



House of Commons

Committee of Public Accounts

Helping farm businesses in England

**Twelfth Report of
Session 2004–05**



House of Commons
Committee of Public Accounts

Helping farm businesses in England

**Twelfth Report of
Session 2004–05**

*Report, together with formal minutes,
oral and written evidence*

*Ordered by The House of Commons
to be printed 9 March 2005*

HC 441
Incorporating HC 1131-i, Session 2003–04
Published on 1 April 2005
by authority of the House of Commons
London: The Stationery Office Limited
£0.00

The Committee of Public Accounts

The Committee of Public Accounts is appointed by the House of Commons to examine “the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit” (Standing Order No 148).

Current membership

Mr Edward Leigh MP (*Conservative, Gainsborough*) (Chairman)
Mr Richard Allan MP (*Liberal Democrat, Sheffield Hallam*)
Mr Richard Bacon MP (*Conservative, South Norfolk*)
Mrs Angela Browning MP (*Conservative, Tiverton and Honiton*)
Jon Cruddas MP (*Labour, Dagenham*)
Rt Hon David Curry MP (*Conservative, Skipton and Ripon*)
Mr Ian Davidson MP (*Labour, Glasgow Pollock*)
Rt Hon Frank Field MP (*Labour, Birkenhead*)
Mr Brian Jenkins MP (*Labour, Tamworth*)
Mr Nigel Jones MP (*Liberal Democrat, Cheltenham*)
Jim Sheridan MP (*Labour, West Renfrewshire*)
Mr Siôn Simon MP (*Labour, Birmingham Erdington*)
Mr Gerry Steinberg MP (*Labour, City of Durham*)
Mr Stephen Timms MP (*Labour, East Ham*)
Jon Trickett MP (*Labour, Hemsworth*)
Rt Hon Alan Williams MP (*Labour, Swansea West*)

The following was also a member of the Committee during the period of this inquiry.

Ms Ruth Kelly MP (*Labour, Bolton West*)

Powers

Powers of the Committee of Public Accounts are set out in House of Commons Standing Orders, principally in SO No 148. These are available on the Internet via www.parliament.uk.

Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at <http://www.parliament.uk/pac>. A list of Reports of the Committee in the present Session is at the back of this volume.

Committee staff

The current staff of the Committee is Nick Wright (Clerk), Christine Randall (Committee Assistant), Emma Sawyer (Committee Assistant), Ronnie Jefferson (Secretary), and Luke Robinson (Media Officer).

Contacts

All correspondence should be addressed to the Clerk, Committee of Public Accounts, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5708; the Committee’s email address is pubaccom@parliament.uk.

Contents

Report	<i>Page</i>
Summary	3
Reform of the Common Agricultural Policy	3
Encouraging better farming and rural development	3
Helping farm businesses adapt to the market	3
Conclusions and recommendations	5
1 Common Agricultural Policy reform and the future of farming	7
2 What forms of support to provide and to whom	9
3 Delivering support more effectively	11
Formal minutes	13
Witnesses	14
List of written evidence	14
List of Reports from the Committee of Public Accounts Session 2004–05	15

Summary

Reform of the Common Agricultural Policy

Farms in England received around £1.6 billion in market-related subsidies in 2003 under the European Union's Common Agricultural Policy. Major reforms agreed in 2003 will bring about fundamental changes to these subsidies. The Department for Environment, Food and Rural Affairs (the Department) is responsible for implementation of the Common Agricultural Policy in England.

The reform will have a significant impact on farm businesses. Subsidies will be “decoupled” — no longer be linked to production — freeing farm businesses to produce what consumers want rather than what the subsidy regimes dictate. From 2005, many existing production-related subsidy schemes will be rolled into a single payment to each farm (the single farm payment), which in England will be based initially on the subsidy farms received between 2000 and 2002. Between 2005 and 2012, the basis for payment will shift in stages to the area of farmland under management.

Encouraging better farming and rural development

All payments will be subject to “cross-compliance” with environmental and animal health standards, to deliver objectives such as a better environment, conservation and access for the public. Similarly, each member state has some discretion, through “modulation” and a “national envelope”, to reduce farm subsidies and transfer those moneys to programmes for more environmentally-friendly farming and wider rural development.

Helping farm businesses adapt to the market

Farm businesses need help to survive in this new market-led environment. The Department is responsible for a range of measures to help farm businesses become more competitive, diverse and flexible. These measures include farm business development schemes, processing and marketing grants, a vocational training scheme and the Farm Business Advice Service. In all, some £250 million has been allocated to these support measures between 2000 and 2006.

Much of that support has been in the form of capital grants, but experience from other countries suggests that other measures could have more success. These include a greater emphasis on advice, better targeting of support on those farms most in need, streamlining the number of separate support schemes and application processes, and a greater focus on supply chains and more co-operative working.

Over the next few years, the Department will need to establish a new set of farm business support measures for the period 2007–2013, within European Union rules, to help farm businesses adapt to the new subsidy regimes and greater market orientation. This will

provide a significant opportunity for the Department to implement our recommendations.

On the basis of a Report by the Comptroller and Auditor General,¹ we examined the Department on its plans to help manage the transition from a subsidy-led to a market-based environment; what forms of farm business support to provide and to whom; and how to deliver this advice and support most effectively.

1 C&AG's Report, *Helping farm businesses in England* (HC 1028, Session 2003–04)

Conclusions and recommendations

- 1. The Department should identify what further changes to the subsidy regime could be made to enable it to encourage environmentally friendly farming or to improve the quality and marketing of farm produce.** These could include, for example, higher rates of modulation, some extension of the requirements of cross-compliance or a different form of “national envelope” fully decoupled from production. Where necessary, it should be prepared to press for further changes to the revised Common Agricultural Policy subsidy regime.
- 2. The Department should put in place a rigorous inspection regime to enforce cross compliance requirements attaching to single farm payments, including improved access to the countryside and preservation of rights of way.** Reduced subsidy payments, or, in extreme cases of non-compliance removal of entitlement, should apply to farmers not meeting the standards.
- 3. Farm business support should be targeted at those enterprises which need it most, usually smaller and intermediate sized farming businesses run by families and individuals, rather than large agribusinesses.** The planned Common Agricultural Policy reforms will lead to some redistribution of subsidies between different types of farm, but more support could be directed at broadening the supply side of the market, and to strengthening rural communities through providing sustainable solutions for smaller and medium sized enterprises.
- 4. Under current schemes, 80% of the Department’s funding is allocated to grants for capital projects but the Department’s own evaluations suggest these grants are of questionable value.** Loan guarantees, for example on similar terms to the Department of Trade and Industry’s Small Firms Loan Guarantee scheme, would help promote a culture of entrepreneurship and potentially at lower cost to the taxpayer. The Department should change the emphasis of its grant schemes from capital grants to the provision of advice and facilitation.
- 5. Good practice from other countries suggests high quality business advice and support, and assistance to farmers in applying for support, is most beneficial in promoting change and diversification.** The Department should develop quickly proposals for a Farm Advisory Service, which it is required to have in place by 2007. The Department should also consider whether schemes might include making direct approaches (“cold calling”) to those businesses most likely to be in need of advice and facilitation.
- 6. The Department’s support for farming should be framed more directly around the need to improve the supply chain from food producer through to consumer.** In particular, it should encourage the development of local partnerships through making grants available to co-operatives, and by providing funds to encourage the development of local farming support and self help networks amongst the local supply chain.
- 7. Running costs can range up to nearly half of scheme costs.** The Department believes that they will be reduced by around 40% with more modern Information

Technology support, and reductions are also expected from new fast tracking procedures. The Department should rationalise the number of support schemes available to farm and rural businesses, simplify the application processes and streamline its administration of schemes, to reduce costs and make more funds available for front line support.

8. **Regional Development Agencies' experience of urban regeneration and sustainable development will not be sufficient to help smaller rural farm businesses to respond to the challenges of Common Agricultural Policy reform,** nor may Agencies be sufficiently locally based to understand local priorities. The Department should work with the Agencies to put in place adequate expertise and understanding of the social and economic issues facing farm businesses and rural communities when the Agencies take over responsibility for some farm business support schemes in April 2005. The Department should retain a role in evaluating progress and promulgating good practice so that effective local initiatives are shared quickly across the country.
9. **Experience in New Zealand shows that the transition from subsidy to a market-led farming industry is likely to be difficult but nevertheless worthwhile. Farm-based businesses need high quality support to help them through this transition.** New Zealand withdrew almost all its subsidies from its farming industry. After severe initial effects, recovery has been marked and sustained, to the point where the farming industry is now thriving. The Department should bear this experience in mind when setting up its new subsidy regimes and in the design of its farm business support schemes. Better support schemes should ease this transition and enable the farming industry to make the most of the opportunities in this new market-led environment.

1 Common Agricultural Policy reform and the future of farming

1. Radical reforms to the Common Agricultural Policy were agreed in 2003 and are due to be implemented from 2005. Ten separate farm subsidies which are based on production levels will be brought together into one subsidy decoupled from production – the “single farm payment”. Scotland, Wales and Northern Ireland have opted for systems which will base the single farm payment wholly or largely on historic entitlements, which in practice will be the amount of subsidy paid during the reference period 2000–2002. In contrast, farms in England will move in stages over the period 2005–2012 from a subsidy based largely on historic entitlement to a subsidy based on the area of farmland managed.²

2. The move in England to a single payment linked to the number of hectares managed marks a departure from subsidies linked to production and will be available to virtually all farmers. For these reforms to be effective, however, the farming industry will need to embrace a change in practice from production to maximise subsidy, to production which responds to the demands of the market and consumers. Historically, the farming sector has reacted relatively slowly to change, having been sheltered by the subsidy regime from market forces. The Department believed that the farming industry had, however, begun to diversify in response to the opportunities and challenges posed by the new regime, and that the removal of the subsidy system should encourage farmers to be more responsive to market signals than had previously been the case.³

3. Member States can decide the basis of the single farm payment, and they also have some discretion over how subsidies are allocated. Member States must top-slice some of the funds available for direct payments and transfer these funds to schemes which seek to promote environmentally-friendly farming (so called agri-environment schemes) and to other rural development schemes including farm business support. This top-slicing and transfer is known as ‘modulation’. The European Union has set a rate of 3% compulsory modulation in 2005, rising to 5% in 2007. Member States that previously operated discretionary modulation may also set additional national modulation up to a combined maximum of 20%, but only insofar as is necessary to fund Rural Development Schemes in place by 2005. In England, the Department has decided to set an additional national rate of 2% in 2005 and 6% in 2006, bringing total modulation to 10% in 2006. (No national rate has been set for 2007 and beyond as there is currently no legal base). The Department could help the industry adapt more quickly if the Council Regulation were amended to permit or require higher rates of modulation.⁴

4. Member States also have an option to implement ‘national envelopes’ which allow up to 10% to be deducted from single farm payments, to be redistributed to more environmentally-friendly farming or to improve the quality and marketing of farm produce. These national envelopes apply within a sector, such as arable or livestock, and must be redistributed within the same sector. In England, the Department decided not to

2 Qq 30–32, 63–65, 74, 125; Ev 5, 9–10, 17

3 Qq 66–67

4 Qq 31, 76–78, 85, 117–118, Ev 21, Ev 5, 11–12, 16

use a national envelope because sector-specific arrangements were not easily reconcilable with the move to an area-based scheme. In addition, envelopes involve a degree of recoupling, albeit indirect, because they must be applied within a production sector. There is also a 'national reserve', which is a mandatory deduction of up to 3% from single farm payments, to be redistributed to those farms which faced business changes after the reference period 2000–2002 and which would otherwise be denied subsidy or unfairly disadvantaged by the changes.⁵

5. The linking of single farm payment to achievement of environmental standards, enforced through an inspection regime, will be beneficial. Previous Common Agricultural Policy rules have tended to promote practices which do not necessarily increase productivity, and which can be detrimental to the taxpayer and the environment. Under the new regime, payment of subsidy to farmers and land managers will be linked to compliance with European Union Directives and Regulations covering aspects of animal husbandry, stewardship of the countryside and the environment (cross compliance). Farmers must also maintain land in good agricultural and environmental condition to protect soil, habitats and landscape features, as defined by the Department within a framework agreed by Member States.⁶

6. The baseline standards set for England include potentially significant benefits to the public through improved access to the countryside and preservation of rights of way. With 75% of the English land mass under the stewardship of the farming sector, this is an important issue. The Department will need a strong inspection regime if it is to enforce the delivery of the standards, and to reduce subsidy payments to farmers who do not meet the standards, or in extreme cases exclude them from entitlement to payment.⁷

7. The experiences of other countries suggest that farmers can adapt to a market environment, although they also suggest that unsupported transitions cause significant distress for rural communities. In New Zealand, for example, the farming sector is unsubsidised and thriving, but the transition to this point has been difficult. Government support to New Zealand's farmers has fallen from 35% of the value of agricultural output in 1983 to 1%. However, the parallels with the UK are not exact because, for example, when New Zealand changed its subsidies it also had a 20% devaluation and its agricultural export and food processing industry was more significant as a proportion of the national economy. In England, the Department sought a farming industry that was able to respond to market signals. The reform of the Common Agricultural Policy provided a significant step towards that goal. Another important difference between the UK and New Zealand situations was the importance the Department here attached to public money being used for the public good, namely to provide environmental benefits and stewardship of the countryside.⁸

5 Ev 40–41

6 Qq 46–47, 126–127

7 Qq 46, 136–138, 145–147; Ev 22

8 Q 13; C&AG's Report, para 1.14 and Figure 8

2 What forms of support to provide and to whom

8. Farming in England comprises a mix of farm types, ranging from large agri-businesses to small hobby farms. In the middle of that range are the small and medium-sized farms, usually family farms, which rely on farming for the bulk of their income. Many of these 93,000 smaller and intermediate sized farms are more likely to need advice and support. The rules of the new subsidy scheme prevent the Department from directly redistributing subsidy from large to smaller businesses, and the Department considered that to do so would run counter to the spirit and economic logic of the reform. The Department did, however, have discretion to devise farm business support measures which focused on those farm businesses which needed help most – the small and medium-sized farms. New systems were now under development to target resources towards advice and support for those farmers and disadvantaged areas most in need.⁹

9. The Department will need to develop innovative strategies to identify and assist the individuals and businesses most in need. Web-based guidance may assist farmers with access to the internet, but not all farmers have access to computer facilities. There were relatively low levels of computer literacy, for example, amongst some keepers and farmers on smaller hill farms. To provide timely and pertinent information and guidance to these farmers, strategies were needed to target those most in need. In Ireland, for example, the Opportunities for Farm Families Programme used cold calling for farms identified as needing assistance. The Department perceived potential operational difficulties with this approach, but it recognised the need to help farm businesses think through their choices more effectively.¹⁰

10. Diversification and assisting farmers to broaden their business base should be encouraged, but business planning skills amongst those farming smaller and intermediate sized farms may be limited. Farmers faced difficult decisions about the direction in which to move their businesses, and needed to balance their incomes from meeting market demand with that available through grants for good land management. Encouraging sound business practices, including the preparation of comprehensive business plans, would be essential if farmers were to be aware of the potential impact of their decisions on the continued viability of their businesses. The Department had made some advice and training available to combat this skill gap, but more emphasis on business viability was needed to make best use of the available resources. The current emphasis is on capital grants, but the provision of advice may bring better overall benefits.¹¹

11. Other countries have considerable experience of providing advice and training to help tackle the problems faced by farmers. In Sweden and Wales, for example, farmers interested in government support for business opportunities can contact a central point to access farm business advisors, who will then help the farmer apply for support. In

9 Qq 11, 14–15, 71, 119; Ev 22

10 Qq 41, 96; 27th Report from the Committee of Public Accounts, *Identifying and tracking livestock in England* (HC 326, Session 2003–04)

11 Qq 2–3, 5, 44, 50–55, 67

Germany, Ireland and Sweden, programmes are available to provide training in business management and to help set up farmers' networks. The Department should consider whether similar schemes would be feasible and more effective than current regimes in England.¹²

12. The former UK national advisory service, the Agricultural Development and Advisory Service was privatised in 1997. Advisory services in England do not meet the needs of farmers, with initiatives providing limited support and being poorly linked. The Department supported the Farm Business Advisory Service and some free environmental advice. Production orientated advice was available from the private sector, and environmental advice on specific local initiatives from a number of public sector sources. To help farmers meet the cross-compliance requirements of the Common Agricultural Policy, European Member States are required to have a Farm Advisory Service in place by 1 January 2007. Proposals for a Farm Advisory Service were still at the planning stage, but the Department was considering how to improve collaboration between advisors to provide a more joined-up service. It agreed there was room for improvement, but considered that there was no simple solution.¹³

13. Having identified an appropriate business opportunity, a shortage of capital and an unwillingness to take on all the risks associated with borrowing to finance a project may prevent some farmers from developing their businesses. The Department currently made some funding available through capital grants, but acknowledged the need to explore the flexibility offered by alternative forms of assistance. Use of loan guarantees, for example, on similar terms to the Small Firms Loan Guarantee scheme provided by the Department for Trade and Industry for small businesses, could stimulate greater private investment. A loan guarantee scheme would help promote a culture of entrepreneurship, and provide assistance to more farmers than a conventional capital grants scheme, and at a lower cost to the taxpayer, without perpetuating a culture of dependency on subsidy or grants.¹⁴

14. Not all initiatives aim to assist individual farms. In France and Denmark, for example, local farmers tended to form partnerships and co-operatives to take advantage of economies of scale, often with some form of public support. Historically, in England there was much less of a tradition of co-operation between local farming businesses. The Department agreed that co-operatives and other local partnerships were one way forward. Schemes such as the farming industry-led English Farming and Food Partnerships encouraged farmers to work together to achieve profit and sustainability through local co-operation and partnership. Co-operatives could result in economies of scale, greater bargaining power, and an opportunity for better connection with the rest of the supply chain by linking production and processing units under shared management. They could, therefore, play a significant part in promoting farm businesses.¹⁵

12 C&AG's Report, Appendix 1.2

13 Q 4

14 Q 43

15 Qq 16, 25, 27-28, 70, 98

3 Delivering support more effectively

15. The Department had already announced that it would be restructuring the present 100 or so rural, agricultural and environmental schemes into three major funding programmes. This action should simplify access to support considerably, but it is likely that rationalisation will be delayed until 2007. The delay has been caused by on-going negotiations with other Member States and the need for primary legislation to set up an integrated agency. This agency will be a new non-departmental public body tasked with protecting and enhancing the environment, and will be formed from the merger of parts of the Countryside Agency, English Nature and the Department's rural development service.¹⁶

16. As well as simplifying schemes to encourage greater take up, the Department also needs to reduce scheme administration costs, particularly for the Rural Enterprise Scheme and Vocational Training Scheme (**Figure 1**). The Department expected the introduction of fast-track applications to reduce running costs, speed up decision-taking and reduce the bureaucracy for farmers. It also anticipated that replacement of an out-dated computer system could reduce overall administration costs by around 40%. Reducing scheme complexities could also generate further running cost savings.¹⁷

Figure 1: Average cost of administering applications and approved grant in 2002–03

Scheme	Running cost of scheme	Running cost proportion of scheme cost	Administration cost of each application	Administration cost of each grant approved	Average grant
Rural Enterprise Scheme	£4.9 million	31%	£2,100	£5,200	£51,100
Processing and Marketing Grants	£0.7 million	15%	£3,000	£6,200	£177,700
Vocational Training Scheme	£1.1 million	46%	£2,600	£5,300	£40,300

Source: National Audit Office

17. Common Agricultural Policy subsidies, including the single farm payment, would continue to be paid by the Rural Payments Agency. From April 2005, regional decision-making and funding for socio-economic schemes to help rural and farm businesses will be delegated to the Regional Development Agencies, whereas agri-environment schemes will be the responsibility of the new integrated agency. Strategically, the Regional Development Agencies should be best placed to link up with the other forms of business support which they already oversaw, and which would be delivered through the Small Business Scheme. Much of the Regional Development Agencies' experience, however, relates to sustainable development in urban areas, and particularly larger scale strategic economic regeneration. The extent to which this experience is directly relevant to, and can assist, local farming and rural food industries to become more sustainable, competitive and customer-focused remains to be seen. To be effective, the Agencies will need to develop or bring on board the

¹⁶ Qq 6–7

¹⁷ Q 81

requisite expertise quickly to assist individual farmers and smaller rural farm businesses to respond to the challenges posed by the Common Agricultural Policy reforms.¹⁸

18. Giving local interests, including farmers, a greater say in the design and running of development schemes is essential to meeting local needs. There is a risk that regionally based organisations, such as Regional Development Agencies, will not be fully attuned to and able to recognise and meet local needs. To mitigate this risk the Department had tasked the Government Offices in the regions to identify the appropriate local participants in each area. The Department favoured allowing each region to identify local priorities and needs within a broader framework of national priorities. This approach was likely to result in up to eleven regional schemes, with a corresponding need to reduce the risks of inefficiencies and identify good practice.¹⁹

18 Qq 37–38, 57–61

19 Qq 8–9

Formal minutes

Wednesday 9 March 2005

Members present:

Mr Edward Leigh, in the Chair

Mr Ian Davidson
Mr Brian Jenkins

Mr Gerry Steinberg
Jon Trickett

The Committee deliberated.

Draft Report (Helping farm businesses in England), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 18 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Twelfth Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select Committees (Reports)) be applied to the Report.

[Adjourned until Monday 21 March at 4.30 pm

Witnesses

Wednesday 13 October 2004

Page

Sir Brian Bender KCB, Mr Peter Cleasby, and Mr Martin Nesbit, Department
for Environment, Food and Rural Affairs

Ev 1

List of written evidence

Department for Environment, Food and Rural Affairs

Ev 21

Department for Environment, Food and Rural Affairs

Ev 39

National Audit Office

Ev 40

List of Reports from the Committee of Public Accounts Session 2004–05

First Report	The management of sickness absence in the Prison Service	HC 146
Second Report	Tackling cancer in England: saving more lives	HC 166
Third Report	The BBC's investment in Freeview	HC 237
Fourth Report	Improving the speed and quality of asylum decisions	HC 238
Fifth Report	Excess Votes 2003–04	HC 310
Sixth Report	Excess Votes (Northern Ireland) 2003–04	HC 311
Seventh Report	Foreign and Commonwealth Office: Visa entry to the United Kingdom: the entry clearance operation	HC 312
Eighth Report	Ministry of Defence: Battlefield Helicopters	HC 386
Ninth Report	The Drug Treatment and Testing Order: early lessons	HC 403
Tenth Report	Welfare to work: tackling the barriers to the employment of older people	HC 439
Eleventh Report	Improving public transport in England through light rail	HC 440
Twelfth Report	Helping farm businesses in England	HC 441

The reference number of the Treasury Minute to each Report will be printed in brackets after the HC printing number

Oral evidence

Taken before the Committee of Public Accounts

on Wednesday 13 October 2004

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Allan
Mr Richard Bacon
Mrs Angela Browning
Mr David Curry
Mr Ian Davison

Jim Sheridan
Mr Gerry Steinberg
Jon Trickett
Mr Alan Williams

Sir John Bourn KCB, Comptroller and Auditor General, National Audit Office, further examined.

Ms Paula Diggle, Second Treasury Officer of Accounts, HM Treasury, further examined.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL:

Helping Farm Businesses in England (HC 1028)

Witnesses: **Sir Brian Bender KCB**, Permanent Secretary; **Mr Peter Cleasby**, Head of Skills and Rural Enterprise Division, and **Mr Martin Nesbit**, Head of Rural Development Division, Department for Environment, Food and Rural Affairs, examined.

Q1 Chairman: Good afternoon, and welcome to the Committee of Public Accounts where today we are looking at the Helping Farm Businesses in England and we are joined, I am pleased to say, by Sir Brian Bender who is the Permanent Secretary at the Department for Environment, Food and Rural Affairs. Could you please introduce your colleagues?

Sir Brian Bender: Thank you, Chairman. On my left is Mr Martin Nesbit, the head of our Rural Development Division, and on my right is Mr Peter Cleasby, head of our Skills and Rural Enterprise Division.

Q2 Chairman: Obviously the Common Agricultural Policy is being reformed at the moment; this is a very interesting time; we are moving into the single farm payments, so we want to, I think, discuss how we can make these grants more effective. If I may, Sir Brian, lead off the questioning, could I ask you to look at pages 24, paragraph 3.7, where you will see that most of your funding, 79%, that is nearly £200 million, goes on grants in this area, and if we read on in those paragraphs down to 3.12, we see that actually, as far as farmers are concerned, advice and training looks far more effective. Why are you spending so much on these grants?

Sir Brian Bender: Our basic approach involves helping the farmers who know they want help, and the purpose of the grants is to help them with the change that is risk based and capital intensive. The aim of the business advice is to help analyse and improve their business. We are looking at the balance of spend; in the short term we will be spending and will need to spend more on advisory support on cross compliance; we will be putting proposals to our ministers on the Farm Business Advisory Scheme replacement; and in the longer term we will want to look at the balance of spend

under the new Rural Development Regulation. So this is something we keep under review and will be reviewing in the period ahead.

Q3 Chairman: To paraphrase then, this is history; you are moving on now; you realise that advice training is probably more effective, and that is where you are heading towards?

Sir Brian Bender: Well, the balance under the existing regulation was based on consultation with the industry. We will want to consult further as we move ahead as to what the right balance is. I would expect a bigger proportion on advisory issues but I would not want to pre-empt that.

Q4 Chairman: Thank you. If you look at paragraph 3.18 and 3.19, we know that it is now seven years since you abolished ADAS, or rather that it was privatised, but we read in paragraphs 3.18 and 3.19, that the services that have replaced ADAS provide "limited support to farmers, and are poorly linked. The Curry Commission concluded that 'we do not think that the current approach to farm advisory services meets the needs of farmers now . . . '". Why is it seven years after you abolish ADAS you are apparently not meeting the needs of farmers?

Sir Brian Bender: We feel there is not a single magic bullet that will get advisers who are expert in every subject from business planning through to technical advice on the ground, and therefore the question is how we can join up better, or get better consistency of advice and better collaboration between advisers, helping to get better co-ordination, and that is what we are working on, including the announcement today for wider rural businesses on rural pathfinders, to get local government and local

 Department for the Environment, Food and Rural Affairs (Defra)

players joining up. It is a matter of effective joining-up between experts on the ground, but there is undoubtedly room for improvement in the service.

Q5 Chairman: We can always come back to that later, that is fine. Thank you very much. If you now look at page 23, paragraph 3.2, you will see there that “The stakeholders we consulted told us that applications to these schemes were bureaucratic, complex and time-consuming . . .”. Indeed farmers need apparently, if they are going to understand this, to pay experts to help them. What is going wrong?

Sir Brian Bender: We have listened to that, we have worked on it, and made a number of changes already to address that issue. This was an evaluation that took place a couple of years back. We now have a fast-track application process for applications below a certain threshold for one or two of the schemes; we have more user-friendly scheme guidance; and we are actually funding some projects to provide independent project facilitation, so we have been on the case on this issue and it is beginning to make some difference.

Q6 Chairman: If we pursue this further and turn to page 21, paragraph 2.17, you will see there that you promised in your Rural Strategy 2004 to simplify the 100 or so schemes currently available; you were going to put them into free funding programmes by 2007. That date of 2007 is not there in that paragraph but that is right, is it not?

Sir Brian Bender: That is correct.

Q7 Chairman: Why so long?

Sir Brian Bender: It is not a straightforward exercise, Chairman. Chris Haskins in his own report recognised that it would take at least a couple of years to make these changes. We have to make sure when we do it we engage and get it right. Some changes will be happening from 1 April next year, so that the current Countryside Agency funds for socio-economic programmes will be delivered at regional and local levels through the Regional Development Agencies. But the full effects, the 2007 date, relates to two things: first of all, the need for primary legislation to set up the new non-departmental public body announced by Mrs Beckett in July, and the second is that some of the simplification will require simplification within the EU Rural Development Regulation, which is currently under negotiation in Brussels.

Q8 Chairman: Could you now, please, turn to paragraph 4.7 which you can find on page 34? Can you give farmers a bigger say in the design and running of these development schemes?

Sir Brian Bender: We do intend giving local interests which include farmers a bigger say through the action we are taking to devolve more responsibility to the Regional Development Agencies and to local players.

Q9 Chairman: I am going to interrupt you straight away. How local is regional? The average farmer is not very interested in the Regional Development Agencies. They want something local on the ground.

Sir Brian Bender: We have asked our Government Offices to set up the appropriate arrangements for local partnerships in each area, as we do not think it is a one size fits all prescription from Whitehall: we want to make sure that the Government Office ensures that the right local players are involved in these arrangements at regional level.

Q10 Chairman: Now, I want to end with a couple of general questions which relate to overall farm subsidies and, if I may say, the politics—with a small “p”—of them.

Sir Brian Bender: Chairman!

Q11 Chairman: If you look now at paragraph 1.6 on page 10, you will see there that we are talking at the end of that paragraph of “around 93,000 small and medium-sized holdings, run largely by individual farmers or farm families. They are heavily dependent on agriculture”—and I would add “and on your subsidies—“and are the most likely to struggle to adapt to the changing environment”. What is their future, Sir Brian?

Sir Brian Bender: We set out in the Sustainable Farming and Food Strategy at the end of 2002 the vision for the future of farming, which was a sustainable industry where farmers would be able to be more connected with the market, and the decoupling of support under the Common Agricultural Policy achieved last year should achieve that, and the public subsidy, public benefit, taxpayer benefit would go towards public benefits like environmental benefits. The reform of the Common Agricultural Policy last summer is a big step towards achieving that; it is then a matter of how the businesses themselves, with support and leadership from within the industry and partnership between the industry and government and supporting schemes from the government, what they can do to help. The government does not have a prescription for the number of farmers in any particular sector. The government is aiming to have a sustainable industry, and to have vibrant rural communities, but that does not mean there should be X dairy farmers in one region or Y arable farmers in another. The government is also interested, as it rightly should be, in how well the environment and countryside is looked after, so we are trying to set a framework that will allow the farming industry to help determine its own future without the subsidy scheme distorting some of their potential behaviour.

Q12 Chairman: Others can come back on that but I put to you that that is, with respect, rather dodging the question. You have these 93,000 smaller holdings; there is a limit to diversification, is there not? There is a limit to how many golf courses, ice cream parlours—all the rest that they can do.

Sir Brian Bender: I have not got the figure immediately to hand. I think it is 58% of farmers who are involved in some form of diversified activity

 Department for the Environment, Food and Rural Affairs (Defra)

or another but clearly it is not the right answer for every farmer. The issue is what is right for their businesses and what support government can give, and what the rest of the industry can do in helping them make those decisions.

Q13 Chairman: Now, the last question I want to ask you is about New Zealand which you can find mentioned in Figure 8. You know that New Zealand now has a large thriving farming sector, their subsidies used to be equivalent to 35% of agricultural output, they are now down to 1%; why do we not go down the New Zealand route?

Sir Brian Bender: Firstly, it is dangerous to draw precise parallels. When they changed their subsidies they also had a 20% devaluation; and their agricultural export and food processing industry is far more significant as a proportion of their overall economy than ours. I described in reply to your last question what the government's overall aim is in the period ahead, which includes an industry that is able to respond to market signals, and the reform of the Common Agricultural Policy last year provided in most sectors a massive step towards that. There are one or two glaring absences like the sugar regime, which is currently on the table; the WTO negotiations provide the next opening for reductions in tariffs and an end-date for export subsidies, so we are progressing towards that but we will not be in the New Zealand position for some time to come. An important difference between the United Kingdom situation and government policy objectives and the New Zealand position is the importance that government attaches to public money being used for a public good, the environmental benefit and the countryside stewardship, so even in the longer term, as and when any direct subsidies may have been phased out, the government sees a likely continuing need to pay farmers for the public benefits that their stewardship of the land involves.

Q14 Chairman: Where I live in Lincolnshire, one agri business, a farm, receives £900,000 a year.

Sir Brian Bender: One farm?

Q15 Chairman: One estate, I should say. Some people in this Committee might suggest to you that that money would be better spent on helping small struggling farmers with some kind of tax credit system?

Sir Brian Bender: Well, there is about £1.7 billion of European taxpayers' money paid back to English farmers through the Common Agricultural Policy and the steps that were taken last year will help a more rational approach to that, but we are not quite at total rationality, Chairman.

Chairman: We will pursue that later.

Q16 Jon Trickett: I do not know a huge amount about agriculture although I think 9/10 of the land area in my constituency is being farmed by a handful of people, actually, but looking at it perhaps from the outside it seems to that one of the issues which needs to be got to grips with is hinted at in paragraph 4.17, at the end of this document. It talks about the

food chain as a whole and it talks about a number of initiatives which you have taken. Do you want to just say something first about how you as a department see the food chain and the relative position of the farmer in that?

Sir Brian Bender: Well, firstly, the simplistic answer is that it is hugely important to the extent to which the farmer is first of all responding to the signals from the end customer and, therefore, is connected with the food chain. We have a number of activities, initiatives, the Food Chain Centre, the Red Meat Industry Forum, English Farming and Food Partnerships, which are led from the industry with some help given from the department to help farm businesses work more effectively with other players in the chain. It is interesting that if you look at the productivity of British farms against the best performance in Europe, the countries that are best, France and Denmark, have a high record on co-operation and collaboration, and that is something that British farmers, for whatever historical reasons, have not been as strong at, and English Farming and Food Partnerships is one vehicle to try and encourage that. I will not get in detail on the end seller, the retailer and supermarket, but the Office of Fair Trading, as the Committee may know, are having a compliance audit of their code of practice on supermarkets.

Q17 Jon Trickett: Yes, because the fact is that the relationship between the farmer as a producer and the consumer is mediated by the supermarkets, is it not? Now, 90% of all grocery purchases are done through four supermarket chains, are they not, in the United Kingdom?

Sir Brian Bender: Yes, and I think about 70% in the biggest.

Q18 Jon Trickett: Well, I think Tesco's dominates. 27% I think of all grocery purchases are done through Tesco's alone. Would you agree that the farmer is held in an armlock by the supermarkets?

Sir Brian Bender: Well, I would not want to comment on the particular quote you are referring to given three or four years ago, Mr Trickett.

Q19 Jon Trickett: That was the Prime Minister who said that, was it not?

Sir Brian Bender: It was indeed. There are real issues around that, and the extent to which any supplier to a supermarket, whether medium or small, feels able to complain at the practice of the buyers. As I said, the OFT, having produced the code of practice, is conducting a compliance audit this year and they aim to report by the end of the year. Separately and in parallel, the NFU have been developing proposals for a voluntary buyers' charter which they have been discussing with the Food and Drink Federation and the British Retail Consortium, so there are various efforts to try and get a handle on this issue.

Q20 Jon Trickett: Is there not statistical evidence which the department has to demonstrate that the relationship between the retail price and the cost paid to the farmer has widened the gap substantially

 Department for the Environment, Food and Rural Affairs (Defra)

at the expense of the farmer? The cost of production is a much smaller element now as a proportion of the price than it was even a few years ago?

Sir Brian Bender: I do not have that data with me. I can certainly provide what analysis we have for the Committee afterwards if that would be useful.¹

Q21 Jon Trickett: I have information that the price of, for example, potatoes is seven times higher than the price paid to the producer, to the farmer. Would that sound about right?

Sir Brian Bender: I would not like to comment, if that is the data you have. There are obviously some explanations within that on packaging where relevant and on other costs—

Q22 Jon Trickett: Yes, but the package of a bunch of spuds hardly takes up to 6/7 of the cost. Obviously there is distribution and warehousing and other things, one is aware of that, and supermarkets are involved in costs themselves. Is it not a fact, though, that in terms of the supply chain the small number of vastly—well, dominant supermarkets have to be at the expense of the smaller scale and multiple nature of the producers?

Sir Brian Bender: Well, I think the only answer I can give on that is that the competition authorities did look at this and did a review of it a few years back and, as a result, the code of practice was produced. Now, the question then is whether this code of practice is working and the answer is that a lot of people at the supply and primary end do not think it is, which is why the OFT are doing this compliance audit.

Q23 Jon Trickett: Are you aware that many farmers say they cannot complain because they are afraid that the buyers will use their dominance?

Sir Brian Bender: I am aware of that. I have discussed it with people in the food chain which is one reason why I think the National Farmers' Union themselves are working in parallel on this voluntary charter to see if that will help at all.

Q24 Jon Trickett: Is it not incumbent on you to form a view as a department rather than just to leave it to a voluntary code?

Sir Brian Bender: I think there are two answers to that. First of all competition policy is made by the competition authorities, not by other departments, but Defra can form a view and give its own evidence to the OFT and the Competition Commission and, secondly, the National Farmers' Union have said to us at the moment that they might want our support for what they are doing at the right time but at this stage they would like to have a free run, so to speak, in talking to other players and seeing what their voluntary talks can lead to, but there may well be a case, as indeed happened two or three years ago, when MAFF was still in existence, where ministers were involved in some work on a voluntary code.

Q25 Jon Trickett: You referred earlier to the English Farming and Food Partnerships. It is a quasi government body which I think you were, and I think Mr Curry was as well probably in some way, a progenitor of this. Now Stuart Thomson, who I think is the chief executive, is quoted as saying that there is a massive chain between the producer and the consumer and that the farmer is the weakest link in that chain, that supermarkets are wholly dominant, and that is manifestly the case, it seems to me. Are you not really being rather passive in relation to this, perhaps because of a fear you may have—I do not know—in relation to the power of the supermarkets.

Sir Brian Bender: No, the department has no view one way or another on that. The work of organisations like the Food Chain Centre and Red Meat Industry Forum is looking at values throughout the chain and some of the analysis would show that some of the weaker links are in the middle of the chain in terms of not adding value, and therefore some of these costs you were referring to earlier can be squeezed out from the middle of the chain and not simply imposed on the beginning of the chain.

Q26 Jon Trickett: The department commissioned, and I am surprised you have not referred to it, a report by London Economics on precisely these matters, did it not, and that report which I have a summary of—it is on the web—I think demonstrates all the points I have been making which I do not think you would necessarily dissent from. But on your own website it says, "At this stage Defra takes a neutral position on London Economics' report's findings" and it talks about calling a seminar to discuss the matter further. Is it not clearly the case that the department is allowing farmers to be fleeced by these multiples?

Sir Brian Bender: Well, the department and the government are keen to get the players together. It is not the role of the department to interfere in the role of the competition authorities but, for example, in the dairy supply chain Lord Whitty has been taking meetings of the various players trying to get a better shared understanding, so the accusation you made a few minutes ago of passivity is a bit unfair, but it is an extraordinarily difficult issue.

Q27 Jon Trickett: It is obvious that one appropriate response maybe on behalf of the small scale producers, as the farmers are, is to come together in co-operatives and other forms, is it not?

Sir Brian Bender: Yes.

Q28 Jon Trickett: That might be one direction in which to go. Can you describe very briefly what the department is doing to stimulate the development of producer co-operation in that way?

Sir Brian Bender: Our primary tool for that is the English Farming and Food Partnerships body that you mentioned earlier, Mr Trickett, and also we talk to the Plunkett Foundation and others. It has to be an important way forward, looking also at international comparisons.

¹ Ev 37–38

 Department for the Environment, Food and Rural Affairs (Defra)

Q29 Jon Trickett: And has this seminar which I just referred to, and you may not have an answer to this, taken place? When is it? Will it be action-orientated? Will it come forward with recommendations? Is it just a talking shop?

Sir Brian Bender: Pass, but I am very happy to provide a note on it.²

Jon Trickett: Thank you.

Q30 Mr Curry: Sir Brian, we should perhaps remember there has been an enormous shake-up in the milk chain recently and that the supermarkets are not a stable feast. After all, Tesco is dominant; Asda is doing quite well; Morrisons is now Safeways and Sainsbury's is in a vertiginous collapse, and we all wait and see whether Marks & Spencers sorts itself out, so the competition between supermarkets is just as important as their relationship down the chain, but that is not what I wanted to talk about. I wanted to talk about this letter you have written to the European Commission setting out how you propose to implement the single farm payment. As a monument of simple English I have to say that leaves something to be desired and my heart goes out to anybody in the Commission who has the important job of reading it. It does demonstrate, of course, that the single farm payment is going to be applied very differently in the four nations of the United Kingdom, and inevitably English farmers get the worst end of all this. They are going to get the toughest rules of costs, cross-compliance—inevitably, and they have also got the greatest instability in that we are changing completely the mechanism and the basis of the payment. On top of that we have the prospect of the Haskins review, so not merely is the actual policy changing but there is a possibility of the instruments by which they are delivered changing as well. What concerns me is the proposal that these instruments should be handed to regional development agencies. It is not because I am against regional development agencies: I think they are there to do large scale, strategic economic jobs. Giving them the nitty gritty of administering farm schemes seems to me to be an entire contradiction of what they are there for. Could I urge, if you get the primary legislation you need to do this, that Lord Haskins' report should go the same way as his proposed directly elected assemblies?

Sir Brian Bender: I prefer to pick up your point about the difference between England, Scotland and Wales, because there are two particular responses. First of all, all four countries are going to have full decoupling, which is the fundamental point and, secondly, the changes which you rightly point out are the way we are doing it in England will be phased in over eight years which is quite a long time.

Q31 Chairman: I think—and I will add this on to Mr Curry's time—you had better explain to all the members of the Committee the modulation of decoupling, briefly.

Sir Brian Bender: Essentially, hitherto, farmers under the Common Agricultural Policy received a large part of their subsidy linked, coupled, to what it was they were producing, so if they had sheep at a certain time of year, if they had a certain volume of production of crops, that related to the subsidy. That, therefore, distorts market behaviour. If you know you get a subsidy by having your sheep at a certain time of year, that discourages you as a farmer from selling them when the market might want. The negotiations of last year allowed Member States to have up to 100% decoupling for most of the regimes, and the benefit of that is it will allow farmers, so to speak, to farm the market rather than the subsidies. It removes the sheltering and distortion that the subsidies provide. Modulation is a top slicing of a part of that subsidy and moving it across to agri-environment types of schemes, and the United Kingdom government began doing that unilaterally under EU rules, but it was the only one to do it a few years ago in 2000. The new regime now has all Member States moving in a certain direction. The United Kingdom government has also agreed to cofund, so the amount of money that goes into rural communities as a result of modulation is larger than the amount taken off the direct payment for farmers. That is, I hope, a brief analysis.

Q32 Chairman: That is very clear. Thank you. Also, Mr Curry mentioned the difference between the four nations. I think Northern Ireland has a static hybrid system and England a dynamic hybrid system. Could you briefly explain to members of the Committee what that means? Your "starter for 10"!

Sir Brian Bender: The fundamental point is that all four are having 100% decoupling. The question then is the extent to which the subsidy is based on the historic entitlement of the farmer or the area of land that the farmer has, and Mrs Beckett had decided and announced earlier this year that in England we would move over an eight year period towards an area-based entitlement, which she felt was a more sustainable way forward over the long term. Scotland and Wales, as I understand it, have based it much more on a historic basis, but, as I said to Mr Curry, because the English arrangements are being phased in over eight years, the ministerial judgment was that that would allow English farmers time to adapt and it was a more logical and sustainable way of providing the subsidy. Now I am afraid I have forgotten the initial question!

Q33 Mr Curry: Just to complete the picture, in order to get their subsidies there has to be a set of rules they have to abide by called cross-compliance and there is a mandatory set of European rules, and we have added discretionary rules on top which do not apply across all four parts of the United Kingdom.

Sir Brian Bender: Although if I may say, and I hope the Committee will not regard this as point scoring, I think at least two members of this Committee engaged in questions or correspondence to our ministers encouraging them to apply this decision—

² Ev 37–38

 Department for the Environment, Food and Rural Affairs (Defra)

Q34 Chairman: That is point scoring!

Sir Brian Bender: In that case I withdraw it, Chairman!

Q35 Mr Steinberg: Who are the members?

Sir Brian Bender: I would have to look at my brief.

Q36 Mr Steinberg: How do you know there were two?

Sir Brian Bender: It may have been more.

Q37 Mr Curry: The point I wanted to make is that I think there is a real problem. I have deep hesitations about asking the regional development agencies to fulfil the role which is what they are going to do. I do not ask you to respond to it; I simply—

Sir Brian Bender: Can I respond? The first thing is the Regional Development Agencies will not be delivering the agri-environment schemes. The schemes of Countryside Stewardship or, as it will be developed, the Entry Level Scheme, will be being delivered by the new Integrated Agency bringing together English Nature, our own Rural Development Service and parts of the Countryside Agency. What is going to Regional Development Agencies is the so-called socio-economic schemes, and the logic of that is that they are better placed to link it up with other forms of business support that they are responsible for overseeing and, through the Small Business Service, for example, will be delivering. So that is the logic of the change.

Q38 Mr Curry: Have you seen anything which has been proposed in Scotland, Wales and Northern Ireland which you think is better than what you are proposing?

Sir Brian Bender: I think the main benefit Scotland and Wales have is size and, therefore, I would suggest that the devolution of responsibility, the delegation of responsibility to more regional and local decision-making, led in this case by the Regional Development Agencies, provides the opportunity to join things up better than we can from Westminster.

Q39 Mr Curry: Do you think it is a disincentive for diversification, and I appreciate that large numbers of farmers have diversified, that when you set up different enterprises within your farm business they all fall under different fiscal regimes, or are taxed separately?

Sir Brian Bender: Well, the answer is it would be a problem, yes.

Q40 Mr Curry: So it would help diversification, it would make it less of a complicated issue to go into, perhaps, if one could look at these under a more collective fiscal nature?

Sir Brian Bender: I would think it would. I am not well sighted on the point but I would think it would.

Q41 Mr Curry: One of the differences between the schemes in England and the scheme in, for example, Ireland is we do first come, first served and I understand in Ireland, according to the report of the

Audit Commission, people go and say “Which are the most vulnerable sort of farmers who might benefit” and they try and sell the policies to them. Do you think there is some merit in using this very self-consciously, proactively as it were, to try and help those who might otherwise be the most vulnerable?

Mr Nesbit: We do not operate a first come first served system. It is a selective system based on public benefits but, you are right, we do not have the same level of intervention very early in the process. What the NAO research has done is throw up some very interesting examples of how other Member States have tackled that issue. The Irish example to which you refer involves a degree of cold-calling on farms, and I suspect the insurance costs of that could be quite prohibitive if we tried it in this country, but the general message of the NAO Report that we need to help farm businesses think through their choices much more effectively is one that I think we could take on board.

Q42 Mr Curry: The Irish, you might say, see this as a sort of welfare, or playing a role in welfare, but you are saying that basically you see this as part of an economic development programme?

Sir Brian Bender: Largely. We see the role essentially of these schemes as helping farmers work out what is right for their businesses, possibly in co-operation at more than one farm.

Q43 Mr Curry: One could argue that if the purpose of decoupling is to put farmers closer to the market place then there is a contradiction in saying that, on the one hand, you are going to get closer to the market place and, on the other, here are lots of grants to help you do it. Is there not some merit in the American scheme of loan guarantees which is a market-placed system; perhaps it can lever in different sort of capital; and even if you had quite a high default rate surely that would come out as a lower cost to the public exchequer than pure grants which are, in any case, a pure disbursement?

Sir Brian Bender: We have not so far issued loan guarantees, as the Report said, for a number of reasons, but the primary reason is we have not had any evidence of need and little evidence of demand for farming organisations, for example, even from tenant farmers. The Tenancy Reform Industry Group did not raise this last year. The Small Firms Loan Guarantee Scheme of the DTI has provided a very small number, about three dozen, loans to agricultural businesses in 2003–04. But we are looking at it, not least in the light of the NAO Report, and will have discussions with DTI on how the DTI scheme might be applied, taking into account the recent Graham review of the loan scheme that was published earlier this month, so again it is something we are looking into but not against the background of a clamour of need.

Q44 Mr Curry: The Report finds that there is a significant degree of deadweight cost and replacement in these grants. Given that all grant schemes have elements of this, this does seem quite a high figure, does it not?

 Department for the Environment, Food and Rural Affairs (Defra)

Sir Brian Bender: It does. I think the crucial sentence from a survey that was done as part of our own evaluation report, rather than the NAO's own work, said that for about half of the successful applicants, and this is for the Processing and Marketing Grant, their project would have gone ahead anyway albeit on a smaller scale or longer time-scale. Our judgment is that last part is key, because the crucial question of whether there is sufficient public benefit needs to take account of whether the grant achieves something of worthwhile difference to the scale, speed or ambition of the project. So I think the figure of half is potentially misleading. But we have actually rejected, I think, about 18 cases and it is something that we look at.

Q45 Mr Curry: Equally, when we look at the schemes which have gone towards support for the supply chain they have been some of the less successful schemes with perhaps not so much money going back towards the producer. One could argue, to take Mr Trickett's point, if we are talking about Tesco, Tesco is not short of a bob or two. Should they not be supporting these supply schemes? Why should we be helping Tesco's business?

Mr Nesbit: Certainly the primary aim of the Processing and Marketing Grant is to ensure, to get back to Mr Trickett's line of questioning, that a greater percentage of the value added goes back to the farm businesses, so there will always be conditions on Processing and Marketing Grant awards to ensure that the raw materials for the processing business come from farmers in the region or area concerned.

Chairman: Thank you very much.

Q46 Mr Steinberg: Could I quote from page 10, paragraph 1.7? "Although farming has been in decline for years, and now employs less than 2% of the United Kingdom workforce and accounts for less than 1% of the economy"—"less than 2% of the workforce and less than 1% of the economy". One could draw a completely different conclusion from this Report than the NAO do. My conclusion would be why do they get any subsidy at all? They do not need it. Why can they not work in the free market and those that are successful would be very successful and those that would fail would fail, just like any other private enterprise? Why do they need these huge subsidies?

Sir Brian Bender: Our ministers did ask this question in the run-up to the publication of our own Sustainable Farming and Food Strategy, as I mentioned earlier. What is the difference between farming and the coal, steel, shipbuilding, vehicles industries, and the answer is they look after 75% of the land mass. Therefore, even in a perfect world where we could decide freely exactly what we wanted to do, there is a public good in terms of the additional cost and burden of looking after the environment effectively that is worth the spend of some taxpayer money. So that is the primary difference. There is also a secondary question of vibrancy of rural communities and the role that farm

businesses may play in that, but I note that 94% of people employed in rural areas are not employed directly in farming.

Q47 Mr Steinberg: Following on, you have basically mentioned the next point I was going to make because further on it does say, "maintaining an attractive landscape, keeping natural resources like water and soil in good health, and preserving wildlife habitats", and the total subsidy is £3 billion a year into the farming industry. It is a hell of a lot of money to pay. Presumably it could be done a lot cheaper than that?

Sir Brian Bender: Quite a lot of the subsidy, at least until next year when the decoupling happens has, as I said earlier, been directly linked to what a farmer produces. That sort of argumentation is why the government some years ago decided to use this device of modulation, and take some of that subsidy and use it on environmental benefits, and it is why, in response to Mr Curry's line of argument, the government decided to introduce rather more rigorous requirements on this thing called cross-compliance, which a farmer has to do in order to get the new decoupled subsidy, than planned in Scotland and Wales. So the government is very conscious of that and is trying to address it within the constraints of the regulations.

Q48 Mr Steinberg: The Chairman mentioned New Zealand and I was on a CPA visit in New Zealand at the beginning of the summer, and this question of subsidy was discussed there, and the problem was it needed a political decision. Somebody had to have the nerve and the audacity, if that is the right word, to bring this policy in because clearly the New Zealand farmers at the time receiving subsidy did not want to lose it, but once somebody grasped the nettle and made that decision and after the interim period of problems which you always get when you have a dramatic change, everybody now is in favour of it including the farmers. I have farmers in my constituency, one who I am particularly friendly with, and believe it or not he is very supportive of the New Zealand way. He says he does not want to have these dammed subsidies, and he would prefer not to have them and work within the free market.

Sir Brian Bender: But I wonder whether your farmer you spoke to would be happy to do that if France did not, because one benefit New Zealand has is it is a relatively isolated market. It has Australia next door, and clearly what we do has to have regard to what other close trading partners do, so we need to co-operate. We have something called the Common Agricultural Policy, but whether or not we had it we would need to operate in a framework of what our major trading partners are doing as well.

Q49 Mr Steinberg: Will there ever be a move towards the abolition of total subsidy?

Sir Brian Bender: I think the World Trade Organisation negotiations, if successful, will get an end-date for export subsidies and that will be hugely important and will open up more access for developing country markets as well. The ceiling for

 Department for the Environment, Food and Rural Affairs (Defra)

overall subsidy was set up to, I think, 2012 by the European Council a couple of years back so we are on a long path here to zero.

Q50 Mr Steinberg: Moving on, the next point I wanted to ask you about was regarding the grants themselves. Do you intend to continue to give grants in the next rural development schemes when they are introduced?

Sir Brian Bender: I might ask Mr Nesbit to respond in more detail but I would expect us to have some grant schemes. I think exactly what we apply would depend on what the regulations allow and what our experience is, but I would be surprised if we moved completely away from some grant schemes for business development.

Mr Nesbit: Yes. Certainly I would expect the future rural development programme to be heavily focused around grants. There are questions about whether you focus those grants on capital expenditure or advice or facilitation. I think that is one area we ought to look at very carefully.

Q51 Mr Steinberg: I was moving on to the fact there are two ways of looking at this. If you give grants to successful innovations, one could argue and say, “Well, they would have been successful anyway so why give grants to something?” On the other hand you could argue and say, “Well, you should only give grants to those who are less well off and not doing so well”, but if you argue that why should public money be given to people who are inefficient and are failing to be successful?

Sir Brian Bender: We are dealing with an industry going through potentially massive change and massive transition, so the question is what is the role of the public taxpayer subsidy to help them through that, and if we can get them through that process, through the single payment process, to look at their business better, to invest in different ways, to invest in innovative ways, that is of benefit over this period of massive transition.

Q52 Mr Steinberg: I come out on the side that one should perhaps reward those who are the most successful, and if there is an innovation then support that innovation to ensure it is very successful but one should not be giving grants away willy nilly to those who are basically not providing a successful business?

Sir Brian Bender: But it may be more than innovation—

Q53 Mr Steinberg: What I am saying is why should the taxpayer subsidise just somebody for the sake of subsidising them, which appears to happen in many cases in the farming industry?

Sir Brian Bender: The business development schemes here are selective, rather like Regional Selective Assistance which I am sure you are very familiar with, and issues arise as to whether they are creating jobs, whether new products are being created—

Q54 Mr Steinberg: Give us some examples of where that is happening, can you?

Sir Brian Bender: I can give you examples of innovation, and I shall read from my briefing, if you will forgive me, “using membrane technology and reverse osmosis to capture waste, processing hemp into industrial fibre products, using new solar-powered hot water system and wind turbine energy in a dairy processing business . . .”—

Q55 Mr Steinberg: Are these creating all new jobs or just sustaining jobs that are already there?

Sir Brian Bender: Well, there will be a mixture. The figure I have in front of me is that by March of this year the Processing and Marketing Grant scheme had resulted in over 5,000 jobs being created or safeguarded.

Q56 Mr Steinberg: Moving away from that now to something that David actually touched on but I do not think you responded. At page 34, paragraph 4.10, David mentioned regional development agencies and that Lord Haskins had suggested that there be decentralisation. It seems to me that whether you like it or not, and I am not sure but I suspect, there is going to be a “yes” vote in the north east of England for regional government and presumably if that happens and you do decentralise then regional government is going to be responsible for what the regional development agencies were. Have you planned for this?

Sir Brian Bender: We are planning for it—present continuous. That is to say, you are right. If the vote is yes, One North East will become a body of the elected regional assembly, and therefore our relationship, instead of being with One North East, as it is at the moment, will need to be with the elected regional assembly.

Q57 Mr Steinberg: You say you are looking into this and working it out; you must be further down the road than just doing that because it is not very far away now, is it? The referendum is early next month. Presumably you are not going to have much time after that. Are you saying that regional government will take over the total role of the regional development agencies in terms of agriculture and rural communities?

Sir Brian Bender: Firstly, the Regional Development Agencies in these areas have a single pot, as you probably know at least as well as I do, and what is going on in Whitehall at the moment is to work out what is called a tasking framework to ensure that the way they use that money reflects central government objectives. In the case of Defra we are ensuring that, within that tasking framework, sustainable development, rural communities and sustainable farming and food is reflected. That will pass to the north east assembly.

Q58 Mr Steinberg: Lastly, David said there were four different systems in the country, or there will be in the United Kingdom when all this is settled. Will there actually be five different systems?

 Department for the Environment, Food and Rural Affairs (Defra)

Sir Brian Bender: In one respect there will be eight or nine, because it will be up to each Regional Development Agency—

Q59 Mr Steinberg: Once you have an elected assembly and you have politicians taking over the running of something, they are not going to be told by Whitehall, are they?

Sir Brian Bender: No, but nor is local government. Local government has its own—

Q60 Mr Steinberg: The regional development agencies at the moment are not local government?

Sir Brian Bender: No, but the Regional Development Agencies and local authorities will have to work together on the delivery of some of these socio-economic schemes. Of course, it will make a difference: the point I was trying to make is that the whole point of devolution is that what is done without a regional assembly in the south west could be different from what is done without a regional assembly in the East Midlands. That is part of the purpose—

Q61 Mr Steinberg: But you could draw the line in there. You will not be able to draw the line in once you have a democratically elected assembly?

Sir Brian Bender: It comes back to setting national priorities and then using our influence on local circumstances. As this Committee itself said in the hearing in May on Regional Development Agencies, Whitehall does not know best on these issues.

Chairman: We will leave it at that then.

Q62 Jim Sheridan: Sir Brian, with the exception of the fishing industry, what other industry in the United Kingdom receives the same level of subsidy in terms of trying to diversify the product?

Sir Brian Bender: I would be amazed if any, including the fishing industry, received that. We are talking about £1.7 billion to English farming.

Q63 Jim Sheridan: Why are farmers different from anyone else?

Sir Brian Bender: Well, I have tried to answer that before. The primary difference is because they look after the land mass.

Q64 Jim Sheridan: So they are subsidised for looking after the land?

Sir Brian Bender: I am sure you know as well as I do, you are trying to draw me down this road, but the reason for the level of subsidy is set in European Union negotiations under the Common Agricultural Policy, which is plainly a reason why this government cannot simply decide unilaterally to do what New Zealand did. As I was discussing earlier with Mr Steinberg, one of the questions would be, even if we were able to do that legally, how our farmers would feel and the food processing industry would feel if near continental neighbours did something completely different.

Q65 Jim Sheridan: As a townie, as some of us are sometimes referred to, you will understand some of the frustrations that my constituents have, particularly some of them who have come from the indigenous industries—shipbuilding, mining, the steel works industry, etc—industries that have all died, and were more than capable of diversifying when the government said “Sorry, live or die because that is the world we live in”. Can you look at farmers and say why are they different from anybody else?

Sir Brian Bender: As I said, when our ministers looked at this a couple of years back their answer was the one I gave you before: that the reason why some public money should go in that direction under any circumstances for the foreseeable future is the public benefit of looking after the countryside and the landscape and the environment. The volume of public money is not entirely within our gift, as I say.

Q66 Jim Sheridan: You will probably understand as well that industry is constantly on a different scale and change, and on page 11 of the Report, paragraph 4 says “Around half of farmers react [relatively] slowly to [change]”. Why is that?

Sir Brian Bender: Well, Mr Cleasby may want to say a bit more because he has been responsible for some of the research we have done into this. I think part of the reason must surely be that up to now farming has been sheltered from the market by the way the subsidy schemes have operated, so if a farmer knows that he or she is going to get a subsidy for having sheep at a certain time of year they are not encouraged to think about what the market wants and what they can supply. So the government strongly believes that the decoupling which is happening as a result of the reforms last year will allow farmers to make some of these decisions and will expose them to market signals. Albeit they will be getting a subsidy, they will be getting it regardless of whether they have 10 sheep, 100 sheep or 1,000 sheep on their land.

Q67 Jim Sheridan: But effectively they refuse to recognise that change is on the horizon, and have not reacted?

Sir Brian Bender: They will be more enabled to follow market signals than they have been up to now. The discouragement will be being removed.

Mr Cleasby: I think I can only add to that in this sense: that one of the consequences of farm businesses having to work in the real market place means that the skills base in farming, which has traditionally in comparison with most other sectors been relatively low, at least in terms of formal qualifications, is going to need to increase. They are going to be faced with some real difficult decisions to make about which direction to move their business in; how to balance the business, for example, between what they can earn in the market place and what they can gain in terms of grants for good land management and, as the Permanent Secretary said, those come under cross-compliance and the single farm payment, and those grants will come with strings. So there is, and I think this is generally acknowledged, a bit of a skills gap particularly

 Department for the Environment, Food and Rural Affairs (Defra)

among the smaller farmers. The big guys are generally okay but among the smaller farmers there is a need for some assistance which accounts for the work that the department has been doing and which is to some extent reflected in the NAO Report to introduce measures that will help farmers access the relevant training, get the necessary advice and so on, to move up the chain.

Q68 Jim Sheridan: Is there any evidence, either in this country, Britain, or indeed abroad, that by giving money to farmers to diversify that will happen, or will the money disappear somewhere else?

Sir Brian Bender: The money for diversification is in response to a specific project or business plan, so the question is how sustainable that is over a long period, but they have to deliver against the project.

Mr Nesbit: And generally, if the project closes down very rapidly after the grant has been paid, then we will retrieve the payments from that grant so it is conditional on the diversification activity continuing some time into the future.

Q69 Jim Sheridan: Who in your department is responsible for that? Who checks up on that?

Mr Nesbit: It is the Rural Development Service.

Sir Brian Bender: It is part of Defra. It will in due course move out to this new agency, but it is part of Defra.

Q70 Jim Sheridan: One of the other projects that interests me, and I would imagine there must be some poor farmers although I have not met any, is why is there not an interest in working together as a co-operative rather than being left to get on with their own?

Sir Brian Bender: Other members of the Committee will probably know this better than me, but in this country there is much less of a tradition of farmers co-operating together with their neighbours than there has been historically in France, Denmark and other countries, and why that is is quite difficult to understand and get to the bottom of. I was talking a year or so ago to a farmer in Essex who had tried to encourage a neighbour of his to join a co-operative in selling grain, and he had managed to demonstrate to the farmer that he would have got a better price over the last couple of years had he done so, and the farmer still did not want to, so I guess it comes down to an independent spirit of mind. But that is why some of the schemes we are running, like English Farming and Food Partnerships, led from the industry, are trying to encourage more co-operation, because it has to be a way forward.

Q71 Jim Sheridan: I can understand that as a single farmer you are perhaps struggling to survive, but I am somewhat concerned that this money could go towards some large conglomerate which not only covers England but perhaps covers the whole of the United Kingdom. What steps are in place to make sure that that does not happen? Companies are already making vast profits.

Mr Nesbit: Certainly the appraisal process that the Rural Development Service operates looks at questions like additionality of grant, whether the business already has sufficient capital to go ahead with the project anyway. Getting back to Mr Steinberg's questioning, we do not have an interest in funding something that is going to go ahead anyway; clearly we have an interest in securing additional public benefits and helping something to go ahead more quickly or with a greater level of public benefit than it would have had otherwise.

Q72 Jim Sheridan: Just to conclude, the farming and, indeed, the agricultural industry does have a wide reputation for exploitation of workers in terms of low pay, conditions, etc, and there is evidence that some of the big retailers have put pressure on farmers to go below the lowest common denominator in terms of delivering goods. Hopefully the new gang master legislation coming in will go some way to addressing that problem in terms of stopping the big retailers from putting pressure on, particularly, individual farmers. Have you any evidence that some of the farmers organisations are concerned that if they had to raise what they pay their employees and the standard of their employment conditions, etc, it could have a detrimental effect on the business?

Sir Brian Bender: As I understand it, and it was your Bill, Mr Sheridan, the National Farmers' Union worked with the Transport and General Workers' Union to support the Bill, so measures you were introducing were supported by the farming industry. Now, there are issues we have with the farming industry over the operation of the Agricultural Wages Board, and when they came up with recommendations both last year and this year there were concerns about the added cost that that would impose on the industry. But certainly for the present there is no plan by ministers to do anything other than continue with the present arrangements for the agricultural minimum wage.

Q73 Jim Sheridan: But from a competitive perspective you do not see that having a detrimental effect?

Sir Brian Bender: Well, the farming industry tells us it does have a competitive disbenefit. The question is whether, nonetheless, because of the low pay of farm workers, there is a continuing need to have an Agricultural Wages Board, and the judgment of Defra ministers has been, at least for the present, yes.

Q74 Mr Allan: Sir Brian, as I understand it the essential logic you set out for the subsidy payments and the payments we are making here is that we need to keep farm businesses sustainable in order that they can be able to keep the countryside attractive and that the alternative is the land is abandoned or converted to golf courses or rubbish dumps or whatever other economic activity would take place, were it not under farming.

Sir Brian Bender: Yes, but there is also a broader reason, that is, to help them supply the market and help them through the transition. If there were no

 Department for the Environment, Food and Rural Affairs (Defra)

food production in Britain, as consumers we would probably survive, but the overall impact on rural and indeed regional economies if the food processing industry disappeared would be massive. That was one of the reasons that Sir Don Curry's Policy Commission, including some of the non-farming industrialists on it, found compelling. So there is an issue of wanting to have a sustainable industry as a food supply industry, without any view as to size of that, but the other primary reason is the countryside, the environment, and, as we saw with foot and mouth, the link between that and income raised from tourism.

Q75 Mr Allan: If I can come to the question of sustainability, there is a chart on page 10, chart number 3, which talks about the total income from farming, the whole-time person equivalent, which shows us this disastrous fall-off from over £25,000 in 1995 to what looks like around £8,000 in 2000, and it is lifting again. Do you have a figure for economic sustainability in your own minds? Is there a target, and which of these years is the right kind of level?

Sir Brian Bender: I do not think there is a straightforward figure, certainly in discussions we have had with the National Farmers' Union. The fact that farmers who own their land have the land as an asset means that they can actually carry on for longer than other businesses might be able to through difficult times. Where we are overall now is 77% above the low point in 2000 but still 50% below the peak in 1995. So things are better, a lot better, and it varies between sectors: dairy farmers would certainly assert that they are still going through a tough time; arable farmers and sheep farmers would say times have been quite a lot better in the last couple of years.

Mr Nesbit: If I could add something on that, the figures shown in the table on farm incomes refer to income from farming, so they do not refer to income from diversification projects. Earning a sustainable livelihood involves both income from farming and developing a broader portfolio of interests.

Sir Brian Bender: About £1,800 per farm has come in on an average from diversified businesses in 2003.

Q76 Mr Allan: In terms of setting the level of subsidy, if the target is economic sustainability, is the level of subsidy being set in order to achieve that or is it simply a function of what we can get from the EU? If we get it from the EU, we are going to hand it all out. Even if all your other schemes have been successful, farmers have diversified, they have income pouring in from all these other sources, will we still give them the same amount of subsidy?

Sir Brian Bender: A large part of the subsidy is non-discretionary. The farmers have a right under the regulations, subject only to meeting the requirements under cross-compliance that Mr Curry was mentioning earlier. The England Rural Development Programme funding that is a large part of this Report, and the advisory scheme, which is another part of this Report, is discretionary, and they would not get it if they did not apply for it, nor would they get it if they did not meet the

qualifications, but the larger volume under the regulations they have a right to, subject to meeting certain conditions.

Q77 Mr Allan: So that is a function of the EU regime.

Sir Brian Bender: Exactly.

Q78 Mr Allan: The discretionary element you can move up or down according to your success in raising farm income. If farm incomes went through the roof, the only bit that is discretionary is the development funds that we are talking about in this Report.

Sir Brian Bender: Largely. The other discretionary element has been this feature called "modulation", where we have top-sliced a bit from the entitlement part and moved it across into the more discretionary part.

Q79 Mr Allan: If I can move on to the scheme specifically, if we look at the targets on table 10 on page 17, they are quite extraordinary figures. They show that at some levels performance is less than targeted if you look at the Rural Enterprise Scheme and Process and Marketing Grants, in that we have handed out far fewer than we expected to, but the targets have been wonderfully met because the jobs created far exceed it. Is this a problem that you were poor in your target-setting? What has happened here that there should be such discrepancy? You thought you needed to assist 6,000 projects, for example, to create and sustain 4,200 jobs and you have actually sustained 6,200 on 920 grants.

Mr Nesbit: I think I would rephrase it slightly and say we were very rapid in our target-setting. The programme was produced working with a wide range of stakeholders, in quite a narrow window between publication of the European regulation and the date for the start-up of the programme. We could have gone through a rather tortuous process of spending several years, using lots of consultants and money, developing targets for this. The targets on number of projects were based around an assumption that the average size of grant would be about £25,000.³ It has tended to be rather higher than that, around £50,000. I think the new fast-tracking process that the Report refers to will help us to increase the number of small grants, and the overall average size of grant will come down as the programme continues. The key thing we are interested in is not so much the number of projects but what the projects are actually buying for the payment of public money.

Q80 Mr Allan: Are you now going to set yourselves some more challenging targets for the next three years so that we can properly assess you against those targets? With the Rural Enterprise Scheme, it looks to me as if you should have something like

³ *Note by witness:* Basis for targets set for Rural Enterprise Scheme; Processing and Marketing Grant targets were based on different assumptions.

 Department for the Environment, Food and Rural Affairs (Defra)

18,000 jobs created or sustained as a reasonable target if you are going to keep going at the same rate rather than 4,000.

Mr Nesbit: We have not specifically decided to revise the targets for the remaining two years of the programme. Clearly, we will need to continue to demonstrate the contribution they are making towards our PSA targets in particular. But I would question the value of going through a long process of adjusting the precise figures in the programme for a couple of years only. What we are going to do is look at the targets for the next programme.

Sir Brian Bender: I would prefer to focus our efforts, as Mr Nesbit says, on the new regulation, learning from what we have been doing under the present one.

Q81 Mr Allan: Can I go to table 11 on the next page, which talks about the running costs for these schemes. These figures do look quite worryingly high. In particular, for the Rural Enterprise Scheme, the running costs are 31%, and for the Vocational Training Scheme 46%. What is your comment?

Sir Brian Bender: There are three dimensions. First of all, we have been simplifying where we can, consistent with value for money, so the fast-track applications not only benefit the farmer customer but also will reduce running costs. Secondly, we have an out-dated and pretty creaky IT system, which we are replacing, and that is planned to reduce administration costs by 40% across the programme as a whole.⁴ Thirdly, some of the complexities are inherent in the regulation, and we are trying, as part of the negotiations for the new regulation, to remove what we regard as unnecessary complexities. With those three dimensions, we will be trying to get these costs down. There is bound to be, since these are discretionary schemes, a relatively higher administration cost than, say, direct CAP payments, but it is too high at the moment.

Q82 Mr Allan: Can I ask about the long-term intention: is it to get farm businesses into the normal framework for business support, advice and grants and so on? When does a farmer cease to be a farmer? At what point are they dealt with by the DTI, by the Small Business Service, put into the normal framework?

Sir Brian Bender: It does depend a little bit on what they might be getting advice and grants on, but, to the extent that it is business advice, business planning advice, and selective assistance that is not related to, say, an environmental scheme or whatever, the plan is to mainstream it with broader government arrangements towards business, and since that is to be delivered via the Regional Development Agencies' Business Links, that is the direction we are moving in. That is the plan, except where we are talking about what I call "land-based" schemes, agri-environment schemes and so on, which will continue to be delivered separately.

⁴ *Note by witness:* It is expected that the replacement computer system will improve productivity (rather than reduce administration costs) by 40% across the programme as a whole.

Q83 Mr Allan: So where it is a diversification that is a regular business that happens to be run from premises in the country, the correct port of call for the advice is a Small Business Service, which hopefully has a rural flavour to it because it is the Small Business Service for a rural area rather than one of your schemes.

Sir Brian Bender: That is where we are now heading. We are not there yet. At the moment it is given by the Rural Development Service from my own Department. The plan is from next year to give the Regional Development Agencies a bigger role in it, and to move all these schemes across under the new regulation so that they are owned and led from the RDAs.

Q84 Mr Allan: So that is a part of the logic.

Sir Brian Bender: Correct.

Q85 Chairman: To get this in simple terms, because this is not a Committee for farmers but a value-for-money Committee, you talk about the difficulties with modulation and decoupling and our relationship with the European Union. You have had a number of questions from Members along the lines of "Why are farmers getting so much money?" If ministers were to decide to give farmers as little as they could under the European Union rules, just remind us how much they get at the moment and how much they could get if you took your maximum modulation and transferred that away from farmers.

Sir Brian Bender: I would need to give you a note, but we would be talking about something close to £1.7 billion, with some percentage points sliced off that.⁵

Q86 Chairman: Can you give us a ball-park figure from your own personal knowledge?

Sir Brian Bender: For English farmers we would probably be talking about—and I will correct this afterwards if I am wrong—around £1.5 billion.

Q87 Chairman: You could take away £1.5 billion?

Sir Brian Bender: No, I am sorry; exactly the opposite. At the moment, £1.7 billion comes through the Common Agricultural Policy. We could only take away about 10% of that. I will look at that and correct it if I am wrong. Can I just make one other point on that, which is that it has probably been impossible up to now to assess the value for money from the Common Agricultural Policy because of the link with production. The decoupling that happened last summer ought to enable us to get a better handle on what that money is buying in terms of public value, farmer behaviour and so on. We ought to be able to address in the future a question that has been impossible up to now.

Q88 Chairman: Do you mean farmer behaviour in terms of looking after the environment?

Sir Brian Bender: In terms of what it is that the £1.5–1.7 billion is buying. Up to now, because there has been an automatic entitlement dependent simply

 Department for the Environment, Food and Rural Affairs (Defra)

on the number of sheep, the bushels or tonnes of production, that has not been a very meaningful calculation. It should be possible over the period ahead for it to be a more meaningful calculation, but it will still be a pretty inexact science.

Q89 Chairman: At the moment you could not help us with it?

Sir Brian Bender: At the moment I cannot help you with it. Again, if there is anything I can say afterwards . . .

Q90 Chairman: You have no idea whether this £1.5 billion gives us value for money. We take the point that, of course, they are looking after the land.

Sir Brian Bender: I think I would like to take the point away as to what we can say at this point in time about the value for money from the large sums of taxpayers' money that go to farming and perhaps cover that in a note.

Q91 Mrs Browning: Sir Brian, you mentioned, I think to Mr Allan, that the Department is looking at economic sustainability as a result of these grants and schemes, but there was no ceiling figure on the part of the Department in terms of what they felt the economic sustainability was. Can I put it to you conversely: from the Department's point of view, how important is the ability of this country to be self-sufficient in food production?

Sir Brian Bender: It is, again, an issue we put specifically to our ministers in the run-up to the publication of the Sustainable Farming and Food Strategy, in the course of which 9/11 happened, so it was a germane question, and the answer was that it should not be a driving consideration. We are as a matter of fact about 64% self-sufficient, which is, oddly enough, a higher figure than it was 50 years ago, though lower than it was 10 or 20 years ago. Current self-sufficiency is about 64%, but the direct answer to the question put to ministers "Should this be a consideration?" in the run-up to publication of that document was "no."

Q92 Mrs Browning: You mentioned it is 64% now, but it has come down quite significantly in recent years, has it not? What would be the Department's bottom line, or is there no bottom line in terms of self-sufficiency?

Sir Brian Bender: I do not think there is a bottom line for self-sufficiency. There is a bottom line in terms of regional economic performance, and therefore, putting it at its most extreme, as I said in my response to Mr Allan earlier, if there were no primary food production, a lot of the food processing in this country would disappear, and that would have a very damaging effect on regional economies generally, but the Government has no view about the number of dairy farmers, the number of beef farmers and so on. The Government has a view that it wishes to have sustainability, a sustainable farming industry, and it wishes to have vibrant rural communities, but the number of farmers in a particular sector is not an issue the Government has a view on.

Q93 Mrs Browning: I was not particularly focused on the number of farmers in a sector, but in terms of the global figure for the country, there must be a point at which the Government would be concerned that the economic sustainability is going to be undermined and that there will be an impact on the rest of the food supply chain. There must be some figure. The reason I am asking is because I am just wondering whether there is any influence in terms of what we require as a country in order to produce our own food, or as much of it as possible, in the way in which grants are scheduled in terms of the headings or the way in which grants individually are given. For example, would people applying for grants be encouraged to increase production of an existing agricultural product or would they be more successful in getting a grant if they diversified into a non-food area? It does seem to me that, laudable as it is to diversify into non-food, and sometimes that is exactly the right thing to do, we should have a concern—and I am surprised the ministry does not have a concern—that so many of these schemes are going away from food production.

Sir Brian Bender: The only area in which the Department has taken a view, what you might call a "dirigiste" type of view, is in relation to organics, where the market is signalling that customers want to buy it, and the proportion supplied from Britain is very low indeed. In that sector the Government has not only had an organic conversion scheme but has actually been talking to the retailers about import substitution by the retailers. That is an area where, because of the behaviour of the market, the Department has taken a view, but overall, the Department has not taken a view, the Government has not taken a view, on what is the right level, nor has the Government done any forecasting to say "Would X be a disaster?" I guess that is the direction you are coming from.

Q94 Mrs Browning: Yes, and whether these schemes would influence that decision-making.

Sir Brian Bender: We have not done that sort of analysis.

Q95 Mrs Browning: Are you likely to?

Sir Brian Bender: It is not part of our current thinking.

Q96 Mrs Browning: Can I just ask you about the way in which the grants are applied for? The Chairman touched on this. We saw on page 23 the concerns, I suspect particularly of the small independent farmers or the small family business farms, about their difficulty in applying for grants. I thought the scheme outlined on page 24 from Farming Connect, and the way in which they take people through certain processes before they get to the stage where they have to apply, looked a very sensible scheme. I take it that that is something that would be universal in the new schemes.

Sir Brian Bender: We have been doing some of that already, even without the Farming Connect precedent. Our people have done awareness seminars, pre-application clinics, with farmers in the

 Department for the Environment, Food and Rural Affairs (Defra)

area. There is something equivalent to the Welsh scheme that has been done in Cumbria—I think it is called Farming Connect Cumbria, which is similar to the Welsh scheme, and one of the benefits of devolution to regional and local level is that things can be set up more easily when they are more attuned to local circumstances.

Q97 Mrs Browning: At figure 12 we see a belief that limited availability might mean a wasted application, and clearly there are problems there. Are all of these schemes and grants based on the question of the application being viewed in terms of a business plan and the fact that it is a suitable plan for the scheme, or are they dealt with on a competitive bid basis?

Mr Nesbit: They are dealt with on a selective basis, and all of the applications for the three of the schemes which are in the rural development programmes (that is, excluding the Farm Business Advice Service), require a business plan, except for individual applications for support for training. Clearly, a business plan would not be sensible if it was one person applying for help to go on a particular course.

Q98 Mrs Browning: Sir Brian mentioned the various organisations who have been involved within the farming industry and the food industry in encouraging farmers to get together and form co-operatives, something which I am extremely keen on, and some of us have been trying for many years to persuade the farming community that this has to be the way forward. We have had one or two comments around the Committee today, and I would just like to take your view on it. It is the case that very often economy of scale is very important, and it particularly applies to some of the bigger companies who are perhaps acting for the bigger supermarkets, and beneath them they have this chain of growers at all stages in the chain. I am very keen that farmers should take a cut of the profit at each stage in the chain, and if they form a co-operative they can be encouraged to do so. But location is no longer important in any business, and it is bizarre to say it, but it also applies to farming. What I want to ask you is this: notwithstanding the dead-weight costs and whether they might have used the money anyway, some of these bigger businesses which really do sustain a local community very often have a great many smaller farms beneath them in the chain. In order to keep them in a location, if they applied for a grant, would that carry any weight?

Mr Nesbit: I think the answer is no. If they were looking for support for continuing their existing activity, then no, we would not be interested in the application. It is rather like, for example, the reason why we do not fund investment in mainstream agriculture but do fund diversification into niche crops and niche products, which is that we regard that as part of the normal cost of the business.

Sir Brian Bender: Can I give you an example which is not quite what you were asking, but under the Rural Enterprise Scheme in the East Midlands there is something called Leading the Ornamental

Challenge, where a number of organisations got together to provide advice and project development assistance to specialist growers in the ornamental plants sector. That has itself brought forward 23 individual projects. So there are ways in which these schemes can be used to bring things together, not quite in the way you were asking, but in ways that actually get a group of farmers or growers in an area or part of a chain in an area to work together.

Q99 Mrs Browning: What I was really thinking of was that the process itself says, “Location does not really matter. I am going to go and produce this in France” or somewhere else, and therefore the chain beneath them would disappear. Would that make any difference in a grant application?

Mr Nesbit: You mean, would we be held to ransom? I think the answer is no.

Q100 Mrs Browning: There are other things that small businesses need if they are going to diversify or add value, particularly in food production, and things like technology transfer and access to technology to test recipes, to test shelf life and that sort of thing are very difficult for small businesses. Do you have any regard or overview as to whether these small businesses that are being encouraged to add value to an existing product or to go from farm gate to producing value-added products genuinely have access to the type of technology that they really need around the country?

Mr Cleasby: I can help with that to some extent. As usual, there is not a uniform pattern right across the country, but using, quite often, the Small Business Service Business Links as a gateway to this, small businesses can find that a number of colleges, for example, around the country, particularly some of the land-based colleges, the former agricultural colleges, are developing what in Learning and Skills Council-speak are called “Centres of Vocational Excellence” and there are quite a number of colleges in the food technology sector which are developing tools essentially for technology transfer, for taking the science and the innovation and translating it into terms that small businesses can make use of and go away and build their business with. I would not want to claim that every small business that wants to access this will find it on their doorstep—I do not think they will—but the pattern is there, and again, it comes back to the devolution arrangements, that it will be very much for those who are planning these facilities, often at regional level, increasingly at sub-regional level, to determine where the best investment is for this sort of facility in terms of helping small businesses.

Q101 Mr Davidson: You mentioned £3 billion in subsidies, and I think you used the phrase “from European taxpayers” but would it be fair to say that since Britain is a net contributor to the European Union, effectively, that is all being paid by UK taxpayers?

 Department for the Environment, Food and Rural Affairs (Defra)

Sir Brian Bender: You are asking me to remember all the details of the Fontainebleau abatement and other things. UK-wide it is £3 billion; in England it is £1.7 billion. Clearly, a lot of it comes from the British taxpayer.⁶

Q102 Mr Davidson: As we are a net contributor, effectively it is all from us.

Sir Brian Bender: I may correct that afterwards, Mr Davidson.

Q103 Mr Davidson: Fine. Can I just clarify this question of subsidy to English farmers. It is going to be done firstly on a historical basis, then on the basis of size. Can I clarify to whom that is paid in the circumstances where you have tenant farmers? Would it go to the owner or the tenant?

Sir Brian Bender: I will give you a note. We have been in discussion with the Tenant Farmers' Association about how they will fare under this. I will come back to you. A tenant farmer will get payment; exactly what the circumstances are I need to come back to you on.

Q104 Mr Davidson: They do not end up getting payment for nothing at all?

Sir Brian Bender: That is what we have been discussing with the TFA, to minimise the risk of that happening, but with apologies, I will have to come back to you on that.

Mr Nesbit: It is the person actively farming who would receive the subsidy, but there is a separate question, as with all these subsidy systems, about to what extent it gets capitalised.

Sir Brian Bender: So the person doing the farming would get the money, so it would be the tenant.

Q105 Mr Davidson: Am I right in thinking therefore that farmers' incomes in future will be an element of subsidy plus an element of sales from what they produce plus an element from other diverse activities that they undertake, and if the subsidy was sufficient in itself for a good living, there is actually no reason why anybody should undertake anything else?

Sir Brian Bender: That is the position now.

Q106 Mr Davidson: Surely not, because if it is a production-based subsidy at the moment, if you do not produce, you do not get any subsidy. If on the other hand it is a land-based subsidy, and you do not produce anything, you still get the subsidy.

Sir Brian Bender: The farmer will have to meet certain conditions, as Mr Curry referred to earlier, of cross-compliance. Subject to that, I think the answer is yes. If they kept the land in the right sort of condition, they could get the subsidy.

Q107 Mr Davidson: So it is possible to keep the land entirely fallow, subject to various environmental conditions, for you to have the money and do nothing for it. That has the merit of clarity. Can you also tell me how many might be receiving subsidy of £1 million and above?

Sir Brian Bender: I will need to come back to you on that.⁷

Q108 Mr Davidson: It would be very helpful if we could have a list. I am interested in seeing this scheme work. It is the question of incentives. I cannot quite see how a farmer who might have enough money coming from subsidy for doing nothing except maintaining the land can actually be incentivised to take up a scheme when he might very well have adequate income coming in just from the subsidy.

Sir Brian Bender: These people are business people, and therefore the question will be what they actually wish to do. Some of them may wish to receive a subsidy for converting their land into wetland or flood storage area and not grow anything on it, and that might be one way forward. That is sometimes patronisingly called farmers being paid to be park-keepers, but given the land they look after, there is not necessarily anything wrong with that. But if they are business people, and they want to make money, surely they will look for opportunities and they will be enabled to do this because of the market.

Q109 Mr Davidson: Undoubtedly there will be some who will want to go down that road. Given that we are presently having discussions about invalidity benefit, where the idea is that in order to incentivise people to do something they reduce their money, in order to incentivise farmers we increase their money. It does not necessarily seem to me that that is joined-up government. Could I clarify the point about average farm incomes on page 10? £8,000 in 2000—I find these figures very difficult to accept. It has always been my experience that you can never trust figures coming from farmers. Can you clarify for me how accurate you believe these to be?

Sir Brian Bender: There are separate surveys that some private sector organisations do to get similar data, and they are all producing roughly similar figures.

Q110 Mr Davidson: Is this self-declared income?

Sir Brian Bender: I am not sure whether any of my colleagues know. I need to come back to the Committee on exactly how we gather the farm income data.⁸

Q111 Mr Davidson: Does it take account of what could be described as “benefits in kind”?

Sir Brian Bender: There are three ways in which a farming family can get income: one is from the farm itself; one is from using the assets one way or another for a different purpose, diversification; and clearly the third is the individual members of the family doing something completely different. Those three together add up to the whole income. The data in the Report is simply total income from farming. There is then, as I mentioned earlier, average earnings in 2002–03 from diversified businesses of £1,800 per farm.

⁶ Ev 21

⁷ Ev 22

⁸ Ev 22–35

 Department for the Environment, Food and Rural Affairs (Defra)

Q112 Mr Davidson: Given that in that year income from farming is alleged to be £8,000, I cannot quite understand why a substantial number of people remain in farming at all.

Sir Brian Bender: For those who have, as I was trying to explain earlier, where they have the land as an asset and it is a way of life, they have kept going through lean times, and now times have got better, and indeed, ten years or so ago times were a lot better. So it is a question of how long one keeps going in difficult times.

Q113 Mr Davidson: In our work, we always hear complaints from farmers that they are poorly off, but I notice, according to your own figures here—and as I have indicated already, I do not entirely believe them—that between 2000 and 2003 they have had a 90% increase in their income from £8,000 to over £15,000. Can you tell me if any other section of the economy, apart from possibly lawyers, where people have received that sort of level of increase?

Sir Brian Bender: Sure. The flipside of that is that they are still 50% below the peak in 1995. They have had peaks and troughs. In the last three years they have done very well. In the three or four years before that they did very badly. That is the market they operate in.

Q114 Mr Davidson: Given that, if they were as badly off as they complain, we would expect to see droves of farmers leaving the land, is that what is happening?

Sir Brian Bender: Again, I do not have the data with me, but there were significant numbers of departures from the land. It also did force some productivity gains. Partly as a result of currency movements but partly as a result of response to this, productivity performance has actually matched that of the better-performing member states in the last few years, though overall, productivity in farming in this country is still well below—a quarter below—the best-performing.

Q115 Mr Davidson: In terms of foot and mouth, which we were told was a disaster and farming was so unpopular that people would never go back, how many of those who were producing livestock at that time actually went back, given as a percentage?

Sir Brian Bender: Again, I do not have the figures with me.⁹ I think a large majority did, and when I appeared before this Committee, one of the questions related to the amount of compensation farmers received for slaughtered livestock. A lot of them did go back into the market, though my recollection is with a generally lower level of density of livestock.

Q116 Mr Davidson: They took the money but went back in, so obviously it could not have been nearly as bad as they were making out beforehand.

Sir Brian Bender: I think the farmers who were most severely affected by foot and mouth were not the ones who actually got the disease on their farm, with

all the tragedy of slaughter, who lost their animals, but those who were under restrictions and could not get income but had to keep their animals and feed them.

Q117 Mr Davidson: I remember that. Can I ask you to look at paragraph 1.5 and the chart on page 11, the indication here, where it actually mentions the word “dependence” on subsidies. We have clearly got a dependency culture amongst farmers on subsidies, and I am not sure that the way in which you are approaching this is sufficient to motivate them to actually transfer into other things. Would you accept that? Clearly, if there is not sufficient financial pressure on people to change, they will not change, which is exactly the issue that we face elsewhere in relation to things like invalidity benefits. In those circumstances, can you just clarify for us what incentives you are applying to farmers to make them want to move, to take up these other grants and so on that you are applying. It does not seem to me that the financial pressure you are applying is sufficient, because we have already heard from you that many of them will get sufficient to live on from subsidies even if they do not take up any of these grants.

Sir Brian Bender: I will not come back on that point. One of the big incentives is this device referred to earlier by Mr Curry called modulation, where we will actually be taking 10% of a farmer’s entitlement and moving it across to something that is selective, that they would need to apply for. Scotland and Wales will be moving at a similar pace, but we are moving faster than other European countries on that.

Q118 Chairman: You are already doing a note for us on the possible savings to taxpayers.

Sir Brian Bender: Yes. I should say I have a small correction on that. The maximum discretion, I am advised, to take off under modulation could be as high as 20%, but I will cover that in the note.¹⁰

Q119 Chairman: Following on Mr Davidson’s questions, could you also do us a note. I can well believe that some farmers, hill farmers, are earning as little as £8,000 a year, but there is, of course, a vast discrepancy between them and agri-businesses in the east of the country. Can you do us a note on the discretion available to ministers to transfer resources from large agri-businesses in terms of subsidy to small struggling farmers in the west.

Sir Brian Bender: Yes, I will.¹¹

Q120 Mr Williams: Sir Brian, I must confess I share some of the doubts expressed by my colleagues at figure 3. Even under the previous farming regime, before we were in the Market, I remember attending a Cabinet Committee dealing with agriculture chaired by George Thompson, and your equivalent attended that day with the Secretary of State for Agriculture and produced a chart not too dissimilar to this, and he said they were starving in 1995, and

⁹ Ev 39

¹⁰ Ev 21

¹¹ Ev 22

 Department for the Environment, Food and Rural Affairs (Defra)

with tears in their eyes, they told us how desperately farming income had fallen since that particular pinnacle. I asked to see the figures for the previous ten years and it turned out that this, believe it or not, was an iceberg. It towered above all previous known experience. Is this another example of that? What about the previous ten years?

Sir Brian Bender: The trough in 2000 was a historically low trough.

Q121 Mr Williams: No, I am going backwards now.

Sir Brian Bender: I am not saying it was historically below everything but it was historically below quite a long time.

Q122 Mr Williams: What I am asking is: what is the norm? Even the heading is deceptive. It steers you. It is actually an emotive heading: "United Kingdom farm incomes fell sharply after 1995." Indeed they did, but they also doubled before 1995, so it would be equally appropriate to say that overall, the levels of farm income post 1995 still fitted in fairly closely and perhaps flatteringly on two of those three years with previous experience. Will you produce for us a note.

Sir Brian Bender: The real-terms trend over 20 years or so. I will gladly do that.¹² I should say the way we publish the data is normally under the sub-heading "total income from farming per whole-time person equivalent." The title was editorial privilege of the National Audit Office.

Q123 Mr Williams: In deciding what farmers need, we need to be able to get some impression of what their potential viability is as we move out of the present system. Why, with what was intended to be a control regime—and I recognise it is allowing for such factors as the abnormality of the foot and mouth catastrophe—with the relative stability of the CAP cash flow, have farm incomes fluctuated quite so dramatically over that period? It is hard to pick out what is the norm except that it is notable that only in four years was it above £15,000.

Sir Brian Bender: A large factor was currency fluctuations. That is the dominant factor in income levels.

Q124 Mr Williams: The year 1995 was, of course, the time of devaluation. Have I got the right year?

Sir Brian Bender: We pulled out of the Exchange Rate Mechanism in 1992, but again, I can provide the Committee with some correlation with currency movements and where there is not a correlation, I am happy to provide a note that covers it.¹³

Q125 Mr Williams: That would be interesting to see. Thank you. Switching again to a question you asked earlier, as a Welshman, you would expect me to be interested to know about the difference between the system in Wales and the system in England, and the whys and wherefores of it, and of course, we have a lot of small hill farmers, so I am sure that is an element in it. To someone who is not an agricultural

economist, what did you mean when you were saying that in Wales it is related more to historic levels than in England. What is the fundamental difference?

Sir Brian Bender: If you will forgive me, I will read from my brief on this because it is quite complicated. In England farmers are going to be allocated an entitlement to a particular value according to the number of eligible hectares they declare. So it is area-based. They can make an annual claim for payment against each entitlement, providing they are meeting the various conditions. Over a transitional period of eight years that will then be translated into a fully flat-rate system based on the number of eligible hectares. So by the end of the period 2012 English farmers will be paid in relation to the area of land. Welsh farmers are going to be paid, as I understand it, in relation to their historic entitlement, which will be different. We will be phasing ours in over the period up to 2012. The Welsh will be static, based on the historic entitlement that a farmer received in the reference period.

Q126 Mr Williams: Is it not going to be exceedingly difficult for you to decide who should have subsidies and what subsidies they should have? You know how many potatoes are produced, you know how many hectares are under production, but how do you quantify the quality of husbandry? How are you going to allocate subsidies in such a context?

Sir Brian Bender: The entitlement will relate to the area of land. Whether or not they get it will then relate to whether or not the farmer is achieving the conditions of cross-compliance that Mr Curry was mentioning earlier, and these are obligations about animal husbandry, stewardship of the countryside and so on, and there will be an inspection regime that will be determining whether or not the farmers are meeting those conditions. If they are not, there will be some sort of deduction or lack of entitlement.

Mr Nesbit: Farmers will also have the option of applying for the Agri-Environment Schemes under the Rural Development Programme, so they could then receive an additional level of funding.

Q127 Mr Williams: The subsidy you are going to be handing out will still be very considerable, and it is going for non-production, and it is going to farmers who are going to possibly have their own views about what constitutes good husbandry of their land. How are you going to be sure that the people who get the subsidy will deserve it? It sounds to me as if it is a marvellous hand-out to people with very little verifiable demand made of them.

Sir Brian Bender: It is not for them to make a judgment of what is good husbandry. The EU regulation sets out what the requirements are based on other EU regulations, whether it is animal welfare or environmental. What they have to do is set out in law, and we will be providing later this year some detailed guidance on that. There will then be an inspection process. It will be a question of how we can co-ordinate that to make sure it is a light-touch inspection, a risk-based inspection process. We are required, again, under the EU regulation to inspect

¹² Ev 36

¹³ Ev 37

 Department for the Environment, Food and Rural Affairs (Defra)

a certain proportion of farmers to ensure that they are respecting those requirements. It is not for them to choose; it is for them to comply with these cross-compliance regulations.

Q128 Mr Williams: I must say that I suspect there are going to be frequent visits to this Committee when the system comes in, because the capacity for abuse seems immense. Switching to another thing, the supermarkets issue, I know you say the OFT is looking at it, and I am not exactly over-inspired by that in view of their recent decisions and the rather low expectations they have. It really is quite a scandal, as my colleague said, the way the supermarkets treat their suppliers. I understand they even demand to know the profit margins of their actual suppliers, and you will be struck off their list if you do not provide that sort of information. Is that so?

Sir Brian Bender: I do not want to sound like an apologist for the supermarkets, but as I understand it, one of the things that Walmart has brought into the Asda chain in this country has been working with some of their suppliers to improve their profit margins and drive out costs. That is part of the Walmart feature internationally. So it is not necessarily a wrong thing to do; it is a question of what they do with that information, whether they actually help the supplying businesses, and as I understand it—and I am not an expert on this—Walmart have used that to the financial benefit of some of their suppliers.

Q129 Mr Williams: That is interesting. It is interesting that an incomer has done that but our own indigenous supermarkets have screwed farmers and their suppliers even to the extent where they will have lorries delivering fresh vegetables and so on turned back if they find stock is not turning over on the day. They will phone their supplier and cancel it, with no compensation; they just do not accept delivery. This seems an appalling way for people to be able to behave. If it were happening in relation to manufacturing industry, there would probably be masses of inquiries into it. Why has it taken so long to look into it?

Sir Brian Bender: It was looked into. There was an inquiry, and a code of practice was drawn up for the Office of Fair Trading. There was a widespread view that it was not working, so now the OFT is looking at a compliance audit. I am only repeating myself. It is a very difficult area.

Q130 Mr Bacon: If I could pick up where Mr Williams left off, I was told by a food manufacturer in my constituency that a competitor of theirs—he would not tell me who it was—a business division with a turnover of £400 million, which made a profit of 3/80 of 1%, so about £150,000 profit on a turnover of £400 million, because of the influence of supermarkets. To hear you answer Mr Williams's question by saying that Walmart, of all people, is now bending over backwards to increase the profits

of suppliers sounds to me, at the very least, extraordinarily surprising, if not detached from reality.

Sir Brian Bender: I did not mean to say they were leaning over backwards. I was trying to say they have a practice of getting into the books of their suppliers and getting into a win-win situation, where they get better value, but the suppliers share some of that value. That is what I understand the position to be. How widely they are doing it in this country I do not know. What I have been informed is that it has been an international practice of Walmart. It is one of the reasons why they have been able to sell cheaply, and they have shared some of that with some of their suppliers. They set pretty demanding conditions to do it.

Q131 Mr Bacon: It strikes me there is a dangerous and damaging oligopoly going on. May I ask you two questions, one about total income from farming. You did say you would write a note. When you do that, can you include something about precisely how it is structured in relation to revenues versus costs. I have what I suppose would be called an agri-business in my constituency, with 2,500 acres, owned by a group of international investors, where the managing director is a very bluff northerner who is most certainly not a man with straw in his ear. The last time I went to see him to talk about his business, he said that he was losing money for the simple reason that it costs £65 per tonne to produce your wheat or your winter barley, with the cost of labour and fertilizers and equipment, but you are only getting £62 in revenue because that is the wheat price, you are going to lose money: £3 a tonne, and if you are producing 7,500 tonnes you are going to lose £20,000. Similarly, if the wheat price goes up from £62 to £70, suddenly you are in profit, and you will make a healthy profit. Can you explain, not least for my benefit but also for Mr Davidson's, whether there is in the total income from farming calculation an account of revenues versus costs? I presume that when one speaks of income, that is what one is talking about.

Sir Brian Bender: Yes. We can produce some data on that. If you take hill farmers, a very high proportion of their income comes from subsidies as opposed to profits or income from what they produce. I will see what we can provide by way of averaging.¹⁴

Q132 Mr Bacon: I would be less interested in averaging than in sectors. Perhaps you could show us hill farmers and big livestock producers and medium sized and big arable producers and so on, so we can see the actual picture, the turnover for large, medium and small farmers and where the line comes between profit and loss.¹⁵ My final question is about the whole thrust of the way we are moving towards payment for land rather than production and how that impacts on land owners who have tenant farmers. It has been put to me that the new single farm payment may very well result in tenant farmers, who rent their farms from landowners, being able to

¹⁴ Ev 22–35

¹⁵ Ev 22–35

 Department for the Environment, Food and Rural Affairs (Defra)

disappear off to the Bahamas, leaving their farm wholly untended, while the single farm payment dribbles into their offshore bank account. If you think I am making this up, of course, one has the experience of the Individual Learning Accounts, which did not come to light until the banks alerted the Government that one bank account had £2 million in it purely from payments from a government computer. It is something which we have seen. Will farmers who are tenants be able to go offshore, get the revenue, and the landowner is left looking after the land but is stuffed, to use a phrase, because he has no capacity whatsoever to access revenue? Is this something you have looked at?

Sir Brian Bender: As I understand it, the tenant farmer would not get this revenue in the Bahamas or wherever else unless they met the conditions of cross-compliance that I was describing in response to Mr Williams. Just leaving the land, they would have to leave it in the right sort of condition. So that would be the constraint on it.

Q133 Mr Bacon: What checks can you make to ensure that if the land is in the right condition on a given day, it is in the right condition two, four, six, 12, 24 weeks later?

Sir Brian Bender: That would depend on the nature of the inspection regime to do it, so I guess your question, which was similar to the one Mr Williams asked, is what is the scope for fraud?

Q134 Mr Bacon: I did not use the word “fraud”. That was the whole problem with the Individual Learning Accounts. Your colleagues in the Civil Service spent two years trying to figure out how much of it was fraud and how much of it was not, and they came to the conclusion that most of it was not fraud, because the rules were so loosely written. I am saying can you give us any assurance that we will not be reading in the newspapers in two years’ time about somebody who has managed to get money out of the taxpayer while essentially doing nothing, while the person who owns the land and from whom they had originally rented it will be left in the position where they are unable to access any funding even though their colleague down the road is able to access money?

Sir Brian Bender: The assurance I can give you is that they would only get that money if they complied with the conditions of the regulation, including on cross-compliance. There is then a question about how that will be policed.

Chairman: They can cut the grass a couple of times a year.

Q135 Mr Bacon: Have you read “On Hunting” by Roger Scruton? He used to do a lot of consulting in Brussels, and he describes how he used to help a lot of dissidents—they were then dissidents—in the late Eighties, before the Berlin Wall fell, and they described the system in the Communist East and how they did not believe in it. He then described the system that he had come across when he had become a consultant in Brussels, and he said, “Everybody believes in it in Brussels” and he said when he explained to them that basically people got paid for

doing nothing, he suddenly got through to them and there was a dawning recognition. There was a resonance with the absurdities with which they had been living in the East for many years, and they suddenly realised what on earth he was on about. Do you not fear that, by going down this route, with the payments link being snapped between producing anything and getting paid, in a few years’ time we will be looking back and thinking “Why on earth did we do that?”

Sir Brian Bender: I would still assert that there is less danger in that than a continuation of the present arrangement, where the farmer’s behaviour is influenced by the subsidy regime rather than by the market. It is a lesser evil to address the risks you have been describing and Mr Williams was talking about and see how to manage those than to continue with an arrangement where the farmer is sheltered from the market and not actually able to respond to some of the signals from it

Q136 Mr Davidson: I want to follow up this point about conditions for receiving the subsidy. I am not quite clear what percentage of it will be conditional upon what list, and whether or not it will be “If you don’t abide by X, that is 5% off Y, and another 5% off . . .” How is this going to be structured? From our experience in the past, I remember the Bowden case, where somebody was claiming for something situated in the North Sea. We have long experience of farmers trying to cheat the system, and I am not entirely clear how strict or vigorous this assessment is going to be.

Sir Brian Bender: Mr Nesbit may come back in a moment on what proportion a penalty might be. There is obviously in all these issues a balance between the intrusiveness of an inspection regime and its effectiveness, and that is one of the things we are working on at the moment with our own Rural Payments Agency, Environment Agency, local government and others to try and get an effective, co-ordinated regime that will actually look at these issues. Mr Bowden’s case was that he was playing two schemes off against the middle, of course, rather than where the farm was alleged to be.

Q137 Mr Davidson: On this point of intrusiveness, I have constituents who are regularly called in for extremely intrusive medical inspections in order to receive state support, and I would hope that this system would be at least as intrusive as that. If it is good enough for my constituents, it should be good enough for farmers.

Sir Brian Bender: I was suggesting Mr Nesbit respond to the point about what proportion could be withheld as a penalty.

Mr Nesbit: I do not know the exact proportion, but the whole of the payment is dependent on compliance with good agricultural and environmental conditions. A failure to achieve good agricultural and environmental conditions will be judged on its severity. If it is a minor failure, the reduction in subsidy will be equally minor.

 Department for the Environment, Food and Rural Affairs (Defra)

Q138 Mr Davidson: I look forward to seeing those guidelines, and I would hope, Chairman, that the Committee will be looking at this very early on. Can I seek clarification on a couple of points? One is the question of access. Access presumably will be one of the conditions. There is a long tradition of farmers saying, “Give us the money” and “Get off my land.” Public access will be one of them, I hope.

Sir Brian Bender: There are two conditions that ministers applied to these cross-compliance regulations in England that were additional to the basic minimum. One was on the areas around the edges of the field and hedges, and the other was access.

Q139 Mr Davidson: I take it they will also be obliged to obey the law of the land as well. Presumably, if anybody engages in or encourages in any way what will then be illegal fox hunting on their land, that will result in a complete loss of subsidy.

Sir Brian Bender: I do not necessarily see the connection. The EU regulations provide a subsidy as of right, subject to certain conditions being met. I am not sure I see the parallel with something that is completely different.

Q140 Mr Davidson: Obeying the law of the land will not be one of the conditions?

Sir Brian Bender: Clearly, if the individual is to be sent to jail for not obeying the law of the land, they would not be able to farm the land. That is a facetious response, but the EU regulations relate to an entitlement subject to conditions set down in those regulations.

Q141 Mr Davidson: So breaking the law by encouraging fox hunting on your land might still enable you to receive the full subsidy. Is that right?

Sir Brian Bender: I think I need to consult inside the Department on that point.¹⁶

Q142 Mr Davidson: I think that would be helpful. Can I clarify this: if somebody loses, for the sake of argument, all the subsidy, does that then have to be shared out amongst all those who are still receiving subsidy or does that come back into the Treasury pot?

Sir Brian Bender: I think it would probably stay at the Brussels end actually. The reverse would be the case, that if we paid a subsidy to a farmer that we should not have paid, the EU audit process would disallow that.

Q143 Mr Davidson: If you reduced it because they do not meet the criteria. It is also to do with the condition of farms that go out of business, say. If that happens, they do not meet the criteria, does that lead to a share-out amongst the rest or does it go back to Brussels?

Sir Brian Bender: The cavalry behind me says it would go into something called the national reserve and therefore be available under certain conditions for other farmers. That is right.

Chairman: You could always do a note for us on that.

Q144 Mr Davidson: The final point I want just to pick up is in relation to competition. Farmers setting 22up in these circumstances might very well be competing with businesses trying to set up in my constituency and I just want to clarify whether or not in these circumstances the sort of hidden subsidies that you receive on farms—exemption from council tax and the like—would be considered by yourself to be an unfair advantage and whether or not there are any other systems of grant that would be seen to be an unfair advantage over an equivalent in an urban area?

Mr Nesbit: I think I am right in saying that some of the specific tax advantages that would apply to farming businesses would not apply to diversification into a non-farming business. That separate non-farming activity would have to comply with the normal tax regime and the normal planning regime.

Q145 Chairman: Just a final question from me taking up the point you made about access. A walk in the countryside is the most popular pastime in this country. I mentioned an agri-business earlier receiving large amounts of public money and I was quite surprised that when that business applied for Farm Stewardship Money, the local Defra office was quite happy with the existing footpath network and did not appear to be pressing for more access. How proactive are you in increasing access? After all, the taxpayer is paying you this money so surely the taxpayer is entitled to more access?

Sir Brian Bender: On that particular case I hope you got a satisfactory reply from Alun Michael in terms of what the position was. These are issues where there is an entitlement for a public to use the access that is opened up and the cross-compliance arrangements would have to be met so that the farmer does provide access. Right?

Q146 Chairman: Yes.

Sir Brian Bender: I am not sure whether proactivity comes into it. The inspection under cross-compliance will be looking at, among other things, whether these conditions that Ministers have set in England on hedges and on access are being met, so it would be part of the inspection process.

Q147 Chairman: So you envisage access on field margins, for instance, being increased under these criteria?

Sir Brian Bender: If access is permitted under right to roam, under the CROW legislation, and is being denied by a particular farmer then that denial would be, I hope, exposed as part of the inspection arrangements under cross-compliance.

Chairman: Thank you very much. Thank you, Sir Brian, for appearing before us and thank you to your colleagues. In our Report we will grapple with how to ensure value for money as well as maintaining the rural infrastructure, which is an issue that we have been grappling with since 1945.

¹⁶ Ev 22

**Supplementary memorandum submitted by the Department for Environment, Food
and Rural Affairs (Defra)**

SUBSIDIES TO FARMERS

Questions 85 and 118 (Chairman): Value of subsidies given to farmers

In England, in 2003, there was £1.6 billion (the higher figure, originally given, would have included an element of agri-environment expenditure) of expenditure on farm subsidies, through regimes under the “first pillar” (ie direct and market support measures) of the Common Agricultural Policy. Many of these will be replaced by expenditure under the Single Farm Payment from next year. The EU legislation governing these regimes is framed in terms of entitlements for those eligible; the Government would therefore have little scope for reducing or refusing to channel the EU expenditure concerned to those eligible to receive it. However farmers will need to meet cross compliance conditions in order to claim the Single Payment. These conditions will give extra protection to the environment, soil, wildlife habitats and the landscape. [They will help contribute to the Government’s objectives set out in the Strategy for Sustainable Farming and Food.] As part of cross compliance farmers will also have to meet existing Europe-wide laws on environment, animal health and welfare, public health and plant health. It would also be questionable in policy terms to decide not to make maximum use of available EU funds.

Modulation (a term explained in answer to question 31) is currently applied to all first pillar subsidies at a flat rate of 3.5%. It will continue to apply to all direct subsidies including the new Single Payment which will be introduced next year, although at a different rate. From 2005 a compulsory system of modulation will be introduced in all EU Member States. The EU-wide modulation rate will start at 3% in 2005, rising to 5% from 2007 onwards. All farmers will have the first €5,000 of their payments exempted from compulsory EU modulation under the new arrangements.

In addition, as part of the CAP reform deal, the UK secured agreement to enable an additional national modulation rate to be levied. Defra will use this flexibility to modulate at a higher level than the compulsory EU rate. In England this will be used to fund agri-environment spending, as part of the Government’s Sustainable Farming and Food Strategy, and in particular the introduction of a new agri-environment scheme, Entry Level Stewardship (www.defra.gov.uk/erdp/default.htm) (ELS) as recommended by the Policy Commission (www.defra.gov.uk/farm/sustain/policycom.htm). The Secretary of State announced on 22 July that the overall rate of modulation (ie compulsory and national modulation) would be 5% in 2005 and 10% in 2006. Under EU rules, the rate we set is limited to bridging the gap between the amount generated by compulsory EU modulation and our funding requirements under the England Rural Development Programme (including the ELS). There is a maximum ceiling on the overall amount of modulation that can be levied of 20%.

The UK’s discretion over voluntary modulation can thus be used to generate a limited reduction in spending under the first pillar I of the CAP. Funds generated through modulation are recycled into the Rural Development Programme which is currently co-funded (at 50%) by the Exchequer. This means that modulation does not produce an overall reduction in taxpayer spending, but it ensures that expenditure is directed towards producing public benefits.

A greater level of discretion is available in respect of payments under the second pillar (ie rural development measures) of the Common Agricultural Policy. In England, second pillar expenditure is made through the England Rural Development Programme (which includes the Rural Enterprise Scheme, Processing and Marketing Grant, and Vocational Training Scheme expenditure covered by the NAO’s Report). Expenditure under the ERDP is co-financed, with roughly half being contributed from national, rather than EU, funds. The Government would, in principle, be able to choose not to provide national funds, and not to draw down the available EU funding. However, since the expenditure concerned is a key component in delivering the Department’s objectives, and since the national funding involves benefits from a substantial gearing effect through the draw-down of EU funds, it is unlikely that the Government will choose this option.

Question 101 (Mr Davidson): Proportion of subsidy funded by UK taxpayer

The UK makes its contributions to the EC Budget as a whole and not to individual categories within it. There is, therefore, no specific UK contribution to CAP expenditure. After taking account of the UK abatement, the UK share of financing the latest Amending EC Budget for 2004 is around 11.93%.

The Government’s latest forecast of the UK’s gross contribution, after abatement, and public sector receipts in 2004 is:

Gross contribution after abatement: £8,931 million

Public Sector Receipts: £4,766 million

Question 107 (Mr Davidson): Subsidies in excess of £1 million

There are currently five applicants who receive more than £1 million under the Arable Area Payments Scheme in England. This provides a good indication of the number of payments of £1 million or more that we can expect to pay out under the Single Payment Scheme being introduced in 2005.

Question 119 (Chairman): Diverting subsidy from large to small farms

The Council Regulations that introduce the new Single Payment allow a high degree of flexibility in the way that Member States implement the scheme. But such flexibility may not be used in a way that is arbitrarily discriminatory and requires objective justification. To seek directly to redistribute subsidy from large to small businesses would have run counter to this general philosophy and, moreover would have been economically questionable.

All farmers will benefit from the simplification of the CAP which will replace ten main subsidy schemes in the UK with one, requiring just one application form and leading to one payment. Farmers will also benefit from the new market opportunities it presents and from the freedom to optimise their production. Decoupling subsidy from production is also likely to increase prices, and Defra economists have estimated that on average farm incomes could rise by about 5% compared to 2003 Total Income from Farming as a result. Restructuring of businesses and greater efficiency encouraged by decoupling might give rise to further improvements.

Ministers believe that we have used the available discretion in our choice of implementation method for the scheme in England in a way that best suits our conditions and the objectives we set out in the Strategy for Sustainable Farming and Food. The transitional nature of the chosen system will mitigate the redistributive effects by spreading them over a number of years. This will give farmers time to adjust their business accordingly.

Question 141 (Mr Davidson): Breaking the law and claiming subsidy

The farmer is entitled to apply for and receive payment from the Single Payment Scheme if he meets the eligibility criteria of the scheme. It is necessary for the farmer to respect cross compliance and this consists of the Statutory Management Requirements (SMRs) which are existing legislation and the Good Agricultural and Environmental Condition (GAEC). Both of these components refer to some legislative provisions which are already transposed in existing domestic legislation by way of criminal offences. Where there is a breach of these provisions the enforcement body could decide, under the enforcement regime of the existing legislation, to prosecute the farmer. That is a matter for the enforcement body.

Separately however, for the purposes of the Single Payment Scheme, the Paying Agency could decide that the breach also amounts to a breach of a cross compliance requirement or standard and within the latitude provided by the EC regulatory framework could decide to impose a reduction or in exceptional circumstances an exclusion. For unrelated legislation there is presently no power to impose a reduction on the farmers single payment.

STATISTICS ON FARM INCOMES

Question 110 (Mr Davidson), Questions 131 and 132 (Mr Bacon): How do we assemble farm income data?

The measure of Total Income from Farming (TIFF) is derived from the UK Aggregate Agricultural Account. Total Income from Farming is income generated by production within the agriculture industry, including subsidies. It represents business profits plus remuneration for work done by owners and other unpaid workers. It is not a self-declared measure of farm income, but rather an estimate of income based on a calculation involving various sources of statistical data.

The compilation of the UK Aggregate Agricultural Account is accordance with the methodologies laid down in the European System of National Accounts 1995 (ESA95). This, in turn, is based on the System of National Accounts 1993, an internationally agreed approach to the construction and presentation of national accounts.

The agricultural industry is defined as the collection of units that carry out agricultural activities including both farms and specialist agricultural contractors. Total Income from Farming for the agricultural industry is calculated as: gross output at basic prices (market prices plus subsidies on products); plus other subsidies less taxes on products (eg set-aside, agri-environment schemes, animal disease compensation); less total intermediate consumption (or variable input costs), total consumption of fixed capital (or depreciation), compensation of employees (or paid labour), rent and interest.

Gross output is the total value of production of crops, livestock and other agricultural activities (eg contract work) including subsidies and levies on product. In general the value of production is calculated from a wide variety of statistics on the quantities and prices for individual commodities derived from various sources. A combination of commodity specific surveys, the annual June agricultural census and administrative data is used to calculate quantities of commodities produced. Prices are obtained from surveys, prices paid at wholesale market or farm gate prices. The statistics on quantity and price are then combined to estimate the value of production.

It should be noted that gross output also includes any inseparable diversified (eg processing milk into cheese, tourism) taking place on the farm. These therefore contribute to Total Income from Farming. In most cases inseparability arises because some or all of the input costs associated with these cannot be separated from other farm costs. Where the diversified activity is run as a separate business with separate accounts then, in accordance with national accounting conventions, the income from this activity is not part of Total Income from Farming.

Intermediate consumption (eg feed, seeds, fertiliser, energy), consumption of fixed capital, compensation of employees, rent and interest are obtained from a variety of surveys and sources of information, but with the main contribution from the Farm Business Survey.

As well as excluding income from diversified activities run as a separate business as noted above, Total Income from Farming also excludes income received by farmers from other jobs, investments and pensions.

Whilst the Farm Business Survey is used for part of the Aggregate Agricultural Account calculation used to derive TIFF, it does provide a largely independent method of measuring farm incomes. The Farm Business Survey is a random sample survey of 1,850 farm businesses in England, with similar surveys in other UK countries. This Defra-funded survey, which is widely acknowledged to be the most authoritative of its kind, is conducted by a consortium of academic institutions.

The sample is designed to be representative of all full-time farms in the country plus part-time farms of a size sufficient to occupy a farmer for at least half of his or her time. [Farms below this size threshold, although numerous, account for less than 3% of agricultural production and are excluded from the survey for budgetary/value for money reasons.]

The information for each farm in the survey is compiled by experienced researchers from accounting documents on farm and from interviews with the farmer. A detailed management account is drawn up covering all revenues, costs, assets, liabilities and physical attributes for measuring business performance. This management account is quite distinct from any tax account for that farm although the same source documents will have been used.

Farm income is only one of the many results produced from this survey. Because of the methodology used, the income measures provided by the Farm Business Survey are different from the Total Income from Farming (TIFF) measure derived using aggregate account methods but they nevertheless provide a good check on it.

The commonly used measure of farm income from the Farm Business Survey is Net Farm Income. Net Farm Income is constructed so that the profitability and performance of different types of farms can be compared. It is defined as the return to the principal farmer and spouse for their manual and managerial labour and on the tenant-type capital of the business. Tenant-type assets include crops, machinery and livestock. An imputed labour cost is deducted for unpaid family labour (other than the farmer and spouse) to compare farms of different business organisation (eg sole trader, partnership and company). Net farm income treats all farms on a consistent basis by separating the tenant from the landlord components of the farm business and considering only the former. This involves including an imputed rent for owner-occupied land.

[The Farm Business Survey operates on accounting years compared to the calendar year calculation of Total Income From Farming.] As for the aggregate measure of Total Income From Farming, Net Farm Income excludes income from diversified activities run as a separate business, income from other jobs, investments and pensions.

The estimate of average UK Net Farm Income for all farm types (excluding horticulture for which the sample is too small to generate reliable estimates) for the accounting year 2003–04 is £20,500 per farm. This compares with an estimate of UK Total Income From Farming per whole time person equivalent of £15,500 in 2003.

It must also be recognised that the average estimates of income mask a range of performance. The following chart shows the distribution of Net Farm Income in 2002–03 for farms in England above the Farm Business Survey size threshold described above.

DISTRIBUTION OF FARM INCOMES FOR ALL FARM TYPES ENGLAND, 2002–03

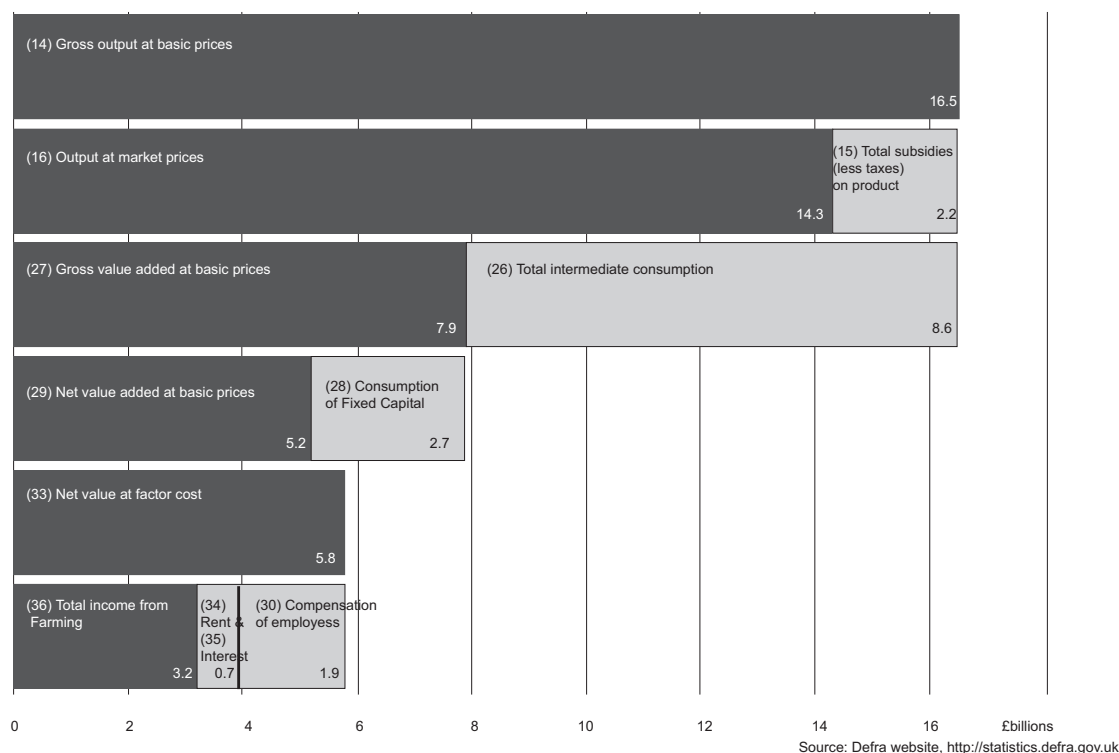
<i>Net Farm Income</i>	
Less than zero	26%
0 to less than £5,000	11%
£5,000 to less than £10,000	12%
£10,000 to less than £20,000	18%
£20,000 to less than £30,000	12%
£30,000 to less than £40,000	7%
£40,000 to less than £50,000	3%
£50,000 and over	10%
Average (Pounds per farm)	£16,435

Source: Table 7.9, Farm Accounts in England.

RELATIONSHIP BETWEEN REVENUE AND COST

The relationship between revenue and costs for 2003 is illustrated in the following chart taken from the *Agriculture in the United Kingdom* publication (see <http://statistics.defra.gov.uk/esg/publications/auk/default.asp>)

Chart 8.1 Main components of the UK production and income account in 2003 (£ billion)

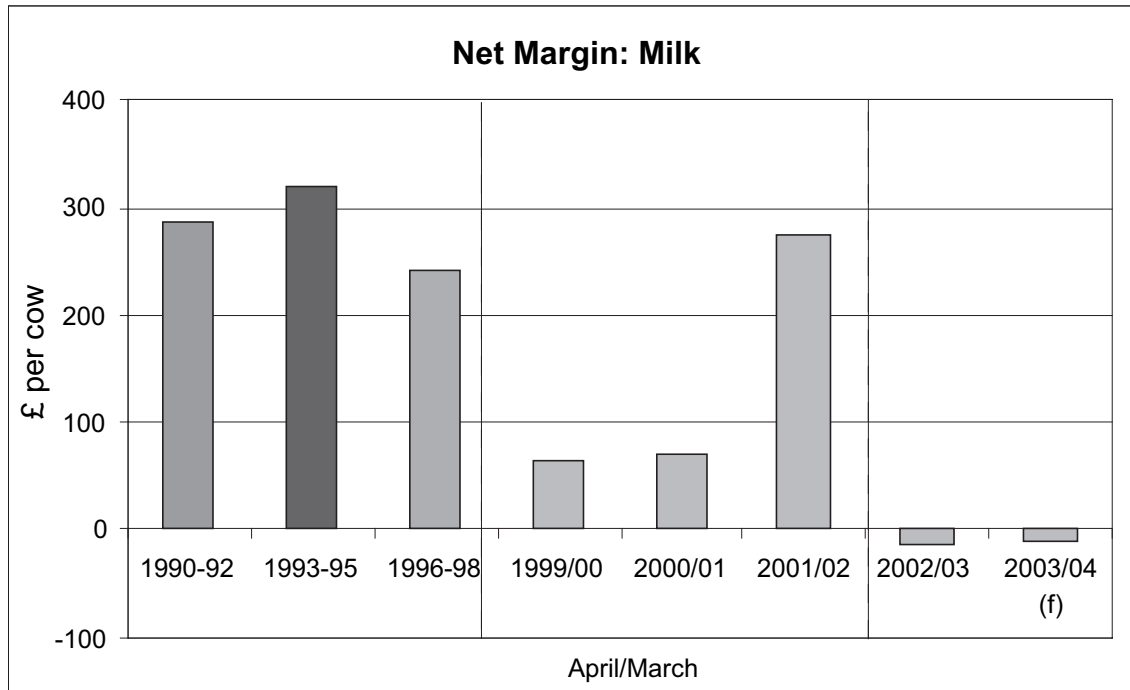


For 2003, Total Income from Farming of £3.2 billion was the value of gross output of £16.5 billion (of which £2.2 billion was subsidies on product) plus other subsidies on production of £0.7 billion less total costs of £14.0 billion.

Analysis by sector

Total Income From Farming is calculated at the aggregate level. Therefore it does not provide a sectoral breakdown of income. The profit generated by each sector is best assessed by analysis of net margins. These provide the return to managerial labour and the return on capital. It should be noted that net margins represent a narrower income measure than TIFF as they net off imputed labour and rental costs. The following provides analysis of net margins for the key commodity sectors. They illustrate the way in which the volatility in net margins for individual sectors is driven by volatility in market prices. This information has been taken from the *Report on the Economic Position of the Farming Industry* published in September on the we and available at <http://statistics.defra.gov.uk/esg/reports/repfi.pdf>.

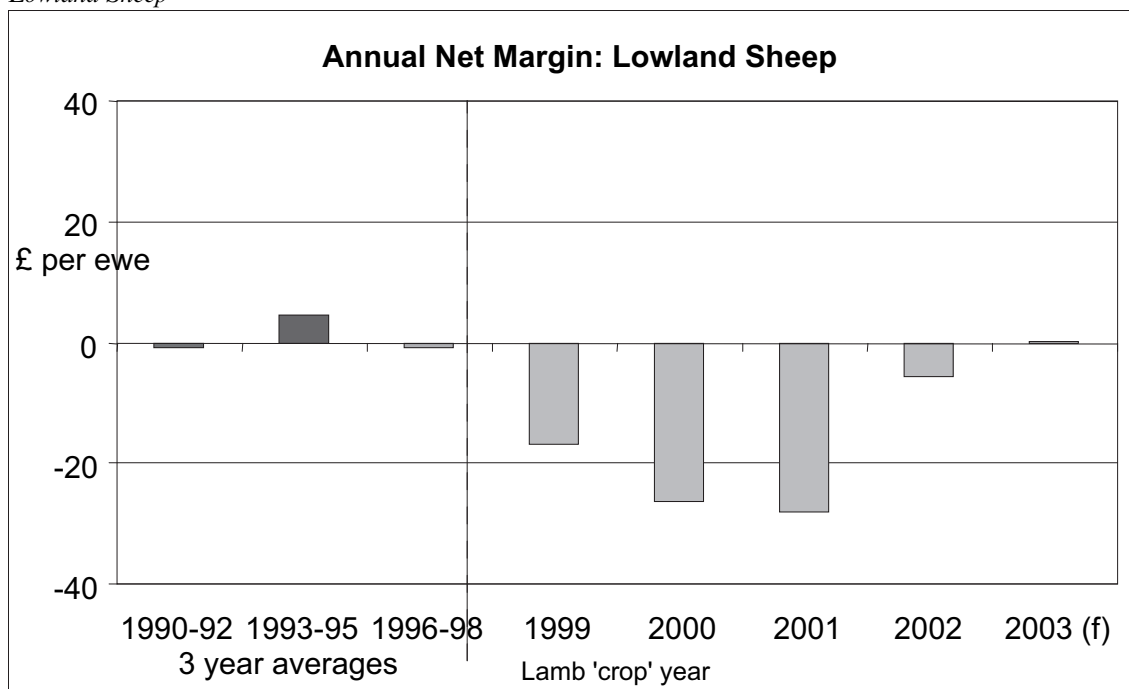
Milk



Source: Net margins based on the series of "Special Studies in Agricultural Economics"

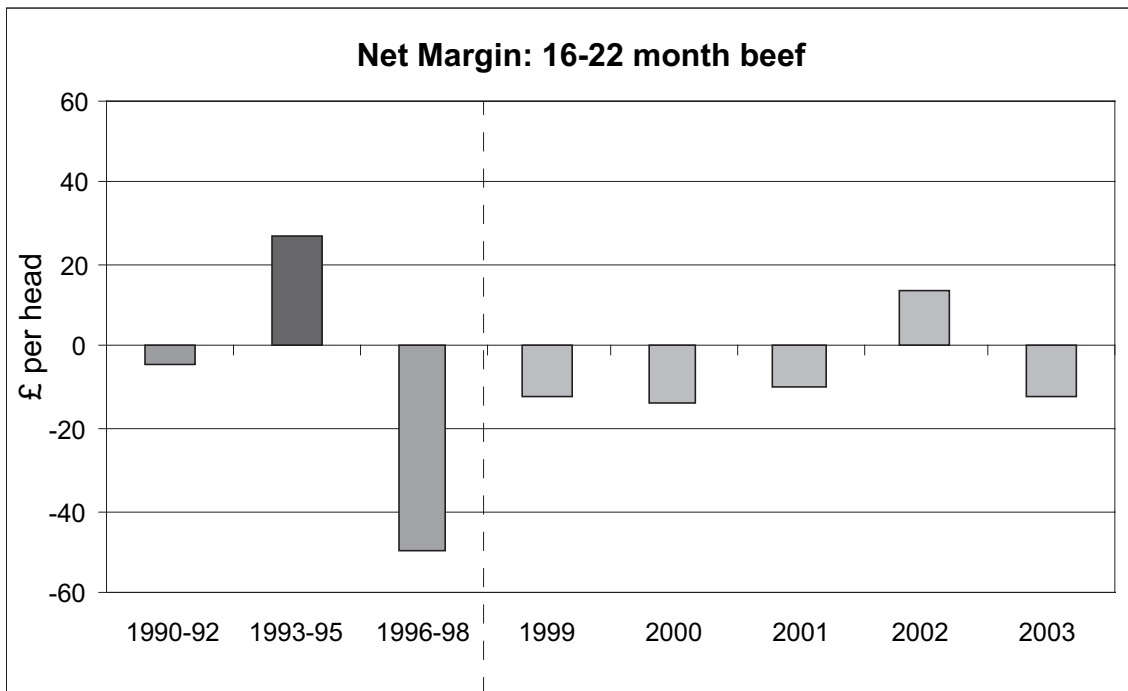
- The net margin for 2002–03 is from the latest special study into the Economics of Milk Production in England and Wales 2002–03 by the University of Manchester. As such, this data isn't directly comparable with that for previous years. Net farm income data for dairy farms suggests that profitability in 2002–03 returned to around the levels observed in 2000–01.
- This Manchester Special Study found that the average total cost of production was 18.33ppl and the average farm-gate milk price was 17.22ppl. Other key findings from this study were:
 - Herd size was found to be important for economic performance, particularly for labour costs. Herd size groups of less than 100 cows recorded average net margin losses in both the lowlands and the uplands. However, there is variation within groups with some smaller herds recorded positive net margins (although none of those were herds with less than 40 cows).
 - 60% of milk was produced at a total cost of less than 18 ppl, 29% below 16 ppl and 8% below 14 ppl.
- Forecast net margins for the year ending March 2004 remain similar to the previous year. Despite higher milk prices input costs have increased, notably feed and those costs associated with quota leasing or purchasing.

Lowland Sheep



Source: Net margins based on the series of “Special Studies in Agricultural Economics”

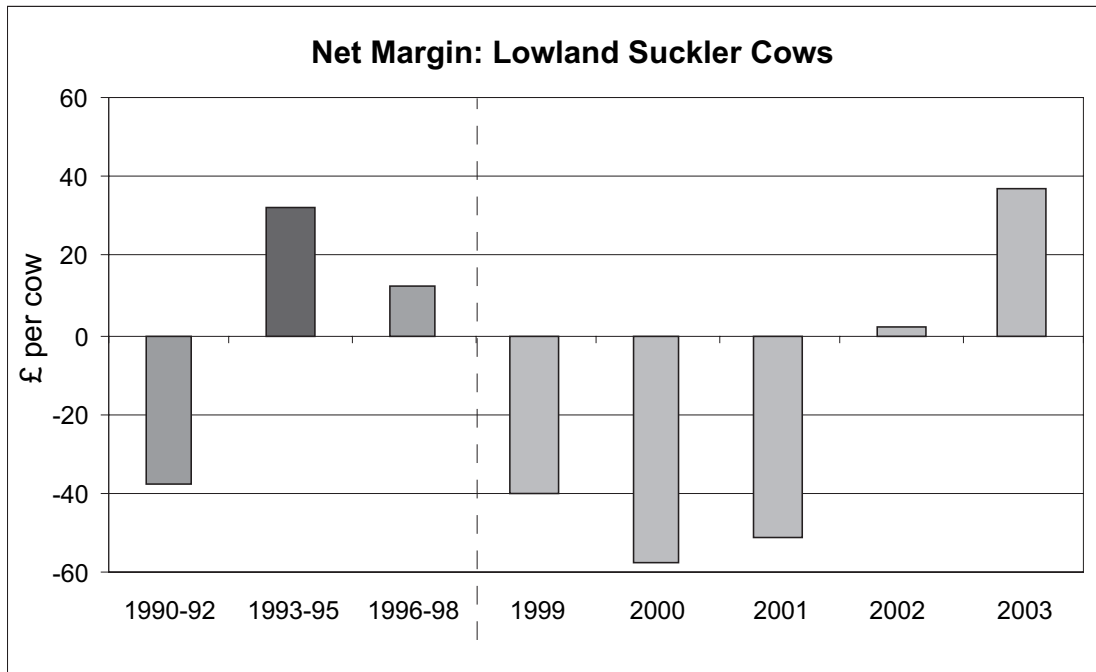
- In 2003 lowland sheep flocks made a very small positive net margin for the first time in several years. This was due to firmer prices for finished lambs as tight supplies kept the market buoyant.
- Following a period of sustained price rises from November 2003 to a mid April 2004 peak of 311p per kg, deadweight sheep prices have declined seasonally as more new season lambs were brought forward. Deadweight lamb prices for the first six months of 2004 have decreased by 2% when compared with 2003. The average prices for July and August 2004 are 252p per kg and 244p per kg respectively dw.

*Lowland Beef**16–22 month beef:*

Source: Net margins based on the series of “Special Studies in Agricultural Economics”

- Net margins for 16–22 month beef fell in 2003. Although beef prices were firm the increased price of store cattle reduced profitability for this sector.
- On average liveweight cattle prices for 2003 remained just above 2002 levels. However, prices rose during the last quarter of 2003 and have maintained this level during 2004.

Lowland Suckler Cows:

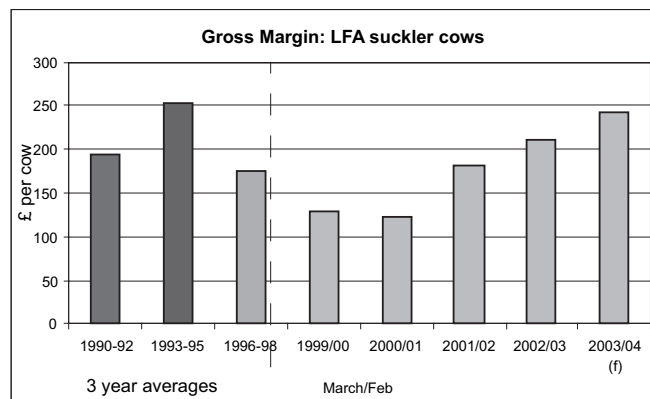
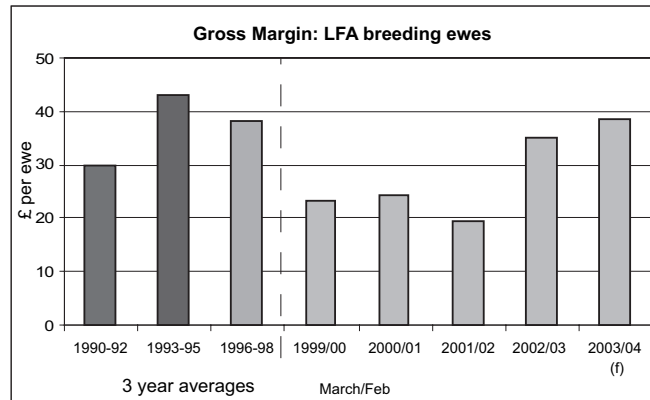


Source: Net margins based on the series of "Special Studies in Agricultural Economics"

- Suckler cow margins increased further in 2003, reflecting higher calf prices and suckler cow premium receipts.

Hill Livestock

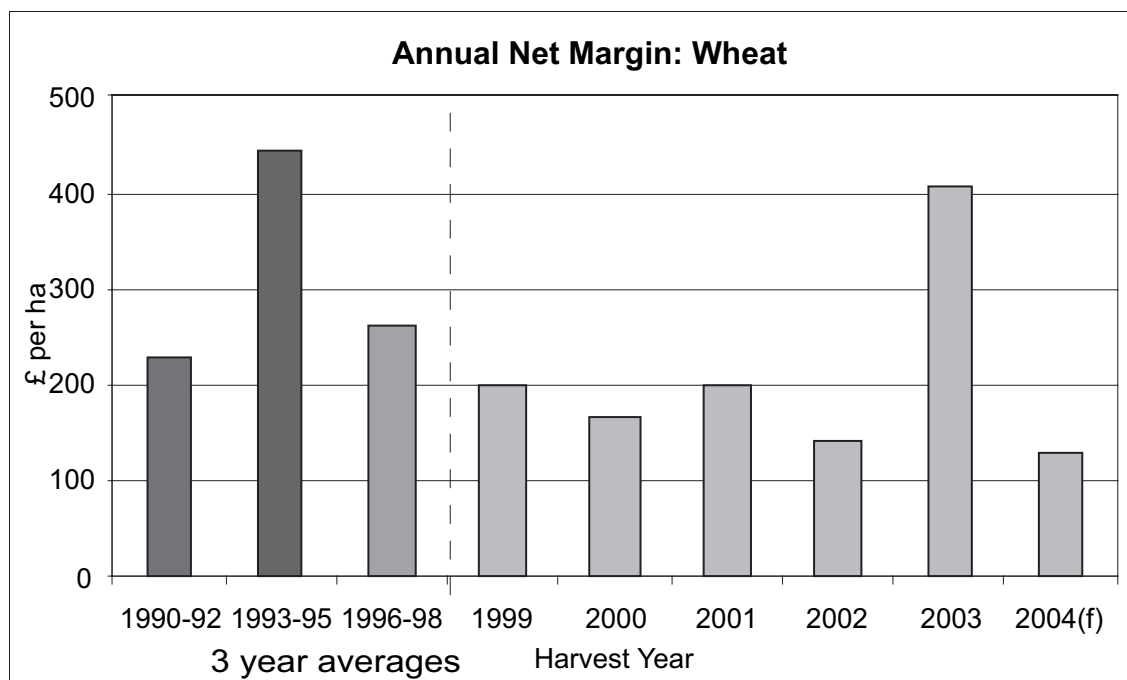
Only gross margins, that is output revenues less the variable costs of production, are available for hill livestock. For consistency, the margins exclude the value of HLCA subsidy payments received until 2000. HLCAs were replaced with the Hill Farm Allowance, an area based payment that is not included in the livestock enterprise margins.



Source: Net margins based on annual Hill Cattle & Sheep Study commissioned by Defra.

- Margins for 2003–04 continued to increase reflecting higher finished lamb prices and firm prices for store sheep and store cattle which are a major component of output on LFA farms.
- Sheep annual premium accounted for approximately 40% of the gross margin in 2003.

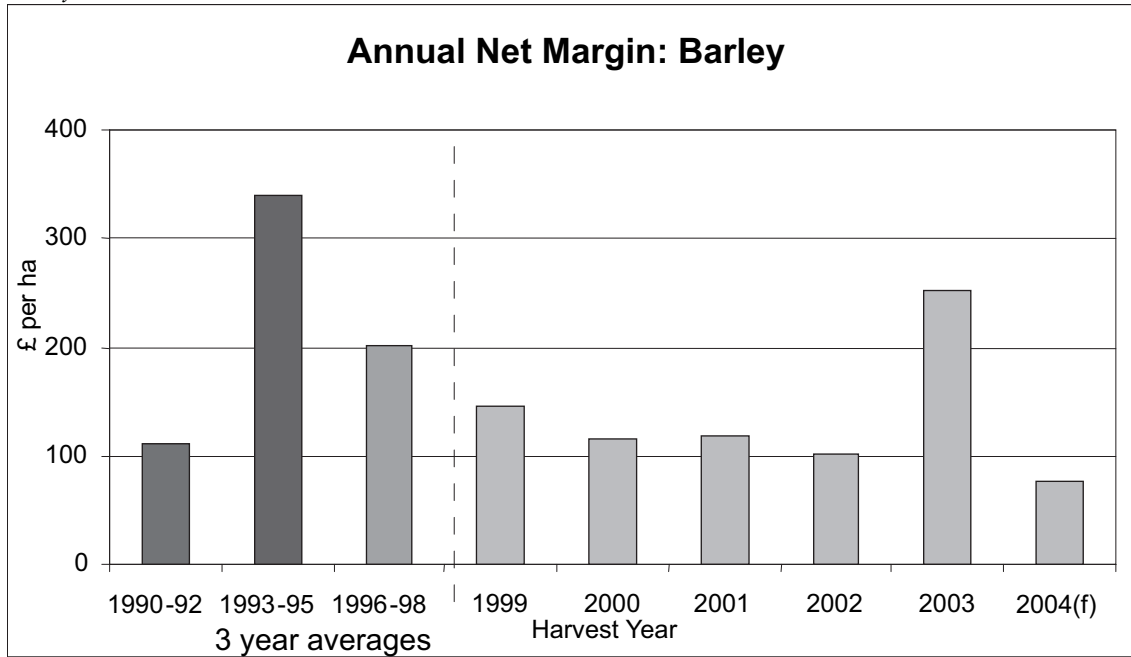
Wheat



Source: Net margins based on the series of "Special Studies in Agricultural Economics"

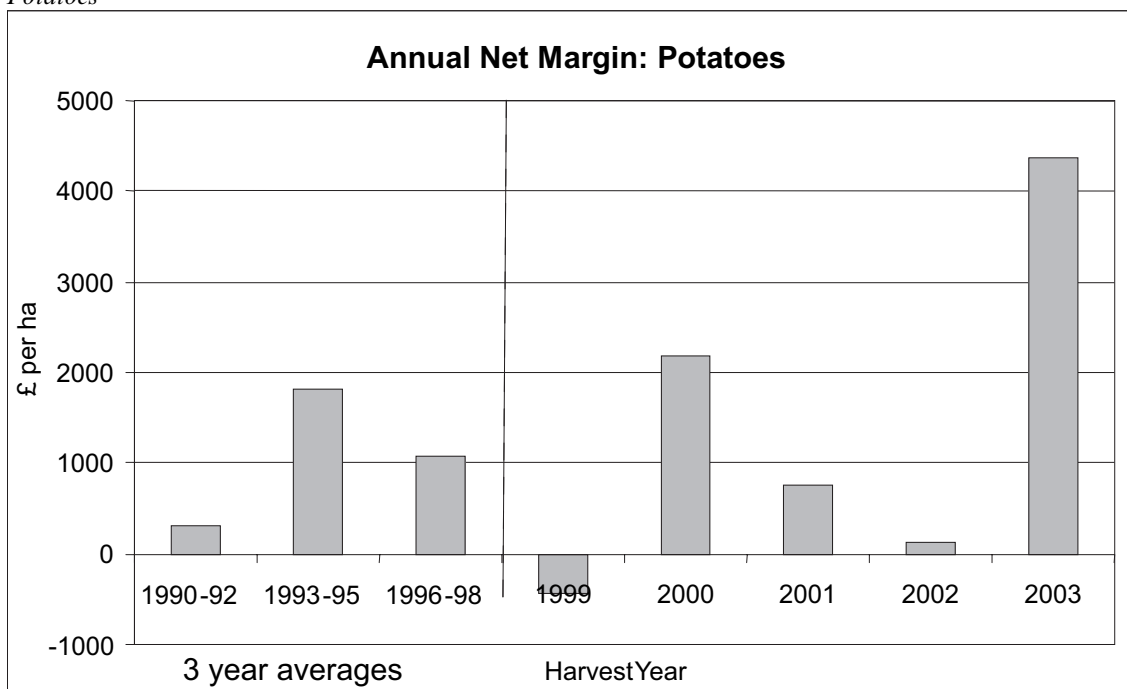
- The net margin for winter wheat for the 2003 harvest was over twice that of the previous year and higher than at any time since 1996. This was due to higher prices because of the tight EU supply situation (particularly for feed grains) and higher area aid due to the change in the exchange rate, whilst input costs were largely unchanged.
- The 2004 harvest was severely delayed by extremely wet weather during August. Whilst total yield is likely to be higher than in 2003, overall quality is poorer reducing farmers' returns in a weaker market, in addition to more expensive field and drying operations.
- UK feed wheat prices for the new crop are currently around £60/tonne, around £25/tonne lower than at the same time in 2003 and similar to the levels seen in 2002. With the prospect of a large UK exportable surplus and ample European and world supplies, this year's feed grain market is likely to be very competitive.
- The difficult harvest has seen bread making premiums rise to around £22/t over feed (compared to £7/t this time last year), with prices particularly high in the north-eastern part of England that was most severely affected by the weather. Price rises have been capped by the availability of good quality third country supplies, particularly from Germany.

Barley



- Barley net margins are based on weighted averages for winter barley and spring barley grown for both feed and malting purposes. As such they reflect the influence of feed barley prices which accounts for some 70% of the barley produced in the UK.
- Substantial increases in net margin were seen for barley crops harvested in 2003 for the same reasons as for wheat. Margins for the 2004 harvest however are forecast to be similar to those in 2002 as prices for competing feed grains have fallen and harvest costs increased.
- Feed barley prices are supported by intervention system. Nevertheless, the current price of just over £60 per tonne which is 20% lower than the same time last year.

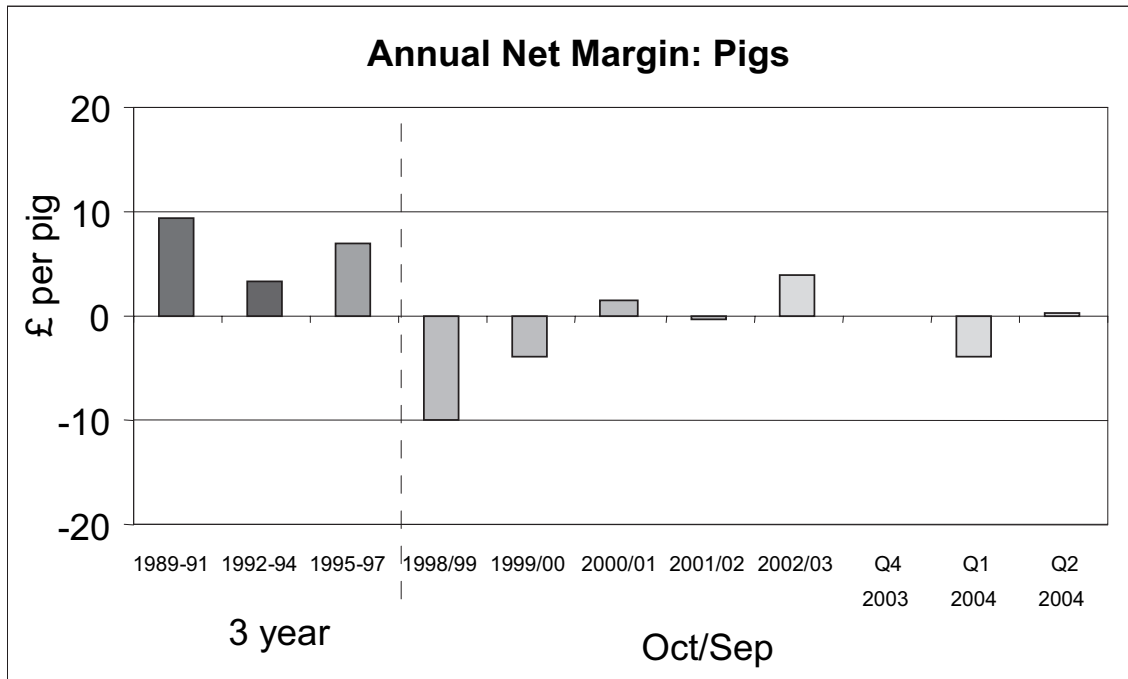
Potatoes



Source: Net margins based on the series of “Special Studies in Agricultural Economics”

- The British Potato Council’s revised estimate of GB total potato plantings for 2004 is 130,896 hectares, 4.6% up on the 2003 GB total potato plantings. Their previous 2004 estimate was 127,800 hectares.
- Approximately one third of the crop has now been harvested. Average yields reported.
- Many fields have been affected by the recent wet weather, causing losses from blight and water-logging. Rot and storage will be potential issues for the long-term supply situation.
- Prices have steadily dropped since a high of £175.41 (average) in May to drop below last year’s level.

Pigs

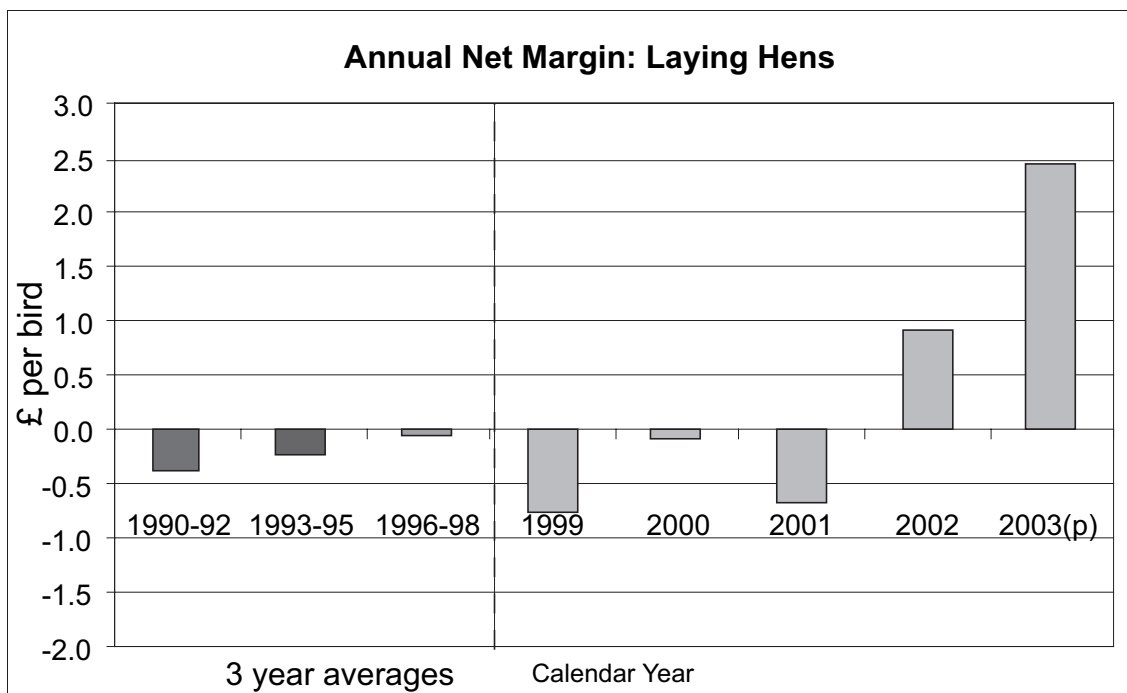


Source: Net margins based on the series of "Special Studies in Agricultural Economics"

- Higher pigmeat prices and slightly heavier killing weights resulted in a positive net margin for the 2002–03 production year.
- Further increases in pigmeat prices were offset in the final quarter of 2003 by increased feed costs as a result of higher cereal and protein prices. Feed prices continued to erode net margins in the first quarter of 2004 although the second quarter saw some recovery as feed prices stabilised and pigmeat prices increased further.
- New crop cereal values and recent falls in the price of soya should result in positive net margins for this sector in the third quarter as long as pigmeat values are sustained.
- UK producer prices remained largely stable at around 108p kg dw during the second quarter of 2004 due to short supplies and a strong EU market. However, during recent months there has been some pressure on the market due to the strength of sterling and increasing imports with October prices falling to around 100p per kg dw.

Poultry

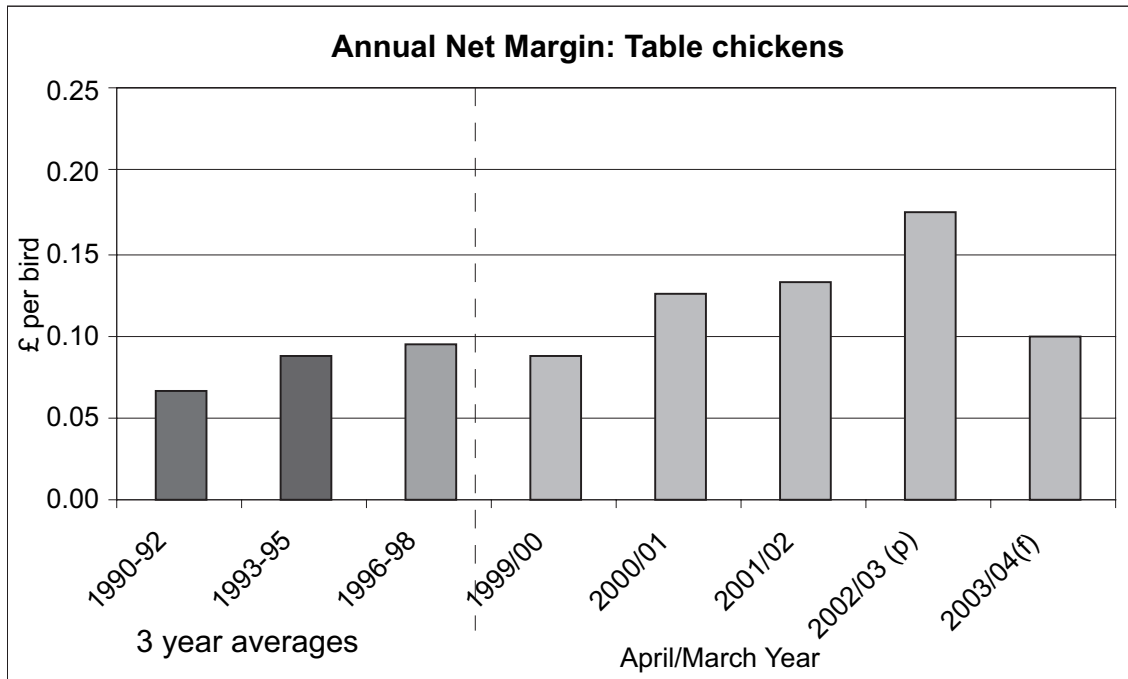
Laying Hens



Source: Net margins based on the series of “Special Studies in Agricultural Economics”

- Net margins for laying hens are based on data from a commissioned survey into the economics of egg production undertaken in 1992. The lapse in time and changes in the industry that have occurred since that time mean that the margins shown here can only be broad estimates but the trends in margin are robust.
- Net margins for 2003 increased as average egg prices increased by nearly 20% compared to the previous year.
- Higher feed prices towards the end of 2003 and in the first part of 2004 will put these margins under pressure.
- Average egg prices in 2004 are around 51p/dozen.

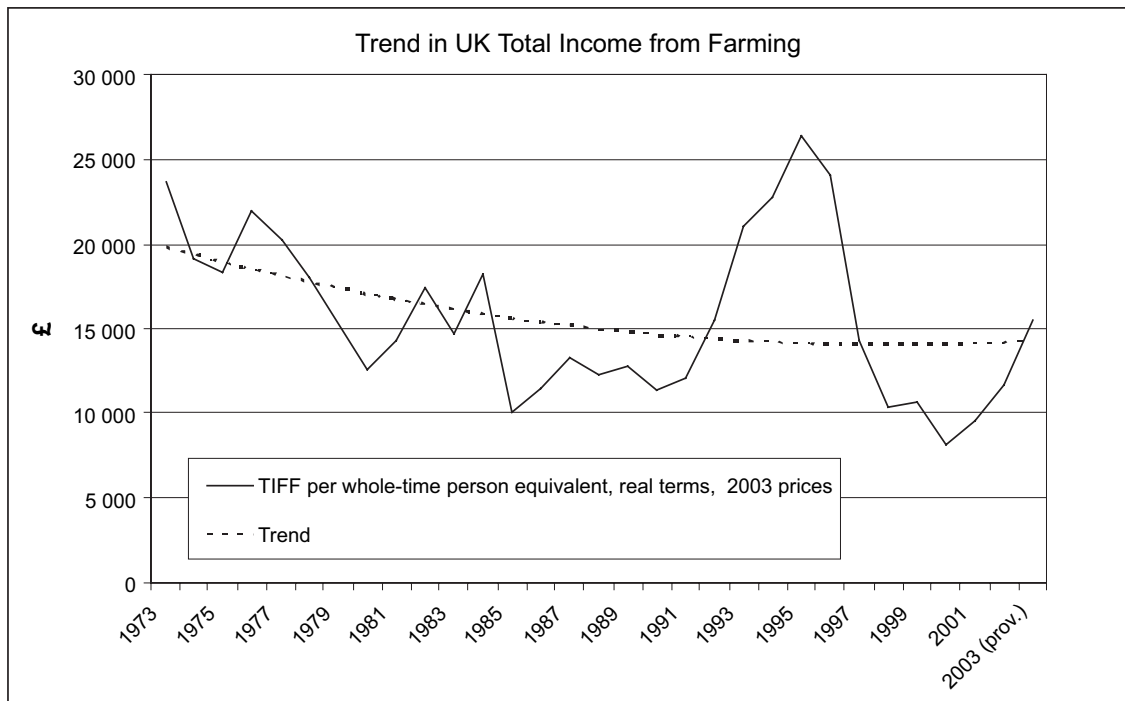
Table Chickens (Broilers)



- Net margins for broilers are estimates based on data from a variety of sources—the margins shown here should only be regarded as broad estimates (the methodology is under review) but the trends in margin are robust.
- Profitability in the broiler sector increased in 2002–03 but fell in 2003–04, due primarily to increased feed costs.
- As with the pig sector, future poultry margins will be affected by cereal prices for 2004 harvest and the cost of imported proteins.

Question 122 (Mr Williams): Long term trend in farm income

Total Income from Farming in the UK per whole-time person equivalent rose by 32% in real terms in 2003. Total Income from Farming is now at a level more in line with levels of the late eighties, being 90% above the low point in 2000 and 41% below the peak in 1995. The chart below shows the trend in Total Income From Farming over the last 30 years.



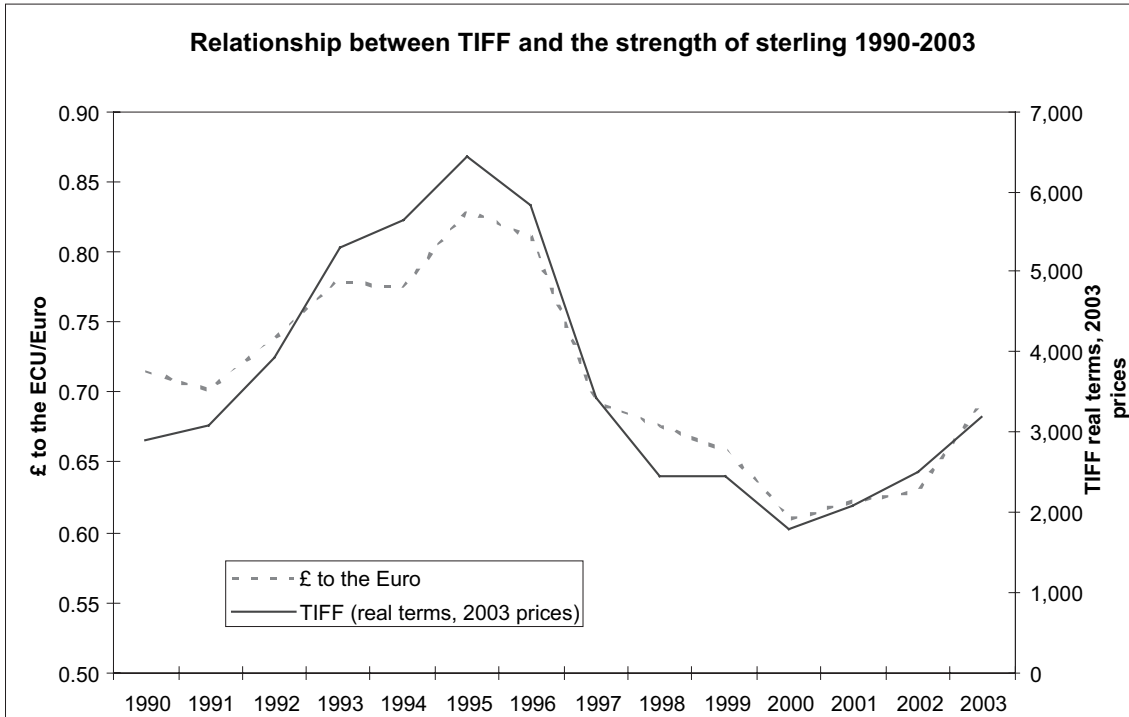
Total Income from Farming is sensitive to small percentage changes in the values of outputs and inputs. This generates the volatility seen in the chart. A long term trend line is also shown on the chart to help smooth out this volatility.

In real terms the long term trend in Total Income from Farming has been downwards since 1973. The trend line has declined by around one quarter over the 30 year period.

The dramatic rise in farming's profitability in the early nineties followed the decline in the strength of sterling after the UK left the Exchange Rate Mechanism. The equally rapid reverse in the second half of the decade was caused by the subsequent strengthening of sterling, lower world commodity prices and the impact of BSE.

Question 124 (Mr Williams): Correlation between income of farmers and currency movements

The exchange rate has been the dominant factor behind trends in UK farm incomes since the early 1990's. The following chart compares the trend in Total Income From Farming (TIFF) with the £/Euro exchange rate for the period 1990 to 2003.



The chart illustrates the way in which the exchange rate has been the dominant factor behind the development in farm incomes during this period. Following sterling's exit from the ERM in September 1992, it continued to weaken in value through to 1995 (which coincided with the peak in TIFF). From this point sterling strengthened relative to the Euro through to 2000 (which coincided with the low point in farm incomes). From 2000 to 2003 the weakening of sterling relative to the Euro has been mirrored by a recovery in incomes.

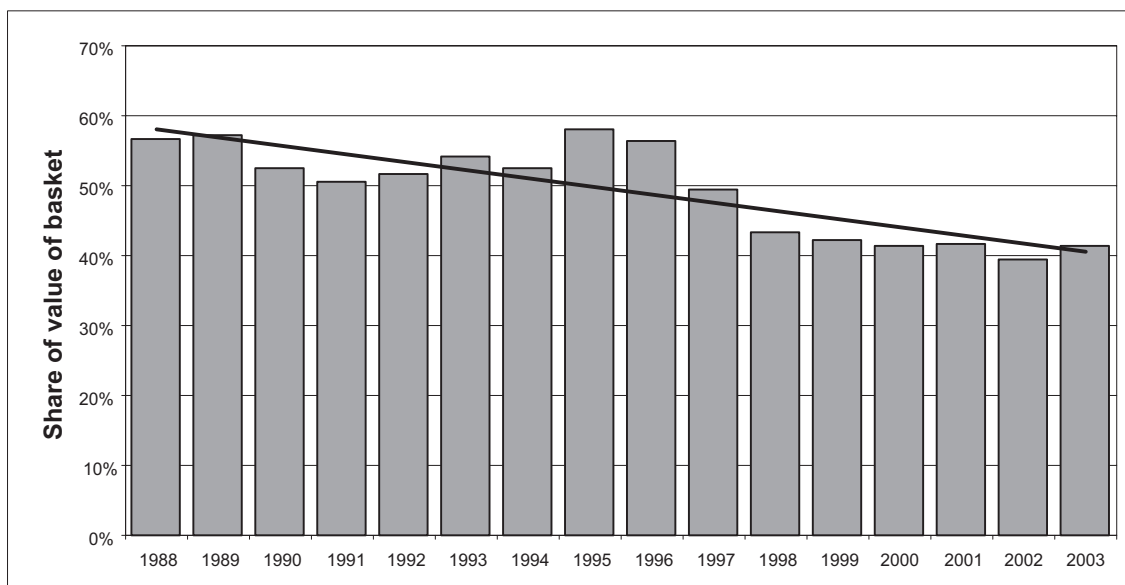
Clearly the exchange rate has an impact on direct subsidies set in Euros. However, there is also a significant impact of the exchange rate upon UK commodity (or producer) prices, reflecting the commodity nature of the majority of agricultural outputs and the effectiveness of the market in which they are sold. This impact of the exchange rate upon producer prices is only partially offset by an impact on input prices, reflecting the way in which certain inputs (eg vets fees, machinery repairs) are not tradable and therefore not subject to the influence of the exchange rate.

Questions 20 and 29 (Mr Trickett): The relationship between the price paid by supermarkets and money received by farmers

According to *Agriculture in the UK*, in 2003 farmers received 41% of the retail price for a basket of food items covering staples of agricultural production. The time trend outlined in chart 1 indicates that farmers received 28% (equivalent to a 13 percentage points reduction in farmer share) less in 2003 for their contribution to the basket than they received in 1988.

Chart 1

DECLINE IN THE FARMERS' SHARE OF RETAIL PRICES



Source: Agriculture in the UK (2003)

Possible explanations for the declining share of the retail food price received by farmers include; increases in processing and packaging beyond the farm gate; additional regulation to ensure food safety; exchange rate factors and supermarket buying power.

Defra commissioned London Economics to analyse the price spread between UK farm gate and retail prices for a selection of unprocessed or lightly processed foods to establish the significance of the various possible explanations for the squeeze in the share of retail food prices received by farmers. Particular attention was paid to the buying power of supermarkets.

Table 1 compares the farmgate shares derived from the price spreads produced and analysed by London Economics with those published by Defra in Agriculture in the UK. Whilst the two are not directly comparable due to differing time periods the two analyses are not contradictory.

Table 1

FARM GATE SHARES OF RETAIL PRICES

Product	<i>Agriculture in the UK (2003)</i>			<i>London Economics</i>		
	<i>FG share 1988 (%)</i>	<i>FG share 2003 (%)</i>	<i>% Change in share</i>	<i>FG share 1990 (%)</i>	<i>FG share 2001 (%)</i>	<i>% Change in share</i>
Apples	54	41	-23	47	36	-23
Beef	67	46	-31	57	44	-23
Carrots	30	44	46	37	45	19
Cabbages	38	42	9	40	43	7
Chicken	47	30	-37	—	—	—
Eggs	29	23	-22	—	18	—
Lamb	65	51	-20	51	41	-19
Onions	26	25	-4	28	22	-21
Pork	57	45	-20	50	44	-13
Potatoes	24	17	-28	29	12	-58
Tomatoes	48	60	26	57	52	-13
Wheat (bread)	23	14	-39	19	13	-33
Milk	66	50	-25	—	—	—

Source: Agriculture in the UK (2003) & London Economics (2004)

London Economics found farm to retail food price spreads in the UK were not out of line with other European states. For a number of foods the retail to farm spread, as a proportion of the farm gate price, was low by EU standards. The dominance of the largest supermarkets in the UK grocery market, measured by the “concentration” ratio, was lower than a majority of the EU-15; further, the share of the UK grocery market accounted for by the largest supermarkets was growing more slowly than in most of Europe over the 1990s.

London Economics established that price changes at farm-gate and retail levels are passed up and down the food chain. For most of UK foods studied farm-gate price reductions tend to be passed on to retail prices as speedily as farm-gate increases.

London Economics’ econometric modeling failed to establish a statistically significant relationship, for a number of broad food groups, between concentration in UK food retailing, used as a proxy for market power, and the farm-retail price spread, with the exception of fruit and vegetables. However, London Economics theorised that their results were not inconsistent with the ability of the supermarkets to exercise market power over suppliers under conditions where the former compete with each other aggressively in selling to the consumer. Price reductions extracted from suppliers are passed on in the form of lower retail prices.

The study concluded that the spread data does not point to a systematic widening of the farm retail price spreads as a result of potentially stronger buyer power. However the debate has continued since the Report was published and the findings are not universally accepted by stakeholders. This may be due in part to the complexity of the econometric modelling under-pinning the Report.

At this stage Defra takes a neutral position on the London Economics report’s findings, neither endorsing nor rejecting the conclusions. It does though consider the research to be a thorough and technically rigorous analysis of the available data and a valuable contribution to our understanding of the issues.

Following on from the publication of the London Economics study, Defra is organising a conference on farm-retail price spreads. The aim is to move towards a consensus on the assessment of the evidence about the determinants of the price spreads.

The conference will take place on 29 November in London at the Mothers’ Union. Defra’s intention is that the conference will be chaired and facilitated by academics who are neutral to the debate and who understand the complexities of the analysis. A wide range of prominent representatives of the food industry and other stakeholders are being invited to debate the issues with representatives of London Economics.

It is hoped that the conference will establish a consensus view on at least some of the arguments. Following the conference Defra will consider what further action to take to help resolve outstanding issues.

Question 115 (Mr Davidson): Impact of foot and mouth disease

Following the FMD outbreak in 2001, ADAS was commissioned to conduct a telephone survey of approximately 1,000 farmers. The aim was to establish how they had been effected by the outbreak and their future intentions.

The study found that by February 2002, 78% of infected premises and 65% of premises classified as Dangerous Contacts intended to restock and continue farming as soon as possible. Only 6% of those classified as a foot and mouth infected premise indicated that they would definitely be “moving out of farming”. 25% indicated that they would “definitely” or “possibly” move some of all of the land on their holding into environmental schemes.

Since this Report, farming trends have been monitored using the agricultural census data. The total number of agricultural holdings in England with cattle, sheep or pigs has fallen by less than 1% since 2001 and the livestock market has remained buoyant throughout this period.

5 November 2004

Further supplementary memorandum submitted by the Department for Environment, Food and Rural Affairs

Question 103 (Mr Davidson): Single payment scheme and tenant farmers

Clarification was asked for on the issue of the landlord/tenant relationship and the Single Payment. In 2005, payment entitlements may be established. This will not be possible after this year. As explained in the answer to question 104 in the hearing, the person carrying out the farming activity will be eligible for a payment entitlement. Only a farmer may establish entitlements and the land against which he seeks to establish entitlements must both be eligible in terms of the Regulation’s requirements and be part of his holding. So in the case where a tenant has a formal tenancy, that land would be part of his holding and the tenant would establish entitlements. Once established, the entitlements belong to the person who established them and have no formal link with the land against which they were established. So they are portable. Only the person who owns the entitlement may claim payment against it, again, subject to eligibility requirements contained in the Regulations.

It is conceivable that a landowner might wish the tenant to surrender entitlements at the end of the tenancy but that would be a separate contractual matter for them to resolve and the question of compensation would no doubt figure in those discussions. The Tenancy Reform Industry Group has published guidance on that question to help the two parties reach agreement which does not disadvantage either of them.

10 February 2004

Supplementary memorandum submitted by the National Audit Office

COMMON AGRICULTURAL POLICY REFORM—IMPLEMENTATION IN THE UK

BACKGROUND TO THE COMMON AGRICULTURAL POLICY REFORM

European Union agricultural ministers reached agreement on a fundamental reform of the Common Agricultural Policy in June 2003¹. This note sets out how the policy reform will affect farmers in the UK.

The Single Payment Scheme

The most significant feature of the reformed Common Agricultural Policy is the introduction of the *Single Payment Scheme*. Under the Scheme, most existing agricultural subsidies will be rolled into a single payment to farmers. Payments will no longer be linked to production. In addition, farmers will be required to meet cross compliance standards relating to the environment.

The removal of the link between production and payment (known as *decoupling*) aims to free farmers to produce in response to market demand and not in response to existing subsidy incentives. This is related to a key aim of the reformed Common Agricultural Policy: to encourage the use of more sustainable farming practices.

The Single Payment Scheme seeks to remove the incentive for farmers to increase production in response to direct support; the environmental damage from intensive farming should thus be reduced. In addition, farmers who claim under the Single Payment Scheme will be required to meet requirements under various European Union Directives and Regulations relating to the environment, public, plant and animal health and animal welfare; as well as the good agricultural and environmental condition standards which focus on soils, habitats and landscape features. Member States are also obliged to prevent a substantial decline in the area of permanent pasture. These requirements are known as *cross-compliance*. The consequence of non-compliance is that a farmer's Single Payment may be reduced. In extreme circumstances they may be excluded from the Scheme.

European Union Member States were given the option of both delaying implementation of the Single Payment Scheme until 2007 and, having introduced the Scheme, maintaining some of the existing coupled schemes alongside it with a reduced budget. This latter option is known as *partial re-coupling*. All four of the UK administrations have opted both to implement the Single Payment Scheme at the earliest possible date (2005) and not to take up any of the re-coupling options. In doing so, nearly all payments and production will be decoupled (aids for energy crops, nuts and proteins remain coupled on a mandatory basis across the European Union). This is sometimes referred to as *full decoupling*.

Farmers' receipts under the Single Payment Scheme will be subject to variables such as *modulation* and the provision of *national envelopes*. These are outlined below and their impact in the UK is detailed in subsequent sections.

Modulation

Modulation (the transfer of funds from farming subsidies to agri-environment and other rural development schemes) applies, at the discretion of the Member State, to existing Common Agricultural Policy subsidies. Under the reformed Common Agricultural Policy, modulation has been introduced on a compulsory basis in all European Union Member States. The European Union-wide modulation rate will be 3% in 2005, rising to 4% in 2006 and 5% in 2007.

¹ The main reforms to the Common Agricultural Policy are set out in Council Regulation (EC) No 1782/2003 and have been supplemented by three main detailed Commission Regulations:

- Commission Regulation (EC) No 796/2004 covers cross-compliance, controls and modulation;
- Commission Regulation (EC) No 795/2004 covers the Single Payment Scheme;
- Commission Regulation (EC) No 2237/2003 covers direct support schemes (to be replaced from 1/1/2005 by Commission Regulation (EC) No 1973/2004.

As part of the Common Agricultural Policy reform package, the UK secured agreement to enable those Member States who have previously applied modulation on an optional basis to apply an additional national modulation rate to all farmers' direct payments, including those under the Single Payment Scheme². Additional national modulation rates can therefore be set on a discretionary basis according to the UK's rural development needs and priorities up to a combined maximum of 20%, but no more than is needed to fund rural development schemes operating in 2005.

In England, the Department for Environment, Food and Rural Affairs has set an additional national modulation rate of 2% in 2005 and 6% in 2006. This will be used to finance an expansion of agri-environment schemes and, in particular, to implement a new agri-environment scheme, Entry Level Stewardship. The rate for 2007 cannot be calculated at this time, as this will be affected by future European Union financing arrangements and the take up for the Entry Level Stewardship scheme.

National Envelopes

The reformed Common Agricultural Policy also provides that up to 10% may be deducted from the value of farmers' Single Payment entitlements to create a *national envelope*. This can be used either to support farming systems that protect or enhance the environment, or to improve the quality and marketing of agricultural products. The national envelope relates to each sector covered by the new regime (such as arable or livestock) and deductions from single payments will be returned to the same sector. European Union Member States may apply these provisions on a discretionary basis. Currently, the Department has no plans to make use of this discretion in England. The Department considered that it would be difficult to reconcile a sector-based scheme with an area-based scheme, and it was also concerned that use of national envelope would also involve a degree of recoupling, albeit limited, because fully decoupled subsidies would be diminished to pay for schemes which were required to be spent in a specific production sector.

Timetable for implementation

Key events in the timetable for implementing the reformed Common Agricultural Policy are summarised below.

June 2003	Political agreement reached on the basis for Common Agricultural Policy reform.
September 2003	Framework legislation agreed by European Union Agriculture Council giving effect to the political agreement.
March 2004	Detailed European Commission legislation agreed for the Single Payment.
July 2004	Decisions made in respect of implementation options in the UK notified to the European Commission.
August 2004	Original deadline for notifying to the European Commission decisions on regions and the basis for the Single Payment Scheme. Deadline extended to August 2005 for Finland, France, the Netherlands and Greece.
1 January 2005	Cross compliance standards commence.
Spring 2005	Main existing direct aid schemes to be replaced by the new Single Payment Scheme.
16 May 2005	Application forms for the Single Payment Scheme to be sent to farmers.
December 2005–June 2006	Deadline for return of Single Payment Scheme applications forms.
	European regulations require 2005 payments to be made within this period.

REGIONAL IMPLEMENTATION IN THE UK

The reformed Common Agricultural Policy allows Member States to implement certain changes differently in different regions. The UK is making use of this option to reflect the different administrative structures within the country. For the purposes of the Single Payment Scheme, the UK has therefore been split into six regions:

- English non-moorland within upland Severely Disadvantaged Areas;
- English moorland within upland Severely Disadvantaged Areas;
- Elsewhere in England;
- Scotland;
- Wales;
- Northern Ireland.

² Those member states previously operating voluntary modulation have the option to implement additional national modulation on a discretionary basis. Commission Regulation (EC) 1655/2004 of 22 September 2004 covers this: http://europa.eu.int/eurlex/pri/en/oj/dat/2004/l_298/l_29820040923en00030005.pdf

The devolved administrations of Scotland, Wales and Northern Ireland each have their own strategic plans and priorities for the development of agriculture within their jurisdictions, as does England. The administrations have thus elected to determine the most appropriate method of allocating entitlement under the Single Payment Scheme on a regional basis. The various options for implementation are described in the next section. The devolved administrations were also able to exercise discretion over the introduction of additional national modulation and national envelopes.

Following representations from many agricultural interest groups, England was divided into three areas. This approach aimed to reduce the level of redistribution from more productive to less productive areas that would otherwise have occurred.

The move to a new basis for entitlement under the Single Payment Scheme, as discussed in the next section, will affect farms' payment levels to differing degrees, and quite significantly in some cases³. The chosen methods for implementation were developed in consultation with stakeholders.

Options for Implementation

The key features of various methods of allocating entitlement under the Single Payment Scheme are summarised below. Hypothetical case examples to illustrate the impact of the methods applied in the UK are provided in Annex 1.

<i>Method of allocation</i>	<i>Key Features</i>	<i>Regions adopting this method for implementation</i>
Flat rate scheme	Number of entitlements to be allocated is to be determined by the number of eligible hectares a farmer declares in 2005. Each hectare to have a common value in each region.	None at present ⁴ .
Historic basis allocation	Number of entitlements to be allocated is to be determined on the basis of the hectares that gave rise to subsidies in a 2000–02 reference period. Value of entitlements to be based on the average subsidies farmers received during the reference period.	Scotland; Wales
Dynamic hybrid moving from historic to flat-rate scheme	Number of entitlements to be allocated as for flat rate. Value of entitlements based, between 2005 and 2012, on a mix of flat rate and historic systems. The proportion of the payment based on the flat rate will increase gradually from 10% to 100% during this period.	English non-moorland within upland Severely Disadvantaged Areas; English moorland within upland Severely Disadvantaged Areas; Elsewhere in England.
Static hybrid model	As for dynamic hybrid, except that the value of entitlements is fixed in 2005.	Northern Ireland.

Historic basis allocation—as implemented in Scotland

In Scotland, entitlement under the Single Payment Scheme will be allocated to farmers on an “historic basis”—the standard system envisaged in the European Union legislation. Payments will be based on the average amounts farmers received for farming activity under existing subsidy schemes during a reference period between 2000 and 2002, and the land used to support the relevant payments. A hypothetical case example is provided in Annex 1.

The Scottish Executive's main reason for using this method was that of stability: the allocation of payments on an historic basis aims to provide stability for farmers during adaptation to the major changes associated with decoupling.

The Department for Environment, Food and Rural Affairs reports that Scottish Ministers have stated their intention to introduce additional national modulation, with a combined rate (national and European Union) of at least 10% by the end of 2007. This provides the opportunity to introduce Land Management Contracts in Scotland. Land Management Contracts are a whole farm support system providing payments for the delivery of a range of environmental, social and economic public goods. Interim rates of national modulation have yet to be announced.

³ Detailed case examples can be found in an economic analysis undertaken by the Department for Environment, Food and Rural Affairs <http://ww.defra.gov.uk/farm/capreform/pdf/webnoterev16.pdf>

⁴ The English regions will adopt this approach in the future under the *Dynamic hybrid moving from historic to flat rate scheme*.

The Scottish Executive also intends to make use of the *national envelope* provisions in the beef sector to encourage-quality beef production and to maintain and protect the environment in more fragile and remote parts of Scotland⁵. This decision was taken in response to major concerns about the impact of decoupling on the suckler cow sector, which is the mainstay of Scottish production. The Scottish Beef Calf Scheme has been developed and will be introduced from 1 January 2005.

Historic basis allocation—as implemented in Wales

In Wales, entitlement under the Single Payment Scheme will also be allocated to farmers on an “*historic basis*”. Payments will therefore be based on the type and value of subsidies, and the amount of land receiving subsidy, between 2000 and 2002. A hypothetical case example is provided in Annex 1.

The Environment, Planning and Countryside Department of the Welsh Assembly Government undertook an assessment of the economic and distributional impact of the implementation options available for Common Agricultural Policy reform. It justified the adoption of the historic basis of Single Payment entitlement as follows⁵:

- Minimising the redistributive effects—The application of a flat rate area scheme to Wales would result in a significant redistribution of the current pattern of Common Agricultural Policy receipts.
- Factors unique to Welsh agriculture—Wales has a high proportion of smaller, traditional family farms, for which flat rate payments would be economically disadvantageous and undermine social, environmental and cultural cohesion in rural communities.

Following consultation, the Welsh Assembly Government decided not to introduce a national envelope for Wales. Separate consultation indicated support for a new entry-level agri-environment scheme called *Tir Cynnal*. This aims to give farmers more opportunity to take part in positive agri-environment actions (such as: protecting wildlife habitats, traditional landscapes and historic features; reducing pollution; and maintaining rights of way). The scheme will be funded by an additional national modulation rate for Wales, supported by matched funding from the Treasury⁶. The Department for Environment, Planning and Countryside estimates, based on predicted take-up of Tir Cynnal, that Wales will need a modulation rate at around 10% by 2006–07 if take-up of the scheme meets targets.

Dynamic hybrid moving from historic to flat-rate scheme—as implemented in England

In England, the Department for Environment, Food and Rural Affairs will adopt a “*dynamic hybrid moving to flat-rate*” model to allocate payments under the Single Payment Scheme.

Payments will comprise a mix of *flat rate payments* based on the area of the land in question and *historic payments* based on previous subsidy levels. To allow the industry time to adjust, the historic proportion of the payments will be gradually phased-out and the proportion of the payment based on the flat rate will increase gradually from 10% in 2005 (the first year of the scheme) to 100% in 2012.

From 2012, all entitlements under the Single Payment Scheme will have a flat-rate value, although a different rate will apply in each of the three English regions. A hypothetical case example is provided in Annex 1.

Final flat rate payments will be lowest in moorland within upland Severely Disadvantaged Areas, higher in non-moorland within upland Severely Disadvantaged Areas and highest in the remaining parts of England. This approach broadly reflects the level of compliance costs that those getting the Single Payments will incur. Compliance costs should be lowest in moorland within upland Severely Disadvantaged Areas, for example, because less intervention should be needed; the final flat rate payment will accordingly be lower than for the other areas.

The division of England into these three areas is intended to reduce the level of redistribution from more productive to less productive areas that would otherwise have occurred. Within each region there will, nevertheless, be a transfer of subsidy from more intensive to less intensive producers, and to land that is not presently in receipt of subsidy. The main losers under this scheme are expected to be dairy, mixed and cereal farms, and the main winners are general cropping, horticulture and cattle and sheep farms. Some 13% of subsidies will be redistributed in this way⁷.

The Department’s reasons for using a “*dynamic hybrid moving to flat-rate*” scheme are:

- Simplicity—the new payment scheme is intended to be as simple and straightforward as possible for farmers.

⁵ Statement by Carwyn Jones, Minister for the Environment, Planning and the Countryside, 11 February 2004, http://www.countryside.wales.gov.uk/fe_news/news_details.asp?newsid=66

⁶ Further details about this scheme can be found on the Welsh Assembly’s website, <http://www.countryside.wales.gov.uk/fe/master.asp?n1=4&n2=628>

⁷ A detailed economic analysis of the impacts upon different farm types under the three-area scheme in England is provided by Defra: <http://www.defra.gov.uk/farm/capreform/pdf/webnoterev16.pdf>

- Sustainability—payments allocated solely on a historic basis will reward farmers according to their previous production patterns. A transition to flat rate payments should encourage farmers to respond to the signals of the reformed Common Agricultural Policy and to alter production patterns accordingly.
- Environmental objectives—the English scheme allows more land to be made subject to cross-compliance conditions than would otherwise be the case (8.8 million hectares compared to 8.3 million hectares under an historical basis).
- Business adjustment—the transition period will facilitate adjustment to the new arrangements.

The national envelope instrument will not be introduced in England, but additional national modulation will be applied to Single Payments. This will be used to finance an expansion of agri-environment schemes such as the *Entry Level Stewardship*. National modulation will be introduced at an initial rate of 2% of Single Payments, though this is expected to rise in future years. The Department states that the low rate of additional national modulation in 2005 will assist farmers as they adjust to the introduction of the Single Payment.

Static hybrid model—as implemented in Northern Ireland

Northern Ireland has opted for a “static hybrid model” with each farmer’s aid entitlement under the Single Payment Scheme to be based on a mix of historic and regional elements.

Using this approach, all farmers in Northern Ireland will receive the same flat rate payment for each hectare of land. They will additionally receive a payment linked to their historic claims, but the subsidies received will be reduced according to the type of production. The “beef special premium” will be reduced by 50% compared with previous levels, and the “rural world supplement” will be reduced by 80%, for example. A hypothetical case example is provided in Annex 1.

Northern Ireland’s Department for Agriculture and Rural Development has justified the choice of the *static hybrid model* because an historic model would take no account of the substantial movement of previous subsidy payments through the beef marketing chain. The beef sector in Northern Ireland is a much bigger part of the total value of agricultural output compared to other parts of the UK. An historic model would transfer significant amounts of payment away from primary beef producers to those further along the marketing chain. The payment model for Northern Ireland therefore seeks to avoid this potential effect by allocating some of the aid on an area basis⁸.

In addition to the European Union compulsory rate of modulation, Northern Irish farmers will also be subject to additional national modulation deductions of 4.5% from their single payment. The levy, which will be introduced in 2006, will be used to fund rural development measures (agri-environment programmes in particular)⁹. The option of national envelopes will not be pursued in Northern Ireland at this point in time.

National Reserve

The National Reserve is a mandatory element of the Single Payment Scheme and will apply throughout the UK¹⁰. Its main purpose is to provide a transitional measure to allow farmers who faced business changes in or after the reference period (2000 to 2002) to obtain subsidy entitlements in much the same way as others. The Reserve will be funded through deductions from single payments. The Department for Environment, Food and Rural Affairs’ initial estimates are that the maximum allowed reduction of payments (3%) will be required to fund the categories of applicant that will receive an automatic award (eg new entrants and dairy converters). The basis for these awards of entitlement has already been announced in some cases and will generally beat the regional average but the basis for some categories has yet to be announced. In addition to this 3% reduction, it may be necessary for the Department to scale back all entitlements before they are issued to ensure full funding for the Reserve.

Annex 1

HYPOTHETICAL CASE EXAMPLES

Please note that the examples provided below are illustrative only. Flat-rate entitlements stated below have been selected arbitrarily, and figures do not account for the effect of compulsory European Union modulation and additional national modulation. The actual subsidy is set in € and its sterling value will depend on the exchange rate. The case examples show farms that gain from the changes before modulation etc, but in practice there will also be farms that lose entitlement.

⁸ More information on implementation of the Single Payment Scheme in Northern Ireland is set out by its Department for Agriculture and Rural Development: http://www.ruralni.gov.uk/bussys/dard_consultation.htm and www.dardni.gov.uk/core/dard1200.htm

⁹ Agra Europe, 19 November 2004.

¹⁰ More information on the National Reserve is provided by Defra: <http://www.defra.gov.uk/farm/capreform/singlepay/natreserve/index.htm>

Single payments made on an historical basis—Scotland and Wales¹¹

Suppose a farmer has 100 hectares and farming of livestock led to receipt of the following historic payments:

<i>Year</i>	<i>Subsidy received</i>
2000	£4,750
2001	£5,000
2002	£5,250
<i>Historic reference period (2000–02) average</i>	£5,000

The farmer is said to have received an average subsidy payment of £5,000 a year in the *historic reference period* (2000–02). The number of hectares in the reference area that a farmer has is also the number of *payment entitlements*. The farmer is said to have 100 payment entitlements at £50 each.

(A) <i>Historic reference period (2000–02) average</i>	£5,000
(B) Hectares in the reference area	100
(C) Individual payment entitlement value = (A)/(B)	£50
Single Payment Scheme payment = (B) x (C)	£5,000

Under the Single Payment Scheme, the farmer would be eligible to receive a payment of £5,000 a year if they retained 50 eligible hectares. This figure would then be subject to deductions for modulation (at the European Union compulsory and additional national rates), the national reserve, and, for Scotland, the national envelope (component of livestock subsidies only).

Single payments made using the static hybrid model—Northern Ireland¹²

Suppose the previous above example is applied in Northern Ireland: a beef farmer with 100 hectares received an average of £5,000 a year in the historic reference period (2000–02). As before, this equates to an historic entitlement of £50 a hectare a year.

Under the static hybrid model, the claim for subsidies on an historic basis would be reduced. It will be reduced by differing amounts depending on the source of the subsidy. Amounts arising from beef special premium and slaughter premium subsidies, for example, will be reduced by 50%. Under the static hybrid model, the farmer would also receive a flat rate payment for each hectare. The value of the area-based flat rate element is estimated to be approximately £48 a hectare¹³.

(A) Average payment in historic reference period (2000–02) £/Hectares/year	£50
(B) Value of historic claim under new arrangements £/Hectares/year = 50% of value of (A)	£25
(C) Flat rate entitlement £/Hectares/year	£48
(D) Single payment entitlement £/Hectares/year = (B) + (C)	£73
(E) Hectares entitled to single payment	100
Single Payment Scheme payment = (D) x (E)	£7,300

The farmer would thus receive a total of £73 a hectare a year to account for both the historic and flat rate contributions. As the farmer has 100 hectares, they would be eligible to receive a single payment of £7,300 a year under the Single Payment Scheme. This figure would then be subject to modulation. A full description of the rationale and detail of the approach being adopted in Northern Ireland can be found at www.dardni.gov.uk/core/dard1200.htm.

Single payments made using dynamic hybrid moving to flat-rate scheme—England

We can take the same example and apply it to England. A beef farmer with 100 hectares received an average of £5,000 a year in the historic reference period (2000–02). This equates to an historic claim of £50 a hectare.¹⁴ The annual flat rate payment will be set according to the region of England in which they are based. In this example suppose the flat rate is £60 a hectare¹⁵.

¹¹ This hypothetical example is adapted from the information provided by the Scottish Executive (<http://www.scotland.gov.uk/library5/agri/capfaq-01.asp>) and Welsh Assembly (<http://www.countryside.wales.gov.uk/fe/master.asp?n1=408&n2=505&n3=511>)

¹² This hypothetical example is adapted from the information provided by the Northern Ireland Department of Agriculture and Rural Development http://www.ruralni.gov.uk/bussys/single_payment_scheme.htm

¹³ A figure of 68 Euro per hectare (exchange rate 1 Euro = £0.70) is estimated by the Northern Ireland Department of Agriculture and Rural Development http://www.ruralni.gov.uk/bussys/single_payment_scheme.htm

¹⁴ This historical payment element in this hypothetical example is adapted from the examples given above.

¹⁵ The flat rate components are based upon the degressive percentages selected by the Department for Environment, Food and Rural Affairs (<http://www.defra.gov.uk/farm/capreform/background/120204.htm>) and are purely hypothetical. Flat-rates for each of the three English areas have yet to be set.

Under this method of allocating entitlement, the proportions of the single payment derived from the historic payment and the flat rate will change over time. An example is provided in the table below.

<i>Component of payment</i>	<i>2005</i>	<i>2007</i>	<i>2010</i>	<i>2012</i>
(A) Flat rate element of payment	10%	30%	75%	100%
(B) Hypothetical flat rate entitlement £60/Hectares/year x (A)	£6	£18	£45	£60
(C) Historic rate element of payment	90%	70%	25%	0%
(D) Hypothetical historic rate entitlement £50/Hectares/year x (C)	£45	£35	£12.50	£0
(E) Total single payment (subject to modulation) £/Hectares/year = (B) + (D)	£51	£53	£57.50	£60

¹ Assuming that the farmer has a subsidy record for the reference period, otherwise this amount will be nil.

The above table necessarily oversimplifies the situation to help show the basic principle more clearly. In practice, the available budget will be split between the flat and historic rate elements for each area in England. In 2005, for example, 10% of the available budget for each English area will be apportioned across all declared hectares. That will form the flat rate entitlement. Then those who have an individual subsidy record for the reference period (a reference amount) will have an additional element calculated. This will be done by totalling all individual reference amounts (the historic part of the entitlement) and comparing the sum with the remaining 90% of the available budget for the area. The reference amounts may then need to be reduced if the budget is exceeded. Compulsory deductions would also apply, for example for modulation and the national reserve.

ISBN 0-215-02362-5



9 780215 023629