

# PROPOSALS TO DELIVER GREATER PRICE AND GROSS MARGIN TRANSPARENCY IN THE EU FOOD SECTOR

Submission to the European  
Commissioner for Agriculture  
and Rural Development Phil Hogan



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## Introduction

1. Action at European level to legislate and regulate for the proper functioning of the food sector is required particularly to provide for full disclosure of profit margins enjoyed by major food retailers. In most of the OECD economies, Governments are concerned about price formation at various stages in the food chain from farmers to consumers. Many OECD governments have put new mechanisms in place or have revamped existing mechanisms to monitor prices in the sector and to analyse trends and developments. The comprehensive work and recommendations of the High Level Forum For A Better Functioning Food Supply Chain is a good example of this work but it now needs to be acted upon and supplemented by EU legislation where required in order to bring about better price transparency in order to support the effectiveness of action by Member States and voluntary action by stakeholders in the food sector.
2. The objectives of the CAP as set out in Article 39 of the Treaty on the Functioning of the European Union—(herein after referred to as TFEU) are;
  - (a) to increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilisation of the factors of production, in particular labour;
  - (b) thus to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture;
  - (c) to stabilise markets;
  - (d) to assure the availability of supplies;
  - (e) to ensure that supplies reach consumers at reasonable prices.
3. The question that should be posed and answered by the EU Commission is whether or not the food retailing sector is contributing to the attainments of this Treaty provision and what are the EU institutions doing to ensure that the food sector at all levels is properly regulated to give full effect to this Treaty provision.

## Factors influencing market income of EU farmers

4. Agricultural commodity markets alone, despite a projected unprecedented and sustained global increase in demand for food linked to increasing population, are unlikely to offer higher income returns to EU farmers. Most medium-term projections for the agricultural sector show food commodity prices at levels above historical averages, but this is partly due to expectations of higher energy and other production costs.

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5. However, farmers' margins are not expected or are unlikely to increase. Furthermore, the opening of access to EU food markets will lead to stronger internal price competition, especially in the livestock sector. For some products, this will open new non-EU markets. With a decrease in direct payments and market interventions by the EU the need to ensure a fair standard of living for farmers from the market place becomes an imperative to fulfil the Treaty obligations set out above.
  6. Furthermore, price volatility is expected to remain significant due to a series of factors, among which are: - uncertainties over energy markets, increased extreme weather events due to climate change, the financialisation of commodity markets and the use of distorting measures (e.g. export restrictions which are likely to increase in the future) which should add to the natural instability of agricultural markets.
  7. The proper functioning of the whole food chain in the EU is central to the favourable development of the market income (total farm income less EU direct payments) of EU farmers.
  8. It is of some significance that Article 38 of the TFEU now specifically provides that;

***“[t]he internal market shall extend to agriculture ... and trade in agricultural products”.***

The text of the Article then defines agriculture products as:-

***“products of the soil, of stockfarming...and first-stage processing directly related to these products”.***

9. Thus I would contend that the requirement of the internal market now extends to the totality of the EU food chain. Furthermore, given the Treaty basis for such, there is an obligation on the EU to give proper effect to this Treaty provision which was brought about by the Lisbon Treaty.
10. Economic analysis shows that the overall competitiveness of the EU food chain and its economic growth have underperformed as compared to the overall EU economy since 1995 (average value-added growth has been 2% lower per year than average growth in the EU). Moreover, the EU food sector is facing increased competition from international suppliers and developments including virtual free trade under WTO. The episodes of significant food price volatility have demonstrated the immediate impact of increases in agricultural prices. Market sub-sectors along the food supply chain suffer from a low and asymmetric price transmission as well as a lack of price transparency and predictability.

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11. Farmers consistently lose out – in particular due to the concentration of market power upstream and downstream (in term of inputs) and an unequal bargaining power among the various parties along the food market chain. The abolition of the milk quota has and will add to this “inequality of arm” in terms of trade with the EU.
  12. With the continuing growth and concentration of firms at the farm input stage, food processing and food retailing, the pendulum has swung even more to the detriment of farmers in recent times. Indeed it may not be an exaggeration to say that farmers are now locked into a type of “corporate feudalism”, bound by unfavourable contractual terms on the purchase of farm inputs and sale of farm produce.
  13. Overall, although prices on food commodity markets are set to remain above historical levels, the agricultural margins and incomes will not grow from the current low levels due to higher input costs and increasing price and production risks. In addition, the relatively weak position of farmers in the food chain invariably means that they bear a disproportionate share of the risks within the chain.
  14. Specialised and local markets offer an alternative, but are not fully developed and sometimes lack the right framework. Innovative production techniques will also be increasingly needed for environmentally-friendly farming, but these will in most cases be at best income neutral from a farmer’s perspective.
  15. Longer-term perspectives for farm families are not as favourable as that increasingly portrayed in the media, the popular press and indeed some members of the farming press and commentators.
  16. What then is required to stem this economic adverse flow against the EU farming sector and EU family farms in particular? The key to improving margins for farmers is to bring about a proper functioning of the EU food sector both at processing and at retailing levels. There is quite considerable agreement, right across the political spectrum, in virtually every Member State, that the EU food market is not operating efficiently or fairly and that farmer and consumers both lose out.

## **Required changes at EU level**

17. A recent paper by McCorrison<sup>1</sup> states that the food sector poses additional problems and issues for anti-trust authorities in addressing competition. These are as follows:-

First the food supply chain is a complex series of interrelated markets where competition at different stages of the supply chain affects the overall functioning of this food sector. Concerns over competition may

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<sup>1</sup> Steve McCorrison, Competition in the Food Sector - Working Paper No. 11, TRANSFOP Transparency of Food Pricing, University of Exeter.

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relate not just to the issue of selling power but also buying power and both can affect the relations between any of the stages in the food supply chain that is retailer–processor or retailer/processor–farmer.

Second, there is universal concern over the farmers’ role in the food sector and the need for increased transparency on how farmers are treated and tied in to the overall functioning of the food chain. This reflects concerns that even if consumers benefit or at least are not harmed by competition at the retail stage of the food chain, the increase in bargaining power of food processors and retailers have a negative impact on the farmer sector.

Finally, the sensitivity over food pricing coupled with the complexity of the food chain has increased the demand from greater transparency in the functioning of the food sector and how prices and competition at and between various stages impact on price transmission along the chain.

18. In a report published in 2014 by the Policy Department in the European Parliament<sup>2</sup> the lack or imbalance in bargaining power was succinctly put as follows:-

“Bargaining power: the output prices received by farmers, as well as the input prices paid, are critical to the economic viability of the family farm. While farmers generally are price takers in the supply chain, small family farms are particularly vulnerable within the supply chain as they lack the power to negotiate with food processors and/or input suppliers. The significant power of large corporations in the food chain, dominating both the processing of agricultural outputs and the production of inputs, means that farms are being squeezed in the middle. Indeed, in the EU’s Public Consultation “The role of family farming, key challenges and priorities for the future”<sup>3</sup> the majority of respondents identified “bargaining power” and competition with large corporations” as the principal threat to the economic survival of family farming”.

19. A Report by the Irish Parliament in 2010<sup>4</sup> focussed on the relationships between suppliers and retailers within the grocery trade in Ireland. The Report found that the high price Irish consumers are paying can partly be attributed to inefficiencies within the supply chain which is mainly caused by retailers retaining profit margins three times greater in Ireland than elsewhere. Whilst the Committee accepts the higher cost of doing business in Ireland, it cannot accept that the price differential should be higher than the difference in the cost of business. More transparency with regard to profits made by multiples, through legislation, would shed light on the actual cost of doing business in Ireland. This would in turn show whether the higher prices in Ireland can be justified. In Ireland, 80 per cent of the retail grocery trade is controlled by three

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<sup>2</sup> CAP 2014-2020, Tools to Enhance Family Farming: Opportunities and Limits In-Depth Analysis.

<sup>3</sup> (EC 2014), European Commission (2014), Public Consultation “The role of family farming, key challenges and priorities for the future.”

<sup>4</sup> The Joint Oireachtas Committee on Enterprise, Trade and Employment - Report on Supplier-Retailer relationships in the Irish Grocery Market 2010.

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players – Tesco, Musgraves and Dunnes. Across Europe however, this is not unusual. In some of the Baltic States, two players have 80 per cent of the market share. In Sweden three retailers also have 80 per cent market share and in Denmark, three retailers account for 90 per cent of the market.

20. In a further report of the Irish Parliament in 2013<sup>5</sup> a list of 13 recommendations were made regarding the proper functioning of the Irish food retailing sector. I would like in particular to refer to recommendation six of that report which states as follows:-

“the Committee considers that there is an urgent need for greater transparency with regard to information published by large retailers. The Committee recommends that legislation should be introduced to force the publication of profits and turnover of the large multiples and large processors operating in this country.”

21. Having regard to the fact that some of the large retailers in Ireland are governed and controlled by legislation in other Member States and publish group accounts with no breakdown by Member State, there is no effective way for this recommendation to be implemented in full, if at all, by domestic Irish legislation. For Member States, this issue can only be properly and effectively addressed and resolved by EU legislation.

### **Tackling unfair trading practices (UTPs) at EU level**

22. The EU Commission in its Communication, July 2014, on tackling unfair trading practices in the business to business food supply chain<sup>6</sup> stated that the increased concentration and vertical integration of market participants across EU have led to structural changes in the food supply chain. These developments have been comprehensively documented by many agencies and Governments for the past 20 years at least.

23. It is significant that the EU Commission in its Communication stated that these developments have contributed to a situation of **significant different levels of bargaining power and economic imbalances in individual trade relations between the actors in the [food supply] chain**. The EU Commission rightly concludes that while differences in bargaining power are common and legitimate commercial relationships - it is the abuse of such differences that lead to unfair trading practices (UTPs).

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<sup>5</sup> The Joint Committee on Agriculture, Food and the Marine Report on the Grocery Goods Sector:- *‘Increasing equity and transparency in producer-processor-retailer relationships’*

<sup>6</sup> COM/2014/0472 final

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24. However it is therefore somewhat surprising, given this structural basis for potential UTPs, that the EU Commission, at that time, did not foresee regulatory action at EU level to address the issue of UTPs but rather encourage stakeholders and Member States to tackle UPTs.
25. In my view this is not a proper and necessary response as these regulatory issues can only be effectively addressed at EU level given that many, if not most, of the major food retailing companies operate in more than one Member State. No individual Member State is in a position to effectively address this problem by national legislation or regulations.
26. I am encouraged by the comments made by Commissioner Hogan to the European Parliament on 2 October 2014 when he stated that he would review any unfair practices in the food supply chain and will introduce legislation on this issue if needs be.
27. The proposed reporting requirements of large food retailers outlined in this submission are a measured and targeted response to the problem of lack of transparency with regard to margins and lack of responses to price changes in the food sector. This lack of transparency directly and negatively affects both consumers and farmer producers.
28. The EU Commission in the conclusion section of its Communication states that a mixed approach i.e. voluntary schemes complemented with credible and effective enforcement is required. However as stated above, it would seem that the EU Commission envisages these enforcement measures as being based entirely on individual Member State legislation only. In my considered view, legislating for greater transparency and disclosure by large food retailers, which operates in more than one Member State, can only be achieved by EU legislation.
29. I am aware of the policy milestones set by DG Growth between now and February 2016 on the supply chain initiative with regard to UTPs generally. While the impact of UTPs in the food sector is rather unique, and thus requiring special regulatory measures, these could be considered in parallel with the work on UTPs currently being undertaken by DG Growth.

### **Proposals for action at European level**

30. Addressing competition in the food sector is not an easy task and is likely to be an ongoing concern particularly due to the likelihood of increased volatility in world agricultural markets and increased emphasis on food security. Effective action to bring about the proper functioning of the EU market requires action at European level. It is neither possible nor desirable that this would be left to individual Member States to apply a raft of different Member State measures which could, or would, lead to a segmentation of the single market for food within the EU. The attempts to implement solutions at Member

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State level may indeed impede rather than improve the proper functioning of the EU food market.

31. Having regard to the principle of subsidiarity, as provided for in Article 5 of the Treaty on European Union the Union, and other Treaty provisions in particular Article 39 of the Treaty on the Functioning of the European Union, the EU can and must take action on this important matter as it is more effective than action taken at Member State level.
32. Effective monitoring of the food sector to ensure proper functioning and competition requires detailed data and information including in particular the direct monitoring of margins of large food retailers and processors.
33. The High Level Forum for a Better Functioning Food Supply Chain, established in 2010, has issued a number of reports which have contributed significantly to the issues of business to business trading practices and food price monitoring other aspects of the food supply chain. In its last report (Report 2014 -Ref. Ares(2014)3414151 - 15/10/2014) the Forum in recommending that its work be continued, stressed the need for measures to eliminate unfair practices in business to business relationship and that they should remain a priority. In addition it stressed that the new Forum should stimulate further progress on the food price monitoring tool (FPMT) and the establishment of more national price observatories.

The farming organisation COPA-COGECA endorsed the Principles of Good Practice, but decided not to join the initiative. In its position paper, The Future of the Common Agricultural Policy post-2013, COPA-COGECA proposed at page 10 that:-

“Farmers and cooperatives should be provided with up-to-date market intelligence including margin and price transmission in the food chain and forecasts;”

34. In a document accompanying the Forum's 2014 report (The State of Food Prices and Food Price Monitoring Europe), in paragraph 6.3 the Forum deals with improvements in the FPMT which should be envisaged. Specifically it states that:-

“The question of whether the FPMT should go beyond price indices and include absolute prices is controversial. Price indices are useful for comparing relative trends in prices for various product categories, but they are not suitable for gauging changes in gross margins, which might be partially measured by absolute prices. However, price indices are the most appropriate statistical tool available for describing price changes for product categories with high internal variability, which include most foodstuffs when considered at European level. Absolute prices may be considered for some specific, relatively standard products (e.g. certain agricultural commodities) only and would probably be of only limited value for cross-supply-chain analysis;”

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35. I agree that price indices are not suitable for gauging changes in gross margins for the major food items which I believe are critically important with regard to eliminating or reducing the level of UTPs by large-scale retailers. The proposal in this submission will complement the existing and probably enhanced work of the FPMT at Member State and at EU level but without any significant increase in burden on commercial operators, National Statistics Institutes or the EU Commission services.
36. The EU established the European Food Prices Monitoring Tool in 2009 and while this tool facilitates comparisons and monitoring of food prices, it does not allow for direct monitoring of margins in the food chain. It would seem that direct monitoring of margins of large scale food processors and retailers would require new EU legislation.
37. The quantification of the profit margins in the farm inputs sector, the food processing and the food retailing sector is the key to getting real and permanent progress on this important matter at European level. Major firms in these sub sectors should be required to provide greater price and margin transparency.
38. With regard to the food wholesale and retailing sector, there should be specific EU legislation making it mandatory on food retailing firms that exceed certain thresholds to supply information and data on the gross margins they obtain on specific food items for each of the Member States in which they operate. Gross margin is here defined as the difference between the purchase price and the selling price. The firms covered by the proposed mandatory price reporting requirement would be required to provide their average monthly purchase price and selling price for specific food items. The well established procedures currently followed by National Statistical Institutions for the compilation of national and EU statistics would provide a good template on how this could be effectively and efficiently achieved at low cost. I attach a short note on the procedures in an Annex to this paper. The Eurostat-OECD list of over 350 comparable food products or items for Purchasing Power Parities calculation would provide a well-defined and established list from which specific food products could be chosen for gross margin monitoring.

This obligation should only apply to large scale food wholesalers and retailers where the scale of the activity is above certain thresholds for example:-

- Food wholesalers and retailers operating in more than one Member State
- Food wholesalers and retailers with turnover above a certain threshold
- Food wholesalers and retailers that have more than 8 per cent of the food retail market in any one Member State or more than 5 per cent of the aggregate food retail market in two or more Member States.

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These food wholesalers and retailing firms should be required by EU law to report on the margins they obtain and provide this data, categorised by Region or Member State, on a monthly basis. The thresholds referred to in this paragraph are merely by way of demonstration and the setting would require detailed consideration so as to ensure that there was no unnecessary increase in compliance burden on food wholesalers and retailers that are not in a position to materially influence the functioning of the food wholesaling and retailing market in the region they operate in.

39. The proposals contained in this proposal paper would be relatively simple to implement and would effectively address an EU wide problem at EU level. The cost and burden on firms required to provide the data on their markets would be relatively low. However the gains would be potentially great by providing for systematic greater transparency in the food market place and all levels. This transparency is required for the proper functioning of the EU food retailing sector.

40. Greater transparency would prevent the abuse of the undoubtedly dominant position currently enjoyed by the large retailers. The resulting benefits would not alone accrue to the consumers and farmer producers but the transparency measures would also protect food processors and all other food retailers operating in the European Union from UTPs regardless of their scale of operation.

Finally, it is my considered view that data on gross margins are essential to give farmer members of Producer Organisations, established under recently enacted EU legislation, an equality of arms in negotiating prices with food wholesalers and retailers.

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## **Annex:**

### **Extract from the Irish Statistical Institute (CSO) Manual for the compilation of the Consumer Price Index**

This manual describes the five yearly updating, of the Consumer Price Index (CPI) and the procedures applied by the Central Statistics Office (CSO) to produce the CPI, the Harmonised Indices of Consumer Prices (HICP) and associated price indices.

#### **3.3 Centralised price collection: general procedure**

Central price collection is typically used where national pricing applies (e.g. health insurance), or where local price collection would not be suitable. There are 126 item headings for which prices are collected centrally through postal, e-mail, telephone enquiries along with internet price collection. All 126 item headings are used in the compilation of the CPI, and 118 item headings are used in the compilation of the HICP (e.g. mortgage interest is excluded from the HICP).

Price data are collected from one central source (e.g. trade associations, Government departments etc.) whenever possible. Where appropriate, prices are collected from a sample of retailers/service providers for the good or service in question. Frequency of enquiry varies across the range of item headings with monthly, quarterly or annual price collection being used as appropriate. In some limited number of cases, price changes will be included as necessary. Typically, this would apply to services where prices are set by a service provider and change at a particular pre-announced point in time, e.g. electricity.

#### **Eurostat-OECD Methodological manual on purchasing power parities**

Eurostat, the OECD and 47 participating countries work together in establishing purchasing power parities, or PPPs, in order to compare the price and volume levels of the GDPs. This programme is called the Eurostat-OECD PPP Programme. The Methodological Manual, 2012 edition, gives a complete, detailed and up-to-date description of the functioning of the programme.

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This includes its organisation, the various surveys carried out by participating countries and the ways PPPs are calculated and disseminated. It also provides guidance on the use of PPPs.

### **PPP product list for consumer goods and services**

PPPs are calculated on the basis of prices for comparable and representative products, collected by all participating countries. The list of products used in the 2012-2014 cycle of price surveys for consumer goods and services can be found at <http://ec.europa.eu/eurostat/web/purchasing-power-parities/overview>.