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Graduate Category

THE PRICE OF CHEESE IN CANADA

How "Supply Management" Eats Up Your Grocery Bill

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Invisible Factors in the Size of Government

Canadians are required to directly pay for almost every government expenditure, an amount which, in 2015, cost each and every man, woman or child an average of $20,733 (approximately 42% of the total GDP of the country) [1,2]. Income and sales taxes are the most visible of those costs, but employment taxes, transfer taxes, sin taxes on alcohol and tobacco, carbon and other so-called externality correcting taxes too make up a sizable portion of the total cost. As we all know, a regular debate especially by a well-informed electorate can and should be had upon the level of government involvement in our lives and whether the actions, behaviors and expenditures of government are just, productive or desirable.

Legislation provides certain food markets enforcement mechanisms to conduct their industries monopolistically with anti-competitive, privately-administered "marketing boards".

But this isn't the only artificial cost borne by Joe Public; there's a whole set of hidden costs and unaccounted deadweight created by many policies which make such well-informed debate difficult. Regulation has direct and indirect compliance costs, inhibits innovation, interferes with efficient price signalling and can redistribute wealth from the less wealthy to the more wealthy, all in ways which are difficult to measure and analyze. All else constant, we should prefer understandable and visible taxes to the invisible and hidden costs created by many more complex forms of regulation, as the visible taxes are easier to analyze and do not obfuscate the true cost of the policy.

One example of an under-visible area of government-created, citizen-borne cost is what economists call regulatory capture: the effect when a policy or government organization gets co-opted for individual interests at the expense of competitiveness, innovation and a healthy and productive economy. There are many cases of regulatory capture and incumbent protectionism in the Canadian economy (and indeed in most other economies). Both the quantitative and qualitative impact on well-being and satisfaction in each and every one of our lives from regulatory capture is immense.

Incumbent industry protectionism is one form of regulatory capture in which government aims to "protect" the existing industry from any external forces: imports, innovation, price competition, changes in the economic climate and any other risk. Often this form of protectionism is done by legislating minimum prices, the lowest price a firm is allowed to charge, or maximum quantities (quotas) to be provided by individual firms, each resulting in prices which are abnormally high for consumers. In other cases, it is done with strict barriers to entry, such as a

requirement of domestic ownership and regulatory approval (the Canadian mobile phone industry) or licenses required to operate which are constrained in supply (taxis in most major cities in Canada).

It is important to immediately recognize that protecting incumbents in any fashion necessarily reduces innovation. This is true both because new firms with better ideas and newer technologies are excluded from the market and because little reward accrues to a firm who innovates. Innovation that could result in lower prices (and thus taking a bigger piece of the pie) has no benefit to the consumer in a market with a binding minimum price.

"Supply Management" and the Dynamic Allocation of Rents

As Canadians, one of the most under-known forms of incumbent protectionism felt by individuals is that of so-called "supply management" organizations. Federal and provincial legislation provides certain food markets enforcement mechanisms to conduct their industries monopolistically with anti-competitive, privately-administered "marketing boards." Industries with managed supply include staple foods such as milk, eggs, cheese, poultry and formerly wheat. Marketing boards mandate maximum quantities of their product produced per farm, discouraging productivity innovation, and minimum prices for the supply and retail levels, resulting in high prices, reduced innovation (both technological and economic) and most importantly—increased costs for food essentials. As an example, the International Dairy Foundation shows that the farm price (costs before transportation, packaging and retail costs) of milk is $0.72 USD per kilogram in Canada, compared to $0.37 and $0.42 USD per kilogram in the United States and European Union respectively, where supply management in the modern day is largely unheard of [4, 5].

Marketing boards are the reason Canadians have a reputation for crossing the border to get a lower price for milk and cheese. Cheese, eggs, and poultry in Canada can be as much as 150% to 500% as expensive as the true "market rate" [9]. Food marketing boards impact all Canadians, but one factor which is without question is how they disproportionately hurt the poor, who may not be able to make the cross-border journey and whose expenditure on these "protected" goods make up a significant portion of their budget. The group of Canadians with the lowest 20% of income spends nearly 50% of their income on essentials like shelter and food. Such a high fractional expenditure and limited budgetary flexibility makes artificially-inflated food prices an especially painful proposition for this group.

While dairy farmers in supply managed markets received $12.67 more per 100L of dairy product than firms outside of supply management, they paid an average of $19.39 per 100L of dairy produced to financial institutions.

Not Even Farmers Benefit—How Financial Institutions Capture Political Rents

The idea that society can benefit from protecting underperforming farms in the long-run is one that requires a suspension of critical thought: farms which are not economically feasible should be closed in favor of those which are more efficient or provide a better quality product. But even if we were to suspend the simple economic analysis, we find that the protection itself does not hold: farmers in the market today, as much as 80 years after the formation of the Canadian Dairy Farmers' Federation in 1934 [7], had to buy their way into the quota system from yesterday's farms.

To see why these policies don't benefit farms, follow the dynamic scenario. As new firms wish to establish and old firms close, the older firms sell their quotas to the newer firms, almost always financed by a bank loan[1]: such a loan, often collateralized by the quota itself, means that the "farm-targeted benefits" of quota systems end up in the coffers of the major banks via increased interest costs on the farm. Unfortunately, this system leaves both farmers and consumers worse off: the farmers with a large debt (and all the associated risks thereof) to purchase a quota, possibly constrained in ability to improve or innovate in their business by price or productivity regulation and individuals paying significantly higher prices for staple commodities. The farmers' responsibility to their quota-related debt means that despite not receiving a benefit from such a policy (with almost all the profit accruing to the financial industry), they stand to lose in the short-term if the policy were retracted, producing an artificial form of political support for a policy which, in the end, hurts everyone.

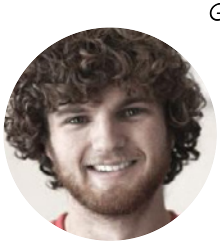
A recent publication of the Montreal Economic Institute (MEI) shows that while dairy farmers in supply managed markets received $12.67 more per 100L of dairy product than firms outside of supply management, they paid an average of $19.39 per 100L of dairy produced to financial institutions in interest payments related to the purchase of their quotas: a net loss of $6.72 per 100L for the businesses who are supposed to benefit from the policy. Outside of this specific example, researchers at the OECD maintain this is the status quo of these policies, saying "over the last two decades, the majority of government agricultural policies and programs in OECD countries have been highly ineffective in translating support into additional income for farm households." [6] This leaves no policy gains for the second-and-later generations of farms, major costs for individuals and a inhibited, slow economy where innovation is no longer rewarded.

A straightforward approach to improve the quality of life for all Canadians is to eliminate the quota system and restore a competitive approach to pricing our basic food inputs.

Assuming similar dynamics for the major managed markets (dairy, eggs and poultry), Figure 1 extends the analysis conducted by the MEI to estimate the total effect on Canadian foodstuff, finding a direct cost of more than $200 per year to the average family, a significant regressive tax on Canadian families, and finding a net loss of more than $38,000 to each Canadian farm for total losses of nearly $2 billion per year as a direct result of supply management.

A straightforward approach to improve the quality of life for all

Canadians is to eliminate the quota system and restore a competitive approach to pricing our basic food inputs. Agricultural protectionism greatly hurts the well-being of all Canadians, and especially lower income Canadians, while nonetheless not achieving the goals it sets out. In a time when food prices are rising rapidly, now is a great time to fight back against this anti-consumer policy and return to a competitive market for agricultural inputs and increase fairness, equality and productivity of our important domestic food industry. C



Giuseppe Burtini graduated from the University of British Columbia with an undergraduate degree in economics and went on to study applied econometrics, statistics and machine learning as a graduate student.

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Endnotes

1 The estimated value of all quotas in food production is provided by Statistics Canada as approximately $30 billion Canadian dollars [5] and as much as $2 million held in the average dairy farm alone [9].