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Brexit Seminars 2016

Implications for UK Farming

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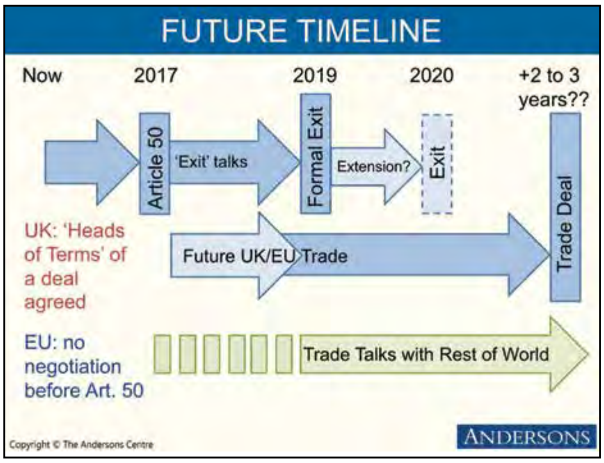
BREXIT - IMPLICATIONS FOR UK FARMING

CURRENT SITUATION AND TIMELINES

The new(ish) Government of Teresa May has repeatedly stated that 'Brexit means Brexit'. Although the referendum was not legally binding, there seems no political appetite to try and reverse the expressed wish of the British people. It has been stated that there will be no attempts to remain inside the EU, no attempts to re-join it through the back door, no second referendum, and no General Election until 2020. The now-famous Article 50 of the Lisbon Treaty governs withdrawal. This mandates a two-year period for negotiations. There will be no decision to invoke Article 50 until Britain's negotiating strategy is clear. It is almost certain to be 2017 before Article 50 is triggered (some believe it will be delayed into 2018 or even later). There is no real precedent for a country leaving the EU under Article 50. Greenland, an autonomous country within the state of Denmark, withdrew in 1985, but this was before the Lisbon Treaty was in effect. For Greenland, the issues were very limited, as the territory only sought Overseas Country and Territory status, rather than a full exit. Even so, withdrawal took three years.



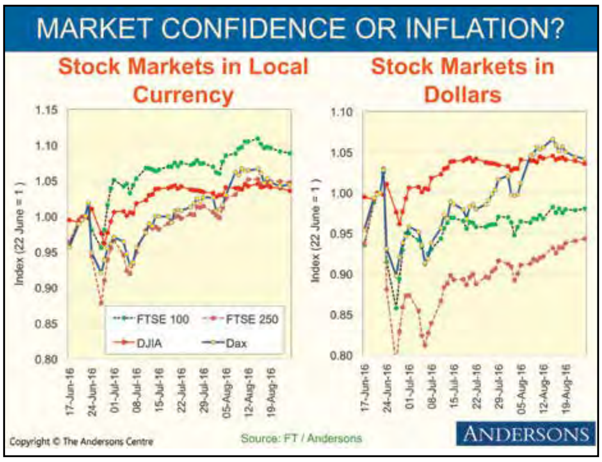
This timeline sets-out how the negotiations are likely to proceed it shows that there will be two sets of talks with the EU once Article 50 is triggered, with the first being on the formal 'Exit' process from the EU and the second focusing on the future trading relationship with the EU. An extension to the Exit negotiations is possible, as such talks are likely to be complex and it is not unheard of within the EU for negotiations to take longer than expected. An extension might not just favour the UK, it could be in the EU's interest as well. That said, the formal legal position is that if the Exit negotiations are not concluded within 2 years, and all EU-27 Member States fail to agree to an extension, then the UK would be out in the cold. It is not necessarily the case that Trade talks will be concluded on the same timescale as the Exit talks. Whilst the talks with the EU take place, discussions will also take place with non-EU countries. Liam Fox (UK's International Trade Minister) has already initiated this process but no trade deals could come into force until the UK has formally exited the EU.

The talks on Exit are focused on the technical matters required to 'unbundle' 40+ years of integration between the EU and the UK. Examples of the areas covered are set out in the following slide. Although there is a lot of ground to cover, the talks may be reasonably straightforward to conclude as the issues are less 'political' than the negotiations on future arrangements. Although the two strands are separate, there is almost certain to be some cross-over between them. It is not clear who David Davis will be negotiating with. The EU Commission (Civil Service) has appointed Frenchman Michael Barnier. The EU Council (Member States) has put the Belgian, Didier Seeuws, in charge of its taskforce. In any event, the final deal will need to be approved by a 'qualified majority' of 72% of the remaining 27 Member States, representing 65% of the population. The European Parliament will also need to be persuaded to approve the Exit deal. Given various elections around Europe there appears a logic to triggering Article 50 in early 2017, with a view to leaving the EU in early 2019.

This is a (non-exhaustive) list of the topics the Exit negotiations will have to cover. Depending on your perspective, this slide will either make you wonder how we could ever leave the EU (especially in two years) or will explain exactly why we need to leave! It highlights some of the linkages that have been established through EU membership beyond the issue of trade.

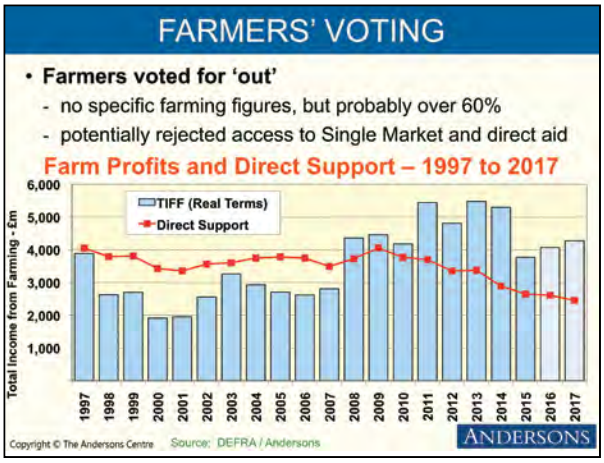
Article 50 invokes negotiations solely around exit, not trade. It has been suggested that talks on future trade relationships cannot even begin until the UK formally exits - otherwise it is, to some extent, negotiating with itself. This seems unlikely in practical terms and the two strands will proceed in parallel. However, the Trade negotiations will probably take substantially longer than the Exit talks. Not least this is because there is a greater amount of politics involved – essentially trading off access to the EU market against a loss of sovereignty. It seems the UK would have to negotiate well or pay a lot to retain free trade status from the start. The bar for the remainder EU agreeing a deal is higher than for the Exit talks too. All Member States must agree the new trade arrangements. There may even be a need for national Parliaments to ratify a deal (as with the current Canadian free-trade deal).

Sterling is the worst performing currency of 2016 so far having undertaken the Argentinean Peso. The relationship between the Pound and the Euro is fundamental for the fortunes of UK farming for two main reasons: Firstly, farmers' subsidies are calculated in Euros then converted into Sterling in September each year. The exchange rate at that point therefore affects the Sterling value of UK BPS payments. In addition, the majority of UK exports are made to the Eurozone. If the Pound is strong, UK exports cost more in foreign currencies and imports into the UK become cheaper in Sterling terms. If Sterling weakens, the opposite happens, supporting UK domestic prices. The direction of Sterling against the Euro over the next few months is even more difficult to call than usual.

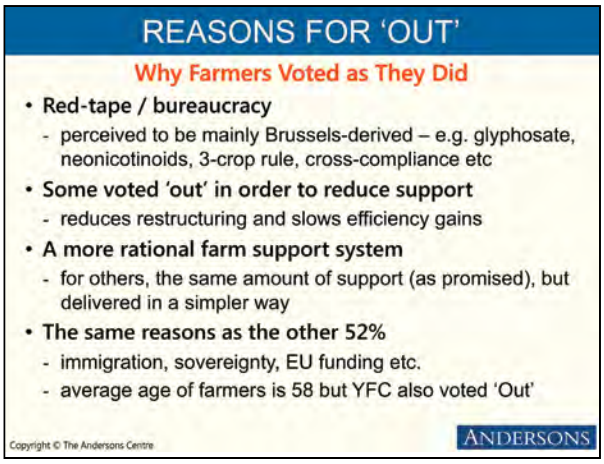


The stock markets are reflecting the imminent likely rise in inflation. Consumer Price Inflation rose 0.5% in June, not a big leap but reflects entirely pre-Brexit data. A fall of a currency makes imports dearer, and exportable home produced goods equally more expensive. Commodities therefore lead the charge, other goods soon follow, leading to High Street inflation. Wage inflation takes a little longer to change. The Bank of England normally manages this with higher base rates, yet the Bank has reduced rates to all-time lows to try and bolster the economy. This is also inflationary, as is quantitative easing.

VOTING PATTERNS: FARMING



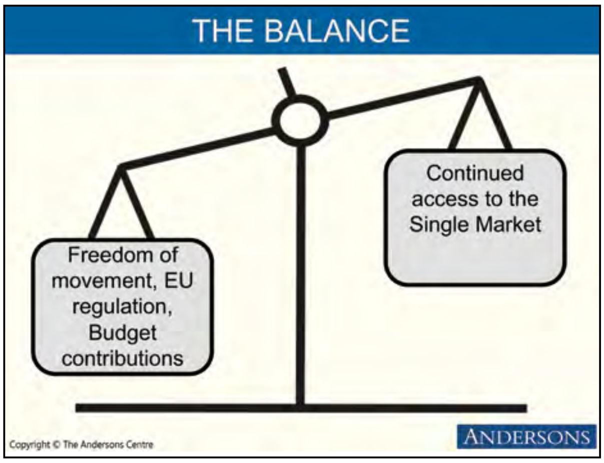
There is no specific breakdown of the voting patterns of farmers in the referendum. However, it seems safe to say that a majority (perhaps a large majority) voted to leave the EU. This might seem perverse when the EU provides the largest market for farm produce and the Common Agricultural Policy (CAP) provides substantial support to the sector. Indeed, as the chart demonstrates, in some years over the past two decades direct payments (inc. agri-environmental payments) were more than the profit in the industry. Under Brexit, neither direct support or Single Market access is guaranteed. Both are currently critical to support UK farming in its present structure.



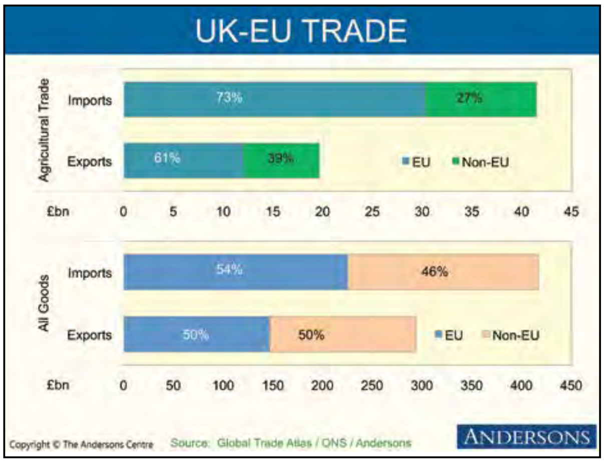
So why the Out vote? A minority of farmers highlight the drag that such subsidies have on developing agriculture - slowing restructuring, keeping inefficient operators in business and holding back the efficient. Most identify the bureaucracy. Specific issues cited include the unscientific refusal to re-authorise glyphosate, the counter-productive restrictions on neonicotinoids or that the three-crop rule is useless in the UK. Others claim to not want cross-compliance and many profess a more general desire to be left alone to 'get on and farm'. It seems incredible that farmers expect these rules to simply disappear on Brexit; being legislative, they are likely to remain in some format. However, in simple terms, the message from the farming community is that less is more.

To step outside of agriculture, and also the UK, Brexit can be viewed as part of a wider trend. There is a backlash against globalisation. This can be perhaps traced back to the financial crisis where 'greedy bankers' were bailed out and everyone else got austerity. This feeds into a more general sense that any gains from globalisation have not been evenly distributed – or to put it into Trump-esque words, the system is rigged against the little guy. Away from economics, migration has meant that people no longer recognise their communities as the ones they grew up in. Overall, a movement of increased protectionism is spreading through the world. Donald Trump's threat to pull out of the WTO, cancel trade agreements and cancel all other negotiations demonstrates this. The popularity of Marine Le Pen in the French polls seconds it.

FUTURE TRADING RELATIONSHIPS

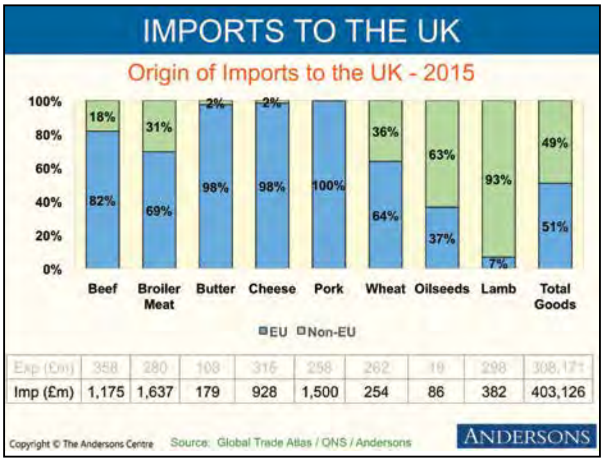


Within the negotiations with the EU over future trading arrangements there is one key trade-off. The UK would like as much access to EU markets as possible – ideally complete access to the Single Market as at present. However, there is also a desire to regain 'sovereignty'. The two objectives are almost mutually exclusive. The EU is clear that the UK cannot have Europe 'a la carte'. This means that if the UK wants tariff-free access to the Single Market then it is likely to also need to agree to most of the following; implementing EU regulations where they affect the Single Market, accepting free movement of people (i.e. EU immigration), and paying in to the EU Budget. This, of course, is not what most people thought they were voting for if they opted for Brexit. If the political 'establishment' comes back with a deal that appears to break the promises made during the campaign, the disillusionment with politics will just become greater.



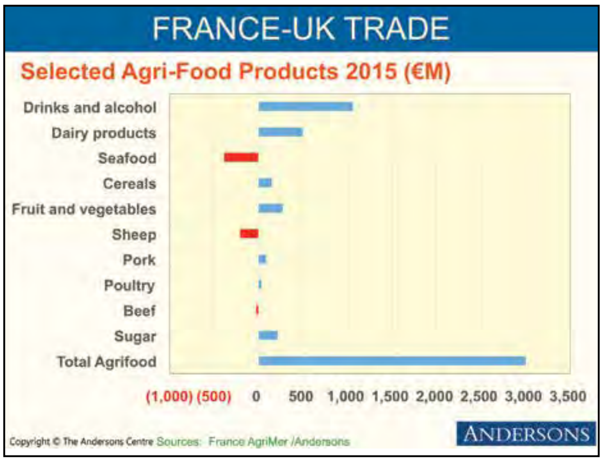
The future trading relationship between the UK and the EU is very important because the block is our largest single trading partner. This is true for all goods (shown on the bottom chart on this slide) and even more so for agricultural products. Services are not shown on the chart, but they are another important segment of trade. It can be seen that the UK imports more ***from*** the EU than it exports ***to*** it. This might suggest that the EU will be keen to do a deal.

This chart shows the percentage breakdown of UK exports to EU and non-EU destinations. Total exports of goods, estimated at over £308 billion, is split evenly between EU and non-EU countries. For crops, the UK exports proportionally more to the EU, particularly for oilseeds. Furthermore, within some livestock sectors, notably beef & pork, exports to the EU account for 80% or more, with Ireland accounting for a significant proportion of this amount. For agriculture generally, Ireland is the leading export destination representing 18% of total exports. France (10%), US (9%), Netherlands (8%) and Germany (7%) are also important destinations. Some commodities are not traded in great quantities, so the table below the chart shows the value of exports of each of the categories.

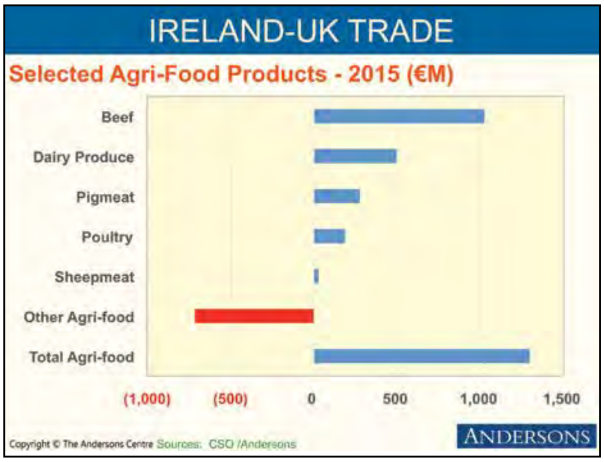


The previous chart focused on exports, whilst this one looks at imports. In 2015, the UK imported £403 billion of goods in total, of this approximately 51% came from the EU. In agriculture, 73% of imports came from the EU. In both agriculture, and goods generally, the UK runs a sizeable trade deficit with the EU (although services show the opposite pattern). The EU accounts for virtually all pork and cheese imports and also accounts for the majority of all other agricultural commodities except for oilseeds and lamb. Ireland accounts for 62% of beef and 35% of cheese imports. Denmark is the largest seller of pork to the UK, representing 26% of the total consumed. Taking all agricultural products together, Netherlands is the largest individual exporter, representing almost 15% of total UK agricultural imports. However, much of this is from redistributed bulk imports into Rotterdam, sold onwards in smaller consignments.

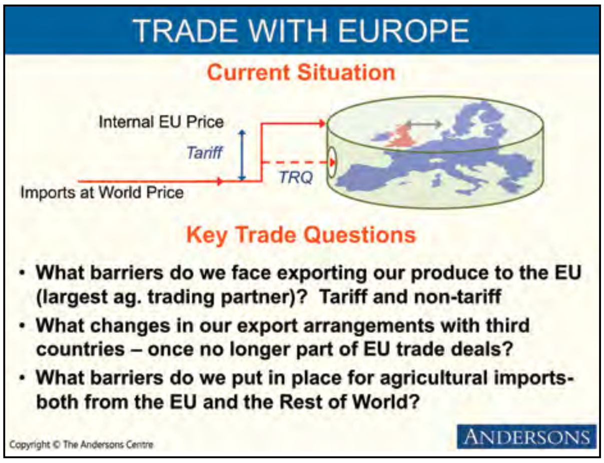
'They need us more than we need them' was an oft-repeated claim during the referendum campaign, indicating that a satisfactory trade deal with Europe would be easy to achieve. The UK does, indeed, import more from the rest of the EU than it sells to it. However, this trade tends to be with a limited number of countries. Also, as this slide shows, taken as a percentage of their respective GDPs, the UK is far more exposed to trade disruption than the rest of the EU. This weighs the cards in favour of European negotiators.



This slide gives a flavour of some of the agricultural trade flows between the France and UK, and therefore who might be keen to do a deal with the UK. As can be seen, in agricultural terms, the UK is an important destination for French food. The large value of sheepmeat going the other way can be seen as well.



This shows the situation for Ireland. The Republic is a major exporter of farm produce to the UK. The 'Other Agrifood' going into Ireland from the UK is largely grains. Away from agriculture, it has been estimated that, aside from the UK, Ireland will be the country most negatively affected by Brexit. In fact, under some scenarios, the economic losses in Ireland will actually be worse than those in the UK. Thus Brexit is a big deal for the Republic.



At present the EU market for agricultural goods is protected by tariff barriers – effectively a 'wall' preventing cheaper, more competitive, world-price imports from entering the market. The height of the wall varies between commodities. Some sectors that appear relatively 'unsupported' by the CAP actually benefit significantly from trade protection (e.g. pigs and poultry). Various deals allow certain quantities of goods in for low or no tariffs. These Tariff Rate Quotas (TRQs) punch a (small) hole in the protected market. At present the UK is inside the wall, so prices for many commodities are kept at levels above the world price.

The biggest questions on trade after Brexit are firstly whether we are inside or outside the wall – i.e. do we have tariff-free access to the Single Market? The next question is, what trade relationships we have with non-EU countries now that we need to conclude our own trade deals with them? Lastly, will the UK re-create tariff barriers to protect its own market, or will it be more open to trade?

TRADE WITH EUROPE

Templates For Future Trade

1. **EEA/EFTA** – Norway
2. **EFTA & Free Trade** – Switzerland
3. **Customs Union** – Turkey
4. **Free-trade Deal** – Canada, Chile
5. **WTO Rules** – New Zealand
6. **Liberal Trade** – Singapore

There are a number of examples that are useful to look at in terms of possible future UK/EU trading relationships. We have identified six, and go into them in more detail in the slides that follow.

1. EEA/EFTA - NORWAY

- **EEA gives free access to the EU Single Market**
- **This means free movement of services, capital and <u>people</u> (immigration) as well as goods**
- **All Single Market rules must be followed**
  - a.k.a. 'Brussels red-tape'
- **Norway pays for Single Market access** (55% of UK rate)
- **Agriculture is excluded from EEA**
  - CAP does not apply; trade in farm goods would face tariffs unless 'side deal' agreed
  - Norway ≠ UK: no farm exports and high domestic prices -

Norway's Import Tariffs	Wheat	Cheese	Lamb	Beef
Tariff - €/t	€228	€3,017	€2,580	€3,449

Membership of the European Economic Area (EEA) gives almost complete access to the EU Single Market. The members of the EEA (which includes Iceland and Liechtenstein as well as Norway) participate in free movement of goods, services, capital and people. This can be seen as both a good thing (tariff free access for goods and services) or a bad thing (labour movement). EEA members have to enact all Single Market regulation (without a say in setting the rules). Norway also contributes to the EU Budget – at around €100 per head compared to the UK's €180 per person. EEA membership is only open to members of EFTA (European Free Trade Association). Note that not all existing EEA members are keen on the UK joining their club. Agriculture and fisheries are not included in the EEA. The EEA is not a Customs Union and EEA countries are free to set their own trade polices (and tariffs) outside the EU. There are 'Country of Origin' rules to prevent EEA members providing a back-door, low tariff route into the EU. These would increase trade costs. Norway sets very high agricultural tariffs to protect its farmers. However, there is a deal between the EU and Norway that means the majority (circa 60% of EU agricultural exports to Norway) do not incur these high tariffs. Although financial services are included in the EEA (important to the UK), the framework is not comprehensive.

2. EFTA & FREE TRADE - SWITZERLAND

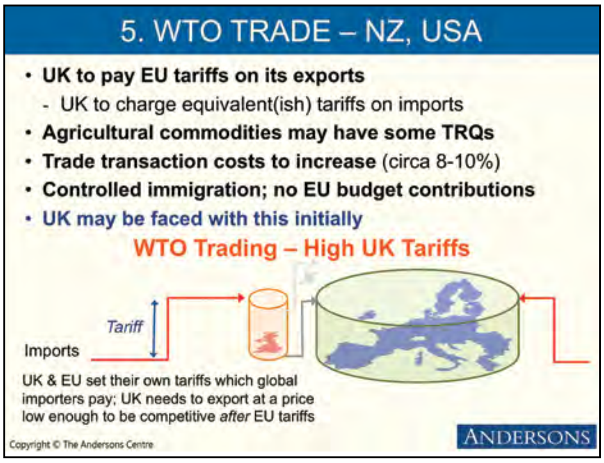
- **Access to the EU Single Market is through a series of bilateral deals** (created over 50+ years)
  - only accepts EU regulations as part of these deals
- **Free movement of people – but Swiss want to restrict**
- **The agricultural deal (2002) does not create free trade in agricultural goods**
  - reduced tariffs and non-tariff barriers
- **More 'bespoke' than EEA, and more arms'-length**
- **But EU unlikely to be keen**
  - trying to get Swiss to move to EEA model.
  - also complex, time-consuming and legislatively clumsy

Switzerland is a member of EFTA, but has not joined the EEA. Instead of gaining Single Market access through the EEA, it does so through a series of bilateral deals. In some areas they have aligned their domestic regulations with those of the EU, in other areas they operate their own laws. This more 'bespoke' arrangement perhaps sounds like an ideal outcome for the UK. However, the EU is unlikely to offer such a 'pick and mix' option to the UK, as it is not altogether happy with the situation regarding Switzerland and is trying to get the Swiss to move towards a similar arrangement to Norway. It is also a complicated arrangement, built up over 50 years, and would be difficult to replicate in a matter of a few years. The Swiss have to accept the free movement of labour. They voted in a referendum in 2014 to restrict immigration from the EU. But the EU has flatly declined to even negotiate on this point. The agricultural bilateral deal does not result in free trade in farm goods, although there is a drive to lower tariffs as much as possible. The Swiss do not have access to the internal EU market in financial services.

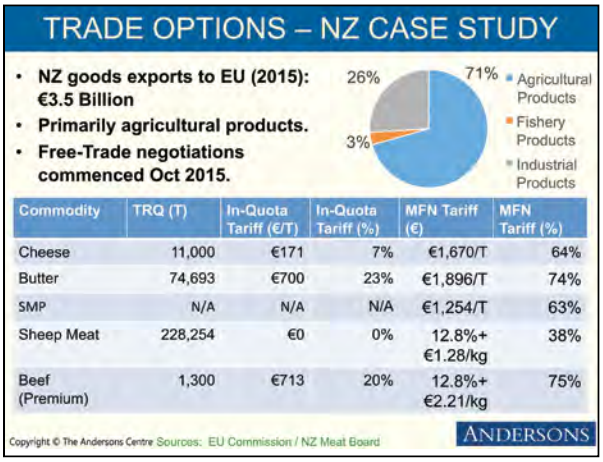
The EU-Turkey Customs Union is relatively limited in scope – it covers all industrial products (including the industrial component of processed agricultural goods). It does not cover agriculture or services (including financial services). Therefore Turkey is not part of the Single Market with its four freedoms, but can sell many goods to Europe without having to pay tariffs. Turkey does not have to enact EU legislation, but there is an ongoing effort to reduce technical barriers to trade (e.g. product standards encompassing food, plant and animal health). As the UK and EU legislation would be aligned upon an exit, this option would appear to be relatively easy to implement initially. Over time however, it is likely that UK and EU legislation might diverge. There is no free movement of people involved in the Customs Union. The fact that a Common External Tariff is set limits Turkey's flexibility in trade negotiations.

The graphic at the bottom of the slide illustrates the Customs Union. Although the UK has floated away from the EU it is still behind the same tariff wall. Trade is conducted at the (higher) internal EU prices. EEA/EFTA are a variant on this – but the UK would be free to set its own tariff levels (with Country of Origin rules as a result). In practice, agriculture tends to fall outside all of these arrangements, and a separate agreement might be required.

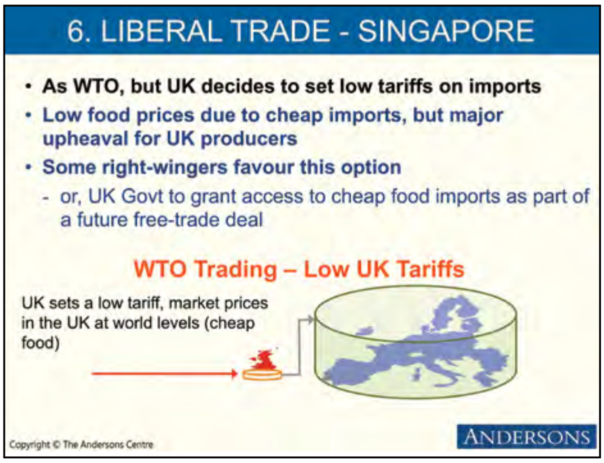
The EU has signed free-trade deals with a number of countries including Chile, Mexico, South Korea, South Africa and Morocco. One with Canada (the Comprehensive Economic and Trade Agreement – CETA), is pending ratification. These agreements all differ. In general, agriculture (as a politically contentious subject) tends not to be fully liberalised. Services are often not included which could be a problem for the UK. Under a Free Trade Agreement, both the EU and the UK can individually set the level of tariffs that apply to the rest of the world. But these tariffs would not apply for trade between the two (again, a 'hole in the wall'). Outside of the Single Market there may be higher costs of trade (i.e. customs procedures and certification). None of the current countries with a free trade deal is as large as the UK in economic terms, or has such a complicated history with Europe. Even these, relatively simple, agreements took years to conclude. It is highly unlikely that any UK-EU agreement could be concluded within the two year timeframe between the triggering of Article 50 and the date of UK exit.



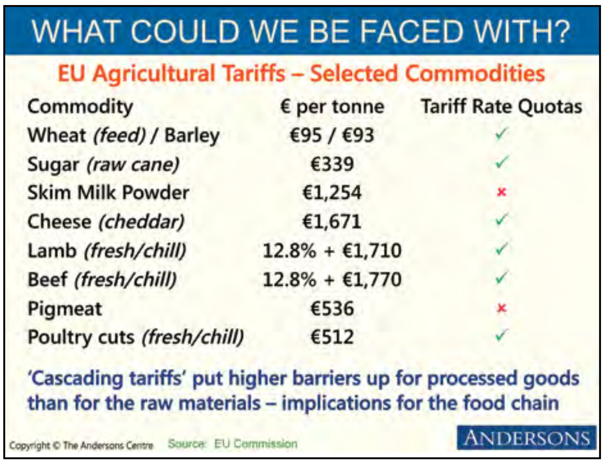
If the UK cannot negotiate preferential access to EU markets, it will trade with Europe under World Trade Organisation (WTO) rules. Tariffs would apply to agricultural and food trade between both parties. UK exporters would pay the EU's Common External Tariff, while imports from the EU would be charged whatever tariffs the UK chooses to implement. Whilst this is often categorised as a 'New Zealand' option, it might be best to think of it more as a USA example. NZ is a country very focused on agricultural exports with a small domestic market. The UK is different. We produce a sizeable amount of farm produce, but consume most domestically, export some, and also import some. In the graphic shown, the UK decides to keep its tariffs for imports at levels similar to the EU. This is an important issue where the current EU (UK) price is above world market levels. If there is no protection for the UK market, domestic producers may be undercut by imports (NZ dairy, US pigmeat, Far Eastern poultrymeat etc.). An alternative to tariffs are non-tariff barriers – these might limit imports if production standards are not up to UK levels. To continue to trade with the EU, our domestic prices would have to fall by the equivalent of the tariff we would be required to pay and vice versa.



This slide shows a case-study of New Zealand agriculture. It can be seen that the nation is a major exporter of farm commodities to the EU. It has preferential access for many of its agricultural commodities. The Empire/Commonwealth was a key supplier of food to the UK. When the UK entered the EEC (as it then was) various Tariff Rate Quotas (TRQs) were provided for countries such as Canada, Australia and New Zealand. The EECs tariffs were much higher than the UK's, and if this access was not granted then there would have been an even greater upheaval in trade flows. It is not yet clear how, or if, existing EU TRQs will be apportioned between the UK and the 'rump' EU. MFN is 'Most Favoured Nation' and is effectively the standard tariff the EU applies to all WTO members. The 'In Quota Tariff %' and 'MFN Tariff %' compare the height of the barrier to current (August 2016) world market prices.



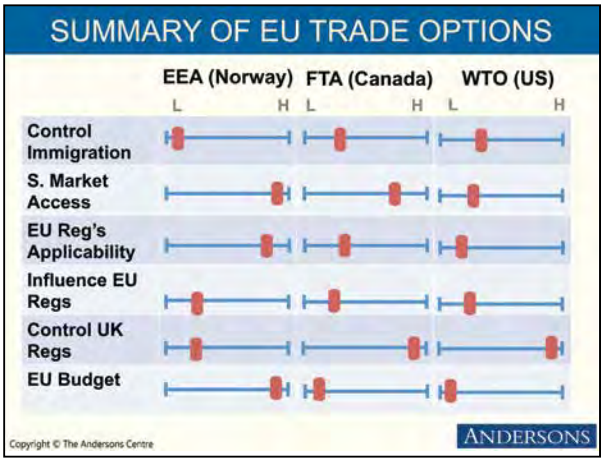
Under Example 5 (USA) it was assumed that the UK would set tariffs at levels close to those it already applies as part of its EU membership. This would make some sense as it maintains more of the 'status quo' and gives something to negotiate in any free-trade deal. However, keeping tariffs at EU levels is likely to raise food prices in the UK (the UK is a net importer of food, and the prices of EU imports would be higher due to the tariff imposed). A UK government may therefore unilaterally reduce tariffs to keep food cheap. This would have negative effects on the UK farming sector. It might be thought that the UK could simply waive tariffs on imports from the EU to keep the situation similar to present. However, under WTO agreements, countries cannot normally discriminate between their trading partners. If the UK grants someone a special favour (such as a lower tariff rate for one of their products) then it must do the same for all other WTO members. This principle is known as Most-Favoured-Nation (MFN) treatment – i.e. you treat everyone as well as your most-favoured trading partner.



As shown earlier, tariffs provide a monetary 'barrier' to imports into the EU. This slide shows a selection of the tariffs that the EU currently imposes. Simplistically, this is the height of the wall UK exporters will need to get over if there is no special trade deal.

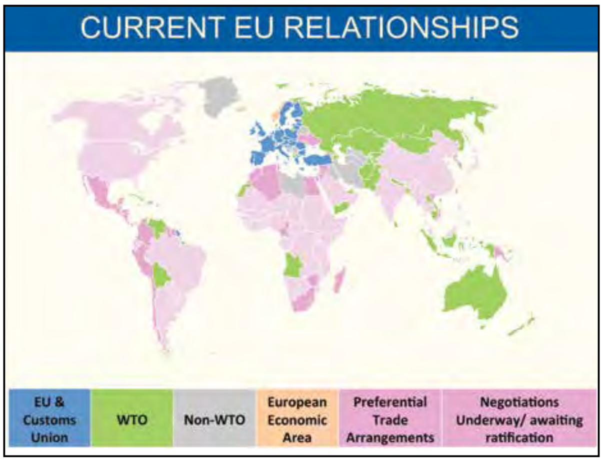
This slide also highlights the issue of 'cascading tariffs'. Under these, a relatively low tariff is applied to the raw material, then ever-higher tariffs the more processing/manufacturing is undertaken. In a very simplistic example, wheat might have a tariff of £100 per tonne, but flour a rate of £500 per tonne and bread £2,000 per tonne. The idea is that the raw materials for processing are allowed in fairly easily, but the 'value added' is encouraged to take place in the country concerned. This has implications for the UK's large food manufacturing sector.

Non-tariff barriers are other policies that prevent the free-flow of goods between countries. As tariffs have been cut around the world over the last 30-40 years non-tariff barriers have become more important. The slide gives some examples of what are included in this category. With the Single Market, there are currently none of these barriers between the UK and the rest of the EU (all standards are the same, no customs etc.). Should we leave the Single Market then these will add further transaction costs to trade. This will eventually result in a lower price to producers.



This slide shows graphically how some of the main options compare. We have only focused on the three that seem the most likely. For example, it seems unlikely that the UK would get a Swiss-type deal, and a Customs Union like Turkey does not seem to cover the right areas (although it could be the basis for a more comprehensive deal). The full trade liberalisation option also looks unlikely. The slide reiterates the overall message at the start of this section. The UK will need to decide how much sovereignty it wants to trade away in return for Single Market access.

It is not simply a question of doing a deal with the EU – although as our largest trading partner it is perhaps the most urgent. As part of the EU we have been party to the 50 trade deals the block has signed. Legal opinion suggests that when we leave the EU, we cannot simply take on these arrangements – we have to negotiate new deals with the other parties. It was mentioned at the start of the presentation the dearth of trade negotiators in the UK. This will be an issue as we try to engage with the rest of the world. It has been suggested that the UK could simply sign up to something that has already been negotiated. Although this would provide a short-cut, the deal done might not always be what the UK would have wanted. There is potential that in any trade deal agriculture might be the 'sacrificial lamb' in order to advance UK interests in other areas.

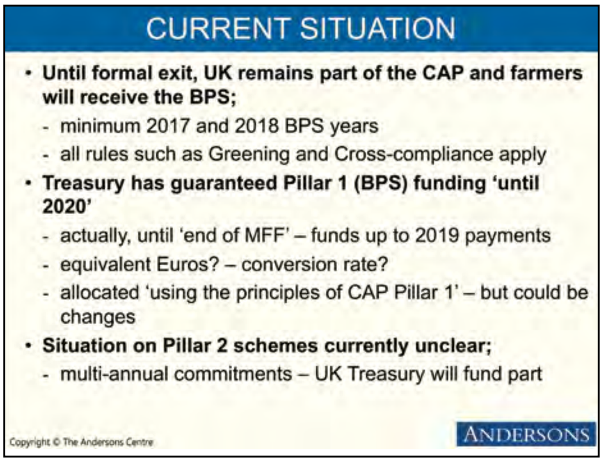


This map shows current EU trade deals. It reinforces that there would be a great deal of work to be done to integrate the UK into global trading partnerships. The process could take a decade or two. It might be a good time to re-train as a trade negotiator!

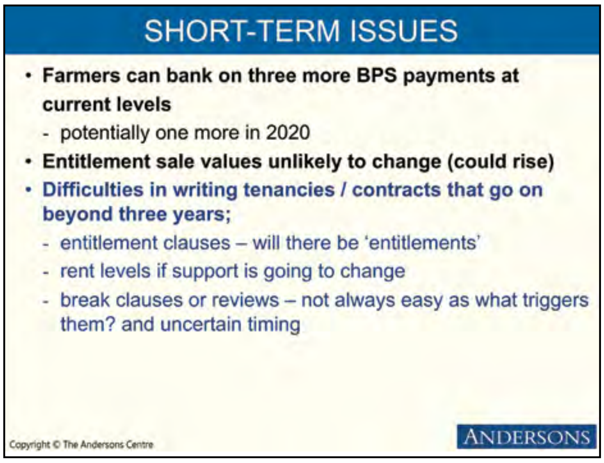
This slide restates some of the key issues that will need to be resolved over the coming years. Remember the EU is not a monolithic block but 27 Member States all with their own national interests. Some will be keen to see trade maximised, but many don't actually trade much with the UK. For some, their main export to the UK is people, so free movement of labour is far more important. At the moment 'Brexiteers' are in charge of the Brexit government departments and the mood seems against any attempt to stay close to Europe if this means giving up sovereignty. However, this may change if the UK enters a prolonged economic downturn. For agriculture especially, the levels of external tariffs that the UK decides to set will be key in determining the future prospects of the sector.

The final slide in this section makes some predictions about where the trade situation will end up for the UK after Brexit. Obviously, making predictions is fraught with danger, especially in such a fluid situation - it will almost certainly be wrong! We believe a deal will be done between the EU and UK, but it will not be neatly tied-up to coincide with the formal exit of the UK. Therefore there could be a period where the UK is trading under WTO rules (perhaps for two to five years). It might be logical to have some sort of bridging arrangements to extend existing trade rules for a limited time if a long-term deal looks possible. Logic does not always drive political decision-making however. None of the templates outlined earlier are likely to fit the UK exactly – it is simply too big and too different. Those leading the exit negotiations appear to favour something like the Turkish option – a Customs Union, but adding-in access for services. Even under any such deal, the City of London is likely to lose some of its trading rights in the EU. It is not guaranteed that agriculture would be 'bolted-on' to any trade deal. Its political clout is small.

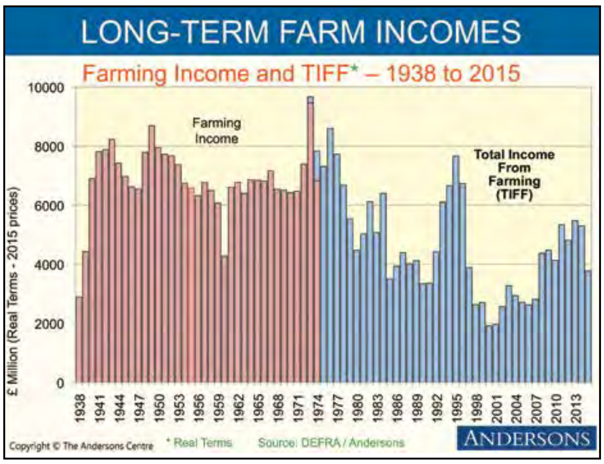
A BRITISH AGRICULTURAL POLICY



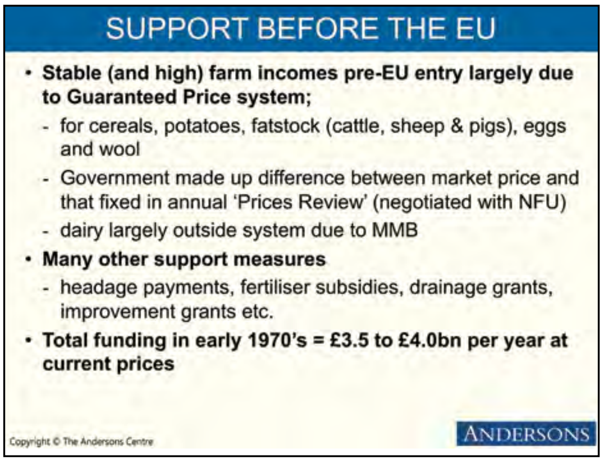
We remain in the EU until we leave and therefore farmers will still receive the BPS until then (although it is not clear what would happen if formal Brexit occurred part-way through a BPS year). In August it was announced by the Treasury that *'[the agricultural sector] will receive the same level of funding that it would have received under Pillar 1 of CAP until end of the Multiannual Financial Framework in 2020'*. However, the final year of the MFF actually pays the 2019 Basic Payment. Even Treasury / DEFRA statements carefully speak about funding being guaranteed *'...up to 2020'*. Therefore, funding may only actually be guaranteed for the 2019 scheme year. The system could change after Brexit, but it is likely that it will be based on the current BPS with tweaks until a whole new policy is worked out. The Treasury announcement was clear that existing agri-environment commitments would be honoured. But at the time of writing, the situation with new Rural Development schemes was unclear.



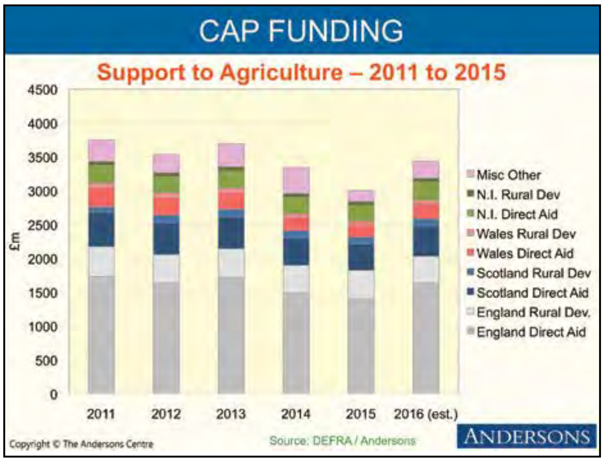
It is pretty certain there will be three more BPS (or BPS-like) payments with the possibility of four. This gives some certainty over the lifespan and value of entitlements. Over this period, the shape of a replacement scheme should become clearer. If there looks like being no place for entitlements in this, then their value will diminish. It is currently very difficult to write clauses in FBT agreements over three years. Most transfer entitlements to the Tenant and then require them to be returned to the Landlord at the end of the lease. By the time the lease ends though, there may be no such things as entitlements. It also makes setting rents, etc. very difficult. If there is a 5-year FBT for example, the level of support could dramatically change at some point during its lifetime (and thus affect the rent that could be paid). Review or break clauses are possible, but some parties don't necessarily want a break. It is also difficult to word what triggers such a review, as the sequence of events is so uncertain.



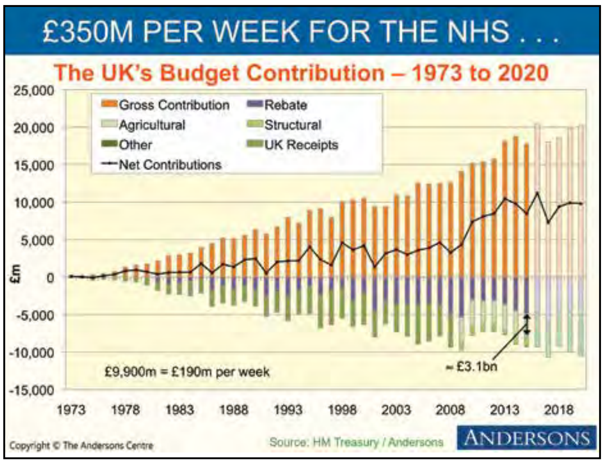
When looking at future support arrangements it is useful to look backwards to start with. This chart shows aggregate farm incomes (profits) for UK agriculture going back to WWII. The most recent statistics are the familiar Total Income From Farming (TIFF) measure. Before that, a UK-measure called 'Farming Income' is used. They do not tally exactly, but are close enough for comparison. It can be seen that, prior to entry into the EEC in 1973, farm incomes in the UK had been relatively high in the post-war period. The subsidy system that operated in the post-war period contributed greatly to this prosperity. It is outlined in more detail on the following slide.



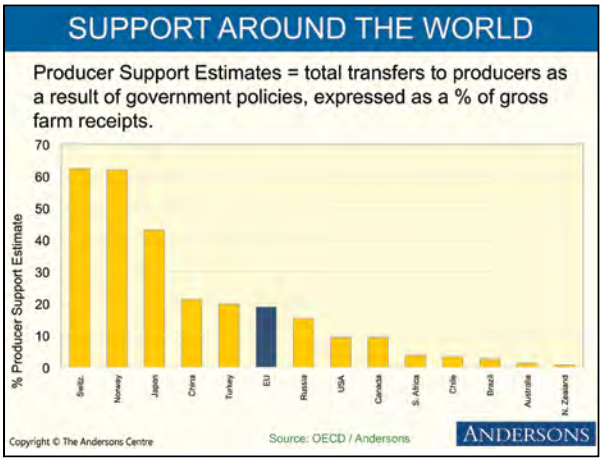
Notwithstanding the caveats on the figures, the previous slide indicated that the period before entry was a prosperous one for UK farming. The predominant support system operating at the time was one of deficiency payments. Under these the government set a fixed price for each commodity covered (in negotiation with the NFU). Market prices were allowed to fluctuate with supply and demand, and imports from Commonwealth countries were freely allowed in. But the shortfall between the market price and the Guaranteed price was paid across to farmers. The quantity of output on which the price was paid was fixed to discourage over-production. Farmers generally liked the system but the Treasury was not keen as the amount of subsidy could not be budgeted for in advance. There were various other supports available at the time to boost the productivity of farming. The overall bill to the taxpayer was not greatly different from now (although it must be remembered that the number of farmers, and the size of the UK economy is somewhat different). But, all this was 40+ years ago, and we should not expect to return to this system of support.



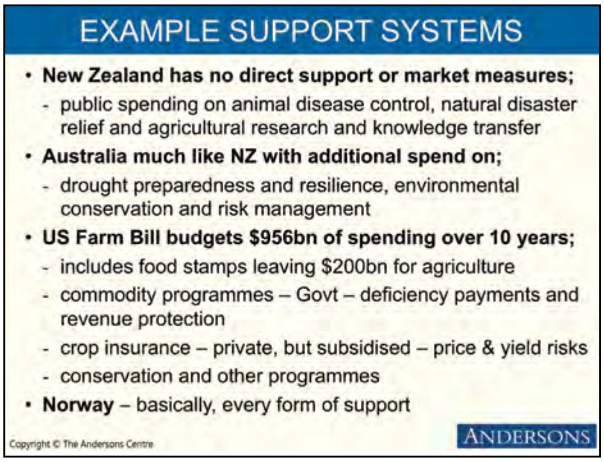
This chart demonstrates the funds that have been spent on UK agriculture over the last five years. The main reason for the change (fall) in payments is exchange rates. Support under the CAP is calculated in Euros and then converted into Sterling. As the Pound strengthened during 2013 and particularly 2014, the value in Sterling terms fell. The 'Misc Other' category is largely market support (intervention buying) plus Producer Organisation spending. On average the farming industry receives over £3bn annually from the CAP.



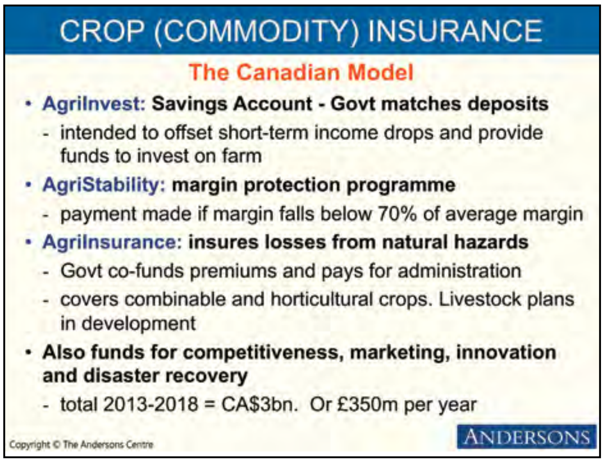
The statistic that got the most 'traction' during the referendum campaign was the one that stated that leaving the EU would free-up £350m a week to spend on the NHS. As was pointed-out at the time, this was, at best, misleading. That figure relates to gross contributions before the UK rebate is factored-in. Even then, significant funds come back to the UK – agriculture is a major part of this. *The difference between the £3.1bn highlighted on this slide of EU funding coming back to agriculture, and the circa £3.5bn receipts to UK farming outlined on the previous slide is the level of UK match-funding provided. This is required for some Rural Development programmes (Pillar 2).* However, the UK does spend a net £10bn per year on EU membership. This money will be freed-up even if the UK continues to spend exactly the same on farming support, structural funds etc. However, the question must be whether Brexit will cause an economic slowdown which might negate any benefit in EU Budget savings. It should also be remembered that any future trade deal may still require the UK to pay into the EU budget.



The Organisation for Economic Cooperation and Development (OECD) tracks how much developed economies support their agricultural sector. This slide shows how 'generous' a selection of countries are. The percentage Producer Support Estimate (%PSE) represents policy transfers to agricultural producers, measured at the farm gate and expressed as a share of gross farm receipts. Simplistically, the higher the percentage, the more support farmers get. Although the EU has a high figure, it is not as high as some other countries.



As the previous slide suggested, the level of support in New Zealand is very low. Funds are targeted at areas that improve the productivity of the sector. Australia is slightly more generous. Due to the climate, many of the measures are focused on dealing with natural disasters or protecting the fragile environment. The US Farm Bill looks incredibly generous. However (for political reasons), the legislation yokes together support to farmers with food programmes for the poor. The food stamps programmes take up much of the funding – but still leaving a sizeable sum for support. There is a mix of programmes, but deficiency payments and revenue protection schemes feature heavily. Some of these are very bureaucratic. Norway is very generous to its farmers with a plethora of schemes. But it can afford to be, with its substantial oil wealth and small population.



George Eustice has spoken in favour of a crop insurance model for a future British Agricultural Policy. He has cited the Canadian example as one to follow. The Canadian farm support model is made up of a number of elements, of which crop insurance is only one. There are issues with this type of support. Savings accounts can become depleted by a run of bad years, and also if an investment is made followed by difficult times. There can be a lot of bureaucracy involved in insurance schemes and it can be expensive too.

WHAT'S ON THE MENU? ~ 1

Policy	Pros	Cons
Keep Domestic Farm Prices High *(tariffs etc.)*	Relatively simple Supports activity Consumers pay	High food prices Encourages output Trade commitments
Deficiency Payments	Market free to operate Supports activity	Setting price levels Can be expensive Encourages output
Insurance Schemes *(prices, yields, revenue)*	Free market Farmers contribute Can be targeted	Potentially complex Risk v reward Level of 'support'
Headage / Area Payments	Simple & targeted Supports activity	Skews incentives Govt funded

ANDERSONS

If the UK Government (or Governments) are truly starting with a blank sheet of paper, what is available to them? This slide, and the next two, outline some of the policy options. We have highlighted some positive and negative aspects of each of the options listed. Note that we have called this a 'menu' – it is possible for policy makers to choose multiple elements to form an overall farm policy.

WHAT'S ON THE MENU? ~ 2

Policy	Pros	Cons
Decoupled Payments 1. Like Existing BPS	Market unaffected Systems in place Can be 'conditional'	Cost to Govt Un-targeted £s to Landlords
2. Alternative DP More targeting – *e.g. hill farms only*	Focused objectives Less spending	Defining areas Active farmer issues
'Bond' system – *personal right to support*	Totally decoupled A way to phase-out support – degressive Allows industry adjustment	No ongoing aid Breaks link with land (no X-compl) Difficult politically

ANDERSONS

This slide sets out further policy options. Where the text states decoupled payments can be 'conditional', this means they can be tied into broader policy objectives. Cross-compliance and Greening would be examples of this. For those that would like more detail on how a 'Bond' scheme might work see - http://centaur.reading.ac.uk/4614/1/The_bond_scheme_-_EU-policy.pdf.

WHAT'S ON THE MENU? ~ 3

Policy	Pros	Cons
Investment Aid	Simple & discrete Farmers like it ↑ productivity (?)	Additionality? Useful investments
Agri-environment schemes	Public goods Targeted	Complexity? VFM
Other 'environment'*	As above	As above
Research, KT, advice, business managm't	↑ productivity	Long term No direct support
Marketing and Promotion	May be needed Farmers support it	Indirect support Questionable VFM

* e.g. floods, soils, water quality - Ecosystem Services

ANDERSONS

The final part of the menu (dessert?) is shown on this slide. VFM is 'value for money'. 'Additionality' refers to the fact that with capital grant schemes you can end up paying grant to someone to do something they were going to do anyway (i.e. it is not achieving anything in 'addition'). Whilst we have tried to be comprehensive, there are almost certainly types of farm support that we have not included in this summary. Perhaps this merely emphasises what a complex subject area it is. Therefore the likelihood for UK administrations finding the optimum blend of policies when confronted with a blank sheet of paper is perhaps small. This means we may have a period of some years (10-15?) where support policies are tweaked and amended to reflect the changed circumstances of the UK.

DEVOLUTION ISSUES

- **Agricultural policy is devolved in the UK;**
  - each part of the UK can set its own policies
  - broadly similar at present as they are under the framework of the CAP
- **Outside the EU would policy diverge further?**
  - could a framework UKAP be agreed to keep the playing field level?
  - would / could the devolved administrations be able to fund at different levels to DEFRA (England)?
- **Trade is a 'reserved matter' so is handled by UK government**
  - as is immigration

ANDERSONS

The process of devolution since 1998 has made the setting of agricultural policy in the UK far more complex. In Scotland, Wales and Northern Ireland the devolution 'settlement' gives the power to set farm policy to national assemblies. At present, the fact that there is a pan-European framework under the CAP for farm policy keeps the different parts of the UK reasonably close. After Brexit there will be no such framework and we may see more divergence in policy. Some matters that affect farming strongly, such as trade and immigration policy, are reserved to the UK government. For more details of the devolution settlement see - https://www.gov.uk/guidance/devolution-of-powers-to-scotland-wales-and-northern-Ireland

EAP/WAP/SAP TIMINGS AND FUNDING

- **Potential 'leave' date of 31st December 2018 ??**
- **Support guaranteed *'until 2020'***
  - unclear whether this covers a 2020 BPS or not
- **Capacity of DEFRA (and devolveds) to write new policies within timescale?**
  - roll-over of BPS with minor tweaks (e.g. no Greening, X-compliance changes) for 2019 (and 2020) years
  - change in 'conditionality' could be an excuse to cut payments – but probably unlikely
  - gap in Rural Development-type funding around 2019-2020?
- **A new set of UK agricultural policies for 2021 onwards**
  - co-dependent on trade deal: freer trade = more support?

ANDERSONS

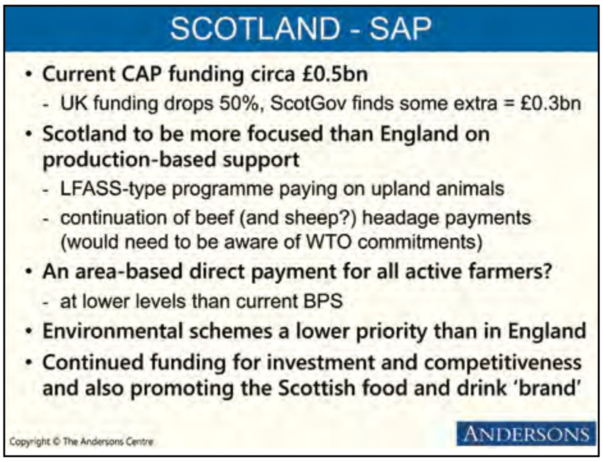
Should Article 50 be triggered early in 2017 then the UK could leave the EU at the start of 2019. Once we leave the EU we also leave the CAP. The August 2016 Treasury announcement guarantees funding for the 2019 year, but there is doubt over 2020. Even so, there is the question whether DEFRA would have the capability to work up a vastly different UK Agricultural Policy in only a few years. Especially if its energies had been devoted to negotiating Exit and Trade deals. Therefore we might see something very much like the BPS rolled-over until such time as a replacement can be agreed. This might well be 2021. At this point the funding could start to diverge from what has been seen to date. It would now be just the UK government(s) decision on how much to support farmers. If the economy was not in good health, would any UK administration be as generous as the CAP? An important point is the linkages between various parts of policy. If there is no trade deal with Europe, and the government lowers tariffs under a 'cheap food' policy, there may be more political will to support farmers. (Although whether there would be funds to do so is another matter.)

POSSIBLE EAP: 2025

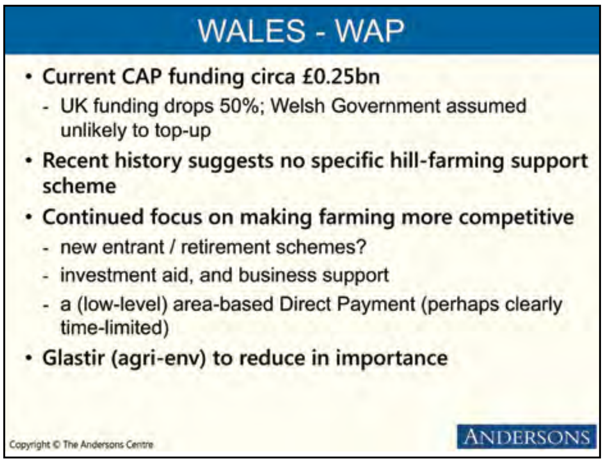
- **Funding down to 50% of current levels? (£1bn v £2bn)**
- **Hill support based on an area payment**
  - 2.2mHa of LFA x £40 per Ha = £0.1bn (land management)
- **Wildlife and Landscapes scheme (agri-environment)**
  - refinement of CSS/ELS; similar budget - £0.4bn
- **'Natural Resources' scheme**
  - water quality, soils, flooding, etc. - £0.15bn
- **Revenue Insurance Scheme**
  - subsidised premiums and admin costs - £0.15bn
- **Other programmes** – remaining £0.2bn
  - enhanced R & D and KT, food promotion, farm efficiencies (inc. a farm grant scheme)

ANDERSONS

The EAP is the English Agricultural Policy. It is assumed that the devolved administrations will take a slightly different (see next slide). Of course, by 2025 the UK as an entity may have altered radically. The biggest assumption is that a future UK government will not support English farming to the same extent as the CAP. We have halved the funds available. It is likely to be phased down in the 5 years 2021 to 2025. There may even be an element of residual Basic Payment for the first few years as 'adjustment aid'. Remember that this is the ***English*** Agricultural Policy. Therefore the starting funds are around £2bn per annum rather than the £3.5bn the whole of the UK gets. Various policy options have been costed out. Environmental actions are almost certain to be funded. Some sort of support for remote hill areas also seems likely. Otherwise, we see a re-orientation of support towards productivity and resilience. This may well be needed if English farming is in a more competitive environment. The name of the policy may well change – 'rural', 'food' and 'environment' may all appear as well as, or instead of, 'agriculture'.



The devolved parts of the UK may take a different approach to farm policy from England. However, their scope to do so could be constrained by funding. Scotland and Wales get a 'block grant' from UK Government (under the Barnett formula). This grant will be increased when agricultural spending is repatriated from the EU (the UK government will decide the overall amount and then the formula works out how much goes to each country). But agriculture is not ring-fenced in this allocation. Therefore respective Governments could decide to top-up, or raid, the agriculture budget. But the overall amount of funding is fixed (unless something like the rate of Scottish Income Tax is changed). Scotland and, to a lesser extent, Wales are seen to be more pro-farming than England. So a little extra funding may be found. As under the current CAP Scotland is likely to want to support hill areas and its beef industry. The environmental focus could be less than in England.



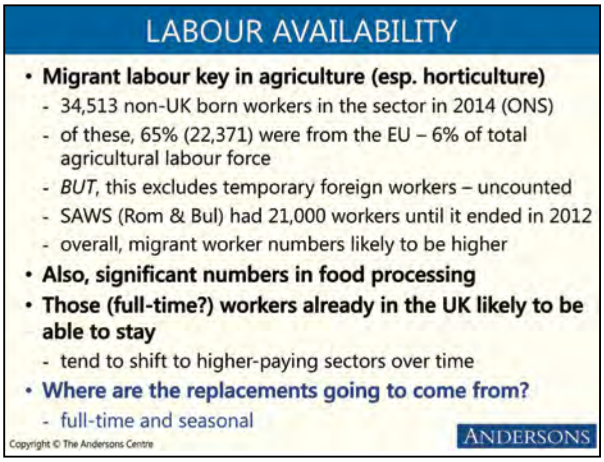
In terms of agricultural policy, Wales may sit somewhere between England and Scotland. There has been a clear desire under recent Welsh administrations to try and improve the competitiveness of the farming sector. Historic-based BPS was seen as preventing restructuring. The move to a flat-rate BPS provided a trigger to move the industry forwards. Something similar may well occur as a result of Brexit. The Welsh agricultural sector is very dependent on beef and sheep farming. The latter could be severely challenged if key EU export markets become more difficult to access.

OTHER BREXIT EFFECTS

Scotland was even more pro-remain than London (60% remain). The turnout in Scotland was lower than the UK average at 67% - perhaps indicating a bit of 'voting fatigue'. The political dynamics of Brexit on Scotland are complex. Although it is clear that the Scottish Nationalists want to retain Single Market access, will any failure to get this necessarily trigger a second Independence Referendum? Although it would like to be an EU Member, an independent Scotland could not simply take over the UK's seat at the table. There would be many practical issues to resolve around having a 'hard' EU/UK land border (these apply to Northern Ireland too). The financial situation for an independent nation is not as good as it was in 2014. Received wisdom (from the Quebec example) is that if two referendums are lost in quick succession, the issue is buried for a generation.

Note that we have not covered Wales on the slide. It voted 52.5% for Leave (although Monmouth, Cardiff, the Vale of Glamorgan, Ceredigion and Gwynedd were all 'Remain'). Therefore, Brexit is fulfilling the overall will of the Welsh nation, and does not seem to throw up any constitutional issues.

The much discussed 'bonfire' of red-tape may not occur. There is a widely quoted figure of '80,000 pages of EU Regulation' *(although it is not clear who has counted all these)*. There is not going to be enough time to review, re-write or delete all of these. Therefore the UK is likely to implement a 'Retain and Reform' model regarding EU legislation. Existing EU-derived rules will be rolled-over into a post-Brexit world, and these would gradually be changed over time. The European Communities Act 1972 would be repealed and legislation put in its place to retain the force of any EU regulations that operate under this act (and are required to be retained). There may be some 'totemic' changes in regulations to show that Brexit ***has*** changed things. Areas that have been discussed in relation to farming include the Water Framework Directive, Working Time Directive and Nitrates legislation. We are not convinced that there is political will to tackle even these areas. As ever, the capacity of government to make big changes must be questioned.

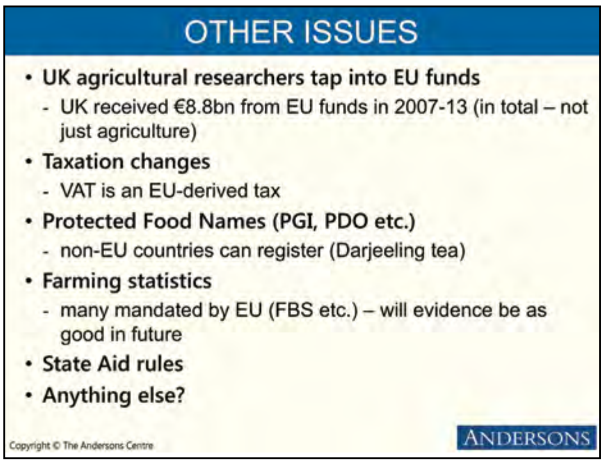


Immigration was one of the key battlegrounds of the referendum campaign. Interestingly, there was a strong correlation between those areas that voted heavily for Brexit and where there had been a high level of ***growth*** in the number of migrants over the last few years (rather than the absolute level of migrants in the locality). Migrant labour is a key issue for UK agriculture – especially in the fruit and vegetable sector. Migrants are also a key source of labour in the food processing sector. However, statistics are not very robust on EU migrants (with free movement of labour, there is no mechanism to count them). Those already in the UK look set to be allowed to stay under any 'Exit' deal (as will UK workers in the EU). But the supply of new workers could dry-up. These will be required as migrants tend to move out of low-paid jobs (or return to their country of origin) over time. The NFU is lobbying hard for labour access. It is not merely a question of introducing a new Seasonal Agricultural Workers (SAWs) scheme, as many of the workers are occupying full-time posts.

In the run-up to the referendum the reauthorisation of Glyphosate (Roundup) was a hot topic. There was a strong sense in the UK farming community that the science pointed clearly to the herbicide being safe, but many EU countries were refusing to authorise it for domestic political reasons. The power of the 'green lobby' is marked in a number of European states. The hope is that the UK post-Brexit will adopt a more science-led approach. Whilst this is possible, it is not inevitable. Firstly, depending on our future trade relations with the EU, we may still be subject to EU regulations to a greater or lesser extent. Secondly, it is perhaps naive to think that the power of special interest groups will be any less in the UK than they are in the EU.

The Producer organisation (PO) system is a slightly obscure branch of the CAP, but is very important in the fruit and vegetable sectors (and highly important for individual businesses). It is estimated that over half of all fruit and vegetables marketed in the UK come via POs. Currently, there are over 30 POs in the UK. Grant funding is limited to a maximum of 4.1% of eligible turnover. The current system started in 1997 and it has been one of the factors behind the success of the soft fruit sector in particular. A future UK government could replicate the system (indeed, some see it as a model for support across other farming sectors). But this is not guaranteed.

Food self-sufficiency is a measure often cited in arguments to support farming. The Food Production to Supply Ratio takes the farmgate value of all raw food produced in the UK and divides it by the raw value of the food consumed. It is more commonly known as the self-sufficiency ratio. It probably makes sense to focus on indigenous food, as some foods modern consumers demand cannot be commercially grown in the UK. Self-sufficiency in indigenous foods has dropped from 85% in 1990 to 76% in 2015 (although the UK population has grown over that period). If we are no longer part of the wider EU trading block does this make the UK level of self-sufficiency more important? Or, in a globalised, free-trading world, is the concept of the UK being self-sufficient as sensible as the Isle of Wight or Lincolnshire producing all its own food?



The final slide in this section rounds up a number of other areas that could be affected by Brexit. The Government has moved to reassure scientists that EU funding for research will be replaced by UK money, but this promise is time-limited. Cross-border collaborations may become less common with UK research becoming more insular. VAT is an 'EU tax' and is partly used to fund the EU budget. A sales tax of some sort is almost certain to remain post-Brexit, but there will be greater flexibility for the UK government on how to operate the tax. Protected food names will continue to operate and UK products can continue to register. However, in future trade deals, the UK may be less robust in promoting them than the EU has been. There may be a reduction in the quality and quantity of farming statistics now they are no longer required to be collected for EU purposes. The removal of EU State Aid rules may allow more targeted government support in certain circumstances.

IMPLICATIONS AND CONCLUSIONS

SOME SIMPLE RULES-OF-THUMB

'It is difficult to make predictions. Especially about the future' – Niels Bohr

1. **If the UK gets good Single Market access for agricultural goods then there will be little price effect**
2. **Where the UK produces a *surplus* of a commodity (wheat, OSR, lamb) then the farmgate price is likely to fall if we do not have Single Market Access**

   If we are outside the Single Market, for commodities where the UK is a net *importer* then;
   - prices would rise if the UK puts on EU-equivalent tariffs
   - farmgate prices could fall under a low-tariff regime

- **Many farm products are both imported and exported. Complicated!**

ANDERSONS

This final section of the Seminar provides a view of what the effects of Brexit might be for the farming industry, and those that trade with and service it. The first point to make is that being very early in the process of Brexit, circumstances will look very different in two or five years time. Therefore we are presenting our 'best guess'. Different commodities will be affected in different ways by Brexit. In fact, if we retain Single Market access, there will probably be little effect at all. If we are outside of the Single Market, then those sectors where we undertake significant amounts of exports look set to be hit hardest. Those sectors with a trade deficit could see prices rise after Brexit if tariff protection similar to that seen under the EU is retained.

MODEL FARMS – MAIN ASSUMPTIONS

- **All physical yields, input levels etc. remain the same**
  - prices only changed where there is a 'Brexit effect'
  - all in Real Terms – general inflation discounted
- **Previous 2017 exchange rate of €1 = 78p, now 85p**
  - 85p retained until 2025 under both scenarios
- **'Soft Brexit': Single Market access retained**
  - some extra trade costs – Customs etc.
  - 'UKAP' funding at 66% of CAP levels
- **'Hard Brexit': UK outside EU with no trade deal**
  - tariff barriers change prices
  - 'UKAP' funding at 33% of CAP levels

ANDERSONS

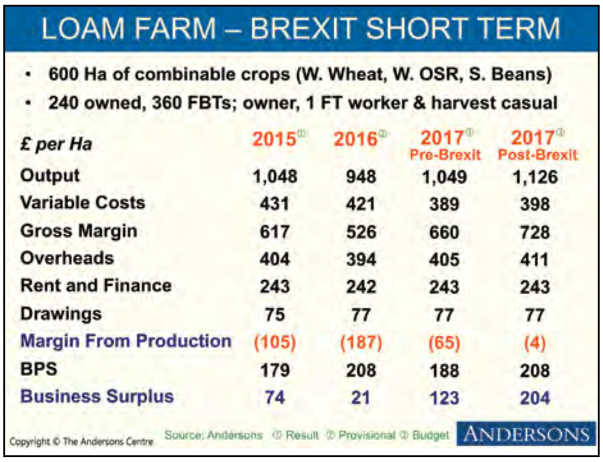
We are using three of our model farms to present the possible financial outcomes of Brexit. Two scenarios have been used – a 'Soft' and a 'Hard' Brexit. Under the Soft conditions the UK retains Single Market access and the cut in support to farmers is 'only' around a third of the current budget. The Hard scenario sees the UK trading outside of the Single Market and having to pay tariffs if it wants to export farm goods to Europe. Support to these lowland faming businesses drops by two-thirds. It should be noted that we are not presenting extreme scenarios – what is being shown is well within the plausible range of outcomes. Figures remain real terms figures, no inflation or market fluctuations are included other than Brexit effects.

HARD BREXIT EXAMPLE: UK LAMB PRICE

- **Current deadweight price, say 400 p/kg**
- **Import tariff into EU 12.8% plus €1.71/kg**
- **UK farmgate price in order to continue to be able to sell at 400 p/kg in France = 226 p/kg** (€1 = 85p)
- **Supply chain absorbs 20% of the loss; farmgate price = 261 p/kg**
- **Would be some 'dynamic' effects as UK price falls;**
  - cheaper domestic lamb replaces imports from NZ, etc.
  - lower prices boost domestic consumer demand
  - some sheep farmers exit industry and supply falls
- **Difficult to model. But assume this offsets half of the price fall. Farmgate price = 330 p/kg. A 17.5% fall**

ANDERSONS

This slide takes one commodity produced by UK farming, lamb, and looks at the potential effects of losing access to the European market. Of course, it is all highly speculative, but it is intended to provide a picture of the type of changes the farming industry could see at some point after 2018. One issue not included in the 'dynamic effects' is that UK lamb could find other markets outside of Europe. This would also help mitigate any price reduction. However, these types of market development projects tend to be a long-term undertaking. Calculations like this underpin the fam models that follow.



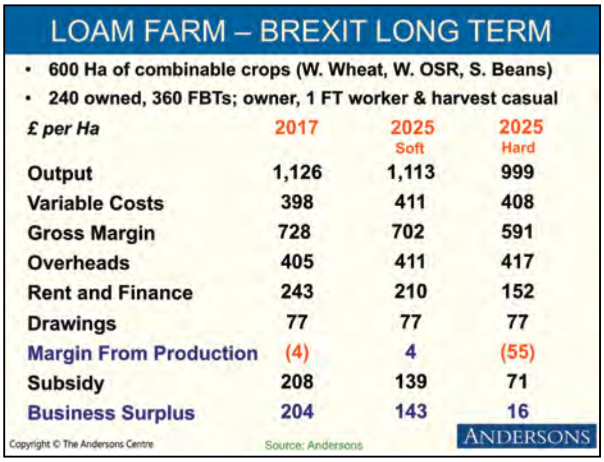
LOAM FARM – BREXIT SHORT TERM

- 600 Ha of combinable crops (W. Wheat, W. OSR, S. Beans)
- 240 owned, 360 FBTs; owner, 1 FT worker & harvest casual

£ per Ha	2015①	2016②	2017③ Pre-Brexit	2017③ Post-Brexit
Output	1,048	948	1,049	1,126
Variable Costs	431	421	389	398
Gross Margin	617	526	660	728
Overheads	404	394	405	411
Rent and Finance	243	242	243	243
Drawings	75	77	77	77
Margin From Production	(105)	(187)	(65)	(4)
BPS	179	208	188	208
Business Surplus	74	21	123	204

Source: Andersons ① Result ② Provisional ③ Budget
ANDERSONS

To illustrate trends in cereals farm profitability we use our 'Loam Farm' model. This is a notional 600 hectare business with a simple rotation of milling wheat, oilseed rape, feed wheat and spring beans, and is based on real-life data. Before we look at long-term trends, it is useful to look at the immediate impact of Brexit. We have stated throughout the presentation that there has been a short-term boost in farm prospects thanks to the weakening of Sterling against the Euro. The figures on this slide illustrate this. Commodities react to exchange rates far more quickly and fully than other costs, some of which are agreed annually for example. Thus output has increased substantially more than inputs.



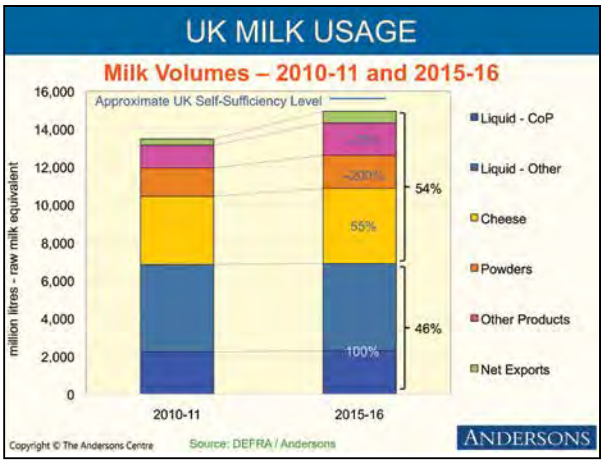
LOAM FARM – BREXIT LONG TERM

- 600 Ha of combinable crops (W. Wheat, W. OSR, S. Beans)
- 240 owned, 360 FBTs; owner, 1 FT worker & harvest casual

£ per Ha	2017	2025 Soft	2025 Hard
Output	1,126	1,113	999
Variable Costs	398	411	408
Gross Margin	728	702	591
Overheads	405	411	417
Rent and Finance	243	210	152
Drawings	77	77	77
Margin From Production	(4)	4	(55)
Subsidy	208	139	71
Business Surplus	204	143	16

Source: Andersons
ANDERSONS

This slide then shows a more long-term analysis of the outlook for Loam Farm. The first column is the immediate-post Brexit situation from the previous slide. Exchange rates and general inflation are not changed. Soft Brexit, with the retained Single Market access, retains similar output, but with a slightly higher trading fee. Costs might also be hardly affected. The Hard Brexit scenario, however, shows some sharp movements. Wheat prices are decreased significantly, the UK being a net exporter. OSR does not change, as the EU has no tariffs for it, and pulses hardly change as its tariff is low. Labour has been increased on the basis that migrant workers are now unavailable, creating wage inflation in Rural Britain. Rent has fallen sharply and subsidy has been slashed by two thirds from current levels.



There has been substantial growth in UK dairy output over the last five years. Much of this has been in the 'manufacturing sector' – i.e. milk going for processing into products like cheese, butter, milk powders etc. This now consumes over half of all UK milk (54%). 'Net exports' is mainly milk being exported from Northern Ireland to the Republic for processing. There will be issues around this with Brexit. The main reason for showing the statistics is to demonstrate that the UK is not-self sufficient in milk and milk products. In the event of a Hard Brexit it might be thought that this would be good for UK milk prices – imports from the rest of the EU would be more difficult if the UK applied matching tariffs, and the price could rise. However, the situation is more complex than that. The figures within the column shows the self-sufficiency figures for individual commodities. There is a far wider spread. It would take time to re-orientate UK processing capacity to substitute for imports.

FRIESIAN FARM MODEL

- 150 cows plus followers on 100 Ha (part rented)
- Year-round calving, liquid contract. Owner + worker

ppl	17/18	25/26 Soft	25/26 Hard
Milk	24.5	24.5	20.8
Total Output	27.2	27.2	23.2
Variable Costs	11.0	11.6	9.9
Overheads	9.1	9.1	9.2
Rent, Finance & Drawings	5.0	4.9	4.7
Total Costs of Production	25.1	25.6	23.8
Margin From Production	2.1	1.6	(0.6)
Subsidy	1.7	1.1	0.6
Business Surplus	3.8	2.7	0

 Source: Andersons ANDERSONS

Friesian Farm is our dairy farm model. The forthcoming 2017/18 year, is before Brexit will occur but still benefits from the weaker Pound with gains in the milk price. Looking to the 2025/26 milk year the two scenarios of Soft and Hard Brexit are created. Soft Brexit, assumes Single Market access is retained or regained with the EU. Both output and costs are therefore very similar to the 2017/18 year, assuming all other variables remain fixed (inflation, market fundamentals etc). However a Hard Brexit could be different. As import tariffs are for various forms of processed milk, some of which we are net importers, others we are net exporters, it might not work out quite so well. Here, a scenario with a 15% reduction in farmgate milk prices is based on the erection of tariff barriers. Concentrate feed reduces with cereals prices, as does rent and subsidy as already discussed in the Loam Farm example.

MEADOW FARM MODEL

- 154 Ha mixed lowland farm (114 Ha owned, 40 Ha FBT)
- Beef (suckler cows, finished bulls, sheep and arable)
- Proprietor, 1FT family worker & casual

£ per Ha	17/18	25/26 Soft	25/26 Hard
Livestock Gross Margin	726	698	596
Crop Area Gross Margin	686	657	486
Total Gross Margin	718	689	573
Overheads	500	512	*513*
Rent, Finance & Drawings	318	309	*300*
Margin From Production	(103)	(131)	(240)
Subsidy	208	139	71
Business Surplus	105	8	(169)

 Source: Andersons ANDERSONS

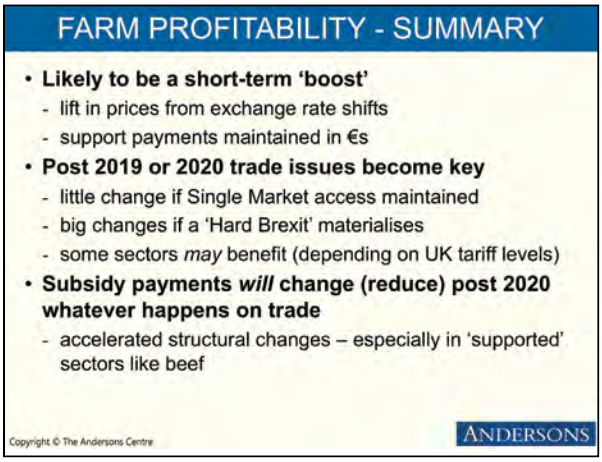
'Meadow Farm' is our notional 154 hectare (380 acre) beef and sheep holding in the Midlands. It consists mostly of grassland, with some wheat and barley grown for livestock feed. There is a 60 cow suckler herd with all progeny being finished, a dairy bull beef enterprise and a 500 ewe breeding flock. It is largely a family farm using family labour. Whilst a loss from production is forecast for 2017/18 (despite the Pound weakening), the support payments enable this farm to be profitable. The Soft Brexit scenario envisaged by 2025 suggest that this farm moves into a position where it is around break-even. This is largely because the farm is so heavily dependant on direct subsidy. A Hard Brexit could be very damaging to this business model. As many as 40% of all UK lambs are exported to Mediterranean Europe so farms like this are heavily reliant on tariff-free access to the EU. Likewise, the beef sector could be vulnerable to the likes of Mercosur countries' exports depending on domestic import tariffs set. A large decline of direct subsidy leaves this business in a serious loss-making situation.

PIGS AND POULTRY

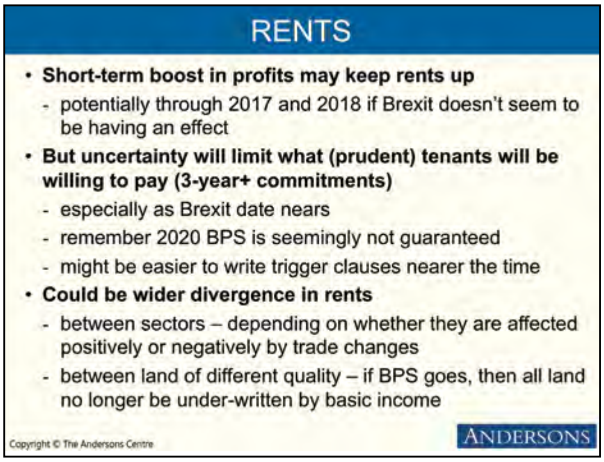
- Appear relatively unsupported currently but there is tariff protection from non-EU imports:
  - €60-80/100kg pig meat *Erga Omnes*
  - €13-60/100kg poultry meat *Erga Omnes*
  - €3.50/100 chicken eggs *Erga Omnes*
  - TRQ for poultry – mainly Brazil and Thailand
- Up to 70% of CoP is feed - cheaper cereals and proteins
- Rules on animal housing and welfare unlikely to change (non-tariff barrier)
- Self Sufficiency:
  - Pig meat; 62%, Poultry meat; 87%, Eggs; 85%

 ANDERSONS

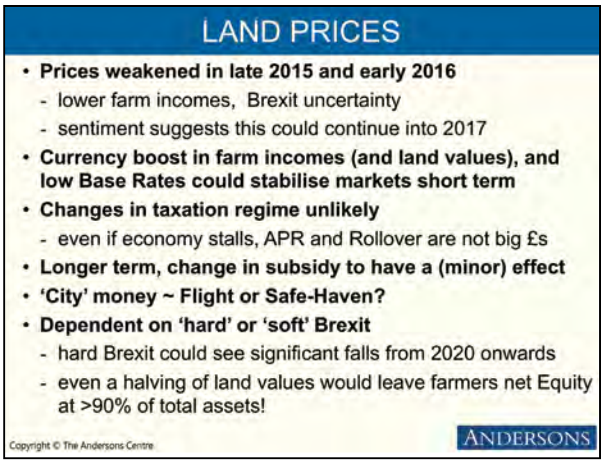
We have not got a model farm for the intensive livestock sector, but it is possible to draw out some general thoughts about how Brexit might impact these farms. Firstly, it is easy to assume these sectors are unsupported but, looking into the import barriers, we see that they are considerable for both pig and poultry products and illustrated. Also, on our assumption that grain prices are likely to fall under hard Brexit conditions, then it also follows that animal feed prices might soften too. This would be excellent news for housed livestock farm systems, as such a large proportion of the costs of production are the animal feed costs. Finally, whilst the UK will have autonomy on re-setting the housing regulations, we should note that the UK led the EU on sow stall bans by 12 years when they did not legally have to and so will probably not relax them Furthermore, if they did, it would potentially create non-tariff barriers, obscuring trade.



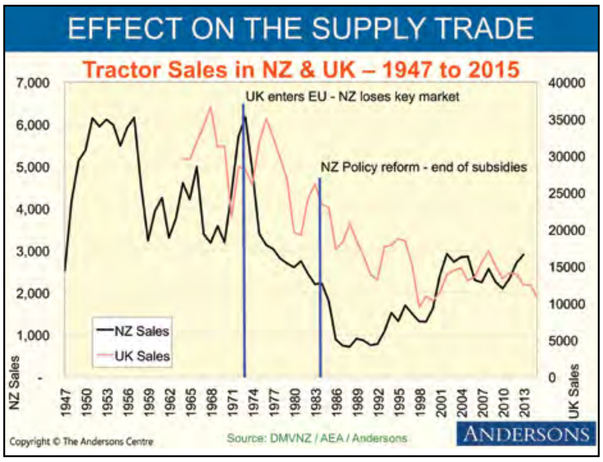
Overall, our modelling of farm profitability demonstrates that returns are unlikely to change much for the next two or three years – beyond the shifts in currency and the usual swings in farm profitability. The real effects of Brexit will be seen from 2019 or 2020 onwards. There is a wide range of possible outcomes depending, to a large extent, on the terms of our future relationship with the EU. It appears that downside outstrips upside in the medium term but the gains from Brexit could grow in the longer term as trade routes are established and non-EU countries become more important trade partners. So much depends on what the Government's plans are and how they are negotiated.



Rents are generally quite reactive to farm profitability. However, there is usually a time-lag as the market adjusts. Those negotiating rents also have to try and forecast future returns, as rents are fixed for a number of years (often three). This sits uncomfortably with a major change such as Brexit, where both the timing, and the effects are uncertain. The better returns forecast in the short-term may help to offset any downwards pressure caused by uncertainly. Longer-term, there may well be a more differentiated rental market. Some sectors will be affected by Brexit more than others, and therefore the ability of farmers in different sectors to pay rents may diverge. Under the CAP, subsidy payments (especially the area-based BPS) have tended to underwrite rents. As all farmland gets the same payment, rents have tended to be similar. In the future there may be greater weight given to land quality and its earnings capacity.

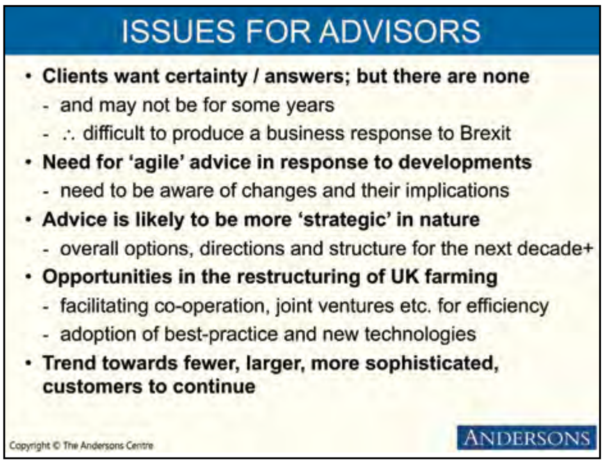


Land prices are more divorced from farm profitability than rents. Other factors such as non-farming buyers, the taxation regime, supply, availability and cost of credit, and farmers' desire to grow their farms all play a part. However, the profitability of farming is still an important driver. There has been a slight fall in land prices over the past 12 months. The slump in farm incomes seen in 2015 and 2016 is part of this. 'Affordability' is another issue, both for farmers and non-farmers following the very strong rises seen over the past decade. In the past months 'Brexit' uncertainty has added to the weakening. There could be a period of stabilisation in land prices before the effects of Brexit really hit. Should a Hard Brexit materialise there could be a sharp downwards shift in prices. A drop of 10-20% compared to 2015 values is possible. It should be noted that even if this occurs, most owner-occupiers would continue to have very strong balance sheets. Alternatively, land is considered by many investors as a safe-haven, and with a weak Pound, overseas buyers might return to the UK. With base rates lower than ever, there are also arguments for land prices to rise.

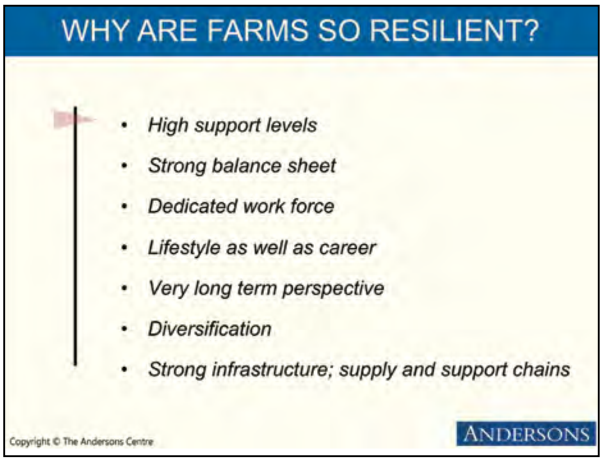


This chart focuses on one input to farming – machinery, and specifically tractors. The New Zealand situation is shown as the agricultural industry there has gone through similar changes to those that Brexit might bring on the UK (although the parallels are not exact). When the UK joined the EEC in 1973 trade with one of New Zealand's major export markets was disrupted. Although the government provided high levels of support to farming, it can be seen that there was still a marked slump in tractor sales. When NZ farming subsidies were reformed (removed) in 1984 there was another slump in sales. The chart only shows units sold – the rise in average horsepower means that volumes were likely to decline anyway. Figures from the UK are therefore shown as a 'control'. Sales volumes have also dropped over the decades shown, but the policy changes in NZ appear to have pushed sales below 'trend'. Overall, the message is that, when times are hard, farmers stop spending money.

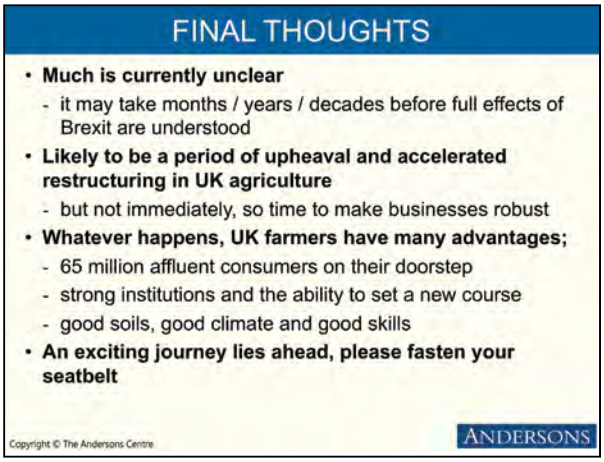
As indicated previously, any Brexit impact on the farming sector is more likely to be positive than negative in the short-term. Therefore those that trade with farmers should not see dramatic changes in their marketplace over the next two or three years. Beyond 2020 the trading conditions will alter. Even under a relatively 'Soft' Brexit, support is likely to drop. With less income available farmers will be questioning of every item of spending. It will be key for suppliers to demonstrate that what they are selling produces a positive return for the farmer and is not just a 'luxury' they can no longer afford. Lower subsidy makes farm businesses more exposed to the (volatile) marketplace, and many will be looking at ways to minimise risk. Past trends in consolidation of farm businesses will continue and probably accelerate.



In uncertain and changing times, farmers are likely to lean on their advisors more than normal. Unfortunately, (perhaps as this Seminar has shown) there are no hard and fast answers at present. This makes reacting to Brexit difficult. It will be vital to keep abreast of events over the next two to five years so that quality advice can be provided to clients. It may be necessary to make decisions quickly in response to political developments. The type of advice required is likely to be more wide-ranging than the annual update of budgets, preparation of tax accounts, or periodic rent review. Advisors are likely to have to work as part of a team to deliver the best results. If Brexit accelerates change in UK farming (which we think it will) then this in itself will increase the need for assistance. The client-base will continue to change over the coming years.



When considering the effects of Brexit it is easy to predict sweeping change in every aspect of UK farming. However, history suggests that change is often slower than might be thought likely. The full effects of Brexit may therefore take many years to manifest themselves. It is worth remembering how robust many (if not most) UK farming businesses are. This is both financially (with strong balance sheets) and personally (being dedicated to their farms, their industry and their way of life). This allows businesses to weather external shocks like Brexit.



UK farming, and the country generally, are at the start of an unprecedented process. We have given our best estimate of where we find ourselves and what the future might hold, but the final outcome may well be very different from what currently seems likely. In a wider sense it should be remembered that Brexit brings opportunities as well as threats. Not the least of these is the ability to plot a new course for UK farming. We are lucky to operate in a modern developed economy with affluent consumers who are increasingly valuing high-quality food.

Please call if there are any questions from this presentation.

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GLOSSARY OF ACRONYMS

BAP	British Agricultural Policy
BPS	Basic Payments Scheme
Brexit	British Exit (from the EU)
CAP	Common Agricultural Policy
CETA	Comprehensive Economic & Trade Agreement (with Canada)
CoP	Cost of Production
DEFRA	Department for Environment Food & Rural Affairs
DP	Decoupled Payment
EAP	English Agricultural Policy
EBA	European Banking Authority
ECA	European Communities Act
ECB	European Central Bank
EEA	European Economic Area
EFTA	European Free Trade Association
ELS	Entry Level Stewardship Scheme
EMA	European Medicines Agency
EU	European Union
FBS	Farm Business Survey
FBT	Farm Business Tenancy
GDP	Gross Domestic Product
GM	Genetically Modified
KT	Knowledge Transfer
LFASS	Less Favoured Area Support Scheme (Scotland)
MFF	Multi-annual Financial Framework (EU Budget)
MFN	Most-Favoured-Nation
MMB	Milk Marketing Board
MS	Member State (of the EU)
NFU	National Farmers Union
NZ	New Zealand
OECD	Organisation for Economic Co-operation & Development
ONS	Office for National Statistics
PDO	Protected Designation of Origin
PGI	Protected Geographical Indication
PM	Prime Minister
PSE	Producer Support Estimate
SAP	Scottish Agricultural Policy
SAWS	Seasonal Agricultural Workers Scheme
SPS	Single Payment Scheme
TIFF	Total Income from Farming
TPP	Trans-Pacific Partnership (trade deal)
TRQ	Tariff Rate Quota
TTIP	Transatlantic Trade and Investment Partnership (EU/US trade deal)
UAE	United Arab Emirates
USA	United States of America
VAT	Value Added Tax
YFC	Young Farmer Clubs
VFM	Value for Money
WAP	Welsh Agricultural Policy
WFD	Water Framework Directive
WTD	Working Time Directive
WTO	World Trade Organisation

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