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Finland

Dairy

Dairy Annual Report 1998

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Report Highlights:

The Finnish Dairy sector is under stress. Exports to Russia of cheese and butter have almost come to a halt and on the domestic market competition is increasing. Production of butter and milk powder will increase.

Includes PSD changes: Yes
Includes Trade Matrix: Yes
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Executive Summary

The situation for the Finnish Dairy sector is very different to last year. All sub sectors are affected: the domestic market for fresh products is exposed to increased competition as yet another dairy cooperative has left the Valio group; the Russian crisis has stopped exports of dairy products which will affect cheese production and steepen competition on international markets. In turn, this will lead to increased production of butter and milk powder. In addition, the poor summer has affected ice-cream consumption negatively. In all cases, profitability is deteriorating both for dairy farmers and for dairies.

However, some structural investments have been made in the sector. The structure is one of the major problems - the average size is still very low, 14-15 cows per herd. According to the Finns, adjustments of the Common Agricultural Policy (CAP) - and the Agenda 2000 - are necessary as the present and proposed support systems do not take into account the reality of the northern European farmer and in fact distort competition. The present proposals increase the difference in cost of production through increasing the relative difference in cost for roughage and grain in northern Europe, compared to the relative difference (and importance) in central and southern European dairy farming. The Finnish Farmers' organizations and the GOF are advocating support to grass silage to compensate for the maize silage support. The Finns are also opposing the reduction in price for milk as this would undercut Finnish production costs even more.

Production is stable at roughly 2,370-2,390 thousand tons of milk delivered to dairies resulting, in 1997, in the production of 83 thousand tons of cheese, 50 thousand tons of butter and 29 thousand tons of milk powder. Roughly 20-25 percent of production goes to exports of dairy products, mainly cheese and butter. Exports to Russia have almost ceased since the last week in August. Although some amounts are still going to the rich of Russia, the bulk of the trade has stopped. Developments in Russia have a great effect on the Finnish dairy sector. Forecasts are therefor very difficult as 30-40 percent of dairy exports in recent years have gone to Russia.

The future outlook hinges also on the final outline for CAP reform within the EU's Agenda 2000. Restructuring will likely continue at a higher rate although production will largely be maintained - at least for the next 3-5 years. Exports of dairy products will likely increase.

The main sources of information for this report are: Food & Farm Facts, The Finnish Farmers' Union, MTK and the Information Center of the Ministry of Agriculture and Forestry. The dollar rate used for 1997 is FIM 5.19 and for 1998, FIM 5.46 (average rate in July).

Production

Milk production is limited by the national milk quota which was 2,388 thousand tons in 1997. The quota year (QY) runs from 1st April to 30th March. In QY 1997, 99,9% of the milk quota was filled. The CY production in 1997 increased by 1.8 per cent on 1996 and totaled 2,370 thousand tons delivered to the dairies. The average fat content was 4.3% and protein content 3.3%. Milk production is forecast to lie just under the quota (98%) in QY 1998, down somewhat due to silage quality problems following the very poor summer of 1998 and due to the reduction in inseminations. Milk production in CY 1998 is expected to be 0.5 per cent lower than 1997.

The main problem in milk production is poor profitability due to the structure - farms are too small - and to circumstances of high input costs but low prices for milk. In 1997, a study on the cost of milk production was carried out in Finland. The study was based on bookkeeping from farms throughout Finland and the conclusion was that on average it costs FIM 3,10 (60 cents) to produce one liter of Finnish milk, including a labor cost of 40 FIM/hour (USD 7.71 - average cost for farm labor). The average price for milk delivered was in 1997 FIM 1.86 (36 cents - same level as in 1996) and average support premiums FIM 0.65 (13 cents). The producer price plus the national support does not even reach the level of costs. Dairy farmers are thus working long hours for little pay - something which does not attract young farmers into the business. To make matters worse, the price situation will only deteriorate - profitability of cooperative dairies will go down due to the heightened competition both on the domestic fresh market and on the international markets. Dairies will not be able to maintain the milk price and a 10 per cent cut is foreseen. National support payments are going down and will even stop in southern parts of the country as the transition period comes to an end. On top of this, Agenda 2000 proposes a 15 per cent price cut.

Roughly 2,000 farmers drop out of production each year while the average milk yield per cow increased by 3 per cent (190 liters) to 6,183 liters. In 1997, 1,900 dairy farmers quit leaving 28,100 in production at the beginning of 1998. At the end of July 1998, 2,000 more farmers had already stopped delivering milk.

The future outlook hinges almost entirely on the final outline for CAP reform within the EU's Agenda 2000. In the 3-5 year outlook, despite the difficulties, production is expected to fill the quota and the structural adjustments will continue.

The structure of the dairy sector comprises of 26,000 farmers (and 380,000 cows) delivering to just over 50 dairies. Only one dairy company is private, namely the Ingman Foods Group. The Swedish dairy Arla is present with a sales office. The Valio group is the dominating company with at present 46 dairy cooperatives contracted and 70 per cent of raw milk deliveries (down from 72% in 1997). Valio lost some deliveries (110 million liters) when the cooperative dairy Maito-Pirkka in Tampere and Valio failed to agree for an extension of their contract which expired at the end of May 1998. This dairy will now be marketing independently on the fresh products' market, which is already very competitive. There are now 11 different dairies on the fresh products' market. Previously some of the Tampere milk was used for butter, cheese and milk powder production. MTK regret that this added competition will erode prices and in the end hurt all dairies - and dairy farmers - who are at present already struggling with poor profitability.

Valio reported at the end of August 1998 a reduction in net sales of 3 per cent compared to the same period last year, explained by the falling prices for domestic fresh fluids, weakened ice-cream sales (unfavorable weather and increased competition from Unilever's GB Glace) and the onset of the Russian crises. Valio and the

Swedish dairy Arla are still investigating a possible merger which may even include Danish MD Foods. Final plans on a possible collaboration/merger are expected by the end of 1998. If a merger would take place, a nordic dairy equivalent in size to Danone would be created. However, national competition authorities have indicated that they do not favor the idea.

Table 1. Milk use in 1997

Dairy Products	Milk use in 1997, %
Fresh Milk Products	42.7
Cheese	40.0
Milk Powders	7.7
Edible Fats	5.5
Others, baby food, ice-cream	4.1
Total	100

Butter Production**Table 2. PSD Table for Butter**

PSD Table						
Country:	Finland					
Commodity:	Dairy, Butter					
		1997		1998		1999
	Old	New	Old	New	Old	New
Calendar Year Begin		01/1997		01/1998		01/1999
Beginning Stocks	1	2	2	1	2	5
Production	50	50	54	52	0	54
Intra EC Imports	1	0	1	0	0	0
Other Imports	0	0	0	0	0	0
TOTAL Imports	1	0	1	0	0	0
TOTAL SUPPLY	52	52	57	53	2	59
Intra EC Exports	18	5	25	5	0	5
Other Exports	0	23	0	20	0	25
TOTAL Exports	18	28	25	25	0	30
Domestic Consumption	32	23	30	23	0	23
TOTAL Use	50	51	55	48	0	53
Ending Stocks	2	1	2	5	0	6
TOTAL DISTRIBUTION	52	52	57	53	0	59
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	0	0	0	0	0	0

Butter production - a means of storing dairy fats - will increase with the current difficult market situation. Production was 7.3 percent higher in 1997 than in 1996, driven by a healthy increase in butter exports - up 32 percent.

Table 3 . Butter production and exports 1993-1997, thousand metric tons

Year	Production	Exports
1993	44,735	16,650
1994	45,304	22,588
1995	44,705	18,260
1996	46,628	21,943
1997	49,979	26,821

Skimmed Milk Powder Production

Production of skimmed milk powder - nonfat milk powder - is the last resort as the profitability is less than for other dairy products. Exports of cheese and butter are suffering due to the Russian crises and stocks are growing. With the international market situation being very difficult for especially cheese, the production of milk powder will increase and the profitability for the dairy company will decrease.

Table 4. PSD for Skimmed Milk Powder

PSD Table						
Country:	Finland					
Commodity:	Dairy, Milk, Nonfat Dry					
		1997		1998		1999
	Old	New	Old	New	Old	New
Calendar Year Begin		01/1997		01/1998		01/1999
Beginning Stocks	3	3	4	5	4	5
Production	29	25	30	26	0	28
Intra EC Imports	0	1	0	1	0	1
Other Imports	0	0	0	0	0	0
TOTAL Imports	0	1	0	1	0	1
TOTAL SUPPLY	32	29	34	32	4	34
Intra EC Exports	0	1	0	1	0	1
Other Exports	21	16	23	19	0	21
TOTAL Exports	21	17	23	20	0	22
Human Dom. Consumption	7	2	7	2	0	2
Other Use, Losses	0	5	0	5	0	5
Total Dom. Consumption	7	7	7	7	0	7
TOTAL Use	28	24	30	27	0	29
Ending Stocks	4	5	4	5	4	5
TOTAL DISTRIBUTION	32	29	34	32	4	34
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	0	0	0	0	0	0

Consumption

European households are spending less and less on food, drink and tobacco, according to an EU-wide survey. Finnish households use 24 percent of their total expenditure, which is just above the EU average, however the range is relatively wide: 15-38 percent. With the growing Finnish economy - GDP growth for 1998 expected to be over 4 per cent - one could expect increased spending on foods, however this is not usually the case. Changes in disposable income influence food consumption very little, overridden strongly by prices, advertizing and health aspects. In 1997, retail prices were relatively stable although dairy products showed some increase.

The trends in consumption of dairy products follow earlier trends. Milk consumption is decreasing whereas

dairy products consumption, especially of low-fat products, is on the increase. Cheese consumption seems to have leveled off. Yoghurt consumption is still showing slight growth. Finnish consumers are now used to imports and these do not lead to increased total consumption. Butter consumption continues its general long term decline, however consumption of butter/margarine blends with 40% fat has increased. Also margarine consumption is on the increase. Butter consumption is estimated at 23,300 tons in 1997, which corresponds to 4,5 kg/capita and year.

Table 4. Per capita consumption of dairy products in Finland, kg (liters for ice-cream)/year

Product	1994	1995	1996	1997e
Milk	134.2	128.2	126.5	120.3
Skimmed milk	30.1	29.3	30.3	32.2
Fermented milk	23.8	23.6	24.2	23.7
Yoghurt	12.9	15.1	16.2	16.6
Cream	6.4	6.8	6.5	6.5
Cheese	13.5	14.8	14.8	14.8
Butter	5.4	5.3	4.9	4.5
Ice-cream (liters)	13.3	14.2	13.4	14.0

Source: Balance Sheet for Food Commodities, Tietopalvelukeskus, 1998.

Numerous customer surveys conclude that Finnish consumers prefer Finnish goods. There is even a special label (a blue and white swan) which indicates that at least 75 percent of the raw material in the product is of domestic origin. However, when the difference in price compared to, for example, imported cheese exceeds roughly 2 FIM/kg (37 cents per kg), according to a Finnish dairy contact, Finns will usually buy the cheaper imported cheese. The market is thus quite price sensitive. In addition, recent years have shown that Finnish consumers are more and more curious of new products. On the cheese market, imported cheeses are different to the local brands. Imported cheese held a 23 per cent market share in 1997 - up from 15 per cent in 1996. On the retail ice-cream market, imports accounted for 13 per cent.

Trade

Foreign trade of dairy products continued to grow in 1997. Exports of cheese grew by 10 per cent - however imports of cheese grew stronger- up 52 per cent to 17,600 tons. This indicates the continued tight competition on the cheese markets. Exports of yoghurt have increased since Valio took over the production of Yoplait also for the Swedish market. Valio reportedly exports 12,000 tons of fruit yoghurt out of which 10,000 tons go to Sweden.

Butter Trade

Exports of butter have increased dramatically in 1997 - up 32 per cent mainly due to a near doubling of exports to Russia. Russia accounted for 56 per cent of the bulk of butter exports. The outlook for 1998 is of course less bright due to the ongoing crises in Russia. How long will it last and how much will it affect exports is difficult to say, statistics are not yet available of trade since the beginning of the crises. Finland has exported roughly 2,000 tons of butter per month in 1997 and 1998, out of which half goes to Russia. If 4 months of exports (August-December) to Russia are lost this could mean a drop of 4,000 tons. As not all exports to Russia are cut the export total is estimated at 25,000 tons. Trade in butter (HS code 040510) in metric tons are shown in the matrices below.

Time period:	CY 1997
Exports for	1997
U.S.	0
Others	
Russia	15555
Germany	2746
Belgium, Lux	2200
Uzbekistan	2000
France	1472
Netherlands	679
Armenia, Rep of	648
Lebanon	385
United Kingdom	362
Switzerland	300
Total for Others	26347
Others not listed	1369
Grand Total	27716

Country:		Units:	metric tons
Commodity:			
Time period:	Jan-June		
Exports for	1997		1998
U.S.	0	U.S.	0
Others		Others	
Russia	8953	Russia	6717
Germany	1393	Germany	1588
Belgium, Lux	1225	Belgium, Lux	1382
France	847	France	1329
Uzbekistan	480	Armenia	373
Netherlands	472	Turkey	360
Lebanon	192	Argentina	300
United Kingdom	174	Saudi Arabia	300
Belarus	150	Lebanon	227
Syria	140	United Kingdom	185
Total for Others	14026		12761
Others not listed	674		483
Grand Total	14700		13244

Time period:	CY 1997
Imports for	1997
U.S.	0
Others	
New Zealand	273
Sweden	30
Italy	2
Belgium, Lux	1
United Kingdom	1
Total for Others	307
Others not listed	0
Grand Total	307

Country:		Units:	metric tons
Commodity:			
Time period:	Jan-June		
Imports for	1997		1998
U.S.	0	U.S.	0
Others		Others	
New Zealand	171	Sweden	293
Sweden	17	Netherlands	9
Belgium, Lux	1	United Kingdom	2
Italy	1	Italy	1
Total for Others	190		305
Others not listed	0		0
Grand Total	190		305

Skimmed Milk Powder Trade

With markets for other dairy products tightening, production and trade with skimmed milk powder is also growing. In 1997 exports more than doubled compared to 1996. Destinations are many but Mexico has surfaced as the most important destination and had already by the end of June 1998 imported more than in CY 1997. Exports are not expected to decrease due to the Russian crises and were at the end of August 12 per cent greater than in the same period 1997. Exports should have since increased and are estimated (by post) to reach 20 thousand tons in 1998. Official trade data differs somewhat from the Ministry of Agriculture's data for 1997, exports in the matrix total 16,612 tons and the MinAg indicates exports of 17,953 tons.

Time period:	CY 1997
Exports for	1997
U.S.	
Others	
Mexico	3300
Indonesia	1855
S.Afr.Cus. Un	1248
Thailand	1175
Egypt	1095
France	960
Brazil	800
Sweden	750
Malaysia	750
Saudi Arabia	592
Total for Others	12525
Others not listed	4087
Grand Total	16612

Country:		Units:	metric tons
Commodity:			
Time period:	Jan-June		
Exports for	1997		1998
U.S.		U.S.	
Others		Others	
Mexico	2725	Mexico	4380
Indonesia	1114	Egypt	930
S.Afr.Cus. Un	1107	Philippines	600
France	624	China	330
Malaysia	425	Malaysia	300
Saudi Arabia	416	Saudi Arabia	256
Japan	400	Sweden	142
Thailand	250	S.Afr.Cus. Un	93
Netherlands	185	Russia	57
Marocko	165	Italy	47
Total for Others	7411		7135
Others not listed	183		53
Grand Total	7594		7188

Time period:	CY
Imports for	1997
U.S.	0
Others	
Sweden	762
Germany	314
Denmark	247
Total for Others	1323
Others not listed	0
Grand Total	1323

Country:		Units:	metric tons
Commodity:			
Time period:	Jan-June		
Imports for	1997		1998
U.S.	0	U.S.	0
Others		Others	
Sweden	280	Sweden	233
Germany	174	Germany	90
Denmark	44	Denmark	80
		Italy	2
		United Kingdom	1
Total for Others	498		406
Others not listed			
Grand Total	498		406

Policy

Production policies in Finland are based on security of domestic supply - particularly given Finland's geographical location on the periphery of the EU. Yet, self-sufficiency cannot be set as objective in the same way as before EU membership, although the objective to fully utilize national production rights within the CAP - which in effect exceed consumption - is maintained.

Finland has through its accession agreement the possibility to support production directly during a transitional period. In addition, the northern area, with higher production costs, is supplemented through the Nordic support. The national support was described in greater detail in Dairy Annual, FI6007. However, national support hinges naturally upon national budgets. Finnish funds for agricultural support in 1999 have been cut by FIM 258 million (USD 47 million) compared to 1998.

An important support to the dairy farmer is the environmental support package which includes area payments for grassland and grazing (FIM 1700/ha = USD 311/ha). The package includes strict requirements for manure management, although a three year transitional period was granted during which an environmental management plan should be drawn up (with expert help) and implemented. This period runs out in 1998.

Within the frame for national support there is support for animal husbandry. For the dairy sector this is purely in the form of price support. In southern Finland this forms part of the support for severe difficulties and in northern Finland, the transitional price support is supplemented with a nordic support which is regionally graded. In early 1997, the EU commission approved the GOF proposal to revise the nordic support. The most

important change refers to milk production and meant that as of April 1996 it is possible to pay price support for the total amount of milk produced - even if this exceeds the individual quota. Only if the national quota is exceeded shall a fine be paid by the individual producers.

Finland was somewhat disappointed with the final results of discussions with the EU commission on the special clause 141 - for areas with severe difficulties - enabling Finland to expand national support to Southern Finland. It was decided that support for animal husbandry could only be paid until 1999.

Animal health and welfare remain central issues in Finland's agriculture which is attaining to acquire marketing advantages due to high standards and quality, as well as purity. In 1996 an obligatory grazing period was enforced for dairy cows, although allowing a 5 year transitional period.

The Finnish farmers are still very restrictive to the use of ag biotechnology and MTK (the Finnish farmers' Union) has declared that it is opposed to the use of GMO's in animal fodder in the food production chain.

Agenda 2000

The GOF and the MTK have reacted firmly against many of the proposals in the Agenda 2000, this includes the proposals of reform within the dairy sector. The price cut is not acceptable as it would (further) undercut production costs. The price cut cannot be compensated by increasing the Finnish quota by 8 per cent as proposed. This would only disrupt the domestic market and further depress prices. The issue of unjust forms of support such as the maize silage support is criticized. Maize is not grown in Finland. Finnish dairy farming is grass silage based, complemented with home grown grain and when needed purchased concentrates. It is vital that a grass silage support is granted for areas not using maize. A study of the economic effects of the early reform proposal of July 1997 and the amended proposal of March 1998, showed that the Finnish dairy farmer stands to lose FIM 120 (USD 22) or FIM 780 (USD 143) respectively per cow and year. The income reduction will be greater the more home-grown feed grain is used, which excludes benefits of reduced grain prices.

The GOF are seeking special arrangements in the negotiations so that the "extremely adverse" production conditions in Finland are adequately taken into account.

Marketing

The open market of the EU has worked in favor of free trading and in favor of imports - at least from within the EU. This, coupled with the increasing concentration of retail and wholesale sectors in Finland, has strengthened the retailers/wholesalers influence over markets. Branded goods are becoming more and more important, whereas producers are becoming more anonymous - and margins less. Aggressive marketing and brand development is necessary also in the dairy sector. This is a concern for domestic producers - and demands concentration also at processing levels, however with competition authorities acting as brakes it is a problem - but could be an advantage to exporters to the Finnish market, especially those working with international brands.

Market opportunities for U.S. dairy products are as mentioned in earlier reports probably strongest on the cheese and possibly yoghurt and ice-cream markets. The Finns are open to trying new products and Danone has recently shown it is possible to win market shares on the yoghurt market. GB Glace has shown that it is possible to enter the ice-cream market, however massive marketing efforts are required. After one year they have 14 per

cent of the retail ice-cream sales. The question remains whether they will maintain their market share - something the Swedish dairy Arla has experienced as difficult as the novelty of their new yoghurt wears off. Arla remains with 10 per cent of the yoghurt market after initially attaining even 30 per cent in certain areas in Finland.