momagri
mouvement pour une organisation mondiale de l'agriculture

Another CAP is possible!



For a sustainable and competitive agriculture

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2012

1 *Momagri's position on the European Commission's proposals for the post-2013 CAP*

The CAP reform project presented by the European Commission on October 12, 2011 appears as a temporary text seeking to maintain a budgetary status quo. It does not answer the strategic challenges of the 21st century. These challenges require an efficiency that must be at the same time economic, social and environmental.

Based on assumptions that agricultural prices will remain high and on an upward trend, the current proposal only partially includes mechanisms to regulate agricultural markets and fight price volatility.

Built on recognized scientific works, the momagri model shows that agricultural markets are structurally unstable. Let's remember that agricultural demand and supply are price inelastic: a fluctuation of 1 to 2 percent in global production can generate price variations of 50 to 100 — even 200 — percent. With the Commission's project, prices will definitely be highly volatile in the coming years — whether downward or upward — similarly to the extreme price variations observed in 2008 and 2010.

Ironically enough, the crisis currently affecting the European Union could well give the opportunity for a new CAP that is to effectively fight the extreme volatility and encourage a quantitative as well as qualitative production.

Indeed, the current crisis is questioning the efficiency of CAP subsidies payments.

Momagri believes that a new economic and budget approach is possible to achieve better efficiency. The budget of this alternative CAP should be flexible enough to allow for a market-oriented policy that prevents and deals with imbalances, without producing overruns for the multi-annual financial framework.

The current proposal of the European Commission is based on a configuration that is out of step with the new challenges of food security and renewable commodities. It would threaten the competitiveness of European agricultural production and agribusinesses without bringing any benefits to consumers.

Another CAP reform is possible!

2 The basic principles of momagri's proposal

A. Hypotheses

Following the CAP founding principles outlined in the Rome Treaty, momagri considers that agriculture is a unique and strategic activity. It has to meet the needs of consumers and insure the competitiveness of related agribusinesses. As an essential component of the European economy, agriculture requires a regulatory policy adapted to the many risks it is confronted to.

Considering the following:

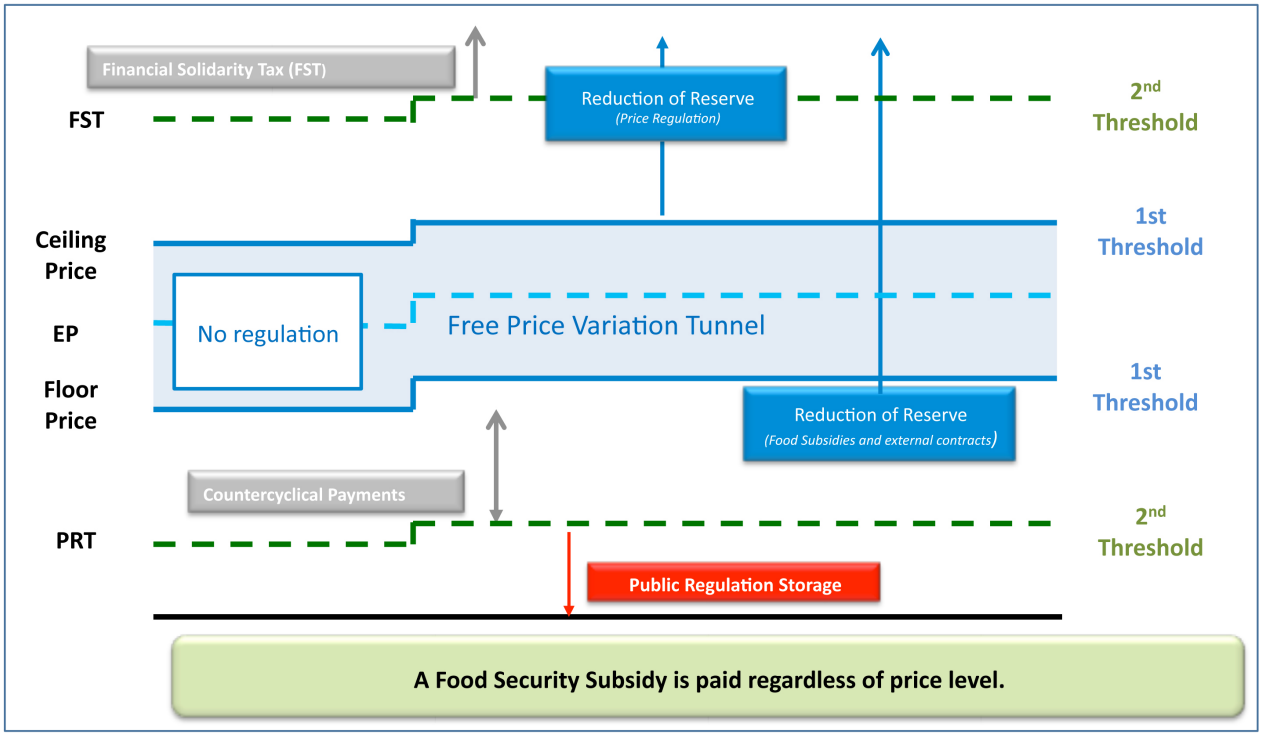
- Agricultural markets do not self-regulate, as proven by the recent agricultural and food crises.
- Agricultural price volatility is structural. Beyond their exposure to climate and epizootic hazards, agricultural markets are subjected to the irreversible nature of crop and investment decisions and to the low price elasticity of demand and supply.
- Total free trade in Agriculture generates systemic risks that increase the frequency of sharp price turnarounds at the global level.
- Unilateral decisions by some agricultural exporting nations to curb and then restart exports — as did Russia — are exacerbating price fluctuations in international markets.
- The growing financiarization of agriculture and speculation on global large agricultural productions since the 2000s — mostly through opaque OTC transactions — lead to agricultural price volatility.

Momagri has developed an alternative CAP project to improve the competitiveness of European agricultural markets. The project is crucial to foster European production on a quantitative and qualitative level, while controlling the allocated budget. It relies on an equilibrating price approach ensuring:

- A better prevention and management of the various risks farmers are exposed to;
- Regulatory mechanisms providing farmers with adequate visibility and fair income for their activities;
- A proactive management of market imbalances;
- An efficient management of agricultural budgets.

Momagri advocates a different CAP, still structured around two pillars but with a part of the budget — including the share currently allocated to SPS — reoriented toward tools to manage agricultural markets according to a countercyclical approach.

B. The new regulatory framework



EP (Equilibrating Price)
FST (Financial Solidarity Threshold)
PRT (Public Regulation Threshold)

A free price variation tunnel around an equilibrating price (EP)
The mechanism relies on an equilibrating price (EP) for each major crop, based on the average production cost recorded in the EU. The price can be revised according to cost fluctuations.
A free price variation tunnel, without any public intervention, is set following an evaluation process taking into consideration the needs for market regulation around such equilibrating price.

The payment of a Food Security Subsidy per acre
The Food Security Subsidy aims at offsetting the economic impact of costs generated by the European agricultural model (family farming as well as quality, health and environmental requirements).
It is the same for all crops and all regions and has been assessed at €30.40/acre in momagri's proposal.

The regulatory measures for physical and financial markets when prices are outside the tunnel
Should prices be outside the tunnel, the European Union would automatically trigger regulatory measures in physical and financial markets, based on guidelines previously agreed upon by the EU Council.

*Market prices are below the floor level (floor price).*Farmers receive countercyclical payments. Based on the gap between the market price observed at regular intervals and the floor price (bottom of the tunnel), this subsidy will be applicable to nearly all production volumes. Should market prices decline and reach a second threshold (defined by the EU as Public Regulation Threshold), public regulation purchases are initiated. They may represent up to eight percent of annual production (regulation storage), and should be added to the strategic permanent food security storage amounting to two percent of annual production.

Market prices are above the ceiling level (ceiling price). A variable solidarity tax will be introduced on all agricultural, financial and physical transactions of traded products. Revenues from this tax finance the Reserve Fund set to cope with eventual crises.

The EU will have the ability to undertake operations of storage reductions in limited proportions with the renewed goal to move toward the equilibrating price.

According to our tests, operations of public storage increase or reduction will not generate any storage buildup. The risk will be even lower, since the growth of non-food industries opportunities will bring out lasting solutions. The mechanism should be effective enough to quickly bring prices in the tunnel by discouraging speculative behavior in markets.

Flexibility for food aid
In case of emergency — to strengthen food aid or to service contracts concerning nations subjected to persistent food crises — the European Council might authorize additional public storage reduction operations.

A multiannual reserve fund
The annual CAP budgets (1st Pillar) might vary according to year-to-year market evolution, within the multiannual limit set by the financial perspectives.

A reserve fund will thus provide, over time, the necessary pooling of EU expenses. It will be financed and used over time according to market conditions.

3 The budget impact of momagri's proposal

A. Underlying assumptions of momagri's proposal

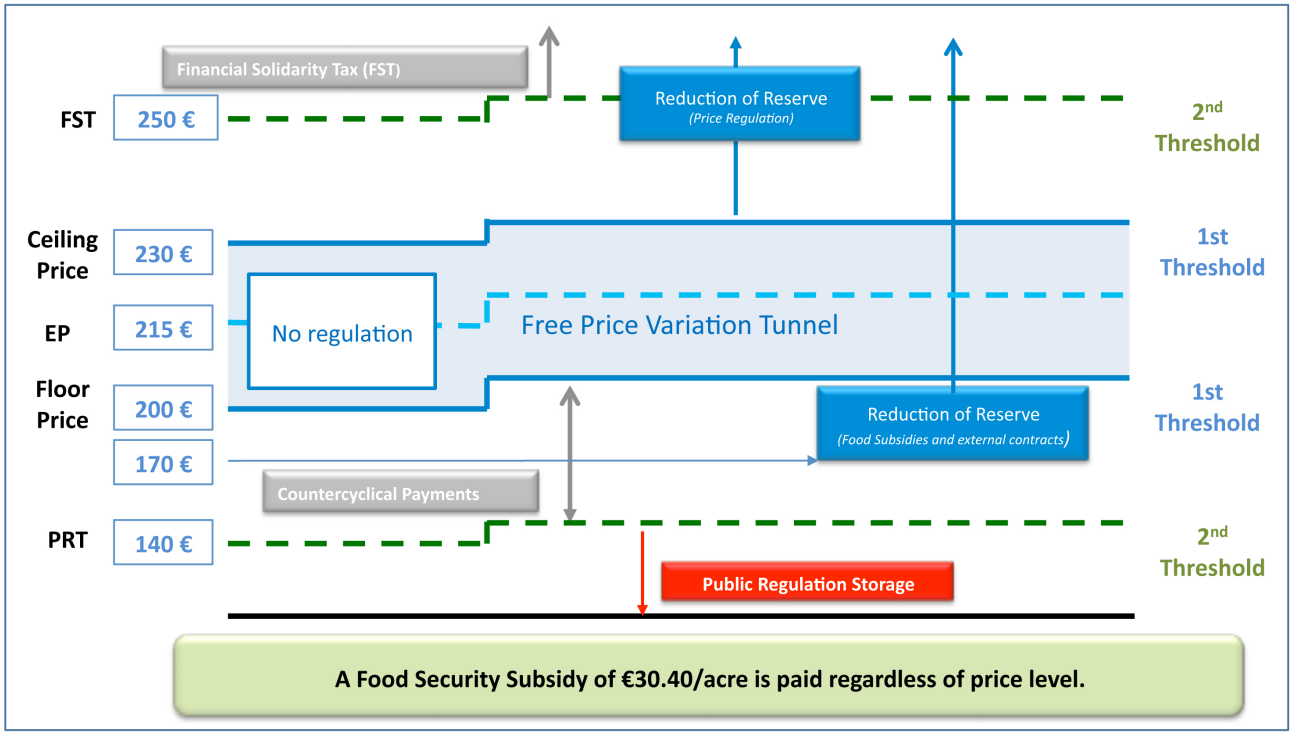
The budget simulations were made for the two following periods: 2006-2010 and 2011e-2020e.

"Interventions in Agricultural Markets" (outside of export refunds) and "Direct Aids" for cereals and milk and milk products are not used anymore. Therefore, the corresponding budgets have been subtracted from the total budget for the 1st Pillar.

For 2010, these subsidies amounted to a budget of €26 billion (59 percent of the 1st Pillar).

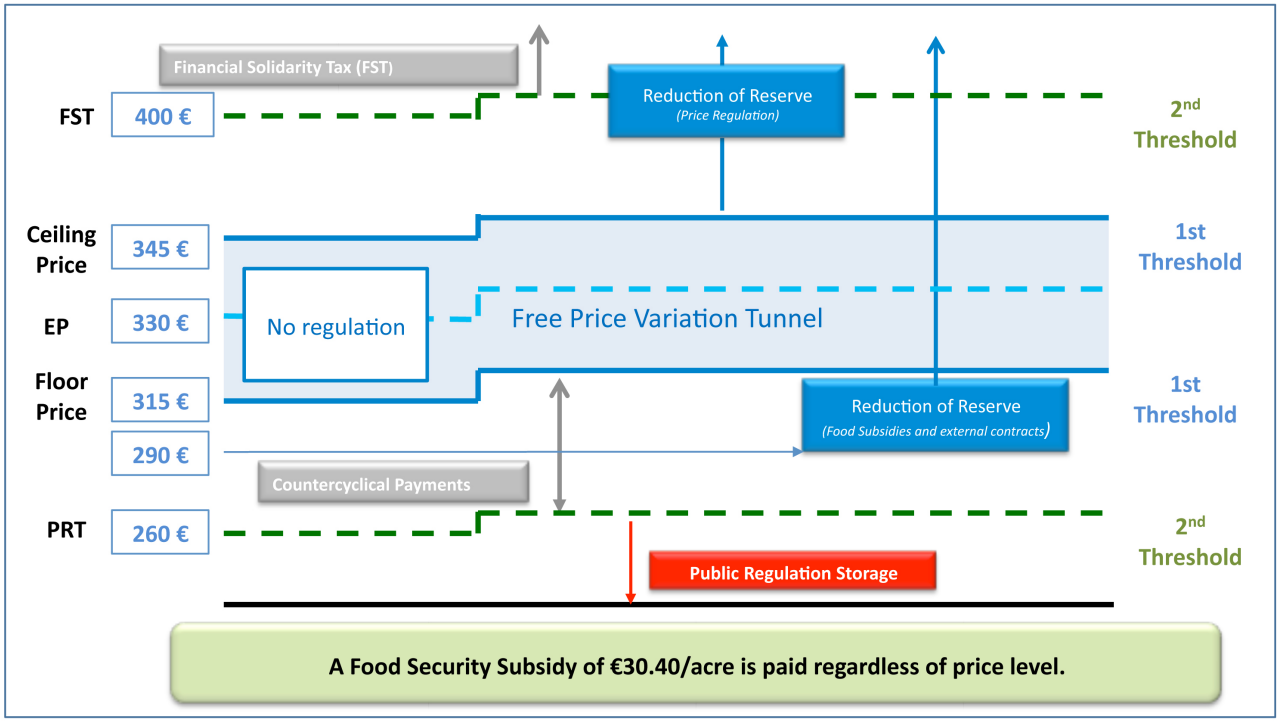
Stress-tests have been made for over fifty simulations to test the robustness of the proposed system in terms of pricing scenarios and of assumptions regarding the regulatory variables.

Figures for cereals



EP (Equilibrating Price)
FST (Financial Solidarity Threshold)
PRT (Public Regulation Threshold)

Figures for milk and milk products



EP (Equilibrating Price)
FST (Financial Solidarity Threshold)
PRT (Public Regulation Threshold)

With the exception of New Zealand that benefits from special conditions, all major milk producers in the world — including the European Union — have implemented supply management policies or target price policies.

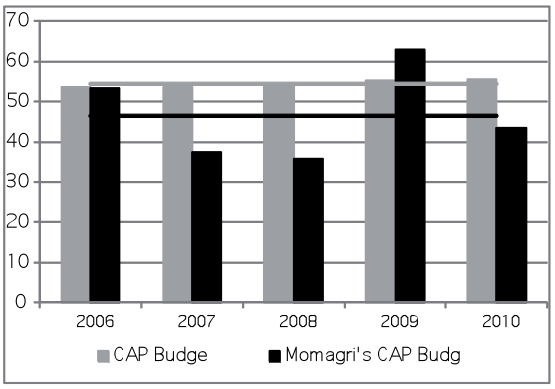
Momagri believes that the elimination of quotas, planned by the European Commission, might lead to a risk of market imbalances. Should the quotas be eliminated, momagri's proposal could provide a solution. It would of course be tailored to the specific nature of agriculture and include measures to curb stocks.

B. Global cost comparison: the current CAP vs. the alternative CAP proposed by momagri

Significant budget savings

If we consider the period 2006-2010, the budget costs following momagri's proposal would have been lower than current expenditures.
Average budgets even show aggregate savings of €40 billion (€8 billion/year), or 15 percent of the budget over the five-year period.
Part of the spared money could have financed the Reserve Fund and be used during the 2007 and 2010 crises.

Global CAP cost vs. momagri (in €billions)



Sources: EC and momagri 2011

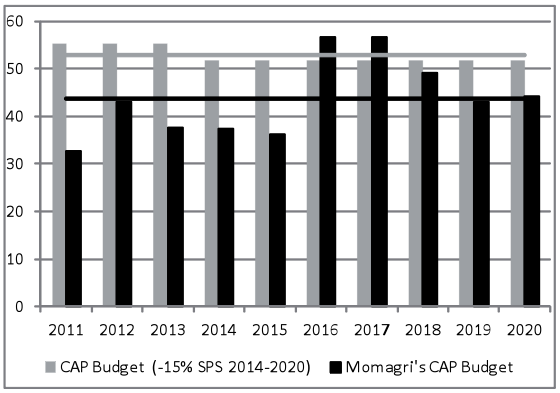
An optimal EU budget management that complies with market conditions

The reported difference is based on the countercyclical approach of the system proposed by momagri. When prices are higher or equal to the tunnel bottom limit (floor), public expenditure is restricted to the Food Security Subsidy (FSS).
Yet, for the period 2006-2010, cereals and milk prices, which were strongly impacted by volatility, reached average levels that were equal to or higher than the bottom limit of the proposed tunnel.

An efficient system over time

In addition, budget simulations were conducted based on price projections realized through the momagri model for the period 2011-2020.
There again, the proposed alternative framework leads to a ten-year budget that is lower by about 15 percent than that of the current CAP reform project.

Global CAP cost vs. momagri (in €billions)



Sources: EC and momagri 2011

An efficient system to fight volatility

In addition, momagri considered the impact of its alternative CAP on farmers' earnings[1].

For the periods 2006-2010 and 2011e-2020e, cereals farmers' revenues would have been slightly lower with momagri's proposal than with the current system, but much less volatile, thus stabilizing the whole agricultural and agribusiness sectors.

[1] Earnings should be understood as "operating result" and thus includes production sales as well as financial aid paid to farmers by the EC budget.

Thanks to its countercyclical approach and market management mechanisms, momagri's CAP allows to:

1 Provide lasting stability to farmers' revenues near the recorded or planned average of the current CAP, without jolts in earnings and with a minimal guarantee close to the equilibrating price.

2 Significantly decrease the CAP budget by about 15 percent due to a regulatory system directed toward market management.

3 Curb excessive price fluctuations — whether upward or downward — because the proposed regulation mechanisms will foster price convergence toward the free price fluctuation tunnel.

4 Improve the effectiveness of EU public expenditures, while facing the issues of agriculture as a crucial strategic asset to meet the challenges of the 21st century.

Momagri focused its work on cereals which, either consumed as such or through animal products, is the base of nutrition in Europe and in the rest of the world.
Thus, stabilizing cereals markets should also lead to the stabilization of markets for oilseed crops and major meat products.
Of course, momagri's proposal does not exclude specific subsidies that aim to maintain economic activities in all regions!
Finally, this proposal is part of the International Agricultural and Food Policy advocated by momagri.

The above-mentioned figures represent a synthesis of the budget simulations that were made. Detailed results will be soon published on momagri's website: www.momagri.org.

Furthermore, momagri conducted research on the required adaptation of regulatory and institutional guidelines. The results proved the political feasibility of this alternative proposal.

For additional information, please address your request to contact@momagri.org.