The European Milk Board's Position Paper on the EU High Level Group Meeting on 2.2.2010

The European Milk Board welcomes the renewed involvement of the milk market players in the EU High Level Expert Group's drawing up of sustainable future models for the milk market in Europe.

We wish to point out that it is crucial to see the larger picture and think invariably in overall concepts that deal with the complexity of the market and to consider individual measures in the respective context.

In accordance with this precept here are our answers to the leading questions:

In the framework of market orientation and competitiveness, are the current intervention measures (combination of public and private storage) correctly tailored to work as a safety net in times of crisis without becoming a permanent outlet?

The experience of last year showed very clearly that the current mechanisms of intervention are not suitable for operating as a safety net for the producers' income. At the beginning of 2009, milk powder and butter could not be stockpiled quickly enough to cope with the existing surplus. What was necessary was curbing milk production in order to balance out supply and demand, and this would have not required any financial resources. In this way, the storage of 30% of the EU annual production of skimmed milk powder and 4-5% of the butter production within six months could have been avoided. These stocks will burden the balance of supply and demand in the current year, too.

Looking to the future, this means that we need regulation by the producers of the milk volume produced in order to enable them to react effectively and promptly to changes in demand.

The example of Switzerland:

This necessity is very evident in present-day Switzerland. Volume restriction at farm level was abolished; split up into 38 producer associations, the milk producers currently have no possibility of adjusting the milk volume effectively to demand. The politicians abolished state regulation without enabling the producers to operate successfully as players in the free market. At the moment the private intervention butter mountains are growing and producer prices are well below production costs.

What applies to Switzerland applies to the EU: it is especially when the state wishes to withdraw from direct supply regulation that it is obliged to furnish the milk producers as the weakest link in the milk food chain with effective mechanisms for preventing surpluses independently and under their own responsibility. What is needed in Switzerland and in the EU is a pooling of producers in large producer associations, independent of the downstream stage and legally empowered to alter the milk volume in line with the market situation.

The German Antitrust Office (*Bundeskartellamt*) also pointed out in its Interim Report on the Milk Sector Inquiry[1] published on 11.1.2010 that the influence of the producers in the market has to be strengthened. As the Office sees it, the feature of the relationship between the milk producers and the dairies (...) (is) one of an "imbalance of power to the detriment of the producers". Because the "market stage of the milk producers (...) is fragmented", while "the market stage of the dairies is more concentrated", the farmers have "no significant market power", according to the report.

The Office suggests to use the exceptions defined by the German legislator to set up regional producer associations in order to strengthen the producers' bargaining position vis-à-vis the dairies. The EMB demands that the EU go one step further and adopt a **directive exempting the milk producers from the cartel ban**, allowing them to pool their resources on a national and European level and giving them the right to take volume-regulating measures to prevent surpluses.

State or private storage is generally a mechanism only to be used with great caution and for small volumes. Sooner or later stored volumes have to be put on the market again, and so can easily upset the sensitive balance of supply and demand. They are therefore mechanisms that can only (if at all) be used by equal players in addition to an existing effective market configuration to check unavoidable production peaks.

The aim of shaping the European milk market must be – and this is stressed by the EU Court of Auditors in its recommendation[2] - to gear **milk production in Europe to the internal market demand**. The world market, it says, is only interesting for Europe in the high-price segment. Milk should therefore only be exported where high added value is possible, such as with special varieties of cheese.

In this matter the milk producers are also supported by the development aid organisations. With regard to export subsidies, these organisations have pointed out time and again that such subsidies distort the markets in non-EU nations. In concrete terms this means that local structures of milk production in developing countries are destroyed because of EU-subsidised, imported products. To some extent this has caused an increase in hunger. Examples of this are markets in Burkina Faso, Cameroon and Bangladesh.

So, from the outset Europe should only produce as much milk as can be sold on the internal market or high-price export markets. This requires a close observation of the market development, something the Monitoring Agency called for by the EMB could do.[3] But it is not enough to determine the exact market demand. In addition, the milk producers have to be put in a position to reduce or increase the milk volume. That means restrictions on volumes are still needed on an individual farm level and that a general binding commitment enables producer associations to adjust

1 The *Bundeskartellamt's* Interim Report studies the structures and the distribution of market power in the relationship between the milk producers and the dairies and in the relationship between the dairies and the trade. ("from the producer to the shop counter") www.bundeskartellamt.de
Press release in English: http://www.bundeskartellamt.de/wEnglisch/News/press/2010_01_11.php
Press release in French: http://www.bundeskartellamt.de/wEnglisch/News/press/2010_01_11.php
Press release in German: http://www.bundeskartellamt.de/wDeutsch/aktuelles/presse/2010_01_11.php

2 "The Commission and the Member States should therefore focus primarily on satisfying the needs of the European domestic market, and also on the production of cheeses and other products of high added value which can be exported without budgetary assistance." (cf. the European Court of Auditors' press release of 15.102009 ECA/09/63.)

3 Here, too, the Court of Auditors backs the EMB analyses with its recommendation: "The Court recommends that monitoring the development of the milk and milk product market should continue, so that liberalisation of the sector does not lead once again to over-production. Failing this, the Commission's objective of keeping to a minimum level of regulation, of the safety net type, might rapidly prove impossible to fulfil." (ibidem)

supply with the aid of voluntary volume reductions. A safety net without supply management, as can be seen in the phrasing of the HLG's questions, would either be ineffective for the producers because set much too low or the state could not afford it owing to the higher level of intervention and it would entail storing large volumes.

Even with less extreme price volatility there is a risk of high income volatility for farmers. Which new tools can be developed to help farmers better face market risks in order to reduce their income volatility? Could such tools be WTO green box compatible?

It is vital for milk producers that the prices they are paid for their produce cover the costs. Climate risks or a year-specific rise in feed costs have to be reflected in the farm-gate milk price. The milk producers have to be able to pass on their higher costs to the subsequent stages in the food chain, i.e. dairies, retailers and consumers.

Contracts that stipulate the volume and the price between producer and processor in the long term are unlikely to influence the total volume. Moreover, they increase the milk producers' dependence on their processors. The German Antitrust Office has already ascertained "an imbalance in power to the detriment of the producers" (see footnote 1). As the EMB sees it, nor are any new insurance models needed that are in turn financed by the producers themselves.
What is necessary instead is to watch milk producer prices and production costs closely and to align them. To do so, it is crucial to **adapt the milk supply to demand** and to **enable producers to reduce or increase their milk volumes.** In reply to Question 3, we will go into detail again about the measures proposed by the EMB that can be implemented cost-effectively and without red tape on EU level.

Permit us to comment on two other ideas that have attracted a certain amount of attention in some quarters: loss of earnings insurance and the US system of the Milk Income Loss Contract Program for Dairy Producers (MILC):

Every model of state-subsidised agricultural **loss of earnings insurance** amounts to considerable windfall gains in the private insurance industry. Put another way: sooner or later the models result in the formation of insurance annuities. These models are very expensive for the state – or after the foreseeable withdrawal of the taxpayer – in the end the producers. It is also questionable whether the milk production less subject to adverse weather conditions and therefore fluctuations in yield is at all suitable for insurance solutions. One indicator is that there are no known insurance solutions worth mentioning.

The **basic principle of the US MILC system** seems to be enticing to some member states for enabling them to legitimise direct payments in high-price phases vis-à-vis the taxpayer. It is quite a question whether the taxpayers will accept making up for the milk producers' losses caused by unnecessary surpluses through the EU budget. What is more, the system has an indirect impact on farm-gate prices, again generating windfall gains: this renewed dependence of payments on production puts the milk industry in a position to factor these state, production-dependent transfer payments back into their farm-gate price configuration. This is no incentive to bring markets into the requisite balance, quite the opposite.

***Do you see the development of a dairy futures market in the EU as relevant and adequate to enhance price transparency and improve the management of price risk? What would be the market conditions necessary for such an instrument to function efficiently*?**

A dairy futures market is definitely not a suitable mechanism for ensuring transparent, stable prices to guarantee market transparency.
Futures markets and the Chicago Stock Exchange provide only a snapshot of the prices of relatively small volumes. These are then taken as the benchmark for other price talks, although they reflect

only a part of the reality. Supply and demand determine the price, if there are many bidders and little supply one day, the price rises. The price has nothing to do with the actual value of milk and all its produce as foodstuffs. Another risk of futures markets is that international dealers manipulate them. The producers no longer have any influence on the pricing.

It is fundamental that the **price is geared to the total production costs** and must not be created by speculation. The later totally ignores the consumers' interests as they can no longer be certain of being able to rely at all times on a high-quality, socially and ecologically compatible product. Futures markets are not a suitable mechanism for ensuring price transparency and price fairness, the preconditions for a balanced milk market.

It is in fact necessary to secure price transparency. Price transparency is required especially in a market with few rules, as aspired to by the EU. Here again, Switzerland is a good example. In Switzerland there is currently a large number of different price systems operated by the dairies. This means that the producers cannot compare farm-gate prices. Surcharges, deductions, varying base prices and other special regulations are too complicated. What is needed here is a base price system and a **Monitoring Agency** that promptly publishes the farm-gate prices actually paid.

As already stated above, in its Special Report the EU Court of Auditors also stresses the necessity for **price transparency through monitoring milk prices**, both on the producer level and on the retail trade level. But price transparency is only worth it if there are mechanisms enabling the market players to influence volumes and prices.

We wish to make the explicit point that only the combination of a balance of market forces and a balance of supply and demand achieved by involving all the players concerned through a Monitoring Agency can guarantee a fully-functioning milk market. That also means that only with this approach can a high quality of product and production, dynamic rural areas, security of supply and climate protection be ensured.

We refer once more to our Position Paper of 10 November 2009, attached.