Roles of governments

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THE UK GOVERNMENT'S ROLE IN POST BREXIT FARM INCOME SUPPORT AND TRADE POLICY

Abstract

Brexit has provided impetus to discuss the UK government's role in policy with the knowledge that a new agricultural policy will be introduced. Decisions on income support are likely to have a bigger influence on farmers than trade issues, in general. However, support levels are within the control of the UK while trade issues may not be.

While the UK government expects to reach new agreement with the EU on trade this may not be achieved. In the absence of agreement the UK would be subject to EU tariffs on exports but would be left with a decision on whether current import tariff levels should remain or be removed unilaterally. Imposition of tariffs would raise many UK consumer and farmer prices. Unilateral reduction would lower prices in some farm sectors and make it difficult to exclude hormone-treated beef and other practices.

Support measures that have been applied by the EU are examined from a practioner's view point.

Decisions that have been made (or at the time of writing are likely to be made) are classified according to how they relate to Brexit. Argument is presented to remove income support measures and improve design of schemes to deliver public goods.

Since the UK is a net contributor to the EU budget the UK tax payer will benefit when the UK leaves the EU. In the longer term, it is likely that expenditure will increasingly be directed away from agriculture.

Initially EU and UK partners trading through TRQs look likely to be largely unaffected or worse off. However, in the longer term the UK may well lower tariffs unilaterally in exchange for access for non-farming goods or simply to lower food prices.

Keywords: Government policy, Brexit, CAP

Background

Brexit (the departure of the UK from membership of the European Union (EU)) implications can be divided into three:

1. Changes enabled by the transfer of control but are not a necessary consequence.
2. Changes that may be imposed on the UK such as tariffs on exports to the EU
3. Consequences, such as exchange rate changes and slowing of investment that are largely a result of policy in sectors other than agriculture.

The EU Common Agricultural Policy (CAP) has evolved to a considerable extent. Production quotas have disappeared, state intervention to purchase produce in times of low prices is now small, or non-existent, and subsidised exports allowing EU prices to be above world prices have largely gone. The EU is a net exporter of most agricultural goods[1]. The EU is an overwhelming exporter of most cereal grains, sugar (from 2017), dairy products, eggs and meats. It is a net importer of maize, rice and sheep meat and most significantly oilseeds. Export prices have to be competitive with other exporters. The export price determines the internal price.

The EU markets are complex and for nearly all of the categories listed above the EU is both an exporter and importer (much more so than the USA for example). As a generality, the EU imports and exports different specific qualities within the larger categorisation.

In contrast the UK is largely a net importer of agricultural products so that adoption of the EU bound tariffs and share of Tariff Rate Quotas (TRQs) defining a volume and tariff, will have more impact on UK prices than they have in recent years. Thus based on data from the HMRC (Her Majesty's Revenue and Customs) the UK is only a significant exporter of barley, lamb and milk powder. The UK has historically also exported wheat but this looks likely to reverse. The UK export of lamb is approximately matched by the import of lamb from New Zealand through the low tariff TRQ. The imports have a seasonality component but there are also differences in quality: the UK has a preference for legs of lamb.

[1] EU Agricultural outlook for the agricultural markets and income 2017-30 https://ec.europa.eu/agriculture/markets-and-prices/medium-term-outlook_en

High historic tariffs followed by radical policy reform has meant that the EU and thus the UK will be well within WTO subsidy limits[2].

Common Agricultural Policy Elements

UK farmers have a long history of subsidy starting before the UK joined the EU with the Corn Laws introduced in 1804 being perhaps the most infamous example. Since then the UK introduced monopoly farmer marketing organisations and various price supports.

Since joining the EU the UK has been subject to the CAP.

UK farmers now receive one of the highest subsidy payments per head in Europe (as calculated from EU documents 'Multiannual Financial Framework 2014-2020 and the financing of the CAP[3] and 'Summary Report on the implementation of direct payments[4]). This is mainly a consequence relatively large farm size but to a lesser extent high crop and dairy yields which initially gave rise to the subsidy.

The most common subsidy level for 2017 in England was about £230/ha. Defra (Department for the Environment, Food and Rural Affairs) states that for the period 2014/15 to 2016/17 42% of farms would have made a loss without subsidy. However, 16% of farms made a loss even with subsidy and no allowance is made post removal of subsidy for adjustments of any sort including rent. In practice, the complex relationship between the amenity value of the farm (e.g. house and environment), lack of non-farm experience (social circle and family history associated with farming), tax benefit (e.g. over manning to improve the quality of life is tax efficient) and commercial interest means that profit maximisation is rarely the only objective.

Mansholt, proposed the original CAP policy, with the intention of reducing the number of farmers by 5 million to create larger, modernised farms. This proved politically unacceptable. Since then a number of measures have been tried.

There is general approval of the EU policy amongst those surveyed (See Commission Survey 'Special Eurobarometer 473 Europeans, Agriculture and the CAP[5]' published February 2018). However, some care must be taken to distinguish between the objectives and actual achievement.

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[2] See Professor Alan Matthews Emeritus of European Agricultural Policy in the Department of Economics at Trinity College, Dublin, Ireland 'Recent trends in EU WTO domestic support notifications' (http://capreform.eu/recent-trends-in-eu-wto-domestic-support-notifications
[3] https://ec.europa.eu/agriculture/sites/agriculture/files/cap-funding/budget/mff-2014-2020/mff-figures-and-cap_en.pdf
[4] https://ec.europa.eu/agriculture/sites/agriculture/files/direct-support/direct-payments/docs/implementation-direct-payments-2016-summary_en.pdf
[5] http://ec.europa.eu/commfrontoffice/publicopinion/index.cfm/survey/getsurveydetail/instruments/special/surveyky/2161

The CAP has used a number of devices, largely aimed at income support and removal of price volatility, to achieve its objectives.

Income support and trade measures

Measure	Objective and practioner view on achievement	Adverse consequence from a practioner's view point
Intervention buying Government purchase of stock and crop when prices are low with the intention of resale when high. Intervention buying is now minimal and largely superseded by direct support schemes.	Stabilisation of prices when used in conjunction with import tariffs and export subsidies. Largely achieved.	Removal of disincentive to produce when price was low with consequent increase in surpluses and high consumer prices.
Import tariffs Tariffs imposed on imported goods	As above.	As above. Also the EU has moved to becoming a net exporter so tariffs have had a reducing impact.
Export subsidies To avoid produce entering or remaining in intervention stores, subsidy is paid to allow the high internal priced product to be exported onto the lower priced global market. These largely no longer apply.	Removal of politically damaging and expensive crop and stock surpluses.	Reduction in world prices, particularly when grain stocks were being reduced, lowering producer prices, contributing to price volatility and damaging developing economies.

Headage payments and crop specific support Payments made per head of stock or per area of crop type (not all crops) Superseded by the Single Payment Scheme (SPS).	Reduction in EU commodity prices and cost of support. Income was protected and some of the volatility resulting from varying crop yields was removed.	Over stocking occurred and different subsidy levels between crops led to supply and demand imbalance. The benefit from higher productivity was reduced. Subsidy maximisation became the objective for many livestock farmers.
Unlinked set-aside Farmers could opt to take all or some of their land out of production in order to receive payment. Still permitted under the replacement SPS and BPS schemes (see below).	To manage over-supply. Effective but the poorest areas of the farm were removed from production, and crop yields continued to increase, resulting in only a small change in production.	Politically difficult i) farmers were paid to do nothing ii) land was removed from production in a time of global shortage. The payment provided the rental floor.
Linked set-aside In order to receive subsidy arable land had to be taken out of production. The mandatory rate varied annually peaking at 15% but farmers could increase up to 50% of the arable area. No longer a requirement.	To manage over-supply. As above.	As above. The cost of production was increased on the cropped area.
Production quotas	Removal of internal milk surpluses to raise internal prices.	Higher production cost as a result of loss of economies of scale for producer and

Limits imposed on production with imposition of fine if exceeded. Milk quotas were tradeable. All now removed.	Reduction in sugar production to ensure compliance with WTO limits on export. Highly effective.	processor. Loss increased as technology advance allowed more economies. Creation of an asset (the quota) that became the main financial constraint. Closure of sugar plants even in deficit areas for sugar. Subsequent removal of quotas resulted in large over production, triggering price instability.
Single Payment Scheme (SPS) Subsidy received in a reference period was converted to a payment voucher that had to be matched with an equivalent area of land farmed in the reference period in order to receive payment. There was some flexibility to link, and increase, the subsidy to production to particular crops. Light environmental conditions and retention of historic grass were required. Implementation detail varied between EU countries.	Reduction in the distortion in production resulting from payment of crop and stock-specific subsidy. WTO compliance was increased. Largely effective.	Except where linked to production, the subsidy set the minimum rent level and was capitalised in land value benefitting the landowner rather than producer. Farmers used the subsidy to cross subsidise production so that production responses were still muted. The application process became more complex particularly as far as the mapping was concerned and some payment agencies struggled to make payments. Politically it became difficult to justify the payment, and the variation in payment. Higher subsidy linkage to

		particular crops in some EU countries disadvantaged others.
Basic Payment Scheme (BPS) This was a development of the SPS and retained the concept of a subsidy voucher that needed to be matched with land. Individual farm payments were averaged and differences between countries narrowed. Stronger environmental measures were introduced specifically a crop rotation and dedicated environmental areas. Options to reduce payments to larger recipients and to support new entrants.	To remove the difference in payment rates between farms (England had already implemented this) and reduce payment differences between EU countries. To increase new entrants. To increase environmental protection.	Administrative problems already associated with the SPS increased. Farmers increasingly relied on consultants to make their application. More payment agencies failed to deliver payment on time. Payments to young farmers maintained the status quo and went to farmers' sons and daughters who would have inherited anyway. The environmental connection delivered very little, if any, benefit but increased cost and bureaucracy, bringing the scheme into disrepute. For most countries capping of payment was modest but discouraged reduction in cost through expansion. Businesses looked for ways to split their businesses to remove the reduction.

Targeted support

In addition to the income support, money was made available to EU countries to fund specific objectives. The implementation detail varied between member states and the following provides only a flavour of the sort of investment that was permitted.

Measure	**Objective**	**Adverse consequence from a practioner's view point**
Capital grants to enhance farm profitability Grants provided for specific items either as part of a development plan or for specific purchases. Items funded included drainage, machinery and buildings. Payment % varied between items.	To improve farm efficiency and increase income generation. Effective.	Grant benefit was often shared between farmer and supplier. Funding was frequently granted for items that would have been purchased in any case. The development plans were bureaucratic often with insufficient information to allow robust justification.
Environmental schemes A list of environmental enhancements were identified and cost of implementation calculated. Detail varied between schemes and for some schemes groups of measures had to be applied. Application for some schemes was competitive.	Enhancement in areas such as diversity, protection of water supplies and reduction in greenhouse gas emissions. The grants raised farmer awareness and many felt obliged to enter. The schemes became a requirement for some marketing and farm assurance organisations. Over 5m ha were estimated to be in the scheme in	Payment had to be based on income foregone to comply with WTO. The initial estimate was not adjusted to reflect varying uptake of options suggesting that the cost varied. Introduction was in a period of high income volatility resulting in under reward in some year. Above average farmers were under compensated and removal of land from production potentially resulted in a higher cost of

	England although in-field options represented only about 60,000 ha or a little over 1% of the area.	production. The payments did not recognise different value of environmental delivery. The schemes have become over-complicated and the number of applications has reduced.
Grants for diversification, marketing and collaborative projects Payments of up to 40% made for development of diversification of projects. Detailed business plans were required and application was competitive. There were usually employment creation targets. Again there were a number of different versions of the concept but they all followed a broadly similar form.	To reduce reliance on farming income. The major benefit is raising awareness of the grant objectives.	Application is time consuming and usually undertaken by a consultant with the applicant left with cost if unsuccessful. In practice outcomes are often highly speculative. The delays involved frequently mean that it is better to progress without the benefit of grant. While the application considers the impact of displacement some impact on competitive businesses does take place. While the applicant has to indicate that the project would not go ahead in the same form without grant, in the majority of occasions this was not the case.

Changes enabled by the transfer of control

There is no absolute reason why UK support policy has to change post Brexit. The proposed change reflects largely political objectives and not technical concerns. Political decisions are needed: to determine any transfer of resource to and from the sector; the need for any level of self-sufficiency; and level of appropriate environmental protection. There is not a definitive correct conclusion.

The current expectation is that subsidy will be both reduced and diverted to fund public goods, such as environmental protection. In the transition period it is proposed that subsidy will be reduced more aggressively for larger recipients and decoupled from land (the subsidy right may be transferred to a non-farmer). The mechanisms for the payments for public good look likely to be along similar lines to those experienced as EU members.

The promised increase in funding is unlikely to bring more land into environmental management but could increase the area of more beneficial, and expensive, options such as pollen and nectar mixes for pollinators and wild bird seed options.

Reduction in subsidy should improve market focus and return on entrepreneurial ability but adjustment will be hard.

Tariffs

The most likely outcome, and both parties' objective, is a **new Free Trade Agreement** (FTA) so tariffs between the UK and the EU would remain as at present. Cost of trade would still rise because the bureaucracy would increase through the need for documentation and customs checks. The Rules of Origin are specific to each FTA and may further complicate trade in even basic manufactured goods such as flour. Up to 20% of the trade in flour and bakery goods (that containing prohibitive levels of Canadian wheat) from N Ireland to the Republic of Ireland might be affected.

If the UK fails to reach agreement with the EU, it would adopt EU Most Favoured Nation (MFN) tariffs and an appropriate share of any TRQs[6]. The UK would be free to reduce these tariffs although it would have no control over the tariffs applied on its exports to the EU.

Prices for goods exported by the UK to the EU would fall.

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[6] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018PC0312&from=EN

Where tariffs were applied the price of EU goods exported to the UK would increase and where they were reduced all trading parties would gain improved access terms.

The non-country-specific TRQs are likely to be of key importance since they enable some trade at a low tariff. For example, on medium and low quality wheat, there is a non-country specific TRQ of 2,378,387 tonnes and a tariff of €12/t while the bound tariff is set at €95/t.

The UK and EU have agreed their respective share of the TRQs. The UK share of the wheat TRQ above is 3.6%. In most years the EU total has been filled by third parties. On average, the UK has exported 1 million tonnes to the EU and imported 1.2 million tonnes from the EU over the last five years. In future, the UK proximity to the EU is likely to mean that EU-UK trade uses the available TRQ. Not surprisingly there has already been dissent expressed by several of the EU's trading partners[7].

In the case of wheat the TRQ tariff is likely to be shared according to whether there is a quality attribute. Where the lowest grade feed wheat was exported either the grower would have to accept the tariff cost, or export to the next available market (North Africa) if cheaper. However, where there is an element of quality the tariff would be shared by buyer and producer or even absorbed entirely by the buyer.

Clearly the bound tariff, if applied, would prevent any trade.

The agreed division of the TRQs between the UK and EU (based on an average of trade patterns) will initially leave Australia and New Zealand exporters worse off for some goods. (The EU and UK averages may on occasion constrain the total volume that can be exported to below the historical level for the two together). For a commodity, such as lamb, there is a risk that if the UK supply to the EU becomes subject to tariffs, the internal UK price would fall. This would make the UK unattractive for New Zealand and Australian exporters. While EU prices would rise (without the benefit of UK exports), benefitting Australian and New Zealand exports within the TRQ, the split TRQ would not allow redirection of those exports previously sent to the UK, to the EU.

A complication that may not be apparent is that the EU currently imports and exports very similar goods. While a simplification, the EU tends to export goods perceived to be of lower quality (at a price competitive with the global market) while importing higher priced goods despite imposition of a tariff raising the internal EU price. In contrast to the EU 28,

[7] https://iegpolicy.agribusinessintelligence.informa.com/-/media/agri-article-media/ieg-policy/2017/10/uk-eu-wto-letter.pdf?la=en&hash=0FEFFE942594C160253D6815049A819C09FE2C6E

the UK tends to be a net importer. If the UK retains tariffs, there is likely to be a complicated rebalancing of, for example, carcass value impacted on by cross elasticities. There would be an opposite rebalancing in the remaining EU although this would be less significant.

In the longer term, the UK may lower agricultural tariffs in exchange for concessions in a new FTA, or simply to reduce UK internal food prices during a period of economic uncertainty. This will provide exciting opportunities for Australian and New Zealand producers particularly for goods deemed to be of a premium quality. Traceability and animal welfare look likely to be important marketing components.

If the UK lowered tariffs unilaterally the EU and all other countries would have low or zero tariff access to UK markets. This avoids higher prices but weakens our negotiating position on tariff reduction with non-EU countries.

Conclusion

EU agricultural policy has explored many policy permutations. Success has been mixed and earlier schemes have often been replaced with new versions to correct the problems that earlier attempts had created. Income support schemes have in practice stifled innovation, made it harder for new entrants and allowed farmers to maintain a higher standard of living than the reported income would suggest. The benefit has been transferred into capital values for land and more particularly into rents.

Import tariffs are difficult to justify in a wealthy economy.

Greater confidence should be placed on consumers to make food choices on issues such as genetic modification, hormone treatment and animal welfare through appropriate labelling of products. Providing the scientific evidence suggests that the practice is safe, preference issues should be passed to the consumer.

There is a role for government intervention to encourage delivery of public goods such as environmental enhancement. Post Brexit policy is moving in this direction. But delivery objectives need to be much clearer and cost implications better understood than they have been to date.

Providing the objectives are clear provision of short term grant aid to improve efficiency and encourage farms to diversify to produce new income streams is desirable to help transition but it does need to be for a finite period. This policy has been accepted as a likely introduction post Brexit.

Since the UK is a net contributor to the EU budget, there will be a saving for the UK tax payer when the UK leaves the EU and before any additional savings in agriculture support. However, the cash saving may not be reflected in economic benefit since the return on investment in the two situations is unclear. In the longer term the UK Treasury has consistently argued to move support away from agriculture to other areas (such as health, education and defence) and support looks likely to fall further. The UK tax payer benefits further if tariffs are reduced.