EU Agriculture, the CAP and Risk Management
Risk management is a topical theme in the CAP

• Because reliance on market intervention/price stabilization has declined?

• Because (international) markets have become more volatile?

• Because macro-economic risk has increased?

• Because risk management is the least controversial type of policy?
Outline

1. Current risk policies under the CAP
2. A few principles
3. Risk management and the future of the CAP
4. Resurrection of the old CAP?
1. Current risk policies under the CAP
Risk reduction without risk policies?

• The CAP still relies (too) much on market price support (35% of the EU's PSE in 2008)

  ... which has some risk-reducing effect

• Specific risk-related policies play minor role in CAP (but larger in some Members states)

• But large direct aids have significant (implicit) risk-reducing effect
Direct aids in the CAP: a factor of stability

Factor income and direct aids in EU25 agriculture, 2008

Billion EUR

Factor income 131 bill. €

Direct aids 38 billion €

29% of factor income

Source: EU Commission
2. A few principles
Objectives need to be defined

• Why is government action considered necessary?
  – market failure (farmers cannot manage risk efficiently)?
  – equity (farmers are too poor to absorb risk)?

• What type of risk is to be managed?
  – natural (weather, pest, disease, ...)?
  – market (output/input prices, interest rates ...)?
  – short or long term? (e.g. volatility versus annual prices)

• Which level is relevant?
  – individual farm, region, nation, EU?
  – yield, revenue, income?
  – individual products, total farm?

holistic approach is appropriate!
Objectives need to be defined (contd.)

- Which degree of risk is concerned?
  - normal
  - insurable
  - catastrophic

- Which risk approach is appropriate?
  - risk reduction or risk mitigation/coping?
  - ex ante or ex post?

- Risk management or support?
  - e.g. volatility or level of price?
Stabilization or support?

![Graph showing stabilization and support comparison]

- **Original**
- **Average Original**
- **Stabilized**
- **Average Stabilized'

Graph comparing original and stabilized data over time.
Stabilization or support?

- Original
- Average original
- Stabilization w/o support
Private or public action?

• How far can private actors help to manage risk?
  – with or without subsidies?
  – with or without government guarantees?

• What is the government's role in institution building and human capital formation?
  – co-operatives, contract farming
  – futures markets, insurance, mutual funds
  – education, training ...

• How can crowding out of private activity be avoided? (Past CAP crowded out private risk management tools)
3. Risk management and the future of the CAP
... is not whether there should be forms of disaster relief, crop insurance and similar approaches

• they exist already at national level – with wide variation across Member states, and possibility of co-financing from Pillar II

• It is whether there should be a new EU-wide system under the CAP post-2013

• Distinction needed between
  – substantive considerations
  – political economy perspective
Substantive considerations (1)

- A new EU-wide regime would be expected to focus on market risk

  ... as natural risk is already covered at national level

  ... and market risk is seen to be related to CAP reform, international markets

- EU-wide approach would essentially mean: some form of an income safety net
Substantive considerations (2)

- Parameters would have to consider WTO green box criteria (>30% / <70% rule)
- EU-wide safety net could become very expensive
- Major re-distribution of transfers would occur, as volatility of farm income varies widely between
  - product sectors (fruit, vegetables, pig more volatile than other sectors)
  - countries/regions (North and South more volatile than Center)
Regional pattern of income risk in EU agriculture

Source: European Commission Joint Research Center, 2008

Figure 30. Risk (30% deductible) of Farm Net Value Added (FNVA) for specialists field crop and specialists horticulture

Source: European Commission Joint Research Center, 2008
Political economy perspective

- Would income safety net be considered an alternative to direct payments?
- Would establishment of income safety net help to reduce/eliminate market intervention?
4. Resurrection of the old CAP?
A long-term trend of CAP reform

• After a long period of repeated policy crises, the CAP embarked on a firm trend towards reforms in the early 1990s

... under Commissioners MacSharry, Fischler and Fischer Boel

• Market intervention was reduced (though not eliminated), and less distortionary measures were introduced
Past CAP reform and risk management

• With a shift from Pillar I to Pillar II, more scope was created for responding to specific situations in individual Member countries

... including in the area of risk-related policies

• Extensive market intervention was considered a policy of the past

... and does not work in the WTO context

• In the past, the Commission has resisted heavy-handed risk-related policies
• we “will always leave the responsibility to the farmer to tackle the normal risks that are in every business”

• “we do not want a European scheme for crisis management, we want Member States to create schemes, but we would be open to look at the possibility of co-financing the premium via the rural development scheme”

• “if there should be any expectations of an income safety net, forget it”
Will this trend continue?

- In the run-up to the debate on the CAP post-2013, there is quite some talk of the need to provide EU farmers with more price stability.

- EU Presidency (Spain), February 2010: "The EU must have an agricultural model with the tools necessary to stabilise markets and deal with price volatility."

- Which approach will the Commission adopt?
EU Commission on the way towards reducing market risk?

- "[Commissioner] Ciolos told MEPs that his efforts will.. be focused on producing CAP reforms which build in the necessary crisis response and price stability tools." (Agra Europe, 23 April 2010)

- Commissioner Ciolos on the 'dairy crisis': "Based on the intervention tools that we currently have at our disposal, used as a safety net, we will make sure we avoid a repeat of situations such as the one which afflicted the dairy sector." (Agra Europe, 23 April 2010)
How severe was the EU's 'dairy crisis'?

Producer price of milk, Germany

Producer price, 3.7% fat, 3.4% protein, w/o VAT. Source: Federal Ministry of Food, Agriculture and Consumer Protection
Conclusions (1)

- More price volatility on EU markets has raised interest in risk-related policies
- Availability of regime for market intervention may not avoid political pressure for extra measures when 'crisis' hits
- Getting used to more price volatility may reduce felt 'need' for risk-related policies
- Return to heavy-handed market intervention should not be considered an option
Conclusions (2)

• Yield risk is best managed at level of Member states

• At EU level, low slung safety net for farm incomes may be an option, but can become very expensive... and should not come on top of continued regime of direct payments

• Policy risk may be as important as market risk (e.g. uncertainty regarding future of direct payments)