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## Inefficiencies in the UK milk quota system<sup>☆</sup>

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### Abstract

Given that the Common Agricultural Policy (CAP) of the European Union has imposed milk marketing quota on producers, the fact that they are tradeable in the UK increases economic efficiency. Nevertheless, significant inefficiencies remain. Modelling work reported here suggests that significantly more quota needed to be transferred from less to more efficient producers in 1996/97 for industry efficiency to be maximised, and that a large number of vulnerable inefficient producers remained in milk production. It is also shown that, despite tradeable quotas, a significant number of dairy farmers still achieve a poor match between available quota and production. It is argued that the rules on quota trading could be changed to increase efficiency. Finally, it is argued that UK milk producers are incurring costs for acquiring quota which add at least 12.5% to production costs: a high price to pay for the market stability which quotas have brought. © 2000 Elsevier Science Ltd. All rights reserved.

*Keywords:* Tradeable quotas; Milk; Costs and inefficiencies

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In a market such as that for milk quota in the UK, inefficiencies can arise (1) from constraints imposed on the operation of the market, and (2) from the inability of milk producers to use the market to its full potential. This paper explores both of these sources of inefficiency, and argues that the inefficiency of producers in using the market exceeds that due to restrictions arising from the rules governing the transfer of quota. It may be argued that another major source of inefficiency has arisen. This is due to the extension of the life of milk quota beyond the life expected when the quota regime was imposed on European Union dairy farmers in 1984. The impli-

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<sup>☆</sup> This paper draws and expands upon elements in the report by Colman et al. (1998).

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cations of the emergence of non-producing quota holders (NPQHS)<sup>1</sup> as a long-lived class of rentiers in the UK, Germany (the, so-called, “sofa farmers”), and some other member states can be assumed to have been unanticipated.

The paper begins by rehearsing the static theory of the tradeable quotas. It then presents arguments to the effect that UK dairy farmers have not achieved the optimally efficient outcome which the theoretical model indicates might be achieved where milk quota is tradeable. It then considers the implications which quota trading rules have for efficiency. Finally it considers the additional costs incurred by active milk producers in the UK as a result of the milk quota system, an issue which embraces the “problem” of the NPQHs.

### Standard theory

The standard theory of the effect of quota on asset values in agriculture is well expressed by Harvey (1983) and Burrell (1987), (1989), Dawson (1991) and Tiffin (1992). This is a static theory, as presented in Fig. 1, which can be used to explain the *annual value* (in effect the lease price) attributed to quota in a perfectly operating market.  $P_s$  is the average milk price received by producers, with the subscript  $s$  denoting that the price is supported by CAP policy.  $SS$  is the supply curve for milk, and this may be defined either for the short-run, in which returns only need to cover variable costs (including leasing), or for some longer run. In the longer run the supply curve must reflect fixed as well as variable costs, and it is such a long term supply curve which is used in the modelling exercise reported below.

In the absence of quota, equilibrium output would reach level  $Q$ . With a quota imposed at  $Q^*$ , and the milk price unchanged, if quota is freely tradeable in a perfect

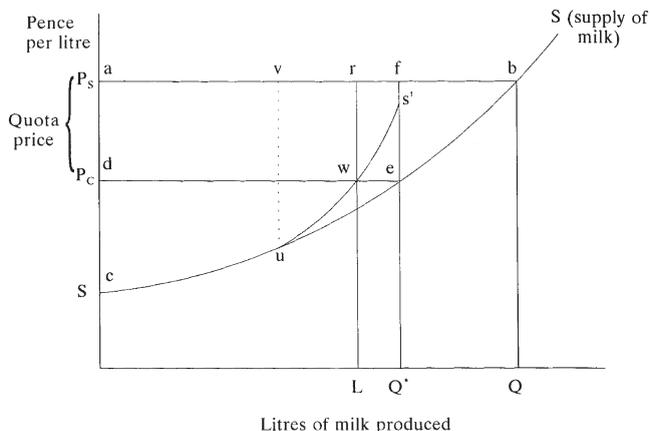


Fig. 1. Quota price determination in a tradeable quota market.

<sup>1</sup> The UK Intervention Board uses the term “Non-Active Quota Holders”, employed in Table 4 below.

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