

**Policy Briefing**

**BREXIT: A MOMENTEOUS CHALLENGE**

**FOR THE EU AGRI-FOOD SECTOR**

**October 2017.**

The political shock of Brexit has yet to be translated in actual economic and commercial terms, but the clock is already ticking.

End March the UK notified its intention to withdraw from the EU, opening up the two-year period for negotiating the terms of the withdrawal and the terms of the future EU-UK relationship.

The uncertainty as to which will be the future model of the trade relationships between the EU and the UK is still paramount. Will the negotiations succeed or fail? If there is success at the end of the day, to which degree will the UK retain access to the EU market in the future? If negotiations fail, what will the consequences be for the EU agri-food sector?

Beyond these uncertainties it is however possible to shed light on a number of factors that will shape the EU/UK relationship in the agri-food sector. There are a number of hard facts and reasonable assumptions that point towards substantial changes to the EU trade with the UK.

This paper examines the consequences of Brexit for the EU-27 agri-food sector under both scenarios, were negotiations to succeed or to fail.

At this stage it is hard to predict which scenario is more likely.

The EU has adopted negotiating guidelines that follow a two-phase approach.

First the EU will seek to settle the terms of the disentanglement of the UK from the EU, clarify the conditions for the EU citizens in a post-Brexit UK and avoiding a hard boarder in Ireland.

Only in a second phase will the EU negotiate the framework for the future relationship, including the crucial future trade relation terms.

The UK has stated its broad objectives for the negotiations, pointing towards a future relationship outside the single market, and linking the terms of disentanglement to the terms of the future relationship. To say it differently, the UK wants to know what the future trade and other conditions will be before agreeing on the terms of its withdrawal, which include the highly contentious issue of its remaining financial responsibilities.

The first rounds of negotiations have taken place in a context where the political hand of the UK side has been weakened by the results of the May election. That makes it even harder to predict the outcome, as the UK negotiation position might become more difficult to steer and its margin of manoeuvre more limited.

It is thus too early to tip the balance in favour of success or failure. The stakes are high, in particular for the UK, and reason would encourage finding acceptable compromises. However the charged political content of many of the issues under negotiation, at the very core of national sovereignty, might hinder agreement. Control of emigration, and border controls in general, the decision on the highest legal court, and due payments for exiting the EU are amongst the most politically charged files that could derail negotiations, in particular as the UK Government has come out weakened from the latest election.

The possibility of a total reversal of Brexit is pursued by some in the UK (and in the EU), betting in a growing realization of its high costs and a harsher economic environment in the UK. But the likelihood of a Brexit reversal is dimed by the current political spectrum in the UK and the public acceptance of the referendum results. It is in our opinion advisable to prepare for the consequences of Brexit, rather than hope for the better.

At present what we face is an extremely difficult negotiation in a very limited time period. On the 29th March, 2019, in 1 ½ years’ time, the UK will most probably no longer be a member of the EU, and will have exited the single market on that date, or at a not so distant date after a short transitional period.

The impact on the EU agri-food sector will be huge, in particular in the scenario where negotiations fail. No other economic sector in the EU faces such a strong impact as the agri-food sector, as a result of the significance of current trade flows with the UK, and the relative high level of the tariffs applied to trade with third-countries.

Let’s turn out now to what that impact might be.

**1) Brexit: the basic facts for the agri-food sector**

*Increased competition*

The agriculture and food sector is by far and large the field in which the EU-UK relationship is the most integrated in political, economic and budgetary terms.

The EU agri-food sector will face much more competition on the UK’s internal market from global competitors, with cascade effects on the internal market irrespective of what will happen in terms of the future EU-UK trade deal.

Agriculture and food have never been a prominent topic across the Channel. A complete U-turn would be surprising, which means that agriculture and the agri-food sector will from the UK side be open to full-fledged free trade arrangements with major trading partners across the world.

Since the UK decided to leave the EU, it has opened exploratory trade talks with 10 countries or groups of countries, including the US.

It is clear that the UK will actively pursue achieving Free Trade Agreements with key players as soon as possible after exiting the single market, as a means of counterbalancing the expected trade and economic losses in the EU market.

The consequences of the UK position is that irrespective of the model of the future UK-EU relationship, the UK market will be a new market for EU products as they will face much more competition from other suppliers. These FTAs to come will have a serious impact in EU exports to the UK, and will create new challenges for the EU market as explained later in detail.

The UK market is today protected by the EU common external tariff, and by a host of EU sanitary and other regulations. While the EU market is already open to some FTA partners, and other FTAs are under negotiation, it is likely that the UK will in the future be open to other countries than those negotiating with the EU and will agree to freer terms of trade in agriculture with the countries with which the EU is negotiating. This is a relevant point, as the EU has protected sensitive sectors in agriculture (cf. meats, sugar) in previous deals and is expected to do so in the future with the likes of the US and Mercosur, whilst the UK will likely have a more liberal position.

Whatever the result of the EU/UK negotiations, both the internal policy shift in the UK and diverging trade strategies between the EU and UK will lead to medium and long terms changes for the EU agri-food sector. This should not be underestimated, even more following the clear commitment of the new British leaders to create the biggest open economy in the world. This strategy will make it difficult a full-free trade agreement between the EU and the UK without any safeguards, as some of the sectorial examples examined below will highlight. Otherwise, London’s open trade strategy would de facto become the EU’s strategy, like it or not.

*General overview of current trade*

60% of the agriculture and food products consumed in the UK are imported. And nearly 75% of these are coming from the EU.

The UK is a major outlet for traditional agri-food export countries such as the Netherlands (€6.9 billion), Ireland (€5.2 billion), France (€5 billion) and Germany (€4.5 billion).

The agri-food sector in Spain (€3.2 billion), Belgium (€2.6 billion), Poland (€1.5 billion) and Denmark (€1.4 billion) are also exposed to Brexit with certain sectors facing serious risks.

A cautionary word is appropriate as the figures for The Netherlands and Belgium might reflect to a large extent the relevance of their ports, rather than domestic production. But that does not diminish the finding that many EU countries have substantial trade interests in the UK market.

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| --- | --- | --- |
|  | Import from the UK  (Euros) | Export to the UK  (Euros) |
| Austria | 94.318.746 | 251.526.706 |
| Belgium | 617.756.600 | 2.604.172.578 |
| Bulgaria | 56.194.333 | 51.222.306 |
| Croatia | 19.447.709 | 7.098.784 |
| Cyprus | 86.165.948 | 71.195.244 |
| Czech Republic | 107.017.996 | 156.908.534 |
| Denmark | 362.851.241 | 1.462.364.846 |
| Estonia | 54.957.773 | 3.803.545 |
| Finland | 119.437.681 | 31.929.068 |
| France | 2.441.796.662 | 5.067.814.230 |
| Germany | 1.397.286.506 | 4.506.542.294 |
| Greece | 131.784.989 | 303.757.531 |
| Hungary | 63.185.940 | 188.578.696 |
| Irish Republic | 3.985.230.782 | 5.228.378.706 |
| Italy | 562.220.945 | 2.895.689.405 |
| Latvia | 83.549.302 | 21.283.486 |
| Lithuania | 19.295.228 | 109.494.990 |
| Luxembourg | 11.347.879 | 14.521.458 |
| Malta | 59.764.250 | 8.873.363 |
| Netherlands | 1.680.708.365 | 6.890.781.462 |
| Poland | 307.409.448 | 1.530.058.102 |
| Portugal | 227.016.503 | 288.970.984 |
| Romania | 43.612.159 | 129.803.664 |
| Slovakia | 16.756.322 | 61.474.370 |
| Slovenia | 12.854.150 | 17.885.818 |
| Spain | 1.010.320.620 | 3.221.110.105 |
| Sweden | 318.031.451 | 375.272.432 |
| **Total** | **13.890.319.530** | **35.500.512.707** |

Table 1: Overview of EU/UK agri-food trade in 2015 (Source: HMRC, UK Gov)

**2) Sectorial overview of the EU-UK post- Brexit trade challenges**

***2.1 Scenario 1- negotiations are successful***

Under this scenario the EU and the UK would agree on the terms of its future trade relationship. Under the likely assumption that the UK would exit the single market as indicated by its Government, this would mean that the UK and the EU would have negotiated a Free Trade Agreement that would kick-in after the UK exit, on 29th March, 2019 or after an agreed transitional period.

*Meat products: a further chill for the EU beef community*

Nearly €1 billion of EU beef meat products are routed to the UK every year, mostly from Ireland (more than €700 billion). This is an additional sword of Damocles for the whole EU beef sector, which is already under pressure from the EU trade agenda while facing a structural crisis at the same time.

It is clear that the real game for the future of this trade flow is not tied with the terms of the EU/UK FTA but rather more with the UK/rest of the world FTAs to come. It is indeed hard to believe that UK FTAs with countries such as Australia, Argentina, Brazil or the US would not pave the way for a significant share of imported beef meat from these countries into the 65 million people British market. EU exporters will in the future have to compete with the most competitive meat producers in the world. It is therefore illusory to think they will keep their UK market share, on the contrary they should expect it to shrink significantly. In addition, these FTAs could have an indirect effect, by pushing Irish beef producers to find new outlets in the world market but also in the EU domestic market.

Danish, German, Dutch and to a lesser extend Spanish and French pig producers will also likely be affected, the UK being a €670 million market for EU exporters. Additional bad news coming from the UK would come on the top of difficult conditions with Russia leading to an enhanced dependence on exports to China.

In turn, the UK is expected to pay a special attention to the €350 million trade flow of sheep meat exported or re-exported, in particular in the context of its future new bilateral relations with the New Zealand. A very significant share of this trade flow is channelled to the French market (€190 million). New Zealand producers benefit from a 280.000 tons tariff free quota to the EU. They see the Brexit as an “opportunity in time of change”.

For the meat products, the cascade effect of trade agreements will have to be carefully assessed. Serious safeguards on future UK exports will be needed to avoid that a post-Brexit UK open to the global meat market does not lead to a de facto opening of the EU to the world market, by diverting the UK beef production to the EU market and satisfying UK’s beef consumption through imports.

*Wine and spirits: New World wines and Scotch whisky*

For more than 20 years EU wine producers have been working hard to stop the drain of their market share in the British market. Their efforts to repel the New World onslaught could be short lived as a result of the UK’s opening to New World exports.

The market seems to have stabilised for traditional EU wine makers at €1.8 billion, with France leading the way (880 million), followed by Italy (€540 million) and Spain (€228 million).

The UK will also be willing to secure a preferential access to the internal market for Scotch whiskies, which is indeed particularly sensitive from an economic point of view. This tariff line (more than €1.2 billion) represents 10% of the UK’s agri-food exports, with France, Spain and Germany being the main outlets.

The willingness of the UK to open its market to New World countries for the wine sector will seriously reduce the attractiveness of the British market for the EU wine sector, and likely further erode its market share.

*Sugar and sugar products: will EU-UK producers dig up the hatchet?*

Having the UK open to the world market will change drastically the EU sugar landscape, and the difficult balance reached between sugar beet and cane refiners. The long-standing tensions between the continental sugar beet cooperatives (German, French and Dutch) and the US owned cane sugar refining company (American Sugar Refining – Tate&Lyle, which owns, in London, 25% of the total refining capacity in the EU) are about to rebound.

On the one hand, the EU sugar producers are enjoying an important outlet in the British market (€880 million in 2015). On the other hand, Tate&Lyle is poised to regain some competitiveness from UK FTAs with sugar cane producing countries. In this case, assuming that the beet sugar producing company maintains its production, the British market would most probably be in a position to switch from a deficit to a surplus position.

Restrictions via current EU strict rules of origins for the sugar sector will need to be also implemented to the UK to avoid a damaging triangular trade in a post-Brexit context, taking into account that raw sugar refining into white sugar is not considered as a substantial transformation allowing operators to rebrand it as “local products”.

*Milk and milk products: more competition in a big market*

On paper, the challenge of Brexit for the milk sector is more than significant (€2.5 billion EU exports). Once again, Ireland (€718 million) but also France (€546 million), Germany (€345 million), the Netherlands (€186 million) and Italy (€167 million) have serious interests in the British market.

Even if the trade balance is not in its favour, the UK also has a significant market position in Ireland (in particular via Northern Ireland) and France. In total, nearly €1 billion of milk products are exported or re-exported from the UK to the EU internal market.

An UK FTA with New Zealand and with the US would inevitably bring added competition in the UK market for EU exporters, which could face an erosion of their market share. The losses in the UK market could lead to increased pressure on the EU-27 internal market, which is the last thing the sector needs after the still fresh dairy crisis.

*Fruits and vegetables: is the carbon foot print a sufficient argument for preferring EU origin?*

With about €4.5 billion of fruits and vegetables exported from the EU to the UK, it’s clear that EU producers are exposed to the Brexit consequences. Spain (€1.6 billion) and The Netherlands (€ 1 billion) are by far the most exposed.

Many other countries are also concerned, such as Italy, Belgium, Ireland, Poland, France, Germany, Greece or Cyprus, which is traditionally exporting potatoes to the UK (€6 million).

The challenge for EU exporters could come from freer access to the UK market from exporters in North Africa.

Nevertheless, the proximity to the market should allow EU producers to keep strong positions, even under enhanced competition with the rest of the world.

***2.2 Scenario 2 – negotiations fail***

Under this scenario the UK leaves the EU without reaching an agreement on the future trade relationship.

On 29th March, 2019 both sides have to apply to each other its WTO tariffs, which incidentally are the same.

These tariffs are in general low, with the notable exception of the sector of interest to us – the agri-food sector. Therefore whilst they are not in general a constraint to the continuation of previous trade flows (although custom procedures will add to trade costs), in the agri-food sector where they average more than 20% and peak at or over 100% in the meats, dairy and sugar sectors, tariffs are definitely a barrier to trade. Even in the less protected sectors tariffs are relatively high for many products. For grains they range from 40% to 90%, and for the fruit and vegetable sector tariffs for citrus are 30% and even higher for apples, pears and fruits juices.

The application of those tariffs would practically eliminate trade on these products between the UK and the EU, in a context where the UK would have reached FTAs with other important countries as seems likely. As the EU currently enjoys an important trade surplus with the UK, it would be the EU agri-food sector which would face the stronger negative impact of a negotiation failure.

At issue are more than 35 billion euros worth of exports that would face a critical shortfall. The impact of that external market loss could not be cushioned by progress in exports to other markets.

In the meat, dairy and sugar sectors, that account for more than 5 billion euros worth of EU annual exports to the UK, trade could come to a near complete halt.

Wine exports would drop as they would face higher tariffs than New World producers benefitting from FTA conditions with the UK.

Even fruit and vegetable exports could be scaled back, if the UK manages to broaden the geographic scope of its new FTAs.

It is difficult to see which EU agri-food exports will not be affected with the exception of some high-end and processed products.

This scenario if made true would also bring about serious disruption of the EU market conditions for so many important agriculture sectors. The EU farmers would be left with a situation of severe oversupply in the meat, dairy and sugar markets, which would lead to drastic price cuts followed by significant farm and processing industry restructuring.

It would also come at a moment where the negotiations on the future of the CAP would probably be gathering steam under significant budget cuts as Brexit will also mean a serious hit for the overall EU budget. Notwithstanding, the EU finance Ministers will have to keep in mind June’s 1984 agreement (Fontainebleau) on the British rebate, stemming directly from the low rate of return for London when it comes to the Common Agriculture Policy. Anyhow, the net reduction from Brexit would be around 3.5 billion euros, a not so negligible amount.

**3. Brexit and EU’s current FTAs and tariff rate quotas**

Existing FTAs have been negotiated for a market that included the UK, and tariff rate quotas (TRQs) for sensitive products have been calculated accordingly. Concerning sugar this is especially significant: the quarter of the raw sugar imported in the EU is now entering via the UK.

The EU without the UK will significantly change that picture. Logically the UK share in current TRQ’s should be extracted, otherwise the existing quotas would no longer reflect the balance of the negotiations and would overburden the EU-27 market.

In addition to that, WTO has implemented rules when a new member is acceding to a custom union (Article XXIV of the GATT). The EU enlargement (including the enlargement with the UK in 1973) has therefore led to concessions to compensate for tariff increases: for sugar, this resulted in CXL quotas. By the same token it would be logical to extract the UK share from these quotas.

However the consequences of a member leaving a custom union in existing FTAs or Art. XXIV concessions is not foreseen by WTO rules. WTO rules are designed to open up markets, and its provisions are geared towards that goal. Freer trade terms are set in stone and reversals are not part of the rules (or are subject to dispute settlement).

Farm Europe welcomes the early agreement between the EU27 and the UK on the sharing-out of these TRQ, and that the agreement is notified to the WTO and FTA interested parties. The European Commission should not be too impressed by the first reactions of other countries and interested parties, which with little surprise seek to extract new concessions from the exit of the UK, and stay the course during the upcoming talks in Geneva.

**4) CONCLUSIONS**

Brexit is a momentous challenge for a sector that is already showing a number of strains, that is investing less than what it should, that has experienced lower productivity and seen revenues stagnate.

The agri-food sector should not in any case underestimate its negative impacts that could be felt in less than 2 years’ time

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Under the best scenario, one in which the new trade relationship between the UK and the EU is set under a Free Trade Agreement, Brexit will bring about additional competition for EU exports in key sectors – beef and other meats, dairy, sugar, wine- and reduce the Member States contributions to the EU budget.

Brexit will also intensify competition in the EU market for some products as a result of the diversion of previous EU exports to the UK, or as a result of triangular trade following the new UK FTAs with other major exporters.

Under the worst scenario, one in which on 29th March, 2019 each party applies to the other exports its WTO tariffs, trade would come practically to a halt in many sectors, and would be scaled back in others. The drastic reduction of the 35 billion worth annual exports to the UK would destabilize many EU markets, severely reduce producer prices, and lead to crisis and restructuring of farms and processing industry.

It would also come at a moment where the negotiations on the future of the CAP would probably be gathering steam under significant budget cuts as Brexit will also mean a serious hit for the overall EU budget.

The negotiation on the future of the CAP will be the most important of the last decades having regard the challenges facing the sector and the budget pressures.

The question is whether the current CAP is designed to meet those challenges. The question is whether this CAP offers the sector what it needs, and in particular the right set of tools to increase resilience to market shocks such as the ones to be expected from Brexit.

The best answer to more competition from other countries, in the UK market or elsewhere, is to improve your own position. In order to improve its position the EU agri-food sector should also seek to improve its competitiveness, and increase its market share at the global level.

That is the subject of discussion in other panels in the Forum. But the challenge from Brexit dramatically adds to the need of policy reform in the EU.