year in current (2000) dollars.
- According to the OECD, some 70 percent of consumer subsidies to all farmers in Canada go to dairy farmers. Of that, 97 percent is attributable to the supply management scheme.
- The per capita consumption of milk in Canada dropped by 14 percent since 1980.
- Farm gate milk prices in Canada are 41 percent higher than in the US and 135 percent above the world reference price set by New Zealand.

- In 2000, the average retail price of fluid milk in Canada was 9 cents per litre higher than in the US. The difference has declined markedly in recent years largely due to the fall in the Canadian dollar relative to the US dollar. If Canadians had paid US milk prices in 2000, they would have saved just under Cdn \$1 billion.
- From 1990 to 2000, the Consumer Price Index rose by 21.7 percent while food prices rose by 17.1 percent. Yet the retail price of fluid milk rose by 37.7 percent. But the estimated cost of production of milk fell by 8.1 percent between 1994 and 2000.
- The total value of milk quotas in Canada in 2000 was some Cdn \$16 billion or \$18,000 per milking cow, or 8.9 percent of each litre of milk sold, or 9.8 percent of each 500 grams of cheddar cheese sold.
- If the total value of milk quotas is set at zero, one can calculate that Canadian consumers transferred to dairy farmers \$839 million in 2000. In addition, Canadians bore the burden of a deadweight loss of \$200 million. In other words, it cost 25 cents in scarce resources for each \$1 in income transferred from consumers to producers.

The Consumer Support Estimate measures the costs to consumers of the price increase due to the supply management scheme for milk.<sup>6</sup> In 2000, the CSE amounted to an average of \$119,903 per farm for each of Canada's 20,600 dairy farms. Thus, each of 30.75 million Canadians paid directly an average of \$80.33 in 2000 so that each *member* of the average "dairy family"<sup>7</sup> could receive \$29,976.

Milk producers are among Canada's most well-off farmers. Their average net cash income per farm in 1998 (the latest year for which figures are publicly available) was \$54,945—compared to \$22,255 for all types of farms.<sup>8</sup> At present, the owners of dairy farms in Canada have an average *net* worth of nearly \$1 million. In 2000, they collected an average of \$119,903 each year in Consumer Support Estimate (i.e., an income transfer) from other Canadian families whose median *net worth* was \$119,300 (Agriculture Canada, 2001; Sauve, 2001).

Finally, the last key fact that has to be explained is why this massive welfare program for such a tiny (and declining)<sup>9</sup> group of citizens (dairy farmers) has persisted for over 30 years. Recall that since 1980, the CSE has totalled some \$50 billion in current (2000) dollars! In other words, the huge per capita compulsory income transfers are not attributable to some emergency or short-term situation.

The body of this paper is organized as follows: Section 2 explains why dairy farmers are the authors of Canada's complex and expensive dairy policy. Section 3 explains why "it ain't all a mistake." The key political decision makers (federal cabinet ministers) do understand what is going on. Section 4 describes the key participants in the politics of

milk and outlines their positions. Section 5 describes the single most important reason why Canada's dairy farmers are able to exploit their fellow citizens to such a degree: the "logic of collective inaction." Section 6 explains the axiom of "the importance of being unimportant" when it comes to the redistribution of income. Section 7 looks at the emotional side of the politics of milk, namely, the psychological ties of urbanites to farmers and the myth of the yeoman farmer. Section 8 discusses the "transitional gains trap" which shows the particular effects of a policy for which the economic benefits are capitalized. Section 9 briefly considers the matter of compensating the owners of milk quotas if the federal government were to eliminate the supply management scheme for milk. Section 10 addresses the question, "Is Canada's dairy policy completely impervious to change?" Finally, the conclusions are briefly stated in section 11.

## 2. It is the milk producers' system

Canada's dairy policy is a very complex web of interrelated policies, programs, and people nested in a number of private and public institutions. In short, it is a system. But it is a system whose creation, expansion, and vigorous defence has been motivated almost entirely by milk producers, i.e., dairy farmers. They are its true authors. If they wanted to end the elaborate supply management marketing scheme, open up the border to imports, or renounce the cash subsidies from governments, these changes would be made very quickly by governments.

Of course a long list of politicians (notably federal and provincial cabinet ministers) have been complicit in creating and maintaining Canada's dairy policy. It is the nature of politicians to be complicit in such endeavours.<sup>10</sup> Politicians have been described as being "awesomely flexible." They call it being "responsive to the will of the electorate." Policies are to be believed in only to the extent they help a party to gain or retain office. Why? Because it is in their self-interest to create such policies at the behest of well-organized and vocal groups like the milk producers (generally, see Stanbury, 1993a). It increases their chances of election or re-election, despite the fact that so many consumers and taxpayers are harmed by the dairy policy, and the total cost imposed on them amounts to about \$2.5 billion per year.<sup>11</sup> Why? Because the victims are essentially politically impotent. They may squawk, but the "logic of collective inaction" prevails (see section 5 below). The structure of incentives is such that it does not pay consumers to get organized and defeat the dairy farmers in the political arena. Canada's milk policy is another example of the triumph of the concentrated few over the dispersed many in the political arena.

The milk producers are the *deus ex machina* in the politics of milk in Canada. Their rational, self-interested behaviour has resulted in a system in which they have been

given enormous control of the government apparatus that determines the price of their output. In how many other occupations do the members get to write their own salary cheques? The deleterious consequences of their highly influential political activities<sup>12</sup> must be brought to the public's attention (yet again!) if there is to be any hope of desirable change (see section 10 below).

Canada's dairy policy is the product of what economists call "rent-seeking" behaviour,<sup>13</sup> an important aspect of political behaviour. It simply means that individuals and groups attempt to influence government to create or change policies that confer economic benefits on them. Efforts to influence government policies use scarce resources, and they are often subject to considerable uncertainty. The uncertainty arises partly because other individuals and groups compete for the ear of politicians in power in two main ways: by directly opposing the efforts of the individuals or group seeking policy X, and by promoting other policies that achieve a higher priority and receive more of government's (really taxpayers') scarce resources.

But rent-seeking is a negative-sum game. In almost every case, the gains achieved by Lobby Group A on behalf of its supporters come out of the pockets of other citizens. Thus, the result is a transfer of income, not an increase in the total Gross Domestic Product (GDP). Further, scarce resources are used by all parties who "play the game." Then there are the administrative costs of the government programs. For society as a whole, real GDP falls because of rent-seeking, hence the phrase "negative-sum game."

And that is not the full story. In order to effect the transfer of income to the members or supporters of Lobby Group A, governments often create allocative and other forms of economic inefficiency (see Stanbury and Lerner, 1983). There is no question that Canada's dairy policies have produced this result. These efficiency losses are "deadweight losses"—they unambiguously reduce total real GDP.<sup>14</sup> But that is not all. The social cost of these income transfer schemes also includes the cost of administering the government programs that effect the transfers. The full *social* cost of transferring \$1 of income from one group of citizens to another group by means of taxation, for example, have been estimated to be from 25 cents to well over a dollar (see Grubel, 2000).

### 3. It ain't all a mistake

The present dairy policy remains firmly in place not because federal and provincial cabinet ministers fail to appreciate what Lippert and I (and others) describe as its large adverse consequences for Canadians, primarily consumers (but also taxpayers). Some time ago, Nobel Laureate economist George Stigler (1982) argued that when a particular public policy is well established (i.e., it has survived one or more general elections,

particularly where the party in power has changed), it can safely be presumed that those with the power to change the policy (in this case the federal cabinet) understand all of the important consequences of the policy. Indeed, they retain the policy because it delivers greater net benefits to them than would the next best alternative. Thus “bad” policies are not, in fact, a mistake or due to the ignorance of political leaders. It is often the case that things described as “adverse consequences” by Lippert, me and most economists—notably the forced redistribution of income from consumers to dairy farmers—is seen as a virtue or benefit by cabinet ministers.<sup>15</sup> They *want* to put plenty of money into dairy farmers’ pockets. As for the various losses in economic efficiency,<sup>16</sup> they are hidden from voters (if not economists and some policy analysts) and so tend to be given little weight in the ministers’ political calculus.

## 4. Players and positions

It is often useful to begin the analysis of the politics of a particular policy (or set of related policies) by identifying the players and describing their positions. In this context, position has two meanings: a) the position of the player in the policy community in question, and b) the position of the player in the sense of his or her support for or opposition to the policy.<sup>17</sup> The two are interrelated; recall the adage of policy analysts: “where you stand depends upon where you sit.” In other words, the stance participants in the policy making process take on an issue depends upon the roles and responsibilities they have.

Here is a list of the key actors (players) and a brief summary of their positions in both senses of that term.

### *Dairy farmers*

These people are the most important group in Canada’s dairy policy. They want, first, to ensure that the economic value of their large investment in milk quotas does not decline,<sup>18</sup> and would also like to obtain a capital gain on their investment in quota. Further, milk producers continue to spend considerable sums on lobbying government to ensure that proposals to make the supply management marketing scheme less restrictive or to abolish it do not succeed, and to try to get higher direct subsidies. Most of the present owners of milk quotas have had to purchase them and probably borrowed money to do so. Thus they are subject to the “transitional gains trap” (see section 8 below). No doubt dairy farmers feel strongly that they are morally entitled to prices that are far above that which would prevail in the absence of the SMMS and related milk

policies.<sup>19</sup> Dairy farmers are the most important “blocking power” preventing reform of the dairy policy that Lippert (2001) and others advocate.

### ***The Federal Cabinet***

Cabinet ministers are near the apex of power in Ottawa; the prime minister is at the pinnacle.<sup>20</sup> They have the legal authority to change Canada’s dairy policy. Their principal goal is to get re-elected personally, or to ensure that their party stays in power. Ministers know well that it is impossible to do the Lord’s work if one is not in power. Power is the capacity to produce intended consequences despite opposition (see Galbraith, 1983). It is the capacity to make things—perhaps important things—happen. Of course, ministers will frequently speak of advancing “the public interest,” largely because this is an evocative and vague term.<sup>21</sup> Besides, it is easy for each minister to rationalize that whatever he or she wants to do, by definition, is in the public interest. In fact, many definitions of the public interest have been put forward by political scientists, philosophers, and others. My own survey of them reveals that many are inconsistent with other definitions, and all are highly general and thus very hard to make operational (Stanbury, 1979).<sup>22</sup>

The most realistic model (perspective) on ministers’ decision making is the public choice approach.<sup>23</sup> Very briefly, it is based on the idea that ministers (and all the other participants in the political arena and policy making process) will usually act in an instrumentally-rational, self-interested fashion.<sup>24</sup> This means that it is logical for them to evaluate proposed new policies or proposed changes in existing ones primarily in terms of how it will likely influence their own and their party’s probability of re-election. In one sense, re-election is “proof” that the policy decisions made over the previous few years meet with the voters’ approval.<sup>25</sup>

The public choice approach argues that the way ministers maximize the probability of re-election is to practice marginal voter politics. This means that they try to focus most of their scarce resources<sup>26</sup> on marginal voters in marginal constituencies. Marginal constituencies are those that “could go either way,” depending on which party promises those things most valued by “swing” or marginal voters. The irony is that voters who are seen to be committed to the party in power will have many fewer resources conferred upon the ridings in which they are numerous. Of course, voters seen as committed to other parties will be promised the least by the party in power. Thus, ministers practice a form of “political triage”—they use most of their scarce resources (political capital) on those voters and/or ridings where they are expected to make the greatest difference to the outcome of the election. In doing so, they are only acting rationally in order to achieve their most important goal—re-election.

## **Consumers**

While almost everyone in Canada drinks some milk (the average per capita consumption is some 88.2 litres per year), the higher price of milk due to the SMMS (including import quotas and taxes), and the higher taxes to finance subsidies to dairy farmers are a tiny fraction of almost every household's income or total expenditures. They amount to an average of about \$80 per capita per year.<sup>27</sup> It is true, however, that poorer families with young children will not be able to buy as much milk as they would otherwise be able to because of Canada's milk policy.<sup>28</sup> They will likely suffer a nutritional disadvantage (see Lippert, 2001, p. 59). While consumers (and taxpayers) constitute a huge group, they are very poorly organized and politically ineffective for very good reasons: the structure of incentives and the nature of the representation of collective interests (see section 4 below). Cabinet ministers can safely ignore the interests of the consumers of milk. They find it useful to engage in bouts of pious rhetoric about protecting consumer interests. However, milk producers are not likely to be alarmed.

## **Provincial Governments**

Several provinces (Quebec, Ontario, and Alberta) have major dairy industries<sup>29</sup>; others are net "importers" of milk from other provinces and so tend to be more interested in the interests of consumers. However, they have put little pressure on other provinces or the federal government to reduce the heavy burden created by the dairy policy. Dairy farming is much more important in Quebec economically and politically than in any other province. In general, Quebec's influence in Ottawa is far, far greater than its share of Canada's population, whether the Liberals or Tories are in power. In the federal-provincial context, Quebec is the dominant force shaping Canada's milk policy.<sup>30</sup>

## **Officials in Agriculture Canada**

Public servants provide analyses of proposed and existing policies. They also implement them. Over time, officials who manage particular programs often come to identify quite strongly with them. Thus, most are unlikely to welcome (and certainly not promote) major changes in the present milk policy.<sup>31</sup> Moreover, at the top, many public servants have become "politicized," but not in a partisan sense. Rather, they devote a great deal of effort on the political aspects of policy issues and too little on high-quality technical work. In some ways, they seem to be doing things that had at one time been left to the minister and his personal advisors. It must be emphasized, however, that the officials in Agriculture Canada do not constitute a major barrier to reforming Canada's dairy policy.



## The Trade Wallahs

We are repeatedly told that we are living in the era of globalization. The central element of this important phenomenon has been the growing number of international treaties aimed at liberalizing the rules governing international trade (e.g., the FTA, NAFTA, and the various rounds of GATT). Some of the other treaties seem to focus more on spelling out the rules of the trade game in a coherent and comprehensive matter for the signatory nations, rather than liberalizing them.

In any event, the trade wallahs<sup>32</sup> now play quite an important role in shaping many of Canada's public policies—including dairy policy. The politics of milk includes their major axiom in trade negotiations: in bargaining among nations to create or modify an international agreement, no nation should ever make a concession unless it will receive something equally valuable in exchange. This seems sensible—but it can also be a formula for preventing unilateral changes in domestic policy that would increase the real economic welfare of a nation—including Canada.

Indeed, sticking with this axiom is foolish under certain circumstances, specifically, a) where it is very unlikely that an international agreement can be reached that would permit every party to “get more than it gives” in its own estimation, or b) where a mutually beneficial agreement seems possible, but only a decade or more in the future. In the latter case, the value of the benefits is effectively reduced because of the delay in being received.

A far better approach would be for Canada to *compare* the expected net present value of the increase in GDP per capita of a) unilateral action taken today that would increase the economic well being of Canadians (e.g., abolishing the SMMS for milk), and b) an international agreement under which Canada and other nations take certain actions in 10 or 15 years time (e.g., eliminating various restrictions on the importation of milk and its products).<sup>33</sup>

The phrase “expected net present value” means that the analysis incorporates the probability that the policy change will, in fact, be made. If the probability of success is only 25 percent and the benefits of success are \$10, then the expected value is \$2.50. “Net present value” means that the *timing* of the benefits and costs of the policy to Canadians is taken into account. It is true that an international agreement to increase import quotas (reduce tariffs) on dairy products would produce larger net benefits for Canadians than the equivalent unilateral action by Canada. However, such international agreements have proven extremely difficult to achieve over the past three decades. Therefore, they are far less certain to occur, and if they do, they will occur years in the future. The time value of economic benefits matters. If we use a discount rate of 10 percent, and we ignore any difference in risk, then a unilateral policy change producing

\$10 billion in net benefits today (i.e., in present value terms) is equivalent of net benefits of \$25.94 billion a decade from now. If there is only a 50:50 chance that the international agreement will be signed in a decade, and it is certain that Canada will act unilaterally, the net benefits must be at least \$51.88 billion before Canada should opt for trying to negotiate an international treaty.<sup>34</sup>

Too often the trade wallahs recommend against capturing certain real gains for Canadian consumers by acting unilaterally, while proposing that Canada hold this “bargaining chip” in the faint hope of exchanging it for reductions in the barriers to trade created by other nations. In fact, Canadian consumers are being held economic hostage by an axiom that does not hold in circumstances that seem to be more common than is usually acknowledged by the trade wallahs.<sup>35</sup>

## 5. The logic of collective inaction

A surprising number of public policies, including Canada’s milk policy, are created and remain in place largely due to what I call “the logic of collective inaction.”<sup>36</sup> This phrase refers to the fact that large numbers of people can be persistently exploited by a much smaller group using the power of government. Thus, the owners of some 20,600 dairy farms have persuaded federal and provincial governments to create a set of policies that forcibly transfer about \$2.47 billion per year (in 2000) from consumers to them, which constitutes an average of \$120,000 per dairy farm. This is done largely by a combination of a government-mandated cartel for milk (called a supply management marketing scheme) and tight constraints on imports of milk and the products made from it (e.g., cheese, butter, ice cream). The dairy farmers are able to do this because they are few in number (relative to the number of consumers and taxpayers), and each stands to obtain a substantial increase in his or her annual income from the set of government policies they want to be put in place or stay in place. Thus, there is a strong pecuniary incentive for milk producers to get organized, and their relatively small number makes it easier to do so.

Meanwhile, consumers of milk and its products, and taxpayers in Canada (the two groups overlap a great deal) number at least 20 million (out of a population of 31 million), which makes them difficult to organize. But, more importantly, they have no incentive to organize because the costs imposed on them in the form of higher retail milk prices and higher income and other taxes needed to pay for the cash subsidies paid to dairy farmers amount to a tiny percentage of their annual income.<sup>37</sup> It simply doesn’t pay them to try to stop the milk producers from exploiting them. The game would not be worth the candle.<sup>38</sup>

This result is reinforced because no household has any incentive to help finance any effort by someone else to oppose the dairy farmers. They can be “free riders”: if a milk drinkers lobby group were to succeed in eliminating the exploitative policies so beneficial to farmers (*mirabile dictu*), every milk drinker and/or taxpayer would benefit. But they could not be prevented from gaining access to the benefits of the lobby group’s efforts even though they did not help finance its activities.

Thus, where the benefits of a policy (economic or otherwise) are highly concentrated (and sufficiently large in absolute terms per person to be noticeable), and its costs are widely diffused, the “logic of collective inaction” almost always applies. A related characteristic of the logic of politics is the axiom of “the importance of being unimportant.”

## 6. The importance of being unimportant

This axiom of practical politics is based on the idea that a small, well-organized and vocal interest group is more likely to get away with exploiting the many if its total economic take is a small percentage of the victims’ total income or total expenditure. Today, dairy farmers and their immediate family (based on four persons per family) constitute about 0.26 percent of the total population. Thus, each milk producer is able to increase his or her gross income by an average of some 58 percent through various federal and provincial government programs.<sup>39</sup> As noted above, in 2000 this amounted to an average of \$120,000 per dairy farm, and the average cost per family of four was \$321.

Thus, well over 99 percent of taxpayers are available to finance the proportionately large benefits given to dairy farmers. If these farmers constituted even 5 percent of the population, it would not be economically or politically feasible to raise their incomes so much by taxing others and transferring income to them. However, because milk producers are a subset of all commercial farmers and a minute fraction of the population, they benefit from the axiom of “the importance of being unimportant.”

## 7. Psychological ties and the yeoman farmer myth

We describe ourselves as *homo sapiens*, wise and thinking man. We are proud of the Enlightenment and its emphasis on rationality. But public policies are influenced—often more than we acknowledge—by emotion, symbols and even myths. Canada’s dairy policy appears to be influenced by urbanites’<sup>40</sup> psychological ties to farmers and the myth of the yeoman farmer.<sup>41</sup>

One of the most enduring and to many, endearing, myths is that of the yeoman farmer. These men and women are seen as the salt of the earth, as exemplars of civic virtue. The yeomen farmers are seen as braving the vicissitudes of nature while working from dawn to dusk seven days per week in order to feed the nation.<sup>42</sup> They do this on “family farms,” sufficiently small to be run by a couple and their children (who start doing chores by age six). The great Thomas Jefferson (1743-1826) was a strong promoter of this idea, but when he lived, farming was the largest occupation and industry.

The myth of the yeoman farmer appears to have several interrelated components. First, there is the usually implicit idea that farmers, being close to the soil and “living a simple life,” are morally superior to those who live in the “corrupt” cities. Second, these farmers supply a fundamental and universal need. Third, they operate on a modest economic scale and so power is dispersed. Fourth, the image of yeoman farmer calls up (inchoate) thoughts of a quieter, less complex life—a kind of arcadian ideal. Fifth, there seems to be a widespread desire for autarky, at least in agriculture products—to be more independent in the event of war or other disruptions in international trade.

Today, most of the food produced in Canada comes from medium to large farms run on a largely commercial basis by business people who wear jeans, down vests, baseball caps, and sturdy boots. The average milk producer works with over \$1 million in assets.<sup>43</sup> Many have degrees in agriculture and/or business. Almost all use personal computers intensively to find the best way to do things like maximizing yield per dollar. As a group, there is no reason to believe that farmers are more or less virtuous than the vast majority of Canadians. They are, however, different than most other businesses operated in Canada in a notable way—the amount of subsidies and other forms of economic benefits they receive from governments.<sup>44</sup> A high proportion of farmers are highly dependent on economic benefits paid by, or effectively mandated by, a government.<sup>45</sup> They are, in effect, “on welfare,” but it is definitely not politically correct to say so.<sup>46</sup>

But in the misty eyes and behind the rose-coloured glasses, many urbanites seem to have the “warm fuzzies” for farmers. After all, they feed us, the urbanites say. And the farm lobby groups (and there are plenty of them) regularly play on the tacit fears of Canadians that unless the flow of economic benefits to farmers continues and is enlarged, millions may go hungry or—god forbid—become dependent on foreigners for their daily bread.<sup>47</sup>

Today, very few Canadians have *ever* lived on or worked on a farm.<sup>48</sup> Yet these millions of city dwellers evidently feel some type of inchoate emotional ties to farmers. Even allowing for the “logic of collective inaction,” the passiveness of urbanites to their systematic exploitation by dairy farmers is quite remarkable. There must be utility in the consumption of myths too. See also section 10 below.

## 8. Transitional gains trap

Some years ago, Gordon Tullock (1975) explained that the benefits of some government policies get capitalized and so are “transitional” in nature.<sup>49</sup> Where the economic benefits from an interest group’s success in persuading a government to establish a policy beneficial to it are capitalized, they go largely<sup>50</sup> to the “first generation,” i.e., the initial recipients of the benefits. Subsequent owners of the asset whose value reflects the capitalization of the economic benefits usually earn only a normal return on the asset. This fact makes it much more difficult to change the policy later.

As of 2000, the estimated total value of milk quotas in Canada was \$16 billion, or an average of \$776,700 per dairy farm, or an average \$18,000 per milk cow.<sup>51</sup> The latest estimate of the total value of milk quotas in Canada is “about \$20 billion,” or about \$1 million for the average farm, or \$17,500 per cow, which is “about seven times more than the cow would cost at auction” (Fagan, 2002).

In the case of the SMMS for milk, the farmers who were the first to be assigned quotas (free of charge)<sup>52</sup> back in 1970 were able to later sell those quotas for a large capital gain. Or they may have given this valuable asset to their children. Second, and subsequent, generations of dairy farmers have had to purchase quota; the total cost of such quota for the average farm is at least as great as the cost of all the *other* assets needed for a dairy operation (land, cows, barns, milking equipment, working capital, etc.).

If the market for quota is efficient, the price (capital value) of such quota will fully reflect the following: a) expected difference between the regulated wholesale price of milk and the true cost of production; b) the risk that the SMMS will be adversely modified or eliminated; and c) the time horizon over which dairy farmers plan their activities.

The second and later generations of dairy farmers can only get a capital gain on their investment in milk quota if one or more of the following events occur: a) there is unexploited market power that would make it pay to raise prices<sup>53</sup>; b) the estimated cost of production falls unexpectedly; c) there is a decline in the perceived risk of the SMMS being changed adversely. The data on the value of milk quotas indicate that they increased over time, but the price of this asset has also fluctuated considerably as well, so there have been risks in holding this asset (see Barichello, 1996). Thus, at least some more recent purchasers of milk quotas have been able to obtain capital gains.

The elimination of the SMMS would cause large, real capital losses for the current owners of milk quotas (an average of \$776,700 per dairy farm in 2000). Naturally, owners of the quotas will resist such a change in government policy. They will almost certainly demand—in the name of “fairness”—that they be fully compensated if the scheme is abolished. What are the moral and other implications of using taxpayers’ money to compensate dairy farmers for the loss in the economic value of milk quotas?

## 9. Compensation: positive and normative perspectives

### *Positive Analysis*

It has been argued if government does not pay compensation<sup>54</sup> to the present owners of milk quotas, it will never be possible to eliminate the supply management scheme.<sup>55</sup>

It seems likely that if compensation is paid, it will create an undesirable precedent. It will encourage other interest groups to try to use their influence to achieve similar results, because a considerable number of changes in public policy generate economic losses for some citizens.<sup>56</sup>

The federal government, under the leadership of Agriculture Canada, has stoutly defended and protected SMMSs against the pressure of the US. In doing so, it has implicitly encouraged farmers to bid up or at least maintain the price of milk quotas.

### *Normative Perspectives*

What are the moral bases for the dairy farmers' claim for compensation if government eliminates the policy under which they or their predecessors have received huge economic benefits?

Here are some arguments against compensation. First, most of the current owners of quota have had fair warning of the risks of holding this particular asset. Buyers of milk quota since the late 1980s, when the terms of the free trade agreement with the US were first under discussion, must be aware of the threats to the continued existence of the supply management scheme. Second, the scheme continues to exist as a result of lobbying power and the "logic of collective inaction." If a counter lobby can win the day, so be it. In general, competition in the political arena is a good thing. Third, the scheme is one in which the few use the power of the state to "tax" the many. This cannot be morally justified. It is, among other things, the reverse of the principle of majority rule. Fourth, the economic value of the property right in quota is based on suppliers restricting domestic output below the competitive level. The scarcity is entirely artificial. If such a cartel had been created by other than government regulation, it would violate the Competition Act.<sup>57</sup> The elimination of the cartel scheme means milk production will become a competitive market. Finally, there is the matter of justice: those who live by the sword of lobby power should die by the same implement.

On average, the *net* wealth of dairy farmers is far higher (over nine times) than the average family who would have to pay the compensation if the federal government

decides it should be paid.<sup>58</sup> Thus, the redistribution would be “uphill,” i.e., from less to more affluent persons. Is that fair?

Since many changes in government regulation inflict capital losses, and these are not compensated by government,<sup>59</sup> why should the owners of milk quotas be compensated if a supply management scheme is dismantled?

For the government to pay compensation is to add insult to injury from the perspective of milk drinkers and taxpayers. For decades they have paid higher prices for milk than have US consumers due to a policy established by government at the behest of farmers in order to increase their incomes. Now, these long-suffering consumers and taxpayers are expected to pay yet more taxes to compensate the dairy farmers for the reduction in the value of milk quotas. To force them to do so is to legitimize the idea that it is right for a determined minority to exploit a large majority by means of their greater influence with government.

The leading argument *for* compensation is this: the current owners of milk quotas were required to purchase them as a necessary part of the investment to establish a dairy operation. They purchased quota in good faith assuming that the long standing SMMS would continue to function more or less as it had in the past. The scheme is a federal-provincial government policy and citizens are entitled to rely on governments not to act so as to severely disadvantage any group of citizens.

In summary terms, the normative case for paying compensation for the loss of the economic value of milk quotas is weak. The key positive argument is this: if compensation is *not* paid, it will not be politically possible to end the supply management marketing scheme and related policies which confers benefits of about \$2.5 billion each year to Canada’s dairy farmers.

## 10. Completely impervious to change?

Canada’s dairy policy represents a “wicked problem” for those who are paying the large bill for it (i.e., consumers and taxpayers). But this policy is not the creation of some evil genius seeking to impose his or her will on some 31 million Canadians. Rather, it has evolved over the past seven decades<sup>60</sup> through a succession of democratically elected provincial and federal governments and has been modified, albeit slightly, in light of a growing number of international trade agreements. It has been the subject of scores of studies by academics, government officials, parliamentary committees, and even by international bodies.

Despite all the analyses and its well-known essential characteristics (consumer prices that are above the competitive level; massive income transfers to milk producers; large amounts of economic inefficiency; and tight restrictions on imports), over time Canada's dairy policy has

- become more intricate and complex (blindingly so),
- seen industrial milk prices rise faster than the overall rate of inflation,
- produced rising prices for milk quotas, and
- required massive efforts by the federal government in international trade negotiations to limit changes that would open up the market and so reduce quota values.<sup>61</sup>

Why has Canada's dairy policy been so impervious to change?<sup>62</sup> These appear to be the most important reasons:

1. The natural opponents of the policy—the victims—are subject to the “logic of collective inaction.” This means, given the incentives they face, they are not able to create an interest group to effectively counter the dairy farmers. The “logic of collective inaction” is reinforced by many urbanites' identification with farmers<sup>63</sup> of which the yeoman farmer myth is part.
2. Dairy farmers have a huge economic stake in preserving the *status quo*: the average farm has a quota value of \$776,700 in 2000. Moreover, people will fight much harder to keep what they have than to increase their wealth by the same amount. There is a strong emotional reaction to threats to the loss of one's “accustomed position.”<sup>64</sup>
3. In light of the “logic of collective inaction,” the key political decision makers (federal cabinet ministers) find it in their best interests (i.e., maximizing the likelihood of re-election) to please the milk producers and to ignore the plight of consumers. Further, at least some ministers see the income transfers to dairy farmers as a “social benefit,” even though they are part of a negative-sum game. Public servants in provincial and federal departments of agriculture currently provide plenty of rationalizations for the status quo. But they are sufficiently “professional” to provide even better arguments for changing Canada's dairy policy if their political masters were to signal that they want to make a change.
4. Dairy farmers benefit from the axiom “the importance of being unimportant.” Being only 0.26 percent of the population means that each farm can receive a large amount (\$120,000) annually, but for the millions who pay the freight, the sum is negligible (\$80 per capita). This fact is also central to the “logic of collective inaction.”



5. Canada's dairy industry is concentrated in Quebec. It has over 47 percent of the national quota, but just under 25 percent of the population. For a variety of other reasons—some too ugly to relate—Quebec wields enormous power in Ottawa. It seldom fails to get what it wants. Quebec loves to see those large income transfers (about \$100,000 per year) to each of its dairy farmers.<sup>65</sup>
6. Globalization and new international trade agreements have not spelled the end of SMMSs, such as Canada's milk policy. Over two decades of efforts to negotiate such agreements has hardly put a dent in Canada's dairy policy. The trade wallahs (recall section 4 above) continue to hold out the prospect of multinational liberalization of trade in milk and its products, but my bet is on the farmers' ability to resist. Like other democratic nations, Canada's foreign policy is largely an extension of its domestic politics. The domestic politics of milk revolves around the preservation of the value of milk producers' quotas.
7. If the SMMS were to be dismantled, and the federal government were to have to pay full compensation for the dairy farmers' loss of quota value, the sum could easily be well in excess of \$10 billion.<sup>66</sup> That thought no doubt discourages cabinet ministers from taking actions that would do much to reduce quota values.
8. Canada's dairy policy is not a simple tax and income transfer scheme, i.e., where virtually all the benefits consist of an income transfer directly from government which is financed by taxes (general revenue). Rather, most of the economic benefit conferred on dairy farmers comes from the supply management scheme for milk (which includes import controls).<sup>67</sup> Government's role was in creating the regulatory regime that allows the representatives of dairy farmers to control the organizations that fix the price of milk at the farm gate well above that which would prevail under competitive conditions. Thus, most of the economic benefits that dairy farmers receive are *not* paid by government. That means that cabinet ministers have no concern about the revenue implications of the policy since the government-imposed tax burden is lower than if all of the benefits going to farmers came *directly* from government. In effect, the government has substituted economic regulation for part of a simple tax and transfer scheme. This makes it less vulnerable.

Can nothing be done? Can this huge Rubik's cube be "cracked"? So far, the answer has been a resounding "no." The juggernaut rolls on getting larger, more complex, and shifting more wealth from millions of consumers and taxpayers to the owners of only 20,600 dairy farms whose average net worth is nine times the median net worth of all families in Canada.

Some commentators have proposed a sort of slow “euthanasia of the rentiers.” That is, the federal cabinet would insist that milk quotas in Canada (and/or imports) would be expanded so that the economic value of quotas would fall slowly. In time, they would become inconsequential. There are two main problems with this strategy: a) it would not take the producers long to catch on and try to stop it, and b) it seems likely that a lobby group sufficiently strong to stop a sudden dismantling of the SMMS would also be strong enough to prevent its members from being strangled slowly.

Future rounds of trade negotiations seem like a useful opportunity to reform the system (see Lippert, 2001). But the dairy farmers and their bureaucratic and political allies have overcome similar threats in the past. They did so again at the WTO meeting in Doha, Qatar, in November 2001 (see Lippert, 2002). But trade-related litigation on this issue continues, and it may result in lower trade barriers for milk and its products.

There may be another glimmer of hope. It comes from reflecting on the experience of a number of other previously highly-regulated industries, e.g., telecommunications, rail freight, trucking, airlines, and some financial services. A great deal of expensive government regulation has been removed or made far less restrictive over the past two decades (see Ostry & Stanbury, 1999). The role of competitive markets has been greatly expanded. Twenty years ago, no one predicted that so much change in long-established policies would occur.

But some price and/or entry control regulatory regimes have stoutly resisted change and supply management marketing schemes is the most prominent example. Others are taxi cab regulation (where medallions or licenses—the equivalent of quotas for milk—trade for up to \$100,000 in some cities), and minimum wage regulation.

So what forces or factors might bring about reform of Canada’s dairy policy?

1. Yet more analysis? This is most unlikely to result in reform, but for us policy analysts hope springs eternal. Good and timely analysis of bad policies is usually a necessary, but not a sufficient condition for change.<sup>68</sup>
2. The burden of the policy continues to increase and eventually provokes a reaction sufficiently strong to clear the Augean stables. In the first half of 2002, the value of milk quotas rose by 18 to 19 percent in Quebec and Ontario—this while the stock market was falling a great deal (see Fagan, 2002). This is a possibility, but Canada’s dairy policy has not become sufficiently awful, although the rot is becoming more and more evident. At the same time, rising quota values—if compensation is to be paid—inhibit changes in the policy.

3. Exogenously created technological change could make continued regulation and government control impracticable, as well as undesirable. This was a major factor in the liberalization and ending of some aspects of the regulation of telecommunications in Canada. But it is hard to see what type of technological change would fatally undermine the present SMMS regime in Canada.<sup>69</sup>
4. A political leader seizes the issue and is able to gain sufficient political support to get into power and dismantle the system. Political entrepreneurs do come along, albeit rarely. But Canada's dairy policy is unlikely to provide a means to obtain sufficient political support. The aggregate gains<sup>70</sup> are not sufficiently large—unless they can be used as a symbol of much bigger problems.
5. There is a widely-reported scandal and/or examples of arrogance. If a major scandal (e.g., evidence of significant corruption) hit the Canadian Dairy Commission or the milk board of a major milk-producing province, and it was widely-reported, it might undermine the legitimacy of the entire SMMS.<sup>71</sup> People who can't understand deadweight loss can understand bribery whether in cash or kind. A similar result could be produced by widely-reported juicy examples of arrogant behaviour by the key regulatory agencies.<sup>72</sup>

## 11. Conclusions

Canada's dairy policy is an exemplar of the “logic of collective inaction” under which the well organized few can exploit the dispersed many by persuading government to create the appropriate policies.

Canada's dairy policy is an example of a policy that may be “bad” in economic terms, but is quite successful in political terms, and so is very difficult to change in ways that would please most economists. By a “bad” policy, I mean one that has two main characteristics: it causes substantial economic inefficiency (allocative, technical, dynamic), and it redistributes income by imposing taxes or other costs on many persons whose average income is far *less* than that of most of the beneficiaries of the income transfers. Further, it is possible to provide the same amount of help for the beneficiaries at less cost to society by other means. “Bad” policies also usually involve stealth—their important consequences are not widely known among electors. This appears to be the case with Canada's dairy policy.

It is the imperfections or “failures” in political markets—analogue to the concept of “market failures” in economic markets—that help to explain why such “bad” policies are created and persist for a long time.

At present, the complex structure of incentives faced by the set of actors directly or indirectly involved in Canada's dairy policy is such that it is unlikely that the policy will be changed in ways that would seriously reduce the value of milk quotas.<sup>73</sup> Worse, the value of these quotas may well continue to rise. In 1998, milk quota in Ontario sold for about \$15,000 per kilogram of butter fat sold daily. In May 2002, the price was up to \$22,950, while in Quebec it was \$29,900 (Fagan, 2002). Thus, if it is necessary to pay near full compensation to the owners of the quotas, it will become politically *more* difficult to reform Canada's dairy policy. It is, as Owen Lippert (2001) suggests, "a perfect mess." Unfortunately, other supply-managed agricultural products also have high quota values that make reforms very difficult to achieve. For example, the average value of quota for a chicken farm (28,000 birds) is \$1.5 million. For the average turkey farm it is \$1.4 million, and for the average egg farm (13,000 hens) it is \$1.75 million (Fagan, 2002). The federal Minister of Agriculture calls these supply management schemes "a unique Canadian achievement." Heaven help us—Ottawa won't.

## Notes

<sup>1</sup>Of course, dairy farmers would be worse off, by from about \$18,000 per cow, or \$360,000 for a herd of 20, or \$1,080,000 for a herd of 60 milking cows if the economic value of their milk quotas fell to zero. See Lippert (2001, pp. 52-52). The issue of whether compensation should be paid is addressed in section 9 below.

<sup>2</sup>The Canadian Dairy Commission was created on October 1, 1966, but it was not until 1970 that most of the elements of the scheme were in place.

<sup>3</sup>Since Lippert's piece was published, Canada has lost another case at the World Trade Organization (see *National Post Online*, June 25, 2002). The WTO held that Canada is illegally subsidizing the export of dairy products (\$200 million per annum, or about 4 percent of industry sales) through the national supply management scheme. The federal government has said it will appeal the decision. The US and New Zealand brought the case to the WTO back in 1998. A WTO panel ruled against Canada in 1999. Subsequently, Ottawa made changes it said fixed the problems. But New Zealand and the US launched another case.

<sup>4</sup>Albert Einstein was quoted as saying something to the effect that it was much more difficult to understand politics than it was nuclear physics and the behaviour of subatomic particles.

<sup>5</sup>This is based on Harold Lasswell's 1936 book, *Politics: Who Gets What, When, How*.

<sup>6</sup>The Producer Support Estimate is a broader measure that includes government subsidies and other payments to farmers. For dairy farmers in Canada in 2000, the PSE was \$2,452 million. Lippert (2001, p. 38) states that, “As a result of policy changes in 1994, the [federal] direct subsidy to industrial milk producers will be eliminated. In 1994, a producer received approximately 10 percent of the target price of industrial milk as a direct payment. The value of the direct subsidy in 1994 was \$230 million. In 2000, a producer receives 2 percent of the target price as a direct payment and the program now only costs \$60 million a year. The payments are scheduled to end on July 31, 2002.”

<sup>7</sup>I assume that a “dairy family” consists of a couple and two children, or four persons per dairy farm (of which there were 20,600 in Canada in 2000). Note that the size of the average household for *all* farms in Canada was 3.1 persons, according to the 1996 Census.

<sup>8</sup>By comparison, the average net cash income for poultry and egg farmers in 1998 was \$64,165 (also subject to supply management regimes), and \$69,622 for potato farmers. In 1998, the average *farm* revenue for all farms in Canada was \$153,962, but it was \$225,223 for dairy farmers, and highest of all for poultry and egg farmers at \$539,553 (Agriculture Canada, 2001).

<sup>9</sup>In 1980, there were some 80,000 dairy farms in Canada, or almost four times the number in 2000 (Lippert, 2001, p. 9).

<sup>10</sup>Politicians have been described as being “awesomely flexible.” They call it being “responsive to the will of the electorate.” Policies are to be believed in only to the extent they help a party to gain or retain office.

<sup>11</sup>In fact, this number does not include the resources used up in rent-seeking and the deadweight losses due to allocative and other forms of inefficiency created by Canada’s dairy policy. See the discussion of the public choice perspective below in this section.

<sup>12</sup>Ironically, the federal government did a great deal to help create and foster key interest groups in agriculture. See Dawson (1975).

<sup>13</sup>See Buchanan *et al.* (1980); Tullock (1987b), (1989); Rowley *et al.* eds. (1988). Note that some interest groups seek non-pecuniary benefits from governments—see Stanbury (2000).

<sup>14</sup>Lippert (2001, p. 5) has calculated the deadweight loss of transferring \$839 million to dairy farmers in 2000 at \$200 million. A more comprehensive discussion of effects of supply management on economic welfare is found in Lippert (2001, pp. 42-48).

<sup>15</sup>The redistribution is an income transfer. The total wealth of society is unchanged because what the consumers lose, the farmers gain. This ignores the fact that scarce resources are used to persuade government to create the policy, to keep the policy in place, and by government to administer it.

<sup>16</sup>The deadweight loss due to supra-competitive prices is quite small, but the likely X-inefficiency (due to higher costs that would prevail in an unregulated market and the losses due to reduced or delayed technological change—so-called “dynamic inefficiency”), are probably quite a bit more. On the other hand, productivity has increased substantially in milk production over the years.

<sup>17</sup>In general, in democracies it is much easier for interest groups, and political leaders to block efforts to change (or eliminate) an existing policy than it is to create a new policy (Stanbury, 1993a). The status quo has real weight in most instances. Democratic governments have a built in bias against change, because change can be costly to some people in both psychological and economic terms.

<sup>18</sup>There is plenty of research showing that, for most people, the disutility of a given chance of a specified decrease in their income (decline from the accustomed position) is far greater than the increase in utility from the same chance of the same increase in their present income (Kahneman and Thaler, 1991; Kahneman, Knetsch, and Thaler, 1991).

<sup>19</sup>It is common for dairy farmers to argue that the prices set by SMSS are merely sufficient to recover their cost of production and earn a “fair” profit on their investment.

<sup>20</sup>While the Minister of Agriculture takes the lead on dairy policy, all ministers are collectively responsible for every policy. Of course, the prime minister appoints all the ministers to his or her cabinet.

<sup>21</sup>It is also why many interest groups describe themselves as a “public interest group.” See Stanbury (1993b) for an explanation and critique.

<sup>22</sup>Adlai Stevenson (1900-1965), twice unsuccessful candidate for president of the United States, went so far as to say that, “Government is more than the sum of all the interests; it is the paramount interest, the public interest.”

<sup>23</sup>Generally, see Tullock (1987a). A summary can be found in Stanbury (1993a).

<sup>24</sup>This does not mean that they will act selfishly. Nor does it mean that they will pursue goals that are largely pecuniary or economic in nature. It means that they act logically to pursue those goals that are likely to provide them with the greatest utility (sense of well-being).

<sup>25</sup>Research by political scientists, however, indicates that policy issues very seldom have much influence on the outcome of general elections. The *perceived* qualities of the party leaders are usually a much more important factor in voters' decision.

<sup>26</sup>For the party in power, these resources consist of various public policies, all of which require at least some public expenditures i.e., even new regulations have an administrative cost. For parties in opposition, promises of new policies or changes in existing ones are offered.

<sup>27</sup>This figure was obtained by dividing the Consumer Support Estimate for dairy farmers (\$2.47 billion in 2000) by the total population (30.75 million in mid-2000). The result is \$80.33 to be precise.

<sup>28</sup>Recall that per capita consumption of milk in Canada has fallen by 14 percent since 1980 (Lippert, 2001, p. 3). The price elasticity of demand for milk is less than one (about 0.50). Thus, the percentage decline in total consumption is less than the percentage increase in price. The income elasticity, however, is close to one.

<sup>29</sup>Quebec (with one quarter of Canada's population) has 47.3 percent of the industrial Market Supply Quota while Ontario has 31.3 percent and Alberta has 6.3 percent (Lippert, 2001, Table 12).

<sup>30</sup>But note that Quebec producers are said to be split on the merits of supply management to a far higher degree than Ontario producers. Given the more vertically integrated structure of the industry in Quebec, there are producers there willing to sacrifice SMMS for export opportunities. Indeed, if one looks at the Quebec milk producers' web page, there are constant pleas for unity on the issue among producers. In any event, those Quebec farmers who support supply management have carried the day. The Ontario farmers have no such split. (I am indebted to Owen Lippert for these points.)

<sup>31</sup>A very few middle and senior officials "lean against the wind" and provide analyses like that contained in Lippert (2001).

<sup>32</sup>I refer primarily to public servants and consultants who provide advice on Canada's trade policies. This is a growing cadre.

<sup>33</sup>The tariffs currently imposed by Canada on imports of dairy products above the import quotas are as follows: 246 percent for grated cheese, processed cheese, fresh cheese; 238 percent for yoghurt; 277 percent for ice cream; and 299 percent for butter (Nazum, 1999).

<sup>34</sup>This assumes Canada is risk neutral. If it is risk averse, the expected future net benefits might have to be 50 to 100 percent higher still to make the international treaty the better opinion.

<sup>35</sup>For example, in Canada-US trade relations, the asymmetries in the power of the two countries mean that reciprocity is often illusory.

<sup>36</sup>I tender my apologies to the late Mancur Olson and refer readers to his highly influential book first published in 1965 (second edition, 1971).

<sup>37</sup>Using the estimated total Consumer Support Estimate going to dairy farmers in 2000, the cost was \$80.33 per capita.

<sup>38</sup>Each consumer has to consider the costs of lobbying against the expected benefit of doing so. The latter takes into account the probability of success (extremely low in the case of any individual) and the potential benefit if the policy is changed (saving each family of four about \$321 per year). On the nature of lobbying in Canada, see Stanbury (1993a).

<sup>39</sup>Lippert (2001) indicates that the Producer Support Equivalent in 2000 estimated for all farms in Canada was \$5,798 million. This amounted to 20 percent of *total* farm gate revenues. The percentage varied by product from 3 percent for poultry to 12 percent for pork to 44 percent for eggs and 58 percent for milk.

<sup>40</sup>The definition of “rural” and “urban” for the purpose of locating the population is a matter of judgment. Using urban to include Census Metropolitan Areas and Census Agglomerations, 77.9 percent of Canada’s population as at July 1, 1996 (28.85 million) was “urban” and 22.1 percent was “rural” (Statistics Canada Catalogue #93-357-XPB). As of mid-2000, the smallest of the 25 CMAs was Thunder Bay with a population of 126,300. The largest was Toronto (4.75 million). Combined, the 25 CMAs accounted for 62.7 percent of the total population of 30.75 million (Statistics Canada Catalogue #91-213-XIB). Do people who live in towns of, say, 5000 people consider themselves to be living in an “urban” area? Even if we define villages of 1000 or more persons as “urban,” over 15 percent of Canada’s population lives in rural areas.

<sup>41</sup>Recall the famous and true adage that “in politics, perception is reality.”

<sup>42</sup>I may be one of the few ex-academics who has milked cows by hand (which must be done seven days per week), mucked-out stinking barns, piled thousands of stones on a “stone boat” to clear fields for planting, and daily fed scores of pigs over several years. I have seen hail wipe out two-thirds of the value of a crop in 20 minutes. Thus, I don’t have a romantic view of farming as a way of life.



<sup>43</sup>\$1.19 million in 1997 (Agriculture Canada, 2001). Based on Lippert's (2001, p. 51) estimate for 2000, the average dairy farm has assets of \$1.6 million.

<sup>44</sup>Farming is different from other occupations in another notable way. On average, farmers earn more of their income *off* the farm than on it. In 1997, the average *total* income for 162,450 farm families in Canada was \$59,195. But 69.6 percent of this came from off-farm sources, including an average of \$27,393 from off-farm employment (Agriculture Canada, 2001).

<sup>45</sup>All provinces and the federal government have created a plethora of policies and programs designed to help farmers. These policies are both more extensive and more expensive than when agriculture was the largest sector in the Canadian economy.

<sup>46</sup>But note that there are whole provinces in Canada where the share of personal income attributable to governments of one type or another exceeds 40 percent.

<sup>47</sup>When I hear this argument, I ask, what about our dependency on central American nations for bananas? *We could* grow them in Inuvik if we spent enough of the taxpayers' money.

<sup>48</sup>Since 1931, more people in Canada have lived in communities of 1000 or more people than in "census rural areas" with a population of under 1000. In 1996, 31.3 percent of Canada's population lived in what Statistics Canada calls "predominantly rural" areas, but 15 percent were in rural, metro-adjacent areas (Statistics Canada, Cat. No. 21-006-XIE). In 1996, Canada had 276,548 farms and a total farm population of 851,410 for a family average size of 3.08 persons. Some 96.2 percent of the farm population lived in rural areas. The farm population was 3.0 percent of the total population and 12.9 percent of Canada's total rural population (data from the 1996 Census).

<sup>49</sup>See also, Tullock (1986).

<sup>50</sup>This requires that there be a market for the "property right" created by government. In case of dairy policy it is milk quotas—the right to sell a specified volume of milk each day at a price well above that which would prevail in the absence of the SMSS.

<sup>51</sup>The value of quota per cow was calculated by Professor LeRoy and reported in Lippert (2001, pp. 51-52). If one divides the average value of milk quota per farm by the average number of cows per dairy farm in Canada (56 in 2000), the figure is \$13,900 per cow.

<sup>52</sup>Rent-seeking (lobbying for policies to generate economic benefits for the members of the group seeking them) can be quite costly. So the net benefit will be smaller than the gross benefit.

<sup>53</sup>This means that the previous holders of quota, through their representatives on provincial boards and the federal board, failed to raise price to the profit-maximizing level. Or they failed to correctly anticipate one or more of the factors on which quota values are based.

<sup>54</sup>This is not the place to get into the economics of compensation, particularly how much compensation might be paid to which milk producers. This is a complex matter. See Lerner & Stanbury (1985) for an earlier effort when quota values were much lower.

<sup>55</sup>Over time, the nominal value of milk quotas has increased. This makes it increasingly costly to pay full compensation.

<sup>56</sup>Note that when a government expropriates land for public purposes (e.g., a school or road), it must pay compensation. When it makes a change in a statute or regulation (subordinate legislation) it may well cause substantial losses, but it is very rare for compensation to be paid.

<sup>57</sup>Under S.45 of the Competition Act, agreements or arrangements among competitors to fix prices, restrict supply, divide up markets, or bar entry are a criminal offence if competition is prevented or lessened “unduly.” SMMs are effectively exempted from S.45 by the “regulated conduct defence.” This is a common law provision (i.e., created by judges, not in the statute) under which otherwise illegal restraints of trade are beyond the reach of the Competition Act so long as there is a constitutional federal or provincial statute regulating the conduct in question. See Stanbury (1996).

<sup>58</sup>At the end of 1997, the average *net* worth of all dairy farms in Canada was \$962,599 (based on farm assets of \$1,189,875). The comparable figures for Quebec dairy farms were \$705,642 and \$897,465 respectively. Those for Ontario dairy farms were \$1,137,562 and \$1,369,056, respectively. (Agriculture Canada, 2001, table B.5). The median net worth (wealth) of all Canadian families was only \$119,300 in 1999 (Sauve, 2001). (The average is not given in Sauve, 2001.)

<sup>59</sup>In recent years, the growing body of environmental protection legislation has inflicted considerable losses on private landowners.

<sup>60</sup>The crucial element of a national supply management marketing scheme has been in operation for some three decades.

<sup>61</sup>See Robertson *et al.* (1997).

<sup>62</sup>Niccolo Machiavelli (1469-1527) wisely observed that, “There is nothing more difficult to take in hand, more perilous to conduct, or more uncertain in success, than to take the lead in the introduction of a new order of things.”

<sup>63</sup>Consumers and taxpayers appear to be suffering from the “Stockholm syndrome.” This term refers to behaviour and verbalizations of innocent persons held hostage by terrorists: they come to identify with the hostage-takers, believe that the latter are responsible for their safety, and express fear that the police seeking to rescue them will harm them. See Gomez (2000), website [www.syntax.net/hoax/stock.php](http://www.syntax.net/hoax/stock.php); and Gibson (2000) for an application in another context. By identifying with dairy farmers, the will of urbanites to resist the depredations caused by government at the behest of the dairy farmers has been sapped.

<sup>64</sup>See the research of Kahneman and Thaler (1991), and Kahneman, Knetsch, and Thaler (1991).

<sup>65</sup>Note that the average size of Quebec dairy farms is smaller than in Ontario, for example, so the economic benefit per farm is also somewhat smaller.

<sup>66</sup>Recall that the estimated total value of milk quotas in 2000 was \$16 billion (Lippert, 2001, p. 51). This is almost one-half the total value of assets employed in dairy farming in Canada.

<sup>67</sup>As Lippert (2001, p. 30) notes, federal cash subsidies are to be phased out by mid-2002. They have gradually been replaced by higher prices set through the SMMS.

<sup>68</sup>A series of careful studies that debunked almost all of the claims of the pro-regulation forces was important in achieving the deregulation of the US airline industry in 1978.

<sup>69</sup>But note that Canadian milk producers have introduced considerable technological innovation and so improved their productivity. This should reassure them that they can compete internationally. Productivity per cow in Canada is well ahead that in Australia and New Zealand, for example.

<sup>70</sup>Here I refer to the sum of the income transfers to the “winners” in the event of reform and the social costs (deadweight losses) that are eliminated by the reform.

<sup>71</sup>A scandal helped to undermine the Civil Aeronautics Board in the US in the mid-1970s: CAB Commissioners were accepting speaking fees and free tickets from the

airlines they were regulating. The scandal weakened the arguments of proponents of price and entry regulation.

<sup>72</sup>Arrogance is characteristic of monopolies, whether private or public.

<sup>73</sup>I appreciate that Lippert (2001) is more optimistic. He argues that a convergence of international and domestic pressures and a rethinking of the economics of industry as Professor Karl Mielke of the University of Guelph has done, demonstrates the potential gain for reform. It is a matter of communicating to both producers and politicians that change is possible and positive, according to Lippert.

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