

**VISION FOR FUTURE OF AGRI-FOOD INDUSTRY:**  
**REPORT FROM THE FUTURE CHALLENGES SUB-GROUP**

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## **1. INTRODUCTION**

### **1.1 Remit of the Future Challenges Sub-Group**

The Sub-Group's remit was:

?? to consider all of the external issues impacting on the agri-food sector, concentrating on analysing their impacts and how Northern Ireland might need to react.

These external issues included, (i) issues arising from the implementation of WTO commitments and the Agenda 2000 reforms of the CAP (including the switch towards direct payments away from market support and the emergence of the Rural Development Regulation as the "second pillar of the CAP"), (ii) further CAP reform in response to any future WTO agreement and EU enlargement, and (iii) any new issues which may be regarded as challenges, or opportunities, including the influence of the retail multiples and e-commerce.

Although, in general, it was agreed that little could be done to change these major external issues, including sterling:euro exchange rates and the need for further CAP reform in response to any new WTO agreement, eastward enlargement of the EU and any consequent budgetary pressures, the Future Challenges Sub-Group's role was to examine and understand these external influences and to develop strategies to respond to them.

Nonetheless, the Group was of the view that every effort should be made to ensure that Northern Ireland's views on these issues were heard and expressed the opinion that the Minister of Agriculture and Rural Development should be urged to relay the concerns of the industry to those involved in the negotiations.

## **2. IDENTIFICATION OF THE MAIN EXTERNAL INFLUENCES AND THE MAIN OPPORTUNITIES/RESPONSES**

### **2.1 The Main External Challenges**

The Group identified the following key external influences on the Northern Ireland agri-food industry:

- ?? globalisation;
- ?? freer trade under the WTO Millennium Round;
- ?? EU enlargement;
- ?? CAP reform;
- ?? possible free trade beyond 2005;
- ?? sterling:euro exchange rate movements;
- ?? consumer trends;
- ?? influence of the retail multiples.

### **2.2 The Main Opportunities/Responses**

The Group identified the following main opportunities/responses:

- ?? the need for an internationally competitive food processing industry to complement a viable farm sector;
- ?? the development of e-commerce;
- ?? demand for organic food;
- ?? demand for non-GM Foods;
- ?? demand for low chemical input and more extensive farming;
- ?? added-value products/niche markets.

## **3. EXAMINATION OF THE MAIN EXTERNAL INFLUENCES**

### **3.1 Globalisation**

- ?? Increasingly, food can be sourced at a lower cost from overseas suppliers because of economies of scale, lower labour costs, and a strong pound.
- ?? Northern Ireland processors are already able to purchase their raw materials more cheaply elsewhere and in future, food processing

might also move outside Northern Ireland to be undertaken more cheaply off-shore. This is a major opportunity for Northern Ireland processors as well as a threat to farmers.

- ?? The increasing market influence of the multinationals is reinforcing the pressure for the liberalisation of international trade. Not all of the present Northern Ireland industry would be able to compete on price in a world market. A likely scenario for the Northern Ireland industry of the future would involve a large group of part-time farmers and a smaller group of bigger, professional farmers. The latter must be able to compete at prices reflecting world market levels.
- ?? The high cost of land, which reflects high producer support under the CAP, inhibits restructuring.

### **3.2 Freer Trade under the WTO Millennium Round**

(See Annex A)

- ?? If freer trade in agricultural produce comes about, it is likely to be under the aegis of the WTO.
- ?? The next WTO round is likely to extend and further the changes introduced by the 1994 Uruguay Round Agreement, including:
  - (i) Reduced domestic agricultural support;
  - (ii) Improved market access and the future of the safeguard clause;
  - (iii) Reduced export subsidisation;
  - (iv) Peace clause (which protects the blue box from challenge but is due to expire in 2003).
- ?? The EU wishes to retain the blue box and to renew the peace clause. However, there is likely to be targeting by the US and the Cairns Group of the blue box (which includes most CAP direct payments) and of export subsidies. These issues are likely to put the EU under pressure to make further reductions in domestic agricultural support and border protection.
- ?? One approach would be for the EU to convert its blue box payments into green box (i.e. having no significant effect on levels of commodity consumption, production and trade).
- ?? While it is in the interests of many parties to the negotiations to resist reform, this should, nevertheless, be accompanied by preparations for change. Defensive positioning should be combined with planning for the future.

### **3.3 EU Enlargement**

(See Annex A)

- ?? Enlargement will have a profound impact on European agriculture, increasing the EU's agricultural area by 45% and more than doubling its agricultural workforce.

- ?? Year 2004 is the likely date for the first accessions of CEECs, but it is likely to take five to ten years for the new countries to become fully competitive with other EU members. However, a number of sectors in some countries are already capable of competing.
- ?? The main features of the EU's enlargement negotiating position in relation to agriculture include:
  - (i) Quotas and base areas to be based on historical not potential production;
  - (ii) EU prices to be applied on accession;
  - (iii) Transitional periods to be the exception;
  - (iv) The question of applicant countries receiving direct producer payments to be decided later.
- ?? The most difficult issue is the question of extending direct payments to applicant countries: the extension of the existing CAP to the CEECs would greatly increase budget costs. The EU Commission recognises that some system for making direct payments is needed to enable the implementation of quotas and other production ceilings.
- ?? The first impact of enlargement is likely to be on the EU budget (including the Structural Funds and the Guarantee section, especially if direct payments are extended to the new members).
- ?? In the longer-term, enlargement will impact differently on different sectors; the impact on the grain sector is likely to be the more immediate, while that on the livestock sector will take longer.
- ?? These considerations point to the desirability, or necessity, of further reform of the CAP before enlargement in 2004/2005.

### **3.4 CAP Reform**

(See Annex A)

- ?? The possible impacts of any new WTO agreement and EU enlargement, together with EU budgetary problems, make further CAP reform inevitable.
- ?? The three main reasons for the Agenda 2000 CAP reform agreement were: (i) to limit the cost of the CAP; (ii) to help the EU meet its GATT/WTO commitments; and (iii) to facilitate future EU enlargement. This reform was, however, significantly less radical than envisaged and is likely to prove insufficient for the CAP to be fully defended in the current WTO round.
- ?? Therefore, as indicated above, further CAP reform is likely before the Agenda 2000 agreement is fully implemented and may include further support price cuts, an extension of direct payments, more decoupling of support from production, the reappearance of degressivity of direct payments and further renationalisation of expenditure (such as greater use of 'national envelopes'). The industry would have to restructure to deal with any reduction in support.

?? The Rural Development Regulation, introduced in the Agenda 2000 reforms as the second pillar of the CAP, provides greater emphasis on the environment and wider rural economy. Future CAP reform is likely to continue the move towards supporting less intensive farming, agri-environmental outputs and the concept of multi-functionality.

### **3.5 Possible Free Trade Beyond 2005**

Although difficult to predict (depending as it will on the outcome of further CAP reform), the post 2005 scenario may involve some or all of the following:

- ?? Price cuts down to world market price levels, thereby moving towards grassland production in a global, free trade world, with the phasing out of quotas.
- ?? In this situation, Ireland, North and South, could become something approaching the New Zealand of the Northern hemisphere.
- ?? Using New Zealand as the model, we might expect silage to be uneconomic to grow and new buildings for winter fattening difficult to justify, leading to more extensive production of grassland beef and a growth in live export trade in beef cattle.
- ?? The intensive sectors may be hit by the higher relative costs of protein.
- ?? It would be essential to produce primary agricultural products as cheaply as possible as processors/retailers will exert downward price pressure (reflecting the availability of cheap external supplies).
- ?? Most produce is likely to be traded in commodity form from areas like Northern Ireland.
- ?? A level playing field in global competition terms would be essential but the EU is constrained by its own animal and plant health and food safety rules.

### **3.6 Sterling:Euro Exchange Rate Movements**

(See Annex B)

- ?? The Northern Ireland FAPRI project carried out at QUB analysed the potential impact of different exchange rate projections on the Northern Ireland agricultural sector for the period 2000 to 2009.
- ?? Northern Ireland is a price taker in terms of agricultural commodities. Exchange rates are, consequently, very important for its highly export dependent agricultural economy (affecting the price achieved for products and the value of direct payments which are denominated in euros).
- ?? In general, milk, beef and sheep prices are projected to remain at current low levels over the next ten years. Consequently, farm

incomes are not expected to return to the high levels achieved in 1995/96 under any of the scenarios studied.

- ?? Exchange rates have a major impact on farm sectoral incomes. The various exchange rate scenarios investigated indicate a near 1:1 relationship between movements in exchange rates and the resulting changes in agricultural income (when both are expressed in percentage terms).
- ?? This can be illustrated by considering the projected impacts of (i) a 10% appreciation and (ii) a 10% depreciation of sterling against the euro on *net receipts (total receipts minus variable costs)* and on average *producer prices* in the beef, dairy and sheep sectors:

**Illustrative comparison of net producer receipts against baseline projections for 2009**

	10% depreciation in sterling:euro rate	10% appreciation in sterling:euro rate
Dairy	+£21.4m (+9.3%)	-£21.5m (-9.3%)
Beef	+£24.2m (+9.2%)	-£24.0m (-9.1%)
Sheep	+£9.5m (+20.4%)	-£8.7m (-18.6%)
All three sectors	+£55.1m (+10.2%)	-£54.3m (-10.0%)

**Illustrative comparison of producer prices against baseline projections for 2009**

	10% depreciation in sterling:euro rate	10% appreciation in sterling:euro rate
Dairy	+1.1 p/litre (+6.1%)	-1.2 p/litre (-6.3%)
Beef	+7.1 p/kg (+5.1%)	-7.2 p/kg (-5.1%)
Sheep	+13.6 p/kg (+6.9%)	-14.3 p/kg (-7.3%)

Source: Derived from 'The Impact of Different Exchange Rate Projections on the Northern Ireland Agricultural Sectors', NI FAPRI Project, Outlook Conference, March 2000. For illustrative purposes the exchange rate scenarios chosen depart from those included in the FAPRI paper.

- ?? To put these scenarios into perspective, sterling deprciated against the ECU by 15% between Quarter 2 1992 and Quarter 2 1996. They subsequently appreciated against the ECU/euro by 37% between Quarter 2 1996 and Quarter 2 2000.
- ?? Looking further ahead to when the UK may participate in the EU Economic and Monetary Union (EMU) and adopt the euro, the rate at which sterling enters against the euro will be crucial.
- ?? While critical, exchange rates and exchange rate decisions are beyond the control of the agricultural sector.

### 3.7 Consumer Trends

(See Annex C)

- ?? Generally, the long-term trend in the consumption of commodities such as red meat, dairy products and eggs is downward. The main areas of expansion are in crops and commodities that Northern Ireland does not produce. However, there may be some potential for the horticultural sector in this area.
- ?? While the total spend on food is rising in absolute terms, the proportion of total consumer spending devoted to food in the UK has fallen since 1980 and this trend is likely to continue. The only area where the proportional spend is increasing is on food eaten outside the home.
- ?? There has been a revolution in eating habits on an international basis (for example, the growth in snacking and eating out of the home) and the convergence between the food service and multiple retailing sectors.
- ?? Some changes in consumer behaviour vary from country to country.
- ?? Food eaten out of the home currently accounts for 30% of the total spend on food in the UK and is predicted to grow to 50% by 2005.
- ?? Demographic factors will affect eating patterns. Although the GB population is static, the number of households is increasing, with 25% of households being single occupant and 50% one to two occupant. The UK has the highest proportion of people over 65 years of age in Europe.
- ?? The UK is the main market for Northern Ireland produce. It is predicted that the only area of growth in that market is the niche food market.
- ?? The food industry is becoming increasingly like the fashion industry in terms of the need for processors to respond flexibly to changing trends. Consumers will continue to demand more quality, value for money, and variety of textures and tastes.
- ?? An increasing interest in convenience foods, health issues, environmental impact, animal welfare and ethical aspects of food production, and a move away from traditional eating patterns, may be expected to affect food consumption patterns.
- ?? In particular, there may be expanding opportunities for the production of 'functional foods', i.e. health-promoting foods that are nutritionally engineered to suit different dietary/health needs, for example, by the addition of ingredients that may help reduce coronary heart disease.
- ?? Emerging technologies will provide opportunities for product development, for managing business processes and for worldwide marketing using e-business.

?? The demand for "just-in-time delivery" may disadvantage Northern Ireland because of our peripheral position in Europe.

### **3.8 Influence of the Retail Multiples**

?? The top four multiples in Northern Ireland account for 55% of grocery sales. The market power of the retailers is expected to increase in the future, leading to even tighter profit margins for suppliers which may, in turn, inhibit the growth of small companies.

?? The retailers' demand for third party auditing, paid for by the producer not the retailer, is also set to continue, putting more pressure on cost.

?? A difficulty exists in establishing effective supply chain partnerships with the multiples. Problems include a lack of trust and a lack of information.

?? Supermarkets have made commitments towards local sourcing but are under no obligation to enter into agreements with local suppliers.

?? Local industry will have to learn how to deal with the supermarkets effectively. This will involve being able to provide the right product and achieve consistency of supply.

## **4. EXAMINATION OF THE MAIN OPPORTUNITIES/RESPONSES**

While we cannot do anything about some of these main external influences directly, the best way to respond is to become competitive.

### **4.1 Need for an Internationally Competitive Food Processing Industry to complement a Viable Farm Sector**

(See Annex D)

?? The gross turnover for the Northern Ireland food industry in 1998 was £2.16 billion.

?? The trend in the food retail market is towards supermarket and manufacturer concentration, with increasing own label dominance.

?? Northern Ireland processors are not big enough to have power and influence in the UK or global food retail markets. The notion of a generic Northern Ireland brand is simply not realistic. This does not mean that the positive attributes and characteristics of Northern Ireland cannot be linked to a product to add value. With the advance of central distribution and e-commerce, it is now possible to put specialist products into as few as two stores.



- ?? Northern Ireland food businesses will need information to identify where they can compete and where they cannot in a global food retail market.
- ?? Small companies may find it easier than large companies to respond flexibly to niche market opportunities. However, in order to compete in such markets, small companies need quality premises. Northern Ireland has traditionally been dependent on grants for capital investment but this situation is unlikely to continue. Processors should be encouraged to seek venture capital from outside and to develop an enterprise culture that acts quickly and responds flexibly to consumer trends. Larger companies also need to consider how they can adjust best to take advantage of niche markets.
- ?? Smaller companies should also consider working in conjunction with larger companies to put product through the larger companies' distribution systems as *their* product.
- ?? The most important "people issue" for the food processing industry is recruitment and retention.
- ?? There may be an opportunity for growth in the Northern Ireland industry by encouraging entrepreneurs and increasing the number of micro-businesses. However, there is a need for the growth of an entrepreneurial culture and an increase in training to support this growth.
- ?? If the industry is to be successful in the future, it will need better products, improved technology, better skills at all levels, more research and development and more innovation.
- ?? Traceability and quality assurance systems will be increasingly important in the retail food market.
- ?? The quality of raw materials is a significant competitiveness issue.
- ?? Integration of the food supply chain is key to enabling those involved to focus on the problems within the supply chain.
- ?? As grants are available to our competitors, Northern Ireland agriculture and agri-processing must have access to similar levels of assistance to maintain a level playing field.

## **4.2 Development of E-commerce**

- ?? E-commerce is expanding rapidly. It is estimated that business to business transactions will grow 60+ fold from 1998 to 2003 and that business to customer transactions will grow 25+ fold from 1998 to 2003. The UK population with internet access via PCs, interactive digital TV and mobile telephones is expected to grow to 25 million, 35 million and 25 million respectively by 2008.
- ?? Currently, the level of access to computers by farmers is perceived to be less than among the general population. However, more definitive

information on this should become available when the results of DARD's Social Survey of Farmers is published in the spring of 2002.

- ?? Government initiatives to increase the level of access and encourage greater use by farmers include, for example, the Agenda for Government and the Modernising Government White Paper. For example, the UK Government has set itself the target of making 100% of Government Services available on-line by 2005.
- ?? E-commerce offers significant on-line marketing opportunities to the Northern Ireland industry, making it easier to access markets all over the world. In particular, it will enable Northern Ireland's small companies to access niche market opportunities globally.

### **4.3 Demand for Organic Food**

(See Annex E)

- ?? Organic food retailing is growing in the UK by 40% per annum; UK organic farming is expanding by 25% per annum.
- ?? It is estimated that 0.3% of Northern Ireland land area is now farmed organically and that by the end of 2010, this may have increased to 5%.
- ?? At present, very little Northern Ireland organic produce is sold via multiple retailers as volumes are not large enough.
- ?? Problems for Northern Ireland include the complicated process involved in switching to organic farming and the high cost of producing organic food. It is considered to be cheaper for a processor to import the raw organic product into Northern Ireland.
- ?? The Rural Development Regulation Plan for Northern Ireland 2000-2006 indicates that organic farming development in Northern Ireland will continue to represent a small percentage of Northern Ireland agriculture.
- ?? The differences between the UK organic standards and European/international standards are unhelpful. There is concern that the UK may be adding costs through its higher standards.
- ?? Organic food expansion in Northern Ireland requires the identification of market demand, the development of production expertise, demonstration/development farms, appropriate research and development, Organic Farming Scheme support, the development of horizontal and vertical supply chains, and the maintenance of the current strong marketing position.
- ?? There is a need to consider the provision of adequate funding to provide the necessary development support/advice.

## **Other issues**

### **4.4 Demand for Non-GM Foods**

- ?? There may be an immediate opportunity to market Northern Ireland non-GM food products with Tesco and Sainsburys, although retailers may not be willing to pay an extra premium for non-GM foods.
- ?? However, the fact that we may be importing inputs (particularly animal feedstuffs) that could contain GM ingredients means that it would not be possible to market Northern Ireland as a GM free region.
- ?? In addition, the Group recognised that, in the longer-term, GMOs may have great potential for the Northern Ireland industry. The potential benefits of GMOs for the underdeveloped world may be great, as may be the environmental benefits.

### **4.5 Demand for Low chemical input farming and more extensive farming**

- ?? Farming in the Less Favoured Areas (75% of Northern Ireland), and in other parts of Northern Ireland, is largely on an extensive basis with generally low chemical input and could, with relatively little difficulty, achieve organic status if that was sought. It is recognised, however, that LFA land may not be of the quality necessary to provide a good return from organic farming.
- ?? Although supermarkets are not particularly interested in intermediate branding, there may be an opportunity to market the produce of Northern Ireland's Less Favoured Area on the basis of low chemical input.
- ?? We should market our green image. To this end, there may be an advantage in associating Northern Ireland with "Irish" or "British" as it suits.

### **4.6 Added-value Products/Niche Markets**

- ?? The effect of changing consumer trends is that the niche market is currently the only area of growth in the UK food market. Consideration should be given to the potential for niche markets and added-value products, while recognising that efficient commodity trading is likely to be the answer for most of the agri-food industry.
- ?? The UK turnover for speciality foods is 5% of the UK total. Sixty per cent of UK companies producing speciality foods source half of their ingredients locally. Forty five per cent sell half of their turnover into local regions. Ecommerce is making it easier to access international markets with these products.

- ?? A comparison of EU micro-businesses in 1996 showed that the percentage turnover of micro-businesses attributable to food products and beverages in Italy was around 14% compared with just under 4% in the UK. There may be opportunities for Northern Ireland companies in this sector, possibly by exploiting the potential of E-commerce.
- ?? There may be opportunities in the expanding "eating out of home" market. Although it may be difficult for Northern Ireland producers to penetrate this market since Northern Ireland products may be unable to compete with imported products on price, there are, nevertheless, opportunities to promote local products that could rival imports in this type of market, or to produce component foods for this market.
- ?? In addition, there are opportunities to target different "life stage" food products at specific demographic groups according to their needs and expectations. Opportunities may include nutritionally engineered foods and health promoting foods.
- ?? There is potential funding available for diversification in Northern Ireland under the EU Peace II Programme.

## **5. CONCLUSIONS AND RECOMMENDATIONS**

### **5.1 The Main External Influences**

It was accepted that there is little or nothing that can be done to influence exchange rates, or change EU agricultural policies. It was also recognised that all of the major external influences will continue to intensify the pressures on the industry, potentially to its disadvantage.

In addition, it was recognised that it is possible to monitor and assess the impacts of these external influences through econometric modeling techniques (such as the FAPRI project at QUB).

The influence of the multiple retailers is expected to increase in future. It will be essential for the local industry to learn how to deal with the supermarkets effectively. This will involve being able to provide the right product and consistency of supply.

**RECOMMEND** that the Minister should act jointly with the ROI Minister to try to ensure that any outcome of EU/international negotiations about the major external issues does not distort trade on the island of Ireland or result in a comparative disadvantage to Northern Ireland.

**RECOMMEND** the need for an effective Northern Ireland permanent representation in Brussels with a strong agricultural portfolio. The

Group also suggested that industry organisations should liaise with their GB, ROI and European counterparts to ensure that Northern Ireland's views were included in the activities of relevant lobby groups.

**RECOMMEND** mechanisms to enhance the dissemination of results of econometric modeling analyses (such as the QUB FAPRI project).

## **5.2 The Main Opportunities/Responses**

A number of opportunities were considered. A few of these were rejected by the Group and some were supported.

The themes **rejected** included the promotion of Northern Ireland as a GM free region, and the promotion of Northern Ireland's LFA as a low chemical input farming region.

The themes **supported** included the following.

### **Need for an Internationally Competitive Food Processing Industry**

- ?? We are yet far from a free trade world but by the end of the period we are looking at, it is probable we will be operating at, or significantly closer to, world market prices, with EU payments to farmers being made for environmental, cultural and other purposes unrelated to agricultural production.
- ?? Northern Ireland processors are already able to source raw materials from outside Northern Ireland. This is both a major opportunity as well as a threat. Food processors should be encouraged to develop strategies which use both local and global raw materials as needed to achieve internationally competitive positions.
- ?? The "old" CAP protected the whole agri-food sector, including food processors. Import restrictions kept prices up and reduced external competition and intervention and export refunds operated at the wholesale level. The switch to direct payments means that support is more focused on the farm sector. The processing sector, therefore, will need to be internationally competitive.
- ?? The achievement of international competitiveness by the food processing industry will not necessarily benefit the local farming sector if raw materials can be sourced more cheaply from elsewhere. The farming industry will need to adapt as well.
- ?? A crucial factor in this will be the future evolution of the CAP. A reformed CAP may continue to allow inefficient farms to survive, whereas there is a general need for farms to become internationally competitive. There is probably a conflict between efficiency (requiring restructuring and rationalisation) and providing 'public goods' (e.g.

environmental benefits). Consequently, some elements of public policy may contain measures which inhibit efficiency.

**RECOMMEND** “Walking the Supply Chain” exercises to assist the integration of the food supply chain. This should improve communication between producers, processors and multiple retailers and lead to a greater understanding of the needs of the market. In addition, DARD, in conjunction with the LMC and meat plants, should consider delivering a “Growing for the Market” demonstration with a view to improving the marketing focus in the beef industry.

### **Other Potential Opportunities**

#### **E-Commerce**

?? E-commerce is vitally important to all Northern Ireland companies. It is fast becoming the business medium of choice for customers and suppliers, including our competitors. E-commerce is a major opportunity and a threat. To secure competitive advantage, the Northern Ireland industry will need to be ahead of its competitors in exploiting e-commerce opportunities.

**RECOMMEND** measures to increase the level of access to, and greater use by, farmers of ICT and e-commerce.

#### **Organic Food**

?? The market for organic food is expanding rapidly, although Northern Ireland has no competitive advantage in organic production.

?? Organic farming will be feasible and profitable for some farmers, requiring better quality land and expertise.

?? Organic expansion in Northern Ireland would require the identification of market demand, the development of production expertise, demonstration/development farms, appropriate research and development, Organic Farming Scheme support, development of horizontal and vertical supply chains and maintenance of the current strong marketing position.

**RECOMMEND** the provision of adequate funding to provide the necessary development support/advice to assist those wishing to diversify into organic production.

### **Added-Value Products / Niche Markets**

- ?? Farm diversification is a potential opportunity for Northern Ireland.
- ?? Changing lifestyles, consumer tastes and concerns mean that there are opportunities for Northern Ireland in the niche market at home and abroad. It is predicted that there will be increasing opportunities in the "eating out of home" market and in markets targeting specific demographic groups according to their needs and expectations.

**RECOMMEND** measures to encourage an enterprise culture that responds flexibly to changing consumer demands, including the provision of information and training.

**LIST OF THOSE FROM WHOM PRESENTATIONS WERE RECEIVED**

Dr Joan Moss	The Queen's University of Belfast
Dr Seamus McErlean	The Queen's University of Belfast
Ivan Hunter	Economics and Statistics Division, DARD
Dr Sam Kennedy	Crops and Horticulture Technology Division, DARD
Denis Legge	Food Technology Division, DARD
Michael Gould	Supply Chain Development Division, DARD



## VISION EXERCISE - FUTURE CHALLENGES SUB-GROUP

### WTO, EU ENLARGEMENT AND CAP REFORM

#### A. GATT/WTO

1. The 1994 Uruguay Round Agreement (URA) of the General Agreement on Tariffs and Trade (GATT) runs from 1995 to 2001. The next round of GATT, now called the World Trade Organisation (WTO), was to have been launched at the abortive ministerial meeting in Seattle in early December 1999, with negotiations due to start in January 2000. The start date of a comprehensive round is now uncertain, although meetings on the agricultural chapter have already begun as part of the in-built review of the URA.

2. With the delayed start of the round, little hard information is yet available about the likely course of the new 'Millennium Round'. Most observers, however, expect that the new round will result broadly in a furthering of the provisions of the URA. In summary, these included, *inter alia*:

- (i) Reduced **domestic support** - global and specific reductions in the level of domestic agricultural support, but with important exemptions (see below).
- (ii) Improved **market access** - reductions in import tariffs and increased import opportunities.
- (iii) Reduced **export subsidisation** - reductions in both the quantities of subsidised exports and in the value of export subsidies.
- (iv) **Peace clause** - protection of the CAP against challenge for 9 years (until the end of 2003), so long as there is observance of the provisions of the URA.

3. A most important feature of the URA was the classification of domestic agricultural support into:

**Amber box** - trade distorting support (such as expenditure on intervention purchases) which must be reduced under (i) above.

**Green box** - non-trade distorting support (such as environmental payments) which may be excluded from the calculation of domestic support and, therefore, from the domestic support reduction commitments.

**Blue box** - support which, while potentially trade distorting, is 'production limiting' by being tied to quotas or production ceilings and is, therefore, also exempt from the reduction commitments. Most CAP direct payments, especially those introduced under the 1992 MacSharry Reforms, fell into this category, as did the former US deficiency payments.

4. It is already clear that the concept and contents of the blue box will be targeted by the US and the Cairns Group in the new round. A recent US position paper proposes reducing the number of boxes to two - 'exempt' and 'non-exempt'. The implication for the blue box is that its contents would either have to be modified to make them green box compatible or they would be subject to whatever reduction commitments may be agreed. The EU has already indicated its intention to defend the present classification, including the blue box.

5. Another target is likely to be export subsidies which both the US and the Cairns Group would like to see progressively abolished, with the Cairns Group proposing a halving of spending on export subsidies by 2004. The EU has declared a willingness to reduce export subsidies further but only on condition that other forms of export assistance (e.g. export credits and some food aid programmes) are also curbed.

6. The 1992 CAP Reforms have been broadly GATT compatible but surpluses of beef, cereals and dairy sectors have re-appeared (partly BSE-induced in the case of beef) and subsidised export constraints have begun to bite in some commodities. The blue box and export subsidy issues are likely to put the EU under added pressure to make further reductions in domestic agricultural support and border protection - over and above those agreed in Agenda 2000 - and for more "de-coupling" of support from production. For its part, the EU wishes to see more recognition within the WTO for agriculture's multi-functional role.

## **B. EU enlargement**

1. Twelve countries - ten central and eastern European countries (CEECs) plus Cyprus and Malta - have applied for membership of the EU. Accession negotiations with the Czech Republic, Cyprus, Estonia, Hungary, Poland and Slovenia (the 'Luxembourg Six') - those countries which were identified as being closest to meeting the criteria for membership - started in March 1998. Following the Helsinki Summit in December 1999, negotiations with the remaining six countries - Bulgaria, Latvia, Lithuania, Malta, Romania and Slovakia (the 'Helsinki Six') - have also begun. The previous notion of two separate 'waves' of candidate countries has been abandoned and countries are now permitted to proceed with membership as quickly as each is able. Technically, the EU is aiming to be ready for the first accessions as early as 2002/03, but 2004 is still regarded as being the more likely timescale.

2. Enlargement to include the ten CEECs would add approximately 106 million people (29% of current EU population) and 1.1 million square kilometres (33% of existing EU area). At least in the medium term, there will, therefore, be opportunities for EU agricultural producers and processors to exploit an

expanded market, as all CEECs apart from Hungary are net importers of agri-food products.

3. Some of the CEECs, notably Poland, have very considerable agricultural production potential. The 10 CEECs would increase the EU's agricultural area by 45% and more than double its agricultural labour force. However, restructuring of their production and marketing systems will be necessary before they become competitive with existing EU producers and this is likely to take perhaps 5-10 years. However, it would be a mistake to dismiss the CEECs as under-developed, third world countries. Visiting agriculturalists from Northern Ireland have reported that some farms and processing firms are technically sophisticated, well able, for example, to meet EU export requirements and hygiene regulations.

4. Specific accession negotiations on the Agriculture Chapter began with the Luxembourg Six in June 2000. The EU's Common Position in relation to agriculture includes *inter alia*

- (i) quotas and base areas to be based on recent *historical* not *potential* production;
- (ii) EU prices to be applied on accession;
- (iii) transitional periods to be the exception and, if agreed, to be limited in time and scope;
- (iv) the question of applicant countries receiving direct payments to be decided later.

5. Extension of the CAP in its present form to the CEECs would greatly increase budget costs (estimated at up to an additional €7 billion per year). It would also be difficult to justify extending payments which were designed to compensate EU agricultural producers for support price *cuts* to producers in countries where accession may result in price *increases*. However, the Commission has acknowledged, relatively recently, that implementation of supply control/production limiting measures (i.e. quotas and other production ceilings) is, in practice, dependent upon systems for making direct payments. This has coloured the attitude of the Commission on this issue and has led to suggestions that the new members may become eligible for direct payments after a (five to seven year?) transition period.

6. EU enlargement could also make it difficult for the EU to meet its GATT/WTO commitments. If the existing CAP were applied in full to the CEECs, the resulting large increase in support would have to be accommodated within *existing* WTO consolidated domestic support commitments. Also, if prospective EU membership stimulated higher production in the CEECs in advance of membership, and since the CEECs generally have limited WTO entitlements to export with subsidy, extra production would add to the unexportable surpluses already being experienced

in the present EU. Both of these considerations point to the desirability, if not necessity, of further reform of the CAP *before* enlargement.

### **C. Reform of the CAP**

1. Reform of the CAP is an on-going process which takes place in response to conditions and pressures at particular times. The Agenda 2000 CAP reform agreement reached in Berlin on 26 March 1999 was needed for three major reasons: (i) to limit the cost of the CAP; (ii) to help the EU meet its GATT Uruguay Round commitments and prepare it for the forthcoming WTO round; and (iii) to facilitate future EU enlargement.

2. The Berlin Agreement on CAP reform comprised, in summary:

- phased cuts in market support prices for beef, cereals and dairy products, but with the dairy cuts (and compensation) delayed until 2005;
- compensation (partial for cereals and dairy) for these support price cuts through increased Arable Area Payments, Beef Special Premium and Suckler Cow Premium, a new Cattle Slaughter Premium and new Dairy Premium;
- 'standard' beef intervention to be discontinued (except for possible 'ad hoc use if market circumstances require it'); retention of Aids to Private Storage and 'safety net' intervention triggered at lower price levels than at present;
- extension of the milk quota system to (possibly) 2008; the regime to be reviewed in 2003, with the aim of abolition after 2006;
- 'national envelopes' (budgets) of support with which Member States may top up direct payments for beef and dairy production according to their particular circumstances;
- optional environmental cross-compliance measures;
- 'rural development' measures\*, agri-environment measures, optional modulation of direct payments and an optional early retirement scheme; and
- freezing of the total agricultural budget (in real terms) for 7 years.

3. The Berlin Agreement represented a significantly less radical reform of the CAP than that envisaged in the Commission's original proposals. It is likely to prove insufficient to enable the CAP to be defended in the forthcoming WTO

Millennium Round negotiations or to enable the 'reformed' CAP to be extended in full to the new applicant countries.

4. Hence, further CAP reform will probably have to be addressed before the current agreement is fully implemented. Several reviews are already built into the Berlin deal:

- a review of price support for cereal crops in 2002;
- a review of the milk quota regime in 2003;
- a report on agricultural spending in 2002, with proposals for any necessary further reforms.

There are indications that Commissioner Fischler is contemplating synchronising and broadening these reviews into a more comprehensive reform package in 2002 to include, in addition, sugar and oilseeds, on the grounds that progress towards reform is more likely when trade-offs between different sectors are possible. Before then, the Commission plans to conduct and publish analyses of several sectors.

5. Although there are as yet no proposals for reform, the package may include the following:

- further **support price cuts** to facilitate *unsubsidised* EU exports, thereby circumventing present and possible future WTO constraints;
- **extension of direct payments** to compensate for support price cuts;
- **more de-coupling** of support from production, probably involving further shifts from headage to area payments and greater emphasis on environmental measures in line with multi-functionality and with a view to making at least some direct aids green box compatible;
- reappearance of proposals for **degressivity** of direct payments - i.e. their gradual phased reduction - to ease their application to new Member States;
- **modulation** - greater emphasis on modulation, possibly on a mandatory instead of the present optional basis;
- **'re-nationalisation'** - greater use of 'national envelopes', including extension of the concept to other commodities.

**Ivan Hunter**  
**Economics and Statistics Division, DARD**  
**September 2000**

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\* In addition to the Agenda 2000 agricultural measures, under the Northern Ireland Structural Funds Programme of 2000-2006, there will be an Agriculture, Rural Development, Forestry and Fisheries sub-programme, with emphasis being placed on agri-environmental schemes and development of the rural economy in the broadest sense.

**VISION EXERCISE – FUTURE CHALLENGES SUB-GROUP**

**THE IMPACT OF DIFFERENT EXCHANGE RATE PROJECTIONS ON THE NORTHERN IRELAND AGRICULTURAL SECTOR**

**(The Northern Ireland FAPRI Project)**

***Text to support the conclusions of the presentation given by Dr Joan Moss and Dr Seamus McErlean (Agricultural and Food Economics Unit, QUB)***

**Conclusions**

- ?? CAP reform will lead to producer prices remaining at their current levels under the three exchange rate scenarios.
- ?? Changes in the £/euro exchange rate have a strong impact on Northern Ireland farm incomes.
- ?? A one per cent strengthening of sterling reduces farm incomes by one per cent.
- ?? Exchange rates, however, are beyond the control of the agricultural sector.

**Extract from recent paper based on exchange rate work**

The NI-FAPRI Project analysis underlines the importance of exchange rates for the agricultural economy of Northern Ireland. When the euro is weak against sterling (as in the Euro:Dollar Parity scenario) then sectoral incomes are substantially lower than when the euro is strong against sterling (as in the WEFA scenario). The exchange rate income transmission effect may be said to be about 1, i.e. a one per cent weakening/strengthening of the euro against sterling is projected to increase/reduce aggregate net receipts in the dairy, beef and sheep sectors by one per cent. This might be said to be a rather dramatic effect, particularly when considered against the backdrop of a 30 per cent (approximately) drop in the value of the euro against the pound sterling since 1995.

We emphasise that our projections are designed to isolate the effects of exchange rates. They are based on a given set of assumptions and should not, therefore, be treated as forecasts. Nevertheless, it may be reasonable to conclude that the regional sectoral outlook is not particularly good. Under all three exchange rate scenarios, producer

prices are projected to remain well below mid-1990's levels and breeding livestock numbers are projected to fall in the long run. On the other hand, sectoral net incomes are projected to increase by 2002, mainly due to increases in direct payments initiated by the Agenda 2000 Berlin Agreement.

The exchange rates in force throughout most of the year 2000 would indicate that the more pessimistic of our exchange rate scenarios may be the most likely in the medium term at least. With the additional prospect of further trade liberalisation arising from pending WTO negotiations and the eastward enlargement of the EU likely to curtail EU compensation levels, the future trends of farming incomes in export dependent regions outside the euro zone, such as Northern Ireland, are likely to bring added pressures for significant structural change.



## VISION EXERCISE – FUTURE CHALLENGES SUB-GROUP

***Text to support a presentation given by Dennis Legge [Food Technology Division, DARD] to the Future Challenges Sub-Group, November 2000.***

### **Factors Affecting Food Consumption**

The environment in which food businesses (and government) now operate is changing rapidly.

We are all part of the global workplace – a world economy, one that is increasingly ***knowledge based and knowledge driven***.

Capital for business projects is now more mobile and technology spreads quickly. Goods can now be made in low cost countries and easily shipped to more developed regions and economies across the world.

Ideas, like capital, can travel the globe as fast as fibre optics and satellites permit.

So businesses are being challenged - in all areas - and it is the ability ***to learn faster and act smarter*** and to exploit those capabilities that our competitors cannot match that may be the only way for businesses in future to gain competitive advantage.

Some of the **key factors** that affect business decisions are :-

**Food is a basic necessity of life** and an understanding of the food market is as much about '*why we eat food*' as '*what we eat*.' It is accepted that people need to eat to live but the basic calorific need is now often met as a by-product of the consumption associated with a wider personal, family or social habit.

Spending on different foods is also dependent on income levels, regional differences, household composition and sociological changes.

**UK is the main market for produce and products from Northern Ireland.** The population of the UK is, however, static at approximately 58 million, while that of Northern Ireland is currently 1.7 million and increasing at around 5% per annum.

The total UK expenditure on food is over £80 billion per annum, of which, approximately £54 billion is spent in retail outlets on food to be eaten 'at home'. Northern Ireland's 'at home' expenditure is approximately £1.3 billion.

**Northern Ireland is small in global terms.** Its population is approximately one quarter that of the city of Paris! All of the big companies in Northern Ireland are small in global terms and the people in many of our businesses at some time or other have a parochial, island mentality.

## **Challenges**

There is a dynamic market for food. And the food strategy team adopted a PLEST model as the method to analyse this market.

### **Political - Legal**

Northern Ireland has new political structures in a **Devolved Assembly** and we continue to hope that political stability will provide a platform for the growth of industry and food businesses in particular. **North South and East West bodies** have been established and new **inter-departmental relationships** are in place. Discussions continue about modernising government and reducing bureaucracy, particularly as it affects SME's. The role of **local government** and councils is under review and these councils might be rationalised on a regional basis in the next 5 years. Devolution in Great Britain will increase competition for **inward investment** within the United Kingdom.

There is a proliferation of regional and community based organisations – i.e. LEA's, District Partnerships, Leader Groups – each with the best interests of their communities at heart, but essentially creating an overcrowded, confused and very fragmented economic development base and potentially leading to duplication and loss of valuable resources.

There is a **world market** for raw materials. The GATT and WTO reforms will force producers to compete globally at world prices. It will reduce support for farms and lead to cheaper foods for consumers on the UK market. Examples include beef from Argentina, chicken from the Far East and milk products from Australia.

As the European Union grows and eastern European farmers adopt modern practices and technology, they will present greater competition in some areas of agricultural production. However, the greatest effects in the shorter term may come from their impact on the future allocation of **structural funds**.

**Targeting Social Need** is now government policy and an integral part of DARD business plans. This special focus on employment and employability aims to erode socio-economic differentials and will result in the targeting of resources within government to ensure a balance of economic development funding across Northern Ireland.

There are 18 million **SME's** in the European Union, employing 60% of the workforce and with 55% of turnover. There are some 3.7 million in the United Kingdom, and Northern Ireland has 34% of its businesses employing less than 50 people. So SME's play a significant role in economic development and Europe recognises this and has introduced special measures to ensure SME inclusion e.g. within the 5<sup>h</sup> Framework Programme

The apparent tidal wave of legislation effecting food manufacture, food safety, health and safety and packaging waste is likely to continue.

### **Economic**

**Economic and Monetary Union** within the EU is now a reality, with the exchange rates of 11 member states fixed against the euro and interest rates set by the European Central Bank. UK government policy aims to keep inflation low and the strength of the pound sterling is having a significant (perhaps the greatest) impact on local business competitiveness.

**GB multiples** control over 80% of food sales at retail level in the UK. [The top four multiples in Northern Ireland account for 55% of grocery sales, with symbol groups controlling almost all of the remainder]. As these multiples continue to increase their power, they will further squeeze the profit margins of suppliers and inhibit the growth of smaller producers. Competition between multiples is rife and exacerbating this problem. New pressures and service level demands like twice daily delivery and third party auditing will be imposed on suppliers at no cost to the multiples.

Sixty per cent of food in the United States of America is spent on **food consumed out of the home**. In the United Kingdom, this figure is currently 30% and is predicted to grow to 50% by the year 2005. Where will it be the year 2010?

Consumers currently spend approx. £800 million in Northern Ireland per annum on food eaten out of the home (in the UK this is £28 billion) and this area has a very fast growth rate, providing many opportunities for existing and new businesses.

**Mergers and acquisitions** are the order of the day in industry, establishing even bigger companies with the capacity to service global retailers. These businesses have **economies of scale** that give them the **competitive advantage** and working capital to buy the latest technology and to keep further ahead of their competitors.

The **cost of new build** for food businesses is high relative to other businesses and those wishing to invest capital on projects may be more inclined to follow more rapidly growing and less capital intensive industries like ICT. There is apparently no solution at present for the high cost of food building construction.

Northern Ireland currently has an **over-dependence on grant support**. It is twice that currently in Wales and 30 times that in the United Kingdom as a whole and this is unlikely to be allowed to continue. Businesses are **adverse to equity and venture capital**. Northern Ireland needs to **cultivate an enterprise culture** and encourage new businesses that will be self reliant, willing to innovate, turning good ideas into products and services – acting quickly and taking risks.

### **Social and cultural**

Northern Ireland has a **younger population** than that of the United Kingdom as a whole, with 0.38 million people (22%) under the age of 15 years. [This figure is, however, likely to decline by the year 2010.] The UK currently has 19% of its population under 15 years. Consumers within this age group **eat different foods** at different times and in different places than the rest of the population. They graze or snack within a 'sound bite' lifestyle.

There are approximately 1 million in the working category between 15-59 years in Northern Ireland. And we currently have **fewer older people**, with 19% over the age of 65.

In the UK there are approximately 9.4 million over the age of 65, 1.2 million of whom are over 85 years.

Northern Ireland, however, has a significant number of **'third age' people** – those over the age of 50 who are currently economically active but who will become "jobless" or retired between 2005 and 2010. How will this affect the skills base? How will they be replaced? Do they need to be replaced and what new skills will be needed? What does it mean for our schools and universities and our training providers?

As customers, all of these age groups have **different needs and expectations for food** in terms of quality, quantity, packaging, accessibility and value for money and it is easy to see “life stage foods” being developed which are nutritionally engineered to tackle specific dietary requirements and meet the individual needs of various groups.

The UK has **25 million households** (540,000 in Northern Ireland). Twenty five per cent of these households have a single occupant and 50% have one or two persons in the household. How will this affect food consumption in the future?

Food is a basic necessity of life, but it is also a fashion industry and can be faddish and fickle. Modern food businesses need to be aware of this and have a degree of flexibility to meet consumer needs.

Since the main market for food in the United Kingdom is static there is no demand-led growth and **opportunities may exist only for niche products.**

**Customers attitudes are changing** – they want better quality, more freshness, more convenience, more service, new tastes, textures and variety. There is more technology in the kitchens, with over 70% of households having microwaves and 90% having freezers. However, there are some UK homes now being constructed without kitchens. Our living rooms have DVD, digital television, videos and PCs, all of which affect eating habits - but at the same time, we have at least one generation without real cooking skills. Unlike previous generations, home economics is not being taught as a key/core subject in schools and there is little interaction between parents and children in the kitchen.]

Meals that once took two and a half hours to prepare in the 1960's took a half hour in the 1990's and now take only 15 minutes.

There is an increased demand to **free up time**, to provide food without preparation. People/consumers all have the same amount of time but now have more things to do with it and this has led to less formal meals, **more convenience** and demand for access to food all day.

Consumers can be defined as either **cash rich and time poor** or cash poor and time rich and this affects the food they buy and of course makes **convenience a key issue**. Individuals have become more important with an “I need, I want “ mentality and with people expressing themselves through the food they eat. There is a **lifestyle association** with food and examples of this are organic, sports drinks or premium wines.

All of these issues, therefore, **affect the way people think about their food and therefore what they buy!**

Industry needs to respond to these trends.

It also needs to recognise that a significant number of people have **genuine concerns** about the food they eat. First, and perhaps most importantly, they expect the food that they buy and feed to their family, no matter what its source, to be **safe** to consume! We have to accept that the average consumer does not read scientific journals but reads the popular press and the industry has suffered from adverse public reaction to ill-informed coverage of crises, whether it is about our production methods or new technology or health.

Consumers do not know which **information they can trust** and they are inclined to listen to the volume of debate rather than the content. What can we do to ensure responsible reporting?

Consumers are also **concerned about their personal health**. This is now a £600 million business in the United Kingdom. Apparently, 59% of males and 60% of females in the United Kingdom think that they are overweight. In the past, creating healthy foods meant taking the “bad things” out (fat, sugar, salt). Now, it means **putting "good things" in** (probiotics, folates, minerals), introducing **stress reducing** foods instead of calorie reducing and **wellness** as replacement for thinness.

Within the next decade, it is predicted that 1 in 5 people in the United Kingdom will be vegetarian. Some 7% of the population are currently non-meat eaters. In the past, these typically would have been 15 to 25 year old females, but that is now changing.

Opportunities exist for cross departmental initiatives [e.g. between DARD and DHSSPS] to develop joint programmes aimed at improving the health of the population through diet and **functional foods**.

### **Technology**

Technological changes are also happening at an unprecedented rate. There are emerging technologies which relate as much to engineering the product as they do to the process – GMO, infrared, high pressure, deep chilling, electric current, post packaging pasteurisation.

**Digital technologies** are enabling new things to be done, with knowledge based methods replacing brawn and enabling businesses, for example, to trace the parentage of animals, track the movement of produce from seed planting to consumer or monitoring the position of

delivery vehicles in transit - giving the exact location and real time temperature information on product being carried, with its estimated time of arrival at the end user.

Process control automation, robotics and data mining will become important measures in **cost reduction** programmes for competitive businesses and '**Just In Time**' technology is now an integral part of logistics and distribution systems. Etrading and e-business will become an essential development for businesses in future.

A revolution in ICT, the increased pace of technological development, globalisation and changes in consumer demand have altered how businesses must operate. Whilst keeping costs down is vital, businesses also need better design, new products, improved processes, better organisation and management systems.

They may only survive in future if they can **differentiate themselves** and to do that they need the knowledge and skills and competencies **at all levels** within the business. They need to know about current **best practice** and match or indeed better it.

Two thirds of the world's advances in science and technology take place outside the EU and the EU has less than 5 scientists and engineers per 1,000 of the population. In the USA, this figure is 75 and in Japan 80. This speaks for itself.

**Innovation** is not a new concept. It is, however, the key factor in stimulating economic development - **an engine for growth**. However, we do not do enough in Northern Ireland, with only 0.6% of GDP spent on R&D. We must become more receptive to exploiting ideas and **investing more in our people and our processes, developing a vision of a global workplace** and recognising that competition exists and that we must deal with it.

To do so, we may have to consider **partnerships and alliances** and co-operation to tackle new markets. Better networking, better trust and more customers may help us succeed in developing this **outward vision**.