

HOUSE OF LORDS

European Union Committee

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15th Report of Session 2015–16

# **Responding to price volatility: creating a more resilient agricultural sector**

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Evidence is published online at <http://www.parliament.uk/price-volatility-agricultural-resilience/> and available for inspection at the Parliamentary Archives (020 7129 3074).

Q in footnotes refers to a question in oral evidence.

## SUMMARY

European farmers provide a secure supply of safe food, manage the land and contribute to the wider rural economy. They have to cope with multiple risks such as often unpredictable and catastrophic weather conditions, the impact of political decisions and volatile international markets while delivering public goods such as a managed environment. They do this within the framework of the EU's Common Agricultural Policy (CAP). Within the UK, agriculture is a devolved matter in Scotland, Wales and Northern Ireland.

Price volatility is an inherent feature of agricultural commodities markets. We found that adverse effects at farm level are caused more by unanticipated periods of sustained low prices than by an increase in levels of volatility. Farmers can manage both by taking measures to increase levels of resilience.

Incremental changes to the CAP have resulted in farmers being more exposed to market forces. Direct income payments continue to provide a degree of financial stability, helping them to withstand protracted periods of low prices. We heard, however, that they can reduce incentives for innovation and efficiency gains.

We also investigated how public policy is used to support farmers in other major producer countries, in particular the United States, Canada and New Zealand. We found that there are fundamental differences between the organisation and structure of the agricultural sectors in the EU and those countries and believe that these differences render the models used by those countries unsuitable for general application in the EU. Lessons can be learned, however, from the US and Canadian approaches to insurance schemes, for example.

We believe that subsidised insurance schemes should not replace the current provision of direct income support through the CAP. They may, however, play a supplementary role in helping to counter the effects of extreme weather events. One-off support packages can also help to counter the impact of uncontrollable factors, but the UK Government should articulate the specific circumstances in which it will seek to access such funding at EU level.

We also see merit in the development of a range of financial instruments that can help farmers manage risk. We recommend that the European Commission and Member State governments work proactively with the financial sector to develop and promote more accessible and practical risk management tools. Government policy should ensure that farmers receive the training and education required to make use of these new instruments.

We were told that farmers needed to acquire the appropriate business skills, knowledge and expertise to calculate and manage their costs of production and overheads. We also heard about the merits of benchmarking. The UK Government should identify examples of best practice in the areas of knowledge exchange and dissemination and seek to promote them across the UK.

We were told that public funding may be keeping less progressive farmers in business at the expense of new entrants. We recommend that the UK Government works to identify the main barriers preventing farmers from exiting the sector, that they consider using Rural Development funding to accelerate the necessary structural change and that they create opportunities for new entrants into farming.

Agriculture has a critical role in the provision of public goods, such as high animal welfare standards and environmental stewardship, and this role should be recognised in the policy and funding framework. We recommend that the European Commission consider restructuring the CAP based mainly around the provision of public goods, potentially removing the distinction between the two pillars currently governing Direct Payments on the one hand and Rural Development on the other.

# Responding to price volatility: creating a more resilient agricultural sector

## CHAPTER 1: INTRODUCTION

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### The challenges facing EU agriculture

1. The agricultural industry provides jobs for 22 million people across the EU who are directly involved in farm work and for many more in related sectors. While a secure supply of safe food is the industry's most visible output, farmers also play an important role in the management of the land and the environment as well as in the wider rural economy.
2. Farms across the EU vary enormously in size and type, from family smallholdings to large commercial agribusinesses. Developing and implementing a common policy to meet the different needs of all farmers presents a serious challenge. The Common Agricultural Policy (CAP), launched in 1962, is the main framework within which EU agriculture is managed. The CAP has undergone incremental change since its inception and, over time, has reduced support provided through prices in favour of support unrelated to production decisions. As a consequence, many farmers are now more exposed to market prices and therefore price volatility.
3. The effects of price volatility are felt differently by different farming sectors and by farms of different sizes. The presence of support under the CAP for certain sectors can also affect levels of resilience, with some less supported sectors even emerging as more resilient than those with a history of substantial support. Price volatility can be an opportunity for some farmers, but for others it can severely affect their livelihoods.
4. In the face of pressure on their incomes, many farmers have turned to diversification to supplement their income and reduce their risk exposure, but not all are able to do so.
5. The capital intensive and long term nature of farming limits the sector's ability to respond quickly to sudden market disruption caused by, for example, extreme weather events or unpredictable political decisions.
6. Against a backdrop of reports of an ongoing crisis in UK agriculture<sup>1</sup>, the Committee undertook an inquiry to examine the extent to which price volatility was increasing and how agricultural resilience to withstand price and other shocks could be strengthened.
7. As a global phenomenon, price volatility is here to stay, and is beyond the control of the individual farmers who feel its effects. Their best defence is to draw upon a range of mitigation measures to improve their resilience, and we have examined various options available in the EU and elsewhere in the world. We have also offered some thoughts on the future of the CAP.

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1 'UK farming faces two more years of pain says Carr's boss', *Daily Telegraph* (11 April 2016): <http://www.telegraph.co.uk/business/2016/04/11/uk-farming-faces-two-more-years-of-pain-says-carrs-boss/> [accessed 5 May 2016]

### The case for public intervention

8. Over the course of our inquiry, it became clear to us that public intervention in the agricultural sector is justified where it can be seen explicitly to support the provision of public goods, such as increased food security, high food safety standards, animal welfare standards, stewardship of the land and a contribution to a well-functioning rural economy.
9. On stewardship, the CAP recognises that much of the EU's agricultural land has to be conserved and farmed in a sustainable manner. We expect farmers to manage hedgerows, woodlands, watercourses and footpaths as well as promoting biodiversity where appropriate, all of which have direct costs and can reduce profitability. We should rightly speak of farmers as 'land managers', and the concept of 'natural capital' should inform policy making. Public funds should support this work where it is already taking place and encourage it where it is not.
10. Global agriculture faces increasing challenges, including climate change. Extreme weather events are on the rise, while demand for available land is increasing. Productivity and efficiency are of the utmost importance if food production and environmental goals are to be secured in the face of global warming, and public policy should be mindful of the need to adapt to a constantly changing world.
11. Developing economies are increasing the competition for food, and it makes sense to focus on productivity and efficiency at both farm and industry level. In our 2014 report, *Counting the Cost of Food Waste: EU Food Waste Prevention*<sup>2</sup>, we argued that levels of food waste in the EU were unacceptably high. Approximately one third of the food produced in the world for human consumption every year—around 1.3 billion tonnes—is lost or wasted.<sup>3</sup> The positive effects of advances in agricultural efficiency and productivity will always be undermined if produce is needlessly wasted at any point, from farmer to processor, from retailer to consumer.
12. Although we do not examine the distinct role of retailers in this report, it is important to acknowledge that co-operation throughout the entire supply chain can bolster agricultural resilience. Longer term contracts can provide stability, but problems arise when retailers use the contracts with their suppliers for their own advantage, sometimes cancelling orders with little notice or compensation. This remains an ongoing cause for concern.
13. The ongoing reform of the CAP provides an opportunity to shape future behaviour in agriculture. A revised CAP should be significantly less complex and should focus on public goods, natural capital and the creation of a more resilient sector.
14. Above all, we were conscious that our work should have a particular focus on the role of those at the centre of agriculture: farmers. They should be at the heart of any changes in public policy and developments in agricultural practice. The potential of UK agriculture is significant, and farmers should be willing to explore new techniques, acquire new skills and share best practice.

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2 European Union Committee, *Counting the Cost of Food Waste: EU Food Waste Prevention* (10th Report, Session 2013–14, HL Paper 154)

3 Food and Agriculture Organization of the United Nations, 'SAVE FOOD: Global Initiative on Food Loss and Waste Reduction': <http://www.fao.org/save-food/resources/keyfindings/en/> [accessed 5 May 2016]

Willingness to benchmark in order to understand the cost of production is key to enhancing farmers' competitiveness.

### **The inquiry and the Committee's work**

15. We issued our Call for Evidence in October 2015 and took oral evidence from a range of witnesses, from the UK and beyond, between December 2015 and February 2016. We received 29 pieces of written evidence and took oral evidence from 22 witnesses, over 7 evidence sessions. In March we visited farms in Hampshire and Berkshire to talk with farmers about the evidence we had received and to gather their views on future public policy options. We would like to thank all who were involved in that visit for their candid comments and willingness to engage with our work.
16. This report is aimed at the UK Government, which is responsible for implementing much of the CAP, and which supplements EU policy with domestic measures to support agriculture. The UK Government must develop a unified approach to agriculture and the environment. We heard with interest that the Department for Environment, Food and Rural Affairs (Defra) is working on a 25 year plan for food and farming, and on a separate 25 year plan for the environment. We are concerned that dividing the two policy areas in this way does not demonstrate awareness of the interconnectedness of agriculture and the environment, or of the value of natural capital. We await the publication of the plans in the near future.
17. Our report is also aimed at the European Commission, who are tasked with initiating ongoing CAP reform and keeping current policies under review. We hope that the voice and experience of national parliaments will inform any preparatory work for the next round of CAP reform.
18. On 23 June 2016 the people of the United Kingdom will decide whether the country should remain in or leave the European Union. We have not, in this report, explored either the options for an alternative UK agricultural policy, were the electorate to vote to leave, or the process whereby the UK would negotiate exit from the CAP and the wider process of policy transition. We trust that the conclusions and recommendations contained in this report will be of value whatever the result of the EU referendum.
19. The members of the EU Energy and Environment Sub-Committee who carried out the inquiry are listed in Appendix 1; and their declared interests are also listed. We are grateful for the written and oral evidence that was submitted to the inquiry; the witnesses are shown in Appendix 2. We are also grateful to Professor Berkeley Hill and Dr Dylan Bradley, who acted as Specialist Advisers to the inquiry.
20. The Call for Evidence is given in Appendix 3. All evidence is published online.
21. We make this report to the House for debate.

## CHAPTER 2: PRICE VOLATILITY

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### Defining price volatility

22. Price volatility in the agricultural sector is generally understood to mean excessive variations in agricultural commodity prices over time. It refers specifically to price fluctuations, upwards and downwards, around an expected level. According to Tim Lloyd, Professor of Economics, Bournemouth University, “volatility will include some high prices and some low prices, but it is distinct from the state of high prices or low prices.”<sup>4</sup>
23. A number of witnesses, including Defra,<sup>5</sup> David Gardner, the Chief Executive of the Royal Agricultural Society of England,<sup>6</sup> and Jared Greenville, Senior Agriculture Policy Analyst at the Organization for Economic Co-operation and Development (OECD),<sup>7</sup> pointed out that price volatility is an intrinsic feature of markets, including agricultural ones, as prices adjust to changing circumstances. Agricultural markets tend to exhibit high levels of volatility for a number of reasons, as explained in a report for the G20 by the Food and Agriculture Organization of the United Nations (FAO), the OECD and others<sup>8</sup>:
- (a) Agricultural production is vulnerable to natural disasters, such as bad weather and pests, as well as to policy changes and international incidents, such as the 2014 Russian embargo on imports of a range of agricultural products from the EU.
  - (b) The inelastic nature of demand and supply of the market, particularly in the short term, means that a large change in prices is required to balance supply and demand after a shock.
  - (c) There is a lag in the supply response to price changes as the agricultural sector requires a considerable time to make changes to production, which can cause cyclical adjustments that add an extra degree of volatility to the markets.
24. Defra agreed that while demand for agricultural commodities tends to be steady, supply depends on natural factors including seasonality and weather.<sup>9</sup>
25. Professor Tim Lloyd, Steve McCorrison, Professor of Agricultural Economics, University of Exeter; and Wyn Morgan, Professor of Economics, University of Sheffield, argued that agricultural markets are additionally prone to occasional spikes, such as those that took place in food markets in 2007–2008 and 2011. They noted, though, that farmers are sometimes able to benefit from this phenomenon.<sup>10</sup> These spikes can be clearly seen in Figure 1 below, which demonstrates price movements in UK price indices for selected agricultural products.

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4 [Q 2](#)

5 Written evidence from the Department for Environment, Food and Rural Affairs (Defra) ([RPV0009](#))

6 [Q 30](#)

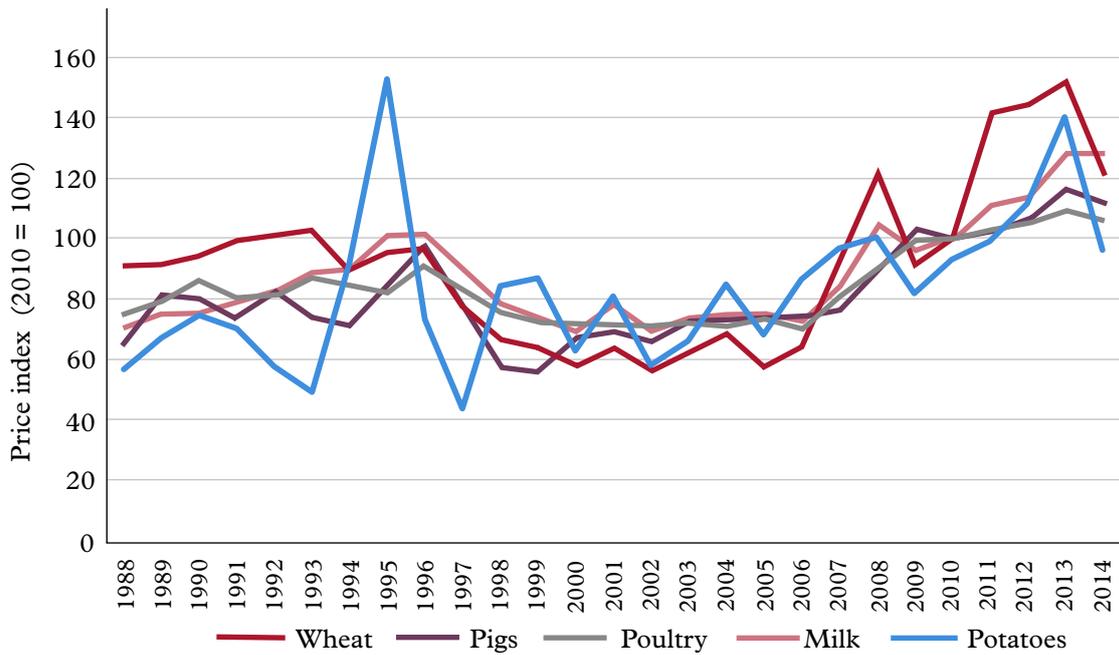
7 [Q 52](#)

8 FAO, IFAD, IMF, OECD, UNCTAD, WFP, the World Bank, the WTO, IFPRI and the UN HLTF, *Price Volatility in Food and Agricultural Markets: Policy Responses* (2 June 2011): <https://www.oecd.org/tad/agricultural-trade/48152638.pdf> [accessed 5 May 2016]

9 Written evidence from Defra ([RPV0009](#))

10 Written evidence from Professor Tim Lloyd, Professor Steve McCorrison, and Professor Wyn Morgan ([RPV0029](#))

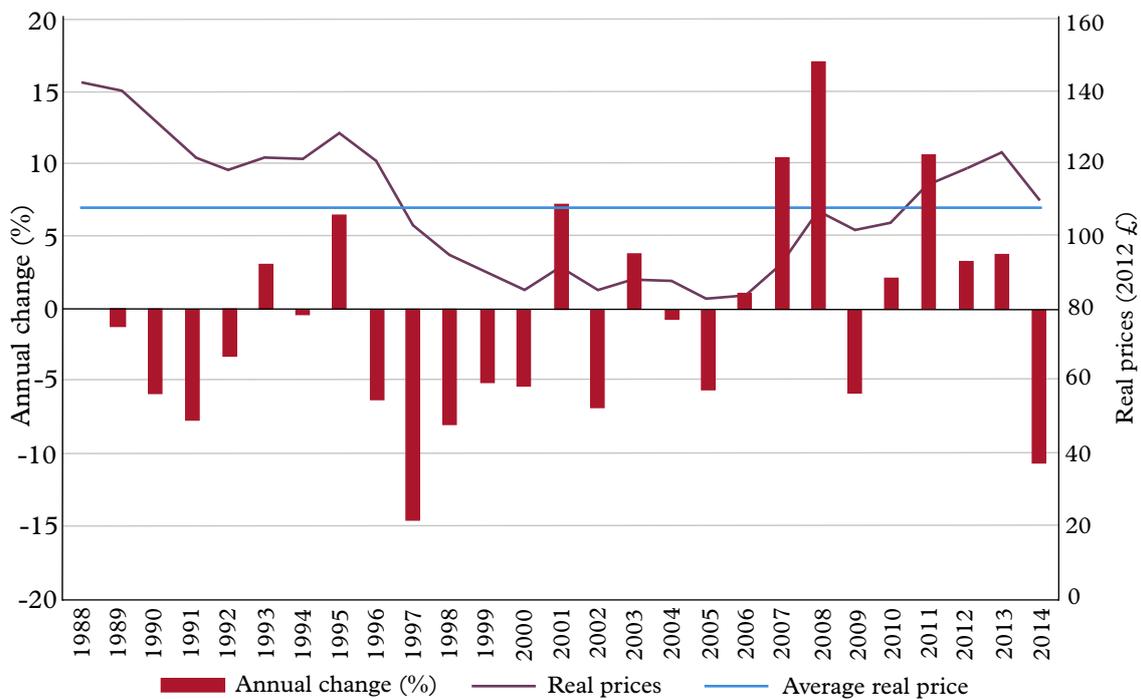
**Figure 1: Real indexed prices for selected agricultural commodities (UK)**



Source: Defra, 'Agriculture in the United Kingdom': [https://data.gov.uk/dataset/agriculture\\_in\\_the\\_united\\_kingdom](https://data.gov.uk/dataset/agriculture_in_the_united_kingdom)

26. Figure 2 demonstrates price movements for all agricultural outputs with respect to the long-term average price. It also shows the extent of annual percentage changes in the price index.

**Figure 2: Real indexed prices for all agricultural outputs (UK)**



Source: Defra, 'Agriculture in the United Kingdom': [https://data.gov.uk/dataset/agriculture\\_in\\_the\\_united\\_kingdom](https://data.gov.uk/dataset/agriculture_in_the_united_kingdom)

27. Professor Lloyd noted that there were different ways of measuring price volatility. The most common measure is the ‘coefficient of variation’, which measures variation of price relative to its average value over some sample period.<sup>11</sup>
28. There appeared to be no consensus, however, over what constitutes excessive volatility. The report for the G20 by the FAO, the OECD and others argued that the answer depends on individual or national circumstances, with small, resource-limited farmers being particularly vulnerable to a fall in prices:

“Suffice it to say that volatility becomes an issue for concern and for possible policy response when it induces risk averse behaviour that leads to inefficient investment decisions and when it creates problems that are beyond the capacity of producers, consumers or nations to cope”.<sup>12</sup>

29. **Price volatility is an inherent feature of agricultural markets, and it will remain a normal risk to be managed by farmers as part of their business strategies.**

### **A historical perspective**

30. Recent years have seen a more volatile period in agricultural commodity prices. The evidence, however, suggests that this current episode is not an anomaly, and that volatile periods have generally been followed by periods of more stable prices.
31. According to the Price Volatility in Food and Agricultural Markets report, “there is little or no evidence that volatility in international agricultural commodity prices, as measured using standard statistical measures is increasing in the long term.” Nevertheless, it noted that volatility had been higher during the decade after 2000 than the previous two decades.<sup>13</sup> Professor Lloyd, Professor McCorrison, and Professor Morgan agreed that, despite the price spikes of 2007–2008 and 2011, research did not point to any general increase in the volatility of prices on world agricultural markets.<sup>14</sup>
32. Professor Lloyd said:
- “Volatility tends to cluster in periods of time and in between each cluster of volatility there is relative stability. If we look at the recent burst of volatility compared to the previous 10 years, which was a relatively stable period, volatility has increased. However, if we go further back and include the 1970s, which was a much more volatile period than we have just been through, we can see the positive trend that we might observe over a short period of time disappears.”<sup>15</sup>
33. Domestic price variations may differ from those seen in international markets depending on how integrated domestic markets are with global

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11 [Q 2](#)

12 FAO, IFAD, IMF, OECD, UNCTAD, WFP, the World Bank, the WTO, IFPRI and the UN HLTF, *Price Volatility in Food and Agricultural Markets: Policy Responses* (2 June 2011): <https://www.oecd.org/tad/agricultural-trade/48152638.pdf> [accessed 5 May 2016]

13 FAO, IFAD, IMF, OECD, UNCTAD, WFP, the World Bank, the WTO, IFPRI and the UN HLTF, *Price Volatility in Food and Agricultural Markets: Policy Responses* (2 June 2011): <https://www.oecd.org/tad/agricultural-trade/48152638.pdf> [accessed 5 May 2016]

14 Written evidence from Professor Tim Lloyd, Professor Steve McCorrison, and Professor Wyn Morgan ([RPV0029](#))

15 [Q 3](#)

prices. Defra used the development of EU dairy market prices to make this point. It argued that the EU milk market was relatively shielded from the world market until 2006 due to import tariffs and the milk quota, with prices hovering above the EU support price. After the liberalisation of the market and the relaxation of the quota, EU milk prices had “begun to align with the more volatile world milk price”.<sup>16</sup>

34. Indeed, the Price Volatility in Food and Agricultural Markets report argued that trade measures such as import duties, export taxes, non-tariff barriers or domestic policies, such as price support, “all influence the extent to which price changes in domestic markets mirror those on international markets”.<sup>17</sup>
35. **Despite increased volatility in agricultural prices in recent years, we conclude that the overall level of price volatility is no higher than at other times in the past.**

### Factors influencing volatility

36. The drivers of price volatility can be numerous and affect both demand and supply. They range from extreme weather events disrupting agricultural production to countries’ trade policy responses. Dr Philip Dawson, Reader in Agricultural Economics, Newcastle University, Professor Lloyd, Professor McCorrison and Professor Morgan, provided a helpful summary of the main drivers for recent price spikes.<sup>18</sup> Their evidence is summarised in Box 1.

### Box 1: Drivers of recent price spikes

- Weather shocks in supplying countries
- Declining stocks
- Low investment
- Trade policy responses of exporting and importing countries
- Increasing demand for biofuels
- Rising demand by emerging nations, especially India and China
- Financialisation of agricultural commodity markets
- High oil/fertiliser prices

Sources: Written evidence from Dr Phil Dawson ([RPV0007](#)), Written evidence from Professor Tim Lloyd, Professor Steve McCorrison and Professor Wyn Morgan ([RPV0029](#))

37. Dr Phil Dawson told us that “Explanations of higher future price volatility include low stocks, increasing speculation, and the current financial crisis. There is no consensus about the relative weights of each explanation.”<sup>19</sup>
38. Exchange rate fluctuations also influence price volatility. Defra noted that a strong pound made imports to the UK market cheaper, depressing UK prices.

16 Written evidence from Defra ([RPV0009](#))

17 FAO, IFAD, IMF, OECD, UNCTAD, WFP, the World Bank, the WTO, IFPRI and the UN HLTF, *Price Volatility in Food and Agricultural Markets: Policy Responses* (2 June 2011): <https://www.oecd.org/tad/agricultural-trade/48152638.pdf> [accessed 5 May 2016]

18 Written evidence from Dr Phil Dawson ([RPV0007](#)) and written evidence from Professor Tim Lloyd, Professor Steve McCorrison, and Professor Wyn Morgan ([RPV0029](#))

19 Written evidence from Dr Phil Dawson ([RPV0007](#))

39. Professors Lloyd, McCorrison and Morgan noted that storage played an important role in mitigating the impact of price spikes. When stocks of commodities were adequate, they smoothed out changes in supply or demand in agricultural markets. Inadequate stocks, however, would exacerbate the situation and lead to more marked price variability.<sup>20</sup>
40. Moreover, the perishability of agricultural produce contributes to levels of price volatility in various commodities. Professor Lloyd argued:
- “We tend to observe, other things remaining equal, very high volatility in fruits, simply because they are perishable products that we cannot store. Wheat, on the other hand, is storable and its volatility tends to be less than others.”<sup>21</sup>
41. Export subsidies to farm products were also highlighted as a source of price volatility on world markets. His Excellency the Rt Hon Sir Lockwood Smith, the High Commissioner of New Zealand to the United Kingdom, commended the World Trade Organization (WTO) commitment in December 2015 to abolish such subsidies, arguing that it had “helped to lead to normal market mechanisms having greater impact on stabilising prices”.<sup>22</sup> Defra agreed that “the EU’s move away from the use of export subsidies also contributes to the stability of world markets.”<sup>23</sup>
42. In the EU, the evolution of the CAP from commodity price support towards decoupled income support and environmental payments has increasingly exposed EU farmers to market prices. According to Defra, “greater market orientation in the EU farming sector can improve efficiency and productivity, but also bring more exposure to price volatility on international markets.”<sup>24</sup> The Agriculture and Horticulture Development Board (AHDB), the statutory levy board, concurred:

“Historically, when many of today’s farming businesses were in their infancy, the CAP provided much of the price risk management required meaning the business could focus purely on optimising the physical attributes.”<sup>25</sup>

### Why does volatility matter?

43. While variations in prices provide important market signals to steer farmers’ production and investment decisions, excessive price volatility caused by transient influences can undermine the economic validity of these signals. For instance, farmers face the risk of losing their productive investments made in times of high prices if prices subsequently drop significantly. This uncertainty may lead to sub-optimal investment decisions.
44. In addition, periods of low prices pose significant problems for farm incomes. The House of Commons’ Environment, Food and Rural Affairs Committee’s recent report on *Farmgate prices*, which investigated farm gate prices for dairy,

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20 Written evidence from Professor Tim Lloyd, Professor Steve McCorrison, and Professor Wyn Morgan ([RPV0029](#))

21 [Q 3](#)

22 [Q 57](#)

23 Written evidence from Defra ([RPV0009](#))

24 Written evidence from Defra ([RPV0009](#))

25 Written evidence from the Agriculture and Horticulture Development Board (AHDB) ([RPV0020](#))

lamb and pork industries in the UK, found that the most recent period had seen prices fall, leading to many farmers suffering financial difficulty.<sup>26</sup>

45. The AHDB noted that farmers tended to struggle with adjusting to low prices:

“Essentially, many businesses still take a very physical rather than a business approach to periods of low prices. This prevents the business from identifying and responding to market signals—for example it is often said that dairy farmers will ‘milk through’ low prices to maintain short-term cash flow—rather than making and taking more challenging business decisions.”<sup>27</sup>

46. **Both price volatility and low prices present challenges for farmers. In our opinion, adverse effects at farm level are caused more by unanticipated periods of sustained low prices than by an increase in levels of price volatility.**

*Normal vs. excessive volatility*

47. The OECD argued that producers should be facing some price volatility as part of “normal business risks that they undertake”. Such limited volatility provided signals to make appropriate investments into the sector, guided by supply and demand:

“A certain amount of risk should be present in the industry, so when we think about price volatility we should really only be thinking in terms of where governments start to ... play a role in helping to overcome these catastrophic and extreme events.”<sup>28</sup>

48. Sir John Marsh, Emeritus Professor at the University of Reading, gave an example of “the traditional pig cycle, where a period of high prices would lead to excessive investment and a subsequent market crash”. He argued that such behaviour would misdirect real resources and increase the cost of technical innovation. Excessive volatility could also have social consequences by pushing marginal producers out of business, which might lead to consequences such as a gradual depopulation of regions.<sup>29</sup>

49. The Price Volatility in Food and Agricultural Markets report argued that:

“Not all price variations are problematic, such as when prices move along a smooth and well-established trend reflecting market fundamentals or when they exhibit a typical and well known seasonal pattern. But variations in prices become problematic when they are large and cannot be anticipated and, as a result, create a level of uncertainty which increases risks for producers, traders, consumers and governments and may lead to sub-optimal decisions.”<sup>30</sup>

26 Environment, Food and Rural Affairs Committee, *Farmgate prices* (Third Report, Session 2015–16, HC474)

27 Written evidence from the Agriculture and Horticulture Development Board (AHDB) ([RPV0020](#))

28 [Q 52](#)

29 Written evidence from Sir John Marsh ([RPV0006](#))

30 FAO, IFAD, IMF, OECD, UNCTAD, WFP, the World Bank, the WTO, IFPRI and the UN HLTF, *Price Volatility in Food and Agricultural Markets: Policy Responses* (2 June 2011): <https://www.oecd.org/tad/agricultural-trade/48152638.pdf> [accessed 5 May 2016]

50. Some witnesses stressed the potential benefits that farmers could derive from price volatility. Paul Wilson, Professor of Agricultural Economics, University of Nottingham, noted that the temporary high prices which resulted from the volatility experienced in 2007–08 was a positive event for cereal farmers, allowing them to reinvest in depreciating assets. He concluded that farmers were able to make a profit on the upswing of prices, and that it was only the downswing that presented a problem.<sup>31</sup>
51. Philip Bicknell from the National Farmers' Union (NFU), said: "When we saw higher prices, we saw investment in plant and machinery, perhaps stuff that has a shorter lifespan." He added, however, that investment in farm buildings and storage needed to maintain an appropriate level of capital stock might not materialise because volatility made longer term forward planning difficult.<sup>32</sup>

### *The impact of speculation*

52. The evidence on the impact of speculation on price volatility was inconclusive. According to Dr Dawson, limiting speculation on agricultural futures markets "may lead to increasing volatility, may mitigate against the important roles of traders who provide liquidity and absorb risk, and may drive funds into international futures markets that have fewer regulations".<sup>33</sup>
53. On the other hand, Professor Morgan argued that some speculation in the futures market was "a response to volatility, not necessarily the cause, although it could reinforce some of the volatility".<sup>34</sup>
54. A 2010 report for the OECD found that increased participation of index fund investments in agricultural commodity markets had not increased price volatility in agricultural futures markets: "There is no statistically significant relationship indicating that changes in index and swap fund positions have increased market volatility."<sup>35</sup>

### *Volatility as a driver of productivity*

55. Price volatility can also drive productivity gains on farms, as farmers adopt strategies to improve their resilience to unexpected price swings and protracted periods of low prices. The New Zealand High Commissioner, for example, reported "staggering" productivity improvements in New Zealand's agricultural sector after the removal of subsidies that had shielded farmers from global market forces.<sup>36</sup> Other witnesses cautioned that there were particular circumstances in New Zealand, which they felt played an important role in the changes that took place, such as currency devaluation.<sup>37</sup>
56. Indeed, many witnesses argued that free trade could have a stabilising influence on prices, while protectionist measures were considered counterproductive. Defra noted that policies such as import bans aimed at

31 [Q 14](#)

32 [Q 14](#)

33 Written evidence from Dr Philip Dawson ([RPV0007](#))

34 [Q 3](#)

35 Irwin, S. H. and D. R. Sanders (2010), *The Impact of Index and Swap Funds on Commodity Futures Markets: Preliminary Results*, OECD Food, Agriculture and Fisheries Working Papers, No. 27, OECD Publishing. <http://www.oecd.org/trade/agricultural-trade/45534528.pdf> [accessed 5 May 2016]

36 [Q 53](#)

37 [Q 16](#) (Philip Bicknell), [Q 43](#), [Q 79](#)

shielding the domestic market from price rises could “export instability onto the world market”.<sup>38</sup>

57. Douglas D. Hedley, former Assistant Deputy Minister in Agriculture and Agri-food of Canada, argued that volatility in commodity prices was not a concern, as long as “open and fair trade rules and non-distorting domestic programs are in place.” He added that “a considerable degree of volatility in prices stems from governmental action in both trade distortions and distorting domestic programs”. As an example, he noted that China’s decision to alter its state purchases of feed grains, dairy products and meats, had “a considerable effect on the recent declines in prices for these commodities”.<sup>39</sup>
58. The evidence we received suggested that farmers being prepared for price variations of both inputs and outputs and periods of low prices, would assist farmers in making decisions on investment and business strategies. Such preparedness would not, however, eliminate the risk arising from unexpected price movements. Managing this risk is complicated by, in particular, the time lag between the decision to produce and the time when marketable output is generated and revenue realised. Dr Dawson argued:
 

“Higher volatility (and therefore higher price risk) may lead farmers, traders, input supply firms and food processors to implement better financial management strategies which include the use of futures and options, insurance, storage, and diversification or collaboration to share costs.”<sup>40</sup>
59. **A degree of price volatility sends crucial market signals, which inform production and investment decisions. It also provides incentives for innovation and efficiency gains.**
60. **Preparedness for price movements will assist farmers in their investment and business decisions, but it will not eliminate risk.**
61. Public policy should not aim to control prices but to help farmers develop resilience mechanisms to manage the risks posed by volatility.

#### *Input prices*

62. Though price volatility, as we have used the term, refers to farm gate prices paid to producers, variations in input costs, such as fertilisers, seeds, animal feed and energy, are also affected by price variations. These may be different from variations in output prices. As an important component of production costs, they affect farm incomes and profitability and can either mitigate or exacerbate the impact of output price volatility.

#### *Impact on different farm groups*

63. The EU agricultural sector is very diverse, involving a wide range of farm types from intensive to conventional and organic, and various types of produce from livestock, to grain and horticulture. Farmers also face different conditions, with additional payments available to those farming in designated ‘areas with natural constraints’, where agricultural production is more difficult due to factors such as soil, slope and climate.

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38 Written evidence from Defra ([RPV0009](#))

39 Written evidence from Douglas D. Hedley ([RPV0033](#))

40 Written evidence from Dr Philip Dawson ([RPV0007](#))

64. The impacts of price volatility differ depending on the type of farm, the ownership and the age of the farmer. Young farmers and tenant farmers are likely to face specific challenges. Young farmers may be particularly vulnerable to price volatility, because they often lack the financial resources required as a buffer during periods of low prices. Difficulty in accessing credit is compounded by the difficulty that many young farmers face in securing land ownership.
65. The OECD outlined the challenge for young farmers, explaining that “what [they] would be particularly vulnerable to are the shocks where they do not have the financial reserves to deal with it”. They were consequently more likely to exit the market “if they enter at the wrong time and there is a sudden shock”.<sup>41</sup> Sir Peter Kendall, Chairman of the AHDB, agreed that young farmers were less resilient, as they might lack land ownership or reserves in the bank.<sup>42</sup>
66. According to Lynsey Martin from the National Federation of Young Farmers’ Clubs, access to finance is a major concern for young farmers when they have limited capital or a limited credit record: “Without a secure form of contract for whatever you are producing, whether it is arable or livestock, young farmers find it very difficult to get some sort of finance.”. She added that because few young farmers can entertain any prospect of land ownership in the current financial climate, innovative ways of farming, such as share farming or joint business ventures, could help them get into the industry.<sup>43</sup>
67. Other witnesses argued that young farmers had an advantage, because they were more capable of adapting to changing circumstances and possessed different and more contemporary skillsets, giving them resilience in the face of shocks. For instance, the European Commission’s Directorate General for Agriculture (DG AGRI) argued that young farmers were more educated and more open to new technologies than the rest of the farming community:
- “Young farmers tend to be better trained ... [The] latest research confirms that, indeed, young farmers are more eager than the rest to develop all entrepreneurial and managerial skills such as marketing, financial, communication, networking and management skills. These skills are essential to guarantee the long-term viability of their farms and cope with the economic challenges that [they] will face in the future.”<sup>44</sup>
68. The AHDB told us that young farmers could help older ones adapt to available technology:
- “The training that is now being given in agricultural colleges is equipping them to understand the markets as well as the technology that will play a fundamental part in our being competitive in the future.”<sup>45</sup>
- The Royal Agricultural Society of England agreed about the value of work done in the colleges, and added that there was an opportunity to work more

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41 [Q 61](#)

42 [Q 32](#)

43 [Q 24](#)

44 Written evidence from the European Commission’s Directorate General for Agriculture (DG AGRI) ([RPV0027](#))

45 [Q 32](#)

closely with young farmers' clubs, to turn them into a vehicle to help "upskill people coming into the industry".<sup>46</sup>

69. Some of the challenges facing tenant farmers are similar to those that young farmers grapple with, including access to finance and a lack of land ownership. Tenants have the additional burden of paying rent: Professor Wilson noted that higher prices tended to drive rents up, but told us that when prices moved to a downward path, some tenants would be paying relatively higher rents than was the case historically.<sup>47</sup>
70. George Dunn, from the Tenant Farmers Association, said that fixed rents and the expense involved in renegotiating tenancy contracts were a major concern for farmers operating in a volatile market. He added that, compared to farmers who own their land, tenant farmers were more constrained when trying to diversify by combining farming with other economic activities to develop resilience.<sup>48</sup>
71. Mr Dunn added that tenant farmers did not have access to the capital value of the land, and that this could become a problem when they needed to borrow to sustain themselves through a volatile period, particularly when prices were low.<sup>49</sup>
72. Mr Dunn also flagged up the length of tenancies as an issue:
- "For people who are on farm business tenancies—we call them the new style of tenancies, but they have been around ... since 1995—a big issue in managing volatility is that they are incredibly short in length. The average length of term is just over three years. In a volatile market, that gives you no time at all to have the ability to manage the highs with the lows."<sup>50</sup>
73. Oliver McEntyre, National Agriculture Strategy Director, Barclays Agriculture, identified short tenancies as a potential barrier to obtaining the credit needed to make long term investments:
- "If we have only a five-year tenancy or an eight-year tenancy, that is all we can look to lend money over. We will lend money into agriculture for 25 years, and even up to 30 in some instances, but if we have only an eight-year tenancy it is not very responsible to lend someone money over 15 years because, after eight years, that business could cease to exist."<sup>51</sup>

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46 [Q 32](#)

47 [Q 13](#)

48 [Q 24](#)

49 [Q 24](#)

50 [Q 24](#)

51 [Q 67](#)

**Table 1: Changes to farm tenancy agreements**

<b>Full Agricultural Tenancy</b>	<b>Farm Business Tenancy</b>
Legislation	
Agricultural Holdings Act 1986 (AHA 1986)	Agricultural Tenancies Act 1995 (ATA 1995)
Effective date of origin	
All new tenancies starting before 1 September 1995 and some starting after in accordance with the provisions of ATA 1995.	All new tenancies starting from 1 September 1995, bar exemptions set out in the Act
Security	
Normally lifetime of tenant. Tenancies starting before 12 July 1984 may have rights of succession.	Determined in the agreement with average now below 4 years in practice.
Notice	
Most notices to quit require tribunal consent, but the landlord has the ability, in specific circumstances to serve incontestable notices to quit for reasons including non-payment of rent, bad husbandry or death of the tenant. Notice to quit on death of tenant is stopped by an application for succession.	Tenancies of two years and less will come to an end automatically. Tenancies of more than two years must be ended by either party serving notice to quit corresponding with the termination date of the tenancy. The minimum notice period is 12 months. The agreement may also include a break clause for either side to terminate the tenancy early.
Rent reviews	
The landlord or tenant has the right to a rent review 3 years after either the start of a tenancy or a previous rent review. The act contains a “rent formula” which takes into consideration the earning capacity of the farm.	Landlords and tenants can negotiate their own rent levels and decide whether they want to have rent reviews. Any rent formula used must not preclude a reduction. In the absence of contractual provisions, either the landlord or the tenant can demand a rent review every 3 years.

Sources: *Tenant Farmers Association; UK Government*

74. There was, however, no consensus over whether volatility affected some farming sectors more than others. Ross Murray, President of the Country Land and Business Association (CLA), argued that all sectors were currently vulnerable to volatility, with no particular sector more affected than others. What would be more interesting, he argued, would be to differentiate between farms with good or bad management within sectors, farm types and tenure types.<sup>52</sup>
75. The NFU, on the other hand, saw differences across sectors, some of which related to the tools that different farm types had at their disposal to manage volatility. He suggested that the dairy and red meat sectors, for example, did

not have the options available to the pig and poultry sectors (such as feed price ratchets) or cereals (such as futures prices).<sup>53</sup>

76. Price volatility may also affect different regions to a different degree. In the case of the devolved administrations, Professor Wilson noted that such regional differences “come down to the farm types that are typically operating in those areas”. He added that there were still significant differences in the way the CAP was implemented in the different regions, potentially creating an uneven playing field. In Scotland, for example, some subsidies were still linked to production in the beef and sheep sectors, providing support which other sectors did not enjoy.<sup>54</sup>
77. **Various sub-groups of farmers experience volatility to different degrees and therefore require different strategies and support to strengthen their resilience. We recommend that the UK Government encourages tenant farmers seeking to diversify and strengthen their resilience. The UK Government and the devolved administrations should also investigate the impact of short-term tenancies on the ability of farmers to make necessary investments.**

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53 [Q 13](#)

54 [Q 15](#)

## CHAPTER 3: RESILIENCE AND THE COMMON AGRICULTURAL POLICY

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78. This chapter looks at how farmers have traditionally sought to improve their levels of resilience. We outline the current options available under the CAP and put these in the context of how the Policy has evolved.

### Types of risk facing farmers

79. Defra noted that farmers “face many risks manifesting as volatility in agricultural markets”, and that such risks differed in their probability and impact, implying different potential roles for the UK Government and farmers.<sup>55</sup>
80. According to the OECD different levels of intervention were required in different circumstances. Normal variations in production, prices and weather could be managed directly by farmers as part of their normal business strategy and did not require a specific policy response. At the other end of the spectrum, infrequent but catastrophic events affecting many farmers over a wide area, such as severe droughts or the outbreak and spread of a damaging disease, were usually beyond farmers’ and markets’ capacity to cope, and might mandate a government response. Finally, marketable risks lying between the normal and catastrophic, such as hail damage and some variations in market prices, could be handled through market tools or through cooperative arrangements among farmers.<sup>56</sup>
81. In addition, as has already been mentioned, climate change is expected to increasingly exacerbate the risk of weather shocks and changing production conditions in the agricultural sector. According to the European Commission, the EU farming sector will be in the frontline, coping with impacts such as changes in rainfall patterns and rising temperatures, as well as more frequent extreme weather events, including heatwaves, droughts, storms and floods.<sup>57</sup>

### Defining resilience

82. Witnesses agreed that resilience encompassed the capacity of the agricultural sector to withstand the impacts of price volatility and low prices, and the ability to maintain competitiveness. Ian Hodge, Professor of Rural Economy at the University of Cambridge noted that resilience relied:

“on a series of different types of capital: financial reserves that can be drawn on when incomes are low, levels of machinery and other assets that give capacity to cope with unfavourable production conditions, human capital that provides knowledge and skills to understand and address changing and unfamiliar circumstances, natural capital that provides ecosystems services in support of production, and social capital that provides access to social networks and support for information and sharing resources”.<sup>58</sup>

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55 Written evidence from Defra (RPV0009)

56 OECD, *Risk Management in Agriculture: What Role for Governments?* (November 2011). <https://www.oecd.org/agriculture/agricultural-policies/49003833.pdf> [accessed 5 May 2016]

57 European Commission, *EU Agriculture and Climate Change factsheet* (September 2015): [http://ec.europa.eu/agriculture/climate-change/factsheet\\_en.pdf](http://ec.europa.eu/agriculture/climate-change/factsheet_en.pdf) [accessed 5 May 2016]

58 Written evidence from Professor Ian Hodge (RPV0016)

83. Menter a Busnes, which implements Farming Connect, a Welsh advisory service for farming families and forestry businesses operated under the Welsh Rural Development Plan, stressed the link between resilience and competitiveness. It argued that both of these were associated with well-run businesses with improved levels of income and productivity, which were therefore better able to manage risk.<sup>59</sup>
84. According to Farm Europe, a think-tank focusing on EU rural economies, “A resilient agricultural sector is one which can respond to risk effectively and take steps to mitigate the wider effects of global price volatility.”<sup>60</sup>

### **The Common Agricultural Policy as a source of support**

85. EU countries’ agricultural sectors are regulated by the CAP, which to a large extent provides the policy framework within which farmers manage risk. DG AGRI told us that EU agricultural policy had shifted “from strong market management with high support prices towards a flexible system consisting of direct payments [including the Basic Payment Scheme] complemented by a market safety net”. This set it apart as a “comprehensive tool to meet the challenge of market volatility in the short, medium and long term”.<sup>61</sup>

### *The evolution of the Common Agricultural Policy*

86. The CAP is one of the oldest EU policies, having been launched in 1962 following the establishment of the European Economic Community. This necessitated transferring national state intervention—a prominent feature in the agricultural sectors of the founding member countries, but incompatible with the principle of free movement of goods—to the Community level.<sup>62</sup>
87. According to the European Commission, the policy was developed in the post-war years when agriculture in Western Europe had been crippled. It aimed to encourage better productivity in the food chain, thereby ensuring a fair standard of living for the agricultural community, stabilise the market and ensure the availability of food supplies to EU consumers at reasonable prices.<sup>63</sup>
88. At the point of its inception, the CAP offered high support prices to farmers, combined with border protection and export support to incentivise production. By the 1980s, however, the EU had permanent surpluses in many of the major farm commodities. The high budgetary cost of the measures and the distortion of some world markets led to the introduction of the milk quota in 1984, and a maximum ceiling for the CAP budget in 1988, as part of efforts to reform the policy without departing from its basic principles.<sup>64</sup>
89. The 1992 reform of the CAP started the shift from production support through market intervention (price support and border tariffs) towards what

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59 Written evidence from Menter a Busnes ([RPV0030](#))

60 Written evidence from Farm Europe ([RPV0015](#))

61 Written evidence from DG AGRI ([RPV0027](#))

62 European Parliament, *The common agricultural policy (CAP) and the Treaty, Fact Sheets on the European Union* (January 2016) [http://www.europarl.europa.eu/atyourservice/en/displayFtu.html?ftuId=FTU\\_5.2.1.html](http://www.europarl.europa.eu/atyourservice/en/displayFtu.html?ftuId=FTU_5.2.1.html) [accessed 5 May 2016]

63 European Commission, *The early years: establishment of the CAP* (22 April 2015): [http://ec.europa.eu/agriculture/cap-history/early-years/index\\_en.htm#](http://ec.europa.eu/agriculture/cap-history/early-years/index_en.htm#) [accessed 5 May 2016]

64 European Commission, *The crisis years II: the 1980s* (22 April 2015): [http://ec.europa.eu/agriculture/cap-history/crisis-years-1980s/index\\_en.htm](http://ec.europa.eu/agriculture/cap-history/crisis-years-1980s/index_en.htm) [accessed 5 May 2016]

has become seen as income support. It introduced Direct Payments<sup>65</sup> to farmers to compensate for the cut in price support.<sup>66</sup> Subsequent reforms further de-coupled support payments from production, increased market orientation and included environmental requirements and reinforced support for rural development.<sup>67</sup>

90. The latest round of reform, covering the period 2014–2020, has continued along the same path, introducing the ‘green payment’ as a new policy instrument. This subjects 30% of Member State total Direct Payments to environmentally beneficial greening practices, such as the maintenance of permanent grassland, ecological focus areas and crop diversification.<sup>68</sup>

#### *Increased market exposure*

91. The evidence strongly suggested that the developments in the CAP from supporting production by intervention in markets towards providing direct forms of income support had exposed EU farmers to the dynamics of global agricultural commodity markets.
92. According to Defra, “the intensity of market intervention has declined significantly as a result of CAP reform” since the early 1990s, leaving EU markets more open to respond to fluctuations of supply and demand”.<sup>69</sup>
93. The AHDB told us that this greater exposure to global volatility presented increased challenges to farmers:

“De-regulation of the EU Agricultural markets has meant that farmers have to now actively manage their own price risk ... Clearly this is a huge challenge for the industry, which requires a broader and new set of management skills, beyond the traditional physical skills.”<sup>70</sup>

94. **Changes to the framework of the CAP have resulted in a greater exposure of production decisions to market forces. Direct Payments, however, provide income support which maintains a degree of financial stability for some farmers.**

#### *Market management tools*

95. Despite the decline in market intervention, Defra pointed out that the EU still retained a number of market management tools, including intervention buying, emergency powers to address “serious market disturbance”, a crisis reserve, and a facility for export subsidies.<sup>71</sup>

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65 Direct payments now comprise the Basic Payment Scheme, the Green Payment, the Small Farmers’ Scheme and the Voluntary Coupled Scheme. The term “Direct Payments” is used in this report to refer to this suite of schemes and those that preceded them (the Single Farm Payment).

66 European Commission, *The 1992 reform (“MacSharry reform”)* (22 April 2015): [http://ec.europa.eu/agriculture/cap-history/1992-reform/index\\_en.htm](http://ec.europa.eu/agriculture/cap-history/1992-reform/index_en.htm) [accessed 5 May 2016]

67 European Commission, *Overview of CAP Reform 2014–2020, Agricultural Policy Perspectives Brief, No* (5 December 2013): [http://ec.europa.eu/agriculture/policy-perspectives/policy-briefs/05\\_en.pdf](http://ec.europa.eu/agriculture/policy-perspectives/policy-briefs/05_en.pdf) [accessed 5 May 2016]

68 European Commission, *Overview of CAP Reform 2014–2020, Agricultural Policy Perspectives Brief, No* (5 December 2013): [http://ec.europa.eu/agriculture/policy-perspectives/policy-briefs/05\\_en.pdf](http://ec.europa.eu/agriculture/policy-perspectives/policy-briefs/05_en.pdf) [accessed 5 May 2016]

69 Written evidence from Defra (RPV0009)

70 Written evidence from AHDB (RPV0020)

71 Written evidence from Defra (RPV0009)

96. As an example of an emergency measure, DG AGRI noted a temporary exceptional aid to milk producers in the Baltic countries and Finland which it introduced in the wake of the August 2014 Russian import embargo on most EU agricultural products.<sup>72</sup>
97. Defra also pointed to the €500 million package of measures announced by the Commission in September 2015, to “support European farmers after a prolonged period of low prices”.<sup>73</sup> The largest part of the package consisted of targeted aid for all Member States to support the dairy sector. Additionally it advanced certain Rural Development payments and included plans to address market imbalance, including the extension of private storage aid.<sup>74</sup>
98. According to DG AGRI, market measures are now deployed only as a last resort, at times when market conditions become adverse and prices collapse: “Thus the policy has gradually shifted from the concept of a safety net based on targeting price signals towards one targeting farm income, and the recent measures in support of the dairy sector reflect this.”<sup>75</sup>
99. It also stressed that a policy delivered through price support, as was previously the practice in the EU, would lead to a vicious cycle: such support effectively increases prices, providing incentives for overproduction, which again leads to collapsing prices, and eventually to demands for volume controls. It concluded: “This recipe may temporarily work for small or isolated countries, but it fails to stabilise income in more open economies.”<sup>76</sup>
100. **The shift in the CAP towards income support and greening is likely to continue. Future policy decisions must focus on addressing the outcomes of price volatility and periods of prolonged low prices and help farmers to develop resilience mechanisms rather than controlling prices.**
101. **While we note the Commission’s ambition to simplify the CAP, the focus must be on reducing complexity for the farmers who use it.**

*The 2015 aid package*

102. The Welsh and Northern Irish administrations welcomed the September 2015 package but argued that much more needed to be done to address the acute situation in the dairy sector. According to the Welsh Government, “EU Aid packages of this type do help but they are by no means the panacea.”<sup>77</sup> The Northern Ireland Assembly Committee for Agriculture and Rural Development agreed that “much more is needed to assist farmers with the cash-flow difficulties they are experiencing [following a] sustained and sharp drop in milk prices”.<sup>78</sup>
103. There was, though, a difference of view over the usefulness of such emergency responses. The Welsh Government argued: “The dairy sector faces many challenges and a one-off relatively modest payment will only have a limited

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72 Written evidence from DG AGRI (RPV0027)

73 Written evidence from Defra (RPV0009)

74 European Commission, *Annex: Comprehensive package of measures, Fact Sheet* (7 September 2015): [http://europa.eu/rapid/press-release\\_MEMO-15-5601\\_en.htm](http://europa.eu/rapid/press-release_MEMO-15-5601_en.htm) [accessed 5 May 2016]

75 Written evidence from DG AGRI (RPV0027)

76 Written evidence from DG AGRI (RPV0027)

77 Written evidence from the Welsh Government (RPV0010)

78 Written evidence from Northern Ireland Assembly Committee for Agriculture and Rural Development (RPV0002)

impact and could well entrench further attitudes within the industry that the Government will ‘bail us out.’” Instead, the focus should be on helping farm businesses and the industry become stronger so that they can cope with such challenges without government intervention.<sup>79</sup>

104. By contrast, the Northern Ireland Assembly Committee for Agriculture and Rural Development stated that farmers “need immediate assistance now or they will go out of business”. It added that the actions geared towards stabilising markets and addressing the functioning of the supply chain were focused on aiding recovery in the medium to long term.<sup>80</sup>
105. George Eustice MP, Minister for Farming, Food and Marine Environment, also noted that Member States could use the CAP’s Rural Development funding to “help farmers get back on their feet” after a natural disaster. This provision allowed Member States to grant farmers aid to restore agricultural production potential damaged by natural disasters, adverse climatic and other catastrophic events and to invest in preventive measures.<sup>81</sup> The Minister told us that the UK Government used the funding to support farmers after floods in the Somerset Levels in 2014.<sup>82</sup>
106. **One-off support packages can help to counter the impact of extreme natural disasters or catastrophic events that are beyond individual farmers’ control. Policy should, however, focus on building the sector’s resilience in the longer term.**
107. **We recommend that the UK Government clearly articulate the specific circumstances under which it will seek to access EU funding to provide emergency aid for farmers in the wake of an extreme natural disaster or a catastrophic event.**

#### *The Risk Management Toolkit*

108. The latest round of CAP reform also introduced a new Risk Management Toolkit, which allows Member States to use Pillar 2<sup>83</sup> funding for Rural Development to finance three different types of risk management instruments:
  - (a) financial contributions to premiums for crop, animal and plant insurance against economic losses to farmers caused by adverse climatic events, animal or plant diseases, pest infestation, or an environmental incident;
  - (b) contributions to mutual funds to pay financial compensation to farmers, for losses caused by adverse climatic events or by the outbreak of an animal or plant disease or pest infestation or an environmental incident;

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79 Written evidence from the Welsh Government ([RPV0010](#))

80 Written evidence from Northern Ireland Assembly Committee for Agriculture and Rural Development ([RPV0002](#))

81 Regulation of the European Parliament and of the Council of 17 December 2013 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD) and repealing Council Regulation (EC) No 1698/2005, Regulation ([EU No 1305/2013](#))

82 Regulation of the European Parliament and of the Council of 17 December 2013 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD) and repealing Council Regulation (EC) No 1698/2005, Regulation ([EU No 1305/2013](#))

83 Pillar 2 refers to rural development policy, while Pillar 1 encompasses product and producer support. Pillar 1 is funded solely from the EU budget, while Pillar 2 is based on multi-annual programmes that require co-financing from Member States.

(c) an income stabilisation tool, in the form of financial contributions to mutual funds, providing compensation to farmers for a severe drop in their income.<sup>84</sup>

109. Some witnesses pointed out that the new risk management options under the CAP had so far not been very popular among Member States. According to DG AGRI, the uptake of the EU risk management tools in the programming period 2014–2020 had been “rather limited”. They told us that in some cases, Member States’ reluctance to include such instruments in their Rural Development Programmes (RDPs) appeared to be caused by a “cultural shift to more sector involvement in managing risks”.<sup>85</sup>

110. Defra added that some Member States had preferred to use national funds under the EU’s state aid rules to provide support for insurance, and were concerned about the potential expense of the income stabilisation tool in comparison with the size of their RDPs.<sup>86</sup>

#### *Increasing farmers’ responsibility*

111. According to DG AGRI, these new options encouraged farmers to “share responsibility in managing specific on-farm risks”.<sup>87</sup> Indeed, some witnesses argued that farmers should take on greater responsibility for managing risk. The OECD said that producers were best placed to manage day-to-day business risks, while the EU and governments should target support towards more extreme, catastrophic risks.<sup>88</sup>

112. The NFU agreed that individual farmers should contribute to their own risk management, for example, by undertaking benchmarking comparisons of their costs with comparable businesses, or by considering ways to buy and sell inputs and outputs. It added:

“Farmers should have access to a range of measures to help them to manage volatility. These measures should be accessible and easily understood. There is a role for government to ensure this is the case.”<sup>89</sup>

113. DG AGRI noted that risks that were specific to certain countries or regions should be left to Member States to manage, including weather and diseases:

“How to address risk at the EU level should depend on the type of risk that is EU-wide, such as market risks (linked to the Common Market, with its internal and external dimensions) or broader environmental risks (with the best example being the impact from climate change).”<sup>90</sup>

We return to this issue in Chapter 7.

#### **The role of Direct Payments**

114. Direct Payments under Pillar 1 of the CAP provide a major source of income to some farmers. The evidence suggested that this income, while protecting these farmers during periods of low prices, could undermine the industry’s competitiveness and resilience in the longer term.

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84 Regulation of the European Parliament and of the Council of 17 December 2013 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD) and repealing Council Regulation (EC) No 1698/2005, [Regulation \(EU\) No 1305/2013](#)

85 Written evidence from DG AGRI ([RPV0027](#))

86 Written evidence from Defra ([RPV0009](#))

87 Written evidence from DG AGRI ([RPV0027](#))

88 [Q 62](#)

89 Written evidence from the National Farmers’ Union (NFU) ([RPV0024](#))

90 Written evidence from DG AGRI ([RPV0027](#))

*Direct Payments as a risk management tool*

115. The NFU argued that Direct Payments provided an “effective risk management function”, complementing measures such as intervention and private storage aid. It also expressed concern that developing alternative risk management tools financed by the CAP would reduce the Direct Payments budget, consequently undermining the existing policy.
116. The AHDB said that Direct Payments were likely to contribute to resilience, but it highlighted the need for farmers to acquire the skills and tools needed in the market. It argued that the payments provided “passive volatility management”, while options such as insurance schemes could be used to manage volatility more actively.<sup>91</sup>
117. DG AGRI also noted that the switch towards Direct Payments allowed a “clear transmission of market signals”, which it said was a key element for the competitiveness of the agricultural sector.<sup>92</sup>

*Direct Payments stifling innovation*

118. Some witnesses, on the other hand, told us that Direct Payments reduced incentives to innovate and might artificially keep ineffective or unproductive farmers in business.
119. The Welsh Government noted that while income support provided a safety net for farm businesses, it might also be the reason why farm businesses “innovate and embrace change more slowly than they might otherwise do”—such a direct subsidy might stop individual businesses and the wider industry from addressing current challenges and realising a long term vision.<sup>93</sup>
120. Nick Tapp, a farmer, agreed that the current policy was delaying the pace of change to meet new demands from the marketplace, “with the result that inefficiency is rewarded, and technical innovation can be ignored”.<sup>94</sup>
121. Professor Ian Hodge noted the important role of shocks in bringing about changes in the agricultural sector:

“When there are major shocks or stresses, as has occurred periodically in the past, it may require more radical changes in agricultural systems and structures that the existing population of farmers or the current structure of farm businesses is unwilling or unable to deliver. The restriction on this more radical adjustment option might have a substantial opportunity cost to society in preventing a shift towards more socially valuable enterprises or techniques.”<sup>95</sup>

He added that some businesses might resist changes “that could be beneficial at a more aggregate level” if they were committed to a particular production type or technology:

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91 Written evidence from AHDB ([RPV0020](#))

92 Written evidence from DG AGRI ([RPV0027](#))

93 Written evidence from the Welsh Government ([RPV0010](#))

94 Written evidence from Nick Tapp ([RPV0005](#))

95 Written evidence from Professor Ian Hodge ([RPV0016](#))

“In this context, the only way in which the industry can change more radically would be through a change in the population of businesses, some leaving the industry and new ones joining.”<sup>96</sup>

122. We also heard evidence suggesting that sectors that did not benefit from Direct Payments might be better prepared to operate in competitive markets. Barclays Agriculture and Allan Wilkinson, Head of Agriculture and Food at HSBC, noted that the pig and poultry sectors, along with the horticulture sector, were ahead of other sectors in terms of having the business knowledge and recording systems to understand their production costs.<sup>97</sup> It is certainly the case that Direct Payments offer farmers a guaranteed income regardless of their actions to improve resilience.
123. Rural Business Research noted that the Direct Payment accounted for 56.4%, or £22,400, of the Farm Business Income (FBI) that English farmers achieved on average for the 2014/15 financial year. Only 5.3% (£2,100) was generated from agriculture and 23.4% (£9,300) from diversification, according to data from the English Farm Business Survey.<sup>98</sup> It should be noted, however, that the Farm Business Survey only covers farms deemed to be ‘commercial’ and excludes the smaller businesses that make up half of UK farms<sup>99</sup>. In addition, while FBI can be equated with financial net profit, it is calculated using differing methods.<sup>100</sup>
124. **Direct Payments provide farmers with important income support to withstand protracted periods of low prices. They can, however, reduce incentives for innovation and efficiency gains and hold back much needed structural change.**
125. In the long term Direct Payments have a crucial role in supporting the provision of public goods. This is discussed in the context of the future shape of the CAP in Chapter 7.

### Voluntary co-operation and diversification

126. Within the framework of the CAP, farmers have traditionally adopted strategies actively to increase the viability of their businesses, including through voluntary co-operation and diversification.
127. Sir John Marsh noted that farmers could co-operate among themselves, or with major customers or suppliers in the form of vertical coordination, potentially leading to vertical integration.<sup>101</sup> Similarly, Menter a Busnes argued that farmers’ competitiveness could be increased by measures such as collaborative buying of inputs, which could have a significant impact on income. It added that cooperation could increase the negotiating power of farmers, who were traditionally perceived as price-takers whose production decisions did not affect the market price.<sup>102</sup>

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96 Written evidence from Professor Ian Hodge (RPV0016)

97 Q 72

98 Written evidence from Rural Business Research (RPV0008)

99 Farm Business Survey, ‘User Guide’: <http://farmbusinesssurvey.co.uk/DataBuilder/Default.aspx?module=UGRepresentation> [accessed 5 May 2016]

100 Farm Business Survey, ‘User Guide’: <http://farmbusinesssurvey.co.uk/DataBuilder/Default.aspx?module=UGCostCentresAllocationTo> [accessed 5 May 2016]

101 Written evidence from Sir John Marsh (RPV0006)

102 Written evidence from Menter a Busnes (RPV0030)

128. The evidence suggested that other common risk management strategies employed by farmers include informal “self-insurance” through saving and borrowing,<sup>103</sup> and increasing storage capacity to allow flexibility in deciding when to sell commodities.<sup>104</sup>
129. Farmers have also sought to reduce their exposure to risk through their choice and mix of farming enterprises (choosing combinations that contrast in ways such as vulnerability to weather shocks), by maintaining a degree of production flexibility, and by diversification. On-farm diversification involves farmers undertaking other income-generating farm activities, such as tourism and farm based retailing. In contrast, off-farm diversification involves farmers or other members of their families diversifying their incomes by taking up employment or business opportunities outside the farm.
130. Rural Business Research, a research consortium led by the University of Nottingham, noted:
- “Although farms have typically become more specialised over time with respect to their agricultural activities, farmers have also engaged with additional income generating activities, including diversifying their business activities drawing on a range of farm and non-farm resources (including value-added to farm produce via on-farm retail, recreation activities drawing on land resources, accommodation provision, including tourism and agricultural contracting).”<sup>105</sup>
131. They added that renewable energy generation, using technologies such as solar, wind and anaerobic digestion, had more recently become a key on-farm diversification activity. Nevertheless, investment requirements and planning controls were significant barriers to large-scale renewable energy projects.<sup>106</sup>
132. Professor Morgan noted that the diversification of production helped farmers spread the risk by producing many different commodities rather than just having a monoculture.<sup>107</sup> The All-Party Parliamentary Group on Agroecology for Sustainable Food and Farming agreed: “The diversification of outputs means that a fall in the price of one agricultural commodity will have less overall effect on the farm business.”<sup>108</sup>
133. Some witnesses noted, though, that there was a trade-off between efficiency gained through specialisation and improved resilience from diversification. According to Menter a Busnes increased competitiveness and efficiency through specialisation could increase exposure to risk, as income became ‘less diversified’.<sup>109</sup>
134. The Irish agriculture and food development authority, Teagasc, agreed that the downside of product diversification was that it was “likely to lead to a less efficient and productive agri-food sector as research has shown that more

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103 Written evidence from Defra ([RPV0009](#))

104 Written evidence from Professor Lloyd, Professor McCorriston, and Professor Morgan ; Written evidence from Professor Ian Hodge ([RPV0016](#))

105 Written evidence from Rural Business Research ([RPV0008](#))

106 Written evidence from Rural Business Research ([RPV0008](#))

107 [Q 11](#)

108 Written evidence from the All-Party Parliamentary Group on Agroecology for Sustainable Food and Farming ([RPV0031](#))

109 Written evidence from Menter a Busnes ([RPV0030](#))

specialised farmers are more efficient”. They added that farmers seeking to control fluctuations in their total household income by taking up off-farm employment could also inadvertently reduce the efficiency of their farms.<sup>110</sup>

135. Mr Dunn, from the Tenant Farmers Association, pointed out that tenant farmers did not always have the option of diversifying beyond agricultural activities, because their tenancy agreements required them to be farmers with landlords reluctant to grant consent for it.<sup>111</sup>
136. The NFU noted that product differentiation and adding value to products were yet another way to mitigate the impact of risk, such as the production of organic milk, but they “may not suit every business and sector”.<sup>112</sup>
137. Farmers also have access to a growing number of market based instruments to manage price volatility. These are discussed in more detail in Chapter 5.

### Supporting farmers to exit the sector

138. In view of the relatively large size of public subsidy compared with overall income, there is a risk that this support may be keeping less progressive farmers in business at the expense of new entrants. This suggests that there could be a case for government intervention to help farmers struggling to cope to retire, allowing new entrants in.
139. The Minister told us that Defra had no plans to encourage farmers to retire proactively, but it had started to consider ways to help farmers minded to do so:

“We have had some discussions on whether you could have mechanisms that enable people to retire with dignity, as it were, and maybe stay on the farm but make it possible to allow a new property to be built for a new farmer coming in and taking it on. We are keen to encourage such things as contract farming and shared farming agreements, which offer an opportunity for somebody to step back from the day-to-day running of the business while keeping an interest in it and staying in their home. We are seeing the development of some models that enable this transfer to take place.”<sup>113</sup>

140. **We recommend that the UK Government works to identify the main barriers preventing farmers from exiting the sector and investigate ways to overcome these barriers. They should consider how Rural Development funding can be used to accelerate structural change and create opportunities for new entrants into farming.**

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110 Written evidence from the Irish Food Development Authority Teagasc ([RPV0013](#))

111 [Q 24](#)

112 Written evidence from the NFU ([RPV0024](#))

113 [Q 80](#)

## CHAPTER 4: INTERNATIONAL MODELS

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### The Common Agricultural Policy in context

141. Despite the fact that the EU trades in agricultural commodities in a globalised context, the structure of the CAP is unique to the EU. Witnesses told us about alternative approaches internationally to promoting resilience in the face of price volatility and extended periods of low returns. We had sought to identify the strengths and weaknesses of such approaches in an attempt to inform the discussion before the next round of CAP reforms.
142. The majority of the evidence focused on New Zealand, the United States of America and Canada. Before making direct comparisons, it is important to acknowledge the marked differences between European agriculture and agriculture elsewhere. In Europe, agricultural land and rural communities tend to be found in close geographic proximity, and sometimes in areas of natural beauty, ecological or cultural significance. As a consequence, the CAP seeks to support a range of public goods simultaneously. In the US, on the other hand, vast farms operate largely unhindered by requirements to conserve environmental features: the scale and organisation of agriculture in the US mean that it can be separated from other societal operations. The varying public policy tools that support agriculture in the EU and its international counterparts reflect these underlying differences.

### New Zealand

143. The New Zealand model presents a radical alternative to the CAP. The High Commissioner, gave a compelling explanation of how in 1985, a range of agricultural subsidies were abolished overnight:

“I remember that there was no warning—it was just boompf. There were dozens and dozens of support systems, be it from the direct subsidy payments and supplementary minimum payments, through fertiliser subsidies to incentives to develop land—you name it, there must have been 30 or 40 different subsidies just wiped.”<sup>114</sup>

144. The High Commissioner argued that, ultimately, this change brought about greater efficiencies and enhanced innovation in New Zealand’s agricultural sector. He told us that in the past, “farmers farmed for subsidies” and spoke of the enormous efficiencies brought about within the sheep industry when subsidies were removed in the mid-1980s.<sup>115</sup>
145. At the same time, he told us that a relatively small number of farmers had left the industry as a result of the changes:

“It is simply the normal action of business that, when you face the prospect of going out of business, you make operation more efficient, and it is extraordinary how farmers in New Zealand have made their operations more efficient. Some went out of business. We had 80,000 farmers in New Zealand in the early 1980s, and 1% of them went out of business when the subsidies were wiped in 1985.”<sup>116</sup>

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114 [Q 56](#)

115 [Q 54](#)

116 [Q 54](#)

He went on to explain that the New Zealand Government had provided one-off exit packages and some financial advice to farmers to help with the transition.

146. Although there was a general consensus among witnesses that a gradual move in the EU away from public support was appropriate, there were doubts over the wisdom of such a radical and sharp change in policy as occurred in New Zealand. Moreover, additional steps would have to be taken if such an approach were to be replicated in the EU. Phillip Bicknell, of the NFU, argued: “My understanding of New Zealand and the impact there was that that was also accompanied by a devaluing of the currency, which helped them compete on export markets.”<sup>117</sup> The Minister also mentioned the sharp depreciation in the New Zealand dollar that had helped them price themselves back into world markets, and also touched on further adjustments:

“In some areas, New Zealand also has a different approach from us on issues such as animal welfare. We have higher regulatory standards ... We would want to try to safeguard that. We have a manifesto commitment to ensure that in the next round of CAP reform there is greater prominence given to issues such as animal welfare. It would not be quite as simple, in my view, as just following what New Zealand did, but that is not to say that there are not important lessons we could learn.”<sup>118</sup>

147. Though such a radical change in policy is unlikely to be adopted in the EU, one particular aspect of New Zealand policy may merit further attention. New Zealand operates an Income Equalisation Scheme designed to address farmers’ income variability. The scheme allows farmers to deposit income from farming for up to five years with the Inland Revenue, where it earns interest. The deposits themselves are tax deductible.<sup>119</sup> According to the New Zealand High Commissioner, the mechanism allowed farmers to cope with volatility by depositing in a good year and withdrawing in a low income year to spread their income and reduce their tax liability. He had himself used the scheme in the past<sup>120</sup>.
148. Australia has a similar scheme called farm management deposits (FMD), which allows producers in years of high return to deposit money into a tax-free savings account held by a private financial institution. Australia also has five-year income tax averaging.<sup>121</sup>

### The United States of America

149. The United States Department of Agriculture (USDA) explained that agricultural policy in the US was governed by the Farm Bill, an omnibus legislative package. It told us that the 2014 Farm Bill amended previous agricultural and related policies and established new policies on a 5-year cycle:

“The 2014 farm bill debate took place in a period of high farm prices and record farm incomes, and centered on the replacement of fixed decoupled payments that went to farmers regardless of market conditions.

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117 [Q 16](#)

118 [Q 80](#)

119 New Zealand Inland Revenue, *Income equalisation scheme*: <http://www.ird.govt.nz/business-income-tax/income-equalisation/income-equalisation-index.html> [accessed 5 May 2016]

120 [Q 53](#)

121 [Q 56](#) (Dr Jared Greenville)

A key element of the ... debate was how to target commodity programs to provide a safety-net in time of unexpected distress and better help farmers manage risk.”<sup>122</sup>

150. One particular public policy tool arose time and time again in discussions about the American approach to supporting agriculture: insurance. As the US removed direct support, it began to support commodities through subsidised insurance schemes.
151. The USDA outlined the main benefits of government-backed insurance schemes. First, they told us that the schemes were a positive substitute for *ad hoc* disaster assistance because producers gained a direct role in managing their risks and participated in pooling risk with other producers, by providing net contributions in good years to offset losses in bad years. Second, they told us that from a budgetary perspective, the cost of a crop insurance programme was more predictable, because producers received indemnity payments in a timely manner when funds were most needed rather than having to wait for the processing of *ad hoc* disaster payments.<sup>123</sup>
152. The USDA was cautious about recommending such a scheme to the EU. The insurance market for agriculture in the EU is underdeveloped, and the evidence suggests that were the EU to move towards an insurance based model, premiums would probably need to be subsidised, as is the practice in the US. The Minister questioned whether the level of premiums would be affordable for farmers drawing on insurance schemes on a regular basis:

“Sometimes the difficulty is in insuring risks where there are regular calls on that insurance. Farming is famously a very risky thing to do because none of us can control the weather, and crops are particularly exposed. Sometimes, the cost that an insurance company will put on underwriting that risk is very high.”<sup>124</sup>

153. The Minister also questioned whether such a method of insurance would be best offered by the private or public sector and expressed caution about the complexity of the US model:

“The big argument against what they are doing in the US is that it is incredibly bureaucratic and administrative. We are in the business of trying to get away from an incredibly bureaucratic and heavily administrative CAP in Europe. We would like to move to something simpler and more logical.”<sup>125</sup>

154. DG AGRI explained that the two models were not directly comparable, and reflected significant institutional, budgetary and structural differences:

“US agriculture is characterized by a legislative process whereby the representation of farm interests in one legislative body is disproportionate to demographic reality, no budgetary constraint exists on farm policy implementation, and the agricultural sector is essentially supply-driven, relying on land abundance and on primarily bulk commodity production. It is thus rather simplistic, naive and deceiving to consider that such a comparison could be useful for EU agriculture.”

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122 Written evidence from the United States Department of Agriculture ([RPV0032](#))

123 Written evidence from the United States Department of Agriculture ([RPV0032](#))

124 [Q 77](#)

125 [Q 77](#)

155. It added that another difference was that over 90% of US payments to risk management schemes went to just three crops—maize, wheat and soybeans.<sup>126</sup>

### Canada

156. Under the Canadian Growing Forward 2 (2013–2018) policy initiative, a suite of programmes is in place to enable farmers to cope with variations in income over time and improve their resilience, collectively known as the Business Risk Management (BRM) tools<sup>127</sup>. These comprise:
- AgriStability—a margin-based programme that provides income support to an individual (or business entity) who declares agricultural income for tax purposes when that producer experiences substantial falls in earnings;
  - AgriInvest—savings accounts for producers that provide flexible coverage for small income declines and support investments that help mitigate risks or improve market income;
  - AgriInsurance—which provides producers with cost-shared insurance for natural hazards in order to minimize the financial implications of production and/or asset losses;
  - AgriRecovery—a framework (rather than a single programme) that guides how federal-provincial-territorial governments work together to assess the impacts of disasters on Canada’s agricultural producers and respond with timely, targeted initiatives where there is need for assistance beyond ongoing programming.
157. The similarities between AgriInvest and the New Zealand Income Equalisation scheme are significant. The AgriInvest account builds as a farmer makes annual deposits based on a percentage of his Allowable Net Sales (ANS) and receives matching contributions from federal, provincial, and territorial governments. Since 2013, farmers have been able to deposit up to 100% of their ANS annually, with the first 1% matched by governments. The limit on matching government contributions is \$15,000 CAD per year. The financial institution notifies Agriculture and Agri-Food Canada once a deposit has been made and the matching government contribution is credited to the account. This approach supports farmers who invest and take responsible long term decisions.
158. The Minister, George Eustice MP, praised the simplicity of the Canadian AgriStability scheme:
- “The US has one, which is very complex and looks at different incomes, state by state, crop by crop. It makes it a very difficult scheme to manage administratively. Most people would agree that the Canadian model is probably the simplest, where they simply target a sharp fall in farm incomes and basically take that as a proxy for something going wrong in the sector, either with price or indeed with crops ... I think the Canadian model is the closest we have got to an insurance scheme that works, just because of the complexity of the US model.”<sup>128</sup>

126 Written evidence from DG AGRI (RPV0027)

127 Agriculture and Agri-Food Canada, *List of Programs and Services* (5 April 2016): <http://www.agr.gc.ca/eng/programs-and-services/list-of-programs-and-services/?id=1362151577626> [accessed 5 May 2016]

128 Q 77

He went on to say that the EU might be able to learn lessons from the Canadian model in the next round of CAP reform, and could even design a system that was simpler still.

159. **There are fundamental differences between the organisation and structure of the EU agriculture sector and those in Canada, New Zealand and the US, especially with regard to scale and amenity and environmental use of land. These differences render the models used by these countries unsuitable for general application in the EU at the present time.**
160. **Even though the Canadian and US experiences have rather different contexts, lessons can be learned on where and how subsidised insurance and disaster compensation may be applied.**
161. **We recommend that the Commission and the UK Government undertake a structured review of public investment deposit schemes in other countries, with a view to identifying approaches that would work in the EU. This would give farmers a secure and guaranteed option to save in times of plenty and withdraw in times of need.**

## CHAPTER 5: ACCESS TO FINANCE AND FINANCIAL INSTRUMENTS

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162. Access to finance plays a crucial role in farmers' ability to withstand shocks and improve their levels of resilience. The previous chapter considered financial tools being used elsewhere in the world. This chapter brings together evidence on the current availability of financial products in the EU as well as options for the future.

### Access to finance

163. The evidence suggested that while access to finance was not a major problem for most farmers at the moment, certain groups, particularly those without land ownership, were experiencing specific problems. In particular, we were told that a lack of financial instruments to help farmers manage volatility might hamper their ability to make long-term investments.

164. The AHDB argued that banks “appear to be fairly keen to lend to farmers that own their land as debt to asset ratios look generally favourable”, but noted that farmers with limited assets, such as tenant or contract farmers, struggled more with securing finance and coping with the impact of volatility:

“This is important as anecdotally, the businesses / individuals that farm the land are becoming increasingly detached from land ownership. With this in mind, lending longer-term into agriculture could be more challenging and less informal than, say, overdrafts. This may well challenge the industry to think how commercial finance to agriculture works and how it flexes around the commodity cycle.”<sup>129</sup>

165. We also heard from commercial banks of some of the challenges facing agricultural banking, from high capital costs to a lack of business skills by loan applicants. Barclays Agriculture told us that “the very high capital cost compared with the quite thin margins, especially at the moment with possibly no margins”, pose difficulties in agricultural banking. They also noted challenges in lending to tenant farmers with increasingly short tenancies restricting the period over which money could be lent.<sup>130</sup> HSBC added, though, that landlords could provide a source of support and capital to help make projects viable.<sup>131</sup> Both Barclays Agriculture and HSBC noted the paramount importance of farmers having the skills to put together a credible business plan.<sup>132</sup>

### Market-based solutions

166. Farmers wishing to mitigate price risk have at their disposal a number of market-based solutions, including forward contracts, futures markets, swaps and options, and similar over-the-counter products. According to Defra, farmers have used such tools for a long time in the United States, where agricultural commodity prices fluctuate widely. They noted that in Europe, in contrast, many farmers were unaccustomed to such hedging instruments, because the CAP had historically supported prices and provided substantial subsidies.<sup>133</sup>

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129 Written evidence from AHDB ([RPV0020](#))

130 [Q 67](#)

131 [Q 67](#)

132 [Q 67](#)

133 Written evidence from Defra ([RPV0009](#))

167. The evidence suggested that the uptake of such instruments varied widely, depending on farm type and other factors such as size, skills and attitude to risk. Futures markets, for example, have been confined to a limited number of sectors, while economically better performing farms are better able make use of such instruments.

#### *Futures markets*

168. The AHDB told us that futures markets were already well established in cereals and oilseeds, but that the characteristics of other commodities, such as their scale and perishability, presented challenges.<sup>134</sup> The NFU confirmed that market based instruments such as futures worked well in the cereals sector, because the product could be stored and shipped globally, and because there were enough buyers and sellers.
169. The evidence suggested, however, that there may be potential to develop similar markets in sectors identified as more challenging, such as dairy, with public support.
170. Dairy UK, the trade association for the dairy supply chain, noted that a developed futures market for dairy would enable some farmers to manage price risk by fixing some or all of their income in advance, and that by using the market in conjunction with forward contracts covering farm inputs, such as wheat, dairy farmers would be able to fix their margins.
171. The Minister, George Eustice MP, noted that Defra had set up a team to explore how the UK Government could help to develop a futures market for the dairy sector. The plan was to model it on the Chicago cash-settled market for dairy products: “London is the world’s financial centre and we do lots of futures and commodities already. It would be the right place to have such a market”.<sup>135</sup>
172. **The UK Government’s efforts to explore how a futures market for dairy could be established in the UK is a positive step and there may be scope to expand this exploration of futures markets to other commodities in the future.**

#### *Insurance schemes*

173. Many witnesses displayed an interest in government-supported insurance schemes to assist farmers in managing farm risk, as an alternative to the current approach to public support. Such schemes, as we have noted in Chapter 4, are used extensively in the US and Canada.
174. Defra warned that “genuine insurance schemes” should be differentiated from payments to producers in times of “adverse” market conditions. They told us that a distinction should be drawn between ‘counter-cyclical’ payments triggered by changes in incomes, administered by government and funded by taxpayers, and insurance relating to a single or multiple risks, provided by the private sector with farmers contributing in the form of premiums.<sup>136</sup>

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134 Written evidence from AHDB ([RPV0020](#))

135 [Q 76](#)

136 Supplementary evidence from Defra ([RPV0034](#))

*Insurance under the Common Agricultural Policy*

175. There has been a move towards offering public support for insurance schemes in the EU in recent years. The latest reform of the CAP offered Member States the possibility to use Rural Development funds for financial contributions to insurance premiums, covering losses caused by adverse climatic events, animal or plant diseases, pest infestation, or an environmental incident. Other options under the new Risk Management Toolkit included contributions either to mutual funds dealing with the same range of events, or to mutual funds dealing with a severe drop in farm incomes (the Income Stabilisation Tool) (see Chapter 3).
176. Defra noted that this toolkit was designed to comply with WTO rules, allowing the insurance and mutual fund products to cover only losses greater than 30% of production or income.<sup>137</sup>
177. Nevertheless, EU Member States have so far made little use of the risk management options available. DG AGRI noted that only 12 out of 28 Member States had programmed the whole or part of the toolkit in their Rural Development Programmes (RDPs). A large part of this total public expenditure of €2.7 billion, targeting 644,487 farmers, was programmed under the Italian, French, and Romanian RDPs. Insurance premiums made up the majority of the expenditure at €2.2 billion, while €357 million was programmed to be spent on mutual funds, and €130 million on the Income Stabilisation Tool.<sup>138</sup>
178. Defra told us that England and the rest of the UK had chosen not to make use of the Risk Management Toolkit, due to at least in part to the small budget available after the risk management options were moved from Pillar 1 (Direct Payments) to Pillar 2 (Rural Development) in the most recent CAP reform. It noted that the UK's allocation under Pillar 2 was the smallest per hectare in the EU.<sup>139</sup>
179. The AHDB told us that insurance premiums would need to be subsidised to be commercially viable, as is the case in the US:
- “With traditional insurance the policy covers high impact, low likelihood events. In insuring volatility though, the events are high impact, high likelihood, which would make premiums commercially unviable. This would likely require the CAP to subsidise premiums and/or underwrite the risk.”<sup>140</sup>
180. Farm Europe, a think tank, argued that existing market mechanisms had proved insufficient to respond to crises, as demonstrated by the recent difficulties experienced by the dairy sector, and that the EU, with its greater resources, should take the lead:
- “Due to the very large financial requirements associated with price insurance schemes ... they should be designed and supported at EU level, with CAP funding. It is unrealistic in our opinion to expect price insurance to be implemented only at national or sub-national level, as it is highly unlikely that the financial needs to cope with sharp price falls would be available.”<sup>141</sup>

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137 Written evidence from Defra ([RPV0009](#))

138 Written evidence from DG AGRI ([RPV0027](#))

139 Written evidence from Defra ([RPV0009](#))

140 Written evidence from AHDB ([RPV0020](#))

141 Written evidence from Farm Europe ([RPV0015](#))

181. DG AGRI disagreed, on the other hand, while acknowledging that 60% of USA payments had recently gone to risk management schemes, noted that more than 90% of these payments had gone to just three crops. Moreover, the percentage of payments going to insurance could be expected to shift substantially each year when prices declined. It argued that the EU's policy design, spreading support over the whole agricultural sector, had made EU farm income less volatile than that in the US in recent years.<sup>142</sup>
182. Tassos Haniotis, Director of the Economic Analysis, Perspectives and Evaluations, and Communication Directorate in DG AGRI, pointed out that US insurance schemes were based on commodities with a long tradition of using financial markets with data going back to the 1930s, adding that the private sector did not dare to take up areas covering plant or animal diseases. He said:
- “We have seen what an EU-wide risk management scheme ... would cost, which would imply cuts in other parts, and would have significant transfers among commodities and among member states towards the ones that are much more volatile price-wise, but not necessarily with lower income.”<sup>143</sup>
183. Many witnesses noted the difficulty of developing well-functioning insurance markets. Teagasc pointed out that the US crop insurance programme started to subsidise premiums for farmers in order to overcome issues such as asymmetric information between insurers and the insured; adverse selection (voluntary schemes attracting farmers with more volatile incomes); moral hazard (insurance against losses encouraging more risky behaviour); and crowding out by government when it offers emergency packages to everyone and not just those insured. These issues were barriers for private companies seeking to enter the market, as they could only offer policies at prices that were unaffordable to most farmers.<sup>144</sup>
184. The OECD, on the other hand, cautioned that “simply providing the subsidy for an insurance premium does not overcome the reason why the market is not there”. Dr Jared Greenville, Senior Agriculture Policy Analyst at the OECD argued that high transaction costs were the main reason why insurance markets did not exist in the EU:
- “There is a real risk that, with poorly designed schemes, workers just count on cyclical payments, which means that you get production that does not respond to changes in prices and events. You could run into environmental problems by encouraging people to hold stock and just continue practices when it is not necessarily a good idea to do so”.<sup>145</sup>
185. Nick Tapp agreed that insurance schemes could remove some market signals to the farmer, while representing “substantial costs” to the taxpayer.<sup>146</sup>

### *Insurance and Direct Payments*

186. Several witnesses warned that designing insurance schemes for agriculture would be complex and would divert funding from Direct Payments.

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142 Written evidence from DG AGRI ([RPV0027](#))

143 [Q 48](#)

144 Written evidence from the Irish Food Development Authority Teagasc ([RPV0013](#))

145 [Q 59](#)

146 Written evidence from Nick Tapp ([RPV0005](#))

According to the NFU, experience had shown that mutual funds and insurance schemes “are likely to be complex and may undermine the value of the decoupled payments”, which were themselves essential risk management tools.<sup>147</sup>

187. We also heard that Direct Payments could hinder the development of insurance schemes. Lindsay Sinclair, Group Chief Executive at NFU Mutual, a mutual company offering insurance, told us:

“We believe that the presence of direct payments influences our customers’ views about the necessity of business interruption insurance, and there is a much lower take-up among farming customers of business interruption insurance than there is among non-farming commercial customers in the belief that they will have an income anyway.”<sup>148</sup>

188. In fact several witnesses suggested that Direct Payments and insurance schemes should be seen as alternatives, rather than complementary approaches. Defra noted:

“Other countries, such as Canada, who have extensive insurance support (and who were the inspiration for the Income Stabilisation Tool) have these supports instead of the direct payments we use in the EU, not alongside them. The recent US Farm Bill which moved US policy to being centred on insurance, also removed their direct payments.”<sup>149</sup>

189. The OECD agreed that US and Canadian style insurance markets “should not sit on top of the income support arrangements”, which themselves brought a degree of risk management.<sup>150</sup>
190. **Subsidised insurance schemes should not replace the current provision of support through the CAP. Uncertainty over costs and administrative complexity weigh against such a change. Nevertheless, we believe that insurance instruments may have a supplementary role to play in helping to counter the effects of extreme weather events, for example, and therefore should not be ruled out entirely.**
191. **We recommend that the UK Government give further consideration to the use of the mutual fund option within the risk management toolkit available under Pillar 2 of the CAP.**

### **The role of public policy**

192. Public policy, both at national and EU level, can play a key role in facilitating the development of and access to various financial instruments to help farmers cope with price volatility.
193. Defra noted that using futures markets to cope with price volatility, or taking out insurance for specific crop risks, targeted less probable and more damaging risks, which were therefore more marketable. Nevertheless, it added that there could be a role for the UK Government to help such private sector tools grow.<sup>151</sup>

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147 Written evidence from the NFU ([RPV0024](#))

148 [Q 70](#)

149 Written evidence from Defra ([RPV0009](#))

150 [Q 62](#)

151 Written evidence from Defra ([RPV0009](#))

194. The Agricultural Industries Confederation, the trade association for companies supplying inputs to the agricultural sector, argued:

“On an ongoing basis there is merit in EU institutions, in conjunction with national governments, ensuring they have sufficient information to determine to what extent these risk management tools are being used and, through consultation with industry, to determine whether future regulatory change is necessary or desirable.”<sup>152</sup>

*Financial Instruments and the European Investment Bank*

195. The Commission, in co-operation with the European Investment Bank (EIB), has already launched work to develop financial instruments that Member States can offer their farmers. Such financial instruments are defined in EU law as:

“Union measures of financial support provided on a complementary basis from the budget in order to address one or more specific policy objectives of the Union. Such instruments may take the form of equity or quasi-equity investments, loans or guarantees, or other risk-sharing instruments, and may, where appropriate, be combined with grants.”<sup>153</sup>

196. DG AGRI told us: “The idea is to try to provide, in the form of easier loans or guarantees from the money that is available in rural development, the possibility for farmers to get loans with better conditions.” It stressed, however, that the work was still in progress.<sup>154</sup>

197. Dr Harald Jahn, Head of Division, Natural Resources and Agro-Industry at the EIB, noted that the EIB’s assignment from the Commission was to help commercial banks to grow their lending portfolio for farmers:

“Compared with commercial bank finance, the loan from financial instruments can be provided on preferential terms and conditions, inter alia the lower interest rates that the EIB can generate on the international capital markets. There are longer repayment periods ... and perhaps less collateral required for tenant farmers. We are working on guarantee instruments, which can also be used to leverage further investment funding from the private banking sector.”<sup>155</sup>

198. The first new product developed by the EIB, a model guarantee instrument for agriculture to ease access to finance for farmers and other rural businesses, was presented in March 2015.<sup>156</sup>

199. For farmers to access any financial instrument scheme developed by the EIB, Member States must first create a financial instrument and programme it in

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152 Written evidence from the Agricultural Industries Confederation ([RPV0023](#))

153 Regulation of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002, [Regulation \(EU, EURATOM\) No 966/2012](#)

154 [Q 49](#)

155 [Q 65](#)

156 European Commission, *Press release* 23 March 2015, [http://europa.eu/rapid/press-release\\_IP-15-4647\\_en.htm](http://europa.eu/rapid/press-release_IP-15-4647_en.htm) [accessed 5 May 2016]

their RDP. A farmer may then apply by submitting a business proposal to the financial institutions through which funding is channelled.<sup>157</sup>

200. EU Agriculture Commissioner Phil Hogan urged agriculture ministers at the Agriculture Council in March to make use of the options offered by the EIB:

“The legal framework is in place and the Commission and the EIB are offering support and guidance to Member States in relation to setting up financial instruments. Colleagues, the ball is in your court—it is time for Member States to act.”<sup>158</sup>

201. Defra told us that the Government was “actively considering the introduction of financial instruments in the new Rural Development Programme”.<sup>159</sup>

202. The Minister said the Government was exploring, in particular, whether it would be possible to access rural development funds through the EIB “to make available loan finance to build additional processing capacity for the dairy sector”. The Minister did not, however, commit to actively encouraging the uptake of such loans by farmers: “The reality is that, if you are making available loan finance on quite generous terms, you probably would not have to promote it very hard. I am sure there would be quite a few takers.”<sup>160</sup>

203. **The UK Government has a key role in facilitating the use of financial instruments by farmers as the options offered by the EIB need to be constructed within the Rural Development Programmes. We recommend that the UK Government promote the use of financial instruments and raise awareness among farmers with operations of different sizes and in different sectors.**

204. At the same time, there is scope for the EIB to accelerate its work and to communicate the benefits for farmers more effectively. UK farming union presidents Allan Bowie, (NFU Scotland), Meurig Raymond (NFU), Ian Marshall (Ulster Farmers’ Union), and Stephen James (NFU Cymru) argued:

“Work with the European Investment Bank needs to be speeded up. There are a range of financial instruments but we need to understand how best this will work and what farmers can do to benefit from EIB lending.”<sup>161</sup>

205. In addition to its ongoing work with the EIB, the Commission has announced the establishment of a new High Level Group to work on market-based solutions, as part of its September 2015 package of measures to help farmers. The Group was tasked with focusing on credit for farmers, and financial

157 European Commission, *Questions & Answers in relation to the Memorandum of Understanding in respect of cooperation in agriculture and rural development within the EU between the European Commission and the European Investment Bank* (23 March 2015): [http://ec.europa.eu/agriculture/events/2015/ec-eib-coop/qa-mou-ec-eib\\_en.pdf](http://ec.europa.eu/agriculture/events/2015/ec-eib-coop/qa-mou-ec-eib_en.pdf) [accessed 5 May 2016]

158 Agriculture Commissioner Phil Hogan at the Agriculture Council, *Statement: The use of Financial Instruments in the Agriculture Sector*, (14 March 2016): <http://ec.europa.eu/agriculture/commissioner-speeches/pdf/hogan-2016-03-14-agrifish-council-financial.pdf> [accessed 5 May 2016]

159 Written evidence from Defra (RPV0009)

160 Q 75

161 NFU Scotland, *UK Farming Union Presidents Say New Farming Measures are a Step in Right Direction*, (15 March 2016): <http://www.nfus.org.uk/news/2016/march/uk-farming-union-presidents-say-new-farming-measures-are-step-right-direction> [accessed 5 May 2016]

and risk management instruments such as futures markets for agricultural products.<sup>162</sup> Defra noted that: “These markets do not guarantee high prices, but are a way of dealing with unanticipated price volatility.”<sup>163</sup>

206. **We recommend that the UK Government works with the private sector in developing new financial tools which could be accessed under Pillar 2 of the CAP.**
207. **We urge the EIB to speed up the work on financial instruments and work more closely with Member State governments and agricultural bodies to disseminate their work.**
208. **The success of the Commission’s efforts to promote the use of financial instruments will ultimately depend on their inclusion by Member States in Rural Development Programmes. It was disappointing that the UK Government was unable to provide us with an assurance that they will make use of any of the options being developed by the EIB.**

*Barriers to the use of financial instruments*

209. Even if useful financial instruments are developed, there are still significant barriers to their use, including a lack of knowledge and experience among farmers.
210. The NFU said that most farmers “lack the technical knowledge and confidence required to utilise market-based instruments”. They added:
- “The introduction of new financial products must be accompanied by a campaign to educate farmers on the applicability of such products to their business ... As an ancillary activity for farmers, market-based instruments must be easy to implement and manage.”
211. CRM Commodities, an independent grain marketing consultancy, noted that information was available online to educate farmers, but it was “rather complex”, while “only a limited amount can be learnt from reading documents”. It suggested that the solution required continuous training and advice to keep farmers up to date with changing markets:
- “Policy and funding can encourage farmers to acquire these skills, but our experience has been that this rural funding has been hard to acquire particularly in recent years and therefore many farmers continue to use relatively primitive forms of marketing without fully embracing what is on offer. Governments could also look into providing ‘education credits’ to farmers encouraging them to take on ongoing education programs on this topic as part of the Common Agricultural Policy.”<sup>164</sup>
212. The AHDB said that registering trade options and becoming involved in financial instruments to manage risk was a “big change of mindset” for farmers. To find solutions, it had established a volatility forum to bring the academic and commercial worlds together with the farming community:
- “There are a number of areas that we are really keen to look at, whether it is forward contracts, forward pricing, the use of derivatives, co-operation

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162 European Commission, *Annex: Comprehensive package of measures, Fact Sheet* (7 September 2015): [http://europa.eu/rapid/press-release\\_MEMO-15-5601\\_en.htm](http://europa.eu/rapid/press-release_MEMO-15-5601_en.htm) [accessed 5 May 2016]

163 Written evidence from Defra (RPV0009)

164 Written evidence from CRM Commodities (RPV0022)

and integration, people creating more strategic balanced businesses or how government policy might be involved to help us manage some of that volatility.”<sup>165</sup>

213. According to Teagasc, “major education and outreach initiatives” would be required to make financial instruments, such as forward contracts, futures markets, swaps and options, commonplace in European farming. It added that such market-based risk management tools had a much longer history in the US, which also has a very different scale of farming.<sup>166</sup>
214. Indeed, the size of farming as a business operation and the level of cash-flows involved were identified as barriers to farmers’ use of financial instruments. The NFU argued that the majority of farmers, as individual enterprises, lacked the scale to engage directly in a futures market. They currently relied on processors and traders to utilise market-based instruments to manage volatility: “For farmers to directly benefit, financial products must consider the scale of farming operations”.<sup>167</sup>
215. Dairy UK argued that Member States should be allowed to use EU Rural Development funds to educate dairy farmers on the use of financial instruments:
- “Whilst other agricultural sectors such as cereals are already fully familiar with futures instruments, this is not the case for dairy. It will take an extensive programme of training and education in the sector before dairy farmers can see the benefits of using futures and are familiar with how they can be exploited.”<sup>168</sup>
216. CRM Commodities added that farmers trading in futures markets also faced a risk of extra cash flow demands in the period between the hedge being placed and the physical being sold. This was a deterrent for farmers whose cash flow was already tight.
217. **We recommend that the European Commission and Member State governments work proactively with the financial sector to develop and promote more accessible and practical risk management tools.**
218. **Government policy should ensure that provision is made for training and education to farmers in accessing and making use of new financial instruments. We encourage bodies who have a role in providing advice to farmers, such as levy boards, to commit sufficient resources for this task.**

### *The availability of data*

219. We heard that the availability of transparent price data was a prerequisite to developing tools to manage price risk, and also that there was a role for public policy to encourage the provision of such data. According to the NFU, a lack of publicly available data for price and volumes traded affected price discovery and consequently discouraged farmers from participating in market based solutions by reducing their confidence in the pricing of derivatives: “Greater market transparency will encourage participation in

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165 Q 30

166 Written evidence from the Irish Food Development Authority Teagasc (RPV0013)

167 Written evidence from the NFU (RPV0024)

168 Written evidence from Dairy UK (RPV0026)

the financial markets as no participant in the supply chain will be able to benefit from asymmetric information.<sup>169</sup> The AHDB called for mandatory price reporting to help price discovery.<sup>170</sup>

220. Defra noted progress in this area, arguing that the Commission was concentrating increasingly on improving market transparency and on disseminating relevant information within the food supply chain. The Department argued that the EU Milk Market Observatory was “evolving into an important facility for improving price transparency and access to data and analysis of future market trends”. The Commission has since launched similar tools for beef, cereals, pigmeat, poultry and sugar.<sup>171</sup>
221. The AHDB added that well-functioning insurance schemes, be it for margin, income or other types of schemes popular in the US, would require “robust systems and good quality data”.<sup>172</sup> Rural Business Research agreed that supporting the development of such schemes required independent and generally accepted data on farm performance.<sup>173</sup>
222. Defra also noted that running counter-cyclical payments schemes would require significant data input:

“Indeed this is a substantial barrier in the short-term to medium-term development of any scheme in the UK as information on the individual income of farmers is not available.”<sup>174</sup>

### *Regulatory burdens*

223. Many witnesses warned of the extra regulatory burden that would fall on farms—often small-scale businesses—with greater use of financial instruments. The AHDB argued that “purely ‘financial’ instruments are unlikely to be of much use to farmers with business size and regulation preventing direct access”. It noted that the increasing amount of regulation aimed at ensuring that such instruments were not misused by speculators could itself give rise to additional volatility. Policy areas such as the revised Markets in Financial Instruments Directive (MiFID II)<sup>175</sup>, which aims to increase transparency and oversight of financial markets, including derivatives markets, could make it more challenging for farmers to use formal market based instruments.<sup>176</sup>
224. MiFID II<sup>177</sup>, was agreed in 2014. The NFU noted that the rules would capture for the first time non-financial businesses producing, trading or processing physical commodities with a futures market in the EU, such as

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169 Written evidence from the NFU ([RPV0024](#))

170 Written evidence from AHDB ([RPV0020](#))

171 Written evidence from Defra ([RPV0009](#))

172 Written evidence from AHDB ([RPV0020](#))

173 Written evidence from Rural Business Research ([RPV0008](#))

174 Supplementary evidence from Defra ([RPV0034](#))

175 Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU ([OJ L 173](#), 12 June 2014, p. 349–496)

176 Written evidence from AHDB ([RPV0020](#))

177 The MiFID II Package comprises two pieces of legislation, the Directive (see above) and Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 ([OJ L 173](#), 12 June 2014, p 84–148).

agricultural commodities, including wheat, milk or rapeseed. Farmers could, however, be exempted from complying with the rules.<sup>178</sup>

225. **Regulatory and implementing technical standards under the Markets in Financial Instruments Directive (MiFID II) should not place an unfeasible burden on farmers, which might discourage them from using financial risk management instruments.**

*National policies*

226. Some witnesses identified further opportunities for Member States to provide support to farmers outside the framework of the CAP, notably through taxation systems.
227. The UK Government extended its existing system of tax averaging for farmers in the 2015 Budget. From April 2016, farmers will be able to average out their farming profits over five years instead of two for tax purposes. Defra told us that this should help farmers manage fluctuations in income caused by industry specific factors “from price movements in global markets to swings in yields caused by the weather or by disease”.<sup>179</sup>
228. The AHDB, on the other hand, called for the development of further products allowing farmers to “save efficiently in good times to offset the bad”.<sup>180</sup> One example of such a practice is New Zealand’s Income Equalisation Scheme (see Chapter 3).
229. **We consider that national taxation policies can make a major contribution by developing regimes such as sheltered reserves and income averaging. The UK Government’s extension of the system of tax averaging for farmers announced in the 2015 Budget was a positive development.**

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178 NFU, *NFU influences EU directive on futures market* (20 April 2016): <http://www.nfuonline.com/assets/61790> [accessed 5 May 2016]

179 Written evidence from Defra (RPV0009)

180 Written evidence from AHDB (RPV0020)

## CHAPTER 6: RESEARCH, INNOVATION AND SKILLS

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230. The ability of agriculture to cope with price volatility and periods of sustained low prices reflects the state of scientific knowledge and the proficiency with which this is transferred to farmers and applied in practice. This chapter examines the debate surrounding the dissemination of knowledge and the latest scientific developments to farm level and it also presents the case for farmers to be more proficient in modern business practices, which would include access to knowledge and the use of financial instruments as mentioned in the previous chapter.

### Public investment

231. Historically, scientific advances have repeatedly led to improvements in agricultural productivity, which in turn help to improve resilience. The Minister presented a positive picture of current UK science and research in agriculture:

“One of the great resources we have in this country is world-beating science. We have some excellent science going on at places like John Innes and universities like Harper Adams, and places like Rothamsted as well. We obviously have the agritech strategy, and through that we are supporting a number of centres of excellence.”<sup>181</sup>

232. The NFU, in contrast, expressed disappointment with both the levels of domestic research funding in the UK and the precautionary approach of the EU to new technologies:

“We are still feeling the effects of the well documented underinvestment in agricultural science over recent decades, a shift in focus away from production, and the reduction of people and resources needed for translational research and commercialisation ... It is deeply disappointing that EU policy and legislation appears sceptical at best, often opposed, to new technologies that offer farm businesses the ability to manage plant and animal disease, weeds and pests, so reducing the EU food system’s ability to manage volatility sustainably.”<sup>182</sup>

233. DG AGRI told us that the Commission was committed to public spending on research and innovation and that agricultural research was being prioritised in the current financial period:

“For the sake of comparison in 2011 the EU represented 15.4% of global public research spending, the USA 10.1% and China 23.6%. Research and innovation investments in agriculture are not just crucial for sustainability of agro-food systems in Europe but also for their competitiveness on global market ... we have doubled the funds to agricultural research in the current financial period ... We have included all the priorities that we have seen are extremely important, from animal and plant diseases that are spreading faster because of climate change to issues related to food security and land management.”<sup>183</sup>

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181 [Q 82](#)

182 Written evidence from the NFU ([RPV0024](#))

183 Written evidence from DG AGRI ([RPV0027](#)) and [Q 44](#)

### Public-private partnership

234. In the US, agricultural research is funded from the public and private sectors, but, as the USDA told us, the funding tends to focus on different areas:

“Federal and State-level public spending on food and agricultural research totals approximately \$5 billion annually; private sector entities invest an additional \$5-6 billion ... While private investment is most heavily concentrated in food manufacturing and crop development, public investment is more broadly distributed, with concentrations not only in crop and animal breeding, but also in environment and natural resources and human nutrition and food safety.”<sup>184</sup>

DG AGRI praised the US approach to research, extension and innovation systems, acknowledging that Europe had a lot to learn and apply.<sup>185</sup>

235. Public-private partnerships also have a role to play. The New Zealand High Commissioner explained how in New Zealand, agricultural research was a joint enterprise with the government and the private sector sharing costs 50:50.<sup>186</sup>

236. He cautioned against governments acting alone in research provision and funding:

“It is up to the farming sector and the agricultural industry itself to organise its distribution of information ... They are all involved in the extension of the latest research information from around the country and around the world. Farmers naturally look towards that, because they know that they need the latest information to manage their businesses. So it is a sort of two-way process. The more that Governments get involved in providing these things free, the less valued they are.”<sup>187</sup>

237. The OECD extolled the benefits of co-funding research between the private and public sectors, arguing that research and development funding was directed towards the projects that the industry wants and needs:

“These co-funding arrangements and the more co-operative research structure have proved beneficial ... It is about trying to exploit the best of both worlds—get the best out of the private sector contribution, where competitive funding models, and so forth, have been used, as well as then making the most of your government spend.”<sup>188</sup>

238. **The funding of agricultural research should be recognised as a priority for both the UK Government and the European Commission. We recommend that they do much more to promote links between research projects and agribusinesses. Joint commitment between the European Commission, Member State governments and the private sector will ensure that research efforts are focused on the areas of greatest need.**

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184 Written evidence from the United States Department of Agriculture ([RPV0032](#))

185 [Q 47](#)

186 [Q 60](#)

187 [Q 61](#)

188 [Q 60](#)

239. Although industry and government can be positive drivers of scientific research, the NFU were clear that scientific research should come before policy decisions, rather than the other way around:

“Legislation and government decision-making must be based on robust scientific evidence if it is to have the desired effect, avoid unintended consequences and stand up to scrutiny.”<sup>189</sup>

240. There is an important role, however, for policy makers in identifying knowledge gaps and commissioning targeted research to inform decision making. This Committee voiced concern that the role of Chief Scientific Adviser (CSA) to the President of the European Commission was discontinued in 2014. This was disappointing at the time and remains a cause for concern.

241. **The evidence based approach to policy making must be maintained. Agricultural research should inform policy direction at both EU and Member State level. Public-private partnerships can assist that research.**

### Dissemination of knowledge

242. David Gardner, of the Royal Agricultural Society of England, expressed concern that research was too fragmented, and that it was not applied where it was needed:

“My great criticism is that nobody pulls all that together and puts it into best practice for the farming community. If a really great piece of research is done in an institute somewhere, it might come up with one bullet point that is really useful for the farming industry and that could be applicable to every farming business in the country—but how does it get embedded in best practice? At the moment there is no formalised process to ensure that that happens. That is the role that, historically, the ADAS technical specialists used to fill when I started farming. In my view, we have never replaced that role. There is still a gap, and it is a big gap.”<sup>190</sup>

243. ADAS was the UK Ministry of Agriculture, Fisheries and Food’s (MAFF) agricultural advisory arm until it was privatised in 1997. Although the current Defra Farming Advice Service provides some help to farmers, it generally focuses on helping them to understand and meet the requirements of Cross Compliance, Greening (under the Basic Payments Scheme) and the European Directives on both water protection and sustainable pesticide use.<sup>191</sup> Other arrangements are in place in other parts of the UK. In Wales the extension service known as Farming Connect (see below) maintains many of the functions that have been lost in England.

244. Levy bodies perform an important function in disseminating information and facilitating skills’ development, for example by providing support for benchmarking. The Minister, George Eustice MP, told us that the statutory levy board, the AHDB, was expected to fulfil some of this role. Its role was:

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189 Written evidence from the NFU ([RPV0024](#))

190 [Q 35](#)

191 HM Government, ‘Farming Advice Service’: <https://www.gov.uk/government/groups/farming-advice-service> [accessed 5 May 2016]

“to support farming, to commission research and development work and to encourage knowledge transfer. They have a very important role to play. They do regular statistics and benchmarking to try to help farmers recognise where they are and what they could do to improve their productivity. There is definitely a role for them there.”<sup>192</sup>

245. The AHDB agreed with the Minister’s assessment:

“We are well aware that we are not going to recreate the ADAS of the 1970s and early ’80s. The day of Government paying for extension services has gone [in England]. We have to look at doing it in a really smart way. The starting point is ... benchmarking ... We need to be of a mindset such that we know that the Danes, the Dutch, the Germans or the French are doing something better than we are, and we want to be as good as them.”<sup>193</sup>

246. Defra’s Agricultural technologies (Agritech) Strategy was developed in partnership with industry. It aims to ensure that the “knowledge and insight from the UK’s ... science base are translated into benefits for society and the economy at home and abroad.”<sup>194</sup> The Strategy was launched in July 2013, with £160 million of funding. The NFU said that they had:

“been encouraged by moves to strengthen the links between research and practice through the development of the Agri-tech Strategy; but the Strategy must deliver for the long term in all sectors. The UK Government has a duty to maintain world class expertise and facilities in this area, and crucially it must ensure that developments and breakthroughs are effectively translated into commercial practice on farms across the country—likewise, the end users of innovation need to have the right skills to be able to make the best use of the appropriate research and technology available to their business.”<sup>195</sup>

247. The Royal Agricultural Society of England told us that the Agritech Strategy was helping with the application of scientific research and they were hopeful that the AHDB may develop a more formal role in knowledge transfer:

“There is too much emphasis on basic research and very little on applied research ... I see no formalised structure to make knowledge transfer/knowledge exchange happen in an organised way. That might be starting to change in terms of what the AHDB has aspirations to do, but it is still going through a period of change.”<sup>196</sup>

248. Lynsey Martin from the National Federation of Young Farmers’ Clubs also told us of the importance of policy being translated into practical tools: “I come back to business. BIS is just as useful to us as Defra, moving forward. It is about having access to all the tools that we can use to improve our business and make it more efficient.”<sup>197</sup>

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192 [Q 81](#)

193 [Q 22](#)

194 HM Government, *UK Agricultural Technologies Strategy* (24 December 2013): <https://www.gov.uk/government/publications/uk-agricultural-technologies-strategy> [Accessed 5 May 2016]

195 Written evidence from the NFU ([RPV0024](#))

196 [Q 35](#)

197 [Q 26](#)

249. Eirwen Williams, Director of Menter a Busnes, which delivers Farming Connect in Wales, agreed and spoke of the “disconnect between the blue-sky academic research” and what made a difference at farm level:

“One of the things the AHDB needs to deliver is making sure that the work that is being done is relevant to challenges on the farm and not something that looks good in an academic paper. It must address the needs of farmers today.”<sup>198</sup>

250. Professor Wilson, in contrast, argued that such knowledge transfer was already happening, and suggested that the ultimate application of research could act as an incentive:

“I am well aware that the drive now is around the impact of research. It is a great thing, from my point of view, that we do research and have to translate that to the sector where it is needed. From our perspective, getting those agricultural innovations that we do in a researched university like Nottingham through to farming is a good thing. It incentivises us to do that and we are all up for it.”<sup>199</sup>

251. The USDA told us that in the US Federal and State-level spending on knowledge transfer programmes, including extension services and technical assistance totals around \$5 billion annually. They also described their system of knowledge exchange:

“Farmers in the US have access to county, state, and national-level extension and education programs tailored to transferring new knowledge and providing training to working farmers across the full range of research topics pursued in USDA, including agricultural production practices and new technologies; business management and economics; natural resources management, climate change, and conservation; markets and trade; among others. Producers also have direct access to a wide range of publicly available reports, websites, web-based management tools, and advisory services both electronically and through local USDA offices”.<sup>200</sup>

252. It was clear that there were different levels of progress in this area across the United Kingdom. Menter a Busnes told us about the work that they were doing to facilitate knowledge exchange in Wales:

“Menter a Busnes and [the Institute of Biological, Environmental and Rural Sciences at the University of Aberystwyth] have recently established a Knowledge Exchange Hub to improve and facilitate the progression of new ideas and technologies to the agricultural and forestry sectors. The Knowledge Exchange Hub will provide a mechanism for assisting the flow of information from research projects into industry as well as keeping abreast of new research and developments in institutes and organisations other than IBERS. This will include research institutes across the UK and world, other knowledge exchange specialist e.g. levy boards, and industrial companies undertaking their own research. In addition the Knowledge Exchange Hub will be the point of contact for farmers and foresters wishing to access funding through the European Innovation Partnerships.”<sup>201</sup>

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198 [Q 35](#)

199 [Q 22](#)

200 Written evidence from the United States Department of Agriculture ([RPV0032](#))

201 Written evidence from Menter a Busnes ([RPV0030](#))

253. We were impressed by the breadth and depth of the services provided by Menter a Busnes. In Scotland, Scotland's Rural College (SRUC) also offers knowledge-exchange services, specifically skills, education and business support, for Scotland's land-based industries.<sup>202</sup>

254. Several witnesses highlighted the problems arising from poor broadband coverage in rural areas. Menter a Busnes told us:

“It is a problem. It is not fast enough to download videos. On our website we have videos and little podcasts of different things that farmers are able to download, but because the internet connection is not fast enough they cannot download them, so it is definitely an issue in rural Wales.”<sup>203</sup>

We are concerned that the Government's broadband Universal Service Obligation (USO) may not include a commitment to rolling out broadband services in hard-to-reach rural areas in the light of recent reports that the forthcoming USO may require individuals to formally request broadband provision from providers.<sup>204</sup>

**255. The provision of knowledge exchange and training differs across the UK. The UK Government should identify examples of best practice of knowledge exchange and dissemination wherever it is to be found and actively support them. It should also increase its efforts to deliver broadband to ensure that farmers in rural areas can access the necessary information online.**

### Modern business skills

256. A lack of adequate awareness and business skills can impede farmers' ability to cope with risk appropriately. The NFU told us:

“Successful modern farming is a skilled operation that requires technical proficiency, business acumen and environmental awareness. The NFU believes that promotion of business management and entrepreneurial skills is crucial to achieving a professional and more productive, profitable and competitive farming sector.”<sup>205</sup>

257. Defra described their efforts to equip farmers with the tools they need:

“Defra has published a wide range of advice available to farmers, including how to write a business plan, manage accounts, undertake benchmarking and plan future activity. This includes information on specialist business and financial support to help farmers run their businesses as efficiently as possible. Advice is also available for farmers who are thinking of diversifying, by adding new business activities to traditional farming.”<sup>206</sup>

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202 SRUC, 'Scotland's Rural College': <http://www.sruc.ac.uk/> [accessed 5 May 2016]

203 Q 32

204 Department for Culture, Media and Sport, *A New Broadband Universal Service Obligation Consultation* (March 2016): [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/510148/Broadband\\_Universal\\_Service\\_Obligation.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/510148/Broadband_Universal_Service_Obligation.pdf), p 10 and BBC, 'Rural broadband only on request, says Government' (6 May 2016): <http://www.bbc.co.uk/news/technology-36225971> [accessed 11 May 2016]

205 Written evidence from the NFU (RPV0024)

206 Written evidence from Defra (RPV0009)

258. Benchmarking allows farmers to compare the financial performance of their businesses to the performance of average and top performing farms of the same farm type. It allows them to compare their profit and loss account, gross margins, balance sheet and performance measures. Professor Wilson suggested that benchmarking could give farmers a stronger understanding of both the cost of production and cost competitiveness and of ways to manage them.<sup>207</sup> The NFU stressed that benchmarking was of paramount importance in improving the performance of agriculture in recent years. It noted that the 2011/12 Farm Business Survey showed that 15% of farmers who frequently benchmark at whole farm level achieved an average Farm Business Income of £128,900 in contrast with £63,000 for the 85% of farmers that did not benchmark.<sup>208</sup>
259. The Farm Business Survey is an annual survey commissioned by the UK Government, under which a range of management accounting information on all aspects of farmer's and grower's businesses is collected. The survey uses a representative sample of farms in terms of farm type, farm size and regional location, and is carried out by a consortium of seven academic institutions. Professor Wilson, who leads the consortium, told us:
- “A key determining factor of farm performance is the management ability of those individual farm businesses. Anything that allows farmers to access greater information—for example, benchmarking, which we do within the Farm Business Survey—or allows them to look at their costs and revenue moving forward, which again we do with our work on our Projection Calculator tool, or which allows people to go in and test different price scenarios for their production: all those things need to marry together with the innovative practices at production level to achieve a successful business.”<sup>209</sup>
260. Menter a Busnes helps Welsh farmers offers programmes for farmers to develop business and management skills. It also organises surgeries with a business consultant; business meetings to provide information on employment laws, farm accounts, and record keeping; and venture programmes on joint opportunities, such as share or contract farming, or succession surgeries with a lawyer.<sup>210</sup>
261. **Benchmarking in agriculture should be promoted among the farming community and encouraged by the UK Government. There is a long term business case for equipping farmers in all parts of the UK with the knowledge and expertise to calculate and manage their costs of production and overheads. Farmers should share their data with their peers to facilitate this benchmarking.**
262. **The least supported farming sectors appear to possess better business skills. Sectors that have enjoyed historic support now face greater exposure to market forces and should, as a priority, be equipped with the skills to improve business knowledge.**

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207 [Q 22](#)

208 Written evidence from the NFU ([RPV0024](#))

209 [Q 22](#)

210 Written evidence from Menter a Busnes ([RPV0030](#))

## CHAPTER 7: THE FUTURE SHAPE OF THE COMMON AGRICULTURAL POLICY

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263. The CAP undergoes periodic major reforms and adjustments; it is expected to undergo a mid-term review in 2017 and will be revised again for the period after 2020. Our recommendations are intended to feed into these revisions, though we have also borne in mind any future UK policy landscape, should the UK decide to leave the EU in the forthcoming referendum.

### Long term objectives

264. The stated official objectives of the CAP remain as they first appeared in the Treaty of Rome in 1957, though the way they have been interpreted has evolved. Box 1 shows how the language used to describe the Policy has changed over the decades:

#### Box 2: The Objectives of the Common Agricultural Policy

##### 1. Treaty of Rome (1957)

Article 39 of the Treaty of Rome, the wording of which has been carried forward into the Treaty on the Functioning of the European Union (Lisbon, 2007), states that the aims of the CAP are:

- To increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilisation of the factors of production, in particular labour;
- Thus to ensure a fair standard of living for the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture;
- To stabilise markets;
- To assure the availability of supplies;
- To ensure that supplies reach consumers at reasonable prices.

##### 2. Agenda 2000

The CAP's original objectives were reformulated in Agenda 2000 by the European Council (the Heads of State and/or government of the Member States, its President and the President of the Commission) as follows:

- Increase competitiveness internally and externally in order to ensure that Union producers take full advantage of positive world market developments;
- Food safety and food quality, which are both fundamental obligations towards consumers;
- Ensuring a fair standard of living for the agricultural community and contributing to the stability of farm incomes;
- The integration of environmental goals into the CAP;
- Promotion of sustainable agriculture;
- The creation of alternative job and income opportunities for farmers and their families;
- Simplification of Union legislation.

### 3. Political settlement of 2013

The Council and the European Parliament, agreed the CAP's long-term objectives for the period 2014–2020 as:

- Delivering viable food production;
- Sustainable management of natural resources and climate action;
- Balanced territorial development.

Sources: Summarised from *Agenda 2000: For a stronger and wider Union, COM (97) 2000 final, Commission of the European Communities and European Commission, 'Agricultural Policy Perspectives Brief No. 5, December 2013': [http://ec.europa.eu/agriculture/policy-perspectives/policy-briefs/05\\_en.pdf](http://ec.europa.eu/agriculture/policy-perspectives/policy-briefs/05_en.pdf) [accessed 5 May 2016]*

265. Professor Morgan narrated these changes:

“The common agricultural policy, as it is now, is a very different animal from the one that I grew up with in the 1970s and 1980s, when we did have butter mountains and wine lakes, and 84% of the [EU] budget went to agriculture and 50% of that went to milk, because of the way that the market was operated. That was about price intervention; that was about subsidies for prices; that was all about market intervention. The current CAP is very different. It is not about market intervention; it is about support for income. It is not about support for a product; it is support for income. It is a very different thing. It is designed to maintain the wider aspects of agriculture, the stewardship of the countryside, et cetera. It is targeting something quite different from the original ideal of the CAP, which was about supporting price. It is a different common agricultural policy, even though its name has never changed. It has evolved.”<sup>211</sup>

#### Support for public goods

266. Many witnesses argued that the concept of public goods should be set as the primary objective of any reformed CAP. Whether it be increased food security, environmental sustainability or climate change mitigation, the CAP should be holistic and should not simply encourage food production at any cost. DG AGRI highlighted the relatively recent shift towards fostering a wider array of public goods:

“The objective of the current system of Direct Payments goes far beyond a pure income support policy tool ... [The objective has made] it possible for the legislator to introduce other important policy objectives (such as the provisions of public goods) as a pre-condition in order to receive support. Decoupled from production decisions, these payments create an incentive for agriculture to provide a combination both of private and public goods, with the latter further enhanced in the more recent reform by making 30% of the payment conditional on greening practices.”<sup>212</sup>

267. The introduction of greening marked a significant step away from unconditional support under Pillar 1, but there is scope for much more. DG AGRI went on to tell us that the Policy must always be able to compensate farmers for the public goods they provide, which may not be recognised by the market:

211 Q 8

212 Written evidence from DG AGRI (RPV0027)

“Farmers produce public goods, but they also produce private goods. Instead of pitting one against the other, we want to bring those together in a complementary way. In this design, even for the future, they need to have some cushion in the overall income of farmers that would compensate them for what the market does not compensate. That remains important. One would have to examine whether the manner in which we distribute payments in the reference we have, which is land, is the most accurate one. In my view, that is where the discussion in the future will have to focus.”<sup>213</sup>

268. It added that decoupled Direct Payments had, by guaranteeing an EU wide minimum level of basic income support, also played a major role in maintaining agricultural activity throughout the EU territory, avoiding negative social consequences in rural areas.<sup>214</sup> It told us that combining the provision of public and private goods without one overriding the other would be challenging:

“That is where volatility and economic viability become important. Before everything else, agriculture is an economic sector, and if it is not economically viable it will not be viable from an environmental or social point of view.”<sup>215</sup>

269. Historically, market price support under the CAP maintained prices above market levels for many products. This generated costs to EU consumers, while providing relative price stability for farmers. However, the intensity of market intervention has declined significantly as a result of CAP reform since the early 1990s, leaving EU markets more open to respond to fluctuations of supply and demand. The move from general price support to more targeted support can be used to enable the provision of public goods. A return to a system of price support and intervention to provide a floor price would signal a step back.<sup>216</sup>

270. **The CAP’s objectives go beyond the production of agricultural goods. They include the provision of public goods, such as land management and maintenance of ecosystem services, as well as the mitigation of adverse social impacts in rural economies.**

271. **Given that the agricultural sector is often expected to provide public goods, there is a case for financial support in certain circumstances. However, policy should display much more explicit links between the expected outcomes and the use of public funds.**

272. Another important role for direct support is in the case of market failure. Professor McCorrison agreed that this could provide a rationale for intervening:

“One of the important issues about whether it is the private or public sector, which is a general principle of policy, is whether there is a market failure. Can the private sector provide enough on its own to resolve the issues of variability? If the answer is no, then there is a potential role for an agricultural policy or CAP in some form to deal with that.”<sup>217</sup>

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213 [Q 41](#)

214 Written evidence from DG AGRI ([RPV0027](#))

215 [Q 50](#)

216 Written evidence from Nick Tapp ([RPV0005](#)) and Defra ([RPV0009](#))

217 [Q 8](#)

273. **There is a case for public intervention where there is market disruption caused by events beyond the control of the industry, such as the recent Russian ban on imports from the EU.**
274. While DG AGRI's evidence makes it clear that agriculture and environmental policy are strongly interlinked, they are currently often dealt with in separate frameworks, which may jeopardise the achievement of the objectives of each policy. The Minister noted that the UK was developing separate 25 year plans for food and farming on the one hand and the environment on the other. He said that the agriculture plan would touch on environmental issues, but that the environment plan “the right place to deal with all the environmental issues, including looking at things such as soil, climate change, water resources and everything else”<sup>218</sup> We are concerned that this separation of the respective policy areas does not demonstrate awareness of the interconnectedness of agriculture and the environment, or of the value of natural capital.
275. **Given the significant synergies between agricultural and environmental policies, they should not be treated as separate policy areas. We urge the UK Government to demonstrate that their 25 year plan for food and farming and their 25 year plan for the environment are consistent with and support one another.**

#### Structural change

276. The previous round of CAP reform sought to move some public support from Direct Payments and Pillar 1 towards Pillar 2. This movement of support from Pillar 1 to Pillar 2 may continue in the next round of reforms and more funding may be dedicated to environmental services and land management. Given that Pillar 2 is co-financed by the Member States, this may not be straightforward.
277. DG AGRI presented this as a process of transition:
- “I think we should realise that the old distinction between Pillar 1 and Pillar 2 is becoming less and less relevant. This distinction was driven by the fact that in Pillar 2 we had—and still have—multiannual budgeting based on programming, and on Pillar 1 it is annual budgeting and there is no programming; it is all financed by the EU. Now we have elements of programming and co-financing in the First Pillar, but the most important thing that brings these two together is land management.”<sup>219</sup>
278. The Commission underlined that land management was at the heart of their vision for the future of the CAP:
- “It is important to start realising that for the same piece of land—one hectare of land, for example—you can see differently from a market point of view the quantities you produce and what impact it has on prices; from a direct payments point of view whether the CAP will support it and how much; from an agri-environmental point of view what type of additional measures you have; from a control point of view how you guarantee this is accurately accounted for; but it is still one hectare of land. The crucial question is what type of land, what are the soil characteristics, what do they imply regarding future environmental

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218 [Q 82](#)

219 [Q 42](#)

challenges, be it climate, soil erosion, water use, or what have you, and how all the measures that we have—and they are and should continue to be more than one—would act in a complementary manner.”<sup>220</sup>

279. The Commission’s approach is entirely consistent with our view that the provision of public goods must be the overall driving force behind the next round of CAP reform. Indeed, as the distinction between Pillar 1 and Pillar 2 disappears, there is an argument for abolishing the distinction altogether and focusing funds on specific public goods.
280. Such a move would allow for EU-wide risks to be more effectively managed at EU level and to be addressed and financed from a single source of funding. As we noted earlier in Chapter 3, DG AGRI classifies these as market risks or broader environmental risks.<sup>221</sup>
281. **We recommend that the European Commission consider a restructuring of the Common Agricultural Policy primarily to support the provision of public goods.**
282. Exposure to market signals is crucial for the self-regulation of agricultural production. Forms of support that remove market signals may artificially keep inefficient or unproductive farmers in business while preventing younger and more skilled farmers from entering the sector and expanding. As has been noted, we heard that farmers in historically less supported sectors were generally more business-oriented than those in more supported sectors. The removal of support may also have wider implications for the rural economy. The debate surrounding the role of Direct Payments is discussed in Chapter 3.
283. **Market signals are key to encouraging farmers to take the right course of action to increase resilience. This will need to be reflected in any future policy to ensure that these signals are not removed.**

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220 [Q 42](#)

221 Written evidence from DG AGRI ([RPV0027](#))

## SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

1. Price volatility is an inherent feature of agricultural markets, and it will remain a normal risk to be managed by farmers as part of their business strategies. (Paragraph 29)
2. Despite increased volatility in agricultural prices in recent years, we conclude that the overall level of price volatility is no higher than at other times in the past. (Paragraph 35)
3. Both price volatility and low prices present challenges for farmers. In our opinion, adverse effects at farm level are caused more by unanticipated periods of sustained low prices than by an increase in levels of price volatility. (Paragraph 46)
4. A degree of price volatility sends crucial market signals, which inform production and investment decisions. It also provides incentives for innovation and efficiency gains. (Paragraph 59)
5. Preparedness for price movements will assist farmers in their investment and business decisions, but it will not eliminate risk. (Paragraph 60)
6. Various sub-groups of farmers experience volatility to different degrees and therefore require different strategies and support to strengthen their resilience. We recommend that the UK Government encourages tenant farmers seeking to diversify and strengthen their resilience. The UK Government and the devolved administrations should also investigate the impact of short-term tenancies on the ability of farmers to make necessary investments. (Recommendation 1, Paragraph 77)
7. Changes to the framework of the CAP have resulted in a greater exposure of production decisions to market forces. Direct Payments, however, provide income support which maintains a degree of financial stability for some farmers. (Paragraph 94)
8. The shift in the CAP towards income support and greening is likely to continue. Future policy decisions must focus on addressing the outcomes of price volatility and periods of prolonged low prices and help farmers to develop resilience mechanisms rather than controlling prices. (Paragraph 100)
9. While we note the Commission's ambition to simplify the CAP, the focus must be on reducing complexity for the farmers who use it. (Paragraph 101)
10. One-off support packages can help to counter the impact of extreme natural disasters or catastrophic events that are beyond individual farmers' control. Policy should, however, focus on building the sector's resilience in the longer term. (Paragraph 106)
11. We recommend that the UK Government clearly articulate the specific circumstances under which it will seek to access EU funding to provide emergency aid for farmers in the wake of an extreme natural disaster or a catastrophic event. (Recommendation 2, Paragraph 107)
12. Direct Payments provide farmers with important income support to withstand protracted periods of low prices. They can, however, reduce

incentives for innovation and efficiency gains and hold back much needed structural change. (Paragraph 124)

13. We recommend that the UK Government works to identify the main barriers preventing farmers from exiting the sector and investigate ways to overcome these barriers. They should consider how Rural Development funding can be used to accelerate structural change and create opportunities for new entrants into farming. (Recommendation 3, Paragraph 140)
14. There are fundamental differences between the organisation and structure of the EU agriculture sector and those in Canada, New Zealand and the US, especially with regard to scale and amenity and environmental use of land. These differences render the models used by these countries unsuitable for general application in the EU at the present time. (Paragraph 159)
15. Even though the Canadian and US experiences have rather different contexts, lessons can be learned on where and how subsidised insurance and disaster compensation may be applied. (Paragraph 160)
16. We recommend that the Commission and the UK Government undertake a structured review of public investment deposit schemes in other countries, with a view to identifying approaches that would work in the EU. This would give farmers a secure and guaranteed option to save in times of plenty and withdraw in times of need. (Recommendation 4, Paragraph 161)
17. The UK Government's efforts to explore how a futures market for dairy could be established in the UK is a positive step and there may be scope to expand this exploration of futures markets to other commodities in the future. (Paragraph 172)
18. Subsidised insurance schemes should not replace the current provision of support through the CAP. Uncertainty over costs and administrative complexity weigh against such a change. Nevertheless, we believe that insurance instruments may have a supplementary role to play in helping to counter the effects of extreme weather events, for example, and therefore should not be ruled out entirely. (Paragraph 190)
19. We recommend that the UK Government give further consideration to the use of the mutual fund option within the risk management toolkit available under Pillar 2 of the CAP. (Recommendation 5, Paragraph 191)
20. The UK Government has a key role in facilitating the use of financial instruments by farmers as the options offered by the EIB need to be constructed within the Rural Development Programmes. We recommend that the UK Government promote the use of financial instruments and raise awareness among farmers with operations of different sizes and in different sectors. (Recommendation 6, Paragraph 203)
21. We recommend that the UK Government works with the private sector in developing new financial tools which could be accessed under Pillar 2 of the CAP. (Recommendation 7, Paragraph 206)
22. We urge the EIB to speed up the work on financial instruments and work more closely with Member State governments and agricultural bodies to disseminate their work. (Recommendation 8, Paragraph 207)

23. The success of the Commission's efforts to promote the use of financial instruments will ultimately depend on their inclusion by Member States in Rural Development Programmes. It was disappointing that the UK Government was unable to provide us with an assurance that they will make use of any of the options being developed by the EIB. (Paragraph 208)
24. We recommend that the European Commission and Member State governments work proactively with the financial sector to develop and promote more accessible and practical risk management tools. (Recommendation 9, Paragraph 217)
25. Government policy should ensure that provision is made for training and education to farmers in accessing and making use of new financial instruments. We encourage bodies who have a role in providing advice to farmers, such as levy boards, to commit sufficient resources for this task. (Recommendation 10, Paragraph 218)
26. Regulatory and implementing technical standards under the Markets in Financial Instruments Directive (MiFID II) should not place an unfeasible burden on farmers, which might discourage them from using financial risk management instruments. (Paragraph 225)
27. We consider that national taxation policies can make a major contribution by developing regimes such as sheltered reserves and income averaging. The UK Government's extension of the system of tax averaging for farmers announced in the 2015 Budget was a positive development. (Paragraph 229)
28. The funding of agricultural research should be recognised as a priority for both the UK Government and the European Commission. We recommend that they do much more to promote links between research projects and agribusinesses. Joint commitment between the European Commission, Member State governments and the private sector will ensure that research efforts are focused on the areas of greatest need. (Recommendation 11, Paragraph 238)
29. The evidence based approach to policy making must be maintained. Agricultural research should inform policy direction at both EU and Member State level. Public-private partnerships can assist that research. (Paragraph 241)
30. The provision of knowledge exchange and training differs across the UK. The UK Government should identify examples of best practice of knowledge exchange and dissemination wherever it is to be found and actively support them. It should also increase its efforts to deliver broadband to ensure that farmers in rural areas can access the necessary information online. (Recommendation 12, Paragraph 255)
31. Benchmarking in agriculture should be promoted among the farming community and encouraged by the UK Government. There is a long term business case for equipping farmers in all parts of the UK with the knowledge and expertise to calculate and manage their costs of production and overheads. Farmers should share their data with their peers to facilitate this benchmarking. (Recommendation 13, Paragraph 261)
32. The least supported farming sectors appear to possess better business skills. Sectors that have enjoyed historic support now face greater exposure

to market forces and should, as a priority, be equipped with the skills to improve business knowledge. (Paragraph 262)

33. The CAP's objectives go beyond the production of agricultural goods. They include the provision of public goods, such as land management and maintenance of ecosystem services, as well as the mitigation of adverse social impacts in rural economies. (Paragraph 270)
34. Given that the agricultural sector is often expected to provide public goods, there is a case for financial support in certain circumstances. However, policy should display much more explicit links between the expected outcomes and the use of public funds. (Paragraph 271)
35. There is a case for public intervention where there is market disruption caused by events beyond the control of the industry, such as the recent Russian ban on imports from the EU. (Paragraph 273)
36. Given the significant synergies between agricultural and environmental policies, they should not be treated as separate policy areas. We urge the UK Government to demonstrate that their 25 year plan for food and farming and their 25 year plan for the environment are consistent with and support one another. (Recommendation 14, Paragraph 275)
37. We recommend that the European Commission consider a restructuring of the Common Agricultural Policy primarily to support the provision of public goods. (Recommendation 15, Paragraph 281)
38. Market signals are key to encouraging farmers to take the right course of action to increase resilience. This will need to be reflected in any future policy to ensure that these signals are not removed. (Paragraph 283)

## APPENDIX 1: LIST OF MEMBERS AND DECLARATIONS OF INTEREST

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### Members

Lord Bowness  
 Lord Cunningham of Felling  
 Lord Curry of Kirkharle  
 Viscount Hanworth  
 Lord Krebs  
 Lord Rooker  
 Baroness Scott of Needham Market (Chairman)  
 Lord Selkirk of Douglas  
 Baroness Sheehan  
 Lord Trees  
 Viscount Ullswater  
 Baroness Wilcox

### Declarations of Interest

Lord Boswell of Aynho (Chairman of the EU Select Committee—attended the Sub-Committee’s meeting on 27 January 2016)

*In receipt of agricultural payments under the CAP*

Lord Bowness

*No relevant interests declared*

Lord Cunningham of Felling

*No relevant interests declared*

Lord Curry of Kirkharle

*Chair. Leckford Estate, Waitrose*

*Trustee. Clinton Devon Estate*

*Trustee. Lawes Trust. Rothamsted*

*Chair. National Land Based College*

*Chair, Better Regulation Executive (retired on 31 December 2015)*

*Partner, Farming business of 440 acres in Northumberland*

*In receipt of agricultural payments under the CAP*

*Chair, Prince’s Countryside Fund*

Viscount Hanworth

*Shareholding in Royal Dutch Shell Plc*

Lord Krebs

*Deputy Chair, Nuffield Foundation*

*Member, Committee on Climate Change*

*Chair, Adaptation Sub-Committee (Sub-Committee of Committee on Climate Change)*

*Chair, Oxford Risk Ltd*

*Scientific Advisor, Marks & Spencer Plc*

*Scientific Advisor, Ajinomoto Inc*

*Scientific Advisor, Wellcome Trust*

*Fellow of the Royal Society*

*Fellow, Academy of Medical Sciences*

Lord Rooker

*No relevant interests declared*

Baroness Scott of Needham Market (Chairman)

*No relevant interests declared*

Lord Selkirk of Douglas

*Chairman of Directors, and Director, Douglas-Hamilton (D Share) Ltd  
(Potential interest in certain wind turbines)*

*Director, Douglas-Hamilton Investments Ltd which has a 50% interest in  
Douglas-Hamilton (D Share) Ltd*

Baroness Sheehan

*Shareholding of 3,000 shares in FIM Sustainable Timber and Energy LP*

Lord Trees

*Chair, Board of Meridien Research Institute, Edinburgh, an independent  
animal health research institute*

Viscount Ullswater

*Paid Director and Trustee of farming estate company in Cumbria*

*Income derived from farming and forestry, quarrying, wind turbines, fishing  
rights, agri-environmental schemes.*

*Life member of SONE (Supporters of Nuclear Energy)*

*Member of the CLA (Country Land and Business Association)*

Baroness Wilcox

*No relevant interests declared*

The following Members of the European Union Select Committee attended the meeting at which the report was approved:

Baroness Armstrong of Hill Top

Lord Blair of Boughton

Lord Borwick

Lord Boswell of Aynho (Chairman)

Earl of Caithness

Lord Davies of Stamford

Baroness Falkner of Margravine

Lord Jay of Ewelme

Baroness Prashar

Baroness Scott of Needham Market

Lord Trees

Lord Tugendhat

Lord Whitty

Baroness Wilcox

During consideration of the report the following Members declared an interest:

Lord Boswell of Aynho

*In receipt of agricultural payments under the CAP*

Lord Davies of Stamford

*In receipt of agricultural payments under the CAP*

Earl of Caithness

*Trustee of Queen Elizabeth Castle of Mey Trust which owns agricultural  
land*

Lord Borwick

*Agricultural land owned personally: Bellshill, Scotland*

*Agricultural land owned by Bicester Lane Ltd in Bellshill. I am a Director  
of Bicester Lane Ltd and have partnership in its parent*

*Agricultural land owned under a lease by Countryside Properties (Bicester)  
Ltd, of which I am Chairman, and of which Bicester Lane Ltd owns 50% of  
shares*

Lord Jay of Ewelme

*Shareholding in Associated British Foods (ABF)*

A full list of Members' interests can be found in the Register of Lords Interests:  
<http://www.publications.parliament.uk/pa/ld/ldreg.htm>

## APPENDIX 2: LIST OF WITNESSES

Evidence is published online at [www.parliament.uk/hleud](http://www.parliament.uk/hleud) and available for inspection at the Parliamentary Archives (020 7219 3074).

Evidence received by the Committee is listed below in chronological order or oral evidence session and in alphabetical order. Those witnesses marked with \*\* gave both oral evidence and written evidence. Those marked with \* gave oral evidence and did not submit any written evidence. All other witnesses submitted written evidence only.

### Oral evidence in chronological order

**	Professor Tim Lloyd	<a href="#">QQ 1-11</a>
**	Professor Steve McCorrison	
**	Professor Wyn Morgan	
*	Country Land and Business Association	<a href="#">QQ 12-28</a>
**	National Farmers Union	
*	Professor Paul Wilson	
*	National Federation of Young Farmers' Clubs	
**	Tenant Farmers Association	
**	Agriculture and Horticulture Development Board	<a href="#">QQ 29-37</a>
**	Menter a Busnes	
*	Royal Agricultural Society of England	
**	DG AGRI, European Commission	<a href="#">QQ 38-51</a>
*	His Excellency Sir Lockwood Smith, High Commissioner for New Zealand to the United Kingdom	<a href="#">QQ 52-63</a>
*	Organisation for Economic Co-operation and Development	
*	Barclays Agriculture	<a href="#">QQ 64-73</a>
*	European Investment Bank	
*	HSBC Bank Plc	
**	NFU Mutual	
*	UK Government	<a href="#">QQ 74-87</a>
**	Department for Environment, Food and Rural Affairs	
*	United States Department of Agriculture	

### Alphabetical list of all witnesses

	Agricultural Industries Confederation	<a href="#">RPV0023</a>
**	Agriculture and Horticulture Development Board (QQ 29-37)	<a href="#">RPV0020</a>
	All-Party Parliamentary Group on Agroecology for Sustainable Food and Farming	<a href="#">RPV0031</a>

*	Barclays Agriculture (QQ 64-73)	
	Centre of Intelligence in Logistics and Supply	<a href="#">RPV0004</a>
*	Country Land and Business Association (QQ 12-28)	
	CRM Commodities	<a href="#">RPV0022</a>
	Dairy UK	<a href="#">RPV0026</a>
	Dr Phil Dawson	<a href="#">RPV0007</a>
**	Department for Environment, Food and Rural Affairs (QQ 74-87)	<a href="#">RPV0009</a> <a href="#">RPV0034</a>
**	DG AGRI, European Commission (QQ 38-51)	<a href="#">RPV0027</a>
*	European Investment Bank (QQ 64-73)	
	Farm Cornwall	<a href="#">RPV0003</a>
	Farm Europe	<a href="#">RPV0015</a>
	Douglas D. Hedley	<a href="#">RPV0033</a>
	Professor Ian Hodge	<a href="#">RPV0016</a>
**	HSBC Bank Plc (QQ 64-73)	<a href="#">RPV0019</a>
**	Professor Tim Lloyd (QQ 1 - 11)	<a href="#">RPV0029</a>
**	Professor Steve McCorrison (QQ 1 - 11)	<a href="#">RPV0029</a>
**	Professor Wyn Morgan (QQ 1 - 11)	<a href="#">RPV0029</a>
	Sir John Marsh	<a href="#">RPV0006</a>
**	Menter a Busnes (QQ 29-37)	<a href="#">RPV0030</a>
**	National Farmers Union (QQ 12-28)	<a href="#">RPV0024</a>
*	National Federation of Young Farmers' Clubs (QQ 12-28)	
*	His Excellency Sir Lockwood Smith, High Commissioner for New Zealand to the United Kingdom (QQ 52-63)	
*	NFU Mutual (QQ 64-73)	
	NFU Scotland	<a href="#">RPV0011</a>
	Northern Ireland Assembly Committee for Agriculture and Rural Development	<a href="#">RPV0002</a>
*	Organisation for Economic Co-operation and Development (QQ 52-63)	
*	Royal Agricultural Society of England (QQ 29-37)	
	Rural Business Research	<a href="#">RPV0008</a>
	Stable Insurance	<a href="#">RPV0025</a>
	Nick Tapp	<a href="#">RPV0005</a>
	Teagasc - Agriculture and Food Development Authority, Ireland	<a href="#">RPV0013</a>
**	Tenant Farmers Association (QQ 12-28)	<a href="#">RPV0014</a>

*	UK Government (QQ 74-87)	
**	United States Department of Agriculture (QQ 74-87)	<a href="#">RPV0032</a>
	Welsh Government	<a href="#">RPV0010</a>
	Martin Wilkinson	<a href="#">RPV0021</a>
*	Professor Paul Wilson (QQ 12-28)	

### APPENDIX 3: CALL FOR EVIDENCE

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The House of Lords EU Energy and Environment Sub-Committee is conducting an inquiry into the various responses to price volatility and the potential for creating a more resilient agricultural sector. The Sub-Committee seeks evidence from anyone with an interest.

Written evidence is sought by 31 December 2015. Evidence sessions will be held in December 2015 and January 2016. The Committee aims to report to the House, with recommendations, by the end of the Parliamentary Session. The report will receive responses from the UK Government and the European Commission, and may be debated in the House.

The resilience of the agricultural sector underpins the secure, sustainable and affordable supply of food to the citizens of the EU, as well as providing financial security for EU farmers. A resilient agricultural sector is one which can respond to risk effectively and take steps to mitigate the wider effects of global price volatility.

Effective risk management can mitigate the adverse effects of price volatility. In the words of the OECD,

“Risk management in agriculture is now an essential tool for farmers to anticipate, avoid and react to shocks. An efficient risk management system for agriculture will preserve the standard of living of those who depend on farming, strengthen the viability of farm businesses, and provide an environment which supports investment in the farming sector.”<sup>222</sup>

The drivers behind price volatility are variable and complex, but a number of assumptions can be made: weather-related events will become more frequent and more extreme; the global population will rise, leading to an ever increasing demand for agricultural products; and the decrease in the availability of land and the increased demand for products will drive up the price of agricultural commodities.

Public policy at an EU and Member State level has a role in responding to these challenges and the ongoing reform of the Common Agricultural Policy should provide an opportunity for a co-ordinated approach.

We seek evidence on any aspect of the topic and particularly on the following questions:

- (1) What is the role of public policy in mitigating the impact of potential price volatility? To what extent should the response be a shared endeavour between the EU institutions and Member State governments? What are the differing roles of industry on the one hand and individual farmers on the other?
- (2) Should public policy responses make a distinction between support for the resilience of the industry as a whole, support for the resilience of specific sectors and support for the resilience of individual units of activity?

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222 OECD, ‘Risk Management in Agriculture: What Role for Governments?’: <https://www.oecd.org/agriculture/agricultural-policies/49003833.pdf> [accessed 5 May 2016]

- (3) Currently, what are the key elements involved in the industry's management of price risk? What further tools are needed?
- (4) What effect has the commoditisation of agricultural goods had on the ability of farmers to respond to risk effectively? How are farmers to mitigate the on-farm effects of volatile global commodity markets and currency fluctuations?
- (5) What are the barriers to more effective on-farm price risk management, including longer term pricing mechanisms, diversification, co-operative working and leasing? How can those barriers be overcome and what is the role of EU and national public policy?
- (6) How 'fit for purpose' are market-based instruments? Could the marketplace help to mitigate risks by providing ways of smoothing out the impact of volatility? Are there ways in which EU and national public policy could encourage, and reduce the risk of introducing new financial products?
- (7) How realistic are terms for access to investment finance? What role is there for the European Investment Bank to support on-farm investment at a low cost? What other instruments could improve access to finance in a volatile environment?
- (8) What level of information is available to farmers to engage with market-based instruments and to consider alternative options for on-farm actions? How might knowledge availability be improved? How can farmers be encouraged to acquire the skills needed to operate a modern business-like operation?
- (9) What role should innovation play in creating a more resilient agricultural sector? Should more be invested in scientific research which could have the potential to transform agricultural practices?
- (10) How effectively does EU agricultural policy currently assist farmers to mitigate the impact of potential price volatility? Is there a need for management of price risk to be an explicit objective of the Common Agricultural Policy?
- (11) What long term changes should be made to the Common Agricultural Policy to support the agricultural industry in responding to price risk more effectively? Should insurance schemes play a more prominent role?

You need not address all these questions in your response.