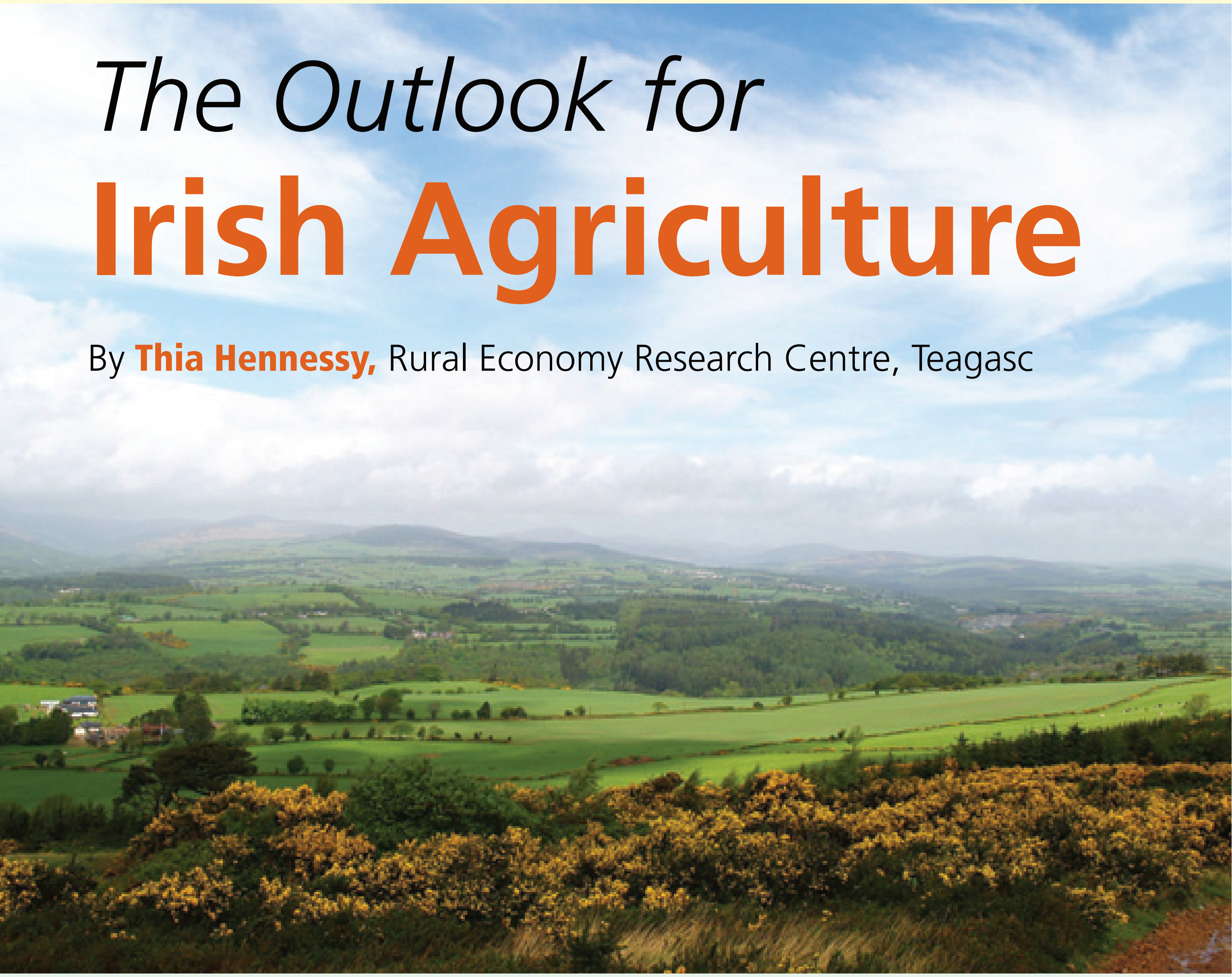


The Outlook for Irish Agriculture

By **Thia Hennessy,** Rural Economy Research Centre, Teagasc

2007 – An Extraordinary year for Agriculture

In 2007 Irish agriculture finally experienced the boom that other sectors of the macro-economy have enjoyed for the last decade. Prices of dairy and cereal products, in particular, rocketed, outstripping previous price records. The milk price paid to Irish farmers increased from approximately 25 cent per litre in the summer of 2006 to 35 cent per litre in 2007, while wheat prices were almost 75 percent higher in 2007 than the previous year. The substantial increases in commodity prices did not go unnoticed by the consumer. High cereal prices have led to "tortilla riots" in Mexico and "pasta protests" in Italy. While high oil prices and climate change are being mooted as the main driving forces behind the turn around in agricultural commodity markets, there are a number of other underlying factors.

The recent price boom is a consequence of growing international demand, as a result of global macroeconomic and population growth, in conjunction with a dampening of international supply due to weather related issues and increased competition between food and fuel production as a land use. It is not unusual for demand and supply to run in counter directions and for commodity prices to increase. However, the extent of the increase in 2007 was unprecedented and can be largely attributed to the depletion of world stocks.

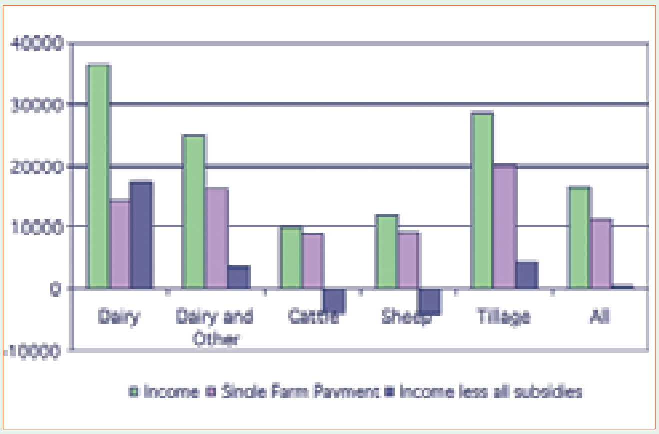
Historically, large trading blocks like the US and the EU withheld product from the market when prices were low and accumulated stocks, which they then released on the world market when prices rose thus dampening any price increase. This stock piling mechanism provided a form of market stability, preventing large price volatility. However, in recent years, world stocks have been depleted due to a number of "freer trade" policy reforms and steady increases in world demand and thus there is less scope to stabilise the market.

The key question now facing those involved in agriculture is whether the current price boom is sustainable into the future? Most agricultural economists and market analysts agree that the extraordinary prices experienced in 2007 are not sustainable. Such high prices are likely to have negative implications for demand, especially in the developing world which accounts for most of the recent increases in world demand, and with time supply will adjust upwards in response to higher prices. The general expectation is that prices will decline but will still remain higher than the levels experienced in the early 2000s.

What does it mean for Irish farmers?

The Teagasc National Farm Survey, the main source of information on farm incomes, collects data from about 1,200 farms annually. The data from 2006, the most recent year available, show that the average family farm income, including both full and part-time farms, was €16,600 and almost €11,000 of this came in the form of the decoupled Single Farm Payment. When all subsidies are deducted from the income figure, the data shows that the average market based income in 2006 was €385, see Figure 1. Incomes tend to be higher and dependence on subsidies lower on specialist dairy and tillage farms. Conversely, the average cattle and sheep farmer made a market based loss in 2006. In other words they would have financially benefited from completely disengaging from production and only using their land to claim the Single Farm Payment.

Figure 1: A Review of Farm Incomes in 2006



Source: National Farm Survey, Teagasc (2006)

While the 2007 income data is not yet available, it is estimated that dairy farm income will be over 60 percent higher than the 2006 level putting it at close to €55,000. Tillage farmers are expected to have almost doubled their income from cereal crops in the past year. Sheep and beef farmers have not been as fortunate. Farm incomes in 2007 are expected to remain at the 2006 level. High dependency on decoupled payments continues to characterise the sheep and beef farming sectors and the future of these decoupled payments is critical to the sustainability of the sector into the future.

2008 is expected to be another good year for dairy and tillage farmers, albeit prices will not be as high as 2007 and input cost inflation is expected to be considerable. The outlook for the beef and sheep sectors seems to be more of the same, with little prospect of vast improvements in commodity prices and continuing cost inflation.

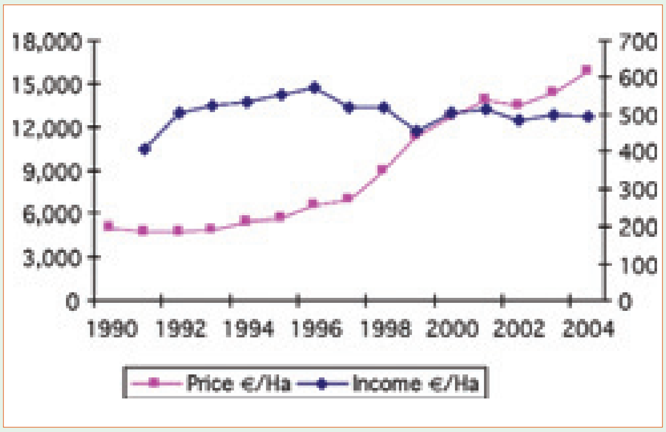
The recent boom in agricultural commodities was not all good news for farmers. The cost of animal feed stuffs, based mostly on grains, increased significantly over the last 12 months and is expected to remain high in 2008. This has, and is expected to continue to, erode some of the profit increases enjoyed by dairy farmers and has placed additional pressure on other livestock producers. Similarly, the cost of seed for tillage farmers has increased in conjunction with increasing output prices.

Energy based inputs are likely to be the biggest threat to the competitiveness of the farm sector in 2008. Increasing oil prices will translate to higher fuel and energy costs and especially higher fertiliser prices. Natural gas prices are a key determinant of fertiliser price. While gas prices remained relatively stable in 2007, there are indications that Russia will seek to increase its gas price by as much as 25 percent in 2008. Higher natural gas prices, increasing demand and fertiliser production capacity constraints, all suggest that fertiliser prices will rise significantly in 2008.

So what does it mean for the land market?

In previous articles for this publication I have discussed the apparent disconnect between land prices and farm profit. Figure 2 shows how the two variables now run in opposite directions with land prices continuing to increase despite falling profit per hectare.

Figure 2: Average Land Sales Price and Average Income per Hectare



Source: Central Statistics Office of Ireland

Given that land price seems to be almost independent of farm profit, it is most likely that the recent commodity price boom will have little impact on the land sales market. If anything, it may slow the supply of land available for sale; the recent price boom seems to have re-invigorated some farmers and may act as a disincentive for some farmers to exit the sector.

Land rental prices in some areas are likely to have increased as demand for conacre by tillage farmers remains strong. Indeed Teagasc was warning tillage farmers to exercise caution when entering leases and not to over pay for conacre on the back of high harvest prices. The boom in dairy prices will have little effect on the land rental market as production continues to be constrained by milk quotas.

What does the future hold?

In relation to agricultural policy the two big policy issues that are ongoing at present are the Health Check of the Common Agricultural Policy (CAP) and the World Trade Organisation (WTO) negotiations. The WTO negotiations on an agreement on agricultural trade are ongoing as they have been for a number of years now. The US and the EU continue to have divergent positions on export subsidies and import tariffs.

In late February 2008 the European Commission released their proposals for reform of the CAP. From an Irish perspective, the most significant components of these proposals are the possible reform of the EU milk quota regime and the proposed shift to flat rate decoupled payments.

The European Commission is proposing to increase the EU milk quota by 1 percent annually from 2010 in advance of its complete removal in 2015. In the negotiation process Ireland is likely to push for larger increases in quota. Research has shown that Ireland is in a relatively positive competitive position to increase milk production if quotas were removed and would benefit from an aggressive approach to milk quota expansion.

Shifting from historically determined decoupled payments to a flat rate national payment, as is also proposed in the Health Check, is likely to create some political tensions in Ireland. At present a farmer's decoupled payment is determined by the amount of direct payment claims made in the period 2001 to 2003. The Commission proposal involves aggregating the country's total decoupled payment and dividing it equally across all producers on a per hectare basis. Analysis shows that such a policy change would lead to the redistribution of decoupled payments from the intensively farmed regions of the South East to smaller, less intensive farms along the western seaboard.