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Special report of the Court of Auditors on aid to skimmed milk processed into casein and caseinates

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I

*(Information)***COURT OF AUDITORS****SPECIAL REPORT OF THE COURT OF AUDITORS****on aid to skimmed milk processed into casein and caseinates****(Observations, Article 206 a of the EEC Treaty****(84/C 41/01)**

This report was adopted by the Court of Auditors in its meeting of 9 June 1983, in application of Article 206a of the EEC Treaty. Previously, on 3 March 1983, the report was sent, for comments, to the Commission, whose replies are attached.

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I. INTRODUCTION

1.1. General comments

The Community organization of the market in milk and milk products⁽¹⁾ includes a number of measures designed to increase and diversify the markets of the product in its various forms.

The aim of this type of aid is, in general, to create conditions which are favourable to the conversion of milk into products which are more easily marketable and more profitable for the Community.

Aid for skimmed milk processed into casein and caseinates belongs to this category.

1.2. Casein

Casein in its various physico-chemical forms is the main form of protein (85 % of the protein component) present in skimmed milk.

It has numerous and varied uses in the food industry, which is its principal market (nearly 80 % of production).

It is also used in other sectors, although it is becoming increasingly less competitive to use as other products can be substituted.

Once the milk has been skimmed, casein is obtained by coagulation in an acid environment or in the presence of rennet. The product is then washed and dried or processed into salts allowing for easier use in certain industrial processes.

1.3. Economic and budgetary aspects

1.3.1. Cost to the budget⁽²⁾

For 1982, Community aid for skimmed milk processed into casein and caseinates represents nearly 243,4 million ECU, or 7,3 % of the milk sector.

(1) Regulation (EEC) No 804/68 of 27 June 1968 on the common organization of the market in milk and milk products (OJ No L 148, 28. 6. 1968, p. 13).

(2) Annexes I and II give information on the cost to the budget of the measure in relation to the other aid measures for skimmed milk and on the geographical distribution of its cost.

The market has developed as a result of the legislation relating thereto. Before 1968, when this legislation was introduced, the world market was dominated by New Zealand, both with regard to quality and quantity.

Since that time, progressive implementation of the objectives of the aid has enabled Europe to strengthen its position considerably. Today, it accounts for 40 % of world production, having attained the point of self-sufficiency in 1979.

1.3.2. Production structure⁽³⁾

Six Member States manufacture casein, although only four of these produce large quantities.

Nevertheless, the number of undertakings involved in this production varies greatly: (54 in France, nine in the Federal Republic of Germany, six in Ireland, three in the United Kingdom and Denmark and only one in the Netherlands). The same applies to their size. It follows from this that the Member States each have a different view of the aid.

1.4. Aims of the audit

The audit undertaken by the Court of Auditors comprised both checks (on the basis of supporting documents and on the spot) of the validity of authorizations established and an economic analysis of the measure. The latter cannot be made in isolation: for this purpose the aid must be placed back in the context of the whole policy for the use of skimmed milk.

It should be stressed here that aid for skimmed milk processed into casein represents about 45 % of the value of the finished product, but when the market is severely depressed this percentage may reach 60 %. Therefore neither the method of calculation, nor the level of aid can remain neutral in the decision to produce the casein.

(3) Annex III gives some statistical information on production.

II. LEGISLATIVE FRAMEWORK

2.1. Introduction

Set up by virtue of Article II of Regulation (EEC) No 804/68, the legislative framework was introduced as from July 1968 by the basic Council Regulation (1). After various amendments, the Implementing Regulation enacted by the Commission was given its final form in 1970 (2) subject to amendments to detail which do not affect its substance (3).

2.2. Basic principle

The legislation is designed as a framework for the work of the national intervention agencies and it leaves them considerable autonomy, of which the ultimate financial sanction is to be found in the clearance procedure. Nevertheless, there exists the possibility of discussions between the national and Community institutions by way of a procedure allowing each intervention agency to ask the Commission specific questions to which the latter replies with its interpretation of the rules.

In any event, this autonomy of management enjoyed by the intervention agencies does not dispense with the need for analysis of the operation of the controls that the Member States have set up.

In carrying out the clearance operations for 1974/75 and 1976/77, the Commission paid particular attention to aid for skimmed milk processed into casein and caseinates. Reference is made to the Commission's considerations in the section dealing with marketing (section 3.1.3).

(1) Council Regulation (EEC) No 987/68 of 15 July 1968 laying down general rules for granting aid for skimmed milk processed into casein or caseinates (OJ No L 169, 18. 7. 1968, p. 6).

(2) Commission Regulation (EEC) No 756/70 of 24 April 1970 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 91, 25. 4. 1970, p. 28).

(3) Annex IV gives a complete index of the legislation in force within the framework of the system of aid for skimmed milk processed into casein and caseinates.

2.3. Implementing rules

2.3.1. Beneficiary

The aid is paid to the casein or caseinates producer by the intervention agency on the understanding that this amount be included in the purchase price paid to the supplier of skimmed milk (Regulation [EEC] No 987/68, Article 2).

2.3.2. Event giving rise to the aid

The aid is due at the time of production and paid at the time of marketing (Regulation [EEC] No 756/70, Article 4).

2.3.3. Principles of calculating the aid

- (i) Variation: the aid may vary, according to whether the skimmed milk is processed into casein or into caseinates and according to the quality of those products (Regulation [EEC] No 987/68, Article 3 (1)).
- (ii) Calculation: the aid is fixed so that the return on skimmed milk processed into casein is equivalent to that on skimmed milk processed into skimmed-milk powder (Regulation [EEC] No 987/68, Article 3 (2)).
- (iii) Nature of supervision: this must consist of at least a regular supervision of the manufacturing concern and of the composition of the product (Regulation [EEC] No 756/70, Article 3 (3)).
- (iv) Obligations of producers: they may not benefit from the aid unless they submit to supervision by the intervention agency and keep the records required (Regulation [EEC] No 756/70, Article 3 (1) and (2)).
- (v) Form of application: the application for aid must be submitted in writing and must show the name and address of the manufacturer and the quantities of skimmed milk processed. The intervention agency may request additional information (Regulation [EEC] No 756/70, Article 4).
- (vi) Obligation of the Member States: they must notify the Commission of the measures they apply over and above the minimum required by the Commission (Regulation [EEC] No 756/70, Article 3 (4)).

III. ADMINISTRATIVE MANAGEMENT

3.1. Observations on the nature of the legislation

3.1.1. *Passing on the effect of the aid*

The justification for this provision can be found in the basic objective of the measure, which is in fact to transfer the benefit of the aid paid to the manufacturer of casein to the producer of skimmed milk, and by this means to contribute to marketing the Community milk production.

The inclusion of this ruling in the body of the legislation rather than in the preamble gives it the character of a formal obligation and a check should normally be carried out to ensure that it has been strictly observed, independently of the legal or economic conditions in which the undertakings operate. In practice, the degree of legal and economic integration is such that it appears impossible to check whether the obligation to pass on the effect of the aid has been respected (1).

The structure of the undertakings means that the way they choose to debit their costs may lead to the transfer of the results of casein production to any other division of the same undertaking.

It follows from this that for obvious reasons of structure or accounting techniques, it is impossible to prove whether the aid has been passed on.

The question may therefore be raised whether it is advisable to include in the Regulation an obligation which cannot be subjected to a thorough check.

3.1.2. *Stability*

The legislation includes a guarantee of stability for the beneficiaries of the aid. This is understandable given the custom of the trade of concluding long-term contracts, the specialized infrastructure necessary for the use of casein — the investment in which can only be recouped if the period is sufficiently long — and the high proportion that the aid represents in the value of the product.

This is a positive statutory requirement that has been given no concrete form.

(1) In general, the casein producer is at the same time the skimmed-milk producer.

From the producers' point of view this would be a system of fixing the aid in advance, which would have deprived the Community of most of its potential for acting on the market. Despite frequent pressure to this effect, no system of this kind has been introduced.

It is therefore for the Commission to ensure that this principle should not be invoked to obstruct a revision of the conditions for granting the aid if that is justified by the need to alter market conditions, particularly if over a long period the aid would appear excessively generous (cf. below 4.2.2).

3.1.3. *Marketing*

This concept, which is one of the essential features of the legislation, determines the date of payment of the aid. It was included for the purposes of supervision: to prevent the aid being obtained twice following inadequate inspection of stocks and to prevent casein being produced for the sole purpose of obtaining the aid.

Marketing takes various forms according to the individual Member State but it in no way implies that the product is immediately intended for the final consumer.

Thus some Member States accept that marketing takes place as soon as the product is transferred to a marketing subsidiary, while one Member State expressly rejects this possibility.

In another Member State where casein was produced to order, marketing took place on the day of production because property in casein passed to the buyer at that point.

In a third case, the Commission considered that the transfer to another division of the factor, even with invoicing and with the assurance that the product would be used as raw material for another manufacturing process, did not amount to marketing.

It is thus clear that undertakings have a strong interest in shortening the period between production and marketing since the latter determines the time of

payment. From the on-the-spot findings, however, it is obvious that the Member States have differing views on the subject.

It may be noted that in its findings in respect of the 1974/75 and 1976/77 clearance operations, the Commission tends to identify marketing with placing on the market together with transfer of ownership.

It should be stressed that maintaining the principle of marketing is useful for supervision purposes but the legal imprecision which is a feature of its application is, at present, likely to create all kinds of difficulties as well as distortions of competition, since all the beneficiaries are not able to proceed in the same manner.

It would be desirable for this concept to be clarified, at least by way of interpretation, in order to ensure equal treatment for all persons concerned, in observance of the spirit of the provision.

3.2. Comments on supervision

3.2.1. Introduction

Supervision as defined by the legislation concerns the entire production process, from the formalities prior to the operation of a new factory to the classification of the finished product.

A number of aspects, however, which merit a more detailed examination are dealt with below.

3.2.2. Notification of supplementary measures

Each Member State is bound to inform the Commission of the measures it takes over and above the minimum required by the regulations.

It appears, however, that the Commission does not possess a full list of the national measures and consequently, it has not been possible to pass any system on from one country to another.

The rule in question is evidence of the wish to harmonize a legislative system which has been in force for 12 years without any notable changes.

However, as will be seen in the following sections, the supervision procedures and methods which have been developed by the Member States within a very broad statutory framework differ greatly from one another.

3.2.3. Regularity of supervision

The basic requirement of the Regulation is 'at least a regular supervision'⁽¹⁾. Taken literally, this would lead to a permanent inspector in each undertaking, which would not always be economically or technically justified. The Member States have resolved this problem in various ways:

- (i) two countries actually have an inspector permanently on the spot (Ireland and the Netherlands): he has numerous duties, in the case of integrated undertakings;
- (ii) the other countries carry out inspections every fortnight or even on request, due to the lack of continuous production and the small quantities produced.

3.2.4. Implementation of supervision

The lack of harmonization of supervision described above (cf. 3.2.2) can be seen in the different ways of carrying out checks, which are rarely of comparable severity.

Samples are taken daily in the Netherlands, Ireland and the United Kingdom. The intervals are greater in France and the Federal Republic of Germany. In the Netherlands and Ireland, samples are taken by staff of the official bodies. In the other cases samples are held at the latter's disposal.

In the same way, the severity of the downgrading resulting from cases of insufficient quality has varying consequences with regard to the quantity concerned, according to the individual countries. The downgrading may cover either the day on which the sample was taken or the entire period covered by the inspection.

Only one country makes the producer pay for all the inspections required by the regulations — the Fed-

⁽¹⁾ Commission Regulation (EEC) No 756/70, Article 3 (3).

eral Republic of Germany⁽¹⁾. All countries allow their undertakings the possibility of appeal against the result of the analysis reclassifying the product they have declared. In two Member States, however, if the expert opinion provided in that event does not confirm the declarations of the producers, they are bound to pay a penalty.

Two countries allow their undertakings to sell the stock produced before sending in the results of the analysis, while this is forbidden by the others.

3.2.5. *The physico-chemical analysis*

The Annexes to the basic Regulation provide the rules with which the finished product must comply in order for the aid to be granted.

The absence of a sufficiently precise *modus operandi* leads to inaccuracies which are likely to prejudice the quality of the analysis of the product, given the differing views which the national inspection laboratories may have on the properties of caseins.

As an illustration, the following provisions may be cited:

- (a) ash content (Regulation [EEC] No 455/73 amending Regulation [EEC] No 756/70, Annex III, Section 3): the Regulation provides that analysis must take place 'at a mild temperature

and in a slight draught'. Visits to the national inspection laboratories have shown that the so-called 'mild' temperatures are between 525 °C and 850 °C. More precise specification of the pressure, temperature and humidity would be welcome;

- (b) free acids content: this refers to extraction in a hot and aqueous atmosphere, but the physico-chemical research conditions are not specified.

3.2.6. *General comments*

It can be seen from the above that there are a number of differences both in the approach to inspection and in its implementation and even in the consequences for the undertakings concerned.

This situation appears to be the price paid for the Regulation's underlying approach: it allows the Member States to implement their own inspection measures without any form of harmonization.

Three main courses of action would appear essential in this respect: pursuit of greater precision in the terms used (concept of regular supervision), an overall re-examination of the inspection systems in order to ensure that distorting factors have — as far as is possible — been eliminated and finally, a clear standardization of the rules governing the analysis of physico-chemical properties.

IV. ECONOMIC ANALYSIS OF THE AID

4.1 The economic context of the aid

4.1.1. *The role of casein in the milk policy*

Council Regulation (EEC) No 1303/81⁽²⁾ gives a list, as follows, of all the measures relating to liquid skimmed milk:

- '1. The buying-in of skimmed-milk powder and consequent transactions carried out by an inter-

(1) The lawfulness of this practice has just been recognized by the Court of Justice of the European Communities, No 233/81.

(2) Council Regulation (EEC) No 1303/81 of 12 May 1981 amending Regulation (EEC) No 1883/78 laying down general rules for the financing of interventions by the EAGGF (Guarantee Section) (OJ No L 130, 16. 5. 1981, p. 2).

vention agency pursuant to Article 7(1) and (2) of Regulation (EEC) No 804/68;

2. The private storage aid for skimmed-milk powder provided for in Article 7(3) of Regulation (EEC) No 804/68;
3. The aid for skimmed milk and skimmed-milk powder used in feedingstuffs provided for in Article 10 of Regulation (EEC) No 804/68;
4. The aid for skimmed milk processed into casein provided for in Article 11 of Regulation (EEC) No 804/68.'

This list shows that the operations in respect of skimmed milk are the subject of a global policy in which casein forms only one component that necessarily interacts with the others.

4.1.2 Measures for the marketing of skimmed milk

The general policy for the marketing of skimmed milk is contained in the following measures:

Nature of the measure	Quantities marketed in 1981 ('000 tonnes)	Level of aid charged to EAGGF ⁽¹⁾ (ECU/100 kg)
I. Skimmed-milk powder		
1. For feedingstuffs for calves	1 300	56
2. Commercial export	323	37
3. Food aid	191,6	37 ⁽³⁾
II. Liquid skimmed milk (equivalent powder)⁽²⁾		
1. For feedingstuffs for calves	155,7	62,70
2. For feedingstuffs for pigs	221,5	85,80
3. For processing into casein	301,9	58,85

⁽¹⁾ Rate in force at 1 March 1982.

⁽²⁾ Conversion ratio: 1 kg of skimmed-milk powder = 11 kg of liquid skimmed milk.

⁽³⁾ The EAGGF only bears the cost of the amount of the refund, the other costs are borne by the 'Aid to developing countries' budget.

It can be seen from this table that the unit rate of aid for skimmed milk processed into casein is an intermediate rate. This aid therefore represents neither the most costly form of aid nor the least expensive aspect of the skimmed-milk policy.

Distribution of the quantities of skimmed milk available cannot, however, be improved simply by taking into consideration the cost to the budget. Even though each instrument of the policy is governed by its own constraints, there exist also interactions between them that are not shown by this table, but which have to be considered if the aim is to alter fundamentally the balance between the component parts of the skimmed-milk policy.

It follows that the level of aid for skimmed milk processed into casein cannot be determined solely on the basis of production conditions or the state of the market; it also requires an understanding of the skimmed-milk policy as a whole⁽¹⁾.

Only this kind of knowledge can lead to a clear view of the consequences of the management of these various instruments. But this in turn depends upon the availability of rapid and complete information.

⁽¹⁾ It should also be remembered that the European Community attained the point of self-sufficiency in 1979.

The latter can only be achieved by means of a rigorous and efficient information system within the Commission. But it must be pointed out that there are shortcomings even in the communication of information by Member States to the Commission under the system in Regulation (EEC) No 210/69⁽²⁾.

4.2 The method of calculating the aid

4.2.1 Method of calculation

Articles 3 and 4 of Regulation (EEC) No 987/68 state that the aid for casein shall be calculated by the difference between the return on the sale of skimmed-milk powder and of casein. However, in each case the return is expressed as the difference between prices and manufacturing costs. The value of the aid for casein is therefore determined as follows:

- (a) the net return resulting from the sale of skimmed-milk powder at intervention is expressed as the difference between the intervention price and the unit manufacturing costs on the basis of liquid skimmed milk. To reach a net value per kilogram of liquid skimmed milk, it is therefore necessary to divide by the yield (by definition 1 kg powder = 11 kg liquid);
- (b) the net return from the sale of casein is equal to the world market price plus certain costs defined by the Regulation (customs, transport), and minus the costs of manufacturing from liquid skimmed milk. Here also, the net value per kg of liquid skimmed milk can be obtained by dividing by the yield (defined by the Regulation according to the quality of the product).
- (c) the unit rate of the aid is the difference between the net returns defined in paragraphs (a) and (b).

4.2.2 Comments

Although the terms relating to skimmed milk result from clear decisions of the Community authorities,

⁽²⁾ Regulation (EEC) No 210/69 of 31 January 1969 on communications between Member States and the Commission with regard to milk and milk products (OJ No L 28, 5. 2. 1969).

the same does not apply to those relating to casein. They are, in fact, riddled with uncertainty:

- (a) world price + costs: casein is the subject of a series of unofficial quotas. There is therefore no way of exactly determining the world price as considered by the Regulation;
- (b) manufacturing costs: the manufacturing costs applied are those of an 'average undertaking', without further explanation. This definition has not changed since the Regulation entered into force, except in so far as the pattern of manufacturing costs has followed that of skimmed-milk powder as fixed by the Regulations. Apart from the fact that the term 'average undertaking' is not defined in the Regulation, the technology and average size of the production units have changed since the legislation entered into force⁽¹⁾;
- (c) the yield: the disparity between the actual yield and that taken into consideration by the Commission leads to an under-estimation of the return from casein which results arithmetically in an increase in the aid.

The need for a detailed economic analysis in order to remove the uncertainties referred to above makes the need for information already mentioned even greater.

A clear and constantly updated picture, both with regard to the development of production methods and to knowledge of the market, would allow more frequent adjustment of the aid in response to changes in the economic environment.

The principle of the stability of the aid should not be allowed to conflict with the obligation to adjust the aid regularly due to the market situation. Without such an adjustment the method of calculation would result in the creation of windfall profits, while the economic data show that the basis of the method no longer corresponds to reality.

4.3. The structural effect

The structural effect analyzed below does not arise from express legal provisions but from the way in which the method of calculation is designed. Appli-

⁽¹⁾ See below, paragraph 4.3.

cation of the concept of average undertaking excludes from consideration small producers and occasional producers, whose manufacturing costs may, for various reasons, be higher than those taken into consideration.

Consideration of the method of calculating the aid therefore leads to the finding that the structural effects are highest where the return is lowest, thus reducing the impact of the aid.

However, the problem has arisen in very different ways according to the country concerned. The larger the undertakings the more the method of calculation acts in their favour against the structural effect.

In particular, it may be noted that in countries where production has only developed under the influence of Community legislation (Denmark, Ireland, United Kingdom), the undertakings immediately started up were of the minimum size. On the other hand, in France, where the producers are widely dispersed this effect is greatly felt⁽²⁾. Annex V gives a detailed table of this development according to class. It may be noted here that the effect of concentration is shown in the following:

- (a) the number of producers is tending to decrease (with the exception of 1980, which can be explained by a particularly favourable economic situation);
- (b) a regular decrease in the number of small producers (less than 100 tonnes) (21 in 1975 against 15 in 1980) whereas the number of large producers is increasing (+ 1 000 tonnes: six in 1975 and 15 in 1980).
- (c) in 1975, the largest number of producers was in the 200 to 500 tonnes class; in 1980 the 1 000 to 2 000 tonnes class had the largest number.

The figures available for 1981 confirm that the reversal of this trend recorded in 1980 was purely due to the economic situation. In 1981, nine undertakings were closed; among the 45 casein factories which remained operational, 70% of production came from 10 undertakings.

However justified the objective of improving the structures may appear it may well have secondary effects whose social and regional cost should be viewed in the light of the general objective which remains the maximum disposal of skimmed milk at the best financial cost for the Community.

⁽²⁾ In the other Member States, the number and size of the undertakings remain stable.

It would therefore be desirable to make an assessment of its contribution to the general objectives of the measure and to determine its impact on the financial management of the skimmed-milk policy.

4.4. Quality ratios and the objective pursued

In view of the varying production conditions, the basic Regulation gave fixed quantities for the amount of skimmed milk used for the production of 1 kilogram of casein of the qualities defined in the Annex to the Regulation.

Analysis of actual practice shows that there is a disparity between the actual quantities of milk used and the quantities fixed. This may, in certain cases, reach 15%.

The Court would like to know how this disparity — a long-term development which shows the progress of technology — can be reconciled with the essential objective of the Regulation which is the maximum use of skimmed milk. It must be acknowledged, however, that seasonal fluctuations in the quality of milk and geographical differences make manipulation of these ratios a delicate matter.

Historical analysis of the Regulations also shows that these quality ratios were used with a view to eliminating the inferior qualities. This trend

continued until 1975 and could be seen in the progressive elimination of the aid for milk used for inferior qualities, accompanied by a tightening of the physico-chemical requirements.

Production quickly adapted to these new standards.

Nevertheless, progress in this direction appears to have ceased as from 1975. No new measure has been taken, and it has not been possible to ascertain the reasons. However, in the view of the producers themselves, some changes in the standards laid down could be envisaged.

It would, moreover, be in keeping with the spirit of the legislation and with the logic of its development to pursue it through further stages. These could be accompanied by a revision of the physico-chemical standards (see 3.3.5).

Progress of this nature would have a considerable influence on the competitive position of the European Community.

It should be noted that the Commission itself appears aware of this need since, on 30 January 1979, it submitted to the Council a proposal for a Directive on the approximation of the laws of the Member States relating to edible caseins and caseinates (1). This proposal was approved by the European Parliament by a resolution adopted on 11 May 1979 (2).

To date, the Council has not acted upon this proposal.

V. CONCLUSION

5.1. The basis of the legislation

Analysis of the system of aid to skimmed milk processed into casein and caseinates reveals two basic problems: the integration of this system into the milk policy as a whole and the problem arising from the increasing disparity between the fixed quantities and the actual quantities of milk used (cf. 4.1 and 4.4).

On the one hand, the advisability of maintaining this system as such may be questioned, in view of

the level of self-sufficiency attained by European production, particularly under the influence of the Community legislation.

On the other hand, as production requires considerable investments which are only paid off after a long period, the existence of this system introduces considerable inflexibility which could not be removed in the event of a reversal of the situation. Further-

(1) OJ No C 50, 24. 2. 1979, p. 5.

(2) OJ No C 140, 5. 6. 1979, p. 174.

more, the disparity between the actual quantities of milk used and the ratios is likely to lead to the basic objective that arises from inclusion of this measure in the 'skimmed milk' policy as a whole being set aside in favour of a purely commercial objective.

If these two problems can be resolved in a positive manner — a contingency on which the usefulness of the measure depends — it still remains to be seen whether this system of rules and the way it is applied are the most appropriate in practice.

5.2. Adapting the instruments to the objectives

By the fact of its being a part of milk policy and because of its method of calculation, a particularly detailed and efficient information system is necessary in respect of aid for casein. The interplay between the various component parts of this policy, no less than the basic elements of calculation, should be open to regular inspection, so as to allow the impact of any decision to be assessed at any time. In the absence of such an instrument, there is a danger of windfall profits, resulting from a delay in adapting the aid conditions to the economic environment (cf. 4.1 and 4.2).

The Court, in fact, found that the Commission does not have such a working instrument, and responsibility for this situation must be shared by the Commission and the Member States whose duty it is to provide a certain amount of information (cf. 4.2).

In addition, the Regulations contain a structural effect, viz. the increasing concentration of production units which arises directly from the method of calculating the aid. Without challenging its advisability, the Court is obliged to point out that its impact is far from negligible. It would have been desirable to assess its contribution to the objectives pursued (cf. 4.3).

Finally, the Court found that the trend towards the improvement of quality commenced in 1968 was not continued beyond 1975 although all the technological conditions for this were present. The Court

would like to know why this progress was interrupted (cf. 4.4).

5.3. Nature and implementation of the legislation

This legislation, which has been in force for 12 years without significant amendment, is primarily designed as a framework for the work of the national intervention agencies.

Bearing this in mind, specific problems in the operation of this legislation arise in three areas:

1. from the nature of the legislation itself;
2. in coordination between the Member States;
3. in the implementation of supervision.

From the outset, the very nature of the guarantee of stability granted to the producers poses a problem; although such a guarantee is indispensable, because the transactions on this market are made on a relatively long-term basis.

It is nevertheless clear that this provision should not prevent amendment to the conditions for granting the aid if justified by market developments over a long period (cf. 3.2.2).

As regards the implementation of the basic principles of the legislation, it was noted that some of these are interpreted in differing ways and this has the effect of creating distortions between the Member States.

These are:

- (a) passing on the aid: the obligation to pass on the amount of the aid to the skimmed-milk producer is impossible to check due to the accounting structure and organization, although the wording of the legislation makes this an express requirement (cf. 3.1.1);
- (b) marketing: the obligation to have sold the casein before obtaining the aid is construed in the Member States as the formal observance of a sales transaction. Differing legal interpretations, moreover, make it difficult to supervise. It would be desirable to specify its scope, even if this were only by means of an explanatory circular (cf. 3.1.3).

Finally, the implementation of supervision itself shows that there are difficulties of interpretation or application of the legislation.

This results, in particular, from the Member States' failure to communicate to the Commission supplementary measures that they have taken: no use has been made of this provision, which could have formed an ideal instrument for effectively harmonizing the market (cf. 3.2.2).

Thus the notion of regular supervision as referred to in the legislation is not economically feasible (cf. 3.2.3).

Furthermore, the inspections are carried out in very different ways, with different technical, economic and financial effects on the producers in the Member States (cf. 3.2.4).

Lastly, the rules governing physico-chemical analysis should be clarified and supplemented (cf. 3.2.4).

The above observations were adopted by the Court of Auditors in its meeting of 9 June 1983.

Done at Luxembourg, 11 November 1983.

For the Court of Auditors
Pierre LELONG
President

ANNEX I

Casein in the milk sector as a whole

(in millions ECU)

	1976	1977	1978	1979	1980	1981	1982
Total EAGGF, Guarantee Section	5 587,1	6 830,4	8 672,7	10 440,7	11 314,9	10 980,2	12 405,6
Milk sector aid	2 277,7	2 924,1	4 014,6	4 537,5	4 752,0	3 349,7	3 327,9
Total skimmed milk ⁽¹⁾ (liquid and powder)	755,5	853,1	1 131,7	1 310,2	1 281,6	1 240,8	1 310,5
Casein	89,8	112,3	142,8	207,7	230,2	170,3	243,4
Casein as a % of the aid to skimmed milk	11,9	13,2	12,6	15,9	18,0	13,7	18,6
% of the milk sector	3,9	3,8	3,6	4,6	4,8	5,1	7,3
% of the EAGGF, Guarantee Section	1,6	1,6	1,6	2,0	2,0	1,6	2,0

⁽¹⁾ Excluding storage costs.

ANNEX II

Geographical distribution of the cost to the budget

Member State	1976		1977		1978		1979		1980		1981		1982	
	Million ECU	%	Million ECU	%	Million ECU	%	Million ECU	%	Million ECU	%	Million ECU	%	Million ECU	%
Denmark	1,456	1,6	1,274	1,3	2,482	1,7	6,678	3,2	9,950	4,3	8,660	5,1	15,132	6,2
Federal Republic of Germany	24,595	27,4	25,588	22,9	31,856	22,3	45,131	21,8	46,717	20,3	31,376	18,4	38,712	15,9
France	25,066	27,8	37,182	33,2	44,641	31,3	67,165	32,3	81,402	35,4	62,882	36,9	84,723	34,8
Ireland	11,817	13,2	14,831	13,4	24,774	17,4	34,678	16,7	35,194	15,3	28,677	16,9	46,380	19,1
Netherlands	24,437	27,2	30,395	27,2	36,072	25,3	49,232	23,7	48,289	20,9	33,425	19,6	50,768	20,8
United Kingdom	2,531	2,8	3,046	2,8	2,951	2,0	4,760	2,3	8,642	3,8	5,250	3,1	7,687	3,2
Total	89,902	100,0	112,316	100,0	142,776	100,0	207,644	100,0	230,194	100,0	170,270	100,0	243,420	100,0

ANNEX III

Development of the production of casein and caseinates

('000 tonnes)

Member State	1960	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
Denmark	—	5	5	4	1	1	1	1	1	1	3	4	5
Federal Republic of Germany	5	10	12	13	14	14	14	13	13	15	16	19	16
France	22	14	19	22	23	27	13	12	19	22	32	39	29
Ireland	—	1	1	1	6	7	2	4	7	11	14	17	15
Netherlands	2	6	8	9	10	12	12	13	14	16	17	19	— ⁽¹⁾
United Kingdom	1	1	1	1	1	1	1	1	1	1	1	2	— ⁽¹⁾
Total	31	37	46	50	55	62	43	44	55	66	83	100	

Notes:

For the Netherlands, estimate.

Sources: until 1977 EEC Dairy Facts and Figures, since then Eurostat.⁽¹⁾ Not available: confidential statistics.

European and world production

('000 tonnes)

	1978	1979	1980
Europe 9	66	83	100
Australia	17	14	15
New Zealand	63	62	68
Soviet Union	31	27	27
Argentina	3	2	3

Notes:

There are other small producers without significance in world trade.

Sources: 'The agricultural situation in the Community', 1981 report.

*ANNEX IV***List of Regulations applicable to casein**

Council Regulation (EEC) No 987/68 of 15 July 1968 laying down general rules for granting aid for skimmed milk processed into casein or caseinates (OJ No L 169, 18. 7. 1968, p. 6).

Commission Regulation (EEC) No 1102/68 of 27 July 1968 laying down the procedures for granting aid for skimmed milk processed into casein and caseinates (OJ No L 184, 29. 7. 1968, p. 19).

Commission Regulation (EEC) No 146/69 of 24 January 1969 laying down the amount of aid for skimmed milk processed into casein and caseinates (OJ No L 21, 28. 1. 1969, p. 3).

Commission Regulation (EEC) No 1658/69 of 22 August 1969 amending Regulation (EEC) No 146/69 laying down the amount of aid for skimmed milk processed into casein and caseinates (OJ No L 211, 23. 8. 1969, p. 15).

Commission Regulation (EEC) No 756/70 of 24 April 1970 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 91, 25. 4. 1970, p. 28).

Commission Regulation (EEC) No 2814/71 of 23 December 1971 amending Regulation (EEC) No 756/70 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 284, 28. 12. 1971, p. 20).

Commission Regulation (EEC) No 455/73 of 31 January 1973 amending Regulation (EEC) No 756/70 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 53, 26. 2. 1973, p. 8).

Commission Regulation (EEC) No 1399/73 of 24 May 1973 amending Regulation (EEC) No 756/70 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 139, 20. 5. 1973, p. 17).

Commission Regulation (EEC) No 2940/73 of 29 October 1973 amending Regulation (EEC) No 756/70 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 301, 30. 10. 1973, p. 23).

Commission Regulation (EEC) No 3061/73 of 12 November 1973 amending Regulation (EEC) No 756/70 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 312, 13. 11. 1973, p. 11).

Commission Regulation (EEC) No 660/74 of 25 March 1974 amending Regulation (EEC) No 756/70 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 80, 26. 3. 1974, p. 7).

Commission Regulation (EEC) No 533/75 of 28 February 1975 amending Regulation (EEC) No 756/70 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 56, 3. 3. 1975, p. 24).

Commission Regulation (EEC) No 2853/75 of 31 October 1975 amending Regulation (EEC) No 756/70 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 283, 1. 11. 1975, p. 56).

Commission Regulation (EEC) No 745/76 of 31 March 1976 amending Regulation (EEC) No 756/70 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 86, 1. 4. 1976, p. 44).

Commission Regulation (EEC) No 984/77 of 10 May 1977 amending Regulation (EEC) No 756/70 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 118, 11. 5. 1977, p. 8).

Commission Regulation (EEC) No 2213/79 of 10 October 1979 amending Regulation (EEC) No 756/70 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 256, 11. 10. 1979, p. 23).

Commission Regulation (EEC) No 873/80 of 10 April 1980 amending Regulation (EEC) No 756/70 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 94, 11. 4. 1980, p. 10).

Commission Regulation (EEC) No 1621/80 of 26 June 1980 amending Regulation (EEC) No 756/70 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 162, 27. 6. 1980, p. 28).

Commission Regulation (EEC) No 2938/80 of 13 November 1980 amending Regulation (EEC) No 756/70 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 305, 14. 11. 1980, p. 14).

Commission Regulation (EEC) No 1585/81 of 10 June 1981 amending Regulation (EEC) No 756/70 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 154, 13. 6. 1981, p. 47).

Commission Regulation (EEC) No 2861/81 of 2 October 1981 amending Regulation (EEC) No 756/70 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 281, 3. 10. 1981, p. 11).

Commission Regulation (EEC) No 1331/82 of 28 May 1982 amending Regulation (EEC) No 756/70 on granting aid for skimmed milk processed into casein and caseinates (OJ No L 150, 29. 5. 1982, p. 75).

ANNEX V

Number of production units in operation (France)

Class (tonnes)	1975	1976	1977	1978	1979	1980
0 to 10	8	5	3	5	5	3
10 to 20	4	4	1	1	1	3
20 to 50	6	4	2	4	4	5
50 to 100	3	5	6	4	3	4
100 to 200	8	6	4	2	8	8
200 to 500	16	16	10	9	9	10
500 to 1 000	14	9	15	12	9	6
1 000 to 2 000	4	6	5	3	8	12
over 2 000	2	2	6	9	3	3
Total	65	57	52	49	50	54

ANNEX VI

REPLIES OF THE COMMISSION

to the special report of the Court of Auditors on aid to skimmed milk processed into casein and caseinates

I. Broad economics of the measure

1. The common organization of the market in milk and milk products seeks to improve the return on skimmed milk; the instruments it uses for this purpose are not just the public storage arrangements for powder but also the aid granted for liquid skimmed milk and skimmed-milk powder for animal feedingstuffs, and for liquid skimmed milk for the manufacture of caseins and caseinates, etc. The level of aid, in particular that granted for milk processed into caseins and caseinates, is varied so that the return on milk used in this way is equivalent to that on milk sold for public storage. Since it is always possible in principle to deliver skimmed-milk powder to the intervention agency, the dairy decides on the end use for liquid skimmed milk with a view to obtaining the best possible return on the basis of a scale of priorities clearly defined by profitability parameters. The amount of aid for skimmed milk processed into caseins and caseinates has to be calculated in such a way that these products can, through the normal interplay of supply and demand, be disposed of on a market whose main characteristics are:

- the low rates of customs duties bound in GATT on caseins and caseinates coming from non-member countries. The effect of this is that any variation in the world market price or in the size of the world market has direct repercussions at Community level,
- the existence of vegetable or chemical substitutes which can be marketed at prices far lower than the cost price for caseins and caseinates.

The level of aid and the conditions governing it have therefore to make due allowance for the market situation and outlook, so that quantities marketed are large enough to reduce deliveries of powder for public storage.

2. The Commission would stress that the main aim of the aid scheme for skimmed milk processed into caseins and caseinates is, therefore, to dispose of the raw material: milk. To achieve this aim, recourse must be had to the casein and caseinate manufacturing industry and to specialized marketing firms.

Once it had been established that disposal of milk covered by this aid is directly linked to the quantities of caseins and caseinates sold, in the operation of the aid scheme since 1969 emphasis has been laid on:

- improving quality by refusing to grant aid for low-quality caseins and caseinates,
- enhancing the image of Community caseins by imposing strict requirements to ensure that products are homogeneous and standardized. This approach has enabled the Community to solve many of the problems posed by competition from caseins and caseinates produced in non-member countries.

Further refinements of this aid system were designed to:

- stimulate the modernization of facilities to allow large-scale production by means of a wide range of coefficients for calculating aid,
- improve casein production structures with a view to eliminating differences between production costs in the various Member States and ensuring a better return on investments.

3. If the Community system for casein production support did not exist, firstly dairies would be forced to dispose of the surplus skimmed milk by processing it into powder and, secondly, Community consumption would have to be covered by imported caseins at rates of duty bound under GATT.

It should be stressed in this respect that by processing skimmed milk into caseins and caseinates it was possible, in 1982, to avoid manufacturing 370 000 tonnes of skimmed-milk powder, most of which would have had to be sold for public storage if the aid scheme had not existed. Then, in order to dispose of the powder in the public stores the EAGGF would have had to spend almost twice as much (for measures such as feeding to pigs and poultry) as the amount actually paid in aid.

II. Replies to the observations by the Court of Auditors

4. *Benefit of the aid* (points 3.1.1 and 5.3)

In order to ensure that the supplier of the skimmed milk, and hence the milk producer, receives the real benefit of the aid, Council Regulation (EEC) No 987/68 laying down the general rules for the aid system, imposes an obligation on casein manufacturers to pass on the aid.

In view of all the other arrangements applying to skimmed milk, it is natural, and experience has shown this to be true, that the aid would in any case be passed on, even without any 'obligation'. Moreover, this obligation, as the Court of Auditors points out, is difficult to monitor. The Commission will therefore see whether it is not possible, on some future occasion when the Regulation is being amended, to state in the recitals to the Regulation the principle that the benefit of the aid be passed on.

5. *Stability of the aid* (points 3.1.2 and 5.3)

The Court of Auditors sees the need for some guarantee of stability, but it also feels that this should not preclude changes in the aid warranted by market movements over a long period.

The Commission shares this opinion and, as the facts show, has acted accordingly on several occasions by reducing the rate of aid.

6. *Improved definition of the concept of 'marketing'* (points 3.1.3 and 5.3)

The Court of Auditors, while agreeing that it is right that aid should be paid after marketing, nonetheless feels that there should be a stricter definition of what constitutes 'marketing'.

The Commission, which is of the same opinion, has initiated studies on this matter. The results so far would seem to indicate that each solution envisaged would have a number of drawbacks which cannot be neglected. Assuming that the general marketing mechanism and some of the characteristics of the system should be maintained, the Commission feels that work should continue into seeking a fairer solution, even though one which would satisfy all parties will not be found easily. The fact is that the organization of the manufacturing undertakings, etc. varies from one Member State to another.

7. *Supervision of aid granted* (points 3.2.2, 3.2.4 and 5.3)

The Community Regulations lay down a number of procedures and rules for supervising aid. The Member States may also introduce additional supervisory measures, which they are required to notify to the Commission.

Generally speaking, it should be pointed out that the Member States are responsible for supervising implementation of the Community Regulations. Given the specific situation obtaining in each Member State (e.g. administrative organization, structure of the sector or undertakings to be supervised) it is clear that the various supervision procedures are not identical in detail.

What really needs to be ascertained is:

- (a) whether the supervision carried out is sufficient and prevents illegalities and irregularities;
- (b) whether the type and scale of supervision do not lead to distortions of competition between producers in the Member States.

On the first point, the Court of Auditors does not call into question the system used. On the second, the Court observes that the effects on producers differ considerably between the various Member States.

With a view to preventing illegalities and irregularities on the one hand and distortions of competition between producers on the other, the Commission is continuing its efforts at harmonizing methods of supervision. In addition, it is seeking to define some general principles with regard to 'permanent' supervision.

8. *Harmonization of methods of analysis* (points 3.2.5 and 5.3)

The Commission has repeatedly tried to harmonize the methods of analysis listed under the 'Definitions' in Annex 4 to Regulation (EEC) No 756/70 and make them more precise. It has failed in this because the Member States have not been sufficiently cooperative. Similarly, as the Court of Auditors points out, discussions initiated in 1979 on the proposal for a Directive to harmonize some of the requirements for the composition of edible casein and caseinates should be concluded in the very near future so that the Directive can be adopted by the

Council. The implementing provisions will include methods of analysis to be stipulated in a Commission Directive. This will be an improvement on the definitions in Annex 4 to Regulation (EEC) No 756/70.

9. *Data on the products and constant updating method (points 4.2.2 and 5.2)*

For determining the amount of aid, the Commission has all the data and factors it requires. Naturally, in a number of cases, these are commercial data for which a certain margin or error must be accepted. The Commission constantly monitors trends in the various components and makes the necessary adjustments. On the other hand, it does not have a working instrument in the form of a detailed economic analysis which would operate, as the Court of Auditors would seem to be asking, like a warning light signalling the need for an adjustment of the aid. In view of the complexity of the problem for the sector involved, and hence the poor results such analyses would provide, the case for providing the Commission with such an instrument does not seem very strong.

10. *Structural effect (point 4.1)*

The Commission can confirm the Court of Auditors' observations as to the organization of the casein manufacturing undertakings, i.e. that there is a concentration effect with a trend towards a smaller number of more competitive undertakings both from the price and quality standpoints. It may also be observed that this secondary effect is compatible with the main objective of the measure, i.e. disposal of surplus skimmed milk.

11. *Improvement of quality (points 4.4 and 5.2)*

Significant results have been obtained with regard to the quality of the product involved. It can be stated that the needs of Community users are now largely met by the quality of Community production.

In addition, satisfactory levels of sales have been achieved in non-member countries in competition with the best quality products.

The Commission does not rule out the possibility that the present system of calculation coefficients (Article 2 of Regulation (EEC) No 756/70) might be simplified, following a review of the rules on quality in order to make them more limitative. However, it should be borne in mind that moves of this nature would be likely to occasion additional expenditure for manufacture, part of which would inevitably have to be financed through Community aid.

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