THE EUROPEAN UNION IS THE BIG CHEESE

July 2010

EU Trade Agreements with Latin America

The Latin America, Caribbean and European Union (EU) Summit, which took place in May 2010, saw the establishment of two Agreements which are of vital importance in the frame of bi-regional relations: the Association Agreement between the EU and Central America, which is the first bi-regional agreement established by the EU with Latin America, and the Free Trade Agreement with Colombia and Peru, also the first multiparty trade agreement negotiated by the EU. The latter includes essential elements of political nature such as the so-called democratic clause, which implies its ratification by the 27 members of the EU.

The negotiations have revealed that the EU does not take account of the important asymmetries between the parties. The EU defined the agenda, terms and modalities of the negotiations to conclude agreements tailored to its interests and needs. The terms agreed on dairy products are one example, where the EU had paramount offensive interests which were put on the negotiation table at the very last minute.

Milk is a fundamental constituent of the basic diet for a family, and therefore essential to guarantee the right to food. In Southern countries such as Colombia, Peru and Central American countries it is furthermore the basis of the rural family sustenance.

This paper addresses the subject in three parts: first some general information on dairy production and trade, secondly the results of the negotiations and the possible impacts, and finally a number of conclusions.

A distorted, residual, volatile and concentrated international market

The world dairy market is heavily distorted due to the overproduction of developed countries with a strongly subsidized dairy sector. The surplus production and its subsequent distribution on the international market at prices inferior to its production costs yields serious circumstances. Indeed, it creates unfair competition which causes a displacement of domestic markets and strongly affects producers and consumers in developing countries, thereby endangering the sustainability of those countries' dairy sector.

A second feature is its residual character since less than 6 % of the world milk production enters into the international trade circuit. In developing countries, the internal consumption, processing and direct selling by the producers themselves weighs heavily. An estimate 80 % of the total milk consumption and trade takes place outside the formal market.

The third characteristic is the concentration of the dairy industry. Only three countries (USA, New Zealand and Australia) and the EU are in charge of 70 % of the total world exports of milk. The sector is controlled by very few international corporations, one of which controls nearly 35 % of the total world trade (Fonterra from New Zealand). A consequence of this high concentration is that any adjustment applied on domestic markets and state interference in these countries significantly affects international prices, causing an extreme volatility of the milk prices on the international market. This chaotic fluctuation affects small and medium- sized producers from North and South and forces them into a vulnerable position.

In this context, it is worth mentioning that on the one hand the involvement of developing countries in the international dairy products trade is indeed growing, but nevertheless remains marginal (17 %). On the other, the increase in import rates is exclusively due to the demand of developing countries.

EU big player in the dairy products sector

The EU is the main milk producer at world scale, reaching a 153 million metric ton (MT) production in 2007, which amounts to 23% of the total world production. The EU is also the first milk and dairy products consumer, covering 21% of the total world consumption.[1]

As regards the dairy products sector, the EU also shows heavy concentration: only six of its members are responsible for more than 70% of the milk production (namely Germany, France, the UK, the Netherlands, Italy and Poland). The concentration is also manifested in the preeminence of wide scale producers above small ones[2]. The average number of cows owned by each producer of the EU in 2007 was 9.8, yet 51% of the cows were to be found in holdings of at least 50 animals and owned by 5% of the holders. The European milk sector has, as is the case of the agricultural sector in general, shifted from a family based mode of production to an agro-industrial model. This entails the disappearance of small-scale farming and bears serious threats to food security and food sovereignty, further complicating the possibilities to design solutions for climate change.[3]

The EU is also one of the main dairy products exporters. The percentage of the EU's exports amidst the total world exports in 2007 are the following: 31.9% cheese; 17.5% low fat milk powder; 20.4% whole milk powder; 30.9% condensed milk.[4]

The European milk sector, like other agricultural sectors, is strongly subsidized. The 2010 Common Agricultural Policy (CAP) annual budget amounted to € 57.600 millions. The European milk sector is being reformed in the frame of the CAP reform. The intervention prices have been diminished and the production quotas will be gradually removed by 2015. As a form of compensation, the direct grants to milk producers have been raised by € 5.000 million annually. Furthermore, an additional € 4.200 million have been granted to face "new challenges", including the sector's restructuration. The direct grants represent an average of € 2.000 per cow each year.

Milk prices soared during 2007 and then plummetted in 2008. The 2008 financial crisis triggered recession around the world, and milk demand declined rapidly in countries that had previously increased their consumption. The situation degenerated further in 2009. Rising production in combination with decreasing demand triggered a rapid drop in the producer price. The EU took special measures to try to cope up with the situation, among which were an additional € 600 millions on market measures in 2010, the extension of the intervention period (public purchasing and storing of the overproduction) until September 2010, and a series of milk promotion campaigns. In January 2009 the EU also restituted the export subsidies, which generates cases of dumping of European dairy products on the markets of developing countries.[5]
The EU's role as protagonist in the world dairy products market is decreasing. The European internal dairy sector is also shrinking, a phenomenon which is further reinforced by the global crisis. To face this situation, the EU is searching for new markets in developing countries, where demand has been growing. This may account for the EU's offensive stand in the negotiations on dairy products in the frame of the Agreements settled with Central America, Peru and Colombia.

COLOMBIA: a mainly poor milk sector

Colombia is the fourth largest milk producer of Latin America. Stockbreeding represents 20% of the country's farming GDP and yields 950.000 direct employments. The Colombian stockbreeding sector is also essentially poor: among the 495.000 cattle farms, 47% owns less than 10 cows and 81% less than 50.[6]

According to the FAO, milk is the most important agricultural product in Colombia, in terms of value. The sector has undergone an important development in the last few years. The total milk production in 2007 was of 6.7 million MT.[7]

According to Colombia's livestock breeders' federation (FEDEGAN), the dairy products market in Colombia is restrained due to the lack of incentives to promote internal demand and the impossibility to trade in new markets. Following the general tendency, Colombia´s milk market is concentrated in a few companies. Five companies buy 65% of the milk to be processed and in fact only 46% of the milk produced is processed. The remaining production is distributed raw or else used for the manufacture of hand-made products.[8]

PERU: Dairy producers affected by milk oligopolies

Peru has at least 850,000 cattle farms. Of these herds, 73% remain in the sierra, and are handled by 78% of the rural families.[9]

According to the Minister for Agriculture of Peru, milk production "is a fundamental activity for the regional development of the country, since it's a source of savings and income for the producers, attaches farmers to rural areas, creates employment and is one of the few farming activities that can be developed in the different natural habitats of the country. Therefore is an issue of high relevance for the country´s food security".

The 2007 milk production amounted to 1.6 million MT, resulting the number five agricultural product of Peru. Approximately 55% of the fresh milk produced is bought by the dairy products industry, headed by Gloria S.A., which concentrates 80% of the farmers' production. This concentration of market power allows the company to fix prices unilaterally. For years, various organizations of milk producers have been unsuccessfully trying to obtain better prices and incomes.

One of the main strategies on the part of the industry to keep low prices for the producers is the use of imported milk powder in the fabrication of evaporated milk, the most popular dairy product in Peru. If producers are claiming for better prices, companies would use imported milk powder instead of national produced milk.

FTA UE - Colombia and Peru: shifting the internal market

As far as Colombia is concerned, the Agreement with the EU includes dairy products import quotas from the EU, which will enter Colombia without tariffs: 4.500 MT of milk powder, 2.500 MT of buttermilk; 2.300 MT of cheese and 1.100 MT of infant milk formula. These numbers will increase gradually and steadily at an annual rate of 10%. A 17-year long safeguard has been stipulated, which will operate if the number of imported goods surpasses 20% of the yearly quotas agreed. Nevertheless, a gradual liberalization of EU dairy products imports was agreed over 15 years.

Due to the farmers' discontent and the pressure they have applied on the Colombian government, the European Commission granted an additional agreement at the very last minute. The arrangement was intended to cushion the impacts for farmers and to quiet down their protests. The solution consists in an additional € 30 million to be granted over 5 years to help financing the restructuration and formalization of the Colombian small-scale milk production. These funds will be taken from the European Commission budget for its development cooperation strategy for Colombia, There will not be additional resources, just a re-orientation of those already assigned.

According to Jorge Hernán Uribe, manager of the National Association of Milk Producers (Analac), "the problem is not of compensations but of prices: while we produce at a cost above 36 dollar cents, the EU, due to the subsidies, produces at 27 dollar cents".

Furthermore, the Colombian government pledged to develop a public policy for the sector by creating a "CONPES" (Consejo Nacional de Política Económica y Social) for the dairy sector. According to the farmers this measures are not enough and do not solve the problem but benefit only the pasteurizers, monopolies which will in addition gain from the import of milk powder.

" Yo tomo leche Colombiana"/ I drink Colombian milk Slogan of the Colombian farmers union against the EU-Colombia FTA http://www.yotomolechecolombiana.com/

In an interview with La Republica, The European Union's Ambassador to Bogota, Fernando Cardesa Garcia, said that Colombia only stands to gain from the free trade agreement. According to Cardesa, the reason for the hostility of Colombian dairy farmers to the FTA is that "Colombian dairy farmers are just like those from the rest of the world, a mournful species. They only see black on the horizon, when they aren't complaining about the price of meat, they complain about milk, or something else."

As far as **Peru** is concerned, the Agreement with the EU includes dairy products import quotas from the EU, which will enter Peru without tariffs: 3.000 MT of milk powder, 2.500 MT of cheese and 500 MT of butter. These numbers will increase gradually and steadily by 10% annually over a period of 17 years. The same period will include a gradual 10% dismantling of import tariffs on dairy products. For buttermilk the liberalization is immediately applicable. [10]

Currently, Colombia and Peru are implementing the "Sistema Andino de Franja de Precios" (Andean price range system). This mechanism is meant to stabilize the import prices of a particular range of agricultural products, whose international market price is very volatile. The stabilization is reached by the increase of ad-valorem tariffs whenever the international price is below the minimum set, and decreasing tariffs when the price is above the maximum. Therefore, the price range system means the conversion of tariffs into a variable factor, which adjusts itself automatically to hold back the external fluctuations of the international price. [11]

In the negotiations with the EU, the Colombian and Peruvian governments agreed to withdraw the price range system for milk in both countries, but the EU will keep its internal production subsidies. The EU accepted to withdraw the export subsidies on dairy products that are liberalized by the FTA.

The Peruvian and Colombian milk producers see this price range withdrawal as a threat. Indeed, it was their primary instrument to cope with the artificially low import prices due to subsidies. The withdrawal of this system further destroys the application of a decision of regional nature, affecting the Andean Integration System.

According to the manager of the Peruvian Stockbreeding Association, Héctor Guevara: “Peru has given up a tool [the price range] that in the future would allow us to protect national fresh milk production against a massive import of powder milk, triggered by a decrease in the price of this imported product.”

The import quotas of milk and dairy products will provoke a shift in the internal market, entailing a drop in the purchase price for local farmers. According to FEDEGAN, the FTA with the EU will jeopardize 400.000 Colombian families living on dairy production.

“We must understand that for one only sector, even if 480.000 families are put in danger, we cannot restrain from signing a free trade agreement.” Andrés Fernández, Minister for Agriculture of Colombia.

The impossibility to compete in fair conditions with the subsidized European dairy products (in terms of quality – price relation) will increase the sector’s vulnerability in both countries and compromise their development possibilities. To cite one example: the quota of mature cheese from the EU that will be imported to Colombia accounts for 50% of the country’s cheese market. [12].

The shift of the demand to import consumption not only affects national production, but also curtails the possibilities of developing a public policy of food security and sovereignty. The consumption will be subject to the international market’s contingencies rather than to the national sector’s reality. Furthermore, the withdrawal of the price range included in the agreement will only increase this vulnerability.

The EU produces in 16 days the same amount of milk that Colombia produces in 1 year.

CENTRAL AMERICA: primarily an intra-regional dairy market

Dairy products are Central America’s major agricultural products. The importance of the production (in terms of value) reads as follows in 2007:

Costa Rica: 890.000 MT – third agricultural product;
Honduras: 724.000 MT – second agricultural product;
Nicaragua: 691.000 MT – main agricultural product;
El Salvador: 535.000 MT – main agricultural product;
Guatemala: 341.000 MT – fifth agricultural product;
Panamá: 180.000 MT – third agricultural product. [13]

Dairy products exports are primarily intra-regional (90%), and 80% of the imports are extra-regional. The primary import product is milk powder (nearly 70%).[14]

In Central America, the dairy production is mainly carried out by small and medium-sized producers, which operate with high production costs. The manufactures vary at the technological levels, ranging from standard technology to hand operated systems.[15]

EU- Central America Association Agreement: a threat to food sovereignty and to the intra-regional market

Small and medium-sized farmers of Central America demanded the exclusion of the dairy products sector from the negotiations of the Association Agreement with the EU, because of the latent threats to Central America’s food sovereignty conveyed by the indiscriminate opening of the dairy market. The outcome of the negotiations, however, did not match the hopes of the producers, despite their efforts to weigh on the final decisions.

The agreement settled a Central American regional quota for the import of certain dairy products from the EU amounting to 1.900 MT of milk powder and 3.000 MT of cheese (excluding fresh cheeses), with a growing annual rate of 5%. Apart from this, no tariff dismantling was agreed. The quota was negotiated by country as follows:

Europe has a highly subsidized agriculture, stockbreeding and milk production. If we don´t achieve an adequate negotiation, we will put in danger a sector that generates an important number of employment places.” Hugo Martínez, Foreign Minister of El Salvador.

- **Costa Rica:** 200 MT milk powder and 317 ton matured cheese16
- **El Salvador:** 200 MT milk powder and 583 ton matured cheese17
- **Honduras:** 400 MT milk powder and 500 ton matured cheese
- **Guatemala:** 400 MT milk powder and 600 ton matured cheese18
- **Nicaragua:** 200 MT milk powder and 400 ton matured cheese
- **Panamá:** 500 MT milk powder and 600 ton matured cheese1

The buttermilk was agreed to be totally liberalized in 3 years.

On the other hand, it was agreed that the EU's tariffs on cheese from Central America were to be liberalized linearly over 7 years, whereas milk powder was not included in the tariff liberalization scheme.

Both the farmers and the Central American milk industry have expressed their disagreement with the terms of the negotiations. They consider these will not benefit the sector. The internal and regional market shift, which will be generated by the European imports, may bring many producers to bankruptcy, trigger an important jobs loss and compromise the region's food sovereignty.

The Central American Federation of the Dairy Sector was very clear in defining it´s position: "We will not give up." Giving up to the Europeans demands will mean "bankruptcy" for the 300.000 milk producers and the 7.000 dairy companies of the region, who generate more than 2.5 million direct and indirect employment places.

GEOGRAPHIC INDICATIONS: the EU's touchy interests

Another controversial issue in the negotiations was the geographic indications (GI), due to the conflicting interests of the parties. For dairy products, the Agreements establish the protection of a number of geographic indications of European interest. In cheeses, for example, European GI for Feta, Gorgonzola, Roquefort, Manchego and others are protected, therefore the Central American, Colombian and Peruvian cheeses that are distributed under these labels must be renamed.

In this sense, the industrial development reached in Central America, Peru and Colombia to develop products with more added value, like matured cheese, will be in considerable risk. This will once again affect the local producers' interests and decrease the distinctive force of their brands, which are an important component of their investment.[20]

The Dairy Market in the EU, Central America, Peru and Colombia

	Milk production in 2007 in Metric Tons (MT)	Total milk imports in 2007 (MT)	Total milk exports in 2007 (MT)	Yearly quota of milk powder import from the EU with zero tariff (MT) / quota growing rate per year	Powder milk imports from the EU in 2009 (MT)	Yearly quota of matured cheese imports from the EU with zero tariff (MT) / quota growing rate per year	Matured cheese imports from the EU in 2009 (MT)	MFN tariff applied to dairy products in 2009 (average)	Tariff liberalization for dairy products imports from the EU.
EU	152.941.000	46.880.000	55.927.000					64.1 %	
Colombia	6.725.000	12.000	64.000	4.500 10%		2.500 10%		26.8 %	Gradual over 15 years
Peru	1.601.000	186.000	117.000	3.000 10%		2.500 10%		13 %	Gradual over 17 years
Costa Rica	890.000	29.000	88.000	200 5%	17	317 5%	130	41.8 %	Not agreed
Honduras	724 .000	139.000	34.000	400 5%	368	500 5%	9	24.5 %	Not agreed
Nicaragua	691.000	28.000	230.000	200 5%	0	400 5%	8	26.8 %	Not agreed
El Salvador	535.000	272.000	11.000	200 5%	197	583 5%	467	26.2 %	Not agreed
Guatemala	341.000	211.000	4.000	400 5%	548	600 5%	386	13.2 %	Not agreed
Panama	180.000	62.000	9.000	500 5%		600 5%		37.2 %	Not agreed

Own elaboration, based on FAO, SIECA and WTO figures.

CONCLUSIONS

The terms agreed on the dairy sector in the frame of the Agreements negotiated between the EU and Central America, Colombia and Peru:

• Do not account for the asymmetries between the dairy products sectors of the EU and those of Colombia, Peru and Central America in terms of subsidies, production capacity and competition in the international market.

• Massively favor the European milk sector, which is highly subsidized, giving it new exporting possibilities, whereas the Central American, Colombian and Peruvian opportunities to partake in the European market are nearly inexistent, which is a blatant indication of the inequity of the Agreement.

• Compromise the possibilities of production, sustainability and growing rate of the Central American, Colombian and Peruvian milk sector, being a threat to food security and sovereignty for these countries and to an important number of producers, especially family farms.

• Constitute a low-price fixing factor for small-scale milk producers on part of the milk oligopolies.

• Will affect the possibilities of industrial development reached so far in Central America, Peru and Colombia to elaborate dairy products with more added value, like matured cheeses, since those will be protected by European geographical indications.

• Reduce considerably the policy instruments for the governments of Colombia, Peru and Central America to develop sovereign agrarian policies. Even though tariffs do not *per se* guarantee the development of the sector, they nevertheless are an important tool for protecting the internal market from unfair competition on part of the wealthier producers like the EU.

• Forces the Colombian and Peruvian milk sectors in a situation of vulnerability by the withdrawal of the Andean Price Range System as a consequence of the Agreement with the EU. This also implies the obliteration of a decision which had been taken in the frame of the Andean Integration System

The Central American, Colombian and Peruvian milk sectors consider themselves the losers of the Agreements for being used as the “exchange coin” in order to conclude the negotiations, which increases the existent social discontent and strengthens the mobilization for a NON ratification of the Agreements.

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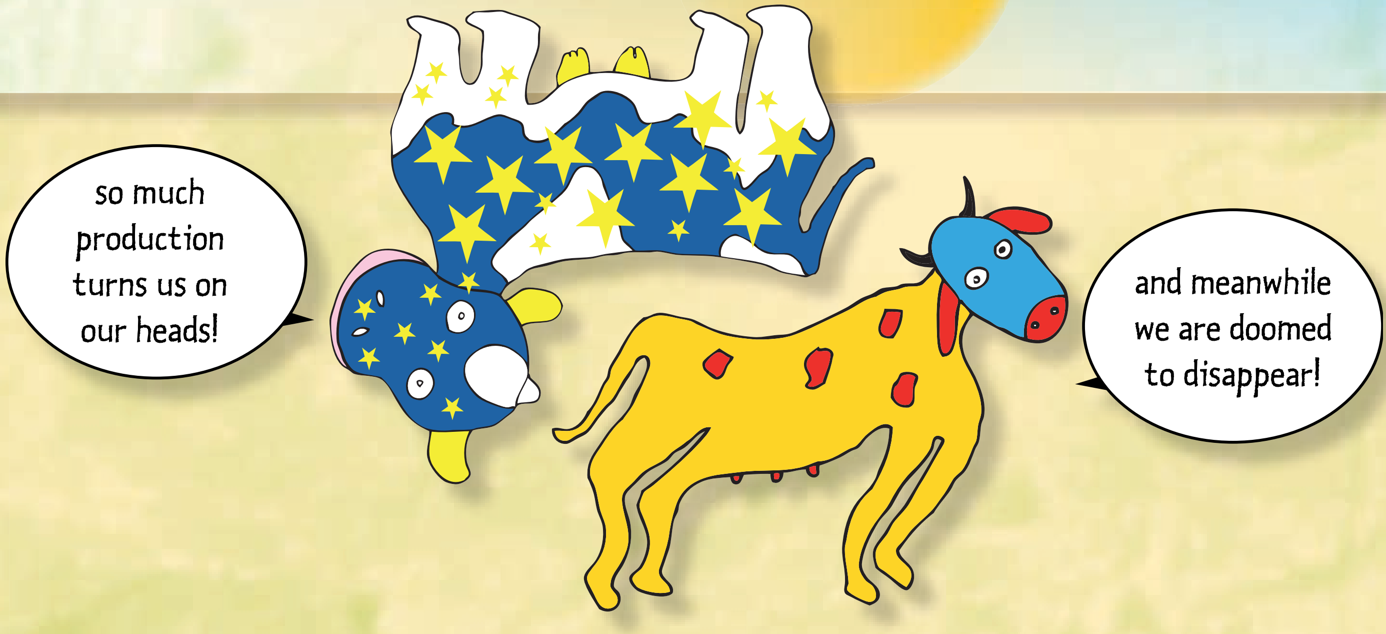

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