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EU Dairy Sector Must Proceed Boldly - but Cautiously - in post Quota Era

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Introduction

There will be some clear winners, but many losers as the EU dairy quota system is abolished, creating an industry that is closer to the New Zealand model, with its unsentimental focus on scale and efficiency.

Share of Global Production

The European Union is the largest producer of dairy products in the world, accounting for 20 percent of global production in 2013. However, production levels have actually decreased by five percent since 1990, when the EU's share of global production was 31 percent.

The quota system was introduced in 1984, to control escalating production levels while maintaining the price-support structure of the Common Agricultural Policy (CAP). The core aim of the CAP was to support farmers' incomes while ensuring an affordable and plentiful supply of food within Europe. This inevitably led to a distortion of market forces, which limited the sector's competitiveness and ability to respond to increased global demand for dairy products.

Quick read

- The abolition of the EU dairy quota system will create winners and losers, as scale and efficiency become the key priorities
- The quota system set up to control escalating production levels in 1984 was meant to support the Common Agricultural Policy's [pricing support structure for farmer incomes
- The system distorted market forces and limited the sector's competitiveness and ability to respond to global demand, hence its disbandment
- The abolition has seen forecasters predict a two track EU dairy industry – with northern countries continuing as before while the rest of Europe will see production fall even further
- Ireland is looking to increase production by 50 per cent under the new rules, and aim to emulate New Zealand's success
- For Ireland, successfully expanding the herd size and increasing efficiency will be critical to future participation in the industry
- New Zealand also benefits from favorable lending conditions; less regulation; a tradition of succession, planning; lower population density, among other advantages

Post - Quota World

In April 2015, the EU's dairy farmers were released from the constraints of the dairy quota system and industry participants are now focused on the present realities and future prospects of the post-quota world.

Industry analysts and participants have outlined two alternative future scenarios. The first possibility is that a two-track European dairy industry will emerge, which will result in no significant change to the production capacity of the EU.

This forecast would suggest that the countries that are currently at, or above, their milk quota will continue to increase production.

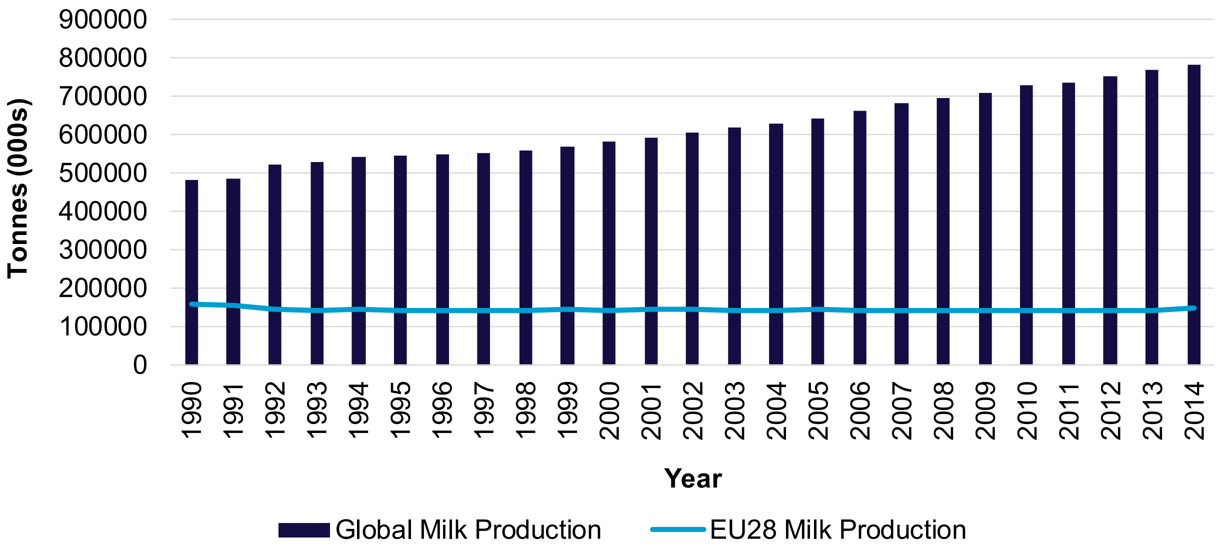
In contrast, those countries that are currently below their assigned quota limit will allow production to fall even further. Those countries likely to expand production are in northern Europe, along a line stretching from Ireland in the west across northern France as far east as Poland and the Baltic countries.

The proposed alternative is that quota abolition will lead to a rapid increase in European production, which would drive global dairy prices down. Regardless of which forecast is correct, EU producers can expect price volatility in the short and medium-term.

The Irish dairy industry aspires to benefit from the demise of the quota system, with an industry-wide aspiration to increase production by 50 percent by 2020. This expansion is supported by government policy and by financial support for investment in primary production. It is also being facilitated by substantial investments made in dairy processing and the development of new markets outside the EU.

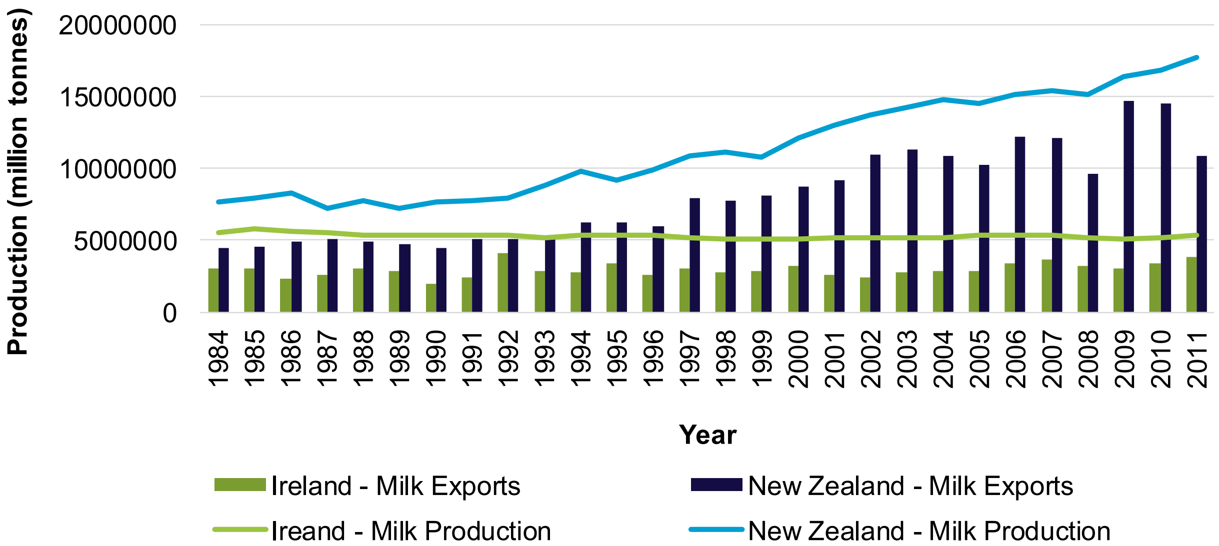
Many in the industry aim to emulate the success of New Zealand, which has become a world leader in the dairy industry during the period that Ireland accepted the limitations of the European quota system. Between 1984 and 2011, New Zealand's production increased at a healthy CAGR of 3.2 percent, allowing it to become the leading exporter in the global market. In contrast, Irish production, as can be seen in Figure 2, started at a comparable point to New Zealand and declined slightly over the period.

Figure 1: Milk Production 1990-2014 – Global vs EU28 Production Levels



Source: OECD-FAO Agricultural Outlook 2014

Figure 2 - Milk Production* and Exports 1984-2011: Ireland vs New Zealand**



*Source: FAO*whole milk production**liquid milk equivalent*

"If it is to succeed, then Irish dairy producers must proceed boldly but cautiously. Successfully expanding the herd size and increasing efficiency will be critical to future participation in the industry."

Similarities

On the one hand, there are significant similarities between Ireland and New Zealand. Both countries' dairy systems are based on low-cost grass-fed production, producing a quality commodity that other countries find hard to match.

On the other hand, Ireland's average herd size is significantly smaller and its processing, distribution and marketing sector is more fragmented. New Zealand also benefits from favorable lending conditions; less regulation; a tradition of succession planning; lower population density; and flexible farmers willing to sell their farms and set up in new areas, where larger tracts of less-expensive land was available.

Success

If it is to succeed, then Irish dairy producers must proceed boldly but cautiously. Successfully expanding the herd size and increasing efficiency will be critical to future participation in the industry.

However, it is important that farmers don't over-extend, as a debt-fuelled expansion leaves farmers dangerously exposed to volatility in both input and output prices. In order to be counted among the winners in the brave new world of European dairy, farmers must cast a cold eye on the business case for expansion.

Conclusion

…The abolition of the EU dairy quota system will create winners and losers. One country set to benefit is Ireland who will want to use its natural advantages in the space to emulate the success of New Zealand. Ireland wants to increase production significantly under the new arrangements but will have considerable work to do to match New Zealand, where lending, regulation, planning and other aspects are at a more advanced state.

Expert in this Insight

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