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EU Dairy Markets Still Looking for Equilibrium after Dairy Crisis

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Report Highlights:

The European Union's (EU) dairy market seems to be slowly emerging from its recent "dairy crisis," when EU farmers were faced with overproduction and the lowest commodity prices since 2009. However, most of the subsequent recovery has been due to the stabilization of global dairy prices due to decreased global and EU production rather than any EU-led interventions. The crisis has nevertheless forced MS to look for other ways to avoid a future repetition of these problems. Unfortunately, recent measures by some MS to impose mandatory labeling of milk and dairy products are meant to support farmers but are more likely to reduce producers' profit margins in the long run.

General Information:

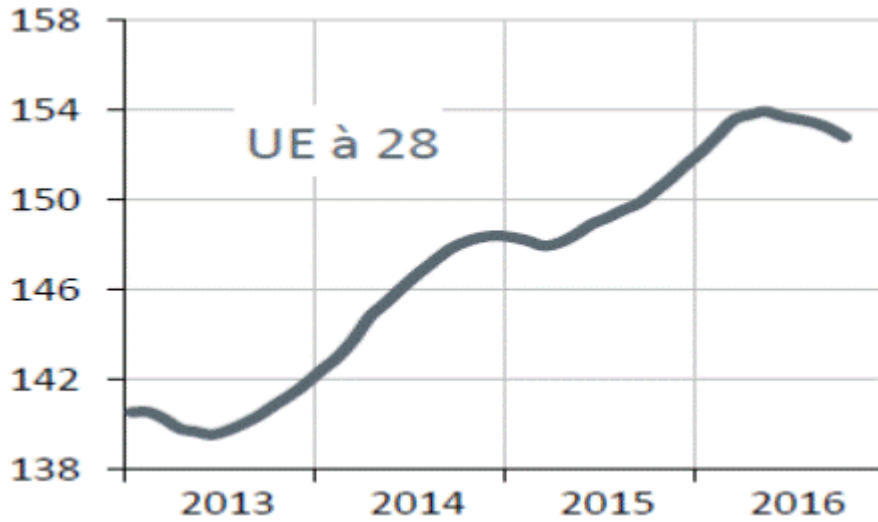
The European Union's (EU) dairy market seems to be slowly emerging from its recent "dairy crisis," when EU farmers were faced with overproduction and the lowest commodity prices since 2009. Increased EU dairy production in anticipation of the end of the EU's dairy quota system in 2015, coupled with the Russian embargo on agricultural products and decreasing world demand, resulted in a crash in dairy prices in 2015-2016 and a crisis for EU dairy farmers. In response to demands from dairy producers and Member States (MS) to support farmers and prop up prices, the EU Commission created a €150 million support voluntary dairy production reduction program and new storage schemes to stabilize prices and remove product from the market. However, most of the subsequent recovery has been due to the stabilization of global dairy prices due to decreased global and EU production rather than any EU-led interventions. The crisis has nevertheless forced MS to look for other ways to avoid a future repetition of these problems. The EU has long used Geographical Indications (GIs) and similar programs to add value to regional dairy products. Unfortunately, recent measures by some MS to impose mandatory labeling of milk and dairy products are meant to support farmers but are more likely to reduce producers' profit margins in the long run.

Origins of the EU Dairy Crisis

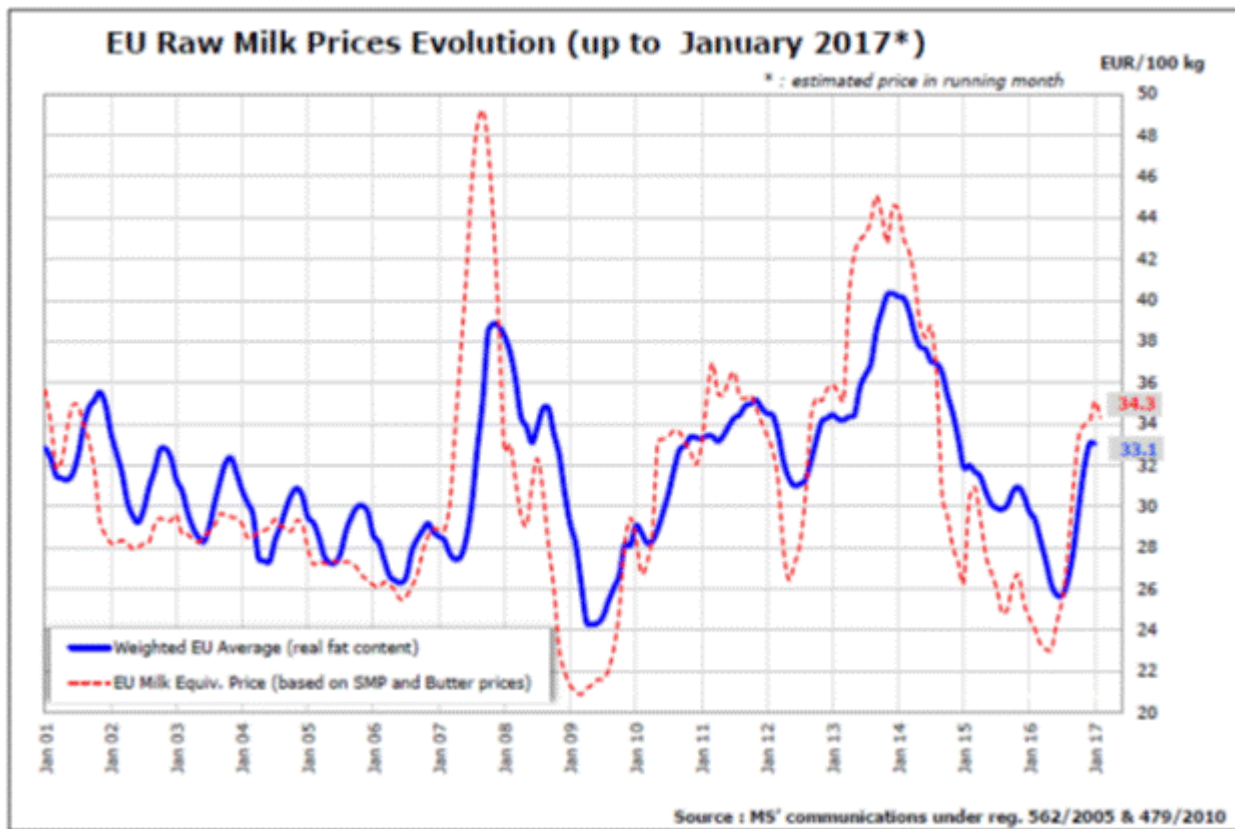
The recent EU dairy crisis was caused by a collision of economic factors and political events that worked together to cause a crash in EU commodity prices. In 2013 and 2014, global dairy commodity prices had surged to record high levels as a result of ongoing droughts in California and Australia and China at the same time that China was making record dairy purchases. As a result, EU dairy farmers invested massively in new dairy production capacity in anticipation of the end of the quota regime on April 1, 2015. By 2014, EU dairy production was already in overdrive, despite the still existing quota limitations, as farm gate prices exceeded the penalty or superlevy, for exceeding farmer's individual production quotas.

In August 2014, the Russian imports ban on EU agricultural products eliminated a major EU export market and badly affected dairy markets in Finland and the Baltic states. In 2015, when China stopped purchasing large quantities of skim milk powder, higher EU production and lower demand put a significant downward pressure on dairy commodity prices. As a result, farmers were faced with both large superlevy bills for the final quota year 2014-15 as well as the need to pay off loans for their production investments. Although the European Commission tried to soften the blow to farmers by allowing EU Member States (MS) to spread repayment of the superlevies over a three-year period, the situation actually worsened because farmers were disincentivized from cutting milk production rapidly. More background on the EU dairy crisis can be found in [GAIN E15033 "A Perfect Storm for EU Dairy Prices."](#)

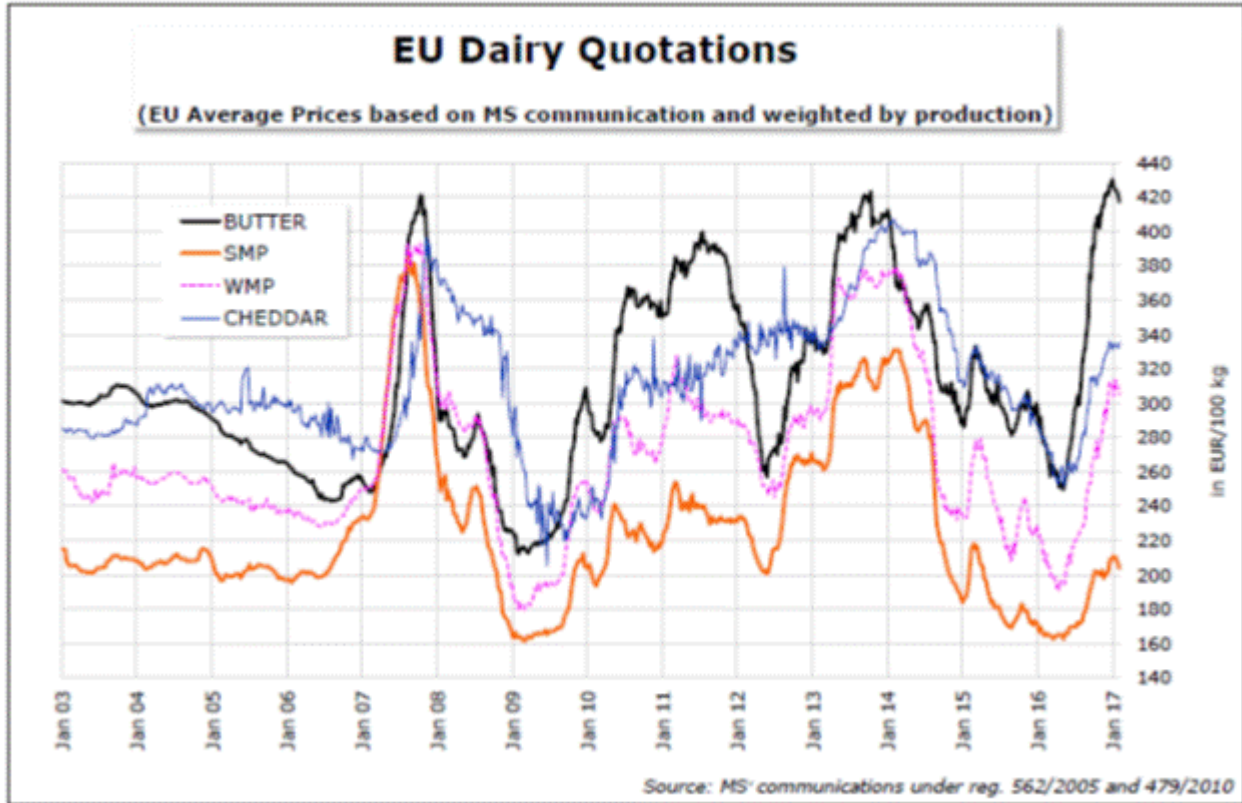
Evolution of European Dairy Production (in million MT)



Source: Centre National Interprofessionnel de l'Economie Laitière (CNIEL) - France



Source: European Commission



Source: European Commission

Measures to Fight the EU Dairy Crisis

On July 18, 2016, the European Commission presented a €500 million [Seven-Point Solidarity Package](#) for agriculture [1] for European farmers, in which €150 million was reserved for a voluntary dairy production reduction scheme and €350 million were awarded to MS. Twenty-five MS then used part of these funds to implement additional measures for the dairy sector. However, by then the majority of farmers who subscribed to this scheme had already decided to cull their dairy cows and reduce milk output.

The EU's Common Agricultural Policy (CAP) already offers tools for removing some commodities from the market to stabilize prices. The CAP allows the Commission to organize Private Storage Aid (PSA) schemes for skim milk powder (SMP), butter, and cheese and for intervention storage schemes for SMP, which can be expanded in volume and extended in time. By September 2016, the Commission had authorized SMP intervention volumes to 335,000 MT (on top of 29,000 MT from 2015), while 87,000 MT of SMP (in addition to 52,000 MT in 2015), 144,000 MT of butter and 53,000 MT of cheese were taken off the market through PSA. At the end of 2016, approximately 8,300 MT of SMP PSA and 11,800 MT of butter of PSA had been released to the market. In December 2016, the first tender for selling SMP from intervention back to the market was opened but yielded only 40 MT of

product sold. Subsequent tenders have all failed to attract interested buyers.

The Commission has also tried to use food aid as a way to use excess commodities. In March 2016, the European Commission announced a €30 million [refugee milk aid package](#). [2] The plan to use dairy supplies to feed migrants came about as tens of thousands of refugees were trapped during the winter of 2016 without food or shelter on the EU's southern borders. However, MS failed to agree on the details for such a measure to feed these migrants. Eventually, after the winter, MS agreed to use remaining money from the previous year's €500 million crisis package for a program to help needy children in Syria. The EU also sponsors a domestic dairy program called the School Milk program in MS to use intervention stocks.

EU Dairy Market Emerges from the Crisis

In 2015, the first year after the expiration of the production quota regime, the EU had a milk and [dairy self-sufficiency](#) [3] rate of over 114 percent, with a net milk equivalent surplus of almost 20 million MT. Of this, more than 10 million MT milk equivalent was exported as SMP or whole milk powder (WMP), while cheese exports accounted for another 6 million MT of milk equivalent. The remainder consisted of packaged milk, condensed milk and cream.

Throughout 2015 and 2016, EU dairy industry and farmers' associations continued to call for the EU Commission to provide support for dairy farmers struggling with low commodity prices and negative production margins. Some groups even advocated for a return to a system of production control, if not a production quota regime. These groups fear that current increase in milk prices will lead to another increase in EU milk production. There are currently still 352,600 MT of skimmed milk powder (SMP) in intervention storage still hanging over the market, with another 68,000 MT in private storage at the end of 2016. For this reason, EU prices for SMP are recovering much slower than for other commodities, despite the EU's failure to destock SMP intervention through consecutive tenders.

As a result of the dairy crisis, EU milk production in 2016 rapidly slowed down after a strong start, ending the year with an increase of 0.4 percent. Global production leveled out during the same period, contributing to an overall stabilization of dairy prices. New Zealand, Australia, and South American countries lowered their production during this period, creating a new equilibrium between global supply and demand. (NOTE: While U.S. growth slowed, the United States actually increased production by 1.9 percent during this time.) Nevertheless, many MS are still looking to increase their production in the coming years.

Adding Value to Support the EU Dairy Sector

With milk production poised to further increase and the domestic market saturated and barely growing, exports will become even more important for EU dairy farmers. Even though only a few MS are able to compete on the world market for dairy commodities, a large share of EU dairy production is still looking for strategies to create new markets and add value to their production. However, the EU cost of production for milk is high and uncompetitive compared to New Zealand or the United States. As a

result, EU dairy processors are focusing on added-value and niche-market products, both for exports and imports. The EU focuses on marketing products like infant powders or raw milk products based on its high food safety standards. Also important are efforts to market [special products](#) [4] from traditional production methods under the Traditional Specialty Guaranteed (TSG) program or products of regional origin under the Geographical Indicator (GI) program. Such products must originate from a well-defined area and are manufactured following a certified quality handbook. Many times the allowed production volume is limited in order to guarantee the quality and prevent oversupply. However, it should be noted that even though GI products receive a premium, they also have a significantly higher cost of production (lower or limited yields, costs for GI registration and certification and other direct and indirect costs related to GI production). An EU sponsored report from 2013, “[Study on Assessing the Added Value of PDO/PGI Products](#),” [5] found that GI-protected products command up to a 100 percent retail premium but farmers and producers only receive a premium between 25 and 40 percent compared to a conventional product.

Similarly, [voluntary quality schemes and optional quality terms](#) [6] are used to generate added value for local producers, like mountain production or products originating from other marginal production areas. Dairy farming is one of the few farming options in large swaths of the EU’s Least Favored Areas (LFAs) and as such can receive coupled dairy support and targeted support for rural development. Over many decades, this has resulted in a rich and varied landscape of niche productions that receive protection and add value through the EU system of GIs and TSGs. The large numbers of small producers involved, together with political sensitivities at local and MS level, have made GIs and TSGs a major focus in EU agricultural trade policy.

Country of Origin Labeling (COOL) Measures

Some European MS have recently turned to more controversial methods of supporting their dairy farmers in an effort to add value to their dairy products. Since July 2016, eight MS have put in place COOL measures that require mandatory labeling of certain agricultural products. Although some of these measures include other products or ingredients, each one requires the mandatory labeling of the national origin of milk and dairy products. France’s measure requiring labeling of milk, milk used in dairy products, and meat used as an ingredient went into force on January 1, 2017. Italy, Lithuania, Portugal, Romania, Greece, and Finland’s COOL rules mandating the labeling of milk and milk used in dairy products have all been approved by the Commission. Spain’s rule on milk and dairy products is still being written.

These measures were approved by the EU Commission despite of vehement opposition by European food and drink associations. These industry associations, along with other MS and third trading partners, are concerned that the measures undermine the EU single market and represent a de facto “renationalization” of supply chains. Opponents of the measures also argue that mandatory labeling will increase the costs of production because of the need to segregate supply chains and change packaging. These higher costs will then be passed on either to consumers in higher prices or to producers in reduced payments for their products. More detail about the COOL measures can be found

in [GAIN E17014](#).

Conclusion

The EU dairy market finally seems to be emerging from its crisis of 2015-2016, although this price stabilization is more a result of decreased EU and world production rather than a result of any actions by the EU Commission or MS. However, EU producers are still looking to the Commission and their MS governments to come up with ways to prevent a repeat of the crisis and ensure that they receive consistently positive profit margins. EU MS and producers are looking to develop export markets for their excess production and many producers take advantage of programs like Geographical Indications to add value. Unfortunately, some MS have turned to more controversial schemes like mandatory national labeling requirements for dairy products. While these measures are ostensibly meant to shore up prices and protect farmers, mandatory national labeling is more likely to eventually reduce the prices that producers receive for their goods. Ultimately, these and other efforts to support dairy prices fail to address the root problems of global overproduction and the volatility of dairy commodity prices.

[1] http://europa.eu/rapid/press-release_IP-16-2563_en.htm

[2] http://europa.eu/rapid/press-release_IP-16-1103_en.htm

[3] http://www.clal.it/en/?section=bilancio_approv_ue

[4] http://ec.europa.eu/agriculture/quality/schemes_en

[5] https://ec.europa.eu/agriculture/sites/agriculture/files/external-studies/2013/added-value-pdo-pgi/exec-sum_en.pdf

[6] http://ec.europa.eu/agriculture/quality/local-farming-direct-sales_en