

indicate the same for 2006. A budget for a 600 hectare English loam farm with a below average cost of production, indicates that SP and Entry Level payments will make up 148% of business profit. The business remains viable with cash flow and equity improving given modest drawings and provision for tax. So, should this business continue to crop for the 2006 harvest?

For the vast majority of cropping businesses, planting should continue as long as at expected yields and prices the crop at least covers the direct costs of production (sprays, fertilisers and seeds) and the overheads that do not disappear by stopping production. These will include machinery depreciation, employed labour, rent and many of the property and administration costs. It is also important not to forget that there will be a cost of cross-complying on idled land.

Some businesses may consider stopping all cropping production, and then of course machinery can be sold and staff laid off, but even then many property and administration costs and rent (unless land is given up) will remain. Then it becomes a matter of how resources of land, farmers' time and capital can be redeployed to make a profit before the SP. This may include non-farming options such as diversifications and agri-environmental schemes.

Combinable crop farmers have a few years to find ways of farming profitably without subsidy. Even then it may be sensible to continue an element of cross-financing. To some extent the SP is compensation for the high costs of production the EU imposes on its farmers by regulation, and it is also a payment for providing environmental public goods. However, there is little doubt that at current crop prices the race is on for further advances in productivity to enable UK combinable crop farmers to compete on the global market in future years when there will be more limited direct and market support from the EU taxpayer.

#### CONCLUSION

Crop areas are unlikely to plummet in the UK in the near future. Generally strong balance sheets enable farmers to take a long view and allows time to adjust to the new economics of cropping. As individual businesses examine their usually unique set of circumstances over the next few years some radical restructuring will take place. Cropping land will be given up but will often be taken up

by a neighbour: some will be put into agri-environmental scheme use and some increase in fallowed land is likely. Andersons' consultants understand the policy issues, the market-place and profitable farming and are uniquely placed to assist all sectors of the industry in the process of restructuring; for contact details see below: -

*Work out **your** future Single Payments through to 2012. A FREE online calculator for all GB regions is available at*

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ARABLE BRIEF

## KEY ISSUES FOR THE ARABLE BUSINESS

*June 2005*

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## INTRODUCTION

The new era of decoupled farmer support is underway in the UK, and for 2005 crop areas appear to have held up well. As farmers come to terms with the new policy, will this change? At current crop prices, only a few can farm profitably without subsidy, but how long will the Single Payment (SP) last and at what levels? Crop prices will always be important – how might prices change in relation to world demand/supply and future WTO agreements? These are just some of the questions addressed in this brief.

## POLICY

The long gestation of the Mid-term Review has spawned different SP systems across Europe, indeed we have four in the UK alone, and there are still plenty of policy issues on the agenda: -

- Single Payment Management, Values and Trading
- Single Payment Deductions
- Future Rural Development Policy
- World Trade Organisation
- Sugar Beet Reform

UK farmers now have to adjust to farming with a SP. Firstly, they have to get used to managing the various types of entitlements – normal / set-aside / authorised. Entitlements are a form of bond with an annual ‘yield’. Capital values will clearly relate to this yield. Farmers will need to ensure they fully comply with the conditions for payment every year to unlock the value of their entitlements.

The initial yield of normal entitlements will vary from farm to farm across the UK, but in England will converge to an equal flat rate by 2012. In Scotland and Wales yields will continue to vary between farms until a political decision is made to change the system. How long will it be before it is politically unacceptable to pay farmers support on the basis of their 2000 - 2002 cropping and stocking?

All types of SP entitlements will be tradable and the different administrations are starting to consult about how trading should take place. For UK farmers not opting to take payment in Euros, a key variable in future yield will be the exchange rate. The date for fixing exchange rate will be the 30<sup>th</sup> September in the calendar year in question. Therefore, for the 2005 SP, the exchange rate will be determined by the rate on 30<sup>th</sup> September 2005.

Once initial National Reserve and National Ceiling deductions have been sorted out, future SP deductions will depend on levels of Modulation and Financial Discipline. Modulation rates are known in the UK until 2006 and are then dependent on EU budget and Rural Development discussions currently on-going in Brussels. The present state of knowledge is:

Modulation	EU	National		
		England	Scotland	Wales
2005	3%	2%	3.5%	1.5%
2006	4%	6%	4.5%	0.5%
2007 onwards	5%	?	?	?

Financial Discipline does not start until 2007. With Romania and Bulgaria joining in 2008, there may well be the need for a 10% deduction from all SPs to finance their CAP cost. With the likelihood of other Balkan countries joining and other budgetary changes a further 10% cut is conceivable. This means farmers could have over 30% deductions from initial gross levels, which in real terms, allowing for 2.5% inflation, means that SPs could more than halve by 2012. Thus an English combinable crop farmer receiving an AAPS payment in 2004 of £240 per hectare might find it has declined in real terms to £115 per hectare by 2012.

Modulation monies will be recycled into Entry Level and other agri-environmental schemes. Overall levels of Rural Development funding will depend on current Brussels negotiations on the EU budget and distribution of funds. It is fairly certain that the next reform will further reduce the SP with on-going support more likely to come from the Rural Development budget.

On top of all this uncertainty, EU underlying market support for cereals is likely to be further weakened when the WTO Doha round reaches conclusion, likely to be a few years off yet. The EU has already made a commitment to end export subsidies (although no date has been set) and there are bound to be reductions in import tariffs and other controls to allow greater market access. The impact on EU prices will depend on world demand/supply at the time but under current conditions there could be a further weakening of price.

All these policy issues mean that UK arable farmers must use the next few years, when they will continue to receive

relatively high levels of support, to find ways of farming profitably without subsidies. In the medium to long term the ability to cross-finance the farming operation from support is likely to disappear.

## MANAGING CROP PRICES

The immediate outlook for the 2005 and 2006 cereal harvests is not exciting. Given expected yields, there are adequate crop areas around the world to keep production and usage roughly in balance. Large forecast crops, both in the UK and the EU are coupled with high intervention stocks from 2004, to be sold back into the domestic market. This means that even the drought in Spain is unlikely to boost UK export values considerably. Neither oilseeds nor protein markets differ from the current cereal position and so, in the absence of a crop disaster in a key production region of the world, it looks like all combinable crops will see a relatively tight price range. This is disconcerting to the farmer businessman, who is increasingly being told that the market must become of greater importance as direct support is reduced. But there are plenty of things farmers can do to improve price or protect future price from the risk of volatility.

Whilst prices cannot be correctly forecast with certainty, the fundamentals pushing them in either direction should be monitored and understood. Farmers should use this information to become active in setting their prices rather than being merely price takers: in other words to sell grain when they think it is at its best, or when they can at least take a profit, rather than when they have to for cash flow reasons or to clear the store for the next crop. Fixed and minimum price contracts are available for the coming crop and beyond, maybe not providing the highest price, but securing a profit so long as yield and costs are within budget.

In order to improve prices further, integration into the food supply chain must continue. Not long ago most farmers just grew for the open market and were price-takers. Now more produce to a contract and some produce to pre-defined production protocols agreed with the processor to meet consumer demand. This adds value to every stage of the supply chain.

## PROFITABILITY

The majority of combinable crop farmers look like making a loss before the SP from the 2005 harvest. Budgets