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. 7 *Heard in Public* *Questions 74 - 87*

WEDNESDAY 10 FEBRUARY 2016

10.55

Witnesses: George Eustice MP, Ian Mitchell and Tim Mordan

Robert Johansson

Members present

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

Examination of Witnesses

George Eustice MP, Minister for Farming, Food and Marine Environment, Defra, **Ian Mitchell**, Deputy Director for International and Strategy Analysis, Defra, and **Tim Mordan**, Deputy Director, Farming Productivity, Defra

Q74 The Chairman: Good morning, Minister. Thank you very much indeed for coming to talk to us today. You know that we have been carrying out an inquiry into volatility in agricultural produce prices and the impact on farmers. We are looking at domestic, European and, indeed, global solutions to this. We are pretty much at the end of our work now. We have learnt a lot in the last few months so this is a really good opportunity to talk to you about how you see some of these questions.

It is a formal evidence session, which means that 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, which you will be able to revise to see if there are any errors. We are on the record, being webcast live and accessible via the parliamentary website in due course. You will have received copies of Committee Members' interests. I would ask all Members to declare any relevant interests the first time that they speak.

I will kick off with a general question about your observations on agricultural price volatility. Do you think it is a problem that is getting worse or is it something that has always been with us? Specifically, is there any role at all for government, either at European or at UK level, in dealing with the price volatility itself? I do not mean the causes or the effects but the price itself.

George Eustice MP: First of all, I welcome the fact that the Committee is looking at this. This is an incredibly topical issue and it is right that it is given attention in this way. To answer your question, the first thing I would say is that there has always been volatility in world agricultural markets. There are a number of reasons for that. First, supply is very prone to disruption through weather. If you get severe weather events, you can get major effects on crops. That has always been the case.

Secondly, there is quite low elasticity on many farm and food products, so that even when prices change you do not get the changes in demand. That tends to exaggerate the swings. A third factor is that there is often a lag between responding to market signals. If the dairy price goes up, by the time you have expanded your herd and built the new dairy and done all that, you just about peak your production in time for the price to go down. Equally, when you are trying to curtail production, there is a long lead time on that.

In addition to that, there are a number of other factors that have probably exacerbated it at a European level. That is a tradition with the CAP, the old-style 1980s interventions and the like, and quota systems. It tended to buffer the European Union, not entirely but to some extent, against these swings in world markets. The removal of those quota systems has meant that Europe is more exposed to those global swings in commodity prices than it is accustomed to.

On your final point about whether there is a role for government, we definitely oppose going back to the old-style interventions, which are distorting to the market. In an era where we have global trade and where we are competing globally, it is the wrong way to go. We are definitely interested in whether government could help foster the development of alternative measures such as futures markets, in particular, to help mitigate the risks of price volatility and create options there for businesses to manage their own risks. There has always been a futures market, for instance, in many of the cereal sectors. I think we are particularly keen to encourage one that would be a success in dairy at the moment.

The Chairman: That is very helpful; thank you. We will go into those in a lot more detail, as you can imagine, because they are the crux of the inquiry.

Q75 Viscount Hanworth: I would like to ask about access to finance and the availability and the use of financial instruments. There has been a joint initiative between the European Investment Bank and the European Union's DG AGRI—Directorate-General for Agriculture—to allow farmers greater access to cheaper loans and financial instruments through the European Union's member states' rural development programmes. Are the UK Government planning to make use of these sorts of opportunities? If not, why not?

George Eustice MP: The short answer is yes. We have had the discussion on this already with Commissioner Hogan. He is quite keen to promote these approaches using the European Investment Bank as the vehicle to make loans, basically under the rural development programme and using the rural development programme funds. My colleagues may correct me if I am wrong, but I think that Spain has already either made such a successful application, or is in the advanced stages of doing so, for one of its sectors. We are exploring in particular whether it would be possible to access those funds through the European Investment Bank to make available loan finance to build additional processing capacity for the dairy sector. Looking for instance at the north-west, where there have been lots of challenges for dairy farmers in that area, we see that they have suffered particularly low prices. But they have a lot going for them. It is a big milk field; it is quite a low intensity, low-cost system of production. We believe that, if we could support the development of processing capacity there to help add value, then we could help to secure the future of those dairy farmers in that very important part of the world.

Viscount Hanworth: Would you actively encourage the uptake of these loans, or would you adopt a more laissez-faire attitude and allow the industry itself to develop an interest?

George Eustice MP: We have piloted things like this previously. For instance, I know that in Cornwall they used the Objective 1 European money through something called the fresh start initiative to pilot soft loans for new entrants coming in, to try to support and encourage new entrants. I am also aware that the Welsh Government have a similar new entrants scheme that they have used. These are quite modest, small steps forward, but we have already piloted it. The reality is that, if you are making available loan finance on quite generous terms, you probably would not have to promote it very hard. I am sure there would be quite a few takers.

Q76 Viscount Hanworth: I move on to financial instruments, which are not used very commonly in the UK. Do the Government support the development of financial instruments, such as forward contracts and options and so on and so forth? There is a much greater use of these instruments, for example, in the United States. What about developments in the UK?

George Eustice MP: Yes. I am very keen to support the development of futures markets in particular. The US used to have a more regulated dairy market, for instance, than it does now. The evidence there is that, once they got rid of all the production quotas, a futures market naturally developed of its own accord. Typically, what a lot of dairy farmers in the US do is perhaps fix the price, using a futures market, get a forward contract price for around 40% of their production and then take their chances on the open market for the remaining 60%. Although that does not remove the volatility altogether, it certainly buffers them against it. We have a team working in Defra at the moment to try to do the thinking on how we could replicate the type of futures market here in London that currently runs in Chicago on dairy products. We have a great opportunity. London is the world’s financial centre and we do lots of futures and commodities already. It would be the right place to have such a market. We are doing the thinking now on the barriers that we would need to remove to enable that to take place.

Viscount Hanworth: I was about to come on to the question of why these have been so delayed. We have this huge financial sector and yet it has not produced very many instruments that are relevant to our agricultural sector. What is the impediment?

George Eustice MP: We have successful futures markets in some sectors, notably cereals. Conventionally, these have been anchored against the physical delivery of a forward contract. That is what they have operated on and that has been the basis. The difficulty with dairy is that liquid milk is a perishable product. If you were going to anchor it against a physical market, it would need to be one probably in skimmed milk powder, which is what has happened in some areas in the US, or indeed anchored against something like cheese or butter. It is harder to make these work because there is less demand for those types of forward contracts in those dairy sectors than there is in cereals. Our conclusion so far is that probably the best chance of making a futures market work is to have one that is cash-settled, so effectively a derivative market that tracks an index on dairy prices. You would necessarily remove the need for a physical delivery of a forward contract. To make that work, you need very reliable market data in which the markets will have confidence and faith. In Chicago, for instance, where they have a cash-settled dairy futures market, they have a regulatory requirement for their dairy producers to publish their sales prices and they make that available in an anonymised but collective form so that they have very accurate and regular data on what is actually going on in the market.

The AHDB does something similar. They collect the price being paid by the dairy companies to farmers and that is published regularly, but that is not quite the same as getting to the bottom of what is really happening in the market, which is the price that the dairy companies themselves are getting for the product they sell. We need to look at this whole area of what data needs to be made available in order to facilitate a cash-settled futures market in which the market speculators and market makers would have confidence.

Viscount Hanworth: Am I right in thinking that there is a highly developed futures market in the US for meat, carcasses and so on, and a complete absence of such in the UK?

George Eustice MP: I do not know whether Ian knows. Traditionally, there was the pork bellies market. I believe there is a poultry market in the US, as well. There is one in poultry meat, so there is definitely a precedent for having these futures markets in other sectors.

Q77 Lord Selkirk of Douglas: I have three questions, but if the answer to the first question is no, then the second and third drop off.

George Eustice MP: And I get off lightly.

Lord Selkirk of Douglas: My first question is this. There has been a clear shift to insurance mechanisms supporting agriculture elsewhere in the world in the place of direct support. Do you see a role for publicly funded insurance schemes as part of EU or member state policies?

George Eustice MP: The European Union did a study looking at this in around 2007 or 2008 and concluded that there could be some mileage in that. They have made provision in Pillar 2 of the existing CAP proposal for member states to take forward some of those options, but it is a very modest offering, which probably is not sufficiently big to make the difference.

Looking forward to longer-term CAP reform, we have always had the view that the single farm payment should be a transitional type of support. We do not see that as being a sensible long-term policy: to just arbitrarily pay people depending on the area of land they have. If the objective of a future agricultural policy had, as one of its themes, mitigating risk in order to promote food security and help those farmers and growers who are putting their money on the line and taking the chance with the weather to grow things, having those types of insurance schemes is certainly something I would be keen to look at.

They are complex. The US has one, which is very complex and looks at different incomes, state by state, crop by crop. It makes it a very difficult scheme to manage administratively. Most people would agree that the Canadian model is probably the simplest, where they simply target a sharp fall in farm incomes and basically take that as a proxy for something going wrong in the sector, either with price or indeed with crops. I would be very interested in the next round of CAP reform to look at whether we can learn lessons from places like Canada, but maybe design a system that is simpler still and actually helps to mitigate risk.

Lord Selkirk of Douglas: Arising out of what you have just said, would it be possible for your department to let us have a little note on the practicality of putting forward a scheme roughly along the lines that you have mentioned and how it would be done? That might be very helpful.

George Eustice MP: That is right. I should stress that our current focus is very much on simplifying the existing CAP. Most of the team are on that. We have started doing some very early thinking about CAP post-2020 and what a wider reform might look like, but we can certainly make available to you the challenge as we see it from those countries.

Lord Selkirk of Douglas: I will ask my last two questions in view of what you have said. If public income and revenue insurance schemes were to be used at all in the EU, what sort of risks should they cover? Should publicly funded insurance schemes cover single commodities or take a whole-farm approach?

George Eustice MP: There would be pros and cons to either approach. In the Canadian approach, they are effectively taking a whole-farm approach because they are targeting sharp falls in farm income. If it falls by a substantial percentage compared with the average in the previous years, then they have a top-up payment. The disadvantage of that is that it can be quite market-distorting. If you have some farmers who are less efficient and not as well managed, you are removing that market signal. The trouble with all these, including the US one, is that it can dampen people's response to market signals and you do not really want to encourage that. The challenge will be to set it in a way that provides some protection but not total protection, because you want people to read market signals and, if the right thing to do is to stop growing potatoes, then you want people to stop growing potatoes.

The advantage of targeting something like crop failure is that you are targeting an actual genuine event that has happened—a bad weather event that has destroyed a crop. It would be much more in line with the conventional approach to insurance, but it can get quite complicated in agriculture. You have to get this trade-off between having something that is very simple but may still distort the market, and something that would be more desirable but is more complex to deliver.

The Chairman: Could you clarify for me right now what sort of procedures and measures are available to your department to deal with natural disasters? We seem to have flooding somewhere now on an annual basis. What tools do you have?

George Eustice MP: My colleague Tim might add some detail, but there is provision within the Pillar 2 rural development programme for emergency crisis measures. Two years ago, with the Somerset floods, we set up a farm recovery fund to make available grant funding effectively to help farmers get back on their feet. We did the same, for instance, out of the fisheries fund for fishermen who had lost all sorts of static net gear. We have a new farm recovery fund to help farmers in Cumbria at the moment. We can turn it around quite quickly and we have quite a bit of flexibility on how we design those. It is basically making available capital grants to repair hedges, tracks, walls and that kind of thing.

The Chairman: Is that all under Pillar 2, or is some of that UK budget?

George Eustice MP: I think that is all under Pillar 2, but all of Pillar 2 also requires some matched funding.

Tim Mordan: In the 2014 Somerset Levels flooding, we used RDP money and we set aside £10 million, of which about half was used. There was a long tail, obviously, because farmers needed to know what they needed to repair sometime after the flooding. On the flooding in the north-west over Christmas, that was also RDP funding, so that was out of Pillar 2 money. The claim period for that is ongoing and does not close until the summer.

The Chairman: That is very helpful; thank you.

Lord Trees: Good morning, Minister. This is secondary to the question on insurance. The information we have about the American system particularly is that to kick-start it, but possibly in a more sustained way, it requires a fairly high degree of public subsidy. Is that something that your Government could envisage? In other respects, if you felt that insurance for a variety of contingencies had a place, could that subsidy be envisaged from your Government or through the EU system?

George Eustice MP: I should say that at the moment we are doing early work on scoping different options. The Government have not yet reached a final negotiating position for the CAP post-2020. Certainly in principle, yes. If one of the objectives of an agricultural policy at the European level is to help to safeguard food security—and one of the threats to food security is risks such as the weather—then, in principle, it is something that could be considered. I should stress one of the difficulties of the insurance scheme and one of the things that would certainly cause some nervousness with the Treasury. With the CAP, for all its faults, we know what it is going to cost. We know how many hectares of land there are and how much we are going to pay per hectare. The slightly difficult thing with an insurance scheme is that you would not want it to be an open-ended blank cheque because you would not really know the costs. From memory, the EU study that was done on this suggested that over the long term an insurance-type scheme as opposed to the single farm payment might be significantly cheaper, but of course there would be quite a lot of variation year to year.

Tim Mordan: I would add a couple of points. The US model is one that is often cited and is one we are looking at very closely. There are two important aspects. One is that in the US model it is instead of direct payments and not alongside. Obviously, that is a relevant factor. The other one is something that the Minister mentioned earlier about having the data available on which to make the right decisions. In America, and indeed in the Canadian model, they have a wealth of data, which we do not have. We would need to be careful about the extra burden not only on government, or whoever is administering it, but on farmers in having to fill in more forms to enable this to happen. They are two things that we are looking at.

Lord Selkirk of Douglas: I will ask a question about the data. One of the points made to us by the witness from Europe was that guidance is given to Governments but not directly to farmers. Is there a role for government research that would directly assist farmers? It seems that there is perhaps a bigger role for research to play. What is your thinking on that?

George Eustice MP: Are you talking in the context of a futures market or in the context of insurance?

Lord Selkirk of Douglas: I am talking in terms of what will work best. I am asking a question; I am not expressing a view.

George Eustice MP: Coming back to my earlier point on the futures market in particular, you have to have really reliable data to which you index any derivative market. One of the things people sometimes say is that it is fanciful to think that dairy farmers are going to go into some futures market and hedge some future exposure. I think that is probably true. However, I would say that in that sort of sector there is a real role for the dairy processors to offer fixed contracts to farmers and then hedge their own exposure in a futures market. These are the people who are large enough and could employ the Treasury experts to go into the financial markets and hedge their risk. My view is that to make this work in practice rather than just in theory, particularly in dairy, you would need to have the buy-in, the support and the enthusiasm of those dairy processors because they would have the wherewithal to accurately hedge their risk.

The Chairman: You have raised some really interesting points. I come from East Anglia, and, clearly, large cereal farmers are very engaged with this. They understand it. But it is very difficult to see how small farmers, at an individual farm unit level, could engage with something as complex as that without significant help.

Viscount Hanworth: Dealing with the issue of insurance, in the US I think the federal support is for the insurance premiums and therefore the budgetary commitment is presumably quite predictable. You have implied that if we were to adopt an insurance scheme it would imply a variable and hazardous budgetary commitment. How do you explain that?

George Eustice MP: If you were simply buying, as you say, the premium on the insurance, that would give you some consistency, except insurance companies do not like losing in the long run. If you had an increased frequency of bad weather events, the premium would go up. The other issue is that there would have to be a judgment call made around whether it was more cost effective to pay the premiums on, say, a private insurance regime being offered, or whether some kind of government-backed mutual fund would be a more cost-effective means. Sometimes the difficulty is in insuring risks where there are regular calls on that insurance. Farming is famously a very risky thing to do because none of us can control the weather, and crops are particularly exposed. Sometimes, the cost that an insurance company will put on underwriting that risk is very high. Just as we have seen with the things we have tried to do in flooding—the Flood Re scheme—sometimes some kind of government-backed mutual is a more cost-effective way of doing these things. If you are doing the latter route, you would definitely have a lot of variability.

Viscount Hanworth: Our insurance industry would not be particularly amenable then to these developments. That is what you are implying, I think.

George Eustice MP: I do not know. We have not really got to the stage of having that discussion with them. In principle, if something like this is working in the US, then it could work here. The big argument against what they are doing in the US is that it is incredibly bureaucratic and administrative. We are in the business of trying to get away from an incredibly bureaucratic and heavily administrative CAP in Europe. We would like to move to something simpler and more logical.

Viscount Hanworth: So the US model is not a good model.

George Eustice MP: I do not think it is. I think the Canadian model is the closest we have got to an insurance scheme that works, just because of the complexity of the US model.

The Chairman: The Committee has just received a briefing document about the American system that made us yearn for the simplicity of the CAP.

Q78 Viscount Ullswater: I should say that I am a trustee of an estate in Cumbria that receives basic farm payments. We have talked quite a bit about what is available under the CAP with Pillar 1 and Pillar 2; and Pillar 2 allows this risk management toolkit. Not many countries within the EU have taken up that side of it. Certainly, in England, it has not been done very much at all. If we look forward and see more money coming from Pillar 1 into Pillar 2—if that is the trend and the drift—is more use going to be made of it for things like insurance premiums and income stabilisation schemes as well as the environmental programmes?

George Eustice MP: We took the view—this was my predecessors before I became a Minister—and I think rightly, that we had lots of calls on Pillar 2. We do very good agri-environment schemes, for instance. We wanted to offer grants to help farmers improve their competitiveness. There are calls on what is actually a very small fund in the grand scheme of things. In the CAP it is only a small percentage of the total. A much higher percentage—around 80%—is in Pillar 1, so that is where all the funds are. The conclusion was that, if you were going to do an insurance scheme, you would need to do it properly and it would cost quite a bit of money. It is the kind of thing you would have to do in Pillar 1 as an alternative to the single farm payment approach. That is where it would sit.

The problem with what they have tried to do in Pillar 2 is that it is so small and limited that, if you tried to take it up, you would have complexity but you would still be whistling in the wind, frankly, and not making much impact in the way you would need to with an insurance scheme. It is the kind of thing that, if you did it, would be a bold reform of the CAP and a bold change from what we currently have in the CAP. It is the kind of thing that would be best done in Pillar 1. With an already complicated CAP and lots of other things we wanted to do with Pillar 2, we took the decision not to take these options forward.

Q79 Lord Bowness: We have had differing evidence about the role that direct payments under Pillar 1 play in bolstering agricultural resilience. Some people have said the guaranteed income protects farmers from market volatility; others argue it is a disincentive to innovation and forward-thinking. What is your view?

George Eustice MP: My view is that they are both right, which might sound counterintuitive. Bluntly, there is no getting away from the fact that, if you have a fixed amount of income coming in at £X per hectare that you are farming under your control, that is going to be a buffer. It means that in good years you will have huge profits and probably have to buy lots and lots of machinery to take advantage of capital allowances to make sure you do not get a huge tax bill, but in very bad years it will help minimise your losses and buffer you against things going wrong. It is quite a blunt instrument for that. It helps buffer farm income. There is no getting away from that fact, but it is quite a blunt way of doing it.

Equally, there is the fact that it is probably a barrier to innovation. It means that some farmers, who probably ought to think about retiring, stay there, whereas they ought to be making way for a new entrant in some cases. It prevents farmers from thinking about how they add value to their products and how they can become more competitive and reduce their costs. It stops some of that innovation.

Lord Bowness: So you would not be supportive of an initiative that New Zealand has talked about, which is stopping subsidies overnight.

George Eustice MP: In the case of New Zealand, you always have to bear in mind that their agricultural exports were such a huge part of their total exports that, at the same time as abolishing all subsidies, they devalued the New Zealand dollar by around 40% in a very short space of time. They took a decision to scrap all subsidies but priced their products back into world markets through a very substantial devaluation. Whether that would happen in a European context is a moot point. I do not think you can make direct correlations with New Zealand, but what we cannot get away from is that it is now a very vibrant and efficient industry that competes around the world.

The Chairman: Presumably, in any analysis of an insurance scheme, whether it was an American or Canadian style, versus direct payments, this question would still arise about how you offer some basic protections without fossilising inefficient practice. That is an issue whichever model of intervention you look at.

George Eustice MP: It is. The reality is that, although there are WTO rules that set parameters, they are quite generous parameters so they give you the scope to run these types of schemes. It is not an easy balance to get right, but the key thing would be to have a scheme that helps mitigate risk so that farmers have the confidence to spend hundreds of thousands of pounds on plants or livestock in order to try to make money, knowing that there will be a bit of a safety net if something goes wrong, while not insulating them against market signals. Certainly if you talk to people like Fonterra in New Zealand, they are very critical of the US system, which they believe insulates US farmers from the market to the extent that they do not follow the market signal. That can then perpetuate low prices for a longer period of time.

The Chairman: I guess their size helps. The size of the American market exacerbates it. That is fascinating.

George Eustice MP: That is right.

Q80 Lord Rooker: I want to take you back to a question when Lord Bowness asked you about New Zealand. Have you been briefed on our session with the high commissioner from New Zealand three weeks ago at all?

George Eustice MP: No, but I know the high commissioner. I have met him several times and we have talked about this issue.

Lord Rooker: We had some information from the EU a week before. There was a comment about New Zealand: "Oh well, they chopped the subsidies but they subsidise the banks". It turned out not to be quite correct in that sense. There were schemes put together for the overnight announcement about the loss of subsidies. He gave us figures about the absolutely staggering increases in productivity in a range of what you might call agricultural products. At the end of the day, the direct consequence was that they lost 1% of farmers, who were pushed out because they went to a market-driven system. They could ease out the 1%. The land was still there and presumably got used. It is a good story. I remember seeing in December that one of our farming periodicals did a big supplement about the effect on farms in New Zealand. I think you admitted in one of our earlier questions that, if they do not get the market signals, they will not move. There is no better way of getting the market signals than by being in the market without feather-bedding.

Would it be a general principle that the market should decide whether a farm carries on farming as it is today, or changes ownership, produce or other ways of running the business because it is a business?

George Eustice MP: Yes. I know that a number of you are former Ministers, and CAP reform has been with us probably ever since we have been in the EU. The truth is that it has changed, in that the interventions we have now with the CAP are less market-distorting, in that we have got rid of most coupled payments and the vast majority of intervention price work has also gone. We are now talking about the single farm payment, which is less distorting. You can argue that it distorts land prices, but it is less distorting on agricultural commodities. I think there has been progress. Fundamentally, you are right. We do not make any secret of the fact that the existence of the single farm payment helps to buffer farmers against management decisions they would otherwise take if that support was not there.

Coming back to New Zealand, there are two things I would say. I do not know the circumstances of whether or not they subsidised the banks instead, but it is undeniable that there was a sharp depreciation in their currency that helped them price themselves back into world markets and gave farmers effectively a higher price, but with the removal of subsidies. In some areas, New Zealand also has a different approach from us on issues such as animal welfare. We have higher regulatory standards on animal welfare than has New Zealand, for instance. We would want to try to safeguard that. We have a manifesto commitment to ensure that in the next round of CAP reform there is greater prominence given to issues such as animal welfare. It would not be quite as simple, in my view, as just following what New Zealand did, but that is not to say that there are not important lessons we could learn.

Lord Rooker: I take your general point. One of the other things we have had raised with us—both New Zealand and someone else raised this—is the fact that there is a system of balancing out the good years and the bad years in terms of a five-year scheme, so that volatility becomes less of a burden. The New Zealand high commissioner said that volatility should be our friend because it encourages innovation. You have indicated that people would go out and spend money on capital equipment. They may not get the full return on their capital equipment but they see the need to spend the money. Perhaps they could park the money in the good year under taxation arrangements so that they are not penalised and draw down in a year where the weather is bad or there was volatility in the markets. Those examples work elsewhere in the world; I cannot remember where we were given another example other than New Zealand, but there was somewhere where there was a five-year balancing arrangement.

George Eustice MP: It is Australia. Australia is often the case mentioned. Indeed, the CLA and others have made this case for a similar type of scheme, which we explored with the Treasury. The cause of it was not helped when the CLA created the term “a farmer’s ISA”. They started to make it sound like it was some kind of pension pot rather than a genuine risk management tool. At that point, enthusiasm for the concept dwindled quite quickly because they did not want another kind of complex thing that would be seen effectively as a retirement tool.

What we have done—and it delivers the same outcome—is allow tax averaging over five years for farm enterprises. It was previously under two years. We have now brought ourselves into line with what the Irish do, which is to allow tax averaging over a longer period of time. If you get a very good year, then you can average that tax against any bad years that you have had previously.

Tim Mordan: That is from April.

Lord Rooker: Do you have any policies or systems at the present time that positively seek to drive farmers out of farming because they cannot cope, are inefficient or not making good use of the land, to allow new entrants in? I have put it in a harsh way, but I mean to encourage them to retire. Are there any positive drives in the department at the present time in that respect?

George Eustice MP: Nothing as proactive as you might have in mind. The one point I would make is that we have seen a very difficult two years for farmers. In fact, over the last 20 years, there has been a lot of consolidation already in terms of losing numbers of farmers, particularly in dairy. We are at the point where our dairy production is actually up from 20 years ago but the number of dairy farmers has gone down substantially.

Lord Rooker: It is 50%.

George Eustice MP: There is consolidation ongoing. Some of the things we have had discussion with others about, but it is at very early stages, are that, if you have a farmer who is in his 70s—you do get these cases—and on an Agricultural Holdings Act 1986-type tenancy, who finds it too much of a wrench to retire because they have their livestock, the farm and it is their home as well as their farm, it is quite a difficult thing to persuade them that it is time to step back and retire to create an opportunity for a new entrant. We have had some discussions on whether you could have mechanisms that enable people to retire with dignity, as it were, and maybe stay on the farm but make it possible to allow a new property to be built for a new farmer coming in and taking it on. We are keen to encourage such things as contract farming and shared farming agreements, which offer an opportunity for somebody to step back from the day-to-day running of the business while keeping an interest in it and staying in their home. We are seeing the development of some models that enable this transfer to take place.

We have our food and farming plan that we are working on now. One of the themes we will be looking at is whether there is more that we can do to encourage contractual models that create opportunities for new entrants coming in—so it is not just a career choice for someone who has inherited a farm down the generations, but somebody who wants to come in and set up their own enterprise—but, equally, to make that work effectively you need to help people leave at the other end.

Lord Krebs: I would like the Minister to follow up briefly on Lord Rooker's question about exposure to the market and innovation. Earlier on in your comments, you alluded to the dairy industry in the north-west and investment in creating added value out of milk. Of course, that is not a new story. I have heard that story talked about for at least 25 years and probably longer, but it does not seem as though a lot has happened. What is going to make it happen right now?

George Eustice MP: We have supported projects like this in the past. Rural development funding was used to help build the new factory at Davidstow in Cornwall for Dairy Crest. It is now a world leader in cheddar cheese and is selling around the world. That is something that government helped support through the rural development programme.

There are some quite thoughtful, innovative, forward-thinking farmers in Cumbria who are keen to try to develop some new processing capacity. They are in touch with us and we are exploring this option of whether we could use an EIB-backed scheme to help build processing capacity. The Government cannot dictate these things by decree; if they did, it would not work. That is the nature of things. However, if you have a group of talented individuals who are going to take control of their own destiny, pull things together and make things work—you always need people with the verve to do these things and make it work—and if we can support them with grant funding or funding through the EIB, we will certainly do our bit to ensure we can.

Lord Krebs: So it is a cultural issue as well as a financial issue.

George Eustice MP: It is. The Government can only create the circumstances where enterprises can flourish. Ultimately, every business needs a talented individual who knows what they are doing and has the determination to succeed.

The Chairman: Colleagues, we have 20 minutes left and three important areas of questioning. I will have to ask you to be fairly succinct in your questioning, please.

Q81 Lord Trees: My question is around research and knowledge sharing, and I suppose competitiveness, which we have touched on. I will narrow them down to two specifics. Rapid-speed broadband is a constant problem that comes up in rural areas. What are the Government doing to encourage and deliver that? That is obviously a key to knowledge transfer.

In terms of competitiveness, we have heard that knowing the cost of production is something that the horticultural, pig and poultry sectors are pretty good at on average, but a much smaller proportion of the enterprise in the red meat sector, and to some extent dairy, know their cost of production, which is key to their competitiveness. What role do you think Government have in encouraging that more business-like approach, that knowledge-sharing and basically improving the competitiveness of those enterprises?

George Eustice MP: On that latter point, there is a very important point here for the AHDB, the levy body that is there to support farming, to commission research and development work and to encourage knowledge transfer. They have a very important role to play. They do regular statistics and benchmarking to try to help farmers recognise where they are and what they could do to improve their productivity. There is definitely a role for them there.

Coming back to the point we made earlier around the impact of CAP and subsidies—it is a long history—it is worth noting that the sectors that tend to be in better shape today and more progressive are the ones that never had any support. Horticulture and soft fruit are very innovative and have seen an expansion. The poultry and pig industries tend to be where you have better technical excellence, and there is no getting away from that. The AHDB has a very important role to play in assisting that knowledge transfer.

Coming back to what I said earlier about different types of models around contract farming, I am very interested in the role that there could be for a slightly more integrated model. I will give you a couple of examples. Tulip, which is a Danish company but responsible for about 10% of UK pig production, runs a model that it calls franchise farming, where it owns the livestock and the unit but has individual entrepreneurs running those units. That means it is able to bring in some talented new people who know what they are doing. It also means it can share its knowledge. It shares all its work on genetics with its own members, and all its work, research and development on feeding regimes with its own farmers. McCain's has a similar model. It has 300 potato farmers around the country. It does work on genetics in potatoes, and licenses that work just to its own growers. It can do machinery-sharing projects around those 300 growers, who tend to be clustered in regions. I think that if you can get a more integrated model, using the strength of some of the larger processors at the top, you can accelerate knowledge transfer. You can fix a lot of the problems that are inherent in having a very fragmented primary sector.

Broadband is a challenge. BDUK is up and running. The aim is to get 95% of people on high-speed broadband by the end of this year or 2017. We have also introduced a voucher system so that those who cannot get broadband are able to get cheap and ready access to satellite broadband, which is a solution for some. Of course, we have put on the table around £10 million to pilot other solutions, whether mobile or fibre to the property in some cases or wireless for the final kilometre or so. There are lots of different technologies there and we are keen to pilot all of them to make sure we can get full penetration of high-speed broadband.

Q82 Lord Cunningham of Felling: The Secretary of State has announced a bold 25-year strategy paper for British agriculture to include, we understand, a strengthening of the British brand and exports, attract investment to industry, boost skills, increase productivity, innovation, research and development and data-sharing. Sensibly, it does not include motherhood and apple pie, but it seems to include almost everything else. When will it be published?

George Eustice MP: We are working on it now. I would anticipate that it will be published in the spring, so possibly during March or April. That is the most likely timescale. We have held a number of different meetings with different sectors to get the input of different stakeholders. I have been encouraged by the enthusiasm with which the industry has embraced it.

Lord Cunningham of Felling: It is bound to be welcomed, one would have thought, across the industry as a whole. I do not suppose the Committee could see in advance what it has to say about risk in agriculture.

George Eustice MP: The point I would make is that this will be a high-level document. I doubt whether it will go into the granular detail that you seek on these specific tools, but we have a team of people working on the futures market idea in particular, as I said. We have already identified that we will probably need a cash-settled market and we are looking at the lessons from Chicago. We are thinking about what kind of regulatory regime we might need to get the data published. We are more than happy to share the current state of our thinking on that with you because that does go into quite granular detail.

Lord Cunningham of Felling: That would be exceedingly helpful and beneficial to our report, I am sure, Minister. Thank you for that. I want to ask you some brief questions specifically about precision farming. We do not seem to be as involved in precision farming as many of our global competitors like Australia, the United States or even Scandinavian countries. Is there a reason for that, or maybe more than one reason?

George Eustice MP: I am not sure that is a fair criticism. One of the great resources we have in this country is world-beating science. We have some excellent science going on at places like John Innes and universities like Harper Adams, and places like Rothamsted as well. We obviously have the agritech strategy, and through that we are supporting a number of centres of excellence. I launched one at Rothamsted at the end of last year, which was looking at how we improve our understanding of data and develop computer models that can make sense of data that is otherwise often confusing. We are now in the process of putting the final touches to designating three others, one of which will look at crops, pest and disease. Another will look at livestock. The third one is precisely on precision farming, so it will be a centre of excellence that tries to take forward our research.

Lord Cunningham of Felling: Forgive me, I am not criticising what the department is doing. I was more concerned about the apparent failure of British agriculture to take up the opportunities of precision farming. For example, the Parliamentary Office of Science and Technology survey points out that 83% of Australian grain growers use GPS steering. I do not think it is anything like that high in the UK.

George Eustice MP: It is a moot point. I guess it probably links back to several of the things we have talked about around the CAP and the disincentive that that can be for modernisation. We are doing it obviously with the agritech strategy. I would also point out that one of the strands of the rural development programme is what we call countryside productivity. A lot of the calls we are doing there is to directly fund pieces of technology that improve our understanding both in livestock and in crops.

Lord Cunningham of Felling: Is there any specific way that the department does, or intends to, promote more involvement of precision farming in UK agriculture?

George Eustice MP: It is through the countryside productivity strand, which is about £150 million over the next four years. There will be a range of calls there that will be specifically focused on technology that can improve productivity.

Lord Cunningham of Felling: Does the department collect data on precision farming in the UK?

Tim Mordan: Not that I am aware of. We certainly would not have precise details on how many farmers use GPS. I do not think we have that kind of granularity of data. We know that the Agriculture and Horticulture Development Board do quite a lot of work in this space. They are very keen, under the food and farming plan, to take some responsibility and leadership for knowledge exchange, which is exactly the sort of thing we were talking about in trying to get the great technology that we have here into the marketplace.

Ian Mitchell: The Farm Practices survey might pick up in general terms on farmers' use of that sort of technology. The other relevant thing that Defra does is the Earth Observations programme, which is looking to make the best use of satellite imagery in farming and in the environment domain. I am very happy to share more information with you on that.

Lord Cunningham of Felling: Precision farming has so many advantages in improving yields and productivity, and even better treatment of the land, for example. Surely this is something, given the thrust of the paper that I hope we are soon going to see, which needs a push.

George Eustice MP: It will definitely be a theme of our food and farming plan and there are intended to be action points in this area.

Lord Cunningham of Felling: Therefore, data sharing is going to be very important.

George Eustice MP: It is. We have taken a lead at the moment in Defra in terms of having a very open approach to data and publishing as many datasets as we can. We have already done a lot of datasets, for instance, from Cefas in the fisheries realm. We want to do more of those because we believe that data can be incredibly powerful.

Lord Krebs: Minister, I just wondered whether the 25-year strategy will refer to the impacts of climate change on agriculture generally, and more specifically on price volatility.

George Eustice MP: Yes; it will touch on climate change and indeed improving our use of resources such as water, for instance, and reducing our reliance on pesticides. We have been clear throughout—and I know some of the NGOs feel uneasy about this—that while the food and farming plan will absolutely have a context around the environment and will be very clear that it is consistent with the environmental strategy, we have a separate 25-year environment plan that is being worked on by my colleague Rory Stewart. That is the right place to deal with all the environmental issues, including looking at things such as soil, climate change, water resources and everything else. There is a separate environment plan that will lead on these things, but clearly there is an overlap and we have always been very open about that.

Q83 Lord Curry of Kirkharle: I declare an interest. I farm in partnership in Northumberland. My other interests are on the record, but I need to record the fact that I have worked, and am working, with Defra on the 25-year plan, as part of the consultation process and the agritech strategy to which the Minister has referred.

I have two questions—one of which follows Lord Cunningham's question—on the timescale of the 25-year plan and our own study here. The synergy between our timetable and the 25-year plan is helpful. Hopefully, what we might conclude could be of interest to Defra within the 25-year plan; and what you might draft in the plan might duplicate to some extent our own conclusions here. There is a need, if possible, to work as closely together as we can in our own conclusions and how they might be of help to Defra with the 25-year plan. I am not sure what that means in practice, but the principle of that would be worth exploring.

I have a question, Minister, first on the 25-year plan and then, secondly, on the future EU reform process. You mentioned the issue of retirement and the need to restructure the agricultural sector, addressing many of the issues that we have already discussed this morning. There are, as you know, initiatives out there to try to help in this respect, where there is a matching service and all those issues. It would be helpful if the 25-year plan were to reinforce the importance of industry initiatives already in place rather than to reinvent wheels, to give them the boost and the recognition that there is an opportunity to move this forward at quite a pace.

I will ask the second question at the same time on future reform of the common agricultural policy. I am well aware of your own desire to simplify the whole process and to work with a commissioner who is also minded to try to help in that respect. As far as our programme here is concerned, we have touched on the issue of risk management tools, et cetera, but is there anything else in the CAP reform process and potential negotiations that could be helpful in this whole issue of volatility resilience of the sector?

George Eustice MP: On the synergies, you have obviously had some very interesting witnesses giving accounts of what happens in the US. I will make sure that we get that evidence and reflect on it, and take it into account in our own work. As I said to Lord Cunningham, we will share with you some of the more granular detail of the work we have been doing, in particular on the futures markets. I agree that we do not want this just to be a government plan. We are very clear that we want action points for industry as well. We are also clear that we do not want it just to be another strategy that is left to one side and gathers dust. We want there to be action points as well as the start of something and not the end of something.

On CAP, it is very early days at the moment in terms of the longer-term reform of CAP. There are some arguments that, having just been through a tortuous process, maybe we should not rush the next reform, particularly if it means that things go backwards again; and maybe we should focus on making the reform we have work. There are some voices that say that in some parts of Europe. As I said, the general approach we would take is to move towards much greater simplicity and maybe not get hung up over the whole Pillar 1 and Pillar 2 thing, but just have some thematic objectives of CAP. One would be promoting food security by mitigating risk. That is where there is a big role for some of these tools. One would undoubtedly be on promoting the protection of the environment. We have the model in the countryside stewardship, with all its difficulties at the moment. The general approach we have had to agri-environment over the last 20 years has proved to be quite effective. We would want to continue that type of scheme in some way.

Thirdly, as I said, we have made clear in our manifesto that as another objective we think there should be greater recognition given to animal welfare issues. As you improve productivity, have a growing world population and intensify production, you start to get quite ethical issues around how we treat farm animals. If we can find ways of encouraging more animal welfare-friendly farming practices, then we should start to consider that as well.

Lord Curry of Kirkharle: I want to press you a bit more on that. Every time we go into CAP reform negotiations, our government approach has been that we need to phase out Pillar 1. This has happened over the last 15 years. Yet we come out of the process with Pillar 1 being perhaps reduced but certainly protected. Bearing in mind the conversation earlier about whether this is good or bad, would it not be helpful to set a timetable in future, if it can be negotiated, saying that Pillar 1 will continue until 2030 or whenever it is, but that after that it will be phased out? Then farmers can begin to adjust to a market economy without that buffer.

George Eustice MP: Sometimes, in a European context, if you set a target, it is an excuse for inaction for a period of time rather than an actual target that people stick to. I understand the sentiment behind what you say. The difficulty is that when you have a 28-country negotiation, all with different political traditions, different political make-up and different farming structures, coherence is never going to be a strong point of a common agricultural policy. That is not to say that we cannot make progress. I think we have made progress over the last 20 years to reform it, but there is further to go.

I know that the last Labour Government faced criticism because they went into the negotiations saying that we should get rid of Pillar 1 altogether and just have Pillar 2. There was some criticism at the time by the then Environment Select Committee saying, "You have just isolated yourself and you have had no influence". Even though that was a different make-up of government from my own, I am not sure that I agree with that. I think your starting principle should be to say what you think the right thing is. If we get into the position where we are too scared to even advocate the right thing because we think it is non-negotiable, I do not think that is a very healthy place for things to end up. I do think it is still right to articulate as a first principle what the right type of agriculture policy is.

The Chairman: Minister, thank you very much for being with us today and to your team for supporting you so well. It has been a very enlightening session. We will begin our work of reporting soon and we look forward to having further dialogue with you on that. In the meantime, thank you very much.

Examination of Witness

Robert Johansson, Chief Economist, United States Department of Agriculture (via videoconference)

Q84 The Chairman: It is good afternoon here, Mr Johansson, and a very early morning for you. Can you hear me all right?

Robert Johansson: Yes, I can hear you fine. Can you hear me, my Lord Chairman?

The Chairman: I certainly can. Thank you very much for joining us at what I know is a very early hour for you. As you know, we have been carrying out an inquiry into the whole question of price volatility in agriculture and the ways in which we might build resilience. Your evidence is an important part of what we need to hear to compare systems.

This is a formal evidence-taking session of our Committee. A full note will be taken and put on the public record in printed form and on the parliamentary website. We will send you a copy of the transcript, which you can check in case of any errors. We are on the record; we are being webcast live and will be accessible via the parliamentary website in due course. You will have received the interests of members of the Committee. They will declare any relevant interests the first time they speak.

First, could you say a word or two about who you are and what your role is? I will start with a general question about your observations on recent trends in agricultural price volatility. Do you think that globally the situation is worsening? Could you outline what the impact of price volatility on the farming sector in the United States is currently?

Robert Johansson: Thank you for the opportunity to speak with you today. I know that we tried to schedule this several weeks earlier. However, due to unforeseen weather events here in Washington—highlighting your inquiry about volatility—we had disruptions to the US Government from snowfall. In fact, we are anticipating some more snow later today. I am glad that we have been able to make the session work.

To start with, I will give you several comments about my background. I will then move right into your question about price volatility. I currently serve as the chief economist here at USDA. I am responsible for providing the Secretary of Agriculture with economic policy advice on US ag issues, including market conditions, trade, domestic support policy and a host of other areas. You may not be aware of this, but we have an office of climate change, an office of cost-benefit analysis and an office of environmental markets. The office of the chief economist plays quite a large role in providing analysis and information to the Secretary on those topics.

I have previously held positions in different parts of the US Government. I worked on the US Council of Economic Advisers at the White House. I was at the US Congressional Budget Office for several years. I also worked at the Office of Management and Budget. Prior to that, I received my PhD in agricultural and applied economics at the University of Minnesota. Prior to that, I served as an agricultural extension agent in several central African countries—the Democratic Republic of Congo and Gabon—between 1990 and 1995.

I turn to price volatility. As you know, price volatility has formed a core concern of the farm policy debate over recent years, particularly since the 2007-08 price spikes. There is some question as to whether or not recently price volatility has been trending upwards or mitigating. Evidence suggests that volatility has not been as great over the last year or two as it was prior that—say, eight years ago or so. I note that recent concerns about price volatility should be tempered somewhat by recent moderation in prices that we have seen, as grain and oilseed stocks have built up over the last three years, primarily as a result of the high prices that we had earlier. As an economist, I would hope that, like most markets, they would move in response to price signals. As I have said, we saw prices move up after 2007-08 and through the 2011 period. Producers globally responded and brought increased acreage into production. We have had three remarkable record years of harvests for a lot of commodities. As a result, we have seen stockbuilding occur and prices have softened.

Putting this in a larger context, we would argue that since World War II—due to productivity, for the most part—we have seen real prices for all agricultural commodities come down fairly consistently. In fact, if we look at some sort of price index since World War II, we would say that real prices have come down by about two-thirds since the 1940s, again as a response to global demand, which has increased during that time. That has pushed producers to produce more efficiently. We have seen that not just in the United States but in other countries.

Focusing a little more on how price volatility can be said to affect producers in the United States or the farming sector here in the US, I would say that producers want to mitigate price risk and will do so using a variety of tools, both management tools and financial tools. Your inquiry is focused mainly on the financial tool sector—crop insurance and so on. I will highlight some of the tools that producers have. I know that we will get to crop insurance in a second, so I will hold off on that.

To set the stage, rapidly rising crop prices are generally not seen as a real concern for producers. In fact, most producers would argue that they would like to see prices go up. They are more of a concern for consumers and producers who need to buy livestock feeds. Falling crop prices, on the other hand, raise concerns for crop producers, whose costs may not be falling as rapidly as prices are. Falling prices can impact on revenues for producers and livestock feeders unable to hedge their risks, who may be forced to market during down cycles of price variability or to buy feed during up cycles, but they provide marketing opportunities to transfer that risk through a range of private management tools. In the United States, we have extensive availability of private risk management tools, including futures and options contracts and forward contracting for local delivery of grain for major commodities offered on the commodity exchanges, as well as from local elevators and processors. Producers of those crops can manage any aspect of price risk by locking in futures prices during upswings and using options to limit losses or to provide gains, if prices change suddenly. Conversely, livestock feeders can benefit from low feed prices by hedging during downswings.

We have looked at what percentage of our producers use these private management tools. Research shows that, among producers of corn, soy beans and wheat who use contracting in their operations, about 30% are participating in hedging risk through futures contracts and about 15% hedge through options. Obviously those tools are a bit more limited for minor crops and, to some extent, for livestock categories, but some of those producers also use production and marketing contracts to manage downstream risk. We would say that more than 40% of US production is under some form of production or marketing contract. Many producers also use on-farm storage and marketing through co-operatives to manage their price risk. An additional way in which many farm households manage risk is through off-farm opportunities, including jobs, non-farm businesses and investment income. For a good percentage of our farm households, we see that a large percentage of income comes from off-farm sources, as opposed to on-farm sources. That is another way in which households diversify their income risk.

I will stop there. There is more that I can add on that, but I know that you have a number of questions you want to get through.

The Chairman: We have. Thank you very much. I remind the Committee that this is only a 30-minute session, so please keep questions fairly snappy.

Q85 Lord Cunningham of Felling: Good morning. What are the main policy instruments and public funding available to US farmers to help them to cope with price volatility and to improve their resilience? What are the main differences between the United States approach and that of the European Union?

Robert Johansson: You are probably familiar with this, but I will give a small amount of background. Ag policy in the United States is generally governed by what is commonly known as the Farm Bill. The Farm Bill amends previous agriculture and related policies on a five-year cycle, roughly. That cycle can be longer or shorter, depending on legislative priorities and how easy it is to reach agreement in our legislative bodies. The Agricultural Act 2014—the one that we enacted two years ago—which we refer to as the 2014 Farm Bill, followed the previous 2008 Farm Bill, which was extended by an additional year. The additional time was needed due to the debate surrounding both the new farm programmes and the associated food assistance programmes that are part of the Farm Bill.

Our Farm Bill comprises roughly US $100 billion a year in annual spending on farm programmes. Of that $100 billion, 80% goes to domestic food assistance programmes and 20% goes to farm programmes, the farm programmes being mainly conservation programmes, commodity programmes and crop insurance programmes. All told, the $20 billion a year that is going to the farm sector translates to roughly $50 per cropland acre in farm payments—I am spreading that across all cropland acres—or roughly $123, or £85, per hectare. As I mentioned, these programmes include crop insurance, commodity programmes and conservation. There is additional spending that is part of the 20% that goes to rural development as well.

The 2014 Farm Bill debate took place at a period of record high income. They started that debate back in 2011-12, when farm income in the United States was at historic highs. The debate was shaped both by the fact that we were at record high farm incomes and by the fact that Congress was very interested in finding budget savings in all the legislation that it was considering at the time. One component that marks this Farm Bill relative to earlier Farm Bills is a pivot away from direct support. Essentially, there was the thought that we would want to provide a farm safety net for producers who were suffering from adverse or other production conditions that were difficult to cope with. However, the debate at the time centred on direct payments being programmes that provided support during times when farmers were already experiencing record high farm income, so there was a desire to move away from that method to a more countercyclical type of payment. I will get to that in a second.

Before the 2014 Farm Bill, other programmes were in place to help farmers to manage risk. There was marketing loan assistance. Those were smaller programmes. By and large, the largest programme will have been the federal crop insurance programme, which provided producers of most major commodities with yield and revenue loss policies. We see that production on approximately 80% of our cropland acres is covered by some form of crop insurance.

As I have mentioned, we pivoted away from direct payments to two main programmes that were based on a safety net/risk management objective. The 2014 Farm Bill introduced the agricultural risk coverage programme—or ARC, as it is called—and the price loss coverage programme, or PLC. It also introduced other new forms of crop insurance called the supplemental coverage option and the stacked income protection plan for upland cotton, which are smaller components of the crop insurance programme portfolio. Perhaps we will have time to get into those, but I will cover just the major components right now. In addition, a new margin protection programme for dairy producers was introduced. That helps to manage risk and replaced the previous market price support programme for dairy that we had.

The ARC programme—the agricultural risk coverage programme—was adopted by a majority of producers. I should point out that at the beginning of the Farm Bill period, in 2014, producers had to decide which programme they wanted to participate in—the ARC programme or the PLC programme. That decision will hold through the life of the Farm Bill, so for five years. ARC payments are made when farm revenue falls below a benchmark level, based on an Olympic average of revenue. PLC payments are made when market prices for a given commodity fall below a set of reference prices. The payments for both ARC and PLC are based on historic acreage that the producer had. For example, even though a producer may receive an ARC payment or a PLC payment for a base acre of corn, soy beans or wheat, that producer does not have to be producing corn, soy beans or wheat to receive that payment. It is decoupled, in that sense, but it is contingent either on what the prevailing revenue is relative to the five-year average or on what the prevailing price is relative to the reference price. In the 2014-15 crop year, which was our first experience with these programmes, we saw that ARC and PLC provided about $5 billion of payments to producers under the programmes.

The US and EU approaches have a number of similarities and a number of differences. First, both the US approach and the EU approach rely on the use of a decoupled historic base acre for payment programmes and on environmental compliance requirements for participation. There are differences, however. As I mentioned, the 2014 Farm Bill moves towards a countercyclical type of approach and away from fixed payments, to avoid providing transfers to producers during good times. The safety net provides additional protection during regular cyclical movements and downturns in ag markets. It also provides US producers with some additional flexibility during those adverse conditions, as I have mentioned. As noted, US producers also have access to a variety of private risk management tools: futures, options and so on. Those risk management tools may be more or less available in the EU—I do not know—but I know that some of them are also utilised in EU countries.

With that, I will stop and see whether you have any questions—or we can move on.

Lord Cunningham of Felling: Do you believe that the principal aims and objectives of the 2014 Farm Bill are being met, given the policy changes you have just talked about?

Robert Johansson: Yes. As I mentioned, we do not have a lot of experience with the programmes. We are now in our second year with them. The crop insurance programme was strengthened; we can talk about that shortly. For the commodity programmes—ARC and PLC—the intent was twofold: first, to provide a safety net during bad times; and, secondly, to provide savings to the budget. Currently payments under the ARC and PLC programmes are more or less what the levels would have been under the older direct payment programme. There is not a huge amount of difference between them. Producers would argue that right now, with low commodity prices and the strong US dollar, there are adverse economic conditions for producers here in the United States. In that sense, the programmes are providing a safety net. I am sure that you would find some producers who would argue that the safety net should be stronger and other groups who might argue that it should be weaker. Nevertheless, the programmes are functioning right now and are providing payments to producers, as prices have come down substantially in the last couple of years.

Looking forward, we will have to wait until the end of the Farm Bill period—an additional three years from now—to evaluate whether the programmes meet their objective. Most producers are enrolled in the ARC programme, which is based on an Olympic five-year average. Right now, the revenue guarantees under ARC are being driven to a large degree by the fact that, within that five-year period, producers had fairly high incomes in 2011, 2012 and 2013. Going forward, as we get closer to 2018, those high-income years will fall out of their ARC revenue guarantee. All else being equal, we would expect overall ARC payments to fall over time, providing the savings that were intended in crafting the programme. That is probably a longer answer than you are looking for, but I would say that our initial experience is that they are meeting their intended goals. I suspect that, after several more years of experience, we will be able to make the claim that they provided the safety net during the bad times and the savings during the good times.

The Chairman: I should bring in Viscount Hanworth. The first part of your question has been dealt with, so perhaps you can ask the second.

Q86 Viscount Hanworth: We have struggled to understand the provisions of the Agricultural Act 2014. You have enlightened us greatly. Perhaps our understanding would be enhanced if we learnt something more about the history of these farm support programmes, because they seem to have chopped and changed quite rapidly. I thought that we went from the 2000 Act to the 2014 Act, but we have just had the 2008 Act interpolated. Maybe you could give us some sense of what was lacking from previous Farm Bills.

Beyond that, we have a notion that the present Farm Bill is immensely favourable to insurance companies, which may have profited unduly. The question that arises in my mind is: would such circumstances threaten the survival of the provisions of the current Act? To go back to what I said previously, what overturned the provisions of the previous Acts? What went wrong? That is the question.

Robert Johansson: I would not want to say that the 2008 Farm Bill was doomed by historic farm income. However, as policymakers were debating the Farm Bill at a time when they were interested in finding budget savings and when farm income in the United States was at record high levels, it was rather easy for them to say, "Should we be providing these direct payments at a time when producers do not particularly need them, because they are receiving record high prices for their crops?" At that point, moving towards more of a safety net/risk management approach was natural.

We had some components of the ARC and PLC programmes built into the 2008 Farm Bill. I would not say that they were pilot programmes, but the ACRE programme laid the groundwork for the ARC programme and we had countercyclical payments, which laid the groundwork for PLC. As you are probably intimately aware, with most farm policy we have tried to make a better mousetrap over time, to see what works. Obviously that will change based on historical economic conditions and how the farm sector is doing. However, it is fair to say that US farm policy has moved over time, over a longer period, towards programmes that are more risk management based and more intended to support producers when something that you were not expecting happens. That is one of the reasons why we see more enrolment and strengthening of the crop insurance programme. It is certainly consistent with the movement towards an ARC or PLC type of programme for commodities. As one of your previous witnesses testified just prior to me, we want to make sure that producers are responding to market signals, not being shielded from them. We want producers to make efficient decisions and to improve productivity. As the market moves, we expect producers to adjust and to make their management decisions accordingly. Programmes that are based on base acres and are decoupled from current production systems are consistent with that approach.

That is one part of your question. The other part of it concerns whether or not the crop insurance companies that are integral to the crop insurance programmes are making returns that are excessive. That is continually being debated here in the United States. The goal of having the private crop insurance providers be part of our crop insurance programme has been around for a long time. We have crop insurance programmes that USDA administers solely, through USDA. For example, most of our disaster programmes for livestock producers are administered solely by USDA. However, the bulk of our expenditures on the crop insurance programme are through the Federal Crop Insurance Corporation.

Private companies are part of that. They are the ones who go out and sell the policies to the producers and who pay the indemnities when there is a loss. The theory behind that is that those companies can do it more efficiently than the US Government, because there are so many producers out there and so many different types of products, and because producers want relief after a loss as quickly as possible, as opposed to waiting a number of months before it can wind its way through Washington and get back out to them. There are reasons why we have a public/private partnership in that sense. As you point out, there are continually debates occurring in the United States—in the private sector, the universities and in government—about the appropriate role of those companies and the appropriate rate of return that we should be looking to give them to provide that partnership with us.

I do not know whether that answers your question. I am not here to say whether it is too high or too low. We have seen various legislation come about that has looked to limit it further. Most recently, in the President's budget that was released yesterday, we have seen other ways to limit the scope of payments for crop insurance, whether it be by lowering the subsidies that are available to encourage producers to enrol in different products or by limiting directly the returns guaranteed to companies. Right now, I can talk about how the programme works for crop producers, if you want.

Viscount Hanworth: No, that will be fine. I just observe that 62% of the premiums are paid by the federal Government. To summarise, I think that you are telling us that it is the countercyclical aspects of the 2014 Act that distinguish it from previous Acts. Would that be correct?

Robert Johansson: Yes. We had countercyclical programmes earlier—

Viscount Hanworth: But this one is advanced.

Robert Johansson: I would certainly argue that the current programme is based much more on the countercyclical nature of returns.

Viscount Hanworth: Thank you very much for that. I have been hugely enlightened.

The Chairman: I move to the final set of questions. Lord Krebs?

Q87 Lord Krebs: Could you give us your views—if you are willing to—on how relevant the US model is to the European Union? Do you think that the different landscapes and institutional arrangements mean that there is no real read-across?

Robert Johansson: It is hard for me to say what would work best for producers in Britain or in the EU. I know that our producers in the United States are very happy with the crop insurance programme. We have expanded it to include other producers who have not traditionally been covered by our crop insurance programme. I would imagine that producers in Europe or Britain would be keen to participate in a similar type of programme. It comes down to being able to have the historic data on yields and the price instruments available to be able to charge an actuarially fair premium for the product. That is a key component of our system.

You are right—as was mentioned previously, the US Government pick up a good amount of the premium subsidy. Nevertheless, the premium that is determined is an actuarially fair premium, which means that, on average, the premium gathered covers the indemnities that are paid out. That is not an easy task to do when you look at the heterogeneity of US production, with different crops and different regions. It may be easier to do that for some producers in the EU or in Britain. There is a varied landscape. The more disaggregated you try to make crop insurance, the harder it becomes, because you need to have that data in order to get an actuarially fair premium.

How do you then come up with the right subsidy? There are always debates about what the right subsidy amount is—whether it is too high or too low and whether or not the Government should back off on subsidies for certain types of products. Obviously producers would argue the opposite. A key component—some of your questions alluded to this; we have not had a chance to talk about all of it, but I know that you have already probed the issue with some of your other witnesses—is that with any farm programme policy you want to make sure that producers are responding to market signals and that there is the opportunity for improved productivity over time. Whichever programme you set up or find is attractive to producers, it needs to be one that does not necessarily shield them from a more efficient choice of production method, crop or livestock category. As prices go up for sorghum, we would expect to see producers in the United States plant more sorghum acres. This year, of course, that premium has disappeared and we are likely to see far fewer acres planted with sorghum. That is an example of how we would like our programmes to work. We would hope that there is a crop insurance product that producers who want to plant sorghum can choose that is not overly generous with regard to subsidy but provides the right subsidy in order to correct for the economic fundamentals of any insurance programme—namely, that adverse selection occurs, so you need to provide some sort of subsidy in order to encourage larger participation by the producers who are growing the crop or buying the product.

You certainly have the tools and data to do that in the EU and Britain. You have heard a lot of other suggestions and good ideas that are out there. What works for the United States, Canada or other countries may be something that would work on a larger scale in Europe. I know that some crop insurance programmes are available to some producers in some EU countries.

Hopefully I have managed to answer a good number of your questions. I would be more than happy to follow up with written responses to some of the questions that we did not have a chance to cover today, if you would like. If so, please reach out. I am more than happy to take more questions, but I understand that we have a limited amount of time today.

The Chairman: We do. Both the offer that you have just made and the clear interest that you have taken in the work that we have done up to now—as well as your evidence-giving today, which has been really helpful to us—are much appreciated by the Committee. On behalf of my colleagues on the Committee, I thank you very much for getting up so early and coming to give evidence to us. I am sure that we will be in touch.

Robert Johansson: It is my pleasure. Thank you.