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The Dairy Policy of the European Community

by Antonio Cioffi

1. Introduction

Milk is by far the most important agricultural good in the European Community (EC). In 1983 the value of the milk production in the EC was about 33 billion of dollars with a share of the final agricultural production that accounted for the 25 percent.

An analysis of the regulation of the dairy industry and of its modifications over time represent an interesting example on how the EC policy makers behave. It provides insights into the goals of the Common Agricultural Policy (CAP), on how they have been pursued since the foundation of the EC and on what effects have been generated by its implementation. It also reflects the nature of the problems created by the quite particular system of relationships between the institutions involved in the CAP decision making process and the directions that this process has taken in the time responding to the changes of the economic environment on which it relates.

In the following pages, I will describe the regulation of the EC dairy industry as it was designed at the beginning of the period of full implementation of the CAP and its major effects on production and consumption. Next, I will describe the modifications of the dairy program that were introduced as a response to the problems generated by the support granted to the industry until the introduction of the quota system in 1984.

2. The Regulation of the EC Dairy Industry

The EC price and market policies on the dairy market are provided by Regulation 804/1968. The system is based on the yearly fixing of a target price for milk with a fat content of 3.7 percent. The target price is not the price that the EC milk producers necessarily receive during the market year. It is the target price level that they should receive, on average, given the instruments to support the market. In order to achieve this price, a set of intervention prices and threshold prices for some dairy products is fixed.

Intervention prices are fixed for butter, skimmed milk powder and for Grana-Padano and Parmigiano-Reggiano cheeses produced in some regions of the EC[1/]. At these prices the intervention agencies of each Member State are allowed to buy the quantities offered by the dairies.

In order to insulate the EC dairy market from the world market, variable levies and export refunds are provided for trade with third non-member countries. The variable levy charged on a product imported in the EC is the difference between its threshold price (minimum import price) and its lowest import c.i.f. price. To cover the wide number of dairy products, threshold prices are fixed for "pilot products", of which each one is representative of a group of homogeneous products called "assimilated products". The variable levy is determined for each "pilote product" and extended to the group of "assimilated products". The variable levies are determined by the Commission every 15 days.

Export refunds are subsidies for the exportation of dairy products to non-member countries. They cover all dairy products and the amount is the difference between the prevailing prices on the world market and those on the EC market. However, the amount of export refund for a product is allowed to change with the country of destination. The export refunds are fixed periodically. The Commission is authorized to change the refunds either at its own discretion or on request by a member state.

The regulation for the EC dairy industry also provides subsidization for the private storage of the intervention products and for other cheeses. Grants are also provided for skimmed mild and skimmed milk powder used as animal feed and for skimmed milk used in the production of casein.

Within the frame of the regulation 804/68, the EC dairy industry is insulated from the world market. At the same time, withdrawals from the market of surpluses of butter and skimmed milk powder have guaranteed a minimum price level for the milk sold to the dairies. According to Harris et al. (1983), the intervention milk price equivalent was 94.6 percent of the target price for 1981/82. Even in situations of heavy surplus of supply over demand support prices have been very close to the target prices.

The subsidization for private storage of dairy products is aimed at increasing the demand of these products when the seasonal cycle of milk supply is at the highest levels, avoiding costly withdrawals from the market. They are provided in the period between April 1 and September 15 of the marketing years. The subsidization of fluid skimmed milk to be used as animal feed is set to make this product competitive with other protein feeds that are imported from non-member countries at very low duties and to reduce production of skimmed milk powder which must be withdrawn from the market by the EC intervention agencies.

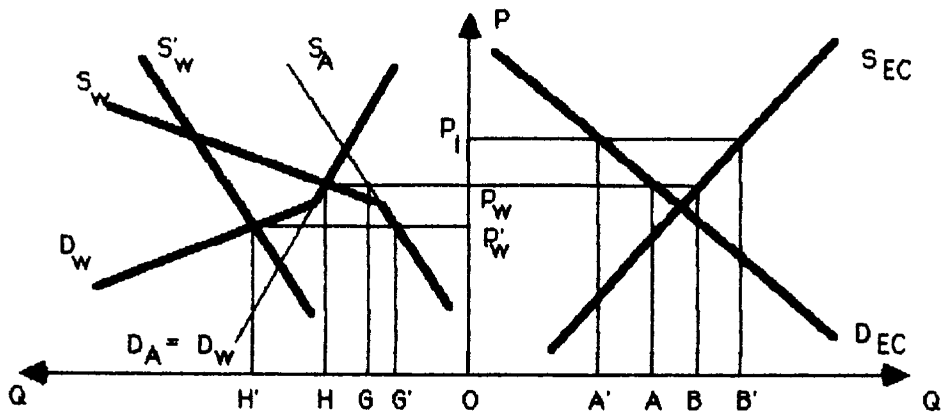
All decisions concerning target price for milk, intervention prices, threshold prices, and subsidies for dairy product storage are made by the

Council of the Ministers of Agriculture on proposal by the Commission. In this way the Commission, which is the administrative institution of the EC, has only the responsibility to propose measures for the implementation of the CAP in the dairy industry but the ultimate decision has to be made by the Council of Ministers which is the political institution of the EC. However the Council has delegated the Commission for decisions on matters concerning the management of the dairy market program. The decision process on the dairy market policies has two stages. First, the Council has to take decision on the support levels guaranteed to the EC milk producers. Second, the Commission has the responsibility to minimize the budget expenditure given the support levels.

3. The Effects of the Intervention in the Dairy Industry

The dairy support program, as it was designed with the regulation 804/68, results in the fact that the price at the farm "gate" is very close to the annual fixed target price. It also provides instruments to insulate the EC dairy industry from the world market and to prevent most fluctuations of the domestic price. In spite of its complexity an example can give insights on the problem of such regulation both on the internal and external markets. The following example can be refered to one product subject to withdrawal from the market as butter or skimmed milk powder. In figure 1 the domestic demand and supply for the EC are D_{EC} and S_{EC}, while the export demand and supply for all countries but the EC are D_A and S_A. Adding to D_A and S_A the export demand and supply for the EC we can obtain the world export demand and supply D_W and S_W. In a situation of free trade the world price is P_W and the quantity traded is OH of which HG is exported by the EC.

Figure 1



Now, let us suppose that the EC decision makers fix an intervention price P_I for the commodity above P_W and that they will pay an export refund in order to sell the excess supply on the world market, while a variable levy equal to the difference between the threshold price (minimum import price) and the world price is introduced to protect the EC domestic market. As a consequence the export supply for the EC will be perfectly inelastic to the world price and the new world export supply will be S^1_W, while the new world export demand will be D_W equivalent to D_A. If the trade partners of the EC do not retaliate, the world price will decrease at P^1_W, while the quantity traded will increase at OH^1 of which H^1G^1 is exported by the EC that will have a larger share of the world market. The EC budget cost for the support of the price at P_1 will be A^1B^1 multiplied by $P_I - P^1_W$.

The implementation of such policy has a number of implications. The EC tax-payers and consumers and the other countries' producers suffer a loss while the EC producers and the other countries' consumers are made better off. It also has a negative impact on the balances of trade of the other countries that have a decrease of the revenues coming from the external trade because both the quantities exported and their price decrease. Furthermore the slopes of the world export supply and demand functions are reduced with a negative impact on the world price stability.

The EC regulation is not "per se" the cause of the burdensome surpluses of dairy products in the EC and the heavy involvement of the EC budget in the support of the market. The problems occured because in 1968 at the beginning of the Common Market the Council of Ministers, under the strong pressure of the farm unions, chose a high price support level for the milk producers, even though the Commission was very concerned about the negative effects of such a decision.

The relatively high level of price support granted at the beginning of the Common Market was not the only factor that generated the heavy surpluses situation in the EC. The criteria used to fix the support levels and the changes that affected the agricultural system in the EC were the other causes of this situation.

The EC policy makers used the price policy as the principal, if not the only, instrument to increase agricultural incomes in the Community. The annual fixing of the agricultural prices in the EC was based on the "objective method" that the Commission for a long time followed to determine its proposal for the price revision to the Council of Ministers. According to the "objective method", the Commission proposed support price changes such to allow the incomes of "modern farms" to be at a comparable level with non-farm incomes in the EC, after considering the changes that took place in the productivity of agricultural resources and in the production costs. On the proposal by the Commission, the Council of Ministries usually granted a higher variation of the level of price support as a result of the complex bargaining process typical of the "Bruxell Marathon" as the meetings for the yearly agricultural prices revision are called in the EC[2/].

The monetary system in the EC also added additional increases in the agricultural support prices as expressed in the national currencies. This was caused by the tendency of the countries with relatively stronger currencies to introduce the use of positive Monetary Compensatory Amounts (MCA) instead of evaluating their "green money", without diminishing the prices to their producers.[3/] While some countries with weaker currencies followed the tendency to avoid the formation of negatitive MCAs devaluating their "green money" and increasing the agricultural prices expressed in national currencies (von Witzke, 1985).

Generally, the price policy of the EC has not been able to avoid the exit. from the industry of the marginal producers. Rather it assured the dairy farms of bigger size the opportunity to expand their operational dimension and to introduce new and improved technologies. Thus in the EC as in the US the number of dairy cows remained constant, the number of dairy holdings declined, while their size increased considerable. The concentration of the dairy production in larger and more efficient holdings and the introduction of new technologies in the industry generated very large increases in the productivity per cow and in milk supply.

The domestic consumption of milk and dairy products increased but less than the supply increases. The consumption of cheeses in the EC increased from 10 kilograms per-capita in 1973 to 13 kg in 1982 and that of fluid milk increased from 101 kg to 106 kg in the same period. The per-capita consumption of butter was apparently constant, but considering only the product not consumed under special measures of incentive it has declined. The decrease of the butter consumption was the result of its higher price relative to other fats and vegetable oils. Other price policies in the EC allowed the entrance in the EC of oilseeds with a low tariff or supported the farm price level in the domestic market with deficiency payments schemes (olives and oilseeds). In order to make the price ratio on butter to other fats and vegetable oils more favorable to the butter and to increase its domestic consumption the Commission made several proposals to tax the consumption of the other fats. To date these proposals have never been accepted.

4. Modifications in the Regulation

The regulation and support granted to the EC dairy industry has been widely criticized. It is charged with generating production of milk and dairy products only to be sold to the intervention agencies, creating misallocation of resources, disrupting the world dairy market and being very costly for the European Agricultural Guidence and Guarantee Fund (EAAGGF). The interventions on the dairy market are very expensive for the EC budget. While in 1973 the support of the dairy industry absorbed about 1.5 billions of Units of Account (UA), equivalent to 39.2 percent of the EAGGF Guarantee Section (Table 1) in 1978 it absorbed 4 billions of UA (46 percent of the EAGGF Guarantee Section) and in 1984, 5.8 billions of ECU (31 percent).[4/]

Various attempts have been made by the Commission to induce the Council of Ministries to introduce measures to control the expansion of the milk production and to lower the expenditure of the EAGGF - Guarantee Section. These attempts have produced very poor results, because the Council of Ministers has been more concerned about the incomes of the dairy farmers in their home countries. Only in the 1984, when the budget constraint became so critical, a major reform was approved, introducing a system of national quotas.

Before the introduction of the quota system, several modifications were made on the regulation 804/68. Some measures were undertaken to increase the domestic demand for butter through price discrimination schemes. They try to upward the demand for this product in some particular periods (the so-called Christmas-butter) and to subsidize its comsumption by some social groups.

There were also measures to subsidize the domestic demand for dairy products not subject to withdrawal from the market thus avoiding price support acquisition of surpluses of butter and skimmed milk powder. This group included regulations granting subsidies for whole liquid milk and whole milk powder used as animal feed, and for the consumption of milk and dairy products of the school-children.

These attempts to control the growth of the expenditure yield little or no results. Under the pressure of the Commission, several measures were taken to avoid further increases of milk supply. The introduction of the co-responsibility levy was one measure. It was established as a transitory measure on September 1977, to be imposed until the end of the milk marketing year 1978/79. It has become an integral part of the EC dairy regime. The levy is charged on all the milk producers except those in hill and mountain areas. It is fixed between the 1.5 percent and six percent of the target price of milk and the revenues arising from the levy are to be used to finance programs aiming to the stabilization and expansion of the dairy market.

Even though on the supply side the co-responsiblity levy is equivalent to a reduction of the support price level, it has not had effects on the demand for dairy products. In the budget of the EAGGF - Guarantee Section, the co-responsibility levy is recorded as a revenue (or a negative expenditure). Some of the levies supported measures for the expansion of milk and dairy product consumption that in 1984 accounted for 239 millions of ECU. It is not clear what is the impact that this measure had on the market and if it has been really effective in the aim to expand the consumption of dairy products. Furthermore, it is possible that an equivalent reduction in price support instead of the co-responsibility levy would have proven more effective in the reduction of the market surpluses.

At the same time that the co-responsibility levy was introduced, the Council of Ministries approved another measure to reduce milk supply. It introduced a system of premiums for the non-marketing of milk and for the conversion of dairy herds.[5/] The premiums were granted to producers that in the 1976 had delivered at least 50,000 kg of milk or with at least 15 cows. To receive the premiums, the producers had to agree not to market milk for a period of at least five years or to convert their dairy herds to beef. At the same time subsidies for the purchase of dairy cows under the programs provided according to the EC - Directive 72/159 (granting subsidies for the modernization of farming in the EC) were also proibited.

The actions taken in 1977 were not able to generate a steady reduction of milk supply or to control the expenditure for the dairy market support. By the end of 1983 the stocks of butter and skimmed milk powder were at record levels. Even higher levels were forecast for 1984. At the same time the funding restrictions for all the EC programs became so strong that the

TABLE 1. E.A.G.G.F. - Guarantee Section Expenditure in the Dairy Sector

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
INTERVENTION:													
Aids for SMP	224.2	361.4	481.0	511.5	656.5	725.5	965.1	1310.2	1281.6	1157.4	1310.5	1630.7	1908.0
SMP Storage				50.4	501.5	287.6	682.2	361.1	20.6	83.4	135.4	634.5	808.0
Butter Storage	110.1	667.7	228.7	133.8	246.1	355.8	618.8	475.6	439.5	214.7	196.6	410.8	837.0
Butter Disposal								169.3	207.6	211.8	414.1	496.4	629.0
Food Aid	50.5	56.2	85.4	.	.	.	.	.	.	.	.		
Revenue from Co-res	--	--	--	--	--	-22.0	-156.1	-94.2	-222.9	-478.5	-537.3	-527.4	-972.0
Extension of Market	--	--	--	--	--	--	--	110.3	109.4	106.2	105.7	154.2	239.0
Other	28.6	62.4	81.5	125.6	108.0	159.8	339.7	107.3	56.8	161.4	177.8	270.1	233.0
TOTAL: INTERV.	413.4	1147.7	986.6	821.3	1512.1	1506.7	2449.7	2439.1	2006.1	1456.4	1806.4	3069.3	3682.0
REFUNDS	160.4	349.3	344.4	328.5	765.6	1417.4	1565.0	2087.9	2745.9	1886.3	1521.3	1326.8	2129.0
TOTAL MILK	573.7	1497.0	1221.0	1164.8	2277.7	2924.1	4014.7	4527.5	4752.0	3342.7	3327.7	4396.1	5811.0
E.A.G.G.F. GUARANTEE SECTION EXPENDITURE	2258.2	3814.6	3107.3	4727.4	5587.1	6830.4	8672.7	10440.7	11314.0	11141.2	12405.6	15919.7	18400.9

Source: E.C. Commission

EC was in danger of not making budgetal payments for the fiscal year 1984.[6/] With this situation a decision to cut expenditure or to stop its growth had to be made and to be effective something should be done to the dairy program because it was the most important EC budget item.

At the beginning of the 1980s the Commission made several attempts to apply a super-levy to milk deliveries exceeding specified levels. The objective was to avoid increases of milk production exceeding those of the domestic consumption. Thus the growth of surpluses of dairy products could be stopped, freezing the expenditure for the support of the market. The Council, in 1982, agreed to adopt a production limit given by the quantity of milk delivered in 1981 plus 0.5 percent, which represented the average increase of the consumption of dairy product in the EC. But the Council adopted the production limit without enforcing instruments deciding to take measures later if the limit was exceeded. So, confronting an increase of milk production well above the limit in 1983 the Council agreed to cut the increase of the target price of milk by the three percent from the average increase of the common prices for the marketing year 1983/84. It also fixed for 1983 as a guarantee threshold, the production delivered in 1981 plus one percent.

Even in 1983 the quantity of milk delivered to dairies exceeded this limit and the stocks of dairy products increased drammatically. Measures to keep under control the dairy industry could no more be delayed. The EC decision makers were confronted with two choices: a sharp reduction of the support prices (to be effective the Commission estimated a cut of 12 percent) or a guarantee threshold and the provision of instruments to make it really effective.

After long discussions, the Council of the Ministers on March 31, 1984 approved the introduction of a guarantee threshold based on a system of national quotas for the production of milk. The quantity of milk to be allowed to price support in the EC was set to 98.2 million tons for the first year, equal to the quantity of milk delivered to dairies in 1981 plus one percent for all countries but Ireland and Italy where the quota was fixed according to the deliveries in 1983 (Table 2).[7/] For the successive years, the guarantee threshold in the EC was set to 97.2 million tons. In this way the deliveries of milk should decrease by 5.3 percent in 1984, with respect to the previous year and by 5.9 percent in 1985. For milk and milk products sold directly by producers to consumers, the quota was fixed according the quantities sold in 1981 plus one percent for all countries.

To enforce the guarantee thresholds and the system of national quotas the production exceeding the quota in each country is charged a super-levy of:

- 75 percent of the target price of milk, where formula A is applied or there are direct sales to consumption;
- 100 percent of the target price of milk, where formula B is applied.

Under formula A the super-levy charged to milk producers, while Formula B charges to dairies. The revenues coming from the super-levy, as those arising from the co-responsibility levy, are allocated to finance the expenditure for the dairy program.

The Council also introduced a "Community reserve," allocation which increased the guarantee threshold in those member states where the implementation of the quota system would significantly affect the production structures. For the milk marketing year 1984/85, the "Community reserve" was set

TABLE 2. Guaranteed quantiteis of milk supply in the E.C. and in the Member States for the marketing years 1984/85 and 1985/86.

	000 tons						
	MARKETING YEAR 1984/85				MARKETING YEAR 1985/86		
	Guarantee thresholds for deliveries to dairies	Guarantee thresholds for direct sales	Community reserve	Guarantee thresholds 1984/85	Guarantee thresholds for deliveries to dairies	Guarantee thresholds for direct sales	Guarantee thresholds 1985/86
Belgium	3,138	505	--	3,643	3,106	505	3,611
Denmark	4,932	1	--	4,933	4,882	1	4,883
W. Germany	23,487	305	--	23,792	23,248	305	23,553
France	25,585	1,183	--	26,768	25,325	1,183	26,508
Greece	472	116	--	588	467	116	583
Ireland	5,280	16	245	5,541	5,280	16	5,296
Italy	8,323	1,591	--	9,914	8,323	1,591	9,914
Luxembourg	268	1	25	294	265	1	266
Netherlands	12,052	145	--	12,197	11,929	145	12,074
United Kingdom	15,698	187	65	15,950	15,538	187	15,725
TOTAL E.C.	99,235	4,050	335	103,620	98,363	4,050	102,413

Source: Official Journal of the E.C.

at 335,000 tons. Successively the Commission decided to allocate the reserve in Ireland (245,000 t.), North-Ireland region of the UK (65,000 t.) and Luxembourg (25,000 t.).

With the introduction of the quota system the Council fixed for the 1984/85 the target price for milk at the same level of 1983/84.[7/] The co-responsibility levy for 1984/85 was set at three percent of the target milk price, up from the two percent for the previous year.

The regulation introducing the quota system also allowed the EC member states to provide grants to compensate milk producers who agree to permanently exit from the dairy industry. Each member state has the authority and the financial responsibility to promote and implement measures intended to reduce the productive capacity of its milk industry to a level consistent with the fixed quota and to reallocate these reductions among their producers according to national criteria.

The introduction of the quotas in the EC dairy program and associated activities are significant measures for reducing EC price support costs. Production of milk in the EC is not likely to exceed the quotas because of the high super-levy imposed on the production of milk exceeding the established quota. The lower milk production and some expansion of the domestic consumption generated by the lowering of real prices should have the effect of reducing the surpluses of butter and skimmed milk powder. However, the EC will continue to have the problem of dairy products supluses, because the production, even though lower than before, will exceed the domestic consumption for the foreseeable future. In the short term the EC budget expenditure for the support of the market will be very large because the problems of handling and disposal of huge stocks of dairy products accumulated in the years before the introduction of the quota system. But in the long term the new measures should reduce the expenditure for the dairy market.

5. Final Remarks

The paper described the major modifications in the EC dairy policy since its inception. For the most part, the program and program changes have failed to rationalize the structure of the dairy industry. The major objective was to lower the EAGGF expenditure for the support of the market. Even the recent introduction of the system of national quotas has not corrected the problems of the support and stabilization of prices in the dairy market. It may slow or stop the continuous growth of public expenditure for dairy programs.

Certainly, these kind of results depend on the particular policy making process in the EC. As for every decision the unanimity of the votes of each member state is necessary, it happens that all political decisions are the result of a complex bargaining process involving the defense of the national interests in the EC. The quota system is a good example of compromise between national interests and the need to lower the budget expenditure.

Notes

1/ The support granted to these two cheeses was established to consider the differences existing in the Italian market where they are produced. The market of the Parmigiano-Reggiano and Grana-Padano cheeses has a very important function in the formation of the prices of milk and dairy products in Italy (Perone-Pacifico et al., 1986). Since the interventions for the price support of these two cheeses has been quite negligible, in the following I will refer only to those of butter and skimmed milk powder.

2/ The criteria that the Commission has to follow in the determination of its proposal of price variation to the Council of Ministries are not well defined. For long time "the objective method" was the most important variable that the Commission took in account. Later, as a consequence of the continuous growth of the budget expenditure for the support of agricultural prices, considerations on the effect of price decisions on the domestic and international markets become more important. For more information on the "objective method" see (de Veer, 1979; Swinbank, 1979).

3/ The common agricultural prices in the EC are fixed in ECU (European Currency Units) and converted into the national currencies according to "green exchange rates." As a member state devaluates (evaluates) its currency with respect to the ECU, the "green exchange rate" does not change automatically. The difference between the two rates is covered by negative (positive) MCAs that correspond to tariffs (subsidies) charged on the intra-community trade of agricultural products. The Council of Ministers can devaluate (evaluate) the "green exchange rate" of a member state eliminating the MCAs. This has the effect of increasing (decreasing) the support price levels in the country. In this way the "green exchange rates" enter into the bargaining process of decision of the EC. For more details on the monetary system in the EC see Fennell (1979), Harris et al. (1982).

4/ Considering that the expenditure of the EAGGF - Guarantee Section is on average 2/3 of the whole EC budget it is quite clear the dramatic involvement of the EC in the milk price support system.

5/ Member states, like Italy, in which the number of dairy cows had been reduced by more than 20 percent in the period 1969-1975 included were allowed to not implement this regulation.

6/ The Treaty of Rome states that the EC budget must be in balance. It means that the EC cannot finance its deficit borrowing or imposing taxes and the only instrument to confront such situations is to delay payments.

7/ For Ireland the quota was fixed at the 1983 production level, plus a further quantity from the "community reserve", to consider that milk production contributes for 9 percent of the G.N.P. For Italy reference was made to 1983 because the 1981 milk production was the lowest in 10 years.

8/ Even if the target price of milk for the marketing year 1984/85 was fixed at the same level of the previous year, considering the adjustment of the "green money" following the elimination of M.C.A.s, the target price increased by 2.9 percent, on average, as expressed in national currencies.

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