INDUSTRY PROFILE

Industry, Science and Technology Canada
Industrie, Sciences et Technologie Canada

Dairy Products

Canada

INDUSTRY PROFILE

DAIRY PRODUCTS

1988

FOREWORD

In a rapidly changing global trade environment, the international competitiveness of Canadian industry is the key to survival and growth. This Industry Profile is one of a series of papers which assess, in a summary form, the current competitiveness of Canada's industrial sectors, taking into account technological and other key factors, and changes anticipated under the Canada-U.S. Free Trade Agreement. Industry participants were consulted in the preparation of the papers.

The series is being published as steps are being taken to create the new Department of Industry, Science and Technology from the consolidation of the Department of Regional Industrial Expansion and the Ministry of State for Science and Technology. It is my intention that the series will be updated on a regular basis and continue to be a product of the new department. I sincerely hope that these profiles will be informative to those interested in Canadian industrial development and serve as a basis for discussion of industrial trends, prospects and strategic directions.

Robert de Cotret

Minister

1. Structure and Performance

Structure

The dairy products industry is made up of two principal types of establishments, each manufacturing a different group of products. The first is engaged primarily in the pasteurization of fluid milk and the production of creams. These products utilize 36 percent of raw milk produced in Canada. Establishments processing what is referred to as fluid milk are situated nationwide, in or near urban centres. The second type of establishment utilizes the other 64 percent of raw milk production. This portion of production is referred to as "industrial" milk because of its use in the production of other products, which include natural and processed cheese, creamery butter, condensed and evaporated milk, milk powder, ice cream, yogurt, frozen desserts such as sherbert, and fruit and yogurt-based drinks. Industrial milk processors are mostly located in rural milk-producing areas where they process all of the milk and cream not utilized by the fluid milk trade.

In 1986, the Canadian dairy industry processed 73.05 million hectolitres of milk into various dairy products valued at approximately $6.28 billion. Employment in 1986 was approximately 25 505.

The Canadian dairy industry generates a positive balance of trade; an average of $120 million since 1980. Exports represent approximately three percent of total shipments. In 1986, exports were $193 million, with the majority going to third-world countries such as Algeria and Nigeria, in the form of surplus milk powder. Imports totalled $104 million, representing less than two percent of the domestic market. The majority of imports enter the country as variety cheeses such as havarti and gouda.

There are three organizational structures in the Canadian dairy processing industry. Approximately 50 percent of the industry is made up of co-operatives, i.e., organizations with professional management teams appointed by owner farm groups; 35 percent of the industry is made up of large public corporations and the remaining 15 percent is composed of smaller, privately held firms. Industrial milk plants are operated mainly by co-operatives, while the processing of fluid milk is done primarily by corporations and privately held companies. Foreign ownership plays a minor but important role in the dairy industry, with foreign-owned firms introducing many new technologies and products into Canada.

Governments of developed countries, including Canada, have sought to protect their dairy farmers through regulatory measures which usually include import controls, coupled with domestic price-support systems designed to provide a satisfactory return to milk producers. The industrial milk target price, set by the federal government, is currently $47.06 per hectolitre. Fluid milk prices are set by provincial agencies or commissions.

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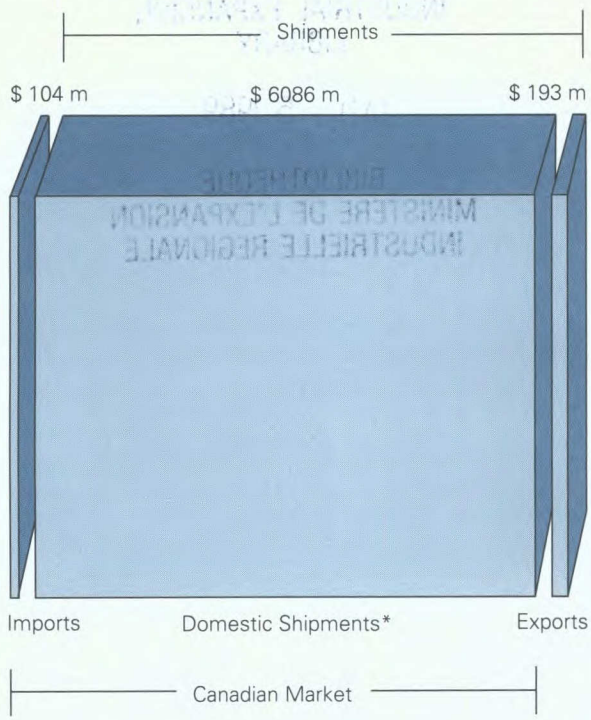


Imports, Exports and Domestic Shipments 1986

** Estimated.*

Performance

In the last 15 years, a trend towards industry rationalization and the introduction of multi-purpose plants has developed. Corporate mergers and takeovers have increased as companies fight for domestic market share, increased industrial milk supplies and greater gross revenues. Changes in demand patterns, demographics, industry technology and economic factors such as energy and transportation costs have all contributed to this trend. For example, the movement of people to urban centres, an aging but more affluent and health-conscious population, and consumer groups demanding greater product variety is forcing some firms to locate operations in or near cities. These new sites manufacture a wider variety of products, as opposed to specialized, single-product sites. Multi-purpose plants, in many cases, result in lower total energy and transportation costs to the company.

Investment has increased steadily from $138 million in 1982 to $181 million in 1986, reflecting new equipment and technology acquisitions, marketing of new product lines and new plant construction. After-tax profits were $150 million in 1982, rising to $181 million in 1984 and $183 million in 1986. As a percentage of sales, profits have remained fairly constant, between two and three percent.

Exports decreased from $285 million in 1982 to $193 million in 1986. This decrease was caused by lower export prices and the planned reductions in the milk quota available for the manufacture of export products.

2. Strengths and Weaknesses

Structural Factors

The national dairy supply-management structure at the farm level has a direct bearing on this sector's competitiveness. The program has provided reliable milk supplies, as opposed to seasonal fluctuations in supply. It has also effectively reduced the over-production of milk, instituted stable prices and provided import protection. All of these factors have been of benefit to the dairy manufacturing sector within Canada.

There have, however, also been costs to the manufacturing segment as a result of the dairy policy. The primary purpose of the national dairy policy has been to ensure the dairy producer a stable and adequate return through the establishment of the target milk price quoted to manufacturers. This price, although applicable to the entire manufacturing segment, has been higher than the equivalent international price, thus often making Canadian dairy products uncompetitive in international markets. It is important to add that most developed countries do have some form of a national dairy support policy, which makes it very difficult to assess issues relating to international trade and competitiveness.

Market sharing quotas (production quotas), have also affected the dairy industry. Because of the regulated supply of milk production, these quotas have taken on a substantial value of their own when dairy farm facilities are sold. That value has, correctly or not, been incorporated, to some extent, into the cost of production formula as reflected in the target price for milk. An alternative to this treatment, acceptable to all parties concerned, has not yet been found.

The supply-management structure of the dairy industry has tended to preserve the regional nature of Canada's dairy industry. Plant distribution basically reflects provincial quota allocations and the demand patterns within a given province. While plant consolidations to gain economies of scale are well advanced, few establishments are geared to supplying out-of-province markets. Some exceptions are where specialization of production of value-added products from provincially regulated milk supplies is taking place and is being sold interprovincially.

Trade-related Factors

Most developed countries have some sort of national dairy policy. Such policies tend to support the industry through production subsidies, surplus disposal programs and non-tariff barriers, thus effectively closing the domestic market to outside sources. International trade, therefore, falls into two categories. The first involves trade between developed countries of value-added products in volumes agreed to within international accords, and at prices reflecting respective national dairy policies. The second type of trade involves exports of dairy products to third-world markets at substantially lower prices as part of a surplus disposal program.

Canada is a relatively significant exporter of milk powders, accounting for an estimated eight percent of total world exports.

Canada's imports of dairy products derived from cow's milk are subject to import controls under the *Export and Import Permits Act*. Products such as butter and milk powders, of which Canada produces a surplus, are prohibited from entry. The major import is cheese, mostly variety cheeses such as gouda and havarti. The import quota for cheese is currently 20 400 tonnes.

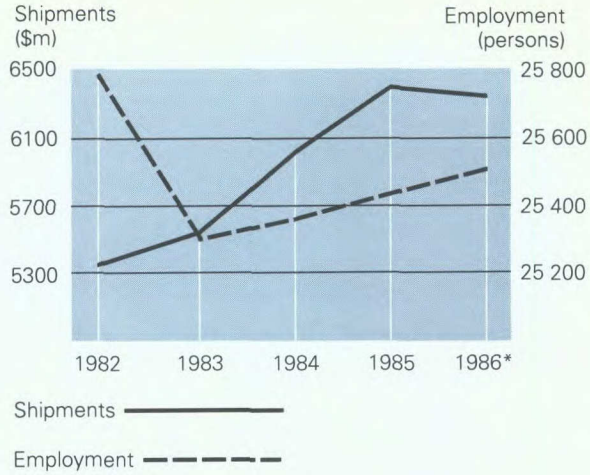
Both the European Community (E.C.) and the United States limit imports of all dairy products by employing country-specific import quotas. The E.C. provides export restitution payments on dairy products while the United States has export-financing arrangements. Such programs are aimed at promoting their own products in the international marketplace, but they also tend to drive down the international price for some products.

Under the Canada-U.S. Free Trade Agreement (FTA), Canada retains existing import controls on most dairy products and the option of adding other dairy products to the Import Control List (ICL), subject to GATT rules. Both Canada and the United States, under Article 710 of the FTA, retain their GATT rights and obligations with respect to agricultural food and beverage products, including import control measures taken under Article XI of GATT. On January 19, 1988, Canada added several dairy products, the most important of which were ice cream and yogurt, to the ICL to parallel U.S. restrictions on similar products.

TARIFFS ON DAIRY PRODUCTS ARE AS FOLLOWS:

	Canada	U.S.	E.C.	Japan
Fluid Milk	17.5%	0.4¢/L	16% + levy*	free
Cream	17.5%	0.5¢/L	16% + levy*	free
Butter	24.6¢/kg	12.3¢/kg	23% + levy*	45%
Cheese	7.72¢/kg	10%-16%	23% + levy*	35%
Milk Powder	7.72¢/kg	3.3¢/kg	18% + levy*	30%
Yogurt	15%	20%	24% + levy*	35%
Ice Cream	15%	20%		

* Levies are usually considered as NTBs.



Total Shipments and Employment*

** Data for 1986 are estimated.*

Under the FTA, duties on dairy products originating in either country will be removed in ten equal, annual stages, starting January 1, 1989 and ending January 1, 1998.

Technological Factors

The Canadian dairy industry generally employs the latest technology for the processing and manufacturing of conventional dairy products. From this viewpoint, the industry is internationally competitive. The major Canadian dairies are constructing large multi-product plants and installing computerized controls in every stage of production. The industry has also developed a state-of-the-art, ultra-high-temperature processing system for the production of long shelf-life fluid products. The industry is also employing a wide variety of packaging shapes and sizes to appeal to changing consumer preferences. This marketing approach closely parallels changes taking place in the American and European dairy markets.

Other Factors

The Canadian dairy industry is highly regulated. In addition to controlling milk supply in the provinces, all provinces regulate the production and marketing of margarine and the production of "spreads" incorporating vegetable oils and butter. This is just one example of protection from cross-product competition.

The federal Department of Agriculture is responsible for the inspection of dairy plants. Consumer and Corporate Affairs administers the *Food and Drugs Act* and the *Consumer Packaging and Labelling Act* to ensure proper labelling of food ingredients. National Health and Welfare administers sections of the *Food and Drugs Act* dealing with product safety, consumer health and freedom from adulteration. External Affairs enforces the *Export and Import Permits Act*, ensuring that the specific quotas for processed dairy products on the ICL are being respected.

3. Evolving Environment

Implementation of the FTA is not expected to have significant repercussions on the dairy processing industry, since the supply-management structure of the dairy industry will remain, as will import quotas. The industry will continue to adapt to a rapidly evolving domestic market which increasingly demands non-traditional dairy products presented in innovative packaging formats.

Export opportunities to the United States are not expected to change dramatically, since American dairy policies will also be maintained under the FTA, including import quotas. Both Canadian and U.S. firms will continue to exploit consumer demand for products that are nutritious, while low in fat content.

4. Competitiveness Assessment

The Canadian dairy industry has evolved within the parameters set by the national milk supply-management policy. Its performance therefore can only be assessed in the context of a highly regulated market.

For most of its products, the industry's operating costs are fully competitive with its counterparts in other developed countries. However, since Canadian raw milk prices are among the highest in the world, and raw material costs account for about 85 percent of the cost of the finished product, processed products are not price competitive internationally.

In the future, the ongoing Multilateral Trade Negotiations, within the context of GATT, may also have an impact on the future competitiveness of the industry. Issues being examined, in anticipation of the Uruguay Round of the GATT talks, include the maintenance of import restrictions (supply-management provisions) as defined by Article XI of the GATT, as well as production and export subsidies.

For further information concerning the subject matter contained in this profile, contact:

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PRINCIPAL STATISTICS

SIC(s) COVERED: 104 (1980)

	1973	1982	1983	1984	1985	1986
Establishments	646	402	400	401	394	392[e]
Employment	27 819	25 796	25 306	25 368	25 445	25 505[e]
Shipments ($ millions)	1 715	5 345	5 615	6 095	6 411	6 279[e]
Gross domestic product (constant 1981 $ millions)	934.2	873.1	795.3	848.7	845.5	837.2
Investment ($ millions)	N/A	138.0	129.4	176.7	184.3	181.3[e]
Profits after tax ($ millions)	48.0	149.9	138.3	181.0	183.0	184.0[e]
(% of income)	2.50	2.43	2.28	2.87	2.70	2.8

TRADE STATISTICS

	1973	1982	1983	1984	1985	1986
Exports ($ millions)	88	285	239	241	217	193
Domestic shipments ($ millions)	1 627	5 060	5 376	5 854	6 194	6 086[e]
Imports ($ millions)	63	97	97	100	104	104
Canadian market ($ millions)	1 690	5 157	5 473	5 954	6 298	6 190[e]
Exports as % of shipments	5.13	5.33	4.26	3.95	3.38	3.07[e]
Imports as % of domestic market	3.73	1.88	1.77	1.68	1.65	1.68[e]
Canadian share of international market (%)	1.89	1.80	1.65	1.66	1.65	1.64
Source of imports (% of total value)			U.S.	E.C.	Asia	Others
		1982	11.05	81.80	0.05	7.84
		1983	10.31	81.43	0.08	8.18
		1984	12.00	79.00	0.01	8.99
		1985	14.42	78.85	0.09	6.64
		1986	15.38	62.42	0.22	21.98
Destination of exports (% of total value)			U.S.	E.C.	Asia	Others
		1982	4.21	6.53	10.87	78.39
		1983	5.85	8.37	11.30	74.48
		1984	5.81	6.22	5.39	82.58
		1985	7.37	7.47	7.80	77.36
		1986	7.77	8.55	12.15	71.53

(continued)

REGIONAL DISTRIBUTION — Average over the last 3 years

	Atlantic	Quebec	Ontario	Prairies	B.C.
Establishments – % of total	10.9[e]	26.9	37.6	18.1[e]	6.2
Employment – % of total	11.6[e]	31.8	32.7	14.3[e]	9.6
Shipments – % of total	7.3[e]	40.5	32.9	11.4[e]	7.7

MAJOR FIRMS

Name	Ownership	Location of Major Plants
Ault Foods Ltd.	Canadian	Ontario, Quebec
Agropur Cooperative	Canadian	Quebec
Kraft Ltd.	American	Ontario, Quebec
Beatrice Foods	Canadian	Ontario, Manitoba, Quebec
Fraser Valley Milk Producers Cooperative	Canadian	British Columbia
Palm Dairies	Canadian	Ontario, British Columbia, Saskatchewan, Alberta
Purdel Cooperative	Canadian	Quebec

e Estimate.
N/A Data not available

Note: Statistics Canada data have been used, to the greatest extent possible, in the preparation of this profile.

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