AGRICULTURE
STRATÉGIES

Milk powder stocks : the Commission's strategy has cost European milk producers € 2.3 billion

How to better manage market crises in the European Union? This is the question that Agriculture Strategies answered for a study **commissioned by MEP Eric Andrieu to feed his proposals for reform of the CMO regulation**, one of the three regulations of the Common Agricultural Policy. While the European Commission is pleased to have finally disposed of the last few tonnes of milk powder stored in Community stocks, **this study provided an assessment of the European Commission's strategy to tackle the 2015/16 milk crisis.**

When the "soft landing" strategy ends in a crash

The 2015/16 milk crisis is directly attributable to the removal of milk quotas on March 31st 2015. This decision, passed in 2008, was taken by the Council of European Ministers in the euphoria of the general rise in agricultural prices observed starting in 2007. The Commission's proposal included **a strategy called "soft landing", which asserted that, by gradually increasing the production ceiling, prices would decrease until they reached their equilibrium level, at which point it would no longer be interesting for producers to produce their entire quota**. Once this transition was completed, the "quota rent" would have disappeared and the quotas could be removed smoothly.

The fact is that things did not go as planned: the "soft landing" strategy will remain in the annals of economic policy errors in agriculture. At issue are **two main factors: the structural instability of international markets and the structure of production costs in dairy farming**. The sharp rise in dairy prices observed between 2012 and 2014, partly due to the artificial reduction of volumes sold on the New Zealand platform Global Dairy Trade, led producers to euphoria: the Chinese stomachs were going to be insatiable. While quotas increased by 7% over the period, the increase in European production was 9.9% between 2008 and 2015, with some producers preferring to pay the fine for exceeding quotas.

Because once investments are done, farmers do not have an individual interest in reducing their production, the fall in prices started in 2014 and amplified by the Russian embargo had no effect on the dynamics of production. Decidedly, **the spontaneous adjustment of supply by prices does not work in agriculture and especially in milk**, which is why the quota option was decieded in 1984 ! And, as we press the accelerator to hope to break through the wall, the end of quotas has not been questioned, further exacerbating the overproduction crisis : the first year post quota, European production has increased by 4,9%!

The voluntary milk production reduction scheme, a definite but partial success

As sonn as July 2015, the fall in the price of powder has triggered public purchases that rose to 350 000 tonnes, exploding the initial ceiling of 108 000 tonnes. Faced with the disarray of producers, the European Ministers of Agriculture in September 2015 started to relfect on the measures to be taken: a direct aid envelope of 500 million euros is released without stopping the crisis.

The European Union being one of the major exporting countries, overproduction has had repercussions on international prices leading to complaints from other countries such as New Zealand. Reducing production has begun to be considered as soon as the Dutch cooperative Friesland-Campina announced support for its producers who would step back, and it was not until April 2016 that the Commission proposed to activate Article 222.

This article allows all actors in the sector, from companies to producers through Interprofessions to derogate from competition law and agree to limit overproduction. There was no effect, or even the slightest initiative between the actors.

It is in July 2016 that the solution, which had been available since the beginning of the crisis, will finally emerge: a voluntary milk production reduction scheme (Article 219). The Commission offered a 500 million euros envelope to reward farmers who undertook to reduce their production over a period of 3 months. **The success is immediate**: while the aid was to be deployed in four stages, 98.8% of aid is requested during the first stage, and **the price of powder goes back up as soon as the measure is announced by its psychological impact on the expectations of market players.**

Of the 500 million euros announced, it is finally 390 million euros that will be spent - some applications are not fully eligible - for a reduction of 2.2% of European production on the last quarter of 2016. It was used by 8.3% of dairy farmers, with Belgium and Ireland leading the way. Given its success in rebalancing the market, it is a shame it wasn't activated sooner: it would have saved public stocks from piling up.

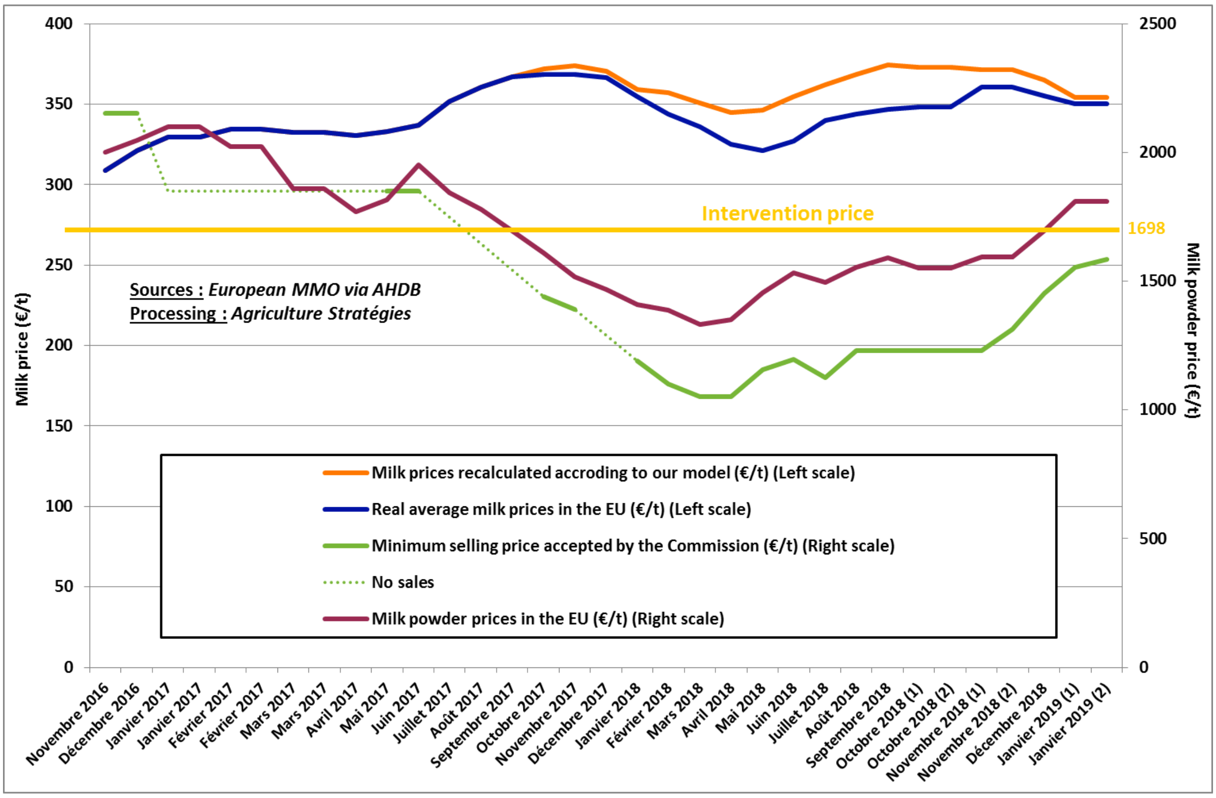
A strategy for the disposal of stocks, which reduced the price of powder for over a year

2017 was the year of recovery for milk prices, which came closer to the level of production costs. It is in September 2017 that the Commission decided to be on the offensive to sell the 350,000 tons of powder stored. This volume is to be put into perspective: it represents around 2% of annual production in Europe. Unlike the previous destocking episodes where several tools had been used, such as donations to charities or feed aids, **the Commission chose to sell the powder only through calls for tenders**. This measure offers the possibility of selling below the intervention price, which makes it possible to consider liquidating stocks very quickly by selling them off.

But here again the Commission seems to have made an analytical error by assuming the interest of economic operators to buy these volumes as quickly as possible. I**t appears that in the end they preferred to take advantage of the dumping effect of tender prices on the price of powder and therefore milk, thus defeating the Commission's strategy**. The latter went so far as to accept bids at € 1050 / ton, well below the European floor price of € 1698 / ton. And, if the stocks were finally sold at the end of 2018, it is largely thanks to the drought that affected important production areas in the summer of 2018.

More than two years to sell the equivalent of a week's milk production, it would surely have been better to use other instruments to liquidate stocks and take advantage of the tensions on the price of butter to play on the expectations of the actors as it was recommended then. Moreover, through the lowering of the price of the powder that they caused, under-priced tenders caused a dumping effect on the price of milk.

Using an econometric model explaining 97% of the variation in the price of milk by different variables including the price of powder, we sought to simulate the price of milk if the price floor of milk powder had been respected. On the graph below the observed real price is represented in blue and the simulated price in orange. **The difference therefore corresponds to a shortfall for European dairy producers, our estimate puts it at 15 € / tonne on average, or 2.3 billion euros over the period when the price of the powder was lower than the price of intervention**. More than a loss for producers, **it is a transfer of value from producers to processors**. And finally, that's how the liquidation of a stock worth a little less than 600 million euros will have cost 2.3 billion to producers !



In addition, by buying cheaper powder that they had sold for € 1698, **the players in the powder market considered globally realized a profit that can be estimated at € 140 million** in its upper range (purchases could have taken place at a price higher than the minimum price accepted). It seems that the Commission does not have information to identity of the buyers, but it can be assumed that **part of this subsidy of 140 million corresponds to an export subsidy,** an instrument that the European Union had committed to no longer use. Finally, to complete the budget balance, we should mention the costs of public and private storage, for which we have not found public information.

In the end, we can only remain doubtful when, in relation to the liquidation of stocks in January 2019, the Commissioner for Agriculture stated**: "I decided on this course of action with the clear aim that we would get rid of most stocks without putting pressure on prices"**. At this stage, the Commission's services have not published any work evaluating their actions during the milk crisis. **This seems necessary as much to initiate a process of progress in the management of the Community markets as to account for the public money mobilized.** This work should also establish the reasons why, in the run-up to the exit of milk quotas, **the Member States have not all implemented the provisions relating to the reinforcement of producer organizations, whose role in the implementation of the balance between supply and demand is all the more necessary in milk production, where supply does not respond spontaneously to lower prices.**

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