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**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND
THE COUNCIL**

**Development of the dairy market situation and the operation of the "Milk Package"
provisions**

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1. SCOPE

Article 225(b) of Regulation (EU) No 1308/2013¹ provides that the Commission shall present a report to the European Parliament and to the Council by 30 June 2014 on the development of the market situation in the milk and milk products sector, and in particular on the operation of Articles 148 to 151, Article 152(3) and Article 157(3), assessing in particular the effects on milk producers and milk production in disadvantaged regions in connection with the general objective of maintaining production in such regions, and covering potential incentives to encourage farmers to enter into joint production agreements, together with any appropriate proposals.

The conference "The EU dairy sector: developing beyond 2015" held in Brussels on 24 September 2013 explored new challenges that the milk sector will face and discussed whether additional instruments were needed and feasible, taking into account the end of the quota system in 2015. Deliberations in the EU institutions on the results of the conference are ongoing. This report brings additional elements for the discussion and the Commission is keen to continue the debate with Parliament, the Member States and stakeholders on how best to manage the markets once the quotas have disappeared with a view to making further proposals where appropriate.

2. EVOLUTION OF THE MARKET SITUATION FOR MILK AND MILK PRODUCTS

The EU milk market is currently² in a quite favourable situation. The EU average milk price in January 2014 was 40.03 c/kg which is 17% higher than in January 2013, and the highest average milk price for January ever recorded (statistics since 1977). This upward trend has also been observed in the price of dairy products, although butter prices have been under some pressure since the beginning of 2014. Up to now, the strong global demand has supported firm prices. However, a correction in prices should not be excluded, given the milk production increase observed across the major exporters.

The medium-term prospects for milk and dairy commodities are favourable on both the world and domestic markets. World demand remains dynamic, especially in the emerging economies. Despite the slowdown in economic growth, dairy products are featuring more prominently in people's diets due to a higher proportion of middleclass households. Production increases resulting from the lifting of quotas can be expected especially in those Member States currently restricted by the quota such as Ireland, Germany, the Netherlands, Denmark, Austria and Poland, as well as in France. Production will depend on the pace of

¹ REGULATION (EU) No 1308/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 17 December 2013 establishing a common organisation of the markets in agricultural products and repealing Council Regulations (EEC) No 922/72, (EEC) No 234/79, (EC) No 1037/2001 and (EC) No 1234/2007 (O.J. L 347, 20.12.2013, p. 671)

² based on data available till mid-March 2014

consumption increase in both the EU and the world and on other factors such as environmental constraints.

More extensive information of the evolution of the market situation is supplied in the Commission staff working document accompanying this report.

3. THE OPERATION OF THE "MILK PACKAGE" PROVISIONS

The so-called "Milk Package"³ was published in March 2012, has been fully in force since 3 October 2012 and applies until 30 June 2020. Implementing and delegated regulations⁴ were published in June and September 2012.

The provisions of the Milk Package (as integrated in Regulation (EU) No 1308/2013) and their operation are described below. The report is based on the replies from Member States to a specific questionnaire⁵ as well as the notifications provided for in the implementing rules.

3.1. COMPULSORY CONTRACTS (ARTICLE 148)

Contracts lay down the responsibilities of operators in the dairy chain, increase awareness of market signals, improve price transmission, adapt supply to demand and avoid certain unfair commercial practices. After abolition of the milk quota system, they are a useful tool for producers and processors to plan their production volumes. Under Article 148 Member States have the possibility to make written contracts between farmers and processors compulsory and to oblige purchasers of milk to offer farmers a minimum contract duration. These contracts should be made in advance of delivery and contain specific elements such as the price, volume, duration, details concerning payment, collection and rules for force majeure. All these elements should be freely negotiated between the parties and farmers have the right to refuse an offer of a minimum duration in a contract. Deliveries by a farmer-member to his cooperative are exempted from this contract obligation if the statutes or rules of the coop contain provisions that have similar effects as the prescribed contract.

So far, 12 Member States provided for compulsory contracts, some even before the Milk Package entered into force.

³ Regulation (EU) No 261/2012; OJ L 94, 30.3.2012, p. 38.

⁴ Commission Implementing Regulation (EU) No 511/2012; OJ L 156, 16.6.2012, p. 39 and Commission Delegated Regulation (EU) No 880/2012; OJ L 263, 28.9.2012, p. 8

⁵ http://ec.europa.eu/agriculture/milk/milk-package/questionnaire-implementation-2013_en.pdf

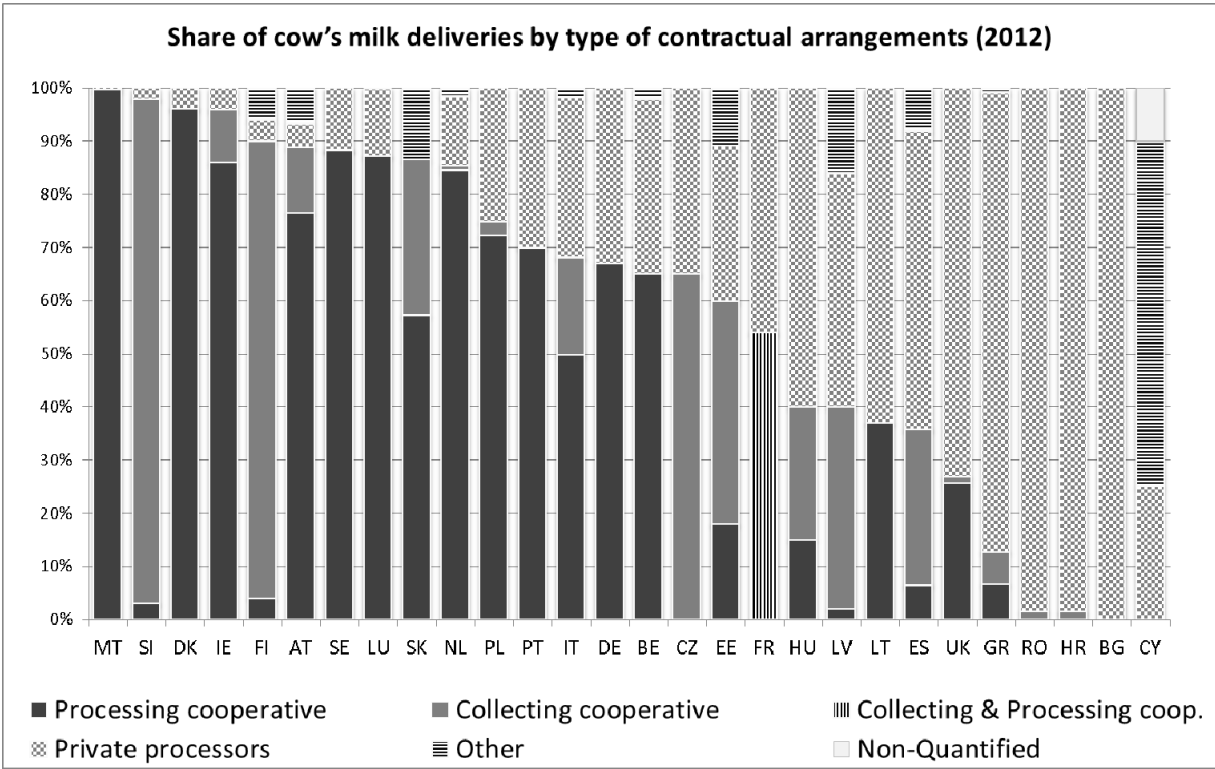
Table 1 Compulsory contracts

Member State	National Legislation	Minimum Contract Duration
Latvia	September 2009	-
France	April 2011	5 years
Italia	March 2012	6 months
Spain	October 2012	1 year
Lithuania	October 2012	-
Hungary	December 2012	6 months
Slovakia	December 2012	-
Croatia	June 2013	6 months
Cyprus	June 2013	6 months
Portugal	June 2013	6 months
Bulgaria	November 2013	6 months
Romania	1st quarter 2014	6 months

7 Member States provided that the contract proposed by the purchaser to the farmer should have a minimum duration of 6 months, while Spain opted for 1 year and France for 5 years contracts. Inspired by the Milk Package provisions, in the United Kingdom a Voluntary Code of Practice was agreed between producers and processors, providing for contracts under similar conditions as those specified in the Milk Package and covering more than 85% of raw milk production. Also in Belgium a code of good practice has been signed by 98% of the processors and the three most important farmer's organisations. It notably includes quality agreements, agreements on the period of notice of farmers and buyers, sustainability agreements and arrangements on the role of producer organisations. In Germany, for deliveries negotiated via POs, model contracts are commonly used which, in addition to quality, price parameters and duration, in future also would comprise more details on the milk volume.

Contracts have been made compulsory notably in Member States where the cooperative structure of contractual relations between producers and processors in the dairy sector was less pronounced. Graph 1 gives an overview of the share of cow's milk production by type of contractual arrangements distinguishing deliveries by member farmers to processing cooperatives and collecting cooperatives and deliveries by farmers to private processors and under other arrangements. The latter predominantly concern deliveries to private collectors or trading companies. Approximately 64% of all deliveries of cow's milk are made by member farmers to their processing or collecting cooperative. For France no distinction could be made between deliveries to processing and collecting cooperatives. For Germany, deliveries to private processors mainly take place through producer organisations or their associations. In general, the shares of the respective types of contractual arrangements are reported to be rather stable over recent years. Nevertheless, several Member States (EE, IT, LV, AT, SK) reported an increase in deliveries to private collectors, though their share in absolute terms is rather limited.

Graph.1 Contractual relations



3.2. PRODUCER ORGANISATIONS (ARTICLE 152(3))

Member States are obliged to formally recognise Producer Organisations (POs) constituted by producers in the milk sector on the initiative of producers and pursuing a specific aim which may include (i) ensuring that production is planned and adjusted to demand, particularly in terms of quality and quantity; (ii) concentration of supply and the placing on the market of the products produced by its members; (iii) optimising production costs and stabilising producer prices. Member States can set a minimum number of members and/or a minimum volume of marketable production that POs have to fulfil in order to be recognised (see annex, table 3).

All recognised POs focus on cow's milk, except one solely for ewe's milk in Spain. A large number of the total 228 POs in the EU dairy sector, notably in Germany and Italy, already existed before the Milk Package came into force. Nevertheless, the number recognitions has increased in 2013 (BE +1; CZ + 8; DE + 18; ES + 3, FR + 27). In Germany, one association of POs has been recognised in 2013 resulting in a total of two. In several Member States national legislation for recognition came only recently in force.

The rather large variation in minimum requirements shows the difficulty of finding a balance between the ambition to aim at large POs that have a potential to increase the bargaining power of producers and the encouragement to create POs by setting realistic thresholds. Nevertheless, it should be born in mind that in a second phase several POs can join in an association of POs that has the same possibilities for collective negotiation as a PO, but at a bigger scale.

It is suggested that the relative favourable market developments in recent year (see point 2) would not have stimulated farmers to join in POs.

In their report "**Analysis on the future developments in the dairy sector**"⁶ expert's suggested, among other things, to strengthen the role of POs notably by ensuring that they have an adequate size in order to have sufficient bargaining power.

The possibility for extension of certain rules of recognised POs and their associations (and interbranch organisations) to non-members and compulsory contributions by non-members under the reformed CAP⁷ now also applies to those organisations in the milk sector and is expected to qualify as an incentive for the creation of representative organisation.

Further incentives for farmers to join in POs are treated under point 3.8.

3.3. COLLECTIVE NEGOTIATIONS (ARTICLE 149)

In order to reinforce the bargaining power of milk producers, farmers can join together in producer organisations (PO) that can negotiate collectively the contracts terms including the price of the raw milk. The volume of milk that a PO can negotiate is bound by certain clearly defined limits (i.e. 3.5% of the EU production, 33% of the national production of the Member State). Deliveries by member farmers to their processing cooperatives cannot be subject of joint negotiations under the Milk Package, while collecting cooperatives can form POs that can negotiate collectively with processors.

Four Member States reported deliveries of raw milk in 2013 under contracts collectively negotiated in the context of this provision.

Table 2. Actual deliveries of cow's milk in 2013 under contracts collectively negotiated

Member State	Volumes raw cow's milk x 1 000 tonnes	Approximate share of deliveries
Czech Republic	445	18%
Germany	11 158	33%
Spain	255	4%
France	2 689	11%

In Germany, 2 associations of POs together with the 143 POs cover almost all milk deliveries to non-cooperative processors. In France almost 90% of the annual marketable volume of the recognised POs was actually negotiated collectively, while in Spain collective negotiations were conducted for about 16% of the marketable volumes of recognised POs. In addition,

⁶ External study prepared by Ernst & Young for the EC Agriculture and Rural Development Directorate-General. See: http://ec.europa.eu/agriculture/events/dairy-conference-2013_en.htm

⁷ Article 164 and 165 of Regulation (EU) No 1308/2013

Spain reported deliveries in 2013 of 68 000 tonnes of ewe's milk compared to a production of 571 000 tonnes. As deliveries by member farmers to their processing cooperative cannot be negotiated under the Milk Package, there is still some potential for collective negotiations, except for Germany and Member States with a high share of cooperative processors.

3.4. REGULATION OF SUPPLY FOR PDO/PGI CHEESES (ARTICLE 150)

In view of the importance of cheeses with a protected designation of origin (PDO) or protected geographical indications (PGI), notably for vulnerable rural regions and in order to ensure the value added and quality, Member States are allowed to apply rules to regulate the supply of PDO/PGI cheeses upon request of a producer organisation (PO), an interbranch organisation (IBO) or a PDO/PGI group. So far, two Member States have adopted rules for supply management for cheese. France adopted measures related to "Comté", applicable from 1 April 2012, to "Beaufort" from 27 February 2014 and Italy adopted rules for "Asiago", applicable from 12 February 2014. In both of these Member States further requests are under examination or being elaborated.

3.5. INTERBRANCH ORGANISATIONS (ARTICLE 157(3))

Specific rules for interbranch organisations (IBOs) in the milk sector allow the actors in the dairy supply chain to dialogue and to carry out a number of activities that under certain conditions can be partially exempted from competition rules (Article 210). These joint activities concern, amongst others things, the improvement of knowledge and transparency of production and the market, promotion, research, innovation and improving quality. IBOs should be made up of representatives of the producers of raw milk and at least one or more of the following stages in the supply chain: processing or trade (including distribution).

IBOs for the dairy sector have been recognised in Spain (one for cow's, ewe's and goat's milk), France (one for cow's milk, one goat's milk and two for ewe's milk), Hungary (for cow's milk) and Portugal. They generally operate at national level, except for the two IBOs for ewe's milk in France that have a regional coverage. They all comprise production and processing, while retail is only represented in the IBO in Hungary.

One practice of a French IBO, notably concerning the dissemination of certain market information and economic indicators, has been accepted in the context of Article 177a of Regulation (EU) No 1234/2007⁸.

3.6. COMPULSORY DECLARATIONS MILK DELIVERIES (ARTICLE 151)

In order to closely follow the development of the market after the milk quota regime expires and for the sake of transparency, this provision caters for timely information on delivered volumes of milk. It applies from 1 April 2015. Implementing rules are being prepared.

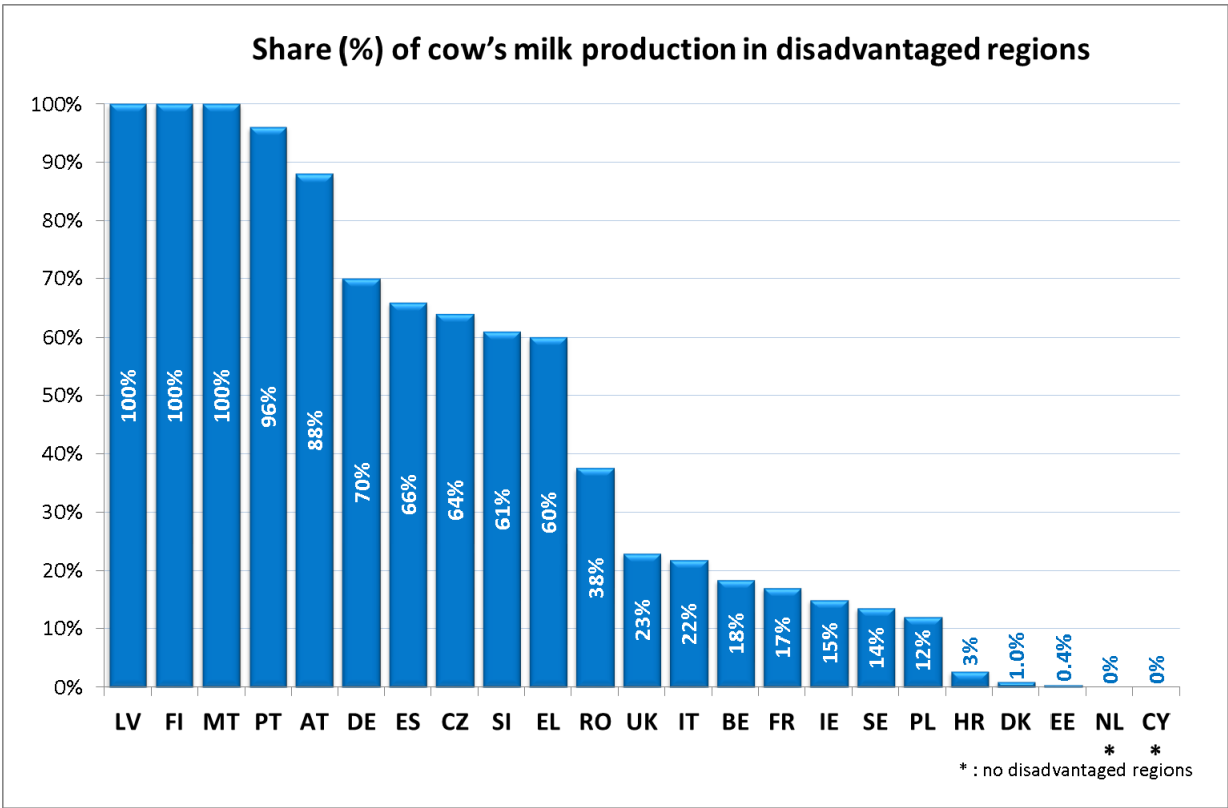
3.7. THE EFFECTS OF THE MILK PACKAGE ON MILK PRODUCERS AND MILK PRODUCTION IN DISADVANTAGED REGIONS

⁸ Now Article 210 of Regulation (EU) No 1308/2013

As there is no uniform definition of "disadvantaged regions" in relation to milk production Member States were asked what criteria they used in this context. Member States mostly refer to mountain areas but also to less-favoured areas affected by specific handicaps, areas in danger of abandonment, less-favoured areas (LFA) in general and outermost regions (e.g. Azores). Some Member States apply different gradations of handicap and/or add specific criteria e.g. remoteness, island, fragmented structure, soil, climate, low milk yields, high production costs etc. mostly referring to their national rural development programmes. Some Member States report that they have no data available on the issue (BG, LT, LU, HU, MT, SK).

On the basis of these rather heterogeneous definitions of "disadvantaged areas" the following data and developments have been registered:

Graph. 2 Milk production in disadvantaged regions



The general decreasing trend in the number of milk producers in all Member States over the recent years can also be observed in these disadvantaged regions, though in Poland the reduction is reported to be higher than in not disadvantaged regions. On the other hand, in France, Austria and Slovenia the decrease in mountain areas is less pronounced than in other regions, while Spain reports a slower reduction in the number of milk producers since 2006 when direct payments were introduced in the milk sector. Milk production volumes in disadvantaged regions are decreasing in Estonia, Greece and Poland, while increasing in Germany, Ireland, Latvia and Austria. Spain registered a significant production increase in particular in regions with low population (representing almost 40% of the national deliveries).

The contractual arrangements in disadvantaged regions, in so far as data are available, are more or less similar to those indicated under point 3.1, however, with a higher share of deliveries to processing cooperatives in Belgium, Ireland, Italy, Poland, Sweden and France. Information on activities of POs in disadvantaged regions is scarce; only France reported that 14 out of the 36 POs operate partly also in such regions, although no notifications for collective negotiations under Article 149 in such regions were received.

Member States did not report a significant effect of the Milk Package on the milk sector in disadvantaged regions notably because the provisions have been implemented only recently and the period of actual application was too short. In addition, most Member States were not able to provide detailed data on the issue.

The inventory shows that the situations and developments on the milk sector in disadvantaged regions in and between Member States are quite heterogeneous and would require a targeted approach. Similar statements can be found in the European Parliament resolution of 11 December 2013 on maintaining milk production in mountain areas, disadvantaged areas and outermost regions after the expiry of the milk quota⁹. Existing and new measures under the reformed CAP cater for such targeting.

Under their Rural Development Programmes¹⁰ Member States can address the specific needs of the dairy sector with a strategic approach by drawing up tailored thematic sub-programs targeted e.g. at restructuring of milk production if the sector has a specific impact on the development of the rural area or at mountain areas. Furthermore, the support for areas facing natural and other specific constraints provides for payments compensating for income foregone and additional costs in those areas where agricultural production is suffering from natural constraints. This could of course also concern milk producers in case they are located in an area under constraint. These payments are particularly important to prevent farmland abandonment. Moreover, the new Rural Development Regulation also features an increased ceiling for payments for areas facing natural or other specific constraints – from 250 to 450 €/ha in mountain areas and from 150 to 250 €/ha in other areas.

Under Direct Payments¹¹, for example, Member States may decide to provide voluntary coupled support, for dairy farmers, up to a certain limit of their national envelope and to the extent necessary to create an incentive to maintain current levels of production. This support will be targeted at sectors or regions where specific types of farming or specific agricultural sectors that are particularly important for economic, social or environmental reasons undergo certain difficulties. Moreover, Member State may decide to grant a payment for areas with natural constraints, up to 5% of the national envelope.

⁹ <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2013-0577+0+DOC+XML+V0//EN&language=EN>

¹⁰ Regulation (EU) No 1305/2013; OJ L 347, 20.12.2013, p. 487.

¹¹ Regulation (EU) No 1307/2013; OJ L 347, 20.12.2013, p. 608.

In addition, for EU's outermost regions the POSEI arrangements¹² ("Programme d'Options Spécifiques à l'Éloignement et l'Insularité") are designed to take account of their geographical and economic handicaps such as remoteness, insularity, small size, difficult topography and climate, economic dependence on a few products.

It is worth mentioning that between 2010 and 2013, 14 Member States have implemented specific support in the dairy sector under Article 68(1)(b) of Regulation (EC) No 73/2009 with a total allocated amount of around EUR 1 billion.

3.8. POTENTIAL INCENTIVES TO ENCOURAGE FARMERS TO ENTER INTO JOINT PRODUCTION AGREEMENTS

In reply to the questionnaire (see point 3) a number of Member States suggest financial support for notably for producer organisations (some referring to the Fruit and Vegetable sector as an example) as an appropriate incentive to encourage farmers to enter into joint production agreements. Other suggestions point to increasing the POs ability to develop other functions, beyond collective negotiations of raw milk deliveries, e.g. more implication in market regulation, joint negotiations with animal feed suppliers or beef fatteners. Also information campaigns raising awareness of the benefits of a PO membership and presenting successful examples were proposed. Another group of Member States saw no need for such incentives referring to the well-developed cooperative structure of their milk sector.

In this context, the reformed Rural Development Policy offers notably the following possibilities:

- Support for the setting up of producer groups has been extended to producer organisations in the period 2014-2020.
- The new measure on cooperation (which is potentially open to producer groups, cooperatives and interbranch organisations) provides for possibilities to support e.g. the development of new products and practices, short supply chains and local markets as well as the cooperation of small operators in organising joint work processes and sharing facilities. In combination with support under the investment measure collective investments may benefit from higher aid rates (possible increase by 20 percentage points).
- Groups of farmers can additionally also benefit from a series of rural development measures, such as investment support, participation in quality schemes and information/promotion activities, agro-environment-climate measures, etc.

4. FINAL REMARKS

The EU milk market situation is currently favourable and the medium term prospects are good, though with probably more episodes of extreme price volatility.

¹² Regulation (EU) No 228/2013; OJ L 78, 20.03.2013, p. 23

The Milk Package provisions have been transposed into national legislation. 12 Member States have provided for compulsory contracts between farmers and processors. In two other Member States codes of good practice inspired by the Milk Package have been agreed between farmers and processors organisations.

Almost all Member States have adopted national criteria for the recognition of Producer Organisations (POs), though some only recently. In 6 Member States a total of 228 POs were recognised by the end of 2013, a number of which existed before the Milk Package came into force. The creation of (new) POs requires time and of course a strong dynamic coming from farmers themselves. The recent favourable market developments and prospects might not have stimulated farmers to join in POs. In this context potential incentives to encourage farmers to enter into joint production agreements have been provided in the reformed Rural Development Policy (support for setting up of POs, new measures on cooperation and eligibility of groups of farmers for a series of rural development measures). Furthermore, the possibilities for extension of certain rules of POs and compulsory contributions for non-members might stimulate the creation of large POs.

Collective negotiations under the Milk Package have been conducted by recognised POs in four Member States. Such negotiations lead to actual deliveries in 2013, varying between 4 to 33% of the total deliveries in the respective Member States.

Regulation of supply for PDO/PGI cheese has, so far, been provided by 2 Member States for 3 cheeses. Further initiatives have been announced.

The possibilities for extension of rules and financial contributions referred to above also apply for interbranch organisations (IBOs) and might be an incentive for their creation. So far, IBOs have been recognised in four Member States.

It is too early to see significant effects of the Milk Package on the milk sector in disadvantaged regions. In so far as data are available and based on the variety of criteria used by Member States to identify "disadvantaged regions", the trends of milk production in those regions vary significantly between Member States and between regions within the same Member State. Nevertheless, in several Member States the share of deliveries to cooperative processors in disadvantaged regions is reported to be higher than in other regions. It was not possible to obtain concrete data on activities of POs in disadvantaged regions.

At the conference "The EU dairy sector: developing beyond 2015" held in Brussels on 24 September 2013, the idea of a European Milk Market Observatory was launched and is currently being implemented by the Commission services. The Observatory is a tool within the European Commission responsible for the dissemination of market data and short-term analysis for the dairy market, with the involvement of producers, processors, trade and retail as well as independent experts, and the ambition of addressing the growing need for transparency through more detailed and timely information. Stakeholders contribute with their expertise and market knowledge, adding a qualitative aspect to the quantitative approach of data collection and market analysis. The ultimate objective is to give quantitative and qualitative tools for economic operators to increase their market awareness and help them with their business decisions. The Observatory will also be in a position to send early warnings to the Commission services, when the market situation so requires.

Under the new CAP (2014-2020), the dairy sector is equipped with a safety net (intervention buying-in for butter and skimmed milk powder, private storage aid for butter , skimmed milk powder and PDO/PGI cheeses), coupled with a regulatory framework for the Commission to react to exceptional circumstances (e.g. extension of the intervention buying-in period, private storage aid for other dairy products, export refunds, authorise a temporary derogation from competition rules as regards agreements and decisions of recognised organisations to take certain measures, exceptional counter-cyclical payments). In addition, milk producers benefit from direct payments and rural development programmes, under which Member States enjoy a considerable leeway to target measures specifically to the milk sector.

The current outlook for world dairy markets remains largely positive. However, there are still doubts on the capacity of the EU regulatory framework to deal with episodes of extreme market volatility or with a crisis situation after the expiry of the quota regime, especially with a view to ensuring the balanced development of milk production across the European Union and avoiding extreme concentration in the most productive areas.

The creation of the Milk Market Observatory will help the Commission to monitor market developments and deploy "safety net provisions" in a proactive manner. Various suggestions to go further and strengthen the available instruments have been put forward. In particular, ideas have been presented on how to equip the EU with the means to preserve viable dairy production in crisis situations, to better manage harmful consequences for milk production in disadvantaged regions and to provide tools to counter a surge in production that could seriously affect long-term market stability. Questions have also been raised on how market actors can be made responsible for their decisions to exploit development opportunities and to contribute to crisis resolution.

The Commission will pursue the debate to address these concerns. In particular, it will explore the need and scope for additional tools for better anticipating crisis situations and for coping better with crisis situations and market volatility. Additionally, further analysis is needed to find more efficient ways of supporting the milk sector so as to contribute to improved competitiveness and sustainability of milk supply across the EU after thirty years of milk quotas. The debate on the instruments already in force and the need for additional ones will take place without delay, before the next Commission report on the operation of the Milk Package and on market developments scheduled for 2018.