2004 INDUSTRIAL MILK SUPPORT PRICES

Consumer Association of Canada
Presentation
To the Canadian Dairy Commission

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Introduction

The Consumers Association of Canada (CAC) believes the price of industrial milk must be frozen at 2003 levels, and urges the Canadian Dairy Commission (CDC) to introduce no price increase for 2004.

The dairy industry is a regulated industry and as such the CDC has a mandate to both producers and consumers. The CDC must balance a fair return to efficient producers with a constant, high quality supply to consumers. The CDC, as regulator, has a responsibility to both groups.

CAC Concerns

A. Mandate of the CDC

It can be expected that producers are primarily interested in maintaining or increasing their price. It can also be expected that processors will resist price increases. It is not expected or warranted, however, that the CDC promotes only the producer position and uses, in an unpredictable manner, the cost of production (COP) formula, market indicators, and any other special considerations to justify what has become a yearly price increase to producers.

By focusing almost exclusively on increasing producer returns, the CAC suggests that the CDC is overstepping its mandate. It is unilaterally changing the COP formula to provide an increase when the figures generated by the COP do not support such an increase. Following are examples of this:

1. At last year's pricing discussions the CDC implemented a price increase based partially on the alleged "gap" that existed between those producers receiving their cost of production and those that did not receive it. The argument in favour of this increase was based on the policy argument that the previous Chairman of the CDC had promised this to producers and therefore it should be done. This year no such policy argument was proposed and the "gap" was build directly into the pricing formula without stakeholder input. It is unacceptable to CAC that the CDC would do this without consulting others.

Furthermore, it is obvious that increasing the number of producers covered increases the number of inefficient producers in the sample. This type of change should be discussed among all stakeholders to determine if there is a policy reason for all to support it. If such discussions are not held, it appears to be a revenue grab by producers and a pooling of additional revenues at the producer level. This is unacceptable in a regulated industry because if there have been efficiency gains by producers, such gains should be shared with consumers.

2. The CDC also built into the COP formula a 5% increase in management remuneration. Although the 1994 COP formula allowed for a periodic review of the management figures, it does not provide the CDC with the power to make this change in the formula without consulting with other stakeholders in the industry.

CAC Recommendation:

CAC recommends that the Minister of Agriculture reappoint a Consultative Committee as required by the CDC Act. Such a reconstituted committee with broad stakeholder representation could address issues such as the percentage of producers to be covered by the formula and the appropriate management remuneration.

The reappointment of the Consultative Committee was recommended by the Auditor General in its 2000 Special Examination Report of the CDC.

B. COP Formula

The COP formula used by the CDC remains problematic for CAC. It is applied in an unpredictable manner and seems to be weighted more heavily if it shows an increase. It is far too broad in what it covers and there are constant attempts to expand it further, as indicated above. After more than 30 years of supply management, it does not define "efficient producer" and contains no standard for an efficient dairy unit. It was last revised in 1994.

CAC believes that the formula is most flawed in the area of labour hours. A CDC paper entitled, Characteristics of Low Cost High Cost Milk Producers (July 1992) states, "Factors that influence high labour hours per hectolitre include a lack of monitoring and control mechanisms, such as the use of standards, benchmarks or any form of reference point to rationalise labour inputs; a consciousness of the dependence of incomes on labour hours reported; and the fact that the COP does not eliminate producers using archaic technology nor does it define the economies of scale which suggest the appropriate volume of milk produced per person employed on the farm." CAC suggests this is still applicable today. There appears to be no incentive for accurate reporting of labour hours or to seek methods that use less labour.

Management returns, which are an arbitrary percentage of labour hours, are then also arguably too high. It can further be argued that outside of regulated industries returns to management are not usually guaranteed and are infact obtained from keeping costs lower than market prices. When prices are regulated and do not fluctuate, the demands on management do not include many of the normal managerial challenges regarding financial and market uncertainty. Management returns, in a regulated industry, should therefore be lower.

<u>CAC Recommendation</u>:

CAC recommends that the COP formula not be changed unilaterally by the CDC. In a regulated industry it is unfair to change the formula without stakeholder input. A unilateral change simply appears to be a poorly disguised price increase for producers.

CAC also recommends that the current COP formula, which is 10 years old, be revised in order to increase its credibility and relevance as a cost capturing tool. It is also recommended that the formula define “efficient production unit”.

C. BSE Situation

The effects of decreased revenues to the dairy industry for culled cows since the discovery of BSE in Canada was discussed.

The current COP formula captures the revenue of culled cows in cow depreciation. Less revenue in this area will be reflected in the figures generated by next year’s COP.

It is recognised that dairy farmers will be able to access all programs put into place by federal and provincial governments to compensate for the loss of revenues due to BSE. This is a transparent process and covered by all taxpayers.

<u>CAC Recommendation</u>:

CAC recommends that no special compensation be provided through milk prices for the loss of value of culled cows. Special compensation for a beef issue should not be considered in milk pricing discussions.

D. Long term Viability of the Industry

In focusing almost exclusively on producer price, the CDC is ignoring consumers. This jeopardizes the long term viability of the industry and is therefore of concern to consumers.

1. Milk Consumption is Down

Consumers, in their purchasing patterns, are indicating their preferences to the dairy industry. 2000 OECD figures indicate a downward trend in overall milk consumption of 15% in the past 20 years. There is also a 5-year downward trend in the use of dairy products in the foodservice industry in Canada.

The reasons for this are complex and may include cost, increasing immigration to Canada of populations that drink less milk, and increasing consumption of non-dairy foods that provide the same nutrients that used to be available exclusively in dairy products. A variety of products including calcium fortified drinks and home meal replacement products have huge growth potential with an ageing population that exercises less and is at greater risk for osteoarthritis and osteoporosis. Soy based foods and drinks are increasingly claiming market share. The commercialisation of health food products has also increased and this will likely continue.

Industry response to declining consumption has been primarily to spend more on promotion of its products. Millions of dollars spent on advertising the product has failed to increase consumption. There is also considerable money spent on lobbying efforts to maintain the privileged protection of the supply management system.

All the monies to carry out these functions come from the pockets of consumers. CAC does not believe consumers are getting good value for their money. As well, if there is a decline in consumption of dairy products and consumers are able to meet their nutritional needs in other ways, there should be a re-examination of the continued need for the industry to receive the protection of supply management.

2. Substitutions are Up

Increasingly the research and development budgets of large companies using dairy ingredients are moving towards the development of substitutions for dairy products. It is not necessarily consumer demand that is increasing substitutions at this point. Processors are trying to maximize profits. Once consumers are exposed to these products, however, and realize they have the choice between dairy and non-dairy ingredients with similar nutrient value in products they purchase, they may drive and demand the products. This is especially likely if price is a factor.

CAC believes that consumers are concerned that increased substitutions may decrease the quality of dairy products purchased. An example of this is the quality difference in ice cream made with butter oil blends as compared to ice cream made with milk products. It is also an issue in that consumers ultimately pay for this research into the development of substitutions. It is unclear how the industry intends to deal with this issue.

<u>CAC Recommendation:</u>

CAC recommends that the dairy industry develop a long term plan regarding substitutions. The industry must determine if it will continue to set policies and prices that encourage the processing sector to increase spending on substitution development. It should instead consider regulatory changes encouraging the development of products containing partial diary product. This could result in increased choice for consumers and increased demand for dairy products. As well, the high quality of the dairy products could be maintained, albeit combined other foodstuffs.

Conclusion

The COP formula does not indicate that a price increase is necessary this year. There is also no social or policy reason why there should be an increase. The production sector is already well compensated as indicated by International Dairy Federation figures that show Canadian dairy farmers receive higher prices than most countries in the world. Only Switzerland, Norway, Iceland, and Japan receive higher prices in the 43 country study. Statistics Canada figures show dairy farms are the most financially stable of all farms in Canada. The health of the industry is also evident in the billions of dollars transferred from consumers to producers in the form of quota values, since the beginning of supply management. Despite these indicators that the production sector of the industry is well compensated, dairy prices to producers have continued to rise.

CAC urges the CDC not to increase dairy support prices. We urge you to immediately reverse building the gap calculations into the COP, and to not unilaterally build a management increase of 5% into the COP formula. We also encourage you to support the reappointment of the Consultative Committee as a broader venue for the discussion of COP and other issues.

The CDC, in focusing almost exclusively on producer returns is failing to consider consumer issues. This is not in the long term best interests of the industry.