SciencesPo. | GEM Groupe d'Économie Mondiale

Working Paper
December 2009

The European Dairy Sector at a Crossroad: Production Quota and Export Refund Opting Out

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Summary

The European Union (EU) reactivated export refunds for dairy products on January 2009. These world market distortive instruments had been previously eliminated from the 2007 second semester on as a result of relative high world prices. This short period went in favour of the European disposition to ban them within a global trade agreement concluding the Doha Round. In a parallel track, the EU decided to open milk quotas restricting production for a quarter century. A reorientation towards market considerations may sequentially lead to a European price drop – strengthening the export refund outlaw initiative. This development is coherent with the policy targeting trend which prevails in Europe but also requests adjustments in the dairy supply chain.

Yet dairy market evolution along with a broad-based European policy led to export refund reintroduction. The World Trade Organization is genuinely not proficient in disciplining export refunds since the EU would be able to spend annually more than 2.3 billion euros in subsidizing its dairy exports while still respecting its multilateral commitments. Between 1995 and 2008, European dairy products sold on foreign markets, mostly developing and least-developed countries, received more than 15 billion euros. Negative welfare effect on net importing countries resulting from a 2013 hypothetical ban of export refunds shall not be underestimated whereas it shall constrain either a decrease in European guaranteed prices or competitiveness damage to few exporting agri-food firms. It sheds light on the close articulation between local, regional and multilateral regulatory reforms.

Keywords:

Dairy products, world trade organization, common agricultural policy

Introduction

The Uruguay Round Agreement on Agriculture (URAA) proscribes export subsidies because they distort both domestic and foreign markets. However, some members of the World Trade Organization (WTO), mostly rich countries, are still able to use such subsidies for the farm products they specified when concluding the Uruguay Round. Export subsidies on industrial products are banned without exception – a shocking example of asymmetrical treatment in favour of developed countries. The European Union (EU) is the largest user of such subsidies with nearly 90% of the total amount of export subsidies notified to the WTO. On July 2004, WTO members agreed to eliminate all export subsidies, and to discipline measures having equivalent effects, such as export credits, state trading enterprises, and food aid. The December 2005 Hong Kong Ministerial set December 2013 as the expiration date for implementation. However, it is conditioned on an agreement on all the topics currently negotiated within the Doha Round, a still distant goal.

It is a prerequisite to point out the *raison d'être* of export refunds. Contrary to a wide established idea, their purpose is not to "dump" European products on foreign market – since to dump a product means for an agri-food firm to export a product at a price lower than the price charged on the home market. In the case of export refunds, the aim is to clear the European market or, better said, sustain guaranteed prices – set above prices which would prevail either in autarky or in an open world. In this respects, analysing the European dairy policy and its evolution is indispensable before export refunds.

High world prices and European production surplus control allowed abolishing gradually export refunds since June 2006. On January 2009, the EU reactivated export refunds for dairy products. The aim of this paper is to provide a cross-analysis of such a regulatory instrument which represents not only an economic interest, but also a crucial rural development and political concern. It sheds light on the articulation between domestic and multilateral regulatory reforms. The domestic level is even multidimensional since it considers a local/national and regional dimension. The first section of the paper provides a microeconomic overview of the European dairy market regulation and upcoming adjustments resulting from the 2008 health check. The second section focuses on follow-on export refunds and trade considerations. The third section estimates the substantial distorting effect allowed by the current WTO commitments which clearly fail in disciplining European export refunds.

1 Domestic market regulatory framework

Since the creation of the Common Market Organisation for milk and milk products in 1968, export refunds have been considered to fill the gap between EU support prices and world prices. Without refunds, excess supply generated by price support policy is not competitive on world markets. If this regulatory instrument was initially designed for punctual oversupplying, it became perpetually employed. Despite a tiny softening of price support, the milk quota system introduced in 1984 – initially planned for lasting five years – has always been an alternative to price support reform when intending reduce overproduction.[1] They should be opened by 2015. The recent evolution of European regulation aims at targeting support but still faces many challenges.

[1] In order to limit overproduction, a producer co-responsibility levy appears also as an alternative to reduction in price support. It has been experimented previously to the introduction of milk quotas but without success. Public storage has always been used to regulate the release of production on the market. Private storage has been recently privileged as illustrated in Appendix 1 in coherence with the willingness to give private operators an increasing responsibility in market regulation. Destruction of production surplus has marginally occurred.

1.1 A pregnant European price policy

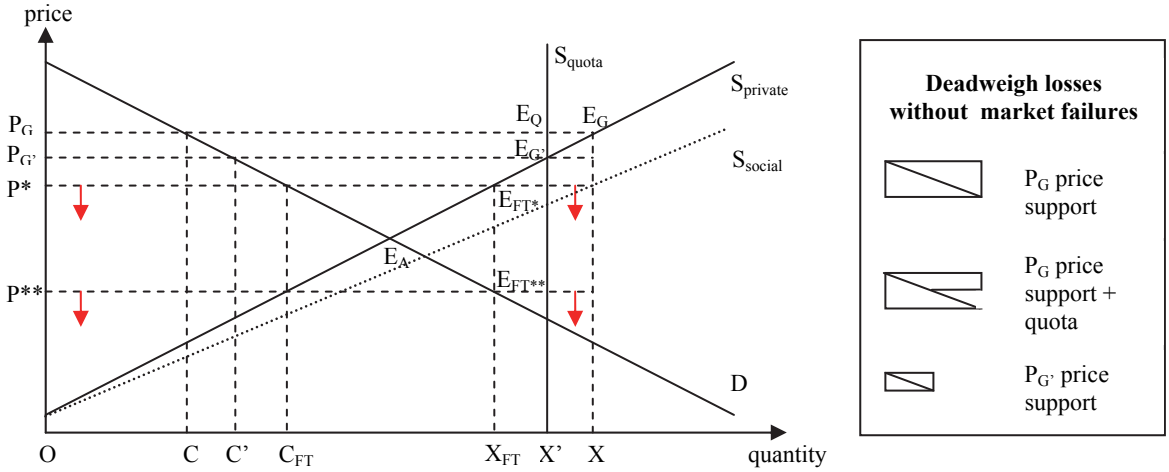
Milk and milk product price support introduced in 1968 has never been significantly reformed – by contrast to other commodity support policies. Intervention prices for butter and skimmed milk powder have been cut respectively by 25% and 15% from the 2004/2005 campaign. Quantitative and timing limits have been agreed for intervention. Price decreases have been compensated with direct payments. They are now decoupled to production and integrated within the single farm payment (SFP) scheme. Figure 1 provides a basic cost-benefit analysis of the embraced mechanism.[2]

European demand and supply are respectively represented by the D and $S_{private}$ curves - with E_A the equilibrium of the market in an autarky situation. Suppose an intervention price is fixed at P_G. Two cases have to be identified regarding the EU net importer or exporter situation prevailing in an open world - with respectively P** and P* the world prices and E_{FT**} and E_{FT*} the free trade market's equilibriums. In the first situation, prohibitive tariffs have to fill the gap between P** and P_G. They artificially raise the price of foreign products circulating in the European market. In the second situation, border protections are inadequate since EU producers are more efficient that foreign counterparts. However in both cases, in order to sustain P_G, market clearing requires the short term withdrawal of production surplus (CX) either by storing/destroying the surplus, subsidizing exports or increasing food aid. On the demand side social, health and marketing programs may be expanded.

Milk quota introduction is illustrated with a vertical supply curve (S_{quota}) because production beyond the quota is not possible – or better said, financially unattractive. Quotas are broken down among the Member States (MS) and then among producers through individual limited quantities. There are important differences between MS as regards quota transfer management within the national/regional territory. In case of a national quota overrun, an additional levy is imposed to the liable MS and then assigned to the producers having contributed to the overrun.

[2] In order to assess market instrument costs and gains, a welfare economic approach aims to quantify them. A partial equilibrium framework is largely used in order to represent such microeconomic concepts. Changes in consumer and producer welfares capture the monetary effects of changes in market's equilibrium. Both are considering the sum of each individual's consumption and production surplus. The consumer welfare measures the monetary gain a consumer gets from purchasing a good on the market – it quantifies the difference between the price he would have been willing to pay for a good and the one actually paid. The producer welfare is a comparable concept which quantifies the monetary gain a producer gets from selling a good on the market – it quantifies the difference between the price he would have been willing to sell a good (equal to the marginal cost in case of perfect competition) and the one he actually receives by selling the good in the market. This latter is assumed to be perfect with a supply and a demand function which are independent from exchange rates and transport costs. Regarding public taxation and redistribution performances, there are supposed to be perfect and without cost. In this framework, (i) the consumer gain is represented with the area under the demand curve and above the market price; (ii) the producer gain is represented with the area above the supply curve and below the market price.

Figure 1: Microeconomic framework of the European milk market



Consider the association of both OX' quota and P_G guaranteed price, the production decreases from OX to OX' – which is the ambition of the quota; whereas domestic consumption is retained to OC – as European market price is not further altered. As a result, production surplus (the $E_QE_GE_{G'}$ area illustrates the producer's welfare decrease) as well as government intervention expenditures fall down. Minor deadweight loss illustrates a net welfare increase but in a lower extent than subsequently a guaranteed price drop.

This static analysis does not acquaint with structural costs induced by a quota policy. First, it constraints gains arisen with geographical specialisation. This latter would be driven by production, collect and local market access costs. Depending on the quota transfer management, they have been some regional specialization within MS, not between them. As a result, dairy sector development of most competitive MS has been held back. Second, rents created by a quota regime inhibit farm holding structural changes. It restrained the extension of most competitive farm holdings and maintained non-viable ones within the sector. These results run against the competitiveness of the dairy sector – especially in an increasing open world.

Now consider achievements of a price support reduction and no more a quota regulation. For the same effect on output, a $P_{G'}$ guaranteed price has to replace P_G. With this lower price, European consumers increase their demand from OC to OC'. It thus reduces the previous production surplus. The producer aggregated welfare loses the $P_GE_GE_{G'}P_{G'}$ area. By contrast, the previous quota system saves a minor $E_QE_GE_{G'}$ area which do not counterbalance the more costly impact on the aggregated European welfare. Even if the guaranteed price would be closer to the world price, intervention would be still required but at a lower budgetary cost.[3] Decreasing price support without permanent compensatory direct payments would minimize deadweight losses and thus increase net welfare of the EU.

Improving the efficiency of the dairy supply chain is determinant as regards potential welfare gains. Since consumers should be the main beneficiaries of any price decrease, transmission of this latter is key. Appendix 2 presents the lack of repercussion to consumers from producer price decreases. It requires a higher transparency in the distribution of added-value between farm holdings, dairy industry and retailers. The European Commission have been recently worried about this deficiency, as well as anti-competitive practices in the dairy sector

[3] The budgetary cost depends (i) on the production surplus and (ii) the difference between domestic and world prices. It would attain regarding initial situation, quota implementation and price decrease CX.(P_G-P*), CX'.(P_G-P*) and C'X'.($P_{G'}$-P*) respectively.

(European Commission, 2009). Those market considerations are nevertheless crucial, especially under the hypothesis of a quota substitution with dairy contracts in order to cope with price volatility.[4]

Less European efficient producers are the main impacted by a price decrease. For those situated in less favoured areas (LFAs), a market price does not consider territorial and environmental amenities they produced. Undiversified structure shall be the first impacted either by a decrease of guaranteed price, quota opening or both actions. This adverse effect deserves targeted actions – at odd with historical public intervention in dairy sector.

1.2 Market failures and dairy reforms

There is a vast literature on the multifunctional aspect of agriculture otherwise the distinction between commodity and non-commodity output production. Multifunctionality of agriculture endeavours a justification for public intervention. Landscape preservation achieved by dairy farms in LFAs contributes to local well being but are not remunerated through the market. With no public intervention, this market failure would trigger an under-provision of positive externality or directly said the disappearance of no efficient dairy farmers in LFAs. First, the lack of diversification possibility in agricultural production for these latter argues in favour of a targeted territorial policy. Second, it appears tricky to amplify the current price differential between mountain and ordinary area milk for the reason that differentiation strategies in quality are already highly exploited (Chatellier and Guyomard, 2008). Third, they suffer from lower productivity gains, higher fixed costs and milk collect costs than the standard plain holdings with larger size and higher stocking density.

Price support policy may lead to lower transaction costs but fail in achieving multiple policy objectives (OECD, 2008). Its intrinsic purpose is to administratively face farm income volatility. Broad-based compensatory direct payments are scarce to justify at the long-run, all the more in case of rising market. A quota policy cares about territorial issues since the allocation procedure may favour specific areas or farm structures. A strict public management of production is however costly since it limits productivity gains in regular areas where prevail market-oriented farm holdings. It sheds light in the territorial perimeter issue when public intervention related to positive externalities is involved.

Free trade equilibrium without taking into account positive externalities is not optimal from the social point of view since it leads to an under-provision of those externalities (Gohin et al., 1999). It is easy to distinguish private and social costs in Figure 1 by taking into account externalities in producer allocation decisions. Assuming a joint production through non-allocable input, targeted public intervention is able to remunerate positive externalities. As a result, S_{social} internalizes the non commodity output. The collective gain is illustrated with the additional welfare area between $S_{private}$ and S_{social} – by contrast to non intervention equilibrium. It removes deadweight losses but requires a territorial coupling since externalities are area-restricted.[5]

It should be remember that transaction and administrative costs are excluded of this analysis. Since targeted support is more costly – in implementing and monitoring – than broad-based price policy, positive welfare effect depends of a trade-off between extra externalities supply and increase of such costs. Identify and then getting a price to an externality – often local – is not straightforward. It is nevertheless the key element in approximating the amount which

[4] For more information on the contracting issue, see Vavra (2009).

[5] With an equivalent theoretical justification and mechanism, social demand, not illustrated in Figure 1, may be considered. In this case, the local dimension of the externality is not relevant and is substituted by the targeted population criteria i.e. young people with milk school schemes or prospective consumers with marketing campaigns.

equals – at the equilibrium – the marginal cost of the non commodity output. These results have strong implications in terms of policy definition, implementation and funding – since it may transfer those competencies from European to national/local level.

1.3 Adjusted European regulation by 2010

A quota opening scheme requires the implementation of targeted measure – *permanent* for farms facing market failures, *transitory* for farms coping with structural adjustments. The CAP health check increases milk quotas by 1% a year from 2009/10 to 2013/14 campaigns. Then, after this soft landing period, the quota system should be ban from 2015.[6] Measures accompanying restructuring of the dairy sector are tied in with this opening. They have been defined as one of the rural development priorities[7] and then will benefit from additional modulation. As part of the second pillar of the CAP, they have to be specified at national levels with effect from 2010.[8] Because a quota opening would impact differently local agricultural production and income[9], it is relevant to give flexibility to MS in programme implementation. In addition to intrinsic targeted second pillar measures, expected evolution of first pillar subsidies aims at targeting payments that historically have been broad-based support.

There are three new provisions related to first pillar subsidies that – if activated – shall directly impact the dairy sector. [10] First, the value of SFP entitlements shall be modified on the basis of the type of agricultural activities exercised by the farmers from 2005 to 2008 and in accordance with objective and non-discriminatory criteria such as agricultural potential and environmental criteria. The aim of this provision is to allow MS that adopted an historical decoupling model to regionally redistribute support – a MS can be considered as a single region (articles 47-48).

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[6] Instead of this 5 years gradual opening, Italia succeeded in getting a one for all 5% increase in 2009. It should be also highlighted that the deal set reviews of the system before December 2010 and 2012. These *rendez-vous* clauses jeopardize the respect of a strict April 1, 2015 ending date.

[7] The identified new challenges are (i) climate change, (ii) renewable energies, (iii) water management, (iv) biodiversity, (v) measures accompanying restructuring of the dairy sector, (vi) innovation linked to the priorities mentioned in points (i), (ii), (iii) and (v).

[8] The EU budget shall cover 75% of the cost (90% in convergence areas) instead of 50% for non-challenge-related measures (75% in convergence areas).

[9] For an assessment of regional effects resulting from quotas abolition, see Fellmann (ed.), 2009.

[10] The two main decoupling models are basic (historical) and regional (flat rate). In the former, the payment entitlements are based on the amount received per farm during a reference period (2000-2002), producing a different payment for each farm. In the latter regional model, the flat rate payment entitlement is averaged out and based on the total amount received in that region during the reference period. Hybrid models have also been implemented, and can be static or dynamic. In the static version, the payment entitlements stay the same over time. The dynamic version usually operates so that the proportion of payment based on historic reference reduces and the flat rate element increases, until the payment entitlements reach a flat rate. The most implemented SPS model is the historic model, which minimises the redistribution of historical direct payments. The new EU member scheme involves payment of uniform amounts per hectare of agricultural land, up to a national ceiling.
With regard to the adopted decoupling model, MS can be classified as following:
[Historic] Austria, Belgium, France, Greece, Ireland, Italy, Netherlands, Portugal, Spain, UK-Scotland & Wales
[Regional] Malta, Slovenia
[Static Hybrid] Denmark, Luxembourg, Sweden, UK-Northern Ireland
[Dynamic Hybrid] Finland, Germany, UK-England

Table 1: Dairy targeted measures and binary objectives resulting from CAP health check agreement

Types of operations	Measures and articles by pillar	Dual objectives related to dairy sector
Pillar 1 – direct payments		
Change in the value of current SFP entitlements	Regionalisation of the single payment scheme and revision of payment entitlements (*articles 47-48*)	Improvement of competitiveness Enhancement of positive externalities
New SFP entitlements or increase in the value of current SFP entitlements	Integration of coupled support into the SFP scheme (*articles 63-67*)	Improvement of competitiveness Enhancement of positive externalities
Support addressing disadvantages that affect farmers in economically vulnerable or environmentally sensitive areas	Specific support (*articles 68-69*)	Improvement of competitiveness Enhancement of the positive externalities
Pillar 2 – Rural development (indicative list)		
Investment support related to dairy production	Modernisation of agricultural holdings (*article 26*)	Improvement of the competitiveness
Improvements in processing and marketing related to dairy	Adding value to agricultural and forestry products (*article 28*)	Improvement of the competitiveness
Innovation related to the dairy sector	Cooperation for development of new products, processes and technologies (*article 29*)	Improvement of the competitiveness
Grassland premia and extensive livestock production, organic production related to dairy production, permanent pasture premia in LFAs, grazing premia	Agri-environment payments (*article 39*)	Enhancement of the positive externalities

Source: Council Regulations n°73/2009 and n° 74/2009 of 19 January 2009, Author's arrangement.

Second, fund resulting from further decoupling shall be reallocated on the basis and with the same criteria as the previous provision.[11] Considering that milk direct payments have already been decoupled, levy might therefore indirectly affect diversified dairy farms (articles 63-67). Third, MS may retain up to 10% of national direct payment ceiling in order to address specific disadvantages production (including milk) or factor of production in economically vulnerable or environmentally sensitive areas.[12] The commodity coupling is limited to 3.5% of the national ceiling whereas it is no capped when environmental externalities are targeted. As a result, dairy farms in mountain or LFAs may appear as natural recipient resulting from the implementation of this provision (article 68). Complementarities with rural development measures are however questionable and make vulnerable the coherence between the two pillars of the CAP.

Focusing in both improvement of competitiveness and enhancement of positive externalities in the dairy sector, Table 1 presents the 2010 targeting framework. Three comments have to be stressed. First, multiple objective of direct payments' adjustment may dwindle effectiveness in reaching them if using a single instrument. It confirms the controversies that surround the direct payments' *raison d'être* or the increasing *a la carte* first pillar of the CAP. Second, it corroborates that current CAP pillar dichotomy only results from historical and

[11] Arable crops, olive and hops will be decoupled from 1st January 2010; seeds will be decoupled by 1st January 2012 at the latest; beef and veal payments, except suckler cow premium will be decoupled by 1st January 2012 at the latest; soft fruits will be decoupled from 2012.

[12] MS may grant specific support to farmers (i) for specific types of farming which are important for the protection or enhancement of the environment; (ii) improving the quality of agricultural products; (iii) improving the marketing of agricultural products; (iv) practising enhanced animal welfare standards; (v) specific agricultural activities entailing additional agri-environment benefit.

budgetary considerations and no on targeting criteria. Third, it confirms that the health check agreement does not prevail on a sound reform of the CAP after 2013. The 2010 adjustments should accompany the sector restructuring but maintain the core of the policy based on guaranteed price, and thus trade distortions.

2 Uphold distortions resulting from the European global actor

In an increasing open world, domestic concerns affect international trade. Even motivated by externalities' remuneration or structural adjustments, public interventions may modify the term of trade and then distort foreign markets. These latter, mostly developing countries, are therefore suspended on CAP reform as well as European exporting operators.

2.1 Impacts on selected trade partners

The EU contributes significantly to dairy product world trade. Processed goods are internationally traded because they can be stored much more easily. They are mostly milk powders, butter or butteroil, and cheese. By contrast, milk production is largely consumed in the area where it originates (on the regional or local level). Table 2 ranks the four major exporters of the main internationally traded dairy products. The EU is systematically in those rankings. World market shares reach 22.1%, 11.6%, 14.9% and 35.8% for European whole and skim products, butter and cheese. The high concentration of dairy exporters is striking since this top-four contribute to more than 70% of international trade. As a result, the European dairy regime is confronted to fierce critics, especially from New Zealand and Australia.

Table 2: Major exporters of dairy products exports, thousand tonnes, 2008

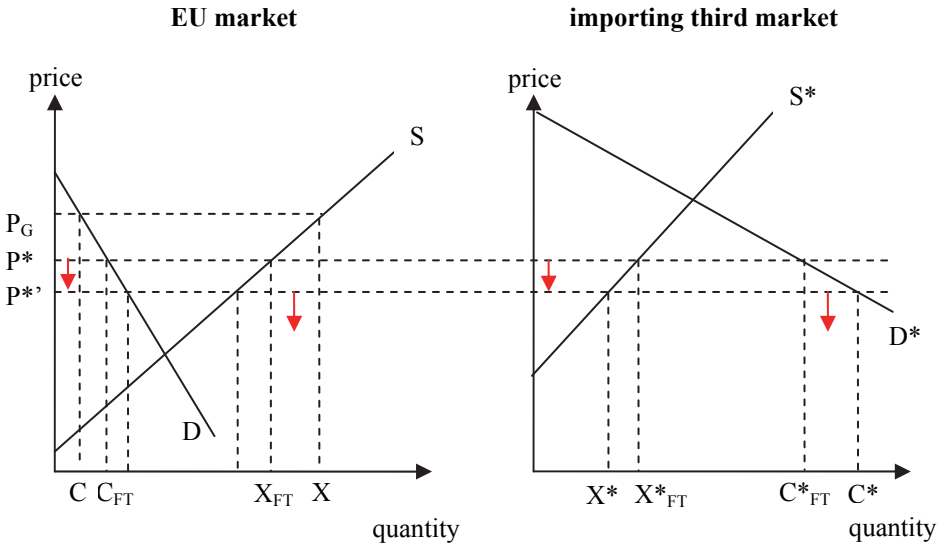
Whole milk powder			**Skim milk powder**			**Butter**			**Cheese**		
major exporters	quantity exported	share of world trade	major exporters	quantity exported	share of world trade	major exporters	quantity exported	share of world trade	major exporters	quantity exported	share of world trade
NZ	612	35.7%	US	275	26.6%	NZ	299	42.5%	**EU**	**598**	**35.8%**
EU	**379**	**22.1%**	NZ	208	20.1%	**EU**	**105**	**14.9%**	NZ	278	16.6%
Arg.	100	5.8%	Aust.	129	12.5%	Aust.	58	8.2%	Aust.	202	12.1%
Austr.	116	6.8%	**EU**	**120**	**11.6%**	Bel.	63	8.9%	Bel.	88	5.3%
others	739	29.6%	others	301	29.1%	others	179	25.4%	others	506	30.3%

Argentina [Arg.] Autralia [Austr.] Belarus [Bel.] European Union [EU] United States [US] New Zealand [NZ]
Source: FAOstat, Author's arrangement.

Because the EU is a large actor on dairy markets, its domestic regulation has an impact on world prices and thus on foreign markets. It could be considered with regard to microeconomic theory as *price maker* – or better said *regional price maker* as developed below.

The partial equilibrium model of Figure 3 illustrates these effects. The adopted framework is similar to Figure 1 with the addition of an aggregation of the importing rest of the world. In a free-trade configuration, the EU would export the quantity $C_{FT}X_{FT}$ at a price P*. The rest of the world would then import the quantity $X^*_{FT}C^*_{FT}$. However, by fixing a guaranteed price P_G higher than a free-trade price P*, the EU exports the quantity CX and the rest of the world imports the quantity X*C*. This supply increase in the world market induces a drop of the world price from P* to P*'. As a result, it worsens the European terms of trade and increases further the budgetary cost of export refunds.

Figure 2: Microeconomic effects of the European export refunds in dairy products



Export refunds are primarily domestic market regulation tools but distort the world market. In order to maintain market shares, exporting countries consequently lower their selling prices which depress even further the world market. World prices could reach very low levels as shown through the down-arrows in Figure 2. Net importing countries, mainly low income countries, benefit then from cheaper imports in the short term (Panagaryia, 1995). It jeopardizes however the development of dairy industries in these countries and make them dependant on the European farm policy.

The European Commission can grant export refunds in a discretionary way, aiming to stimulate European exports towards specific geographical areas. For instance, the amount refunded for an identical cheese product, varies according to the final destination. It can even be prohibited in some cases as a result of (i) specific agreement with dairy exporting countries as the Unites States, New Zealand, Australia or Canada, (ii) concessions agreed within a global free-trade agreement as the one with European Free Trade Agreement countries, South Africa or Turkey.

To the extent that net importing countries benefit from cheaper dairy products, the share of imports of these countries which comes from the EU is presented in Tables 3. It highlights two critical observations. First, a *regional price maker* standing for the EU would be more pertinent than a *world price maker*. Table 2 put the EU among the main dairy exporters but without a clear leading of the world market shares. By contrast, it tends to be the main provider for Table 3A's developing and least developed countries. Thus the European domestic regulation impacts more precisely those selected foreign markets.

Second, Tables 3 sheds light on asymmetric trade relations exacerbated with the use of export refunds. For instance, the main dairy supplier of North African countries[13] is the EU. As regards imports of milk product, butter and cheese, 44%, 65% and 52% respectively come from the EU. These high market shares as regards North African imports have to be compared with their relative low European corresponding exports. North Africa represents respectively 17%, 15% and 5% of European export markets. These asymmetrical ratios are also particularly relevant for other selected groups of low income counties.

[13] North Africa gathers Algeria, Egypt, Libya, Morocco, Sudan, Tunisia and Western Sahara

Table 3A: Share of EU imports, % imported value, 2007

Reading assistance: 52.5% of cheese imported by North Africa come from the EU (in current dollar value).

	Milk and milk products	Butter and butteroil	Cheese
ACP Countries	31.7%	45.2%	27.5%
Asia Middle East	41.7%	48.0%	30.8%
Europe former USSR	28.1%	47.7%	47.4%
LDCs	30.2%	17.5%	27.2%
North Africa	44.1%	65.0%	52.5%

Source: Comtrade, Author's arrangement.

Table 3B: Share of EU exports, % exported value, 2007

Reading assistance: 4.6% of cheese exported by the EU go to North Africa (in current dollar value).

	Milk and milk products	Butter and butteroil	Cheese
ACP Countries	22.6%	11.1%	3.9%
Asia Middle East	18.5%	22.4%	8.7%
Europe former USSR	4.4%	16.6%	21.2%
LDCs	8.6%	2.2%	0.8%
North Africa	17.2%	15.3%	4.6%

Source: Comtrade, Author's arrangement

These results have strong implications in terms of either European neighbourhood stability or European commitments in favour of development. Both shall be jeopardized when banning export refunds without reforming the whole European dairy regulation. Bilateral trade agreements should include specific provisions compensating negative effects of such a ban. This is a crucial political concern. When opting out export refund, trading loss for the European agri-food firms should also be considered.

2.2 Concentrated domestic exporters

Export refunds aim at retaining the competitiveness of European agribusiness in international markets but recipients are very concentrated. Figure 3 shows the exhaustive distribution of dairy export refunds paid by the French intervention office (IO) in 2004. They compensated 104 operators.

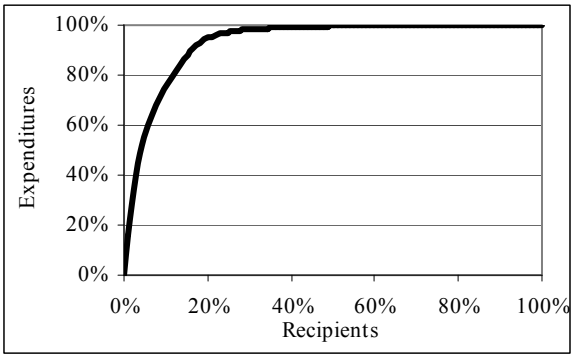
The French IO paid more than 156 million euros on refunds[14] - half of it to only four firms. This result is to be compared with the fact that four French firms account for roughly two third of total dairy sector turnover as presented in Appendix 3. The parallel between the high concentration of the dairy sector and the distribution of export refunds is striking. It should be mentioned that export refunds may create market entry barriers, strengthening the high level of concentration that already exists in this sector – with potential negative impacts as regards the transmission of production price decrease to consumer final price.

French operators get more than the refunds paid in France because a national IO pays refunds to any exporter clearing through customs on that MS. Figure 4 reveals the refunds received by Nestlé SA in five European countries for 2000 and 2004. This multinational agri-food firm produces in Europe and exports processed products containing milk, sugar and cereals benefiting from refunds paid by one, two or three IOs according to the MS involved. Because guaranteed prices of many commodities experienced reduction, the amount went down from 130 to 84 million euros. Dutch agri-food competitiveness associated to the port of Rotterdam justifies the very high amounts received by the Dutch IO[15].

[14] In 2004, the amount of export refunds paid by the French dairy intervention office fell in comparison with the previous year because of the decrease in French exports, handicapped by the dollar's weakness, and because of the increase in French exports from the Netherlands - and therefore under disbursement competency of the respective Dutch IO.

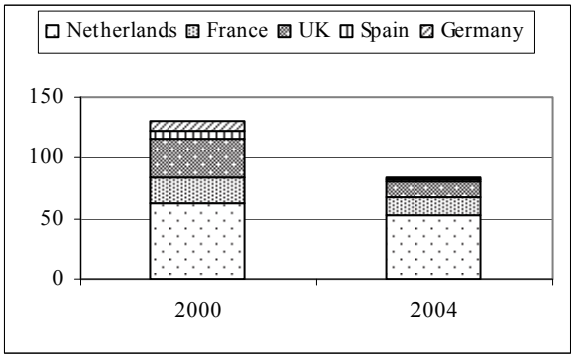
[15] Refunds paid by the Belgian IO would also be significant considering Antwerp's export performance.

Figure 3: Distribution of dairy export refunds paid in France: cumulative share of recipients and expenditures, %, 2004



Source : Author's data request to French dairy Office.

Figure 4: Nestlé's export refunds received from five European countries, million euros, 2000, 2004



Source : Author's interview.

Export refunds are thus mere compensations for operators using European commodity inputs which are more costly than those available in the world markets. This conclusion requires one caveat. When refunds are paid to exporting and food processing firms which have structural links with farmers – because they are cooperatives or own farm land - they can then constitute (in total or, more likely, in part only) subsidies to the firms concerned which benefit from both price market support and export refunds. The April 30, 2009 compulsory nominative disclosure of European Agricultural Guarantee Fund (EAGF) recipients aims to allow doing further research on this issue. It also set sights on public concern as regards public support distribution.

Export refunds are capped in value and volume at the WTO. The issue of how these levels are proficient in preventing high distortions in the world market is going to be examined in the next section.

3 Effectiveness of multilateral export refund regulation

The URAA disciplines export refunds since 1995 without schedules a full elimination. As a result, the EU spent more than 15 billion euros for the entire 1995-2008 period. This barely credible sum represents less than half of the WTO permitted amount. By progressively substituting European price support with direct payments, the use of export refunds substantially decreased – but can still hit anachronistic ceilings.

3.1 Price volatility and refunds

European dairy export refunds have been gradually eliminated between June 2006 and June 2007[16]. Nevertheless by still being included in the European regulation, there was no obstruction to unilaterally reintroduce them. World prices were very high in 2007 but fell in 2008 subsequently to an increase in world supply. It came from a higher United States production which also benefited from a relative weak dollar, an elevated output from New Zealand and Australia, and the decrease of Argentinean export tax (Office de l'élevage, 2008). This increase in world supply faced stagnation in the demand. In response to drops in world prices, the European Commission reintroduced export refunds in January 2009. It set short-term amounts and quantities for milk and milk products. Nevertheless, these limits can be easily adjusted accordingly to market evolutions.

[16] The only dairy export refund which has not been eliminated is that tied to sugar which amounts 2.02 million euros and 16,200 tonnes in 2007/2008 (Office de l'élevage, 2008).

The 2009 world prices are not particularly low as illustrated in Table 4. If they are by contrast to the two previous years, they are roughly close to the one prevailing in 2006. It thus wonders the ability of European operators to make use of relative high world price period for adjusting their production structures.

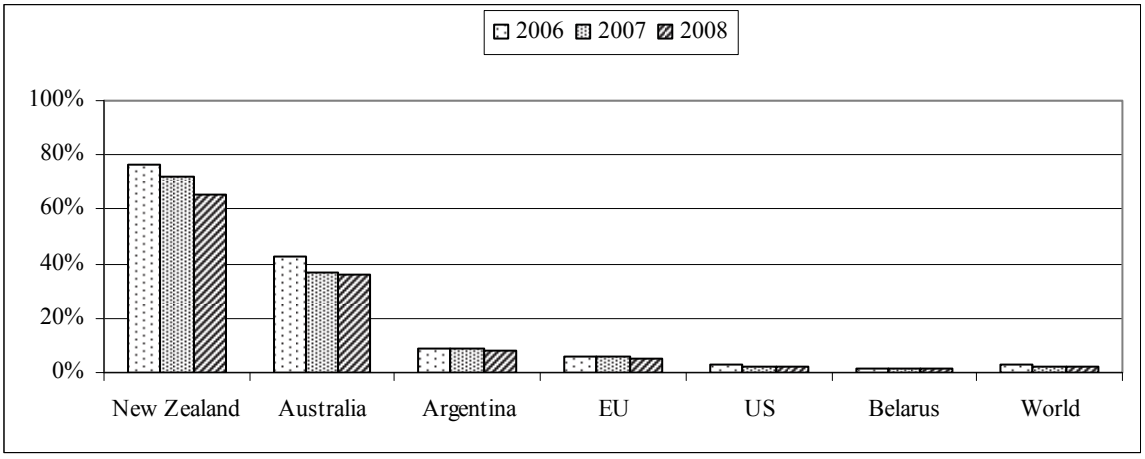
Table 4: World prices in selected dairy products, August 2009
dollars per metric ton, current price index, various basis year

	August 2008 basis 100	August 2007 basis 100	August 2006 basis 100
skim milk powder	62.0	41.2	**93.0**
whole milk powder	52.2	42.7	**94.8**
cheddar cheese	60.7	59.3	**103.8**
butter	57.1	57.1	**118.5**

Prices are averages of north European and selected world ports (F.O.B. ship).
Source: US Dairy Export Council, Dairy Market Outlook's January and November 08, Author's arrangement.

Dairy exports contribute positively to the European trade balance as presented in Appendix 4. It exports however less than 10% of its total production. This ratio attains more than 20% for skim milk powder (Office de l'élevage, 2008). If exporters are affected with the decrease in world prices, other exporting countries are also impacted with this price volatility. As regards the relative low share of the European production devoted to be exported, New Zealand or Australia are even more affected as illustrated with Figure 5. These two countries present an offensive interest in banning export refunds since there are the most impacted by such instruments.

Figure 5: Export of dairy products as a share of domestic production, %, 2007



Source : FAO Stat, Author's arrangement.

The positive European trade balance in dairy products is also attention-grabbing when focusing in dairy market access. As reminded previously, border protection is a corollary of a price support system. The positive trade balance of the EU in dairy product is the consequence of the activation of the three dimension of protectionism: internal support, border protection and export competition.

3.2 WTO regulation: no binding commitments

Dairy product trade benefits from a special treatment within the WTO. European dairy imports represent 0.1% of European total imports. In addition to non-tariff barriers (norms), dairy product imports face the highest duties European agricultural imports are confronted to. Tariff rate quotas are widely privileged. Table 5 presents bound and applied *ad valorem* equivalent duties. The simple averages attain 66.8% and 62.4% with tariff peaks up to 237% and 215% respectively. The reintroduction of export refunds is a further step towards a

distorted trading system. The URAA disciplines export refunds since 1995 whereas the current Doha Round negotiations aim, among other issues, to abolish them.

Table 5: European duties and imports by product groups, %, several years

Part A.2 Tariffs and imports by product groups

Product groups	Final bound duties AVG Duty-free Max Binding in % in %	MFN applied duties AVG Duty-free Max Binding in % in %	Imports % in %
Animal products	26.8 20.6 *215* 100	25.9 23.6 *215*	0.4 15.2
Dairy products	66.8 0 *237* 100	62.4 0 *215*	0.1 0
Fruit, vegetables, plants	10.7 22.8 *231* 100	11.6 18.5 *231*	1.6 11.4
Coffee, tea	6.9 27.1 *88* 100	6.9 27.1 *88*	0.7 80.4
Cereals & preparations	24.3 6.3 *116* 100	19.8 10.7 *116*	0.4 26.7
Oilseeds, fats & oils	5.6 48.2 *113* 100	6.0 43.1 *113*	1.2 69.1
Sugars and confectionery	29.5 0 *133* 100	29.8 0 *133*	0.2 0
Beverages & tobacco	23.2 23.0 *210* 100	20.0 19.8 *191*	0.6 15.3
Cotton	0.0 100.0 0 100	0.0 100.0 0	0.0 100.0
Other agricultural products	5.1 67.1 *120* 100	5.6 65.1 *119*	0.5 68.3

Final bound duties (2009)
MFN applied duties (2007)
-AVG: Simple average of final bound duties.
-duty-free: Share of duty-free harmonised system (HS nomenclature) six-digit subheadings in the total number of subheadings in the product group. Partially duty-free subheadings are taken into account on a pro rata basis.
-max: Highest *ad valorem* duty or *ad valorem* equivalent within the product group.
Imports (2006)
-share: Share of imports falling under product group.
-duty-free: Share of MFN duty-free imports falling under product group in total imports in that product group. Partially duty-free subheadings are taken into account on a pro rata basis if tariff line imports are not available.

Agricultural product groups	Final bound duties (2009)			MFN applied duties (2007)			Imports (2006)	
	AVG	duty-free	max	AVG	duty-free	max	share	duty-free
animal products	26.8	20.6	215	25.9	23.6	215	0.4	15.2
dairy products	**66.8**	**0**	**237**	**62.4**	**0**	**215**	**0.1**	**0**
fruits & vegetables	10.7	22.8	231	11.6	18.5	231	1.6	11.4
coffee, tea	6.9	27.1	88	6.9	271	88	0.7	80.4
cereals & preparations	24.3	6.3	116	19.8	10.7	116	0.4	26.7
oilseeds, fats & oils	5.6	48.2	113	6	43.1	113	1.2	69.1
sugars &confectionery	29.5	0	133	29.8	0	133	0.2	0
beverages & tobacco	23.2	23	210	20	19.8	191	0.6	15.3
cotton	0	100	0	0	100	0	0	100
others products	5.1	67.1	120	5.6	65.1	119	0.5	68.3

Source: WTO (2009)

Within the Doha Round, an accord on the ban of export refunds and measures having equivalent effects has been agreed on August 1st, 2004. The December 2005 Hong Kong Ministerial set December 2013 as the elimination deadline for developed countries. Draft modalities for agriculture which circulate among WTO members deal with the scheduled budgetary and quantity commitments. The December 2008 Chair Text states that budgetary commitments shall be reduced by 50% by December 2010 and 100% by December 2013 in equal annual steps. On quantity commitments, their level shall be lower than the 2003-2005 quantity average during the implementation period. Additionally, during the transitory period, there shall be no refunds on new market and new products. However, these commitments are no compulsory since there are conditioned to an agreement on all the topics currently negotiated at the WTO.

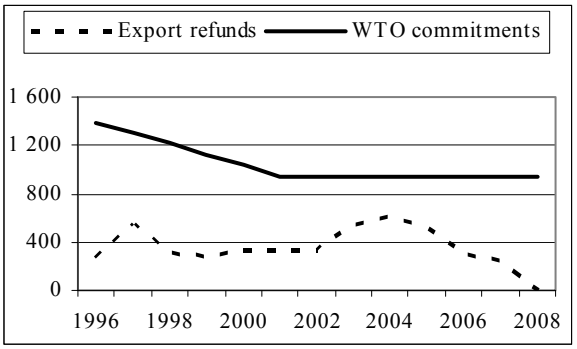
Since 1995, dairy refund value and volume are annually capped – ventilated in four categories: (i) butter and butteroil, (ii) skim milk powder, (iii) cheese, and (iv) other milk products. The EU is presently free to sharply increase its export refund expenditures while still respecting its multilateral commitments. When negotiating the URAA, a substantial flexibility has been given to members as regards the base period for export refunds commitments. The European references reflect past sky-scraping amount of export refunds

linked to a European market only administrated with price support and quotas. Figure 6 presents the difference between the maximum amount of refunds allowed at the WTO and the effective spending since the implementation of the URAA. The present huge water jeopardizes the stability of international trade in dairy products. Indeed, the EU would be able to spend more than 2.3 billion euros per year with no option for legal complaint from other exporting countries. This amount could be even higher since the EU could take advantage of its past under-use of WTO commitments to legitimate exceptional over spending. This configuration already occurred in 2000 for skim milk powder and other milk products.

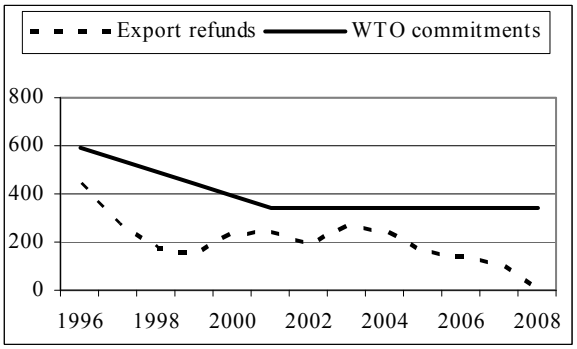
Figure 6: Water in export refunds for dairy products, million euros, 1995-2008

Difference between European export refund values and WTO commitments

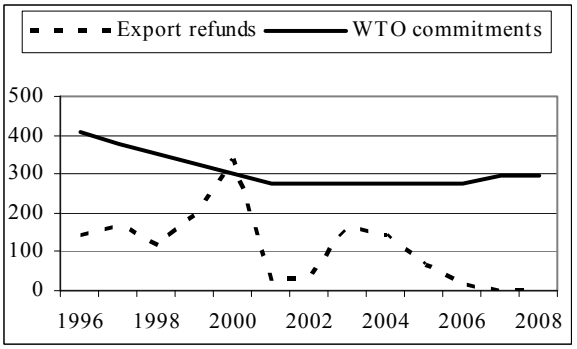
Butter and butteroil



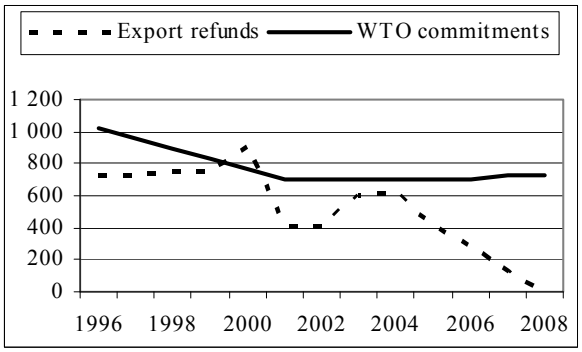
Cheese



Skim milk powder



Other milk products



Data for year N indicates data for the campaign starting July 1, N-1 and ending June 30, N.
Source : WTO notifications' several years, Office de l'élevage (2008), Author's arrangement.

EU commitments at the WTO do not constrain an eventual boom in refund expenditures. In May 2009, the United States also introduced export refunds for dairy products. They indirectly gave to the EU the responsibility of such reintroduction since European refunds depress further world prices. This development raised the concern at the WTO of Australia, New Zealand, Australia, Argentina, Brazil and China in July 2009.[17] It argues in favour of the "pacifying" impact the conclusion of the Doha Round may have on international trade relations as developed by Messerlin (2008). The uncertainty produced by a potential expansion of export refunds could be dramatic in an attempt to discipline farm policies. Last but not least, the integration of dairy payments within the SFP runs against the respect of URAA decoupling provisions. Because quotas are regulating milk production at least until 2015, SFPs do not fit the green box criteria and could be easily challenged at the WTO dispute settlement body.

Concluding remarks

An export refund ban at the WTO would preserve international trade relations from highly distorting measures. It is an ensured outcome from an eventual conclusion of the Doha Round – an easy European concession when prices (and expected prices) are high, a politically risky one when prices tend to drop. Such a commitment would constrain the EU to further decrease guaranteed prices and therefore expand risk management alternatives – from diversification to insurance scheme – in order farm holdings to cope with price volatility. The price transmission to consumers is key as regards welfare gains from quota opening and request transparency in the dairy supply chain.

[17] http://www.wto.org/english/news_e/news09_e/ag_com_02jul09_e.htm – Webpage consulted in August 2009.

From January 2010, measures accompanying the adjustments of the European dairy sector are considered as a priority in rural development programs. They should be temporary whereas those remunerating amenities should be permanent. Because of the intrinsic local dimension of such non commodity output, it may request a new paradigm as regards measure definition, implementation and funding. The starting point of this issue deals with the objectives of the CAP which are decisive when refunding the European policy after 2013.

The elimination of export subsidies will be the result of a refunded CAP. It would bring an increase in world economic welfare only if the WTO members reform their agricultural policies. Without a decrease in distortive instruments, net food-importing countries will be hurt to the extent that they will need to import food products that are less heavily subsidized, and hence more expensive. This deterioration will be particularly marked among countries located south of the Mediterranean Sea and in the Arabian Peninsula which are, almost all of them, large net food importing countries. Therefore, a CAP reform represents not only an economic interest, but also a crucial political concern.

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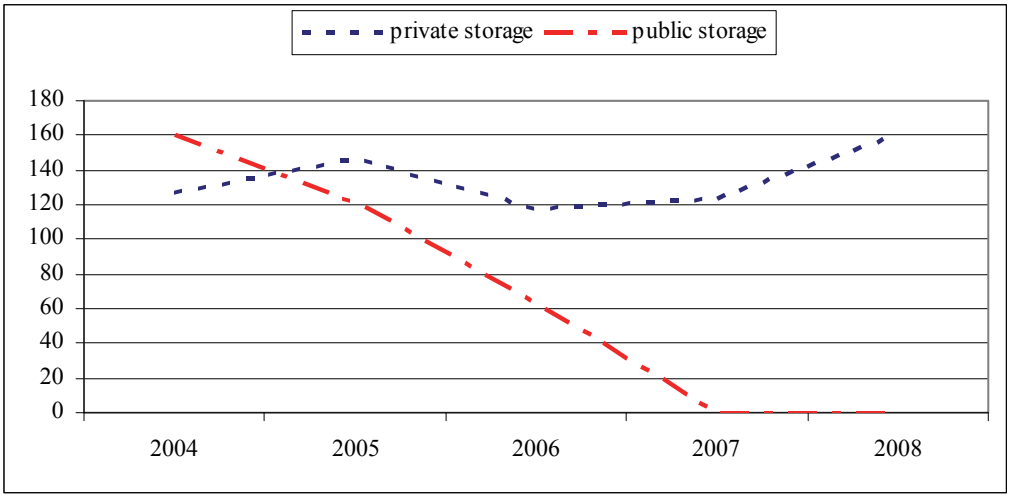
Appendix 1: European private vs. public storage of butter, thousand tonnes, 2004-2008



Source: Office de l'élevage (2008); Author's arrangement.

Appendix 2: Producer and Consumer price changes, %, Q1 2009 compared to Q4 2007

	Producer prices (farmers, processors)				Consumer prices	
	Raw milk	Skimmed milk powder	Butter	Cheese	Food	Milk, Cheese, Eggs
EU	**-28%**	**-42%**	**-37%**	**-21%**	**6%**	**4%**
Belgium	-45%	-48%	-42%		6%	6%
Bulgaria	-11%				9%	5%
Czech Republic	-38%	-49%	-46%	-29%	3%	-4%
Denmark	-30%	-47%	-23%		5%	2%
Germany	-39%	-49%	-43%	-37%	3%	-3%
Estonia	-28%			-14%	7%	-1%
Ireland	-43%	-44%	-41%		4%	9%
Greece	-13%				6%	4%
Spain	-28%		-24%		3%	0%
France	-12%	-46%	-44%		5%	7%
Italy	-12%		-45%		5%	5%
Cyprus	20%				13%	5%
Latvia	-34%	-11%	-41%	-19%	15%	8%
Lithuania	-43%			-7%	14%	-2%
Luxembourg	-35%				4%	5%
Hungary	-33%	-46%	-1%		8%	5%
Malta					13%	10%
Netherlands	-39%	-47%	-46%	-44%	7%	7%
Austria	-20%				5%	-2%
Poland	-40%	-54%	-44%	-44%	6%	0%
Portugal	-17%		-39%		3%	1%
Romania					9%	14%
Slovenia	-6%			1%	6%	10%
Slovakia	-32%	-20%	-29%	-33%	3%	-2%
Finland	3%		-30%	0%	14%	22%
Sweden	-33%				9%	8%
U. Kingdom	-27%		-57%	-27%	13%	11%

Source: European Commission (2009).

Appendix 3. Rankings of the 25 major French recipients of export refunds paid by ONILAIT and the 25 largest French dairy firms, million euros, %, 2004

rank	export refunds paid (thousand euros)	share of the total paid (%)
1	25,005	*16.00%*
2	20,545	*13.15%*
3	17,006	*10.88%*
4	14,185	*9.08%*
5	9,632	*6.16%*
6	7,942	*5.08%*
7	5,840	*3.74%*
8	5,615	*3.59%*
9	5,583	*3.57%*
10	4,663	*2.98%*
11	4,096	*2.62%*
12	4,058	*2.60%*
13	3,600	*2.30%*
14	3,558	*2.28%*
15	3,509	*2.25%*
16	3,218	*2.06%*
17	2,766	*1.77%*
18	2,491	*1.59%*
19	2,289	*1.46%*
20	1,462	*0.94%*
21	1,236	*0.79%*
22	895	*0.57%*
23	871	*0.56%*
24	871	*0.56%*
25	465	*0.30%*
26-104	4 877	*3.12%*
Total	**156,278**	*100.00%*

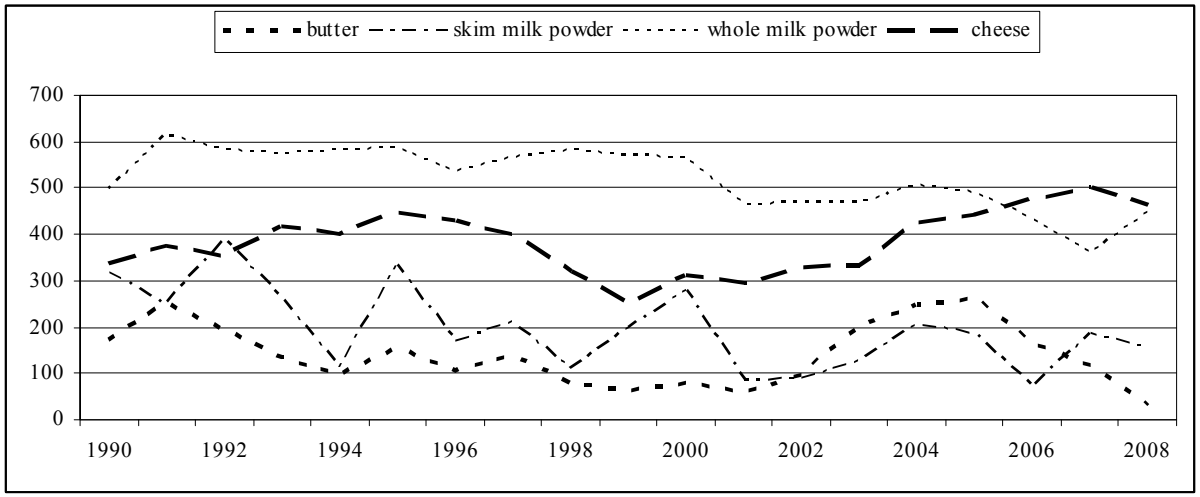
rank	dairy firms and cooperatives	turnover (million euros)	of which out of France (million euros)*
1	Danone**	6,914	5,122
2	Groupe Lactalis	5,675	2,280
3	Bongrain	4,128	2,204
4	Sodiaal	2,666	507
5	Fromageries Bel	2,025	1,359
6	Entremont	1,094	414
7	Groupe 3A	862	240
8	Nestlé France	800	
9	Senoble	705	229
10	Eurial Poitouraine [C]	509	94
11	Unicopa	506	155
12	Novandie	500	
13	Coopagri Bretagne L[C]	444	
14	Glac [C]	428	16
15	Groupe Ermitage [C]	324	38
16	Laiterie Val d'Anc. [C]	277	41
17	Groupe Even	262	30
18	Triballat Noyal	260	11
19	Prospérité fermière [C]	250	138
20	Laiterie Triballat SA	236	25
21	M L du Cotentin [C]	211	34
22	Célia SA	210	197
23	Fléchard SA	187	54
24	Isigny Sainte-Mère [C]	155	55
25	SILL	125	60

* Subsidiaries and exports do the turnover realized outside France.
** Data in relation to Danone are only those of the "fresh dairy product" group.
[C] Cooperatives.

Source : Boulanger (2005).

2004.

Appendix 4: European trade balance, thousand tonnes, 1990-2008



Source: Office de l'élevage (2008); Author's arrangement.