



European Economic and Social Committee

NAT/450
Future strategy for the EU
dairy industry

Brussels, 5 January 2010

PRELIMINARY DRAFT OPINION

of the
Section for Agriculture, Rural Development and the Environment
on the
Future strategy for the EU dairy industry for the period 2010-2015 and beyond
(own-initiative opinion)

Rapporteur: **Frank Allen**

To the members of the Study Group on **Future strategy for the EU dairy industry**
(Section for Agriculture, Rural Development and the Environment)

N.B.: This document will be discussed at the Study Group meeting on **11 January 2010 beginning at 2.30 p.m.**

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Study Group on
Future strategy for the EU dairy
industry

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On 16 July 2009 the European Economic and Social Committee, acting under Rule 29(2) of its Rules of Procedure, decided to draw up an own-initiative opinion on the

Future strategy for the EU dairy industry for the period 2010-2015 and beyond.

The Section for Agriculture, Rural Development and the Environment, which was responsible for preparing the Committee's work on the subject, adopted its opinion on The rapporteur was Mr Allen.

At its ... plenary session, held on ... (meeting of ...), the European Economic and Social Committee adopted the following opinion by ... votes to ... with ... abstentions.

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1. Conclusions and recommendations

- 1.1 There is an imbalance in the market situation to the detriment of milk farmers and to a limited extent in the case of the dairy processors. It is the retail sector that has the least transparency. The milk farmer provides the greatest transparency in the milk supply chain. Greater transparency is needed at retail level.
- 1.2 The first essential is to prevent a recurrence of the price volatility that occurred in 2007/08. This must be achieved by the use of adequate support measures plus a proper monitoring of the market to ensure a reasonable balance between supply and demand.
- 1.3 The EU has the option to react to the market situation by using the quota system (at least until 2015) to curtail production as appropriate. There is nothing wrong with changing a decision already taken if the new circumstances show that the previous decision should be changed.
- 1.4 The establishment of an EU monitoring agency would help to manage, regulate and bring greater transparency to the EU dairy industry.
- 1.5 The EU dairy industry is of long term strategic importance in its role of supplying high quality safe dairy products to EU citizens. The EU must never become dependant on non EU sources of milk supply because in such a situation we could not guarantee our citizens an adequate supply of quality and safe dairy products with high animal welfare standards.

- 1.6 Farmers will continue to produce good quality milk provided it is profitable to do so. EU milk production will decline and vanish altogether from some areas unless we stabilise prices and such prices return a profit. Milk farmers must also receive a financial return for delivering "public service non-commodity goods" such as protecting and developing the rural landscape, biodiversity, natural habitats and rural art and culture.
- 1.7 To ensure the viability of the EU dairy industry after 2015 it will be necessary to have a supply management system centrally regulated combined with a price support safety net system which will prevent prices falling below a certain level and provide sufficient reserve stocks to cover unforeseen shortages or natural disasters. Food in general and milk in particular is too important for the well-being of citizens to be subject to the vagaries of a free unregulated market system.

2. Introduction

- 2.1 Dairy farming is one of the main agricultural activities in the EU. One million farmers produced 150 million tons of milk in 2008 with a value of over 40 billion euro which is 14% of the value of EU agricultural production. Over 60% of beef produced in the EU comes from dairy herds. According to figures from the International Dairy Federation (IDF), the EU is the world's biggest milk producer at 27% of world production, followed by India at 20% and the USA at 16%.
- 2.2 The dairy processing sector employs around 400 000 people in the EU.
- 2.3 Dairying plays a very important part in maintaining the economic and social structure in the Less Favoured Areas (LFA). Indeed 60% of EU25 dairy farms are in LFAs. Dairying is the most suitable enterprise to keep farming families in the LFAs and plays a major role in protecting the landscape and the environment.

3. Background

- 3.1 Global dairy markets have seen major price swings during the last two years. In 2007 and early 2008 we saw a record increase in world dairy commodity prices which gave rise to substantial price increases on all dairy products. This was followed in the 2nd half of 2008 by an even more dramatic collapse in world dairy product prices.
- 3.2 Most milk production is consumed in the region where it is produced. Around 8% of global dairy production is traded on the world market and consequently a small change in global production can have a significant influence on the world market. For example, a 2% gap between global production and global consumption is the equivalent of about 25% of the world dairy market trade.

- 3.3 While the EU is a significant exporter of cheese, nevertheless commodity products i.e. powders and butter constitute the majority of dairy export sales out of the EU. Indeed the world dairy market can be described as mainly a dairy commodity market.
- 3.4 Since the EU is 109% self sufficient in dairy products, the 9% surplus is available for export onto the world market.
- 3.5 Since 2000, global dairy consumption has been growing at 2.5% per annum on average. This has now dropped to 1% per annum.
- 3.6 From 2004 to 2006, global dairy consumption exceeded production and consequently all reserves were used up. This was the principal reason for the sudden rise in world dairy commodity prices. Since 2008 the relationship has changed with the result that production exceeds demand.
- 3.7 The sudden rise in milk prices caused a drop in market share as consumers switched to cheaper substitutes. In particular dairy ingredients were replaced with cheaper alternatives. The global recession and the drop in oil prices added to a further reduction in sales of dairy products.
- 3.8 While price movements of higher value dairy products are more difficult to track than in the case of commodities, it is obvious that sales of value added dairy products have declined as customers have switched to cheaper products.
- 3.9 The Commission in its July 2009 report to the Council said that the price surge in the 2nd half of 2007 generated a rapid increase in milk prices and a strong increase in consumer prices. In contrast, the falling prices in the 2nd half of 2008/2009 which saw the price of butter fall by 39%, SMP (skimmed milk powder) by 49% , cheese by 18% and milk by 31% only caused (an EU average) consumer price drop of some 2%. Indeed consumer prices have remained on average 14% higher than before the price surge occurred. However, those countries that have high sales of dairy products to discounters have seen a "price war" in 2009 as dairy products are used by the discounters to undercut other retailers.
- 3.10 Rationalization and increasing concentration within the EU retail sector has given the retail sector bargaining power ability unmatched by the remainder of the food supply chain. Farmers have become price takers rather than price makers especially when milk supply exceeds demand. It would appear that in practice the competition authorities have on balance been of greater benefit to the multiple retail sector rather than to one million dairy farmers.

4. **Market outlook**

4.1 European Union

- 4.1.1 The EU dairy market is one where production exceeds consumption by 9%.
- 4.1.2 Dairy products are also imported into the EU from third countries at reduced tariffs. These imports are small relative to total EU consumption.
- 4.1.3 Up to 40% of EU milk is made into cheese and about 30% is used for fresh dairy products. These two product types have been the main drivers of growth in consumption within the EU over the last decade. The remaining 30% is made into butter, powders and casein.
- 4.1.4 Intervention stocks of butter and SMP are growing rapidly as a result of weak consumption within the EU, the downturn in world market prices and the global recession and EU production which did not sufficiently respond by reducing output. The EU quota was increased by 2% in 2008 and 1% in 2009 which together with future quota increases already agreed will ultimately lead to increased milk production in the EU.
- 4.1.5 The use of export refunds has prevented even larger stocks going into intervention.
- 4.1.6 The actions undertaken by the Commission have prevented EU milk prices falling to world market prices of 14-15 eurocent per litre. EU prices have been held at 20 eurocent per litre which is under the cost of production.
- 4.1.7 Milk production is currently 4.2% below quota and it is expected that production will be under quota for 2009/2010.
- 4.1.8 The recovery in EU prices (which has already started) is likely to be very gradual. The existence of substantial intervention stocks overhanging the market could delay a faster recovery depending on when the Commission decides to release intervention stocks onto the market.
- 4.1.9 Cow slaughterings have increased according to EU data. It is likely that increased numbers of dairy cows are being slaughtered which will depress dairy production in the immediate future. However, the gradual increase in milk prices will lead to increased production in a small number of countries in the short term.
- 4.1.10 As milk prices recover in the medium term, milk production will increase over the period to 2015 and is likely to keep pace with quota increases agreed in the Health Check.
- 4.1.11 The trend of declining milk production in Southern Europe is likely to continue.

- 4.1.12 EU cheese and fresh dairy product consumption is likely to remain weak due to lower income growth prospects.
- 4.1.13 The Commission predicts a decline in the butter surplus over the period to 2015 due to reduced butter production and greater cheese production. This would facilitate the removal of export refunds.
- 4.1.14 Some market experts believe that butter fat levels could increase due to greater production of low fat dairy products and lack of growth in cheese consumption.
- 4.1.15 The market outlook within the EU up to 2015 remains uncertain and is unlikely to demonstrate the growth as seen over the last decade.
- 4.2 USA
- 4.2.1 In the USA, during the last five years up to 2008, dairy production has been growing at 2.5% per annum and consumption has been growing at about 1% per annum. The USA has had an annual exportable surplus of up to 5 million tons. The weakness of the US dollar has helped exports.
- 4.2.2 The short-term outlook for the US dairy industry is not good. There was a reduction of 1% in production in 2009 and there is the expectation of a further reduction of 1% in 2010. In the medium term, with a recovery in milk prices and affordable feed costs, some growth in production is likely. Any such production increase is likely to go into cheese and be consumed internally.
- 4.3 New Zealand
- 4.3.1 New Zealand is the largest dairy exporter in the world. Production was depressed by about 3% in 2007/2008 thus reducing exports. It increased by 8% in 2008/2009. Commentators expect an average growth of 3% per annum but it should fall again by 2015. Since New Zealand production is grass-based, weather conditions can have a major impact on production levels.
- 4.3.2 Low prices have not caused a drop in production in New Zealand to date. In the future, because of increased use of concentrate feed and fertilizer, it is likely that a recurrence of low prices could lead to reduced growth in milk production.
- 4.3.3 Environmental issues are becoming more important in New Zealand and this could also hinder long term growth.
- 4.3.4 It is likely that New Zealand will continue its dairy export growth.

- 4.4 South America is growing in importance as a dairy exporter and is likely to compete with the EU in African markets rather than with New Zealand for Asian markets. In particular Brazil's exportable surplus is likely to continue up to 2015.
- 4.5 China
- 4.5.1 The expansion of Chinese dairy production over the last decade has been extremely rapid but the level of growth will probably slow down over the next decade. Chinese production has not matched consumption but dairy imports into China are not as large as originally anticipated.
- 4.5.2 In the medium term it is expected that Chinese imports of cheese and SMP will increase while Chinese exports of WMP (whole milk powder) will also increase.
- 4.6 The overall world market outlook is one of slow growth and depending on the extent of the global economic recovery this will determine the growth in consumption, especially in Third World countries.
- 4.7 Most population growth in the next 30 years will take place in Third World countries and this should lead to growing demand for dairy products. However, unless there is adequate economic growth, such countries will be unable to purchase increased amounts of dairy products. Dairy products are not a traditional staple diet in Asia and in Third World countries.
- 4.8 Issues such as nutrition and health claims for dairy products will be key ways of maintaining and developing market share for dairy products.

5. **High Level Group**

- 5.1 Commissioner Fischer Boel has established a HLG on milk and this group will issue its final report by the end of June 2010.
- 5.2 The HLG will discuss the following issues:
- Contractual relations between milk producers and dairies to better balance supply and demand on the dairy market.
 - What can be done to strengthen the bargaining power of milk producers?
 - Transparency and information to consumers, quality, health and labelling issues.
 - Innovation and research with a view to making the sector more competitive.
 - A possible futures market in dairy.

6. **Franco-German initiative**

- 6.1 The French Agriculture Minister Mr Le Maire outlined three key objectives for European agriculture:

- strong regulatory instruments would be needed to guarantee stable and decent revenues for farmers,
- prices throughout the whole food supply chain should be more transparent, with the possible appointment of a European watchdog, and
- innovation and investment in the agri-food sector should be put at the heart of the Lisbon Agenda.

6.2 The Franco-German initiative calls for more EU action to protect dairy farmers. It suggests temporarily increasing the minimum EU intervention price at which the EU would commit to buying surpluses from farmers.

7. **Policy up to 2015**

7.1 The Commission is firmly opposed to any changes to the increase in quotas as decided in the Health Check. At present these increases are having little impact because EU is 4.5% under quota and is also likely to be under quota next year. However, as the milk price improves in the medium term, production will rise and increase the gap between milk production and consumption, thus tending to drive down farmgate prices depending on the world market situation.

7.2 World dairy commodity prices are usually under the EU price; therefore, why would the EU be trying to sell even more product into a loss making market? The EU model of dairy farming will never be able to compete with New Zealand and some other countries because of a totally different structure of input costs and size of dairy unit.

7.3 Cheese exports out of the EU are generally competitive but an increase in consumption outside the EU is dependent on sustained economic growth over a period of time.

7.4 The idea of increasing quotas irrespective of the level of quota use and world demand to achieve a so called soft landing is contradictory if we wish to maintain the European model of farming and ensure the continuation of milk production in LFAs.

7.5 Increasing milk quotas irrespective of market conditions would be logical if the EU wishes to develop the New Zealand and US model of farming. The emergence of very large feedlot systems in the US with over 2 000 cows is seen in the USA as the way forward. At the current rate of change just 500 farms will soon produce 1/3 of US milk. Such a policy would pose significant dangers to the EU's rural cultural heritage, biodiversity protection, rural landscape, environment, rural development and would cause the abandonment of uplands and wetlands. We would see the rejection of the EU model of multifunctional agriculture (see NAT/449 Ribbe).

- 7.6 Large scale feedlot dairy farming has major implications for the environment.
- 7.7 At present 50% of EU milk production is concentrated in 11% of EU territory. Irrespective of the policy decisions made, in the future the average EU herd size will continue to increase. However, it can hardly be desirable to adopt policy options that will encourage very large and intensive dairy farming in areas that have a particular input cost advantage.
- 7.8 Dairy farmers are participants in the EU model of multifunctional agriculture. Such a model is not sustainable if price volatility becomes a recurring event for dairy farmers. Price stability, where dairy farmers get a reasonable income, is good for farmers and consumers

8. **After 2015**

- 8.1 If dairy farming is to be maintained as a viable industry throughout the EU, dairy farmers must get a reasonable income allowing them to live a normal lifestyle and also invest in their future as dairy farmers.
- 8.2 Art. 33 of the EC treaty sets out the objectives of the CAP which include the provision (a) to ensure a fair standard of living for the agricultural community, (b) to stabilise markets, (c) to assure availability of supplies and (d) to ensure that supplies reach consumers at reasonable prices.
- 8.3 The Commission wishes to retain intervention measures in order to maintain a floor price for milk even after quotas are abolished.
- 8.4 The Court of Auditors' special report 14/2009 states in Recommendation 1 that "the Commission must continue to supervise the development of the market in milk and milk products by implementing the measures required to make sure deregulation of the sector does not lead to a recurrence of overproduction. Failing this, the Commission's objective of keeping to a minimum level of regulation, of the safety net type, might rapidly prove impossible to fulfil". The EESC is convinced that safety net intervention can only work successfully in the context of supply management.
- 8.5 Deregulation will not guarantee the future of a viable EU wide dairy industry.
- 8.6 A system of regulation combining supply management and adequate support systems is essential to ensure an EU dairy industry which will fulfil the social, economic and environmental needs of society.

9. **Specific comments**

- 9.1 The use of a "futures market" to in any way determine milk prices would be wrong. Have we learned anything from the global financial turmoil stemming from the inappropriate use of

financial products? In NAT/449 Lutz Ribbe writes: "Foodstuffs therefore must be viewed in a completely different light from, say, industrial goods, where cost factors largely determine where those goods are produced". Issues such as food sovereignty and food security are also relevant.

- 9.2 Voluntary contracts between the individual farmer and a dairy processor will transfer power away from farmers and concentrate it in the hands of the dairy processors. We would then have a situation where the dairy processors and the multiple retailers could decide who would produce milk, where it is to be produced and at what price.
- 9.3 External protection must continue so that the EU market is not flooded by cheap imports whose standards of production are not comparable with EU standards.
- 9.4 There is need to establish an EU monitoring agency to analyse the supply and demand situation on the milk market and to ascertain the costs of milk production on a regular basis. Milk producers, Commission officials, dairy processors, retailers and consumer organisations should be represented at the monitoring agency. The necessary instruments must be available to ensure that farmers receive an adequate milk price which covers their costs and returns a profit. The EU must maintain its capability to produce adequate milk supplies. We cannot allow ourselves to become dependent on supplies of milk from outside of EU. If we pursue the wrong policies this could happen in the distant future.
- 9.5 There is merit in the suggestion to attempt to achieve a global agreement on the management of food generally and of milk in particular. We cannot ignore issues of hunger and lack of adequate food resources in the Third World. Issues of global climate change, global food price and global food supply are closely related. We have a responsibility to help the underdeveloped world.