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FOOD PRICES

After thirty years of falling global food prices in real terms, a surge in prices for agricultural products has been taking place in the last two years. Although today's food prices are still, in real terms, lower on average than they were in the 1980s, the increase is quite impressive. Between September 2006 and February 2008, for example, wheat prices in Europe increased by 96 % and prices for dairy products by 30 %.

Causes

The food price surge has been caused by a variety of factors. Some of them are linked to temporary circumstances, others are deeper-rooted and of a structural nature. Essentially, its main driving forces come from outside the European Union.

Demand for food products is increasing because the world's population is growing and living standards in large emerging countries like China, India or Brazil are rising. The result is not only quantitatively higher demand, but also a change in consumption patterns, particularly with increasing meat consumption. Stronger demand for meat means a boost for livestock production which in turn leads to increased demand for cereals to be used as feedstuffs, contributing to the rise in prices for agricultural products.

Moreover, demand stemming from **bio-fuel** production is increasingly entering into competition with food product demand, inducing a shift in supply from crops devoted to food to energy crop production; this trend strongly impacts in particular on prices for maize and soybeans. Again, this factor mainly has to be considered on a global level, bearing in mind that the USA is the world's major producer of ethanol, followed by Brazil, whereas in the European Union currently less than 1 % of cereal production is used for bio-fuel production.

P R E S S

Rising **oil and energy prices** are also driving up prices of agricultural products, because farmers are facing higher input prices, for instance for the use of machinery and fertilizers, and transport and food processing costs are increasing. According to a World Bank study, a 10% rise in crude oil prices translates into a 1-2% increase in food prices.

Price movements have been strongly influenced by a contraction in the **supply** of agricultural commodities. A structural factor relevant in this regard is the slowing down of growth in **cereal yields**, which concerns Europe in particular, but is also the result of underinvestment in developing countries. Furthermore, several temporary factors on the global supply side have been affecting food prices:

- Adverse **climate conditions** in 2006 and 2007 were the cause of exceptionally poor harvests, for example in Australia. These temporary effects may be the sign of lasting climate changes, which in the short term could lead to increased instability of agricultural production due to extreme weather events and which in the long term are likely to have a negative impact on supply due to reduction in cultivable land.
- Historically low levels of international **stocks**, especially in cereals, made it impossible to compensate for the shortfalls and to cushion the price surge by releasing a sufficient quantity of stocks.
- A number of major producer countries have imposed **export restrictions** to avoid domestic shortages, further tightening the market situation.
- **Financial speculation** may also have influenced agricultural prices, with a shift in investment markets towards commodities against the backdrop of low interest rates and global imbalances.

Impact

While soaring food prices are a worldwide phenomenon, their impact, of course, varies considerably depending on the conditions in different countries.

Most severely affected are the world's poorest populations in developing - and especially in some less developed - countries which are net importers of food and therefore particularly vulnerable to price increases on the world agricultural markets. Recent food riots have shown the acuteness of the problem.

In Europe, the hike in food prices is not only being felt by low income households, but is also contributing to an increase in overall inflation.

As far as farmers are concerned, crop producers have benefited from higher cereal prices, whereas livestock farmers who depend on cereals and oil seeds for feed have come under pressure. In the longer term, however, higher food prices may offer new opportunities for farmers in Europe as well as in developing countries by making agricultural production more profitable.

1. Prospects for the evolution of food prices

Food prices have probably passed their peak and are beginning to fall. It is expected that they will move along more moderate lines in the near future. Nevertheless, they are likely to remain higher than in the past as demand will continue to increase owing to global demographic growth, combined with rising income levels and changing consumption patterns in emerging countries.

Europe's response

The different reasons behind the agricultural commodity price increases need further and deeper analysis, including as regards the future effects of climate change on agricultural production. The European Union will continue with this task and closely monitor developments. At the same time, it has started action to respond to problems generated by the situation on the food market, both internally and at an international level.

Measures at EU level

In order to moderate price increases in the European Union, a number of concrete short-term measures have already been taken:

- the compulsory set-aside regime whose main purpose is to limit production by leaving a given percentage of arable land uncultivated has been suspended for 2008, thus increasing the volume of arable land available for food production;
- the milk production potential has been increased for 2008 by raising the milk quotas;
- Community intervention stocks, i.e. stocks established in order to support agricultural activity in the EU by maintaining prices, have been released;
- export refunds, which give an incentive to export by compensating the difference between higher internal and lower world market prices, have been significantly reduced;
- import duties on almost all cereals have been suspended.

In addition, some member states are considering temporary measures to mitigate the impact of food price increases on low income households. In this respect, the European Council will stress that any measures of this kind should be short-term and targeted so as to avoid undesirable repercussions on the development of wages and prices.

But the European Union will also address the issue of food prices in Europe through a medium and long-term approach.

- It will continue to enhance the **market orientation** of agricultural production, helping it better adapt to evolving demand. The revision of the Common Agricultural Policy (CAP) currently under way, the so-called "CAP health check", will offer an opportunity to further underpin this orientation.

- In order to promote **supply** of agricultural products and ensure **food security**, the "CAP health check" will also include consideration of measures such as permanent abolition of the set-aside requirement, phasing-out of the milk quota system and elimination of the current energy crop premiums.
- Energy crop production must be compatible with agricultural production for food and feed. The possible adverse impact of the **bio-fuel** sector on food production needs to be assessed and, where necessary, measures have to be taken to correct shortcomings and to ensure the sustainability of bio-fuel production. In this context, the development of second-generation bio-fuels made from by-products such as agricultural waste and thus not competing with the food sector opens promising prospects and will be encouraged.
- Emphasis has to be put on **research** and innovation in agriculture to enhance its productivity and energy efficiency.

Moreover, certain member states are planning to reform restrictive legislation in the **retail** sector in order to improve the functioning of the food supply chain by strengthening competition.

The European Union will also strengthen monitoring activities in commodity-related **financial markets** and their impact on price movements.

Initiatives at international level

The surge in food prices primarily affects the developing countries. To alleviate the most urgent needs, the European Union is already providing **food aid** and humanitarian assistance. A significant additional amount for urgent humanitarian food aid will be made available in 2008. Moreover, the European Union will finance safety net programmes for the support of poor and vulnerable population groups

But a more lasting solution aimed at reducing the gap between demand and supply requires the **development of the agricultural markets** in developing countries. The European Union will encourage strongly supply-oriented agricultural policies in those countries and stands ready to help by assisting in the use of risk management instruments, financing agricultural inputs and fostering public and private investments in agriculture. Particular attention will be paid to small-scale farmers. In this context, the European Development Fund will provide substantial aid for agricultural development potentials in African countries.

For a consistent longer term response to the global challenges posed by the food crisis, **coordination** with Europe's international partners is essential, in particular with the G 8 countries, the United Nations, and other international organisations. The establishment of the UN High-level task force on the global food security crisis is a step in this process. The recent FAO summit in Rome has also provided an opportunity to discuss the issues at stake in a forum of 181 participating countries. The European Union is determined to play its full part in implementing the summit declaration.

In its dialogue with third countries as well as in international forums such as the WTO, the European Union will seek to **discourage food export restrictions** in order to enhance the availability of food supplies.

Furthermore, the European Union will promote **sustainable production of bio-fuels** and **efficient use of energy** also at international level. In the long run, measures in that direction, by helping combat climate change and reducing dependence on oil markets, will help tackle some of the factors underlying the spike in food prices as well, and in particular the problem of rising **oil prices**. To address this latter problem, the European Union will, in addition, enhance the dialogue with oil producing countries and foster competition and transparency in energy markets, besides EU internal measures such as modernising transport systems and encouraging renewable energy sources.

More generally, it is important to work towards a **stable global macroeconomic environment** in order to limit price volatility and the economic and social risks associated with it.

For more detailed information see also

- note from the Council (ECOFIN) to the European Council on "Recent developments in food prices - main drivers and policy responses", Council document n° 10326/08,
- communication from the European Commission: "Tackling the challenge of rising food prices - directions for EU action", Council document n° 9923/08.
