EUROPEAN EXPORT REFUND OPTING OUT: A DAIRY CASE STUDY

Pierre Boulanger

Groupe d’Economie Mondiale, Sciences Po, Paris, France

pierre.boulanger@sciences-po.org

2009

Copyright 2009 by authors. All rights reserved. Readers may make verbatim copies of this document for non-commercial purposes by any means, provided that this copyright notice appears on all such copies.
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 fourth 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 Agreement on Agriculture 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

1. 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. Indeed,
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.

2 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. They should be opened by 2015. The recent evolution of European regulation aims at targeting support but still faces many challenges.

2.1 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 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 latter privileged in coherence with the willingness to give private operators an increasing responsibility in market regulation. Destruction of production surplus has marginally occurred.

3 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
European demand and supply are respectively represented by the $D$ and $S_{\text{private}}$ 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 than 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 ($S_{\text{quota}}$) because production beyond the quota is not possible – or better said, financially unattractive. Quotas are broken down among the member states and then among producers through individual limited quantities. There are important differences between member states 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 member state and then reverberated to the producers having contributed to the overrun.

**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 (producer’s welfare wastes the $E_QE_GE_G'$ area) 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 member states, not between them. As a result, dairy sector development of most competitive member states 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 have to substitute $P_G$. With this lower price, European consumers increase their demand from $OC$ to $OC'$. It thus reduces the production surplus. The producer aggregated welfare loses the $P_GE_GE_G'P_G$ area. By contrast, the previous quota system saves a smaller $E_GE_G'P_G$ area without counterbalancing 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. 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 are the main beneficiary of price decrease, transmission of this latter is key. There is however a lack of repercussion to consumers of producer price decreases whereas increases are typically reverberated to consumers. It thus 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 (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.

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.

2.2 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

---

4 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.
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 is not optimal from the social point of view since it leads to an under-provision of positive 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 mentioned that transaction costs are excluded of this analysis even if targeted measures are more costly than broad-based price policy. In addition, 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 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.

2.3 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 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.\(^7\) Because a quota opening would impact differently local agricultural production and income\(^8\), it is relevant to give flexibility to member states 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. 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 member states that adopted an historical decoupling model to regionally redistribute support – a member state can be considered as a single region (articles 47-48). Second, fund resulting from further decoupling shall be reallocated on the basis and with the same criteria as the previous provision.\(^9\)

---

\(^5\) 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.

\(^6\) 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 EU budget shall cover 75% of the cost (90% in convergence areas) instead of 50% for non-challenge-related measures (75% in convergence areas).

\(^8\) For an assessment of regional effects resulting from quotas abolition, please refer to Fellmann (ed.), 2009.

\(^9\) 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.
Considering that milk direct payments have already been decoupled, levy might therefore indirectly affect diversified dairy farms (articles 63-67).

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

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


Third, member state 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. 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 LFA 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 struggle 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 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.

### 3. Uphold distortions resulting from the European global actor
In an increasing open world, domestic concern affects international trade. Even motivated by externalities’ remuneration or structural adjustments, public intervention may modify the term of trade and then distorts foreign markets. These latter, mostly developing countries, are therefore suspended on CAP reform as well as European exporting operators.

### 3.1 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 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**

<table>
<thead>
<tr>
<th>Whole milk powder</th>
<th>Skim milk powder</th>
<th>Butter</th>
<th>Cheese</th>
</tr>
</thead>
<tbody>
<tr>
<td>Major exporters</td>
<td>Quantity exported</td>
<td>Share of world trade</td>
<td>Major exporters</td>
</tr>
<tr>
<td>NZ 612</td>
<td>35.7%</td>
<td>US 275</td>
<td>26.6%</td>
</tr>
<tr>
<td>EU 379</td>
<td>22.1%</td>
<td>NZ 208</td>
<td>20.1%</td>
</tr>
<tr>
<td>Arg. 100</td>
<td>5.8%</td>
<td>Aust. 129</td>
<td>12.5%</td>
</tr>
<tr>
<td>Austr. 116</td>
<td>6.8%</td>
<td>EU 120</td>
<td>11.6%</td>
</tr>
<tr>
<td>others 739</td>
<td>29.6%</td>
<td>others 301</td>
<td>29.1%</td>
</tr>
</tbody>
</table>


Source: FAOstat, Author’s arrangement.

Because the EU is a large actor on dairy markets, it can be considered with regard to microeconomic theory as *price maker*. Its domestic regulation has therefore an impact on world prices and thus on foreign markets. By fixing a guaranteed price higher than the world price, the EU has to increase its exports with the assistance of refunds. This supply expansion in the world market induces a drop of the world price. As a result, it worsens the European terms of trade and increases further the budgetary cost of export refunds.

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. 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 sheds light on asymmetric trade relations exacerbated with the use of export refunds. For instance, the main
dairy supplier of North African countries\textsuperscript{10} 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.

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

<table>
<thead>
<tr>
<th>Region</th>
<th>Milk and milk products</th>
<th>Butter and butteroil</th>
<th>Cheese</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACP Countries</td>
<td>31.7%</td>
<td>45.2%</td>
<td>27.5%</td>
</tr>
<tr>
<td>Asia Middle East</td>
<td>41.7%</td>
<td>48.0%</td>
<td>30.8%</td>
</tr>
<tr>
<td>Europe former USSR</td>
<td>28.1%</td>
<td>47.7%</td>
<td>47.4%</td>
</tr>
<tr>
<td>LDCs</td>
<td>30.2%</td>
<td>17.5%</td>
<td>27.2%</td>
</tr>
<tr>
<td>North Africa</td>
<td>44.1%</td>
<td>65.0%</td>
<td>52.5%</td>
</tr>
</tbody>
</table>

Source: Comtrade, Author's arrangement.

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

<table>
<thead>
<tr>
<th>Region</th>
<th>Milk and milk products</th>
<th>Butter and butteroil</th>
<th>Cheese</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACP Countries</td>
<td>22.6%</td>
<td>11.1%</td>
<td>3.9%</td>
</tr>
<tr>
<td>Asia Middle East</td>
<td>18.5%</td>
<td>22.4%</td>
<td>8.7%</td>
</tr>
<tr>
<td>Europe former USSR</td>
<td>4.4%</td>
<td>16.6%</td>
<td>21.2%</td>
</tr>
<tr>
<td>LDCs</td>
<td>8.6%</td>
<td>2.2%</td>
<td>0.8%</td>
</tr>
<tr>
<td>North Africa</td>
<td>17.2%</td>
<td>15.3%</td>
<td>4.6%</td>
</tr>
</tbody>
</table>

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.

3.2 Concentrated domestic exporters

Export refunds aim at retaining the competitiveness of European agribusiness in international markets but recipients are very concentrated. Figure 2 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\textsuperscript{11} - 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 (Boulanger, 2005). 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 member state IO pays refunds to any exporter clearing through customs on that member. Figure 3 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

\textsuperscript{10} North Africa gathers Algeria, Egypt, Libya, Morocco, Sudan, Tunisia and Western Sahara

\textsuperscript{11} 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.
member state 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.\textsuperscript{12}

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.

**Figure 2: Distribution of dairy export refunds paid in France: cumulative share of recipients and expenditures, %, 2004**

**Figure 3: Nestlé’s export refunds received from five European countries, million euros, 2000, 2004**

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.

### 4 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.

#### 4.1 Price volatility and refunds

European dairy export refunds have been gradually eliminated between June 2006 and June 2007\textsuperscript{13}. 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).

\textsuperscript{12} Refunds paid by the Belgian IO would also be significant considering Antwerp’s export performance.

\textsuperscript{13} 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).
This increase in world supply faced stagnation in the demand. Between November 2007 and October 2008, world prices went down as presented in Table 4. In response to those drops, 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.

### Table 4: World prices in selected dairy products, per tonne, October 2008

<table>
<thead>
<tr>
<th>Product</th>
<th>Price (Basis 100: November 2007)</th>
</tr>
</thead>
<tbody>
<tr>
<td>butter</td>
<td>81</td>
</tr>
<tr>
<td>dry whey</td>
<td>53</td>
</tr>
<tr>
<td>butteroil</td>
<td>79</td>
</tr>
<tr>
<td>skim milk powder</td>
<td>50</td>
</tr>
<tr>
<td>cheddar cheese</td>
<td>77</td>
</tr>
<tr>
<td>Lactose</td>
<td>44</td>
</tr>
<tr>
<td>whole milk powder</td>
<td>71</td>
</tr>
<tr>
<td>whey protein</td>
<td>36</td>
</tr>
</tbody>
</table>

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. 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). The exports – or storage/destruction – of this latter are thus necessary in order to clear the European domestic market. They are affected with the division by two of its world price in less than a year. Nevertheless, 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 since 71% and 43% of their dairy production are exported. These two countries present an offensive interest in banning export refunds since there are the most impacted by such instruments.

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.

### 4.2 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. Bound and applied ad valorem equivalent duties 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 URRA disciplines export refunds since 1995 whereas the current Doha Round negotiations aim, among other issues, to abolish them.

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 member states 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.

---

14 Average data from FAO Stat for the 2006-2008 period.
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 member state 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 4 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 4: Water in export refunds for dairy products, million euros, 1995-2008**

Difference between European export refund value and WTO commitments

EU commitments at the WTO unfit 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 dairy exporting countries together with Brazil and China in July 2009. 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.

5 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.

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 distorting 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.

Literature