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CONTENT

1	Introduction to the dairy sector	4
2	A dual sector ?.....	5
3	Prospects for dairy product consumption.....	6
4	Expert views on the challenges at the level of the milk production.....	6
5	Expert views on the challenges at the stage of milk collection from farms	8
6	Expert views on the challenges at the milk processing stage	9
7	Conclusion.....	10

1 Introduction to the dairy sector

The Cyprus dairy industry is different from that of the EU – 15 countries in respect of structure, trends in production and consumption, range of products and proportions of sheep and goats milk. The main difference however, is that in Cyprus about one third of raw milk produced is sheep and goats' milk which constitutes 40% of the value of all milk produced. This milk is processed as cheese and yoghurt.

The cows' milk produced in Cyprus at around 140,000 – 145,000 tons annually is insignificant in relation to the total EU production but is more than sufficient to meet the demand in Cyprus for liquid fresh milk, which has shown a rising trend in the last 25 years.

The total number of cattle in Cyprus - which reached a peak of 70,000 animals in the mid 90's and fell to a low of 53,000 in the late 90's - has stabilised to around 60,000 animals of which some 25,000 are dairy cows. In total in Cyprus there are 241 milking herds, giving an average herd size of over 100 cows, which is five times greater than that of the EU countries (Table 7 in Annex).

Milk accounts for about 10% of the gross output of Agriculture. Considering that agriculture's share of the GDP in Cyprus is 3%, the milk sector's contribution to the GDP is 0.3%. However, further economic significance is added by the milk-processing sector and this makes the sector of roughly equal importance to the economies of Cyprus and the EU countries.

It has been estimated that 55% of all milk delivered to dairies in Cyprus is pasteurised and sold for liquid consumption, 25% is used for producing a traditional Cypriot Cheese (halloumi) and about 15% is used for producing other cheeses, 4% for yoghurt and 1% for ice – cream. Insignificant amounts of by product butterfat are used for cream but butterfat content and average yield per cow in Cyprus are somewhat lower than in the EU. Overall Cyprus is about 75% self sufficient in cows' milk and milk products.

In the milk pasteurisation industry, there is a trend of foreign companies buying a stake in Cypriot ones. The companies acquiring a stake in the Cypriot market are mainly Greek ones and are also interested in related industries like meat factories.

The consumption of milk in Cyprus has been relatively steady with a small increase to reflect the population increase. The trade in milk products has seen a significant increase following EU-Accession with the imports of Edam, feta cheese and non-concentrated milk and cream benefiting the most. Exports have also increased considerably post -Accession consisting almost exclusively of halloumi cheese.

Cyprus has already met its milk quota. In fact, there has been a slight surplus during 2005. Milk producers are not in favor of an increase in the quota fearing that it would lead to a drop in the price and their revenues. On the other hand, milk processors argue for a higher quota. They do have a good argument stemming from the fact that there is unsatisfied demand for exports of halloumi cheese. In particular, one of the major companies in Cyprus has come to an agreement with Mark & Spencer for providing their British stores with halloumi cheese. The issue would become even more serious if the percentage content of cows' milk in halloumi cheese production increases.

Before Accession the following measures were in effect in an effort to support the dairy sector and control production:

- Fodder cereals were monopolistically provided by the Cyprus Grain Commission at a substantially subsidised price
- Grants and subsidies were given for the preparation of fodder
- Subsidies for buying sperm of bulls considered of high genetic value
- Quotas in the production of cow milk, subsidies for the slaughtering of young calves and subsidies for the production of Edam cheese
- Subsidisation of the interest rate on loans issued for improvement of livestock farms, for buying new equipment and for the improvement of existing structures etc

A note should be made here of the case of halloumi cheese in Cyprus. Halloumi cheese is made by cow milk in addition to goat and/or sheep milk. The value of halloumi production is approximately equal to that of all other types of cheese and yoghurt combined. A major issue for Cyprus is establishing halloumi as a Designated Product of country of origin. The designation has been delayed because there is no agreement on what percentage of each type of milk (cow, sheep and goat) should be used in halloumi product. Since countries like Turkey, Greece, Bulgaria and Denmark are now producing cheese with the indication "halloumi" this has become a pressing issue for the industry and the Cyprus Government is trying to find a compromise among the producers of cow, goat and sheep milk.

It should be noted that sheep and goat milk has a somewhat higher economic value than cow milk due to a higher protein and fat content. On the other hand, even though employment in the sheep and goat industry is much higher than in the cow industry, remuneration for those employed in the goat and sheep industry is significantly lower. Since halloumi cheese is made by cow and sheep and/or goat milk, this means that different types of milk may be interdependent and competing for the major cheese product of Cyprus.

2 A dual sector?

Over 60% of those working on the farms are also owners and family members. Therefore, they may also use the milk for their own consumption or they may process it themselves. They are, though, professional producers as most of their produce is sold to the industries. The fact that 90% of milk producing farms have a herd of 35 animals or more indicates that the vast majority of producers are in the sector for more than just covering their own dairy needs. The quota for milk processed by the farm owners themselves is only 2.5% of the grand quota for milk production. Most of the milk is, therefore, sold to professional units.

3 Prospects for dairy product consumption

Per capita milk consumption has been on the rise, with the exception of the year 2004 (Table 3 in Annex). There is an interesting component in dairy product consumption. Cyprus is a popular tourist destination for a total of tourist arrivals that far exceeds its own population. The mixture of tourists and local population provides stability in dairy product consumption that does not reflect cultural taste shifts. On the other hand, periodical fluctuations of tourist arrivals – mainly due to international instability – may lead to a drop in dairy products consumption for the summer months.

There has been a shift in the dairy product consumption (other than milk) away from local products and towards imported ones. This was a result of EU-Accession that led to the abolition of subsidies for local products and abolition of quotas and import duties for milk products imported from EU countries. Consumption has been relatively steady since the effect observed was mainly that of a substitution. Businesses such as pizza houses and restaurants are now exclusively buying imported products.

There has long been a preference for full-fat milk in Cyprus. Even though there has been a modest decrease in its market share, its dominant position remains unchallenged. The second most popular milk has been semi-skimmed milk. It is mainly this category that has been absorbing most of the decline in full-fat milk consumption.

UHT milk is very unlikely to gain any significant share in the market due to the preferences of the Cypriot consumers. The small size of Cyprus ensures access to local pasteurised milk and its geographical position implies increased costs for importing UHT milk.

Products made of goat and/or sheep milk like yoghurt, halloumi and pasteurised milk, may in time gain momentum in the consumers preferences. These shifts in preferences do not play a significant role in overall consumption but may play a role for the Cypriot industry. The reason is that goat and sheep milk products consumed are exclusively Cypriot products while cow milk products consumed are a combination of both domestically produced and imported products.

4 Expert views on the challenges at the level of the milk production

The price of milk in Cyprus is the highest amongst the EU-25. Despite that, importing milk is very difficult due to geographical reasons. Thus, the market for milk used in pasteurisation and processing originates from local farmers. Another reason why only local fresh milk will be used for pasteurisation and processing is the very short «sell by» period for milk. It is true that if consumers welcome Extended Shelf Life milk, producers will face difficulties. As indicated above, though, this seems improbable.

Until 1999 milk price (for producers) was the same for all milk regardless of fat and protein content. In that year, price fluctuations were weighted with fat content carrying a

weight of 42% and protein content a weight of 58% (Table 4 in Annex). The effects of this pricing change were dramatic (Table 1 in Annex). Fat content, as a percentage, had been declining from 3.26% in 1993 to 3.1% in 1998. Since 1999 it has been increasing reaching 3.6% in 2004. Protein percentage was also up from 3.19% in 2000 to 3.38% in 2004. The lowest fat percentage occurs between May and August and the highest between November and January with December as the peak (Table 2 in Annex). This is a result of the weather conditions in Cyprus coupled with animal nutrition.

Even though price fluctuations were linked to milk quality, a market failure still existed until 2003. Before 2003, the milk price was determined administratively according to its cost. Farmers were trying to inflate their costs and deflate their production. Cyprus Milk Industry Organization (CMIO) and the Price Committee decided not to challenge them and to keep increasing milk price. This was done in an effort to increase the farmers' disposable income, in order to facilitate investments before EU-Accession in 2004. Since 2003, market forces have determined the milk price. The small number of the big processing firms may prevent the market from being perfectly competitive. Still, the milk price remains the highest among the EU-25 countries.

Milk quotas were slightly exceeded in 2005. The increasing productivity of dairy farms indicates the need for a reduction in the herd numbers. A 5-10% reduction may be needed to keep milk production within the specified quotas and this could be done through exports.

Since Accession in 2004, farmers lost subsidies of up to an estimated Euro 157.5 per cow as well as subsidies for barley. But, better milk-collecting and feeding equipment, bought through money provided by the Rural Development Plan 2004-2006, increased productivity.

Productivity in the sector has been increasing due to the following:

- Genetic improvement – sperm was imported both by the private sector and the Agricultural Department of the Ministry of Agriculture, Natural Resources and Environment (MANRE)
- Better equipment for the provision and processing of fodder
- Mills for fodder production
- Subsidies for slaughtering of cows at younger age (until accession) –aimed mainly at retaining the population at desirable levels to avoid overproduction
- Plan for recoding of the yield of milk producing cows – Aims towards genetic improvement and better farm management

CMIO checks that producers do not sell more than their quotas. It also checks milk before collection for microorganism and antibody content.

CMIO forecasts of 15 cents per litre did not come true and producers are better off because, following encouragement from the Cypriot government, the farmers formed the Cyprus Cattle Producers Organisation (CCPO) which rapidly achieved monopoly power through having 80% of milk producers in membership. They used their dominant position to influence the farmgate milk price and devised a price plan that puts disincentives on excessive fat (and protein) content so that their quota is not reduced.

5 Expert views on the challenges at the stage of milk collection from farms

Before Accession milk was collected by local associations and delivered to CMIO for distribution. From our discussions with the Director of CMIO the following comments can be made about the role and status of the Organisation.

CMIO's role and activities before Accession:

- Monopolistic Status
- Answerable to the Ministry of Commerce and Industry
- Self financed budget
- Trading of milk, dairy products and meat
- Daily collection, transport and delivery of milk

After EU Accession:

- Kept semi-governmental status
- Answerable to the Ministry of Agriculture, National Resources and Environment
- Signed a 5-year contract with the Cyprus Agricultural Payments Organisation (CAPO) for the delegation of the authorisation of payments and the technical services of the following market measures and schemes
 - Quota System
 - Private and/or public intervention of SMP and butter
 - Private storage aid for long keeping cheeses
 - SMP intended for use as feeding stuffs
 - Disposal of cream or butter at reduced prices to
 - Non profit organisations and institutions
 - Manufacturers of pastry products and ice cream
 - Manufacturers of feedstuff
 - School milk feeding program
 - Direct payment to farmers (Dairy Premium)

Since 2005 the producers' organisation CCPO controls more than 80 % of milk production and distribution. The remaining 20% is controlled by about 30 cow milk producers who sell most of their milk to a pasteuriser of fresh milk.

The CMIO forecast for a 15% drop in the milk price post-Accession did not occur because the monopoly power of CCPO proved stronger than the oligopoly power of milk processors. Processors who buy milk from non – members of CCPO are refused supplies of raw milk when they need to process more.

The CCPO looks after the interest of its members and has established good relations with the processors. In fact CCPO now charges all of its customers the same price regardless of size and location.

In the past milk destruction had been a problem since processing firms did not accept deliveries during some weekends and some holidays. Producers claimed that this was

done by the firms in an effort to ensure lower prices from desperate producers. Since the creation of CCPO, processing firms accept deliveries on all days.

CMIO used to pay solely according to quantity. Now CCPO has price plans and adjusts the payment according to the course distance. This leads to better cost allocation and greater efficiency. Each firm's needs are known beforehand and tank-wagon drivers know how much to deliver to each firm. The last firm is responsible for paying for washing the tank-wagon but they are reimbursed accordingly by money collected from the other firms. CCPO only needs 3 employees for the collection and distribution department due to a very good computerised system. CMIO needed much more manpower. CMIO is running the lab tests for milk randomly collected at the time of tank-wagon loading and oversees milk destruction.

Overall, the majority of milk collection and distribution runs smoothly due to the computerised system, small distances and good road transport network.

6 Expert views on the challenges at the milk processing stage

Traditionally the Cypriot milk processors produced a limited number of types of cheese such as halloumi, feta, cheese for Easter pastries, and a hard cheese named kefalotiri and yoghurt. In the early eighties and nineties due to the overproduction of milk the government encouraged the processors to produce new types of cheeses such as Edam, cheddar and cheese for the pizza makers.

Apart from the three companies selling pasteurised fresh milk there are:

- 8 milk processors each using more than 2 000 000 litres milk annually
- 12 milk processors each using between 500 000 – 2 000 000 litres milk annually
- 52 milk processors each using less than 500 000 litres milk annually
- 10 ice – cream producers

The eight largest milk processors (over 2 million litres annually) produce all the range of cheese products and also yoghurt.

In the home market Cypriot processors are adopting a three–pronged defensive strategy that involves:

- a) Production of products that have a comparative advantage such as kefalotiri cheese (a hard natural rind cheese long matured) and anari which is a ricotta cheese.
- b) Making strategic alliances with foreign manufactures especially Greek ones such as Delta and Efga in order to produce feta cheese and other products in Greece and sell them in Cyprus.
- c) Increasing exports of certain milk products, especially halloumi.

The challenge for the milk processors in Cyprus is to boost the exports of halloumi especially if halloumi will be approved as a Designated Product of country of origin. In order to achieve higher exports, however, it is necessary to increase the milk quota or at least increase the percentage of milk allocated to milk processors.

In 2004 and 2005 importers of cheese products in Cyprus (merchants, supermarket chains, wholesalers etc) decided to increase their own profit margins instead of passing the benefits of EU entry to the consumers in the form of lower prices. There are signs, however, that the price of imported cheese products will be lowered and this will affect the competitiveness of local producers.

During the past few years and because of EU-Accession there has been a noteworthy increase of imported and exported cheese, mainly in the former category. Imports of Edam and feta cheese have increased considerably as well as the exports of halloumi cheese. On the other hand the exports of feta cheese have decreased. The countries that have increased their exports to Cyprus the most were Germany, Great Britain, Greece and Netherlands. In the case of yogurt, imports have picked up in the last years, but Cypriot yogurt is unique and no imported product is expected to replace the traditional one.

7 Conclusion

There are quite a few issues that have arisen post-Accession. Imported dairy products substituted local ones to a large extent. Manufacturers have stopped producing products which were no longer competitive and started importing them, as they are cheaper to import than to manufacture or made strategic alliances with EU manufactures. Others have managed to keep their products in the market at higher prices than the imported ones mainly due to higher quality, better taste and brand loyalty. The case of Souroulla Cheese Factory is a very good example. They produce Edam type cheese which retails at 9 Euros which outsells in all supermarkets German Edam cheese which retails at about 5 Euros. Cheaper but lower quality cheese is now imported in bulk by/for pizza houses, restaurants etc.

Some manufacturers ask for higher national quotas but producers do not seem to embrace the idea wholeheartedly. At best, they will ask for guarantees that all the milk will be sold at a minimum price if they are to support such a demand. Finally, the producers' organisation (CCPO) has acquired monopoly power and this may be an obstacle to free market forces. There has been already a 25% increase in milk price in favor of producers.

In the case of yogurt, imported fruit flavored ones are the only ones that seemed to be able to have a market share. Since feta cheese was established as a Designated Protected Product of Greek origin, the producers and manufacturers of Cypriot feta cheese are losing out. On the other hand, restaurants saw the opportunity of serving cheaper imported feta. The halloumi cheese case is the most important of all. If halloumi containing both sheep/goat and cow milk is not established as a designated protected product of Cyprus origin then manufacturers and producers will be severely affected. As

far as UHT milk is concerned, its market penetration will be insignificant for reasons already explained.

Other issues:

- Due to pre-existing strict hygiene regulations, no serious related problems were encountered at accession
- Farm waste remains a serious issue. They have a high cost of removal and no adequate solution has been found. If cows milk producers are forced to install biological stations for effluents with a high cost they will go out of business unless they get generous grants for the purpose by the Government
- As far as mills (on farm) for the preparation of feeding stuff are concerned, subsidies were already given to modernise and conform with international standards
- As civil servant employees lack knowledge and EU experience, subsidies can be lost and advice given to farmers is sometimes incomplete or misleading.
- CCPO has the opinion that CAPO should have autonomous services rather than delegate them to others (in this case CMIO)

The Cyprus Government is urgently preparing legislation in order to enable the Committee which has been set up to prepare the case for registering halloumi cheese as a designated protected product of Cyprus Origin to submit the relevant documents to Brussels in 2006.