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TPP attack on Supply Management: a beggar thy neighbour strategy

—by Cathy Holtslander, NFU Director of Research and Policy

In the Trans Pacific Partnership (TPP) negotiations Canada's supply management system, particularly in dairy, is under relentless attack. The 12 TPP countries* tried to finalize the trade agreement in July, but left the Hawaii meetings without a deal. Media reports indicate Canada made last-minute concessions on dairy tariffs; however, details are still a secret. A look at the dairy business in New Zealand, Australia and the USA – and their EU rivals – sheds light on why they are so eager to get more access to Canada.

Most nations' dairy policies focus on providing milk for their own populations. As a result, only a small portion of the world's dairy is traded, and exports are generally surplus to domestic needs. When countries shift from a domestic milk strategy to a dairy export strategy, the selling price of exports becomes a major factor in setting the farm-gate price.

New Zealand

New Zealand exports 95% of its dairy production. One-third of internationally-traded dairy products are from New Zealand. New Zealand has been promoting dairy exports since 2001 and is now highly dependent on dairy. Fonterra, a mega-co-operative, purchases nearly all milk produced in New Zealand. Its strategy is to rapidly increase volume and to add value through processing. It has grown by selling to countries that have rising populations and less-developed dairy sectors, such as China. It also partners with corporations in the USA, South Africa and Europe to sell specialized milk ingredients.

New Zealand farm-gate prices are set by Fonterra, based on international dairy auction prices. On July 31, 2015 Fonterra warned it planned to reduce the price due to lack of foreign demand – or in other words, excess supply. Two of its biggest markets – China and Russia – have significantly reduced imports. China has increased its own production and now has large stockpiles of powdered milk, while Russia closed its borders to food imports in response to international political sanctions. Its biggest competitor, the European Union (EU), is also challenging New Zealand's sales.

On August 19, Fonterra's farm-gate price went down from $5.35/per kg milk solids to $3.25 (New Zealand dollars). Farmers' cost of production is estimated to be $6.00. For every dollar reduction in milk price, approximately $2 billion is lost from the dairy economy. Fonterra laid off more than 500 employees in August, while farmers are forced to take on more debt, reduce herds, and in some cases exit the sector. These multi-billion dollar losses ripple throughout rural communities.

Australia

Australia exports almost half the milk it produces, and provides around 10% of all dairy products traded internationally. Until 2000, Australia had a two-price system where the regulated domestic price was set higher than the export price. Now, the Australian farm-gate price closely tracks the international price, which is influenced by currency exchange rates and the dynamics of the large dairy trading countries. Australia exports primarily into China, Japan and Southeast Asian countries.

Australian check-off organizations collect levies from farmers and use the funds to promote higher farm productivity and increased sales to export markets. These

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*Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, USA and Vietnam. Note that China is not part of the TPP.

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organizations have strong representation from dairy processors and corporate dairy farms, prompting some Australians to question whose interests they actually serve. The Australian dairy industry seeks new markets – such as Canada's – hoping the trade situation will shift to one where demand chases supply, leading to price increases.

The USA

From 1985 until 2010, the US Farm Bill's Dairy Export Incentive Program promoted American dairy exports with subsidies. US exports now comprise 16% of world trade in dairy products and 15% of the USA's total dairy production. 8% of American dairy exports already enter the Canadian market. As the volume of export-oriented production has increased, the world price for dairy products decreased, while the US dollar strengthened against other currencies, putting additional pressure on US export prices. The dairy lobby in the US is pushing their government to obtain full access to Canada's market as a way to increase sales and partially compensate for low prices.

Europe

The European Union (EU) is not part of the TPP, but because it is the world's second-largest exporter its dairy policy has an impact on negotiations. On April 1, 2015, the EU completed its phase-out of the quota system that has prevented over-production for decades. Many dairy farmers have ramped up in anticipation of bigger sales. Now all are facing a severe price slump – estimated at 40% below the cost of production. Farmers in the United Kingdom and France are protesting in grocery stores and on the streets.

Vicious circle

Farmers in all major dairy exporting jurisdictions are subject to price volatility caused by fluctuations in both international supply-demand dynamics and currency exchange rates. Classical economic theory suggests that when expenses exceed revenues production will decrease until supply and demand balance again. However, dairy cows cannot be turned on and off like machines, or be laid off like human workers. Sending the cows to slaughter under these circumstances will impair future income potential and reduce only some costs, such as feed, labour and vet bills, but not loan payments. When the price is below the cost of production it makes sense to try to bring in as much revenue as possible – even if it is not profitable – by increasing output to pay for at least some of the animals' feed and care, as well as to service mounting debt. This vicious circle makes the excess supply problem worse until a breaking point is reached, followed by widespread bankruptcies and herd reductions.

Price volatility ratchets up the scale of production, as smaller operations exit and larger operations seek credit to expand production when prices are low. As smaller farms go out of business, larger operations consolidate to increase their sales volume, albeit with smaller margins. Dairy farms in New Zealand, Australia and the USA are much larger than in Canada due to the volatility inherent in their systems. There are now several corporate dairy farms in Australia running herds ranging from 3,500 to 15,000 cows. The biggest in the USA milks 30,000 – more than the total number of dairy cows in Saskatchewan. New Zealand farms are getting bigger too. In all three countries there is increasing public concern about impacts of larger-scale, more intensive dairy operations.

Export-oriented dairy strategy invariably puts downward pressure on domestic prices. An extended period of low world prices is causing hardship, even despair, for many farmers who are trying to make a living in New Zealand, the USA and Australia. Their governments are trying to pry open Canada's market to solve their own dairy income problems by selling more milk. However, when the price is below the cost of production, increasing sales volume also increases total losses. Instead of pursuing a "beggar thy neighbour" strategy, these countries would be better off if they set up their own supply management systems.

New Zealand, the USA and Australia are also competing with each other and the EU for export sales. If our government negotiates away import controls to get a deal, Canada would become one of their battlegrounds. Who, other than global food corporations seeking low-cost dairy ingredients, would benefit from the TPP nations' dairy farmers losing even more money by undercutting Canadian farmers?

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