

Abolition of the Milk Quota System in Switzerland

Summary of the study conducted by Dr. Therese Haller

from the Bern University of Applied Sciences / School of Agricultural, Forest and Food Sciences
(HAFL), Agronomy, Expert Group on agricultural economics

I) Situation in Switzerland

Abolition of the milk quota system	As part of the liberalisation process in the Swiss dairy market, the decision was taken in 2003 to abolish the milk quota system with effect as of 1st May 2009. During the three years prior to the abolition, milk producer organisations and organisations representing both milk producers and processors could be granted a volume increase if they could prove that there was an corresponding demand from the processing industry. Nevertheless, the time frame for the above-mentioned early exit of the quota system coincided with the extraordinary favourable conditions on the international milk market of the years 2006/07. High world market prices and the resulting low pressure on prices thus further amplified the expected strong increase in production.
High pressure on producer prices	But the definitive abolition of milk quotas in Switzerland was only implemented after the situation on the world market had "returned to normal", that is after prices had collapsed again. As in other countries, in Switzerland this resulted in high pressure on producer prices – a situation that was even worsened by the previous volume increase. If we take the milk price of the years 2000/02 as a reference (= 100%), we see that within ten years (until 2010/12) industrial milk in Switzerland has lost 24% of its value, milk processed into cheese 15% and organic milk 19%.
Elasticity of demand smaller than expected	When all types of commercial milk are taken into account, the overall value loss amounts to 22%. The price decrease observed was higher than expected before the quota abolition. Demand elasticity was clearly smaller than expected.
Supply management under private-law not implemented	Given prices were dropping again at the moment of the actual abolition of quotas, milk producer representatives tried to put into place a private system of supply regulation. During the political debates on the quota abolition, such a system had been recognised as a sensible follow-up arrangement. But most of the measures for stabilising the market or for the implementation of a supply management system based on private law, which had been proposed in the context of the quota abolition, were not or only partially implemented. Even five years after the quota abolition, milk producers lack stable long-term market conditions.
Still no stable market conditions	
Volume increase after the quota abolition not well distributed	The allocation of additional volumes between the different product groups is unfavourable for producers. As a matter of fact, the increase mainly concerns products for which it is not possible to reach higher milk prices on an international level (such as

butter and long-life dairy products, in particular milk powder) – even if a higher price would be justified due to product quality or animal welfare aspects. With regard to the potential of value creation it is for example questionable that the volume increase occurred more than proportionally in the production of butter, which can only be exported taking into account high losses. Since 2008, the amount of butter produced in Switzerland has exceeded demand every year. These exports are excess quantities and do not respond to a demand of the market.

Problem on the cheese market: import increase bigger than increase in exports

The cheese processing sector developed to a much lower extent than expected. Overall cheese exports went up by 15% between 2000/02 and 2010/12. Nonetheless, exports of the most important type of cheese for export, i.e. hard cheese (to which Emmental and Gruyere cheese belong), dropped by 10%. Semi-hard cheese exports more than doubled and exports of fresh cheese started (cf. TSM 2011, 2013). In other words, cheese rich in content was partially replaced by cheese of less rich content. As in the course of the liberalisation of the cheese market cheese imports also increased, the trade balance of cheese decreased (Flury et al., 2014), i.e. imports increased more than exports.

Market concentration increased in the processing sector

In parallel, market concentration in the processing sector further increased. The four largest dairy processors increased their processed milk volumes by 38% between 2003 and 2012, while their share in the total milk quantity processed in Switzerland augmented from 44% to 56%.

Regional structures: differences between mountain and valley regions on a rise

The differences between mountain and valley regions also further increased. The reason why this does not have stronger consequences on the income situation is due to income stabilising effect of direct payments, which are higher in higher altitudes than in lower ones. In mountain areas, the share of direct payments in the overall performance of a farm is higher than the share of milk sales – this is not the case in hilly or valley regions (cf. Grundlagenbericht der Zentralen Auswertung, Hoop & Schmid 2013). Without these differences in the calculation of public subsidies, regional differences following the consequences of the quota abolition would have been more severe.

II) Conclusions concerning the quota abolition in the EU

Focus on quality products	Value chains: it is in the interest of the dairy sector – and also of consumers – not to focus only on (generic) mass products with competitive prices. When it comes to quality products, competition does not concern so much the price (and the costs) of the product, but rather the quality of the end product for which consumers are willing to pay a higher price.
Balance of power to the disadvantage of producers	Market power: the power balance in the dairy sector is to the disadvantage of producers (and consumers). As single companies have a strong position in some regions, they have the ability to play off the producer groups against each other. This asymmetrical distribution of power reveals the existence of market failures.
Overcapacity leads to plant closures	Overcapacity in the processing sector: the expectations of the processing sector regarding the abolition of quotas in Switzerland were high. The same currently applies to the EU. This leads to investments in facilities, which for financial reasons will need to run to capacity. In this context, overcapacity issues are to be expected, which could result in a high competition for milk. Milk producers thereby are at risk to become puppets of the large corporations. When overcapacity issues are dealt with, it leads to plant closures. Given the size of the companies, serious consequences are to be expected in affected regions.
Illusion of solidarity between milk producers	Conflict of interest among producers: as far as producers are concerned, we must be aware that different interests are at stake, which very much limits joint actions. The case of Switzerland has shown that it is wishful thinking to expect strong solidarity among milk producers. This concerns above all the implementation of limitations to entrepreneurial freedom based on private law agreements. Structural problems cannot be solved on the basis of private law.
Risks for other actors of the dairy market	But the abolition of quotas also involves risks which do not only concern milk producers and which therefore require a broader attention:
Food standards, working conditions and animal welfare at risk	Quality: the aim of the abolition of quotas is to increase efficiency through the production of higher quantities. But apart from focussing on lowering costs, one should not forget the importance of quality. In particular in value chains where international pressure on costs is quite high, it is crucial to fight for minimum standards in the field of quality and food safety, as well as for socially acceptable working conditions and animal protection standards. This must also be in the advantage of processing companies and it is a matter of public interest.
Risk of depopulation and loss of agricultural land and production capacity in the EU	Regions: the abolition of quotas leads to an increased competition among producers. This is an important objective of this liberalisation phase, as due to the competition milk will be produced in regions where costs are the lowest. But in contradiction to this there are regional interests: if milk production entirely disappears from some regions, the cultural

heritage connected to milk production and processing will be lost. Depending on agricultural possibilities, production will be shifted to other sectors or alternatively agriculture is abandoned. This can lead to depopulation of the affected regions or in remote areas to forestation. On the long term this is not efficient. Given the global food situation, Europe should put efforts into maintaining its agricultural land and its production capacity, including in less favourable areas. This justifies the preservation of milk production also in less competitive regions. In Europe the model of multifunctional agriculture prevails – price competition can thus not be the only objective. Despite everything, milk production will thus most probably stay on the agenda of agricultural policy, also in the future.

Higher costs justified if linked to services requested by citizens

Single farm approach instead of sectoral approach: when speaking about the advantages of liberalisation, the arguments mentioned usually follow a global economic or a sectoral approach. But there will always be winners and losers. A single farm approach can help to illustrate the problems which the potential losers will be facing. This can concern several of the above-mentioned issues. Higher costs are also justified from a macroeconomic point of view if they are linked to performances requested by citizens or consumers. These also include the needs of future generations.