



COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

Dairy market situation 2009

{SEC(2009) 1050}

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MANDATE:

The June European Council conclusions stated: "The European Council discussed the current situation on the dairy market. It invited the Commission to present an in-depth market analysis within the next two months, including possible options for stabilising the dairy market, while respecting the outcome of the Health Check".

BACKGROUND:

The dairy market situation has deteriorated dramatically during the last 12 months. After a price spike in 2007 alongside the high food prices in general, prices have dropped substantially affecting dairy producers' income. Prices for milk delivered to the dairy have come down from 30-40c/l to an EU-27 weighted average of 24c/l with prices for many producers at 20-21c/l or less. This has triggered substantial unrest amongst dairy farmers with many demonstrations.

1. INTRODUCTION

This Communication describes the dairy reform process up to the Health Check, given that the European Council has determined its outcome as the basis for examination of further measures. It contains an EU and international market situation analysis, a summary of Commission market support measures, other instruments available to the Commission and the Member States within existing legislation and options for further action and discussion. It is accompanied by a Commission Staff Working Document (CSWD) with further detail.

2. THE REFORM PROCESS

2.1. Agenda 2000 and the 2003 CAP reform

The reform of the dairy sector, in line with the CAP reform in general, has aimed at a greater market orientation of production. Therefore, intervention measures were redefined with lower intervention prices gradually being implemented. As compensation, EUR 5 billion were distributed among dairy farmers as direct support to their revenue and linked to the production. This is now fully decoupled and subject to public and animal health and environmental standards (cross-compliance). Also, the intervention quantity (the Community purchase of market surpluses at fixed prices) was limited to 30 000 tonnes of butter and 109 000 tonnes of skimmed milk powder per year. The Commission may however continue intervention for greater quantities should the market situation require it. Last, milk quotas were increased by 1.5% (by more and sooner for some Member States) and extended to 31 March 2015.

All these measures were meant to support increased competitiveness and help milk producers prepare for future challenges on the international scene, whilst providing income support by way of direct payments.

2.2. Health Check

Following the Commission Communication on the Health Check and in anticipation of the final Health Check decisions, there was strong pressure in the Council to increase production

possibilities. As a result quotas were increased by 2%. The outcome of the Health Check confirmed the logic of the reforms since 1992. Quotas will expire in 2015. To ensure a controlled and soft phasing-out, quotas are increased by 1% each year from 2009 until 2013, with an additional measure (fat correction reduction) which further increases production potential. Ideally the "soft landing" should be ensured by gradually eroding the value of quotas to reach zero at 1 April 2015. Already the value is low or near to zero in several Member States whose production is below their quotas. Additionally, under the second pillar of the CAP, support for "dairy restructuring" was acknowledged as an additional priority theme. This allows Member States to use additional funds from modulation to support dairy farmers in preparing for the end of quotas.

Finally it was agreed that the Commission should present two market reports, before December 2010 and December 2012 to see if additional measures would be needed to ensure the soft landing, without questioning the phasing out of the quota system.

3. MARKET SITUATION

3.1. Market situation to July 2009

EU milk production has not increased as a result of the various quota increases. By 31 March 2009, total milk production is estimated at 4.2% below the overall quota. Demand however has decreased both in the EU and on the world market. The drop in the EU demand was mainly affecting quality products like cheese, which is particularly important as more than 40 % of EU milk is processed into cheese.

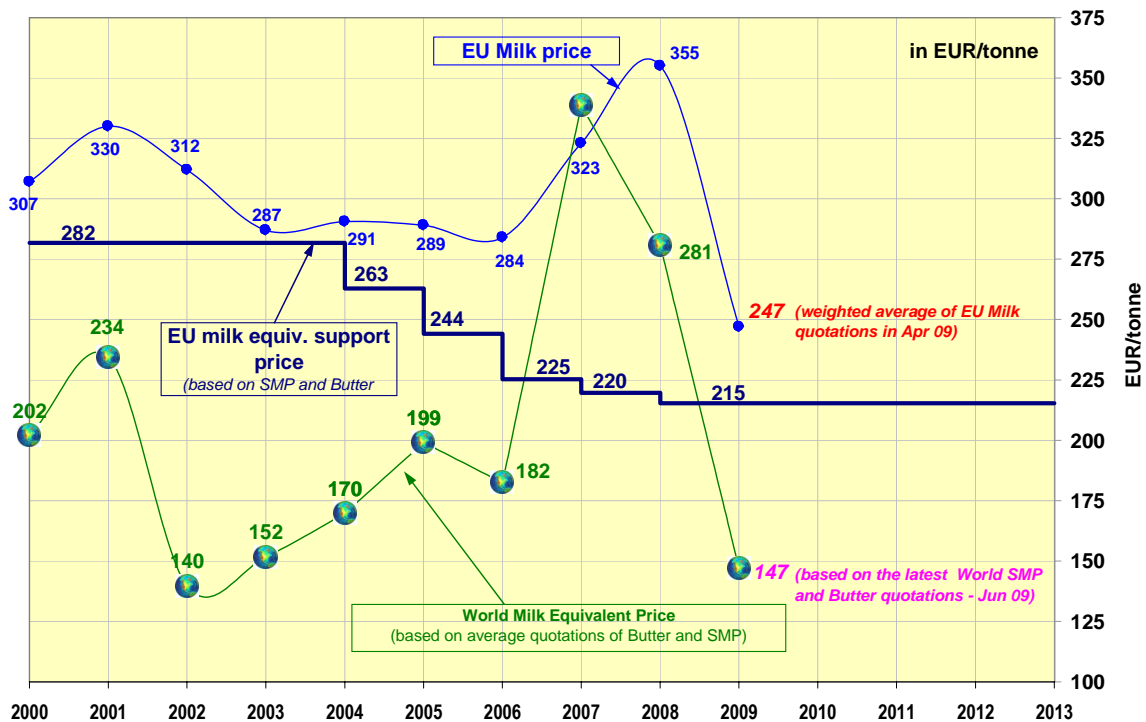
The world market shows a high degree of volatility, due to the fact that quantities traded are small in comparison to total production and consumption. Prices on world markets decreased considerably due to a combination of production increases by other suppliers (New Zealand, Australia, Argentina, Brazil and until recently also the US) and a drop in global demand connected with the economic crisis.

Reduced demand in the EU and collapsing world market prices had a direct effect on EU market prices. The result has been milk prices moving towards 21c/l and even below in some Member States (see CSWD for further details).

3.2. EU prices

In 2007, world market prices increased substantially above EU intervention levels and EU prices climbed in line with them. In the second half of 2008 world market prices dropped below EU intervention levels, reinforced by the weak US dollar, and EU prices again dropped in line with them. The Commission applied support measures which prevented EU prices from falling even further.

Average EU raw milk prices have always been somewhat above the milk equivalent support price for milk, see graph below. The reduction of the intervention level has had little impact after the 2003 reform and prices increased significantly in 2007/8. However the current lower demand caused a market imbalance and prices fell towards the milk equivalent support price, which is much lower than before the 2003 reform.



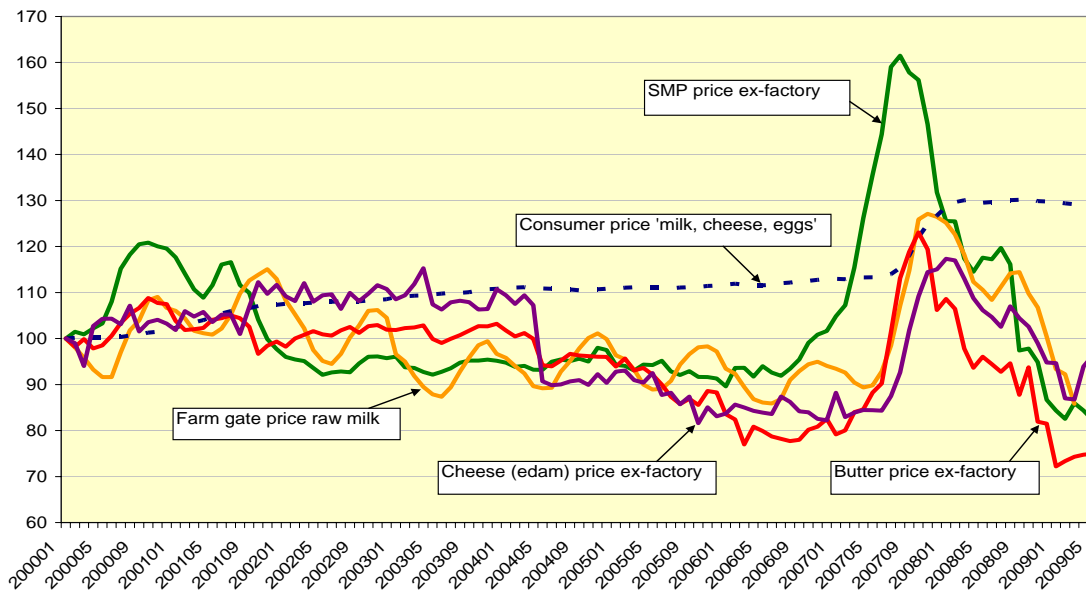
At the current average EU milk price of about 24 c/l with significant variation between Member States, (see details on national prices in CSWD), farmers still cover their variable costs. As feed, fertiliser and other inputs may have been bought at the start of the year and grass is still readily available in many regions, farmers continue to produce milk to be able to pay a higher share of their fixed costs, which are not covered for many farmers.

3.3. Consumer prices versus farmers' prices

The commodity price surge during the second half of 2007 generated a rapid increase in milk producer prices and a strong increase in consumer prices which peaked in spring 2008. By contrast the pronounced fall in the prices of milk and dairy commodities since the end of 2007 (-39% for butter, -49% for SMP, -18% for cheese, -31% for milk), only triggered a slight decline in the consumer prices of dairy products by some 2%. The lack of adjustment of consumer prices to the fall in ex-factory prices is even more striking when assessed over a longer time period: whereas the ex-factory prices of most dairy products have now fallen below their levels before the price surge, dairy consumer prices have remained at high levels (more than 14% before the price rise).

There could be several reasons why consumer prices of milk have remained stable while raw milk prices and ex-factory prices have declined as milk is only one of the costs in the consumer price of dairy products. However, the magnitude, the delay and asymmetry in the downward adjustment of dairy consumer prices - which is particularly marked in some Member States - clearly shows that the EU dairy supply chain does not function efficiently. Preventing consumers to benefit from lower prices constraints the development of demand for dairy products and thus hinders the strength and pace of recovery of the dairy sector. This situation also raises serious concerns regarding the distribution of value-added in the chain between farmers, milk processing factories, the dairy industry and retailers.

Graph 2 Price index developments at different stages of the EU dairy supply chain (Jan 2000=100)



Note: The consumer prices for the "milk, cheese and eggs" category do not cover the consumer price of butter.

Improvement in the effectiveness and efficiency of the dairy supply chain appears essential to raise its competitiveness, to mitigate the fall in the producer prices and to ensure that price changes are passed on to final consumers. This will hinge on addressing certain issues, notably the lack of comprehensive and reliable data on prices and margins in the whole food chain. Greater transparency, a better understanding of value-added distribution and price transmission, and a clearer view of the structural factors would be a significant first step in identifying the appropriate measures which could contribute to improve the efficiency of the dairy supply chain and secure a fair outcome for each actor (see point 10). This could in turn contribute to enhance the countervailing power of the actors concerned.

3.4. Market developments: short to medium term

The short-term perspectives remain dominated by the economic crisis. Prospects for cheese and value-added fresh dairy products markets are determined by restrained EU and world demand and show a production decline in 2009 and marginal improvement in 2010 driven by a slight demand recovery. As a sufficient revival in the EU and world market prices is not expected in the short term, the accumulation of intervention stocks for butter and SMP is projected to continue in 2009 and 2010. Furthermore, export refunds can for the time being contribute to balance the EU market, although low world demand and strong competition from lower-priced exporters limit EU export potential.

The medium- and long term outlook for the EU dairy market is expected to remain positive in the light of the eventual economic recovery, which should help supporting the growth in demand for higher value added dairy products.

4. DEMAND SIDE

4.1. Action taken by the Commission: market support measures

The Commission rapidly recognised the seriousness of the dairy market situation due to the expected seasonal increases of milk deliveries in the first half of the year and so decided on a pro-active support policy:

a) Private storage aid for butter started at the beginning of January, two months earlier than usual. It is open until 15 August and up to 28 June, 105 800 t had been stored, 14 000 t less than 2008.

b) Export refunds were reactivated for all dairy commodities to the usual destinations on 23 January (in full compliance with the EU's international commitments). Since the introduction of refunds the EU has been able to maintain exports at about the same level as the previous year. However, in June, there has been a sharp drop in the demand for export certificates, which might point to a further weakening of world market demand.

c) Intervention buying started on 1 March for butter and SMP:

- 81 900 t of butter have been bought, about 8% of January-June production of butter. Beyond the 30 000 t fixed price ceiling, bids were accepted up to a 99.2% of the fixed reference price of EUR 2 218/t.
- 231 000 tonnes of SMP were bought, about 43.5% of January-June 2009 production of SMP. Beyond the 109 000 t fixed price ceiling, bids were accepted up to a maximum price of 98.9% of the fixed reference price of EUR 1 698/t. Payments have also been advanced by 2 to 3 months.

The butter stock of 81 900 t is equivalent to 1.1% of EU milk production, and the SMP stock of 203 000 is equivalent to 1.8% of EU milk production.

4.2. Budgetary consequences

The estimated total cost of the measures taken to date is about EUR 350 million. A major part of this expenditure has not been paid yet (e.g. the lag in payment of refunds after issuing certificates). However, the estimated total costs of the measures foreseen including prolonging intervention (see point 5) is more than EUR 600 million.

4.3. Other measures to support milk production outlets

a) Marketing standards

Community law definitions require dairy products (including milk, butter, cream, whey, yogurt and cheese) to be 100% dairy-based. The appearance on the market of substitute products like so-called "analogue" cheese or ice cream where milk fat is replaced by vegetable oils further erodes the market outlet of dairy products.

As regards existing dairy denominations Member States need to pro-actively take action to enforce the dairy definitions to prevent further damage to the dairy market.

b) Other measures

With regard to school milk, the scheme has been recently adapted, making it simpler, extending it to secondary school and increasing the product coverage. As to the latter discussion are on going to make the scheme more attractive (for example adding products with 75% milk and 25% fruit content). As regard aid for SMP for feed, the analysis shows that such a production aid is economically not justifiable (see further details in CSWD).

5. FURTHER COMMISSION ACTION TO SUPPORT DAIRY AND OTHER FARMERS

a) Advanced direct payments

The Commission will allow Member States to pay up to 70% of direct payments from 16 October instead of from 1 December. Member States may also grant *de minimis* state aid or loans at market conditions to help milk producers with liquidity problems.

b) Promotion

The Commission will propose, to a July Management Committee, an additional round of dairy product promotion programmes on the internal market with submissions to the Member States by 30 September, forwarding to the Commission by 15 October, and Commission decisions by 15 December (see further details in CSWD).

c) Intervention

On 13 July the Commission presented a proposal to continue butter and SMP intervention buying after August, on a temporary basis for 2009/10 and potentially 2010/11.

Intervention stocks will remain in store until the internal or world market is able to absorb them without disturbance.

d) Private storage

Private storage will be extended beyond 15 August.

e) Refunds

The Commission will continue to provide export refunds on an objective basis for as long as needed bearing in mind ongoing international negotiations.

f) Quarterly report

The Commission will report on the dairy market to the Council every quarter.

6. 2010 CAP BUDGET

The Preliminary Draft Budget for 2010 leaves a theoretical margin of manoeuvre of EUR 1 000 million for market measures and direct aids but EUR 300 million of this amount must, in line with sound budgetary management, be kept under the sub-ceiling. The Council and the European Parliament will decide later this year on the final 2010 budget along with the still outstanding decision on the financing of the EUR 2 400 million in the European Economic Recovery Plan. The Recovery Plan already foresees that an additional EUR 420 million must be reserved in Heading 2 in 2010 for rural development, including measures for restructuring the dairy sector.

The possibility to finance new measures in the dairy sector in budget year 2010 therefore seems quite limited. As part of the annual budget procedure in autumn, the Commission will of course examine all consequences for the 2010 budget in the Amending Letter for agricultural expenditure. In budget year 2011, the margin of manoeuvre is similarly limited, mainly due to the phasing in of the EU-12 direct aids.

7. MEASURES TO REDUCE SUPPLY

7.1. Changes to quota regulation

Quota system changes would not respect the outcome of the Health Check since these matters were discussed in depth during its negotiation which would exclude ideas such as a 5 % quota reduction or a freeze on quota increases. Such measures would have no immediate effect, since they could not be applied before the new quota year on 1 April 2010 due to the legitimate expectations of producers.

7.2. Quota management on an individual producer level

Much subsidiarity is already built into the dairy quota system allowing Member States to manage national quotas based on objective criteria and their specific need and structures (see CSWD).

Regarding application of quotas at individual level under current Community law there are two situations:

- 1) If the national quota is exceeded, Member States may use the excess of contributions paid by producers to finance voluntary retirement from milk production or redistribute it to priority groups, but
- 2) If the national quota is not exceeded the advances collected by Member States are reimbursed to individual producers.

An option would be, on a temporary basis, to allow Member States to use the advances collected also in the second case. This would give Member States the possibility to apply a brake to production by penalising those producers exceeding their individual quota in favour of a restructuring of the dairy sector. The Commission will reflect on the most efficient way on how to implement this.

7.3. EU Cow Slaughter Scheme

The most direct way to reduce supply is to eliminate production before it takes place by reducing cow numbers (not necessarily whole herds). However an immediate effect can only be reached by slaughtering cows with an EU subsidy. It will be difficult to justify spending taxpayers money for such a measure. (See further details in the CSWD).

8. MEASURES TO SUPPORT INCOME

8.1. Increasing intervention prices

Current market prices have for the first time since 2003 reached the lower intervention price level decided during Agenda 2000 and 2003 reform. However increasing intervention prices is not an option. Such a policy would be a total reversal of the last 15 years of CAP reforms towards market orientation and ensuring that the reduced intervention prices work as a safety net for exceptional circumstances and not a permanent feature of the market. It would certainly not be in line with the Health Check, since it would increase the value of quota contrary to the objective of reducing it as we approach the end of quotas.

Further there would be a political as well as a practical problem as dairy farmers have received a decoupled payment (3.5c/kg) on the basis of the reduced intervention prices. The decoupled amounts cannot be returned as many farmers have stopped dairy farming between 2004 and today and the dairy premium is included in the single farm payment.

8.2. Redistribution of direct aids – specific support

The provisions provided for in Article 68 of Regulation (EC) No 73/2009 will allow a certain degree of redistribution of direct payments between farmers, sectors and regions within a Member State. Member States may set up schemes to improve quality and marketing of agricultural products and enhance the environment or animal welfare. More specifically and to buffer the consequences of the phasing out of milk quotas, Member States can establish specific aids for vulnerable areas or vulnerable types of farming in the dairy sector.

Member States have the possibility to apply decoupled measures (granting new SPS payment entitlements or increasing its value) in areas under restructuring or development programmes, up to a level of 10% of the SPS and SAPS envelope, representing about EUR 4 000 million.

Within this limit of 10%, 3.5% can be coupled, representing about EUR 1 400 million.

Member States decisions on specific support for 2010 are needed by 1 August 2009. However, Member States that would wish to apply specific support as from 2011 could still decide so by 1 August 2010. The Council regulation allows Member States to revise their decisions by 1 August 2011. If this creates difficulties it could be considered to make these provisions more flexible.

The Health Check also enlarged the scope of state aid to dairy farmers. In order to avoid reducing the payments to farmers more than necessary, Member States are allowed to finance up to 55%, within the 3.5% limit, by way of specific state aid to dairy farmers.

8.3. State aids

As a consequence of the financial crisis, farmers encounter increased difficulties to obtain credit. The Temporary Framework for State Aid measures to support access to finance foresees that aid not exceeding a cash grant of EUR 500 000 can be granted to undertakings until 31.12.2010, but at the moment excludes primary agricultural producers. Any *de-minimis* aid already received by individual undertakings since the beginning of 2008 has to be deducted from this amount. In light of the exceptional and transitory financing problems linked to the financial crisis, a modification providing a similar possibility for farmers, but at a substantially lower level in order to avoid distortion of competition in the agricultural sector could be examined.

For farmers a separate limited amount of aid could be introduced by modifying point 4.2.2 of the Temporary Framework. An amount of EUR 15 000 could be appropriate to limit distortions of competition between farms located in different Member States. This aid would benefit all producers, not just dairy. An urgency procedure would be possible for the modification of the Temporary Framework and the subsequent approval of the national aid schemes notified to the Commission under Article 87(3)(b) of the Treaty.

(See further details in CSWD)

9. RESTRUCTURING OF THE DAIRY SECTOR

The CAP has a number of instruments available to help restructuring in the dairy sector. These are available to Member States as an option.

9.1. Rural Development

Rural Development policy does not aim at immediate income support but provides options to support dairy farmers to become more competitive and to keep milk production in traditional dairy regions where it contributes to maintain the countryside.

EU rural development funds in 2007-13 are EUR 91.3 billion with about EUR 70 billion more of national public support. The Health Check and Recovery Package have added EUR 4.2 billion to address new challenges. "Dairy restructuring" has been identified as one of the new challenges.

Options under rural development for dairy producers include:

- Investment support, e.g. to improve the efficiency of milk production or enhanced animal welfare,
- Payments for dairy farmers in Less Favoured Areas,
- Support for environmentally friendly forms of dairy production, e.g. organic production, grassland management with reduced fertiliser use or mountain pasture management,

- Support for specific livestock-keeping practices improving animal welfare e.g. grazing premiums,
- Support diversification their activities, e.g. support for on-the-farm shops or renewable energy production,
- Support for dairy farmers who would like to leave the sector including possibly early retirement.

Moreover, as a further element for the restructuring of the dairy sector Member States could promote the formation of strong producers organisation in the dairy sector.

9.2. Other restructuring Measures

As mentioned in 8.2, restructuring in the dairy sector can also be encouraged by granting specific support under Article 68. The Temporary Framework for State Aid measures to support access to finance provides for the period until end of 2010 further aid instruments (notably subsidised interest rates and loan guarantees) which can be used to stimulate the restructuring process. Moreover, as noted in 7.2, Member States may use the excess to finance voluntary retirement from milk production or redistribute it to priority groups.

10. MARKET TRANSPARENCY AND COMPETITION

The market analysis above underlines current concerns about price transmission and the distribution of value-added in the dairy food chain between producers, processors and retailers. The best way to tackle such concerns would be effective and efficient functioning of the supply chain, in particular by enhancing market transparency and helping a fairer market operation. Competition Authorities at EU and national level should remain vigilant and effectively cooperate with a view to addressing any potential anti-competitive practices which may affect dairy markets. Farmers should be actively encouraged to work together to improve the efficiency of their operations by increasing their economies of scale and scope. This could also contribute to strengthen their countervailing power vis-à-vis larger processors and retailers. The dialogue between all actors in the food chain could also be further stimulated including a possible adoption of a European-wide code of conduct as recommended by the High Level Group on the Competitiveness of the Agro-Food Industry. But there can be no place for anti-competitive measures such as price-fixing and production restraints, which amount to hardcore cartels, national product labelling or national origin requirements.

10.1. Market transparency

The Commission is implementing the roadmap proposed in its Communication on Food Prices in Europe. The final report is expected at the end of 2009 including a specific analysis of the food chain in the dairy and pig meat sectors.

Without anticipating its full scope, it is worth noting that more transparent price information may facilitate competition law enforcement and consumers' choice. A permanent Europe-wide system for monitoring food prices could be set up, with comparable price and quality information at producer, processor and retail levels, as planned in the roadmap. This should cover all sectors, not just dairy, using statistical reporting mechanisms run by Eurostat.

Meanwhile, it would not seem useful to replicate the reporting of price data to Eurostat by Member States (to the extent that they currently collect such data) by the creation of *ad hoc* systems in the dairy sector. Member States could nevertheless reinforce their own statistical services to gather more complete data at all levels of the food chain.

10.2. Competition

The Commission, led by DG Competition, is examining potential anti-competitive practices in the food supply chain, especially the dairy sector. Competition policy plays a key role in maintaining a level playing field and ensuring that competition is not distorted in the sector. If the Commission finds competition is not functioning, it will not hesitate to act using all its powers under the Treaty. National competition authorities have similar powers and must play an equally important role in applying competition law due to the particularities of national markets. Therefore, co-operation and exchange of best practices between these services will be strengthened formally by a reinforced dialogue in the European Competition Network and by further informal discussions. A fast-track survey on dairy markets has been recommended to the ECN Food Sub-group meeting in early July, to stimulate and co-ordinate simultaneous monitoring and data collection by national competition authorities and a working group will be set up to that end.

Actors in the market should also look to improve its efficiency. Many dairy farmers are already organised in processor cooperatives that could look for better ways to adapt their members' milk supply to existing and future demand. Dairy farmers could also co-operate more effectively through producer organisations to increase their countervailing power vis-à-vis processors and retailers.

Inter-branch organisations – involving all the actors in the dairy food chain – could also foster a useful dialogue between all the players active in dairy markets. However, initiatives such as the above remain subject to the limits and conditions laid down in the competition rules applicable to the agricultural sector and it would be unprecedented and highly undesirable to allow anti-competitive practices in any sector.

In its Retail Monitoring communication the Commission is also examining best practices across Member States in terms of contractual relations between suppliers and retailers. This should help identify means to improve and render more transparent contractual terms between for example farmers co-operatives and the retail sector.

Member States could use the possibilities under Community law to encourage the formation of producer organisations in the dairy sector. To go further, to allocate specific financial support for the operating costs of producer or marketing organisations:

- At Community level, Council legislation and additional financial resources would be needed. Funds for olive oil and hops organisations were originally taken from direct payments in those sectors. There is a specific budget for fruit and vegetables where all the sector-specific support is paid via the operational programmes of producer organisations. The current scope under the direct payments legislation for such support is very limited, even under specific support measures since these require support to be paid directly to farmers and not to producer organisations,
- at national level it can be done by state aid authorisation. Start-up aid for producer groups for up to 5 years and EUR 400 000 in total is already allowed under the Agricultural Block Exemption Regulation and the Agricultural State Aid Guidelines. Those rules could be amended to allow more long-term aid and/or higher amounts.

11. CONCLUDING REMARKS

The Commission is committed to continue to support dairy farmers and stabilise the dairy market with the means at its disposal.

The catalogue of measures shows that the Member States have a considerable number of instruments available to them to alleviate the situation, to assist in the restructuring process and contribute to a soft landing for the dairy sector in light of the disappearance of quotas on 1 April 2015.

The European Council has asked for possible options for stabilising the dairy market, while respecting the outcome of the Health Check and thereby excluding policy changes for the dairy sector due to short-term difficulties.

Putting this policy into question, would only create uncertainty, delay the restructuring process and render no service to the many dairy producers who need clear guidance as they plan for their future. A steady course must be kept with the long-term perspective in mind.



COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMISSION STAFF WORKING DOCUMENT

accompanying the

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

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Communication from the Commission to the Council

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1. ADDITIONAL INFO REFERRING TO POINT 3.1 – MARKET SITUATION TO JULY 2009

1.1. EU milk supply

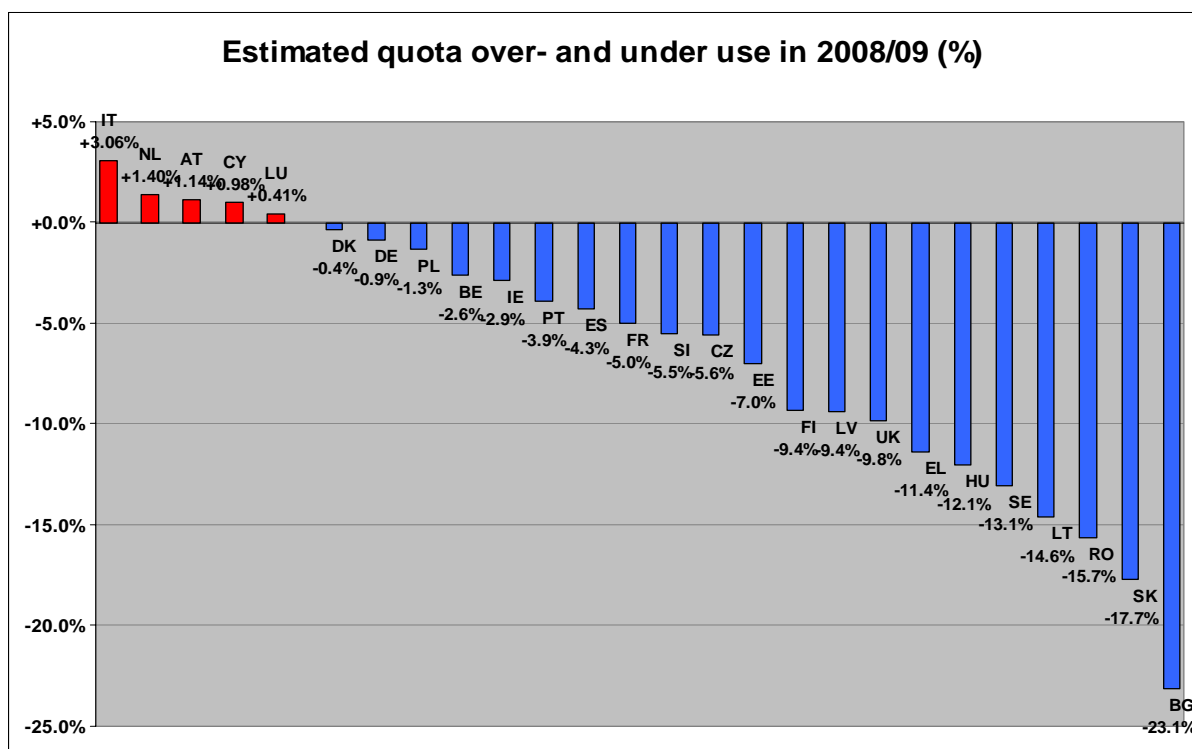
EU milk production has not increased as a result of the various quota increases. Milk deliveries to dairies, adjusted for milk fat, under the quota system was 137.8 million t in 2007/08 and is estimated at 136.4 million t for 2008/9. Despite the increase of the quotas by 2-2.5 % in the 2008/09 quota year, milk production in the EU-27 fell by 0.9 %. At 31 March 2009, total milk production was estimated to be 4.2% below the overall deliveries quota. On 1 April 2009, quotas were further increased by 1% and the fat correction reduced. Latest statistics indicate that EU-27 production increased by 0.5 % in May 2009 (see table 1). As the figures only relate to May 2009 compared to May 2008, it may be too early to draw final conclusions. Weather conditions in north-west Europe were favourable for dairy production in May, with relatively high average temperatures.

Table 1: Milk deliveries in April 2009 compared to April 2008

Countries with higher production			Countries with lower production		
	%	1000 Tonnes		%	1000 Tonnes
DE	+8.5%	+197.9	GR	-0.5%	-0.3
DK	+4.5%	+18.3	ES	-1.8%	-9.2
IT	+3.8%	+34.4	PT	-1.4%	-2.5
PL	+3.1%	+26.0	CZ	-1.8%	-3.8
LU	+2.3%	+0.6	UK	-1.9%	-24.6
AT	+2.0%	+5.0	SI	-2.6%	-1.2
NL	+1.6%	+15.3	HU	-3.2%	-4.2
FI	+1.3%	+2.7	FR	-4.3%	-94.6
SE	+1.2%	+3.0	IE	-5.2%	-36.3
BE	+0.9%	+2.3	EE	-5.2%	-2.9
			CY	-7.8%	-1.0
			SK	-8.3%	-7.0
			RO	-8.5%	-9.5
			LV	-10.4%	-6.1
			LT	-12.8%	-16.4
			BG	-25.9%	-18.3
			%		
			1000 Tonnes		
Total EU			+ 0.5%		
			+ 67.5		

Source : EUROSTAT (BE, GR and CY: other sources)

For individual Member States, the situation as regards their quota use is mixed with some Member States producing close to or more than their quota and others producing less and in some cases substantially less than their quota, see graph below:



National data for NL, DE and AT

Costs of milk production are collected via the Farm Accountancy Data Network. The most recent report, using 2006 figures, is available at:

http://ec.europa.eu/agriculture/analysis/fadn/reports/sa207_milk.pdf

1.2. EU demand

Dairy products made of milk are used in four main outlets: households, industry, food service and exports. For households there is some ad hoc information in member states available, but the use by industry and especially food service is very limited, if any at all.

A little over 40% of the EU milk is processed into cheese and 30 % into fresh dairy products. The rest is processed into powders, butter and casein. In the cheese market about 7% is exported and it is estimated that about 20 % is used in the industry and food service and. This would mean that a little over 70 % of the EU cheese is consumed by households.

However, while no overall consumption figures exist for the EU in 2009, the production figures of fresh products give a direct indication of consumption developments. In January to April 2009 production for drinking milk decreased by 2.5 %, fermented products by 1.3 % and cream by 0.8 %. For cheese the link between production and consumption is less clear as cheese can be stored longer. However the reduction in cheese production by 2.3 % in the first four months of the year may be a good indicator of reduction in cheese consumption.

It is clear that, dairy product consumption has suffered from the economic and financial crisis, in particular for the more expensive high quality products like cheese and fresh dairy products. This is a very noticeable development for cheese and fresh products as their consumption has been consistently increasing every year. Since more than 470% of milk is used to manufacture cheese and fresh dairy products, the effect of lower consumption is

important. Further, the use of dairy products in industrial processing is reported to have declined with buyers finding competitive substitution products.

Consumption or disappearance figures can be derived at the end of the year, on the basis of annual production figures and exports/imports. Detailed information can be found on the internet address indicated below:

http://ec.europa.eu/agriculture/publi/caprep/prospects2008/index_en.htm

1.3. World milk supply

According to FAO statistics the total world milk production in 2007 was 671 million tonnes, of which 560 million tonnes cow's milk. Milk production in major southern hemisphere exporters, strongly increased in the season just ended: New Zealand +7 %, Australia +2 %, Argentina +5 %. US milk production, after several strong annual increases, seems to have stabilised in 2009 with increases of 0.1 % in March/April and 0.2 % in May.

1.4. World market demand

While production increased, there is less demand on the world market. Most notable is the decrease in world-wide cheese exports which went up until 2007 but decreased by 7.8 % in 2008 and 12.3 % in the first three months of 2009. The EU is particularly hit by this development as the largest cheese exporter.

Table 2: Total world exports of major dairy commodities

	2005	2006	2007	2008	Difference 2007-2008
Butter (oil)	777 856	790 718	752 203	694 831	-7.6 %
SMP	1079 589	1094 527	1058 562	1110 877	+4.9 %
WMP	1710 683	1776 703	1641 817	1838 980	+12 %
Cheese	1475 022	1512 794	1586 459	1463 269	-7.8 %
Whey	823 395	917 897	1040 968	961 953	-7.6 %
EU share (%)					
Butter (oil)	40 %	30 %	27 %	21 %	
SMP	18 %	8 %	19 %	16 %	
WMP	29 %	24 %	22 %	26 %	
Cheese	37 %	39 %	38 %	38 %	
Whey	41 %	38 %	35 %	37 %	

	Jan-Mar 2008	Jan-Mar 2009	difference
Butter (oil)	185 078	175 256	-5.3 %
SMP	282 758	267 350	-5.4 %
WMP	453 012	448 487	-1,0 %
Cheese	376 434	330 035	-12.3 %
Whey	228 505	222 809	-2.5 %

Source: GTA

EU exports take place mainly in the form of cheese, whole milk powder and whey powder. While there are also considerable exports of skimmed milk powder, butter and condensed milk. The EU world market share is decreasing for most commodities, while it remains stable for cheese. In order to give an overall estimation of the size of the EU exports the total fat and protein content of the exports are compared to the total fat and protein of EU milk production. The share of EU milk exported is between 7.6 % for the fat and 10.6 % for the proteins. Certain dairy products are supported by refunds. Imports are smaller with only 1.4 % and 1.1 % of EU milk fat and milk protein production. Imports are mainly in the form of butter and cheese within Tariff Rate Quotas or products with low tariffs like casein.

Table 3: Share of EU milk production exported and imported.

million tonnes		2000/01(EU-15)	2008/09 (EU-27)
Production	Milk fat	4.6 million tonnes	5.5 million tonnes
	Milk protein	3.8 million tonnes	4.5 million tonnes
Share exported	Milk fat	9.7 %	7.6 %
	Milk protein	14.5 %	10.6 %
Share imported	Milk fat	2.7 %	1.4 %
	Milk protein	2.7 %	1.1 %

1.5. World market prices

The imbalance on a world market where trade is marginal to total production and consumption resulted in a significant collapse of prices compared to 2007, remaining at those levels after refunds were introduced. Refunds have been set objectively to not undercut world market price, as indicated in the tables below.

Table 4: World market prices

\$/tonne	Peak level	19 January 2009	2 July 2009
Butter	4 200 (Nov 2007)	1 950	1 900
SMP	5 200 (July 2007)	1 875	1 977
WMP	5 100 (Oct 2007)	1 950	2 050
Cheese	5 500 (Dec 2007)	2 750	2 600

Table 5: EU compared to world market prices

EUR/t 2 July 2009	Intervention price/equivalent price (a)	Current market price ¹ (b)	World market price ² (c)	Difference (c)- (b)	Difference (a) – (c)	Common Refund
Butter	2 218	2 236	1 348	- 888	-870	650
SMP	1 698	1 662	1 402	- 260	-296	228
WMP	2 066	1 966	1 454	- 512	-612	350
Cheese(cheddar)	2 484	2 296	1 844	- 452	-640	220

Table 6: demand for export licences

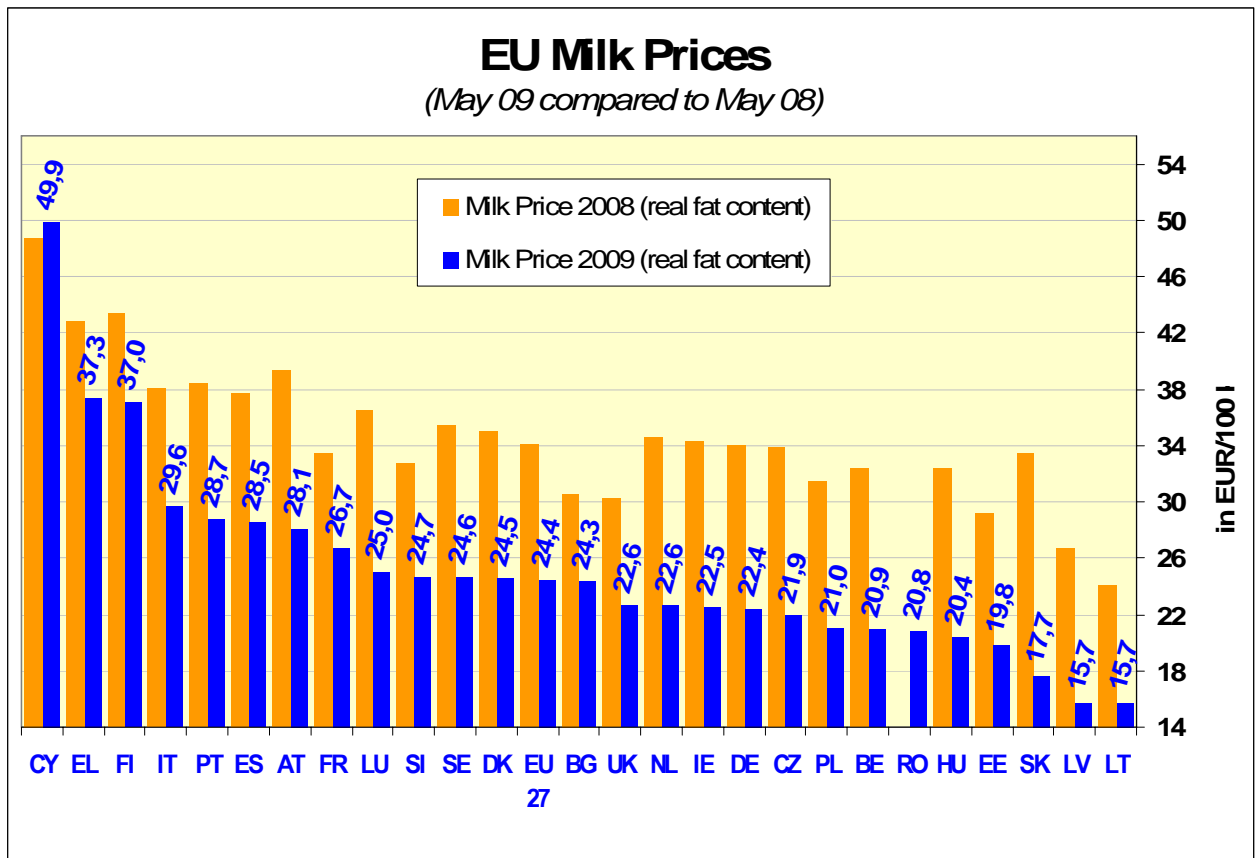
	23.1.09-23.6.09
Butter/oil	97 500 t
SMP	121 600 t
Cheese	144 000 t
Others (incl. WMP)	518 300 t

As of the month of June, demand for export licences slowed down considerably for powders and butter.

¹ Weighted average price of 7 main exporting MS.

² Oceania quotations (Source: USDA Agricultural marketing service).

2. ADDITIONAL INFO REFERRING TO POINT 3.2 – PRICES IN THE EU



3. ADDITIONAL INFO REFERRING TO POINT 3.3 – PRICES PAID BY CONSUMERS VERSUS PRICES PAID TO FARMERS

Table 7: Change in the producer and consumer prices for dairy products in the EU (% , Q1 2009 compared to Q4 2007)

	Producer prices (farmers, processors)				Consumer prices	
	Raw milk	SMP	Butter	Cheese	Food	Milk/cheese/eggs
EU	-28%	-42%	-37%	-21%	6%	4%
Belgium	-45%	-48%	-42%		6%	6%
Bulgaria	-11%				9%	5%
Czech Republic	-38%	-49%	-46%	-29%	3%	-4%
Denmark	-30%	-47%	-23%		5%	2%
Germany	-39%	-49%	-43%	-37%	3%	-3%
Estonia	-28%			-14%	7%	-1%
Ireland	-43%	-44%	-41%		4%	9%
Greece	-13%				6%	4%
Spain	-28%		-24%		3%	0%
France	-12%	-46%	-44%		5%	7%
Italy	-12%		-45%		5%	5%
Cyprus	20%				13%	5%
Latvia	-34%	-11%	-41%	-19%	15%	8%
Lithuania	-43%			-7%	14%	-2%
Luxembourg	-35%				4%	5%
Hungary	-33%	-46%	-1%		8%	5%
Malta					13%	10%
Netherlands	-39%	-47%	-46%	-44%	7%	7%
Austria	-20%				5%	-2%
Poland	-40%	-54%	-44%	-44%	6%	0%
Portugal	-17%		-39%		3%	1%
Romania					9%	14%
Slovenia	-6%			1%	6%	10%
Slovakia	-32%	-20%	-29%	-33%	3%	-2%
Finland	3%		-30%	0%	14%	22%
Sweden	-33%				9%	8%
United Kingdom	-27%		-57%	-27%	13%	11%

NB: Source: Agriview – Member State communication – Absolute raw milk prices ex-farm; absolute ex-factory prices for SMP, butter, cheese (depending on the country, prices for the following cheese types have been taken into consideration: Edam, Emmental, Gouda, Cheddar); Eurostat: consumer price indices for food and milk/cheese/eggs in retail

4. ADDITIONAL INFO REFERRING TO POINT 4.3 – OTHER MEASURES TO SUPPORT THE OUTLET OF MILK PRODUCTION

4.1. Marketing standards milk products

The single CMO, **Article 114** and Annexes XII and XIII lays down provisions on protected designations for milk products. The original legislation on the subject was adopted in 1987 (Reg. 1898/87) at a time when some products, with no milk products, used references suggesting the use of milk products or qualities of milk products.

Some designations (whey, cream, butter, buttermilk, butter oil, caseins, anhydrous milk fat, cheese, yogurt, kephir, koumiss, villi/fil, smetana, fil) are limited for milk products as referred by the Regulation ('milk products' means products derived exclusively from milk, on the understanding that substances necessary for their manufacture may be added provided that those substances are not used for the purpose of replacing, in whole or in part, any milk constituent.)

Decision 88/566 published a list of designations which were acceptable by derogation. Whereas the single CMO establishes the principle that the descriptions 'milk' and 'milk products' may not be used for milk products other than those described in Article 2 thereof; whereas, as an exception, this principle is not applicable to the description of products the exact nature of which is known because of traditional use and/or when the designations are clearly used to describe a characteristic quality of the product;), such as

Coconut milk

'Cream ...' or 'Milk ...'

Used in the description of a spirituous beverage not containing milk or other milk products or milk or milk product imitations (e.g. cream sherry, milk sherry)

Cream soda

Lait d'amande

Lait de coco

'Crème ...'

used in the description of a soup not containing milk or other milk products or milk or milk product imitations (e.g. crème de volailles, crème de légumes, crème de tomates, crème d'asperges, crème de bolets, etc.)

'Crème ...'

used in the description of spirituous beverages not containing milk or other milk products or milk or milk product imitations (e.g. crème de cassis, crème de framboise, crème de banane, crème de cacao, crème de menthe, etc.)

Pindakaas

Hoofdkaas

Cacaoboter

Margarinost

The example of "analogue cheese," when labelled as cheese, is not in conformity with EU legislation. A complete labelling of all ingredients would not be satisfactory, as it would refer to a non-dairy product but using the positive image of cheese as a sales argument.

Some designations, as "ice cream" were not covered as there were already national definitions for the product (exclusively with milk fat or not). The word "cream", relating to the texture of the product, is acceptable under Decision 88/566.

Modifying the current rules to include more protected designations would have to be done at Council level. One element to be taken into consideration is that the aim to simplify the legislation (Communication on the agricultural products quality policy) might be questioned

There are also requests to extend the list of derogations, for example for soy drinks to be designated "soy milk". It is clear that a designation presenting soy drinks as alternative to milk is meant to boost the sales, probably at the expense of 'real' milk, while the product is already widely available for consumers who prefer or who need this alternative product.

There is no reliable data on competing products market share but, with the exception of margarine, it is estimated not to exceed 1 – 2% of the milk market. Although the Commission has no concrete figures available, it is reported that the use of substitutes for cheese is increasing.

Article 115 and Annex XV of Regulation 1234/2007 refers to spreadable fats, regulating the designations of a) milk fats, b) fats and c) fats composed of plant and/or animal fats, covering in particular the designations 'three-quarter butter', "half butter" and "dairy spread x%"

Member states are responsible for the application of the EU legislation and they shall control and restrict the use of designations which do not respect the protected designations.

4.2. School milk scheme

Commission Regulation (EC) No 657/2008 lays down detailed rules for applying Council Regulation (EC) No 1234/2007 as regards Community aid for supplying milk and certain milk products to pupils in educational establishments.

Other dairy products are also available under the school milk scheme and are listed in Annex I of Commission Regulation (EC) No 657/2008. The amount of aid for these products is derived from the basic aid.

The school milk regime has only recently been adapted, making it more simple by having the same aid amounts for all milk (18,15 cents /litre based on a 0,25 l/day portion), extending it to secondary schools and increasing the product coverage. The level of aid is fixed by the Council. The value of the EU aid in relation to the price varies from Member State to Member State, but on average is in the order of 15%.

As to the product coverage, this is Commission competence, where the discussion in the Management Committee is ongoing since April, again with the purpose of making the scheme more attractive. The Commission proposed in the management committee of 9 July 2009 to reduce the minimum milk content to 75%, which allows adding 25% other products, like fruit, to milk (current eligible products must contain at least 80 % milk).

4.3. Aid for SMP in veal or SMP into casein

Council Regulation (EC) No 1234/2007 establishes in Article 99 an option to use a disposal aid for skimmed milk powder for use as feedingstuffs.

Before the 2003 reform the EU had an intervention price of 205 €/100g for SMP. In order not to lose a substantial outlet of SMP to the veal sector, the sector received an aid of 60 €/100kg. This brought their net price back to 145 €/100kg and kept the sector a buyer of SMP to feed to their calves. Today the intervention price for food grade SMP is 169.8 €/100kg and the market price for feed grade SMP is around 140 €/100kg. This means that the veal sector, which is suffering from the economic situation as well, is able to buy SMP at a lower price than before and without having to deal with a large administrative burden of the disposal aid. However, despite the low SMP price the sector seems to have turned away from SMP and buys more whey powder. While introducing the measure would be expensive in terms of subsidising existing use and administrative costs, the additional demand given the already very low price of SMP is estimated to be very limited. In that case the subsidy for the additional demand would exceed the price of SMP.

Council Regulation (EC) No 1234/2007 establishes in Article 100 an option to give an aid for skimmed milk processed into casein and caseinates.

For the aid of skimmed milk processed into casein the same applies, as casein producers can buy very cheap skimmed milk today and there is no need for this kind of production aid.

5. ADDITIONAL INFO REFERRING TO POINT 5B – PROMOTION

On the basis of the Council Regulation (EC) No 3/2008 of 17 December 2007 on information provision and promotion measures for agricultural products on the internal market and in third countries, the European Community can (co-)finance measures that provide information on, or promote, EU agricultural products and food on the Internal Market as well as in so called "third countries", i.e. outside the European Union.

Currently, 19 programmes (among 135 still active programmes) are exclusively promoting milk and milk products. Those 19 active programmes were adopted for a total amount of €66.5 million (EU participation: €33.3 million). It corresponds to 18.3% of the total amount of the active promotion programmes.

The Commission is expected to adopt on 7 July 2009 a new decision approving 16 new information and promotion programmes on the internal market and among them 4 programmes cover milk and milk products for a total amount of €19.4 million (EU participation : €8.1 million).

On the internal market, the implementing Regulation (CE) n° 501/2008 of the Commission currently stipulates that the trade organisations deposit their promotion programmes before 30 November, that Member States forward the programmes selected to the Commission before 15 February, and that the Commission decides at the latest on 30 June.

For third country programmes, the same Regulation foresees that programmes are deposited by the trade organizations before 31 March, forwarded to the Commission before the 30 June, and adopted by the Commission before 30 November.

Experience has shown that co-financed promotion programmes initiated by the trade organisations of this sector and co-financed at national and EU levels provide a valuable incentive.

6. ADDITIONAL INFO REFERRING TO POINT 7.2 – QUOTA MANAGEMENT ON AN INDIVIDUAL PRODUCER LEVEL

In the current Council Regulation, a super levy is due when the national quota is exceeded in any given year. The Member State concerned is liable to EAGF for the surplus levy but the super levy is subsequently claimed from all producers who have contributed to the national overrun.

Milk purchasers (often the dairies) are responsible for collecting the contributions from the milk producers and shall forward those amounts to the competent body of the Member State. The purchaser normally starts to deduct a part of the super levy from the milk price once the producer has exceeded his/her individual quota. The final account is made after the end of the quota year where underrun of individual quotas are matched against overruns and after account is taken of the national reserve. Where, as a result, it appears that there is no national overrun, the money collected is reimbursed to the producers concerned. Where on the other hand it appears that a surplus levy in fact is due, the final amount of levy per overrunning producer is generally reduced in function of other producers' under delivery. It may happen that contributions collected from producers are greater than the levy. In such cases, Member States may:

- use, partly or totally, the excess to finance voluntary retirement from milk production, and/or
- redistribute, partly or totally, to priority groups of producers.

Each Member State is managing a national reserve as part of its national quota. The national reserve is replenished by the yearly 1% increase (Health Check) and may furthermore be replenished by applying Article 72 of the single CMO where "Member States may decide whether and on what conditions all or part of the unused individual quota shall revert to the national reserve" in cases where producers do not market a quantity at least equal to 85 % of their quota ("inactivity rule"), up from 70 % as part of the Health Check. The national quota may also be increased by retaining part of quota transfers (Member State option) or Member States may decide to make an across-the-board reduction in all individual quotas.

In any case, where at the end of the quota year the Member State has not redistributed all of the national reserve to producers the residual quantity is still taken into account in determining whether the Member State is liable of a super levy or not.

Milk producers may therefore take this flexibility into account in exceeding their individual quota, estimating that the national reserve and/or other producers' under delivery would protect them from paying a super levy on at least some of their overrun.

In that context, the following elements have been identified to discourage milk production to a certain extent: (1) the 85% inactivity rule, (2) the rule providing for a temporary or permanent transfer of quotas, (3) allocation of the national reserve, like the 1% increase, to the direct sales quota and (4) the neutralisation of under delivery in the levy calculation.

As to the "inactivity rule", an invitation to Member States not to confiscate the unused quantity may, if followed, lead to more "sleeping quotas" and arguably less production.

Temporary transfer of quotas or permanent transfer of quotas (without land) are also left to Member States' discretion i.e. the Member State may decide not to allow such transfers. In this case, some quotas would remain inactive but the impact on total production would still depend on the willingness to take risk among the more progressive producers.

Thirdly, Member States may at present allocate any additional quota received to the direct sales part of the national reserve. By doing this the deliveries part of the national reserve is held constant and farmers cannot deliver more milk under the deliveries quota. As the direct sales quota is rarely fully used in any Member States, there is less risk of extra production to match the extra quota. However, allowing Member States the scope to subsequently reclassify any quota held in the reserve from one category to another category would require an amendment to the Council Regulation at a later stage.

A fourth element/option for Member States impacting the supply would be, in case a Member State is exceeding its quota and has to pay super levy, to disregard the unused part of the national quota allocated to deliveries when calculating each producer's contribution to the payment of the super levy. In that case, the progressive producers can no longer bank on the under delivery of others and would need to pay the full levy for his full excess quantity. Member States may then use the additional part of the collected levy, not destined for "Brussels", for restructuring purposes. The impact on supply is likely to be more important than under the first two options, although again limited to the Member States paying levy or risking to do so.

The overall effect of the above-mentioned potential measures would be to encourage a reduction of the supply of milk and dairy products, where the third option, may have more effect than the first three options, albeit limited to the countries close to their quota levels. However, a number of points should be emphasised:

- Production impacts, if any, will only be felt at the end of the quota year (Feb/March) provided that changes can be taken in this market year without harming legitimate expectations;
- Production impact from such measures, if taken, is highly dependent on each producer's perceived risk in terms of paying superlevy. Where that risk is remote more progressive producers will still expect to benefit fully from the underrun of others and from the national reserve;
- By restricting the leasing of quotas the prices for permanent transfers go up;
- By restricting all quota transfers, the sector will be "frozen";
- Basically, the recommendations/proposals will penalise the most efficient/ progressive milk producers and increase the cost of quota transfer;
- The production decisions will be based more on speculation and risk taking than to-day, in particular where the unused quotas and national reserves are increased.
- In principle such measures should be of temporary nature to meet the objective of solving the current imbalance of the market.

7. ADDITIONAL INFO REFERRING TO POINT 7.3 – COW SLAUGHTER SCHEME.

US HERD RETIREMENT SCHEME

The Coops Working Together (CWT) Herd Retirement Scheme is used in the USA to reduce the number of dairy cows in certain circumstances. It operates on a tender basis; producers offer to have their entire herd slaughtered if they receive a certain price per volume of milk production foregone. The CWT selects the most attractive bids and a payment is made when a selected producer proves his entire herd of milking animals has been slaughtered. The CWT payment is additional to the price received by the producer for the culled cows. Producers do not make a long term commitment to stay out of production.

The CWT operates a Herd Retirement Scheme only when certain criteria relating to milk margin and dairy cow numbers are observed. The Scheme was first put in place in 2003. 275 000 cows have been subject of the scheme and this is estimated by the CWT to have reduced output by about 675 000 tonnes in 2008 (about 0.8% of US production). The latest round accepted bids for almost 103 000 cows to be retired.

Dairy cow herd 1000 head	US herd	# cows taken out	Price accepted (\$/cwt)*	Milk production (Million tonnes)
2003	9 081	32.7	4.03	76.7
2004	9 010	50.5	5.24	76.9
2005	9 050	64.1	6.75	79.7
2006	9 137	-	-	81.8
2007	9 189	52.8	5.50	83.5
2008	9 315	75.2	6.10 – 6.49	85.4
2009	-	103	n.a.	-

* US intervention equivalent price is \$ 9.90/cwt

However, as indicated above the number of dairy cows in the US was never reduced. It is noted that US milk production has risen by 11.3% in the period since the CWT was first launched in 2003.

The CWT promotes claims that this measure has added almost 5% to the milk price (both of these claims are in comparison to what would have occurred if those cows and their offspring had stayed in production). Further analysis would be needed to assess the validity of those claims. As the CWT scheme is a producer financed scheme, so even if the extravagant claims made for it are not fully confirmed, the producers continued financing of the system suggests it does deliver benefits to those who pay for it.

An EU scheme, even if fully complying with rules on animal welfare, may not be well accepted by European citizens in relation to the intrinsic value given to the animals as defined by the protocol on animal protection in the European Treaty³.

8. ADDITIONAL INFO REFERRING TO POINT 8.2 – REDISTRIBUTION OF DIRECT AIDS – SPECIFIC SUPPORT

The Health Check - Regulation (EC) No 73/2009 has introduced three main means to redistribute direct payments between farmers/sectors/regions within a Member State:

- Article 68 measures,
- options for further decoupling of remaining coupled support (Articles 63 to 65),
- and options for revising payment entitlements (Articles 46 to 49).

These measures may be applied simultaneously, offering a large scope of options. They apply from 2010, Member States shall take their decisions for 2010 by 1 August 2009.

³ Treaty of Amsterdam amending the Treaty of the European Union, The Treaties establishing the European Communities and certain related acts – Protocol annexed to the Treaty of the European Community – Protocol on protection and welfare of animals (OJ C 340, 10.11.1997, p. 110).

Article 68 measures

- financed from the national reserve and/or unused amounts and/or reduction of all the payments entitlements
 - Various coupled measures
 - 68(1)(a), i.e. those taken over from the previous Article 69 of 1782/2003 (quality, marketing, environment) plus animal welfare and
 - 68(1)(b) which allows granting payments to dairy, beef and veal, sheepmeat and goatmeat and rice sectors in "economic vulnerable or environmentally sensitive areas or for economically vulnerable types of farming"
 - limited to 3.5 % of the SPS national envelope
 - One decoupled measure
 - 68(1)(c) : increase the value of the payment entitlements, or allocate new payment entitlements, "in areas subject to restructuring and/or development programs in order to ensure against land being abandoned and/or to address specific disadvantages for farmers in those areas" – limited to 10 % of the SPS national envelope, minus the part of this envelope that is used for other Article 68 measures

Example: Combination of Articles 68(1)(b) and 68(1)(c) for dairy farmers in mountainous areas- potentially up to 10 % of the SPS national envelope. The coupled part could be linked to the number of dairy cows and/or the milk quota and/or the milk production in 2010. The decoupled measure under Article 68(1)(c) could be linked to the milk quota in 2007, or any other historical reference, or to the criteria used for restructuring under the second pillar.

Further decoupling

- Support under a number of coupled support schemes fully or partially excluded from SPS is to be integrated in the SPS as from 2010. Schemes and dates are listed in annex XI of Regulation 73/2009.
- Hereby, Member States have a discretionary margin to allocate the additional amounts in the SPS. They can notably (Article 63) decide to allocate all or part of the additional amounts to farmers in other sectors than the sector that is to be decoupled. In that case, the allocation between farmers is:
 - based on the agricultural activity during a reference period to be fixed by the MS which shall be one or more years in the period 2005-2008
 - in accordance with objective and non-discriminatory criteria "such as the agricultural potential or environmental criteria".
- To protect legitimate expectation the redistribution is limited: the overall support a farmer receives must not fall below 75% of the total support (coupled and decoupled) received prior to further decoupling.

Examples: The amounts that could be used from 2010 for redistribution in relation to further decoupling vary a lot from between MS: no more than 16 millions EUR in Germany, close to 2 billions EUR in France. The reason is that where no partial recoupling option has been used in the first year of application of the SPS (German case), few amounts remain to be decoupled from 2010.

Revising payment entitlements

- The basic principle consists of annual progressive modifications of payment entitlements with a view to a flatter rate and based on objective and non-discriminatory criteria. Also based on objective and non-discriminatory criteria Member States can identify particular regions, where the value of the entitlements is to be increased, at the expense of the value of entitlements in the other regions. The necessary reduction of payment entitlements has to be done in various steps to protect legitimate expectations of the owners of these entitlements.
- One criterion for the regions to be identified can be the agricultural potential. This can be regions with predominant grassland or dairy production.
- The revision can start in 2010 (decision by 1.8.2009) or later (decision by 1.8.2010).

Examples: in addition to the articles 68 measures described in point 2, payment entitlements to dairy farmers in mountainous areas may be increased from 2010 via:

- Article 45 for MS using an historical model, and Article 48(1) for MS switching to a regional/hybrid model from 2010, which allow approximating the value of the payment entitlements "at the appropriate geographical level"; the effect would be an increase of the value of the payment entitlements for regions where farmers practice extensive types of production;

- Article 46, for MS that have used an historical approach for decoupling and allowing transfers between regions; the transfer shall not induce any payment entitlement being reduced by more than 10 %; this provision would for instance allow moving up to 10 % of the amounts from favoured regions to less favoured ones; Article 46 may be combined with Article 45 or Article 47;

- Article 47, allowing MS using an historical model to apply a regional model from 2010 (or at a later stage); depending on the way the regions are defined, and in conjunction with the optional use of Article 46, moving to a regional model could also induce some transfers in favour of dairy farmers, notably the ones using extensive production practises;

- Article 48(2), allowing MS applying a regional model from the first year of SPS implementation to revise the regions and/or the regional amounts and/or, to approximate the value of the payment entitlements.

The Health Check offers various options allowing significant redistribution of direct payments to farmers in the dairy sector. They can be combined and applied in addition to measures under the second pillar and/or state aid measures. For instance, they can be applied together with second pillar measures funded via Article 136 of R.73/2009, i.e. the transfer of the SPS "unused amounts" to the second pillar (amounts fixed in Commission Regulation, no more than 4 % of the SPS national envelope).

Apart from advancing the payments from 1 December 2009 to 16 October, the direct payment legal framework does not provide for a means that would allow alleviating the financial situation of the dairy farmers in the short term.

9. ADDITIONAL INFO REFERRING TO POINT 8.3 – STATE AIDS

To improve farm income in the context of the current crisis a modification of the Temporary Crisis Framework⁴ could be envisaged. The Framework foresees that a limited amount of aid of up to € 500 000 can be granted to undertakings but at the moment excludes primary agricultural producers from this possibility. A modification of the Framework could introduce a similar aid possibility to farmers, but at a substantially lower amount in order to avoid distortion of competition in the agricultural sector.

Point 4.2.2 of the Temporary Framework foresees that aid not exceeding a cash grant of €500 000 can be granted per undertaking until 31.12.2010. Any *de-minimis* aid already received by individual undertakings since the beginning of 2008 has to be deducted from this amount. Undertakings active in the processing and marketing of agricultural products are eligible unless the amount of aid is fixed on the basis of the price or quantity of such products. Primary agricultural producers are excluded from this aid possibility.

For farmers (primary producers) a separate limited amount of aid could be introduced by modifying point 4.2.2 of the Temporary Framework. An amount of 15,000 EURO would be appropriate in order to avoid distortions of competition. This aid would not be limited to milk producers but all primary producers could benefit of it.

An urgent procedure both for the adoption of the modification of the Temporary Framework and afterwards for the approval of the national aid schemes could be envisaged.

Aid measures under the Temporary Framework have to be notified as aid schemes to the Commission. They are approved on the basis of Article 87 (3) (b) EC Treaty.

Point 4.1 of the Temporary Framework requires Member States to demonstrate that the notified measure is necessary, appropriate and proportionate to remedy a serious disturbance in the economy of the respective Member State. A scheme limited to primary agricultural production is therefore unlikely to be approved as a stand-alone measure. It could, however, be approved as complementary measure (as of end of June 2009, the Commission has already approved for 18 Member States schemes with compatible limited amount of aid), or could be notified as comprehensive measure open to all sectors (with different aid levels) where no such scheme is in place yet.

10. ADDITIONAL INFO REFERRING TO POINT 9.1 – RURAL DEVELOPMENT

Rural Development policy is an integrated EU policy and part of the Common Agricultural Policy. It is a modern, flexible and integrated policy that puts emphasis on innovation and the development of human and social capital. The policy has successfully evolved over time to take on board the new priorities of European society. The strategic approach ensures an added

⁴ Consolidated version OJ C 83, 7.4.2009, p. 1.

value at European level. Making additional funds available for the new challenges in the context of the Health Check is only one reflection of this.

Rural development programmes in the Member States are adapted to reflect changing circumstances. Following the Health Check and the Recovery Package one major revision is foreseen in 2009. This revision of the existing rural development programmes provides the opportunity to inject the additional funds and to direct them towards dairy restructuring and/or the other new challenges and broadband infrastructure.

EU's rural development brings together economic, environmental and social aspects in an integrated approach. The policy has a three-fold aim: fostering competitiveness of the agricultural and forestry sector (Axis I), improving the environment and the countryside (Axis II) and improving the quality of life in rural areas and encouraging diversification of the rural economy (Axis III). In addition, the LEADER approach (Axis 4) plays an important role in improving governance and mobilising the endogenous development potential of rural areas.

EU's rural development has a well defined policy framework. It is based on a strategic approach involving four consecutive steps:

- First, the Community strategic guidelines for rural development set the priorities at the Community level;
- In a second step, each Member State submits a national strategy plan which translates the Community priorities in the national context;
- Thirdly, Member States and regions establish their rural development programmes with specific measures;
- Finally, both Member States and the Commission closely monitor and evaluate the results.

Based on this approach Member States should show what the recent trends in the dairy sector imply in terms of strengths and weaknesses. Based on this analysis Member States have to decide whether or not to provide additional support for dairy farmers. And, if yes, which support measures should be used.

An additional change introduced with the Health Check was to abolish the limitation of investment support for dairy farmers to the availability of dairy quotas. Now farmers may get investment support which exceeds the farm-specific quota rights. This should facilitate the provision of investment support to the more competitive farmers. Particularly those who intend to expand their production capacities in view of grasping a higher share in the world market may benefit from the simplification of this rule for investment support granted to dairy producers.

Because the situation of rural areas is diverse across the 27 Member States, it is up to Member States to decide whether or not they will provide in the rural development programmes for the possibility to use the additional funds under the second pillar for support of dairy farmers or not. The revised rural development programmes indicating the use and distribution of the additional funds from Health Check and Recovery package across the new challenges, including support for dairy restructuring and for support for broadband infrastructure, shall be submitted by Member States to the Commission by 15 July 2009.