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Eurointegration 2.0

THE UKRAINIAN DAIRY SECTOR VOLUME 2: DAIRY SUPPLY CHAIN BOTTLENECKS

Author: Valentyn Litvinov

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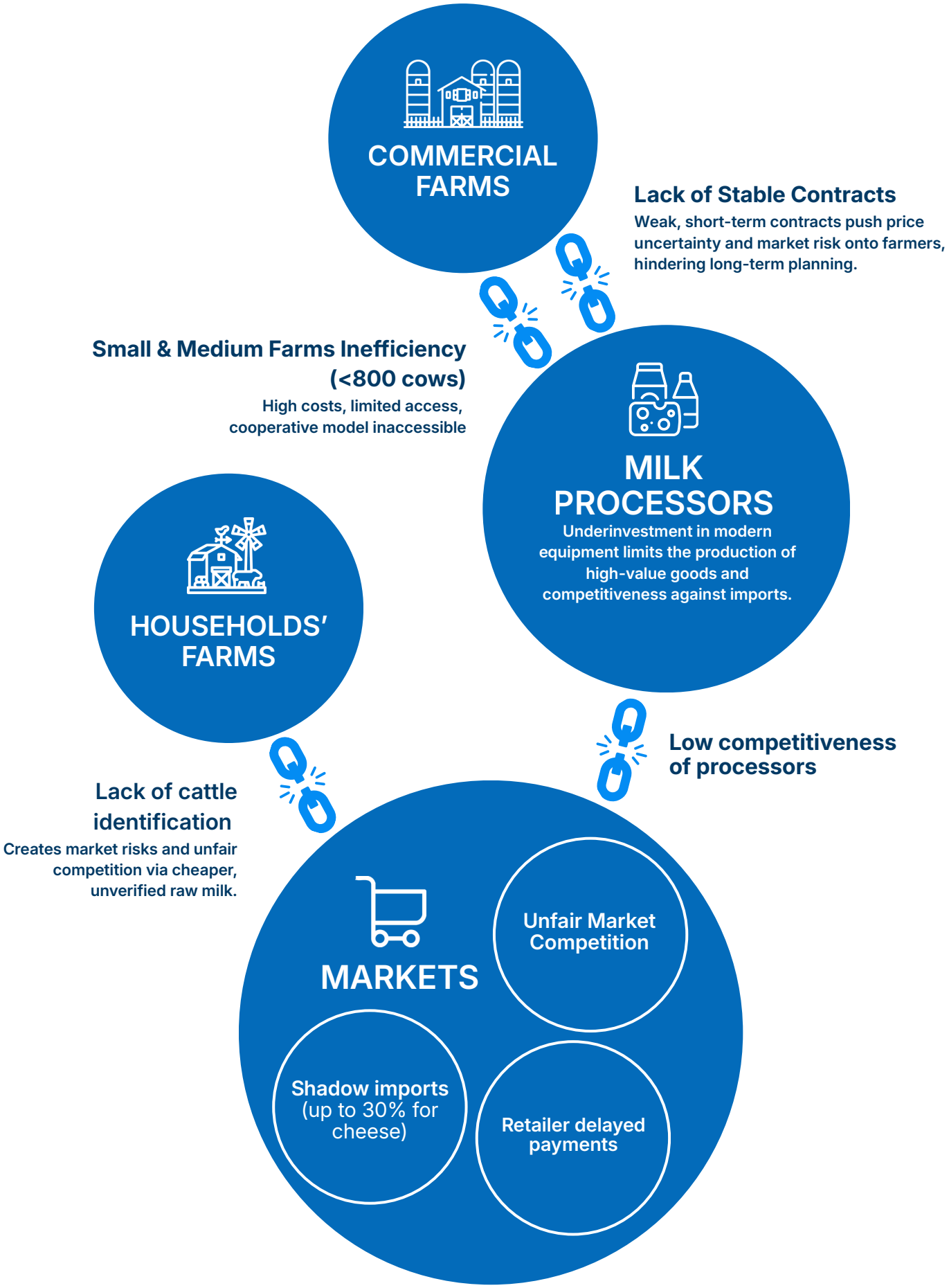
Figure 1. Bottlenecks Summary



This volume advances *Eurointegration 2.0: The Ukrainian Dairy Sector*[1] by shifting the focus from the sector's assessment and alignment with the EU to the **operational bottlenecks that constrain the dairy supply chain in practice.** While regulatory convergence and market access are steadily advancing, persistent failures in coordination, contracting, investment, and market institutions continue to fragment value creation and weaken incentives across the chain. Identifying and addressing these bottlenecks is critical for translating eurointegration into sustained productivity growth and competitiveness.

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BOTTLENECK 1. WEAK INSTITUTIONAL CAPACITY FOR TRANSPARENCY AND EQUAL ACCESS TO THE MARKET

Institutional gaps in key areas of (1) transparent traceability of cattle and milk from households, (2) the enforcement of equal market access, and (3) the anticipation and prevention of potential abuse of market power by downstream actors have created a bottleneck in the dairy sector.

Although state statistics report the number of cattle and the volume of milk collected by households, these figures are largely based on estimations rather than on an actual count of animals. Due to the slowed process of animal identification, mainly due to halted payment schemes for animal registration, the real number of cattle kept in households may differ substantially from official data. This creates risks for equal market access, as dairy products produced from raw milk purchased from households (which is cheaper but, in most cases, characterized by unverified indicators not for compliance with safety and quality standards) directly compete with products from dairy farms that use more expensive raw milk complying with regulatory and market standards.

Another source of market distortion is the presence of unaccountable (shadow) imported dairy products on the consumer market. These products are imported with partial or no

1 https://kse.ua/wp-content/uploads/2025/10/Eurointegration-2.0.-The-Ukrainian-Dairy-Sector.pdf

duties and taxes paid, which distorts competition and undermines supply from official domestic producers. Taken together, the shadow market may account for up to 20% of total market volume, and for certain products (e.g., cheese) - up to 30%[2].

Finally, downstream actors, namely retailers selling processed dairy products, may abuse their market position due to poorly regulated payment terms[3]. In practice, this takes the form of delayed payments for finished products supplied by upstream to downstream players (often, from dairy processors to retail). Such behavior effectively drains liquidity from processors, who in turn are unable to pay dairy farms for raw milk on time and in full. According to interviewed experts, the entire sector is effectively providing interest-free credits (in the form of delayed payments to upstream processors and producers) to retail chains, financing both their operational and investment expenditures.

According to the OECD Producer Support Estimate (PSE)[4], Ukraine has recorded predominantly negative market price support (MPS) for milk over the past decade, meaning that domestic producer prices have often been kept below international reference levels. In effect, income is transferred away from farmers, and milk producers frequently receive less than the "economic" market price for their output, undermining incentives to enter into longer-term commitments in terms of herd quality and size.

BOTTLENECK 2. THE COOPERATIVE MODEL REMAINS INACCESSIBLE, REINFORCING THE STRUCTURAL INEFFICIENCY OF SMALL DAIRY FARMS

Ukraine's gross raw milk supply is still dominated by household producers with 1-3 cows focusing on semi-subsistence productions and when entering the market, receive a negative price premium (typically 60–70% of the price paid to commercial dairy farms) due to lower quality and safety standards. Small (up to 100 cows) and medium-sized farms (up to 400 cows), while generally able to produce safe and marketable milk, face strong efficiency pressures. According to interviewed experts, an economically efficient dairy herd starts at around 800–1,000 cows, as this scale allows farms to assemble milk batches that match the capacity of milk tankers, thereby reducing transportation costs through more efficient use of

2 https://avm-ua.org/uk/post/obsag-sirogo-importu-siru-ak-potraplae-v-ukrainu-comu-ce-skodit-ekonomici-kraini-olena-zupinas
3 https://itd.rada.gov.ua/billinfo/Bills/Card/59328
4 https://doi.org/10.1787/a80ac398-en

collection vehicles and ensuring a stable supply volume sufficient for processing plants. In addition, farms of this size typically operate modern milking parlors equipped with rapid milk-cooling systems that chill milk immediately after milking before it enters storage tanks, helping to preserve quality. Farms below this threshold are more likely to struggle to supply processors consistently and competitively.

Labor availability constitutes an additional constraint. Small and medium farms often lose competition for qualified labor because, due to lower turnover, they are less able to offer competitive wages. This problem is particularly acute for small farms and medium farms, which frequently cannot match the salary levels offered by larger dairy farms. Combined with the severe labor market crisis and shortages in labor supply, this further increases pressure on dairy producers.

Land availability is another critical factor. To maintain sufficient rough fodder production, dairy farming requires approximately 1 hectare of land per cow. This creates an additional burden for farmers, who must either purchase land or compete in the rental market.
In principle, cooperative processing enterprises could help align and balance risks between small and medium milk producers and processors. However, the establishment of cooperative processing remains difficult in practice. Key barriers include the absence of comprehensive legislative regulation (in particular with respect to the taxation of patronage dividends), limited access to investment capital for the construction of large-scale cooperative processing plants, and restricted access to stable sales markets.

BOTTLENECK 3. LACK OF STABLE CONTRACTUAL MODELS

Written bilateral contracts govern Raw milk procurement in Ukraine; however, these contracts do not fully constitute stable, market-coordinating instruments. They typically comprise frequent price revisions[5] and lack long-term production volume planning; moreover, they lack a transparent, market-wide pricing formula and enforceable mechanisms for mid- and long-term planning, resulting in high price uncertainty and weak risk-sharing between dairy farms and processors.

In practice, milk prices are determined through bilateral negotiations and periodically revised

5 https://milkua.info/uk/post/na-rinku-moloka-ukraini-planuut-zaprovaditi-dovgostrokovi-cinovi-ugodi
Written bilateral contracts govern Raw milk procurement in UkrainWritten bilateral contracts govern Raw milk procurement in Ukraine

price protocols rather than through objective pricing mechanisms. As a result, price shocks are rapidly transmitted to the farm level, while farmers, given their weaker market position[6], absorb a larger share of market risk. Existing contracts rarely include symmetric and enforceable safeguards to ensure compliance by both parties, such as penalties for systematic underdelivery by farms or unjustified refusal by processors to accept raw milk of agreed quality outside force majeure circumstances. The absence of such provisions limits coordinated planning of raw milk volumes and weakens trust and predictability in farm–processor relationships.

In the European Union, the Common Market Organisation Regulation (EU) No. 1308/2013[7] explicitly promotes written contracts for raw milk, typically with minimum durations of at least six months, and allows Member States to make such contracts compulsory. These contracts often include objective pricing formulas linked to dairy commodity or cost indices, which reduces price volatility and improves the predictability and bankability of supply relationships.

BOTTLENECK 4. CHRONICALLY UNDERINVESTED AND TECHNOLOGICALLY OUTDATED PROCESSING LINES

The competitiveness of Ukrainian dairy products is constrained not only by price factors but also by the prevailing processing model. Limited and uneven investment in large-scale, modern, high-technology, and deep-processing capacity restricts the generation of value added and reduces the ability of processors to diversify toward higher-margin dairy products and to systematically expand sales channels. As claimed by experts interviewed, a significant share of processing capacities remains oriented toward basic commodities with low processing depth, despite partial modernization in recent years.

This structural limitation weakens the position of domestic processors on the internal market, where they face strong competition from imports originating in neighboring countries (most notably Poland), whose dairy sectors are characterized by more technologically advanced and integrated processing systems. In these systems, products such as block cheese (e.g., block Mozzarella, Gouda/Edam) are often produced as by-products of more sophisticated processing lines, allowing processors to achieve lower unit costs and offer more competitive prices on the Ukrainian market.

6 https://doi.org/10.51599/are.2022.08.01.08
7 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?u,ri=CELEX%3A02013R1308-20230101

The same technological constraints limit the ability of Ukrainian processors to consistently transmit quality-based price premiums to farms. In particular, witnessed imperfect milk separation and standardization technologies reduce processors' capacity to fully capitalize on higher protein fractions, even when higher-quality raw milk is supplied. Although more than 50 Ukrainian dairy plants have modernized production lines and obtained certification for exports to the European Union[8], policy and industry experts indicate that inefficient and technologically outdated equipment remains widespread across the processing plants.

As a result, the sector's overall processing efficiency and capacity to produce higher-value products remain constrained, which in turn limits the establishment of stable, contractually secured export flows. The absence of technologically driven scale and product diversification reinforces reliance on domestic markets of lower-value products (mostly drinking milk, yoghurts, kefir) while failing to compete with imported products fully.

BOTTLENECK 5.
FRAGMENTED SUPPORT POLICIES

The development of efficient sales markets in the dairy sector is constrained by the fragmented and inconsistent role of the state in market regulation and support. Historically, agricultural policy in Ukraine has combined systematic production subsidies (such as per-head payments and compensation for capital investments) with ad hoc market interventions. In practice, payments linked to stock of animals or production volumes have often depressed producer prices for key commodities while sustaining inefficient producers, thereby distorting market incentives[9] and weakening price signals along the value chain. In turn, experts' interviews indicate that compensation mechanisms for capital investments and access to concessional credit have been fragmented in time, insufficient in support value, and imperfect implementation mechanisms, limiting the ability of dairy farms to utilize these support instruments effectively.

Analysis by the World Bank further indicates that public spending on agriculture is around 0.33% of GDP and poorly aligned with productivity growth and structural transformation[10], calling for a reorientation toward innovation, risk management, and infrastructure. In the dairy

8 https://www.agroberichtenbuitenland.nl/actueel/nieuws/2024/08/08/ukraine-dairy-challenges
9 https://doi.org/10.22004/AG.ECON.44059
10 hrequirementstottps://documents1.worldbank.org/curated/en/099062524074615884/pdf/P1801981319afe091b8b71b33b7a901d4e.pdf

sector specifically, repeated episodes of large negative Market Price Support (domestic farms receive prices below costs-adjusted international reference levels) - 16% of gross commodity receipts in 2022-2024, EUR 33 million in 2024[11] despite nominal per-head payments and capital investment subsidies. At the same time, support for general services, including research, innovation, SPS services, and infrastructure, remains very limited by international standards (only about 0.8% of the value of agricultural production).

This bottleneck is further intensified by Ukraine's ongoing adaptation to the EU requirements. Alignment with EU standards implies that milk from household producers will no longer be marketable in its current form, requiring their transformation (e.g., into family farms or craft producers), a process more complex than the adjustment faced by commercial farms. Industrial farms will encounter stricter animal-welfare requirements and higher feed costs due to tighter restrictions on plant protection products. Together with adverse demographic trends, these factors increase uncertainty around future production volumes and prices. At the same time, weak development of stable export channels and markets for higher-value dairy products constrains investment incentives along the value chain. In the absence of fair, transparent, and predictable domestic market rules, supported by stronger general services, both dairy producers and processors face limited market access and distorted price formation, reinforcing this bottleneck.

11 https://doi.org/10.1787/a80ac398-en

Contacts

Center for Food
and Land Use Research (KSE Agrocenter)

Kyiv School of Economics
Mykoly Shpaka St, 3

www.agrocenter.kse.ua

mbogonos@kse.org.ua
vlitvinov@kse.org.ua

Telegram chanel
KSE Agrocenter

www.kse.ua

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