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Policy Brief

The impacts of changes in agricultural policies in the United Kingdom on trade and agriculture especially in New Zealand – the Swiss Option.

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On June 23, 2016, the United Kingdom (UK) voted narrowly (52:48) to leave the European Union (EU). The UK government then officially notified the EU on March 29, 2017, of its intention to leave, thus triggering Article 50 of the EU Treaty, which specifies that within two years the UK will cease to be a member. However, the date for Brexit is still unclear as the European Union leaders have granted the UK a six-month extension to Brexit until October 31, 2019. Consequently, the nature of the economic relationship between the UK and the remaining EU-27 is still to be defined (Belke & Gros, 2017).

Brexit will change the domestic and trade policies affecting agriculture in the UK and will have important implications for agricultural commodity trade worldwide. The trade policy changes are key factors in determining the consequences of Brexit for agricultural markets in Europe and elsewhere. New Zealand (NZ) is a small open economy which is heavily dependent on its agricultural exports. The UK is an important export market for New Zealand, especially for agricultural commodities. Since 1973, New Zealand's agricultural exports to the UK were subject to EU trade policy, hence, the UK exiting the EU will affect trade between the UK, the EU and other countries like NZ.

In 1973 the UK entered the EU, then called the European Community (EC), which was established on March 25, 1957 when the Treaty of Rome was signed. Since then the UK and the EU are highly integrated through the Common Agricultural Policy (CAP) among other policies. The Common Agriculture Policy (CAP) has a common external barrier and a system of subsidies and support programmes for agriculture. The policy was established in 1963, and it effectively set internal minimum prices well above world market levels and restricted imports in order to raise domestic prices (Saunders, 2008). Since its launch the CAP has been reformed considerably, aiming to reduce its costs (from 71 per cent of the EU budget in 1984 to 39 per cent in 2013) and to include objectives for a rural policy (Agenda 2000 reforms). In the event of Brexit, the UK will withdraw from the EU and the CAP. This means that it is no longer entitled to subsidies under the CAP and will also face restrictions on exports entering the EU (HM Government, 2017).

Currently, the UK has free movement of agricultural goods within the EU. There are no tariffs or tariff quotas on agricultural commodities traded between the UK and EU member states. In addition, being a part of the Customs Union, the UK imposes the EU's common external tariff on goods imported into the UK from non-EU countries (Saunders et al., 2016). External tariffs on agricultural goods tend to be considerably higher than non-agricultural goods. A number of countries have free trade agreements with the EU (e.g. South Africa, Mexico, Chile and Korea) and thus face lower or no tariffs on agricultural exports. In addition, the EU has

numerous preferential trade agreements (e.g. Switzerland) (Potton & Webb, 2017). The EU has a system of tariff rate quotas (TRQs) which allow imports to come into the EU at a lower tariff rate up to a quota. There are 87 TRQ schemes for agricultural, food and beverage products which comprise of more than 120 individual tariff quotas (Revell, 2017). In the event of Brexit, both the UK and the EU would need to make a decision on splitting the current TRQs between them. This would involve negotiating trade agreements not only between the remaining EU countries and the UK, but also with third country exporters regarding market access (Revell, 2017).

The agri-food sectors of the UK and EU have become highly integrated since the UK joined the EU in 1973. In 2018, 62 per cent of all UK agri-food exports went to the EU, at a value of approximately £13.9 billion. In particular, seven of the UK's ten largest export markets for agri-food products are EU member states. Similarly, the UK is reliant on imports of many agri-food commodities from the EU, with EU agri-food imports comprising approximately 70 per cent of total agri-food imports in 2018. In particular, nine of the UK's ten largest importers for agri-food products are EU member states (Defra, 2019).

NZ and the UK have a long history of agricultural trade. The NZ agricultural sector originally developed to service the UK market. However, over the 1960s it became clearer that the UK would enter the EC and that NZ agricultural trade would be seriously affected by the CAP. The CAP was based upon fixed support prices with barriers to entry from third country imports (Saunders, 2008; Potton & Webb, 2017). NZ currently has country-specific TRQs for its beef, sheep, cheese and butter exports to the EU market. However, once the UK exits the EU, it can negotiate its own trade policies with third countries like NZ. In recent years, the UK's historical position as NZ's key trading partner has decreased, however it remains an important market for NZ exporters especially for sheepmeat and retains a position as NZ's eighth-largest trade partner in merchandise trade by total export value in 2018 (Statistics NZ, 2018).

Several studies have assessed the potential effects of the UK exiting the EU on the UK economy and in particular on its agricultural sector using various scenarios and assumptions. These scenarios range from soft/optimistic Brexit scenarios (e.g. Swiss Option, Norwegian Option, Unilateral Free Trade etc.) with new trade tariffs combined with changes in trade transaction costs as non-tariff barriers (with various ranges) to the hard/ pessimistic Brexit scenario (e.g. WTO Option/ No deal scenario). The majority of these scenarios projected a negative impact on the UK's economy from Brexit with a projected reduction of GDP and loss in household income to varying degrees depending on the scenario assumptions and the type of trade agreement met with the EU (HM Treasury, 2016; PWC, 2016; Dhingra et al., 2017; Booth et al., 2015; Boulanger & Philippidis, 2015); Mion & Ponattu, 2019). The studies further showed that these welfare impacts vary regionally with welfare losses predicted to be stronger the closer a country is to the UK (Mion & Ponattu, 2019). At industry level, a few studies have assessed the potential effects of the UK exiting the EU on the UK agricultural sector. Results from these studies were mixed depending on the scenarios examined. While some studies projected a positive impact on the UK agricultural sector with increased producer prices across the agricultural commodities (Davis et al, 2017; Jongeneel et al., 2016; Van Berkum, 2016; Sik Choi et al., 2019), other studies projected price drops especially for the beef and sheepmeat sector (The Andersons Centre, 2019; Davis et al., 2017). In contrast, a Unilateral Trade scenario (i.e. all UK import tariffs drop) showed a significant negative impact on prices, production and incomes across the agricultural sector (Jongeneel et al., 2016; Hubbard et al., 2018). Further, these studies have shown a decrease in bilateral agricultural trade between the UK and the EU with larger impacts on trade patterns in the UK compared to the EU27 but also affecting other EU member states, particularly Ireland (Bellora et al., 2017). In addition, the majority of studies and scenarios predicted a negative impact on the UK's domestic consumption facing higher food prices.

A study undertaken by the Agribusiness and Economics Research Unit at Lincoln University, New Zealand (Saunders et al., 2019) and funded by the EU assessed how the agricultural sector in the UK, the EU and NZ would be affected if the UK applied the agricultural policy currently in place between by Switzerland and the EU. Two bilateral agreements (Bilateral Agreement I and II) are currently in place between Switzerland and the EU. These agreements allow Switzerland limited access to the EU's Single Market. In these agreements,

tariffs are reduced on fruits and vegetables, horticulture, meat and wine. Additionally, trade in cheese and a large amount of processed agri-food products (e.g. chocolate, biscuits) are liberalised between the EU and Switzerland. The agreement also reduces or eliminates non-tariff barriers (Dhingra & Sampson, 2016; Schweizerische Eidgenossenschaft, 2016; Copenhagen Economics, 2016).

In their study, in order to assess the potential impact of an agricultural policy for the UK that resembles the current agreements between Switzerland and the EU, a Swiss scenario was developed applying trade weighted ad valorem tariffs derived from these agreements to bilateral UK – EU trade; additionally 10 per cent trade transaction costs were applied. This option represents a ‘soft Brexit’ version of outcomes where the UK seeks to maintain favourable trade relations with the EU for most sectors the exception being agriculture. Trade with third countries were subject to WTO tariff rates. The Lincoln Trade and Environment Model (LTEM), a partial equilibrium trade model that simulates international trade, production and consumption of agricultural commodities was then used for the analysis. The model assessed the impacts of the Swiss scenario on crops, meat and dairy production, consumption and trade for the UK, the EU and NZ by 2030.

Study results focus on the impact on bilateral trade between the UK and the EU and are presented as percentage changes to the baseline scenario (i.e. the UK remaining in the EU) in 2030. The influence of higher tariff rates and transaction costs between the countries was expected to have two effects, (1) an increase in total producer prices as the demand for goods must be satisfied by domestic production, higher prices from the EU, and/or imports from other third party nations; (2) a consequential increase in price for consumers as the cost of traded goods increases. In the case of the EU, demand can also be satisfied by intra-EU trade. Outside of these general predictions, the results show the extent of these effects and the difference between commodities, as tariff levels and volume of trade vary between commodity groups. Then, the results for NZ are presented.

Model projections from the Swiss scenario indicated large drops in UK producer returns for meat exports (ranging from -32 to -35 per cent) and dairy exports (ranging from -6 to -35 per cent) to the EU in 2030. Similarly, EU producer returns from exports to the UK market were also projected to decrease significantly across all commodities (except for cheese which was projected to remain relatively unchanged). The largest decrease was projected for returns for beef exports (-56 per cent), then export of butter (-52 per cent). In case of trade volumes between the EU and the UK, modelling results indicated a decline of bilateral trade. Of UK exports to the EU, wheat and meat products were projected to have the largest absolute decrease, whereas EU exports of wheat to the UK were projected to decrease significantly by 2030. With regards to net trade, the UK was expected to remain a net importer of EU goods, albeit in lower volumes.

In case of UK consumer spending on EU imports, modelling projections showed increases across all commodities, reflecting the higher prices. UK consumer spending was projected to increase more for EU dairy imports (except for cheese) than for EU meat imports (ranging from 4 per cent to 35 per cent).

Model projections on EU consumer spending for UK imports showed mixed results, particularly for UK dairy imports. While EU consumer spending on imports from the UK was projected to grow for butter and whole milk powder imports, consumer spending on cheese and skim milk powder was projected to drop by 2030. EU consumer spending on UK sheepmeat and beef was projected to increase only slightly (ranging from 1 to 8 per cent) by 2030.

In case of NZ, the impact on producers and consumers from the Swiss scenario was minimal, with slight changes to world prices having a slight follow-on impact. NZ producer returns were affected slightly across all commodities with returns from the majority of commodities predicted to remain unchanged by 2030. Also, NZ consumer spending was projected to remain unchanged for most commodities by 2030. With regards to agricultural trade, results showed slight drops in NZ dairy exports while NZ meat exports were projected to increase by 2030.

The authors identified some limitations to their study. The tariff levels used for this scenario were taken from Swiss – EU trade, these granular data were then trade weighted to fit the profile of UK-EU trade. This mirroring of trade relationships may not tell the entire story, as the negotiating of trade agreements is often centred on key commodities or areas of importance for each country. These results do not express what a ‘Swiss style’ agreement would look like for the UK, to simulate such an agreement would take some degree of speculation and presumption on what the key areas for the UK would be under a similar agreement. Furthermore, the scenarios presented have focused on isolating the impacts of the trading relationship between the EU and the UK. The UK’s outward facing tariff agreements with other countries were set to WTO tariffs to third countries and further research could examine the UK taking a similar, more nuanced approach with regards to third party trading partners.

To conclude, the UK’s exit from the EU will have a range of implications for the UK, the EU and other countries like NZ. The nature and extent of its impacts will be determined by the terms under which the UK exits, hence the impact of Brexit is yet unknown. If the UK would implement an agricultural policy that resembles the current agreements between Switzerland and the EU, this would have a significant impact on bilateral EU – UK trade of agricultural goods while the agricultural sector in NZ would be only slightly affected by the new trade policy. However, the UK leaving the EU could work to strengthen the trading relationship with NZ depending on the UK’s access to the EU’s Single Market.

The study is part of a series of discussion documents on the impacts of changes in EU policies that have the potential to affect New Zealand and how these can be discussed and communicated across a number of interested communities. The study is initial analysis of what the possibilities are and the potential methods to assess this. Clearly, there are a number of further options which can be assessed especially as more detail is released on the future of EU and UK policy.

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