The European Policy for Food Quality and the Fischler's Reform

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Abstract

Fischler's Reform of the Cap has introduced economic support to reinforce the range of instruments aimed at promoting food quality. Before the Reform, European Union market intervention for food quality was confined to the regulatory ground. The paper discusses the economic justifications for financial aid in the case of quality improvement and in the case of information circulation and provision of assurance to consumers. The possibility to add new Quality Schemes at the existing ones is criticized because of the information overcrowding. Furthermore, it is argued that a "race to the bottom" mechanism could be enforced as a result of the introduction of the possibility to settle Quality Schemes on a national basis. The paper also shows that the unsatisfactory functioning of existing Quality Schemes could be better faced by simplification of the whole quality certification system; by a communication effort at a general level and not only for single Quality Schemes; and by a better coordination of the different strategies of the different stakeholders in the food chains.

Key words: *Quality Schemes, Cap Reform, Information, Reputation, Economic Support*

1. Introduction

Market intervention of Common Agricultural Policy (Cap) have been increasingly criticized, among the other reasons, for its negative effects on food safety, on the environmental equilibrium and on the overall quality of productions (Lobstein, 1999). Together with the increase in consumers' interest in these topics, this is why with the Cap reform process, started at the beginning of the nineties, financial aid to agriculture has been more and more justified with the corrections of the past distortions. Food quality and safety, environmental protection, economic diversification and preservation of traditional products and landscapes, have become the new justifications of support that seem to gather, up to now, an increasing consensus.
In this context, with respect to food quality, the new reform approved in 2003, known as Fischler's Reform, introduced, for the first time, economic incentives to farmers and to farmers' associations. Incentives are given both to improve production quality and to increase communication between producers and consumers, in order to enhance consumers' knowledge of food quality and their trust in the European agro-food sector. The European Union (EU) regulatory framework for the so called Quality Schemes (QSs) has not been changed by the Reform, and it is essentially based on Reg. 2081/92 for Pdo and Pgi, Reg.

1493/99 for VQPRD, Reg. 2082/92 for Tsg, and Reg. 2092/91 for Organic farming products. Nevertheless, new QSs are entitled to receive financial aid even when they are defined at the national level.
The paper discusses the implications of the new course of the European policy for food quality, both from the point of view of the economic justifications and of the expected impacts of the new measures. Furthermore, the efficacy of payments aimed at enhancing the use of Quality Schemes is questioned on the basis of the discussion of the causes of their actual unsatisfactory performance.
The paper is organized as follows. Section two summarizes the content of the new measures introduced by the Reform, both in the Regulation for Rural Development and in the so called "Horizontal Regulation". Section three briefly discusses the scope for public market intervention for food quality; in particular a distinction is made between those cases in which the regulation addresses a market failure, and those in which payments are aimed at overcoming structural barriers, or to promote innovative behaviour. Section four is devoted to the analysis of the causes of the limited success of existing QSs, with special reference to the Pdos; on this basis, it will be discussed the likely effect of the introduction of the incentives to the adoption of QSs. In section five the attention focuses on some remedies that could have been adopted to make the actual EU quality certification system be more effective, but have not been adopted.

2. The measures for quality in the Fischler's Reform

Both the so called "First Pillar" and "Second Pillar" of the new Cap provide for enhancing to products quality, and introduce, for the first time, the possibility to support, with financial aid, producers committed to quality improvement. In this section there is a very short presentation of the Reform contents with respect to quality.
The first justification given in Reg. 1783/03 (the regulation on Rural Development) for introducing new measures for the enhancement of quality is that: "the range of instruments to promote food quality needs to be reinforced." In the sense that "farmers should be encouraged to participate in Community or National food quality schemes". Besides, "there is a need to improve consumers' awareness of the existence and specifications of products produced under Community or national food quality schemes".
Article 24 introduces temporary financial support to farmers who improve production quality and/or for the promotion of high quality products (up to 3,000 Euros per year for no more than five years in the proportion of 70% of eligible costs as a maximum). Payments should be targeted to the following objectives: i) to help producers who provide assurances to consumers on the quality of the product, or on the production process, through the participation in food quality schemes; ii) to increase the value added of primary products and to enhance market opportunities; iii) to improve consumer information on the availability and specifications of such products. Support is granted to producers who participate to EU or National-level quality schemes which comply with a number of conditions, including the following: quality has to be obtained by specific production rules; compliance with those specifications has to be verified by an independent body; the scheme has to be open to all producers; the scheme has to respond to current or foreseeable market opportunities.

Also the so called “horizontal” Regulation -Reg. 1782/03- includes a measure for quality. In particular, article 69 introduces the possibility for Member States to finance, on a voluntary basis, specific programs aimed at: i) improving the quality of production; ii) preserving the environment; iii)improving market opportunities for the products. Member States can use for this purpose up to 10% of the “national ceilings”, and these should be spent within the same sector. Hence, the direct payment generated in this way is at least partially coupled to production. This measure has been, up to now, implemented by only few Member States and the quality standard fixed as a requirement to receive the payment has largely been objected as to loose or not relevant.

Furthermore, other measures introduced with the 2003 Reform are indirectly aimed at promoting product quality, despite quality is not their major objective. This is the case of the so called conditionality, of the support to farm audit, and the support to farmers who adopt production process that are respectful of animal welfare.

3. Economic justification for public intervention in food quality markets

Public regulation for product quality is commonly justified by market failures due to the important role played by information. The lack of information and its asymmetric distribution among agents leads to different cases of market failure: firstly, the moral hazard behaviour of firms selling low-quality goods but pretending they are high-quality (Akerlof, 1970); secondly, negative externalities are generated by the impossibility to distinguish goods of different producers, even in absence of opportunistic behaviour (Hennessy et al., 2003). Furthermore, the semi-public nature of quality information may induce sub-optimal production (Arrow, 1962). In such situations, public regulation is aimed at increasing, directly or indirectly, the amount of reliable information circulating within the market.

One additional justification of public intervention is based on the existence of entry barriers arising from the fixed costs which firms needs to bear in order to establish their reputation in the market .Such costs may generate scale economies that penalise small firms and reduce competition. Regulation is thus meant to provide the institutional framework for establishing collective reputation of small-scale producers, gathering together within a common name. The Regulation also prevents free riding behaviour that may arise in such cases (Tirole, 1996; Carbone, 1997).

Asymmetric distribution of information, its semi public good nature and the small average size of firms in the agro-food sector usually justify public regulation. In the case of food, quality takes often the form of credence attributes and it is mainly guaranteed by certifications within the framework of National or EU laws. These norms are, thus, explicitly aimed at providing reliable information to consumers, but they are also meant to help small scale traditional firms of the agro-food sector to gain visibility in the markets (see, for example, the introduction of EU Reg.2081/92).

The idea underling this approach is that consumers would be willing to pay the higher price corresponding to the higher costs of producing a better quality, if they are provided with reliable information on the true quality of goods.

In this vein, financial incentives to produce and communicate information –as settled with EU Reg.1783/03- could be only partially justified by the above mentioned reputation costs, as the scale economies in this case should be reached by the mean of the collective reputation

associated to the QS. Economic support could be required because of the necessity to settle the reputation of the whole European certification system. The complexity of such information requires for a coordinated effort at the central level.
Financial support aimed at increasing food quality itself – as envisaged in art. 24 of EU Reg.1783/03 and in art. 69 of EU Reg.1782/03- cannot be justified in the same framework. The determination of product quality is one of the strategic choice in firms' life, and there are no reasons that justify public intervention for fixing quality standards apart from quality aspects related to food safety The higher costs of producing higher quality should be undertaken only in the case in which consumers are willing to pay for it. Payments to farmers aimed at promoting the production of specific qualities could be only justified, on a temporary basis, by structural barriers preventing farmers to adjust production.

4. Problems with EU Quality Schemes

As already recalled, the main objective of the quality measures introduced with the Reform is to enhance the effectiveness of the pre-existing legislative framework. Therefore, it is worth discussing evidence of the way the Quality Schemes have been functioning to date. The focus here is to Pdo and Pgi in Italy, a country where there is, indeed, a true and rooted interest in typical, traditional products both from the demand and the supply side. In Italy there are 151 Pdo-Pgi product (the figure refers to October, 5th, 2005), while in 1996, when Reg. 2081/92 was enforced, they were 66. Their number, hence, more than doubled in ten years and, in 2002, their value (at firm prices) accounts for 11.3% of the total value of the corresponding industry (cheese, preserved meet, olive oil, cereals and fruits and vegetables). These is the main evidence of the supposed success of the Pdo Quality Schemes.
Nevertheless, a deeper insight shows that only ten products out of 151 Pdos and Pgis represent about 90% of their total market value, and that two third of this value come from only the first four products: Parmigiano Reggiano, Grana Padano, Parma ham and S.Daniele ham; products whose reputation and market success goes far beyond the existence of the certification of origin. Furthermore, the great majority of the other Pdo-Pgi products are almost absent from the markets and their economic value is insignificant even if compared with the production potential of the area protected by the Pdo-Pgi certification. This means that the vast majority of actual production obtained within the area entitled to use the certification, is sold in the market without any certification.
The relevant question is then: what are the reasons why new Pdo-Pgi are settled if they are not used? and which are the causes of the difficulties that apparently arise? Furthermore it should be understood the extent to which the financial aid to farmers joining Quality Schemes, introduced with the Reform, could be effective in removing existing constraints.
A first type of difficulty in using Pdo and Pgi -or similar kinds of certifications or "Shared brand names"- pertains to the dimension of the production units as well as to the dimension of the target market. The small production scale may prevents vertical integration, and prevent farmers to sell in the final food product market. Under such conditions, farmers may have no incentive to certify their products. Furthermore, in local markets producers-consumers communication is direct, and trust does not need formal guarantees. Consumers would not accept to be charged the costs of certification, because they already know the product, and trust its quality.

A second type of difficulty is due to the complexity of the functioning mechanism of collective reputation. Gathering under a common name (i.e. the Pdo-Pgi name) implies the establishment of a complex set of relations among producers. Firstly, the common reputation implies that the performance of each firm depends on what the others do. This is the reason why a common set of rules should be set in order to limit quality heterogeneity and variability, and in order to prevent opportunistic behaviour. Secondly, these common rules, once put in place, represent an additional set of relations among producers. Thirdly, if producers are organised in chains they are also vertically co-ordinated. This means that they sell and buy to each other raw materials and intermediate goods. Firms may, then, be exposed to opportunistic behaviours, and they may also act in the role of price takers if confronted with processing firm and retailers of bigger size. Furthermore, agreements on production rules are less likely to be reached, the more the firms are structurally diversified, have different market strategies and show different degrees of local roots.
A third type of difficulties concern the demand side. Consumers are increasingly involved in food quality, in traditional products, in typical food. Nonetheless, empirical evidence shows that about 35% of consumers in the European Union relate the quality of a product to its geographical origin; moreover, 80% do not know the meaning of the acronym PGI, and 72% do not know PDO (Nomisma, 2001). Most authors explain this situation with the complexity of the concept of quality and the high number of relevant quality attributes. This, in turn, has brought to the creation a wide range of Quality Schemes, both as a result of public regulation, and as a result of firms autonomous marketing strategies. This high number of “quality signs” in the market has brought about a loss of visibility of individual schemes (Hassan and Monier-Dilhan, 2002; Verbeke, 2005; Carbone and Sorrentino, 2003).
To make it more difficult for consumers to understand the huge amount of information generated by all these quality schemes, some of them do admit significant exceptions to the general rules settled with Regulations. For example, this is the case of Pdo and Pgi: Parma ham is a Pdo, but it is produced with pork meat produced in many Italian regions, an area far more large than what we call Parma region, so that, following what Reg. 2081/92 says, it should be a Pgi. About 95% of Pecorino Romano cheese is produced in Sardinia, an island far away from Rome, which the name of the Pdo is supposed to suggest.
If Pdo-Pgi hardly have proven effective in helping producers to increase their market shares, at least in Italy, it is to be understood the reason why they are continuously increasing in number. In Italy this is mainly due to the role played by the Public Administrations (PAs). At the local level, PAs are often more involved than producers in the process that leads to a new Pdo-Pgi: the Pas are convinced of the usefulness of the common labels, which are considered a rather simple, visible and low-cost kind of intervention. It is therefore regarded as a relatively easy way for maximizing political consensus among producers. And yet it must be explained why producers are not involved, or not sufficiently involved, when setting product characteristics, production areas, and other rules. The reason is that, both policy makers and producers, commonly believe that establishing a common label is the only element of a common competitive strategy. The misconception is that a common label is in itself sufficient to create demand for the product; for increasing consumer willingness to pay and in reducing competition and preventing moral hazard.
The search for political consensus has deep consequences on the features of common labels. It may drive PAs towards labels that include as many producers as possible, covering large

areas, and lowering quality standard, simply because higher quality requirements would exclude producers who are not able to meet them. It is clear, then, that there is a trade-off between policy makers' objective to maximize consensus and the conditions for a proper market functioning for common labels.

It should now be clear how the poor utilization of Quality Schemes is due to a complex set of reasons that go far beyond the single farm structural and behavioral characteristics. It is then inappropriate to simply frame the problem as a matter of financial support. Furthermore, the eligibility to financial aid could be an incentive for farmers to join Quality Schemes even if they do not intend to certificate the product they sell. Should this be the case, the results would not only be a waste of money, but also an increase of Quality Schemes in a market that is already overloaded of information, and in which it is difficult to distinguish reliable from unreliable information, and useful from useless information.

This problem of information overload especially arises in the case of new Quality Schemes entitled to support under article 24 of Reg. 1783/03. Particularly, new Quality Schemes set up at the national level may weaken all the EU quality certification system for more than one reasons. Firstly, because of the potential proliferations of QS in the 25 European Union member countries. Secondly, because the national QS will compete in the market, and this would lead to a "regulatory chill" situation, or even to a "race to the bottom" of the quality standards adopted by the apparently similar QS of the different countries. Actually, a situation like this seems to contradict the significant effort carried over the last decades to unify the regulatory framework for food quality and information with the twofold scope to help producers in the competition game and to protect consumers from the consequences of information asymmetry.

5. Conclusions

This last section contains hints on positive actions that could effectively improve the functioning of the existing European regulatory framework for food quality:

1. Firstly, a line of action should concern a stronger information strategy. As shown, despite a wide and increasing interest in quality on a general ground, consumers suffer from an evident lack of information on the relevant quality attributes and on the different factors affecting food quality. Consumers also lack information on the different characteristics of QS, in terms of the quality attributes to which they refer and in terms of the kind of guarantee and the associated level of trust. There is the need for a sort of European Authority aimed at promoting information and trust in the European quality certification system. Such an Authority should supervise the coherence of the whole system, its relaibility and correct functioning and should actively promote the circulation of information on food quality.
2. Secondly, the actual framework for QS needs a re-organization. Particularly, as seen, consumers may get confused by the very slight differences existing between Pdo and Pgi, as stated by Reg.2081/92, and bythe numerous existing exceptions to the general rules. Some products are accepted as Pdos, while they should in fact be Pgi according to a strict interpretation of the regulation. The likely result of such a situation is that consumers get confused, and tend to lose trust in the whole certification system.

3. Thirdly, there is a need to incentive the different stakeholders along the food chain to coordinate their communication strategies. Generally speaking, the presence in the market of brands of producers and distributors represents a serious threat to the effectiveness of public certification, at least potentially. Firstly, distinctive signals of a private nature benefit from considerable economies of scale, both in defining the content of the message and in its diffusion. *Viceversa*, the majority of companies that utilise certifications are small scale firms, and therefore they have few resources for investments in communication. One more advantage for private brands is that they convey very simple messages. On the other hand, the quality claims associated with brands tend to be more vague when compared to the certification ones. These two features are the consequence of the lack of legal obligation, as well as of the need for simplicity arising from the attempt to make the message more understandable and memorable. Nevertheless, major retailing chains have shown, in recent years, a growing interest in placing genuine PDO products in their display window distinct from their standard industrial fare, which anyway, stills remains the hard core of their product range. This strategy, that is a response to the need for an image more in line with consumer trends, leaves room for some cooperation with local producers of certified products.

As it should now be clear, the three line of intervention already outlined are strictly related. A better general information activity is possible and effective only if the message to be conveyed is rather simple and if there are no relevant exceptions to the general rule that weaken the reliability of the information conveyed. At the same time, an effective and reliable communication strategy for food quality could not ignore the role played by the retailers and thus requires for coordination along the food chain to avoid overlapping and contradiction, and to promote synergies.

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