Post-Quota Welsh Dairy Sector

FUW UNDEB AMAETHWYR CYMRU

A Farmers' Union of Wales Report into the Post-Quota Welsh Dairy Sector

WHERE ARE WE NOW?

The Welsh dairy industry continues to reel under months of continuing low prices and poor profitability.

The FUW is extremely concerned that any sign of a price recovery may still be some way into the future due to a continuing global supply and demand imbalance.

This briefing represents a synopsis of the main issues contributing to the current dairy sector crisis in which almost half of dairy farmers in Britain have stated an intention to quit the sector.*

BACKGROUND

The introduction of the EU milk quota regime in 1984 followed the notorious butter mountains and milks lakes which were borne out of oversupply in the EU market in the 1970s and 80s. The objectives of this new milk management system included limiting public expenditure on the dairy sector, exerting some control on the volume of milk produced and stabilising dairy farmer incomes.

The loss of milk quotas in April last year followed an ever-increasing emphasis within the EU on market awareness and many industry bodies and organisations had been led to believe that quotas had become an archaic mechanism in an increasingly market orientated environment.

'Abandoning milk quotas will be a bad thing for the dairy industry, and that is something we cannot support.' FUW October 2009

*RABDF Farmer Intention Survey, September 2015. http://www.rabdf.co.uk/latest-news/2015/9/7/rabdf-survey-reveals-50-of-producers-set-quit-dairy-farming

The move towards a flat rate payment system could see dairy farmers in Wales lose as much as 50% of income.

'In 2009, the FUW called for a national debate on the impact abolishing milk quotas would have on the Welsh dairy sector. However, despite an Assembly Inquiry into the Welsh Dairy Sector in 2009, the issue of quota abolition was largely ignored in Wales and the UK despite its critical importance to the sector.'

The original 5 year shelf life of milk quotas had been extended several times. The 2014 deadline for their abandonment was confirmed some 6 years before, however, to date, there has been little discussion on the use of alternative market measures and, apart from the 'soft-landing approach' which saw the amount of quota offered to each member State rise by 1 percent per year from 2009 to 2013, very little has been achieved to protect dairy producers from the potential wrath of a global market.

'A more flexible approach to such challenges is needed, rather than the wholesale liberalisation of the current regime.' FUW April 2009

DAIRY PRICES

Dairy producers are thought to be somewhat protected from price volatility in the EU marketplace by those instruments, such as Private Storage Aid, which still exist under the Common Market Organisation.

The EC recently announced a doubling of SMP intervention to 209,000 tonnes; although this remains to be ratified. Although the Council has decided to retain public intervention as a 'safety net', this safety net is so thin that there is a risk it will be of only limited use in a major crisis and quite inadequate in relation to the risks in respect of the surpluses that the EU might face.

Furthermore, given that intervention stocks must eventually be placed back onto the global market, price increases could be further delayed if this mechanism is not properly utilised and product is returned to the market during a surplus.
SMP volumes reached the original 109,000 tonne limit in march this year.

Whilst the EU retains the right to intervene under 'exceptional circumstances', such as during the current Russian dairy embargo which began in 2014, EU intervention is largely ineffectual during periods of sustained low prices. As with price extremes and crashes, long periods of sustained low prices also function to threaten the viability of Welsh dairy producers. The latter is especially important given that the present low prices received by producers have lasted longer than any other price cycle.

Producers in Wales differ from some of their European counterparts in that many of the domestic instruments which may be applied under EU policy, such as voluntary support for certain regions of sectors deemed to be in need, have not been preserved for use in Wales. A total of 18 Member States introduced a coupled payment for the dairy sector in 2015 and this was worth around 800 million Euros. Other options include support for the establishment of Producer Organisations; support which was denied to Welsh producers following an FUW request for funding from the Welsh Government in 2014.

DAIRY PRODUCTION

Between December 2014 and 2015, Ireland increased milk production by over 30%

The resultant effects of a post-quota market were predicted to be diverse and, as would be expected, highly dependent on provenance. According to an EU economic impact report**, a reduction in UK milk production of between 5–7 percent was envisaged by 2020, with concomitant increases in both herd numbers and milk volumes predicted for countries such as Germany, the Netherlands, Austria, Belgium, Spain and Ireland. Significantly, it was expected that these regions with high quota rents would 'exert economic pressure on regions with low quota rents', such as the UK. However, according to recent figures from AHDB Dairy, just 7 of the EU-28 member states saw a decrease in milk deliveries between December 2014 and December 2015. Ireland saw the largest percentage increase over this period at 31.3 percent.

'Whilst some forecasts predict a decline in global milk supplies in the latter half of 2015, the Russian trade embargo, coupled with reduced demand in China and a weak economic environment, will likely delay price rises beyond any potential downturn in production.'

FUW January 2015

Southern hemisphere countries have reacted to the decline in prices faster than their northern counterparts.

With the spring flush imminent, there is concern that those pushing forward will produce even more milk at a time when the market simply cannot cope.

Those countries, such as Croatia and Sweden, which have reduced the volume of milk produced, do not produce sufficient enough volumes to counteract the substantial increases elsewhere.

The lack of any substantive decline in EU milk production is, in part, due to the implementation of strategies in some member states which encourage production increases as a way to capitalise on future expected rises in demand for dairy products.

Predictions of future consumption and demands for dairy produce should be cautious and must account for the fact that the demand in countries such as India will be largely met from domestic production.

Furthermore, the very nature of the sector means that production capacities remain relatively inflexible and it is difficult for producers to swiftly respond to fluctuations in demand.

'...some member states encourage production increases as a way to capitalise on future expected rises in demand for dairy products.'

** EU Economic Impact of the Abolition of the Milk Quota Regime. IPTS in collaboration with EuroCARE GmbH, Bonn.

DAIRY PRICES
PRODUCER NUMBERS

The continuing glut of milk within the EU has functioned to further weaken the position of dairy producers in the supply chain and cemented their position as price-takers. The steep decline in the number of Welsh dairy farmers will continue as long as supply chain profits continue to be asymmetrically shared.

Whilst the FUW recognises that some retailers have made small in-roads in this area, it remains imperative that the prices paid to producers not only cover the cost of production, but also provide room for investment in order to allow the sector to innovate and remain competitive.

'Is it not, and never has been, the job of the producer to fund supermarket price cuts

or to enhance a retailer's market share. Sacrificing [dairy] producers to a retailer price war can only function to further break an already fractured supply chain.'
FUW May 2015

The unfair position of producers in the supply chain is evidenced by the fact that farmgate and consumer prices do not follow parallel trends. Indeed, a 2009 special report by the European Court of Auditors stated that 'Between the beginning of 2000 and mid-2007 nominal consumer prices for milk products increased by 17 % while the nominal price paid to the producer fell by 6%'.

Predicted income losses for the post-quota EU-27 dairy sector were purported to be in the region of 14 percent. This reduction in producers' incomes was predicted in spite of an 'increase in the quantities produced', and was predicted to be coupled with "a stimulation of the EU's exports, possibly causing a downturn in world prices".

Dairy producers continue to optimise production and improve efficiencies; with the industry predicted to reduce cost of production by 4.56ppl between March 2015 and 2016†. However, data from the House of Commons demonstrates that between November 2013 and November 2015, UK dairy prices fell by around 30 percent. According to the data available from AHDB dairy , prices for Welsh producers in January 2016 averaged around 19.67ppl; although there will inevitably be a range around this figure. Indeed, some FUW members are receiving as little as 10ppl for some milk. According to AHDB Dairy, for the 12 months ending December 2015, total full economic costs of production ranged from 25.7 to 34.4ppl. These costs include unpaid family labour, depreciation, rental value of owner occupied land and imputed financial costs.

The number of dairy farms in Wales is now just...

1 7 5 8

'Whilst the Union recognises that dairy farmers supplying supermarkets on a dedicated supply contract have received more favourable milk prices, such farmers represent only a small fraction of the Welsh dairy sector – around 4% of production –therefore unrepresentative of industry...'
FUW January 2015

An EU analysis of post quota dairy herd numbers in the UK predicted a decline of around 5.8 percent by 2020.
In 2009, there were just over 2000 dairy herds in Wales. Assuming the EU prediction of a 5.8 percent decline is expected uniformly throughout the UK, this would see the number of dairy farms in Wales fall to 1908 by 2020*† .
According to AHDB Dairy, the number of dairy farmers in England and Wales currently stands at around 9,586.
In Wales, the number of dairy farmers in 2016 was just 1,758. In other words, the number of dairy farms in Wales is already significantly less than the decline predicted to occur in the future.

†Kite Consulting Ltd, AHDB Dairy Conference April 2016.
††Data represents UK Arla Farmers Liquid, Glanbia Llangefni, South Caernarfon Creameries, Meadow Foods A & B and Arla Direct Manufacturing.
*† Assumes a 2009 starting figure of around 2025 producers.

DAIRY CONTRACTS + SUPPLY CHAIN

The introduction of the Dairy Code of Practise in 2012 has done little to positively affect the farm gate prices received by producers and is largely ineffectual in the midst of market surpluses and a lack of alternative options.

Indeed, the Code can do nothing to better the prospects of producers who have been served notice and the Union continues to reiterate that smaller producers and those in remote areas are being left vulnerable during periods of oversupply. The industry could see even more falls in producer numbers as processors 'cherry-pick' producers in a bid to reduce operational costs.

For producers wishing to take up the option, the FUW has been a long-standing supporter of the inclusion of market-related pricing formulas within dairy contracts. Supporters of the formula believe it could form the foundation for prices which, while continuing to vary between contracts, nevertheless represent the true value of milk. This would reflect a supply and demand dynamic that UK milk prices have failed to recognise over the last decade.

Other types of contracts, such a futures, may be of benefit to some producers; although this will depend on the individual business and the degree to which some or all of the milk is included. Indeed, whilst the industry needs different types of contracts to cope with embedded marketplace volatility, there must also be a concurrent effort to increase transparency and proper policing in the UK supply chain. Contracts which include mechanisms such as A and B pricing must also work for the producer when demand outstrips supply and should not be used primarily to reduce incomes in periods of oversupply. Proper policing, including an expansion of the Groceries Adjudicator's power to include non-aligned contracts, should help to ensure that contracts remain fair and do not exploit primary producers.

'We would like to see a system whereby the dairy code is properly policed so that we can tell straightaway if the purchasers are cherry-picking and if they are not playing fair' FUW May 2013

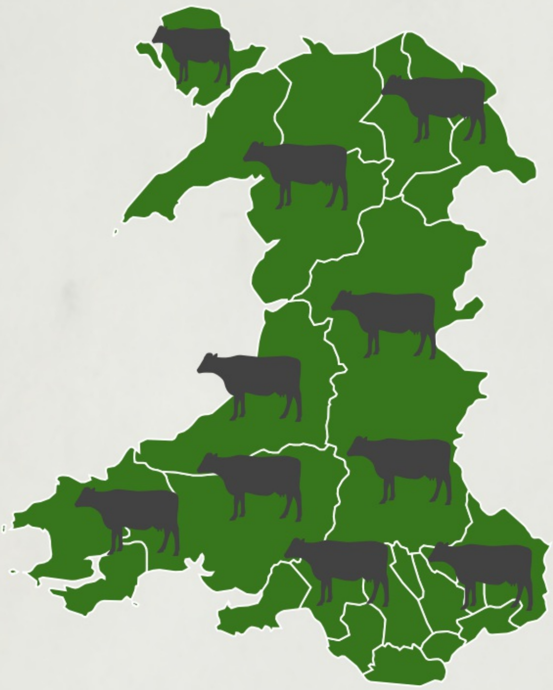
'There is growing concern amongst many farmers in Wales....that the full implications of the abandonment of the quota regime have not been properly recognised by the European Commission and others'. FUW May 2009

PROCESSING CAPACITY

The Welsh production-processing gap was 890 million litres in 2015.
No major processing facilities have been established in Wales in the last 10 years.

For producers in Wales there is a growing gap between the milk produced in Wales and that which is processed in Wales. According to AHDB dairy, the production-processing gap in 2015 was around 890 million litres.

No major processing facilities have been established in Wales in the last 10 years and there has been a loss of milk and cheese processing at a time of increased supply. Furthermore, with no balancing sites in Wales, extra production volume travels to Westbury and is exposed to the pitfalls of the global slump in prices.



The recent Welsh Government report into the feasibility of increased milk processing in South Wales concluded that 'the way forward will be the expansion of the existing and established milk processors, which will enable dairy farmers to increase production, grow sales and secure their future'±. However, given that the processing investments proposed would function to increase the capacity for cheese production, including for export, exposure to the commodity market will continue. Almost 90 percent of the milk retained in Wales goes into cheese production, with only 8 percent of the milk processed in Wales going into the liquid market. Future strategies must also examine the potential for the production of high value commodities.

Given that the Welsh Government aspiration to produce 2 billion litres of milk by 2020 'now looks increasingly likely to be met' it is imperative that increased capacity does not occur without an understanding of the consumer and the products which will add value and reduce producers exposure to the volatility now inherent in the global market.

'...it is imperative that the milk market is managed in a manner which stabilises prices, ensures a fair standard of living, protects producers from the effects of unfair practises and strengthens their position in the supply chain.'
FUW 2016

'...the on-going Russian trade embargo, coupled with reduced demand in China and a weak economic environment will likely delay price rises beyond any potential downturn in production.'
FUW 2016

In order to preserve the future of Welsh and British dairy farmers, it will be crucial to ensure that resilience does not merely focus on producing milk at lower prices, but instead recognises the need to intervene in a way which mitigates the wealth of issues which remain out with the control of the primary producer.

±Welsh Government Written Statement – Report into the Feasibility of Increasing Milk processing in South Wales. March 2016.
http://gov.wales/about/cabinet/cabinetstatements/2016/dairyfeasibilitystudy/?lang=en