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Executive brief

Dairy sector

1. Background and key issues

In the ACP, there is significant rural development potential for successful dairy sector development strategies based on smallholder farming. Yet substantial challenges are faced in efficiently linking milk producers to dairy processors. This can give rise to imports of milk powder that structurally undermine efforts to develop local milk supply chains. Managing milk powder imports in ways that support both value-added processing and the development of local milk supplies can be seen as a major policy challenge.

This challenge can be greatly compounded by moves towards regional integration in areas where major coastal economic powers dominate the dairy sector (e.g. Kenya and South Africa). The rapid growth of ultra-heat treated (UHT) milk production further complicates matters by greatly expanding the scope for trade in liquid milk.

There have been long-standing criticisms of the negative impact of EU bulk dairy commodity exports on the development of milk production in ACP countries. While the EU is seeking to expand exports of value-added dairy products, the rapid expansion of skimmed-milk powder (SMP) exports which followed EU emergency measures in the dairy sector in 2009 has led to a renewal of ACP concerns.

In view of the EU's commitment to policy coherence for development, agreed in the Lisbon Treaty, the scope exists for using existing EU administrative measures to manage the deployment of dairy sector policy instruments in a manner that promotes development. Central to this will be the establishment of coherent and comprehensive dairy sector development strategies in the ACP countries concerned. Intensified dialogue with the EU on the use of new policies related to the functioning of dairy supply chains, as well as on the use of traditional dairy sector tools, could then play a complementary role, provided that this forms part of non-discriminatory policies applied by ACP governments to all dairy imports.

2. Latest developments

Global dairy market developments

While world market dairy prices fell from mid 2011, they at first remained above the average of the previous years. However, by October 2011 they had fallen to a 14-month low.

At the beginning of 2012, world prices remained stable for whole-milk powder (WMP) and SMP, and increased for cheese and butter. Prices of milk products subsequently fell, with pressure on prices arising from increased supply in the EU, US and Oceania. In March 2012, the EC expressed concerns that recent price falls could lead to decreased production in the second half of the year, despite strong global demand.

Demand in China is seen as critical to overall global demand, with dairy imports increasing from 220,000 to over 1,000,000 tonnes between 2001 and 2011. For the Chinese market, while Oceanian producers enjoy the advantages of being closer geographically, currency movements can have an important bearing on the relative competitiveness of suppliers.

On the supply side, there was strong growth in 2011 in dairy product exports from Latin American suppliers (between 32 and 42%).

Looking to the future, *Thecattlesite.com* noted that 'whilst there are many challenges facing the global dairy industry in the coming year, global trade, production efficiency and growing demand will present many opportunities'.

A major trend identified by the global packaging company Tetra Pak is the projected 30% increase in consumption

> *"A 30% increase in global consumption of liquid dairy products is projected over the coming decade"*

of liquid dairy products over the coming decade, with 'most of this growth … in emerging markets', linked to high rates of urbanisation in China and India. This expansion of liquid dairy product consumption will largely be at the expense of 'loose milk', i.e. unpasteurised milk sold in large metal cans (see *Agritrade* article 'Global packaged milk consumption expected to rise 30% in 10 years', 25 October 2011).

The projected increase in long-life milk sales potentially has important trade policy implications for ACP countries seeking to develop their own national dairy sectors.

EU dairy sector developments

The EC's 'Prospects for agricultural markets and income in the EU 2011-2020' published in December 2011 notes that following the 'strong market turbulence' from 2007 to 2009, 'in 2010 and the first nine months of 2011 dairy markets witnessed relatively favourable price developments', although this varied among EU member states. Improved global dairy prices did not always immediately translate into improved farm gate prices. In March 2011, EU SMP, butter and cheese prices were respectively 24%, 37% and 18% above prices in March 2010. Prices then moved up and down, with declines dominating. In February 2012, SMP and butter prices had fallen 6.2% and 9.3% respectively over the previous 12 months, while cheese prices were 0.7% above February 2011 levels (as shown in Table 1).

In September 2011, average EU milk prices were 6.6% above September 2010 levels (€34.8/100 kg). After an estimated 1.2% increase in 2010, EU milk deliveries in 2011 grew 2% on the back of higher yields, despite a declining herd. This trend is forecast to continue through 2013.

EU cheese production is believed to have risen 0.2% in 2011 and is forecast to rise 0.8% per annum in 2012 and 2013. Growth in production of fresh dairy products slowed in 2011 to 0.3%, with similar growth expected in 2012 and 2013. Whole-milk powder production was projected to contract by 3% in 2011.

Table 1: Comparison of change in EU agricultural commodity dairy prices

	Skimmed-milk powder	Butter	Cheese
Percentage change (comparing February 2012 to February 2011)	-6.2%	-9.3%	+0.7%

Source: EC, 'March 2012 update on recent agricultural commodity and food Price developments in the EU (based on February 2012 prices), Brussels L2/LG d (2012), 21 March 2012, http://ec.europa.eu/agriculture/analysis/markets/foodprices/food03_2012_en.pdf

EU SMP production is projected to grow strongly – by 13% in 2011, 4% in 2012 and 2% in 2013. SMP exports are estimated to have grown by 37% in 2011, and 'are forecast to stay at this high level during the next two years'. This is the development of greatest potential interest to ACP dairy producers, given the impact it can have on the functioning of local milk supply chains in ACP countries (see *Agritrade* article 'EU skimmed-milk powder production on strong rising trend', 25 March 2012).

At a policy level, the EU Council in February 2012 formally adopted a regulation on improving the functioning of milk supply chains, after consultation with the European Parliament. The main elements of the regulation included:

- the potential reinforcement of the bargaining power of milk producers, by allowing them to set up producer organisations;
- the option for member state governments to establish obligatory written contracts for the supply of milk, and/or obligatory written offers to be made to producers which they can accept or reject;
- where contracts exist, all elements should be freely negotiated, with member states able to set a minimum contract period of at least 6 months;
- the introduction of measures to improve the transparency of EU milk production and the creation of geographical indication (GI) protection for cheeses.

The fact that the regulation left national governments to determine whether contracts should be compulsory reflected a lack of consensus in the EU on how far relationships along supply chains should be regulated. Developments at national level have therefore taken on more significance.

In France, legislation now 'obliges French dairies to draw up raw-milk supply contracts to submit to their farmers'. While the intention of the act was to improve the position of farmers vis-à-vis processors, towards the end of 2011 only 5% of French farmers had taken up contracts, with the contracts offered described as 'totally unacceptable' in the absence of concrete commitments on the price and volumes to be supplied.

In response, the France Milk Board (FMB, the *Office du Lait*) has now drawn up a model contract to be used by farmers when negotiating with milk processors, and is seeking Ministerial endorsement for use of the model contract. Producers who adopt the contract pass their right to negotiate with processors to the FMB for a 5-year period. The model contract 'specifies the supply volume and stipulates a milk price based on real production costs, verified annually by an independent commission'.

Similarly, in April 2011 Scottish farmers tabled a proposal for 'a new transparent and market-related pricing formula' for milk, with the aim of establishing a price that represents the true value of the product (see *Agritrade* articles 'UK dairy farmers take initiatives to improve functioning of dairy supply chain', 10 June 2011 and 'Elaboration of measures to strengthen the functioning of EU dairy supply chains continue', 18 March 2012). Later in 2011, it became apparent that the establishment of the new policy framework was beginning to impact on the behaviour of some retailers. For example, the UK Co-operative retail group began to offer contracts for the supply of liquid milk that paid a premium for compliance with certain key conditions (see *Agritrade* article 'Moving forward improvements in the functioning of the EU dairy supply chain', 6 October 2011). However, by May 2012 a range of dairies had resorted to sudden milk price reductions in response to global price trends, highlighting the limitations of the voluntary approach to strengthening dairy supply chains.

The European Milk Board (EMB) favours the French approach, calling for 'production costs plus' arrangements. In this context, EMB was critical of the EU Council's rejection of Parliamentary proposals to link milk prices to production costs.

Future trajectory of the EU dairy sector

As market prices are expected to remain above intervention price levels, it is anticipated that market intervention mechanisms will only be used at times of market crisis. Such measures will then be financed under the proposed €3.5 billion emergency reserve (see *Agritrade* article 'Multi-annual budget framework sets scene for CAP reform proposals', 6 September 2011). However, since such 'safety-net' interventions help to sustain EU milk production

> *"Safety-net interventions help to sustain EU milk production by removing a level of uncertainty in an era of global price volatility"*

by removing a level of uncertainty in an era of global price volatility, there are concerns that this could lead to 'adjustment displacement', with non-EU milk producers carrying the burden of necessary global adjustments in milk production levels during the lows of volatile price cycles.

More broadly, the EU remains on track for the abolition of milk production quotas in 2015. The dominant effect of quota abolition is expected to be a geographical shift in milk production to north and west Europe, with producers in Denmark, France, UK, Ireland, Netherlands and Ger-

many being major beneficiaries. This shift in production will, it is argued, reduce the average costs of EU milk production.

Analysts maintain that EU milk production quotas have not significantly held back milk production, given the move towards more market-based systems of price formulation. In this context, it is maintained that the abolition of milk production quotas will generate 'an additional nine billion litres of milk' production annually, with some 67% of this finding its way onto export markets.

While the main export markets are expected to be in the Middle East, North Africa and Russia, this does not mean that increased EU exports of SMP will leave ACP markets unaffected. Given the relative scale of EU production and exports and the size of individual ACP dairy markets, even relatively small volumes of exports (by EU standards) could profoundly affect the development of individual ACP dairy sectors.

By 2020, the EC projects an 8.9% increase in EU commercial milk production over the period, while EU consumption of higher-value dairy products is projected to increase steadily, though at a slower rate than in the period before 2007. The EC's projected levels of dairy exports are set out in Table 2.

Table 2: Projected trends in EU dairy exports ('000 tonnes, 2009–2020)

Product	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
SMP	231 (231)	378 (379)	486 (518)	491 (518)	412 (518)	419	412	418	418	430	438	443
WMP	459 (460)	442 (447)	420 (390)	398 (393)	402 (401)	419	419	424	428	433	442	441
Cheese	578 (578)	676 (676)	695 (682)	717 (689)	684 (698)	695	703	707	708	705	717	727
Butter	154 (152)	161 (157)	144 (124)	145 (126)	125 (128)	134	140	140	133	130	128	129

Note: Bracketed figures come from a later Commission document, published in February 2012.
Source: EC, 'Prospects for agricultural markets and income 2011-2020', December 2011 http://ec.europa.eu/agriculture/publi/caprep/prospects2011/fullrep_en.pdf

EC, 'Short term outlook for arable crop, meat and dairy markets', February 2012 http://ec.europa.eu/agriculture/analysis/markets/sto-crop-meat-dairy/2012-02_en.pdf

The most significant trend shown in Table 2 is in EU production and exports of SMP, with the EU's share of global exports projected to increase by 4 percentage points to 23% by 2020 (see *Agritrade* article 'EU skimmed-milk powder production on strong rising trend', 25 March 2012). An EC revision of these estimates in January 2012 put export levels of SMP at even higher levels in the short term (2011–13), at an average of 518,000 tonnes. This builds on the growth in EU SMP exports stimulated by EU's emergency interventions during the 2009 dairy price crisis.

> *"By 2012 EU exports of skimmed-milk powder will be more than double their level in 2009"*

By 2012, SMP exports will be more than double their level in 2009 (+134% according to revised estimates) and equivalent to more than half the volume of EU SMP production in 2009. Only in 2012 will EU ending stocks return to the normal levels, with the stocks accumulated during the 2009 dairy sector crisis finally being disposed of. After 2014, export volumes are projected to fall, but will still be between 80 and 92% above 2009 levels. EU production of SMP is projected to be 8–10% above average for 2009–11, in a context where EU consumption is projected to stagnate at around 600,000 tonnes, more than 400,000 tonnes less than production levels.

While China and Algeria are expected to be the main markets for EU SMP exports, this expanding trade is generating concerns in some ACP regions, notably West Africa.

Trade consequences of EU safety net measures: Rising skimmed milk powder exports

Analysis published by the United States Department of Agriculture (USDA) in July 2011 pointed out how the use of safety-net measures by the EU in response to the dairy crisis of 2008–09 led to a major expansion of EU inter-

vention buying of SMP, from a ceiling of 109,000 tonnes, to 282,587 tonnes. While the export refund allocation was increased dramatically, a subsequent recovery in global prices meant that SMP export refund expenditures remained constant.

This highlights an important feature of price volatility: while prices go down, they subsequently recover, so the policy challenge is to sustain producers during the downturn but also equip them to effectively exploit the upturn when it comes.

The EU measures led to increases in SMP exports of 64% in 2010 and 37% in 2011, with this export level projected

"EU safety-net measures led to increases in skimmed-milk powder exports of 64% in 2010 and 37% in 2011"

to be sustained through 2013. There are concerns that the increased volumes of SMP available could disrupt ACP milk supply chains, undermining producer prices in ACP countries.

Dairy sector developments in the Caribbean

Caribbean dairy industries have traditionally been central to domestic fresh milk supply. However, local production of dairy products generally falls short of domestic demand. Milk powder has traditionally been imported for further processing and more recently for production of 'fresh' UHT and other milk drinks. However the volume of milk powder imports has been growing, facilitated by a government policy emphasis on 'cheap food'.

These imports are seen as a key factor in the contraction of the Caribbean dairy sector over the last 20 years. In Jamaica, for example, milk production has fallen by 64% since 1992, with local farmers now supplying only 4.2% of the domestic market. Even in the Dominican Republic, increased consumption of dairy products has been

"In Jamaica, milk production has fallen by 64% since 1992 – local farmers now supply only 4.2% of the domestic market"

based on increased milk powder imports. Milk made from reconstituted powder is in fact the major form of milk consumed in the region.

In Guyana, some expansion of dairy production is taking place, and in Barbados there have been new investments in modernisation: Pine Hill Dairy, for example, has established a modern, automated production facility, supported by strong branding of differentiated products for both national and regional markets. At present, non-tariff measures are used by some other CARICOM members to block Barbadian exports, but this is being resolved. Dairy imports to Barbados have only increased gradually, as while the country has dismantled non-tariff barriers, it has kept high tariff levels in place, including those applied to EU dairy products (see *Agritrade* Special Report 'Caribbean dairy sector', forthcoming).

According to press reports from the region, within the framework of globalisation and liberalisation, the policies of multinationals such as Nestlé Jamaica, which has steadily reduced local buying over many years while increasing imports of milk solids, have meant that developments in the global dairy industry are replicated in the local Caribbean dairy sector.

In the context of heightened price volatility, this appears to be posing problems in a number of Caribbean countries. For example, in the Dominican Republic, milk producers affirmed in September 2011 that their sector was 'near the brink of collapse', and in Trinidad and Tobago, a director of the Livestock and Livestock Products Board described the local dairy industry in December 2011 as being 'in crisis', with 'a constant decline both in milk production and the supply of beef for the local market', adding that 'imported milk powder was largely responsible for the decline in milk production'.

Rising feed and fuel prices, along with high levels of milk powder imports, have compounded inherent inefficiencies in many countries. Self-sufficiency is therefore widely seen as unrealistic although a continued potential for supplies to specific components of the market, such as high-quality fresh milk is seen as viable.

Efforts continue in countries such as Jamaica and Trinidad and Tobago to develop models for dairy sector development which will promote greater self-reliance, by integrating small farmer production within a large farm model. This needs to be seen in a context where the governments of Jamaica, Trinidad and Tobago, Barbados and Guyana have all reasserted the centrality of local dairy production to food and nutrition security, employment and rural incomes in their respective countries. Against this background a re-evaluation is under way of the various industry-led and public policy initiatives in place to sustain and promote the Caribbean dairy sector.

Dairy sector developments in West and Central Africa

A detailed analysis of EU export figures carried out by CONCORD Denmark, the network of Danish development non-governmental organisations (NGOs), showed that EU milk-powder exports to Nigeria and Ghana increased in volume terms by 69% and 72% respectively

in 2010, higher than the average increase in EU exports.

In September 2010, a West African dairy sector workshop called for both greater investment in developing the production and marketing of milk, and the regulation of milk powder and other dairy imports, in line with national milk sector development strategies.

"In September 2010, West African dairy stakeholders called for the regulation of milk powder and other dairy imports"

Senegal is a case in point. Efforts are under way to promote more commercial dairy sector development, but the local industry is at a disadvantage in the context of rising dairy imports. This, however, needs to be seen against the backdrop of a number of factors holding back competitive milk production in the region, including:

- 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 prioritised 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.

Similar issue are found in 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' (see *Agritrade* article 'Developing a value-added dairy sector in West Africa', 2 May 2011).

This provides background to concerns over the accumulation of SMP stocks during the dairy crisis in 2009 and the subsequent high and sustained levels of EU SMP exports.

The functioning of local dairy supply chains is critical to the impact of EU SMP exports on local markets. 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 developments in Southern and Eastern Africa

Dairy sector policy debates in the Southern African Customs Union

The use of trade policy tools in the dairy sector continues to be an area of discussion and debate within the Southern African Customs Union (SACU).

In Namibia, infant industry protection for the dairy sector is scheduled to be phased out in 2012, so the debate has shifted to the use of other trade policy tools. Hubertus Hamm, Managing Director of Namibia's largest dairy, suggests a need in the long term for a permit system similar to that applied to maize under the Agronomic Board Act which regulates imports at harvest time, or to certain horticulture products under the Horticulture Act, linking import permits to local sourcing, consistent with the type of permit system applied in Lesotho and Swaziland.

"The use of trade policy tools in the dairy sector continues to be debated within SACU"

The use of these policy tools needs to be seen in the context of South Africa's dominance of the region in the dairy sector (Namibia's production of 22 million litres of milk compares to South Africa's 2.4 billion litres). According to Mr Hamm, 'a little bit of juggling with price or market diversion' could lead to the Namibian industry being 'crushed'.

After concerns were raised in 2011 by the Namibian Dairy Producers' Association over 'very cheap UHT imports from the EU and other countries', the debate in Namibia intensified (see *Agritrade* article 'Dairy sector expansion raises issues of national policy needs and regional policy commitments', 5 July 2011). The competition from the EU in particular was widely seen as unfair, in view of the subsidies provided to EU producers, while increased exchange rate volatility was seen as posing further problems for long-term planning, with UHT imports moving in parallel with the strength of the rand against the euro. Industry stakeholders considered that these short-term factors could seriously disrupt local dairy sector development.

However, the national self-sufficiency concerns, which have been driving the efforts to secure a supportive policy framework in Namibia, cannot be isolated from important intra-regional dimensions. Namibia Dairies, for example, has been exporting to Angola since March 2005 and is exploring other regional markets for its products. Policies to support and assist smaller producers in meeting national dairy needs can thus also support larger producers in expanding exports. The debate on the future policy framework for Namibian dairy production therefore cannot be divorced from the wider regional discussions on the elimination of NTBs in the context of discussions in the Southern African Development Community (SADC) and regarding the wider tripartite free-trade area (FTA) discussions.

Indeed, many analysts have argued that getting to grips with the elimination of NTBs is central to expanding intra-regional trade. This however sidesteps the practical problems arising from the vast inequalities in the scale of production in the SADC and wider Southern and Eastern African region. It is these inequalities which have led to a nuanced approach to the use of trade-policy tools in the SACU context.

Dairy sector policy developments in the East African Community

In the East African Community (EAC) there is seen to be tremendous potential to expand milk consumption. Per capita consumption of milk in Kenya is less than half the intake recommended by the World Health Organization (WHO), and under a quarter of the level of the other EAC countries. Initiatives are taking place under the auspices of the East African Regulatory Authorities Council to establish a common regional framework for dairy sector development. This focuses on:

"In the EAC, there is seen to be tremendous potential to expand milk consumption"

- improving milk production;
- promoting milk consumption;
- establishing 'regional dairy industry sanitary standards';
- facilitating access for dairy products to all markets in the EAC.

In July 2011, Dr Enos Bukuku, Deputy Secretary General of the EAC, called for 'increased efforts to develop, modernise and commercialise the dairy industry in the region'. He argued that 'milk should be processed to extend its shelf life and the value chain lengthened by processing milk into other milk-related products and by-products.' Currently it is estimated that in the EAC region, 'no more than 15 per cent of the milk produced is marketed through the formal markets'.

The challenge of establishing harmonised regional standards in East Africa became evident in 2011, when a report commissioned by the World Bank expressed concerns that the new EAC harmonised standards 'may be a source of trade conflicts in the future'. The standards were described as 'unrealistic', as microbiological levels were set at levels currently 'unreachable for nearly the entire EAC industry'. This was held to be a risky approach, since it could either restrict trade or make regional standards irrelevant. The report called for the new standards to be reviewed, and withdrawn if they 'do not meet public health or market demands' (see *Agritrade* article 'Initiatives to establish an EAC regional dairy development strategy', 6 October 2011).

As in the SACU region, the debate on future regional dairy sector policy takes place against the dominance of the EAC market by one regional producer, Kenya, which accounts for 86% of the region's dairy exports.

Regional policy formulation needs to be seen against the background of national efforts to promote dairy sector development. In October 2011, press reports from Uganda indicated plans to expand milk processing capacity through a US$15 million investment to increase production of SMP, butter oil, liquid milk, ghee and cheese. The investment was indicative of the regional expansion of Kenya-based dairy operators (see *Agritrade* article 'New milk processing plant to be established in Uganda', 28 November 2011).

In Tanzania, dairy sector experts warned in May 2011 of the imminent collapse of the dairy sector in the face of 'stiff competition from well established players in the East African Community common market', where 'most of the local milk processors lack technologies and adequate facilities to produce quality dairy products for export and local consumption.' In this situation, a stakeholder maintained that 'the government has to devise policies that protect local dairy industries against cheap imports from other countries as the unfair competition curtails the growth of budding local milk factories' (see *Agritrade* article 'Potential expansion of Kenyan long-life milk production could raise regional concerns', 5 July 2011).

These fears cannot be divorced from the launching of 'an aggressive marketing campaign' to promote exports by the Kenyan dairy sector. While the campaign targets markets in West Africa and the Middle East, its foundations lie firmly in the Eastern and Southern African region. The fears of neighbouring countries are compounded by analysis

from Tetra Pak East Africa on the market potential for long-life milk in the region and the measures to facilitate the collection of milk and boost UHT milk processing. This development of expanded long-life milk production could bring significant change to the regional trade in dairy products in Southern and Eastern Africa, while the emerging use of milk-powder reserves to meet liquid milk shortages potentially opens up expanded international trade with SMP-surplus regions like the EU.

These developments have led to the Chairman of Eastern and Southern African Dairy Association (ESADA), Alnoor Hussein, underlining the need to develop a model for regional dairy production that 'meets international benchmark[s] without denying the African primary producer[s] of their livelihoods by driving them out of business'.

The Kenyan Livestock Minister Mohammed Kuti describes the situation slightly differently, challenging the local industry to 'address the imbalances that exist in the value chain and ensure that the interests of all stakeholders from the farmers through to the consumers are taken care of'. According to the Minister, what is needed is 'an organisation where the primary producers, the processors and consumers are represented to determine what everybody takes home' (see *Agritrade* article 'Scope for expansion and strengthening of functioning of Kenyan dairy sector', 31 March 2012).

This suggests that policy discussions over the strengthening of dairy supply chains, which have been so closely debated in the EU since 2010, could have considerable relevance in Eastern and Southern Africa as well.

Dairy sector concerns in Zambia

In the past, imports of Kenyan dairy products have been restricted in Zambia on the grounds of sanitary and phytosanitary (SPS) and food quality considerations. Pressure is however now mounting to dismantle NTBs to trade within the Common Market for Eastern and Southern Africa (COMESA). This is causing concern among Zambian dairy producers, who in 2011 complained about imports of subsidised milk products and called for a revision of government policy. Particular concerns were expressed about some processors' milk powder imports, which were seen to be undermining prices for fresh milk (see *Agritrade* article 'Global packaged milk consumption expected to rise 30% in 10 years', 25 October 2011).

According to the Dairy Association of Zambia, 'the cost of milk production in Kenya is very low, such that its [landed] cost will still be cheaper than ours.' The Association's general manager maintained that for local processors to stay in business, they would have to lower prices paid to Zambian milk producers by as much as one-third. Concerns over Kenyan imports come on top of wider concerns about very competitively priced imports from South Africa (see *Agritrade* article 'Scope for expansion and strengthening of functioning of Kenyan dairy sector', 31 March 2012).

While Zambia's Deputy Minister of Trade and Industry said, in response to producers' concerns, that the government would do everything possible to ensure that the dairy sector played a major role in economic development, it is unclear what steps the government intends to take, given its regional trade policy commitments and the extensive shadow cast by the two major regional dairy producers, South Africa and Kenya.

Dairy sector developments in the Pacific

Dairy production in the Pacific Island Countries and Territories (PICTs) is largely confined to the production of fresh milk, both in the formal and informal sectors of the industry. Fiji accounts for around 90% of all whole fresh milk produced in the PICTs. Fiji also has a small dairy product processing and packaging industry that has remained relatively stable. Fiji's per capita dairy production is 85 kg per annum, five times higher than its nearest rival, Vanuatu, while that of Papua New Guinea (PNG) is only 0.05 kg per annum. Nevertheless, in recent years local production in PNG has been expanding and imports have been declining, and PNG is seen as offering one of the best prospects for growth in Pacific ACP dairy production. Efforts are also taking place in Fiji to improve production by importing New Zealand heifers to strengthen the breeding stock.

In terms of trade, small volumes of exports do take place, but imports dominate and continue to grow across the region, with the tourist market in many countries representing a major component of demand. Most imports, especially to Fiji, Vanuatu and Solomon Islands, come from Australia and New Zealand. For Fiji, New Zealand is clearly the major supplier, representing about 75% of the country's dairy imports. In the case of Vanuatu and Solomon Islands, the major source is Australia. Only Fiji, Vanuatu and Tonga import less than 50% of their whole fresh milk requirement, with small island states (e.g. Cook Islands and Kiribati) importing their entire national requirements.

Overall, while the focus at the industry level – especially in the larger PICTs – is directed at production and productivity policies, and assisted from the Land Resource Division of the Secretariat of the Pacific Community, the policy focus at the macro level is directed at imports

to address persistent supply shortfall and at meeting increasing local demand. Earlier analysis by the UN Food and Agriculture Organization (FAO) suggested, however, that the larger countries that enjoy some comparative advantage can be competitive in fresh milk production in the future, given increased demand and lower subsidised exports of milk products principally from the EU and the USA.

In some countries, residual protectionist policies remain, and these gained new life following the 2008 food price crisis and the growing policy focus on food security. A recent FAO project summary, 'Forage based smallholder dairy production in Fiji', argued that one of the benefits of expanded dairy production would be 'better food security in remote areas through diversified production and decreased reliance on imports'.

Given the growing focus of regional leaders on food security since 2010, there would appear to be a need to accommodate these concerns in current trade negotiations (e.g. Economic Partnership Agreements, the Pacific Island Country Trade Agreement/PICTA and Pacific Agreement on Closer Economic Relations/PACER Plus negotiations).

3. Implications for the ACP

Strengthening the information base for dairy policy formulation and implementation

The purchasing policies of locally established dairies are critical factors in the impact of EU SMP exports on milk production in ACP countries. They determine whether SMP imports help to support investment in dairy processing while local milk supplies are built up, or whether they drive down fresh milk prices and undermine local milk production.

Getting a clearer understanding of the impact of SMP imports on the functioning of local supply chains is an essential part of targeting interventions to eliminate the adverse effects of EU exports of SMP, while allowing trade in SMP to continue, where this is integrated with coherent strategies for national and regional dairy sector development.

This suggests a need for the establishment of dairy product trade flow monitoring programmes in affected countries, in close association with affected stakeholder bodies. Such initiatives would seek to monitor the actual impact of trade flows on the functioning of local supply chains, as part of coherent government efforts to promote local dairy sector development.

On this basis a dialogue could then be initiated with the EU about how to deploy the EU's dairy sector policy tools in ways that are consistent with ACP dairy sector development aspirations.

Dealing with the external consequences of safety-net policies

EU producer support and safety-net policies sustain EU production and exports above the levels they would reach in the absence of such policies. The danger that safety-net measures can lead to 'adjustment displacement', disrupting the functioning of milk supply chains in ACP countries, means that use of safety-net measures needs to be carefully monitored and evaluated.

Consideration could be given to using existing EU administrative arrangements (e.g. country- and product-specific export licensing arrangements) in the dairy sector, thereby allowing the more sophisticated and pro-development deployment of EU safety-net policy tools.

This would be consistent with the EU's strong political commitment to operationalising its obligation formally agreed in the Lisbon Treaty to ensure policy coherence between its development objectives and the policies it pursues in other areas.

Such measures would need to be implemented in the context of an intensified dialogue with ACP governments and affected stakeholders in countries actively pursuing dairy sector development strategies, to ensure that such measures designed to support dairy sector development were implemented across to board with all trade partners.

Strengthening the functioning of dairy supply chains in ACP countries

Given the role that purchasing policies of locally established dairies play in the development of milk production, lessons could potentially be learnt from the current EU efforts to strengthen the functioning of dairy supply chains in the areas of addressing unequal power relationships and managing heightened global price volatility.

Elements relevant to an ACP context include:

- providing support to strengthen milk producers' organisations and their capacity for collective bargaining;
- reviewing the regulatory framework for contractual arrangements between milk producers and dairy processing companies, in order to promote best practices;
- promoting industry-wide stakeholder consultative structures in support of national dairy sector development.

These could potentially constitute a basis for intensified cooperation between concerned ACP governments and EU member state governments most actively involved

in developing policies to strengthen the functioning of national dairy supply chains. Essential to this, however, would be the involvement of dairy farmers from the respective countries.

Challenges arising from technological innovation

The increase of UHT milk production and trade changes the context for the management of dairy sector trade relations. Previously, competition on fresh milk markets largely consisted of reconstituted milk product, whereas it now encompasses 'convenient-storage liquid milk products', such as UHT.

This poses new challenges for regional dairy sector trade integration, particularly in ensuring that periodic surpluses in large milk-producing countries do not undermine milk production in smaller neighbouring countries.

This will require a careful definition of the scope for the use of dairy sector trade policy measures, within an accountable and transparent regional policy framework.

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Using trade policy tools in a transparent and accountable regional framework

In Namibia, import licensing arrangements have been successfully used in transforming the behaviour of importers and retailers and strengthening the functioning of supply chains to the benefit of local producers. In the horticulture sector where this policy was piloted, this involved the establishment of computer-based market information systems accessible to all stakeholders, and the use of import licences to promote local purchasing. The possible use of similar arrangements in the Namibian dairy sector is under consideration to replace SACU infant industry protection, which is scheduled to lapse.

The use of such arrangements in a transparent and accountable manner may be relevant not only in the Namibian dairy sector but elsewhere in the region (e.g. Zambia), as governments seek to build up their dairy sectors in an era of progressive regional trade liberalisation.

Establishing regional dairy sector standards

The experience in the East African Community highlights how controversial the establishment of harmonised regional standards can be, given the differential impact standards can have on different sub-sectors of the regional dairy economy.

It is essential therefore that all dairy sector stakeholders are equally involved in elaborating regional standards, in order to avoid structural discrimination against small-scale producers or smaller national dairy sectors.

This may require a long transition period for the phasing in of harmonised regional standards and the establishment of flanking measures to support necessary investments by small-scale operators.

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About this update

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