

They have a massive dairy problem, too

U.S. dairy surpluses are no match for those across the Atlantic, where the 10-nation European Community is trying to turn back a tidal wave of milk. In the following article, economists Reed Friend and Ron Trostle of USDA's Economic Research Service examine recent dairy policy decisions in the European Community (EC) and the implications of those decisions for the EC and the United States:

In late March, after nearly a year of debate, agricultural ministers of the European Community agreed on a variety of farm policy and price reforms. Dairy received special attention, with two related decisions that mark a significant departure from the past.

The ministers voted to reduce production by imposing milk delivery quotas and to freeze the official target price for milk at last year's level.

Up until this time, EC dairy farmers could produce unlimited quantities at guaranteed prices. The guaranteed support prices were routinely boosted every year, providing a strong incentive to expand output.

If the resulting EC dairy problem found a sympathetic ear in the United States, American farmers can hardly be pleased with the remedy. U.S. agriculture has little to gain and somewhat more to lose from the recent EC actions.

These actions are expected to reduce EC milk production by about 5 percent, not nearly enough to eliminate the surpluses or curtail subsidized EC dairy exports. EC production exceeds usage by an estimated 23 percent.

The quotas, however, will encourage the slaughter of less productive cows, putting more beef on world markets in the months ahead. Fewer cows and lower feeding rates also suggest some reduction in EC demand for feedstuffs, including corn gluten feed and citrus pulp imported from the United States.

Dairying, EC style

The EC has more than twice as many milk cows as the United States and produces roughly 75 percent more milk. That's far too much for a population of around 285 million, 25 percent larger than the U.S. population.

Part of the excess production goes into dairy products that are subsidized for sale outside the EC. In 1983, the EC exported nearly 3 million tons of cheese, nonfat dry milk, and butter — more than 10 times the U.S. export volume of these products.

Even with a large export program, surplus stocks are huge and growing. Inventories of nonfat dry milk and butter reached a record 1.9 million tons in December 1983, compared with U.S. butter and dry milk stocks of less than 800,000 tons. To help finance the surpluses, EC farmers pay a 2-percent "co-responsibility" tax on their deliveries to dairy processors, but the tax hasn't cut production.

Milk output has increased at an average rate of 2.1 percent per year since 1970, with 1983's 3.7-percent gain well above the average. Like their American counterparts, EC farmers have boosted the productivity of their cows through genetic improvements in the herd, as well as higher yielding management and feeding practices. While milk cow numbers held fairly steady at around 25½ million, annual yields rose from 6,929 pounds of milk per cow in 1970 to 9,689 pounds last year.

Excess production in the dairy sector, and in several other

commodities, has a price. The price has escalated so much and so rapidly that it precipitated a budget crisis in the EC last year — a situation that is not yet fully resolved. And dairy is the EC's most expensive commodity price support program.

Costs for disposing of surplus butter and nonfat dry milk are estimated at more than \$4 billion for 1983, about 30 percent of total EC price support expenditures. In 1975, the tab was only \$1.1 billion. Three-fifths of 1983's expenditures went for storage, export market development, and subsidies for feed use of skim milk and domestic butter consumption. Two-fifths went for export subsidies.

Time for action

Faced with mounting surpluses and rising costs that were bumping up against budget ceilings, the EC recognized that it had to take action. Of the two dairy program decisions, the quota on milk deliveries is the most significant.

The decision not to raise dairy support prices in 1984/85 is largely symbolic because the target price is set in European Currency Units (ECUs), an artificial currency that is based on weighted averages of members' currencies. When ECUs are converted to francs, pounds, lire, and other national currencies that farmers actually receive, milk prices will rise in most of the EC countries. The increases, however, are not enough to keep up with the costs of production as they have usually been in previous years.

The approval of 5-year quotas on milk deliveries to processors represents a much sharper break with the past — and with the basic philosophical underpinnings of EC agricultural policy. EC agricultural policy originated in an environment of food shortages, and it was intended to stimulate, not inhibit, production growth.

Under the quota system, producers will receive the guaranteed price support for milk deliveries falling within established quotas. Milk deliveries above the quota will be subject to a levy or tax amounting to 75 percent of the milk target price.

For the 1984/85 marketing year, EC agricultural ministers approved an overall milk quota of 99.2 million tons, plus a small reserve divided among Ireland, Northern Ireland (part of the United Kingdom), and Luxembourg. Together, the quota and the reserve amount to 99.6 million tons, 4 percent below the EC's milk deliveries in 1983. For the next 4 years, the overall quota drops to 98.4 million tons.

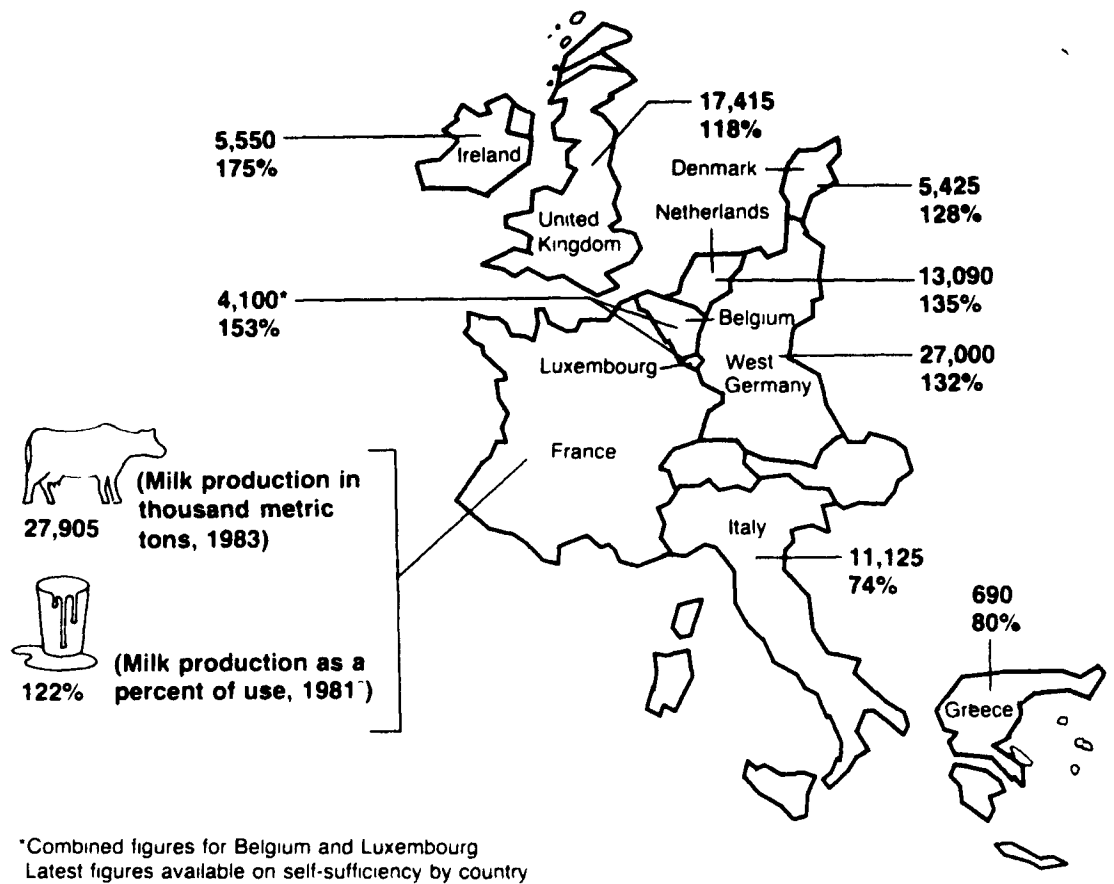
Most of the individual quotas for member nations are based on their 1981 milk deliveries, plus about 1 percent. This means a substantial cutback from 1983 production for West Germany, the United Kingdom, and the Netherlands. For Ireland, Italy, and Greece, the base is 1983 deliveries, with a small upward adjustment.

The establishment of these quotas is not a minor accomplishment, given the differences in interests and the intense debate that preceded agreement. Ireland, for example, had asked that it be completely exempt from any quota because its dairy sector has been slow to develop and could be frozen at a lower state of technology relative to other EC members. In one of many compromises, Ireland was guaranteed that its quota would not be reduced.

Measuring impact

The impact of the delivery quotas can be viewed from different perspectives because there are implications both for the EC dairy sector and for other nations, including the United States.

Most EC Members Produce Far More Milk Than They Can Use



Within the EC, the relatively small reduction in milk production stemming from the quotas is not expected to trim the number of dairy farms. An estimated one-third of EC farmers produce milk for sale off the farm. Pressure to support farm incomes by maintaining high support prices for milk will, therefore, remain strong, and the EC may be more likely to give in to such demands under the security umbrella of a quota.

To meet on-farm needs and to ensure that they fulfill their quotas, EC dairy farmers will probably continue to produce more milk than they deliver to dairies. However, with the 75-percent tax on additional marketings, milk producers can be expected to cut their output close to their quotas.

In 1983, milk deliveries from EC producers to dairy processors totaled 104 million metric tons, about 93 percent of the 112 million tons of milk produced. Domestic use, excluding stock accumulation, is estimated at 91 million tons, so the EC producers about 21 million tons more than it needs to meet internal demand. If the quota reductions in deliveries translate into a comparable cut in production, the surplus will be reduced only about one-fourth.

Consequently, the EC will still be burdened with large surpluses, and it will remain the world's largest exporter of dairy products.

Trade implications

The reductions in milk output will be achieved through a culling of less productive cows and a cutback in the feeding of concentrates. Culling is likely to get the most emphasis because the program lasts for 5 years. Most cull cows will probably be sold for slaughter rather than converted to suckling cows because the typically small EC dairy farms do not have the grazing land available for producing beef animals.

With fewer EC dairy cows on feed and more slaughter cow meat coming to market, the direct trade implications for exporters of feed and lower priced beef are not favorable. If many cows are slaughtered, this could depress world prices and add to the already burdensome EC stocks of beef.

More significant to the United States is the impact on EC imports of feedstuffs for its dairy herd. It must be noted that not only will

milk production be reduced, but the 2 to 4 percent annual growth rate in milk output, characteristic of the last decade, will cease.

EC dairy rations make heavy use of corn gluten feed and citrus pellets imported from the United States. Last year, the EC purchased 3.8 million tons of U.S. corn gluten feed and meal and a half-million tons of U.S. citrus pellets.

Another U.S. concern is the recent EC decision to negotiate controls on imports of U.S. corn gluten feed through the GATT

(General Agreement on Tariffs and Trade). The United States has refused to voluntarily limit its exports and has lodged a strong objection to the EC action.

The only potential benefit to U.S. agriculture relates to U.S. dairy exports, which are relatively small in volume and value. And even this benefit won't materialize unless the EC cutback in milk production eventually leads to reduced European dairy exports and improved world prices.

Dairy Sector Comparisons for 1983: EC versus USA

	European Community	United States
Cow milk produced (million metric tons)	112.1	63.5
Number of milk cows (millions)	25.5	11.1
Average yield per cow (pounds)	9,689	12,587
Average number of cows per farm	14.3	35.7
Annual rate of increase in milk production since 1970 (percent)	2.1	1.5
Milk target price (\$ per 100 lbs.)	10.91	12.60
Butter stocks (thousand tons)	866	165
Nonfat dry milk stocks (thousand tons)	1,006	620
Per capita butter consumption (pounds)	14.1	5.1
Per capita liquid milk consumption (pounds)	278	210
Butter exports (thousand tons)	804	34
Cheese exports (thousand tons)	1,178	17
Nonfat dairy milk exports (thousand tons)	957 -	234

At 1980 exchange rates, the current EC target price would be \$17.29.

