

The European Dairy Market - Supply Management with the Aid of a Monitoring Body

I. Reasoning

The structure of the European dairy market is quite special. On the producer side its main features are strong competition, a high degree of transparency and exchangeability (milk being the raw material). On the dairy industry side and particularly in the retail trade there is a heavy concentration in the hands of few companies.¹

In its study of the dairy sector the German Cartel Office wrote of the relationship between dairies and producers²: “the relationship between milk producers and dairies (...) (is) characterised by an unequal distribution of power in favour of the dairies”. According to the report, because the “milk producers’ market level is (...) fragmented”, but “the dairies’ market level is more concentrated”, the farmers have “no significant market power”. The Cartel Office attributes the farmers’ weak position of power primarily to their lack of influence on pricing. Nor does the Cartel Office see the farmers’ situation in co-operative dairies as in any way better. The report says: “Pricing from the producers’ perspective (“bottom up”) occurs – if at all – only vis-à-vis private dairies; “upside down” pricing (“the farmer gets what is left over from the sales markets depending on turnover”) occurs at present in the relationship between the co-operative dairies and their members.” In the eyes of the competition watchdogs, this upside down pricing offers “few incentives” for co-operatives “to achieve a better deal from their own customers (e.g. the trade) than if they (the co-operatives) were to first negotiate the farm-gate price with their members”.

The European Court of Auditors, too, wrote in its press release on the Special Milk Report of October 2009: “The concentration of processing and retailing companies must not reduce milk producers to “pricetakers”, and must not restrict opportunities for final consumers to fairly benefit from decreases in prices”

At the moment milk producers and end consumers are the weakest links in the milk value and processing chain. Their position vis-à-vis the other players in the dairy market must be strengthened to enable the market to function healthily. Only such a market can ensure cost-covering farm-gate prices and cater for society’s interest in a sustainable supply of high-quality milk. The volume produced must be geared to demand. To this end the European Commission ought to set up **a European monitoring body**. This monitoring body can provide the framework for a reconciliation of interests between milk producers and the dairy industry, and ensure that social concerns are respected.

¹ In Western Europe the ten largest supermarket chains have a market share of just under 40% (Vorley 2007:9). The concentration is even more marked on the level of individual member states: in Germany and France the five largest retail chains had a market share of 70% in 2007 (Agribusiness Accountability Initiative 2007)

² Federal Cartel Office (2009): Milk Sector Study Interim Report (B2-19/08), <http://www.bundeskartellamt.de/wDeutsch/publikationen/Sektoruntersuchung.php>

II. Composition

The monitoring body is set up on a European level. Each member country seconds one milk producer representative to it. The consumers are likewise involved in the monitoring body as observers, thus ensuring that their interests and the aims of the European Agricultural Policy are respected. Representatives of the dairy industry contribute their expertise on market developments. The monitoring body is also equipped with full-time specialists that collect the requisite data regarding the development of production costs, demand, farm-gate and retail prices, calculate the target price bracket, and in conjunction with the European administration implement and monitor the measures adopted. In this way the EU policy operates as a kind of guardian for the sensible configuration of the dairy market, thus creating the conditions for sustainable milk production in Europe.

III. How it operates

The monitoring body representatives ascertain the full costs of milk production in Europe, and in line with a defined procedure stipulate the upper and lower limit of the target farm-gate price for 1 kg milk containing 3.7% fat, 3.4% protein. This produces a target range (target price bracket), Fig. 1, for the average European milk price. No prices are determined or prescribed by this model. As before, prices are to be set by the free market. If the market price strays out of the stipulated bracket, parameters (ratio of supply to demand) are adjusted, but not the pricing mechanism itself. This guarantees a maximum of market economy in the dairy market.³

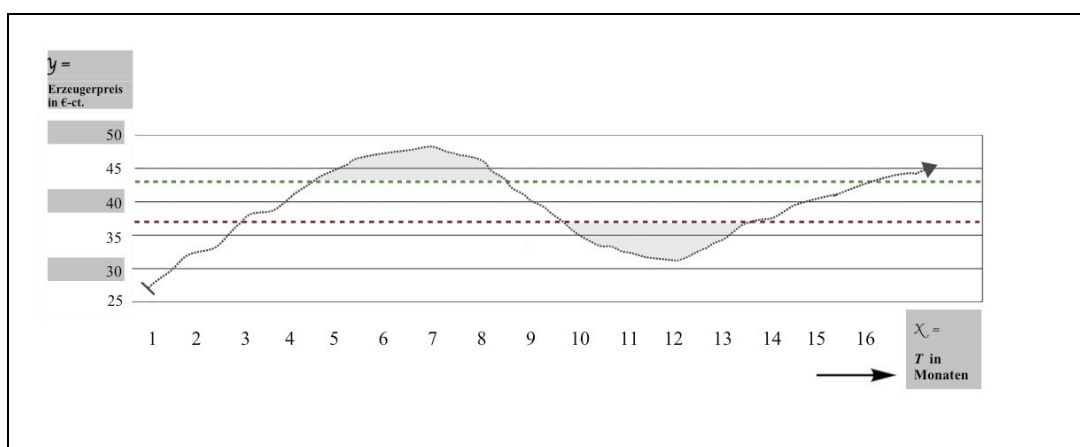


Fig.1 Example of a target price bracket (37 – 43 cents/kg fat-corrected milk, FCM)

Should the average European farm-gate price exceed the upper price limit, the volume of milk will be successively increased until the average farm-gate price is back in the bracket. If the farm-gate price falls below the lower limit of the bracket, European milk production will be successively cut back until the farm-gate price is back in the bracket. Since the milk price already reacts to changes in volume of 1 to 2%, only minor re-adjustments will ever be

³ The European Parliament also calls on the European Commission in the Bové Report to come up with new proposed legislation for reforming competition law, thus strengthening the producers' bargaining power and enabling a better organisation of small and medium-sized farms, for example in the form of dairy farmer organisations. The report further highlights the importance of cost-covering prices. <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2010-0302+0+DOC+XML+V0//DE>

necessary, as the market is monitored continuously and suitable measures are taken with regard to milk production.

It is vital to incorporate consumer representatives in this process to guarantee that decisions are transparent and geared to the aims of the monitoring agency.

IV. Preconditions

The basis requirement of this system is the continuation of an **individual farm volume limit which is universally binding** that ensures that each and every member of the national or regional dairy farmer organisations or every milk producer adheres to the stipulated volumes. A system like this has already been introduced with the European milk quota. Successive adjustments upwards and downwards have already been put into practice under the existing system. What is new is that in future, volumes will be adjusted depending on the market situation.

An **exemption clause in European Competition law** is required to enable this to be organised in the future by the dairy farmers on a more commercial basis. This must allow producers to unite in large dairy farmer organisations. A block exemption for milk producers would be a good mechanism for strengthening their market position.⁴

If Europe declares itself prepared to limit its own milk production, there are also good chances on the WTO level of **maintaining protection from outside**. This is essential for protecting milk production in Europe and with it the market for milk produce from cheap imports.

V. Administrability and costs

Apart from marginal administrative costs there will be no additional burden on the EU budget, unlike alternative approaches such as compensatory payments, intervention and export subsidies. The organisational and financial expense is extremely low and affordable by every member state, because existing structures can be utilised. Most of the data required to define the price bracket and the other data on market development can be taken from existing exhaustive surveys, meaning no extra expense on data collection is incurred. All that is needed is for the surveys to be refined, conducted on an ongoing basis and better co-ordinated.⁵ Compared to all alternative models, this model is by far the easiest to administer.

⁴ The European Milk Board's draft "Block Exemption Regulation for Milk Producers in European Competition Law" at <http://www.europeanmilkboard.org/emb/positions.html>

⁵ For instance, every three years the European Commission uses the agricultural bookkeeping available on the information network to collect data on the costs of producing milk in every member state. (http://www.ec.europa.eu/agriculture/rca/pdf/site_de.pdf) These studies would have to be carried out on a prompter basis and the costs of wages and other pricing costs also taken into consideration. They can then be used as the basis for the monitoring body's work.

VI. Practical implementation - Alternatives

a. Using existing governmental mechanisms

The monitoring body notifies the European Commission of any need for adjustment; the Commission implements this straight away and passes the stipulations on to every member state. These put them into effect accordingly; the customs authorities monitor compliance as hitherto.

b. Using national milk boards

Once the state quota regulation has been abolished, national milk boards can be responsible for implementing the monitoring body's stipulations. Where applicable they pass the stipulations on via subordinate producer organisations to the individual dairy farmers.

What is vital to the success of this commercial approach is the "universal applicability". This must be transferred by legislation from the EU to a European milk producers' organisation. This means that without exception every dairy farmer must adhere to the stipulations of this organisation under the producers' own responsibility. The "universal applicability" therefore explicitly includes the right for this organisation to be able to impose sanctions in the event of non-compliance with the stipulations.

VII. Milk volume mechanisms

A. A reserve

By setting aside a reserve of 3-5 % of the delivery rights, a "reserve volume" can be created enabling changes in the market to be reacted to promptly and without red tape.

Conditions:

- Volumes can be released on a percentage basis to dairy farmers for production depending on the market situation.
- These extra delivery rights are time-limited
- These time-limited delivery rights are not transferred to the farms, instead they are made available only for supply
- If there is a reduction in demand, these production rights can be withdrawn again promptly and without red tape.

B. Remunerated voluntary suspension of volumes

Additionally, until a sufficient "mass" is in the reserve, a remunerated voluntary suspension scheme can be applied.

Conditions:

There is an invitation to tender for the suspension

- Participation in the scheme is time-limited and relates to a farm's partial volumes
- The remuneration can come from public funds or from a producer-financed market management fund
- Super-levies can be used for financing

C. Strategic storage

The recommendation is to store a limited quantity of butter and SMP, e.g. 50,000 tons in each case.

Reasons:

- To balance natural, seasonal fluctuations in milk delivery
- To avoid supply bottlenecks

- To prevent speculation on milk products effectively
- To absorb short-term oversupplies/undersupplies in the case of necessary adjustments to production
- Financing similar to the voluntary suspension scheme

The buying-up level should be on the lower end of the price bracket. This will prevent a further drop in the price until the producers have adjusted production. In addition it ensures that when prices rise again the stored volumes can be fed back promptly into the market with no negative impact on the price. If prices rise sharply, the market can be supplied from the strategic storage until production is increased.

This strategic storage can thus be implemented with no effect on costs.

VIII. Acceptance of the model

Such a model will clearly reinforce the position of dairy farmers and consumers. Supply management strengthens the milk producers' position vis-à-vis the processing industry; the lesser volatility of the market resulting from the system strengthens the consumers' position with regard to trade speculation. The market can function better – the monitoring body creates the basic conditions for this by adjusting the balance of power and also saves taxpayers money that no longer has to be paid out on measures for distributing surpluses and on acute aid measures.⁶ Consumers can rely on stable prices on a fair level. It will be possible to maintain and develop sustainable milk production in every region of Europe. The monitoring body can therefore be expected to achieve a high degree of acceptance.

IX. Summary and global perspective

Greater market orientation and saving EU budget funds are stated aims of European politics. The Treaty of Lisbon includes the securing of a fair standard of living for those working in agriculture, and stabilising markets as aims of the CAP (Common Agricultural Policy). The European Commission's "Milk Package"⁷ proposals will not enable these aims to be achieved in the dairy sector. The proposals do not go far enough, are not consistent in their implementation.⁸ If they were to be implemented unaltered, concentration and displacement processes would be an even greater feature of the EU dairy sector than they are at present, and sustainable milk production throughout Europe would be impossible.

The EU politicians must analyse more examples from practice to gain a realistic assessment of their own course. In Switzerland, for instance, it is evident that the deregulation of the market is

⁶ Setting up a monitoring body as described is in line with the European institutions for strengthening the position of dairy farmers in the food supply chain. In the European Commission's communication on the CAP Reform after 2013 it says: "Finally, improving the functioning of the food supply chain is necessary. Long term prospects for agriculture will not improve if farmers cannot reverse the steadily decreasing trend in their share of the value added generated by the food supply chain. Indeed, the share of agriculture in the food supply chain has decreased from 29% in 2000 to 24% in 2005, while over the same period the share of the food industry, wholesale and the distribution sector have all increased." http://ec.europa.eu/agriculture/cap-post-2013/communication/index_en.htm

⁷ The Milk Package can be found at http://ec.europa.eu/agriculture/milk/index_en.htm

⁸ Initial comments in the EMB press release of 9.12.2010 at [http://www.europeanmilkboard.org/de/special-content/news/news-details/article/press-release-the-commissions-proposals-cannot-prevent-another-milk-crisis.html?tx_ttnews\[backPid\]=55&cHash=259faad81b](http://www.europeanmilkboard.org/de/special-content/news/news-details/article/press-release-the-commissions-proposals-cannot-prevent-another-milk-crisis.html?tx_ttnews[backPid]=55&cHash=259faad81b). Brief details of the EMB's standpoint on the European Commission's proposals at www.europeanmilkboard.org

causing severe problems at present. Since the quota was abandoned in May 2009, surpluses have been produced and record-high butter mountains amassed. The dream of conquering the world market with Swiss production is still just a dream. Exports have gone up slightly, but so have imports: EU milk processors use the Swiss market as a new sales outlet. Farm-gate prices are tumbling.

That is why a change in direction is already evident in Swiss politics: 16 months after the abolition of the milk quota in Switzerland the first chamber of Parliament (the National Council) voted on 1 October 2010 in favour of instituting supply management by dairy farmers. Under this regulation, which still has to be passed by the second chamber of Parliament, each producer is to continue being allowed to supply as much milk as he wants to. However, in future he will have to pay a levy of not more than 30 centimes (about 22 cents) a litre on milk produced in excess of his contractual quantity, and this is to cover the costs of offloading this volume on the low-price world market. The milk quota from the last year of the milk quota system is to be taken as the basis for the contractual quantity.

What goes for Switzerland goes for the EU: it is when the state intends to withdraw from direct regulation of volumes that it should be obliged to give the dairy farmers – the weakest link in the milk food chain – a helping hand with effective mechanisms for preventing surpluses autonomously and of their own responsibility. **The monitoring body would be such an instrument with a stabilising effect for farmers, processors and consumers.**

Australia and the USA are rethinking their deregulated systems to counteract extremely low farm-gate prices and high retail prices. In the USA they are currently discussing switching to a volume management system on a national level. These examples make it clear: volume control is indispensable. The mistakes of the countries referred to must not be repeated in Europe. There is too much at stake: the continued existence of the European model of multifunctional agriculture.

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