Agricultural policy models in different parts of the world
SCENE SETTING

In this edition of Horizon we will look at different agricultural support models from specific countries around the world and evaluate their impact on the agricultural industry.

Brexit has created the opportunity for the UK to create its own agricultural policy. To date, there has been no official announcement on a future UK agricultural policy and this article is not intended to predict in which direction the UK Government may choose to go but to outline examples of the alternative models that currently exist.

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Agricultural policy exists for two main reasons: To ensure food security and for the provision of public goods. The weight that these two objectives are given varies by country. Here in the UK, post war, food security was the main objective of UK and, subsequently, EU policy. However, in more recent times, the emphasis has been shifting towards environmental aspects and the provision of public goods.

In the process of creating a new post-Brexit UK agricultural policy, the Government may look to models elsewhere in the world. Government spokespeople have indicated a preference for a more market-oriented policy with lower support (see page 13). The case studies below look to countries that have already adopted this approach.

The UK has a variety of policy measures to consider. Specific policy measures around the world include direct support, insurance schemes, provision of disaster assistance, enhancement of markets for derivatives, fiscal measures, counter-cyclical payments, mutual funds, storage support and improving the access to credit for farmers. This article presents an overview of the public instruments that are used to tackle price and income volatility in the United States, Canada, Australia and New Zealand. These are all countries that have a lower level of support than the EU.

Levels of support vary across the world. The OECD measure, Producer Support Estimate (PSE) represents policy transfers to agricultural producers, measured at the farmgate and expressed as a share of gross farm receipts. This allows us to compare levels of support between different countries.

Below is a chart showing PSE by country in 2015.
UNITED STATES

Support to producers in the USA is roughly half the OECD average, representing around 0.5% of GDP in 2013-15. The share of payments based on commodity output and payments based on input use is high at 49% of PSE. However, 38% of payments based on input use are subject to voluntary environmental constraints.

Twenty percent of PSE payments relate to farm insurance and are based on the difference between observed production, yield or revenue, and a pre-planting reference at individual farm or county level.

The United States is the largest exporter of agricultural commodities in the world and has a big domestic market for these products. The country shifted its agricultural policy away from the traditional price support schemes with the Farm Bills of 1985, 1990 and 1996, in order to fulfil the requirements of the World Trade Organisation (WTO). To compensate farmers for these reduced market payments, there was a move towards direct payments with the 2002 and 2008 Farm Bills, which introduced the counter-cyclical payment programmes. As a result, fixed direct payments became the most important source of support for farmers from the 1990s until 2013.

The 2014 Farm Bill led to somewhat of a step change in US policy, bringing to an end many direct payment schemes and, for the crop sectors, putting insurance centre stage. Crop insurance, though, is nothing new in the US and has been around in some form for about the last 30 years. However, it was small in comparison to direct support.

Trends in Crop insurance by type

![Graph showing trends in crop insurance by type](image)

Notes: Yield = Actual production history (farm or sub-farm unit level); Revenue = Actual production history yield X national price (farm or sub-farm unit level); Group = Country yield or county revenue; Index = Rainfall or vegetation (pasture, rangeland, and forage).

Initially, crop insurance took the form of relatively straightforward yield insurance. From there, though, more sophisticated models have been developed which now help farmers insure revenue. The chart above shows just how long crop insurance has been in play in the US, albeit in the shadow of other schemes, and how the trend toward a revenue-based model has developed.

The ARC (Agricultural Risk Coverage) scheme is a key revenue protection scheme for the US crop sector. Revenue insurance essentially uses historical average income as a benchmark – the reference, if you will. The farmer can then insure this historical level for the coming year. The ARC uses average revenue of the last five years as the benchmark and, typically, guarantees 85% of this level for the coming year.

In 2015, the USDA announced that there would be nationwide access to ‘Whole-Farm Revenue Protection’ (WFRP). Rather than considering each commodity at a time, producers are now able to put a safety net in place for the whole farm – especially for those producing a diverse range of commodities.

In short, the US agricultural policy uses a very different set of tools and instruments to deal with price and income volatility for farmers than those available through the CAP. While the EU provides direct payments to support the income that farmers receive from the market for their products, the US terminated their system of direct payments and now focuses on market income, while reducing the risks for farmers by promoting the use of insurances.

These differences become clear when we look at the respective weight of different instruments in the US and the EU: while the US agricultural policy consists of at least 60% insurance tools and no direct payments, the CAP only involves less than 1% insurance instruments and 60% income support through direct payments.

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Pros and Cons of a US-style policy

1. The 2014 US Farm Bill is expensive, with the projected cost of the 2014-18 period at $489Bn – approximately £376Bn.

2. Unlike blanket direct payments, insurance pay-outs will of course vary by year and are unpredictable in nature. This clearly presents a challenge for those managing public budgets, unless spending caps are put in place.

3. It requires accurate and robust data. Providing national, regional, county or indeed farm level insurance cover relies heavily on data to reliably inform what the benchmark (historic) reference is and to ascertain when a claim can be made. In some of the US insurance schemes, farmers are required to provide Actual Production/Revenue History (APH/ARH). This is time consuming for the farmer.

4. The amount outlaid on farm level support is relatively small when you consider that 79% of the projected Farm Bill budget is earmarked for ‘nutrition’ – public facing services providing assistance programmes and education activity. This means that the farm support, ie revenue protection is relatively small and, therefore, the variability in cash demands that comes with providing an insurance scheme can be absorbed with some ease.

5. Strong public-private partnership: Although the insurance-type schemes in the US are publically regulated and underpinned (risk sharing), the delivery is very much driven by the private sector. The roles of the public and private sectors are very well defined with close working relationships. There are currently 17 Approved Insurance Providers (AIPs) in the US.
Canada has reduced agricultural support significantly since the 1980s. This was largely due to the discontinuation of market price support (MPS) to the grain industry. Canada does still have MPS for dairy, poultry and eggs and this accounted for around 64% of PSE in 2013-15. Lower levels of disaster payments in recent years and a shift of budgetary expenditures towards generic, not farm specific, support to the sector since the mid 1990s have resulted in lower farm income support overall.

On average, prices received by farmers were 7% higher in 2013-15 than those observed on world markets. This was mainly due to the MPS for milk, poultry and eggs as most other commodity prices were broadly in line with border prices.

Canada provides support though its ‘Going Forward 2’ (GF2) Policy Framework. This runs from 2013 through to 2018 and is a joint initiative between federal, provincial and territorial governments.

“GF2 programs will focus on innovation, competitiveness and market development to ensure Canadian producers and processors have the tools and resources they need to continue to innovate and capitalize on emerging market opportunities.”

Agriculture and Agri-Food Canada

Under the GF2 framework are a number of support programmes:

- **AgrilInvest** – Essentially a savings scheme where, to a limit, government matches deposits made by farmers. The scheme is designed to help farmers cope with ‘small’ income declines.

- **AgriStability** – This program is designed to help Canadian producers cope with large margin declines. This typically comes into play when margins fall below 70% of the reference margin. This is very similar to the US revenue protection schemes and is based on the previous rolling five-year history.

- **AgrilInsurance** – These schemes are designed at the province level and are geared to help protect farmers from the impacts of natural hazards.

- **AgriRecovery** – This needs to be viewed as a process framework rather than a specific scheme. This framework is essentially about providing disaster relief to producers that incur extraordinary costs as a result of disasters. This approach relies on the provincial government declaring a ‘disaster’.

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**Pros and Cons of a Canadian style policy**

1. Over the past five years, $3 billion has been spent on agriculture. Two-thirds of this went into stabilization programs to support farm incomes.

2. Nonetheless, the evidence is that Canadian programs have modest impacts on production, but that chemical and fertilizer input use may be higher than in the absence of the program.

3. While cross-compliance could be considered in the Canadian context, policies that directly target specific environmental issues in agriculture may have greater impact.

4. This level of support raises questions about the environmental consequences of enhanced agricultural production. Canadian government expenditures on environmental initiatives in agriculture, as a share of farm income, are more than 10 times smaller than those in the US and the EU.
Support to producers in Australia has been continuously reduced from the 1980s, and its Producer Support Estimate (PSE) is the second lowest in the OECD. Total support to agriculture amounted to 0.1% of GDP in recent years. General services support (GSSE) makes up the largest share of total support, with the main elements funding the Agricultural Knowledge and Innovation System and the development of infrastructure, which account for 58% and 31% of GSSE expenditure, respectively.

Australia is an important producer and exporter of agricultural commodities and has a consistently large surplus for agri-food trade. Since the 1980s, the country’s market price support to its agricultural producers has been gradually eliminated and replaced by more targeted payments. As the tariffs on imports of agriculture and food products are also very low, the Australian farming industry is now strongly market-oriented. The reforms have led to domestic prices that are at parity with world prices.

Today, the Australian agricultural policy is mainly focused on assisting farmers to manage several production risks. While half of the agricultural budget is also spent on support to general services, environmental conservation, and R&D programmes, the main policy instruments to prevent severe income losses for farmers consist of disaster assistance and tax concessions.

As Australian farmers are occasionally confronted with extreme weather conditions (such as cyclones, bush fires, hail storms, floods and droughts), these risks are addressed by various disaster assistance programmes implemented by the central and local governments.

In 2014, a number of additional assistance measures were introduced through the Intergovernmental Agreement on National Drought Program Reform between the federal, state and territory governments. This new approach replaced the existing arrangements for droughts and is now focused on different causes of financial hardship for farmers. In particular, the Farm Household Allowance programme was created to provide income support payments to farmers who experience financial hardship, regardless of its reasons (so not limited to natural disasters). The reimbursements of this programme do not rely on triggers, but depend on the financial position of each farm, which is determined by a Farm Financial Assessment.

The Intergovernmental Agreement of 2014 also extended several tax concessions to agricultural producers. Firstly, and similarly to what we now have in the UK, Australian farmers can average profits over five years for tax purposes. The justification for this is that it will put farm businesses on an even keel with other tax payers that are likely to have more of a uniform income.

There is now improved access for farmers to the Farm Management Deposits (FMD) Scheme, which aims to smooth income fluctuations for farmers and improve their long-term financial security. This is, essentially, a tax-free savings scheme, so, in the good years, farmers can make deposits into their FMD account and can draw it down in leaner years. The amount of money on these deposits should be at least 700 dollars and not more than 285,000 dollars, and is exempt from several tax obligations.

Moreover, the Farm Finance Concessional Loans Scheme was extended, providing additional concessional loans with subsidised interest rates in a number of states. These loans can be used for debt restructuring, to fund operating expenses, and for drought recovery and preparedness activities. Finally, tax incentives are also provided to promote investments and sustainable production systems.

In 2014, the Australian government spent 157 million dollars on disaster assistance programmes and 308 million dollars on tax concessions and, together, these programmes amount to more than half of the total agricultural policy budget of 830 million dollars.
1. It is simple. In comparison to the complexity of the North American approaches, which we discuss later, Australia appears to be taking a more straightforward approach, using the existing infrastructure of the tax system to help manage variable income.

2. It is low cost. After New Zealand, Australia has the lowest PSE in any of the OECD countries.

Benefits of an Australian style policy
NEW ZEALAND

New Zealand is one of the few countries in the OECD and elsewhere to abandon price support systems for its agricultural sector and to embark on a free trade policy for agriculture. Starting in 1984, subsidy programmes for agricultural products were discontinued or phased out as part of a general reform programme for the economy. The effects of the programme have been to improve productivity in the agricultural sector particularly and to encourage growth in the rest of the economy. Several factors led them towards abolition rather than reform, but probably the biggest factor was political will as part of a general economic restructuring in response to global economic reality.

New Zealand has set an example which others could follow by deregulating the agricultural sector in a general framework of economic reform. Although there were problems of short-term adjustment to the new regime, the New Zealand experience shows that agricultural producers can adjust to changing market conditions and lower subsidies and yet maintain incomes at reasonable levels.

New Zealand is a small open economy with a relatively high dependence on international trade. It is a net exporter of agricultural products, with more than 50% of its exports coming from the agri-food sector. It is the world's largest exporter of sheep and dairy products. The importance of agriculture is higher than in many other OECD countries, representing 7% of both GDP and employment.

New Zealand’s PSE is currently the lowest among OECD members. Very few of New Zealand’s agricultural production and trade distorting policies from pre-1986 remain today. Most domestic prices are aligned with world prices and payments only provided for animal disease control and relief in the event of large-scale climate and natural disasters.

In the event of natural disasters that are beyond the response capacity of private insurance, farmers may receive restricted assistance to help replace production capacity. In the event of a medium or large-scale natural disaster, farmers whose income falls below a threshold level may, for a limited period of time, be eligible for the equivalent of unemployment benefit.

National frameworks for land and water quality and allocation have been established to enhance the sustainable management of biological and natural resources, (public goods). Under current policy settings, the Emissions Trading Scheme is to be extended to include the agricultural sector. This will extend the price-based mechanism to encourage reduction of agricultural greenhouse gas emissions.

Many activities such as market research and development, quality assurance, and plant and animal health protection are funded by producer levies. Levies can only be imposed if they are supported by producers, and the producers themselves decide how the levies are spent. With a very limited number of exceptions, levy funds may not be spent on commercial or trading activities. The levying organisations must seek a new mandate to collect levies every six years through a referendum of levy payers.
What we can learn for New Zealand’s agricultural reform

1. The New Zealand reforms show that agricultural markets do adjust by themselves and that farmers do not bear all the costs of reforms. In particular, land markets adjust to the expected flow of net returns and land values will find their market levels.

2. The New Zealand reform policies reduced the costs of government intervention substantially. The welfare of farmers, as measured by income streams, was markedly reduced in the period immediately after the reforms were introduced, but, over a seven-year period, necessary adjustments were made in choice of enterprise, input levels and capital investment. Farm incomes were rising by 1988–89.

3. Exchange rate changes have proved to be an unpredictable factor in the recovery and have increased uncertainty in planning decisions for both farmers and marketing organisations. Forward exchange cover is needed on all overseas transactions in this kind of environment.

4. The farm sector would have benefited from a more coordinated sequencing of reforms in the economy. Farmers’ cooperation in the agricultural reform programme was underpinned by the plans to remove tariffs on imported inputs, but the lowering of tariffs did not proceed as quickly as the removal of agricultural support.

5. The reforms have had significant effects in factor markets. Prices of land have returned to a normal relationship with product earnings.

(Source: Adapted from http://users.actrix.co.nz/simonjohnson/iea.pdf)
EUROPEAN UNION

As a member of the EU, the UK agricultural sector is covered by the Common Agricultural Policy (CAP).

Article 39 TFEU sets out the specific objectives of the CAP:

a. To increase agricultural productivity by promoting technical progress and ensuring the optimum use of the factors of production, in particular labour.

b. To ensure a fair standard of living for farmers.

c. To stabilise markets.

d. To ensure the availability of supplies.

e. To ensure reasonable prices for consumers.

These objectives are both economic (Article 39(a), (c) and (d)) and social (Article 39(b) and (e)) and are intended to safeguard the interests of producers and consumers.

When the Treaty of Rome established the common market in 1958, state intervention was a major feature of agriculture in the six founding Member States. What is more, at the time, intervention in agriculture reflected the broad consensus regarding the specific characteristics of the sector — that is to say that it is highly dependent on climate and geography and prone to systemic imbalances between supply and demand, thus often resulting in substantial fluctuations in prices and incomes. CAP has then gradually evolved to a more market-oriented approach and support for the public goods aspects of agriculture (environment, climate change, biodiversity, etc.) have become a more important feature of today’s CAP.

The 2003 CAP reform took a key step in decoupling income support from production, and introduced cross compliance in order to receive direct payments and some other forms of support. Additional requirements have been introduced through the years, such as greening measures under the 2013 CAP reform. Decoupled direct payments to farmers made up 26 per cent of Pillar 1 payments in 2004, compared to 99 per cent in 2014.

Current support

- Pillar 1. Direct payments provide an important support for farmers in order to help stabilise their incomes, linked to complying with safety norms, environmental and animal welfare standards. With these annual payments predominantly “decoupled” from production — ie farmers choose what to produce on the basis of the likely return from the market, rather than on the basis of public support - they support the long-term viability of farms in the face of volatile markets and unpredictable weather conditions, and recognise the environmental contribution and public goods that farmers provide to society. These payments are fully financed by the EU, and account for over 70% of overall CAP spending. With the 2013 reform, 30% of direct payments are linked to respecting three sustainable agricultural practices which are beneficial to environmental and climate change concerns, notably soil quality, biodiversity and carbon sequestration – the so-called “Greening” measures.

- Market measures provide a range of tools including measures to address the situation if normal market forces fail. For example, if there is a sudden drop in demand because of a health scare or a fall in prices because of a temporary oversupply on the market, the European Commission can activate market support measures. Such spending, also from the EAGF, is by its nature rather unpredictable, but tends to account for around 5% of overall CAP spending. This part of the budget also includes elements such as promotion of EU farm products and the EU school schemes.

- Pillar 2. Rural development programmes provide a framework to invest in individual projects on farms or in other activities in rural areas on the basis of economic, environmental or social priorities designed at national or regional level. Funded through the EAFRD, this covers projects such as on-farm investment and modernisation, installation grants for young farmers, agri-environment measures, organic conversion, agri-tourism, village renewal, or providing broadband internet coverage in rural areas. Accounting for almost 25% of CAP funding, these measures are generally co-financed by national, regional or private funds and generally extend over several years.
Direct payments are linked to land area rather than production and it could be argued that an unintended consequence of this policy has been to subsidise land ownership, driving up land prices and rents to tenant farmers.

The next reform of the CAP is due to be in place in 2020, with reform scheduled to happen in parallel with negotiation of the Multiannual Financial Framework – essentially the EU budget. So, at a time when the UK will be discovering what its agricultural policy looks like, EU policy will likely be going through a period of change.

Support to the agriculture and horticulture sectors through CAP is significant. In 2015, UK farmers received €3,084 billion in Pillar 1 payments. In 2014/15, the Single Farm Payment (SFP) formed 55 per cent of farm business income, according to the Farm Business Survey.

The chart above shows sources of income by farm type for 2014/15 and demonstrates the importance of support payments through the single payment scheme and agri-environmental schemes. It is important to highlight that these results are for one year and, as such, represent a snapshot in time. In line with the findings from recent years, the results for 2014/15 show that, on average, livestock farms would be loss making in the absence of support payment. Cereals and general cropping farms were also loss making in 2014/15 but this was unusual in comparison to recent years and largely a result of volatility in crops commodity markets. As illustrated in the chart, for some sectors, direct payments form a substantial proportion of farm income and their withdrawal would cause enormous disruption for UK farmers.
THE LIKELY DIRECTION OF TRAVEL FOR UK AGRICULTURAL POLICY

Although the Government’s approach to farm subsidies in the event of an EU exit has yet to be debated, current and previous UK governments have indicated that they want to see a more market-orientated policy with competitiveness at its heart to ensure that farmers can prepare for a future without income support. This would involve a phasing out of Pillar 1 payments and a less indiscriminate, more targeted approach replacing them. This could lead to a smaller number of large-scale holdings in the most productive land areas.

It is possible that, in future, the Government may favour more environmental or other support, currently covered under Pillar 2, which recognises the value of providing public goods, where farming is unsustainable in some areas without financial subsidy.

There is little certainty about UK agricultural policy beyond the point that the UK formally leaves the EU, which is likely to happen two years from Article 50 being invoked. Prime Minister Theresa May has stated this will not happen until next year (2017), meaning current support may be terminated in 2019. Currently, funding is agreed on the basis of a seven-year rolling period. It is unlikely that, under a UK national system, the government would commit to this, as most funding decisions extend over one to two years. Even then, they may be subject to change should the situation arise.

“The direct payments to farmers in Pillar 1 of the CAP should be phased out, and there should be a parallel reduction in red tape and regulation in order to ensure a globally competitive farming sector.”

The Fresh Start Project: Manifesto for change. A new vision for the UK in Europe (January 2013)

“The majority of Pillar 1 expenditure remains on direct payments, however, there is little rationale for them. Direct payments are not targeted on any particular market failure, and provide little value for money for the taxpayer. Other forms of public expenditure can usually demonstrate greater benefit than direct payments.”


“There clearly needs to be a system of agricultural support and British farming must remain profitable and competitive.”

Liz Truss, Former Secretary of State for Defra (June 2016)

“The truth of the matter is if we left the EU there would be an £18bn a year Brexit dividend, so could we find the money to spend £2bn a year on farming and the environment? Of course we could. Would we? Without a shadow of a doubt.”

George Eustice, Farming Minister, NFU conference (February 2016)
On leaving the EU, it is assumed that the UK will seek to join the World Trade Organisation (WTO) in its own right. Whatever policy options the UK government considers for farm support, it must ensure that they are compliant with WTO rules. WTO groups support payments into three categories, the so-called Green, Blue and Amber boxes.

The EU treats decoupled direct payments as being in the Green Box, although this is disputed by some other WTO members. Many other payments under CAP, such as environmental and rural development programmes also fall under this box. Coupled support payments have, typically, been considered as Blue Box measures. Most market management measures fall within the Amber Box.

The value of support which countries are allowed to provide within the Amber Box is limited under WTO rules. This would apply to the UK as a WTO member and, therefore, would constrain the type and extent of support policy that could operate.
THE POSSIBLE EFFECTS OF A REDUCTION IN DIRECT PAYMENTS FOR UK AGRICULTURE

A recent study by the Department for Environment, Food and Rural Affairs (Defra) looked at the relationship between CAP payments and farm income, using data from the Farm Business Survey (FBS).

Distribution of farms were generated (by farm type) for:

- FBI (which includes the Single Payment)
- FBI minus 50% of Single Payment
- FBI minus 100% of Single Payment

This allowed for the estimation of how the distribution of farm incomes changes with the scenarios above. This does not account for any costs farmers incurred in order to claim Single Payment.

The table below shows the number of farms in England within different FBI groups (averaged over the five years 2010/11-2014/15) for the three scenarios mentioned above.

Table 1: Number of Farms within each average income group with different levels of SPS payments, England (average 2010/11-2014/15)

<table>
<thead>
<tr>
<th>Farm Business Income bracket</th>
<th>Including 100% of direct payments</th>
<th>Excluding 50% of direct payments</th>
<th>Excluding 100% of direct payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than £0</td>
<td>5,900</td>
<td>10,700</td>
<td>20,600</td>
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<tr>
<td>£0 to £10,000</td>
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<td>£10,000 to £25,000</td>
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<td>4,200</td>
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<tr>
<td>Over £75,000</td>
<td>11,500</td>
<td>8,800</td>
<td>6,300</td>
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<tr>
<td>TOTAL</td>
<td>57,500</td>
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The UK farming industry should be preparing for a possible reduction in direct support. Post-Brexit agricultural policy is yet to be decided but past and current UK governments from across the political spectrum have indicated that a more market-oriented approach is most favoured. This may well have taken place even if we had stayed in the EU, as CAP reform appears to be leaning towards a reduction in Pillar 1 payments, and direct subsidies may well have been phased out over time anyway.

It may be that, if the UK chooses to compete in EU markets on a level playing field, UK policy may continue along current and future EU policy lines and take reform more slowly. Alternatively, the UK may look upon Brexit as an opportunity to create a completely new agricultural policy, and look to alternative models around the world as a guide for new policy development.

The reduction or removal of direct subsidies would affect the viability of many UK farms. This could lead to restructuring of the industry, with production potentially polarising towards larger-scale businesses without subsidies at one end and custodial ‘living heritage’ farming supported by enhanced environmental/custodial subsidies (for the provision of public goods) at the other.

Whatever support for the industry the government decides upon, it is important to remember that it must be compatible with WTO rules. WTO does not favour any type of support that directly or indirectly supports production, as this inevitably distorts global trade. Even direct payments indirectly distort production, adding weight to the likelihood that they will not be the main feature of a new UK policy. Having looked at alternative models of support, it may be that an insurance-based agricultural policy, as in the US and Australia, may be something that the UK Government will consider.

Interestingly, the Australian model averages tax liabilities over multiple years, which has the benefit of smoothing the peaks and troughs of market volatility. Following a period of intensive lobbying by the NFU, this is a measure that the UK government announced in April 2015. This may be the first piece of ‘hard evidence’ as to where UK policy may be heading.

**Key messages**

- Different approaches have varying levels of complexity and cost.
- There are likely differences between the protection that the different schemes deliver to farmers, which the UK will have to weigh up when choosing a ‘new’ support regime.
- The focus on resilience in the face of natural hazards is an interesting one. Would UK policy include something on ‘biblical wets’ summer support? Arguably, if this is provided to agriculture, would the tourist industry feel left out?
- All of the case studies reviewed are not fixed policies and have evolved over time.

The direction of agricultural policy is a major issue post Brexit and will be followed closely by AHDB. We will continue to share information with our stakeholders as soon as it becomes available.
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