

FOREWORD

British farms provide 60% of the food we eat and are the bedrock of the nation's food industry - worth £109bn and employing 3.8m people.¹ Farming is central to the rural economy and it protects the nation's countryside and wildlife.

Given the right framework, British farming could flourish out of the European Union, but this is heavily dependent on the policy decision taken by our government. Numerous impact assessments have shown the potential impact of different outcomes arising from Brexit. Economic models have their limitations, but many have shown that if the government pursues a trade liberalisation agenda, along with greatly reduced public investment in agriculture, it would have a devastating financial impact on many farm businesses. If we were to couple this with the degree of volatility we have seen in agricultural commodity markets over the past 10 years, it's clear just how vital getting the decisions right for the future of our sector will be.

Supporting farms to manage price volatility is not solely for their benefit, but rather puts them in a better position to produce safe and affordable food, maintain and improve the UK's environment and continue to contribute to the UK's food and drink sector – all of great benefit to the British economy and consumers

As we lead up to the point of exit from the EU in April 2019, there will remain a need for area based payments similar to our current system as the primary measure to support farm incomes against market volatility. In the longer term however there is potential to devise a better targeted, more market orientated approach to managing the impacts of market volatility on farm businesses. In order to pursue a smooth transition to a new support mechanism for volatility mitigation there are many steps government can begin to take now in order to build our capacity to implement and deliver market based solutions in the future.

This report sets out the NFU's latest thinking on the future of agricultural policy once we leave the European Union. It builds on the Domestic Agriculture Policy Vision document published in early 2017 and comes ahead of government plans to publish an Agriculture Bill in Parliament shortly. The document provides a framework for continued consultation with members as well as being a useful guiding document for policy makers as they set about the task of drafting the government's future Agriculture Bill.

NFU VISION FOR A DOMESTIC AGRICULTURAL POLICY

Once we leave the EU we will have the opportunity to develop a new deal for British farming – one in which farm businesses are provided with the incentive, support and means to become more productive and resilient, and to better meet the expectations and needs of society at large.

To facilitate the development of a future agricultural policy, we are proposing a framework formed of three constituent parts:

- Productivity measures and business resilience
- Volatility mitigation measures and risk management tools
- Environmental measures

Farm businesses should be able to draw down bespoke assistance from across a range of measures within each of these three cornerstones, potentially in different proportions depending on both individual and wider economic circumstances. Crucially these measures are not mutually exclusive; they all work together to enable farming to be competitive, profitable and progressive, and an integral part of a dynamic UK food supply chain.

Transitional Arrangements

The government has stated that it wants to deliver a smooth exit from the EU and that it wants to “avoid a disruptive cliff-edge”, acknowledging the potential need for phasing in any new arrangements. The NFU believes it is crucial that transitional arrangements are agreed at an early stage to ensure continuity and certainty for farm businesses when we leave the EU.

In order to minimise disruption at the moment we leave the EU, we believe there should be a gradual transition from the current structure of farm support to a new agricultural policy over a period of years. Exactly how many will depend on a number of variables, including the future shape of the CAP and the support framework of farmers in the EU; the shape of future trade agreements with the EU and subsequently third countries; and other policy priorities of the UK government such as immigration and access to labour.

Productivity

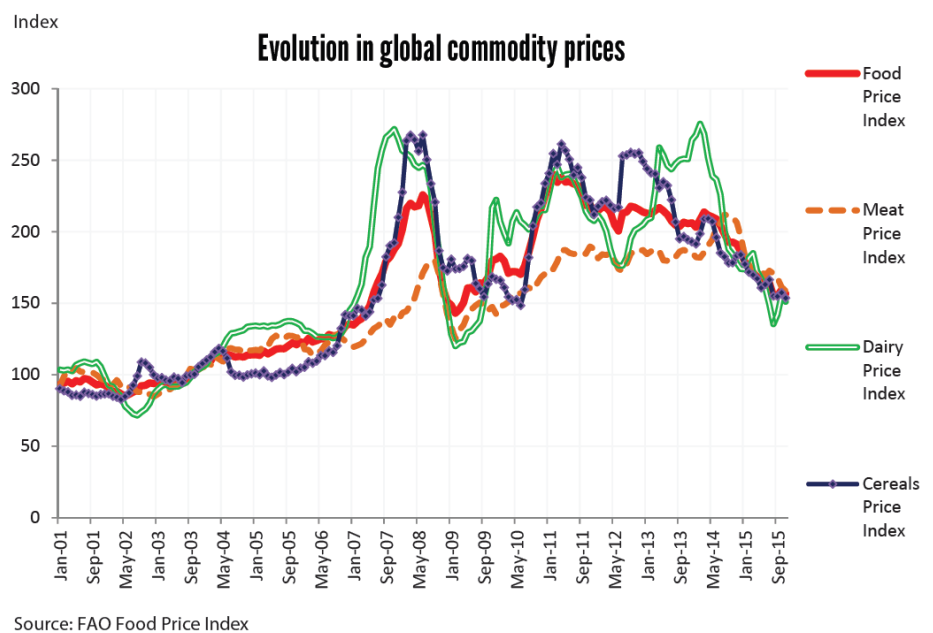


Environment Volatility

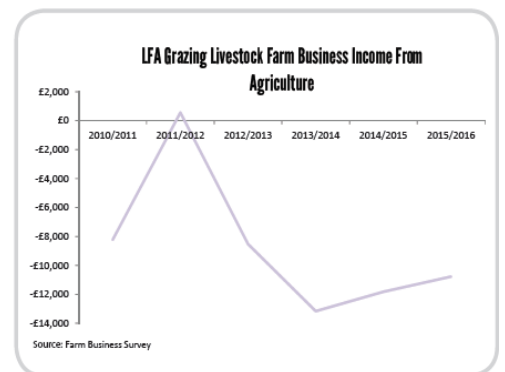
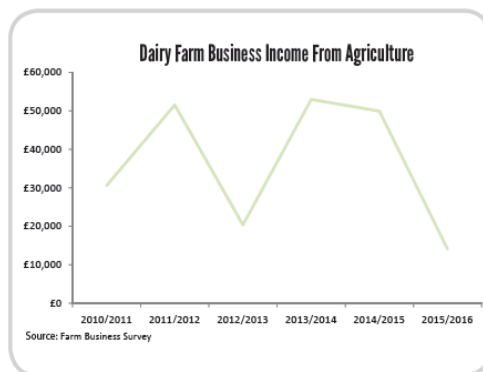
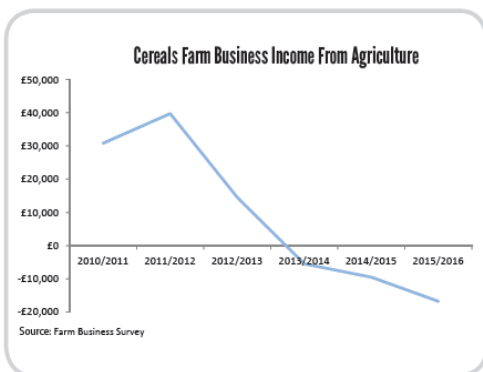
WHY PUBLIC INVESTMENT IN AGRICULTURE TO MANAGE VOLATILITY IS IMPORTANT

The dynamics of agricultural commodity markets have shifted over the past ten years. The food price spike in 2007/8 saw the impacts of volatility first hit home, and global commodity markets have seldom stood still ever since.² Significant price movements have become increasingly frequent often responding to the latest supply and demand prospects from around the world as was observed with the sharp reduction in dairy prices following the Russian Embargo introduced in 2014.³ The reasons behind this are multiple and complex, but extreme weather, geo-political events, currency fluctuations and changes in farm policy and agricultural support around the world have all contributed to volatility in agricultural markets. UK farmers are much more exposed to global markets today than they have been in the past and our departure from the CAP may exacerbate that depending on government decisions around a future Domestic Agriculture Policy.

Extreme price volatility weighs heavily on farm businesses. It impacts on farm profitability, it squeezes cash-flow and in turn this impacts on working capital. As a result, farmers are less able to efficiently manage farm operations in the short term and may be required to delay or cancel much needed investment on-farm. Short-term impacts on cash-flow can also place significant pressure on the financial viability of an otherwise profitable business which significantly undermines investor confidence thereby having an adverse impact on long-term profitability.



In regards to profitability, farm business income from agriculture between the years 2010-2016 has moved an average of 76% year on year for cereals farmers and 74% for dairy farmers.⁴ Few other sectors of the economy experience such extremes of volatility. It is clear that with the rollercoaster of farm gate prices seen in recent years that many farmers would not be able to continue in business without current levels of public investment in the sector through direct payments.

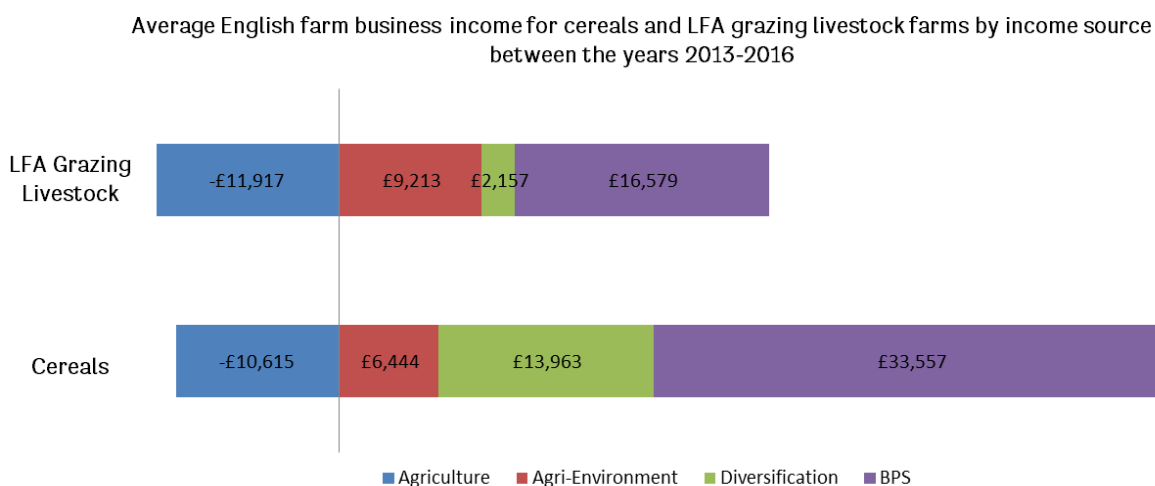


Current public investment in agriculture

Price volatility is damaging and despite the best efforts of farmers to become less reliant on public support, the significant impacts of increasingly volatile markets means that income support in the form of direct payments still remains an important component of net farm income.

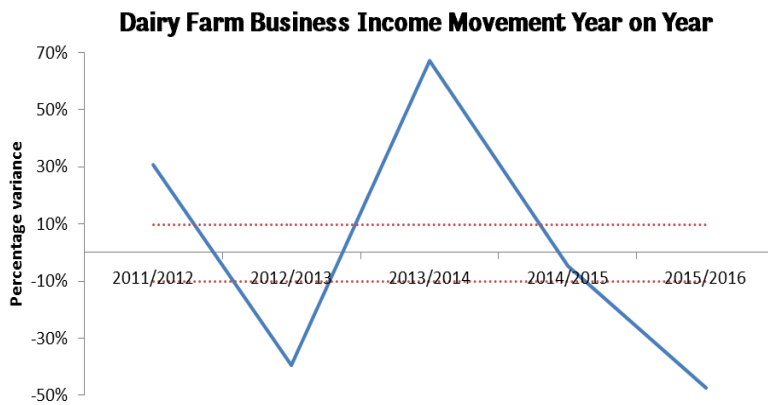
Whilst it may not be an express objective of direct payments, they are one of the primary mechanisms by which farmers may mitigate the impact of volatile markets. In years of low income due to a price downturn or low yields, direct payments provide a stable and reliable source of income which is not impacted by market forces. A key strength of area based payments is that they are a broad measure of support which can be targeted towards multiple sectors such as the crops, livestock and dairy sectors and to enterprises of varying sizes with relatively low transaction costs. Direct Payments can also be effectively structured in line with WTO Green Box (non-trade distorting) requirements making them less open to challenge by our international trade partners.

In recent years we have observed how direct payments have helped to support businesses which have experienced sustained periods of poor economic returns from the market due to a depression in prices. A prime example is the cereals sector in England, which experienced a significant downturn in commodity prices between the years 2013-2016.⁵ As a result, farm business income from agriculture fell from an average annual income of £28,000 between the years 2010-2013 to a loss of £10,600 between the years 2013-2016, as the figure below illustrates.⁶ Another example as illustrated in the figure below would be the LFA livestock sector which has encountered average losses of £11,900 (£3,000 loss for top 25% of performers) from agriculture in the same period. For lowland grazing livestock average losses amounted to £8,600 (Income of £12,600 for the top 25% of performers during the years 2013-2015).⁷ During this period, direct payments have been critical in mitigating any losses and ensuring the survival and resilience of many otherwise profitable farm businesses.



Source: Farm Business Survey

As levels of market orientation and in turn volatility have increased, the effectiveness of direct payments alone to stabilise farm incomes and support farmers during periods of a cash-flow squeeze has become increasingly limited. In the 2013-2016 period of depressed prices, average cereals farm business income was £43,000 and £16,000 for LFA grazing livestock. In practice, this income would need to fund household income, working capital on farm and in part any maintenance and investment all in an environment of uncertain future returns.



Source: Farm Business Survey

The graph to the left illustrates how uncertain future returns can be for farmers with average English dairy farm business income (including the benefits of diversified income, direct payments and agri-environment payments) moving far beyond 10% (red dashed lines) year on year. This is because whilst direct payments provide a relatively stable source of income they do little to stabilise the overall income profile of farm businesses which significantly inhibits a farmer's ability to plan and invest.

As such, market-based measures such as a revenue/margin insurance mechanism, counter-cyclical payments scheme or deferred tax savings schemes which can empower farmers to smooth their income profile and therefore plan and invest for the future are required to work alongside direct payments as an income resilience measure.

What can farmers do themselves to manage risk?

It is clear that volatility is here to stay in today's global market place and as such, farm businesses will have to be at their very best. We believe that achieving lower costs of production with technical efficiency, benchmarking, forward planning and budgeting are all key elements in coping with the challenges of volatility. Whilst farmers can work to build more resilient businesses, public investment through direct payments and through supporting the development of market based risk management solutions will be critical to create the stable conditions to encourage investment and innovation over the long-term. It is in this respect that Brexit presents a threat for British farmers in regards to their ability to access existing risk management mechanisms such as EU based Futures markets but also an opportunity for the UK to design more dynamic public-private sector partnership led risk management solutions.

The following section outlines the NFU's vision of how public investment could be structured over time to create the market conditions for British agriculture to compete and thrive in a global market.

THE ARCHITECTURE OF A NEW POLICY: MANAGING VOLATILITY

Farmers in the UK share the aspiration of reducing their reliance on direct income support payments. This is a long term goal and cannot be met by arbitrarily setting deadlines for the removal of direct payments. In practice, farmers to varying degrees, face both sustained periods of low commodity prices and inter-year market volatility both of which have a significantly adverse impact on cash-flow, their ability to plan and in turn confidence to invest. As such, there exists a requirement for public and private sector investment in measures to support farmers in mitigating the impacts of market volatility.

In respect to volatility mitigation, measures would need to meet two primary objectives in order to effectively empower farmers to manage the impacts of market volatility:

1. **Provide income resilience** during sustained periods of poor returns from the marketplace.
2. **Support inter-year volatility management** in order to smooth the significant variability in income year on year.

Support for basic income provides farmers with a degree of resilience whilst volatility management allows farmers to operate with greater certainty. Fulfilment of these objectives would provide a resilient and relatively stable income profile upon which farmers would have the confidence to invest in productivity as well as sustainably deliver public goods.

Shifting focus over time

We envisage moving towards a new domestic agricultural policy over a period of years. Over time, emphasis could switch from almost exclusive income resilience measures designed to broadly mitigate the effects of sustained periods of low commodity prices and to some degree inter-year volatility to a toolbox approach of income resilience measures combined with targeted volatility mitigation measures. Here the weighting of income resilience measures to targeted volatility mitigation measures would be dependent on the characteristics of agricultural commodities (for example whether a product is perishable, easily stored, length of production cycles etc.) and the respective suitability of targeted measures to address inter-year volatility.



The UK currently lacks the quality of market data, experience or institutional capacity required to deliver more targeted volatility mitigation measures. As such, decoupled direct support is foreseen to remain the most appropriate measure until concerted efforts are made by government and industry to create the

conditions which allow the development of more sophisticated volatility mitigation tools. Whilst for some sectors sustained low commodity prices are the primary concern and therefore income resilience will remain the most appropriate objective, for others improved market data and the piloting of volatility mitigation measures such as revenue insurance schemes may build the UK's ability to develop a better targeted risk management regime. The achievement of the proposed approach will also be dependent on the government's stance on issues like trade, regulation and labour. Policies which enable British agriculture to flourish will facilitate this shift away from broad public investment measures such as direct income support, conversely emphasis would need to remain on such support if government fails to back farming in its Brexit settlement.

The following sections explore the achievement of the two objectives of income resilience and volatility mitigation in more detail.

Mitigating the impacts of market volatility

As illustrated in the table below, only direct payments, counter-cyclical payments (which pay against reference prices) and a crisis management fund have the potential to support farmers during periods of sustained low commodity prices or extreme market events. This is because potential volatility mitigating, income smoothing measures identified in the table below are only effective when periods of low market returns are closely preceded by sufficiently frequent periods of reasonable to high market returns. This in turn incentivises saving in deferred tax savings schemes or drives a suitable stimulus to insure revenue against potential falls.

Examples of measures to mitigate market volatility	
Income Resilience Measure	Volatility Mitigation Measure
Decoupled Direct Support Payments	
Crisis Management Fund	
	Match Funded Savings Schemes
	Deferred Tax Savings Schemes
Counter-cyclical payments—Reference prices set by Government	
	Revenue Insurance Scheme
	Futures Markets
	Forward Contracts

From the three identified income resilience measures, decoupled direct payments is viewed as the most feasible and efficient means of directing support across the agricultural sectors. This is because the setting of reference prices for a counter-cyclical measure may distort markets, is reliant on currently lacking high quality market data and is more complicated to deliver thereby increasing transaction costs. In contrast a crisis management fund is a more flexible tool designed to address exceptionally rare events such as a significant market crash in prices or a natural disaster event which impacts production. Such a fund would work alongside direct payments in extreme scenarios.

Decoupled Direct Support Payments

Decoupled direct payments to farmers must remain a key component of the Domestic Agricultural Policy post Brexit. They will continue to be the primary mechanism for supporting farm businesses with the impacts of market volatility and remain an important component of net farm income.

Increasingly conditions have been attached to direct payments, with full receipt dependent on undertaking actions beneficial for the environment or supplements paid for helping younger farmers into the industry for example. Moreover rules around eligibility to receive payments have been designed to deliver funds to those that actively farm and payments are only made to those who hold payment entitlements.

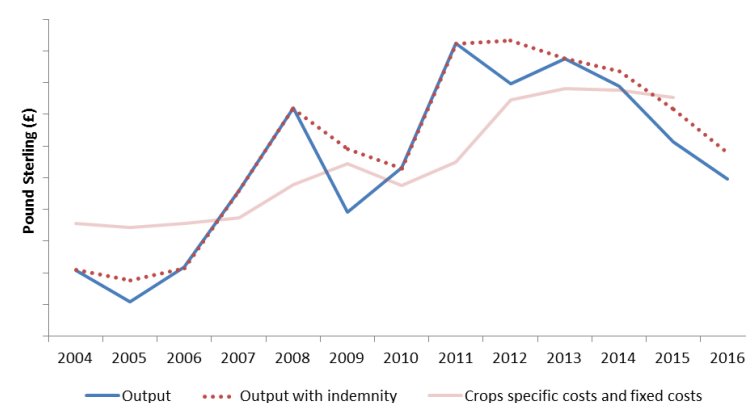
The NFU recognises the significant levels of public investment directed at direct payments and welcomes the opportunity to discuss with government the conditions attached to future direct payments. The NFU will continue to consult with members how best to target decoupled direct support payments post Brexit. Over the medium to long-term the UK government has the potential to better target a proportion of support currently offered under direct payments to help smooth the income profile of farm businesses by developing the volatility mitigation measures listed in the table above.

Developing more targeted volatility mitigation measures

The UK is currently very limited in regards to the availability of volatility mitigation tools. There exists a UK based futures market for feed wheat (ICE exchange) which is utilised by grain merchants who are then able to offer forward contracts to farmers. Across the EU there is also a highly liquid wheat futures market based in France (MATIF exchange) and an increasingly popular dairy futures contract based in Germany (EEX exchange) which is also now being used by key processors in the UK to lock in forward prices with dairy farmers. The usefulness of EU futures markets post-Brexit is dependent on the impact of trade barriers on the relationship of UK commodity prices to EU prices. In sharp contrast, the US and Canada benefit from highly liquid commodity futures markets for grains, dairy and livestock (CME exchange) and also offer revenue and margin insurance mechanisms to support the industry with volatility. Similarly, New Zealand also operates multiple dairy futures contracts through its NZX derivatives market to support farmers with forward selling their produce in order to empower farmers to manage market volatility.

Given the availability of volatility mitigation tools to support farmers in the US, Canada, EU and New Zealand, the NFU believes the UK government should look into the development of volatility mitigation tools to ensure British farmers are competitive and resilient on a global scale. These may be developed and delivered by government such as through the adoption of counter-cyclical measures, public-private partnerships through the adoption of revenue/margin insurance schemes or by the private sector by supporting the development of futures markets.

The NFU has modelled a range of revenue and margin insurance tools to assess their feasibility for the UK.⁸ The graph to the right illustrates the smoothing effects of a feed wheat revenue insurance model whereby net insurance payments (red dashed line) help smooth significant falls in feed wheat revenues (blue line). Notably in years 2009 and 2012 such a mechanism ensures that the farmer remains in a profitable position with revenues exceeding total costs (solid red line) whereby feed wheat output alone would have taken the farmer into or close to a loss making position.



The model also highlights however that whilst insurance payments have the ability to smooth the income profile of businesses, despite the payment the farmer would still be close to a loss making position in certain scenarios such as in 2009. It is during this period that income resilience measures, agri-environment measures and income diversification would play a key role in ensuring overall profitability of the farm enterprise.

EXISTING EXAMPLES OF VOLATILITY MITIGATION MEASURES

Beyond direct payments, public and private sector investment to support farmers in managing market risk takes many forms both in the UK and globally. Some of these key mechanisms are explored in more detail.

Crisis management fund

A crisis management fund is an emergency source of funding utilised to support farm businesses significantly impacted by exceptional events related to an extreme downturn in market conditions, natural disasters or outbreaks of pest and diseases. The objective of the reserve is to assist businesses with recovery from an extreme event, supporting with the recuperation of losses and the cost of restoring farm operations. As well as in the EU, similar reserves are also available in other countries such as the US who provide ad-hoc disaster payments and Canada through their AgriRecovery scheme which are used to address impacts not covered by direct support or insurance programmes.

Match funded savings schemes

The best example of an operating scheme is in Canada where direct support is channelled through a savings scheme for farmers called AgriInvest. The government match fund farmer deposits into the scheme up to a maximum of 1% of allowable net sales with match funding capped at \$15,000 per year (C. £9,000). The government contribution is taxable upon withdrawal from the account whilst the farmer contribution to the account would be from post-tax income. The taxable government contribution must be withdrawn prior to withdrawal of personal contributions from the account. As such, this stimulates countercyclical behaviour in that farmers are incentivised to withdraw funds during periods of low income thereby providing cash flow support for working capital or investment. This is designed to help farmers manage small inter-year income declines with funds building up over time.

Deferred tax savings schemes

A good example is the Australian Farm Management Deposits (FMD) Scheme which was established in April 1999. The primary objective of the FMD Scheme is to assist primary producers deal more effectively with fluctuations in their cash flow resulting from climate variations and changes in market prices. Unlike the Canadian match funding model there is no match funding by the government but the farmers deposits are made from pre-tax earnings so tax is deferred until such point as the funds are drawn on. Individuals are able to build up to AUS \$800,000 of funds on deposit. (c.£488,000) and the total amount invested is currently approximately AUS \$6bn (£3.7bn).⁹

The benefit with the Australian model is that it provides farmers with the ability to put aside substantial pre-tax profits in years they do not need to spend them to be able to draw down on in years when they have lower profits or need to make cyclical investment. In this way income is more closely matched with expenditure and the business' cash flow is improved.

Counter-cyclical payments

Counter-cyclical payments support farmer incomes when prices or revenue fall below reference levels. A reference price may be set by government as part of the programming period or be based on historical averages. Similarly, reference levels for a revenue based countercyclical payment could be based on historical levels of price and yield.

The US operates two countercyclical programmes named Agricultural Risk Coverage which safeguards farmers from a decline in farm revenue based on historical yields and prices and Price Loss Coverage whereby crops are covered when the national marketing year average price falls below reference prices set in the Farm Bill.

Revenue insurance scheme

Revenue insurance has the potential to target income support at those farmers who have been significantly impacted by a fall in market prices or yield. Crop insurance is a prominent risk management measure used by arable farmers in the United States and has achieved a 90% participation rate with approximately 240 million acres insured.¹⁰ The majority of the uptake of crop insurance has been for revenue protection plans (approximately 84%) which has significantly increased in popularity over time. These programmes utilise production, yield and futures market data to provide reference levels to insure revenue against.

The benefits of such a programme are in its relative simplicity in comparison to a margin insurance programme (see next section) as production and price indices may be used to devise a reference for revenue and trigger level for payments when there is a fall in revenue. The use of such indices helps to simplify the product, making farmer engagement easier and potentially cheaper to deliver. In comparison to area-based payments this system may also better target the active farmer as it is not linked to land but rather the production of specific commodities.

The limitations of revenue insurance are that it is only suitable for sectors where there exists a strong relationship between business performance and any reference industry price/yield indices. It is therefore most suitable for the crops sector with some potential for the dairy sector. It would be difficult to deliver for the livestock and horticulture sectors where the variability in business models, production systems and pricing models would limit the appeal of such an approach. A revenue insurance approach also neglects the impacts of price volatility for inputs. In addition, initial modelling by the NFU suggests that for a revenue insurance mechanism to effectively support farmers, it would need to be classified as Amber Box as defined in WTO rules. Modelling showed that payments in useful insurance systems are triggered well within a 30% reduction in income. However, WTO rules stipulate that payments made in such cases are defined as Amber Box, or trade distorting, thus limiting government spending. As such, implementing an effective mechanism is highly dependent on the UK to securing an Amber Box threshold as part of its WTO negotiations.

Margin insurance scheme

A margin insurance scheme looks to insure individual farm business production margins against a fall relative to average margins in previous years. The Canadians utilise a margin insurance scheme named AgriStability which relies on individual farm financial data via tax returns and financial adjustments often prepared by professional accountants. Feedback on the Canadian scheme suggests that delivering a farm level margin insurance programme is highly complex, expensive and inaccessible for farmers. Due to this, the AgriStability scheme has encountered significant issues with declining participation rates and high levels of dissatisfaction amongst farmers. Similar issues have been expressed for the US whole farm revenue protection product and the EU Income Stabilisation Tool has also struggled to gain buy-in from member states.

The significant benefit of this measure is that it is able to target funding in accordance with the margin pressures individual farm businesses face as it is based on individual tax accounts. In contrast to a revenue insurance approach, a significant strength of margin insurance schemes is that they can be utilised by the majority of farming sectors as the mechanism is not designed around a specific commodity or linked to a market indices associated with a particular commodity group. In addition, unlike revenue insurance such a scheme is able to help mitigate the impact of input price volatility as well as output volatility.

Futures markets

Futures markets are an important risk management mechanism primarily utilised in the UK by the crops sector with some early adoption in the dairy sector. In the US, futures markets are highly developed with contracts offered for a range of agricultural commodities including grains, different classes of milk and processed dairy products and livestock amongst others. The challenge for the UK post-Brexit is that key agricultural futures exchanges for commodities such as milling wheat and dairy are located in the EU and therefore any introduction of trade barriers may limit the ability of UK's Agri-food sector to utilise such markets to manage market risk.

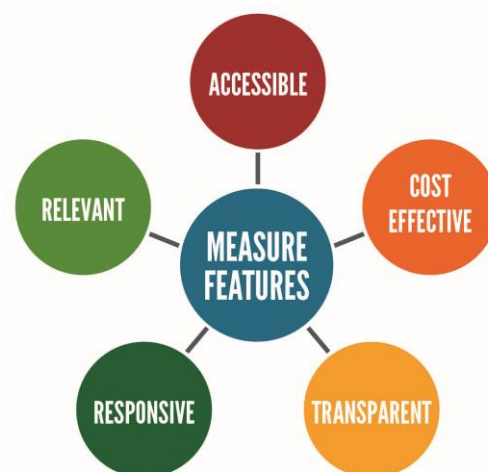
IMPORTANT CHARACTERISTICS OF VOLATILITY MITIGATION MEASURES

The NFU believes the design and delivery of volatility mitigation measures should conform to five key characteristics if the final measure is to prove effective in empowering farmers to manage the impacts of market volatility on income. In order to deliver the objective of increasing business resilience and to drive industry confidence to invest in productivity, measures should be relevant, accessible, cost-effective, transparent and responsive.

Relevant

A mitigation measure must be designed to counteract the cash-flow pressures encountered by farm businesses. Such pressures would differ for each sector based on investment cycles, working capital demands, levels of commodity price volatility, structure of the supply chain and sector profitability. Where a sector encounters sustained levels of poor market returns, a level of income resilience support would be required to ensure farm businesses are able to remain resilient during market downturns.

Other sectors may achieve favourable returns over the long-term from the market but may be more vulnerable to frequent market volatility which undermines confidence and impacts cash-flow over the short-term. Such sectors would benefit from a market linked tool such as revenue insurance, savings schemes and private sector tools such as futures markets. In addition, it is critical that measures target the intended beneficiary which in this case is the active farmer and that the majority of the value of any measure is captured by the farmer.



Accessible

It is important that measures are designed to maximise their accessibility. Whilst sophisticated schemes may better target funding to those who deliver prescribed outcomes or require support with mitigating the impacts of market volatility, they can also be prohibitively complex thereby reducing farmer participation. Examples of such schemes include Countryside Stewardship Scheme, certain productivity grants and the Canadian margin insurance programme which is suffering from reduced participation rates and high levels of complaints from beneficiaries. In order to encourage uptake farmers must be able to understand how to best utilise the measure and the administrative and reporting requirements must be proportionate to its benefits.

Cost-Effective

The transaction costs associated with the mechanism must be kept to a minimum in order to ensure funds are effectively directed to address their intended cause. There is a concern that sophisticated insurance mechanisms may carry a significant administrative burden for all parties involved. This diverts crucial funds away from the final beneficiary. It is important to ensure that the delivery process is designed to minimise transaction costs for the government, private sector partners and for the farmers as the final users.

Transparent

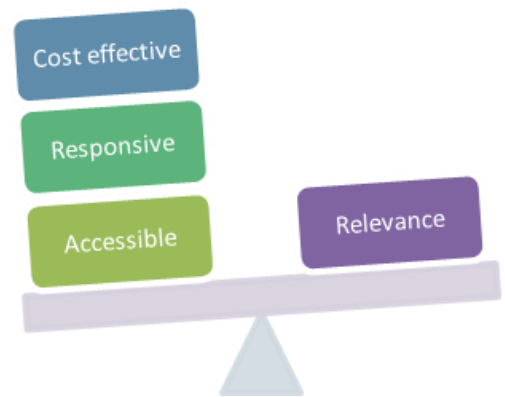
The process of allocating support and entitlements under a measure must remain transparent to ensure trust and credibility in the process. Similarly, the design of a market linked mechanism should be transparent whereby if reference data is used as a basis for payments, such data should be independently sourced and publically available. The methodology behind collecting data for such indices must be clear with data independently audited to ensure its integrity.

Responsive

Payments made from the measure must be responsive to ensure farmers are supported when they incur adverse impacts from market volatility. A key criticism of a margin insurance approach is that it requires annual tax returns and financial adjustments to be submitted and processed prior to a payment being made. In contrast, a revenue insurance product or counter-cyclical payments which are based on market indices can be more responsive, providing payments much sooner following market induced cash-flow pressures. The responsiveness of a mechanism is closely linked to the simplicity of its design and delivery which is a central factor in ensuring its effectiveness.

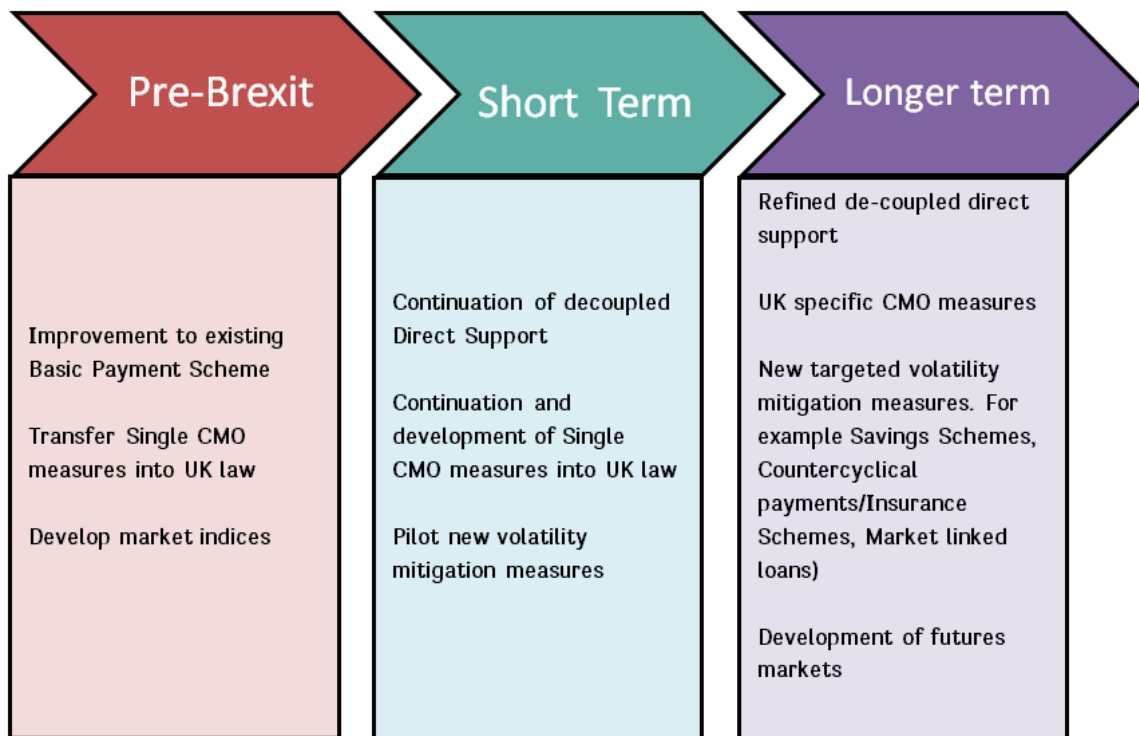
The Trade-off

Inevitably there exists a trade-off between the cost effectiveness, responsiveness and accessibility of a measure versus its relevance or ability to mitigate the impacts of market volatility on individual farm businesses. The more tailored and specific a measure to an individual farm business, the greater the complexity in delivering the measure. An example is a margin protection scheme whereby payments are related to individual farm business margins. Such schemes typically incur high operating costs, are slow to respond and are complicated to understand due to their technical requirements. In contrast a revenue insurance model based on regional price and yield indices can be more responsive, relatively simpler and in turn incur lower administrative costs. The trade-off however is that as such schemes use broader indices as a basis for payments, the final payment may not effectively help manage cash-flow pressures on farm. The indiscriminate nature of direct payments receive similar criticism due to their lack of ability to target payments however it is an example of a relatively simple mechanism which if administered effectively can distribute payments in a responsive manner.



NEXT STEPS

In order to pursue a smooth transition to a new support mechanism for volatility mitigation there are many steps government can begin to take now in order to build our capacity to implement and deliver market based solutions in the future.



Improve provisioning and reporting of market data

Due to a lack of institutional capacity to deliver market-based risk management solutions owing to the UK's limited experience in delivering such schemes and due to current poor quality of market data, it is foreseen that direct payments will remain the primary means for managing the impacts of market volatility in the medium term. In order to facilitate the development of more market orientated volatility mitigation measures, it is critical that government acts now to improve the provisioning and reporting of market data. Improvement in market data will also support the development of market linked pricing mechanisms in the supply chain.

Pilot revenue insurance schemes

To compliment a baseline level of support from direct payments, there is potential to introduce a market-orientated revenue insurance/countercyclical payments programme to support farmers in smoothing their income profile. If such an approach is a longer term objective of government, it is essential that small scale pilot schemes are delivered during the transition period post-Brexit which if successful could then be scaled up over time. This scheme would be most suitable for the arable sector with some potential for the dairy sector and operate as a public-private partnership. The government would be required to play a crucial role in subsidising premiums to affordable levels, procuring and reporting on market data and overseeing the delivery of the scheme by private insurers who have the technical delivery expertise. As the UK currently has very limited experience of delivering market-orientated schemes, a range of pilot schemes would build the UK's capacity to understand how such a scheme could be best structured and delivered to support farmers and incentivise uptake.

Establishing a ceiling for Amber Box measures

When the UK leaves the EU it will establish its own schedules at the World Trade Organisation. Importantly, some of the measures that combat volatility described above would likely need to be structured as Amber Box measures. For example, while direct payments linked to land area are not Amber Box, many viable revenue insurance schemes would be. Some WTO members have negotiated various bespoke limits, on top of a universally applied small threshold, within which they may spend set amounts on such measures. These limits were calculated on how much countries were spending on support during the years 1986-1988 and known as the Aggregate Measure of Support (AMS) allowance or ceiling. The UK's current AMS allowance is part of the EU's, which is €72bn and applies to the bloc as a whole. In reality however, the EU only currently spends €6bn on Amber Box policies.¹¹

Leaving the EU will mean the UK establishing its own schedules at the WTO, including a new AMS allowance which will dictate the limit of UK spending on Amber Box measures. In order to ensure sufficient flexibility in the design of volatility mitigation measures, it is important that the UK looks to achieve a proportionate AMS allowance as failure to do so will significantly restrict policy options in the long term. Given that the EU allocation comprises the UK's contribution to the AMS ceiling when it was established during the base period 1986-1988, the NFU believes that there is a case for the UK to retain a share of the EU's AMS ceiling going forward. The UK must ensure its farmers are provided a level playing field by providing the capability to implement relevant market risk management measures.

Common Market Organisation measures

The NFU supports as a priority the establishment of a free trade agreement with the EU that maintains two-way tariff free trade in agricultural goods between the UK and EU. In order to ensure fairness for British farmers, we support, in the short term the continuation of existing rules governing the functioning of the common market. Essentially a "lift and shift" of the single Common Market Organisation (sCMO) regulation. We believe that in the longer term, there is the opportunity to look at developing the sCMO rules to include new forms of volatility mitigation and to ensure that the tools that do exist are tailored to UK farmers' needs.

SUMMARY

- ✓ As the UK looks to develop international trade relationships there is significant potential for volatility to increase as markets are increasingly exposed to global factors such as weather, pest, disease and trade relations.
- ✓ The NFU believes that an effective programme for volatility mitigation should fulfil the objectives of income resilience for sustained periods of market downturns combined with volatility management tools for the increasingly frequent levels of market volatility observed in the commodity markets.
- ✓ In the short to medium term it is envisioned that direct payments combined with agri-environment payments will continue to be the primary mechanism for supporting farm businesses with the impacts of market volatility.
- ✓ In the medium to long-term the UK should look to develop market based tools which complement such measures in helping to smooth the impact of market forces on farm incomes.
- ✓ Overall, a cost-effective, responsive and accessible scheme is preferred to a farm specific complicated scheme such as a margin insurance programme.
- ✓ A crisis reserve will be an important feature to allow tailored response to exceptional events which impact domestic production and markets
- ✓ Mandatory price and volume reporting must be introduced for the dairy, livestock and crops sectors to increase market transparency as a basis for risk management tools and greater market orientation.
- ✓ Pilot revenue insurance programmes should be implemented during the transition period to build our capacity to deliver market orientated solutions.
- ✓ An Amber Box threshold must be agreed to provide the flexibility required to design an effective market-orientated volatility management programme.
- ✓ Access to futures markets for the agri-food sector should be enhanced and safeguarded to stimulate private sector solutions for commodity risk management.

REFERENCES

1. Defra. *Agriculture in the United Kingdom 2016*. 2017
<https://www.gov.uk/government/statistics/agriculture-in-the-united-kingdom-2016>
2. Food and Agriculture Organisation of the United Nations. *Food Price Index*. 2017
<http://www.fao.org/worldfoodsituation/foodpricesindex/en/>
3. European Commission. *Prices of EU Dairy commodities*. 2017
https://ec.europa.eu/agriculture/sites/agriculture/files/market-observatory/milk/pdf/eu-dairy-commodity-prices_en.pdf & https://ec.europa.eu/agriculture/russian-import-ban_nl
4. Farm Business Survey. *Farm Business Survey*. Multiple years.
<https://www.gov.uk/government/collections/farm-business-survey>
5. Agriculture and Horticulture Development Board. *Arable & Potatoes Dashboard*. 2017
<https://cereals.ahdb.org.uk/media/1299017/ArableandPotatoesDashboardSeptember2017.pdf>
6. Farm Business Survey. *Farm Business Survey*. Multiple years.
<https://www.gov.uk/government/collections/farm-business-survey>
7. Ibid
8. NFU own work. 2017.
9. Australian Government, Department of Agriculture and Water Resources. *Farm management deposit scheme statistics*. June 2017.
<http://www.agriculture.gov.au/SiteCollectionDocuments/agriculture-food/drought/assistance/fmd/fmdstats-jun2017.pdf>
10. United States Department of Agriculture. *The Risk Management Safety Net: Market Penetration and Market Potential. Analysis of the Federal Crop Insurance Portfolio September 2017*. 2017
<https://www.rma.usda.gov/pubs/2017/portfolio/portfolio.pdf>
11. European Commission/World Trade Organisation. *European Union notification of domestic support commitments for marketing year 2013/14*. 2017.
https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=234539,234506,234411,234424,234425,234363,234345,234312,234322,234254&CurrentCatalogueIdIndex=7&FullTextHash=371857150&HasEnglishRecord=True&HasFrenchRecord=True&HasSpanishRecord=True