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***Outcomes of the High-Level Group
on the Competitiveness of the Agro-Food Industry
Proposals to increase the efficiency
and competitiveness of the EU food supply chain***

Accompanying document to the

**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL
COMMITTEE AND THE COMMITTEE OF THE REGIONS**

A better functioning food supply chain in Europe

{COM(2009) 591 final}

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Outcomes of the High-Level Group on the Competitiveness of the Agro-Food Industry: proposals to increase the efficiency and competitiveness of the EU food supply chain

1. INTRODUCTION

In its Communication on "Food prices in Europe"¹, the Commission highlighted that "the food supply chain connects three economically important sectors: the agricultural sector, the food processing industry and the distribution sectors. These sectors account for 6% of EU value added and 12% of EU employment. As the food processing industry and the distribution sectors have many interactions with other sectors, market malfunctioning along the food supply chain can have significant repercussions. The slow productivity growth in these sectors in comparison with the US indicates that there is room for efficiency improvements. A proactive competitiveness policy, such as [...] discussed by the High Level Group on the Competitiveness of the Agro-Food Industry², [...] could contribute to such improvements."

As a follow-up to this Communication, the purpose of this paper is to present the main outcomes of the High Level Group on the Competitiveness of the Agro-Food Industry (HLG).

2. A STRONG SECTOR FACING STRUCTURAL CHANGES AND A LOWERING COMPETITIVENESS

2.1. Basic facts and figures on the food processing industry

According to Eurostat Structural Business Statistics, the food processing industry currently represents 2% of Europe's gross domestic product and 13.5% of total employment in the EU's manufacturing sector. It contributes an annual production of more than €870 billion to the EU economy. The food industry consists of approximately 310.000 enterprises, some of which are global leaders. In value-added terms, the food industry is the second largest sector in the manufacturing industry, after the basic metals and fabricated metal products.

The completion of the Internal Market has brought huge opportunities for the food supply chain. Since its creation, it has enabled the food industry to develop considerably by providing access to 500 million consumers who enjoy a wide range of safe products at affordable prices originating in all Member States. It continues to play a fundamental role in satisfying the needs of consumers.

Furthermore, harmonised EU food legislation continues to contribute to food safety, consumer confidence, free circulation of goods and indeed to the competitiveness of the food industry across the European Union.

¹ Commission Communication on "Food prices in Europe" {COM(2008) 821 final}

² Commission Decision n° 2008/359/EC of 28 April 2008 setting up the High Level Group on the Competitiveness of the Agro-Food Industry

2.2. A lowering competitiveness

However, at this point in time, the entire European food supply chain has entered a period of structural adjustment. According to the results of a study published by the European Commission in 2007³, the competitiveness of the EU food industry is weaker than that of other sectors and other competing countries. Although the agro-food industry remains a significant contributor to employment and value-added growth among EU manufacturing industries, labour productivity and the level of investment in research and development is significantly lower in the food sector. At world level, EU food products are losing market share to Brazil, Canada and Australia. Furthermore, growth in value-added and labour productivity within the EU food industry is outpaced by that of the United States.

The main weaknesses of the European food industry as pointed out in this study are a low level of labour productivity and limited economies of scale and scope leading to lower value added growth. The low level of labour productivity reflects an underlying problem of insufficient investment in research and innovation, which poses a particular challenge for the sector.

There are trends towards concentration in both the food manufacturing and retail sectors. According to the results of the 2007 study on the competitiveness of the food industry (see footnote 3), consolidation in the retail sector is outpacing that of food processors. This evolution has an impact on the relationships between the different players.

Consumer preferences are also changing as a result of income developments as well as shifts in population structures and lifestyles. Customer concerns about prices, food safety and health have also imposed stringent, though understandable, requirements on companies operating in the sector.

In the global context, the liberalisation of trade, as well as the growing prosperity of a number of emerging economies, has provided new market opportunities. On the other hand, the rapid fluctuations in the price of raw materials create significant trading uncertainties for many food and drink companies, in particular Small and Medium-sized Enterprises (SMEs), which account for 99% of the food processing companies.

2.3. The impact of the financial crisis

In addition, the global financial crisis hit Europe in 2008 and the credit squeeze, the fall in house prices and tumbling stock markets produced a slump in consumer confidence, consumption and investment. Even if the food industry was not as severely impacted by the crisis as other industries such as the automotive and financial services industries, it has not escaped the shock. According to Eurostat data, the turnover of the food and beverages manufacturing industry has decreased by 4% between early 2008 and the second quarter of 2009.

2.4. Challenges ahead for the food industry

High safety and quality standards, as well as structural changes and the recent crisis, have placed the European food industry in a fundamentally different “playing field”

³ WIJNANDS J. H. M., VAN DER MEULEN B. M. J. and POPPE K. J., 2007. Competitiveness of the European Food Industry. An economic and legal assessment, European Commission. Brussels, 320 pp. (http://ec.europa.eu/enterprise/sectors/food/files/competitiveness_study_en.pdf)

than the one it faced a decade ago. In this context, the achievement of the EU internal market and the evolution of EU food legislation are relevant.

European policies also have to acknowledge that the food industry evolves in a wider context in which a changing market situation, driven by exciting new technological developments in areas such as Information and Communication Technologies (ICT), biotechnologies and nanotechnologies, presents new challenges and opportunities.

In addition, increased international trade in food and beverages, and cross-border mobility of investment have resulted in significant changes to traditional markets and trading patterns. It has become clear that an essential prerequisite for future growth and competitiveness in the European food industry is the preparedness of the authorities and industry to address the impact of globalisation and to face these challenges and take advantage of the opportunities offered by globalisation. European policies and regulations, in relation to the food supply chain, should ensure that the European agro-food industry can operate effectively within a global network of commodities, distribution channels and mobile investment.

3. METHODOLOGY FOLLOWED TO IDENTIFY WAYS OF IMPROVEMENTS

3.1. The High Level Group on the Competitiveness of the Agro-Food Industry

The High Level Group on the Competitiveness of the Agro-Food Industry (HLG) was set up in 2008 with a mandate to identify the factors that influence the competitive position of the European food industry and to formulate a set of recommendations for EU policy makers. It combined high level representatives from both the European Commission and the Member States together with representatives of industry, civil society and trade associations.

The creation of the HLG symbolised the European Commission's commitment to setting out a "forward looking" approach for the industry while addressing the challenges and opportunities that it currently faces. The aim of the HLG was to promote the competitive position of this key EU industry in global markets whilst ensuring that its recommendations are in line with the Lisbon strategy in facilitating job creation and securing sustainable economic growth.

The HLG Members sought to establish an integrated, holistic approach to their task that would encompass all relevant existing policy areas having an impact on either the supply or demand side of the industry, from farm to fork, taking into account the vision of the respective HLG members for the future of the sector. In the course of their work, they examined ways to reduce costs, where possible, and to enhance the growth and efficiency of the whole food supply chain, from the primary sector to the retail sector, whilst securing sustainable, safe, nutritious, high-quality and diversified food products at affordable prices for the consumer.

3.2. Complementary studies

In addition to the major study published in 2007 on the competitiveness of the European food industry (see footnote 3), the Commission has also ordered an assessment of the impact of Community legislation on the competitiveness of the EU

food industry, focussed on case studies in the dairy sector⁴. One of the objectives of the study was to assess the impact of an EU origin marking scheme.

Following the debates within the HLG, additional studies are being launched, which are expected to deliver their conclusions by mid-2010. A first study will assess the legal and economic aspects of the private labels (retailers own brands) and their impact on the functioning of the food supply chain. A particular attention will be paid to the positive and negative impacts of the private labels on the competitiveness of the SMEs. The study will include an impact assessment of several proposed policy options in this field. A second study will be focussed on a micro-economic approach of the relationships between producers, processors and distributors. Based on a detailed analysis of the costs and on a qualitative approach of the strategies of the operators, the study is aimed at better understanding the relationships between the actors and thus identifying potential issues which can have an impact on the competitiveness of the food industry without falling under competition law.

4. ANALYTICAL RESULTS

The works of the High Level Group and complementary studies have led to the following analytical results and findings⁵.

4.1. Regulatory burden

The European food industry accepts the relatively high regulatory burden related to the European legal framework, which promotes food safety, quality and the free circulation of goods under fair and transparent conditions. Demands from clients also drive food safety and quality systems. Therefore, the industry does not advocate a policy that would reduce regulation at the expense of food safety and quality. Furthermore, it is considered that integration of food safety and quality requirements can alleviate compliance costs.

However, in some aspects of Community law, administrative burdens are less accepted by the industry. The industry would welcome improvements in stability, clarity and accessibility of both legislation and authorities. Authorisation procedures for certain additives and technologies, health claims, labelling provisions and food information are identified as sometimes being unnecessarily burdensome. For the industry, there is also an evident necessity that the EU legal framework remains enforceable, proportionate and is implemented in a harmonised way throughout the EU.

4.2. Access to raw materials

Access to raw materials at competitive prices is vital for the European food industry in order to remain competitive and to provide foodstuffs at affordable prices to consumers. Agricultural price developments in the past three years trigger increased uncertainty on the future state of the global markets and indicate that price fluctuations are likely to occur more frequently in the future.

⁴ POPPE K. J. et al., 2008. Food legislation and competitiveness in the EU food industry. Case studies in the dairy industry. European Commission, Brussels, 135 pp.

⁵ Only key findings are mentioned here. For more information, see the complete report available on: <http://ec.europa.eu/enterprise/sectors/food/competitiveness/high-level-group/documentation/>

From the food industry point of view, it would be of crucial importance to find a way to facilitate sufficient supply of competitively-priced raw materials, as a mean to limit price volatility and achieve sustainable growth for the sector.

Certain aspects arising from the structure of EC agricultural production and from the EU regulatory framework, such as the different timelines for the approval of genetically modified crops for food and feed between the EU and trading partners, restrain access to raw materials for the food industry. On the one hand, these aspects are usually related to health and safety concerns which are of paramount importance for European consumers. On the other hand, the difference of approach between the EU and third countries lead to asynchronous authorisations which have negative consequences on the competitiveness of the EU food industry. The availability of pesticides for the treatment of certain crops of fruits and vegetables in the Community, leading to risks to their continued cultivation in the EU, is another important concern.

As regards animal feedstuff, some stakeholders claim that the current "feed ban" on products of ruminant origin lowers the competitiveness of their businesses as it results in higher management and raw material costs, as well as in challenges related to the quality of the meat products. Therefore, they support the view that the EU legislation needs to be reviewed and developed further where necessary. This is in line with the roadmap of the Commission on Bovine Spongiform Encephalopathy (BSE) and the opinion of the European Economic and Social Committee that propose a review of the current ban.

In any case, authorisation procedures should be based on sound scientific opinion and should aim at protecting the health or safety of the European consumer.

4.3. Innovation

Innovation is one of the major drivers and indicators of the competitiveness of the food industry. Research and Development is driven by new challenges, such as globalisation, environmental sustainability, public health and consumer demand for high quality, healthy, convenient and sustainable food. For instance, eco-innovation is essential in order to meet the growing demand for environment-friendly products. Eco-innovation encompasses all the elements of food supply chain: it can concern raw materials, packaging, logistics, industrial processes, transport, distribution, etc. Therefore, this field of innovation is of utmost importance for the sector as a whole.

The EU legal framework has indirect impacts on innovation. On the one hand, process innovations are stimulated by food law, in the sense that new systems and procedures have to be installed in order to comply with standards.

But on the other hand, product innovations (e.g. the development of new ingredients) require pre-market approval which often entails lengthy procedures. Pre-market approvals are a core requirement of the EU regulatory framework, reflecting a strong consumer insistence that safety should be scientifically proven. Time-to-market of new products is relatively long, compared to the USA where different procedures apply, notably the "GRAS" principle (generally regarded as safe). As a consequence, costs are relatively high and have a negative impact on the capacity of companies to invest in product innovation. This is particularly relevant for SMEs. The regulatory framework in relation to these procedures has recently undergone a major reform which will improve efficiency, transparency and predictability but without weakening the commitment to high levels of safety.

4.4. Internal market for food

The efficient functioning of the internal market is of key importance for the competitiveness of the food industry. Divergent interpretation and implementation of EC law impedes the competition within the internal market, leading to a sub-optimal allocation of resources and an increase in administrative burdens. As regards food safety, for example, business operators should develop, implement and maintain management systems in order to achieve the objectives and meet the requirements laid down in feed and food law. These systems may take account of international standards such as ISO 22000. However, management systems voluntarily developed on the basis of this standard are not recognised by all Member States, which in some cases may create additional administrative costs.

Another example would be the origin marking schemes. On the one hand, it is essential that consumers have access to clear information which allows the identification of cultural or traditional specificities of a product. But, on the other hand, labelling schemes should not restrict the free circulation of goods in the internal market.

4.5. Relationships within the food supply chain

The food chain is composed of a wide diversity of enterprises that operate in different markets selling products to the various purchasers. Several forms of interactions between supply and demand occur at each level of the chain. In the agricultural sector, in the processing industry and in the distribution sector, small and big players are present, each having a different level of bargaining power. In some cases, lack of transparency and asymmetries of information (e.g. between small and bigger processors) regarding price formation mechanisms may have negative consequences on the competitiveness of some players.

Small and medium-sized enterprises (SMEs) represent 99% of the food and drink companies and provide 63% of the employment of the food and beverages sector. Although they respond to the diversified demand that arises from the cultural differences among the EU, they may suffer from a lack of economies of scale. In comparison, the very limited number of large companies generates 52.9% of the value added of the sector and has a significantly higher level of apparent labour productivity. Consolidation and more vertical integration may be seen as a way to increase the efficiency of the food SMEs and to reduce the asymmetry of bargaining power between processors and distributors. But it may also reduce competition on price-related criteria between processors and possibly lead to a lessening of competitive interactions between the remaining market players. Public authorities have their role in making sure that the on-going consolidation process does not worsen upstream and downstream competition conditions at the local level, to the detriment of businesses and consumers.

The market share of private labels (retailer's own brand) has been growing at a quick pace. According to retailer panels, private labels now exceed 30% of the food market in several Member States. Private labels reflect a new form of relationships between processors, retailers and consumers. They often allow SMEs to access large markets. Compared to A-brands, marketing costs are relatively low for private labels. Therefore, consumer prices are generally lower. They are also more reactive: changes in the price of raw agricultural materials have usually more impact on the price of private labels than on the price of A-brand products. Private labels often imply that the consumer has no information concerning the processor. From the

processors' point of view, this absence of visibility may be seen as an opportunity in some cases, especially for non-differentiated products. On the contrary, for differentiated products, processors may be disadvantaged by this lack of visibility. Through private labels, retailers have become direct competitors to their suppliers. This has a significant impact on the structure of the food chain, which deserves to be followed up.

4.6. Trade with third countries

The unprecedented pace of globalisation has brought a huge amount of new opportunities regarding markets and investment possibilities. Progressively opening trade can lead to significant increases in growth and productivity for the sector. In addition, as the EU market is mature, the growth in domestic production is lower than in the past and therefore the development of European food companies becomes more and more dependant on the external dimension and access to foreign markets both for exporting and importing goods. To this end, EU trade and commercial policy is vital to achieve sustainable development and operate under fair trade conditions.

Currently, trade statistics indicate that the European food industry is maintaining its export performance and is a major player on world food markets. However, its share appears to be decreasing overall in the long-run, to the benefit of emerging economies, thus challenging the industry's global competitive position.

EU exporters face a number of barriers such as tariff and non-tariff barriers, diverging regulations, administrative procedures, etc. The increase in counterfeiting in third countries carries another significant threat for the EU food industry.

4.7. On-going analytical work and timetable

As mentioned in paragraph 2.2, two complementary studies are being launched (effect of private labels on the SMEs and structure of costs within the food supply chain). Final reports should not be expected before mid 2010.

5. RECOMMENDATIONS ISSUED BY THE HIGH LEVEL GROUP

On March 17, 2009, the HLG issued a report and a set of 30 recommendations for actions. This was followed by the adoption, on July 6, 2009, of a Roadmap of Key Initiatives with a list of concrete actions aimed at implementing the recommendations⁶.

The group's recommendations cover 5 major areas of interest:

- Agricultural and Environmental Policy
- The Internal Market for Food
- The Operation of the Food Chain
- Research and Innovation
- Trade and Exports.

The nature of the recommendations reflects the composition and working methodology of the group. They constitute a first step towards an in-depth look into

⁶ <http://ec.europa.eu/enterprise/sectors/food/competitiveness/high-level-group/documentation/>

how the food supply chain operates and into the role the framework conditions in the EU are playing in shaping this industry.

The recommendations are consistent with ensuring the enforcement of the better regulation principle; the need for fair participation in world markets; social and economic cohesion concerns; and the need for technology transfer to stimulate innovation. Small and medium sized enterprises were placed at the heart of the discussions at all stages of the deliberation process.

The recommendations of the HLG are addressed to Stakeholders and Member States, as well as to the European Institutions in general and the European Commission in particular.

Out of the recommendations of the HLG and of the related studies, the following axis of work could be put forward in the coming reflections on actions to be taken at Community level.

5.1. Ensure a holistic approach for the European food industry

Adopting an integrated and holistic approach with respect to European Union and National policies would ensure that the specificities of the food chain from the supply and demand side are duly taken into account, thus enhancing the overall sustainable competitiveness of the food industry, from farm to fork, whilst maintaining high food safety standards. This approach would ensure coherence among the different policy objectives and consistency of agreed measures in the design of the industrial policy in the food sector.

5.2. Agricultural and environmental policy

- Continued support for an ambitious development of the Common Agricultural Policy which enables farmers to better respond to market signals, while addressing production and market risks, and the availability of sufficient supply of raw materials at competitive prices.
- Design an environmental and sustainable industrial policy, and promote energy efficiency for the European agro-food industry.

5.3. The Internal Market for Food

- Effective implementation of the regulatory framework on products authorisation.
- Ensure that impact assessments of new food legislation fully take into consideration the impacts on the food processing SMEs.
- Ensure harmonised implementation and enforcement of EU laws by Member States.

5.4. The Operation of the Food Chain

- Promote the adoption of a European-wide code of conduct concerning the contractual relationships between processors and distributors and promote more transparency in the price formation along the food supply chain, in order to reduce the asymmetries of information among the players. Means to reach these objectives would be discussed within the European forum that the HLG recommended to put in place.
- Launch a debate on private labels and consider scenarios which would enhance the visibility of the processors.

- Pay a specific attention to SMEs and cooperatives by enhancing and publicising the existing tools (access to finance, innovation platforms...) as well as by developing new forms of support to small businesses, e.g. for exports (see 4.2.6). Better regulation should also remain an important axis of industrial policy, with a view to reduce burdensome procedures.
- Consider the relevance of promoting increased economies of scale and scope e.g. by financing consolidation in sub-sectors and regions where the atomisation of the processors creates non-competitive situations.

5.5. Research and Innovation

- Further develop support to research and innovation in the food sector on strategic issues (biotechnologies, nanotechnologies, environment-friendly technologies, packaging...), through technological and innovation platforms and regional competitiveness clusters.

5.6. Trade and Exports

- Set up an EU economic intelligence network in order to support European SMEs exporting to third countries.
- Aim at concluding a balanced WTO agreement and/or bilateral free trade agreements allowing a better access of European processed agricultural products to other markets.
- In order to enhance the respect of international property rights by third countries, the Commission may explore the feasibility of setting up a market surveillance mechanism of counterfeiting.
- Promote the uptake of international standards.

6. CONCLUSION

The HLG issued a comprehensive set of recommendations addressed to political and economical actors in order to improve the efficiency of the EU food supply chain.

In the communication to which this working document is attached, the European Commission fully takes these recommendations into account.

**ANNEX: MEMBERSHIP OF THE HIGH LEVEL GROUP ON THE COMPETITIVENESS
OF THE AGRO-FOOD INDUSTRY**

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