

Milking the CAP

How Europe's dairy regime is devastating livelihoods in the developing world

European citizens are supporting the dairy industry to the tune of €16 billion a year. This is equivalent to more than \$2 per cow per day – half the world's people live on less than this amount. EU surpluses of milk and milk products are dumped on world markets using costly export subsidies, which destroy people's livelihoods in some of the world's poorest countries. Dairy processing and trading companies are the direct beneficiaries of these subsidies. Meanwhile, many small-scale European dairy farmers are struggling to make ends meet. Oxfam is calling for an immediate end to EU dairy export dumping and for agricultural support to target small-scale farmers.



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Summary

'EU dairy dumping...is abhorrent. Protectionist policies in those countries that subsidise dairy production and exports do not consider at all the harm they inflict on developing countries.'

David Cueto, Executive Director of CONALECHE (National Council for the Regulation & Promotion of the Dominican Republic Dairy Industry).

'...It is dumping that is the major issue. The problem is that most of the milk imported [into Kenya] is heavily subsidised by the governments of the countries of origin. Kenya lacks the capacity to do the same. It is therefore very unfair for our local producers because they cannot compete effectively.'

Vincent Ngurare, Managing Director of the Kenya Dairy Board.¹

European citizens are supporting the dairy industry to the tune of €16bn each year through a regime that destroys people's livelihoods in some of the world's poorest countries.² The Common Agricultural Policy (CAP) encourages the over-production of milk and milk products, and the resulting surpluses are dumped on world markets using costly export subsidies. This undermines markets for farmers in the developing world. Processing and trading companies are the direct beneficiaries of these export subsidies, while many small European dairy farmers are struggling to make ends meet. Like dairy farmers in developing countries, they are among the losers from the CAP.

This paper shows how the CAP dairy regime is devastating livelihoods in developing countries, by creating unfair competition. **EU dairy dumping is just one example of the rigged rules and double standards that prevent trade from working for the poor.** Ending export subsidies by rich countries is vital if poorer countries are to get a fair chance in world markets. In theory, the EU, along with other industrialised countries, agreed to this goal as a core objective of the new WTO round of negotiations. In practice, they are continuing business as usual, notably in the EU dairy sector.

Apart from undermining poor countries and threatening prospects for a successful outcome to the current WTO agricultural negotiations, the CAP dairy regime is failing on its own terms. A key CAP objective is to support farm incomes. This goal is widely supported by European citizens: a recent survey showed that 80 per cent want EU farm policy to protect small-scale farmers.³ Yet record numbers of dairy farmers are leaving the sector because they can no longer make a living.

The EU dairy sector is protected and supported through a complex system of price support, production quotas, import restrictions, and export subsidies. Despite production-limiting quotas, the EU produces more milk and milk products than it needs to satisfy domestic consumption. This results in a structural surplus, which is disposed of on internal and external markets using subsidies.

The OECD estimates that in 2001 the EU supported its dairy sector to the tune of €16bn (40 per cent of the value of EU dairy production).⁴ **This is equivalent to more than \$2 per cow per day – half the world's people live on less than this amount.**⁵ The regime directly costs EU taxpayers around €2.5bn each year, at least half of which is spent on export subsidies to dump surplus production on world markets. Further subsidies to promote the domestic consumption of milk, and milk products account for the majority of the remainder. In addition, and as a result of the system of price support, EU consumers pay a higher price for dairy produce than they would without it.

The direct beneficiaries of EU dairy subsidies are processing and trading companies, not farmers. These companies receive more than one billion euros each year from European taxpayers in export subsidies alone. Yet it is impossible to obtain a breakdown of which companies receive what subsidies – highlighting the lack of transparency in how taxpayers' money is spent through the CAP subsidy system. For example, the UK Rural Payments Agency told Oxfam that it is unable to disclose which companies receive dairy subsidies because this information is 'commercially sensitive'. The recipients include such companies as Nestlé and Arla Foods, and we urge greater transparency about the level of subsidies paid to these companies.

Producers in developing countries pay a high price for CAP subsidies. This paper documents how:

- Millions of euros of European taxpayers' money has been spent helping to develop the Indian dairy industry over the past 30 years. At the same time, European taxpayers are paying to support the CAP dairy regime, which threatens the livelihoods of Indian milk producers by creating unfair competition in local and third markets.
- The livelihoods of thousands of poor small-scale farmers in Jamaica, the Dominican Republic, and Kenya have been destroyed by imports of cheap subsidised EU dairy products.

Contrary to the received wisdom of EU policy makers, the CAP dairy regime has failed to address the problems of small-scale European farmers. Many are struggling to make ends meet because low farmgate prices have reduced their income. The number of EU dairy farmers has fallen by more than 50 per cent over the past decade, while average herd size has increased by 55 per cent.

The approach to reform favoured by the European Commission and most member states is based on an obsession with defending EU export market shares, regardless of the costs to European taxpayers, small-scale European farmers, and developing-country milk producers. What is actually needed is a deep cut in production quotas in order to end dumping, allied to measures to redistribute agricultural support to small-scale farmers in support of environmental conservation and rural development objectives.

Oxfam proposes that the Mid-Term Review of the CAP introduce reforms to:

- **Eliminate the need for dairy export subsidies, which undermine the livelihoods of poor farmers in developing countries, by cutting milk production quotas to levels that bring domestic EU production in line with internal consumption – as recommended in the 2001 EC Court of Auditors report.**
- **Restructure agricultural support so that the benefits flow to small-scale farmers, and so that subsidies are targeted towards achieving environmental conservation and rural development objectives. The EU should shift a substantial share of agricultural expenditure to the rural development budget of the CAP.**
- **Increase the transparency of the CAP by making public how agricultural subsidies are distributed. Each EU member state should be required to publish an annual account of subsidy transfers to companies.**

In addition, in the WTO negotiations on agriculture, the EU should:

- **Agree a binding timetable to eliminate all forms of export subsidies before the 5th WTO Ministerial Conference in Mexico (September 2003).**
- **Support the introduction of a development box in the Agreement on Agriculture to provide developing-country governments with the flexibility to protect their small-scale farmers from dumping.**

1 Introduction

The EU dairy sector is protected under the Common Agricultural Policy (CAP) through a system of price support, production quotas, import restrictions, and export subsidies. Despite the production quotas, the EU produces more milk and milk products (such as butter and milk powder) than it needs to satisfy domestic consumption. This results in a structural surplus of dairy produce, which is disposed of on internal and external markets using subsidies.

The export of heavily subsidised surplus EU dairy products directly benefits dairy processing and trading companies, not European farmers. These companies receive more than one billion euros in export subsidies each year, which bridge the gap between high internal EU prices and lower world prices. But EU exports come at a high price for poor producers in developing and transition countries, many of whom live in acute poverty, and face unfair competition from cheap subsidised EU produce in their local markets and in export markets.

This paper examines the EU dairy regime and makes the case for urgent reform, focusing on the need to end export dumping. Section 2 provides an overview of the dairy sector, including the EU's role in world dairy markets. Section 3 explains the instruments used under the dairy regime. Section 4 attempts to identify the main beneficiaries of the system of dairy export subsidies, and Section 5 shows how the CAP dairy regime affects poor milk producers in developing countries, with case studies from India, the Dominican Republic, Jamaica and Kenya. Section 6 makes the case for urgent reform of the CAP dairy regime, and presents Oxfam's policy proposals.

2 The EU dairy sector

Milk production is the most important agricultural activity in the majority of EU member states, and in the EU as a whole. It represents around 14 per cent (€38bn) of the total value of agricultural production. More than 600,000 farmers are involved in the sector, which is particularly important for Germany, France, the UK, the Netherlands, Ireland, and Italy. Together, these countries account for three-quarters of EU milk production.⁶

The European dairy sector contains a wide range of actors, from milk farmers with small herds of between 5 and 15 cows in Italy and the Austrian mountains, to some of the most powerful multinational

corporations in the world, such as Nestlé. Standing between farmer and consumer in the milk market are the processing industry and the retailers, dominated in many EU member states by large supermarket chains.

Numbers of farmers falling, but herd size rising...

The structure of the sector has changed substantially over the past decade and is becoming increasingly concentrated. The number of dairy farmers has fallen from nearly 1.5 million in 1990 to 642,000 in 2000, a decline of more than 50 per cent. In each of the last five years, between four and five per cent of dairy farmers have gone out of business.

Average EU herd sizes have grown over the same period: from 18 cows in 1990 to 28 cows in 2000. However, there are substantial differences in herd size between member states and across regions. In absolute terms, south-east England, Scotland, and East Germany have the biggest average dairy herd size (of more than 100 cows). By contrast, the average herd size in Austria is eight cows, with only one per cent of herds exceeding 30 cows.

...fewer cows, more milk

Milk output per farm is rising faster than the growth in herd size because the average yield per cow has significantly increased. UK farms produce the most milk per cow, but Danish farms are catching up fast. The next largest farms are in the Netherlands, Sweden, and Germany. The rising yield per cow has led to a reduction in the number of dairy cows in the EU since the introduction of milk quotas in 1984.

The role of co-operatives

The dairy processing sector comprises both private companies and co-operatives. About half of all dairy businesses (over 2000) are farmer-owned co-operatives. By their nature, co-operatives generally deliver higher milk prices to producers than private companies, who will seek higher profit margins for shareholders.

Co-operatives handle between 60-70 per cent of butter and milk powder manufacture in most EU countries, 40-60 per cent of cheese, and around 60-90 per cent of liquid milk. The UK is an exception to this since there is very little milk processing under the control of farmer co-operatives. At the other extreme, the dairy sectors in

Ireland, the Scandinavian countries, and the Netherlands are almost entirely co-operative-dominated.

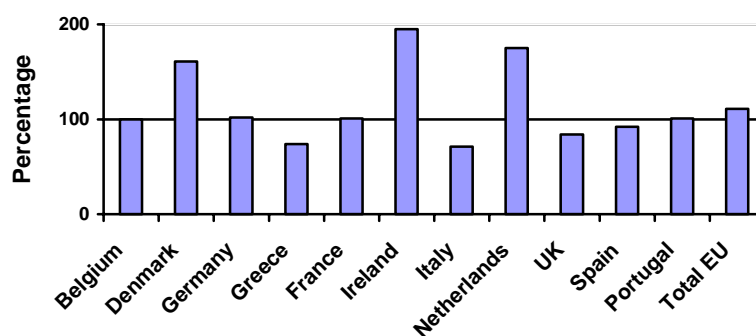
Surpluses despite quotas...

Despite a system of milk quotas designed to cap production, the EU systematically produces a surplus of milk and milk products. This is because production quota levels have been set higher than is required to meet the needs of domestic consumption. The self-sufficiency ratio of milk production varies across EU member states: milk production exceeds consumption in Denmark, Ireland, and the Netherlands, and is lower than consumption in Greece, Spain, Italy, and the UK (see Figure 1). The overall self-sufficiency ratio for the EU is around 110 per cent.

...even in 'deficit' countries

Denmark, Ireland, and the Netherlands are among the biggest EU dairy-exporting countries. However, some member states with balanced domestic markets, and even those that are less than self-sufficient, are also involved in exports. For example, the UK is only 84 per cent self-sufficient in milk production, and imports large volumes of dairy produce, particularly butter and cheese. But the UK also exports substantial quantities of butter, cream, and milk powder to EU and third markets.

Figure 1: Self-sufficiency in milk production, 1998



Source: EC Court of Auditors Report, 2001.

The EU: a major player on world markets

Although its world market share has declined in recent years, the EU remains one of the biggest exporters of milk and milk products in the world, accounting for 40 per cent of whole milk powder (WMP)

exports, 32 per cent of cheese exports, 31 per cent of skimmed milk powder (SMP) exports, and 20 per cent of butter exports (see Annexes 1 and 2 for graphs showing the EU share of world export markets and the destination of EU dairy exports).⁷

The EU can only maintain its position in world markets because of the export subsidies made available under the CAP dairy regime. Oxfam estimates that the EU exports SMP at prices representing around one-half of the costs of production.⁸ It is these export subsidies, and the EU's role as a major exporter of dairy produce, that makes the CAP and its reform a key issue for farmers across the developing world.

3 The CAP dairy regime

One of the objectives of the CAP is to support farm incomes.⁹ Most European citizens (80 per cent) are in favour of EU farm policy protecting small-scale farmers.¹⁰ However, the CAP has failed to achieve this, especially in the dairy sector. This is despite the high cost of the CAP dairy regime, which accounted for six per cent of the total CAP budget (€2.5bn) in 2000.

A broader indicator of the level of EU support to its dairy sector – the OECD Producer Support Estimate – suggests that in 2001 the EU supported its dairy sector to the tune of €16bn (40 per cent of the value of EU dairy production), equivalent to more than \$2 per day per cow. Half the world's people live on less than this amount.¹¹

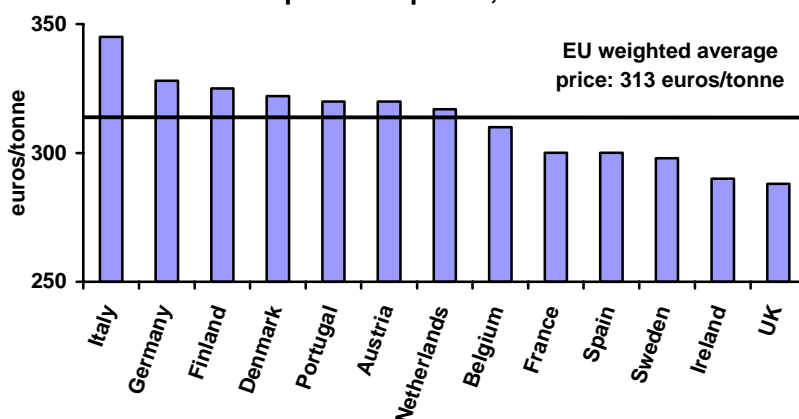
One reason that subsidies have failed to protect farm incomes is that they are directed to the dairy processing and exporting industry. The benefits are expected to trickle down to farmers, but in practice, this does not always happen, and the dairy companies capture the lion's share – assured of a fixed price for their output, guaranteed markets overseas, and what amounts to a corporate welfare cheque from EU taxpayers.

Prices are supported...

Farmgate milk prices are indirectly regulated by intervention in the markets for processed dairy products, specifically for skimmed milk powder (SMP) and butter. This is because fresh milk is perishable and cannot be stored in order to adjust seasonal supply to demand. In theory, intervention in the markets for processed dairy products is intended to maintain a 'target price' for producers of fresh milk, which is agreed by the Council of EU Agricultural Ministers (currently €309.8/tonne). However, this target price is not always

met: milk producers in several EU member states, including the UK, Spain, Austria, Ireland, Portugal, Belgium, and France, have not received the target price for the past five years (see section 4 below).

Figure 2: Comparison of EU milk producer prices, 2001



Source: Dairy Market Update, MDC Datum, April 2002

The intervention system sets a guaranteed price for butter and SMP – currently €3,282/tonne and €2,055/tonne respectively. In addition, aid is provided for the storage of SMP and cheese by private agencies when required to rebalance the market.¹²

...quotas limit production

Historically, high guaranteed prices have been strong incentives for increased milk production. This in turn has forced policy makers into ever-more desperate (and largely ineffective) measures to control production. The EU introduced a system of production quotas in 1984 in an attempt to counter rising levels of output,¹³ but this failed to balance EU dairy markets. One reason is that the quota is set at 120m tonnes of milk each year, equivalent to around 110 per cent of domestic consumption (see Annex 3).¹⁴ In other words, a large export surplus is built into the quota system.

The production of this surplus is the underlying cause of EU dairy dumping, which is destroying the livelihoods of poor farmers in developing countries. A 2001 EC Court of Auditors report recommended that milk production quotas should be cut to bring overall EU milk production in line with unsubsidised internal consumption plus unsubsidised exports. However, the European Commission has not accepted this recommendation.

Subsidies are used to export excess production...

In order to enable the export of EU dairy produce, subsidies are provided to bridge the gap between prices on the world market and the higher internal EU prices.¹⁵ The level of export refunds varies over time, depending on changes in world market prices, and may also vary according to the destination of exports. In October 2002, EU export refunds were €1850/tonne for butter (equivalent to 56 per cent of the butter intervention price) and €760/tonne for SMP (36 per cent of the SMP intervention price).

Export subsidies have accounted for around €1.5bn or 50 per cent of the EU's expenditure on the dairy sector in recent years. The WTO's limits on export subsidies have reduced expenditure on export refunds for some products (such as cheese), but have been no restraint on subsidies for other exports (such as butter and SMP).¹⁶

...and for domestic use

In addition to export refunds, the EU provides subsidies to promote domestic consumption of butter and SMP, for example through sales schemes for butter used in the manufacture of pastry and ice cream (more than 500,000 tonnes of butter was subsidised through this channel in 1999),¹⁷ and for SMP used in animal feed and the manufacture of casein.¹⁸ The value of these subsidies in 2000 was more than €1.1bn.

Imports are restricted

Import restrictions are the flipside of the export subsidy system. Without tariffs, the high internal EU prices for dairy products would attract large volumes of imports. Therefore, the EU maintains high tariffs against imports of dairy produce in order to protect domestic producers from competition. In 2001, EU import tariffs were as high as 150 per cent for butter, more than 50 per cent for SMP, and above 60 per cent for WMP.¹⁹

In addition to these high tariffs, potential exporters to the EU face a bewildering array of non-tariff barriers – especially if they happen to be located in developing countries. These barriers include health and safety regulations, some of which stretch credibility (see Box 1).

Box 1: Camel cheese blocked by EU import restrictions

Tariffs are not the only problem. Non-tariff barriers, particularly high and complex product standards, also block imports into the EU. A successful Mauritanian enterprise, Tiviski, has been prevented from selling its pasteurised camel cheese to the EU for several years because of such restrictions. Despite finding a buyer in Germany, Tiviski's efforts have been thwarted by EU trade regulations – or rather a lack of them! The EU has no specific regulations relating to camels, and would need to pass a special directive to allow Tiviski to export its camel cheese, leaving the company unable to access lucrative EU markets. This means lost opportunities for the 800 nomadic herders who have benefited from higher incomes as a result of selling their milk to the company.

Source: 'African's Camel Cheese Meets EU Bureaucracy (Or How Poor Countries Try, and Fail, To Trade)', by Barry James, *International Herald Tribune*, 14 May 2001.

US and Canada protect their dairy sectors too

It is not only the EU that supports its dairy industry. Other industrialised countries do the same, albeit through different policy instruments (see Box 2).

Box 2: US and Canadian dairy regimes

The 2002 US Farm Act introduced a new milk price support expected to add \$775m to farm subsidies in the first year. Other US instruments are particularly damaging to developing countries. The Dairy Export Incentive Program subsidises exports with cash, enabling processing firms to export dairy products for less than they pay for them. Under the Price Support Program for Milk, the government's Commodities Credit Corporation can buy unlimited amounts of butter, cheese, and SMP for stock, some of which is then used as food aid under the USA's Public Law 480. PL480 aid increased from 18,500mt of dairy products in the whole of 2001 to 32,230mt over the first 255 days of 2002. Most of this went to politically important countries in the Asian region such as Afghanistan, Indonesia, and Pakistan.

Far from helping small farmers, US dairy subsidies have promoted a highly concentrated dairy sector. In 2001, the number of dairy farms fell below 100,000, less than one-sixth as many as in the EU. Just three per cent of them had over 500 cows, but these produced 40 per cent of the milk.

Canada operates a dairy supply management system under which milk prices and marketing arrangements are carefully regulated by the federal government. Supply is restricted through production quotas, and minimum floor prices are set for butter and SMP. Canada also implements restrictive import policies. Farmers have a relatively strong input into the system and farmgate prices are one-quarter higher than in the US, although retail prices are lower.

When milk surpluses are anticipated, Canadian producers export at prices which the Department of Foreign Affairs and International Trade admits are considerably lower than those on the domestic market. The foreign trade parts of the system have been successfully challenged at the WTO by the USA and New Zealand. As a result, Canada deregulated exports of dairy surpluses, eliminating any government role in the process. However, Canada's export prices remain lower than those on the domestic (supply managed) market, and the US lodged a second WTO challenge. Canadian farmers insist they can only export at world market prices, which have been driven down by massive EU and US subsidies, and that Canadian domestic prices should have no bearing on determining unfair trading practices. A decision was expected December 20, 2002.

4 Who benefits from EU dairy subsidies?

One of the enduring myths of the CAP is that the subsidies it provides are targeted at small farmers. Nothing could be further from the truth. More than half the EU dairy budget is spent on export refunds for processed dairy products (butter, SMP, WMP, and cheese). The direct beneficiaries of these payments are not milk producers but the dairy processing and trading companies that export these products. These subsidies are responsible for the practice of EU dairy dumping, which is so damaging to developing countries. The assumption is that the benefits will trickle down to European farmers, but this does not always happen.

Growing concentration in the processing industry

The EU dairy processing industry is becoming increasingly concentrated. Between 1985 and 1997 the number of dairy processing companies fell, but the capacity of those remaining in business rose on average from 19,711 tonnes to 29,710 tonnes. The biggest companies are getting bigger by merging with, or buying out, other medium-sized and large companies.²⁰ The top ten companies in 2001 processed 20 per cent more milk than the top ten companies in 1998. Just 40 dairy companies are now estimated to process 65 per cent of the milk produced in the EU.²¹ The top 150 European dairy companies account for 85 per cent of European milk processing (see table 1).

Table 1: Europe's top ten milk processors in 2001

Processor	Private company/ Co-operative	Country of origin	Milk purchases (million litres/year)
Arla	C	Denmark/Sweden	7,200
Lactalis	P	France	7,000
Campina	C	Netherlands	5,750
Friesland	C	Netherlands	5,600
Nordmilch	C	Germany	4,187
Bongrain/CLE	P	France	4,125
Dairy Crest	P	UK	3,000
Nestlé	P	Switzerland	2,800
Humana Milchunion	C	Germany	2,457
Glanbia	C/P	Ireland	2,450

Source: Europe's Dairy Industry 2001/02

Box 3: Europe's major milk processors and dairy-trading companies

Nestlé (multinational: HQ in Switzerland) is the world's largest food and dairy company: it processes around 10bn litres of milk per year. Nestlé dominates international trade in powdered milk, accounting for over 50 per cent of the world market (much of it in developing countries) as well as 11 per cent of the world dairy market. The net profit of their milk products, nutrition, and ice cream division in 2000 was €1.8bn.

Arla Foods (Denmark) is Europe's largest dairy company and co-operative, and the third largest dairy group in the world. It was created in April 2000 as the result of a merger between Arla (64 per cent of Swedish milk supplies) and MD Foods (92 per cent of Danish milk supplies). It has a large subsidiary processing operation in the UK. Milk powder accounts for 15 per cent of its turnover, and non-European markets for a further 15 per cent. The group has an annual turnover of around €5.1bn.

Lactalis (France) is the largest European private dairy company. It processes almost 7bn litres of milk a year, two-thirds of which is processed in France (20 per cent of national milk production). The company's turnover is around €5.5bn.

Campina (Netherlands) and Friesland (see below) together control about 80 per cent of all milk processing in the Netherlands. Campina is also a major player in the German market. In the Netherlands around 7,500 members, who effectively own the business, supply Campina. In 2000, the company's turnover was €3,894m, with a net profit of €22.7m.

Friesland Coberco Dairy Foods (Netherlands) is the largest Dutch milk processor, accounting for 50 per cent of total Dutch milk deliveries in 2000.

The company has 13 production plants outside the Netherlands (including in South-East Asia and South America), compared with 22 domestically.

Nordmilch (Germany) is the largest German dairy business. The co-operative has 15,000 farmer members and processes around 15 per cent of German milk output. Around 25 per cent of turnover comes from exports of butter, cheese, and powders, which are mainly within the EU and to Eastern Europe. The group's turnover in 1999 was over €2bn.

Bongrain (France) is the second largest French dairy company. Their overseas subsidiaries (in other European countries, the USA, South America, and India) produce 100,000 tonnes of cheese a year. A further 60,000 tonnes of cheese a year is exported from France. In 2000, the company's turnover was €3.9bn, with a net profit of €56m.

Dairy Crest (UK) is the largest UK dairy company. It processes about 20 per cent of UK milk deliveries. Dairy Crest is the largest cheese maker in the UK, and the biggest butter and SMP maker.

Dairy trading companies

The European dairy trade association, EUCOLAIT (based in Brussels), has over 700 members, including both dairy-processing companies and specialist dairy traders. The latter are generally secretive about their operations and financial performance, making it impossible to estimate their share of the market. But they play a major role in the trade of butter, milk powders, and certain cheeses. Some large trading businesses have grown out of dairy co-operatives, such as the Irish Dairy Board and the German Deutsche Milch Kontor. The Netherlands, as a major EU dairy-exporter, is home to a large number of dairy trading companies such as Hoogwegt Group BV, Vreugdenmil BV, Oak Trading Group, and Interfood BV Hapert-Holland.

Source: Europe's Dairy Industry, 2001-02

Lack of transparency over who gets the subsidies

Most of the direct benefits provided through the CAP dairy regime take the form of corporate welfare cheques to companies with a clear vested interest in maintaining and defending the system. Oxfam has tried to obtain information about the recipients of these subsidies from both the European Commission and the UK Rural Payments Agency, only to be told that such information is unavailable or 'commercially sensitive'.²² This highlights the high levels of secrecy and lack of transparency that characterise the operation of the CAP subsidies system. In many cases, EU taxpayers are propping up the profit margins of private companies – and denied the right to know which companies these are, or how much they receive.

In an effort to identify the likely main beneficiaries of dairy export subsidies, Oxfam examined the case of skimmed milk powder (SMP). By multiplying the volume of extra-EU exports of SMP for each member state in 2000 by a rough average of the SMP export refund rate in the same year, the value of export refunds allocated to each EU member state was calculated.²³

On this (conservative) estimate, the Netherlands, Germany, and Belgium each received more than €40m in SMP export subsidies in 2000. The direct beneficiaries of these subsidies would have included the major processing and trading companies in each country, such as Campina and Friesland in the Netherlands, Nordmilch and the Deutsche Milch Kontor in Germany, and a range of (often foreign) processing and trading companies that operate in Belgium. Several of these companies are active in more than one market, such as Arla Foods, Nestlé and Campina. As one of the biggest milk purchasers and processors in Europe, and the dominant player in world milk powder markets, Nestlé is likely to reap a sizeable proportion of the benefits of EU SMP export subsidies, which are used to dump EU surpluses on the world market. Despite this, Nestlé has adopted a public position in favour of the elimination of agricultural subsidies in industrialised countries.²⁴ The inconsistency in these two positions challenges the company to take action to promote the elimination of EU export subsidies. While official secrecy makes precise comparison difficult, in many cases it is the dairy companies – not the majority of small-scale European dairy farmers – that are reaping the benefits of the CAP dairy regime.

Irish and French processors and traders also appear to have received substantial levels of SMP export subsidies in 2000, amounting to €30m and €22m respectively. The main beneficiaries of these subsidies would likely include the Irish Dairy Board and Laita in France, as well as various private trading companies.

Not all dairy farmers are equal...

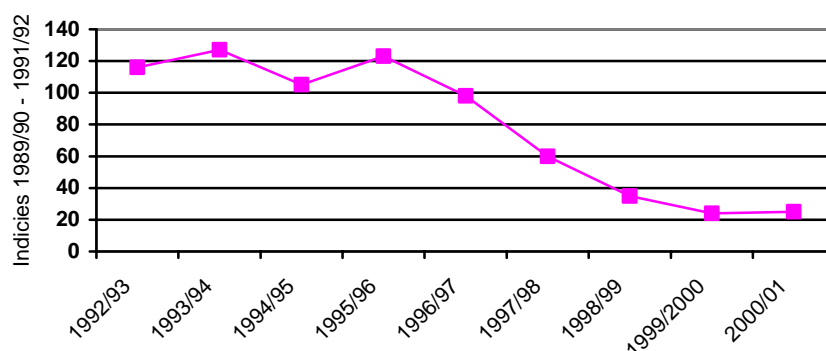
While these companies are clear beneficiaries of dairy subsidies, small farmers in Europe have mixed experiences of the CAP dairy regime. In spite of the common EU dairy policy and the target price agreed for milk (€309.8/tonne), farmers in different EU member states receive vastly different prices. The average EU producer milk price was consistently below the target price throughout the 1990s.

This reflects the different nature of the industry in each member state, particularly the extent to which farmers are involved in the processing sector. For example, milk producers in Germany and Denmark receive some of the highest prices in the EU, which partly

reflects the dominance of farmer-owned co-operatives in the processing sector. By contrast, in the UK – where farmers receive the lowest prices – there is very little milk processing under the control of farmers’ co-operatives.

Many small European dairy farmers are being forced out of business due to the CAP dairy regime’s failure to maintain their income at remunerative levels. Average EU prices rose in 2001 to exceed the target price (by one per cent) for the first time in ten years, but the UK price (the lowest in the EU) remained seven per cent below the CAP target price; it was between 14 per cent and 16 per cent below the target price in 1998-2000.²⁵ In 2000, the average UK milk price received by farmers was only 40 per cent of the average price paid in Italy.²⁶

Figure 4: UK average net farm income per dairy farm (in real terms)



Source: UK Milk Task Force Report, December 2001

...but some are even less equal than others

Low producer prices have significantly affected dairy farm incomes in some member states. UK incomes have fallen dramatically in recent years because of falling producer prices plus rising input costs. Between 1999 and 2000, UK producer prices were below the costs of production. Average net dairy farm income fell by 26 per cent to £9000 (€14,000).²⁷

5 The damage done to developing countries

The EU dairy regime affects developing countries in three main ways: by depressing world market prices, by pushing developing country exporters out of third markets, and by directly undermining domestic markets in developing countries. These affect both major developing-country dairy exporters, such as Argentina, and poor countries seeking to develop or maintain their domestic dairy industries, such as the Dominican Republic, India, and Jamaica.

EU exports depress prices for other exporters...

It is difficult to estimate precisely how high world market prices would rise in the absence of the CAP dairy regime, but a number of studies suggest that EU subsidies have a substantial depressing effect. A 2001 Australian government study showed that if the volume of subsidised EU and US dairy exports were halved, world dairy prices would be between 17 and 35 per cent higher.²⁸ Due to the EU's dominant role in world dairy trade, the CAP dairy regime must account for a major proportion of this price depression.

As a major exporter of dairy products, EU dumping prices have a significant influence on world market prices. Because the overall effect is to lower prices, dairy farmers in developing countries lose income and investment opportunities. This affects existing developing-country exporters of dairy products, such as Argentina, but also prevents other countries with export potential, such as India, from breaking into export markets.

...and destroy local markets

Where subsidised EU dairy exports enter developing-country markets, they compete unfairly with domestic milk production. During the past two decades, many developing countries have rapidly opened their agricultural markets to imports, in many cases under the auspices of IMF-World Bank reform programmes. This has exposed local milk producers to direct competition with European surpluses at heavily subsidised prices. The result is that domestic prices are depressed and local producers, many of whom live in poverty, are driven out of business.

The Indian dairy sector

The experience of the Indian dairy industry illustrates the effects of the CAP on developing countries. Between 1970 and 2000, India's annual milk production quadrupled from 22m tonnes to over 80m tonnes. Nearly 11 million Indian farmers are involved in the dairy sector: more than 75 per cent are smallholders or landless, and many are women. The development of the industry has been so successful that India is now self-sufficient in milk production, and has recently begun to develop small, but significant, quantities of dairy exports.²⁹

But the prospects for the sector are clouded by the impact of the CAP dairy regime:

- Exports of Indian milk powder more than doubled between 2000 and 2002 (albeit from a low base). Most of these exports were destined for Bangladesh and the Middle East, which are also major outlets for subsidised EU exports. EU export subsidies hamper the ability of Indian exporters to match the prices offered by their European competitors in these markets. The result is that Indian companies are deprived of potential export market shares and foreign exchange earnings.
- The Indian dairy industry complains that domestic milk producers are unable to compete with imports of heavily subsidised EU butter and milk powder. India imported over 130,000 tonnes of EU SMP in 1999-2000. This quantity of EU SMP exports is likely to have attracted subsidies worth as much as €5m, 10,000 times the annual income of a small-scale Indian milk producer.³⁰

Ironically, the EU was a major contributor to the programme of international assistance – known as Operation Flood – which supported the successful development of the Indian dairy industry. 'We would have remained poor and would not have been able to send our children to school had there not been a dairy co-operative society in our village', says Gayatri Devi, a milk farmer in Mehsana. Yet Gayatri's livelihood, and that of millions of other small farmers like him, is threatened by the CAP dairy regime.

The wider costs

India is not an isolated case. In Jamaica, trade liberalisation in the early 1990s resulted in domestically produced fresh milk being pushed out of the market by subsidised European milk powder as the major input for the Jamaican dairy processing industry. The volume of subsidised EU milk powder exports to Jamaica more than

doubled during the 1990s. This had devastating consequences for local milk producers, many of whom are women running their own businesses. Producers in the Dominican Republic are facing similar problems (see Box 4).

The dairy sector in Kenya employs more than 600,000 small-scale farmers, and accounts for around 10 per cent of total GDP. The country is self-sufficient in milk production, but in 2001 Kenya experienced a surge in imports of EU milk powder and butter. These products were imported by dairy and food processing companies, including Nestlé Foods Ltd, Spin Knit Ltd, and Wonder Foods Ltd, at cheap (subsidised) prices. As a result, dairy and processing companies lowered the prices they offered to local producers for fresh milk to a level below domestic costs of production.³¹

After a lobby campaign by the Kenya Dairy Board, the government agreed to double dairy import tariffs in order to protect local producers.³² However, there is concern within the industry that these higher tariffs are not being enforced, leaving producers subject to continued unfair competition from cheap subsidised imports.

Time to end export dumping

These examples illustrate the negative impacts of the CAP dairy regime on rural livelihoods in developing countries. They highlight the urgent need for the EU to agree an immediate end to the use of export subsidies. The EU and other industrialised countries made a commitment to phase out agricultural export subsidies in the WTO Doha Declaration. EU agricultural ministers should take a lead by agreeing a timetable to end agricultural export subsidies by 2005.

Similarly, these examples show the importance for developing countries of maintaining the right to protect their domestic agricultural sectors in order to promote food security and rural livelihoods, which are crucial for the achievement of poverty reduction. WTO rules should enshrine this right by, for example, incorporating a Development Box in the Agreement on Agriculture.³³

Box 4: EU dairy dumping in the Dominican Republic

'I'm only able to produce 100 bottles of milk every day, and the price I get from the intermediaries is not enough to cover my costs. I don't want to leave my town and work in the construction sector, but I don't think I'll have many chances if things remain the same.' Pedro Cruz, small-scale dairy producer.

Around 30,000 farmers are involved in milk production in the Dominican Republic, producing over 380,000m litres in 2000. Most of these farmers produce on a small-scale; many live in acute poverty. Fifteen per cent of milk producers live in the Northwest region of the country, where half the population lives in extreme poverty and only one child in two goes to school.

Although national dairy consumption doubled in the 1990s, rising demand has largely been met by increasing quantities of cheap imported dairy products. Domestic milk production has remained stagnant. The volume of dairy imports more than trebled during the 1990s, reaching 352m litres in 2000.

Part of the reason for this increase was import liberalisation following the Dominican Republic's accession to the WTO in 1995. Milk powder imports are regulated by a tariff quota system under which 32,000 tonnes can enter the country at a low tariff rate of 20 per cent.³⁴ The import quota is distributed between suppliers according to historical levels, with the EU accounting for 70 per cent (22,400 tonnes).³⁵

According to CONALECHE, the price of EU milk powder imports systematically undercuts the local price of fresh milk by 25 per cent – at least partly because of the level of EU export subsidies. In 2000, the EU export subsidy rate for WMP ranged from €680/tonne to €1,090/tonne. In the same year, the Dominican Republic was the fifth most important market for EU WMP exports. Local milk producers cannot hope to compete against heavily subsidised European imports. Around 10,000 farmers are thought to have been forced out of business during the past two decades, in spite of considerable investment in the dairy sector by the government and the industry itself. Lower incomes in the dairy sector reduce the purchasing power of those affected and undermine the wider rural economy.

Ironically, the European Union is spending millions of euros in aid to support rural development in some of the poorest regions of the Dominican Republic. Some of this money is going to support cattle-rearing schemes. What the EU is giving through aid, it is simultaneously destroying through trade.

Source: G. Fanjul, EU Dairy Dumping in the Dominican Republic, November 2002

6 Ending dairy dumping

The damage inflicted on developing countries, allied with the high costs and failure of the CAP dairy regime to support the livelihoods of many small-scale European farmers, ought to make this sector a priority for radical reform. However, the current mid-term review of the CAP makes no proposals to this effect.³⁶

But pressure for reform is now building as a result of the EU's obligations to cut agricultural subsidies in the current Doha round of WTO negotiations, and because of domestic budgetary pressures associated with EU enlargement. At the WTO Ministerial Conference that launched the 'Doha Round' of multilateral trade negotiations, the EU and other industrialised countries pledged to phase out agricultural export subsidies.

Unfortunately, the CAP reform proposals that have emerged to date, notably those that EU member states agreed to implement from 2005/06, will fail to address the central challenge of ending dairy export dumping, and offer little hope for the future of small-scale European milk producers.³⁷

The approach to reform favoured by the European Commission and many EU member states focuses on retaining the EU's export position in world dairy markets by reducing domestic prices and increasing quotas over time. Adopting this strategy would expand the European production surplus, increasing the quantity of EU exports. Lower prices would squeeze out small-scale EU farmers who are most in need of support, accelerating concentration in the sector. At the same time, direct income payments would enable the remaining larger EU producers to offset some of their costs of production, resulting in a continuation of export dumping, albeit in a disguised form.³⁸

At a time when the EU public is demanding a transition to less intensive and more environmentally responsible production, when the plight of small EU farmers is progressively worsening, and when the impact of the CAP on developing countries is under increasingly close scrutiny, EU member states and the Commission offer only one vision for the future – more of the same.

What is actually needed is a deep cut in quotas – as recommended by the EC Court of Auditors – allied with measures to redistribute agricultural support to small-scale farmers in support of environmental and rural development objectives. This should include a substantial shift of resources to the rural development budget (the so-called second pillar) of the CAP. One of the major benefits of such an approach is that it would enable the EU to deliver on its WTO commitments to end export subsidies and dumping.

Small-scale EU farmers could benefit from a reformed dairy regime that doesn't dump on the poor. Large processing and trading companies are the direct beneficiaries of the current policies that are so damaging to developing countries. The quota supply management system has brought clear social benefits in terms of maintaining smaller farms, including in less favoured areas.³⁹ By contrast, the direction of reform favoured by the European Commission is likely

to result in the further concentration of the sector and an acceleration of the loss of family farms.

Instead of the current subsidies system, EU agricultural spending should be targeted to those sectors of the farming community most in need of support, particularly the many small-scale dairy farmers based in less-favoured areas. These farmers would benefit from support measures designed to promote lower output by rewarding the use of sustainable production methods that protect the environment. Such payments would compensate for the cut in production quotas needed to bring supply into balance with domestic consumption.

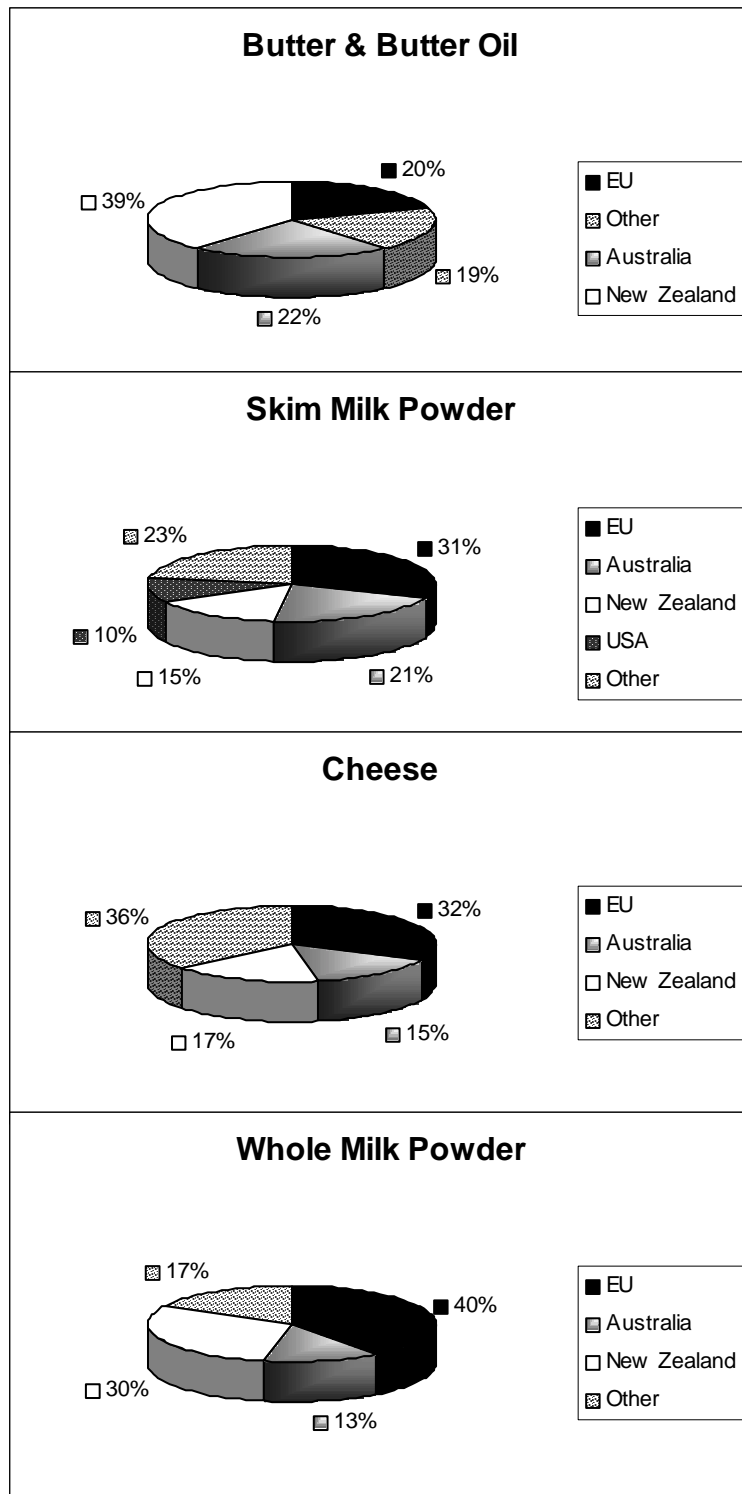
Oxfam proposes that the Mid-Term Review introduce reforms to:

- **Eliminate the need for dairy export subsidies, which undermine the livelihoods of poor farmers in developing countries, by cutting milk production quotas to levels that bring domestic EU production in line with internal consumption – as recommended in the 2001 EC Court of Auditors report.**
- **Restructure agricultural support so that the benefits flow to small-scale farmers, and so that subsidies are targeted towards achieving environmental conservation and rural development objectives. The EU should shift a substantial share of agricultural expenditure to the rural development budget of the CAP.**
- **Increase the transparency of the CAP by making public how agricultural subsidies are distributed. Each EU member state should be required to publish an annual account of subsidy transfers to companies.**

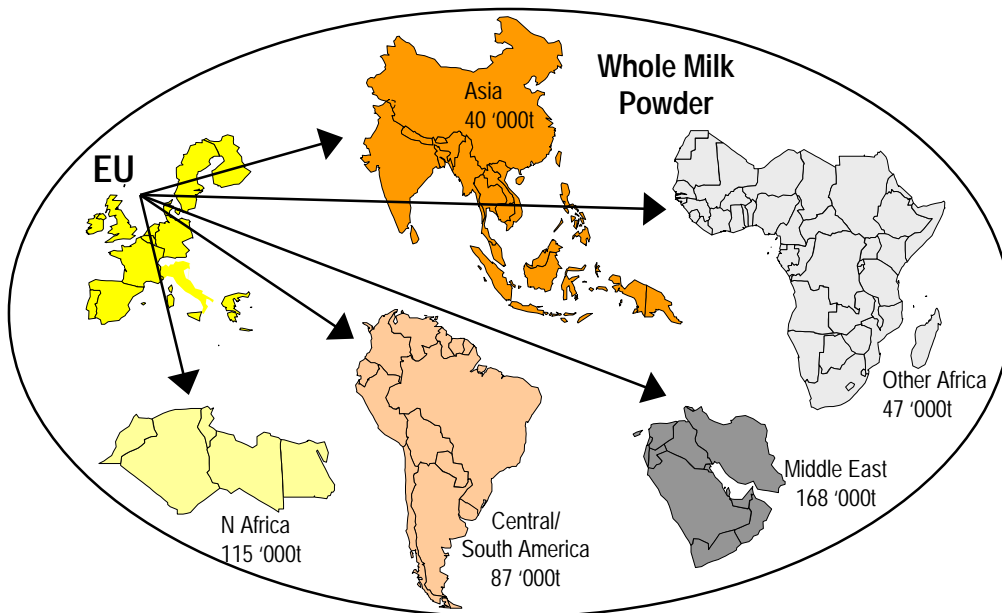
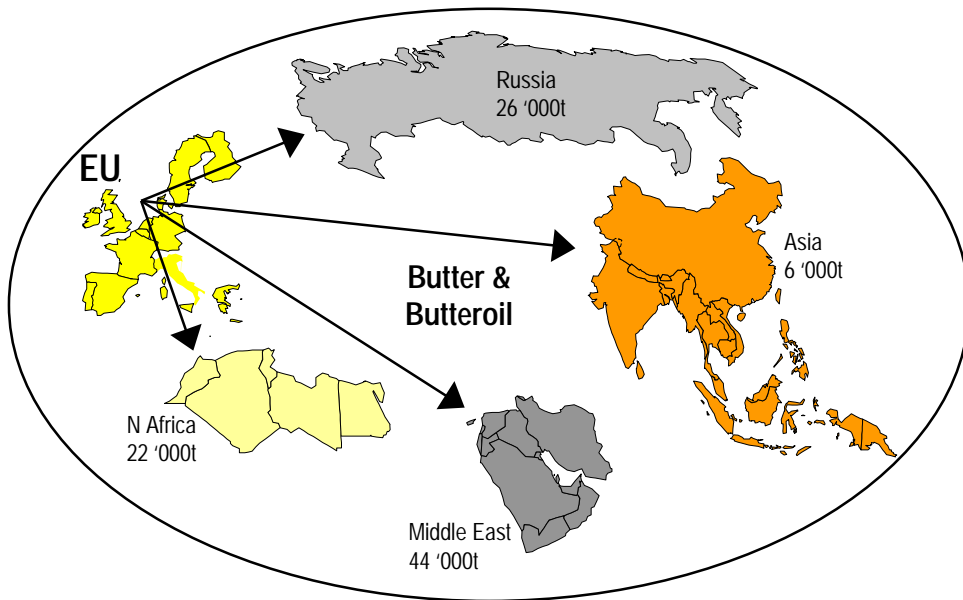
In addition, in the WTO negotiations on agriculture, the EU should:

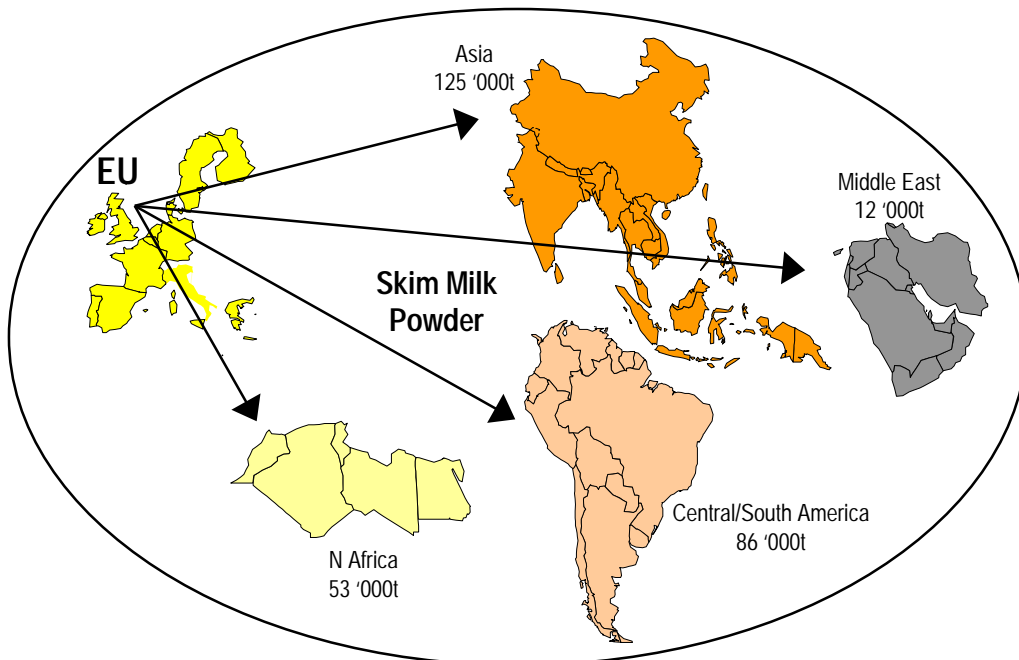
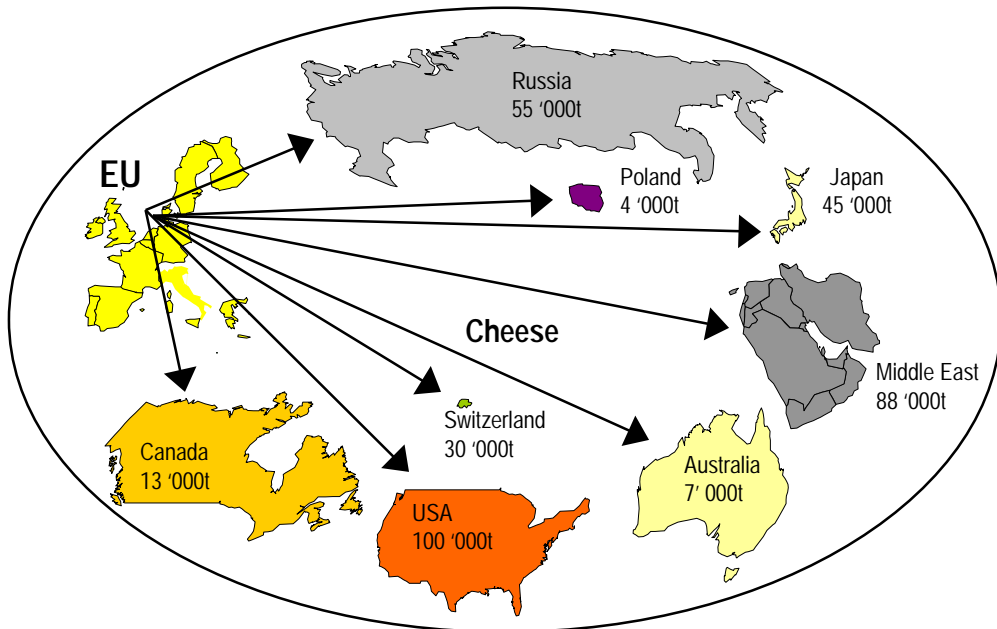
- **Agree a binding timetable to eliminate all forms of export subsidies before the 5th WTO Ministerial Conference in Mexico (September 2003).**
- **Support the introduction of a development box in the Agreement on Agriculture to provide developing-country governments with the flexibility to protect their small-scale farmers from dumping.**

Annex 1: World Dairy Export Market Shares (2000)⁴⁰



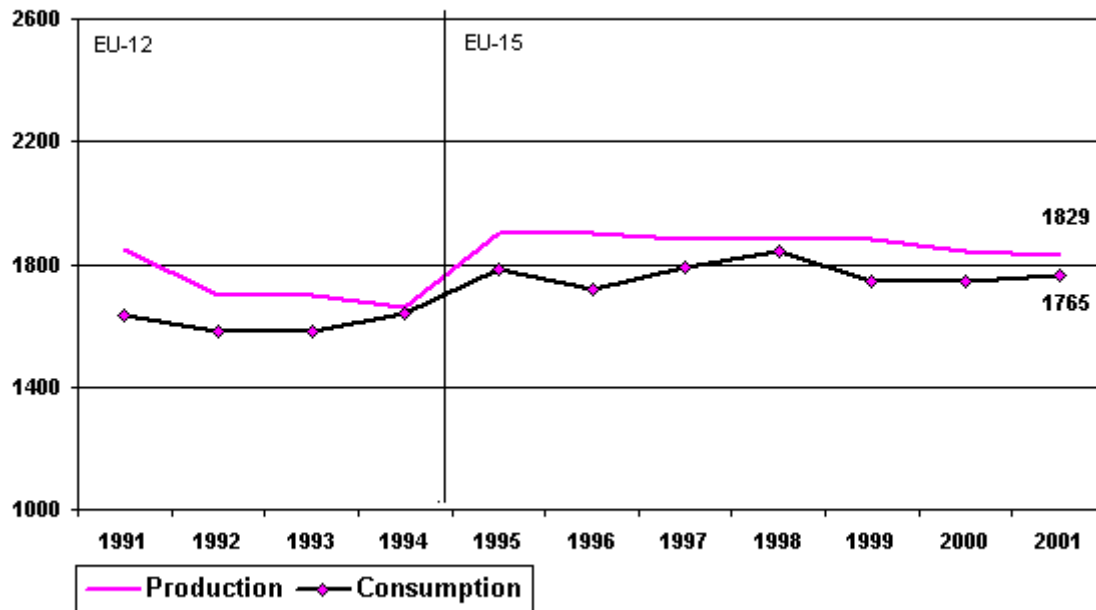
Annex 2: Map of EU Dairy Exports (2000)⁴¹





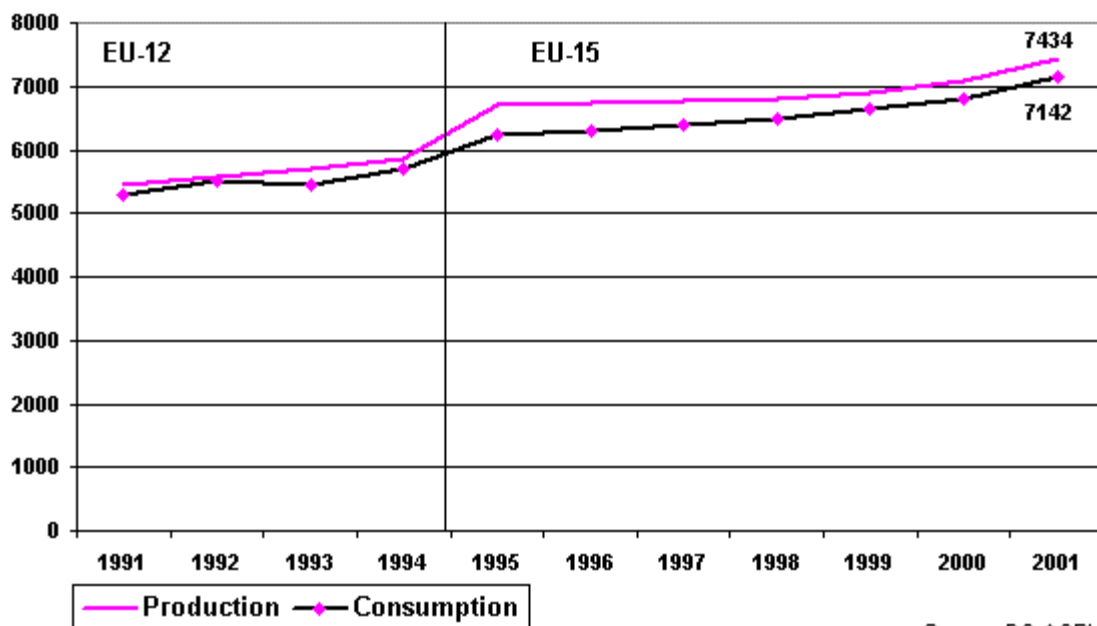
Annex 3: EU Dairy Production vs. Consumption⁴²

Development of European balance sheet - Butter
(thousand tonnes)



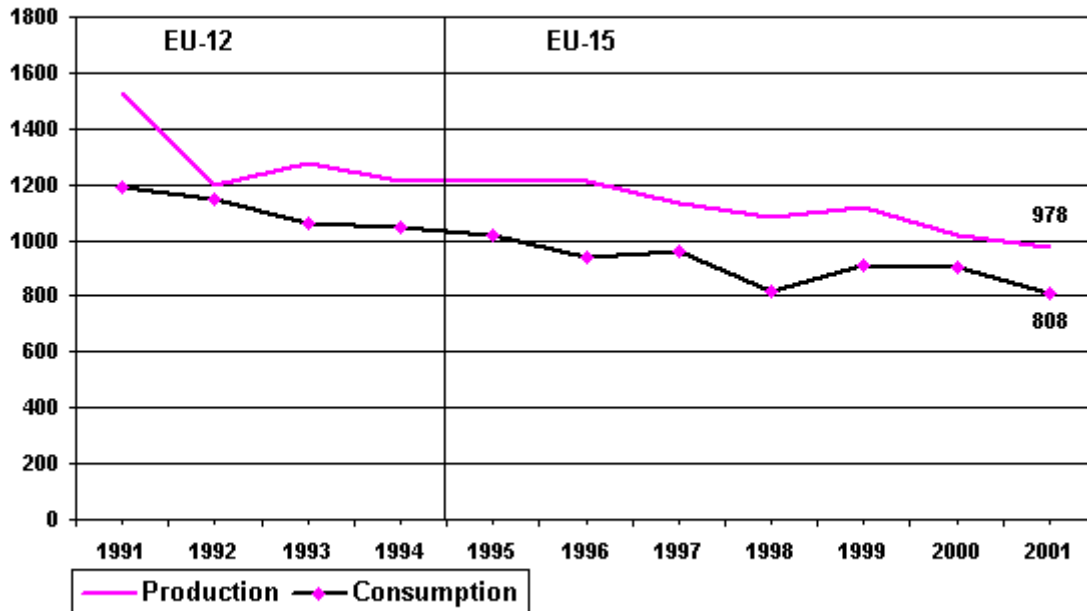
Source: Eurostat; DG AGRI.
European agriculture entering the 21st century

Development of European balance sheet - Cheese
(thousand tonnes)



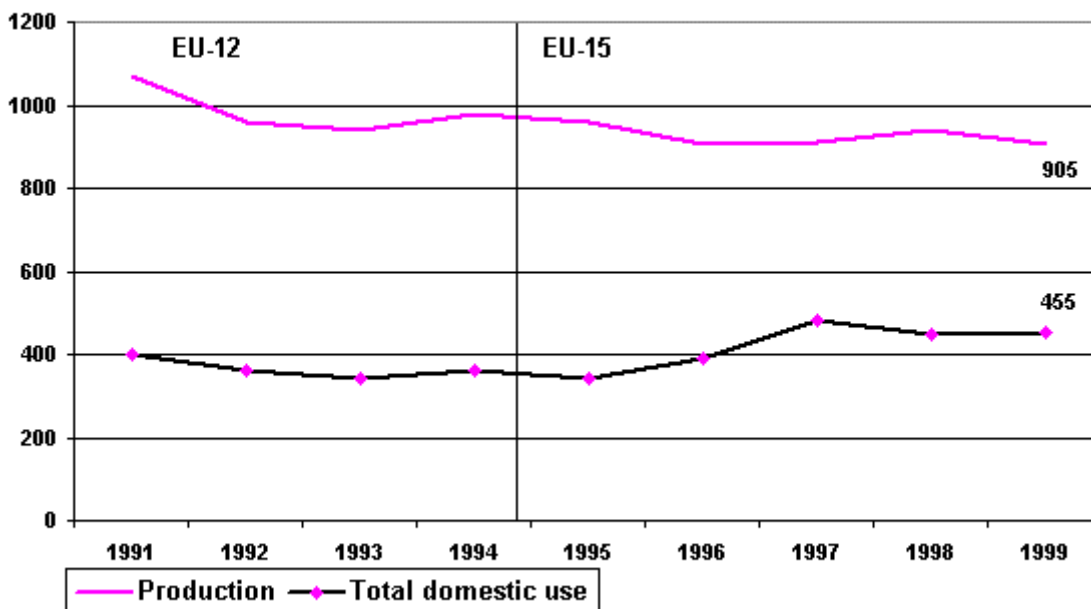
Source: DG AGRI.
European agriculture entering the 21st century

Development of European balance sheet Skimmed Milk Powder (thousand tonnes)



Source: Eurostat; DG AGRI.
European agriculture entering the 21st century

Development of European balance sheet Whole Milk Powder (thousand tonnes)



Source: Eurostat.
European agriculture entering the 21st century

Notes

¹ Omondi, V. 'Nairobi Cushions Dairy Industry with 100PC Tax', *The East African*, Nairobi, 1 April 2002.

² OECD, 2002.

³ Eurobarometer opinion poll, 2002
http://europa.eu.int/comm/agriculture/survey/index_en.htm (checked November 2002).

⁴ The OECD Producer Support Estimate is an indicator of the annual monetary value of gross transfers from consumers, as well as taxpayers, to agricultural producers, measured at the farmgate level, that support agriculture.

⁵ Cafod, 2002.

⁶ Germany and France account for 23 per cent and 20 per cent respectively of EU milk production.

⁷ In spite of these subsidies, more efficient producers, such as New Zealand and Australia, are now close to becoming larger exporters than the EU of most dairy products, with the exception of cheese.

⁸ Oxfam (2001), page 115.

⁹ The other objectives of the CAP are to raise agricultural productivity, to stabilise markets, to secure the availability of food, and to guarantee fair prices for consumers.

¹⁰ Eurobarometer opinion poll, 2002.
http://europa.eu.int/comm/agriculture/survey/index_en.htm (checked November 2002).

¹¹ See note 4.

¹² The quantities of SMP and butter held in intervention stocks have fallen substantially since the mid-1980s – the era of butter mountains and milk lakes. SMP stocks disappeared altogether in 2000, due to strong world demand and high prices, although SMP stocks and export refund expenditure have risen sharply in 2002.

¹³ To enforce the quota system, a penalty charge, known as a 'superlevy' was introduced, payable on quantities of milk delivered in excess of the national quota. However, the super-levy has not proved effective in preventing farmers from regularly exceeding their milk production quotas. Although producers are penalised for any over-production via the levy, the excess milk still enters the marketplace.

¹⁴ EU enlargement will bring further pressure on the dairy regime, increasing surpluses and the difficulty of disposing of them.

¹⁵ Internal EU dairy prices are as much as 50-100 per cent higher than world market prices.

¹⁶ This is because recent export volumes of butter and SMP have been well below the WTO subsidy limits, which are based on the much larger volumes exported by the EU in the late 1980s.

¹⁷ Bessey, Allsop and Wilson, (2001) p. 10.

¹⁸ Casein is the principal protein of cow's milk. It is used in the manufacture of a range of products including coffee whiteners, infant formulas, pharmaceutical products, paints, and cosmetics.

¹⁹ Dairy import tariffs are applied on a specific (euro per tonne) rather than an ad valorem (percentage of the import value) basis. But these approximate percentage tariff equivalents have been calculated on the basis of tariff rates and world market prices for butter, SMP, and WMP in 2001.

²⁰ Bessey, Allsop and Wilson, 2001, p. 29.

²¹ EC Milk Quota Report, July 2002.

²² Letter to Oxfam GB, dated 12 November 2002, from Ian Fugler, Head of Operations Newcastle, UK Rural Payments Agency.

²³ The SMP refund rate varied substantially during 2000, ranging from 760 euro/tonne in January to 150 euro/tonne in October due to rising world prices over the period. As a result of high world prices, SMP export refunds were set at zero for the first time in mid-2001, but have since risen to 850 euro/tonne. For our calculations, we used a rough average for the level of export refunds in the first half of 2000 before the unusually sharp rise in world prices caused the fall in export refund rates.

²⁴ Nestlé presentation to the CSR Europe – Business and Human Rights Group on 'Low coffee prices: causes and potential solutions', 12 July 2002.

²⁵ Mdc Datum, Comparison of EU milk producer prices, April 2002.

²⁶ Bessey, Allsop and Wilson, 2001.

²⁷ UK Milk Task Force Report, December 2001.

²⁸ ABARE Report, 'Trade Liberalisation in World Dairy Markets'.
<http://www.abare.gov.au/htdocs/pages/media/2001/current%20issues01.htm>
(checked Nov. 2002)

²⁹ Milk is now the single largest agricultural commodity produced in India, and India accounts for 13 per cent of global milk output.

³⁰ EU SMP export subsidy rates varied substantially, but at a rough average were approximately €40/tonne over this period. Since then, India has increased its tariff on SMP imports so as to provide increased protection for domestic producers.

³¹ Omondi, V. 'Nairobi Cushions Dairy Industry with 100PC Tax', The East African (Nairobi), 1 April 2002.

³² Ibid

³³ A Development Box would provide developing-country governments with flexibility in WTO rules to protect their small-scale farmers from dumping.

³⁴ Any imports beyond the quota limit face a higher tariff of 56 per cent.

³⁵ New Zealand accounts for 15 per cent, and other suppliers account for the remaining 15 per cent.

³⁶ The European Commission's Mid-Term Review document sets out four options for reform of the dairy regime from 2008-2015: maintain the Agenda 2000 measures (status quo), repeat the Agenda 2000 approach (further cut intervention prices and increase quotas), introduce a two-tier quota system (one for domestic use, and one for export), and abolish the quota regime. The impacts of these different options were analysed in a 2002 report on Milk Quotas commissioned by the European Commission, but the report does not come down clearly in favour of any of the four options.

³⁷ As part of the CAP Agenda 2000 reforms, EU agricultural ministers agreed that price support will be reduced by 15 per cent between 2005 and 2008, with direct income payments being paid to farmers to compensate them for the fall in prices. At the same time, quotas will be increased by 1.5 per cent.

³⁸ The European Commission's approach to 'de-coupling' support, while designed to bring the CAP into compliance with WTO rules, would in practice amount to a continuation of production and export subsidies.

³⁹ The milk quota policy has retained production in less-favoured areas, which accounted for around 33 per cent of total EC milk production in 1997 – EC Milk Quota report (p. 14).

⁴⁰ Bessey, Allsop and Wilson (2001)

⁴¹ Ibid

⁴² European Commission (2002) 'European Agriculture Entering the 21st Century', October 2002

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