

# Market Responsibility Programme



# Market Responsibility Programme – MRP

## Brief description

*To be able to counteract looming market crises in the milk sector early and properly in future, additional regulations applicable throughout the EU are required.*

*The EMB/BDM have developed a Market Responsibility Programme (MRP) for this purpose.*

## A. Application of the MRP

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The MRP is a programme for the EU milk sector that is used when there is a risk of a milk market imbalance. A combination of monitoring and response to the market enables impending crises to be recognised and reacted to in a three-phase programme.

### Recognising crises – Market Index

- A Market Index comprising the trend in product quotations, milk prices and production costs (margin) enables crises to be anticipated.
- If the index is over 100, the prices are covering the production costs – the market is stable, no action needs to be taken. If the index falls below the 100 threshold, costs are not being covered. If the shortfall is too big, the Market Responsibility Programme is started.

### Reacting to crises – applying the MRP

The plan is to apply the MRP in three phases.

#### 1. Early warning (Market Index falls by 7.5 %)

- Monitoring agency announces early warning
- Private storage is opened
- Incentive programmes for extra consumption such as sucking-calf production, milk fattening of heifers etc.
- Phase is maintained until the index returns to 100

#### 2. Crisis (Market Index falls by 15 %)

- The crisis is officially established and announced by the Monitoring Agency
- Core elements of the Market Responsibility Programme are started
- A reference period is defined
- A restraint on supply is imposed (at least 5 %), bonus for reducing production
- Market responsibility levy from the first kilo for farms increasing production

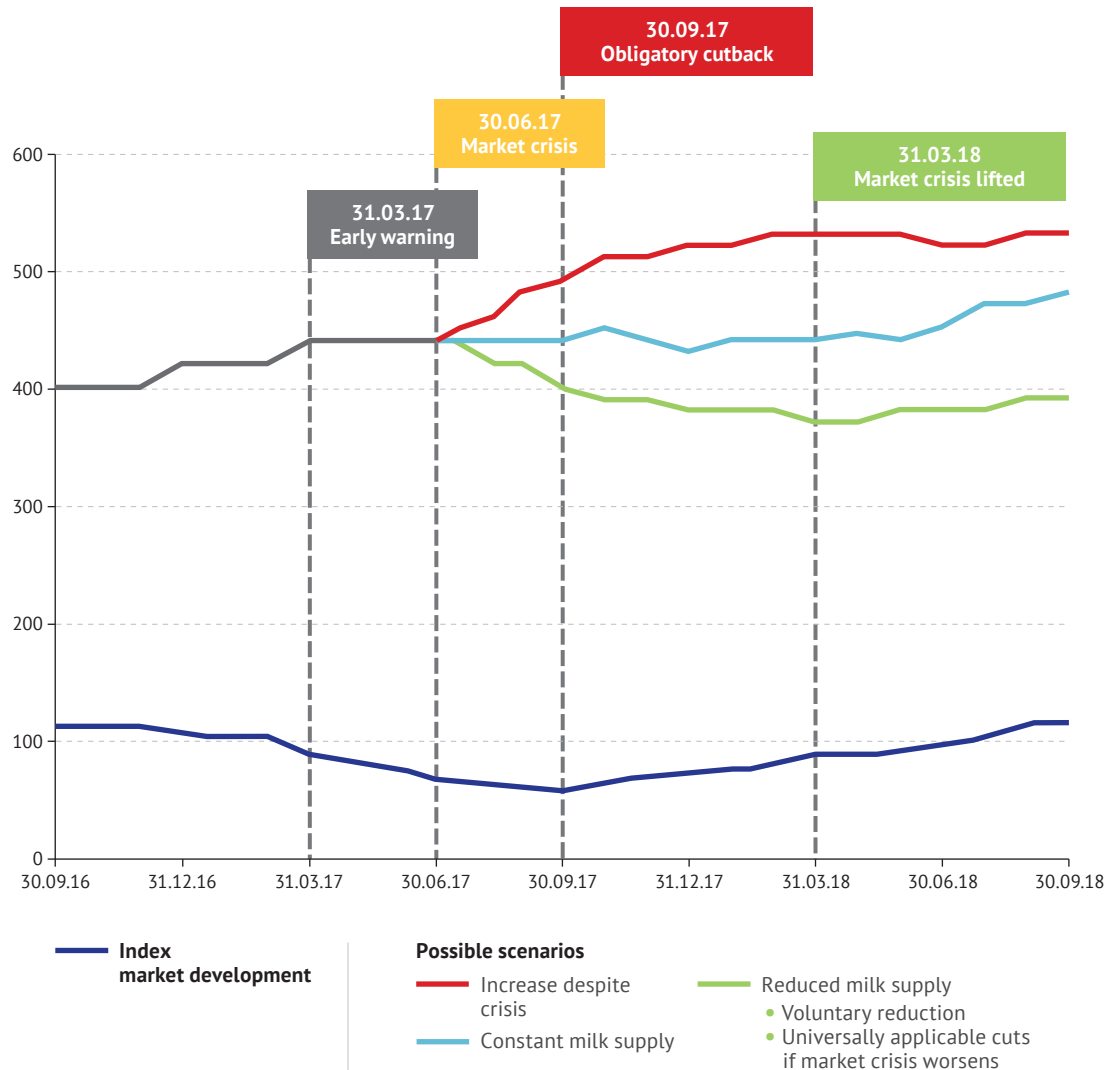
#### 3. Obligatory cutback phase (Market Index falls by 25 %)

- Universally applicable reduction in the supply of milk by 2–3 % for a defined period, e.g. 6 months

## End of the crisis – crisis measures lifted

If the index trend continues towards 100 points and the Monitoring Agency’s forecasts for the further market development are positive, the crisis can be declared over. On this date all measures restricting production end. Commitments entered into on a voluntary, contractual basis end as agreed.

Figure: Option for producers in the event of a crisis

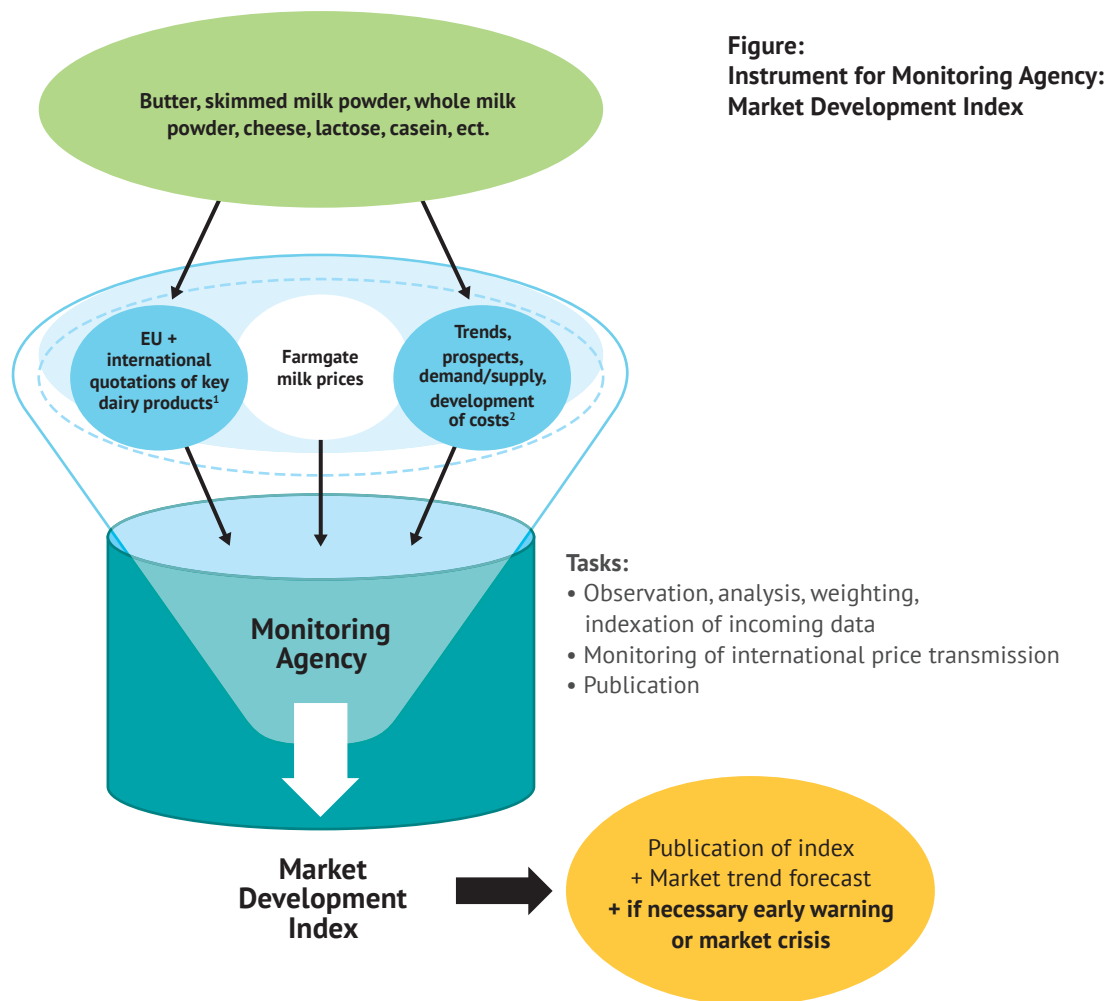


When the Market Index falls to a critical level, first an early warning is given. The following options are possible for a dairy farm: production is increased despite the crisis, putting further pressure on the market. Or the farm keeps production constant, up until option 3, when supply is reduced – initially on the basis of a voluntary restraint on supply. If this is not enough, a binding cut in production volume of, say, 2–3% per farm is imposed under the MRP. Because of the reduction the Market Index rises to a stable level. The crisis is then lifted.

## B. What is required for the MRP to function

Some basic conditions have to be met for the MRP to be able to function smoothly. To co-ordinate the MRP promptly, it is advisable to develop the Observatory already set up on the EU level into an effective **central Monitoring Agency**. The functioning of the Monitoring Agency is regulated by **predetermined, binding criteria; decisions** are taken in a transparent and verifiable way **using the index**. This forms the **basis for decisions**.

What is also required is a **legal basis applicable throughout the EU (universal applicability)**, to enable the programme to be applied bindingly throughout the EU. Interventions relating to quantities must already be taken by producers **on an individual farm level according to the 'polluter pays' principle**. Hence in the event of a crisis situation the production of milk can be adjusted to the changing market circumstances. This saves unnecessary processing and storage costs, and so is by far the most efficient solution.



1 e.g. to be gathered from: DCA, CLAL, DGT, CME

2 e.g. to be gathered from: Eurex, IFCN, ife, FAO

## C. Challenges for the MRP

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A few challenges have to be overcome when putting the MRP into practice. One question for instance has to be clarified: **When is there a crisis/How do you define a crisis situation?** From the producers' viewpoint, the term "crisis" can undoubtedly be used when average production costs are not covered over a longer period. This is manifested when **the index** comprising quotations and producer's margin **significantly falls below the cost-covering 100 mark**.

In a time without individual farm quotas, **defining the reference period** becomes of prime importance, too. There are several possibilities here. In light of practice, however, the following method is the most suitable one: the reference period encompasses **the 12 months before the date the crisis is officially established**. In this way even the individual farm supply curves are taken into consideration. This seems particularly appropriate in view of the very different individual farm strategies, e. g. seasonal calving.<sup>3</sup>

Further questions include **from when are fines necessary for the farms** that carry on increasing production despite the crisis being declared **and how much should the fines be?** To enable market-damaging increases in volumes of milk by individual farms to be effectively curbed in a crisis situation, the levy amounting to 110–120% of the milk price should be imposed by not later than when the crisis is declared. This levy applies from the first kilo of increased production. The supply behaviour of individual farms can be worked out easily after the crisis is over by making a comparison with the reference period. *For example: The crisis lasts from 1 October 2014 to 28 February 2015. In this case the reference period is from 1 October 2013 to 28 February 2014.*

**When is the crisis over?** If the index rises to 95 points and the Monitoring Agency's forecasts for the coming months are positive, the Monitoring Agency declares the crisis over.

**The crisis period blocks farm development!** It should also be noticed that the capping of production in the defined crisis period blocks farm development. This problem can be countered by implementing measures immediately and effectively to restrict volumes. The aim is to overcome the crisis as quickly as possible, making it no longer necessary to cap production.

**The amount of the bonus payment for reducing production in a voluntary restraint on supply – funding?** Another question to be answered is how much the suspension bonus should be and how this measure can be funded. Here, too, the guiding principle is act quickly and clearly. The means of choice here seems to be a tendering procedure. It could begin with a high level of remuneration, which is then reduced over the course of time: for instance, 30 cents/kg for tenders submitted by milk producers in the first week, 20 cents/kg for tenders in the second week and 10 cents/kg in the third week. This ensures a quick take-up from those interested. The level of the reduction per farm should be limited to between 5 and 30%. Below this level, only deadweight loss effects are to be expected. If the reduced volume is too high in proportion to total production, there is a risk of financing termination of farms unnecessarily. The commitment period must be contractually stipulated and should encompass the crisis period plus three months. Once the commitment period is over, stock can likewise be taken on the basis of the reference period. If the

<sup>3</sup> Exceptionally daily production can be taken as the reference volume for newcomers to milk production that cannot show a 12-month reference period yet.

actual reduction in volume does not equate to the commitment entered into, the excess volume produced is to be rated as an increase in volume and sanctioned.

The funding can be a mix of:

- state crisis fund and
- penalties for farmers increasing their volumes and
- a producer levy as and when required, limited to the year of the crisis

## D. Advantages of the Market Responsibility Programme

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Applying the MRP offers a number of advantages over other crisis instruments. For instance, firstly a **collapse of farm-gate prices can be prevented** and secondly **the crisis can be overcome quickly with little state funding**.

What is crucial, however, is that this concept relies heavily on milk producers behaving in a manner appropriate to the market circumstances. In future what the dairy farmers will have to do is keep a permanent watch on the market development and react to the market signals. This applies especially in crisis situations. Such “businesslike” conduct can only come about if the collective liability hitherto in the event of falling milk prices is replaced by causer’s liability. This means that farms which still increase their production in a situation in which supply manifestly exceeds demand also have to bear co-responsibility for their anti-market behaviour. On the other hand, it is more than legitimate for farms that cut their production in a market crisis and thus help overcome the crisis swiftly to be compensated financially.

The administrative costs for the MRP are manageable and can be afforded with the data already available.

Taking all the arguments into account the Market Responsibility Programme can therefore be described as an **extremely market-oriented instrument**.



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