Policy Brief

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

John T. Saunders, Meike Guenther & Caroline Saunders (2019)

Agribusiness and Economics Research Unit (AERU), Lincoln University, New Zealand

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 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 third party countries like NZ.

In 1973 the UK entered the EU, then called the European Community (EC), which was established on 25 March 1957 when the Treaty of Rome was signed. Since then the UK and the EU have become highly integrated through the Common Agricultural Policy (CAP) among other polices. 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 the subsidies under the CAP and will also face restrictions on entering the EU for agricultural exports (HM Government, 2017).

Currently, the UK has free movement of its agricultural goods within the EU. There are no tariffs or tariff quotas on the agricultural commodities traded between the UK and EU member states. In addition, being a part of the Customs Union, the UK has imposed 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). Additionally 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 separate 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 trading agricultural commodities. 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 was allocated country-specific TRQs for its beef, sheep, cheese, and butter exports to the EU market, which have been maintained. 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 importance as NZ's key trading partner has decreased, however it remains an important market for NZ exporters of 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 facilitation costs as non-tariff barriers (with various ranges) to the hard/ pessimistic Brexit scenario (e.g. WTO Option/ No deal scenario), where no trade agreement is made and trade is carried out at WTO tariff levels. The majority of these studies 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 also indicated that these welfare impacts would vary regionally across the EU, 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 which option was 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 consumers 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 does not reach a trade agreement with the EU by the 31st of October 2019. By default, the UK would have to comply with the WTO rules to trade with the EU, and third countries. Under WTO rules, all members must follow the MFN principles for goods trade; and the UK would lose its tariff-free market access to the EU Single Market. However, the UK would stop making financial contribution to the EU budget (Dhingra & Sampson, 2016). New trade relations will most likely be accompanied by increased trade transaction costs due to the introduction of tariffs and non-tariff measures. As a consequence of these changes to trade policy, there are likely to be significant factors affecting international agricultural trade, and this will have implications for the UK, the EU and other countries like NZ.

In their study, in order to assess the potential impact of the No Deal Scenario that the UK falls back to the WTO default position, one scenario was developed applying trade weighted outbound facing MFN tariffs to imports from the EU and other third countries. In addition, the change in trade transaction costs was set at 10 per cent. 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 No Deal Scenario on crops, meat and dairy production, consumption and trade for the UK, the EU and NZ by 2030.

Overall, model projections from this scenario showed a significant impact on UK consumption and production of crop, meat and dairy commodities compared to the UK remaining in the EU (baseline scenario), if the UK would fall back to the WTO default position at the end of October 2019. Modelling results indicated large increases in UK producer returns for crops (ranging from 43 to 59 per cent). Interestingly, projections for producer returns from dairy commodities were mixed with large increases estimated for cheese (+66 per cent) and skim milk powder (+20 per cent) but decreases recorded for returns from whole milk powder (-5 per cent). Similarly, the projected producer returns for UK meat commodities were mixed. In case of the EU, results showed slight changes in producer returns from crop, meat and dairy commodities with returns from most commodities predicted to fall by 1 per cent by 2030. In comparison, NZ producer returns from the majority of commodities were estimated to remain unchanged. With regards to UK consumer spending, projections showed large increases across all examined commodities (ranging from 3 per cent to 26 per cent). In contrast, changes in EU consumer spending were projected to be minimal. NZ consumer spending was projected to remain unchanged for most commodities by 2030. Modelling results on UK, EU and NZ trade were mixed. While the UK was projected to experience an increase in exports across all commodities (except for sheepmeat), EU trade was projected to decrease for most exported commodities by 2030, especially wheat and cheese. Finally, the impact on New Zealand was small, with minor disturbances to world prices for meat and dairy commodities.

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 leave the EU without a deal and falls back to MFN tariffs end of October 2019, this would have a significant impact on UK's production and consumption of agricultural goods while the agricultural sector in the EU and 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 impact 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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