Canada’s Supply-Managed Dairy Policy: How We Got Here

**At a Glance**

- The dairy supply management system was created to deal with chronic milk surpluses and low returns to dairy farmers.
- Supply management has reduced the surpluses and provided higher, more stable returns to dairy farmers.
- These benefits have come at significant cost to the industry, including stagnant markets compared with the growth in peer countries and restrictions on Canada’s access to export markets.
- The system has evolved in response to conditions unforeseen when it was created.

**THIS BRIEFING IN CONTEXT**

Though most Canadians drink milk or eat yogurt or cheese, few are aware of the long-standing, complex supply management system that sets milk prices at the farm level and limits milk supply and dairy imports (another Conference Board analysis explains how the system works in practice).

More are beginning to notice now. In June 2012, Canada was accepted into Transpacific Partnership trade talks. Media reports have focused on how partner countries want access to Canada’s long-protected dairy market in return for greater access to their markets for all goods and services. (Partner countries will also seek access to other Canadian sectors, as well as changes to other policies, such as Canadian competition policies.)
Canada is also negotiating a trade deal with the European Union. Greater access to Canada’s dairy market in return for greater access to the EU market for all goods and services could be part of the deal. Pressure to abandon the long-standing protection of Canada’s dairy (as well as poultry and egg) sector from international competition has intensified.

What is clear is that Canada’s long-standing policy will need to change—whether marginally, dramatically, or somewhere in between—in response to domestic and international pressures. But why do we have such a policy? How did it come to be, and how has it evolved over time? Does it still help dairy farmers? What are its intended—and unintended—consequences for them?

We hope that an understanding of the origins and evolution of this policy will help inform decision-makers in making changes to dairy policy that take into account the realities of today’s industry, the domestic and international contexts, and Canada’s larger trade and public policy interests.

While other studies have examined the effect of the supply management system on broad Canadian public interests, this briefing by the George Morris Centre brings in a different perspective that considers the dairy industry’s situation. The authors explain the low farmer returns and chronic surpluses that led to this policy being created and describe the system’s fragmented evolution into today’s bureaucratic, complex system. The authors also describe how Canada’s supply-managed dairy system has reduced chronic milk surpluses and provided stable, higher returns to farmers, but it has come at a significant cost to the industry’s economic performance.

—The Conference Board of Canada

### Glossary and Abbreviations

- **CDC**—Canadian Dairy Commission: administers support prices for butter and skim milk powder and industrial milk quota.
- **Canadian Milk Supply Management Committee** establishes the level of industrial milk quotas in Canada and monitors the performance of the national supply management system.
- **MPC**—milk protein concentrate: ranges from about 70 to 85 per cent protein.
- **MSQ**—Market Sharing Quota: quota for milk used in manufacturing.
- **P5 Eastern Milk Pool**: interprovincial pooling agreement among Canada’s eastern provinces (Ontario, Quebec, Nova Scotia, New Brunswick, and Prince Edward Island).
- **SEQ**—subsidy eligibility quotas.
- **SMP**—Skim Milk Powder: approximately 1 to 3 per cent fat, 36 to 40 per cent protein.
- **WMP**—Western Milk Pool: interprovincial pooling agreement among Canada’s western provinces (British Columbia, Alberta, Saskatchewan, and Manitoba).
- **World Trade Organization**: facilitates and implements trade rules and agreements.

### BEFORE SUPPLY MANAGEMENT: THE DAIRY INDUSTRY

Canada has had a significant dairy farming and processing sector since before Confederation. Our current supply management system was created in the 1960s and early 1970s, though its origins are much earlier.

Canada was a dairy product exporter in the early 20th century, particularly of cheese. (See Chart 1.) Through the late 1920s and the Depression, dairy exports dropped off. During the Second World War, Canada was a significant supplier of dairy products.

(especially cheese) to the United Kingdom, which was cut off from its traditional supply in continental Europe. Following the war, as continental European dairy production recovered, Canadian cheese exports declined sharply.\(^2\)

This reduction in cheese exports forced the Canadian dairy industry to focus on its domestic market, which grew based on both population and income in the 1950s and 1960s.

But because the scale of the Canadian industry was based on an extensive export market, shifting this production capacity to serve the domestic market resulted in surpluses. Large volumes of milk shifted from cheese production into butter and milk powder production caused surpluses of creamery butter and skim milk powder (SMP). Periodic large exports were required to deal with those stocks—particularly the significant exports of butter in the late 1950s and early 1960s, culminating in very large exports in 1964. (See Chart 1.)

**Reduction in cheese exports post-WWII forced the Canadian dairy industry to focus on its domestic market.**

Structural shifts led to less on-farm processing of milk into products such as cheese and butter. The unused milk was released to the market, where it contributed to surpluses. Production of margarine as a butter substitute also contributed to dairy surpluses. Chart 2 illustrates the reduction in the proportion of milk used to make cheddar cheese through the early 1960s, from around 13 per cent during the Second World War to only about 5 per cent in the mid-1950s.

At the same time, more milk was being used in manufacturing butter and concentrated milk products and as fluid milk. Another factor of the time was the structural shift of milk away from farm-produced butter and cheese and fluid milk consumed on the farm. The shift in butterfat allocation among products and between farm and off-farm sales was remarkable. (See Chart 2.)

This occurred just as margarine was approved for sale in the late 1940s. That reduced butter consumption,\(^3\) exacerbating the mounting stocks of butter and SMP\(^4\) and the milk surpluses. (See Chart 3.) Domestic disappearance data (a method of estimating consumption) for margarine

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2 McCormick, A Hundred Years in the Dairy Industry.

3 Ibid.

4 Ibid.
grew dramatically after its introduction in 1949. Though butter disappearance also increased with a growing population and incomes, it peaked in 1964, while margarine consumption continued to grow.

Domestic milk markets in the 1950s and 1960s faced other difficulties as well. As a highly perishable product, fluid milk could be seasonally short, especially in large urban areas, due to production seasonality. Milk marketing was a complex web that fragmented producers across regions, producer associations, and markets.

For example, in Ontario, producers were fragmented between milk used for the retail fluid market and industrial milk for processing into dairy products. Fluid milk prices, which were negotiated between the Ontario Whole Milk Producers’ League and the Ontario Milk Distributors’ Association, were subject to a floor price scheme supervised by the Ontario government. Access to the fluid market was limited by quotas issued by processors. Milk used in cheese manufacturing was priced under a separate collective bargaining arrangement, and yet another collective bargaining process was used to establish prices for milk used in making butter and milk powders. As Chart 2 shows, the growth in fluid markets was entirely different from that in butter and cheese markets.

In Ontario, producers were fragmented between milk used for the retail fluid market and industrial milk for processing into dairy products.

In the 1950s and 1960s in Ontario, prices for milk used in fluid bottling and milk used to manufacture cheese and butter differed sharply, creating discontent among producers. Among producers supplying fluid milk, prices varied widely according to the plant being supplied, and the quotas associated with the supply of some fluid plants increased rapidly in value. This also created discontent among producers. Milk prices were inflexible and insensitive due to the regulation intended to stabilize the fluid supply.

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5 McCormick, A Hundred Years in the Dairy Industry.


8 Ibid.

9 Ibid.
The problem occurred throughout the country. In its report in 1967, the Nova Scotia Milk Industry Inquiry declared that the dairy industry’s major problem was surplus production, related to poor production efficiencies, low levels of investment in farm and processing facilities and in human capital, and lack of industry coordination. This is similar to the findings of the 1956 Clyne Commission in British Columbia, which observed surplus production in relation to the wide spread between fluid milk and industrial milk prices. Because producers had difficulty understanding the size of their markets and suffered from cyclical overproduction, processors could exert market power over producers.

Table 1 shows evidence of the broad effect of collective marketing arrangements. Through the late 1950s and 1960s, marketing boards were responsible for relatively moderate shares of dairy farm cash receipts. It was not until the late 1960s and 1970s, as the modern supply management system developed, that marketing boards had dominant (and eventually complete) shares of milk marketing receipts.

### DAIRY POLICY PRE-SUPPLY MANAGEMENT

In response to the above market conditions, federal and provincial governments implemented policies to stabilize markets.

Following the Second World War, a range of measures authorized the federal government to support the prices of manufactured dairy products—notably butter, cheese, and skim milk powder. These included the Agricultural Products Act (1947), the Agricultural Stabilization Act (1958), and the Agricultural Products Board Act (1951). These established floor prices for products to support farm milk prices.

<table>
<thead>
<tr>
<th>Year</th>
<th>Value of receipts</th>
<th>Share of total milk receipts</th>
</tr>
</thead>
<tbody>
<tr>
<td>1957–58</td>
<td>73</td>
<td>16</td>
</tr>
<tr>
<td>58–59</td>
<td>108</td>
<td>22</td>
</tr>
<tr>
<td>59–60</td>
<td>115</td>
<td>22</td>
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<td>60–61</td>
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<td>89</td>
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<td>74–75</td>
<td>1,301</td>
<td>99</td>
</tr>
<tr>
<td>75–76</td>
<td>1,608</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Statistics Canada Archives, Series M494.

13 McCormick, A Hundred Years in the Dairy Industry.
14 Ibid.
15 Scullion, The Canadian Dairy Commission.
By the late 1960s, offer-to-purchase and other support programs were being used to purchase about one-quarter of the butter production and over 60 per cent of skim milk powder production. Deficiency payments to farmers ranged from $0.25 per hundred pounds in the early 1960s to $1.25 per hundred pounds and subject to a quota by the early 1970s. Product support and deficiency payments were very expensive, at least by the standards of the time. (See Table 2.) Annual program costs increased, in nominal terms, from about $60 million in the early 1960s to well over $100 million by the early 1970s.

### Table 2

<table>
<thead>
<tr>
<th>Period</th>
<th>Cost</th>
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<tbody>
<tr>
<td>1962–63</td>
<td>59.7</td>
</tr>
<tr>
<td>63–64</td>
<td>117.2</td>
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<tr>
<td>64–65</td>
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<td>113.8</td>
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<td>71–72</td>
<td>119.4</td>
</tr>
</tbody>
</table>


Provincial governments implemented policies relating to dairy producer agencies, milk price-setting processes, milk transportation, and public health/milk quality regulations. By the 1960s, most provincial governments had created authority for producer agencies or marketing boards, and they had regulations regarding how these agencies represented producers and engaged processors on their behalf. In other cases, provincial governments regulated pricing directly—such as the formula that the Ontario Milk Industry Board applied in fluid milk price negotiations.

### SUPPLY MANAGEMENT POLICY

The above policies began to coalesce into what is recognized as the Canadian supply management system in the mid-1960s. This involved a number of elements. Firstly, provinces streamlined their producer agencies involved in milk marketing. For example, Quebec created the Conseil de l’industrie laitière du Québec to represent processors in a single body, and Ontario created the Ontario Milk Marketing Board to represent producers, in place of multiple and separate producer agencies. Biggs notes that this process of organizing Ontario producers under the authority of a mandatory system was controversial, with many raucous public debates and legal challenges from producer groups and processors.

Secondly, in 1967–68, the federal government, through the Canadian Dairy Commission (CDC) (established in 1967), introduced subsidy eligibility quotas (SEQ). SEQ was distributed to producers based on 1966–67 production; McCormick notes that this was government’s first attempt to link dairy support to domestic market size. In an attempt to phase out inefficient production, SEQ was not issued to producers who delivered fewer than 12,000 pounds of milk or 420 pounds of butterfat in 1966–67; these producers received a phase-out payment.

Finally, in January 1971, an interprovincial market-sharing agreement on industrial milk was reached between the Canadian Dairy Commission, the Ontario government, the government of Quebec, and the respective dairy marketing organizations in those two provinces. Prince Edward Island entered the agreement in late 1971, with most other provinces entering in 1972.

17 Scullion, The Canadian Dairy Commission.
19 Biggs, The Challenge of Achievement.
Under the agreement, provinces agreed to come under a national butterfat-based quota. Provincial agencies allocated quotas to individual producers and collected levies within quota and in excess of quota, and they remitted those levies to the CDC. The agreement also allocated industrial milk quota to producers who held fluid quota to account for the excess fluid milk that was diverted to the industrial milk market. This provided some coordination to the fluid and industrial milk markets and helped alleviate the seasonality of fluid supply. This federal–provincial agreement formed the basis for the Comprehensive Milk Marketing Plan and for Market Sharing Quota (MSQ).

Thus, with a quota system, a means of supporting dairy product and milk prices, and border controls, the basics of the modern milk supply management system were in place. By the early 1970s, supply management had been implemented nationally, with the exception of Newfoundland and Labrador and the Territories. The system was still interim and evolving. A formal cost-of-production formula for industrial milk was introduced in 1975 to replace the less-formal mechanism to set target prices for deficiency payments that had been implemented under SEQ.

For the most part, the MSQ did not constrain milk production between 1970 and 1975. This was because provinces entered the agreement based on existing production levels, and those levels were not permitted to decrease for three years. Moreover, poor weather conditions and increasing costs in the early 1970s dampened production.

In response to those conditions and the resulting butter shortage, the CDC aggressively increased support prices and imported butter in 1972–73. The federal direct subsidy on industrial milk was increased and capped at $2.66 per hundred pounds ($6.03 per hectolitre) in 1975. However, by 1976, surplus became the problem, and the government’s costs to manage surpluses were becoming extremely large. In response, the MSQ was reduced by 18 per cent, which resulted in a raucous mass dairy farmer protest on Parliament Hill.

Dairy policy continued to evolve. Adjustments increased flexibility within the MSQ for product exports (the “sleeve”), and levies were created and altered over time to fund promotion and research and to reconcile flows of fluid and industrial milk utilization within provinces, and between provinces.

As described by Scullion, milk supply management evolved throughout the 1980s, with regulatory changes occurring in response to market changes.

In 1983, the interim supply management system was replaced by the National Milk Marketing Plan, which defined the provincial marketing boards’ roles at the national level, as well as the role of the Canadian Milk Supply Management Committee. It also defined provincial market shares of MSQ and levy schedules.

With a quota system, means of supporting dairy product and milk prices, and border controls, the basics of the modern milk supply management system were in place.

Later that year, British Columbia opted out of the national system over concerns about the allocation of MSQ across provinces (and the subsidy that went with it); this was later reconciled with an amendment to the plan, and B.C. was allocated more MSQ.

By the mid-1980s, the industry had adopted a new cost-of-production formula and new mechanisms to set the support price of butter and skim milk powder. The fiscal pressures of the 1980s also limited the federal government’s means and willingness to finance certain elements of dairy policy, particularly with respect to surplus removal. In the late 1980s, the federal government stopped paying the direct subsidy on

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22 Hiscocks and Stephens, “Review of the Canadian Dairy Commission.”
23 McLaughlin, “Address to the National Mastitis Council, Inc.”
25 Forbes et al., Economic Intervention and Regulation in Canadian Agriculture.
26 Scullion, The Canadian Dairy Commission.
exports within quota, and it allocated the carrying costs of butter and skim milk powder in storage to producers. These costs were passed on in milk price increases.

The 1990s and 2000s saw supply management pressured by free trade discussions with the United States and later with Mexico, the multilateral Uruguay Round Agreement on Agriculture, domestic fiscal pressures, and market changes brought about by substitute products.

These and other factors resulted in a range of changes in milk supply management:

- conversion of binding import quotas protecting the dairy product market to a schedule of tariffs and tariff-rate quotas
- consolidation of fluid and industrial milk quota into a single quota
- establishment of regional pools in eastern Canada (P5) and in western Canada (WMP)
- implementation of, followed by suspension of, interprovincial movement in production quota between some provinces
- loss of U.S. export markets under the North American Free Trade Agreement (NAFTA)
- phase-out of the dairy direct subsidy, beginning in 1995
- trade irritants:
  - significant import of butteroil-sugar blends exclusive of tariffs, largely from the United States
  - United States and New Zealand’s trade challenges regarding the use of special milk classes for exports, first under NAFTA and later (successfully) using the World Trade Organization dispute resolution process (Canadian dairy exports were deemed subsidized and subject to subsidized export limits negotiated in the Uruguay Round; this sharply lowered Canadian dairy exports)
  - increased imports of milk protein concentrate (MPC) through the 2000s that were substituted for Canadian milk in the manufacture of cheese, yogurt, and other dairy products (following a Canadian International Trade Tribunal review, Canada established new tariffs for MPC using the World Trade Organization Article 28 mechanism and created compositional standards for cheese that regulate the nature and extent of MPC use in cheese)

**Dairy Policy Today**

Milk supply management is commonly described as operating under three “pillars”: production controls (quota), administered pricing, and import controls. The following summarizes how this complex system operates:

- Target prices at the farm level are determined. Historically, the target price was based on surveyed cost of production. Today, the desired price target draws on the cost of production and other market factors.
- The Canadian Dairy Commission implements the price target by adjusting the support prices for butter and skim milk powder (SMP). Provincial marketing boards adjust prices for butterfat proportionally with the change in the butter support price, and they adjust protein/other solids prices proportional to the SMP support price. Provincial marketing boards maintain authority for fluid milk pricing, but the price follows changes in industrial milk prices established at the national level.
- In practice, the price target is implemented using classified prices in which marketing boards sell milk to processors at different prices according to end use. For the purpose of payment to farmers, these end-use class prices are blended (pooled); blended price corresponds to the price target.
- Production quotas are adjusted to sell farmers’ milk at the target price. Quotas are adjusted according to market conditions to clear the market at the target price.
- Since target milk prices are well above world prices, tariffs on dairy products are used to protect the domestic market.
- provincial-level quota administration evolution from a system with essentially freely traded quota to one that includes an assessment taken on quota sales, and in many provinces to a price-cap system with limits on quota prices and limitations on certain forms of transfer

**HOW POLICY HAS EVOLVED**

Historically, the main purpose of dairy policy in Canada has been to limit surplus supplies of milk and dairy products.

This was particularly significant following the Second World War. Canada emerged from the war leveraged toward export, but post-war export markets declined sharply just as improvements in technology increased
milk production and margarine was introduced as a substitute for butter. The results were large, long-lasting milk and dairy product surplus and low returns for farmers. Some producers earned much more than others, and problems developed due to processors’ market power.

Canadian dairy policy has not developed smoothly. The industry was highly fragmented, both within provinces and regions and between fluid and industrial milk markets. Initial attempts to manage surpluses and increase returns involved significant government purchases and deficiency payments to producers. These were replaced with quotas to allocate the deficiency payments, followed by quotas to limit production. Early attempts to limit production with quotas proved insufficient; quotas were sharply tightened in 1976.

**Control of milk surpluses and market access/equity and increased producer returns at manageable public cost have been the goals of supply management in Canada.**

Dairy policy has evolved constantly as the regulated system attempts to adapt to changes in markets, trade, government finances, and technology.

A main influencer of milk supply management has been the cost to governments of managing surpluses. This accounted for changes in national milk policy in the late 1960s and in the 1970s, 1980s, and 1990s.

More recently, trade pressures have shaped supply management: from competition by imported substitute products such as butteroil/sugar blends and, more recently, MPC, as well as from trade challenges to classified pricing schemes for exported product. Improved technology has sharply increased milk production efficiency and scale and produced new forms of dairy products not anticipated by policy-makers in the past. The system has been buffeted by pressures and challenges and has been constantly changing in response.

The control of milk surpluses and market access/equity and increased producer returns at manageable public cost have been the goals of supply management in Canada. This was born out of a difficult situation of chronic surplus and low returns, and the system has developed effectively achieve these goals.

However, this success has come at a cost. Canada’s competitor country dairy industries have seen significant milk market growth, while in aggregate, Canada has seen no growth in overall milk volumes—despite large increases in both population and income.

The prices generated under supply management have attracted more imports and encouraged the development of substitute products. At the same time, returns have been heavily capitalized into milk quotas, depressing overall financial returns even as operating returns are increasing. The regulatory instruments developed to maintain milk price levels and restrain quota value appreciation have restricted export market access, sharply limited access to milk quota for transfer purposes, and fragmented the domestic market. All of this is implemented through a highly bureaucratic system.

**Evolving policy without being trapped by history**

Much of Canada’s milk supply management regulation goes beyond the necessary, creating unintended costs and burdens to the operation of the system. The challenge for the Canadian dairy industry and policy-makers is to retain the elements of supply management that maintain its functions and purpose, while allowing changes in other elements—without being trapped by the system’s history.

**Bibliography**


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by R. Allan Mussell, Bob Seguin, and Janalee Sweetland

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