

DIRECTORATE-GENERAL FOR INTERNAL POLICIES  
POLICY DEPARTMENT B  
STRUCTURAL AND COHESION POLICIES



# Addressing market volatility: CMO mechanisms and risk management tools in the new CAP

Alexandre GOHIN  
UMR SMART INRA  
Rennes France

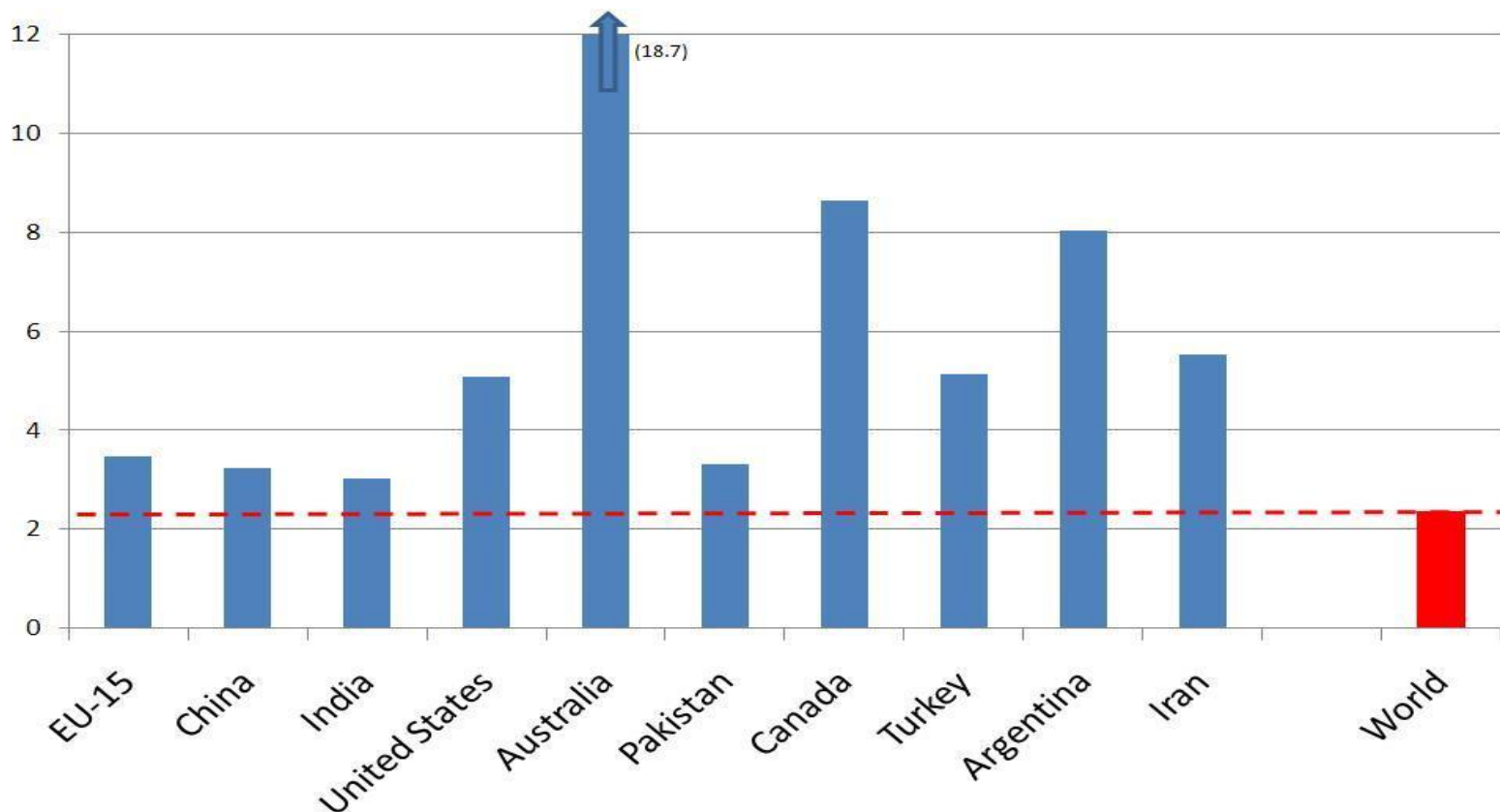
## Structure of the presentation

- Why a public policy for risk management in agriculture?
- Arguments advanced by the EC for risk measures in the CAP
- Analysis of proposals and suggestions

# 1. Relevance of public action for agricultural risk management

- Numerous sources of risks and inelastic supply and demand induce excessive volatility of agricultural prices (King)
- But this omits various mechanisms that reduces and allows farmers to cope with risks:
  - Stocks allow temporal smoothing
  - Trade allows spatial smoothing

# Coefficient of variation of wheat yield 1960-2010



# 1. Relevance of public action for agricultural risk management

- This law omits :
  - Contracts with food processors, insurers, investors, land owners
  - Portfolio diversification (inside/outside farming)
  - Timing of Investment decisions
  - Saving and borrowing decisions

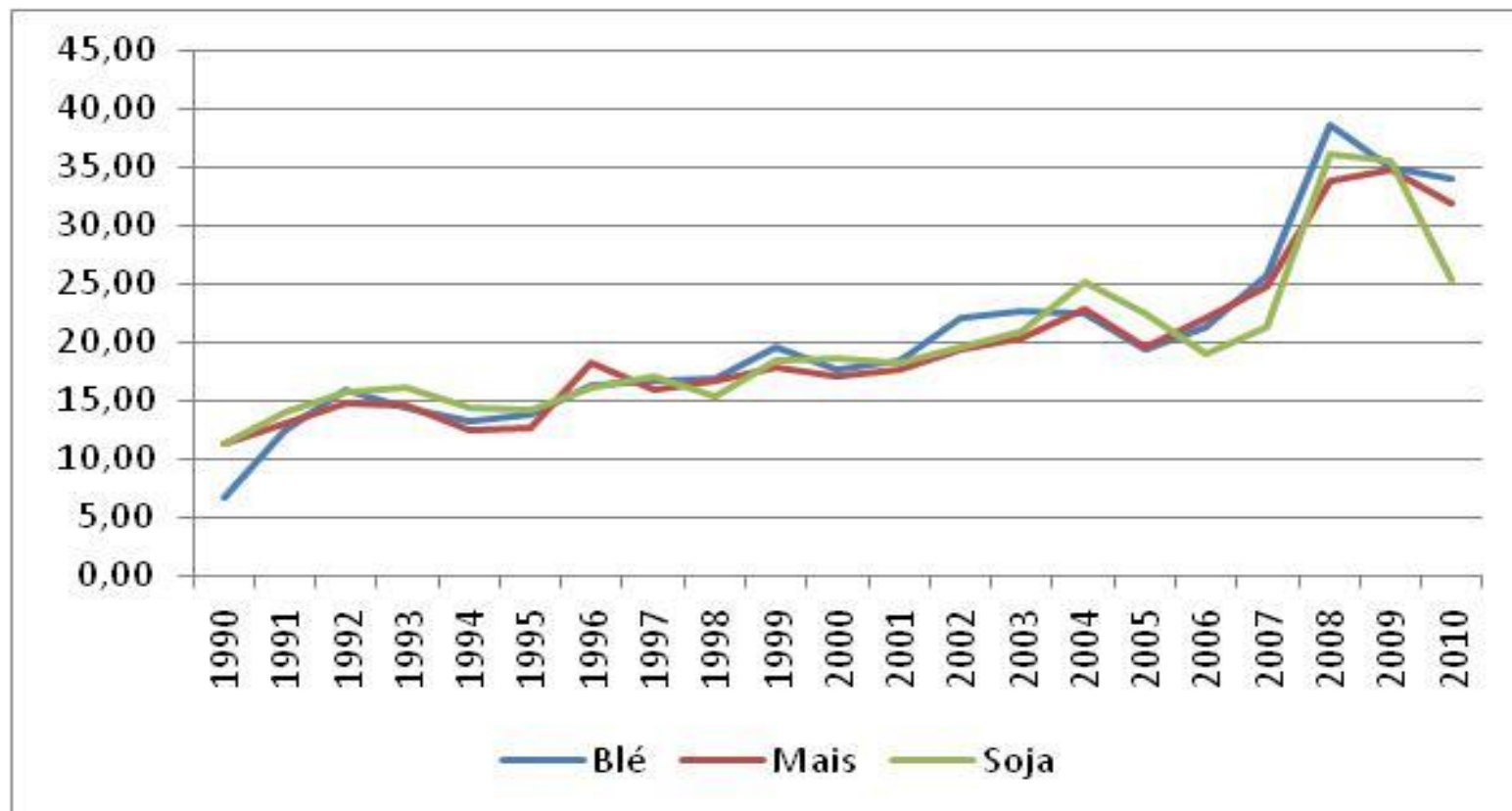
# 1. 1. Relevance of public action for agricultural risk management

- Is efficient when there are market failures
- Main failures identified :
  - Information (asymmetry, cost, uncertainty)
  - Market power
  - Public goods and bads
- Hence the role of public action
  - Provide information / Deal with catastrophic events
  - Ensure competition (including on future markets)
  - Promote (prevent) public goods (bads)

## 2. Arguments raised by the Commission

- Increase of the volatility of agricultural prices
  - Climate change
  - Correlation with energy prices (biofuels)
  - Financialisation
- Weak evidence or debatable arguments:
  - Flexible / fixe mandate
  - Future markets allow hedging and thus production

# Evolution of implied volatility

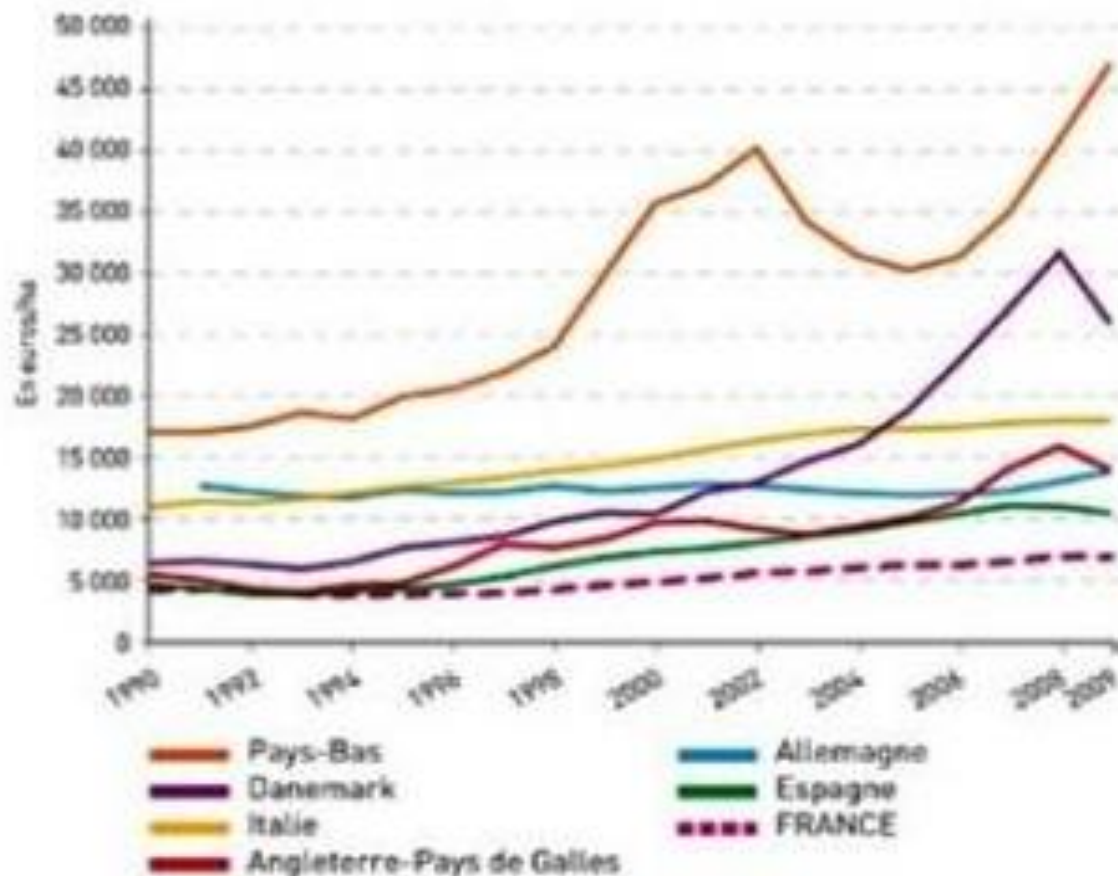




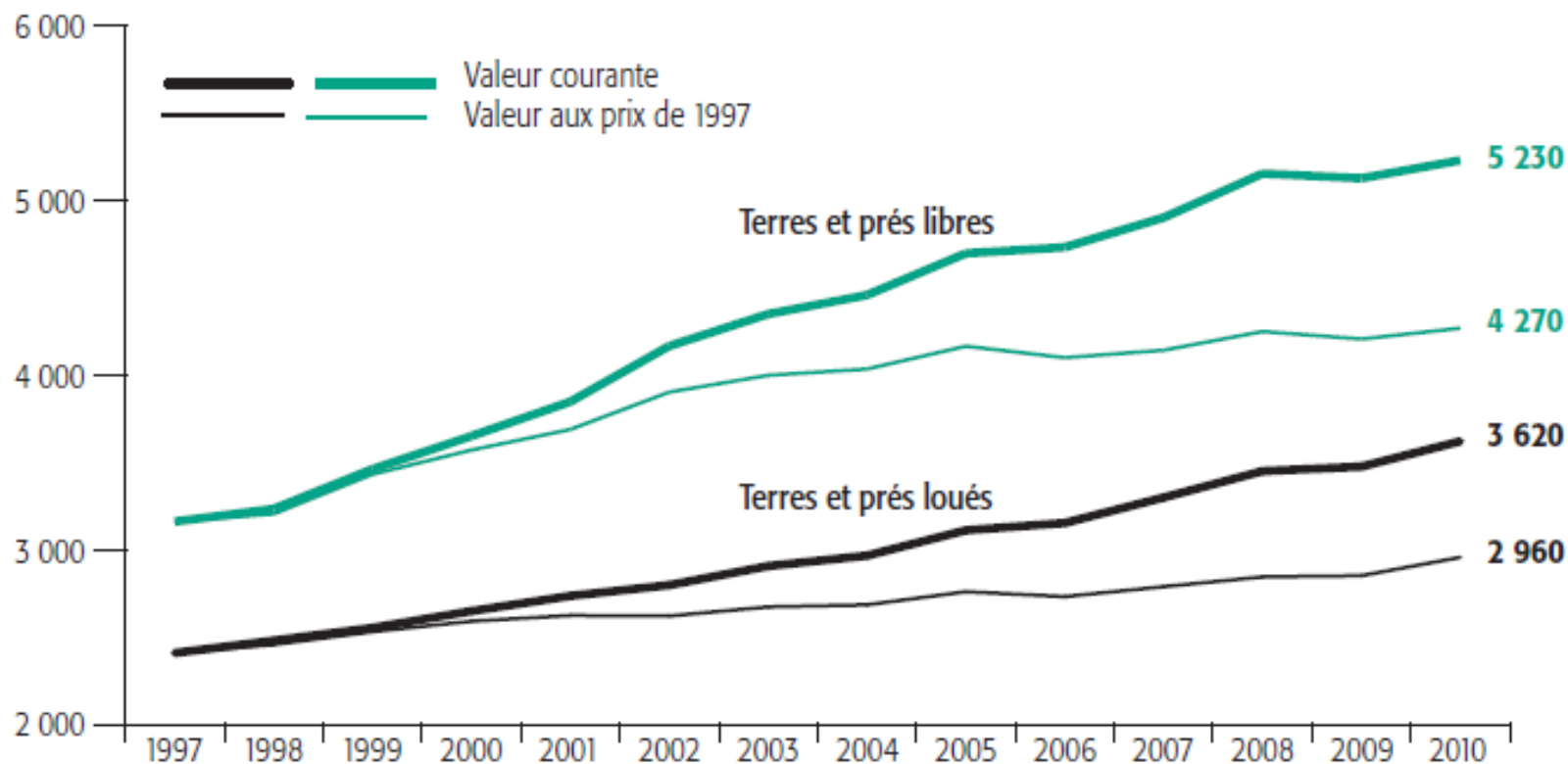
## 2. Arguments raised by the Commission

- Relatively low farm income and more volatile farm income
  - Higher increase of input prices => margin squeeze
  - Imperfect price transmission in the food chain
- Recurrent arguments without strong empirical supports:
  - Lasting debate on the income from farming versus the income (wealth) of farm households
  - What about the level and volatility of the margin made by food processors/retailers?

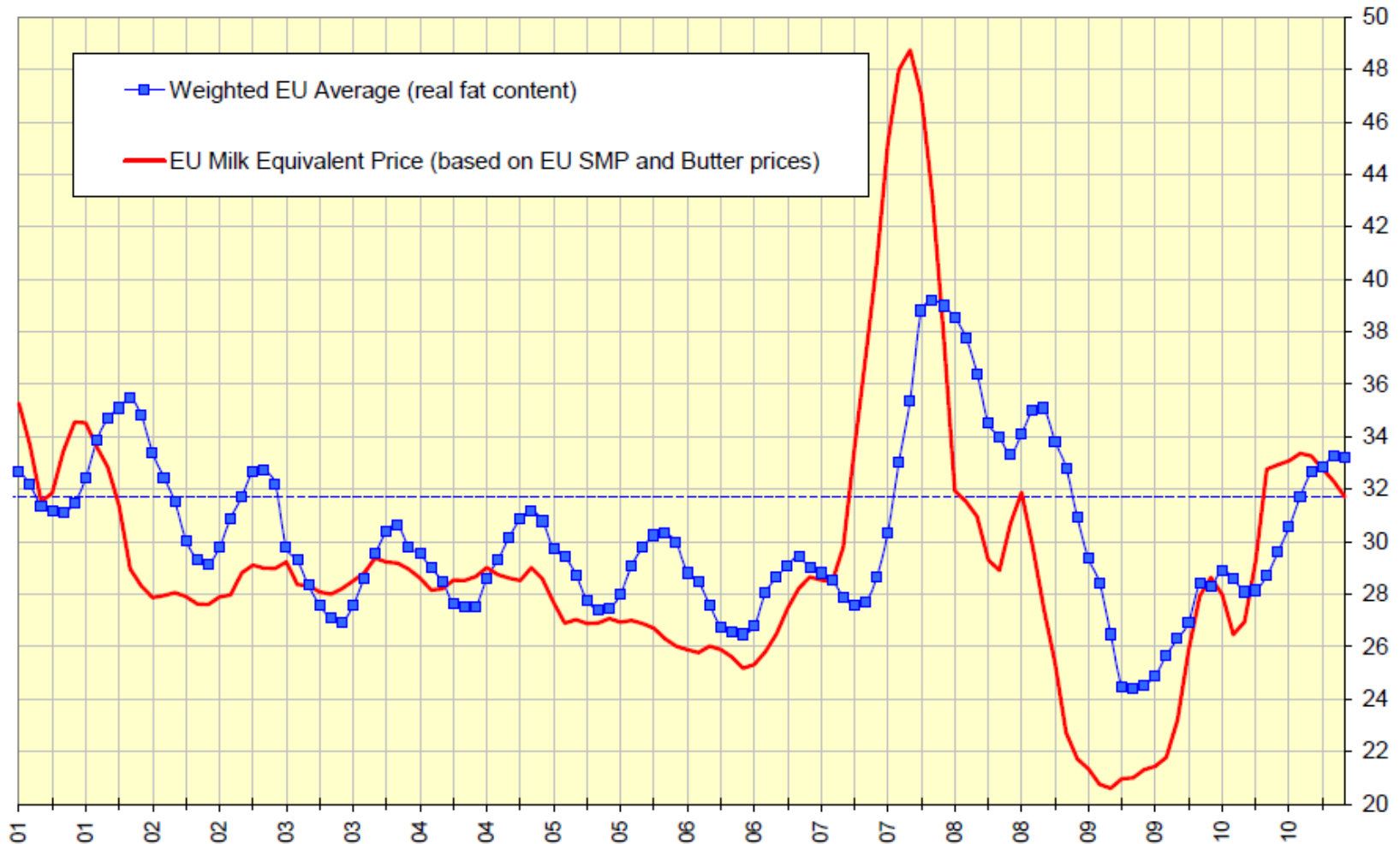
# Real prices of agricultural lands in Europe



# Agricultural land prices in France



# Real price of milk / Equivalent Butter/SMP price



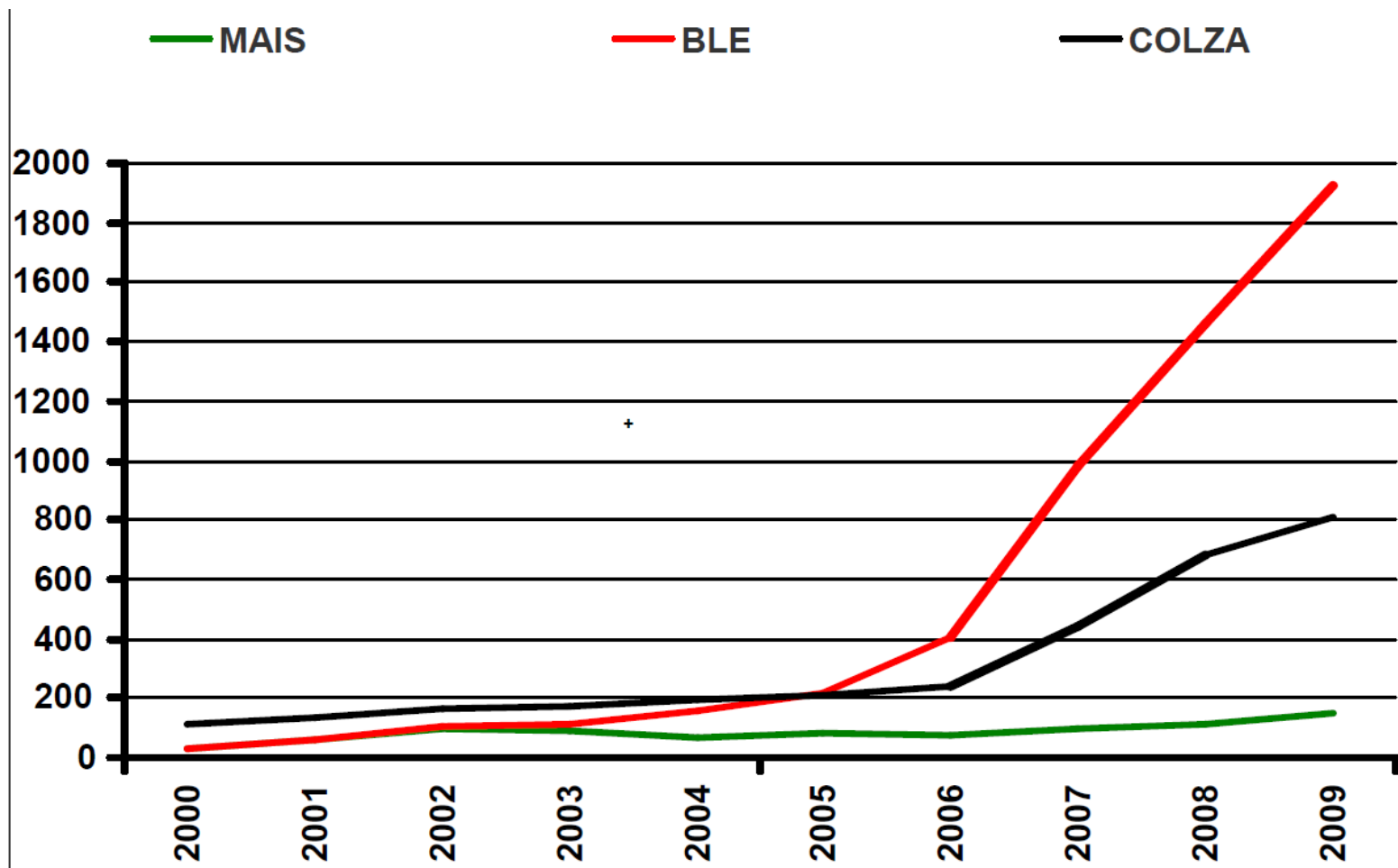
### 3. Analysis of proposals and suggestions

- Public intervention and private storage
- Sectoral subsidies
- Contracts/ Interprofessions
- Trade measures
- Exceptional measures/ crisis reserve
- Production quotas
- Direct payments
- Risk management tools of the second pillar

## 3. 1. Public intervention and private storage

- Main proposals:
  - Reference prices are unchanged
  - Mandatory intervention only for wheat, SMP and butter
- Analysis
  - Many uncertainties (date, volume, release, ...)
  - Mainly a support instrument rather a risk management tool

# Liquidity of European future markets



## 3. 1. Public intervention and private storage

### Suggestions:

- Harmonization between sectors
- Transparency of rules
- Flexible reference prices, the rule should not be based on production costs



## 3. 2. Sectoral subsidies

- Main proposals:
  - Less direct interventions (withdrawals) and more risk management tools (insurance, mutual funds) in the F&V and wine sectors
- Suggestions
  - Relevant in a transition period
  - Less relevant in the medium term (diversification, savings and credit for usual risks)

### 3. 3. Contrats and producer organisations (PO)

- Main proposals:
  - A specific framework in the milk sector (milk package / HLG on milk)
  - All sectors eligible to interprofessions and PO
- Recommendations
  - Relevant to sustain production and diffusion of economic information
  - Great care with increasing the power of negotiation of farmers (risk of double margin), better to remove downstream market power if any (cooperative)

## 3. 4. Trade measures

- Main proposals:
  - Import and export measures basically unchanged
  - Adjustment fund to globalization
- Suggestions
  - Efficiency of dissuasive instruments
  - A more aggressive attitude should be adopted with a conditional removal of export subsidies

## 3. 5. Exceptional measures and crisis reserve

- Main proposals:
  - All sectors eligible to exceptional measures due to loss of confidence by consumers
  - Crisis reserve
- Suggestion
  - Public action fully relevant for catastrophic event
  - Useful flexibility of budget and measures
  - Clarification of rules (when, who, ...)

## 3. 6. Production quotas

- Main proposals:
  - ending sugar quotas in 2015/16
- Suggestions
  - Production quotas are not efficient risk management tools (like international stocks)
  - Not efficient to delay this decision

## 3. 7. Direct payments

- Main proposals:
  - Payments are more and more tailored to the provision (reduction) of public goods (bads)
  - Coupled payments are allowed in case of difficulties
- Suggestions
  - Very uncertain budget to basic payments. Are they really legitimate?
  - Coupled payments are not efficient risk management instruments. To remove (at least not introduce countercyclical payments)

## 3. 8. Risk management instruments of the 2<sup>nd</sup> pillar

- Main proposals:
  - A move to the second pillar of “co-financed” first pillar measures (insurance subsidies and mutual funds for diseases)
  - Support to mutual funds for income losses
- Suggestions
  - Relevant in the short term of insurance subsidies, not in the medium term
  - The support to mutual funds for income loss puts responsibility to farmers (Relevant again in the short term only)

## Conclusions

- Transparent rules are required to help farmers taking their optimal decisions and to favor risk management markets
- Information is lacking while very crucial
- Member states have flexibility with fiscal policies or land regulations. This justifies a second pillar approach for some measures.