Policy Briefing

Double performance of EU agri-food sectors

A key condition :
Empowering farmers to increase economic stability

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For more than two decades the credo of policy-makers (the Commission more than anyone, Council and European Parliament) has been to promote a closer connection between farmers and market change, or, in the terms of the now traditional expression a “market-oriented farming”.

Yet, beyond the rhetoric and wishful thinking, the question that has refused to go away since 2008 is this: has the CAP itself adapted to the markets? with the way they function, with their ups and downs… in such a way that every industry segment in the European agricultural and agri-food sector is not only fully embedded in but also proactive in its markets?

The economic premise adopted by decision-makers throughout the 2003-2013 period has been, as far as possible, to cut the link between public support and production, with the markets determining what farmers should do or produce, unencumbered by any external influences. In other words, the underlying logic of the reforms of 2003 and post-Health Check modifications was to put in place a form of fixed-rate annual *income* support based on hectarage but paid as if merely “settling an account”, job done! Moreover, safety nets have been pulled away and now offer only low rates of support *when* the market is in deep crisis (extremely low, even with no connection with markets reality for the beef and veal sector).

With its toolkit limited by its economic philosophy, the CAP has appeared to oscillate between two assumptions: on the one hand, that markets function perfectly, and, on the other, that European agriculture is still enough protected from worsening global volatility – in reality the EU has opened its borders hoping for a greater penetration of global markets by EU agricultural and agri-food products, but without the public support to back up this strategy.

In seeking to link European agriculture and global markets, the EU's diverse agricultural industries have, as a result, found themselves disarmed in the face of increasing market volatility, a volatility which has only worsened both in amplitude and frequency and that has become firmly established since 2007-2009 as a 'inevitable' fact of life in global agricultural and agri-food markets.

It is also a reality that, while direct support under the CAP's Pillar 1 constitutes the EU's core support for protecting farmers' revenue, it has not be conceived and can't be ask to cover risks that farmers face, such as:

- **A more unpredictable climate.** Due to climate change, weather events are set to be more intense. Hailstones, drought, flooding… there is no longer a single year in which emergency support is not needed.

- **Increased price volatility.** An imbalance of just a few percent between supply and demand in global markets can generate sudden and disproportionately high fluctuations in the prices that producers receive, even if the global market is only a small fraction of total sales for the products in question. This domino effect has been ravaging the European dairy sector since 2009.

- **More frequent animal/plant health incidents.** Trade between countries and with third countries carries greater inherent risks, which are more difficult to manage, and sometimes new.

- **Serious market failure when major crises occur**. Sudden falls in price caused by oversupply can lead, especially in the case of short-cycle production, to individual behaviour that is poles apart from a collective approach to resolving or mitigating crises, i.e. increasing one's own production to offset reduced margins with volume. Such spirals in which individual economic agents "dig their own grave" while hoping that their neighbours will go under first, destroy value, and are ultimately costly to the public purse, which is called to the rescue as a last resort. But these spirals also hit the farmers with good prospects the hardest, i.e. those who have recently invested to improve their productivity, but who are bled dry before anyone else when a crisis strikes.

Depending on the market segment, between 10 and 40 % of European production is exported. Yet, there are some who have called for – often with demagoguery – the EU to become more inwardly-focused, with a more or less disguised return to the policies of the 70's and of high guaranteed prices (the result of which would also be destructive isolationism and a U-turn in terms of creating value). And others have proposed turning farmers into civil servants, effectively revoking their right to private enterprise as they become mere instruments for a societal engineering strategy that forgets agriculture's primary *productive* function. Both of these routes should be condemned with vigour and the proposals associated with them rejected. They would only lead to the impoverishment of agricultural industries and rural areas – the most vulnerable first – and of the European Union as a whole; or an over-administration leading to both out-of-control funding and a business development impasse.

The European Union needs to be more ambitious and have the courage to envision the agricultural sector as an industry, one made up of entrepreneurs who engage in business and who trade, and to state its economic importance for the EU.

The core support that ensures the development of the agricultural sector is the **direct support from the CAP's Pillar 1.** The Union needs, as a first step, to **reaffirm its legitimacy**, and notably in relation to:

- requirements made of farmers that are not remunerated by the market but which farmers are asked to comply with;
- the costs of meeting European quality standards, desired by both the European legislator and the European consumer;
- and the right of European farmers to a fair standard of living, in Europe, whereas it is still 40% lower on average than that of other industry sectors, a state of affairs that cannot be justified by invoking the variable economic standards of global competitors.

In light of the different risks prevalent in agriculture, the European Union needs to change tack and adopt a governance approach that sees farmers as responsible entrepreneurs operating in an industry and market and which:

- **gives farmers a central role in the response to climate/weather hazards and market variability;**
- **acknowledges the European Union's responsibility to provide support that is tuned to the fundamental economic needs of the agricultural sector in times of acute crisis.**

Ahead of the European negotiations for the Commission's Financial Omnibus proposal, the 2016 Global Food Forum looked at how the current CAP could be modified to ensure that European farmers are able, from 2018 onwards, to voluntarily construct more robust strategies to protect their businesses from climate/weather risks and market variability.

In this regard, the 2016 Global Food Forum identified **three types of instrument – possessing the right combination of economic efficiency and effectiveness – that should be put in place for farmers from 2018 by the CAP**:

- An effective incentive to take out **insurance against weather risks**, via CAP co-financing (at 65%) of crop insurance premiums, with an index-based payout threshold set at a recorded loss of **20 %**. As weather constitutes the most frequent, most unpredictable and most destructive risk in agriculture, it is no longer tenable to manage through 'political headline grabbing' allocations of emergency funds, hostage to the vagueries of budget availability. Crop insurance is widely used by our international competitors and has demonstrated its value. The EU needs to join the leading pack.

- The option of saving collectively **within sectoral mutual funds that provide margin insurance (sectoral income stabilisation tools - IST).** These funds would provide payments if recorded margins were to fall in relation to index-based reference level by more than **20%** and they would receive **CAP co-financing** (65%) **at the time of saving i.e. at the time of contribution into the fund** and not when a crisis strikes. These industry-specific IST could offer quick and efficient solutions when the industry-market in question is characterised by sudden fluctuations, such as is the case in dairy or sugar markets. Producers — farmers – absorb the full hit and are, moreover, unable to stock their produce, even temporarily, without losing its 'fresh from the farm' value.

- **For specific agricultural industries: the ability to set up** more operable **mutual funds to cover crop and livestock health risks** based on the existing Pillar 2 risk management measures introduced with the 2013 reform, but with more streamlined administration (payment trigger thresholds, calculation of loss).

The Forum also stressed the importance of making progress on individual precautionary savings plans (with their national tax component) and experimentation with margin insurance tools (over and above mutual funds).

The negotiations for the agricultural part of the Omnibus financial regulation have borne fruit in this respect. While the Commission's proposal opens the door to sectoral IST, **the European Parliament has recognized the importance for European agriculture of this negotiation**.

MEPs have taken the measure of responsibility that is theirs, with the Financial Omnibus being the only credible legislative window of opportunity this side of 2020 to respond to a pressing industry need for a means of managing weather and market risks without waiting for the next crisis to strike.

The EP (leading), the Council and the Commission have approved what is a useful legislative framework and a **first practical step towards giving the CAP a structured business-oriented dimension, where the 2013 reforms had merely put down a marker.**

Modified by the financial Omnibus, the CAP is thus moving towards a business vision in which European farmers are more equipped to take their own decisions in the market, with:

- **core support in the form of direct support,** with its legitimacy confirmed, and designed to enable farmers to develop their business and to plan on the basis of 'normal' market conditions and trends;

- **agricultural industries take responsibility for the management of weather and market volatility risks,** which is made possible by putting in place functional CAP incentives for farmers who choose to take out protection (individually and collectively) against such risks;

- **<u>But one line of action, which is necessary for the coherence and efficiency of the whole risk management tool kit, remains to be put in place: what public action should do in cases when the sheer scale of a crisis exceeds the level of risk protection economic agents are expected to provide?</u>**

In exceptional crises, whether related to crop/livestock welfare, the weather or the market, a public bridging measure needs to be designed and deployed in such a way as to preserve the European Union's agriculture as an industrial asset. It needs to complement the individual and group schemes taken out by farmers. Standard risk management schemes are simply not designed to deal with 'exceptional risk', that is, 'extreme events', and it would be unthinkable to leave farmers unprotected from them.

To date, in agriculture as in other industries – automotive, steel, banks, to name just a few, the policy response in times of severe crisis has mainly been to pull a financial sticking plaster out of the hat to avoid the complete disappearance of a vital industry. Moreover, any debate about agriculture and food must also think through how to ensure food sovereignty – once this is set up as a strategic goal.

And the legitimate expectation we should have towards a European economic policy, which the CAP is, is that sticking plasters won't do. At best, they have no development effect and at worst, they have adverse effects.

When a serious crisis strikes, policy action needs to be:

- **rapid**, implying real-time analysis and deployment **of pre-existing resources**;
- **consistent with private risk and hazard management** so as to avoid overlapping/competing provision or individual or group windfall behaviours;

- **economically virtuous**, by giving private agents an incentive to participate actively in the resolution of… or at the least the alleviation of, crises;
- **designed for EU-scale implementation**, which is the only scale at which it is possible to maximise efficiency and respect the European single market – the national, regional and local levels are simply not equipped to intervene in the case, which concerns us here, of global crises.

The frequency of crises (market, weather) striking agricultural industries is unlikely to abate in the future, and so the European Union is going to have to tackle them – and they may be very deep crises.

Another and probably inevitable reality for the coming years, after Heads of State and governments have completed negotiations for the post-2020 budget, will be the absence of annual financial margins in the CAP budget. It would seem perilous to rely on the European Union's ability to find 'fresh money' to alleviate future crisis in the world of agriculture.

It is also incumbent **on policy-makers to have in place a permanent rapid crisis response facility, with finance secured from the outset and whose administration/use should be both straightforward and tailored to the type of crisis involved.**

Squaring the circle ?

Backing up private sector crisis and hazard management, responding to market failures during crises, guiding agricultural industries towards virtuous behaviours and away from individualist behaviours that can deepen crises, these should be the CAP's objectives, in other words, preventing difficult situations from turning into crises.

To achieve these objectives, and *over and above the current market management instruments – either public intervention or private storage* – the creation of a **<u>European fund for the prevention of crises in agriculture</u>** would appear to offer the most functional instrument for the EU.

The creation of this fund, and its initial capital allocation, should be the object of a decision by Heads of State and governments as part of discussions for the MFF, in 2018 and 2019, as should also be the annual allocation to this fund from the crisis reserve introduced by the CAP in 2013, which will go the make up a predetermined fund total.

This fund, with an initial allocation drawn from the European budget and pre-determined annual allocations from the CAP budget, would be a permanent, multiannual fund and ring-fenced for specific uses set out in its Statutes. It could be run from and financially administered by, for example, the European Investment Bank (EIB).

To fulfill its role as an efficient European risk and hazard management instrument for agriculture, **this fund would have two principal tasks**:

- the reinsurance of **insurance instruments** taken out voluntarily by agricultural industries in the European Union. Trigger-criteria for this reinsurance need to be determined carefully in order to provide a backup for these instruments without reducing the accountability of those who implement them to do so in an efficient manner;
- **the financing ad hoc measures that the European Commission would determine** on the basis of power afforded to it by the 2013 CAP to tackle particularly serious crises. These could be, for example, measures of the kind implemented in 2015 for the voluntary reduction of milk production in the European Union. In this regard, whenever a crisis triggers the activation of individual and or collective risk and hazard management instruments, the Commission could be required to present an analysis to Member States and ad hoc consultation groups – of the situation in the industries concerned, including measures that might be taken to avoid a crisis and irreversible damage.

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By adopting the new three-part support package described in this paper:

- **core business support** (Pillar 1 support);
- **insurance schemes, taken out voluntarily by farmers, to reduce the impacts of weather and market risks** on their farm businesses;
- **a European fund for the prevention of crises in agriculture** to ensure the continued existence of European agricultural industries.

the European Union will have chosen to:

- **no longer have to hurriedly decide on action in emergency conditions**, with funds allocated to reduce political pressure but having no economic impact (for example, in resolving the 2015 milk crisis approx. 1 billion Euros were spent but this spending has had no proven impact);
- **recognise farmers' entrepreneurial ability**, to encourage them to plan for weather hazards and market imperfections;
- to clearly refute the dream merchants' belief that public support can correct any and all market imperfections;
- **concentrate its intervention where policy action is most meaningful, to protect when there is a serious crisis, thereby preserving the potential of EU agricultural to grow and encouraging its farmers and other stakeholders to plan for such growth.**

Such a system would also be consistent with the objective of facilitating and enabling the ecological transition of European agriculture; by seeing farmers as responsible entrepreneurs, encouraged to create added value – while being protected in an effective way from extreme hazards, and empowered, as a result, to invest and plan for the future.