



HOUSE OF LORDS

Revised transcript of evidence taken before

The Select Committee on the European Union

Energy and Environment Sub-Committee

Inquiry on

**RESPONDING TO PRICE VOLATILITY: CREATING A MORE
RESILIENT AGRICULTURAL SECTOR**

Evidence Session No. 5

Heard in Public

Questions 52 - 63

WEDNESDAY 27 JANUARY 2016

11 am

Witnesses: His Excellency the Rt Hon Sir Lockwood Smith and Dr Jared Greenville

Members present

Baroness Scott of Needham Market (Chairman)
 Lord Boswell
 Lord Bowness
 Lord Cunningham of Felling
 Lord Curry of Kirkharle
 Viscount Hanworth
 Lord Krebs
 Lord Rooker
 Lord Selkirk of Douglas
 Baroness Sheehan
 Lord Trees
 Viscount Ullswater
 Baroness Wilcox

Examination of Witnesses

His Excellency the Rt Hon Sir Lockwood Smith, High Commissioner of New Zealand to the United Kingdom, and **Dr Jared Greenville**, Senior Agriculture Policy Analyst, OECD

Q52 The Chairman: Good morning. On behalf of the Committee, I welcome Sir Lockwood Smith, High Commissioner of New Zealand to the United Kingdom, and Jared Greenville Snr, agricultural policy analyst from the OECD. You have come from Paris today, so we are grateful to both of you for giving up time in what I know are busy schedules to come and give evidence to the Committee this morning. As you know, we are carrying out an inquiry into the impacts of price volatility in agriculture on farmers and on farming. Having spent quite a lot of time looking at the UK and then, last week, talking to the Commission, today's focus is really on the international situation. Your evidence from the different perspectives will be really useful to us.

This is a formal evidence-taking session of our Committee. A full note will be taken, put on the public record in printed form and on the parliamentary website. We will send you a copy of the transcript and you can revise any minor errors. We are being webcast live and that will be available on the parliamentary website. You will have received a list of the interests declared by Members. I remind my colleagues to declare any relevant interests on the first occasion they speak in this session.

With that, I will kick off with the first introductory question—but perhaps before you answer it you might want to say one or two words about yourselves and particularly your involvement with this topic. How do you see recent trends in agricultural price volatility? Do you think that

the situation is worsening, or are its impacts worsening? It is not quite the same thing. You can just give us a general overview on that.

Sir Lockwood Smith: Lord Chairman, thank you for this opportunity to be with you today. It is a real tribute. I have spent many years on that side of the table in New Zealand politics and it is interesting to be on this side. My background in agriculture is pretty simple: I am a farmer. I still farm; I farm a 900-acre beef property, running about 700 head of cattle from here in London. The farm is in New Zealand, of course. I grew up on a farm. I was an agricultural scientist for a while, then I went into international marketing; I used to manage the New Zealand Dairy Board's marketing business across southern and eastern Asia. From there, I went into politics and into Parliament in 1984, the year before all subsidies were eliminated from agriculture in New Zealand. I then became Minister of Agriculture in New Zealand for a time and then Minister for International Trade, and I was heavily involved in a number of global trade initiatives. Finally, I was Speaker of the Parliament before coming here to the UK three years ago.

In response to your first question, price volatility is obviously a concern to everyone in agriculture when it becomes extreme, and at the moment we are seeing extreme price volatility in some sectors—not in all sectors, but in some, notably from the New Zealand perspective the dairy sector, which at the moment is experiencing extreme price volatility. There are a number of reasons for that that are pretty obvious. One factor that you have in agriculture is that such a small portion of overall production is traded freely. So when you get shifts in supply in supply and demand, the impact is exacerbated in the area that is traded freely.

I will give you a little example of what I mean by that. New Zealand produces only 2% of global dairy products, yet we control over one-third of what is traded freely between countries. We produce 6% of the world's sheep meat, yet control more than half of global inter-country trade in sheep meat. So the amount of total production that is traded freely is very tiny. When you get shifts in supply and demand, especially a fall-off in demand, or just small increases in supply, they tend to have their impact in that traded sector. So the impact on price volatility is huge. At the moment, of course, there is China, having reduced its demand for dairy products—we believe temporarily—and the Russian import ban on dairy products, along with the removal of quota constraints across the EU, seeing some increase in production across the EU. The US had a very good production year in dairy products last year; New Zealand had a good production year last year. So the impact on prices is quite extreme because of those quite small shifts in supply and demand in the tradable sector then

spilling over into the non-traded sector. The single greatest thing that could be done globally to reduce volatility in agricultural products is to open up markets, because markets operating freely will never have that kind of volatility.

The Chairman: That is an interesting point, which I do not think we have heard before. Dr Greenville?

Dr Jared Greenville: Just as background for myself, I am an Australian originally—so you have an antipodean link here—but I work at the OECD at the moment. I have worked at the OECD for a few years. My main role there is to lead a lot of the work that we do on agriculture trade policy, which includes things to do with the WTO and global value chains. I also look at a lot of work relating to food security in agricultural markets and how those markets influence outcomes and things like that, particularly for some of our developing non-members of the OECD. So price volatility and so forth links to that.

I echo some of the comments that were just made, but when we are thinking about price volatility it is worth thinking about world versus domestic markets. Then, also, you think long term and short term. We are seeing these claims of increasing food and agricultural price volatility, but the long-term trend in world markets is of declining volatility in most products. Most products internationally traded have gradually become less volatile over time. There are exceptions, of course—there are exceptions in time, such as during the 1970s and during the last part of the 2000s—but the general pattern towards a lower volatility outlook in world markets seems to have persisted over a fairly long history. There are some good reasons for that, and they relate back to movements that have been made to free up world markets and trade. As Sir Lockwood just mentioned, part of the reason why you would expect a degree of volatility, or a higher degree of volatility, in world markets is because this is a residual product. It is traded as the excessive supplies and demands from individual countries, so in that way it can be more influenced by smaller shocks. But as trade liberalisation has created freer world markets, agricultural products have started to become more pervasive, and we have seen increasing trading volumes and an increase in the diversity of supplies and sellers, which has helped to place a downward pressure on volatility. It allows international markets to start to play a bit of a hedge role. We can contrast that with domestic markets, which are generally much more open and susceptible to localised shocks, be it climate shocks, droughts in Australia, or floods or adverse weather events—yield shocks, and so forth. Those markets are often susceptible to the general variation that we get in seasonal patterns and other things, which have a certain price volatility component to them, but that can be effectively hedged against in some ways by international markets.

I guess when we move on to thinking about some of the impacts, we also need to remember that some level of price volatility is necessary. There is some normal price volatility that producers should be facing as part of their normal business risks that they undertake. An agricultural business, just like any other business or sector of economy, needs to have some signal of risk to make appropriate investments into that sector. Without some level of volatility, it is hard to know what level of investment should be made in agriculture versus other areas of the economy, and a world without any risk would see production decisions that are independent of the realities of supply and demand, or just the nature of the returns that are possible from the industry. A certain amount of risk should be present in the industry, so when we think about price volatility we should really only be thinking in terms of where Governments start to think to play a role in helping to overcome these catastrophic and extreme events. I mean those one-off events and rare events that can push otherwise profitable producers, who undertake all the necessary business-as-usual risk management strategies, into a situation where they might exit, which might lead to some longer-term costs that we do not want to bear. The question is whether the impacts of those are starting to increase or become more frequent. At this point in time, the evidence is not there to say that those events are becoming more frequent, but there is an open question as to how things will look as the world progresses, with the climate influencing more production and also influencing comparative advantages in producing regions. In any kind of thinking about where Governments should play a role in relation to these catastrophic risks, it cannot just be backwards-focused; it needs also to be forward-focused.

The Chairman: Okay. That is a really thoughtful and helpful introduction to this morning's session.

Q53 Lord Trees: Good morning. I am going to ask you about the tools for managing risk. We have been struck in recent weeks from different evidence that we have had about the difference in the tools in the toolkit between Europe and America in particular. In the EU, the CAP budget is devoted to insurance and 60% to direct farm payments, which is obviously a major buffer against volatility, whereas in the US it is almost the reverse. In New Zealand, of course, you removed all subsidies. What is your opinion of the main policy instruments and public funding available to deal with price volatility or to mitigate it? What is the effectiveness of each of those?

Sir Lockwood Smith: We have not colluded in our responses—I have never met Jared before—but it is interesting. We must not lose sight of what Jared has just said to us about the value of natural volatility in ensuring that we get ongoing innovation and productivity

improvements in agriculture. It is crucial that farms as businesses need to make volatility their friend, because during difficult times you get the innovation that leads to greater productivity. I can share with you that the productivity improvements since the subsidies were removed in New Zealand are just staggering. To come back to your principal question about support mechanisms, in New Zealand our overall subsidy level remains just under 1% on the OECD producer subsidy equivalent system. The Government fund some research, but do not directly fund any support payments to in any way reduce volatility of prices. They do, however, have quite a useful scheme involving the Inland Revenue department. In New Zealand, farmers in years of high income can deposit income with the inland revenue—they get 3% interest on that at the moment—and they have to withdraw it again within five years, but they can withdraw it in a financial year of low income and perhaps not have to pay tax on it. If they withdraw it in a year when they have made a loss, they could withdraw the amount that brings them up to breaking even and pay no tax on that money. That is quite a useful mechanism for farmers in an industry where profitability moves about rather more than in some other businesses. The Government are not subsidising it, but they pay interest on the money when it is deposited with them and farmers have to pay tax on it if they make a profit in the short to medium term. That does help with coping with volatility. I even used it as a farmer once myself, in the past 30 years when I have been running my farm.

Lord Curry of Kirkharle: Do you have price averaging over a period of time? We have recently introduced five-year price averaging here for farmers. Does that link to that at all?

Sir Lockwood Smith: Not at all, no. In New Zealand, there is no price averaging.

Lord Curry of Kirkharle: Sorry, I meant tax averaging.

Sir Lockwood Smith: The only mechanism is the mechanism to spread your income—otherwise, like any business, you pay tax on your profit. You pay provisional tax, so at the end of the year you might not have a huge tax bill, and you may actually get a tax refund if you have paid too much provisional tax. But I used to be revenue spokesperson and a deputy Finance Minister, and I cannot think of any tax averaging mechanism that we have. It is that spreading of your income that is allowed for farmers; by and large, it is a privilege that farmers do get, which recognises the fact that income can swing around a fair bit year to year.

Q54 Baroness Sheehan: You have talked about volatility driving innovation. Can you cite one or two examples of that?

Sir Lockwood Smith: Maybe I could share with you where support reduction and therefore short-term dropping of prices has led to innovation. I can give you two quick examples. New Zealand's wine industry is a classic example. By the mid-1980s, it had a wine industry in

crisis. We had a wine lake, which was protected by a 40% tariff; you could not export the stuff—it was battery acid. Thirty years later, wine is now New Zealand's second biggest export to the UK and the whole of the EU and our biggest export to the Republic of Ireland and our third biggest export to Australia. We command the highest average price here in the UK. Why? Because of innovation. Once the protection around the industry was removed, the New Zealand wine industry led the world in canopy management, in stainless steel fermentation and in screw caps on bottles. Now we command a higher average price in the UK market than does France. Another classic example would be the New Zealand sheep industry. The producer support equivalent subsidy for sheep meat in the mid-1980s or early 1980s got up to 90% of the value of the product produced. Farmers farmed for subsidies. Since that subsidy was removed in one year, in 1985, the productivity improvement in the sheep industry has been staggering. Sheep numbers dropped from 70 million now to under 30 million, and we produce the same amount of lamb from fewer than 30 million sheep that we used to produce from 70 million. That is the productivity improvement that has happened since farmers and wine producers had to face the realities of the market place.

Viscount Hanworth: With respect, you have not given us an idea of the causal link. These are correlations, but how has it happened? Maybe I am being a bit obtuse but, short of shaking inefficient producers out of the industry I cannot see how volatility is going to advance productivity.

Sir Lockwood Smith: What is fascinating about it as a business person is how you can improve your productivity, when you are looking down the plughole and facing the realities of going out of business. That is why private business and capitalism works—that when you face the realities of going out of business it is extraordinary the lengths that the private operator will go to to improve their efficiency to survive. Right at the moment, given the low dairy prices, DairyNZ, an organisation funded by dairy farmers, is working with dairy farmers on how they can squeeze more efficiency out of their farming operations. That is a project going on right now.

Viscount Hanworth: So it is the stringency of their circumstances that leads them to find any recourse that will rescue them.

Sir Lockwood Smith: That is what drives it. It is simply the normal action of business that, when you face the prospect of going out of business, you make operation more efficient, and it is extraordinary how farmers in New Zealand have made their operations more efficient. Some went out of business. We had 80,000 farmers in New Zealand in the early 1980s, and 1% of them went out of business when the subsidies were wiped in 1985. The Government

helped with one-off exit packages and some financial advice to farmers to help to sort out whether they had a viable future. So we lost 800 out of 80,000.

Q55 The Chairman: We will come back to you shortly on the global perspective, but let us just stick with New Zealand for a bit. What measures were the Government able to take to help farmers during the period of transition? If they had no capital to invest in some of these more efficient ways, or they did not have the knowledge base because the skills transfers are poor, was there a role for the New Zealand Government in that transition?

Sir Lockwood Smith: The Government did indeed help a little—I stress “a little”—back there in 1985. I had just entered Parliament and I was farming at the time. When they wiped the subsidies, there was the biggest protest I have ever seen outside the New Zealand parliament; there were farmers for miles. The Government provided some assistance, in an exit package, a one-off package amounting in total value to around two-thirds of the farmers’ income in the years preceding their exit. They provided a bit of money to set up an advisory trust to help to advise farmers on the exact details. The advisory trust provided financial advice to farmers on whether they should leave the land or stay in business. The trust employed eight advisers nationwide, so it was not a huge operation. Some farmers were financed through a bank called the Rural Bank, which was government-owned, and through that bank the Government provided assistance with mortgage repayments and that kind of thing. I could not tell you the proportion of farmers who were funded through the Rural Bank—I certainly was not—and the bank was sold not long after that. The Government provided subsidies for a very brief period of time to assist with the sale of the bank, I guess, because some of the loans would have been very poorly performing. There was that short period of transitional assistance and one-off exit packages to help farmers. As I say, we lost 800 out of 80,000, which was probably far less than most people projected. The advisory trust with eight advisers was set up nationwide to advise farmers whether to stay with it, and those financed through the Rural Bank got some help with mortgage repayments. But of course the private sector provided help, too, because banks naturally had significant exposure to farming in New Zealand, so they worked with their clients. This is what happens today in New Zealand: everything is conducted on a normal business basis. Banks during this downturn now are working with their dairy farmer clients to look at whether they defer payments for a period of time and whether a client is financially viable in the medium term. The normal bank-client interaction went on back then and still goes on today.

The Chairman: Lord Trees, did you want to come back on New Zealand?

Lord Trees: Yes, it was just on the socioeconomic impact. You said as a throwaway line, “We lost a few farmers”. In Britain and certainly in continental Europe, the socioeconomic upheaval would be far more. You said that you lost 800 out of 80,000 farmers; we have already lost far more dairy farmers as a proportion of the total. But I think you have answered the questions about intervention in terms of mitigating a transition; that is one of the things that concerns everybody in Europe. We can make farms more efficient, which would mean fewer farms, but we have all these people in the rural economy, and what are we going to do about that?

Sir Lockwood Smith: In New Zealand, we did not have a lot of choice, because farming is now about 6% of our GDP; it has gone up slightly, because it was about 5% of our GDP previously. The agricultural industry at large represents about 20% of our GDP, when you include manufacturing, and it is about 60% of our export income. Politicians in New Zealand cannot think of farming as something to be treated as something that it is nice to look after; it is a fundamental part of our economy. New Zealand’s economic success, which has been quite staggering since the mid-1980s, has largely been a result of looking at all sectors of the economy through that lens and seeing that they matter to the economy and the well-being of all New Zealanders. When I was addressing the WTO as Trade Minister, I did an estimate of what the CAP cost Europe and lost well-being across Europe, and the figure I came up with was quite a significant cost in loss of overall GDP growth. As Jared mentioned, it is about the misdirection of investment and having businesses focused on where they can get more government support rather than on how they could operate more effectively in the marketplace. The change that happens is quite staggering when businesses focus on the market and on how to get maximum value out of it, instead of focusing on the Government and where they can get more support out of the Government. That is ultimately a dead-end route.

The Chairman: We have one final question for the High Commissioner before we bring Dr Greenville in.

Q56 Lord Rooker: I have a minor declaration. On my second and last private visit to New Zealand in 2010 with my partner, we married in Christchurch.

Sir Lockwood Smith: I am pleased that the building was still standing.

Lord Rooker: I do not think the registry office is still standing. On what you have said, bearing in mind some of the evidence that we have had previously, can you confirm that New Zealand did not give general subsidies to the banking sector to facilitate the change and the abolition of subsidies?

Sir Lockwood Smith: Correct.

Lord Rooker: It was quite specific in how you modelled it. How much notice was given, in terms of debate, before the change in 1985?

Sir Lockwood Smith: I think not one day. I was in Parliament at the time and I remember the budget well. I think that the first that the farmers were aware of it was when the budget happened. These days New Zealand Governments tend to try to make sure that budgets are part of ongoing business; they try to pre-release a lot of information that will be in the budget, so that markets do not respond. Back in those days, New Zealand's markets were cast in iron; they did not exist, really—or the foreign exchange market did not exist properly. There were price controls and wage freezes and all sorts of crazy things back in New Zealand in the early 1980s. I remember that there was no warning—it was just *boom*. There were dozens and dozens of support systems, be it from the direct subsidy payments and supplementary minimum payments, through fertiliser subsidies to incentives to develop land—you name it, there must have been 30 or 40 different subsidies just wiped.

Lord Rooker: In terms of food and animal production, did the subsidies cover the range? Obviously, in Europe, it was sheep and cattle but not pigs.

Sir Lockwood Smith: The subsidies varied very significantly. It is fascinating. It was mainly livestock, but not exclusively; the subsidies were for crops in general terms, but the supplementary minimum payments were for beef and dairy. The producers' subsidy equivalents in beef and dairy were of the order of 19%—probably, in round figures, about 20%. For lamb or sheep meat the producer subsidy equivalent was 90%. That is why we got that huge increase in the number of sheep, because farmers did very well out of farming more sheep, but the damage to our environment was very significant. Hill country was brought into farming sheep that should never have been used for sheep farming, and the erosion that followed was dreadful. What is fascinating is that in the sector with the highest subsidy—90% in the sheep meat industry—subsequently the productivity has been the highest. Compared to dairy and beef, the productivity improvement in the sheep industry has been about 100% since the subsidies were wiped, whereas in the dairy industry, productivity growth has been 30% to 40% and in the beef industry it has been no more than 10%. There are interesting reasons for that, but those at the highest level of subsidy when the subsidies were wiped saw the greatest level of productivity improvement.

Lord Curry of Kirkharle: But did it not coincide with a switch from wool to meat significantly at that time?

Sir Lockwood Smith: I suppose, Lord Curry, that wool markets had been in decline for some time, so farmers tended to respond to that to some extent. They changed the genetic make-up of our ewe flock in New Zealand to bring in more fertile breeds, such as the Finnish Landrace, introducing them into our basic Romney ewe flock. As a consequence, lamb production tended to dominate far more than wool production. It is interesting that now wool is our fourth biggest export to the UK, and wine exports earn New Zealand 50% more than wool exports. It is fascinating how producers respond to the global market.

The Chairman: The rest of the world!

Dr Jared Greenville: Obviously, across the OECD there is a diverse range of countries. Europe is a member, and there are many other countries. So there is a wide range of different policies in use, and again there is a differential that you can make in terms of what policies Governments can have and what policies producers can take advantage of so that Governments will enact or enable them. There are a certain amount of things that Governments can do that relate to world markets and to providing better information for producers and for government policy-makers, so that they do not just react. A lot of the problems that we saw with the price volatility spikes in the late 2000s were significantly driven by government policy decisions, putting in place export restrictions and altering input tariffs. All those things compounded movements that were occurring in supply and demand in those markets. We saw spikes. At one extreme, the rice market had no fundamental changes that suggested that prices would go up, and prices spiked really quite steeply, which had large global effects on welfare, on producers and consumers. That was all pretty much driven by government policy and export restrictions. One of the biggest things that Governments can do is to contribute to better information about stocks and policy decisions. The OECD with the G20 and the FAO is in a process of putting together an early warning system to put in place projections of where they think prices and world markets will go, how policy changes are evolving and how the outlook with stocks and so on will progress. That is a key policy avenue that Governments should continue to look at to ensure better information so that producers can get a better handle on what prices will be like next year, or a year or so after, when they will be making production decisions, so they are not caught out by sudden movements. They are more aware of these normal business risks.

The other role for government is enabling marketable risks to find the market, so they are enabling those kinds of markets to work. In some countries, there are private, non-government-sponsored insurance markets, in which certain types of risks can be insured against. The role of government there is to make sure that those markets do not fail and that

the regulations and prudential requirements are in place so those markets can evolve. It is similar for futures markets, although they not used extensively by producers, or at least not by the majority of producers. But again they help with providing that information about expectations as to where prices might go in future and about decisions made on farms about when or what to plant, when to sell or hold, and those types of things. Again, touching on some of the regions, it is about having better trade policies.

Going back to my opening statement, a large benefit could be had by having freer agricultural markets to reduce price volatility and its effects—or unnecessary and excessive, catastrophic price volatility. To touch back on some of the more domestic instruments that can be used by producers, there was a discussion about tax averaging and preferential savings schemes. I can give a couple of examples from Australia, which has both those things. There is a five-year income tax averaging arrangement, which is valuable to producers. There is also a system called farm management deposits, which is used more frequently than income tax averaging. Essentially, it allows producers, when they have a good year and a high return, to put that money into a savings account held by a private financial institution, but it is not counted as tax. So when they draw that down over a period, they can use it and it becomes part of their income, which helps to smooth the regular ups and downs that you get when you have price changes.

It is not only about prices, although price is one risk that they are managing. Producers are also managing a whole range of other risks, such as weather-related risks and demand risks. Prices should be considered only part of the bundle of risks that producers face. Farm management deposits seem to be used in Australia for that risk management, particularly for drought, because droughts occur. To some extent, they are predictable, but they have quite significant effects on production. The other advantage of that kind of scheme is that when it is in place you may have other arrangements, such as a tax system allowing for excessive or accelerated depreciation of capital goods. Sometimes when you have a good year, your incentive rather than to save and smooth your income is to invest into capital, because you get that accelerated depreciation and do not face a tax. That does not help in managing price risks necessarily, unless it is an investment driven by a move to a new production system or something that allows you to cope and mitigate those risks on the farm through changes in practices. But at least if you have both you have a complementary system.

One way you can look to manage risks holistically, through income transfers through time, and in another way you can look at an incentive to adopt new practices and technology. Something that may come up in more detail later is the safety net, and income support that

farmers receive. For whatever reason, a decoupled income stream that comes from a source outside agriculture will act as a risk management device for the household. That does not necessarily mean that it needs to come from the Government; part of the risk management strategy for a producer or a household, if they are in a farming household, in a highly variable income situation, would be to look for alternative sources of income. I guess this, again, comes back to the initial points that I made about trying to differentiate between what Governments should think about doing and the policies that they should think about offering, from those that help to manage the extreme, more catastrophic risks to those that are just about managing business risk. Those business risks are best managed by the producers themselves, rather than Governments.

The Chairman: I will take two questions, from Lord Cunningham and Viscount Hanworth and then move on.

Q57 Lord Cunningham of Felling: Both of you have suggested that one of the best ways forward would be to open up markets to have better trade policies and fewer obstacles to more open trading. First, is that the committed policy position of the OECD?

Dr Jared Greenville: I would say that it was an evidence-based position. We are recently doing some work to look at the new platform.

Lord Cunningham of Felling: Please say yes or no.

Dr Jared Greenville: Yes, in the sense that it is evidence-based. We only ever come up with a set of policy recommendations.

Lord Cunningham of Felling: I understand that it is New Zealand policy, of course—they invented it, almost.

The Chairman: I think that Dr Greenville is making a fair point in that it is not an organisation that makes policy from an ideological perspective.

Lord Cunningham of Felling: Let us assume then—I do not want to put words into mouths—that more open markets and freer trade would be one of the biggest ways in which to reduce risk in agriculture. Would you say that was so?

Sir Lockwood Smith: I would like to pick up on what Jared said. I was actively involved in marketing dairy produce back in the days when subsidies were more prolific across the globe. What Jared has said about the impact that that used to have on price spiking is so true. I remember when every day in my work we would look at what the EU restitution level was, because whatever it changed the restitution level to meant that global dairy prices would spike up or down. We have made progress now. Under the common agricultural policy there are fewer production-linked payments; decoupling of payments from production has been a major

step forward. What is more, at a global level just recently at the 10th ministerial conference of the WTO in Nairobi, the WTO agreed to the abolition of export subsidies. That will be significant because, as Jared also mentioned, during the latter part of the first decade of this century, when the global financial crisis hit, some countries started to use things like food aid, a subsidy that purchased excessive supply from their farmers at often inflated prices and then put it into other markets, supplanting other products and suppressing prices. That will now all be banned by the WTO's decision. So we are already seeing things happen and progress being made: the decoupling of subsidies from production and the removal of constraints over quotas in the EU as well as the WTO's decision to abolish export subsidies. All those things, even the Uruguay round and the progress made there, have helped to lead to normal market mechanisms having greater impact on stabilising prices.

Lord Cunningham of Felling: How would that affect the operation of the common agricultural policy, if all that progress goes smoothly forward? I know that it will not all go smoothly forward, but let us say that it goes forward. Where would that leave the CAP?

Sir Lockwood Smith: I have to be very careful here, because decisions on the common agricultural policy are nothing to do with me. I would observe that change is inevitable, partly for social reasons. I do not think that young businesspeople are going to want to live their lives whereby their business future depends on politicians. I would think in this day and age that for young people—certainly young farmers in New Zealand—that would be the last thing that they would ever want to happen. I think we will start to see people moving away from the kind of farming where decisions are made by politicians. I had better not tell you this story—

The Chairman: We probably need to move on anyway, because we still have a lot to get through, and we have already had 40 minutes. Could this be really brief, please?

Q58 Viscount Hanworth: Are the income transfer schemes universal in Australia and New Zealand?

Dr Jared Greenville: With the income transfer schemes, the access to farm management deposits and income tax averaging, the condition is that you basically just need to be a farmer.

Viscount Hanworth: Is the participation universal?

Dr Jared Greenville: No, not everyone participates.

Viscount Hanworth: In New Zealand, is it the same?

Sir Lockwood Smith: We have a very similar scheme called income equalisation. The only difference is that the money is deposited with the Inland Revenue department. I could not tell you how many farmers use it, but we could probably get that information.

Viscount Hanworth: I would like to know, as it is crucial to assessing the impact and importance of that scheme.

The Chairman: I would like to move us on to insurance, please.

Q59 Viscount Ullswater: We have heard a lot of evidence that in the USA and Canada insurance is a big thing in the agricultural market, but I have not heard you mention it for New Zealand. Does it exist in New Zealand? Do you have a futures market in milk, for instance? How would an insurance scheme work, if you had one? Would it be publicly or privately funded? You have talked a little about the intervention of banks when you had that big change, but perhaps you would like to explain a little bit about insurance and whether it exists.

Sir Lockwood Smith: Certainly, were such a thing to develop, I would be pretty certain that the Government would not be funding it—absolutely not. I am not aware of widespread insurance schemes in New Zealand in terms of trying to insure price stability. But what we do see is the development of a futures market, particularly in the dairy sector, run by the New Zealand stock exchange and participated in by processing companies and, probably, larger farming operations. More corporate farmers would use it, and it is not used so much by smaller farmers. However, a lot of processing companies offer longer-term contracts that smaller farmers could enter into at the start of a season. Of course, in the dairy industry they have that kind of contracting arrangement, and farmers contract with the dairy company for a supply season, so they have a reasonable guide as to what the pay-out will be from the dairy companies. In the meat industry, most meat companies offer forward contracts, though not all, and farmers can forward-contract at a known quantity and price and forward-contract a portion of what they know their product will be for that year. I am not aware of insurance schemes, as such. However, as Jared said, I think we will see the futures market develop a little more, because it is a useful indicator of where prices are going.

Viscount Ullswater: What about drought insurance in Australia, and catastrophe insurance in general?

Dr Jared Greenville: The general term is multi-peril insurance, to do with a range of different risks—price, drought, weather, and catastrophic events generally. There are some—but very limited—products on the market in Australia for multi-peril crop insurance for producers, but it is a fairly new market.

Viscount Ullswater: But it is run by the insurance industry.

Dr Jared Greenville: It is run purely privately. The Australian Government released an agricultural competitiveness White Paper at the end of last year which talks a little bit about

insurance and insurance policy. There is some thought about looking to overcome some of the market problems by informing farmers as opposed to intervening and subsidising premiums and the like. So it is about that information discovery. The main reason why these markets do not exist is often because of the high costs of transacting. You cannot tell your good risks from your bad, and you cannot tell what people will do after they get it. Will they abandon all their own risk management strategies that they have in place and just make themselves susceptible? So there are a lot of issues—and Governments cannot necessarily do better, for the same reasons that these markets do not exist. Simply providing the subsidy for an insurance premium does not overcome the reason why the market is not there. You are not necessarily going to get the outcomes that you want just by providing that subsidy, so care needs to be taken with the design of any scheme. There is a real risk that, with poorly designed schemes, workers just count on cyclical payments, which means that you get production that does not respond to changes in prices and events. You could run into environmental problems by encouraging people to hold stock and just continue practices when it is not necessarily a good idea to do so.

Sir Lockwood Smith: The New Zealand Government do provide a scheme for extreme environmental circumstances, such as extreme droughts and natural disasters. At the end of the day, in terms of income support, when there is an area declared like that, a family in a farming operation can receive working family tax credits as normal employees would have available to them but business people do not normally have available to them. That is made available to families in an extreme event, when the Government declare an area or a region as an extreme event. There are some low-level assistance measures available there.

Viscount Ullswater: But that is a government decision rather than a business decision by the farmer.

Sir Lockwood Smith: Yes, that is a government decision, in recognising that a serious drought has affected an area, for example. Almost every year now there might be one area in New Zealand where such a declaration is made.

The Chairman: I want to move us on now to research and innovation.

Q60 Lord Curry of Kirkharle: Both New Zealand and Australia have great reputations for the quality of their science and the investment in agricultural science. Having been to some of your institutes, we are very impressed by the commitment to research. I am interested in the extent to which Governments are committed to this and whether you believe that this is a contributory factor in mitigating global price volatility. There is the development of new tools and new scientific knowledge. I would also like to know whether, in the case of New Zealand,

the removal of subsidies coincided with an increase in government commitment to the funding of science, and whether there is any role in government in translating that research knowledge. One big criticism that we get here is about the gap between research funding and the translation of that research knowledge into practical solutions.

The Chairman: Perhaps we can start with Dr Greenville on that one, in the generality. We are running perilously late now.

Dr Jared Greenville: I shall be quick. Markets are becoming more complex, as is production. Research and development and, importantly, the matched extension of training and advice is a critical tool to help producers start to develop those on-farm production and risk management techniques. So there is a clear link between R&D extension and risk management—I think that goes without saying. There has been a general shift towards decreasing funding in all these areas. The public sector remains the major funder, although there is a whole range of different models. You mention that Australia and New Zealand have a certain type of model, which is true; they have a model that is much more matched to co-funding. The advantage of those systems is that you can ensure that whatever research and development funding is spent is directed towards the projects that the industry wants and needs. So these co-funding arrangements and the more co-operative research structure have proved beneficial for those type of outcomes. Across OECD countries, there is always a clear role for government to provide some level of extension advisory service, particularly related to those of a more public good nature—new technologies and so forth. When you think about those that are driven towards more sustainable productivity development, which is also an important longer-term risk management strategy, there is a clear role for government, because the private sector is unlikely to play a role. There is a continuum there. It is about trying to exploit the best of both worlds—get the best out of the private sector contribution, where competitive funding models, and so forth, have been used, as well as then making the most of your government spend.

Sir Lockwood Smith: In New Zealand, when the subsidies were eliminated in the mid-1980s, the funding for the advisory service was also wiped. The Government probably spend less now on direct funding to AgResearch in New Zealand than they used to, but in order to make sure that funding goes where the greatest benefits will come, the Government's primary growth partnership involves a 50:50 sharing of costs with a whole range of people interested in research across the agricultural sector—so the Government pay 50% and private sector pays 50%. The Government have now put several hundred million dollars into that.

I recently gave a paper to the British Society of Animal Science on the link between science and policy uptake; you mentioned that that is a disturbing problem. I did a full analysis of the history of New Zealand's agriculture from its start in the 1880s. What was so compelling about that was the period where there was the least uptake of science and technology. I broke New Zealand's history into four periods: the early phase up to the Second World War, post-Second World War to the UK/Britain joining the EEC, the period of subsidies from 1973 to 1985, and the post-subsidy period. The period with the least uptake of science and technology was the period of maximum subsidy from the Government. That was so compelling; it just killed the uptake of science and technology.

The Chairman: Is there any evidence of that phenomenon elsewhere? I suppose you took the dramatic step of creating a benchmark by sudden withdrawal. Is it difficult to make those comparisons elsewhere?

Dr Jared Greenville: Yes, it is difficult to make those comparisons without the link between the uptake of R&D, innovation and subsidies, but we generally see that productivity levels and productivity growth are slower in economies where subsidies and government protection are higher, because there is just not the business need to adapt. There is also a mix of the overuse of certain imports or shifting and shaping to areas that you would not otherwise want.

The Chairman: That is helpful. We are moving into the area that you wanted to explore, Baroness Sheehan.

Q61 Baroness Sheehan: Yes, on knowledge, sharing and information. I will quickly quote what the National Farmers' Union told us a few weeks ago: "Successful modern farming is a skilled operation that requires technical proficiency, business acumen and environmental awareness". Without wishing to put words in your mouth, I think I heard you say something similar at the start of the meeting. Could you just explain what publicly funded knowledge transfer and training is available to farmers in your country? Do young farmers and/or tenant farmers have specific skill requirements to protect themselves from the effects of price volatility and to cope with the technological and commercial challenges of modern agriculture?

Dr Jared Greenville: I will start from the OECD's perspective. I can provide more detailed information afterwards. We have a little table—I have it in front of me—on different systems and which countries make use of different systems, which might be of use to the Committee. Again, the range is diverse. Some are purely state-funded, some are a public/private partnership, and some are purely private in the way they go about their extension.

Specifically on risk management, price volatility and so forth, there is not only a need for R&D, new production techniques and so forth—that level and type of risk management; there is also the financial side: how to manage a business, how to do budgets and forecast for risk, how to understand and transpose price margins and what it might mean. That side of the extension does not seem to be all that common across countries in the OECD.

Going back again to Australia—I am sorry, but I guess it is closer to home—there is the Rural Financial Counselling Service, which is in place to advise on this part of the business, so that they can hopefully better manage risks and so forth. That is all publicly funded. It could be tied to be the use of other financial instruments, such as the tax instruments, farm management deposits, and so forth. So there is always a range. Farming is a business in which you need skills and knowledge—not just young but existing farmers—but what young farmers would be particularly vulnerable to are the shocks where they do not have the financial reserves to deal with it. They are more vulnerable to exit if they enter at the wrong time and there is a sudden shock, and so forth. In that sense, there is potentially a role for more ex ante type information provision to see what is expected, so that they go in with their eyes wide open.

Sir Lockwood Smith: New Zealand has a very good system of primary or fundamental training in agriculture, which started many years ago. New Zealand had nothing indigenous about farming, in that all our pasture species and animals are exogenous to New Zealand. So the Government put normal amounts of money into opportunities for young people to study agricultural science at university level and polytechnic level, with more applied learning—and then at farm training system level. We have a number of training farms across New Zealand, where young people can get government support to pursue their learning about the farming industry. They are very good. But beyond that, it is up to the farming sector and the agricultural industry itself to organise its distribution of information, and they do have that—farmers fund DairyNZ as well as Beef + Lamb New Zealand and Federated Farmers. They are all involved in the extension of the latest research information from around the country and around the world. Farmers naturally look towards that, because they know that they need the latest information to manage their businesses. So it is a sort of two-way process. The more that Governments get involved in providing these things free, the less valued they are.

The Chairman: I want to finish this session with one final set of questions, which Lord Krebs will lead on. This is really asking you to put your necks on the line and offer an external perspective on what the EU should do next.

Q62 Lord Krebs: Thank you, Chairman. I think, Sir Lockwood, you have already mentioned a couple of things that happened in the CAP—the decoupling of subsidies from production and the removal of quotas, which you thought had helped in reducing price volatility. Could you offer us your views on what further measures might be taken to reduce price volatility after 2020, when the CAP is further revised. Do you think that insurance could play a role? Do you think that there are lessons that we can learn from other countries and the financial instruments that are deployed in your country and elsewhere?

Sir Lockwood Smith: One has to be very careful in suggesting what our respected friends in your country and the EU should do; it is your business. All I would tend to say is that, as you have heard Jared mention, Governments trying to organise insurance schemes to reduce price volatility are challenged because they are no better than anyone else at assessing risk, and it is so difficult to assess risk, as Jared said, in our primary industries. I suspect that created insurance programmes will have problems, otherwise they would have been developed long ago. To me the greatest thing that could be done in the EU is to carry on with what is already happening—opening markets progressively and looking outwardly. The reason why New Zealand can withstand price volatility is that we are so outwardly focused and we operate in so many diversified markets. New Zealand is marketing primary produce in more than 100 markets globally, and when one goes up another goes down. So the greatest thing that the EU could do to maximise global well-being in food security and agriculture would be to keep progressively opening up agriculture, as with any normal business, because markets are remarkably effective at delivering when we politicians—I am thinking of my former career—cannot actually do that sort of thing. My advice would be to carry on with what has been started, looking towards becoming more outwardly focused, more than so internally focused. I was the keynote speaker at the National Farmers' Union conference a couple of years ago, and they were bemoaning the control that supermarkets have over them. I said that one of the problems was that they were so internally focused; once they are involved much more in international markets, supermarket chains cannot dictate the price any more.

Dr Jared Greenville: I will disappoint slightly and sit on the fence for a little bit, because we are currently doing a review of the recent CAP reforms, which we will put out towards the end of this year. It will have some recommendations as to where we think future reforms are going. I have a couple of points—and some of it is food for thought. Definitely, we would advise continuing on this path towards decoupling; that is an important part of the future CAP. It will be important that producers then become more able to manage those business risks. The things to be mindful of in thinking about price volatility or any kind of risk

management is that the Governments and the EU do not want to get into the business of trying to manage those business risks. It should be targeted towards the catastrophic-type end of those risks and not look at the day-to-day. In considering any shift that moves towards the US and Canada-style insurance market, there are significant difficulties in getting those markets and systems to work as you would want them to work in the first place. Then there is also the issue that they should not sit on top of the income support arrangements that are there as well; you should not be doing both. Income support arrangements do have some level of risk management to them; we have not touched on that so much today, but they are an alternative way in which to do insurance. There are also issues with insurance-type arrangements with fiscal costs and the potentially open-ended nature of the liabilities that would be brought to bear with the budgets, and how that would work with the CAP and the financial regulations. I shall leave it at that.

Q63 The Chairman: I have one final question, because I would be interested in having your perspectives. In the evidence we took from the Commission last week, Mr Haniotis made the observation that he thought we should be much more focused in future on land than on individual crops or sectors. There are questions about greening and the extent to which farmers contribute to the broader rural economy. How do you see the role of public policy with regard to how farmers sit in that bigger space, beyond agricultural production?

Dr Jared Greenville: The OECD in our regular reporting on the CAP has been supportive of those moves. Moving towards something more decoupled is essentially code for more land-based areas payment and greening. The key would be in defining what the outcomes are, and making sure that payments actually deliver on those outcomes. As you get more into these environmental services, monitoring and enforcement becomes more difficult and expensive. Thinking towards more market-based design for some of these instruments would also be a worthwhile endeavour, rather than it being done purely on the basis of registered facts and so forth, in order to get the most out of the government spend.

Sir Lockwood Smith: I have no argument with that at all. I would wrap that up with thinking about sustainability as we look to the future. The Government have a legitimate role in making sure that custodians of our land manage it in a sustainable way, looking to the future. One thing that has not been talked much about today is global value chains and their rise and impact potentially on price stability. I wanted to leave you with one thought about that, because it is fascinating how it is developing so rapidly. The main New Zealand dairy company, Fonterra, has a significant investment in the Netherlands. In Europe, you produce a lot of cheese, and we do not produce so much in New Zealand. One by-product of cheese

production is lactose production, so the New Zealand investment in the Netherlands exports to one of your companies here in the UK, Dairy Crest, lactose by-product produced out of the Netherlands. Your company, Dairy Crest, with which Fonterra also has a joint venture operation, turns that lactose into galacto-oligosaccharide, which is a very valuable ingredient in infant formulae. Dairy Crest also produces a fair bit of cheese, and from that it has a by-product, demineralised whey. Fonterra then exports both that demineralised whey and the galacto-oligosaccharide to a joint-venture company that it has in China called Beingmate. In China, they then manufacture that then into infant formula, which is sold across China by this joint venture and by Fonterra. So there you have a value chain starting on one side of the world in the Netherlands, passing through the UK, where a lot of value is added. The final product is manufactured in China and marketed across China—and a New Zealand company, Fonterra, has organised all that and invested in it. We would see much more of that kind of investment if there were not the impediments and barriers to ingredient import and export within the EU. That is a classic example of how you could see much more product diversification and utilisation of products that are not returning high value in the EU at the moment, if only markets were less constrained by trade constraints. To me, it is a classic example of where the future lies, and where greater stability and greater return will come, as these products are turned into far higher-value products.

The Chairman: That is a very interesting perspective. I am going to draw it to a close. You may have seen that we were joined by Lord Boswell part way through; he is taking a great interest, not just as chair of our main European Union Select Committee but because he is a farmer. We appreciate your interest, Lord Boswell. Thank you, both, very much for coming and giving such interesting, insightful and thought-provoking evidence.