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A UK perspective – what happens to UK agriculture post - Brexit?[1]

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This article from a UK-based author examines the issues leading up to and surrounding the current Brexit negotiations, particularly the impact on their agricultural sector and the possible effects for other countries such as New Zealand.

How did we get here?

The UK voted in a national referendum, and by a close margin of 52-48%, to leave the European Union just over three years ago. Although Article 50 (the legal mechanism by which a country can leave the EU) was then triggered, two dates by when we should have left have already passed. The latest date is now set for the end of October 2019.

Views on the impact of this on the UK agricultural and food sector are almost as polarised as the result of the vote itself. Some will point to a highly positive view of the UK being able to farm and produce food in a manner free from the supposed shackles of the Common Agricultural Policy (CAP), and able to take advantage of new trade deals with the likes of India, China, other Asian markets, the US and Oceania. Others hold a more cautious view and, in some instances, predict a potential disaster.

Political log jam – and a new Prime Minister

In the UK Parliament, there has been an unbreakable political log jam for many months. Some EU countries, such as Ireland and The Netherlands, have made it clear that they would rather the UK didn't leave at all and would be prepared for further discussions on how any adverse impacts of the UK departure can be minimised when it exits the EU.

The agri-food sectors of both these countries are intertwined with the UK, not just over trade, but with a series of significant investments in joint ventures, mergers and acquisitions over a prolonged period of time. In Ireland, there is additional concern over the nature of border and security arrangements between the Northern Ireland and Ireland. Others in the European Commission and European Parliament are more tough nosed in their approach and have stated that there can be no further negotiation on what has been agreed to date.

The ongoing political wrangling in the UK eventually cost Theresa May, the Prime Minister throughout most of this process, her position. She was personally a 'remainer', and looked to reach a consensus across the political spectrum but failed. She therefore ended up pleasing no-one.

Enter a new Prime Minister in July – Boris Johnson. He is a committed 'leaver', and his first Cabinet appointments were also packed full of other committed 'leavers'. He has said repeatedly he is willing to walk away from the EU in October without any deal in place. Even if Johnson wants to do this, it still needs to be ratified by the UK Parliament, but to date this has proved to be impossible. In the spring of 2019, seven different options on how to leave the EU were all rejected by Parliament. However, a US$6 billion package to prepare for a No Deal, and a US$125 million public advertising campaign on this that was funded by the Government, suggests he is deadly serious about this.

Deal or No Deal?

Leaving the EU without a deal would mean reverting to trade with other EU countries on World Trade Organisation (WTO) terms with much higher import and export tariffs in place for the UK and much stricter regulations on the movement of labour around the UK and EU as well as a potential hard border between Northern and Southern Ireland. A ''deal'' would see a much softer approach to all of these issues and maybe the UK staying in the EU customs union for a further period.

Johnson has stated initially that he sees the chances of a No Deal Brexit as minimal and we could still stay in the EU Customs Union for a further two years while the UK re-negotiates what was agreed under May's leadership. In more recent days he has also stated that this could now also be a ''touch and go'' process and that No Deal is still on the table as far as the UK concerned. Even in the time between now and the end of October, it seems likely that a good deal of brinkmanship on both sides is inevitable.

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Johnson has also stated that the blame for a No Deal scenario would be laid squarely at the door of the European Commission in Brussels for failing to re-engage in further talks on what conditions underpin the UK's departure. It is clear to see why he might not be the most popular person in Brussels at the moment.

We need to import

Where has this left the agricultural and food sector and what might be the consequences especially of a No Deal Brexit? Historically, the UK has over a very long period of time been a large net importer of agricultural and food products, and its one reason we had an Empire. We are now only about 60% self-sufficient in food production, and this is even lower in some cases such as horticulture. Put bluntly, we have to import. There is a big danger that these imports could be severely impacted if the UK left with a No Deal. Increases in UK production could be seen, but there is an awful lot of ground to regain and investment required to do this.

WTO tariffs for fresh produce, as an example, range between 15% and 20%; for dairy the rate is 35% and for red meat up to, in some cases, 80%. This would inevitably see supply chain prices rise, but no-one wants that, not least the consumer. And certainly not fresh fruit and vegetable exporters to the UK from the rest of the EU, the US, Chile, Peru, South Africa, New Zealand etc, or dairy exporters from the EU and Oceania countries.

The imposition of import tariffs would see domestic grower/producer prices rise, but on top of import tariffs, additional costs incurred such as border and phytosanitary checks and potential transport delays might add anywhere from 5-8% to import costs. Increased prices in the supply chain would logically lead to food inflation and potentially reduced consumption. This is not good news for UK farmers, the rest of the supply chain or consumers.

New trade deals?

There has also been lots of talk of new trade deals with the rest of the world, post-Brexit, and this includes the US. On his recent visit to the UK, President Trump talked of doing a 'quick and outstanding' trade deal with the UK. But how quick is quick – two years, three years, five years? And 'outstanding' for who? Agriculture and food would be at the heart of this. And rightly or wrongly, the UK has very strong views on areas such as chlorinated chicken, hormone-treated beef and GM soybeans, all of which the US would love to export to the UK. This will not be an easy negotiation.

Talks on this could begin in August though, according to latest reports, and might end up with US exporters having much better access to the UK. This would only add to the competitive pressure faced by UK farmers. They might have also lost great access to lucrative EU markets – something of a double whammy.

There is similar concern that a trade deal with Australia and New Zealand would benefit farmers in these countries, more than it would do so the UK, not least as their producers are already well versed in operating in international markets. Much depends on whether Oceania-based farmers and exporters see the future opportunity in the UK or other exciting markets (such as China), or other South East Asian countries (such as Indonesia, the Philippines and Malaysia), where they have already established an increasingly strong foothold.

Areas of concern

There are a number of areas of huge concern for the UK agricultural industry about the impacts on domestic farming and food such as:

- **The UK Government will need to develop its own agricultural policy**
  This will be in time to replace the EU Common Agricultural Policy. The HM Treasury has in the past stated that the only reason they pay out subsidies is because they have to as part of our EU membership. Given an opportunity to remove these subsidies, they would, as it does not fit UK Government thinking, almost regardless of which political party is in power.
  A new UK Agricultural Bill is working its way through Parliament, but has been bogged down in the Brexit process. There will be increased payments for good environmental practices and the supply of public goods and services, but reductions for more conventional production support. Existing levels of support for farmers will be guaranteed in the relatively short term, but will then almost certainly go through a fundamental review over the next five years.
  The reality is that too many farmers in the UK are overly-dependent on CAP-type support. Without an urgent restructure of how farms are managed and financed, any reduction of CAP type support will put UK farmers under severe financial pressure. This is particularly the case in the beef and sheep sectors, and potentially smaller dairy farms, whereas the horticultural sector has not traditionally received high levels of production support and thus would see less of a detrimental impact from any reduced support.

- **Market access to the EU**
  A very high percentage of UK exports go to the EU, and in return many products are imported from there. For example, in the case of fresh produce, for The Netherlands, the UK is their second most important market with trade in fruits and vegetables worth some £1.1 billion per annum. For Spain, the UK is their third most important market, with fresh produce exports to the UK worth about £1.6 billion. For many horticultural products, especially tomatoes, cucumbers and peppers, there are few alternative external suppliers of high-quality produce beyond the EU, especially The Netherlands and Spain.

- **Access to labour**
  Many farms in the UK are now very dependent on migrant labour from Eastern Europe, and in the build-up to Brexit we have already seen a steady stream begin to leave the country. This is because, in some cases, they no longer feel welcome in the UK per se, but also with a weakened Sterling, the wages of East European nationals living in the UK have already fallen compared to what they might be able to earn in other parts of Europe.
  We are already struggling to find the right labour for our farms and this issue will become more acute.

Post-Brexit, it is likely that the supply of this labour could be restricted and the administrative burden associated with sourcing it will increase.

- **Effects on costs and prices**
  As most crop inputs are traded globally in USD, any weakening of the Sterling would see the costs of fertilisers and chemicals to growers increase. At the same time, a weaker Sterling might also see UK agri-food production become more price competitive against imports per se. It is expected that, overall, there will be more price volatility in the UK market.

Initial impacts on the dairy sector

For individual sectors, at Promar International we have carried out an analysis of a number of specific sub-sectors, including dairy, which is of special interest to New Zealand. We believe that the true impact of Brexit might not be felt for some time, but will accelerate (at least in the short term) many of the trends and changes we have seen already playing out over the last 10 years.

Based on our insight and industry feedback, we also suspect there will be no drastic wholesale exit from the sector, but this will continue at the same levels as seen in the past at around 3% per annum. Herd and farm sizes will gradually get bigger over time. Exit levels will still be driven by the relative age of dairy farmers in the UK and the lack of effective succession planning. In some cases, this might provide opportunities for younger farmers.

Those farmers who are on the so-called aligned contracts with major retailers will be best positioned to continue to invest in their farming operations, while those who are not will remain more vulnerable to volatility in overall market conditions. The key task for dairy farmers will still be to have a greater understanding of the true costs of production and then have the ability to control these.

Most of the farming systems found in the UK dairy sector will largely remain. However, there might be a move, in some cases, towards more specialisation with the increased use of spring calving and robotics, etc, which is already happening.

Welfare standards upheld

At one stage, many farmers who voted for Brexit seemed to believe that exiting the EU and the CAP might end in a ‘bonfire of the (EU) legislation’. UK retail support for liquid milk, however, will remain high and standard/accreditation schemes such as ‘Red Tractor’ will continue to set the minimum requirement for suppliers beyond any statutory legislation.

Supermarkets will raise the standards required by looking for the additional attributes of animal welfare, animal health and the all-round sustainability credentials of their farmers. Animal welfare will still be seen as a key issue for farmers to address and there will be no slackening of these. UK consumers will still want to see dairy products being produced to a high standard.

No-one is totally safe

Lower-performing farms, regardless of size, will be put under pressure first and could easily end up quite quickly with serious financial difficulties and face bankruptcy and insolvency. The pressure to exit the sector will increase on the lower-performing herds. Even the more able farmers might consider exiting the sector when faced with the cold facts, but their decision to do so will be based less on emotion and more on the reality of the situation. Indeed, they might be the first to exit, as some others will continue to bury their heads in the sand and pretend this is not happening. Banks are unlikely to lend to any dairy farmers who do not have in place well-developed business and succession plans.

Processors and retailers alike will want to protect their milk pools and avoid any sense of panic. This will see them look to strengthen the integrated nature of their supply chains.

The really talented dairy farmers will be more involved in the multiple ownership of units on different sites and the development of new units. They will be the farmers to lead any growth in UK production. There might be some farmers switching from beef/sheep (and the arable sectors), as they are likely to be hit harder by Brexit and might end up considerably less profitable than in the past. Farmers who have excellent all-round management skills will do best of all.

More volatility is the new norm

With reduced protection in the mid to long term, UK dairy farmers will truly be more exposed than ever to global milk price volatility, and when/if prices go low the traditional response of ‘tightening the belt further’ is unlikely to be enough on its own. Farms of between 200 and 300 cows will feel the pressure of labour issues most of all. Some will choose to go down the robotic route and more skilled labour will inevitably be required, but as noted this is already in short supply.

There will be a move towards bigger farms, with more use of larger rotary type parlours and not just the use of robotics. Farmers might find it more difficult to obtain credit with adverse knock-on impacts to the rest of the supply chain such as vets, feed companies and other input suppliers.

The need to control and reduce costs will see more farmers move to more grazing-based systems and focus on keeping farming systems as simple as possible, especially for the use of labour and machinery. There is likely to be a move to more shared farming agreements/arrangements and collaboration between farmers on a ‘needs must’ basis.

Farmers who can control/manage their costs well will still be able to make money from dairy farming, but those who are not able to do this will find life tough. Those with high levels of existing debt will struggle in particular. All UK dairy farms might be at some risk, but clearly some will be more so than others. Farms still need to be run more efficiently and in a much more business-like manner. UK dairy farmers will be producing in a very different market environment and the overall mindset of the industry will be forced to change.

Supply chain impacts

UK milk production is running at around 14 billion litres over the last few years. The 5 year average UK farm gate milk price being 27.23 pence per litre (ppl) in the summer of 2019, down 2.4% from the same the month in 2018, when it was 27.91ppl, showing the relative stability of the 5-year average.

The average though, can hide a wide degree of variation though with the highest prices being paid to UK dairy farmers reaching 33 ppl and the lowest, typically for processing contracts, much nearer 25/26 ppl.

The UK dairy sector is strongly intertwinned with the rest of the EU. 90% of our dairy imports are from the EU and 70% of our dairy exports go to the EU too. And a number of the leading processors - the likes of Muller and Arla etc are all EU based businesses too.

The impact of leaving the EU in October 2019 is likely to have far reaching consequences across the supply chain as a result.

High-end retailers will encourage farmers towards outdoor systems of production, but the majority will want them to control the costs of production, and so there will not be an automatic move to these. Indeed, there might be moves to increase indoor production and the development of higher-yielding herds.

The issues surrounding the availability of labour will act as a brake on the development of so-called super units. There will be no major change in the key geographic areas of dairy production in the UK. Any potential expansion in the sector to potentially replace UK imports of dairy products will be driven by the demands made by retailers and the ability of processors to expand capacity and invest in this.

Processors might find it difficult to procure sufficient volumes of milk. The smaller, less efficient of these, in particular those producing non-branded products or own label retail products, will find life much more difficult. The potential lack of milk would drive the further consolidation of processing capacity, especially for cheese.

To do this, there will need to be investment in processing capacity by the leading players, many of whom are somewhat ironically owned by the Irish, Danes, Germans and French. Like it or not, the fate of the UK dairy sector is massively interlinked with Europe, regardless of Brexit. A great British dairy sector? We are part of a global supply chain, but sometimes act like we are not.

The likely reaction of the UK retailers to a No Deal would be that, faced with less options for imported products, they would look to encourage additional production in order to provide a full range of dairy products for their consumers and also help keep a lid on the price of these products. They would still want to be able to meet the full range of choice of products required by UK consumers and have efficient producers to supply them. The more able and talented dairy farmers, in particular, should be able to thrive in this scenario.

Others will be impacted too

It is unlikely that there will be any expansion in the demand for liquid milk, which has been the subject of long-term decline in the UK. Any growth in the UK dairy sector will therefore be driven by increased demand for products such as cheese, butter and ingredients. This would help displace some of the UK's current imports, especially from countries such as Ireland, who under the prospect of a No Deal Brexit will see their exports to the UK become more expensive.

Indeed, the impact of a No Deal will be felt as much in countries that export to the UK, such as Ireland, as it is here. The Irish have as much, if not more, to fear from a No Deal Brexit than the UK. As a result, the well-organised and resourced Irish Food Board, Bord Bia, is stepping up efforts to identify and develop new export markets, especially in Asia and the Middle East.

So – what next?

No-one still really knows. The European Commission has said repeatedly that there is no further room for negotiation on what has been agreed to date. The pro-Brexit members of the UK Government believe there is still time to achieve this, but if not they are willing to walk away with a No Deal. This would still have to be ratified by the UK Parliament and, to date, they have been just as divided on this issue as the wider population.

The Government has a wafer thin overall majority. Getting a No Deal through Parliament will still be a huge challenge – and time is running out. The UK is due to leave the EU by the end of October 2019, but Johnson has indicated that this could be done with a further two-year transition period agreed.

In the meantime, the UK economy overall still continues to do relatively well against some of our European neighbours such as Germany, Italy and France. Consumer confidence is somewhat fragile though – and understandably so. The threat of a No Deal Brexit still acts a brake on many areas of commercial activity. At a retail level, online shopping and the role of the discount stores, Aldi and Lidl, still put pressure on the more established Big 4 supermarkets.

And – for food producers?

For farmers, nothing is agreed, and nothing is certain. What is known though is that the UK farming and food sector is about to go through a huge amount of change in the next five to 10 years. This was happening already, but whatever sort of Brexit we end up with, what we have seen happening over the last 10 years will be accelerated. Farmers need to be preparing for change and doing this now – not waiting to see what happens over the next five years and then pretending the direction of travel has not been seen coming.

There are many highly able and extremely competent farmers in the UK, but we are going to need more of them in the future. We also need:

- More farming for public goods and services
- Less overall subsidy support
- More use of agri-tech in all its forms
- More genuine supply chain partnerships
- More formal benchmarking
- Better marketing and promotional support
- More efficient production per se.

These will all be part of the future. For those who get organised, plan ahead and engage with suppliers, customers and consumers, it will be an exciting time.

Disclaimer

The views expressed in this article are based on a combination of research carried out for organisations such as the UK Agricultural and Horticulture Development Board, the Welsh Government and a range of private sector clients from across the UK and international supply chain, and (in some cases) are of a more personal opinion.

About the author

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