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COMPETITION AND COMMODITY PRICE VOLATILITY

Contribution from Romania

-- Session I --

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-- Romania --

1. According to the 2009 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*, over the past couple of years, prices along the food supply chain have fluctuated widely. Thus, from mid-2007 to mid-2008, agricultural commodity prices rose sharply at EU level, which resulted in increased consumer food prices and higher inflation levels overall. After mid-2008, under the verge of the global economic crisis, prices of many commodities have come down to levels comparable to or even lower than those reached before the start of the price surge. However, the Communication underlined that consumer food prices continued to increase and only started declining in May 2009 raising concerns about the functioning of the food supply chain. These fluctuations have affected both the agricultural producers and the consumers.

2. Under this backdrop, this paper is organised as follows. Section 1 describes the situation in Romania with respect to the evaluation of the link between agricultural commodity prices and changes in consumer food prices. Section 2 identifies the main challenges faced by the food supply chain in Romania. Section 3 presents a number of Romanian Competition Council's policy initiatives aimed at overcoming them and Section 4 concludes.

1. Evaluation of the link between agricultural commodity prices and changes in consumer food prices in Romania

3. Over the past 20 years, the Romanian agro-food sector has experienced winding developments related to the structural changes and to certain external influences over the sector. The land restitution, the privatization, the price liberalization, the need to adapt to the Community requirements and to other specific policy measures have put its mark on the current national efficiency of the sector and on the international competitiveness.

4. In Romania, agricultural prices increased by 28% in December 2007, compared to December 2006, and decreased by 22% in August 2008 relative to December 2007. Consumer prices increased by 9.3% in December 2007 relative to December 2006. Overall, that means that consumer prices have been more stable over time, while agricultural prices have had very great fluctuations from one period to another. On the contrary, in the period when agricultural prices decreased, following the month of May 2008, the consumer prices continued to slowly increase or stagnated in the best case, while the production prices experienced a significant drop.

5. The volatility of agricultural prices seems to be higher in the case of crop products, on the average, compared to that of animal products. A research paper made by a Romanian expert shows that over the period 2006-2010, the products with the highest price volatility are mainly those that are based on vegetable agricultural products, namely: oils (16.9%), milling and baking products (8.4%) to which we add the products from the group milk, dairy, eggs (9.6%), vegetables (8.9%) and fruit (8.2%).

6. As concerns the volatility of producer and consumer prices, the latest statistics from Eurostat show that the producer food price increased by 69.74% in August 2011 compared to 2005 which means an increase by 28.13% than the value recorded in August 2009 relative to August 2008.

7. Compared to other EU Member States, in August 2011, Romania recorded the most accelerated dynamics of food producer prices, ahead with 48.28 % of the European average, virtually being last-ranked in EU-27. On the contrary, the dynamics of food consumer prices was much lower, but still on a rising trend, i.e. from 21.22% (in August 2009 compared to 2005) to 30.82% (in August 2011 compared to 2005). The increase by 30.82% in consumer prices ranks Romania on the 20th rank, out of the 27 EU Member States.

8. If at European level, consumer prices raised slowly than producer prices by only 2.90 %, in Romania, consumer price hike was 38.92% below producer price hike, in August 2011 compared to 2005.

9. This specific situation from Romania shows that price transmission along the agro-food chains has an asymmetric character i.e. the production price increases even when the agricultural price decreases while the consumer price increases at a much slower pace than producer price.

10. Against this backdrop, one may conclude that the prices along the agro-food chains in Romania feature a higher volatility in the primary stage of chains (agriculture), while in the consumer stage the volatility is lower. This raises certain questions with regard to the operation of downstream markets and mainly to the competition on these markets.

2. Challenges faced by the food supply chain in Romania

11. Given the economic and social importance of the sectors involved in the agro-food chains, the need to identify market failures and, of course, to detect and correct the potential anticompetitive issues, the Romanian Competition Council (hereinafter referred as *RCC*) launched a series of sector inquiries in the field over the last years.

12. The bread cereals (wheat) and the cow milk – the producer-processor economic sector inquiries finalized by *RCC* in 2009, respectively 2010 revealed that the adaptation by farmers to a market environment characterised by a volatility of demand and prices is a great challenge in Romania, especially in the context of the economic downturn and the resulting sharp drop in agricultural commodity prices in mid-2008.

13. The distortions in price variation transmission along the food supply chain presented above may be mainly due to three major problems signalled by *RCC* in the Romanian agro-food sector, with direct impact on the competitiveness and performance of the sector. First, the current high fragmentation of the agricultural exploitations is being reflected in the existence of a large number of individual farms (very small).

14. Second, the asymmetry of the negotiation power between the economic operators on the agro-food chains and the farmers in most cases leads to unilateral price setting for the agricultural products, to the imposition of unfavourable conditions to farmers, to the lack of contracts, or where they exist, they are in beneficial net terms only for one party; Moreover, the Romanian milk producers are in a weaker position in terms of bargaining power because they do not hold shares in the downstream industry, i.e. within the processing firms as it happens in other EU Member States; all these issues affect directly or indirectly the final price received by farmers for the goods they offer;

15. Third, a study on the “*Competition in the food retail sector*” - as a follow-up of the 2009 food retail sector inquiry, - published in the 2010 Annual Report¹ entitled “*The challenges of the single market and the competition in sensitive sectors*” revealed that distortions in the agro-food chain may be due as well to the low level of performance of the processing industry, the increase of imports of cheaper agricultural products and the need of alignment with the EU requirements. That is why the world and European market evolutions in the sector are directly felt by the Romanian consumers.

16. Thus, a significant part of the consumed food products in Romania comes from import, for example vegetables, fruit, even cereals in some poor agricultural years. This situation is due to certain deficiencies invoked by the large Romanian retailers in relation with the national producers. The Romanian producers do not meet the minimum standards required for commercialising fruit and vegetables through the retail networks. In general, they have no equipment for sorting their products, no storage capacity and no appropriate packaging. In addition, the production of Romanian vegetables and fruit records a maximum peak during the summer, the offer for the remaining seasons remaining insignificant. This state of affairs automatically leads to imports.

17. Fourth, the study also pointed out that price growth transmission to final consumers may be much attenuated in Romania, due to the competitive pressures exercised at the level of retail sector. Final consumer’s weaker purchasing power in Romania may have played as well an important role in attenuating the full pass-through of the excessive variations of agricultural prices into the consumer prices. Although foodstuffs are basic commodities and have a relatively inelastic demand, it becomes apparent that in the case of an excessive price increase of these products, consumers will switch to cheaper products or to self-consumption, in particular in the rural areas. Moreover, most foodstuffs are perishable products. Therefore, the operators in the retail sector have no reason to increase selling prices very much when the agricultural prices explode, and they do not decrease them either when the agricultural prices significantly decline.

18. Finally, some regulatory features have as well an impact over the productivity growth in the sectors involved along the agro-food supply chain. We shall further expand on this issue when discussing RCC’s policy interventions in the sector

3. RCC’s Policy Interventions

3.1 Advocacy measures

19. The RCC has undertaken over the last 3 years a series of policy initiatives aimed at addressing distortions along the agro-food chain.

20. In order to resolve the bargaining power imbalances of the parties involved along the agro-food chain, RCC recommended that farmers should associate under different forms allowed by competition law that range from joint commercialisation, such as the use of a common broker, to joint production agreements, including the development of agro-food cooperatives as long as they are not used to fix prices. This measure linked to the CAP support measures was considered by RCC as helpful for addressing the sector current challenges.

21. The RCC has also advocated for an increase oversight and overall transparency of agricultural commodity derivatives markets to encourage competition and improve its resilience to price volatility. Thus, each manufacturer could have accurate and timely information about the prices in the region provided that the local authorities would get involved in the monitoring process and in the dissemination of information related to agricultural product prices.

¹ http://www.consiliulconcurrentei.ro/uploads/docs/items/id6479/the_challenges_of_the_single_market_and.pdf

22. Regarding retail prices, a 2011 initiative of the Ministry of Economy (not yet finalised and therefore the RCC hasn't had the opportunity to give advice on the matter) proposed the establishment of a Price Observer, that would closely monitor the prices in 1400 locations in order to properly inform the consumers. However, this initiative did not materialize yet since it was poorly received by the stakeholders involved.

23. Since 2010, RCC has started to collect and process data on average monthly retail prices of most popular food products (milk, eggs, bread, flour, pork meat, beef meat, poultry) in the biggest retail chains in Romania through its territorial units spread throughout the country. The purpose of this exercise is to grasp the main reasons behind retail price changes and the use of the findings for initiating ex-officio investigations under the National Competition Law given the local nature of food markets. Until now, several investigations have been opened, in order to assess whether a number of undertakings engaged in the marketing of food products, in particular bakery goods have participated in anticompetitive agreements or concerted practices.

24. The findings of the milk market (in the economic segment producer-processor) inquiry were made publicly available during the 2010 October event hosted by RCC and entitled *Competition in sensitive sectors of Romanian economy*. On that occasion, RCC underlined that one of the purposes of the sector inquiries performed by RCC is to ensure the smooth functioning of market mechanisms, with direct effects on the final consumer. But, to achieve better functioning markets, to limit or even eliminate any possible anticompetitive practices, the involvement of all decision makers, not only from the food sector, is necessary.

25. The examination of the milk market highlighted as well that the functioning of the Romanian milk market (the producer-processor segment) is constrained by the statutory rules, largely related to the EU policies in the field and that the provisions of the Competition Law fully applies on the Romanian milk market (there are no legal exceptions for agricultural or for the agro-food sector). Regarding these issues, the competition authority is currently involved in discussions with the Ministry of Agriculture and Rural Development to identify solutions that will lead to a balanced milk market, including in terms of the competition rules.

26. As competition authority, the Competition Council focused constantly on monitoring the regulations in the field, in order to eliminate the potential anticompetitive provisions from the normative acts.

27. Concerning the superior negotiating power of great retail chains, mostly over the small and medium-sized producers, as a result of the 2009 RCC's inquiry on the market of food products commercialization in Romania, some rules have been established in the Supermarkets Code of Practice² endorsed by RCC that stated general rules for an improved relationship between the two parties.

28. The Code was translated into a law³ that mainly followed the conditions of the code but, in addition, settled new payment terms for different types of food products (starting from 12 days). The RCC has issued a recommendation that the proposed payment terms should not be regulated since a standardisation of the contents of the contracts would run counter the principle of contractual freedom and negotiation between parties. The national legislation on the payment time limits is currently producing negative effects for the Romanian producers, certain large retailers confirming already that the regulation of fixed payment terms is encouraging the imports of products because the related invoices enjoy more attractive payment terms (not subject to the restrictions established by Law no.321/ 2009 concerning the sales of food products).

² On 26th of March 2008.

³ Law no. 321/2009 concerning the sales of food products.

29. The Competition Council intervened as well for eliminating the ban on selling below cost and for eliminating the definition of an acquisition cost level below which market prices must not go down, because these principles are contrary to the provisions of the Competition Law. The direct effect of such legislation is that of perpetuating a system that does not allow certain retail chains to decrease substantially the shelf prices. Actually, the RCC has militated against forbidding selling and reselling at a loss, ever since 2000, when the Emergency Ordinance⁴ was first issued. Also, the RCC has recommended that the time criterion for price reductions should be abolished. In fact, in the current form of the normative act, selling below cost is prohibited, except in certain specific situations, specifically mentioned⁵.

30. Yet, certain conclusions and recommendations of the Competition Council have already had the desired effect.

31. First, *RCC* welcomed the proposal of eliminating the MFN⁶ clause from the retailers' contracts by means of an article introduced in the Law no.321/2009 concerning the sales of food products aiming at maintaining a normal competitive environment for all the reselling traders in the market and protecting the welfare of the final consumers. It deserves to be mentioned in this context that *RCC*'s investigation on the market of food products commercialization finalized in 2009 showed that the MFN clause jointly with the shelf tax charged by certain store chains would have induced additional artificial costs for the traditional trade hindering its ability to compete with the modern trade operators.

32. Second, another recommendation of *RCC* (resulting from the same inquiry on the market of food products commercialization) taken up by the Romanian legislator is that addressing the superior negotiating power of great retail chains over the small and medium-sized producers. Thus, the Law no.321/2009 provides that the retailers should not charge the suppliers for compensation in the cases of increasing the selling surface, opening new stores, refurbishing and changes in the bar codes.

33. Third, *RCC* signalled in the autumn of 2010 that the restrictive establishment rules in the current legal framework are in contradiction with the provisions of the EU Services Directive, unjustifiably protects the existing retail outlets and hamper the opening of new stores and thereby the diffusion of innovation. In fact, art. 8 of the Government Decision nr. 1454/2004⁷ states that the authorisation of retail structures should take into account some criteria among which "the favourable influence of the retail price level, the impact on existing commerce, the number and size of competitors, the protection of existing retail structures, the avoidance of competition disfunctionalities etc". The Decision further states that a commission will be established that should comprise, among representatives of local authorities, also

⁴ No 99/2000 concerning the sale of goods and services on the market.

⁵ These exceptions are provided by article 16 of Government Ordinance nr.99/2000, namely: a) liquidation sales; b) temporary reduced price sales; c) the selling made within specific structures, named factory shops or factory warehouses; e) the selling of products to meet occasional needs of consumers, after an event has ended and when it is obvious that the products can no longer be sold in normal commercial terms; f) the selling of products which were not sold over a period of three months from the supply moment; g) accelerated selling of products likely to deteriorate rapidly or that can no longer be preserved until the end of their validity; h) selling of a product at a price aligned to the level of the legal price practiced by other traders for the same product and in the same shopping area, as it resulted from the interaction with the competition environment; i) selling of products with identical characteristics, whose resupply prices felt.

⁶ Most favored customer clause, called the *anti-discrimination clause*, or *MFN clause* („*Most Favoured Nation*"), is a promise of a party, e.g. a supplier, to deal with a buyer (retailer) just as it treats its best customer. If the supplier reduces the prices offered to one of its customers, then prices for all customers benefiting from this clause will be reduced at the same level.

⁷ For approving the criteria for implementation of retail structures of great surface and the definition of types of retail structures.

representatives of economic agents set in the immediate vicinity of the proposed structure. Also, there are several factors that need to be met, such as the structure's location in areas with low commercial activity, usually outside towns. As a result of its advocacy efforts in this area, the above mentioned regulatory barriers are about to be eliminated through a Government Decision amending the previous one.

34. Last but not least, the RCC has issued a negative point of view to the Agency for Government Strategies for starting a campaign called "Buy Romanian", considering that any Member State should avoid such protectionist and discriminatory measures, and that an open market is a quintessential condition for the ones that find business opportunities could grow and provide jobs that would help with the overcoming of the crisis.

3.2 *Enforcement measures*

35. Alongside these advocacy measures, another important tool of RCC is the vigorous application of the competition rules aiming at fighting against the anticompetitive practices that may affect the proper functioning of the supply chain to the detriment of consumers and for ensuring a level playing field for all economic operators along the agro-food chain.

36. Thus, in 2007, the RCC opened investigations for cartel behaviour in a few local bread markets finding evidence that producers were harming consumers with anticompetitive agreements to increase their profits (see Decision no.61/7.12.2009⁸ on the infringement of art. 5(1)(a) of Competition Law no.21/1996, republished, by the 17 undertakings operating on the bread market of the Maramureş County and Decision no.62/07.12.2009⁹ on the infringement of art. 5(1)(a) of Competition Law no.21/1996, republished, by the 31 undertakings operating on the bread market of the Vrancea County.

37. For instance, in Vrancea County, the evidence showed that 31 undertakings raised bread prices almost in the same day (13% to 70% increase compared to the preceding month's price). Price increases followed meetings of bread producers, during which they discussed the levels of selling prices applied in their County. The total of the fines applied to undertakings in this County in 2009 was around EUR 1.35 million. It was estimated that the harm for consumers during the cartel period was around EUR 2 million.

38. Another investigation on the wheat storage market finalized by RCC in 2009 proved that the Association of the Romanian Wheat Traders and Depositors (former Romanian Employers' Association of the Wholesalers of Cereals) intervened in the commercial activity of its members by means of its decision of 22.07.2004 aiming among others at fixing among its members the level of future tariffs for the services provided in connection to certain wheat storage operations. The value of the fine for the Association represented 8% of the association's incomes in 2008. In respect to the 17 undertakings, members of the Association, *RCC* didn't find enough evidence for proving the infringement of art.5 (1) (a) of Competition Law no.21/1996, republished (see Decision no.63/07.12.2009 on the infringement of art. 5(1)(a) of Competition Law no.21/1996, republished, by the Romanian Wheat Traders and Depositors on the wheat storage market).¹⁰

⁸ Available on the website of the Competition Council at: www.consiliulconcurentei.ro/documente/oficiale/concurenta/decizii/bunuri_de_consum/61.

⁹ Available on the website of the Competition Council at: www.consiliulconcurentei.ro/documente/oficiale/concurenta/decizii/bunuri_de_consum/62

¹⁰ Available on the website of the Competition Council at: www.consiliulconcurentei.ro/documente/oficiale/concurenta/decizii/bunuri_de_consum/63.

39. Moreover, the findings of the sector inquiry in the market of food products commercialization finalized in 2009 made *RCC* to initiate certain investigations on the possible law infringements in the sector of food products retail. Conclusions of these investigations are not available at this stage.

40. In relation to merger assessment, it deserves to be highlighted that a series of acquisitions have started to take place in the Romanian fast moving consumer goods sector proving thus the particular vulnerability of the retail and distribution markets to the effects of the financial and economic downturn.

41. As the economic downturn is likely to continue in Romania, we will probably continue to see the trend of consolidation of the retail or distribution of fast-moving consumer goods continuing. Accordingly, *RCC* will pay due attention to a careful merger control analysis to ensure that the efficiency effects of the consolidation process would not be countervailed by its negative effects.

4. Conclusions

As shown throughout the paper, *RCC* has intensively made use of its advocacy and enforcement tools in order to ensure that the benefits of any efficiency gains upstream are being passed in the supply chains downstream, to end consumers.