Impacts on Changes in the Wider Economy on Agriculture and the Agri-Environment

Report to Department for Environment Food and Rural Affairs

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This report, prepared for Defra, presents the findings from a short research project and conveys the views of the authors and, critically, the project participants and does not necessarily represent the views of Defra. This short review, with an in-depth but relatively limited sample of respondents, should not be taken as a indication of policy intent but seeks to inform a wider understanding of issues affecting agriculture and the environment.
EXECUTIVE SUMMARY

GENERAL CONCLUSIONS

1. On balance, there has been little overall negative impact on agriculture from the changing conditions in the wider economy – i.e. the credit crunch and recession. In fact, the greatest effect so far, albeit indirect, has been a positive one. The recession has prompted a realignment of exchange rates that has greatly benefitted UK farming.

2. Other short-term trends have also been positive. The reduction in base rates has resulted in the sector paying lower borrowing charges, despite increases in borrowing margins and fees. The great strength that agriculture has in balance sheet terms became a particular benefit during a time when lenders were forced into being ultra-cautious. The general global slowdown has also reduced input cost inflation, so lowering costs of production for many producers. It is reported that certain farm diversifications, notably tourism, have actually benefitted from the recession as more of the population holiday at home.

3. Some negatives have been identified. Some businesses have found it more difficult to access credit, but this is only in selected cases; usually where the business was weak before the downturn hit, or where borrowing is for non-agricultural purposes. Global commodity prices have weakened following the recession; this is particularly evident in the cereals market. Whether this is a direct recessionary effect, or more do with increasing supply is uncertain. In many other sectors of UK farming, any fall in ‘world’ or EU prices has been more than offset by the effects of the weakness of Sterling.

4. Within the food market the recession has resulted in a general ‘trading down’ by consumers. Apart from those farmers that have moved up the food chain, this seems to have had little direct effect on primary producers. One exception to this is the organic market, where farmgate price premiums have tended to weaken as a result of slower sales at the consumer end. By way of contrast, the trends towards paying premium prices in return for higher standards of animal welfare and consumer wellbeing have shown themselves to be very robust in the face of the recession.

5. Farmers who have diversified into property lets have suffered as a result of the general downturn in the economy, and the property market in particular. However, this trend is not universal and there are regional variations. There are some signs that weakness in the labour market is making it easier for farm businesses to recruit staff.

6. Many of the trends outlined above are short-term. It is expected that some will fade as the economy returns to growth. In terms of the structure of the industry, land management, and environmental issues, the trends that existed before the credit crunch still continue. It is hard to discern any acceleration (or indeed, deceleration) in these at this point. It must be remembered that we are still very close to the financial turmoil, and, as yet unrecognised, effects may yet be seen in the coming years.

More detail on the key impacts are given below:
FINANCIAL MARKET EFFECTS

7. Despite the ‘credit crunch’, agriculture has escaped relatively unscathed with credit availability not being a problem for the vast majority of businesses. The high net worth and low risk profile of the industry has made it one of the banks ‘favoured sectors’ during the last two years.

8. Margins over the base rate have risen by around 1%-3% in general. Some businesses with a poor risk profile will have seen higher increases. Arrangement fees have also increased (or been levied for the first time). Despite this, the drop in the underlying base rate has seen many farm businesses paying less for borrowing than before the financial crisis hit. However, if and when base rates rise, the extra margin applied in particular to weak borrowers may quite quickly place them in a precarious position. The gap that has opened in the borrowing positions of the weak and the strong may prove to be one of the important lasting effects of the ‘credit crunch’ with all that it might imply in terms of accelerated structural change.

9. The pattern of lending to farming has not altered as a result of the changes in the wider economy. Overdrafts are still an important feature of farm borrowing; being prized for their flexibility and, until recently, little extra cost compared to other forms of finance. There is some evidence that farm borrowing has moved onto term-loans, but this is not widespread.

10. There is at least a perception that competition has reduced as a result of the rationalisation in the banking sector, as well as the remaining banks adopting a more cautious attitude to lending.

11. In the same way that bankers have continued to regard agriculture as a ‘safe bet’, the supply trade has also continued to offer trading terms to farmers relatively unchanged. The recession has not had a large impact on merchants and processors, so farmers have not changed their marketing arrangements.

12. The decline in pension values as a result of the financial crisis has had some effect on farmers’ decision-making regarding retirement. However, it was noted that pension investment is patchy in agriculture, and therefore this factor is not necessarily widely applicable.

EXCHANGE RATES

13. The shift in Sterling’s value against the Euro over the last two years has seen the biggest effect of the recession on agriculture. A weaker Pound has been very positive for farm returns. The change in exchange rates has insulated UK farming from the commodity price falls that have caused sharp drops in profitability in other EU countries.

14. The consensus among forecasters is for Sterling to appreciate slightly over the medium term – although not back to pre-recession levels.

15. Faced with volatile exchange rates there has been interest from farmers in ‘fixing’ the conversion rate for the Single Payment. At present this is still a minority activity; probably less than 5% of claimants.

16. It is generally accepted that there is little an individual farmer can do to hedge against currency movements other than via the Single Payments. Any other risk-management strategies for exchange rates are likely to be through contracts with merchants and buyers.
Commodity Market Volatility

17. The past two or three years have seen massive volatility in both farm input and output prices. It is difficult to disentangle how much of the volatility was a result of the economic boom and subsequent bust, and how much down to factors specifically related to agricultural market imbalances.

18. Some farmers have reacted to the volatility by adopting a more sophisticated marketing strategy. This was more prevalent in the arable sector, but even here it is by no means universal. Livestock farmers are handicapped by not having access to a futures market for their products, on which many risk management tools are based.

19. It was reported that the industry had still to fully embrace the concept of calculating costs of production. Without this level of management information then a sophisticated approach to production planning and marketing was difficult, if not impossible.

20. Some farmers had recognised environmental schemes as a means of risk management. With relatively secure, government-backed payments guaranteed for 10 years the Higher Level Stewardship (HLS) was seen as an attractive option for making environmental improvements. The easily accommodated and lower standard payment rates for Entry Level Stewardship (ELS) is still regarded as a positive ‘bolt-on’ to commercial farming.

21. Farm input costs have also been volatile. Although it is possible to buy-forward, there is limited scope for farmers to deal with input price changes over the medium term. Faced with higher input costs, there have been reductions in input use, and a more targeted approach. This varies between sectors with more scope for ‘precision farming’ in arable situations, but more opportunities for input substitution (i.e. manure for manufactured fertiliser) on livestock farms.

The Food Market

22. The main feature of the recession in the wider food market has been the phenomenon of ‘trading down’. This has seen consumers looking for value in their purchases.

23. The effect at the farm level has been limited, with most of the impact being on retailers, food processors and providers of food outside the home (foodservice). One area that is an exception to this is the organic market. Weakening retail demand has seen farmgate prices fall for organic products. There is little sign that this has caused a widespread move from organic to conventional production so far, but it may be too early to tell. Conversion to organic is a lengthy process and entails receipt of payments that must be refunded if the process is reversed within five years. Therefore the decision to revert back to conventional is not taken lightly by farmers.

24. There was a body of opinion within the Focus Groups that ‘local food’ will emerge from the downturn as a strong sector; possibly taking market share from organic. It is too early for any concrete evidence of this to emerge and food industry analysts generally took a contrary view. The analysts commented that local sourcing is difficult and expensive for supermarket supply logistics, and that these costs would have to be
passed on. This would then run contrary to the drive for value that has been a feature of consumer spending in the recession.

25. The supermarkets have proved themselves to be very adept during the downturn in how they quickly adapted their retail offer to match the consumer mood. This provides a good illustration of how flexible and sophisticated the multiple retailers (and their supplies) have become.

**FARM DIVERSIFICATION**

26. The effects of changes in the wider economy on farm diversification activities are mixed. Property enterprises (mostly the re-letting of redundant farm buildings) have been adversely affected. But this is not a universal feature, with demand for letting in some markets holding up well.

27. The provision of holiday accommodation is widely felt to have benefitted from the recession, as more people have taken holidays in the UK. However, FBS data suggests that overall income from farm tourism has not increased and this may be because occupancy outside the peak holiday periods may have suffered as result in cutbacks on second holidays and weekend breaks.

28. Diversifications based on other leisure activities, such as equine, country sports etc., have also seen demand drop as disposable incomes have fallen (or perhaps more accurately, people have become more concerned about their future income prospects).

29. Where members of farming families have taken off-farm employment, little effect is yet reported from changes in the labour market as a result of the recession. This is likely to be partly due to unemployment not increasing greatly so far, the type of jobs that farming family members have, and the sectors of the economy that they are employed in.

30. Opinions on the availability of casual labour are mixed. On balance, the majority thought that there was greater availability (albeit marginally) of UK workers than before the recession. Although shifts in the exchange rate have reduced numbers of migrant workers from some countries, this has been offset by increased numbers from ‘further East’. It should be noted that there was a significant minority who dissented from these views, and thought that casual labour availability was no better, and possibly worse, than two or three years ago. The market for such workers seems very localised.

31. In terms of skilled labour, employed for the long term, the situation again seems to have improved very slightly as a result of changes in the wider economy. Employers report that it is easier to recruit good quality staff.

**BUSINESS CHANGES**

32. The appreciation in the value of assets held by farmers (primarily land) had greatly increased the wealth of owner-occupiers. Although this had helped the sector through the credit crunch in terms of allowing borrowing to be maintained, it had not really affected the decision-making process on farms. As farmers almost never sold land, the notional value of it did not enter into their business planning.
33. Any sharp fall in land values caused by the financial crisis would be potentially disruptive to the farming sector. However, it was widely felt that prices would remain firm in the foreseeable future.

34. Rising asset values had not persuaded owners to invest in their holdings – it was widely perceived there was a backlog of investment on farms, especially in buildings and fixed equipment. With higher prices and profits in some sectors, this under-investment is slowly being addressed. If investment were to continue at a low level, this is likely to have a detrimental effect on future productivity.

35. Despite the very low level of land being sold, the farming sector has undergone a period of considerable consolidation with the average business size continuing to rise. This has occurred through various arrangements that allow the ‘farmer’ to remain on the holding, but the agricultural activity be managed by someone else.

36. The number of actual ‘decision-makers’ in farming is well below the notional number of farmers shown in the statistics. There is a question whether land let on these (short-term) arrangements is subject to the same level of stewardship. Views were mixed, with some interviewees strongly believing that the ‘stewardship ethic’ was lost under such arrangements. Others did not detect any great reduction in the care and attention given to land management.

37. The best businesses (often, but not always, those that have expanded) are making big productivity gains. But there remains a large rump of businesses that are standing still in terms of performance. Thus the gap between the strong and the weaker performers is growing.

ENVIRONMENTAL IMPACTS

38. Poorly performing pensions (and the difficulty of the younger generation finding sufficient capital to buy-out the farm business) means that the older farmers are maintaining an interest in the business for longer. There was a view that this could have a negative environmental impact, as the younger generation were more ‘attuned’ to the environment. However, this generalisation should be treated with some caution.

39. Economic pressures, often of longstanding and not necessarily linked to the economic crisis, had led to more specialisation in agriculture. The decline of mixed farming was considered bad for the environment, both in terms of biodiversity, but also more generally in terms of integrated and resilient farming systems that may be better placed to undertake lower carbon farming. The trend towards specialisation is not expected to change.

40. Farm specialisation is also linked to growing enterprise size and consolidation. It was thought that this may have negative effects on environmental scheme uptake, due to lack of management time to devote to an ‘environmental enterprise’. Consolidation is less evident in the organic sector which with the degree of management required perhaps lends itself less readily to structures such as contract farming. This could place the sector at a competitive disadvantage.

41. More careful use of inputs as a result of input price increases are likely to create environmental improvements in water quality and Greenhouse Gas (GHG) emissions.
42. The downturn in the economy has affected the market for game shooting. A sizeable amount of the habitat management on farm is linked with shooting and the desire to improve shoots has been an influence on some farmers’ willingness to participate in agri-environmental schemes. At present there seems little concrete evidence of a change in behaviour, but there could be a negative environmental impact if the level of habitat management drops. Conversely, there could be environmental benefits if the intensity of some of the most commercial shoots lessened.

43. Amongst the environmental organisations interviewed there was concern that CAP reform could severely reduce the funds and therefore the impact of agri-environmental schemes under Pillar 2. It is only an indirect effect of the financial crisis, but problems with government finances right across Europe may see CAP funding cut in future.
## CONTENTS

1. **INTRODUCTION** .......................................................................................................................... 1

1.1. **THE PROJECT** ......................................................................................................................... 1

1.2. **PROJECT APPROACH** ................................................................................................................ 1

1.3. **STRUCTURE OF THIS REPORT** ................................................................................................. 3

2. **BACKGROUND** ........................................................................................................................... 4

2.1. **THE FINANCIAL CRISIS** ........................................................................................................... 4

2.2. **POSSIBLE FUTURE ECONOMIC TRENDS** ............................................................................. 6

2.3. **TRENDS IN UK AGRICULTURE PRIOR TO THE FINANCIAL CRISIS** ................................. 7

3. **FINANCIAL MARKET EFFECTS AT THE FARM LEVEL** .............................................................. 13

3.1. **CREDIT AVAILABILITY FOR AGRICULTURE** ......................................................................... 13

3.2. **BORROWING COSTS** ................................................................................................................ 15

3.3. **BORROWING STRUCTURE AND RISK MANAGEMENT** .......................................................... 18

3.4. **SUPPLY-CHAIN TRADING RELATIONSHIPS** .......................................................................... 20

3.5. **PENSIONS AND THE FINANCIAL CRISIS** ............................................................................ 22

4. **EXCHANGE RATES** .................................................................................................................... 24

4.1. **BACKGROUND** ......................................................................................................................... 24

4.2. **DEALING WITH EXCHANGE RATE VOLATILITY** ..................................................................... 28

4.3. **EUROPEAN COMPARISON** ...................................................................................................... 30

5. **COMMODITY MARKET VOLATILITY** ........................................................................................ 31

5.1. **FARM OUTPUTS** ........................................................................................................................ 31

5.2. **INPUT COST VOLATILITY** ......................................................................................................... 37

6. **THE FOOD MARKET** ................................................................................................................ 42

6.1. **TRADING DOWN** ....................................................................................................................... 42

6.2. **ORGANIC, LOCAL AND WELFARE** ........................................................................................ 44

6.3. **FOOD CHAIN STRUCTURE** ...................................................................................................... 47

6.4. **OTHER ISSUES** ........................................................................................................................ 47

6.5. **THE FUTURE** ............................................................................................................................ 48

7. **DIVERSIFICATION AND EMPLOYMENT** ................................................................................... 50

7.1. **GENERAL** ............................................................................................................................... 50

7.2. **FARM DIVERSIFICATION** ......................................................................................................... 50

7.3. **OFF-FARM INCOME** ................................................................................................................ 55

7.4. **LABOUR AVAILABILITY** ........................................................................................................... 56

8. **BUSINESS CHANGES** ................................................................................................................ 61

8.1. **GENERAL** ............................................................................................................................... 61

8.2. **ASSET (LAND) PRICES** .......................................................................................................... 61

8.3. **INVESTMENT** .......................................................................................................................... 63

8.4. **STRUCTURAL CHANGES AND BUSINESS MANAGEMENT** .................................................. 63

9. **ENVIRONMENTAL IMPACTS** .................................................................................................... 66

9.1. **INTRODUCTION** ...................................................................................................................... 66

9.2. **INTERVIEWS WITH ENVIRONMENTAL ORGANISATIONS** .................................................... 66

vii
10. CONCLUSIONS ...........................................................................................................73

APPENDIX 1 – REFERENCES ..........................................................................................75

APPENDIX 2 – INTERVIEWEES ......................................................................................78

APPENDIX 3 – FACILITATORS GUIDE ...........................................................................79

APPENDIX 4 – INTRODUCTION LETTER: ENVIRONMENTAL INTERVIEWS .................83

APPENDIX 5 – ENVIRONMENTAL CONSEQUENCES: INTERVIEW PRO-FORMA ..........84
1. INTRODUCTION

1.1. THE PROJECT

Precipitated by the crisis in the banking sector, the UK economy has undergone the deepest recession since the second world war. This has caused significant changes in the business environment, with key variables such as consumer spending, inflation, interest rates & borrowing costs, commodity prices and exchange rates all seeing marked shifts.

The aim of this study was to find out what effect these economic changes have had on farm businesses, and the agricultural sector. Further, it will see if the change in the business environment has affected the choices being made by individual decision-makers in agriculture, and what effect (if any) these emerging trends will have on the rural environment, business performance and competitiveness, and resilience of the farming and food sector. The environmental consequences of any changes will be explored.

The key objective of the project is to improve Defra’s understanding of the external financial pressures faced by the farming sector in England, and what the likely result will be in terms of business and land management changes, and the environmental implications of such changes. Effectively, the question being asked is ‘has the recession and ‘credit crunch’ changed anything for agriculture?’

*The report looks at the immediate effects resulting from the financial crisis. However, as the project progressed it became clear that many of those who were interviewed were more concerned with longer-term issues within the industry; especially the financial, regulatory and structural factors that were perceived to restrict the competitiveness of UK agriculture. These views have been included in this final report as they are believed to offer a useful guide for policymakers.*

1.2. PROJECT APPROACH

The project comprises two main elements:

- A desk review of the current literature covering the topic
- Interviews and focus group discussions to gather opinions from a representative group of farmers and wider industry figures.

1.2.1. Desk Review

The desk review has included material from a wide range of sources – these include academic studies, reports and surveys, and press articles.

It was expected that, in working through the published literature, certain themes and topics would begin to emerge. These would form the basis for the subsequent interview processes. This was duly the case, and the project has been structured around the following six areas:
- Direct financial market effects
- Exchange rates
- Commodity markets
- Food market impacts
- Diversification effects
- Business changes – asset values, structural change, investment

We then conclude by reviewing the implications of the findings under all of these headings for the environment.

1.2.2. Interviews
The interviews were conducted in two ways. The majority of those questioned were via a series of ‘focus group’ meetings. These groups were held after the Andersons Seminars at eleven sites in England as follows; Brooksby College (Leicestershire), Peterborough, Harper Adams (Shropshire), Worcester, Salisbury, Exeter, NAC Stoneleigh (Warwickshire), Bury St. Edmunds, Westmorland, Askam Bryan (York), and London.

A selection of those attending the Seminars were invited to attend the focus groups, plus a number of additional invitees chosen to make the group representative. These additional invitees were mostly farmers, or farm managers. Around 90 people took part in the groups. These comprised representatives from the following areas;
- Farmers and large estates
- Bankers
- Accountants
- Solicitors
- (Rural) Surveyors
- Agricultural consultants
- Supply trade and processors
- Journalists
- Government, and Levy Boards
- Colleges (Education and training)

In addition to the focus groups, a number of individual interviews were also conducted to ‘round out’ the range of organisations and sectors covered in the research. These were a mix of face-to-face interviews, supplemented by telephone interviews where it was difficult or impractical to organise a meeting in person.

A list of all those formally interviewed, either through the focus groups or directly, has been provided to Defra. For reasons of anonymity, the details of those who helped in the project have not been included in this published report. **The authors would however like to thank all those who gave their time to enable this research to be undertaken.**

*During the course of the project, members of the consortium were continuing to work within the agriculture sector, and met many other people from within the industry. Opinions on many of the topics under investigation*
in this report were sought on an ad-hoc basis. Although not formally conducted, these ‘soundings’ contributed to the general background information, and were a useful supplement to the formal interview process in getting a sense of what the industry was thinking.

1.3. Structure of this Report

This report is generally structured around the six topics that were outlined in the previous section. A separate chapter is devoted to each of these. However, before the results of the desk review and interviews are presented, there is a chapter providing some background to the banking crisis and subsequent recession. This is not intended to be a full history of the ‘credit crunch’ - instead, it will look to ‘paint a picture’ of recent events to allow the subsequent topics to be put in context.

A further chapter, looking in detail at some of the possible environmental impacts of the effects that have been noted, is also included.

A conclusion, summarising the findings of the study is provided at the end of the report.
2. BACKGROUND

2.1. THE FINANCIAL CRISIS

The banking and financial crisis, described as the worst since 1929-33 (Barrell & Davis, 2008), is widely dated to have begun in the summer of 2007. The French bank BNP Paribas prevented investors from withdrawing money from two of its funds as the assets within them could not be valued due to ‘a complete evaporation of liquidity’ from the market.

Defaults on US sub-prime mortgage loans were at the heart of the crisis (Blundell-Wignall, 2008). A housing bubble had developed in the US, fuelled by a period of low real interest rates (Barrell & Davis, 2008). The cost of borrowing was kept low by large influxes of foreign capital into the US. Rising asset prices and low borrowing cost persuaded many who might not otherwise have been able to afford a mortgage to enter the housing market. This ‘sub-prime’ market further inflated house prices.

Rising US interest rates over the period 2004 to 2006 caused many who could barely afford mortgages previously, to default on their repayments. The losses from these defaults spread rapidly throughout the world financial system thanks to financial innovation. Products such as mortgage backed securities (MBS) and collateralised debt obligations (CDO) packaged up the risks and rewards from mortgage lending for sale to investors. These products became so complicated that when losses started to accrue many financial institutions could not calculate what their financial position was. The losses, and the uncertainty over future losses, saw banks starting to hoard capital and reduce their inter-bank lending.

The first major casualty was Northern Rock. Its business model relied on securing funds from the (short-term) capital markets to fund its (long-term) mortgage business. As inter-bank lending became scarce, or only available at very high cost, the bank began to run short of funds. A request for assistance from the Bank of England prompted a run on the bank in September 2007. As banks had been able to borrow heavily, reliant upon external funds of other financial institutions (high leverage), there is a consensus that the regulatory framework had failed as they had been able to take undue risks (Weale, 2008).

An injection of funds into the banking system from governments and central banks around the world, coupled by a reduction in interest rates appeared to have settled the situation through late 2007 and early 2008, despite large losses reported by many financial institutions. Whilst in the US LIBOR rates had been falling in the early months of 2008 as the Federal Reserve cut base rates, the differential between central banks’ base rates and LIBOR widened. As the LIBOR rate reflects the average borrowing costs of banks, this indicated increasing concerns regarding the liquidity of financial institutions. Banks were compelled to curtail lending and therefore re-allocated funds to more creditworthy customers. Such behaviour subsequently led to difficulties accessing capital and credit at reasonable interest rates, resulting in liquidity and insolvency pressures (as had been seen with Northern Rock). So despite the efforts from central banks, a lack of credit emerged, introducing the threat of bankruptcies, repossessions, job losses and recession. Global growth was already slowing.
The crisis entered its most serious phase in September 2008. After posting massive losses, the first major bank to collapse as a result of the credit crisis was Lehman Brothers. This prompted panic in the markets and inter-bank lending almost completely ceased as concerns over which institutions were credit-worthy multiplied. A number of banks were nationalised to prevent collapse, as well as other government bail-out solutions. In the autumn of 2008, the Royal Bank of Scotland and Lloyds TSB, two of the largest lenders to UK farm businesses, received £37 billion in a government hand-out (Edwards, 2010). The Bank of England became the lender of only resort, rather than the lender of last resort (Roubini, 2008).

The following weeks saw bank bail-outs and nationalisations around the world, with vast amounts of public funds being committed. Base rates were reduced even further in dramatic cuts. The US, Eurozone and UK economies all went into recession during the winter of 2008.

Despite the official definition, market commentators, journalists and the general public refer to the ‘credit crunch’ relatively informally as the wider and encompassing macro-economic, micro-economic and individual financial problems resulting from a range of developments during the latter part of 2007 and 2008. According to PriceWaterhouseCoopers the effects of the ‘credit crunch’ fed into the real economy through the following routes:

- A reduction in the availability and increase in the cost of both bank lending (and other finance);
- Depressing house and share prices, with adverse wealth and collateral effects on household spending and business investment.
- A general increase in uncertainty feeding through into reduced business and consumer confidence and spending; and;
- Adverse impacts on UK exports to (and repatriated profits from) the US and other economies hit by the direct and indirect effects of the global credit crunch.

In the UK GDP growth was 0% in the second quarter of 2008 and minus 0.7% in the third quarter of the year. This was the first time since 1991 that the UK had fallen into recession. UK GDP shrank by 1.5% during the final quarter of 2008 to a level that was 1.9% below that in the fourth quarter of 2007 (National Statistics, 2009). It was not until January 2010, that it was confirmed that the UK had come out of recession with GDP growth at 0.1% in the final quarter of 2009 (subsequently revised to +0.3%), compared with economic contraction for six consecutive quarters prior to this.

At the outset of the crisis the apparent strength of the global economy made the prospect of recession seem unlikely (Ezrati, 2008). Consequently, it was not foreseen by many commentators, economists and policy-makers, and few expected the deep and long-lasting recession that became apparent. This was despite predictions from high profile businessman and investors such as Warren Buffet (CNBC, 2008).
2.2. **POSSIBLE FUTURE ECONOMIC TRENDS**

2.2.1. **General Economic Trends**

The start of 2010 has bought more positive news regarding the UK economic situation, with the UK economy coming out of recession (albeit marginally). A further indication of recovery came in January 2010 with unemployment falling for the second consecutive month.

Inflation (CPI) moved ahead to 3.5% in January 2010, up from 2.9% in December 2009 and up from 1.9% in November 2009 (National Statistics, 2010). With the restoration of VAT to 17.5% in January 2010, CPI is likely to rise further in the short-term (Barclays, 2010). Market commentators expected UK inflation to break through the Bank of England’s upper CPI target of 3% in the first half of 2010. Inflationary pressure is likely to remain until the close of 2010 when the new government attempts to control the unsustainable budget deficit. Whilst cuts to public spending are inevitable, it is the scale of these cuts which will be the important factor that will affect economic growth. Base interest rates remain deliberately low, partly to fuel bank liquidity to enable them to re-strengthen their balance sheets by charging greater margins over current base rates.

Consequently, growing pressure will develop for the Bank of England to raise interest rates. However, a significant delay is likely as the Bank of England continues with accommodative monetary policy to avoid choking the already slow economic recovery. Market interest rates will continue to rise on the back of higher inflation (reduced purchasing power of money), independent of a slowly increasing base rate.

Lloyds Banking Group’s Chief Economist Patrick Foley believes that UK economic growth for 2010 will be circa 1.8%. The Treasury predict GDP growth to Economic growth for the 2010 calendar year between 1% and 1½%, whilst prospects for 2011 are for a 3% to 3½% increase. (In terms of borrowing, the forecast deficit for the 2009-10 year was reduced in the early 2010 Budget from £178bn to £167bn). This limited and slow economic recovery in the UK is likely to keep interest rates low for much of 2010. Lloyds expect no more than a 0.25% rise in interest rates during 2010, despite some inflationary pressure.

2.2.2. **Commodity Values**

As Western economies experienced negative growth (or slower positive growth in future), demand for many of the manufactured goods produced by developing nations declined. It was thought that this would export the downturn to the emerging nations of the world. In fact, these countries appear to have weathered the economic storm reasonably well. For example economic growth in China still averaged 8.7% in 2009 (OECD, 2010). Domestic demand prompted by stimulus packages replaced western demand. There is also growing trade between emerging nations themselves.

This continued demand has meant that commodity prices, after an initial downturn, have remained relatively firm. This applies both generally (i.e. the oil price), and to farm commodities. The one main exception is global cereals prices. But here the weakening of values is more to do with plentiful supply, than weak demand.
2.2.3. Government Finances and Spending

It is suggested by commentators that the UK government’s finances are in the worst state since the Second World War. In the wake of the financial crisis, UK net debt is set to soar from around 40% of GDP to just below 90% at £1.6 trillion. One recent indicator of the state of government finances are the results from January 2010. This was the worst January on record for government borrowing, the first January that the government has been forced to borrow since monthly records began in 1993. January is the month in which the majority of Income, Corporation and Capital Gains taxes are received. Public sector net borrowing was £4.34 billion in January 2010, compared with a repayment of £5.27 billion a year earlier. Increased spending and significantly reduced receipts from taxation relating to the 2008-09 year (due to a depressed economy) were the main contributors. Rising departmental spending and higher interest payments also burdened the deficit (Allen, 2010).

One risk to the UK at present is that if Greece (and possibly other Southern European states) defaults on its public sector borrowing, the markets will fear a ‘chain_reaction.’ As a consequence, the cost of public sector borrowing is likely to rise for many other countries with deficit and debt issues, including the UK (NFU, 2010). This additional cost threatens to impose greater taxation and reduce spending. The NFU has predicted that departmental spending will have to fall by almost 10% in real terms by 2012-2013, potentially impacting on support to farmers (Edwards, 2010). This effect will last into the medium term as attempts continue to re-build government finances.

The UK and the countries of the Eurozone will be looking to reduce their deficits, partly to reassure markets that the debt is manageable. Changes in market sentiment regarding relative future economic performance may see large swings in the Pound / Euro exchange rate. Similar effects may be seen against the Dollar.

Looking to Europe, most EU member states face huge budget deficits. As a consequence, the EU budget will almost certainly not increase. Therefore, any new EU activities will have to be financed from within the current budget limits and inevitably there will be a focus upon the €55 billion that the CAP costs each year (Thurston, 2010). Given its large share (40%) of the total EU budget and the perceived inefficiencies of agricultural support, the magnitude of this expenditure will inevitably be scrutinised. Should CAP reform in 2013 result in significant reductions in subsidy support for UK farmers, farm income and business profitability is likely to reduce.

2.3. Trends in UK Agriculture Prior to The Financial Crisis

2.3.1. Farm Profitability Trends

The main data source that will be used to look at farm profitability is ‘Total Income from Farming’ (TIFF). This is produced by Defra. In technical terms, it is the aggregate return to all the entrepreneurs in UK agriculture and horticulture for their management, labour and their own capital in their businesses. In simplistic terms it is the profit of ‘UK Farming Plc’. However, it is not directly comparable to a Plc profit, as these are reported with all the wage costs of the businesses taken out. The TIFF figure is before the many sole-traders and partnerships in UK farming have taken a return for their labour in terms of drawings. The figures are produced on a calendar year basis. The figures from 1990 to the present are shown in Figure 1 below. These are in real terms at 2009 prices.
The light blue line shows that, in real terms, the trend in farm incomes is downwards. It can be seen that the mid-1990s were particularly good years for UK farmers. Profitability then declined sharply to reach a nadir in 2000. They have subsequently been mostly in the £2-£3bn range for a decade. The mid-1990s were an anomaly; looking back on a longer time series the trend in farm incomes has been for a long term decline. This is at least the case since the TIFF series started in the early 1970s and probably back to the end of the Second World War. Individual businesses survive, and even prosper, because the number of farmers has reduced.

TIFF only relates to profitability, it does not look at capital appreciation. This has been substantial in agriculture over the past 10 years thanks to rapid rises in property and land values. This is covered in more detail in section 2.3.3.

TIFF, as an aggregate measure, also disguises the differences between the different sectors of UK farming. Often the profitability of different parts of farming can move in quite different direction within the same time period (the old saying ‘Up Horn, Down Corn’ contains an element of truth). Figure 2 below shows the profitability for different types of farms in England over the last five years. They are a different measure from TIFF, being averages for all part and full-time farms (any business with over half a Standard Labour Unit requirement). The measure is Farm Business Income (FBI) which runs on a March to February basis.

Figure 2 demonstrates the variability in profitability between sectors. However, TIFF remains useful as a simple expression of the financial health of UK agriculture.
Andersons' projections for 2010 suggest a marginal improvement in TIFF, although there is likely to be a sectoral shift with lower contributions from cropping but significant improvement in incomes from the livestock sectors.

2.3.2. Past Recessions and Agricultural Profitability

Before looking at the effect of the current recession on agriculture, it may be useful to look at past effects. In terms of the effect of the economic cycle upon farm incomes, there is much conflicting evidence. There is a view by some commentators that farm profitability is actually enhanced during a recession. Clarke (2008) asserted that farm incomes have traditionally grown during periods of economic downturn. This was evident when farm incomes rose in the mid 1970s following the world oil crisis and in the early to mid 1990s (see Figure 1 above) when house prices crashed and sterling left the Exchange Rate Mechanism (ERM) (Clarke, 2008).

However, some academics have different theories. Kohls and Uhl (1998) wrote that reduced consumer demand during a recession weakens farm prices because the value of food sales declines as consumers switch to less expensive products. This is potentially compounded as farmers fail to react to contraction phases of the business cycle, maintaining supply, due to both their production focus and inability to react to changing market conditions due to long production cycles. However, inputs, such as machinery and chemicals, often increase in price during recessions in response to declining demand. Subsequently, overall farm incomes decline during a recession (Kohls & Uhl, 1998).

To test these conflicting claims it is possible to look at the relationship between UK Gross Domestic Product (GDP) and UK Total Income From Farming (TIFF). It is accepted that this is not measuring like-for-like as TIFF.
is a profitability measure, but the analysis should be robust enough to illustrate the relationship between agriculture and the wider economy. Gross Domestic Product is from National Statistics and is the ABMI series – GDP at market prices seasonally adjusted in real terms. Total Income from Farming is from Defra, deflated to 2009 prices.

During the period from 1973 UK GDP has grown consistently, apart from four recessions – the early 1970s, early 1980s, early 1990s and the present downturn. The size of the UK economy in 2009 was almost double that in 1973. At the same time farm incomes have been on a downwards trend (see Figure 1). Therefore, at the aggregate level, there seems little obvious correlation between general UK economic performance and farming incomes. Farming incomes are far more volatile in percentage terms and trend downwards over the long-term, whilst the general economy trends upwards. As mentioned earlier, individual farming businesses survive by the number of farms continuing to consolidate. Arguably exchange rate is one of the most important factors for UK farm incomes and when Sterling is weak farm incomes benefit (e.g. through higher support payments that are made in Euros, and higher relative commodity prices). Almost by definition this often is correlated with weakness in the macro-economy rather than strength.

It might be thought that the rate of change in incomes (i.e. economic growth) might be more important than the absolute level of GDP. Below are plotted changes in UK GDP against changes in TIFF. Because volatility in farm incomes is far greater than that in the general economy the scale used for these is ten times that for GDP.

Figure 3 ~ UK GDP and TIFF Changes

Source: DEFRA/Treasury/Andersons
Looking at the times when the UK goes into recession (when the red line drops below the ‘0%’), there seems no causal relationship between this and what happens to farm incomes. But to check this more formally a regression analysis was undertaken.

The r-squared figure for the entire period 1973 to 2009 was 41%. This looks quite good but on closer inspection the x-variable is actually negative. This would indicate that as the overall UK economy faltered, this actually caused farm incomes to rise. The fact that this negative correlation occurs will almost certainly be because of the long-term upwards and downwards trends in GDP and TIFF respectively. Therefore it may be better to use the yearly percentage changes shown in Figure 3. If this is done then an R-squared figure of just 1% is produced.

Historically, there appears to be no correlation between general economic growth and TIFF, contrary to both Kohls & Uhl (1998) and Clarke (2008). The concept that agriculture is successful during a recession is potentially due to its performance relative to other sectors and the perception that food is price inelastic. But conversely the figures also show that farming’s fortunes is not necessarily dragged down by poor overall economic performance. Agriculture suffers large swings in its profitability almost irrespective of what occurs in the general economy (weather, disease, currency, the CAP, and world commodity markets being far more important).

_However_, the fact that there has been no direct effect on agriculture from recession in the wider economy in the past does not necessarily mean that this will be the case during the economic downturn. More importantly, looking at these aggregate measures misses any effects that may impact on individual businesses.

### 2.3.3. UK Agriculture – The Capital Situation

Profitability has to be the key measure in looking at the ‘health’ of the UK farming sector. However, agriculture is in some ways different to other parts of the economy in that it has always been an asset-rich / cash-poor industry. Therefore what happens to capital values, and particularly property values, is also important to the overall economic health of the sector.

Bank lending to agriculture, as measured by Defra, has grown considerably over the last 10 years, from around £7.6 billion to over £9.5 billion at the end of 2008 (Bank of England figures show a slightly higher rate of Borrowing). This Defra balance sheet for UK farming is shown in Figure 4 below.

#### Figure 4 ~ UK Farming Balance Sheet

<table>
<thead>
<tr>
<th>£ Billion</th>
<th>1997-99</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land &amp; Buildings</td>
<td>87.7</td>
<td>188.8</td>
</tr>
<tr>
<td>Plant &amp; Machinery</td>
<td>8.1</td>
<td>8.4</td>
</tr>
<tr>
<td>Breeding Livestock</td>
<td>3.9</td>
<td>6.6</td>
</tr>
<tr>
<td>Current Assets</td>
<td>8.7</td>
<td>11.6</td>
</tr>
<tr>
<td>Total Liabilities</td>
<td>9.4</td>
<td>12.0</td>
</tr>
<tr>
<td>Of which is Bank Lending</td>
<td>7.6</td>
<td>9.5</td>
</tr>
<tr>
<td>Net Worth</td>
<td><strong>99.1</strong></td>
<td><strong>203.3</strong></td>
</tr>
</tbody>
</table>

Source: DEFRA/Bank of England/Andersons
The increase in borrowing is mainly attributable to two factors. One is higher working capital requirements, due to relatively high input prices. The other is borrowing to fund drawings in excess of the profitability being delivered by the farming operation. Very low interest rates (historically) have contributed to this trend, making debt easier to service.

Despite greater borrowing, the level of overall debt remains relatively low when compared to asset values, which have grown significantly in value. This asset value appreciation has produced a ‘profit’ of around £10 billion per year on average from 1998 to 2008; far greater than the cash reward represented by TIFF. The Net Worth of UK Agriculture has grown from £99 billion in 1997-99 to over £200 billion in 2008, whilst total liabilities have increased by only £2.6 billion over the same period. Therefore the gearing ratio at an aggregate level has effectively reduced.

It should be noted that tenant farmers, not having agricultural property, are not in such a favourable situation.
3.  **FINANCIAL MARKET EFFECTS AT THE FARM LEVEL**

Both the desk review and the interviews identified a number of direct financial effects that have arisen due to the ‘credit crunch’. This chapter looks at these in more detail.

3.1.  **CREDIT AVAILABILITY FOR AGRICULTURE**

As set out in section 2.1, the origins of the economic downturn were in the financial markets, with the use of the phrase ‘credit crunch’ acknowledging that it was primarily the drying up of bank lending that precipitated the recession.

The literature is agreed that the main reason why credit was denied to many individuals and businesses across the wider economy was that the banks were unaware of the solvency of those they were trading with, many of whom were other financial institutions. This counter-party risk led to rationed credit and a reduced availability of loan capital, as lenders began to strengthen their own balance sheets (Franks, 2009).

In interviews with bankers the effect of Basle II was mentioned. These international rules require banks to increase the level of capital they hold if the risks the bank faces increases. As global uncertainty increased, capital ratios rose, and ‘de-leveraging’ occurred. As capital became a scarcer commodity, the pricing and allocation of it changed. Lending was channelled away from sectors deemed as ‘risky’; where lending was available the costs were high to compensate for the perceived risks. As an example, lending to the construction and manufacturing sectors declined by over 11% and 9% respectively from the 3rd quarter of 2008 to the 3rd quarter of 2009 (Bank of England, cited by NFU, 2009).

Despite the reluctance to lend to businesses generally across the economy, lending to agriculture has not been affected to the same extent. This was reported in the literature, and borne out at the farm level by the Focus Groups, and confirmed by agricultural bankers.

The continued availability of capital is a reflection of the high net worth of the industry (see section 2.3.3.) and the fact that, although profitability of the industry remains marginal and increasingly volatile, agriculture has been managed conservatively, prudently geared and driven by long-term objectives (Parsons, 2008). The bankers interviewed identified a number of factors that affected the availability of borrowing:

- Cashflow – the ability to pay interest and principal (this will be closely linked to profitability).
- Security Cover – the assets backing any loan.
- Product – for example, overdrafts tend to be more ‘hungry’ of capital from the banks perspective. If capital is short, term loans may be easier to achieve.
- Management – the confidence the bank has in how the business is being run can have a large effect on whether it can borrow (and at what rates).
Due to its asset base, the agricultural sector was looked on favourably. Indeed, one banker stated that farming had "got off lightly" from the credit crunch. Even farmers with, for example, poor cashflow or management were able to benefit from the ‘halo effect’ of being in agriculture. To paraphrase one banker, “a poor farming business was still treated more leniently than a good property business”.

Coming from the banks themselves, the cynical might judge these comments as self-serving. But other sources corroborate these views. The National Farmers Union (NFU) surveyed its members during the banking crisis to gauge the effects. One in six farmers in December 2008 believed that credit was a high risk to their business. By mid 2009, this had increased to one in four farmers, highlighting the perceived difficulties relating to availability of credit. However, the NFU Banking Conditions Report and Survey revealed that 90% of farmers who applied for an overdraft and 76% who applied for a loan were granted approval in the 2nd quarter of 2009. Approval rates for tenant farmers were 70% for overdrafts and 70% for loans, therefore lower than the average for all farm businesses (NFU, 2009). This suggests that despite the concern about credit availability, the farming industry was still able to borrow reasonably easily albeit with what appears to be a widening gap between the treatment of secure and less secure lending.

Dairy farmers stood out as being twice as likely to apply for a business loan compared to other sectors, but yet only half as likely to take out an overdraft facility, when compared to other sectors of agriculture. The investment required to satisfy Nitrate Vulnerable Zone (NVZ) legislation may explain increased loan applications (NFU, 2009). The low approval and/or demand for overdraft facilities may reflect the fact that borrowing had been diverted into long term investment to meet NVZ requirements and a lack of profitability to allow increased borrowing on all fronts.

As farming is such a seasonal business, problems associated with the withdrawal of credit could have been catastrophic, as long production cycles would have pressurised cash flow (Edwards, 2010).

The findings of the NFU survey were echoed by the results from our focus group interviews in early 2010. In terms of comments from non-bankers, there was almost a universal consensus that availability of finance for farming has been much less affected than nearly all other sectors. A summary of the comments made are;

- In the past, the asset value of the collateral against which the lending is to be secured would be sufficient, but banks are increasingly requiring evidence of ability to service loans and repay capital. Therefore, a greater emphasis is now placed on projected cash flow and budgeted profitability. This is particularly important for new/un-proven projects.
- There is more use of banking covenants (agreements) – stipulations that the business must remain within e.g. gearing ratios, meeting budgets, cashflows etc.
- Tenants have found it more difficult than owner-occupiers to get funding, but tenants with a good track record and a profitable business will still find financing.
- Local agricultural bank managers were granted less autonomy than in the past, with more decisions mandated by ‘head-office’. Although more authority has recently been returned.
Some of these points can be summed-up by quoting from a consultant who attended the focus groups. “Most of my clients are owner-occupiers, so from an equity point of view, the risk [to lenders] is minimal. Availability [of credit] is still there, but margins have risen. The margin is what the computer tells us it is – the customer can take it or leave it. In some cases it seemed the bank wanted them to leave it as they were considered poor risks”.

As well as tenants, others in the industry without strong balance sheets have been affected. To quote one machinery manufacturer –“one sector we are seeing that has had more difficulties is the contract services sector where they don’t have a land asset. There are many different types of contracting business, and it is not just the out-and-out contractors that have been affected”.

One issue that was raised a number of times in the Focus Groups was that, although lending to agriculture was relatively unaffected, capital for new diversification ventures was far more difficult to obtain. This is picked up in Chapter 7 of this report.

As alluded to above, although most farm businesses have not had problems borrowing the money they need, the cost of borrowing has changed. This is looked at in the following section.

Much of the discussion in the Focus Groups was on the supply of credit. However, comments were also made about the demand for credit. Most believed the farming industry was being quite conservative in its use of borrowing. To quote one interviewee –“People believe that interest rates will rise, so they are frightened to stick their necks out [with increased borrowing]. For many it is a case of battening-down the hatches”.

3.2. BORROWING COSTS

3.2.1. Margins Over Base

Base rates have fallen to their lowest level since the Bank of England was founded in 1694, being reduced to 0.5% in March 2009. Within the Focus Groups there was a general agreement that lending rates have increased over base by at least 1%. The average for owner-occupiers would be in the range 2-3% over base, assuming their businesses are sound. It was noted that many farm businesses were actually paying less to service borrowings than they were 2 or three years ago, even with margin increases, because of the sharp fall in the underlying base rate. There were some comments from interviewees that a number of businesses were seeing this as an opportunity to borrow cheaply. However, this tended to be a minority view with most farm business being wary of future base rate rises being coupled with continuing high margins. On this point, it was widely held that margins would be maintained at current levels, even as base rates started to rise.

As with credit availability, tenants were perceived to be in a worse position than those with the collateral of land ownership. Interviewees reported that for some tenants the increase in margins over base might be as much as 4%. This means that some are now paying rates as high as 6-7%. These will be tenants considered a bad risk by the banks and there is some evidence that banks are deliberately trying to “price some business off their books”.
To quote one such farmer – “I’m a tenant farmer myself, and it [the margin] is considerably above the 2-3% above base that was the case before. Borrowing money to diversify has been almost impossible; you can’t do the things you want to”.

The bankers interviewed highlighted that there would be more variability in borrowing costs between businesses, both in the short and long term. This would not just apply to the difference between tenanted farms and owner-occupiers and between farms in different sectors of agriculture. Two farms that superficially might be very similar could have widely differing borrowing rates; for example due to cashflow or management differences. With capital being scarcer, it is being priced in a more sophisticated way.

The findings from our interviews are replicated in other surveys. According to the results of the NFU’s Banking Conditions Report and Survey, it would appear that increases are less than those imposed on other SMEs. 40% of farmers surveyed at the end of the 4th quarter of 2008 had experienced interest rate rises on their overdraft. This figure increased to 50% by the end of the 2nd quarter of 2009 (NFU, 2009). There appears to be a wide range in the increase of margins over base, with increases of between 1% and 4% reported, depending upon the lender and the credit rating of the farm business. Franks (2009) also reports that the margins charged over the base rate have widened, despite absolute borrowing rates remaining low.

There is a perception (especially amongst the farmers) that margins over base have risen simply to restore the profitability of banks. The bankers interviewed, not surprisingly, pointed to the rising wholesale cost of money as the main reason for increases. The banks have been forced to re-capitalise their balance sheets following the financial crisis. Due to the weak positions of banks, much lending has been based upon LIBOR rates in the short-term (the rate at which banks lend money to each other). This caused marginal rates charged by banks to rise. Figure 5 demonstrates the disparity that existed between LIBOR and base rates during the financial crisis, particularly in the autumn of 2008. Whilst LIBOR rates have fallen more recently, correlated with falls in base rates, the margins remain higher than in the past. These higher rates have been passed on to customers.
It was pointed out by the bankers interviewed that where term debt was involved the lower base rates have been passed on in full. This amounts to 50% of lending for some banks. There has been some move by farmers and bankers to restructure borrowing so that long term debt is moved off overdraft and onto term debt with structured repayment – see section 3.3.

It was widely held amongst those interviewed that there was much less competition in the marketplace. In fact the word ‘cartel’ was mentioned. Not surprisingly, the bankers dissented from this view – one stating that “there was still competition in the marketplace”. In general, it was felt that in most parts of the country there were still at least two banks that were active in the local/regional agricultural market – although they tended to be different banks in different places. Interestingly, what made a bank ‘strong’ locally was less to do with the corporate health of any institution, or head office policies towards agriculture, but rather how good the local agricultural manager or team was. This perhaps illustrates that farming is still an industry that relies on personal relationships.

3.2.2. Arrangement Fees

Within the Focus Groups the consensus was that arrangement fees for new loans have also increased or been imposed by lenders where they were waived previously. More importantly, the negative changes to the terms and conditions of lending had often been imposed without prior consultation with the borrower: often a ‘standard letter’ being issued by way of explanation. To corroborate this, one in three respondents to the NFU survey stated that adverse changes had been made to the terms of their overdraft in the first six months of 2009 (NFU, 2009). Individual negotiations appear to have been more difficult, with enforcement made by ‘Head Office’ rather than Relationship Managers (Moody, 2009).
Interviewees reported that the change in borrowing terms (both fees and margins) were particularly marked where businesses were trying to extend their borrowing, rather than simply rolling-over an existing facility.

In addition, banks are often insisting on annual renewals and this can make agreement to restructure borrowing more attractive.

Despite higher charges there is little evidence from the Focus Groups that businesses are any more likely to change banks than in the past. This is partly due to the longstanding inertia of farming businesses; many farms have banked at the same branch of the same bank for generations. There is a widespread feeling amongst farmers that “all banks are the same” so there is little point in changing. More recently there is a perception that competition between banks has lessened – partly because there are now fewer of them, but more generally that they have been managing their existing client base rather than actively courting new business.

3.3. Borrowing Structure and Risk Management

A number of those interviewed identified that there had been moves by farmers and bankers to restructure borrowing so that long term debt is moved off overdraft and onto term debt with structured repayment. This trend seemed more prevalent in the Eastern (arable) areas than in the West where smaller scale and livestock farming predominate. The impetus for the debt restructuring is partly due to the increased annual renewal cost of overdrafts; farmers have taken the view to sort ‘solid borrowing’, restructuring it onto long term loans and so avoiding having to pay annual overdraft renewal costs.

It is also motivated by a wariness that, when base rates rise, the higher margins and fees charged by banks will be maintained; thus pushing up borrowing costs higher than they have been for ten years or more. Businesses are ‘locking-in’ into historically low interest rates for longer terms (5 or 10 year terms were mentioned). Some good fixed rates appear to have been available for circa 20 years, but only for well secured lending to good farmers. These are very select – described as “blue chip farms” by one banker.

At present though, it appears to be a limited number of farm businesses that are actually restructuring debt into long term arrangements. Two main reasons were given by those interviewed. Firstly, there are perceived business advantages in having borrowing on overdraft as all the interest can be charged against tax. Moving to a term loan usually means that an element of repayment has to be made as well.

Secondly, variable rates on overdrafts are so low (despite margin and fee rises), many businesses are still paying far less than has been the case historically. There is limited incentive to move from these low rate overdrafts, especially as the perception is that base rates will remain low for some time. The older generation, who remember much higher base rates in the past, are the keenest on moving some borrowing onto fixed term loans. Base rates averaged 8.75% between 1989 and 1999 and 4.75% between 1999 and 2008.
Section 2.2.1. discussed future base rate movements. Not surprisingly, within the Focus Groups there was also general consensus that base rates would rise. Interviewees were not specifically asked what prospects for base rates were but some comments were offered that a return to levels around 5-6% seemed likely. At these levels, the effect of the increase in margins would be widely felt.

If base interest rates rise quickly in the latter half of 2010 and into 2011 as predicted, it will be the extent to which the banks retain their margins that is the important factor. If margins remain high in the short-term as base rates rise, the impact upon businesses will be significant in terms of interest costs. Many businesses, especially tenant farms or those with lower credit ratings, would eventually be paying double figure interest rates. Alternatively, if margins decline as base rates rise, the impact will be reduced. This ultimately relies upon LIBOR rates, bank liquidity (and the level of market competition). This will in turn depend on confidence in the banking industry, determined in part by confidence in the wider economy. At present, this appears to be low and improving only slowly. Therefore, it seems that greater marginal rates of interest (over base) are likely to remain as a lasting effect of the financial crisis for the foreseeable future, until bank balance sheets are sufficiently re-capitalised.

It was widely felt by those interviewed that the first base rate rise would trigger much greater interest amongst farmers in fixing an element of their core borrowing.

In terms of more sophisticated risk management practices on borrowing, there was almost universal agreement within the Focus Groups and individual interviews that these had failed to gain much traction in agriculture. This covers mechanisms such as caps and collars. A cap protects against rising interest rates; a collar creates a band within which the buyer’s effective interest rate fluctuates. Reasons for this include:

- Current low interest rates means that borrowing costs are usually a very small part of overall business costs – management time is focused on other areas.
- Low interest rates also make it seem less attractive to pay the premiums involved with these risk management mechanisms.
- There is a suspicion that these are a ‘product’ being sold by banks in order to generate extra margin.
- The most common reason cited is that these instruments only make sense when total business borrowings are large. A threshold of £100,000 was mentioned by some, but others put the figure at £1m plus.

One comment that sums up the situation was that “agriculture is no more sophisticated in its banking arrangements than it was 5 years ago”.

A final comment that is perhaps worth noting, following a long discussion of borrowing costs, is from a banker who stated that “half of our farming customers don’t borrow”. It should be remembered that changing credit conditions are not a problem for every farming business. In the same way, many farmers have substantial deposits. They have been adversely affected by the fall in interest rates and subsequent drop in income.
3.4. SUPPLY-CHAIN TRADING RELATIONSHIPS

The question was asked as to whether suppliers to farmers had changed their trading terms as a result of the financial crisis. Additionally, views were sought on whether farmers themselves had become more wary of who they sell to in terms of the potential for having unpaid debts.

The need for farmers, as much as any other business in the economy, to tighten control of debtors and trading agreements was highlighted by the collapse of the farmer owned dairy co-operative, Dairy Farmers of Britain in June 2009. The withdrawal of bank funding from the failing co-operative highlights the devastating impacts of counter-party risk (Franks, 2009). Farmer members lost a reported £150 million through farmer investments (capital retained by DFoB) and unpaid milk cheques as a result of DFoB’s demise. Average losses were circa £60,000 - £65,000 each, although some members lost in excess of £100,000 (Stocks & Hunt, 2010). In addition to the headline losses, 1,813 milk producers were forced to seek alternative buyers for their milk, a somewhat challenging task for many. Despite DFoB’s poor performance, over-ambition, and difficulties in raising capital, whether financiers would have withdrawn sources of finance, regardless of the financial crisis, is not certain.

Processors are typically highly geared, i.e. a high proportion of debt compared to capital – especially compared to farmers. Therefore any changes to revenues can have major effects on the cash-flow position of the business. Some analysts predicted significant consolidation in the food processing sector during 2009 and 2010 as a result of both pressure from retailers (in terms of price to maintain competitiveness during the recession) and lenders (Davies, 2009). However, at least in the UK, this does not seem to have materialised as yet.

In general, those interviewed did not feel that farmers had materially changed their selling behaviour. Business failures in the supply chain had happened before the ‘credit-crunch’ (Viking Cereals being cited), and would happen again. The most common way to deal with such counter-party risk was for farmers to sell to a number of outlets. In particular, the fresh produce sector was specifically mentioned in the groups as one where processor margins were tight, and farmers did look carefully at who they were trading with. To quote - “In the fruit and vegetable sector we see a lot of farmers taking the view to send produce to three or four different outlets to spread risk. Interestingly, farmers are also concerned that there are too many selling desks and this means that they can be picked off by supermarkets”. The implication was that the answer would be to have fewer, but stronger processing businesses that farmers could be more certain in dealing with.

Within the groups it was not generally thought that the practice of spreading sales had become significantly more widespread as a result of the financial problems. In fact, with the consolidation of many supply chains, it was sometimes more difficult to find a range of buyers. This was particularly true in specific geographic areas. The lack of livestock markets in some parts of the country was specifically mentioned. However, in the west, a resurgence in selling through markets was mentioned. This was due to farmers’ concerns over dealing directly with processors. To quote directly - “There is a fear of not being paid in the livestock sector. Slaughterhouses have a lot of money hanging on hooks. Farmers get paid at the same time as before, and supermarkets will not pay any quicker. With animals being worth 50% more someone is carrying a lot of debt. A lot of those kinds of firms were probably not at the top of the lending list anyway”.
In most sectors of farming, the decision on where to sell is often driven by personal relationships – “farmers sell to those who they know”. To quote a cereals producer – “The firms we deal with are big enough that I don’t worry about their solvency. People phone up to get business, but I send my crops where I want them to go. Often they are not offering a great deal more anyway. Why chase the extra rather than dealing with someone you trust?” The personal relationship, and the marketing advice that is often received as part of the selling ‘package’, is widely valued by farmers. This is especially the case as markets become more volatile – see section 5.

Firms were having more difficulty than farmers in terms of their relationships within the supply chain. Risk insurance was more expensive and difficult to come by.

Turning to the terms on which farmers buy their inputs, there was little change mentioned. In general, representatives of the ‘supply trade’ said they had not altered their payment terms. One quote is that, compared to other sectors, agriculture is seen as “more secure, more trusting and more reliable”. However, with this overall picture, some contrasting trends could be seen;

- As their cost of capital increased, supply firms were less willing to act as bankers to farmers, and were becoming stricter that accounts were settled by the due date.
- Those with a good credit history, or who had traded with the firm for some years were given more latitude.
- There had been a winnowing out of the worst businesses by some supplies (often by refusing to ship more goods until accounts had been settled). Accounts were not being allowed to run up to the same levels.

All this can be summed-up by the comments of one of the interviewees from the supply chain – “We have made a policy decision that we are not bankers to the agricultural industry, and we have stuck to it. We will help out longer-term customers if we can, but we are only prepared to take on new customers to a fixed level. Once their account is at that level there is no more [product] until we are paid. We are also putting all new businesses onto direct debit”. In this case, it was stated that the policy was more to do with the underlying profitability of farming businesses, rather than any direct credit crunch effects.

Some interviewees mentioned that the importance of non-bank lending (e.g. trade finance) had been declining for some years, so changes in supply trade’s attitude was less important than the banks in terms of farmers being able to fund their operations. It was also highlighted that government funds had been channelled mainly to the high street banks, and other, alternative, providers of funding were still short of cheap capital. There was some mention that the end of the NFU’s rolling finance scheme that had been used to fund working capital up to £20,000 would be a problem for some businesses.

The findings from the focus groups were backed up by other research. ADAS undertook a survey on behalf of Defra in early 2009, looking at the impact of the credit crunch on businesses supplying and servicing agriculture (and on their farming customers). The survey of 50 covered auctioneers, machinery dealers, merchants, contractors, vets and banks. Over half of the businesses (excluding banks) surveyed reported that the impacts on them were no more than negligible. While some 40% of businesses indicated that the impacts on them were
negative, less than 10% reported these as being significant. “With respect to their impacts on their farmer customers around half the businesses perceived that these would be negative but less than 5% thought these would be significant in either the short or longer term”. (ADAS, 2009, reported in the May 2009 Defra Food and Farming Brief).

3.5. PENSIONS AND THE FINANCIAL CRISIS

The credit crisis has damaged private pensions. Defined contribution schemes have been hit by falling markets. Rate cuts have worsened annuity rates. Insurance companies are struggling with their annuity books, as backing assets (e.g. corporate bonds) have declined. Defined benefit schemes’ assets have plummeted, while exceptionally low long gilt yields have increased liabilities (Altmann, 2009).

The question was asked within interviews whether this will have affected older farmers’ retirement decisions, and consequently the speed of structural change within the industry. The issue of structural change is picked up more fully in Section 8, but here we look at any effects particularly related to changes in pension values.

A recurring point from the Focus Groups was that farmers often do not have private pensions. As someone at the Bury St Edmunds meeting noted “Farmers are notoriously bad for putting money away for their retirement – they perceive that the next generation will provide for their retirement or that their land (or animals) will act as their pension where there is no next generation”. This may prove to have been a more sensible strategy than it appeared before the financial crisis. In many cases the farm business has not been profitable enough to afford contributions to personal pensions.

For those that do have a personal pension, there was a view from interviewees that the poor performance of annuities etc. may have an effect on decision-making. In the past farmers might have sold a piece of land and used the proceeds to purchase an annuity, but now they carry on. Where there is succession this means the farm has to work harder to support more families, possibly diversifying or intensifying. High land values are exacerbating this situation because the next generation is not able to buy out the older generation. This means the older generation maintain an interest in the farm for longer than might otherwise be the case, probably slowing down the adoption of new techniques and practices.

The consensus within the Focus Groups was that the same issues of farmers tending to continue occurs even where there is no succession. In this case, there is often some extensification of the farming as the business ‘winds-down’, which may be seen as good for the environment. However, the general feeling of interviewees was that the older generation are less environmentally aware and that environmental management, like all management, tends to decline as the business principal gets older. Thus the tendency of farmers to carry on farming as they do not have the financial choice to retire slows down rationalisation of holdings.

For the future, the poor performance of pensions is making those that currently contribute rethink. It was reported that farmers are looking at investing in the farm instead (which may be positive for agriculture). An alternative is
investment outside the business, with buy-to-let properties being cited in a number of cases. The complication of the pension rules, and the fact that money is tied-up, are also seen as disincentives to pension savings.
4. EXCHANGE RATES

4.1. BACKGROUND

Up until mid to late 2007, exchange rates had been in a state of relative stability for a number of years – certainly since the start of 2004. The Pound versus Euro rate had been particularly steady at £1 = €1.40 to €1.45 (around €1 = 68p). The financial crisis has precipitated a major readjustment in exchange rates. This is the effect of the ‘credit crunch’ that has, so far, had the greatest effect on UK agriculture.

Sterling gradually depreciated against the Euro and US Dollar for the two year period from mid 2007 to mid 2009. This is in response to declining economic performance, falling interest rates, an increasing UK current account deficit and the strength of the Euro relative to other currencies (particularly the US Dollar – increasing the demand for Euros). In response to falling economic output, the Bank of England cut interest rates on numerous occasions leading into and during the recession, in an attempt to instil confidence for investment and spending. With base rates reduced to 0.5% on 5th March 2009, investment in the UK economy fell, further weakening Sterling against the Euro. Comparatively strong results from the Eurozone and quantitative easing in the UK maintained the weakness of the Pound throughout 2009. In the summer of 2009, Sterling strengthened relative to the US Dollar following concerns about the US economy, although the Pound remains weak compared to its position two years ago. Figure 6 shows the trend in exchange rates (£/€ and £/$) from January 1999 to March 2010.

Figure 6 ~ Exchange Rates

![Graph of Exchange Rates](image_url)
The biggest determinant of the profitability of UK agriculture is exchange rates. This may appear odd, given all the other factors that affect farming profits; but the terms of trade have the biggest effect on profitability, particularly the relationship between Sterling and the Euro. This is shown on Figure 7 below where the £/€ exchange rate is overlaid on the previous TIFF figures.

**Figure 7 ~ TIFF and Exchange Rates**

There are three reasons why the UK farming industry is so sensitive to currency movements;

- **Exports** – if the Pound weakens against the Euro then UK farm products become more competitive on European markets.
- **Imports** – likewise, if the Pound weakens against the Euro then imports into the UK become relatively more expensive. This allows domestic prices to rise (many UK prices are ‘capped’ by the price of imported product)
- **Support under the Single Payment Scheme** is set in Euros. As Sterling weakens, the value in Pound terms of this support rises to UK farmers. The total amount of direct public support paid to farmers is also shown on Figure 7. It can be seen that subsidy is actually higher than the profit being made in many years over the past decade.

A Defra Working Group on Risk Management reporting in 2003 found that between half and three quarters of the contraction in UK farm incomes in the second half of the 1990s could be explained by Sterling’s appreciation. It estimated that a 5% shift in the £/€ changed UK TIFF by £0.3 billion or 15%.
Figure 7 shows that, to some extent, the relationship between currency and farm incomes (profit) seems to have become less direct in the last couple of years. This is largely due to cost increases. On Andersons calculations, comparing back to 2006, before costs started to take off, levels in 2009 were some £2.5bn higher (in real terms) than three years earlier. Adding this back to the TIIFF shown above would see the industry back towards the levels the exchange rate suggests it ‘should’ be.

Within the £2.5bn increase around £0.7bn is due to overhead costs. Around half of this is accounted for by higher depreciation due to the re-equipping seen over that three year period (with perhaps more to come). But the biggest increase has been in the direct costs. The big jump in fertiliser prices is a large factor in the higher costs base of the industry. The weak pound is a double-edged sword in some respects. At the same time as making UK agricultural exports more competitive, it has increased the costs of a range of farm inputs. A weaker Sterling has increased the cost of imports of already expensive farm inputs. From the Eurozone, the price of machinery and agro-chemicals has increased significantly (although it must be remembered that prices were already rising due to manufacturing costs). The same effect is evident with imported products from the USA, such as soya. However, the exchange rate has assisted the value of UK food and drink exports which rose by 15.5% in the first half of 2008 (Agra Europe, 2008). This is because of the increased competitiveness of UK produce relative to domestic produce in the Eurozone. Grain and sheep meat exports to the EU have been particular beneficiaries. The weaker currency has also made UK pigmeat and dairy products more attractive to UK consumers compared with European products.

4.1.1. Future of Exchange Rates

As future exchange rate levels are likely to be the biggest influence on farm incomes in at least the short and medium term, it was decided to look at the range of forecasts. Of course, predicting exchange rates is imprecise, and there is no guarantee that any of the individual forecasts reported below, or indeed the general consensus on movements will prove to be correct.

At the time of writing (May 2010) the attention of the financial markets has turned away from the UK towards the Eurozone. This is due to the ongoing crisis in the Greek economy, and possible problems in funding the deficits in other Eurozone countries. This remains a significant negative factor for the Euro and is likely to continue to mean the Single Currency remains under pressure against other currencies. However, there may be less movement in the £/€ rate. Throughout February, the Euro lost 1.9% of its value when weighted against all currencies, whilst the Sterling/Euro exchange rate remained unchanged. This implies that, at least for the short-term, investors are considering Sterling and the Euro of equal risk (NFU, 2010).

Political uncertainty in the UK had an effect on the confidence of investors in Sterling in the run-up and immediately after the General Election. The forming of a collation government appears to have settled markets and could herald a further strengthening of Sterling if the new government appears to be serious about tackling the UK’s deficit.
Projections for the forthcoming year and 2011 are difficult given the exceptional nature of the current economic situation. Ultimately, exchange rates will depend on the nature of UK economic recovery relative to Europe. Predictions do vary, understandable given the volatile nature of markets. A number of projections and comments from analysts are shown below (mostly made in early 2010):

- Barclays’ ‘Interest and Exchange Rate Outlook’ February bulletin suggests that Sterling will remain relatively weak against the Euro, around the £1 = €1.14 (€1 = £0.88) mark from mid 2010 until early 2011 (on average). Relative to the US Dollar, Sterling weakened significantly in early 2010, with the Pound at an eight month low against the Dollar. Future projections suggest that Sterling will regain some ground throughout 2010 and into 2011, on average around the £1 = $1.56 mark (Barclays 2010).

- Barclays Capital Chief Sterling Strategist, Paul Robinson is quoted as saying “Our expectation is that Sterling will appreciate against the Euro over the next few months returning to €1=£0.87 in six months time and €1=£0.84 in 12 months”.

- Royal Bank of Scotland Market Strategist, Neil Parker, forecasts an average rate of €1 = 93p at the end of the first quarter of 2010. This will decline to 82p by the end of 2010, and 77p by the final quarter of 2011. The Dollar is also forecast to fall against Sterling to $1.65 by the end of 2010 (quoted in Farmbrief, 2010).

- The Lloyds Banking Group Chief Economist, Patrick Foley states “…the UK economic recovery is likely to be slower than in other parts of the world which would keep the Pound weak”.

- The Economist Magazine (6th March Ed.) writes “On purchasing power parities … [the Pound] is now fairly priced against the Dollar and some 15% undervalued against the Euro”. At the time the Euro was worth around 90-91p – indicating a ‘fair’ value of 77p.

- Tom Vosa, the Chief Economist for National Australia Bank, speaking at the Eblex Outlook Conference, stated that the banks calculations suggested a “long run equilibrium level of €1 = 78p; but that this rate would not be reached anytime soon”. This indicates a Sterling level weaker than 80p in the short-term, being close to 85p for much of 2011.

Therefore, on balance, there is some consensus that Sterling will strengthen marginally in the short-term term, given the relative weakness of the economies across the Eurozone and small signs of UK economic recovery. In the long-term, the NFU expect the £/€ exchange rate to return to around €1=£0.80 as long-run trading patterns resume post recession and the balance of trade returns to a similar position to that prior to the financial crisis.

Despite this expected appreciation of the Pound, it does mean that Sterling has undertaken a fundamental shift (rather than a short-term change) in its trading parameters relative to the Euro, and is likely to remain within this range for the medium term. Nevertheless, it must be borne in mind that further developments regarding economic recovery cannot be predicted with much degree of accuracy at present, given the unfamiliar economic territory. Ultimately, markets are vulnerable to shocks and speculators have the ability to move large sums of money and thus shift exchange rates significantly.
4.2. DEALING WITH EXCHANGE RATE VOLATILITY

Faced with this volatility in the vitally important area of exchange rates, interviewees (within Focus Groups and individually) were asked what farmers were doing (if anything) to manage their exchange rate risk.

4.2.1. Fixing the SPS

The main farm-level mechanism for dealing with exchange rate risk was fixing of SPS conversion rates. Each years Single Payment is converted from Euros to Sterling using the official European Central Bank rate on the 30th September. This spot rate leaves farmers’ payments susceptible to the vagaries of the foreign exchange markets (the ECB rate is based on market values). The consensus within the groups was that farmers have been looking increasingly at hedging some of this risk.

There are two main hedging mechanisms available;

- The Forward Exchange Contract – a ‘paper’ exercise based on the exchange rate on the 30th September. This produces a profit or loss which can then be set against the eventual Single Payment offsetting the effect of any currency movements. There are cashflow implications, but it has the benefit of simplicity, with no need for Euro bank accounts.
- A Currency Option – allowing the conversion of the SP at a fixed exchange rate within a set ‘window’. This requires the claimant to take payments in Euros, but means that the conversion is only done once the RPA has made payment.

There is also effectively a third option – simply take the SPS in Euros and pay it into a Euro bank account. It can then be converted into Sterling at a time and rate of the claimant’s choosing. This however, assumes that there is a favourable conversion rate available at some point after payment. Some farmers have combined taking payment in Euros with taking out a Euro loan for some of their ‘core’ borrowing. This gives them a use for Euros and means no conversion is required. Andersons experience suggests that the use of this is fairly limited, and has declined as interest rates in the UK and Eurozone have converged. There has been discussion of farmers using Euros to purchase inputs (including machinery) direct from Europe, but in practice this has been even more of a minority pursuit than taking out Euro loans.

Interviewees felt that, in terms of fixing the SPS, there has been a considerable interest in the last two years but relatively little actual activity. Some bankers and accountants with relatively large farmer client bases mainly in the East of England reported interest as high at 30% but with perhaps closer to 10% actually fixing their Single Payment. In other parts of the country, notably the South West and North West there is much less interest. One accountant with 160 contacts reported only 3 showing interest and none taking action. Overall, it is believed that well below 5% of SPS claimants will have fixed in some way in 2009. The percentage doing so in 2010 is thought unlikely to be much higher. In terms of the total value of the SPS being fixed, it is likely to be greater than the 5% figure – as it is mainly larger businesses that have been using these mechanisms. Various minimum SPS levels were quoted in the groups at which it becomes ‘worthwhile’ – the lowest was £20,000, the highest £100,000.
Various reasons are given why more SPS claimants are not fixing:

- The cost of taking out the hedging instruments described above. This may be more perceived than actual, although it also links with the wide range of minimum economic sizes quoted above.

- Leading on from the previous point, there generally seems a lack of knowledge and awareness surrounding the whole issue, not just cost and minimum size, but the process as well. A number of interviewees commented on a “lack of assistance” from banks in explaining the process – confusing advice being given, or claimants being pushed towards one type of product. It was also clear from the Focus Groups that there is still confusion amongst farmers and their advisors about the difference between hedging or fixing with no cost other than the margin that the finance house makes from the exchange rate deal and the more complicated currency options which may involve actual fees.

- Although it was stated that there “is generally more awareness of the effect of currency on profitability”, this has not translated into action. It was felt that fixing SP conversion rates was “one more job”, and that “so many skills were required for farming in today’s world – and that farmers can’t possibly have all of them”.

- Uncertainty over the timing of payment (RPA delays), and the value of payment (the changing English dynamic hybrid system), appears to have contributed to a reluctance to use the hedging mechanisms – to quote “because you don’t know when you’re going to get your SFP, it is difficult to fix the currency”. Talking to a group of bankers that operate both sides of the Scottish/English border, they stated that there had been much greater take-up of the risk management approaches in Scotland due to certainty on timing and amounts of payment.

- The history of the SPS seems to have worked against the fixing of SPS payments. Interest only really took off for the 2009 SPS after the weakening of Sterling – claimants were looking to lock-in at the ‘new’ historically attractive rates. There was a surge of activity in early 2009 as the conversion rate broke the €1 = 90p mark (£1 = €1.11) - see Figure 6. Many of those that did fix did so at rates slightly below this level. During the summer the rate fell back towards 85p, meaning that the fix looked worthwhile. However, Sterling weakened again just before the September 30th conversion rate which resulted in an official conversion rate of £0.9093. Therefore many questioned whether fixing had been worth the effort. The fact that the conversion rate for 2009 was above 90p also seems to have put this as a threshold in farmers’ minds – it was reported in the groups that they will fix above this rate but not below. And there have been few opportunities in 2010 to lock-in at 90p plus.

- Following on from the above, there is a perception amongst some farmers that fixing the exchange rate is about getting a better conversion rate than the standard 30th September one. Therefore, seeing what happened last year has made them wary.

Notwithstanding the point above, in general it was reported that those who had fixed were happy they did so. To quote one banker “Interestingly enough, those people who did fix last year last year, none of them regretted it. Even if they lost in cash terms, they went in with their eyes open and felt it was the right thing to do”. These farmers generally appreciate the risk management value of fixing rather than a case of “beating the market”.

Recent developments reported are that claimants are only fixing part of their SPS and leaving some to ‘float’ with the 30th September rate. Others, usually with quite large claims, are fixing parts of it in blocks over a period of
time. In this way, the SPS is becoming more like grain marketing where a variety of risk management strategies are employed. More sophisticated business managers are also looking at fixing for one and two years ahead – not just for the current year.

4.2.2. Other Exchange Rate Mitigation Measures

Interviewees were also asked what else farmers could do to mitigate the business effects of exchange rate volatility. Almost universally, the response was “not much” - indicating that at the farm level the options for mitigating the effect of currency movements are limited. However, there was a comment that traders performed this function for farmers by hedging. This covers both inputs, with the hedging activities of feed firms being quoted, and also outputs, e.g. forward selling of grain. It was noted that the opportunities for taking on such risk management was more limited for livestock products.

One banker commented that he still felt that there was great scope for the ‘supply trade’ to get more involved in hedging. This should not only help the individual business, but the benefits would flow though to the farm level.

It was commented at a number of venues that a fixed income from an environmental scheme often looks attractive in comparison with unpredictable income from selling agricultural goods (whether caused by exchange rates or not). These market volatility issues are looked at in the next section.

4.3. EUROPEAN COMPARISON

A number of interviewees had experience of agriculture in other countries of the EU. As outlined above, the UK has been ‘protected’ from falls in output prices (see following Chapter) by the weakness of Sterling. This is not the case of countries in the Eurozone. Many of the representatives from the supply trade were also involved in Ireland’s farming industry. It was reported that this had seen far larger drops in farm incomes than the UK. The main export destination for output from the Irish farming industry is still the UK. The weakness of Sterling compared to the Euro had had a depressing effect on many prices within Ireland.

In addition, the Irish economy had arguably experienced a larger property ‘bubble’ than the UK. Many Irish farmers had benefitted from this, either directly through off-farm employment in the construction industry, or indirectly through rising property asset values. The economic recession has sharply reversed both of these trends. In addition, government spending, some of which flowed to agriculture, has been deeply cut as a result of the need to reduce the government deficit. As a result of all these factors, many farming businesses were struggling. It was commented that the depreciation of Sterling had “insulated our farming industry from the pain felt elsewhere in Europe”.

Looking further afield, a machinery manufacturer contrasted the effect of the credit crunch on UK agriculture compared with that in the former Soviet Union (FSU). “In the FSU the market has collapsed. Not because farmers don’t want the product, but because there is no credit. It is very different in the UK. This is still a good place to do business even though most importers are taking reduced margins due to the currency”.
5. COMMODITY MARKET VOLATILITY

5.1. FARM OUTPUTS

5.1.1. Volatility in Agricultural Commodity Markets

World prices of agricultural commodities experienced unprecedented volatility in the period 2007-09. Markets saw rapidly increasing prices during the latter part of 2007 and early 2008. Prices then subsequently collapsed. In practice the large price swings were mostly confined to combinable crops and dairy products, but these are important elements within UK agriculture;

- UK physical feed wheat prices peaked at £185 per tonne ex-farm in March 2008 – double that of a year earlier. This compares with values of £85 per tonne in October 2006 and November 2008 each side of the ‘boom’ (HGCA, 2009)
- Dairy commodity markets experienced similar exponential growth during 2007. However, UK farmgate price rises were significantly delayed from the commodity market peaks (butter and milk powder). The differential between the average farmgate milk price and the Actual Milk Price Equivalent (AMPE) rapidly widened before farmgate prices caught up. The weighted rolling 12-month average of Defra milk prices was 17.8 pence per litre (ppl) for the 2006/07 milk year. For 2007/08 it had climbed to 22.7ppl, and reached 25.37ppl for 2008/09. For 2009/10 it looks likely to reduce to around 23.5ppl.
- The falls from the height of the boom have been mitigated to a large extent in the UK by changes in the exchange rate - see Chapter 4. Producers in other parts of Europe and the world have seen much greater falls in output prices.

It is arguable how much the boom and bust can be related to the downturn in the global economy. It certainly seems highly likely that the surging global economy prior to 2007 may have contributed to the boom. It has also been argued within the literature that commodities experienced a boost in 2007 and 2008 as the signs of the faltering financial system led investors to seek out alternatives to property and shares. However, with specific supply constraints evident during 2007 and 2008, commodity prices [became] somewhat decoupled from the global economic cycle (Parsons, 2008). Likewise, the global slowdown is likely to have contributed to the sharp downwards move in prices, but this has also been driven by production increases.

Volatility on world commodity markets is nothing new. The effect of weather and disease, and the long production cycles in agriculture, mean that output levels can vary significantly from season to season. With inelastic demand, this causes large fluctuations in price. There is a perception right across the industry that volatility has increased recently (not surprising in light of the last three years). The Organisation for Economic Co-operation and Development (OECD, 2008) puts this down to the following:

- Reduced protectionism – trade liberalisation through World Trade Organisation (WTO) attempts to eliminate trade barriers (quotas, tariffs, duties and quality standards).
- Increased speculation in commodity markets – large investment funds’ have been active in futures markets for short term gain, particularly as growth in world stock markets slowed. Speculative positions on futures
markets have created price ‘bubbles,’ whereby market prices far exceed values determined by market fundamentals (supply and demand) (Sanders et al., 2008).

- Climate change and freak weather events – droughts in key production regions (e.g. Australia).
- Low worldwide food stocks – record low stocks of grains and milk products in the period up to 2007/08.
- Fluctuating biofuel demand – changes in crude oil prices quickly alter the profitability of biofuel production, affecting demand for wheat and oilseeds.

Marketing in volatile conditions inevitably creates uncertainty for farm decision-makers who are unable to complete budgets accurately, as well as discouraging long-term investment in their farming business. When profitability becomes uncertain due to volatile prices for outputs and inputs, managing risk (when purchasing and selling) becomes essential. There are risk management instruments available when marketing agricultural produce, ranging from forward selling to futures and options contracts. Farm characteristics, such as size and diversification, and producer attributes, such as risk aversion and market orientation, are key determinants of whether and what tools to adopt (Pennings et al., 2008). Traditionally, UK farmers have not had to consider risk management, as they have been largely protected from market forces by the Common Agricultural Policy (CAP). Therefore, dealing with commodity market fluctuations is a relatively new area of farm business management.

5.1.2. Dealing With Market Risk

The question asked within the Focus Groups (and other interviews) was ‘have farmers changed their business strategy in response to market risk?’

In all of the Focus Groups the reaction to this question was to start talking about how farmers sell their produce – especially forward selling, futures, and long-term contracts. Interestingly, there was little talk of farmers ‘marketing’ in its broadest sense – i.e. finding what the market wants and then producing it. Production-led thinking (for example growing a crop, and then considering how to sell it) still predominates in many parts of UK agriculture. The fresh produce sector is a notable exception to this. This did not just apply to farmers; other participants in the focus groups also tended to look at the ‘selling’ rather than ‘marketing’ of farm produce.

There was some mention of producers working more closely with buyers to supply the product the market wants. One farmer commented that “the buyer needs you more” if you are producing something that is a little out of the ordinary. Although premiums could be had, it was also widely mentioned that price is often set at a premium over the basic commodity level. Therefore price volatility is difficult to totally avoid.

In terms of selling, in the arable parts of the country the main strategy for managing risk and volatility was moving away from ‘spot’ sales (i.e. simply contacting a buyer and striking a deal at the prevailing market price). Sometimes this involved products such as pools and trackers offered by grain traders, but the most common mechanism mentioned was forward selling of grain.

It was felt that this was now practiced as a matter-of-course by the best-managed arable farms (perhaps the most efficient 15%). The remainder “talk about it a lot, but don’t do very much”. The 2007 season, when a lot of grain
was sold forward at prices which turned out to be far lower than the eventual price achievable on the open market, was cited. It was felt that this had “put off many people who had just started to dabble in forward selling”. In general the view from traders and advisers was that farmers seemed more concerned when they did not manage to sell at the top of the market, than they were if they had to sell at the bottom.

The vast majority of forward selling was still through grain traders. Very few farms were operating on the futures market itself. Even fewer were directly using derivative mechanisms such as ‘options’ – estimated at less than 1%. The barriers highlighted within the groups are complexity, with farmers not really understanding the futures market. But also cost, especially in the case of options. These are viewed as very expensive at present (with a high charge due to market volatility) and so these are less popular. It was stated that farmers don’t recognise it as a volatility premium - the charge simply represents too high a percentage of the wheat price for it to look attractive – “sale prices are low at present, but yet an option may cost £25”.

Forward selling was also thought to be constrained by a more basic instinct. Many farmers were unwilling to commit to sales before they had the crop safely harvested, or at the very least growing well in the field.

At all the Focus Groups it was clearly felt that selling strategies had to be combined with knowledge of costs of production – otherwise how could producers ‘target’ a price that delivered a return? It was felt that this was an area that the industry was getting better at – but only slowly; “creeping professionalism” was a phrased use. A large rump (perhaps well over half by number) of cereal farmers would not have a budgeted cost of production on which to base marketing decisions.

Other comments, specifically in relation to grain marketing were:

- Even if you sell forward, the prices quoted are still linked to underlying commodity markets – you cannot completely remove yourself from volatility.
- Many of the most ‘progressive’ producers were looking to sell forward two or even three crops ahead.
- Some farmers will lock in at prices they know will produce a loss, but knowing that the price at least minimises the potential losses.
- Some negative comments were made that buyers attempted to “wriggle out of contracts using spurious quality issues” if the agreed forward prices were above the prevailing market price.

Those that were in, and dealing with, the livestock sector were quick to point out that there were no futures markets that UK farmers could use in dairy, beef, lamb, pigs and poultry. There was a strong sense that this put them at a disadvantage to the cereals sector.

Any price stability in these sectors came from long-term supply agreements. It was commented that these were few and far between in many sectors. There were no real long-term agreements; merely price arrangements that were ‘sticky’ for a period of time (usually a few months). An example would be milk prices in which the processor might hold the price for a period of time as market conditions changed, but would eventually adjust it to the prevailing market levels. Similar phenomena were noted in the red meat market. In the grazing livestock
sector (beef and sheep), it was felt that there was little opportunity to get away from market volatility unless the producer started to move up the food chain away from ‘pure’ commodity production.

It was commented that some producers have a very limited pool of buyers to choose from. Examples were milk producers in some of the more isolated parts of the west, and also beef and sheep producers, with a limited range of livestock markets in a local area.

It was widely felt that skills were a limiting factor in this area. This covers both the calculation of costs of production, and the marketing operation itself. Many interviewees felt that such risk management practices were not something the industry engaged with, as it was simply something that did not interest them greatly. They were far more turned on by the “business of farming, rather than the farming business”. In many ways, farmers were happy to ‘outsource’ the marketing of their output to the local grain trader or livestock marketing group.

Representatives were interviewed from a number of organisations that have been trying to get the industry to engage more in the marketing side of their businesses. It was felt that some progress was being made, but there was “still some way to go”.

5.1.3. Income From Beyond the Commodity Market

A comment made by many of those interviewed was that one way to reduce volatility was to diversify the income sources of a farm business. Suggestions included:

- Operating a range of farming enterprises, so that the business was exposed to different markets.
- Move up the food chain away from commodity production.
- Diversify into non-agricultural areas.
- Maximise income from agri-environmental schemes which is not linked to market prices.

Although the first point was raised as a theoretical possibility, most of those interviewed believed that the trend in farm businesses was actually in the opposite direction, i.e. towards specialisation. The reasons were the increasing sophistication of farming businesses and the difficulty of keeping technically up-to-date on a variety of enterprises. The other main driver was the belief within the industry that scale brought greater efficiency. With many holdings limited by available land, if one enterprise is to scale up, then others tend to be pushed out. A couple of advisors pointed out that economies of scale per se were a myth. ‘Scale matching’ was more important for efficiency – i.e. fitting enterprise size to some of the ‘lumpy’ inputs such as labour units, combines, milking parlours etc.

A couple of areas were highlighted where there was a move towards a mix of farming enterprises. One of these was livestock farmers growing more arable crops. These were to feed to their own stock, so they weren’t subject to the volatility in animal feed prices. The other specific area was poultry production. A number of farmers had set up free range egg enterprises to boost farm turnover. Not requiring much land, this did not affect existing farm operations. To quote one interviewee - “this is been done predominantly at the instigation of the younger
generation, under 40 years old, which is encouraging”. The driver was often the need to increase farm turnover so that two families could be supported.

The specialisation of production has meant that traditional mixed farms have become less prevalent. The interviewees believed the number is likely to shrink further in future. This may have landscape and environmental effects with parts of the country becoming ‘all grass’ and other areas being ‘all arable’. This is looked at in more detail in chapter 9.

In terms of producers moving up the food chain it was recognised within the groups that those selling a value-added product are less likely to see large swings in price. However, moving up the food chain usually requires a considerable investment in time and money – bringing other kinds of risks into play. Such producer-processors are really in the ‘food’ market. The effect of changes in the wider economy on this is looked at in the next chapter.

Likewise, the effect of the economic downturn on ‘diversification’ activities is looked at in chapter 7.

Participation in agri-environmental schemes can perhaps be considered as a type of diversification. However, it has a particular characteristic in that payments are provided by the government rather than the (volatile) marketplace.

5.1.4. Agri-Environmental Schemes as an Income Source

Interviewees were asked whether uncertainty in the wider economy, and volatility in commodity markets, had made farmers more likely to embrace agri-environmental payments.

In general it was thought not. When prompted, farmers and their advisers recognised and appreciated the regularity and certainty of agri-environmental payments. But risk management was not a prime motivation for entering the schemes, particularly Entry Level Stewardship (ELS). Some of the main reasons cited were:

- Requirements for funding fits relatively easily with the farm business.
- It is a way of recovering modulation money.
- It is a viable use of marginal areas of the farm (better than growing crops in many circumstances).
- It helps with the public perception of farming.

A number of farmers stated that they liked looking after their farms and the countryside (‘stewardship’ in its widest sense of the word). The ELS provides some funding for the type of activity they might wish to be doing anyway. Some farmers had to change practically none of the management on their holdings to secure an agreement but recognised the need to be accountable for providing environmental benefits.

To quote one managing agent – “Almost all of our tenants have gone into it [the ELS]. They are not all committed environmentalists. They do it because they are paid to do it. It was pretty easy money for many of them”.

It may be a feature of when the interviews were held, but practically nobody raised the issue of ELS entry being helpful in meeting the objectives of the Campaign for the Farmed Environment (CFE). This may be because the CFE publicity had yet to really pick up speed by February / March.

Mention of the ELS inevitably led to the question of ELS renewals (a big issue in 2010). Although not linked specifically to the financial crisis, a number of consistent messages came across on this issue from the groups that it is worth reporting:

- The loss of management plans was seen as a big barrier to renewals (especially in arable areas). In general, the industry would like less change in the rules and options – so they “didn’t have to relearn the scheme”.
- Some farmers have become very good at completing forms, but any kind of extra paperwork remains a big barrier to some producers.
- The level of payment remains an issue for some. “If [arable] prices had remained at the levels seen in 2007-08 then many farmers would have been unlikely to renew”. As it is, some are questioning whether to sign up again. This is mainly a cropping phenomenon, in the ‘livestock areas’ of the north and west there was a widespread view that farmers would continue to participate. It was felt that ELS income formed a bigger part of overall farm revenue for livestock producers. Within arable areas the largest resistance to renewals was from farmers on the most productive land - this was characterised as land “east of the A1”. Some professionals pointed to the basis of calculation, ‘income foregone’ as a problem – leaving no profit element for farmers.
- The five-year time agreement length was an issue for some. This did not always fit well with landlord and tenant arrangements. In terms of the Organic ELS, some producers felt ‘locked-in’ to an organic system by the scheme, as they would have to pay money received back if they came out of organic production.

Andersons gave talks to Natural England (NE) staff in both the East and West Midlands who were working on-the-ground with ELS. These issues were raised. NE staff felt that all these barriers could be overcome, if landowners and the advisors were given the right level of targeted advice and support.

The HLS (Higher Level Stewardship) was generally seen in a rather different way to the ELS by those interviewed. The ELS was almost regarded as relatively easy to join bolt-on to an ongoing commercial farming business. With the HLS, there were far more instances provided by the interviewees where it had been used to take risk out of the business. Whole farms, or large proportions of them, had been entered into the HLS, resulting in high levels of scheme income. The farming operation had really become secondary, and was there “to service the HLS agreement”. In these cases people were attracted by the certainty of 10-year agreements. It was felt that the recent volatility may have made such certainty attractive ‘at the margins’ – i.e. it wouldn’t be the only reason to enter an agreement, but might be a contributory factor.

There was a view that it might be a good time to enter these schemes now. Funding did not appear to be a problem as long as the farm was suitable. With the problems in the government’s finances, there was a view that the money for these programmes could be a casualty of future UK spending cuts, although a large proportion of funding for the Rural Development Programme comes from Europe.
In general terms, it was thought that the better farms would also be better at environmental management. This may seem counter-intuitive. It might be thought that the less well-managed holdings would be less intensive, and so leave more ‘space’ for the environment. This was not widely held to be true by those interviewed. Although ‘neglect’ did provide environmental opportunities, it was believed that active management produced better outcomes. Another widely held view was that traditional landowners (e.g. estates, family farms) that thought in multi-generational timescales would have more interest in the environment. Lastly, it was believed that the younger generation, on average, had more interest in environmental matters. This is because it has been on the public agenda for the past few decades – i.e. “they had grown up with it”. Older farmers had their opinions formed in the decades following the Second World War when output was key. Some of these issues are picked up in Chapters 8 and 9.

5.2. INPUT COST VOLATILITY

5.2.1. Market Movements

It is not only farm output prices that have seen a period of intense volatility in the past two or three years; farm input prices have also been far more erratic (and higher) than historically.

Many inputs are linked to the oil price – diesel, fertiliser, and agro-chemicals. Other inputs are affected by fuel costs due to transport charges and the energy used in their manufacture. Crude oil prices doubled from mid 2007 to mid 2008, reaching record levels at over $140/barrel in July 2008. This was caused by constrained production capacity and strong increase in demand, driven by global economic growth. Such rises significantly increased food production costs (NFU, 2008). Shortages of mineral based fertiliser and rising gas prices during 2007 and 2008 drove fertiliser prices to record levels. With countries such as India subsidising the cost of fertiliser, the supply-demand imbalance was constrained further.

Feed prices also rose sharply during late 2007 and the first half of 2008 on the back of bullish markets for grains, oilseeds and proteins (as described in earlier chapters). The British Pig Executive (2008) estimated that the increase in feed costs had added 38p to the cost of producing 1kg of pig meat (dead weight) from April 2006 to April 2008, increasing feed’s share of total pig production costs by 14%.

The global recession saw energy prices fall. Prices dipped below $40/barrel in early 2009 as fears about the global recession reached their height. At the time of writing (May 2010) the oil price was around $80/barrel, a recognition that economic growth is recovering. Despite the falls in energy prices from their peak, farm input prices remain historically high and markets volatile. The weakness of Sterling against the Dollar since mid-2008 has also adversely affected the price of inputs which are priced in Dollars (such as oil). The weakness of Sterling relative to the Euro has also increased prices of products imported from the EU, such as agro-chemicals and farm machinery.

Within the Focus Groups, the representatives of both machinery suppliers and agro-chemical firms pointed out that the full price changes caused by exchange rate movements had not yet been passed on to farmers. A
proportion had been absorbed within the manufacturers and suppliers margins. The implication is that, if exchange rates stay at their present level, and these companies eventually wish to return margins to their previous levels, some input costs still have further to rise.

Figure 8 below shows the volatility experienced and overriding trend of increasing prices in farm inputs over the last few years. Firstly it shows how food inflation (pink line) has risen faster than general (RPI) inflation (black line). Although some of this can be attributed to the rising cost of food raw materials as represented by ‘all farm outputs’, in practice much of the rise was down to high fuel prices and thus increases in manufacturing and transport costs of food.

Input costs (‘all farm inputs’) were slower to take-off than output prices, but recently the two have moved in tandem. Both are much higher than they were only two years ago, and have increased much faster than general inflation levels.

Within the basket of farm inputs farmers have faced even greater volatility in individual cost items. The figure shows the price levels of three of the main farm inputs - fuel, feed and fertiliser. Indeed, fertiliser actually goes off the top of the chart for a period.

**Figure 8 ~ Agricultural Inflation**

![Agricultural Inflation Chart](chart)

Source: DEFRA/Andersons

5.2.2. Future of Inputs

Attempting to predict movements in input prices is exceptionally difficult. However, it is possible to look at some of the broad trends that, based on evidence from the Focus Groups and the literature, are likely to influence cost levels in the medium term;
• As in many areas, exchange rates will be key. The future development of these was considered in the previous chapter.
• For livestock feed, given that world cereal stocks have increased significantly, the high prices and volatility apparent in 2007 and 2008 is not predicted for the forthcoming two or three years. The protein element of feed is currently based on the soya price, which remains strong despite good harvests, thanks to Chinese demand. There may be changes in the next few years as the bio-ethanol plants on the east coast of England start to produce high protein co-products in large quantities. In general feed prices (the single largest cost category for UK farming) should be relatively constrained.
• Those inputs linked to global markets, namely fuel and fertiliser, are likely to suffer from further upward price pressure. World growth rates remain the main driver influencing demand, especially in the developing world, and these look set to remain strong.

5.2.3. Farming’s Reaction to Input Cost Changes
With the volatility outlined above, and prospects for input costs to remain at levels higher than historically seen, the question was asked within interviews whether this has changed (or will change) farmer behaviour.

The general consensus was that farmers had changed their behaviour – both in the way they used inputs and the way they were purchased. It should be noted that the biggest changes mostly related to ‘variable’ or ‘direct’ inputs – seeds, fertilisers, sprays and feed. It was commented that firstly, this was because these costs had seen the biggest increase in prices, and secondly, farmers have always tended to focus management on the variable costs because “they are more visible”. Although overheads (labour, power & machinery, property costs) had also gone up, there was less focus on cost control in this area. Interviewees pointed out that it often requires some structural change in the business to really affect the level of overheads, which is a more difficult decision to address. These issues are looked at in more detail in Chapter 8.

As prices have risen, not surprisingly, farmers have started to look at their use of inputs. One of the major changes brought up within the groups was that the arable sector has seen much greater interest in ‘precision farming’ techniques – only using inputs when and where they are needed. This was a trend noted by both machinery suppliers (who make the precision farming equipment), and those selling the inputs themselves. With the high cost of fertiliser, interest in variable applications has been particularly strong. It was commented that this technology is becoming “more mainstream and less specialist”.

There were a number of comments that precision farming “had become fashionable” and that some were looking at it simply for ‘me-too’ reasons. As it required a degree of management skill to get the best results, it was felt that some people would end up disappointed by the results. However, others thought that the use of the technology was becoming more considered – i.e. not just the latest gadget being bought. This trend would result in lower amounts of fertiliser being used. In a similar way agro-chemical use was becoming more targeted. Many producers are working more closely with agronomists to tailor their spray programme on a seasonal and even field-by-field basis.
It was felt that this would be a long-term change, the environmental consequences of which are noted in Chapter 9. Once such techniques have been adopted, arable farmers are unlikely to return to the more broad-brush application techniques of the past, even if input prices subsequently fall to former levels (which seems unlikely).

One area where there may be a reaction is in the use of P and K fertilisers. It was reported that many farmers had taken a ‘holiday’ on Phosphate and Potash applications when prices peaked in the second half of 2008. As prices have dropped somewhat, then it was expected that use may pick up. However, a minority commented that many farmers had not seen any yield effects so far from the reduced applications – perhaps indicating they had been over-using these inputs in the past.

In the livestock sector there has also been much greater interest in reducing the use of inputs as prices have risen. It has been mentioned previously how some livestock farmers are looking to grow their own feed. Of more prevalence is reducing the use of feed through the efficient use of grazed grass. It might be thought that this would push up fertiliser use, but, in fact, the better management of swards, and the increasing use of techniques such as clover-rich leys have allowed more feed to be produced with the same, or less, inputs. In some areas, particularly beef and sheep production, there has been an extensification of production, so that little or no purchased fertiliser is actually used anymore.

The other main trend reported in the livestock sector is to see slurry and manure as a valuable resource rather than a waste product. Partly, this has been influenced by the Nitrate Vulnerable Zone (NVZ) regulations. These have forced farmers to think more about their manure, and also, importantly, increased the storage requirements on farm. Although there were numerous comments about the extra cost this has placed on the industry, it was recognised that this allows slurry to be applied when it can do the most good for crops.

Turning to the way inputs are purchased, again some change was noted from the participants in the groups. However, this is not universal. At some venues it was reported that the use of buying groups to achieve the ‘best price’ for inputs had increased, others saw little or no change in whether farmers used these.

One comment that came up repeatedly was the difficulty in taking out volatility from the input buying process. Although it was possible to buy fertiliser some months ahead, and enter into feed contracts at set prices for a period of months, many of the other inputs could only really be purchased ‘spot’. There was no real equivalent of the forward selling mechanisms for one or two years hence seen in the arable market. This meant that, even if producers could minimise volatility on the output side of their businesses, they were still susceptible to large changes in cost levels. It was widely thought that, if inputs prices are likely to be more volatile in future, additional mechanisms for forward buying would be welcomed in the industry. Representatives of the supply trade pointed out that if they were to offer such long-term deals, risk would be transferred from farmers into their businesses.
5.2.4. Other Input Issues

Two other issues relating to input use were raised a number of times within the Focus Groups. Although not directly relevant to the recession, it was felt that these were worth reporting.

The topic of carbon foot-printing was brought up. This is still very rare at the farm level, and “the interest isn’t there among producers”. There was widespread questioning of its benefits (and in some cases the methodology). Farmers would only get engaged if there was a quantifiable benefit – if it gave their produce a unique selling point, if there was additional payment, or if they were forced to do it by retailers or processors. One obvious recessionary effect noted was that the whole issue of carbon had been pushed to the background by the bigger problem of the economic crisis. There were diverging views on whether the issue would resurface once economic growth restarted in the UK, or whether the “moment had passed” (especially in light of growing climate-change scepticism).

Although knowledge was limited, it was felt that a carbon trading market that included farming would be a ‘good thing’ as there was more potential economic benefit than drawback. In terms of any industry carbon reduction targets, there was very little awareness of these. Of those that were aware, most thought that farming would be unaffected thanks to declining input use – as outlined above.

The final input-related topic mentioned was the issue of regulation. NVZs came up repeatedly, and also the issue of regulation of agro-chemicals. The cost to the manufacturers of getting regulatory approval was cited as a reason why costs were high, and the number of new products was declining. There was a feeling that the industry was being asked to increase production and productivity, but was being denied the tools to do the job.
6. THE FOOD MARKET

6.1. TRADING DOWN

6.1.1. Background

A feature widely reported on in commentary of the food market during the recession was ‘trading down’. Rising household bills, record consumer debt and worries over future incomes contributed to changes in consumers’ food shopping patterns throughout 2008 and 2009. Consumers demanded cheaper food, trading down from premium brands and switching to the discounter multiples for ‘value’ products (Watts, 2008). A study by Mintel in 2008 revealed that 41% of shoppers claimed to have switched to cheaper brands in response to their concerns over price. One third of consumers sampled professed to have reduced the number of premium foods they bought, with 20% of people buying cheaper cuts of meat such as mince instead of steaks (Mintel, 2008).

Within the Focus Groups, it was pointed out that few people had actually lost their jobs to date as a result of the downturn. For those that remained in employment, their household finances were probably in a better state than before 2008 – mortgage payments for many had fallen along with base rates, and there was deflation in the price of many items (e.g. fuel) which meant that disposable income was actually higher. Therefore, it was more the uncertainty about the future, the desire to increase the savings rate, and a view that they should not be seen to be extravagant during a recession that drove the trend.

The food industry analysts interviewed pointed out that this recession was different from previous ones in that it was focused on the South East and the professional classes. In earlier downturns the brunt of the impact was taken by the North and industry/manufacturing. As the affected consumers were wealthier, then there was more scope for buying patterns to alter dramatically. As a basic commodity, it is the pattern of food consumption rather than total consumption that is likely to be affected in a recession.

6.1.2. Trading Down Examples

Examples of trading down were found in the literature review, Focus Groups, and individual interviews. These include the following changes;

- Less processed food and more fresh food purchased
- More ambient and frozen against chilled
- Value lines have done well and premium lines (Sainsbury’s ‘Taste the Difference’ and Tesco’s ‘Finest’) have suffered
- Reduction in the amount of eating out
- Less new product development as manufacturers and consumers are fearful of trying new things at a time of consumer retrenchment

In general, both market commentary and the food industry analysts stated that the consumer has been looking for ‘value’. It was pointed out that this does not necessarily mean ‘cheapest’. Consumers are still willing to buy
higher cost products (sometimes as a ‘treat’) as long as they believe the extra price is justified. Supermarkets have been adept at altering their offer to respond to the consumer mood.

The analysts set out that there has been quite a radical repositioning of consumer allegiance to market segments in the trading down process;

**Worst affected;**
- Organic – this became exposed on value. Concern about price highlighted potential deficiencies they had previously been accepting e.g. some found the conventional products kept better, had less blemishes etc. Some of the issues around organic (and local food) are picked up in more detail in the following section.
- Environmental – concern levels drop when value is uppermost on consumer’s minds.
- Local – this is seen as ‘peripheral’, and because of transport logistics based on centralised hubs local sourcing makes procurement expensive. Hence in a price competitive environment this is a sector that is likely to suffer.

**Some effect;**
- Fair trade and international development – this sector has seen some effect but price premiums are not all that great and, because of exchange rate pressure, imported tropical products generally have not offered much leeway for discounting.

**Least affected/most robust;**
- Well being – diet related, health care etc. This sector has enduring appeal that has been largely recession-proof.
- Animal welfare – has remained robust. The move from battery to ‘happy eggs’ has gone on unabated despite price implications. The same can be seen for welfare friendly pork, outdoor-reared chickens etc. Sterling weakness has helped because the less welfare friendly imports have also been more expensive than they were.
- All the big retailers have noted a step up in COOL (Country of Origin Labelling) as being important. The retailers are keen to emphasis that this is full sourcing not just imported raw materials processed in the UK.

In terms of brands versus own labels the story was mixed according to the analysts. It might be thought that the trading down process would see an increase in own-label sales. However, consumers were also looking for the reassurance of familiar brands in uncertain times. To quote; “if own-label versus brands is a war, then the recession has not seen a decisive victory for either side”.

One further piece of anecdotal evidence tends to illustrate the trading-down issue nicely. When Lehman Brothers collapsed consumers applied austerity measures in a mood of panic for two or three months. For example, two sectors hit hard and instantly were ready made sandwiches and ready meals. People thought they could make their own more cheaply from basic ingredients. However, it didn’t last. As the mood of panic subsided, people got bored with eating the same old cheese and ham sandwiches and crept back to ready made. The same happened
with ready meals. Effectively, the fundamentals that support prepared food won over – time poor consumers, convenience, shelf life, etc.

In addition, retailers and processors did not sit back and let the new trends happen without reacting to them.

6.1.3. Industry Reaction
Faced with the new trading environment, retailers have had to be pro-active. For example Tesco reinvented itself as ‘Britain’s Biggest Discounter’ introducing 350 new discount brands to help retain competitiveness over traditional discounters such as Aldi and Lidl (Leyland, 2008).

The food industry analysts pointed out that retailers and processors have worked together to mitigate the effects of trading down. With the decline in eating out many supermarkets began deals such as a meal for £10 – main course, bottle of wine and a pudding. These were specifically designed to appeal to those who might have previously have eaten out. Tesco actually repackaged its premium meal range as the ‘Restaurant Collection’ to pick up on this trend.

A big increase in promotional activity was highlighted by the analysts. For example, buy one get one free, short term price cut, in-store offers, second one half price, points promotions etc. As input costs have fallen it has been decided that it is better to use the widening cash margin to fund promotional activity rather than simply let prices fall back. In addition, advertising rates fell sharply during the recession, so backing promotion with advertising was more cost-effective. Selling on promotion is now so widespread that it is almost the norm in some sectors - 70% of soft drinks are sold on promotion. Cheese is also becoming very involved in promotions. It is a test of ‘brand equity’ as to whether something needs promotions – i.e. strong brands sell themselves.

6.1.4. Effect at the Farm Level
It was widely felt by all those interviewed that these shifts in consumer trends had little effect at farm level. It was commented that “farmers were not part of the story”. The exception to this is organic, as discussed in the next section. It was the processors and retailers that had reacted, and they were buying from primary processors in much the same way as before. As a farmer noted “we’ve not really seen the pressures in farmgate prices”.

Some future trends in food chain that affected farmers were outlined. These are set out in section 6.5. Areas that came up repeatedly in our conversations, and have a strong direct effect at the farm level were organic, local food, and welfare food. Therefore these are looked at in more detail below.

6.2. ORGANIC, LOCAL AND WELFARE

6.2.1. Organic Trends
The organic food market, like other premium food sectors, has suffered during the recession. In terms of volume, sales of organic bread fell by 29%, fruit by 20%, eggs by 12% and vegetables by 8% during the year to the end of January 2009. At an aggregate level, sales of organic food in value terms declined by 1%, whilst the value of non-organic food sales rose by 7% over the same period (Cripps, 2009). During 2009, total organic food sales
declined by 12.9%, down to £1.84 billion, the largest share of this fall being in the independent retail sector. Supermarket sales of organic dairy products fell by 6.5%, fruit and vegetables by 14.8% and fresh meat down by 22.7% in 2009 compared to the previous year (Soil Association, 2010). As a result, supermarket shelf space for organic products reduced and product ranges became more limited.

Corresponding with the views of the food industry analysts, the statistics reinforce the fact that organic status, as a determinant of product choice, has declined in importance. IGD research revealed that fewer shoppers now specifically purchase organic food in a given month, declining from 24% to 17% over the past two years (IGD, 2010).

It appears that organic is not an attribute that consumers are willing to pay a premium for during times of recession. A food analyst interviewed stated that “it is expensive, but also perceived to be expensive”. Shelf life is poor and consumers have been more conscious of both waste and price. Especially with fresh produce this means organic will have to fight to recover market share. As another said “it is not the end for organic but certainly a reality check”.

These views were echoed by members of the Focus Groups who had also experienced the weakening of the organic market (some organic farmers were represented). It was widely commented that organic did not have a good enough ‘story’ to tell. It defined itself as what it was not (i.e. conventionally produced), rather than what it was for. Where the benefits were communicated, there was not a simple message about why consumers should be paying more for it. Various benefits were given – better for the environment, less climate change effects, taste, local-ness etc.

There is some evidence from sales statistics that the gloom surrounding organic might have been overdone. It is believed that shopper confidence in 2010 is beginning to improve. Tesco and Waitrose, whose combined sales represent 45% of the organic market, predict growth in the organic sector of 1% and 3-5% respectively in 2010. Also, organic liquid milk has bucked the trend with sales at record levels at the end of 2009. This is thought to be due to the small premium (approximately 15%) over conventional products (Organic Food & Drink, 2010). Therefore, despite the financial squeeze, small premiums remain acceptable to consumers. The question is whether these premiums will be large enough to offset the higher production costs associated with organic systems.

6.2.2. Local Food (versus Organic)

Within the Focus Groups, it was widely felt that “local could be the new organic”. This was believed to stem from increasing consumer interest and knowledge of farming. Evidence cited was farming programmes (and cooking programmes encompassing farming) coming back onto prime time television. People were more interested in where their food came from. It was felt that ‘local food’ was a simpler story, and therefore easier, to sell to consumers.
There is little hard data on the recent evolution of the local food market. This is due to the fact that, unlike organic, there is no definition of what constitutes ‘local’. Therefore measuring it is almost impossible.

Interestingly, the food analysts took a rather different view of the future of local food than the Focus Groups which included farmers and those dealing with farmers. The analysts believed that this sector would struggle to develop – certainly with the multiple retailers. The distribution networks of the main supermarkets are now highly centralised and efficient. Bringing in local sourcing “… represents added cost and it is inefficient. It is a gimmick”. It is not clear there is consumer appetite to pay a premium to cover the extra costs. It was commented that supermarkets only got involved to get the public to view them in a better light (especially in the milk market).

Andersons believe this divergence of views can perhaps be explained by a number of factors;

- The food analysts have a ‘top-down’ view of the food chain that focuses on large companies, be they multiple retailers or food processors. Local may well be an inconvenience for these businesses. Those in the focus groups have a more ‘bottom-up’ view – many are involved in farm shops, farmers markets etc. At this level the ‘local’ issue is likely to work much better.
- Many farmers (and those in related industries) perhaps want to believe local is the new organic. There is residual mistrust on both sides of the organic / conventional debate. Anything that appears to be knocking organic is perhaps welcomed in some quarters. More charitably, organic is a ‘closed shop’ to the majority of farmers, because of the exacting production standards. They therefore cannot benefit from that market. Potentially, any UK farmer could benefit from an upturn in demand for local food, and therefore it is greeted positively.
- There may be an element of confusion of ‘local’ with ‘regional’ or ‘provenance’ food. In theory, promoting something as ‘traditional West-Country Cider’ should have the same marketing advantage in Hartlepool as it does in Taunton, i.e. it is not a question of all food coming from within 20 miles of where it is produced, it is more demonstrating a link between the food and certain attributes – tradition, ethical production, taste, quality etc.

The latter point perhaps also applies to welfare. Local food may be seen as more welfare-friendly, but equally ethically produced food does not have to be local. If consumers have more interest in where their food comes from, this may not necessarily translate into wanting to know which farm it has been produced on, merely that certain standards have been met.

Echoing the views of the analysts, the Focus Group members believed that animal welfare was an issue that was here to stay. Indeed, some felt that consumer interest might move on from the current preoccupations of poultry and pigs, and start to question some of the production methods employed in the dairy industry – particularly all-year-round housing.
6.3. FOOD CHAIN STRUCTURE

6.3.1. Buying Behaviour
As set out in section 6.1., there has been no discernable change in retailers/processors buying behaviour as a direct result of the recession. It might have been thought that if margins at the retail end of the food chain were coming under pressure, reductions would have been pushed down to farm level. This does not seem to have happened. The exchange rate making UK produce more competitive appears to be a major factor. Alternative, non-UK, sources of supply have become less attractive. Declining domestic production volumes in certain sectors such as pigs, milk, and to a certain extent poultry and fresh produce have also seen potential downwards price pressure mitigated.

Despite this, the Focus Groups did produce a number of comments about the continuing pressure that suppliers to the multiple retailers were subjected to. This was most prevalent in the fresh produce sector. It was widely felt the Supermarket Ombudsman would not be effective in curbing the worst abuses of power. The fact that any supplier going to the Ombudsman would become known to the supermarkets would see them “frozen out” in any future deals.

6.3.2. Industry Consolidation
The food industry analysts made some perceptive comments about consolidation in the food processing sector that will result from the economic downturn.

Up until the credit crunch there had been a lot of merger and acquisition (M&A) activity in the sector. But this had largely been driven by Private Equity firms, using cheap capital and “financial engineering”. It often did not involve any consolidation in the sector. Many of these firms will have problems with financing in the future, given the changed climate for credit availability when current banking covenants expire; they will be looking to sell. There is likely to be a surge of M&A activity in the near future in the food sector. This time it will be companies buying each other as Private Equity will be absent, and so further consolidation will be introduced into the processing sector.

In some ways this is a continuation of an ongoing trend. There are already high levels of concentration now in the some parts of the UK food chain. A high proportion of liquid milk goes through three dairy companies (Arla, Dairy Crest and Robert Wiseman) and a high proportion of bread goes through four bakery companies.

The level of concentration means that in some sectors margins are increasing as manufacturers can resist pressure from retailers – again the milk sector is an example of this. Of course, concentration in the middle of the chain does not mean an easier time for primary producers at the bottom.

6.4. OTHER ISSUES
A number of other pertinent comments were made in the Focus Groups;
The recession has had a detrimental effect on farmer-retailers. Vegetable box schemes have been affected – partly this is due to price, but it is also due to the issue of wastage with food not being eaten. This was perceived to be more of an issue in recessionary times. Farm shops have also seen takings fall. People have not cut back on a good joint for Sunday lunch (i.e. a ‘treat’), but general food shopping is now perhaps more likely to be done in the supermarkets.

The importance of ‘ethnic’ demand has grown strongly in certain niches over the last few years. Examples given were goat meat and cull ewes for mutton. This category appears to have held up well during the recession.

Some of the more specialist food production systems have become less popular as consumers appear to be sticking with basics. For example a sharp fall in demand for wild-boar meat was reported (perhaps linked with a fall in restaurant eating where some of these more exotic foods are likely to go). One grower also saw a switch in products as a risk management strategy – “you could always sell a cauliflower, but might be left with a field of celeriac!”

6.5. THE FUTURE

Agriculture and food production, has, in the past, been considered to be ‘recession proof’ with food demand relatively price inelastic. In the aggregate, this is probably true, but the structure of food demand is clearly not recession proof. Spending patterns can change markedly - the demand is still there, but in different places (RuSource, 2010). In fact, the industry analysts commented that food, as an item that is bought regularly, shows up consumers spending changes better than sectors where purchases are large and infrequent (consumer goods, cars etc.).

The recession has proved a clear test of how robust consumer buying behaviour is relative to products, brands, categories and modes of consumption when placed under pressure. Those where premium prices have endured have a greater long-term future than those where consumers have defected (albeit for the time-being). It has also shown the speed of response and adaptability of which supermarkets are capable and expect the same of their suppliers.

The economy is now showing some signs of recovery. This in turn appears to be reflected in the food market, as reported in recent market commentary. Sales of Tesco’s premium priced ‘Finest Food’ range began to increase again in late 2009, following a year of decline, whilst Waitrose also announced an improvement in sales of its ‘top-end’ prepared food (Brass, 2010). The IGD (2010) found that 48% of shoppers are shopping as normal and do not expect to change their food purchasing habits even if the recession worsens. This is compared to 40% answering with the same response in 2009, demonstrating improving confidence.

Nevertheless, 75% of those shoppers that have already altered their food purchasing patterns in response to the recession intend to continue with their new habits even if the economy improves. Consumers appear to have learnt how to spend their money much more efficiently by making much more considered purchasing decisions in terms of achieving value for money. They are buying cheaper products from some supermarkets, whilst
supplementing this with more spending on luxurious goods from their preferred supermarket (described as a 'treat' by some retail analysts). Opportunities for discounters (such as Aldi and Lidl) remain relatively strong, as 18% of shoppers still desire a locally situated discount store (IGD, 2010).

This shift in consumer behaviour is likely to remain post recession, as the 'old days’ of conspicuous consumption are unlikely to return quickly (Brass, 2010). Therefore, the recession is likely to leave a lasting effect upon the food industry for the medium term. This is backed up by the views of the Focus Groups. To quote, “when the recession ends, people’s spending will return, but whether it will return to the same patterns is uncertain”.

In terms of when spending patterns may reassert themselves, Andersons believes the level of unemployment is probably the biggest factor. This tends to be a ‘lagging indicator’ and may keep rising after economic growth returns. The scale of the government’s deficit also makes redundancies in the public sector likely. Whilst the threat of being out of work hangs over consumers, spending is likely to remain constrained.

Therefore, a highly competitive market is likely to remain for UK farmers for the medium term (both in the UK and EU), as processors and retailers remain under pressure to retain low prices due to the commercial environment in which they are trading (RuSource, 2008). Retailers have proved their ability to be flexible in response to economic difficulties (Grocer, 2010). Greater marketing responsiveness to changes in the market place will be essential going forward (Brass, 2010).

In terms of what the future might hold for food-chain relationships for the majority of farmers, a few trends are discernable;

- The shortfall in supply and the price reaction has been a wake up call to buyers in a number of sectors.
- The desire to make long term supply relationships with farmers may increase. But it is hard to generalise. The move will be out of a genuine desire to ensure supply rather than as a hedge against market volatility (i.e. supply is more important than price).
- Traceability requirements will increase. There will be more due diligence requirements and there is an ongoing process towards closer contractual relationships.
- The recession has tended to put peripheral issues like carbon foot-printing to one side. This may come back if economic growth resumes.
- All this may see more demand for UK grown produce. But it should be recognised this is not out of a sense of patriotic duty from the retailers. It is self interest in maintaining full shelves, and creating the right brand image with consumers. The industry will still be required to produce what retailers (and consumers) want at a price they are prepared to pay.
7. DIVERSIFICATION AND EMPLOYMENT

7.1. GENERAL

Many farm businesses no longer rely solely on agriculture for their income. ‘Diversification’ into non-farming activities has been a feature of the sector for many years, and the contribution of these enterprises has grown in importance in the decade preceding the financial crisis as farming incomes stagnated. Defra statistics show that 51% of farm businesses in England have diversified beyond their core agricultural activities. Most of these enterprises rely heavily upon the health of the wider economy: probably more so then pure farming. Therefore the prospects for diversification activities may well have altered as a result of the recession. Views on this, and the possible changes resulting on farming businesses, were gathered.

As well as on-farm diversification, many farming families have reacted to falling farm incomes by finding off-farm employment. This area was also investigated. This led on to a discussion of the labour market more generally. Although completely separate from diversification, some interesting views were aired on whether the recession had changed the prospects for farming businesses as employers.

7.2. FARM DIVERSIFICATION

7.2.1. Rental Income

The most important farm diversification activity by size is the letting out of buildings. According to Defra statistics, 76% of all diversification income was generated from letting out farm buildings for non-agricultural use in 2008/09 (Farm Business Survey). Of the businesses which let out buildings, on average this income accounts for approximately 15% of their total farm income. Therefore on average, this activity is not inconsequential. For some farm businesses rental income is actually more important than farming. What might be termed such ‘rural businesses’ would also encompass many of the traditional rural estates which have large property lettings.

The building rental category covers a wide range of activities. It ranges from offices, through light industrial units and workshops to storage. Such activities also cover a wide spectrum of ‘professionalism’. For example it was noted in the Focus Groups that ‘storage’ could range from a farmer operating a sophisticated self-store enterprise open to the general public, down to someone renting a corner of a barn to store a few pieces of equipment for a bit of cash. Therefore, farmers are ‘plugged into’ the wider economy at every level.

The rural economy was not immune to the effect of the credit crisis. A report by the Commission for Rural Communities set out the effects of the downturn on rural areas – “Businesses of all sectors, sizes, stages and places have been challenged by the credit crunch and recession. Although some companies have performed well, most rural firms have had to deal with a mix of restructuring and closures, staff layoffs, difficulties in retaining customers, securing funds, and maintaining cash flow. The recession has demonstrated the interconnectedness of rural businesses with the wider UK and global economy’’.
This all meant that demand for the property that farmers were letting fell, as small businesses went into receivership or contracted. The recession has also reduced the number of start-up companies and therefore there are fewer and fewer businesses seeking to rent premises. As demand dropped the market became oversupplied and many units remained un-let. The statistics show that the number of farms letting buildings for non-farming use has fallen from 21,400 in 2006/07 to 20,200 in 2008/09 (Defra 2010).

These statistics were confirmed by the findings of the Focus Groups, it was widely reported that the market had become difficult in many areas.

In an oversupplied market, interviewees reported that quality became paramount. Firstly, this relates to location. Although people value rural locations, the property still has to have good access, and obviously be close enough to population centres to create a demand. Those that have attempted projects in unsuitable, remote locations have struggled. Secondly, the quality of the letting has become far more important. For example for office lets, the ability (or not) to get high-speed broadband was cited in a number of Focus Groups as determining whether a project was letable or not. The quality of the conversion is important across the range of lets – from the finish in offices, to the facilities within workshop units, down to the level of security offered in storage projects.

It was suggested that the lets that have suffered most are those that were ill-conceived from the start; where landowners had not understood or researched the market. This has been compounded where the execution of the project was poor.

In general, little regional variation could be discerned within the Focus Groups. The trend towards letting farm buildings had been strongest near urban conurbations, and particularly London and the South East. It might be thought that this area, having suffered badly in the recession, would report a greater effect. This does not seem to be the case. At many of the venues, it was reported that there were local ‘hotspots’ where lettings were still relatively easy, and other ‘deadspots’ where the market was saturated and lettings very difficult.

Other trends highlighted during the interview process were;

- A trading down in ‘ambition’. Where someone might have considered converting redundant farm buildings for office use, they now might be content with storage lettings. This is partly attributable to certain parts of the market becoming oversupplied. However, as quality requirements have increased, then the capital costs (and risks) of high-end conversions become greater. Compounded by the difficulty in borrowing money, people have shifted towards a low cost, low return, model.

- There has been a shift in use away from business lettings (offices, workshops etc.) more towards leisure uses, and particularly the holiday accommodation market. This has held up well in the recession (see below), and cases were quoted of un-let offices being re-converted into holiday cottages.

- Even those that have managed to let their units have had to reduce prices to get voids filled. In the eastern counties it was reported that rents had fallen from £25 per sq ft to £18. So overall income has tended to reduce even for successful lettings.
• In general many new projects had been put-off as a result of the problems in the wider economy. Most interviewees thought that at present these schemes had been “postponed rather than cancelled”. Most landowners were looking to see how local letting markets developed in the next couple of years. In some cases it was believed that the individuals were probably deluding themselves that their particular project was ever going to be viable.

• The decision to levy Business Rates on empty property was criticised in a number of the groups. The threat of having to pay rates on converted buildings that might not be let had put some off converting them from agricultural use. As one person stated “business rates on empty property are very much a tax on the recession”.

• In one or two cases it was noted that some businesses were operating a counter-cyclical strategy. Building costs had fallen in the recession, and some long-term borrowing deals were attractive. These people were pressing on with projects in the belief that the market would recover. In general such attitudes had to be backed-up by a strong underlying business to enable the funding for the conversion to be possible.

• It was noted that very few businesses had managed to “diversify themselves out of trouble”. If the management of the farming operation was poor, it was likely that this would be carried through into any diversification. It was commented that many farmers are not used to (and not good at) dealing with the public. In these cases, diversification that require little ongoing management (or where management could be out-sourced to letting agents) were particularly attractive.

7.2.2. Tourism and Leisure

The tourism and leisure market does not show uniform trends. The provision of accommodation has been relatively buoyant during the recession, whilst other leisure activities have suffered somewhat.

There has been much talk of the ‘staycation’ phenomenon – people choosing to holiday in the UK rather than going abroad. The trends said to be driving this are the weakness of Sterling, household budgets being squeezed, and increasing environmental awareness. The Office for National Statistics figures show that visits abroad made by UK residents fell by 15% in 2009 compared with 2008.

This was borne out in the interviews, with holiday cottages, B & B and caravan sites all reportedly doing well. However, here the effects could be regional. Certainly in Cumbria there was said to be an over supply of B & B and a poor year in 2009. Other regions, especially East Anglia and the South West thought tourism had generally benefitted from the recession. This anecdotal evidence is somewhat contradicted by the data though; according to the Defra Farm Diversification statistics average income (profit) per on-farm tourist accommodation and catering enterprise has fallen by a third from £5,300 in 2006/07 to £3,500 in 2008/09.

Although main-season demand was strong, it was highlighted that occupancy levels in the off-season were more problematic. It is thought that ‘staycationers’ may have moved to the UK for their main holiday. This may make it less likely that they take another domestic break at a different time of the year. There is also the issue of less willingness to spend on short-breaks in a recessionary climate.
In a similar way to the general letting market, the demand is for higher quality accommodation – to quote one interviewee from the South West, accommodation is “getting posher and classier; holiday lets now need an indoor pool and sauna etc.” If people are going to forego a foreign holiday, they don’t want spartan or shabby conditions in the UK. There was a feeling that quite a lot of farm-based accommodation still left a bit to be desired in terms of quality.

Although existing businesses were doing well, interviewees felt that new investment in accommodation had slowed down during the recession. Proprietors were also putting-off upgrades in some cases.

Other leisure sectors had fared less well than tourist accommodation. The equine sector had suffered as consumers had reigned-in their spending. Most interviewees’ direct experience was of the livery market, as this is where farmers interact with the equine market. Other equine enterprises (riding schools, studs, training yards etc.) were also probably suffering, but these tend to be stand-alone businesses and not farm diversifications.

In a very similar way to business lets, demand fell, leading to an oversupply – particularly within certain localities where a number of enterprises were operating. Again, good location, good facilities and good management could mitigate these problems. The level of investment in new facilities had dropped markedly, but had not completely disappeared.

Those businesses that have moved into on-farm food processing and retailing were also reportedly suffering due to the changes in the food market generally, specifically ‘trading down’ – see previous chapter. This is corroborated by Defra statistics show that more businesses discontinued their on-farm processing/retailing ventures during 2007/2008 than the number that established new enterprises in this sector. One growth area mentioned in a number of the Focus Groups was the provisions of ‘venues’ on-farm. These were building converted for the use of wedding receptions, birthday parties etc. It may be that this represents a trading down from hotels and other more costly venues and hence has grown rather than contracted under recessionary pressure.

Shooting has also been negatively affected by the economic downturn. The results from the 2009 Smiths Gore Shoot Intentions Survey showed that many commercial shoots were putting down fewer birds and expect to sell fewer let days; 58% of the shoots surveyed expected their income to fall in the 2009/2010 season. If the situation persists for a number of shooting seasons, this is likely to have knock on-effects on the environment given the large amount of wildlife and habitat management work that shoots carry out. The survey identified a number of shoots that were either ceasing altogether or reducing the amount of time they spend on habitat management (Smiths Gore, 2009). This was backed-up by comments within the Focus Groups – people would not abandon country sports altogether, but the difficulty in selling let days would see the level of active management drop, and a move towards more ‘rough-shooting’ just for the owner’s personal use.

7.2.3. The Future and Investment Prospects

If economic growth returns then pre-recession consumer spending patterns may reassert themselves in farm diversifications. A lot of projects have been put on hold pending an upturn in demand. In reality, some of these
investments may never be made – one thing the recession has highlighted is the danger of speculative and ill-researched property development. There will almost certainly be a higher degree of rigour applied to proposals.

It was widely believed by interviewees that the staycation trend may prove to be more than a short-term factor; because the environmental issues surrounding air travel should persist.

A number of barriers to the growth and success in this area were consistently mentioned within interviews. Few of these relate directly to the recession, but if they could be addressed, it is believed the recovery from the downturn will be accelerated;

- Planning continues to be an issue with diversifications. Some interviewees detected “a slight softening in planners attitudes”, but generally it was felt there was often obstruction at local level, even if general government planning policy was trying to promote farm diversification.
- It was widely felt that the tax system works against diversification. If the farm has diversified ‘too much’, then Inheritance Tax reliefs can be jeopardised (Agricultural Property Relief).
- In much the same way, landlords are often reluctant to let tenants diversify as it may prejudice the landowner’s tax position. Conversely, tenants can be wary as they do not want to spend time building up a diversification enterprise that they are not compensated for at the end of a letting. Some older ‘succession tenancies’ actively discourage the younger generation from gaining too much income from non-agricultural activities. Then there is the question of how the proceeds of any non-farming activity is split between the landlord and tenant. The Tenancy Reform Industry Group (TRIG) has attempted to address some of these problems, but the effectiveness of this still remains to be seen.
- The level of rates payable on developed property is an issue. Reliefs are due to be phased-out. The prospect of a property remaining empty for some time (and incurring rates) has meant that some projects have been postponed.
- For holiday cottages, the proposed changes to the tax treatment of income was highlighted. Although not a sole reason to delay projects, it was cited as a contributory reason that farmers have used to postpone developments.

Although the issues above are important, perhaps the biggest barrier to diversification is the availability of finance. Unlike agriculture, it was reported within the groups that this has changed markedly for diversification activities. Credit availability almost disappeared completely for anything that was flagged up as ‘property development’. To quote one interviewee – “One of the things that surprises me is that it is very easy to get a sensible and sound [borrowing] proposition through on a farm business, but they [the banks] are very averse to anything to do with diversification. They are looking at the commercial sector, which is dead, and assuming the same applies to farm diversifications”.

It was noted that a farm business could often still borrow for such developments by trading on the underlying agricultural operation; as seen in chapter 3, credit supply to farming was largely unaffected. But if the property element became too large in relation to the underlying farm business then this tended to see the application dealt
with very differently. It meant that the application was dealt with by “commercial banking rather than agricultural banking”, with very different credit conditions applying.

Although interviewees expressed views that the commercial credit situation was easing somewhat, generally it was still felt that it would be difficult to finance property-related projects for some time, unless the borrowing could be backed by a (strong) underlying farm business.

Generally the appetite for new diversification appears to have been severely affected by the recession. There are exceptions, particularly where there are real opportunities and good business plans and often this is where the younger generation are coming back into the business and there is a need for additional income. One other factor mentioned on a number of occasions was that farmers often did not diversify because they wanted to – it had been driven by necessity due to low farming incomes. It was felt that if agricultural incomes increased, then many proprietors would be happy to stick to their ‘core’ business of farming. Successful existing diversifications would continue, but it would give those whose enterprises were struggling a chance to close them. It might also stop new developments.

7.3. OFF-FARM INCOME

Off-farm income, meant in this case as income earned by the family away from the farm (i.e. not diversification), is a significant source of income in some households. This is particularly true in the recent past when profitability has been low. Andersons experience, backed up by comments in the Focus Groups, is that many farming families are increasingly reliant upon off-farm wages from either part-time work by the farmer themselves, or income from their spouse and/or son/daughter.

Although agriculture has performed relatively well against other sectors of the economy, this is not necessarily true of the rural economy as a whole. Although Defra’s ‘Recovery/Recession Dashboard of Indicators’ Survey revealed that generally the rates of business insolvencies were lower in rural areas than in urban areas, insolvencies inevitably result in redundancies. The number of redundancies per 1,000 workers in rural areas increased by 120% from the fourth quarter of 2007 to the fourth quarter of 2008, prior to a 23% fall to the fourth quarter of 2009 (Defra, 2010). Similarly, in January 2010 2.5% of the working age population in rural England was claiming unemployment related benefits compared with 2.0% in January 2009. This increase has been lower than that observed for England as a whole where 4.4% of the working age population were claiming unemployment related benefits (Defra, 2010). This serves to demonstrate the fact that whilst the rural economy appears to have been less affected by the economic downturn than urban industries, jobs have still been lost. As a consequence, some farming family members working off-farm to supplement income may have faced redundancies.

When questioned on this point, the Focus Groups did not generally report a noticeable effect. Where people were working off-farm then there had tended to be few redundancies. It was thought that there were still jobs available for those within farming families who were looking for new employment positions. One reason proposed in the groups was that many farming spouses and sons/daughters were employed in areas related to agriculture. Like
farming itself, these had come through the downturn relatively unscathed. Due to geography, not many members of farming households worked in the financial services industry or the motor trade for example. The decline in retail was perhaps felt more.

Another factor is that unemployment had not increased greatly at the time the interviews were undertaken – the recession up to early 2010 had been relatively benign in terms of redundancies. As set out in section 6.5 unemployment may have further to rise; especially if government cuts result in a reduction in public-sector employment. Therefore the full effects of this part of the economic downturn may yet happen.

There was one area where there had been a noticeable effect on the ability of farmers themselves to achieve off-farm income. It was commented that a number of farmers had worked on a part-time basis in the building trade. Due to the collapse in house building, these income opportunities had disappeared.

One other related effect of the recession that was often mentioned; where farming families had sons/daughters that had recently completed their university education, some of these graduates were returning home to work on the family farm temporarily in response to the difficulties of obtaining their desired type of employment. Importantly, however, these ex-students did not want to pursue a career in agriculture long-term.

Discussion on the attractiveness of agriculture as a career inevitably led on to a discussion of labour availability in the industry more generally.

7.4. LABOUR AVAILABILITY

The fact that the issue of labour was raised in all the Focus Groups and many of the other interviews (often without any prompting) illustrates that it is a topic that is of great concern to the farming sector. The difficulty of finding good labour is a problem that, of course, predates the financial crisis. However, there was some reason to believe that the effects of the credit crunch may have altered the dynamics of the agricultural labour market.

The agricultural labour market is not homogenous. It can crudely be divided into two categories - skilled and unskilled (or perhaps alternatively defined as permanent and casual). The demand for unskilled casual labour comes primarily from the horticulture sector. According to the NFU, over half of all Grade 1 and 2 workers (as defined by the Agricultural Wages Board) are employed in horticulture. It is possibly unfair to label such workers as ‘unskilled’ as they are often undertaking tasks that require a high level of aptitude. The defining characteristics of such jobs are that they tend to be manual, and seasonal. This distinguishes them from the other broad category of farm labour – full-time trained employees.

7.4.1. Casual Labour

Over the past decade or so much of the seasonal labour requirement of UK agriculture has been supplied by Eastern European labour. The caricature is of the Polish worker. This has a strong basis in fact as large numbers of Poles were employed in the UK, particularly in the years after the accession of the CEEC-10 in 2004. Other nationalities were also represented. Since then, there has tended to be a shift Eastwards in terms of the source of
labour. This was boosted with the further expansion of the EU in 2007 to include Bulgaria and Romania. Many workers also come from the Baltic States and now Ukraine. The evidence for this tends to be anecdotal however, as it is not easy to quantify the prevalence of such migrant workers in UK farming. EU rules mean that there is free movement of labour for workers from the CEEC-10 so there is no process to count arrival and departures (and what activity they are undertaking whilst in the UK).

The interviewees believed such labour was vital in many sectors such as fresh produce and soft fruit. The general view was that they “worked harder, were more reliable, and were less demanding” than ‘indigenous’ UK workers. It was commented that local people “won’t do the work because it is too hard”.

It was commented within the groups that the quality of the migrant labour had fallen in the last few years – thus narrowing the gap on UK workers (but causing further problems for employers). This was because the ‘first wave’ that came over were often educated professional people. As their own economies have improved they “have returned to become dentists”. This means the labour now arriving is “further down the employment food chain, and less able”.

The two main issues arising out of changes in the wider economy is, ‘has it promoted a change in the supply of migrant labour?’, and ‘has there been any change in the supply of local labour?’

As seen in chapter 4, one of the effects of the recession in the UK has been a shift in the £/€ exchange rate. Sterling began to weaken in 2008, there were initial fears that EU migrant labour may leave the UK to other countries where wages would effectively be higher (as money earned would not need to be exchanged at the unfavourable rate). A number of East-European countries (notably Poland) have weathered the downturn better than the UK, with a consequent increase in the attractiveness of its labour market.

Although the number of foreign nationals employed within the UK has fallen, the effect upon agriculture has been relatively low due to the increase in the size of the Seasonal Agricultural Workers Scheme (Edwards, 2010). In effect, any reduction in labour from the CEEC-10 has been offset by increases from further east in Europe. This was largely echoed in the focus groups with comments such as “casual labour is widely available” from one soft-fruit grower. This view was not unanimous however. A significant minority thought that migrant labour availability had decreased. This was not a regional or sectoral issue - there were no discernable trends in terms of where availability was deemed to be adequate or difficult.

In terms of the increasing availability of indigenous workers, the picture was again mixed. The NFU, based on a survey into seasonal labour availability in horticulture, takes the view that the recession appears to have had a positive impact upon the number of domestic workers applying for seasonal jobs in agriculture and horticulture. “Both the number of applications and the suitability of those personnel applying improved”. This is thought to demonstrate the movement of employees between economic sectors (as a result of redundancies) and/or that more British people are seeking additional work to supplement their income from their other employment.
Within the Focus Groups this was backed up in some cases. One fruit grower stated that an advert in the local paper for casual work “produced 350 responses”. Others also reported greater willingness of the local population to consider seasonal farm work. However, this view was opposed by other interviewees. They stated that it was, to quote, “still impossible to get local casuals”. It was further commented that there are significant barriers to UK workers getting jobs in this sector;

- Many posts are filled by East European students (especially under SAWS). Local populations are unlikely to have the mobility of a student population. By definition, these jobs are in the countryside, whilst the largest pool of labour is in towns and cities. Those with families are unlikely to be tempted by hostel accommodation, and travel costs and time will be a negative factor – especially if the job is low-paying.
- The structure of the benefits system (and tax credits) discourages the unemployed from taking temporary, seasonal work.
- The fresh produce industry has become more ‘just-in-time’ with orders coming through from retailers at very short notice that have to be filled. It is easier for producers/packers to deal with this by having labour supplied through an agency (which may well use migrant labour), rather than organising their own pool of (local) labour.
- Seasonal farm work is often ‘romanticised’. Workers expectations are often at odds with the reality of the work. This can mean they quickly become disillusioned, and staff turnover can be high. A grower commented that to keep 70-80 places filled they turned over 140 workers in a month.

7.4.2. Skilled Labour

There is not a clean divide between casual and skilled labour. For example the interviewees reported how the dairy industry was also increasingly reliant on migrant labour. However, although the work is reasonably skilled, such employment still tends to be on short-term contracts. Indeed one interviewee stated that it was better to keep a flow of staff, as they started out motivated and focused, but “gradually got slacker” as their period of employment increased. Therefore such staff play an important role in UK farming, but do not tend to be making their careers for the long-term in the sector.

It was believed that the recession in other parts of the economy and the relative buoyancy of the farming sector may have led to greater availability of skilled labour. Again, the evidence from the Focus Groups was mixed, indicating that the financial crisis has probably produced no major shift in trends so far. Again, as unemployment tends to be a lagging indicator, more effects may be seen in the coming years. The balance of opinion from the sessions was that the employment situation had probably got slightly better, albeit the effect was not huge.

Some comments may help to illustrate the issue;

- One farmer had lost agricultural employees to the construction industry in the past. This was happening less often now. Another reported that he had recruited people who had previously worked in the building trade. They could not say with any certainty whether these would be long-term converts to the farming sector, or would revert to construction if that sector picked up.
- It is not just the economics of farming (versus the general economy) that makes it an attractive option. The media’s portrayal is equally, if not more, important in whether the sector is seen as ‘sexy’ or not.
• One of the big problems is that training schemes and colleges are not producing general farm workers. Those that go to college are being trained for management – “all graduates expect to do clean hands” jobs. A gap is being left.

• The perception of farming is still poor. It is seen as offering long hours and dirty working conditions; “the industry had been left behind”. Other jobs had become safer, easier, shorter, cleaner etc. whilst there was still an attitude in farming (especially in the older generation) that ‘I worked in these conditions so why can’t the youth of today’.

• However, others felt that the pay, conditions etc. on farms had improved greatly in the last few years. But prospective employees’ perceptions had not kept up with the reality and were reluctant to consider the sector. There was perhaps an educational task to be done to promote careers in agriculture.

• It was stated that there was still a drive to only pay at the Agricultural Minimum Wage. However, some interviewees detected a move to give more status, salary and training to workers. Quality labour could actually bring savings in terms of efficiency of getting the job done, and reduced management time.

• The technology involved in farming was now at a different level. Being a farmworker was no longer about “lifting things, chasing animals and being able to drive in a straight line”.

• As well as the need to have brainpower to get the most out of the latest equipment, it was pointed out that, from a risk point of view, it was “crazy to put a [untrained] student on a £250,000 piece of equipment”.

• The age profile of farmworkers is as ‘bad’, if not worse, than the proprietors of farms. It is difficult to “teach these old dogs new tricks”. New blood is needed. There will also be a reckoning in a few years as a large batch of workers all retire at once. As one interviewee put it - “highly qualified and technically sound labour will be at a premium. The calibre of people will definitely be an issue. The farming industry will have to pay for these ‘farming technicians’.”

• Other, allied, sectors also had this problem. Agricultural engineering and agronomy being specifically mentioned as areas of the industry where skills shortages were present. The agricultural engineering industry had recognised this with many firms coming together to produce the Land-based Technician Accreditation (LTA) programme which sets out a recognised career path.

• As farm businesses get larger it can make it easier to manage labour. For example, having three employees rather than one allows shifts to be set up, so guaranteeing some free weekends/evenings etc. It also allows someone to progress in the industry – e.g. from farmworker to foreman.

• There is a trend towards self-employment or the sharing of labour – i.e. a worker works three days on one farm, then 2 or 3 on another etc

The comments above relate to employed labour. But the majority of the labour requirement in UK farming is supplied by the proprietors and their families. Defra statistics show that as at June 2009 there were 49,000 full time workers employed in English farming, but 95,000 full time farmers.

Many of the comments on employed labour also apply to the next generation of farming families coming into the industry. As set out in section 7.3. there does seem to be some anecdotal evidence of a greater interest in the younger generation in taking over a farming business. But again, this is patchy and rather inconclusive. In addition to the points raised above, the profitability, and perceived future profitability prospects of the industry
will be a much greater influence on the behaviour of this category. As the future owners of farm businesses, an increase in the likely earnings from being involved in farming should influence behaviour.
8. BUSINESS CHANGES

8.1. GENERAL

The final section of the interview process asked a series of questions which attempted to look at some of the more long-term trends within agriculture. Particularly around structural change, the way land is farmed and managed, and what effect these changes might have.

In this, it is difficult to separate out what would have happened anyway from the effects from the financial crisis. As set out in the preceding chapters, the effects of the credit crunch and recession have not, in aggregate, been profound on the farming sector. Therefore, most of the issues covered in this chapter are to do with the ongoing evolution of the sector, rather than ‘trend breaks’ caused by changes in the wider economy. It was thought that it was still worthwhile covering the views of interviewees on these topics.

One area where the changing economic climate may affect structural change is on asset values, and specifically land prices.

8.2. ASSET (LAND) PRICES

The assets held by farming businesses are comprised of a mix. As set out in Figure 4, this includes livestock values, machinery & equipment, stocks & stores, and deposits. But by far the most important category of assets is property. This section looks into that area in more detail. The property owned by farmers also comprises a mix; land, buildings, houses etc. For simplicity, this basket of property will just be referred to as ‘land’ and ‘land values’.

As set out in section 2.3.3 the growth in the value of land assets has greatly added to the wealth of farming businesses. During the last decade of low profitability, it has enabled many businesses to continue trading; either through borrowing more against their appreciating assets, or periodically selling off some assets to recapitalise the business. As stated previously, one of the reasons farming has “got off lightly” during the credit crunch was the high level of the sector’s net worth.

If land values were to change dramatically, then this would be likely to alter the sectors credit rating, and change borrowing costs. If they felt less ‘wealthy’, then farmers’ business decision making might also change.

Within the interviews, strong land values were generally seen as a positive for the industry for the reasons set out above. However, a common comment was that farmers never sold land so its value made little difference – i.e. farmers don’t ever really consider the capital value of their farm when making decisions. This in turn means that, despite the increase in wealth due to rising land prices, a surge in investment in holdings has not resulted. It was commented that attitudes to investment were “driven largely by cashflow and borrowing rates”.

Looking at the future of land prices, the general view from the sessions was that prices would remain buoyant, and this would provide long-term stability for the sector. The reasons stated by interviewees were as follows;

Supply of farms for sale will continue to be very limited. The tax advantages of owning land were mentioned. This means that if farmers wish to retire then they tend to remain as owners but contract-out the actual farming of the land rather than sell outright. This is also the preferred option for emotional reasons. It was commented that farmers do not like selling the farm because they feel “they are letting down past and future generations”.

Farmers tend to always want more land. This applies to both what they own and also what they farm. It was commented that a factory owner wouldn’t expand just for the sake of it – the extra investment would need to be justified. This does not happen with land purchase – asset values are so high in relation to likely returns that the return on capital is often well be below 3%. Economies of scale are often given as the justification for increasing farm size, but it was felt the figures do not really work in terms of purchasing land. The real reasons are more emotional, and therefore prices above what is economically rational tend to be paid. A classic example is that a neighbouring farm will only come up for sale “once in a generation”. Therefore the farmer feels the opportunity has to be seized. One banker pointed out that a certain client had used the once-in-a-generation argument three times in the last 10 years!

Outside influences also prop up demand for farmland. The buyer profile has been dynamic over the past decade with a steady rise in the proportion of ‘lifestyle’ buyers whose primary motive is not income generation (Savills, 2010). But the archetypal ‘city buyer’ using bonus money to buy a farm or small estate has declined during the recession. According to Savills Agricultural Land Market Survey 2010, farmers represented 61% of all buyers in 2009, significantly more than the 53% recorded in 2008. In 2009 new ‘lifestyle’ buyers represented just 21% of all buyers, similar to the 23% recorded in 2008, but well-down on the pre-crunch figure of 33% in 2007. With such constrained supply, the drop in lifestyle buyers only caused a small ‘plateauing’ of prices in 2008 and early 2009, and values are now increasing again (RICS, 2010). It was widely felt in the Focus Groups that these buyers would return once strong economic growth was re-established.

Although investment by institutions had not been a big factor in the land market in recent years, they did still constitute part of the demand. As other assets and investments had declined in value, it was believed by interviewees that farmland was being looked at more favourably.

The foreign influence on the UK land market in recent years was also mentioned within the groups. Particularly Irish, Dutch and Danish farmers had been active buyers – adding to demand and prices. It was reported by the Surveyors interviewed that the Irish had largely disappeared due to their purchasing power disappearing with the economic problems of the Irish economy. The presence of farmers from continental Europe was still noted.

Despite the general positive outlook for land prices some notes of caution were raised by those spoken to;

- A ‘double-dip’ recession, or prolonged period of slow growth, will influence the external demand for farmland. Any legislation against large bonuses might also have a (marginal) effect.
• The favourable tax regime for farmland might change due to the poor state of the government finances. The possible effect of measures such as the abolition of Agricultural Property Relief for farmland were difficult to gauge. Some thought there would be major effects, other interviewees were more sanguine.

• Higher interest rates could be a problem in the future, but it was thought they would not rise to levels that would cause a surge of forced sales, and thus a possible collapse of values.

• There might be more variation in values. Land prices had gone up across the board in the past decade. There was now some thought that prices for ‘pure’ agricultural land, especially if it was in remote areas would weaken.

Differentiation was drawn between agricultural land values and rural property values and also forestry values, which have both been affected downwards by the recession. There was one report on forest being felled and returned to livestock farming.

8.3. INVESTMENT

The level of investment in the farming sector is important for its long-term health, and future productivity. It was felt within the groups that over the decade to 2008, a large backlog had built up due to low profitability. As set out in the preceding section, it is the level of profits (or perhaps even more simplistically, prices) which drives both the ability, and the confidence to invest.

On investment there were several comments that the loss of agricultural building allowances was a mistake. Also that the March Budget allowing capital allowances for machinery were encouraging investment in machines whereas in the long term interest of farming there was actually a need for building reinstatement where now there was little or no tax incentive. This was seen as bad for the future of the agricultural industry but also encouraging the purchase of imported machinery, whereas building construction would provide UK jobs.

The livestock sector was getting some new investment particularly poultry and pigs and in some cases dairy, beef and sheep. Little was happening in grain storage which badly needed improvement.

8.4. STRUCTURAL CHANGES AND BUSINESS MANAGEMENT

As seen in Figure 1, long-term trend in farm incomes is downwards. As the size of overall profits decline, those sharing them must become fewer to retain individual business profitability. As a consequence, over the last decade (and longer), the number of farming businesses has reduced as businesses have consolidated and farms generally increased in size.

It can be seen from the preceding section that the industry is not restructuring by farms being consolidated through sales. Andersons experience is that various arrangements have been put in place to allow the farmer to remain in place, whilst the actual farming is carried out by someone else. Such mechanisms range from formal tenancies, through contract and share farming arrangements, to licences, and the use of contractors. Some of these arrangements are formalised, but many are ad-hoc and no more than a ‘handshake deal’. Often there can be
multiple arrangements on one farm – for example the arable land could be under a contract farming agreement, whilst the grassland is let on a grazing licence.

It is very difficult to quantify the scale of such arrangements. Official statistics do not pick up such practices well. Within the interviewees it was widely felt that such arrangements were steadily increasing. This is much more marked in the East where the drive for economies of scale in arable farming is more prevalent. Contract farming and other joint ventures are not yet so prominent in the West with livestock and mixed farming. In the South West there was little interest reported in co-operation but much more use of outsourcing machinery jobs by using contractors. As a result livestock farms had fewer and fewer tractors.

This means land ownership and land management is becoming more detached. It was widely agreed within those interviewed that the number of ‘farming decision-makers’ within the farming sector will be far less than the statistics for ‘farmers’ tends to show.

The FBT legislation was widely accepted as freeing-up the market in land. However, it was felt that it had done little to encourage new entrants to the sector, as they always struggled to match the rents paid by existing businesses taking on extra land. This was largely the fault of the industry itself as the desire for extra land (often coupled with spurious reasoning related to economies of scale) led businesses to pay rental levels above that which could be economically justified. One (tenant) farmer stated - “The land tenure regime is totally wrong in order to encourage new entrants into agriculture. It’s good from a landowner’s perspective because you can rent land on a short term basis. But a tenant cannot base a business plan, and borrow money on the basis of that. The reason that young people do not come in is that there is no security on which to base a business”. This was echoed elsewhere – “Historically, people went into rented farms with the dream of eventually owning land. I’ve got examples where people started with nothing and gradually built up their business. With prices at £10,000 per acre tenants are going to have to live to a very old age to afford to buy now”.

One other issue concerning the tenanted sector was that it was now harder for tenants to retire with sufficient capital. Although the recent increase in livestock prices had helped, many tenants in the past had been “set up” in their retirement by landlords paying them a lump sum to surrender their protected Agricultural Holdings Act tenancy. There was now much less willingness for landlords to do this, especially if it was clear there was no successor within the business. This resulted in tenants “just hanging-on” so they continued to have somewhere to live.

Some concerns were expressed that the move towards short-term land occupation arrangements (contract farming or FBTs) resulted in a decline in the general ‘stewardship’ of the land. As high rents or rent-equivalents were being paid, there was a temptation to work the land as hard as possible to make a return. However, against this a number of comments were made that there was a wrong perception that large farm businesses do not look after the environment, as often the reverse is true. This is especially the case with large estates (often with sporting interests and ability to fund public benefits) which often do far more than the smaller businesses.
In terms of business management, many of the issues raised in section 5.1.2. in terms of risk management apply more generally. It was thought that the overall level of professionalism in terms of management of farms was improving; but this was often from a low base and improvements were slow.

A widely held view within the interviews was that the gap between the best business and the worst was increasing. A large ‘rump’ of businesses was standing still in terms of efficiency and competitiveness. Whilst at the top end, impressive strides were being made. On aggregate the industry did not appear to be moving ahead quickly, because of the dragging effect of the worst performers.

Some questioned whether this was actually a problem. If farmers wanted to subsidise their loss-making farming operation through the Single Payment, off-farm income, or increasing borrowings “then that was their business”. It was “a problem that would solve itself” as these businesses would eventually be forced out. Others took issue with this position, pointing out that these under-performing businesses often tied-up assets (especially land) that others could use more productively. It was also mentioned that they tended to depress prices by being happy to produce at a loss.

In general there was more evidence of long-term and strategic thinking in businesses. But often, farms carried on doing what they had always been doing until a specific ‘trigger’ forced a major rethink. The main triggers cited within the Focus Groups were:

- Succession – if there is not another generation coming through, then farmers are forced to rethink their business as they get older and wish to retire.
- Labour – a similar point to the above, but often it is the retirement of a farmworker that triggers the business change. If the proprietor cannot find a replacement, or does not wish to ‘start again’, then a policy change results.
- Investment – many farming enterprises require large investment in fixed equipment that has a finite lifespan. If a farmer is faced with an investment of many thousands of pounds in a new combine, milking parlour etc. then this can crystallise thinking about the future direction of the business. Of particular relevance at present, is investment to comply with NVZ rules. Unlike other investment, this does not necessarily bring much economic return – it simply allows the business to keep operating.
- Profits – surprisingly perhaps, ongoing low profitability is not as important as some of the other factors. As it can be dealt with through frugal living, other income sources, increased borrowings or occasional asset sales. It is only usually when bank support is lost that this becomes a triggering factor in business change.

An overriding theme mentioned at a number of groups is that structural change is always slower than you think it will be, and slower than economics would suggest it should be. “Farmers like farming” was one comment, and are prepared to make quite large sacrifices to continue doing so. All these features are corroborated by Andersons experiences in working with a large number of farming businesses.
9. ENVIRONMENTAL IMPACTS

9.1. INTRODUCTION

Subsequent to the desk review of current and relevant literature, the study developed and explored key themes and topics predominantly based upon data and opinion from representative Focus Groups and interviews from within the agricultural industry.

The preceding chapters have focused on exploring the impacts on agriculture of the wider economy which has separated out into six key themes, and these are all explored from an environmental perspective below:

- Direct financial market effects
- Exchange rates
- Commodity markets
- Demand change in the food market
- Diversification effects
- Asset values / Structural Changes

9.2. INTERVIEWS WITH ENVIRONMENTAL ORGANISATIONS

These themes have been predominantly concerned and related to economic impacts. A number of specific issues and/or questions relating to the environment have also been identified within each chapter, and these have been subsequently developed and tested to explore environmental implications of change. This has been undertaken with an interview series targeted at key representatives from the major and relevant environment organisations. Key senior individuals from both government and non-government organisations with national responsibilities and experience in the agricultural sector were contacted initially by email (see Appendix 4) which was then followed up by a semi-structured telephone interview. The pro-forma used is attached in Appendix 5.

The organisations included: Natural England, Environment Agency, RSPB, Soil Association, National Trust, LEAF and NFU.

9.3. DIRECT FINANCIAL MARKET EFFECTS

9.3.1. Key Points from Focus Groups and Initial Interviews: Financial Issues and Environmental Awareness

Although changes in borrowing costs and availability are important in business terms, the Focus Groups and initial individual interviews did not perceive there to have been any direct environmental outcomes in relation to financial issues. The same is true of trading relationships within the agricultural supply chain.

The Focus Groups identified that changes in financial markets, specifically related to pension values, had had an effect on farmers’ retirement decisions (albeit, perhaps marginally). The view was that the younger generation are not able to afford to buy out the farm business, and in part the older generations are maintaining an interest in the
farm for longer as they cannot afford to retire. In many instances the older generations are ‘winding down’ farming activity (a not uncommon example would perhaps be a reduction in livestock numbers), which may have positive or negative impacts on the environment depending on individual circumstances. Concurrent to this is the perception that older farmers are environmentally less aware than younger farmers.

9.3.2. Environmental Sector Interviews: Environmental Awareness

There was no confirmation of the perception outlined above from the environmental sector interviews. Certainly there is a strong view in some quarters that younger farmers care and know more about the environment, but this is graded by others to a more marginal difference. Perhaps this specific issue cannot nor should be generalised. Older generations have had to make significant changes as indeed younger generations are doing now, in part in response to government policies including compliance with tighter environmental regulations.

9.4. EXCHANGE RATES

No specific environmental points were identified and developed

9.5. COMMODITY MARKETS

9.5.1. Key Points from Focus Groups and Initial Interviews: Mixed Farming

The recognised high volatility in commodity prices might lend itself towards farmers offering a range of enterprises i.e. “not having all your eggs in one basket”. However, the findings from the Focus Groups and other interviews confirmed that the trend is generally in the opposite direction, i.e. towards increasing specialisation, with mixed farming likely to shrink further in the future. This tendency is not new but the major changes to CAP policy including decoupling of support payments, and more recent economic pressures continue to increase this trend.

Generally, mixed farming might be characterised by arable and livestock enterprises operating on the same farm holding, and with the integrated cropping systems and rotations providing the heterogeneity to deliver increased biodiversity benefits. Mixed farming also provides easier access to facilitate more efficient use of waste products on the same farm. The consequent environmental effects are integral to the assessments surrounding the relative merits of mixed farming – and it is this that was explored with the environmental sector interviews.

9.5.2. Environmental Sector Interviews: Mixed Farming

Generally, the commonly held views are that mixed farming is better for the environment, but there is a degree of inconsistency around this issue. Views ranged from unambiguous benefits to farmland biodiversity through to more resilient farming systems better equipped to deliver lower carbon systems. However it is also recognised that this is an area in which there are challenges in defining and measuring the term ‘mixed farming’.
9.5.3. Key Points from Focus Groups and Initial Interviews: Environmental Stewardship as an Income Source

The Focus Groups considered participation in the Entry Level Stewardship Scheme had not been adversely affected by pressures and uncertainty in the wider economy. The reasons cited supported existing known norms including; financial benefits, recovery of modulation funds, optimising use of marginal areas of the farm and public perception of farming.

An interesting connection was made with previous comment concerning trends towards specialisation (see 9.5.1). This can lend itself towards a more simplified management structure and covering larger areas of land, an aspect covered in more detail in Section 9.8.1. Within these parameters there may be a disincentive to farm within ELS and thus avoid increased management instructions and variations to field operations etc. In this respect wider structural changes within agriculture may indirectly influence participation / renewal in ELS.

During the Focus Groups, issues around the Campaign for the Farmed Environment (CFE) arose within this theme. As this is closely linked to ELS participation, it merited a deeper investigation of discernible impacts from the environmental sector interviews. A recognisable theme is that the CFE has capitalised upon its own publicity momentum and has concurrently raised the profile of ELS. The CFE is aiding the process of getting farmers/advisors to think more carefully about option selection etc within ELS, particularly in relation to those options primarily targeting improved arable habitats for biodiversity and resource protection.

Higher Level Stewardship Scheme was viewed differently in many respects within the initial findings of this theme. In some cases the Focus Groups reported that farming operations had become secondary – effectively there to ‘service’ the HLS management. The availability of funding for the scheme suggested now was a good time to enter. There was also a perception that recent volatility in markets has had a positive contributory influence on participation in HLS.

9.5.4. Environmental Sector Interviews: Environmental Stewardship as an Income Source

A key environmental issue however, remains the continuing and future intentions of farmers and whether to renew their ELS agreements. It is this issue that was discussed further with the environmental sector interviews. It was recognised that there was some degree of flexibility of primary motives. For some farmers economic pressure is not the main driver for entering into the scheme. Participation in ELS was not considered a big issue. For others however, they might view participation and renewal as a sensible bulwark in a volatile market place and contributions to profit, however small, are crucial.

In order to explore this latter point further, the role of volatility in markets and its influence on participation in HLS was also explored with the environmental sector interviews. There was a general consensus that there was a lack of any clear evidence of direct connections between volatility in markets and participation in agri-environmental schemes.
In terms of the Campaign for the Farmed Environment several of the environmental organisations interviewed are represented on the Steering Group of the CFE. They are positive but conscious that there is and will be a time lag and that it is too early to measure discernible environmental impacts.

9.5.5. Key Points from Focus Groups and Initial Interviews: Input Costs
The study found that, within the parameters of volatility in markets, farmer behaviour has recognisably changed towards variable cost inputs. This includes for example precision farming techniques becoming more mainstream and more considered, and embedded targeting of agri-inputs. Further examples of behaviour and management change that raised particular questions in respect of their potential environmental effects included improved grassland sward management and the use of organic manures.

9.5.6. Environmental Sector Interviews: Input Costs
These points were also addressed with the environmental sector interviews. Although there has certainly been indications of higher input costs affecting and driving change in farmer behaviour – there are differences between the sectors. The arable sector have access to more readily available and appropriate ICM technology, whereas the livestock sector is perhaps more price insensitive. However, in the livestock sector there has been some evidence of an increased interest in clover leys to reduce reliance on artificial N. This would in turn decrease the likelihood of nitrate leaching and greenhouse gas emissions, thus having a positive effect on the environment. However, there was some evidence that this interest has dropped off in response to falling N prices.

With regard to use of organic manures – there is some support for an existing trend in that greater value is given to organic wastes as a resource rather than a disposal problem, aided by the increased focus on this issue that tighter NVZ regulations has delivered. Despite the reduction in fertiliser prices, the better use of on farm resources is better ‘embedded’, perhaps more so for dairy farmers - they have found a way to substitute for bought-in fertilisers. This is an area that significant opportunities remain for better diagnostic technology to improve analysis and precision applications etc. More so in that there are potential environmental risks to trade off against use of organic manures. For example, slurry is higher in nutrients than composted FYM, but there are greater risks with run off and potential pollution risks.

9.6. DEMAND CHANGE IN THE FOOD MARKET

9.6.1. Key Points from Focus Groups and Initial Interviews: Environmental Purchasing
Overall consumers’ concern levels for environmental issues have dropped in correlation with increased food price costs and concerns with value for money. In particular, the literature review, Focus Groups, and initial individual interviews all reported that organic sales have generally suffered: “It is not the end for organic but certainly a reality check” was a noted comment from a food analyst in the earlier part of this study.

9.6.2. Environmental Sector Interviews: Environmental Purchasing
This was explored further with the environmental sector interviews. There was general view that this was a fair statement, but that it was a more complex picture than sometimes presented. For example, any fall in sales should be set against significant increases in demand over preceding years. Similarly, the concerns with perception of
expense that are associated with organic produce are not always based on reality or fair comparability. There is a widespread recognition of the environmental benefits of organic farming. A key issue, of course, is the substitution effects in its place if land is converted back to ‘conventional’, with potential loss of integrated mixed farming systems, increased uses of agro-chemicals and a reduction in the resilience in the farming system leading to overall losses of the associated environmental benefits.

Those interviewed within environmental organisations, and more widely, did not yet report any widespread switch out of organic status.

9.7. DIVERSIFICATION EFFECTS

9.7.1. Key Points from Focus Groups and Initial Interviews: Shooting
A summary of the Focus Groups’ views was that the appetite for diversification generally has been severely affected by recession with some exceptions. An area that did arise within this theme which raised questions directly related to its effect on the wider environment is that of game shooting. This has been pressured by the economic downturn and if this persists there was an implication that as a consequence would result in a negative impact on woodland and habitat management.

9.7.2. Environmental Sector Interviews: Shooting
Environmental sector interviews implied that this view is probably too simplistic. A key factor is the positive and potential role that game shooting can have in catalysing participation in agri-environment schemes, with the subsequent environmental benefits then achieved. It is also clear that, particularly in the more intensive situations, shooting interests can and does have some negative environmental impacts, e.g. localised damage to ground flora and increased rat populations, so conversely any downturn could have environmental benefits. Overall the downturn in this market has perhaps not been on the scale to present impacts on a measurable scale.

9.8. ASSET VALUES / STRUCTURAL CHANGES

9.8.1. Key Points from Focus Groups and Initial Interviews: Contract Farming
It was generally found that the long term trends of land values remains broadly unchanged i.e. prices continue to rise. However, the volume of land sales is historically low. The interview process (Focus Groups and individuals) found that there is considerably more interest and movement with the structuring of how the land is managed i.e. tenancy arrangements, contract farming and other outsourcing arrangements.

9.8.2. Environmental Sector Interviews: Contract Farming
The effects on the environment of this detachment of land management from land ownership and possible loss of ‘stewardship ethic’ surrounding the short term nature of arrangements is a legitimate area of concern and was further explored with the environmental sector interviews.

There is certainly some concern over this scenario, particularly related to contract farming operations – distilled down to lack of time and attention given and less careful approach to infrastructure etc. However there is a
converse view that runs counter to this and that larger contract farmed areas give greater scope to leave areas unmanaged (broadly equivalent to an ‘estate owner approach’). This is also underpinned by the cross-compliance measures which effectively give a built-in minimum standard to operations.

There is also a recognised difficulty and potential competitive disadvantage with organic farming, whose particular micro-management requirements do not lend themselves so easily to contract farming.

9.8.3. Key Point from Focus Groups and Initial Interviews: Poorly Performing Farms

A further and related area that was also recognised within this theme was the continuation of a significant ‘rump’ of poorly performing farm businesses operating at the bottom end of the sector’s productivity spectrum. It was challenged as to whether this was a problem - but this in turn developed the question as to the impact, if any, on the environment of such a ‘rump’

9.8.4. Environmental Sector Interviews: Poorly Performing Farms

The impact of poor farming performance which was investigated further with the environmental sector interviews:-

Such ‘poorer’ farms can have a default benefit more probably towards biodiversity, that might include for example the benefits of less intensive grazing pressures leading to greater diversity of grazing habitats, overgrown hedgerows, and generally a less ‘tidy’ farm. Conversely however such farms can demonstrate negative impacts with less capital investment and technology available to counter pollution and resource protection issues. It is a more complex picture than perhaps traditionally presented, with some farmers possibly prioritising the environment over economic performance and others ‘disengaged’ from environmental concerns and perspectives.

9.8.5. CAP Reform

The area and question of CAP reform was not addressed within a specific key theme, but the opportunity was taken to briefly develop this related aspect to the broader questions surrounding the impacts on the wider economy.

Within the parameters that CAP reform will result in significant challenges for UK farmers, and that farm incomes and profitability is likely to reduce – the perceived impacts on the environment were tested with the environmental sector interviewees:-

There is real concern with any impact on Pillar II funding that could reduce range and participation in agri-environment schemes, resulting in negative environmental effects. Divergent views were expressed with regard to any effects of reduction in Pillar I payments. At one end of the spectrum a concern that any such reduction will result in “reduced traction” of existing and established cross-compliance measures, through to a lack of concern that farmers would actually drop out of these reduced payments and their associated cross-compliance systems.
10. CONCLUSIONS

On balance, there has been little overall negative impact on agriculture from the changing conditions in the wider economy – i.e. the credit crunch and recession.

In fact, the greatest effect so far, albeit indirect, has been a positive one. The recession has prompted a realignment of exchange rates that has greatly benefitted UK farming. Other short-term trends have also been positive. The reduction in base rates has resulted in the sector paying lower borrowing charges, despite increases in borrowing margins and fees. The great strength that agriculture has in balance sheet terms became a particular benefit during a time when lenders were forced into being ultra-cautious.

The general global slowdown has also reduced input cost inflation, so lowering costs of production for many producers. It is reported that certain farm diversifications, notably tourism, have actually benefitted from the recession as more of the population holiday at home.

Some negatives have been identified. Some businesses have found it more difficult to access credit, but this is only in selected cases; usually where the business was weak before the downturn hit, or where borrowing is for non-agricultural purposes. Global commodity prices have weakened following the recession; this is particularly evident in the cereals market. Whether this is a direct recessionary effect, or more do with increasing supply is uncertain. In many other sectors of UK farming, any fall in ‘world’ or EU prices has been more than offset by the effects of the weakness of Sterling.

Within the food market the recession has resulted in a general ‘trading down’ by consumers. Apart from those farmers that have moved up the food chain, this seems to have had little direct effect on primary producers. One exception to this is the organic market, where farmgate price premiums have tended to weaken as a result of slower sales at the consumer end. By way of contrast, the trends towards paying premium prices in return for higher standards of animal welfare and consumer wellbeing have shown themselves to be very robust in the face of the recession.

Farmers who have diversified into property lets have suffered as a result of the general downturn in the economy, and the property market in particular. However, this trend is not universal and there are regional variations. There are some signs that weakness in the labour market is making it easier for farm businesses to recruit staff.

Many of the trends outlined above are short-term. It is expected that some will fade as the economy returns to growth. In terms of the structure of the industry, land management, and environmental issues, the trends that existed before the credit crunch still continue. It is hard to discern any acceleration (or indeed, deceleration) in these at this point.

It must be remembered that we are still very close to the financial turmoil, and, as yet unrecognised, effects may yet be seen in the coming years. Some of the possible longer term trends could be;
- More difficulty for businesses (even those deemed as strong) to get credit. The cost of credit to be higher.
- A permanent move to food consumers looking for ‘value’. Slower growth, or even stagnation in the organic market.
- A shift in exchange rates to a new trading range (possibly in the medium term only)
- Possibly a greater labour availability for agriculture, although the evidence in this area is mixed

Overall, the farming industry has emerged from the recession relatively unscathed so far, and there are few signs of any fundamental problems appearing in the next few years.
APPENDIX 1 – REFERENCES


Barclays. 2010.


Moody, J. 2008. The credit crunch and faming. CAAV internal paper


RuSource. 2008.


APPENDIX 2 – INTERVIEWEES

List supplied to Defra – suppressed for reasons of confidentiality.
APPENDIX 3 – FACILITATORS GUIDE

Defra Study:
Impacts on Agriculture from Changes in the Wider Economy

Remember - Paper, Pens and Flipchart. Badges for Farmers not coming to Seminars. Load Powerpoint presentation.

INTRODUCTION
Thank you for giving up your time this afternoon.
As we said in our invitation - Andersons has been commissioned by Defra to undertake a study into how changes in the wider economy are affecting farming, and what the implications might be for land management and the environment.
To do this we are gathering the insights and opinions of those within the sector. These groups are part of that process. We will be providing Defra with details of those we have spoken to, but your names will not appear in the final published report, and no quotes will be directly attributed – so don’t hold back.
Although we certainly want to talk about the effect of the credit crunch and the recession, we want to go a bit wider as well.
As well as thinking about what has happened, it would be really useful if we can also consider what might happen in the future.
Defra want to be sure they are not ‘missing anything’ that could have a big effect on the industry, either now or in the future.
There are no right or wrong answers in this kind of format, so please contribute fully and freely – we want to gather as wide a range of views and opinions as possible.
Saying that, there is potentially a lot of ground to cover. Therefore we may have to be quite strict on moving the discussion on. Please don’t be offended.
We intend to go through to around half past three – is there anyone who has to get away a bit earlier than that?
You hopefully know who we are, having been to the presentation this morning. But perhaps we can just go around the group and give your name and the business (or organisation) you represent. Start at one end, go around.

OPENING
Use ‘hum’ group technique.
To get things started, working individually please write down:
‘The top five things you have noticed that are different about farming or farm decision making in the last 18 months to 2 years’ Put question up on screen.
They can be about pressures, opportunities or just factual changes.
After two minutes (or less). Please now pair off with your neighbour (indicate), and compare notes.
After another two minutes when there’s a good ‘hum’ going, take feed back from each pair and put them up on the flipchart.
Keep going around the pairs until the ideas run out.

There seems to be certain themes emerging, which thankfully match what we have already found through our initial research.
Put them up on the Powerpoint Screen - pick out the issues the group has suggested and allocate them to our themes.

- Direct financial markets effects
- Exchange rates
- Commodity markets
- Demand change in the food market
- Diversification effects
- Asset values / Structural Changes
We’ll try and cover the effects of each of these in a bit more detail in the rest of the session. As we said, we want you to crystal-ball gaze a bit as well as just telling us what has happened already. As we go through each issue we would like you to keep in mind the following questions. *Have these two come up on the screen as well;*

- What has been the effect of the issue on farm decision making?
- Are there any emerging or anticipated affects land management and the environment?

**FINANCIAL MARKET EFFECTS**

Starting with the most direct effects. We would like you to consider the following question; *Put up on screen (include final two bullets from above as well)*;

‘What are the top issues, if any, you have noticed about any immediate, direct effects arising from the so-called ‘Credit Crunch’?’

Issues to perhaps consider include access to credit / borrowing, risk management, trading conditions etc.

*If discussion needs prompting, perhaps ask the question ‘Do you think the banks attitude to lending to farmers has changed over the past two years?’*

Remember to try and cover the following areas {tick off};

- Borrowing costs altered over the last 2 years? Margin over base and arrangement fees.
- Has credit availability for agriculture altered? More emphasis on ability to service loans rather than asset collateral? Tenanted v Owner-occupied.
- Have farm businesses restructured their borrowing (e.g. more long-term debt, less overdrafts?).
- Are farm businesses looking at more sophisticated risk-management practices in terms of borrowing (Cap and Collar etc.)?
- Have suppliers changed their trading terms – either explicitly or in practice?
- Are farmers more wary of who they sell to / deal with in terms of the potential for having unpaid debts? Ref. DFoB.
- Has the change in pension values affected older farmers’ retirement decisions?

Thank you for your views, that was very useful. We are now going to move onto the next topic.

**EXCHANGE RATES**

Obviously exchange rates have shifted in favour of UK farming over the last couple of years as an indirect effect of the credit crunch. This has helped firm prices and boosted the SP.

We would like you to consider the following question; *Put up on screen (include final two bullets above as well)*;

‘Are farm businesses doing anything to hedge against currency changes? E.g. fixing SPs? Is there anything else they can reasonably do to manage exchange rate volatility?’

This should be a relatively short section. *If discussion needs prompting, perhaps ask any farmers whether they have considered fixing their SP.*

**COMMODITY MARKETS**

World commodity prices for cereals and dairy have weakened after their boom in 2007-08 – probably at least partly due to the global recession. Also input prices have been volatile, especially fuel, fertiliser and feed, and not forgetting machinery.

We are not asking you to predict where commodity prices are going in the next few years! Instead it would be useful to get your views on whether this volatility is changing the way farmers operate. *Flash up on screen:*

‘Have farmers changed their business strategy in response to market risk? Consider both the marketing of produce and the sourcing of inputs.’

Remember to try and cover the following areas {tick off}. Use as prompts if discussion slows;
• Is there more ‘marketing’ of outputs - forward selling, long-term contacts etc.
• Is the enterprise mix on farms changing – specialisation versus diversification
• Has rises in the cost of inputs changed the way inputs are purchased or changed the way they are used (quantity)?
• Has the financial crisis introduced an increased interest in business efficiency / productivity (or are other, ongoing, factors more important)?
• Is there more focus on strategic business management – i.e. longer-term planning?
• Economic pressure = focus on bottom-line : less environmental management?
• Is participation in agri-environment schemes regarded as a risk amelioration strategy? – fixed, consistent payments.

Remember to cover any general environment impacts

THE WIDER ECONOMY – THE FOOD MARKET
We now want to move away from purely agricultural matters to look at the fallout on farm businesses from demand changes in the wider economy. We’ll start by looking at the effect the recession has had on farm businesses via food markets.

Note this may lead on naturally from the previous section on commodity prices if the group gets onto retailers actions in the marketplace

‘Have you noticed any effect at farm level from changes in consumer spending patterns brought on by the recession? Is this affecting farming generally, or just those in ‘niche’ production’.

Checklist -
• Premium food to value ranges. (Esp. organic).
• Are the trends universal, or have different sectors behaved differently?
• Will this effect continue or is it a ‘blip’?
• Supermarkets role in the market

THE WIDER ECONOMY – DIVERSIFICATION AND EMPLOYMENT
The next issue is farm diversification, and how this has been affected by changes in the wider economy. However, we want to broaden things out a bit to include employment factors. Therefore we have two questions. We’ll look at each in turn.

‘How has farm diversification been affected by the downturn? Is this changing future diversification plans?’

‘How have farm businesses been affected by changes in the labour market? – both as employers, and for those looking for off-farm income’.

Prompt for first part is to ask surveyors on group what the effect on lettings has been.

Checklist -
• Effect on on-farm property rentals? Significant or ‘incidental’?
• Long-term or blip – effect on future plans
• What has been the effect of the recession on the ‘leisure’ market – equine, tourism, others?
• Again, are any effects short or long-term. Has the recession changed future plans?
• Has credit availability / cost for non-farming projects changed? Is this preventing diversification?
• Have the opportunities for finding off-farm income (employment / self-employment) changed? Does this materially affect UK farming households?
• Has the relative ‘stability’ of agriculture during the recession made it a more attractive career choice? Is the quantity / quality of people entering the industry improved? What might the effects be on long-term productivity?
• Has the economic downturn affected causal labour availability and cost?
• Has there been changes in other factor costs due the economic downturn? – e.g. buildings, repairs, services etc.
3.10

**ASSET VALUES, INVESTMENTS, STRUCTURAL CHANGE**

This is a bit of a catch-all category, and hopefully gives us the chance to cover ‘any-other-business’ and also look ahead a bit more. The question(s) we are going to look at is;

“How has the economic downturn affected farmer’s asset values now and in the future? What changes, if any, have you detected at the farm level on farmer’s attitude to investment and their business structure?”

*Bit of a rag-bag of questions, but hopefully the group will be into their stride by now!*

**Prompt question might be ‘Is farmers’ decision-making influenced more by asset values rather than by profitability’.** Checklist;

- Change in asset values and therefore farmers’ balance sheets = change their decision making? Lenders attitudes?
- Has the economic downturn materially affected rural property prices? What might happen in the short/medium/long-term?
- Is possible change in future government taxation policy a big threat to asset values?
- Would any changes in support under the CAP trigger large land price changes?
- Will the methods of restructuring change – i.e. joint ventures, contracting and letting rather than outright land sale change in the future?
- Is it perceived that larger businesses gain economies of scale, and are better able to withstand volatility than smaller ones?
- Have structural adjustment trends (consolidation) accelerated as a result of recent problems in the wider economy?
- Will they change in light of any of the factors outlined above?
- Has the economic environment changed investment decisions – e.g. spending on new buildings and infrastructure. Does this have longer-term implications for output levels and future productivity?
- Is there a change in nature of businesses – e.g. move to less capital intensive production systems (outdoor pigs, low-input dairy, min-till arable etc.)
- Any other issues anyone wishes to raise?

**CLOSE**

Again, thank you all for your time this afternoon. We have had a very useful discussion and your insights and views have been most welcome.

Our contact details are on the slide behind you. {Put up details} If any further thoughts come to mind on this subject over the coming weeks please feel free to let us know.

The final report should be ready in June. If anyone would like a copy, it should be available on the Defra website and we will point you in the right direction.

We wish you a safe journey home, and we hope to see you at our Seminars next year if not before.
APPENDIX 4 – INTRODUCTION LETTER: ENVIRONMENTAL INTERVIEWS

Dear …….

Andersons Farm Consultants and the Royal Agricultural College are undertaking a study for DEFRA to better understand the effects of the recent downturn in the UK economy on the agricultural sector - and if changes in the business environment has affected the choices being made by individual decision-makers in agriculture. Further – we are investigating the environmental consequences (if any) of these choices.

The project has initially formed around six broad economic themes and arising from these have been a number of specific points and questions relating to the consequent impacts on the environment. It is this latter part I would like to discuss with experienced individuals with key organisations that have a role and influence in farming and the environment.

It is to this end that I am contacting you to outline the direction of this study and give you some prior notice that I would like to interview you on the telephone. I hope that this will be acceptable with you – and I will telephone you within the next few days. If you have any immediate queries please contact me directly on 01285 652531 x2261. Please be assured that no interviewees will be identified in the results of the research and that individuals’ details will not be passed to a third party under any circumstances.

Yours sincerely
APPENDIX 5 – ENVIRONMENTAL CONSEQUENCES: INTERVIEW PRO-FORMA

The project has developed around six theme/topic areas as follows:

- Direct financial market effects
- Exchange rates
- Commodity markets
- Demand change in the food market
- Diversification effects
- Asset values / Structural Changes

The data and opinions gathered from industry / sector representatives were analysed and assimilated into respective chapters within the Interim Report. From each of these - key points and questions that impact more directly on environmental matters have been subsequently developed to test and explore further with key representatives from the environment sector.

**Commodity markets**

Very high volatility in world prices – mostly in relation to combinable crops and dairy products (both very imp to UK)

To counter risks – move towards a range of enterprises BUT trend is in opposite direction ie towards specialisation. (some indication of livestock framers growing more arable crops for own feed use / free range poultry enterprises.

Belief / trend that scale brought efficiency.. this can result in a squeezing out of one enterprise to accommodate growth of another.

**Q1 – Traditional mixed farms likely to shrink further in future. Trend is towards all grass / all arable. Has the economic pressures increased / accelerated this move away from mixed farming enterprises? (nb as per CAP reform studies ..)**

**Q2 – Is mixed farming better for the environment?**

**ELS** - In general thought uncertainty in wider economy is not making farmers embrace ELS.

**Q3 - Test out above scenario – ie wider economic pressures is not the driver in participation with ELS**

**Q4 Will farmers be renewing ELS?**

**Q5 Is / has there been a discernible impact of CFE**

**HLS**

Is viewed differently. In some case farming operations had become secondary – effectively there to ‘service’ the HLS management.. Funding evidently not a problem and a good time to enter.

**Q6 - What role has volatility in markets contributed to participation in HLS?**

**INPUTS**

Farmer behaviour has changed towards variable costs. More interest in precision farming techniques which are becoming more mainstream and less specialist. Feeling is that this more considered targeting of agro-chemicals/fertilisers was long term…

**Q7– In respect of livestock sector - Is there a more considered and better management of swards (ie clover rich leys)? And/ or greater extensification of production …**
Q8 - Explore - more value / care given to use of organic manures. What are environmental impacts of this trend?

**ENERGY**
Carbon foot-printing – very rare at farm level. No interest and significant scepticism. Lacks a quantifiable benefit.

**Direct financial market effects**
Older generations are maintaining an interest in the farm for longer. Younger generations not able to afford to buy out the land etc..

**Q9 – Older generation ‘winding down’ -**
Perception that older generation who are environmentally less aware

Overall is this good/bad for the environment….

**Exchange rates**
Biggest determinant of profitability of UK agriculture is exchange rate – particularly in respect of Sterling and Euro.

**Demand change in the food market**
Environmental issues around consumers concern levels drop when cost/ value is uppermost in consumers minds. Local may also suffer – again on cost. More difficult to measure ’local’. Generally organic sales have suffered.

**Q10 - “It is not the end for organic but certainly a reality check”**
Is this fair?

**Q11 - Despite financial squeeze, small premiums for organic produce remain acceptable to consumers (eg milk). But are these premiums large enough to sustain production costs?**
Diversification effects

Appetite for diversification generally has been severely affected by recession with some exceptions. The full effects of any downturn in employment affecting off–farm jobs and income perhaps yet to kick in.

Q12 - Shooting has been hit by downturn. If persists likely to have knock on effects on decreased environmental management activities (woodland and habitat management).

Is this view rationale?

Asset values / Structural Changes

Long term trends of land values/sales are broadly similar (ie continue to rise). There remains the ‘emotional’ pull of buying neighbouring farmland.

Contract farming – more in arable east, not so prominent in livestock/mixed areas where outsourcing machinery jobs increasingly common.

Q13 - Land ownership and land management is becoming more detached – Short term nature of tenancies and contract farming result in a decline in ‘stewardship’ of the land.

Is there a decline in ‘stewardship’ of the land? and if so what are the recognisable impacts on the environment?

Still a large ‘rump’ of poor performing farms at bottom end.

Q14 - Is this a problem? Are the poor performing farms impacting positively or negatively upon the environment?

ADDITIONAL QUESTION

Q15 - Should CAP reform result in significant reductions for UK farmers, farm incomes and profitability is likely to reduce.

Test and explore the perceived impacts on the environment…