Nuffield Report 1995

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INTRODUCTION

I am a self employed Dairy Farmer in partnership with my wife, Kathy. We have been farming river flats and terraces at Motupipi in Golden Bay for the past 13 years.
We currently milk 240 cows, and operate a bull beef unit in conjunction with the dairy unit, on a total of 156 Ha.

I currently hold positions as
Chairman, Board of Trustees, Motupipi School.
Executive Member, Golden Bay Federated Farmers
Convenor, Livestock Improvement Corp. Takaka
Convenor, NZDB Farm Discussion Group, Motupipi
Corporal, Takaka Citizens' Band.

I completed a Bachelor of Agricultural Commerce, majoring in Financial Management and Dairy Science at Lincoln College in 1979. I then spent time computer programming for the Kellogg Unit at the College.
Further Post Graduate studies have been in International Economics (extramural).

Prior to returning to my family farm, I was employed as a Farm Advisory Officer with the Ministry of Agricultural and Fisheries, in the Poverty Bay region.

ACKNOWLEDGEMENTS

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Special thanks to

- the staff of the New Zealand Dairy Board in the UK and Moscow.

- the director of the United Kingdom Scholarship Trust, Steven Bullock, and his secretary Evelyn Jenkinson for organising an interesting introductory tour programme, and for their willing assistance and advice.

- the support, hospitality and friendship extended to me be my hosts, the Butler family, was much appreciated.

- other scholars and their contacts who gave advice, time, energy and assistance to make this trip so enjoyable.

- to the members and staff of the many organisations who gave their thoughts and time so freely on the various areas of my study.

- to the 1995 Nuffield Scholars International for the camaraderie and friendship we all shared together, this will be a lifelong treasure.

- a special thanks to my wife, Kathy, and children, Ben, Alice and Dan for their love, support and encouragement, which enabled me to take this wonderful opportunity.

Finally, the Nuffield Scholarship is a fantastic opportunity to study not only European agriculture, but that of fellow international scholars. It is both an honour and a privilege to be a Nuffield Scholar. The personal contacts and the level of entry to organisations are, I see, the greatest benefit.

STUDY OBJECTIVES

The objective of the study was to examine the social effects of the General Agreement on Tariffs and Trade (GATT), and the likely changes that will evolve in the Common Agricultural Policy (CAP). Also reported are a number of related areas. Issues covered in this report are as follows:

- Examination of the social effects of the GATT on the Common Agricultural Policy
- Deregulation of the British Milk Marketing Board
- Power of the Consumer
- Environmental issues in Agriculture
- Animal Welfare Issues

EXECUTIVE SUMMARY

The social effects of the GATT Agreement on the Common Agricultural Policy:

- The decoupling of income support payments from market. The present arrangements are an inefficient and market distorting way of supporting rural communities, and of achieving the wider social policy objectives.
- A reduction in supply controls and a move to a 'freer' market approach.
- As has already been foreshadowed in Britain, there will be a shift to effective and holistic policies for the rural economy and for the maintenance of rural communities.
- A greater emphasis on cross-compliance, especially on environmental issues within the single market. There will be a need for Europeans to speedily exploit developments in agricultural research and development, to achieve a competitive edge. The impact of this move to a more environmental focus will have an effect on New Zealand Agriculture. We will be forced to meet or exceed their level of environmental standards. In this major area our land based industries must act on now, documenting environmental outcomes, not only to demonstrate that we are clean and green, but that we are on a continuing plane of improvement.
- The phasing out of export subsidies and thus real pressure to curb both over-production within Europe, and to maintain the present EU share of world markets.
- Increased legislation and consumer pressure on animal welfare issues.

Despite the best intentions for a managed change, it may take a crisis, before any major changes to policy will occur. It is unlikely any change will occur until early in the next century and in the intervening period, Europe will continue to be largely cocooned from the free market. The forces of the international marketplace will not be felt at anywhere near the pace as in this country.

THE IMPACT OF THE GATT AGREEMENT ON THE COMMON AGRICULTURAL POLICY

Introduction

The GATT Agreement served notice that export subsidies and border tariffs are on the hit list and need to be addressed. A brief review of the outcomes of the GATT agreement is useful, if the impact of the agreement is to be compared with the necessary changes to the CAP. The CAP was set up in 1957 with the Treaty of Rome . It is in effect a social policy. Its main purpose is to provide food security for the European Union, stable internal markets, and to stop rural depopulation. Because of the insistence of the Europeans to exclude from the GATT negotiation, any "Green Box" payments, many environmental and social payments which are presently part of the CAP are not affected. These so called "Green Box" payments, or domestic support which is Issues from production, such as conservation programmes and payments to less favoured areas, will remain.

Overview of GATT

Agriculture and horticulture were included within effective GATT disciplines for the first time when the Uruguay Agreement was initialled by all 116 signatories on 15 December 1993, after seven years of negotiations.

The agreement also included commitments for trade in clothing and textiles, trade in services, aspects of intellectual property rights, rules and procedures for settlement of disputes, rules of origin and import licensing procedures. The Agreement of Agriculture provides a framework for the long term reform of agricultural trade and domestic support policies. The agricultural section contains 20 articles, including access, domestic support, export subsidies, sanitary and phytosanitary measures, provision for an on-going negotiation process and a "Peace Clause".

The key result for agriculture is the conversion of all non tariff barriers into tariffs of equivalent effect, and a subsequent 36% average reduction of all agricultural tariffs between 1995 and 2000. The tariff equivalents are based on the difference between domestic and export prices in the 1986-88 period. The minimum tariff reduction on any one product is to be 15 % from the base period tariff equivalent. The average tariff reduction is less for undeveloped countries. Tariffs are expressed as a percentage of landed value, as a fixed rate per unit or a combination of both methods. As tariff equivalents may remain high for some time, the Agreement provides for the maintenance of existing or "current" access with a tariff quota. Existing access is defined as the average volume of product imported in the base years of 1986-88, or high access volumes where appropriate. The existing access tariff is derived by a variety of methods, and may be country specific or a global entitlement . Safeguard provisions exist for domestic producers. Additional tariffs are able to be imposed if the volume or price of imports in excess of the tariff quota breach pre-determined trigger levels.

Domestic support expenditure on agriculture or horticulture, which involves a transfer from consumers to producers, is subject to a 20% reduction of domestic support payments made in the base period. Domestic support payments are accumulated into an aggregate measure of support. "Green Box" support is domestic support expenditure which is "decoupled" from production. Green Box expenditure is exempt from the reduction requirements and includes expenditure on research and development, training, advisory and inspection services. Direct payments to producers which are not related to the volume, type or prices of products are also exempt. Much of the EU's CAP and USA agricultural support payments are in the "Green Box" category.

Similarly, the settlement requires a 36% reduction in expenditure on export subsidies and a 21% cut in the volume of subsidised exports. The base years are the averages form 1986-90. Reductions cannot be achieved over aggregated groups of products. This has enhanced the discipline required to meet the reduction in the subsidy which most distorts trade. An amendment to the "Blair House Agreement" allows the starting point for the reduction in the volume of subsidised exports to be taken as the average of the 1991-92 years where the volume of exports in this period exceed the 1986-1990 base. This allows a higher than previously agreed volume of subsidised exports in the initial two-three years of the implementation period. The end result has to be a 21 % reduction in the volume of subsidised exports and a 36% reduction in export subsidies from the 1986-1990 base year.

The "Peace Clause" prohibits a challenge of any agricultural policy in GATT unless the policy directly contravenes provisions of the Uruguay settlement. The clause has a nine year life from implementation of the Uruguay treaty. This clause has effectively given legitimacy to the EU's Common Agricultural Policy for the first time, protects it until at least 2003 and includes the "Peace Clause" in the "Continuation of Reform Process". The reform process is to be initiated in 1999, one year before the end of the implementation period.

The Sanitary and Phytosanitary Measures Agreement limits the extent that these issues can be used as barriers to trade. The agreement specifies that sanitary (animal and human health) and phytosanitary (plant, pest and disease) issues can only be used to protect human, animal or plant health. Any measures implemented are to be based on scientific principles. Health measures must not constitute a disguised trade barrier or discriminate between countries where the same conditions exist. The provisions for regions to be declared pest or disease free is a key feature of the agreement.

SHORT TERM OUTCOMES OF THE GATT

Introduction

Following the McSharry reforms of 1992 and the 20% devaluation of the green pound, UK farming incomes took a substantial rise. Meanwhile, agricultural productivity across the European Union achieved considerable improvements, with both livestock and crop yields increasing steadily. The number of producers, in all major sectors, in UK and European agriculture is declining, as the long term trend continues toward larger production units. While the impact of the agreement in the short term will be minor, due mainly to the McSharry reforms of 1992 and the 'green box' exemptions, each sector will be effected.

In the following section the impact on each agricultural sector is examined and the likely pressure points, as they relate to the CAP.

Impact on Different Agricultural Sectors

CEREALS

Indications are that surpluses in the cereal sector are likely to become a problem toward the end of the decade. The situation may be even worse if the EU is unable to export such large quantities over the next two or three years. As internal EU cereal prices fall and the volume of subsidised exports declines, the world price of cereals will be of greater significance to the EU agricultural sector, than in the past. Some commentators have expressed the hope that there will be scope for unsubsidised grain exports in the light of CAP reform. It needs to be appreciated, however, just how wide the gap between current world prices and likely level of British grain prices at the end of the CAP reform round of price cuts really is. If historical relationships between intervention and feed cereal prices hold (although allowing for feed wheat to trade on a par with feed barley in the absence of intervention for feed wheat) then anticipate feed wheat/barley prices for the 1995/96 marketing year to be running at around $NZ206 per tonne in the absence of any major currency fluctuations. The current world spot price for feed wheat is about $NZ153 per tonne. Either a substantial recovery in world prices or a significant appreciation of the pound against the ECU would be required before EU grain could be exported onto the world market without subsidies or further price cuts. This can only lead to the conclusion that either more land is going to have to be set aside in the late 1990s or that cereal prices are likely to fall substantially. Any surplus may well find it's way into the Dairy and Beef industries.

BEEF

A situation of oversupply may arise in the beef sector especially in the mid 1990s and beyond, especially if the BSE problem worsens. With the limits now in place on the quantity of beef that can be taken into intervention (introduced under the CAP reform in 1992), any over production will put beef prices under severe pressure until the breeding herd contracts and production are reduced. If the EU beef supply and demand is brought into balance, an average cut in production of up to 5 % may be needed. Since EC stocks will be run down over the same period, a cut in excess of 5 % would be required. With the annual decrease in the dairy herd, the brunt of this adjustment is likely to fall on the beef suckler herds.

SHEEP

The internal support cut will not apply to the ewe premium now that it is controlled by a quota it is treated as being included in the 'green box'. EU export sheepmeat is not significant so export restrictions will not directly affect this sector. There is, however, a risk of knock-on problems due to lower white meat and beef prices putting lamb prices under pressure. The voluntary restraint agreements have now been agreed. New Zealand will be allowed to import 205,600 tonnes of sheepmeat at zero levy into the EU in 1994 (of which 13,500 tonnes chilled), and Australia (17,500), Argentina (19,000), and also other countries including Eastern Europe.

DAIRY

The impact of the settlement in the dairy sector depends chiefly on two factors:

- the restrictions on the volumes of exports and the potential increase in imports; and
- the underlying trends in EU consumption of milk products.

The tariff on butter of up to 85% fat content, will be set initially at 2,962 ECU per tonne. This will then be reduced to 36% by the year 2000, to 1,896 ECU. World price of butter should approach the GATT minimum price of $1,350 per tonne, then the world price plus the 1,896ECU tariff would comfortably exceed the EC intervention price for butter, thus imported butter would be unable to displace domestic production. Over the last three years the world butter price has, on average, been less than 10 % above the GATT minimum. Although the reduction in tariff protection for the EU milk market is unlikely to undermine EU support prices, the settlement does allow for some increase in imports. Under the access obligation the EU must be prepared to allow imports to rise to an amount equivalent to 5 % of the world market. Current special access arrangements (e.g. for New Zealand butter) will count toward meeting this obligation. Additional imports under the access obligations could amount to 1.8 million tonnes of milk. The settlement requires (in milk equivalent) a reduction in exports of more than 3 million tonnes by 2000. By allowing a choice between a base period of 1991-92 or 1986-90 the initial reduction in exports of cheese has been eased by the settlement. When combined with the potential increase in imports this is equivalent to an overall quota cut of some 5 %. Whether this order of cut would be sufficient to meet the EU obligations under the GATT depends critically on the EU's trends in consumption. Overall, liquid milk consumption appears to be declining very slowly, though within the total there is a drift toward semi-skimmed and skimmed milk. Consumption of butter and cream are also on declining trends but cheese consumption is rising. Some commentators believe that the increase in the consumption of cheese combined with increases in subsidised consumption of butter and skimmed milk powder will be sufficient to offset the fall in exports and the rise in imports. This assumption may be optimistic since any increase in subsidised consumption has an associated budget cost and greater subsidised consumption is likely to depress unsubsidised consumption. On balance overall EU supply and demand balance seems finely poised. It is therefore reasonable to conclude that dairy farmers are unlikely to suffer a cut of between 4 and 5 % in milk quotas before the year 2000. The agreement for the proper implementation of quotas by the Mediterranean countries who appear, at present, to be reluctant to adopt, may take some time to work through. For many years EU milk yields have been rising at an underlying rate of more than one per cent per year. This trend is likely to continue, so by the year 2000 the EU dairy herd could be down by between 11 per cent and 13 % (of which approximately 7 % is due to rising yields). This suggests a reduction of about 2.5mn dairy cows, across the EU.

SUMMARY OF OUTCOMES

As can be seen by the above commentary, the short term effects will be minimal. But towards the end of this century and early next century, there is indeed mounting pressure for change, and this will have a flow on effect to the rural community. Consumers and tax payers, along with politicians are indeed demanding change. The failure of the GATT Uruguay Round agreement so far to reduce significantly the level of support to developed country agriculture will need to be addressed if the full benefits for New Zealand of free market access are to be achieved. The OECD report on agricultural policies shows that the level of support, most observers would say over-support, to farmers has, if anything, increased since 1993. In the case of the European Union, the OECD report confirms that the switch to direct subsidies in the key arable cropping area has meant that the overall level of subsidisation has remained largely unchanged, but with the proportion of subsidisation in the form of direct payments increasing. Direct subsidies in the EU increased by over 20%.

Within the EU, the 1992 CAP reforms have not only failed to reduce returns and thus discourage increased production, but have also increased subsidy-dependency.

The World Bank report also underlines the assessment that the agreement on agricultural trade was largely a deal done between Washington and Brussels to preserve domestic agricultural support systems while limiting their impact on the international market.

The final agreement is shaped largely by the fact that is was negotiated by the US and the EU. Despite the rhetoric about ridding the world of trade-distorting subsidies, the US had as its ultimate object the effective international control over the EU's expanding use of export subsidies. Control or elimination of export subsidies of both the EU and the US was also the prime objective of the Cairns Group. The EU and Japan had as their prime objective the continuation of their very high levels of effective protection and isolation from world market forces. This was a defensive strategy, and to a large extent it worked. Despite all the political furore, the agreement created in those countries, their farmers will be heavily protected from outside competition.

DRIVERS FOR CAP REFORM

Introduction

The GATT Agreement is just one of the drivers of Common Agricultural Policy reform. But change is required. There are four areas where pressure for change is being applied on the Common Agricultural Policy. Over the coming years, these drivers will change the face of the CAP, creating a far more environmental context, while still basically remaining a social policy document.

* GATT
* Supply and Demand
* Cost
* Central & Eastern Countries

Supply and Demand

The European Union remains an over supplied market.

Expanding production has raised self sufficiency levels in all major commodities. The result of this expanding production will be increased exports as internal consumption is growing at a slower rate. These exports will only be possible with the aid of export subsidies and will create pressure on world markets.

This is particularly evident in the arable area, where forecasts in production suggest that pressure will develop toward the end of the century.

Forecast EU Cereal Balance sheet (million tonnes)

	1994/95	**1995/96**		**2000/01**	
Annual Yield Increase	N/A	1%	1.5%	1%	1.5%
Estimated Production	161	165	167	174	180
Imports	5	5	5	5	5
Domestic Consumption	146	148	148	150	150
Surplus available for export	20	22	24	29	35
GATT Subsidised					
Export Limit	N/A	31.3	31.3	23.4	23.4

Source: ADAS, MAFF

Cost of Agricultural Support

The third major driver of reform is the increasing cost of agricultural support. With the CAP remaining the largest element of expenditure in the EU budget, there is mounting pressure in the UK, both from the political level and from consumers and tax payers, for a review of funding.

EU Expenditure on Agriculture

bn ECU

1990	30.6
1991	32.5
1992	35.1
1993	36.7
1994	36.5
1995 (est)	37.9
1996 (bgt)	40.1

Source: E.U. Documents

This accounts for almost half of the total EU budget, at around NZ$72 billion, and is forecast to increase steadily in the years ahead.

The CAP remains the biggest element of EU expenditure accounting for 47% of the total budget (1995). However within other OECD Countries support levels have risen faster, and to greater levels, with the exception of New Zealand and Australia. Within the EU the spending on agriculture has increased across the EU to the point where it is close to the budget guidelines agreed by the Council of Ministers.

Farming income has depended heavily on public support. The 1992 CAP reforms made support much more transparent and more easily applied to farm incomes since many payments are now made directly to producers.

The CAP costs the average family $NZ57 per week in higher taxes and food prices. The rise in expectations of city folk to see tangible results for their investment in agriculture, and to have more say in the way any assistance is delivered, has been heightened in recent years. A greater level of transparency is required.

EU Enlargement

The final driver of reform of the CAP is European Union expansion to include some Central and Eastern European countries (CEE) . Since the lifting of the Iron Curtain in 1989 the agricultural impact of these countries on the European Union has grown. The 1993 European Council opened the possibility for these countries to apply for Union membership, and two have already done so. In December 1991 the European Union signed Association Agreements - also known as Europe Agreements - with Poland, Hungary and the Czech and Slovak Federal Republic. These Agreements provide for co-operation in various fields and reduce trade barriers, leading eventually to a free trade zone in most products (but not agriculture). The possibility of ultimate EU membership was recognised, but not a formal goal. In February 1993, Romania, and in March 1993, Bulgaria also signed Europe Agreements. If CEE agricultural production is stimulated by higher CAP prices this could have enormous consequences for the CAP budget and for the European Union's GATT commitments.

The OECD report notes that privileged access to higher priced EU markets by the Europe Agreements may already have started to distort production decisions in the CEE countries.
The Europe Agreements, by increasing the Access of CEE goods on the EU market will increase the cost of the CAP. Estimates put this effect as a relatively minor one, perhaps an additional 100 m. ECU budget by 1996. (The current agricultural budget is 37.9 billion ECU).
Not only would the cost of applying the CAP to these countries by prohibitively expensive, these countries' exports are projected to exceed significantly the limits permitted by GATT for export with subsidy, whilst the present EU is likely to be a its limits by the time they join. This means that the enlarged EU will be producing surplus food far in excess of the amounts it will be allowed under GATT to export with subsidy. It is estimated that this excess could be as high as 75% over the GATT limits. Storage or destruction of surpluses of this magnitude would not be

acceptable politically. Neither is it realistic to believe that the central and east European countries could somehow be obliged to apply only part of the CAP. That would be unsustainable in a single market. Equally fanciful is the idea which some have put forward that the EU will somehow persuade its partners in the GATT to relax its agricultural constraints so as to facilitate enlargement. Given that the main reason the Uruguay Round took 7 years to complete was the determination of the United States and other agricultural exporting countries to rein back the CAP - and the 1999 review is to take the process further - a relaxation of the limits hardly seems a likely outcome. The only realistic alternative therefore is to change the policies so that EU farmers can export their products to third countries without the necessity for subsidy. It is for this reason that CAP reform becomes inevitable. The only questions then are what kind of reform is needed and when should it occur.

Summary

The present Agricultural Policy has led to a high cost structure which in a large measure, can only compete with the aid of subsidy. However, the increasing pressures will force the European Union into strategic choice, between moving to a more open, liberal policy of reducing support toward world market levels, or tightening further supply controls, which are the only other way of containing production to meet the GATT limits. But it is clear that reducing support policies toward world levels can only be part of the solution. As I eluded to earlier, sustaining rural populations in remote parts of the community, conserving and enhancing the environment, and maintaining farmers' incomes are equally important social objectives. There are considerable economic benefits to the European Union of reducing production related supports towards world levels. MAF UK estimates show that under the above circumstances the level of support could lead to increases in world prices for cereals by 20%, for milk products and sugar by 50%, and sheep and beef products by 30%. In addition farmers inputs and costs may fall.

Clearly change is required, this is a view of many in the United Kingdom. However once you cross over the Channel, it quickly becomes obvious that the mood for change is not so great, and that much of the impetus being pushed by politicians and farming leaders in the UK is not shared by their counterparts in mainland Europe. Indeed, the Europeans are driving strongly to maintain the status quo in many cases.

UK farmers benefit from this, by virtue of the scale of their operations, with many of them being much larger than in mainland Europe.

So what are the realistic changes that we may see develop in the years ahead?

OPTIONS FOR THE FUTURE

Introduction

The future shape of the CAP will be moulded be the pressures outlined above, and world trade negotiations. The willingness of the EU and the USA to open their markets to world prices will have an overriding effect on the likely shape of world markets in the twenty-first century. The EU has a number of options and directions by which support can be placed into rural areas. The commission itself has set out a number of objectives for the CAP. They are:

- to increase competitiveness internally and externally in order to ensure that EU producers take full advantage of positive world market developments;
- maintain food safety and food quality, which are both fundamental obligations toward consumers. To ensure a fair standard of living for the agricultural community, and contributing to the stability of farm incomes. The legislation is in great need of simplification. The integration of environmental goals into the CAP and the creation of alternative job and income opportunities for farmers and their families are likely to the be the single greatest focus area for any change in the CAP.

The following is a brief look at the four main delivery vehicles that may be used to change the face of the Common Agricultural Policy.

1: OUTPUT QUOTAS

This strategy controls production rigidly, such as limiting production at farm level. The milk quota regime is a prime example of this policy, where excess production carried the risk of penalty. It has the advantage of maintaining farm incomes by avoiding the need to cut prices. It controls production, thereby reducing the need for intervention and/or subsidised exports, as well as cutting public spending. Prices do not need to be reduced and price support can be maintained. Output quotas are already in place for milk and sugar beet. They encourage producers to give greater attention to cost reduction - contributing to improvements in efficiency. Tradable quotas may provide a valuable asset and assist those who may want to get out of the industry. Balanced against this is that they are complex to administer (for cereals and beef) and run counter to the world-wide trend toward open markets. The gap between EU and world prices may widen, reducing competitiveness. Quotas leave commodities vulnerable to substitute products and reduce efficiency of quota if not held by the most efficient producers. They also act as a barrier to entrants. Extending output quotas may create knock-on effects throughout the industry with no evidence of environmental benefits. Future GATT rounds will cut export subsidies leading to reduced quotas. Cuts in import levies will reduce the price premium form output quotas.

2: INPUT QUOTAS

These are designed to control production indirectly by controlling a key input. Set-aside is the best example of this strategy at present. The main advantage is that they are already a central part of the CAP and more likely to be developed than abandoned. They allow support either through price support, direct payments or a mix of both - balancing support from the market and tax-payer. Controls can be adjusted as needed, for example set-aside could be increased if over-production became a problem. They are environmentally friendly. Set-aside may be used to provide public benefits and controls of stocking density imposed to reduce production intensity. Balanced against this that they are less precise in their impact on production as they influence output indirectly, and may need to be continually cut as productivity gains are made.

3: BONDS

These are based on the theory that by giving individual farmers a tradable annual support payment in the form of a bond, the less efficient will cash them in and leave the industry. Alternatively, farmers can hold on to the bond which entitles them to continue receiving payments. At the end of the bonds life, agricultural support will be withdrawn. However, to work successfully all current support would need to stop immediately, otherwise the value of the bond may not be set high enough to encourage sufficient leavers.

This would lead to rapid restructuring of the EU farming industry, ensuring more competitiveness on world markets. Market prices are allowed to fall to world prices - clearing surpluses and avoiding the need for subsidised exports to meet GATT obligations. The lower input prices improve internal competitiveness of the EU food industry. They don't need mechanisms to control production and also lower asset prices, especially for land, allow newcomers to become competitive quickly and efficient producers to expand more easily.

In the longer-term, costs for agricultural support would be reduced with, perhaps, more money available for environmental projects. However, short-term, the costs of the Bond may reduce the funds available. Balanced against this is the problem that the Bond amount will become a political issue as the extent of the fall in farm prices will not be known beforehand. Full compensation would double CAP budget. As prices fall, large numbers of farmers would be forced out of the industry. Farming practices on the remaining land would change radically. Large areas of more marginal land would be left unfarmed and become derelict. Owner-occupiers could find the Bond value eroded by falls in land value. Tenant farmers may find themselves facing land-lord's claims against the Bond to compensate. The Bond value would be affected by movements in interest rates, could present taxation difficulties, and will need to be cut as future GATT rounds reduce subsidised exports. As import levies are cut in future GATT rounds the price premium may not be enough to justify the quotas. They also run counter to world-wide rends towards freer markets, require penalties and cause administration difficulties, and can be environmentally unfriendly. They may also slow down structural change, creating inefficiency and acting as a barrier to entrants, and make products vulnerable to substitutes and alter relative profitability of different commodities.

4: DECOUPLING

This system of support relies solely on direct payments which are totally unrelated to production, as opposed to current methods of support which involve intervention in commodity markets either to control production or manage demand. The single most important factor with de-Coupling is that it breaks the link between production and support, thereby reducing the risk of over-production and the need to subsidise exports. Some price support could be kept if border protection remained and production did not exceed internal consumption. But there is no need for complex mechanisms for input or output controls. With lower input prices, the international competitiveness of the EU fool industry would be improved. The environmental benefits, while linking payments to environmental objectives, may make support more sustainable. But the cost of direct payments needed to maintain farm incomes at current levels in absence of price support would soar. The EU may be unwilling or unable to fund the full cost. Payments may not be sustainable in the long term, and/or may be restricted to smaller-scale farmers. Direct payments are more likely to attract cross-compliance requirements, and farm gate prices would fall markedly and be subject to greater fluctuation, more as we are used to in this country. But the higher levels of direct payments may reduce competitiveness by reducing the incentives to restructure and the initial allocation of direct payments raises equity and administration problems. The high level of bureaucracy is likely to continue, and land owners will continue to lose more control and flexibility over land use. Even with these problems, it appears that this is the favoured way for the future.

	BONDS	DECOUPLING
Price Cuts →	Long term removal of all support	Direct payments unrelated to production
	INDIRECT QUOTAS	OUTPUT QUOTAS
Supply Control →	Restrict key input in order to limit production	Directly limit production at farm level

THE FUTURE SHAPE OF EUROPEAN RURAL POLICY

The major shifts I see over the coming years are:

- The decoupling of income payments from market support mechanisms. The present arrangements are an inefficient and market distorting way of supporting rural communities or of achieving wider social policy objectives.
- A reduction in supply controls and a move to a 'freer' market approach.
- As has already been foreshadowed in Britain, there will be a shift to effective and holistic policies for the rural economy and for the maintenance of rural communities. See employment section later in this report.
- A greater emphasis on cross-compliance, especially on environmental issues within the single market. There will be a need for Europeans to speedily exploit developments in agricultural research and development, to achieve a competitive edge. The impact of this move to a more environmental focus will have it's on New Zealand Agriculture. We will be forced to have equal or greater than the level of environmental standards, as they are supported to achieve. This is a major area that our land based industries have to act on now, documenting the outcomes of current practices, not only to demonstrate that we are clean and green, but that we are on a continuing plane of improvement. See environment section later in this report.
- The phasing out of export subsidies and thus real pressure both to curb over-production within Europe and to maintain the present EU share of world markets.
- Increased consumer pressure for legislation on animal welfare. See animal welfare section latter in this report.

Despite the best intentions for a managed change, it may take a crisis before any major changes in policy will occur. I would be surprised to see much change until early in the next century, and in the intervening period, Europe will continue to be cocooned from major changes. The forces of the international marketplace will not be felt at anywhere near the pace as in this country.

MILK MARKET DEREGULATION

Prior to November 1994, all dairy farmers in England and Wales received prices for their milk, calculated on the same basis, regardless of end use. More than half of the milk production has traditionally been consumed as fresh product, this being more profitable than manufacturing it into commodity products such as butter, skim milk powder and cheese. Producers now have the option of forming independent selling co-operatives, or contracting directly to milk processors . Concerned with their potentially weak bargaining position, many have opted for selling co-operatives. More than 30 such groups have been formed, each with a unique contractual offering. . The majority of producers, 65% in England and Wales, have opted to join the new producer co-operative, developed out of the old Milk Marketing Board. Milk Marque as it is known, is only concerned with selling milk, and has no processing capacity of its own, and no preferential supply agreements with individual processors.

Competition between buyers has resulted in a significantly higher milk price paid to producers. There has been an 8% increase in the average post deregulation price, but there is considerable variation . However, these prices look unsustainable, and have over recent months been dropping, particularly with the BSE scare and realities of the international market place. Consumption has been adversely affected by health concerns of eating saturated fats. However, the reduction in consumption has been more than offset by the 17% decrease in production since 1984 with the introduction of milk quotes.

Consumers have experienced a slight increase in the prices of dairy products, in particular butter and cheese, but these do not reflect fully the increases paid to farmers. The main effect so far has been a significant reduction in margins achieved by the processing sector, resulting in profits falling, staff cuts and plant closures

The processing sector of the dairy industry has some major restructuring ahead. The 600 manufacturing sites will over time need to improve efficiency and scale, if they are to remain viable. The Euro comparisons are stark. The average UK cheese plant is 2500 tons, the Irish average is 10,000 tons, and the Dutch average is 35,000 tons. One effect of deregulation is that there is now more scope for processors to tailor their requirements, both in terms of quality and timing of supply.

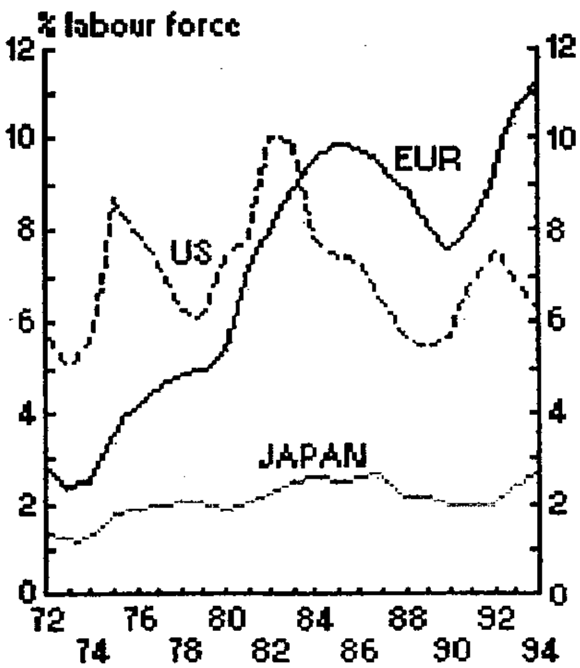
With the deregulation, the home delivery truck may become a rare sight in the years ahead. The supermarkets are placing considerable pressure on that service using milk as a loss leader, with prices as low as 22 pence per pint, while home delivery service can be as high as 40 pence per pint. So the milk market in the UK is still in an early evolutionary phase, with much uncertainty and restructuring likely. We in New Zealand must learn, and not let power and greed destroy the very essence of our competitive advantage - the single desk-seller and integrated ownership from the cow to the customer. Who wins out of any deregulation of our Producer Boards? The customer, by lower prices, and we as an industry and country lose!

LABOUR AND EMPLOYMENT

With only 2% of the UK population involved in agriculture, the family links with farming are getting more remote. Farmers will have to be more accountable, accept more bureaucracy, and surrender more control.

Ten million people, one fifth of the population, live and work in rural England. In certain respects the condition of rural England has been improving. Between 1981-91 the population of more remote rural districts rose by 6.4%. Between 1981-89 employment in high technology industries grew by 12% in the most rural counties and fell by 16% in urban areas. 1993 employment in manufacturing accounted for a similar proportion of the labour force in rural districts as in urban districts (20% and 18%). However, many rural areas, particularly the more remote locations, continue to suffer from limited job opportunities and under-employment, outward migration of young adults and decline in traditional employment sectors. For example nearly 60,000 jobs have been lost in rural sector collieries since 1984, and rural jobs are also disappearing as a result of change in the agricultural sector, defence restructuring and the decline of seaside tourism and fisheries. There has been a continuing decline in the agricultural labour force during the 1990s and it is likely that a further 65,000 full-time jobs in farming will have been lost by the end of the decade. The shortage of affordable housing is a critical problem. The influx of more affluent long-distance commuters, retired people and second homeowners has pushed up house prices. The lack of affordable housing is forcing many young people and families to move away, depriving rural areas of their skills, and adding to urban pressures. In recent years homelessness has become an increasing problem in many rural areas. The poor provision of local services makes it difficult for people to get to shops, doctors, schools and other essential facilities, especially for those who do not have the use of a car where public transport is limited and expensive. A 1994 survey found that: 41% of parishes have no shop, 43% no post office, 52% no school, 29% no village hall and 71% no daily bus service.

Uneployment Rates, 1972-94



Developments in telecommunications are likely to influence future economic trends. Rural areas may be left at a disadvantage if new technologies are concentrated in populous areas.

One of the great benefits of the CAP to date has been the employment of labour in rural areas. Any change to the policy will need to ensure that levels of unemployment do not increase above the levels that exist at present, and indeed any improvement could well be justified. At present there are some 18 million people out of work in the European Union. These people have no control of their own destiny, and any change could well produce social unrest.

After some months in the UK, it was interesting to note that the organisation of labour and age structure on farms. The average farmer is aged 57, and farm labour is specialised into areas such as herdsman, tractor driver, mechanic. Not having an overall view of farming operations, or being multi-skilled to the extent we expect of our farm labour, the uptake of new scientific findings and changes in management systems appear slow to flow through to the farm. As farmers returns improve, existing farmers are consolidating and expanding, making the step for farm ownership for most, to great to even start. The biggest down side to this is that keen, motivated young people are not entering the industry and staying with it. These people can bring with them not only new ideas in practical areas, but also the uptake of new management systems. There are parallels for us here in New Zealand. Innovation of farm management ideas has always been driven by this group of people, and kept our low cost system evolving. We as an industry must endeavour to maintain pathways for young people to enter and move through the industry to further their goals, be it as professional managers, share milkers, or land owners, to the mutual benefit of all.

POWER OF THE CONSUMER

Introduction

With the move in the coming years to more environmental and social payments to rural communities, consumer expectations will undoubtedly be linked to environmental issues. There will be increasing demand from the buying agencies for documented evidence of continual improvement in environmental standards. This may be best handled here in New Zealand by having a benchmark, and measuring the percentage of producers that exceed this mark, then gradually lifting the benchmark. The initial benchmark may not necessarily be too difficult to achieve, as most of our current practices are of acceptable standard, but simply not documented.

Supermarkets

The power the top five supermarkets have in the UK of discretionary food spending continues to grow. With 65% of the grocery trade handled by this group, they largely dictate what the consumer will buy. This is a trend which is mirrored here in New Zealand. With many products that have a short shelf life, the contracts offered are ruthless. They must be produced to both quality and quantity specifications, but if it doesn't sell, the producer does not receive payment. One interesting area to note is the move toward smaller household sizes, and the continuing rise of people living on their own, requiring ready prepared meals, built around convenience, but still favouring the health conscious diet. With continuity of supply to supermarkets improved, seasonality of product has been overcome, with supermarkets able to source from many areas. This blurs the link between the supermarket shelf and what the consumer sees in the countryside.

Environmental Issues

Introduction

A liberal view is taken of the term environmental constraints. This can range from the obvious components of pollution of soil, air and water, but also covers such areas as the social effects of depopulation, public access, and effects on the landscape to look at the total rural environment.

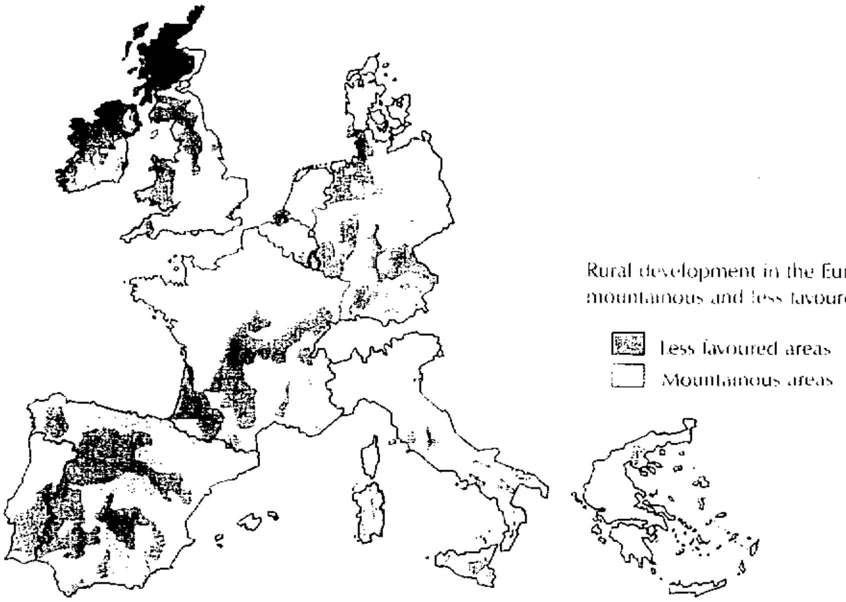
In the years ahead, agriculture will have to adapt to further changes in market developments, market policy and trade rules. Locals economies in rural areas will, of course, also be affected by these changes, at a time when many such areas are confronting acute development problems. Moreover, rural areas are increasingly required to fulfil important environmental and recreational functions. A prominent role will be given to agri-environmental instruments to support a sustainable development of rural areas and respond to society's increasing demand for environmental services.

Most of the environmental protection policies in the UK are promoted on a voluntary basis through codes of good agricultural policy and practise. This contrasts with Denmark and the Netherlands, in particular, where a strong regulatory approach is persued. In the UK, the main impact of legislation is on livestock farming. Regulation controls the building of slurry and silage pits, and in 650,000ha of nitrate vulnerable zones, farmers will be legally required to limit their animal manure applications. These factors have increased production costs on many farms, and will have the greatest impact in Northern European Union countries. Significant strides in pollution controls of slurry and silage effluent have been taken in the UK. MAF UK figures estimate that 11,500 farmers have improved facilities at a cost of 300 million pounds in the last 5 years.

Pesticide levels in drinking water remain an issue. Because such small amounts cause drinking water levels to be exceeded, reviews of the use of current pesticides will almost certainly lead to tighter controls, if not a total ban on some these ingredients. This leads to even more expensive and sometimes less efficient alternatives, putting further pressure on farming gross margins.

Targeted agri-environmental measures will be reinforced and encouraged through increased budgetary means and, where necessary, higher co-financing rates. Most relevant are services which call for an extra effort by farmers, such as organic farming, maintenance of semi-natural habitats, alpine cattle keeping, etc.

Another possibility which deserves further consideration, is to take into account the considerable overlap between Less Favoured Areas (LFAs) and areas of high natural value, and to gradually transform the related support scheme into a basic instrument to maintain and promote low-input farming systems. The farmland located in mountainous and less favoured areas represents 50% of the area farmed in the EU.



Rural development in the European Community: mountainous and less favoured areas

The Commission approved 130 agri-environmental programmes or groups of programmes submitted by the Member States or regions. In the case of 50 of these programmes, the Commission also approved the amendments requested by the Member States in the light of their initial experiences of implementation. Finally, with respect to better integrating the environment into the CAP, the Commission may make a proposal enabling Member States to make direct payments conditional on the respect of environmental provisions. As far as the other aspects of sustainable rural development are concerned,. the Commission suggests that these developments should be encouraged and supported by a reorganisation of the existing rural policy instruments. In this way it should be possible to ensure that the reform of the CAP, in addition to continuing market and income support, be accompanied throughout the Union by a broad range of rural development measures, without neglecting the objectives of economic and social cohesion.

An example of this is the LEAF Environmental Audit. It is the Linking Environment And Farming , LEAF. The solution needs to be practical, economic and environmentally responsible. On farms employing only a handful of people, and perhaps no outside help beyond the farmers family, the weight of bureaucracy could become difficult to bear. It must be recognised that EU regulations limiting the use of inputs, and probably leading to ongoing aid, are likely to increase with reform of the CAP, and that farmers must position themselves to respond. The LEAF environmental audit is primarily a management tool, a self-assessing checklist looking at every aspect of the farm and farm practices. It is simple to use and cost effective, and used over a period of years will provide a practical record of progress. It is a common sense, non-prescriptive way for farmers to look objectively at their business, record current practices, identify areas for improvement, assess strengths and weaknesses and identify input savings. Furthermore the audit is unique and practical as a management tool for a fully integrated farming system that is site specific and covers the whole farm enterprise. This includes landscape features, wildlife habitats, management of the soil, crop protection, conservation of energy, pollution control, organisation and planning and animal welfare. Carried out on an annual basis it allows farmers to respond to changes and aim towards continual overall improvement on the farm, both in terms of the environment and the farm's economic viability. A pilot run of the LEAF environmental audit in 1993 indicated that the self assessment approach "made farmers think" and some who carried it out even confessed that they enjoyed doing it!

The aim of the audit is to:

- Set out the environmental plan and statement;
- Set out the whole farm management policy;
- Follow the LEAF environmental audit self assessment sheets;
- Identify areas for action.

The objective of all this is not only to improve the environment, which is crucial, but also to become the preferred suppliers to a food industry which is becoming more demanding, as are its

customers, in respect of the way commodities are produced. Responsibilities, ethics and welfare will play an ever increasing part in the marketing of farm produce.
The LEAF audit is unique. It offers an easy assessment, which is inexpensive to implement and it addresses the main areas where environmental impact can take place on the whole farm. Not just the fabric of the countryside but also the principle resources of water, air and soil.

It is important that there is full management and team commitment towards environmental improvements and the LEAF Environmental Audit provides the management tool through which such progression can be directed, so that annual improvements can be recorded and demonstrated to the marketplace. A point that we as farmers in New Zealand must take on board and ensure that, as an industry, we are able to document the progress that is taking place in environmental improvement, to provide a sustainable future.

Animal Welfare.

Public opinion in the UK is a major driver behind changes in animal welfare. If consumers do not find production methods acceptable, they have tremendous power to refuse to buy the products from such methods. This was clearly demonstrated with the Veal calf exports to France and the Netherlands during my time in the UK. Welfare standards are currently judged against a criteria laid down by the Farmed Animal Welfare Council, under the heading of the five freedoms. These were developed as a guide to achieve a positive welfare, and go beyond the avoidance of cruelty. Farm Animal Welfare Council "5 freedoms" are now fundamental to all welfare issues.

- Freedom from hunger and thirst
- Freedom from discomfort
- Freedom from pain, injury or disease
- Freedom to express normal behaviour
- Freedom from fear and distress

These guidelines are supported with legislation, which place constraints particularly on intensive livestock industries, such as battery cages in poultry production, and sow stalls in the pig industry. New Zealand must take heed, we must become proactive in many of the animal welfare related areas. We must ensure as an industry that we continue to improve and monitor production from our farms. Food quality and the environment in which it is produced are becoming paramount. This produce only has value when the customer is prepared to buy. People doing the buying must have confidence in the production methods that we use. Areas that our industry needs to pay close attention to are the docking of cows tails, transport of cows in late pregnancy and early lactation, and inductions. Although another area which was vehemently attacked while in the UK talking with these protesters, was the area of easy care lambing - seen as no care lambing. One important message though, is that once the picture of a product is in the minds of the consumer, it will take a large amount of investment to change the way this product is perceived by the customer - emotion rules over scientific logic.

Public opinion can and does bring about change, but it is important that the alternatives are also practicable, and so achieve higher welfare standards. The current spotlight on welfare presents an opportunity to the livestock industry to work closely with their customers to provide quality products reared in acceptable conditions. The market place and customer expectations will ultimately dictate, not scientific research and logic .