ECO200 (Microeconomic Theory)

The Dairy Industry and Supply Management: A Policy Brief

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Executive Summary

The supply management policy targets Canadian agricultural markets using the tools of production control, pricing mechanisms, and import control to: prevent price volatility, protect from predatory imports, and maintain market stability (Tasker, 2018). I submit that while alternatives could increase short-term social welfare, supply management ought to be maintained since it does not strain the national budget or the current account. Furthermore, supply management eliminates economic uncertainty.

Supply Management and the Dairy Market

Supply management was instated during the 1960s to counteract shortages, overproduction, and unstable farm incomes (‘NFU’, n.a.). It involves the dairy, poultry, and egg markets. Supply management’s principal tool is production control in the form of a permit-based output quota. This restricts the allowed total quantity supplied of dairy (our focus market) to a threshold below what would be supplied if the market was unregulated. Consequently, dairy products scarcer and thus more expensive. Here, the second tool of supply management intervenes: the pricing mechanism guarantees dairy producers a new minimum price since the price won’t fall without an increase in output (impossible given the output cap). This thwarts price fluctuations.

Quotas always decrease consumers’ wellbeing. Not only do consumers suffer higher prices, there are fewer consumers willing to pay above the quota price (signifying lower excess utility). Producers, however, gain: they charge more and, at previous production costs, receive higher profits. Nevertheless, the extent of producers' gain is largely determined by consumers' sensitivity to changes in dairy prices. Since consumers of most dairy products have few alternatives and are strongly insensitive to price changes (Chouinard et. al, 2010), they transfer much welfare to producers. Intuitively, few buyers switch to other markets and must accept higher prices or end consumption.

Thirdly, the government charges high tariffs on foreign dairy products. This prevents dependence on imports, keeps high market standards, and protects domestic businesses.

Alternatives to Supply Management

A notable alternative to supply management is a direct per-unit production subsidy. Subsidies lower the cost of production for producers allowing them to expand supply and decrease prices. Importantly, the producer receives higher per-unit revenue after the subsidy despite the lower price because the government adds revenue onto individual consumer purchases. Consumers benefit by paying a lower price, while producers benefit by selling more at higher per-unit revenues. Considering dairy's unsensitive demand, consumers would gain most welfare from the subsidy; the decrease in the price they pay would be proportionately more than the increase in the revenue for the producer. However, the subsidy requires government financing which costs society an increase in taxes. Hence, the incidence of the subsidy does eventually bedevil the public. Taxes hurt disposable incomes and decrease aggregate consumption, hindering growth. If Canada enters budget deficit, further spending will seriously stunt investment.

A subsidy is a worthwhile consideration because it returns the forces of demand and supply into balance, and the market into efficiency. Presently, the quota system enables mostly large producers to produce, since the up-front price of a permit is immense (Talker, 2018). Such large establishments can afford to be inefficient and waste resources. If a subsidy lowered the barriers to enter the dairy market, small, efficient producers could increase market productivity. Crucially, loss of social welfare is inevitable in a regulated market. Both quotas and subsidies create welfare loss.

Policy Recommendation

Supply management should be maintained. The U.S.A.'s inferior agricultural subsidies burden the national budget and make for a less stable industry. Many American farmers look at the Canadian enterprise with envy (Talker, 2018). In fact, Canada’s current dairy prices compare favourably to those in similar economies (Talker, 2018).

Supply management’s import control is vital toward protecting domestic businesses, maintaining product quality (important in the food industry), and collecting government revenue. It also nurtures a healthy current account balance, prevents outflows of capital which could hurt the exchange rate, and provides domestic jobs. To ease inflationary pressures, supply management could be modified by releasing additional permits to invite more producers, partially lower prices, and increase market efficiency.

Bibliography

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