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icos Irish Cooperative Organisation Society
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Cover Story

Milk Supply Agreements are a Necessity

Since early 2010, ICOS has been urging co-ops and their members to address the new supplier relationships, which will be necessary post quota. It is a fact that some type of Milk Supply Agreement will be needed, to provide guarantees to farmers and their co-ops, in relation to the amount of milk which can and will be supplied and to provide a basis for planning and funding expansion.

<u>This is not an attempt to stifle the ambition of dairy farmers, or to reintroduce quotas by the back door</u>, it is a necessary measure to protect the interests of co-op members and to avoid the prospect of milk being spilled, for lack of capacity at peak.

ICOS would like to reiterate its position in relation to the new supply relationship, with the first necessary step being the agreement on a format for the new Milk Supply Agreements. ICOS has proposed that such an agreement should allocate processing capacity to existing member suppliers, probably on the basis of milk quota (if the quota is supplied in full). Further spare capacity, if it exists, should be allocated in the following order of priority;

1. Existing supplier members
2. Existing non supplier members
3. Exiting supplier non members
4. New Entrants

Agreements would be renewable annually, with additional capacity being allocated on the basis of a business plan demonstrating a genuine capacity to expand, with allocations being reduced if supplies don't match the allocation (subject to force majeure provisions etc).

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Market Insight

Dairy Markets

Commodity Prices	Sep-11 Butter Index	Sep-11 SMP Index	Sep-11 Fonterra Auction WMP	Holland Milk Price per litre** (Irish solids)	Jul-11 Ireland Milk Deliveries
September	€4,007	$2,255	$3,314	33.11c	7.3%
August	€4,077	$2,297	$3,474	34.06c	Compared with same month in 2010
July	€4,212	$2,430	$3,638	33.40c	
	Eurex *	Eurex *	GDT	FrieslandCampina - Incl. seasonal premium of 2.45c	

Market News

Favourable weather conditions have resulted in global milk production running ahead of this time last year. For the first six months of 2011, the EU 27 milk production was up 2.25% when compared with the same period last year. Quota correction is taking place in certain EU countries as they enter the seasonal trough. In Ireland milk production is up 11% in the first six months of the year boosted by favourable weather, milk price and increased dairy cow numbers. Milk production in New Zealand is up around 12% for the first six months of 2011. The snow storms in New Zealand did little other than disrupt milk collection and milk production continues to show growth over the previous year with cows and pasture conditions reported to indicate a bumper year. Meanwhile in China and India milk production is up 10% and 4% on the same period as last year. The gloomy economic news from the USA and EU countries is impacting on consumer sentiment in the developed world, while emerging economies continue to show more positive economic data. European prices for spot butter have stabilised, but most of the trade is internal as prices are higher than what international buyers are willing to buy at. The Private Storage Aid Scheme for butter closed at the end of August with almost 106,000 tonnes of butter entered into the programme, compared with 94,000 tonnes the previous year. European whole milk powder markets are sluggish and prices are weak as EU prices are higher than international prices and international buyers are unwilling to trade at these prices. The Fonterra Auction (6 Sept) reported prices down 1.4%. Cheese markets have stabilised but Russian buying and higher UK milk prices are required.

ICOS News

Henry Van Der Heyden visits ICOS

Sir Henry Van Der Heyden met with the ICOS Board at Cillin Hill, Kilkenny, on September 5th, to discuss strategies which might strengthen the position of dairy co-ops in Ireland as well as New Zealand. The disarmingly direct Kiwi highlighted the ground which had been lost by the Irish dairy industry since milk quotas were introduced. At that time, Ireland and New Zealand had equal milk pools; since then Irish production has been stagnant, while New Zealand production increased almost four fold.

Indeed, he conceded that in the early stages of development of the New Zealand industry, they had studied the Irish structure, (including the Irish Dairy Board), and decided that it represented the most appropriate model for them to adopt. More recently, however, they decided to integrate all the major players in the industry, including their Dairy Board, in an attempt to capture value for their members, and to strengthen their position in the market.

He strongly advocated the "globalDairyTrade" auction system, as a way of maximising returns from the market, and also, as a way of minimising the cash flow pressures associated with a highly seasonal milk supply.

His key message, however, was that the Irish dairy industry should consolidate, around the Irish Dairy Board, thereby freeing up the resources necessary to drive expansion and member returns. He suggested that Fonterra would like to co-operate with the Irish dairy industry, given our common seasonality and grass production models, but that currently the Irish industry is not structured in such a way as to make this possible.

Pictured above are Sir Henry Van Der Heyden, Fonterra Chairman, with Pat McLoughlin ICOS President, Bertie O'Leary, Chairman ICOS Dairy Committee, David Murphy, Plunkett Scholar, and TJ Flanagan, ICOS Dairy Committe Secretary.

Brussels Bites

Commission proposals on the future of CAP unveiled

The EU Commission will open inter-service consultation, at the beginning of this month on its proposal on the future CAP. The proposal is set to be officially released on October 12. The draft Commission proposal seen by ICOS on direct payments suggests a further greening of the CAP's first pillar without any increased financing.

The draft Commission proposal proposes a mandatory **"greening"** component of direct payments by supporting environmental measures applicable across the whole of the EU territory. Farmers would have to perform 3 mandatory measures that go beyond cross-compliance requirements – crop diversification (of at least 3 different crops each covering over 5% of their arable land); maintenance of permanent grassland and designation of 5% of land to ecological purposes eg buffer strips – if they want to receive aid over and above the basic income support. This would make 30% of direct payments dependent upon complying with greening measures.

From an Irish context, ICOS calculations estimate that €390 million of annual Irish farm payments would directly come under this new 'greening' mechanism.

The Commission has also proposed moving away from the **historical reference model** for direct support, setting a deadline of January 1, 2019 by which national or regional payments should be based on a uniform unit value. This would be similar to how the UK transitioned over an 8 year period, from 2005 to 2012, from the historic payment to a flat rate payment.

The proposal also suggests **capping or putting an upper ceiling on direct payments** received by bigger individual farmers. The phased-in capping rate would start at 20% for amounts between €150,000 - €200,000; 40% for amounts between €200,000 - €250,000; 70% for amounts between €250,000 - €300,000 ; with a total cap at €300,000.

In addition, the proposal maintains **voluntary coupled support** in sectors and regions where it is vital to maintain production. Member **S**tates should be allowed to use 5 or 10% of their national ceilings for this, depending on the current situation. In some situations, Member States could use more than 10% of the said ceiling. A review is scheduled before August 1, 2016. A **simplified scheme for small farmers** is also proposed.

ICOS is heavily involved in the process and new information is coming out almost on a daily basis.

Ireland gets some respite in EU Co-funding Rules

The EU Commission has proposed raising the EU co-funding rate to a maximum of 95% for EU Schemes, such as rural development, for countries experiencing financial difficulties. The Member States involved are Greece, Portugal, Latvia, Romania, Hungary and ourselves. The maximum co-funding rate would go up from 75% to 95% in these areas, to enable projects which had previously been hampered by a lack of funds to get off the ground.

EU Commission Proposal to Electronically Tag Cattle Released

The beginning of September saw proposals introduced for the first time for an electronic identification system (EID) for cattle on a voluntary basis. The Commission has released some initial documents on the matter that also deal with the labelling of beef. The ICOS Expert Committees will be examining the documents in detail over the coming weeks and will revert with a policy on the matter.

Expansion Strategies Post Milk Quota

A project undertaken by University College Cork in partnership with Teagasc Moorepark, the Rural Economy Research Centre and Cork Institute of Technology funded by the Department of Agricultural Stimulus Fund examined milk transport options for an expanded dairy industry post milk quota removal in 2015.

In the study the FAPRI-Ireland farm level model was used to estimate the regional increases in milk production post quota abolition. The analysis evaluated expansion levels at a number of different milk prices and projected an increase of 45% by 2020 at a milk price of 28c/l, with the vast majority of this expansion in the south of the country. Based on current processing capacity nationally, there would be a requirement to construct additional processing capacity to process the milk at peak. The milk transport model was used to identify the optimal locations for expansion of existing facilities as well as building new Greenfield milk processing facilities (with 29 different locations evaluated).

When the additional milk supply in 2020 was routed to one site currently in operation, Mitchelstown was found to be the site with the lowest milk transport costs which equated to 1.01c/l with all existing milk routed to its existing original milk plants. When two existing sites were expanded instead of one, the two optimum expanded sites became Mitchelstown and Macroom with transport costs of 0.97c/l. When three sites were expanded, the three optimum expanded sites became Mitchelstown, Macroom and Ballyragget with transport costs of 0.94c/l.

In the study, Glanmire was found to be the least cost Greenfield location with national transport costs of 1.01c/l with all existing milk routed to its existing original milk plants. Other Greenfield sites examined included Dungarvan, Croom, Horse and Jockey and Belview Port with transport costs of 1.03c/l, 1.04c/l, 1.07c/l and 1.10c/l respectively.

Further cost reductions could be made if the milk was collected by optimal milk catchment regions. In order for this to occur milk processors would need to route milk to the closest plants rather than the current situation where milk is routed by catchment region. This would equate to yearly savings of €6.6 million, €6.32 million and €6.28 or 9.65%, 9.65% and 9.92% for 1 site, 2 sites and 3 sites respectively. Therefore the findings suggest that processors would achieve significant cost reductions by co-operating in milk transport activities.

There are milk transport cost savings available from increased numbers of sites and for milk to be collected by optimal location to processing site. The next phase of this analysis is integrating the effect of plant scale and operating costs with milk transport cost.

If you require further information about this study please contact Carrie Quinlan at carriequinlan.ucc@gmail.com

The support received from the Department of Agriculture, Fisheries and Food Stimulus fund for this research is gratefully acknowledged.

Eleventh Milk Quota Trading Scheme• Priority Pool Price to Remain at 5 cent per litre

The Department of Agriculture, Fisheries and Food announced the eleventh Milk Quota Trading Scheme on the 17th of August, which will be the first of two Trading Schemes to allocate quota in respect of the 2012/2013 milk quota year.

The Minister, in his announcement, welcomed the fact that the recent review of the 2011/2012 Trading Scheme with the farming organisations and with ICOS had concluded that the Scheme is working well and that minimal changes are considered necessary. Indeed, the only change from last year is that **eligibility under the successor category in the priority pool will be extended from the son or daughter of a former milk producer to now include the niece/nephew of the former producer.**

"The review with the farming organisations and ICOS has made it clear that the structure of the Milk Quota Trading Scheme does not require radical alteration this year. I have therefore decided to leave the main elements unchanged, with, for example, the priority pool price remaining at 5 cent per litre, and the national redistribution mechanism for partially unsold quota, which was made available but not used last year, remaining in place in respect of the 2012/2013 Scheme. I have, however, agreed to an extension of the successor category to include the nephew/niece of a former producer".

The Minister confirmed that the Scheme will again be run in respect of each Co-op area, and will comprise a priority pool and a market exchange. Sellers will continue to contribute 30 per cent of the total quota offered for sale to the priority pool. The method for calculating the market clearing price, including the 40 per cent price corridor, will remain unchanged. The 3:2 ratio on the distribution of priority pool quota between young farmers and producers with quotas of less than 350,000 litres will be retained, as will the option for sellers in certain Co-op areas to sell at one or two cent per litre less than their original offer price.

The Minister announced that the closing date for receipt of applications to the eleventh Milk Quota Trading Scheme will be Friday 7 October 2011.

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Milk Supply Agreements a Necessity

Capacity allocations should be made on the basis of peak supply, as opposed to total annual volume (subject to variation for current winter/liquid suppliers, and in such a way as not to penalise current suppliers who have a flatter supply curve). This would allow farmers to produce significantly more milk than currently, across the year, while remaining within their supply allocation. The supply allocations would, at all times, remain the property of the Society (and all its members), but could be transferable to close family members, by agreement with the Society.

ICOS proposes that, where possible, a share standard should apply for new supply allocations, i.e. producers should hold a minimum number of shares per litre of milk supplied. Currently member suppliers of Irish co-ops hold, typically, shares to the value of about 1c/l - 3c/l of milk supply. In competitor co-ops in Europe, members subscribe share capital to the value of 6c/l - 16c/l of milk supply, with Fonterra demanding that new or expanding suppliers subscribe, in full, to the value of about 30c/l, before a drop of milk can be collected.

Finally, in the event of all current capacity being fully allocated, and there still being a demand amongst members for expansion, then those who wish to supply extra milk must make a significant contribution to the cost of such expansion. Remember, it's not just about the cost of the new drier; it's about all the other associated costs, such as working capital, investment in R&D, new routes to market etc. All these investments will have to be funded, and it all comes out of the litre of milk ultimately, so farmers would be well advised to consider funding mechanisms which maximise their ownership and control of their own business.

Separately, the European Union institutions are negotiating proposed milk supply contracts which they wish to have put in place between suppliers and purchasers of milk. While it is likely that co-ops will not be required to have mandatory contracts, they would only have a derogation if they have in place, Agreements which fundamentally satisfy the requirements of a contract.

Milk Quota Trading Scheme

Despite the fact that we have already completed 5 years of Milk Quota Trading Schemes (10 phases in total) some producers may still be unclear in regard to the operation of the Milk Quota Trading Scheme. The following are some of the main points;

- The Milk Quota Trading Scheme replaced the Milk Quota Restructuring Scheme and like the Milk Quota Restructuring Scheme is co-operative based
- It comprises two elements: a market exchange and a maximum price priority pool
- A producer selling all or part of his quota is barred from purchasing from a Trading Scheme for a period of three years and equally not entitled to an allocation under the fleximilk or temporary leasing schemes for a period of three years
- 30% of quota offered for sale is allocated to the priority pool at a fixed price of 5 cent per litre
- The priority pool is made available for priority categories e.g. successors, lost leases, new and recent entrants and category 1 producers (less than 350,000 litres)
- In general the maximum that can be purchased under the Milk Quota Trading Scheme is 100,000 litres
- The market exchange element operates by producers tendering the price they are willing to purchase quota on the application form to the Department of Agriculture. Likewise producers who have offered to sell their quota have tendered a price which they are prepared to sell
- An exchange is run for each individual milk purchaser whose producers have submitted to the Department applications to sell their quota
- Offers to sell quota which are at or below the market clearing price are deemed to be sold at the market clearing price
- Bids to buy quota at or above the market clearing price are deemed to have been purchased at the market clearing price

Quota holders in 11 specified co-operative areas may indicate on the application form that they will avail of an option to sell their quota at 1 or 2 cent below their tendered price. If such producers are still left with unsold quota that quota will form a national pool and will be made available to buyers in other co-operative areas who have purchased some quota in their market exchange but whose demand had not been fully satisfied.

Diary Dates

EU Farm Ministers Informal Meeting on September 11th - 13th

Market Movement

	€1 : US$	1€ : GB£	Oil Price (Brent) - US$ pbl	Carbon Spot: 1 EUA
September	$1.41	£0.879	$113.52	€11.55
August	$1.41	£0.868	$107.96	€11.55
July	$1.43	£0.895	$116.34	€13.38

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Irish Cooperative Organisation Society

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ICOS_BXL

Irish Cooperative Organisation Society
The Plunkett House, 84 Merrion Square, Dublin 2
Tel: +353 (0)1 6764783

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