Brexit Briefing Paper 1

Scottish red meat trade - challenges and opportunities resulting from Brexit

INTRODUCTION

The rearing of cattle, sheep and pigs for meat production is at the heart of Scottish farming; collectively delivering 40% of total Scottish farm output.

Beef production alone makes up some 27% of total farm output, making it the single most important enterprise in Scottish farming. While the majority of the animals produced in Scotland are used by Scottish abattoirs, meat production is centred on the slaughter of prime livestock with limited interest in the slaughtering of cull or mature livestock.

This results in significant export of cows, sows and ewes to the rest of the UK for slaughter. There is also significant trade in prime sheep and pigs to the rest of the UK.

Scottish abattoirs produce around 170,000 tonnes of beef, 26,500 tonnes of sheep meat and 25,000 tonnes of pig meat annually. The volume of meat produced by Scottish abattoirs is well in excess of domestic demand for beef and sheep meat, resulting in significant trade with the rest of the UK and internationally.

Typically, only around 23% of Scottish abattoir annual turnover is derived from meat sales to customers within Scotland. Two-thirds of the turnover comes from sales to customers in the rest of the UK and 10% of turnover, some £75m per annum, comes from international sales.

International trade is particularly important in the case of Scottish sheep meat abattoirs which generate more than 25% of turnover from sales outside the UK; only minimal quantities of pig meat are exported outwith the UK by Scottish abattoirs.

Trade in livestock and meat to destinations outside Scotland is fundamental to the long-term sustainability of the Scottish red meat industry. Consequently, changes to the terms of trade associated with Brexit discussions will have considerable impact on the sustainability of the Scottish red meat supply chain.

In this context three themes have to be addressed:

- Access to the European Union market
- Access to non-EU markets
- Management of imports.

ACCESS TO THE EUROPEAN UNION MARKET

Industry surveys by QMS show that over the past three years, on average, more than 95% of Scotland's international trade is with members of the European Union particularly France, Italy and the Benelux region but also with Germany and some Nordic countries.

Equally, because of the importance of the rest of the UK market both for meat and live animals, the trade relationships of the whole of the UK also impact on Scotland's livestock and meat sector.

Over the past three years on average 15% of UK beef production, 36% of sheep meat production and 25% of pig meat is exported. The European Union dominates this international trade with, over the past three years, on average 94% of the UK's beef exports, 88% of sheep meat exports and three quarters of the fresh and frozen pig meat exports going to the EU.

Current trade rules covering trade with the European Union

As a member of the European Union a member state has unrestricted free access to the whole of the European Union market. Any non-EU country that does not have preferential access to the EU market through, for example, tariff rate quotas faces punitive tariffs.

In broad terms and based on the average export price of UK exports to the EU in the opening eight months of 2016, if Scotland did not have free access to the European Union exporters would face the following tariff rates on exports of whole carcases:

- 92% on a beef carcase
- 45% on a lamb carcase
- 53% for a pig carcase

However, increasingly exports are of cuts of meat and not carcases and tariff rates vary between cuts and whether the product is fresh or frozen.

There are, for example, 14 tariff lines for prime cuts and carcases of beef; they all face a fixed tariff of 12.8% of the price but, in addition, they all have a fixed tariff applied ranging (at current exchange rates) from £1.20 per kg product weight to £2.57 per kg.

In broad terms these differences can result in effective tariff rates on beef ranging from less than 70% to more than 100%. Similarly, the effective tariff rate on boneless sheep meat is around 63% while bone-in sheep meat cuts face a lower effective tariff rate of 45%.

Equally frozen pork cuts have a much lower effective tariff rate than fresh pork. There are also an equally diverse range of tariffs on meat -based products like sausages, cured meats and offals.

Tariff rate quotas offer limited access to the EU market at zero or reduced tariff for particular countries or particular classes of meat. There are over 30 tariff rate quota schemes covering beef, sheep meat and pig meat available to EU importers.

However, not all are useable because other trade rules, see below, may prevent the quota from being used.

The most significant of these arrangements are zero tariff rate quotas for sheep meat and reduced tariff rate quotas on some beef imports; the best known of which are the high quality beef quota often referred to as the "Hilton quota" and the hormone-free, grain fed scheme.

Historically, these EU quota schemes have been reviewed and in some cases adjusted when new member states have joined the EU to reflect existing trading patterns with "new" member states.

It remains to be seen how the European Commission will review and adjust tariff rate quotas when a member state leaves the European Union.

The Brexit challenge

Losing duty free access to the European Union market would result in significant market destabilisation.

The extreme position would be one where Scotland and the UK traded with the European Union as a non-member state and face the punitive tariff rates described above and the likelihood of significant reduction in export volumes unless there was significant price correction.

While an agreed tariff rate quota would offer potential access at preferential terms they may not be tariff free and it would make it difficult, if not impossible, to grow exports to the EU beyond the limits of the quota.

ACCESS TO NON-EU MARKETS

In its most recent review of the Agricultural Market the OECD[1] concluded that demand for meat would grow relatively strongly through to 2025 but that most of that growth would occur in Asia, Latin America and the Middle East.

For Scotland to benefit from this opportunity clearly requires access to non-EU markets. As a member of the European Union, Scotland and the UK benefits from trade agreements negotiated by the European Commission in respect of tariff rate quotas and phytosanitary rules.

However, there are many developing countries that are identified by the OECD as growth markets for which the EU does not have trade agreements in place.

Equally there are a number of more developed markets who are significant importers of red meat for example, the USA, China, Japan and Russia where the EU do not currently have trade agreements. Nevertheless, there are a number of markets where the UK has an export licence for some or all red meats but where trade is limited for other reasons including phytosanitary requirements or the general level of tariff applied by the importing country making the product uncompetitive.

For example, Canada has an out of quota tariff of 26.5% on beef but under the Canadian-EU trade agreement (CETA) – where discussions began in 2009 with final ratification expected shortly - would reduce this tariff to 0%.

The Brexit challenge

Leaving the European Union would open up the opportunity for the UK to negotiate its own terms of trade with target markets resulting in the potential to increase existing access or gain access to markets currently closed to the UK and Scotland.

However, the time taken and resources required to reach agreement should not be underestimated, neither should the time and resource required to build a market in those countries where the UK currently has no trade or limited trade.

[1] OECD/FAO Agricultural market outlook 2016-2025 http://www.fao.org/3/a-i5778e.pdf

MANAGEMENT OF IMPORTS

Although Scotland is more than self-sufficient in beef and sheep meat production, the UK as a whole is not. If the UK did not export any beef, lamb or pork it would be broadly self-sufficient in sheep meat and only 80% self-sufficient in beef and 60% self-sufficient in pig meat.

In practice, though, exports are a key part of managing seasonal supply and demand for cuts and at current levels of exports, UK self-sufficiency rates fall to 66% for sheep meat, 70% for beef and 53% for pig meat. Consequently, imports of red meat into the UK play a significant part in the market place for Scottish red meat.

Ninety percent of beef imports come from the European Union with Ireland alone supplying around two-thirds of all the beef imports. Indeed, Bord Bia report[2] that in 2015 the UK accounted for 57% of all Irish beef exports. Ninety-nine percent of pig meat imports come from the European Union. In contrast, only 10% of sheep meat imports come from the European Union, with Australia supplying 15% and New Zealand supplying around three-quarters.

Current trade rules covering imports

As a member of the European Union, EU member states have unrestricted access to the UK. Imports from non-EU member states are managed within the constraints of the EU trade rules described above. In respect to sheep meat imports to the UK, all of the non-EU trade is covered by EU preferential terms allowing duty free trade. Around half of New Zealand's EU quota and more than two-thirds of Australia's quota is delivered to the UK. Only small quantities of beef and pork enter the UK from outside the EU under full tariff paid conditions.

The Brexit challenge

Leaving the EU gives the UK greater control over its import policy and the opportunity to negotiate bilateral terms of trade with individual countries or trading blocks. These negotiations will inevitably take time but will create opportunities to manage imports if desired.

Until such time as agreements are reached, UK imports post- Brexit would be ruled by WTO terms. The UK's current WTO terms are those of the EU and these are generally considered to be what would apply in a Brexit situation[3]. In practice this would mean all imports would initially face the tariffs currently applied by the EU to non-member states as described earlier in this paper. Under this scenario, and until such time as alternative arrangements were agreed, wholesale prices for imported red meats would be considerably higher.

QMS
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[2] Export performance and prospects 2015-2016
http://www.bordbia.ie/industry/manufacturers/insight/publications/MarketReviews/Documents/Export-Performance-and-Prospects-2016.pdf

[3] The UK is currently a member of WTO through its membership of the EU, there remains doubts as to how easily the UK would regain membership of the WTO when it leaves the EU
https://www.instituteforgovernment.org.uk/brexit-explained/brexit-explained-10-things-know-about-world-trade-organization-wto