

Ontario Dairyman Explains Canada's Milk Marketing/Pricing System

by Pete Hardin

The complexities of Canada's dairy marketing/pricing system were detailed by a board member of the Dairy Farmers of Ontario (DFO) in early February at the Wisconsin Farmers Union convention. DFO is the province of Ontario's milk marketing board.

Murray Sherk – vice-chairman of DFO – presented a thorough overview of Canada's dairy industry to a very attentive audience. Sherk and his family milk 130 cows in Waterloo County, west of Toronto. He transitioned back to his family's dairy farm after a career in agricultural banking that spanned more than two decades. The following is a summary of key points and facts Sherk presented at that meeting:

Milk quotas are based on kilograms of butterfat. Canada's system of on-farm milk quotas is based upon quota-holding producers' right to sell kilograms (2.2 lbs.) of butterfat. Canada's overall strategy is to aim to try to produce butterfat in volumes close to the estimated needs of that nation. Milk in Ontario can only be sold through DFO, which in turn sells it to processors in the province. Each dairy farmer selling milk to DFO has an individual quota. At the national level, butterfat needs are estimated by the Canadian Dairy Commission, and then apportioned out among the provincial milk marketing boards. In 2017, Canada targeted production of 367.26 million kilograms of butterfat.

Milk quotas (per kilogram) are high-priced. Hold your breath on this one. The value of quota in Ontario for a farm to sell one average milk cow's worth of annual butterfat output is **\$24,000**. (Yes: Dollar sign, Two-four-zero-zero-zero.) Sherk explained that in recent years, DFO has put cap on the quota value (per k/g of butterfat) to keep those prices from surging even higher. When Canada's provinces adopted milk quotas in the late 1960s/early 1970s, quota had no value and was allocated to producers based upon their historic milk production volumes. Back then, Canada's nascent provincial dairy boards apportioned quota, based upon a percentage of production history, among all producers in the province – relative to estimated milk needs by dairy processors. Over time, quotas developed economic value as some farmers exited production, while others sought to enter the industry or expand their farms. Rather than looking at milk quotas as a costly barrier to entry, Sherk emphasized the viewpoint that DFO's quotas represent the value of a stable, profitable system.

Milk quotas are valuable assets and may be traded – sold and purchased among farmers — through DFO. Farmers' milk quotas may be bought/sold monthly, through an Exchange managed by DFO. Producers wishing to expand or reduce their farm's production may notify DFO of their intent. Milk quotas are not sold farmer-to-farmer other than when through whole farm sales. As well, DFO will issue new quota to all farmers, on a percentage basis, when more milk is required to meet the market requirements. This represents growth and investment for the farmers, and if they do not want to produce the milk, they can sell the quota growth.

Over-reaching goal is to keep land-owning producers on the farm. A primary goal of DFO is to keep milk quotas in the hands of land-owning, active dairy producers. Quota-holders must either reside at the dairy farm, or live within ten kilometers of the milking premises. When an active dairy farm's ownership is transferred, quota-holders may directly transfer their holdings to family members, without penalty or fee, as part of transferring ownership of the active dairy farm. In instances where an active dairy farm is sold to someone who is not a member of the immediate family, the quota maybe transferred with the farm so long as the buyer abides by the rules laid out by DFO.

All milk produced in Ontario sold to DFO. Under its rules, all cow's milk produced in Ontario Province is sold to DFO. That provincial marketing board conducts the logistics of milk hauling. (DFO owns no milk trucks or trailers, but contracts private firms for milk hauling.) All farmers receive the same component blend price. In the case of what we in the United States call "producer-handlers," – those businesses sell their milk to DFO and DFO sells their milk back to that producer for on-farm processing. In a situation where a dairy farm over-produces behind his/her milk quota, a penalty is invoked. And when the over-production exceeds 10 days' worth of milk (on an annual basis), DFO accepts the milk but does not pay the producer one cent for that surplus. In such instances, the producer is also liable for milk hauling costs. Thus, Sherk emphasized, it only makes financial sense for producers in Ontario to closely match each farm's milk sales to it's quota holdings. It is how their system matches the supply to the demand or requirements.

Milk prices for Classes 1-4 are determined by a formula that incorporates 50% of annual changes in Production Costs and 50% of the annual change Consumer Price Index. Canada's milk prices for producers are calculated using a formula that equally weighs two factors: Dairy producer costs of production and a national Consumer Price Index (CPI). (Important to note: the Canadian CPI is a measure of **all** consumer costs for goods and services, not just strictly those for dairy products. If, for example, energy costs were to rise significantly, that would be reflected in the CPI.)

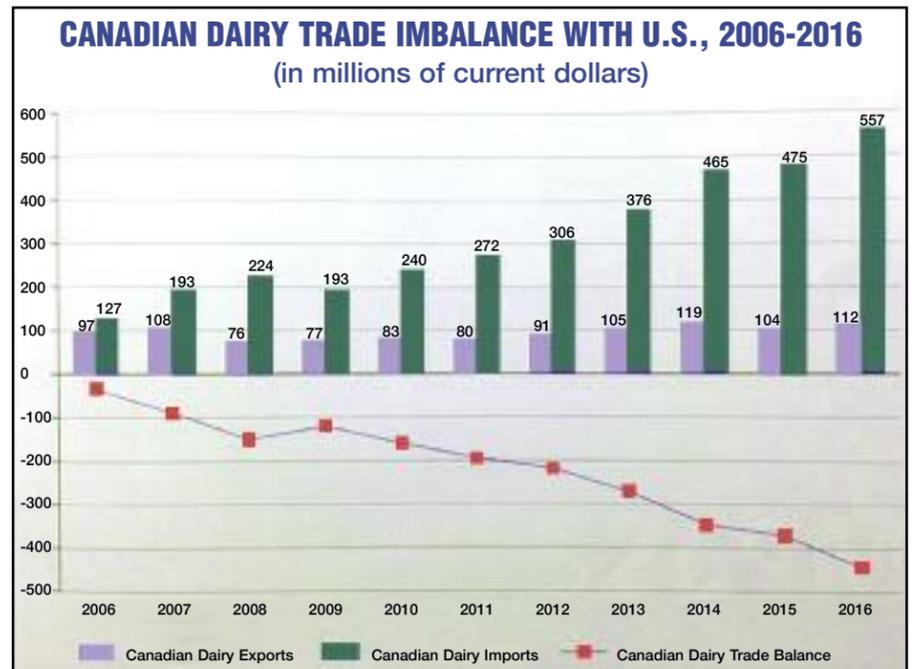
In Canada, there are four basic class prices for farm milk, which are similar to those in the United States' federal milk order system. In Canada, Class 1 milk is for fluid milk and cream. Class 2 milk is for milk processed into yogurt and ice cream. Class 3 milk is processed into cheese. And Class 4 milk is processed into butter.

The recently-created, controversial Class 7 milk is a milk powder price for dairy protein powders such as nonfat dry milk and Skim Milk Powder –including exports. Class 7 is discussed in the accompanying article on page 9.

DFO producer prices in 2017 were about \$27/Cwt. (US\$) after factoring in the relative currency values between our nations. Sherk acknowledged that Canadian dairy producers' milk prices have slipped from previous higher levels. He presented a chart tracking relative changes in DFO prices versus prices received by New

York State dairy farmers during the past decade-plus. (See the bottom of this column.) The dramatic, up-and-down cycles experienced by New York State producers contrasted dramatically with the relatively stable milk prices received by producers. Sherk, invoking his background knowledge as a former agricultural banker, explained that the lending community desires relatively stable agriculture prices, which in turn stabilize values for related assets (farms, farmland, machinery, and livestock).

Driven by strong, increased demand for milkfat, Canada has boosted farm milk quotas by 24% during 2015-2017. Historically, Canada's national strategy has been to try to meet (or come close) the nation's butterfat needs. As part of that strategy, historically, Canada's dairy leaders acknowledged they would have residual dairy proteins to export. Over the past three years, Canada has seen huge growth in consumer demand for milkfat – a fact that spurred provincial dairy boards to allocate large volumes of additional quota to producers at no cost. Unstated by Sherk, the logic of extending 24% more quota — freely allocated to producers — is to try to keep pace with Canada's growing tastes for butter, cream ... and other products laden with milkfat.



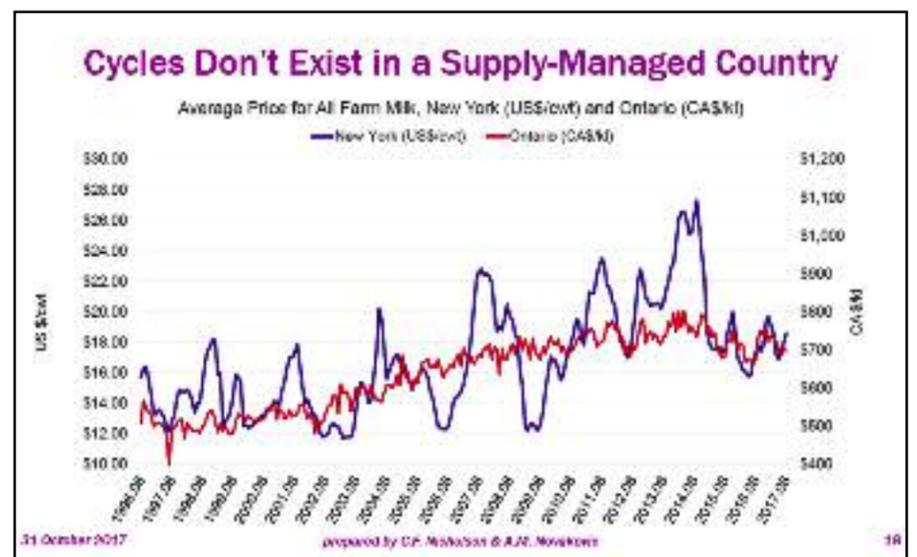
This graph shows U.S./Canadian dairy trade balances for 2006-2016. The dark green bars represents annual U.S. dairy product dollar sales to Canada. The light blue bars show Canadian dairy sales to the U.S. The descending grey line with orange squares shows the imbalance of trade for the Canadians. In 2016, the U.S. enjoyed an approximate 5:1 ratio of dairy export/imports with Canada. What is the problem, from a U.S. perspective???

Sherk credited, in part, author Nina Teicholz's book, *The Big Fat Surprise*, as a major factor helping shift consumers' milkfat consumption trends North of the Border. Teicholz' book documented the bought-and-paid-for, phony research that propelled the dietary "wizdumb" that scorned consumption of animal fats during the past several decades.

Cream in coffee is a huge driver of Canada's increased butterfat demand. "Canadians are big coffee drinkers," Sherk explained. In Canada, the Tim Horton's franchise of coffee and donut shops enjoys a significant market share of that sector. (Note: Horton was a star defenseman for the Toronto Maple Leafs professional hockey team.) "We like our 'Double-Doubles,'" Sherk admitted. [A "Double-Double" is a Canadian term for a cup of coffee with two sugars and two creams (18% butterfat). The "Double-Double" is a very popular item at the Tim Horton coffee shops.]

Consumer prices about the same as in the United States. Despite higher prices received by Canadian dairy farmers, Sherk emphasized that retail dairy product prices are about the same in Canada as in the United States. He posted data showing ranges of prices for Canadian dairy products, but no comparable U.S. data. (Note: If anything, from Sherk's data, Canadian consumers appear to pay less for their dairy products than their counterparts in the United States. But that's a matter for another time ...)

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This graph tracks milk prices for the past two decades for dairy producers in New York State (blue line) and Ontario Province (red line). Read the NYS price off the US\$/cwt. legend on the left side the graph. The Canadian milk prices are reported in Canadian dollars per kilo-liter. The extreme volatility of U.S. farm milk prices is evident.

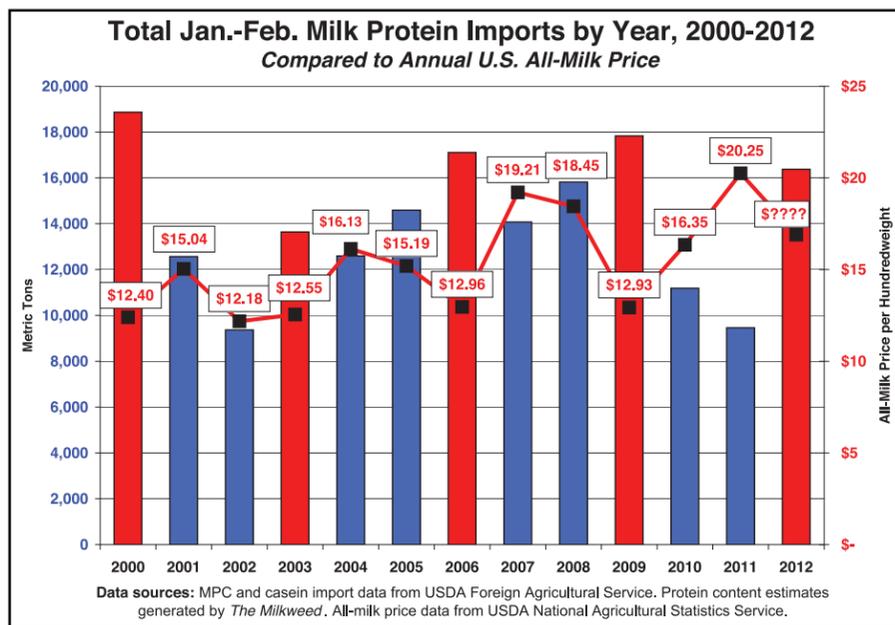
U.S. Converted from MPC “Screwie” to MPC “Screwie”

by Pete Hardin

By all accounts, the mid-1990s revisions of global trade rules left a wide-open loophole that New Zealand quickly exploited: Milk Protein Concentrates (MPCs).

In the late 1990s, increased volumes of dry MPCs flooded into the United States – primarily from New Zealand but sometimes from some pretty obscure corners of the world. Kraft Foods was quick to widely adopt MPCs as an ingredient in processed dairy products and other foods.

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In May 2012, *The Milkweed* created the above graph, which shows that selected “bad milk price years” (2000, 2003, 2006, 2009 and 2012), correlated with spikes in the January-February MPC imports totals. MPC and casein imports helped drive down U.S. farm milk prices in those years.

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More butterfat demand boosts farm milk production, which leads to more residual dairy protein powders ... hence, Canada’s “Class 7” pricing formula. Regardless of the breed (or mixture thereof), and without heed to where in the world dairy cows are commercially milked, a fact of life is that milkfat and solids-not-fat levels correlate in fairly predictable ratios. And that’s dairy’s current marketing dilemma – in Europe, Canada, the United States, Oceania, etc.

As Canada has boosted its farm milk production roughly 24% in the past three years to meet higher domestic demands for butter and milkfat, that nation has faced a growing volume of residual dairy protein powders. No help that the world market has been glutted with dairy protein powders for much of that same period.

Atop growing internal volumes of dairy protein powders, Canada faced the problem of dramatic increases in imports of various forms of Milk Protein Concentrates (MPCs) coming from the United States – specifically from New York State, Wisconsin, Idaho, and, to a lesser degree, Michigan. These imported MPCs were primarily ending up in Canada’s cheese vats – bumping out demand by some cheese plants for Canadian-sourced farm milk. Thus, Canadian dairy policy makers faced a double-whammy: not only were their domestic volumes of dairy protein powders piling up, but they faced ballooning volumes imports of cheap MPCs that were displacing cheese plants’ demands for local farm milk.

These circumstances all combined in the controversial decision by Canada to create its “Class 7” milk pricing system – a scheme that uses the world price of exported dairy protein powders. (In his presentation at the WFU convention, Murray Sherk assumed the role as a “goodwill ambassador,” sticking strictly to the role of explaining Canada’s dairy policies and their logical origins. Sherk diplomatically avoided stepping into the minefield of current U.S.-Canadian trade relations. He did, however, enjoy a few good chuckles at some of the audience members’ comments about bone-headed undisciplined U.S. milk production, policies, and blaming Canada for this nation’s dairy surplus woes.)

DFO “Factoids” ...

- Ontario Province counts approximately 3,600 dairy producers.
- DFO was established in 1965 – in the midst of highly disruptive milk marketing conditions.
- DFO currently has a 12-member board of dairy farmers, who represent combined counties in Ontario.
- DFO has a \$120 million annual budget, with a staff of 85 personnel.
- Ontario’s 3,600 dairy producers produce about three billion liters of milk with a value of \$2.3 billion. The average farm size in Ontario is about 80 milk cows.
- Industry structure. Quebec and Ontario are Canada’s top two milk-producing provinces. Quebec producers account for 42% of Canada’s milk supply,

while Ontario makes around 32%.

- Four national dairy processors handle about 85% of Canada’s farm milk supply: Parmalat, Saputo, Agropur (a closed co-op of Quebec farmers), and Gaylea. Canada is in the midst of an estimated surge \$600 million in dairy processing capacity. (Unmentioned by Sherk ... the Canadian government is laying out significant financial incentives to boost both dairy production and processing capacity.)

- The Canadian Dairy Commission, with farmer, processor and government direct input, manages dairy at the national level, estimates volumes of butterfat needed annually, and allocates quotas proportionally among the provincial dairy boards.

- There are organic dairy producers in Canada, but their returns are only modestly higher than prices paid to conventional dairy producers at this time. Sherk estimated that organic producers receive a premium of perhaps 30% more than what conventional dairy producers receive. Canadian consumers’ retail costs for organic dairy products are about twice as much for non-organic products – pretty much the same as in the United States.

- “Grass-fed” milk producers are emerging as processors seek to meet Canadian consumers’ demand for such dairy products.

- “GMO-free” dairy products are being processed and marketed in Canada, by at least one cheese plant in Manitoba.

To summarize: Sherk noted that the Canadian dairy industry is directed by producer interests, in partnership with government agencies (national and provincial). **He explained that dairy farmers in Canada receive a larger share of the consumer dollar spent for dairy products. That is achieved in great part by eliminating some of “the middle,” he claimed.**

When asked about relative differences between the United States and Canada, Sherk noted the importance of agricultural boards guiding output of dairy, poultry, and eggs through quota systems. Disciplined production helps even out the dramatic up-and-down swings in farm prices, and provides overall stability to Canadian agriculture. Sherk noted that he perceives that farmers in the United States have a bigger voice in their government at the national level, because each state has two U.S. Senators. Canada, in contrast, operates on a representative government system. And that system tends to put most of the political clout in the hands of urban voters.

The Wisconsin Farmers Union will sponsor a series of meetings in mid-March, at which speakers from Canada will detail their nation’s milk marketing system. Meetings are set for: March 13 in Eau Claire; March 14 in Fond du Lac; March 15 in Dodgeville; and March 15 in Viroqua. All meetings except the Viroqua meeting start at 11:30 a.m. See Wisconsin Farmers’ Union’s website for more details: www.wisconsinfarmersunion.com