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Imperfect competition, border protection and consumer boycott: The future of the dairy industry in Israel☆

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Abstract

Recent increases in prices of dairy products in Israel led to consumer unrest and boycotts against dairy producers during the summer of 2011. The Israeli dairy industry is highly distorted with production quotas and administered prices for raw milk, tariff rate quotas and an oligopoly in dairy processing. Since the issue of self-sufficiency and food security is at the top of Israel's national priorities, the future of the dairy industry is generating heated debate. Thus, we use a general equilibrium model to estimate the effects associated with particular alternative policies actually discussed to liberalize the Israeli dairy industry.

Keywords: Dairy; Computable general equilibrium (CGE) model; Imperfect competition; Tariff rate quotas; Israel; Agricultural policy; Trade policy

1. Introduction

Recent increases in the prices of dairy products in Israel led to consumer unrest and, in some cases, to ongoing protests and boycotts against particular dairy producers and specific dairy products during the summer of 2011. The Israeli dairy market is not competitive in either of its two segments – the production of raw milk and dairy processing – for the following reasons:

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first, Israel maintains a closed system of production quotas and administered prices for raw milk, and the import of raw milk is not practical due to the geographical distance of Israel from its major trade partners. Second, in practice, dairy processing is dominated by three large firms – Tnuva, which controls about two thirds of domestic consumption, and Tara and Strauss, which jointly supply almost the entire remaining amount. In addition, tariff rate quotas (TRQs) protect domestic production from competition from imported processed dairy products. The current industry structure has thus remained unchanged for a number of years. However, as a result of the wide-ranging consumer protests of the summer of 2011, the social cost of maintaining the above-described structure is currently being reassessed by policy makers.

Currently, a government committee (the Kedmi Committee) is addressing possible ways to deal with the situation.[1] In particular, two central policies involving structural changes are being considered – liberalizing trade in dairy products and liberalizing domestic production. Opening the market for importing dairy products has already been applied for a small range of hard cheeses and is expected to extend to other products if import policies are further liberalized. With regard to domestic production, the Committee recommended to publicly support the construction of additional milk processing plants with the aim to increase competition among milk processors. Another expected policy change will take the form of a permanent decrease in the regulated price of raw milk to farmers together with the establishment of a secondary out-of-quota production market. The ultimate goal of this move is learning by doing the impact of liberalizing the production quota mechanism toward removing it entirely in the long run.

Naturally, this move has drawn objections from the agricultural lobby in Israel. The arguments include the risk related to exposure to world price volatility and the inability to balance the seasonal gap between domestic demand and supply. Another argument (not treated here) is based on the ideological grounds of supporting rural communities in Israel, since it is generally understood that the recommendations of the Committee are expected to have significant welfare effects on dairy farmers, processors, importers and consumers. Moreover, since the issue of self-sufficiency and food security is at the top of Israel's list of national priorities, the future of the dairy industry is currently generating heated debate in many parts of the population.

The lessons of what a textbook example for a small country as Israel can do in order to solve this situation goes far beyond this study. Small countries are often characterized by one or more of the following: high protecting tariffs, a concentrated processing phase and a milk production quota system. Due to the complexity associated with structural changes, the liberalization of each segment is usually considered and analyzed separately. In Israel, present circumstances force the Israeli government to reconsider all its policies along the supply chain of milk and dairy products at the same time. Which motivates a simultaneous side-by-side comparison of implications of partially and full liberalization.

The aim of this paper is to model the particular alternative policies currently being considered by the Kedmi Committee and hence to predict the effects associated with these particular policies. With the background of the consumer boycott the question arises how different consumer groups are affected by the policies and to what extent consumers should care which liberalization policies are actually applied. To this end, we examine four alternative policy scenarios for the Israeli dairy and milk sectors, which are actually discussed in Israel. Because the alternative policies would constitute a dramatic change in Israel's agricultural sector, it may be expected that any

[1] The preliminary debated recommendations of the Kedmi Committee can be viewed (in Hebrew) on the Israel government portal at http://www.shituf.gov.il/discussion/657.