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Mandatory Price Reporting

1. Introduction

Market transparency is critical for efficiently functioning dairy, sugar and livestock sectors and is required to underpin the successful implementation of risk management tools that can help to tackle market volatility. Clear market signals on price and volumes traded are necessary to stimulate greater levels of farmer responsiveness to demand by allowing farmers to adjust output accordingly. Lack of transparency leads to a mistrust in market signals and as a result farmers may continue to overproduce as price decreases are associated with market abuse from buyers rather than a glut in supply. Greater visibility of market trends derived from independent market indices therefore serves to enhance the linkages within the supply chain and promote collaboration. Working collaboratively is encouraged as market participants gain confidence on the basis that cross industry decision making is rooted in publically available and audited market information.

In a post-quota world, the dairy sector is in need of reform particularly in regards to increasing on-farm business resilience, improving cross industry collaboration and providing tools to encourage proactive risk management. The abolition of sugar quotas in October 2017 is set to alter industry dynamics which in turn will require producers to respond to a new set of market signals in order to balance production. Lessons from the dairy sector highlight the importance of establishing a high level of market transparency to avoid a significant imbalance in supply. Publically available, robust market data will provide the foundation to support such developments.

2. Managing Price Volatility

The importance of high quality market information for effective price discovery is particularly relevant to the following risk management mechanisms:

2.1 Futures market – Reliable price indices are necessary to allow contracts to be cash-settled. Data must be reliable, accurate and timely in order to provide the investor confidence required to support the necessary levels of liquidity on a futures exchange. Price indexation would also allow reliable convergence to spot market eliminating arbitrage opportunities. Lack of transparency increases the risk of arbitrage (a mark of market inefficiency) which in turn reduces market confidence in the price discovery mechanism on a futures exchange. Consequently, participation in a futures exchange will only become feasible once robust market price and traded volume data is available. This is particularly relevant to the dairy and sugar sectors where derivatives such as futures markets have the potential to play a central role in managing risk.

2.2 Formula pricing – In the absence of reliable market indices a number of retailers pay their liquid milk supplying farmers based on actual cost-of production. Whilst a valuable tool, there is greater potential to incentivise efficient market orientated practices by linking formula contracts to market indices. Most current cost of production based contracts provide no stimulus for farmers to focus on business efficiency as well as output. An example of this is the Dairy Crest Direct liquid formula price which considers movements in five variables (feed, fuel, fertiliser, bulk price of cream and the retail price of milk). This formula pricing mechanism will cease in February 2017.

2.3 Forward contracts – A fair forward price could be negotiated by all parties if supported by high quality independent price and volume data. This helps to eliminate disputes, increase the speed and market responsiveness of transactions which drives market efficiency. There is currently no active market for beet and therefore growers rely on outdated EU sugar market prices as a basis for negotiation. The market share of isoglucose on the EU sweetners market is forecast to grow post 2017. There is currently no EU wide market data on isoglucose (also known as high fructose corn syrup) and such data must be established to enhance the visibility of changing sugar market dynamics post quotas.

2.4 Industry collaboration – Without the privilege of asymmetric market information, something which retailers and processors currently benefit from, greater collaboration across the industry is encouraged. Transparency will improve trust across the supply chain incentivising closer industry relationships. Currently farm-gate and retail milk pricing is well documented but little information is available on pricing and volumes sold within the supply chain. There is no reason why weekly/ fortnightly collated information on UK volumes and prices for spot, wholesale milk and dairy products traded could not be made available.

2.5 Business resilience – Visibility of trends in volumes transacted and industry prices supports less reactive and more strategic planning for farm businesses. Farmers will be able to base investment decisions on market trends and manage production accordingly. A clear understanding of pricing mechanisms supports more accurate forecasting of revenues and in turn better management of cash-flows. This also supports a behavioural shift away from an output orientated management approach (revenue maximisation) to a margin orientated approach (profit maximisation).

3. Required improvements to existing market data

3.1 Dairy sector

Current EU regulations require that member states provide the Commission with collated information on milk volumes and prices paid at farm-gate as well as some wholesale dairy product information. This information is not standardised and Member States can choose what information they provide (due to a different dairy product mix across the EU). This information is collated and an EU wide price and volume is published.

In the UK Defra collects information from most milk purchasers on liquid milk collected from farm in the previous month and the total price paid to farmers for this milk. This is then grossed up and published as the official Defra UK average milk price. As at February 2016 the latest published price is for December 2015 whilst many UK farmers now know their base price for March.

AHDB Dairy collects weekly information on volumes from a number of large milk processors which is then scaled to estimate total UK deliveries using the latest Defra UK production figures.

In light of shortcomings in the above listed data sources, existing mandatory dairy price and volume data collected by the EU under EC regulation 1308/2013, Commission implementing regulation 479/2010 as amended by EC regulation 1191/2011 should be reviewed by the Commission to include the following,

a. Highly standardised product specifications for bulk butter, 40% cream, skimmed milk powder, mild cheddar cheese and liquid milk.
b. Quality and constituent requirements must be standardised.
c. Price and volume data for product contracted and spot traded during the preceding week.
d. Frequency of reporting should be weekly to support market responsiveness.
e. Segmented price and volume data to a member state or devolved region level.
f. Data submissions should be independently audited to ensure data integrity.

g. Data should be collected from manufacturers of the products listed in point A. This includes dairy processors. For the United Kingdom this could be facilitated through DairyUK and PTF.

3.2 Livestock sector

Price reporting is standardised and mandatory for cattle but optional for sheep. Dressing to the EC scale and price reporting is mandatory for all plants processing more than 75 bovines a week. The wording is different for sheep in that,

“The Member States that apply classification of sheep carcasses in accordance with second subparagraph of Article 10 of Regulation (EU) No 1308/2013 **may** decide that the requirements on classification of sheep carcasses shall not be compulsory for certain slaughterhouses .”

And in the second subparagraph of Article 10 of Regulation (EU) No 1308/2013,

“In the sheepmeat and goatmeat sector, Member States **may** apply a Union scale for the classification of sheep carcasses in accordance with the rules laid down in point C of Annex IV.”

The EC scale for sheep is laid out in Regulation (EU) No 2137/1992 and is based on work conducted in the UK by the then Meat and Livestock Commission (MLC), now MLC services ltd.

This difference, whereby the word “shall” used in the legislation for cattle and pigs has been replaced by the word “may” for sheep has led to a situation where not only is there limited scope for price reporting from abattoirs, but also where the actual dressing specifications that sheep are weighed to, and indeed the precision of the measurements used in the UK, are extremely inconsistent.

Mandatory standardisation will encourage competitiveness as farmers will be able to compare “like for like”, with abattoirs having to weigh to 0.1 of a kilo and using a set dressing specification. It cannot be emphasised enough that a simple change to mandatory dressing specifications and price reporting would have a significant impact on market transparency in the sector. The current lack of a consistent EUROP type grading system also stifles market signals, which in the long term means the sector will not meet its full potential in terms of efficiency or profitability.

Existing dressing specifications and price reporting for cattle and sheep collected by the EU under EC regulation 1308/2013 should be amended as follows,

a. Wording to be changed in 1308/2013 to make dressing and reporting to the European Commission scale as set out in 2137/1992 mandatory, in line with that required for cattle and pigs.
b. Cattle price reporting should be reviewed to examine the use of “bonuses”, for example in the Tesco Angus scheme. Bonuses are paid using different methods throughout the industry and can therefore skew the overall deadweight price, as bonus payments may or may not be included in the weekly price reported by the abattoir.

3.3 Sugar sector

Currently monthly price reporting from the European Commission does not reflect a spot price but rather the average price achieved by sugar producers across the EU in the month. This could reflect prices agreed in contracts from six months previously or longer which does not serve as a reliable indicator of current market prices. This is why the EU sugar price tends to lag the world raw and white futures prices by several months or more. Timely price reporting is an important tool for beet growers in their price negotiations with processors.

The abolition of EU production quotas represents an opportunity to alter the current price reporting structure in order to prepare the industry for the post-quota transition.

Existing mandatory price reporting requirements under Article 126 of EC regulation 1308/2013 should be reviewed by the Commission to include the following,

a. Highly standardised product specifications for sugar for food use, non-food use and isoglucose.
b. Quality and constituent requirements must be standardised.
c. Price and volume data for product contracted and spot traded during the preceding month.
d. Frequency of reporting should be monthly to support market responsiveness.
e. Segmented price and volume data to a member state or devolved region level.
f. Data submissions should be independently audited to ensure data integrity.
g. Data should be collected from processors of the products listed in point A.