OFFICE OF THE PARLIAMENTARY BUDGET OFFICER
BUREAU DU DIRECTEUR PARLEMENTAIRE DU BUDGET

Legislative Costing Note

This is an independent cost estimate of a budgetary measure contained in the federal government's Fall Economic Statement 2020 (FES 2020). A list of the PBO's cost estimates of components of the FES 2020 can be viewed on its website.

Publication Date:	2021-02-10
Short Title:	Financial compensation for supply-managed sectors
Description:	Estimates the cost of the Government's commitment to provide full and fair compensation to dairy, poultry and egg producers and processors for providing increased access to domestic markets under the Canada-United States-Mexico Agreement (CUSMA). Fall Economic Statement 2020 reiterated the Government's commitment to compensate the supply-managed sector for CUSMA but did not provide a cost estimate.

Data Sources:

Variable	Source
International trade data	Canada international merchandise trade
Changes to trade parameters	CUSMA treaty text
Import prices	Canada international merchandise trade
Domestic commodity prices	Agricultural and Agri-Food Canada (AAFC) medium-term outlook 2020
Agricultural projections	AAFC medium-term outlook 2020
Dairy product conversion factors	AAFC
Industry value added	Detailed supply and use tables 2017
Farm operating revenues and expenses	Statistics Canada
Discount rate	Treasury Board Secretariat

Estimation and Projection Method:

CUSMA impacts the supply-managed sector primarily through increases to tariff rate quotas (TRQs) for agricultural commodities, as well as new limits on Canadian exports of infant formula, skim milk powder and milk protein concentrates. We interpreted—without implying endorsement—the Government's commitment to provide "full and fair compensation" for CUSMA as a financial payment to the supply-managed sector. This compensation is assumed to offset the projected decline in income for farmers and processors from lower domestic market share and from lower exports.

Underlying our analysis is the assumption that projected increases in demand are larger than the changed quotas for any year going forward. Thus, the compensation is for lost expansion opportunities – in particular, lost *additional* net income or profits.

National quotas for raw milk production are set by the Canadian Dairy Commission, which also determines the raw-milk price based on its prescribed formula. The increases in the TRQ (imports) of supply-managed commodities are expected to reduce one-for-one their respective domestic equivalents (which PBO has assumed). Since each domestic product can be expressed in milk equivalents, the implied reduction in farm output of milk can be calculated. Using the unchanged price, foregone revenue by producers can then be estimated. To determine full and fair compensation, this is then turned into a net income loss by adjusting for reduced expenditures by producers. We estimate producers' net income margin based on average revenues and expenses over 2015 to 2019.

For processors, full and fair compensation is calculated as the income that would be lost to the firms' owners. Though labour will also lose income, it is primarily for new workers that would have otherwise been hired, so compensating labour in impractical.

We used the ratio of new imports to (expanding) domestic production (in respective values) to determine the proportion of a firm's gross operating surplus that would be foregone. This is done using industry value added from Statistics Canada's detailed supply and use tables.

We also assumed that, under new CUSMA export restrictions, processors will export lower volumes of infant formula, skim milk powder and protein concentrates. We assume that producers will be forced to sell excess skim milk powder and protein concentrates at domestic animal feed prices, which are lower than the export price of these commodities.

Our loss estimates are projected forward using variables from AAFC's medium-term outlook 2020. After 2029, variables are projected forward based on their 2029 growth rate.

Our estimate of full and fair compensation is calculated as the net present value of foregone income over 25 years (2020 to 2044, inclusive). We assumed a discount rate of 9 per cent, consistent with Treasury Board Secretariat guidelines. The compensation to producers and processors is taxable income and we have assumed that it would be taxable at the general corporate rate of 15 per cent. We have assumed that the compensation to producers and processors would be paid in full in fiscal year 2021-22.

Sources of Uncertainty:

The primary source of uncertainty in our estimate is that we assumed no changes to domestic commodity prices resulting from CUSMA.

We did not include a behavioural response as this went beyond the scope of our methodology. However, the supply-managed sector may use the compensation to increase its competitiveness which could potentially limit future losses from CUSMA.

Our estimate is also sensitive to projections of demand and prices for agricultural commodities.

The timing of the payment of compensation to producers and processors is uncertain and could occur over several years.

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Cost of proposed measure

$ millions	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Total cost	-	786	-	-	-	-

Supplementary information

$ millions	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Cost before recovery	-	925	-	-	-	-
Cost recovery	-	139	-	-	-	-
Total cost after recovery	-	786	-	-	-	-

$ millions	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Dairy producers	-	588	-	-	-	-
Dairy processors	-	305	-	-	-	-
Poultry and egg producers		30				
Poultry processors		2				
Cost before recovery	-	925	-	-	-	-

Notes

· Estimates are presented on an accruals basis as would appear in the budget and public accounts.
· Rounding may explain adding errors
· Positive numbers subtract from the budgetary balance, negative numbers contribute to the budget balance.
· "-" = PBO does not expect a financial cost.