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I

(Information)

COURT OF AUDITORS

SPECIAL REPORT No 8/2000

on the Community measures for the disposal of butterfat accompanied by the Commission's replies

(pursuant to Article 248(4), second subparagraph, EC)

(2000/C 132/01)

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MAIN AUDIT FINDINGS

EU butter production (1 840 000 tonnes in 1998) accounts for about 45 % of worldwide production. Including imports and stocks, some 2 000 000 tonnes of butter is available on the market each year, but only 1 290 000 tonnes is sold at market prices. The remainder is subsidised, either by disposal measures, export refunds or public and private storage (see paragraphs 1 to 3).

Per capita consumption of butter dropped by 15 % during the second half of the 1980s. While consumption remained relatively stable in the 1990s a further decrease in consumption is anticipated. The increase of milk quotas will allow higher production in future years — which may exacerbate the surplus situation (see paragraphs 10 to 12).

Butter disposal measures aim at increasing consumption by providing aid for the use of butter. There are three measures ('butter for pastry', 'butterfat for direct consumption' and 'butter for non-profit organisations'). Annual expenditure amounts to ECU 600 million, covering around 500 000 tonnes of butter each year (paragraphs 17 to 22).

The lowest possible aid level is not attained by the existing tender system. The aid level (about 30 % of the market price of butter) could be further reduced, if market forces were allowed to play their role fully (see paragraphs 23 to 27 and 68 to 71).

Lower quality and imported butter are eligible for EU support, thereby reducing the impact of the measures (see paragraphs 28 to 34).

The relevant Commission regulations foresee the adding of tracers to products for control reasons. According to an expert's opinion some of the substances involved give rise to a health risk. The Commission should take initiatives to assure prior testing and approval of tracers and the declaration of their presence on product packaging (see paragraphs 35 to 38).

VAT is imposed on EU subsidies in some Member States. This breaches the principle of equal treatment and moreover it undermines the general purpose of the subsidies. The Commission should reflect on the implications of EU subsidies not reaching their intended beneficiaries in full (paragraphs 39 to 41).

Improvements are necessary at Member State level concerning the approval and inspection of establishments entitled to incorporate aided butterfats, the control of the adding of tracers and the controls on the European origin of butter for direct consumption (paragraph 51).

The justification for the disposal measures rests on the creation of additional demand, but the Commission has no comprehensive information, analysis or studies on their impact. For some traditional or premium products the use of butter is necessary to obtain the expected final product characteristics. For other products, competing fats such as vegetable oils and margarine which are much cheaper (by at least 50 %) can be used. For croissants or ice cream, which are among the most important products in which aided butter is incorporated, the EU aid has a limited effect on retail prices and therefore on overall demand by final consumers (paragraphs 54 to 71).

While disposal measures are less expensive than intervention and export refunds, this comparison is only valid if additional demand is created. However, there are reasonable indications that a substantial proportion of butter disposed of with EU aid would have been consumed anyway (paragraph 75).

Introduced in 1969 on a temporary basis, the butter disposal measures became permanent schemes to deal with structural surpluses. As well as aiming to reduce the cost of disposal measures, the Commission should also consider structural measures to improve demand for non-subsidised butter or limiting its supply (paragraphs 76 to 78).

The Commission should undertake a comprehensive assessment of the disposal measures. Meanwhile, the current tendering procedures should be revised, aid should be progressively reduced and concentrated only on quality non-imported butterfats for products where it is likely that additional demand is in fact created (paragraph 84).

INTRODUCTION

The butter disposal measures

1. One third of the milk produced in the European Union (EU) is either consumed fresh as drinking milk or converted into fresh products, such as yoghurt. The remaining two thirds are converted into the three broad product categories, butter, cheese and skimmed milk. The EU butter production, of 1 843 000 tonnes in 1998 ⁽¹⁾, accounts for about 45 % of the worldwide production ⁽²⁾. Including imports and stocks, 1 984 000 tonnes of butter ⁽³⁾ is available on the market, but only 1 290 000 tonnes ⁽⁴⁾ is sold at market prices.

2. The remainder (694 000 tonnes in 1998) is subsidised, either for consumption through the various disposal measures or exported with the assistance of export refunds or taken into public or subsidised private storage ⁽⁵⁾. For the overall market balance see *Table 1*.

3. Butter is normally produced from cream, which is the first product obtained in the course of separating milk fat from milk. It has a minimum fat content of 82 % (80 % if salted). Concentrated butter or butteroil (99,8 % fat content), which can be stored over a longer period without refrigeration, is used in the food-processing industry and for household cooking, particularly in certain regions of Germany.

4. Introduced in 1969, the EU disposal measures aim to limit surpluses by providing subsidies for the use of butter, particularly where there is competition from other fats such as vegetable oils ⁽⁶⁾. There are three EU disposal measures: a measure principally for the use of cream, butter and concentrated butter in pastry and ice cream ('butter for pastry'), a measure for concentrated butter intended for direct consumption including private households ('butter for direct consumption') and a measure for the use of butter by institutions and non-profit organisations such as hospitals or social canteens ('butter for non-profit organisations'). Some ECU 600 million ⁽⁷⁾ is spent annually on these measures, which was 20 % of the total EU expenditure of ECU 2 956 million on the common market organisation (CMO) for the milk sector in 1998 (see *Table 2*).

Table 1
Overall market balance

(1 000 t)

	EU-10 1984	EU-12 1994	EU-15 1995	EU-15 1996	EU-15 1997	EU-15 1998
<i>Opening stocks:</i>						
1. Private stocks (with EU aid)	161	47	59	50	54	40
2. Public stocks	692	161	59	20	40	11
3. Total opening stocks	853	208	118	70	94	51
4. Production	2 115	1 675	1 892	1 893	1 863	1 843
5. Imports	89	65	73	95	90	90
6. Available for use	3 057	1 948	2 083	2 058	2 047	1 984
<i>Consumption:</i>						
7. At market prices	1 342	1 161	1 298	1 291	1 291	1 290
8. Aided consumption	358	506	486	470	478	464
9. Total consumption	1 700	1 667	1 784	1 761	1 769	1 754
Consumption per capita (kg) in the EU:	5,30	4,70	4,74	4,70	4,70	4,68
<i>Exports:</i>						
10. Commercial	235	152	219	202	226	170
11. Food aid	59	0	1	1	1	0
12. Special price	114	11	9	0	0	0
13. Total exports	408	163	229	203	227	170
<i>Closing stocks:</i>						
14. Private stocks (with EU aid)	108	59	50	54	40	57
15. Public stocks	841	59	20	40	11	3
16. Total closing stocks (6 – 9 – 13)	949	118	70	94	51	60

Explanatory notes:

The quantities for 'Aided consumption' at row 8 are different from those for 'total butter equivalent disposed of' in note 1, Table 5, because the latter includes dairy fat disposed of in the form of cream under Regulation (EC) No 2571/97. The two sets of figures are reconciled as follows:

	1994	1995	1996	1997	1998
Aided consumption	506	486	470	478	464
add dairy fat disposed of in the form of cream	17	23	24	29	32
Total butter equivalent disposed of, as per Table 5	523	509	494	507	496

Consumption per capita in 1984 is for EU-12.

Sources: For 1984: Agricultural situation yearbook, 1987.

1994 to 1998: Commission DG VI, Spreadsheet entitled 'Balance sheet — butter stocks'.

Table 2
Expenditure on milk 1994 to 1999

		(million ECU/EUR)						
Notes	Budget reference	Category of expenditure	1994	1995	1996	1997	1998	1999
								(Estimate)
	B1-2 0 0 0 B1-3 0 1 3	Butter and butteroil Export Refunds	251	477	237	525	337	250
		Export Refunds — non-Annex II	47	65	64	85	82	76
			299	542	300	610	420	326
	B1-2 0 3 1...2 0 3 4 B1-2 0 3 0	Storage operations: Public storage	18	-74	26	-9	-45	-4
		Private storage	49	34	28	30	22	32
			68	-40	54	21	-23	28
1	B1-2 0 4	Disposal measures: (analysed in Table 5)	656	618	625	598	584	491
	B1-2 0	<i>Chapter B1-2 0 subtotal</i>	975	1 055	916	1 145	899	769
	B1-3 0	<i>Chapter B1-3 0 subtotal</i>	47	65	64	85	82	76
		<i>Expenditure on butter and butteroil:</i>	1 023	1 119	980	1 230	981	845
	B1-2 0 0 1 B1-3 0 1 2	Skimmed milk and skimmed-milk powder (SMP) Export Refunds	73	199	138	171	133	122
		Export Refunds — non-Annex II	137	144	132	160	172	155
			210	343	270	331	305	277
	B1-2 0 1 1...2 0 1 4 B1-2 0 1 0	Storage operations Public storage	69	-89	155	30	90	45
		Private storage	0	0	0	0	0	0
			69	-89	155	30	90	45
	B1-2 0 2 0...2 0 2 3 B1-2 0 2 4	Disposal measures: Aid for animal feed	500	448	439	386	367	364
		Aid for casein	279	343	311	288	287	289
			779	791	750	675	654	653
	B1-2 0	<i>Chapter B1-2 0 subtotal</i>	922	901	1 042	875	877	820
	B1-3 0	<i>Chapter B1-3 0 subtotal</i>	137	144	132	160	172	155
		<i>Expenditure on skimmed milk and SMP:</i>	1 059	1 045	1 174	1 035	1 049	975
	B1-2 0 0 2 N/A B1-2 0 5 0	Cheese Export Refunds	592	584	469	272	181	181
		Storage operations: Public storage	0	0	0	0	0	0
		Private storage	89	89	84	99	74	93
			89	89	84	99	74	93
		<i>Chapter B1-2 0 expenditure on cheese:</i>	681	673	553	371	255	274
	B1-2 0 0 3	Other milk products Export Refunds	1 010	1 008	761	785	775	706
		<i>Chapter B1-2 0 Expenditure on other milk products:</i>	1 010	1 008	761	785	775	706
2	B1-2 0 6 1	Other measures relating to milk: School milk scheme	155	112	124	108	—	—
2	B1-3 1 2	School milk scheme	—	—	—	—	105	96
3	B1-2 0 6 2, 3, 4 B1-2 0 6 5, 6, 8	Development of marketing and quality Compensation for reducing or abandoning milk production	34	16	5	0	—	—
		Additional milk levy	412	316	348	353	6	6
3	B1-2 0 7 B1-2 0 6 7 B1-2 0 6 9/B1-2 0 9	Compensation for non-allocation of milk quotas Other measures	-2	-80	-194	-547	-214	0
			15	-1	0	0	2	0
			33	29	16	3	-2	6
		<i>Chapter B1-2 0 subtotal</i>	647	392	299	-83	-209	12
		<i>Chapter B1-3 1 subtotal</i>	0	0	0	0	105	96
		<i>Expenditure on other measures relating to milk:</i>	647	392	299	-83	-104	108
4		<i>Chapter B1-2 0 subtotal</i>	4 236	4 028	3 572	3 093	2 597	2 581
		<i>Chapter B1-3 0 subtotal</i>	184	208	196	245	254	231
		<i>Chapter B1-3 1 subtotal</i>	0	0	0	0	105	96
		Total expenditure on milk:	4 420	4 236	3 767	3 337	2 956	2 908

Differences in totals due to roundings.

1. In 1998, disposal of social assistance butter (ECU 4 million) was transferred from B1-2 0 4 to B1-3 1 3.

The table excludes expenditure on social assistance butter (B1-2 0 4 0) for all years.

2. In 1998, school milk (ECU 105 million) was transferred from B1-2 0 6 1 to B1-3 1 2. The table includes expenditure on school milk for all years for consistency.

3. In 1997, these lines were included under B1-2 0 6 9.

4. Reconciliation to budget Chapter B1-2 0:

		1994	1995	1996	1997	1998	1999
B1-2 0	Milk and milk products	4 249	4 039	3 582	3 101	2 597	2 581
B1-2 0 4 0	deduct social assistance butter	13	11	11	9	0	0
		4 236	4 028	3 571	3 093	2 597	2 581

Note: The table excludes expenditure for butter distributed to deprived persons in the Community (B1-3 1 0 0/B1-3 5 0), expenditure for social assistance butter (B1-2 0 4 0/B1-3 1 3), and expenditure on export refunds for butter used for food aid (B1-3 3 5).

Sources: Evolution of EAGGF expenditure, DG VI, for 1994 to 1998, and EU budget for 1999.

The Court's audit

5. The Court's audit was carried out in 1998 and the first half of 1999 at the Commission and in six Member States (Germany, Belgium, Spain, France, the Netherlands and the United Kingdom). It centred on the management of the measures and it included an appreciation of the cost-effectiveness and related aspects of the efficiency of the measures. The observations of the Court are based on an examination of the systems involved and the testing of the key controls as well as on the examination of a number of selected transactions. Particular attention was paid to the butter for pastry measure which accounted for 87 % of the expenditure on disposal measures in 1998. The disposal measures for butterfat were previously audited by the Court in 1989⁽⁸⁾. The Court commented at that time on the complexity of the measures and on the need to increase the frequency of on-the-spot checks and to improve their central monitoring.

THE MILK CMO AND THE BUTTER SURPLUSES

The milk CMO

6. The CMO for milk was set up under Council Regulation (EEC) No 804/68⁽⁹⁾. Intervention measures to deal with production surpluses centre on butter and cream (for the fat content of the milk) and on skimmed-milk powder and casein (for the protein content of the milk)⁽¹⁰⁾. There is also aid for the private storage of certain cheeses under certain conditions and in certain regions.

7. The milk price support system led to substantial overproduction and increasing expenditure in the past. Milk quotas were implemented from 1984 in order to control milk production and, indirectly, limit the production of butter and skimmed milk powder, the two products into which all milk surpluses are eventually transformed. However, as quotas were established on the basis of historical production, the surplus situation has never been solved.

8. The Court has underlined, notably in its Opinion No 10/98 on the Commission's Agenda 2000 CAP reform proposals⁽¹¹⁾, that the current levels of guaranteed prices and milk quotas inevitably lead to a surplus of milk and milk products and consequent recourse to intervention⁽¹²⁾. Furthermore, the Court has recently highlighted that only 35 % of skimmed milk powder (SMP) is sold without EU subsidies and aid is also paid for a further 395 000 tonnes of SMP-equivalent transformed into casein, resulting in annual EU expenditure of around ECU 1 050 million⁽¹³⁾.

9. Initially adopted for a period of five years from 1984, the milk quota system was extended to the year 2000⁽¹⁴⁾. A further prolongation to the year 2008, accompanied by an increase of the quotas of up to 2,4 % together with a 15 % reduction of the intervention price, has been decided in the context of the Agenda 2000 CAP reform. Assuming that the current product mix does not change, the additional quotas will lead to increased annual butter production of 44 000 tonnes⁽¹⁵⁾.

The EU butter surplus

10. According to the Commission's services, there is a slight increase in demand for milk products each year, mainly due to the growth of the population, but the EU still produces more milk and milk products than it consumes. In terms of milk-equivalent, milk delivery as a whole exceeds consumption by 11 %, or by 20 % if one excludes subsidised consumption⁽¹⁶⁾.

11. The market situation for butter has been relatively stable in recent years. This has been mainly due to the introduction of milk quotas and less attractive rules and prices for public storage. Public intervention stocks decreased from a high of 1 300 000 tonnes at the end of 1986, to 3 000 tonnes at the end of 1998. The current market situation is characterised by:

- (a) stabilised butter production since 1995, at a level of between 1,8 and 1,9 million tonnes per annum⁽¹⁷⁾;
- (b) a relatively stable level of aided private storage of butter, totalling some 180 000 tonnes contracted in 1998⁽¹⁸⁾;
- (c) stable consumption of between 1,7 and 1,8 million tonnes per annum since 1995⁽¹⁹⁾;
- (d) a continuing surplus of exports over imports.

12. Despite the relative stabilisation of the market, the proportion of consumption which is subsidised by disposal measures has not been reduced and remains at approximately 500 000 tonnes, or 25 % of the total available on the EU market. Per capita consumption of butter (4,7 kg), though relatively stable in the 1990s, has never recovered from the 15 % decrease⁽²⁰⁾ during the second half of the 1980s which mainly affected countries where per capita butter consumption was high, such as Belgium, Denmark, Ireland and Finland, see *Table 3*. A further decrease in per capita consumption of 1 % annually is forecast, to 4,5 kg by 2001 and 4,3 kg by 2003⁽²¹⁾. This decrease cannot be compensated by the expected increase in EU population so that total consumption of butter in the EU is expected to decrease annually by 0,8 %.

Table 3

Butter consumption per capita in the EU

	1984	1991	1994	1995	1996	1997	1998
Belgium	8,58	7,91	6,63	6,12	6,11	6,10	6,08
Denmark	11,85	8,14	5,95	5,00	4,74	4,44	4,06
Germany	7,24	6,90	6,88	7,15	7,26	7,21	7,20
Greece	0,71	0,98	1,06	0,96	0,96	0,86	0,86
Spain	0,46	0,43	0,43	0,55	0,64	0,56	0,53
France	9,55	8,26	8,64	8,65	8,05	8,19	8,07
Ireland	11,18	3,86	3,77	3,73	3,71	3,70	3,68
Italy	2,28	2,43	2,21	2,24	2,27	2,30	2,34
Luxembourg	13,67	5,98	5,49	5,41	5,33	5,26	5,23
Netherlands	3,89	3,33	3,32	3,50	3,42	3,34	3,33
Portugal	0,83	1,54	1,54	1,51	1,51	1,51	1,51
United Kingdom	5,14	3,87	4,20	4,09	4,31	4,32	4,39
EU-12 average	5,30	4,68	4,70	4,74	4,71	4,71	4,70
Austria	4,84	4,42	4,18	4,48	4,59	4,57	4,56
Finland	10,37	6,06	5,24	5,14	4,69	4,53	4,27
Sweden	7,18	5,03	5,90	4,95	4,35	4,52	4,51
EU-15 average	5,40	4,70	4,72	4,74	4,70	4,70	4,68

Source: Commission DG VI.

Table 4

Butter and butteroil import/export summary

Notes		1995	1996	1997	1998
	<i>GATT commitments</i>				(million ECU)
1	GATT expenditure commitment	1 392	1 303	1 214	1 126
2	Actual expenditure	542	300	610	420
1	GATT quantity commitment	487 800	470 100	452 400	434 700
	<i>Actual exports</i>	215 428	184 021	216 316	(tonnes) 162 489
	Main countries of export:				
	Russia	75 899	30 900	81 555	29 145
	Saudi Arabia	17 388	17 530	15 505	16 333
	Baltic Republics	3 572	5 302	14 482	3 992
	Lebanon	5 631	5 462	5 063	5 155
	Syria	5 059	5 638	5 330	3 397
	Singapore	5 127	5 799	5 875	6 457
	Egypt	9 938	24 107	4 740	15 336
	Mexico	6 126	6 332	7 116	4 528
	Morocco	4 636	7 295	4 238	7 849
	United Arab Emirates	4 767	4 282	3 143	3 094
	Other countries	77 285	71 374	69 269	67 203
	<i>Actual imports</i>	66 941	83 143	76 694	(tonnes) 71 213
	Main countries of import:				
3	New Zealand	59 402	70 258	62 819	60 211
3	CEEC countries				
	Estonia	371	783	2 244	944
	Latvia	100	983	1 558	1 230
	Lithuania	688	1 287	1 527	1 560
	Czech Republic	1 109	1 600	1 496	1 974
	Hungary	337	58	19	274
	Poland	1 277	1 514	1 547	809
	Slovakia	190	498	669	639
	Other countries	3 467	6 162	4 815	3 572

Notes

1. GATT Uruguay Round export commitments, for year ending 30 June.

2. Evolution of EAGGF expenditure, DG VI.

3. Imports from CEEC and New Zealand qualify for preferential rates of duty.

NB: This table shows the actual import/export figures of the calendar year. They differ from the Commission's estimate for the overall market balance shown in Table 1.

Source: Actual imports and exports: Regime 1 normal trade statistics, Commission DG VI.

Evolution of EAGGF expenditure, GATT commitments.

The external butter market

13. Annual EU exports of butter exceed imports on average by 120 000 tonnes per year (see *Table 4*). The external market contributes therefore to the stabilisation of the EU butter market although world market prices for butter are below the European price level: at the end of 1998, world market prices for butter were around ECU 1 480 per tonne fob, while prices in the EU Member States varied between ECU 3 060 and ECU 3 460 ⁽²²⁾ per tonne. Almost all exports of butter and butteroil from the EU are dependent on EU export refunds ⁽²³⁾. The level of export refunds for butter declined from ECU 1 932 per tonne on 1 January 1995 to ECU 1 700 ⁽²⁴⁾ in November 1997, in line with an increase in world market prices.

14. Subsidised exports are running at less than half of the maximum volume permitted under the EU's GATT/WTO commitments ⁽²⁵⁾. The resulting expenditure on export refunds (ECU 420 million in 1998) is also less than half of the maximum amount permitted. The WTO commitments would give scope to increase subsidised exports if market opportunities could be found. However, it is questionable whether real outlets exist for increased exports of EU butter, given the current competitive situation and oversupply on the world market ⁽²⁶⁾.

15. Imports of butter and butteroil to the EU are subject to payment of duty. The full rate of import duty declined from ECU 2 780 per tonne on 1 January 1995, to ECU 2 250 in July 1998. However, in practice, over 80 % of such imports take place within

the framework of the preferential agreement with New Zealand ⁽²⁷⁾. A further 10 % is covered by preferential agreements with Poland, the Czech Republic, Slovakia, Estonia, Latvia and Lithuania.

16. On 31 December 1998, the preferential duty on New Zealand butter was ECU 868,80 per tonne (since 1 July 1995) and ECU 450,20 for butter from the central and east European countries. Aid rates for the disposal measures, for which imported butter is eligible, exceed preferential import duties.

The relative importance of the different disposal measures

17. The EU uses the following measures and exchange mechanism to deal with butterfat surpluses:

- (a) public storage, if market prices for butter fall below a guaranteed price level;
- (b) aid for private storage of butter taken into store between 1 April and 15 August (for 1998) ⁽²⁸⁾;
- (c) an exchange mechanism with third countries, with import duties, export refunds and control of trade by licences;
- (d) 'disposal measures', financed by the EU when surpluses of milk products build up, or are likely to occur. The cost of these measures is outlined in the following table:

Regulation/measure	Expenditure 1998 (million ECU)	Average cost per tonne disposed of in 1998 (ECU per tonne)
Regulation (EC) No 2571/97 — 'butter for pastry'	511	1 151
Regulation (EEC) No 429/90 — 'concentrated butter for direct consumption'	26	1 422
Regulation (EEC) No 2191/81 — 'non-profit organisations'	47	1 577

18. Council Regulation (EEC) No 1723/81 ⁽²⁹⁾ indicates the types of disposal measures for which specific Commission Regulations apply ⁽³⁰⁾. *Table 5* shows the quantities disposed of under each measure in the last five years. The disposal measures are particu-

larly significant for France, Germany, Belgium, the United Kingdom and the Netherlands, which account for over 92 % of the expenditure (see *Table 6*).

Table 5
Importance of the disposal measures

Quantities of butter involved under the disposal measures

(1 000 t)

	Regulation	Description	1994	1995	1996	1997	1998
	570/88 & 2571/97	Sales to the food industry					
		Pastry	352	341	339	344	360
		Ice cream	99	89	73	90	84
		Sub total	451	430	412	434	444
	2191/81	Non-profit organisations	37	37	39	33	30
	429/90	Concentrated butter	22	23	20	24	18
		Total (see notes 1 and 2)	510	490	471	491	492

Cost of butter disposed of

(million ECU)

Budget line	Regulation	Description	1994	1995	1996	1997	1998
	570/88 & 2571/97	Sales to the food industry					
B1-2 0 4 9-0 0 1+ 0 0 7		Pastry	435	395	428	420	413
B1-2 0 4 9-0 0 2		Ice cream	118	131	115	101	98
		Sub total	553	526	543	521	511
B1-2 0 4 9-0 0 3	2191/81	Non-profit organisations	64	54	52	47	47
B1-2 0 4 9-0 0 4	429/90	Concentrated butter	40	38	30	31	26
		Total	656	618	625	598	584

Cost per tonne of butter disposed of

(ECU)

Budget line	Regulation	Description	1994	1995	1996	1997	1998
	570/88 & 2571/97	Sales to the food industry					
B1-2 0 4 9-0 0 1+ 0 0 7		Pastry	1 236	1 159	1 262	1 221	1 147
B1-2 0 4 9-0 0 2		Ice cream	1 191	1 469	1 573	1 117	1 169
		Average	1 226	1 223	1 317	1 199	1 151
B1-2 0 4 9-0 0 3	2191/81	Non-profit organisations	1 719	1 465	1 331	1 412	1 577
B1-2 0 4 9-0 0 4	429/90	Concentrated butter	1 818	1 635	1 520	1 288	1 422
		Total	1 287	1 260	1 327	1 218	1 187

Differences in totals due to roundings.

Notes:

1. 'Quantities disposed of' in this context do not include butter disposed of under the social assistance and deprived persons schemes, which are not considered as market disposal measures. The quantities involved for these schemes are:

	1994	1995	1996	1997	1998
Social assistance butter (Regulation (EEC) No 2990/82)	8	8	7	5	4
Deprived persons (Regulation (EEC) No 3149/92)	5	11	16	11	0
	13	19	23	16	4

Total butter equivalent disposals are the sum of these social schemes, and the above market disposal measures:

	1994	1995	1996	1997	1998
Social schemes	13	19	23	16	4
Market disposal measures	510	490	471	491	492
Total butter equivalent disposed of	523	509	494	507	496

2. The quantities for 'Total butter equivalent disposed of' are different from those in the overall market balance sheet (row 8 at Table 1), because the latter excludes dairy fats disposed of in the form of cream under Regulation (EC) No 2571/97. The two sets of figures are reconciled as follows:

	1994	1995	1996	1997	1998
Total butter equivalent disposed of	523	509	494	507	496
less dairy fat disposed of in the form of cream	17	23	24	29	32
Aided consumption, per overall market balance sheet	506	486	470	478	464

Source: Commission DG VI, spreadsheet entitled 'Butter disposal measures' bal.xls, Evolution of EAGGF expenditure, Commission DG VI.

Table 6

Expenditure on disposal measures in 1998 by category and Member State

(million ECU)

Budget heading	B1-2 0 4 0 0 0 1	B1-2 0 4 0 0 0 2	B1-2 0 4 0 0 0 7	Subtotal	B1-2 0 4 0 0 0 4	B1-2 0 4 0 0 0 3	Total B1-2 0 4 0	
	Regulation (EC) No 2571/97 and Regulation (EEC) No 570/88 Butterfats for pastry	Regulation (EC) No 2571/97 and Regulation (EEC) No 570/88 Butterfats for ice cream	Regulation (EC) No 2571/97 and Regulation (EEC) No 570/88 Butterfats for food preparat.	Regulation (EC) No 2571/97 and Regulation (EEC) No 570/88 Subtotal	Regulation (EEC) No 429/90 Concentrated butter for direct consumption	Regulation (EEC) No 2191/81 Butter for non-profit organisations	7=4+5+6	(%)
	1	2	3	4=1+2+3	5	6	7=4+5+6	(%)
Member State								
Belgium	76,8	12,0	0	88,8	3,1	0,8	92,7	15,9
Denmark	0,1	1,8	0,2	2,1	0,0	0,7	2,8	0,5
Germany	37,3	23,9	0	61,2	13,5	23,6	98,3	16,8
Greece	0,3	1,3	0,3	1,9	0,6	0,0	2,5	0,4
Spain	4,7	2,1	0	6,8	0,0	0,0	6,8	1,2
France	171,5	21,3	0	192,8	0,9	15,9	209,6	35,9
Ireland	3,2	1,3	0	4,5	0,0	0,4	4,9	0,8
Italy	6,9	3,6	0	10,5	2,6	0,4	13,5	2,3
Luxembourg	0,1	0,1	0	0,2	0,0	0,1	0,3	0,1
Netherlands	47,4	14,8	0	62,2	1,0	0,5	63,7	10,9
Austria	0,8	0,0	0	0,8	0,8	1,0	2,6	0,4
Portugal	0,0	0,9	0	0,9	0,0	0,0	0,9	0,2
Finland	3,6	4,0	0	7,6	0,0	0,0	7,6	1,3
Sweden	1,6	2,9	0	4,5	0,0	0,0	4,5	0,8
United Kingdom	58,1	8,2	0	66,3	3,1	3,9	73,3	12,6
Total	412,4	98,2	0,5	511,1	25,6	47,3	584,0	100,0

Source: Commission, DG VI.

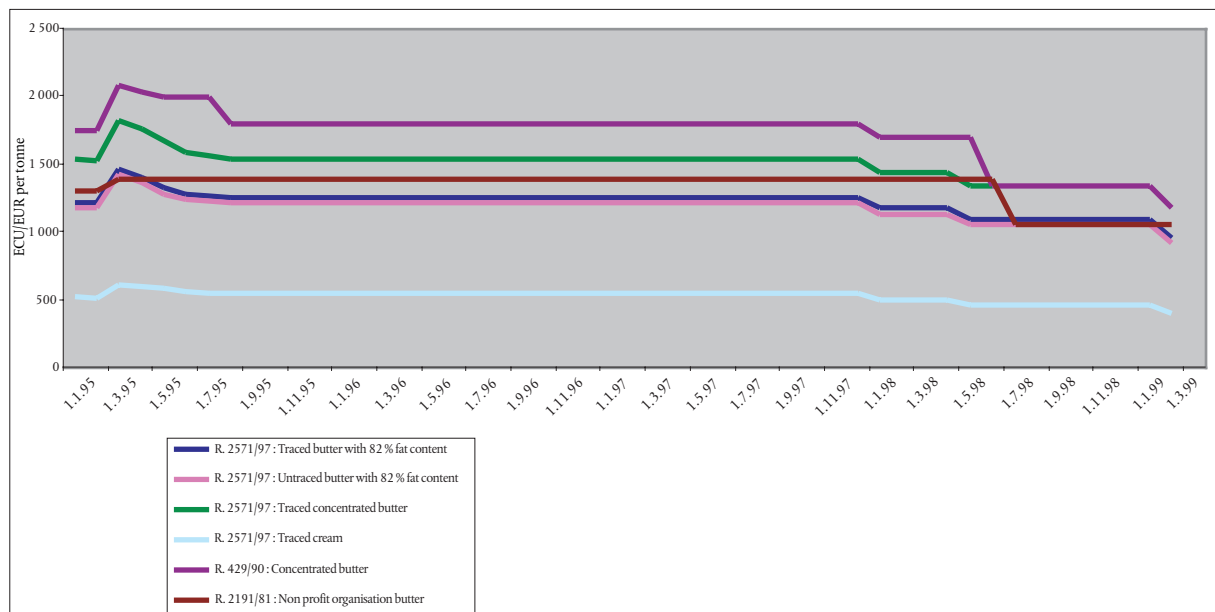
19. 'Butter for pastry' is the most important disposal measure and accounted for the disposal of 444 000 tonnes in 1998, for which EU aid of ECU 511,1 million was paid. Its objective is to encourage the use of butterfat instead of other fats by the food-processing sector. Subventions are paid for the use of cream, butter and concentrated butter in the manufacture of pastry products, ice creams and other foodstuffs. There are particular formulae set out in Commission Regulation (EC) No 2571/97 to take into account the different types of products for which butterfat is used⁽³¹⁾.

20. The measure 'butter for direct consumption' provides aid for concentrated butter intended for direct consumption. It accounted for the disposal of 18 000 tonnes in 1998 for which EU aid of ECU 25,6 million was paid, more than half of it in Germany. The products covered are mainly used by final consumers for the preparation of food⁽³²⁾.

21. The measure 'butter for non-profit organisations' provides for subsidies for the use of butter at reduced prices by institutions and non-profit organisations and accounted for the disposal of 30 000 tonnes in 1998 for which EU aid of ECU 47,3 million was paid, mainly in Germany and France.

22. Different management and control systems apply for the three measures and different aid rates apply for butter, concentrated butter and cream. Aid rates for traced products⁽³³⁾ are higher than for untraced products. The overall aid level has been reduced during recent years, due to more favourable market conditions, but it still corresponds to some 30 % of the market price of butter. Figure 1 shows the recent evolution of aid rates.

Figure 1
DEVELOPMENT OF ACCEPTED AID RATES, 1995 TO 1999



Aid rates per tonne						
Regulation	2571/97	2571/97	2571/97	2571/97	429/90	2191/81
Type of aid	Traced butter with 82 % fat content	Untraced butter with 82 % fat content	Traced concentrated butter	Traced cream	Concentrated butter	Non-profit organisation butter
1.1.1995	1 210	1 180	1 530	520	1 750	1 300
1.4.1995 (°)	1 400	1 360	1 760	600	2 030	1 390
1.7.1995	1 260	1 220	1 560	540	1 990	1 390
1.10.1995	1 250	1 210	1 540	540	1 790	1 390
1.1.1996	1 250	1 210	1 540	540	1 790	1 390
1.4.1996	1 250	1 210	1 540	540	1 790	1 390
1.7.1996	1 250	1 210	1 540	540	1 790	1 390
1.10.1996	1 250	1 210	1 540	540	1 790	1 390
1.1.1997	1 250	1 210	1 540	540	1 790	1 390
1.4.1997	1 250	1 210	1 540	540	1 790	1 390
1.7.1997	1 250	1 210	1 540	540	1 790	1 390
1.10.1997	1 250	1 210	1 540	540	1 790	1 390
1.1.1998	1 170	1 130	1 440	500	1 690	1 390
1.4.1998	1 170	1 130	1 440	500	1 690	1 390
1.7.1998	1 090	1 050	1 340	460	1 340	1 050
1.10.1998	1 090	1 050	1 340	460	1 340	1 050
1.1.1999	1 090	1 050	1 340	460	1 340	1 050
1.4.1999	950	910	1 170	400	1 170	1 050

Source: Court of Auditors analysis of documents provided by Commission DG VI.

(°) The increase shown in the aid rate for the first quarter of 1995 is not an effective increase but is due to the adjustment of the green rate mechanism.

OBSERVATIONS RELATING TO THE DISPOSAL SCHEMES

Fixing the level of aid

23. While the aid rates for the measure 'butter for non-profit organisations' are fixed by Commission Regulation ⁽³⁴⁾, the amount of Community aid for the other disposal measures ('butter for pastry' and 'direct consumption') is determined by public tender. In the context of these tenders, which are organised twice monthly by the intervention agencies in the Member States ⁽³⁵⁾, tenderers have to state for each product included in their bid the aid rate required ⁽³⁶⁾, the quantity they propose to process, and which of the product formulae permitted by the Regulation will be followed.

24. Bids have to be submitted together with the written undertaking stipulated by the Regulations and a tendering security of ECU 350 per tonne for 'butter for pastry' or ECU 181 per tonne for 'butter for direct consumption'. The Commission fixes a maximum aid rate for each tendering procedure up to which bids are accepted. The corresponding decision is published in the *Official Journal of the European Communities* after each tendering date.

25. The audit has shown that the tendering system operates in a particular way. In practice, tenderers are specialised companies, very few in number (little more than 10 in most Member States visited, 35 in Germany and 50 in France). The stability of the aid level means that the tenderers can readily estimate the likely aid level that the Commission will accept and make their quantitative bids accordingly. As a result, almost all bids are at the maximum aid level and thus there is no competition on aid, which adversely affects the efficiency of the tendering procedure. The Commission therefore manages the scheme not by determining each time the least possible aid level but by monitoring the quantities for which tenders were submitted. If there is a particular increase in quantities tendered exceeding the overall demand pattern per period (this happens notably when the industry fears that the Commission is likely to reduce the aid rates), the Commission may determine a lower aid level.

26. The Commission balances the accepted bids for quantities up to the annual target quantity of 500 000 tonnes for the three disposal measures. Although the Commission was successful in reducing the aid rates several times (most recently in January 1999) there is no established formal approach or set of calculations justifying the fixing of a particular aid level. The Commission tries to avoid abrupt modifications of aid rates because it fears that this could make the use of butterfat less attractive for the industry. However, if market forces were fully allowed to play their role, the aid level could be further reduced.

27. However, there are additional tools the Commission uses to obtain compliance between tendered quantities and the monthly demand pattern for the target quantities. The Commission can increase the amount of the required tendering security (which increased for 'butter for pastry' from ECU 180 per tonne to ECU 350 per tonne in 1998). Furthermore, the Commission can shorten the deadline for the processing and incorporation of subsidised butterfats into final products following the closing date for the submission of tenders. This deadline, initially set at six months, has been modified several times, and is currently set at four months. A reduction of the deadline has the impact that beneficiaries can only bid for a relatively short period and therefore they reduce the quantities for which aid is requested. In addition, certain industries, such as ice cream manufacturers, who plan their production and retail prices for the whole summer season ⁽³⁷⁾, cannot count on a given aid level for the whole period of the campaign.

Quality requirements

28. Quality requirements for butter and for the products eligible for the granting of the aid are not harmonised with those for storage ⁽³⁸⁾. Furthermore, Article 1(2) of Commission Regulation (EC) No 2571/97 ('butter for pastry') stipulates detailed quality requirements for butter and cream only if taken from the market ('beurre du marché') ⁽³⁹⁾. However, there are no quality requirements at all for butter and cream used for the production of concentrated butter. As a consequence, all sorts of butter can benefit from the aid, if converted into concentrated butter. Likewise, Commission Regulation (EEC) No 429/90 ('direct consumption') does not stipulate quality requirements for the cream or butter used for the production of concentrated butter.

29. The audit revealed that low quality butter, such as whey butter, crude butter and various spreadable milk fats with different fat contents are used for the production of concentrated butter ⁽⁴⁰⁾. Whey is a by-product of cheese production and as such, it is not eligible for EU subsidy. However, from whey, butter ⁽⁴¹⁾ can be produced which is used for the production of concentrated butter and, in this manner, whey can qualify for EU subsidies. Besides, since 1993 an amendment to Commission Regulation (EEC) No 570/88 as well as the new Commission Regulation (EC) No 2571/97 allow the use of concentrated butter for the production of 'recombined butter' ⁽⁴²⁾ without losing the aid.

30. To the extent that low grade ingredients are being used by claimants as substitutes for quality butter and cream the contribution of the EU subsidy to the overall balance of the butter market is weakened.

Payment of the aid for imported butter

31. Whereas under the 'direct consumption' measure the cream or butter used for the manufacture of concentrated butter must be

of European origin, the 'butter for pastry' measure does not impose a similar condition.

32. Butter imported under preferential regimes, notably from New Zealand, can be and is used to produce concentrated butter⁽⁴³⁾ which is fully entitled to EU aid under the 'butter for pastry' disposal measure. This is an attractive option which avoids packaging and distribution arrangements and costs associated with retail sales. Furthermore, the concentrated butter is also eligible for export refunds under the regime for non-Annex II products⁽⁴⁴⁾. The use of imported butter is therefore profitable because the product can be bought at world market prices and the aid receivable is higher than the import duties to be paid. In effect, the EU is providing a net subsidy for the use of butter imported at preferential rates which displaces demand for EU-produced butter.

33. The 'butter for pastry' measure creates an attractive market for imported butter, and is therefore counterproductive to the objective of balancing the European milk market. The Court has already commented on this situation in its Special Report No 4/98⁽⁴⁵⁾ and calculated that the annual net cost to the EU budget for the disposal of New Zealand butter amounts to ECU 7,7 million. In its reply the Commission stated that 'New Zealand butter forms part of the supply and, from a management point of view, it is not relevant which butter is used for industrial purposes. The Commission has always estimated the cost of the butter concession to New Zealand as the sum required to export an equivalent quantity of butter to third countries less the reduced levy/duty paid on import'. However, the Management Committee for Milk and Milk Products has twice rejected Commission proposals to exclude this butter from the scheme⁽⁴⁶⁾.

34. The Council, in its discharge decision on the budget year 1997⁽⁴⁷⁾, has recommended inserting a clause requiring products to have European origin in the context of Commission Regulation (EEC) No 570/88 (since replaced by Commission Regulation (EC) No 2571/97). The Court also suggests a corresponding clause in Council Regulation (EEC) No 1723/81, authorising the disposal measures. In addition, the aid for 'butter for non-profit organisations' should also be limited to quality butter of European origin.

Particular health aspects

35. Both the 'direct consumption' and 'butter for pastry' disposal measures stipulate the adding of tracers to the products⁽⁴⁸⁾ for control reasons. Tracers include substances which provide a specific aroma such as those obtained from vanilla or from synthetic vanillin, substances to add colour, such as those obtained from carotene, and a number of other substances that are obligatory for the chemical tracing of the products.

36. Tracers were introduced some 20 years ago but the Commission could not provide evidence that the substances were subjected to prior testing and approval in respect of their possible toxicological risk.

37. The Commission argues that these tracers have been considered to be harmless for human consumption, since no Member States have forbidden their use and since it was not informed about any problems with the existing tracers. Furthermore, the declaration of the presence of tracers in the final food is generally not required if the content of butter, butter concentrate or cream in the final product does not exceed 25 %⁽⁴⁹⁾.

38. According to an expert's opinion (Bundesinstitut für gesundheitlichen Verbraucherschutz of the German Federal Ministry of Health) some of the substances foreseen as tracers by Commission Regulation (EC) No 2571/97 give rise to a health risk. The Commission should review this file and take appropriate initiatives to assure that prior testing and approval procedures are adopted. The introduction of provisions requiring the declaration of the presence of tracers should be required in accordance with the principle of consumer information and protection.

Value added tax (VAT) on EU subsidies

39. Apart from the general provisions laid down in the sixth VAT Directive⁽⁵⁰⁾, so far there has not been any specific EU legislation concerning VAT on subsidies paid in the context of the disposal measures.

40. In most Member States visited by the Court the VAT rate on subsidies for butterfat is effectively zero. Either the subsidies are exempt from VAT taxation (Spain), the VAT on butter and consequently on the aid is zero rated (United Kingdom) or the VAT is compensated by a national subsidy (France). On the other hand, in Belgium and Germany, VAT must be paid on the subsidy for 'butter for non-profit organisations'. In Germany, VAT on EAGGF subsidies for 'butter for pastry' was also paid by a beneficiary visited in Bavaria but not by beneficiaries in the *Land* of Lower Saxony.

41. The different treatment of EU subsidies for butterfat breaches the principle of equal treatment and undermines the general purpose of the subsidies. Moreover, the Commission should seriously reflect on the implications of EAGGF subsidies not reaching the beneficiaries in full.

Particular weaknesses affecting Commission Regulation (EC) No 2571/97 ('butter for pastry')

Complex rules

42. Commission Regulation (EC) No 2571/97, applicable from January 1998, replaced Commission Regulation (EEC) No 570/88 which was modified several times and needed updating (see paragraph 5). However, the new Regulation is still complicated, because it combines rules for several products, taken either from the market or from public storage, and establishes complex procedures in order to avoid, as much as possible, incorrect use of the aid.

43. The payment of the aid to the tenderers — who are, in most cases, butter suppliers — is governed by detailed rules concerning the approval of establishments, production controls and the movement of products from the initial processing stages to the various end-users of subsidised butterfat.

44. Each successful tender must be inspected at least once. In order to minimise the financial risk in case of irregularity, tenderers split up their bids into smaller quantities, which implies a multiplication of controls and inspections by the Member States. The Commission should consider increasing the minimum tendering quantity of 5 tonnes set by Article 16(4)(b) of the Regulation.

45. There are various authorised uses for butterfats in different products, involving various production processes and specific rules for the control of the incorporation of butterfats into the final product, ranging from large industrial groups to small corner bakeries. Descriptions of formulae and final products are complicated and sometimes not even logical (for example, for ice cream, chocolate coatings are eligible for the use of subsidised butterfat but not the chocolate coating of a praline though some pralines' contents may, nevertheless, be eligible). Rules should be simplified by concentrating on key product groups and should at least correspond to the codes of the Combined Nomenclature to which the Regulation refers (for ice cream and preparations a minimum fat content of 4,5 % is required by the Regulation but the code to which it refers allows a minimum fat content of 3 %).

Monitoring deficiencies

46. Expenditure on 'butter for pastry' is concentrated in Belgium, France, Germany, the Netherlands and the United Kingdom. However, this does not necessarily reflect where butter is processed and incorporated, because the butter accepted by tender in one Member State (where the aid is paid) may be sent to another Member State for concentration and might be sent to a

third Member State for incorporation into the final product. The complex trade patterns do not allow verification of the quantities processed and finally incorporated in the Member States. Furthermore, no information is available about the use of the subsidised butterfat by category of final products, other than the two global formulae A (all products other than ice cream) and B (ice cream).

47. In 1998, Commission Regulation (EC) No 2571/97 introduced a reporting system under which Member States are required to report, periodically, a set of statistical data and information⁽⁵¹⁾. Some Member States were slow in providing information (notably Greece, France and Italy). As a result, the reporting system has only properly functioned since autumn 1998. For its part the Commission was slow in evaluating the results. By April 1999 the Commission's services had not yet evaluated the information received. Such information could have been used to make better informed decisions on, for example, targeting the aid for appropriate end uses or reducing aid levels.

Particular weaknesses affecting Commission Regulation (EEC) No 2191/81 ('butter for non-profit organisations')

48. The disposal measure 'butter for non-profit organisations' provides aid for up to 2 kg of butter per month per eligible consumer (i.e. persons to whom meals are served) but most non-profit organisations buy less. Although the non-profit organisations are considered as beneficiaries, the aid is paid to the suppliers, who have to present, with their aid request, the original documents proving delivery. This leads to a clerical burden for the paying agency, which has to check the compliance of each delivery document with the quantities claimed.

49. This procedure should be simplified by dropping the requirement to send in the documents proving delivery. In this case the Regulation would have to include precise rules requiring checks based on risk analysis and adequate representative sampling of transactions to be inspected. Such rules do not exist at the moment. Many suppliers offer the possibility of the sale of price-reduced butter to beneficiaries only in the hope of selling other products as well, and it is against this background that they take on the heavy administrative burden involved.

50. By its nature the measure is a social rather than a disposal one. The Commission should consider its transfer to budget heading B1-3 1 (Food aid) which applies already for the aid for school milk. A direct payment of the aid to the non-profit organisations could be envisaged, linked to the fixing of minimum quantities to exclude 'mini-cases'.

ADMINISTRATIVE WEAKNESSES ENCOUNTERED IN MEMBER STATES

Control weaknesses

51. The disposal measures for butterfat have been operating for 30 years. Despite their complexity, authorities of Member States are generally well aware of the regulatory requirements and have made enough staff available for the administration of the measures. Nevertheless, the audit identified a certain number of weaknesses, such as:

- (a) control inadequacies relating to the requirement that key processes concerning the 'butter for pastry' measure shall be carried out in approved establishments⁽⁵²⁾. In France and Spain, the approval files need to be completed. Furthermore, the periodic review of the respect of the approval conditions by the establishments, as required by the Regulation, was not adequately documented in the control reports (France, Spain, the Netherlands and the United Kingdom);
- (b) approved establishments are obliged to keep registers in order to record transactions and to facilitate controls on compliance with the conditions stipulated by the Regulation. These registers were often not kept in the format prescribed in the Regulation nor were they maintained according to generally accepted standards⁽⁵³⁾. Particular weaknesses were identified in France, Germany and Spain. National inspection services should pay more attention to these aspects because in the absence of correct registers proper control is very difficult or even impossible;
- (c) other aspects of control systems were found to be unsatisfactory:
 - (i) absence of rotation of inspectors (Belgium);
 - (ii) lack of documentary evidence of inspections and scrutiny (Belgium);
 - (iii) the absence of product samples before tracing in Belgium, the Netherlands and Spain, and a case of inadequate sample-taking in France⁽⁵⁴⁾;
 - (iv) incompleteness of certain checks⁽⁵⁵⁾ (Spain);
 - (v) weaknesses concerning inspections of non-profit organisations in respect of the corresponding disposal measure (Belgium and Germany);
- (d) Commission Regulation (EC) No 2571/97 ('butter for pastry') does not stipulate particular inspections for small end-users (in most cases local pastry makers) using less than 9 tonnes of butter equivalent or 14 tonnes of cream per year if they

submit a declaration confirming the fulfilment of their obligations⁽⁵⁶⁾ for the use of subsidised butterfat. In the view of the Court, there should be controls to ensure that the upper limit is respected, because there is a risk that it could be exceeded if small users were to issue declarations to several different suppliers. At present, in France and Germany⁽⁵⁷⁾ there are no databases recording the declarations issued by small users so that an efficient check⁽⁵⁸⁾ of compliance with this condition cannot be carried out;

- (e) the European origin of the butter used for the production of butterfat was not checked in France despite the requirements stipulated by Commission Regulation (EEC) No 429/90 (butterfat for 'direct consumption'). Besides, for a beneficiary visited in the context of the audit, the European origin of most of the butter/cream used for the production of concentrated butter could not be proved by supporting documents, such as certificates of origin or contracts or invoices indicating the origin of the butter;
- (f) for deliveries to other Member States there are fixed deadlines by which the end-use of the aided butterfats must be certified on the T 5 control copy⁽⁵⁹⁾ to the paying agency of the 'exporting' Member State. The audit revealed that the issue of the T 5 copies with the certificate of use was sometimes delayed, particularly in France, due to complex trading structures.

Inadequate application of regulations

52. Commission Regulation (EC) No 2571/97 ('butter for pastry') made possible the payment of subsidies for untraced cream, in response to the requirements of the ice cream industry. However, in France this option was not used in 1998 because of the need to introduce new specific control procedures and to conclude contracts with the establishments concerned.

53. Commission Regulation (EEC) No 2191/81 ('butter for non-profit organisations') is operated in the Netherlands in a way that does not conform with the Regulation. The paying agency is itself the butter supplier, and its declaration of expenditure, sent monthly to the Commission, is based on quantities delivered multiplied by the aid rates but not, as it should be, on real payments.

THE EFFICIENCY AND COST-EFFECTIVENESS OF THE DISPOSAL MEASURES

Determination of efficiency and cost-effectiveness

54. The current disposal measures can be considered efficient and cost-effective if they encourage maximum demand at minimum levels of aid and, in this context, the costs relating to other forms of market intervention can also be relevant.

55. The Commission assesses the success of the disposal schemes in the context of the overall dairy-fat market. As the market is stable, with low levels of intervention stocks, the management of the dairy-fat market is considered to be successful. The Commission explains the stable level of demand for butter under the scheme, despite constant aid reductions, as being due to a constant increase in the overall demand for butter. The increase in demand is limited by lower aid rates. The schemes' success is measured by the Commission against a previously determined 'target quantity' of some 500 000 tonnes per year for all three disposal measures. In fact, the justification for the disposal measures rests on the creation of additional demand for butterfats which would not otherwise be met at market prices.

56. The audit has shown that the Commission has no comprehensive information, analyses or studies on the impact of the disposal measures and on the creation of additional demand. Paragraphs 57 to 71 report on data collected suggesting that EU aid generated only limited additional demand for butter.

Factors determining demand on the internal market

Characteristics of the market

57. The market for fats is diverse, with wide variations within and between Member States and food industry segments. Different types and qualities of butterfats are used for different purposes. The use of dairy fats is traditionally rather limited in some Member States. For example, Greece, Spain and Portugal have traditionally used vegetable fats, while Belgium, Denmark, Germany and France use considerably more dairy fats per capita.

58. While many products can be made with either butter or vegetable fats (or a mix of fats) some require, by their nature, by tradition or for marketing reasons, the use of butter. For example, 'Gallettes' from Brittany, 'Stollen' from Germany, or 'butter shortbread' from Scotland require butter, if produced in the traditional way. In such cases, there is no risk of substitute products being used.

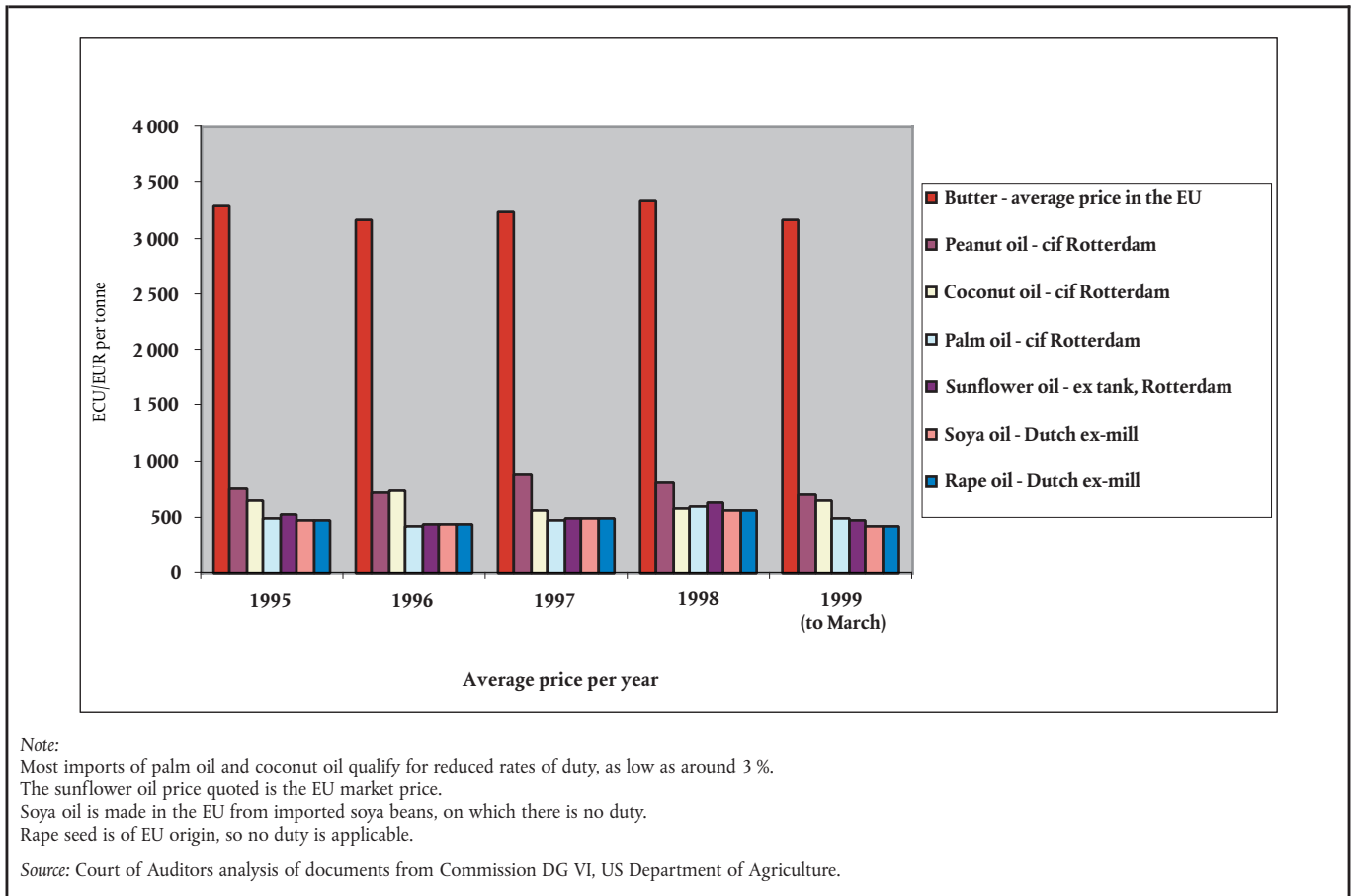
59. The choice of whether to use butter or not is also marketing-driven. Expensive premium products sometimes contain more butterfat, while mass market products — where price is the determining factor — might contain more vegetable fats. In addition there are recognised brands where the use of dairy or non-dairy fats is irrelevant to their successful marketing. Finally, the use of vegetable-based fats for some products could be determined by health considerations.

60. Where producers currently use butterfats, they are to an extent committed to using butter in the short to medium term, since switching to vegetable fats would require investment and changes in production and marketing strategies. However, once they make the switch to non-butterfats, it is unlikely that they will return quickly to butter-based products, unless required by the market.

Competitive position of butter in relation to other fats

61. Although margarine may also be produced on the basis of animal fats, vegetable fats are the main substitutes for butter in the food industry. Palm oil ⁽⁶⁰⁾ and coconut oil ⁽⁶¹⁾ are particularly of interest for the ice cream industry, while vegetable margarine is the main butter substitute for the pastry industry ⁽⁶²⁾. While the price for 82 % fat content butter is EUR 3 053 per tonne, competing fats are still much cheaper than butter and concentrated butter, even after including aid (see Figure 2).

Figure 2
BUTTER PRICE COMPARED WITH VEGETABLE FAT PRICES



62. The price of vegetable oils, such as refined palm oil, can be estimated at about EUR 700 per tonne⁽⁶³⁾ while the price range for vegetable margarine is about EUR 1 000 to EUR 1 050 per tonne.

63. Butter is expensive when compared to alternative fats. Therefore, the existing level of aid does not provide significant incentive for using butter, if price is the main consideration. Producers using butterfat consider that the higher price of butter is compensated for by consumer preference, allowing for selling prices and/or quantities which compensate for higher production costs. In the light of the enormous difference in prices between butterfats and substitute vegetable fats, the risk that producers would switch to substitute vegetable fats if aid levels were reduced (or indeed abolished) seems low.

Impact of the aid on prices of final products

64. For most products the impact value of the subsidy paid is not significant in terms of the product's final selling price. In the case of a butter croissant, for instance, the EU subsidy would reduce its price by only FRF 0,08 (slightly more than EUR 0,01). For a premium ice cream, with a relatively high content of butter-

fat, the EU subsidy amounts to FRF 0,15 (slightly more than EUR 0,02).

65. Therefore, for products such as croissants or ice cream, which are among the most important products in terms of expenditure under the disposal measures, the existence of the aid has little effect on prices and on demand. However, there are some premium products (see paragraph 58), with a high butter content, more than 30 % in some cases, for which the retail price could be significantly affected by changes in aid rates in so far as the cost of ingredients is a determining element in the pricing of the product.

66. In practice the impact of the aid on the retail prices of products may be lower than calculated. In fact, part of the aid may be absorbed by processing costs, including packaging, the trade margin of the company, and by extra costs required for qualifying for the aid, such as the cost of adding tracers, participating in the tendering procedures and financing the related tendering and processing securities.

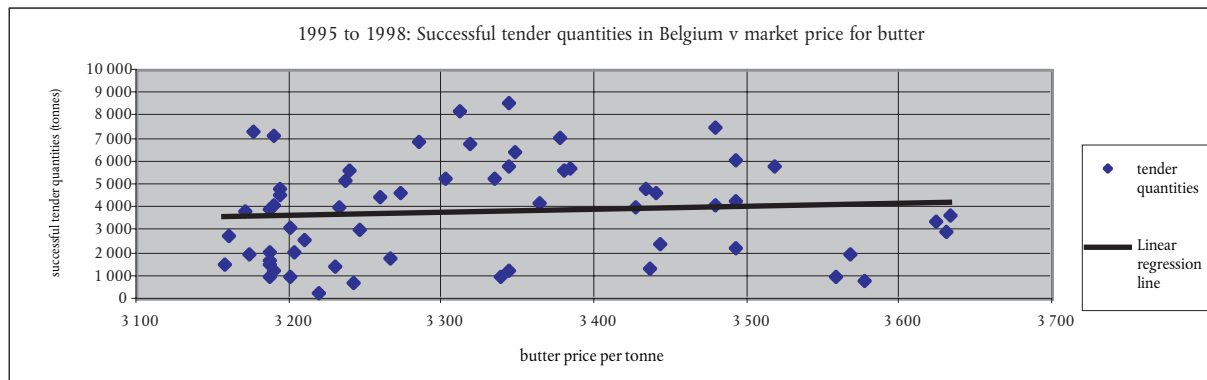
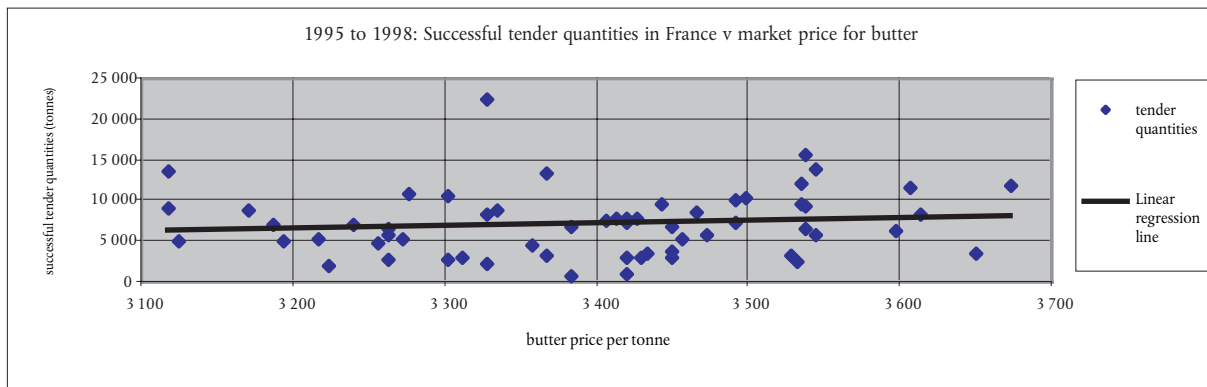
67. The above elements suggest that the impact of the aid on the prices of final products is limited and that the overall demand by final customers is not greatly influenced by the level of the aid.

The relation between demand, aid rates and market prices

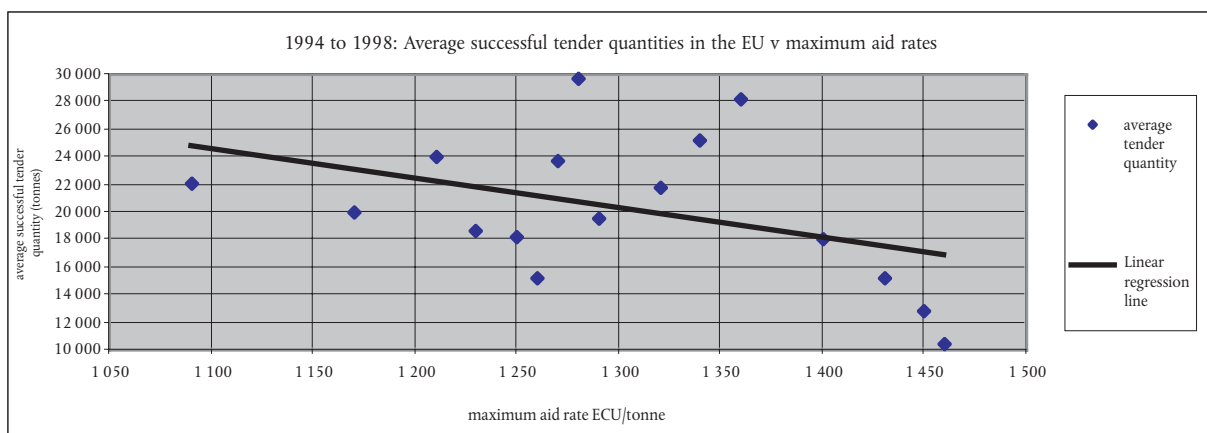
68. The aid rates for the disposal measures, other than the subsidy of butter for non-profit organisations, are determined by adjudication in the framework of tendering procedures. While highly variable from one tender to the next, the average tendered

quantities have remained stable since 1994, even though maximum aid rates have been progressively reduced by some 35 % (64). Analysis of tendered quantities in the two most important Member States for this measure (France and Belgium) also shows that demand for subsidised butterfat did not increase when market prices dropped (see Figure 3).

Figure 3
TENDER QUANTITIES IN RELATION TO MARKET PRICES AND AID RATES



In France and Belgium, there is no significant relationship between market prices for butter and demand under Regulation (EEC) No 570/88 and Regulation (EC) No 2571/97. The coefficient of correlation is 0,107 for France and 0,087 for Belgium, where 0 indicates no correlation, and 1 indicates perfect correlation.



Tender quantities have not been lower when maximum aid rates were reduced. In fact the opposite occurred — there has been negative correlation between aid rates and successful tender quantities, of -0,416, where 0 indicates no correlation, and -1 indicates perfect negative correlation.

Note: the aid rate used is for 82 % traced butter; quantities are in tonnes of butter equivalent.

Source: Court of Auditors analysis of Commission DG VI documents.

69. By contrast, for 'butter for direct consumption' demand decreased when the aid was reduced ⁽⁶⁵⁾. Likewise, the non-profit organisations — often operating on low budgets — reacted quickly to the reduction in aid rates by reducing their use of butter. However, both these measures have only a minor effect on the market, together accounting for some 10 % of the disposed quantities.

70. On the basis of the 444 000 tonnes subsidised in 1998 for 'butter for pastry', each ECU 1 reduction in the aid rate would have saved ECU 4,4 million for the EU budget ⁽⁶⁶⁾. However, the Commission does not know to what extent it could reduce the aid while still maintaining demand.

71. The demand for subsidised 'butter for pastry' has not been significantly affected by previous reductions in aid levels even when combined with other Commission measures to reduce short-term demand under the scheme by increasing the tendering security and reducing the time limit for incorporation of the subsidised butterfat into final products. The aid may therefore still be set at too high a level.

Structural factors

72. The butterfat processing industry has developed, specialised and adapted to new market conditions since the introduction of the disposal measures in 1969. Industries have also obtained the necessary know-how to comply with the complex requirements of the regulations.

73. New distribution channels and markets have also emerged ⁽⁶⁷⁾. Specialised products, based on butterfat, were developed to meet the requirements of particular production processes

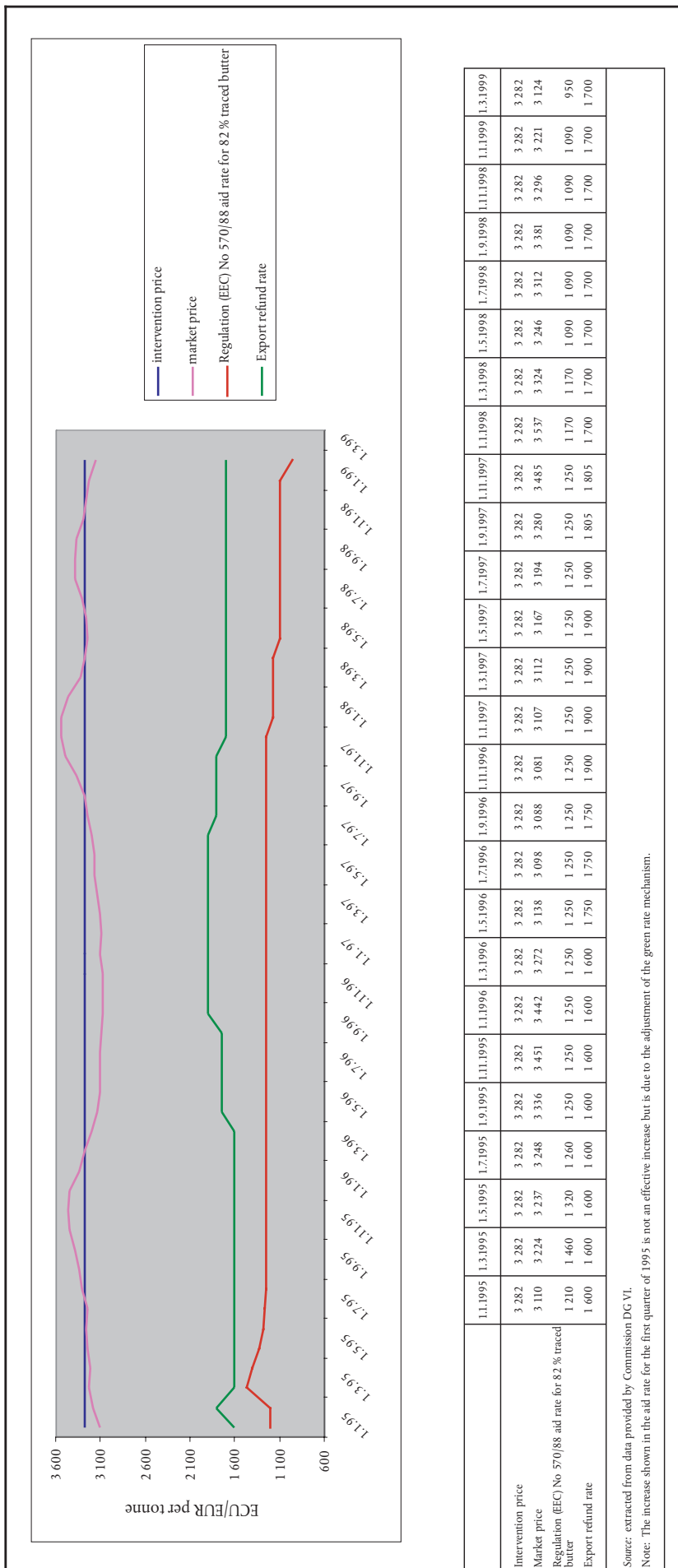
(such as fractionated butterfats ⁽⁶⁸⁾ for pastry). Meanwhile, the structure of the food industry as a whole has changed, with a growing production of prepared foods for which subsidised butterfat is often used ⁽⁶⁹⁾. The activity of the butter-processing industry in convincing the food industry of the use of butterfats must certainly be taken into consideration when evaluating the impact of the disposal measures on creating additional demand.

Comparison between disposal measures and other forms of market intervention

74. With export refunds for butter of currently EUR 1 700 per tonne, and aid for untraced 'butter for pastry' of EUR 910 ⁽⁷⁰⁾, each tonne of butter disposed of under this scheme costs EUR 790 less than butter exported with the help of export refunds. Furthermore, at the current level of refunds it is probably not possible to increase exports significantly. See *Figure 4* for a comparison of export refund rates, aid levels, average market prices, and intervention prices.

75. According to the Commission, the disposal measures are significantly cheaper than public intervention and export refunds, the other main market-management tools to deal with the butter structural surplus. In fact, 83 % of intervention stocks between 1992 and 1998 benefited from aid under the butterfat disposal measure when finally sold. As regards the comparison with export refunds, the Commission's assertion is valid to the extent that the disposal measures create additional demand. There are reasonable indications, however, that a substantial part of the butter disposed of with EU aid would have been consumed anyway (see paragraphs 63 to 67).

Figure 4
COMPARISON OF KEY BUTTER STATISTICS



Source: extracted from data provided by Commission DG VI.
Note: The increase shown in the aid rate for the first quarter of 1995 is not an effective increase but is due to the adjustment of the green rate mechanism.

Structural surplus

76. The first disposal measure, introduced in 1969 ⁽⁷¹⁾, was seen as a temporary measure, limited to sales of butter from intervention stocks to the processing industry. However, disposal measures have continued ever since. They were expanded to also include butter from private storage and cream and butter taken from the market, as well as concentrated butter, and evolved into permanent aid schemes to increase demand, notably in the food industry.

77. Considering the forecast decrease in demand during the next five years (see paragraph 12) and the level of the quotas decided in the context of the Agenda 2000 reform (see paragraph 9), no reduction in the surplus that has characterised the butter market in the last decade can be expected.

78. As well as aiming to reduce the cost of disposal measures for surplus butter to a minimum, the Commission should also consider structural measures to improve demand for non-subsidised butter and/or limiting its supply. As regards the latter, the Court has previously suggested the review of the mechanism preventing excessive fat content of milk ⁽⁷²⁾ and notes that the reduction in the guaranteed price levels has been postponed until 2005 by the European Council of Berlin ⁽⁷³⁾.

CONCLUSION

79. Introduced in 1969 on a temporary basis, the butter disposal measures developed and became permanent schemes to deal with the structural surplus of butter resulting from the overproduction which characterises the milk sector, despite the introduction of the milk quotas in 1984 (see paragraph 76).

80. Certain weaknesses relating to the regulatory provisions governing the disposal measures and to their implementation also affected the efficiency of the EU aids. Lower quality and imported

butter are eligible for EU support, aid is not fixed at its lowest possible level, and VAT is charged on EU subsidies in some Member States (see paragraphs 28 to 34).

81. Member State authorities are generally well aware of the complex requirements of the regulations and have made enough resources available for the administration of the disposal measures. However, the audit showed that improvements are necessary, notably concerning the approval and the inspection of establishments entitled to incorporate aided butter, the control of the adding of tracers and of the European origin of butter for direct consumption (see paragraphs 31 to 34 and 51 and 52).

82. The Commission has made no comprehensive evaluation of the impact of these measures on demand. However, the data collected suggests that EU aid created only limited additional demand for butter, given the considerable price advantage of competing fats and the marginal value of the aid in relation to consumer prices of most of the products into which subsidised butter is currently integrated (see paragraphs 61 to 67).

83. The persisting EU milk-production surplus is the combined result of the limited impact of the quota regime on production and the substantial reduction in per capita consumption which took place in the late 1980s. The current butter disposal measures alone are not an appropriate way to deal with structural surpluses. A reduction in the guaranteed price level combined with production control measures has to be considered (see paragraphs 7, 8 and 78).

84. The Commission should make a comprehensive assessment of the disposal measures. Meanwhile, the current tendering procedures should be revised, aid should be progressively reduced and concentrated only on quality non-imported butterfats used for products where it is likely that additional demand will in fact be created. Furthermore, alternative measures, aiming at improving demand for non-subsidised butterfats and measures to penalise the increase in the fat content of fresh milk, should be considered (see paragraphs 12, 77 and 78).

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 23 and 24 February 2000.

For the Court of Auditors

Jan O. KARLSSON

President

NOTES

- (¹) Including some 15 000 tonnes of farm butter.
- (²) Source: ZMP Bonn. Worldwide butter production is 4 065 000 tonnes. Data for 1997 compiled from various sources, including Eurostat, FAO and USDA but covering only producing countries for which detailed data are available. A substantial proportion of cow's-milk is produced in developing countries for which no details are available. The European share of total cow's-milk production, including developing countries, is about 25 %.
- (³) The total quantity available on the market consists of public and private stocks (51 000 tonnes) plus imports (90 000 tonnes) plus EU production (1 843 000 tonnes).
- (⁴) Total consumption less subsidised consumption (see also Table 1).
- (⁵) Public storage (3 000 tonnes) and private storage (57 000 tonnes) at the end of 1998; some 9 000 tonnes higher than in the previous year (differences to the total due to roundings). For disposal measures the quantities (464 000 tonnes) indicated for 1998 in the butter balance sheet do not include cream that has also been subsidised by the disposal measures.
- (⁶) Situation and outlook dairy sector, April 1997 (Commission DG VI — Working document CAP 2000).
- (⁷) Financial amounts are expressed in ecu when referring to periods before 1.1.1999 and in euro for subsequent periods.
- (⁸) Annual Report concerning the financial year 1989, paragraphs 4.1.1 to 4.1.26 (OJ C 313, 12.12.1990).
- (⁹) OJ L 148, 28.6.1968, p. 13.
- (¹⁰) The measures for skimmed-milk powder were examined by the Court in 1998. See Special Report No 1/99 (OJ C 147, 27.5.1999).
- (¹¹) OJ C 401, 22.12.1998.
- (¹²) The intervention price of butter is ECU 3 282,00 per tonne and for skimmed milk ECU 2 055,20 per tonne (this price has been applicable since 1995). However, public storage only takes place if market prices are less than 92 % of the intervention price. The buying-in price fixed by the Commission shall not be less than 90 % of the intervention price.
- (¹³) See chapter 4 of the Court's Annual Report concerning the financial year 1993, paragraphs 4.1 to 4.54 on aid for casein and caseinates from skimmed milk (OJ C 327, 24.11.1994) and Special Report No 1/99 on aid for the use of skimmed milk and skimmed-milk powder as animal feed, notably Table 2 (OJ C 147, 27.5.1999). Including SMP-equivalent of casein the EU production totals 1,6 million tonnes. The expenditure of ECU 1 050 million in 1998 includes ECU 367 million for disposal measures on SMP and a further ECU 287 million aid for casein.
- (¹⁴) Milk quotas were implemented by Council Regulation (EEC) No 856/84 of 31 March 1984 (OJ L 90, 1.4.1984, p. 10). The current system is ruled by Council Regulation (EEC) No 3950/92 of 28 December 1992 (OJ L 405, 31.12.1992, p. 1).
- (¹⁵) This will increase the milk quotas from 117 492,6 million tonnes to 120 324,1 million tonnes. Assuming that the production pattern does not change, the increase in quotas will result in a proportional increase in butter production of 44 232 tonnes which has to be sold on the market, with or without subsidies.
- (¹⁶) Overall milk balance 1997 in terms of milk equivalent: deliveries 113,28 million tonnes, equivalent to 111 % of total consumption and 120 % of total consumption at market prices. For milk fats the situation is more favourable: deliveries and total consumption are balanced, but if only consumption at market prices is taken into account, the oversupply is 9 % (Source: ZMP Bonn, cow's milk balance of the European Union).
- (¹⁷) Even though this includes approximately 140 000 tonnes annual production of the three new Member States, current EU production is significantly lower than production levels between 1980 and 1987, when production ranged between 1,9 and 2,3 million tonnes per annum.
- (¹⁸) The contracted quantity is higher than the quantity indicated in the milk balance (Table 1) for private stocks because of their rotation during the year. Contracted quantities 1996: 205 000 tonnes, 1997: 144 000 tonnes, 1998: 181 000 tonnes, forecast 1999: 200 000 tonnes.
- (¹⁹) This represents a slightly higher level of consumption than in previous years, even after taking into account the extra 100 000 tonnes consumed annually in the three new Member States.
- (²⁰) The reduction of per capita consumption is commonly explained by changes in consumer preferences, notably because of health considerations and the increased availability of alternative products.
- (²¹) CAP reports: Prospects for agricultural market 1998 to 2005, Commission, DG VI, October 1998.
- (²²) Source: European Commission, DG VI. D1 'Butter prices communicated by Member States (in percentage of intervention prices) (Commission Regulation (EEC) No 1547/87)'.
(²³) 'Situation and outlook: dairy sector' (April 1997) — the table on page 28 indicates that all butter and butteroil exports are subsidised.
- (²⁴) Setting the level of export refunds is complicated because prices of dairy products vary across Member States and are significantly higher than world-market prices, which are quoted in USD. For example, since 1995, prices in Germany for 82 % fat content butter have been on average 4 % higher than in the United Kingdom.
- (²⁵) Under the GATT Uruguay Round Export commitments, the EU committed itself to limiting its export refunds for butter and butteroil. The annual outlay on export refunds was limited to ECU 1 392,1 million in 1995/1996, reducing progressively to ECU 947,8 million in 2000/2001. The annual quantity on which export refunds could be paid was limited to 487 800 tonnes in 1995/1996, reducing progressively to 399 300 tonnes in 2000/2001. Actual exports of the EU in 1995 were 220 000 tonnes and in 1998, 170 000 tonnes.
- (²⁶) Source: The agricultural situation in the European Union, 1997 Report. COM (1998) 611 final, 8.12.1998.
- (²⁷) See paragraph 1.3 of the Court's Special Report No 4/98, which describes the background to the New Zealand quota and reduced levy rates.
- (²⁸) Private storage aid is available on the basis of storage contracts between beneficiaries and paying agencies for a period of at least 90 days. The aid is paid for a maximum of 210 days. The aid is ECU 24 per tonne for fixed costs and ECU 0,7591 per tonne and day in 1998 (EUR 0,6773 in 1999). Total aid for 1 tonne over the maximum period of 210 days would be ECU 183,41 in 1998 (EUR 166,23 in 1999).
- (²⁹) OJ L 172, 30.6.1981, p. 14.
- (³⁰) A fourth disposal measure, butter for the army (Commission Regulation (EEC) No 2192/81 of 31 July 1981), was suspended in 1989 and finally repealed by Commission Regulation (EC) No 479/1999 of 4 March 1999 (OJ L 57, 5.3.1999, p. 5).
- (³¹) Under Commission Regulation (EEC) No 570/88 (OJ L 55, 1.3.1988, p. 32) formula A concerns the use of butter for pastries and under its terms different products, which are considered similar, are included. Formula B is for the use for ice cream. Formula C concerns food preparations of flour, starch or malt extract. Formula D concerns conserves/preparations of meat, fish, sauces and soups. From 1998 the Regulation is replaced by Commission Regulation (EC) No 2571/97 (OJ L 350, 20.12.1997, p. 3). The new Regulation stipulates only two formulae: A (this corresponds to the old formulae A, C, D) and B (this corresponds to the old formula B). However, there are no major differences between the old and the new Regulations. Because of the delay between tendering and the payment of the aid, linked to the presentation of the evidence of end use, there are still payments made under the old Commission Regulation (EEC) No 570/88. Observations of the Court cover both the new and the old Regulation, if not otherwise stated.
- (³²) The high acceptance in Germany is explained by the traditional use of cooking butter in the south of Germany. The formula 'butter ghee' is mainly used for Indian and Pakistani cuisine. Because of the limited impact of the Regulation, the Commission suspended it in January 1998, but this was repealed in May 1998, notably because of the German market.
- (³³) Tracers have to be added in order to indicate that the products were subsidised. Untraced products are only eligible for aid under certain conditions and subject to more control.

- ⁽³⁴⁾ The most recent revision of aid rates in January 1999 did not, however, include any reduction in the aid rate for non-profit organisations.
- ⁽³⁵⁾ Tendering procedures are carried out twice monthly, except, however, in the months of August and December when there is only one tendering procedure.
- ⁽³⁶⁾ The procedure described concerns cream, butter or butterfat produced from quantities taken from the market for which the aid rate is paid. For butter from public intervention storage the tenderers have to quote a price for the intervention butter they want to buy.
- ⁽³⁷⁾ For ice cream the programme and price level is calculated and fixed in January/February for the whole summer season and it is difficult for producers to make price corrections during the season.
- ⁽³⁸⁾ While the most severe quality requirements are for butter for public storage, the requirements for butter for private storage are less strict, for example the butter can be salted and need not be produced directly and exclusively from pasteurised cream.
- ⁽³⁹⁾ This butter must be produced directly and exclusively from pasteurised cream and meet the requirements of Article 6(2) of Council Regulation (EEC) No 804/68 and the requirements of national quality classes. Cream must comply with Article 6(5) of the same Regulation and, in addition, have a fat content of not less than 35 %.
- ⁽⁴⁰⁾ Concentrated butter needs only to comply with the conditions of Annex 1 to Commission Regulation (EC) No 2571/97; 99,8 % minimum fat content; moisture content and non-milk fat constituents 0,2 %, free fatty acids 0,35 %; peroxides maximum 0,5 %; fresh flavour, absence of extraneous odours, absence of neutralising agents and absence of non-milk fat.
- ⁽⁴¹⁾ Whey butter has a particularly strong taste and is not marketed for direct human consumption.
- ⁽⁴²⁾ Recombined butter is produced on the basis of butteroil by adding water and/or cream in order to obtain a type of milk fat with a fat content corresponding to that of fresh butter.
- ⁽⁴³⁾ The total amount of imported butter used for the production of subsidised concentrated butter cannot be quantified because no statistical data are available.
- ⁽⁴⁴⁾ The preferential import duty for New Zealand butter with 80 % fat content is EUR 868,88 per tonne, which corresponds to a rate of EUR 1083,38 per tonne if calculated on 99,8 % fat content. The product is eligible for the subsidy for butteroil of EUR 1 130 if untraced and EUR 1 170 per tonne if traced. The rate already exceeds the import duty. The final product, if exported as a non-Annex II product, can benefit from export refunds of EUR 2 160 per tonne from which the aid received has to be deducted. The import of New Zealand butter for the production of butteroil is therefore more profitable compared with using EU butter because the butter can be imported at world-market prices which are far below the European price level.
- ⁽⁴⁵⁾ Special report on importation of New Zealand milk products and Swiss cheese (OJ C 127, 24.4.1998, paragraphs 3.32 and 3.33).
- ⁽⁴⁶⁾ According to the Commission's services an attempt was made to include in Regulation (EC) No 2571/97 a condition in favour of European products, similar to Regulation (EEC) No 429/90, but the Management Committee did not agree.
- ⁽⁴⁷⁾ Document 5911/99 of the Council of 19 February 1999, Annex III to the Annex: Conclusions concerning the Court's Special Report No 4/98.
- ⁽⁴⁸⁾ Commission Regulation (EC) No 2571/97 also allows the payment of a subsidy for untraced products but at lower aid rates and under certain particular conditions only.
- ⁽⁴⁹⁾ Council Directive 79/112/EEC of 18 December 1979. For the 25 % rule Article 6(7) applies. However, even in cases where the butter content of the final products exceeds 25 % it is unlikely that the tracers will be declared by the final producer since there is no obligation to declare the substance on the part of the wholesaler of the butterfats.
- ⁽⁵⁰⁾ Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of VAT: uniform basis of assessment (OJ L 145, 13.6.1977, p. 1).
- ⁽⁵¹⁾ A monthly table shows tenders received and quantities accepted. Quarterly tables show quantities entering and leaving the Member State by T 5 control copies and data about their incorporation into final products. Furthermore, Article 25 requires the communication of prices paid by final users and cases where it was found that the terms of Article 1(2) of Commission Regulation (EC) No 2571/97 have not been complied with (this paragraph concerns the quality of butter, concentrated butter and cream).
- ⁽⁵²⁾ This concerns, according to Commission Regulation (EC) No 2571/97, the adding of tracers, the repacking of concentrated butter, the incorporation into intermediate products and, where applicable, the incorporation of butter, concentrated butter, intermediate products and cream into final products. Commission Regulation (EEC) No 429/90 also stipulates the approval of establishments for the production of concentrated butter and for its packaging.
- ⁽⁵³⁾ For example, entries were made in pencil and/or on various slips of paper. Others contained no reference to the transaction number, or only recorded global figures which could not be reconciled with the transaction concerned.
- ⁽⁵⁴⁾ Several cases were reported in this respect: the quality of the butterfat must be checked by laboratory analysis both before and after the adding of the tracer. The test before adding the tracer was not documented in the Netherlands and not carried out by one beneficiary in Belgium who was entitled to autocontrol. In Spain the taking of samples before adding the tracers was abolished. At one major producer in France samples were taken from a central tank but the movements were not documented so that there is no evidence that the samples were taken from the appropriate production batches to be inspected.
- ⁽⁵⁵⁾ The Spanish authorities certified final use of products imported under T 5 control copies despite incorrect or incomplete description of the product on the T 5 copy.
- ⁽⁵⁶⁾ They have to confirm their undertaking to incorporate the butterfat into final products and state that they are aware of the penalties they may incur if any check which the public authorities may perform reveals that they have not fulfilled the obligations they have entered into.
- ⁽⁵⁷⁾ In the case of Germany, such a database is expected to be established during the coming months.
- ⁽⁵⁸⁾ Controls are made at regional level (1 % of declarations) in Germany: no controls are carried out in France.
- ⁽⁵⁹⁾ For deliveries to other Member States T 5 control copies have to be issued indicating the product, the formula and relevant deadlines. The 'importing' Member State is responsible for checking on the end-use.
- ⁽⁶⁰⁾ Palm oil is the main product of palm and the main substitute for butteroil in the manufacture of ice cream. The first stage in the process is extracting the crude palm oil from the ectocarp of oil palms. This product is further processed into cooking oil. The main exporter is Malaysia.
- ⁽⁶¹⁾ Coconut oil is derived from coconut palms. It currently is facing a loss of competitiveness vis-à-vis other vegetable oils due to lack of research into new applications and also because of ageing plantations. Main producers are South East Asia, Africa and the Pacific.
- ⁽⁶²⁾ Margarine is not only made from vegetable fats but can also be made from animal fats. The price competition is, however, determined by vegetable fats and therefore the examples are based on these fats.
- ⁽⁶³⁾ In the absence of reliable statistical data on the commercial values the price is estimated on the basis of data submitted by the Commission: cif price Rotterdam for palm oil in 1998: ECU 600 plus 3 % import duty plus estimated costs of refining of ECU 40 = ECU 658 per tonne. Commercial trade margins have to be added.
- ⁽⁶⁴⁾ For traced butter, for example, from ECU 1 460 per tonne in 1995 to EUR 950 per tonne in 1999.
- ⁽⁶⁵⁾ There are already replacement products being developed which contain mainly vegetable fats and some unsubsidised butter.
- ⁽⁶⁶⁾ The aid rate is fixed per 100 kg. Reducing the aid rate per 100 kg by ECU 1 corresponds to an overall saving of ECU 10 per tonne.
- ⁽⁶⁷⁾ In Germany, for instance, the development of the brand 'Butaris', supported by advertising, for the use of butterfat as cooking butter in restaurants and private households. Other examples are brands designed for butter ghee for the ethnic market, notably in the United Kingdom, and a number of brands developed by several different processors for concentrated butter for pastry producers.
- ⁽⁶⁸⁾ For pastry production it is important that fats used deliver good results at a given baking temperature and duration. By varying the treatment and mixture of the different fats included in butter (sterol, cholesterol and oleicole) fractionated butter is able to provide consistent results throughout the year.
- ⁽⁶⁹⁾ For instance, use of prefabricated products by local pastry makers.

⁽⁷⁰⁾ Since January 1999, this is the aid rate for untraced 82 % butter taken from the market. For concentrated butter higher aid rates apply.

⁽⁷¹⁾ Commission Regulation (EEC) No 198/69 of 31 January 1969 (OJ L 26, 1.2.1969, p. 31).

⁽⁷²⁾ In its Special Report No 4/93 (OJ C 12, 15.1.1994) on the quota system the Court observed that 'the penalty imposed in the event of the reference fat content being exceeded lacks dissuasive effect'. The fat content of cow's milk delivered increased from 3,87 % in 1984 (EEC-10) to 4,09 % in 1997 (EU-15). The increase in fat content has a direct

impact on butter production. For the calculation of the milk production, the quantity of milk is increased by 0,18 % per 0,1 g of additional fat per kg of milk. For example, an increase in the fat content of 22,2 % (from 3,6 % to 4,4 %) would result in an increase in the milk production figure of 1,44 %.

⁽⁷³⁾ A gradual reduction in the target prices and intervention prices for butter and skimmed-milk powder will start from 1 July 2005. See Council Regulation (EC) No 1255/1999 of 17 May 1999 (OJ L 160, 26.6.1999, p. 48).

THE COMMISSION'S REPLIES

MAIN AUDIT FINDINGS

The milk sector is in structural surplus with production of butter exceeding demand at normal market prices. The Council has therefore, in the framework of the common agricultural policy, required that support measures are applied in the form of an intervention system for butter and skimmed milk powder (SMP), as well as internal and external disposal measures, with the purpose of improving market balance and ensuring stability for both consumers and milk producers.

The internal disposal measures are indispensable in a situation where consumption of butter continues to decrease, and they have in the past proved to be an efficient means of maintaining stability and avoiding more expensive buying into public intervention. For almost 30 years, the pastry and ice-cream scheme in particular has been an important instrument to improve the market balance for butter. Over time, improvements have been made to the regulations, and the Council in the Agenda 2000 agreement also confirmed the need to ensure continuation of the disposal measures.

Aid levels and quantities for the pastry and ice-cream scheme and the concentrated-cooking-butter scheme are fixed through a tender system, and the Commission is confident that the application of the system in the past has ensured that the aid levels and quantities have been established at an appropriate level, ensuring stability and the most economic disposal of the butter surplus in the short, medium and long term. Reductions in the aid of around 35 % have been realised since 1995 and, despite the fact that expensive intervention buying has temporarily been necessary, the Commission has succeeded in slowing down the increased use of subsidised butter and achieved a reasonable market balance.

Reductions in the aid since 1995 have resulted in annual savings of around EUR 250 million for a quantity of approximately 500 000 tonnes, but there are risks in reducing the aid further, especially during a period with low prices and buying into intervention. Aid levels and contracted quantities are followed closely by the Commission and Member States in the framework of the Management Committee for Milk and Milk Products.

Second-quality butter and imported butter both form part of the butter supply and the internal disposal measures ensure disposal of surplus milk fat in the form of butter, cream and butter concentrate (BC). Lower quality butter and imported butter is not eligible as such but can be used for the production of high-quality BC without the impact of the scheme being reduced. Furthermore, international concessions and agreements must be respected for imported butter.

The expert study referred to by the Court especially queried two tracers and their influence on health. However, according to information subsequently received from Member States these tracers are in fact not used under the pastry and ice-cream scheme. The Commission will therefore delete them from the Regulation. Moreover, as flavourings they will be evaluated by the Scientific Committee for Food as required by Regulation (EC) No 2232/96 of the Council and the European Parliament. At present it is not envisaged to change the Council Directive on labelling requirements, which already covers flavourings and aspects of consumer information and protection.

The Commission has taken note of the Court's remarks concerning VAT and will consider them in the framework of future action aimed at modernising and simplifying the VAT system.

The Member States will be notified about the remarks made by the Court concerning their administration of the disposal measures and, if relevant, financial corrections will be made in the framework of the clearance of accounts procedure.

The purpose of the pastry and ice-cream scheme is primarily to ensure that milk fat is used as raw material instead of competing vegetable fats. The eligible products have been carefully selected with this in mind in the Milk Management Committee. Information concerning the use of subsidised milk fat in various final product groups will shortly become available and, in addition, an evaluation of the entire market organisation for milk (including the quota scheme) for milk is foreseen in 2001, so that results will be available when the quota system is reviewed in 2003.

Following the Council's decisions in the framework of Agenda 2000, the structural surplus will remain, and except for limited Community support for general promotion activities, it is considered to be the task of the industry and the various organisations defending the interests of the milk sector to promote milk and milk products and increase demand.

Because of the policy practised in the milk sector in the last decade, in particular in relation to the operation of the milk quota system, buying into intervention between 1995 and 1998 was small and the stocks limited to around 3 000 tonnes at the end of 1998 compared with 1,3 million tonnes at the end of 1986. Unfortunately stocks started to build up again in 1999. In addition, the milk sector's share of the budget has dropped from its peak of around ECU 6 billion or 30 % of total expenditure in 1985 to less than EUR 3 billion or 7 % of total expenditure in 1999.

THE MILK CMO AND THE BUTTER SURPLUSES

6-22. The introduction of the milk quota system in 1984 resulted in immediate reductions in milk deliveries, and subsequent reductions in quotas together with continued internal and external disposal measures have improved the market situation for butter considerably.

The level of milk quotas is a highly political question which has been subject of intense negotiations in the Council. However, the reductions in quotas made in the past have only decreased and not eliminated the structural surplus.

The butter stocks in public intervention dropped from 841 000 tonnes at the end of 1984 to 3 000 tonnes at the end of 1998 (after reaching a peak of 1,3 million tonnes at the end of 1986) and buying into intervention has been limited to around 43 000 tonnes for the period 1995 to 1998. However, in 1999, when public intervention was opened due to low market prices in 11 Member States, buying-in increased to almost 55 000 tonnes.

The Council has decided in the framework of Agenda 2000 that an increase in quotas will be accompanied by reductions in support prices of 15 % for butter and skimmed-milk powder (SMP) and, given the downward trend in butter consumption at normal market prices, a structural surplus will remain. Consequently, internal disposal measures for butter and SMP will be indispensable in the coming years.

The Commission recalls its reply to the Court's report No 1/99 concerning the aid for use of skimmed milk and SMP as animal feed, that surplus milk which cannot be processed into other value-added dairy products is used for the manufacture of butter and SMP, the two intervention products which form the basis of the market support mechanism in the dairy sector.

Considering the current stable production, reduced exports, increased imports, relatively stable uptake of butter under the internal disposal measures and reduced normal consumption, the Commission is of the opinion that the internal disposal measures have a substantial effect on market balance, especially when public stocks have declined and there has been limited buying into intervention.

The structural surplus in milk-equivalent of 20 % (excluding subsidised consumption) referred to by the Court requires both internal subsidised sales of around 500 000 tonnes in butter-equivalent and exports with refunds. Otherwise, butter will end up in public intervention in a market characterised by low prices. As the Court points out in paragraph 14, it is questionable whether real outlets exist for increased exports of EU butter, and reduced uptake under the internal disposal measures will therefore to a large extent result in expensive public intervention buying.

The average cost per tonne indicated by the Court in paragraph 17(d) may not fully reflect the situation due to the time lag between the tender quantities and the final payment of the aid. The aid rate from January 1999 for pastry and ice-cream butter (82 % untraced) amounts to EUR 910/t, refunds to EUR 1 700/t and the intervention purchase price to EUR 2 954/t.

OBSERVATIONS RELATING TO THE DISPOSAL SCHEMES

Fixing the level of aid

23-27. The Commission sets a limit on aid for each tender, taking account of the quantities requested. The nature of the operations involved means that the operator has to be able to plan regular supplies. He presents his offer accordingly and the maximum level of aid set for the tender in question will allow or disallow the quantity presented by the operator. If the aid is set at a level which results in his offers being repeatedly refused he will turn to alternative sources of raw material and cease to participate in the scheme. Consequently, the scheme would not be as efficient as it is today in disposing of butterfat. Efficient application of the tender system ensuring an optimum aid level does not prevent aid levels and selling prices for intervention butter from remaining unchanged in certain periods, if the quantities and aid levels requested by operators in a given market situation are in line with the aims of the Commission. Furthermore, the Commission can decide not to accept any of the offers received.

In the present situation there is no indication that demand for aid is higher than the target quantity and the Commission is confident, on the basis of current discussions in the Milk Management Committee, that aid levels are appropriate and that the tender system is working correctly.

Under the present tendering system it has been possible to reduce aid levels considerably over time. Since the beginning of 1995 the aid for 82 % traced butter under the pastry and ice-cream scheme has been reduced by 35 % from ECU 146/100 kg (or 45 % of the intervention price (IP)) to EUR 95/100 kg (or 29 % of the IP). The aid share of the market price has dropped during the same period from around 45 % to around 30 %.

The aid for concentrated-cooking-butter was reduced during the same period from ECU 209/100 kg to EUR 117/100 kg or 40 % and the aid to non-profit making organisations from ECU 156/100 kg to EUR 105/100 kg or 32 %.

The tender system is considered by Member States and the Commission to be clear for both operators and administrations and the best method to manage quantities. It was introduced in order to ensure equal access for all purchasers, to fix the aid at the level strictly necessary and to supervise the quantities concerned effectively. Stability is essential for the users and for smooth functioning of the schemes.

Quality requirements

28-30. The Commission wishes to stress that the aids awarded under the internal disposal measures are introduced to ensure disposal of surplus milk fat in the form of butter, cream or butter concentrate (BC). The intervention price for butter is established on the basis of specific product criteria and related production costs, and if the aid level for BC depended on the same criteria and costs the aid for BC would need to be higher. The quality requirements for subsidised butter therefore do not need to be identical to those applied for public or private storage butter. Moreover, the aid is granted to butter concentrate, where high quality norms are required by the Regulation, and not to the raw materials used to produce it. The butter concentrate can be used for a traced 82 % fat intermediary product ('recombined butter') and the aid is equal to the aid for traced 82 % butter.

The Commission is of the opinion that if lower quality products are not allowed to be used for production of butter concentrate, they will remain on the market where they may push higher quality and more expensive butter into public intervention.

Payment of the aid for imported butter

31-33. Following an earlier recommendation from the Court, the Commission has already tried in the Management Committee

to exclude imported butter from the pastry and ice-cream scheme. For market and control reasons this has been refused by Member States, who also underlined that the real problem was that the butter was allowed to be imported under preferential conditions by the Council and international agreements; but once imported it should be treated in the same way as EU butter. Furthermore, the Commission is bound by international concessions and agreements and as such cannot stop refunds being paid on non-Annex I products although they contain processed imported products classified under other CN codes.

According to the Court, it is attractive to use butter imported under preferential regimes for BC under the pastry and ice-cream scheme because the packaging and distribution costs associated with retail sales are avoided. However, the Commission considers that although the elimination of retail distribution costs may be an advantage, this is offset to some degree by the fact that the price obtained for bulk butter is lower than that for small-pack retail butter. Furthermore, it is more expensive to produce BC from butter than cream, which is normally used as a raw material, and on which the aid is based. In addition, operators make use of this option only occasionally, depending on market conditions.

34. Although the Council, in its opinion ⁽¹⁾ on the discharge for the 1997 budget year recommended a Community-origin condition for BC for the pastry and ice-cream scheme, in its new Basic Regulation (EC) No 1255/1999 (which incorporates Council Regulation (EEC) No 1723/81 authorising disposal measures), it has not excluded imported butter from use in the production of butter concentrate. However, imported butter as such is already excluded from the scheme.

Particular health aspects

35-38. At the request of Member States, tracers were introduced more than 20 years ago for control reasons. Traced products are subject to less strict controls compared with untraced products. At that time no Community legislation was yet in place concerning food additives, flavourings, etc. It was therefore not incumbent on the Commission to require prior testing or approval of the use of tracers in the form and very limited quantity required. It was the responsibility of Member States, having accepted tracers in the Community legislation, to ensure that they were acceptable for human consumption in the form and very limited quantity required in accordance with national legislation.

The recent Community legislation on additives and novel foods has not changed this basic position as tracers in general are not considered food additives in accordance with Directive 89/107/EEC and they serve another purpose.

⁽¹⁾ Recommendation of the Council of 15 March 1999 (Document 5911/99 of the Council).

The expert study referred to by the Court questions two tracers in particular: thymol and capsaicin. However, not all tracers allowed under the pastry and ice-cream scheme are in fact used, and according to information subsequently received from Member States, these two flavouring substances are not used. On the other hand they are included in the Community Register of around 3 000 flavourings which is to be evaluated by the Scientific Committee for Food in the coming five years as required by Regulation (EC) No 2232/96 ⁽¹⁾ of the Council and European Parliament. The Commission will propose to the Milk Management Committee that it delete the above two tracers from the pastry and ice-cream schemes.

Furthermore, under the pastry and ice-cream scheme the tracers are added to butter, BC or cream intended for further processing and for making composite foods which are covered by the normal labelling requirements in Council Directive 79/112/EEC ⁽²⁾. The Directive already covers aspects of consumer information and protection and no particular labelling requirements for tracers are therefore at present envisaged.

Value added tax (VAT) on EU subsidies

39-41. The Court's finding that there is a lack of harmonisation in the VAT treatment of subsidies is in part a direct result of the VAT Directive itself.

The Commission has tried by various means to achieve a more uniform treatment of VAT on subsidies, without success, since the Member States have been unable to reach unanimous agreement among themselves. As part of its efforts to modernise and simplify the VAT system, the Commission currently plans to propose an in-depth reworking of the VAT treatment of subsidies in the Union. In the process, it will be taking the Court's remarks into account.

Particular weaknesses affecting Commission Regulation (EC) No 2571/97 ('butter for pastry')

Complex rules

42-45. Regulation (EC) No 2571/97 replaced Regulation (EEC) No 570/88 as from 1 January 1998 and is the result of more than two years' preparatory work in working groups under the Management Committee for Milk and Milk Products. National experts (required to cover all aspects in relation to the management of the scheme) as well as Commission experts from the market division, supported by legal, customs, EAGGF and financial control departments, participated in the preparation of the Regulation. The Regulation also incorporates recommendations from the Court

and an external expert simplification group established, following the Court's recommendations in the framework of Regulation (EEC) No 570/88, which combined two Regulations.

The structure and rules of the Regulation reflect the requirements for improved management and control of the Community market and funds as well as the complexity of the industry and of carefully selected products, where reference to the Combined Nomenclature is a key element, which can benefit from the scheme.

The Commission notes the position of the Court regarding the use of the aid and agrees with the requirement for constant management and control appraisal. However, experience obtained during the first two years of operation of the new Regulation has shown that the scheme has worked satisfactorily.

The Court's suggestion in paragraph 44 to increase the minimum tender quantity would reduce the number of controls referred to in Article 23(2) of the pastry and ice-cream scheme. The Commission will examine this suggestion.

Monitoring deficiencies

46-47. The Combined Nomenclature codes and eligible product groups have in the past been carefully selected in order to ensure the highest possible efficiency. With the introduction of Regulation (EC) No 2571/97 (especially Article 25 and Annexes VIII to XIII), more statistical information concerning the use of different kinds of eligible products, intermediary products and specified final-product groups will become available as recommended by the Court. Sufficient comparable information has not yet been received by the Commission from two important Member States enabling it to make a reliable evaluation. However, this has not prevented the Commission from pursuing prudent market management and, through the tender system, reducing aid levels. Member States have on several occasions been asked to forward missing information and to comply with time limits given in the Regulation.

Particular weaknesses affecting Commission Regulation (EEC) No 2191/81 ('butter for non-profit organisations')

48-49. The Regulation stipulates that the Member States are to institute all the necessary controls to ensure compliance with the provisions of the Regulation, and the clerical burden in the paying agency referred to by the Court may well be caused by the competent authority itself.

50. This disposal measure was introduced in order to contribute to the disposal of the surplus of milk fat which is the objective of all the disposal measures on the internal market. The legal basis set out by the Council is also the same. The Commission cannot therefore endorse the Court's proposal to transfer the scheme to the budget line for food aid.

⁽¹⁾ OJ L 299, 23.11.1996, p. 1.

⁽²⁾ OJ L 33, 8.2.1979, p. 1.

ADMINISTRATIVE WEAKNESSES ENCOUNTERED IN MEMBER STATES

51-53. In noting the Court's comments regarding controls the Commission would like to point out that around 500 000 tonnes of butter equivalent has been subsidised each year since 1995 and that, while a number of irregularities have been reported over this period by the Member States, the Commission is satisfied that in relative terms the system has worked very well.

The Court's observations will be followed up in the clearance of accounts procedure and duly notified to the Member States concerned. If confirmed, they might lead to financial corrections. For the case mentioned by the Court concerning the Netherlands (paragraph 53) the Commission has initiated the procedure for the necessary follow-up checks.

THE EFFICIENCY AND COST-EFFECTIVENESS OF THE DISPOSAL MEASURES

Determination of efficiency and cost-effectiveness

54-56. Council Regulations (EEC) No 804/68 and (EEC) No 1723/81 (replaced by (EC) No 1255/1999) oblige the Commission in the present surplus situation to support the butter market. Various disposal measures supporting the total consumption of milkfat in the form of butter, butter concentrate and cream have therefore been introduced.

The butter balances and information concerning realised subsidised sales justify the disposal measures and, together with the intervention system, they ensure that the market price for milk moves closer to the target price fixed by the Council. The measures have clearly limited buying into intervention in the past.

The Commission stresses that, although no specific evaluation study has been carried out until now, it has closely followed the market management measures for butter in association with Member States in the framework of the Milk Management Committee.

However, a system is being established which will enable the Commission to evaluate the three market organisations subject to the reforms of Agenda 2000 (arable crops, beef and milk) in the medium term (between 2002 and 2006).

In this context, it is planned to evaluate the entire market organisation for milk (including the quota regulation) in 2001, in order to obtain results in time to be available for the review of the quota system in 2003.

Factors determining demand on the internal market

Characteristics of the market

57-60. Many factors influence operators' choice between various kinds of fats to be used as raw material. The aid level for milk

fat and changes in the aid level will certainly influence the choice between different fats and have an impact on the quantities contracted; but also the context in which the changes are made as well as many other factors will have an impact on operators' decisions and on the quantities tendered in both the short and long run. Changes in and expectations of aid levels, availability of raw material as well as prices for competing vegetable products, recipes, brand names, image, quality, taste, strategy, production process, introduction of new products, etc. will influence the immediate and future demand of operators.

An analysis of each one of these factors and its influence on uptake can only be made with limited certainty considering the complexity of the economic interrelations.

Competitive position of butter in relation to other fats

61-63. The difficult point is in practice to ensure that operators use butter/milkfat as raw material instead of other fats and that through the tender system the aid is fixed at the lowest possible level.

The quality and taste of butter is superior to that of vegetable fats but owing to the relatively higher price for butter, the industry is in constant search of ways of replacing butter with cheaper raw materials. Continuous reductions in the aid level will therefore push operators away from butter (especially for new final products) and decrease the efficiency of the scheme, resulting in far more expensive intervention buying.

It is extremely expensive to create a recognised brand name and therefore difficult/costly to withdraw special recipes. When an operator decides to turn away from butter and replace it with vegetable fats, it is unlikely that he will return to butter.

Given the above factors and that operators have three to six months to incorporate butter into final products, cuts in the aid may have a short-term reverse effect to the one expected and result in increased demand, especially if operators expect a further reduction in aid. It is normal consumer behaviour in the short term to optimise purchases if the aid is expected to decrease and to minimise purchases if the aid is expected to increase.

Impact of the aid on prices of final products

64-67. It is not the primary objective of the pastry and ice-cream scheme to reduce the consumer price for final products but rather to ensure the use of milk fat as raw material instead of other fats. Furthermore, it is very difficult to identify precisely the impact on consumer prices and sales of a price change of one single raw material (which can originate in changes in aid for butter or in butter market prices), especially when the share of the raw material in the value of the final product is small.

The aid is not passed on in full to the retail price but the reduction in the effect of the aid should be limited to the actual additional costs linked to the participation in the scheme. Processing costs, packaging costs, distribution costs, etc. are more or less identical for subsidised and non-subsidised products and should therefore not be counted as a reduction in the effect of the aid but rather as necessary costs required to obtain a desired product.

Considering the above points, the Commission finds that there is a constant risk that operators, especially following reductions in aid and/or increased raw material prices, will switch to cheaper vegetable fats. The risk will increase when the price difference between butterfat and suitable substitute vegetable fats and uncertainty concerning butterfat prices become greater.

The relation between demand, aid rates and market prices

68-71. In the Commission's view, an increased purchase price will, other things being equal, reduce the absolute uptake or halt the general tendency of increased use of milk fat in food products. The Commission would like to illustrate its view with the following description of the actual development of the market.

In 1994 the uptake for pastry and ice-cream amounted to 450 000 tonnes, as a result of the progressively reduced aid levels in the first half of 1995, there was a reduction in the uptake of 50 000 tonnes to around 400 000 tonnes in 1996. During the same period purchases of butter into public intervention amounted to 40 000 tonnes. However, the uptake in 1997 increased by 22 000 tonnes despite increases in market prices for butter and a constant aid level until December, since operators wanted to secure supplies at the prevailing aid level.

The reduction in aid rates in December 1997 and April 1998 were counterbalanced by lower market prices. However, following declines in the deadline for incorporation from six to three months in May 1998 and from five to four months in January 1999, the contracted demand decreased by 25 000 tonnes during the first five months of 1999.

During the first six months of 1999, 25 000 tonnes was purchased into intervention and the increase in quantities contracted for pastry and ice cream for the period June to August 1999 was not sufficient to prevent purchases of a further 30 000 tonnes into public storage during the rest of 1999.

70. Application of the tender system has in the past ensured the necessary and appropriate disposal of surplus milk fat. As noted above, reductions in aid levels since 1995 amount to around 35 %, corresponding to yearly savings in the order of EUR 250 million for a total quantity of around 500 000 tonnes. The aid has been reduced over time under the tender system to its lower limit and

is at present not considered to be too high, especially when intervention buying continues to take place.

Comparison between disposal measures and other forms of market intervention

74-75. The aid for pastry and ice-cream butter (EUR 910/t for untraced 82 % butter) is considerably lower than export refunds (EUR 1 700/t) but the actual disposal costs will depend on the efficiency coefficient under the two measures. The Commission finds that the efficiency coefficient is lower for internal disposal measures than for exports but under all circumstances it is cheaper to support butter directly from the market instead of buying it into intervention and later selling it at reduced prices.

It is obvious that abolishing the aid schemes would not push the total supported quantity into intervention — but a substantial part of it would be. It is not realistic to expect 100 % efficiency for any disposal measure in a surplus market.

Structural surplus

76-78. The structural surplus has continued to exist within the milk sector and the internal and external support measures have been adjusted in order to meet the requirements for improved market balance. Despite previous reductions in the milk quotas and following the Council's decision in the framework of Agenda 2000, support measures will continue to be needed in future.

The Commission has, over time, supported promotion of the consumption of milk and milk products in general in order to maintain or increase total consumption, while a specific promotion campaign for butter is considered to be the task of the industry or dairy organisations.

As far as the quotas and adjustment in the deliveries following an increase in the milk-fat content is concerned, the Commission has already pointed out in its reply to the Court's special report No 4/93 that, 'it is not the objective of the scheme introducing reference quantities for milk production to prevent an increase of the fat content of milk as long as milk production is adjusted accordingly'.

In its 1994 reply quoted above, the Commission compared the overrun penalty with the price of butter and showed that the additional penalty where the fat content was above the quota was already 55 %, well beyond the 15 % set by the Council for milk in excess of the quota. The coefficient corresponding simply to the 'commercial' neutralisation of the fat produced in excess (assumed to be valued at the price of butter), without penalty, is around 0,012.

The Commission stressed in its reply that too severe a penalty would run counter to the desired goal. It could in fact lead to a black market in the excess fat.

To sum up, the Commission considers that the present coefficient attains its goal, which is to keep the total volume of milk deliveries within the quantity set.

CONCLUSION

79. The structural surplus and consequent continued need for permanent disposal measures for milk fat are the result of political decisions by the Council.

80. Both second-quality butter and imported butter form part of the butter supply, and the internal disposal measures have been introduced to ensure disposal of surplus milk fat in the form of butter, cream and butter concentrate.

The aid levels and quantities for the pastry and ice-cream scheme and the concentrated-cooking-butter scheme are fixed through a tender system and the Commission is confident that the application of the system in the past has ensured that aid has been established at an appropriate level ensuring stability and disposal of the butter surplus in the short, medium and long term.

The Commission has taken note of the remarks made by the Court concerning VAT and will consider them in the framework of future actions aiming at modernising and simplifying the VAT system.

81. Member States will be notified of the Court's remarks concerning their administration of the disposal measures and, if relevant, financial corrections will be made in the framework of the clearance of accounts procedure.

However, the Commission would like to point out that around 500 000 tonnes of butter equivalent have been subsidised per year since 1995 and that, while a number of irregularities have been reported over the period by the Member States, the Commission is satisfied that in relative terms the system has worked very well.

82. Experience over the last few years demonstrates a delicate interrelationship between aid levels, the subsequent uptake under the aid schemes and the level of intervention buying. The bigger the price difference between subsidised milk fat and vegetable fats becomes, the greater is the risk of a switch away from milk fat and of increased intervention buying. Given the structural surplus of milk fat, the disposal measures are indispensable.

83. Following the Council's decisions already taken in the framework of Agenda 2000, the structural surplus will remain, and except for limited Community-supported general promotion activities it is considered to be the task of the industry and various organisations defending the interests of the milk sector to promote milk and milk products and increase demand. The Commission will continue its efforts through efficient application of disposal measures to ensure balance between supply and demand. It is planned to start an evaluation of the entire market organisation of milk in 2001, including the effectiveness and efficiency of internal disposal measures for butter and for skimmed-milk powder.

The Commission considers the tender system to be efficient in its present form. Since the beginning of 1995 the aid for butter under the pastry and ice-cream scheme has been reduced by 35%. Second-quality butter and imported butter form part of the general butterfat surplus which must be disposed of. The Commission does not intend to limit aid only to quality non-imported butter and finds no reasons for increasing the penalty in cases of increased fat content of raw milk delivered under the milk quota system.

Finally, the Commission would like to stress that, because of the policy practised in the milk sector in the last decade, in particular in relation to the operation of the milk quota system, buying into intervention was small between 1995 and 1998 and stocks limited to around 3 000 tonnes at the end of 1998 compared with 1,3 million tonnes at the end of 1986. Unfortunately stocks started to build up again in 1999, reaching around 56 000 tonnes at the end of the year. In addition, the milk sector's share of the budget has dropped from its peak of around ECU 6 billion or 30 % of total expenditure in 1985 to less than EUR 3 billion or 7 % of the expenditure in 1999.