MEMORANDUM

QED Conference on
EU Agricultural Commodities Markets

State of play and challenges ahead

SPEAKERS

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Advisor to the Director on Markets and Observatories, DG AGRI, European Commission

Nicholas Kennedy
Head of Commodities, Euronext

Prof. dr. hab. Andrzej Babuchowski
President and CEO, Dairy Industry Innovation Institute, Poland

Philippe Mitko
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Marta Zuluaga Zilbermann
Director of Policy & Government Relations, Cargill

MODERATOR

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Fabien Santini
Advisor to the Director on Markets and Observatories, DG AGRI, European Commission

Mr Santini said that the EU’s approach to the agricultural commodities markets is one of market orientation to increase trade opportunities. This resulted in a reduction of the gap between EU domestic and world prices and so in an increased exposure of EU operators to price risks and volatility of the world market. In addition, there is a context of imbalances of power in the food chain and asymmetry / delays in price signals transmission to producers, while producers cannot always adjust quickly their production level. Another increasingly important area is exposure to production risks from extreme climatic events. This translates into lower and/or variable yields. All these contextual elements translate into an income volatility for farmers, i.e. a significant share of farmers has been recorded in certain Member States to face over 30% variability. Mr Santini reviewed the elements in the CAP 2020 proposal on strategic plans and its nine objectives, and from the agricultural markets task force reports that aim at providing EU farmers and other stakeholders with policy tools to better adapt to this context. These are among others cooperation/contractualisation, Unfair Trading Practices (UTPs), and market transparency. On market transparency, he said that two new observatories on wine and fruit and vegetables have just been created to complement the four existing ones. **"As regards risk management, the Commission proposes that the Member States will include in their CAP strategic plan a coherent and integrated approach to risk management."**

> *Euronext allows people from the commercial, physical world – farmers, cooperatives, traders, buyers, sellers, etc. – to lock in their price either as a seller or a buyer, and in this way protect their margins.*

Nicholas Kennedy

Head of Commodities, Euronext

Mr Kennedy gave an overview of the working of Euronext, in particular its relation to the introduction of risk management in agricultural commodities markets. **"Euronext allows people from the commercial, physical world – farmers, cooperatives, traders, buyers, sellers, etc. – to lock in their price either as a seller or a buyer, and in this way protect their margins."** He said that these contracts are physically delivered. A contract that is purchased can be held until its expiration and the product will be delivered at that agreed, locked-in, price. This way of working protects the critical period between buying a contract and selling the product where climate and other factors can create severe price volatility; the futures contract provides protection. Mr Kennedy gave the example of wheat. Europe produces roughly 150 million tons per year, but three times that amount was traded by Euronext in 2018 in equivalent tons of traded material. This is different from the US, which produces 60 million tons per year, but over 90% of that would be traded in Chicago for instance, which underlines the very financial nature of the older Chicago contracts. Finally he said that he would like to see greater promotion of these tools, which form part of a more comprehensive Euronext toolbox.

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Prof. dr hab. Andrzej Babuchowski

President and CEO, Dairy Industry Innovation Institute, Poland

Prof Babuchowski gave some general characteristics of the agricultural markets, focusing on dairy where specific problems exist. **"To start a dairy farm from scratch takes two years and millions of euros, so if a dairy farm disappears it will never appear again."** Another problem inherent to the dairy sector is that dairy goods are perishable and are produced daily. Moving on to other challenges, high costs of dairy farming and the 7-day working week are driving younger farmers to switch to crops. Climatic and environmental changes are also putting pressure on the sector. There is therefore the pressing need for integrated risk management tool box for farmers, and he gave a few recommendations. These are a minimum rural development allocation for risk management; smart proxies for losses and reimbursements; a platform to exchange best practices; mapping of data and risk; and possibility of shifting money from direct payments for this purpose. Prof Babuchowski discussed how the Commission proposal aims to improve the role of farmers in the wider food supply chain by banning some of the most common Unfair Trading Practices that they face, such as late payments for perishable food products; last-minute order cancellations; payment by suppliers for wastage of food products that occurs on the buyer's premises and unilateral or retroactive changes to contracts. He said that “the problem with the Directive is that each country fulfils it according to its own conditions, so that they fulfil the main goal but in an inconsistent, overall manner.” Finally he mentioned that there is huge potential in parts of Europe to increase wheat yields.

> *The key message to remember is that the world's trades set the world's prices.*

Philippe Mitko
Public Affairs, InVivo Trading

According to Mr Mitko, agri-commodities are at the crossroads of different worlds, including global economy and finance. Agri markets are correlated with other commodities (energy, metals…). Their main characteristic are: one crop per year and inelastic demand; products that are alive; and challenges surrounding organisation of the offer. He said that the main risks to be managed by a trading company are meteorology; counterparty, country & politics; compliance & regulation; quantity & shortage; price; freight; logistics & primary transportation; bank, currency & credit/treasury; people; and quality (especially sanitary). Globally the main agri-commodities volumes traded are continually increasing, following the world's population, particularly in Africa, and Mr Mitko gave the export numbers for some key crops in 2018/19: 24% of the world's wheat production and 42% of soybeans are exported. He said that **"the key message to remember is that the world's trades set the world's prices."**

> *They seek to reduce costs through improving and optimizing supply chain logistics, involving ownership of physical assets or facilities.*

Marta Zuluaga Zilbermann

Director of Policy & Government Relations, Cargill

Ms Zuluaga, speaking on behalf of Cargill and the Commodity Markets Council Europe (CMCE), explained the role of commodity firms, which work to meet the challenge of matching supply of commodities with demand by organising the supply chain and managing associated risks. This includes originating, transporting, storing and transforming commodities. **"They seek to reduce costs through improving and optimizing supply chain logistics, involving ownership of physical assets or facilities."** She also spoke of the risks accumulated in the value chain, from origination through to logistics, processing and distribution and noted that liquid and well-functioning global futures markets are essential for allowing commodity firms to hedge some of the risks related to their physical activities and assets. At one end is the farmer with high price expectations; at the other end is the end-user with low price expectations. The challenge is to meet both expectations through the efficient management of all risk elements along the value chain. Ms Zuluaga described "the world of megatrends" such as economics, supply, climate, demographics and consumer trends. At the same time there are major disruptors such as weather, geopolitics & governments, logistics bottlenecks, and unforeseen events. She gave an example of a rapeseed processor managing price risk through futures markets, where hedging protects value chain actors from fluctuating price movements.

Panel discussion

The Moderator asked whether the amendments to the CMO regulation are going to make it more difficult for interventions to address some of the problems and challenges highlighted by panellists? Mr Santini gave reassurance that, in the Commission's proposals, the single CMO is not changing in its broad principles. He sees the Commission's approach as being complementary to a market orientation; devolving to the Member States the right strategy that is adapted to the local conditions to tackle the challenges they face, whether economic, environmental or social. He believes the Member States are better placed to find the optimal policy mix.

Mr Mitko considers the key word of the CMO proposal to be "sustainability". In this respect he believes Europe's agriculture industry should not have to choose between increasing its productivity, which is absolutely needed anyway, or go towards the organic model, which is a major societal trend. Consequently, a "third way needs to be found which will require the implementation of a huge number of new solutions in farming or throughout the supply chains." He also sees "simplification" as key, but is afraid that this won't be attainable due to these different and new solutions and processes, requiring a high level of skills and know how.

The Moderator asked how more small farmers and cooperative could become more active in the futures markets, and smarter in managing risk? "French farmers are already quite heavily involved from the beginning of Euronext's futures contracts," said Mr Mitko, but pointed out that “managing risk does not mean eliminating risk. You have to live with risk, and therefore deal with it. If the price is low, it’s low, and no risk management tool can help you.”

A delegate asked if there is a contradiction between greater market orientation and what seems to be more intervention? Mr Santini said that in terms of the CMO, intervention only refers to the top level of the classic pyramid of risk, when the system can no longer cope. He said that a crisis reserve fund of around 460 million euros per year was available to meet such crises. “In the proposal currently on the table, roughly the same amount is available, and anything not used in this crisis fund will be transferred to the next year.”

A delegate asked about carbon price on agriculture and meat. Mr Santini stated that the sector is not under the Emission Trading Scheme and there is no plan for the moment to do so. However, in the CAP there is a strong element that focuses on climate and environmental objectives. This involves focusing more on policy performance; tracking the performance of EU agriculture, including specifically its GHG emissions or other environmental indicators for instance. “Unfortunately in the last three years we have seen GHG emissions increasing again, so there is still a lot of work to do.” Ms Zuluaga said that climate change is a priority for most companies in this sector, including Cargill, so they are seeking to reduce the environmental impact of their operations and, in addition, across the whole supply chain from farmers to consumption. She mentioned specific actions such as “reducing GHG emissions of cows through changing the formulas of feed, and looking at protein alternatives from new sources and processes such as gas fermentation.”

In the view of Prof Babuchowski, agriculture should be paid for the amount of CO2 that is captured from the atmosphere by crops and other eco-friendly plants. He said that a second green revolution is essential to feed the growing population of the world, now and into the future. “We must produce plants which are drought and heat resistant, but I don’t see any chance of doing this rapidly without genetic engineering.” He pointed out that the inconsistency that almost every country is against GMOs in food, but accepts GMOs in pesticides, medicine etc. “We have to change our attitude in this area, otherwise we will be left in disarray.”

Ms Zuluaga added that in regard to soybeans, where demand continues to grow rapidly, it’s vital to produce with more resource efficiency while addressing the environmental impact of this crop. In Brazil, Cargill has been working for many years on promoting better farming practices in cooperation with organizations such as The Nature Conservancy and is looking at how to help farmers implement the Forest Code and promoting joint actions by all active players to help sector transformation. Prof Babuchowski agreed that we cannot allow the levels of deforestation that were in place under the policy of promoting the planting of biofuel crops, when huge tracts of forest were removed to allow the planting of palm trees for palm oil.

Mr Mitko underlined that climate change will increase further the trade needs for agricultural and food products. It is therefore extremely important to also watch these questions from a long term geopolitical perspective.

The Moderator wondered where the innovation was that would enable new financial products? “And how do keep them here and not in Chicago, for instance?” Mr Kennedy said you can’t just throw new products at people if they don’t want to use them- furthermore not everyone seeks the transparency and security that futures markets offer. He pointed out that eight out of ten contracts die after two years. However, before inventing new products, he would like to see the more extensive roll-out of existing products in all Member States. This should not involve simply replicating other models. He would like to see how easier access products can be offered, that don’t have to be physically delivered, such as cash settled offerings. He is also keen to see better sharing of referential data, and in this respect Euronext is working with price reporting agencies looking at how best to compile and share data.