Challenge & duty for the European Union : overcome the crisis in the dairy sector

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With over 150 million tons of annual cow's milk production, the European Union (EU) is a major player in the dairy sector with a big internal and external impact. At present, though, the EU faces a major challenge. Massive overproduction has pushed the dairy sector into a serious crisis, forcing many producers throughout Europe, including Spain, France, Portugal and Italy, onto the streets to protest. The crisis can be overcome if the EU politicians put in place a crisis instrument that addresses the production volume.

There are two cogent reasons for applying such an instrument:

- The EU internal economy would be stabilised, with fair farm-gate prices throughout the EU keeping milk production centres alive. The jobs in the dairy sector and in related sectors thus secured would prevent rural regions bleeding to death. At the same time, growth in milk production would not be blocked. If there is enough demand, milk production can be increased.

- Curbing overproduction in the EU will help not to affect growth in non-EU countries. Producers in developing nations will be able to sell their products and earn an income. This will reduce poverty and hunger – reasons for emigration.

The interconnections in the EU market/the EU policy have a great influence on the dairy sector in every member state. The impact both on the Mediterranean and the other members of the union of states is very similar. That is why in this respect the EU situation should be viewed as a whole.

2003: turning point in EU milk policy

EU milk policy took a turn in 2003 when deregulation of the milk market started. This policy peaked in 2015 with the abolition of production quotas, which were introduced in 1984 as a response to massive overproduction. In the last 30 years, these quotas kept the EU from continuing to produce milk lakes and butter mountains.

As a preparation for the end of quotas in 2015, the production limits were already raised by 9.8% between 2004/05 and 2014/15 – with visible effects on farm-gate prices. Supply had not been in balance with demand. Overproduction occurred with the result that in 2009 farm-gate prices plummeted to around 25 cents/kilo of milk (EU-27), causing a loss of revenue of around 11 billion euros for European dairy farmers (see Fink-Keßler/EMB 2013: 4). This milk price crisis forced many farmers out of business and heavily burdened the financial reserves of those remaining.

Since the end of the milk quota system on 31 March 2015, the dairy market has faced an even bigger challenge, because the successor system lacks effective instruments for preventing a damaging surplus of production. Already in 2014 higher prices and expectations of a quota-free market triggered a 4.3% production increase in the EU (see Gorn 2015: 21). Additional volume increases of 10% in New Zealand and 2.4% in the US together with EU production have resulted in a production surplus on the world market of over 11 million tons of milk (see Pflimlin 2015: 3).

It is obvious that so far the ability to produce milk has not been an issue for the EU. The problem lies elsewhere: the challenge actually consists in not producing too much milk. The market is saturated and the additional volume is putting immense pressure on farm-gate prices. That is also becoming clear in 2015, with an additional production volume of 2.8% in the EU between April and July compared to the same period in 2014 (see Milk Market Observatory 2015). Prices have dropped dramatically, so that at the end of this summer farmers in the Baltic States are already being paid less than 20 cents a litre. In Italy farmers are paid around 34 cents and in France around 32 cents, while Spanish prices have already fallen well below the threshold of 30 cents. In Belgium the price is around 25 cents, in the Netherlands 24-28 cents and in Germany 25–30 cents a litre.

These prices cannot cover production costs, as shown by studies from individual countries. These studies show production costs of 45 and 39 cents a litre for France and Italy respectively (see Jürgens 2014 and Jürgens 2015c). In Belgium, production costs are 46 cents (see Jürgens 2015a) and in the Netherlands 42 cents (see Jürgens 2015b). This huge gap between costs and prices means that losses for dairy farms are very high.

Therefore a reasonable reaction from the EU would be to recognise market signals and slow down production throughout the EU. That requires an adequate framework implemented by EU policymakers. Only then is an EU-wide reaction possible. This is even more urgent in the light of demand-influencing factors such as a decreasing thirst for European milk in China and the Russian embargo. Since August 2014 the latter is preventing exports of cheese and butter to a big market. This has affected about 2 million tons of milk per year (see Pflimlin 2015: 3).

Whatever it is that reduces demand for EU dairy products, a European policy should be able to react to it, while focusing on the factor that it can influence: the supply of milk. That remains the biggest challenge for EU policy and the dairy sector, because so far the current political strategy has tended to stimulate production instead of slowing it down. The current crisis is hitting dairy producers especially hard, resulting in protests throughout the EU. In Spain and France in particular, dairy farmers are organizing remarkable demonstrations, but also in other countries like Belgium or Germany many demonstrations and campaigns are taking place.

The crisis will eventually also be problematical for processors that are losing their regional providers of raw milk. It will continue to damage the EU as a production centre as long as there are no adequate crisis instruments implemented. That is shown by the examples from Switzerland and Australia. When Australian milk quotas were abolished in 2000, national milk production dwindled. Whereas in 2000 the milk volume was about 11 million tons, by 2015 it had shrunk to approx. 9.5 million tons (see Muirhead 2015). But there are crisis concepts targeting the damaging overproduction in the EU such as the Market Responsibility Programme (MRP) (see EMB 2015).

How the crisis instrument works

The MRP works on the basis of a market index showing the imbalance between production costs and farm-gate prices. At the value of 100 the market is stable. A number below that limit signals discrepancies. If the discrepancies are significant, the MRP kicks in. It reacts to minor market discrepancies with gentler measures, such as opening up private storage – i.e. the temporary storage of dairy products thus withdrawn from the market – or incentive programmes for extra consumption such as sucking-calf production. If the index slides further, the second stage of the MRP is triggered off with a voluntary restraint on supply.

The total volume necessary to restore balance to the milk market is calculated on an EU level. Dairy farmers are asked, by means of an invitation to tender geared to the total volume calculated, to cut their production volume voluntarily by a few per cent. Any dairy farmer taking up the invitation receives financial compensation for every kilo of milk s/he does not produce. In many cases these first two stages can already help restore balance to the market. Should there be very severe market distortions, however, a third stage is available. If the index falls by more than 25 per cent, there is an option of cutting the production volume for each producer across the EU by 2 to 3 per cent during a defined timeframe.

Fears that this instrument would restrict the development of a dairy farm are unfounded. Of course, in stage 3 discipline will be required of each and every producer for a brief period to return farm-gate prices to a reasonable level. Yet this stable price ensures that dairy farms will no longer have to sell their milk at prices below their production costs. This enables them to generate an income as well as have financial resources to invest in the farm's future.

The rock-bottom prices that are the feature of the current milk market barely provide a livelihood, let alone create a profit. The reliability of fair prices, however, gives the producers planning security and enables them to step up production in line with demand. Moreover, the 3rd stage referred to, entailing an obligatory reduction in production for a short period, will only be necessary in a very few cases. Before that, both the first stage measures and the voluntary restraint on supply will ease the market. What is more, the MRP is applied only in times of crisis. At all other times the market operates without any supply management.

Stabilising its dairy sector by means of sensible instruments and thus maintaining production and jobs is not only a possibility for the EU, it is also its duty. Many other countries are very conscious of this duty. The USA has always regarded the dairy sector as very important to its economy and deemed it worthy of protection. That is made clear in the Margin Protection Program for Dairy (MPP Dairy) and also the Dairy Product Donation Program (DPDP). In calculating margins the MPP Dairy is geared to the trend in production costs inter alia. China, Japan and Canada, too, do not leave their dairy sector to free market forces, but actively ensure stable conditions. So why should precisely the EU stand by and do nothing as its own dairy sector plunges into a crisis?

A consideration of the interconnections in the common market makes it clear that action has to be taken on the EU level. The individual EU states' scope for having a long-term influence on the dairy sector with national strategies is very limited. A milk policy in Spain, France or Portugal and Greece, for instance, is invariably strongly affected by the decisions of the EU. The union of states is therefore under a great responsibility, in terms of its own internal development with a view to a stable economy, regional production centres and also preserving jobs in rural regions. A price level that excludes its own farmers and causes entire production regions to be lost does not square with this responsibility, however.

As EU milk policy has a big external influence, the EU also bears responsibility for the development of other countries. This challenge can be ignored or taken up. In the interest of economic progress in developing nations, though, the EU ought not to choose ignorance. The problem is EU overproduction in the dairy sector, because it washes up on the developing countries' markets as milk powder, say, damaging milk production there. This limits the scope for local farmers to generate an income; economic growth is stunted. Yet it is precisely here that positive development is required. For farmers the world over are hard hit by hunger. As the UN's Food and Agricultural Organization (FAO) shows, smallholders make up 90% of the poor rural population and the majority of the starving world population (see FAO 2013: ix).

Economic growth can reduce malnutrition, rises in the income of family farms can lead to a positive development. This is countered, however, by an EU policy that promotes the surplus production and dumping of milk. Or as the FAO puts it: "*Food sectors in developing countries that are characterized by low productivity and lack of competitiveness are especially vulnerable to import surges. A sudden disruption of domestic production can have disastrous impacts on domestic farmers and workers – loss of jobs and reduced incomes, with potentially negative consequences for food security*" (see FAO 2015: 34). It is in this sense that the current export drive by EU dairies has severe negative consequences for local milk producers in West African countries, for instance.

Conclusion

In the EU, though, people ought to have a strong interest in other countries developing, opening up sources of income for their citizens and thus enabling them to take care of themselves. This is also certainly true in view of the great flood of refugees reaching the whole of Europe because of war and economic hardship. In this regard, a crisis instrument for the European milk market would help to reduce price dumping, which harms dairy farmers in developing countries, while also balancing the domestic market. This would enable producers both inside and outside Europe to continue producing milk.

There must, however, also be a will in the EU for a balanced policy. This will is certainly evident in institutions like the EU Parliament[1], the European Court of Auditors[2], the Committee of the Regions[3] and also individual national ministers. But there is still much to be done, especially by the EU Commission. Otherwise the EU will not be able to meet the challenge to overcome the current crisis in the dairy sector and also prevent future crises.

[1] Thus the proposal for a voluntary restraint on supply originates from the EU Parliament.

[2] The European Court of Auditors was warning back in 2009 that the deregulation of the sector should not be allowed to result in a new surplus production. European Court of Auditors (2009). "Have the management instruments applied to the market in milk and milk products achieved their main objectives?" Special Report No 14, page 9. http://www.eca.europa.eu/Lists/ECADocuments/SR09_14/SR09_14_DE.PDF (Download 6.10.2015)

[3] In its opinion "The future of the dairy industry", the Committee of the Regions: "notes that the Market Responsibility Programme put forward by the European Milk Board (to be applied when the milk market is threatened by imbalance) is a cheap and flexible proposal that should be examined and assessed as to its feasibility and effectiveness by taking 2014 as the test year;" Opinion of the European Committee of the Regions (2015). "The future of the dairy industry", (2015/C 195/03), page 20.http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015IR0642&from=DE (Download 5.10. 2015)

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