

ASSEMBLY OF THE REPUBLIC
EUROPEAN AFFAIRS COMMITTEE

Opinion

COM(2012)741

**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT
AND THE COUNCIL on the evolution of the market situation and the consequent
conditions for smoothly phasing out the milk quota system – second "soft landing"
report**

PART I – INTRODUCTORY NOTE

Pursuant to Article 7 of Law No 43/2006 of 25 August 2006 on the monitoring, examination and issuing of opinions by the Assembly of the Portuguese Republic in the context of the process of EU integration, subsequently amended by Law No 21/2012 of 17 May 2012, and in accordance with the Guidelines for the Scrutiny of EU Initiatives approved on 8 January 2013, the European Affairs Committee received the REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL on the evolution of the market situation and the consequent conditions for smoothly phasing out the milk quota system – second "soft landing" report (COM(2012)741).

PART II – RECITALS

1 – This initiative concerns the REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL on the evolution of the market situation and the consequent conditions for smoothly phasing out the milk quota system.

2 – According to this document, the prospects for the milk market and for dairy products in the medium and long term are favourable. The document also states that price developments show a 'trend towards higher levels', but in the long run a balance between supply and demand might be reached. In this respect, the so-called Milk Package¹ offers the necessary tools for operators in the dairy supply chain to attune their supply to the market. The document states that both the evolution of milk production versus milk quotas, and the downward trend in quota prices show that a "soft landing"² is on track, starting in 2015. This means that the Commission believes that the conditions are in place to move towards liberalising the market from 2015, the period when the current system of milk quotas expires. This situation means that amendments are needed to the legislative framework that applies in this case.

There is nonetheless a certain amount of concern as regards rural areas in which milk production plays a central role, in particular in the context of milk quota expiry. Despite this, the view is that the proposals to reform the Common Agricultural Policy (CAP) contain the necessary instruments to mitigate potential impacts as regards the liberalisation of the market.

3 – Given the subject matter, this initiative was submitted to the Committee for Agriculture and the Sea for its assessment. The Report appended to the present Opinion was adopted and is an integral part thereof.

PART III – OPINION OF THE RAPPORTEUR

The conclusion from analysing this document is that the milk sector is definitively moving towards the free market.

¹ Regulation (EU) No 261/2012 of the European Parliament and of the Council of 14 March 2012 amending Council Regulation (EC) No 1234/2007 as regards contractual relations in the milk and milk products sector. This has been fully applicable since 3 October 2012.

² According to the Commission Communication on the dairy market situation, the "soft landing" should be ensured by gradually eroding the value of quotas to reach zero at 1 April 2015 – COM(2009) 385.

However we take the view that the territorial impact of cutting the milk quotas across the regions of the European Union should have been considered in more depth, particularly from the economic, social and environmental perspective. It should be remembered that more than two-thirds of dairy farms are located in disadvantaged areas and are faced with a variety of constraints, and these include outermost regions.

As far as Portugal is concerned, this situation gives us great cause for concern: Portugal has outermost regions, for instance the Azores, where the dairy sector accounts for around 70% of regional agricultural activity and where yields have dropped significantly in recent years. The abolition of the quota system means the start of the liberalisation of the European milk and dairy products sector, allowing for free competition. In the name of cohesion an effort must be made to include the geographical position of the regions in the conditions of economic competitiveness.

In this connection it should be noted that the current quota system protects disadvantaged areas as is the case of the North region of the country and the outermost regions, particularly the Azores. When the system is abolished, these regions will inevitably confront increased difficulty in being competitive in a liberalised market. This could result in a concentration of milk production in countries that are more productive and – therefore – more competitive.

We recognise that the so-called 'dairy package' included measures designed to minimise the effects of abolishing the quota system and which could have been important in these regions. One example is the measure designed to compensate for serious imbalances in the milk and dairy products market. The idea of this measure was that after the end of the quota system and when a crisis in the sector was demonstrated, the European Commission could give help to milk producers which voluntarily reduced their production by a minimum of 5% compared to the same period a year earlier. The Commission could equally impose, for a minimum period of three months, limits on milk producers which increased production by a minimum of 5%.

We are not overly optimistic, but we do hope that the instruments adopted produce the desired effects as regards disadvantaged regions so that the impact of liberalisation in the dairy sector on products is lessened and so that milk may still be produced in Europe's disadvantaged regions.

PART IV – OPINION

In the light of the grounds set out above and the Report of the competent Committee, the European Affairs Committee is of the opinion that:

1. Since this is not a legislative initiative the principle of subsidiarity does not apply.
2. The European Commission should carry out additional studies to assess the territorial impact of the abolition of quotas as it affects groups of countries, regions – particularly the outermost regions – and disadvantaged regions, with the goal of controlling the future risk that production plants move away from many of these regions leaving them in decline.
3. This concludes the scrutiny of the initiative in question.

Palácio de S. Bento, 12 November 2013

The Rapporteur

[signed]

(Jacinto Serrão)

The Chairman of the Committee

[signed]

(Paulo Mota Pinto)

PART V – ANNEX

Report from the Committee for Agriculture and the Sea.

ASSEMBLY OF THE REPUBLIC
COMMITTEE FOR AGRICULTURE AND THE SEA

[Handwritten note, not fully legible: 'Adopted in the meeting of the Committee for Agriculture and the Sea of 8 October 2013 by a majority of votes of the (...) of the PSD, PS, CDS/PP and PEV. The (...) of the PCP voted against and the (...) of the BE did not attend the meeting. 8 October 2013.']

Report of the Committee for Agriculture and the Sea

**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT
AND THE COUNCIL on the evolution of the market situation and the consequent
conditions for smoothly phasing out the milk quota system – second "soft landing"
report**

COM(2012)741

MP Fernando Jesus

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PART I – INTRODUCTORY NOTE

Pursuant to Article 5(4) of Law No 43/2006 of 25 August 2006, subsequently amended by Law No 21/2012 of 17 May 2012 on the monitoring, examination and issuing of opinions by the Assembly of the Republic on matters relating to EU integration, the **REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL on the evolution of the market situation and the consequent conditions for smoothly phasing out the milk quota system – second "soft landing" report** (COM(2012)741) was submitted to this Committee, in view of the content of that initiative, so that the Committee could examine the document and issue an opinion.

PART II – RECITALS

The report on the "soft landing" of the elimination of milk quotas was issued in accordance with Article 184(6) of Council Regulation (EC) No 1234/2007 of 22 October 2007 establishing a common organisation of agricultural markets and on specific provisions for certain agricultural products (Single CMO Regulation). This Article provides that the Commission shall present a report before 31 December 2010 and 31 December 2012 to the European Parliament and Council regarding the evolution of the market situation and the consequent conditions for smoothly phasing out the milk quota system.

This first "soft landing" report (COM(2010) 727 final) published on 8 December 2010 was not examined by this Committee, unlike the present report, which is the second on this subject.

The report is divided into three distinct parts: Part 1 **describes the evolution of the market situation for cows' milk and milk products since mid-2010** (the end of the period covered by the first report) and sets out an overview of the perspectives in the medium term; Part 2 **assesses the way in which the smooth phasing out of the milk quotas has been carried out**; and Part 3 contains some **concluding remarks**.

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

1.1. Market developments to date

Volatility – although not to the extent observed in 2007-2009 – **persisted in the milk and dairy market** until the end of 2010. This volatility somewhat receded in 2011 and in 2012. As prices reached high levels in 2010 and 2011, production increased leading to a price correction. Prices started to move upwards again in the third quarter of 2012.

Cow milk collection in the EU and in the main milk producing regions of the world **has increased**. In Europe it has increased consistently over the past three years: + 1.4% in 2010, + 2% in 2011 and some 1.5% in the first seven months of 2012. Meanwhile, the combined production of USA, New Zealand, Australia and Argentina increased by 5.4%. Milk production in the first eight months of 2012 increased by + 2.8% in the USA, +11.4% in New Zealand (until July only), +4.7% in Australia and + 5.9% in Argentina.

Average EU farm gate milk prices stayed at around 33 c/kg until April 2011 and constantly increased again to 35.1 c/kg in November 2011. However, there was a drop in

prices in 2012 that lasted until the summer, exceeding the seasonal trend and responding to pressure from increased milk supply in and outside the EU. The latest EU average farm gate milk price is estimated at 31.3 c/kg for August 2012.

The **recovery in dairy commodity prices** in 2010 and the first semester of 2011 was due to increased demand, notably from emerging economies, and limited supplies from the Southern Hemisphere.

But from the middle of 2011 dairy product prices came under pressure following increased availability of dairy products from the main dairy supplying regions of the world. Downward pressure continued in the first months of 2012 until finding a bottom level in May. In June prices started to increase and developments until the date the report was drafted have continued upwards, notably due to reduced milk availability from the US in the wake of an unprecedented heat wave and to a simultaneous drop in milk production in the EU as well, while the Southern Hemisphere was in its winter, i.e. low production, season.

EU exports increased in 2010 and 2011 for all major dairy products, with the exception of butter/butteroil and whole milk powder. EU exports have been particularly dynamic for skimmed milk powder. There was a noticeable recovery of butter exports in the first seven months of 2012.

During most of 2011, **increasing operating costs** were compensated by increasing milk prices. In the first quarter of 2012, milk margins declined in the wake of decreasing farm gate milk prices.

According to first estimates for the second quarter of 2012, **the gross margin of milk producers fell by 17%** due to an increase in production costs and an 8% decrease in the farm gate milk price.

1.2. Medium term market prospects

The forecasts contained in the report show that the medium-term market prospects for markets in dairy products are favourable, boosted by the constant increase in demand at a global level and the increasing appetite for dairy products (this is also due to an increase in *per capita* consumption). If any of these forecasts/assumptions (based on the Aglink-Cosimo model) do not materialise, this would affect the resulting projections significantly.

Sustained import demand, particularly from emerging countries, would have a positive impact on **dairy commodity prices**, thus fuelling EU export potential. Nevertheless, EU market shares are projected to slightly deteriorate as a result of a high rate of increase in exports from countries outside Europe.

EU milk production is projected to continue increasing from 2012 onwards at a moderate growth rate (a cumulative increase of about 8% from 2009 to 2022) but to remain below the potential growth rate provided by the phasing-out of the milk quota regime. By the last quota year (2014-15), EU milk deliveries are projected to be some 6% below quota.

EU production of **fresh dairy products** (including drinking milk, cream, yogurts, etc.) is projected to increase by almost 8% (from 2009 to 2022, the same as for milk production) and **cheese** by almost 10%. These positive trends are forecast both for the internal and

world markets. Substantial demand on the world market would allow for a progressive increase of EU exports. However, the EU will gradually lose world market share, though it will still account for around 31% of the market in 2022.

Whole milk powder production in the EU is expected to stay relatively stable over the short term, supported by an increase in world demand, led by China. The EU share in global exports is expected to decline gradually, however, to 14% by 2020 (from 25% in 2009).

EU **skimmed milk powder production** is projected to increase by about 28% throughout the forecast period, boosted by a strong global demand for imports, which would drive a favourable outlook for exports and which could reach a market share of almost 31% of global exports in 2022.

The outlook indicates continued market stability for **butter**, resulting from positive market conditions over the projection period, with prices at relatively high levels and firm EU demand.

2. SMOOTH PHASING OUT OF THE MILK QUOTAS

2.1. Milk production compared to quota ceilings

The CAP Health Check deal of November 2008 resulted in an annual increase in milk quotas by 1% over five consecutive years until the expiry of the quota system on 1 April 2015, with a year remaining of increase in quotas in the EU.

According to the Commission's report, year on year, milk quotas are gradually becoming less relevant, as actual milk output falls short of these ceilings in a number of Member States. In quota year 2010-11, only five Member States exceeded their milk quota, while overall EU production was 6% below quota. In the 2011-12 quota year, EU milk deliveries were approximately 4.7% under quota.

In the case of Portugal, Graph 1 in Annex III of the report shows that milk production was under the national quota, with the 2009-10 quota year the period with the lowest under-use, and the 2010-11 quota year the period with the highest under-use, with a slight drop in under-use in the 2011-12 quota year.

Good weather conditions prompted increased production levels in 2010 and 2011, not only in the EU but in all milk supplying regions around the world. This exerted downward pressure on farm gate milk prices, and milk production started to respond by slowing down in the subsequent months.

In the report, the Commission states that *'Those developments show that production response is gradually shaping according to market signals but also that weather conditions are a true player in the dairy market.'* But it also says that *'With milk quotas becoming less and less relevant, EU milk supply can better respond to market opportunities'* with less distorted prices and efficiency gains achieved through restructuring.

2.2. Milk quota price evolution

According to the Commission, *'The milk quota price should be decreasing with the shortening life of the quota regime and this is actually the case in a majority of Member States where the quota price is very low or equal to zero'*.

The Commission says that in Member States whose milk deliveries are well below quota ceilings, the quota price is already very low or equal to zero. However, in Member States whose milk deliveries are close to the quota ceilings and in the Member States whose milk deliveries exceed their ceilings, the quota price depends on the expectation of a surplus levy. The Commission says that *'quota purchases are projected to be further declining towards zero, with fluctuations due to occasional surplus production under favourable weather conditions and remunerating milk prices.'*

3. Concluding remarks

The Commission's second "soft landing" report, which is the subject of this opinion, contains the following conclusions:

- Medium and long term prospects are favourable for the milk and dairy sector in line with population growth and appetite for western diet in emerging economies.
- As regards drops in prices, the current difficulties endured by dairy farmers in certain areas more severely hit by the hike in the price of feedstuffs cannot hide the overall positive picture of the sector.
- In the long run, the balance between supply and demand depends on a large variety of factors, ranging from economic parameters to policy decisions. In this respect, the so-called Milk Package³ offers tools for operators in the dairy supply chain to attune their supply to the market.
- Both the evolution of milk production versus milk quotas, and the downward trend in quota prices show that "soft landing" is on track.
- No change is required in the existing framework, which has been providing certainty to milk producers since 2008 and is proving its efficiency in securing a smooth phasing-out of the system of quotas.
- Despite the concept of soft landing, some concerns are voiced with regard to rural areas in which milk production is playing a central role, in particular in the context of milk quota expiry. In this respect, the inclusion of the milk sector in the so-called "new challenges" under the second pillar of the CAP is providing further support to dairy farmers in preparing for the end of quotas.
- The CAP reform proposals contain instruments that could mitigate potential impacts. Furthermore, the Commission has issued an open call for tenders for an analysis by independent experts of future developments in the milk sector from 2015 onwards, and will report to the European Parliament and the Council by 30

³ Regulation (EU) No 261/2012 of the European Parliament and of the Council of 14 March 2012 amending Council Regulation (EC) No 1234/2007 as regards contractual relations in the milk and milk products sector

June 2014 on the concrete operation of the Milk Package⁴ provisions, 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.

A. Principle of subsidiarity and principle of proportionality

Since this Commission report has no legislative impact there is no discussion of compliance with the principle of subsidiarity and with the principle of proportionality.

PART III – CONCLUSIONS

In light of the above, the Committee concludes as follows:

1. The Report from the Commission to the European Parliament and the Council on the evolution of the market situation and the consequent conditions for smoothly phasing out the milk quota system – second "soft landing" report (COM(2012)741) was submitted to this Committee, in view of the content of that European initiative, so that the Committee could examine the document and issue an opinion.
2. Since this Commission report has no legislative impact there is no discussion of compliance with the principle of subsidiarity and with the principle of proportionality.
3. The Committee for Agriculture and the Sea hereby concludes the scrutiny of this initiative and submits this opinion for transmission, in accordance with Law No 43/2006 of 25 August 2006, republished in Law No 21/2012 of 17 May 2012, to the European Affairs Committee.

Palácio de S. Bento, 7 October 2013

The Rapporteur

[signed]

(Fernando Jesus)

⁴ See point 9 of Article 184 of the single CMO Regulation 1234/2007, as inserted by the so-called Milk Package Regulation 261/2012.

The Chairman of the Committee

[signed]

(Vasco Cunha)