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NOTE

From:	General Secretariat of the Council
To:	Delegations
Subject:	The EU pigmeat sector and market mechanisms

Delegations will find in Annex, the response from the Commission to Member States requests for use of market measures in support of the Union's pig meat sector as follow-up to the AGRIFISH Council of 17 January 2022.

ANNEX

The EU pigmeat sector and market mechanisms

In a nutshell

- The market developments in the sector since March 2020 have been very unstable and raised concerns. They have gone beyond seasonality, aggravated by exogenous factors (ASF, China trade, COVID).
- The relative short production cycle allows effective supply reaction to demand signals.
- Small producers are to be found in most Member States but the sector is mainly concentrated in three main Member States accounting for more than half of total production.
- The size of pig farms varies significantly across and within Member States. The level of vertical integration is also varying.
- Given that diversity, rural development and State aid measures appear as the most appropriate. Some market support measures could also help, should Member States and stakeholders take the necessary steps.
- Granting a lump-sum of liquidity aid to the sector could be counterproductive and raise questions about its nature and scope.
- Member States are invited to consider measures under Article 222 (collective actions by farmers and their associations) or 220 (in areas under veterinary restrictions due to African Swine Fever (ASF)), under the Common Market Organisation (CMO), in addition to rural development and State aid measures.
- Member States are also invited to consider the pigmeat sector in the design of their CAP Strategic Plans, including their risk management measures.

1. The EU pigmeat sector

1.1. Market developments since 2018

The pigmeat sector has gone through a roller coaster period. EU pig prices[1] increased by 43 % from December 2019 to March 2020, driven by dynamic demand, in particular from China confronted with wide-ranging outbreaks of African Swine Fever (ASF).

[1] Monthly EU average weighted price for Class E

After peaking in March 2020, prices went down gradually until January 2021 (-33%), following the restoration of pig production in China, the impact of the Covid pandemic on pigmeat served in food services and the further spread of ASF in more EU Member States.

The upward cycle restarted towards a new peak in June 2021 (+ 28%), driven by the reopening of the economy after strict lockdown throughout 2020.

From that peak, the downward trend has been constant until November 2021 (-21%) as it became clear that economic recovery was not enough to counterbalance increased EU pig production and a slowdown in EU exports to China. Indeed, in 2021 production increased despite low prices and farmers' margins coming under pressure due to surging input (feed and energy) costs. Production growth took place in several of the biggest producing Member States, in particular Denmark, Italy, the Netherlands and Spain. Production decreases were only recorded in Germany and some smaller producing Member States.

Today's situation allows for cautious optimism. December prices were 2% higher than the November dip and January prices are rather stable and slightly increasing. This is encouraging as, in the normal production cycle, prices fall at this time of year before rising in spring. In addition, piglet prices started increasing as early as October and the trend has continued until now, showing producers' confidence in the future.

1.2. Seasonality

Apart from the above mentioned external shocks, the pigmeat sector is used to seasonal cycles: demand usually peaks in summer, known as the barbecue effect, and in late autumn to secure traditional supply for Christmas. There are thus cyclical low price periods, especially in the first months of every year, owing to reduced slaughter during the Christmas break and lower demand from the retail sector.

At Member State's level, there can be relative stronger price impacts, which may be over-represented in public debates. This applies to both peaks and dips.

While in 2019 and 2020, prices were mainly influenced by exogenous factors (demand from China, the impact of the Covid pandemic and the further spread of ASF), pigmeat prices in 2021 followed the seasonal pattern. The aggravating factor is increased production.

1.3. The pig production cycle

The pig production cycle is rather short. It is longer than the poultry cycle but much shorter than the bovine one. Piglets are typically weaned 1 month after birth. Their fattening starts when they are 2 months old and finishes some 4 months later.

This short cycle coupled with a relatively high level of vertical integration of the sector allows for demand signals to quickly reach the supply side, allowing the latter to adjust.

1.4. A concentrated sector

There are 250 million pigs slaughtered each year in the EU. There are in turn 1.5 million pig producers, but with production very heavily concentrated. 2% of producers account for 75% of production, which is in turn concentrated in a few Member States: 3 Member States represent more than 50% of EU production: Spain, Germany and France.

Romania accounts for 60% of total pig farms in the EU but 99% have less than 10 pigs. At the other end of the spectrum, Denmark accounts for less than 1% of total pig farms in the EU but 72% have more than 1 000 pigs. The variety of situations is detailed in the statistical Annex.

1.5. An export oriented sector

The EU trade balance for pig meat is hugely positive. The EU is the world's most important exporter of pig products, ahead of the United States, Canada and Brazil, importing only very small quantities.

Exports are to a large extent driven by demand from Asian markets. There has been a very strong increase in exports over the last years, in particular to China. This growth has come to an end with the recovery of Chinese production and subsequent lower import demand. Nevertheless, China is still the first destination of EU pig products.

To reduce their dependency on the Chinese market, EU exporters are searching for alternative markets. Worth mentioning in this respect are the Philippines and South Korea. Yet, increased exports to other destinations do not offset lower volumes exported to China.

ASF also plays a role in pigmeat trade: many third countries block market access for Member States where the disease is present. This is the case for the EU's main destinations (China, Japan, South Korea, and other mostly Asian countries), which means that Member States, like Germany or Poland, are banned to export to those countries.

Spain, Denmark, the Netherlands and Germany are the EU's leading exporters that cover together three quarters of the EU's exports (6 million tonnes in 2020).

1.6. The challenge of rising input costs

The recent surge in input prices, mainly triggered by high energy prices and bottlenecks in the supply chain arising from COVID, is impacting on the entire EU economy. This includes the agri-food sector. There has been a big increase in input prices and especially those inputs critical to the EU's food production systems such as fuel, fertilisers, minerals and animal feed. The costs of all of those commodities have risen very sharply.

Agricultural inputs have increased by 13% according to the latest Eurostat available data (Q3-2021) during the year 2021,. Some inputs have been under particular pressure, such as fertilisers, energy and feed, growing by respectively 28%, 25% and 16% from Q3-2020 to Q3-2021. The situation was further amplified in the last quarter of 2021, with a peak in natural gas prices and, as a consequence, for nitrogen fertilisers, the price of which are strongly correlated. In December 2021, the World Bank fertiliser index was 164% above its level one year previously.

Most of the other farm inputs remained contained within normal range of inflation. Over the same period of time, agricultural output prices remained at good levels and increased by 8%. To date, the impact on farmers' incomes has been contained in most agricultural sectors by the higher prices they receive, with the important exception of the pig meat sector. There are nonetheless concerns that this situation could be changing and that the agri-food sector in general risks to be squeezed by higher costs not fully compensated by higher selling prices.

However, the expectation from the main international and European organisations remains that there will be a moderation of inflationary pressures in general in the course of 2022 and a return to more stable price trends, including for energy prices. This has already started with natural gas decreasing by 50 % since its peak on 20 December, nitrogen fertilisers prices stabilising and freight price indices decreasing. The increased costs and prices levels in agriculture are transmitted slowly through the food supply chain. Following two years of moderation in food prices, the level of yearly food inflation increased in December 2021 up to +4.3% at EU level (from a level close to zero in the first half of 2021), with some Member States being more exposed (up to +12%) than others (below +2% in several MS). Overall, the situation in relation to prices has been highly volatile and future trends will require close monitoring in relation to their impact on producer prices, farmer incomes and consumer food prices.

The problems of the **pigmeat sector** have been particularly compounded by the surge in input prices. The pigmeat sector is especially exposed to increases in animal feed costs, which is its single biggest cost input. As mentioned above, boosted by the prices of grains and oilseeds, feed costs for the sector have risen sharply over the past twelve months. This was partly offset by falls in prices for piglet prices, the second biggest input for the sector, which fell by 10% during the same period.

The aggregate impact of these price trends – sharply falling producer prices, higher feed costs, lower piglet costs - was to reduce the "surplus" available to the sector (see chart in the statistical Annex).

The pigmeat sector has been especially impacted and unlike many other sectors it has been unable to recover these additional costs through higher producer prices. The prospects for recovery in the sector will obviously be very dependent on future trends in relation to input prices.

2. Market support measures (Regulation (EC) No 1308/2013)

The pig sector operates in a market oriented framework. There has never been a product specific support within the CAP. Coupled support explicitly excludes the sector and public intervention has not been open for decades to pigmeat. The sector itself has the capacity to adapt quickly and to adjust production in response to market signals. Any intervention would risk sending the wrong signal and actually encourage producers to maintain or, worse, to increase production.

This, as well as the diversity of the sector across Member States, explains why Member States are invited to use rural development measures, state aid possibilities and *de minimis* measures to provide targeted support to the most impacted farmers.

There are also measures under the Common Market Organisation (CMO) which could be considered. For example:

- Under Article 220, there are compensation measures for market losses related to veterinary measures taken to fight against animal diseases.
- Under Article 222, the Commission is ready to look into exemptions from normal competition rules for pigmeat producers in relation to, for example, the planning of production.

The other possibilities under the CMO have important limitations.

2.1 Private storage aid (PSA) – Article 17

The safety net under the CMO does not foresee public intervention for pigmeat. It only provides for aid for private storage to be granted when there is a particularly difficult market situation.

This possibility does not enjoy broad support from the sector itself in the present situation, as it would postpone or even make the problem worse, because the relevant stocks would eventually have to find a market at a later stage. It would also not be of real interest to smaller scale pigmeat producers. It must also pass the test of available storage capacities, which is a particular challenge for the moment.

Private storage aid was efficient when sporadically used in the past, because the stored meat could ultimately be exported. Import bans by China and other third countries make this impossible for Member States, like Poland or Germany, because of ASF. China's reduced demand is also to be taken into account.

2.2 Measures against market disturbance – Article 219

The pigmeat sector is not benefitting from direct payments. It is also explicitly excluded from coupled support. The sector has evolved – and grown hugely - without any significant support or intervention under the CAP.

There is the possibility of taking measures under Article 219, including in the form of budget envelopes allocated to Member States for supporting their most affected farmers. Strong conditionality would be needed to make such a measure compatible with priorities under the Green Deal and Farm to Fork Strategy. Art. 219 has been mainly used in the past for MS to <u>address the market situation</u> (a requirement by law); this has occasionally taken the form of support to their most affected farmers, as a means to ensure the continuity of the market and linked to the condition that farmers make a specific effort to become more resilient (reduce production, participate in a quality scheme, in an environmental scheme, join forces in POs, etc.). In the limited cases where measures under Art 219 have been taken to the benefit of the pigmeat sector, it was never as a stand-alone, but part of an overall measure for livestock.

Importantly, it is highly uncertain that it would help restore market balance, as it could postpone or dis-incentivise adjustment measures.

For all of the above reasons, budget envelopes would be difficult to justify in light of the need to address the market situation and from an economic point of view, as they are not the answer to the current problems.

Article 219 has also been used in the past to operate a voluntary production reduction scheme. While it successfully accompanied the recovery of the milk sector in 2016, introducing it for pigmeat has a number of drawbacks, including a significant deadweight for such a market oriented sector and a substantial cost given the turnover of the sector.

<u>2.3. Exceptional market support measures related to animal diseases – Article 220</u>

The Commission can adopt an implementing regulation compensating market losses generated by veterinary measures that restrict animal movements to fight against the spread of a disease. Such measures were taken in the past when ASF appeared in Eastern Europe for the first time. The uptake by the Member States concerned was very limited.

The measures are of a temporary nature and not designed to grant a permanent income support for farmers keeping animals in areas with an endemic disease.

Such measures are taken at the request of the Member State concerned and must be co-financed by the latter.

2.4. Exceptional market support measures to resolve specific problems – Article 221

The Commission can adopt an implementing regulation to solve a specific market problem that cannot be addressed under Article 219 or 220. Such a measure is limited in time (12 months maximum).

Such measures have been used to a very limited extent in the past. Each time they targeted a very specific problem affecting one or a few MS. For pigmeat, this has been used only once to compensate for the closure of small pig farms located in ASF areas in Poland that could not upgrade their biosecurity level. The requirements to adopt such exceptional support (specific problem, absence of other measures) seem difficult to meet in the current situation.

2.5. Competition exemption for collective action in crisis periods – Article 222

The Commission can, in periods of severe market imbalance, adopt an implementing regulation to exempt (for max 6 months, with possible reconduction once) one or more collective actions (by farmers and their associations, by recognised POs or recognised IBOs) from competition rules, provided that such collective actions do not undermine the proper functioning of the internal market, strictly aim to stabilise the sector concerned and fall under one or more of the categories listed in the CMO, i.e.:

(a) market withdrawal or free distribution of their products;

(b) transformation and processing;

(c) storage by private operators;

(d) joint promotion measures;

(e) agreements on quality requirements;

(f) joint purchasing of inputs necessary to combat the spread of pests and diseases in animals and plants in the Union or of inputs necessary to address the effects of natural disasters in the Union;

(g) temporary planning of production taking into account the specific nature of the production cycle.

Collective actions such as the temporary planning of production could indeed make sense in the present situation, in particular in countries where the sector is scattered.

Art. 222 measures are not accompanied by EU financing.

The activation of Art. 222 in the past proved feasible when based on a concrete action planned by the sector. So far, the Commission has not received any request from the sector to put in place voluntarily and collectively any of the actions listed in Art. 222.

2.6. Impact of potential EU support

When considering any EU support measures, it should not be overlooked who would benefit from any type of support, what would be the consequences and the total cost. The pigmeat sector is a huge sector whose production value has varied between €38 and 40€ billion per annum in recent years. This needs to be kept in mind while assessing the potential impact of any EU support in the current situation.

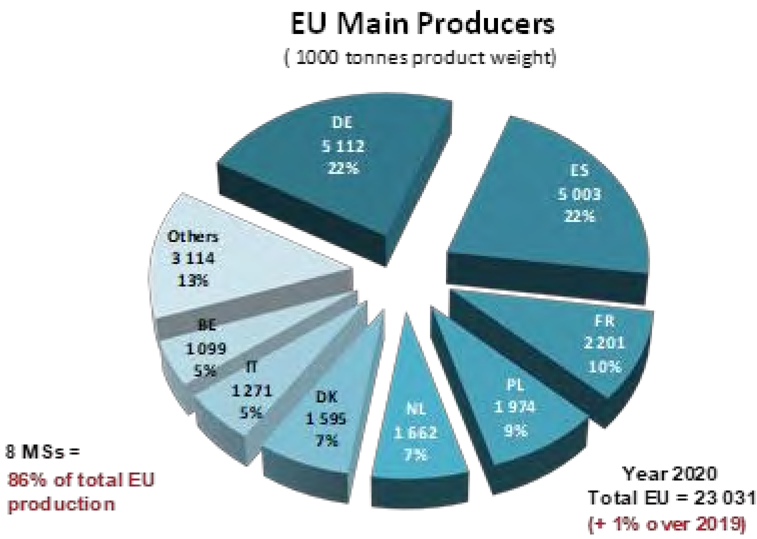
Therefore, any support for exceptional or private storage measures would not necessarily have any meaningful impact given the sheer size of the sector. Given the heavy concentration of the sector, both geographically and in terms of size of holdings, it would be very difficult to avoid the aid going to the biggest producers in the biggest Member States. The requirement for some form of conditionality would also lead to reductions in production. The end result could, therefore, be to make the sector even more concentrated.

2.7 The way forward

The sector is clearly suffering in the current conditions. However, the sector itself did not strongly advocate for market support measures under the CAP, reflecting its long-standing market autonomy. The measures most often cited by producers as necessary for a return to more stable conditions are instead the control and eradication of ASF, greater acceptance of EU regionalisation decisions leading to better export opportunities, a stop to the recent surge in input prices (feed costs which account for more than 50% of pigmeat sector input costs have risen by 35% in 2021) and an end to the market disruption caused by COVID. In all of these areas the Commission will continue to work with Member States and stakeholders to improve the commercial environment in which the pigmeat sector operates.

In the design of their CAP Strategic Plans, Member States are to assess the needs of each agricultural sector, including pigmeat, and to put forward an appropriate combination of interventions to accompany agriculture towards more environmental, social and economic sustainability. The handling of the pigmeat sector in Member States' plans is being scrutinised.

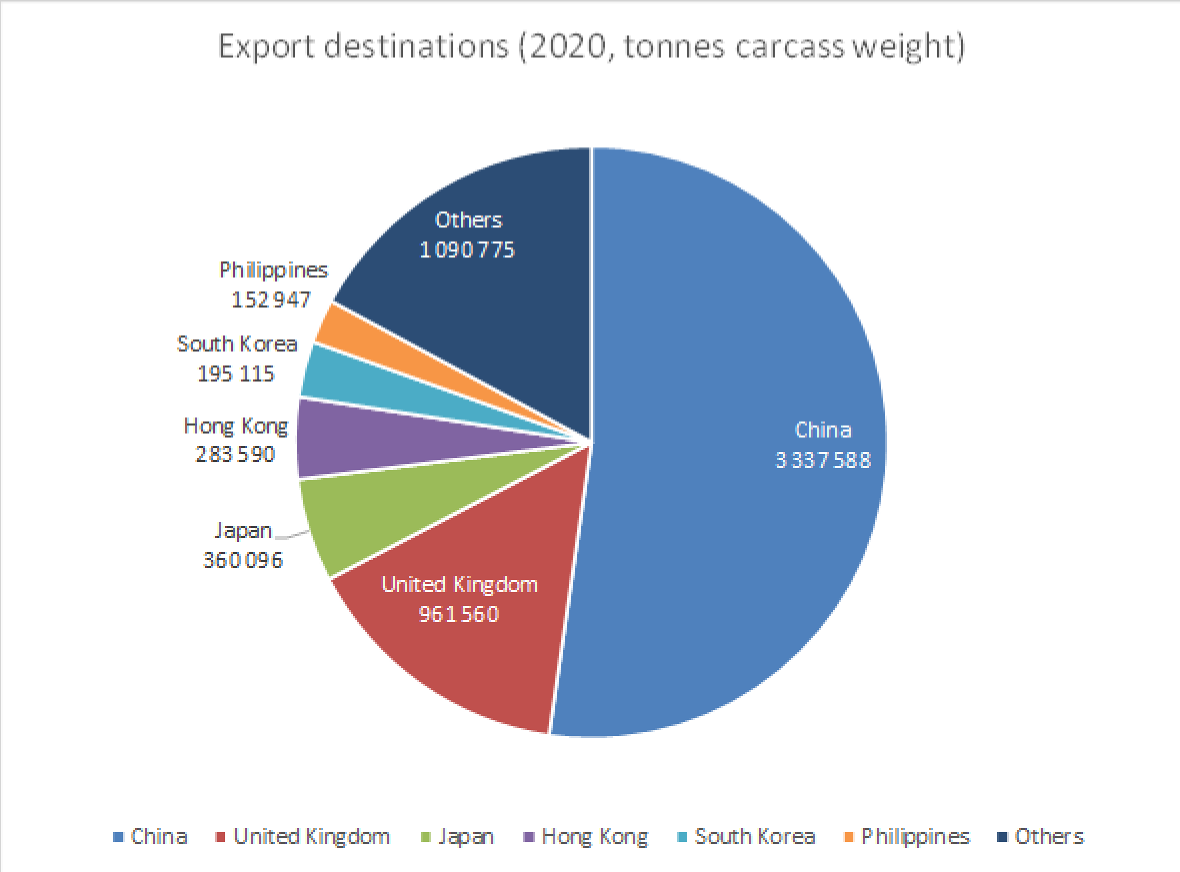
Statistical Annex



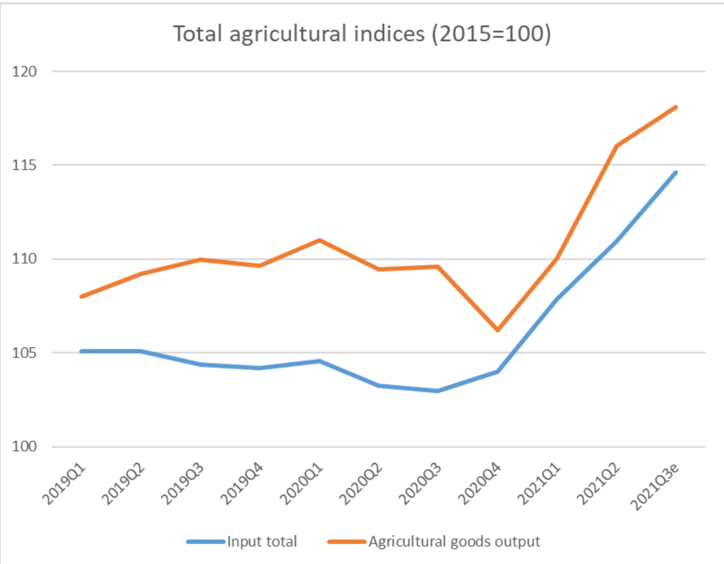
Pig farm structure (2016) covering 'Other pigs' (no 'Piglets' and no 'Breeding sows') as a proxy to pigs for fattening

MS	1-9 heads		10-99 heads		100-999 heads		>=1000 heads		Total farm nr	Total pig nr	% MS' farms in total
	Farm nr	Pig nr	Farm nr	Pig nr	Farm nr	Pig nr	Farm nr	Pig nr			
DE	23%	0%	18%	1%	35%	29%	24%	69%	37.120	17.354.940	3%
ES	52%	0%	13%	1%	18%	15%	17%	84%	35.890	14.445.090	2%
FR	23%	0%	15%	1%	33%	23%	29%	77%	15.390	8.243.480	1%
PL	36%	2%	52%	21%	11%	39%	1%	38%	140.570	7.108.340	10%
DK	8%	0%	7%	0%	13%	3%	72%	97%	3.260	6.830.250	0%
NL	3%	0%	4%	0%	34%	11%	58%	89%	4.360	5.827.510	0%
IT	61%	1%	26%	2%	7%	7%	7%	90%	22.890	5.599.900	2%
BE	5%	0%	4%	0%	45%	22%	46%	78%	4.390	4.181.450	0%
RO	99%	49%	1%	4%	0%	1%	0%	47%	875.010	2.447.680	60%
HU	90%	11%	9%	6%	1%	6%	0%	76%	101.570	2.032.070	7%
AT	66%	2%	12%	5%	20%	77%	1%	16%	25.970	1.853.640	2%
PT	91%	5%	7%	2%	1%	8%	1%	85%	35.620	1.055.010	2%
IE	70%	0%	4%	0%	6%	3%	19%	97%	1.130	1.006.640	0%
CZ	62%	1%	25%	2%	8%	8%	6%	89%	3.740	910.410	0%
SE	21%	0%	14%	0%	26%	13%	39%	87%	1.140	836.810	0%
FI	2%	0%	5%	0%	65%	37%	27%	63%	1.210	576.660	0%
HR	72%	23%	27%	24%	1%	11%	0%	42%	50.150	543.970	3%
BG	97%	9%	2%	2%	0%	4%	0%	85%	28.460	473.200	2%
EL	82%	4%	14%	4%	3%	11%	1%	81%	10.870	365.200	1%
LT	98%	21%	2%	2%	0%	3%	0%	75%	27.240	343.920	2%
SK	87%	4%	10%	3%	2%	9%	1%	85%	4.940	292.490	0%
LV	91%	9%	8%	5%	0%	4%	0%	83%	10.140	247.100	1%
SI	87%	30%	11%	19%	2%	33%	0%	18%	22.010	181.430	2%
CY	77%	0%	13%	0%	0%	1%	10%	99%	300	151.650	0%
EE	31%	0%	25%	1%	19%	2%	25%	97%	160	139.860	0%
LU	22%	0%	22%	0%	22%	9%	33%	90%	90	59.580	0%
MT	0%	0%	22%	2%	67%	55%	11%	42%	90	27.670	0%
EU27	85%	3%	10%	3%	4%	20%	2%	75%	1.463.710	83.135.950	**100%**

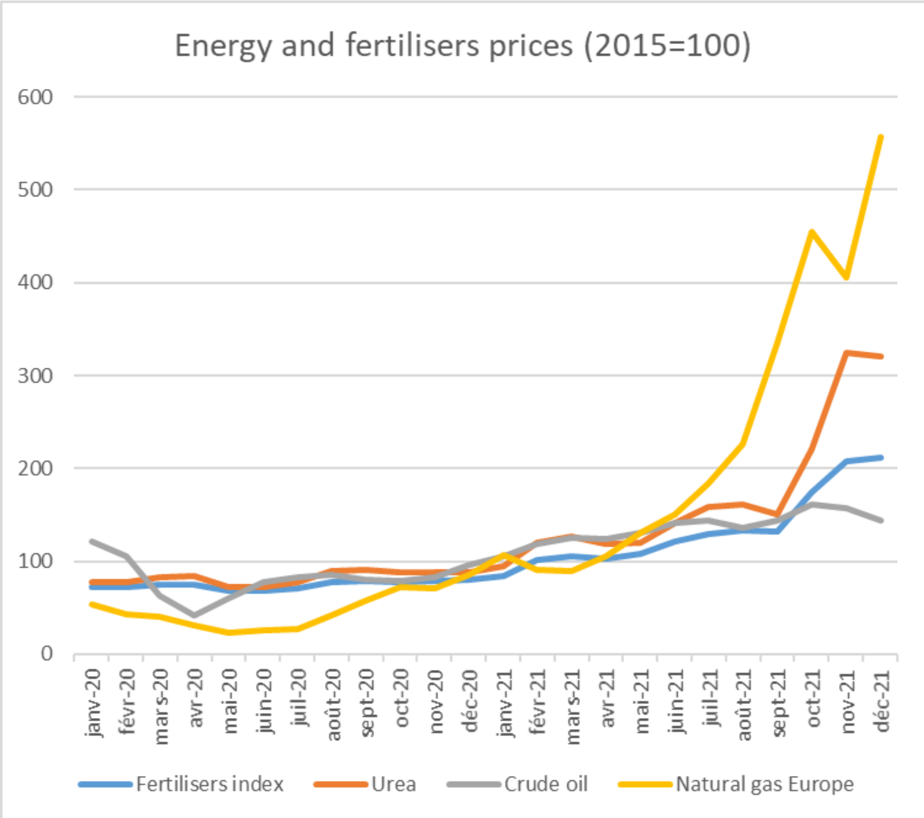
EU export destinations (2020, tonnes)



Input prices



Source Eurostat



Source: World Bank

<u>Pig « remainders » as a proxy for margin monitoring</u>