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Savills World Research
UK Rural
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FOOD AND FARMING: SUBSIDIES AND TRADE
Brexit Briefing

BREXIT BRIEFING

RISKS & OPPORTUNITIES
Navigating through the complexity of the post Brexit landscape

SUMMARY

The impact on the farming sector of leaving the EU is likely to be high

The threats and opportunities to UK agriculture and the food supply chain of leaving the EU are probably higher than in any other industry. There are likely to be changes in the supply and demand (both quantity and source) of many agricultural goods and these factors will affect price.

The headline figures for the potential loss to agriculture from subsidies and trade are similar but our analysis suggests that the impact of changes to trade agreements could be far more significant than changes to the existing agricultural subsidy.

POTENTIAL LOSS TO AGRICULTURE

£2.5bn
Direct Subsidy

£2.1bn
Trade

"There are likely to be changes in supply and demand of goods"

Ian Bailey, Savills Research

RELATED CONTENT
For more information on UK farmland, please visit savills.co.uk/research

IMPACT

The key is understanding what impact these changes may have on your business and how advantage can be taken of new opportunities and any risks mitigated.

So how do nations justify subsidy and trade restrictions? Reasons include:

- increase food security
- enhance the environment
- reduce depopulation of the countryside (with consequences for other rural businesses)
- protect a developing sector
- help maintain employment
- other emotional factors such as genetic modification, hormone treatment, animal welfare

These factors mean agricultural trade deals are often the most difficult to agree and at macro UK trade level agri-food trade is relatively small.

Top five export locations outside the EU are: United States, Hong Kong, United Arab Emirates and Canada.

FIGURE 1

The current trade situation in figures

	EXPORTS	IMPORTS
Total UK trade	£295bn	£415bn
Agri-food	£20bn	£40bn
Agri-food %	7%	10%
Total UK trade outside EU	53%	46%

Source: ONS

SUBSIDY

Currently UK farms receive subsidy from the Common Agricultural Policy (CAP) of the European Union (EU), this also includes grants and environmental payments. Obviously the CAP will no longer fund these payments once we leave the EU.

Current support is made up of two parts:

1. Direct support (known as Pillar 1)
2. Support for rural development and public goods (known as Pillar 2). The current priorities (for 2014-2020) are:

- to promote knowledge transfer and innovation in agriculture and forestry
- to increase the viability and competitiveness of all types of agriculture and support sustainable forest management
- to promote the organisation of the food production chain, animal welfare and risk management in farming
- to restore, preserve and reinforce agricultural and forest ecosystems (biodiversity, water and soil)
- to promote the efficient use of resources (water and energy) and support the transition to allow carbon economy
- to promote social inclusion, poverty reduction and economic development in rural areas.

In August (2016) the Treasury guaranteed to back EU funded schemes such as Countryside Stewardship which were signed before this year's Autumn Statement and to continue CAP Pillar 1 funding until 2020. New applications to Mid Tier Countryside Stewardship closed on 30 September 2016.

What is potentially at stake if agricultural support is withdrawn?

1. **FARM INCOMES:** direct subsidy represents around 57% of average farm incomes but there is a wide range between farm types. In addition, there will be variation between years depending on the variation of physical yields and output prices. Figure 2 below shows the impact of complete subsidy removal could be very significant.
2. **ENVIRONMENT:** it is estimated by the CLA that there are around 16 million acres of farmland, which equates to 37% of UK farmland, under environmental land management schemes. In monetary terms this amounts to around £600 million pounds and represents a useful income stream especially to those farming in marginal areas.
3. **RURAL COMMUNITIES**: agricultural subsidies also indirectly support rural economies and communities by providing jobs.

> "The key is to understanding what impact these changes may have on your business and how advantage can be taken of new opportunities and any risks mitigated"
>
> **Ian Bailey, Savills Research**

Currently payments for rural development and public goods represents just 9% of the total UK subsidy cheque. As mentioned above we do not know how the final 'UK Agricultural Policy' will look and what form, if any, payments will take. However, with the current noise from the environmental groups there is plenty of scope for our politicians to increase the Environmental/Public Goods proportion.

There are examples around the world where agriculture operates with little or no subsidy. The Food & Agricultural Organisation (FAO) calculate an 'Agricultural Productivity Index'. The Index tracks agricultural output and clearly there is a range of reasons why the output of countries differs.

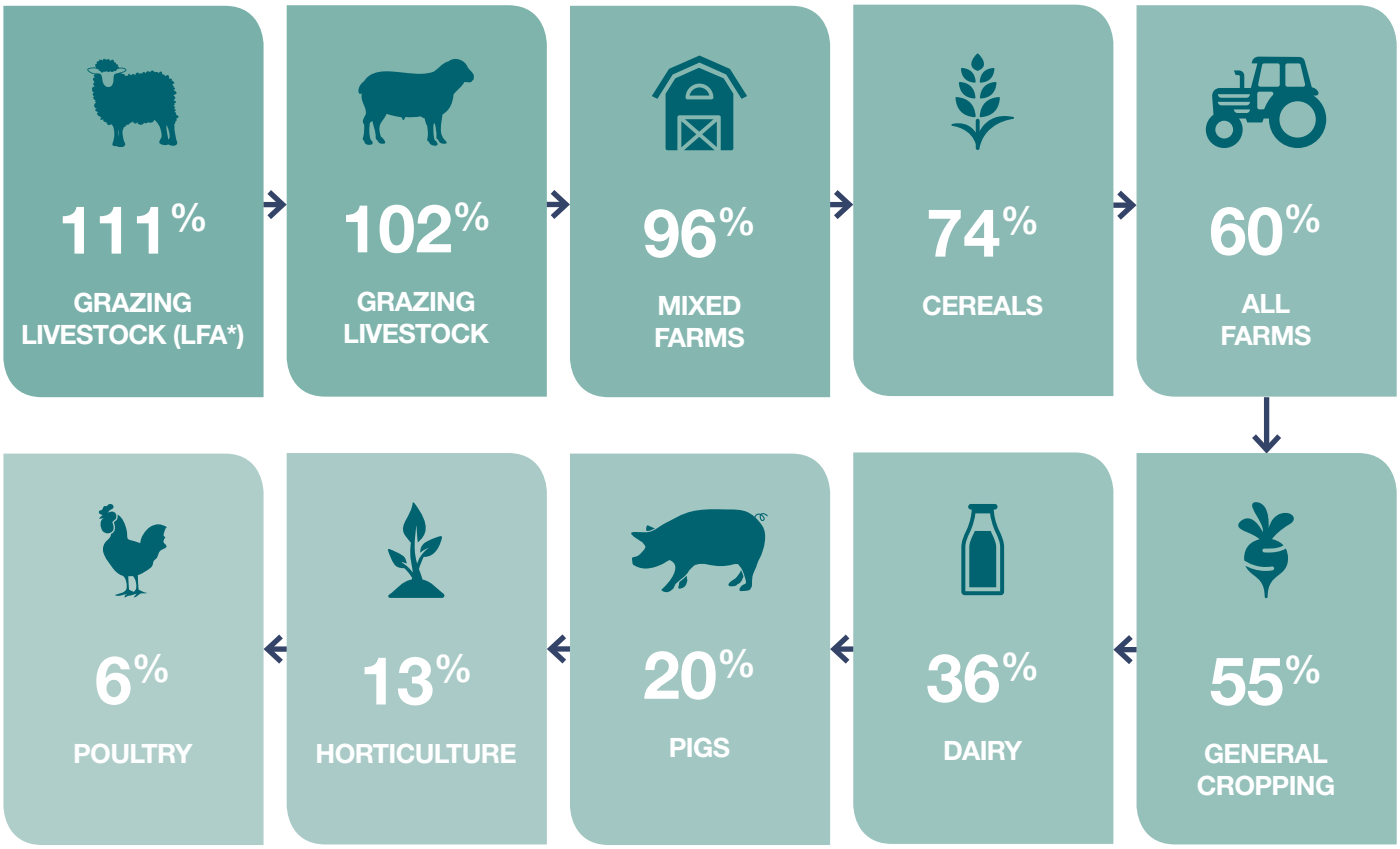
However, there is a clear pattern between the productivity of a heavily subsidised agriculture (the UK) and the other countries illustrated. The data asks the question of whether subsidies have stifled UK agricultural output. The UK joined the EU in 1973, after which productivity increased by around 20% over the next 12 years but since 1985 and up until 2012 the index records a total fall of -6%.

It is interesting to take a look at New Zealand where productivity has increased two thirds since subsidies were discontinued in around 1984 as part of a general reform programme for the national economy. We accept there are differences between the structure of agriculture in the UK and New Zealand but the changes should not be ignored in our analysis and debate:

- The importance of agriculture is high at 7% of GDP and employment
- Input use fell significantly, e.g. fertiliser use fell by half
- Significant restructuring with intensified livestock production concentrated on the most productive land
  - Only 1% of farmers went out of business
  - Dairy cow numbers have increased almost 90% and output is up almost 200%
  - Beef numbers have fallen but productivity is up 18%
  - Although lamb output has fallen around 10% it is from 47% fewer sheep
  - Focus is now on resource and cost efficiency which drives innovation.
- The industry has become more focused on producing what the consumer wants with exports representing 95% of output
- Some commentators note that this may have been at the expense of some environmental benefits in the intensified areas but the concentration of production halted land clearance and reduced farming in marginal areas which has had a positive effect on biodiversity in many locations.

FIGURE 2

Subsidy as % of farm business income by farm type (4-year average 2012/13-2015/16)



Source: DEFRA, Savills Research

* LFA = Less Favoured Areas

TRADE

Future UK trade agreements will have a significant effect on UK agricultural and horticultural businesses; both at the farmgate and along the supply chain. Our trading relationships – domestic and international – underpin productivity and profitability. The outcome of trade negotiations will determine the level of exposure to the peaks and troughs of global price volatility and market dynamics.

If the UK loses tariff-free access to the EU single market and the EU imposes tariffs on imports, trade with the EU is likely to change radically across all sectors. We currently have an industry whose investment and structural development has been defined by 40 years of EU membership.

Terms of trade are likely to be as much about technical standards, such as sanitary and phytosanitary (SPS) issues, as tariffs and quotas.

Trade costs, regardless of tariffs, often arise due to additional compliance requirements.

At the simplest level there are three agricultural trade aspects imposed by the World Trade Organisation (WTO) and currently applied by the EU.

1. PERMITTED INTERNAL SUPPORT

- subsidy – as discussed on pages 2 and 3

2. EXPORT REFUNDS (restitutions)

- the EU has reduced the use of these to negligible levels and it is difficult to envisage the UK wanting to adopt higher export subsidies

3. IMPORT TARIFFS (including preferential arrangements)

- the EU general tariffs are likely to be adopted by the UK while the share in Tariff Rate Quotas (TRQs) will require negotiation
- the countries now benefiting from TRQs are not always the same countries that allowed their introduction
- the current EU tariffs will provide the maximum the UK can apply but these may be reduced either unilaterally or as part of subsequent trade deals.

The impact on individual businesses and sectors will depend on a variety of factors but price and volume of goods will be the most significant. Tariffs are often higher on processed goods than the raw material and change could disrupt the supply chain.

In addition there are situations where a raw commodity is exported, processed and reimported.

The actual price change is unlikely to equal the full tariff applied and the impact on price and volume will be influenced by:

- the number of different tariffs frequently relating to a specific farm product (e.g. beef is subject to around 50 different tariffs according to the cut exported) and preferential access agreements
- seasonal aspects
- the impact of changes in the price of inputs such as feed
- elasticity of supply and demand (i.e. if price changes impact on production and consumption
- legislative and compliance changes.

Figure 3 below shows in simple terms the price change for UK producers and consumers for tariff changes on imports and exports.

+200

Number of countries UK food is exported to

"We currently have an industry whose investment and structural development has been defined by 40 years of EU membership"

Ian Bailey, Savills Research

FIGURE 3

Direction of price change for change in tariff for producers and consumers

Tariff change (on imports)	Producer price	Consumer price
Increased	↑ Up	↑ Up
Decreased	↓ Down	↓ Down
Tariff change (on exports)	**Producer price**	**Consumer price**
Increased	↓ Down (less competitive)	→ None (or down as draws in cheaper imports)
Decreased	↑ Up (more competitive)	↑ Up (as domestic supply will fall as more exported)

NOTE: The absolute price differential will depend on % change in tariff.

- We appreciate there are complications to the situations described opposite but it does give an overall feel for change. These include:
  - Where the EU already imports a commodity subject to tariff, the price is already inflated so that if the UK applies the same tariff post Brexit (and also imports) there is no change in price
  - Where the EU as a whole imports but the UK exports, the price will be lower for the UK after Brexit because there would be a tariff on our exports; or other markets would become more profitable but with higher transport costs.
  - Consideration of the UK and EU import-export status for a product
  - For many commodities we upgrade quality so there are much higher tariffs on semi or fully processed goods than unprocessed goods.

Source: Savills Research

FIGURE 4

Complexity of tariffs

OILSEED RAPE

No Tariff

WHEAT AND BREAD

- Cereal tariffs protect when global prices are low
- Soft wheat subject to a fixed €95 per tonne tariff, but
- Variable duty system applied to high quality wheat, durum wheat, rye, maize and sorghum
- System of TRQs for low and medium quality:
  - Less of an issue for exports but
  - If full tariff applied to feed imports impact could be significant for livestock producers

CATTLE/BEEF

- Over 50 different tariffs – many are complex
- Potential for 50% increase
- Whether import is:
  - Live
  - Fresh/chilled
  - Frozen
- By:
  - Cut of meat
  - Origin
- There are preferential agreements with lower tariffs from some regions

SHEEP/LAMB

- 10 different tariffs
- As per beef, but
  - New Zealand and Australian lamb through TRQs into the EU (UK)
  - UK self-sufficient but exports surplus created by TRQs above
  - Re export will be a problem when UK leaves EU

Source: Savills Research

WTO AND THE EU

- WTO (World Trade Organisation) regulations allow more flexibility than many realise and restrictions are seldom absolute.
- While the WTO aims to reduce trade restrictions in order to improve overall welfare and wealth, there is a trade-off between making progress and achieving an absolute target.
- EU trade is determined by a customs union and manages compliance with the WTO agreements on behalf of its members.
- WTO restrictions are not applied to individual EU members but to the EU as a whole.
- However, the UK is a member of WTO in its own right as an original member of GATT (General Agreement on Trade and Tariffs), the predecessor to the WTO.
- Many of the historic preferential trade relationships are no longer entirely with the member state that gave rise to the arrangement but with another EU member, e.g. in the 1980s New Zealand exports to France were about 5% of those to the UK. They are now about 35% of those of the UK.
- Countries subsequently joining the EU added their WTO trade limits to the EU pool.
- It would be extraordinary if the UK's future trade arrangements were not compatible with the WTO.

Glossary

- **Tariff Rate Quotas (TRQs):** allows a specified quantity of goods/produce to be imported at reduced (or zero) tariff
- **Free Trade Agreements (FTA):** agreements which involve cooperation between at least two countries to reduce trade barriers – import quotas and tariffs – and to increase trade of goods and services with each other. They are bound by WTO rules with more tolerance for developing countries. It is possible to phase in the agreement but agriculture is very often omitted on the grounds of food security, protection of employment in labour intensive systems, cultural reasons
- **Most Favoured Nation (MFN):** a status or level of treatment accorded by one state to another in international trade. WTO members have a basic permitted level of tariffs. These have to be applied to all countries equally so if reduced for one country they have to be reduced for all. These tariffs were applied prior to the Uruguay round of the WTO.

CONCLUSIONS

In conclusion, the Brexit challenges include:

- changes in trade terms
- changes in trading partners
- changes for farm and environmental support
- changes in regulations and compliance
- new renewables policies
- new regulations for seasonal workers

These factors may impact on the areas below:

- turnover (physical volumes and cash)
- profitability
- return on investment
- investment strategy

In addition to agricultural income many farms and estates offer opportunities to generate an income stream from other assets. These may include residential and commercial property as well as diversified enterprises such as golf courses, equestrian centres and leisure type businesses. Figure 5, using data from our 2016 Estate Benchmarking Survey, illustrates some of the opportunities available to land based businesses and how their contribution to gross incomes has changed over the past 16 years diluting the exposure to agriculture and therefore to the subsidy and trade factors discussed above. We will follow the debate and continue our sectoral analysis of the various scenarios that may affect agricultural and food businesses.

Now is the opportunity to quantify and to understand the potential effects on your business. These may include opportunities as well as risks and we are able to help you through this process. Our research team has a deep understanding of the supply chain from producer to retailer. Agricultural policy and particularly trade policy is complex. This is not new territory for us.

BREXIT FOR BUSINESS

Risk score your business and understand the implications

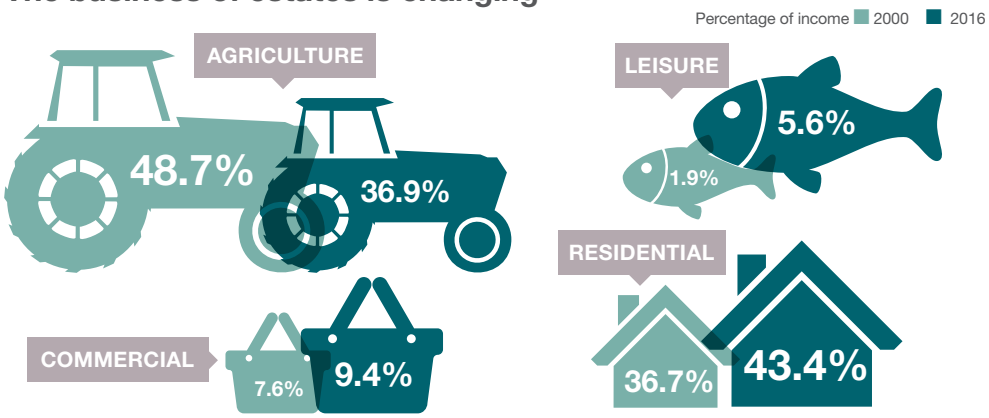
Explore the risk:

- Trade and currency
- Employment
- Supply chain relationships
- Regulation
- Subsidy

Contact Ian Bailey (details below) for more information.

FIGURE 5

The business of estates is changing



Source: Savills Research

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