NFUScotland

Briefing

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THE UK'S WITHDRAWAL FROM THE EUROPEAN UNION – THE POTENTIAL IMPLICATIIONS FOR AGRICULTURAL POLICY AND AGRI-FOOD TRADE

1. Given the close policy and trading relationship with the European Union which the UK farming and food processing industries have developed, not least through the Common agricultural Policy (CAP), detachment from the EU is likely to be very significant for Scottish agriculture and its food and drinks sectors.

2. These could be the most seriously affected of any sectors of the British economy as a result of the EU referendum, but that in turn depends on the final shape of the agreed 'Brexit' withdrawal.

3. This Briefing attempts set out some of the issues, address some of the questions, and consider some of the scenarios.

4. At this stage, it is impossible to provide many answers. This Briefing is intended to highlight some of the key issues that will be crucial in discussions ahead that NFU Scotland will be closely involved in.

5. The information provided in this Briefing is based on the author's current understanding, and any views presented are not necessarily those of NFU Scotland.

The Importance of the CAP to the UK

6. British (and Scottish) agriculture currently derives a significantly high proportion of its total income from EU support payments, and the UK food industry exports more than 60 per cent of its output to other EU countries. In the case of a complete withdrawal from any sort of relationship, clearly UK farming incomes would be substantially cut and the food industry could face a high and expensive tariff wall if it wanted to maintain its trade with the EU.

7. For many farmers and crofters, CAP support remains of incredibly important – if not vital. The most significant financial element of the CAP is the direct payments of Pillar 1, which would total €25.1 billion for the 2014-2020 period. The CAP is expected to inject more than €4.5 billion into the Scottish economy over this period.

8. On an annual basis, this amounts to around £2.88 billion to UK farmers, of which the best part of £470 million comes to Scotland each year.

9. Over the past 5 years total income from farming has increased in the UK. However, in 2012 CAP support payments still accounted for 68 per cent of Total Income from Farming (TIFF) and prior to 2007 CAP support was consistently greater than the TIFF.

10. However, in Scotland, TIFF was estimated at £777 million in 2014, being made up of £3.1 billion in outputs and £489 million in support payments, offset by £2.8 billion in costs. In effect, support payments made up some 63 per cent of farm income.

11. The TIFF for 2015 in Scotland was £667 million. The decrease in 2015 relative to 2014 was linked to lower prices, particularly in milk, which outweighed small increases in volumes. The longer term trend in TIFF has been rising since the turn of the century, but with fluctuations from year to year, and this was only the second time since then that it had dropped two years in a row.

12. Income from agriculture made up about one per cent of the Scottish economy.

13. It is beyond question that the support payments derived from the CAP are hugely significant to the viability of Scottish agriculture. The vast majority of farm business and crofts remain highly dependent on Pillar 1 direct support payments.

14. In fact, although support to Scottish agriculture is shrinking, its ‘value’ has increased as almost all commodities have seen prolonged downward pressure on market prices.

The Importance of the UK to the CAP

15. Just as important to the rest of the EU, however, may be the UK’s contribution to the EU budget and therefore to the financing of the CAP.

16. Currently, Britain’s contribution to the EU’s own resources is upwards of €17 billion a year – around 15 per cent of the total EU budget. But EU expenditure in the UK amounts to only around €6 billion, making the UK a net contributor to the tune of €10.8 billion (after the UK rebate has been deducted).

17. The UK is among the five countries – along with Germany, France, Italy and Spain – who contribute nearly half of the total budget. Filling this gap in the EU budget would require either expenditure reductions, or larger contributions by the remaining Member States following Brexit.

18. Some Member States who are current net gainers from the agricultural budget may have to become net contributors.

19. It would also affect the political structure of the EU. In the Council of Ministers, which has a significant role in agreeing the CAP’s regulations, etc., under the double majority qualified voting system operating since November 2014 the UK has 12.3 per cent of the votes based on population. The UK’s withdrawal would change significantly the voting majorities in the Council.

Possible UK Agricultural Policies After Brexit

20. The UK Government has long been a strong critic of the CAP. Based on historical experience, the UK is likely to provide less direct support for its farmers than in the current EU, and is more likely to switch expenditure to Pillar 2-type, investment and innovation measures, and agri-environment schemes for the promotion of public goods, rather than Pillar 1-type direct income support.

21. In general terms, this would be slightly at odds with the policy approach favoured by successive Scottish Governments over recent years, where direct support (including elements of coupled support and less favoured areas support) have been prioritised to underpin activity and production – especially in more disadvantage areas.

22. The UK Treasury is unlikely to cut all spending in terms of direct payments, if only because these are hugely important to farmers in Scotland Wales and Northern Ireland, but a lower level can be expected. Lower support for UK farming might be assumed to lead to lower UK production, possibly leading to a larger UK and/or Scottish market for remaining EU and non-EU suppliers as a result.

23. Equally, given the budget pressures and uncertainties within the UK's devolved administrations (including the Scottish Government), it is equally difficult to predict with any confidence what levels of support might be made available via a future Scottish Government budget.

24. However, the long-term relationship between farm support and output is not clear. Lower support also encourages structural change and productivity improvement which could help to maintain output, as was the case in New Zealand.

25. A significant concern (and interest) will be the uncertainty about the future shape of Scottish agriculture, which in turn will be highly dependent on the

levels of direct support and the ways in which such funding were to be distributed and delivered.

26. A ‘farming’ argument in favour of Brexit was that the EU is over-reaching its regulatory competences, making too many regulations (too much red tape) and setting too many standards which should remain the prerogative of Member States.

27. Given this motivation, it might be that after Brexit the UK (and Scotland) would make use of its new-found regulatory freedom to reduce or adapt many compliance measures that have irked many farmers over the years.

28. At the same time, consumer, environmental and public health organisations also have significant influence in the UK and it can also be expected that stronger regulations might emerge in some areas than was the case under EU membership.

29. It may be that there is an increased regulatory divergence between farming interests and others.

30. However, as the EU is likely to remain an important trading partner, the UK might find it in its interests to align its regulations and standards closely to those in force in the EU.

31. Also, in many areas including food and agricultural policy, EU standards are based on wider global standards where it can be expected that independent UK standards would not be significantly different.

32. Nonetheless, there are a number of areas where the UK has been a vocal critic of EU regulations and where changes in the UK may be expected – or at least argued for. Examples might include the regulation of plant protection products (PPPs), biotechnology (GM), and food labelling.

The Importance of EU Agri-Food Markets to the UK

33. If no post-Brexit preferential trade deal is negotiated, the blunt outcome would be the high tariffs which UK exports could face to maintain access to EU markets. Processed food tariffs average around 15 per cent, other major agricultural products could face tariffs of over 30 per cent. The impact of Brexit on the UK's farming and food industry, with close to two-thirds of its export trade going to the EU and then facing average tariffs of over 20 per cent, could be massive and with significant disruption.

34. And exporters to Europe would have to comply with EU regulations on which they would no longer have any influence.

35. In addition, there would be the potential loss arising from lack of preferential access to the EU's free trade agreements with other regions. Global tariffs on food and agricultural products remain high and the UK would no longer have an automatic right to benefit from trade deals negotiated on behalf of the EU.

36. Equally, the UK's withdrawal from the EU could lead to changes in supply chains, as some UK food processors could begin to source cheaper inputs and ingredients for their products from outside Europe, but others could face much stiffer international competition as rival imports become cheaper.

37. The EU currently receives 62 per cent of UK food exports, while 70 per cent of the UK's food imports come from the rest of the EU (2013 figures). The UK's agri-food sector is much more dependent on EU markets than the EU is on the UK - with the exception of Ireland, no EU country sends more than 10 per cent of its food exports to the UK.

38. At the same time however, the UK has a deficit in food trade with the EU of €23.2bn. This is something which the EU would be likely to want to maintain. Were the UK to retain a modest tariff with the rest of the world and offer the EU duty free access, it is likely that the EU would reciprocate because its producers would still have an advantage

Possible Post-Brexit Trading Arrangements

39. A hugely significant, but currently unknown, dimension for the agriculture and food sectors post-Brexit will be the exact type of relationship which the UK will be able to negotiate and maintain with the EU.

40. Four alternatives are likely to be available. In order of their degree of integration, they are

    - a European Economic Area (EEA) agreement with the EU (such as currently applies for European Free Trade Area (EFTA) members Norway, Iceland and Lichtenstein)
    - EFTA membership with EU free trade agreement (as with Switzerland) plus bilateral treaties on individual Single Market issues
    - a Customs Union with the EU (as with Turkey)
    - a Free Trade Agreement (as with Canada or under negotiation with the USA)

41. The ranking of these options shows that for the UK there is a trade-off between, on one hand, the level of access to the Single Market (i.e. freedom from tariff and non-tariff barriers to trade) and, on the other, freedom from EU product regulations, social and employment legislation, and budgetary contributions. Some of these options are clearly more likely than others because of resistance either on the UK or the EU side, or both.

42. The current arrangements for relations with the EU which are maintained by Norway, as a member of the European Economic Area, or Switzerland, may not be appropriate for the UK. Such a deal would, in effect, involve the disadvantages of EU membership with precious few of the advantages - the UK may be obliged to adopt some or all of the body of EU Single Market law with no effective power to shape it.

43. If it is in the UK's interest to remain in the Single Market, now that it has opted to leave the EU, it may have to bid for radical institutional (EU) change to give decision-making rights in the Single Market to all its participating states, i.e. those outside the EU as well as Member States. It is hard to say how politically achievable that might be.

44. Iceland, Norway, Switzerland and Liechtenstein are all EFTA members. The original 1960 European Free Trade Area agreement was reached between countries that sought the benefits of trade without full membership of what was then the EEC.

45. The countries of EFTA first lowered tariffs between themselves, and then signed bilateral Free Trade Agreements (FTAs) with the EEC from 1973 onwards. The current European Economic Area (EEA) Agreement subsequently superseded those with Norway, Iceland and Liechtenstein.

46. A number of countries which are now EU Member States were formerly EFTA members. The UK was a founder EFTA member, alongside Denmark, Norway, Sweden, Austria, Switzerland and Portugal. EFTA Free Trade Agreements (FTAs) have established free trade areas between the partners.

47. But although they provide for free trade in industrial goods, including fish and other marine products, trade in basic agricultural products is covered by separate bilateral agreements relating to the FTA.

48. The EEA Agreement extends the EU Single Market and free movement of goods, services, people and capital, together with laws in areas such as employment, consumer protection, environmental policy and competition to its members.

49. In other words, the free movement of labour (and also many of the EU regulations deemed by some as most burdensome to businesses, such as the Working Time Directive) would still apply if the UK left the EU but remained a member of the EEA.

50. At the same time, the UK may be bound by future EU laws in these areas, with less influence over their content. Liechtenstein, Norway and Iceland have no representation in any of the EU institutions and only indirect influence – including the right to be consulted – on EU proposals affecting them.

51. Under the ‘Swiss Model’, EU and Swiss nationals both enjoy the right of entry, residence, access to paid work, establishment on a self-employed basis, and the right to stay in the territory after their employment has finished.

52. The right of entry and residence applies to everyone, including those without an economic activity in the host country. The host country must accord foreign nationals the same living, employment and working conditions as those accorded to nationals.

53. Under a ‘Swiss Model’ or an EEA model, assuming such an arrangement could be negotiated, the restrictions on trade which would otherwise result from the UK’s withdrawal from the EU would be significantly reduced.

54. In particular, the EEA has full, tariff-free access to the internal market, and the EU’s ‘four freedoms’ concerning movement of goods, services, capital and labour, apply equally to Norway, Iceland and Liechtenstein as they do to full Member States.

55. Membership of the EEA gives access to the EU’s preferential trade agreements with non-EU other countries. If it were not a member of this looser grouping, the UK would also then have to negotiate on-going market access with these countries, or else scale the MFN tariffs levied by these countries.

56. If the UK were not part of this grouping, the implication for the EU would be that it could have to pay compensation to the affected countries with which it has FTAs, due to the ‘shrinking’ of the market from what was originally agreed.

57. In short, probably the biggest and most obvious difference between EEA membership and being a full Member State is the removal of any involvement in the CAP – although it does cover various aspects of trade in agricultural products.

58. Since there would be no CAP to finance, there would be a much lower UK financial contribution. There would be no Customs Union or Common Trade Policy, nor Common Foreign and Security Policy. And the EEA does not include any provisions for monetary union.

59. That leaves the concept of a Free Trade Agreement (FTA) similar to that currently existing between the EU and Canada. This would likely mean free trade in agricultural and food products, but with the UK no longer having full access to the Single Market.

60. Essentially, UK traders would find themselves reverting to the pre-1992 situation before the establishment of the Single Market.

61. In that pre-Single Market period, many non-tariff barriers (covering food safety, plant health, and veterinary regulations for example) impeded the free flow of products between Member States, and incurring significant handling costs. Trading costs between the UK and the EU may well increase in a similar way, depending on the trade deal finally struck between the UK and the EU.

62. Assuming that such an FTA could be established during the two years needed for the withdrawal process, full tariff liberalisation in the agriculture and food sector could be negotiated on the grounds that given that the UK is a relatively minor exporter to the EU, there would be no justification for the EU to impose a defensive tariff wall.

63. The UK, for its part, is unlikely to want to maintain high tariffs on EU food imports given its intrinsic commitment to lower consumer prices. But would that help British and Scottish farmers?

64. The main cost to the UK food industry would arise from the re-introduction of customs procedures, and changes in UK trade policy with third countries.

65. How soon might the food industry have to face up to these possible changes? Depending on when the British Government notifies its intention to withdraw from the EU (Article 50), the withdrawal is scheduled to take place two years later. So the industry could be facing the new situation by 2019.

66. However, this period could be extended by the Council of Ministers. It may well may be that the conclusion of UK membership will take place at the end of the current budgetary period in 2020.