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NOTE

From:	General Secretariat of the Council
To:	Delegations
Subject:	Market situation

Further to the ministerial lunch discussion held on 15 February 2016 and in preparation for the March Agriculture and Fisheries Council, delegations will find attached a note from the French delegation on the abovementioned subject.

ANNEX

Contribution from the French authorities

Proposal for crisis management measures

Crisis management measures based on the single CMO (in particular Articles 219, 221 and 222)

1-Milk market

1.1 - Situation in the milk and milk products market in Europe

Milk powder and butter prices have continued to fall in early 2016. Skimmed milk powder has been particularly affected, with prices having fallen to intervention levels. Cheese prices have all been falling for several weeks (with the exception of emmental), reflecting the high saturation of the milk powder market and the carry-over of milk into the cheese market, which has thus also been destabilised. The milk prices paid to producers continue to fall:

(Source: European Commission)

As a result, despite the implementation since September 2015 of the package of measures set out in the EU emergency plan, the situation in the milk market continues to be of great concern. Milk collection in the EU is continuing to increase energetically in 2016, which is preventing balance from being restored between supply and demand. Although prices remain low, European milk production is not expected to ease off in the coming months, given that the high milk production season is still to come. Many producers have invested heavily in preparation for the removal of quotas, and are continuing to produce on a huge scale to recoup these costs. **Price signals are therefore having no effect on production volumes, and a deflationary spiral currently seems to be a genuine risk.**

In the world market, milk production is slowing in other exporting regions (particularly Oceania and the United States), but this trend cannot offset the significant increases in EU production. In addition, international demand has been negatively affected by the continuing Russian embargo, the return of Chinese demand to more normal levels, and low oil prices, which have reduced the revenues of certain importing countries.

As a result, the public intervention scheme for skimmed milk powder has been very popular, with over 29 000 tonnes offered since the beginning of 2016. Among the measures currently available, this tool will have a major role to play in the coming months in preventing a collapse in milk prices. However, the EU-wide ceiling of 109 000 tonnes may well be reached in just a few months, and will therefore need to be increased to ensure that product can continue to be offered at a fixed price. Furthermore, the intervention prices for skimmed milk powder and butter are currently too low to ensure that the market floor price is at an adequate level compared with farmers' production costs. Despite the simultaneous opening of private storage, **it would appear that conventional market measures will still not be enough to contain this crisis, which is essentially one of overproduction.**

1.2 - Existing crisis management provisions in the Single CMO Regulation

In the framework of the latest CAP reform, a set of 'exceptional measures clauses' were added to the Single CMO Regulation. These clauses include:

- **Article 219**, which enables the Commission to adopt delegated acts to deal with threats of market disturbance or prevent a situation which could cause market disturbances from deteriorating, '**provided that any other measures available under this Regulation appear to be insufficient**'. These acts may be adopted under the urgency procedure (Article 228). Up to now, the measures put in place by the Commission in response to the crisis situation in the dairy markets – namely direct aid and exceptional private storage schemes – have been adopted on the basis of this Article.

- **Article 221**, which enables the Commission to adopt implementing acts which **derogate from the rules of the single CMO**. These acts may also be adopted under the urgency procedure (Article 229). The Article specifies that **such acts should be adopted only if it is not possible to adopt the required measures on the basis of Article 219.** Given that the acts adopted to date on the basis of Article 219 have failed to curb production or bring about an upswing in market prices, we must now consider using Article 221.

- **Article 222**, which enables the Commission to introduce derogations from European competition law for a range of measures taken by recognised producer organisations, associations of producer organisations and interbranch organisations.

1.3 - First option: using these instruments in a preventive way

These Articles, in particular Article 221, could be used by the Commission in a preventive way. In Article 221, the possible derogations from the CMO are accompanied by conditions relating to their activation, but there is no indication of restrictions concerning the exact nature of the measures that may be adopted or how the Commission could use the powers assigned to it.

In this first option, **we propose that the Commission use this Article as part of a dissuasive approach: it could thus announce that it will, on the basis of Article 221 of the CMO, adopt a measure designed to limit milk production volumes in the Member States, if there is no voluntary reduction in production within a specific time-frame** (for instance, within two months). The scope of the Commission's powers under Article 221 would make this kind of approach entirely feasible.

Two scenarios are then possible:

- if, by the deadline it has set (for instance, after the 2 months referred to above), the Commission finds that there is a substantial reduction (- 3 %) in production volumes at EU level, it may either refrain from adopting a binding measure or set a new deadline if it considers it necessary to continue efforts to reduce volumes;

- if, by the deadline it has set, the Commission finds that there is no substantial reduction in production volumes at EU level, it will then, on the basis of Article 221, need to adopt a binding measure, involving the application of such a reduction to all collectors together with a dissuasive penalty for those failing to comply. This financial penalty would be applied to collectors who have increased their purchases of raw milk from producers.

The first option has the advantage of:

- bringing about a reduction in volumes placed on the market, which is now necessary to allow price recovery;
- not necessitating the deployment of funds from the EU budget, in the event that the Commission fails to release marginal funds from this budget or there is no majority of Member States in favour of using the crisis fund.

1.4 - Second option: using these instruments to promote the voluntary reduction of production

This mechanism would be implemented though Article 221 and would require a dedicated budget based either on:

- any marginal funds within the EU budget;
- or on the crisis fund (which would only be used in a crisis of this magnitude).

In its forecast, the European Commission is counting on an increase in the volume of milk collected of nearly 1 % in 2016 compared to 2015.

Given the projected increase in the volume of milk collected, the aim could be to reduce EU production by 3 % compared with 2015 over a period of 5 months, from May to September, which is a period of strong seasonal production.

This 3 % reduction over a 5 -month period corresponds to a volume of around 2 billion litres of milk not produced compared with 2015 (150 billion litres x 3 % x 5/12). This reduced volume would avoid the production of around 180 000 tonnes of skimmed milk powder and 90 000 tonnes of butter. The effect on market balance would therefore be significant.

Achieving this overall reduction target would involve the voluntary, incentive-based commitment of members of the farming community. Given the **voluntary nature** of the reduction, we propose that aid be set at **EUR 100 for every 1000 litres of milk not produced** by way of incentive.

On this basis, a maximum budget of EUR 200 million would be necessary (which would amount to half of the available funds in the Reserve for crises).

To achieve this 3 % target, we propose that each litre of milk not produced compared with the previous year baseline should be compensated with a minimum EUR 500 subsidy (corresponding to a 5 000 litre reduction), so as to avoid paying too small amounts, and a 20 % reduction threshold aimed at precluding special cases and deadweight effects (cessation of activity, etc.).

Example: a farmer producing 500 000 litres per year and reducing production by 5 % on average during the period May-September (through reduced use of concentrates, reforms made, early cessation of milk production) would reduce production by approximately 10 400 litres (500 000 x 5 % x 5/12) and would accordingly be entitled to EUR 1 040 in aid. The loss of turnover would be around EUR 3 000 (10 400 x EUR 280 / 1000l). The loss of margin depends on the milk price and marginal operational costs (in particular feed costs).

The commitment would be made by each individual farmer and not by the buyer. Each farmer would make a choice based on personal circumstances, costs of production, possible investments made in preparation for withdrawing from quotas and the debt incurred for that purpose. However, the purchaser would be required to provide reference data (production figures for the previous year based on invoices) as well as the data for 2016 (also invoices). Checks could be carried out mainly at national level.

In order to be limit expenditure, a stabilising mechanism would be set up at EU level. Thus, in the event of budget overrun, a reduction coefficient would be applied to EU grants based on the ratio of grant payable at European level and the available budget.

If this stabiliser were to be activated, compensation not covered by the EU budget could be covered by national budgets, up to the level set for aid (EUR 100/1 000 litres).

Purchasers could also compensate all or some of the farmers concerned, on a voluntary basis.

The **main advantages** of this system are as follows:

- a significant potential effect on the markets: reduction of the milk supply, surpluses turned into skimmed milk powder and butter, less intervention selling (and thus a potential saving for the European budget), better market balance;
- a controlled cost for the European budget, through the available budgetary stability mechanism;
- greater responsibility for farmers.

1.5 - Third option: promote a measure for voluntary reduction of production by means of a broader Article 222 that offers incentives

Article 222 of the Single CMO Regulation allows producer organisations, associations of producer organisations and recognised interbranch organisations to derogate from the competition rules during periods of severe imbalance in markets, through the implementation of certain measures and in particular 'temporary planning of production taking into account the specific nature of the production cycle'.

Insofar as this is a voluntary measure, it is essential for it to be widely available and incentive-based.

We would therefore propose applying the provisions set out in Article 222, adapting them via the options provided for in Article 221, as follows:

- **broadening the eligibility criterion** relating to producer organisations, associations of producer organisations and recognised interbranch organisations, allowing other operators (cooperatives, dairy companies, for example) also to plan production temporarily;
- giving operators **incentives** to use this article:
    - via supplementary financial support (the source of the dedicated funds is still to be discussed: national aid, state/EU co-financing, European funds taken from the margins or from the reserve for crises); and/or
    - by allowing only collectors/processors participating in this supply reduction mechanism to use other regulatory instruments, such as public intervention in butter at a higher price, set in advance. It is important to raise the intervention price for butter temporarily, as this product is displaying short-term downward signals that can be stopped quickly via this measure, with a direct effect on the price paid to producers. This will prevent the sector from being drawn into a crisis at least as great as the one in 2009.

The **main advantages** of this system, if it is broadened and offers incentives, are as follows:

- an innovative system to deal with a large-scale crisis, which is in keeping with the spirit of the CMO reform as it gives economic operators greater responsibility;
- a significant potential effect on the markets if it is made available to all operators, and not just to producer organisations, associations of producer organisations and recognised interbranch organisations;
- a controlled cost for the European budget.

1.6 - Public storage: arrangements for intervention

A - Raising the ceilings for intervention

The public intervention scheme for skimmed milk powder is now operating on a large scale, in several Member States. **The rate of taking into intervention has increased significantly since the beginning of 2016:** while the total volume taken into intervention was a little over 40 000 tonnes for the whole of 2015, around 37 000 tonnes have already been taken into intervention since the beginning of 2016. Among the schemes currently available, this tool will have a major role to play in the coming months in preventing a collapse in milk prices, especially as the European Commission is forecasting an increase in collection of almost 1 % in 2016 compared to 2015. The scheme will therefore be used intensively in the coming months and there is a risk that the ceiling will be reached fairly quickly (within a few months). Above that ceiling, purchasing is done via tendering, and therefore at prices that are potentially lower, or considerably lower, than the intervention price of EUR 1 698/tonne.

We should therefore consider **raising the EU ceiling for intervention at a fixed price** (109 000 tonnes of skimmed milk powder per calendar year) for 2016, on a temporary basis. A recognised statistics body (ZMB) is predicting purchases of skimmed milk powder at a level of **160 000 tonnes** in 2016. It might be necessary to raise the ceiling to this level temporarily.

Such a raising of the ceiling is covered by the 'Fixing Regulation', Regulation (EU) No 1370/2013 (legal basis: Article 43(3) TFEU), and therefore requires a proposal from the Commission to the Council.

A discussion should be held without delay on the relevance of similar measures for butter; due to the surplus of milk powder on the market, the carry-over effect means that additional volumes place a burden on the market for other milk products. Consequently, the price of butter has been falling regularly since the beginning of 2016. As the intervention price has not yet been reached, there is still time to prepare for a possible activation of the intervention system for this product. The volume set for fixed price intervention is 50 000 tonnes. If placing into intervention was done at a steady pace, the ceiling might be increased (to 80 000 t for example).

B – Increase in the intervention price

At European level, there remains the issue of a **rise in the level of intervention prices**. The expected positive effect on the market prices for skimmed milk powder and butter, and accordingly on the price of milk, would be beneficial. For the time being, the intervention price is too low to ensure that the market floor price is at a satisfactory level compared with farmers' production costs. This request, made by many MS, has so far not been endorsed by the Commission.

Further discussion of the relevance of a re-evaluation of the reference thresholds in the CMO (Article 7(2)), or the intervention prices fixed under 'Regulation 43.3' on the basis of the reference thresholds, could be addressed in the medium term, within the framework of the establishment of a high-level group.

1.7 - Evolution of private storage schemes

The private storage schemes for skimmed milk powder (normal and enhanced) and butter have been extended up to 30 September 2016 without any change to their operation. If there are still market imbalances on that date, the issue of extending these schemes will be reopened.

If the above recommendations on an intervention mechanism were accepted, consideration could be given to maintaining only enhanced private storage of skimmed-milk powder, with the possibility of early withdrawal without penalty, (if necessary after a minimum period) **when the goods are exported to third countries.**

2-Pigmeat market

In the spring of 2015 and again in January 2016, the European Commission used the only tool for intervention on the domestic market provided for pig meat in the CMO Regulation, i.e. private storage aid. However, in the absence of sufficiently strong incentive export volumes (90 025 tonnes in January 2016), this tool ultimately only had a temporary effect on prices. France puts forward the following options for making the tool more effective:

2.1 - Private storage with an export obligation

One proposal is to develop the private storage scheme by replacing the incentives to export by an obligation to export the quantities stored at the end of the storage period.

- Legal basis: it would be necessary to use Articles 219 and 221 of the CMO Regulation, since this obligation is not covered in the rules;
- Advantages: an obligation to export would prevent the return of volumes stored on an internal market still under pressure, and reduce the risk of the deadweight effect induced by the nature of the private storage measures;
- Conditions for triggering: as the market is already significantly disrupted, the conditions for triggering laid down in the single CMO for exceptional measures of this type are definitely met;
- Compliance with international agreements: such a measure cannot be equated with an export subsidy, especially when the differential between the European price and the international price is low; it does not therefore seem to be in contradiction with our CMO commitments.

2.2 - Private storage with a ceiling for each Member State

The proposals made in early September 2015 to increase aid for private storage of pigment compared with the spring 2015 marketing year have been partially acted upon by the Commission: the list of eligible products extended to pig fat, increase in the amount of aid to 20 % and the possibility of premature removal from storage in the case of export. However, two proposals were rejected: firstly, the extension of the duration of storage; secondly, the setting of a volume limit, distributed among the Member States. The setting of a volume limit, and the provision for a longer period than before may again be proposed. In order to maximise the impact of the scheme on the market, a mechanism for mid-term reallocation of quotas that were under-utilised by the Member States could be set up, along the lines of the existing mechanism for cheeses.

- Legal basis: it might be necessary to use Articles 219 and 221 of the CMO Regulation;
- Storage duration: 180 days with possibility of premature exit from storage without penalty for export;
- Estimated cost of the measure: if we set the objective of withdrawing 200 000 tonnes from the market (i.e. slightly more than double the amount withdrawn under the previous scheme), the cost of the measure would be approx. EUR 70 million;
- Distribution key: base this either on each Member State's share in slaughtering or on exports to Russia.

2.3 - Lifting of the Russian health ban

This measure, which would make it possible to rebalance the market, remains essential and complements the CMO exceptional measures mentioned above.

2.4 - Extension of the Milk Market Observatory (MMO) to other sectors of farming, in particular pigmeat and beef

The recent changes to the functioning of the Milk Market Observatory (more parameters monitored, publication of a regular 'Dashboard') have shown the importance of such a tool. More specifically, at its last meeting in January, the Observatory confirmed the widening gap between the increase in production on the one hand, and stabilisation/reduction of demand on the other.

A similar observatory covering other livestock sectors, in particular pork and beef, would therefore seem essential.

Other measures

1. Possibility of mobilising national aid and the need to raise the *de minimis* ceilings

In the context of the current agricultural crisis, much use has been made of the *de minimis* Regulation for the provision of emergency aid. A solution must therefore be found so as to avoid saturating both the individual and national ceilings set by the agricultural *de minimis* Regulation. One conceivable solution is to raise the *de minimis* ceilings. The de minimis Regulation could thus be amended so as to raise the individual and national ceilings.
The current Regulation was renegotiated in 2013, and the reform made it possible to double the aid ceilings (now EUR 15 000 compared with EUR 7 500 previously) and adapt the national ceilings.

Texts on state aid come under the exclusive competence of the Commission, and broad support from the majority of MS would be needed.

2. Towards the creation of an EU tool dedicated to developing agricultural and agri-food exports

Establishing an EU-level guarantee system for short-term credit, specifically for agricultural products, could supplement the national supply.

It could be based on the US programme which in 2015 covered exports of agricultural and agri-food products totalling USD 5 500 million dollars (at least 90 % of the agricultural commodity used in manufacturing the 'high-value' agri-food products must come from the US).

The GSM-102 programme is a guarantee system operating in the same way as COFACE, but with a much broader application than the French system: once the contract between the exporter and the importer has been concluded, it is covered by a public guarantee that secures the transaction for both the bank and the exporter.

It would be a matter of setting up a short-term credit guarantee system (repayment within 18 months and establishment of bank guarantees), which would be based on the US scheme.

It would enable greater access to overseas markets for European agricultural systems, particularly to those countries deemed to be at risk despite their substantial market potential.

Taking Africa and the Middle East as examples, United States-based operators export agricultural commodities to these – reputedly difficult – markets using export credit mechanisms (in 2015, guarantees were issued in respect of agricultural products exported to this region with an equivalent value of USD 115 million).

3 - Food aid: developing the supply of food products produced by sectors in crisis

Under current legislation, the only method of developing the supply of food products using products in crisis (milk and meat) at European level is the valuation of public intervention stocks via the Fund for European Aid to the Most Deprived (FEAD).

3.1 - Operation of the Fund for European Aid to the Most Deprived (FEAD)

Historically linked to the public intervention mechanism of the CAP, of which it partially valued the stocks, the FEAD (formerly the PEAD) is now part of the 2014-2020 programme in heading 1B [(Economic, social and territorial cohesion)] of the EU budget.

The fund, governed by Regulation (EU) No 223/2014, lends support to national food aid and/or basic material assistance measures benefiting the most deprived people through the intermediary of partner organisations (PO) approved by the MS. The FEAD is jointly managed by the MS and has a European co-financing rate of 85 % (total provisional European budget for this item of EUR 3 826 million for seven years). Its implementation in MS is based on national operational programmes (OP).

3.2 - Link FEAD-CAP

Although the direct link between the FEAD and the CAP has now been abolished, Article 16 of Regulation (EU) No 1308/2013 on the CMO indicates that products purchased within the framework of public intervention can be disposed of by making them available to the FEAD. Regulation (EU) No 223/2014 on the FEAD specifies in Article 23 that products from intervention may be sold for the benefit of the FEAD if this is the most economically advantageous solution and the proceeds of the sale do not lead to a decrease in the co-financing of the programme by the MS. This relationship between the intervention measures and the FEAD has not been used since the beginning of the current programme.

3.3 - Proposal

Implementing acts establishing procedures for the use, transformation and sale of products from intervention in favour of the FEAD should be adopted by the Commission.
Three possibilities could be envisaged:

- the proceeds of the sale of the stocks from intervention would replenish the FEAD general budget and could be used by MS, subject to national co-financing of 15 %;
- these proceeds would act as a substitute for the European financing provided for in the context of the FEAD;
- or, as with the previous system, a system of swapping raw materials from intervention for finished food products via national calls for tender would be put in place to complement or as a substitute for FEAD financing.