

Momagri's Position Paper on the Task Force report on agricultural markets

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Presented as one of the reports structuring the European Union thought on the Common Agricultural Policy's up-coming changes, the Task Force report on agricultural markets deserves an in-depth analysis, especially when the future CAP reform is open for public consultation. Set up in September 2015 by Commissioner Hogan, the expert group called Agricultural Markets Task Force (AMTF) submitted their report last November. Recognizing that farmers have been suffering from their weak negotiating position in the supply chain, the mandate given by the Commission was to come up with solutions in terms of market transparency, better producer organization as well as reliance on futures markets. Result of a large consultation, the report structure the concerns expressed by different players in the food supply chain.

We develop below a part-by-part analysis of the report's assessments and proposals.

1) Generally speaking, it is revealed to Momagri that :

- **The scope of the mandate given to the Task Force is too narrow since we cannot consider risk management without thinking about crisis handling.** If farmers and agribusiness enterprises have to adopt risk management strategies, then crisis management (and thus crisis prevention measures) must rely exclusively on public authorities. The principal risk that farmers have to bear is that related to their income. It is hence necessary to mention direct payments and their conversion to counter-cyclical support when addressing agricultural risk management.

- **The role of public authorities in correcting different market failures examined in the report is not clearly defined.** Private sector's voluntary initiatives are not sufficient to overcome the problems caused by excessive downstream concentration as well as transparency shortage.

- **While it is important to give an account of negotiating power imbalances in, probably most often, upstream stages of the agricultural supply chain, this is obviously not much of a novelty.** In fact, it has always been one of the reasons for public intervention. Given the fall in value across all sectors due to bargaining power imbalances and higher costs linked to agricultural market instability, the Commission has to urgently revise its leitmotiv of « market orientation » as regards its actual functioning. Momagri particularly regrets that the PPE proposal of a mandatory double labelling on retailer's branded products was not adopted.

- **The report completely ignores the use of Article 222 by missing out the results of the implemented milk production reduction support.** The measure was however disclosed and carried out during the Task Force's operational period. Recalling that the Article's alias is « crisis cartel », Momagri denounces the European Commission's strategy to back away from its accountability. We cannot advocate competition rules while keeping calling for cartel creation to overcome crises.

- **The single CMO regulation turns out to be extremely confusing, juxtaposing each production's own rules.** Whereas it is important to clarify the prevailing of the CAP over the competition law, it is also essential to harmonize the economic organization principles across all sectors.

- **The report revives the proposals of reliance on « financial instruments » put forward by the Commission and the Juncker Plan. Look out for induced bad practices!** As the current crisis is primarily a result of the global overproduction, it is more than a little absurd that investment and thus over-indebtedness is encouraged. Calling for easier margin calls financing on futures markets through these « financial instruments » could also lead to improper practices. This is in direct opposition to the prudential framework which requires that all risks taken must be hedged by adequate collateral.

2) Analysis of principal assessments and recommendations of the Task Force

a) Improve market transparency

Real agricultural market characteristics are quite different from those associated with theoretical perfect markets which display complete transparency and full access for all participants to perfect information. The reports indicates that downstream markets are especially opaque, in contrast to

upstream stages where farmers' production costs are known. This situation is considered detrimental to all market participants since it could result in expectation errors. Price and profit margin observatories introduced in France in 2010 under the initiative of Bruno Lemaire is highlighted. The report also refers to an American scheme implemented since 1999 which imposes mandatory electronic price report throughout the whole supply chain for most of the livestock sector. The advisory group's main recommendation points exactly to the implementation of similar facilities in Europe.

For Momagri :

- This proposal makes good senses as market information has public goods features. Everyone wishes to make use of this information but nobody on his own finds it advantageous to disclose his data.
- It is essential to standardize the market statistics system whose performance has been worsen since public intervention has either waned in former Member States or just been set up in the latest newcomers. A thermometer is in fact not necessary anymore for the doctor does not want to continue his job!
- It is appropriate to take advantage of new information and communication technologies to collect and disseminate this information in a cost-effective manner while ensuring total anonymity. Finally, it is important to remind that a major part of the pricing process is still carried out through traders' involvement.

b) Risk management tools

Risk management tools consist of all facilities at farmers' disposal to mitigate their exposure to different production and market risks. Also included are national fiscal means that can smooth out tax collection to contain the consequences of price volatility on farming results. The report evokes the principal obstacle to climate risk insurance development: *« Insurance schemes are the most apt to address weather-related risks from an ex ante point of view. In contrast, systemic risk (e.g. market) increases the potential for very substantial pay-outs and thus reduces the attractiveness for insurance companies to invest in such portfolios »*. As regards weather-related insurance schemes, the report suggests a downward revision of critical thresholds, in coherence with in-progress discussions over the Omnibus rule. Given the limited development of mutual funds introduced in the last CAP reform,

the report proposes that this type of funds can be governed by sectoral organizations[1] (i.e. those gathering producers of the same products). And notably that these funds' functioning rules are not based on real farm income levels but indices. Lastly, by urging to take into account the heterogeneity of risks, the European agriculture diversity and existing national initiatives, the Task Force members insist on shifting the CAP towards a strategic risk-management policy.

For Momagri :

- The report properly reminds the factors that confine price-related risk insurance development.
- It is meaningful to recommend a transformation of the CAP towards a risk-management policy. But this is not enough since limiting actions to the sole management of risks always costs more than trying to remedy or even prevent these risks. As such, Momagri calls for a policy that devotes to risk and crisis prevention and management. Converting current decoupled payments to counter-cyclical support will be the cornerstone of the reformed policy. The coordination among insurance schemes, counter-cyclical payments and market balancing measures will offer real perspectives of income stabilization and crisis management with true EU-wide added value and virtuous public funds administration.
- Inversely, the mutual fund subject appears much less promising for us, even though this type of instruments should be thought of. Certainly, creating funds by sector/product seems obvious. Furthermore, suggesting that for each fund, triggering levels are based on indices (price, theoretical gross margin, etc.) rather than farmers' real income is relevant. This is because of the time needed for farm accounting to be completed and the heterogeneity of, often diversified, farm businesses, not to mention the adverse effects related to bookkeeping entries. For all that, once the mutual funds are filled up with public money, public authorities have to look at the indice-based triggering limits in order to avoid possible large fiscal slippages. Hence, the Commission or Member States will have to regulate the fund functioning by defining product-wise reference prices and margins, as for a counter-cyclical payment system. However, the rule is not the same in case of high prices when funds should be loaded with farmers' capital. On this last point, it is appropriate not to think that producer organizations are able to handle this issue without risks of implosion. We have already seen the difficulty to improve or just maintain the collective structures to ensure production

[1] Proposal that we submitted in March 2016 : http://www.momagri.org/FR/articles/Rapport-pour-le-Parlement-europeen-sur-les-outils-de-gestion-de-risque-les-idees-de-Momagri-avancent-_1742.html

marketing or sectoral dialogue. Adding the fund management to their responsibilities, notably in periods of high prices when farmers are asked to make contributions to the funds, presupposes an unachievable collective discipline without any enforcement power of public authorities.

- Finally, another interest of the debate on mutual funds is the questioning of the CAP first pillar's annual budget stability. Indeed, this is required in case of a public co-financing proportional to farmers' savings, which are by definition variable depending on the economic situation. In sum, for Momagri, the discussion on mutual funds will result in the conclusion that a counter-cyclical payment system is much more pertinent.

c) Futures markets

Futures markets can offer an important tool to cope with price volatility and ensure price formation transparency in sectors where they are adequately developed. The report correctly indicates that « *while futures can protect market participants from impacts of short-term price volatility, they are less effective in hedging against prolonged periods of low prices* ». As the most suitable instrument, futures can « *strengthen farmers' competitive position in relation to bigger and better-informed operators in the supply chain* ». Moreover, cooperatives provide farmers with privileged, direct or indirect, access to futures markets. Lastly, the Task Force members underscore that the application of Barnier directives (EMIR, Mifid2 and MAD) will allow to move OTC (over the counter) transactions to regulated platforms which will improve futures market liquidity.

For Momagri :

- The regulations related to transparency and counterpart risk control, by applying Barnier directives, make futures contracts interesting tools as long as we do not expect them, like some others instruments, to stabilize prices.
- At present, futures markets exist in particular for grains, oilseeds and sugar. Expanding their development to other products requires, above all, an increase in transparency, if not the centralization of certain physical transactions. Political willingness, which seems to be absent at this stage, would be demanded for this to be done because it may be necessary to restructure certain sectors where opacity and private arrangement are beneficial for just a few dominant players.
- Proposing to finance margin calls with public funds and the « financial instruments » is not serious. In effect, one must keep in mind that margin calls become losses when the futures contract expires. Enabling such public financing would participate in circumventing the

fundamental prudential rules which limit the amount of risk that an operator is allowed to take to as high as the collateral he possesses. At least, this hazard-inducing proposal reminds us that volatility management is costly for agricultural sectors.

d) Unfair trading practices

« *Unduly late payments, unfair shifting of business risk to the other party, unilateral or retroactive changes to contracts, unfair termination of contracts »,* there are numerous types of unfair trading practices. They lead to « *inefficiency and negatively affect operators that would otherwise be commercially viable* ». Nonetheless, the authors see themselves *« under no illusion that a legislation will be a panacea for imbalances of bargaining power in the supply chain* ». Examples of independent authorities in Spain and the UK in charge of investigating the victims at their discretion to avoid any « fear factor » are highlighted.

For Momagri :

- This part of the report appears to be under-developed regarding the problems that agri-food sectors have to suffer due to the oligopolistic feature of product distribution in Europe. The right of suppliers applied in other sectors should be a more solid discussion foundation than the « food supply chain initiative » currently proposed by the Commission.
- The PPE recommendation to enforce double labelling on retailers' branded products was unfortunately not adopted.[2]
- Founding an agricultural and food policy on the principle of competition and « market orientation » while remaining pusillanimous against a quasi-monopoly could not be sustainable in the long term.
- Finally, is it necessary to recall that market regulation measures which have been smartly unraveled since two decades now were also intended to limit the consequences of strong downstream concentration? As far as expecting consumers to pay more for products so that producers are paid decently (cf. praiseworthy initiatives of « make milk » or « who is the boss »), the EU agri-food policy has shown off one of the most striking symbols of its responsibility default.

e) 'Contractualisation'

[2] See this note by Momagri http://www.momagri.org/FR/regards-sur-l-actualite/Crise-agricole-les-Allemands-s-en-melent-et-c-est-tant-mieux_1789.html

« The term 'contractualisation' is rarely or never used in standard English […] ». This short chapter begins like that. In particular, it witnesses the stalemate of debates in France on sectoral organization. The concept of *«* value sharing » is brought forward by referring to the grape price fixing scheme based on per-bottle wine price in the US. Are there similar examples in Europe? Among those cited in the report to prove the benefits of contracts, we can see Glanbia cases where the Irish milk processor proposes different price fixing mechanisms to its milk suppliers. Notwithstanding, it is not emphasized strongly enough that these examples mostly correspond to cooperatives' price-fixing proposals to their members which gives the latter more visibility. Meanwhile, it is desirable that this kind of practices is adopted by producer organizations which have no bargaining power and companies which, not being cooperatives, have no interest in doing the same.

For Momagri :

- It is appropriate to recall that good governance of cooperatives is a daily challenge to cooperative managers, who cannot look after the sustainability of their enterprise without consideration of the consequences for all the members. Given the importance of livestock cooperatives in most Member States, the French exception of 'contractualisation' has to be downplayed. A contract on its own is never be able to help rebalance a trade relationship.
- The Milk Package has, in general, clarified the legal framework of cheese inter-branch organizations based on registered designations of origin. This grouping mode at work for the Comté or the Roquefort or elsewhere in France now has to demonstrate its efficiency in terms of notably an equal sharing of added value. The doubts that persist on the euro-compliance of such organization schemes for other sectors have to be discarded by an adequate regulatory response.

f) The CAP and competition law

« Farmers may use collective action and horizontal cooperation to achieve common interests related to their agricultural business. » where collective action can be done through a production planning. This part of the report expresses the trauma that has been experienced after several interventions of competition authorities, especially in case of endive in France. Although many kinds of flexibility have been offered to farmers to create their producer organizations (POs) which are also funded by the CAP's second pillar, there is a need for a clarification in the Single CMO. This would emphasize *« the primacy of the objective of the CAP over those of competition policy »*. The authors suggest in addition to rely on Article 222 CMO (namely 'crisis cartel' article) which allow temporary collective action between POs or through vertical cooperation (with other downstream market players) to

schedule production in crisis in particular. They even wish to go further by introducing an extension rule that make the decision applicable to all producers, including non-members of POs. The authors also state that this sort of measure needs not to be limited as one of « last resort », i.e. in case of severe crisis, only.

For Momagri :

- It seems indeed important to speak of this clarification to remove the doubts about the contradictions between the CAP and the competition law. It appears all the more critical since a discrepancy between the reaction of national authorities and that of the European competition authority has sometimes been perceived.
- However, possibilities of collective action allowing better organization of farmers have already been numerous. And the imaginary fear of the competition watchdog concerning certain agricultural sectors has been so strong that it has sometimes resulted in their irrational positions on the false « euro noncompliance » of some grouping forms.
- Single CMO rules are quite confusing on this issue. They should be rewritten so that economic organization regulations become truly coherent with those in the CAP for all and every sector.
- The Task Force does not mention the milk production reduction support scheme implemented during 2016Q4 even though their works were in progress when the measure was carried out. Since Article 222 has been for a long time considered solution of last resort to cope with the milk crisis, the consequences of the milk production reduction support should be drawn. In April 2016, POs, inter-branch orgaizations and cooperatives are allowed to plan their production by themselves under Article 222, but this did not work out. Therefore, the Commission decided in July 2016 to pay 14 cents per liter of milk not produced. It is unrealistic to believe that operators can come to an agreement on their own to rebalance a market in time of crisis. Meanwhile, prohibiting producers to form cartels is not enough to prevent them from doing so. Waiting for the opposite behaviors to happen is such a theoretical view. The role of public authorities and thus the Commission in determining what a crisis is and notably in coordinating and calibrating measures to tackle crises is essential.

g) Access to finance

In order to improve the agricultural sector's access to finance, the report promotes the use of public funds to encourage access to « financial instruments » defined as « *equity investments, loans,*

guarantees or other risk-sharing instruments ». This consists, as specified in the document, in financing viable projects that can « *generate enough income and savings to pay back the support received* ». The main objective is « *to stimulate access to finance for recipients who have difficulties in finding funding for their investments* ». This is because *« agriculture continues to be considered risky in the world of financing […] due to agricultural particular features and a lack of knowledge about them in standard financial institutions »*. The authors hence propose to use « *CAP money* » to back the implementation of « financial instruments » so that they become embedded in « *the toolbox of the future CAP* » to finance *« price volatility management* » and « *young farmers who intend to purchase productive land* ».

For Momagri :

- It is quite risky to advance such Juncker Plan-rejecting proposals without relying on any demand analysis. Interest rates are historically low and banks have been supported by « unconventional » monetary policies conducted by the ECB since many years now. Are there any other levers than subsidizing banks with « CAP money »?
- For shortages that may exist in the East, the European agricultural sector has always been, since the CAP creation, able to turn to public or semi-public banks which are close to the agricultural world. Bringing forward the financial sector's lack of knowledge about agricultural particular features is not an admissible argument.
- Difficulties encountered by many sectors can be explained by a global overproduction crisis. Encouraged to overinvest in this post-crisis period for tax optimization purposes in particular, French and European agriculture suffer more from the weight and costs of their over-indebtedness than development hardship due to limited access to finance. Helping debt refinancing using CAP funds may also induce bad practices.
- The success of the first CAP before 1992 results from the stability given to farmers which allows them to modernize their business and make investments to improve productivity. This was finally beneficial for consumers as food prices were reduced. The riskiness of farming activities has undeniably increased by the combination of the dismantling of market management tools and the inability to build a coherent and efficient system to prevent and tackle risks and crises. If the European Commission wants to effectively widen access to finance, it has to do so by focusing on protecting farmers' economic environment rather than subsidizing banks further.