THE CASE FOR A HIGHER EU DAIRY "SAFETY NET"

Introduction

Last adjusted in 2008, as part of the 2005-2013 reform of the CAP, the "reference thresholds" for intervention for SMP and butter are as set now set out in Article 7. 1. (e) of Parliament and Council Regulation 1308/2013 as outlined below:

- SMP = €1698.0/t
- Butter= €2463.90/t

Article 7.2. states that "The reference thresholds provided for in the paragraph 1 shall be kept under review by the Commission, taking account of objective criteria, notably developments in production, costs of production, (particularly inputs), and market trends. When necessary, the reference thresholds shall be updated in accordance with the ordinary legislative procedure in the light of developments in production and markets"

Throughout the negotiations of the new Common Agriculture Policy, reference has been made to intervention providing a "safety net". According to the Oxford Dictionary, a safety net is meant to "catch an acrobat in case of a fall". It can only do so if it is set above the floor.

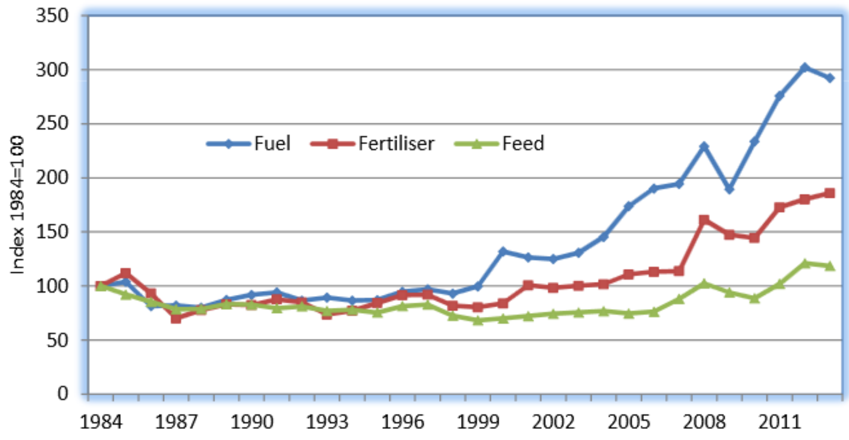
IFA contends that the current intervention level is set below the floor (i.e. below the level of production costs).

We therefore believe the update process the Commission is mandated to undertake as outlined in Article 7.2 of 1308/2013 must now be set in train – specifically, an increase in the reference thresholds must be implemented to secure a functional safety net.

Production costs in Ireland

Irish farm production costs have increased very substantially especially in the last two decades. Fuel costs have trebled since 1984, while fertiliser costs have nearly doubled (see Graph 1 below). While feed unit costs have increased more modestly, it is a fact that the quantities of concentrate feed fed to cows has more than doubled from around 500 kilos in 1984 to a current level in excess of 1 tonne, so that expenditure on feed has increased substantially (see Graph 2 below).

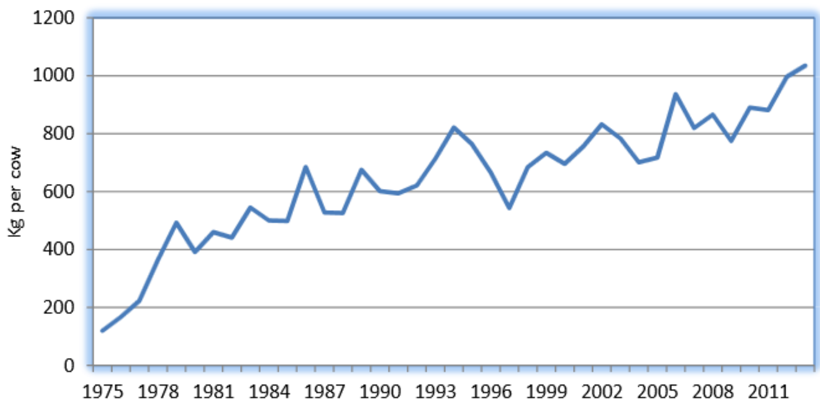
Graph 1 – input cost indices over the last 30 years - Teagasc



Source: CSO and authors' estimates

Graph 2 – Concentrate feed per cow - Teagasc

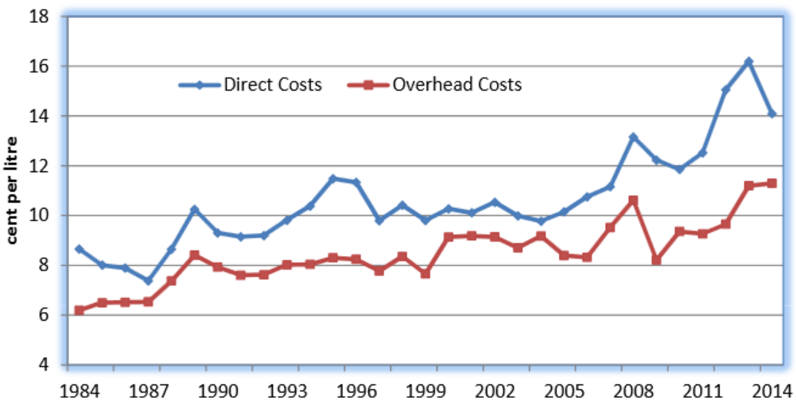
Figure 4.18: Concentrate Feed per Cow 1975 to 2014



Source: Adapted from DAFM and CSO data

Dairy specific production costs, as measured by the Teagasc National Farm Survey, have also increased quite substantially, from a total (direct + overhead) of around 15 cents per litre in 1984, to 25.5 cents per litre in 2014. It should be noted that the methodology of calculation used to assess direct and indirect costs does not include provision for the remuneration of the farmer's own labour.

Graph 3 – Direct and Overhead Costs on Irish dairy farms 1984 to 2014 - Teagasc

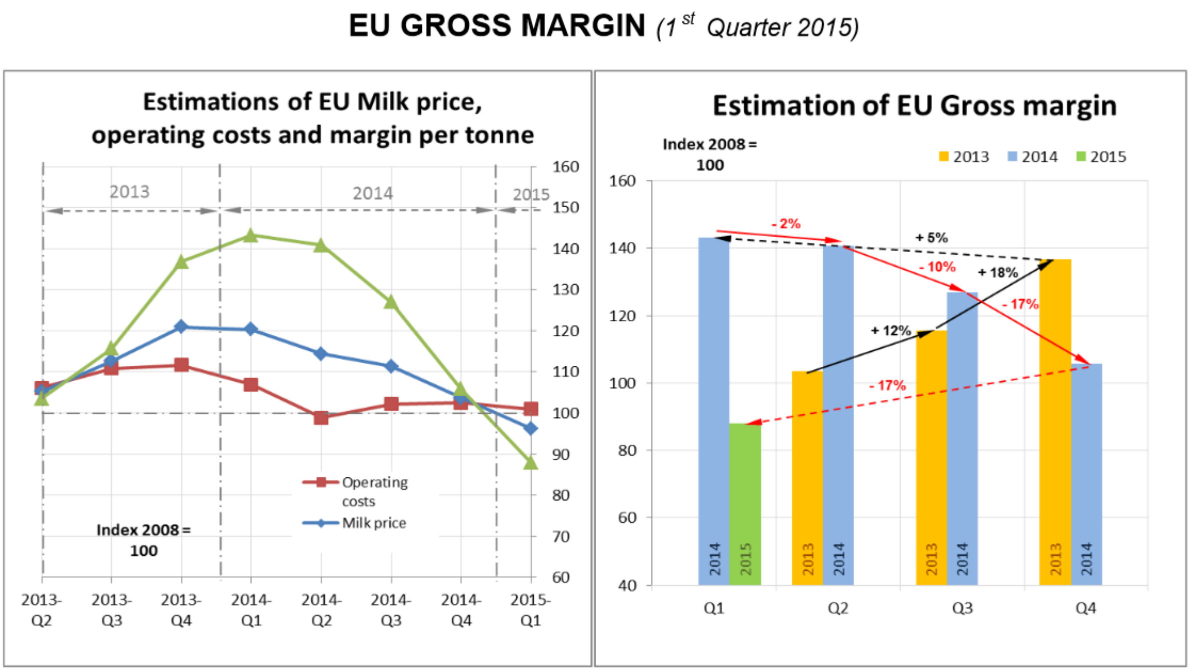


Source: Teagasc National Farm Survey (various years), 2014 authors' estimates

Dairy production costs in the rest of Europe

While data in this area is difficult to obtain, the monitoring of average EU dairy farm margins carried out by the EU Milk Market Observatory on a quarterly basis shows clearly that since the last quarter of 2014, European dairy farmers have, on average, been producing milk at a loss. Current market and price trends would suggest this situation will worsen over the coming months.

Graph 4 – EU MMO monitoring of gross dairy margins

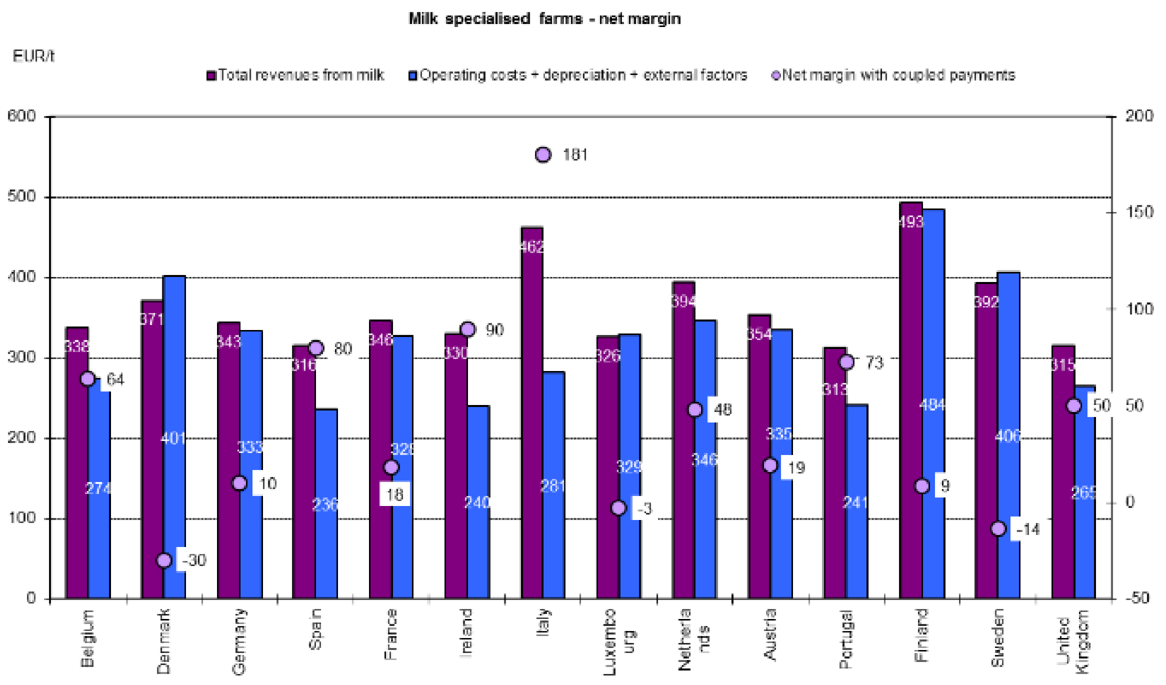


Source : FADN - base year 2011 + indexes: Eurostat, DG AGRI

The graphic below sets out "operating costs" – i.e. direct and indirect costs, for specialist milk producing farms in the EU 15 member states, among which the most important milk production regions in Europe. The data the graph is based on is 2013 data – which may well overstate slightly Ireland's costs, due to the significant added expenditure on feed incurred during the fodder crisis in the spring of that year.

Even allowing for this, the graph clearly shows that Ireland at €240/tonne (or 24c/kg of milk), is among the lowest cost producing regions.

Graph 5 – Operating costs and margins on specialist dairy farms - FADN



Current "reference thresholds" inadequate to provide a realistic safety net

We have shown that, at a current (2015) average (National Farm Survey) of just over **25c/l,** Ireland is among the most efficient milk producing countries in Europe.

Yet, if market prices for butter and SMP were to fall all the way to the "reference thresholds" as they currently stand in the Common Market Organisation EP and Council Regulation 1308/2013, the equivalent return, net of processing cost, would at best be **21c/l.**

It is clear that the intervention system in general is not intended to provide an alternative to real markets, nor should it be.

However, to provide a genuine safety net, it is essential that the "reference thresholds" or intervention prices, would allow farmers to cover a very substantial portion of their basic production costs (direct + overheads).

To do this, in the case of Ireland, the threshold would need to yield a net return after processing costs of 25c/l.

Conclusion:
The EU Commission must announce a review of the "reference thresholds" without delay

As stated previously, the CMO EP and Council Regulation 1308/2013, under article 7.2 specifically states that the EU Commission shall keep the "reference thresholds" under review, taking account of objective criteria, including production and input costs, and market trends.

Announcing the intention to carry out such a review would, we believe, in itself, have a major effect, as it would signal the official recognition that the current "safety net" may not be fit for purpose.

While we understand that the actual review, and the necessary threshold increases it should lead to, will take some time, and be most relevant for the longer term, we believe an immediate announcement that such a review is about to take place would prove the unsustainability of current market prices, and influence global dairy market sentiment in a fashion which will speed up the reversal of the current downturn.

CL/IFA/22nd June, 2015