

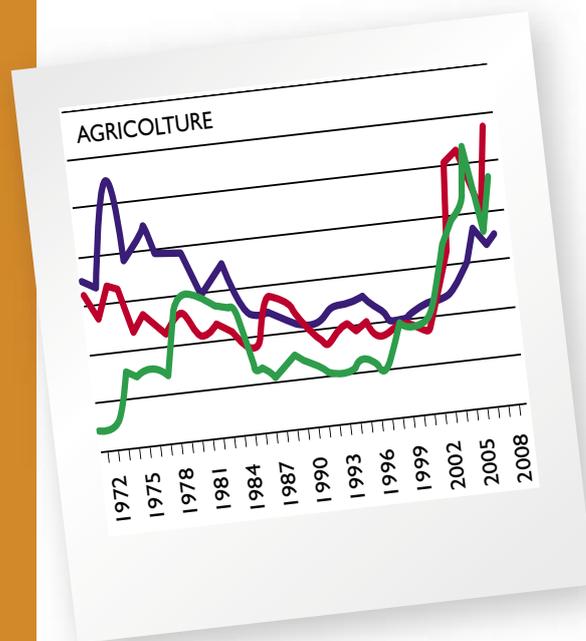
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# Agricultural Market Stabilization System policy instruments to be included in the CAP

Policy Recommendation  
Paper Executive Summary



The paper has been launched on 14th of March at the OPERA seminar "Managing agricultural markets towards stabilization, in the CAP" organized in the margins of the Forum for the Future of Agriculture 2011.

The full report can be downloaded on [www.opera-indicators.eu](http://www.opera-indicators.eu) and a printed copy is available at the OPERA stand at FFA 2011.



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## A SYSTEM FOR MARKET STABILITY

Fifty years after it was set up, the general objectives of the CAP were reconfirmed by the Lisbon Treaty. The CAP instruments to ensure market stability played an important role as they provided for a better environment to develop farming and a greater appetite for investment in innovative technologies and their application.

The paper starts from the identified realities and commonly accepted facts surrounding the agricultural markets instability and to build for the CAP a pragmatic and applicable system of instruments which can positively impact on the issue.

As for the **cause of this volatility**, there is a broad range of opinions on the issue. As the OECD has recently emphasized, agriculture is subject to many risks, and it distinguishes between production, market, institutional, personal and financial risks.

Price volatility depends on how variable its determinants will be. Among the relevant determinants are: **global balance between supply and demand; Climate change; Trade liberalization; Food markets increasingly interlinked with energy markets.**

Market stability can be further promoted by a combination of a number of factors. Our approach is to address the issue from the perspective of five main directions for policy action so as to reduce the negative effects generated by the instability in the agricultural markets, as follows:

- The development of the existing CAP instruments
- Supply stabilization mechanisms
- Price and income stabilization instruments
- Market transparency
- Cooperation and structural issues.

## SUPPLY STABILITY

We should address in the CAP the issue of production risk from losses due to weather damage, crop pest infestation, or animal disease outbreaks.

The **role of technology is paramount in managing the risks associated with the production** process.

Effective technologies for pest and disease management can help **reduce yield volatility**. The added threat of global climate change clearly makes even more imperative the need for the uptake in production technologies and proper crop management to address future threats to agricultural production.

From a long term perspective, developments in markets have always been influenced by **innovation**. It is important that the **potential of innovation is taken into account when considering the requirements for supply stability**.

If these lead to a stabilization of supply, they will implicitly lead also to stabilization of markets and of farmers' income. For this to be achieved, **better horizontal policy integration is required, as well as an intensification of public-private sector cooperation**.

## REDUCING PRICE AND INCOME VOLATILITY

Price and income volatility has to be addressed in the CAP with two mechanisms. The first component, "Price and income safety net" should address directly the issue of the excessive volatility of agricultural commodity prices. The second component, "risk reduction" should address the production and income related risks so as to reduce the exposure of the farmer to the abnormal variations of the market.

### **A Price and income safety net**

The mix of instruments to be used in the price safety net should be built on the existing instruments, adapted to better respond to extraordinary market situations.

**Intervention purchasing and withdrawals:** Public intervention should operate more as a safety net. The use of automatic triggering mechanisms and fixed prices for intervention should be avoided. The instrument should be flexible and easy to use by the Commission when required.

**Aid for private storage (APS):** Depending on the state of the market, the Community authorities should have the option of encouraging additional private storage, through targeted aid. Such schemes could be used in combination with the alternative: public intervention.

**Subsidies designed to promote internal consumption:** As a general principle it should be avoided that these measures lead to the re-emergence of intervention as a regular market outlet.

**State aids:** These provisions should remain virtually unchanged. The primary role of this instrument is to stabilize the income of the farmers in exceptional economically difficult situations.

**Income safety net:** An instrument should be made accessible, under the rural development instrument, so that Member States may provide farmers with financial compensation for significant reduction of their income. The instrument should be compatible with WTO rules.

Various options such as the creation of mutual funds need to play a greater role in the CAP.

## **B Risk reduction - Market based risk management instruments**

Market driven instruments are in place to help farmers to reduce their exposure to risks associated to production and the risks for their income. In addition new instruments should be promoted to reduce farmer exposure to risks related to the volatility of their production and income.

**Forward contracting:** Promoting long term contracts as a measure to reduce volatility, will also have a positive impact on the competitiveness of the whole food chain. The CAP needs to develop a system of incentives, including financial ones; to promote vertical integration and the new framework for Rural Development can be the place to do it.

**Futures markets** play an important role in price discovery as well as allowing producers and processors to hedge their price risk. Futures markets have a number of drawbacks which may limit participation: basic risks and trading costs; markets not available for all commodities; quantities specified in the contracts may too large for many producers; they are more useful in addressing within year volatility rather than cyclical price fluctuations; lack of understanding due to inadequate information and training.

The EU can promote their development by ensuring an appropriate and effective regulatory and supervision environment; by ensuring the availability of high quality, timely and reliable market information; and by encouraging and supporting training and education in the use of these risk management tools.

**Revenue or income insurance:** While doubts were expressed on the low transfer efficiency of such instruments in terms of income support as compared to direct payments, insurance subsidies may be more effective in reducing income variability.

However, in Europe total farmers' welfare is found to benefit more from direct payments than from insurance subsidies. Hence, from the perspective of maintaining farmer income at a reasonable level compared to other sectors, direct payments should be maintained in the CAP.

**Mutual funds:** The policy should take a pro-active attitude in supporting the development of such mechanisms wherever they are appropriate and feasible.

Increasingly, farmers complain of **unjustified practices in the food chain**, imposing unnecessary production conditions above and beyond those mandatory in food safety legislation or environment protection legislation, to support marketing campaigns. These affect the proper functioning of trade flows in the internal market potentially increasing price levels and volatility for consumers.

On the internal market, we often observe that market instability has its roots in **local, regional or national imbalances** in supply and demand. This is relevant particularly in certain regions with insufficiently developed transport infrastructure. In other cases, the proper functioning of trade flows to regulate supply and demand is hindered by significant disparities in marketing and food safety standards.

**Price monitoring at different stages could be one of the major tools** to better understand markets so that we can improve transparency. The most suitable solution is to provide public support for the setting up and development of **independent price monitoring structures**, in parallel with the official collection of relevant information and statistical data. The model of coordinated price observatories seems suitable for this purpose.

The future CAP needs to actively promote more frequent systematic projections on food prices which are transparent to the public and farmers. Such an instrument is an essential tool to help farmers to address the price risk and to increase the effectiveness of market mechanisms in regulating imbalances.

Competition law, it has become evident that more usable guidelines over competition policy are needed to clarify these aspects and also to act as a catalyst for associates to enter into forms of cooperation that have been deemed unattractive in the past.

## **MARKET TRANSPARENCY**



## COOPERATION AND STRUCTURAL ISSUES

## THE GLOBAL DIMENSION FOR FOOD SECURITY

Cooperation on a variety of layers has shown to be an effective tool to boost the negotiation power of the agricultural sector with the rest of the food chain. **The CAP needs to develop pro-active mechanisms to promote cooperation and integration on the food chain.** This is one possible solution to empower farmers to be able to respond to a rapidly changing market.

There is still very little dialogue between farmers, traders, processors and supermarkets. **Improving the producer-processor-consumer relationship** is a must for the future policy. The transfer of information along the whole food chain helps farmers and processors to better respond to consumer demands while consumers are able to conceptualize the roles in food production and assign a value to agricultural products.

At global level the EU should avoid that the reduction in domestic price volatility translates into increased volatility of international prices. It should actively participate in developing effective solutions, on a multilateral basis, to reduce the volatility of the international agricultural markets and address food security issues.

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