**Submission from Department of Finance to Department**

**of Agriculture, Food and the Marine**

**Public Consultation on 2025 Agri-Food Strategy**

**Introduction**

Agri-Food Strategy 2025 provides an important opportunity to take stock and consider how the industry should develop over the next ten years in the context of a changing global market with significant emphasis on environmentally sustainable production. The Department of Finance welcomes the opportunity to provide its views on some key issues that should be taken into account in the formulation of the Agri-Food Strategy 2025. This is particularly opportune in light of the Department’s recent joint work with the Department of Agriculture on the Agri-Taxation Review.

We have reviewed the background documents provided and considered the issues posed in the questionnaire. Given the Department of Finance’s broad economic policy role, this submission focuses on broader, “macro” aspects at the level of the themes under which the questionnaire is structured.

**Overview**

Before addressing the questionnaire themes, there are a number of general considerations that the Department feels should be borne in mind in the development of the strategy.

* The agri-food sector is recognised in the *Medium-Term Economic Strategy* (MTES) as an area where Ireland has particular strengths and as an important indigenous industry which can be a contributor to export-led recovery. The proposed agri-food strategy falls under the third pillar of MTES (“supporting employment and living standards”). It is an important sector which provides employment in all parts of the country.
* In general, sectoral strategies of the type represented by the Agri-Food Strategy are important for future planning purposes. To be effective, it is important to ensure consistency with overall national economic policy and the fiscal and other constraints imposed by our EU obligations.
* National economic policy focuses, as appropriate, on framework conditions, i.e., the horizontal conditions that facilitate the development of all sectors of the economy. These include: a stable macroeconomic policy environment; openness to flows of goods, services, capital and knowledge; a flexible labour market, appropriate levels of competition and regulation; a well-functioning financial system; and high quality infrastructure and education systems.
* The appropriate role for sectoral strategies - such as that proposed for the agri-food sector - is on identifying and addressing market failures or distortions that could impede the development or growth of the sector in question. They can also highlight possible complementarities or synergies with other government policy areas or sectoral strategies. In seeking to boost the contribution of a sector, care should be taken to ensure that this is not to the detriment of other sectors of the economy.
* It is vitally important that these strategies are based on rigorous analysis and a clear diagnosis of barriers or other factors that may be preventing a sector from realising its potential.
* Sectoral strategies should avoid “second-best” solutions and aim to directly address the market failures or distortions in question. We welcome the 2025 Agri-Food Strategy Committee’s intention that the report will be “short and specific”, as this should help avoid the creation of “wish lists” in the form of non-specific recommendations or options for which cost estimates have not been established.
* Targets for the agri-food sector’s performance should be set using appropriate metrics such as gross value added and, where relevant, by reference to NACE codes. This will ensure accurate assessment of the sector’s performance over time and with other countries.
* Regarding proposals for Government intervention or new initiatives it is important that consideration is given to the duration of such interventions and how they are to be phased out and preference should be given to once-off reforms to the structure of the market which do not require ongoing exchequer spending. Further, the concepts of market failure, deadweight, displacement and opportunity cost should be to the fore in the consideration of supports.
* Finally, given the envisaged horizon of the strategy out to 2025, it should be designed in a flexible way that allows refinement or adaptation in response to unforeseen developments (positive or negative).

**Food Harvest 2020**

**Benchmarking agri-food sector’s performance**

In order to correctly assess the agri-food sector’s performance over time and against other countries it is necessary that appropriate metrics are used. The points made here are relevant for setting targets for the Agri-Food Strategy 2025 but also for assessing the performance of Food Harvest 2020.

Targets for the new Agri-Food Strategy 2025 should focus more on gross value added (GVA) in the sector. The existing strategy makes reference to this but it should be given greater prominence. Some types of agri-food output have a very high import content and as such growth in exports is not evidence of success per se. GVA is a much better metric of the employment- and tax-intensity of the sector.

Greater focus should be put on productivity as measured by output per worker, particularly in the primary sector. NACE 01-03 agriculture accounts for about nearly 5% of total employment but only about 1.5% of GVA. This makes it one of the lowest-productivity sectors in the economy. In the long-run income growth can only be driven by productivity growth. It would be useful to benchmark Irish agricultural output per worker at market prices (not income per worker) against European norms and perhaps use some level of convergence as a target. To improve productivity it may be unrealistic to expect both growth in GVA and employment, particularly at NACE 01-03 level.

Since 2000, a large proportion of the increase in GVA in the processing sector has come from increased gross operating surplus (i.e. greater profitability). This holds in both absolute and relative terms. Compensation of employees is essentially flat over the period and down in real terms and as a share of GVA. It would be useful if some reference were made to the reasons for this large shift in the capital/labour ratio and to measured productivity. Is it improved mechanical processes or perhaps evidence of returns to multinational production which is very IP-intensive?

When assessing the export performance of the sector, consideration should be given to growth in global market share as target metric of success. It is reasonably easy to calculate, particularly for commodity-type exports by reference to the UN *Comtrade* database. It could then be broken down further into market share by export category and target market.

Finally, it would be useful if the targets were more clearly set by reference to NACE codes. It is often difficult to establish exactly what is included in the agri-food sector and what is not. The CSO have some new data on the components of GVA by NACE code.

**Sustainability/ Climate change**

It is clear the issues of climate change and sustainability are key challenges that must be addressed across all sectors of the economy. However, the agri-food sector is one where the need for adjustment is greater compared with other sectors. It is important that sustainability concerns are fully addressed and integrated into the strategy.

As discussed in the background paper on climate change and sustainability, greater pressures will continue to be placed on our natural resources as global population increases and food demands change into the foreseeable future. There is now a strong emphasis, both at the national and international level, to develop and adopt sustainable agricultural production systems that ensure resources are efficiently managed in order to achieve biodiversity, air and water quality targets.

Furthermore, the agri-food sectors face an important trade off as the envisaged expansion of the sector continues so too will the rise in associated pollutants which will place significant pressure on Ireland’s ability to meet its climate change policy targets. This point is raised on a number of occasions in the various documents provided. One specific example of note is in the background paper where reference is made to the EU Climate and Energy Package of 2008, and it is stated that the target set out *“is a very challenging target for Ireland especially as agriculture has the largest emissions profile in the non-ETS. A high share of the emissions come from agricultural livestock where there is limited availability of cost effective mitigation options”.*

Missed targets can result in the imposition of fines which might fall on the Exchequer. In line with the polluter pays principle, where appropriate, the costs associated with climate change should be internalised. In this context, the findings of the Environmental Analysis of the 2025 Agri-Food Strategy will be particularly relevant in ensuring that sustainability concerns are fully addressed and integrated into the strategy.

**Global market context including opportunities for FDI**

In terms of the major changes and challenges that are likely to emerge in the global market in the period up to 2025, it is expected that the continued integration of economies across the globe, driven by technological developments and trade liberalisation initiatives, will proceed. While this offers many economic opportunities in terms of greater access to new markets, labour and investment, it also brings with it challenges such as increased international competition and a greater threat of contagion and price volatility. To date, Ireland and indeed the agri-food sector has been particularly successful in adapting to globalisation. However, there is a need to continue to improve flexibility and enhance its capacity to adapt to future changes in the international environment.

***Farm configuration***

In the context of a longer term strategic examination of the sector, one of the key structural issues that the agri-food industry should address in order to be better placed to compete in the global market is farm size and fragmented holdings. It is evident from a number of the background documents that the viability of farms is an issue, and that the current configuration of farms acts as a serious obstacle to the realisation of economies of scale and scope. Inability to attain such economies limits producers’ ability to improve productivity and competitiveness.

***Export diversification***

Regarding agri-food industry’s engagement in the global market, there is significant merit in seeking to diversify exports both in terms of destinations and products from an economic stability perspective. This is especially relevant in the context of Ireland’s trade relationship with the UK, where for historical and geographical reasons, a large proportion of Irish goods and services are exported to.

Export diversification is possible to the extent that producers can increase productivity to overcome the higher entry costs associated with more distant markets. However, the scope for producers to enhance their productivity and production capacity and expand their destination market base will vary by enterprise and product and will depend on the relevant global value chains. Differences also likely to exist in the type of trade barriers faced by producers in the sector.

To address these barriers and improve export performance, there is a need to ensure an appropriate framework is in place to allow for engagement with producers so that evolving constraints are highlighted and tackled appropriately. In addition, greater innovation by producers should lead to higher productivity and support higher levels of exporting activity. As well as supporting export diversification, such a framework would place the agri-food sector in a better position to compete in the global market and provide producers with opportunities to enter more distant, rapidly growing economies over the next decade.

***Foreign direct investment***

International investment in our agri-food sector should be encouraged where benefits can accrue to the economy directly through capital formation and employment, and also indirectly through the transfer/spillovers of managerial and organisational knowledge from foreign firms to indigenous firms. Furthermore, the presence of foreign multinational companies increases the opportunities for indigenous firms to access both intra-sectoral and inter-sectoral supply chain networks. It is also important to point out that outward FDI by producers in the Agri Food sector has also had significant positive benefits for the Irish economy.

The development of strategic alliances with partners in rapidly growing markets provide additional channels through which indigenous firms can expand. Such an investment strategy should reduce the costs of accessing rapidly growing markets.

**Competitiveness and innovation**

In order to improve the competitiveness of the agri-food sector and increase its market share on the international food market, the industry will need to continue to improve productivity and reduce costs over the next ten years. Research, development and innovation can potentially play a role in increasing productivity through the introduction of new products and processes, organisational or marketing changes.

***Evaluation of public funding support***

Public funding of research, in particular primary research, is seen as an important contributor to research activity in Ireland. Such investment is justified on the basis that it supports research which is often characterised as a “public good”, whereby due to positive externalities, the private level of investment is less than what is considered socially optimal. However, it is important to point out that government intervention should be only be justified to address such market failures where the benefits exceed the direct and indirect costs of intervention. In the current economic environment of limited resources, there is a clear need to continue with the targeted prioritised approach to R&D funding as set out by the National Research Prioritisation Exercise. We welcome the focus on the need to translate research into quantifiable innovative output in order to ensure value for money. Furthermore, when considering future innovation supports, we advocate that such interventions are based on rigorous analysis using the approaches outlined in *Public Spending Code* (and, in the case of tax expenditures, those set out in the Department of Finance’s *Guidelines for Tax Expenditure Evaluation*[[1]](#footnote-1)).

***RD&I investment and collaboration***

Innovation occurs not only within the firm but also through collaboration with other suppliers, customers and educational/research institutions and also across international borders. However, as discussed in the background document on Research and Innovation, there is relatively low investment and collaborative involvement in research and innovation by firms/producers in the industry. A key challenge the agri-food industry faces is to tackle the barriers that deter private RD&I investment and collaboration. As the background document notes (page 15), the current funding mechanisms are fragmented and complex in nature. The question arises whether such a structure will best support greater involvement by private firms in industry in the future. Furthermore, it is noted on page 15 that “DAFM competitive programmes have engaged in joint funding of research to a limited extent in the past with EPA, MI & HRB and have found it to be administratively cumbersome”. Such administrative barriers and even the perception of their existence may also deter industry involvement with public funded partners and should be addressed.

It would appear appropriate to consider whether current schemes could be rationalised to reduce Exchequer costs supporting innovation.

The *National Expert Advisory Group on Agri-food Research and Innovation* appears to have been an important forum which facilitated greater involvement by industry in refining and prioritising the research agenda funded by the State. Forums of this nature are important in facilitating a better alignment of the public and private research interests and help encourage greater industry involvement and create opportunities for collaboration.

***Integration and coordination of complementing policies***

In the context of the strategic assessment of future direction of the agri-food industry, policy efforts to support innovation in the agri-food industry should not be pursued in isolation. The agri-food strategy should consider how to integrate and coordinate policies where clear complementarities exist. Such efforts will support policies aimed at increasing innovation activity in the agri-food industry.

***Absorptive capacity***

To maximise the returns to research and innovation in the agri-food sector, it is important that research findings are disseminated effectively. In this regard, based on the background document, it appears that many bodies including Teagasc and Enterprise Ireland have been particularly active. However, research has shown that knowledge spillovers are not automatic and are conditioned and enhanced by enterprises’ absorptive capacities. Therefore, it is important that such bodies continue to monitor and assess the speed and efficiency with which new knowledge is successfully adopted by producers and businesses. Where adoption rates of new technologies is low/slow, it is necessary for relevant bodies to have in place review mechanisms and methodologies that can identify and assess what deficiencies need to be tackled in order to improve absorptive capacity of new knowledge and technology.

**Risks**

***Greater price volatility***

With the continued international integration and unexpected geopolitical events, many sectors could be exposed to potentially greater price volatility.

A case in point is the dairy industry which will see the elimination of the milk quota system in 2015. The abolition of the quota system means producers will have to accept the going world market price which will be more volatile. The Exchequer should not be expected to support producers during periods of low prices. The development within the sector of appropriate price volatility absorption mechanisms will help support the sustainability of dairy production. Appropriate financial support mechanisms should be provided by the industry in conjunction with the financial sector. Regarding taxation support schemes that are used to address income volatility in other countries, the Teagasc document “Drivers and scenarios of land use change” provides an interesting comparison with New Zealand. On page 19 it notes that “On the taxation side, zero level capital gains tax and the agri deposit type scheme which operates to handle income volatility are two very important differences in taxation policy, which facilitate agricultural expansion.” However, in the course of the Review, it was concluded that an agri deposit type scheme on the lines of the New Zealand or Australian models was most likely not compatible with EU State Aid rules. Also, while Budget 2015 extended capital gains tax (CGT) relief to whole-farm restructuring, the issue of zero CGT for the farming sector would not be a policy option while it remained for all other sectors of the economy.

**Other issues**

***Taxation interventions***

From a longer term strategic perspective, the sector should consider the role of agri-tax measures and their effectiveness in addressing the market failures or distortions they are intended to address. We note the statement in the Department of Agriculture, Food and the Marine document on Farm incomes, farm structures and agri-taxation (page 15), that “the Review provides a strong evidence base for continued assistance to the primary sector through taxation measures”. However, the cost benefit analysis (pages 42-43 of the Review) concluded that the total economic cost of agri-tax measures amounted to €681m, while the benefits were of the order of €790, and that in aggregate the agri-tax reliefs have a small positive net economic benefit to the Irish economy. It is important not to overstate the findings of this analysis.

**Department of Finance**

**January, 2015**

1. The Department of Finance Guidelines for Tax Expenditure Evaluation Paper is available at http://www.budget.gov.ie/Budgets/2015/Documents/Tax\_Expenditures\_Oct14.pdf [↑](#footnote-ref-1)