

VISION FOR THE FUTURE OF FARMING



A NEW OUTLOOK ON INTERNATIONAL TRADE

Delivering for farmers and for the public



INTRODUCTION

As we stand at the brink of the beginning of the Brexit negotiations the question of the UK's future trading relationship with the EU and the rest of the world has been thrust into the forefront of political debate. There are number of potential outcomes to the Brexit negotiations: a comprehensive free trade agreement with the EU followed by new trade agreements being struck with countries across the world; or perhaps a failure of the forthcoming EU/UK negotiations leading to tariffs applied on all trade between the two blocs, with the Government subsequently reducing import tariffs to arrest inflation; and of course any combination of myriad options in between these two scenarios.

All of this leaves a number of unanswered questions – what will the impact be on farming? What should our future trading relationship with the EU be? How might a new customs agreement with the EU work? How will goods be traded between Ireland and the UK across the Northern Irish border? How do we ensure our production standards are not undermined by imported products? As the negotiations begin, we set out in this paper the principles the UK government must observe in answering those, and many more, questions.

The NFU wants to see an outcome on trade that supports our farmers to grow their businesses and to grow food for Britain and beyond. To do so, we need our Government to take a bold but composed approach to forthcoming trade negotiations with both the EU and non-EU countries; one that ensures British farmers can continue to produce food to the current high standards of which they are proud; one that ensures they do so on a level-playing field with producers elsewhere in the world; and one that maintains access to current markets for domestic produce, while growing demand at home and abroad.

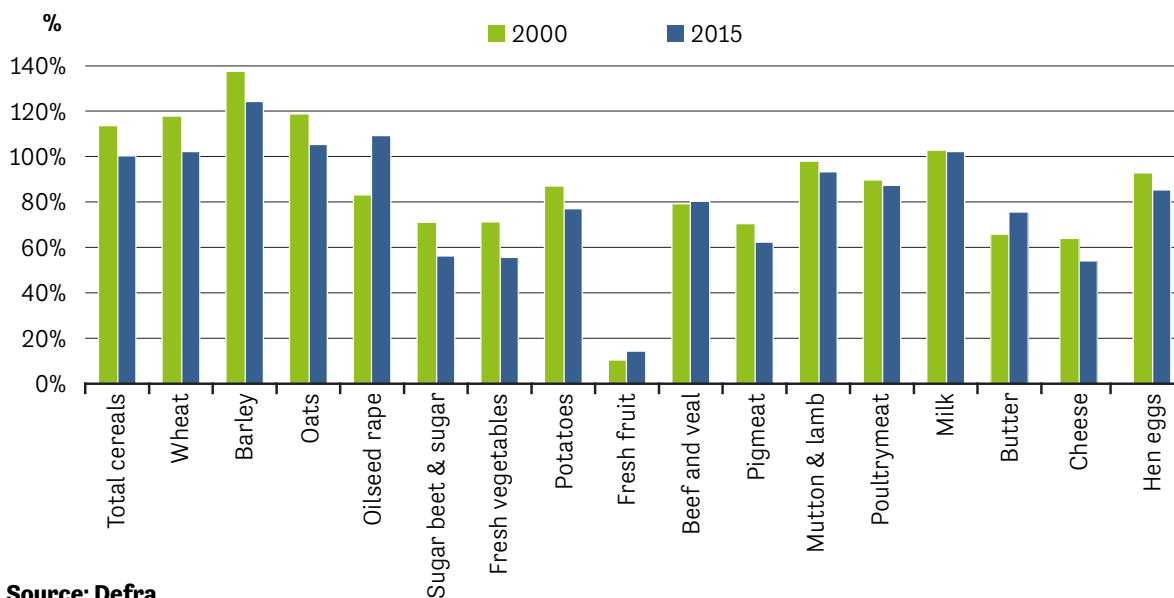
In this, the second of our “Vision for the Future of Farming Papers”, we set out the key issues that need to be addressed if UK farmers are to benefit from the international trading environment post-Brexit, and the approach we expect Government to take on trade policy. Alongside supporting the industry's labour needs and putting in place domestic agricultural policy and regulatory regimes that support British farming, we believe this approach will help Government realise our vision for farming as a resilient, productive and sustainable part of the UK's economy.

WHY TRADE POLICY MATTERS

Trade is fundamental to farming, the value chain it services, and the consumers who buy our products. UK farmers are proud to produce high quality and affordable food that the public trusts and enjoys. Developing new markets abroad and better promoting our product at home is essential for UK agriculture. But the opportunities, as well as the risks, have been brought into sharp focus by the UK's decision to leave the EU.

Any discussion on Brexit and trade must not overlook the importance of the home market. There is much to be done in growing our domestic markets, promoting UK produce better amongst UK consumers and increasing demand, for instance through greater public procurement of UK food.

Self-sufficiency in selected commodities



Source: Defra

However, in the context of Brexit much of the debate understandably focuses on the UK's trading relationships with overseas partners, both within and beyond Europe, and this paper focuses on the international dimension of our trade in agri-food products.

It is hard to overstate the potential international trade implications of Brexit for UK farmers. Whatever the eventual outcome from the forthcoming negotiations, there are likely to be significant changes to the competitive landscape in which our farmers operate. These may result from changes in the size and location of markets for our goods, in the associated costs of selling into those markets, and in the access granted to UK markets for food and farming products from overseas.

There are a range of potential scenarios regarding our future trading relationships with the EU and the rest of the world which will have different implications for British farmers and growers. We look at these scenarios in more detail later in this paper. It is crucial that the UK government examines these scenarios closely – the best outcome for British farming and consumers should be understood before talks begin, to ensure farming continues to occupy a unique place and perform an irreplaceable service to the UK:

- **We deliver for the wellbeing of the nation, providing a traceable, safe and affordable domestic supply of food, which the public trusts. If we undermine our food security by reducing our capacity to produce food at home, we instead rely on imports produced to different environmental and welfare standards and under food safety systems over which we have little or no control.**
- **We deliver for our environment, caring for our cherished local countryside and the environmental benefits the public value. Farmers are proud to be responsible for the upkeep of over 70% of the UK landmass, which remains feasible only as long as they run viable businesses.**
- **And we deliver for our economy, providing jobs and driving growth in rural communities and the wider economy. Farmers deliver the raw materials for a domestic food industry that employs over 3.9m people and which, as the UK's largest manufacturing sector, generates £108bn in value for the UK economy. Farm businesses are also the bedrock of the rural economy, through agriculture and other industries such as renewable energy and tourism. Indeed, for every £1 of public money invested in farming, it returns £7.40 to the national economy.**

This is why the Government has a legitimate interest in keeping the health and vitality of UK farming at the forefront of its thinking as it negotiates our future relationship with the EU and casts its eyes towards potential trade deals with the rest of the world.

TRADE IN AGRICULTURAL GOODS: THE CHALLENGE FOR THE UK

The newly-created Department for International Trade will set the direction for non-EU trade and investment in and out of the UK, while the Department for Exiting the European Union will focus on the relationship with the EU. Importantly, both departments must work with Defra on trade in agricultural goods. Shaping the country's trade policy has high geo-political and economic implications. It is a complex and multi-faceted issue that involves:

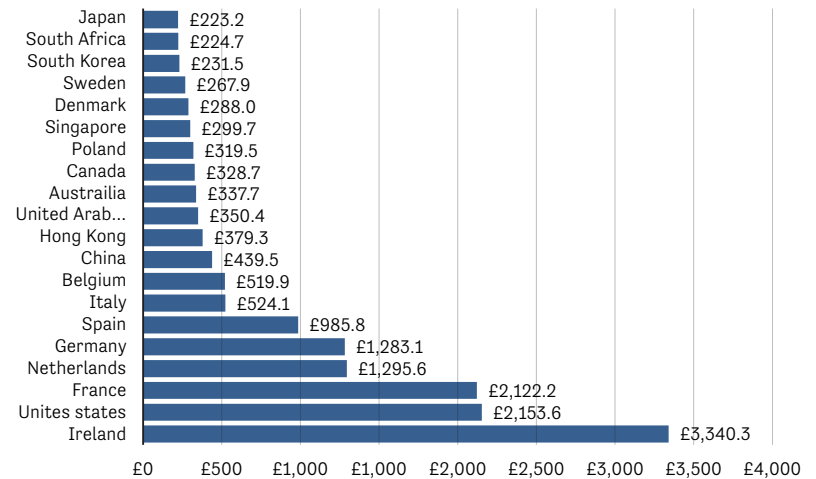
- Negotiating trade agreements at regional, multilateral and bilateral levels
- Implementing the agreed trade and investment policies
- Providing operational support for exports and facilitating inward and outward investment

Last year the UK exported £13.8bn worth of food and non-alcoholic drinks. 71.4% of those exports went to the EU and 28.6% to non-EU markets. The top three export markets were Ireland, United States and France. UK exports range from high-value, processed products to low-value products that struggle to find a market in the UK (e.g. fifth quarter of animal carcasses).

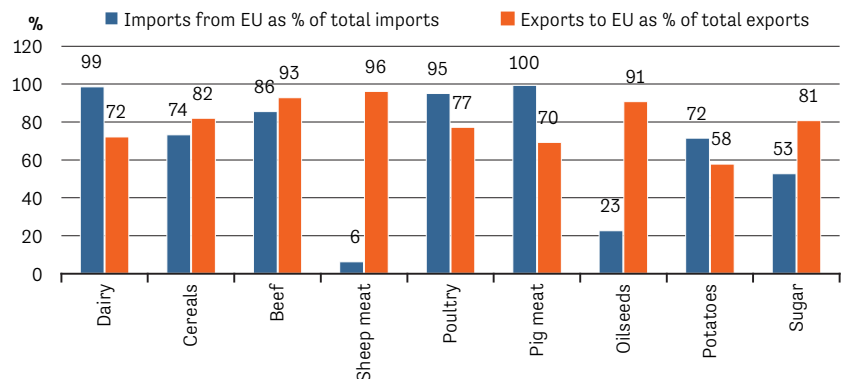
However, the UK trade balance is -£22.4bn, which makes the UK a net importer of food. In fact, the UK self-sufficiency ratio is 61% for all food and 75% for indigenous food. This shows there is considerable scope for the UK food chain to deliver an increasing proportion of the nation's demand for high quality, safe, affordable food, as well as to new export markets.

UK trade in agricultural goods is dominated by trade with the EU, so maintaining access to EU markets that is as free and frictionless as possible is a fundamental priority. Further to this, the UK government must take great care not to allow the pursuit of free trade agreements with new markets around the world to undermine our domestic agricultural sector.

Top 20 markets for UK food and drink exports in 2016 (£millions)



UK agricultural trade with the EU 2015 (value)



The NFU expects the UK government to observe three important principles in its approach to our future trading environment once we are no longer members of the EU:

- A commitment to maintain continued access to the EU single market with minimal tariff and non-tariff barriers.
- A requirement for detailed economic assessments supporting trade negotiations so government has a clear view of the sensitivities of putative trade deals. This analysis should be completed in consultation with food and farming businesses before any offers are exchanged.
- A commitment to fully account for differences in regulations and standards when market access is negotiated with other countries and trade blocs, ensuring UK farmers are not put at a competitive disadvantage to overseas producers subject to different standards.

Alongside these important principles, there are a number of issues relating to our withdrawal from the EU and engagement with the rest of the world which must be resolved in the coming months and years, and all of which could have significant impacts on UK agriculture. These are set out in the next section.

KEY ISSUES FOR THE UK TRADE POLICY

UK membership at the World Trade Organisation (WTO)

The UK is a WTO member, both as a member of the EU and in its own right. This means that the UK applies the EU's set of WTO schedules.

The schedules are specific commitments made by individual WTO member governments. For trade in goods in general, these usually consist of maximum tariff levels which are often referred to as "bound tariffs". In the case of agricultural products, these concessions and commitments also relate to tariff rate quotas (TRQs), limits on export subsidies, and some kinds of domestic support.

The UK will have to establish its own set of schedules at the WTO once it leaves the EU. The UK Government has already indicated that it intends "to replicate our existing trade regime as far as possible in our new schedules". This would see, in broad terms, the UK adopting the EU's schedules and should limit the UK's exposure to objections from other WTO members, providing stability and certainty for trading businesses.

In practice, draft schedules will be established when the UK leaves the EU, and the UK will be able to trade according to those schedules even prior to their formal approval. This certification process of schedules requires unanimity from 164 WTO members and it can take years.

The table shows some examples of EU Most Favoured Nation (MFN) tariffs applied to imports coming from countries that do not have a preferential trade arrangement with the EU. The percentages show the share of duty against 2015 commodity prices and the column on the right gives an indication of the level of duties based on current prices. In the event that a free trade agreement was not agreed between the UK and the EU, these are the tariffs that would be applied on both imports and exports.

EU Most Favoured Nation (MFN) import tariffs

Product	Effective % tariff (2015 prices)	Tariff (p/kg) (current)
Fresh/chilled pig carcasses	50%	47.8
Frozen boneless pork cuts	65%	77.5
Fresh milk	74%	19.4
Natural butter	63%	169.0
Cheddar cheese	42%	149.0
Fresh/chilled sheep meat, bone-in, excluding short forequarters, chines/best ends	51%	236.7
Wheat (excluding seed and durum wheat)	53%	8.2
Barley (excluding seed)	53%	8

WTO tariff rate quotas (TRQs)

Despite the stability provided by the adoption of the EU's schedules, the UK will have to negotiate with the EU and other WTO members its newly established TRQs (and domestic support notification – see below). These TRQs provide for lower tariff rates for specified quantities of certain imported goods, and MFN rates for quantities that exceed the quota. Agreement of appropriate size for these TRQs is of great concern to UK farmers, especially those in the livestock sector.

Establishing the UK's own TRQs at the WTO, taking into account UK imports of goods subject to existing EU TRQs, will be complicated, and future levels of TRQs will be of keen interest to many parties. For instance, some countries may object to TRQs based on historical trade flows arguing that a division of a current EU quota is worth less than the sum of its parts, restricting flexibility in terms of which country exporters can supply into.

The NFU believes that a principled approach should be taken to the issue of TRQs as a whole, which can be accepted by all parties (EU, UK and WTO members) and so does not undermine the possibility of securing a wider free trade agreement with the EU. This approach should acknowledge existing trade flows so they do not unfairly disadvantage UK producers. Other issues, for example devising TRQs to take account of seasonal fluctuations in the availability of certain products, should also be included in these negotiations.

Domestic support notification to WTO

Under WTO rules all domestic support measures are allocated to colour-coded “boxes” signifying the relative trade impact: green (permitted), amber (trade distorting, to be quantified and limited), and red (forbidden). In agriculture, there is no red box, although domestic support exceeding the reduction commitment levels agreed at the Uruguay Round in the amber box is prohibited; and there is a blue box for subsidies that are tied to programmes that limit production. Agricultural policy in England and Wales falls into the green box.

Trade-distorting agricultural subsidies are capped by WTO at 5% of the country's total agricultural production. The EU negotiated a bespoke subsidy cap at the WTO that amounts to €72.4bn (Total Aggregate Measurement of Support). The NFU believes that the UK should be allocated a share of the EU's commitments. If we are unable to do so, it will significantly restrict the type of domestic agricultural policy the UK can devise and implement post-Brexit.

Regulation and standards

As countries or trading blocs introduce new technical regulations these can impose barriers to trade if market access depends on meeting a given domestic regulation or standard. As anticipated by the report the NFU commissioned in 2016 from Wageningen University, diverging regulatory standards impose ongoing costs for exporting businesses. This is because they need to adapt products to meet different regulatory requirements, make payments for conformity testing or conduct research into markets to assess the costs of entry. The WTO recognises non-tariff barriers such as:

1. Technical barriers to trade, which can be divided into:
 - a. Sanitary and phytosanitary measures covered by the Agreement on the Application of Sanitary and Phytosanitary Measures (the “SPS Agreement”)
 - b. The general category of technical barriers to trade set out in the Technical Barrier (“TBT”) Agreement
2. Customs formalities and procedures
3. Government procurement practices

The most relevant for the agricultural sector is the WTO agreement on Sanitary and Phytosanitary (SPS) Measures which encourages governments to “harmonise” national SPS measures with international standards, guidelines and recommendations developed by WTO member governments in other international organisations.

The Agreement allows members to choose not to use the international standards, but if the national requirement results in a greater restriction of trade the member will be asked to provide scientific justification, demonstrating that the relevant international standard would not result in the level of health protection the country considered appropriate. For instance, in 1998 the EU lost a dispute at WTO with regard to its hormone-free beef standard. As a consequence, in 2009 the EU chose to provide compensation to the affected countries in the form of better access to the EU market through a tariff-rate quota for hormone-free beef.

A key issue for UK farmers and growers concerns the use of Plant Protection Products (PPP), where Maximum Residue Levels (MRLs) are set by countries (or the EU for its Member States) for traded agricultural commodities. An MRL outlines the maximum amount of pesticide residue that a country permits on specific commodities. Once the UK leaves the EU, there is an expectation that we will move to a risk-based approach to pesticide approvals which improves access to effective products. However, in order to trade agricultural commodities with the EU the UK would have to comply with the EU MRLs. At the same time, the UK could develop its own pesticide MRLs based on international guidance.

The government must continue to value our high production standards and ensure UK farmers are not put at a competitive disadvantage to overseas producers subject to different standards. Moreover, the government should ensure appropriate levels of regulatory coherence between the UK and its trading partners to facilitate trading relationships, while developing a domestic regulatory environment suited to the specific requirements of UK farmers and growers.

EU trade agreements

The EU has concluded trade agreements with around 50 countries. The names of the trade agreements differ depending on the content of the agreement: the Economic Partnership Agreements with partners such as African, Caribbean and Pacific (ACP) countries are aimed primarily at supporting development. Free Trade Agreements (FTAs) with developed countries and emerging economies are economically driven and based on reciprocal opening of markets. Some trade agreements are part of broader political agreements, such as with some Association Agreements. The EU also enters into non-preferential trade agreements, as part of broader agreements such as Partnership and Cooperation Agreements (PCAs).

The UK Government's intention is to adopt the current EU FTAs when the UK leaves the EU to ensure a smooth transition until the UK negotiates its own trade agreements. The UK's transitional adoption of current EU FTAs should be a three-way negotiation between the UK, the relevant trading partner and the EU. There is considerable difference of opinion, however, about whether the UK will be able to adopt all, or even some, of the EU's trade agreements on a fully functioning basis at the point of leaving the EU. Nevertheless, the NFU believes the UK government should seek to adopt existing EU preferential trade agreements, as well as of any preferential access for UK agri-food exports, at least until government can replace them with acceptable alternative arrangements.

Future UK FTAs

The UK will be able to negotiate its own trade arrangements once it has left the EU. A trade negotiation is a long process that starts with an informal dialogue with the third country on the content of a future negotiation. It is important that the government holds a public consultation on the content and options for any FTA and conducts a detailed economic assessment of the impact of any deal.

It is crucial that the Government understands both offensive and defensive interests when engaging in trade negotiations. Opening up trade through a reduction in tariffs with third countries may bring benefits for the UK economy, including the creation of some opportunities for food and drink exports. Such agreements will also increase market access for those countries to the UK and so increase competition for UK businesses. However, while such agreements may bring benefits in terms of increasing agricultural competitiveness, they may also mean UK farmers are unable to compete fairly with imports from third countries as a consequence of domestic policy and legislative choices, for instance the high standards expected of UK producers.

Our determination is that any future trading arrangements with any country must be balanced, with the same conditions applying to imports as to exports. This should be supported by a requirement that produce with different environmental or animal welfare standards should be mandatorily labelled to enable consumers to make informed choices. The Government must ensure an adequate level of tariff protection for UK sensitive sectors when trade agreements are negotiated, and food and farming businesses must be a part of Government's future trade talks from day one, as is common practice in other trading nations.

Irish border

Trade flows between the Republic of Ireland (RoI), Northern Ireland and the rest of the UK reflect a highly integrated agri-food sector and complex processing and supply chains, with goods regularly flowing across the border numerous times.

The main UK export destinations of food, feed and drink to the EU in 2015 was the Irish Republic, amounting to £3.0 billion in value, while £3.9 billion in food, feed and drink items were imported into the UK from the Irish Republic, second only to the Netherlands (which includes imports being re-routed from non-EU countries). Overall, in 2015, exports of agricultural products from Northern Ireland to Ireland were €567m (including food, drink, forestry and animal by-products), with imports from Ireland into Northern Ireland were €750m.

The impact of a "hard" border being erected between the RoI and Northern Ireland could clearly have devastating impact on the agri-food industries on both sides of the border, but also more widely for the UK food chain. Agriculture is a very important part of both the Irish and Northern Irish economies. It is imperative, therefore, that the Government ensures trade between the UK and Ireland is as free and frictionless as possible, with an open border uninhibited by administrative and other tariff barriers.

POTENTIAL TRADE SCENARIOS

There are a range of trade scenarios which may exist after Brexit, depending on the success of the EU/UK negotiations, the terms of any EU/UK deal, and the policy approach the UK government takes to future trade deals with non-EU countries. It is vital that we secure the right scenario both for UK farmers and for the UK public at large. A trade deal that undermines the profitability and viability of UK farming would have many serious consequences for the country. It would put in peril farming's contribution to the UK's economy and our rural communities. It would damage the ability for farmers to manage our cherished countryside. And it would destabilise our food security, meaning the British public will become overly-reliant on imports, often produced to different environmental and welfare standards and under food safety systems over which we have little or no control.

The NFU commissioned a world-leading agricultural research institute - the LEI at Wageningen University - to consider the impact of a number of possible trade and farm support scenarios that would be open to the UK Government in the event of the country voting to leave the EU. We have summarised the results in a previous report, *British Agriculture: The Implications of a UK Exit from the EU*. Some of the scenarios appear to suggest that there could be serious risks to farm income from leaving the EU, while the results of others suggest there could be a more favourable outcome. It comes down to a matter of judgement as to which of the scenarios appears the most likely. This in turn will depend on the policy position adopted by the UK Government. Three trade scenarios were modelled:

1. A Free Trade Agreement (FTA) between the UK and the EU
2. The World Trade Organisation (WTO) default position
3. UK Trade Liberalisation involving unilateral 50% reduction in import tariffs

Given the Prime Minister has indicated that she wants to pursue a bespoke trade agreement with the EU ("a new deep and special partnership"), the modelled FTA scenario would appear to most closely fit the UK Government's current preferred outcome. However, both the UK and the EU have acknowledged the risk of failing to reach an agreement at the end of the two year negotiation period, in which case both the WTO and Trade Liberalisation scenarios become pertinent.

The first scenario, a FTA between the UK and the EU, assumes that agricultural trade between the EU and the UK is broadly tariff-free, apart from UK lamb exports to the EU, which the EU would deem as a sensitive product and therefore seek to limit. Based on those assumptions, UK farmgate prices tend to increase due to the trade facilitation costs.

Under the second scenario (WTO default), future domestic agriculture policy would become more protectionist. Trade in agricultural products between the EU and UK would follow the WTO's non-discrimination "Most Favoured Nation" (MFN) rules. Those rules apply equally to all 164 WTO members. The estimated impacts for British food and farming are: an increase in farmgate prices; imports would become more expensive due to trade costs and, under the WTO agreement, higher tariffs to pay to trade with the EU. This would result in stimulation of domestic production caused by higher farmgate prices.

The third scenario is that of UK Trade Liberalisation, where the UK government introduces a reduction in its agreed WTO tariffs of 50%. Estimated impacts for British food and farming are lower prices for UK meat and dairy in particular, an impact on production levels and a decrease in the availability of assured British products in shops.

In the absence of any change in farm support payments, price changes due to Brexit would generally have a positive impact on farm incomes in

both the first and second scenarios. Under the third scenario, most sectors would experience negative impacts on farm incomes.

In many sectors the second scenario (WTO default) suggests the most positive impact on farm incomes. However, this scenario, which essentially represents a protectionist policy approach, would represent a reverse of the policies that successive British governments have pursued for the past 40 years. Furthermore, it would run counter to many of the arguments put forward by the Leave campaign in the EU referendum for opening up trade to overseas producers and stimulating downward trends in food prices.

Therefore, in the event that the UK and EU fail to reach an agreement on a future trading relationship, there are serious questions as to how long the UK government would wish to trade universally under the subsequent WTO MFN terms. Some form of trade liberalisation involving a unilateral reduction in import tariffs along the lines of the third scenario would appear to be a likely response from government, not least in an attempt to tackle potential food price inflation. But this sort of trade liberalisation scenario would have a hugely negative impact on the viability of many British farms. Not only is it uncertain that such an approach would lead to cheaper food for consumers, any such advantage to the British public would be more than offset by the damage done to the ability of UK farmers and growers to deliver the many benefits they currently provide (see page 5).

A free trade agreement between the EU and UK, along the lines of the first scenario, would therefore be the best outcome for both British farmers and the British public. So that farmers and growers can thrive in a post-Brexit Britain, and so that they can continue to deliver for our environment, for our economy and for our wellbeing, a deal that maintains free and frictionless trade between the EU and the UK should be the government's stated priority.

SUMMARY

- ✓ The UK government must, as a priority, seek to establish an ambitious free trade agreement with the EU that maintains two-way tariff-free trade in agricultural goods between the UK and the EU, and avoids costly and disruptive customs checks, processes and procedures.
- ✓ If such an agreement is not concluded by the end of the negotiating period, and therefore at the time the UK leaves the EU, transitional arrangements must be agreed in good time. These must ensure a smooth and orderly Brexit and maintain current free and frictionless trade between the EU and UK until such time as a formal free trade agreement comes into effect.
- ✓ We expect the UK to establish itself as an independent member of WTO on leaving the EU, providing continuity and predictability by adopting the EU's current schedule of Most Favoured Nation bound tariff rates.
- ✓ The UK government should work with the EU and WTO to establish a consistent approach to the EU's current Tariff Rate Quotas (TRQs) that provides for the UK to adopt a fair share of those TRQs, but which does not unfairly disadvantage UK producers. The UK should also seek an allocation of a share of the EU's WTO domestic support commitments.
- ✓ The UK government should seek to secure the benefits for UK traders of existing EU preferential trade agreements, as well as of any preferential access for UK agri-food exports, at least until government can replace them with acceptable alternative arrangements.
- ✓ Only once the terms of the UK's future trading relations with the EU and other existing preferential trading partners are clear should the UK begin to engage in formal trade negotiations with third countries. We would not want resource and focus diverted from important priority issues such as the UK-EU negotiations on a future trade deal, establishing the UK's position at WTO and the adoption of current EU preferential trade agreements.
- ✓ A critical element of any potential future trade deals outside the EU will be clear and comprehensive consultation between the UK government and stakeholders on the risks and benefits of any potential deal. Furthermore, the government must undertake detailed economic impact assessments when trade negotiations are opened and before any offers are exchanged.
- ✓ The UK government must also establish cooperation with third countries on regulatory equivalence and ensure that all new trade agreements account for differences in regulations and standards when market access is negotiated. The government must continue to value our high production standards and ensure UK farmers are not put at a competitive disadvantage to overseas producers subject to different standards.
- ✓ The Government must also ensure an adequate level of tariff protection for UK sensitive sectors when trade agreements are negotiated

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