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# **HOW TO STABILIZE THE CEREALS MARKET IN A TRANSITION ECONOMY**

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*Paper prepared for presentation at the XI<sup>th</sup> Congress of the EAAE  
(European Association of Agricultural Economists),  
‘The Future of Rural Europe in the Global Agri-Food System’, Copenhagen, Denmark,  
date as in: August 24-27, 2005*

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## **Abstract**

The Romanian cereals market is in a state of transition, because the grain marketing system is characterized by high risk for market participants. The current situation of grain market is used to estimate the necessary solutions to stabilize the market

**Keywords:** grain grading system; price monitoring systems; commodity exchange; Q13

Romania is a European country with a significant agrarian potential, provided by its natural conditions, which at present is not used to its full extent.

At present Romanian agriculture is based upon small-sized individual farms (households), under the lower limit of economic viability.

Land property consolidation and the establishment of larger-sized farms were hindered by the absence of a functional land market.

An important constraint for farm production is the diminution of industrial input use: fertilizers, pesticides, irrigations, certified seeds, etc. Most often obsolete technologies are used on peasant farms that are specific to the beginning of the last century.

The productivity of production factors is low in Romania. The average yields/hectare have not increased compared to their levels before 1990, while in many crops they diminished (for example in wheat, sunflower, sugar beet). At the same time, the livestock herds/100 hectares also declined, in all species.

Agriculture became less integrated to total national economy. The part of agricultural production that goes directly to final consumption increased from 22.5% in 1989 to 45.1% in 1998 – of total agricultural production utilizations.

Self-consumption in peasant households is quite high for all products (over 50%), with few exceptions.

If the agricultural production index is fluctuating mainly due to climatic conjecture, the food industry index falls as a consequence of the chain's general functioning deterioration. The decline of the agri-food industry varied according to the chain. The demand restructuring seems to be the determining element that inhibited or stimulated the growth of the product supply that crossed the agri-food chains.

During the whole transition period, the agro-food trade balance was negative; thus Romania became a net importer of agro-food products. By far, the processed agricultural products take the largest share -varying between 40 and 70% of the total agro-food imports, depending on the year.

## **Cereals Market Overview**

Traditionally Romania has been a leading exporting country on the world cereals market in early thirties. However, following the past policies and restructuring of agriculture into a centralized sector, Romania lost its advantage of supplier for the region and became in the nineties from a net exporting country a net importer country.

Grain markets in Romania are in a state of transition. The basic reforms are now completed: state controls have been removed; international and domestic trade in grain is unrestricted. However the private sector storage and trading system is still at an early stage of development: many storekeepers have only recently acquired their assets, typically through management-employee buy-outs, and the financing mechanism for private traders and millers to acquire the crop are not yet fully functioning. International trading companies have entered the market and are actively seeking opportunities, mainly for external transactions in grain.

In Romania, the average of the last 10 years shows that 66% in total arable land is cultivated with cereals. In 2004, the main cultivated cereals were: corn and sorghum 47%, wheat 41%, barley 8% and the rest of 4% were cultivated with oats and an insignificant area with rice.

Due to the structure of ownership over agricultural land in Romania, about 86% in the cultivated area with cereals are concentrated in the private sector and a significant proportion out of this is worked on small surfaces.

The average production of all cereals has fluctuated within this period. Main reasons for the fluctuations are: (a) concentration of cultivated areas with cereals (about 50%) in small exploitations under 2.4 ha, which dispose of (b) limited financial resources for the use of proper quantities of inputs. As farmers had no (c) information available related to the prices of the future crops but also due to the fact that cereals are produced in Romania, as a rule, without having a (d) firm contract with a potential buyer, they pursued all along this time to reduce their costs by using reduced quantities of inputs. (e) Using only 350,000 ha of the acreage having irrigation facilities, determined a big exposure for the agricultural producers to weather risks. Very few farmers (under 1%) are willing to (f) insure crops.

The grain marketing system is characterized by high risk for market participants. The use of private storage facilities is still risky.

The milling and baking industry went through a restructuring process meaning that new small and middle capacity units appeared which are adapted to local demand. The factories were preoccupied to assure a diversification of production and to improve the level in labeling and packaging products so that some of them received ISO certification for some products. Still, it is imposed to further invest in this sector in order make it be competitive having in view the accession of Romania into the European Union.

Mills or bakeries choose within the last years to ensure an important quantity of cereals from their own exploitations or many commercial farms choose to build their own mill, bakery, so that they have their crop sold and minimize the risk of their trading.

But there are also vertically integrated units which produce, store and process cereals, either in units for milling and baking or in their own factories for concentrated fodder, having as destination the use for their own livestock.

The average cereal consumption per capita registered within the past 10 years an average level of 210 kilograms, of which 168 kilograms represent wheat and 40.1 kilograms is corn. Bread is the main product consumed in Romania.

Due to the fact that cereal products is on a great number of farms using varying of agricultural inputs, the crops present a large range of quality levels. This renders more difficult any process of selling/buying cereals. First of all, traders try, by their own means, to determine the offer existing on the market and the related prices to it as there is no system of market information yet and the statistical data have a historical character.

Traders are disposed to buy cereals having a certain quality, but the costs associated to building homogenous lots are high, so the price offered to agricultural producers are reduced accordingly. This is why it is considered necessary to have a law of commodity exchanges and make them operate in order to give the buyers and sellers of cereals the benefit of the best price.

Seasonal wheat price volatility as well as the inter-year large differences (harvest period gluts are associated with low prices while production shortages dramatically raise prices all along the marketing chain) determined the policy makers to look for solutions to stabilize the market.

### **Producer associations/ marketing organizations**

The sales of agricultural products from the peasant households follow an “archaic” channel, which supposes that each small producer sells his production on the market by himself. According to the data of a survey conducted by IAE together with CURS in December 1998<sup>1</sup>, it resulted that in the case of vegetable products only 4.7% of investigated subjects sold their products on contract basis. In the case of livestock products, 17.4% of investigated subjects sold products on contract basis<sup>2</sup>.

Under these conditions, it is difficult to speak about the existence and operation of real production – marketing chains by products/groups of products.

The associations or farmer groups by products or groups of products are relatively weakly represented and cannot have a decisive influence in supply and price organization. As regards demand, the situation is quite opposite, as it concentrated in the hands of an extremely reduce number of processing operators, often having a local monopoly position. Therefore, competitions between market

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<sup>1</sup> Project PHARE-ACE P 96-6090-R, 1998.

<sup>2</sup> See Dinu Gavrilescu (coordinator) “Farm Restructuring Romania – causes, efficiency and policy implication”, 1999.

participants, operators is in one way (it mainly exists in the field of supply) and consequently it is extremely unbalanced to the detriment of small scale farms, which are less favored as regards economic power, negotiation ability, information degree, compared to the processing units for agricultural products.

In Romania, there is still very strong felling of the individualism, keeping in their memory the remembering of the previous CAP (Agricultural Co-operatives for Production), which did not offer anything for their works. The farmers are aware of the benefits of selling together. However they fear of grouping. Their idea of working together is associated with the negative aspects of the present associations (based on law 36/1991). The non-associating attitude is firstly due to the different mistrust reasons in agricultural association, than that the individuals prefer to work by themselves their land - this latter is especially the situation of machinery owners and retired/dismissed persons. Very often, these “amateur” and “forced to be” farmers are not commercial and can not be unless they get knowledge and services related to crops/livestock and marketing.

### **Market chain for cereals**

In general, cereals are cultivated in Romania without having concluded a firm contract between agricultural producers and processors or traders of cereals.

As bread is a perishable product, relatively big in volume and small in value, with rapid circulation and low possibilities of recycling returned quantities, its distribution represents the key-point. Processing bread is carried out especially during the night and distribution takes place early in the morning starting at 4 hrs a.m. The larger is the area of the distributor, the earlier is the distribution. Production is generally adapted to the distribution system and orders are also taken into account. This is why issues like how much is being bought or what will be bought are to be known well in order to stop production. Due to the specific features in producing bread, the moment to stop activity has to be anticipated by three hours.

As a rule, bakers dispose of their own transport means for the distribution of bread. Small bakers, usually, are covering the local market and big bakeries are using more transport means to distribute bread and flour in bulk to big bakeries.

There is a tendency to use specialised companies for the distribution of flour in sacks packages, which is destined to small and medium size factories. Big bakers more and more often use the specialised divisions of the specialised companies in distribution in order to handle flour for house consumption and for other bakery products having a longer validity time.

Generally, millers and bakers have their own selling stores but in most of the cases bread selling shops were changed into general stores, as the daily circulation of bread is not high enough to justify their expenses. Independent bakery stores do not allow the factories to make an accurate planning, as these stores are clients for many processors.

Supermarkets, as a rule, selling bakery specialties having a longer validity time (toast bread, deep frozen products) and in this case deliveries are taking place twice a week. For snacks, biscuits, cookies, deliveries are made once a week.

There also are more modern modalities adopting selling bakery products. So, there are now stores working in franchising system, by which products are produced right under the eyes of the clients on basis of pre-baked dough's.

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Although in some periods an external demand existed for some cereals, the possibility to build homogenous lots in relative short time as to supply the requested cereals could not be achieved and consequently the external demand could not be met in total. Therefore, the establishment of grading system of cereals and monitoring their quality is necessary for accelerating in cereals trading.

In case a demand exists on the domestic market and cannot be met by the domestic resources, traders try to cover through contracts a quantity they are willing to import, but their business is also in this case subject to risks as there is no law regarding the “enforcement of contract” and anybody may come out of the contract without damages at the time when they break the contract. Penalties may be later reimbursed after long legal trials meaning time and money and may be also getting a company out of the market.

## **Grain Storage Facilities**

Romania has a storage capacity of cereals and of grain oil seeds of over 10 million tons. These capacities, which until 1994 belonged to the Autonomous Company “Romcereal” were transformed into trade companies in two successive stages, by setting up 41 companies of the “Comcereal” kind and afterwards, by setting up 29 more trade companies “Cerealcom”. Most of these capacities have access to roads, railroads, rivers and sea.

In grain storage, most companies became private and where due to be privatized in late 1999.

Consequently, as compared to 1989, the property structure modified, becoming mostly private. In terms of storage capacity grain companies of COMCEREAL type owe about 6.5 million of grain storage capacity, followed by CEREALCOM companies, which manage about 3.6 million tons of storage capacity. The State Emergency Reserve of Wheat will be kept below 350,000 tons, in warehouses leased and inspected by the National Administration of State Reserves. The new private ownership structure is a major step forward, but use of private storage facilities is still risky and financing for purchase and storage is limited.

Investors in grain storage sector were almost local. Although there were repeated requests for opening for sale the grain storage companies coming from international grain traders, no multinational companies present in Romania bought any Comcereal / Cerealcom and not even some of their assets.

Some interested traders failed to buy silos due to different reasons: high and not justified price, bureaucracy etc. There are some small Romanian traders that bought some independent silos. Grain traders are interested in the financial power of the newly privatized storage companies since they could offer better services at fair prices. Since important traders will stick to grain exports they can only hope that the new private storage companies will operate for the benefit of all parties involved.

The privatization enabled some new entrants on the Romanian grain market that bought a large share of the storage capacity. The new entries' position on grain storage market is significant. Most of the storage companies bought by the new entries are located in key areas – either in important grain basins or close to Danube and Black Sea ports. Since they did not have experience in the field, the question was whether they have financial power to stay in business. Some of them did not apply for credit to make these investments, but used their own funds. Several parties involved in the grain marketing chain were surprised to see that few companies are spending hundreds of billion lei to buy storage companies and are committed to spend more for investments.

For a new entry on the grain market (none of the important grain traders knew anything about them before), with little experience in the field, such investments appear very risky and raised a lot of questioning related to capital source and firms' future plans. The subsequent good performance of most new entrants (none of them was reported bankrupt) proved that they made a very good prior business assessment and applied sound management.

They applied different market strategies: some of them were interested to get involved in the whole grain marketing chain, even to leasing agricultural land, grains production, processing and export, import inputs (e.g. Rompac International, Interagro); some other decided to stick to storage & conditioning services (e.g. Broadhurst Investments).

Market strategies of new private storage companies differ depending on the management staff. Several companies privatized through PAS (employees association) or those that were ceded to SIF are reluctant to develop and diversify their objects of activity since most of them lack financial powers. So far they stick to storage & conditioning services and domestic trade. Some of them that tried more

various activities like leasing land and agricultural production made large losses. If they export, they do it most of the time through intermediaries. Another key issue for grain storage companies privatized through PAS is linked to their lack of funds to invest in revamping silos and limited access to bank loans because they borrowed to buy their company's shares and they try to repay these loans from profits. However, privatization through PAS was encouraged by some professional organizations as a means to fight against the newly created 'private monopoly': "few new entries bought over 20% of the total storage capacity and tried to get rid of any small competitors". On this basis, claims for state support for the companies newly privatized through PAS were also made; as to help them stay on the market and compete with the stronger ones.

Grain storage and handling infrastructure were not further rehabilitated and have worn out; as a result, grain trade opportunities are low, due to the lack of confidence in the grain quality produced in Romania.

### **How does Strategic Grain Reserves (SGR) affect the storage market?**

The State Reserve Agency (SRA) started with a nominal stock of 850,000 t and was reduced in 1997 at 350,000 tonnes. The grain loan deals which the State Reserve has entered into this year can be criticized on several grounds:

- the 6 month delay between release and replenishment, which bridges the harvest, means that the releases have had a strongly stabilizing effect on the market;
- no distinction has been maintained between rotation and stabilization activities;
- the level of prices at which stabilization releases have taken place has been too low in relation to import parity, thereby reducing the markets expectations of substantial seasonal price rise in future years.

This will naturally tend to reduce the willingness of the domestic trade to hold seasonal stocks and reduce the ability of the domestic market to be self-stabilizing.

Budgetary considerations have been an important factor behind the pattern of releases adopted by the SR manager. Adoption of a truly neutral rotation policy, characterized by synchronous releases and replenishment operations, would involve substantial net budgetary cost. This is because the SR's selling price (for a given grain quality) is equal to or lower than its buying price at any point of time and because its stores are located in producing areas and the offer price from millers located in cities allows for transporting the grain to their mills. There is no margin in buying for immediate resale as the millers are able to purchase on the same markets as the SRA.

Private sector storage companies know that the SGR is going to intervene to buy stock in August and resell in April/May. So why carry stocks, especially if the SGR is going to intervene without warning later during the high price season, lowering prices and destroying returns to seasonal storage? Better to let the Government bear the costs of storage and walk the halls of Ministry of Agricultural in April to gain access to subsidized wheat from the SGR. This is what the private grain millers and bakers associations have done over the past 3 years

### **Grain milling and bakery**

Milling and baking industry is in full process of consolidation, by the development of more groups of companies lately active in the field (investment fund Broadhurst, Greek company Louis, Romanian-Belgian group Overseas, Dobrogea Constanta ). Competition is on a raise trend what makes big operators on this market seek new ways of development, either by diversification, or by approaching new market segments or improving sales.

At the level of the whole milling and baking industry, investments in technologies have been about \$100 million. So, at present, modernized capacity within milling sector is 4,500 tons/day, in pastes industry 160 tons/day and in biscuits industry 180 tons/day.

The number of enterprises that produce milling, bakery, and flower products increased every year. At present, there are almost 6,500 enterprises, out of which are 75 with tradition and large capacity and over 4,900 small companies with private capital.

This technology consisted mainly in endowment of equipment for peeling and milling of cereals, technological automatic lines for pastes and biscuits production and equipment for marking and packing the finished products.

Factories in this industry united in two professional associations: Romanian Patronat of millers and bakers “Rompan” and National Association of Millers and Bakers”ANAMOB”, associations representing their interests before policy makers. “Rompan” comprises 180 companies that represent about 60% in the market of milling and baking industry.

There is a strong need for significant improvement in the cereal based processing industry, in order to harmonize the regulations regarding quality requirements, food safety regulations, all along the products chains. This will include the adoption of all EU standards and quality requirements from the stage of agricultural production, collection, manipulation, transport, processing, packaging and marketing agro-food products.

Main features of the milling and bakery industry in Romania:

- Due to low costs of labor, the unit price of bread is about 16 percent lower than in the UE, as Romanian factories are producing bread in higher quantities having the advantage of scale of economy.
- A great part of millers and bakers are buying wheat directly from agricultural producers, but only for 2-3 months after harvest. After this period, wheat is bought from wholesalers, associations or producers who keep small quantities of wheat;
- Important in keeping a constant production all over the year is to have raw material supplied. In this case, main constraint is the fact that Romanian commodity exchanges for goods are “institutions existing, but not operating”<sup>3</sup>, some of the big processors preferring to import wheat and corn, as the expenses implied by buying raw materials from domestic sources are too high or the quality of Romanian raw material does not meet their demand;
- Unfair competition on bread market is due to those who sell bread without paying their related taxes and fees, which determines very narrow production margins for processors who do pay their taxes and fees.

## **Grades and standards**

The primary scope of grain grades and standards is to provide uniform measures of quality to facilitate communication between buyers and sellers. Uniformity is the key concept in the attempt of accurately estimating value and establishing prices based on description in market transactions. The high-volume, low-margin sales that characterize the modern grain market require technical standards, which describe condition and quality and serve as a basis for blending diverse characteristics into a few uniform lots.

Although the Laboratory for Baking of the Institute of Food Chemistry is every year performing a detailed study regarding the quality of wheat on the level of counties, the wheat producers do not get their money according to the quality of their wheat, as in Romania no Grading System for Grains is yet in operation. This is why at present the main grains are paid for as regards their physical features (humidity, foreign matters, and hectoliter weight).

It is necessary to implement a grain grading system because:

- grains produced generally have a poor and inconsistent quality;
- high costs associated to assuring grain quality for domestic consumption and exports are high;
- large costs associated to quality assessment by the processors;
- lack of flexibility for development adequate institutions required for an effective grains market, including warehouse receipts and post-harvest financing programs, and crop diversification, and crop insurance programs.

Though a legal framework for introducing of grading system for grains and oilseed plants exists even since January 2000, specific by laws has not been yet worked out in order to regulate and put the

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<sup>3</sup> “Biz” magazine no. 32 iuly, 2001 –pg.21 interviewe with Fotini Teodorescu – Dobrogea Constanta

system into operation (Government Decision and Statute of the National Commission for Grading Cereals) and the Ministry for Agriculture, Food and Forests should also approve the Manual for Grading Cereals and Oilseeds and license the graders. The later the grading system will be implemented, the less transparency will be quality assessment so necessary on cereals market and limit efficiency of this market.

In the long run, in order to prepare for EU Accession, the Ministry for Agriculture, Food and Forests is expected to harmonize the standards for wheat with the EU. During 2002, the standards for other cereals will be harmonized for the same reasons. In this respect the main measures that need to be implemented are:

- setting up new laboratory equipment to obtain accurate data regarding quality of grain such as:
  - Gluten content;
  - Protein content;
  - Hagberg number;
  - Errucyc acid content;
  - Glucosynolat content.
- This equipment is necessary both for the future intervention centers and for quality control for oilseed crops, especially for rapeseed (Regulation EU658/96).
- The adoption of EU analysis methods for cereals. The modernization of storage, cleaning and drying facilities will be necessary.
- Harmonization of the legal framework need to be carried out in parallel with investments and modernization of laboratories and storage facilities.
- Training farmers on the requested EU quality standards (or international standards) and on the advantages of reaching high quality parameters for grains in order to increase competitiveness.

## **Pricing**

Starting 1997, minimum guaranteed prices and premia for wheat as well as flour/bread price controls were removed.

Seasonal wheat price variation as well as the inter-year large differences (harvest period gluts are associated with low prices while production shortages dramatically raise prices all along the marketing chain) determined the policy makers to look for solutions to stabilize the market. This is both because producers exert pressure to get budgetary support and consumers are switching more and more to inferior goods, as their purchasing power is deteriorating. Governments have tried to intervene to support storage and stabilize prices for storage.

After last year's extremely tight situation, which led to spectacular appreciation of wheat, barley and corn domestic prices, over the MY 2004/05 domestic bids have crept down bit by bit. Nonetheless, local wheat (either for milling or for feed) enjoyed no demand by exporters in the context of an abundant regional supply, which made inventories from neighboring countries more affordable.

This situation pushed farmers for price lessening towards the end of CY2004. In-silo prices for milling wheat reached \$150-160/ton in November-December 2004, 33 percent down from the corresponding 2003 period. The beginning of the year 2005 brought some price appreciation (to \$170/tone), as many market operators revived their activity with the upcoming new crop on the horizon.

Barley prices dropped immediately after harvest to levels around \$100/tone (in-silo) and were steady in the following months, making this commodity the best seller in the market, both domestically and for export purposes.

Farmers have been quite displeased with the bids offered for domestic corn, which have constantly depreciated after the October harvest. The tremendous carryover seems to be giving the buyer extra bargaining power, although an additional reason for the current downward scenario seems to be related to product quality, which led farmers to try to sell as soon as possible and avoid paying additional storage for a low grade corn.

### *Price influence by the wheat loan for State Reserve*

The most important influence upon the wheat price during the year, especially in the period February-May, was performed by loans from the state reserve granted by the government to the milling-baking companies. This made the demand for wheat within this period to be higher.

This is why operators on the grains market are not willing to buy more wheat than they can sell in the period July-January and the producers are not tempted to pay for the service of warehousing the wheat during these periods, as the risk to have wheat in stock is very high.

### **Cereals trade**

Romania's trade regime with grains is moderately protective, with no licensing system in place, except for the commodities under preferential quotas (Table 1). In July 2003, the government suspended customs duties for 1 million tone of wheat. In October 2003, the Tariff Quota and the licensing system were revoked and milling wheat imports fully liberalized until the new harvest. At the same time, imports of barley malt as well as corn for feed and processing were fully liberalized until June 30, 2004.

Table 1. Import Duties in the year 2004 on Selected Cereals Products

HS	Product	MFN Tariff	Special EU Preference
1001	Wheat		
1001.1000	Durum what	Ex	Ex
1001.9091	For sowing	25	0 for TRQ (2)
1001.9099	Common wheat, other	25 (1)	0 for TRQ (2)
1003	Barley		
1003.0010	For sowing	25 (3)	18.8 for 1,118 tone
1003.0090	Other	25 (1)	18.8 for 55,882 tone
1005.10	Corn seeds for sowing	3	0 for 1,000 tone
1005.9000	Other	30 (1)	0 for 49,000 tone
1006.10	Rice, paddy rice		
1006.10.21, 23, 25, 27, 92, 94, 96,98	Other	10	0 for TRQ (4)
1006.20	Cargo or brown rice	10	0 for TRQ (4)
1006.24	White rice	25	0 for TRQ (4)
1101.00	Wheat flour	40	0 for 3,000 tone

(1) Customs duties suspended between Jan 1-June 30;

(2) TRQ FOR WHEAT IS 125,000 tone; (3) Customs duties suspended between Jan 1-April 30;

(4) TRQ for rice is 10,000 tone

Wheat and barley have been significantly traded by Romania since July 2003, as drought tightened domestic supplies and elevated domestic and regional prices. The domestic market prices were driven lower by import pressure in February and March, and the pace of Romania's wheat imports remains strong until the new harvest.

According to the Romanian Customs, up to the end of March 2004, Romania imported over 1.8 million tone of wheat, the main sources being France, the Russian Federation, Hungary and Canada. The US supplied 9 percent (about 170,000 tone) of this amount, despite the fact that on April 8 the accumulated exports to Romania reportedly stood at 556,000 tone. This is consistent with the figures provided by local traders on transshipments on the Danube towards Serbia, Bulgaria and western destinations, which make the balance. Import prices have appreciated very much since December, after regional supplies dried up and Romania had to resort to farther sources.

As the new harvest is approaching and the perspectives for the new crop year are relatively good, currently farmers have started selling their inventories stored on-farm. With a total monthly urban consumption averaging 120,000 tone, almost 500,000 tone of wheat are still necessary until July, of which likely 150,000 will be likely sourced outside the domestic market.

For the marketing year 2004/05, we anticipate that about 300,000 tone of wheat (especially with good milling parameters, for blending) will be needed to augment the domestic supplies.

About 130,000 tone of barley (almost all for malt) were imported to Romania before the end of March, the major suppliers being France, the Russian Federation, the Czech Republic, Hungary, and Ukraine. With the area planted to spring two-row barley significantly increased and good crop prospects, barley imports are expected to dramatically diminish during the marketing year 2004/05, to some 30,000 tone in total. Feed barley export prospects, on the other hand, will likely be in the range of 300,000 tone, assuming normal conditions until harvest.

About 180,000 tone corn benefited from customs duty exemptions during the October 2003-March 2004 period, mainly originated from Hungary, the Republic of Moldova, the Czech Republic, the Slovak Republic, and Brazil. The temporary duty suspension will last until June 30, after which corn imports will be taxed at 30 percent, except for the EU-originated imports, which enjoy duty-free regime for a 49,000 tone Tariff Quota. FAS Bucharest anticipates that, given the large inventories still existing on-farm, corn imports will slow down and just about 70,000 tone more will be brought to Romania until the end of the current marketing year. Again assuming normal weather conditions, Romania's exportable surplus of corn will reach 800,000 tone during the marketing year 2004/05.

### **Main characteristics of the cereals marketing chain**

All marketing chain is characterized by:

- The lack of market information, in due time, referring to prices and quantities correlated to these prices;
- The transport costs are generally high because the supply is dispersed;
- The lack of enforcement contracts which increase the risk of selling the products;
- The quality standards are not always applied by the small farmers;
- The lack of commodity exchanges which should lead to growth of transparency for agricultural markets and would diminish the transaction costs;

From this reason, very many actors on the agricultural markets have the tendency to integrate vertically in order not to depend on other operators on the same market.

But the lack of instruments and specific institutions to the market lead to formation of regional monopolies and the agricultural producers see themselves forced to respect the rules imposed by these ones.

### **Financial conditions on the agricultural markets**

Agricultural financial markets perform poorly, diminishing both supply and demand for credit. It is unanimously admitted that there is an insufficient availability of credit and investment capital in rural areas, with important consequences on agricultural growth and rural poverty. There are several major reasons leading to this:

- current macroeconomic policies - Commercial banks are reluctant to invest their liquidity in agriculture, considered highly risky and far less attractive compared to the inter-bank lending and the investments in Government treasury bills (crowding effect of public debt).
- failings in the institutional and legal framework - (regarding assets that can be used as collateral; lack of crop pre-financing schemes; the limited use of leasing).
- past Government practices in financing agriculture - Although given up at the end of 1996, the massive interventions in the sector (directed credit lines to agriculture, refinanced by the National Bank of Romania, debt forgiveness programs) have had the effect of not creating any incentive either to the final borrower or to the commercial bank to act on economic principles. Under such circumstances, retail lending capacity of the banking industry is still poor.

### **Main problems on the Romanian cereals market**

Producers' level:

- low utilization degree of certified seeds in wheat crops;

- lack of agricultural credit or impossibility to access to it, no possibility to warrant land or grain crop;
- lack of own facilities for conditioning, drying, cleaning, as, in most cases, combines used for harvest, plus technologies of applied crop make wheat need all these operations. Agricultural producers, usually possess wheat presenting humidity (through years when rains were very frequent at harvest time) or, due to the low performance of the harvesting combines, a high percentage of foreign matters (more than 5%);
- unsuitable storing of wheat, the farms do not dispose of warehousing facilities;
- lack of own transport means and impossibility to cover the costs of transports of grains for relative big distances;
- high risks in wheat trading further to the lack of a Grading System and a Warehousing Certificates System;

All these malfunctions determine the producers to apply each year for subsidies from the state which doesn't solve their problems directly, but will postpone them for next year.

Both producers and traders' level:

- lack of information on the market referring to prices, quantities and qualities of wheat in different regions;
- high tariffs collected for storing plus risk of replacement of goods or their damage by handling (especially manifest in the increase of broken kernels);
- rigid contractual terms established by the storing units: e.g. there is a contractual clause stipulating that the deliveries of the silos have priority against any other deliveries: you may say exactly when you put the goods into the silo, but it is uncertain when you can have them back.
- monopoly performed by grain warehouses. Their privatisation was conditioned in most cases by buying all storing rooms of Comcereal or Cerealcon in one county. This made, on one hand, that these storing rooms become unattractive to the big transnational companies such as Dreyfuss, Cargill, which intended to buy only one warehouse, not all the chain of warehouses in a county. Those who dared buy the whole chain of warehouses are in the situation to compete with themselves and, in fact, operate as a regional monopoly because the agricultural producers, in most cases, do not have transport means to carry the goods from one region to another.

Traders' level:

- unknown quality of wheat, so that each trader must test the goods for quality and make long journeys throughout the country, in order to find those quantities and qualities of wheat which meet the demands for export;
- incoherent agricultural policy. Imports of wheat exempted from custom duties are approved and, soon, loans from the state reserve are allowed, which facilitates an incorrect estimate of quantities to be traded and further on imports for the enlargement of stocks are expected and performed.

Problems faced by silos:

- they do not dispose of financial resources to buy grains, therefore the majority of silos provide only storing services;
- tariffs asked for the storing are intended to cover all the costs of the silo, although in most cases the storing capacity is used at most 50%;
- they are buyers of sunflower seeds on behalf of the oil factories and provide storing services for these ones;
- they dry and condition rapeseeds upon harvesting and deliver them to exporters or intermediaries indicated by rapeseed producers;
- they buy wheat from state reserve against cash, but then store it and get paid for this service by the end of the year.

## **Some measures (policy option) proposed to improve private storage**

- Develop clear operational definitions for an *emergency* and rules for *stock release* (e.g. do not release stocks for an "economic emergency" unless domestic prices remain at least 15% above import parity for a prescribed period).
- Shift State Grain Reserve stocks over time from government to private storage facilities (when State Grain Reserve) stocks are co-mingled with commercial stocks in private facilities, stock rotation ceases to be a problem for the public sector as it occurs automatically rotate in the course of the silo's commercial transactions); and in the meantime.
- Stretch State Grain Reserve stock rotations over the longest possible time period to reduce their market impact, public announcement of a rotation schedule in advance, and synchronize purchase transactions with sales transactions so that market impact of rotation sales and replenishment purchases are neutralized. This is critical, since the Government may claim that it is only buying and selling to rotate old stock. This is surely necessary, but it can be done in such a way as to minimise market impact.
- Continue with steps to establish a warehouse receipts and grain grading system to improve private storage incentives, and increase storage security and general transparency.
- An efficient *marketing system* where buyers and sellers have equal access to information about value for their various uses, requires uniform measures of grain quality, able to serve as a basis for ascertaining the value of individual lots of grain without visually inspecting each shipment. Most countries have formalized these measures into official grades and standards. Grades provide the terminology and the means for describing and communicating selected grain characteristics, but they do not create quality. At the same time, grades do not determine the distribution of profits between buyer and seller.

The primary scope of grain grades and standards is to provide uniform measures of quality to facilitate communication between buyers and sellers. Uniformity is the key concept in the attempt of accurately estimating value and establishing prices based on description in market transactions. The high-volume, low-margin sales that characterize the modern grain market require technical standards which describe condition and quality and serve as a basis for blending diverse characteristics into a few uniform lots.

Following the above measures, direct subsidies for private storage might then be justified if a suitable targeting system were developed. At a minimum, this would require clear definition of eligibility criteria, consistent with the aims of the subsidy, and establishment of information systems means to objectively verify eligibility (i.e., not just based on personal statement of recipients saying that they meet the criteria).

- Establish a wheat price monitoring system to provide timely and accurate price information to several types of users. Market participants attempting to learn about market options and reference prices. The aim is to monitor transaction prices for a specific quality of bread wheat, in specific locations, on a regular basis. This allows consistent comparisons over time, place and product form.

## **Conclusions:**

- Continue with steps to establish a warehouse receipts and grain grading system to improve private storage incentives, and increase storage security and general transparency.
- An efficient marketing system where buyers and sellers have equal access to information about value for their various uses requires uniform measures of grain quality, able to serve as a basis for ascertaining the value of individual lots of grain without visually inspecting each shipment. Most countries have formalized these measures into official grades and standards.

Grades provide the terminology and the means for describing and communicating selected grain characteristics, but they do not create quality. At the same time, grades do not determine the distribution of profits between buyer and seller.

- Establish a grain price monitoring system to provide timely and accurate price information to several types of users. Market participants attempting to learn about market options and reference prices. Establish an outlook service. The aim is to monitor transaction prices for a specific quality, in specific locations, on a regular basis. This allows consistent comparisons over time, place and product form.
- Promote the establishment of a commodity exchange
- Promote the establishment of a national inter-professional grain association

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