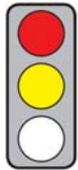


## MAIN ISSUES

**Objective of the Communication:** The Commission wishes to remove market distortions from the food supply chain.

**Parties affected:** Farmers, food producers, wholesalers and retailers, exchange traders, consumers.



**Pros:** The EU-wide harmonisation of food safety standards creates value added.

**Cons:** (1) The market distortion in the food sector described by the Commission is not comprehensible and also contradicts what is stated in the accompanying documents. Alleging that political inaction causes the “escalation” of food prices is pure alarmism.

(2) The EU should restrict itself to removing obstacles from the single market.

(3) Standard contracts curb competition and run the risk of curtailing freedom of contract.

## CONTENT

### Title

**Communication [COM\(2009\) 591](#)** of 28 October 2009: **A better functioning food supply chain in Europe** and **Commission Staff Working Documents [SEC\(2009\) 1445](#), [SEC\(2009\) 1446](#), [SEC\(2009\) 1447](#), [SEC\(2009\) 1448](#), [SEC\(2009\) 1449](#)** and **[SEC\(2009\) 1450](#)** of 28 October 2009

### Brief Summary

#### ► Context

- The food supply chain comprises agricultural enterprises producing agricultural commodities, commodity exchange traders, food processing companies (producers) and food retailers. The single market players are active either as large-scale enterprises or small to medium-sized enterprises (SME).
- According to the Commission, the food supply chain accounts for 5% of the aggregate value added in the EU and for 7% of employment. Food represents 16% of the EU households’ expenditures.
- The Commission sees a need for improvement in view of international competitiveness. Moreover, it is concerned that the food sector’s economic growth lags behind growth of the overall EU economy.
- The Commission criticises a lack of “resilience” to boosting commodity prices (“shocks in agricultural prices”). It deems a “better functioning food supply chain” to be “urgently” needed in order to avoid an “escalation” in prices as economic recovery sets in. (P. 2).
- The Commission is planning measures to “promote sustainable and market-based relationships” between stakeholders in the food supply chain, to foster the “integration” of the national food markets into the internal market in order to improve its competitiveness, and to increase transparency.

#### ► Deficiencies in the pricing system

- According to the Commission, producers and distributors reacted much more slowly and less decisively to the commodity price decline in the second quarter of 2008 than they did in 2007 when prices increased. Food producer prices continued to rise until the end of 2008. Consumer food prices did not start to fall (slightly) until May 2009.
- The Commission concedes that the share of agricultural commodity prices, which anyway make up only a small proportion of the overall production costs of food, will plummet further. Moreover, it argues that producers and distributors have partly “absorbed” the price increase in agricultural commodities due to their heavy competitive pressure.
- According to the Commission, the discrepancy between the price trend of agricultural commodities and that of consumer prices has a negative impact on the food supply chain, since price reductions are not transmitted to consumers. In addition, “necessary adjustments” are delayed and “market deficiencies” continue.
- The Commission attributes this discrepancy to “structural weaknesses”, such as the number of intermediaries, the competitive structure at each individual stage of the food supply chain and unequal bargaining power during contract negotiations.
- The Commission criticises the vast differences in price levels and price developments between single Member States. It puts these differences down to national factors, such as differences in average household incomes, in the levels of value-added tax and even different tastes, though differences in market dynamics and legal frameworks also play an important role.

► **Fostering sustainable, market-based relationships**

- Unequal bargaining power can lead to unfair trading practices when larger market players (e.g. large food producers or distributors) exploit their power to dictate conditions to smaller players (e.g. small-sized agricultural enterprises or small-sized food processing enterprises).
- As far as the Commission is concerned, unfair trading practices include late payment, unilateral contract alteration and upfront payments as “entry fees” to negotiations.
- According to the Commission, unfair trading practices have a negative impact on the profitability of smaller players in that they limit their ability to invest in product quality and innovations.
- The Commission finds that “classic” cartels, joint commercialisation agreements, buying alliances, tying and bundling and the increasing use of private labels are potentially anti-competitive.
- According to the Commission, after weighing up the efficiency-enhancing impact of certain business practices against their anti-competitive effects and taking into account the specific local market situation, it has to be decided on an individual basis whether or not a restriction of competition exists.
- By 2010, the Commission wishes to:
  - exchange information with the Member States on contractual practice and rights and the legality of commonly used contractual clauses (e.g. Ombudsmen, actions by authorities and collective actions), as well as to take action and launch awareness campaigns to help curb unfair contractual practices;
  - prepare “sets of standard contracts”, whose use would be voluntary, to help prevent unfair contractual practices amongst the food supply chain stakeholders;
  - work with the national competition authorities in the European Competition Network (ECN) to analyse specific practices and markets in order to develop “a common approach” to relevant competition issues.

► **Increasing price transparency**

- The Commission complains that there is a lack of price transparency and “predictability” along the food supply chain.
- The Commission deems it “desirable” that “price comparison services” via websites or so-called smart phones, that can be used in stores to scan and compare products, are further developed. In this way it intends to ensure the exchange of best practices.
- On 28 October 2009 the “harmonised index of consumer prices to monitor food prices” (HICP) was published. The HICP monitors in all Member States:
  - the consumer price index for food and
  - the price trend for selected products such as milk at every stage of the chain.
 The index serves to expedite the transmission of price changes to consumers.
- The Commission deems derivatives important in order to “cope with” the volatility of agricultural commodity prices (p. 8). Derivatives are financial contracts whose value is derived from an underlying base value (e.g. product price). Should a predefined event occur, one of the contract parties has the right to purchase or sell the derivative.
- The Commission wishes to ensure that derivatives keep serving their “initial purpose” of price discovery and keep preventing “excessive speculation” on agricultural commodity markets (p. 8).
- Within the framework of the overall derivative concept [COM(2009) 563; cp. [CEP Policy Brief](#)] and the revision of the Directive on markets for financial instruments [2004/39/EC], by the end of 2010 the Commission intends to:
  - extend reporting requirements to agricultural commodity derivatives traded over-the-counter;
  - oblige “defined categories” of traders to submit data on each traded derivative (“position reporting”).

► **Integration of the food supply chain**

- The Commission wishes to foster cross-border trade. Therefore, it criticises any restraints on territorial supply and hindrances to the purchase of goods in other Member States where the same product is offered cheaper (“parallel trade”).
- In order to remove barriers which fragment the internal market, the Commission is planning to:
  - assess measures to address territorial supply constraints and submit an impact assessment by the end of 2010;
  - continue working towards a harmonisation of food safety standards and “urge” the Council and the European Parliament (EP) to revise and adopt the legislation on labelling rules [COM(2008) 40; cp. [CEP Policy Brief](#) in German only];
  - review environmental standards and origin labelling [cp. COM(2009) 234].

► **Competitiveness**

- The Commission criticises that the growth of value added and productivity in the EU has been outpaced by those in the USA since 1995 and that the EU is losing market shares at world level to Brazil, Canada and Australia.
- In order to foster competitiveness the Commission wishes to
  - promote the reorganisation and consolidation of the agricultural sector – in particular through the establishment of voluntary agricultural producer organisations;
  - have the high-level expert group (HLG) on milk examine the situation of the milk sector;
  - broaden the HLG’s “scope” of action and composition in order to improve the competitiveness of the agricultural and food sector and to “take action” to bring forward the proposals (p. 12).

## Statement on Subsidiarity

The EU Commission does not address the question of subsidiarity. However, it does emphasise that food markets are mainly national or local markets.

## Policy Context

In 2007, the EP was already criticising the widening gap between production and consumer prices (Explanation No. 88/2007). In 2008, the European Economic and Social Committee proposed a voluntary national code of conduct for contracts between industry and retailers (CCMI/050). Since the end of 2007, the Commission has been tracking trends in food prices [COM(2007) 724 and SEC(2007) 1517], and in 2008 it published an interim report [COM(2008) 821]. The Second Consumer Scoreboard [COM(2009) 25; cp. [CEP Policy Brief](#)] concluded that consumers are satisfied with food retailing but that there is “relative lack of satisfaction” with the comparability of food prices.

The German Antitrust Authority (*Kartellamt*) is investigating the meat industry and flour producers for illegal price fixing, and one retailer is being investigated for exploiting their market power in order to obtain subsequent supply discounts. Another retailer was prosecuted for continually selling goods below cost price [Decision B9-77/07] and three coffee roasters for illegal price fixing.

## Options for Influencing the Political Process

Leading Directorate General: DG Agriculture and Rural Development

# ASSESSMENT

## Economic Impact Assessment

### Ordoliberal Assessment

In its Communication **the Commission reveals a fundamental lack of understanding and mistrust of market forces**. Somewhat disquieting is the fact that it complains about the lack of predictability in food price trends and uses this to justify the introduction of policy action such as price control at state level. In a market economy, however, you can't go about defining price development as you wish; it is based on actual supply and demand behaviour. Thus prices provide important information regarding actual scarcity, which market players use in their own interests for activities which help to reduce such scarcity.

Moreover, **it is strange that the problem description in the Communication and the deduced necessity for policy actions partly contradicts the detailed statements given in the Commission's Impact Assessments**, which are the official accompanying documents to the Communication [SEC(2009) 1445 – 1450].

In the Impact Assessments the Commission points out, quite justifiably, that the diverging developments in agricultural commodity prices and food prices do not constitute any “structural weaknesses” or market deficiencies in the food supply chain, not least because many food prices are affected to a large extent by labour and energy costs [SEC(2009) 1450, p. 5-6]. In its Communication, however, the Commission ignores its own insight.

The Communication's overall impression, namely that the food sector in Europe *per se* has a massive competition problem which requires measures that go beyond the usual supervision of competition, runs counter to the key message of the Impact Assessment, which is based on the results of consultations of market players (including national antitrust authorities) carried out by the DG Competition [SEC(2009) 1449]. That document draws a much more differentiated picture of the single food sectors in Europe. For instance, the retail sector is described as “fiercely” competitive, even by the food industry. This is seen as the reason why the price development for food remains behind the general price development and why consumers benefit from competition [SEC(2009) 1449, p. 8-9].

**It is therefore not comprehensible why the Commission calls for “urgent” policy action to improve the food supply chain.** In view of all accompanying documents, **the Commission's allegation that political inaction causes food prices to escalate is pure alarmism.** On the contrary, there is no need to doubt the generally sound operation of the food sector in Europe nor to take any action beyond normal market supervision.

### Impact on Efficiency and Individual Freedom of Choice

The HICP is not a very reliable instrument for the comparison of food prices in Europe. Even the Commission itself refers to the fact that food prices differ due to diverging national preferences and living conditions. Besides, there is a risk that the Commission takes price control as a first step only to directly intervene into pricing later where it considers prices to be “too high”. This, however, would affect the function of prices as scarcity indicators and thus would impair the efficiency of the overall economy.

Principally, it is not the responsibility of the government to call for price comparison services for consumers or even to offer such a service itself, as the Commission implies [SEC(2009) 1446, p. 15]. Here, one has to trust in private economic initiatives as they already exist in certain Member States such as in Great Britain.

The protection of competition, however, is – without a doubt – a governmental task. Yet national antitrust authorities are no less strict in the food sector than they are in any other sector. A close cooperation between national antitrust authorities is principally to be welcomed. However, it should not lead to an increase in administrative costs for companies, which is exactly what the propagated exchange of information on contract practices, to be moderated by the Commission, would do.

#### Impact on Growth and Employment

From an economic standpoint it is not comprehensible that the Commission is concerned about the growth of the food sector lagging behind the growth of the overall economy. In fact, a lower growth in that sector is an indication of wealth: In developed economies expenditures for food do not normally increase to the same degree as consumer incomes do. Instead, increases in incomes are used rather for the acquisition of other goods and services and lead to higher growth there.

#### Impact on Europe as a Business Location

An inappropriate regulation of the food sector reduces the incentives for the market entry of new market players and for investments to be made by existing market players.

### Legal Assessment

#### Legislative Competence

Depending on the focus of each measure, the EU's legislative competence follows either from Art. 114 TFEU (Internal Market; ex-Art. 95 TEC), Art. 169 TFEU (Consumer Protection; ex-Art. 153 TEC) or Art. 192 TFEU (Environment; ex-Art. 175 TEC). For measures affecting civil procedural law, Art. 81 TFEU (ex-Art. 65 TEC), which requires a "cross-border reference", applies.

#### Subsidiarity

The Commission emphasises that the food sector is mainly dominated by national and local markets. The issues related to these markets have no cross-border relevance and therefore can be better tackled by national and local authorities, which can better assess the characteristics locally. **The EU should limit itself to removing obstacles to the internal market** (e.g. through different labelling requirements). **The EU-wide harmonisation of food safety standards provides added value.**

#### Proportionality

Should the Commission plan measures in the field of civil procedural law, it will have to take into account the different structures and functionality of the legal systems across Member States. Collective action, for instance, is in conflict with the opinion – widespread in many Member States – that civil procedural law serves to enforce individual rights [[CEP Policy Brief](#) COM(2008) 165; [CEP Policy Brief](#) COM(2008) 794].

**Standard contracts run the risk of curtailing the freedom of contract**, for instance by being referred to as guidelines before the courts. Besides, **standard contracts reduce** the positive conditions of **competition** to the disadvantage of consumers. It is the task of competition law to prevent unfair trading practices. Therefore, companies in Germany are not allowed to exploit their market-dominating position by demanding unjustified advantages from other companies [§§ 19 (1), 20 (3) Law against restricted competition].

#### Compatibility with EU Law

Unproblematic.

#### Compatibility with German Law

Unproblematic.

### Alternative Action

The EU should abstain from controlling prices along the food supply chain and leave the protection of competition to the competent competition authorities.

### Possible Future EU Action

In a Communication ("Retail Market Monitoring") the Commission intends to present proposals for strengthening the competitiveness of the retail sector in the EU. Furthermore, it plans to submit a "follow-up report" to the present Communication by the end of 2010. At the beginning of 2010 the Commission wishes to adopt a new block exemption regulation for vertical contracts [Draft C(2009) 5365/23; cp. [CEP Policy Brief](#)].

### Conclusion

The market distortion in the food sector described by the Commission is not comprehensible. Moreover, it contradicts the statements given in the accompanying documents. Alleging that political inaction causes the "escalation" of food prices is pure alarmism. The EU should limit its activities to the removal of obstacles to the single market and leave the protection of competition to competition authorities. Standard contracts curb competition and threaten to curtail the freedom of contract. The EU-wide harmonisation of food safety standards, however, creates value added.