



Rabobank

The Devil is in the Derogation

research.rabobank.com/far

RaboResearch

Food & Agribusiness
far.rabobank.com

Matthew Johnson
Analyst - Dairy

Dutch dairy farming is potentially on the brink of a seismic change. After years of argument and negotiation, a potential agreement on phosphate regulations was abandoned.

On 13 October, Dutch Minister for Agriculture, Martijn van Dam, announced that the agreement on reducing phosphate through the issue of phosphate permits (which would immediately acquire a market value) had been abandoned due to infringing EU regulations regarding State Aid. And this will create a problem, because by failing to make a successful proposal to reduce phosphate, the Dutch Government risks losing a 'derogation' (special permission) it has from the EU Commission on nitrate levels. Losing this derogation could deal a massive blow to Dutch dairy farmers and the wider industry, as 3.5m tonnes of milk could be lost.

What had been agreed?

Dutch dairy production has always been intensive. Dutch milk production produces 13,000kg per hectare. In comparison, Germany, which is the largest producer of milk in Europe, produces just over 7,000kg per hectare. Therefore, the Netherlands has always been keen to include environmental considerations.

Over the last few years, discussions have focused on the amount of phosphate produced from the manure excreted by dairy cows. The proposed legislation sought to reduce the amount of phosphate produced through the issuing of phosphate permits. According to a specified reference rate, farmers would be issued with phosphate permits which could be traded. Every time these permits are traded, the government would remove 10%, providing a 'sinking lid' to the amount of phosphate.

Combining initial reductions with the sinking lid suggested that cow numbers would fall by just over 200,000 head and that milk production could drop by more than 1bn kg in the next two years.

Why it fell down?

The 'problem' with the phosphate permits issued by the Dutch government is that they will be transferable, and therefore will have a value.

To preserve fair competition across the EU market, individual states are not normally allowed to provide businesses with grants or subsidies that are unavailable in other EU states. Such grants are viewed as a 'state aid'. Those circumstances where state aid is allowed are covered by complex rules. These rules state that you cannot use state aid for a situation where an EU regulation is being or has been breached. Unfortunately, the Netherlands has breached the required levels of nutrient applications in the past, so the plan proposed by the Dutch government has been judged to be illegal.

Losing the derogation could mean...?

This reaction by the EU Commission means that a new solution has to be found—and the pressure is building. This is because if no solution is found, the Dutch government could lose its derogation covering nitrate usage from the EU Commission.

This 'derogation', granted in recognition of the intensive nature of Dutch agriculture, is a special permission allowing Dutch farmers to apply more nitrates to land compared with other EU regions—for farms which are 80% grass, the annual application from manure can be 250kg per hectare compared with the norm of 170kg per hectare elsewhere in Europe.

The derogation was conditional on meeting requirements, including the regular monitoring of groundwater levels and complying with required phosphate restrictions. The failure to introduce a control mechanism raises the possibility that the derogation on nitrate levels will be lost.

If this happened, it would mean an immediate 30% cut in the amount of nitrates that can be applied to land. Given that most nitrates come from manure rather than artificial fertiliser, it could effectively mean a requirement to cut the Dutch dairy herd by nearly 30%. It will depend on the yield of the remaining animals how much milk would then be produced. Assuming 500,000 cows were removed (approx. 30% of the national herd), with an average annual yield of 7,000 kg per cow (assuming lower yielding animals are culled first), this would mean 3.5m tonnes of milk being lost—equivalent to 26% of the milk produced in 2015—impacting both farming operations and the wider industry, following capacity expansions in the lead up to milk quota removal in 2015.

Imprint

RaboResearch

Food & Agribusiness

far.rabobank.com

Matthew Johnson Analyst - Dairy

© 2018 – All rights reserved

This document has been prepared exclusively for your benefit and does not carry any right of publication or disclosure other than to Coöperatieve Rabobank U.A. ("Rabobank"), registered in Amsterdam. Neither this document nor any of its contents may be distributed, reproduced or used for any other purpose without the prior written consent of Rabobank. The information in this document reflects prevailing market conditions and our judgement as of this date, all of which may be subject to change. This document is based on public information. The information and opinions contained in this document have been compiled or derived from sources believed to be reliable, without independent verification. The information and opinions contained in this document are indicative and for discussion purposes only. No rights may be derived from any potential offers, transactions, commercial ideas et cetera contained in this document. This document does not constitute an offer or invitation. This document shall not form the basis of or cannot be relied upon in connection with any contract or commitment whatsoever. The information in this document is not intended and may not be understood as an advice (including without limitation an advice within the meaning of article 1:1 and article 4:23 of the Dutch Financial Supervision Act). This document is governed by Dutch law. The competent court in Amsterdam, The Netherlands has exclusive jurisdiction to settle any dispute which may arise out of or in connection with this document and/or any discussions or negotiations based on it. This report has been published in line with Rabobank's long-term commitment to international food and agribusiness. It is one of a series of publications undertaken by the global department of RaboResearch Food & Agribusiness.

