

WELSH RURAL POLICY OUTSIDE OF THE EU

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Context

Agricultural and rural policies have been devolved to Wales since the initial Government of Wales Act (1998). Leaving the EU provides a number of opportunities. For example, there is scope to respond to farmers' concerns about complicated and time-consuming regulations, or to improve integration between rural and regional development policies. However, there will also be considerable new challenges and responsibilities to legislators and officials in the Welsh Government. In theory, complete latitude for change exists. In practice, there are a number of constraints that need to be addressed by careful consideration and creative thinking. This short introduction outlines the scope for a return to 'first principles' of agricultural and rural policies. It then uses the framework to identify important questions and explore options for development.

The farm sector in Wales

Welsh agriculture is predominantly based on pastoral livestock enterprises, due to climate, soils and topography. On average over the years 2013-15, milk and milk products accounted for 32% of gross agricultural output, cattle 24% and sheep 16%. With structural problems of weak scale economies and small farm business sizes, the result is low farm incomes in comparison with the overall UK average. However, agriculture (together with other types of rural land use) jointly produces rare ecosystems, and a cultural landscape that provides valuable recreation opportunities. These major characteristics should influence agricultural and rural policy design.

Principles of agricultural policy

In most industrial countries, agricultural policies have been designed to address the sector's multiple external cost and benefit and public good problems. Equity, in terms of spatial and industrial differentials, is also an issue. Farmers face a price-cost squeeze because their industry is composed of a large number of small businesses, but suppliers of their inputs and purchasers of their outputs are highly concentrated and powerful. Limited incomes are compounded by low mobility of factors of production, especially labour.

Thus in classical terms, objectives of policy have included (i) achieving acceptable levels and stability of farm income, (ii) providing secure supplies of safe, high quality food for consumers at fair prices (iii) contributing to the viability of rural areas, and (iv) protecting the natural environment, landscapes and biodiversity for society as a whole. Historically, both farm income support and reduction of price volatility were addressed through market interventions. In the EEC, as it then was, agricultural prices were supported through high tariffs and intervention purchasing. In the UK before accession, (and some other countries) deficiency payments were used to encourage domestic production. Both approaches were ruinously expensive in budgetary terms. Moreover, in the EU, the policy-driven incentives to intensify produced the surplus stocks of major commodities, and also caused significant and substantial environmental damage. In Wales in the 1980s, additional incentives to 'improve' grassland accentuated high sheep stocking densities and produced mainly ryegrass monocultures, localised soil erosion and some visual landscape changes, particularly in the hills. In the dairy sector, a 'technology treadmill' has had similar effects.

A contemporary approach for agricultural policy design

A return to large-scale market intervention would not only be undesirable, but also unlikely for two main reasons. On one hand, the Welsh budget, limited by the Barnett formula and its consequentials, could not

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afford it. It is unlikely that the current £260 million of CAP expenditure could be much augmented in a situation of overall revenue grant decline; more likely, it will be eroded. On the other, the UK remains a member of the WTO and is bound by its Uruguay Round Agreement on Agriculture. Very substantial changes from inherited policy would attract scrutiny, the possibility of challenge, and in the extreme, damaging retaliatory tariffs.

Trade policy is not a devolved matter, and even in the UK there is concern about a lack of expertise. A devolved administration such as Wales will find it hard to get good advice on the effect of different negotiating positions on their local interests. This also raises a more general issue; Welsh Government policy development expertise is in relation to limited. Until now, its main task has been to interpret, and locally implement, EU Agriculture Council decisions. In the new current circumstances, strengthening of in-house agricultural policymaking know-how would provide considerable benefits.

Since the late 1990s, many countries have embarked on agricultural reform processes that improve WTO-compliance. The OECD's 2002 report *A Positive Reform Agenda*¹ contributed to this process by identifying two typical reform routes. The first is decoupling of policies from production levels. This removes some incentives stimulating intensification. It also provides a much more efficient form of income support and some insulation from price volatility. The second is more focused targeting to correct external cost and benefit effects. This addresses environmental and other concerns. The result is greater market-driven incentives for agricultural production. Although debateable, these should in principle make agriculture more competitive, and contribute to both consumer welfare and the viability of rural areas.

An important additional policy stream seeks to improve the quality and consumer appeal of farm and other rural products. This provides scope for a longer term resolution of the farm income problem, but has had less emphasis, historically. For example, the current EU Rural Development Programme (Pillar Two) devotes only 20% of its total resources to farm viability, competitiveness, and sustainable forest management; Pillar Two itself is less than 40% of the overall CAP budget.²

Choices and questions

Cross-compliance requirements make direct payments more cost-effective by dealing with some wider society concerns. Even so, many countries, including in Wales, are gradually shifting emphasis from cross-compliant decoupled direct payments to targeted agri-environment schemes. Decoupled payments are not entirely incentive-compatible, because they get capitalised into land values. This makes farming a mainly hereditary occupation, and leads to concerns about limited opportunities for new entrants into farming. Agri-environment schemes can more easily be focused on specific local problems, although these are not perfect either. For instance, they mostly act indirectly by constraining inputs, outputs or modes of production, and monitoring and evaluation are consequently problematic.

Two relevant countries' policy frameworks are often discussed as examples in this context: Canada, and Norway. Canada has very few direct payments and deals with the effects of price volatility through revenue insurance schemes, half of the costs of which are borne by the federal and provincial governments. Norway has more generous direct payments than in the EU, and also maintains some market price interventions such as target prices and production quotas. It also has wide-ranging rural payments to maintain populations in areas outside the Oslo capital city region. These two extremes illustrate the boundaries of a future policy choice set. Political preference plays a major role in determining the balance between each strand of the

¹ OECD (2002). *Agricultural Policies in OECD Countries: A Positive Reform Agenda*. Paris: OECD.

² See European Commission (2013). *Multiannual Financial Framework 2014-2020 and the financing of the CAP*. Available at: http://ec.europa.eu/agriculture/cap-funding/budget/mff-2014-2020/mff-figures-and-cap_en.pdf

reform process, with direct payments favoured by an emphasis on equity, and policy targeting favoured by an emphasis on efficiency.

In conclusion, the discussion raises a number of weighty and urgent questions about Welsh agricultural and rural policy after leaving the EU.

- **Future financial support arrangements** cannot depart rapidly, or far, from a mix of income support, targeted payments to ensure the spill-over effects are managed, and measures to improve the quality and marketing of rural products. The last-mentioned is the most effective long-term solution to the farm income problem. A safe option would be to adopt inherited current EU policy wholesale, as it is unquestionably WTO-compliant. This, though, would negate the argument for bespoke measures that better address the special characteristics of the Welsh countryside. More effort on enhancing farm competitiveness could accelerate structural change, but could also result in high short-term disruption costs.
- The most important **unresolved question** at present is the shape of the post-Brexit trade agreement with the EU-27. Single market access would be the best immediate outcome for Welsh agriculture, because physical market logistics are integrated with continental supply chains. However, the current stance of the negotiating partners does not suggest a speedy or completely liberal outcome. In the short to medium term, most-favoured nation access to European markets (that is, in the absence of any immediate UK-EU trade agreement) would, for example, imply a 12.8% tariff plus €1,713 per tonne for sheep meat exports.³ While each polar outcome is possible, scenario planning for the potential consequences should be undertaken.
- Experience shows that **changes in agricultural policy**, whether major or slight, can be more efficiently introduced with careful preparation. This requires thorough study of likely impacts, including modelling, so that the intention of policy restructuring is clear, and appropriate mitigating (but emphatically transitional) measures are designed to accompany the changes. An important fulfilment of the Committee's scrutiny function should be to ascertain whether and what preparation is already under way.
- **Excellent mutual understanding** between Defra and the Welsh Government is essential, since England is Wales' largest agricultural export market. The degree to which policy frameworks can diverge from those in England should not be tested to destruction, even if Wales has a reputation for policy innovation (for example, in the widely admired *Tir Cymen* experiment and its successor schemes). Too radical a departure could be considered an unfair advantage (or disadvantage, depending) for the Welsh farm sector, and provoke a localised interregional trade dispute.

³ Swinbank, A. (2016), Brexit or Bremain? Future Options for UK Agricultural Policy and the CAP. EuroChoices, 15: 5–10. doi:10.1111/1746-692X.12126