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Briefing 2333

Agricultural implications of BREXIT

Summary

The author expects the status quo will prevail and the UK will remain in the EU. If we leave the changes will cause some disruption and hardship in the short run. Farms most vulnerable are those dependent on current payments, for example the grazing livestock sector, and farms which are heavily borrowed. However, markets for all inputs and services to farming will adjust to these shocks, and processors and retailers will be concerned to ensure continuity of supplies. Farmers themselves will adjust; there is much scope to improve UK agricultural productivity which has slipped compared to other EU countries.

This paper is taken from the key messages of a report by Emeritus Professor Allan Buckwell for the Worshipful Company of Farmers The report can be accessed at:
http://ca1-fml.edcdn.com/downloads/WCF-Brexit-18.01.16-pdf.pdf?mtime=20160207094708

1. A referendum to remain or leave the European Union will take place before 31/12/17, and is most likely between June 2016 and April 2017. The policies which follow Brexit will not be clear by the referendum, only general indications.

2. Following a ‘leave’ vote, there will be a two-year negotiation period of intense debate on Britain’s trading relationship with the EU and the rest of the world, and on the British Agricultural Policy (BAP) to replace the Common Agricultural Policy (CAP).

3. The EU trade question is fundamentally a choice between remaining close to the EU single market, and therefore having to retain most EU existing regulation, or leaving the single market in order to allow some deregulation.

4. Whichever outcome, there will be more customs controls, and thus higher trading costs, than now on trade with the EU (both ways). These could depress UK farm prices and raise some consumer costs. If the UK then chooses lower protection levels on agriculture with the rest of the world this would also depress some UK farmer prices, but reduce consumer costs. Therefore together, farmers might face weaker prices, whilst consumer food prices, on balance, may not be much affected.

5. UK domestic agricultural support will not be higher than now under the CAP, and could well be lower. It is likely that a UK government will continue with some direct payments to farmers – but for how long, with what conditions is unknown. Aspects of rural development policy are also likely to

continue. UK policy could be less risk averse and more positive with respect to agricultural technology. The details of these policies will diverge between England, Scotland, Wales and Northern Ireland.

6. These uncertainties, starting from depressed prices in 2016, will reduce confidence and investment in agriculture, and probably reduce rents, land prices and lending to agriculture, unless and until clarity emerges on the new British Agricultural policy.

7. Direct payments are decoupled from production, so agricultural production effects of any cuts will be small, production changes may arise if third country trade is opened.

8. The effects of these changes will cause some disruption and hardship in the short run. Farms most vulnerable are those dependent on current payments, for example the grazing livestock sector, and farms which are heavily borrowed.

9. However, markets for all inputs and services to farming will adjust to these shocks, and processors and retailers will be concerned to ensure continuity of supplies. Farmers themselves will adjust; there is much scope to improve UK agricultural productivity which has slipped compared to other EU countries. There could be a catalytic effect of Brexit with beneficial long run effects for the sector as a whole.

10. From a countryside and environmental perspective there are strong downside risks associated with these potential developments. Much therefore depends on how the opportunity to design a new British rural policy better tuned to UK needs is grasped.

11. This author expects the status quo will prevail and the UK will remain in the EU. However, the referendum debate will expose, yet again, that current CAP is not well tuned to support environmentally sustainable and viable farming. The so-called ‘reformed EU’ will still have an insufficiently reformed agricultural policy.

Referendum, renegotiations and timing

12. A referendum on whether the United Kingdom should remain in or leave the European Union will be held before 31 December 2017, most likely between June 2016 and April 2017. The terms of the renegotiation for a ‘reformed EU’ underway at the time of writing have no direct bearing on agricultural or food issues. The outcome of the referendum is unpredictable; opinion polls on continued EU membership are running close, but with still maybe a sixth of voters undecided.

13. In the event of a ‘Leave’ result in the referendum the withdrawal negotiations will formally commence when the government notifies the EU of its intention to quit. Brexit will not be an overnight affair it will be a long drawn-out process with significant uncertainty for the UK farming sector and those who sell to and buy from it. The withdrawal negotiations should be completed in two years, but could be extended.

14. It is frequently suggested that exit before the end of the EU’s seven-year Multiannual Financial Framework (MFF) would be awkward and thus the likely date of departure would be 31st December 2020. This would be seven months into the next Government, and potentially between 3 and 4½ years after the referendum result. This seems an undesirable prolongation of uncertainty.

15. This report considers the implications, principally for the agricultural sector and farmers, of a vote to leave the EU. It has not been possible to explore the different perspectives of the devolved territories of the UK. So the report may appear as an English view; but Euroscepticism, which is driving the issue, is heavily an English phenomenon. The report is an exercise in conjecture. Those advocating ‘Leave’ have not detailed their preferred policies. Unless these emerge during the referendum debate, voters, including farmers, will be deciding with no clarity on the policies which will apply on EU exit. Only broad directions and implications can therefore be explored at this stage. Have the EU and CAP been beneficial for UK agriculture?

16. It seems reasonable to pose and answer this question before analysing the impacts of withdrawal. For farmers, and their representative organisations, the EU means its Common Agricultural Policy. Few inside, and especially outside, British agriculture think this is a well-articulated and expedited policy. The main criticisms are that the support mechanisms are badly targeted, inefficient and poor value for public money.

17. Examination of the output and incomes in agriculture before and after the UK joined the EEC in 1973 do not show that agriculture boomed after accession, although land prices certainly rose. This suggests that departure from the CAP will therefore not necessarily cause output and incomes to plummet.

18. These observations validate economists' suggestion that injection of subsidy into a competitive market sector like agriculture does not raise the incomes earned in that sector. Rather they are shared throughout all the trading partners in the food supply chain, and they become capitalized into land values. This suggests that withdrawing subsidy may have the reverse effect – initial shock to incomes, subsequently dispersed up and down the food chain and reflected in land values and rents.

19. Assembling lists of good and bad features of the experience of 42 years under the CAP leads to the conclusion that the CAP has not been an unambiguously 'good thing' for UK farming, and prompts the thought that escaping the CAP per se would not necessarily be a complete disaster.

What will replace EU policies upon withdrawal?

20. The two key areas that farmers should probe in order to be in a position to assess the effects of withdrawal from the EU are (i) the UK trading relationship with the EU and with the rest of the world, and (ii) the post-Brexit UK agricultural policy.

21. Prior to the announcement of the referendum date there is no definitive account of the key policies which a UK government outside the EU will favour. There is however a reasonably clear indication of general policy principles and direction of those who favour leaving the EU. Their rhetoric suggests a predisposition towards free trade, deregulation, relatively low priority to environment and small government. This contrasts with agriculture as guided under the CAP, which: has well-developed border protection, is heavily regulated, has given a progressively higher priority to dealing with environmental market failures, and it is generously supported from the public purse. Juxtaposing these two observations suggests a rather different approach to agricultural policy post-Brexit.

22. The strategy post-Brexit could take a 'cold bath' approach stressing the power of strong competition, the healthy release from the burdens of regulation and deadening effects of subsidy which will unleash a surge in farm restructuring, improved productivity and profitability. Or it could acknowledge multifunctional farming, in which released EU budget contributions are redeployed in the UK recognizing the special characteristics and multiple roles of farming which produces food and also stewards a high proportion of the British natural environment.

23. Where on this spectrum of possibilities the UK ends up will depend on what will undoubtedly be an intense UK political debate on the goals of agricultural policy which will immediately follow a 'leave' referendum result. This will have the active participation of farming and other stakeholders. There is nothing pre-ordained about the outcome.

Trade policy

24. The UK has run a substantial trade deficit in agricultural and food products for a very long time. UK self-supply in temperate agricultural products has fluctuated between 30% and 70% since the mid-nineteenth Century. In round figures the UK currently imports about £40b of food products and exports about £20b. This deficit has grown. Seventy percent of UK agri-food imports originate in, and 62% of agri-food exports are destined to, the EU.

25. There is a great deal of speculation about the trading relationship which the UK will seek with the EU. This is a complex area with a wide range of possibilities. However, the outcome is not simply a matter of UK choice. It will depend on what can be negotiated with the EU. In this negotiation between the UK and the European Commission on behalf of the EU27, each party will of course pursue their own economic interests. The negotiation will be conducted in the context that UK politicians have just persuaded voters that the EU is an enormous failure which is a drag on UK economy and society. This suggests a less than cheerful atmosphere.

26. A key aspect of the negotiation is to find an optimal position in the trade-off between maintaining open access to the EU single market, which UK businesses will want to preserve, and freeing the UK from what is depicted by Eurosceptics as an excessive EU regulatory burden. Success in achieving a Norwegian- or Swiss-like position with open access to the single market could allow trading

relationships to continue seamlessly. However, it also implies adopting most single market regulation, with some influence but no vote on how it evolves, and also contributing to the EU budget. Seeking a bilateral Free Trade Agreement with the EU may free the UK from some existing regulation (when the UK eventually gets round to amending such regulation in its own legislation) and eliminate any contributions to the EU budget, but all trade destined for the EU will still have to respect EU regulatory standards.

27. Equally important for UK farming is the relationship achieved with third country markets in the rest of the world. The options here are just as complex. The UK as an independent country may seek to continue to apply the same terms as under the EU's 138 Free Trade Agreements (FTAs) and Preferential Trade Agreements (PTAs) in place or under negotiation. Or the UK may seek to renegotiate these agreements. A critical issue for UK farming is whether and how much the UK might seek a more liberal trade stance, lowering the tariff protection including for sensitive agricultural products such as beef, lamb, dairy and fruit and vegetables.

28. Over many years there has been enormous progress in liberalizing merchandise trade, tariff barriers are low, the exceptions remain the service and agricultural sectors. Non-tariff barriers have become more important and one of the greatest achievements of the EU has been in creating the single market which reduces these barriers and associated costs. The UK currently enjoys the best possible access to the single market as a full EU member, therefore any alternative arrangement almost inevitably must involve more border and custom controls and thus higher trading costs. The UK might be able to extend the benefits of current EU trade agreements with third countries; it will take considerable time to negotiate better terms on its own. It is hard to see how trading costs could be lower outside the EU, benefits of exit must therefore revolve around lower regulatory costs for business.

British Agricultural Policy

29. If the UK exits the EU it will then be able to choose whatever agricultural policy it considers is in the best interests of its farmers, consumers and society. The question is what policy would it choose? The answer to this will differ between England, Scotland, Wales and Northern Ireland. This aspect is not considered further here.

30. The agricultural policy chosen will of course be heavily determined by the budget resources the government is prepared to vote, the views and approaches taken by the main interested parties – which generally comprise farmers, the food chain, consumers and environmental interests – and conditioned by the trade policy adopted. There can be no doubt that farmers' organisations will be prominent in these discussions emphasizing the competitive terms between British farmers and their EU and third-country counterparts. But so too will be countryside and environmental interests who will stress the public land management role of farming.

31. It is assumed that all current CAP payments and rural development contracts will continue to apply until the date of UK exit. If UK exit is 31/12/2020, then the full terms of the current CAP regulations which extend to this date will apply.

32. It is suggested that post-Brexit, agriculture and food will still be considered exceptional and there will therefore be a British agricultural policy to follow the CAP. It can be predicted with reasonable confidence that there will not be a return to a market intervention (e.g. deficiency payment) approach to agriculture as existed pre-EEC entry. The objectives of British agricultural policy will be the customary mix of: stimulating productivity; improving resource efficiency; helping farmers reduce pollution, deal with volatility, market imperfections and especially the pervasive environmental market failures surrounding land management; and also deal with the particular difficulties of farming in the remoter and marginal rural areas.

33. The UK post-CAP policy will inevitably be structured around how much, and in what way, the current instruments of the CAP are rolled over and changed to suit the UK public purse, and conditions. A prime focus of the post-exit debate will be on the fate of the CAP direct payments (£2.5 billion in 2014) which constitute 75% of current EU CAP related agricultural expenditure in the UK.

34. The report examines a number of official statements and other opinions on this question. It is concluded that UK will not walk away overnight from direct payments to its farmers post-Brexit. Some form of such payments, paid from the UK Treasury will continue, but details at what rate, to whom, for

how long and with what conditionality is not yet knowable. These will be determined following intense negotiations in the UK during the withdrawal period.

35. A strategic decision about continued but nationalized direct payments is whether they are explicitly referred to as transitional and thus only paid for a specified finite period (say 5 to 10 years), perhaps even convertible to a bond which could be cashed-in. Other key decisions will be their environmental conditionality, whether they are progressively tapered or limited by size of payment, and how the issue of active farmer is dealt with.

36. Any continuing direct payments are likely to continue to be made as a uniform per hectare payment in one or two regions (of England) and decoupled from production. To the extent that young farmer and greening payment ideas might be dropped then English direct payments may be correspondingly smaller. Different decisions on these details can be expected in the other territories.

37. It is suggested that the main elements of current rural development programmes will continue in UK rural policy. Whether they remain as multi-annual and programmed structures will no doubt be reviewed. The objectives will likely remain a mix of: improving agricultural productivity and marketing, purchasing public environmental services from farmers, supporting rural infrastructure and encouraging economic diversification. Agreeing the objectives and measures to deal with farming and land use in the uplands, i.e. the remote and marginal areas will be a difficult aspect of this debate. This is not a settled area of policy and current controversy over upland land management during the late 2015 floods in Cumbria, Lancashire, Yorkshire and Scotland will figure in such debate.

Other policy

38. Agriculture is subject to a wide variety of other regulation which emanates from the EU. Thirty-one such areas of regulation are listed in the report. The future applicability of these EU regulations and directives in the UK in event of exit from the EU is uncertain. Continental traders can be expected to be extremely vigilant that the UK is not seeking, through Brexit, to achieve competitive advantage by deregulating its domestic business whilst maintaining open access to the EU market It would be most unwise of any business to consider that if the UK has left the EU then these regulations would no longer apply. The terms of access to seasonal and casual labour, much of which is currently provided by citizens of the EU, will also be a highly important issue for several parts of UK agriculture and food processing. Economic effects of Brexit

39. It is a difficult task to assess the likely effects of policy change which is not well specified. Clearly the impacts will be greater the wider the divergence from the status quo. But in all cases there will be a long lead-in time before policy changes take effect, and some of the new policies could be phased in over an adjustment period.

40. From an economic perspective, because direct payments to farmers are largely decoupled from production, any cut in these payments is not expected to have large impacts on production levels. It is the trade policy changes which might bring about changes in prices, costs and therefore production and consumption. Increases in trade costs tend to drive a wedge between producer and consumer prices, driving the former down and the latter up. This could happen for trade with the EU. Reducing trade barriers with the rest of the world could reduce producer and consumer prices in the UK. Without knowing the outcome of the trade negotiations it is very hard to quantify these effects.

Comparative static impacts

41. Frightening impacts can be suggested by showing data on the current dependence on direct payments of different UK farming systems and calculating the drop in farm business income if these payments were eliminated from one year to the next and nothing else changes. Such figures show falls in farm business income ranging from 31% for dairy farms to 112% and 137% for grazing farms in the lowlands and Less Favoured Areas, respectively.

42. There can be no doubt that if direct payments were abolished in this way the effects would be disastrous for a great many farms. However, there will be several years notice of any such likelihood starting from the day after the referendum. Also there are precedents suggesting that payments are more likely to be phased down, and even then with some degree of protection for certain types, sizes, or locations of farm, or those undertaking specified public services. Knock on indirect and induced effects

43. The time lags in coming to the decisions and then implementing any new British agricultural policy are important because economic agents anticipate and react. This applies to farming which has alert and responsive representative organisations and media. The introduction of the CAP in the UK was not accompanied by a sustained rise in farmers' income so it is not obvious that subsidy removal should cause a prolonged collapse. There will be a series of indirect and induced effects resulting from any substantial removal of CAP supports, which will soften the impact.

44. The land market will be amongst the first to react. In the event of credible information that direct payments were planned to disappear over a short time period, the market could quickly swing from the current excess demand to the opposite situation. No one will bid current rents given the prospect or fear of withdrawal of direct payments and a more competitive trading environment for farming. Land owners would struggle to find anyone to take on the land and they might be reluctant to take it back in hand themselves in these circumstances. Rents would therefore be expected to falter and fall. Impacts on land prices would follow. It is shown that land prices have reacted to past CAP changes, so there is every reason to expect a reaction to withdrawal from the EU and CAP. Of course this reaction will depend on the extent to which a British Government decides to continue to fund direct payments.

45. Uncertainty accompanying a vote to leave will cause a loss of confidence in farming which will spread up and down the food chain. A fierce, open policy debate on continuation of direct payments will induce a highly cautious attitude towards any farm expenditures and especially new investment. Farm machinery, equipment manufacturers and input suppliers will certainly notice, and there will of course be some attempts to induce farmers to continue buying. In short, price pressures for other farm inputs besides rents would ease. For the livestock half of British agriculture a major cost is feed, these costs are already at a low level. A depressed UK market beset by Brexit anxiety (which coincides with a period of slow growth globally) would tend to keep it that way.

46. In addition, farmers themselves would adjust. Brexit would be a significant wake-up call to the industry and perhaps catalyse change. Of course the best farmers are already alive to the benefits of precision and knowledge-intensive farming, but the tail in productivity performance in UK agriculture is still long. There is wide scope to improve the efficiency of use of fertilisers, crop protection products, energy and animal feed, and this does not all require expensive investment in GPS-based electronic monitoring and control systems.

Evidence of modelling and the NZ experience

47. There is little modelling evidence available to date, and of course model results depend on model assumptions. A recent report assumes the UK nationalizes the CAP payments (i.e. continues them) calculates the economy-wide effects of higher trade costs resulting from Brexit. These costs more than offset the budget benefits of leaving the EU and result in real losses in the UK of between 0.2% and 0.67% of national income (depending if trade facilitation costs rose 2% or 5% respectively).

48. An often-cited example of dramatic agricultural policy change is the case of the New Zealand withdrawal of supports in the mid-1980s. New Zealand farming in the 1980s was not at all similar to the UK farm sector in the 2020s facing Brexit. New Zealand agriculture (6% of GDP, 7% of employment) is a key economic sector providing 53% of merchandise exports which are produced at great distance from markets. Whereas UK agriculture contributes just 0.5% of GDP, 0.8% of employment, and is a net importer. Along with the short duration of the NZ subsidies in contrast to the UK's 42 years of EU membership and the large devaluation of the New Zealand dollar, these all suggest caution in drawing lessons from New Zealand for UK agricultural subsidy removal. Brexit for the UK could be a much bigger event than subsidy reduction in New Zealand. However, the NZ experience certainly showed that the pain of subsidy removal was short-lived.

Wider implications for the EU and for the UK

49. European integration itself will falter if the UK exits. This outcome would be seen in Paris, Berlin and the other EU capitals as a highly significant and negative development. It might precipitate other exits, and it could put back the course of European integration noticeably. The EU will have a budget hole left by UK exit which it will have to fund either by increased subscriptions from the remaining members or by cutting expenditures. This smaller EU might even decide, post-2020, to follow the UK

and cut agricultural support expenditures. This would lessen some of the pain of UK adjustment to lower farm support.

50. UK exit is highly likely to disrupt the UK ‘settlement’. There are very different degrees to which the four UK territories benefit from the EU, and similarly there are differences also between regions within England, including rural versus urban areas. Post-Brexit, Scottish independence becomes more likely (though not a forgone conclusion). This would be a complication for many sectors including agriculture, for example livestock trade, which would take many years to resolve.

Final words

51. A referendum vote to leave the UK will create massive uncertainty and anxiety in the UK food and farming sector undermining confidence for many years. Agricultural policy is the most highly developed EU sectoral policy. It still takes more than a third of the EU budget, and it has dominated UK thinking for over four decades. Departure from the EU is a significant rupture from the past.

52. The worst fear of farmers is the combination of: fast removal of direct payments, much if not all existing regulation remaining, continued free access to the UK for the still-supported EU farmers, and exposure of UK farming to more competition from the world’s lowest cost exporters. This outcome would be regarded as equally undesirable by environmental interests. The very anticipation of this scenario will drive a significant and powerful reaction to try and ensure it does not come about. The outcome is still likely to include a reduction in agricultural support levels. There will ensue a vigorous UK debate on the most sensible policy to achieve an efficient, viable and environmentally sustainable industry for the long term.

53. Probably the greatest shock to UK farming will be in the 12 months following a ‘leave’ vote in the referendum. As the effects of this shock work through the system, and critically, depending on the intelligence of the policy debate which then follows, the longer run course of British agriculture could be a less precarious, more resilient industry capable of dealing with the inevitable challenges it will continue to face not least from climate change.

54. This author judges that most British people are not so fed up with the EU, and are unlikely to be convinced that an alternative is self-evidently better, so inertia will win and the vote will be to ‘remain’. If so, Britain and the rest of the EU are left with an agricultural policy with all the problems exposed by this discussion – not least the dangerous dependency of many farmers on poorly calibrated supports and an agricultural sector not in balance with its natural environment. No change in agricultural policy in or out of the EU is not a sensible option.

Alan Spedding, 09 February 2016

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http://www.arthurrankcentre.org.uk/publications-and-resources/rusource

RuSource is a voluntary project partly supported by donations and sponsorship.

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