

# Current Status of the European Dairy Industry

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## ■ Take Home Messages

- ▶ The milk quotas in the EU will disappear in 2015.
- ▶ The whole dairy sector has to prepare for it. Many but not all stakeholders are doing so.
- ▶ The sector has to move from a supply driven production to a demand driven production.
- ▶ Given the negotiations for multilateral or bilateral trade agreements, the EU sector will have to be competitive, both on the EU and the world market.
- ▶ Competition has existed most of the time, coming from non-EU27 dairy producers.
- ▶ Competition for protein and fat is also coming now from alternative sources (vegetable)
- ▶ Developing and trading high value added products is essential
- ▶ Nutrition and environmental concerns are increasing
- ▶ The dairy sector will also have to learn to live with price volatility

## ■ The History

After World War 2, European countries were not self-sufficient food wise. Incentives were given by national governments to increase production and thus to reach self-sufficiency. The objective was to maximise agricultural production.

Objectives of the CAP (Common Agricultural Policy, article 39 of the Treaty of

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Rome – 1957):

- increase agricultural productivity
- ensure a fair standard of living for the agricultural community
- stabilise markets
- assure the availability of supplies
- ensure that supplies reach consumers at reasonable prices

By means of a Common Market Organisation (article 40)

- common organisation by means of common rules on competition
- compulsory co-ordination of the various national market organisations
- a European market organisation

Soon this led to overproduction, farmers were producing disregarding what the market could absorb and surpluses were bought by the European Commission.

What market instruments were introduced for the dairy sector?

- Possibility to sell butter and skimmed milk powder into intervention (which is the European public stock, equivalent to the CCC stocks in the US), insuring a guaranteed price
- Private storage schemes (butter, cheese)
- Import quotas and import duties
- Export refunds to bridge the gap between the internal prices and the world prices
- Aid at production level for casein/caseinates
- Aid at consumption level for butter (pastry and ice cream, non-profit organisations and institutions, concentrated butter), SMP (into feed), school milk
- Quota production (milk quotas in 1984)

For what result?

- This led to food security (in the 70's, the EU was still a net importer of agricultural products)
- Guaranteed a more decent living for farmers
- Prices stabilised
- The EU was protected against large imports of dairy products thanks to high import duties and/or quotas

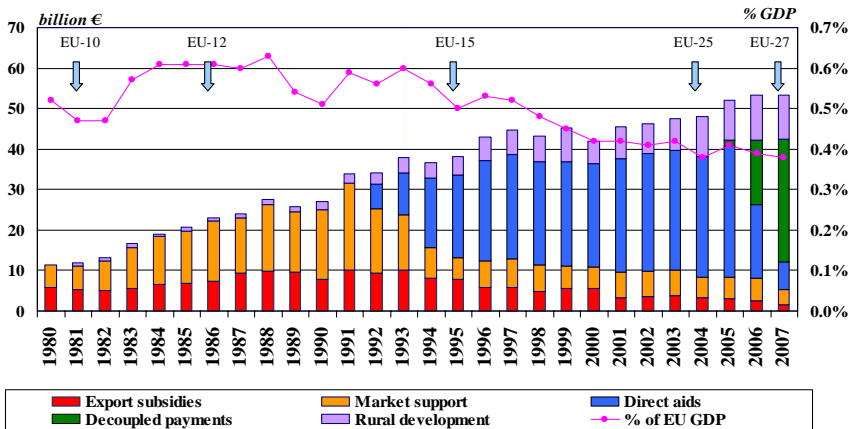
But

- It also led to overproduction
- And thus huge sales of products to public stocks
- Production was supply driven rather than demand driven

## Financing the CAP

The Common Agricultural Policy is financed by the European Agricultural Guidance and Guaranteed Fund (EAGGF) and is split in two sections:

- The guidance section meant for structural reforms in agriculture and rural development.
- The guaranteed section meant to finance the common organisation of the markets



Source: European Commission, DG AGRI

**Figure 1: Evolution of CAP spending 1980-2007**

### ■ The Reform(s)

The 2003 Reform was a further step in the reform started in 1992 (McSharry Reform), confirmed in 1999 by the Agenda 2000 Reform. It mainly reduced price support and introduced the direct income aid in compensation. Decoupling and conditionality were the two new concepts, the conditionality aiming at reinforcing rural development aid.

The health check of 2008 confirmed the process towards a liberalised market, with the phasing out of quotas in 2015.

Commissioner Fischer Boel presented on May 20, 2008 the Commission’s proposals on the CAP Health Check. The following issues were relevant for the European Dairy Industry:

- In regard to the soft landing of the milk quota abolition, the proposal set out a 5 times annual 1% increase that should start in the 2009/2010 quota

year

- ▶ Before June 30, 2011 the EC would present a report to the Council and EP in which it could propose possible other measures to facilitate the phasing out of the quotas (such as further quota increase, super levy reduction)
- ▶ For producers in less favoured areas that are affected by the quota abolition, financial support was proposed under article 68 (69) giving Member States the option to distribute 10% of their single farm payment to these areas
- ▶ The introduction of a tendering system in the butter and SMP intervention mechanisms
- ▶ The abolition of the private storage aid for cheeses and the butter aid schemes (pastry & ice-cream and direct consumption)
- ▶ The usage of private storage aid for butter and the disposal aid for using SMP in feed and casein would become optional depending on the EC's assessment of the market situation.

The Commission intended to have the text approved by the Parliament and Council at the end of November 2008. Since opinions on all items were very diverse within both institutions, EDA saw room for manoeuvre and expected the final outcome to be different from what the Commission proposed.

In parallel, discussions had started in the European Parliament and the Rapporteur underlined that the reform of the dairy sector was one of the most sensitive aspects of the Health Check as it gave rise to the widest variety of opinions due to the huge differences in production conditions throughout the EU.

After the European Parliament voted on the CAP Health Check, the Council of EU Agriculture ministers reached an agreement at the end of November 2008. The following changes to the current situation were the most relevant for the European dairy sector:

- ▶ Phasing out milk quotas: As milk quotas will expire by April 2015 a 'soft landing' is ensured by increasing quotas by 1% every year between 2009/10 and 2013/14. In 2009/10 and 2010/11, farmers who exceed their milk quotas by more than 6% will have to pay a levy 50% higher than the normal penalty.
- ▶ Intervention mechanisms: For butter and skimmed milk powder, limits remain 30,000 tonnes and 109,000 tonnes respectively, beyond which intervention will be by tender.
- ▶ Decoupling of support: The CAP reform "decoupled" direct aid to farmers i.e. payments were no longer linked to the production of a specific

product. However, some Member States chose to maintain some "coupled" payments. Today, these remaining coupled payments will be decoupled and moved into the Single Payment Scheme (SPS), with the exception of suckler cow, goat and sheep premia, where Member States may maintain current levels of coupled support.

- ▶ The rate of modulation (shifting funds from direct aids to rural development aids) will be raised from 5% at present to 10% by 2012. The increase will be made gradually: 7% in 2009, 8% in 2010, and 9% in 2011. The progressive modulation concept has been watered down; only recipients of more than €300,000 will face a higher modulation rate: 4% points higher than the standard rate. The resulting money will be allocated for 'new challenges' - climate change, energy, biodiversity and water management but it will also have to fund "accompanying measures" for the dairy sector.
- ▶ A maximum of 10% of each country's single farm payment allocation may be re-allocated under Article 68 schemes that allow for sectoral targeting of aid. The Council increased the proportion of this money that may be coupled to production from 25% to 35%. €90m per year saved by the abolition of energy crop subsidies will be allocated for Article 68 measures in the 12 new Member States.
- ▶ Single Farm Payments (SFP) will not be paid below a minimum value of €250, or a minimum one hectare of SFP-eligible farm area. Countries may be entitled to vary this threshold upwards or downwards, according to their own circumstances.

In 2009, there have been many demonstrations throughout Europe, many protests from the dairy farmers and many questions from the Commission and the European Parliament regarding the price transmission across the food chain.

In May 2009, Commissioner Fischer Boel was requested to increase intervention prices and export refunds. Both were rejected but the Commission proposed to extend the buying in intervention beyond August 31, 2009 as well as extending the Private Storage Aid for butter beyond August 15, 2009.

She accepted to advance 70% of the Single Farm Payment to 16<sup>th</sup> October 2009 (an earlier date is impossible because it would fall under the previous budget year). All this led to discussions on **Food Prices (see later)**.

Given the difficult situation experienced by the dairy sector, the Commission decided in October 2009 to create a High Level Experts Group (HLeG) on milk, whose mission and work would be divided in three blocks.

1. The first block dedicated to contractual relations and bargaining power
2. The second block to look at the existing market instruments and transparency and information to consumers
3. The third block will be dedicated to innovation and research and ask whether a futures market for dairy would be a useful tool to combat price volatility

The HLeG will provide its overall conclusions in June 2010.

What happened in 2007?

- Demand was higher than supply
- Intervention stocks were empty in the EU and in the US
- Oceania had low supply due to drought
- Argentina had low supply due to floods
- High feed cost
- Competition of biodiesel
- Finance crisis
- Lower oil prices

Consequences:

- High prices paid to farmers
- Substitution of dairy products by cheaper (vegetable) proteins and fats

In Europe, *in 2008*, one million farmers produced 150 million tons of milk, for a value of more than 40 billion euros. This represents 14% of the value of all European agricultural production. According to IDF statistics, the EU is the first milk producer in the world, with 27% of milk production, followed by India which produces 20%. In third position comes the USA with 16%.

The dairy processing industry employs circa 400,000 people in the EU.

Most of the milk produced is consumed in the area of production. Around 8% is traded on the world market. This means that a very small variation between production and consumption has significant consequence on the overall balance (2% equals 25% of world trade).

It is to be noted that:

- ▶ 60% of dairy farms in the EU 25 are located in Less Favourable Areas\*.
- ▶ World market is a commodity market.
- ▶ Growth of consumption has decreased from 2.5% in early 2000 to 1% today.

In parallel to the discussions especially dedicated to the dairy sector, the Commission published on October 28, 2009 a Communication entitled “A better functioning food supply chain in Europe”. This Communication included 6 Staff Working Documents, respectively dedicated to

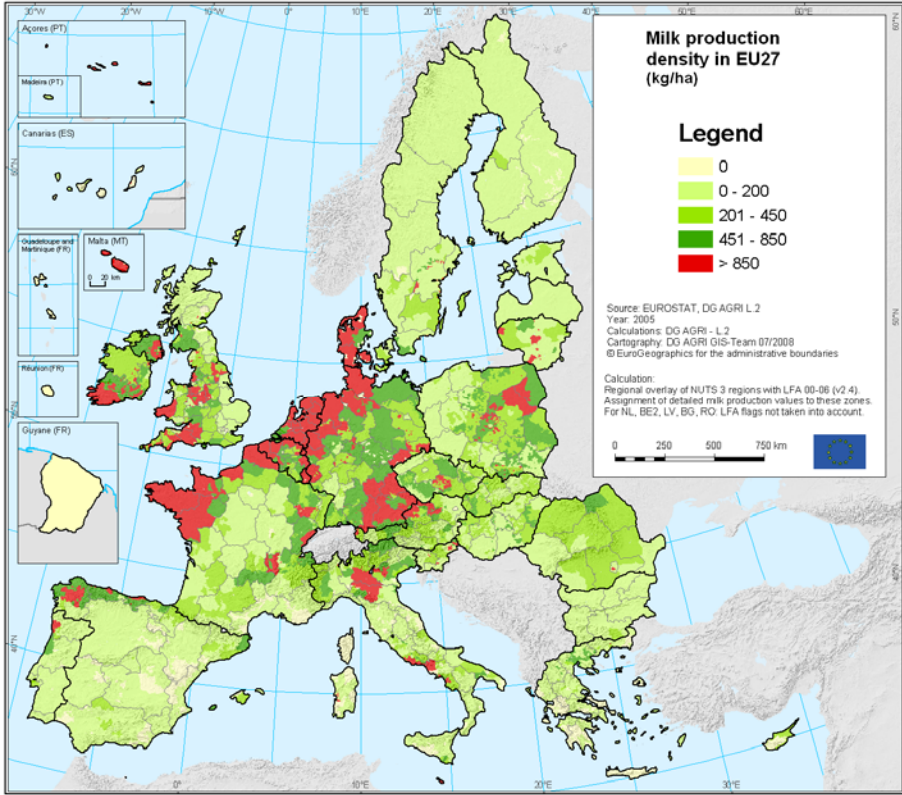
- ▶ Improving Price Transparency along the food supply chain for consumers and policy makers
- ▶ The evolution of value-added repartition along the European food supply chain
- ▶ Agricultural Commodity Derivative Markets: the way ahead
- ▶ Outcomes of the HLeG on the Competitiveness of the Agro-Food Industry. Proposals to increase the efficiency and competitiveness of the EU food supply chain
- ▶ Competition in the Food Supply Chain
- ▶ Analysis of price transmission along the food supply chain in the EU

The Communication concluded with 10 recommendations aiming at eliminating unfair contractual practices between business actors through the food supply chain, addressing competition issues, improving transparency, publishing European Food Prices Monitoring tool, providing food retail price comparison services, addressing territorial supply constraints, adopting the Commission’s proposal for the revision of the legislation on labelling rules, reviewing selected environmental standards and origin labelling schemes, promoting and facilitating the restructuring and consolidation of the agricultural sector and bringing forward the proposals of the HLeG aiming to improve the competitiveness of the agri food sector.

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\*LFA are areas suffering from natural handicaps, for example mountain areas, and any areas which for geographical/geological reasons are considered as less favourable for producing agricultural products than other ones. When the quota will disappear, milk production could disappear from these regions.

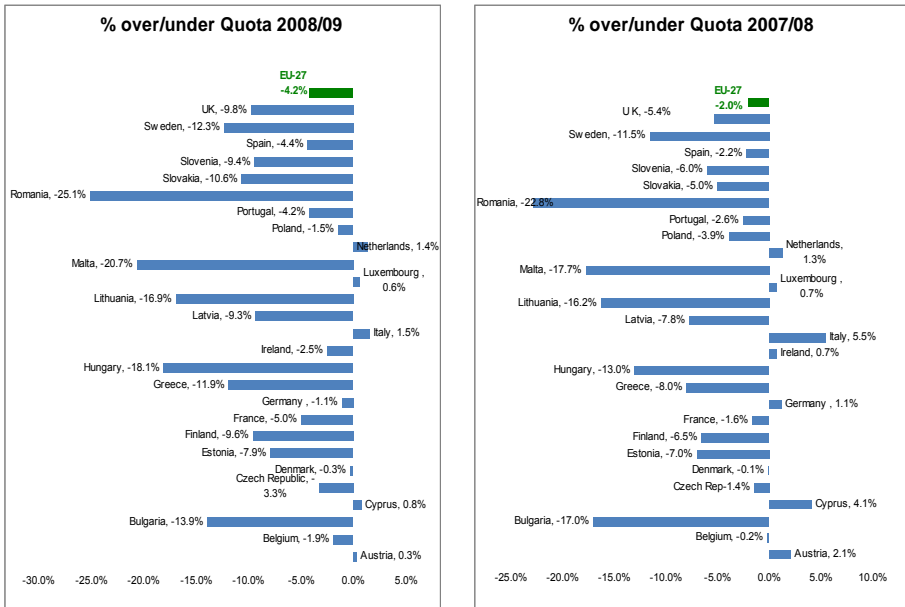
## ■ Situation Today



**Figure 2: Milk production density in EU27**

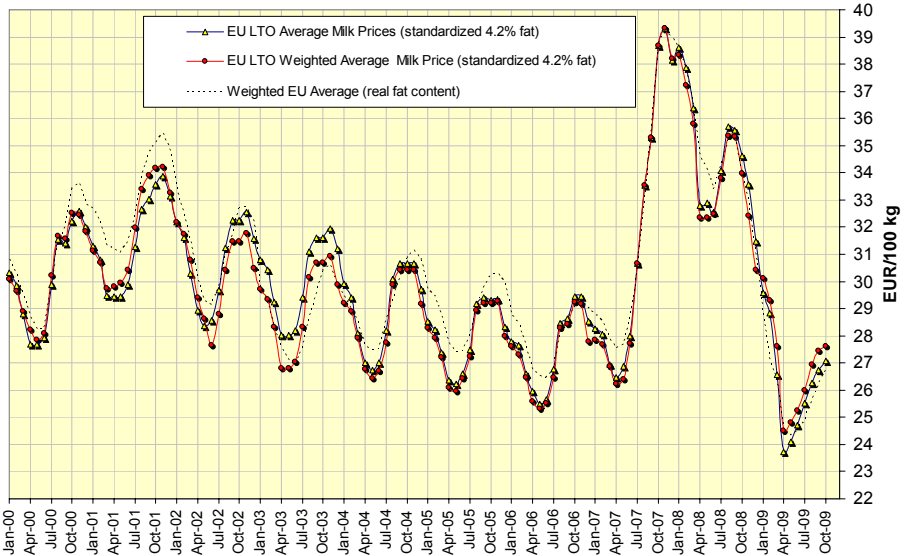
It is to be noted that since 2004, the EU total quota has never been used in full.





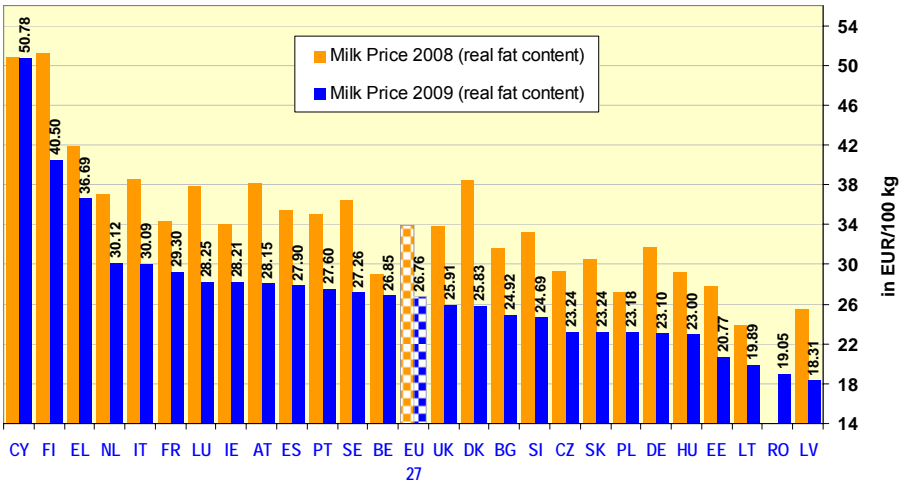
**Figure 3: Quota position by member state 2007/2008 - 2008/2009**

For the quota year 2009/2010, milk deliveries are more than 4% below quota and it is expected that the quota level will not be reached at the end of March 2010.



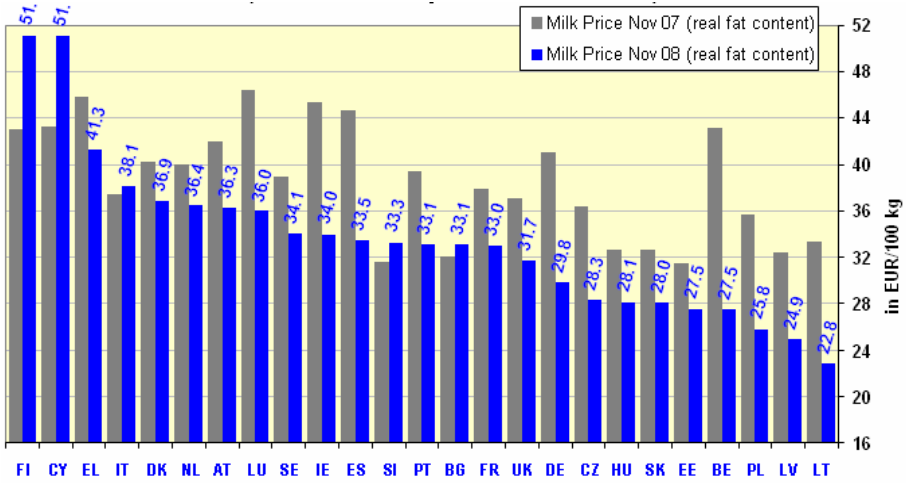
Source: : LTO [www.milkprice.nl](http://www.milkprice.nl) /European Commission, DG AGRI

**Figure 4: EU milk prices evolution (Jan 2000- Oct. 2009)**



Source: European Commission, DG AGRI

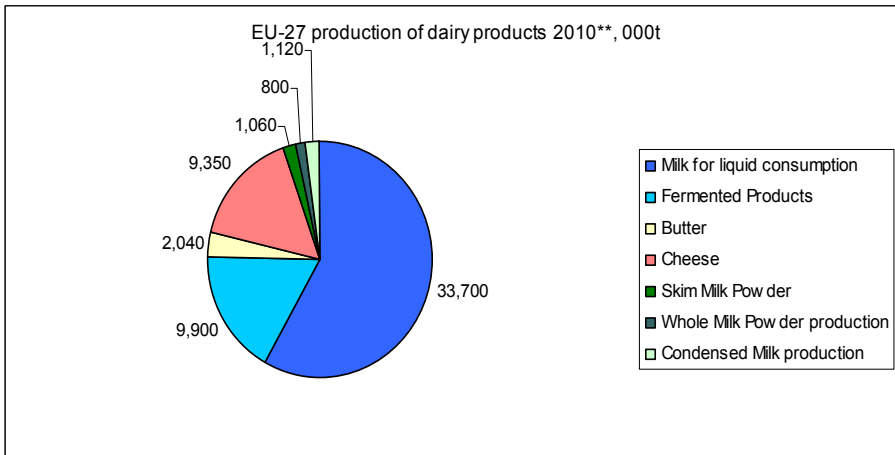
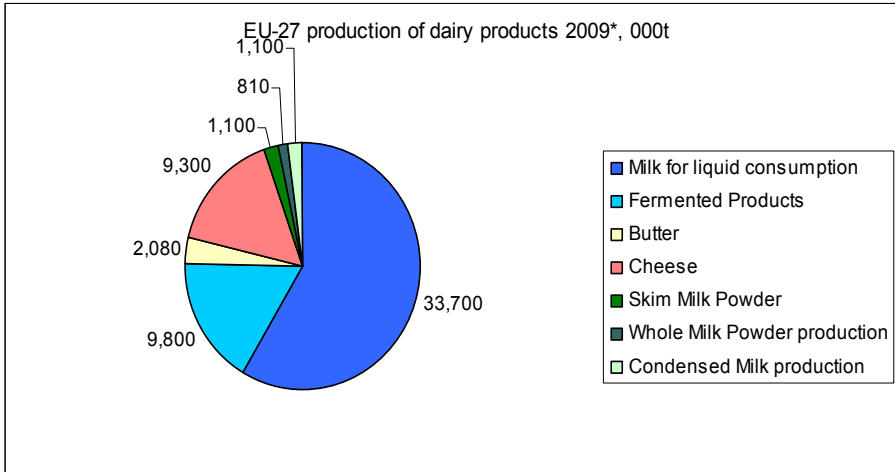
**Figure 5: Milk price by Member State Oct 2008 compared to Oct 2009**



Source: European Commission, DG AGRI

**Figure 6: Milk price by Member State Nov 2007 compared to Nov 2008**

What do we produce with our milk?



Source: ZMB, Berlin (\*) estimated (\*\*) forecast

**Figure 7: EU27 production of dairy products 2009-2010**

**■ What are the Expectations for the Future?**

Short term, the situation will continue to increase but at low speed due to existing intervention stocks. The timing and the way they will be released will be decisive. It is essential that the Commission wisely considers any effect that such release may have on the balance of the market.

If milk prices continue to increase, it may be expected that slaughtered cows will be replaced in order to increase production. It is expected that milk

supply will increase mainly in the North of Europe.

Cheese and fresh dairy product consumption have suffered from the financial crisis.

Butter may remain the main concern as more and more dairy products are consumed “light”. The best way to deal with it is to increase the production and consumption of cheese.

**Table 1: Milk production, deliveries and dairy herds in the EU27, 2006 - 2015**

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
<b>Total production (million t)</b>	<b>148.1</b>	<b>148.0</b>	<b>148.7</b>	<b>147.4</b>	<b>147.5</b>	<b>148.2</b>	<b>148.7</b>	<b>149.6</b>	<b>149.8</b>	<b>151.4</b>
of which EU15	119.6	119.7	120.2	119.4	119.6	120.4	121.3	122.2	122.5	124.3
of which EU12	28.5	28.3	28.5	28.1	27.9	27.8	27.4	27.5	27.3	27.1
<b>Deliveries (million t)</b>	<b>132.6</b>	<b>132.9</b>	<b>133.6</b>	<b>132.7</b>	<b>133.1</b>	<b>134.0</b>	<b>134.8</b>	<b>135.9</b>	<b>136.4</b>	<b>138.2</b>
of which EU15	113.9	114.1	114.6	113.8	114.1	114.9	115.9	116.8	117.1	119.0
of which EU12	18.8	18.8	19.0	18.8	18.9	19.1	18.9	19.1	19.2	19.2
<b>Delivery ratio (in %)</b>	<b>89.6</b>	<b>89.8</b>	<b>89.9</b>	<b>90.0</b>	<b>90.2</b>	<b>90.4</b>	<b>90.6</b>	<b>90.8</b>	<b>91.0</b>	<b>91.3</b>
of which EU15	95.2	95.3	95.3	95.4	95.4	95.5	95.5	95.6	95.6	95.7
of which EU12	65.9	66.3	66.8	67.1	67.9	68.6	68.9	69.7	70.3	70.8
<b>Fat content (in %)</b>	<b>4.04</b>	<b>4.04</b>	<b>4.04</b>	<b>4.04</b>	<b>4.05</b>	<b>4.05</b>	<b>4.05</b>	<b>4.05</b>	<b>4.05</b>	<b>4.05</b>
<b>Protein content (in %)</b>	<b>3.34</b>	<b>3.36</b>	<b>3.36</b>	<b>3.36</b>	<b>3.36</b>	<b>3.36</b>	<b>3.36</b>	<b>3.36</b>	<b>3.36</b>	<b>3.36</b>
<b>Milk yield (kg/dairy cow)</b>	<b>6093</b>	<b>6124</b>	<b>6200</b>	<b>6277</b>	<b>6346</b>	<b>6426</b>	<b>6520</b>	<b>6629</b>	<b>6693</b>	<b>6753</b>
of which EU15	6654	6690	6745	6817	6880	6941	7033	7121	7154	7173
of which EU12	4501	4509	4623	4693	4763	4864	4928	5069	5196	5325
<b>Dairy cows (million head)</b>	<b>24.3</b>	<b>24.2</b>	<b>24.0</b>	<b>23.5</b>	<b>23.2</b>	<b>23.1</b>	<b>22.8</b>	<b>22.6</b>	<b>22.4</b>	<b>22.4</b>
of which EU15	18.0	17.9	17.8	17.5	17.4	17.3	17.2	17.2	17.1	17.3
of which EU12	6.3	6.3	6.2	6.0	5.9	5.7	5.6	5.4	5.3	5.1

Note: Dairy cow numbers refer to the end of the year (historical figures from the December cattle survey)

Source: European Commission (Prospects for agricultural markets and income in the European Union 2008-2015)

**Table 2: Cheese market projections for the EU27, 2006 - 2015 ('000t)**

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
<b>Total production</b>	<b>8 926</b>	<b>8 932</b>	<b>8 969</b>	<b>8 997</b>	<b>9 082</b>	<b>9 246</b>	<b>9 395</b>	<b>9 542</b>	<b>9 646</b>	<b>9 879</b>
of which EU15	7 727	7 745	7 768	7 795	7 857	7 974	8 104	8 211	8 288	8 512
of which EU12	1 199	1 187	1 201	1 202	1 225	1 272	1 292	1 330	1 358	1 367
<b>Imports</b>	<b>101</b>	<b>94</b>	<b>81</b>	<b>81</b>	<b>81</b>	<b>83</b>	<b>85</b>	<b>87</b>	<b>89</b>	<b>91</b>
<b>Exports</b>	<b>586</b>	<b>596</b>	<b>545</b>	<b>542</b>	<b>543</b>	<b>543</b>	<b>558</b>	<b>558</b>	<b>536</b>	<b>525</b>
<b>Total consumption</b>	<b>8 441</b>	<b>8 430</b>	<b>8 506</b>	<b>8 536</b>	<b>8 620</b>	<b>8 785</b>	<b>8 923</b>	<b>9 071</b>	<b>9 199</b>	<b>9 445</b>
<b>Per capita consumption (kg)</b>	<b>17.3</b>	<b>17.2</b>	<b>17.2</b>	<b>17.2</b>	<b>17.3</b>	<b>17.6</b>	<b>17.8</b>	<b>18.0</b>	<b>18.2</b>	<b>18.7</b>
of which EU15	19.1	18.9	18.9	18.9	19.0	19.2	19.2	19.4	19.4	19.8
of which EU12	10.5	10.8	10.9	10.8	11.1	11.5	12.2	12.9	13.5	14.1

Note: production and consumption includes cheese used for processed cheese but excludes farm cheese

Source: European Commission (Prospects for agricultural markets and income in the European Union 2008-2015)

**Table 3: Butter market projections for the EU27, 2006 - 2015 ('000t)**

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
<b>Total production</b>	<b>2 076</b>	<b>2 151</b>	<b>2 158</b>	<b>2 163</b>	<b>2 092</b>	<b>2 028</b>	<b>1 991</b>	<b>1 996</b>	<b>1 964</b>	<b>1 949</b>
of which EU15	1 883	1 891	1 911	1 928	1 870	1 815	1 792	1 799	1 777	1 775
of which EU12	193	260	247	235	222	213	199	197	187	174
<b>Imports</b>	<b>90</b>	<b>91</b>	<b>62</b>	<b>85</b>	<b>85</b>	<b>85</b>	<b>85</b>	<b>85</b>	<b>85</b>	<b>85</b>
<b>Exports</b>	<b>241</b>	<b>212</b>	<b>143</b>	<b>156</b>	<b>133</b>	<b>135</b>	<b>104</b>	<b>46</b>	<b>28</b>	<b>24</b>
<b>Total consumption</b>	<b>2 047</b>	<b>2 050</b>	<b>2 036</b>	<b>2 053</b>	<b>2 054</b>	<b>2 048</b>	<b>2 042</b>	<b>2 035</b>	<b>2 021</b>	<b>2 009</b>
<b>per capita consumption (kg)</b>	<b>4.18</b>	<b>4.17</b>	<b>4.13</b>	<b>4.14</b>	<b>4.13</b>	<b>4.10</b>	<b>4.07</b>	<b>4.05</b>	<b>4.01</b>	<b>3.97</b>
of which EU15	4.73	4.72	4.67	4.67	4.64	4.61	4.57	4.53	4.48	4.43
of which EU12	2.15	2.14	2.10	2.15	2.16	2.16	2.16	2.17	2.16	2.16
<b>Ending Stocks</b>										
of which private	37	81	121	90	50	10	10	10	10	10
of which intervention	63	0	0	70	100	70	0	0	0	0
Stock changes	-121	-19	40	39	-10	-70	-70	0	0	0

Note: The figures on imports and exports are referring to total trade, i.e. including inward processing.

Source: European Commission (Prospects for agricultural markets and income in the European Union 2008-2015)

**Table 4: SMP market projections for the EU27, 2006 - 2015 ('000t)**

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
<b>Total production</b>	<b>866</b>	<b>913</b>	<b>860</b>	<b>839</b>	<b>843</b>	<b>830</b>	<b>792</b>	<b>825</b>	<b>774</b>	<b>787</b>
of which EU15	694	726	698	675	687	678	640	676	631	651
of which EU12	172	186	162	164	155	153	151	149	143	137
<b>Imports</b>	<b>21</b>	<b>10</b>	<b>8</b>	<b>8</b>	<b>8</b>	<b>8</b>	<b>8</b>	<b>8</b>	<b>8</b>	<b>8</b>
<b>Exports</b>	<b>85</b>	<b>202</b>	<b>163</b>	<b>125</b>	<b>110</b>	<b>127</b>	<b>96</b>	<b>90</b>	<b>77</b>	<b>101</b>
<b>Total consumption</b>	<b>783</b>	<b>688</b>	<b>660</b>	<b>700</b>	<b>720</b>	<b>736</b>	<b>734</b>	<b>728</b>	<b>728</b>	<b>729</b>
of which EU15	715	602	571	607	623	638	638	634	635	637
of which EU12	67	86	88	93	97	97	96	94	93	92
<b>Ending Stocks</b>	<b>95</b>	<b>128</b>	<b>173</b>	<b>195</b>	<b>215</b>	<b>190</b>	<b>160</b>	<b>175</b>	<b>152</b>	<b>117</b>
of which private	95	128	173	75	75	75	75	75	75	75
of which intervention	0	0	0	120	140	115	85	100	77	42
Stock changes	20	33	45	22	20	-25	-30	15	-23	-35

Note: The figures on imports and exports are referring to total trade, i.e. including inward processing.

Source: European Commission (Prospects for agricultural markets and income in the European Union 2008-2015)

## ■ Conclusions

Milk quota will disappear in March 2015. This was the decision made in 2003, confirmed by the Health Check and by Commissioner Fisher Boel permanently. Commissioner-designate, Mr Ciolos, also said during his hearing at the European Parliament on January 15, 2010 that the "solution is not to go backwards on quotas".

Budget perspectives will be reviewed in 2013 and it is expected that spendings for agriculture will be decreased again. The coming discussion on "What the CAP after 2013 should be?" will have to take that element on board.

Last but not least, the date of implementation and the content of the DDA (Doha Development Agreement) will have a major impact on the European dairy sector. The challenge ahead is to be competitive on the world market if we want to keep our market shares, but also in the internal European market, once the border protection will be seriously decreased.

Besides these purely economic aspects, nutrition and environment are high on the agenda and should not be neglected.

