



What might
Brexit mean
for UK trade
in dairy products?

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In this report, we examine trade flows between the UK, the EU and its other major global trading partners for dairy products and how relationships might change after the UK leaves the EU. We also examine the major global trade flows, to identify areas of potential UK export growth and areas that may be vulnerable to increased competition post-Brexit.

The UK has not yet defined the post-Brexit trade relationship it intends to seek with the EU or with the rest of the world. If the UK were to negotiate free access to the Single Market, little would change in terms of the UK's trade in dairy products. However, other possible scenarios may have a significant impact on trade flows between the UK and both the EU and non-EU countries.

One option is that the UK may seek a Free Trade Agreement (FTA) with the EU but the complex negotiations involved mean it is possible, perhaps even likely, a deal may not have been reached by the time it leaves. If this happens, there may be an interim deal allowing free trade to continue while a permanent agreement is negotiated. If this is not possible, the UK would revert to trading with the EU on the same basis as other WTO members, with UK exports subject to EU import tariffs.

If it is outside the Single Market, the UK would need to decide whether to impose import tariffs of its own, including on imports from the EU. However, this could lead to higher consumer prices, which may be politically unacceptable. Therefore, the UK may prefer to allow wider access to the UK market, at least for some products, by reducing or removing tariffs or by using tariff rate quotas.

The most common type of import tariff is 'ad valorem', where a percentage of the price is paid. Tariffs can also be a fixed amount in monetary terms or a mix of the two. Examples of EU tariffs for dairy products can be found at the back of this report.

Tariff rate quotas (TRQs) allow a specified quantity to enter the market at a reduced (or zero) tariff. Once the limit has been reached, the tariff reverts to the standard rate. Quotas can be specific to one exporting country, a group of specified countries or can be open to all suppliers.

If the UK is outside the EU Customs Union, it would be free to negotiate FTAs with trading partners of its choosing. The position of agricultural goods in these negotiations is likely to be complex. In many trade agreements, tariffs remain in place on 'sensitive products', including agricultural goods. In addition, non-tariff barriers are often used to limit trade in agricultural products.

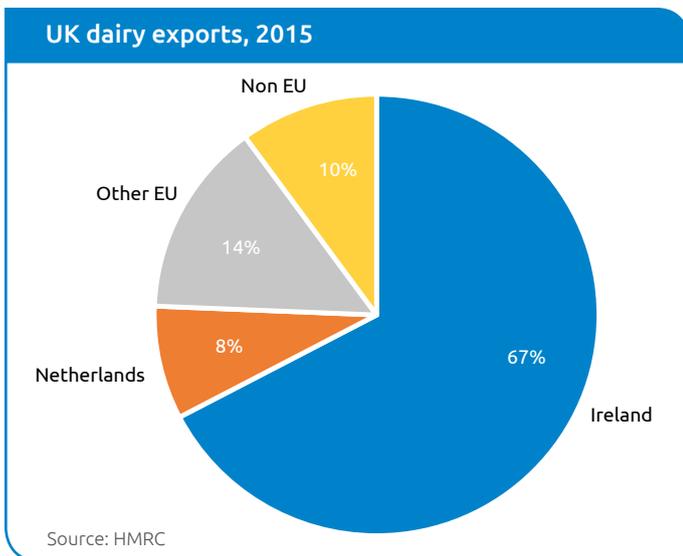
Both the EU and the UK also have many bilateral agreements covering technical aspects of trade. Some UK agreements rely on the fact that they are subject to EU rules and regulations. Many of these bilateral agreements will require renegotiation to reflect the new situation, and failure to do so could close off trade with the countries involved.

Non-tariff barriers include sanitary and phytosanitary (SPS) measures and technical barriers to trade. SPS measures are used to protect human, animal or plant life or health. Technical barriers are often deemed necessary for environmental protection, safety, national security or consumer information. In practice, these measures are often the hardest to agree in trade negotiations.

Trans-shipment, the unloading of goods from one ship and loading into another to complete a journey, is significant for many UK exports. The most important port involved is Rotterdam in the Netherlands. This gives rise to the so-called 'Rotterdam effect' – the theory that recorded trade with the Netherlands is artificially inflated by goods routed through Rotterdam. This can distort views of the UK's trade relationship with EU and non-EU countries, by increasing reported trade with the EU and reducing it with non-EU countries.



Current situation – exports



The overall value of exports of dairy products in 2015 amounted to £1.1 billion. Of this, nearly £800 million was generated by sales to other EU countries, with £300 million in sales to third countries. Around 90 per cent of UK dairy exports by volume are destined for the EU.

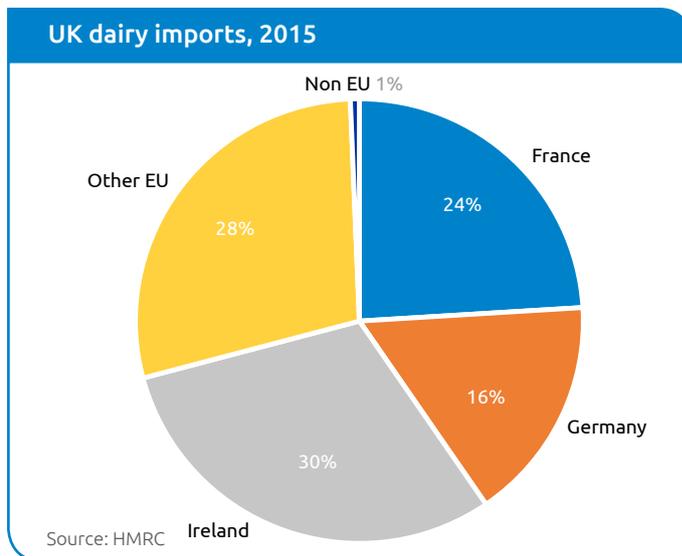
Exports tend to fluctuate with domestic milk production, suggesting many are dealing with the UK's surplus milk rather than being customer-focused. This is shown by the UK's trade balance worsening between 2011 and 2013 while improving in 2014 and 2015 in line with milk production.

Exports of milk and cream appear high, at 660,000 tonnes in 2015 but, for liquid milk, the majority of trade, in both directions, is across the Irish border. Most of this exported milk is likely to be for processing and some of the finished products will then return to the UK.

Other exports of liquid milk are mainly UHT sales. Cheese is the next most important export for the dairy industry at 150,000 tonnes, again dominated by the EU, with Ireland, France and the Netherlands the main destinations. Cheese sales will be a combination of customer-focused added-value products and low-value stock clearing sales. Cheddar and mozzarella are the two biggest cheese export products.

Exports to countries outside the EU are predominantly made up of powders (around 50,000 tonnes in 2015) and cheese (26,000 tonnes). Processing developments underway may open up new export trades, for example, in infant formula.

Current situation – imports



The situation with imports is similar to that for exports, as the EU accounts for around 99 per cent of total UK dairy imports.

Ireland is the big player regarding imports. As well as the trade in milk and cream mentioned before, Ireland also exported 65,000 tonnes of butter and dairy spreads and 139,000 tonnes of cheese to the UK in 2015. Irish butter is used in some branded products as well as in manufactured goods. Cheddar is the main cheese exported from Ireland to the UK. The majority of this cheddar will be packed into retail products for either branded or value own-label cheeses. Irish cheddar will also go through the foodservice and industrial usage routes.

Speciality cheese from the continent also features highly on the UK's import list. Buttermilk and yoghurts are other key imports, with the former most likely used in manufacturing.

Overall, the UK is around 75 per cent self-sufficient in butter and 55 per cent for cheese. However, with some home production exported, around half of butter and over 60 per cent of cheese consumed on the UK market is imported. In contrast, the UK is a net exporter of milk powders.

Current situation – tariffs and trade barriers

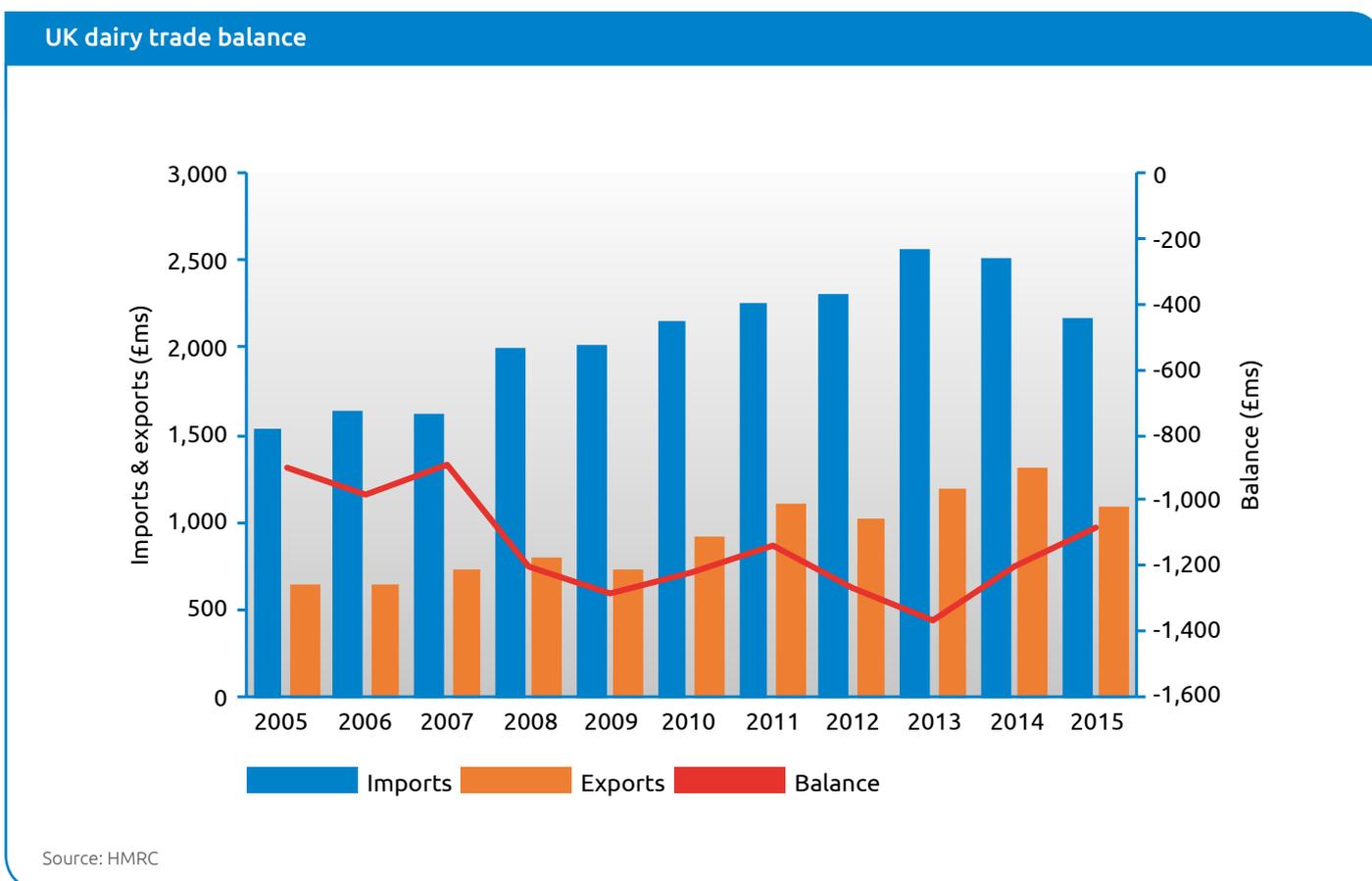
Most dairy imports into the EU are subject to import tariffs, which are, typically, a fixed value based either on total weight or the weight of lactic matter in the product. As an example, tariffs on most butter imports are €1,896 per tonne, while for cheddar, the tariff is €1,671 per tonne.

These tariffs prevent most imports of dairy products into the EU. However, the EU does operate preferential import quotas for butter and cheese. The main supplier of butter to the EU is New Zealand, although its shipments have declined significantly since 2014, as market prices have made the EU a less attractive destination. The main source of imported cheese is Switzerland, which has tariff-free access to the EU market through a bilateral deal. It exports around 50,000 tonnes to the EU annually. Volumes from other suppliers, such as New Zealand, Australia and the US fluctuate, depending on market conditions.

For some dairy products, in particular speciality cheeses, EU rules on geographical indications (GIs) provide protection from imports.

Most of the EU's existing FTAs have limited significance for the dairy trade as the countries involved are neither major importers nor exporters. When ratified, the proposed FTA between the EU and Canada has the potential to open up trade in dairy products in both directions. In particular, it will improve access to the EU market for Canadian cheese, while protecting EU GIs in Canada.

Most other dairy importing countries also have tariff and non-tariff barriers in place. For example, China applies tariffs of between 10 per cent and 20 per cent on imports of most dairy products.



Opportunities

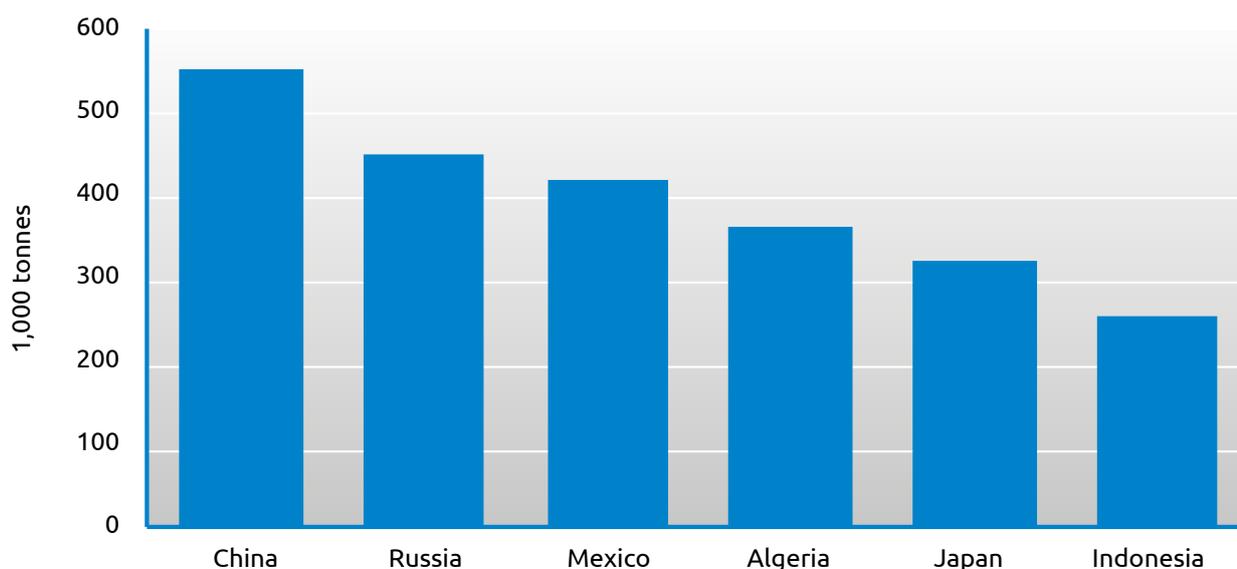
The main trade-related opportunities of Brexit for the UK dairy industry will focus on displacing imports or growing new export markets. If the UK manages to negotiate a trade deal with the EU allowing tariff-free access, then the likelihood is for business as usual with the EU. However, if not, any import tariffs imposed by the UK could provide an opportunity to substitute a number of imports with British milk. Experience from the EU suggests that tariffs may limit the scale of imports of commodity-type products, although speciality products will probably still reach the UK.

Combined with increased supply chain investment, this could see the UK progress as an industry. At present, the UK has two major milk processors, whose dominance could help rebalance the supply chain, leading to an increase in processing investment – if managed correctly.

The other key opportunity is the ever growing global population, with increasing numbers of affluent consumers seeking dairy products. The UK may be better able to agree favourable trade arrangements with some of these emerging markets alone, compared with the EU. Targeting specific countries looking for value-added products could be a great opportunity to improve the returns for the supply chain and push the brand of UK products around the world.

An earlier study undertaken by AHDB Dairy identified Russia as the main growth opportunity for UK exports outside the EU but that market is likely to remain closed for some time. Therefore, growth opportunities are most likely to come from China and other emerging markets in Asia, the Middle East and North Africa. These regions are expected to be the focus of most of the global growth in dairy imports and there may be some opportunities for UK exporters there.

Leading dairy importers, 2015



Source: UN Comtrade

Dairy sector at a glance

The UK is reliant on imports of butter and cheese to satisfy domestic demand

Ireland is a key trading partner for the dairy sector, including as a major processor of UK-produced liquid milk, which often returns to the UK as finished product

Reduction or removal of tariffs could see more global competition in butter and cheese supply, with impacts throughout the supply chain

China and emerging markets in Asia, North Africa and the Middle East are the focus of global growth opportunities

Potential barriers to EU exports could hamper investment during trade negotiations

Threats

The eventual deal between the UK and EU will be key for the UK dairy industry. The EU currently provides the home for the majority of UK exports, and milk production is expected to return to growth over the coming years, production of commodity products is likely to grow. Any tariffs imposed could, therefore, incentivise processors to encourage milk production to stagnate, depending on deals struck with other nations and buyer interest/competitiveness.

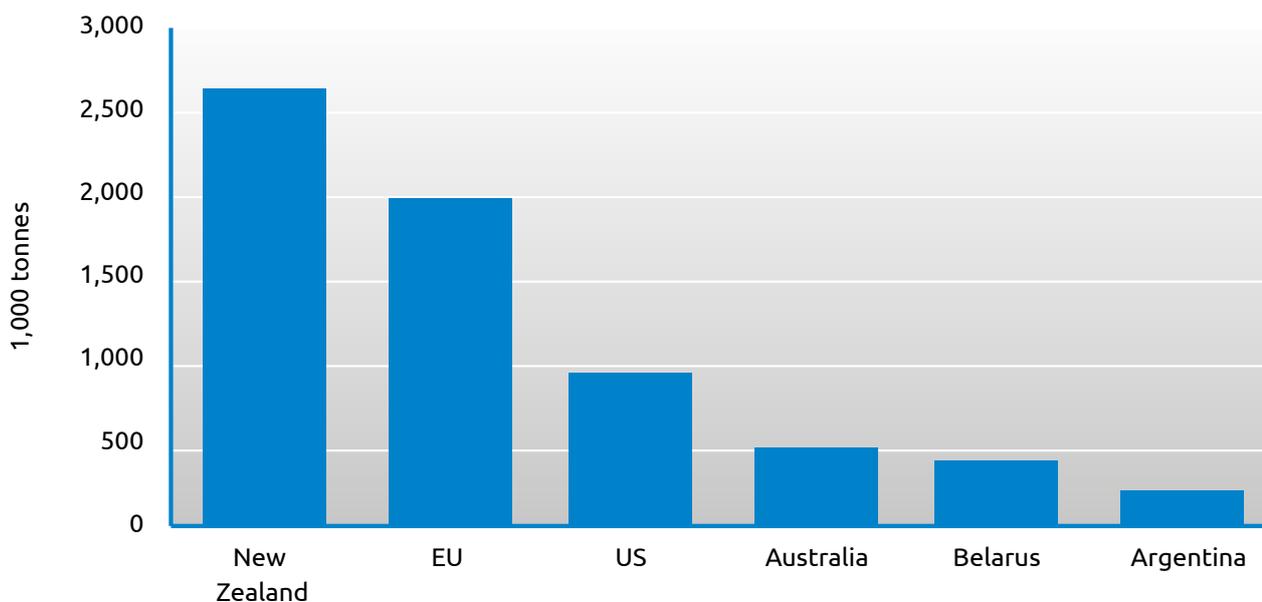
Any imposition of tariffs on UK exports to the EU could cause particular issues for the cross-border trade with Ireland. As indicated above, large volumes of milk are exported from the UK for processing in the Irish Republic. This trade would be threatened if tariffs were put in place. Furthermore, any of the resulting product which returns to the UK may also be subject to import tariffs, which would almost certainly make this trade uneconomic. While this could have major consequences for the Irish processing sector, there might also be challenges for the UK industry in processing the milk which was previously being exported.

There is also the issue of the time required for negotiating new trade deals, which could hamper industry growth if negotiations are protracted. With limited opportunities to grow domestic markets, particularly if lack of free movement of EU workers reduces population growth, barriers to EU exports could hit investment levels. In this context, it is worth remembering that the largest dairy companies in the UK are foreign-owned.

If, rather than impose high tariffs on imports from the EU and elsewhere, the UK government decides to reduce or remove them, it could open up the domestic industry to competition from outside the EU. The most likely products involved would be butter and cheese. The UK is a net exporter of powders and the short shelf life and high costs of transporting most other dairy products would be prohibitive.

The main global exporter of butter is New Zealand. It currently has access to the UK market via EU quotas but may seek to increase shipments, providing competition for both UK and Irish supplies. For cheese, there is a wider variety of potential suppliers, including Australia, New Zealand, the US and Canada. Most would be likely to target manufacturing uses but Canada may also seek to increase its sales of cheddar for the retail market. These suppliers could provide increased competition for domestic cheese, potentially driving down prices throughout the supply chain.

Leading dairy exporters, 2015



Source: UN Comtrade

EU import tariff rates for selected dairy products

Within a report of this kind, it is impractical to list tariff rates for all dairy products. The table below, therefore, covers a selection of the main products either imported or exported by the UK.

Code	Product	Tariff rate	Effective ad valorem rate (2015 prices)
0401	Milk and cream, not concentrated or sweetened		
04012011	Fat content 1-3%, in immediate packings of <=2 litres	€18.8/100kg	39%
04012099	Fat content 3-6%, in immediate packings of >2 litres	€21.8/100kg	74%
04015039	Fat content 21-45%, in immediate packings of >2 litres	€109.1/100kg	50%
0402	Milk & cream, concentrated or sweetened		
04021019	In solid forms, unsweetened, fat content <=1.5%, in immediate packings >2.5kg	€118.8/100kg	63%
04022118	In solid forms, unsweetened, fat content 1.5%-27%, in immediate packings >2.5kg	€130.4/100kg	46%
04022919	In solid forms, sweetened, fat content 1.5-27%, in immediate packings >2.5kg	€1.31/kg of lactic material + €16.8/100kg	n/a
0403	Buttermilk, yoghurt and similar products		
04031091	Yoghurt, flavoured or with added fruit, nuts or cocoa, of milkfat content <=3%	8.3% + €12.4/100kg	14%
04039091	Buttermilk and similar products, flavoured or with added fruit, nuts or cocoa, of milkfat content <=3%	8.3% + €12.4/100kg	12%
04039093	Buttermilk and similar products, flavoured or with added fruit, nuts or cocoa, of milkfat content 3-6%	8.3% + €17.1/100kg	12%
04039099	Buttermilk and similar products, flavoured or with added fruit, nuts or cocoa, of milkfat content >6%	8.3% + €26.6/100kg	17%
0404	Whey and whey products		
04041002	In solid forms, unsweetened, protein content <=15%, fat content <=1.5%	€7.0/100kg	6%
04041014	In solid forms, unsweetened, protein content >15%, fat content 1.5%-27%	€135.7/100kg	52%
0405	Butter, fats/oils and dairy spreads		
04051011	Natural butter, fat content <=85%, in immediate packings of <=1kg	€189.6/100kg	49%
04051019	Natural butter, fat content <=85%, in immediate packings >1kg	€189.6/100kg	63%
04052010	Dairy spreads, fat content 39-60%	Derived by formula based on constituents	n/a
04059010	Other fats & oils derived from milk, fat content >=99.3%, water content <=0.5%	€231.3/100kg	63%
0406	Cheese and curd		
04061030	Fresh Mozzarella, fat content <=40%	€185.2/100kg	41%
04061050	Other unripened cheese, fat content <=40%	€185.2/100kg	59%
04061080	Unripened or uncured cheese, fat content >40%	€221.2/100kg	68%
04062000	Grated or powdered cheese	€188.2/100kg	50%
04063010	Processed Emmental, Gruyere and Appenzell cheese	€144.9/100kg	34%
04063031	Other processed cheese, fat content <=48%	€139.1/100kg	36%
04063039	Other processed cheese, fat content >48%	€144.9/100kg	22%
04064090	Blue-veined cheese other than Roquefort, Gorgonzola	€140.9/100kg	14%
04069021	Cheddar - (not grated or for processing)	€167.1/100kg	42%
04069032	Feta	€151.0/100kg	28%
04069061	Grana Padano, Parmigiano Reggiano	€188.2/100kg	19%
04069081	Cantal, Cheshire, Wensleydale, Lancashire, Double Gloucester, Blarney, Colby and Monterey	€151.0/100kg	19%
04069089	Other cheese, fat content <=40%, water content 52%-62%	€151/100kg	21%
04069099	Other cheese, fat content >40%	€221.2/100kg	50%

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