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A cup of hot milk for Bulgarian dairy reform

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Report Highlights:

Dairy reform is one of the most serious challenges in 2007 for Bulgarian agriculture policy makers. It is causing economic, social and political complications, especially in rural areas. Bulgaria is negotiating with the EC an extended grace period for milk quality until 2010, a decision perceived with mixed feelings by the industry. In addition, the newly approved major legislation is still far from the European and international approach and preserves the government functions in selection and breeding work, thus restricting the development of breeding associations and potentially hurting U.S. genetics exports.

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Summary

The dairy sector reform turned out to be a much more serious challenge for the local industry and policy makers than they initially thought. The reform had lots of economic, social and political implications. Politicians had to take difficult decisions, not always based on the best market approach. Gray sector, red tape practices and lack of trust between various private and public players further complicate reform implementation.

Legislation and Policy

In June, the Bulgarian Parliament passed the major legislation covering the livestock sector – the 2007 Livestock Act. The new law aimed to support the development of the breeding associations, and to accelerate dairy/livestock sector investment in land, genetics and capital.

The debate over the law was focused on the role and functions of the Executive Agency for Selection and Reproduction in Animal Husbandry (EASRAB). Most farmers and dairy industry groups insisted on a clear definition of Agency's role as not performing selection and/or breeding programs, which should be implemented by the local Breeding Associations. Experts were unanimous that the Agency should have exclusively and only control functions. However, the EASRAB insisted on keeping management and control on genetic resources.

In the final version, EASRAB responsibilities were not clearly formulated – the Agency will not privatize the artificial insemination stations; will continue to manage genetic resources and execute selection and breeding work in cases when the Minister authorizes it (by virtue of annual ordinances). Thus, state intervention and control in genetics work is preserved. Newly established local Breeding Associations have to compete under unequal terms with a state institution which has much bigger resources, assets and power. At the same time, the Agency will not only fulfill the identical functions/role as the breeding associations, but will also control them.

One of the most egregious of provisions in the Law is the new article (art. 44 b) that gives the EASRAB control of imports of breeding livestock, semen, eggs and embryos from third countries. Many experts are concerned that the Agency will use this right to stop or restrict imports of quality genetic resources to weaken the local Breeding Associations in a disadvantaged position, and allow EASRAB to benefit from its monopoly status. Thus, the new legislation may slow imports, including U.S. origin, and limit use of imported genetics and investment at dairy farms.

Dairy sector development

Restructuring of the dairy sector has continued in 2006 and 2007 with further commercialization, consolidation and enlargement of bigger farms, and decline in the number and role of smaller family-type farms.

In 2006/07, there is a significant growth in the number of farms with 10-20 cows, 32 percent, and for farms with 20-30 cows, 15 percent. Similarly, the number of farms with more than 100 dairy cows rose 18.3 percent although they still account for only 7 percent of all cows. Farms with only one cow (backyard rural semi-subsistence farms) in 2006 were 10.2 percent fewer than in 2005 and accounted for 25 percent of Bulgaria's dairy cows. The number of small farms raising up to 9 dairy cows has also fallen by 8.4 percent.

Table 1. Structure of the dairy farm sector in Bulgaria in 2006

| Dairy cows per a farm | Farms | | Dairy Cows | |
|-----------------------|---------|--------------|------------|--------------|
| | Number | Change 06/05 | Number | Change 06/05 |
| 1-2 | 113,328 | -9.9 percent | 140,500 | -9.6 percent |
| 3-9 | 21,470 | 0.5 percent | 92,400 | 2.6 percent |
| 10-19 | 3,552 | 31.8 percent | 44,700 | 28.1 percent |
| 20 and more | 1,578 | 2.5 percent | 72,500 | 7.9 percent |
| Total | 139,928 | -7.5 percent | 350,100 | 0.7 percent |

Source: MinAg bulletin #105

According to the National Dairy Board (NDB) data, as of March 2007, Bulgaria had 96,595 registered dairy farms which were grouped in three categories depending on their compliance with the EC hygiene and milk quality standards:

First category (fully responding to EC standards) – 1,125 farms;

Second category (meeting EC equipment and hygiene standards but not fully covering milk quality standards) – 1,238 farms;

Third category (not responding to EC standards) – 94,232 farms

Out of total registered farms, small ones with up to 10 cows are 90,415; average size (10-50 cows) are 5,749, and large farms (more than 50 cows) are only 431. According to another industry source, Association of Milk Processors (AMP), 78 percent of farmers have 1-9 cows. Milk is collected at 4,200 milk collection stations.

Milk supply

Total milk produced in 2006 was 1.515 million MT (1.471 million in liters) of which 1,298 million MT (86 percent) cow milk, 107,000 MT (7 percent) sheep milk and 102,000 MT (6.7 percent) goat milk. The 2006 milk supply was slightly (0.5 percent) higher than in 2005 with a stable growth for buffalo and sheep milk, decline for goat milk and very slight increase in cow milk. The average milk yield in 2006 was 3,600 liters per a cow, 1,428 liters for buffalo; 87.3 liters for ewes; and 221 liters for she-goats.

Production of processed dairy products was 12.6 percent less than in 2005. About 50 percent of all fresh milk produced at farms was delivered to dairies.

Table 2. Milk production in Bulgaria in 2006

| Production of milk at farms by types of dairy livestock, in MT, for 2002-2006 | | | | | |
|---|-------------|-------------|-------------|--------------|---------------------------|
| Year | Cow | Buffalo | Sheep | Goat | Total |
| 2002 | 1,305,912 | 4,410 | 93,479 | 104,820 | 1,508,621 |
| 2003 | 1,308,525 | 5,276 | 88,679 | 101,530 | 1,504,010 |
| 2004 | 1,344,750 | 6,229 | 117,682 | 129,381 | 1,598,042 |
| 2005 | 1,286,909 | 6,989 | 105,057 | 109,114 | 1,508,069 |
| 2006 | 1,298,709 | 7,132 | 107,535 | 102,297 | 1,515,673 |
| 2006 in thousand liters | 1,260,883 | 6,891 | 104,201 | 99,414 | 1,471,389 thousand liters |
| Change 06 vs. 05 | 0.9 percent | 2.0 percent | 2.4 percent | -6.2 percent | 0.5 percent |

Source: MinAg bulletin #105

Milk quotas

Introduction and distribution of milk quotas in May-July caused lots of economic and political turmoil. The dairy industry was split over the issue. The two major industry organizations, the NDB and AMP, expressed very different positions and had heated media debates. These differences were conceptual, sometimes politicized, or related to certain economic interests. The NDB has 8 regional dairy boards. It is supportive of faster market reforms and concentration despite the negative social/political effects. The AMP has 120 members. It is more concerned about the social and political effects in rural areas and the goal is to continue life of smaller dairy farms as a backbone of the dairy industry (see a summary of these different positions in Table A).

The national reference quantity for milk set for Bulgaria in 07/08 is 979,000 MT, of which 722,000 MT for deliveries and 257,000 MT for direct sales, much less than the traditional production of 1.2-1.3 MMT. To this, a "Reserve" quota of 39,180 MT may be added in 2009 (counting current on-farm consumption). The referent average fat content is 3.91 percent.

The Government has requested 167,000 MT from the direct sales quota to be transferred to the milk deliveries quota, but there is has been no EC response yet.

As of June/July, total 96,572 farmers had individual dairy quotas. The average dairy farm has a quota for 7.0 MT for deliveries and 3.0 MT for direct sales. According to the NDB, farms with more than 10 cows are 5,100 (5.25 percent of all dairy farms) and can produce under quota 220,000 MT of milk. Large farms (more than 50 cows) are 446 and their milk quota is 189,000 MT. These figures are disputable, according to processors, who claim that only 35 percent of the total milk quota is produced by the large farms while the remaining 65 percent is collected from small family type farms.

Milk deliveries quota

The demand for milk deliveries quota was exceeding the limit by more than 200,000 MT (NDB data). Thus, the NDB had to reduce the quantity of requested milk to the size of the quota. The reduction was done mainly for farms which produce sub-standard quality milk (the third category, see above) based on methodology approved by the MinAg in Decree #51.

A special reserve within the milk deliveries of 92,463 MT was set based on MinAg information about investment projects. This decision was approved by the Agricultural Minister in Ordinance 09-231/ April 13, 2007. The AMP, however, protested against the nature of this decision, the way the amount was set, and blamed the NDB in lack of transparency about collected requests.

Thus, the quantity of milk deliveries remained for actual distribution was 630,000 MT. It was distributed as follows: 192,400 MT to all farms in the first category (1,125) meeting 100percent of their applications; 94,600 MT to all farms in the second category (1,238) also meeting 100percent of their applications; and 342,500 MT to farms in the third category (94,209) which means 47 percent reduction compared to the applications. By regions, the regional dairy boards in Plovdiv and Rousse received the highest shares, 22 percent and 17 percent, respectively.

Reduction in quotas for the third category farms, the most numerous group, caused protests and dissatisfaction. Although there is clear legislation (Decree #51) about quota distribution, the lack of a public register of farms and their individual quotas resulted in speculations about NDB justification for its decision.

At some of the reduced quota farms, the quota is lower than the average milk yield. For example, in Yambol area, there are 3,606 dairy farms in the third category compared to 48 in the first and 123 farms in the second. Most of these farms will not be able to go to the second category at the end of 2007 which means that in 2008, many will be shut down and dairy cattle should be either slaughtered or sold. In region of Dobrich, farmers started to sell cows at a low price of 250 Euro or slaughter them due to reduced quotas (140,000 MT requested and 90,000 MT approved). A farmer reported an annual production of 12,000 MT white his quota was set at 5,000 MT. There are already voices that some farmers who may exceed their quotas will try to record the excess cow milk as sheep or goat milk (which is not limited by quotas). Processors are concerned that it is possible due to still strong gray sector, at up to 30 percent share in total dairy production.

Farmers who are not satisfied about their reduced quotas protested to pick up quota certificates. As of end-June, three months after the milk quotas were introduced, about 30 percent of individual milk quota certificates (190,000 MT) were not yet received by farmers.

Without quota documents, farmers can not legally operate on the market. Delayed quota certification distribution can easily block milk deliveries and trade later in the year. Milk processors still do not face milk shortages, however, if farmers don't get their certificates, processors may encounter a deficit. The milk quota distribution process may add to gray market activity and cause problems with the monitoring of quotas, milk quality and safety. In the medium term, it may complicate the fragile status of local dairy processors, who are struggling to trade their products on the single EU market.

Milk direct sales quota

Milk direct sales quotas did not attract many farm applications – all requests were fully met since farms applied for only 77,600 MT. Out of that, 10,213 MT were distributed to the first category farms; 6,176 MT to the second category, and 61,202 MT to the third category. By regions, the highest share of quotas was received by Blagoevgrad, 30 percent and Sliven, 26 percent. Thus, 186,000 MT remained unused.

The MinAg has requested 167,000 MT of this quantity to be transferred to the milk deliveries quota. Despite lack of clarity on EC response, the dairy industry has already made plans. The NDB proposes to use the same methodology applied to date (Decree #51) which means that these quantities will be directed to farms in the first and second category meeting EU milk quality criteria. Larger farmers feel discriminated against, in favor of small farmers - they think the milk reserve quotas should be given to those who have prospects to grow and progress on the market. Small farms cannot improve despite quotas which they will be forced to sell anyway in 1-2 years. On the other hand, the AMP suggests the bulk of milk reserve be given to farmers with reduced quotas (third category) since they have already suffered from reduced deliveries quotas.

Dairy manufacturers response

Currently, dairy manufacturers evaluate their fixed expenses for registration, reporting, monitoring and traceability for milk from smaller farms as much higher than their profit from milk processing. Many will try to optimize milk purchases by switching to a smaller number of larger suppliers, and/or imports of powder milk/whey as a substitute for fresh milk. The industry estimates that Bulgarian milk production will be efficient only when most farms produce 6-7,000 liters average milk yield with a potential for 10,000 liters (currently, it is about 3,600 liters) which means not more than 170,000-200,000 cows for meeting the current ceiling of 979,000 MT.

Milk quality

In 2006/07, 70-80 percent of milk was produced by small farms in the third category. Various estimates show that only 10-40 percent of milk on the market meets EC standards. Today, the milk quality issue represents the major challenge for the dairy industry.

According to the current policy, the third category farms (see above) should improve their barns, equipment and hygiene until Dec. 31, 2007. Starting from January 1, 2008, these farms should be either shut down or they should join the second category. Despite active promotional and educational campaign, many such farms do not have the will and/or ability to upgrade. Often, the vet authorities do not provide the necessary recommendations. Milk is still illegally purchased by non-approved intermediaries. Milk traders often do not provide a feedback to farms about the quality tests of their milk. Not all farmers are interested in rightful and legal recording and milk quality monitoring.

Although Bulgaria has a grace period for production of sub standard quality milk, many processors have already refused to purchase and process such milk.

A new extended grace period

In January 2007, the GOB agreed with the EC for one year grace period for dairy processing establishments. At that time, the majority of dairy plants and the meat industry did not want a longer grace period due to their strong investment efforts and plans to start trading on the EU market as fast as possible. The one year ban was imposed by the EC due to deficiencies in the food safety system, and due to strong Russian concerns about safety and animal health issues in both Bulgaria and Romania.

Later in the year, however, certain veterinary officials, politicians and representatives of the dairy industry (AMP), realized that the complexity of the dairy reform would require much higher administrative and infrastructure capacity, more stringent safety and milk quality control, and last but not least, will adversely affect many small/medium size dairy farms, thus leading to undesirable social and political effects.

According to the AMP, Bulgaria needs a longer grace period for introduction of EC quality milk standards. It estimated that by 2008 when milk purchases from the third category farms should be terminated, it will affect about 500,000 rural families and their social status. The annual loss from milk produced but not purchased is estimated at 175 million Euro. The decline in production may lead to not filling country's milk quota and therefore, a gradual reduction in the quota. The AMP advocated for a longer grace period until 2010 and insisted on additional government resources to introduce modern milking equipment, cooling tanks etc. at a cost of 75 million Euro.

Based on a recent political decision, on July 9, at a technical meeting in Brussels, Bulgaria requested an extension of the grace period for all meat and dairy establishments until the end of 2009, or for two more years. Brussels agreed to revise current Decision 2007/31/EC and final official decision is expected by early September.

According to the new procedure, meat and dairy establishments will be categorized in two lists – positive (trading with the EU) and negative (trading on the local market only). Every two months the Bulgarian vet office will review establishments: those who meet the EU criteria will be added to the positive list (currently 63 meat and dairy plants; the last change was made on July 19 when 19 dairy and meat establishments were added to the positive list); those who have no prospects to meet the requirements in the next 1-2 years,

will be shut down. Newly established plants will be put in operation only if they fully meet the EU norms and will be automatically added to the positive list. No approvals will be left for last-minute inspections, as was the situation at the end of 2006.

A new element is the formation of so called group "60+". It consists of dairies which use sub-standard quality milk but produce cheeses that mature/age at least 60 days, thus eliminating safety risks. These plants are included in the positive list and will be able to trade in cheeses on the EU market. The EC, however, did not agree with the Bulgarian proposal about the composite products, butter and curd, produced at these plants, to be sold at the local market. Current EC decision bans any trade in these products.

According to the new derogation plan, the requirements for the safety/quality of milk change as follows:

2007 - max. 750,000 microorganisms/liter; less than 600,000 somatic cells;
2008 – max. 500,000 microorganisms/liter; less than 500,000 somatic cells;
2009 – max. 500,000 microorganisms/liter; less than 500,000 somatic cells;
2010 – max. 100,000 microorganisms/liter; less than 400,000 somatic cells or the EU standard.

The new decision was perceived with mixed feelings by the industry. It was not supported by the meat industry and by larger, market oriented dairy plants. The dairy industry was split in its reactions expressed by the two industry organizations, NDB and AMP. Differences were conceptual. The NDB considered the grace period extension as a long and painful postponement which would not help the sector. They thought small farms were a major market generator and a longer grace period would preserve this trend. The AMP fully supported the new grace period (see above) as a more gradual adjustment for smaller farms with slower and less negative economic sacrifices.

Laboratory capacity

There is a lack of sufficient lab capacities for testing of milk quality under the quotas. Currently, there are 22 state vet labs which should test for the content of microorganisms, somatic cells, and fat content. Fifteen of these labs are in process of introduction of the required ISO 17025/2006 for dairy products. At the end of May, MinAg approved an establishment of four new independent milk testing labs, with the financial support of EC-PHARE program. The availability of many small fragmented milk suppliers makes lab testing more difficult, resource intensive, not cost efficient and often, inaccurate.

Dairy products market

The issue with milk quality is tightly related to the dynamism of the dairy products market.

- Commercial supply of major dairy products (fluid milk, yogurt and cheese) has slowly increased since 2003 at the expense of home production although it still remains high.

- Over the past 5 years, distribution and sales of dairy products have steadily moved from traditional smaller retail outlets to supermarkets and hypermarkets where quality and hygiene requirements are more stringent. For example, in 2006/07, 48percent - 89percent of various types of fluid milk were sold in super/hypermarkets.

- Retail quality and safety requirements for dairy products become increasingly stringent. In early July, major retailers announced that they would require a new certification - IFS (International Food Standard, introduced by German and French retailers, recently accepted

by Italy) standards from local suppliers. Since only a few have such a standard in place, the pressure for more investment is likely to increase, which in turn will affect the purchases of raw milk. If Bulgarian companies are not fast enough to respond to retailers' demand, imports from EU MS can quickly replace local supply.

The dairy processing sector continues to attract foreign investors. After a Greek company purchased one of the largest dairies in April this year, in June, a Spanish investor (GED Capital Development) purchased the leading dairy company Fama for 9.0 million Euro. Fama is in the top three dairy companies and a market leader in North East Bulgaria. It is located close to the Romanian market, has well developed milk purchasing and collection system; well known brands and an experience to work under a private label; loyal clients; and good distribution. In 2006, Fama grew by acquiring Dobrich dairy processing company (Serdika 90) and thus expanded its market share. Current Fama capacity is 180 MT milk for processing daily. Reportedly, the Spanish investors value the stable and steady growth of the local dairy market: 5percent-6percent annually in value, and 2percent-3percent, in tonnage; proximity to the Romanian market; local traditions in production of high quality products and the potential for diversification.

The ice cream market also attracted several major investors over the past year. Currently, the market size is estimated at 40 million Euro or 11,000 MT with the prospect to grow to 15,000 MT or 20 percent in the next 1-2 years. Top companies on this market are Nestle (via Delta) 35 percent market share, and Darko, recently purchased by the Balkan Accession Fund, 22 percent market share. The remaining 45 percent is split among several local companies with about 10 percent share each (Karil, Izida, Deni). In 2006, players registered a growth of 5percent-20percent vs. 2005, and the same upward trend is foreseen for 2007.

Trade

Table 3. Dairy products trade in Bulgaria, 2006

| HS number | Imports | | | Exports | | |
|-----------|---------|-------------|---------------------------------|---------|-------------|---------------------------------|
| | MT | Million USD | Major suppliers | MT | Million USD | Major destinations |
| 0401 | 294 | 0.295 | EU | 316 | 0.439 | Various |
| 0402 | 8,183 | 16.5 | Czech Republic, Ukraine, Poland | 79 | 0.119 | Various |
| 0403 | 167 | 0.270 | Germany | 1,100 | 1.09 | Macedonia, Romania |
| 0404 | 7,299 | 6.5 | Greece, France, Holland | 4 | 0.013 | Various |
| 0405 | 1,360 | 3.15 | Germany, France | 570 | 0.93 | Greece |
| 0406 | 3,597 | 12.98 | Germany, Poland | 13,784 | 45.0 | Greece, USA, Australia, Lebanon |
| Total | | 39.69 | | | 47.6 | |

Source: Bulgarian Customs

In 2006, imports of dairy products remained stable in tonnage but increased by \$7.3 million in value. Exports were at about the same level as in 2005, however, at 12percent lower value. Still, Bulgaria remains a net exporter of dairy products with about \$8.0 million positive trade balance. The trade product structure is steady - more than 50 percent of imports are milk substitutes for processing (powder milk and whey), followed by cheeses.

In 2006 and in 2007, over 95 percent of dairy exports are cheeses and over 55 percent of them are made of sheep milk. About 80 percent of produced white type "feta" sheep cheese and 40 percent of yellow sheep cheese are exported. Due to good export potential and lack of quantitative restrictions, it is expected that sheep milk production and processing will be slowly but steadily developed in the future.

Recently, the MinAg appealed to the dairy industry to put more efforts to add value to local dairy products, to preserve their identity and authenticity. The Ag Minister was concerned that Bulgarian cheese was sold to Greece, packaged, labeled and traded as "feta" in the EU. Another issue was the identity of the traditional Bulgarian yogurt. Most processors add whey or powder milk as a substitute of fresh milk, and call the final product yogurt which is a violation of the traditional recipe and technology. Therefore, more efforts might be needed to differentiate local traditional product with live bacteria from the internationally adopted term.

Table A. Major differences in positions and policies pursued by the National Dairy Board and the Association of Milk Processors

| Association of Milk Processors | National Dairy Board |
|---|--|
| <p>Grace period: Longer grace period is needed since 80percent of milk produced is sub-standard, and at small farms (1-2 cows). Thus, rural areas will lose 150 million Euro from 2008 on, if the grace period is not extended. This will negatively affect about 500,000 people in villages.</p> | <p>Grace period: Longer grace period is not needed. Small farms will remain off the market since they have no chance to improve enough to meet EU requirements. Those who wanted to progress have already invested with the help of pre-accession programs (SAPARD). Extended grace period is a more painful and longer agony.</p> |
| <p>Quotas and milk reserve: Milk quotas are distributed by NDB in secrecy, based on hidden economic interests and hurt small producers. Larger farmers get higher quotas in order to profit from their future sales in 2008. Milk reserve should be distributed among all farmers and a preference should be given to smaller farmers with reduced quotas.</p> | <p>Quotas and milk reserve: Milk quotas are distributed based on the methodology approved by the MinAg in Decree #51. The AgMinister approved and signed a decision about milk quotas distribution - Ordinance 09-231/April 13, 2007. According to this regulation, the quota for direct sales is 70,770 MT and the quota for deliveries is 629,537 MT. The law for the organization of the common market, art. 49 (1) says that the national dairy quota and the national dairy reserve are managed by the MinAg. The milk reserve should be distributed based on current regulations to farms with more 10 cows.</p> |
| <p>Trade in quotas: It is not clear if the country needs a milk quota exchange. The exchange may motivate hidden economic interests and corruption.</p> | <p>Trade in quotas: The NDB hopes that the milk quota exchange will be the accelerator which can help larger and more progressive farms to strengthen. Smaller ones can specialize in a non-dairy, most likely meat, production.</p> |
| <p>Lab tests: Milk tests for fat content and other milk characteristics can be done at own labs at dairies. No need to pay extra for tests at independent labs, about 6 million Euro total. Ring tests are sufficient.</p> | <p>Lab tests: Milk tests should be done at only accredited labs and 2.5 Euro fee is paid per a sample test. Independent tests should be done at non-government accredited labs.</p> |
| <p>Re the NDB Bulgaria does not need a NDB. Such organization exists in Denmark where the dairy sector is very different from Bulgarian. Quotas and other dairy reform decisions should be taken by the MinAg which is politically responsible for eventual deficiencies. This will eliminate potential conflict of interests. Industry organizations should play only an</p> | <p>Re the NDB The NDB exists is several EU MS- Denmark, Greece and Holland. The industry should work in close coordination with the MinAg but also should undertake its responsibilities.</p> |

| | |
|--|--|
| <p>advisory/consultative role. Bulgaria should take lessons from Romania and Poland where the dairy farming is similar – small and fragmented.</p> | |
| <p>The NDB illegally requests 10 leva per each milk quota certificate and 3 leva/cow. This mean total 11 million Euro collected from 100,000 dairy producers for 340,000 cows.</p> | <p>The NDB collects only its membership fee. Quota certificates are free. Certificates are distributed not by the regional dairy boards but by MinAg regional offices.</p> |