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## **PROJECTED CHANGES IN POLISH DAIRY COOPERATIVES MANAGEMENT AFTER THE REMOVAL OF THE MILK QUOTA SYSTEM IN THE EUROPEAN UNION<sup>1</sup>**

*Stability of the EU milk market after elimination of milk quotas and production regulation is discussed. Repealing milk quotas without effective mechanisms for stabilizing the EU milk market will be unfavourable for European milk producers. It is likely that the dairy cooperatives in Poland, and other European Union countries, will need to improve management in such ways as to enrich competitive product range for domestic and foreign markets, outside the European Union as well. Competition necessitates production of dairy products with higher added value, better quality management and better processing. As a result, dairy co-operatives will be able to increase economic efficiency, therefore increasing net profits of the cooperatives i.e. milk producing farmers, in partnership with the cooperatives will be able to participate in the dividends as compensation for losses caused by lower raw milk wholesale prices. At the level of the European Union or Member States, the removal of the quota system may be partially offset by subsidies for milk producers arising from intensification of economic policies in areas such as environment or social assistance, as well as research and innovation.*

**Key words:** costs and quality management, dairy cooperatives, elimination of milk quotas.

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## **ПЛАНУВАННЯ ЗМІН В УПРАВЛІННІ ПОЛЬСЬКИМИ МОЛОЧНИМИ КООПЕРАТИВАМИ ПІСЛЯ ВІДМІНИ СИСТЕМИ КВОТ НА МОЛОКОПРОДУКТИ У ЄВРОСОЮЗІ**

*Обговорюється стабільність на молочному ринку ЄС після усунення молочних квот та виробничого регулювання. Анулювання молочних квот без запровадження ефективних механізмів стабілізації молочного ринку ЄС буде несприятливим для європейських виробників молока. Ймовірно, що молочним кооперативам у Польщі та інших країнах Європейського Союзу буде необхідно покращити управління у такий спосіб, що підвищити конкурентоспроможність продукції для внутрішнього і зовнішнього ринку, у тому числі і поза межами Європейського Союзу. Конкуренція вимагає виробництва молокопродуктів з вищою доданою вартістю, покращенням управління якістю та виробничим процесом. Як результат, молочні кооперативи матимуть можливість покращити економічну ефективність, підвищуючи чистий прибуток кооперативів, тобто фермери-виробники молока в партнерстві з кооперативами матимуть змогу брати участь у розподілі дивідендів, таких як компенсація збитків, спричинених нижчими оптовими цінами на молоко. На рівні країн-членів Європейського Союзу відміна системи квотування може бути частково компенсована шляхом субсидій для виробників молока, які випливають з інтенсифікації економічної політики у таких сферах, як охорона навколишнього середовища чи соціальна допомога, а також дослідження та інновації.*

**Ключові слова:** управління витратами та якістю, молочні кооперативи, відміна квот на молокопродукти.

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## **ПЛАНИРОВАНИЕ ИЗМЕНЕНИЙ В УПРАВЛЕНИИ ПОЛЬСКИМИ МОЛОЧНЫМИ КООПЕРАТИВАМИ ПОСЛЕ ОТМЕНЫ СИСТЕМЫ КВОТ НА МОЛОКОПРОДУКТЫ В ЕВРОСОЮЗЕ**

*Обсуждается стабильность на молочном рынке ЕС после устранения молочных квот и производственного регулирования. Анулирование молочных квот без внедрения эффективных механизмов стабилизации молочного рынка ЕС будет неблагоприятным для европейских производителей молока. Вероятно, что молочным кооперативам в Польше и других странах Европейского Союза будет необходимо улучшить управление таким образом, чтобы повысить конкурентоспособность продукции для внутреннего и внешнего рынка, в том числе и за пределами Ев-*

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роейского Союза. Конкуренция требует производства молочных продуктов с более высокой добавленной стоимостью, улучшением управления качеством и производственным процессом. Как результат, молочные кооперативы будут иметь возможность улучшить экономическую эффективность, повышая чистую прибыль кооперативов, то есть фермеры-производители молока в партнерстве с кооперативами будут иметь возможность участвовать в распределении дивидендов, таких как компенсация убытков, вызванных низкими оптовыми ценами на молоко. На уровне стран-членов Европейского Союза отмена системы квотирования может быть частично компенсирована путем субсидий для производителей молока, которые вытекают из интенсификации экономической политики в таких сферах, как охрана окружающей среды или социальная помощь, а также исследования и инновации.

**Ключевые слова:** управление затратами и качеством, молочные кооперативы, отмена квот на молокопродукты.

## Introduction

Having in mind the present market conditions of the European Union's member states and the anticipated direction of change, it is inadvisable to avoid difficult questions. Indeed, they should be raised – can we declare the European Union's food safety is presently a moot point? Are we sure that the future will never serve us food shortages? Can we, and do we have the right to ignore fundamental human needs simply because the present Common Agricultural Policy (CAP) is very effective? These questions seem to be rhetorical, yet the axiom is the assertion that nothing is forever. Not that long ago, hunger was evident in post-war Europe and was the motivation for the Common Agricultural Policy, the main pillar of the Treaty of Rome and the European Common Market. Worthwhile remembering is that prudence demands not forgetting history, which can repeat itself.

Producing your own food is a great asset, whereas having the possibility of purchase is a great illusion of independence and a grave financial unknown. That which is relatively inexpensive today, does not have to be in the future, especially when global production and demand structures shift.

It should be remembered that the Common Agricultural Policy – its vision and mission – built the European Common Market and presently drives the European Union. Weakening that agricultural policy may mean weakening the EU in its entirety; therefore, the Common Agricultural Policy should be improved, not liquidated.

Changes to the attributes of the common policy are, however, necessary since improvement requires adjustment. Pursuing better solutions is the responsibility of humans and that is why changes have to be introduced – well prepared changes which meld low risk and high success probability.

It bears emphasis that success, or good solution, in the market reality is a relative concept for the farmer, milk producer or consumer. The key issue for the milk producer (and for every producer) is maximum profit. This means that producers and their representatives will endorse:

- maintaining quotas for as long as possible because this instrument limits over production, and as such partially stabilizes wholesale prices,
- maintaining highest wholesale prices,
- maintaining highest various subsidies,
- maintaining the most advantageous production intensification to the limits of acceptable profit margin,
- maintaining the most advantageous production scale based on subsidy limits (higher sums are better than lower),
- lowering unit production costs (which is the most challenging).

With this in mind, it is worthwhile stressing that there are approximately one million milk producers and about five thousand dairies in the European Union, generally co-operative. Taking into account involved family members, production and milk processing, directly and indirectly affected are about 5 to 6 million people. Theoretically speaking, milk consumption and its processing pertains to all inhabitants of the EU i.e. approximately 499.7 million people for whom priorities differ from those of the producers. Worthwhile is noting that the consumer economic spectrum in the EU is wide, especially after expanded membership integration; 40 million consumers live at poverty levels and another 40 million live at near poverty levels. Dependent on wealth levels, consumers can expect of the dairy industry:

- new, better quality milk products with high added value at reasonable price hike,
- better quality of existing brands with no price hike,
- products with no quality change at lower prices, and
- substitution of current products at substantially lower prices.

The key factors for consumers are quality and price; whereas, for the producer, maximum profit which, in effect means maximum direct revenue surplus from milk production.

The decision of repealing milk quotas from the EU's Common Agricultural Policy in 2015 has been for all practical purposes decided; however, this decision should have been preceded – and it was not – with developed alternative mechanisms, which, on the one hand, would be in accordance with WTO principles, and on the other, effectively stabilize production, wholesale prices and farmer incomes. It bears attention that the milk market is

not only sensitive, but also atypical. In the event of removing milk quotas, wholesale price reductions may cause higher production for some period – not lower – as a means of compensation by producers for lower prices. This, in turn, could cause social and political perturbations greater than anticipated. Thus the consideration of stabilizing mechanisms is advisory in order to reduce negative impact when milk quotas are rescinded.

#### **Potential stabilizing mechanisms reducing impacts from milk quota repeal.**

It is likely that the dairy cooperatives in Poland and other European Union countries will need to improve management to enrich the production of product ranges and be competitive in the domestic and foreign markets, outside the European Union as well. Necessity is the production of dairy products with higher added value, better quality management and better processing. As a result, the dairy co-operatives will be able to increase economic efficiency. This will increase the net profit of the cooperatives and milk producing farmers, who co-own the cooperative, will be able to participate in the dividends to compensate for losses due to lower wholesale prices for raw milk.

‘Key success factors’ (KSF) influence producers’ lifestyle and production profitability [1]. Contrary to popular belief, there aren’t many; in fact, just a few. They can have various attributes – economic, organizational, technological, legal, administrative and, in exceptional instances, political.

Regarding milk production in the Common Agricultural Policy, one can consider factors which especially concern themselves with economics, organization, law and administration [2]. Separating these considerations is difficult since they influence each other i.e. they are interfaced.

Having in mind a holistic and dialectical approach to global market development, one can accept without greater risk the notion that indirect mechanisms are more effective in the long run than rigid direct mechanisms such as subsidies, minimum prices, proscriptions or prescriptions [3]. Indirect mechanisms – currency volume, currency price, tax and credit preferences, for example – have the disadvantage that they don’t give immediate results and one has to wait longer for, relatively speaking, lasting, understood and majority accepted effects.

With the perspective of the EU milk production quotas repeal, parallel and specific evaluation of the following methods (by no means comprehensive) would seem to be in order to reduce the impact of having no quota system.

#### **Tying milk production with EU environmental protection policy.**

Rational milk production with regard to scale and volume has strategic weight for environmental protection; cattle on pastures or large corrals also affect countryside landscapes. Therefore, taking advantage of EU environmental funds, in the form of subsidies for farms respecting environmental requirements, may be an effective method for rational rural development maintaining natural values cherished by the whole society i.e. equally for affluent and indigent countries, urban and rural residents, as well. These regulations can be understood and accepted. Furthermore, the key of this approach may be protecting landscapes, as well as environmental protection, from irrational intensity and scale of agricultural production [4].

For example, a condition for a farm to receive appropriately scaled subsidies from the EU environmental funds may be:

- not surpassing maximum milk sales of e.g. 8 tons/hectare annually calculated by each physical agricultural hectare of the farm,
- not surpassing general milk sales by a farm in the volume of e.g. 1 million kg annually,
- maintaining appropriate manure tanks and pads,
- possession and utilization of pastures,
- possession and utilization of large corrals specifying minimum area for one bull or one cow,
- fulfilling requirements of animal welfare e.g. proportional to annual average number of cows on the farm,
- milk production in agriculturally less favored areas (LFA) proportionally to production scale or annual average of milking cows on the farm.

#### **Linking milk production with EU social and aid policies.**

Tying profitability of milk production to EU institutions responsible for social and aid policies may be an important stabilizing element.

This could be tied into already existing and utilized programs such as subsidies for milk consumption in schools, consumption of butter in mass catering, or use of butter in ice cream production.

Regardless of the above examples, it may be advisable to institutionalize activities which will be probably introduced in EU aid programs directed to EU citizens living in poverty or near-poverty conditions; this pertains to approximately 80 million people who need support. These kinds of endeavors would significantly strengthen the Union’s authority and at the same time, could be the rationale for Union contracts within these policies for powdered milk and butter. This in turn would be an important stabilizing factor for milk production profitability.

Another significant consideration may be the value of maintaining reserves of powdered skim milk, butter and hard cheeses for external EU aid needs. Appropriate reserves earmarked for foreign aid should be maintained

and administrated under the EU's humanitarian aid policies. Here again, as mentioned above, the authority of the EU would be reinforced (but on the international scale) and would be the rationale for additional powdered milk, butter and hard cheese contracts, further stabilizing the profitability of milk production.

#### **Linking milk production to European Union common policies for innovation.**

From the perspective of Keynesian theory, economic development results from several dynamics, among them rising demand and active participation of the state, especially in the area of infrastructure investment. Desiring production growth and guaranteed wholesale milk prices for producers, the market should be earlier surveyed for potential growth in demand for new generation processed milk products with the highest added values. This may be resultant of the EU's innovation policies; a system of incentives for scientific research which would develop new technologies and products causing growth in demand for an attractive range of milk products at relatively high prices.

Such initiatives, in the long run, may bring surprisingly good results for milk producers as well; however, this research demands consistent and suitable funding [5]. With the duration, expense and relevance of the concept in mind, it is necessary that the EU engage itself institutionally in said proposal.

#### **Linking milk production with the European Union's common energy policy.**

Agriculture can and should produce more for energy. This creates new opportunities for farms, especially those less profitable. Besides great natural gas projects – as well as crude oil, nuclear energy, wind and water generation – one should not, cannot minimize energy sources derived from farms.

European Union energy policy can, in the future, financially support production of:

- energy crop growth,
- ethanol,
- bio-diesel,
- biogas from farms engaged in beef, pork or milk production.

Funding could be directed to end or commodity production. Transferring this issue to the EU's common energy policy may, in the future, be seen as justified.

#### **Establishing minimum wholesale milk prices administratively through the European Commission.**

This proposal would have to reconcile, on the one hand, the variable need of the market, and on the other, the stabilizing role. Therefore, it would be prudent to consider minimum wholesale prices in the European Union at a level of e.g. 90% of the average wholesale price for the past 3 years in the EU.

The above proposal would gradually cause adjusting production volume to the need of the market with a moderate mechanism for stabilizing wholesale prices in the EU.

#### **Direct administrative subsidies for milk production.**

In the case where quotas were repealed, production increased and wholesale prices fell, prudence may indicate partial compensation of production costs through a system of direct subsidies for milk production throughout the EU where 50% of the recommended subsidy came from the Commission's budget and at least 50% of said subsidy came from member-state budgets.

This mechanism could function temporarily through the nearest financial period. The rate of funding for milk production should be negotiated and be established as e.g. 10 eurocents for 1 kilogram of milk sold by the dairy farmer, where 5 eurocents came from the EU budget and at least 5 eurocents came from that member-state's budget. A condition for EU budget payment should be initial member-state payment.

#### **Futures contracting insuring minimum sales price for skimmed milk powder, bulk butter and selected hard cheese earmarked for export.**

The European Commission could, through a designated agency and/or agencies, participate in futures markets to insure minimum sales price of skimmed milk powder (SMP), bulk butter and selected hard cheese. These commodities could originate from EU market intervention.

Such a mechanism would stabilize prices for SMP, bulk butter and hard cheese, and in turn, stabilize wholesale milk price.

However, it should be noticed that in the long-term, futures contracts can only stabilize prices, but they cannot continually raise those prices. Therefore, in the case of repealed milk quotas, futures contracts will not cause prices to rise to present levels in the long-term i.e. contract prices may be stable, but at lower than present levels. The influence of futures contracts on prices can be stabilizing or destabilizing. Stabilizing effect can be attained through careful analysis of milk prices and milk products and appropriate anticipatory intervention which would reflect countercyclical – not procyclical – features. Variations in price changes vary in time state-by-state, therefore the decisions for contracting should be undertaken in reference to each state's reality by that state and realized by the appropriate state agency.

The stabilization of prices at a lower level through futures contacts is not only a great value for producers, it

also allows forecasting the market as well. In the event there were no futures contracts, lower wholesale prices and their high variability would generally give a negative social and political effect.

Another issue to consider is the possibility to establish minimum wholesale prices to facilitate a given state's intervention with regard to exporting skimmed milk powder, butter and hard cheese. The minimum wholesale price of milk should be determined at least one year earlier for any given year.

Summarizing these considerations, it remains to mention that the above propositions don't have to be instituted all at once – they can be initiated individually, as package programs, or altogether. Furthermore, they in no way exhaust other possibilities in this issue.

### Conclusions

1. These considerations are fragmentary and do not comprehensively explore the issue. They may have missed actual conditions, yet may be motivation for consideration regarding the EU milk market after repeal of milk quotas and releasing said market.

2. Repealing milk quotas without effective mechanisms for stabilizing the EU milk market will be unfavorable for European producers. This impact may be partially ameliorated through suggested direct and indirect activity tying milk production with other EU policy areas e.g.

- environmental protection,
- social assistance,
- innovation and research, and
- energy.

3. There are additional proposals:

- establishing minimal milk wholesale prices administratively by the European Commission,
- direct administrative subsidies for milk production,
- acting on the price of wholesale milk by earlier establishing minimum prices for hard cheese, skimmed milk powder and butter,
- futures contracts insuring minimum sale prices for SMP, bulk butter and selected hard cheese earmarked for export, or for internal and external EU aid. The effect of futures on prices may have stabilizing or destabilizing effect. Gaining stabilizing effect may be attained through careful analysis of milk price and derivative products, and early intervention in order to promote anti-cyclical, and not pro-cyclical dynamics. Delaying price change vary in different countries, however decisions of price-freeze should be undertaken country-by-country through their state agencies.

4. The dairy cooperatives in Poland and other European Union countries will need to change management in such a way as to enrich production and product range being more competitive in the domestic and foreign markets, also outside the European Union. A necessity is the production of dairy products with higher added value, better quality management and better processing. As a result of the dairy co-operatives will be able to increase economic efficiency. This will increase the net profit of cooperatives and milk producing farmers, who co-own the cooperatives, will be able to participate in the dividends compensating losses due to lower wholesale prices for raw milk.

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