

22 December 2006

Joe O'Reilly
Department of Agriculture and Rural Development
Policy and Economics
Room 810
Dundonald House
Upper Newtownards Road
BELFAST
BT4 3SB

Also by email: joe.o'reilly@dardni.gov.uk

Dear Joe

Consultation on Proposed Changes to Farm Income Statistical Indicators

Thank you for your correspondence of 7 November 2006 and for the opportunity to comment on your proposals for change to farm income statistical indicators. We do indeed believe that it is opportune in the wake of the decoupling of subsidies to have a fundamental review of the performance indicators that are published in respect of farming in general and also in respect of different farm enterprises. As we are now in a market-driven agri-food environment, we believe that it is critical that we move towards identifying, with appropriate indicators, the performance arising from the various markets which are served by farming businesses. We applaud, therefore, the initiative to review indicators, but would propose more fundamental change than you have suggested at this time.

In dealing with this issue, we feel it appropriate to highlight that there are a range of different audiences for the indicators published. These include the following:

Government

It is appropriate that Government has an understanding of performance within the farming industry and in particular of the performance of production agriculture. National and regional policy formulation frequently depends upon having a good understanding by policy makers of areas in which they are not intimately involved, and we must ensure that the indicators are meaningful in this context. It is disappointing to note the frequent misrepresentation by Government officials of the performance of agricultural production based on existing indicators.

We are of course further aware that Government must contribute also to EU information gathering in this area.

Public

There is of course a considerable interest from the public at large in regard to the performance of those that produce their food, and the merits of whether the public are supportive of local production will frequently be influenced by the public perception of the fairness and appropriateness of return to our farmers. The public interest in the use of taxation funds is of course also relevant and needs to be satisfied through channels appropriate to this need.

Food Processing Businesses

Food processors of course have an interest in understanding the sustainability of their supply base from farms throughout the country. In most instances, processors recognise that they are fundamentally dependent on their supply base, and when that supply base is in jeopardy due to a lack of adequate returns, they will understand the necessity for them to respond to support that supply base as far as it is possible for them to do.

Farmers

Farmers themselves are a critical audience for agricultural production performance indicators. There is a massive diversity in the scale and sophistication of farm businesses. The majority of farmers, we believe, do not have a good understanding of their own business performance and rely on the publication of broad industry performance indicators, both to understand whether they themselves can improve their agricultural business performance, but also to understand when it is simply not possible for them to continue with a fundamentally unprofitable enterprise.

Retailers

The major multiple retailers in particular are fairly sophisticated in their business planning and need to understand the dynamics of their food supply chain including the sustainability of those chains of supply.

The role of performance indicators – the issues

We believe that there are two issues to resolve:

- (i) The correct use of the word “profit” and prevention of its misuse.
- (ii) The separation of income from production agriculture from other income streams, and the appropriate headlining of that component.

It is the view of LMC that indicators of performance must provide as much transparency as possible of the real performance, not only of farm businesses but also of the significant enterprises that make up that farm business (e.g. milk production, beef production, cereals production etc.). All of the above audiences will benefit from sight of clear and transparent indicators which properly deal with the totality of costs in indicating performance.

The issue of profit

When we examine indicators of “profit” that have been historically published, we believe that there are two areas that have not been satisfactorily reported upon. These two factors are indeed referred to in your consultation document – the treatment of the equity type capital (mainly land) and the treatment of family farm labour. As a general rule, in the reporting of business performance throughout the commercial world, the term “profit” is used to describe the reward for equity type capital. In the case of farm performance indicators, therefore, it might be deemed

to be appropriate to use the term “profit” as the reward for the capital that would constitute the basic equity in the farm business. What we cannot accept, however, is the use of the term “profit” to describe a business performance when a fundamental part of the cost has not been included. Examples of these excluded costs are the “unpaid” farm family labour, a rental cost of use for owner-occupied land equivalent to the actual cash outflow of rent paid by a tenant farmer, and a charge for interest on working capital that could have been gained had the investment been made in a secure financial market and not in livestock and animal feedstuffs.

There seems to us to be some confusion caused by either different representation of these costs or different interpretative definitions of them in the Aggregate Agricultural Account (AAA) showing Total Income From Farming (TIFF) (reference source: Statistical Review of Northern Ireland Agriculture 2005, DARD 2006), and Net Farm Income (NFI) at farm business level (reference source: Farm Incomes in Northern Ireland 2004/05, DARD 2006).

TIFF in the AAA is the Net Value Added minus Paid Labour, Interest (without definition assumed to be interest on borrowings), and Net Rent (defined as conacre payments to non-producing landowners). [Net Value Added is Gross Output – Gross Input – Consumption of Fixed Capital (depreciation?) + Subsidies not paid on products (e.g. SFP and LFACA)].

NFI is defined as Gross Margin less Fixed Costs including notional labour costs and a notional rent but excluding interest paid. Furthermore it is also stated that NFI represents the reward to the farmer and spouse for their manual labour, which is in contradiction to “notional” labour costs (i.e. own labour) being included in the fixed costs. There is also a difference between the components of the aggregate farm income figure and the farm business income figure, for which we suggest there should be reconciliation, as it is the different representations that cause confusion. We propose that aggregate should be what it says – the aggregate of all the individual farm businesses.

We fully recognise that part of the reason why the labour issue has not historically been well addressed is essentially because it is a difficult area. If the farmer, for example, has other sources of income, and in consequence does not draw any income from the farm business, it is difficult to impute a figure for his personal labour and management. On the other hand, in the case of a full-time farmer who is depending on his farming business to gain a livelihood for himself and his family, he should not be penalised by perceptions of farming businesses’ performance being portrayed falsely through the exclusion of the essential element of labour and management charges.

Likewise an owner occupier should not be portrayed as having a lower cost of production than his neighbouring tenant farmer simply because a charge for the use of his land has been excluded. It is of course also exceedingly difficult if we accept the principle of imputing costs, especially for labour, in order not to obscure the reality of profitability (defined as the reward for capital) of a farm business, how can we avoid the problem of dealing fairly with the imputation as between an efficient farmer and one who is grossly inefficient? This is indeed a conundrum. What is clear to us, however, is that we must ensure that all of the audiences previously defined do not draw conclusions on business performance within the agricultural industry that are patently wrong because Agriculture Departments cannot find a means of resolving this

conundrum. The implication of such a deception in the new market-driven, subsidy-decoupled era could be part of fulfilling the prophecy of the demise of sectors such as the beef and perhaps sheep industries.

We conclude that if you seek to use the term “farm business profit” as an indicator, this must be the reward for the equity capital of the business and by some means deal with the labour issue. If, however, you wish to proceed with the proposed indicator, an alternative descriptor needs to be found or net farm income is maintained with headline descriptions of its meaning. We would prefer the former.

The treatment of production agriculture and other income streams (e.g. diversification activities) in farm income

DARD produces annually an Aggregate **Agricultural** Account which tabulates the Total Income From **Farming** (TIFF). The Oxford English Dictionary defines a “farm” as “an area of land and its buildings used under one management for growing crops and rearing animals”. “Agriculture”, on the other hand, is defined from the same source as “the science or practice of cultivating the soil and rearing animals”. We are drawn to the conclusion, therefore, that the term “farming” should represent the broader defined activities including some diversification activities but only where these activities use and cannot be separated from farm resources. Examples of the latter may be activities such a pony trekking, cross compliance environmental measures etc. There are also non-farm related activities e.g. driving the school bus which should not under any circumstances be implicated in the derivation of indicators of farm performance. We believe that agricultural contracting should be regarded as a diversification activity and should not be associated with agricultural production since it does not relate to the production enterprise.

In dealing with this matter, we are keen to ensure that once again we have a transparent revelation of true agricultural performance again ensuring that capital and labour issues are faced up to. There is, however, one area where we would challenge your thinking and that is in regard to the single farm payment. We would suggest that in fact the single farm payment is a “landlord type activity” (reference paragraph 8.3 of your document). We rationalise to this conclusion on the basis that the majority of single farm payments throughout the UK are area-based payments which we believe are claimed for the most part by the landowner rather than the farmer. We believe that this is not a diversification, it is not a production enterprise and it is not attributable to “the entrepreneurial use of production resources ...” The receipt of a single farm payment can certainly not be described as entrepreneurial in nature and we believe that it should be excluded from any statement of income from production agriculture or individual enterprises within the farm business; likewise for other diversification activities. In this regard there needs to be clarification of the definitions of “production agriculture” and “farming”.

Of significant importance also in dealing with this subject is to ensure that as information is communicated, it needs to be made explicitly clear what conclusion should be drawn in regard to the “production agriculture” performance. This is particularly important in dealing with the non-farming, non-agricultural audience since their support for local agricultural production can be influenced by their understanding of the real profitability/sustainability of such production.

Furthermore we believe that consideration ought to be given as to how an appropriate allocation of total farm fixed costs could be made to production agriculture, agricultural contracting, agri-environment activity, single farm payment and non-agricultural diversification. We understand the pure economist who would argue that this is not possible, but to achieve a realistic understanding there are means of doing so, such as allocating the fixed costs in proportion to the turnover from the various activities.

Apart from this qualification, we are supportive of the proposed treatment of diversification activities in farm income but again we would highlight the critical importance of ensuring that the diversification activity is properly reported through the inclusion of all of the costs including labour and that the term "profit" is used to describe the reward for that part of the farm business equity properly attributable to the diversified activity.

We will move now to dealing with the specific questions which you have raised in your consultation document.

Q. 1 Do you agree that net farm income is no longer fit for purpose as the main statistical indicator of farm income in Northern Ireland and should be replaced?

We agree with the proposition as stated, but it should not be replaced with an equally unsatisfactory or inferior indicator. However NFI could be made acceptable if an explanation of what it meant was always headlined with it.

Q.2 Is farm business profit an acceptable replacement for net farm income in Northern Ireland?

No. As described above, your proposal is not in accord with the universal business understanding of the term "profit".

Q.3 Should net farm income continue to be available as a supplementary statistical measure of farm income?

We of course believe that some transition from existing indicators to new indicators is appropriate. However we urge the adoption of statistical measures as quickly and as universally as possible that would more appropriately represent production agriculture enterprise performance, or that statistical measures should be adopted that clearly distinguish income from agricultural production and income from using farm resources as defined in the pursuit of non-production enterprises.

Q. 4 Do you agree with the proposal to include diversification activity in the new farm income measure only when it involved the entrepreneurial use of dedicated farm resources (i.e. land, buildings and machinery) in non-farm activities and the costs incurred are financially inseparable from the costs of the main farming business?

We are generally supportive of the concept other than that we would categorise single farm payment as a “landlord activity” as it is non-entrepreneurial (see answer to Q.3).

Q. 5 Do you support the proposal to continue publishing cash income and/or occupier's net income as a supplementary measure of farm income?

Yes. Additionally we should generally distinguish in accounts between costs that have a cash outflow, and costs that are imputed values.

Q. 6 Are there other income indicators which you think should be published?

Yes. We are strongly of the view that individual enterprises associated with individual market segments need to be measured and disclosed with as much transparency as possible, so that, for example, the real performance of a suckler beef production enterprise is better understood as a stand-alone entity and without the subsidisation of either single farm payment or “free” labour provided by the farming family.

We trust that you can embrace these views in your ultimate conclusion on this important matter.

Yours sincerely



David Rutledge
CHIEF EXECUTIVE