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MILK CHAIN IN ROMANIA AT THE START OF ROMANIA'S INTEGRATION INTO THE EUROPEAN UNION

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Abstract:

In the perspective of accession to the EU, the Romanian dairy sector will have to comply with the EU norms and standards. Institutional capacity building, the creation and operation of certain specific market structures, sector revamping until the accession moment represent a priority objective of the domestic agricultural policy. The calculations regarding the EU direct support reveal that Romania will need additional funding sources in order to cover the needs in relation to the allocated milk quota.

Key words: direct support (direct and additional payments), milk quota, investments; Q13

Characteristics of milk and dairy sector

Milk and dairy products are extremely important for the food sector. In value terms, milk accounted for 40% in total livestock production and 15% in agricultural output value in 2003 (a twofold increase in the last 8 years). At the same time, the share of the value of dairy processing sector in total value of food industry increased from 4.2% in 1998 to 7.1% in 2003.

In the last years, the number of dairy cows was relatively stable. The general trend featured a diminution of dairy cow herds in the state sector and a slight increase in the private sector. However, it is worth mentioning that the total breeding stock (cows, buffalo cows and heifers) diminished by 711 thousand heads (30%) in the period 1989-2003 (figure 1).

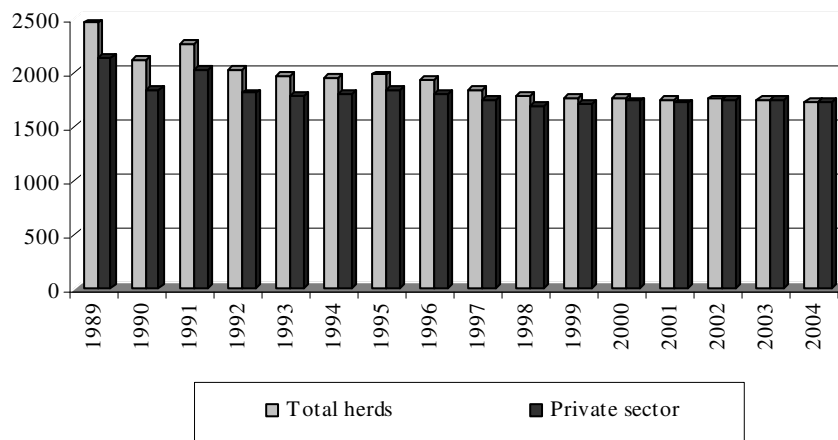


Figure 1. Evolution of dairy cow herds in the period 1989-2004

The total cow milk production increased by 5791 thou.hl in 2003 compared to 2000; this increase mainly comes from the private sector, which prevails in this industry. Compared to 1989, the total production and average yields in cow milk increased by 26%, by 72% respectively in the year 2003 (figure 2).

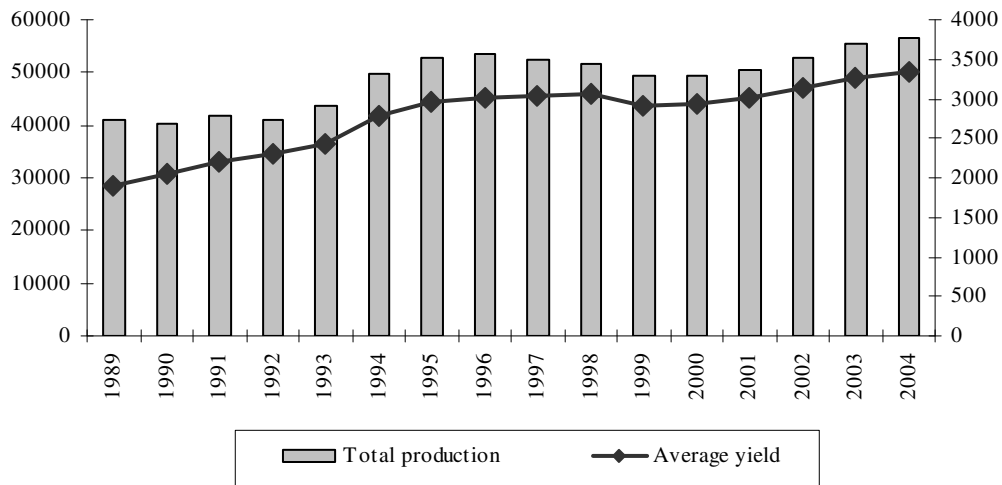


Figure 2. Evolution of cow milk production and yields in the period 1989-2004

The privatization process of dairy farms resulted in their fragmentation. Thus, the private sector has the largest share: in the year 2003, 99% of total cow herds was in private hands, supplying 98% of the milk production; this private sector is mainly represented by the small family farms. There are 1.2 million dairy farms in Romania, with a total number of 1.7 million heads. The average farm size is 1.46 dairy cow heads, the households with 1-2 heads having the largest share (95%). The farms with over 100 heads represent only 0.01% of total farms and about 84% of them belong to the former state sector.

At present, a main characteristic of the milk producing sector is the use of a significant part of production on the farm (household) and for direct sales on the peasant markets. Thus, family consumption (self-consumption) is estimated at about 41% while consumption for animal feeding at 12%; the quantities sold directly by producers into the market and the direct sales to consumers with low incomes account for 26%.

Only about 20% of the raw milk is delivered to the processing industry. Hence, the permanent decrease of the raw milk quantity delivered to processors led to the diminution of processed products in the period 1989-2003: 87% for butter, 72% for fresh milk, 63% for cheese and 67% for powder milk.

The collection system is deteriorated, fragmented and in many areas the collection centers and points do not have sufficient cooling installations. In general, the collected quantities are quite small in many collection centers, along the milk flow from producer to consumer, while the quality of raw milk is low. The high costs implied by milk and dairy produce collection, transport and distribution are added to this.

In the year 2003, about 812 processors were operating; out of these, the largest part belonged to the economic operators with private capital. Most of the processing units are small as regards the number of their staff: 90% have less than 50 employees, while 10% have more than 50 employees. From the analyses effected by the governmental authorities, it resulted that only 18 of these processing units comply with the EU norms at present, 35 will comply with the EU norms at the moment of accession, while 28 are listed for the transition period.

The total processing capacity of Romania is 30000 thou.hl annually, with an average utilisation level of only 40-50%. As in Romania most of the processing units have the capacity to produce 3000-4000 hl. milk yearly, while the utilisation level only seldom exceeds 50%, one can draw the conclusion that their viability is questioned; that means that in the future these units will not be able to develop profitable operations.

Compared to other food products, milk consumption in the period 1989-2003 had the most significant increase (41%). At the same time, a qualitative depreciation could be noticed, as processed

milk consumption permanently decreased in favour of unprocessed milk consumption increase (figure 3).

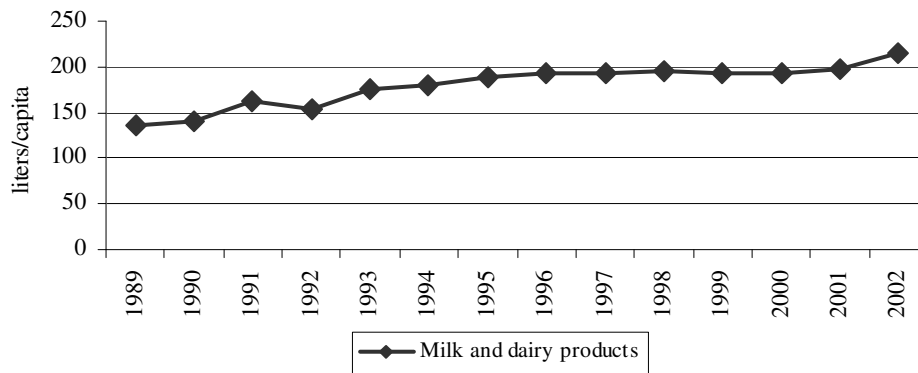


Figure 3: Evolution of yearly average consumption of milk and dairy products, in milk equivalent (butter excluded)

Investment absorption capacity

Investments play a central part in economy, as regards both production and consumption, being the factor that simultaneously influence the supply and demand of different goods and services.

Investments represent the main tool for reaching economic growth.

Among all the investment forms, foreign direct investments seem to be the most advantageous for the receiver country, due to the effects they generate not only by the presence of foreign capital on the Romanian market, but also by the direct involvement of investors (presumed to have a rich experience) in the respective business management. This adds to the participation of other economic sectors together with the agrifood operations in the national economic circuit, both in the rural and the urban areas, as well as the emergence and development of new activities.

The net investments in the milk and dairy subsector ranged from 17 mil.USD in 1998 to 43 mil.USD in 2003, with a peak of almost 53 mil.USD in the year 2000. The share of net investments from this subsector in total food industry was 8% in the year 2003; however, higher levels were reached in other years, i.e. 19% in 2000 or lower levels as well, i.e. in 1998. Most investments were found in the private sector.

Own investments represented more than 90% of the total volume of investments. By main items, more than 50% were the investments in equipment. As regards the foreign direct investments in the milk and dairy subsector, it can be noticed that these had quite a strange, inconstant evolution, the same as in other economic sectors and subsectors.

According to the number of commercial companies with foreign capital participation, registered by the end of 2003, food industry accounted for 5.1% in total companies with foreign capital registered in Romania, while agriculture 4.1%.

According to the value of subscribed registered capital in the same period, food industry represented 9%, while agriculture only 1%. This proves that although the foreign investors established many commercial companies in equal shares in both sectors, agriculture was less attractive than food industry according to the invested value, as a result of the higher risk implied by investing in agriculture. This also apply to the milk and dairy subsector, with higher investments in the processing industry than in the primary sector.

In the food industry, by the end of 2002, 64.5 mil.USD foreign capital had been invested for producing dairy products, which represents 8.5% of foreign direct investments in the food industry; only 7.1% of the total number of foreign companies were registered in this sector. 1998 and 1999 were the years in which the most significant foreign direct investments were made in this subsector, that represented almost half of total investments in the period 1991-2002. Most of the commercial companies with foreign capital were established in the years 1992, 1993, 1994 (149), which represents

almost half of the total number of companies registered in the period 1991-1992 . It is worth mentioning that these years are not those in which the invested value was maximum, which reveals the absence of a direct link between the number of investors and the amount these were willing to invest (figure 4).

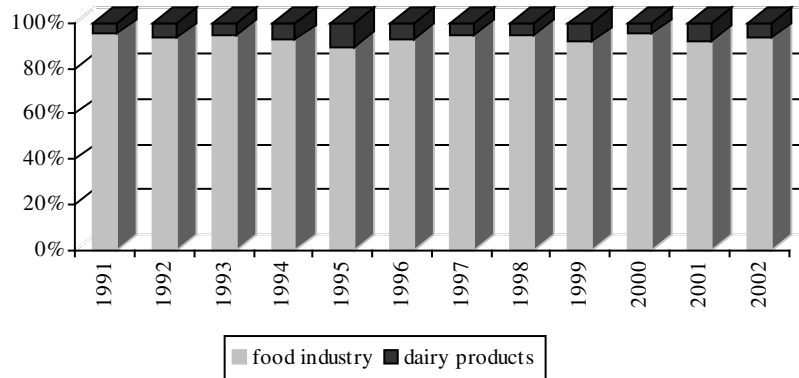


Figure 4. Foreign investors evolution-share of subsector in food industry

A characteristic feature for Romania is that a great number of investors invested low amounts in the processing of milk and dairy products and only a small number of investors had a significant contribution to the total value of foreign direct investments in the food industry. Most of business operations developed in Romania are in the segment of small and medium-sized business.

The most important players on the domestic market as regards the turnover rate and the investments made in the last years are the following: Danone, Napolact, Hochland, Somesana, Delta Romania. These are also the greatest domestic processors, together with Friesland and Raraul Campulung Moldovenesc.

Investment support for dairy farms and milk and dairy processors is extremely important, mainly under the competition conditions on the EU market, that will be operating beginning with 2007, but mainly after 2009. The SAPARD Program, through measure 3.1. “Investments on farms”, supports the process of dairy farm establishment and modernization, as an urgent need for the revigoration of raw milk production for the processing units.

The sector perspectives after the accession to the European Union

In the negotiation process with the European Union, for the milk sector Romania asked for a 7,500 thou.tons quota in the year 2007. This level was reviewed afterwards, and a quota of 5,000 thou.tons of milk was established.

By the end of the negotiation process on Chapter 7 – Agriculture, completed on June 4, 2004, Romania’s situation as regards the allocated quotas and the transition periods was the following: a quota of 3,057,000 tons of milk/year, out of which 1,093,000 tons of milk for the deliveries to processors and 1,964,000 tons for direct sales. During the last negotiations, Romania also obtained a reserve quota of 188,000 tons of milk/year beginning with the year 2009.

Considering the specificity of the dairy cow raising in our country, mainly on very small farms, we can mention that Romania obtained the highest level of direct sales (i.e. 64.2%) compared to the EU Member States and the New Member States that joined the European Union in the year 2004 (Latvia 32.5% and Lithuania 23.7% had the highest shares in this respect).

The milk quota delivered to the processing units, totalling 1093000 tons/year, can be covered by the present processing capacities in the context in which the raw milk received by processors was 904790 tons of milk.

The necessary number of dairy cows and the yields negotiated for covering the total milk quota is 826,216 heads, 3,700 liters/cow/year respectively. It should be specified that this necessary level is totally covered by the existing herds (1,757,000 dairy cow heads).

The surplus cow number, i.e. 930,784 heads will cover the milk quantity necessary for human consumption and for animal feeding. These herds can be also eligible in the rural development measures, for the semisubsistence farms (1000 Euro/year), for five years for efficiency.

The transition period asked for by Romania until the end of 2009 for complying with the EU requirements as regards the dairy farms, for the modernization and revamping of milk processing units, as well as for the organization of milk collection and standardisation centers will permit the following: gradually, as funds are allocated for the development of peasant farms and for the establishment of other forms of raising dairy cows on farms, associations and other units, measures could be applied providing for uniform systems of raw milk production and collection, as well as milk quality hygiene control at the level of standards imposed by the European Union.

Beginning with the year 2007, the farmers that obtain the quota as well as the processors will benefit from substantial support through the rural development pillar; they will have 3 years at their disposal to use the additional incomes that they obtained in this way in order to comply with the European Union requirements.

Estimating the direct EU support for the milk sector

In conformity with R 1255/99, Chapter IV – Direct payments, Art.16, Romania is notified that, beginning with the accession moment, the national producers should comply with the EU criteria for receiving the milk premia established by calendar year, by farm and by ton of individual reference quality eligible for premia and available on the farm.

In conformity with R 1255/99, Chapter IV – Direct payments, Art.17, Romania asks for the allocation of additional payments every year, beginning with the accession moment, under the form of:

- additional premia
- area payments (per hectare of permanent pasture)

In the European Union, the additional payments for milk are established each year on a differentiated basis by country.

The Council Regulation (EC) no.1782/2003, as well as the Conclusions of the Council from March 22, 2004, provide that in the 10 new Member States the direct payments should be gradually introduced, according to the following scheme compared to the level applied to the present Member States (EU 15): 25% - 2007; 30% - 2008; 35% - 2009; 40% - 2010; after that, the percentage will increase by 10%, so that by 2016 the direct payments will be fully introduced.

The estimation of the direct support (direct payments and additional payments) for the milk sector in Romania was made starting from the present farm subsidy policy of the European Union; however, new evolutions can be foreseen until Romania joins the European Union.

The calculations had in view the following methodological hypotheses:

- the milk quota resulting from the negotiations: 3057 thou.tons in the year 2007 and 2008, 3245 thou.tons respectively in the period 2009-2016;
- direct payments: 24.94 euro/ton of milk, i.e. 25% - 2007; 30% - 2008; 35% - 2009; 40% - 2010; 50% - 2011; 60% - 2012; 70% - 2013; 80% - 2014; 90% - 2015; 100% - 2016;
- additional payments: 16.76 euro/ton of milk, i.e., 25% - 2007; 30% - 2008; 35% - 2009; 40% - 2010; 50% - 2011; 60% - 2012; 70% 2013; 80% - 2014; 90% - 2015; 100% - 2016.

Thus, in the conditions in which the Romanian milk producers receive direct payments on a full basis – situation valid for the year 2016 – the allocations for this sector from the EU budget will be 135.3 million euro consisting of 80.9 mil.euro direct payments (60%) and 54.4 mil.euro (40%) additional payments (table 1).

In the situation in which the direct payments in the first year of accession (2007) account for 25% of those received by farmers in the present Member States, the Community allocations will be 31.9 mil.euro, out of which 19.1 mil.euro direct payments (25% out of 76.3 mil Euro) and 12.8 mil.euro additional payments (25% out of 51.2 mil Euro).

Out of the data presented above, it results that in the year 2007, the deficit of support to milk producers will represent 95.6 mil. euro (75% of the necessary). If we take into consideration the fact that, at present, the domestic budgetary support for a production of 1090 thousand tons is 43.4 mil. euro (2004) - representing the milk premia - we can draw the conclusion that not all the necessary amount could be covered by this system of payments. Under these conditions, considering the negotiated quota and the domestic production achieved, it is the governmental bodies that should find solutions and additional funding sources. In this respect, the creation of an institutional framework favourable to sector revamping and to attracting new investment sources represents a priority objective on which the attention of decision makers should be focused in the next period.

Table 1: Direct community support

Specification	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Milk quota (thou.tons/year)	3057	3057	3245	3245	3245	3245	3245	3245	3245	3245
Direct payments (euro/ton)	24.94	24.94	24.94	24.94	24.94	24.94	24.94	24.94	24.94	24.94
Total direct payments (mil.thou. euro)	76.2	76.2	80.9	80.9	80.9	80.9	80.9	80.9	80.9	80.9
Additional payments (euro/ton)	16.76	16.76	16.76	16.76	16.76	16.76	16.76	16.76	16.76	16.76
Total additional payments (mil.thou. euro)	51.2	51.2	54.4	54.4	54.4	54.4	54.4	54.4	54.4	54.4
Total necessary payments (mil.thou. euro)	127.5	127.5	135.3	135.3	135.3	135.3	135.3	135.3	135.3	135.3
Community budget (mil.thou. euro)	31.9	38.2	47.4	54.1	67.7	81.2	94.7	108.2	121.8	135.3
	25%	30%	35%	40%	50%	60%	70%	80%	90%	100%

Source: calculations by Grodea, M., Milk market – quantitative and qualitative barriers for the Romanian dairy products, IAE, Bucharest, 2004

As a result, the use of all eligible funds depends on a large extent upon a successful institutional capacity development of our country until the accession moment, upon the establishment and operation of certain specific structures, e.g. the Integrated Administration and Control System (IACS), the Farm Accountancy Data Network (FADN) etc.

The absence of an adequate institutional capacity could make Romania a net contributor to the Community budget, instead of a net beneficiary.

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