Monitoring Agency –

A flexible supply management instrument for the European milk market

Summary of the expertise

commissioned by the European Milk Board (EMB)

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Preliminary remark

The political process for the reshaping of the European milk market after 2015 has not yet been completed. The European dairy farmer associations represented by the European Milk Board (EMB) already developed the political demand for flexible and temporary regulation of supply with the assistance of a **Monitoring Agency** during the milk crisis of 2008/09**.**

Their expectations from this supply management instrument are that it:

- adapts the produced volume of milk flexibly to demand based on the direct responsibility of the market partners;
- keeps the prices within a target price bracket, thereby containing price fluctuations and helping to stabilise the prices at a cost-covering level;
- creates a reliable framework for sustainable milk production;
- guarantees the supply of high-quality milk to consumers throughout Europe.

The European Milk Board commissioned the "Landforscher" to draft arguments and considerations which speak in favour of establishing this instrument. The following will be presented:

(1) Initial considerations on the consequences of the milk crisis and the instruments which will be necessary in future to safeguard a sustainable milk industry in Europe.

(2) The concept of flexible and temporary regulation of supply and the functioning of a Monitoring Agency.

(3) The expected effects.

Preliminary remarks on the forecasts, empirical values and method adopted in this study:

The estimates made by this expertise are founded both on data-based trends and in particular on the concrete experience made by dairy farmers on the milk markets and which they continue to make on a daily basis.

We have deliberately refrained from making mathematically simulated forecasts about the functioning of the proposed instrument. Experience with this type of forecast and our own investigations have shown that the results hardly withstand real developments. In view of the high complexity, above all of the price structure, the mere omission or addition of individual factors leads to large and different forecast results.[1] *Our own examinations of the OECD price forecasts demonstrated that neither the strong price fluctuations*

[1] IDFA (2012): DMSP Potential Impact on U.S. Dairy Exports. Informa economics, p. 9 and p. 12 "Models, by definition, are simplifications of more complicated systems. It simply is not possible to include all of the potential influences on exports in a single equation (…) While we do not have a conclusion about what the "right" way to model U.S. exports is, the discussion does show how difficult modelling exports is and how adding or removing a single variable can have a large impact on the estimated elasticity and consequently have a large impact on the final quantities and prices generated by the models under various scenarios."

nor the crisis could be covered by them. The constantly positive price forecasts therefore had to be corrected to suit reality after a very short period of time.[2]

Developments in the milk sector: Why flexible supply regulation is necessary

1. Milk is a traditional and valuable food in Europe. 32 million dairy cows provide the foundation for its production. This in turn represents 13 per cent of the value of European agricultural production (2011).[3] Milk production has characterised the countryside for centuries. It offers income to a large diversity of dairy farms and is simultaneously the basis for a sales-strong and employment-intensive milk industry. Europe is the world's largest milk production area with a sales market of 500 million consumers which by far exceeds the size of the global milk market [outside Europe]. From a global point of view, milk production increases in correlation to the growing population and the assumption of western consumer habits as a consequence of improved income and urbanisation.

2. The EU milk market has been strongly regulated since it was founded in 1968. In the same way as regulation in many other industrial countries, this goes back to the experience made in the worldwide economic crisis of 1928. In the EU the objectives and recitals formulated in Article 39 TFEU continue to be seen as the reasons for this regulation:[4] (1) stabilisation of the markets, (2) safeguarding of a fair standard of living for the agricultural population and (3) securing the supply to consumers at appropriate prices.

Since the 1990s, political (WTO negotiations) and economic forces have been pushing towards globalisation and therefore a deregulation of agricultural and also milk markets. Many states have nevertheless kept the regulations of the milk market. In Norway, Israel and Canada the milk market order is geared to domestic consumption and stabilising producer prices. In the USA the dairy farmer federation developed a programme proposal in reaction to the milk crisis which, with the assistance of voluntary supply regulation, directly intervenes in the milk (surplus) supply to stabilise the markets and farm gate prices. It was still unclear in August 2013 whether this programme, which has already been approved by the Senate, is to be incorporated in the new Farm Bill or not.

Deregulation and the consequences of the milk crisis of 2008/09

3. **The milk market has been in the process of deregulation since 2003** with the objective of improving competitiveness on the world markets.[5] The milk quotas will also expire in 2015. In

[2] Poppinga (2012): Paper given at the BDM Milk Conference East Frisia in Hesel on 9.4.2012.

[3] Marquer, P. (2013): Milk and dairy production statistics. Statistics in focus 17/2013. http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Milk_and_dairy_production_statistics, download on 14.08.2013.

[4] Treaty on the Functioning of the European Union, Official Journal C 115/47 of 9 May 2008. Article 39 corresponds to the former Article 33 of the Treaty on the European Union.

[5] Recital 4 of Regulation (EC) No 1255/1999 and Recital 16 of Regulation (EC) No 1234/2007.

preparation, the milk quota was gradually increased as from 2004/05 (by 9.8 per cent in total by 2015). Masked by nominally stable prices, the dairy farmers of the five major producer countries have been confronted with the issue of **declining farm gate prices in real terms since the 1990s** (a drop of 55 per cent between 1989 and 2006).[6] **As a consequence of deregulation (abolition of the reference price, reduction of the intervention price level to a very low level), the prices also dropped nominally as from 2003. Since then, however, they have also increasingly followed the course of the volatile, i.e. steeply increasing and decreasing, global market prices**.[7]

4. **The milk crisis of 2008/09** followed a price boom on the world markets in 2007. By June 2009, milk prices in the EU-25 slumped by 25 per cent compared to the previous year and therefore to far below the production costs.[8] Whilst it was possible for the first time to make exports to third countries without additional export refunds, this crisis was a disaster with long term consequences for Europe's dairy farmers on the whole despite large differences between the Member States:

   - The price slump by an average of 24.5 per cent (2009 compared to 2008 / minus 18 per cent for 2009 compared to 2007) lead to **lost revenue** of 11 billion euro in 2009 alone.[9]
   - The specialised dairy farms (see Table 1) suffered a **drop in income** of over 6 billion euro.[10] In the EU-15, their income fell below the level of 2001 (in nominal and real terms). The net profit margin per tonne of milk (revenue from milk less non-specific costs, depreciation and fixed costs) dropped from 64 euro in 2007 to 9 euro in 2009. The significance of direct payments to income in the EU-15 increased accordingly from 44 per cent (2006) to 64 per cent (2009).
   - This too was characterised by great differences between the Member States (see Table 2). Whilst in Italy the crisis was noticeable to some extent at high level, the losses amongst the Danish dairy farmers were devastating. Their net income per worker dropped to minus 36,563 euro in 2009. This is associated with the fact that 47 per cent of agricultural workers are wage earners and the Danish farms have to bear high capital costs as a result of inheritance law. Both cost factors rose steeply between 2007 and 2009 (a rise of 19 per cent for wages and of 27 per cent for capital costs) and could no longer be recovered from the lower revenue.[11]

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[6] If, however, the deflated farm gate price is considered, and if it is assumed that the year 2000 = 100, the prices dropped from 1989 (index 140) to 100 in 2000 and by 2006 to a level of 85 and therefore by 55 per cent below the level of 1989 in real terms. EU Court of Auditors (2009): P. 27 et seq. as well as Points 22 – 26 and EU Court of Auditors (2001): Special Report No 6 dated 30.10.2001/OJ C 305.

[7] The reduction in the intervention price level for butter and SMP cushions the milk prices only up to 21.5 cents/kg and therefore some 7 cents below the level of 2000. On 1 June 2004, reduction in the intervention price for butter to 305.32 and for SMP to 195.24 euro/100 kg. Since 1.9.2008, prices apply of 221.75 euro/100 kg butter and 169.80 euro/100 kg SMP. From: MIV (2012): Table 13_1. The basis since 1.9.2008 is Regulation (EC) No 361/2008.

[8] MIV (Association of the German Dairy Industry) (2010): 2009/2010 Annual Report, p. 18.

[9] Internal calculations: The paid price in 2009 was on average (EU-27) 25.6 cent/kg and therefore 8.3 cent/kg below the previous year's price of 33.9 cent/kg. Supplied volume 2009: 133,234,000 tonnes.

[10] EU COM (2013): Dairy Farms Report 2012. Only covers dairy farms with accounting starting from a specific farm size via the Farms Accountancy Data Network (FADN). The data cover 78 per cent of the 147,614 dairy farmers in the EU-27 in 2009.

[11] EU COM (2013): Dairy Farms Report 2012, P. 32. The standard gross margin is used as the basis for ascertaining the economic size of farms (expressed in European Size Units (ESU). 1 ESU corresponds to a certain amount in euro of the gross margin (from 2002 to 2009 1 ESU = 1,200 euro standard gross margin).

Table 1: Revenue, costs, gross margin and operating income in the EU-27 and EU-15						
EU-27	**2006**	**2007**	**2008**	**2009**	**2009: 2007**	**2009: 2008**
Total revenues from milk (price, national aids) in euro/t milk		344	344	286	-17%	-17%
Costs (variable costs, fixed costs and depreciation) in euro/t milk		280	301	277	-1 %	-8 %
Gross margin in euro/t milk (revenues from milk less operating costs/non-specific costs)		147	131	92	-37 %	-30 %
Net margin in euro /t milk (revenues from milk minus non-specific costs plus depreciation plus fixed factors)		64	43	9	-86 %	-80%
Farm net income in euro per labour unit[12]		16,524	15,373	10,220	-38%	-36%
Decoupled direct payments in euro/labour unit		5,431	6,107	6,027		
Share of payments in farm net income per labour unit		33 %	40 %	59 %		
EU-15	**2006**	**2007**	**2008**	**2009**	**2009: 2007**	**2009: 2008**
Total revenues from milk (price, national aids) in euro/t milk	304	350	349	293	-16%	-16%
Costs (variable costs, fixed costs and depreciation) in euro/t milk	182	201	217	198	-1.5%	-8%
Gross margin in euro/t milk (revenues from milk less operating costs/non-specific costs)	114	148	131	93	-37%	-29%
Net margin in euro/t milk (revenues from milk minus non-specific costs plus depreciation plus fixed factors)	29	60	39	5	-92%	-87%
Farm net income in euro per labour unit	22,122	28,918	23,720	16,145	-44%	-32%
Decoupled direct payments in euro/labour unit	9,825	10,467	10,496	10,310		
Share of payments in farm net income per labour unit	44%	36%	44%	64%		
Source : EU COM (2013): Dairy Farms Report						

[12] The farm net income is calculated from total revenues from dairy farming plus direct payments less non-specific costs, depreciation, fixed factors such as wages, interest and accounts receivables. See EU COM (2013): Dairy Farms Report, Annex I, P. 37 et seq.

Table 2: Gross and net margins (milk revenues less operating and fixed costs but without labour costs plus national aids) for specialised dairy farms in the EU (FADN data) in euro/t milk					
		2004	2007	2008	2009
EU-27	Gross Margin		147	131	92
	Net Margin		64	43	9
EU-15	Gross Margin		148	131	93
	Net Margin	62	61	41	7
EU-10	Gross Margin		121	110	67
	Net Margin	49	59	36	2
Denmark	Gross Margin		136	140	66
	Net Margin	2	-11	-70	-114
Germany	Gross Margin		151	91	81
	Net Margin	40	59	-2	-8
France	Gross Margin		118	121	82
	Net Margin	43	22	18	-23
Ireland	Gross Margin		157	148	58
	Net Margin	83	84	58	1
Netherlands	Gross Margin		169	146	87
	Net Margin	63	65	33	-24
Italy	Gross Margin		199	212	196
	Net Margin	130	131	151	128
Poland	Gross Margin		139	123	80
	Net Margin	70	95	66	30
Source : EU COM (2013): Dairy Farms Report					

5. In Germany it has been possible to observe the following **consequences and long term effects of the crisis** in the specialised professional dairy farms.[13] After the farm net income rose distinctly between 2006 and 2007, high income losses were recorded in the two subsequent years. At 46 per cent, these were particularly high amongst large farms (over 100 ESU or economic size class 6). These farms also had to withstand substantial **capital losses**. Extrapolated for Germany, losses of 1.22 million euro result for the specialised dairy farms in the two crisis years. Consequently, **net investments per hectare dropped**. The **farm liabilities rose for the large farms by 11 per cent** whilst in the favourable locations of the North, liabilities remained at a high lever at 31 to 32 cents per litre milk despite extension of the milk volume produced (2005 to 2009).

   If the cash flow II is considered, i.e. the free resources actually available to finance the cost of living (including costs for pensions, social insurance contributions) and to form provisions, it becomes clear that the farms could not even have paid the contributions to the social insurance scheme without additional farm subsidies (Table 3). Despite the complete use of depreciation, the cost of living would have had to have been almost completely covered by loans or by any reserves.

In 2007, the large farms in Lower Saxony (economic size class 6 with an average of 107 hectare agricultural area and 107 dairy cows in 2009) had a cash flow II without single farm subsidy of 59,291 euro to cover the

[13] FADN data, internal calculations by Onno Poppinga and Karin Jürgens

cost of living of the family (1.8 family work units). In the following crisis year, no more funds existed and without the single farm payment the farms would have had to take 1,725 euro from assets. By contrast, medium-sized farms (economic size class 5 or 46 dairy cows and 55 hectare agricultural area in 2009) would have had to have contributed 9,902 euro from assets to cover the cost of living. [14]

Table 3: Farm net income in different federal states of Germany (internal calculations on the basis of FADN data)

Federal Land	Farm net income in 2007 in euro	2008 compared with 2007	2008 compared with 2006	Cash flow II minus single farm subsidy in 2008 in euro/farm
Bavaria	55,285	61%	82%	6,936
Baden Württemberg	61,225	57%	79%	255
Hesse/RLP	64,079	64%	93%	-203
NRW	112,843	57%	93%	-9,999
Schleswig-Holstein	115,240	61%	80%	9,450
Lower Saxony	116,140	56%	87%	-4,429

Table 4: Gross investments and liabilities in the three economic size classes of specialised dairy farms in Germany from 2006 to 2010

	Gross investments euro/hectare			Liabilities euro/hectare		
	16-<40 ESU	40-<100 ESU	>100 ESU	16-<40 ESU	40-<100 ESU	>100 ESU
2006/07	465	586	695	1,284	1,810	2,233
2007/08	333	708	741	1,159	1,728	2,248
2008/09	448	591	729	1,159	1,736	2,347
2009/10	234	460	562	1,147	1,757	2,498

Despite the large differences between the regions and farms (see Table 4), a trend can nevertheless be observed in that in the years following the 2008/09 crisis, the repayment of debts was slow and in many farms the ratio of equity (whose value drops anyway due to inflation) to third-party borrowing worsened. Despite further extension of milk production, the costs per litre of milk in the favourable regions virtually remained at the high level. New investments are therefore delayed or postponed whilst other farms were still investing in the phase of the lowest milk prices.

6. **Long term consequences**: Only one year after the crisis the long term consequences were apparent in a decline in investments (e.g. in Germany by 500 million euro in 2009/10). In the summer of 2012, a "dip" in the milk prices with a simultaneous steep rise in feed and other operating costs placed many farms in a situation comparable to that during the 2008/09 crisis.[15] Many farms had made use of the government-granted bridging loans during the crisis years but

[14] Jürgens (2013): Paper given as part of a congress of the MUELV in Mainz on 13 September 2013. Data from FADN and internal calculations

[15] Fahlbusch et al (2010): Der Markt für Milch und Milcherzeugnisse. In: GJAE 59, Supplement, p. 45-62, p. 51.

had to repay these as from 2012 and could now not do so.[16] **The crisis and the subsequent years therefore led to the financial ruin of many farmers.** They lost income, were unable to reduce their debt, used up any existing provisions they may have had and some of them became insolvent. **This affected in particular the large specialised dairy farms which had grown so strongly and which were to be the backbone for the future of Europe according to politicians and consultants. In other words: they lost the financial buffer which would have enabled them to withstand another comparable crisis.**

7. One year after the 2008/09 crisis, every third dairy farmer in Europe who was still farming in 2007 (EU-27) had given up (if the period between 2003 and 2010 is considered then the figure is even higher at 43 per cent of farms).[17] The decline in dairy farms was particularly steep in the Eastern European member states who were additionally involved in restructuring their dairy industry. But also in the EU-15, every fifth dairy farmer gave up between 2006/07 and 2011/12.[18] If there are any more crises **Europe runs the risk of losing its extensive milk production.** The less favoured areas and mountain regions are particularly endangered here.

8. The milk crisis brought with it **high social costs**: public storage followed by refunds for third-country exports (totalling 703 million euro) had to be used to a greater extent.[19] A crisis fund of 300 million euro offered the dairy farmers immediate assistance (294 million euro were paid out relatively late, however) and individual member states set up their own special programmes and granted subsidies (Germany totalling 808 million euro).

9. **The consumers benefitted little.** Contrary to the assumptions of traditional economic theory, in 2009 consumer prices were still 14 per cent above the prices before the price increase 07/08.[20] The consumer prices were "largely decoupled" from farm gate prices, as confirmed by the EU Commission in its report of 2009 on the food supply chain. [21]

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[16] The Deutsche Rentenbank set up an immediate aid credit programme in 2009 which provided for one per cent interest financed by the government for four years exempt from repayment in the first year. Many farmers took advantage of this immediate assistance.

[17] Fahlbusch et al (2011): Der Markt für Milch und Milcherzeugnisse. In: GJAE 60, Supplement, p. 52-71 therein Table 9, p. 59 data from Statistical Federal Agency. Fahlbusch et al (2013): Der Markt für Milch und Milcherzeugnisse im Jahr 2012. In: GJAE 62, Supplement, p. 46-66 therein Table 8 P.54. Between 2000 and 2012, 34.4 % of dairy farmers gave up. LEL (2012): Milchmärkte 2012. Tab.12_23, p. 24; MIV (2012): Daten, Zahlen Fakten. Therein: Table 8_3_1 Milchkuhhaltung nach Bestandsgrößen

[18] DairyCo (2013): Dairy Statistics 2013: P.12.

[19] MIV (2012): Daten Fakten 2010/2012 Tab. 14_3 and Tab. 13_4_1. According to information of the EU Commission in response to the Inquiry DE-E-009016/2013 of the Green Party in the EP, the expenditure from 2009 to 2013 rose to 373 million euro export refunds and 36 million euro storage costs. Net income after sale: 50 million euro.

[20] EU COM (2009) 385: Dairy market situation 2009, P. 5; EU Court of Auditors (2009): Have the management instruments applied to the market in milk and milk products market achieved their main objectives? Point 28; EU COM (2010) 728: Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No 1234/2007 as regards contractual relations in the milk and milk products sector, p. 2.

[21] EU COM (2009) 591: A better functioning food supply chain in Europe.

Why flexible supply management is needed

10. **The 2008/09 crisis brought the structural shortcomings of pricing on the milk market which distinctly worsened the crisis to the attention of politicians and public.**[22]

    - According to the analysis of the EU Commission, imbalances in the bargaining power of the different actors in the milk market lead to unfair practices through to anti-competitive behaviour. The EU Court of Auditors determined that there is no functioning competition and negotiating environment particularly for the dairy farmers and the usual "upside down" pricing of the cooperatives was pushing the producers into the role of the "price-takers".[23]
    - In view of the poor position of the producers within the value chain, the price risks are pushed onto them whilst the resultant added value goes to the processors and the retail trade, according to the High-Level Group established by the EU Commission in the crisis.[24]
    - The deregulation process initiated by the EU had led to a little more competitiveness on the world markets, but the pressure on the dairies and also on the cooperative dairies had been increased to purchase raw milk as cheaply as possible.[25]

11. The EU Commission reacted to this by **adopting the Milk Package**, which came into force in October 2012. The objective of the Milk Package is to enhance market transparency and strengthen the position of the milk producers in the value chain by (1) contracts, (2) producer organisations and (3) inter-branch organisations such as to facilitate pricing which is more in line with the market.[26]

12. **However, the Milk Package is not enough to facilitate more market compliant pricing.** From the point of view of the dairy farmer organisations the lines drawn here to pool supply in the amount of 3.5 per cent of the EU milk produced (or 33 per cent of the national production) are by no means sufficient in view of the actual concentration of the dairies. Companies such as Friesland-Campina (NL) already concentrate 7.4 per cent of the European milk supplied, and in relationship to the EU-15 even 8.5 per cent, and cover over 88 per cent of Dutch milk. Releasing the cooperatives from their duty to conclude contracts is also not appropriate in view of the real circumstances. The "inefficiency" of the milk market will not really be rectified in this manner.

13. **The existing safety net is no protection for crises.** As part of the agricultural reform decisions in 2013, the remaining instruments of market regulation (state intervention at a continuous low level, subsidies for private storage, export subsidies are currently only suspended) in combination with direct payments from the first column of the Common Agricultural Policy (CAP) were described as a "safety net". However, the direct payments and market measures were not developed as crisis instruments but rather, according to the Commission by way of justification for the CAP, were intended to "offer a basic safeguard for the annual income of the EU farmers and support in the event of specific disturbances to the market". However, they are designed neither

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[22] EU COM (2009) 385; EU COM (2009) 591; EU COM (2010) 727 and 728; High-Level Group (2010); EU Court of Auditors (2009), Federal Cartel Agency (2009): Milk Sector Study. Interim Report December 2009, P.56.

[23] EU Court of Auditors (2009): p. 46.

[24] EU COM (2010) 727: p. 3.

[25] Federal Cartel Agency (2009): p. 58 et seq.

[26] Regulation (EU) No 261/2012; Regulation (EU) No 511/2010; Regulation (EU) No 880/2012; http://ec.europa.eu/agriculture/milk/milk-package/index_de.htm

for volatile prices nor for crises.[27] Buying up milk and storing it proved to be more effective in the crisis. However, additional state funding was required to mitigate the liquidity bottlenecks of the producers somewhat (see point 8). The basic design errors in the intervention measures are to be found, however, in the fact that the cause for the slump in prices, the surplus of milk, is not avoided and that buying up the quantities stored in the crisis then placed pressure on the world market prices again.[28]

More effective is supply regulation which addresses the cause – the milk production itself – and therefore breaks the cycle of storage and subsequent sale on the world market which serves to push prices down. An instrument is therefore required which can regulate supply in both directions and is therefore able to stabilise the internal market and the global market alike.

14. The **abolition of the milk quota without subsequent regulation endangers the stability of the single market.** Guaranteeing stability of the single market is a prime objective of the CAP and according to Article 39 TFEU justifies the intervention on the milk market to secure the common good. This stability is endangered after 2015. The milk industry itself is also expressing great concerns here.[29] At the same time it is preparing to guarantee milk suppliers a certain price level only for specific quantities (A milk) and to purchase unrestricted B milk at randomly low prices. This gives the large dairies a competitive advantage which should not be underestimated and enhances the process of concentration. At the same time, it permits an aggressive policy on the world markets which undermines the local markets. The Swiss milk industry can be examined to show which consequences may result from an uncontrolled abolition of the milk quota and the establishment of a system of A and B milk. After ruinous surpluses and price slumps, the dairy farmers have been bled dry: although the long downward price spiral was reversed for the first time again in 2013, milk production will not recover. Too many farms have given up[30] or they simply have no resources to purchase feed (bad spring) or new animals. An uncontrolled surplus production (a surplus of some 10 per cent is still being produced in relationship to the EU internal market consumption) will first jeopardise prices and then the foundation of milk production itself in the EU after 2015. This danger was pointed out by the EU Court of Auditors as early as 2009, demanding that suitable measures be taken.[31] **The EU Court of Auditors recommended in 2009 that policy be geared to the internal market. Its stability must take precedence over additional exports to third-country markets.** Based on similar concerns, the European Parliament called for the establishment of a "remunerated voluntary suspension of supply" for crisis intervention as part of the 2013 CAP reform. Even in the USA, discussions are underway with good chances of success on whether with falling profit margins a restriction to the milk produced (in return for compensation) may be helpful in stabilising the milk market and the income of producers.[32]

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[27] EU COM (2011) 625: Rules for direct payments to farmers under support schemes within the framework of the common agricultural policy, P 2; Agricultural Policy Advisory Council at the German Federal Ministry for Food, Agriculture and Consumer Protection (BMELV) (2011): Risiko- und Krisenmanagement in der Landwirtschaft, April 2011, P. 21 et seq.

[28] Fahlbusch et al. (2010): P. 59.

[29] Interview with Josef Schwaiger. www.topagrar.com/news/Home-top-News-1074996.html. Download 14. 8. 2013

[30] Milk Statistics of Switzerland (2010): Table 8.2, www.swissmilk.ch

[31] EU Court of Auditors (2009): P. 45 and a Recommendation of the EU Court of Auditors (2009): No 4, p.48.

[32] www.nmpf.org.

Flexible regulation of supply with the assistance of a Monitoring Agency

Objectives and instruments

15. The European Milk Board has described the instrument of a Monitoring Agency (MA) it has developed on many occasions.[33]

    The objectives of the Monitoring Agency are as follows:

    - Improve market transparency and send price signals of the milk market to the dairy farmers.
    - Flexibly adjust the milk production volume to demand in order to restore market balance.
    - Stabilise prices at an average cost-covering level.
    - Secure a sustainable and comprehensive milk production and supply in the European Union.

    The Monitoring Agency is a European body. The decisions of the Monitoring Agency are generally binding on the dairy farmers. The EU bestowed this power on it by legal act to take actions in a binding manner in the interest of the following objectives and to also be able to impose corresponding sanctions.

    In this way, the dairy farmers can regulate their milk supply on their own responsibility in accordance with market requirements. The balancing of interests with the dairies will continue on the market and against the background of a negotiating position of the dairy farmers which has been improved by the Monitoring Agency.

16. **Tasks and mode of operation:** The Monitoring Agency requires a binding supply regulation system implemented throughout Europe with individual supply rights on the basis of the existing milk volume distribution in Europe. The changes in volume are made flexibly, i.e. depending on the market situation. The number of volume adjustments over the course of time and the magnitude of the volume adjustment therefore result exclusively from the course taken by the market.

    The representatives of the Monitoring Agency determine the respective costs of milk production[34] in Europe and stipulate the upper and lower level of the farm gate price aspired to for one kilogramme of milk, 4.0 per cent fat, 3.4 per cent protein, in accordance with a defined method. This produces a target range (**target price bracket**) within which the average European milk price should be. If the market price strays from the set bracket, only parameters (relationship between supply and demand) are adjusted but not the pricing mechanism itself.

    If the average European farm gate price strays below the lower limit of the bracket, European milk production is successively cut back until the farm gate price is back in the bracket once again. If

[33] EMB (2012): The European Dairy Market. Supply Management with the Aid of a Monitoring Body. http://www.europeanmilkboard.org/fileadmin/Dokumente/Positions_EMB/12-02_Positions/11-01_EMB_Monitoringstelle_EN.pdf. Download 10 July 2013.

[34] For the calculation of costs and method, see Jürgens, K. (2013a): What is the cost of producing milk? Calculation of the milk production costs in Germany for the years 2002 to 2012, Report on behalf of the MEG Milch Board e.V., Gleichen.

the farm gate price exceeds the upper price limit, the milk volume is successively increased until the average farm gate price is within the bracket once again.

In view of the great diversity of the European dairy farmers, it is particularly important that the stipulations of the Monitoring Agency ensure a fair balance of interests between Europe's dairy farmers. Further studies and deliberations will be required here.

The **Monitoring Agency is funded** via a milk compensation fund into which the producers pay using a levy system (per kilogramme of milk). There may also be co-funding by the EU.

Protection at external borders outside as a prerequisite. A prerequisite for the correct functioning of the Monitoring Agency is that the existing regulations on protection from outside are maintained. These were agreed in 1998 in the Uruguay Round of the WTO negotiations and continue to apply. They provide for a customs duty for milk and milk products on the current world market price of plus 90 per cent. A customs duty free market access for 5 per cent of EU milk production (butter and skimmed milk powder) was also agreed. Hardly any use is currently made of it.

In the subsequent Doha Round which has not yet been formally brought to an end, the EU offered to reduce import duties from a current 90 per cent to 60 per cent and to forego export refunds starting from 2013. Since this Doha Round was discontinued in 2008 without results, the old agreements of the Uruguay Round continue to apply. It is to be assumed that these regulations on protection from outside will be able to be maintained because milk and milk products are viewed to be "sensitive products" for which a higher level of protection is possible.

17. **Instruments**: The calculation and definition of the average costs such as prices and in particular of the milk volume necessary for a correction are of central importance. Preliminary work has already been done and also submitted to the Commission.[35] Instruments of supply management are as follows:

    - **Basic volume.** Continuation of the national farm-level distribution of milk volumes.
    - **Supply rights.** A "manoeuvring mass" is created in an amount of three to five per cent of the existing supply rights. These supply rights will be granted to, or withdrawn from, the dairy farmers for production depending on market situation. They are granted for a restricted period and do not pass into the possession of the farm.
    - **Remunerated voluntary suspension of production.** Additionally, a certain volume produced by a dairy farm can be suspended voluntarily. The award is made on the basis of invitations to tender. Funding may be provided from a market regulation fund.
    - **Strategic storage**. Strategic storage serves (1) to balance fluctuations in milk delivery and (2) to adjust volumes until production has been adjusted (see point and 2). A restriction to 50,000 tonnes of butter and skimmed milk powder (SMP) respectively is recommended. This is similarly financed from the market regulation fund. The buying-up level should be at the lower end of the price bracket.

The Monitoring Agency improves competition on the European milk markets. It is not an instrument of market control or price fixing, because pricing takes place on the market. Competition for raw milk takes place for the first time as a result of the improved position of the

[35] Jürgens (2013b): Paper to the EU Commission, June 2013

dairy farmers and a fairer distribution of the added value along the value chain can be achieved. Only if prices have strayed from the defined and ever changeable price bracket, is the market balance restored by ordered supply regulation. Individual-farm supply rights permit politicians to promote milk production selectively and cost favourably in less favourable regions.

18. Two alternatives are possible for **implementation:** (1) **Using governmental mechanisms:** The Monitoring Agency notifies the EU Commission of any need for action. The Commission implements this and passes the stipulations on to every member state. Monitoring of compliance of the supply rights by the customs authorities in the future, too. (2) **Responsibility with national milk boards:** The national milk boards assume the task of the customs authorities and pass on the need for action determined by the Monitoring Agency to producer associations or to individual dairy farmers.

19. Experience made in dealing with the 2008/09 milk crisis and internal calculations have shown that a **reduction in the annual milk volume by 1 up to a maximum of 2 per cent** may be enough to stabilise prices (see also point 23). However, every dairy farmer knows exactly how he can increase or reduce the milk volume produced at short notice by a large number of measures, and this to a far greater extent than the one or two per cent called for. For example by: (1) reducing the use of concentrated feed, (2) feeding calves with full milk, (3) extended dry period for cows, (4) insemination of heifers later or (5) selling old dairy cows earlier than planned.

Flexibility and own responsibility

20. The instrument of supply rights opens up room for a political approach and the consideration of the great diversity of the European dairy farms and their different locations and operational strategies.

    - Regions which are particularly affected by the decline in milk (less favourable regions, mountainous areas) can be supported by an allocation of higher supply rights or by upholding the supply rights contrary to an ordered reduction in volume.
    - Special rules on the allocation of supply rights can also be agreed with young farmers and start-ups.
    - It would also be possible for directly marketed milk volumes to be basically exempted from financial participation (levy) and from regulation.

21. The proposed new and flexible system of supply regulation differs essentially from the “old” milk quotas:

    - It is made at the own responsibility of the dairy farmers, improves their negotiating position and facilitates competition for milk as a raw material.
    - It permits a flexible reaction to the market situation and a fast restoration of the market balance.
    - It functions both for surplus production and for underproduction.
    - The supply rights to be assigned in addition to the existing supply rights do not pass over to the farmers (French model) and do not therefore constitute a cost factor for the farms.

- Individual farm changes including growth are not impeded by the introduction of a price bracket. It is to be expected, however, that qualitative over quantitative changes will assume greater importance.

22. The regulation of supply by the Monitoring Agency (MA) differs from the proposal of the European Commission to establish a "remunerated voluntary suspension of production (voluntary suspension)" as follows.

    - The MA supports continuous market observation and clear rules on supply regulation. By contrast, the voluntary suspension requires a definition of a case of crisis. This definition may depend on the respective political and economic sphere of power and is at all events triggered at a lower price level than the MA.
    - The MA is binding and cost neutral. The suspension is voluntary and requires special incentives (volume remuneration) and restrictions to limit greater production by farms wishing to expand (charges).
    - The voluntary suspension can mitigate crises but cannot safeguard the average farm gate price. Therefore, the dairy farms could sustain substantial losses and it is also probable that additional publicly funded assistance programmes will remain necessary.
    - The voluntary suspension does not offer additional political room for manoeuvre for less favourable regions or mountainous areas.

    Nevertheless, the voluntary suspension is the best alternative amongst the crisis instruments so far discussed. In the same way as the Monitoring Agency, it is aimed at restoring market balance and contains surpluses when they arise.

Which effects are to be expected?

Price stability and the avoidance of further crises

23. The European milk market has a degree of self-supply of 112 per cent (2011). The experience made by all market participants has shown that irrespective of global trading with milk, only small volume changes on the EU single market and also within the member states are required for milk prices to rise or fall.

    A reduction of 0.55 per cent in milk delivery was sufficient during the milk supply boycott in 2008 in Germany to initially stop the further slump in prices. In 2012 a reduction in the supplied milk volume of 535,000 tonnes compared to the previous year's period was able to stop prices falling. This correlation was also confirmed recently by Josef Schwaiger from Germany's largest dairy DMK when he stated that "a 3 per cent higher milk volume a year ago (2012) led to price reductions of up to 35 per cent in the industrial sector. This year just under 2 per cent less milk leads to price increases of up to 50 per cent."[36]

[36] LebensmittelZeitung 25 of 21.6.2013 and internal calculations on the German milk strike and EU COM (2012): Milk Market Situation, Brussels.

During the 2008/09 milk crisis, intervention purchases caused some 1.24 per cent of the milk produced (in relationship to butter) and 1.33 per cent (in relationship to skimmed milk powder SMP) to be taken from the market. It was possible to stabilise prices in this manner. The EU Commission also indicated at a later date that 1 to 2 per cent were sufficient.[37]

24. If a Monitoring Agency had already been in operation at the time of the milk crisis, then:

    - The decline in world market prices for butter and SMP would already have been noticed at the end of 2007. By the end of 2007 at the latest, when the ex-factory prices started to fall in Europe, a resolution for the expected drop in farm gate prices could have been prepared.
    - Buying-up and storage could already have been underway when in the spring of 2008 the ex-dairy butter prices had fallen in the EU by 39 per cent and the SMP prices by 49 per cent. This could have bridged the time up to the reduction in the milk delivery volume. This would have had an impact by May 2008 at the latest.
    - Unlike the storage of surplus milk volume in full and its selloff which placed pressure on the world market price[38], the reduction in supplied milk would not have had effects on the world market but rather would have contributed to a stabilisation.
    - A crisis to the extent of that in 2008/09 could have been avoided.

25. The Monitoring Agency manages supply in line with the current market to stabilise the market balance and therefore the prices. It does this at an average European level (target price bracket). This is not therefore a stipulation of prices. Since the actual farm gate prices in the EU-27 are broadly spread (they differ by a factor of 1.3 in the EU-15)[39], the competition and incentives remain to cut costs and to manage farms economically. However, because excessively high price volatility and crises are avoided, the farms willing to expand are not exposed to financial ruin (see points 5 and 6) and sufficient possibilities remain to build up equity for further investments.

Reliable framework promotes more sustainable milk production

26. **The Monitoring Agency would offer the milk industry in Europe and in particular the dairy farmers with a reliable framework which could provide room for the development not only of an economically but also of ecologically and socially sustainable milk production.**

    This room does not currently exist. Cost calculations from Germany show that in 2012 too, the paid milk prices (an average of 33 cents/kg milk) were far removed from the costs of the farms. In the North these were 43 cents/kg and in the East 45 cents/kg.[40] In 2006 the International Farm Comparison Network (IFCN) determined milk prices which did not cover costs for the entire decade.[41] The growth steps which cannot be funded solely from the milk industry for this reason are therefore assisted publicly from the EAFRD funds in many member states.

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[37] EU COM (2010) 727: p. 4.

[38] Fahlbusch et al. (2010): SP. 53. According to Fahlbusch et al., the subsidised exports after 2009 placed pressure once again on the global market prices.

[39] MIV (2012): Daten, Fakten Zahlen 2012, Table 8_8.

[40] Jürgens (2013a): P. 26 et seq.

[41] Hemme et al. (2006): IFCN Dairy Report, Kiel.

Supply management and restoration of (average) cost-covering milk prices with the assistance of the Monitoring Agency is viewed by its critics as "a step back on the path to a modern milk industry" because it "further impedes structural change" and is geared to "non-performance-oriented" dairy farming.[42] As long as the future approach is equated with economic efficiency by using effects of scale, this criticism is correct. The instrument proposed by the dairy farmers is openly opposed to this understanding of "progress". Its suggestion is carried, however, by the knowledge that this type of "progress" in the long term endangers the basis of milk production itself, no longer complies with consumer wishes for quality (including the health of the dairy cows and an intact environment) and will also no longer guarantee the supply to the European consumers. What is more, this type of progress is not an answer to the large future challenges formulated by the EU itself (primarily climate, biodiversity).

27. **The purely quantitative growth of milk production jeopardises its very foundation: the health of the dairy cows and that of the humans looking after them**.[43] For example, the life of dairy cows has been drastically reduced under the pressure of performance (Germany 2.2 years useful life of the cows). In 2009 the European Food Safety Authority (ESFA) determined that performance-oriented breeding, intensive feeding but primarily "zero grazing", i.e. the move away from grazing associated with increases in herd size, greatly impair the health and wellbeing of the dairy cows.[44] The enlargement of dairy cow herds is meeting its limits through health problems of milkers and the shortage of skilled workers, for example, which will become an even more serious problem in the future. These limits will be overcome to only a restricted extent through the introduction of milking robots. Health problems such as chronic botulism affect animals and humans alike and could result from the combination of intensive feeding, animal management and biogas generation. The reliable framework which would be provided by a Monitoring Agency would take the pressure off the farms and permit them to concentrate more than before on improved performance over the life of the cows and on their own health and working capacity. They could make investments from an improved equity ratio and use these for competitiveness and efficiency through qualitative growth. They could react to the wishes of consumers in this way.

28. In the meantime **social resistance is growing to milk production which is driven only by economic efficiency**[45] and the ethically unacceptable development through to a type of a "disposable cow". Alternatives to this such as organic milk have claimed an established place in supermarket shelves for years even if they have not been spared quantitative growth and quality reductions. Their prices and development options are coupled with the prices of "normal milk", however. Reliable and cost covering framework conditions would also help these alternatives to develop.

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[42] Weber, S. (2013): Opinion on the supplementary proposal of the European Parliament on controlling serious disturbances on the milk market, p. 5 and 15.

[43] Hörning, B. (2013): Qualzucht bei Nutztieren. Study on behalf of the Green Party, p. 5-7; AgrarBündnis (2013): Wandel und Zukunft der Landwirtschaft am Beispiel milchviehhaltender Betriebe. Minutes and theses of the expert talk on 19 March 2013 in Kassel.

[44] ESFA (2009): Scientific Opinion of the Panel on Animal Health and Welfare on a Request from the Commission on the Risk Assessment of the Impact of Housing, Feeding, Management and Genetic Selection on Behaviour, Fear and Pain Problems in Dairy Cows. In: The EFSA Journal 1139, P.1-66.

[45] Gerlach, S. und A. Spiller (2006): Stallbaukonflikte in Nicht-Veredlungsregionen. Contribution to GEWISOLA Congress on 5 October 2006 in Gießen. http://www.uni-goettingen.de/de/34023.html. Download on 2.8.2013.

Stabilisation of the dairy farming structure and secure supply for consumers

29. **In only a few regions is the milk production industry growing; the majority of regions are losing milk. A stabilisation of the farm gate prices to an average cost-covering level could contribute to stabilising the dairy farming structure and therefore supply security in Europe. Both are endangered by the current development trends**:[46]

30. European milk production and delivery volumes are growing slowly[47] and the milk quota was undercut by 4.5 per cent in 2011/12.[48] This **under supply affects primarily the EU-10 now and in future.** In 2011/12 the quota was undercut in Bulgaria by 53 per cent, in Romania by 43 per cent and in Hungary by 28 per cent. As a result of restructuring, small farmers (above all in Romania, Bulgaria and also Poland) will no longer be available in future for local supply and it is questionable whether the large farms will permit a sufficient number of family-run operations to be established after restructuring to compensate for this loss of milk production. **But traditional milk regions are also losing milk in the EU-15, the "old" member states:** Sweden (quota undercut by 21 per cent), Finland (13.5 per cent undercut) and the United Kingdom (8.9 per cent undercut) and Austria (4.2 per cent undercut) or will be unable to comply with the ordered growth.

31. The regions with widespread pastureland, less favourable areas and mountainous regions count among the losers throughout Europe. This has already been pointed out by the EU Court of Auditors, the EU Commission itself and in 2013 once more by the Committee of the Regions (CoR).[49]

    Two thirds of the farms managing over 2.48 million dairy cows in Europe operate in these regions. Ten per cent of European milk is produced in the mountainous regions alone and in some member states such as Austria, Finland, Slovenia, this share is over 60 per cent. In other member states the mountainous regions similarly assume high importance for the dairy industry and the dairy industry for its part contributes to the maintenance of these cultural landscapes.

32. **The growth of milk production is concentrated increasingly on fewer member states and in these member states on specific regions** around the North Sea and the Atlantic: North West France, Netherlands, Denmark, northern Germany and southern Ireland. The former pastures are being transformed into intensive fodder-growing regions. This is because of the steep rise in concentrated feed prices (primarily soy, cereals), which is why the basic production of feed from the field (corn) has gained significance and the fields are used even more intensively (specialisation, multiple cuts, ploughing and new planting). Wherever possible, the pastureland is being replaced by the cultivation of agricultural grass and corn. It is questionable how a future local milk supply is to be generated in those regions which have lost milk production.

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[46] A risk which was also cited by Dairy Australia in its 2012 outlook. Dairy Australia (2012): Dairy 2012. Situation and Outlook. www.dairyaustralia.com.au.

[47] Average growth 2004 to 2009 by 0.2 per cent per year, rise in 2011 by 2.1 per cent compared to the previous year to 139 million t; 2013 plus 0.6 per cent. See EU COM: Prospects for agricultural market and income in the EU 2011-2020.

[48] Press release of the EU Commission of 18.10.2012 IP/12/1116.

[49] Committee of the Regions NAT-V-028 Draft of an Opinion, Point 26 to 28; see also EU Court of Auditors (2009): P. 43et seq. and EU COM (2012) 741: P. 8.

> ***Example of Croatia:*** *In the first half of 2013, Croatia lost 12.5 per cent of the volume of milk delivered to the dairies. In the same period, the Netherlands increased their milk volume by 2.3 per cent and the German dairy farmers by 0.9 per cent.*[50] *The Netherlands have a self-supply degree of 168 per cent. Will the Dutch dairy farmers now supply the Croatian city dwellers with fresh milk? Will tankers with raw milk now also travel to Croatia instead of Italy? Or will the Dutch and German milk end up in drying towers as has been the case so far and then sent to the bakeries of deep freeze manufacturers so that only UHT milk lands on Croatian breakfast tables?*

33. **Even today the growth (not only but in particular) of the intensive regions is reaching its limits.** In view of the fact that milk production requires a relatively high amount of space due to being used to cultivate feed and spread liquid manure, growth particularly in these intensive regions is already reaching its limits in terms of available space. In order to maintain the statutory limits of nutrient introduction to the soils and herd density, the liquid manure is spread nationally and leads to conflicts in other regions. Added to this is the climate relevance of these developments which must be given greater consideration in the future.

Opportunities for quality in the single market

34. The Monitoring Agency restricts the growth in production volume of European milk to the extent that this volume cannot be sold on the market and therefore leads to market imbalances. Instead of concentrating on cost leadership in export and therefore making greater investments in new spraying towers for skimmed milk powder production (as would appear to be necessary for some dairy processing companies in Germany[51]), the prospect of volume restriction would **promote investments in the qualitative development of the milk supply**. The new Nestlé study of 2010 has raised this subject once again: the milk industry needs qualitative growth and the segment of the quality-oriented consumers is also increasing in Germany, albeit slowly.[52] The EU Regulation 1151/2012 on quality schemes for agricultural products and foodstuffs instigated with the Milk Package and which facilitated the protected geographical indication “alpine products”, points to a direction which must be addressed politically to a greater extent in future.

35. Numerous smaller dairies have shown most successfully in recent years that **a good business can be conducted with this quality differentiation.** Large enterprises such as Friesland/Campina are now working on improving process quality. It is primarily their product “Landliebe” with the logo “genetically unmodified” that has market relevance.[53] But they also go further to prepare themselves for the future challenges (climate, biodiversity, energy consumption, health of the herd). The Dutch dairy CONO Kaasmakers is viewed to be a prominent example outside the organic segment. Together with nature conservationists, the American manufacturers

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[50] AMI (2013): Volume of milk produced in the EU 2013. http://www.ami-informiert.de/ami-maerkte/ami-milchwirtschaft/ami-meldungen-milchwirtschaft/meldungen-single-ansicht/article/milchanlieferung-in-der-eu-im-1-halbjahr-2013-ruecklaeufig.html. Download 1. 9. 2013 sowie Gloy (2013): Die Zukunft des DMK. Paper given on 4.6.2013 in Güstrow

[51] Gloy (2013): Die Zukunft des DMK, Paper given in Güstrow on 4.6.2013

[52] Nestlé (2010): Das is(st) Qualität. Abbreviated version, Frankfurt/M. quoted according to et.al (2013): p. 48.

[53] LebensmittelZeitung 2010 “Landliebe mit mehr „ohne Gentechnik”, 10.6.2010.

Ben & Jerry's (Unilever), dairy farmers and environmental protectionists, they are working on solutions as to how nature conservation on pastureland, additional climate protection through using the warmth produced from the cowshed can be combined with higher milk and therefore cheese quality (Beemster cheese) whilst at the same time achieving a fair farm gate price.[54]

Global markets – a second but well paid option

36. The establishment of a flexible supply regulation in the EU-28 will not be without effects on the global trade with milk. Conversely, the volume of the milk to be taken from the market to restore the EU market balance will also be influenced by the developments of the world milk markets and the demand here.

    Depending on respective interests, the relationship between the EU single market and the global milk market is described as:

    - An opportunity not to be missed because after 2015 a larger (and cheaper) volume of milk will be available in order to serve the "lucrative export markets" of the threshold countries.[55]
    - A necessity to stabilise the single market in view of the milk supply which is still 13.9 million tonnes above the internal market demand.[56]
    - A risk for the stability of the internal market because only small quantities of dairy products which cannot be sold on the world market are sufficient to place great pressure on internal market prices.

37. **The opportunities on the world markets essentially remain a promise.** If the quantities and values are considered then it is only the third-country business with cheese and whey which is moving upwards. Butter sales are declining and the sale of milk powder fluctuates. If one considers the promise to only sell high-quality goods, it is apparent that only ten per cent of the cheese sold in third countries in 2012 belonged to the higher quality category (more than 7.50 euro/kg). By contrast, 65 per cent of the 3.6 billion euro in cheese revenue was achieved with cheap cheese of under 5 euro/kg.[57]

38. Irrespective of the current necessity to sell the milk volume not required on the EU single market to third states, we would like to emphasize the aspect of risk. If the EU continues to focus on an export strategy, then these risks will in future have a greater effect on price volatility and therefore on the stability and the development opportunities of the EU milk market:

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[54] Pfeil, M. (2010): Kühe würden Lely kaufen. In: Brand eins, No 7, p. 93-97. Fink-Keßler, A. (2012): Milch. Vom Mythos zur Massenware, Munich, p. 241 et seq.

[55] See estimation of Weber (2013): p. 5. So far there have not been sufficient raw milk quantities to be present on all lucrative export markets. See also EU COM (2012) 741: Second "soft landing" report, p. 5.

[56] Estimation amongst other others of the ZMB Deutschland: "The export business continues to remain important for a balanced market situation. The sale of dairy products on the world market from the EU has risen distinctly with the growing supply over the past four years. (...) Presumably no further export increases will be necessary to keep the market in balance". ZMB (2012): Milchmarkt 2012, Berlin, p. 10.

[57] Wohlgemuth (2013): Außenhandel mit Käse. Found in: Foreign Trade Database of the EU (Easy Comext).

- The world milk market is viewed to be a **"thin" market,** because in relationship to overall milk production of over 614 million tonnes (2011), only 7 per cent (2012) of the milk produced or 43 million tonnes of raw milk are traded.[58]
- Only few providers of milk products (New Zealand with a current market share of 30 per cent, EU-27 with a share of 25 per cent, USA with a 10 per cent and Australia with 6 per cent share in the world milk trade[59]) are contrasted by a large number of different customers. The **market power** has been increasingly concentrated on the New Zealand cooperative Fonterra since 2001. This enterprise controls more than half of the global export of skimmed milk powder directly or indirectly.[60]
- The pricing itself can now no longer be explained solely by the "fundamental factors" of supply, demand and storage.[61] **Psychological and speculative factors** similarly play a role here.
- The milk supply and therefore the prices will in future be determined to a greater extent by **environmental and weather risks** and by costs.
- On the demand side, **the exchange rates** and therefore the developments on the international financial markets play a large role for the emerging countries (currently: devaluation in India, Brazil).
- **Global food scandals are also emerging in the dairy sector** as a result of the globalisation of the value chains. These have a strong impact on demand in part (for example, the melamine scandal in 2009 triggered the increased demand for milk powder from China on the world market; currently the DCD residue and clostridium in milk powder from Fonterra could influence demand).

39. The stabilisation of the EU internal market via flexible supply management will not reduce exports but a one-sided expansive strategy aimed at cost leadership will. The EU continues to count among the largest actors of the world milk market (No 1 is now New Zealand with 16.8 million tonnes, in 2011 "only" 14.3 million tonnes of milk were produced in the EU-27 (converted into milk equivalents). The stabilising effect on the world markets which could originate from a market balance of the EU single market should not be underestimated. Not least for this reason is the stabilisation of the markets in the USA and in the EU attributed great significance internationally - alongside the distortions provoked by climate change - with respect to the question of future stability (and avoidance of excessively high volatilities and distortions) of the global milk market.[62]

> ***International search for solutions:*** *In view of the fact that the risks of volatile prices and their negative effects on the safeguarding of food for the poor in the world have increased, solutions are now being sought at an international level as to how the globalised food markets/commodity futures markets can be regulated and how the risks*

[58] Fellmann, Th. und S. Hélaine (2012): Commodity Market Development in Europe – Outlook. Proceedings of the October 2012 Workshop. EU COM (editor) JRC Scientific and Policy Reports, Luxembourg, p. 53.

[59] Fellmann & Hélaine (2012): P. 53.

[60] Fahlbusch et al. (2009): Der Markt für Milch und Milcherzeugnisse. In: Agrarwirtschaft 58, H. 1, P. 36-53, P. 105.

[61] Fahlbusch (2009): P. 47.

[62] Dairy Australia (2013): P. 23.

of a renewed food, financial and global economic crisis can be restricted.[63] *The International Food Policy Research Institute tabled proposals for a physical and virtual food reserve in 2009.*[64] *Apart from specific storage (cereals), the Institute proposes that a further instrument be created (virtual reserve) to be able to keep the prices for contracts on the commodity future markets within a dynamically formulated price band. On straying from the price band, the amount of money made available by the countries would be used to purchase or sell futures contracts and therefore to achieve a stabilisation of the spot prices by stabilising the futures prices.*

Outlook and open questions

The 2008/2009 milk crisis did not only show the higher vulnerability of the European milk market after its deregulation, but also showed up the structural shortcomings of pricing on it. However, from the point of view of the European dairy farmers, the answers so far found - such as the EU Milk Package and the safety network of intervention and direct payments - are not sufficient: they can neither avert comparable crises nor essentially eliminate the shortcomings in pricing.

Based on the experience with the crisis, and the following developments on the milk markets and out of concern for the future stability of the EU milk market, a sufficient supply to European consumers and in particular the maintenance of development opportunities for sustainable milk production, the European dairy farmers of the European Milk Board (EMB) call for the establishment of a further reaching instrument of market observation and supply management: the Monitoring Agency.

The generally binding Monitoring Agency permits a fast and effective transmission of price signals of the market to the dairy farmers. By flexibly adjusting the milk volume produced, the market balance can be maintained and stable prices achieved within the target price bracket at an average cost-covering level. This instrument differs from the old milk quota in terms of its flexibility and orientation to the requirements of the market and through the improvement of competition for raw milk. Contrary to the "voluntary production suspension", the proposal of the European Parliament on the 2013 CAP reform, a Monitoring Agency supports continuous market observation and clear and transparent rules of flexible upward and downward supply management. This instrument also offers political room to maintain milk production also in less favourable and mountainous regions.

The European dairy farmers and the milk industry have a reliable framework in the form of a Monitoring Agency to provide room for the development of milk production which is sustainable not only in economic but also in social and ecological terms, and based on this to achieve quality-oriented production.

If, however, the EU fails to agree a subsequent supply management system after the milk quotas expiry in 2015, the objective of comprehensive milk production will be relinquished. The 2008/09 crisis was almost the financial ruin of precisely those farms willing to grow. Further comparable crises will lead to losses in the dairy farmer structure which cannot be cushioned by growth in the few

[63] FAO (2008): The State of Food Insecurity in the World 2008, Rome. See also Proposal for a Directive of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC.

[64] http://www.ifpri.org/sites/default/files/publications/20090326jvbEADSgr.pdf, download 27.07.2013.

remaining intensive regions. Growth is already at its limits here in terms of available space, environmental compatibility and the health of the cows and the humans managing them.

The existing conflict of targets of the CAP – stability of the markets/adequate income for the agricultural population/supply reliability for consumers versus improvement in competitiveness on the global markets -is answered by the instrument proposed by the EMB which moves in the direction of a stable EU milk market and farmer structure towards more sustainable milk production. This at the same time responds to the imminent global challenges. They refer not only to the question as to how a growing global population can be fed adequately and well. They also address the issue as to how the associated export opportunities are to be used. The question of a future global distribution of the risks must also be asked: risks of volatile prices ranging from the control of food and hunger through to ruinous losses of incomes; greater risks of weather and environmental influences which restrict the food foundation of dairy animals and risks of the global financial markets and food scandals which influence the demand for dairy products.

Political activity must therefore be focussed on creating framework conditions and processes which lead to a fair and global balance of opportunities and risks on the (global) milk and agricultural markets. The special challenges still to be solved in future concern maintaining the existing diversity (not only) of the European dairy farmers and giving them the opportunity to independently develop in the context of the European international and globalised markets and the companies supplying them.

This much can be said: new, flexible and resistant regulations are required which incorporate not only the global opportunities but above all the global risks of the milk markets. In this respect the Monitoring Agency would be a worthwhile approach to solving the issues. It facilitates not only a flexible stabilisation of the EU single market but at the same time strengthens fair pricing processes. It would also be a contribution of all actors of the European milk market to the necessary assumption of responsibility in solving the problems of our “global village”. Not only in Europe but throughout the world, new framework conditions and instruments are required to provide room for the development of stable markets, sustainable milk production, sustainable consumption and an associated fair balance of interests of all actors associated with milk.

The European dairy farmers of the European Milk Board have made their suggestion.