

COMMISSION OF THE EUROPEAN COMMUNITIES

COM (78) 430 final

Brussels, 27 september 1978

R E P O R T

on the situation in the milk sector

COM (78) 430 final

Summary

At its 516 th meeting, from 8-12 May 1978, the Council recognised the factors which continue to prevent a return to a balanced market for milk and milk products and decided to review the situation before 1 October 1978. The Commission was requested to present a full report on the situation together with proposals for any new regulations it considered appropriate (1).

The Commission has again examined the milk market situation with special attention to developments since 1968 and has assessed the effectiveness of the action taken for the progressive achievement of balance (2).

Serious imbalances persist on the Community market in the milk sector. The estimates available to the Commission indicate a worsening of these imbalances in the future. The world market is already over-supplied and there are few additional export outlets. Despite the adoption of a number of measures over the past few years, those now in force are not capable of mastering the situation. The budgetary cost of milk sector measures is becoming more difficult to support and it is clear that the high price level together with the absolute guarantee system can only encourage increased production, while consumption and outlets are more or less stable. The Commission is ^{/also} fully aware, however, that milk makes the biggest contribution to final agricultural production in the Community and that it involves the greatest number of farmers.

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- (1) See summary of the decisions taken by the Council at its 516th meeting of 8, 9, 10, 11 and 12 May 1978 (Agriculture): Document T/445/78 (AGRI) of 19 May 1978 Annex, pages 5-6.
- (2) Action programme (1977-80) for the progressive achievement of balance in the milk market (COM(76) 300 of 6 July 1976).

The Commission recommends that it is essential to define more precisely the objectives to be pursued in the milk sector. These guidelines should be: to stop the increase in production, to avoid all national and Community measures which run contrary to this objective, ^{/and} to put the stress on measures which allow the level of consumption to be maintained, to increase the outlets for milk and to reduce the milk production potential.

The Commission reiterates its intention to continue a prudent price policy, an active policy of disposal of existing stocks and to look for new outlets for milk.

In addition, the Commission will undertake active studies directed to adaptation of the existing system. To be effective, any action of this kind must restrain the incentive to produce. The Commission thinks that this could be achieved by a system linking intervention price to production or intervention quantity; or ^{by} a better use of the co-responsibility levy; or by returning some milk to producers in the form of liquid skimmed milk or powder; or by restricting unconditional access to intervention; or by a combination of these methods. Furthermore, the Commission considers that it may be necessary to take measures which will take account of the social situation of small milk producers working in particularly difficult conditions.

The analyses of the market and the discussion on possible action, after account has been taken of the views expressed by all those concerned, will form the basis for proposals to be submitted by the Commission later this year for decision in the 1979/80 price package.

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Part 1

MARKET IMBALANCE AND THE INADEQUACY OF PAST ACTION

1. Analysis of the situation of the milk sector in the Community and on the world market reveals a persistent and increasing imbalance between supply and demand due essentially to steadily increasing production and static consumption⁽¹⁾.

Internal and external demand

2. Milk and milk products are used for both human and animal consumption.

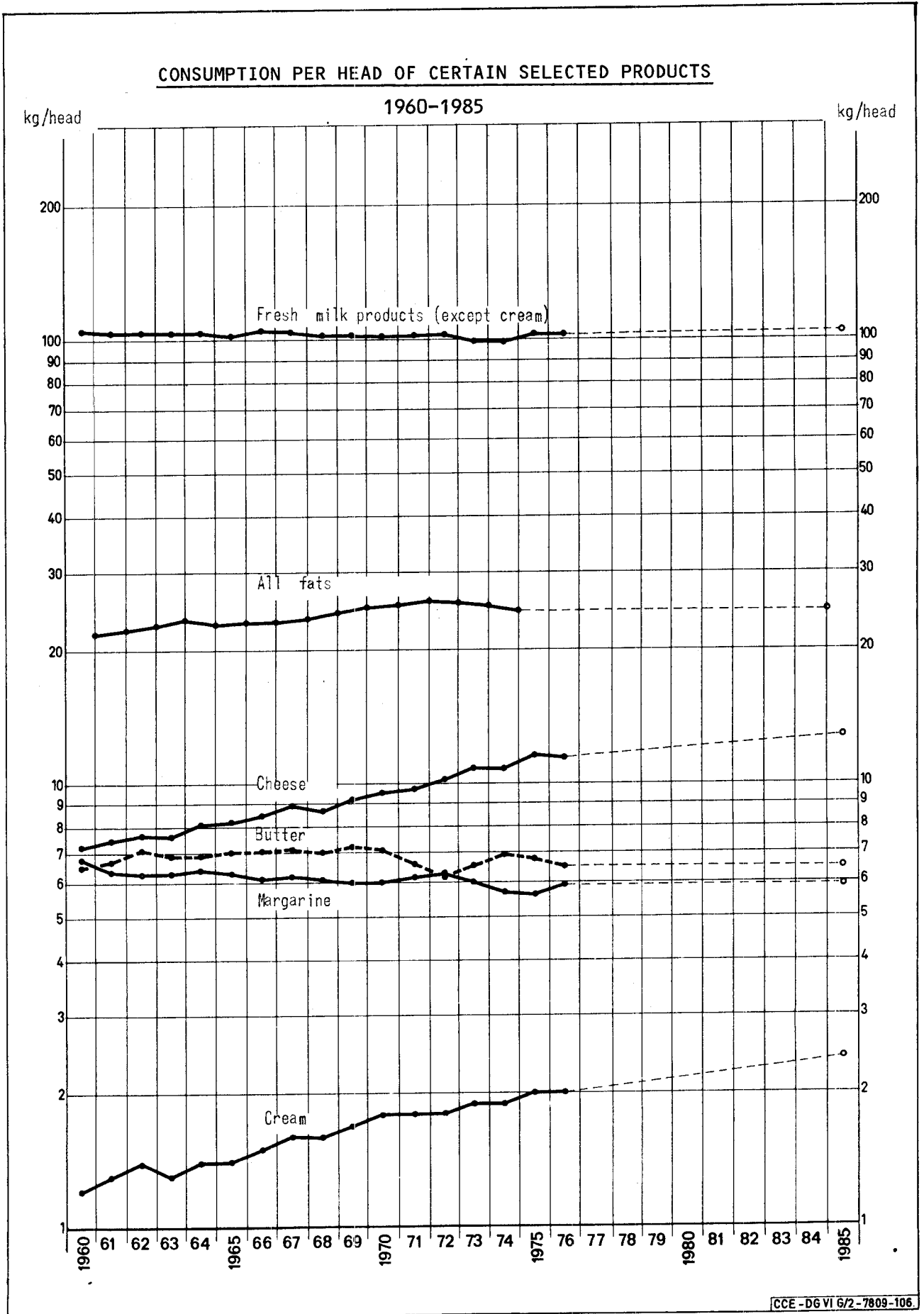
Products for human consumption are normally sold at market prices and consumption has remained more or less unchanged for four or five years. The yearly consumption per head is around 12.5 kg of fat and 7.1 kg of protein. These overall averages vary little between Member States but there is much more variation if one considers separately butter, cheese and drinking milk.

Products for animal consumption are, on the other hand, being subsidised to an ever-increasing extent and high quantities of milk protein are now being used in animal feed. The sharp fall in the price of soya since 1975 and the change in the fat/protein ratio for the valorisation of milk have led to a large increase in the aid given for milk intended for animal feeding.

3. Butter consumption per head is decreasing in the long-term; it was 7 kg in 1968 and 6.5 in 1976. The effect of high prices on consumption should be a major consideration influencing price decisions in the Community. The reasons for this decline are also competition from the substitute products margarine and table oil and changes in consumption habits.

(1) The forecasts contained in this report have been prepared by the Commission, which has taken into consideration the projections prepared by other international organizations (FAO, OECD etc.) and by national organizations.

Graph 1



The poor competitive position of butter vis-à-vis its substitutes is due to the particularly favourable terms on which vegetable fats can be imported into the Community. It is true that margarine consumption is also diminishing but it is doing so less rapidly than butter consumption. The increasing use of butter consumption subsidies has however checked this movement.

Another reason for the reduction in butter consumption is consumer desire to reduce total fat intake in the interests of a better nutritional balance, considered important for good health. Changes in working conditions are another factor leading to the establishment of new consumption habits.

4. Cheese consumption per head on the other hand is steadily increasing: it was 8.7 kg in 1968 and 10.7 kg in 1976. Because of its diversity cheese is more adaptable than certain other milk products to consumer requirements and for this reason price increases have not had as much effect.
5. Annual consumption per head of drinking milk and fresh products appears to be stable at around 102 kg. Until 1976 the fat content of these products was going down and this was only partially compensated by increased consumption of cream. Cream consumption rose from 1.6 kg in 1968 to 2.0 kg in 1976. Since then there has been a certain improvement following the fixing of a minimum fat content for drinking milk. Increased consumption can also be expected not only of cheese but also of certain fresh milk products, which are however under competitive pressure from soft drinks and the like and are also subject to competition from new products in which the milk constituents are replaced by soya derivatives costing much less.
6. Two milk products, liquid skimmed milk and skimmed-milk powder, are used principally for feeding calves and pigs. Traditionally liquid skimmed milk has returned to the farm but since 1968 there has been a trend towards the processing of liquid milk into powder. Thus, over two million tonnes of powder were produced in 1976, double the

figure for 10 years previously. More than 80% of this goes for animal feed, thanks to increasingly large subsidies aimed at making it more competitive with feeding stuffs produced from vegetable matter. Milk-based milk-replacer feed for calves absorbs 1.2 million tonnes per year.

A special measure designed to accelerate the disposal of skimmed-milk powder stocks by allowing manufacturers of feeds for pigs and poultry to use skimmed-milk powder in place of other proteins has had some success, 450,000 tonnes being disposed of annually in this way.

It has on the contrary turned out to be very difficult to reverse the steady reduction in the quantity of liquid milk used directly on the farm for feeding calves and pigs. This declined from 5.5 million tonnes in 1968 to 3.5 million in 1977. The trend in animal feeding techniques is more and more towards the use of compound feeds that are easier to use than liquid milk. It could be curbed, however, by action to promote the use of liquid milk.

7. The Community is traditionally one of the largest operators on the world market in milk products. For some products, such as condensed milk (about 80%), whole milk powder (65% to 70%) and cheese (35% to 45%), the Community's share of the world market remains relatively stable. In other products it varies greatly depending on the export policy followed and on the market outlets: between 1973 and 1976 the Community's share varied between 15% and 60% for butter and between 25% and 40% for skimmed milk powder; in 1977 the Community's exports of butter and skimmed milk powder accounted for nearly half of the world market.

However, the world market⁽¹⁾ is often no more than a marginal outlet compared with the Community market, and particularly in respect of processed products, such as cheese (7%) and butter (11%).

(1) Excluding food aid.

8. Food aid consists mainly of butteroil (about 45 000 t per year) and skimmed milk powder (about 100 000 t per year). The recipient countries have set up programmes in towns for distributing reconstituted liquid milk, which is often mixed with locally produced fresh milk. An effort has been made to ensure that at least half of the skimmed milk powder supplied comes from vitamin-enriched milk.

The development of these supplies is hampered by inadequate organization of the milk sector in the recipient countries and by problems of transport and distribution which are difficult for the local administration to overcome. The result is a certain delay in the implementation of programmes adopted by the Council.

Internal and external supplies

9. The economic importance of the milk sector is demonstrated by the fact that it accounts for about 19% of the final agricultural production of the Community and about 27% of the production of all products subject to common prices.

The milk sector is thus the most important sector in Community agriculture, followed by beef and veal, which is largely linked to it and which accounts for about 16% of total final production.

1 950 000 farmers are involved in dairy farming, one third of all Community farmers.

10. The Community market is supplied from home production and from certain imports, particularly of butter and cheese.

Most of the milk supply comes from Community production. In the long term milk production rises by about 1.7% per year. This rise is mainly due to the continuous growth of the average milk yield per dairy cow, for the number of cows remains steady at about 25 million head. The milk yield rose from 3 444 kg in 1968 to 3 770 kg in 1976, owing to increased efficiency in dairy production (breeds, feeding, management). •

Of the three factors making for higher yields the strongest is the choice of feed. In recent years greater use of compound feeds with a high nutritive value have accelerated the rate of increase in milk yield. Between 1960 and 1976 consumption of compound feedingstuffs

for dairy cows increased more than fourfold throughout the Community. This trend has been encouraged since 1973 by the low cost of feedingstuffs which has improved the relationship between producer prices for milk and the cost of animal feeds.

11. An increasing proportion of the milk produced is processed and marketed by dairies (84.9% in 1968 and 90% in 1976). Deliveries of milk to dairies rose by more than 10.5 million tonnes between 1968 and 1976; about one-third of this increase was due to the rise in milk yields and two-thirds to the rise in the percentage of production delivered to dairies, the latter being due to the gradual abandonment of the practice of feeding calves on the farm and to structural changes. In recent years deliveries of milk to dairies have risen by an annual average of 2.5%; in some regions of the Community the figure is far above this average, while the figure is negative in others (see graph N° 2).
12. The rise in deliveries to dairies has led to increased production of milk products. Since 1968 the production of milk products which are not subject to intervention has generally corresponded to internal and external market outlets.

Production of butter rises by 1.5% annually and production of skimmed milk powder by 4.9%. The rapid increase in the production of skimmed milk powder is due to changes in feeding methods on the farm and to the almost five-fold increase in ten years in the production capacity of dairies.
13. The development of milk production is accompanied by far-reaching structural changes both on the farm and at the dairy. The size of the average herd has doubled in the past ten years; at present 23% of the dairy cows in the Community are in herds of more than 40 cows (4% of all dairy farms) and more than half are in herds of more than 20 cows (16% of dairy farms). However, 35% of all dairy farms in the Community still have fewer than five cows.

The increase in the size of the farm permits the use of modern techniques for housing and feeding animals and for collecting milk (tanks on the farm, collection by tanker truck), while the need to amortize invested capital (whether the farmer's own or borrowed), induces a continuing intensification of production. Farms of this kind may, consequently, be expected to be much more sensitive to variations in price.

14. This trend in the structures of milk production is one of the most difficult problems in the sector. The disappearance of the least efficient farms ought to be encouraged on economic grounds, but the common agricultural policy must not neglect its social responsibility to these holdings.
15. For its part, the dairy industry is undergoing concentration on two fronts. Between 1960 and 1976 the number of dairies fell by more than two-thirds; this trend was combined with the rapid increase in the average per unit capacity which led to increased rationalization; the need to amortize invested capital meant that the dairy had to collect enough milk to allow the optimum use of equipment and explains why most dairies are opposed to any measure reducing milk deliveries.

A concentration of economic power is also under way in the dairy sector, inasmuch as an increased number of dairies are under a single or a concentrated management. For example, all the dairies in the United Kingdom are attached to seven decision-making centres, while the figures for the Netherlands and Luxembourg are three and two respectively. This concentration of economic power encourages the optimal use of capacity.

16. Supplies from Community production are supplemented by butter and cheese in respect of which the Community has undertaken import commitments.

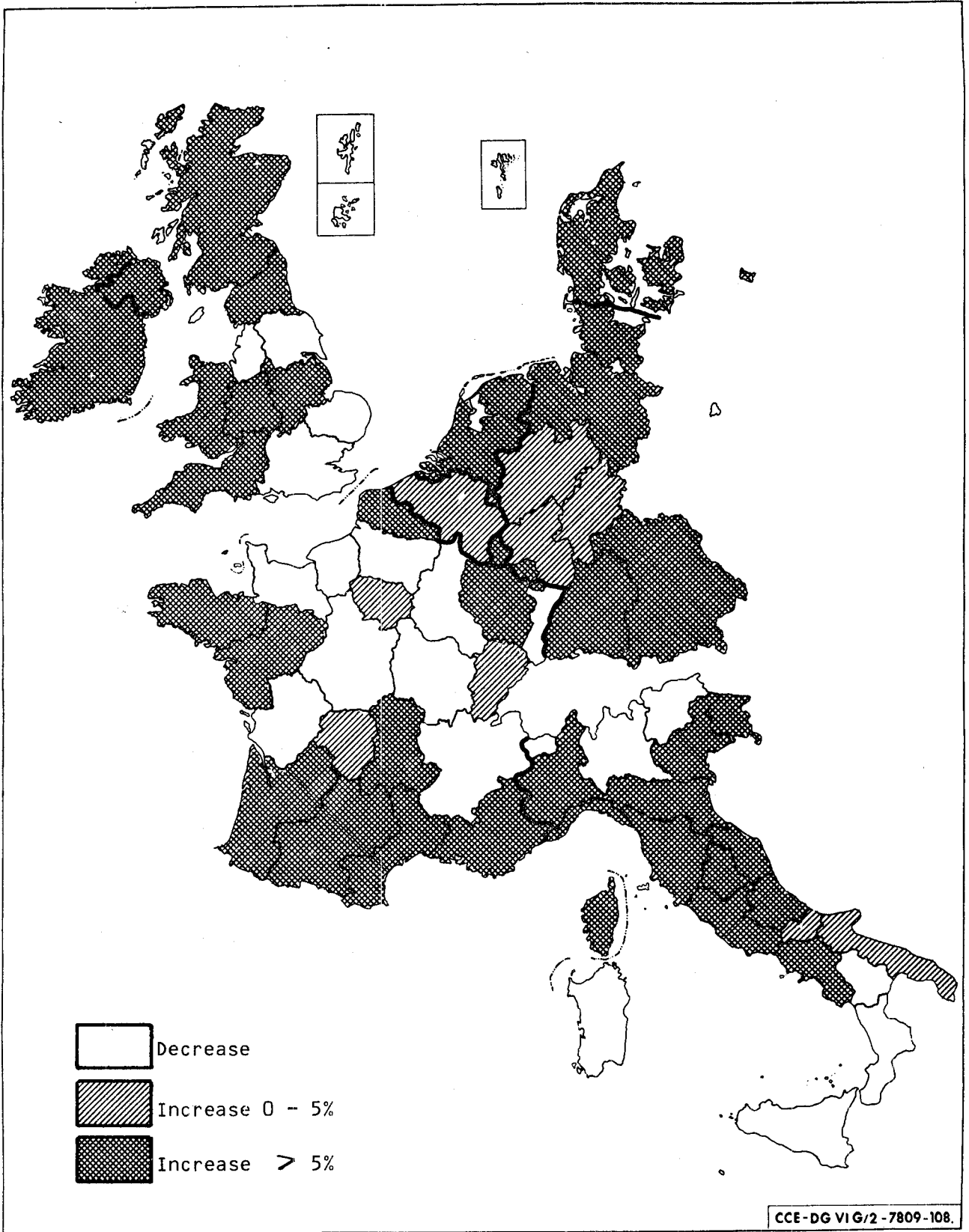
In the butter sector, this undertaking extends until 1980 in respect of imports from New Zealand. The figures are:

125 000 t in 1978
120 000 t in 1979
115 000 t in 1980

Graph 2

DELIVERIES OF COW'S MILK TO DAIRIES BY REGION

(changes between 1973 and 1977)



In the cheese sector, the Community regularly imports 60000 to 80 000 t of cheese from Switzerland, Austria and Finland under the GATT Agreements.

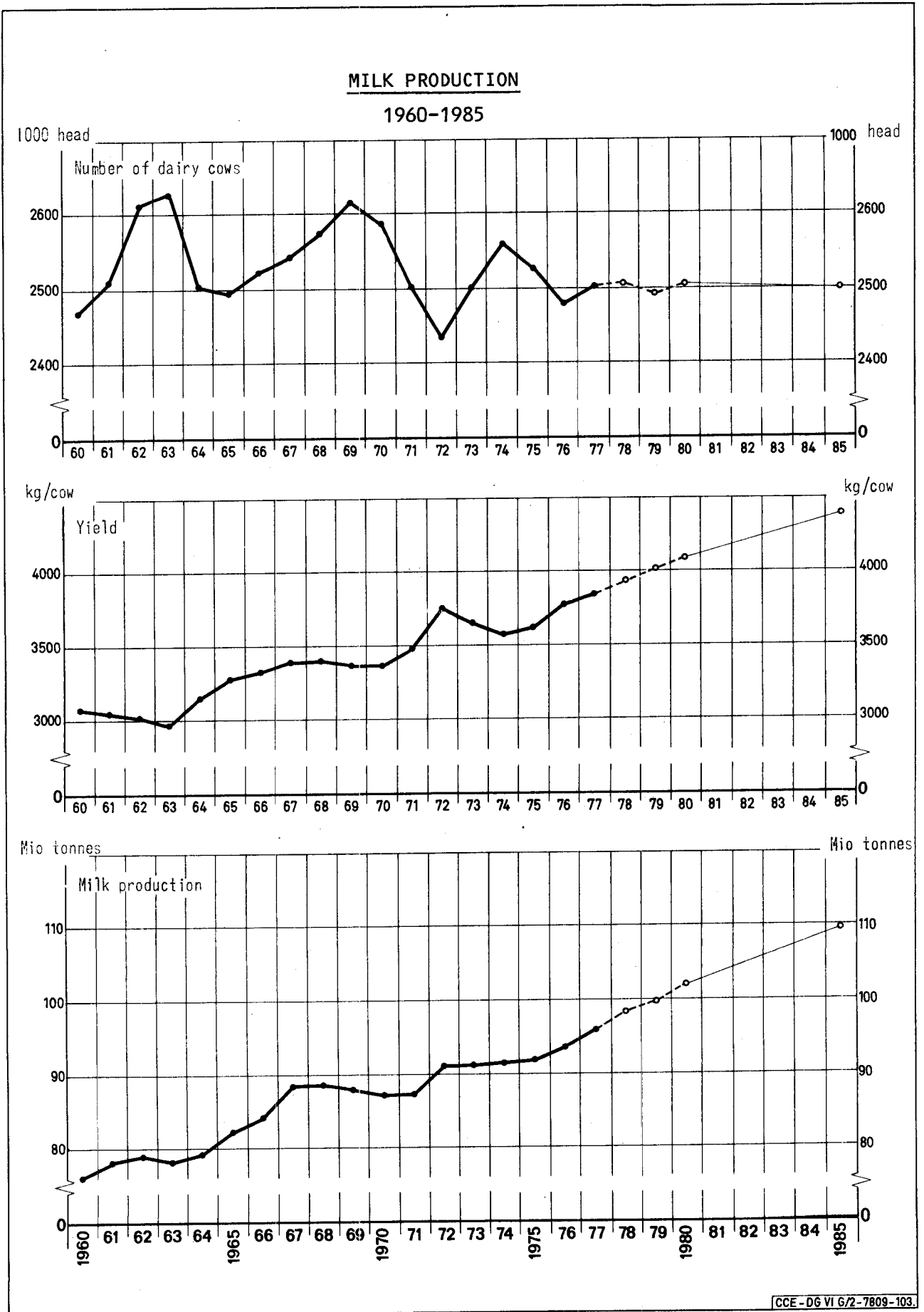
These imports represent only about 7% of Community butter production and 2.5% of Community cheese production.

The persistent imbalance

17. Analysis of the market in the milk sector shows that the surplus is a structural one. In 1976 the Commission estimated this surplus at about 10% of the milk delivered to dairies and since then the situation has worsened.
18. This imbalance has called forth, at regular intervals, various special measures, designed either to reduce production or to increase demand. The deterioration of the situation is reflected in the growing cost of such measures: EAGGF, Guarantee Section, expenditure for the milk sector has increased from 600 million u.a. in 1968 in the Community of Six to 1 500 million u.a. in 1973 in the Community of Nine, rising to 3 000 million u.a. in 1977 (see graph No 4). In 1977 this expenditure represented about 20% of the value of the final production of the milk sector compared with only 10% in 1968.

The fact that expenditure has doubled since 1973 while the milk price has only increased by 40% indicates a substantial increase in the quantities subsidized. Between 1968 and 1977, the Community was forced to sell 15% of butter production and 80% of skimmed milk production in powdered or liquid form, at reduced prices. After the rapid increase in expenditure in 1976 and 1977, the rate of increase of expenditure on milk products appears to be slowing down and the share of EAGGF Guarantee Section expenditure on milk products has stabilized around 38%.
19. The persistent imbalance on the milk market is due principally to an annual increase of 1.7% in production, in spite of practically stagnating consumption. The imbalance is aggravated by the commitment bound within the GATT to import fats and proteins of vegetable origin at zero or very low rates of duty. It is further affected by the commitments undertaken by the Community in respect of butter and cheese imports.

Graph 3



However, two remarks must be made concerning the Community's import commitments. First of all, if such commitments were to disappear these products would be transferred to the world market where they would compete with Community products. Secondly, these quantities, which in the case of butter come up for review in 1980 are fixed, while the gap between Community production and available outlets is doomed to increase steadily in the future. In other words, it is false to believe that stopping imports would solve the milk problem in the long term and relieve the Community of its responsibility to restore the balance. It would in effect only be a short-term remedy, and the problem would re-emerge in due course as acutely as ever.

20. In this context the main point to be borne in mind is that the world market is in a state of relative saturation, so that the scope for reasonably priced exports is limited.

In recent years the world market for milk products has not been in balance, since production has increased faster than consumption. In an effort to restore the market balance, some of the larger milk-producing countries succeeded temporarily at least, in reducing the production of certain milk products such as butter and skimmed milk powder. However, in other parts of the world milk production is increasing, so that global supply is increasing faster than demand. Available projections suggest that the world imbalance will persist in the short and medium term.

The measures taken

21. Since the creation of the common organization of markets in 1968 the Community has constantly had to take measures to deal with the imbalance on the milk market. Three factors have thwarted such efforts. Firstly the size and unconditional nature of the guarantee given by the common organization of markets itself.

Secondly, the very close link between beef production and milk production means that the measures taken to support prices in the two sectors have a cumulative effect where the milk producer is concerned; the result is that measures in favour of beef and veal may actually encourage milk production. Finally, events outside the influence or control of the milk policy in force may directly counteract the objectives pursued: examples of this are the monetary situation, the fall in the price of feedingstuffs and the prolonged economic recession.

22. Of all the instruments employed in the milk sector, the price policy is the most important. The price freeze applied between 1969 and 1971 showed clearly that producers react to such a policy, as they did also when prices caught up in subsequent years. A very cautious prices policy has again been pursued over the last two marketing years.

The last ten years have shown that an increase in production is set off by three phenomena, particularly when they appear in combination as has been the case in the Community. These are:

- (a) an attractive milk price level;
- (b) an unconditional guarantee system in respect of butter and milk powder;
- (c) the limited possibilities for conversion to other types of production.

By and large, this has indeed been the situation ever since the introduction of the common organization of the market in milk and milk products, even in marketing years when the milk price did not increase or increased only slightly, and it has applied particularly to holdings with a good average structure.

It should also be said that the relationship between milk prices and the prices of other products, and also the relationship between the price of products and the cost of producing them, has accentuated the trend to increase milk production.

Consequently, under this system of unconditional guarantees, all the conditions existed for an increase in milk production, whereas the sole economic check to any increase in the volume of production, namely dissuasion through prices, did not exist at all, or was inadequate.

It is not true, as some people think, that a higher price level would have dissuaded the farmers from increasing the quantities produced or that a reduction in prices would stimulate production. In effect, in view of the unlimited quantities of non-Community feedingstuffs available with a more favourable feedingstuff/milk price ratio and the advantages of improved animal genetics, better stalling and better milking techniques, farmers naturally tend to increase production as long as an incentive is provided by the relationship of the milk price to feeding-costs and to the interest rates on the loans raised to cover investment expenditure.

The price policy should therefore act as a brake on investments in this sector. This is all the more likely to be effective since a growing number of farms purchase the greater part of their feedingstuffs outside the Community and need increased financial resources to improve the quality of their herds or to make the necessary investments for animal housing.

For this reason the Commission is still convinced that the cautious price policy which it has already adopted is the cornerstone of any measure to restore balance on the milk market.

On the other hand, the Commission considers that the case of small milk producers should be carefully examined since a tough price policy could place them in a very difficult economic and social situation.

23. In recent years the Commission has proposed to the Council a cautious price policy accompanied by other measures.

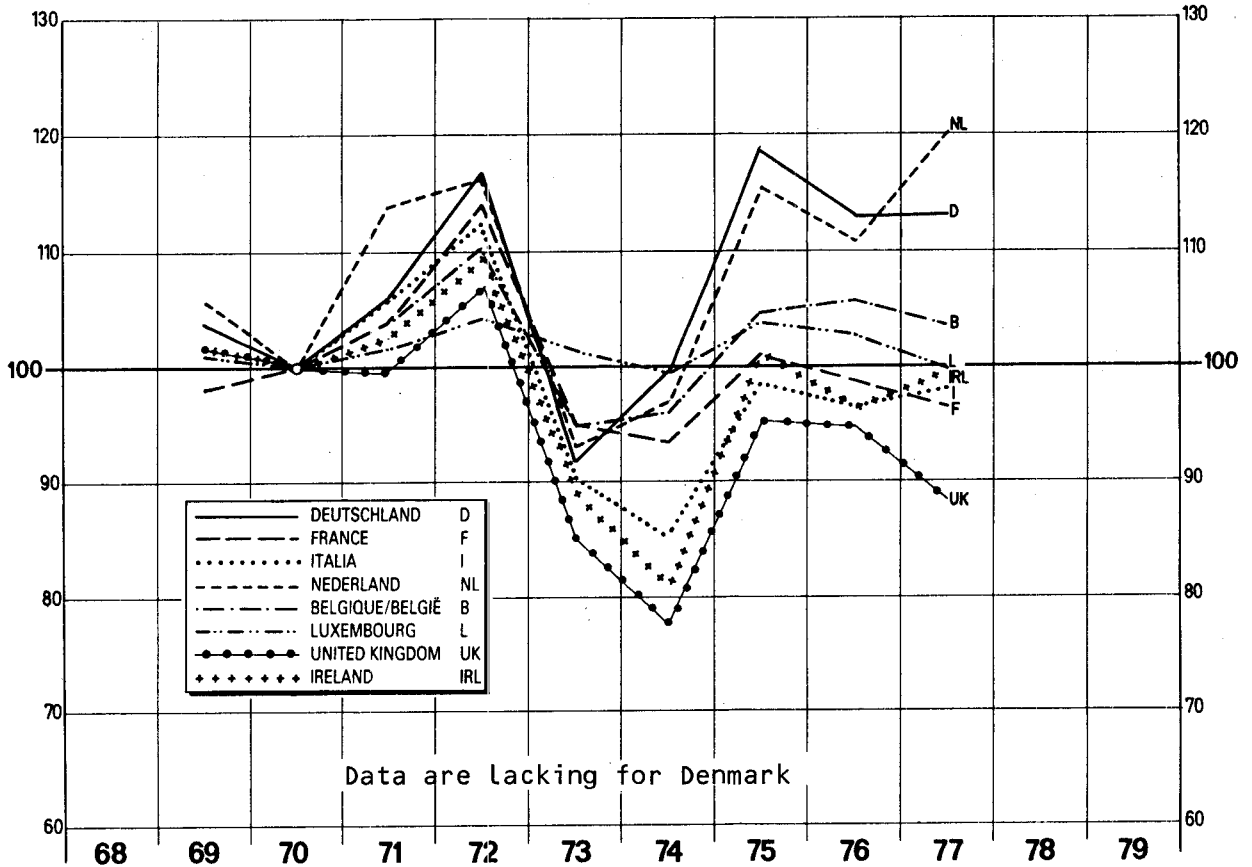
Of these the co-responsibility levy which was introduced in 1977 should have played a major part. If such was not the case this was because the idea of a variable levy was not accepted. As a result this levy has not served the purpose of cutting back milk production; its object has rather been to make milk producers share the financial responsibility for it within certain limits.

It is against this background that the co-responsibility levy should be judged, and it should also be recalled that the introduction of this levy was partially offset by the price increase decided at the same time.

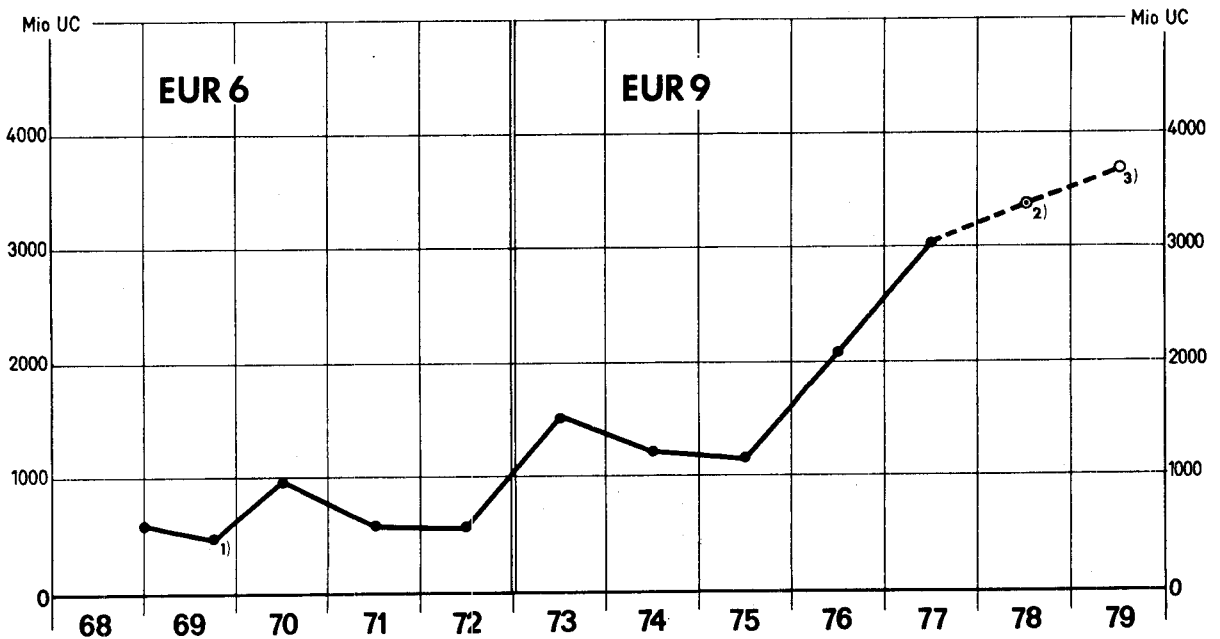
At its current level, the maintenance of the levy may be open to question, as receipts barely exceed collection costs. However, the impact that a variable levy would have, whether or not accompanied by amendments to the intervention system, should not be overlooked.

Graph 4

A. RATIO : $\frac{\text{PRICE ON THE MILK MARKET}}{\text{PRICE ON THE COMPOUND FEEDINGSTUFFS MARKET}}$
 1970=100 (Index in national currency)



B. EAGGF (GUARANTEE) : EXPENDITURE IN THE MILK SECTOR



1) six months, 2) appropriation, 3) estimates in EUA

In any case, the introduction of the levy has served to make public opinion more aware of the seriousness of the problems.

24. The imbalance on the milk market arises because there are more dairy cows than are justified by the market outlets. For that reason the Commission as far back as 1969 has sought to get to the root of the problem by introducing a system of premiums for slaughtering dairy cows and the non-marketing of milk and then in 1973 a system of premiums for the conversion of dairy herds to meat production. This set of measures met with appreciable success. Since the imbalance persisted, the Community introduced a system of non-marketing and conversion premiums in 1977. During the first ten months of its application about 400 000 cows or 1.6% of the dairy herd were slaughtered under this system. As the measure proved inadequate, the Community decided to reinforce this system considerably in 1978. However, even such a reinforced system cannot solve the milk problem on its own; it could be much more effective if backed up by other measures to restrict milk production.
25. In connection with the agricultural price proposals for 1978/79 the Commission had proposed to suspend intervention in respect of skimmed milk powder during the winter months. This proposal which was not adopted and is still before the Council shows that it is possible to modify the present rigid intervention system because the proposed aid would have represented a guarantee of some value for producers.
26. Since the beginning of the common market in milk the Community has tried to increase outlets for milk products both within the Community and outside. These measures relate especially to butter, to liquid skimmed milk and to skimmed milk powder. They were continually expanded and as a result have given rise to increasingly heavy budgetary expenditure.

27. The Community has implemented a number of important measures to stimulate outlets for butter. Since 1973 the then existing measures have been supplemented by the introduction of a system of aid for butter consumption which has been applied in the United Kingdom and intermittently in Ireland, Denmark and Luxembourg. While the quantities disposed of under these special measures have not increased considerably, disposal costs have continued to rise.

Thus by applying the special measures in 1973 110 000 tonnes of butter from public stocks were sold on the internal market at a cost of about 1 200 u.a. per tonne; in 1977 the corresponding quantity was 140 000 tonnes and the cost was about 1 500 u.a. per tonne. Such measures cannot be developed further without risk of reduced economic and financial effectiveness. Other measures, such as the subsidy for milk products consumed in schools, though useful, cannot in themselves provide a solution.

28. With regard to animal feed, technical developments and the level of prices of substitute feedingstuffs for milk have created a situation in which liquid milk or skimmed milk powder can no longer be marketed without increasingly substantial subsidies. Thus at present the Community is obliged to subsidize 45% of the milk powder for feeding to calves and 85% of the amount for the pig industry.

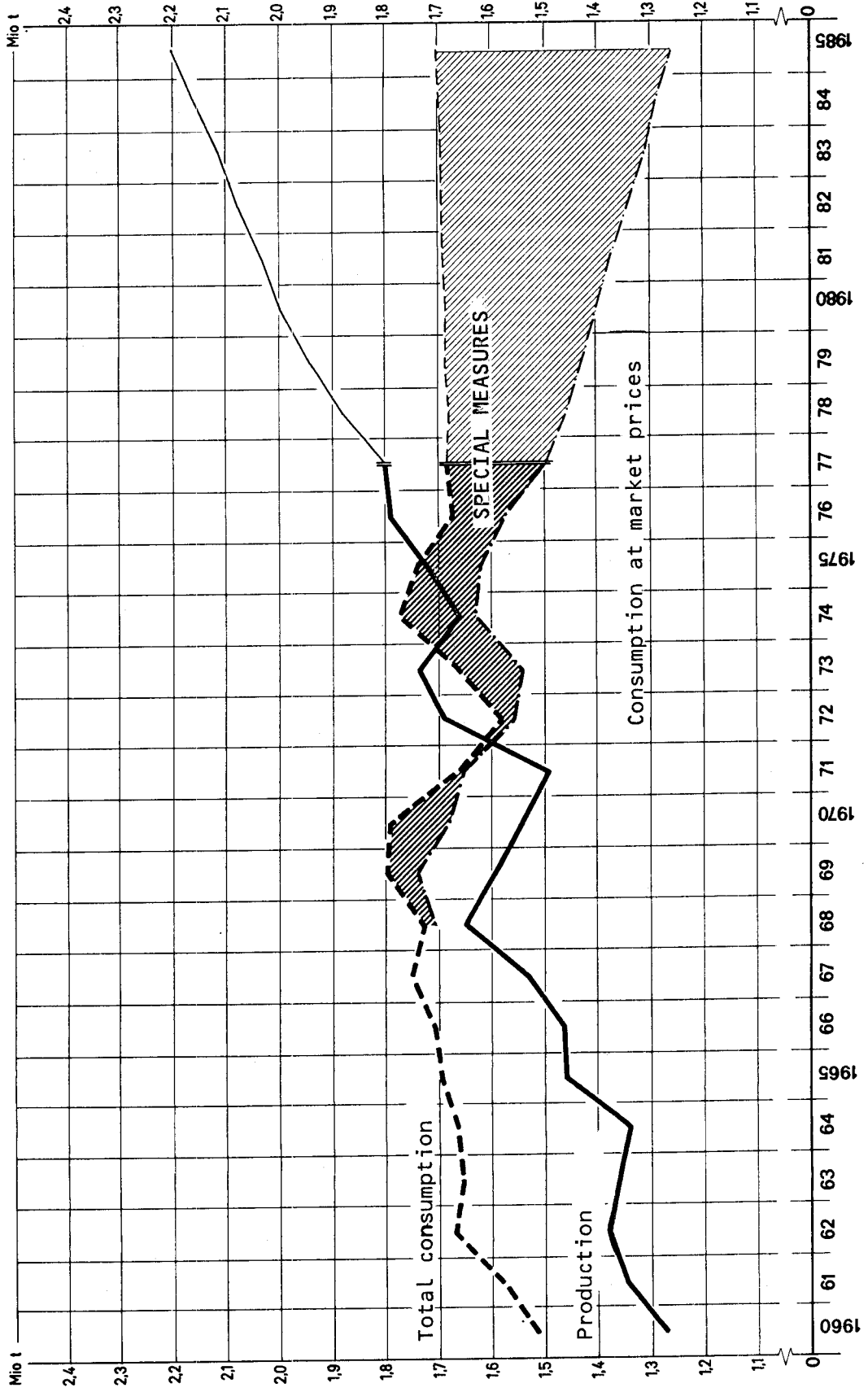
In the pig industry the unit cost of the aid is high. However, it should be pointed out that in 1977 an outlet was thus ensured for 450 000 tonnes of skimmed milk powder (one quarter of the Community production) which otherwise would have been taken by vegetable protein.

The aid granted for liquid skimmed milk has an equivalent effect but also has the advantage of making processing into powder unnecessary and thereby eliminates the resultant storage costs. In order to ensure that this aid is effective the Commission considers that it should be made permanent.

29. The Community has continually made use of the disposal possibilities available on the world market. At present the refunds granted on butter represent about 70% of its value, those granted on skimmed milk powder sometimes as much as 85%. Although the quantity of milk products being delivered as food aid is increasing, it is still rather limited; in volume, it represents about one third of the butter and milk powder exports.
30. If many of the measures taken have seemed inadequate to solve the problem of imbalance, it is not so much the fault of the measures in themselves or of the manner in which they have been applied, but rather because increases in production, stimulated by the system of guarantees have counteracted their effect. Moreover, a number of measures, whether at national or even Community level, tend to run counter to the objective of balancing the milk market. This is the case, for example, with certain national aid measures; although it is difficult to make an accurate assessment of the importance and impact of national subsidies granted directly or indirectly to the milk sector, the total expenditure which the Member States incurred in the agricultural sector (more than six milliard u.a. in 1977, apart from expenditure in the social field) suggests that the amount spent directly or indirectly on milk is high, given the importance of the sector.

The Commission has, in this connection, paid particular attention to dairies: from 1964 to 1977, the Guidance Section of the EAGGF financed more than 700 projects in the milk sector, representing a total investment of almost 1.5 milliard u.a. Certain projects relating to the production of surplus products were not financed by the Fund. Thus while aid granted for projects in the milk sector represented up to 1973 40% of all aid granted for the marketing and processing of agricultural products, it was less than 10% in 1977. The policy on the modernization of farms (Directive 72/159/EEC) had some effect but the effect was limited by delays in implementation in most of the Community regions.

BUTTER PRODUCTION AND CONSUMPTION FOR THE COMMUNITY
(1960-1985)



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Graph 5

The outlook

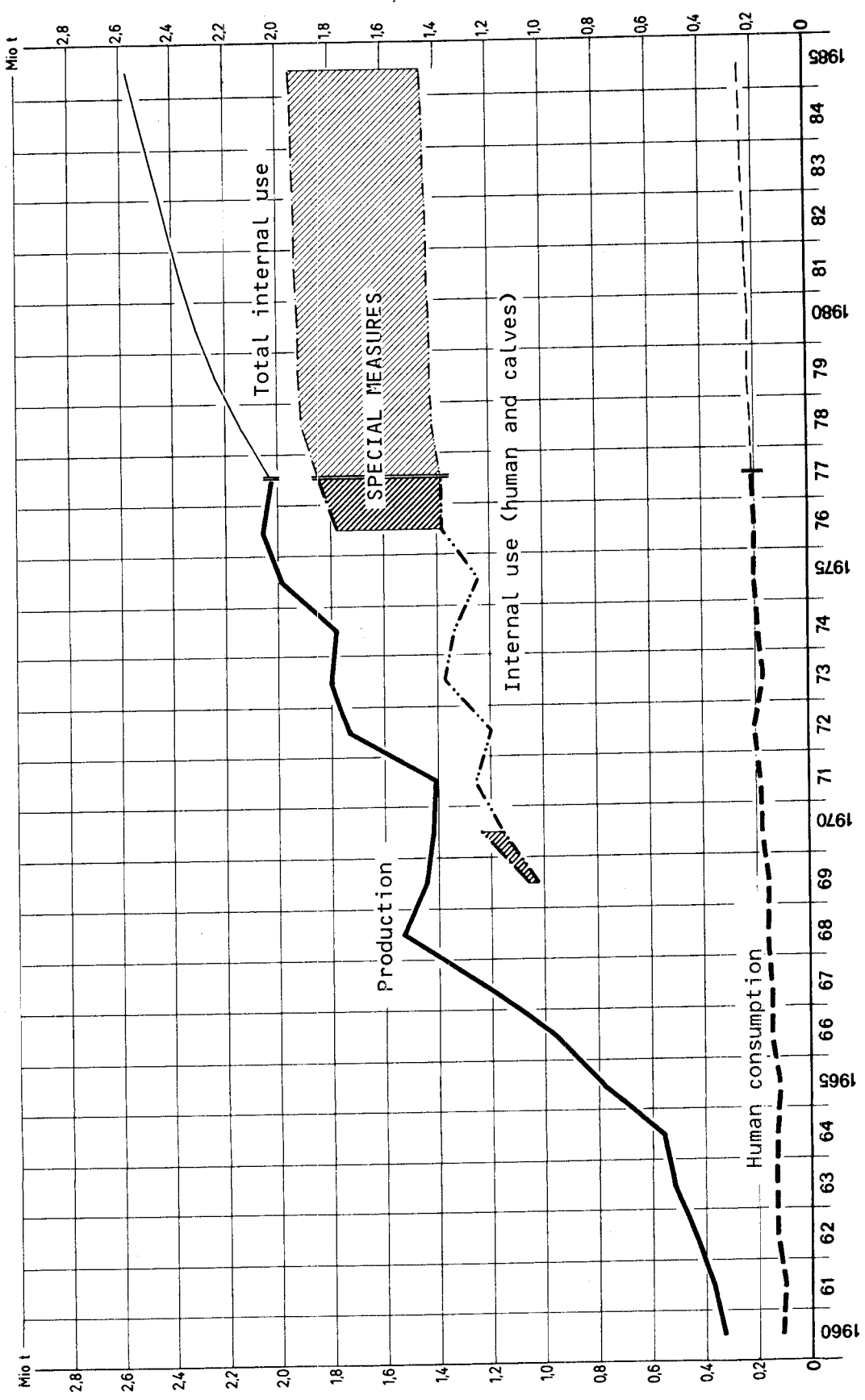
31. All the information at present available to the Commission indicates that the situation can only get worse.
Consumption can be maintained at its present level only through a steady increase in budgetary expenditure; the possibility of it rising, save through an excessive financial effort, seems completely ruled out. Similarly, given the situation of imbalance prevailing on the world market, there is no hope for any substantial increase in Community exports at satisfactory price levels; food aid in itself will probably provide only limited additional outlets.

32. On the other hand, there is no indication that the steady increase in production will stop. Although livestock numbers have remained more or less constant, with probably slightly less than 25 million dairy cows following the measures currently being implemented, milk production should continue to rise owing to steadily increasing yields. Moreover, until 1980, butter availabilities will continue to be affected by contractual import obligations. Cheese imports will be similarly affected by agreements entered into under GATT.

33. The imbalance between supply and demand will no doubt lead to increased quantities offered for intervention. Disposal of such products will soon give rise to problems because of saturation on internal and external markets and the prohibitive nature of the financial effort required.

34. The possible enlargement of the Community to include Greece, Portugal and Spain will not make it easier to dispose of milk products. These countries, in spite of being net importers of milk products, have rather limited import needs and these are largely taken care of by the Community as now constituted.

SKIMMED MILK POWDER PRODUCTION AND CONSUMPTION FOR THE COMMUNITY
(1960-1985)



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Graph 6

In these countries, the dairy herd is not great and yields per cow are low; on the other hand, there are relatively large numbers of sheep and goats.

The application of the common organization of markets to these countries, however, will probably lead to increased production on the milk sector, particularly in Spain where production has increased by more than 50 % over the last ten years.

35. It would be futile to attempt to assess with any precision the quantities of milk products for which there will be a surplus in coming years. But it is certain that, if the situation is allowed to go on as it is, the imbalance on the milk market can only get worse without there being the slightest hope of reducing it.

Part II

DEFINITION OF OBJECTIVES

36. The Community has already put into effect a number of measures intended to improve the balance in the milk market. Although these measures have been of real value, they have not been sufficient to avoid increasing problems. The available forecasts indicate growing imbalance in the future despite the measures taken. In these circumstances the Commission considers that the policy in the milk sector should be more precisely defined. The Commission considers also that it is desirable that producers and all those engaged in the milk industry should know clearly the objectives which the Community intends to follow in this sector and should understand the necessity for the measures envisaged as well as the way in which they will work.
37. In setting its objectives the Community must be aware of a certain number of restraints which limit the possibilities for action, in particular,
- the price relation between milk fat and protein and vegetable fat and protein which is influenced by the differing levels of external protection
 - the socio-economic situation of many small milk producers farming in regions which offer hardly any alternative possibilities
 - the limited outlets available on the world market, either because of restrictions in certain third countries or because of the high cost of additional exports
 - the continuation of agricultural monetary measures
 - the general economic situation in the Community which is characterized by a high level of unemployment.
38. Taking account of the results of the analysis set out earlier in this report, the Commission considers it necessary to pursue over the next few years the following guidelines in the milk sector
- a) to stop the increase in production
 - b) to avoid all measures which run contrary to this objective and, in particular, all aids to investment given by public funds at the Community or national level, which favour higher production and which are still

given both at the level of the farm and at the level of the processing and marketing enterprises

- c) to put the stress, where possible, on measures which allow the level of consumption to be maintained, to increase the outlets for milk and to reduce the milk production potential
- d) to take the necessary additional measures which will take account of the social situation of small milk producers working in particularly difficult conditions.

At the same time that the Commission recommends the objectives, it reiterates its intention to continue the following main elements of the existing policy

- a) a prudent and moderate price policy, which is an essential element necessary to establish an equilibrium on the market
- b) an active policy of disposal of existing stocks, which should give, wherever reasonable, priority to the Community's own consumers and preference to direct use of fresh products rather than the purchase and sale of products through the intervention agencies
- c) to look for new outlets for milk products both within the Community and on export markets, for example through long term contracts.

39. The Commission intends to submit to the Council specific proposals for additional measures necessary to check the increase in milk production. In the Commission's opinion the continuation of the guarantee for the existing quantities represents, with the new measures proposed, an element of co-responsibility between the Community and its milk producers. When the Council adopts the new measures it will also be necessary to decide whether the co-responsibility tax should continue in its present form or be modified or be replaced by new measures to apply from the beginning of the 1979/80 marketing year.

40. The suspension of national and Community aids

The existence of national policies which are directed to increases in milk production runs against the Community's action intended to establish a balance on the milk market. These national policies can cause difficulties insofar as they involve important financial contributions to the milk industry. For this reason the Commission intends first of all to check

investments in the milk sector but to encourage those investments which concern new products or new outlets.

41. In relation to processing and marketing of milk and milk products, the Commission considers that aids from public funds to such investments must now be seriously limited; the only exceptions should be for investments such as ~~for~~ ^{liquid} milk for consumption which has been pasteurized and not otherwise treated, the use of liquid skimmed milk for animal feed, new research, the production of new products, energy saving and the protection of the environment.

42. Furthermore, the Commission considers that ~~those~~ ^{and which favor increased production} aids to investment which are directly linked to milk production/must now be suspended for a period of time until the market balance in the milk sector has been restored to a more reasonable level.

Conversion to other forms of production

43. The measures which give most effective help to re-establishing the milk market balance are those which contribute to possible conversions from milk production to other agricultural enterprises, either by modifying the price relationship or by the payment of grants. It is an essential element in the future policy that the system of grants for the non-commercialization of milk and conversion to beef or sheep should be continued and that the maximum advantage should be taken of the improvements, both in the level of grants and administrative operation which have recently been introduced. The Commission will, at the appropriate time, present a report to the Council on the effects of the recent improvements in these schemes.

Measures to maintain or increase the disposal of milk products

44. While the necessary action is being taken to check the increasing volume of milk production, the Commission remains committed to the special measures which have been introduced in order to facilitate the disposal of the existing surpluses. These measures have proved effective and indeed

essential to maintain the common milk policy in the most recent period. The Commission strongly supports continued aid for fresh products such as liquid skimmed milk and fresh skimmed milk powder in order to reduce the incentive to pass these milk products through intervention. In due course, as a better balance is obtained in the milk market, the cost of these measures will decline. In the meantime, they will be pursued with vigour.

45. The importance of the action necessary on the internal market should be reflected in the Commission's approach to obligations on imports and the possibilities for exports. Thus, the arrangements on the import of butter from New Zealand for the period after 1980 should take account of the market situation on the internal market for milk fats. Sales of the Community's milk products towards third countries should be developed by the present active export policy intended, in particular, to enlarge the outlets for Community processed products. In this context the Commission will also examine the opportunity for long-term contracts for butter and skimmed milk powder. In the field of food aid, the special effort which has been made in 1977 on the execution of the programmes for milk powder with added vitamins and for butteroil will be actively pursued in order to enable developing countries to increase their consumption of milk product and to improve their level of nutrition which is at present very low in comparison to industrialised countries (ratio 1:6 for dairy products).
46. In the Multilateral Trade Negotiations, the Commission, in accordance with the mandate received from the Council, will increase its negotiating efforts intended to arrive at an international policy which would assure the respect of minimum prices for milk powder (whole and skimmed), butter and butteroil. The success of these negotiations would lead to a more stable international market which could help to maintain the level of consumption while reducing the cost of the Community's export refunds. Any arrangements reached in the form of bilateral agreements on imports or exports of cheeses will be taken in full knowledge of their impact on the Community market.

Temporary limits on an open-ended price guarantee

47. Notwithstanding the measures already taken or discussed earlier in this report, the open-ended nature and the high level of the guarantees remain a barrier to the re-establishment of the milk market balance. Any policy which does not take account of this fact is bound to fail. The principle of these guarantees must not be put in question; but the adaptation of the support measures is clearly necessary so long as the serious imbalance continues.

48. The Commission is examining the various possible solutions. The two broad approaches possible are either the imposition on the common milk policy of a system of production quotas (whether at the level of the individual farm, the dairy or the Member State) or the adaptation of the existing system, so long as necessary, by action on the price or the guarantees which could be **linked to increases in production**. Although a system of quotas could have an immediate effect, the Commission is not in favour of such a system. Such measures would be difficult to reconcile with the Community's approach, based on free decision and internal trade; it would be almost impossible to construct such a policy without some inequity between different producers or regions of the Community; production quotas tend to fossilize the existing structure; quotas would be extremely difficult to negotiate and even more difficult to change; and consequently there is a risk that in due course there would be a return to surplus production
49. The Commission considers, therefore, that the action to be taken before the next marketing year should be directed to adaptations of the existing system, so that it works as originally intended. It is clear that, in order to be effective, the action to be taken must, by one means or another, restrain the incentive to produce and encourage the use of milk for the production of products which are not in surplus or for which markets can be expanded. This can be achieved by relating intervention prices to the level of Community production within certain limits; or by making the co-responsibility tax variable in accordance with the level of Community production and hence using this tax as a regulator of supply; or by returning a certain quantity of milk delivered to dairies back to producers in the form of liquid or dried skimmed milk; or by restricting unconditional access to intervention; or by a combination of these methods.
50. The Commission takes the view that active study should now be undertaken, in the period between publication of this report and the tabling of proposals for decision in the 1979 price package, of the form of any scheme linking the level of intervention prices directly to the level of production or intervention. Such a formula, in addition to its simple operation, would not put in question the operation of the market economy. Furthermore, if production or intervention did not increase above an agreed threshold or, after increasing, fell back in response to a price disincentive, the arrangement would automatically have no further effect. The more effective the action on the price, the less necessary would be other restrictive measures on the guarantees. At the same time it would

be essential to take account of the difficulties of certain producers either through direct aids to revenue or through other forms of aid such as grants for suckling cows.

Aid for the revenues of certain milk producers

51. The introduction of additional measures and, in particular, action on the intervention prices or guarantees would put pressure on the revenues of certain milk producers. The Commission is, therefore, giving active consideration to a scheme of a social kind, which would give these producers some assurance of maintained revenues. This could be effected for example through a system of direct aids to the income of certain full-time farmers who are producing milk and could find themselves without any realistic alternative. The scheme could be based on very selective conditions concerning the size and nature of enterprise - number of cows etc., - and other relevant factors such as eligibility to take advantage of Directive 160/72.

The aid would be temporary and would be linked to the person.