

# Workshop for Dairy Economists and Policy Analysts

**Responsive Comment by Rick Phillips**  
**Director of Policy and Strategic Planning**  
**Dairy Farmers of Canada**

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## Adjustment and Distribution Effects are Important

- Interpretation of what constitutes the best policy course is often a function of underlying economic assumptions
  - If you assume instantaneous adjustment to equilibrium the dynamics of moving from one equilibrium to another may not matter to you
- I would suggest, however, that the main job for economists from a policy perspective is to focus on the dynamics of adjustment to equilibrium and its associated distributional effects.



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## Price Adjustment vs Quantity Adjustment to Equilibrium

- NeoClassical economics has come to view price adjustment as the only mechanism to move from one equilibrium to another
- Sometimes the costs associated with price adjustment to equilibrium are excessively high
- In some circumstances quantity adjustment to equilibrium (perhaps in conjunction with some help from price) can get us to equilibrium with lower adjustment costs and fewer undesirable distributional effects.



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## Price Adjustment vs Quantity Adjustment to Equilibrium a Real World Dairy Example

Supply and Demand  
Global Milk Balance Estimation



(Million tonnes)	2001	2002	2003	2004	2005	2006	2007	2008
Milk Production	589.6	601.9	614.6	626.0	645.1	661.2	679.2	689.8
Consumption	589.1	598.2	614.6	627.8	647.8	663.1	679.2	685.8
Stock Change	+ 0.5	+ 3.6	0.0	- 1.7	- 2.7	- 2.0	0.0	+ 4.0

Source: International Dairy Federation, World Dairy Situation, 2008



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## Price Adjustment vs Quantity Adjustment to Equilibrium a Real World Dairy Example

- The Graphic in the previous slide outlines world demand and supply conditions for milk delivered to plants leading up to “the event”; a massive decline in milk prices
- During 2008 the amount of milk that was produced that was not required; was on the order of 4.0 Million tonnes (less than 1% of supply).
- If farmers had been persuaded not to produce that 4 million tonnes; price levels could have presumably maintained at higher levels and the significant market disruptions that dairy farmers were subjected to could perhaps have been avoided.
- When I ask producers to choose between a 1% reduction in output or a 30% reduction in price to get to equilibrium; they invariably state a preference for the quantity adjustment path.



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## Some Final Thoughts on Policy Discussions

- Moderation in growth of supply could be an important mechanism to get us to equilibrium with lower adjustment costs and fewer undesirable distribution effects
- Other policies that reduce or mitigate risk are also potentially helpful
- These approaches are not necessarily mutually exclusive



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