

The Interface Between Domestic Dairy Policies and Dairy Trade

For dairy industries in individual countries, the first priority is to provide an adequate supply of milk to satisfy domestic market needs, first the fluid market, and then manufactured product markets. Domestic dairy policies and programs are generally mechanisms to promote milk production in a country, but in some cases around the world they have promoted surplus production above domestic needs. Those surpluses are available for export but may also impede imports—for which they are termed trade distorting. By explicitly including agricultural trade and domestic agricultural support policies in its negotiations, the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) opened the door for several contentious debates during trade talks that often centered on domestic dairy policies and programs. As evidenced by these discussions, firms interested in greater international market participation may benefit from an assessment of the effects of domestic dairy policies and programs as they interface with dairy trade policies.

As the global dairy industry continues to evolve, it is important to determine those countries for which the interface between international dairy trade and domestic dairy policy is an issue. Table 3 shows the top five countries or areas of the world for production, consumption, imports, and exports of butter, cheese, nonfat dry milk, and whole milk powder. Almost all countries have tariffs or tariff-rate quota (TRQ) systems in place and at least two countries have both. The bottom line in the table identifies four countries with significant institutional structures, other than tariffs and TRQs, in place to provide domestic dairy industry support: the EU, Canada, Japan, and the United States.

Dairy-Trading Nations With Significant Domestic Support

With the exception of the EU, the four countries/regions where significant domestic support for dairy is prevalent are not dominant players in international dairy product markets. The focus here is to provide a general descriptive outline of the key elements of current policy and programs; historical information for each area can be found in other detailed sources. The details of many domestic dairy programs can be daunting and are available from the governmental agencies charged with their implementation and operation. References are cited for each country in the following sections.

The European Union (EU)

EU agricultural policy is embodied in the Common Agricultural Policy (CAP). Reforms of the CAP in 2003 significantly moved the EU toward using decoupled direct payments (called single farm payments) to support agriculture. The fundamental dairy policy components of the current CAP include a milk production quota and intervention programs for butter and nonfat dry milk. The reforms called for reduction of both the butter and the nonfat dry milk intervention prices. The 25-percent reduction for butter prices is to be spread over 4

Table 3

Dairy trade and domestic dairy policy/programs, 2004

Milk production	Top five nations in each category				
	European Union	United States	India	Russia	Brazil
Dairy products:					
Production					
Butter	European Union	United States	New Zealand	Russia	Ukraine
Cheese	European Union	United States	Australia	Brazil	Russia
Nonfat dry milk	European Union	United States	New Zealand	India	Australia
Whole milk powder	European Union	China	New Zealand	Brazil	Argentina
Consumption					
Butter	European Union	United States	Russia	Ukraine	Mexico
Cheese	European Union	United States	Russia	Egypt	Canada
Nonfat dry milk	European Union	United States	Mexico	India	Japan
Whole milk powder	China	Brazil	European Union	Venezuela	Russia
Exports					
Butter	New Zealand	European Union	Australia	Ukraine	Canada
Cheese	European Union	New Zealand	Australia	Ukraine	United States
Nonfat dry milk	New Zealand	European Union	United States	Australia	Ukraine
Whole milk powder	New Zealand	European Union	Australia	Argentina	Philippines
Imports					
Butter	Russia	European Union	Algeria	Mexico	Canada
Cheese	United States/Japan	Russia	European Union	Mexico	Australia
Nonfat dry milk	Mexico	Indonesia	Philippines	Thailand	China
Whole milk powder	China	Venezuela	Malaysia	Mexico/Philippines	Thailand
Domestic policy "coverage"	European Union	United States	Canada	Japan	

Source: Prepared by USDA, Economic Research Service using data from USDA, Foreign Agricultural Service.

years—a 7-percent reduction per year in 2005-07 and a 4-percent reduction in 2008. For nonfat dry milk, the price reductions are uniform at 5 percent per year from 2004 to 2006, reductions that actually did occur. A limit has been established for annual intervention purchases of 30,000 tons of butter by 2008, starting from 70,000 tons in 2004 and reduced by 10,000 tons annually. The EU will make direct payments, which may be coupled to milk production or not, to cover lost revenues due to price reductions. Member states may make additional payments from a national budget provided by the EU. In 2008, dairy payments will be incorporated into the (noncommodity-specific) single farm payment (Kelch and Normile, 2004).

The EU today is much different from that of 3 or 4 years ago and is far removed from the original six-member Economic Community of 1967. In May 2004, eight Central and Eastern European countries (Poland, Hungary, Czech Republic, Slovakia, Slovenia, Estonia, Latvia, and Lithuania), Malta, and Cyprus joined the EU-15 to form the EU-25 (Cochrane, 2004). With the addition of the 10 new member states, the EU increased its population by nearly 30 percent and its arable land by nearly 40 percent. Other countries are also scheduled for membership, including Romania and Bulgaria in 2007. The ongoing changes in the EU will result in its having a larger presence in global agricultural markets, but whether it will be an importing or exporting area for various products is to be determined.

Canada

Canadian dairy policy rests first and foremost on the supply management system implemented in the mid-1970s. All current programs are designed with this system as the backdrop. Both the Federal and the Provincial Governments are involved in regulating milk markets.

Canada's domestic production and marketing controls are intended to match milk supplies, classified as industrial or fluid, with estimated demand at an administered price. The national production target for industrial milk, called the market sharing quota, is allocated to provinces largely based on historical shares. An annual fluid milk quota is determined in each province. The quotas are assigned in each province by marketing boards. The dairy quotas are tradable and have become a valuable asset for producers. The administered industrial milk and fluid milk prices are based on cost-of-production estimates and other market information.

Canada has several other programs in place that address seasonality, domestic dairy product innovation, the marketing of dairy ingredients, and the provision of milk components through a special use permit for use in manufactured products. A revenue pooling system in place since 1996 serves as a means for revenues from all milk sales, fluid and industrial, adjusted by several factors, to be used to establish blend prices for producers. Canada also employs a purchase program for butter and skim milk powder that establishes reference (support) prices for milk used in manufactured products.

Canada implemented several TRQs for dairy products under the terms of the World Trade Organization (WTO) in 1994, the primary TRQ being for butter. Approximately two-thirds of the butter TRQ is allocated to New Zealand (Canadian Dairy Commission, 2005).

Japan

Dairy policies in Japan emphasize self-sufficiency in milk and dairy product production through milk supply controls and direct producer income support. There are two milk markets—one for drinking milk and one for manufacturing milk. The quantity of fluid milk is set by a national board of designated milk producers and allocated to regional members who voluntarily accept their quota and face penalties if they exceed it. Manufacturing milk constitutes about 40 percent of total production (Bull and Roberts, 2001) and is subject to a formal quota system, except for milk to be used for cheese production. Quota participation is voluntary, and those who participate receive direct payments for milk produced within their quota and no payment for milk produced over their quota. The direct payment system replaced a deficiency payment system in 2001. Japan initiated an income stabilization program for milk producers in 2001 to reduce the effects of dairy product price declines. The Agriculture and Livestock Industries Corporation, a state trade enterprise, is authorized to stabilize dairy product prices by market intervention and stockpiling when necessary (Obara, Dyck, and Stout, 2005).

United States

U.S. milk producers have received government support since the 1930s. Current domestic programs include milk price support, the Federal milk marketing order system, and direct payments under the Milk Income Loss Contract (MILC) program. Dairy policies and programs have been modified to meet changing economic relationships over time, but underlying general objectives remain the same: ensure the orderly marketing of an adequate supply of fresh wholesome milk to meet consumer demands at reasonable prices and provide adequate returns to milk producers (Manchester and Blayney, 2001).

WTO commitments in 1994 had immediate implications for the U.S. dairy industry. Legislation in 1996 addressed meeting the WTO commitments and proposed fundamental changes in domestic dairy policies and programs that, if implemented, would reduce trade-distorting support. The Dairy Export Incentive Program (DEIP), a program for subsidizing certain dairy product exports, was limited by WTO commitments, and the end of the price support program was proposed. Milk price support never actually ended. It was revived in its more traditional “permanent” form in 2002, and a direct payment program for milk producers, MILC, was authorized with payments first made in 2003. The DEIP was continued still subject to the reduced levels agreed to under the WTO.

Dairy-Trading Nations With Little Domestic Support

Most of the remaining countries that appear as major dairy product exporters or importers have few or no domestic dairy policies or programs (see table 3). Australia and New Zealand are long-time international dairy market participants. New Zealand has not had significant agricultural support of any kind since the mid-1980s. The Australian dairy industry generally has been more protected, but efforts to tie its agricultural industries to international markets have led to domestic dairy policy changes—the most recent in 2000 when fluid milk market pricing was reformed.

Countries such as Brazil and Argentina are relatively new participants in international dairy-market exporting, and their long-term prospects are unknown. However, they are clearly recognized as potential key suppliers and have relatively unregulated domestic industries. Other importing and exporting relationships seem to be based on regional proximity and possibly former political ties.

Domestic dairy policies and programs in key trading areas or nations are still a significant determinant of global dairy product flows. Dairy industry representatives in the United States emphasize three major concerns in statements regarding international dairy trade: (1) market access (including administration of border measures), (2) export subsidies, and (3) change in existing domestic dairy support programs. Milk producers, processors, product manufacturers, and dairy marketing firms in other countries have generally expressed the same concern—but to different degrees. Assessments of dairy trade liberalization often posit complete elimination of domestic policies and programs, dairy border measures, and export subsidies.