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## **Milking the poor**

How EU subsidies hurt dairy producers in Bangladesh

September 2011

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### **Milking the poor**

How EU subsidies hurt dairy producers in Bangladesh

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Cover photo: CARE Bangladesh

## Introduction

**“The rate we get for milk doesn’t suffice.” - Hossain Fakir, Bangladeshi farmer<sup>1</sup>**

For decades, European dairy farmers have been given massive subsidies under the Common Agricultural Policy (CAP) of the European Union (EU). This has enabled them to export cheap milk powder, among other products, at prices lower than production costs. The EU’s dairy regime has routinely damaged developing countries in three main ways: by undermining domestic dairy producers, by depressing world market prices, and by pushing developing country exporters out of third markets.<sup>2</sup>

In 2005, however, the EU decided to change the nature of those subsidies by ‘decoupling’ them from the production levels of farmers. The aim was supposedly to avoid distorting international trade and prices for agricultural products. But the amount spent on subsidies remains the same; it is only the way they are given that has changed. The decoupled subsidies are placed in what the World Trade Organisation (WTO) refers to as the ‘Green Box’, which are measures that have no, or at most minimal, trade-distorting effects on production. However, this report shows that the EU’s decoupled subsidies are continuing to hurt dairy farmers in developing countries.

Looking at the case of Bangladesh, where millions of poor people support their low incomes through milk production, the report reveals that milk imports are continuing to undermine poor farmers, competing on unfair terms with locally produced milk and suppressing investment in the dairy industry. It also shows that the giant Danish-Swedish dairy company, Arla Foods, is profiting from EU-subsidised milk powder sales to Bangladesh which are harming Bangladeshi milk farmers.

The report highlights the fact that many European farmers - including Danish farmers - are selling below production costs and that some would not even be able to maintain production without EU subsidies, and thus those exports are only possible thanks to the continuation of subsidies. At the same time, Denmark and the European Commission (EC) are funding aid programmes in Bangladesh to reduce poverty, including those designed to support agricultural development.

The EU is preparing a comprehensive reform of the CAP, which is expected to come into force in 2014. Most of the negotiations will take place in autumn 2011 and spring 2012, when Denmark will hold the presidency of the EU. According to the United Nations Special Rapporteur on the Right to Food, the reform of the CAP offers a “unique opportunity” to take into account the impact of the EU’s agricultural policies on the right to food in developing countries.<sup>3</sup> Indeed, CAP reform is the ultimate test of the EU’s willingness to fulfil its treaty-bound obligations to ensure that all its policies are coherently promoting development in poor countries.

## Milk production in Bangladesh – A way out of poverty

Around 150 million farm households across the world are involved in milk production, amounting to some 750 to 900 million people (or 12-14 per cent of the world’s population)<sup>4</sup>. In Bangladesh, 1.4 million family dairy farms, comprising around 7 million people, work very small plots of land and typically own two cows. Amongst these dairy farmers are some of the poorest and most marginalised women.<sup>5</sup>

Amidst widespread poverty milk-producing cows are one of the most valuable assets rural households can own. Cows can provide farmers with a regular cash flow from milk sales, nutritional milk for home consumption, draught power and manure for fertiliser.<sup>6</sup> Milk, the source of vital vitamins and minerals, is a crucial source of nutrition in a country which has one of the highest rates of under-nutrition in the world; 48 per cent of Bangladesh’s children are chronically undernourished and 30 per cent of the total population is below the minimum level of dietary energy consumption.<sup>7</sup>

However, the incomes of most dairy farmers are extremely low, usually ranging from Taka 31 – 60 (€ 0.30 - 0.59) per day.<sup>11</sup> Many dairy farmers both consume and sell some of their milk, generating income for the family. More than 90 per cent of small farmers’ milk is sold through informal channels, such as to neighbours or at the local market; less than 10 per cent is sold to formal milk processing companies.<sup>12</sup> Dairy farming is a potential pathway out of poverty for millions of Bangladeshis. Indeed, the country has already developed successful examples of commercial dairy farming whereby tens of thousands of smallholders, organised in hundreds of cooperatives, provide milk to commercial enterprises which is then processed and distributed throughout the country. By some estimates, tens of thousands of poor rural households have already graduated out of

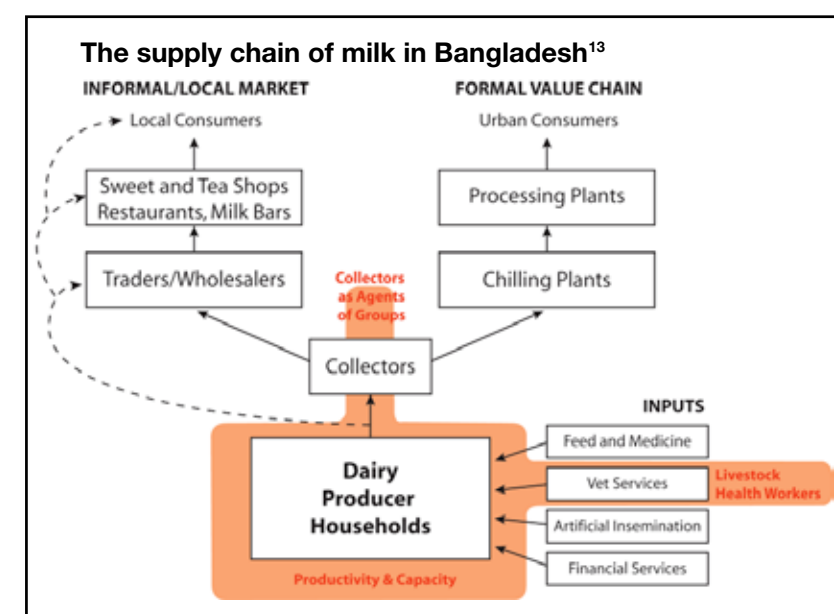
poverty as a result of such models.<sup>14</sup> Studies suggest that dairy production, processing and marketing in Bangladesh generate more regular cash income and employment per unit value than crop farming.<sup>15</sup>

Bangladesh is also internationally well placed to produce milk - what some economists might call a ‘comparative advantage’. Along with many other developing countries, Bangladesh is a relatively low cost producer of milk, in contrast to high cost producers in Europe and the US.<sup>17</sup> One recent analysis found that a typical farm in Bangladesh (with two cows) produces milk 50 per cent cheaper than a typical farm in Germany (with 31 cows.) The same study found that for every million kg of milk produced by EU dairy farmers, 7.6 jobs are created, but in Bangladesh the number is 350 jobs – 46 times as many.<sup>18</sup>

Indeed, the milk industry in Bangladesh also has a huge potential for growth due to the growing domestic demand for milk that comes with rising

### Poverty in Bangladesh

Bangladesh has a population of over 160 million of whom 72 per cent live in rural areas. Around half the rural population live below the poverty line<sup>9</sup>. More than half of rural dwellers own less than 0.5 acres and the poorest 40 per cent possess just 3 per cent of the land.<sup>9</sup> Agriculture employs 70 million people and accounts for 20 per cent of the national GDP.<sup>10</sup>





## The problem of cheap imports

### Dairy Farming: A powerful tool for reducing poverty

A recent study by the UN's Food and Agriculture Organisation (FAO) notes that small-scale milk production not only improves the food security of milk-producing households but also helps to create numerous employment opportunities throughout the dairy chain, such as in small-scale rural processing and intermediary activities. The strengths of smallholder dairy systems include low production costs, relative resilience to rising feed prices and low liabilities. The study also notes that the overall profitability of milk production appears to be higher in developing countries than in industrialised countries, mainly because of the lower costs of feed and the overall 'low-tech' approach. It argues that, if they are well-organised, smallholder producers should be able to compete with large-scale, capital intensive and 'hightech' dairy farming systems in industrialised countries. Smallholder dairy farming has been shown to be successful in a number of countries, notably in India and Kenya. However the study finds that one threat to this potential is from policy support for (and competition from) dairy farmers in OECD country governments for their farmers. Other challenges to small producers include access to technical knowhow, support services and credit, and poor milk quality.<sup>16</sup>

incomes and changing diets. Current consumption of milk and milk products in Bangladesh is low; the average Bangladeshi consumes 42 ml of milk per day – mainly for drinking in tea.<sup>19</sup> This is significantly less than the average for developing countries (120 g) and well below the 280 g per day recommended by the FAO and the World Health Organisation (WHO)<sup>20</sup>. However, milk demand in Bangladesh is already greater than the current production of 2.7 million tonnes of milk a year, with one estimate being as high as 7.2 million tonnes.<sup>21</sup> Recent figures cited by Community-based Dairy Veterinary Foundation suggest that in order to be self-sufficient in milk production by 2021, Bangladesh has to produce 17.9 million tonnes of milk, and to meet growing customer demand, the industry would have to grow by more than 10 per cent.

Domestic production can indeed be increased. Currently, only 3.5 million cattle out of a total cattle population of 24 million actually produce

milk<sup>22</sup>, and the growth rate of livestock is less than 4 per cent.<sup>23</sup> Yields can also be increased. They are currently low and largely variable because of poor feed resources and the breed of cattle typically owned.<sup>24</sup> Among small producers, a typical cow yields 721 kg per year,<sup>25</sup> far less than cows in neighbouring countries such as Pakistan and India.<sup>26</sup> Bangladeshi milk producers also face many other challenges, notably the lack of availability of appropriate feed at low prices and livestock health care.<sup>27</sup>

The potential for increased production is shown in the 16 per cent spike in production in 2007/8, which coincided with a 'melamine scare' – the fear that a potentially toxic chemical compound was present in some brands of powdered milk from China. This caused some consumers of powder milk to shift to raw or pasteurized milk creating. The scare created a temporary extra demand for fresh milk.<sup>28</sup>

Private sector entrepreneurs have already ventured into the growing market of the dairy sector, supporting small farms with improved dairy breeds, quality input supplies, as well as marketing facilities for milk products.<sup>29</sup> With higher milk prices, private participation in the development of the sector can be anticipated to increase.<sup>30</sup>

In its 'Poverty Reduction Strategy Paper' of 2009, the Bangladeshi government states that it is striving to be self-sufficient in food by 2013, taking all possible measures to ensure food security for all its citizens. One of the identified requirements to reach this goal is to create "a level playing field to compete with others and reap the benefits of a globalized world"<sup>31</sup>. The government recognises that it is important to support the milk sector and has taken several steps to do so in recent years.

A key factor undermining Bangladesh's milk industry is imported milk powder. Whole milk powder is imported and marketed directly to consumers, and skimmed milk powder is imported and used for production of dairy products. For one thing, this is a massive cost to the country. In 2007-08, 41,000 tonnes of milk powder were imported at a cost of Taka 10.5 billion (€ 102.5 million).<sup>32</sup> Overall, Bangladesh imports around 27 per cent of its milk consumption needs<sup>33</sup> and between 20 and 50 per cent of imports of skimmed milk powder have come from the EU in recent years.<sup>34</sup>

With the right support and further development of the dairy sector, these imports could have been produced by Bangladeshi farmers themselves. Not only do imports cost a lot, they often enter Bangladesh at prices competitive with domestic milk and are heavily marketed and branded, undercutting local producers of fresh milk and domestic processors of milk powder. Importers have considerable market power, especially in urban markets.<sup>35</sup>

In Bangladesh, the price of fresh milk is also influenced by milk powder prices because milk powder is a substitute for fresh milk. Local milk processors will increase their use of skimmed milk powder instead of fresh milk if the price of imports, including tariffs, falls below the local milk price.<sup>36</sup>

### The problem with importing EU milk powder

"The availability of EU powdered milk on the world market remains unfair competition, limiting the growth of the dairy sector in developing countries and undermining the incentives for farmers to boost local production to keep track with the growing demand." (Recent analysis by Trinity College Dublin<sup>43</sup>)

The EU exported 378,000 tonnes of skimmed milk powder around the world in 2010, up 63 per cent from 2009; a further 11 per cent increase is projected for 2011.<sup>44</sup> EU milk powder exports go mainly to developing countries, particularly in Africa and the Middle East. Indeed, the EU supplies around 70 per cent of sub-Saharan Africa's dairy imports.<sup>45</sup> Imports of skimmed milk powder are the greatest concern

### Cheap imports with devastating effects

In 2009, the Bangladeshi media reported that prices of imported milk powder fell close to US\$ 2,000 (€ 1,510) a tonne from more than US\$ 4,500 (€ 3,398) in 2008. The retail price of a litre of milk fell from Taka 33 (€ 0.32) at the beginning of 2009 to around Taka 26 (€ 0.25) by mid-year.<sup>37</sup> This price fall inspired sweet makers, who buy much of the milk produced in Bangladesh, to shift from purchasing milk produced by local farmers to purchasing imported milk powder.<sup>38</sup> In April 2009, hundreds of dairy farmers poured milk onto highways to protest against falling prices and cheap imports.<sup>39</sup> Both large and small dairy farmers suffered and many said that the price they received was now below the costs of production. Some farmers saw their incomes from milk fall by 40 per cent.<sup>40</sup>



**Noorjahan, a dairy farmer<sup>41</sup>**

Dairy farmer Noorjahan lives in a small house with her daughter and one cow close to Sirajganj city in central Bangladesh. The cow gives her milk, which she sells to the dairy company, Milk Vita, for Taka 30 (€ 0.29) per litre. The income from the milk covers most of her household costs and enables her to pay for her daughter's preparation classes for college. But Noorjahan argues that dairy processors like Milk Vita should pay a larger share of the retail price to farmers. Noorjahan thinks she should get at least 40 taka (€ 0.39) per litre. Currently, the farm gate price of milk does not leave much profit after the costs of rearing the cows are met.

**Waz Ali, a dairy farmer<sup>42</sup>**

Waz Ali is a dairy farmer in Sirajganj, a major dairy hub, who owns 23 cows producing 100 litres of milk a day – a relatively large farmer for Bangladesh. He said that his income fell from Taka 24,000 (€ 234) a week before the price was cut to Taka 18,000 (€ 176) a week after. “I sold one of my cows last month to pay micro credit instalment as my weekly income from milk sales dropped by Tk 6,000 (€ 59) because of the price cut”, said Waz Ali.



to milk producers in the African, Caribbean and Pacific (ACP)<sup>46</sup> states with whom the EU has formal trade and aid agreements. Even relatively small volumes of EU exports to smaller ACP markets can have an impact on the local dairy sector, given the volume of EU exports relative to national ACP market demand. Increased milk powder imports can reduce both demands for, and prices of, locally produced milk, disrupting the development of local supply chains.<sup>47</sup> NGOs have long shown the devastating impacts of cheap dairy imports in Africa and the Caribbean, as a result of the CAP.<sup>48</sup>

In Bangladesh, the Bangladesh Milk Producers Cooperative Union, known as Milk Vita, had virtually collapsed by the mid-1980s, with problem attributed to unfair competition from imports flooding in from subsidised over-production in Europe.<sup>49</sup> At Milk Vita, the gap between milk supply and demand was originally met by re-combining butter oil and skimmed milk powder (that DANIDA and the EU provided) into liquid milk. By the end of the 1970s, village cooperatives had been established and annual milk collection from some 36 000 smallholders had been built up to 15 million litres. But by the mid 1980s, Milk Vita had virtually collapsed, collecting less than 3 million litres of milk a year. The collapse was attributed to unfair competition from imports flooding in from subsidized over-production in Europe. At this time whole milk powder was retailing at less than 20 percent of its cost price in Europe and one-third of the cost of milk production in Bangladesh.<sup>50</sup>

A counter-argument put forward by some is that the EU milk powder imports increase the availability of dairy products, particularly in urban areas, and benefit consumers who might not otherwise be able to afford them. In many African countries, for example, domestic supply cannot keep up with the growth in domestic de-

mand. In Bangladesh, the domestic supply cannot meet the demand because of the continued underdevelopment in the sector. In addition to this, the middle and upper class tend to prefer milk powder due to its practicality, reliability and marketing. The poorer sections of the population tend to avoid consumption of milk due to limited availability and high prices. Increased domestic production and availability of fresh quality milk would help solve these problems.

Milk powder imports increase competition with domestic milk producers and reduced incentives for domestic investment and expansion and also deter small producers from producing more milk to satisfy local demands. Looking at recent prices it is important to note that although local milk is currently slightly cheaper than imported milk, imported milk powder is not only comparable in terms of price, but also more intensively marketed than local milk.

To support dairy farmers the Bangladeshi government has imposed a certain level of trade tariffs on imported milk powder. Tariffs have fallen in recent years from as high as 75 per cent in 2007 to a proposal in the last budget to reduce them to as low as 5 per cent.<sup>53</sup> This prompted protests from local milk producers for whom tariffs are their only protection against competition from developed countries' milk powder brands, including subsidised EU milk. A local entrepreneur in the dairy sector said: “The local dairy industry is not getting momentum because of the government's excessive liberal policy”.<sup>54</sup>

Domestic milk prices are no longer controlled, and the government eliminated direct subsidies to farmers in 1996 and only temporarily reinstated smaller subsidies in 2002 before soon discontinuing them.<sup>55</sup> The government provides subsidies only to Milk Vita in the form of low

**Milk Prices in supermarkets Dhaka-Bangladesh – July 2011<sup>51</sup>****Local Fresh Milk:**

Milk Vita 1 liter = 52 Taka  
Aarong (BRAC) 1 liter = 52 Taka

**Powder Milk:** (400 g of powder makes 3.1 litres of milk)<sup>52</sup>

400g Aarong 180 Taka (local)  
400g Starship 180 Taka (Australia)  
400g Marks 195 Taka (New Zealand)  
400g Farmland 200 Taka (New Zealand)  
400g Dano 210 Taka (Denmark)  
400g Red Cow 215 Taka (New Zealand)  
400g Diploma, 220 Taka (New Zealand/Australia)  
400g Anchor 245 Taka (New Zealand)  
500g Milk Vita 210 Taka (local)  
500g Aarong 240 Taka (local)  
500g Pran 240 Taka (local)  
500g Dano 257 Taka (Denmark)

Note: During Ramadan and Eid, fresh milk prices tend to rise to 70 Taka per litre.

interest loans, grants and project funds – useful support to the company but which prevents other milk processing firms from competing in the market.<sup>56</sup> The dairy industry's contribution to the national GDP is around 2.7 per cent, yet the government's budget allocation to the sector is ten times less, at just 0.27 per cent.<sup>57</sup> Thus, the government in Bangladesh should seek to employ a comprehensive strategy to ensure that its dairy farmers are supported and invest in the dairy sector so that it develops its potential and competitiveness.

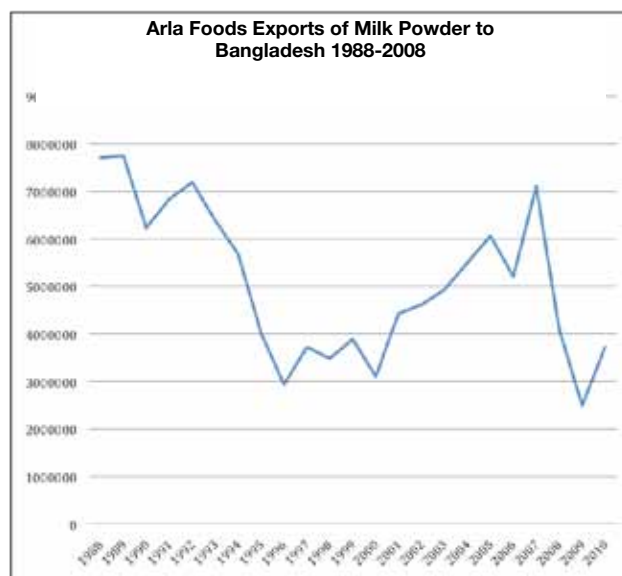


# Arla Foods: Profiting from exports of subsidised milk

One of the biggest exporters of milk powder to Bangladesh is the Danish-Swedish dairy giant Arla Foods, which has supplied between 3.700 and 6,000 tonnes of milk powder to Bangladesh per year in recent years.<sup>58</sup> Arla Foods manufactures the leading foreign milk powder brand in Bangladesh – Dano, which has recently accounted for over 20 per cent of all milk sales in the country.<sup>59</sup> Dano milk powder is mainly exported as bulk and repacked into consumer bags at a plant in Bangladesh that employs around 50 people.<sup>60</sup>

The box below<sup>61</sup> shows that Arla has been a large exporter of milk to Bangladesh for many years and that a fall in Arla's exports coincided with the melamine scandal in 2008. Since then, exports have started to pick up again.

Arla has received nearly one billion Euros in subsidies from the EU since 2000<sup>62</sup>, allowing it to establish a strong position in the Bangladeshi dairy market. Although direct EU support to Arla has reduced in recent years, the farmers supplying Arla continue to receive substantial subsidies.



Arla Foods' literature does not mention the adverse impacts that its milk powder exports might have on Bangladeshi dairy farmers. By contrast, the most recent press release (from 2007) mentioning Dano on Arla Foods' website is entitled 'Dano sales are booming in Bangladesh', and notes that "Dano milk powder is a real hit with Bangladeshi consumers". In 2006, they drank 240 million glasses of the product. "We've succeeded in doubling sales over nine years, a result we're very proud of," a company spokesperson was quoted as saying.<sup>63</sup>

The trade is certainly profitable. Arla Foods' milk powder for consumers<sup>64</sup>, which is exported primarily to developing countries, generated revenues of DKK 831 million (€ 112 million) in 2010 (1.7 per cent of total company revenues).<sup>65</sup> According to Arla Foods, sales of milk powder in developing countries generate more earnings than sales of high quality cheese to Danish consumers.<sup>66</sup> Around 15 per cent of Arla Foods' whole milk powder exports go to Asia, but the company does not provide figures on how much profit it makes from sales in Bangladesh.<sup>67</sup>

### Corporate social responsibility

Arla Foods says it is a socially responsible company and produces an annual corporate social responsibility (CSR) report. Since 2008, Arla Foods has also been linked to the Global Compact, a UN voluntary initiative to promote



ethical business practices.<sup>71</sup> Arla Foods states that it:

"has a responsibility for society, the environment and the people who interface with our products and production...Arla Foods addresses ethical and quality matters in a sustainable and responsible manner, in order to safeguard the company's reputation and profitability. Our objective is to develop our business on a foundation of long-term perspectives with respect for, and in harmony with, our surroundings."<sup>72</sup>

In the company's code of conduct - called 'Our Responsibility' - Arla Foods states:

"We support competition on equal terms... We interact with local communities and contribute to their development... In the markets in which we are a major player, we have the added responsibility of not abusing our position."<sup>73</sup>

Some of these claims - e.g. that Arla Foods contributes to the development of local communities - are questionable in light of Arla Foods' subsidised milk powder exports to Bangladesh.

Arla Foods' only CSR project in Bangladesh is called "Children for Life", which provides one glass of milk a day to around 800 children in three countries – Vietnam, the Dominican Republic and Bangladesh. The project costs DKK 1 million (€ 134,228), which amounts to 0.08 per cent of the company's net profits in 2010. In Bangladesh, the project begun in 2010 and "provides teaching, food and milk" for 235 pupils at a school in the slum area of Korali on the outskirts of Dhaka.<sup>74</sup> Arla Foods' primary donation in the project is Arla's own imported milk powder. Yet, a 2007 study for the FAO states: "School milk feeding schemes based on imported pre-packed milk are seen as counter-productive to sustainable smallholder dairy development".<sup>75</sup>

### Arla Foods

Arla Foods is a global dairy company and a co-operative owned mainly by Danish and Swedish dairy farmers, plus a small number of German farmers. Arla Foods has a virtual monopoly on milk and dairy production in Sweden and Denmark and is Scandinavia's biggest producer of milk powder, which it manufactures in two factories in Denmark and its newest one in Sweden<sup>68</sup>. It has production facilities in 13 countries and sales offices in a further 20, with more than 16,000 employees. Its best known brands include Arla, Lurpak and Castello, which it sells to over 100 countries. Arla Foods' largest market is the UK, where it is the second largest dairy company; it is currently building the world's largest milk dairy in London.<sup>69</sup> In 2010 the company's turnover was DKK 49 billion (€ 6.6 billion); and its net profit was DKK 1.27 billion (€ 170 million).<sup>70</sup>

Furthermore, the company's CSR report is explicit in stating that this CSR project is intimately related to its sales strategy. Its 2010 report states: "The Children for Life project was conceived ...by the department responsible for sales of milk powder across the world". It also states: "Apart from the three countries in which the Children for Life project is currently running, Nigeria and China are also important markets for Arla Foods' milk powder. For this reason, there are plans to set up similar projects there".<sup>76</sup>

## The root of the problem: EU subsidies

At the root of the problem of cheap milk powder imports in Bangladesh are the massive subsidies given to European dairy farmers.<sup>77</sup> These subsidies contrast with the plight of Bangladeshi milk producers, who, as noted, receive no direct support from their government:

- The 'single payment' scheme of **decoupled payments** delivers a massive € 5 billion per year to EU dairy farmers. This level of support has risen from around € 2.75 billion in 2005 and € 4.5 billion in 2007.<sup>78</sup>
- In addition, EU dairy farmers are protected by high **EU import tariffs**, which effectively close the EU market to dairy imports from third countries (apart from the limited volumes which enter under quota arrangements and preferential agreements).<sup>79</sup>
- The EU also maintains a policy of **direct intervention** to buy farmers' outputs at a certain period of the year to maintain market prices.
- In addition, the EU has in recent years initiated major **'safety-net' support programmes** for dairy farmers to sustain milk production in the face of price declines. In 2009, for example, the EU spent an additional € 600 million on top of the € 5

billion in direct payments in response to low prices at the time.

- The EU also pays farmers an **export subsidy** (or 'refund') at times when Europe an dairy prices are higher than world prices to enable them to access world markets. During 1996 to 2006, EU export subsidies on dairy products were high, ranging from € 475 million to € 1.8 billion.<sup>80</sup> Overall, export subsidies have been reduced in recent years and, since the end of 2009, have been set at zero. They were revoked for the first time in 40 years in 2007, but revived in January 2009 to help the industry cope with a global price slump.<sup>81</sup> At this point, the EU began offering subsidies of up to 50 per cent on its milk powder, butter and cheese exports.<sup>82</sup> At the 2005 WTO negotiations, it was agreed that all export subsidies should end by 2013, provided that a full multilateral trade agreement had been reached, but these negotiations are still ongoing.

### Export subsidies and Arla Foods

When dairy prices fell in early 2009, the EU reintroduced both export 'refunds' and milk premiums for farmers based on the amount of milk produced: an aid package of € 280 million for EU dairy farmers was agreed on and € 600 million budgeted for market measures.<sup>90</sup> In Denmark, 4,300 milk producers received DKK 73.3 million (€ 9.8 million) in milk premiums.<sup>91</sup> Danish milk processed by Arla Foods in 2009/10 was supported with approximately DKK 64.1 million (€ 8.6 million).<sup>92</sup> Export subsidies were also reintroduced in Denmark. All of this was in addition to the normal subsidies granted to farmers.

In the first nine months of 2009, Arla Foods exported 1.5 million kg of milk powder to Bangladesh at the price of DKK 26 million (€ 35 million).<sup>93</sup> This was subsidised at a rate of DKK

260 (€ 35) per 100 kg,<sup>94</sup> and corresponds to 15 per cent of the export price, meaning that without the subsidies, Arla Foods would have had to raise the export price 15 per cent to earn the same income. This cost was covered by European taxpayers.

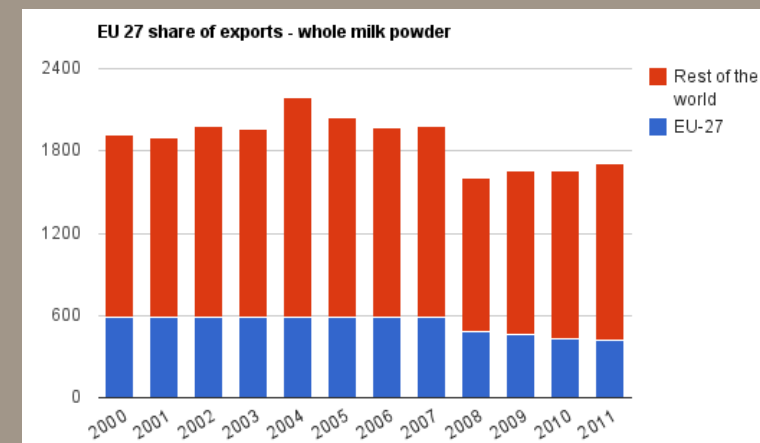
### 'Decoupled' payments increase production and reduce world prices

Proponents of decoupled payments claim that after having switched from traditional subsidies that increased as production rose, the new system has no impact on production or international trade flows. Yet, several recent academic studies show the opposite, that decoupled payments do indeed increase production in the EU and help to reduce international prices, and thus may inflict economic injury upon third countries.<sup>96</sup> Similarly, a 2010 report by the Danish Economic Council, states that the CAP "leads to a higher level of production compared to a free market situation" and that Danish agricultural production, for example, would fall if the EU subsidies were phased out.<sup>97</sup>

The effect on prices is serious in that low prices for milk sales is a major problem faced by Bangladeshi milk farmers, evidenced in the recent protests noted above. In a 2008 survey of dairy farmers in northern Bangladesh by CARE-Bangladesh, low price was identified as the major challenge, mentioned by 42 per cent of those surveyed.<sup>98</sup>

### EU export subsidies also reduce world prices

The EU's export subsidies, by encouraging production and export, have also tended to lower world market prices for milk. Without the subsidies, the EU would produce less and have fewer goods to export at low prices, which would increase world market prices, and shift the balance of trade towards third countries.<sup>102</sup>



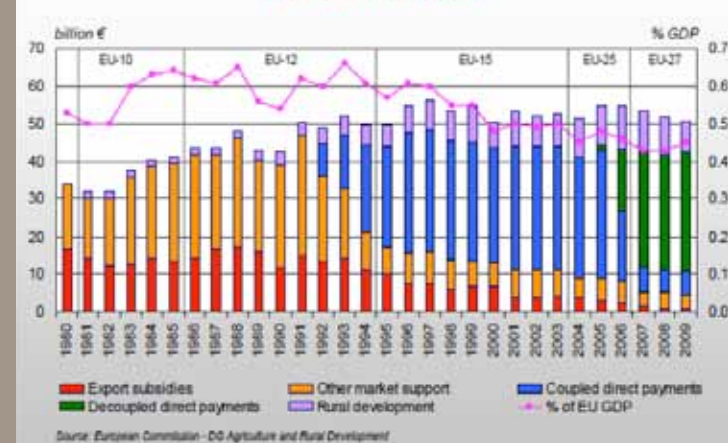
### The EU as a milk producer and exporter<sup>86</sup>

The EU with its 27 member countries is the world's biggest producer of milk, accounting for around a quarter of the world total, ahead of the United States and India.<sup>87</sup> The EU is also the world's second largest exporter of milk (after New Zealand), and accounted for 26 per cent of whole milk powder exports and 27 per cent of skimmed milk powder exports in 2010.<sup>88</sup> There are over one million milk producers in the EU.<sup>89</sup>

### The Common Agricultural Policy (CAP)

The CAP was one of the first policies of the European Community in the 1950s – aimed at making Europe self-sufficient in food by ensuring a stable supply of food for European citizens at a low price, and a reasonable selling price for farmers. Although the level of farm subsidies has reduced since the 1950s, the CAP remains the biggest item on the EU budget, accounting for 40 per cent of the total EU budget in 2011.<sup>83</sup> In 2010 the CAP budget amounted to € 43.8 billion.<sup>84</sup> Direct farm subsidies are by far the largest expenditure of the CAP. Studies show that many of the recipients of CAP subsidies are not small farmers but large landowners and agribusiness, over 1,000 of whom have become 'farm subsidy millionaires'.<sup>85</sup>

### CAP expenditure and CAP reform path (2007 constant prices)



### CAP Expenditure and CAP Reform<sup>95</sup>

While the form of subsidy has moved away from coupled payment and export subsidies, the overall level of farm subsidies is still comparable with the level of the early 1980s in terms of the proportion of EU GDP it represents. Overall - in part due to the expansion of the EU - the level of support has increased. As well as undermining developing countries' milk producers by promoting cheap imports, these EU subsidies also depress world market prices.



**'Green Box' subsidies can be trade-distorting**

Since the EU argues that decoupled payments have no impact on production or international trade flows, they are placed in what the WTO refers to as the 'Green Box' in international trade discussions. Yet the 'Green Box' designation is disputed by several actors. Some argue that subsidies in the form of decoupled payments allow for "effects on farmers' ability to cover fixed and/or variable costs; ... isolates the farmer from market signals and reduces risks, etc". It is also argued that, out of all the 'Green Box' direct payments, 'decoupled' income support programmes distort trade the most.<sup>99</sup>

A study by researchers at Humboldt university in Berlin found that decoupled payments are not production neutral, but act to stimulate production and investment in agriculture compared to a situation with no subsidies. In particular, decoupled EU farm subsidies provide funding to producers, reduce risk and generate the expectation on the part of the recipients that future changes in agricultural policies may also be based on past production, as they currently are. All of this ensures that farmers maintain production at a higher level than without such subsidies.<sup>100</sup>

Similarly, a recent analysis by the International Centre for Trade and Sustainable Development in Geneva concludes that "evidence ... suggests that the sheer volume of subsidies provided may have risk/insurance effects on production - even if such support is provided through relatively decoupled policies." It also notes that "existing studies show that Green Box subsidies encourage agricultural production by creating a guaranteed income stream and a lower perceived risk for farmers, which raises the potential for overproduction".<sup>101</sup>

Although export subsidies are currently set at zero, they can be reimposed, as they were in 2009.

In a 2009 study, the International Farm Comparison Network (IFCN) estimated that the removal of EU export subsidies would increase world dairy prices by 16.7 per cent.<sup>103</sup> Its analysis also showed that an EU export subsidy of € 5 per 100 kg of milk – which prevailed in 2009 when the EU reintroduced export subsidies – reduces the world market price by € 2.5 per kg. In Bangladesh, the impact on family farm income is significant. Such a reduction in the world market

price would lead to a loss of income for a typical Bangladeshi dairy farm of Taka 3,425 (€ 36) per year – a reduction in dairy income of 43 per cent and a loss in overall household income of 7–16 per cent. Around 7 million people would be affected by these income losses.<sup>104</sup>

**According to the Agritrade:**

"While the EU routinely cuts export refund levels for dairy commodities when world market prices rise, it is the opposite trend, of increasing export refund levels when world market prices fall, which is the major source of concern in Africa. While the export of milk powder as raw materials for use in newly established African dairies can enhance capacity utilisation and financial viability while domestic supplies are built up, this requires a carefully conceived import-management policy linked to a national dairy-sector development, if unregulated dairy imports are not to undermine local investor confidence in the returns which can be obtained from dairy-sector investments. This is the principal concern regarding the impact of EU dairy-sector policies.... The EU's active use of a range of support measures to sustain and promote domestic EU dairy production, many of which have important external implications ..., by insulating EU milk producers from the worst effects of price declines, sustain EU milk production and subsequent exports at levels which would simply not be the case in the absence of this range of safety-net interventions. Being unable to benefit from similar support measures, dairy producers in ACP countries would have to bear the full risk of severe dairy-market price volatility, particularly during periods of declining prices."<sup>105</sup>

**Farmers surviving only by subsidies**

"European producers [of basic milk products such as butter and milk powder] have only been competitive on world markets when prices have been high. Outside these periods, they can only export with the assistance of the Community budget."<sup>106</sup>

As the above quote from the European Court of Auditors suggests, many EU dairy farmers who are effectively competing with, and undermining, their Bangladeshi counterparts, could not survive without subsidies. Other evidence supports this view. A recent study by academics at Humboldt University in Berlin, for example, found that during 2004-08, the returns to dairy farmers in Germany amounted to just 49-59 per cent of their costs. Thus "the Common Agricultural Policy has enabled and continues to enable farmers to sell below cost".<sup>107</sup>

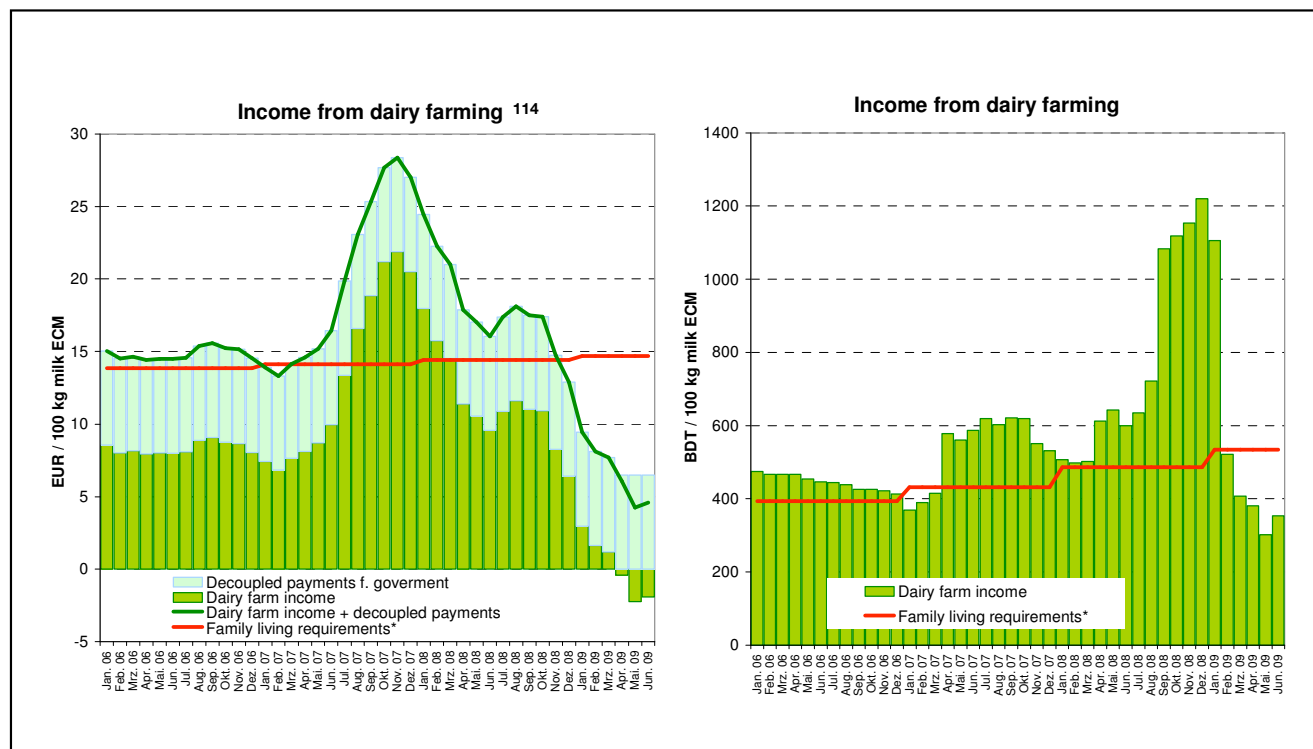
The table shows the proportion of dairy farmers' gross income accounted for by subsidies paid to them. The figures range from a massive 77 per cent in Finland to 16 per cent in Italy for 2006. In Denmark, 31 per cent of dairy farmers' gross income was made up of subsidy payments in 2006 – a proportion that has risen considerably since 2000.

Other sources suggest that many EU farms (not just dairy farms) would simply close down without subsidies. The EU figures show that the share of direct payments and total subsidies in agricultural factor income is 28 per cent and 40 per cent, respectively, for the EU-27, suggesting that much EU agricultural production would not be economically sustainable in the absence of this support.<sup>109</sup> In 2005/06, only 35 per cent of farms in EU-25 were able to cover all costs. This was especially the case for small farms. The share of profitable large farms was only just above 62 per cent.<sup>110</sup>

**Subsidies as a share of gross income of dairy farms before taxes and levies (2000, 2004 and 2006)<sup>108</sup>**

	2000	2004	2006
Belgium	11 %	19 %	28 %
Czech Republic		44 %	60 %
Denmark	18 %	28 %	31 %
Germany	18 %	31 %	36 %
Greece	14 %		46 %
Spain	5 %	12 %	17 %
Estonia		32 %	43 %
France	22 %	33 %	40 %
Hungary		42 %	41 %
Ireland	15 %	22 %	36 %
Italy	10 %	11 %	16 %
Lithuania		35 %	37 %
Luxembourg	31 %	43 %	46 %
Latvia		58 %	63 %
Netherlands	4 %	12 %	23 %
Austria	32 %	44 %	42 %
Poland		22 %	35 %
Portugal	18 %	27 %	37 %
Finland	72 %	73 %	77 %
Sweden	36 %	41 %	56 %
Slovakia		43 %	65 %
Slovenia		37 %	37 %
United Kingdom	16 %	23 %	34 %





Indeed, as the UN Special Rapporteur on the Right to Food, Olivier de Schutter, has recently noted, “Without these various forms of support, the EU producers would not be in a position to compete on world markets, since the social and environmental conditions under which they operate would not allow them to be competitive”.<sup>111</sup>

Currently, many European dairy farmers are incurring losses. In December 2010, for example, the UK National Farmers’ Union claimed there was a gap between the price paid for milk and the costs of producing it of some £ 330 million (€ 389.4 million), with British farmers losing an average of 3 pence (€ 0.35)<sup>112</sup>, on every litre of milk they produced. This poor financial situation is attributed to “the huge increase in feed and bedding costs” and the absence of a “fair” milk price.<sup>113</sup>

The graph above covering a three-and-a-half year period show that only for a few short months did the EU dairy farmers receive an income above their living requirements without need for a subsidy. For the rest of the time, farmers’ incomes were only above living requirements thanks to decoupled subsidies. This clearly shows that the EU farmers are for the most part selling below production costs.

During the melamine scandal, when consumption of imported milkpowder was low, farmers in Bangladesh had an income well above living requirements. At other times the price was around the same level as living requirements or even below.

According to Agritrade, it is precisely the EU’s direct aid payments – which currently amount to 3.4 euro cents per litre of milk produced - which







are sustaining UK milk farmers in business, despite the losses they are incurring.<sup>115</sup>

#### **Agritrade notes:**

“In the absence of direct aid payments, it is likely that a significant number of EU dairy farmers who currently face losses on the market price received for their milk would review their ongoing engagement in dairy production. This would not be immediate, but would occur when reinvestment decisions need to be taken, and would be likely to reduce overall levels of EU milk production. Given that around 5 per cent of EU dairy production is exported, even a small reduction in overall EU milk production would carry important implications. This is particularly the case for lower-value dairy products, such as skimmed milk powder. With more EU milk being used for higher-value products, production of skimmed milk powder and other bulk dairy com-

modities would be likely to decline most dramatically. There have been numerous reports of EU exports of milk powder undermining efforts to promote local dairy production to meet local market needs in Africa, particularly in West and Central Africa.”<sup>116</sup>

#### **Giving with one hand, taking with another: The EU’s incoherence**

The EU and Denmark are supporting Bangladesh through aid while simultaneously undermining it through trade policy. While EU milk powder imports are harming Bangladeshi dairy farmers, the EC is, for example, funding a National Food Policy Capacity Strengthening Programme (to the tune of € 3.3 million<sup>117</sup>) helping the Bangladeshi government promote a national food policy.<sup>118</sup>

Bangladesh is also one of the main recipients of Danish development aid. In 2010, the Danish International Development Agency (DANIDA) spent DKK 471 million (€ 63 million) in Bangladesh.<sup>119</sup> Agriculture is one of DANIDA’s priority areas, and agricultural development is identified as essential for poverty reduction in Bangladesh. In the 1970s, DANIDA supported the establishment of the Bangladesh Milk Producers Co-operative Union Limited (BMPCUL) which produces milk under the trade name Milk Vita.<sup>120</sup>

DANIDA correctly notes that increasing agricultural production and income improves food security, reduces vulnerability of farming households and reduces malnutrition and mortality amongst children.<sup>121</sup> In 2004, before decoupling of subsidies, Carsten Staur, Chief of DANIDA stated: “It is clearly a problem that agricultural subsidies are contributing to maintain a production in the world, which is not appropriate on the basis of an idea of the global division of labour. We are maintaining a production in Europe, which is not competitive.”<sup>122</sup>

EU milk powder imports also undermine aid directed specifically to Bangladeshi milk powder producers. It was announced in June 2011 that the International Finance Corporation (IFC), the private sector lending arm of the World Bank, is providing a € 5.3 million loan to PRAN Group – the largest food processing company in Bangladesh - to expand its local dairy procurement and processing capacity.

The IFC says this will help increase the incomes of about 17,000 Bangladeshi dairy farmers and contribute to the country’s food security. It also notes that “Bangladesh has one of the lowest per capita milk consumption levels in the world and imports milk powder to meet 15 per cent of its dairy demand”. IFC’s investment will help PRAN raise processing capacity across its

product range, including ultra-heat-treated milk, pasteurised milk, and milk powder, and increase raw milk procurement from local dairy farmers. “PRAN’s expansion will help increase the local supply of value-added dairy products, contributing to food security in Bangladesh,” said an IFC spokesperson.<sup>123</sup>

In the 2005 “European Consensus on Development”, the issue of Policy Coherence for Development was identified by the EU as a pioneering concept for achieving the Millennium Development Goals. The EU has committed itself to ensuring that its various policies do not undermine social and economic progress in developing countries. Article 208 of the 2009 Lisbon Treaty states that: “Union development cooperation policy shall have as its primary objective the reduction and, in the long term, the eradication of poverty. The union shall take account of the objectives of development cooperation in the policies that it implements which are likely to affect developing countries.”

In the spring of 2010, the EC conducted a public hearing online, and in the Commission’s summary, it states: “The EU should avoid damaging the economies or food production capacities of developing countries.”<sup>124</sup> However, in the Commission’s communication on the CAP post-2013, published in November 2010, no reference is made to the effect of the CAP on developing countries, except in the context of food security, where it is stated that EU agriculture should contribute to world food demand by maintaining and improving production capacity, while respecting EU commitments in international trade and Policy Coherence for Development.<sup>125</sup> As this report shows, it is precisely the high production level that has a damaging effect on agricultural development in developing countries.

## Denmark's milk production

The farmers that own and deliver milk to Arla Foods are direct beneficiaries of EU subsidies under the CAP. The following Table 2 shows an example of a typical Danish dairy farmer receiving over DKK 330,000 (€ 44,295) a year in subsidies. Some farmers, however, receive as much as € 500,000.<sup>126</sup>

This is not the sum total of EU support to Danish dairy farmers. The dairy sector is supported through a range of other measures, such as a premium for male animals (of DKK 735-1174 (€ 99-158)) depending on the age when slaughtered and whether the animal is steered),<sup>128</sup> support for school milk schemes, support for storing of butter and aid for the disposal of skimmed milk.<sup>129</sup>

Our analysis in the previous section suggested that although subsidies have been decoupled from production, they enable otherwise loss-making EU milk producers to stay in business. Below, we calculate the costs and cost-effectiveness of Danish dairy farmers.<sup>130</sup> Table 3 shows that, without subsidies, Danish dairy farming was unprofitable for both large (+200 cows) and small (0-100 cows) farms in 2009. The value of production covered only 88 per cent of costs for small farms. In 2008 only large farms were profitable, and only by a margin of 4 per cent of costs.

Moreover, as Denmark is the country with highest yield per cow in the EU and Danish farms are bigger than in most other EU countries<sup>131</sup>, many farmers in other countries are also likely to mean even more farmers would be loss-making. Thus EU subsidies that enable these otherwise loss-making dairy farmers to continue exporting in ways that undermine many milk producers in poorer parts of the world.

<b>Cost effectiveness of dairy production, 2008 and 2009<sup>132</sup></b>			
<b>2008</b>			
	<b>Small farms</b>	<b>Large farms</b>	<b>All farms</b>
Milk production, kg per cow	8,114	8,775	8,659
	DKK per cow	DKK per cow	DKK per cow
Value of milk production	20336	21992	21702
Value of manure	56	132	88
Total costs	22342	21179	21878
<b>Net profit</b>	<b>-1950</b>	<b>945</b>	<b>-88</b>
<b>Returns in per cent of costs</b>	<b>91.3</b>	<b>104.5</b>	<b>99.6</b>
<b>2009</b>			
(Detailed presentation of cost for 2009 is provided in annex A on page 21)			
	<b>Small farms</b>	<b>Large farms</b>	<b>All farms</b>
Milk production, kg per cow	7,956	8,979	8,810
	DKK per cow	DKK per cow	DKK per cow
Value of milk production	17150	19355	18991
Value of manure	256	252	213
Total costs	19682	20166	20195
<b>Net profit</b>	<b>-2276</b>	<b>-559</b>	<b>-991</b>
<b>Returns in per cent of costs</b>	<b>88.4</b>	<b>97.2</b>	<b>95.1</b>

### Danish farmers and subsidies<sup>133</sup>

The Danish dairy farmer Niels Kristian Jørgensen has 230 cows. He receives DKK 739,000 (€ 99,195) in EU subsidies, and says that the price he gets for his produce does not cover his costs. He explains that, without the subsidies, consumers would pay three times the current price for one litre of milk. When asked if he could keep farming if the subsidies were abolished, he answers: "Not unless the prices go up significantly and the costs are kept steady - and I consider this a utopia!"

Henning Skov Andersen runs a farm with 95 cows and 85 hectares. He says that with the high costs of production in Denmark, the DKK 300,000 (€ 40,268) he receives in subsidies are needed to make ends meet. Without the subsidies, he would have a deficit every year, and in the end he would need to close down the farm.

Michael Kristensen, with 160 cows and 140 hectares, receives subsidies worth DKK 480,000 (€ 64,430) every year, and says he could not keep farming without them. He thinks that the farm subsidies should have never been introduced in the first place.

<b>Example of subsidies to a milk producer with milk production of 500 tons, 92 hectares of tilled fields, 8 hectares of fallow land and 8 hectares of permanent grazing fields<sup>127</sup></b>					
Type of area with payment entitlement	Area in ha	Base rate per payment entitlement (DKK)	Milk addition per payment entitlement 2006 (DKK)	Total subsidies per payment entitlement 2006 (DKK)	Subsidies granted in 2006 (DKK)
Tilled fields	92	2300	965	3265	300380
Fallow land	8	2300	0	2300	18400
Permanent grazing fields	8	500	965	1465	11720
<b>Total</b>					<b>DKK330500 (€44362)</b>



## Conclusion

For decades, European dairy farmers have been given massive subsidies under the EU's CAP. This has enabled them to export cheap milk powder, among other products, on international markets at low prices. In 2005, however, the EU decided to change the nature of those subsidies by 'decoupling' them from the production levels of farmers. However, this report shows that the EU's decoupled subsidies are continuing to damage dairy farmers in Bangladesh, where millions of poor people support their low incomes through milk production.

At the root of the problem of cheap milk powder imports in Bangladesh are the massive subsidies given to European dairy farmers. European and Danish taxpayers are continuing to fund EU farmers to harm the livelihoods of poor dairy

farmers in Bangladesh, at the same time as funding aid programmes designed to help them. Whilst the EU has committed itself to promoting Policy Coherence for Development - ensuring that its various policies do not undermine social and economic progress in developing countries - this aim is being undermined by cases such as the one illustrated in this report.

The EU is preparing a comprehensive reform of the CAP, which is expected to come into force in 2014. Much of the negotiations will take place in early 2012, when Denmark will be hold the presidency of the EU. This represents an important political opportunity to reform the CAP in a way that ends all damaging subsidies and will be a test of the EU's willingness to ensure that its policies are coherently promoting development in poor countries.



## Annex

<b>Annex A</b>			
<b>Costs of production, Danish dairy farmers, 2009</b>			
<b>Costs of milk production</b>			
<b>( DKK per cow)</b>	<b>2009</b>	<b>2009</b>	<b>2009</b>
	<b>Small farms</b>	<b>Large farms</b>	<b>All farms</b>
<b>Operating (variable) costs</b>	<b>11544</b>	<b>11982</b>	<b>12012</b>
Insemination	258	293	285
Feed	8295	8572	8542
Veterinary and medicine	696	664	712
Other operating costs	731	937	907
Machinery costs	689	618	660
Energy	464	484	486
Interest on operating inputs	410	414	421
<b>Partially variable costs</b>	<b>5914</b>	<b>5309</b>	<b>5493</b>
Hired and opportunity costs of labour	4068	2753	3105
Maintenance of equipment	820	850	855
Depreciation of equipment	793	1294	1166
Interest on equipment	234	412	367
<b>Fixed costs</b>	<b>2224</b>	<b>2875</b>	<b>2690</b>
Real estate tax and energy levy	54	62	61
Insurance	133	109	117
Maintenance and depreciation, buildings	738	1069	962
Interest on buildings	956	1363	1250
Other fixed costs	344	273	300
<b>Total costs</b>	<b>19682</b>	<b>20166</b>	<b>20195</b>

## Endnotes

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**11** International Farm Comparison Network. 2009. Dairy Policy Impacts on Bangladesh & EU 15 Dairy Farmers' Livelihoods, p.2, 5; CARE Bangladesh. 2008. 'Pro-Poor Analysis of the Dairy Value Chain', p. 20; Dairy farming provides an average of around 16 per cent of family income, the rest provided by other farming activity and off-farm income.

**12** International Farm Comparison Network. 2009. Dairy Policy Impacts on Bangladesh & EU 15 Dairy Farmers' Livelihoods, p.2.

**13** Siddiquee, N.A. & and Southwood, R. 2011. 'Strengthening the dairy Value Chain in Bangladesh'. Slideshow presented at the Gender and Market Oriented Agriculture (AgriGender 2011) Workshop, Addis Ababa, Ethiopia, 31 January–2 February. Available at: <http://www.slideshare.net/ILRI/strengthening-the-dairy-value-chain-in-bangladesh-changing-lives-for-dairy-farmers>.

**14** Haque, S.A. 2007. Lessons Learned Study: Bangladesh – Smallholder Milk Producers, Nutrition, Incomes, Jobs. Rome: FAO, p.13.

**15** Shamsuddin, M. et al. 2006. 'A Survey to Identify Economic Opportunities for Smallholder Dairy Farms in Bangladesh'. Journal of Tropical Animal Health and Production, 38(2), p. 131-140.; The livestock sub-sector contributes only 3 per cent of Bangladesh's GDP but provides employment to around 20 per cent of the rural population by some estimates, and is one of the most important economic activities in the country; PRAN-RFL Group. 2007. Report on the Development of Dairy Industry in Bangladesh, p.2.

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**22** Katherine Barker and Michael Hinsch, 'Tetra Pak in Bangladesh: Partnering to Improve Nutrition and Develop the Dairy Industry', undated

**23** 'Dairy industry seeks greater policy support', Independent (Bangladesh), 20 June 2011

**24** Hemme,T. et al. 2002. 'A Review of Milk Production in Bangladesh with Particular Emphasis on Small-scale Producers'. Available at: [http://www.fao.org/ag/againfo/programmes/en/pplpi/docarc/execsumm\\_wp07.pdf](http://www.fao.org/ag/againfo/programmes/en/pplpi/docarc/execsumm_wp07.pdf).

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