ICAEW

REPRESENTATION 46/18

RESPONSE TO THE CONSULTATION DOCUMENT – HEALTH AND HARMONY

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ICAEW welcomes the opportunity to respond to the *Future for food, farming and the environment* consultation published by DEFRA on 27 February 2018.

This response has been drafted by members of the ICAEW Farming and Rural business community, a group of Chartered Accountants within the ICAEW whose members have a specialist interest and expertise in farming and rural businesses mostly as advisers to such businesses.

Statistical references are taken from the DEFRA document *Agriculture in the UK* last updated in June 2017 or from the *John Nix pocketbook for farm management*, 2018 edition. Assumptions regarding individual statistics are shown within each response.

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GENERAL COMMENTS

The Health and Harmony discussion document seems to have been drafted very much with individual farmers in mind, and most of the commentary sections ask for subjective views which will by their nature be personal to each respondent. As a group, however, we believe we are well placed to make some general comments on the whole approach adopted by the paper.

We believe that the move away from a flat rate land based subsidy in favour of a system which gives support for environmental benefits and encourages greater efficiency has much to recommend it. However, we would query whether the UK farming industry can survive, let alone expand or provide enhanced environmental benefits without a level of subsidy which in absolute terms stands at similar levels to those being given today.

Total Income from Farming (TIFF) has been running, on average, at £4.6bn per annum over the five years to 2016. There are some 73,000 farms of a size over 100ha, and these comprise 88% of the farmed acreage. This gives an average farming profit of £63,000 per farm over that period, which not only represents a return on the proprietor's labour but also on his/her invested capital and a deemed rent on owned land. There are approximately 200,000 full time equivalent farmers (Assuming that part timers are 50% FTEs) so this equates to £23,000 for each individual farmer. If there is an average working week of 50 hours throughout the year the return per hour will be about £9.20 prior to any return on capital or imputed rent. The real return for labour only is likely to be well below the living wage of £7.83.

These figures are, of course, inclusive of current subsidy levels of, on average, £3.1bn per annum (ie, 67% of the average profit). In the total absence of any such subsidy, the return to a proprietor drops to £3.30 per hour, far below a living wage, and a level which gives little scope for capital investment, without which enhanced productivity becomes unlikely.

The paper also works on a presumption that enhanced productivity is feasible for most farmers. We would comment on this point as follows:-

- We believe that for many years farmers have been trying to improve productivity, and have not been content to merely live on their land based subsidies. Reducing these subsidies will not necessarily enhance productivity, but it may drive smaller farms, in particular, out of business.
- Some farms may be able to improve their productivity by taking a larger share of profit from the food chain but these will tend to be those involved in horticulture and specialist crops (where the markets are of limited size and an increase in the number of producers will adversely impact on the whole sector). 94% of the arable area in 2016 was planted with the key commodity crops of cereals, pulses, oilseeds, and Sugar Beet. Producers of these crops have little control over their selling prices which are fixed in international markets, and very little control over their input costs which are largely determined by a very small number of internationally based suppliers.
- Most overheads such as rent or interest are at best semi variable and in many cases virtually fixed. The principle variable in productivity is yield, which is heavily influenced by weather. The degree to which productivity or profit can be controlled by improving machinery costs is relatively low, and is nowhere near the magnitude of current level of subsidy. For example the average gross output on wheat is £1204 per ha. Direct costs of seed, fertiliser and spray are £460 and stubble to stubble machinery costs are about £375. A notional rent would be about £250 so this leaves £110 plus the basic payment

of about £205 to cover interest and other overheads and provide a living for the proprietor. If the current level of subsidy is to be replaced by an increase in productivity, machinery cost (the variable which is most susceptible to control) would need to drop by an unrealistic 55%.

- Farming is by its nature a long term business with production cycles which are rarely less than 18 months and in some cases far longer. Even where cost saving measures such as more sophisticated machinery or machinery sharing are feasible they can take years to implement, the drivers being perhaps the obsolescence of existing equipment, farm reorganisation or even generational succession. For these reasons we believe that transition arrangements may need to take place over a very long period and certainly well in excess of the current five year plans which have been in place under CAP.
- Similarly, some of the environmental schemes will, if they are to have maximum benefit, require a commitment extending over decades. Some landowners will be reluctant to tie land into schemes which take years to develop unless they can see that the financial and environmental benefits will accrue over a longer term.
- The paper makes virtually no mention of fiscal incentives (or disincentives). We believe that fiscal issues are relevant when planning future agricultural policy. In particular we fail to understand why investment in modern agricultural buildings, which will almost always be constructed to aid productivity but will only have a finite productive life, receive no tax relief.

SPECIFIC RESPONSES

Whilst the questions posed within the paper are primarily directed at working farmers, we believe that a response from the group on behalf of its farming clients is perfectly valid, and may encompass the views of many of the smaller and less sophisticated farming clients who are unlikely to respond directly to a consultation document. The agricultural accountant’s relationship with an agricultural business and particularly a small business is a very close one, often extending across two or three generations. In many cases the accountant will be the only person outside the family who will be privy to financial discussions, and surveys (such as the MHA surveys on attitudes in farming, 2015-2018) show that the accountant is almost always the main professional source of advice when financial decisions are being taken.

How would you simplify current CAP rules?

1. Simplify the application form.
2. Develop more simplified packages.
3. Reduce evidence requirements.

Uptake of Stewardship schemes is heavily driven by press comment and the experience of other farmers, and discussion with professional advisers. If the schemes are attractive they will be taken up.

What is the best way of applying reductions in Direct Payments?

Apply a cap to the largest payments, probably those over £200,000.

What conditions would be attached to Direct Payments during the agricultural transition?

Retain but simplify current cross compliance rules.

The reduction of Direct Payments should be a long one perhaps extending over at least ten years and possibly as much as twenty years. Since farm profitability is so closely driven by product prices, a transition linked to the prices of the main agricultural outputs might have some merits.

How to improve knowledge take up?

1. Developing formal incentives to encourage training
2. Better access to skills providers
3. Working with the industry to improve standards.

What are the barriers to capital investment?

1. Underlying profitability of the business
2. Investments in new buildings, equipment, technology are expensive
3. Uncertainty about the future.

It is difficult to see that more young people will be attracted into the industry unless it can become more profitable. Existing tenancy law is an amalgam of the interests of landlords and tenants and, given their sometimes diametrically opposed views, is probably ‘fit for purpose’. Access to alternative sources of low cost capital for tenants coupled with fiscal advantages for landlords letting to new entrants might do something to encourage such lettings.

What are the priority research topics?

1. Plant and animal breeding
2. Crop and livestock health and welfare
3. Managing resource and ag chemical sustainably.

How can industry and government ensure that R & D delivers?

1. Encouraging a stronger focus on near market R & D
2. Giving the industry more say in the direction of R & D
3. Bringing groups of farms together to develop practical solutions.

The mains barriers to innovation are the innate conservatism within the industry and financial caution in using new technology. Financial incentives will help to lower both these barriers.

What are the priority skills gaps?

1. Research
2. Engineering
3. Manufacturing.

Lack of profitability will be a persistent factor in making agriculture a career choice. A more profitable sector will be more resilient in every way.

Which environmental outcomes are the most important for the public?

1. Enhanced beauty, heritage etc.
2. Improved water quality

3. Improved soil health.

Which other public good should be supported?

1. World class animal welfare
2. High animal health standards
3. Preserving rural resilience and landscapes.

Which outcomes could be best achieved by incentivising action?

1. Habitat restoration
2. Species recovery
3. Soil quality.

It seems likely that, eventually, outcome based environmental land management schemes will be the way in which agriculture can be supported against a financial environment where the agricultural goods produced may cost more to grow or raise than the public are prepared to pay. Such a scheme will need to reflect the differing needs and possibilities in individual geographical areas.

Farmers and land managers could be encouraged by the availability of free feasibility studies to point out what options could be available to individual farms or land parcels.

Animal welfare

1. There is a strong case for government funded pilots into welfare enhancement schemes.
2. Government should set minimum standards for consistent information at point of purchase.
3. Government could improve animal health by, in order, use of regulation, financial incentives and supporting targeted advice through vets.

Challenges to rural communities

1. Broadband coverage
2. Mobile phone coverage
3. Access to skilled labour.

Addressing the first two issues by way of incentivising or compelling the relevant service providers will do much to help achieve the third objective.

How to improve the inspection process

1. Greater use of risk base targeting
2. Increased options for self-reporting
3. Better data sharing.

The system might be better if individual assessors had greater flexibility: for example where there are accidental minor infringements in some areas but significant overprovision in other environmental features, some of which might not be specifically claimed as part of a scheme, it may be appropriate for penalties to be mitigated or waived.

What factors weigh on farm insurance decisions?

1. Desire to cover specific risks
2. Desire to cover general risks
3. Cost of insurance.

Farmers can often mitigate volatility by using pools and cooperative arrangements but these will not help mitigate the danger of worldwide long term price movements. Whilst minimum output prices would be attractive, it may be that some sort of area based subsidy linked to output prices could help sustain the industry and protect farm viability during longer periods of low prices.

Crop and plant health

It seems logical that if the government is providing a safety net of support in other environmental areas, an emergency fund to help with disease, to provide a secure supply chain and to help in post disease recovery would be fair.

Improving fairness in the supply chain

1. Provide a statutory code of conduct
2. Promote Producer organisations
3. Relax conditions for smaller producers to enable them to access consumers directly, cutting across the supply chain with minimum bureaucracy.

Farmers collaborate on a local basis far more frequently than is supposed, but such collaboration is often informal and undocumented. Formal collaboration takes time and money. Some argue that organisations which have existed in the past such as the milk and potato marketing boards were very valuable and should be reinstated.

Cross border issues within the UK

Because of the fluidity of borders within the UK (especially outside Northern Ireland) any diversion from a single set of rules will lead to problems. Government should aim for the greatest possible consistency of rules.

International issues

The broad priorities set out in the document seem appropriate. The government needs to set out trade missions to other countries to promote British produce, inviting industry groups to contribute ideas, develop products appropriate to particular markets and in due course attend trade fairs. Key selling points for British food will be animal welfare standards, and traceability.

Legislation

The powers of the Agriculture Bill as set out seem very wide ranging. However, they could include the power to give fiscal incentives as well as purely financial ones and also to establish new forms of incentivised landlord and tenant relationships.