

Analysis on future developments in the milk sector

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Introduction

- ▶ Purpose of the study : a prospective vision of the future of the European milk market after the removal of the quotas in 2015
- ▶ The analysis draws perspectives of the milk sector in terms of:
 - ▶ Theme 1 - Market balance and competitiveness
 - ▶ Theme 2 - Sustainable milk production including territorial dimension
- ▶ Three independent experts were selected for each theme
- ▶ EY role was to coordinate the work of experts, to consolidate their replies and to synthesize the most likely evolutions

Theme 1 / Market balance and competitiveness

Selected experts



Prof. Ludwig Theuvsen

Full professor of management in agribusiness at the Department of Agricultural Economics and Rural Development, Gottingen University, Germany



Prof. Joost M.E. Pennings

Professor in Finance & Marketing at Maastricht University, Professor in Commodity Futures Markets at Wageningen University and Adjunct Professor in the Office for futures & Options Research, Marketing & Decision Sciences Group at the University of Illinois at Urbana-Champaign



Prof. Paolo Sckokai

Associate professor in Agricultural Economics at the Faculty of Agriculture, Università Cattolica, Piacenza, Italy

Theme 2 / Sustainable milk production

Selected experts



Dr. Michel de Haan

Expert on economy, farm development and sustainability in dairy farming. Michel is employed by Wageningen University and Research centre (WUR) and acting as a project leader in several dairy projects



Mrs Susanne Clausen

She has 20 years of experience within the dairy sector, 17 of these from working as a consultant at the Knowledge Centre for Agriculture



Prof. Heikki Lehtonen

Professor, docent, DSc(Tech.) is specialised in agricultural sector modeling and farm economic modeling approaches and their applications in analyzing agricultural and dairy sector developments since 1995

Theme 1 / Market balance and competitiveness

Analysis questions

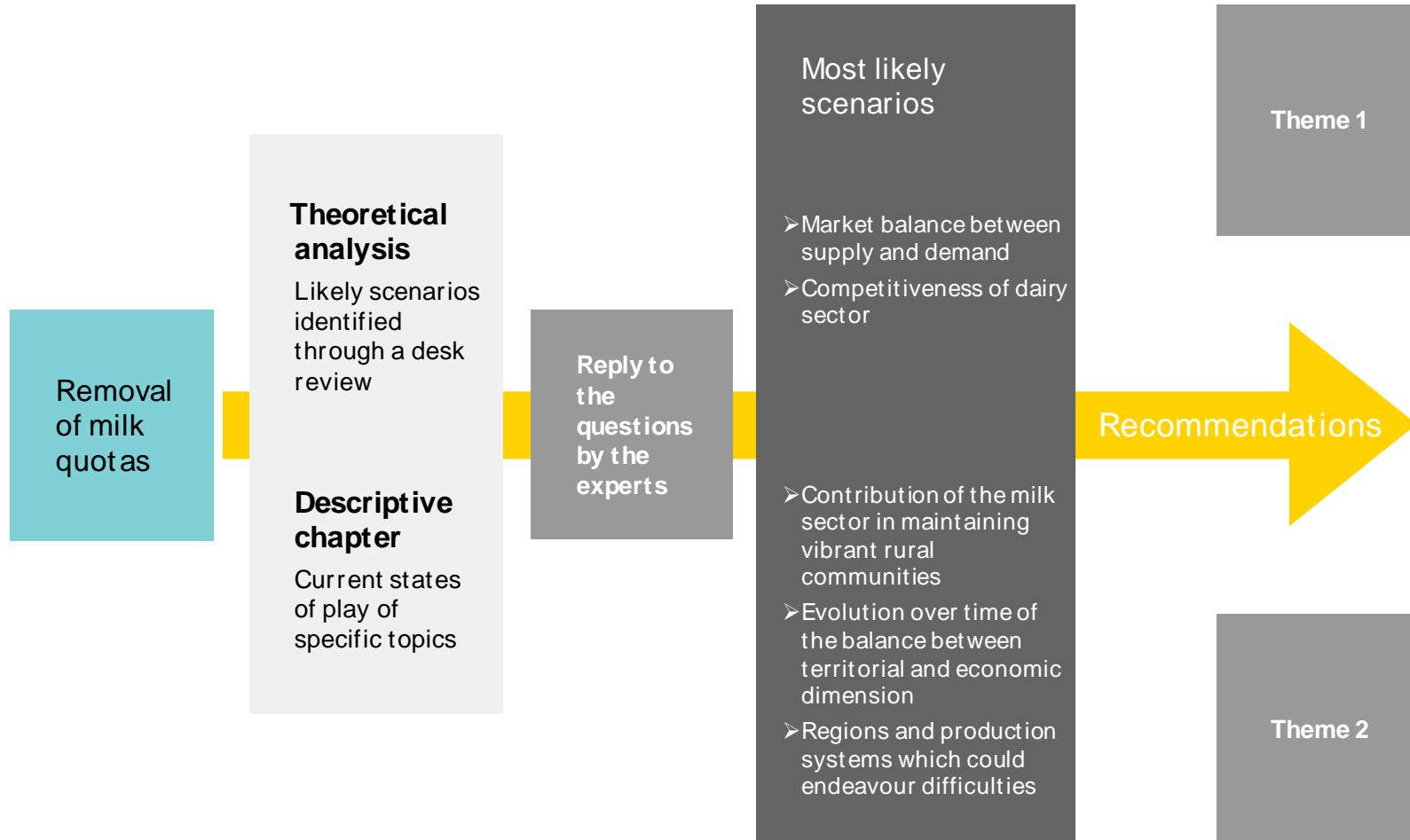
- ▶ How will the balance between supply and demand be affected by market forces, organisational systems of the supply chain (in particular POs and IBOs) and policy measures, including market support mechanisms, in a non-quota regulatory framework?
- ▶ How will those elements affect the sector's competitiveness in terms of added value and portfolio of products, ability to react to changes in demand, competitive position of the EU in the world market, and need of investments in the production and processing industry?
- ▶ How could a possible buy-out scheme be operated in a workable and effective way?

Theme 2 / Sustainable milk production

Analysis questions

- ▶ What will be the contribution of the milk sector to maintaining vibrant rural communities, especially in the most fragile areas?
- ▶ How will the balance between the territorial and economic dimension of milk production evolve over time?
- ▶ What are the regions and production systems which could endeavour difficulties?
- ▶ What actions could be envisaged with the view to secure a sustainable balance between the economic and territorial dimension of the milk sector?

General approach



Most likely evolution of market balance
and competitiveness

Market balance between supply and demand

High price volatility a challenge for producers

- ▶ Quotas are no more binding today
- ▶ Foreign countries increase their demand for EU dairy products (e.g. China and Russia + Algeria, Egypt...)
- ▶ High price volatility
 - ▶ Since 2007 price volatility has increased from an averaged 7.16 percent 11.41 percent
 - ▶ Volatility has been more marked in the EU with respect to the rest of the world
- ▶ Limited redistribution of milk production across European countries
 - ▶ Land availabilities
 - ▶ Local policies

Competitiveness of the dairy sector

- ▶ The experts did not share the same view on the evolution of products portfolio
 - ▶ Demand driven market will lead to increase variety of products
 - ▶ Enhance competitiveness will increase innovation
 - ▶ No impact – products portfolio already diversified with past reforms
- ▶ POs and IBOs could rebalance the distribution of added value
 - ▶ Lessons from other sectors
 - ➔ Enhanced readiness in managing unexpected crisis
 - ➔ POs increase transparency as information platforms or service providers
 - ▶ POs not viewed as an effective tool to strengthen farmers' bargaining power

Competitiveness of the dairy sector (continued)

- ▶ Ability to react to change in demand
 - ▶ An enhanced level of reaction required by both producers and processors
 - ▶ POs could foster cooperative adaptiveness: changes coordinated accross supply chain
 - ▶ PDO/PGI production plans in the limits of the milk package
- ▶ Improved competitiveness of the European Union
 - ▶ Continuing shifts of production from less productive regions to regions with more marked comparative advantages

Possible applications of a buy out scheme

- ▶ More workable on a voluntary basis
- ▶ Technical constraints in controlling milk production per cows: feed control or reduction of herds
- ▶ Reducing herd size
 - ▶ Negative spill over effects in the meat markets
 - ▶ Interfere with contractual arrangements
 - ▶ Not a temporary measure

Proposition to make a buy out scheme workable

- ▶ Experts think it is difficult to make it work
- ▶ Effectiveness of the buy out scheme
 - ▶ Low in the short and long term
 - ▶ Depend on key parameters
 - ▶ Possible wrong price incentives
- ▶ Put in place an automatic system
 - ▶ Based on revenue indicators & monitoring system
 - ▶ Financed by the dairy farmers themselves

Most likely scenarios of sustainability in the milk sector

Contribution of the milk sector in maintaining vibrant rural communities

- ▶ A marginal and declining contribution of milk sector to the economy
 - ▶ Economic growth and job creation only in a limited number of regions
 - ▶ No major change following the removal of quotas
- ▶ Rural communities in fragile areas may be at risk
 - ▶ Different definitions of fragile areas : employment and economic weight or regions with no alternative than milk production
 - ▶ Lack of shared views on which areas are going to suffer the most

Evolution over time of the balance between the territorial and economic dimension

- ▶ No change in the restructuring trend
 - ▶ Continuing process
- ▶ Exacerbation of environmental conditions
 - ▶ More intensive production techniques / farming
 - ▶ Abandonment of areas where pasture and grassland disappear leading to loss of biodiversity
 - ▶ Potential limitation of growth in environmentally sensitive areas

Summary of recommendations

Theme 1 - Develop instruments to limit or cope with price volatility

- ▶ Current instruments should be refined or complemented
- ▶ Price and volume information asymmetries in the chain could be eliminated or reduced by the creation of a clear price and volume information platform
- ▶ The safety net should be perpetuated
- ▶ The safety net could be triggered by early warning signals

Theme 1 - Refrain from implementing the buy-out scheme

- ▶ Difficulty in determining when and at what price level it should be introduced
- ▶ The effectiveness of a buy-out scheme is reduced both in the short and long term
- ▶ The implementation of such scheme should not be regarded as a priority for the Commission

Theme 1 - Strengthen the role of POs and IBOs

- ▶ To stimulate the creation of commercial POs,
- ▶ It should be ensured that POs and IBOs have an adequate size
- ▶ Appropriate incentives should be given to increase the size of Pos and IBOs

Theme 2 - Attention should be paid to fragile regions

- ▶ Create a precise mapping of fragile areas. Areas
 - ▶ Which are heavily dependent on milk production for the employment and the economy of the community
 - ▶ With no or few alternatives to milk production
 - ▶ Where milk production is associated with extra costs due to the conditions inherent in nature

- ▶ Selection of clear and objective indicators

Theme 2 - Use coupled payments to protect less favoured areas

- ▶ Less favoured areas should receive payments for added value toward society
- ▶ Support by development of brands (e.g. PDOs or PGIs)
- ▶ To develop dairy support programmes for international cooperatives in countries with significant share of milk production in less favoured areas
 - ▶ Small-scale local actors may not have resources for expanding their product portfolio and compete with multinational companies
 - ▶ Loss of market shares for smaller dairy processors operation on a local basis

Theme 2 - Foster environmental awareness and know-how

- ▶ Introduce R&D programme to enhance sustainability for the dairy sector
- ▶ In line with other EU directives aiming at improving environmental quality
- ▶ Moreover it is remarked that dairy farms often lack effective and affordable tools to improve the less sustainable practices (e.g. manure management)

Theme 2 - Set up bespoke regional programmes

- ▶ The introduction of custom-made regional restructuring programmes for the dairy sector
- ▶ A policy instrument should be put in place to preserve regions with ecologically valuable habitats

Theme 2 - Stimulate investments in the dairy sector

- ▶ Support farmers with knowledge, training and advisory service on how to effectively operate producer organisations
- ▶ Ease access to capital
- ▶ The establishment of a futures market
- ▶ Introduce political initiatives targeting young people to invest in and start dairy farms
- ▶ Develop training and education programmes to prepare farmers: Both in terms of management of grassland, fodder crops, cattle and production facilities in an efficient and sustainable way and in terms of risk management and business management

Theme 2 - Focus on strategic regional strengths

- ▶ The momentum should be on the strategic geographical advantages rather than on subsidizing the agricultural sector
- ▶ OECD recommendations are in favour of investments on key territorial assets, which include also public goods as an indirect support to farms
- ▶ This should be accompanied by a process of decentralization and an increased use of partnerships between public, private and voluntary sectors

Theme 2 - Promote regional economic resilience

- ▶ It is recommended to introduce regional programmes to foster regional economic resilience
- ▶ The aim of such programmes should be to identify strengths of the region in terms of professional skills, knowledge and experience, authentic character, touristic attractiveness, potential of alternative agricultural products as well as stimulate the creation of new networks to develop new commercial activities
- ▶ These activities could be funded through CAP funds as well as Structural Funds

Theme 2 - Reassess the usefulness of land payments

- ▶ It might be also useful to reconsider the role of land payments as they might exert an upward pressure on land price with the main effect of hindering investments in dairy production in less favoured regions
 - ▶ Expensive land may decrease competitiveness of milk production and also lead to intensive production and environmental problems
- ▶ If grassland areas are more easily eligible than other crops for full CAP direct payments subject to cross compliance and other conditions, the position of dairy farmers in local land markets will improve
 - ▶ Some environmental benefits of grasslands, e.g. lower nutrient surplus, less erosion, higher biodiversity, might be more encouraged

Market balance and competitiveness

Challenges	Recommendations	Experts in favour
Price volatility	Current instruments should be refined or complemented by further tools. A clear price and volume information platform should be instated.	Joost M.E. Pennings
	Buy-out scheme should not be implemented.	Joost M.E. Pennings Ludwig Theuvsen Paolo Sckokai
	Strengthen the safety net for extreme market situations.	Ludwig Theuvsen Paolo Sckokai
Disadvantaged areas	The current legal framework should be reinforced for less favoured areas. It could be reconsidered whether less favoured regions could possibly be reconverted to less intensive farming practices, such as e.g. beef production.	Ludwig Theuvsen
Unbalanced distribution of value added across the supply chain	The roles of POs and IBOs should be reinforced.	Joost M.E. Pennings Ludwig Theuvsen Paolo Sckokai
	The creation of commercial POs should be stimulated.	Paolo Sckokai
	The law should fix adequate sizes for POs and IBOs in order to make them more effective and for POs to improve their bargaining power. Foster the coordination of farms with institutional bodies to promote PDO/PGIs.	

Sustainable milk production including territorial dimension

Challenges	Recommendations	Experts in favour
	It is recommendable to introduce R&D programmes to enhance sustainability for the dairy sector.	Michel de Haan and Jelle Zijlstra Susanne Clausen
Environmental degradation	A part of land payments should be conditional to suitable environmental criteria.	Heikki Lehtonen
	Establishment of environmentally sustainable production systems.	Michel de Haan and Jelle Zijlstra Susanne Clausen
Farmland abandonment	It is recommendable to put in place policy instruments in order to preserve regions with ecologically valuable habitats.	Michel de Haan and Jelle Zijlstra
	Production coupled payments should be maintained in less favoured areas if milk production in these areas is pursued as a strategic objective.	Heikki Lehtonen Susanne Clausen
	Coupled payments could be complemented by branding support (e.g. PDOs or PGIs).	Heikki Lehtonen
High vulnerability of fragile areas to prices fluctuations	A precise mapping of fragile areas should be created and this implies the selection of clear and objective indicators to do so.	Heikki Lehtonen

Sustainable milk production including territorial dimension (continued)

Challenges	Recommendations	Experts in favour
	<p>Follow up on the implementation of the Milk Package and support farmers with knowledge, training and advisory service on how to effectively operate producer organisations in order to strengthen farmer's position in the value chain.</p> <p>The establishment of a futures market could be a way to enable farmers better managing risks associated with volatile milk and feed prices. This will, however, require considerable amount of education and training of farmers in how to use this.</p>	Susanne Clausen
Lack of investments	<p>Access to capital should be facilitated especially in more disadvantaged areas for instance by establishing a loan fund for farmers.</p> <p>Political initiatives targeting young people and rendering milk production attractive should be introduced.</p> <p>Training and education programmes should be considered to prepare farmers in tackling challenges, such as market instability and to become more market oriented.</p> <p>Know-how on the design of environmental friendly production systems facilities should be fostered.</p> <p>Restructure programmes for regions with many small farms and dairy processors.</p>	<p>Susanne Clausen</p> <p>Michel de Haan and Jelle Zijlstra</p>
Lack of coordination in efforts performed through European funding programmes	<p>Combine EU funds for regional development to create regional economic development and foster coordination in financial efforts.</p>	Michel de Haan and Jelle Zijlstra

Questions to the panel of experts

