momagri
mouvement pour une organisation mondiale de l'agriculture

# White Paper

## A new strategic course for the CAP



*Paris, August 30, 2016*

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# Glossary

| | |
|---|---|
| EQA | Europe Quality Aid |
| EC | European Commission |
| FAO | Food and Agriculture Organization of the United Nations |
| IMF | International Monetary Fund |
| AMS | Aggregate Measurement of Support |
| OECD | Organization for Economic Cooperation and Development |
| WTO | World Trade Organization |
| WHO | World Health Organization |
| UN | United Nations |
| FADN | Farm Accountancy Data Network |
| CAP | Common Agricultural Policy |
| CCP | Counter-Cyclical Payments |
| EP | Equilibrium Price |
| FP | Floor Price |
| CP | Ceiling Price |
| DSTE | Domestic Support with Trade-distorting Effects |
| SGPAA | Global Support to Agricultural and Food Production<br>*Soutiens Globaux à la Production Agricole et à l'Alimentation* |
| PRT | Public Regulation Threshold |
| FST | Financial Solidarity Threshold |
| TAFTA | Trans-Atlantic Free Trade Agreement |
| EU | European Union |

# Summary

## 1. Momagri's position on the CAP reform

The new Common Agricultural Policy (CAP), which took effect in early 2015, comes in a turbulent international context and an unchartered economic environment that reveal the need to give a new strategic course to the European agricultural policy.

In effect, it is no longer acceptable to justify the dismantling of European crisis management mechanisms:

- on the basis of the WTO rules which do not include food security and are circumvented by main agricultural countries,
- on the belief on upward trends of agricultural prices while they have collapsed and without considering price volatility,
- on the idea that greening is the only approach to transform the CAP whereas securing farmers is an essential prerequisite for better production practices.

This is a fundamental political fallacy which, by ignoring price volatility and agricultural crises, fuels Euro-skepticism on a daily basis.

In fact, the European agricultural policy no longer has tools to intervene in case of market instability despite a large number of mechanisms in its "tool box". Confronted to negative consequences of agricultural markets' excessive volatility, policy responses cannot just focus on limiting those effects by trying to make farms more "resilient". It must, like other agricultural powerhouses, also prevent and directly act to curb price movements that go way beyond the scope of supply-demand adjustment.

In this respect, Momagri recalls that not only agricultural market volatility is structural but also extreme price movements tend to be amplified, due in particular to the growing financialization of agricultural markets. Farmland reserves and productivity gaps are such that the scenario of a trend of higher agricultural prices resulting from an insatiable demand fueled by the prospect of "nine billion mouths to feed in 2050" is not credible.

On the contrary, a decade of relatively high prices we just experienced have stimulated unprecedented investment in agriculture throughout the world. Land recently farmed, new equipment to increase farming labor productivity and newly established animal husbandry might boost production far beyond consumption growth, and lead worldwide agriculture to a long and painful overproduction crisis.

In such context, the inability to assume the Doha Round failure and to draw its conclusions to design the foundations of a new world governance system for agricultural policies, is indeed

instructive. For lack of a better coordination of agricultural policies that would help emerge genuine international cooperation on market stabilization, the instability of international prices will inevitably be synonymous to trade openness reduction. As what happens in the international commodity trade has proved, it is stability that allows increasing trade, not the reverse.

With the latest CAP reform, and even more with the milk crisis induced by the quota removal and the release of the European dairy productive potential without any safety net (the EU is the top world producer of dairy products), the European Union continues its tragic course like a headless duck.

At the same time, the United States, Brazil, China and many other nations have learned from the 2007/2008 food crisis, and strengthened their support programs to prevent their farmers from "sinking into the red" in times of agricultural price collapses. There, agriculture and food production are considered as strategic assets, while in the Old Continent it "would be modern" to let a vital sector of our economy at the mercy of climate events and demand-driven adjustments, that are all the more painful as not being facilitated in an orderly fashion.

Paradoxically, the crisis currently occurring in the European Union might put forth a new CAP able to effectively fight the scourge of volatility and further safeguard its agricultural sector. This CAP should be the one which puts agriculture in the best conditions in order to face the many challenges of the 21st century––food and population challenges, climate change, dwindling fossil fuels and preservation of natural resources, etc.

At stake is the EU added value of the CAP to intervene when markets fail and to have the adequate budget leeway to implement a policy that prevents and manages crises.

All major agricultural powerhouses have designed their agricultural policies in order to cope with or tackle price volatility, except the European Union. The bloc is now the only one to pursue the logic of decoupling which, by definition, has no "counter-cyclical effect" or stabilizing factor on farm incomes, since it means granting subsidies without any consideration of production type or price level.

In addition, decoupled subsidies can be referred to as unwarranted rents. Those payments eventually impair competitiveness by increasing production costs (over-investment and increasingly costly production factors, rent-seeking by downstream). They also enmesh European farmers in a rationale of buying social peace with adverse consequences on the profession's image and attractiveness, even though European production will continue to weigh in international balance.

Yet it is indeed when markets are collapsing that farmers need support. This is the motivation of counter-cyclical measures that enable budgetary resource deployment to mitigate the "cycle" effects and increase support when low prices so require.

**This is the reason why Momagri calls for urgent thought about a revision of the CAP which integrates crisis prevention and management mechanisms as well as a new budget approach.**

It is as such crucial that the CAP has the adequate economic and budgetary flexibility for:

- Ensuring a more stable income to farmers, and thus giving them better visibility in the future,
- Improving the competitiveness of European agricultural production and agri-food industries that are significant job providers,
- Meeting Europe's strategic challenges in terms of food security and development of renewable raw materials,
- While benefiting European consumers both quantitatively and qualitatively.

## 2. Founding principles of the Momagri proposal

### A. Assumptions and choices

In line with the founding principles of the CAP established by the Treaty of Rome (1957), the Momagri proposal is based on the acknowledgement that agriculture is a strategic and specific activity that must protect its farmers, meet consumer needs and ensure the competitiveness of agribusinesses.

Below are the requirements that the alternative CAP project proposed by Momagri must satisfy:

- Implementing regulation mechanisms providing farmers with adequate visibility and fair compensation for their productions,
- Improving the functioning of European agricultural markets by correcting market failures and encouraging farmers to set up effective producers' organizations,
- Promoting European production in terms of quantity and quality to enhance food security,
- Ensuring better prevention and management of risks, especially the economic risks confronting farmers,
- Further safeguarding the food chain functioning to help farmers, consumers and intermediary operators achieve true social and environmental progress,
- Enhancing the CAP budget effectiveness and recovering a genuine "community added-value",
- Filling the current gap between the CAP and the agricultural policies conducted by the world major economic and agricultural powerhouses.

Analyzing the risks confronting farmers reveals that, while a great portion of production risks can be dealt with by approaches based on risk pooling and insurance, economic or market risks are inherently systemic (affecting all farmers at the same time). These latter require public intervention, not only to limit their negative impacts on farmers but also to curb the costs of agricultural price volatility which hurt the whole economy.

The development of revenue or margin insurances is restricted by the systemic nature of market risks. Proposing such instruments forces insurers to cover themselves by transferring the risks to futures markets. Revenue insurances are thus based on prices that cannot differ from prevailing quotations. In this way, if markets are depressed, the coverage will be quite limited.

Defied by this structural instability and the numerous imperfections of agricultural markets, public intervention is therefore justified. For Momagri, combining counter-cyclical direct support––that vary according to prices––with crisis management measures to adapt supply to demand is the most effective and efficient solution for the CAP.

Among the crisis management measures, giving more flexibility to biofuel policies serves as an important lever supplementing the classical intervention measures based on public stockpiling. Such type of measure has already been implemented in Brazil and partially in the United States. It is one of the means to stabilize key agricultural commodity markets in wide enough price ranges to enable adjustments. Reconsidering the instruments to promote first-generation biofuel consumption and agricultural policies as a whole seems to be an indispensable step to make them more flexible by introducing mandate waivers within a renewed global governance.

In this white paper entitled "A New Strategic Course for the CAP", we develop a completed application model of a counter-cyclical support system for grain, oilseed and milk production at the European level –– the Momagri-CAP. Beyond the familiarization with the terms and ideas related to such a system, the model constructed here allows to fully consider the consequences in terms of budget control and efficiency as well as effectiveness to support farming incomes and compliance with WTO rules.

While it is built on the principles operational in the United States with the Price Loss Coverage (PLC) for grains and oilseeds, the counter-cyclical payment system developed here presents the unique feature to be extended to the milk sector. Other sectors could potentially be involved, such as meat, sugar and possibly some fruit and vegetables. However, counter-cyclical subsidies seem to fit more with agricultural commodities whose prices fluctuate with international trade. And some production chains have more to obtain from collective organization-based facilities (cooperatives and inter-professional organizations) and support to modernization through investment support notably. In addition, extending the Momagri-CAP principles must also take into account the current or future support forms: the large amount of coupled payments, the compensatory allowance for permanent natural handicaps and possibly support for pastures whose carbon capture must be included.

Lastly, before presenting the various components of counter-cyclical support system in the Momagri-CAP, we should indicate that most of the parameters of the scheme are calculated based on historical references, and not on current annual data to be collected from beneficiaries. It is the case for base acreages, yields and prices. The aim is to avoid that payments interfere in farmers' behaviors. We can thus prevent the adverse effects that could be generated by subsidy optimization strategies. Farmers will in this way continue their crop rotations and marketing choices according to actual market opportunities.

Another advantage of resorting to historical references is the avoidance of a cumbersome administrative collection system, speeding up subsidy disbursements. It also enables to keep the system under control, and thus prevents risks of budget slippages due to increased acreages or yields.

## B. Operational framework of the Momagri-CAP

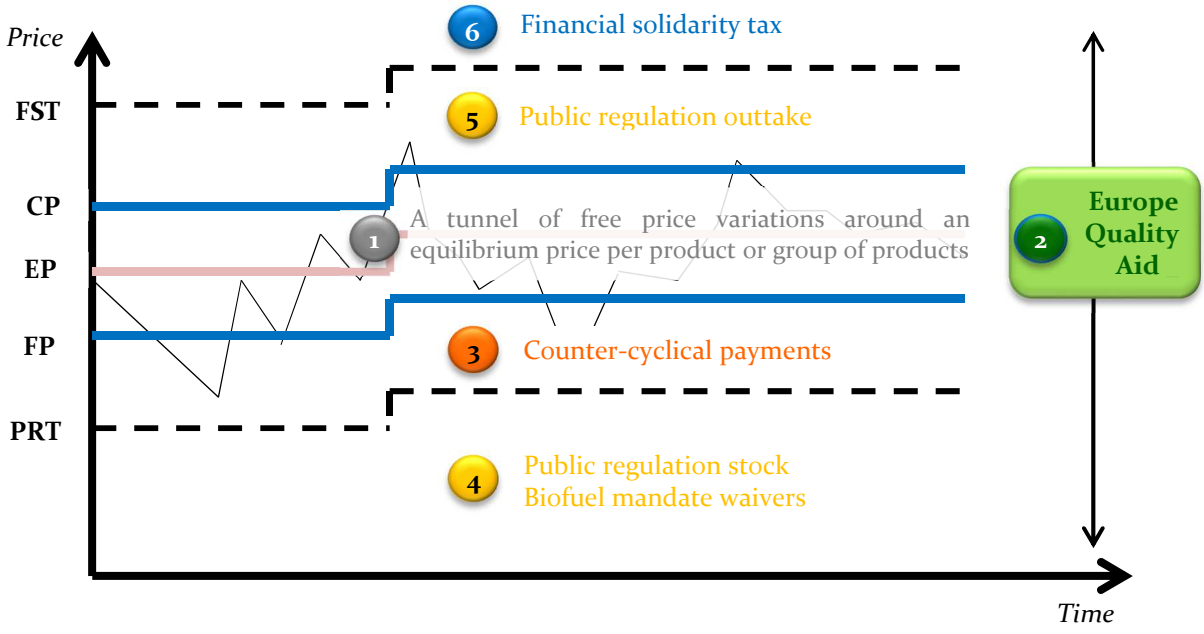
The Momagri-CAP functions on the basis of an equilibrium price (EP) serving as the central marker of the regulation system. A price tunnel ① is to be defined around the EP, where there would no longer be any subsidy paid to farmers.

Below the floor price (FP), a system of counter-cyclical payment ③ would be initiated. This support is reinforced below a public regulation threshold (PRT) by public stockpiling schemes ④ limited to 4% of annual production, and biofuels and other non-food uses stimulating measures.

Symmetrically, beyond a financial solidarity threshold (FST) a direct tax on transactions ⑥ would be in place to avert excessive speculation, and public inventories would be progressively released ⑤.

A payment of €75/hectare––the Europe quality aid (EQA) ② would be paid to farmers. It is designed to offset farmers' required efforts towards environmental and land management issues.

The following diagram depicts the various components of the Momagri-CAP.



- **A tunnel of free price variation around an equilibrium price (EP)**

For each product, an equilibrium price (EP) corresponding to the average cost price is recorded in the EU based on production cost data. This equilibrium price is the central element of the system, being reviewable depending on cost changes.

A tunnel of free price variation, where prices fluctuate without any public intervention, is determined around the equilibrium price according to an assessment procedure consistent with market regulation needs. This is the "snake in the tunnel" principle.

For the grain, oilseed and milk sectors, the average cost price was calculated by weighting the annual average cost price in producing Member States by their share of volume produced in the European Union total production over the 2006-2013 period (sources FADN and European Commission).

By convention, the equilibrium price is equal to the average annual cost price. The floor and ceiling prices are estimated in relation to the average cost price dispersion across Member States as follows: Floor price = Equilibrium price - 1σ and Ceiling price = Equilibrium price + 1σ, where σ denotes standard deviation. So for the grain sector, CP=€230/t, EP=€215/t, FP=€200/t, to be compared with the wheat benchmark price of €202/t in the United States' PLC system.

Monitoring market prices and equilibrium prices will be the responsibility of the management committee. Equilibrium prices can be adjusted when their evolution exceeds a percentage to be pre-established by the Council of Ministers.

- **The Europe Quality Aid (EQA), a flat-rate subsidy per hectare**

The Europe Quality Aid (EQA) is a subsidy designed to offset the economic impact of costs induced by the European agricultural model––quality, sanitary and environmental requirements. It has been set on €75/hectare.

- **Disbursements of counter-cyclical payments and regulation stockpiling**

When prices are outside the tunnel and below its bottom, farmers receive the counter-cyclical payments.

Calculated on the basis of the gap between the market price observed in a defined period and the floor price (lower limit of the tunnel), this support will be available for almost all production (90%). In the case where prices decline to a second threshold set by the EU as the public regulation threshold, public regulation purchases will be made. Amounting up to 4% of annual production (regulation stocks), they are complementary to a permanent strategic stock for food security representing 2% of the annual production.

It will be possible for the EU to run public regulation stockpiling/outtake operations, under managed proportions, to move prices towards the equilibrium. These operations will balance

over time, and thus will not generate any stock buildup. This risk will be all the more small that the growth of non-food industrial outlets and more flexible promotion policies for biofuel production will constitute sustainable solutions. This mechanism should be strong enough to rapidly bring prices back inside the tunnel by deterring market speculative behaviors.

In emergency cases, when it comes to strengthen food aid or assist nations with ongoing food crises, the European Council will be able to make additional public outtake operations.

- **The financial solidarity tax and the multi-annual reserve fund**

When prices are outside the tunnel and beyond the financial solidarity threshold (FST) set by the EU, a variable solidarity tax will be introduced on agricultural commodity transactions. The receipts from this financial solidarity tax will finance the reserve fund for crisis management.

The CAP annual budgets (1st Pillar) may vary from year to year, following market regulation needs, within the multi-annual limit fixed by the financial prospects. A reserve fund will as such ensure the necessary temporal pooling of EU expenditures. It will be financed or spent over time in line with market conditions.

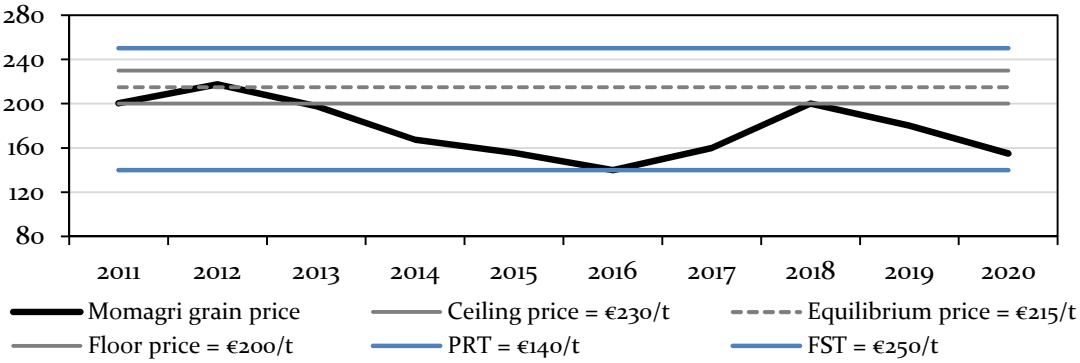
# 3. Impact on budget and incomes, and WTO compliance of the Momagri-CAP

## A. Assumptions on key parameters

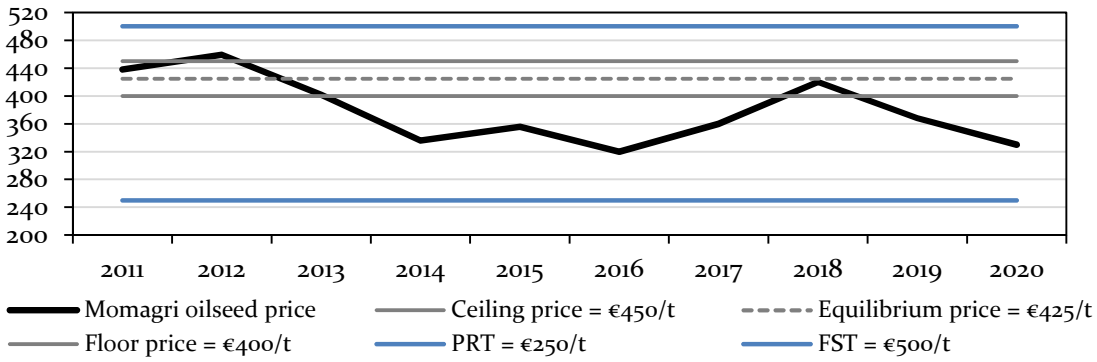
Budget simulations were conducted for the 2011-2020 period. The budget assumed for the simulation model below contains the 1st pillar direct payments allocated to European farms producing grain, oilseeds and milk, representing about 61% of the 1st pillar in 2014. All other subsidies remain identical in this budget model.

For each commodity, 2015-2020 price change assumptions came from simulation results of the Momagri model. Equilibrium prices (EP) were calculated based on the European FADN data.

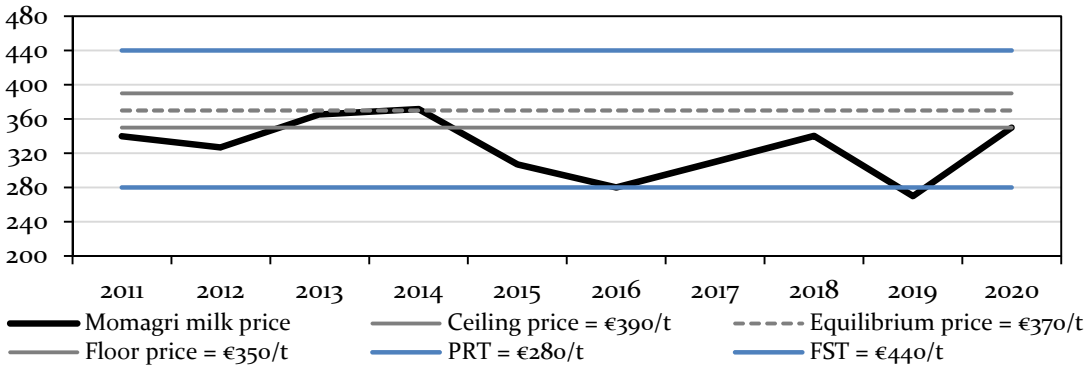
**Grain price assumptions, €/t**



**Oilseed price assumptions, €/t**




**Milk price assumptions, €/t**



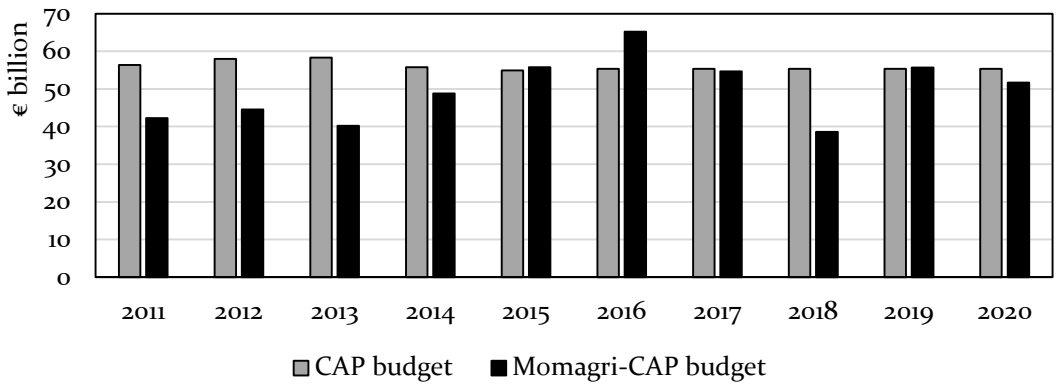

*Source: Momagri*

## B. Budget implications and impact on incomes

### ➢ Significant budget savings

For the 2011-2015 period, the Momagri-CAP budget costs would have been lower than actual expenditures by about €10.4 billion on average per year, or 18% of the CAP budget. Under the presented price assumptions, budget savings reach €11 billion over the period of 2016-2020, or an annual €2.2 billion. On the whole, savings are close to €63 billion between 2011 and 2020.

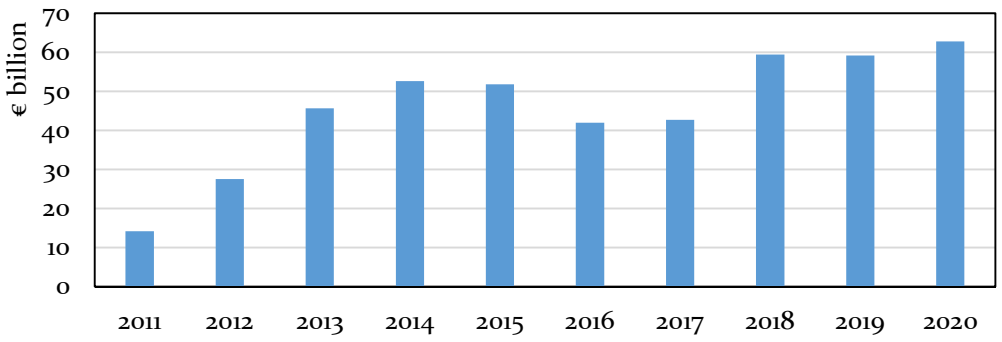
**Budget comparison CAP vs. Momagri-CAP, 2011-2020, in € billion**



Average annual CAP budget: €56.0 billion (stable)
Average annual Momagri-CAP budget: €49.7 billion (flexible)

Average annual savings for:
2011-2020: €6.3 billion (€63 billion over 10 years)
2016-2020: €2.2 billion (€11 billion over 5 years)

**Cumulative budget gap between CAP and Momagri-CAP, 2011-2020, in € billion**

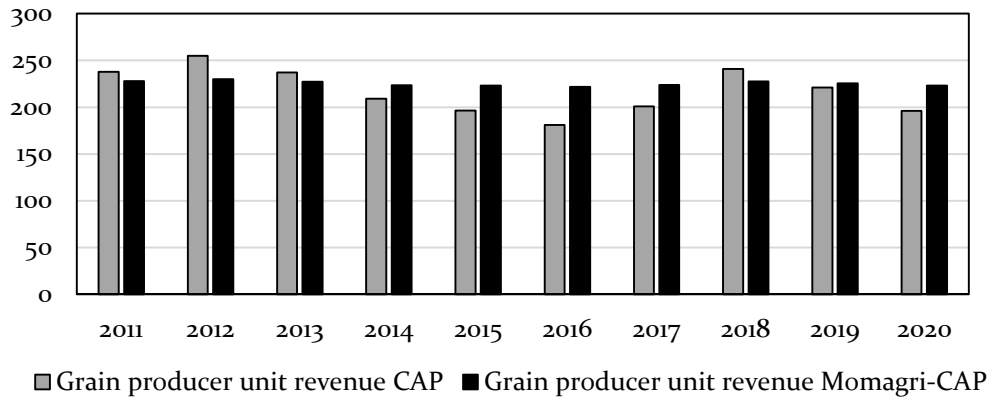



*Source: Momagri*

➢ **More stable turnover**

Based on the preceding hypotheses, economic simulations were conducted to measure the impact of the CAP and the Momagri-CAP proposals on per ton revenue for the grain, oilseed and milk sectors. They enable assessing and comparing the Momagri-CAP outcomes in terms of average revenue and its volatility for the 2011-2020 period.

**Comparison of grain revenue per ton, CAP vs. Momagri-CAP**




*Source: Momagri*

Under the indicated assumptions, it appears that between 2011 and 2020 with the current CAP, the average unit revenue of European grain farmers should total €218/t, with a minimum level of €181/t in 2016 and a maximum of €255/t in 2012.

Within the Momagri-CAP proposal, the average unit revenue for a European grain farmer would be €225/t, with a minimum of €222/t (2016) and a maximum of €230/t (2012).

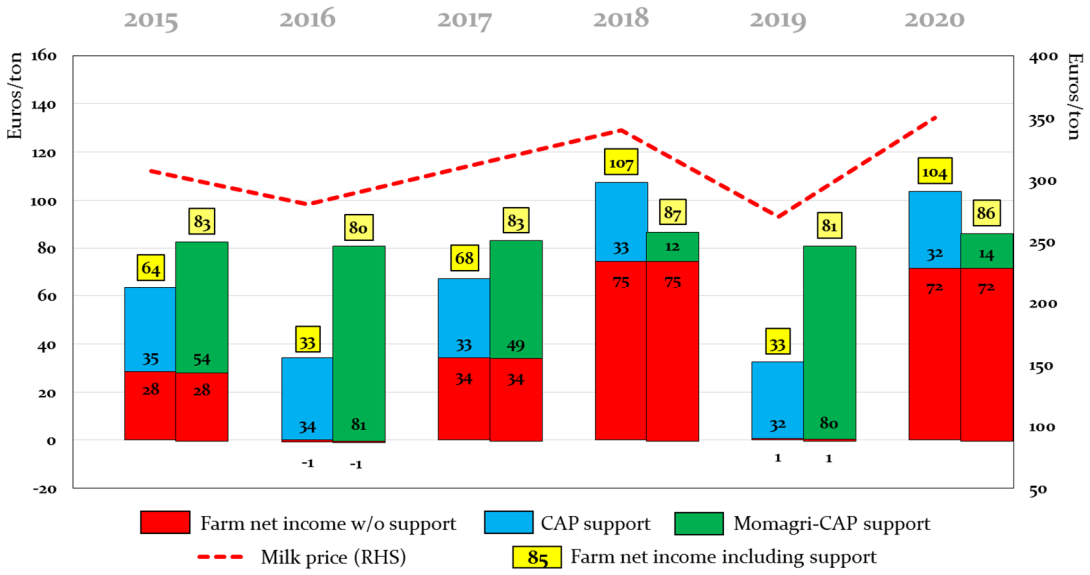
The results obtained for oilseeds and milk are in a similar range for grains. They show that adopting the Momagri-CAP proposal helps stabilize turnover to a level close to the one observed with the current CAP.

➢ **A better economic effectiveness to support incomes**

More efficient, the CAP budget also becomes more effective to support incomes: the Momagri-CAP can smooth out impacts of price volatility on incomes by limiting the scope of income variations.

Based on accounting data from 600 farms specializing in arable crops in Eastern France (Marne) and 2,300 dairy farms operating in the Western France, we were able to compute average production costs and build typical farms. Under the price assumptions indicated above, we obtain the annual farm net income per ton of milk (before taxes, without own factors remuneration) for a typical dairy farm working on 77 hectares, of which 16 hectares for cash crops, and counting 59 lactating dairy cows (See chart below). The average yield is 6,957 liters per milk cow, and 7.2t/hectare for wheat. For each year, the amount of the current CAP payments is indicated in the blue box on the left, and on the right in green is the amount of the Momagri-CAP payments. The farm net income including support is shown in the yellow boxes.

**Estimation of the farm net income for a typical dairy farm in Western France, in €/tons of milk**




*Source: FDSEA51, Momagri*

It appears that with a milk price below €280/t, the farm net income without support becomes negative, i.e. farmers cannot pay their own factors of production (land, labor and capital)

without subsidies. Thanks to the Momagri-CAP, the farm net income would be stabilized around €83/t in a relatively narrow band, with prices assumed not to exceed the floor price of €350/t. On average, the farm net income is higher to that of the current CAP.

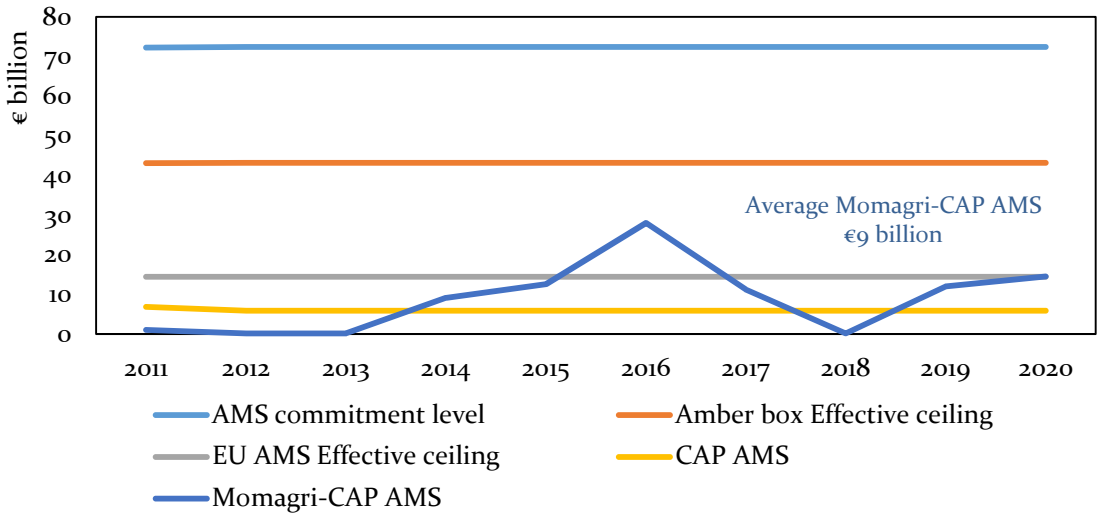
In general, counter-cyclical subsidies allow to smooth out income fluctuations induced by agricultural price volatility. The gaps between average levels of income mainly depend on the performance and size of farms at the execution of counter-cyclical support.

| 2015-2020 | CAP | Momagri-CAP |
|---|---|---|
| Average farm net income (€/t) | 68 | 83 |
| Minimum farm net income (€/t) | 33 | 80 |

## C. Compliance of the Momagri-CAP with the WTO rules

The WTO-compliance of the Momagri-CAP proposal was assessed for the 2011-2020 period regarding the WTO classification of domestic support, the prevailing limits for the EU-27 on the so-called distorting support (assigned to the blue and amber boxes), as well as the latest notifications provided by the EU-27.

**Compliance of the Momagri-CAP**




Considering that the Europe Quality Aid is classified in the green box[1] and counter-cyclical payments as well as public regulation stockpiling/outtake operations in the amber box[2], it is obvious that not only the Momagri-CAP project is WTO-compliant but significant leeway would

[1] Including non-distorting support, the green box is allowed without any limits.

[2] The amber box includes support considered as distorting, being limited at €39.9 billion. Yet, a part of counter-cyclical payments could be assigned to the blue box if the concerned production is lower than the threshold of 85% of the basic production level.

also persist. Optimizing the *de minimis* clause and the high commitment level notified for the Aggregate Measurement of Support (AMS) offers in fact significant latitude.

***

**In sum**, thanks to a counter-cyclical approach and crisis management tools, the Momagri-PAC allows:

- Lastingly stabilizing farmers' incomes and turnovers at levels that are close to the reported or projected average with the current CAP, in a smooth manner and with a minimum guarantee close to the equilibrium price,

- Significantly curbing the CAP budget through a crisis management-based regulatory framework,

- Limiting excessive upward and downward price fluctuations, since the proposed regulation mechanisms will stimulate price convergence towards the free price fluctuation tunnel, and thus towards the equilibrium price,

- Improving the effectiveness of EU public spending while preserving the role of agriculture, considered as a crucial strategic asset to deal with the 21st century challenges.

# Part I
# International Strategic Context

## 1. Agriculture at the heart of the 21st century global strategies

The Global Development Report published by the World Bank in 2008 presented agriculture as the pillar of economic development and the key to the future of our planet:

*"The overriding objectives for the 21st century––eliminating hunger and poverty, protecting the environment, ensuring security and managing world health––will not be reached without agriculture."*

Eight years later, the agricultural outlook seems to be brighter. For the third consecutive year, world grain production is exceeding the level of 2.5 billion tons in 2016. This increase in volumes––close to 25% in 10 years––comes with stock rebuilding, and thus price easing, or even a clear contraction that could last.

But the current period of calm of the global food security seems to be temporary. Agriculture and food remain at the center of a series of heterogeneous forces--including technological, social, economic, environmental and political forces––whose balance always seems to be highly precarious.

The arguments in favor of a structural change in agricultural markets are indeed well known. They are for instance: population growth and above all the "nutritional transition" in emerging countries; the slowdown of productivity gains linked to the Green revolution; the still high level of waste in the production chain; the rising scarcity of fossil resources––oil, potash and phosphorus; the development of non-food uses that expand agricultural production outlets; and lastly the climate change effects.

For some observers, these six factors might usher a new era of high agricultural prices, breaking with the long-term trend that, since the 1860s, has seen the value of agricultural output constantly lowered compared to other products. In fact, the huge productivity gains recorded in agriculture during the 20th century have led to what Cochrane, an economist and close advisor on agriculture to President Kennedy, qualified as the "treadmill effect". In order to maintain their living standards, farmers must constantly improve productivity, thereby fuel the trend of production increase, and thus lower prices.

Unfortunately, this new era of high agricultural prices takes the form of an illusion, whose main collateral risk would results in concluding the ineffectiveness of stabilizing agricultural policies and renewed global agricultural governance. The reserves of uncultivated arable land in

developing countries represent 200 to 500 million hectares, mostly in Africa, South America and Russia.

In addition, the per-hectare productivity gap between manual cultivation without inputs and farming profiting from technical progress goes from one to ten, or even from one to twenty. While climate and soil conditions provide a partial explanation, yields in the poorest countries should double, or even triple, in the next twenty years thanks to targeted investments and input addition.

Furthermore, the structural instability of agricultural markets that are left to their own resources remains unchanged. Demand inelasticity, supply short-term rigidity and the poor price transmission along the value chain have always meant, among other factors, that small gaps between production and consumption can lead to price variations that are quite far from normal. In 2008, a 1% gap brought about a 50% price boom.

This is all the more true since the short decade of high prices––sometimes abnormally high prices––that we recently experienced has stimulated unprecedented investment in agriculture throughout the world. Land recently farmed, new equipment to increase farm labor productivity, and newly established animal husbandry might indeed increase production far beyond consumption growth, and lead world agriculture in an overproduction crisis caused by such overcapacity.

Consequently, we are facing a double paradox that includes:

- A world agriculture with adequate reserves to potentially feed nine billion people––the FAO estimates that global output should grow by 30% to 70% by 2050––or even more, but is unable to eradicate hunger.

- An increasingly spreading instability in international markets that we will be unable, in the short-term, to determine if it validates or not the end of agricultural prices' decreasing trend.

In fact, and more than ever in history, everything will depend on the agricultural policies implemented by the major producing countries, their trade choices and their ability to renew a global governance for agricultural policies and trade. On the latter, the bilateral agreements–– such as the TAFTA/TTIP and the stalemate (or even the clinical death) of the WTO's Doha Round––respectively seem like a headlong rush and a persistent failure that are calling for a growing awareness. After 30 years during which the role of agriculture has been gradually diminished under a too rigid acceptance of liberal theories, a blind belief in industrialization and the emergence of service sector as the sum and substance of economic development, we have now reached a crucial time in strategic reorientation.

We shall see later that the world's major powerhouses have adopted this approach, while Europe is persevering in options that are more and more disconnected from reality.

Here are the fundamental factors to be considered:

***Factor No.1***

*The population growth, which will bring mankind to nine billion people by 2050 (eight billion by 2030), mostly in African and Asian developing countries.*

To this regard, it should be recalled that the world only counted one billion people in 1900, three billion in 1950 and seven billion in 2013. Europe totals 500 million people and benefits from an exceptional agricultural and agro-food potential. It must be preserved and strengthened through a twofold action of market regulation and innovation stimulation. Given their geographic proximity and common history, European countries have a specific role to play in the southern shore of the Mediterranean Sea and more generally in Africa, where population growth is the strongest and potential economic development is the most dynamic in the 21st century.

***Factor No.2***

*The advent of global economic powerhouses, with a considerable productive, financial and political potential––China, India, Brazil, Indonesia, Russia, Iran and Mexico––not to mention the regional clusters that will get stronger in the coming years.*

Most of them gave priority, in their development plans, to food security––even food sovereignty––and objectives of market share gains for both agricultural commodities and agribusinesses. This led to policies clearly oriented to support farmers' incomes and offset market instability through administered prices, income-coupled subsidies, counter-cyclical payments, insurance schemes, as well as "strategic" trade management or the financing of security stocks––a key WTO stumbling block supported by India, the G33 leader. The whole package of agricultural support policies is thus implemented. What a stark contrast with Europe which is taking the opposite path!

***Factor No.3***

*The continued existence of people in distress coexisting with the beneficiaries of vibrant economic growth in emerging countries, generating increasing food supply tensions between survival needs and the consumption of more protein-rich products.*

According to FAO estimates, 805 million people were suffering from hunger in the period of 2012-2014, or 11.3% of the world population. The Millennium Goal to halve the number of people suffering from hunger between 1990 and 2015 has not been reached in spite of remarkable progress at the end of the period. Yet this widely published indicator only provides a partial picture of the global food situation, since close to two billion people are victim of micro-nutriment deficiencies. Fighting hunger also requires considering farmers from the poorest nations, for whom low agricultural prices and the lack of agricultural policy represent dramatic poverty traps.

***Factor No.4***

*An inadequate use of land in countries with a rapidly growing population but for different reasons:*

*- An under-utilization of available land that is not cultivated due to the population extreme poverty and low investments in production and infrastructures (Africa),*

*- A limited access to farmland of local communities because of export crop development motivated by national concerns or foreign interests, especially within the land grabbing process (Africa and South America).*

In spite of significant potentials, there is very little increase in cultivated land areas. It only grew by 4.5% between 1980 and 2005, while the world population increased by 45% in the same period.

Population growth without simultaneous economic development in rural areas results in rural exodus without alternative opportunities in terms of jobs. This contributes to the formation of poverty bubbles around third world cities, which, far from providing substitute activities, become huge no man's land and wretched districts populated by prospective migrants.

***Factor No.5***

*A growing concern for environmental protection and biodiversity in a context of population growth and mega-cities development that, in very different ways among countries, tends to advance environmental policies sometimes at the expense of economic progress.*

This is the debate on greening in the new CAP which will lead to outcomes contrary to expected results. This is due to increasingly bureaucratic constraints that weight down agricultural holdings and will translate into additional costs for farmers, costs that are not offset by the public management of market instability.

The attempts to reduce the CAP to an environmental policy for farmland thus might weaken the agricultural sector and prompt a progressive abandonment of land, especially in Europe. In addition, the anxieties concerning implementing additional constraints in Europe in the name of climate change are bound to distort competition with nations that are less involved in the issue, without recognizing these distortions through border compensatory measures.

***Factor No.6***

*Arable land has become a new strategic challenge, as pointed out in a report published by the World Bank in 2010:*

*"The scope and often the speculative aspect of land transactions reported recently caught everybody by surprise. […] As a result, acquisitions are often made at the expense of local communities, especially those who are the most vulnerable, without providing them with any adequate compensations."*

In fact, international purchases of land have significantly increased since the 2007/2008 food crisis, as a number of countries and investment funds found it necessary to guarantee a secure supply for the future, and acquire a powerful impetus for speculative operations. The latest data

provided by *Landmatrix* indicates that the trend would concern about 42 million hectares and no less than 1,230 transactions. This represents a real challenge of global regulation for agriculture and world stability.

***Factor No.7***

*The financialization process in commodity markets recorded since the early 2000s is the cause of increasingly intense speculation on agricultural markets and leads to the dramatic consequences, such as the food riots experienced by developing countries. Such speculation results from the growing permeability between the financial world and agricultural markets, and the considerable weight and mobility of the financial resources at stake.*

The role of financial speculators in agricultural price instability is now recognized, as outlined in a note by the Special Rapporteur on the Right to Food[3] in 2010. The 2010 Dodd-Frank Act marked the end of the deregulation process initiated in the 1980s by calling for a stronger supervision and a greater transparency of derivatives markets. The effectiveness of this new regulation framework will depend on the ability of regulators to implement the new means given by the law.

Similarly, during its 2011 Cannes Summit, the G20 adopted the principle of limiting the maximum position of a given operator in these markets. In Europe, this proposal was registered in the review of the European directive on financial instrument markets (MIFID2) adopted in April 2014, but whose implementing provisions remain to be outlined.

***Factor No. 8***

*Agriculture as determining factor of the fragility or power of nations*

The 2007-2008 food riots have reminded us of the extent to which agricultural and food issues are at the center of geopolitical stakes, just like domestic policies. On the one hand, agricultural markets are subject to governmental interventions, either to carry out domestic policy objectives (curbing domestic price increases) or to exert pressure on other countries; On the other hand, food insecurity within a country can destabilize its government.

Agricultural and food issues thus logically occupy a prominent place in international discussions in various official arenas, such as the G8/G20, the Rio Summit and the UN organizations in general. Yet, everything unfolds as if the inability to recognize the Doha Round failure in its liberalization project holds up any progress toward the renewal of a new agricultural governance truly based on cooperation, so that we can continue to get the benefits of controlled trade openness. We have no choice but note that the degree of cooperation between nations remains limited on an issue considered by many countries as strategic and relevant to their national sovereignty.

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[3] Olivier de Schutter, "Food Commodities Speculation and Food Price Crises. Regulation to Reduce the Risks of Price Volatility", Briefing Note by the Special Rapporteur on the Right to Food, September 2010.

We only need to list the negotiations for the free-trade agreements between Europe and several major partners, such as Canada and the United States. Europe is in fact committed to these negotiations without any strategy for itself and for the world but an unrealistic and minimal GDP gain, at the cost of a potential abandonment of its last customs protection in agriculture and a possible questioning regarding its non-tariff choices. This shows once again that, in Europe, agriculture is no longer part of strategic challenges, while this rapid review of fundamental factors to be considered clearly reflects the contrary.

## 2. Europe is going against the trend

Only recently did we see the emergence of awareness on the consequences of these factors on agriculture. And they are still far from being shared by many political leaders, heads of international organizations or experts.

In fact, we are experiencing the last jolts of the deep changes that marked the 1980s. Between the fall of communism, the triumph of liberalism and the certainty that multilateralism will be the best defense against neo-colonialism, a paradox concept of international cooperation was born. It is that of unregulated trade openness that was supposed to spontaneously promote economic development in developing countries.

The only criticisms came from the anti-globalization movement and the pro-development NGOs (Oxfam), which are based on a "monotheist" vision of the world considering that rich nations must dismantle their support to production and export in order to allow the poorer countries to develop, not giving any further thought but believing that, at that price, liberalization would be a good thing.

In reality, each movement exploited the other, but none of them anticipated what is occurring today, as well as tomorrow's considerable dangers. The international community certainly did not prepare for the situation, since it continues to focus on unfruitful negotiations. In fact, the compartmentalization of each international organization prevents dealing with problems in a transversal manner, and the preeminence taken by the WTO has "encysted" them on ideological positions supported by technocratic barriers.

The fact that the Doha Round was labeled as the development round nevertheless compels key nations to adopt a very prudent attitude regarding a negotiation failure that is yet almost inevitable. No country wants, in the eyes of its public opinion, to be responsible for a definitive standoff, at a time when a possible agreement––even a symbolic one––would not resolve anything, especially in poorer countries. If an increasing number of voices are being heard to underscore the dangers of "*laisser-faire*" in agricultural issues, many international decision-makers keep exerting pressure to sell, one last time, the Doha Round conclusion on agriculture as the solution to all evils.

Common sense realities have even been rejected, such as the strategic importance of minimal food security, when it is well known that trade development alone will not meet the growth of global demand. As a result, we are at risk to bear the full brunt of the delayed impact of poor choices made during the past twenty years, both at the WTO and in Europe. In any case, if we do not act, the formula for failure is in place. Its advent is caused by a collective myopia fueled by the influence of ideologies and a guilty disregard from a wide majority of political leaders.

This is all the more detrimental since the radically new economic, political and strategic context pleads for a new European Union strategy in agricultural issues, as it is implemented by the world's major economic and agricultural powerhouses, such as the United States, China and Brazil. Independently of a profound shift in European policy based on a strategy that remains to be designed, it is thus urgent to initiate a new international cooperation on agriculture and food.

Today, this cooperation is quite inadequate since the international organizations involved in this major issue are many, but none of them has a federating function at the policy level. Among the FAO, the WTO, the World Bank, the IMF, the OECD, the UNPD, the WHO and many others, the global post-WWII institutional framework still prevails, at a time when the world population has more than doubled and when strategic issues have fundamentally changed.

It lacks a forum for dialog, prevention and management of crises that could anticipate their occurrences and implement an effective international cooperation. Price volatility, speculation and the determining factors we outlined above all require that a global Food Security Council––such as the United Nations Security Council––be created in the next ten years. The G20 decisions on agriculture in 2011 only represent a first step in that direction, which must be quickly surpassed before the political leaders of the major agricultural countries solidify exit strategies and increase competition between nations.

### *a. Priority to policies to secure production in key agricultural powerhouses*

Since the early 2000s, agriculture has been playing a key role in governmental priorities outside Europe, due to the combination of determining factors:

- Beyond the turmoil and recession it generated in most areas of the world, the 2008 financial and economic crisis not only revealed the inability of markets to self-regulate, but more importantly the dangers of economic *laisser-faire* in financialized markets, such as agricultural markets.

- The repeated food crises that have occurred since 2008 in several regions of the world and the overrun of the critical threshold of one billion people worldwide suffering from hunger in 2009 have reminded all developed and developing nations of agriculture strategic significance and supply security in agricultural and food commodities, as for energy commodities.

- The debt crisis affecting most nations in the world is placing agriculture first among ailing economic sectors, and requires improving the added value of public intervention,

as evidenced by the United States' decisions to improve its Farm Bill. Such effort has still not been made in Europe, where people have thought only of budget cuts at the expense of the search for new and more effective forms of support adapted to the specific nature of agriculture.

- The issues linked to climate change, energy resources and more generally sustainable development are restoring agriculture to a strategic place in the management of territorial balance.

The world in which these concerns are taking shape has totally changed compared to that prevailing at the end of WWII, and where the first *modern* agricultural policies were initiated–– the Farm Bill in the United States or the Common Agricultural Policy (CAP) in Europe. We now have more complexity, more market actors, more interaction, more changes, more uncertainty, more risks but also more opportunities for the countries that will know how to come up with the resources, given the demographic, economic, food and non-food challenges of the 21st century.

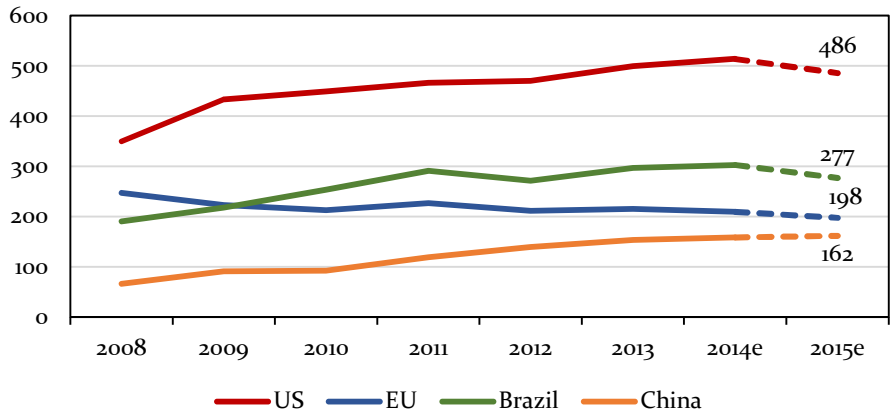
A long-term efficient management of public domestic support to restrict the damaging effects of agricultural price hyper-volatility has thus become the crucial condition for the performance and competitiveness of farms, irrespective of the regions involved. The failure of the WTO successive negotiations on agriculture can be partly explained by the very low degree of initial consensus on the definition, perimeter and impact on trade of agricultural public intervention of each country. Whereas most part of the failure can find its explanation in agriculture strategic scope which Member States are not willing to sacrifice on the altar of economic and trade justifications.

Agricultural issues cannot be reduced to simple trade considerations driven by applying the theory of comparative advantages. The security of supply, maintaining political land social balance in addition to the growing significance of climate change are as many reasons that give agriculture a specific status that is often considered by heads of states as directly relevant to national security.

In such context, it is crucial to identify and compare the strategies carried out by the world's major economic and agricultural countries to recognize preferable development trends, allocated means and implemented support procedures. Such an analysis is vital to have a better idea of tomorrow's key agricultural powerhouses and anticipate the development dynamics to best position the ongoing debate regarding CAP reform.

The SGPAA (*Global Support to Agricultural and Food Production*) indicator designed by Momagri sheds an interesting light on the issue. It assesses the reality of direct and indirect support actually provided to agriculture and food by major nations, thanks to the creation of an international classification. All public support expenditures allocated by the United States, Brazil and China have increased since 2008, at a speed significantly higher than the rates of population growth: +154% for China, +55% for Brazil and +47% for the United States. Only the European Union is posting expenditures that declined by 18% between 2008 and 2015.

**Per-capita SGPAA, 2008-2015, in US$**




*Source: Momagri*

### *The United States*

*A double system of agricultural production security and strong food policy*

Between 2008 and 2015, US public support rose by $50 billion to $156 billion from $106 billion. This increase in support is mostly explained by the expansion of domestic food assistance, market reorganization and the development of new activities via supporting biofuel production notably. A safety net guarantees farmers' incomes and/or margins, thanks to counter-cyclical payments and subsidized insurance systems. The newly reformed Farm Bill of 2014 has boosted these support programs and eliminated all types of decoupled support. Per-capita public support equals to $486 in 2015, a 39% increase compared to the 2008 figure. Compared to the total value of agricultural output, it accounts for 40%.

### *Brazil*

*A proactive policy to support national production and promote the demand for food and non-food products*

Between 2008 and 2015, total Brazilian support to agriculture increased by 55% to US$56 billion from US$36 billion. This increase is essentially explained by higher support to biofuels, market interventions through auctions and investment subsidies via the *Programa de Fortalecimento da Agriculture Familiar (PRONAF*) dedicated to family farming financing. Per-capita public support amounts to US$277 in 2015, a 44% increase over the 2008 value. Total support represents 31% of the total agricultural production value.

### *China*

*An interventionist policy to secure economic and rural balance*

Between 2008 and 2015, public support increased by 154% to US$224 billion from US$88 billion. This upsurge is mainly due to raising production-coupled subsidies, support to agricultural productivity, and infrastructures and rural housing. One should note that the implementation of domestic price support for most field crops (wheat and rice) represents one of the pillars of

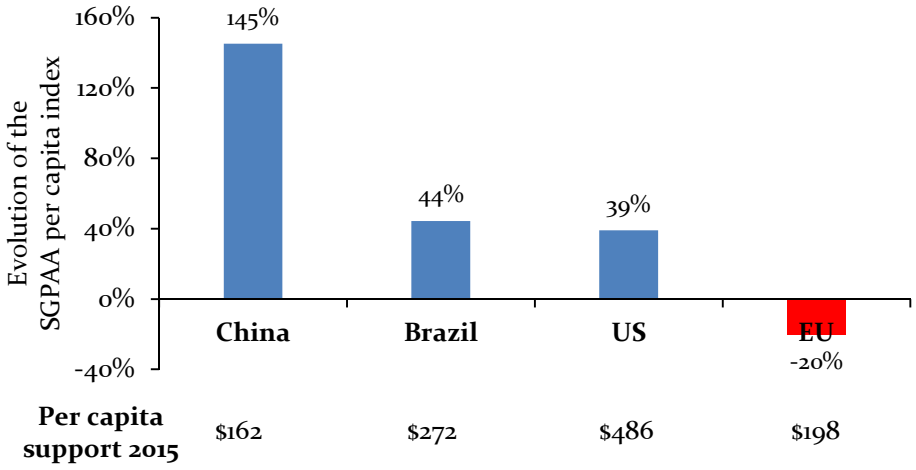
public support to agriculture. Compared to the population size, public support totals US$162, a 145% increase compared to what observed in 2008. In proportion to the total agricultural output value, it accounts for 23% in 2014.

### European Union

*A gradual generalization of decoupling subsidies with counter-productive impacts*

Estimated at US$100 billion in 2015[4], European public support records an apparent decline of 18.7% since 2008. In fact, some subsidies have been widely cut since 2008, particularly due to the policy of progressive removal of coupled support carried out by the European Union, such as export support or production and productivity subsidies. These reductions have mostly been made to favor decoupled payments and "green payments". Per-capita public support equals to US$198 in 2015, a 20% drop over the 2008 level. Public support accounts for 21% of the total agricultural production value.

**Evolution of per-capita public support to agriculture and food (in % and US$) between 2008 and 2015**




*Source: Momagri*

The overall evolution of public support allocated to agriculture reflects the economic and strategic importance it carries for the United States, Brazil and China. Its increases are continuous during the period considered at a speed higher than the rate of population growth, expressing these countries' strategy and will to stimulate domestic demand through assistance to the most vulnerable people and biofuels production.

The growing trend of support in emerging powerhouses––Brazil and China––deserves to be underscored. While the Brazilian per-capita support amounted to $189 in 2012 against $207 in the EU, it has largely exceeded the European level in 2015. On the other side, if support growth

[4] CAP budget + budget of Member States

continues in the recent pace, the per-capita public support to agriculture in China could reach the same level as that of the European Union as early as 2017, while the European population is three times smaller.

Beyond these global changes, the analysis of support provisions and favored development lines can show us interesting and useful trends in the future debates on Common Agricultural Policy reform.

### *b. The new Farm Bill*

The American agricultural policy––referred to as the Farm Bill––is a clear demonstration that agriculture plays a strategic role in the United States. Adopted on February 7, 2014, the new Farm Bill is the successor of the American agricultural policies initiated in the 1930s, which recognize that, if left on their own, agricultural markets cannot ensure sustainable agricultural development and food security.

Primarily focused on production and farms' economic health, the Farm Bill has, for almost a century, been responding to the chronic market instability and the damaging effects of climate hazards. The reason for this is simple: Market and production risks bring about irreversible consequences to the production potential. It is true that producers subjected to severe and recurring price volatility cannot develop their activities, or even have to stop their production. Similarly, through the combination of clever and varying mechanisms, the revenues of American farmers––especially grain producers––are supported and stabilized around reference prices set by law. Other matters, such as environmental issues, are clearly supplementary.

The new Farm Bill also confirms the American pragmatism: If a mechanism is no longer pertinent, it is discarded. This is what happened to decoupled direct support in favor of a shift toward systems guaranteeing incomes or prices (depending on support choice), i.e. support coupled to production and markets. As another incongruity for the Europeans, the $956 billion authorized for the next ten years could actually be spent in the next five years. New budget commitments will be made in 2018 based on realized expenditures from 2014. This is why $972 billion were spent between 2008 and 2013, or two times more than what should have been if followed a linear budget. We are indeed very far from the European budget practices, which set a multi-annual package that cannot be exceeded!

Apart from programs involving domestic food aid and support for biofuels that secure the outlet for a portion of American agricultural production, and thus ensure a form of regulation, US legislators focus on risk coverage through Title I and Title XI. This way, what is broadly called an insurance program––close to 70% of budget expenditures apart from domestic food assistance––is becoming the cornerstone of the support system.

The term covers a complex reality, which combines counter-cyclical payments and insurance policies. The first kind of support provides coverage against price risks, while the second also protects against climate hazards. Sometimes opposed by certain observers, the two forms of public intervention are complementary. In fact, the development of insurance schemes is the

result of a strong commitment from public authorities (average premium subsidies of 60%, premium definition by a federal agency, public reassurance, etc.). In addition, like insurance systems, the participation to various counter-cyclical measures is increasingly dependent on farmers' choice.

**The key titles of the Farm Bill**

Close to 99% of public support is allocated to the four following Titles[5]:

- Title I "Commodity Programs" include the free insurance safety nets that are known as "Marketing Loans", "Price Loss Coverage (PLC)", "Agricultural Risk Coverage (county ARC and individual ARC)". Their budget allocation totals over $44 billion.

- Title II "Conservation", with a $57 billion budget for environmental stewardship, bearing a reduction in the number of programs to 13 from 23 and a 1% budget cut.

- Title IV "Nutrition" maintains close to 80% of the total budget with $756 billion (a $8.6 billion cut). Emblematic program, the Supplemental Nutrition Assistance Program (SNAP) is much more than food assistance. It is also a plan to ease market sales, since food purchases by Americans involve over 90% of the national production.

- Title XI "Crop Insurance" with an allocation of $89 billion, supplements the Title I that protects farmers from market instability and input price volatility. The Supplemental Coverage Option (SCO) and the Stacked Income Protection Plan (STAX) are among the new insurance products whose premiums are subsidized.

**The Farm Bill main programs against market risks for grains and milk**

1- The Marketing Assistance Loan Program represents the basic safety net for most field crops. Set at $108/t for wheat and $77/t for corn, farmers are guaranteed to get these prices, especially through the counter-cyclical subsidies that are called loan deficiency payments. Above this safety net, grain farmers can choose between two types of counter-cyclical programs––the PLC and the ARC.

[5] The 2014 Farm Bill includes 12 Titles.

2- The Price Loss Coverage (PLC) grants subsidies to cover the difference between market price and reference price. The latter thus serves as a floor price. The latest Farm Bill has increased references prices as follows:

- $202/t for wheat (+32%),
- $146/t for corn (+40%) to reflect competitive advantages given to American farmers,
- $309/t for soybean.

Payments are made on 85% of the referenced production volumes, and referenced acreages and yields are set on the basis of historical records. In addition, the 2014 Farm Bill offers the possibility to update these references.

3- The Agriculture Risk Coverage (ARC) also falls in the category of counter-cyclical support. Unlike the PLC, payments are made to offset a drop in turnover but only partially: Subsidies are capped at 10% of referenced revenues. The Olympic average for the past five years is used as reference at the individual or county level.

4- Revenue insurance plans involve different types, depending on what is taken as reference triggering the protection. Variables for consideration are individual crop revenue (Revenue Protection), county's yield (Area Risk Protection), or actual revenue of the whole farm (Whole Farm Revenue Protection). The first two programs are the most developed. With the payment of a subsidized premium at about 60%, farmers can cover 50 to 85% of revenues based on a price equivalent to the maximum between forward prices at the time of sowing and the forward price at time of harvest.

Between PLC, ARC and revenue insurance programs, the performance of insurance coverage depends on multi-annual price variations. If the PLC is not affected in cases of declining prices, the ARC is progressively reduced as the average revenue declines, while the revenue insurance program will provide no relief in cases of depressed markets.

5 – Regarding milk, the latest Farm Bill introduced the Dairy Producer Margin Protection Program (DPMPP), a counter-cyclical program that is triggered according to changes in the theoretical gross margin of dairy farmers, computed as the difference between the selling price and the cost of a fodder ration. Access to this program is voluntary: For $100, each farmer can get coverage for a minimum $80 per ton of milk in theoretical gross margin, and for an approximate $23 per ton, coverage can reach $160 per ton.

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Already endowed with vast competitive advantages––farm acreages, access to all forms of innovation and an adapted tax system––American agriculture seems to be well prepared to confront the intrinsic volatility of international markets and negotiate a free-trade agreement with Europe.

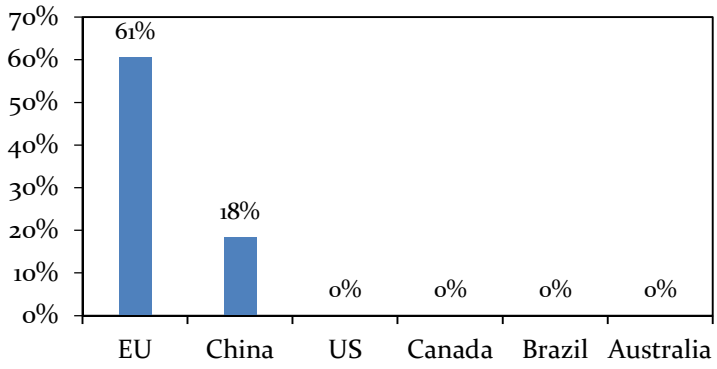
### c. ***Europe is now alone to favor decoupled support***

Comparing the various agricultural policies implemented in the four countries examined and their evolution since 2008 shows sharp differences, in terms of both the public authorities' approach to support production chains and their allocation procedures.

The United States, Brazil and China all have support and regulation mechanisms for agricultural production through production-coupled subsidies (fluctuating according to international prices), or direct market interventions on supply and demand. Moreover, there is indirect support to promote the sale of national agricultural production, such as stimulating insolvent demand with public domestic food assistance or biofuels production. Classified in the amber category according to the WTO nomenclature, production-coupled support is growing rapidly in Brazil and China, and remains one of the pillars of the American agricultural policy with counter-cyclical coupled payments, whose economic and budgetary effectiveness in volatile markets no longer requires any validation.

The European Union is therefore the only entity to base its agricultural policy on support decoupled from production with environmental constraints (classified in the WTO green box) in line with the WTO recommendations. The European Union agricultural strategy thus widely differs from those implemented by other major economic and agricultural powerhouses. Consequently, it leaves the European agriculture to suffer from price volatility, a major risk against which no appropriate instruments have been proposed by the EU.

**Comparison of decoupled payments' share in global support in 2015**




*Source: Momagri*

## 3. A major risk to be contained: Agricultural price volatility

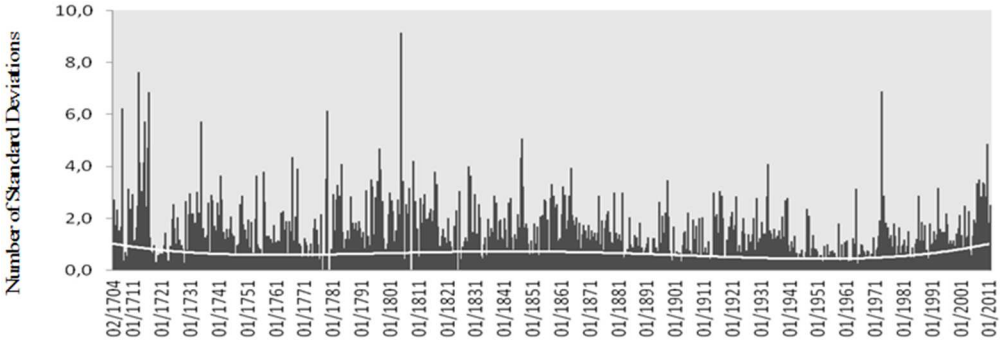
### a. ***Albeit structural, agricultural price volatility is increasing***

To implement the economic policy best adapted to agriculture, it is crucial to identify the risks to which the sector is exposed. Until recently, most international experts and decision makers considered that agricultural price volatility was caused by the sole existence of exogenous or natural hazards, such as epizootic diseases or climate conditions.

Yet, these risks, which are by definition independent from market agents' behaviors, should be mitigated by the liberalization of international agricultural trade. The latter acts as a risk-pooling agent at the global level, as a climate event cannot affect all regions in the world simultaneously and abruptly. However, while trade liberalization has been going on for several decades, the volatility of agricultural commodity prices has not declined, quite the contrary.

The graph below depicts the evolution of wheat price volatility since 1704 measured in number of standard deviation. It should be noted that the frequency and magnitude of volatility regularly increased since the early 2000s.

**Evolution of monthly wheat price volatility since 1704**




*Source: Philadelphia and Chicago exchanges, Calculation: Bertrand Munier - Momagri*

This graph shows that agricultural price volatility is historical and structural, and the risks confronting agricultural markets are multiple. Factors that explain price volatility––climate and epizootic diseases for instance––do not in effect come from outside of the agricultural markets but represent an intrinsic component of price volatility.

Picking up the distinction made by J.M. Boussard, these risks can be classified as endogenous, as opposed to exogenous risks. They relate to market agents' expectation errors, mimetic events as well as, to some extent, the existence of irrecoverable fixed costs that restrict the adjustment ability of supply to prices.

The key problem stays in the fact that such instability sources are seldom or never modeled, neither assessed nor precisely quantified by commonly used models at the international level––OECD, World Bank, FAPRI, etc. The result is a misunderstanding of the market mechanisms at work to effectively explain the causes of volatility.

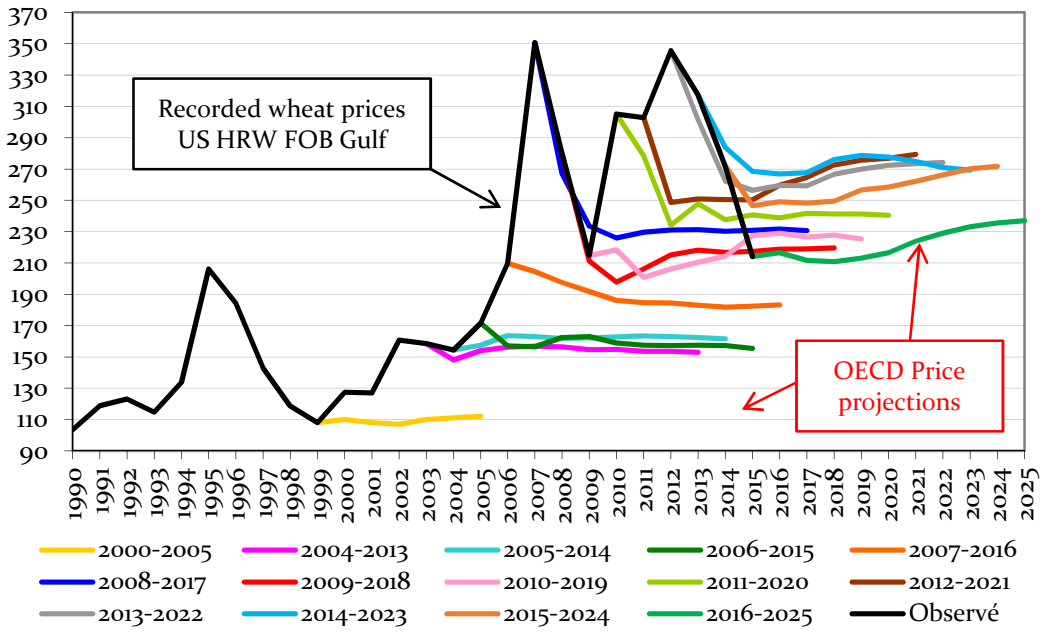
The following figure shows evidence of highly chaotic evolution of wheat price over the period 1990-2015 (black line). Still, the ten-year price projections have always been systematically linear and stable (colored lines).

Momagri thus strives to integrate the characteristics that underlie price variability in a projection model––the Momagri model––to provide the authorities in charge of agricultural policies with a more realistic decision-support tool. The Momagri economic model is designed to simulate agricultural price volatility in world markets by modeling various exogenous and

endogenous factors of risks to which these markets are exposed. It evaluates the impact of various economic policies on price volatility, particularly that of total or partial liberalization of agricultural markets.

Regardless of the tested scenarios, the results are irrefutable: Unregulated trade liberalization (total or partial) goes hand in hand with an increase in the volatility of agricultural commodity prices, contrary to the linear and steadily rising projections released by the World Bank and the OECD.

**Projections of prices disconnected from reality**
**The example of wheat international prices ($/t) from the Aglink model (OECD)**




*Source: OECD, IGC*
*Formatting: French Ministry of Agriculture, CEP*

### *b. Volatility has intensified with the financialization of agricultural markets*

Since the early 2000s, agricultural markets has registered a financialization process characterized by:

1) An increase in trade volumes and open positions in futures markets. For instance, open positions on major commodities at the Chicago Board of Trade multiplied by the factor three between 2003 and 2010. In 2008, across worldwide agricultural commodity markets, the annual volume of transactions of wheat and maize equals respectively 8 and 15 times the global production in 2010.

2) In addition to regulated marketplaces, OTC transactions are expanding outside of any prudential framework at the expense of transparence and protection against counterparty risks.

3) Among various types of futures market users, the share of commercial operators is declining––they hold less than 25% of open positions. While the presence of institutional investors is needed for liquidity purposes, their dominance in terms of open positions and especially volumes disrupts price formation, since their decisions are more motivated by considerations that are unrelated to the fundamentals of agricultural markets.

4) A new group of investors appeared in the mid-2000s: The index funds. Contrary to other speculators, they basically take long positions to profit from rising prices. These funds are used as diversification strategies against inflation impacts on investment portfolios. Account on their own for up to 30% of open long positions, they amplify the hikes of price.

5) Since the end of the 1990s (Enron scandal), electronic trading has upset price formation and allowed the influx of new trading techniques, such as high frequency trading.

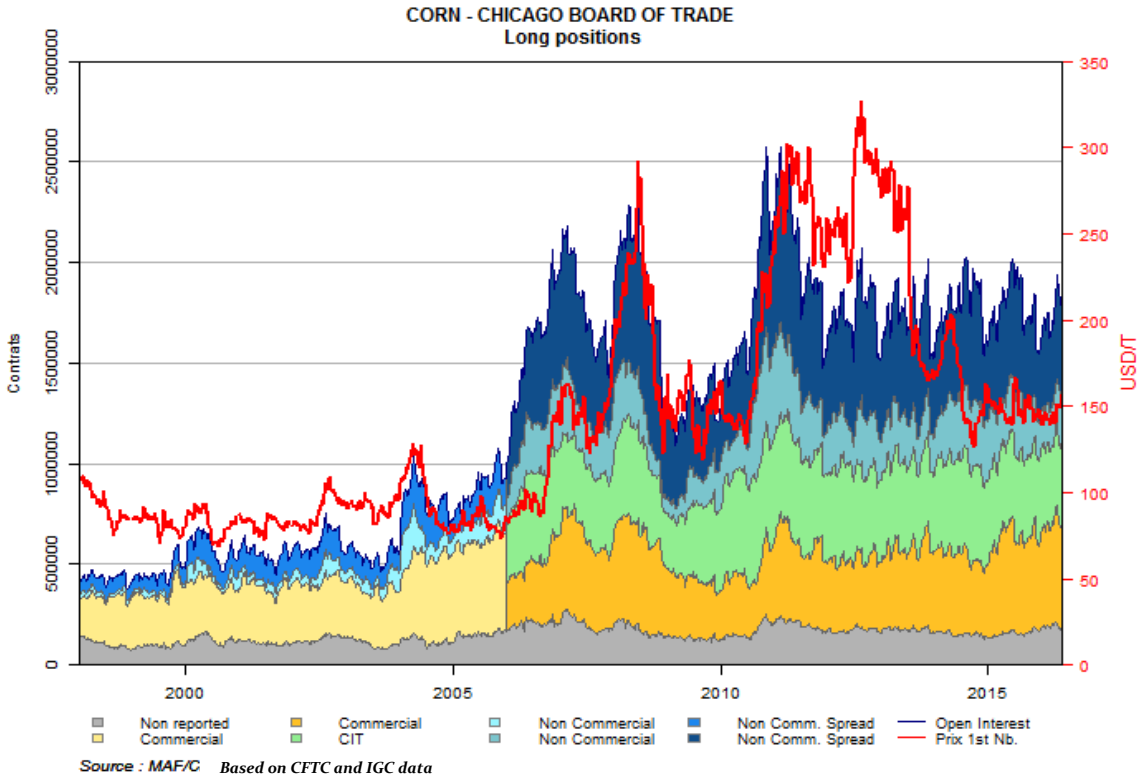
6) Futures markets have become the price reference for major agricultural commodities due to the absence of spot markets. All market actors must take these price changes observed in reference markets as given.

7) The supervisory framework deregulation observed since the 1990s in the United States––home to the most active marketplaces––partially explains these changes. The regulation of agricultural commodity futures markets was built in the 1930s in response to observed shortcomings, and did drastically curb the use of options and also impose restrictions on the number of positions held by an operator (position limits).

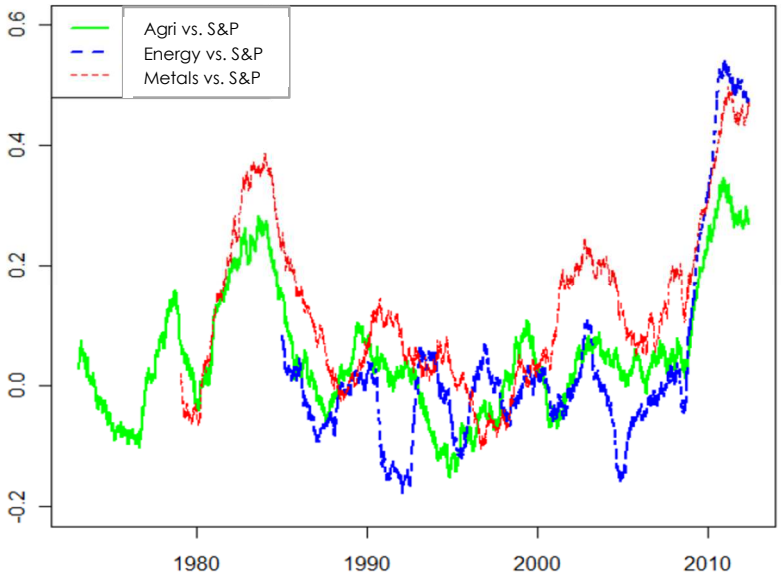
The first graph in the following page represents evolution of prices (in red) and open positions on the Chicago corn futures market since 1998. Open positions are broken down by types of parties involved. Commercial operators are shown in orange, and index funds in green (these two categories were not separated before 2006). Open positions reached 2.5 million in 2010, from 500,000 contracts in the early 2000s.

Consequently, the continuous financialization of agricultural markets has led to a fundamental change: Agricultural products are now considered as a group of financial assets like any others. Given the small size of agricultural commodity market capitalization, such connection to the financial sector cannot but increase the volatility of agricultural markets, which are already structurally unstable. The financialization of agricultural markets also results in growing correlation between commodity prices and other financial assets exhibited in the second graph below by the Standard & Poor's 500 Index.

**Evolution of open long positions on corn contracts at the Chicago Board of Trade**




**Evolution of price correlations**
**between different types of commodities and financial assets**




*Source: Ohana et al., 2012.*

The financialization of agricultural markets and the induced increase of instability requires designing regulations to prevent excessive price and agricultural income variations. It also calls for the reinforcement of financial market supervisory framework. In the United States, the 2010 Dodd-Frank Act is a step in that direction by strengthening the prerogatives of the financial regulator––the Commodities Futures Trading Commission. In Europe, the Barnier directives, whose application measures are not totally implemented yet, will enable the Old continent to partially catch up with the United States.

### *c. Unregulated trade openness aggravates the situation*

Trade openness is a stabilizing factor of agricultural prices to the extent that climate conditions offset one another at the global level. This is an application of the law of large numbers. There is in some ways a large-scale pooling of risks. Unfortunately, there exist other destabilizing factors of agricultural markets––the endogenous risks––that tend to be reinforced in cases of unregulated trade openness.

As a result, agricultural markets fail to deliver the equilibrium price, as conceived in the law of supply and demand. This equilibrium price must correspond to the marginal production cost, i.e. the production cost of the least competitive producer but necessary to meet demand. In these circumstances, international markets are showing a trend of alternating periods of depression, when prices are close to costs in countries with the most effective producers, with (shorter) periods of tensions on prices, when production systems and reserves have been destabilized by periods of depression.

While population growth is an undeniable fact, it does not call into question the erratic functioning of agricultural markets, where a slight surplus can sink prices below production costs for a vast majority of producers.

Agricultural markets are not governed by an intangible golden rule, like the one we know in physics, which would let tomorrow's prices stabilize around the equilibrium price, and consequently give producers a fair remuneration in all regions of the world. Following a decade of high prices, the prospect of seeing agricultural markets engulfed in an overproduction crisis must trigger a better governance for agricultural and regional policies, so that we can continue to benefit from the partial stabilizing agent represented by trade openness.

It is therefore vital to implement regulatory policies that are adapted to this reality, rather than continuing the senseless and dangerous gamble of thinking that the free play of market forces will be the antidote to price hyper-volatility and the risks it generates. This is however the direction taken by Europe with the 2014-2020 CAP.

# Part II
# Reshaping the CAP for 2020:
# The Momagri-CAP project

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## 1. The 2014-2020 CAP misses the point

The Summit of Heads of States and Government on December 19, 2013 of the 27 nations ended on a lackluster note regarding the Multi-annual Financial Framework:

- €960 billion (2011 value) for commitment appropriations (CA), or 1% of the EU GNI.
- €908,4 billion for payment appropriations, or slightly less than €130 billion a year.

This decision reflects a 3.4% drop compared to the 2007-2013 period, or €34 billion in CA. The CAP records the largest cut, since the CA package is reduced to €373.4 billion from €420.6 billion over the 2007-2013 period, equivalent to a 12.6% decline. Structural funds, for their part, decrease by €30 billion, or -8.5%. All other European policies increase by €44 billion, or a 20% upsurge, including mainly those for economic growth and competitiveness (+37.4%). Admittedly, this agreement is only the window dressing of a contingency compromise.

The budget crisis creates ever-greater constraints within the European Union and its Member States. In that regard, it should be noted that the outstanding amount—*Reste à Liquider* or *RAL*––correspond to mostly two years of budget implementation. This means that there is a chronic budget under-financing, and thus a sizeable virtual deficit. As a result, this compromise "is running on empty" since it does not provide any new course to Europe. Only a modest perspective for greater flexibility has been made because unused payments can now be reported to the next year. What a stark contrast with the other major nations that are diffusing ambitious agricultural policies that can effectively answer the G20 call to increase agricultural production to safeguard the food security of the planet.

Following the April 2010 public forum on the future of the CAP initiated by Dacian Ciolos that tended to revive the debate on the status of agriculture, the Commission set out three key challenges for the CAP reform:

- Food security,
- Territorial balance,
- Environmental protection and climate change.

It also stated precise objectives in order the address these challenges:

- Contributing to agricultural incomes and curbing income variations,
- Improving the agriculture competitiveness,
- Compensating the regions subjected to specific natural constraints,
- Guaranteeing the implementation of sustainable production practices,
- Promoting environmental-friendly growth through innovation,
- Pursuing climate change mitigation actions,
- Supporting employment and preserving the social fabric.

While such goals seemed quite pertinent, the instruments available today will not allow reaching them. This is in particular because no solution is proposed to resolve the problem, albeit central, of the high volatility of agricultural commodity prices, like in grain and dairy markets notably. Without mechanisms to regulate price instability, which has devastating effects for farmers and agribusinesses, the above-mentioned objectives will not be fulfilled.

The convergence of a portion of direct support between new and older Member States was an expected political gesture. To make sure that this convergence is fair, its application should take into account the specific features concerning production conditions and discrepancies in social and monetary systems.

Far from providing additional resources, the Commission proposes an unchanging budget, but only seemingly. Because in fact, the principle of a gradual attrition is now approved. How can we not question the sustainability of the benefit from direct support for farmers? The posted objective of 30% of support allocated to greening procedures to maintain the agricultural budget is a dangerous illusion that might endorse the rhetoric of those advocating a restructuring of the CAP into a policy reduced to the sole environmental component.

At a time when Europe's competitors are striving to increase their production, this measure raises the double issue of its impact on the reduction of European agricultural production and the competitiveness of European farmers. In addition, when all market actors are demanding a simplification of the CAP, there is a considerable risk of increasing the procedure burden and bureaucracy. One only has to see the difficulties and complexities of the decision making process at national level to have an image of a "disconnected" policy.

Yet it will be necessary in the future to admit that farmers are the first to be involved in environmental protection, and that they have undertaken significant efforts to lessen the impact of their practices on the environment for more than two decades. Without farmers, who will take care of our land? Land conservation is thus primarily done through maintaining agricultural activities, which cannot however be sustained while farmers have to bear higher costs than their competitors.

An annual reserve of €430 million[6] for crisis management seems to be quite paltry. Supposed to serve as a safety net activated in case of strong market disturbances, it can only play this role if a regulation policy is implemented to prevent crises, or even alleviate them while there is still time. When we know that the European grain production amounts to over 300Mt and grain prices are hyper-volatile, we understand that this fund will become rapidly insufficient in cases of severe agricultural crises. Furthermore, public stockpiling is neutralized while it provides a true lever to prevent crises and curb the volatility of agricultural prices. It will even be eliminated for durum wheat and sorghum, and optionally allowed for bovine meat, barley and corn. Governed by volume- and price-based guidelines, it remains at very low levels for common wheat, butter and milk powder. As regards export refunds, the affected budgets were reduced to zero in 2013 without any counterpart.

The Commission's proposed budget estimates, which do not include market regulation mechanisms, is not going to resist to a scenario of repeated crises driven by price volatility, natural hazards or international events. The mechanistic determination to adopt a theoretical liberal scheme to highly chaotic markets has reached its end, that is to say a strategic "cul de sac". Under the pressure of events, the European Commission must therefore "go back to the drawing board" and, sooner or later, propose a reform project that ensures market regulation and agricultural income stability.

## 2. The CAP in a strategic dead end

### a. ***The end of a dismantling process***

The latest reform of the CAP, which covers the 2014-2020 period, is the product of a process started in the early 1990s––the decoupling of public support to agriculture. Originally based on fixed or slightly variable guaranteed prices, which were on average higher than international ones, the pre-1993 CAP allowed for adjusting domestic supply and demand through the use of various instruments, such as variable customs duties, public stockpiling measures (intervention purchases), supply controlling procedures and export subsidies.

Following the 1993 introduction of direct support and its progressive decoupling until its conversion in payment entitlements independent from production, the successive reforms of the CAP gradually dismantle regulation tools and increasingly expose European farmers to international markets. Decoupled direct support, firstly linked to historical references then to farm acreage, are supposed to support farmers' income while having no impact on production and thus on trade (non-distorting in the WTO sense).

By doing so, the European Union abandons it responsibility to stabilize agricultural markets, an objective that nevertheless figures in Article 39 of the Treaty on the Functioning of the European Union (TFEU). It also prefers to buy farmers' social consent by granting them decoupled

[6] Constant Euros

subsidies, thus calling on them to make rational choices and maximize their incomes, no matter which fluctuations they are subjected to. As a result, intervention stocks, export restitutions and production quotas are disappearing. Customs duties are about to drop to symbolic levels (cf. the free trade agreements under negotiation).

The instigators of decoupling have already written the next phase of reforms––the elimination of subsidies through the conversion of payment entitlements into fixed term Treasury Bonds. All direct subsidies would then be removed, so that any support measure would be definitively laid to rest, except compensation for non-marketable public goods (environmental protection, land preservation and social policy). The road is wide open for green agriculture, representing 30% of direct payments, and redistributive payments for the first hectares. In addition, with the EU's regional and national convergence mechanisms of payment entitlements, it is shown that the 28 members are incapable to define common strategic objectives, but equip themselves with the only prospect of a bureaucratic egalitarianism in subsidy allocation.

And while the share of agriculture steadily declines in the EU budget, it can be seen that the added value of budget expenditures is unsatisfactory given the serious shortfalls of the 2014-2020 CAP. This version of the CAP will in fact conclude fifty years of evolution of the common policy, marked by two major periods––1962-1992 and 1992-2020. Designed to protect agriculture from market instability, the first period did allow a strong increase in production and yields, but in some cases cause over-production and large budget costs due to a lack of effective control. The second period, inspired by a liberal approach, has taken the exact opposite course by favoring the decoupling of subsidies, the environmental objectives and the market-driven approach. This is done without however any consideration for the strategic and economic realities of the agricultural and agro-food sectors, and any inclination to correct the many evident weaknesses of agricultural markets.

It is now high time to design a CAP that blends these two streams of thought together and provides agriculture and agro-food industries with the required tools to protect them from market instability, while encouraging innovation and competitiveness in order to face with the strategic challenges of the 21st century. Environmental protection ranks among these goals, but it cannot become the be-all and end-all of our agricultural policy: without securing farmers' economic health, all agro-environmental policies are bound to fail.

This evolution of the future CAP can and must be carried out within the limits of multi-annual financial packages. In this way and by improving the budget effectiveness of the euros allocated by the European public authorities, we can prevent all risks of budget slippage––the main criticism against the pre-1992 CAP. It is necessary to have in advance a good understanding of the major drawbacks of the 2014-2020 CAP to best outline the scope of proposals for a new CAP.

### *b. Major drawbacks*

The CAP reform does not resolve the strategic issues facing European agriculture. The post-2013 is a transitional solution that weakens Europe compared to big countries, such as the United

States, Brazil, Russia, China and India, which all have global ambitions for agriculture. The progress of the free trade negotiations with the United States should make us less naïve. It is an opportunity for European farmers to receive the same advantages to those on the other side of the Atlantic. Otherwise, we will entrust our food dependence to the rest of the world.

We need to seriously review the founding principles of the CAP, and select effective and efficient public intervention measures to correct market failures and repair the shortcomings that make the CAP inoperative or even dangerous.

Here are the main topics in question:

- Price instability and the crises it generates on major markets are not taken into account;
- The decoupling of direct subsidies is wasteful which is referred to as the disengagement of public authorities;
- Prioritizing environmental and social objectives interferes strategic choices;
- The CAP is becoming a costly administrative structure that deals less and less with agriculture and is decreasingly common, which will deeply influence the European agricultural model.

### *b.1. Price instability and crisis management are not taken into account*

The CAP totally ignores price instability while it is one of the structural components of agricultural markets. The resulting volatility has been heightened for the past decade, simultaneously with the withdrawal of public direct intervention in Europe and the US and the development of excessive speculation in financial markets fueled by considerable movements of capital.

But excessive price fluctuations are extremely detrimental not only to farmers but to the economy as a whole. For some countries, agricultural policies still represent the means to fight inflationist pressures. Even in developed economies, the consequences of agricultural price volatility should not be neglected. The damage of market instability should be compared to the costs of stabilization policies to rationalize the snap judgments that are too often heard regarding these latter.

The observed price variations are going far beyond the “natural” adjustment of supply and demand. International prices may be lower than production costs for most farmers, and hamper an entire sector, since supply is particularly rigid in short-term for scattered producers that are able to sustain low remunerations for their work and capital. Conversely, abnormally high prices will result in inappropriate production choices for years to come, maintaining or even intensifying the instability which itself is the root of increasingly destabilizing speculation. Consequently, farmers are progressively losing their visibility, distorting their investment options and the integration of technical advancement.

If the first period of the CAP did promote the deployment of production and yields to that extent, it was just because long-term visibility was inherent to a protection against market instability. By dismantling this system for reasons primarily related to budget costs and more opening to competition, we have opened up the Pandora Box of devastating effects of price instability that became more serious over time.

Worse even, European experts and political leaders thought as if markets were purely and perfectly competitive, and therefore had to be freed from any regulatory intervention to be able to express the price signals that mechanically lead to supply and demand adjustment. No other country in the world has engaged in such a denial of reality and scarified as many anti-crisis mechanisms.

In short, the European Union is totally exposed to price volatility. It is now urgent to offset this flaw through adequate mechanisms, especially with counter-cyclical payments based on a reference price. This is all the more critical since most of the EU budget is dedicated to decoupled subsidies whose economic utility is as low as it becomes costly.

***b.2. Decoupling direct support ignores economic reality and conveys a disengagement of public authorities.***

The European Commission estimates that decoupled payments (or SPSs) accounted for 94% of the EU direct payments in 2014, with variations between 77% and 100% according to Member States. In fact, the decoupling of subsidies has been increasing since 2003, and has stepped up in 2010 to comply with WTO requirements. The new CAP reform for 2014-2020 does not significantly alter the situation: Member States are authorized to raise the share of coupled support in the first pillar budget by 15%. In France, €982 million--the maximum allowed amount--will be distributed to different productions following this rule.

Furthermore, while SPSs were eliminated at the end 2014 to be replaced by the new "basic payment schemes" (or BPSs), the latter follows exactly the same principles and remains unrelated to production or even to markets. Initiated as early as 1993, the decoupling of subsidies was effectively implemented in 2003 and completed by the 2009 "Health Report". It is now in contradiction with the principles behind the creation of the CAP (Article 39 of the Treaty), i.e. the need to stabilize markets to guarantee the sustainability of production capabilities and supplies, as well as reasonable and stable prices for consumers.

This CAP evolution totally ignores the upheaval in agricultural markets recorded since the early 2000s. On one side, farmers are more and more exposed to price instability, and on the other, the decoupling of subsidies leads to nonsense and waste. How to justify decoupled payments when prices are high? Contrarily, what use is granting these subsidies when prices are low and when it is not enough to cover production costs for most European farmers?

Decoupling has become synonymous with the irresponsibility of European public authorities. By denying market realities, they have designed a disconnected, costly and ineffective system, distorted policy choices by introducing environmental and social objectives that contradict the

economic imperatives increasingly confronting farmers. This is a surprising paradox at a time when the primary justification of the current CAP is to let markets function freely!
There is also another paradox in advocating "market orientation" in agriculture, and at the same time installing a rent system. Because decoupled support has indeed all the features of a rent, which beyond expressing a disparagement towards production (one can get the rent even for doing nothing!), also provokes adverse effects damaging the sector competitiveness. As a result, on the one hand, the rent can be more easily seized postproduction through the selling prices of agricultural products. On the other hand, it contributes to artificially raise the value of some production factors like land and especially farmers' operating capital––equipment, materials and buildings. In this way, decoupled support increases production costs, which is detrimental to the sector competitiveness and thus contrary to the initial objectives.

### b.3. ***Greening and convergence are not enough to found a European agricultural strategy***

The greening—as high as 30% of the first pillar budget, the convergence of direct support and the redistributive payment for the first hectares do not constitute the axes of a reform that aims to ensure the food security of 500 million Europeans. This is particularly the case given the fact that in order to feed the world population, agricultural production must increase by 70% in the next 30 years. It seems that we are the only ones not taking the extent of this figure. We prefer to focus on peripheral issues for lack of ambitious strategic objectives.

The debate on convergence and greening has also contributed in overshadowing the issue of agricultural price volatility that is nevertheless at the center of policies in other major producing nations. The European Union departs from its trading partners as it no longer has specific measures adapted to the risks confronting farmers. So even if the prevailing talk insists on the fact that the European agricultural budget has been saved, it is nothing but an illusion. It is declining in constant prices, and its implementation will be constrained by both greening and convergence procedures. Let's not forget that, in the same time, our competitors are boosting their agricultural budgets and making use of counter-cyclical payments.

The greening of the CAP arises from the theoretical approach that wants to dissociate marketable production––which must be compensated only by the market––from production with environmental amenities––which can be financed solely by public authorities. In practice, this distinction is inoperative to design effective public policies, since these two types of production cannot be separated as they result from the same choices made by farmers.

Consequently, by handing marketable production over to the sole determination of supply and demand, we are building systems that pursue unreachable environmental and social objectives, since farmers cannot forgo the profitability of their agricultural production. Eventually, by giving a growing prominence to environmental and social targets, the current CAP is losing. By not assuming its regulatory function concerning food production, the common policy abandons its fundamental purpose while averting its effectiveness in environmental and social issues by adopting an approach that dissociates the production of marketable goods from that of non-marketable products.

***b.4. The CAP thus becomes a bureaucratic monument that undermines the European agricultural model.***

The CAP is on a path of "becoming less and less common" due to the absence of common objectives in terms of food security, sectorial and export policies as well as the re-nationalization of many decisions made in the name of subsidiarity that cannot hide the CAP loss of direction. Because of the latitudes given to Member States in the subsidy convergence, the implementation of greening directives, the recourse of redistributive payments or compensations for natural drawbacks, not to mention allocation transfers between the first and second pillar, the CAP is now entirely relying on national choices. This generates competitive distortions and discriminations between European farmers. While the CAP was conceived as one of the key components of the European project to reunite the regional population, does it just mean that the divergence of national applications of the CAP is the introduction of an opposing system for European farmers?

The CAP is on a path of "becoming more and more disconnected from agriculture" since it ineluctably leads to a transformation of the European agricultural model. In fact, farmers continue to leave the land as they can no longer earn a living from farming. The risk is that family farming is replaced by a financialized agriculture controlled by investment funds or agri-food multinational corporations. Food diversity and land management will be shattered without safeguarding Europe's food security and the competitiveness of agribusinesses that create employment.

It is therefore urgent to establish the CAP on new bases and initiate an in-depth reform during the new legislative mandate. The next phase of the CAP to start in 2020 at the latest must be designed now, so that the Commission can address ambitious reform proposals to the Parliament and the Council. Such reform will mainly be based on the rationale of counter-cyclical payments for key sectors, such as grain, oilseed and milk production.

## 3. Foundations of the Momagri-CAP

### *a. Principles*

Entirely in line with the founding principles of the CAP in The Treaty of Rome and with the changes of the global geo-strategic context, the Momagri proposal is structured around the three following observations:

- What this policy must take into account:
  - The markets, especially agricultural markets, do not self-regulate. The recent economic, financial and food crises have proved this reality again.
  - Price volatility is a structural component of agricultural markets. Beyond their exposure to climate events and epizootic diseases, they are impacted by the short-

term irreversibility of production and investment decisions, and by the low elasticity of supply and demand to prices.

- The unregulated trade openness generates systemic risks that increase the probability of sharp price reversals worldwide.
- The lack of a reliable global governance system results in unilateral decisions by some countries, which contributes to aggravate sharp price variations in international markets.
- The growing financialization of agricultural markets and speculation on major crops in the world since the 2000s intensify agricultural price volatility.

- The errors and deficiencies of the current CAP to be avoided:
  - It is based on a decoupling rationale that prevents the implementation of a strategy to develop agriculture activities adapted to the 21st century challenges.
  - It maintains costly, ineffective and increasingly divergent systems according to member states and types of production at the expense of mechanisms to fight price and income volatility.
  - Through various mechanisms, it encourages a progressive re-nationalization of the CAP, which pulls Europe away from consolidating an integrated and more strategic policy.
  - It creates a greater confusion between agricultural policy and environmental policy, which weakens one without developing the other.

- The imperatives to be met by the CAP alternative project proposed by Momagri:
  - Implementing regulation mechanisms to provide farmers with adequate visibility and fair remuneration for their production,
  - Improving the functioning of European agricultural markets by correcting market failures and favoring effective organization procedures of production chains.
  - Encouraging European production quantitatively and qualitatively to optimize food security.
  - Ensuring better prevention and management of various types of risks, in particular the market risks confronting farmers.
  - Securing agricultural producers' economic health as well as that of consumers and intermediaries, so that effective social and environmental progress is boosted.
  - Optimizing the budgetary effectiveness of the CAP and recovering a true "EU added value".
  - Filling the gap between the current CAP and the strategic orientations of agricultural policies conducted by the major world economic and agricultural powerhouses.

In this context, Momagri calls for another CAP. Our proposed policy is still based on two pillars, but the greater part of the first pillar budget currently allocated to basic payment schemes and to greening would be redeployed towards tools to manage agricultural markets and farmers' incomes according to a counter-cyclical rationale. In addition, a Europe "Quality Aid" of identical amount for all productions would be granted to farmers on the basis of cultivated hectares, as counterpart for higher European production standards. This project has been applied to the grain, oilseed and dairy sectors.

### *b. Tools tailored to the nature of risks*

To implement the above-mentioned principles, we must have an approach based on detailed risk characterization (nature, intensity, frequency and interdependence, etc.) so that we can define the level of responsibility to confront hazards––individual, collective entity and public authorities––and employ the appropriate tools.

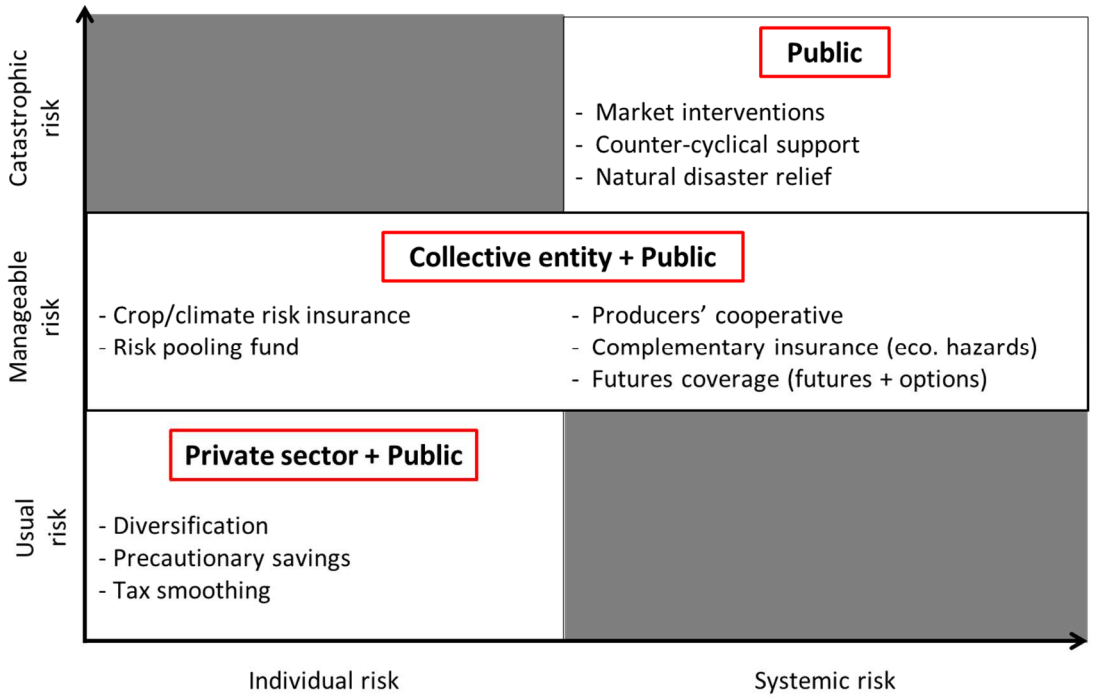
Risk categorization is primarily based on the criterion of the independence of the hazard occurrence, i.e. the presence or not of a correlation between event occurrences in a population. When this correlation is high, a systemic risk is referred to, since all individuals are affected at the same time, whereas in the opposite case, it is an independent or individual risk. For the latter, risk pooling is possible. The risk is therefore insurable. This is the case for instance for car accidents or localized hailstorms in agriculture.

In general, we consider that production risks, whether linked to climate or sanitary conditions––disease outbreak and pest infestations among others––fall in the category of independent risks, even if droughts or epizootic diseases may very well affect vast areas. By contrast, market risks or price risks are intrinsically systemic, since temporary upheavals affect all economic agents at simultaneously.

In such case, pooling between producers is not possible, as strictly speaking market risks are not insurable. The way to obtain coverage against price risks then depends on the possibility to transfer the risk to financial markets, when futures contracts exist for the given product or for a similar product. Yet the main limit to risk transfers through futures markets is linked to the fact that the proposed coverage level relies on the prevailing price, which means that if prices are already low, coverage will not be interesting. Price risk transfers are only advantageous to profit from price variations.

The second significant criterion of risks relates to the intensity of events, and thus the amount of losses suffered by farmers. Schematically speaking, there are three distinct increasing levels––normal, manageable and catastrophic. The chart below represents this aspect on its vertical axis. By crossing the two proposed criteria to describe risks, we get a map of risks allowing the identification of the levels of responsibility linked to hazard management, as well as the pertinent tools to meet these challenges.

**Presentation of instruments to prevent and manage risks according to their nature and the level of responsibility involved**




Usual risks are a matter of sound farming management. The diversification of productions or marketing channels, must answer to the saying "do not put all your eggs in one basket". Financial management must also integrate potential hazards. This implies pursuing a pertinent investment strategy, so that a cash flow cushion can be used, or precautionary reserves are built up (contingency deduction in France). Tax regulations must also assist farmers to manage usual risks by adapting direct debit procedures to account for the variability of economic results.

Manageable risks are too strong to be managed by farmers alone. Producers than must resort to solutions involving pooling between farmers, solutions whose effectiveness and/or attraction that can be strengthened by public authorities through subsidies. The main form of risk pooling is a matter of participating in a farming cooperative firm, since it allows securing the marketing of products, profiting from collective strategies to develop markets or even a simplified access to futures markets, among others.

Pooling funds and insurance contracts also belong to this category. As far as climate and health related risks are concerned, these tools are appropriate since the nature of these risks allows pooling. It is not the case for market risks. While the latest CAP reform planned to finance such tools to promote their development, in the end no member state chose to resort to this type of instruments in significant proportion to cover price risks, which shows their limitations in case of systemic risks. In fact, market risk pooling funds face the challenge of implementing pooling systems between producers in different production chains, and do not present the advantage of improving price formation in the sense of a better distribution of the added-value and exposure to risks, such as farmer cooperative firms.

The development of insurance systems on farming revenue or gross margin is also limited by the systemic nature of market risks. Proposing such tools requires insurers to cover themselves by transferring the risks to futures markets. Insurance contracts on revenue are thus based on the reference price that cannot differ from prevailing quotations. That way, if markets are depressed, the proposed coverage will be quite limited. In the end, revenue insurance is not miracle tools, as some are claiming. Its advantage exists only in addition to other tools that cover important price declines (counter-cyclical support) and prevent markets to drown in overproduction (tools that balance supply with demand).

Catastrophic risks require instruments under the responsibility of public authorities. In cases of major climate events, only the national solidarity can intervene, especially through public reinsurance and subsidies to offset the damages of natural calamities. For market risks resulting from the structural instability of agricultural markets, combining counter-cyclical subsidies––that vary according to prices––and crisis management measures to encourage the adaptation of supply to demand seems to be the most effective and cost-saving solution. Among the crisis management measures, making non-food production more flexible represents a significant lever of action that complements to the classical intervention measures based on public stockpiling.

Unlike the CAP decoupled subsidies, whose legitimacy and effectiveness in supporting incomes are declining as market price volatility develops, and their value is captured by the economic environment of farmers, counter-cyclical subsidies must be the cornerstone of the next CAP to match the new economic context and rebuild a genuine strategy for one of the EU key policies. We will now develop the operational blueprint for the Momagri-CAP proposal based on counter-cyclical support.

### *c. Operational blueprint*

**A free variation price tunnel based on an equilibrium price (EP)[7]**

For each product, an equilibrium price (EP) corresponding to the average cost price recorded in the EU is the central component of the system. It can be adjusted according to price variations. A free fluctuation tunnel (snake in the tunnel), in which prices vary without any public intervention, is determined according to an evaluation procedure corresponding to market regulation requirements around this equilibrium price. By convention, the equilibrium price is equal to the average cost price[8], and the ceiling and floor thresholds are set according to the average dispersion of cost prices recorded in member states (standard deviation).

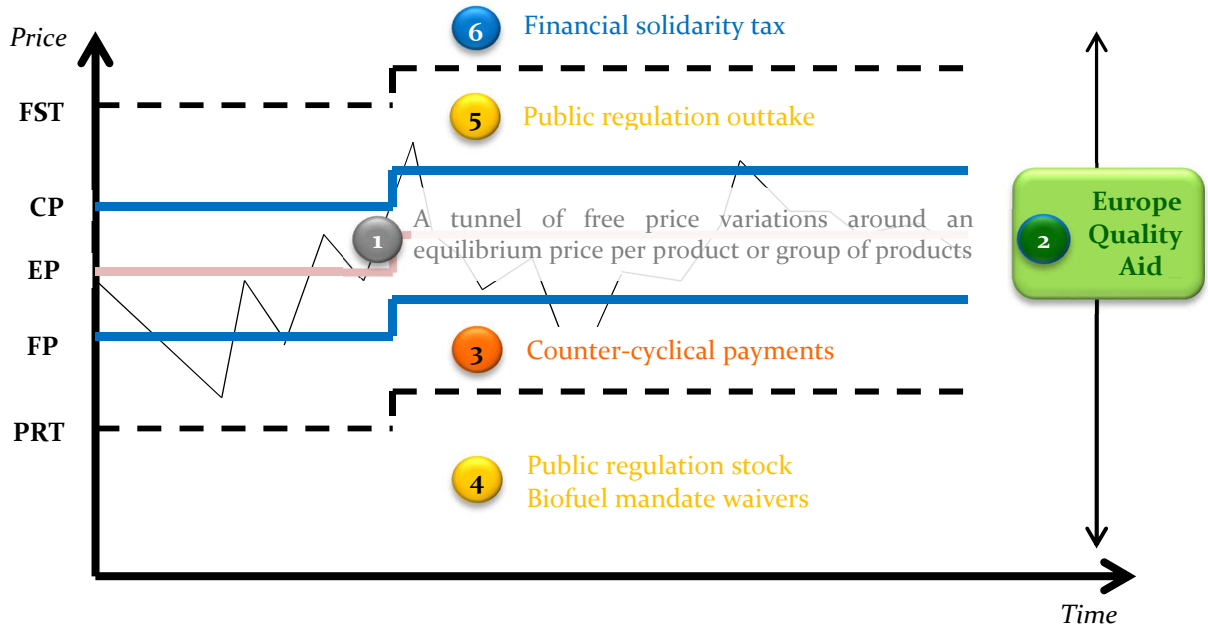
[7] The term "equilibrium" here is used in the sense of the required equilibrium between a fair compensation for farmers and an acceptable price for consumers.

[8] Based on a five-year rolling plan, except if the variation is higher than a threshold to be determined by the Council.

**Payment of a flat rate "Europe Quality" aid (EQA) per hectare**

The "Europe Quality" Aid is a subsidy to offset the costs incurred by the European agricultural model to meet the qualitative, sanitary and environmental requirements. It is assessed at €75 per hectare for all acreages.

**Operational blueprint for the Momagri-CAP proposal**




**When prices are outside the tunnel and below the floor, producers receive counter-cyclical payments.**

Calculated from the gap between the recorded market price and the floor price (lower limit of the tunnel), this subsidy will be available for almost the entire production based on the individual reference in terms of yields and acreages. If prices drop below a second threshold set by the EU--the public regulation threshold--regulation measures including public regulation purchases will be initiated. They could amount up to 4% of annual output (regulation stocks), and represents a complement for the permanent strategic reserve for food security of 2% of annual output built up during the first year of the Momagi-CAP implementation.

**Conversely, when prices are outside the tunnel above the ceiling**

The EU will initiate public regulation outtake operations in managed proportions. Beyond a financial solidarity threshold set by the EU, a variable solidarity tax will be implemented on the first production marketing operation. The revenue from this financial solidarity tax will finance the contingency fund for crisis management.

## 4. Close examination of the Momagri-CAP mechanisms

The above-outlined blueprint calls for some scrutiny to better assess the innovative and effective characteristics of its principles.

From the outset, it must be pointed out that all agricultural sectors can adopt the Momagri-CAP mechanisms. Yet, we chose to apply these mechanisms to only three major product groups–– grains, oilseeds and cow milk. These sectors share three common factors: being major beneficiaries of decoupled subsidies, strongly subjected to the volatility of international markets and able to be stockpiled (powder and butter for milk).

It appears that other sectors, such as vineyards or fruit and vegetables, can benefit more from the strengthening of current collective production management systems that are completed by investment support, rather than counter-cyclical subsidies. As regard meat sector, the situation seems to be less clear-cut, although progress could already be made through a collective organization of production. For bovine and sheep meat, there is also the rationale of coupled support, which was backed in the latest reform, and the support to grassland and deprived areas that led us to not adapt the Momagri-CAP project to these commodities. As a general rule, all sectors subjected to market instability can find specific solutions to their sectors.

The results obtained for the grain, oilseed and milk sectors are sufficiently determinant (see Part III) to launch this reform project now.

### *a. Principle No.1: Creation of an equilibrium price per agricultural product*

The guiding principle is defining an equilibrium price for each agricultural product corresponding to a fair and stabilizing compensation for farmers, while remaining affordable for consumers. These prices would serve as benchmarks representing balanced markets in which production costs would be covered. Updating equilibrium prices would take into account variations in production costs and producers' improved performance.

Setting equilibrium prices will be the responsibility of a direction of the European Commission, in coordination with Member States via the management committee and Special Committee for Agriculture (SCA). In case of disagreement, there would be an arbitrage process (Coreper then Council of Ministers). The goal is to build a benchmark that takes into account the economic reality of production factors in order to correct the fact that international trade prices only reflect sporadically real production conditions.

Markets will operate freely without any intervention on spot markets, between the tunnel's ceiling threshold and the public regulation threshold, or between €230/t and €140/t for grains, thus representing a significant potential fluctuation margin.

Equilibrium prices will be defined by calculation conventions and a common nomenclature, so that the reference will be "traceable" and explainable. Just like any international convention,

these calculations will be transparent and result from informed choices based on recognized experts' works who are party to the EU decision-making body.

These equilibrium prices will be determined based on a representative panel of agricultural holdings that integrate the economic differences prevailing in the European Union––farm sizes, production zones and degree of mechanization, among others. The Farm Accountancy Data Network will join forces and possibly be strengthened to that end. The equilibrium price selection for a given product will have to largely cover the average cost price for the farms in the representative panel, and thus illustrate the will to improve the global performance of European agriculture.

In fact, settling equilibrium prices too high and fluctuation margins of the tunnel too narrow would be difficult to finance. This project aims to ensure income stability for farmers to prevent crises without budgetary inflation, and an intervention mechanism in the form of budget reserve to prevent and rapidly manage crises.

### *b. Principle No.2: Variation ranges free from any regulation*

A range of price variation around these equilibrium prices would be set, via negotiations between Member States, to be free from any regulation since it involves a bearable variability for all economic actors. This range is established by convention at +/- 1 standard deviation of average production costs (over a five-year period) weighted by the major products of the EU Member States. If the agricultural product price, for a period exceeding a minimal time, significantly differ from the range of price variation, counter-cyclical payments would be carried out.

The fluctuation margins determining the tunnel will be calculated following a double approach:

- The economic approach in which the sizing of the tunnel margins comes, at first glance, from the standard deviation of cost prices compared to the EU average. This is what we retained for the simulations concerning the grain, oilseed and milk markets.
- The budgetary approach in which the average of intervention budgets should not exceed the multi-annual average of the financial outlook allocation to ensure the CAP strategic objectives.

The implementation procedures suppose that simulations were made from various assumptions of equilibrium and market prices to ensure that the system will be solid, even in a severe crisis.

### *c. Principle No.3: Payment of a subsidy recognizing the societal role of farmers, the "Europe Quality" Aid*

The "Europe Quality" aid is a subsidy granted to all farmers to include the non-tradable role of land management, environmental preservation, respect of sanitary constraints and qualitative standards that contribute to European agriculture's high quality in every sense of the word.

Designed not as a constraint but the recognition of a major societal role, it becomes the positive outcome of greening practices, which is perceived as a sanction system in the current reform. Besides, by going from constraint to recognition, we move away from the bureaucratic dilemma caused by the shift to historical SPSs that only resulted in consolidating extremely contrasting situations in the Union.

As a consequence, the convergence objectives that shape a significant part of decisions in the recent CAP reform will no longer be required, since this "Europe Quality" aid will have a flat rate of €75/ha. The possible sanctions for not abiding to EU regulations will stem from controls and investigations conducted by the appropriate services. They are established following rules that are no longer related to whether a producer is fully eligible for EQA. Lastly, the EQA will be included in the green box, being a decoupled payment.

### *d. Principle No.4: Counter-cyclical support*

To overcome the drawbacks of the current CAP, we have to start from a pragmatic basis that deals with the price instability-generated risks and provides farmers with enough visibility to make a decent living and investment.

This basis is primarily made of a counter-cyclical mechanism, completed by various instruments that are specific to each market. To prevent the fact that subsidy payment interferes farmers' behaviors, the Momagri-CAP is founded on a system of counter-cyclical subsidies based on historical references for surfaces and acreages. In this way, we avoid the adverse effects that could result from subsidy optimization strategies. Farmers will thus continue to make crop choices according to actual market opportunities.

Likewise, prices used to calculate subsidy amounts will not be set depending on prices at which farmers actually market their production, but rather on the basis of the referenced market's average quotation during sufficient time to cover a large part of the marketing period. This allows not interfering with usual marketing procedures. Resorting to historical references also presents two other advantages. It avoids the constitution of a cumbersome administrative system to collect yields and sale price data, speeding up subsidy disbursements. Furthermore, it enables keeping the system under control, and thus averts the risks of budget slippages due to increased acreages or yields.

Why counter-cyclical support?

***Because it is cost-effective***

The question of counter-cyclical payments concerns high or low price levels as much as their hyper-volatility. In such context, flexible support is much more cost-effective than flat rate decoupled payments to assist farmers in a difficult cyclical situation.

In fact, decoupled subsidies are not legitimate when prices are high, whereas often insufficient when prices are too low. During good years, they inflate incomes and lead to fiscal practices that

ultimately strain production costs. And in general, these subsidies are picked up by downstream of production chains, and drawn back on farms' value, reducing their effectiveness.

***Because it is efficient on budgetary grounds***

Flexible subsidies are more budget-efficient over time compared to today's situation, if they are defined by floor and ceiling thresholds that limit their budget scope, while giving them a strong lever to rebalance incomes.

This is proved by the budget simulations we conducted (see below), and consolidated by the strategic directions taken by the United States with the 2014 Agricultural Act and other major agricultural powerhouses such as Brazil. A recent American study[9] also shows that eliminating all existing agricultural support in the framework of the Farm Bill and replacing them with a counter-cyclical private stockpiling support would have made significant budget savings for the 1998-2010 period.

***Because it is strategically needed***

It is not possible for farmers to manage the specific risks confronting agricultural markets by themselves over time. Yet without any visibility, farmers cannot commit to a sustainable investment process, since the risks of market reversals are too high in the absence of effective safety nets.

This situation presents a real threat for the stability and competitiveness of European agriculture, all the more so since the other major agricultural powerhouses––United States, Brazil, China and Canada among others––are implementing mechanisms to secure their agricultural production through counter-cyclical support or subsidized insurance systems.

Moving in that direction will allow reversing today's prevailing rationale, which consists in stabilizing the agricultural budget at the cost of strong income volatility, and stabilizing instead farmers' incomes thanks to flexible budgets.

***Because it is politically acceptable***

The crises we are now experiencing have deeply altered the perception of European decision-makers regarding the CAP, whose primary objective is now better managing price instability at the lowest cost. Yet, in our current hyper-volatility context, flat rate decoupled subsidies are largely unable to protect farmers from international price fluctuations. And since the CAP budget is now becoming increasingly restricted, decoupled subsidies could strongly decline because of their overwhelming share.

[9] http://agpolicy.org/weekcol/608.html

Accordingly, the implementation of an alternative and flexible system, which would safeguard comparable compensation levels for farmers while stabilizing their incomes over time at a lower overall cost, is an option that must spark a great deal of interest from European decision-makers.

Such a system could also be WTO-compliant for Europe, and remain in the authorized margins of the amber and blue boxes, as shown in the study on WTO-compliance in our proposal (see Part IV). These counter-cyclical payments can be made on up to 90% of each farmer's output. They will be paid to farmers and thus allow them to smooth out their yearly revenues over time.

### *e. Principle No.5: The intervention thresholds*

Two intervention thresholds are created:

- A public regulation threshold that triggers market regulation measures, including a mechanism of public stockpiling in case of market prices below this threshold;
- A financial solidarity threshold when prices exceed the corresponding limit showing an increase in excessive speculation.

In the first case, public purchases at the threshold price are limited to 4% of annual production, which prevents the risks of budgetary slippage experienced in the first CAP while helping to stabilize markets. In case of major crisis, the Council of Ministers can decide to exceed this 4% threshold under an international dialogue within the World Food Security Council. In addition, mechanisms acting on supply or demand––notably the transformation of agricultural products to biofuels––will supplement these stockpiling measures to bring prices back in the tunnel.

The budget cost of public regulation stockpiling is therefore capped by design. The simulations we conducted on the grain, oilseed and milk markets demonstrate that if, during crisis years, the budget cost can be slightly higher than the observed average budget, over a multi-annual period the Momagri-CAP generate significant savings while ensuring equivalent and stabilized incomes for farmers.

In the second case, that is to say above a financial solidarity threshold set by the EU, a solidarity tax is applied to the transactions of derivatives. This financial transaction tax will reduce the liquidity during extreme bullish period. The receipt from this financial solidarity tax will finance the reserve fund to manage crises. New resources will then be gained by this plan, further improving the effectiveness of the new budget rules. In general, when market prices are near the equilibrium level or beyond, it will be possible for the EU to run public outtake operations, under managed proportions, to move price towards the equilibrium.

These operations might balance stock building purchases and do not generate any excessive stock accumulation over time. This risk will be all the more small that the growth of non-food industrial outlets will constitute sustainable solutions. This mechanism should be strong enough to rapidly bring prices back inside the tunnel by deterring market speculative behaviors. In emergency cases, when it comes to strengthen food aid or assist countries with ongoing good

crises, the European Council will be able to make additional public outtake operations at prices below the equilibrium price, or even reverse the denaturalization measures.

### *f. Principle No.6: A tariff system to level playing field*

In order to fully implement the governance principles designed by Momagri, trade conducted between major homogenous economic zones should be managed through a tariff system that level playing field depending on origin and destination zones. As long as trade prices are contained inside the variation-free price range, these direct debits would not be applied. Goods would therefore travel without any customs duty.

This could effectively open up markets without costly and distorting trade subsidies while maintaining the possibility for some countries––especially developing ones––to implement a system of locks at borders and develop their agriculture. This direct control at borders would give protection to farmers and indispensable financial means for investments. This is, to some extent, spreading the CAP principles to the rest of the world, within a totally new international cooperation that is adapted to world changes.

Regarding the specific case of the Momagri-CAP, the tax level should thus be based on the public regulation threshold, taking account of each nation's will to carry out the required counter-cyclical regulation mechanisms. In this way, we could avoid opportunist behaviors (free rider), and prompt each producing country's responsibility in stabilizing international trade within a worldwide coordination to exit crises.

***

Applying the above-mentioned principles will give a new strategic course to the CAP, without entailing additional budget costs. Quite the contrary, the plan we propose to implement is stabilizing and leads to budget spending only in case of crisis.

We performed simulations whose results regarding three major agricultural sectors––grain, oilseeds and milk––were analyzed. These findings are very encouraging and plead for an expansion to other sectors as long as their characteristics so allow. But the central and administrating feature of these three major sectors will create a regulation benchmark which might be enough on its own to return the CAP to a long-term strategic development path.

Stabilizing and strengthening the effectiveness of the measures undertaken in the first pillar will maximize the efficacy of the social and environmental measures currently included in the second pillar.

# Part III
# Economic and budgetary consequences of the Momagri-CAP

## 1. General assumptions

Sectorial application scope of the Momagri-CAP proposal

Economic and budgetary impact studies of the Momagri-CAP were conducted on three sectors––grains, oilseeds and milk.

The budget simulations covered the 2011-2020 years by taking into account the CAP reform and the latest budgetary prospects of the Multi-Annual Financial Framework, adopted by the Parliament and the Council. All budget data considered are effective payments for 2011-2014, and forecasted numbers for the 2015-2020 period[10].

**CAP budgets, in €billion, 2011-2020**

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017-2020 |
|---|---|---|---|---|---|---|---|
| **Budget** | 56.3 | 57.9 | 58.3 | 55.8 | 54.9 | 55.4 | 55.4 per year |

*Source: EC, Momagri projections*

Budget simulation methodology

The simulations were made by replacing interventions on the grain, oilseed and milk markets and the decoupled support allocated to these three commodities with the Momagri-CAP expenditures, that is to say with the EQA (Europe Quality Aid), counter-cyclical payments and public or regulation stockpiling costs. The decoupled support allocation was carried out based on grain and oilseed areas as well as other acreages of dairy farms.

Applying the Momagri-CAP principles hence generates budget modifications that only concern the Titles 05 02 and 05 03 of the CAP budget, while budget expenditures of the other Titles[11] remain unchanged.

[10] Payment appropriation for 2015 and payment budget for 2016

[11] Including the expenditures committed for rural development and Titles 05 05, 05 06, 05 07, 05 08, 05 09 et 05 AWBL-01

Market interventions (Title 05 02), decoupled direct payments and other direct subsidies (Title 05 03) for the grain, oilseed and milk sectors have thus been deducted from total amounts, with the exception of export refunds. In 2014, the amount of support allocated to grain, oilseed and dairy farms represents 61% of the first pillar. For other sectors, all support is kept identical in this budget model.

A "Europe Quality" Aid (EQA) is introduced for these three sectors, regardless of market price levels. It is set at a flat rate of €75/hectare for all field crops (grains and oilseeds) as well as fodder crops for dairy farms.

Counter-cyclical payments are made and public purchases for stockpiling are initiated depending on market price levels. The cost of public regulation through stockpiling/outtake operations is taken into account in the budget evaluations. The cost of stock maintenance is estimated at an annual 5% of the stock value (cumulative stocks valued at the floor price of the tunnel). At this stage, no new resources have been integrated in case of prices overrunning the financial solidarity threshold.

Setting equilibrium prices and the tunnel's floor and ceiling thresholds

The equilibrium price provides a useful benchmark to qualify market price levels. It is calculated on average cost prices according to the European Commission publications based on the data from the Farm Accountancy Data Network (FADN).

In this simulation, the equilibrium price is assessed by average cost prices recorded during the 2006-2010 period that precedes the first year of the simulation exercise. Between 2010 and 2013, cost prices changed very little and do not justify a modification of the equilibrium price.

The floor and ceiling thresholds corresponding to the limits from which price volatility is considered as excessive are determined based on a study of the fluctuation of cost prices over 2006-2010. They are set as follows:

- Floor price = equilibrium price + 1 standard deviation
- Ceiling price = equilibrium price – 1 standard deviation

**For grain and oilseed crops**

*Grain crops*

We calculated average cost prices during the 2006-2010 period for the four major grain crops–– common wheat, durum wheat, corn and barley. These four crops represent on average 88% of the total EU-28 grain production. The composite measure of cost prices for the grain sector is the average of production costs for the four crops, weighted by their share of grain production. The following table sums up the parameters for the 2006-2010 period.

In accordance with the established rules, we can evaluate the floor and ceiling prices, as well as the equilibrium price for that period as follows:

- Equilibrium price = €215/t
- Floor price = €200/t
- Ceiling price = €230/t

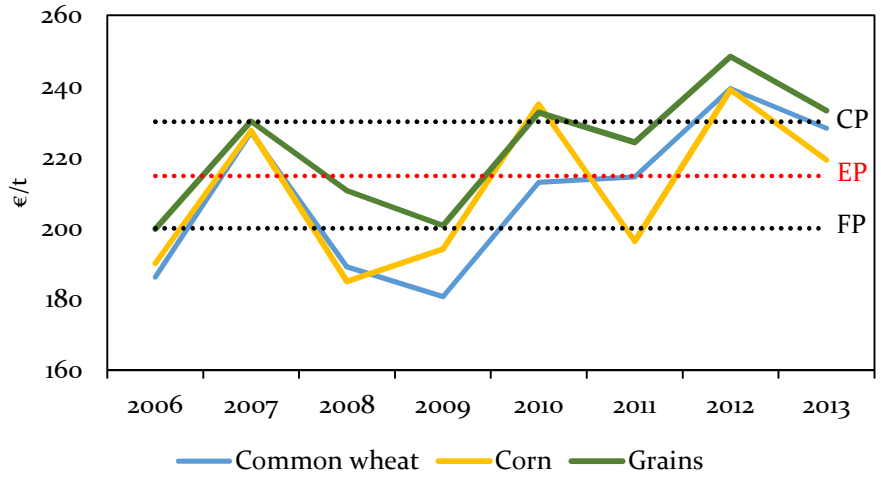
**Evaluation of EU-28 average cost prices, 2006-2010**

| Crop | Average cost price (€/t) | Standard deviation (€/t) |
|---|---|---|
| Common wheat | 199 | 20 |
| Durum wheat | 358 | 33 |
| Corn | 206 | 23 |
| Barley | 235 | 19 |
| Grains* | 215 | 16 |

** Composite measure corresponding to the weighted average of 4 grain crops*
*Source: EC, FADN, Momagri*

As mentioned above, changes in cost prices in the post-2010 years do not justify changing these parameters, since price costs are remaining close to those of previous years. In fact, between 2006 and 2013, average cost prices remained within the tunnel bound by the floor and ceiling thresholds for five out of eight years.

**Evolution of EU average cost prices for wheat and corn, and evaluation of the equilibrium price and the floor and ceiling thresholds for grains, 2006-2013, €/t, farm-gate prices**




*Sources: FADN, Momagri*

*Oilseed crops*

The analysis of European production costs for the oilseed sector shows that the average cost prices for the 2010-2012 years was €425/t for a standard deviation of €30/t. Just like grain and according to the proposed definitions, we set the floor and ceiling prices as well as the equilibrium price for the entire simulation period:

- Equilibrium price = €425/t
- Floor price = €400/t
- Ceiling price = €450/t

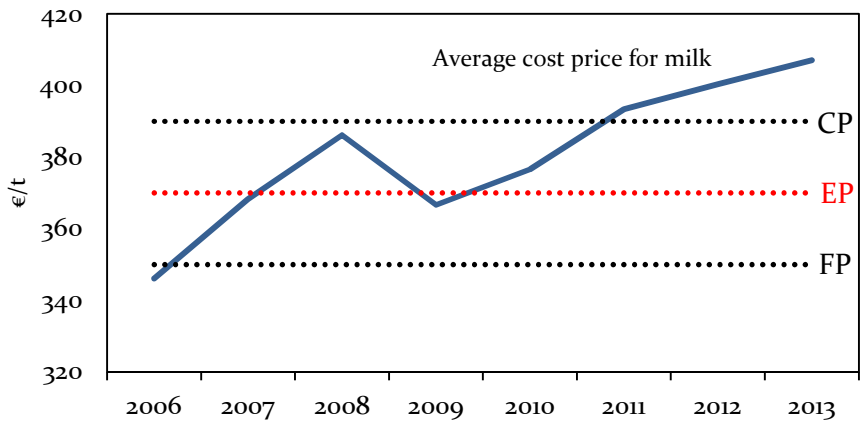
**For milk**

An analysis of European production costs for the milk sector shows that the average cost price for the 2006-2010 period is €369/t with a standard deviation of €20/t. This leads to an equilibrium price and floor and ceiling prices as follows:

- Equilibrium price = €370/t
- Floor price = €350/t
- Ceiling price = €390/t

Cost prices for the dairy sector in the EU-28 have followed an upward trend since 2010. Yet, we have decided to not amend the equilibrium price or the tunnel, since the scope of the increase remains in acceptable limits (lower than 10% of the equilibrium price).

**Evolution of the average EU cost price and the floor and ceiling prices for milk, in €/t**




*Sources: FADN, Momagri*

Evolution in total EU cost prices shows that, for four out of eight years, cost prices were within the tunnel delimited by the floor and the ceiling thresholds. Total cost prices were above the floor prices during three of the eight years.

One of the specific features of the milk market is that milk cannot be stockpiled, contrary to milk powder and butter, and that these two markets are quite different, because of their respective geographic coverage––local for the first and international for the second. It is thus essential that the reform proposal include, in its operational rationale, these two markets at their corresponding level:

- Milk collected at the farm for assessing counter-cyclical payments granted to farmers,
- Milk powder and butter for assessing the stocks qualified for public interventions.

Equivalent prices for "milk collected at the farm" will be based on quotations for "milk powder and butter" in order to connect the budgets for these two markets that obey to distinct rationales and goals, especially regarding the level of public regulation threshold.

Counter-cyclical payments will be triggered on the basis of farm-gate milk price. They will be paid to farmers when the price of milk collected at the farm will be lower than the floor price of the tunnel which is set by the management committee based on the calculation formula adopted by the Council. Like grain and oilseed sectors, and with the objective of not encouraging overproduction, a maximal production level eligible for counter-cyclical support will be defined by country and by agricultural holding, and the subsidy will involve 90% of this referenced production.

Public stockpiling will only concern milk powder and butter. It will become effective when market prices for milk powder and butter are lower than the public regulation threshold (calculated on an equivalent price for drinking milk, the formula remains to be set based on current processing rates). A food security strategic reserve equivalent to 2% of produced volumes will be invested during the first year of the system implementation. The commercial regulation reserve will be limited to 4% of the annual output. Public outtake operations will only concern milk powder and butter. It will be effective when market prices for milk powder are above ceiling prices.

## 2. Assumptions retained for the grain sector

### *a. Market prices*

The market prices used in the budget simulations for the 2011-2015 period are the annual average prices for common wheat delivered in Rouen (in €/t), from which €15/t is deducted for the average cost of transportation and stockpiling. The assumptions of wheat market prices projected for 2016-2020 were set based on the Momagri model[12] simulation results.

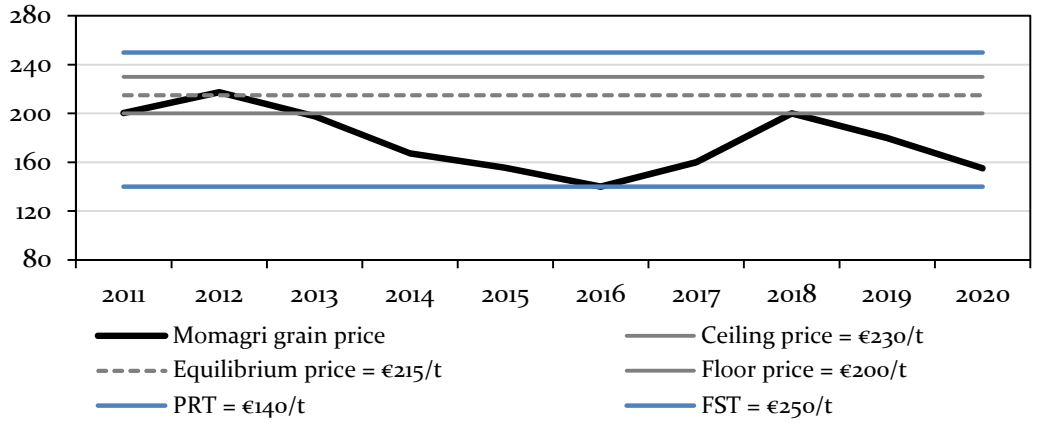
The following graph shows the benchmark price (market price net of transportation costs)[13] as well as the Momagri-CAP intervention thresholds for 2011-2020 budget simulations in the grain

[12] The Momagri model is a computable and sequential general equilibrium economic model. It includes a linear central equilibrium module and a risk module that models the various types of exogenous and endogenous risks confronting agricultural markets. Its key specific feature is agricultural price volatility modelling. For more information, please visit www.momagri.org.

[13] By convention, in the following sections, prices are presented net farmers, i.e. market prices net of transportation costs.

sector. The equilibrium price (EP) is shown by a gray dotted line. The floor and ceiling thresholds are indicated in gray continuous lines. The public regulation threshold (PRT) is plotted in a continuous blue line, as is the financial solidarity threshold (FST).

**Evolution of benchmark prices for grain in the simulations, €/t**




*Source: Momagri*

### *b. Produced volumes and the activation of regulation mechanisms*

The counter-cyclical payment system will be set up on individual references based on historical output. For the budget forecast, the referenced volumes will be established on the average of the 2012, 2013 and 2014 years whose data are collected from Eurostat.

**Volumes of grains produced in the EU-28, in million tons, Historical data for 2011-2014, projections for 2015-2020**

| | 2011 | 2012 | 2013 | 2014 | 2015-2020 |
|---|---|---|---|---|---|
| **Production** | 292 | 282 | 307 | 332 | 307 per year |

*Sources: EC, Momagri assumptions*

**Breakdown of volumes produced by price range**

| | < €140/t | €140-200/t | €200-230/t | >€230/t |
|---|---|---|---|---|
| Qualified for CCPs | 90% | 90% | 0% | 0% |
| Not-qualified for CCPs | 6% | 10% | 100% | 100% |
| Stockpiled | 4%* | 0% | 0% | 0% |
| Outtake from stockpiling | 0% | 0% | 2%** | 2%** |

CCPs: Counter-cyclical payments
* Maximum threshold that can be exceeded upon Council's decision
** In average and can get to 8% over two years.

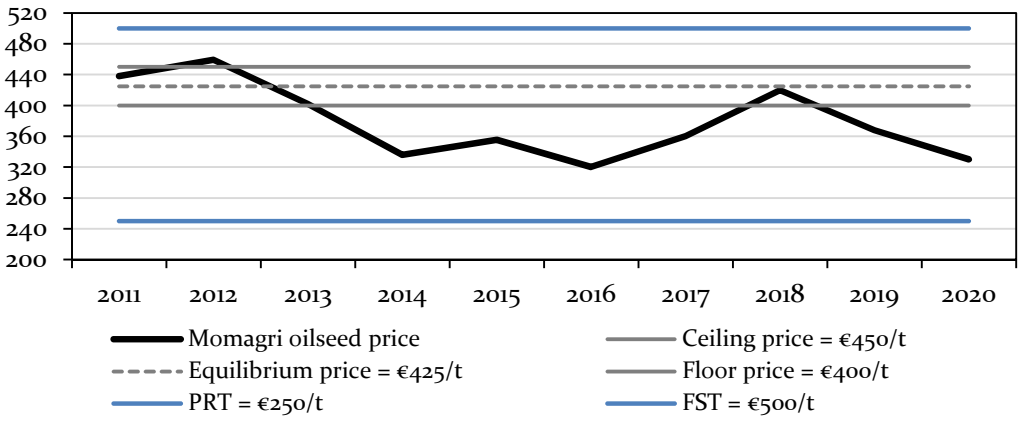
The various regulation mechanisms considered are activated according to market price levels, and the qualified volumes vary according to these two features. The chart above presents the qualification of produced volumes for each regulation mechanism that is proposed according to market price levels.

## 3. Assumptions retained for the oilseed sector

### *a. Market prices*

Budget simulations for the 2011-2015 period were conducted on the basis of annual average rapeseed prices recorded on the Hamburg quotation in €/t. The reference price to determine the amount of counter-cyclical payments and stockpiling costs equals to the average quoted price minus €15/t intended for the average transportation cost. For the 2016-2020 period, the benchmark price comes from the Momagri model results. Parameters retained for budget simulations for the 2011-2020 period are presented in the following graph.

**Evolution of oilseed benchmark prices for simulation purposes, €/t**




*Source: Momagri*

### *b. Volumes produced and activation of regulation mechanisms*

For the 2011-2014 period, data on oilseed production volumes are also obtained from Eurostat. By applying the same principle used for grain, the 2012-2014 average production serves as a reference volume for the budget simulation starting in 2015.

**Oilseed production volumes in the EU-28, in million tons**
**Historical data for 2011-2014, projections for 2015-2020**

| | 2011 | 2012 | 2013 | 2014 | 2015-2020 |
|---|---|---|---|---|---|
| **Production** | 29.1 | 27.3 | 31.4 | 35.2 | 31.3 per year |

*Sources: EC, Momagri assumptions*

Various regulation mechanisms are activated according to market price levels, and volumes vary in accordance with these two features. The following chart presents the qualifying nature of oilseed production by proposed regulation mechanism according to market prices.

**Breakdown of production volumes by price range**

| | < €250/t | €250-400/t | €400-450/t | >€450€/t |
|---|---|---|---|---|
| Qualified for CCPs | 90% | 90% | 0% | 0% |
| Not-qualified for CCPs | 6% | 10% | 100% | 100% |
| Stockpiled | 4%* | 0% | 0% | 0% |
| Outtake from stockpiling | 0% | 0% | 2%** | 2%** |

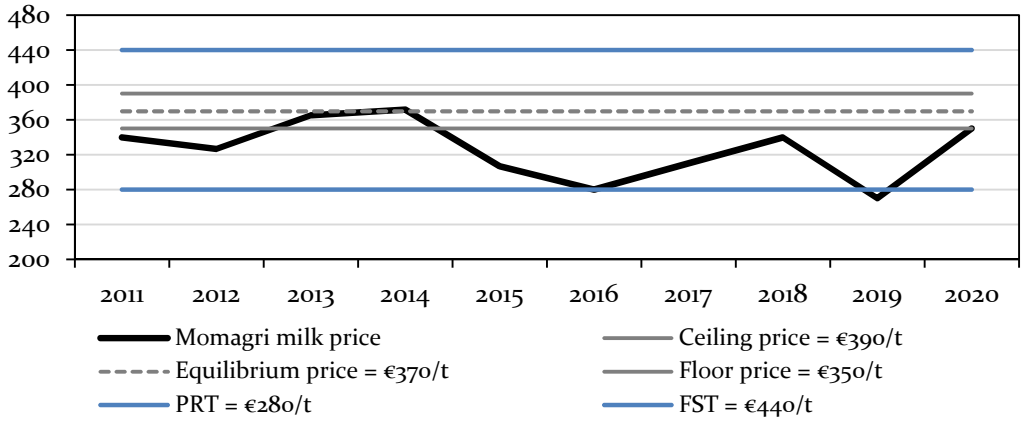
CCPs: Counter-cyclical payments
* Maximum threshold that can be exceeded upon Council's decision
** In average and can get to 8% over two years.

## 4. Assumptions retained for the milk sector

### a. ***Market prices***

The budget simulations for 2011-2015 were conducted on the basis of the EU weighted average farm-gate milk price (real fat content), in €/ton. Unlike the grain and oilseed sectors, transportation costs were not taken into account, since the reference price is that of milk collected at the farm. The following graph displays the assumptions of market prices retained to establish budget simulations over the 2011-2020 period.

**Evolution of benchmark milk prices for simulation purposes, €/t**




*Source : EC, Momagri*

### b. *Volumes produced and activation of regulation mechanisms*

The EU-28 wholesale milk delivered volumes were collected from Eurostat database for the 2011-2014 period. The post-2014 budget simulation is made on the reference volumes based on the 2012-2014 average production.

**Milk deliveries in the EU-28, in million tons**
**Historical data for 2011-2014, Projection for 2015-2020**

| | 2011 | 2012 | 2013 | 2014 | 2015-2020 |
|---|---|---|---|---|---|
| **Volumes delivered** | 140 | 140 | 141 | 148 | 143 per year |

*Sources: EC, Momagri assumptions*

Various regulation mechanisms are activated according to market price levels, and the qualified volumes vary according to these two features. The following chart presents the qualification of milk volumes for each regulation mechanism by market price ranges.

**Breakdown of milk volumes by price range**

| | < €280/t | €280-350/t | €350-390/t | >€390€/t |
|---|---|---|---|---|
| Qualified for CCPs | 90% | 90% | 0% | 0% |
| Not-qualified for CCPs | 6% | 10% | 100% | 100% |
| Stockpiled | 4%* | 0% | 0% | 0% |
| Outtake from stockpiling | 0% | 0% | 2%** | 2%** |

CCPs: Counter-cyclical payments
* Maximum threshold that can be exceeded upon Council's decision
** In average and can get to 8% over two years.

## 5. Simulations and results

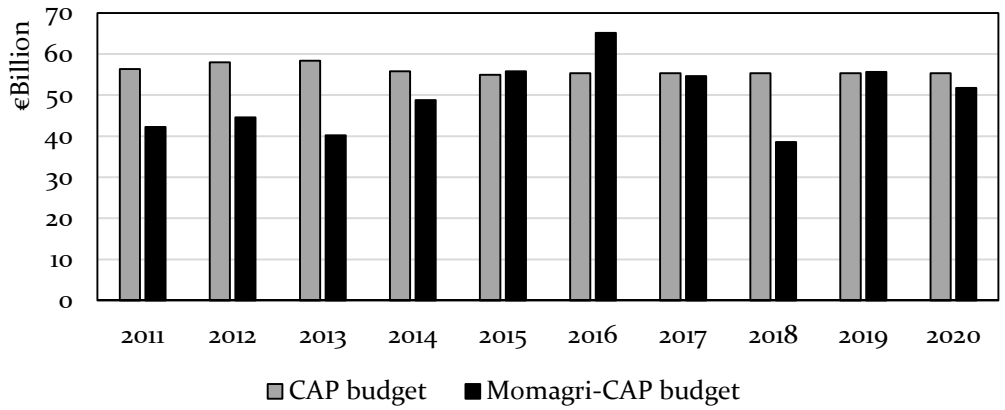
Budget simulations are conducted in this section. They involve a ten-year period from 2011 to 2020. The budget simulations concern the impact of the Momagri-CAP on the whole EU agricultural budget, including the expenditures allocated to the grain, oilseed and milk sectors. The values for the other sectors and the second pillar allocation are taken as given.

We also carry out economic simulations regarding the impact of the CAP and Momagri-CAP proposals on the revenues and incomes of field crop and dairy farmers. Detailed in Part IV, these simulations are based on the same market assumptions than those retained for budget calculation. They do not aim to provide the average revenue/income that could be obtained by European producers in the future, but to compare, all things being equal, how field crop and milk farmers' revenue/income is formed in the framework of the CAP and Momagri-CAP respectively, especially in terms of average level and volatility.

### *a. <u>A better use of budget resources</u>*

The following graph represents the budget impact of the Momagri-CAP principles in comparison with the budget forecast of the current CAP.

**Comparison of annual budgets, CAP vs. Momagri-CAP, 2011-2020, in €billion**




*Sources: EC, Momagri*

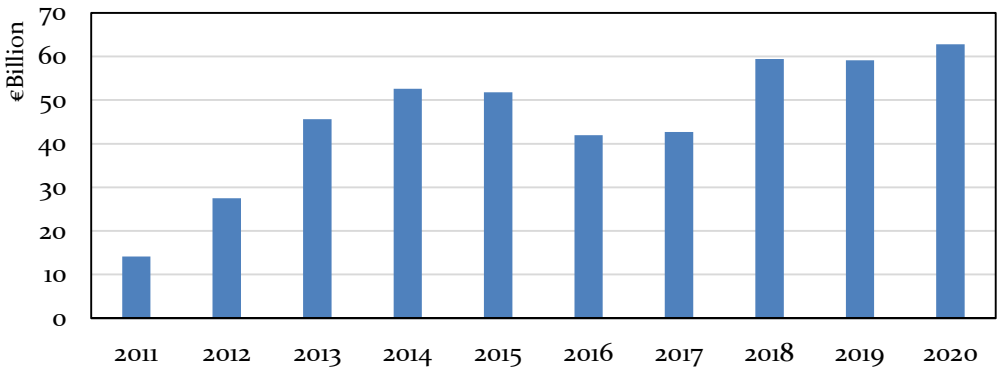
Average annual CAP budget: €56.0 (stable)
Average Momagri-CAP budget: €49.7 (flexible)

Average annual savings for:
2011-2020: €6.3 billion (€63 billion over 10 years)
2016-2020: €2.2 billion (€11 billion over 5 years)

Applying the principles of the Momagri-CAP over the 2011-2020 period would have saved €63 billion, or €6.3 billion annually, compared to the budgets that were actually allocated. In fact, the average annual budget of the Momagri-CAP would be €49.7 billion, against €56 billion in the CAP––equivalent to an 11% drop. By considering solely the upcoming years, the average annual budget savings between 2016 and 2020 would be €2.2 billion due to a significant decline in market prices during the period. In addition, applying the Momagri-CAP principles would also lead to greater multi-annual budget flexibility. The Momagri-CAP budget could vary between €39 billion and €65 billion.

Consequently, the cumulative budget gap over the period is €62.7 billion, equivalent to a 13.4 fiscal month saving, or 11.2% of the total CAP budget over ten years (see graph below).

**Cumulative budget gaps, CAP vs. Momagri-CAP, 2011-2020, in € billion**




*Source: Momagri*

### *b. <u>An optimal management of the EU budget for better market regulation</u>*

The observed budget difference is due to the introduction of new counter-cyclical regulation mechanisms. When prices are higher than, or equal to, the lower bound of the tunnel (€200/t for grains, €400/t for oilseeds and €350/t for milk), the public expenditure is limited to the sole EQA.

Yet, between 2011 and 2014, field crop and milk prices were strongly impacted by volatility, and reached average levels that were close to, or higher than, these thresholds (€196/t on average for grains, €409/t for oilseeds and €315/t for milk).

Not only cost-effective, the Momagri-CAP proposal is also efficient to regulate farmers' revenues and incomes when market conditions so require.

In the framework of the current CAP, budgets are stable while farmers' revenues are volatile. Agricultural budgets are thus disconnected from the reality of agricultural markets, whose volatility, although structural, has been rising in the past few years. The allocated public support is mainly decoupled, and unable to "aid" farmers in managing the price hyper-volatility to which they are confronted. These subsidies represent at most a price supplement whose level, being stable compared to unstable prices, is thus never appropriate to the situation. As a result, agricultural producers are subjected to price volatility, as shown by the volatility of their incomes, which is even higher than that of prices.

The rationale underlying the Momagri-CAP proposal focuses on an opposite view of the one prevailing today. In the framework of the Momagri-CAP proposal, budgets are flexible and farmers' revenues are stabilized, in contrast to what has happened with the current CAP.

The introduction of counter-cyclical coupled subsidies increases the CAP responsiveness to market reality. Furthermore, the non-systematic nature of counter-cyclical payments greatly limits some of the most adverse effects of the current support.

### c. ***An average revenue level stabilized to better support farmers' incomes and improve sector competitiveness***

#### *c.1) A stabilized average revenue level*

As one of the goals of the Momagri-CAP is maximizing the efficiency of European agricultural public expenditures, economic simulations are conducted in addition to budget simulations. This aims to measure the potential impact of the Momagri-CAP on the earnings of European grain and dairy farmers, compared to those that would have been received with the CAP.

The economic simulations are carried out for the same period to that retained for budget simulations (2011-2020), with identical market assumptions. They allow assessing and comparing the consequences resulting from the Momagri-CAP over these ten years, in terms of the average level of revenues and its volatility.

Consequently, the key interest of these simulations lies less in the gross values that are presented than the comparisons they generate. They show the pertinence of the Momagri-CAP proposal compared to the CAP in issues of economic regulation and compensation for average European grain and milk farmers. A concrete and quantified application of the Momagri-CAP proposal on French farming balance sheets has also been conducted, confirming the consistency and efficiency of the system (see Part IV.4).

The results obtained show that applying the Momagri-CAP brings in revenue stabilization at levels that are close to, or higher than, those in the current CAP.

#### *c.2) An effective support of revenues at a minimum level*

Better spending and more support is possible, provided that we are not hostile to any new ideas. In the framework of the current CAP with its decoupled subsidy rationale, farmers receive a relatively stable share of public support regardless of price levels.

In the Momagri-CAP proposal, public support is not only variable but also not systematic. It is paid only when market conditions so justify––low prices in general, strong volatility and cost prices not being covered. In this respect, one should keep in mind that this line of reasoning is one of the arguments that justified the Farm Bill in the United States and the abandonment of decoupled direct payments.

Two cases must then be differentiated:

- When prices are higher than the lower bound of the tunnel––floor price (case 1),
- When prices are lower than the floor price (case 2).

The first case is straightforward. The Momagri-CAP generates significant budget savings but brings out lower average revenues than the current CAP, because the amount of public subsidies

is quite lower. In the second case, the situation is much more interesting. It is indeed when prices and farmers' margins are low that the economic and budget effectiveness of the Momagri-CAP becomes evident.

The counter-cyclical nature of subsidies, together with the multi-annual budget flexibility, allows to optimize budget resources through balanced and efficient management of public expenditures, as it is done in the United States. Contrary to decoupled and coupled subsidies that still prevail in the current CAP, counter-cyclical payments are not systematic, being applied only to a qualified percentage of production. They represent a support allowing farmers to smooth out their annual revenues.

By doing so, this system allows farmers:

- To manage market risks[14], which could not be financially feasible without counter-cyclical payments,
- To increase their visibility in markets which are structurally volatile,
- Thus to improve their investments that drive competitiveness and future profitability.

Counter-cyclical payments therefore present a twofold benefit––an economical and budgetary advantage. They allow to smooth out farmers' revenues and offset the many imperfections and drawbacks of agricultural markets that can sustainably affect the economic stability of European farms. The budget expenditure of such a system is optimized, savings are generated when prices meet the expectations while contrarily more resources are available in crisis times.

Let's consider the example of a European grain producer and a €165/t Rouen delivered market price, i.e. €150/t paid to the farmer.

*With the Momagri-CAP*, he would have received:

- €150/t corresponding to the sale of his production at market price,
- €75/t as "Europe Quality" Aid on his whole production, or about €10/t for a 7t/hectare yield,
- €45/t in counter-cyclical payments corresponding to a €50/t subsidy[15] for 90% of his production,
- So a total sale price of €205/t.

*With the current CAP,* and based on a total average BPS of €40/t, he would have received €190/t. The 8% gap is in favor of the Momagri-CAP.

As a result, it is possible to achieve significant budget savings, while allowing farmers to maintain, and most importantly to stabilize their incomes through more budget flexibility and

[14] In the case when prices are not lower than the public regulation threshold.

[15] Equals to the difference between the floor price (€200/t) and market price (€150/t)

counter-cyclical payments. More detailed analyses by sector are given in Part IV, as well as the results obtained at farm level in France's department of the Marne and Western areas.

## 6. Conclusion

Even with the assumptions of more chaotic price changes, budget costs for the 2011-2020 period would be lower than actual expenditures, generating a cumulative savings of €63 billion––or €6.3 billion annually. The 2016-2020 budget projections made with the assumptions of much lower prices––accompanied with more important counter-cyclical payments––remain positive in terms of savings since they would amount to €11 billion.

At the same time, the revenue levels of farmers would have been close, or even higher in some cases, and much less volatile. Please also note that the (positive) impact of the removal of decoupled support and its adverse effects has not been accounted for in the simulations.

Which findings can we draw from this implementation of the Momagri-CAP in the grain, oilseed and milk sectors?

- The EU agricultural budget will be best managed while ensuring better market regulation.

- It is possible to spend differently to better support farming incomes and improve sector competitiveness.

- It is possible and preferable to set aside non-allocated budgets, while introducing a sunset clause, within a dedicated fund to have adequate financial resources in case of crisis,

- Overall, Europe will have a genuine long-term agricultural strategy.

# Part IV
# Applicability of the Momagri-CAP

## 1. WTO compliance

### a. ***WTO classification of domestic support***

In WTO general terminology, the domestic support to agriculture is classified in three categories, or boxes of different colors: amber, blue and green.

#### *Amber box*

According to the WTO, "all domestic support measures considered to distort production and trade (with some exceptions) fall into the Amber Box." Defined by the Article 6 on the Agreement on Agriculture (AoA) negotiated during the Uruguay Round, the amber box includes all domestic supports except those belonging to the blue and green boxes. These involve measures to support prices, or subsidies that are directly related to production quantities.

These supports are subject to limits and reduction commitments are expressed through a "Total Aggregate Measurement Support" (Total AMS), which gathers in one single figure all support for specified products as well as non-product-specific support (granted across the whole sector).

A minimal amount of support––or "*de minimis*"––is authorized:

- For each agricultural product, up to 5% (for developed countries[16]) of the production value of the given product;
- For the "non-product-specific" category, up to 5% of the value of the total agricultural production.

The rule applying to the "*de minimis*" clause is that of "all or nothing": If the amount of support is above the 5% threshold, even if it were only 0.1%, all concerned support is not qualified for the "*de minimis*" exclusion. All support classified in the amber box is then counted toward the country's total AMS. If, on the contrary, that amount is below the threshold, it is reduced to 0.

During current negotiations, various proposals have been presented on the issue of how much further these subsidies must be reduced, and whether it is appropriate to set by-product ceilings rather than to maintain the current system of a "global", total and unique, ceiling. The AMS is defined in Article I and Appendices 3 and 4 in the AoA.

[16] 10% for developing countries

### *Blue box*

The blue box represents the intermediate category. It covers all direct supports that are coupled with a sort of production reduction. Any direct support normally amber can be classified in the blue box if it also requires farmers to limit their production.

The detailed method of inclusion in the blue box are set out in Paragraph 5 of Article 6 in the AoA. Direct payments under a production limiting program can be qualified for exemption in the blue box if they are:

- based on fixed areas and yields; or
- made on 85% or less of the base production level; or,
- if livestock payments, made on a fixed number of heads.

At present, no limits are placed on blue box spending. Some nations consider the blue category crucial for the distorting support curbing movement initiated since 1995. Others, on the contrary, want to set limits or reduction commitments, or even move these supports into the amber box.

### *Green box*

Qualified in the green box, subsidies must not distort trade, or at most cause minimal distortion. The green category is defined in Appendix 2 of the AoA. Support classified in this box is not targeted at particular products, and generally represents a direct income support for farmers that are not related to current production levels or prices (decoupled payments). It can also take the form of environmental protection or regional development programs.

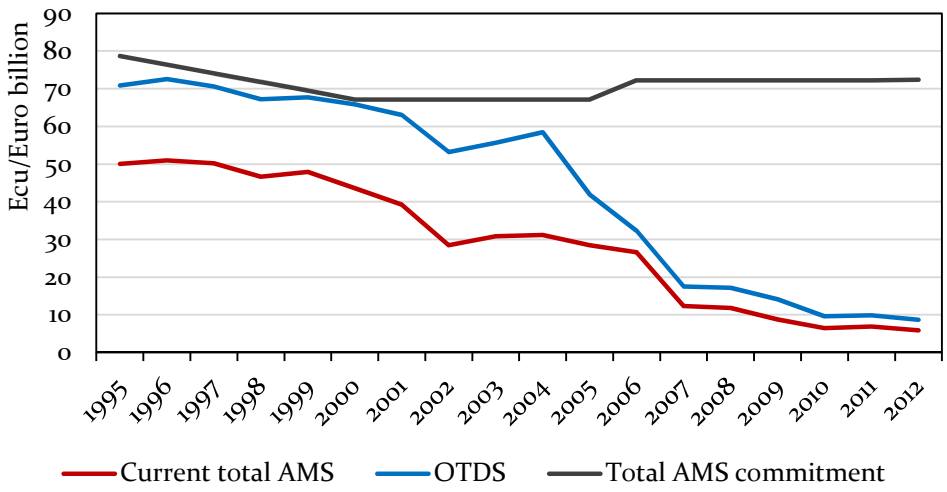
Green box subsidies are allowed without any limits. However, it must be financed by public funds and not by consumers through higher prices. During current negotiations, many countries have challenged the legitimacy of the green box, which, given the large amounts of payments or the nature of these subsidies, might cause significant distorting effects on trade (as in the case of decoupled income support).

### *b. EU effective leeway*

Section I in Part IV of the EU Listing includes the commitments to cut domestic support expressed in terms of total AMS and annual final consolidated commitment levels. The current total AMS value of the non-exempt subsidies must not exceed the total AMS limit recorded in the Listing, and this neither for any given year of the implementation period nor afterward.

The EU's notified and commitment levels from 1995 to 2012 (the last notified year) are presented in the following figure.

**Evolution of the EU maximal commitment level on Total AMS, Current total AMS and OTDS[17], in Ecu (1995-1999) and Euro (1999-2012) billion**




*Source: WTO*

The total AMS commitment level is a theoretical maximum for the EU, which is nevertheless subjected to more restrictions following various negotiations and commitments to reduce the AMS total amount. The negotiations started since 1995 on domestic support to agriculture aim to achieve "substantial reductions of the domestic support with trade distortions", through the establishment of limits and quantified reduction commitments for the OTDS and each of its four components, the consolidated total AMS, the product- or non-product-specific *de minimis* levels, and the blue box.

The various ministerial conferences held since 2001––particularly in Hong Kong in 2005 and Bali in 2013––clarify several issues and provide quantified indications but they do not constitute a binding statutory term. The assumption of cutting the AMS by 80% of its maximal commitment level[18] is a unilateral decision of the EU. We are therefore assuming it as the maximal AMS threshold for the EU.

The following table summarizes the effective maximum thresholds of the current total AMS and the product- and non-product-specific *de minimis* levels[19]. From 2007 to 2012, the exhibited values correspond to amounts that were actually notified by the EU, while values for 2013-2020 are forecasts by taking identical amounts of the latest year of notification (2012).

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[17] The Overall Trade-Distorting Support (OTDS) is assessed by the sum of four elements: the consolidated final Total product-specific AMS, the authorized product-specific *de minimis* level (<5% of the agricultural production value by product), the authorized non-product-specific *de minimis* level (<5% of the value of the total agricultural production) and the blue box payments.

[18] Corresponding to an effective maximal AMS threshold of €14.4 billion for the EU over the 2007-2020 period.

[19] The United States makes a significant use of the "non-product-specific AMS" as the support counted in this category reached $9.5 billion in 2011, against €0.7 billion for the EU.

**AMS, *de minimis* and amber box maximum levels, UE, 2011-2020, in €billion**

| | 2011 | 2012 | 2013-2020 |
|---|---|---|---|
| Current total AMS (-80% maximum level) | 14.4 | 14.5 | 14.5 per year |
| Product-specific *de minimis* max | 10.2 | 10.0 | 10.0 per year |
| Non-product-specific *de minimis* max | 18.5 | 18.7 | 18.7 per year |
| Amber box limit | 43.1 | 43.2 | 43.2 per year |

*Sources: WTO, Momagri calculations*

**AMS, *de minimis* and amber box effective levels, EU, 2011-2020, in €billion**

| | 2011 | 2012 | 2013-2020 |
|---|---|---|---|
| Current total AMS | 6.9 | 5.9 | 5.9 per year |
| Product-specific *de minimis* | 0.3 | 1.0 | 1.0 per year |
| Non-product-specific *de minimis* | 0.7 | 0.8 | 0.8 per year |
| Amber box total | 7.9 | 7.7 | 7.7 per year |

*Sources : WTO, Momagri calculations*

Considering the total AMS notified by the EU up to 2012, the EU effective leeway on the amber box and the OTDS are as follows (in €billion):

**Amber box and OTDS leeway, EU, 2011-2020, in €billion**

| | 2011 | 2012 | 2013-2020 |
|---|---|---|---|
| Amber box leeway | 35.2 | 35.5 | 35.5 per year |
| Blue box leeway | 15.5 | 15.9 | 15.9 per year |
| OTDS leeway | 50.7 | 51.4 | 51.4 per year |

*Sources: WTO, Momagri calculations*

### c. ***WTO compliance of the Momagri-CAP proposal***

The support measures of the Momagri-CAP proposal can be classified into WTO green, blue and amber boxes.

| **Support mechanisms Momagri-CAP** | **WTO category[1]** |
|---|---|
| "Europe Quality" Aid | Green |
| Counter-cyclical payments | Amber or Blue[2] |
| Regulation stockpiling | Amber |

[1] *Under the Agreement on Agriculture*
[2] *Assumption retained for simulations: amber box*

The EQA is a decoupled support. It can therefore be arranged in the green box.

Being partially coupled to production, counter-cyclical payments and the public regulation stockpiling can be assigned either to the amber or to the blue box. They are considered amber in our simulations.

In the Momagri-CAP proposal, it is assumed that if the *de minimis* levels for grains, oilseeds and milk are saturated when counter-cyclical payments and regulation stockpiling are implemented, the unused non-product-specific *de minimis* can be employed in accounting the AMS of these three commodities.

Given the average relative weight of direct payments linked to grain, oilseed and milk production areas over total subsidies (~64%), we consider that 64% of the non-product-specific AMS leeway (€17.9 billion from 2012 on) can cover all or a part of counter-cyclical payments for grains, oilseeds and milk, per the following breakdown: 54% for grains, 12% for oilseeds and 34% for milk.

Compiled in the table below are the AMS used in the Momagri-CAP for the three products considered, the AMS for other products and the non-product-specific AMS before accounting for the *de minimis* clauses.

**Amounts of product-specific, non-product-specific and current total AMS prior to *de minimis* exclusions, in €billion**

| Year | Initial product-specific AMS | | | | Initial non-product-specific AMS | Initial current total AMS |
|---|---|---|---|---|---|---|
| | Grains | Milk | Oilseeds | Others | | |
| 2011 | 0 | 1.3 | 0 | 1.2 | 0.7 | 3.2 |
| 2012 | 0 | 2.5 | 0 | 0.9 | 0.8 | 4.2 |
| 2013 | 1.4 | 0 | 0 | 0.9 | 0.8 | 3.1 |
| 2014 | 9.0 | 0 | 0.5 | 0.9 | 0.8 | 11.2 |
| 2015 | 12.4 | 5.5 | 0.8 | 0.9 | 0.8 | 20.4 |
| 2016 | 16.6 | 9.0 | 2.3 | 0.9 | 0.8 | 29.6 |
| 2017 | 11.1 | 5.2 | 1.1 | 0.9 | 0.8 | 19.1 |
| 2018 | 0 | 1.3 | 0 | 0.9 | 0.8 | 3.0 |
| 2019 | 5.5 | 11.9 | 0.9 | 0.9 | 0.8 | 20.0 |
| 2020 | 12.4 | 0 | 2.0 | 0.9 | 0.8 | 16.1 |

*Sources: WTO, Momagri calculations*

The current total AMS for the EU is the sum of the product-specific AMS for grains, oilseeds, milk, and other products[20], as well as the non-product-specific AMS. The amounts counted in

[20] Supposed unchanged compared to the amounts notified by the EU.

initial grain, oilseed and milk AMS are deducted from the total AMS, and replaced by counter-cyclical payments and regulation stockpiling when these types of support are activated. To obtain the amounts that could have been––and could be––effectively notified for any year between 2011 and 2020, we applied the product-specific *de minimis* clauses as well as the leeway allowed by the non-product-specific *de minimis* based on the assumptions outlined above. The product- and non-product-specific *de minimis* clauses are demonstrated in the table right below.

**The product-specific and non-product-specific *de minimis* levels**

| | 2011 | 2012 | 2013-2020 |
|---|---|---|---|
| Product-specific *de minimis* levels | | | |
| Grains | 2.7 | 2.7 | 2,7 per year |
| Milk | 2.6 | 2,6 | 2.6 per year |
| Oilseeds | 0 | 0 | 0 per year |
| Others* | 7.0 | 6,0 | 6.0 per year |
| Total non-product-specific *de minimis* | 18.5 | 18.7 | 18.7 per year |
| Of which amount for: | | | |
| Grains | 6.2 | 6.2 | 6.2 per year |
| Milk | 3.9 | 3.9 | 3.9 per year |
| Oilseeds | 1.4 | 1.4 | 1.4 per year |

** Equivalent to the sum of de minimis for other products. Sources: WTO, Momagri calculations*

**Details of the product-specific AMS calculations for the grain, oilseed and milk sectors with the Momagri-CAP subsidies**

| Year | Initial product-specific AMS | | | Sum of product-specific and non-product-specific *de minimis* allocated | | | Product-specific AMS after *de minimis* exclusions | | |
|---|---|---|---|---|---|---|---|---|---|
| | Grains | Milk | Oilseeds | Grains | Milk | Oilseeds | Grain | Milk | Oilseed |
| 2011 | 0.0 | 1.3 | 0.0 | 8.9 | 6.5 | 1.4 | 0.0 | 0.0 | 0.0 |
| 2012 | 0.0 | 2.5 | 0.0 | 8.9 | 6.5 | 1.4 | 0.0 | 0.0 | 0.0 |
| 2013 | 1.4 | 0.0 | 0.0 | 8.9 | 6.5 | 1.4 | 0.0 | 0.0 | 0.0 |
| 2014 | 9.0 | 0.0 | 0.5 | 8.9 | 6.5 | 1.4 | 9.0 | 0.0 | 0.0 |
| 2015 | 12.4 | 5.5 | 0.8 | 8.9 | 6.5 | 1.4 | 12.4 | 0.0 | 0.0 |
| 2016 | 16.6 | 9.0 | 2.3 | 8.9 | 6.5 | 1.4 | 16.6 | 9.0 | 2.3 |
| 2017 | 11.1 | 5.2 | 1.1 | 8.9 | 6.5 | 1.4 | 11.1 | 0.0 | 0.0 |
| 2018 | 0.0 | 1.3 | 0.0 | 8.9 | 6.5 | 1.4 | 0.0 | 0.0 | 0.0 |
| 2019 | 5.5 | 11.9 | 0.9 | 8.9 | 6.5 | 1.4 | 0.0 | 11.9 | 0.0 |
| 2020 | 12.4 | 0.0 | 2.0 | 8.9 | 6.5 | 1.4 | 12.4 | 0.0 | 2.0 |

*Source: WTO, Momagri*

Let's take 2015 as an example, the total current AMS for the EU would be €20.4 billion. Under the Momagri-CAP proposal, counter-cyclical payments and/or stockpiling equaling €12.4 billion would have been paid for grain, €5.5 billion for milk and €0.8 billion for oilseed production.

The level of the product-specific *de minimis* coupled with the leeway of the non-product-specific *de minimis* (€11.5bn out of €18.7bn are granted to the three commodities considered) allow to calculate the notified product-specific AMS. In effect, by reaching €12.4bn, the grain AMS is higher than the sum of the grain *de minimis* (€2.7bn) plus the amount of the non-product-specific *de minimis* allocated to the grain sector (€8.9bn), thus not qualifying for the *de minimis* exclusion. As regards milk and oilseeds, the amounts of *de minimis* being greater than the respective AMS, the latter are then exempted (see above table). Finally, the total product-specific AMS for the three commodities notified for 2015 would amount to €12.4bn. The calculation of the product-specific AMS for grain, milk and oilseed sectors is detailed in the table preceding this paragraph.

The last step consists in identifying the current total AMS by pooling all of its components. The current total AMS notified is the sum of product-specific AMS (grains, milk, oilseeds and other products) and the non-product-specific AMS after *de minimis* exclusions. The following table summarizes the amounts that could actually be notified for 2011-2020 by applying these principles.

**Notifications of product-specific, non-product-specific and current total AMS after *de minimis* exclusions, in €billion**

| Year | Product-specific AMS after *de minimis* | | | | Non-product-specific AMS after *de minimis** | Current total AMS notified |
|---|---|---|---|---|---|---|
| | Grain | Milk | Oilseeds | Others* | | |
| 2011 | 0 | 0 | 0 | 1.0 | 0 | 1.0 |
| 2012 | 0 | 0 | 0 | 0.1 | 0 | 0.1 |
| 2013 | 0 | 0 | 0 | 0.1 | 0 | 0.1 |
| 2014 | 9.0 | 0 | 0 | 0.1 | 0 | 9.1 |
| 2015 | 12.4 | 0 | 0 | 0.1 | 0 | 12.5 |
| 2016 | 16.6 | 9.0 | 2.3 | 0,1 | 0 | 28.0 |
| 2017 | 11.1 | 0 | 0 | 0.1 | 0 | 11.2 |
| 2018 | 0 | 0 | 0 | 0.1 | 0 | 0.1 |
| 2019 | 0 | 11.9 | 0 | 0.1 | 0 | 12.1 |
| 2020 | 12.4 | 0 | 2.0 | 0.1 | 0 | 14.5 |

** AMS reported as in WTO notifications. Sources: WTO, Momagri calculations*

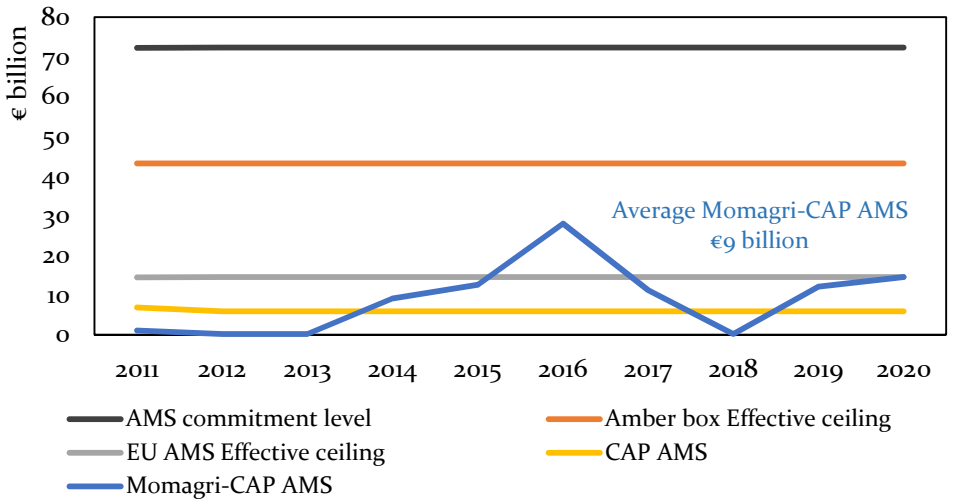
Given the notifications and the above-mentioned effective limits as well as the breakdown of the Momagri-CAP subsidies in colored boxes under domestic support classification, the WTO-compliance of the Momagri-CAP proposal can be examined.

The sum of counter-cyclical payments and public regulation stockpiling, after profiting the *de minimis* exclusion rules, remains for any year between 2011 and 2020 below the total AMS theoretical limit. Concerning the actual threshold, which was unilaterally decided by the EU, corresponding to an 80% cut of the maximum commitment level, there is only one year (2016) that this constraint could be broken. Over the whole period, the Momagri-CAP AMS averages €9bn, or 38% below the effective EU limit. The graph immediately following reveals that the Momagri-CAP complies with the WTO's AMS rules.

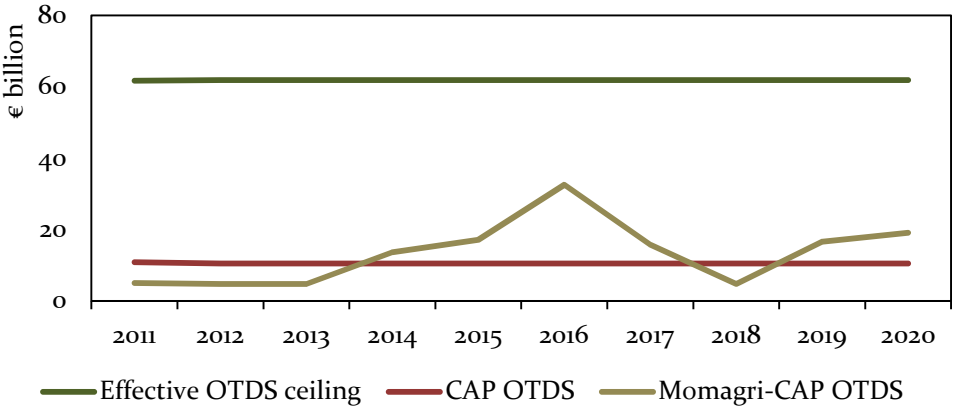
The Momagri-CAP proposal is also fully compliant with WTO rules regarding the OTDS. The subsidies counted toward the OTDS within the Momagri-CAP are proved to be lower than the OTDS actual limit for any given year (see the second graph below). The Momagri-CAP 2011-2020 average OTDS is also smaller than the notified number under the current CAP.

**WTO-Compliance of the Momagri-CAP**

**(a) Regarding the AMS**




**(b) Regarding the OTDS**




*Sources : WTO, Momagri*

The Momagri-CAP proposal is therefore compliant with WTO rules, taking into account EU notifications and commitments of distorting support reduction.

Please note that additional leeway exists but has not been used, in particular from the blue box, which can lead to even lower notifications. The same goes for the green box, which is not examined here as not bound by any commitment of reduction. The Momagri-CAP proposal carries with it a significant decline in green box subsidies, since the SPSs (2011-2014) and BPSs (2015-2020) for grains, oilseeds and milk are replaced by the EQA whose amounts are quite lower (€75/ha).

## 2. Impact on stocks

The Momagri-CAP proposal supposes that public stockpiling operations are triggered when market prices are lastingly under the public regulation threshold set at €140/t, €250/t and €280/t for grains, oilseeds, and milk powder and butter (proxy for milk price) respectively. Conversely, public stock releases can be carried out when market prices are enduringly above the upper limit of the tunnel, accordingly settled for grains, oilseeds, and milk at €230/t, €450/t and €390/t.

In view of the past (2011-2015) and projected (2016-2020) development of grain prices, as well as the assumptions on volumes that can be stockpiled and out-taken, no public acquisition/discharge[21] would have been conducted for grains. This is because grain prices has always been contained inside the limits of stockpiling and outtake activation. In contrast, an outtake operation could have been made in 2012 for oilseeds, and a stockpiling operation could be conducted for milk in 2019 (see the graph below). The Momagri-CAP is therefore not associated with an inventory overhang like what happened in the past.

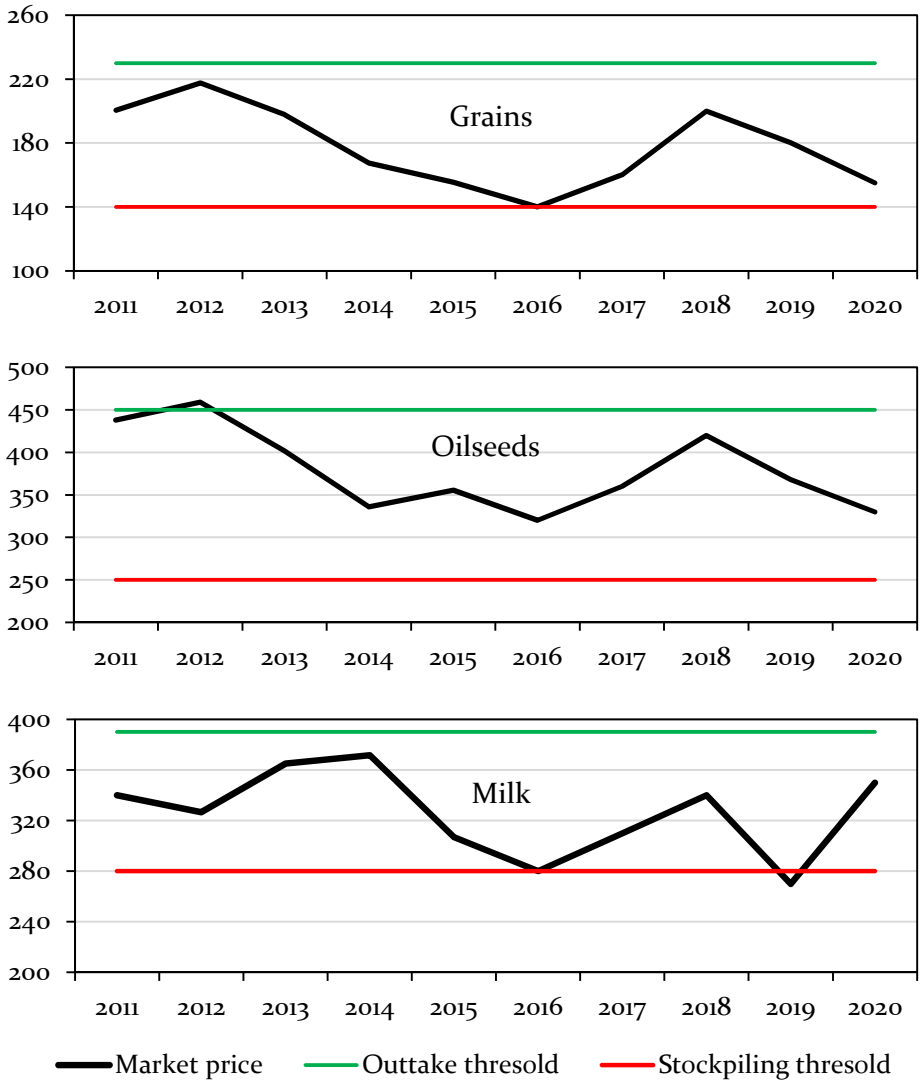
Hence for grains, the initial 5.6Mt stock remains unchanged since no stockpiling/outtake operation was realized during the 2011-2020 period.

Regarding oilseeds, for which a stock outtake is presumed in 2012, the stock volume declines significantly to 30,000 tons in 2012 from 577,000 tons initially. If nothing is programmed in terms of strategic stock, this level will remain stable until 2020.

Milk is mostly stocked in form of powder––Whole Milk Powder (WMP) and Skim Milk Powder (SMP)––and butter. The milk-equivalent (ME) conversion coefficients are 7.6 for milk powder and 6.6 for butter. The quantities of milk eligible for public stockpiling within the Momagri-CAP proposal have been converted in ME according to the associated dry matter index and the average breakdowns recorded in 2009 and 2010, i.e. 80% for milk powder and 20% for butter.

[21] Excluding strategic storage (2% of volumes produced in 2010) made for the first year of simulation (2011).

**Evolution of grain, oilseed and milk market prices and stockpiling/outtake triggering thresholds, in €/t**




*Source: Momagri*

As a result, we obtain the following ME quantities for 2.7Mt of milk as initial stock in 2011 (2% of the production):

- Milk powder: 289,000 tons,
- Butter: 83,000 tons.

This level of dairy product stock is kept constant until 2018. It would then be revised upward following the stockpiling about to take place in 2019. The annual levels of dairy product stocks are shown hereafter:

| | 2011-2018 | 2019-2020 |
|---|---|---|
| Public stock of milk powder (1,000t) | 289 per year | 892 per year |
| Public stock of butter (1,000t) | 83 per year | 257 per year |

*Source: Momagri*

## 3. Impact on revenues

Economic simulations have been conducted to study the impact of the Momagri-CAP on average revenue of grain, oilseed and milk farmers. They are based on the same assumptions as those for budget simulations. They do not aim to formally "record" the average revenues that could be received by European farmers in the future, but to compare, all things being equal, the unit (per ton) revenues for field crops and dairy farmers within the current CAP and the Momagri-CAP, as well as their volatility.

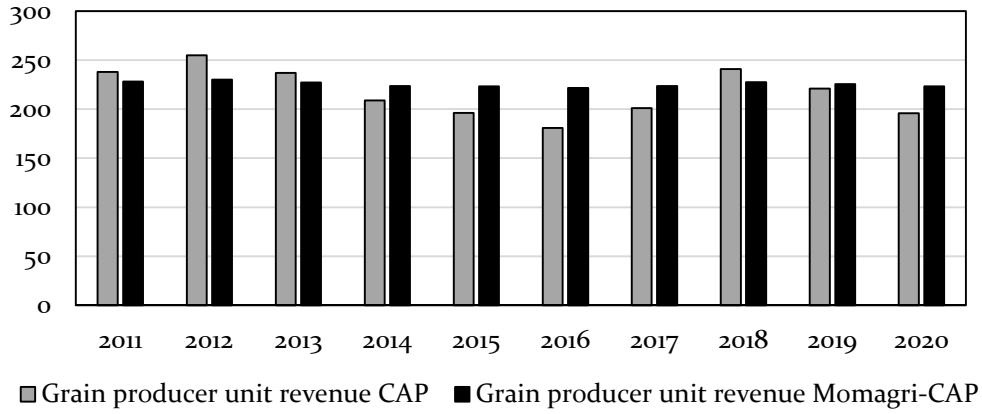
These economic simulations were performed over the period of 2011-2020, as for budget simulations. They allow an assessment of the Momagri-CAP implication over this decade, in terms of average revenues and volatility.

### *a. Impact on grain farmers' revenue*

Under the stated hypotheses, especially in terms of 2016-2020 price movements and acreage-based breakdown of decoupled payments, it appears that the average unit revenue[22] for a given European grain farmer should attain €218/t, with a minimum of €181/t in 2016 and a maximum of €255/t in 2012. Within the Momagri-CAP proposal, the average unit revenue for a European grain farmer would be €225/t, with a minimum of €222/t (2016) and a maximum of €230/t (2012). The average unit revenue under the Momagri-CAP would therefore be 4% higher than that of the CAP, also much more stable. The revenue simulation results are exhibited in the graph.

We do in this way measure how an agricultural budget built on the Momagri-CAP principles is more effective, both for farmers, who can stabilize their revenues while gaining better long-term visibility, and for European taxpayers, who can get more added value from budget resources.

**Comparison of grain revenues per ton, CAP vs. Momagri-CAP**




*Sources: EC, Momagri*

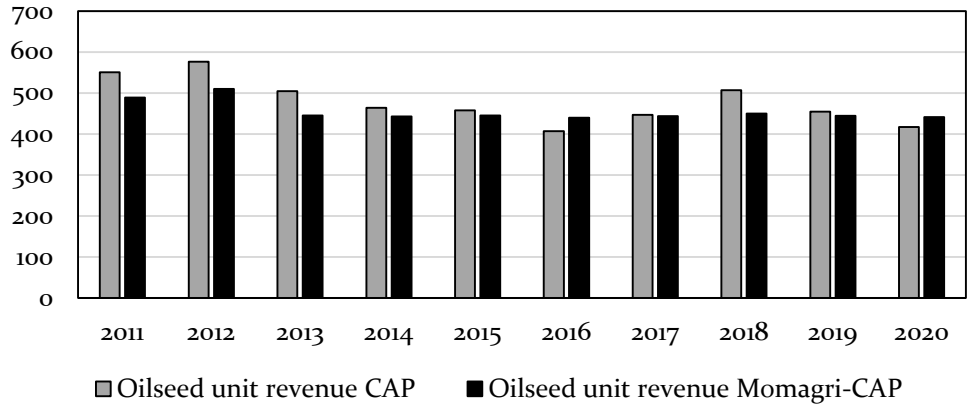
[22] Revenues per ton during the simulation period.

### *b. Impact on oilseed farmers' revenue*

For the 2011-2020 period and based on retained assumptions, the average unit revenue for a given oilseed farmer would reach €479/t in the current CAP and €455/t in the Momagri-CAP proposal. Like the grain sector, the turnover would also be much more stable with the Momagri-CAP than with the CAP. The average unit revenue for a European oilseed farmer could fluctuate between €407/t and €577/t under the CAP, against a range of €440/t to €510/t under the Momagri-CAP proposal.

During the upcoming years between 2016 and 2020, the average revenue in the Momagri-CAP would be almost identical to that of the CAP (€444/t vs. €447/t).

**Comparison of oilseed unit revenues CAP vs. Momagri-CAP**




*Sources: EC, Momagri*

Farmers' turnover would therefore be much more stable over this period within the Momagri-CAP proposal than in the current situation, with a far more attractive minimum level (€440/t vs. €407/t). The preceding graph compares the evolution of oilseed farmers' unit revenues within the two CAP programs.

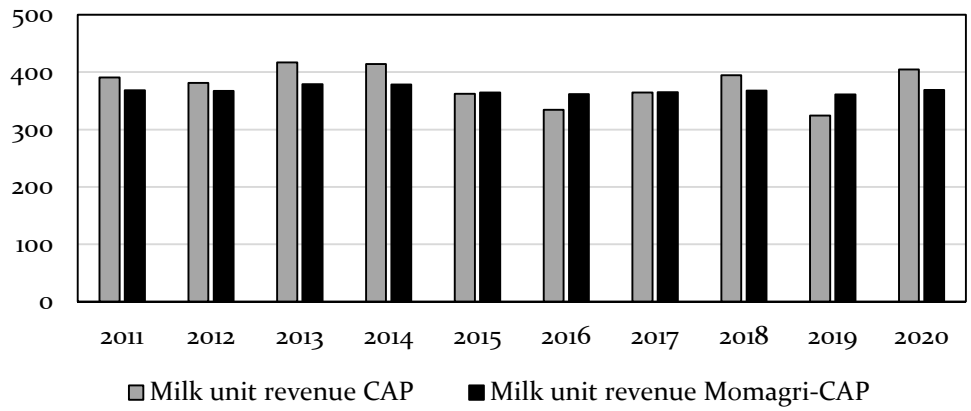
### *c. Impact on dairy farmers' revenue*

For the years between 2011 and 2020, we find that with the CAP the average unit revenue of a European dairy farmer would reach €379/t, with a minimum of €325/t in 2019, and a maximum of €417/t in 2013. Under the Momagri-CAP proposal, the average unit turnover would equal €368/t, with a minimum of €361/t (20019), and a maximum of €379/t (2013). Refer to the following graph for more details.

The average unit revenue of a given dairy farmer would thus have been 3% lower than what has been actually received. Yet, from 2016 to 2020, the average unit revenue under the two policy frameworks would become identical at €365/t.

In addition, just like grain and oilseed sectors, turnover would also be much more stable with the Momagri-CAP than with the CAP. Adopting the Momagri-CAP proposal would then lead to a stabilization of farmers' revenue to a level very close to the one observed during this period.

**Comparison of revenues per ton of milk, CAP vs. Momagri-CAP**




*Sources: EC, Momagri*

The main interest of these simulations resides, in consequence, less in the rough values presented than in the comparisons they generate. They reveal the relevance of the Momagri-CAP compared to the current CAP as regards economic regulation and compensation for a grain, oilseed and milk average European farmer.

The achieved results demonstrate that adopting the Momagri-CAP is associated with a revenue stabilization to levels close to those in the current CAP for oilseed and dairy farmers, and quite higher levels for grain producers.

## 4. Impact on incomes

Beyond the impact on unit revenue, we also tested the applicability of the Momagri-CAP by using real farm accounting data in order to more precisely depict its impact on agricultural incomes. Several researches have been conducted with our partners, such as the Federation of Farmers' Unions in the department of the Marne (FDSEA 51) and a dairy farm management center located in France's Western region. These studies enable us to build typical farms with their net income, i.e. farm income before taxes and without own factors, input for our analyses.

**Application to the French Marne department (field crops)**

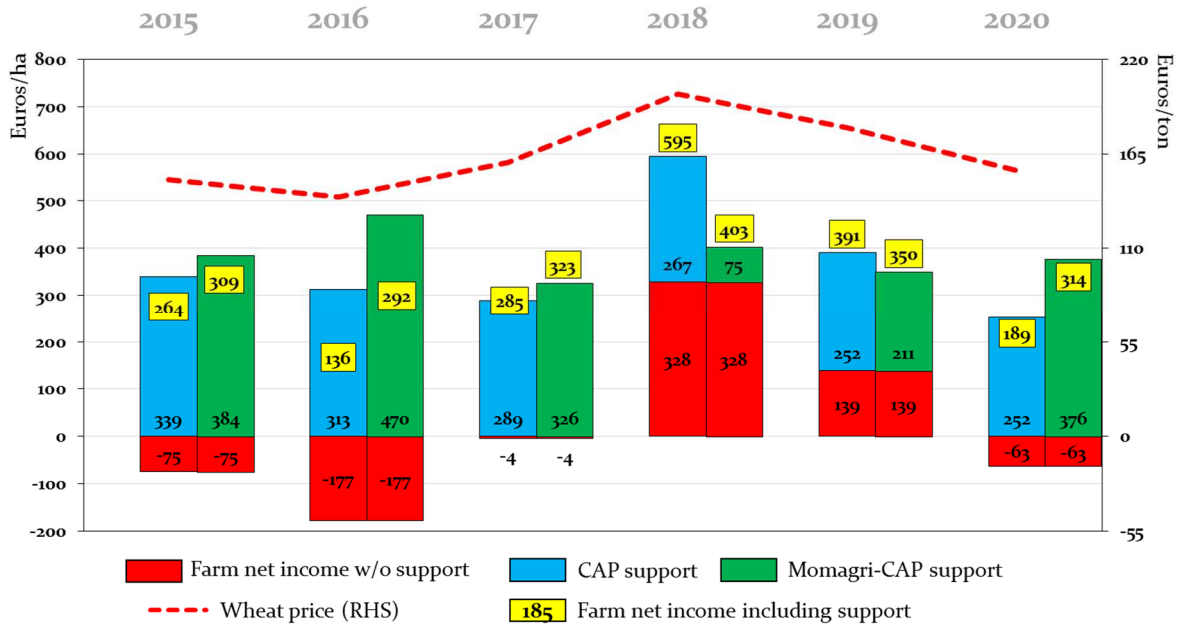
We develop below the key results obtained from the Marne sample of 600 farms specialized in field crops. With production costs slightly lower than average, the yields are 8.5t/ha for wheat, 8.8t/ha for corn and 3.4t/ha for rapeseed with an average usable agricultural area of 113 hectares.

The average amount of decoupled payments per hectare in 2013 was €351, and may decline to €252 at the end of the period.

The simulation performed over the 2015-2020 period shows, on average, a higher farm net income for the Marne department under the Momagri-CAP proposal than what would be with the CAP. Over these years, the average net income per hectare would attain €332 with the Momagri-CAP, against €310 with the CAP, equivalent to a 7% increase. In addition, the minimum income level is two times higher with the Momagri-CAP compared to the CAP (€292/ha vs. €136/ha).

The graph below summarizes the simulation results. It is quite clear that the lower market prices, the more profitable the Momagri-CAP is in terms of current income, when compared with today's CAP.

**Estimation of farm net income of a typical field crop farm, Marne department, €/ha**




*Source: FDSEA51, Momagri*

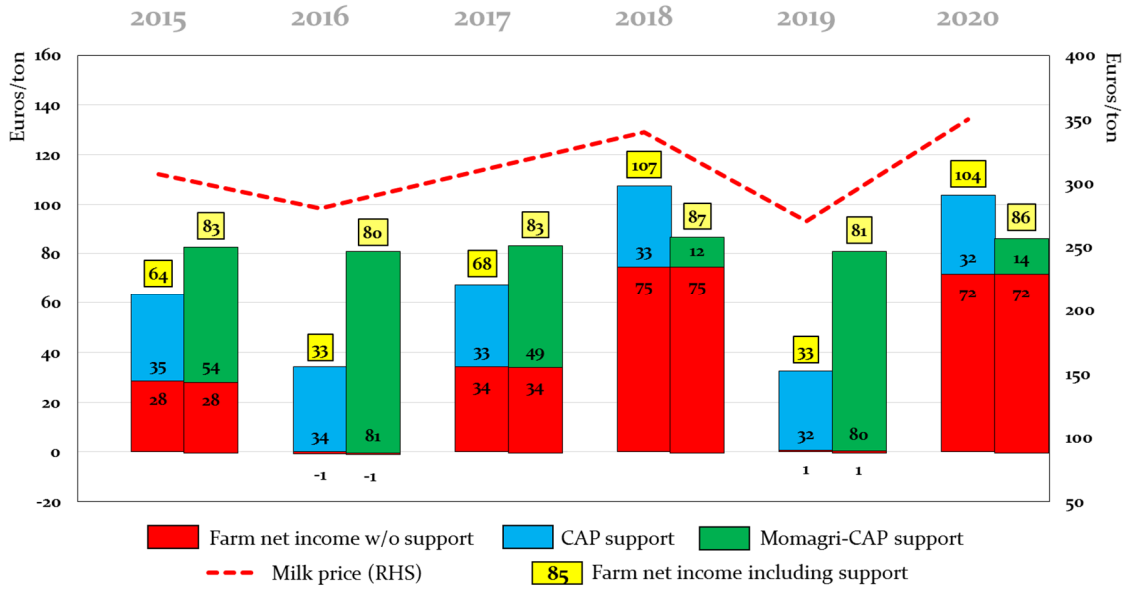
| 2015-2020 | CAP | Momagri-CAP |
|---|---|---|
| Average farm net income (€/ha) | 310 | 332 |
| Minimum farm net income (€/ha) | 136 | 292 |

**Application to Western France (Milk)**

An identical simulation is conducted based on a sample of 2,600 dairy farms located in Brittany. A typical farm operates on 77 ha, of which 16 ha reserved for cash crops, and 59 lactating milk

cows. Production costs are slightly lower than the national average. The average yield is 6,957 liters per milk cow and 7.2t/ha for wheat. The amount of decoupled payments per hectare should decline to €259/ha in 2020 from €334/ha in 2013 (consequence of the convergence of subsidies that is partially offset by the over-allocation for the first hectares), to which we must add €34 of coupled support for the first 40 milk cows from 2015 on. Calculated per ton of milk, this is equivalent to a total amount of first pillar support of €40 in 2013, which is about to fall to €32 in 2020. The farm net income is computed by including revenues from milk, byproducts from the dairy herd (cull cows and calves) and cash crops. The findings of farm net income estimation for 2015-2020 are presented in the following graph.

**Estimation of a typical dairy farm's net income**
**France's Western Region, €/t**




*Sources: FDSEA51, Momagri*

| 2015-2020 | CAP | Momagri-CAP |
|---|---|---|
| Average farm net income (€/t) | 68 | 83 |
| Minimum farm net income (€/t) | 33 | 80 |

The projections of farm net income for the 2015-2020 period reveals the Momagri-CAP's ability to provide more support to agricultural incomes while avoiding harmful fluctuations. The decoupled payments of the current CAP leaves dairy farmers' income to swing to and fro with market fluctuations. On the contrary, the Momagri-CAP stabilizes farm net income by compensating shortfalls in difficult years. As a result, for the 2015-2020 period, the average farm net income per ton of milk is considerably (23%) higher with the Momagri-CAP: €83 against €68 with the CAP. In addition, the minimum net income level with the Momagri-CAP is twice that of the CAP (€80/t vs. €33/t).

The Momagri-CAP proposal could therefore efficiently curb the negative impact of bad years on incomes while still having a bullish impact on farmers' earnings under the price assumptions we used here.

## 5. The institutional process

In order to implement the Momagri-CAP, it will be required to adapt some regulatory or institutional procedures. To that end, several issues must be addressed, such as multi-annual budgets, the agricultural reserve fund, and the applicability of the Momagri-CAP to other sectors.

More generally, a new environment will be created for the CAP, which will have multiple consequences for both the farming community and international cooperation.

### *a. Multi-annual budgets and agricultural reserve fund*

The Momagri-CAP is based on a market and income regulation budget (1st pillar), which will consist of two elements:

- A **core budget** designed according to forecasts of prices and production quantities updated at the time it is drafted;

- A **reserve fund** endowed with:

  - Initially, an amount corresponding to the gap between the annual average of financial prospects and the core budget as it would have been computed,

  - Then, for the following years, an amount including: the fund balance in year n-1, possibly the unused balance of the core budget for year n-1 and the difference between the average annual of the financial prospects and the core budget of year n.

Depending on circumstances, this reserve fund will be totally or partially used in crisis years, while remaining intact in good years. Consequently, the financial prospects must be given an annually updated reference budget serving as the annual limit of authorized spending.

Total authorized payments will include payments out of the core budget and the updated amount of the reserve fund. The expenditures out of the reserve fund will however be subject to the Commission's preliminary approval which is contingent upon whether counter-cyclical payments were carried out or not.

Should the reserve fund expands beyond a threshold set previously, it could be capped with the sunset clause. It will then be the responsibility of the budget authorities (Council + Parliament) to legislate by redirecting or canceling all, or part of, the amounts exceeding such threshold. The

perspective of drastic savings currently pursued by most European countries makes this assumption plausible.

Yet we must remember that the core budget and the reserve fund will be based on lower spending forecasts compared to the current projections, due to the fundamental change in intervention methods proposed by the Momagri-CAP.

This is the reason why, while the reserve fund is a requirement induced by our proposed scheme, it is preferred to have, at the stage of budget projections, the best anticipation of price slippage risks to ensure a well-fitted initial allocation. This allocation can also be modified with a letter of amendment that could propose changes to the reserve fund.

As a result, the Momagri-CAP will fit in a multi-annual spending evaluation process, which is a significant innovation leading to a noteworthy development in budgetary rules, beyond the new provisions voted in the framework of the multi-annual financial outlook. The mid-term review clause can provide the opportunity to do so.

### *b. Extension to other sectors*

The simulations we conducted involved the grain, oilseed and milk sectors. They could be extended to other agricultural sectors, such as meat, sugar and possibly some fruit and vegetables.

However, counter-cyclical subsidies seem to fit more with agricultural commodities whose prices fluctuate with international trade. Whereas some production chains have more to obtain from collective organization-based facilities (cooperatives and inter-professional organizations) and support to modernization through investment support notably. In addition, extending the Momagri-CAP principles must also take into account the current or future support forms: the large amount of coupled payments, the compensatory allowance for permanent natural handicaps and possibly support for pastures whose carbon capture must be included.

The assessment criteria to be considered to gain more insight of the applicability of the reform advocated by Momagri are as follows:

- Level of differentiation between products,
- Level of trade openness/size of involved market,
- Level of farmers' and production chains' organization,
- Existing alternative kinds of support,
- Intrinsic characters of the product (ability to be stockpiled, mass, etc).

Adopting a system of counter-cyclical subsidies would clearly not exclude other forms of implemented or foreseeable forms of regulation. The specific nature of each production could thus engender variations on the founding principles of the Momagri-CAP.

# Conclusion

The Momagri-CAP project has to restore the agricultural community's hope in its future, and give Europe the opportunity to renew with ambitious strategic objectives for its agriculture and agro-food industries.

The systematic spotlight given to the CAP budget cost, yet very low compared to the challenges of the sector (less than 0.4% of the European GDP), has become an ideological deterrent to the necessary reforms. This has also resulted in harmful decisions mostly generated by ideological positions, lack of vision and political courage to break away from the directions chosen in the 1990s.

At a time when the Doha Round seems totally ill adapted to food security and international cooperation objectives, it is now urgent to change by engaging ourselves in a thorough and bold reform.

The reform proposed by Momagri meets the objectives of market regulation and farm income stabilization. It also improves the added value of EU expenditures and creates budgetary leeway. Although it will be necessary to alter budget procedures and overcome the counterproductive constraints imposed by the WTO, a switch to the Momagri-CAP is worthwhile. Indeed, decoupling has caused an economic illusion that almost brought about a disembodying of public support, i.e. bureaucracy interference and ineffectiveness.

The debate on our proposal has been initiated. It is now necessary to implement the policy change to give it all the chances of success it deserves. This is why we publish this revised version of the White Paper in mid-2016, as the debates on the upcoming reform are opening in a context of severe agricultural crisis. We hope that our proposal provides the European Commission and the Parliament, the governments of Member States, the European Council and the representatives of agricultural communities with the opportunity of a serious reflection on the feasibility of a project that will renovate one of the key European policies, and thus resolve a deadlock that fuels Euro-skepticism on a daily basis.

Established on the initiative of several French agricultural cooperatives, Momagri is a think tank chaired by Christian Pèes, gathering agricultural leaders and personalities from various backgrounds.

Since its creation in 2005, Momagri works primarily on the causes and consequences of the structural instability of agricultural markets as well as the analysis of agricultural policies in the world, in order to shed some light on the impacts of trade liberalization without adequate safeguards and the stakes of a renewed global agricultural governance.

Momagri's mission is to create new assessment tools and put forward proposals for agricultural policies that are adapted to the XXI century challenges in France, Europe and around the world.

*The Momagri team is available for any additional information*

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mouvement pour une organisation mondiale de l'agriculture

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