**Public regulatory framework for the European dairy sector**

**1. Description**

Objectives, perimeter and activities

## EU milk value chains developed with a high level of public protection and support…

After the World War II and the establishment of the European Community, European national and later common agricultural policies had two main aims:

* Securing national and then regional autonomy in food supplies;
* Assuring low cost food products to consumers and at the same time living wages to farmers.

These aims were pursued through a protectionist policy package based on high food import tariffs and a fairly high support price, which public authorities were ready to pay to farmers, when market prices fell too low. The supply surpluses generated by this policy either were stocked by public bodies or received subsidies to be exported outside the European Community, usually in Developing Countries. These mechanisms were implemented in various agricultural sectors, in particular the dairy one.

Thanks to this high level of support, European dairy value chains thrived and developed, while European consumers enjoyed low prices of dairy products. However, the possibility of increasing supply without affecting prices stimulated the affirmation of highly productivist models and the geographical concentration of increasingly big milk farms along the Atlantic coasts. These farms produced a considerable amount of surpluses, which became expensive and difficult to stock and to export.

In order to solve the surpluses crisis, in 1984 the European Community adopted a policy of quotas – to be distributed to member states depending on their historical production levels and to be managed autonomously by national authorities. This policy raised considerable consensus in France, because public authorities decided to bind quotas to the territories, slowing down geographical concentration of dairy farms and developing a peculiar tool of rural development in marginalized areas.

In other European countries, however, the quota policy was often contested:

* It was considered to hinder private entrepreneurship by liberal Nordic countries;
* It assigned low quotas’ levels to Southern and later Eastern European Countries, forcing them to import dairy products to satisfy their internal demand and frustrating their aspirations to develop their dairy value chains.

Along the years the European Community, then European Union, has experienced several enlargements, adding Member States up to 28 members in 2007. European common policies have been taking on the task of regulating increasingly varied realities, characterized by very different: soil and climate conditions; dairy traditions and practices; market institutions and production models; and value chains structures. This variety is considered by many as a wealth and a key to the sustainability of the region, to be preserved and valorized by appropriate policies and programs. However, the elaboration of such policies revealed to be very difficult in such a numerous Council of 28 members, which established an increasing consensus over deregulation and disengagement of public intervention.

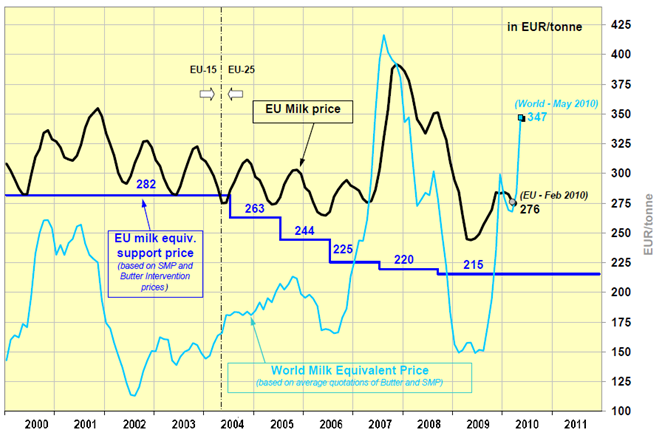
## ….to later open up to liberalization and global market forces.

The signature of the Marrakesh agreements in 1992 engaged the European Union in a process of increasing liberalization of its agricultural markets. Dairy ones were affected at first in 1999 with the 15% reduction of the intervention price and even more strongly in 2003, when the Luxembourg agreements decided an additional cut of 10% of the intervention price and the phasing out of the quota system, to be definitively abolished in 2015.

The new policy priorities, as stated in Agenda 2000, were to enhance the competitiveness of European dairy farmers and to allow them to thrive in the international markets. The latter was considered very promising, as European analysts estimated that the growing demand of Asian countries (especially China) could be difficultly met by an internal supply increasing at the same pace. Global demand was estimated high and increasing in the long run and with it the level of global prices. European enterprises did not need price support anymore, but access to the international market places.

Results

The first test for the new policy line came during the world financial and food prices crisis of 2007, when international milk prices suddenly shot up, and later precipitate in 2009 at unprecedented low levels. During this period the European Union has not established effective anti-cyclical measures to avoid worst consequences for producers, while it has continued the process of liberalization and of reduction of quotas.



Source: High Level Group on Milk, European Commission

The sudden fall of prices was a hard hit for milk producers, who saw their revenues fall and their livelihoods jeopardized, while no safety net was put in place to help them make their ends meet. Protests and demonstrations spread in Europe and the European authorities called a High Level Group on Milk to study the roots of the crisis and possible solutions for avoiding these repercussions of international markets instability.

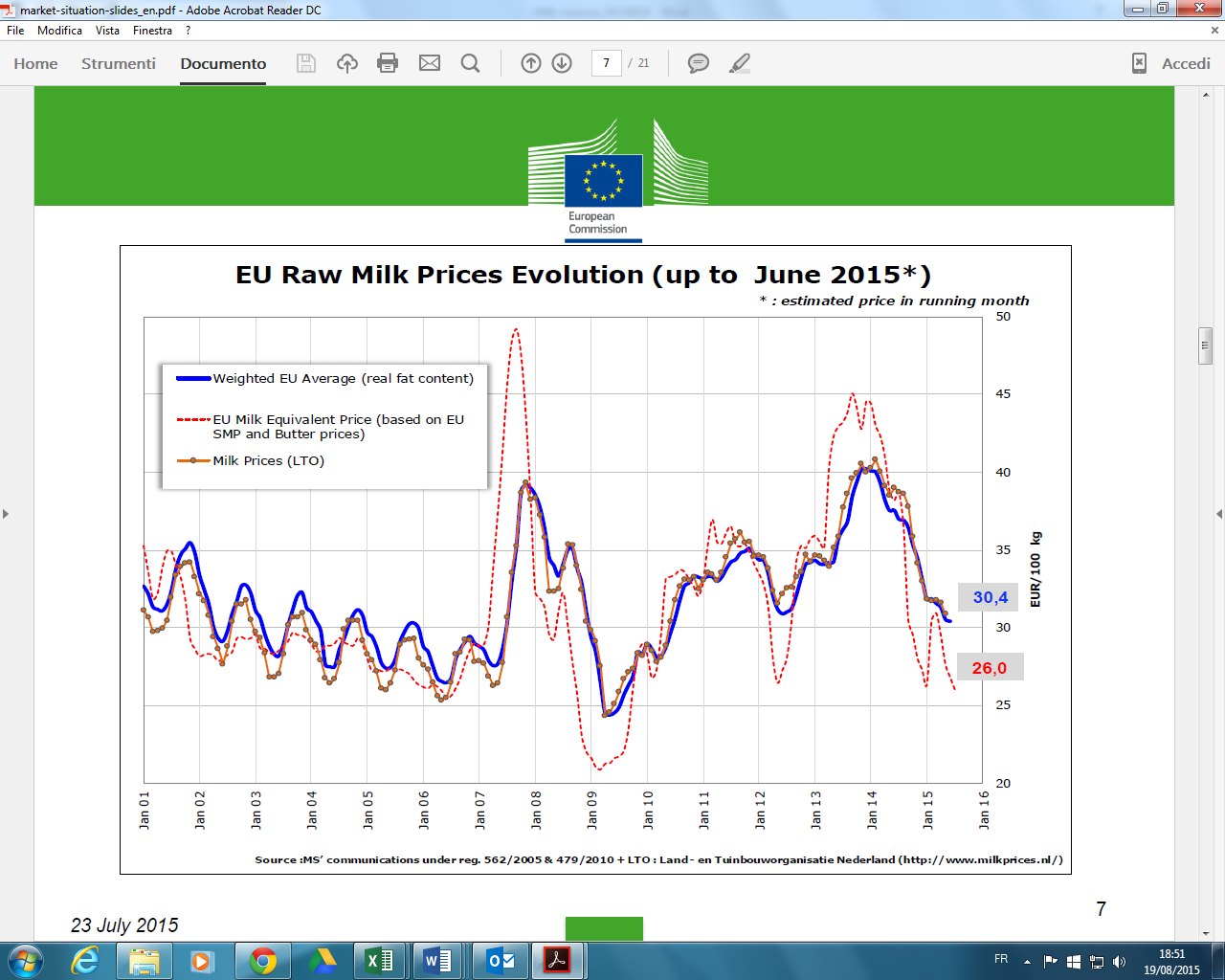
The analysis of the High level Group[[1]](#footnote-1) recognizes that the main problem generated by the liberalization process is to expose the European value chains to the volatility and possibly low levels of international prices. Now that the public sector does not protect producers from instability with quantity control and support prices, market actors have to establish a governance mechanism that reinforces their resilience to sudden price change.

In order to solve these problems, the EU issued in 2012 **a new set of measures called the *Milk Package****[[2]](#footnote-2)*, envisaging:

* The faculty for every member state to **make compulsory the establishment of written contracts**, with a minimum duration, between milk producers and milk buyers. These contracts can be negotiated collectively by farmers’ organizations, grouping farmers whose production cannot not exceed the 3.5% of European production and 33% of national production.
* Member states can facilitate and recognize the establishments of **inter branch organizations**, with the aim of encouraging multi-stakeholders’ discussions about improvements to the organization of the value chains.
* The EU will improve the **transparency of the value chains, by establishing a Milk Market Observatory,** with the aim of supporting the two steps above, by providing reliable information for multi-stakeholders’ discussions and value chain negotiations.

The HLG evaluated that **prices volatility should be dealt with by the private sector**, through the resort to relevant financial instruments, i.e. the establishment of a **future market**. If, in fact, the public sector is not willing anymore to cover the risk of price fluctuations for the milk farmers, private speculators can take on the task, as they do already for other agricultural commodities, such as cereals. Future markets would then reduce the price uncertainties and let the farmers take advantage of long term higher prices.

**Fig 3: EU raw milk prices evolution (up to June 2015)**



Source: European Market Observatory

Prices recovered after 2009 but instability and volatility continued to characterize the milk courses. After a pick in 2014, prices have been falling for the whole 2015 generating a new crisis in the sector and a new test for European Policies and the Milk Package[[3]](#footnote-3).

Widespread protests and manifestations in France, let us doubt that the provisions of the Milk Package led to the establishment of effective inter branch platforms and a more harmonious governance of the milk value chains.

**2. Systemic dimension**

Link between the local, national and international levels

The agricultural policy of the European Union in milk illustrates the pitfalls of so-called "universal" approaches. In the 1980s, the quota system has been greatly inspired by one country - France - which is the only one that implemented it in order to protect the diversity of its dairy models, especially mountain farming. In contrast, most other countries have used to accompany the industrialization of their dairy sectors. Given the limits of the quota system and the growing criticism, a full liberalization of the sector began in 2012, apparently inspired by another country-specific model: the German producer organizations (in particular the Bavarian ones).

In addition, the analysis of the High level Group (HLG) recognizes that the main problem generated by the liberalization process is to expose the European value chains to the volatility and possibly low levels of international prices. Now that the public sector does not protect producers from instability with quantity control and support prices, market actors have to establish a governance mechanism that reinforces their resilience to sudden price change.

Capacity building of the most vulnerable stakeholders

Interviews with key experts revealed that an obstacle for the activation of multi-stakeholders dynamics lie in the fact that farmers have not been traditionally grouped in territorial producers’ organizations, but rather in cooperative structures which are also processing private actors and that do not count as Producer Organizations for the European regulation.

For example, in France, at the issuing of the Milk Package in 2012, roughly half of the farmers was grouped in such structures, while the other half was not grouped under any PO and had individual relations to the rest of the value chain. Multi-stakeholders’ discussions were not a common practice and the private actors traditionally strongly relied on the public authorities to mediate and intervene into possible conflicts.

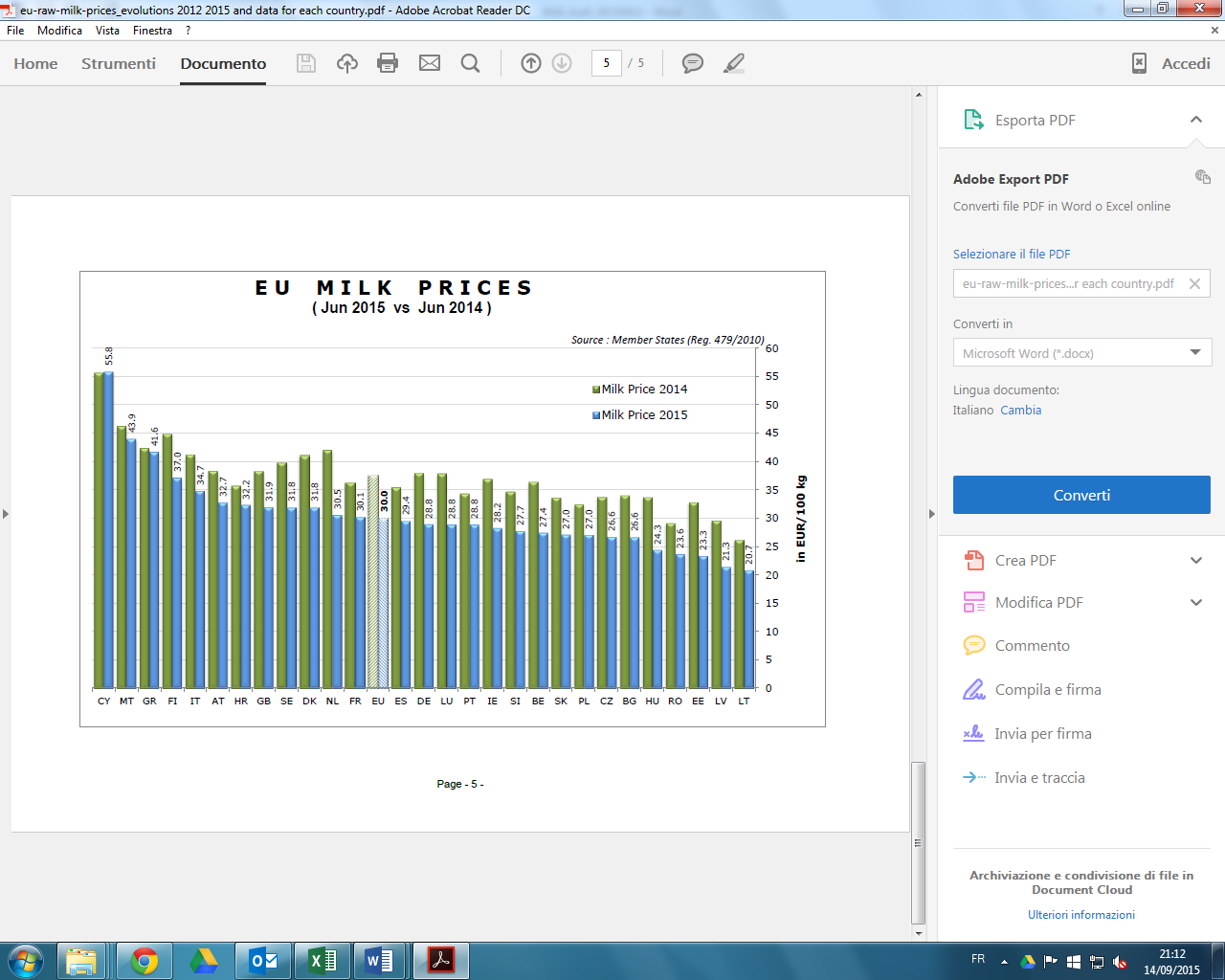
Therefore, the transition to a more deregulated framework was perceived by all the actors as threatening and problematic and the MP was hurriedly applied, through the swift establishment of obligatory contracts between producers and transformers. This did not allow for Producers Organizations to be formed and the contracts generated were not been negotiated collectively.

The POs that were later formed had to work within a contractual relation already established and therefore their bargaining power was undermined and difficult to develop. Farmers’ unions maintain that before signing the contracts, time and resources should have been spent for structuring and strengthening territorial POs, capable to negotiate with industrial groups.

The situation seems to have worked quite differently in Bavaria, a Southern Lander of Germany, where the application of the Milk Package seemed to have taken place relatively smoothly. Bavaria is characterized by a strong milk production and the presence of diversified farming models, with farms smaller than the German average and with the significant presence of high value milk production farms. There is also a high concentration of industrial transformation actors that compete for securing their milk supplies, while milk farms generally mutualize the activities of milk collection. In this scenario milk farmers have been traditionally grouped in strong Producers’ Organizations that are represented at Lander level by an umbrella organization, which has strong bargaining power and which periodically negotiate with industrial groups. For farmers in Bavaria, long term contracts are not necessarily advantageous as they limit their bargaining power and their capacity to obtain better conditions. This reality is similar to that of other European Countries, such as Netherlands and Denmark, where farmers are traditionally organized in strong producers’ organizations.

Finally, data suggest that what good negotiations grant is not necessarily a high level of price, but rather an efficient price transmission dynamic. Price continue to fluctuate with international volatility, but, if the farmers have an efficient saving mechanism, they can enjoy higher prices in the long term.

**Fig 4: EU Milk Prices (Jun 2015 vs Jun 2014)**



Source: European Milk Market Observatory

Link between the social, environmental and economic dimensions

The regulation of the dairy sector in Europe is a good example of an initiative that focused solely on the economic dimension, an approach that proved detrimental to the social and environmental aspects. Financial support is granted on the basis of "historical references of production": the biggest farmers receiving the largest amounts, regardless of their environmental practices.

The strengthening of "environmental measures", as well as support for organic farming, are still insufficient to curb the sector's industrialization trend and the significant impacts it generates. As for the least impactful models like raising mountains and livestock to pasture, they struggled to break even to survive in a racing context yields and economies of scale. Unsustainable farming practices generated a double burden to society, which was paying for supporting their economic activity and for getting rid of their negative externalities. According to advocates of liberal policies, sustainable milk production models can well develop in a free market economy and should be supported through ad hoc policies that remunerates farms directly for the eco systemic services that they produce, for e.g. reinforcing the 2nd pillar of the CAP.

On one side, advocates of liberal milk policies point out to the fact that protectionist models with a set minimum price support sustainable and unsustainable farms alike, discourage economic practices in terms of inputs and finally generate subnormal profits for farms that produce at lower costs, falsifying competition. In particular, if minimum prices are set on costs of production’s estimates, farmers do not have incentives to find efficient inputs solutions and often engage in environmental unfriendly practices.

On the other side, critics of the liberalization system, maintain that measures like the ones contained in the 2nd pillar of the CAP are very weak and that present deregulated and unbalanced value chains produce negative impacts on sustainability. Large and geographically concentrated farms are not particularly viable and they do not naturally thrive in a free market system. However, they are the preferred model of collecting industrial groups that prefer to have few, large and geographically concentrated suppliers in order to facilitate their operations and realize economies of scale.

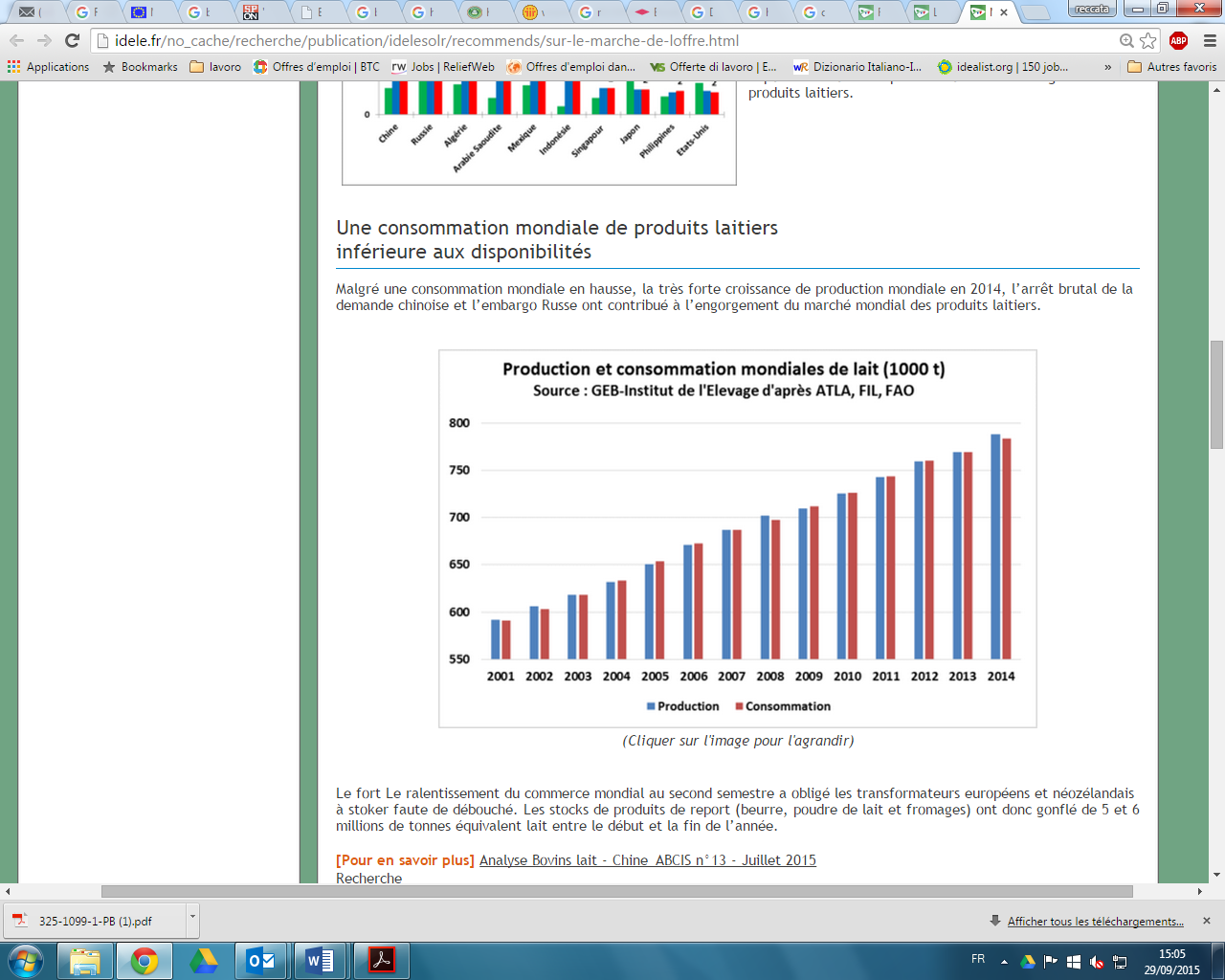
Another way of looking at this polarized debate might be to observe positive examples of sustainable milk farming model and their characteristics in terms of governance. In his book “Europe laitière” André Pflimlin observes how some milk farming sustainable and economically viable models developed in disadvantaged regions of France, despite the relatively small help from public actors. These farms are characterized by strong localization, production of typical products and a deep environmental and social attachment to the territory. Often this models are framed within specific value chains, such as organic ones or Geographic Indications.

Hard Law / Soft Law linkages

Some experts state that multi-stakeholders’ dynamics would be more effective if they were inserted in a state-initiated framework and if public authorities were willing to play a more active role in them.

On one side, critics to deregulation state that opening the focusing the dairy strategy on exports development is a mistake. As we saw before EU analysts considered international markets very promising in the first 2000s, due to the increasing Asian demand. However, the latest projections show that even if Asian demand is growing in the following years, the same is happening to its and global supply.

**Fig 5: World milk production and consumption (1000 t)**

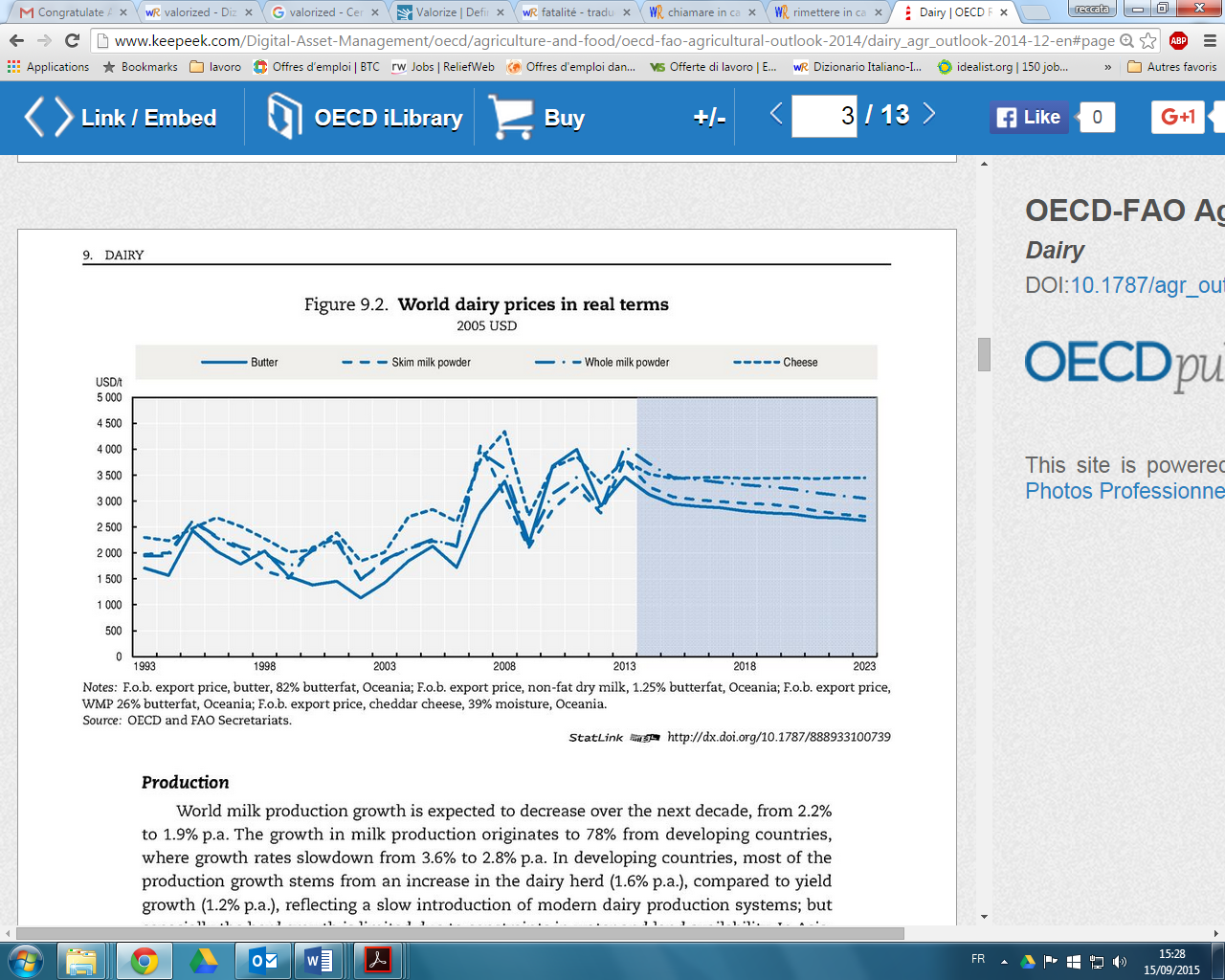


Source: GEB- Insitute d’élevage with data from ATLA, FIL, FAO

According to FAO’s projections therefore prices will remain constant in nominal terms, decreasing in real terms and risk to be volatile. The prices’ projections shown below are in fact based on the hypothesis of constant climatic conditions. However, the report admits that climate change models predict the increasing occurrence of instable and extreme climatic events, which will highly affect dairy production of the main exporting countries (NZ, AU and AR) increasing the probability of price crisis and volatility. Considering these less optimist projections, several analysts doubt the wisdom of focusing the EU milk strategy on business opportunities in the external market, also considering that 93% of the European dairy products are produced for internal consumption and only 7% is exported.

This is the case of the European Milk Board and Via Campesina, two among the three main European milk farmers’ unions, who advocate for the reintroduction of import tariffs and a shift in focus to the development and stabilization of the internal market. The latter will be an important enabling condition for policies and actions aimed at better actors’ dynamics in the value chains.

**Fig 6: World dairy prices in real terms, 2005 USD**



Source: OECD-FAO Agricultural Outlook 2014 Dairy

Furthermore, the same farmers’ unions maintain that improving the dynamics of the value chains requires a higher level of engagement of public actors. In their opinion, the present situation, generally characterized by weak producers’ organizations and strong and highly organized industrial groups, is not favorable for the establishment of successful multi-stakeholders’ platforms and inter-branch collaborative management of the value chains. In order to encourage such dynamics, the public actors should put in place a more formal and regulated framework, which will compel the actors to negotiate collectively.

Canada is often quoted as a positive example of such setting, thanks to a peculiar mix of public engagement, strong producers’ organizations and well-functioning multi stakeholders’ platform, holding on three main institutions:

* A strong producers’ Union, who defends the instances of milk farmers in relation to public actors and industrial groups with a single voice.
* The Canadian Milk Commission, a public organism, who is in charge of fixing minimum milk prices, which are calculated on the basis of cost of production estimates.
* The Canadian Milk Supply Management Committee (CMSMC), which is a multi –stakeholders’ platform and is the main managing organism of the value chain. Here, the actors gather mainly with the objective of regulating the quantity produced in order to satisfy internal demand at the set price and not to produce surpluses.

This carefully managed system has the advantage of allowing milk farmers to gain sustainable revenues, milk transformers to have stable and foreseeable supplies, public authorities to drastically reduce their costs of stocking of surpluses and Canadian consumers to have fairly cheap dairy products.

Despite these advantages, importing this system to the EU would certainly encounter considerable obstacles, due to its highly diversified cultural, natural and productive realities, which could hardly fit in a single regulatory setting. Such an operation will therefore require a careful consideration of a suitable geographical scale and allow for a flexible adaptation of the model to each local existing actors’ dynamics.

As a result, the role of public actors emerges as very important also in a context of increased deregulation. On one side, the State can play an explicitly active role in establishing multi-stakeholders’ dynamics, by issuing regulation that obliges the stakeholders to take concerted decisions, as in the Canadian case. On the other side, the state can act as a facilitator, by setting institutional frameworks.

**3. Governance**

Participation and representativeness of actors

The strength and representativeness of the Producers Organizations is fundamental for determining the degree in which farmers can participate in negotiations. Farmers alone cannot indeed withstand negotiations with industrial groups, but they acquire bargaining power if they can build Producer Organizations that regroup a critical mass of milk production.

At the same time, these unions should have a democratic and participatory functioning, to avoid the risk of them becoming just another intermediary linkage of the value chain. If multi-stakeholders dynamics want to be established, then, a certain amount of time and resources has to be devoted to the strengthening and capacity building of POs, in order to enable farmers to take part in the process.

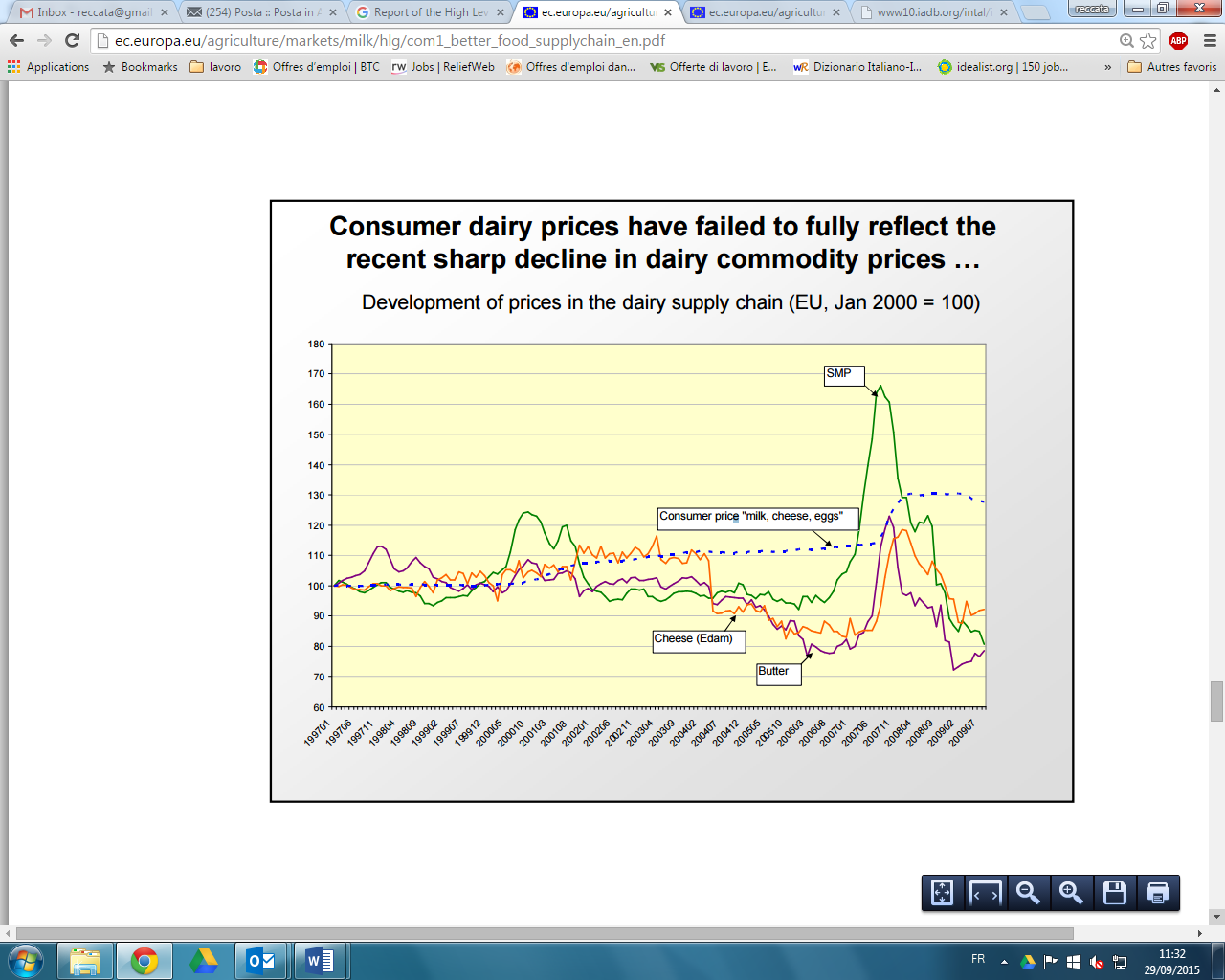
Power relations and equal voice

For the HLG the root causes of the current crisis lie in the imbalances in bargaining power of the different actors of the milk value chains, which during the crisis led to imperfect price transmission.

During the crisis, the actors of the lower end of the chain (retailers) managed to put most of the weight of price fluctuations on the upper end side (producers). In 2007 prices paid to the producers and consumers prices raised alike, while the same did not happen when prices fell in 2009. Then, consumers’ prices decreased much slower and as a consequence the demand took more time to adjust. Revenues of the producers were disproportionally affected, while industrial and retailers groups saw their margins rise.

**Unequal relations, weakness of producers in negotiation and low transparency in the value chains** were singled out as the main factors threatening the good functioning of the value chain and as a consequence threatening the stability of the market and the security of milk producers’ livelihoods.

**Fig 2: Development of prices in the dairy supply chain (EU, Jan 2000 = 100)**



Source: High Level Expert Group on Milk (2009)

Disproportionate power of end of chain actors is therefore pushing family farms out of the market, threatening the diversity that characterizes the European landscape and that assures the security and resilience of its food system. Moreover, the establishment of a dairy futures market also seem to presents several risks in terms of sustainability. On one side, it promotes models that maximize profits and productivity in the short and medium run, with possible negative environmental impacts in the long run. On the other side, it hinders the participation of small actors, reducing their power even more in respect to the others actors of the chain.

Decision-making

Finally, the issues of scale and sustainability suggests to us that probably there is no *one fits for all* European solution for the governance of milk value chains and that different natural, historical and economic contexts should develop different governance mechanisms.

The challenge of European authorities is then to design a common institutional mechanism or framework that allow for actors dynamics to thrive and to crystalize in time. One solution might be to propose inter-branch platforms at sub national level (milk basin for example) and to support the capacity building of negotiation capacity of the different actors.

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1. All the documents related to the consultations and analysis of the High Level Group – experts’ analysis, interest groups position papers and the conclusion and propositions of the Commission - can be found at http://ec.europa.eu/agriculture/markets/milk/hlg/index\_en.htm [↑](#footnote-ref-1)
2. All the documents related to the milk package- overviews, legislative proposal, citizens summary- can be found at http://ec.europa.eu/agriculture/milk/milk-package/index\_en.htm [↑](#footnote-ref-2)
3. European Parliament (2015) [↑](#footnote-ref-3)