Challenges and possibilities for the dairy sector in the EU

A new context after the removal of the quotas system

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A short history (1)

- In 1962, the CAP was settled with simple principles : high domestic prices guaranteed by European authorities on the main agricultural commodities and an external protection by tariffs
- This led, in the dairy sector, in a continuous growth of dairy production, bigger than the market could absorb. The EU had to buy any quantity of butter and milk powder proposed by European dairies
- The cost of this policy was growing every year and represented 20% of the overall CAP budget
- In the beginning of the 80's, the EU stocks of butter reached the incredible level of 1 MT
- It was not politically acceptable to maintain such a policy

A short history (2)

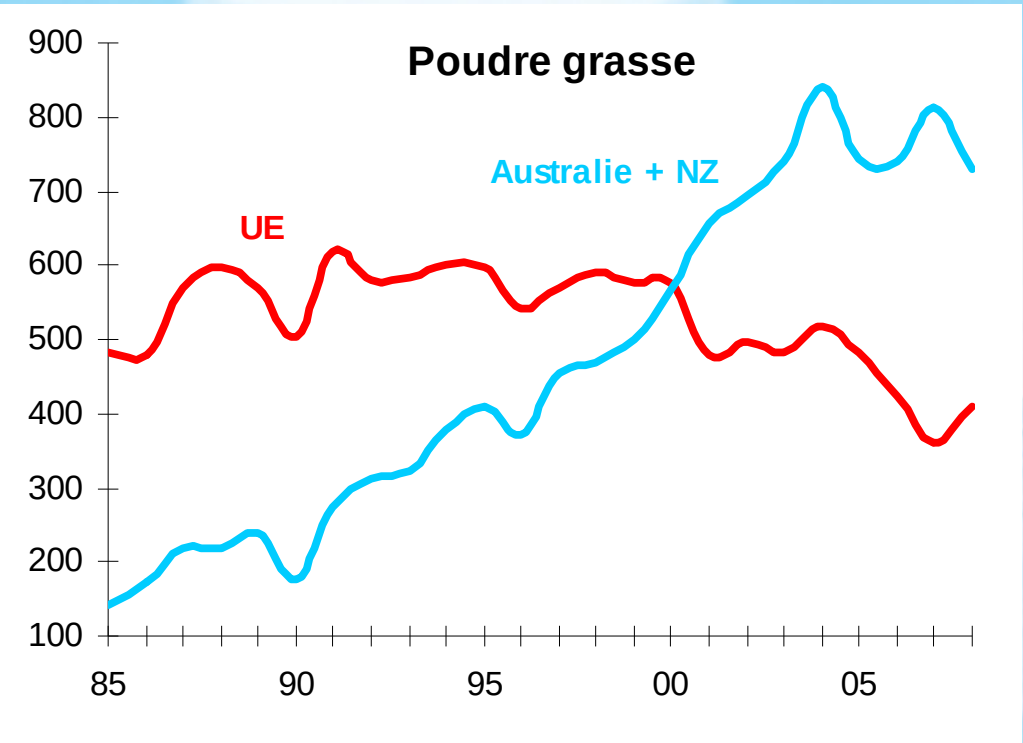
- **In 1984, the EU Council of agriculture had a simple choice :**
  - Either decrease the EU price by 20%
  - Or limit the production
- **They obviously chose the second solution, and put in place the quota system**
- **Every member state had a “reference quantity” of milk, not to be surpassed, with very high penalties if overproduction**
- **The system was successful, and after 3 years, the stocks began to decrease, the EU market was more or less cleared (thanks also to Russia which bought huge quantities of butter to Europe at discounted prices)**
- **The dairy expenses began to decrease at the same time**

The quota system

- **In a first step :**
- **The farmers are happy with stable milk prices and value of the quota : better access to funding from the banks, and increased value of the farm (high value for quotas in some countries, e.g. Nederland)**
- **The dairies are happy because the continuation of the support measures and subsidies give them good opportunities of profit, without having too many commercial costs : the intervention systems were very comfortable for many companies, especially coops in France and Germany**
- **The politicians, particularly in France, are very happy with that system which protects the small farmers and maintains milk production in fragile zones (Mountains, less favoured zones)**

The quotas and the world market

- With the quotas, except for the quantities, the CAP model was not fundamentally changed : high prices and tariffs were maintained
- The EU dairy sector was less competitive on a growing world market, and EU left the room to the pacific area, mainly New Zealand



The challenges for CAP

- **From the beginning of the 90s, the situation is changing :**
  - The world market shows new opportunities while the domestic market is dynamic
  - The CAP is more and more attacked internally for its cost and externally from many countries for the market distortion due to export subsidies and tariffs
  - The cost of export subsidies is very high and the growth of dairy markets justifies less and less this support
  - The globalization of economy pushes to new approach of agricultural policy, more opened to trade between different zones
  - **This leads to the Marrakech agreement in 1993, where the EU accepts to lower its protections to agriculture and open its agricultural markets**

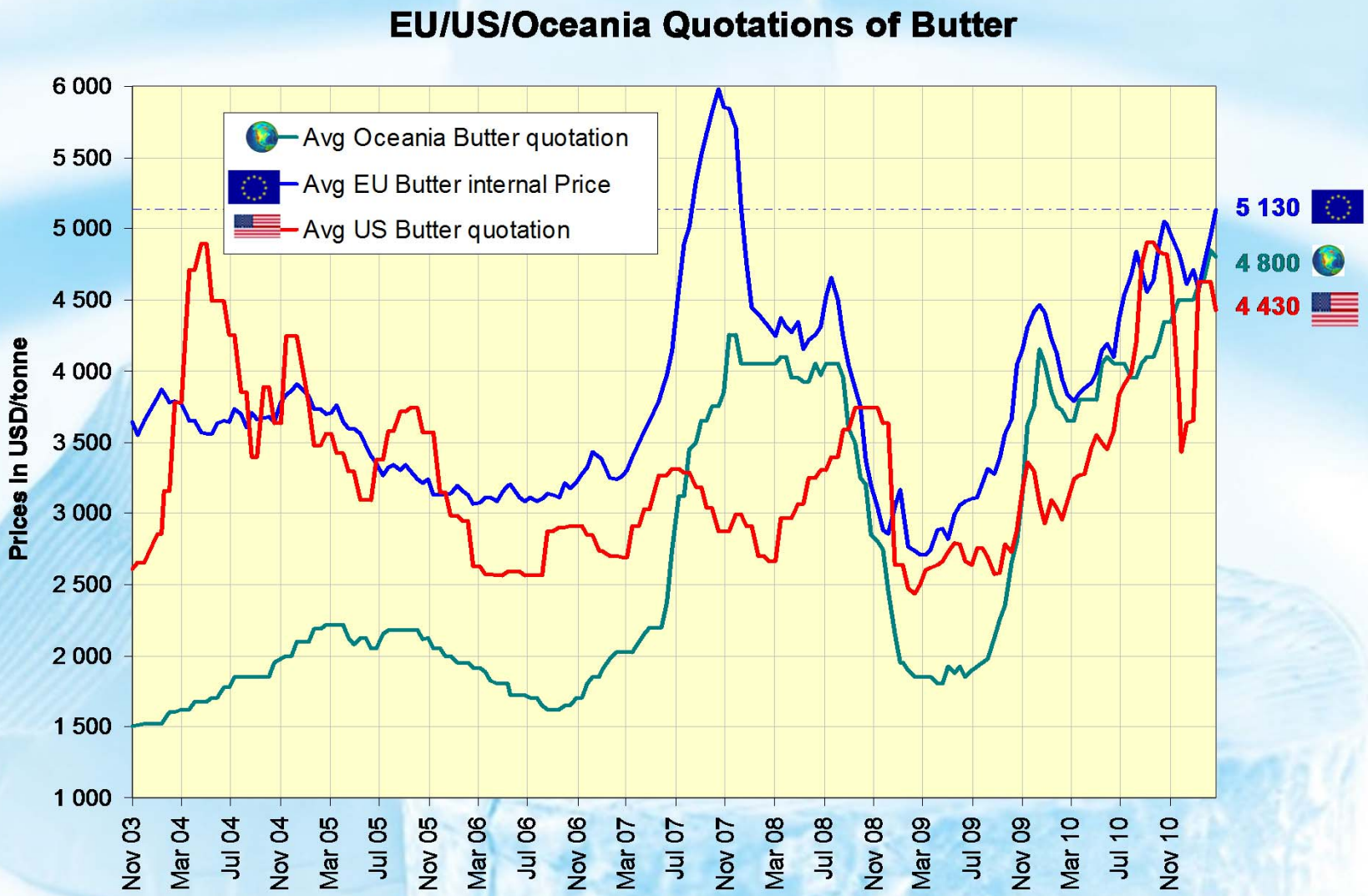
The incentives to changes from the 90s

- **During the 90s, and beginning of 2000s, more and more operators within EU begin to question the quota system for different reasons :**
  - The most dynamic farmers see the system as an obstacle to develop their farm and made it competitive in front of the stakes of globalization. They had to buy quotas instead of modernizing their farms.
  - The liberal approach is more and more dominant in EU dairy stakeholders, (Northern Europe). More and more countries consider that administration must no more manage the markets
  - The emergence of larger companies is the result of WTO agreements. They need a big size to face the stakes of globalization in a more opened dairy world.
  - These dynamic companies, more and more present on the fast growing world market, are desirous to profit from these opportunities and reinforce their worldwide presence : they less and less accept the quotas constraints
  - On the other hand, some countries like France and, generally speaking, countries with small average farm size, want to maintain the system, with an economic control of the dairy sector. They are very reluctant to a change which could lead to a desertification of some mountain zones, which is for them an essential concern

The 2003 reform

- **All these evolutions lead to fundamental changes in the CAP**
- **After the first step in 1992 in cereals, the EU puts in place in 2003 a big reform in the agricultural sector**
- **The liberalization is generalized : lower intervention prices, compensated by direct subsidies to farmers.**
- **This reform is the consequence of the WTO agreements, and answers to many internal critics on the cost of CAP**
- **In the dairy sector intervention prices are lowered by around 20%**
- **This reform gives arguments to the Northern Europe to phase out from the quotas : they need more flexibility to address the challenges of the future, with dairy prices closer to the world market prices**
- **As there is no consensus, the EU decides to wait until 2008 for a final decision on milk quotas**

EU prices aligned on world prices



The new challenges after the 2003 reform

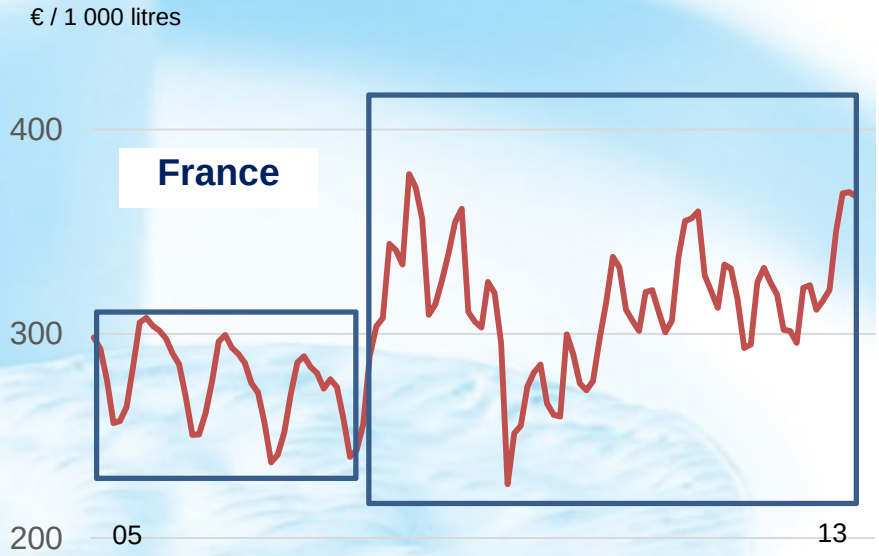
- Many changes have occurred in the CAP : less support means that the European prices may be more competitive on the world market
- At the same time, the world market is growing fast
- But this world market is very volatile due to its small size.
- And the domestic market in EU is less dynamic : Growth comes now from outside
- In front of these opportunities, the quota system is an obstacle when the companies need to develop outside Europe and have unsufficient possibilities for growth.
- Farmers need to increase the size of their farms to cope with the volatility in a less protected EU

The 2009 crisis

- The 2003 reform is well accepted by the farmers and companies, and the prices are favourable in a period where the economic growth is strong.
- After a bright period 2005 – 2007, when the world prices are very high, the crisis occurs at the end of 2008, and world prices drop very fast. The EU commission reacts fast and avoids a collapse, but many farmers suffer a lot during this period.
- This provokes many questions on the new CAP and the 2003 reform : the quotas were comfortable for (small) farmers. Some countries (France, Poland, Spain…) are asking for a delay in the phasing out
- The debate is strong, but the decision is maintained : the quotas will be suppressed on the 1st of April 2015
- Happily, the market is much better from 2011, and the situation is favourable until the end of 2014 due to a strong growth in demand, particularly in China

The price volatility for farmers has increased

Big differences between 2 EU countries !!!



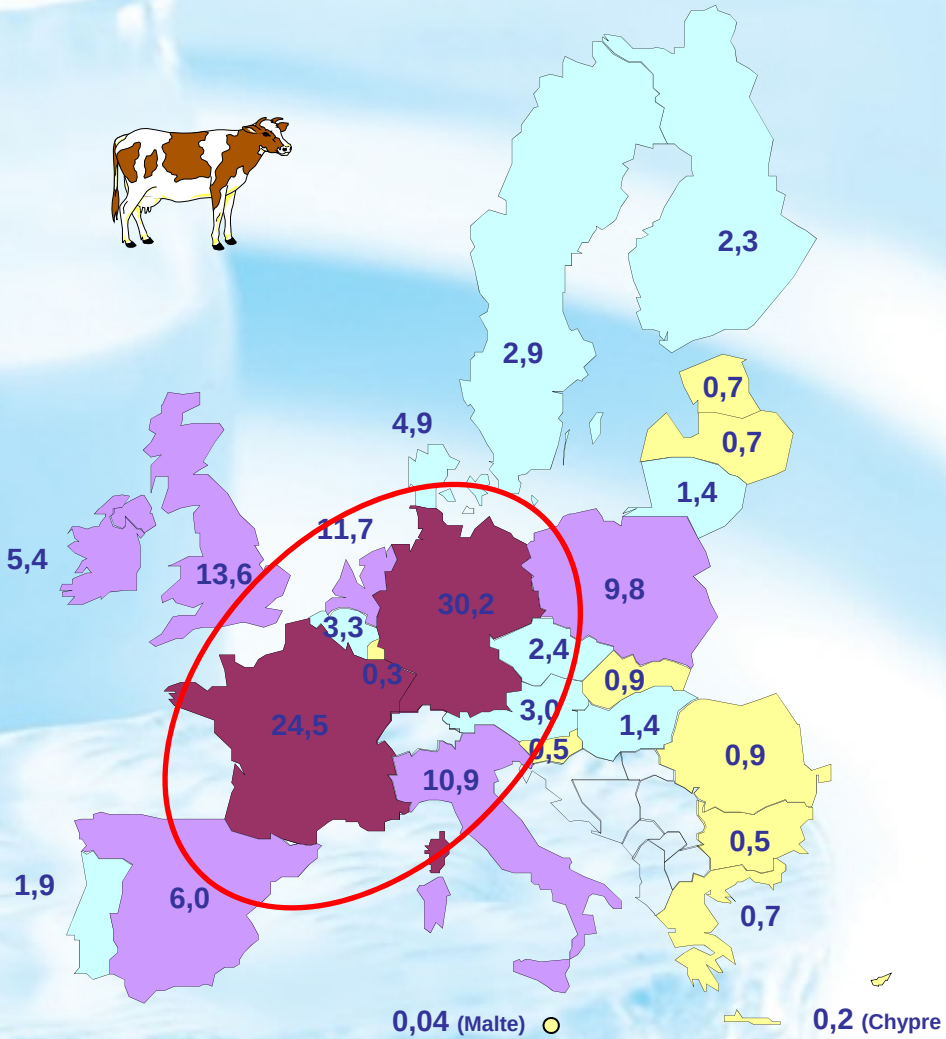
At the eve of the end, where are we ?

Some figures to understand the situation

UE: La collecte de lait de vache

Milk production in EU

Year 2013
Total UE-27 : 140,7 MT
25% of the world production
(India 135MT)



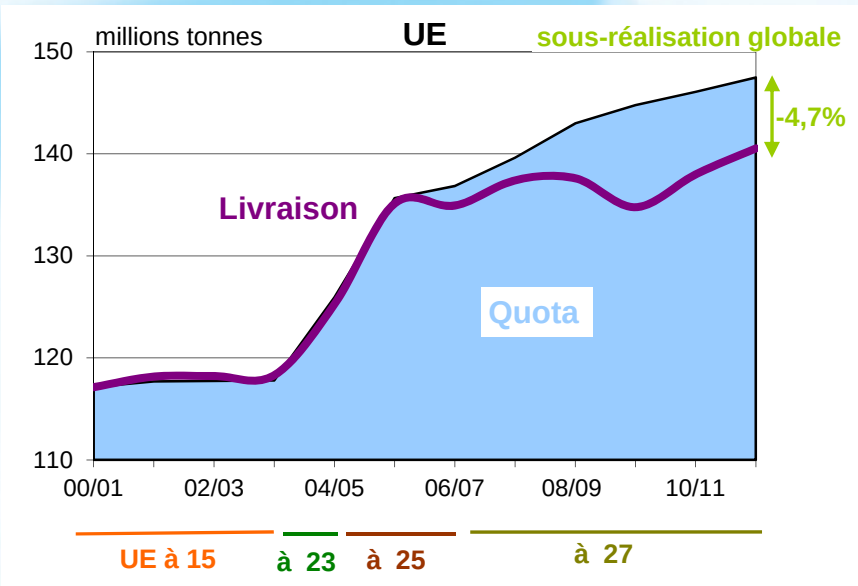
> 15 million tons
5 -15
1 -5
< 1

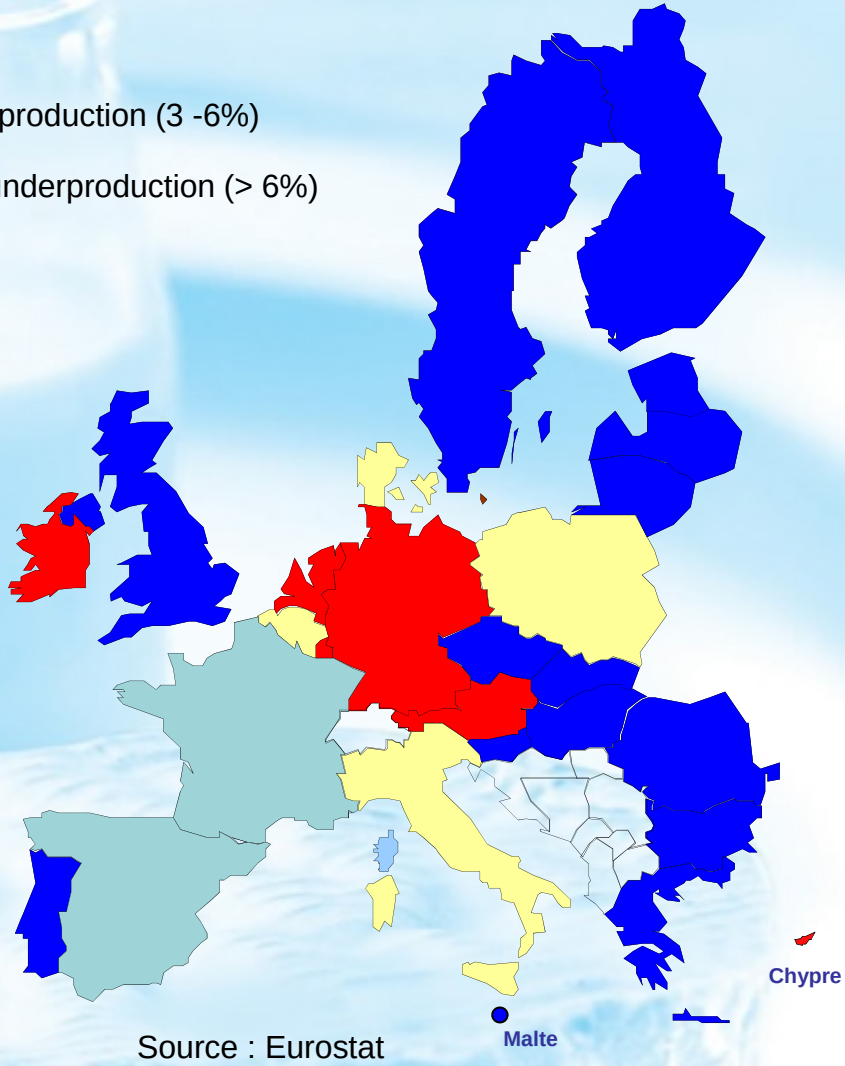
Source : Cniel / Eurostat, ZMB

Situation of production vs quotas

- Overquota
- Low underproduction (< 3%)
- High underproduction (3 -6%)
- Very High underproduction (> 6%)

Global evolution⇩

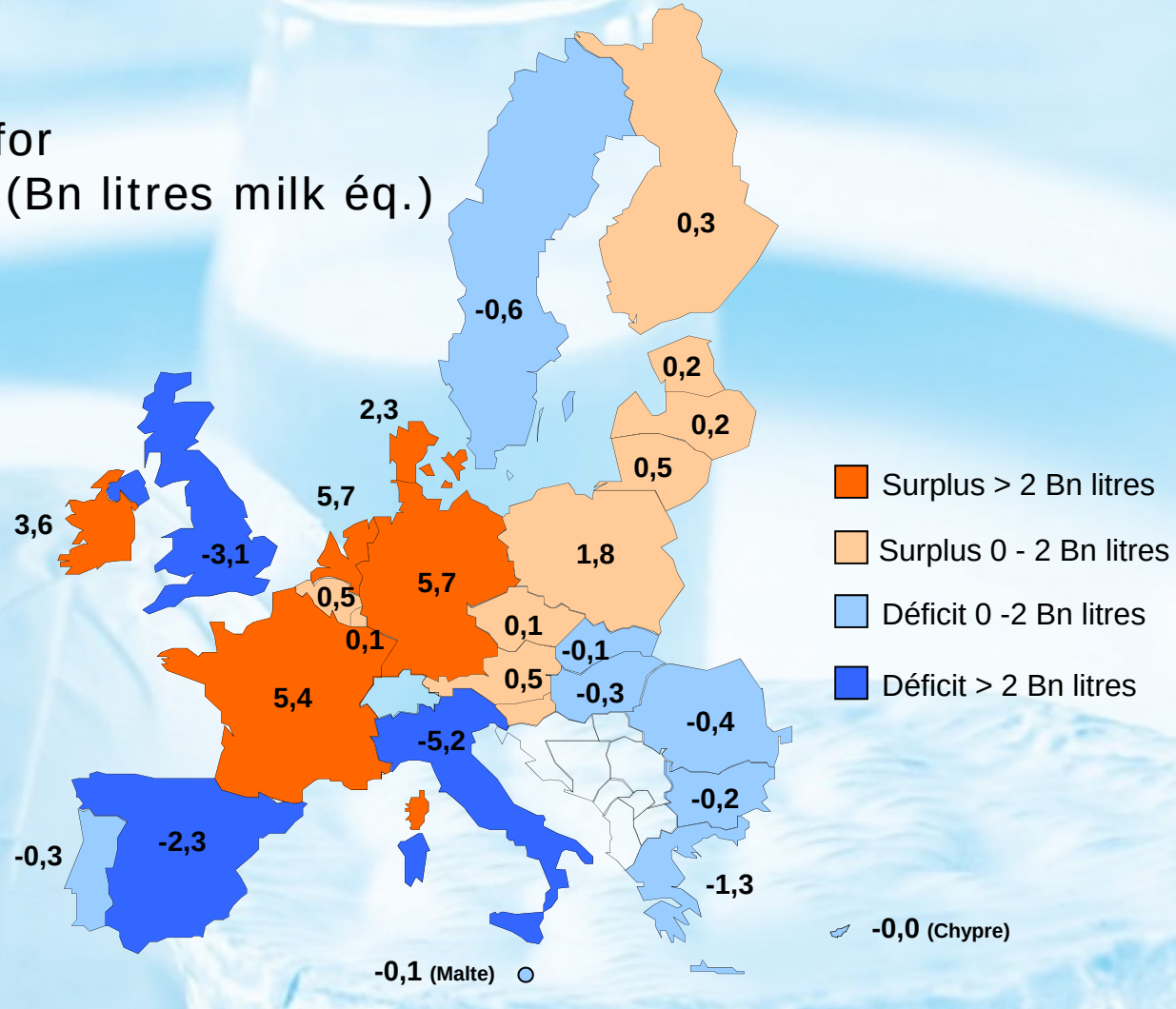




Source : Eurostat

Big differences in trade balances

Trade balance for
dairy products (Bn litres milk éq.)

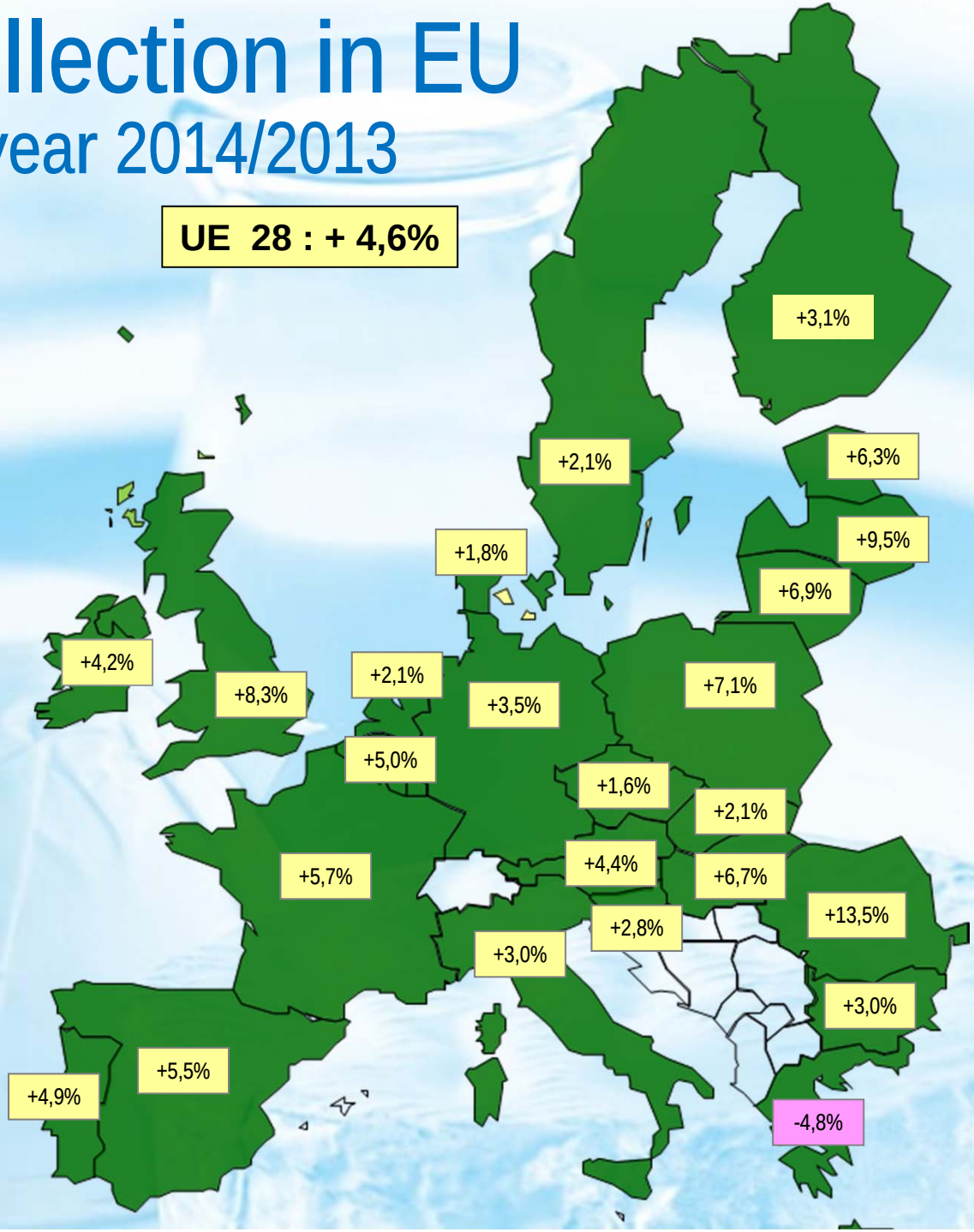


Source : Eurostat – Année 2011

Milk Collection in EU

Full year 2014/2013

UE 28 : + 4,6%



The world market

Buyers

Country	Skim M P	Whole M P	Butter	Cheeses
China	252	670	80	65
Russia	77		126	288
USA				165
Mexico	181			88
Japan				231
Venezuela		200 (?)		

Sellers

EU and NZ : > 50% of world trade, US 12%, Aus 7%
NZ : 65% market share in WMP
EU : 36% market share in cheeses

Volume

~ 50 MT milk eq, 7% of the world global production
30% growth from 2010

Products

90% commodities (ingredients) with low added value

The end of EU milk quotas

- After the crisis of 2009, some countries aim to set a new system of price guarantees, if the market drops again to low levels.
- This proposal has no success, although strongly supported by many MEPs. The “milk package” is adopted at the end of 2011, and does not change the fundamentals of the new CAP. It only gives to farmers the possibility to group in PO, Producer’s Organisations, striving to settle this way some power to the producers.
- But the co-ops of Northern Europe (DE, NL, DK, SW) say they are not concerned because they are the expression of producer’s voice. There is one more time an opposition between Northern and Southern Europe.
- After 2010 every stakeholder in the dairy sector is convinced that the quota will disappear anyway (Except some Unions in France!)
- The main issue for all is :**How to prepare this exit ?**

How to prepare the exit ?

- The quota were comfortable, but limiting the capacity of growth on a volatile market
- The quota rent, important in some countries, has limited the possibility of a fast exit
- The countries of Southern Europe are afraid of a strong competition between EU countries with the risk of a new 2009 crisis and the disappearance of many small producers (and the political problems linked to that!)
- On the contrary, the main producers of Northern Europe, see the exit as a fantastic opportunity to develop their production and capture a better share of the world market

The farmer’s side

- **Some certainties :**
  - The market will be more and more volatile and subject to political decisions, i.e. Russian ban
  - Anyway, the farm size will be a important aspect : Germans consider that the current optimal size is around 120 cows, Irish 90 cows
  - Managing the cost of production will be clearly the discriminating factor amongst the farmers
  - There will be no more intervention from the European Commission to manage the markets, except for a safety net.
  - The growth of world market is a fantastic opportunity, and the EU products have a very good reputation of quality and security in China
  - NZ, the main EU competitor, will find limits in its growth and price competitiveness
- **Some Uncertainties**
  - The growth of production may lead to a new crisis, worse than in 2009, due to the surplus on a straight market
  - The environmental constraints may limit the cost effectiveness
  - The consumers are more and more sensitive against “industrial” farming

Which forecast for EU production ?

- **Main assumptions for main countries within 5 yrs**
  - Germany : development in the North with big farms
    +15% around 2 - 3 Bn litres
  - Ireland : a goal of 50% increase, but reasonably
    +25% means 2 Bn litres
  - Denmark : particular situation (high debts for farmers)
    +15% means 0,8 Bn litres
  - Nederland : High potential but environmental constraints
    +15% means 1,5 Bn litres
  - France : Political constraints and limiting companies policy
    +15% means 1,5 Bn litres
  - Poland : High potential, but financial and technical limits
    +10% means 1 Bn litres
  - UK : Limited growth with high price sensitivity
    +5% means 0,5 Bn Litres

And the others ?

- The other European countries will produce a bit more, but not significantly in terms of potential destabilization of the market.
- All these increases will take place in limited geographic areas, along the seashore. These zones have very favourable conditions for the dairy production, particularly in terms of water supply, which will be the essential key for dairy in the future.
- If we make a sum of all these forecast, we have a global increase of around :
- **10 MT in 2020,** which means a percentage of **8%**

A new situation

- **The dairy sector is facing now an brand new situation :**
  - No more support from intervention systems
  - A liberalized market with a potential volatility
  - A real risk af a new crisis without the same protection and market organisation
  - An uncertainty on the real growth capacity of the milk collection in Europe

Let’s try to see how companies and farmers can cope with that

The company's side

- The companies have a very different approach
- The Northern ones push the development of production (pushed by their farmers – owners) and favour the growth, sure of their development and market opportunities in ingredients
- The Southern ones prefer have contracts limiting the potential volume for their farmers (private), or putting in place a two-tier price policy (co-ops) depending on the final use of the milk
- All the companies are confident in the development of the market potential, but act differently in terms of profitability.

Why this opposition between North and South Europe ?

- **Not only a political issue, but a structural one :**
  - The dairy industry has different characteristics according to the zone
  - The northern zone is dominated by big co-ops, with a quasi-monopoly in some countries (95% DK, 65% SW, 90% SF, 80% NL, 80% IE,70% North Germany) (You know that in Norway!)
  - The Southern Europe has many powerful private companies (many of them French) : Lactalis, Bongrain, Danone, Muller, Pascual
- **These differences induce different choices in terms of production growth options.**

Growth strategies for companies (and farmers!)

- **The private way :**
  - No obligation (milk package in EU, US system) to buy all the milk from producers
  - Build on the leading brands and reduce the proportion of ingredients in the mix
- **The Co-op way :**
  - Follow the demand from producers to increase the production
  - Reinforce the proportion of ingredients in the mix
  - Profit from the development of the dairy market worldwide
- **Private rather focused on brands,**
- **Co-ops rather pushed by milk flow**
-

And on the demand side ?

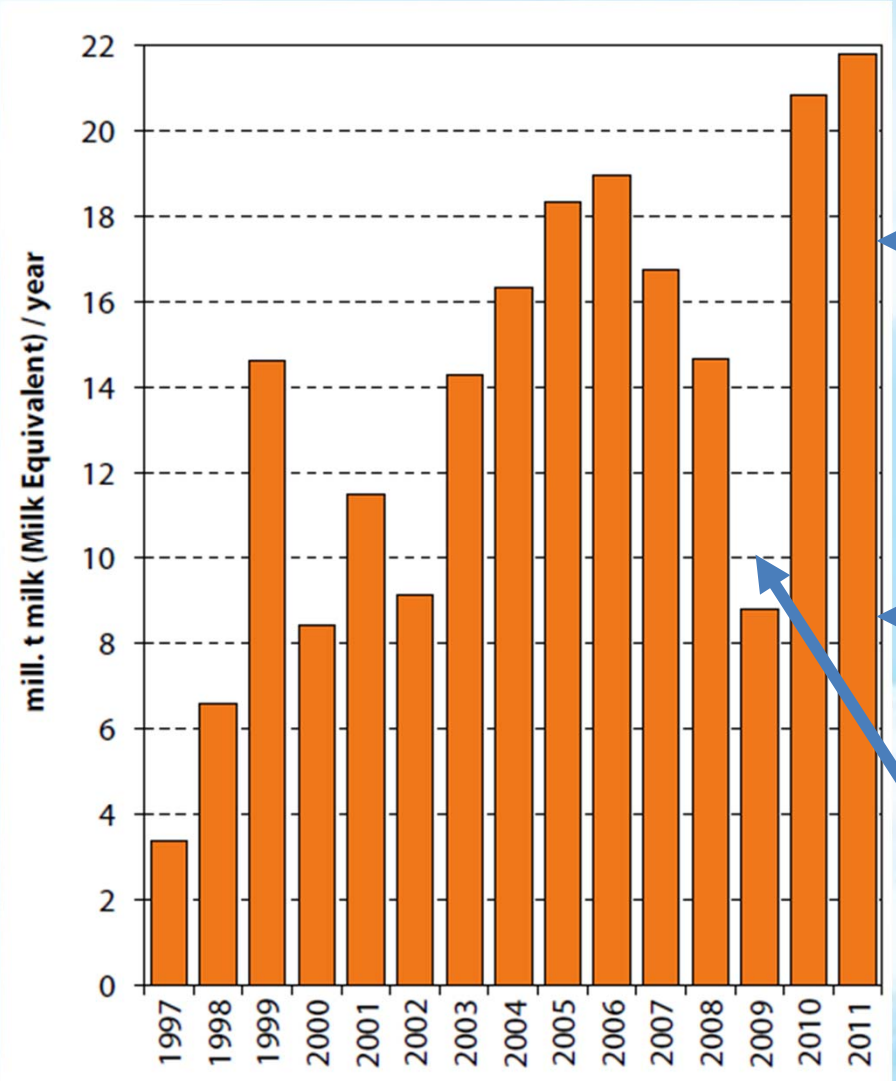
- In global terms, in a long term perspective, the growth of consumption would be around 2% per year, showing a huge potential for the development of European dairy production, whereas the other dairy regions will have some limits: water supply, costs of production and land prices in New Zealand, water supply in the exporting zones of US, California and Idaho.
- The growth of EU milk production won't be linear, depending on the climate.
- That may change the perspectives depending on the years. Oversupply may induce a strong new crisis, (worse than 2009?)
- The Europan commission remains relatively confident with the market potential and the EU operators capacity

A balanced future ???

- (If China, Russia, Middle East go on consuming more and more dairy products),
- seems likely…and hopefully !

We need per year 20 mill t more milk

World milk demand growth 1996 – 2011



12 MT via more per capita consumption

8 MT via more people on earth

But… big variations in demand on a straight market

Source :IFCN

Main consumption trends

Product	EU	US	Others
Liquid milk	– –	– –	++
Yoghurts	– –	=	++
Cheeses	=	+	+++

Some figures to think about

- **- 2% of liquid milk consumption in EU and US means 1,2 Bn litres**
- **Which means :**
  - 10 times the annual growth of chinese liquid milk market
  - 50% of the total imports of China in WMP
  - 65% of the total annual consumption of Indonesia
- **10% increase in consumption of cheese in China means…0,07 Bn litres**
- **2% decrease in the milk market in US is equivalent to 30% of the yoghurt market**
- **The EU – US dairy markets are key in volumes…but they are stables and any growth in volume goes to commodities**

Which global perspectives for farmers ?

- The European dairy farmers will be less and less numerous, with bigger and bigger farms (150 – 250 cows, although not the US model !)
- They will be exposed to a bigger volatility, with a crisis risk
- The price should remain in average between 30 – 40 €c except in the “big” crisis case
- The most competitive ones will survive, with reserves made in the good years (and margin guarantee insurance tools ?)
- This is limited by environmental constraints, annual variations of weather conditions and…
- Water supply !

Which global perspectives for companies ?

- An acceleration of the worldwide concentration of industry around private or cooperative poles,
- A relative disengagement of private groups on sourcing : they want to limit their supply to consumers needs, and in Europe, after the end of quotas. A big change in this industry
- In other zones like Lat Am, CIS, Africa, Asia no change with the reinforcement of local companies well settled and more and more powerful and profitable (buying ingredients to the big EU co-ops)
- The new situation :
- Co-ops mainly on sourcing and ingredients,
- Private mainly on consumer products ?
- (not so simple, but…)

New cha(lle)nges in perspective ...

Thank you for your attention