



## **Milk: High Level Group to look at medium/ long-term future of dairy sector**

*Supporting paper on the position of EUCOLAÏT*

EUROPEAN UNION  
OF DAIRY TRADE  
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EUROPÄISCHE UNION  
DES HANDELS  
MIT MILCHERZEUGNISSEN  
H  
UNION EUROPEENNE  
DU COMMERCE  
DES PRODUITS LAITIERS  
ET DERIVES

On October 5<sup>th</sup> Commissioner Fischer Boel presented a High Level Expert Group on Milk (HLG). The aim of the HLG is “to discuss medium and long-term arrangements for the dairy sector given the expiry of milk quotas on 1 April 2015”.

The HLG will study whether new arrangements should be put in place which can further contribute to stabilising the market and producers' incomes, reducing price volatility and enhancing market transparency.

### **High Level Group**

The HLG on milk started October 13<sup>th</sup> their work and was chaired by DG Demarty. Members are the Member State representatives. The HLG should deliver a report in June 2010. The following items are under discussion:

- Contractual relations between milk producers and dairies to better balance supply and demand on the dairy market
- What can be done to strengthen the bargaining power of milk producers?
- Are the existing market instruments appropriate?
- Transparency and information to consumers, quality, health and labeling issues
- Innovation and research with a view to making the sector more competitive
- A possible futures market in dairy

Several stakeholders have also asked to be involved in the discussions. After those demands the Commission decided to invite a number of stakeholders for a meeting scheduled on November 10<sup>th</sup>.

To contribute in that meeting EUCOLAÏT formulated once again its basic position towards the future dairy policy. The question is what is needed after the current financial perspectives are finalized (2013) or after the termination of the super levy (2015) .

Based on this Supporting paper, position papers will be prepared for the meetings of the HLG.

### **Position of EUCOLAÏT during the Health Check discussions**

EUCOLAÏT always pleaded for an environment in which market forces determine as much as possible commercial decisions. Trade without hindrances at the internal EU market and between the EU and the world market are at the heart of the work of this organization. To trade products the availability of enough dairy products at competitive prices and the required quality is also of the utmost importance.

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Main elements of EUCOLAIT position on dairy policy in the context of the CAP Health Check Review were the following:

EUCOLAIT gave its comment under the “unprecedented” situation on dairy markets in 2007. EU milk and dairy product prices rose to historically high levels in that year which was caused by a production deficit in key milk producing regions (including in the EU) to meet a persistent growth in demand for dairy products.

While medium term price projections are positive, the prices experienced in 2007 have proven not to be sustainable in the short term and indeed have in the last 3 months already fallen back significantly from their record levels. EUCOLAIT stated at the stake holders meeting “we are here in uncharted territory here with regards to volatility and swings”.

The following conditions were mentioned:

- EU must be able to participate in the growing world markets.
- To this end, sufficient availability of milk in the whole of the EU is key. Dairy farmers must have confidence in getting a reasonable return for their labours in order to continue to the production of milk.
- The milk quota system should be phased out by 2015 under condition of a real soft landing
- To ensure a managed change and facilitate the ‘soft landing’ advocated by the Commission towards 2015, the current market instruments will need to stay activated. Whether we like it or not, there is still a role to be played by “Brussels” in the EU dairy markets, albeit, at times, this role will be one more of an overseer, than an active player.
- It is important that this review of EU dairy policy is not based solely on the unprecedented market situation in 2007.
- The current intervention scheme for butter with a 30 000 ton ceiling should remain as a buyer at the last resort. The private storage aid scheme on the other hand is possibly the most cost effective instrument currently operated in the dairy sector and is key to limiting seasonal imbalances.
- The instruments of intervention and internal protein support should be revitalized again if needed.
- EUCOLAIT very much welcomes the Commission’s commitment to continue to pay refunds for dairy products where necessary up until 2013. It may well be necessary to reintroduce them already in 2008 if a build-up of intervention stocks is to be avoided.
- There is a strong case for the market instruments as we know them not be dismantled any further and to be used in a timely fashion to help pave the way of a smooth evolution of the sector. Bullish markets do not continue indefinitely and some market management will continue to be necessary in the future. Its timing should be pro-active and not just as last minute interventions when markets are near to collapsing.

EUCOLAIT revealed this position during the stakeholders’ conference in January 2008. It took until 20 November 2008 till a final package on the Health Check was agreed. In fact for dairy the most striking decision was the ending of the quota system in April 2015. Also the bakery scheme and the private storage regime for cheese were deleted; almost all the other elements of the market regulation stayed. In conclusion the outcome is close to what EUCOLAIT has pleaded for.

<i>Measure</i>	<i>Situation before HC</i>	<i>HC Proposals</i>	<i>After Nov 2008</i>
Intervention	Intervention at fixed price till 30 000 t butter and 109 000 t SMP	Only intervention with tender	Status quo
Quota	Fixed quota; for 2008/2009 +2%	5 * 1% extra milk till 2015	+ fat correction Front loading Ital
Private Storage	Mandatory for butter/ cheese clear conditions	Optional depending on market conditions; No cheese	Status quo for butter
Bakery program	Open/ support no	Deleted	Deleted
Casein/ feed	Open/ support no	On hold	On hold

### **Developments since the Health Check**

Due to the market developments in dairy markets in 2008 and 2009 the Commission was not able anymore merely to oversee the situation and instead was forced to act. Refunds were introduced and intervention was applied. On a political level the November 2008 Council adopted some guidelines for the future of the CAP after 2013. But member states were more interested in dairy crisis measures.

Based on demands of member states the EU Commission presented on July 10<sup>th</sup> a Communication of the Dairy Market in 2009. The communication had the character of a catalogue and member states urged for more activity of the EU Commission to stabilize dairy prices. In a letter of 8 member states of July 31<sup>st</sup> it was clearly indicated that the Communication was a good analysis but that amongst others more attention should be given to market management, in particular intervention (higher price), private storage also for cheese and increased export refunds. They also pleaded for a freeze of the quota extension.

On an Informal Council on October 5<sup>th</sup> the HLG was raised. At the next formal Council a number of emergency measures were adopted. Most important was emergency market powers of the Commission (art. 186 of the CMO) and extension of intervention possibility. Next to that the Commission made a fund available of € 280 million for dairy farmers. Herewith the Commission argues nearly all the points of critical Member States have been captured. The Commissioner repeated endlessly that the fundamentals of the Health Check were nevertheless untouched.

## **Position of EUCOLAIT in relation to the dairy crisis and the emergency measures**

When assessing the recent measures, one has to take into account the unprecedented state of the dairy market. Dairy demand was meager and supply was stable. EUCOLAIT in general supported measures which could counter this crisis in demand.

EUCOLAIT is convinced that the measures as executed recently by the EU have minimized the downturn of EU dairy markets and have contributed to recovery. Most effective tool in an emergency situation is intervention. Refunds are politically more sensitive. EUCOLAIT never actively promoted for the installment of the refunds instrument but from a retro perspective the overall assessment should be that also refunds have contributed to recovery. Conditions for usage of refunds are that they do not spoil prices at the world market and lead to extra volumes of exports. By and large these 2 conditions have been met and therefore the overall judgment of EUCOLAIT of the recent emergency measures is positive.

The present intervention level leads to milk prices of about 21 cts. It is clear that those prices are far below the cost of production. An increase in intervention prices, as has been raised lately by several member states, would be the most straight forward answer to solve this problem. Nevertheless EUCOLAIT, as a trade organization is not the first one to comment such an increase. Such an increase should not hurt EU dairy's competitive position and not lead to an incentive to produce solely for intervention. These two conditions will limit the possibilities in this area.

Next to the level of the intervention prices, volatility of market prices is seen as a major problem. EUCOLAIT is of the opinion that some fluctuation in prices, more than past years, is seen as unavoidable. The only way of restoring old price stability, like we knew in the years before the Mid Term review, is to increase intervention levels and reintroduce guidance prices. However this will bring an end to the market orientation we have seen past years. This situation is not what EUCOLAIT foresees as a preferable scenario.

Therefore we should better concentrate on avoiding the extreme volatility and accept normal volatility in pricing.

In order to avoid extreme volatility an active use of the tool box of the EU Common Market Organization is needed. Next to that EUCOLAIT has underlined the importance of futures as an instrument to cope with volatility for individual farmers, processors, traders or buyers of dairy products. At the same time also EUCOLAIT's work on futures have demonstrated that this instrument is not the overall solution.

In the future EU intervention policy could turn into buffer stock policy. However this discussion goes further than just using intervention as a way to limit price volatility and is part of the broader discussion on food security.

**Assessment regarding the usage of market instruments: the medium to long term perspective: the need for new instruments (HLG questions)**

EUCOLAIT as a trade organization is focused at the well functioning of dairy trade. Key is the availability of the required products and quality. For the maintenance of adequate supply reasonable pricing for milk as raw material is necessary. Also EUCOLAIT underlines again that the well functioning of the internal EU market as well as the position of EU dairy trade at the world market are absolute conditions. To be able to respond to the expected growing demand, in particular at the world market, we should not return to the supply management. In this sense recent developments should not question the principles of the Health Check.

Despite the fact that EUCOLAIT, together with the main international institutes like OECD and FAO, remains very positive about the long term demand for dairy products we have to look at ways to minimize extreme price fluctuations.

As we have seen past months the present set of so called old fashioned market tools, in particular intervention, did serve their goal very well. Prices of the main dairy commodities have increased from the lowest till the present levels with about 50%! In order to prevent situations with temporary shortages it is about time we feel to release in a careful way part of the intervention stock of butter and powder.

More specific on the issues of the issues mentioned as agenda points in the HLG EUCOLAIT would like to make the following remarks.

- *Contractual relations between milk producers and dairies to better balance supply and demand on the dairy market*

Although dairy trade is in general not directly concerned, contractual relations between producers and suppliers can have repercussions for dairy trade. Recent experience has shown it is extremely difficult to forecast what is needed by the processor. Next to this quantitative aspect there is also the matter of price. In a situation of forward pricing the major question is if the buyer is able to carry the increased risk. If to the contrary the environment would be more predictable and stable, with the help of market instruments, the risk for both parties to go into longer standing agreements would be more manageable.

- *What can be done to strengthen the bargaining power of milk producers?*

This question suggests that the milk producers are in general the weakest party in the chain. Fortunately this is not always the case. Often producers have a good long standing relation with the private processors or in a cooperative even are owners themselves. Of course producers have the possibility and in particular cases should align. But the point we want to make here that it is not as much the unwillingness to pay the right price, but the payment capacity which is at stake.

Interprofessional organizations are often mentioned as a means to regulate markets. EUCOLAIT would state here that that we are reluctant to this solution when it would lead to infringement of the free markets principles. Prices should preferably be determined by sound market forces and not set by cartels. If such organizations nevertheless further be promoted, it is important a common EU framework is agreed upon and that all the stakeholders are equally represented.

At the same time we see tendencies at the moment to frustrate the free internal market by national product labeling or national origin requirements.

In fact it would therefore be advisable that adequate conditions are created, a sound economic environment whereby all the various actors in the chain can flourish. In view of EUCOLAIT the best guarantee for open markets is that EU Commission maintains and executes its role as responsible overseer to guarantee the right environment. If Brussels

does not fulfill this role we are running the risk of hurting the free movement of goods within the EU.

- *Transparency for the benefit of milk producers, dairy industry and consumers*

In general EUCOLAIT appreciates efforts that could contribute to increased transparency of the dairy chain. Generic information on for instance production, storage, consumption, exports and imports are among the basic data operators in the market will need to manage their business. Apart from a wide area of information operators need also timely information. In this respect the EU could learn something from the situation in the United States where a whole range of relevant statistical information is available. Based on this information operators in the market can make funded decisions.

When we turn to quality and information EUCOLAIT can state again we support every effort which could contribute to the justified information to the consumer. In this respect marketing standards are important instruments for both producers and consumers ensuring they get the products they want. The existing standards for dairy products worked well and should stay. On the contrary EUCOLAIT opposes the misuse of certain information as a protectionist measure. In this context we have strong reservations on mandatory "place of farming labeling" for agricultural raw materials.

The previous three questions will be dealt with at the first HLG/ stakeholders meeting on November 10<sup>th</sup> 2009. The following questions are likely to be treated at a second HLG/ stakeholders meeting (not sure yet).

- *Are the existing market instruments appropriate?*

Existing markets instruments proved to be effective and efficient. In particular intervention should be one of the tools of present and future dairy policy. In the past intervention functioned as a tool to support prices to achieve the guidance price. Nowadays intervention of butter and SMP has the goal of establishing a safety net. The level of the safety net will be subject for discussion. Most important for EUCOLAIT is that, when an adaption is executed, it should not harm our competitive position. Private storage is needed as a tool to compensate seasonal fluctuations and must remain in the future.

In the Doha Development Round the EU negotiators have put export refunds on the table. Export refunds would be stopped in 2013 if other contracting parties in WTO apply equivalent measures. Initially in the WTO negotiations were foreseen to cover the period from 2001 till 2006. Now the closure of negotiations, if any, is foreseen about 5-6 years later. It is quite unique that the EU mentioned a fixed date in the negotiations. Irrespective of the willingness in the EU to apply export refunds it is from a negotiating point of view not sensible to mention a date unilaterally. EUCOLAIT always underlined the need for parallelism when discussing facing out of export refunds and other like measures. Advancing the deletion of the possibility of using export refunds will limit the tool box that might be needed when markets deteriorate rapidly. In concluding EUCOLAIT would plead for the equivalent postponement of the end date for export refunds: meaning 5-6 years later than 2013.

The internal programmes for casein support and skimmed milk into feed have been put on hold. During the past months, even when prices were at their lowest, those measures were not reinstalled. For casein support EUCOLAIT pleads therefore for the total deletion of the program. Also for other programmes of the past, in particular the bakery programme, EUCOLAIT will not plead for reintroduction since this programme involves too much administration and leaves too little room for market forces.

In summary EUCOLAIT insists in particular on an active approach for intervention as an emergency/ stabilization measure. Private storage should also be maintained. Export refunds as a tool proved to be useful but possible application depends on how far the EU limits herself under the WTO.

- *A possible futures market in dairy*

Experiences with future markets have shown that in individual cases they might constitute a risk management tool. In general, however, futures do not contribute to stability for the market as a whole. These conclusions could be drawn from several meetings within our organization on futures.

Also at the recent IDF summit in Berlin Andrew M. Novakovic, of Cornell University concluded his introduction by saying that "e.g. futures markets are often offered as a way to reduce risk, implying helping with unstable prices (...) but they don't do that, they only help with Certainty" He continued that when we want stability "Federal price supports can help with stability".

This having been said EUCOLAIT considers it nevertheless useful to develop future markets for those participants in the markets who want to invest in it. It will however not be an easy task. The first condition for a well functioning future market, being merely "price volatility" is not enough. A minimum number of participants is needed to get the market running. Participants will have to agree on standardized contracts and need reliable statistical tools. Also reliable market price information, to be able to constitute a reference price, is not available.

In summary: futures have some merits but they do not perform the sole solution to achieve a higher degree in price stability in general.

EUCOLAIT, 2 November 2009