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Dairy policies around the world: What would we gain from getting rid of them?

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Despite the general globalization of agricultural markets, trade and production of dairy products are still highly distorted in most countries. This article discusses the impact of these distortions and the likely gains that would result from reforming existing policies.

Import restrictions are present in many countries, and export subsidies are often used. Dairy imports are distorted by tariff-rate quotas (TRQ), which are a two-tier import tax or tariff system. Imports up to a certain level (the so-called minimum access commitment) are allowed in a country at a relatively low import tax rate. Additional imports (above the quota) are taxed at a higher tariff rate.

Many TRQs are unfilled, and tariffs remain very high, often prohibiting over-quota imports. The multitude of TRQ schedules and nomenclatures is confusing and restrictive. The lack of transparency in the administration of the TRQs may explain why some quotas are unfilled, despite the fact that these quotas are usually very low. Major gains could be realized by defining fewer and more aggregate TRQ categories, and by increasing the transparency and efficiency of TRQ administration.

Domestic dairy policies remain complex and arcane in many countries, often relying on a combination of price discrimination schemes via price pooling and production quotas. The price discrimination schemes rely on the low price responsiveness of fluid milk consumption, charging a higher price for fluid milk, and allowing markets to determine the price of milk used for manufacturing dairy products.

Dairy producers receive a “pooled” price based on the pooled values of deliveries in all milk markets. Because of trade barriers, the price of manufactured dairy products is artificially high. And this higher price stimulates the milk market. Both domestic and trade policies, then, contribute to higher milk prices.

Dairy products are priced artificially high because of trade barriers preventing price arbitrage through trade. In some countries, production quotas limit the expansion of milk production induced by market distortions. These milk production quotas contribute to higher milk prices by restricting supply. Finally, in the European Union (EU) and other countries, dairy prices are also supported by government purchase of butter and milk powder, which has the same qualitative effects as trade barriers.

What is happening in the EU as a result of policy reforms? Based on recent Center for Rural and Agricultural Development (CARD) policy analysis, it appears that reforms of the Common Agricultural Policy (CAP) in the EU under the Berlin Accord’s “Agenda 2000” would have small effects on dairy markets because dairy is essentially spared until 2005. The current EU system of domestic producer price support and quota remains little affected.

Export subsidies and large inventories help absorb EU excess supplies of dairy products. No real fundamental and definite reform is planned after 2005 either. By contrast, if enlargement of the EU to include Central and Eastern European Countries (CEECs) occurs in 2003, there would be major repercussions in EU dairy markets, but relatively small effects on world dairy markets.

The EU enlargement is likely to induce lower internal dairy prices in the EU and a major price hike in CEECs. Consumers in those countries would be major losers upon EU accession, whereas major gains would accrue to dairy producers in the CEECs who receive EU prices. Internal EU trade would expand considerably.

World dairy markets would see little effect from CAP reforms and from EU enlargement. However, the cost of the CAP would balloon following enlargement and would probably induce further reforms to contain cost. The reforms currently planned for after 2005 in the Berlin

References:
Accord would achieve “too little too late” to contain the cost of the EU dairy policy.

Another important new trend in dairy markets is the rapid growth in Asian dairy markets, despite very distorted and restricted trade flows. Urbanization and income growth are fueling Asian dairy consumption; and increased access to dairy markets in Asian countries should be a promising source of world dairy market growth. However, Australia and New Zealand would capture the bulk of these new export opportunities in Asia because of their geographic proximity.

What would trade liberalization bring? There is a strong consensus among dairy economists that trade liberalization experienced to date under the last World Trade Organization (WTO) agreement has had moderate effects on world markets and on efficiency in resource allocation.

Further liberalization would improve the allocation of resources in the sense that low-cost producers would expand their production at the expense of high-cost producers. But those gains in aggregate are likely to be only a small share of the value of dairy production. However, current policies induce major transfers from consumers (losers) to producers (winners) in the EU, Canada, Japan, Korea, and to a lesser extent in the United States.

**Domestic dairy policies remain complex and arcane in many countries, often relying on a combination of price discrimination schemes via price pooling and production quotas.**

Inefficiencies in resource allocation induced by current policies are moderate, primarily because of the lack of price responsiveness of supply and demand in many dairy markets. Production quotas have raised prices with limits on output expansion, which partly explains the lack of price responsiveness.

Further, trade liberalization would induce dynamic gains in terms of productivity gains and a larger choice of products for consumers. These gains are hard to quantify and tend to be overlooked by some economists, but they may be as important as the gains induced by the price discipline of more open markets. For example, the Mexican dairy market had such gains following the trade liberalization that accompanied its accession to the WTO and, more recently, with the North American Free Trade Agreement (NAFTA). Foreign investment, the transfer of dairy technology, and increased competition have induced an improvement in the quality of Mexican dairy products. U.S. and U.S.-like branded products are progressively substituting for more basic local dairy products, such as generic milk powder.

Who would gain the most from global trade liberalization in dairy markets? Producers in New Zealand and Australia would be large “winners” following world dairy trade liberalization. These nations are natural exporters of dairy products. Consumers in the protected markets of Japan, Korea, Europe, and Canada would also be large gainers from global liberalization.

To learn more on domestic and trade dairy policy, visit the CARD Web site at [http://www.card.iastate.edu/about/dairy_policy_symposium/dairy.html](http://www.card.iastate.edu/about/dairy_policy_symposium/dairy.html).