

European dairy policy, market conditions, contracts and economic power

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Storyline

“In the new food economy farmers will have more problems keeping value than in adding value” (Richard Levins)

- Background (market disturbances, High Level Group, Cie reponse)
- Problem (relatively weak position dairy farmers)
- Proposed solution (bargaining collective contracts between producers and processors)
- Expected results (better distribution of rewards along the supply chain) => **My conclusion**: this will be only partly successful

Background (Trends in EU-9 incl struct change)

- Since introduction milk quota number of dairy farms declined by more than 70% and dairy herd decreased by 40-45% in EU-9
- Milk price decreased in period 2001-2006, sharp increase in 2007/2008, sharp decrease 2008/2009, gradual increase in 2010-11
- Average family farm income in period 2004-2007 well above average family farm income in period 2000-2003
- Dairy farms are heterogeneous wrt structure, location, and management, which is reflected in costs of production (critical milk price)

Background (Policy reforms)

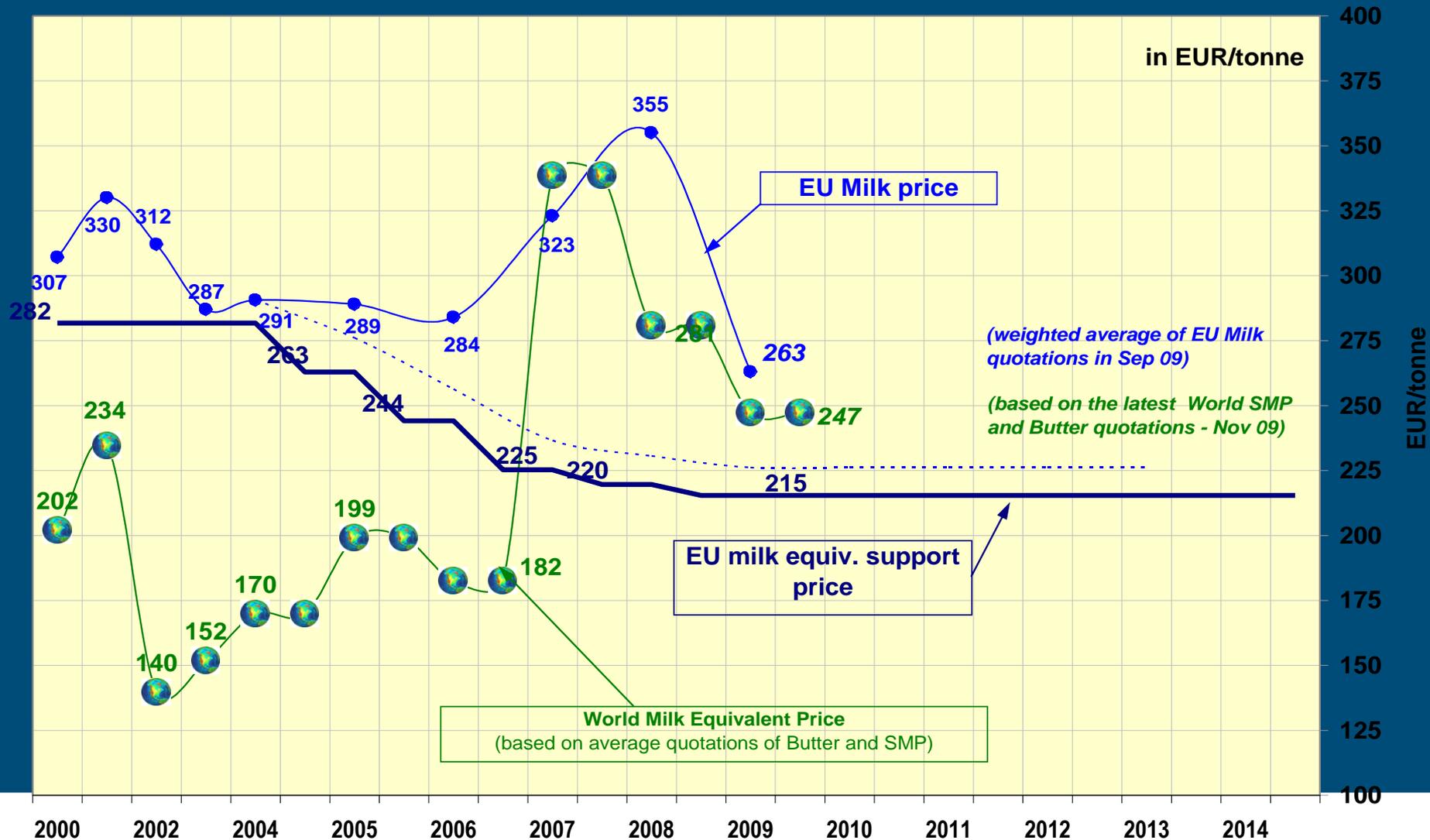
■ EU dairy policy reforms

- Fishler Reform 2003 (price declines, milk premium)
- Health Check reform 2008 (soft landing)
- Safety net provision

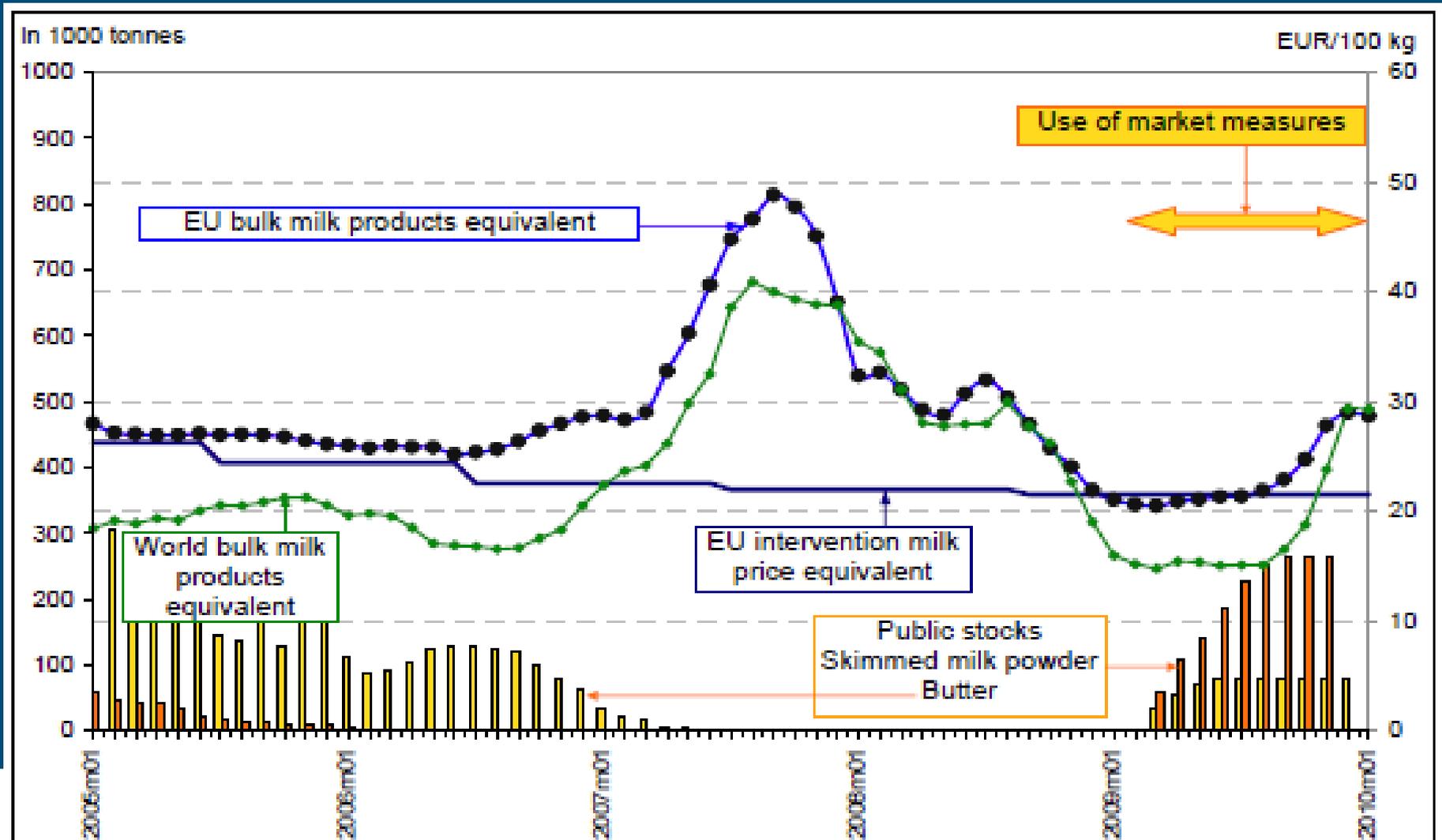
■ Market turbulence 2006-2009

- Low and volatile prices
- Social action: milk delivery strikes
- Discussions within the High Level Group of the EU Commission

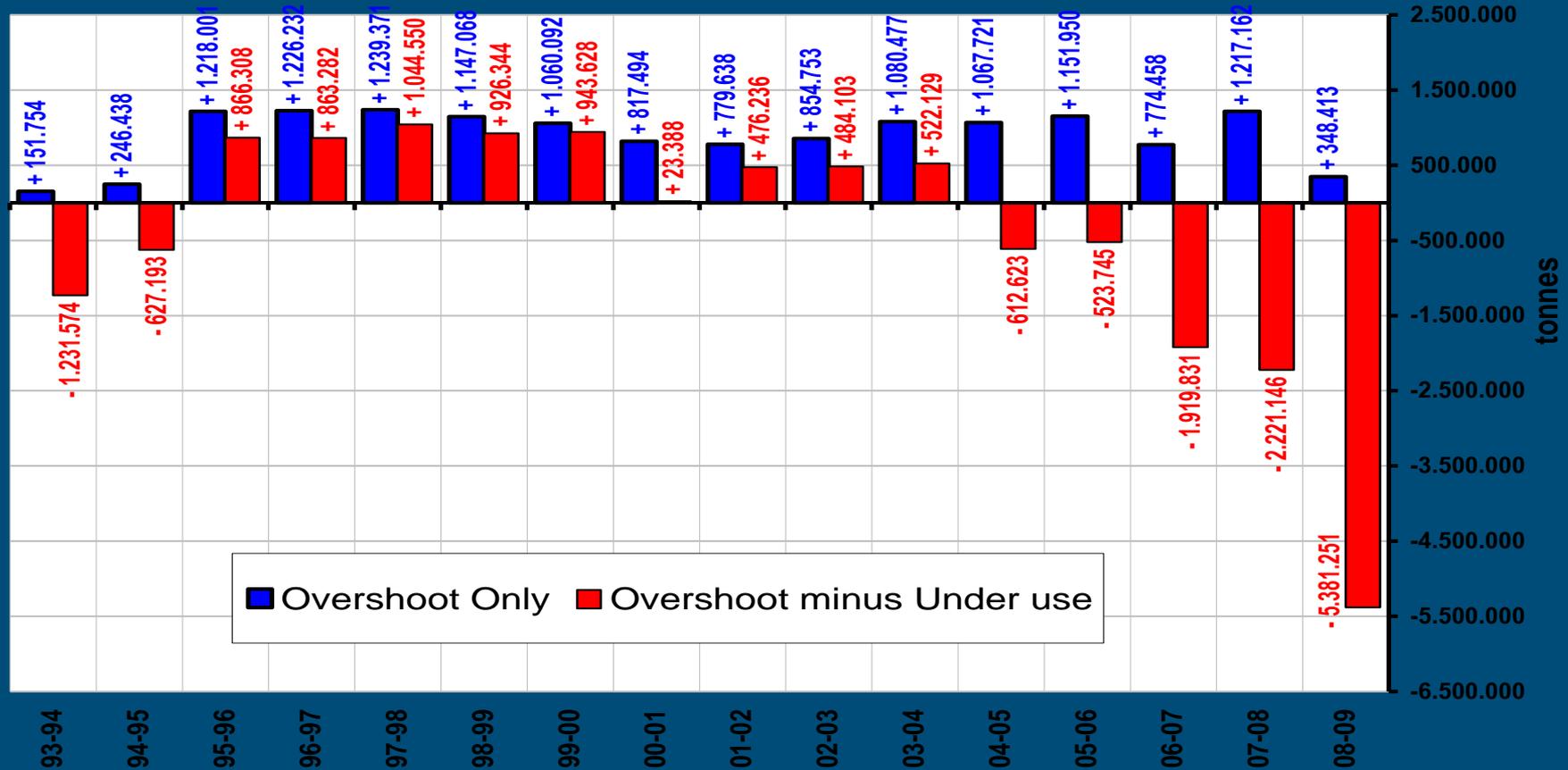
Background (Price in EU and world market)



Background (Recent developments in raw milk price and stocks)



Background (How effective are the milk quota?)



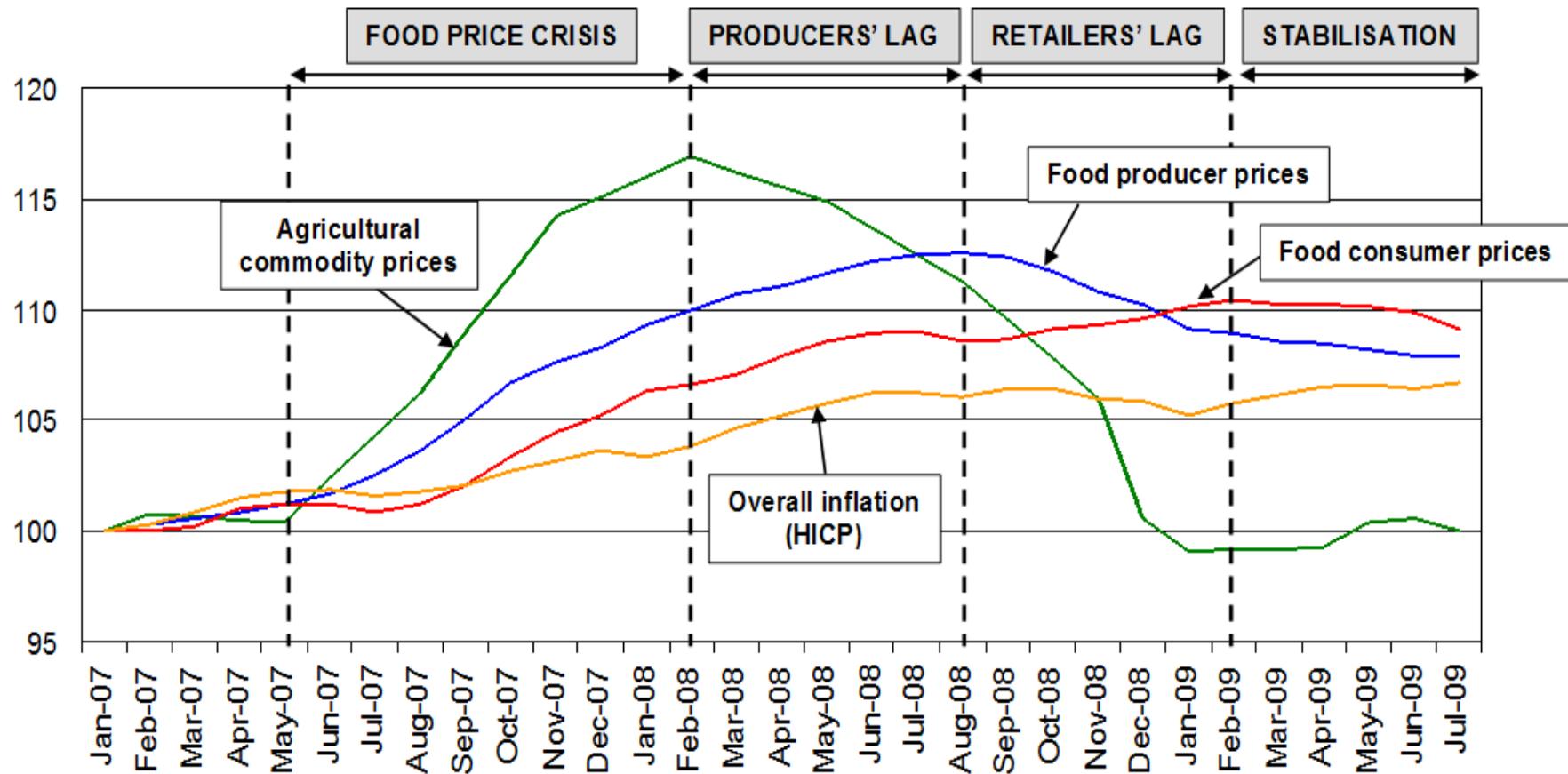
The end of public supply management is advancing

Note: the new context is one of deregulation

What about the exploitation of market power?

- Deregulated policy environment allows more space for prices to move
- Prices will move in order to balance demand and supply (under all conditions)
- Economic theory: classical solution to oligopsony market power is an appropriate “minimum price policy”
- In the CAP intervention prices now establish only a safety net (against extreme downside price risk)
- Is there reason for action? How serious is unbalanced market power?

Evidence on market power: price transmission



Source: European Commission – DG Economic and Financial Affairs, based on Eurostat data

Slow, limited, asymmetric price transmission along the chain

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In large producer countries, about 50% of processing is often concentrated in 5 biggest companies and 60-90% within 10 largest companies.

er: Level of processors (year 2002)

	Germany	Italy	France	UK
Liquid Milk CR-3 CR-6	49.8	56.2	63.0	73.0
Butter CR-3	24.3	26.1	46.0	87.0
Powders CR-3 CR-6	40.4	-	40.0	67.6
All cheeses CR-3 CR-8 CR-10 CR-16	49.3		0	74.0
Hard cheese CR-3		22.6		

A report from Competition. Authorities in France shows that processors of size over 200 000 t. represent 5% of the total and process over 50% of the milk

Concentration rates are s
(source: contributions of EDIM project researchers)



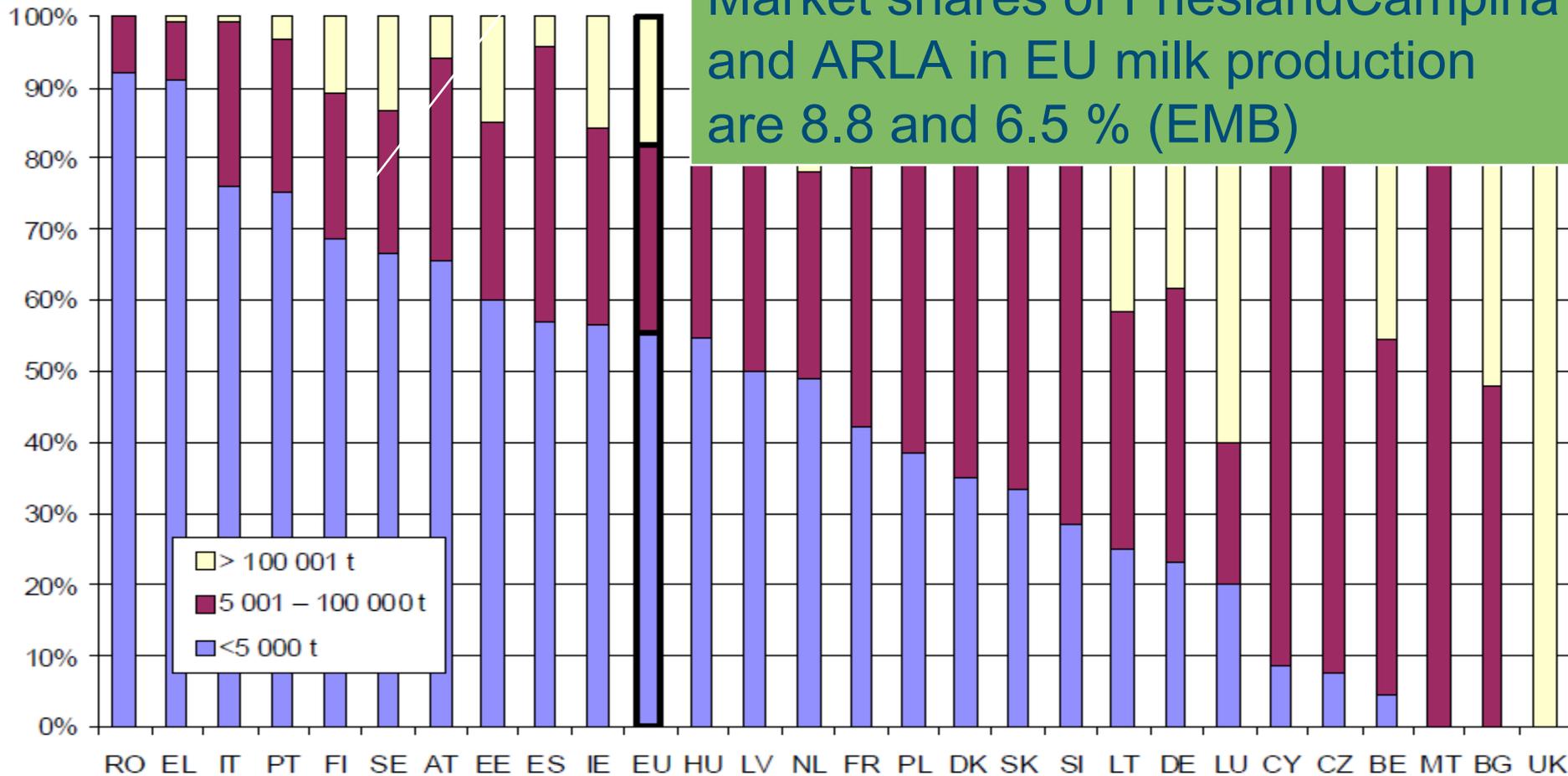
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Structure of process

In Denmark Arla firm has a 95% market share

Market shares of FrieslandCampina and ARLA in EU milk production are 8.8 and 6.5 % (EMB)



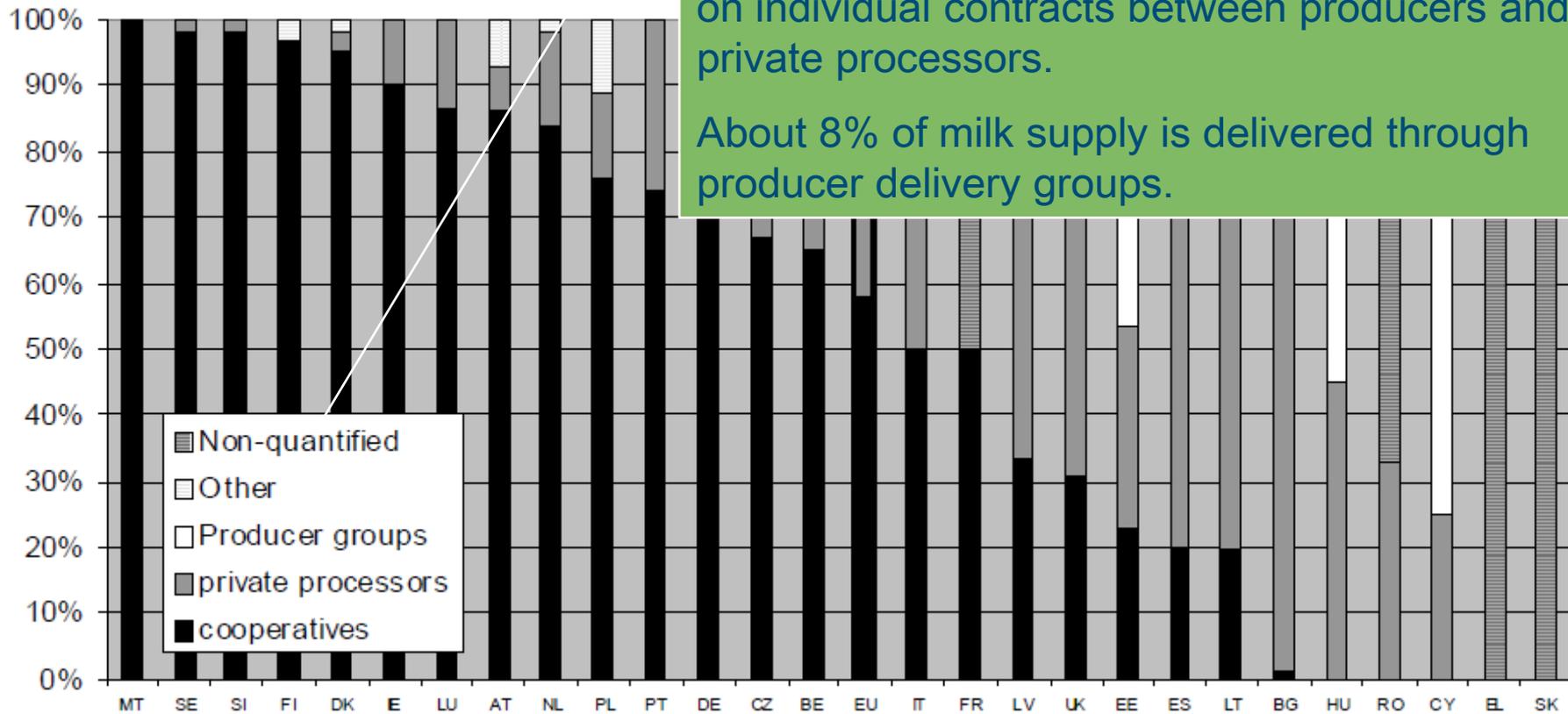
Share of # firms of having a certain processing capacity

Structure of process

About 58% of milk supply in the EU is delivered by members to their cooperatives.

Roughly 20% of milk supply is delivered based on individual contracts between producers and private processors.

About 8% of milk supply is delivered through producer delivery groups.



Share of milk production by contractual arrangements

Structure of the retail sector (C5 grocery & daily goods)

	1993	1996	1999
Austria	54.2	58.6	60.2
Belgium+Luxembourg	60.2	61.6	60.9
Denmark	54.2	59.5	56.4
Finland	93.5	89.1	68.4
France	47.5	50.6	56.3
Germany	45.1	45.4	44.1
Greece	10.9	25.8	26.8
Ireland	62.6	64.2	58.3
Italy	10.9	11.8	17.6
Netherlands	52.5	50.4	56.2
Portugal	36.5	55.7	63.2
Spain	21.6	32.1	40.3
Sweden	79.3	77.9	78.2
UK	50.2	56.2	63.0
EU 15 (weighted av)	40.7	43.7	48.9

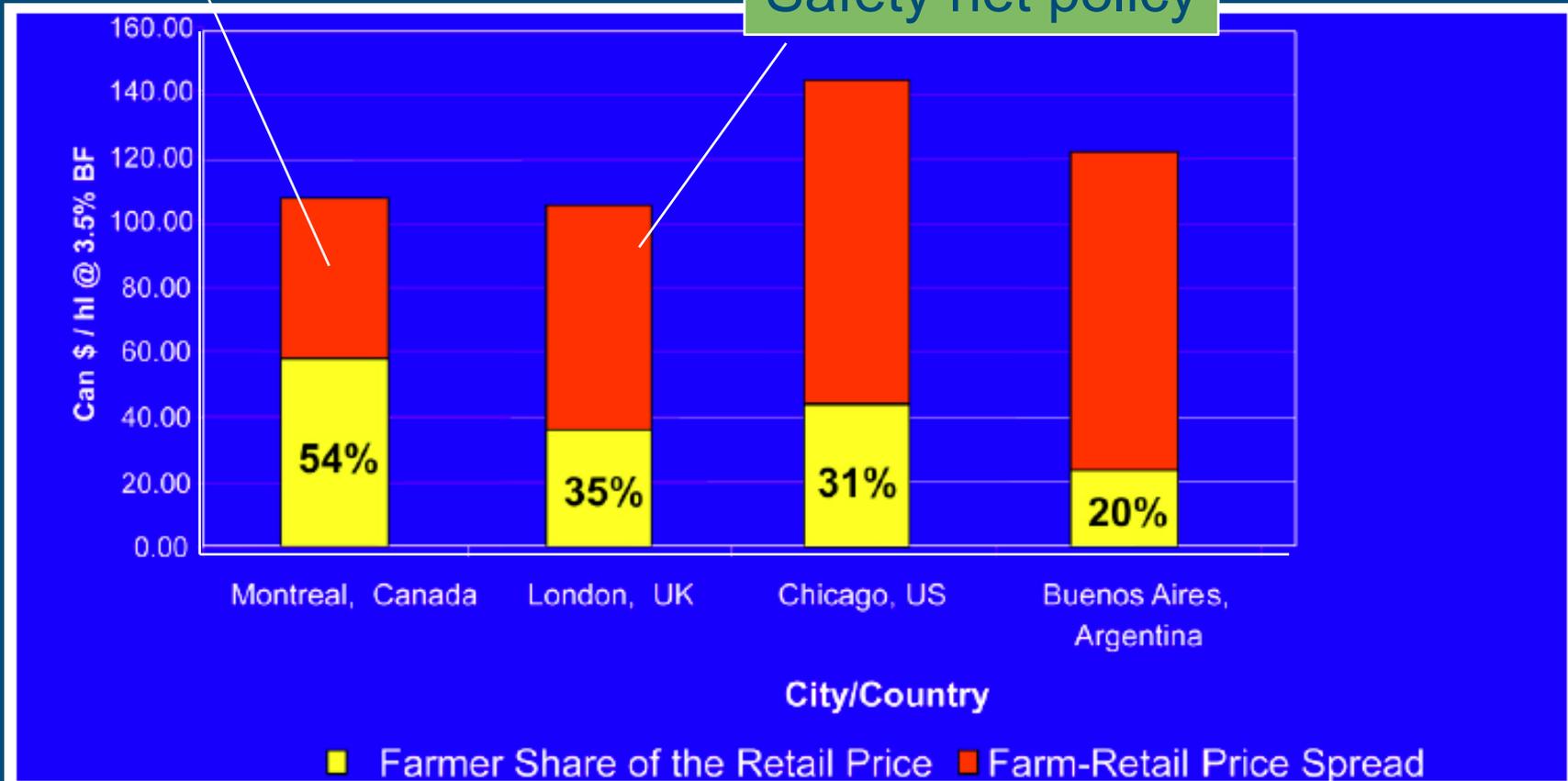


LEARN Retail sector is concentrated and concentration is
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 still increasing

Source Dobson et al 2003 JAE

Price support policy

Safety net policy



“More liberalized markets show lower farmer shares”
(EMB)

Market power: evidence and qualifications

- Evidence on market power is still indicative and incomplete and proper assessment is complex
 - Imperfect horizontal and vertical price transmission *)
 - CRs are significant at various stages of the supply chain (power distribution, processors, retailers)
 - Role of cooperatives (countervailing power devices / presence-effect / farm interest)
 - Heterogeneity among member states is large (scale, coops, contract arrangements)
 - Role of CAP measures (was effective minimum P policy?)

Problem: weak position of dairy farmers

- Dairy dominated by small family farms, having a relatively high fixed cost structure (specific investments, hold-up)
- # dairy farms (955 000) is large relative to downstream (processing 5000, retail) and upstream industries (compound feed)
- Empirical evidence on price transmission and CRs suggests transmission to be imperfect and market power at other supply chain stages playing a role

Commission proposal

- Aim of improving contractual relations with processors and putting producers and producer organisations on a more even footing
- Optional, guidelines, ...
- Issues to be dealt with in contracts
 - Price
 - Length of contract (duration)
 - Volume
 - Quality
- Negotiate collectively (prod.organisations)
- Anti-trust (exemptions, but still constraints on degree of pooling; <3.5% of EU milk supply; <33% of MS milk supply)
- Members of dairy cooperatives excluded form pooling

Is this going to work?

- Issue has long history in Ag Policy (coops, PBs, ...)
- Vertical contracts between producer groups and dairies are no remedy for solving demand and supply imbalances or disturbances (unless system would end in a 'contractualized' supply control system, e.g. Burrell)
- Raw milk is bulk product, highly perishable, costly to transport. Farmers are often 'small', tied to location and have a high specific investment structure.

How effective is this likely to be

- On one hand farmers face a oligopsony (or even monopsony) situation, but also processors might have limited milk procurement alternatives
- The potential effectiveness of collective contract negotiation depends on the degree of market imperfection prevailing (how serious?)
- Contracts can play a role in improving conditions (price, volume) to farmers, but the terms will depend on bargaining power structure

How effective is this likely to be

- New environment may give rise to contracts reflecting final product market differentiation (e.g. A (base volume) and B ('surplus milk') contracts)
- Contracts can play a role in risk sharing (price stabilization) but again the terms will depend on bargaining power structure
- Capacity building of farmers to better understand the supply chain, their processor's business and negotiate (while having access to transparent information and advice) is crucial to balance their interests against others

Thank you for your attention

“In business, you don’t get what you deserve, you get what you negotiate”
(Richard Levins)

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