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**ROUNDTABLE ON COMPETITION AND REGULATION IN AGRICULTURE: MONOPSONY
BUYING AND JOINT SELLING**

-- Republic of Lithuania --

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COMPETITION AND REGULATION IN AGRICULTURE: MONOPSONY BUYING AND JOINT SELLING

Contribution from Lithuania

(The Competition Council of the Republic of Lithuania)

Buyer concentration and its impact on upstream markets

1. The level of concentration among purchasers and processors of agricultural products has increased significantly in Lithuania during the last decade. The five largest retailers sold approximately 73% of all groceries in 2003, however, their share in the one-stop shopping grocery store market is significantly higher. Even though concentration among retailers is rather high, there have been no indications that consumers are paying exploitatively high prices for grocery items so far. On the contrary, the rapid growth of large-scale retailers was accompanied by falling grocery prices during the last five years. The Statistics Office of Lithuania reports the growth of food prices that is close to zero or even negative during every year since 1999. The presence of large-scale multi-product retailers not only serves the interest of consumer by providing convenient one-stop shopping opportunity but also increases competition among producers and enables consumers to afford more non-food items.

2. Large multi-product retailers exert downward pressure on prices in the downstream markets and do drive smaller and less efficient competitors out of the market. Nevertheless, this is a part of a competitive process and by no means is an exercise of the exploitative market power that harms consumers. The Competition Council of the Republic of Lithuania didn't receive any formal complaints concerning the exploitative behavior of the large retailers against suppliers. Market investigations showed that in general upstream price reductions are being transferred downstream to consumers. Although some suppliers complain about contractual terms imposed by large scale retailers, many producers benefit from being able to supply substantial share of their output in a much more predictable economic environment with substantially reduced risk that a buyer would default the payment or other obligations. The rapid growth of large-scale retailers in Lithuania preceded the technological restructuring and modernization in the processing level of the food supply chain. There is no evidence that buyer power made it impossible to finance required investments. On the contrary, the most prominent places on the shelves in the stores of retailers in Lithuania presently belong to those local suppliers that recently invested into their productive capacity and increased productive efficiency.

3. The most important sectors in processing of agricultural products in Lithuania are sugar production, dairy products and meat industry. Sugar production is the most concentrated among them. In this sector, Danisco Sugar A/S controls two factories and the third factory is locally owned by the *UAB Arvi cukrus* (private limited liability company). The two factories controlled by Danisco Sugar A/S have approximately 80% of national sugar production quota, they also purchase similar share of sugar beet from the local farmers. The latter are represented by six regional co-operatives and thereby are able to defend their interests during contractual negotiations with the two powerful buyers. Although aforementioned sector was regulated by the national laws or other national legal acts before the most recent EU enlargement, its market structure did not seem to change in any significant way after the Council Regulation (EC) No 1260/2001 of 19 June 2001 on the common organisation of the markets in the sugar sector became applicable directly.

4. The dairy sector is also highly concentrated. The three largest producers of milk products purchased and processed approximately 85% of all raw milk in 2003. (The five largest producers purchased and processed approximately 94% of all raw milk.) According to the experts, this industry is characterized by significant economies of scale and scope, therefore large concentration of producers is justifiable on efficiency grounds.

5. Meat processing industry is much less concentrated comparing to either sugar production or dairy industry. The three largest meat processors had slightly less than 18% market share in 2003 while the twelve largest meat processors had approximately 27% market share. The experts and business consultants recommend consolidation using mergers as a way of reaching efficient scale of operation. Only six producers in 2002 were able to establish reliable long-term supply relationships with the largest local retailers by being able to meet their demands in terms of qualitative and quantitative parameters. Many producers complain about being unable to get their products on the shelves of the large international retailer chains. The main reason is an insufficient productive capacity relative to the demand of a large retail chain.

6. Although the sugar and dairy industries are very concentrated, producers are unable to exercise their market power because they have to compete for a place on the shelves in the stores of the powerful large-scale retailers. In the case of meat production the further market concentration should result in a more efficient scale of operation.

7. When looking at the food supply chain in Lithuania one might be left with an impression that technological progress, innovation and dynamism are the most prominent in downstream markets but barely visible in the very upstream markets. The retailing sector employs modern methods and rapidly adjusts to changing market conditions thanks to the harsh discipline of competition. Successful processors of agricultural products either already succeeded to modernize their production capacities or at least intend to make necessary investments and improve their competitive positions in the foreseeable future. However, agricultural producers suffer from severe structural crisis. The share of agriculture, hunting and forestry in the gross value added of Lithuania decreased from 11.3% in 1995 to 6.1% in 2003. Nevertheless, it still remains enormously high compared to any Member State that belonged to the EU before the most recent enlargement. Almost 18% of all Lithuanian working population in 2002 was employed in the agricultural sector. These numbers reveal the alarmingly low productivity in the agricultural sector compared to the other sectors of the national economy.

8. Currently, the three types of farms exist: agricultural companies (corporate type farms also involved in food processing), family farms and small household plots (typically operated by shareholders). Family farms dominate the other two types, they are very small on average (11.9 hectares) compared to farm size in other EU Member States and are not specialised. Inefficient farming structure, small scale of operation, lack of investment in better technology impedes overall agricultural productivity and competitiveness. The fact that GDP per capita in Lithuania makes up only 39% (measured at PPP) of the EU average can be to a large part explained by considerably higher dependency on agricultural sector that lags behind in terms of quality, productivity, efficiency and competitiveness.

9. If from the viewpoint of productive efficiency the farm size is too small and labour input share in the overall cost structure is too high then the exit of the substantial part of agricultural producers is inevitable in the long run. A reasonable economic policy should make such exit less painful but only the most efficient producers should remain in the long run. Although the most powerful buyers of agricultural products in Lithuania were able to depress prices (for example in the dairy industry), however, the most successful farms already succeeded with technological improvements and reduction of average production costs. This allowed them to gain competitive advantage against other farmers but the most important consequence is the improved bargaining position against powerful buyers. Such farmers can supply a large

quantity of an essential raw material that satisfies certain qualitative parameters and therefore are needed as long-term partners to large-scale buyers.

Producer “joint-activity” organizations (co-operatives, marketing orders, market organizations) and the national competition law

10. The Competition Council of the Republic of Lithuania is not aware of the existence of any “joint-activity” farmer organization in Lithuania that would create anticompetitive harm by creating market power, limiting supply or raising prices. The only nationally authorized market organization existed in sugar sector and was replaced by the common market organization after Lithuania’s accession into the EU.

11. The Law on Competition of the Republic of Lithuania does not provide any specific exemptions for anticompetitive behaviour in the agricultural sector. However the Law on Competition contains a clause which states that “[t]his Law shall prohibit undertakings from performing actions which restrict or may restrict competition, regardless of the character of their activity, except in cases where this Law or laws governing individual areas of economic activity provide for exemptions and permit certain actions prohibited under this Law.” Therefore it is possible to introduce antitrust exemptions using other laws, however, such instances are very rare. National competition law contains very similar prohibitions to the ones that are applied in the EU because during the pre-accession years there was a need to harmonize national competition rules with the EC law.

12. The national competition law prohibits agreements between undertakings which have as their object or effect the restriction of competition. The Competition Council recently adopted a resolution which made clear that national competition rules apply to production and trade of agricultural products to very similar extent as it is stated in the EC Council Regulation 26. In general the Competition Council treats all agreements, decisions and practices which are *necessary* for the attainment of a fair standard of living for the agricultural community and market stabilization as deserving antitrust exemption only when there are no less restrictive means that could allow the achievement of such goals. Although the farmers’ co-operatives virtually do not exist in Lithuania (except sugar beet sector), the Competition Council would not prosecute the joint-activity organizations that would use common facilities for the storage, processing or transportation of agricultural products. The same applies to the co-operation of farmers in selling their products via the co-operatives as long as such arrangements would not involve obligation to charge identical prices and would not exclude competition. In general, co-operation in various stages of production or marketing should help the participating farmers to achieve the more efficient scale of operation and increase productivity. Under current conditions it is hardly imaginable that such co-operation would attract a large number of market participants. Therefore there is no reason for being concerned about the possible abuse of market power. The Competition Council tries to make its position very clear on every possible occasion: co-operation among farmers is always welcome as long as it creates economic benefits, provides for improvements in technology, production and distribution, increases competitiveness, and does not allow to substantially lessen competition. For a large co-operative it would make sense to behave in a way similar to a dominant firm because it could exercise its market power by restricting supply or raising price. Since a small co-operative would not be able to influence market price by restricting its supply, the most likely reasons for its existence should be efficiency gains that are beneficial to society.