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COMMISSION STAFF WORKING DOCUMENT

accompanying the

Communication from the Commission to the Council

Dairy market situation 2009

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1. ADDITIONAL INFO REFERRING TO POINT 3.1 – MARKET SITUATION TO JULY 2009

1.1. EU milk supply

EU milk production has not increased as a result of the various quota increases. Milk deliveries to dairies, adjusted for milk fat, under the quota system was 137.8 million t in 2007/08 and is estimated at 136.4 million t for 2008/9. Despite the increase of the quotas by 2-2.5 % in the 2008/09 quota year, milk production in the EU-27 fell by 0.9 %. At 31 March 2009, total milk production was estimated to be 4.2% below the overall deliveries quota. On 1 April 2009, quotas were further increased by 1% and the fat correction reduced. Latest statistics indicate that EU-27 production increased by 0.5 % in May 2009 (see table 1). As the figures only relate to May 2009 compared to May 2008, it may be too early to draw final conclusions. Weather conditions in north-west Europe were favourable for dairy production in May, with relatively high average temperatures.

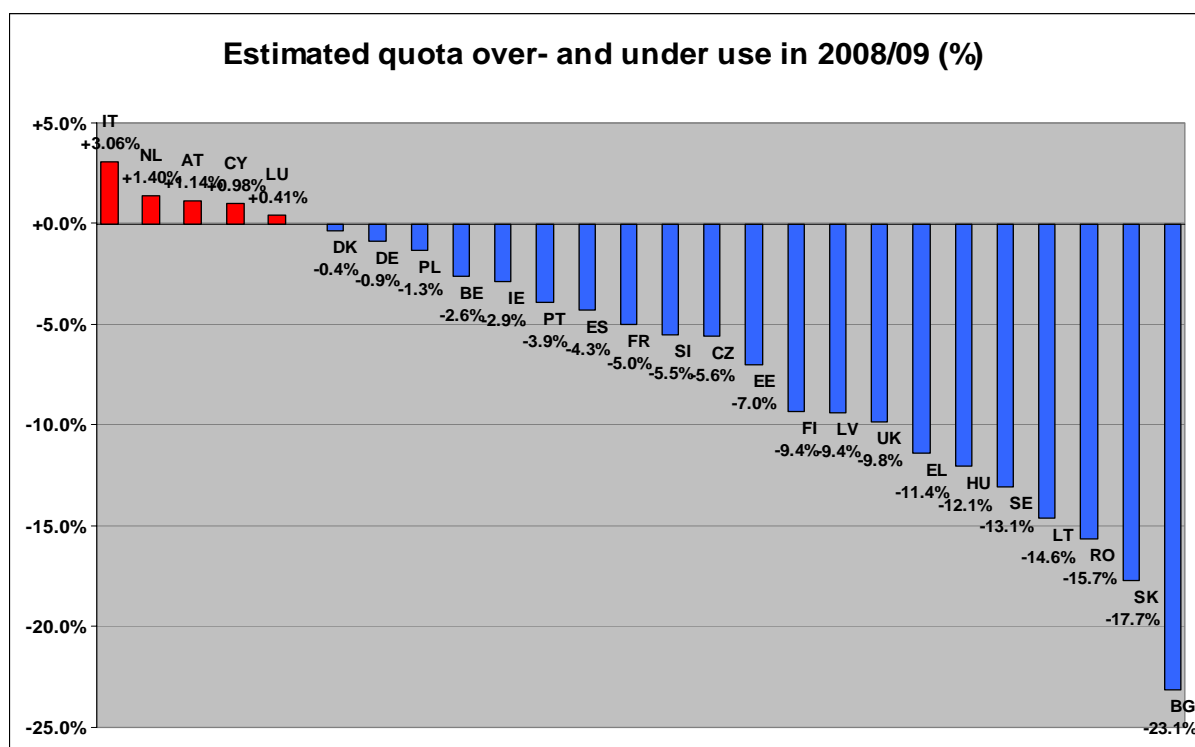
Table 1: Milk deliveries in May 2009 compared to May 2008

Countries with higher production			Countries with lower production		
	%	1000 Tonnes		%	1000 Tonnes
DE	+8.5%	+197.9	GR	-0.5%	-0.3
DK	+4.5%	+18.3	ES	-1.8%	-9.2
IT	+3.8%	+34.4	PT	-1.4%	-2.5
PL	+3.1%	+26.0	CZ	-1.8%	-3.8
LU	+2.3%	+0.6	UK	-1.9%	-24.6
AT	+2.0%	+5.0	SI	-2.6%	-1.2
NL	+1.6%	+15.3	HU	-3.2%	-4.2
FI	+1.3%	+2.7	FR	-4.3%	-94.6
SE	+1.2%	+3.0	IE	-5.2%	-36.3
BE	+0.9%	+2.3	EE	-5.2%	-2.9
			CY	-7.8%	-1.0
			SK	-8.3%	-7.0
			RO	-8.5%	-9.5
			LV	-10.4%	-6.1
			LT	-12.8%	-16.4
			BG	-25.9%	-18.3

	%	1000 Tonnes
Total EU	+ 0.5%	+ 67.5

Source : EUROSTAT (BE, GR and CY: other sources)

For individual Member States, the situation as regards their quota use is mixed with some Member States producing close to or more than their quota and others producing less and in some cases substantially less than their quota, see graph below:



National data for NL, DE and AT

Costs of milk production are collected via the Farm Accountancy Data Network. The most recent report, using 2006 figures, is available at:

http://ec.europa.eu/agriculture/analysis/fadn/reports/sa207_milk.pdf

1.2. EU demand

Dairy products made of milk are used in four main outlets: households, industry, food service and exports. For households there is some ad hoc information in member states available, but the use by industry and especially food service is very limited, if any at all.

A little over 40% of the EU milk is processed into cheese and 30 % into fresh dairy products. The rest is processed into powders, butter and casein. In the cheese market about 7% is exported and it is estimated that about 20 % is used in the industry and food service and. This would mean that a little over 70 % of the EU cheese is consumed by households.

However, while no overall consumption figures exist for the EU in 2009, the production figures of fresh products give a direct indication of consumption developments. In January to April 2009 production for drinking milk decreased by 2.5 %, fermented products by 1.3 % and cream by 0.8 %. For cheese the link between production and consumption is less clear as cheese can be stored longer. However the reduction in cheese production by 2.3 % in the first four months of the year may be a good indicator of reduction in cheese consumption.

It is clear that, dairy product consumption has suffered from the economic and financial crisis, in particular for the more expensive high quality products like cheese and fresh dairy products. This is a very noticeable development for cheese and fresh products as their consumption has been consistently increasing every year. Since more than 470% of milk is used to manufacture cheese and fresh dairy products, the effect of lower consumption is

important. Further, the use of dairy products in industrial processing is reported to have declined with buyers finding competitive substitution products.

Consumption or disappearance figures can be derived at the end of the year, on the basis of annual production figures and exports/imports. Detailed information can be found on the internet address indicated below:

http://ec.europa.eu/agriculture/publi/caprep/prospects2008/index_en.htm

1.3. World milk supply

According to FAO statistics the total world milk production in 2007 was 671 million tonnes, of which 560 million tonnes cow's milk. Milk production in major southern hemisphere exporters, strongly increased in the season just ended: New Zealand +7 %, Australia +2 %, Argentina +5 %. US milk production, after several strong annual increases, seems to have stabilised in 2009 with increases of 0.1 % in March/April and 0.2 % in May.

1.4. World market demand

While production increased, there is less demand on the world market. Most notable is the decrease in world-wide cheese exports which went up until 2007 but decreased by 7.8 % in 2008 and 12.3 % in the first three months of 2009. The EU is particularly hit by this development as the largest cheese exporter.

Table 2: Total world exports of major dairy commodities

	2005	2006	2007	2008	Difference 2007-2008
Butter (oil)	777 856	790 718	752 203	694 831	-7.6 %
SMP	1079 589	1094 527	1058 562	1110 877	+4.9 %
WMP	1710 683	1776 703	1641 817	1838 980	+12 %
Cheese	1475 022	1512 794	1586 459	1463 269	-7.8 %
Whey	823 395	917 897	1040 968	961 953	-7.6 %
EU share (%)					
Butter (oil)	40 %	30 %	27 %	21 %	
SMP	18 %	8 %	19 %	16 %	
WMP	29 %	24 %	22 %	26 %	
Cheese	37 %	39 %	38 %	38 %	
Whey	41 %	38 %	35 %	37 %	

	Jan-Mar 2008	Jan-Mar 2009	difference
Butter (oil)	185 078	175 256	-5.3 %
SMP	282 758	267 350	-5.4 %
WMP	453 012	448 487	-1,0 %
Cheese	376 434	330 035	-12.3 %
Whey	228 505	222 809	-2.5 %

Source: GTA

EU exports take place mainly in the form of cheese, whole milk powder and whey powder. While there are also considerable exports of skimmed milk powder, butter and condensed milk. The EU world market share is decreasing for most commodities, while it remains stable for cheese. In order to give an overall estimation of the size of the EU exports the total fat and protein content of the exports are compared to the total fat and protein of EU milk production. The share of EU milk exported is between 7.6 % for the fat and 10.6 % for the proteins. Certain dairy products are supported by refunds. Imports are smaller with only 1.4 % and 1.1 % of EU milk fat and milk protein production. Imports are mainly in the form of butter and cheese within Tariff Rate Quotas or products with low tariffs like casein.

Table 3: Share of EU milk production exported and imported.

million tonnes		2000/01(EU-15)	2008/09 (EU-27)
Production	Milk fat	4.6 million tonnes	5.5 million tonnes
	Milk protein	3.8 million tonnes	4.5 million tonnes
Share exported	Milk fat	9.7 %	7.6 %
	Milk protein	14.5 %	10.6 %
Share imported	Milk fat	2.7 %	1.4 %
	Milk protein	2.7 %	1.1 %

1.5. World market prices

The imbalance on a world market where trade is marginal to total production and consumption resulted in a significant collapse of prices compared to 2007, remaining at those levels after refunds were introduced. Refunds have been set objectively to not undercut world market price, as indicated in the tables below.

Table 4: World market prices

\$/tonne	Peak level	19 January 2009	2 July 2009
Butter	4 200 (Nov 2007)	1 950	1 900
SMP	5 200 (July 2007)	1 875	1 977
WMP	5 100 (Oct 2007)	1 950	2 050
Cheese	5 500 (Dec 2007)	2 750	2 600

Table 5: EU compared to world market prices

EUR/t 2 July 2009	Intervention price/equivalent price (a)	Current market price ¹ (b)	World market price ² (c)	Difference (c)- (b)	Difference (a) – (c)	Common Refund
Butter	2 218	2 236	1 348	- 888	-870	650
SMP	1 698	1 662	1 402	- 260	-296	228
WMP	2 066	1 966	1 454	- 512	-612	350
Cheese(cheddar)	2 484	2 296	1 844	- 452	-640	220

Table 6: demand for export licences

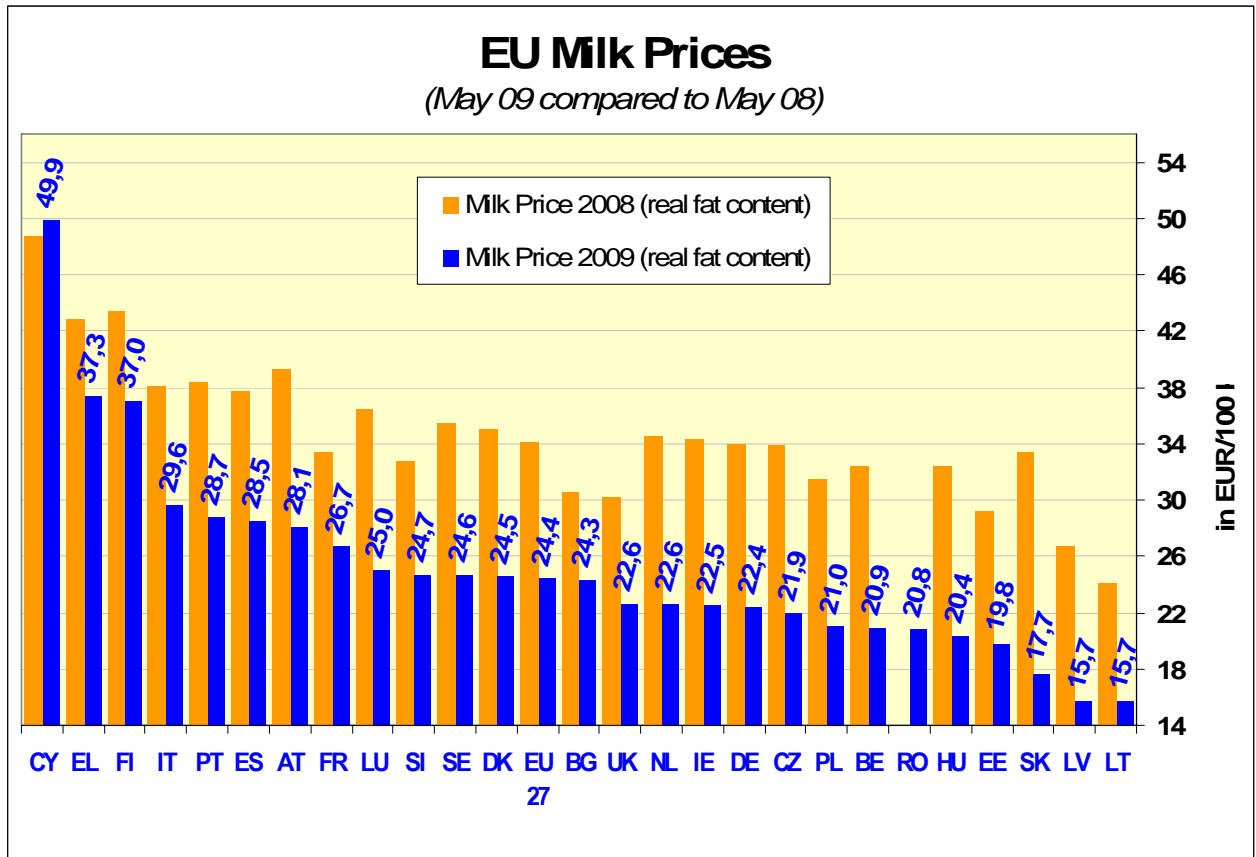
	23.1.09-23.6.09
Butter/oil	97 500 t
SMP	121 600 t
Cheese	144 000 t
Others (incl. WMP)	518 300 t

As of the month of June, demand for export licences slowed down considerably for powders and butter.

¹ Weighted average price of 7 main exporting MS.

² Oceania quotations (Source: USDA Agricultural marketing service).

2. ADDITIONAL INFO REFERRING TO POINT 3.2 – PRICES IN THE EU



3. ADDITIONAL INFO REFERRING TO POINT 3.3 – PRICES PAID BY CONSUMERS VERSUS PRICES PAID TO FARMERS

Table 7: Change in the producer and consumer prices for dairy products in the EU (% , Q1 2009 compared to Q4 2007)

	Producer prices (farmers, processors)				Consumer prices	
	Raw milk	SMP	Butter	Cheese	Food	Milk/cheese/eggs
EU	-28%	-42%	-37%	-21%	6%	4%
Belgium	-45%	-48%	-42%		6%	6%
Bulgaria	-11%				9%	5%
Czech Republic	-38%	-49%	-46%	-29%	3%	-4%
Denmark	-30%	-47%	-23%		5%	2%
Germany	-39%	-49%	-43%	-37%	3%	-3%
Estonia	-28%			-14%	7%	-1%
Ireland	-43%	-44%	-41%		4%	9%
Greece	-13%				6%	4%
Spain	-28%		-24%		3%	0%
France	-12%	-46%	-44%		5%	7%
Italy	-12%		-45%		5%	5%
Cyprus	20%				13%	5%
Latvia	-34%	-11%	-41%	-19%	15%	8%
Lithuania	-43%			-7%	14%	-2%
Luxembourg	-35%				4%	5%
Hungary	-33%	-46%	-1%		8%	5%
Malta					13%	10%
Netherlands	-39%	-47%	-46%	-44%	7%	7%
Austria	-20%				5%	-2%
Poland	-40%	-54%	-44%	-44%	6%	0%
Portugal	-17%		-39%		3%	1%
Romania					9%	14%
Slovenia	-6%			1%	6%	10%
Slovakia	-32%	-20%	-29%	-33%	3%	-2%
Finland	3%		-30%	0%	14%	22%
Sweden	-33%				9%	8%
United Kingdom	-27%		-57%	-27%	13%	11%

NB: Source: Agriview – Member State communication – Absolute raw milk prices ex-farm; absolute ex-factory prices for SMP, butter, cheese (depending on the country, prices for the following cheese types have been taken into consideration: Edam, Emmental, Gouda, Cheddar); Eurostat: consumer price indices for food and milk/cheese/eggs in retail

4. ADDITIONAL INFO REFERRING TO POINT 4.3 – OTHER MEASURES TO SUPPORT THE OUTLET OF MILK PRODUCTION

4.1. Marketing standards milk products

The single CMO, **Article 114** and Annexes XII and XIII lays down provisions on protected designations for milk products. The original legislation on the subject was adopted in 1987 (Reg. 1898/87) at a time when some products, with no milk products, used references suggesting the use of milk products or qualities of milk products.

Some designations (whey, cream, butter, buttermilk, butter oil, caseins, anhydrous milk fat, cheese, yogurt, kephir, koumiss, villi/fil, smetana, fil) are limited for milk products as referred by the Regulation ('milk products' means products derived exclusively from milk, on the understanding that substances necessary for their manufacture may be added provided that those substances are not used for the purpose of replacing, in whole or in part, any milk constituent.)

Decision 88/566 published a list of designations which were acceptable by derogation. Whereas the single CMO establishes the principle that the descriptions 'milk' and 'milk products' may not be used for milk products other than those described in Article 2 thereof; whereas, as an exception, this principle is not applicable to the description of products the exact nature of which is known because of traditional use and/or when the designations are clearly used to describe a characteristic quality of the product;), such as

Coconut milk

'Cream ...' or 'Milk ...'

Used in the description of a spirituous beverage not containing milk or other milk products or milk or milk product imitations (e.g. cream sherry, milk sherry)

Cream soda

Lait d'amande

Lait de coco

'Crème ...'

used in the description of a soup not containing milk or other milk products or milk or milk product imitations (e.g. crème de volailles, crème de légumes, crème de tomates, crème d'asperges, crème de bolets, etc.)

'Crème ...'

used in the description of spirituous beverages not containing milk or other milk products or milk or milk product imitations (e.g. crème de cassis, crème de framboise, crème de banane, crème de cacao, crème de menthe, etc.)

Pindakaas

Hoofdkaas

Cacaoboter

Margarinost

The example of "analogue cheese," when labelled as cheese, is not in conformity with EU legislation. A complete labelling of all ingredients would not be satisfactory, as it would refer to a non-dairy product but using the positive image of cheese as a sales argument.

Some designations, as "ice cream" were not covered as there were already national definitions for the product (exclusively with milk fat or not). The word "cream", relating to the texture of the product, is acceptable under Decision 88/566.

Modifying the current rules to include more protected designations would have to be done at Council level. One element to be taken into consideration is that the aim to simplify the legislation (Communication on the agricultural products quality policy) might be questioned

There are also requests to extend the list of derogations, for example for soy drinks to be designated "soy milk". It is clear that a designation presenting soy drinks as alternative to milk is meant to boost the sales, probably at the expense of 'real' milk, while the product is already widely available for consumers who prefer or who need this alternative product.

There is no reliable data on competing products market share but, with the exception of margarine, it is estimated not to exceed 1 – 2% of the milk market. Although the Commission has no concrete figures available, it is reported that the use of substitutes for cheese is increasing.

Article 115 and Annex XV of Regulation 1234/2007 refers to spreadable fats, regulating the designations of a) milk fats, b) fats and c) fats composed of plant and/or animal fats, covering in particular the designations 'three-quarter butter', 'half butter' and 'dairy spread x%'

Member states are responsible for the application of the EU legislation and they shall control and restrict the use of designations which do not respect the protected designations.

4.2. School milk scheme

Commission Regulation (EC) No 657/2008 lays down detailed rules for applying Council Regulation (EC) No 1234/2007 as regards Community aid for supplying milk and certain milk products to pupils in educational establishments.

Other dairy products are also available under the school milk scheme and are listed in Annex I of Commission Regulation (EC) No 657/2008. The amount of aid for these products is derived from the basic aid.

The school milk regime has only recently been adapted, making it more simple by having the same aid amounts for all milk (18,15 cents /litre based on a 0,25 l/day portion), extending it to secondary schools and increasing the product coverage. The level of aid is fixed by the Council. The value of the EU aid in relation to the price varies from Member State to Member State, but on average is in the order of 15%.

As to the product coverage, this is Commission competence, where the discussion in the Management Committee is ongoing since April, again with the purpose of making the scheme more attractive. The Commission proposed in the management committee of 9 July 2009 to reduce the minimum milk content to 75%, which allows adding 25% other products, like fruit, to milk (current eligible products must contain at least 80 % milk).

4.3. Aid for SMP in veal or SMP into casein

Council Regulation (EC) No 1234/2007 establishes in Article 99 an option to use a disposal aid for skimmed milk powder for use as feedingstuffs.

Before the 2003 reform the EU had an intervention price of 205 €/100g for SMP. In order not to lose a substantial outlet of SMP to the veal sector, the sector received an aid of 60 €/100kg. This brought their net price back to 145 €/100kg and kept the sector a buyer of SMP to feed to their calves. Today the intervention price for food grade SMP is 169.8 €/100kg and the market price for feed grade SMP is around 140 €/100kg. This means that the veal sector, which is suffering from the economic situation as well, is able to buy SMP at a lower price than before and without having to deal with a large administrative burden of the disposal aid. However, despite the low SMP price the sector seems to have turned away from SMP and buys more whey powder. While introducing the measure would be expensive in terms of subsidising existing use and administrative costs, the additional demand given the already very low price of SMP is estimated to be very limited. In that case the subsidy for the additional demand would exceed the price of SMP.

Council Regulation (EC) No 1234/2007 establishes in Article 100 an option to give an aid for skimmed milk processed into casein and caseinates.

For the aid of skimmed milk processed into casein the same applies, as casein producers can buy very cheap skimmed milk today and there is no need for this kind of production aid.

5. ADDITIONAL INFO REFERRING TO POINT 5B – PROMOTION

On the basis of the Council Regulation (EC) No 3/2008 of 17 December 2007 on information provision and promotion measures for agricultural products on the internal market and in third countries, the European Community can (co-)finance measures that provide information on, or promote, EU agricultural products and food on the Internal Market as well as in so called "third countries", i.e. outside the European Union.

Currently, 19 programmes (among 135 still active programmes) are exclusively promoting milk and milk products. Those 19 active programmes were adopted for a total amount of €66.5 million (EU participation: €33.3 million). It corresponds to 18.3% of the total amount of the active promotion programmes.

The Commission is expected to adopt on 7 July 2009 a new decision approving 16 new information and promotion programmes on the internal market and among them 4 programmes cover milk and milk products for a total amount of €19.4 million (EU participation : €8.1 million).

On the internal market, the implementing Regulation (CE) n° 501/2008 of the Commission currently stipulates that the trade organisations deposit their promotion programmes before 30 November, that Member States forward the programmes selected to the Commission before 15 February, and that the Commission decides at the latest on 30 June.

For third country programmes, the same Regulation foresees that programmes are deposited by the trade organizations before 31 March, forwarded to the Commission before the 30 June, and adopted by the Commission before 30 November.

Experience has shown that co-financed promotion programmes initiated by the trade organisations of this sector and co-financed at national and EU levels provide a valuable incentive.

6. ADDITIONAL INFO REFERRING TO POINT 7.2 – QUOTA MANAGEMENT ON AN INDIVIDUAL PRODUCER LEVEL

In the current Council Regulation, a super levy is due when the national quota is exceeded in any given year. The Member State concerned is liable to EAGF for the surplus levy but the super levy is subsequently claimed from all producers who have contributed to the national overrun.

Milk purchasers (often the dairies) are responsible for collecting the contributions from the milk producers and shall forward those amounts to the competent body of the Member State. The purchaser normally starts to deduct a part of the super levy from the milk price once the producer has exceeded his/her individual quota. The final account is made after the end of the quota year where underrun of individual quotas are matched against overruns and after account is taken of the national reserve. Where, as a result, it appears that there is no national overrun, the money collected is reimbursed to the producers concerned. Where on the other hand it appears that a surplus levy in fact is due, the final amount of levy per overrunning producer is generally reduced in function of other producers' under delivery. It may happen

that contributions collected from producers are greater than the levy. In such cases, Member States may:

- use, partly or totally, the excess to finance voluntary retirement from milk production, and/or
- redistribute, partly or totally, to priority groups of producers.

Each Member State is managing a national reserve as part of its national quota. The national reserve is replenished by the yearly 1% increase (Health Check) and may furthermore be replenished by applying Article 72 of the single CMO where "Member States may decide whether and on what conditions all or part of the unused individual quota shall revert to the national reserve" in cases where producers do not market a quantity at least equal to 85 % of their quota ("inactivity rule"), up from 70 % as part of the Health Check. The national quota may also be increased by retaining part of quota transfers (Member State option) or Member States may decide to make an across-the-board reduction in all individual quotas.

In any case, where at the end of the quota year the Member State has not redistributed all of the national reserve to producers the residual quantity is still taken into account in determining whether the Member State is liable of a super levy or not.

Milk producers may therefore take this flexibility into account in exceeding their individual quota, estimating that the national reserve and/or other producers' under delivery would protect them from paying a super levy on at least some of their overrun.

In that context, the following elements have been identified to discourage milk production to a certain extent: (1) the 85% inactivity rule, (2) the rule providing for a temporary or permanent transfer of quotas, (3) allocation of the national reserve, like the 1% increase, to the direct sales quota and (4) the neutralisation of under delivery in the levy calculation.

As to the "inactivity rule", an invitation to Member States not to confiscate the unused quantity may, if followed, lead to more "sleeping quotas" and arguably less production.

Temporary transfer of quotas or permanent transfer of quotas (without land) are also left to Member States' discretion i.e. the Member State may decide not to allow such transfers. In this case, some quotas would remain inactive but the impact on total production would still depend on the willingness to take risk among the more progressive producers.

Thirdly, Member States may at present allocate any additional quota received to the direct sales part of the national reserve. By doing this the deliveries part of the national reserve is held constant and farmers cannot deliver more milk under the deliveries quota. As the direct sales quota is rarely fully used in any Member States, there is less risk of extra production to match the extra quota. However, allowing Member States the scope to subsequently reclassify any quota held in the reserve from one category to another category would require an amendment to the Council Regulation at a later stage.

A fourth element/option for Member States impacting the supply would be, in case a Member State is exceeding its quota and has to pay super levy, to disregard the unused part of the national quota allocated to deliveries when calculating each producer's contribution to the payment of the super levy. In that case, the progressive producers can no longer bank on the under delivery of others and would need to pay the full levy for his full excess quantity. Member States may then use the additional part of the collected levy, not destined for

"Brussels", for restructuring purposes. The impact on supply is likely to be more important than under the first two options, although again limited to the Member States paying levy or risking to do so.

The overall effect of the above-mentioned potential measures would be to encourage a reduction of the supply of milk and dairy products, where the third option, may have more effect than the first three options, albeit limited to the countries close to their quota levels. However, a number of points should be emphasised:

- Production impacts, if any, will only be felt at the end of the quota year (Feb/March) provided that changes can be taken in this market year without harming legitimate expectations;
- Production impact from such measures, if taken, is highly dependent on each producer's perceived risk in terms of paying superlevy. Where that risk is remote more progressive producers will still expect to benefit fully from the underrun of others and from the national reserve;
- By restricting the leasing of quotas the prices for permanent transfers go up;
- By restricting all quota transfers, the sector will be "frozen";
- Basically, the recommendations/proposals will penalise the most efficient/ progressive milk producers and increase the cost of quota transfer;
- The production decisions will be based more on speculation and risk taking than to-day, in particular where the unused quotas and national reserves are increased.
- In principle such measures should be of temporary nature to meet the objective of solving the current imbalance of the market.

7. ADDITIONAL INFO REFERRING TO POINT 7.3 – COW SLAUGHTER SCHEME.

US HERD RETIREMENT SCHEME

The Coops Working Together (CWT) Herd Retirement Scheme is used in the USA to reduce the number of dairy cows in certain circumstances. It operates on a tender basis; producers offer to have their entire herd slaughtered if they receive a certain price per volume of milk production foregone. The CWT selects the most attractive bids and a payment is made when a selected producer proves his entire herd of milking animals has been slaughtered. The CWT payment is additional to the price received by the producer for the culled cows. Producers do not make a long term commitment to stay out of production.

The CWT operates a Herd Retirement Scheme only when certain criteria relating to milk margin and dairy cow numbers are observed. The Scheme was first put in place in 2003. 275 000 cows have been subject of the scheme and this is estimated by the CWT to have reduced output by about 675 000 tonnes in 2008 (about 0.8% of US production). The latest round accepted bids for almost 103 000 cows to be retired.

Dairy cow herd 1000 head	US herd	# cows taken out	Price accepted (\$/cwt)*	Milk production (Million tonnes)
2003	9 081	32.7	4.03	76.7
2004	9 010	50.5	5.24	76.9
2005	9 050	64.1	6.75	79.7
2006	9 137	-	-	81.8
2007	9 189	52.8	5.50	83.5
2008	9 315	75.2	6.10 – 6.49	85.4
2009	-	103	n.a.	-

* US intervention equivalent price is \$ 9.90/cwt

However, as indicated above the number of dairy cows in the US was never reduced. It is noted that US milk production has risen by 11.3% in the period since the CWT was first launched in 2003.

The CWT promotes claims that this measure has added almost 5% to the milk price (both of these claims are in comparison to what would have occurred if those cows and their offspring had stayed in production). Further analysis would be needed to assess the validity of those claims. As the CWT scheme is a producer financed scheme, so even if the extravagant claims made for it are not fully confirmed, the producers continued financing of the system suggests it does deliver benefits to those who pay for it.

An EU scheme, even if fully complying with rules on animal welfare, may not be well accepted by European citizens in relation to the intrinsic value given to the animals as defined by the protocol on animal protection in the European Treaty³.

8. ADDITIONAL INFO REFERRING TO POINT 8.2 – REDISTRIBUTION OF DIRECT AIDS – SPECIFIC SUPPORT

The Health Check - Regulation (EC) No 73/2009 has introduced three main means to redistribute direct payments between farmers/sectors/regions within a Member State:

- Article 68 measures,
- options for further decoupling of remaining coupled support (Articles 63 to 65),
- and options for revising payment entitlements (Articles 46 to 49).

These measures may be applied simultaneously, offering a large scope of options. They apply from 2010, Member States shall take their decisions for 2010 by 1 August 2009.

³ Treaty of Amsterdam amending the Treaty of the European Union, The Treaties establishing the European Communities and certain related acts – Protocol annexed to the Treaty of the European Community – Protocol on protection and welfare of animals (OJ C 340, 10.11.1997, p. 110).

Article 68 measures

- financed from the national reserve and/or unused amounts and/or reduction of all the payments entitlements
 - Various coupled measures
 - 68(1)(a), i.e. those taken over from the previous Article 69 of 1782/2003 (quality, marketing, environment) plus animal welfare and
 - 68(1)(b) which allows granting payments to dairy, beef and veal, sheepmeat and goatmeat and rice sectors in "economic vulnerable or environmentally sensitive areas or for economically vulnerable types of farming"
 - limited to 3.5 % of the SPS national envelope
 - One decoupled measure
 - 68(1)(c) : increase the value of the payment entitlements, or allocate new payment entitlements, "in areas subject to restructuring and/or development programs in order to ensure against land being abandoned and/or to address specific disadvantages for farmers in those areas" – limited to 10 % of the SPS national envelope, minus the part of this envelope that is used for other Article 68 measures

Example: Combination of Articles 68(1)(b) and 68(1)(c) for dairy farmers in mountainous areas- potentially up to 10 % of the SPS national envelope. The coupled part could be linked to the number of dairy cows and/or the milk quota and/or the milk production in 2010. The decoupled measure under Article 68(1)(c) could be linked to the milk quota in 2007, or any other historical reference, or to the criteria used for restructuring under the second pillar.

Further decoupling

- Support under a number of coupled support schemes fully or partially excluded from SPS is to be integrated in the SPS as from 2010. Schemes and dates are listed in annex XI of Regulation 73/2009.
- Hereby, Member States have a discretionary margin to allocate the additional amounts in the SPS. They can notably (Article 63) decide to allocate all or part of the additional amounts to farmers in other sectors than the sector that is to be decoupled. In that case, the allocation between farmers is:
 - based on the agricultural activity during a reference period to be fixed by the MS which shall be one or more years in the period 2005-2008
 - in accordance with objective and non-discriminatory criteria "such as the agricultural potential or environmental criteria".

- To protect legitimate expectation the redistribution is limited: the overall support a farmer receives must not fall below 75% of the total support (coupled and decoupled) received prior to further decoupling.

Examples: The amounts that could be used from 2010 for redistribution in relation to further decoupling vary a lot from between MS: no more than 16 millions EUR in Germany, close to 2 billions EUR in France. The reason is that where no partial recoupling option has been used in the first year of application of the SPS (German case), few amounts remain to be decoupled from 2010.

Revising payment entitlements

- The basic principle consists of annual progressive modifications of payment entitlements with a view to a flatter rate and based on objective and non-discriminatory criteria. Also based on objective and non-discriminatory criteria Member States can identify particular regions, where the value of the entitlements is to be increased, at the expense of the value of entitlements in the other regions. The necessary reduction of payment entitlements has to be done in various steps to protect legitimate expectations of the owners of these entitlements.
- One criterion for the regions to be identified can be the agricultural potential. This can be regions with predominant grassland or dairy production.
- The revision can start in 2010 (decision by 1.8.2009) or later (decision by 1.8.2010).

Examples: in addition to the articles 68 measures described in point 2, payment entitlements to dairy farmers in mountainous areas may be increased from 2010 via:

- Article 45 for MS using an historical model, and Article 48(1) for MS switching to a regional/hybrid model from 2010, which allow approximating the value of the payment entitlements "at the appropriate geographical level"; the effect would be an increase of the value of the payment entitlements for regions where farmers practice extensive types of production;
- Article 46, for MS that have used an historical approach for decoupling and allowing transfers between regions; the transfer shall not induce any payment entitlement being reduced by more than 10 %; this provision would for instance allow moving up to 10 % of the amounts from favoured regions to less favoured ones; Article 46 may be combined with Article 45 or Article 47;
- Article 47, allowing MS using an historical model to apply a regional model from 2010 (or at a later stage); depending on the way the regions are defined, and in conjunction with the optional use of Article 46, moving to a regional model could also induce some transfers in favour of dairy farmers, notably the ones using extensive production practises;
- Article 48(2), allowing MS applying a regional model from the first year of SPS implementation to revise the regions and/or the regional amounts and/or, to approximate the value of the payment entitlements.

The Health Check offers various options allowing significant redistribution of direct payments to farmers in the dairy sector. They can be combined and applied in addition to measures

under the second pillar and/or state aid measures. For instance, they can be applied together with second pillar measures funded via Article 136 of R.73/2009, i.e. the transfer of the SPS "unused amounts" to the second pillar (amounts fixed in Commission Regulation, no more than 4 % of the SPS national envelope).

Apart from advancing the payments from 1 December 2009 to 16 October, the direct payment legal framework does not provide for a means that would allow alleviating the financial situation of the dairy farmers in the short term.

9. ADDITIONAL INFO REFERRING TO POINT 8.3 – STATE AIDS

To improve farm income in the context of the current crisis a modification of the Temporary Crisis Framework⁴ could be envisaged. The Framework foresees that a limited amount of aid of up to € 500 000 can be granted to undertakings but at the moment excludes primary agricultural producers from this possibility. A modification of the Framework could introduce a similar aid possibility to farmers, but at a substantially lower amount in order to avoid distortion of competition in the agricultural sector.

Point 4.2.2 of the Temporary Framework foresees that aid not exceeding a cash grant of €500 000 can be granted per undertaking until 31.12.2010. Any *de-minimis* aid already received by individual undertakings since the beginning of 2008 has to be deducted from this amount. Undertakings active in the processing and marketing of agricultural products are eligible unless the amount of aid is fixed on the basis of the price or quantity of such products. Primary agricultural producers are excluded from this aid possibility.

For farmers (primary producers) a separate limited amount of aid could be introduced by modifying point 4.2.2 of the Temporary Framework. An amount of 15,000 EURO would be appropriate in order to avoid distortions of competition. This aid would not be limited to milk producers but all primary producers could benefit of it.

An urgent procedure both for the adoption of the modification of the Temporary Framework and afterwards for the approval of the national aid schemes could be envisaged.

Aid measures under the Temporary Framework have to be notified as aid schemes to the Commission. They are approved on the basis of Article 87 (3) (b) EC Treaty.

Point 4.1 of the Temporary Framework requires Member States to demonstrate that the notified measure is necessary, appropriate and proportionate to remedy a serious disturbance in the economy of the respective Member State. A scheme limited to primary agricultural production is therefore unlikely to be approved as a stand-alone measure. It could, however, be approved as complementary measure (as of end of June 2009, the Commission has already approved for 18 Member States schemes with compatible limited amount of aid), or could be notified as comprehensive measure open to all sectors (with different aid levels) where no such scheme is in place yet.

⁴ Consolidated version OJ C 83, 7.4.2009, p. 1.

10. ADDITIONAL INFO REFERRING TO POINT 9.1 – RURAL DEVELOPMENT

Rural Development policy is an integrated EU policy and part of the Common Agricultural Policy. It is a modern, flexible and integrated policy that puts emphasis on innovation and the development of human and social capital. The policy has successfully evolved over time to take on board the new priorities of European society. The strategic approach ensures an added value at European level. Making additional funds available for the new challenges in the context of the Health Check is only one reflection of this.

Rural development programmes in the Member States are adapted to reflect changing circumstances. Following the Health Check and the Recovery Package one major revision is foreseen in 2009. This revision of the existing rural development programmes provides the opportunity to inject the additional funds and to direct them towards dairy restructuring and/or the other new challenges and broadband infrastructure.

EU's rural development brings together economic, environmental and social aspects in an integrated approach. The policy has a three-fold aim: fostering competitiveness of the agricultural and forestry sector (Axis I), improving the environment and the countryside (Axis II) and improving the quality of life in rural areas and encouraging diversification of the rural economy (Axis III). In addition, the LEADER approach (Axis 4) plays an important role in improving governance and mobilising the endogenous development potential of rural areas.

EU's rural development has a well defined policy framework. It is based on a strategic approach involving four consecutive steps:

- First, the Community strategic guidelines for rural development set the priorities at the Community level;
- In a second step, each Member State submits a national strategy plan which translates the Community priorities in the national context;
- Thirdly, Member States and regions establish their rural development programmes with specific measures;
- Finally, both Member States and the Commission closely monitor and evaluate the results.

Based on this approach Member States should show what the recent trends in the dairy sector imply in terms of strengths and weaknesses. Based on this analysis Member States have to decide whether or not to provide additional support for dairy farmers. And, if yes, which support measures should be used.

An additional change introduced with the Health Check was to abolish the limitation of investment support for dairy farmers to the availability of dairy quotas. Now farmers may get investment support which exceeds the farm-specific quota rights. This should facilitate the provision of investment support to the more competitive farmers. Particularly those who intend to expand their production capacities in view of grasping a higher share in the world market may benefit from the simplification of this rule for investment support granted to dairy producers.

Because the situation of rural areas is diverse across the 27 Member States, it is up to Member States to decide whether or not they will provide in the rural development programmes for the possibility to use the additional funds under the second pillar for support of dairy farmers or not. The revised rural development programmes indicating the use and distribution of the

additional funds from Health Check and Recovery package across the new challenges, including support for dairy restructuring and for support for broadband infrastructure, shall be submitted by Member States to the Commission by 15 July 2009.