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I

*(Information).***COURT OF AUDITORS**

SPECIAL REPORT OF THE COURT OF AUDITORS
on the system of aid for liquid skimmed milk used as animal feed
(Observations, Article 206a of the EEC Treaty)

(85/C 91/01)

This report was adopted by the Court of Auditors at its meeting of 13 December 1984, in accordance with Article 206a of the EEC Treaty. The draft report had been sent on 27 July 1984 to the Commission, whose replies are attached.

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1. INTRODUCTION

1.1. The economic context and the Regulations

An inevitable by-product of the production of butter and other butterfats, liquid skimmed milk (LSM) is in turn the raw material for skimmed-milk powder (SMP). Community aid for LSM forms part of the common organization of the market in milk and milk products for the following reasons.

For several years now, the European Community's market in milk and milk products has been faced with the problem of structural surpluses. The common organization of this market rests on guaranteed intervention buying of storable milk products, i.e. butter and skimmed-milk powder. Because of the high costs of storing the latter, the Community as of 1968 developed measures whose purpose was 'that the maximum quantity of skimmed milk be used in the liquid state as feed' (second recital of Regulation (EEC) No 986/68, repeated by Regulation (EEC) No 876/77 ⁽¹⁾).

Animal feed is by far the largest outlet for the Community production of both liquid and powdered skimmed milk, absorbing over 40%, i.e. more than 20 million tonnes of liquid equivalent or one fifth of the gross production of whole milk. Of these 20 million tonnes, depending on the year, around 16 million are consumed in powder form and 4 million as liquid.

In the range of ways in which milk is used as feed, aid for liquid skimmed milk falls between on the one hand, aid for suckler cows ⁽²⁾, where the natural whole milk, by definition, has not undergone any processing, and on the other hand, aid for SMP. The first of these measures, applying only to farmers who do not sell milk, is linked with the arrangements for beef and veal, since it aims to encourage the production of quality beef. The second was intended primarily to be a complementary measure to the intervention buying of milk and milk products.

1.2. General outline of the system for liquid skimmed milk

The LSM system was originally included in a global

⁽¹⁾ Council Regulation (EEC) No 986/68 of 15 July 1968 laying down general rules for granting aid for skimmed milk and skimmed-milk powder for use as feed (OJ No L 169, 18. 7. 1968, pp. 4 ff).

⁽¹⁾ Council Regulation (EEC) No 876/77 of 26 April 1977, amending Regulation (EEC) No 986/68 (OJ No L 106, 29. 4. 1977, p. 24).

⁽²⁾ Council Regulation (EEC) No 1357/80 of 5 June 1980 (OJ No L 140, 5. 6. 1980, p. 1).

measure for using milk as feed ⁽³⁾. But since 1977 this system has been split into two aids, one for calves and one for animals other than calves ⁽⁴⁾. In practice, these animals are in most cases pigs, although in theory there is nothing to stop the aid being used for other animals.

This splitting of the system into two aids is due to the fact that, in terms of nutrition, milk (skimmed or whole) is in varying degrees an indispensable product as such for young calves ⁽⁵⁾. Pigs, by contrast, are omnivorous and can consume large quantities of skimmed milk, but it is possible to use several cheap substitutes, for the most part imported, such as plant proteins (soya, etc.). The consumption of LSM for pigs is therefore more strongly influenced by that of cheap substitutes, which is why this measure calls for a higher rate of aid.

The two present aids for the consumption of LSM therefore have markedly different rates, which entail specific procedures for controlling the use of the milk:

- aid for LSM for use as feed for calves, which will be called 'normal aid' in this report; rate of aid at 1 June 1983 for the milk year 1983/84: 6,45 ECU/100 kg;
- aid for LSM for other animals, called 'special aid'; rate of aid (same date): 9,60 ECU/100 kg.

1.3. Budgetary impact

The amounts paid out for 1983 were as follows:

- item 2021 — Aid for LSM, calves: 120 million ECU

⁽³⁾ Commission Regulation (EEC) No 1105/68 of 27 July 1968 on detailed rules for granting aid for skimmed milk for use as feed (OJ No L 184, 29. 7. 1968, pp. 24 ff).

⁽⁴⁾ The afore-mentioned Council Regulation (EEC) No 876/77 and Commission Regulation (EEC) No 2793/77 of 15 December 1977 on detailed rules of application for granting special aid for skimmed milk for use as feed for animals other than young calves (OJ No L 321, 16. 12. 1977).

⁽⁵⁾ To date, it has proved difficult to find a substitute for milk for very young calves. After this stage, substitutes may be used in increasing quantities. If this were not so, however, budgetary aid for milk (powdered or liquid) for calves would not be justifiable from the point of view of disposing of milk surpluses.

— item 2023 — Aid for LSM, other animals:	315 million ECU
— Total LSM, animals, 1983:	435 million ECU

Depending on the year (cf. Annex I), the expenditure represents around 8 % of the total for the milk sector, or 3 % of EAGGF/Guarantee Section expenditure. It should be compared with the 900 million ECU (1983) in aid for SMP for use as feed, bearing in mind that the LSM system aims to favour the use of skimmed milk in the liquid state.

1.4. The audit

Following previous audits by the Court on the various measures constituting the mechanism for organizing the market in milk and milk products, the audit which led to this report was carried out between February and June 1982, then in 1983, at the Commission and in four main recipient countries: the Federal Republic of Germany, Denmark, Belgium and the United Kingdom. Its aim was to examine, in the light of the objective assigned to the Regulations on aid for the consumption of LSM:

- the administrative management of the system,
- the economic effectiveness of the system.

2. THE ADMINISTRATIVE MANAGEMENT OF THE SYSTEM

2.1. Analysis of the system

(a) Organization of the system

The system of aid for LSM for animal feed subsidizes and organizes the sale or resale to farmers of liquid skimmed milk exclusively for use as feed. The aid is usually distributed to the dairies, which are responsible for passing it on to the beneficiary farmers by means of a reduction of the appropriate amount in the price of the milk being sold or resold ⁽¹⁾. The maximum resale price

⁽¹⁾ Aid is provided for farmers who themselves make and sell butter or cream. It is distributed to them by the intervention agency of the Member State, without being transferred via a dairy. This aspect of the system concerns 380 000 tonnes of LSM (1983), or a little less than 8 %, and is virtually limited to one country: Belgium.

and the corresponding aid are fixed at least once a year by the Commission. For animals other than calves, this statutory resale price has, since the introduction of special aid, always been fixed at a level lower than that for milk for calves, for the reasons explained above (cf. paragraph 1.2).

(b) Conditions of eligibility for the aid

The milk must be rendered unfit for human consumption and, more precisely, for any use other than that for which it has been declared. The authorized denaturing methods are defined in the Regulations. If the milk is not denatured, its use must be the subject of an administrative control offering equivalent guarantees.

The only milk eligible for the aid is that which is delivered to a breeder who has stated in writing that this milk will be used as feed on his own farm. The dairy in possession of these statements must keep them. It must also take samples and keep records according to the conditions prescribed, in order to provide proof of the deliveries. A breeder may apply to only one dairy for aid.

(c) Types of recipient farms

Apart from the case of normal aid granted to breeders holding only calves, the Regulations make a distinction between specialized farms and mixed farms.

A specialized farm is one keeping any animals except calves, or one which keeps both calves and other animals but whose farmer has undertaken to take delivery only of milk rendered unfit for calves by special denaturing involving the addition of pentahydrate copper sulphate. The breeder receives the special aid resale price.

A mixed farm is one which keeps both calves and other animals but where the farmer has not undertaken to take delivery only of milk denatured exclusively by means of copper sulphate. The LSM is resold to the farmer at the normal resale price which applies to compulsory standard quantities, defined in three possible options, in accordance with the size and nature of his herd as stated in a forward estimate to be lodged at the dairy before the beginning of each quarter. The quantities of milk in excess of these fixed amounts are resold at the special aid price.

The application in a given Member State of the options open to mixed farms is left for the national authorities to decide.

2.2. Difficulties in the administrative management of the system

(a) Complexity of the Regulations

The LSM Regulations, of which only a very simplified outline description is given above, have since 1968 grown steadily more and more complex, to such an extent that their implementation is impeded and the parties responsible for applying the Regulations have come to interpret them in their own way. In one Member State, for example, the dairy visited – interpreting the Regulations and thus taking the place of the national administration – strongly ‘advised’ producers against choosing one of the options open to mixed farms.

In all the Member States visited, the difficulty of applying the Regulations was stressed. In some, inconsistencies or translation errors were pointed out.

The Court considers it essential that steps be taken to clarify the Regulations.

(b) Problems regarding the forward estimate of the size of the herd

In all the Member States visited, it was also emphasized that difficulties were experienced by breeders in drawing up the forward estimates, because of the impossibility of accurately forecasting certain dates (such as calving) or certain events (twin births).

According to the Regulations, a young calf means one which is not more than five months (or 150 days) old, and it is the forward estimate of the number of calves which determines the quantity of milk and the period of time for which it is delivered.

It would be possible to alter the system, however, whilst still being able to carry out checks. It was suggested in one Member State that this forward estimate be replaced by a declaration giving the situation at the beginning of the period, followed by amending declarations at regular intervals (for example, monthly). The delivery of milk would thus be made compulsory for a period of five months beginning on the date of the amended declaration of the animal's birth.

(c) Compliance with the maximum resale price

Fixing the maximum statutory price for milk resold to breeders by the dairies is clearly an indispensable

condition for implementing the system. The maximum resale price is defined ex-dairy, and the price paid by the breeder is surrounded by some uncertainty as regards the transport costs. It is therefore essential, if the Regulations are to be observed, that the resale price and the other costs are clearly shown in the invoices, which is not the case in certain Member States. It is for the Commission to spell out the Regulations in this matter (see also paragraph 3.3 (c)).

(d) Check on the use of skimmed milk

Practice in this respect varies considerably. Some Member States carry out only an administrative control, others make this check when the milk is being denatured.

(i) Responsibility for denaturing

The responsibility for the denaturing of deliveries eligible for special aid is explicitly included in the general responsibility of the dairy by Regulation (EEC) No 2793/77. By contrast, the Regulations gloss over the question of responsibility in respect of normal aid deliveries. For the dairies this tends to cause a degree of confusion in relation to all their daily delivery operations (special and normal), which are closely interlinked. This is confirmed by the practices observed in the Member States.

Given the control requirements, and the abuses and irregularities which this vagueness allows – as administrators in the Member States visited recognized – the Court considers that responsibility for denaturing should be clearly assigned to the dairy in all cases.

(ii) The equivalent administrative control

The organizing of the equivalent administrative control is left entirely to the discretion of the Member States and no provision in the Regulation explains the term ‘equivalent’. Although the Commission has specifically questioned the Member States concerned about their own practices, it has not taken any harmonizing measures. The need clearly to define this notion of equivalence is all the greater in that, where denaturing does not occur, the administrative control is the only way of ensuring that the milk has been used for the purpose intended.

The weaknesses of the administrative management of the aid for LSM, as highlighted in section 2 above, are bound

to undermine both the economic effectiveness of the system and the reliability of the statistics for the use of LSM as feed. It is with this latter reservation in mind that section 3 below examines these statistics, which are, of necessity, the springboard for an analysis of the economic and financial effectiveness of the system.

3. THE ECONOMIC EFFECTIVENESS OF THE SYSTEM

3.1. Objectives of the system and instruments of management

(a) Objectives

The main objective of the LSM system, which was the basis for Regulation (EEC) No 986/68, as amended by Regulation (EEC) No 876/77, is to promote the use of the maximum quantity of skimmed milk in the liquid state as feed and, in so doing, to reduce the cost to the budget of the use of powdered milk (cf. paragraph 1.1 above). This is why the same Regulation laid down the principle of a suitable relation between the rates of aid for milk powder and for liquid milk ⁽¹⁾. The LSM instrument, comprising both a normal and a special aid, has a direct counterpart in a SMP instrument.

(b) Organic relationships between the LSM instrument and the SMP instrument

The two rates of aid of the LSM system are derived each year from the intervention price for the powder, which, together with that for butter, constitutes one of the two guiding factors of the common organization of the market in milk and milk products. Along with the intervention price for SMP, there is a corresponding liquid-equivalent price, or current price (exclusive of aid) for LSM, which the Commission calculates for each milk year. The difference between these two prices represents the cost of pulverizing and packing the SMP, plus the standard costs of delivering it to the intervention centre. For some years this difference has amounted to about 15% of the intervention price of the packed and delivered SMP. The rates of special aid also take account of the prices of vegetable substitutes.

For the purpose of comparing, from the breeder's point of view, the respective subsidized prices of LSM and SMP,

⁽¹⁾ Article 2a (3), added by Council Regulation (EEC) No 666/74 (OJ No L 85, 29. 3. 1974).

Annex II shows the various figures, referred to above, for the milk year 1983/84. It should be noted that, before reaching the breeder, almost all the SMP passes through the hands of the manufacturer of compound feedingstuffs: the prices indicated for SMP therefore represent, for the breeder, minimum prices. The prices shown in the annex do not include the delivery costs to the breeder, which vary considerably. The impact of these costs is dealt with further on, at paragraph 3.3 (c) of this report.

(c) Rates of normal aid

The rate of aid (as at 1 June 1983) for liquid milk (6,4 ECU/100 kg) is higher than that for powdered milk (5,9 ECU/100 kg), as has been the case every year since 1978. In terms of prices for the breeder, since the current (intervention) price, exclusive of aid, for SMP is already higher than the current price, exclusive of aid, for LSM, the result is that the price for subsidized LSM is 5,2 ECU as against 7,7 ECU for that for subsidized SMP, i.e. 33% less, still excluding the costs of delivering the LSM to the farm. In accordance with the aim of the LSM system, the rates of normal aid tend to promote LSM more than SMP.

(d) Rates of special aid

Special aid for powdered milk for pigs (and poultry) is provided only in certain years, during periods of large surpluses of intervention stocks, in order directly to dispose of the latter. Unlike powdered milk for calves, which is bought by manufacturers of compound feedingstuffs on the commercial market, the powdered milk for pigs is bought by the same manufacturers, mainly ex-intervention stocks, by auction, at the intervention price for SMP minus the amount of aid.

For this reason, the rate of aid for powdered milk for pigs has been set at a level which is higher than that for liquid milk, as was the case, for example, at 1 June 1983. In terms of subsidized prices for the breeder, the price of SMP remains slightly lower.

3.2. Results of the system

(a) Overall stagnation of use

An examination of the years 1973 to 1982 inclusive shows a decline in the use of LSM, interrupted from 1978

to 1980 after the introduction of special aid. In 1983 there was once again an upturn (cf. Annex III). This erratic development is shown in more detail by the three specific indicators below.

(b) *As compared to milk production*

Skimmed milk used in the liquid state as feed accounts for about 4 % of milk production and since 1978 has shown an irregular trend, with an increase in 1983 (cf. Annex IV, line L).

(c) *As compared to skimmed-milk powder, normal aid*

Because the aid for skimmed-milk powder for pigs and poultry is provided only in certain years, it is possible to draw a comparison only for normal aid. The quantity of LSM used for calves, proportionately to that of SMP, represents only 12 % throughout the Community in 1983. This proportion dropped from 17 % in 1978, and has stagnated since (cf. Annex V).

The evolution of the consumption of whole milk by calves at the farm itself, which the premium for suckler cows aims to promote, does not explain the stagnating use of LSM, since consumption here does not show a rise parallel to the stagnation of LSM consumption: it fell from 13,5 million tonnes in 1978 to 12,9 million tonnes in 1982 ⁽¹⁾.

The relationship between the utilization of LSM and that of SMP, moreover, varies considerably from one country to another: it ranges from about 1 % in France and the Netherlands, to 36 % in the Federal Republic of Germany and 358 % in Denmark.

These relationships have proved relatively stable. The Community system has not therefore helped to alter breeders' practices to bring them more into line with those in Denmark, where the implementation of the LSM system for calves is highly organized.

(d) *As compared to meat production, special aid*

Annex VI shows that the use of LSM is low: the EEC average is 0,3 kilogram of LSM for 1 kilogram of pigmeat produced (1983), as compared with the maximum, found

in Ireland, of 2,3 kilograms of LSM for 1 kilogram of meat produced.

From the point of view of the effect of Community aid, it may be noted that since 1978, the second year of application of special aid, this utilization, expressed as a percentage, has risen in the EEC only from 18 to 29 % in 1983.

Here again, big differences can be seen from one Member State to another: 1 % in France, 4 % in the Netherlands, 229 % in Ireland. Annexes V and VI also show that the Member States making the most use of special aid are only in some cases also those Member States which are the greatest users of normal aid.

3.3. Factors explaining the under-utilization of the system

(a) *The precariousness of the system*

Since the introduction of the general Regulation on the organization of the market in milk and milk products ((EEC) No 804/68) ⁽²⁾, the precariousness of the LSM arrangements has been a feature of the text ('if special circumstances so require'). Commission Regulation (EEC) No 1438/79, with the aim of reducing this precariousness, introduced for special aid a provision that a two-year period of notice must be given prior to this aid being abolished ⁽³⁾.

The uncertainty diminishes the farmers' incentive to invest, since any animal feed system involves certain investments which must be used over a sufficient period of time. The Community Regulations concerning LSM, however, are designed as an instrument to regulate in the short-term any milk surpluses. These opposing elements undermine the development of the LSM system.

It should be noted here that the 'precariousness' factor has been stressed in particular in one Member State making extensive use of the LSM system (the Federal Republic of Germany). Certain analyses ⁽⁴⁾ point to the difficulty

⁽¹⁾ Source: Eurostat agricultural yearbook, 1984 edition, page 116.

⁽²⁾ Council Regulation (EEC) No 804/68 (OJ No L 148, 28. 6. 1968, Article 10 (2)).

⁽³⁾ Commission Regulation (EEC) No 1438/79, amending Regulation (EEC) No 2793/77 (OJ No L 175, 12. 7. 1979, p. 23, Article 1).

⁽⁴⁾ Cf. Dr P. Hinrichs, Institute for Business Management ('Institut für Betriebswirtschaft'): 'The competitiveness of skimmed milk as feed in different farming situations', note sent to the Court by the Federal Ministry of Agriculture, Federal Republic of Germany, and by the Deutscher Bauernverband, DBV (German farmer's organization).

experienced by breeders, for this reason, in obtaining long-term supply contracts, and estimate that a period of three to four years is needed to recover the cost of the facilities installed on the farm for storing and handling the liquid milk.

(b) *Lack of information*

It seems that farmers are not always correctly informed about the existence and advantages of the LSM system. There are several reasons for this. It has already been pointed out at paragraph 2.2 (a) that the Regulations are very complex.

Secondly, although this system is surrounded by uncertainty, the Community bodies have not launched a campaign to disseminate information about this measure. This explains why the farmers do not appear to be properly informed that LSM is intended, by virtue of the general economic thinking behind the Community regulations for the milk sector as a whole, normally to stay at a price which is more favourable than that for skimmed milk made into powder, excluding the costs of transport to and storage on the farm.

(c) *The costs of transport to and storage on the farm*

(i) *Transport costs*

The cost of dispatching the LSM from the dairy to the farm is high in relation to its resale price. A recent analysis, carried out in the Federal Republic of Germany⁽¹⁾, estimates that in practice this cost is over 25% of the price. A cost item of this proportion can virtually cancel out the advantage afforded to LSM by the relative LSM/SMP rates of aid, since that advantage works out at 33% (35% in 1982) for normal aid.

That this is indeed a very real problem is explicitly confirmed by a study drawn up in a country which makes little use of the LSM system: France; this study, precisely for this reason, supports the idea of aid for concentrated

liquid skimmed milk for feed for calves⁽²⁾. A subsequent Commission proposal in fact puts the objective of reducing transport costs amongst its recitals⁽³⁾.

Moreover, the transport costs vary considerably, not only according to the geographical lay-out of the countries and the regions, but also according to the density of location of the dairies. A statistical analysis for whole milk drawn up by the Milk Marketing Board⁽⁴⁾, shows that for the milk year 1982/83 the average cost of collection per litre works out 67% higher for the most expensive region, North Scotland, than for the least expensive region, Northern Ireland. In the Federal Republic of Germany, for LSM, these costs have been found to vary by as much as 100% within the same region⁽⁵⁾.

(ii) *Costs of storage on the farm*

Liquid skimmed milk has to be stored and reprocessed at the farm at suitable temperatures in special tanks. As regards the storage and handling costs, the afore-mentioned FORMA study estimates at about 10% the extra costs incurred by the farm by the use of concentrated liquid milk rather than powdered milk. This figure is, by its very nature, certainly higher for unconcentrated LSM.

(d) *The economic choices of the dairies*

There is a correlation, in reality, between the Member States which have encouraged the installation of drying towers, and a low utilization of liquid milk. France and the Netherlands, both countries which have huge milk surpluses and corresponding storage problems, have granted structural aids for this purpose, some of which have been taken over for joint financing by the EAGGF Guidance Section. There exists, moreover, a certain regional differentiation within each milk-producing country, depending on the density of location of not only the dairies but also the drying towers.

⁽¹⁾ 'TOP-AGRAR' journal, published by Landwirtschaftsverlag-Münster, special issue 'Top Spezial', No 7/83, page 24, study by Dr H. Stiewe, Westphalian Chamber of Agriculture, Münster, sent to the Court by the West German Federal Ministry of Agriculture.

⁽²⁾ 'Fonds d'orientation et de régularisation des marchés agricoles' (FORMA) (Fund for the guidance and stabilization of agricultural markets), study dated 15 March 1982, 'Note on the use of concentrated liquid skimmed milk as feed for veal calves', sent to the Court by the 'Office national interprofessionnel du lait et des produits laitiers' (ONILAIT), Paris.

⁽³⁾ 'Proposal for a Council Regulation laying down general rules on the granting of aid for concentrated skimmed milk and concentrated milk for use as animal feed', document COM(83) 611 of 6 October 1983, page 1.

⁽⁴⁾ 'United Kingdom Dairy Facts and Figures', 1983, page 186, published by the Federation of United Kingdom Milk Marketing Boards.

⁽⁵⁾ Cf. 'The organization of the delivery of resold liquid skimmed milk', study by J. P. Stöckl and J. Betz, Institut für Betriebswirtschaft, Munich, sent to the Court by the DBV.

Under these circumstances, the farmers' behaviour can easily be understood: it derives from the management choice made by the dairy, which has to make the investment profitable. This also enables the dairy, in so doing, to increase its turnover, since the processing into powder brings an extra value-added as compared with the mere skimming of the liquid milk. The dairy is therefore led to restrict the recipient farmer's access to aid under this system, and it can do this all the more easily since powdered milk has a guaranteed outlet in the event of over-production: intervention.

Since aids for this type of investment have been in existence up until recent years, it may be concluded that the present situation will remain as it is for several years to come.

(e) *The predominant feed systems*

The degree of utilization of LSM as compared with SMP also seems to be a result just as much – if not more – of the predominant feed systems as of the Community system for LSM.

(i) *Example of a low-user country: France*

In France, over 75 % of the fattening of calves is carried out on factory farms ('battery' production, independent of land) and is the subject of 'integration' contracts, made partly by slaughter companies but mainly by manufacturers of compound feedingstuffs⁽¹⁾. The manufacturers in fact supply not only the milk replacers manufactured from SMP, but also the 'suckling' calves, with a contractual guarantee to buy back the animals at a given carcass weight, after about four months. The breeders in this branch of meat production, called 'white meat', find that these contracts offer advantages, especially in terms of cash funds, and they are obviously not encouraged to compare these advantages with those of the LSM system.

The impact of this problem on the Community system can be measured, for France alone, by two figures:

in 1982 this country accounted for 47 % of the calves slaughtered⁽²⁾, but only 5 % of the use of LSM for calves.

⁽¹⁾ Cf. in particular Bulletin of the Ministry of Agriculture (BIMA), Paris, No 1046, 19 December 1983 and 'Economie et Finances Agricoles', journal of the 'Caisse nationale de Crédit Agricole', Paris, October 1983, page 7.

⁽²⁾ 'The market in meat and poultry products', report of December 1983 of the 'Office national des viandes et de l'élevage' (OFIVAL) (National meat and stockbreeding Board), Paris, sent to the Court by the Board (page 99).

(ii) *Example of a high-user country: Denmark*

For over 60 years, Denmark has developed a large production of butter for export. This has led to corresponding quantities of the by-product, LSM or buttermilk, being available, and this factor prompted the development and the high degree of organization in Denmark of the use of LSM for feed.

3.4. **Factors of overall assessment of the system and its management**

(a) *Inadequately measured effectiveness*

The Commission, having made no effort to launch a methodical information campaign for the benefit of farmers, has also failed to set up a detailed analysis of the system's economic effectiveness, on the basis of information supplied by users and Member States. Now animal consumption of skimmed milk (LSM + SMP) represents overall, as the Commission puts it, the main stabilizing factor of the milk market⁽³⁾ and, in addition, the priority objective is still the disposal of skimmed milk in liquid form.

Thus, although the basic information exists, neither the annual reports made by the Commission to the Council on intervention in the milk sector, nor the working documents for the corresponding management committee make an in-depth analysis of the degree of utilization, for calves, of LSM as compared with SMP. Similarly, for special aid, the trends shown by the specific indicators of its effectiveness are not examined.

Since there is no satisfactory check on herds, the Commission does not know the number of normal, mixed and specialized farms. Similarly, there is still uncertainty surrounding the impact on breeders of transport and storage costs, despite the fact that the cost of animal feedingstuffs is of fundamental importance for the production costs of not only the milk sector, but also the beef and veal and pigmeat sectors: for these latter two, of the order of 60 % of the cost price of the meat produced⁽⁴⁾.

⁽³⁾ Cf. 'Mechanisms of the common organization of agricultural markets, livestock products', 'Green Europe', No 188, 1982, page 9.

⁽⁴⁾ Cf. in particular 'Policy for animal feedingstuffs: the case of cereal "substitutes"', 'Green Europe' No 177, 1981, page 8.
Cf. also R. Fabre: 'Les prix de l'alimentation animale et la compétitivité', 'Economie et Finances agricoles', Paris, March 1984, page 4.

The Court considers that the introduction of an in-depth analysis of the results of the systems of aid for skimmed milk (LSM and SMP) for use as feed, is indispensable for a better evaluation of their effectiveness in terms of the objectives of the disposal policy.

(b) *An unnecessarily high amount of normal aid*

(i) *An objective which is ill-defined in economic terms*

Skimmed-milk powder for calves is virtually all fresh powder which does not go through the circuit of the intervention stocks. Normal aid for liquid skimmed milk, contrary to its claimed objective, cannot therefore result in a marked reduction in the budgetary costs of storing milk powder. This being so, there is no apparent reason for giving preference, in respect of calves, to the disposal of LSM as opposed to SMP.

(ii) *An unsuitable ratio between the rates of aid*

Therefore, a ratio between the rates of normal aid which is kept strictly above unity in favour of LSM results in the disposal of LSM costing the Community budget more than that of milk processed into powder. From the point of view of financial management, a ratio of the rates of aid which is neutral in terms of the budgetary cost, would thus appear to be more suitable.

If the Commission had clarified the impact of the costs of transporting and storing LSM, it could have fixed a ratio of this kind in fuller knowledge of the facts. Moreover, in the countries with a milk surplus there were other factors, quite apart from rates of aid and in part owing to the abovementioned EAGGF guidance measures, which in any case impeded the use of LSM. There is therefore reason to believe, in the light of the information collected by the Court, that since 1978 the rate of normal aid has constantly been set at an unnecessarily high level.

(c) *Lack of a regular disposal objective for special aid*

Aid for LSM for piglets deserves special monitoring by the Commission. It represents over half the LSM consumed by animals and, moreover, in the years in which the special aid for SMP is applied, this branch absorbs large tonnages of powder. For 1983, during which year the prices for SMP were made competitive in relation to imported substitutes, provisional figures show an estimated 505 000 tonnes of powder for pigs (and poultry), i.e. about 5,8 million tonnes of LSM equivalent, in addition to 3 million tonnes consumed in liquid form.

The Community, as mentioned in paragraph 1.2 hereof, imports these plant proteins at low prices for use as substitute pigfeed. These imports have a considerable impact on the budgetary cost of the aids for liquid skimmed milk, since the level of these aids has to be adjusted to the prices of these vegetable substitutes (chiefly soya). The Court's special report drawn up at the request of the European Council held in Stuttgart in June 1983, raised this question of imports of vegetable substitutes which, in the absence of a mechanism regulating them, constitute an important factor upsetting the milk market and a heavy financial burden for the Community ⁽¹⁾.

An in-depth study of this question would go beyond the bounds of this report. Here it may simply be noted that, in view of the sharp fluctuations in the world market in plant proteins and given the — all the more pressing — need for long-term security of supply for pig-breeders, the Community authorities have not fixed any objective for regular disposal of surpluses of LSM and SMP. They have done so neither from the point of view of the Community milk market nor, despite the intrinsic nutritious advantages of milk ⁽²⁾, from the point of view of the yield from animal feed.

4. CONCLUSIONS

4.1. Weaknesses in the administrative management

Concerning administrative management, the legal instruments constituting the regulations for LSM have grown more and more complex, to such an extent that the application of the system is impeded. Certain shortcomings have also been found in various key procedures for the distribution of the aid:

- (a) At the level of the breeder, no satisfactory solution has been found for checking the size of the herd, since the forward estimate procedure has proved difficult to apply.

⁽¹⁾ Report of the Court in response to the conclusions of the European Council of 18 June 1983 (OJ No G 287, 24. 10. 1983).

⁽²⁾ Cf. in particular the Commission report on special aid: 'The supply of liquid skimmed milk to pig producers in the Community'. H. De Baere, Commission of the European Community. Pig Health Society, Proceedings of the ninth Annual Winter Symposium, University College Dublin, 22 March 1979.

Cf. also the analysis referred to in paragraph 3.3 (c), Westphalian Chamber of Agriculture, Federal Republic of Germany.

- (b) At the level of relations between the breeder and the dairy, the maximum statutory price of the skimmed milk resold by the dairies is not always clearly shown, because the regulations do not require the dairies to invoice transport costs separately.
- (c) At the level of the dairy, the responsibility for the denaturing of the milk, a procedure designed to guarantee that the milk is used for the purpose intended, is not clearly defined for all the cases of aid.

4.2. Poor economic effectiveness

The application of the system's rates of aid favours liquid skimmed milk more than milk powder. Liquid skimmed milk is, nonetheless, greatly under-utilized and, seen over a long period, this utilization appears to be stagnating.

This state of affairs at the level of the results seems to be linked with certain factors influencing the management choices of the farms and the dairies:

- (a) In respect of the farms, the precariousness, incorporated into the LSM Regulations with a view to short-term regulation, is a disincentive to farmers who have to make long-term investments. A lack of information about the Community LSM system constitutes a major handicap to its use. The transport costs, in regions where dairies are few and far between, may also act as a deterrent to breeders.
- (b) In respect of the dairies, those which have opted to invest heavily in drying installations tend to encourage, at the expense of the re-sale of LSM, the production of powder, which brings them more work, and for which they have a guaranteed outlet: intervention.
- (c) In respect of both the farms and/or the dairies, the feed systems, linked in each Member State with consumer habits or commercial practices, have more influence than the aid system itself on the degree of utilization of liquid skimmed milk.

These observations were adopted by the Court of Auditors at its meeting of 13 December 1984.

Luxembourg, 15 January 1985.

4.3. Uncertain economic management

The Community authorities have not introduced any proper monitoring of the economic results obtained by the systems of aid for skimmed milk, with a view to making them into an effective instrument of management. As regards the LSM system, its very objectives may be questioned in view of the findings of this audit. Until its reply to this report on 19 October 1984, the Commission had never, to the Court's knowledge, questioned the validity of the objectives of the system of aid for LSM, as set out not only in the recitals of the regulations but also in the Commission's own reports.

- (a) In respect of normal aid for calves, since the use of milk is to quite a considerable extent essential for young calves, and since the SMP which is used for their feed is fresh powder that does not pass via the intervention circuit, the LSM system cannot appreciably reduce the cost to the budget of storing milk powder. This being so, and in view of the inflexibility mentioned earlier, there are grounds for thinking that the rate of normal aid for LSM has since 1978 constantly been fixed at a level which is unnecessarily costly for the Community budget.
- (b) The special aid for pigs, representing a large potential market, has no permanent objectives which are tailored to the breeders' need for security of supplies and which would make LSM a feedingstuff able to compete properly with vegetable substitutes, imported in large quantities from the world market.

All things considered, the question arises as to whether all the objectives of the aids for the use of milk as feed ought not to be redefined in the light of the particular conditions of breeding and meat production, rather than continue as a measure originating simply in the lack of control of milk production.

For the Court of Auditors

Marcel MART

President of the Court

ANNEXES

ANNEX I

GLOBAL BUDGETARY EXPENDITURE AND UNIT RATES OF AID FOR SKIMMED MILK FOR USE AS FEED

Budgetary expenditure (1)	Budgetary expenditure (million ECU)					
	1978 (2)	1979 (3)	1980 (4)	1981 (5)	1982 (6)	1983 (7)
(a) Aid for skimmed-milk powder for use as feed for calves	(a) + (c) = 756	703	725	696	753	832
(b) Aid for liquid skimmed milk for use as feed for calves		126	105	98	117	120
(c) Aid for skimmed-milk powder for use as feed for animals other than calves	(b) + (c) = 252	93	5	1	1	61
(d) Aid for liquid skimmed milk for use as feed for animals other than calves		177	217	192	195	315
Total of the measures dealt with in this report ((b) + (d))	n/a	303	322	290	312	435
Grand total of expenditure in the milk sector		4 527	4 751	3 342	3 327	4 395
% of the measures dealt with in this report/total expenditure in the milk sector		6,7	6,8	9,7	9,4	9,9
Rate of aid (8)	Rate of aid ECU/100 kg liquid equivalent 1/11,5					
	(9)	(10)	(11)	(12)	(13)	(14)
Rate of aid for skimmed milk for use as feed for calves						
A. — Liquid	5,10	5,47	5,55	5,63	6,07	6,33
B. — Powder	4,32	4,67	4,74	4,81	5,15	5,46
C. — Difference between (A) and (B)	+ 18 %	+ 17 %	+ 17 %	+ 17 %	+ 18 %	+ 16 %
Rate of aid for skimmed milk for use as feed for other animals						
D. — Liquids	7,44	7,46	7,60	7,58	8,72	9,45
E. — Powder	/	8,35	/	/	9,54	10,88
F. — Difference between (D) and (E)		- 12 %			- 9 %	- 13 %

Sources: EAGGF annual financial reports and annual reports on intervention in the milk sector, Commission documents. The rates of aid are annual averages.

ANNEX II

RATES OF AID AND PRICES OF SKIMMED MILK

at 1 June 1983, ECU/100 kg liquid equivalent ⁽¹⁾

ECU/100 kg	SMP		LSM	
13,6	Intervention price = current price for SMP delivered into intervention			
	NORMAL AID	Costs processing LSM + delivery SMP	- 15 %	
11,6			Estimated current price ex-dairy	
10,0	5,9			
7,7		SPECIAL AID	NORMAL AID	SPECIAL AID
	Price of SMP for incorporation in compound feedingstuffs, calves		- 33 %	
5,2		11,7	6,4	9,6
2,0			Resale price for breeder, calves	
1,9				
		Selling price ex-intervention stocks, for incorporation in compound feedingstuffs, pigs or poultry		Resale price for breeder, pigs etc.

Sources: — CAP-MONITOR, published 14 March 1984, page 7.03.

— Commission Regulation (EEC) No 1443/83 (OJ No L 146, 4. 6. 1983, p. 15).

— Commission Regulation (EEC) No 1444/83 (OJ No L 146, 4. 6. 1983, p. 16).

— Commission report 1983 on intervention in the milk sector, page 37, and note from the Commission to the Court, 19 October 1984.

⁽¹⁾ The rates of equivalence have varied between 11,0 and 11,5. The figures in this Annex are based on 11,0.

ANNEX III

OVERALL SUBSIDIZED QUANTITIES OF SKIMMED MILK FOR USE AS FEED,
SINCE 1973

('000 tonnes)

Year (1)	Liquid			Powder ⁽³⁾		
	Calves (2)	Other animals (3)	Total liquid (4)	Calves (5)	Other animals (6)	Total powder (7)
1973		—	4 855		—	13 802
1974		—	4 326		—	13 125
1975		—	3 583		—	12 045
1976	3 157	465 ⁽¹⁾	3 622	13 532	4 493	18 025
1977	2 296	1 552 ⁽²⁾	3 848	13 495	5 378	18 873
1978	2 333	1 735	4 068	13 484	7 437	20 921
1979	1 835	2 584	4 419	15 014	5 826	20 840
1980	1 832	2 684	4 516	14 662	—	14 662
1981	1 713	2 437	4 150	14 954	—	14 954
1982	1 760	2 241	4 001	14 492	982	15 474
1983 (provisional)	1 847	3 077	4 924	14 996	5 813	20 809

⁽¹⁾ Special measures for drought-stricken regions.⁽²⁾ Of which 1 143 in drought-stricken regions.⁽³⁾ In LSM equivalent, conversion factor 11,5.

Source: Commission report on intervention in the milk sector, financial year 1983, document No VI/1383/84, GD VI-D-1, 1 March 1984.

ANNEX IV

EVOLUTION OF THE USE OF LSM AS FEED/PRODUCTION OF MILK
AND SKIMMED MILK

('000 tonnes)

Type of aid (1)	1978 (2)	1979 (3)	1980 (4)	1981 (5)	1982 (6)	1983 (7)
LSM						(provi- sional)
A. — Normal aid	2 333	1 835	1 832	1 713	1 760	1 847
B. — Special aid	1 735	2 584	2 684	2 437	2 241	3 077
C. — Total LSM — animals (aided quantities, C = A + B)	4 068	4 419	4 516	4 150	4 001	4 924
SMP						
D. — Normal aid (in liquid equivalent)	13 495	15 014	14 662	14 954	14 492	14 996
E. — Special aid (in liquid equivalent)	7 437	5 826	—	—	982	5 813
F. — Total SMP — animals (aided quantities, F = D + E)	20 932	20 840	14 662	14 954	15 474	20 809
G. — Total normal aid (LSM + SMP) (G = A + D)	15 828	16 849	16 494	16 667	16 252	16 843
H. — Total special aid (LSM + SMP) (H = B + E)	9 172	8 410	2 684	2 437	3 223	8 890
I. — Total skimmed milk — animals (LSM + SMP) (I = C + F + G + H)	25 000	25 259	19 178	19 104	19 475	25 733
J. — Milk production (dairy cows)	100 905	102 967	104 456	104 451	107 681	111 450
K. — Production LSM + butter- milk (dairy cows)	45 899	47 014	47 123	46 276	49 518	n/a
L. — Relation LSM — animals (C)/Milk production (J)	4,0 %	4,2 %	4,3 %	3,9 %	3,6 %	4,3 %
M. — Relation skimmed milk- animals (I)/Production LSM + buttermilk (K)	55 %	54 %	41 %	41 %	37 %	
N. — Relation total normal aid (G)/Production LSM + buttermilk (K)	35 %	36 %	35 %	36 %	33 %	
O. — Relation total special aid (H)/Production LSM + buttermilk (K)	20 %	18 %	6 %	5 %	7 %	

Sources: C, F and L = cf. EC Commission, report on intervention measures in the milk sector 1983.
J and K = 'Document des prévisions FEOGA-garantie', Com. DG VI-G1, ref. VI/210/83,
28 May 1984, pages 104 to 106.

NB.: The tonnages for the production of LSM include the part used for processing into SMP.

ANNEX V

RELATION BETWEEN QUANTITIES OF LSM/SMP USED FOR CALVES, BY MEMBER STATE

(aided quantities, 1 000 tonnes of LSM equivalent, on the basis 1/11,5)

Member States (1)	1978			1979			1980			1981			1982			1983		
	Liquid (2)	Powder (3)	L/P (4)	Liquid (5)	Powder (6)	L/P (7)	Liquid (8)	Powder (9)	L/P (10)	Liquid (11)	Powder (12)	L/P (13)	Liquid (14)	Powder (15)	L/P (16)	Liquid (17)	Powder (18)	L/P (19)
Belgium	398	400	99 %	119	376	32 %	153	402	38 %	112	355	32 %	170	449	38 %	170	448	38 %
Denmark	792	198	400 %	732	208	352 %	672	126	533 %	639	220	290 %	600	173	347 %	576	161	358 %
Germany	947	2 761	34 %	825	2 896	28 %	829	2 898	29 %	793	2 833	28 %	833	2 634	32 %	956	2 656	36 %
Greece	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
France	78	6 141	1 %	83	6 396	1 %	79	6 164	1 %	104	5 985	2 %	86	6 279	1 %	74	6 532	1 %
Ireland	12	237	5 %	5	340	1 %	7	253	3 %	8	344	2 %	11	127	9 %	6	356	2 %
Italy	66	1 426	5 %	36	2 372	2 %	35	2 438	1 %	5	2 357	0,2 %	3	1 875	0,1 %	6	1 886	0,3 %
Luxembourg	3	15	20 %	2	18	11 %	1	12	8 %	0,8	18	4 %	1	11	9 %	1	10	10 %
Netherlands	10	2 105	0,4 %	15	2 142	0,7 %	22	2 093	1 %	23	2 574	1 %	24	2 576	0,9 %	37	2 668	1 %
United Kingdom	27	212	13 %	18	266	7 %	24	276	9 %	28	268	10 %	32	368	9 %	21	276	8 %
EEC	2 333	13 495	17 %	1 835	15 014	12 %	1 822	14 662	12 %	1 713	14 954	12 %	1 760	14 492	12 %	1 847	14 996	12 %

Sources: Table drawn up on the basis of Commission (DG VI-D-1) annual reports on intervention in the milk sector.

NB.: In Italy and Greece, countries which have a deficit of milk and milk products, virtually the entire milk production, except for calves feeding from their mother, is used for human consumption. Italy and, in small quantities, Greece import skimmed milk for young calves, in the form of powder, from elsewhere in the EEC.

ANNEX VI
UTILIZATION OF LSM FOR PIGS, BY MEMBER STATE
(aided quantities for 'other animals' in 1 000 tonnes/Meat production in 1 000 tonnes)

Member States (1)	1978			1979			1980			1981			1982			1983		
	LSM used (2)	Pig-meat production (3)	Use (2)/(3) %	LSM used (5)	Pig-meat production (6)	Use (5)/(6) %	LSM used (8)	Pig-meat production (9)	Use (8)/(9) %	LSM used (11)	Pig-meat production (12)	Use (11)/(12) %	LSM used (14)	Pig-meat production (1) (15)	Use (14)/(15) %	LSM used (17)	Pig-meat production (1) (18)	Use (17)/(18) %
Belgium and Luxembourg	22	682	3 %	263	677	39 %	233	674	35 %	251	653	38 %	191	650	29 %	190	670	28 %
Denmark	439	815	54 %	609	901	68 %	373	979	38 %	276	1 000	28 %	212	1 000	21 %	223	1 050	21 %
FR of Germany	752	2 998	25 %	864	3 089	28 %	1 031	3 140	33 %	940	3 081	31 %	836	3 000	28 %	1 055	3 150	34 %
Greece	—	134	0 %	—	147	0 %	—	144	0 %	—	154	0 %	—	154	0 %	—	148	0 %
France	1	1 656	0 %	6	1 735	0 %	12	1 747	1 %	—	1 786	0 %	24	1 700	1 %	25	1 760	1 %
Ireland	159	137	116 %	249	153	163 %	291	143	203 %	212	137	155 %	233	140	166 %	357	156	229 %
Italy	—	922	0 %	36	969	4 %	35	984	4 %	90	1 061	9 %	65	1 060	6 %	85	1 075	8 %
Netherlands	31	1 193	3 %	76	1 288	6 %	51	1 351	4 %	50	1 407	4 %	37	1 450	3 %	60	1 455	4 %
United Kingdom	339	984	35 %	482	940	51 %	658	946	70 %	618	977	63 %	592	960	62 %	1 082	1 044	104 %
EEC	1 743	9 521	18 %	2 584	9 899	26 %	2 684	10 256	27 %	2 437	10 256	24 %	2 190	10 114	22 %	3 077	10 508	29 %

Sources: Table drawn up on the basis of the following documents:

- annual reports of the Commission (DG VI-D-1) on intervention in the milk sector,
- SOEC Yearbook of agricultural statistics, 1983 edition (gross indigenous production) supplemented by the annual reports 'The agricultural situation'.

(1) 1982 estimate on the basis of the 1983 report 'The agricultural situation in the Community', page 391 and 1983 estimate on the basis of the 1983 OFIVAL report (Office des viandes, de l'élevage et de l'aviculture, Paris). 'The market in meat (. . .)', page 113.

THE COMMISSION'S REPLIES

1. Introduction

- (a) The Commission notes that the Court's observations relate without distinction to the arrangements laid down by the Council and to their implementation by the Commission.
- (b) The Court's report takes as one of its main starting points a restrictive interpretation of the purpose of the system of aid for liquid skimmed milk.

By focusing its attention on one part of one of the recitals of a 1968 Regulation (also included in the 1977 Regulation), which gives only a partial view of the matter, the Court gives a very narrow definition of this purpose, implying that it is concerned only with encouraging the use of liquid skimmed milk rather than skimmed-milk powder with a view to lightening Community budget costs.

But the situation has changed in recent years to one of heavy surpluses so that, at certain periods, as many market outlets as possible have to be found for skimmed milk whether liquid or as powder. There have also been changes in animal feeding techniques. A clear distinction must be made, when considering the economic purpose of the aid, between the normal aid for liquid skimmed milk to be fed to calves and the special aid for liquid skimmed milk to be fed to other animals.

The aid for liquid skimmed milk for calves is not only a scheme which could well replace subsidized skimmed-milk powder, but also – and chiefly – an adjunct to the system of aid for skimmed-milk powder. Production systems vary widely from one Member State to another. The two aid systems, which have both been in operation for a number of years, have stabilized and even slightly increased the use of skimmed milk for calves.

The special aid for liquid skimmed milk for other animals is a supplementary scheme for disposing of the product by using it as a direct replacement for vegetable proteins in feed for these animals (especially pigs). Its effectiveness can therefore be assessed only in the wider context of skimmed-milk powder surpluses; in other words, increases in the quantity of liquid skimmed milk in pigfeed can be justified only if surpluses require them.

2. Administrative management

2.2. (a) *The complexity of the Regulations*

The Regulations have become complex because they aim to cover as many as possible of the individual situations which may obtain on the user farms, particularly as a result of the coexistence of two aid schemes (for calves and for other animals) at appreciably different rates on the same farms.

The Commission considers, however, that this complexity has not impeded use of the system; on the contrary, the many amendments to the Regulations, which have complicated the texts, were on each occasion introduced at the request of the Member States, to take account of situations which has not previously been covered and to increase the use of liquid skimmed milk.

2.2 (b), (c) and (d)

The Commission is willing to consider amendments to the texts governing the particular points mentioned: control of livestock, compliance with the maximum 'retrocession' price and responsibility for the denaturing of milk sold under the normal aid arrangements.

However, the Commission does not agree that the notion of 'equivalent administrative control' should be clearly defined. The Member States are responsible for supervising the implementation of Community arrangements on their territories. The supervision is carried out by the national administrative departments. Clearly, therefore, supervision must take account of the individual characteristics and requirements of each Member State and may well thus differ in detail and from one Member State to another.

It would consequently be difficult, if not impossible, to attempt to define in detail in the Regulations how the Member States should carry out their administrative control. This would not only make the Regulations even more complicated, but would relieve the national administrative departments of an important part of their responsibilities as organizers of on-the-spot checks. Realizing the importance of such checks, and in view of the use made of communications of irregularities in accordance with Article 3 of Regulation (EEC) No 283/72, the Commission asked the Member States concerned, in its letter of 21 January 1981, to provide further information on the control measures adopted by

their departments. The information received, which is very detailed in the case of most Member States, shows that the administrative checks carried out by Member States are reliable.

3. Economic effectiveness

3.1, 3.2, 3.3. Objectives and results

The economic effectiveness of the scheme can be assessed only if the objectives of the aid system are kept in view. The Court sees the main objective as promoting the use of liquid skimmed milk rather than skimmed-milk powder. The Court concludes that this objective has not been attained, that liquid skimmed milk is largely under-utilized and that nothing is being done to make better use of it.

In view of the actual objectives as stated in paragraph 1, the Commission does not agree with the Court's conclusion.

A state of equilibrium has been reached between normal aid and the system of aid for skimmed-milk powder. The two aid schemes taken together have obviated the need to develop substitute products for feeding calves. If there had been no aid for liquid skimmed milk, the product's utilization for this purpose would have ceased.

As regards the special aid, the use of liquid skimmed milk in pigfeed is more flexible and this use is more closely related to the level of aid. Nonetheless, it is justified only where skimmed milk surpluses remain after other less expensive disposal measures have been exploited to the full. In the context of structural surpluses, however, the system of special aid, which has been in continuous operation since 1977, has become more important than that of normal aid.

With regard to factors which may impede the utilization of liquid skimmed milk, the Commission considers that:

- (i) the precariousness of the system, which was stressed in the Court's report, must not be exaggerated; not only must two years' notice be given for special aid, but the stable operation of the system over the last seven years has greatly reduced the element of uncertainty involved in the scheme;
- (ii) detailed information for farmers is not the Commission's responsibility; it must be obtained nationally;

- (iii) the costs of transport to and storage on the farm are actually higher for liquid skimmed milk than for skimmed-milk powder.

3.4 Overall assessment

(a) and (b) Effectiveness and level of aid

In making an overall assessment of the system's economic effectiveness, the Court again argues from the narrow definition of purpose mentioned in its introduction (1.1) and in paragraph 3.1, namely the attempt to promote the use of liquid skimmed milk rather than skimmed-milk powder so as to relieve the burden on the Community budget.

Inevitably, therefore, the Court draws a number of conclusions and makes a number of comments about the aim of the system, its effectiveness and the relationship between the different types of aid which have no bearing on the real problems that have arisen over the last few years.

The aim of economic management, particularly as regards normal aid, must be to stabilize the use of liquid skimmed milk as far as possible while adjusting the level of aid according to suitable parameters. The need for stability was rightly stressed in the Court's report. The level of aid must be adjusted not only on the basis of an economic analysis of the results obtained but also on the basis of movement in the prices of substitute products, the availability of liquid skimmed milk and the economic performance of farms.

With these reasons in mind, the Commission disputes the Court's conclusion (and this is repeated in point 4.3 of the conclusion) that '*there are grounds for thinking*'⁽¹⁾ that the rate of normal aid for liquid skimmed milk has since 1978 constantly been fixed at a level which is unnecessarily costly'. It is true that the level of aid for liquid skimmed milk has been fixed at about 10% above the level for skimmed-milk powder, but it must be borne in mind that, as was stressed in the Court's report, the use of skimmed milk in liquid form involves higher transport costs and requires costly facilities for the storage and distribution of the liquid milk.

3.4 (c) Disposal objectives

The Commission agrees with the Court that the importation of crop substitutes without suitable controls at the frontier has an appreciable effect on milk production and on the scope for using milk products as animal feed.

⁽¹⁾ Commission's italics.

The Commission cannot, however, accept the Court's criticisms that there is a lack of an objective of regular disposal: aid for the use of skimmed-milk powder or liquid skimmed milk in animal feed was initiated mainly in response to the need to dispose of milk surpluses. However, as regards feed for calves, these objectives coincide with farmer's needs and those of meat production and they have always been taken into account when drawing up the arrangements.

As regards feed for pigs the purpose of the aid is simply to dispose of surplus skimmed milk and this milk does not have to meet any particular feed requirements.

Conclusion

4.1 *Weaknesses in the administrative management*

The problems touched on by the Court arise mainly from the fact that the aid scheme is operated in respect of individual farms, which complicates matters because of the varying structures of the farms eligible.

The Commission is considering changes in the texts to deal with some of the specific points mentioned by the Court while avoiding, as far as possible, the complications also pointed out by the Court.

4.2 *Poor economic effectiveness*

Certain technical considerations make it less advantageous to use liquid skimmed milk than to use skimmed-milk powder. This results, in some cases, in a lower level of economic effectiveness for the purchaser, a problem which can be overcome only by lowering the price and therefore increasing aid.

4.3 *Uncertain economic management*

The Commission stressed that the system of aid for skimmed milk, whether in powder or liquid form, is motivated by the need to dispose of milk surpluses. At the same time, the special needs of stockfarming are borne in mind. However, the dominant problem with respect to animal feed is that protein-rich crop products enter the Community almost completely free of duties and levies. This means that the level of aid for skimmed milk must be very high (up to 75 % of the product's value) if the milk is to compete with the imported products.

The aim of dairy policy is not primarily to develop market outlets for milk surpluses by using them as animal feed. It is to achieve a balance between supply of and demand for milk and milk products. This is why the Council, acting on a proposal from the Commission, has taken steps to reduce milk production, thus reducing the quantities of skimmed milk requiring disposal as animal feed at a high level of aid.

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