Briefing
June 2015

The future of the EU dairy sector after the end of milk quotas

SUMMARY

Milk is produced in every EU Member State and EU milk production is growing. As the leading worldwide exporter of many dairy products, the EU is a major player in the global dairy market; within the Union, dairy is an essential agricultural sector with significant economic, social and territorial importance. For more than 30 years, EU milk supply was managed by the EU milk quota system, which expired at the end of March 2015. Although long-term market prospects are generally quite positive, with an overall rise in global demand which could offer opportunities to the sector, the challenges to be faced in coming years are numerous. The current tensions regarding milk prices and the 2009 milk price crisis demonstrate that market liberalisation and dependence on international markets can increase market instability and price volatility.

At the July 2015 plenary session, Parliament is due to vote on an own-initiative report on prospects for the EU dairy sector. The report addresses the concerns arising from the end of milk quotas and any subsequent market volatility. It suggests that a series of tools could be developed or improved, such as establishing compulsory written contracts between milk producers and processors, enhancing the role of producer organisations and the recently-created Milk Market Observatory, tackling unfair trading practices in the food chain, pursuing new trade agreements, and improving information and promotion programmes for the dairy sector and school milk scheme, as well as new measures to protect farmers' profit margins.

In this briefing:

EPRS | European Parliamentary Research Service
Author: Francesco Tropea
Members' Research Service
PE 564.359
EN

Background

Milk is produced in all EU Member States without exception and overall EU milk production is growing. Indeed, in terms of value, milk is the EU's number one agricultural product, accounting for approximately 15% of agricultural output with around 148 million tonnes of cow milk delivered in 2014 in the EU28. As the leading exporter of many dairy products, the EU is a major player in the world dairy market. Within the EU, the sector is of significant economic, social and territorial importance. It encompasses over 650 000 specialised dairy farmers with almost 18 million milk cows and a labour force of 1.2 million people (Eurostat census 2010, in annual work units).

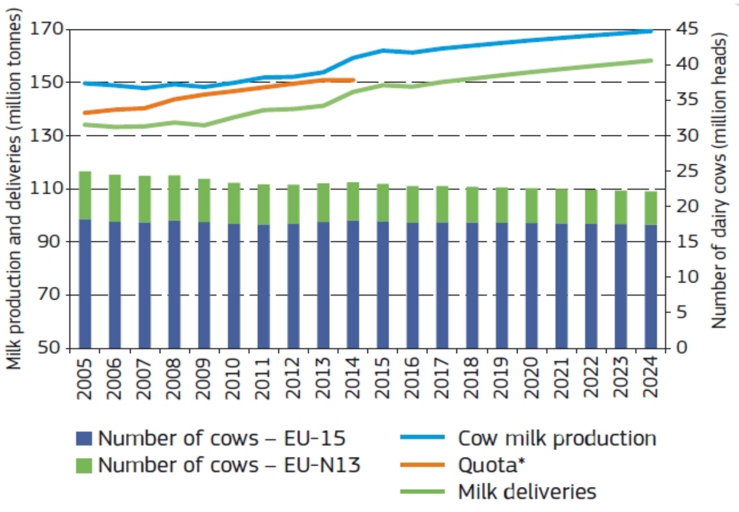
For more than 30 years, the EU milk supply was managed by the EU milk quota system which expired at the end of March 2015. This system, introduced in 1984, provided a national quota at Member State level and an individual quota fixed for each producer or purchaser, with a levy (the 'superlevy') payable for those who exceeded their quota. Subsequent changes have meant that producers were only required to pay the levy when the Member State also exceeded its national quota. The EU milk quotas were introduced to address the structural oversupply in the EU market during the late 1970s and early 1980s, when the system of guaranteed prices at a level well above world market prices led to a structural surplus, with the European Commission obliged to buy large volumes of butter and skimmed milk powder (SMP). On occasions these 'mountains' exceeded 1 million tonnes for both SMP and butter.

The removal of the milk production quotas is the main change to the European dairy industry since their introduction in 1984, signifying that, from 1 April 2015, market forces are the primary driver of EU milk production.

Production developments

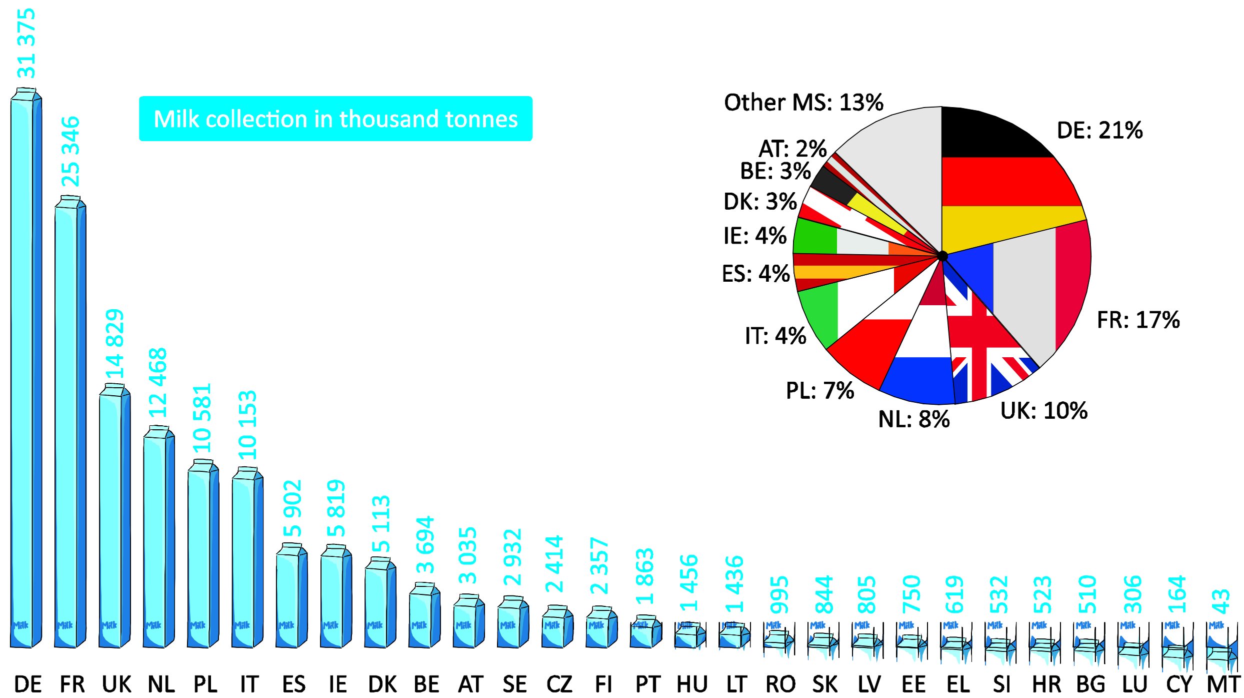
In recent years, EU milk production has constantly expanded. As recently as 2014, it rose by about 5% and overall forecasts are positive (see figure 1). In Germany, France, UK, the Netherlands, Poland, Ireland, Austria, Denmark and Belgium, milk production has increased in the last 10 years (see figure 2 and 3) and the forecasts to 2024 are generally positive (see figure 3). Most of the EU milk output is processed as cheese, butter or skimmed milk powder, as well as a wide variety of yoghurts, creams, ice creams and other value-added products.

Figure 1 – EU cow milk supply and EU dairy herd developments.



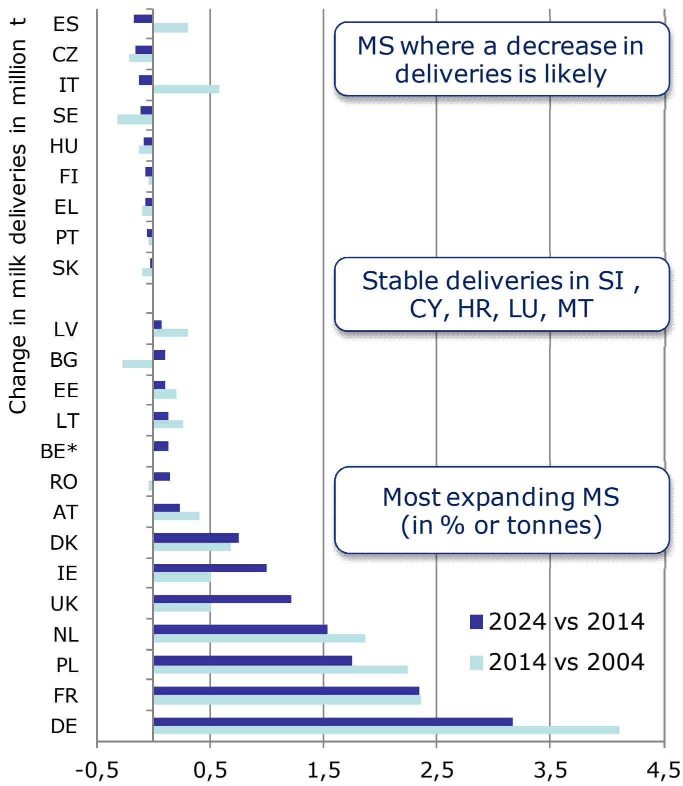
Source: European Commission, DG AGRI.

Figure 2 – Milk collection in 2014 by Member State, in 1 000 tonnes



Source: EPRS calculation from Eurostat data.

Figure 3 – Milk deliveries forecast to 2024

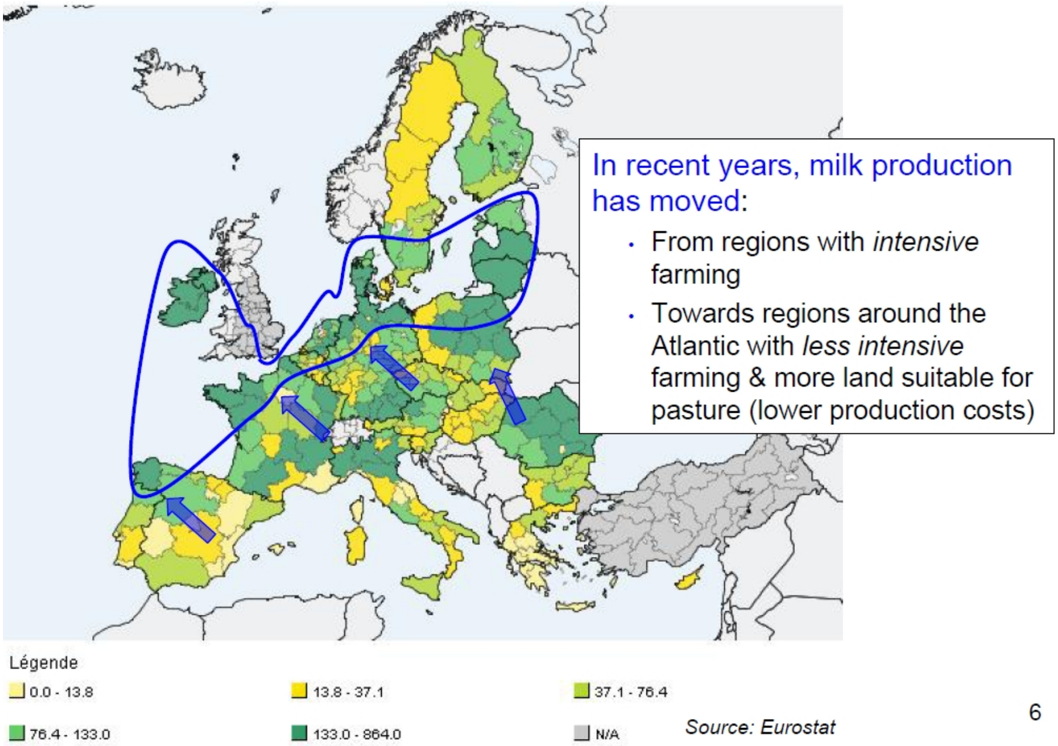


Source: European Commission, DG AGRI.

Challenges and market developments

After 30 years of milk quotas, long-term market prospects, as indicated in figures 1 and 3 above, are generally positive; the overall rise in **global demand could offer opportunities to the sector**. Nevertheless, the challenges to be faced in coming years remain numerous. The 2009 crisis showed that market liberalisation and dependence on international markets were followed by increased market instability and price volatility. **Increased volatility can lead to severe economic crises**, jeopardising the development of sustainable business and production, in particular in the most vulnerable areas, such as mountainous or less competitive areas. As noted above, milk production is expected to grow in the Member States indicated in figure 3, especially in the most competitive areas. On the other hand, small farmers, farmers in mountain areas, or areas with higher production costs, may suffer without the protection of the quota system.

Map 1 – Movements in milk production at regional level in the EU

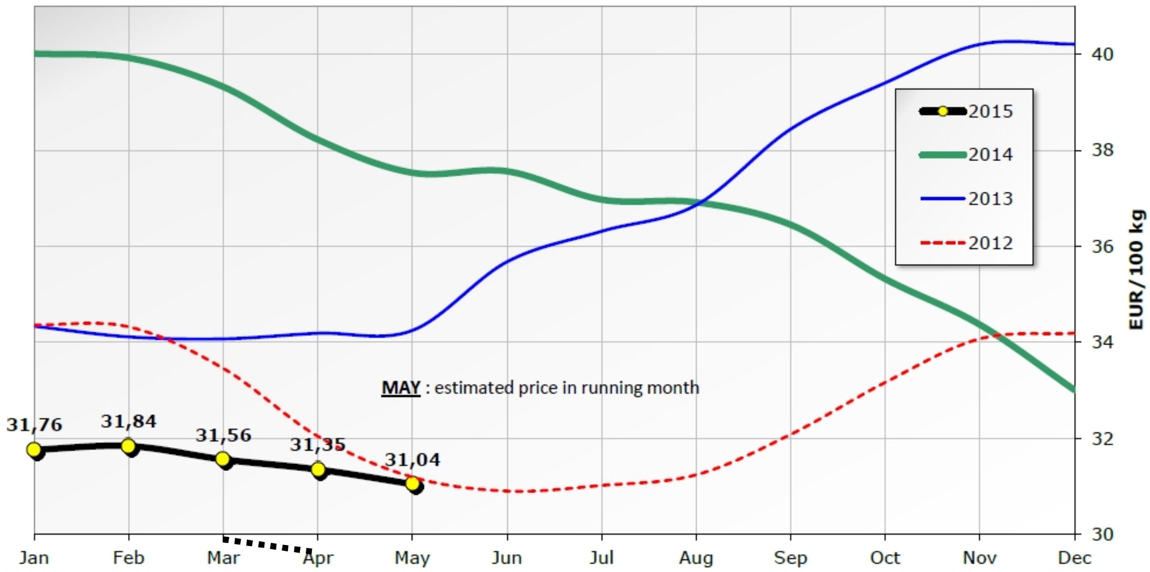


Source: GIRA, UK data not available.

In this context, an analysis provided in 2012 by an external consultancy firm (see map above), indicates that EU milk production is moving to the Atlantic regions and shrinking in less competitive areas. Within this perspective, the dairy sector will continue to shift from the family business model towards more specialised and intensive industrial farming.

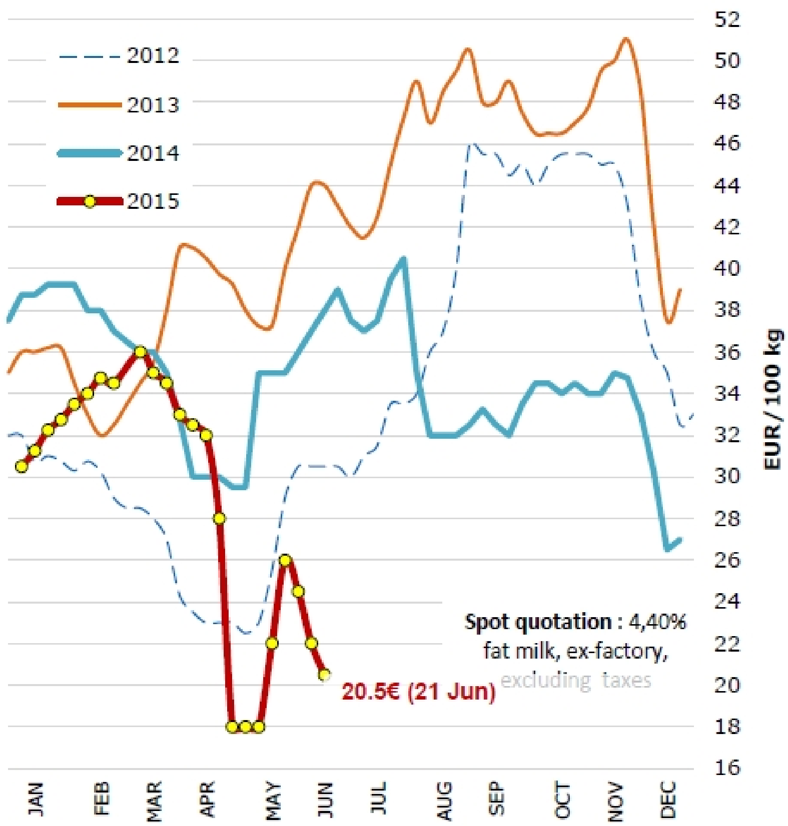
Moreover, the recent Russian embargo has further increased market uncertainty, at least in the short-term. European dairy prices have declined significantly since the announcement of the embargo in August 2014, and again after the end of milk quotas, as shown in figures 4 and 5.

Figure 4 – Average milk prices paid to producers in the EU28 (weighted average)



Source: Milk Market Observatory.

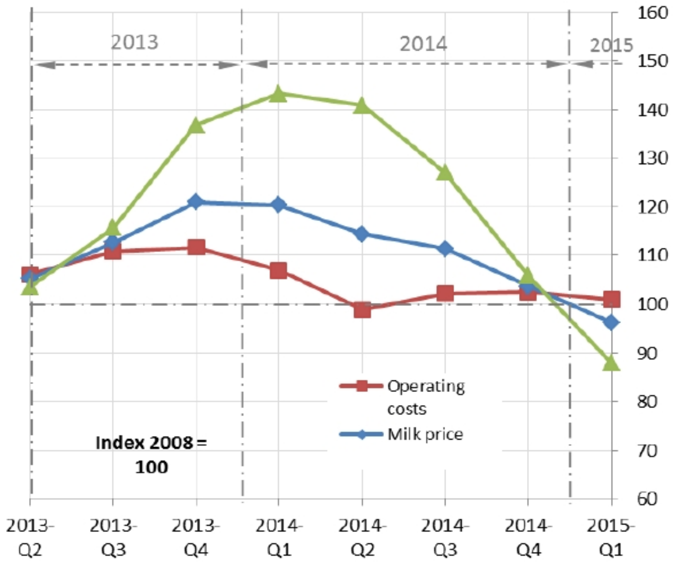
Figure 5 – Milk spot prices, the price paid to producers at a specified time and place, in the Netherlands



Source: Milk Market Observatory and Clal.it.

Even if the EU28 milk price average is above the threshold of €0.3/litre, looking at the actual price paid to producers in each Member State, the milk spot price on the free market in the Netherlands, for example, is lower: €0.3/l. As shown in figure 5, there is a tension regarding milk spot prices, decreasing below the threshold of €0.3/l. In terms of profitability, at the beginning of 2015 there was a drop in milk gross margin per tonne, as illustrated in figure 6. As a consequence, prospects for the rest of 2015 deserve the utmost vigilance, especially in light of the fact that some farmers could be further penalised in facing payments of 'super-levies' due in the last year of quotas. This could create, in some rural areas and Member States, a sensitive social situation.

Figure 6 – Estimates of EU milk prices, gross margin (in green) and operating cost per tonne



Source: Milk Market Observatory.

Taking stock of the EU tools and measures available

'Milk package'

After the 2009 milk market crisis, when milk prices dropped under €0.3/l, the Council and the European Parliament adopted the so called 'Milk Package', published in March 2012 and now integrated in Regulation (EU) No 1308/2013 on a common organisation of the markets for agricultural products. The package contains some measures aimed at boosting the position of producers in the dairy supply chain and preparing the sector for a more market-oriented and sustainable future. In particular, to strengthen the supply chain relationship, written contracts were seen as a concrete method of ensuring equitable distribution of the risks along the supply chain, and reinforcing stakeholder responsibility to take account of market situations and respond accordingly. On this basis, for the moment, 12 Member States[1] have decided on **compulsory written contracts between milk producers and processors**. In two other Member States,[2] codes of good practice inspired by the 'Milk Package' have been agreed between farmers and processor organisations.

Another important provision for Member States is compulsory recognition of **producer organisations** (POs), constituted by milk producers pursuing specific aims, such as:

- ensuring that production is planned and adjusted to demand, particularly in terms of quality and quantity;
- concentration of supply and placing the products produced by its members on the market;
- optimising production costs and stabilising producer prices.

Once milk quotas have ended, most experts believe enforcing the role of producer organisations in the EU is essential, and sufficient financial support should be provided both for current and new POs under Pillar II (rural development) of the Common Agricultural Policy (CAP).

An essential tool introduced by the European Commission in April 2014 is the Milk Market Observatory, which aims to monitor the EU dairy sector, in a transparent way, by disseminating market data and short-term analysis in a timely manner throughout the milk supply chain.

Safety net and income stabilisation tool

Regulation (EU) No 1308/2013 on a common market organisation of agricultural products provided a safety net in case of severe market crisis, with the possibility to use **public intervention or private storage for milk and dairy products** (see below). These tools can be activated only in cases of severe crisis, as they are very expensive in terms of the Union budget.

An interesting instrument to be further developed is the **income stabilisation tool** provided by Article 39 of Regulation (EU) No 1305/2013 on rural development. This risk management tool supports farmers facing a severe fall in income (minimum 30% loss compared to the three previous years). Nevertheless, only a few Member States have activated and allocated enough resources to the instrument, probably due to its complexity and lack of available historical income data, as well as the rigidity of the threshold of the drop in income.

Under the **2014-20 CAP**, the dairy sector is equipped with a safety net (intervention buying-in for butter and skimmed milk powder; private storage aid for butter, skimmed milk powder and PDO/PGI[3] cheeses); coupled with a regulatory framework for the Commission to react to exceptional circumstances (e.g. extension of the intervention buying-in period; private storage aid for other dairy products; export refunds, temporary derogations from competition rules as regards agreements and decisions by recognised organisations on particular measures; exceptional counter-cyclical payments). Member States may grant coupled support to milk producers facing difficulties under certain limited conditions. Moreover, measures under the rural development plans could be implemented in specific areas.

Better functioning of the food chain

In July 2014, a Commission Communication on tackling unfair trading practices in the business-to-business food supply chain suggested a number of priorities to help establish an effective EU-wide framework for **addressing unfair trading practices (UTPs)**, such as monopolistic behaviour, delay in payments, hidden costs of promotional campaigns and fraudulent practices. It does not propose regulatory action at EU level, but encourages Member States to ensure that they have appropriate measures against UTPs. In Committee on Agriculture and Rural Development debates, tackling unfair trading practices in the dairy sector has been cited as an issue to be further developed and enforced at EU level.

Labelling of origin

The Commission published a report to Parliament and Council in May 2015 on the issue of mandatory labelling of the country of origin for milk, milk products and certain types of meat. The report analysed three scenarios: 1. Status quo (voluntary labelling); 2. Mandatory origin labelling as 'EU origin/non-EU origin'; 3. Mandatory origin labelling indicating the Member State(s) or third country.

The report estimated that mandatory origin labelling might encourage consumers to favour domestically-produced goods, noting however that, according to a Eurobarometer survey published in 2014, while consumers wish to be well-informed about the provenance of their foodstuffs, there may be little willingness to pay extra if the costs of providing such information are passed to the public.

Promotion and school milk schemes

In 2015, the European Commission has already approved 41 new programmes to promote agricultural products in the EU and in third country markets, worth €130 million over three years, half of which comes from the EU budget. Six of these are new information and promotion programmes for the dairy sector, all targeting third country markets. Overall, they will receive nearly €12.2 million from the EU budget over three years, and will mainly begin in the middle of 2015. These new programmes come in addition to 14 on-going multi-annual programmes for the dairy sector, launched between 2011 and 2014.

Promotion plans are essential to benefit from export demand opportunities, while the school milk scheme aims to boost domestic consumption. This scheme offers support for the supply of milk products to pupils, with two core objectives: increasing EU milk consumption and milk demand; and milk and milk product consumption by children and young people.

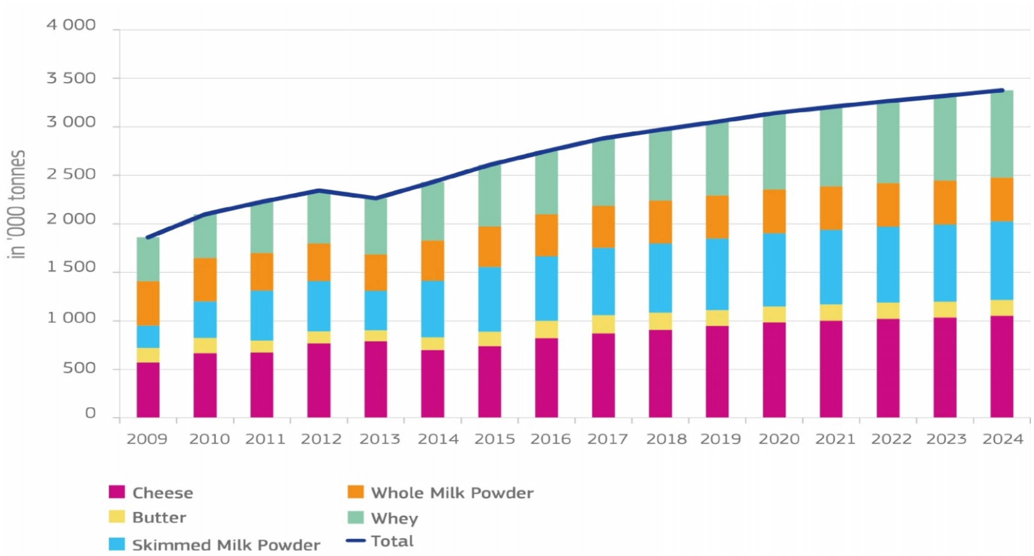
Last year the European Commission proposed to bring two separate EU schemes on milk and fruit together under a joint framework, with a budget of €230 million per school year, of which €80 million is for milk. The European Parliament acknowledges the importance of the proposal, while the Council contests the legal basis. The Council considers Article 43(3) TFEU (special legislative procedure) more appropriate than Article 43(2) (ordinary legislative procedure).

New markets and trade liberalisation

EU milk production is increasing, as is world demand, while EU internal demand is currently steady or stagnant. In this scenario, the Commission encourages exploitation of all the possibilities offered by on-going and **new trade agreements** and by the reduction of non-tariff and sanitary barriers to trade.

As shown in figure 7, EU dairy exports, particularly cheese, are expected to increase.

Figure 7 – Projected development of EU dairy exports to 2024



Source: European Commission, DG AGRI.

A 2014 European Parliament study: 'Risks and opportunities for the EU agri-food sector in a possible EU-US trade agreement', noted that the EU has a strong dairy product industry and that recent reforms have led to a reduction in the cost of milk, reducing the burden faced by potential exporters of processed products. EU dairy products face high tariffs that limit their entry into the US market, and preferential access under the TTIP could provide a cost advantage compared to competitors such as New Zealand or Argentina. On the other hand, market distortion (currently hidden by high tariffs in the EU) already exists in the dairy sector, given that the EU prohibits the use of hormones (rBGH/BST), but not imports of dairy products from animals treated with hormones (one reason being that artificial hormone residues are difficult to distinguish from those of natural hormones). While the gain in milk production differs widely according to the production system, it is estimated to exceed 10% in most intensive farming systems, providing therefore a significant cost advantage for US producers.

European Parliament

The European Parliament adopted a resolution in 2013 on maintaining milk production in mountain areas, disadvantaged areas and outermost regions after the expiry of the milk quota. The resolution underlined that the 'dairy package', aimed at strengthening producer bargaining power, was only a first step in the right direction and would not be able to secure the future of the milk production in these most vulnerable areas. It stressed the need to monitor the sector after the end of milk quotas and to focus on less favoured areas, mountain areas and the outermost regions, to ensure a decent living for farmers and the vitality of rural areas, especially as the 2013 CAP reform did not completely address this issue.

On 8 June 2015, the Committee on Agriculture and Rural Development adopted a report on 'prospects for the EU dairy sector – review of the implementation of the dairy package' (rapporteur James Nicholson, ECR, UK), to be voted on in plenary in July 2015. In this report, the Committee has taken into account most of the concerns arising from the end of milk quotas and any subsequent market volatility. In particular, it underlines the importance of maintaining milk production, as dairy farming makes an important socio-economic contribution to the EU, especially in less favoured areas, mountain areas and outermost regions. It calls on the Commission to monitor the functioning of the supply chain, the single market for dairy products and to set up an action plan to mitigate the risk after the end of milk quotas.

It further encourages the Commission to propose regulatory actions at EU level to enforce appropriate measures against unfair trading practices in the milk supply chain. The role of producer organisations is seen as crucial; sufficient financial support under Pillar II could be provided both for current and new producer organisations, including lending facilities. Moreover, new measures to protect farmers' profit margins and an income stabilisation tool should be further developed and supported.

Main references

Milk quota expiry & market prospects for the dairy sector, DG Agriculture and rural development, European Commission, March 2015.

European Dairy Industry 2015-2020, the European Dairy Industry towards 2020, challenges, strategies and change, PROMAR international, 2014.

Report from the Commission to the European Parliament and the Council on the development of the dairy market situation and the operation of the 'Milk Package' COM(2014) 354 final, European Commission, June 2014.

European Milk Market Observatory, DG Agriculture and rural development, European Commission.

Prospects of EU agricultural markets and income 2014-2024; DG Agriculture and rural development, European Commission, December 2014.

www.girafood.com, Consulting and market research throughout the whole food & drink chain.

www.clal.it/en, Dairy Economic Consulting firm that analyses the Dairy Market, interprets trends and provides data.

Endnotes

[1] Latvia, France, Italy, Spain, Lithuania, Hungary, Slovakia, Croatia, Cyprus, Portugal, Bulgaria, Romania.

[2] Belgium and UK.

[3] PDO: Protected Designation of Origin; PGI: Protected Geographical Indication.

Disclaimer and Copyright

eprs@ep.europa.eu
http://www.eprs.ep.parl.union.eu (intranet)
http://www.europarl.europa.eu/thinktank (internet)
http://epthinktank.eu (blog)