The European milk crisis

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The European agricultural sector is in turmoil. In the summer 2015 milk and meat (pork and beef) producers, in particular, protested in many European countries. Many rallies took place, with the protests culminating in a massive recent demonstration in Brussels on 7 September 2015. The protesters were particularly complaining about how the downward trend in producers' prices was seriously affecting milk farmers. This downward trend came after a period in which remuneration at the farm gate had been considered to be at good levels. However, the protesters claim that the current lowering trend cannot be explained by the normal cycles of agricultural production and the standard fluctuation in prices in agricultural markets.

According to the European Commission's Milk Market Observatory, prices diminished roughly 25% between 2014 and 2015, falling from an EU average of 40 euro cents per litre to 30 or less. This is the kind of price volatility that can make farms go out of business. It should be taken into account that, in the EU agricultural sector, milk production is a common denominator in all countries but wide differences exist between countries. Milk is produced in every EU country and it is the main source of revenue for more than 700,000 farms spread all over the EU. Taken as a single product, it accounts for approximately 15% of all agricultural output in terms of value.

The structure of the supply chain is similar all over the EU, but with some remarkable exceptions. Usually, dairy farmers sell their milk to dairy processors, then it enters the food chain. In some cases, however, dairy farmers market their milk directly to retailers, as happens in the UK. Despite the single European market, however, many different production conditions coexist. This means that in the EU, dairy farms can be profitable at different price levels, depending on the country - sometimes depending on the region - and on the margins, i.e. the difference between revenues and costs.

As Professor Alan Matthews from Trinity College in Dublin points out, "*As there are great differences in costs of milk production across the EU, it hardly makes sense to talk about 'a' cost to produce a litre of milk. Also, low prices and low margins this year follow a year of record high prices and margins in 2014. It is clear, nonetheless, that many dairy farmers are now producing below the costs of production. This volatility is a challenge for the dairy industry, which so far it has been slow to address*".[1] According to the Dairy Farmers' Report 2013 of the European Commission, the 2008-2012 period was characterised by "wide variations in milk producers' margins from one year to the next", with volatility observed "from one quarter to another within the same year".

The extreme volatility of prices took centre stage in EU agricultural policies in 2008/09 because of a harsh crisis in the milk sector at that time. The memory of that event still seems to be fresh in the minds of EU legislators today. That experience and the social and economic relevance of milk production all over the EU are sufficient to trigger anxiety whenever a perturbation appears in the milk market.

The perception in Brussels, however, is that the current situation is better than it was in 2009. At that time, after a price spike in 2007 (alongside high food prices in general), the drops in prices were dramatic: milk delivered to the dairy went down from 30-40 euro cents per litre to an EU average of 24 euro cents per litre, "*with prices for many producers at 20-21 c/l or less*".[2] This was a sort of revelation, that global price volatility in agricultural markets could hit European farms so hard and that the old generation policy tools, such as the quota regime, could not provide any real relief. As a structural phenomenon in commodities market, the volatility in agricultural markets reduced following the three food price spikes of 2008-2012. Yet, it still affected European farmers' revenue.

What are the causes of the current situation? The milk quota scheme, in force for roughly 30 years in the EU, expired March 2015. Over the past year since the scheme expired, the expectations from the ending of production ceilings has been driving competition among European milk and dairy suppliers, leading them to invest and to increase production in order to seize the opportunity of exploiting current good growth prospects due to the increased global dairy demand in the medium- and long-term. In fact, all the international analysts agree almost on the same outlook, e.g. FAO, USDA, OECD and the Agricultural Policy and Economics Analysis and Perspectives Unit of the European Commission also share the view that the demand for dairy products is destined to increase around 2% per annum until at least 2023.

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[1] Matthews A., Is the producer price of milk too low? http://capreform.eu/is-the-producer-price-of-milk-too-low/

[2] European Commission Communication to the Council, Dairy Market Situation 2009, Brussels 22.07.2009

European milk farmers are aware of this outlook and in the last year of the quota regime increased production (+0.8%), as did competitors in the US (+1.6% in production), New Zealand (+0.9%) and Australia (+2.5%). Various factors, however, are preventing European farmers' investments reaching their potential and instead are causing cash-flow problems. Addressing the European ministers of agriculture, the Commission Vice-president Jyrki Katainen listed the causes of the current market crisis as follows: "*The continuing impact of the Russian ban, not only for those Member States exposed to that market, but for all Member States; weakening demand in a number of key markets, notably China, and others where purchasing power has been hit, for example, by falling oil prices; a global oversupply of milk, with increased production recorded in all the major producing regions (Europe, the US, New Zealand and Australia)*".[3]

The farmers' demonstrations

After local demonstrations in France, Spain, UK, Belgium, Luxembourg, Ireland and Poland, farmers from all over the EU gathered in Brussels on 7 September 2015 in order to protest against market situation in different sectors. The Brussels rally was preceded by a sort of test by French farmers and their leaders, who called for a big demonstration in Paris on 3 September 2015. A few days later, attention shifted to Brussels, where over 5,000 farmers and 1,500 tractors blocked the roads of the European quarter of the Belgian capital, with two different marches. The first one was organised by the European Milk Board, and occupied the Rond Point Schumann – in front of the buildings of the European Commission and European Council – and confronted the police demanding the return of the milk quota regime, even in the form of a temporary mechanism to be activated only in the case of a crisis.

Copa-Cogeca, which accounts for the biggest farmers' organisations and agri-cooperatives across Europe, promoted the second demonstration. Representatives of many sectors took part in the march. Milk farmers, pork and cattle breeders and fruit and vegetable producers were in the front line. Copa-Cogeca tabled an articulate set of proposals calling for measures to ensure a fair remuneration to farmers for their daily work.

For European farmers, the critical situation in the milk market acted as a catalyst to express concerns about a more general distress, related to the increasing uncertainty of agricultural markets since 2008. The fact is that, in the globalised world, the risk factors in investing in food production have multiplied and diversified and are no longer just economic, but political as well.

From the point of view of the market, farmers suffer more and more the squeezing of their revenue margins due to the weak bargaining power of a fragmented sector facing a high level of concentration in the industry and retail sector.

[3] Speech by Vice-president Jyrki Katainen at the Extraordinary Agriculture and Fisheries Council 7.09.2015

In terms of the "non-market" factors, two examples in particular are worth mentioning. When, in 2014, Russia implemented its ban on agricultural imports from the EU in retaliation to the EU and its allies imposing sanctions on Moscow, European agri-food companies lost one of its main customers overnight. The embargo is still ongoing and it is completely motivated by politics, not economic concerns.

A second relates to an incident in 2011, when an outbreak of a deadly strain of *Escherichia coli* spread in the Hamburg region of Germany. On that occasion, inaccurate information about the origin of the outbreak led to a collapse in demand for fruit and vegetable products and a subsequent drop in prices to producers. While the farmers rallied, the EU ministers of agriculture met in the European Council building to listen to the proposals of the European Commission to address the crisis.

The Commission aid package

On 15 September 2015, the EU ministers of agriculture backed the extraordinary aid package tabled by the Commission on 7 September 2015. This package is worth 500 million euros, where the bulk of the sum, 420 million euros, is to be distributed among the 28 Member States to support the livestock sector. As a derogation of the EU rules, Member States are also allowed to add funds up to 100% of the national envelope. As the milk sector is the most affected, the distribution key of the financial resources follows the level of production in different countries, taking the national 2014/15 milk quotas as the reference point. The Commission rejected the requests from the Parliament and from many governments of the block to increase the "price of intervention" for milk, i.e. the price threshold under which the Commission is obliged to intervene.

The executive arm of the EU highlighted three goals of the plan: (1) to address the cash-flow difficulties, (2) to stabilise the markets and (3) to address the functioning of the supply chain. Besides the funds given to national authorities and the reference to a number of Common Agricultural Policy tools already available, the plan provides:

- Possibility for governments to anticipate the terms to pay "direct payments" (the direct aid that Brussels provides for farmers) and funds under certain programmes of rural development. A similar measure was utilised in the 2009 crisis.

- Extension and enhancement of the so-called safety net measures: Private Storage Aid (PSA) for butter and skimmed milk powder; new PSA schemes for cheeses and pig meat.

- Increase of the 2016 funding on promotion programmes.

- Strengthening the transparency in the milk market through new features for the European Commission Milk Market Observatory.

- Anticipation to 2016 of the publication of the report on the 2012 "milk package", initially expected for late 2018, "*in order to consider its possible prolongation and improvement, including the extension of its provisions to other sectors*".[4]

- Launch of a new "High Level Group" to focus on the functioning of the food supply chain, addressing also the unfair trade practices issue. A similar forum existed for almost five years (2010-2014) in the Barroso II Commission – although, then the parts of the chain represented in the group did not reach a shared view on significant matters such as the enforcement of measures to contrast unfair trade practices.

It is too early to draw conclusion on the effectiveness of the plan. It should be noted, however, that the new characteristics of the recurrent crisis affecting the EU agricultural sector might be worth a specific analysis and policy responses to address the structure of global agricultural markets as has been shaped over the last 15 years.

Focus: the strange case of "cheese without milk"

In the turmoil of the milk sector, the Italian government engaged in a discussion about a very specific topic with the European Commission. Following a complaint by an Italian dairy industry company, the executive arm of the EU invited Rome to repeal a 1974 law that still prevents the use of condensed and powdered milk in any dairy products, although it allows their use in other categories of food products, such as in pastries and ice-creams. In the view of the Commission, this disposition is stricter than the European law and discriminates Italian dairy firms in comparison with their EU competitors that can make use of dehydrated milk. The request sparked controversy between Rome and Brussels and the story has garnered remarkable coverage in the mainstream media, not only in Italy.

This is due mainly to the effective frame setting conceived from the communication office of the biggest Italian farmers' organisation, Coldiretti. Providing a "sexy" angle on the story, Coldiretti described the European Commission initiative as an attempt to impose on Italy the production of "cheese without milk", as milk powder was not milk. This framing, together with the fame of Italian quality cheeses in northern-European markets, such as in the UK and Germany, made the news appealing for British and German media. Some examples of the headlines are the following: "Brussels is whey out of order – say cheese makers" (The Times), "Italy: EU request for powder milk in mozzarella is attack on cultural heritage" (Daily Telegraph), "Brussels cheese ruling grates with Italians" (Financial Times).

This frame setting, however, does not mention that the famous Italian PDO, PGI and TSG cheeses – from Parmigiano to Mozzarella, accounting for more than 50% of the Italian milk production – are not included in the Commission remarks. The cultural heritage of their recipe is safe. Besides, Italian authorities are right when they show that the 1974 law does not disrupt the single market and does not prevent the circulation of milk powder in the national territory. Italy, in fact, is the fourth largest European importer of milk powder in terms of quantity, and is the third when it comes to skimmed milk powder. But, in the view of the Commission, this is not the point.

The Commission is not obliging anybody to make cheese without fresh milk, but is asking for the repeal of a norm preventing producers in Italy making use of a quite common industrial practice. From a technical point of view, moreover, using milk powder to make cheeses – even the standard cheese currently available in the European market – is not an ideal solution. As the website *Il Fatto Alimentare* points out, replacing fresh milk with powdered milk to produce cheese could lead to a curd failure and to a final product that is disappointing, both from an aesthetic and taste point of view. In other terms, it could be commercial suicide for a dairy producer.

In industrial yogurt production, instead, the use of a small portion of dehydrated milk is quite common because it gives more consistency and density to the cream. Foreign origin yogurt brands that are very much appreciated in Italy use 2-4% milk powder, while Italian yogurt producers cannot use this ingredient due to the 1974 law.[5] As a matter of fact, the first one to raise the question on an institutional side was an Italian Member of the European Parliament, Oreste Rossi. In a written question to the Commission on 17 January 2013, the former MEP underlined the "*enormous economic and competitive damage*" to "*Italian yogurt-producing companies (for whom concentrated milk is an essential ingredient)*" resulting from the Italian 1974 law.[6]

The "cheese without milk" story is misleading, albeit nonetheless appealing for the broadcast media. It conceals the long-standing harsh polarisation existing between farmers and the dairy industry in the Italian food supply chain. Farmers fret about the higher pressure that dairy industry could apply on prices to producers as a consequence of the repealing of the 1974 law. The *Informatore Agrario*, the most influential Italian farmers' magazine that started publications in 1945, puts it this way: "*Beyond the issue of product quality and consumer protection, we must consider that if Italy complies with the demands of Brussels, industry will gain contractual power even more than now*". This would mean "*making another large portion of our farms go out of business*".[7]

[4] European Commission – Fact Sheet, Annex "Comprehensive package of measures" http://europa.eu/rapid/press-release_MEMO-15-5601_en.htm

[5] http://www.ilfattoalimentare.it/formaggio-senza-latte-commissione-europea.html

[6] http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+WQ+E-2013-000494+0+DOC+XML+V0//EN

[7] L'Informatore Agrario 27/2015

The issue of the ongoing conflict among different parties in the food supply chain, in some EU regions resulting in unfair trade practices, is a reason of concern in the EU. The Commission believes that this kind of friction weakens the efficiency of the system and reduces the competitiveness of European agricultural and food production as a whole and states: "*A better functioning food supply chain is crucial for consumers and for ensuring a sustainable distribution of value added along the chain, thus contributing towards raising its overall competitiveness*".[8]

[8] A better functioning of food supply chain in Europe, Communication from the European Commission 2009.