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## **Introducing minimum milk prices: A move with negative economic implications**

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**On May 10<sup>th</sup>, the Draft Law #10443 "On amendments to the Law of Ukraine "On milk and milk products"" has been registered in the Parliament. It suggests introducing minimum farm-gate prices for raw milk to secure the incomes of dairy farms. It is, however, the least efficient instrument to reach this target, with significant negative fiscal and economic consequences. Moreover, it is incompatible with WTO standards. The law should be dropped altogether.**

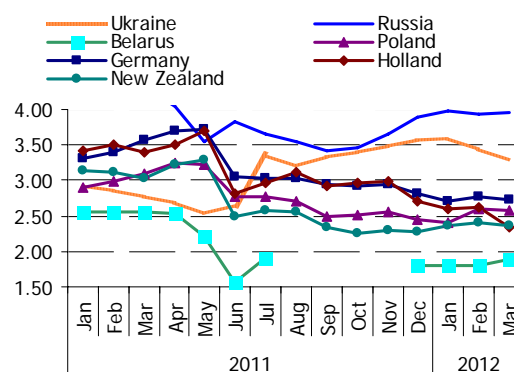
Due to the ongoing dairy conflict between Ukraine and Russia (see AFPR #2) and the pronounced seasonality of the raw milk supply in Ukraine, dairy farm-gate prices began their 'bearish season'. Especially against the background of the dairy conflict, this became a topical issue and as a result a new draft law proposes introducing the minimum farm-gate raw milk prices to help out to raw milk producers.

First of all, we would like to demonstrate (Figure 1) that Ukrainian dairy producers generally receive high prices compared with many other major producing countries. This is mainly driven by tough competition for the resource supply among dairy processors against the background of decreasing raw milk production in Ukraine. This is already a comparative disadvantage for the Ukrainian dairy processors – the main driver or element in the entire dairy value chain in Ukraine. Minimum prices would increase the farm-gate prices and this would only worsen the competitiveness position of the entire Ukrainian supply chain.

Figure 2, using Belarus as an example, demonstrates a basic problem with minimum prices. These minimum raw milk farm-gate prices are enforced administratively in Belarus and set at levels that allow dairy farmers to generate 'normal' profits. This is what is suggested in the draft law. The figure demonstrates the distributions of variable and total production costs (in Belarusian Rubles, BYR) per kg of raw milk in Belarus. The vertical lines demonstrate the minimum prices for raw milk set by the Government of Belarus in different periods in 2010. As the figure shows, the minimum prices changed 5 times in 2010, adjusting to world market trends. For example, consider the price of BYR770/kg that was applied from March to June 2010. This price covered the variable costs of almost all the dairy farms and the total costs of more than half of the dairy farms in 2010. So the minimum price system was basically a subsidy to

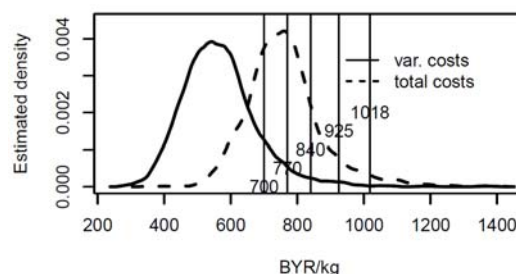
dairy farming, allowing very efficient farms to generate 'above normal' profits, while inefficient dairy farms generated some profits but remained in the sector rather than being forced to improve their production or exit. This prevents the sector from restructuring and adds the costs to the entire value chain, passing the burden of this regulation onto consumers in higher prices.

**Figure 1** Raw milk farm-gate price in different countries (adjusted for quality), UAH/kg



Source: *milkua.info*; prices adjusted for 3.4% milkfat and 3.0% protein content.

**Figure 2** Raw milk production costs and minimum farm-gate prices in Belarus, 2010



Source: *Nivievskiy & von Cramon-Taubadel (2011): Dairy Supply Chain in Belarus: Bottlenecks and the scope for improvements. Policy Paper, BE Berlin Economics.*

More important, however, is that empirical economic research is quite unanimous about the negative consequences of minimum prices. This is the least efficient policy instrument for securing the incomes of producers. In addition, it is incompatible with WTO standards, proved to be unsustainable in European agriculture and triggered the reform of its Common Agricultural Policy (CAP) back in 1992. Depending on the measures to ensure these minimum prices, it inflicts huge budget expenditures, higher consumers and inputs prices, and makes the country overall poorer. We strongly urge lawmakers not to adopt this draft law.