



House of Commons
Environment, Food and Rural
Affairs Committee

Implementation of CAP Reform in the UK: Government Reply to the Committee's Report

Tenth Special Report

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The Environment, Food and Rural Affairs Committee

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Committee staff

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TENTH SPECIAL REPORT

The Environment, Food and Rural Affairs Committee reported to the House on *Implementation of CAP Reform in the UK* in its Seventh Report of Session 2003–04, published on 6 May 2004 as HC 226. The Government's Reply to the Report was received on 7 July 2004.

Government response

Introduction

The Government welcomes the Select Committee's report. It is particularly pleased at the support the Committee has given for the Secretary of State's decision to allocate entitlement to the new CAP Single Payment on the basis of three regions in England.

The Government agrees with the Committee concerning the desirability of publishing further assessments and analysis of the impact of the implementation of the CAP reform on the industry and the environment and of the need to research further the future impacts. The Government has published an analysis of the impact of the chosen payment method and other possible payment models.

The Government also agrees with the Committee that the timetable for implementation in 2005 is challenging. However, we remain on target for the new payment scheme to be delivered on schedule. Defra and the Rural Payments Agency (RPA) have joint programme management systems in place, working very closely with Devolved Administrations, to ensure this happens.

This response comments in turn on each of the Committee's recommendations and conclusions. The Committee's recommendations are reproduced in bold.

Recommendation 1

We believe that the Government should have produced an in-depth study of the likely impacts of the various options for the Single Payment Scheme prior to making its decision about the Scheme. We strongly recommend that it now speedily produce its promised detailed analysis of the economic impacts of the model it has adopted, and that such an analysis also set out the likely environmental impacts too. (Paragraph 11)

The Government carried out substantial analysis which underpinned the decision on the model for the single payment. In particular this analysis examined the distributional implications of the different ways of allocating eligibility for the single payment, and the

implications for the land market. The analysis also included an assessment of the impacts of decoupling on agricultural production and markets, the environment and the wider rural economy.

Some analysis was published on the Defra website at an early stage. However, a complete version was delayed pending further consideration of industry representations following the February announcement. The fuller report now available on the Defra website contains all the economic analysis undertaken in support of the Government's decision.

In addition to the analysis carried out by Defra for on the options for England, the Welsh Assembly produced a report on the impact of various options to inform decisions in Wales. A copy of this report is available on the Assembly website. The Scottish Executive Environment and Rural Affairs Department (SEERAD) and The Department of Agriculture and Rural Development for Northern Ireland (DARD NI) also carried out analysis on options and environmental impacts and these are available on their respective websites.

Recommendation 2

We recommend that Defra set out their detailed assessment of (a) gainers and losers in the new Scheme, (b) what environmental gains will result from the new system, and (c) the case made by other European Union member states in favour of a ceiling on area-based payments. (Paragraph 12)

a) In deciding how best to implement the new Single Payment Scheme in England the Government took account of its objectives for sustainable farming set out in the Strategy for Sustainable Farming and Food in England. Inevitably, the new flat rate payments will result in some recipients receiving more and other less than under the previous system. Relative to historic subsidies, flat-rates redistribute payments from more intensive to less intensive producers and to land not formerly in receipt of direct payments. By determining three regions in England, the larger re-distribution that would have resulted from adopting a single uniform flat-rate is avoided. In addition, the Government has announced a significant transition period to give the industry time to adjust to these changes.

The Farm Business Survey (FBS) has been used to analyse the re-distributive effects of various regional payment models. Unfortunately, it has not been possible to model the 3-region model in detail using the FBS because moorland farms are not explicitly identified by the survey. Nevertheless, it is possible to make some general statements about the impacts and to quantify them to some extent. General cropping farms and horticulture will tend to gain relative to historic payments as will cattle and sheep farms. Other farm types will tend to lose. Within farm types, however, there will always be cases of individual winners and losers so that for example, even though, typically, cattle and sheep farms gain as a group, it will tend to be sheep farms that gain and cattle farms

(particularly intensive beef producers) that lose. Within the dairy sector, larger producers tend to lose, whilst small producers gain. Overall we expect just under half of all farms to be losers with about 13 per cent of the total subsidy budget to be redistributed from the losers to the winners.

Analysis has also been conducted into the effects of the new arrangements on different regions of England. By the end of the transitional period some regions will have gained or lost compared to their historical subsidy receipts. The direction and degree of redistribution depends on the regional composition of the industry by farm type and size. The Eastern region, the South East and the North West will probably gain; other regions will tend to lose. But the consequential effects on local economies are difficult to estimate as there will be general gains from the market freedom associated with decoupling and, of course, there is no guarantee that decoupled subsidy receipts will be spent in the regions concerned.

b) Breaking the link between support and production should bring environmental benefits by removing incentives to produce in excess of true market demands. This should help alleviate problems caused by overstocking and excess use of pesticides and fertilizers. It should also lead to an increase in the area of fallow land. However, in some locations restructuring of farm businesses may put more pressure on the environment. The cross-compliance rules will mean farmers must meet the requirements of certain EU environmental directives in order to qualify for subsidy. This will increase the incentive for farmers to comply. Farmers must also maintain their land in good agricultural and environmental condition which should lead to a higher standard of soil and habitat management. Both those provisions apply across the whole holding, whether all of it is eligible for payment or not. In addition modulation will continue to apply at a flat rate across every sector, irrespective of how the payment is calculated. From 2005, modulation will be compulsory across all Member States, the rate will increase progressively from 3% of direct payments in 2005 to 5% from 2007 onwards. The UK will also take advantage of an additional national modulation, and in England will be used to transfer funds to the second pillar, and in particular will fund the new Entry Level Stewardship (ELS).

There is an increased flexibility for Member States to allow farmers to use narrower strips for particular environmental reasons to count towards their set-aside obligations, encouraging them for example to leave buffer strips alongside sensitive habitats. Whilst the UK would have preferred to see an end to compulsory set-aside under a fully decoupled system, the new flexibilities represent major opportunities to maximise the environmental benefits that set-aside can deliver. In particular, the reductions in minimum area and strip width will mean that set-aside can be sited where it will provide the most environmental benefit, particularly in respect of biodiversity and the provision of food and habitat for farmland birds in hedges and field margins and protecting water quality. The ability to grow on set-aside land non-food crops also has the potential to make a significant contribution in areas like renewable energy.

c) The UK Government made clear during the CAP reform negotiations that it opposed the proposal to put a ceiling on individual CAP payments because it would have penalised UK agriculture relative to some of its European competitors and obstructed progress towards a more competitive farming industry, without any discernible reduction on the overall negative impacts of the CAP. We were supported in this view by several Member States including France and Germany.

Our analysis of the original proposal to cap payments suggested that UK farmers would have contributed 13.8% to the EU but received only 9.8% back. In the end the June deal, which did not set a ceiling, meant that UK agriculture would receive 11%.

Recommendation 3

We recommend that, going forward, Defra produce an annual assessment of English and United Kingdom farming in order to monitor the impact of its policy decision. It should focus on environmental impacts and also on socio-economic concerns, such as land ownership and the incomes of those who work on the land. (Paragraph 13)

Defra, in conjunction with the Devolved Administrations, currently produces an annual assessment of UK agriculture (Agriculture in the UK, AUK). This includes a breakdown into England, Wales, Scotland and Northern Ireland for a number of the key statistics. Over time, as CAP reform impacts on the industry, developments will be picked up and reported in AUK. Further country breakdowns within AUK will be considered as part of the annual seminar held with representative bodies to discuss the content of AUK. More specifically, Defra plans a programme of research to monitor and assess the environmental, economic and social impacts of the CAP reform package in England. This will include the establishment of an 'environmental observatory' function to co-ordinate data from a range of sources, collating the resulting information so as to identify significant trends in farming patterns and practices and their resulting environmental impacts. The Observatory will also seek to predict the longer term impacts of farm practice changes, highlighting any areas of particular concern or success and assessing the implications for the delivery of the objectives of Defra and its Agencies. A specification for an initial scoping study for such a function is currently being drawn up to establish what to monitor, a baseline against which to make comparisons, the extent to which we can rely on existing surveys or whether we need to modify those surveys or commission entirely new ones to fill gaps in the evidence base. The scoping study will also consider how to achieve effective co-ordination of the Environmental Observatory function with planned or proposed studies addressing the socio-economic impacts of CAP reform and potential mechanisms for linking these with the Observatory's environmental impacts to cover the three pillars of sustainable development.

The Government also plans to commission a number of discrete projects relating to different aspects of CAP reform impacts. These include research into the implications for the economic linkages between farms, upstream and downstream industries in the agri-food chain and other businesses within the immediate wider rural economy, of decoupling and changing the distribution of subsidy payments in England. There will also be a project aimed at assessing the wider social impacts of changes in the structure of agricultural businesses. Further research proposals are likely to be guided by the outcome of the observatory scoping study but we are particularly conscious, given the uncertainty surrounding the effects of CAP reform, to identify at an early stage any adverse impacts so that remedial action can be taken where necessary. It will also be important to monitor the extent and magnitude of the beneficial impacts and assess how these might be maximised.

Recommendation 4

We are pleased that the Government has now responded to the problems which may have resulted from having significant differences in the level of support given to Severely Disadvantaged Areas and the rest of England. (Paragraph 19)

The Government welcomes the Committee's comment on this. We accepted that the original decision to divide England into 2 regions (the Severely Disadvantage Area (SDA) and outside the SDA) would have had some unintended adverse affects. This is why we listened to our key stakeholders and agreed to a small refinement which all key stakeholders support. This demonstrates the Government's commitment to work in partnership with key stakeholders that are affected by these changes.

Recommendation 5

We recommend that Defra, in conjunction with the devolved administrations, commission research into the likely effects on farming production of adopting different single farm payment regimes in the nations of the United Kingdom. We further recommend that it consider what support and assistance it might be able to offer farmers particularly affected, such as those who operate on either side of the border between the nations. Farmers whose holdings are divided by a border should have the right to opt for the regime which they consider most appropriate for the whole of their holding. (Paragraph 21)

Scotland and Wales intend to determine eligibility to the Single Payment on the basis of historic receipts. England, following a long transition period phasing out historic payments, will be using a regional flat-rate system and Northern Ireland will use a model which combines historic and flat-rate elements. In all four countries however the payments will be fully decoupled from 2005; in other words, the linkage between production and subsidy will not exist from that date. The single payment will be conditional on land being kept in good agricultural and environmental condition and meeting other cross compliance requirements. Farmers will be free to decide what and how much to produce on the basis of market demand and their own costs of

production. The payment regime will not therefore fundamentally affect the profitability of production between the constitutional parts of the UK. It will no doubt take time for farmers to adjust to decoupled payments particularly in some sectors which have received high per hectare levels of support and where therefore a greater market reorientation is necessary. The scheme to be adopted in England allows for a seven year transition period to facilitate this adjustment. It is decoupling which will have the main impact on farmers' decision making and production patterns rather than the method for creating eligibility for entitlement to the single payment. Defra has published various research projects which examine the impact of decoupling on livestock and arable production in the UK. The results of these projects produced quite a wide range in the projections of future production and underline the uncertainty associated with quantifying the effects of decoupling on output. We also recognise that changing the distribution of subsidy in England will have impacts on farmers' wealth and perhaps attitudes to risk which may in turn affect some production decisions. We intend to monitor the impacts on agricultural production patterns and incomes (see response to recommendation 3 above) and we are considering the feasibility of further analysis to project farmers' rational economic responses to the Single Payment in England.

The Regulations would not allow the latitude suggested by the Committee for farms that straddle borders. To give such flexibility to some in a region but not others could be said to be discriminatory. We are currently in discussion with other agriculture departments to see how the question of holdings that cross internal boundaries can best be dealt with.

Recommendation 6

The RPA is being asked to deliver a new and complicated Single Payment Scheme against a tight deadline. It is an administrative process which will initially bring with it all of the problems of introducing a historic scheme whilst at the same time having to manage the transition to an area-based payment. We recommend that Ministers pay close attention to the steps taken by the Agency up to 1 January 2005 to ensure that all necessary systems are in place on time, and report to us by 1 October 2004 about the progress made. We also recommend that if additional resources are required by the RPA to deliver the new Scheme that Ministers commit themselves to providing those without hesitation. (Paragraph 24)

The Government recognises that the timetable is an ambitious one. This is why Defra and RPA have a joint 'policy to delivery' implementation programme which reports to the Permanent Secretary and to Ministers. This is a significant programme for the Department and every effort is being made to ensure that we deliver the new arrangements in time for the 2005 scheme year. A considerable amount of work has already been done on policy and operational development.

The Government recognises the Committee's concern about the ability of new systems to be delivered on time to implement the new scheme and notes its request for a report by 1 October. We will endeavour to send the Committee a progress report as soon as possible during the Autumn.

Recommendation 7

We recommend that Defra and the RPA provide us with an explanation of how the existing Change Programme can be adapted to provide the systems needed to underpin the Single Payment Scheme. We further recommend that they set out what work in the Change Programme has proved unnecessary due to the introduction of a single farm payment, and thus what expenditure has been nugatory. (Paragraph 25)

The RPA was aware, when the contract to deliver the new IT system was let, that discussions on CAP reform might impact the solution. Options were included in the contract on the bovine schemes, which seemed the most likely, at that stage, to be amended or replaced. The design of the solution involved:

- databases containing customer, land and animal details;
- a generic 'claim-to-pay' processing system, using workflow capability;
- interfaces for cross checking and inspection (including risk analysis) purposes; and
- business rules which are specific to individual schemes.

The solution works equally well for the Single Payment Scheme and it follows that there has been no nugatory expenditure as a result of the EU Council's decisions on the CAP reform. The cost of the solution has increased, however, to reflect significant changes which needed to be made to the delivery schedule to reflect the timing of the agreement on the EU regulations and the subsequent decisions on implementation. The overall length of the contract has increased from the 21 months originally envisaged to 33 months.

Recommendation 8

We intend to return to this subject in the second part of our inquiry, to be conducted in due course. At that time we will address issues including:

- **Cross-compliance, and what public goods are expected to be delivered in return for continuing public support for agriculture;**
- **The particular details of what will be required of farmers under an entry-level scheme; and**
- **The specific issues faced by sectors such as orchards, forestry, keeping horses and others. (Paragraph 27)**

The Government welcome the Committee's interest in this area of Defra's work and will co-operate with its inquiry fully. The areas it has highlighted for a further inquiry are important areas and ones that will have a major impact on the farming and rural community.

Department for Environment, Food and Rural Affairs
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