FROM THE PRESIDENT: MEURIG RAYMOND

Rt Hon George Osborne MP
Chancellor of the Exchequer
HM Treasury
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Your ref:
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Date: 23 October 2014

Dear Chancellor,

Autumn Statement 2014

In recent years, British farming has been delivering for the nation's economy and has been one of the few success stories during a period of bleak economic news. UK agriculture's contribution to the economy grew by 34 per cent in the 5 years to 2013. At the same time, farm output has grown by 31 per cent to over £25.7billion. Although faced with some short term challenges due to market volatility, the long term outlook for agriculture is positive. Therefore, I would like to ask you to consider how, in your final Autumn Statement of this Parliament, you might empower the UK agricultural industry further, to realise our growth potential by sending the right business signals to farmers across the UK.

In our submission we will outline five critical areas to promote investment and prioritise and deliver returns on government spending in relation to the agricultural industry:

- Taxation tools to improve farm business management of volatility
- The introduction of an infrastructure investment allowance
- Retain an appropriate and consistent level for the Annual Investment Allowance (AIA)
- Government spending on broadband, flooding, and animal health and welfare
- The Agri-Tech Strategy and encouraging knowledge exchange

Earlier in this parliament you recognised the long term need to rebalance the economy in favour of manufacturing. You will already know that the food industry is our largest manufacturing sector and that UK farming acts as its bedrock through its provision of raw materials. Therefore, I hope you will take the opportunity in your Autumn Statement to set out your strategy for achieving this over the course of the next parliament. For the agricultural industry this will mean a commitment to a more joined up approach of working across government departments, and with industry, to identify and understand where barriers to greater success exist and consider how best to overcome them.

High levels of volatility currently characterise global commodity markets. For farmers, weather further exaggerates the prevailing uncertainty. I believe that we can adapt to this volatility, find ways of becoming less reliant on CAP support, and reduce our trade deficit in the process. However, this first needs the right policy and fiscal environment across government which encourages us to increase efficiency, develop and embrace technological advances, and take a long term balanced view to investment.

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The wider policy challenges facing our industry are considered in more detail in the enclosed NFU manifesto. These challenges cut across a wide range of government departments, which I am sure you will appreciate from having met farmers in your constituency. However, H M Treasury in particular can help the industry to shape a better long term future by creating the right conditions for farmers to invest at a consistent level, take advantage of technological advances to improve their businesses, and continue to produce food to the highest standards. Therefore, I would ask you to address the barriers to these outcomes.

Specifically the UK system of capital allowances is no longer in line with other G7 economies. By bringing it back in to line the Government would significantly boost much needed investment and create a more balanced long term approach. This is essential if UK primary producers are to compete in global markets. Encouraging investment right across the food and drink supply chain would create a pull through effect and encourage investment in new modern, efficient farm buildings and structures. This could include structures such as farm reservoirs, which after many years of low returns and underinvestment within the agricultural industry are much needed and would help manage uncertainties in water availability caused by changes in weather patterns or the abstraction regime.

We are already seeing farm businesses in other parts of the EU and further afield being encouraged to invest by capital allowances regimes which provide tax relief for both infrastructure and equipment. For example, in Ireland the Government has identified significant development opportunities to expand they dairy sector with the abolition of milk quota. This will be aided by the fact that Ireland has a capital allowances system which relieves the cost of equipment over eight years and farm buildings over seven years. In addition, the Irish Government commissioned a report from Indecon which confirmed that there is "a positive cost benefit analysis on Capital Allowances in the agriculture sector" and their econometric analysis concludes that there is a positive relationship between investment and output. It states 'Indecon's judgement is that it is likely that the capital allowances on plant and equipment and on farm buildings result in a higher level of investment in the sector than would be economically justified if farmers were not in a position to have any tax allowance for investment in the sector".

Recommendation 1 -Taxation tools to improve farm business management of volatility

As I mentioned earlier in this letter, farming will always suffer from volatility and farmers will need to become more resilient to this by finding ways to manage the effects. However, building a cash reserve out of net profits is extremely difficult, particularly for unincorporated businesses. Therefore, I would like to make a further suggestion over how the Government could encourage farmers to better manage the effects of volatility of prices, costs and the weather. Farmers' ability to manage the volatility in their businesses has been reduced as we have started to see more frequent severe and prolonged adverse weather conditions, such as the flooding in the Somerset Levels where land was flooded for many months. The impact is often severe and prevents businesses from returning to their previous productive capacity for a number of years.

The NFU is seeking new measures to enable farmers to retain profits in good years to meet the demands of bad years, such as when adverse weather conditions or market volatility affects their profitability for a prolonged period. These measures could follow the lead of countries such as Australia which allow a limited amount of farming profits in a good year to be placed on a designated bank account and deducted from farming profits. The profits are then taxed when the monies are withdrawn to meet the farmer's business needs in poorer years. There are normally certain restrictions within schemes like this. For example, there are limits in the amounts that can be invested in Australia, whilst in France there are restrictions on the use of the funds.

A further option, which specifically addresses the longer term impact of severe weather conditions, would be an extension of profit averaging for farming profits. For example, whilst the UK does allow farmers to average profits over a two year period, competitor countries allow longer periods of profit averaging. In recent weeks the Irish Government have extended the period of profit averaging from three to five years.

Recommendation 2 – Retain an appropriate and consistent level for the Annual Investment Allowance (AIA)

As part of the need to ensure UK businesses continue to invest in replacing equipment and embracing new developments, it is essential that the Annual Investment Allowance is not allowed to return to a level of just £25,000 in 2016. This would result in capital intensive businesses having to reduce cyclical expenditure rather than investing more to match their competitors in other countries.

The NFU welcomed the initial increase in the level of the AIA in autumn statement 2012 to £250,000 and its subsequent boost to £500,000. However, the transitory nature of this increase limits its usefulness. A great deal of capital expenditure is cyclical; the temporary nature and complex transitional rules when the level of the AIA changes makes it virtually impossible for businesses to plan expenditure. For agriculture the temporary increase could not have come at a worse time as farm businesses have been experiencing significant financial pressures during this two year temporary period. Crisis in the dairy sector and extremely poor crop conditions characterised 2012, as well as impacting business performance into 2013. Similarly, the media has captured the devastating impacts of flooding on some farm businesses so far this year, and more recently, the slump in commodity prices has shaped investment decisions.

Agriculture is a capital hungry sector and although we use specialist machinery, it has a limited lifespan. A permanent AIA level of £250,000 would encourage SMEs to increase their levels of investment in specialist plant and machinery and be able to plan investment cycles ensuring that UK farmers take advantage of technological developments and remain as efficient as their counterparts in other countries.

Recommendation 3 – The introduction of an infrastructure investment allowance

Most G20 countries support business capital infrastructure investment by providing some form of tax allowance. The lack of these allowances in the UK is creating a barrier to investment for many farm businesses because of the high marginal rates of tax suffered. The combination of abolished capital allowances and disparity between income tax and corporate tax rates, makes infrastructure investment by an unincorporated business prohibitively expensive compared with alternative forms of investment. Whilst characteristic of farming, this would also be relevant to a large proportion of SMEs and Microbusinesses where corporations are not the typical business structure.

The UK Government should introduce an infrastructure allowance, which would deliver relief over a maximum period of 25 years. This would send the right signal to businesses that the Government wants to encourage them to invest in their businesses and grow, whilst delivering the relief in an affordable manner for the Government. This relief would also stimulate investment which remains in the UK and benefits the wider economy. Stimulating investment in productive capacity would create the conditions needed for reducing our reliance on imports and facilitate export opportunities, whilst benefiting our domestic food manufacturing and distribution sectors. In a wider context it could stimulate further investment in manufacturing which in turn could assist with a rebalancing of the economy in favour of manufacturing.

A less attractive, but nevertheless valid approach used in countries such as France and the Netherlands, would be to allow depreciation costs for buildings used in all forms of primary production. Where the value of the building appreciates no allowance would be given but where it depreciates over time this real business cost would be recognised.

Recommendation 4 – Government spending and agriculture

We have very real concerns over the impact of both current and future spending cuts on rural areas. Many national infrastructure projects have impacts on rural areas, but two that have a direct impact on the success of British farmers include broadband and flood protection. The shifting targets for rural broadband coverage and the growing gap between connectivity in urban and rural areas continues to frustrate farmers, particularly given the Government's shift to Digital by Default.

We are currently concerned about the level and criteria of funding for flood defences, and the impact of spending cuts on government agencies dealing with animal health and welfare costs. We therefore set out two recommendations in relation to these areas which we hope you will consider within your spending plans for the term of the next Parliament:

- Devastating floods have hit the UK in recent years, most recently last winter. As the Environment Agency's next Long-Term Investment Strategy is finalised, we urge the Government to better defend UK farmland and rural communities by investing sufficiently in the maintenance of watercourses and existing defences. We urge the Government to identify those areas with the highest chance of flooding and commit to increasing investment over time this must include greater flexibility for the Environment Agency to transfer funding between capital and revenue maintenance budgets as the latter are often cut to meet wider revenue needs. The starting point for greater investment must be for the Government to close the £500 million shortfall[1] between current spending and the need forecast by the Environment Agency in its Long Term Investment Strategy of 2009[2].

- Farmland and rural communities are simply too valuable to be sacrificed as the lowest priority in managing the nation's floods. We need the Government to revisit how they value the benefit derived from agricultural land when assessing flood management works. This valuation needs to properly take account of agriculture's contribution to the economy as part of the UK food chain, including such factors as food processing, import substitution and employment. The Government also needs to increase the national payment rates for flood risk management partnership funding per unit of benefit to agriculture.

[1] Adaptation Sub-Committee, Climate Change Committee (2014a). Policy note: flood and coastal erosion risk management spending.

[2] Environment Agency (2009). Investing for the future. Flood and coastal risk management in England – a long-term investment strategy.

The NFU does not accept the premise for mandatory cost recovery in relation to animal health and welfare. Therefore we are increasingly concerned that some government agencies, having already made efforts to rationalise operations and meet departmental budget cuts, are now imposing mandatory cost recovery on farmers and planning to expand this. We feel that justifying any cost recovery on the basis of the Official Feed and Food Controls (the OFFC) is premature. The OFFC represents a major EU regulatory review which is being developed through a Co-Decision procedure under the Amsterdam Treaty. Its aim is to harmonise regulations relating to animal health, plant health, plant reproductive materials, official controls and other official activities, under single budgetary and regulatory frameworks. As we are nowhere near the final adoption of the OFFC, indeed negotiations have not even begun and many are in favour of exempting primary producers, continuing to impose this on UK primary producers puts us at a disadvantage against European counterparts. This could result in national legislative frameworks and administrative burdens being placed on a sector which, in 18-24 months' time, could contravene European policy.

Recommendation 5 – The Agri-Tech Strategy and encouraging knowledge exchange

The Government recognises the importance of encouraging research and development and has recently made improvements to R&D tax credits. However within the agriculture and horticulture industry there is also a need for more effective knowledge exchange and translation of science into commercial practice. This should be addressed by the Government's Agri-Tech Strategy, but barriers remain. Government must take responsibility for maintaining robust UK capacity for research to support the productive potential of UK farming, and to enable Defra to fund high quality research on which to base all its policies.

Yours sincerely,

Meurig

Meurig Raymond MBE, FRAgS
President