UK triggers EU exit process – implications for the fertilizer sector

The UK government will formally notify the EU on 29 March of its intention to leave the union. This will begin a two-year exit process, with the UK expected to withdraw from the bloc by April 2019.

The immediate impact on the UK in the coming weeks will be limited. The UK will remain a member of the EU, subject to its laws and tariff schedules, until the exit process is complete. Long-term changes to fertilizer demand and trade flows are most likely to follow from subsequent changes affecting farm economics, regulation and, potentially, a reduction to fertilizer import duties.

Agricultural demand for fertilizers will be affected by the UK's ability to trade with the EU and countries elsewhere, but also by internal UK decisions regarding farm subsidies, crop protection, genetically modified (GM) seeds and seasonal labour.

The UK government has made few public statements of intent that could have a direct impact on the agricultural sector, but the principal ones are listed below:

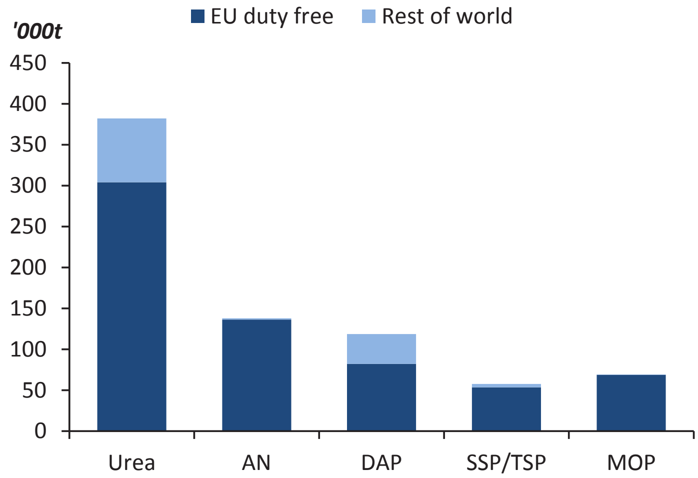
- **To leave the EU single market and Common External Tariff, but to seek a "comprehensive, bold and ambitious" free-trade agreement with the EU.**
- **To continue farm support payments equivalent to those under the EU Common Agricultural Policy (CAP) Pillar 1 up to 2020.**
- **To deregulate where possible, aiming to "free farmers to grow more, sell more and export more".**
- **To seek free-trade agreements globally.**
- **To manage the transition in phases, rather than plunge off a 'cliff edge' or experience a 'big bang'.**

The EU is yet to provide an indication of what its aims will be with regard to a future UK-EU agricultural relationship.

Fertilizer trade

The UK imports most of its fertilizer requirements from either the EU or countries such as Morocco, Algeria or Egypt, which are able to sell to the EU duty free under the Euromed agreement. It is quite possible that the UK will reduce tariffs on fertilizer imports after leaving the EU. Anti-dumping duties on Russian ammonium nitrate (AN) and AN-based fertilizers may also cease to apply. Russian fertilizer producers already supply the UK despite the 6.5pc duty (and €32.82-47.07 extra anti-dumping duty on AN); without the duties it is quite likely that Russian supply would increase. New barriers to fertilizer trade are unlikely to be introduced — the UK has limited domestic primary fertilizer production beyond CF's nitrates and ICL's polyhalite output, and the government has shown no inclination to restrict imports.

FIGURE 1: UK FERTILIZER IMPORTS BY DUTY



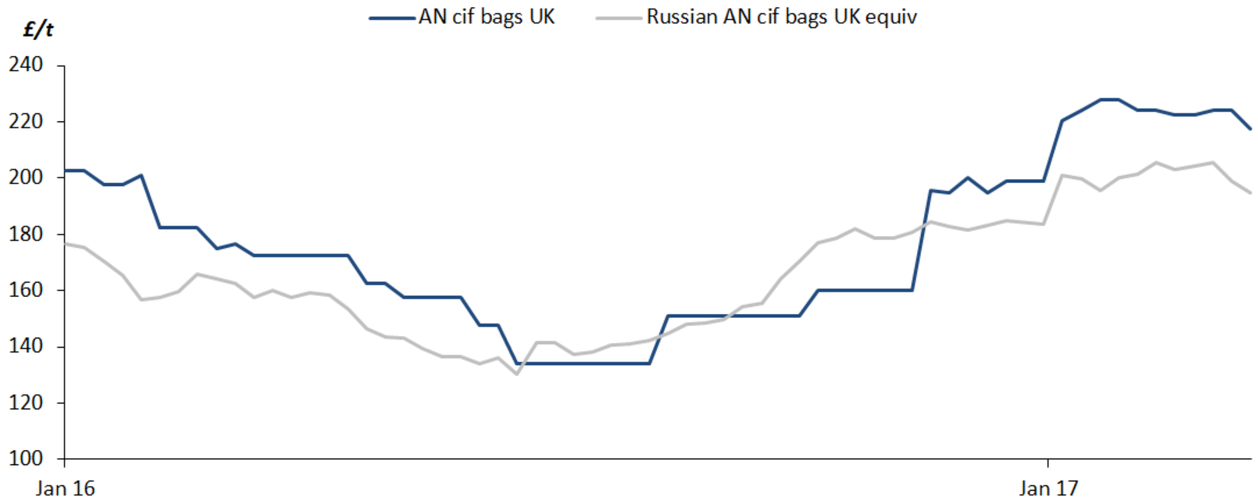
Imports to the UK of most products from outside the EU customs zone incur a 6.5pc duty. Of the approximately 830,000t of urea imported in the 2015-16 fertilizer year, 80pc was from sources attracting 0pc duty. Ammonium nitrate imports totalled about 400,000t, of which 99pc was duty free. DAP imports of 119,000t were more diverse, with only 69pc from duty-free origins, while superphosphates imports of

58,000t were 93pc from duty-free countries. MOP imports of 69,000t were almost all from within the EU.

CF exports AN from its UK production sites — 30,000t in 2015-16 — with 99pc directed to EU markets. Without a new trade agreement between the EU and the UK after 2019, EU buyers would have to pay 6.5pc duty to import CF product, and could look elsewhere. But this is a relatively small part of CF's UK output, and has been declining for several years.

will continue with "high levels of market access in future". Alternatives include trading with the EU under WTO rules, which would impose significant barriers to agricultural trade and would be likely to result in lower farm income. Wheat attracts a €12/t duty under the EU's tariff rate quota system for medium and low-quality wheat, while the rate for barley is €16/t. If UK farmers were to compete for cereals markets outside the EU, their netbacks would be considerably lower than at present.

FIGURE 2: OPPORTUNITY FOR RUSSIAN AN TO ENTER UK AFTER BREXIT



Russian AN producers could secure higher netbacks from the UK market than from sales to Central and South America if anti-dumping duties were removed, although CF has shown a willingness to protect market share against imports this year.

Trade in phosphates and potash is unlikely to change dramatically, as the UK already sources phosphate from EU and non-EU sources, and MOP attracts no import duty. If a proposed EU regulation on cadmium levels in fertilizers enters force in its current form — which is expected in 2018 — it would restrict EU imports of phosphates from north Africa. The regulation will automatically, along with most EU legislation, remain a UK law once the exit process is complete, although the government could choose to repeal it after the UK has left the EU.

Crop and livestock trade

A UK free-trade agreement with the EU, resulting in no tariffs on agricultural goods, would maintain the status quo. The UK exports approximately €16bn/yr ($17.4bn/yr) of agricultural, fisheries and food products to the EU — including 80pc of its wheat and nearly all of its lamb exports in 2015-16 — while importing €40bn/yr worth of products. The UK government has expressed a hope that this trade

Trade agreements with other countries could pressure UK domestic cereal and livestock prices, with particular concern from the livestock sector that countries with lower animal welfare standards — and concomitant lower production costs — could gain greater access to the UK market. The grassland sector is an important, and price-sensitive, consumer of fertilizers and is likely to continue as the marginal consumer.

Farm support

Farm support payments under the CAP account for 50-60pc of UK farm income on average, according to government figures. Changes to the payments, and the criteria for accessing them, will have an immediate impact on farmer choices.

No decisions have been made yet on farm support payments other than a commitment to maintain them until 2020, UK environment, food and rural affairs junior minister George Eustice says. But he also says he would like to "use that money to do things that are a public good" and support raising productivity, risk management and environmental sustainability. He also expresses general concern over the distorting effects of subsidies. It is possible that changes to the farm support system along those lines could lead to lower farm spending on inputs.

Regulations

EU regulation — as applied by the UK government — has a significant impact on UK crop patterns, imposing restrictions on fertilizer and crop protection applications. A recent example is that the 2016-17 winter drilling of rapeseed was delayed and cut back because the UK government rejected an application to use neonicotinoid pesticides, which have been restricted by EU regulation since 2013, to control cabbage stem flea beetle. There is some hope at farm level that rules on crop protection will be relaxed.

UK environment, food and rural affairs minister Andrea Leadsom said: "I will be looking at scrapping the rules that hold us back... We will free our farmers to grow more, sell more and export more." Leadsom specifically cited the three-crop rule — which requires farms over 30 hectares (300,000m²) in size to plant at least three crops — as a regulation due to be repealed. The three-crop rule has led farmers to plant more legumes and spring crops, which have lower fertilizer needs, and its removal could lead to more winter planting and a return to crops with higher fertilizer requirements. But some distributors expect little change to planting patterns, as some farmers find the multiple-crop requirement helpful in managing black-grass problems.

GM crops are restricted at present, but Eustice says that "as part of the preparations for EU exit, the government is considering possible future arrangements for the regulation of genetically modified organisms". Some GM products are used in livestock feed already, and a study by the UK Agriculture and Horticulture Development Board recommended that GM crops be permitted in the UK.

Outlook

It is possible that significant difficulties lie ahead. A worst-case scenario could see farmers lose support payments and tariff-free access to the EU market, and have to compete with low-cost production in the global market. This would almost certainly reduce farm income, and spend on fertilizers, until the market is restructured. But the UK government is expressly in favour of phasing in any transition, which should give the market time to adjust. Clarity is expected to improve as the exit date approaches.