The 2016 EU Agricultural Outlook Conference

Income volatility and risk management in the EU

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Outline of issues covered

1. Types of risks affecting EU agriculture
2. CAP measures addressing risks
3. Update of risk-relevant analyses
Introducing the recent dairy challenge...

Source: DG Agriculture and Rural Development calculations based on ESTAT and OECD/FAO data.
...and placing it in a risk-management context

**Multiple causes** lie behind the recent dairy crisis – opinions for their weight differ

- World oversupply coincides with slowdown in Chinese imports and the Russian embargo
- Broader macro developments (exchange rate, oil) push all commodity prices down
- Recent increase of the EU dairy herd reverses a very long downward trend

**The EU's main policy response focused on targeting income**

- By addressing immediately the cash-flow difficulties that farmers were facing
- By attempting to stabilise markets, maximising the use of existing measures
- By aiming to improve the functioning of the supply chain (setting of Agricultural Markets Task Force)

**The EU's policy response refrained from replacing market signals**

- Higher price signals in the context of oversupply will amplify price pressures
- Long-term competitiveness and market orientation of CAP need to continue
- Similar price pressures exist also under very different farm policy regimes

- **Recovery started, but questions on how to avoid similar events in the future (and what to actually avoid) remain**
What lessons from the dairy crisis?

Opinions on the causes of risk in agricultural markets differ, namely on

- The influence and role of external/exogenous versus internal/endogenous factors
- The role of market-driven developments against policy-driven interpretations
- The role of price volatility and its difference to "excessive" price volatility (and how to define it)

Risk management addresses different risks: price-related, production, or income

- Level of future prices, excessive price volatility, co-movement of commodity prices
- Climatic/nature events (drought, flooding, wildlife, etc...), plant and animal diseases, climate change
- Increased income variability, farm cash-flow constraints, bottlenecks in the food chain

Different policy measures address these risks

- Price risks are addresses via intervention schemes, futures markets, or contractualisation
- Production risks are addressed via insurance schemes, mutual funds, ex-post natural disaster aid,
- Income risks are addressed via decoupled, coupled or counter-cyclical support schemes

> Whatever lessons learned now need to be translated into forward-looking policy proposals
What CAP choices for price risks?

The CAP reform process has opted for gradual market orientation
- CAP now has measures that increased exposure of farmers to world price fluctuations
  - Price gap between EU and world market prices was either closed or reduced
  - Agro-food trade turned positive with value-added production main beneficiary
  - Income became more volatile, but reversed previous negative trend

Price safety net is still available – but at lower price levels
- Public intervention, and exceptional measures, still very much operational
  - Public intervention has had very limited use, except during the two dairy crises
  - Private storage removed some pressure from the market in cyclical price downturns
  - Yet existing measures have limited scope in improvement of their efficiency

Price volatility remains inherent in agricultural production

- Policy question: Is there a different policy mix desirable and feasible?
What CAP choices for production risks?

Ex-ante risk management
- Measures exist in both Pillars of the CAP
  - In sector-specific operational programmes (fruits & vegetables; wine) – Pillar I
  - In insurance schemes and mutual funds in Rural Development programmes 2014-20
    - 12 RDP’s (10 MS) supporting insurance premiums (2.2 billion €)
    - 3 RDP’s mutual funds (357 mio € economic compensation for animal/plant diseases)

Natural disaster aid (mostly ex-post)
- Compensation is based on both EU and MS funding
  - Implemented by MS, mainly through state aids
  - Address mainly regionally specific risks
  - RD restoration and preventive measures are available (limited to investment aids)

Production risks increase output, and thus income volatility

- Policy question: Why is the uptake of production-reducing risk schemes limited?
What CAP choices for income risks?

The CAP has chosen to directly support farm income

- At EU-level via common policy measures
  - Via area-based decoupled income support for more than 90% of direct payments
  - Via limited voluntary coupled support in sectors presenting production risks
  - Via additional targeted aid during crises (Russian ban, dairy and livestock sectors)

RD measures have expanded the possibility of income support

- At MS-level via new or enhanced instruments in RD
  - Income Stabilisation Tool included in Rural Development Programmes for 2014-2020
  - Limited uptake - 3 IST's (Italy, Hungary, Castilla y Leon) totalling €130 million
  - Questions have been raised about the conditionality of the measure

Income volatility is expected to continue, or even increase in the future

- Policy question: Why is the uptake of different income support schemes limited?
What reasons explain limited uptake of IST in RD?

Budget unpredictability

- Annual structure of budget rules excludes such schemes from Pillar I
- Significant amounts of funds need to be blocked with uncertainty on their use
- Despite caveats, direct support presents more certainty, thus limiting scope in RD

Definition of income in Basic Act

- Income is defined as total revenues + public subsidies – input costs
- High reliance of some sectors on total public support (e.g. livestock, dairy)
- Thus, even in severe market crises, the trigger would not easily be activated

WTO Green Box requirements

- Targeting of specific sectors is not possible
- Income trigger of a minimum loss of 30% has to be respected
- Need to calculate income losses at individual farm level (use of indices not allowed)
The role of subsidies in EU farm income by sector

Proportion of subsidies (excluding on investments) to farm income (FNVA) by type of farming (avg 2007-2013)

Source: DG Agriculture and Rural Development calculations based on FADN.
Share of farms with income losses exceeding 30% - by MS

**Number and % of farms where farm income (FNVA) losses exceed 30% per MS, avg 2007-2013**

Source: DG Agriculture and Rural Development calculations based on FADN.
A US-type indicator reflects US farm reality

Why?

- The US indicator accounts for hay (up to 28% of the ration), whose price varies much less than maize and soymeal prices
- EU farmers sell milk at current (monthly) market price, buy feed when prices are low, don't use futures
- When feed prices are high, farmers adapt rations to reduce costs (farmers have ways to adapt!)
- Purchased feed weighs less in EU systems than in the US

Source: DG Agriculture and Rural Development calculations based on ESTAT, FADN and USDA/ERS.
Share of purchased feed in operating costs by MS

Source: DG Agriculture and Rural Development calculations based on FADN and ERS/USDA.
The "take away" messages

Caveats of an EU-wide Income Stabilisation Tool

- Too big administrative burden, huge technical difficulties to implement at EU level
- A system of monitoring individual farm income developments would be needed
- It implies important redistribution of support, in favour of only a few Member States

The update of analysis confirms previous conclusions

- Smaller economic sizes report higher income losses (but also depend more on DP)
- Higher income volatility does not necessarily affect sectors with high income pressure
- Very significant differences exists among MS, reflecting their different structures

To increase the actual uptake by MS for ISTs, what is needed is

- To explore the possibility and feasibility for sector-specific IST (Omnibus proposal)
- Lowering the income loss trigger or focus on market revenue (Omnibus proposal)
- Explore the requirements to introduce and use of indices (market transparency essential)

Whatever final choices are made, a distinction needs to be made between the complementarity or the trade-offs between different policy options
Reports and data available at:

http://ec.europa.eu/agriculture/index_en.htm


Thank you for your attention!