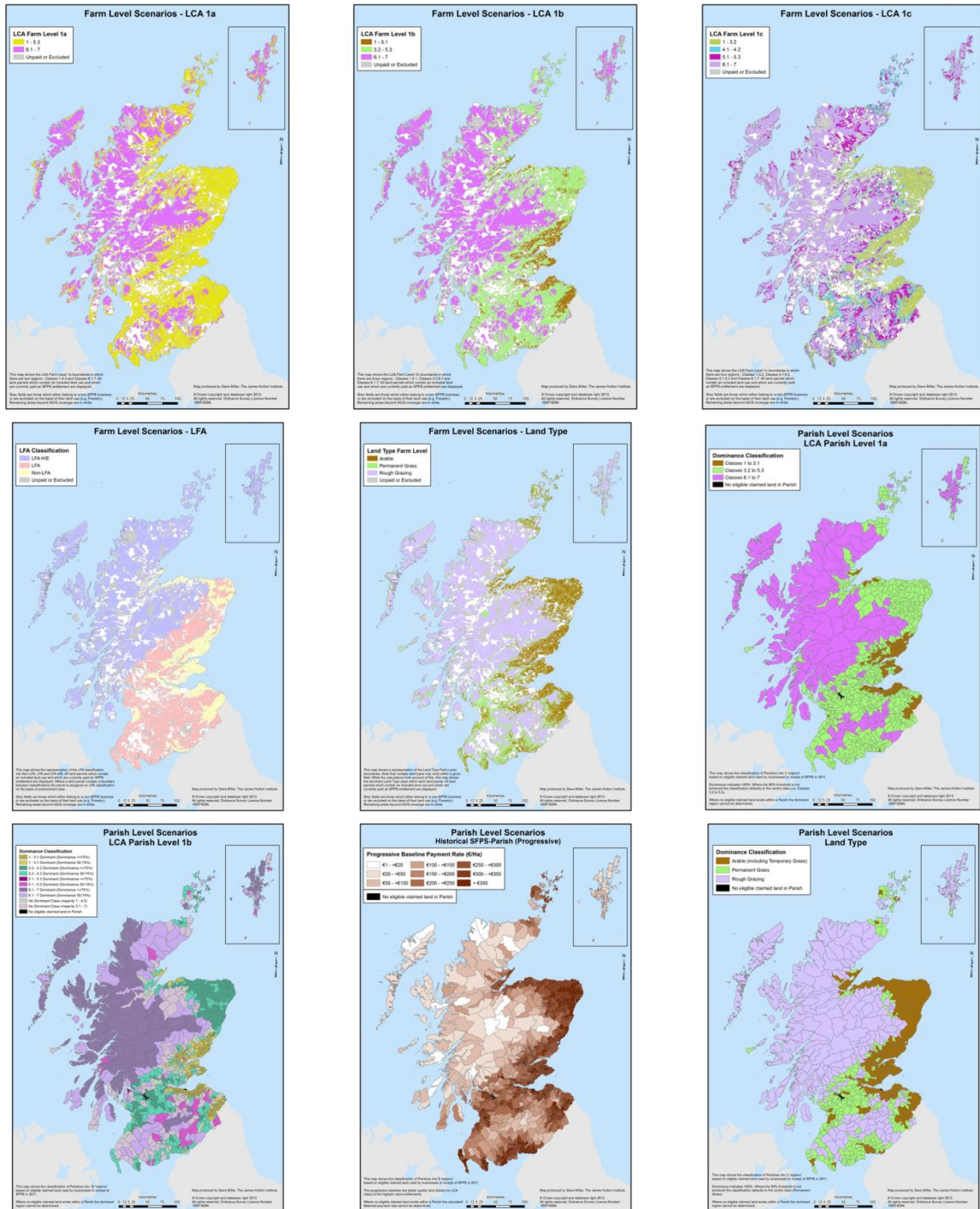


**Written Submission from the James Hutton Institute**

*Future CAP – Research at James Hutton Institute: A summary of research by the James Hutton Institute on options for Direct Payments post 2015.*



**Introduction**

The purpose of this document is to introduce the research being undertaken by the James Hutton Institute for Scottish Government on future options for Direct

Payments. In *Interpreting the Analysis* the document summarises key findings, the context for which is provided in the *Background* and *Scope of the Analysis*.

## **Background**

The reform, from 2015, of Direct Payments is a major change in the way agriculture is supported in Scotland. Significant changes are planned including new mechanisms (such as area-based payments), how budgets will be used (potentially, for a larger eligible area), and changes in funding to existing options (such as voluntary coupled support).

A key consequence of area-based payments is a more even distribution of support across all farm businesses than is the case under the current payment system. However, breaking the link between intensity of production and levels of direct payments may lead to undesirable outcomes for important yet vulnerable farm enterprises. For these cases, voluntary coupled support takes a share of the overall budget from all farm types and uses this to offset the disadvantages being experienced by particular enterprises, for example suckler-beef herds. Beyond the redistributive effects it is also essential to recognise that the overall budget for Direct Payments available to existing recipients will be affected by: EU/UK budget decisions, the need to fund other new mandatory elements, and perhaps more significantly the need to increase transfers to Pillar 2 to support the Scottish Rural Development Programme.

The EU regulations make extensive provision for Member States and regions to implement reforms in ways that best suit their particular circumstances. This has meant the need to investigate large numbers of policy options, and how these options can be combined, to deliver a coherent package that is most likely to achieve the balance of policy outcomes sought by Scottish Government.

The James Hutton Institute has been funded by government to support policy decision makers by analysing potential changes in payments to all farm businesses in Scotland currently in receipt of Single Farm Payment. Change to Direct Payments is a long studied issue, including within the Scottish Government funded Strategic Research Programmes (SRP) since 2009, and in 2010 through support for the Inquiry into Future Agricultural Support for Scotland (the Pack Inquiry). More detailed work has been carried out in the Economic Adaptation Theme of the Environmental Change Programme (2011 to present) and through SRP Underpinning Capacity call-down projects.

Two phases of analysis have been undertaken. Phase-1 assessed a range of options for defining payment regions and budgets. These options included Land Capability for Agriculture classes (as defined by the Macaulay System), Land Types (groupings of land uses), and Administrative Designations (Less Favoured Area regions). Phase-2 included further analyses of regions and budgets, notably options which used two regions and variations in the payment rates for rough grazing. Phase-2 also looked at the effects of: Voluntary Coupled Support (VCS) options for beef calves; Redistributive Payments where higher payments are made on up to the first 54 ha of land; potential additional areas that could become eligible for payment in 2015, and the changes in payments that would be made to designated areas. All

of these analyses have been published via the James Hutton Institute website<sup>i</sup> and have also been presented at a range of stakeholder meetings.

## Scope of the Analysis

The research has been carried out by the James Hutton Institute in partnership with Scottish Government analysts working within Rural and Environment Science and Analytical Services (RESAS). The research has analysed the effects of specific components of the regulations rather than the overall package. Therefore, the specific payment rates and other values within the reports will not match those within the current Scottish Government consultation - for example in the ready reckoner<sup>ii</sup>. Where possible, the James Hutton Institute research has made like-for-like comparisons to determine the effects of specific technical choices, mechanisms and policy options, for example in defining payment regions. They have also provided underpinning data for the direct payments model being developed by RESAS. In some cases a range of scenarios have been considered to explore different policy options. However, this does not imply that these are the only options possible. The scenarios have been used to assess issues of technical feasibility, effects of particular threshold values, or trade-offs.

## Interpreting the Analysis

In all cases the interpretations of results presented are those made by the research team and do not reflect any policy position or decision by the Scottish Government. For the detailed reports underpinning this interpretation please see the CAP policy support page<sup>iii</sup> on the James Hutton Institute website.

**Flattening.** Historic entitlements reflect previous patterns of land use and intensities of production. They vary significantly, and locally, between businesses with the same resource base as defined by payment regions. This spatial heterogeneity of historic payment rates cannot be reflected in future area-based payments with a single rate per payment region. The introduction of an area-based payment per region necessarily results in redistribution from intensive to extensive systems within each payment region.

**Budget Setting Options.** These affect the funds available per payment region and thus the payment rate per hectare (ha) for that region. The budget is a key policy decision that seeks, with multiple payment regions, to balance the outcomes being sought. After Phase-1, the preferred budgeting mechanism was to apply weightings to payment region areas to determine budgets. Comparing future budgets with current expenditure within proposed payment regions remains inherently uncertain due to the technical challenges of linking historic entitlements to the specific land parcels that generated them. Averaging total entitlements across all eligible land in a business overestimates the financial value of lower quality land. This means that, when comparing area-based payments with current entitlements, there is a tendency to underestimate the redistribution towards poorer quality land.

**Redistribution.** To date, there is no combination of budgets and regions assessed that result in less than 42% redistribution (i.e. the sum of gains and losses). While minimisation of redistribution is not a policy goal, high levels of redistribution could result in undesirable consequences. Redistribution can, however, simply recognise

changes in management (e.g. reductions in stocking rate since the 2000-2002 historic entitlements period) or reflect increased payments to active land managers that currently have zero or limited historic entitlement values (particularly new entrants). Redistribution also occurs when high value entitlements can no longer be activated on low quality, rented land (a form of 'slipper farming').

**Numbers of Regions.** When combined with particular budget choices the use of more regions can reduce redistribution, but with diminishing returns for each region added. More regions mean greater inter-regional boundary lengths and a higher administrative burden. Options of two and three regions were retained after Phase-1. Two regions are proposed in the Scottish Government consultation. Options for using parish level characteristics to determine the rate for all land within the parish were tested but found to generate higher levels of within-parish redistribution and to be challenging to implement for a variety of technical reasons.

**Defining Regions.** Two options were retained after the Phase-1 analysis: 1) Land Type as defined by groups of Integrated Administration and Control System (IACS) crop codes, and 2) groups of Land Capability for Agriculture classes. Land Type in all cases differentiates between rough grazing (including commons), and for three region models also differentiates between permanent grasslands and arable (including temporary grasslands).

**Defining Increases and Reductions.** Two classes of change in payments were distinguished rather than only presenting current and future payments. The first class comprises businesses where the reduction is larger (in percentage terms) than would be anticipated by changes due to EU/UK budget decisions, transfers between Pillars, and other mandatory provisions such as the National Reserve. These businesses may be argued to have been negatively affected by measures in the reforms with redistributive effects - principally the use of area-based payments. However, within this class there will be instances where the reduction in payment simply recognises changes in farming practice since the historic baseline period. Outwith this group all businesses have seen either a smaller reduction than would be anticipated by overall changes to budget, or a benefit from redistributive mechanisms to such an extent that their payments increase relative to the current direct payments scheme.

**Within Sector or Geographical Region Effects.** With 18,790 current recipients it is necessary to summarise outcomes by sector and by geographical region. However, a key finding of the research is that such summaries can hide redistribution. For example, at sector level Specialist Beef type businesses experience a near neutral effect for many scenarios, but this is the net outcome of significant redistribution within the sector with both large increases and large decreases.

**Sector Level Effects.** There are consistent losses in Cropping, Dairy and related mixed business types. Specialist Sheep consistently sees the largest increases followed by Mixed Cattle and Sheep. Before accounting for budget cuts, the effect on Specialist Beef is neutral but with a strong redistribution within the sector. For all types there are businesses with particular circumstances which result in unexpected outcomes - for example Specialist Sheep businesses that see reduced payments. Shaping policy options to address small numbers of cases may not be possible

within the scope of the Direct Payment regulations or may result in more undesirable outcomes in other sectors or regions.

**Geographical Region Effects.** Regional distributions are more affected by decisions on budgets with special sensitivity to the rough grazing rate. The allocation to Highland Region sees the largest increase under most scenarios, although under some rates it experiences the biggest losses. Consistent reductions occur for North-East Scotland and Dumfries and Galloway. These are lessened but not eliminated by VCS.

**Business Size Effects.** The greatest redistribution in terms of financial amount occurs in the largest size classes (250 ha plus). The balance between gain and loss within size classes is scenario dependent, but for the majority of scenarios the largest size class sees the biggest net increase.

**Voluntary Coupled Support (VCS).** The effective increase in payment is less than the headline percentage alone would indicate since the scheme is funded by a levy on all businesses including those receiving VCS. In terms of benefits, there is a broadly even split between businesses that receive reduced payments under area-based payments alone and those that see increased payments. Thus, nearly half of the effective VCS budget does not offset losses but further increases gains.

**Redistributive Payment.** This provides an uplift in payments to the first 54 ha on the farm (the UK average size). For the scenario assessed there are gains for smaller businesses (up to 150 ha), the mid-range is neutral (150 to 250 ha), and there are reductions for larger businesses (above 250 ha), with more gainers overall.

**New Areas.** There is potential for a significant increase in eligible area. In terms of percentage of current area, the upper limits on increases are ~10% for Arable (including Temporary Grassland), ~21% for Permanent Grassland and ~32% for Rough Grazing (~32% would equate to ~0.9 M ha). For Rough Grazing the stocking rate may be used to limit eligibility to only those areas stocked above a threshold level. However, setting the threshold value is challenging. If set too low, little land area is excluded, especially where management change is allowed for. Set too high, then the threshold could generate large numbers of appeals for derogation on the basis of environmentally appropriate management. An approximate guide is that the number of livestock required to ensure that all existing land remains eligible equates to about 5% of the 2013 sheep flock.

**Designated Areas.** A significant proportion of environmentally designated areas are managed by businesses that receive Single Farm Payment (SFP) (59%) or submit a Single Application Form (SAF) (80%). Payments for these areas are lowest when using production-oriented regions and budgets, but most scenarios see net gains. The limitations of the analysis for comparison between payment regions in the baseline and future periods also hold here. Gains are underestimated and any losses overestimated.

## **Ongoing Research**

Ongoing research is being led by RESAS on the outcomes of the complete package of Direct Payment changes. The James Hutton Institute is assisting in the provision

of input datasets to support new options being considered – such as differentiating payment rates within the rough grazing payment region on the basis of land quality. More detailed impact assessments are also being developed, including economic modelling by The James Hutton Institute and Scotland’s Rural College and an investigation into possible adaptive responses to Direct Payment reforms based on a survey of 2,416 holdings conducted in 2013.

### **Acknowledgements**

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<sup>i</sup> [www.hutton.ac.uk/landsystems](http://www.hutton.ac.uk/landsystems)

<sup>ii</sup> [www.scotland.gov.uk/Resource/0044/00445774.pdf](http://www.scotland.gov.uk/Resource/0044/00445774.pdf)

<sup>iii</sup> [www.hutton.ac.uk/CAPreform](http://www.hutton.ac.uk/CAPreform)