

The functioning of the food supply chain and its effects on food prices in the European Union

By Lina Bukeviciute, Adriaan Dierx and Fabienne Ilzkovitz
(European Commission, Directorate-General for Economic and Financial Affairs)

Between 2007 and summer 2008 the prices of agricultural products such as cereals and milk increased at an exceptionally high speed. These price increases had a number of causes, including rising food demand, high energy prices, low stocks, adverse weather conditions and trade restrictions. The increase in agricultural prices was largely reflected in higher consumer food prices. As a result the purchasing power of an average European household declined by around 1%, with low income households being hit even harder.

Since the arrival of the economic crisis in the second half of 2008, agricultural prices have decreased sharply. Prices of food products are expected to follow suit. However, structural factors like the growth in global food demand and the decline in food crop productivity growth are likely to hold prices up over the medium-term.

The paper aims to improve our understanding of how changes in agricultural prices affect prices charged by the food processing industry to wholesalers and retailers (i.e. the so-called 'producer' prices) as well as the prices charged by retailers to consumers (i.e. the 'consumer' prices). In order to achieve this objective, the paper investigates the functioning of the food supply chain, which connects the agricultural sector with the food processing industry and the wholesale and retail distribution sectors. The food supply chain covers a wide variety of food products. The bargaining power of the different firms along the chain appears to have a significant effect on producer and consumer prices.

This investigation into the functioning of the food supply chain is the first in-depth market monitoring exercise organised as a follow-up to the November 2007 Single Market Review. Such market monitoring exercises aim to analyse the functioning of markets in important sectors, evaluating the regulatory framework, the degree of integration and competition in the market and the innovative performance of the sector. The objective of such market monitoring exercises is to arrive at comprehensive policy conclusions taking into account these different elements.

The paper finds that the sharp rise in agricultural prices has had different effects in different EU Member States. This is seen as evidence of the fragmentation of the European Single Market for food. The relatively large increases in food prices in the new Member States can be explained by various factors, including exchange rate developments, the generally higher levels of wage and price inflation in these countries, the relatively high share of energy and

agricultural inputs in the food production process and relatively low competitive pressures along the food supply chain.

A further investigation into the price transmission along the food supply revealed that in a majority of old Member States retailers had absorbed part of the producer price shock, while this was not the case in the new Member States. Moreover, we find evidence of the asymmetry in the pass-through in the case of the new Member States. While it is difficult to generalise and these results should be interpreted with care, they suggest that the retail markets in the euro area are relatively competitive whereas this seems to be less the case for new Member States. The retail sector in the new Member States is undergoing an increase in consolidation. While consolidation can lead to productivity gains and put a downward pressure on prices, it can also cause a deterioration of competition conditions leading to higher prices.

On the basis of these conclusions, and in the light of the current economic slowdown, the European Commission has expressed its intention to:

- Ensure a vigorous and coherent enforcement of competition and consumer protection rules in the food supply markets by the European Commission and National Competition and Consumer Authorities;
- Review regulations that negatively affect the functioning of the food supply chain and contribute to the fragmentation of the European Single Market. In particular, regulations that restrict entry, limit price competition and restrict shop opening hours will be examined, taking into account the wider policy objectives of these regulations;
- Provide better information to consumers, public authorities and market operators by setting up a permanent European monitoring of food prices and the supply chain.