New income stabilisation tools and price volatility in agricultural markets

SUMMARY
Farmers are often confronted with substantial changes in the prices they receive for the sale of their agricultural products, which causes financial uncertainty about their incomes. Commonly referred to as 'price volatility', this phenomenon is more evident in agriculture than in other economic sectors due to a variety of economic, natural and political factors. Data provided by the United Nations Food and Agriculture Organisation suggest that global price volatility has been on the increase since 2005 and is likely to remain a major concern for farmers in the coming decades.

The Common Agricultural Policy for the 2014–2020 period is mainly aimed at compensating farmers for the negative effects of price volatility and at tackling income volatility, rather than directly addressing price volatility itself. Indeed, market interventions have been reduced and now play the limited role of safety net measures which are only activated when prices drop below certain levels. The main policy instrument involves direct payments which provide a stable form of income for farmers regardless of market conditions. Additionally, Member States have the possibility to support three risk management tools (insurance schemes, mutual funds and an Income Stabilisation Tool) through their rural development programmes. In the framework of the Multiannual Financial Framework review, on 14 September 2016, the Commission proposed some changes to the Income Stabilisation Tool. The European Parliament has been working actively on the issue of price volatility in agricultural markets, notably by organising a hearing and launching an own-initiative report on the subject. Looking to the future, direct payments, which reduce income volatility by providing a stable form of revenue for farmers, will probably still play a role in the CAP after 2020, but a political shift towards the further development of risk management tools could be at the core of the debate on the future of European agricultural policy.

This briefing updates ‘Price volatility in agricultural markets’ published in July 2016.

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Glossary

**Price volatility:** substantial variations in the prices of (agricultural) products over a given period of time.

**Risk management instruments:** measures aimed at helping farmers to deal with various types of risks related to their production, prices and income, which can include individual on-farm strategies, market instruments and public policies and support.

**Income Stabilisation Tool:** a risk management tool, as provided for in Article 39 of Regulation (EU) No 1305/2013, in the form of financial contributions to mutual funds, providing compensation to farmers in case of a severe drop in their income.

**What is price volatility?**

The concept of price volatility describes how frequently the prices of (agricultural) products change over time, both upwards (increases) and downwards (decreases). While some variation in prices is considered to be a normal aspect of well-functioning markets, volatility becomes problematic when price movements are large and unpredictable.

High levels of price volatility can create financial risks for farmers, since their incomes will be less predictable and can be threatened by sudden price drops. Price volatility also reduces capacities for long-term investments, particularly for young farmers. Moreover, increases in agricultural prices can reduce the ability of lower-income households to fulfil their basic needs, especially in developing countries, as the cost of food represents a large share of their income.

A number of factors explain why agriculture is confronted with higher levels of price volatility than other economic sectors:

**Market factors**

In the short-term, because the market fundamentals of supply and demand are inflexible towards agricultural products, reconciling these two forces can be hard when it comes to such products. Demand is rather fixed because food is a basic human necessity, while supply is unable to adapt quickly because food takes time to be produced. As a result, even small changes in agricultural supply or demand can cause large variations in prices, causing permanent market instability. Apart from these micro-economic fundamentals, changes in macro-economic factors, such as exchange rates and oil prices, can also have a substantial influence on food prices.

**Climate and weather factors**

The agricultural production process is particularly sensitive to natural factors such as adverse weather conditions and plant or animal diseases can have a significant impact on seasonal agricultural output.

**Policy decisions**

Changes in agricultural and trade policies can also increase price volatility and its consequences for farmers. For instance, in recent decades developed countries have, in the spirit of the World Trade Organisation (WTO) agreements, made their agricultural sectors more open to global markets and hence more vulnerable to changes in international food prices. Trade restrictions imposed by governments, such as the Russian ban on certain EU agri-food products, can also have a destabilising effect on agricultural markets and lead to sharper price fluctuations.
Financial investments and speculation

Financial investments in agricultural products are also often seen as a cause of increased price volatility, since they tend to make prices more vulnerable to speculation and shocks in other commodity markets. Nevertheless, this remains a subject of intense disagreement among agricultural policy analysts and institutions. While some argue that financial actors’ involvement is a root cause of price volatility (for instance, the United Nations Conference on Trade and Development, UNCTAD), others, such as the experts on the ULYSSES project, claim that there is no empirical evidence to support the argument that speculation affects agricultural price levels.

Other elements, such as the increase in food consumption in developing countries, the worsening of conditions for agriculture due to climate change and the increase in biofuel production, can put even more pressure on agricultural markets in the future and are expected to magnify price fluctuations. It is therefore likely that price volatility will remain a major concern for farmers in the near future.

Agriculture market perspectives

The issue of price volatility can be illustrated by data from the Food and Agriculture Organisation (FAO) on global food prices between 1990 and 2016. The general trend is represented by the ‘food price index’, which indicates that food prices were relatively stable between 1990 and 2005, while price volatility appears to have increased from 2005 onwards. Strong price peaks occurred in 2006–2008 and 2010–2011, and were followed by a long period of gradual price decline (see Figure 1).

These statistics also show the evolution of prices for specific agricultural products:

- **Meat**: There was a big price peak in 2008–2009 and a minor one in 2014–15; meat prices have been decreasing since 2014.
- **Cereals**: There was already a small price peak in 1996, yet the biggest ones took place in 2008, 2010–11, and 2013; prices have been dropping since 2013.
Oilseeds: Price spikes developed in 2008 and 2011; the last one was followed by a gradual decline in prices.

The Organisation for Economic Co-operation and Development (OECD) and FAO have made predictions on future price levels in their joint Agricultural Outlook 2015–2024, based on several assumptions related to production and consumption, economic growth, population growth, inflation, exchange rates and energy prices. They expect that agricultural prices in the 2015–2024 period will be lower than in 2014, but higher than in the period before 2007 (see Figure 2).

Figure 2 does not include expectations on future volatility levels because precise short-term price changes are often very difficult, if not impossible, to predict. Nevertheless, it is likely that the prices of agricultural products will remain volatile in the next decade, as economic, environmental and political shocks will continue to disrupt the delicate balance between demand and supply.

EU approach to price volatility

Recent price developments have generated a debate on how agricultural policy should respond to the issue of price volatility. In this respect, it is useful to distinguish between two types of policy measures:

1. Measures aimed at reducing price volatility itself by stabilising the prices that farmers receive for their products, such as market intervention measures.

2. Measures aimed at reducing the negative consequences of price volatility by stabilising the incomes of farmers, including direct payments or risk management tools such as insurance schemes, mutual funds and futures.

Traditionally, the EU's CAP was predominantly based on the first approach. Since its establishment in 1962, the CAP sought to stabilise markets and ensure a fair standard of living (as laid down in Article 39 of the Treaty on the Functioning of the European Union, (TFEU)) through market interventions, both within the EU and at its borders, guaranteeing high and stable prices for the main agricultural products. This policy remained largely in place during the 1970s and 1980s, apart from the introduction of production quotas for milk, sugar and wine.

However, as these market interventions increasingly often resulted in overproduction and high budgetary costs, and were considered economically inefficient, unsustainable and having a distorting effect on international trade, EU policy-makers decided to slowly change this approach.

The first major CAP reform occurred in 1992. It gradually reduced the system of guaranteed prices and compensated farmers for this by providing them with direct payments. These payments were initially coupled to the amount of agricultural production, but since 2005 they were gradually 'de-coupled' from production and became dependent on the hectares of land or number of animals owned by farmers.

Over time, CAP reforms have gradually reduced market interventions in support of guaranteed prices and replaced them by a more market-oriented approach. A small number of market interventions are still possible when prices become too low, through safety nets included in the Single Common Market Organisation (sCMO). Nevertheless, the current CAP is still mainly aimed at compensating farmers for the negative effects of price volatility, by providing income support through direct payments. Additionally, EU
Member States have the possibility to support risk management tools for farmers through their rural development programmes.

**Direct payments**

Direct payments, as included in Regulation (EU) No 1307/2013, represent the main policy instrument in the current CAP for the 2014–2020 period with a share of 70% in total CAP expenditure and a yearly budget up to €42 billion (in current prices).

Direct payments are annual payments directly granted to EU farmers and consist of multiple components aimed at different policy outcomes:

I. A basic payment per hectare to provide basic income support to farmers;  
II. Greening payments as a compensation for the use of agricultural practices beneficial for the environment;  
III. Additional support for young farmers (under the age of 40) for a maximum period of five years, in order to encourage young people to enter and stay in the agricultural sector;  
IV. Redistributive payments for the first hectares on a farm, used for re-allocating funds from large to small and medium-sized farms;  
V. Payments to farmers working in areas with specific natural constraints, to compensate them for their higher production costs;  
VI. Coupled payments related to production, which are granted in order to protect specific agricultural sectors;  
VII. A simplified system where small farmers get paid up to €1,250 to offset their administrative costs.

The implementation of the first three schemes is compulsory, while the last four are optional. Member States need to allocate 30% of their direct payments budget to the greening component, while the remaining 70% is used to fund the basic payment scheme and the remaining types of payments.

In general, direct payments represent a stable form of income for farmers, as they are based on the number of hectares of agricultural land the farmers manage and are decoupled from any type of agricultural production. As such, these payments have a stabilising effect on farmers' income, since they complement the more variable revenues coming from market sales (which depend on production and price levels).

Indeed, several studies indicate that direct payments account for around a third of farmers' income in the EU-28. For instance, a Commission analysis covering 2010–2014 shows that direct payments represented 28% of agricultural income during that period. A study by European economic interest grouping, Agrosynergie, found that without direct payments, farm incomes would have fallen by 27% in the 2004–2007 period. It also points out that these payments represented around 50% of the income for livestock farms, 40% for crop farms and mixed farms, and 30% for dairy farms.

**Safety nets in the Single Common Market Organisation (sCMO)**

The Single Common Market Organisation (sCMO) in Pillar I of the CAP, as laid down in Regulation (EU) No 1308/2013, establishes the rules on market management for specific agricultural products. The CMO contains several provisions enabling the EU to intervene in agricultural markets during severe price crises or disruptions:

- **Market intervention mechanisms** involve public buying, storage and disposal of agricultural products by EU authorities and providing financial support for the private storage of these products. Public interventions can only be made for wheat, barley, maize, rice, beef and veal, butter and milk powder at a fixed price and during certain periods. For instance, interventions for butter are possible when the price drops below €246.39 per 100 kilograms. Private storage aid can be granted on a case-by-
case basis for sugar, olive oil, flax fibre, butter, cheese, milk powder, bovine meat, pig meat, sheep meat and goat meat.

- The Commission may also take *exceptional measures* in the case of serious market disturbances caused by plant or animal diseases, natural disasters or health risks. These measures can be supported by a newly created crisis reserve which involves an annual amount of €400 million for the 2014–2020 period (in constant 2011 prices) and is funded by a 1.3% reduction in direct payments higher than €2 000.

- Under certain circumstances, the Commission can also authorise *producer organisations* to take temporary measures to manage supply in order to stabilise agricultural markets, for instance through Article 222 of Regulation (EU) No 1308/2013.

A number of agricultural sectors also receive specific types of support included in the sCMO, such as quotas on the production of sugar (which will expire in 2017) and schemes promoting the consumption of milk, fruit and vegetables.

On 14 March 2016, the Commission activated a number of *exceptional measures* to support EU farmers in dealing with the current agricultural crisis, particularly aimed at the dairy, pigmeat and fruit and vegetable sectors. Article 222 of the sCMO was thus activated for the first time, enabling producer organisations, inter-branch organisations and cooperatives in the dairy sector to establish *voluntary agreements to temporarily reduce their production and supply*. Other actions included a temporary acceptance of state aid up to €15 000 per year, an increase in the intervention limits for skimmed milk and butter to 350 000 and 100 000 tonnes, and an additional €30 million to support the promotion of agricultural products.

While market intervention measures were a key component of the CAP in the first decades after its creation, they are now regarded more as 'safety nets' for farmers, only to be activated during crises. As such, they are used as instruments to manage (extreme levels of) volatility on agricultural markets, especially when prices are very low.

**Risk management tools in rural development programmes**

The risk management tools included in the CAP are currently part of Pillar II on Rural Development, as laid down in Articles 36 to 39 of Regulation (EU) No 1305/2013. This means that EU Member States or their regions have the option to include these measures in their rural development programmes. If the measures are implemented, they are partly financed by the EU and partly by the Member State itself. The following three risk management instruments are available for the 2014–2020 period:

1. **Insurance**: Farmers can take out insurance to protect their crops, animals and plants, and will be compensated by the insurance company if they experience serious production losses. These losses should be higher than 30% of the average annual production in the last three or five years and should have been caused by animal and plant diseases or adverse climatic and environmental events. In order to be insured, farmers need to pay a fee (called a 'premium') to the insurance company. The rural development measure promotes the use of these forms of insurance by financing up to 65% of the premium costs.

2. **Mutual funds** are financial reserves based on the contributions of the participants and are used for compensating farmers experiencing serious production losses. These losses should also be the result of animal and plants diseases or adverse climatic and environmental events. The EU encourages the use of mutual funds by giving financial
support for their creation and the compensatory payments they make to farmers. Financial aid is also limited to 65% of the costs, while losses should be higher than 30% of the average annual production in the last three or five years.

3. The **Income Stabilisation Tool (IST)** is similar to a mutual fund, with the difference being that the former compensates farmers for **income losses higher than 30%** of their average annual income in the past three or five years, instead of production losses. The rural development measure can be used to create an IST and compensate farmers. In order to be classified as a 'green box' measure by the WTO, farmers' compensation can be triggered only for losses higher than 30%, with a maximum compensation of up to 70% of lost income.¹

The financial contributions may only be related to the administrative costs of setting up the mutual fund and to the amounts paid by the mutual fund as financial compensation to farmers. In addition, the financial contribution may relate to interest on commercial loans taken out by the mutual fund for the purpose of paying financial compensation to farmers in the case of a crisis situation. In the current IST, no contribution by public funds can be made to the initial capital stock (Article 39(4) of Regulation (EU) No 1305/2013).

On 14 September 2016, in the context of the **review of the 2014-2020 Multiannual Financial Framework (MFF)**, the Commission **proposed** some enhancements to the Income Stabilisation Tool. The proposed changes, subject to the ordinary legislative procedure, are the following:

- considering that farmers are exposed to increasing economic risks and those risks do not affect all agricultural sectors equally, Member States should have the possibility to help farmers with a **new sector-specific income stabilisation tool**, in particular for sectors affected by severe income drops (requests had been made by Member States for the dairy and meat sectors);

- for the IST for farmers in a specific sector, the compensation can be triggered when the **drop in income exceeds 20%** of the average annual income of the individual farmer in the preceding three-year period or a three-year average based on the preceding five-year period excluding the highest and lowest years.

- considering the difficulties in the implementation of the IST, a **public contribution to the initial capital stock** of the mutual fund will be allowed;

Overall, these amendments could potentially improve the implementation of the IST, but this would be better assessed by examining the impact of a sector specific IST.

**In the 2014–2020 period, almost €2.7 billion** have been allocated on **risk management tools**, of which €1.7 billion is funded by the CAP Pillar II budget and €1 billion by the Member States. At least one risk management tool was included in the rural development programmes of Italy, France, Romania, Portugal, Hungary, Croatia, the Netherlands, Lithuania, Latvia and Malta, and of two regions: Castilla y León and Flanders. Insurance premiums are projected to receive €2.2 billion, while this amount is €357 million for mutual funds and €130 million for the Income Stabilisation Tool. However, despite this increase, the share of the CAP budget spent on risk management is still very low, as it represents only 2% of the Pillar II budget and 0.4% of the total CAP budget for the 2014–2020 period. There are also large differences in the share of farmers potentially covered by these measures.
According to a study conducted for Parliament’s Committee on Agriculture and Rural Development (AGRI), the risk management instruments included in the CAP suffer from three main weaknesses. Firstly, their inclusion in Pillar II leads to large differences between Member States and their regions in how they implement the available instruments, and as a result there is no harmonised EU approach to risk management. Secondly, this also means that introducing new risk management tools in Pillar II would involve a reduction in the budget for other important support measures in Pillar I. Thirdly, the conditions for receiving support through insurance schemes, mutual funds, and the Income Stabilisation Tool are rather demanding because they have to comply with strict WTO rules.

In general, insurance schemes are the most developed instrument, while the implementation of the mutual funds, and especially the Income Stabilisation Tool, remains very limited. Only two Member States and one region (Italy, Hungary and Castilla y Léon) are currently using the IST, while three Member States (France, Italy and Romania) support the creation of mutual funds. A major problem for the IST is that it requires precise measurements on farm incomes which are largely unavailable at the moment, while mutual funds often struggle to attract a sufficient number of participating farmers. Nevertheless, the Income Stabilisation Tool could become a promising risk management tool for farmers if it is further developed and tested.

Stakeholders’ view

COPA-COGECA, the organisation representing farmers and agri-cooperatives in the EU, acknowledges the challenge of extreme price volatility and observes that the current low prices for agricultural products have made EU farmers rather pessimistic about their future prospects. In terms of policy instruments, they have supported the maintenance of the CAP’s existing two-pillar structure with direct payments and rural development, while advocating the strengthening of market management measures and risk management tools as safety nets for farmers. They also urge the EU to implement policies to reinforce the weak bargaining position of farmers in the food-supply chain and enhance the role of producer organisations and cooperatives in managing agricultural markets. According to COPA-COGECA, the potential of other instruments to deal with price volatility, such as insurance schemes, futures (see page 10) and a margin protection system as implemented for dairy farmers in the USA (see page 11), needs to be further investigated, but these should remain voluntary options for farmers.

Environmental NGOs, such as BirdLife Europe and IFOAM EU, argue that the CAP should be more targeted at environmentally friendly practices and family farming instead of further encouraging the industrial intensification of European food production. These organisations therefore advocate a redistribution of the CAP budget from the income support in Pillar I to the more targeted measures in Pillar II. They also regret the creation of expensive risk management instruments within the Rural Development Pillar, as these compete for funds with measures aimed at the provision of public goods, such as biodiversity preservation and social inclusion.

Agricultural think-tank Farm Europe expects that volatility will remain an issue and observes that the CAP is currently spending less than 1% of its budget on supporting insurance schemes, while more than 60% is used for direct payments unrelated to market fluctuations. They argue that this policy framework has been insufficient to mitigate the effects of price volatility, as is demonstrated by the ongoing crisis in the dairy sector. According to Farm Europe, both EU and national policies have a role to play
in helping farmers to manage their risks, by providing appropriate tools such as insurance schemes and strengthening the existing risk management tools.

**European Parliament**

On 23 February 2016, Parliament’s Committee on Agriculture and Rural Development (AGRI) organised a hearing on tools to reduce price volatility in agricultural markets. Five academics and experts were invited to give a presentation on the topic and engage in a discussion with MEPs. They provided an explanation of the concept, causes and consequences of price volatility and gave an overview of the different approaches and instruments which the EU could adopt to address this phenomenon.

In the final presentation, representatives of the Commission's Directorate General for Agriculture and Rural Development (DG AGRI) outlined its position by discussing the long-term trends in agricultural prices and farmers' income. The Commission argued that the most worrying development for the agricultural sector is not price volatility alone, but rather the co-existence of three parallel trends: volatility, co-movement of all commodity prices and the uncertainty of farmers about future price levels. While recognising that agriculture is confronted with volatility, the Commission noted that these volatility levels are higher for the fertiliser and energy sectors.

The Commission defended the CAP approach by arguing that decoupled direct payments reduce income volatility by providing financial support independent from market fluctuations. This support allows market signals to help producers make the optimal production decisions. In contrast, it stated that targeting prices is ineffective and fails to stabilise income in open economies, as previous experiences of over-production have shown.

It also compared the EU and US agricultural policy in terms of results, observing that EU farm incomes have been less volatile and have declined less in recent years than farm incomes in the USA. The Commission' conclusion was that the EU should not focus on price volatility, but rather address income volatility as a priority.

The hearing ended with a final round of questions and discussions. In general, both the policy experts and MEPs seemed to agree that there is no single or 'silver bullet' solution to tackle the issue of price volatility.

On 10 March 2016, the AGRI Committee decided to launch an own-initiative report on CAP tools to reduce price volatility in agricultural markets. In the draft report prepared by Angélique Delahaye (EPP, France), the Commission is recommended to facilitate the introduction of contractual relations by adapting competition law; to further develop the risk management tools, particularly the various types of insurance and mutual funds; and to implement a European agricultural price observatory for the various agricultural sectors.

**Other possible policy instruments**

**Insurance schemes**

**Crop or livestock insurance**, which protects farmers' production against natural risks, is the most developed type of insurance in Europe. Private insurance against single risks, in particular against hail and frost damage, exist in every Member State. In several EU countries, farmers also have access to combined insurance policies covering multiple types of natural risks, including droughts, fires and floods. These agricultural insurance schemes are mostly subsidised in part by the relevant national governments.
There are significant differences in the implementation of these insurance schemes, not only in terms of the number of farms covered, but also in the amount of losses that have to occur before the insurance company makes compensatory payments to farmers. Spain has one of the most developed insurance regimes for both single-risk and combined insurance, in which the national and regional government subsidise up to 60% of the premiums farmers pay to their insurance provider.

**Income and revenue insurance** schemes are less common in the EU, especially when compared to the United States. These schemes may be more attractive for farmers as they protect them against falls in farm income or in the value of their production, but are more difficult to implement because it is difficult to collect the necessary information on these two indicators. Moreover, it should be noted that the WTO considers the US insurance support schemes to be trade-distorting 'amber box' measures.

**Futures**

Futures are contracts in which a buyer and seller agree to trade an amount of (agricultural) products for a fixed price on a certain date in the future. These contracts always have standardised conditions and are traded on public exchanges. In practice, futures are more a financial product than an actual trade agreement, since a large majority of the contracts are settled through transactions on an exchange.

Futures can be an effective tool for farmers to deal with price volatility, as they may provide them with a fixed price for their products and enable them to estimate these prices at the beginning of the production process. However, engaging in futures also entails several disadvantages for farmers. In the first place, if the future exchanges are not functioning properly, it is possible that farmers will not receive the price agreed in their contract. The use of this instrument is also rather costly: futures contracts are managed by brokerage firms which demand commissions and fees, and the complexity of this tool often requires farmers to undergo training and/or hire financial advisors. These costs can make futures unattractive or unaffordable for farmers, especially for those with small farms.

Crucially, futures do not reduce price volatility on agricultural markets; such volatility is a necessary condition for their effective functioning. Indeed, if agricultural product prices do not change over time, financial actors searching to profit from price movements would not invest in futures and the farmers' contracts would fail. Moreover, there is evidence that excessive speculation on futures can lead to artificial price bubbles and therefore even increase price volatility for farmers.

There are currently a number of exchanges in which farmers can trade futures for agricultural products, the largest ones being the ICE Futures Europe in London and the MATIF in Paris. Nevertheless, the use of futures remains rather limited in the EU, especially in comparison with the United States, and not every agricultural sector has the same possibilities to engage in this instrument.

**Food supply chain measures**

In recent years, EU policy-makers have also paid increasing attention to the functioning of the food-supply chain, which refers to the process by which food is produced, processed, transported, and eventually sold to consumers. Specifically, there are concerns that some parts of the chain abuse their market power and create unfair trading practices (UTPs) which can magnify the negative impact of price volatility for EU
farmers. For instance, larger and more powerful actors, such as food producers or retailers, might be able to impose contracts to their advantage when dealing with small farmers and cooperatives, resulting in the farmers receiving lower prices for their agricultural products than they should.

The Commission addressed this issue in its 2009 communication *A better functioning Food Supply Chain in Europe* and launched a *High Level Forum for a Better Functioning Food Supply Chain* in 2010 to provide recommendations on food chain issues. One of its main projects involved the creation of a voluntary code of conduct for the food and retail sector to promote fair business practices, called *the Supply Chain Initiative*, although this has only led to very modest results in practice.

More recently, on 7 June 2016, Parliament adopted a *resolution* on unfair trading practices in the food supply chain. The main provisions of the resolution, which was based on an own-initiative report ([2015/2065(INI)](https://www.europarl.europa.eu/doe/document/rapporteur/K-06-2015-0286_EN.pdf) prepared by the Internal Market and Consumer Protection committee (rapporteur Edward Czesak (ECR, Poland)), concern the power imbalances in the food supply chain. The resolution also stresses the limitations of the voluntary Supply Chain Initiative and urges the Commission to assess the effectiveness of both regulatory and non-regulatory measures in tackling unfair trading practices.

### The United States' Dairy Margin Protection Programme

The 2014 US Farm Bill introduced the *Dairy Margin Protection Programme* (DMPP), a new voluntary risk management tool for dairy farmers. This programme essentially insures the margins of producers, which are defined as the difference between the national milk price and the average feed costs. This margin is calculated by the US Department of Agriculture on a monthly basis.

Every year, US dairy farms can choose to protect 25 to 90 percent of their historical production (based on the three past years) and to cover margins ranging from US$4 to US$8 per hundredweight. Producers are required to pay an annual registration fee of US$100 and an insurance premium if their margin coverage exceeds the basic coverage of US$4 per hundredweight. The programme makes compensatory payments to farmers when their margins fall below their selected coverage levels within a determined two-month period. As such, dairy producers are protected from declining milk prices, rising feed prices, or both of these risk factors.

More than half of the US dairy farms are currently participating in this programme. However, it is unclear whether a similar programme aimed at protecting margins could be implemented in the EU, as there are large differences in cost prices between the EU Member States. Moreover, this programme requires a high and unpredictable amount of public expenditure by the US Government, and it is likely that the WTO will categorise the DMPP as a trade distorting 'amber box' measure.

### Outlook

Price volatility is expected to remain a major concern for farmers in the near future, as economic, environmental and political factors will continue to put pressure on agricultural markets. In particular, the impact of climate change on farmland might lead to **greater instability in agricultural supply**, while the prices received by farmers will continue to depend on global market conditions, in a context where the EU is working actively on international trade agreements such as the Transatlantic Trade and Investment Partnership (TTIP) and the EU-Canada Comprehensive Economic and Trade Agreement (CETA).

It is likely that the CAP will continue to focus its policies on helping farmers to deal with the negative effects of price volatility and on addressing income volatility, rather than attempting to prevent price volatility as such. This means that market interventions, as
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included in the single Common Market Organisation, will remain exceptional measures only to be activated when prices are considered to be excessively low.

Direct payments, which reduce income volatility for farmers by providing them with a stable form of revenue, will probably continue to play a role in the CAP after 2020. However, while its different components can contribute to several policy goals, this instrument might come under increasing scrutiny from public policy-makers. A possible weakness of this instrument is that it does not take into account the specific conditions in agricultural markets, as the amount of financial support farmers receive remains the same regardless of whether prices are high or low.

A political shift towards the further development of risk management tools, especially a revised Income Stabilisation Tool, will be at the core of the debate on the future of European agricultural policy. Indeed, on 14 September 2016, in the context of the MFF review, the Commission proposed some enhancements to the Income Stabilisation Tool. Furthermore, most likely in summer 2017, the Commission is to present some policy options for the CAP post 2020.

In any case, the role of the Parliament as co-legislator will be crucial in determining the policy framework of the CAP for the post-2020 period.

Main references

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Endnotes

1 The WTO categorises subsidies in ‘boxes’ according to the colours of traffic lights. For the agricultural sector, there are ‘green box’ measures, which are allowed because they are considered to cause only minimal or no distortions to trade, and ‘amber box’ measures, which are seen as significantly trade-distorting and should be reduced as soon as possible. For more information, see the WTO Background Fact Sheet on Agriculture negotiations.

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