USDA Foreign Agricultural Service
GAIN Report
Global Agriculture Information Network

Template Version 2.09

Voluntary Report - public distribution

Date: 3/2/2004

GAIN Report Number: E24028

European Union

Dairy and Products

New EU dairy aid payments will boost milk production

2004

Approved by:
Justina Torry
U.S. Mission to the European Union, Brussels

Prepared by:
Karin Bendz

Report Highlights:
The European Unions new direct payments for dairy farmers, which come into operation in 2005 are likely to act as an incentive to increase efficiency. Smaller, less efficient farms may loose economically while larger more efficient units will be maintained. Fewer farms will be producing the same amount of milk on larger and more intensive farmed units.

Includes PSD Changes: No
Includes Trade Matrix: No
Unscheduled Report
Brussels USEU [BE2]
[E2]

Executive Summary

The European Union’s new direct payments for dairy farmers, which come into operation in 2005, are likely to act as an incentive to increase efficiency.

If EU dairy farmers regard the direct payments as coupled, the dependence on market prices to determine supply will be lessened and there is a greater chance that national quotas will be fully used and that more producers will remain.

If dairy farmers treat direct payments as decoupled, the incentive price might fall, milk production could drop and the producer numbers may fall.

Application of the new policy from 2005, combined with domestic and international market conditions, is predicted to bring about a steady decline in the milk price. By 2010 this combination would reduce the producer price to below the average costs of production and, without the subsidy, would be expected to result in a substantial reduction in milk production.

Smaller, less efficient farms may loose economically while larger more efficient units will be maintained. Fewer farms are anticipated to be producing the same amount of milk on larger and more intensive farmed units.

New EU dairy aid payments will boost milk production

According to a recent study, the European Union’s new direct payments for dairy farmers, which come into operation in 2005, are likely to act as an incentive to increase efficiency, will stimulate the consolidation and enlargement of dairy holdings – and are likely to maintain production at current levels.

The report suggests that dairy farmers are likely to regard the new payments as part of their return to milk production, rather than a detached income supplement, and that therefore production will be sustained at present levels. Without the subsidies, it can be concluded profitability of dairy farming in Europe would decline substantially and production would fall.

In addition, seen from the point of view of European policy objectives, the new policy will have the opposite of the intended extensification of production, but rather will lead to intensification of production and no reduction in milk output.

A crucial question to be answered in any assessment of the impact of the new policy on the dairy industry is: will dairy farmers regard the direct payments as decoupled in the practical sense of not being part of their calculations of profit and loss, or will they include them in their sum of total revenue and therefore as an important contribution to profitability?

If producers, as expected, treat any direct payments as coupled, dependence on market prices to determine supply will be lessened, and there is a greater chance that a national quota will be fully used and that more producers will remain.

If on the other hand, dairy farmers treat direct payments as decoupled, the projections presented are that the incentive price might fall.

Application of the new policy from 2005, combined with domestic and international market conditions, is predicted to bring about a steady decline milk prices. By 2010 this combination would reduce the producer price to below the average costs of production and, without the subsidy, would be expected to result in a substantial reduction in milk production.

Dairy farmers do not and will not respond in an economically rational manner to reductions in profitability. Many family dairy farms will remain in business, despite the fact that their operations are not making an adequate return to family labor. In other words they are determined to remain as farmers despite the fact that they are earning less than an average wage. By extension, it is assumed that this attitude will result in the direct payment being regarded as the means of maintaining the business rather than as a decoupled income supplement.

The implications of the report for the achievement or otherwise of the EU's aim of extensification are serious. The figures suggest that large number of less profit-making small dairy farmers will go out of production, but that profitability for the, generally larger, efficient units will be maintained.

As the smaller, less efficient farmers are forced out of business their resources, including quota allocation, will be taken over by the larger units. Fewer farmers will be producing the same amount of milk on larger and more intensively farmed units.

The report points out that most of the least profitable farms are in the 'less than 70 cows' grouping in the 2002-03 survey. While profitability of the best 25% of these farms matched that of the majority of the larger farm grouping.

The payment of the subsidy will do little to arrest the decline in profitability of these small dairy farms. It will however improve and maintain the profitability of larger units and is likely to accelerate the trend in farm structural change of the last decade.

The assessment of future intentions of the farms surveyed showed that the intention to expand production during the next five years increases with herd size. Three quarters of the farms in the '150 cow plus' category intended to increase output.

These figures strongly reinforce the picture of small herds diminishing sharply in numbers, while a committed core of dairy farmers are planning expansion at a rate that will more than compensate for those quitting in terms of output potential.

But in a situation of increasing productivity where the direct subsidy is regarded as an important contribution to profitability, output of the larger farms will increase and EU milk production will remain at its current level of 15+ % above domestic consumption. Thus it is likely that the world dairy market can expect no reduction in the pressure from EU surpluses.

The information in this report was transcribed from Agra-Europe. The report indicated can be found on www.agra-net.com. It is concerned specifically with the impact of the new European agriculture policy on UK dairy farming, however, its conclusions have important implications for the European dairy industry as a whole.

Visit our website: our website **www.useu.be/agri/usda.html** provides a broad range of useful information on EU import rules and food laws and allows easy access to USEU reports, trade information and other practical information. E-mail: AgUSEUBrussels@usda.gov

Related reports from USEU Brussels:

Report Number	Title	Date Released
E24041	Dairy Management Committee decides on export refund rules	3/1/04
E23198	Dairy Annual	10/21/03
E23077	Dairy Semi- Annual	5/20/03
These reports can be accessed through our website www.useu.be/agri or through the FAS website http://www.fas.usda.gov/scriptsw/attacherep/default.asp.		