EU Dairy Sector Policies and their impact on Countries in Sub-Saharan Africa

Paul Goodison

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List of Abbreviations

EC - European Commission
EPA - Economic Partnership Agreements
EU- European Union
FCW - FrieslandCampina WAMCO
SACU - Southern African Customs Union
SMP - skimmed milk powder
SSA – Sub-Saharan Africa(n)
TRQs - Tariff Rate Quotas
UHT - Ultra-high temperature
WAEMU - West African Economic and Monetary Union
WTO – World Trade Organisation

Summary

The dairy sector potentially offers a powerful tool for reducing poverty in Sub-Saharan Africa (SSA) by putting cash in the hands of smallholder farmers on a weekly basis. However, in SSA the realisation of this potential faces ***serious internal constraints and growing international challenges.*** *These international challenges are being made more acute by the effects of EU dairy sector reforms (particularly the abolition of milk production quotas) and the EC's increasingly aggressive agro-food sector trade policy, which is seeking not only a dismantling of import tariffs, but also the abandonment of all traditional non-tariff trade policy tools.*

The threat to local dairy sector development in SSA comes not primarily from expanded exports of EU consumer ready dairy products, but rather the current and projected expansion of EU exports of milk powders (doubling between 2013 and 2024). This is likely to ***increase the attractiveness of meeting expanding African demand for dairy products through the local value added processing of imported milk powders and associated bulk dairy commodities****. This could potentially* ***disrupt efforts to develop new local milk-to-dairy supply chains*** *and could even* ***undermine some existing milk-to dairy supply chains*** *in certain parts of SSA.*

These developments cannot be delinked from new patterns of EU support to the dairy sector. While the EU has moved away from the most directly trade distorting support – ***export refunds*** *– which were intimately linked to the former high producer price policy,* ***the cumulative effect of new support measures*** *('decoupled' payments, 'coupled' payments, the continuation of a protective managed dairy sector trade regime and the enhanced 'safety net' policy aimed at insulating EU milk producers from the worst effects of global dairy market price volatility and market disruptions), coupled with milk production quota abolition****, is supporting a dramatic expansion in EU dairy exports, particularly skimmed milk powder*** *(SMP).*

While in the face of rising consumer demand, imports of milk powder can help address local deficits in fresh milk production, supporting local dairy processing and keeping consumer prices down, there are dangers. This is particularly the case at times of low dairy commodity prices, when increased imports of milk powder can lead to a substitution of milk powders for fresh milk in the production of a range of value added dairy products. This can serve to disrupt existing local milk to dairy supply chains and undermine efforts to develop new local milk to dairy supply chains.

This can then pose serious problems when world market dairy prices return to their higher price long-term trend. This can leave developing countries not only with a host of missed opportunities for using expanding local dairy market demand to boost cash flows to rural areas, but can also give rise to a greatly increased dairy sector import bill in the long term.

While new forms of EU dairy sector support are largely compatible with current interpretations of WTO rules on domestic and export support, ***this does not mean EU dairy sector policies do not distort trade outcomes to the detriment of SSA milk producers****.*

For example, in 2014, in the context of wider EU support programmes, the application of EU 'safety net' measures in response to the loss of the Russian market for EU exports of dairy products saw an almost 59% expansion of EU SMP exports[1]*, despite a 50% decline in global skimmed milk powder prices.*

This EU trade in SMP does not follow conventional economic logic, where price declines normally lead to a reduction in supply. Broader EU agricultural support policies give rise to a far from normal market response.

[1] See, EC, 'Short term outlook for EU arable crops, dairy and meat markets – Winter 2015', http://ec.europa.eu/agriculture/markets-and-prices/short-term-outlook/pdf/2015-03_en.pdf

This anomalous expansion of EU SMP exports needs to be seen in the context of two important trends. Firstly, the recent EU corporate investment in expanded production of milk powders in preparation for the abolition of EU milk production quotas. Secondly, patterns of EU corporate investment in SSA designed to provide easier outlets for milk powder exports ***in ways, which allow the EU parent company to maximize returns from the final sale of consumer ready dairy products on SSA markets****.*

These trends raise important issues for the development of local SSA milk-to-dairy supply chains, which need to be taken up and addressed both in the WTO and under newly concluded bilateral trade agreements.

There are indications that at least one major EU dairy company (namely Arla) is alert to these issues. In January 2015, Arla made a commitment to ***developing responsible patterns of trade and investment, aimed at minimising adverse effects on local milk producers in SSA***[2]*. However, real tensions exist between this long term corporate social responsibility commitment to developing responsible trade and investment links in SSA and short term market pressures, in the context of expanding EU dairy production, reduced export opportunities and declines in global dairy commodity price (to which preparations for EU production quota abolition have contributed).*

How this tension is resolved at the individual country level in the dairy sector as a whole will have an important bearing on the future development of local milk-to-dairy supply chains in Africa. The reality is that with total Chinese dairy import demand contracting 38% in the first five months of 2015, and the closure of the Russian market being extended, competition for SSA dairy markets is intensifying, with different EU dairy companies jockeying for market position, on the basis of different corporate philosophies and business approaches.

Against this background, it would appear important that the EU takes its commitment to ***policy coherence for development*** *seriously in the dairy sector, through:*

a) *Promoting a dialogue on responsible patterns of EU trade and investment in African dairy sectors, so as to accommodate African aspirations for the development of local milk-to-dairy supply chains;*

b) *Extending the work of the EU Milk Market Observatory to include detailed monitoring of evolving patterns of EU dairy exports to Africa, so as to provide an early warning of any adverse effects on local milk-to-dairy supply chains arising from the on-going expansion of EU dairy product exports;*

c) *Ensuring the provisions of recently concluded EU trade agreements with Sub-Saharan African countries are not applied in ways which prevent the use of trade policy tools to manage dairy sector imports as part of broader policies to strengthen local milk-to-dairy supply chains, in the face of heightened global dairy market price volatility.*

While these issues of ***policy coherence for development*** *can be seen as particularly acute in countries where the EU is deploying development assistance in support of smallholder livestock development programmes,* ***this should not be a prerequisite for setting in place mechanisms to ensure greater policy coherence for development in the dairy sector in relation to all SSA countries where government and the private sector effort are underway to develop milk-to-dairy supply chains****.*

*In addition, there would also appear to be a need to revisit proposals first advanced in 2013 by Joseph Stiglitz and Andrew Charlton to enshrine a '****right to development'*** *in WTO rules*[3]*. This proposal*

[2] Arla, 'Arla Foods to ensure responsible approach to African markets', 12 January 2015 http://www.arla.com/about-us/news-and-press/2015/pressrelease/arla-foods-to-ensure-responsible-approach-to-african-markets-1104299/

[3] The proposal for a 'right to development' was included in a 2013 report by Joseph Stiglitz and Andrew Charlton, entitled 'The right to trade: Rethinking the aid for trade agenda', , http://thecommonwealth.org/media/news/professor-joseph-stiglitz-calls-%E2%80%98right-trade%E2%80%99.

*would seek to limit '**the applicability of WTO obligations when the enforcement of such obligations would have a significant adverse effect on development**'. This would create a right for developing countries '**not to be harmed by the imposition of trade rules**'. This would appear to be particularly important in developing countries seeking to promote the development of local milk-to-dairy supply chains as part of their broader agriculture and rural development policies.*

Indeed, allowing developing countries to continue to have the right to protect their emerging dairy sectors from the worst effects of global price volatility would appear to mirror EU 'safety net' policy measures which are explicitly aimed at insulating EU milk producers from the worst effects of global dairy market price volatility. This would appear to be particularly important since EU policies serve to sustain EU milk production at higher levels than would otherwise be the case, thereby serving to fuel EU exports of dairy products[4].

However, it needs to be recognised that in SSA countries, government budgets are constrained, with traditional agro-food sector trade policy tools being far more extensively used to manage dairy sector markets in the interests of local producers. This right to use traditional agro-food sector trade policy tools needs to be preserved, if growing African demand for dairy products is to be met through increased local milk production, rather than the manufacturing of dairy products based increasingly on imports of bulk dairy commodities.

Recommendations

- The EU needs to take its commitment to policy coherence for development more seriously in the dairy sector, not only in countries where EU aid is being extended to smallholder livestock development programmes, but also in all countries where government and private sector initiatives are underway to develop local milk-to-dairy supply chains.
- The EC should promote a dialogue on responsible patterns of EU trade and investment in African dairy sectors, so as to accommodate African aspirations for the development of local milk-to-dairy supply chains. This could include the development of a locally relevant ***"Code of Conduct for Responsible Trade and Investment in African Dairy Sector Development"***, which would take account of: government and private sector aspirations for the development of local milk-to-dairy supply chains; the underlying environmental and ecological constraints on sustainable milk production; and the short, medium and long term role which milk powder imports could play in dairy sector development.
- The EC should extend the work of the EU Milk Market Observatory to include detailed monitoring of evolving patterns of EU dairy exports to Africa, so as to provide an early warning of any adverse effects on local milk-to-dairy supply chains arising from the on-going expansion of EU dairy product exports, in those countries where initiatives to develop local milk-to dairy supply chains are under preparation or underway.
- The EC should commit to ensuring the provisions of recently concluded EU trade agreements with Sub-Saharan African countries are not applied in ways which prevent the use of trade policy tools to manage dairy sector imports, as part of broader policies to strengthen local milk-to-dairy supply chains, in the face of heightened global dairy market price volatility.
- Initiatives in the dairy sector provide an opportunity for the practical application of the concept of a '**right to development**' as an operational mechanism for ensuring full respect for the EU's legal obligation to ensure policy coherence for development.
- In an era of heightened global market price volatility, where necessary global supply side adjustments are impeded by the evolution of EU dairy sector policies, practically applying the

[4] For details of EU production and export trends for specific dairy products go to the EU Milk Market Observatory at: http://ec.europa.eu/agriculture/milk-market-observatory/index_en.htm

concept of a ‘***right to development’*** would appear to be particularly important for Sub-Saharan African countries seeking to promote the development of local milk-to-dairy supply chains, as part of their broader agriculture and rural development policies.

- The right to use traditional agro-food sector trade policy tools needs to be preserved, if growing African demand for dairy products is to be met through increased local milk production, rather than the manufacturing of dairy products based increasingly on imports of bulk dairy commodities.

The Growing Importance of Milk in Sub-Saharan Africa

The Growing Demand for Dairy Products in Africa

While per capita consumption of milk and milk products is higher in developed countries than most developing countries, this gap is narrowing. With rising incomes, urbanisation and changing patterns of consumption, demand for dairy products in the developing world is growing faster than in mature established markets for dairy products.

After a period of declining per capita consumption, with economic growth taking off in many countries of Sub-Saharan Africa in the six years to 2012, OECD/FAO analysis suggested demand for dairy products in Sub-Saharan Africa grew 22%[5]. However, per capita consumption of commercially produced dairy products remains relatively low in Sub-Saharan Africa, accounting for only around a third of the dietary energy supply and dietary protein supply compared to milks role in the diet of Europeans[6].

This is seen as leaving tremendous scope for further expansion of Sub-Saharan African dairy markets. What is more with demand for dairy products in Sub-Saharan Africa growing at twice the rate of supply, this is creating growing opportunities for trade in dairy products between major milk producing regions such as the EU and Sub-Saharan Africa.

The Potential Rural Development Impact of Milk Production

Milk production has the potential to play a major role in promoting economic development in rural areas. This was certainly the case in Ireland, where EU support policies in the dairy sector provided a major stimulus to farm incomes and demand in the rural economy.

While currently in Sub-Saharan Africa as a whole, small holder milk production makes a more important contribution to family nutritional needs than it does to household cash incomes, the commercialisation of smallholder milk production in a number of regions of Sub-Saharan Africa has the potential to provide a regular daily/weekly source of cash income, which can improve living standards and boost productivity in other areas of family farming.

However, there is considerable variation in the level of dairy sector development in Sub-Saharan Africa. For example, while in Eastern and Southern Africa the dairy sector is well established locally, and in East Africa includes a vibrant smallholder farming sector, in West and Central Africa a high dependence remains on imports of both finished dairy products and bulk dairy commodities (there is a regional average of a 90% import dependency for dairy products, but with considerable variation between countries)[7].

However, across the whole of Sub-Saharan Africa since the 2007/08 food price crisis, growing policy attention has been focussed on reducing import dependency in the dairy sector, with even in West Africa efforts continuing to promote the development of local milk-to-dairy supply chains. The West African regional farmers organisation ROAPPA, for example, has called for increased tariff protection for milk products as part of the establishment of the common external tariff for West Africa[8].

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[5] OECD-FAO, 'Agricultural Outlook 2012-2021', 2012, http://www.fao.org/fileadmin/templates/est/COMM_MARKETS_MONITORING/Oilcrops/Documents/OECD_Reports/Ch5StatAnnex.pdf

[6] FAO, 'Milk and Milk products', http://www.fao.org/agriculture/dairy-gateway/milk-and-milk-products/en/#.VbXOUPmqpBc

[7] See for example, USDA the USDA exporters guides to Ghana and Nigeria at http://gain.fas.usda.gov

[8] Agritrade, 'The evolving EU-Africa dairy trade: EU corporate responses to milk production quota abolition', September 2014, http://agritrade.cta.int/Agriculture/Commodities/Dairy/The-evolving-EU-Africa-dairy-trade-EU-corporate-responses-to-milk-production-quota-abolition

Challenges Facing Smallholder Milk Producers

However, in many countries in Sub-Saharan Africa both existing and emerging smallholder milk production is facing increasing commercial pressures as the nature of both the international and intra-regional trade in dairy products has been transformed by technological innovations. This compounds the pre-existing problems of productivity and collection, which increase unit costs of milk produced under smallholder farming systems.

In well-established milk production regions of Sub-Saharan Africa, this is seeing a considerable reduction in the number of commercial milk producers and an expansion of average herd size[9]. It is also seeing a consolidation of local dairy processing companies, with increasingly strong corporate links with overseas dairy companies being established, particular EU dairy companies[10]. This needs to be seen in the context of a history of EU milk powder exports disrupting the development of local milk-to-dairy supply chains.

Factors Holding Back Competitive Milk Production in West Africa

Factors holding back competitive milk production in West Africa include:

- "*a lack of stakeholder organisations, which limits prospects for the aggregation of milk supplies and weakens the market position of smallholder milk producers;*
- *a lack of structural investment in developing value chains;*
- *a policy bias towards processors, in view of urban consumption needs*".

"*While these competitive disadvantages lead to claims in Europe that West Africa should stay away from commercial dairy production, the dairy sector is one of the 14 sectors prioritized by the West African Economic and Monetary Union (WAEMU), as part of initiatives to improve access to animal feed, credit, inputs and technology, as well as promoting investment in infrastructure*".

"*In West and Central Africa, where unregulated flows of SMP in the past have served to disrupt the development of local milk supply chains, a significant challenge will be to develop a better understanding of the commercial relationships involved, not only at national level, but also within evolving regional trading arrangements*."

Dairy Sector, Executive Brief 2011, September 2012, Agritrade
http://agritrade.cta.int/en/Agriculture/Commodities/Dairy/Executive-Brief-Update-2012-Dairy-sector

Trends in EU Skimmed Milk Powder exports to West Africa (tonnes)

	2006	2007	2008	2009	2010	2011	2012	2013
West Africa	12,893.6	16,847.9	18,293.4	17,502.8	29,645.9	36,827.9	34,906.0	36,951.8
- Nigeria	10,867.2	13,636.9	12,873.4	13,128.2	22,087.7	26,.62.1	25,039.7	27,284.2
- Ghana	839,1	2,205.2	2,879.3	2,399.0	4,119.6	5,044.2	4,647.6	6,987.1

How Imports Can Undermine Local Milk-to-Dairy Supply Chains: The Case of Cameroon

Analysis published by Brot für die Welt/Evangelischer Entwicklungdienst in 2009 highlighted how imports of EU milk powder in 2008–09 undermined efforts to develop smallholder dairy production in Cameroon by changing the ***input composition of value-added products***, to the detriment of fresh milk producers. This was seen by a local commentator as '*a clear message to all domestic investors to keep out of the dairy economy and let the world market profit from the huge opportunities offered by the Cameroon dairy market'*[11].

Dairy Sector, Executive Brief 2011, September 2012, Agritrade
http://agritrade.cta.int/en/Agriculture/Commodities/Dairy/Executive-Brief-Update-2012-Dairy-sector

[9] For example see, MPO, Lactodata Statistics 'South African Outlook', Lactodata Vol 18, No 1. May 2015, http://www.mpo.co.za/images/downloads/LACTO_DATA_MEI_15.pdf

[10] See Agritrade Special report,' The evolving EU–Africa dairy trade: EU corporate responses to milk production quota abolition', 5 September 2014, http://agritrade.cta.int/Agriculture/Commodities/Dairy/The-evolving-EU-Africa-dairy-trade-EU-corporate-responses-to-milk-production-quota-abolition

[11] For more details see Agritrade article 'Developing a value-added dairy sector in West Africa', 2 May 2011. http://agritrade.cta.int/Agriculture/Commodities/Dairy/Developing-a-value-added-dairy-sector-in-West-Africa

Preparations for Quota Abolition and its Impact on Countries in Sub-Saharan Africa

Putting Quota Abolition in the Context of the Broader Process of EU Dairy Sector Reforms

The forgoing provides the background in Sub-Saharan Africa up to the final stage of EU milk sector policy reform. This final stage of EU dairy sector reform has involved the abolition of milk production quotas, which formerly placed a ceiling on EU milk production. National milk production quotas served to limit the scale and geographical distribution of EU, strongly affecting EU dairy exports.

The First Phase of EU Dairy Sector Reforms

In line with the broader EU agricultural policy reform, from 2005 the EU began the shift from price support to decoupled direct aid payments in the dairy sector. However, this took place in the context of a commitment to the maintenance of EU milk production quotas[12] until 2017 (with in the final 5 years a phased expansion of production quotas) and the maintenance of certain ‘coupled’ payments (see annex 1 for changing patterns of EU dairy support payments).

While with the removal of price guarantees EU milk prices initially fell, prices subsequently began to pick up, but with the EU dairy market subject to periodic price volatility. This saw the active use of traditional policy tools, such as intervention buying, support for storage[13] and export refunds[14] to help clear EU dairy markets. This came to form part of an enhanced ‘safety net’ policy designed to insulate EU milk producers from the worst effects of the transmission of global dairy price volatility onto EU markets.

However, the implementation of these policy measures can give rise ***to trade flows, which shift the burden of adjustment to volatile world market prices on to non-EU milk producers***. For example, the 2008/09 measures saw a surge in EU milk powder exports to West Africa which threatened to undermine efforts to develop local milk-to-dairy supply chains. In the case of Nigeria, EU SMP exports double in two years and increased 150% within 5 years. This surge in EU SMP exports ironically coincided with joint government/private sector efforts to expand local milk collection and strengthen local milk-to-dairy supply chains[15].

The 2007/9 EU dairy market crisis also saw the development of a programme of measures to ***strengthen the functioning of milk-to-dairy supply chains in the EU***, aimed at reducing the scope for abuse of power inequalities along dairy supply chains and strengthening the position of milk producer organisations within individual supply chains, by improving the transparency in price formation along milk supply chains.

In 2008, it was estimated that EU dairy farmers received approximately €5,000 million per annum in direct aid payments (both ‘coupled’ and ‘decoupled’ payments combined). By 2012, it was calculated that the

[12]As part of this EU milk production quota regime, punitive ‘super levies’ were imposed for overproduction.

[13] This is increasingly taking the form of EU support for private storage. This covers the costs of storage of dairy products by dairy companies for a limited period while alternative markets are found, or global market demand and prices recover.

[14] The use of which was discontinued in 2012, when the refund level was set at zero. However the EU retains the export refund policy tool in place, in case the EU market situation should ever require a renewal of this form of support.

[15] In 2010, the Dutch dairy cooperative FrieslandCampina set up a milk collection initiative in Nigeria with local fresh milk being used in production of evaporated milk. In 2011 FrieslandCampina reached agreement with the Nigerian government to set up a network of Milk Collection Centres (initially on a pilot project basis), with an initial target of 10% local sourcing being set, within a longer term vision of 50% local sourcing, based on smallholder production within a cooperative structure. However it was acknowledged, it was cheaper to import raw materials and add value locally. In 2013 domestic production costs were estimated at N90/litre compared to N70 to N80 per litre using locally sourced milk. This required cross subsidisation of local sourcing operations, with the level of cross subsidization required being increased substantially as milk powder prices fell 50% in 2014(for details see: Agritrade, ‘Expanding Dutch corporate involvement in local milk procurement in Nigeria’, 15 April 2013, http://agritrade.cta.int/en/Agriculture/Commodities/Dairy/Expanding-Dutch-corporate-involvement-in-local-milk-procurement-in-Nigeria).

On 1st September 2014 FrieslandCampina acquired Olam’s dairy business in Cote d’Ivoire, which is focused on production of condensed milk and evaporated milk, using largely imported milk powder. According to FC representatives the provides ‘an opportunity to export milk powder from the Netherlands to the Ivory Coast’ (for details see Agritrade, ‘FrieslandCampina to take over Ivorian dairy business’, 07 November 2014, http://agritrade.cta.int/en/Agriculture/Commodities/Dairy/FrieslandCampina-to-take-over-Ivorian-dairy-business). In 2014 FrieslandCampina reported losses of €60 million as a result of the Russian import embargo embargo (see FrieslandCampina, ‘FrieslandCampina: satisfactory result in a dynamic year’, 12 March 2015, https://www.frieslandcampina.com/en/news/frieslandcampina-satisfactory-result-in-a-dynamic-year/).

contribution of direct payments to dairy farmer incomes remained significant, *representing, on average, around 31 % of the farm net value added per annual work unit*[16].

However, the final stage of reform needs to be seen in the context of the broader process of shifting from ***price support*** to ***farmer support*** in the milk sector and the establishment of 'safety net' policies designed to insulate EU milk producers form the worst effects of their increased exposure to global dairy market price volatility.

In the years running up to the ending of milk production quotas on 1 April 2015, an intensive process of restructuring and market positioning took place aimed at enabling EU dairy processing companies to take full advantage of growing long-term global demand for dairy products.

Recent Trends in EU Milk Production 2013-2015

In the five years to 2013, EU milk production, in line with quota expansion, increased around 1% per annum. However, in 2014 milk deliveries to dairies in the EU increased 4.5%. This was equivalent to the cumulative increase in the preceding five year. This 2014 expansion in milk deliveries was far larger than anticipated, with particularly strong growth in competitive milk producing regions such as the UK, Poland, Hungary, the Benelux, and the Baltic states, where annualised growth in milk production exceeded 6%[17]. This expansion in milk production occurred despite:

a) declining dairy product prices (average EU farm gate milk prices were 18% lower in December 2014 compared to December 2013);
b) the August 2014 Russian import embargo, which closed the EU's largest dairy export market;
c) efforts by farmers in a number of member states to slow down milk deliveries, including through slaughtering their least productive milk cows, so as to avoid 'super-levy' fines.

This increased EU milk production was processed into ***22.5% more skimmed milk powder***, 5.4% more whole milk powder, 4.1% more cream, 4.1% more butter, 1.7% more cheese and 0.5% more concentrated milk.

In the final five months of 2014, patterns of EU milk utilisation were strongly influenced by the introduction of the Russian import embargo. The Russian market was particularly important for cheese and butter exports, representing 33% and 29% of extra EU exports respectively (but only 5.2% of SMP and 5% of whey exports). This left EU dairy companies looking for ***alternative markets for the milk used in the production of approximately 262,000 tonnes of cheese and 210,000 tonnes of butter and butter oil per annum***[18].

This saw EU dairy companies ***channelling part of the milk previously used in 'Putin' cheese production into the production of skimmed milk powder*** (SMP) and **butter** (both of which are easier to store). This move to increased production of SMP and butter was assisted by the announcement at the end of August 2014 of ***expanded EU financial assistance to private storage of milk powder and butter, using the financial scope provide by the 'Emergency Reserve' facility***. This policy initiative was aimed at reducing pressure on EU milk prices by taking milk off the EU market.

This gave rise in 2014 to ***a massive 58.7% increase in EU SMP exports***[19]***, despite a 50% decline in global skimmed milk powder prices***[20]. This needs to be seen in the context of a projected virtual

[16] EC, 'Farm Economy Preview: Dairy Sector', EU Agricultural and Farm Economics Briefs No 4, March 2015 http://ec.europa.eu/agriculture/rural-area-economics/briefs/pdf/004_en.pdf
[17] EC, 'Short term outlook for EU arable crops, dairy and meat markets – Winter 2015', http://ec.europa.eu/agriculture/markets-and-prices/short-term-outlook/pdf/2015-03_en.pdf
[18] EC, 'Milk – Russia', 14 August 2014, http://ec.europa.eu/agriculture/milk-market-observatory/pdf/russia-ban-dairy-ppt.pdf
[19] EC, 'Short term outlook for EU arable crops, dairy and meat markets – Winter 2015', http://ec.europa.eu/agriculture/markets-and-prices/short-term-outlook/pdf/2015-03_en.pdf
[20] For details of projected trends in other EU dairy commodity exports see annex 2

doubling of EU skimmed milk powder exports between 2013 and 2024, with this growth in exports having been given added dynamism in 2014 by the impact of the Russian import embargo.

EU Skimmed Powder Exports 2013 and Projected Levels from 2015 to 2024 ('000 tonnes)

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
407°	646°	668	661	693	716	737	756	759	781	795	810

Source: EC, 'Prospects for Agricultural Markets and Income in the EU 2014-2024', December 2014
° EC, 'Short Term Outlook for EU arable crops, dairy and meat markets 12015 and 2016', Winter 2015

This suggests that the use of EU 'safety net' tools (notably support to private storage while companies find alternative outlets for SMP), alongside new patterns of EU corporate investment in Africa, ***could lead to a process of 'adjustment displacement', at times of stress on global and EU dairy markets***.

This could result in ***farmers in non-EU countries (including Sub-Saharan Africa) having to carry the burden of milk production adjustments required to rebalance global dairy markets in the face of dramatic declines in global dairy commodity prices***.

The Main Features of the Reformed EU Dairy Regime[21]

The aim of EU dairy sector reforms has been to ***enhance the global price competitiveness of the EU dairy sector*** through the establishment of WTO compatible systems of agricultural support. The most important features of the EU's reformed dairy regime are:

- the move over to 'decoupled' support payments, which are green box compatible;
- the maintenance of 'coupled' payments at the discretion of EU member states, within WTO amber box limits;
- a continued commitment to managed trade in the dairy sector, including the maintenance of a disaggregated system of high fixed duties, alongside a system of Tariff Rate Quotas (TRQs), which enables the EU to regulate imports in the light of market conditions;
- the establishment of a WTO compatible 'safety net system' to protect EU dairy farmers from price volatility and sudden market disruptions;
- the establishment of a regulatory framework to strengthen the functioning of milk-to-dairy supply chains to the benefit of EU milk producers;
- the abolition of national EU milk production quotas from 1st April 2015.

The most significant of these measures, in terms of external trade, is the abolition of milk production quotas, since this eliminates the ceiling on EU milk production. However, this cannot be seen in isolation from the restructuring of broader EU dairy sector support measures, to bring them into line with current WTO rules on domestic support and current and potential rules on export support.

Equally, it cannot be seen in isolation from the EU's increasingly aggressive and contradictory trade policy, which while maintaining a strictly managed trade regime for dairy products at home, seeks the complete abolition of tariff and non-tariff barriers to EU dairy exports to third country markets.

The External Effects of the Second Phase of EU Dairy Sector Reform

As in other sectors, the external effects of EU dairy sector policy changes make themselves felt through ***the corporate decision making of EU companies***. With the framework for policy change in place, EU dairy companies began to prepare for the process of EU production quota abolition. This began with a process of dairy industry consolidation, through a process of mergers and acquisitions. It continued through a process of investment in production of commodities which would find ready markets beyond the EU in regions where rapid growth in demand for dairy products is underway (50% of all recent dairy sector investment has gone into expanded milk powder production). It then extended to a process of international acquisitions and partnerships, which allows EU dairy companies to

[21] While EU milk production quotas have now been abolished for a snapshot of the EU's tool box in the dairy sector prior to quota abolition see Agritrade, 'The EU's agricultural policy toolbox: A sector-by-sector review', special report, 13 December 2011, http://agritrade.cta.int/en/Agriculture/Topics/CAP-reform/Special-report-The-EU-s-agricultural-policy-toolbox-A-sector-by-sector-review

maximise the value gained from the sale of final consumer-ready dairy products in non-EU countries. Since 2013, this internationalisation has included Sub-Saharan African countries. The consolidation and internationalisation of EU dairy companies cannot be divorced from the domestic EU agricultural policies, which continue to support milk production in Europe.

To put this in context, the Danish dairy cooperative **Arla** believes up to two thirds of its expanded milk production will need go into dairy products destined for markets beyond the EU's borders. Indeed, finding new markets for expanded dairy production is seen as vital to maintaining '*a viable dairy business'* in Denmark and other regions of the EU where Arla now has milk production interests[22].

Recent EU Corporate Engagement in Sub-Saharan African Dairy Sectors

Arla Group - (3rd largest dairy company in Europe and 5th largest in the world by milk intake)
July 2013: Arla announces "a new mobile milk powder packaging facility out of three 40-foot containers", as a means of testing new markets for milk powder in Africa.
September 2013: Arla announces formation of a joint venture in Cote d'Ivoire with the soup packaging company Mata Holdings, for the packaging and sale of milk powders using its new mobile unit.
2014: Arla announces plans to invest DKK 60 million in Africa in rolling out its new mobile processing unit concept.
2015: Arla announces new milk powder formula for manufacturing of "high quality specialty cheeses without fresh milk".
2015: Arla announces new joint venture initiative with Ethiopian dairy product manufacturing enterprises.

FrieslandCampina - (4th largest dairy company in Europe and 6th largest in the world by milk intake)
2008: FrieslandCampina WAMCO (FCW) Nigeria begins exploring local milk sourcing.
2011: FCW reaches agreement with the Nigerian government setting up pilot Milk Collection Centres.
2013: FCW sets target of 10% local milk procurement.
2014: FrieslandCampina acquires Olam's dairy business in Cote d'Ivoire.

Danone - (5th largest dairy company in Europe and 8th in the world by milk intake)
1998: Danone enters South African market forming joint venture with Clover.
2005: Danone takes a 20% shareholding in Laitiere du Berger, which uses 50% imported milk powder in the production of a range of dairy products.
2009: Danone announces full acquisition of Clover Danone shares, with termination supply agreement in 2014.
October 2013: Danone acquired a 49% shareholding in Fan Milk International, a major West African milk powder reconstitution company.
July 2014: Danone confirms the acquisition of a 40% share in Kenya's Brookside Dairies, which accounts for 44% of the Kenyan market, with in 2015 Brookside beginning a process of take overs of dairy companies in neighbouring countries.

Nestlé - (2nd largest dairy company in Europe and 4th largest in the world by milk intake)
July 2014: Nestlé announced the launch of a modular factory for reconstituted dairy products, which can be established in half the time and at 50-60% of the cost of a conventional factory. Malawi Tanzania, Uganda, Rwanda and Mozambique were identified as target countries for the new facilities.

The Dangers Arising from Expanded EU Exports of Milk Powders

Indeed, in this context the very real danger exists that in milk deficit areas of Sub-Saharan Africa ***imports of milk powder could be substituted for fresh milk in the production of a range of dairy products, since under current market conditions reconstituted dairy products are much cheaper than dairy products produced from fresh milk***.

In increasingly competitive regional markets, ***companies not responding to the relative prices of domestic milk and imported dairy raw materials run the risk of losing market share as their less scrupulous corporate competitors undercut their final product prices***. This is a particular danger given the patterns of EU corporate investment underway since 2013[23] and the ***new technical***

[22] Just-food.com , 'Arla Foods debuts new strategy focus on emerging markets', 11 January 2013 http://www.just-food.com/news/arla-foods-debuts-new-strategy-focus-on-emerging-markets_id121715.aspx

[23] See Agritrade, 'The evolving EU–Africa dairy trade: EU corporate responses to milk production quota abolition', special report, 5 September 2014, http://agritrade.cta.int/Agriculture/Commodities/Dairy/The-evolving-EU-Africa-dairy-trade-EU-corporate-responses-to-milk-production-quota-abolition

innovations being introduced in the design of low cost processing units[24] and the composition of milk powder formulas[25].

This potentially raises important issues of policy coherence, even where the policy tools being used by the EU are compatible with current interpretations placed on WTO rules on public sector support to agriculture. However, it should be noted that the Australian Anti-Dumping Commission has reopened a case against two Italian tinned tomato exporters to examine whether EU agricultural support measures, which are generally considered WTO compatible, are in fact providing effective subsidies to EU exports[26]. This could potentially raise questions about the compatibility of the EU's use of a wide range of EU agricultural support tools ***with the underlying WTO principle that such support measures should be non-trade distorting.***

The Scope for Initiatives to Minimise Adverse Effects on African Farmers

It also raises important questions related ***to corporate social responsibility in the dairy sector***, where recently the Danish dairy cooperative Arla has been taking some important corporate social responsibility initiatives.

In January 2015, Arla made a commitment to avoiding '*negative consequences for the local farming sector'* in developing its trade and investment relations with Sub-Saharan Africa (SSA). According to statements from the company, Arla wants to expand its presence in SSA in a responsible way '*that does not bring unintentional consequences for the local farming industry and its related communities*'. Arla has committed to introducing due diligence procedures and undertaking audits to promote a responsible development of its trade and investment relations in Africa[27].

This Arla initiative ***potentially opens up prospects for a responsible approach to EU corporate engagement with Sub-Saharan African dairy sectors***. However, at the moment this remains only a potential. The reality is that with a multiplicity of major EU dairy companies competing for the same markets in Africa, any initiative to promote more responsible patterns of EU corporate trade and investment in Sub-Saharan Africa dairy sectors needs to apply sector wide.

This suggests a need for a ***"Code of Conduct for Responsible Trade and Investment in African Dairy Sector Development"***. If the current Arla initiative could be extended first to all EU dairy cooperatives[28] and subsequently all EU dairy companies, then scope would exist for promoting responsible patterns of EU corporate engagement with Sub-Saharan Africa dairy sector development. This could then meet both rapidly expanding African demand for dairy products and progressively develop local-milk-to dairy supply chains, so that rising global dairy prices in the long term also serve to raise the living standards of African milk producers.

The Role of Government Policy in Sub-Saharan Africa

In a number of African countries, governments are seeking to promote more responsible engagement in local dairy sector development through the use of agricultural trade policy tools[29]. This involves the establishment of a 'managed trade' regime for dairy products. However, under many of the EU's new Economic Partnership Agreements (EPA) with Sub-Saharan African governments, the EC is seeking

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[24] See for example Agritrade, 'Arla launches turnkey milk powder packaging facility in Côte d'Ivoire ', 27 October 2013, http://agritrade.cta.int/Agriculture/Commodities/Dairy/Arla-launches-turnkey-milk-powder-packaging-facility-in-Cote-d-Ivoire

[25] See for example Dairyreporter.com, 'Poor milk yields great cheese', 8 January 2015, http://www.foodmanufacture.co.uk/Ingredients/Cheese-production-without-need-for-fresh-milk

[26] abc.net.au, 'AU anti-dumping EU subsidies should be included', 22 January 2015, http://www.freshplaza.com/article/133972/AU-anti-dumping-EU-subsidies-should-be-included

[27] Arla, 'Arla Foods to ensure responsible approach to African markets', 12 January 2015, http://www.arla.com/about-us/news-and-press/2015/pressrelease/arla-foods-to-ensure-responsible-approach-to-african-markets-1104299/

[28] 6 of Europe's top 21 cooperatives are active in the dairy sector with two dairy cooperatives being amongst the top six global dairy companies being EU dairy cooperatives.

[29] Unfortunately these trade policy tools can also be used as personal 'rent seeking' mechanisms or to protect inefficient industries at the expense of urban consumers.

the elimination of all quantitative restrictions on imports from the EU, including through prohibiting the use of import licensing arrangements linked to local procurement.

If the European Commission were to interpret EPA commitments in ways which required African governments to abandon the use of these trade policy tools, this would leave African milk producers and locally integrated dairy sectors vulnerable to the ups and downs of global dairy markets, which are subject to increasingly dramatic price volatility. This ***could prove disastrous for efforts to promote locally integrated forms of dairy sector development, based on the progressive development of local milk-to-dairy supply chains***[30]. This could see dairy processing industries expanding or being established without any significant growth in local milk production. This would mean the rapid rise in African demand for dairy products, particularly UHT milk, would have little effect on local agricultural and rural development and hence little effect in term of the efforts underway to reduce rural poverty.

Growth in UHT Demand in Africa: An Illustrative Example

Overall, given population growth in Africa and assessment of trends in the contribution of dairy products to the daily per capita calorific intake, it is likely that demand for dairy products in SSA will double by 2050. This growth, however, will not be spread evenly across all dairy products.

According to packaging manufacturer SIG Combibloc, demand for long-life milk in Africa is set to '*grow exponentially*'. It is maintained, demand for packaging used in UHT production in Africa and the Middle East '*has witnessed growth rates of up to 35% per year*' since 2001[31].

Milk and milk product markets are most strongly established in Southern and Eastern Africa[32]. In Southern Africa, strong growth in demand for yoghurts, flavoured milk and mixed fruit and dairy drinks is underway, with in certain countries demand for cheese also growing strongly. Meanwhile in West Africa, '*the majority of white milk is sold in powdered form'* while '*other dairy products like fermented milk, flavoured milk and drinking yoghurt are hugely popular*'.

In milk deficit areas, all of these trends generate increased potential for the production of dairy products on the basis of imported skimmed milk powder rather than fresh milk. This potential is being enhanced both by ***technological innovations in the preparation of milk powder mixes*** (some of which can now be used to produce high quality soft cheeses) and ***innovations in the design of mobile and low cost, milk powder re-packaging and reconstitution facilities***, which are at the heart of the African investment plans of a number of EU dairy companies.

This would raise important issues of policy coherence, for the EU itself, has recognised the dangers posed to domestic milk producers from the full transmission of global price volatility to local dairy markets. Since 2010, this has seen the EC develop a more comprehensive 'safety net' policy designed to insulate EU dairy farmers from the vagaries and volatility of global dairy markets. This more comprehensive 'safety net' policy consist of a combination of financial and trade policy instruments.

Against this background, it would appear essential that Sub-Saharan African governments be ***allowed the agricultural trade policy space to promote local milk-to-dairy supply chains***, while ***allowing imported bulk dairy commodities to pay a role in meeting rapidly expanding consumer demand***.

This highlights the importance in the dairy sector of proposals to enshrine a '*right to development*' in WTO rules. This proposal would seek to limit '***the applicability of WTO obligations when the***

[30] With of course imports of milk powder playing a part in the expansion of dairy product manufacturing to meet expanding Sub-Saharan African demand for dairy products

[31] Dairyreporter.com, 'African UHT milk demand will drive future aseptic orders: SIG Combibloc', 5 December 2013, http://www.dairyreporter.com/Processing-Packaging/African-UHT-milk-demand-will-drive-future-aseptic-orders-SIG-Combibloc

[32] See Agritrade, 'Exponential growth in UHT milk demand foreseen in Africa', 3 February 2014, http://agritrade.cta.int/en/Agriculture/Commodities/Dairy/Exponential-growth-in-UHT-milk-demand-foreseen-in-Africa

enforcement of such obligations would have a significant adverse effect on development'. It would create a right for developing countries '***not to be harmed by the imposition of trade rules***'[33].

What is more, the enshrining of a '*right to development'* in WTO rules would seek to 'hardwire' the principle of special and differential treatment incorporated into WTO agreement into the ***application of commitments entered into through bilateral trade agreements***, where the implementation of the agreed commitments could undermine the development of particular sectors.

Namibia's Use of Traditional Trade Policy Tools to Promote Dairy Sector Development

To promote local dairy sector development, the Namibian government has used variously the infant industry provisions of the SACU agreement and its national Import and Export Control Act to manage imports of dairy products into Namibia (including from neighbouring South Africa a fellow member of the Southern African Customs Union). These arrangements are permitted under various provisions of the 2002 SACU agreement[34].

However, the September 2013 announcement by the Namibian Minister of Trade and Industry that imports of dairy products would only be allowed with import permits, the issuing of which would be restricted to 500,000 litres per month for milk and cream and 200,000 litres per month for cultured milk products has been challenged in the High Court by a combination of Namibian importing companies (Matador Enterprises and Clover Dairy Namibia[35]) and a South African dairy company (Parmalat SA[36]). These measures were temporarily set aside when the High Court ruled against the measures on a technicality[37], but with the Namibian government appealing[38] and planning to reintroduce the measure under a modified procedure.

This is the local context within which, in the coming years, ***the EC may seek to revisit the issue of the Namibian government's use of quantitative restrictions and import licences.*** Given the importance of traditional trade policy tools to Namibia's agro-food sector development strategy, the SADC Group-EU EPA has less stringent commitments on the elimination of quantitative restrictions than all other EU EPA agreements[39]. Nevertheless, ***the interpretation to be placed on these EPA commitments are likely to be an important terrain of political struggle in the coming years, with the outcome of these struggles providing an important indication of the EU's commitment to its legal obligation to ensure policy coherence for development***.

Annex 1: Some More Details on the EU's Reformed Dairy Sector Regime

Overview

Through the implementation of its dairy sector reforms, the EU sought to bring its systems of agricultural support into line with agreed WTO rules. This has led to a discontinuation of the routine use of certain policy tools (export refunds), and the expansion of other policy tools ('decoupled' support payments). However, it continues to provide certain forms of coupled support and under its broader 'safety net' policy, assistance to private storage at times of market stress. The EU also maintains a highly managed import regime for dairy products and to varying degrees permits member states to regulate the functioning of dairy supply chains within the EU.

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[33] See Joseph Stiglitz and Andrew Charlton, 'The right to trade: Rethinking the aid for trade agenda', 2013 http://thecommonwealth.org/media/news/professor-joseph-stiglitz-calls-%E2%80%98right-trade%E2%80%99

[34] Most notable under Article 26 Protection of Infant Industries and Article 29: Arrangement for Regulating the Marketing and Agricultural Products.

[35] Clover Dairy Namibia is a subsidiary of Clover South Africa.

[36] Parmalat SA is owned by the French dairy company Lactalis

[37] High Court of Namibia , main Division, Judgements Case no: A 94/2014 http://www.saflii.org/na/cases/NAHCMD/2014/331.pdf

[38] See Namibian, 'Government appeals High Court dairy import ruling', 22 May 2014, http://www.namibian.com.na/indexx.php?archive_id=123532&page_type=archive_story_detail&page=1

[39] While all other EPA agreements commit signatory Sub-Saharan African governments to the elimination '*upon entry into force of this agreement*' of '*all prohibitions and restrictions*' other than '*customs duties taxes, fees and other charges*' provided for under other provisions of the agreement '*whether made effective through quotas, import or export licenses or other measures'*, the SADC EPA allows the Sub-Saharan African signatories to '*apply quantitative restrictions provided such restrictions are applied in conformity with the WTO Agreement*'.

Changing Pattern of EU Dairy Sector Support payments

Coupled Dairy Sector payments	**Allocation 2014**
Suckler cow premiums	€ 902,000,000
Additional suckler cow premium	€ 49,000,000
Dairy premium	Discontinued from end of 2006
Additional payments for milk producers	Discontinued from end of 2006
Other Dairy Related Payments	
Export refunds	Discontinued from end 2012
Public intervention storage for skimmed milk powder	Discontinued from 2010
Public intervention storage for butter	Discontinued from 2010
Public intervention storage for cheese	Discontinued from 2010
Aid for disposal of skimmed milk	Discontinued from 2010
Intervention storage of butter and cream	€ 6,000,000
School milk programme	€ 75,000, 000
Other measures (milk and milk products)	€ 100,000
General Financial Measures from Which the Dairy Sector Also Benefits in Part	
Single Farm Payment	€ 30,083,000,000
Emergency Reserve (Safety Net Facility)	(seven year period) € 3,500,000,000

Source: EU Annual Budgets

The EU Dairy Sector Trade Regime

In the dairy sector, the EU maintains a ***highly dis-aggregated system of fixed duties*** per 100 kg of imports. The specific duties vary considerably from product to product, from a low of €13.1/tonne to a high of €1,837/tonne.

The EU also operates a system of ***Tariff Rate Quotas (TRQs)*** in the dairy sector, the management of which can be ***regulated in the course of the year in the light of market conditions***[40]. This TRQ system is applied using a system of import licensing which is closely linked to the structured marketing of dairy products. This revolves around a system of '***approved undertakings'***. Under food hygiene legislation, food businesses handling milk and dairy products require approval (unless they benefit from specific exemptions). Commonly these approvals are granted by local authorities. Traditionally this has meant that only EU dairy companies are allowed to place dairy products for sale on the EU market.

Recent Policy Innovations: Strengthening the Functioning of Dairy Supply Chains

The 2008/09 EU milk crisis saw a further policy innovation with the introduction of domestic policy measures to ***strengthen the functioning of milk-to dairy supply chains***. This was aimed at resolving three related problems:

- the tensions in contractual relations arising from inequalities in power relationships along milk-to-dairy-to-retailer supply chains;
- a lack of transparency in price formation along milk supply chains;
- the EU's increased exposure to global dairy market price volatility.

These policy measures took the form of:

- EU guidelines on '*contractual relations between milk producers and dairies and EU framework legislation to avoid unfair contractual practices*';

[40] In the first four months of 2015 EU imports of butter were down 85% on the corresponding period in 2014, while imports of cheeses were down 44%. This can be seen as a direct response to the dairy market consequences of the August 2014 Russian import embargo. This needs to be seen in the context of a 66% decline in EU butter imports between 2003 and 2014 and a 57% decline in cheese imports.

- support for strengthening milk producers organisations, including recognition of the role of inter-branch organisations;
- the establishment of a milk market observatory, to closely monitor milk market developments.

Annex 2: Projected Trends in EU Dairy Commodity exports 2013-2024 ('000 tonnes)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
SMP	407°	646°	668	661	693	716	737	756	759	781	795	810
WMP	374°	389°	418	435	436	441	444	449	450	450	450	450
Whey	578	602	636	650	695	729	760	789	818	846	873	900
Cheese*	787°	721°	739	822	869	908	847	982	1003	1021	1035	1052
Butter*	116°	137°	146	180	190	175	164	166	166	167	165	164

Source: EC, 'Prospects for Agricultural Markets and Income in the EU 2014-2024', December 2014
° EC, 'Short Term Outlook for EU arable crops, dairy and meat markets 12015 and 2016', Winter 2015

* *Note: The continued closure of the Russian market which formerly accounted for 33% of extra-EU cheese exports and 29% of extra-EU butter exports (but only 5.2% of SMP and 5% of whey exports) could lead to a slower rate of growth in extra-EU butter exports than projected in December 2014 and potentially even a slower rate of growth in extra-EU cheese exports (although in the short term alternative markets are being found for some of these cheese exports). This could then translate into even higher SMP production, with the importance of SSA markets as an outlet for this SMP production increasing.*

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