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REFORM OF EU DAIRY POLICIES—IMPLICATIONS FOR U.S. AND WORLD DAIRY MARKETS

European Union (EU) dairy policies are undergoing sweeping changes as part of a reform of the Union's Common Agricultural Policies (CAP) that began in the 1990s and early 2000s. For dairy, the changes that have occurred or are in prospect include expansion of EU farm milk quotas after 2008, elimination of milk quotas after 2014/15, cuts in EU intervention prices for butter and skim milk powder (SMP), withdrawal of EU support for casein, curtailed use of dairy export subsidies, and replacement of market intervention with decoupled direct payments to dairy farmers.

Why are these changes in the EU-CAP being made? The EU's decision to reform CAP policies is an attempt to achieve several goals. These include reducing the EU budget allocated to agriculture, simplifying the application of CAP programs in the expanded 27-country Union, increasing the international competitiveness of the Union's agricultural sector, reducing CAP-induced distortions in international markets to make it easier for the Union comply with World Trade Organization commitments, and exploiting the increased willingness of some EU farmers to give up price support programs. In addition, EU power brokers—mainly Germany and France, which have resisted CAP reforms in the past—are now more receptive to reforms.

What do the changes in EU dairy policies mean for the U.S. and world dairy markets? As changes in EU dairy policies unfold, they are likely to have the following effects on the U.S. and world dairy markets:

- Subsidized exports of EU dairy products will continue to decline over the next few years. This will further reduce the EU's share of world dairy exports, which has already fallen from about 44 percent in 1997 to about 31 percent in 2002–2003. Among other things, the reduction in subsidized EU dairy exports will increase world prices for SMP, expanding opportunities for U.S. and other exporters, and opening the door for international price leadership by the U.S. or New Zealand.
- EU production and exports of casein will decline. Some Irish and other EU processors already have switched from production of casein to skim milk powder as a result of the withdrawal of EU support for casein.
- EU countries are likely to increase production and exports of differentiated (value-added) dairy products and reduce production and exports of dairy commodities. With limited export subsidies, the EU cannot compete effectively with exporters from countries such as New Zealand in selling bulk dairy commodities.
- The location of milk production within the EU will change as a result of the end of EU milk quotas. Milk production is likely to increase in Ireland (perhaps by 20 percent or more), Sweden, Holland, Denmark, parts of Germany, and the Northwest of France, and probably in Poland and Hungary. Lower milk production is likely in Italy and in parts of Germany and France. It is unclear how much overall EU milk production and farm milk prices will change as a result of eliminating farm milk quotas. Dairy exporters located outside of the EU will find it useful to monitor EU milk production, and milk and dairy product prices in the Union to determine whether (and for which products) the EU will become a competitive exporter after the dairy reforms.
- While the EU is making sweeping reforms in some aspects of dairy policy, the Union will retain strong border protection (mainly tariffs). Therefore, opportunities for U.S. firms and others to export dairy products to EU countries will remain limited after the reforms.

Will the EU back away from the sweeping CAP reforms? The possibility of an about-face seems remote since the Union has strong incentives to continue the reforms and current high prices for most farm goods, including milk, have tempered farmers' apprehension. But the real test of the durability of the reforms will occur if incomes of EU farmers become sharply depressed for extended periods under the emerging policy regime.

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