Land Use Policy Group

The GB statutory conservation, countryside and environment agencies

The Review of Area-based Less Favoured Area Payments Across Great Britain

A report for the LUPG

by

CJC CONSULTING

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www.lupg.org

English Nature · The Countryside Agency · Cyngor Cefn Gwlad Cymru Countryside Council for Wales · Environment Agency · Scottish Natural Heritage · Joint Nature Conservation Committee

The Land Use Policy Group

The Land Use Policy Group (LUPG) of the GB statutory conservation, countryside and environment agencies comprises the Countryside Agency, Countryside Council for Wales, English Nature, Environment Agency, Joint Nature Conservation Committee and Scottish Natural Heritage.

The LUPG aims to advise on policy matters of common concern related to agriculture, woodlands and other rural land uses. It seeks to improve understanding of the pros and cons of policy mechanisms related to land use, particularly farming and forestry; to develop a common view of desirable reforms to existing policies; and to promote these views.

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Countryside Council for Wales

Countryside Council for Wales (CCW) is the Government's statutory adviser on sustaining natural beauty, wildlife and the opportunities for outdoor enjoyment throughout Wales and its inshore waters. With English Nature and Scottish Natural Heritage, CCW delivers its statutory responsibilities for Great Britain as a whole, and internationally, through the Joint Nature Conservation Committee. http://www.ccw.gov.uk

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English Nature is the Government Agency that champions the conservation of wildlife and geology throughout England. It does this by: advising Government, other agencies, communities and individuals; regulating activities affecting the special nature conservation sites in England; helping others to manage land for nature conservation and advocating nature conservation for all and biodiversity as a key test of sustainable development. http://www.english-nature.org.uk

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Joint Nature Conservation Committee
The Joint Nature Conservation Committee (JNCC) is the forum through which the three country conservation agencies – CCW, EN and SNH - deliver their statutory responsibilities for Great Britain as a whole, and internationally. These responsibilities contribute to sustaining and enriching biological diversity, enhancing geological features and sustaining natural systems. As well as a source of advice and knowledge for the public, JNCC is the Government's wildlife adviser, providing guidance on the development of policies for, or affecting, nature conservation in GB or internationally. http://www.jncc.gov.uk

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This report was produced by CJC Consulting on behalf of the Land Use Policy Group (LUPG). The views expressed within the report are those of the contractor and do not necessarily reflect the views of the agencies within LUPG.

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Abbreviations

AER	Areas with Environmental Restrictions
CA	Less-Favoured Area Compensatory Allowance
CAP	Common Agricultural Policy
DA	Disadvantaged Area of the LFA
ESU	European Size Unit
ERDP	England Rural Development Programme
EU	European Union
GFP	Good Farming Practice
HFA	Hill Farming Allowance
HLCA	Hill Livestock Compensatory Allowance
IACS	Integrated Administration and Control System
LFA	Less-Favoured Area
LFASS	Less Favoured Area Support Scheme
LU	Livestock Unit
LUPG	Land Use Policy Group of the GB statutory conservation, countryside and environment agencies
MS	Member State
MTR	Mid Term Review of the CAP
NFI	Net Farm Income
RDP	Rural Development Programme
RDPS	Rural Development Plan for Scotland
RDPW	Rural Development Plea for Wales
RDR	Rural Development Regulation (EC) No 1257/1999
SDA	Severely Disadvantaged Area of the LFA
SFP	Single Farm Payment
SSSI	Site of Special Scientific Interest
UAA	Utilised Agricultural Area

Preface

The Land Use Policy Group (LUPG)[1] of the GB statutory conservation, countryside and environment agencies aims to advise on policy matters of common concern related to agriculture, woodlands and other rural land uses (see www.lupg.org.uk). It undertakes research into aspects of European land management and rural development policy. The LUPG has recently completed a major study into the planning and implementation of the Rural Development Programme (RDR) across Europe (Dwyer *et al*., 2002).

The LUPG has funded this study on policy development for less-favoured areas (LFAs) in Great Britain in parallel with a study on how the Agenda 2000 revised objectives of the RDR's LFA measure are being implemented in other EU Member States.

The views expressed in this report are those of the contractor and do not necessarily reflect the views of the agencies within the LUPG.

[1] LUPG consists of English Nature, the Countryside Agency, Scottish Natural Heritage, the Environment Agency, the Countryside Council for Wales and the Joint Nature Conservation Committee.

Summary

Context

The EU Rural Development Regulation 1257/99 (RDR) set new objectives for the payment of compensatory allowances to farmers in Less-Favoured Areas (LFA):

- to ensure continued land use and thereby contribute to the maintenance of a viable rural community;
- to maintain the countryside; and
- to maintain and promote sustainable farming systems, which, in particular, take, account of environmental protection requirements.

Under the regulation, compensatory allowances are no longer to be made per head of livestock (headage) but instead on an area basis; payments should be differentiated to reflect the severity of the natural handicap, particular environmental problems and the production structure; and payments can only be made where farmers are complying with Good Farming Practice requirements (GFP).

Remit

The objective of this research project was to:

1. Provide a comparative overview of
   - How England, Wales and Scotland have implemented the Agenda 2000 LFA area-based measure;
   - How economic, social and environmental objectives have been included under the schemes.
2. Compare key elements of the UK approaches with those of other Member States – to highlight issues, approaches and lessons that should be taken into account in developing UK LFA policies and schemes, and in future development of the RDR and identifying policy recommendation; and
3. Assess the implications for UK domestic and EU LFA policy arising from the CAP Mid Term Review package.

Characteristics of the LFAs in England, Wales and Scotland

The proportion of LFA in the farmed area in England is 12%. In Wales and Scotland it is much higher at 78% and 84% respectively. Within GB, LFA Cattle and Sheep farms in Scotland have the lowest average stocking rates, and those in Wales the highest (see table below). Welsh farms are the smallest, have lower farm incomes and are most heavily dependent on subsidies. The LFA allowances are an important element in the 'direct general subsidies' in all countries. However, subsidy delivered through the livestock premium schemes is much more important source of income.

Cattle and Sheep farm statsitics 2001/02 (means)

	England	Scotland	Wales
Total hectares farmed	182	344	142
Total livestock units	121	122	114
Direct livestock subsidies (£'000)	19.4	17.7	19.9
Direct general subsidies (£'000)	4.5	9.4	2.6
Direct crop subsidies (£'000)	0.5	1.1	0.2
Net farm income (£'000)	9.7	9.8	1.7

Environmental concerns in LFAs

The LFAs hold the largest area of natural and semi-natural vegetation in GB and have very significant wildlife, amenity and natural heritage value. Much of the land is under agricultural management.

The countryside agencies have long been concerned about environmental degradation in the uplands. Overgrazing has been the major issue but there have also been concerns with unsuitable supplementary feeding and heather burning.

New LFA schemes

Each country has developed a new scheme which satisfies the RDR. The three schemes are

- Hill Farming Allowance (HFA) - England
- Less Favoured Areas Support Scheme (LFASS) – Scotland
- Tir Mynydd - Wales

The primary concern in designing new schemes has been to maintain the pattern of payment distribution to farmers that occurred in the previous schemes. The outcome has been three schemes with quite different structures. In England there are different payment rates for moorland, common land, SDA and DA land. Wales continues to differentiate payments on the basis of SDA and DA. Scotland has a highly contrived scheme in which payments are based primarily on stocking rates in 2001. In both England and Scotland the poorest quality land receives the lowest payments per ha. All schemes give additional payments for farms that satisfy ‘environmental enhancement’ criteria.

The table below compares the eligibility rules and payment rates of the three schemes. Scotland has the most unrestricted scheme is terms of eligibility conditions or limits on total payments. There is no very evident targeting other than to minimise payment redistribution. The HFA scheme has the strongest cut-offs in relation to minimum and maximum area, and this suggests that it is being targeted as a social measure, discriminating against farmers with other income sources and those with large holdings. Tir Mynydd also exhibits targeting towards the ‘traditional Welsh family farm’, an important focus for RDR policy in Wales.

Eligibility and payments in the GB schemes (2003)

	England	Scotland	Wales
Minimum area (ha)	10.0	3.0	6.0
Maximum area (ha)	700	None	800
Payment range (£ per ha)*	16.0-42.7	6.1-35.6	23.0-35.0
Minimum payment in 2003 (£)	None specified	£350	None specified
Environmental enhancement available (%)	20.0	70.0	20.0
Stocking rates limits (LU per ha)	> 0.15	0.12-2.0	> 0.10 (inspection at 1.8)

* Payments are reduced for larger areas in England and Wales.

Comparisons with other Member States

The table below shows that the average payments in GB, in absolute terms and as a percentage of farm income, are higher than in a number of other EU countries. Whilst comparisons must be interpreted carefully they emphasise the dependency of GB LFA farms on subsidy, especially in Wales.

Contribution of LFA Compensatory allowances to farm income (2001-2002)

	Mean LFA compensatory allowance payment per farm (euros)	Mean income from all public support on LFA farms (euros)	Mean LFA farm income net of costs (euros)	Farm income from LFA compensatory allowances (%)
England	5,609	34,892	13,871	40.4
Wales	5,447	32,461	2,431	156.7
Scotland	6,625	40,326	14,014	34.8
Austria (mountain farms)	4,135	15,791	21,637	19
Germany (Bavaria)	2,520	N/a	N/a	12.0
France (mountain area)	4,300-7,000	12,200-19,600	16,700-22,400	22-38
Greece	801	N/a	N/a	N/a
Spain	1,300	N/a	12,000	10.8
Finland	5,640	21,336	13,236	22-82

Other Member States have different eligibility criteria for LFA payments, including age, training, and the proportion of income derived from farming. In some countries all LFA farm types are eligible. The case for using such socio-economic criteria to refine policy targeting needs to be examined in the context of any post-Mid Term Review assessment of LFA policy. No other Member State has an environmental enhancement element in the LFA measure.

The recent European Court of Auditors (2003) report on LFAs noted that the Commission does not have enough sound information on the impact of the measure and, in particular, on the justification for the level of compensation provided.

Socio-economic impacts

The effects of the new schemes (as compared to the previous ones) will be minimal. Schemes have been designed to minimise changes in the distribution of payments, and the allowances are relatively modest as compared to the livestock premia. Some redistribution away from highly stocked farms will occur. There is some evidence of renting of land to circumvent stocking rate limits.

The switch to area-based payments will not by itself deliver change to stocking rates because the LFA payments are not the main determinant of farm management decisions.

Environmental impacts

All the GB schemes have mechanisms that aim to protect the environment and target payments to farms that have more environmental capital and farm in a sustainable way. In England, the scheme is unlikely to contribute much to resolving the issue of overgrazing as many farmers met the environmental enhancement criteria without reducing stocking levels. There is no limit on stocking rate and the enhancement element is weak. In Wales and England, high stocking triggers off inspections and this has at least the potential to be effective, although Defra has noted in its recent review of the HFA that the number of inspections is limited. The Scottish enhancement is mainly designed to redistribute support to suckler cow owners but may offer some incentive to retain mixed farming practices.

The revised payment structures in England and Scotland no longer make the highest levels of payment to the most disadvantaged (least productive) land. Where such hill and moorland has a high environmental value which depends on continued farming, there may be a case for allocating more LFA support to such land.

Mid Term Review of the CAP

It is not yet known how the UK will choose to implement the flexibilities provided for in the June 2003 CAP reform package. The Minister in England has elected to choose full decoupling but Wales and Scotland may retain some livestock premia.

Under total de-coupling, the Single Farm Payment (SFP) will be paid independently from levels of production, and research suggests that many LFA farms, and especially specialist sheep farms, will have little incentive to farm. This implies that stocking rates will fall to the minimum permitted by the SFP cross compliance or LFA payment conditions. These conditions, and particularly those for the SFP, will be critical in determining how land is used. The changes following decoupling are not easy to predict, but there may be effective abandonment of some LFA land. This will bring ecological benefits from the reduction in grazing pressure, and could provide opportunities for alternative environmentally beneficial uses for the land. However, a loss of grazing on some land in the longer-term may be detrimental to the conservation interest.

Conclusions

- It seems unlikely that the change to an area-based system of payments will deliver significant changes in land use whilst subsidy to LFA farms is dominated by sheep and cattle premia. Limits imposed on stocking rates are also not very restrictive. Hence, impacts on stocking rates will be minor. The inspection regime within Tir Mynydd is a compromise approach that could be more widely adopted.
- Environmental enhancement within the LFA schemes is a weak mechanism for addressing major environmental concerns such as overgrazing. The application of GFP is a desirable step for limiting clearly damaging practices. However, implementation has been slow and it is too early to draw conclusions on the likely benefits.
- Total decoupling has major implications for the operation of LFA farms but further research is required to assess how LFA farms are likely to respond to the policy options specified in the June 2003 agreement. The impact on LFA farms, in terms of management and profitability will depend on the conditions attached to SFP receipts and the land management required to meet these cross-compliance conditions.
- Under full decoupling, not much is to be gained in LFA policy reviews by arguing for a tightening of the eligibility conditions (e.g. maximum stocking rate) or environmental enhancement conditions. The real issue is the future role for LFA policy in a decoupled CAP and in relation to agri-environment and other RDR schemes – particularly when RDR funding is limited. For example, agri-environment schemes provide an incentive for more identifiable environmental outputs than seem

to be achievable through LFA schemes. In addition, significant environmental benefits would be achieved by tightening the regulatory and monitoring procedures to reduce damage from inappropriate stocking rates and unsuitable feeding. These types of procedures will have a critical role in protecting habitats and landscapes under the reformed CAP.

- Under partial decoupling, this case for tightening regulatory mechanisms still holds. But there may be an argument for other changes to the LFA mechanisms, including consideration of whether other RDR mechanisms might not be a more cost effective way to support farming and achieve environmental benefits in the uplands. One of the main limitations of LFA schemes is the difficulty of meaningfully reviewing or amending LFA environmental enhancement elements to make them more effective without duplicating agri-environment prescriptions.
- Further investigation is required to answer a number of questions relating to the reform of the CAP:
  - How will different types of LFA farm respond to decoupling in terms of farm and land management, and what implications does this have for environmental priorities and the structure of rural development measures?
  - To what extent will the function of LFA allowances change under the new CAP package? With the significant changes likely to arise from implementing the June CAP package, is it realistic to use the LFA mechanism to support farm income, maintain farming and address environmental problems?
  - How will SFP and LFA conditions be best defined in relationship to each other, to agri-environment prescriptions, and to the need to protect the environment in the hills and uplands?

1 Introduction

1.1 Less Favoured Areas in the CAP

Special support for Less Favoured Areas (LFA) has been a long-standing component of agricultural policy in the UK and EU. Under the Community's LFA Directive (75/268/EEC[2]) Member States were required to identify certain areas used for hill farming or less-favoured areas defined by natural physical handicap, and in particular, altitude, slope, infertility or "low productivity of the environment". Direct income payments could be made to farmers within these LFAs for "the continuation of farming, thereby maintaining a minimum population level or conserving the countryside".

1.1.1 Rural Development Regulation

Policy on LFAs was revised under the Agenda 2000 agreement in 1999, and Articles 13-21 of the EU Rural Development Regulation 1257/99 (RDR) refer to Less Favoured Areas and Areas with Environmental Restrictions (AER).

The LFA budget as a proportion of the RDR budget varies markedly between countries in the EU. Table 1.1 shows the GB country allocations in relation to a sample of other Member States (CJC Consulting, 2003). LFA expenditure as a proportion of the RDR budget is high in GB. This is particularly evident in Scotland. In Wales many of the agricultural investment programmes were funded through Objective One.

Table 1.1 Planned allocation of RDR spending 2002-2006 (%)

	LFA/AER	Early retirement	Agri-environment	Afforestation	Other measures
Austria	28.6	0.0	54.3	0.2	16.9
Germany	11.1	0.1	26.2	1.1	61.5
France	17.2	2.3	13.9	0.7	65.9
Greece	16.4	19.7	6.9	2.8	54.2
Spain	4.8	2.8	9.5	7.0	75.9
Finland	51.0	5.7	28.9	1.0	13.4
England	31.1	0.0	35.9	7.5	25.5
Scotland	59.2	0.0	22.0	16.9	1.9
Wales	56.1	0.0	31.6	2.5	9.8
EU-15	15.6	3.1	24.6	3.7	52.9

Source Dwyer *et al*. (2002) and GB country Rural Development Plans.
Note LFA/AER refers to less favoured areas and areas with environmental restrictions as indicated in Chapter V of 1257/99.

[2] Directive 75/268/EEC on mountain and hill farming and farming in certain less favoured areas. The support measures were later incorporated into regulation 797/85, which was itself replaced by regulation 2328/91 and that in turn by 950/97.

The objectives specified in the RDR for naturally less favoured areas are now:

- to ensure continued land use and thereby contribute to the maintenance of a viable rural community;
- to maintain the countryside; and
- to maintain and promote sustainable farming systems which, in particular, take account of environmental protection requirements.

The only mechanism permitted in the RDR for achieving LFA policy is the payment of compensatory allowances (CAs) per hectare of land for agriculture to farmers who satisfy three criteria:

- Farm a minimum area of land;
- Undertake to pursue their farming activity for at least five years; and
- Apply good farming practices compatible with the need to safeguard the environment and maintain the countryside, in particular by sustainable farming.

The payment together with the good farm practice conditions is intended to deliver on the three objectives specified for LFAs. The regulation requires that compensatory allowances are fixed at a level sufficient to make an effective contribution to compensation for existing handicaps but avoiding overcompensation; and that CAs shall be differentiated taking into account the situation and development objectives of a region and the severity of the permanent natural handicap, any particular environmental problems and the type of production and economic structure of the holding. With some exceptions, allowances are to be fixed between €25 and €200 per ha.

Compared with the previous Directive, the RDR contains a number of fundamental changes:

- Member States can now choose to make LFA payments or to use these funds for other elements of the RDR;
- LFA payments are no longer to be made per head of livestock (headage) but instead on an area basis;
- Payments can only be made to farmers meeting specified criteria relating to the social and environmental objectives for the LFA; and
- Payments can only be made where farmers comply with Good Farming Practice (GFP) requirements.

This revised LFA policy has been in operation for almost three years. The LUPG has commissioned a study of LFA implementation in six Member States (France, Germany, Finland, Greece, Spain and Austria) (CJC Consulting, 2003). The current study complements this by examining the implementation of the RDR LFA measures in England, Wales and Scotland. This is timely given the Mid-Term Review (MTR) proposals of the Commission of the EC (2003) and the agreement reached by the Council of Ministers in June 2003.

1.2 Objectives of the study

The objective of this research project was to build on the preview review and other LUPG research (Dwyer *et al*., 2002) by:

1. Providing a comparative overview of
   - How England, Wales and Scotland have implemented the Agenda 2000 LFA area-based measure;
   - How economic, social and environmental objectives have been included under the schemes.
2. Comparing key elements of the UK approaches with those of other Member States – to highlight issues, approaches and lessons that should be taken into account in developing UK LFA policies and schemes, and in future development of the RDR and identifying policy recommendation; and
3. Assessing the implications for UK domestic and EU LFA policy arising from the CAP MTR package.

1.3 The LFAs in England, Wales and Scotland

Table 1.2 indicates the areas of LFA as a proportion of the agricultural area in selected EU countries. Wales and Scotland have large areas of poor quality land much of which is upland or mountainous. In England the LFA is mainly located in the north and south west, and small areas near the Welsh border. Designation as LFA refers to the physical handicaps faced by farmers: high rainfall, low temperatures, poor soils, steep gradients, and to low or declining populations with a higher than normal dependence on agriculture. Historically in GB there have been two categories of disadvantage – *Severely Disadvantaged* and *Disadvantaged* – but only England and Wales still apply this distinction for the purposes of the RDR.

Table 1.2 Proportion of the Utilised Agricultural Area designated as less-favoured in selected countries

Country/ region	LFA area as % of UAA
England	12
Wales	78
Scotland	84
Austria	71
Germany	50
Germany (Bavaria)	45
France	44
Greece	69
Spain	80
Spain (Catalonia)	56
Finland	100

1.4 Environmental concerns in the LFAs

The LFAs hold the largest area of natural and semi-natural vegetation in GB and have very significant wildlife, amenity and natural heritage value. Much of the land is under agricultural management, particularly in England and Wales. The countryside agencies have long been concerned about environmental degradation in the uplands, and the question of how to shape agricultural policy to promote sustainable farming and the protection of natural capital (e.g. Countryside Agencies of England and Wales, 2000; English Nature, 2001).

Overgrazing has been the major issue but there have also been concerns with unsuitable supplementary feeding and heather burning. The agencies' view was that headage based payments, including the LFA allowances, gave an incentive to stock at rates that may exceed those that are environmentally sustainable. In 1992, government introduced conditions attached to the HLCA scheme, and subsequently extended to all livestock schemes, to prevent the payment of compensatory allowances in cases of overgrazing. However, these regulations have not proved entirely effective. For example, English Nature (2003) state that overgrazing is widespread and that 139,000 ha of SSSI land in England is in unfavourable condition due to overgrazing.

Defra (2003g) has launched a public consultation on overgrazing and unsuitable supplementary feeding, as part of a review of the cross compliance rules associated with CAP payments. Defra has received 199 reports of overgrazing and unsuitable supplementary feeding since 1989 covering 105,507 ha. Of these 85% concern land that lies within the moorland line of the LFA. It seems likely that these are some of the more extreme examples where significant damage is most readily demonstrated.

Environmental interests have advocated the switch to an area-based payment system in order to remove the additional incentive for high stocking rates through headage-based compensatory allowances. However, the extent of the anticipated environmental benefits has been over-estimated. Drew Associates (1997), in their review of the HLCA scheme in England, concluded that compensatory allowances had little effect in shaping farmers' day-to-day management decisions such as stocking rates. The CAP direct payments for sheep and suckler cows were the main drivers of farming policy. Drew Associates were sceptical about the ability of area-based LFA payments on their own to improve upland vegetation so long as headage-based livestock premia dominated the support received by upland farmers.

The agencies lobbied government on the structure of the RDPs, favouring a two tiered structure of allowances based on the existing environmental value of the farm (Countryside Agencies, 2000; Countryside Agencies of England and Wales, 2000). Detailed environmental criteria were proposed and these were largely adopted in the English and Welsh RDPs but not in Scotland. These aspects are discussed in later sections.

1.5 Implementation of Articles 13-21 of the RDR

Under the RDR (Articles 40 to 44 of 1260/1999), Member States were required to present rural development plans which would indicate their proposed measures and expenditures during 2000-2006. Within the UK, this was a devolved activity, and there are separate plans for England, Wales and Scotland:

- The England Rural Development Programme 2000-2006 (ERDP) (MAFF, 2000b and http://www.defra.gov.uk).
- The Rural Development Plan for Wales 2000-2006 (National Assembly for Wales, 2000 and http://www.wales.gov.uk)
- The Rural Development Plan for Scotland 2000-2006 (Scottish Executive, 2000 and http://www.scotland.gov.uk)

1.6 Funding of the LFA measure

Table 1.3 indicates how the proposed LFA funding under the RDPs changes during the six years of the development plans. In all cases the budget is predicted to fall over time and this reduction is greater in percentage terms in England and Wales than in Scotland. Further details on the reasons for the reductions are given in the country chapters.

Table 1.3 Public cost of LFA measures within country Rural Development Plans (€m)

	2000	2001	2002	2003	2004	2005	2006
England	67.3	69.5	65.0	59.4	55.3	43.2	43.2
Wales	62.0	61.6	58.4	54.2	42.5	42.5	42.5
Scotland	97.6	100.6	93.5	89.4	80.5	80.5	80.5

2 England

2.1 Rural Development Programme objectives

The England Rural Development Programme (ERDP) (MAFF, 2000b) does not have objectives as such. Rather, it has programme priorities within objectives that are set for rural and countryside policy, as follows:

- To facilitate the development of dynamic, competitive and sustainable economies in the countryside, tackling poverty in rural areas;
- To maintain and stimulate communities, and secure access to services which is equitable in all the circumstances, for those who live or work in the countryside:
- To conserve and enhance rural landscapes and the diversity and abundance of wildlife;
- To increase opportunities for people to enjoy the countryside; and
- To promote government responsiveness to rural communities through better working together between central departments, local government and government agencies and better cooperation with non-government bodies.

The ERDP has two priorities:

- A. Creation of a productive and sustainable rural economy; and
- B Conservation and enhancement of the rural environment.

Within Priority A, the priority for the rural economy and agriculture is: to facilitate the development of dynamic, competitive and sustainable economies in the English countryside, tackling poverty in rural areas; by encouraging an agricultural sector that is:

- Competitive, diverse and flexible and better able to respond to changing market opportunities;
- Responsive to consumer wishes;
- Environmentally responsible…seeking to achieve sustainable land management and contribute to biodiversity, cultural and landscape targets; and
- Managed as an integral part of the rural economy.

2.1.1 LFA objective

The objective for LFA policy within the ERDP is to ' help preserve the farmed upland environment by ensuring that land in the LFAs is managed sustainably, and to contribute to the maintenance of the social fabric in upland communities through support for continued agricultural use'. More generally the government stated that 'the rationale for supporting hill farms was to secure the social and environmental benefits that farming activities provide in areas where agricultural production and the rural economy in general face structural disadvantages' (MAFF, 2000a).

The LFA measure is included in Priority B, although it also contributes to the agricultural objectives within Priority A.

2.2 Characteristics of the LFAs

The total LFA area in England is 2,213,691 ha, of which 73.5% is SDA and the remainder DA (Defra, 2003h). 10,978 holdings received LFA support in 2000/01, and

9,941 in 2001/02 (Defra, 2003h). The area paid in 2001/02 was 1,225,029 ha at an average payment of £3,923 per holding.

Table 2.1 gives basic information from the farm business survey about the average size and number of livestock on farms classified as Cattle and Sheep (LFA) (Defra, 2003a).

Table 2.1 LFA Cattle and Sheep farms 2000/01 and 2001/02 (means)

	2000/2001	2001/2002
Average size of business (ESUs)	39	38
Total hectares farmed	181	182
Total livestock units	123	121
Beef cows (head)	41	40
Ewes (head)	454	445
Labour (annual units)	1.8	1.7

2.3 Economic profile of LFA farms

Published data on the structure and economic performance of LFA farms are quite limited on a country basis. Table 2.2 gives data for Cattle and Sheep (LFA) farms (Defra, 2003a). LFA payments are part of the ‘ direct general subsidies’. Subsidy payments in total averaged £24,400 in 2001/2002 compared with a net farm income (NFI) of only £9,700, indicating the important contribution that both LFA and livestock subsidies make to farm income in the LFAs. Despite the subsidies paid, 31% of farms within this sample had a negative NFI (Defra, 2003a).

Table 2.2 Output and incomes of LFA Cattle and Sheep farms 2000/01 and 2001/02 (means)

	2000/2001	2001/2002
Total farm output (£, 000)	67.1	68.1
Of which		
Direct livestock subsidies (£’ 000)	18.3	19.4
Direct general subsidies (£’ 000)	4.4	4.5
Direct crop subsidies (£’ 000)	0.5	0.5
Net farm income (£’ 000)	6.7	9.7

Farm incomes in the uplands are relatively low compared with the average for all farms in England, for which the net farm income was £14,500 in 2001/2002. A small improvement in overall farm incomes is forecast to 2007 (Agriculture Departments, 2003).

2.4 Environmental concerns in the uplands

The English uplands are an important location for wildlife habitats and for the provision of amenity benefits to the public. Almost a quarter of SSSIs are located in the uplands (English Nature, 2001). These sites have many plant and animal communities that are found only in the uplands, and many of the species there are rare and threatened (English Nature, 2001).

There has long been concern with damaging agricultural practices, and in particular overgrazing. On common land there are also problems with uncoordinated management of grazing. A high percentage of upland grassland and dwarf shrub heathland on SSSIs is in unfavourable condition (English Nature 2002a) and the main cause of this is overgrazing (English Nature, 2002b). This is particularly relevant in the context of Defra achieving its Public Service Agreement target that 95% of SSSI land should be in favourable or recovering condition by 2010.

There have been difficulties in defining overgrazing in an unambiguous and measurable way. Defra (2003g) are currently reviewing the operation of the cross compliance rules (see Section 1.4).

English Nature together with other agencies (Countryside Agencies of England and Wales, 2000) lobbied at the time of the development of the ERDP to introduce an environmental premium into the revised LFA scheme (see Section 1.4).

2.5 Hill Livestock Compensatory Allowance (HLCA) Scheme

In the year 2000 a slightly modified version of the previous HLCA Scheme was operated as a transitional mechanism; the new HFA scheme was introduced in 2001 (see 2.6). Under the previous HLCA scheme, payments were made on a per head basis for eligible breeding sheep and breeding cows. The rate of allowance in the DA was lower than that in the SDA. CAs were paid only on extensively grazed beef and/or sheep flocks, and dairy cows were excluded.

Maximum payments were fixed per ha of eligible land as £102.75 per ha in the SDA and £60.85 per ha in the DA. Payments were also restricted to a maximum stocking rate of 6 ewes (SDA) or 9 ewes (DA), and 1.4 LUs in total per ha. For stock in excess of these limits no payments were made.

2.6 The Hill farm Allowance Scheme (HFA)

In England, the diversity in the quality of grazing and corresponding variation in stocking rates created major problems for the switch to a scheme based on area payments. Any simple reallocation of payments based on area would re-distribute payments towards extensive farms with large areas of hill/moorland and low rates of stocking (Defra, 2002). A large number of farmers would lose a significant proportion of their allowances and this would pose a risk of destabilising fragile hill farms (MAFF, 2000a). Such redistribution was both politically and socially undesirable. Differentiation of payments, using moorland and common land as additional criteria, was used to limit the extent of the redistribution.

The re-design of the scheme thus became a compromise between creating a scheme that was credible in terms of delivering the LFA objectives whilst at the same time avoiding too great a redistribution of payments. As with all LFA measures under the RDR, the essential characteristics of the new scheme relate to (a) eligibility criteria, and (b) payment rates and their differentiation. Full details are given in the ERDP (MAFF, 2000b) and Defra (2003b).

2.6.1 Eligibility

The main requirements for 2003 are that claimants must:

- Have 10 ha of eligible land in the LFA. Eligible land is that which meets the definition of forage area for the purposes of IACS area aid.
- Keep breeding cattle or sheep.
- Stock at a density of at least 0.15 LU per ha unless agri-environment considerations require a lower rate of stocking, or stocking is low as a result of a Foot and Mouth outbreak.

2.6.2 Payment rates and differentiation

Basic Payments

The basic payments for 2003 and 2004 are given in Table 2.3.

Table 2.3 LFA payment rates 2003 and 2004 (£ per ha)

	2003		2004	
	0-350 ha	351-700ha	0-350 ha	351-700ha
Moorland	16.02	8.01	11.27	5.64
Common land	16.02	8.01	11.27	5.64
Other SDA	42.74	21.37	29.80	14.90
Other DA	22.90	11.45	16.11	8.06

The original ERDP reduced the LFA payments over time as RDR finance was moved to other activities. However the introduction of the safety net meant that the basic HFA payments in 2001 and 2002 were significantly lower than those under the HLCA scheme because of the money reserved for the safety net. As the safety net has been phased out the payment rates have been increased.

The maximum basic payment per holding in 2003 is £26,926 (excluding safety net), and this is payable where a claim is made for 700 ha of SDA land. This may be enhanced by 20% if two environmental criteria are met (see below). This maximum falls to £18,774 in 2004 because the rates for 2004 are substantially lower (Table 2.3).

Environmental enhancements

Payments are increased by 10% for farmers who meet one of a set of environmental criteria, and by 20% for those who meet two or more criteria. In summary these criteria are:

- Maintaining 1ha or 5% of arable or woodland cover.
- Registered organic farmer.
- At least 15% of the LUs are cattle.
- Stocking rate below 1.2 LUs per ha.
- Stocking rate below 1.0 LUs per ha.

Maximum and minimum payments

These are determined indirectly by the minimum and maximum areas, and the payment rates.

2.6.3 Safety net

A payment safety net was introduced as a transitional measure to taper the impact of changes in payment levels to individual farmers. In 2001, all farmers received 90% of the difference in any shortfall between payments calculated under the HFA and those paid in 2000. This safety net is reduced to 50% of the difference in 2003 and 0% in 2004.

2.7 Good Farming Practice

The LFA payments are subject to compliance with GFP, which also applies to other livestock subsidy schemes. The main GFP conditions (Defra, 2003b) state that farmers must:

- Avoid overgrazing defined as 'grazing land with livestock in such numbers as to adversely affect growth, quality or species composition of vegetation (other than vegetation normally grazed to destruction) on that land to a significant degree'.
- Avoid undergrazing defined, as 'land where there is evidence of the annual growth not being fully utilised, or scrub or coarse vegetation is becoming evident, and such changes are detrimental to the environmental interest of the site'.
- Avoid unsuitable supplementary feeding.
- Not remove or destroy field boundaries.
- Not engage in damaging operations on SSSIs.
- Consult the appropriate agency when building silage or slurry stores, or disposing of sheep dip.
- Not trim hedgerows between March 1st and July 31st.
- Comply with specified environmental legislation including the Heather and Grass etc. (Burning) Regulations 1986.
- Follow certain Codes of Good Agricultural Practice.

2.8 Socio-economic effects of the transition to the HFA scheme

Defra (2002) undertook a detailed analysis of the redistributive effects of the changes introduced in the HFA scheme. The main change in eligibility related to the 10 ha minimum forage area (as compared to 3ha). The structure and differentiation of payments in the HFA scheme differed from that under the original HLCA scheme because of the area-basis of payment and the use of moorland and common land to differentiate payment rates.

The 10 ha minimum forage area criterion made 2,550 small farms ineligible, leaving around 10,800 eligible claimants. These 2,550 farms represented 21% of the total number of claimants, double the number predicted in the ERDP. They lost on average £360 per farm. The 10 ha limit was introduced following a study (Drew Associates, 1997) which indicated that raising the limit would not lead to land abandonment because only 3% of very small (and therefore mainly part-time) farmers said that loss of the compensatory allowances would lead to them giving up farming.

The average LFA stocking rate in 2001/02 under HFA was 0.78 LU per ha. Under the HLCA in 1999/2000 it was 0.69 (Defra, 2003h). However, Defra consider that this apparent increase reflects movement restrictions under foot and mouth. They conclude that there is little evidence for any change in stocking rate following the introduction of HFA.

The Defra (2002) analysis showed that, as expected, low stocking rate holdings (<0.5LU per ha) mainly gained from the change whilst those with higher stocking rates lost. Excluding the safety net, almost 50% of farms lost more than £1000, whilst 31% gained at least £1000. Those losing most are those farmers who have very large numbers of livestock but are now restricted on claims by the limit of 700 hectares. 188 farms have lost more than £10,000 per year and 2 farms more than £100,000.

The impact of this redistribution of payments is hard to assess. If anything, it may have been positive environmentally, by shifting support away from farms with higher stocking rates. However, any impacts on overgrazing are likely to be very small because of the limited role that LFA allowances play in farm management decisions (Drew Associates, 1997).

2.9 Environmental effects

Enhancement to support good environmental practice

Environmental enhancement is a simple method of providing extra support to those farmers who were delivering more public good environmental output. In 2002, 80% of farmers received the 20% enhancement and a further 3.4% received the 10% increase (Defra, 2003h). The main reason why claimants qualify is that they operate at stocking rates below 1.2 LU per ha. This might indicate that the stocking rate ceiling was set at too high a level. The basis would be that farms stocked at higher rates produced lower level of environmental outputs than farms stocked less heavily. However, more detailed analysis would be required to substantiate this aspect.

The environmental enhancement seems to be a somewhat crude mechanism which needs to be refined if payments are to be used to support farms which deliver more environmental outputs. This is particularly so since checking compliance is a relatively expensive operation (Defra, 2002). The desired benefits and disbenefits need to be clarified, but some apparent options (such as entry into an agri-environment scheme as the criterion) may be unacceptable to the Commission as being too environmentally driven in the context of Article 13a of 1257/99.

Overgrazing

As far as we are aware, no studies have been undertaken to assess the environmental impacts of the switch to area-based LFA payments. Given the longstanding pressure to remove headage-based incentives one might expect that the new scheme would lead to a reduction in over-stocking.

In theory, farmers have an incentive to reduce stocking rates when the income (including livestock premia) from the marginal sheep or beef cow falls to zero. Given the diversity of LFA farming, a detailed study would be needed on a sample of farm businesses to assess the stocking rate implications of a switch to area-based payments. However, a brief assessment suggests that the switch from LFA headage payment is unlikely to have much impact on over-stocking, even on heavily stocked SDA farms where the change in margin per head would be greatest. The reason is that in the great majority of cases, additional stock still contribute to farm income, in part because of substantial livestock headage payments. Any changes in livestock numbers on farms are more likely to come as a result of low incomes and a reassessment of farm business structure. The new scheme may have slightly reduced any likelihood of increases in stocking which is already deterred by the eligibility criteria for the sheep and suckler cow premia.

Good farming practice

This should produce environmental benefits through better farm practice. However, the development of a set of operating procedures is still in progress and no one has been penalised for failures to observe GFP. Benefits from GFP must be anticipated for the future.

The overgrazing and undergrazing criteria are particularly important given the environmental concerns with 'inappropriate' grazing. However, the difficulty of definition and the protracted and time-consuming process of acquiring evidence and proceeding with cases pose major practical problems. For example, the regulations deal with current grazing practices whereas the evidence from the vegetation relates to historic grazing. It is therefore not easy to make a clear case for damage. Rejections of claims because of overgrazing have been rare in the past and there is little to suggest that under GFP the situation will change.

2.10 Overall assessment

The overall assessment of the impacts in England is as follows:

- The transition to area-based payments was heavily predicated by mechanisms to avoid substantial redistribution of payments. Whilst partially successful, there will be significant gainers and losers especially from 2004 when the safety net is removed. The complexity of the effects makes it difficult to assess how redistribution of payments will affect either land use or the achievement of the ERDP objectives.
- The increase in the minimum eligible forage area removed 21% of farms from the scheme. However, these were thought to be mainly hobby farms where farming would not be abandoned following the cut in payments (Drew Associates, 1997; MAFF, 2000)
- The environmental enhancement element of the HFA scheme has not differentiated recipients to any degree. Although a two tier structure of payments based on environmental value was proposed by the Countryside Agencies (2000) the objectives and mechanisms of the current enhancement scheme are unclear and a re-assessment is desirable.
- The HFA scheme is unlikely to contribute much to resolving the concerns over overgrazing. Neither the move to area-based payments or the GFP requirements will have been very effective because most support is still headage-based and HFA payments make only a relatively small contribution to farm revenue. Decoupling following the MTR is expected to have a major but unpredictable impact in reducing stocking rates (see Chapter 6).
- The ERDP set out to cut LFA payments significantly over the six years of the RDR and focus expenditure on other Pillar 2 elements. The economic case is for focusing payments on farms that deliver the greatest value for money in terms of public goods. These may include maintaining the character of the LFA countryside, landscape features and environmental diversity, and farming-based rural communities (Drew Associates, 1997). However, what this implies for LFA payments and their differentiation is not at all clear in the current context of the Review of the CAP. Major changes to the support system will demand a more fundamental review of LFA support, its magnitude and focus.

3 Scotland

3.1 Rural Development Programme objectives

The Rural Development Plans for Scotland (RDPS) has two key priorities:

Priority 1: To assist the future viability and sustainability of Scottish farming.

Priority 2: The encouragement of farming practices which contribute to the economic, social and environmental sustainability of Scotland's rural areas.

Support for LFAs is one of two measures (the other is forestry) specified as the delivery mechanism for the Priority 1. The RDPS is thus heavily focussed towards agriculture both in terms of contributing to its viability and its role in contributing to the sustainability of rural areas.

3.1.1 LFA objectives

The RDPS does not give specific objectives for the LFA measure apart from those given in Article 13 of the regulation (see Section 1.1).

3.2 Characteristics of the LFA

Scotland has vast tracks of poor quality farmland a reflection of soil quality, climate and peripherality. 84% of the agricultural land (excluding common land) is designated LFA, and 98% of that is designated as SDA. DA farms tend to be located on periphery of the LFA or in isolated pockets. Much of the LFA has high natural heritage value in terms of habitats and landscapes, and is an important resource for tourism.

There are 34,199 holdings where at least 50% of the land is classified as SDA or DA (Scottish Executive, 2003b). The holdings are highly variable, from small crofting units with access to common land, to large estates. The total LFA area is 4.64m ha (excluding common grazing) (SEERAD, 2003a). 13,716 holdings received LFA support in 2001/02 on an area of 3.332m ha at an average payment of £4,633 per holding.

Table 3.1 gives information from the farm business survey about the average size and number of livestock on farms classified as Cattle and Sheep (LFA) (Defra, 2003a).

Table 3.1 LFA Cattle and Sheep farms 2000/01 and 2001/02 (means)

	2000/2001	2001/2002
Average size of business (ESUs)	43	42
Total hectares farmed	342	344
Total livestock units	120	122
Beef cows (head)	52	52
Ewes (head)	340	332
Labour (annual units)	1.5	1.5

3.3 Economic data on LFA farms

Table 3.2 gives income data from Defra (2003a) for farms classified as 'Cattle and Sheep (LFA)'. Income from LFA payments is included in the ' direct general subsidies'.

These are a major source of income and in 2001/2002 approximately equalled the net farm income. Subsidies in total averaged £28,200 whereas net farm income was only £9,600. 26% of farms within this sample had a negative NFI (Defra, 2003).

Table 3.2 Output and incomes of LFA Cattle and Sheep farms 2000/01 and 2001/02 (means)

	2000/2001	2001/2002
Total farm output (£, 000)	64.1	69.5
Of which		
Direct livestock subsidies (£' 000)	18.9	17.7
Direct general subsidies (£' 000)	8.4	9.4
Direct crop subsidies (£' 000)	1.2	1.1
Net farm income (£' 000)	5.6	9.8

3.4 The Less Favoured Area Support Scheme (LFASS)

The transition from a headage to an area-based system was particularly difficult in Scotland because of the variation in land quality within the LFA. The main issue was to avoid over-compensation of farms with large areas of unproductive rough grazing to the detriment of smaller, more intensively run farms in locations such as Orkney.

The previous headage-based system that used an SDA and DA classification was initially morphed into an LFASS system based on three farm types (Moorland, Southern Upland and Northern Upland) with payments for improved pasture and rough grazing. This system of payment differentiation was used in 2001 and 2002 (Scottish Executive, 2002). While this would undoubtedly have led to a major re-distribution of payments, the safety net to 2002 largely compensated for any losses.

In 2003 the scheme was radically changed by the introduction of a new land classification system based on stocking rates in 2001 (Scottish Executive, 2003a). There are five elements to the new scheme:

Grazing category

There are four grazing categories reflecting land quality (Table 3.3).

Table 3.3 LFASS Grazing categories

Grazing Category	Stocking density (LU per ha)	Weight
A	Up to 0.19	0.167
B	0.2-0.39	0.333
C	0.4-0.59	0.667
D	0.6 or more	0.800

The basic hectare measure for the compensatory allowances is the eligible area multiplied by the hectare value. The stocking density takes into account the number of suckler cows, litres of milk quota, breeding sheep and gimmers, farmed deer, goats and alpaca.

Environmental measure

One environmental mechanism in the new scheme is the encouragement of beef production and its associated benefits. The numbers of eligible hectares are enhanced by 70% for those producers who have 50% or more of livestock units as cattle (suckler cows and heifers), and by 35% for those who have 10-50% of LUs as cattle.

Although cast as an environmental mechanism this has an important distributive effect. It enhances payments to many beef and mixed farmers who previously received suckler cow headage payments and would lose significant income from an area-based scheme. There were thus important socio-economic reasons behind the introduction of the adjustment.

Rates of payment

Rates of aid are differentiated according to parish. All businesses are categorised into one of three classes according to parish (Table 3.4).

Table 3.4 Compensatory allowance payments rates

Category	Payment rate (£ per ha)
Very fragile	44.50
Fragile	42.50
Standard	36.50

Minimum and maximum payments

The minimum payment is £350. There is no maximum. Total payments made under the LFASS, which was introduced in 2001, have closely matched those made under the previous HLCA scheme. Payments were £61.9m in 2001 and £63.9 in 2002 (SEERAD, 2003), as compared with £61.5m in 2000.

Safety net

The safety net arrangements for 2003 are the same as those in England, i.e. 50% of any reduction as compared with the HLCA 2000 payment. This will disappear in 2004.

3.4.1 Eligibility

The main requirements for LFASS are that claimants must:

- Have 3 ha of eligible land in the LFA.
- Keep eligible stock (see 3.4).
- Stock at a density of at least 0.12 LU per ha and less than 2.0 LU per ha. Farms stocked at rates outside these limits remain eligible but the eligible hectares are scaled back according to a formula.

3.5 Good Farming Practice

The LFA payments are subject to compliance with GFP. The main GFP conditions (Scottish Executive, 2003a) are summarised below:

- Avoid overgrazing, undergrazing and unsuitable supplementary feeding. Each of these is defined in the scheme documentation.
- Not to remove or clear flagstone dykes or walls, hedges or hedgerow trees.
- Not engage in damaging operations on SSSIs.

- Consult the appropriate agency when building silage or slurry stores, or disposing of sheep dip.
- Obtain a felling licence or approval under a Forestry Commission Grant Scheme before felling trees.

3.6 Socio-economic effects of the transition to the HFA scheme

The main thrust in the design of the 2003 LFASS has been the minimisation of payment redistribution. Two aspects were particularly important: (i) to avoid the potential gains on holdings with large areas of moorland and rough grazing where stocking rates are very low; and (ii) to avoid the potential losses faced by more intensive farms and those with both cattle and sheep. On these the relatively small land area and loss of suckler cow and beef premia payments could result in significant reductions in income.

The analysis undertaken in 2002 (SEERAD, 2003a) showed that the proposed 2003 scheme had a much lower redistributive impact than the 2002 scheme. Even so, 812 farms lost more than 40% of their payments and 30 farms lost more than £10,000. The majority gained but it appeared to be very large farms (>2,000 ha) and those at low stocking densities (<0.1 LU per ha) that gained most. Minor changes introduced in the actual 2003 scheme would have tended to reduce these anomalies.

The socio-economic impacts of the new scheme would seem to be fairly neutral. Around 55% of farms gain from the new scheme, and with some exceptions, the redistribution of payments now seem to be constrained. There are no very significant regional re-distributive effects. It is surprising that there is no upper limit on payments – some payments must be very large and it would be helpful to see these justified as a social measure in value for money terms.

The area basis for payments has produced some side effects. The market in grazing lets, which is significant in Scotland, has been affected as farmers rent LFA grazing land to increase their forage hectares. All LFA land is now categorized by grazing category (A to D) and this determines its value within the compensatory allowance system. The value attributed to land by the payments system may also impact on entry into agri-environment schemes if the agri-environment agreement resulted in a reduction in forage area, and hence in LFA payments.

3.7 Environmental effects

Payments and differentiation

Without more detailed information it is difficult to analyse the potential impacts on the environment. Impacts on farm management are likely to be small because LFA payments are still much less significant than direct payments for livestock (see Table 3.2). There is likely to be some reduction in support to highly stocked farms that do not have suckler cows, and increases in support to large, extensive holdings.

Environmental enhancement

This is almost certainly a mechanism mainly conceived to reduce the redistribution of payments away from beef farmers. In so far as it maintains the *status quo* on payment receipts, any additional environmental benefits as compared to those under the HLCA scheme will be very small. However, in many areas there is a nature conservation case for maintaining cattle grazing, and the LFASS takes this into account.

Over- and undergrazing

It is not possible to draw any conclusions on this aspect without a much more detailed analysis of how individual farms in over or undergrazing contexts are affected by the new scheme. It does not seem that the area basis for payments will contribute increased grazing in under-utilised situations. Impacts on overgrazing are also likely to be minimal because farm management decisions will not be determined by changes to the LFA payments alone.

The minimum stocking rate conditions for eligibility in Scotland differ from those in England in one important respect. In England, stocking rates less than 0.15 LU per ha are permitted where there is an agri-environment agreement which commits the owner to a lower stocking rate. In Scotland there is no discretion to have stocking rates lower than the LFASS minimum (0.12 LU per ha) even if there is an environmental case for doing so.

Good farming practice

Whilst this should contribute to better environmental practice, it is too early to indicate any impacts. Comments made under this section in Chapter 2 would also apply to Scotland.

3.8 Overall assessment

The main features and impacts of the LFASS scheme in Scotland are:

- The re-design of the scheme has no additional objectives over those implicit in the previous scheme and stated in 1257/99. It has not intentionally changed the focus of support present in the HLCA scheme.
- The new scheme has been crafted primarily to avoid major payment re-distribution between farmers. This was essential to avoid a largely arbitrary redistribution of payments, mainly to large holdings with very low levels of stocking. There are also strong social and economic arguments for supporting economically active farmers in vulnerable regions.
- The classification of land is now based on the density of stocking recorded in 2001, and this is the main measure of 'disadvantage'. The previous SDA/DA distinction and locational classifications are no longer used as a basis for payment differentiation.
- The eligibility and payment criteria pose few restrictions on claimants. The minimum area is 3 ha and there is no maximum limit on payments.
- The environmental measure is mainly designed to limit redistribution but should assist in retaining suckler cows on mixed farms. It is not clear that it will be more effective than the previous scheme in this respect.
- There seem to be no very clear environmental benefits from the new scheme (as compared with the HLCA scheme). The area-based scheme is improved by the incentive to retain beef suckler cows but will be insufficient to attract farmers into beef production.
- Compliance with GFP should confer environmental benefits but much will depend on the interpretation and policing of the grazing rules.

4 Wales

4.1 Rural Development

The Rural Development Plans for Wales 2000-2006 (RDPW) has three priorities:

Priority 1: To create stronger agriculture and forestry sectors.

Priority 2: To improve the economic competitiveness of rural communities and areas.

Priority 3. To maintain and protect the environment and rural heritage.

The development plan notes the important contribution that compensatory allowances make to the social sustainability of the uplands in Wales. It quotes an evaluation of HLCAs (Welsh Institute of Rural Studies, 1998), which showed that HLCAs reduce structural change in upland farming by slowing the trend towards fewer and larger farms.

4.1.1 LFA objectives

The RDPW indicates that the support offered under the LFA measure will contribute to:

- Ensuring continued agricultural land use and therefore contributing to the maintenance of a visible rural community.
- Maintaining the countryside.
- Maintaining and promoting sustainable farming systems, which protect the environment.
- Ensuring environmental requirements and safeguard farming in areas with environmental restrictions.
- Encouraging farmers to apply good farming practice compatible with the need to safeguard the environment and maintain the countryside by sustainable farming.

The new scheme (Tir Mynydd) has its own objectives:

- To contribute to the maintenance of the social fabric in upland rural communities, through support for continued agricultural use: and
- To help to preserve the farmed upland landscape by ensuring that land in the LFAs is managed in a sustainable way.

4.2 Characteristics of the LFA

Wales comprises mainly upland and mountainous land with 52% of the land designated as SDA and 26% as DA. Table 4.1 gives average business size, area and stocking on Cattle and Sheep farms (LFA) (Defra, 2003a).

Table 4.1 LFA Cattle and Sheep farms 2000/01 and 2001/02 (means)

	2000/2001	2001/2002
Average size of business (ESUs)	35	33
Total hectares farmed	141	142
Total livestock units	117	114
Beef cows (head)	62	18
Ewes (head)	657	628
Labour (annual units)	1.7	1.7

4.3 Economic data on LFA farms

Table 4.2 indicates the incomes of farms classified as 'Cattle and Sheep (LFA)' (Defra, 2003a). Net farm incomes on these farms have been extremely low in recent years despite major injections of subsidy. 51% of farms within this sample had a negative NFI (Defra, 2003). The LFA payments are relatively small as compared with livestock headage payments, and it is clear that changes to the LFA scheme alone cannot exert much influence on land management.

Table 4.2 Output and incomes of LFA Cattle and Sheep farms 2000/01 and 2001/02 (means)

	2000/2001	**2001/2002**
Total farm output (£, 000)	57.4	57.0
Of which		
Direct livestock subsidies (£' 000)	17.8	19.9
Direct general subsidies (£' 000)	2.4	2.6
Direct crop subsidies (£' 000)	0.2	0.2
Net farm income (£' 000)	3.2	1.7

4.4 Environmental concerns in upland Wales

The RDPW indicates major problems for achieving environmental sustainability on farmed land. Progressive intensification, increases in sheep numbers and stocking rates, and a trend away from mixed farming towards sheep monoculture in the uplands has led to a significant loss of species and habitat diversity. The switch from hay making to silage has also been detrimental. Heathland is in poor condition with a loss of both wet and dry heaths.

There is considerable concern about the degrading impact of overgrazing on Natura 2000 upland habitats (CCW, 2003). Estimated reductions in stocking rate of between 29% and 86% are required on a sample of Natura sites if grazing is to be environmentally sustainable.

More generally, it could be concluded that to achieve agricultural sustainability measures are required that prevent further damage and assist in restoration. The LFA measure could potentially have a role in maintaining the remaining important semi-natural habitats, encouraging mixed farming and reducing grazing levels. However, the socio-economic impact of any measure that might reduce income could be severe given the very low average incomes in Welsh hill farming.

4.5 Tir Mynydd

The previous HLCA scheme (National Assembly for Wales, 2000) was replaced by a new area-based scheme (Tir Mynydd) in 2001. The RDPW plan allowed for a public cost of £61.98m in 2000 falling to £42.54m in 2006 (see Table 1.2).

4.5.1 Eligibility

The main requirements in 2003 (National Assembly for Wales, 2003) are that claimants must:

- Have a minimum of 6 ha of eligible LFA forage land.
- Keep breeding sheep and/or suckler cows.
- Stock at a density of at least 0.10 LU per ha unless there is an agreement to stock at lower rates.

There is no maximum stocking density but farms stocked above 1.8 LU per ha are likely to be inspected. If there is evidence of overgrazing, a management regime will be required to provide the farmer with time to adjust land management.

4.5.2 Payment rates and differentiation

The scheme uses the differentiation into SDA and DA previously used in the HLCA scheme. There are two elements – the basic payment (Element 1), and an enhancement (Element 2) that is subject to environmental criteria. The basic rates for 2003 are £35 per ha (SDA) and £23 per ha (DA). These are unchanged from 2001.

Social and environmental enhancements

Payments are increased by up to 10% for farmers who meet one of a set of criteria, and up to 20% for farmers who meet two or more criteria. This enhancement is intended to 'reward good, mixed farming practice and animal husbandry and to reflect the objectives of the RDR that allowances should help to maintain and promote sustainable farming practice'. In practice the enhancements in 2002 were 3.6% and 7.2% for farmers who met one or two criteria respectively.

In brief, the criteria on which the enhancements are based are:

- Both breeding cows and sheep (with at least 1 cow per 30 ewes).
- Registered organic farm.
- At least 2% of the land, and at least 1 ha, under arable crops, root crops or field horticultural crops. Land on which Arable Area Payments are claimed is ineligible.
- Stocking density at or below 1.2 LU per ha forage area.
- Exercise grazing rights on a common on condition that all active graziers remove all stock for 3 months between September and February.
- At least 2% of the holding, and at least 1 ha, as fenced deciduous woodland so that access for grazing may be permitted.
- Registered under an approved farm assurance scheme.

Tapering mechanism

This is introduced to reduce the risk of payment redistribution to farmers with large holdings. The payment is at the full rate for the first 140 ha, at 65% between 140 and 640 ha, and 30% between 640 and 800 ha. No payment is made on claims exceeding 800 ha.

Minimum and maximum payments

Maximum and minimum payments are defined by the payment rates and differentiation. The minimum is for 6 ha of DA land without enhancement (£138). The maximum payment is 800 ha of SDA land with 20% enhancement (£21,546).

4.5.3 Safety net

The safety net arrangements for 2003 are the same as those in England (see 2.6.3), i.e. 50% of any reduction as compared with the HLCA 2000 payment. This will disappear in 2004.

4.5.4 Changes to the scheme

The 2002 consultation paper (National Assembly for Wales, 2002) suggested a number of changes to payment rates and tapering in order to focus payments on the ‘traditional Welsh family farm’. It also discussed possible changes to eligibility criteria including minimum and maximum stocking rates. In the event no changes were introduced.

4.6 Good Farming Practice

Farmers must comply with existing environmental legislation. In addition there is a list of verifiable standards as follows:

- Consult the appropriate agency when building silage or slurry stores, or disposing of sheep dip or other wastes.
- Not remove or destroy field boundaries.
- Not trim hedgerows between March 15th and July 31st.
- Not engage in damaging operations on SSSIs or scheduled ancient monuments.
- Avoid overgrazing defined as ‘grazing land with livestock in such numbers as to adversely affect growth, quality or species composition of vegetation (other than vegetation normally grazed to destruction) on that land to a significant degree’. Inspections are likely to be undertaken on farms claiming at stocking rates in excess of 1.8 LU per ha.
- Avoid unsuitable supplementary feeding.
- Follow the Codes of Good Agricultural Practice for air, soil and water.

4.7 Socio-economic effects of the transition to the HFA scheme

The 2002 consultation paper (National Assembly for Wales (2002) compares the distribution of payments under the scheme in 2004 with what would have occurred under an HLCA scheme with an equivalent budget. Only very small and large farms suffered a loss of payments. However, no analysis was offered with stocking rate as a variable. We cannot therefore conclude that little redistribution will take place. In fact, the likelihood must be that significant re-distribution will occur towards farms with lower stocking rates.

The impacts of the change in payment distribution on farm viability and the structure of agriculture are hard to determine without more detailed analysis. LFA payments are less important as a source of subsidy in Wales than elsewhere in GB as direct livestock subsidies are higher, and compared with livestock premia, LFA payments are relatively unimportant. However some farms will suffer a loss of income when income levels are already low.

It seems highly unlikely that the change in payments will affect farm management on surviving farms. The LFA payments are not sufficiently important to drive stocking decisions.

4.8 Environmental effects

Effects on stocking rate and overgrazing

ADAS (2002) undertook a study of the potential impacts of the switch to an area-based scheme on landscape, environment and biodiversity. They concluded that there would be environmental benefits from reduced stocking, and other management changes including reduced fertiliser use, although in some cases stocking rates were forecast to rise where farmers increased stocking to meet the minimum requirements for eligibility. The report, however, found that farmers were confused about the scheme and its financial implications. It was difficult to isolate impacts of the scheme from other economic influences on farming and, in particular, the overshadowing effect of the Sheep Annual Premium. The report does not discuss the merit of the environmental enhancement.

We are more dubious than ADAS about reductions in stocking rate as a result of the change to an area basis for payments. This is simply because the subsidy is not sufficiently large to influence stocking rate decisions.

The effectiveness of the decision to monitor farms stocking at more than 1.8 LU per ha will not itself change land management since no immediate threat of loss of payment is involved. However, if cases of over-grazing are rigorously pursed, this has the potential to have some effect on overgrazing. The extent of the changes in stocking rate required to counter ecological overgrazing is, however, so great in some cases (see CCW, 2003) that this measure alone will have only a limited impact.

Environmental enhancement

In 2001, 87.4% of applicants qualified for a small enhancement payment. In 2002, the percentage was 94.5. This indicates that the enhancement is not very effective in discriminating amongst farms. It also may imply that farmers have responded by changing their farm characteristics so as to meet the criteria. Whether this has any environmental benefit depends on the changes made, and on this there is no information. The enhancement may well provide an incentive for farmers to join a farm assurance scheme, but it is doubtful if the incentive is great enough in most circumstances to reduce stocking or raise the number of breeding cows. It will provide limited support to retain mixed farming.

From an environmental perspective the question remains as to whether it will change land management in a beneficial direction. Only limited impacts can be expected from the financial incentive offered but it is a useful marker in the re-design of LFA policy.

Good farming practice

Whilst this should contribute to better environmental practice it is too early to indicate any impacts. Comments made under this section in Chapter 2 would also apply to Wales.

4.9 Overall assessment

The main conclusions regarding the effects of the change to Tir Mynydd are:

- The scheme has maintained the land classification structure from the HLCA scheme and not undertaken a fundamental re-design to limit payment re-distribution. This in part reflects the lesser importance in Wales of large holdings with extensive moorland or hill land, as compared to Scotland and England. Although only limited information is available, it is to be expected that some re-distribution of payments will occur in Wales once the safety net is removed. A tapering device is used to limit the extent of this redistribution.

- The LFA payments are of relatively minor importance relative to the livestock premia, but with farm incomes under great pressure they still contribute significantly to income. Use of the LFA mechanism to achieve environmental objectives is especially difficult in Wales because of the social consequences of any associated reduction in farm income.
- The scheme does not have a rigid maximum stocking rate and it remains to be seen how effective the monitoring system will be in limiting damage on highly stocked farms.
- The enhancement mechanism (Element 2) does not appear very effective in distributing payments towards (and away from) certain types of holding. It will not address the key issue of heavy stocking. It cannot at the current levels provide a real incentive to change farm practices. However, its function is mostly to indicate to farmers that the sustainability of their farming now influences the level of LFA support that they receive.

5 Comparative assessment

5.1 Application of the RDR measures

The different GB countries are following the same pattern as other Member States in designing LFA measures that meet their policy priorities and interest group pressures. The earlier comparative studies of the RDR in the EU (Dwyer *et al*., 2002; CJC Consulting, 2003) demonstrated how Member States have established schemes within the scope of 1257/99 to meet their specific needs. In some cases (e.g. Spain) this led to minimal use of the LFA measure and a preference for allocating resources to more targeted rural development measures. In Finland, the LFA measure was used as an important source of income support, with little differentiation between recipients. In other countries, differentiation was precisely targeted based on detailed procedures for calculating disadvantage (e.g. Germany, Austria).

5.2 Objectives in scheme design

The objectives for the LFA measure as stated by the different GB countries dictate the design of the schemes. In all cases, the main aim is broadly social - that is to support the incomes of hill farmers. The environmental case is certainly present in the objectives and in the original regulation (1257/99), but this has had a lesser impact on the design of the schemes. In economic terms the allowances slow down structural change by partially cushioning farm businesses against financial pressures.

In practice, the design of schemes in GB has been heavily influenced by the need to limit the payment redistribution that would have occurred when payments were switched from headage to area-based. Minimising change has been the main aim, particularly in Scotland where a wholesale redesign has been undertaken, largely to minimise redistribution. Other EU countries have done much the same, but in most cases they have increased payment rates to minimise the number of 'losers'. In GB, the mechanism has been re-design, coupled with a safety net, although some increases in payment rates have occurred.

A characteristic of GB schemes has been the weak element of environmental enhancement, in which the aim has been to favour those farms that meet environmental criteria. This tends to differentiate the GB schemes from those elsewhere in Europe – in Germany, for example, payment rates are related to environmental criteria and priorities. However, the evidence suggests that in GB the enhancements are not very effective since the criteria appear to allow the great majority of farms to qualify without making any real changes to management practices. One of the reasons for this is the difficulty of identifying simple criteria that do not overlap with existing measures that enable farmers to qualify for agri-environment payments.

5.3 Eligibility and conditions

The GB schemes now differ markedly in the variables used to differentiate rates of payment. While Tir Mynydd has kept the SDA and DA classification, England and Scotland have generated new approaches to classification.

There are also differences in the conditions for eligibility and these are summarised in Table 5.1. There are differences both within and between countries in the type of stock on which the stocking rate calculation is based, and this effectively determines stock eligibility. In Scotland, in contrast to England and Wales, alpaca and deer are eligible and milk quota is also eligible in specified areas.

Scotland has the most unrestricted scheme is terms of eligibility conditions or limits on total payments. This in part reflects the range of conditions that occur in LFA farming there, but also suggests an absence of any real targeting of the scheme. The HFA scheme in England has the strongest cut-offs in relation to minimum and maximum area, and this indicates that it is being targeted as a social measure away from farmers with other income sources and those with large holdings. The Tir Mynydd also exhibits social targeting towards the 'traditional Welsh family farm', an important focus for RDR policy in Wales. The Tir Gofal agri-environment scheme was also modified to facilitate entry of such farms into the scheme (Centre for Rural Economics Research and CJC Consulting, 2002). Taken literally, Scotland has the strongest element of environmental enhancement, followed by England. The Welsh element has, in practice, been limited to 7.2%.

Table 5.1 Eligibility and payments in the GB schemes (2003)

	England	Scotland	Wales
Minimum area (ha)	10.0	3.0	6.0
Maximum area (ha)	700	None	800
Minimum payment in 2003 (£)	None specified	£350	None specified
Reduction of payment rate with increasing area?	Yes	No	Yes
Maximum payment (excluding safety net, including enhancements) (£)	£26,926	None	£21,546
Maximum environmental enhancem ent (%)	20.0	70.0	20.0 (7.2% paid in 2002)
Stocking rates limits (LU per ha)	> 0.15	0.12-2.0 (scaled back outside this range)	> 0.10 (inspection at 1.8)

Some other EU countries use criteria based on age and farm income to determine eligibility, and there are differences in the farm types that are eligible (CJC Consulting, 2003). For example, farmers must be under 65 in France and Greece, and they must obtain at least 50% of income from agriculture in France, Greece and Spain. This income criterion may not be sensible in the UK since it could prove a barrier to diversification and encourage dependency on subsidy. However, such additional criteria merit further investigation as a way of improving the targeting of payments.

5.3.1 Disadvantage

Austria and Germany have immensely detailed methods for quantifying disadvantage. Payment rates are differentiated in favour of small farms and those in vulnerable areas in order to maintain the cultural landscape and social fabric of remote communities. Without a clear consensus on policy objectives such detailed approaches are unworkable.

Issues of redistribution have dominated the re-design in GB and one outcome has been that some poor quality land is subsidised at lower rates that better quality land. This is an effect of the moorland class in England and the environmental enhancement in Scotland.

It is clear that disadvantage as indicated by soil quality and climate no longer provides an unambiguous underpinning for the schemes in these countries. In fact, it could be argued that LFA policy in England and Scotland has lost any transparency of purpose it may have had with respect to the distribution of payments between LFA farms.

The European Court of Auditors noted that the Commission has insufficient evidence to show that the classification of LFA is valid. Following observations from the Court in 1990, the Commission commenced a review of existing classifications, but this review was not finalised due, in part, to opposition from some Member States. Subsequently, although some macro- and socio-economic indicators had changed significantly and some classifications might no longer be valid, the Commission did not propose any amendment of the regulatory framework.

5.4 LFA farm incomes

Table 5.2 compares the contribution that the LFA allowances make in the GB countries as compared with other Member States (see CJC Consulting, 2003 for details). The absolute average payments in GB are higher than elsewhere and this is also true for the proportion of farm income derived from the LFA support. These figures have to be interpreted carefully because LFA farm incomes in GB, calculated before subsidy, are substantially negative. Even so, they emphasise the dependency of GB LFA farms on subsidy and the important role that the LFA allowances have in agricultural policy in GB.

Table 5.2. Contribution of LFA Compensatory allowances to farm income (2001-2002)

	Mean LFA compensatory allowance payment per farm (euros)	Mean income from all public support on LFA farms (euros)	Mean LFA farm income net of costs (euros)	Farm income from LFA compensatory allowances (%)
England***	5,609	34,892	13,871	40.4
Wales****	5,447	32,461	2,431	156.7
Scotland***	6,625	40,326	14,014	34.8
Austria (mountain farms)	4,135	15,791	21,637	19
Germany (Bavaria)	2,520	N/a	N/a	12.0
France** (mountain area)	4,300-7,000	12,200-19,600	16,700-22,400	22-38
Greece	801	N/a	N/a	N/a
Spain*	1,300	N/a	12,000**	10.8
Finland	5,640	21,336	13,236	22-82

* Data for 2001. An error in Spanish regulation led to a significant and exceptional increase in the payments for the year 2001. The more typical average payment figure (€414) given in paragraph 6.4.1 refers to the year 2000. No data are available for 2002.
** All French data are for 2000.
***GB data refer to LFA Cattle and Sheep farms. Sterling converted at 1.43 euros =£1.
**** 2002 data

5.5 Environmental impacts

The GB LFA schemes have mechanisms that protect the environment and target payments to farms that undertake environmental enhancement criteria. However, limiting the area on which claims can be made in England and Wales may mean those farmers with large areas of upland habitat – often above the moorland line, do not receive support across their entire holding. In England there is no maximum stocking rate condition; however farmers are expected to manage land in line with Good Farm Practice and inspections are triggered above 1.4 LU/ha, although in practice inspections have been limited (Defra, 2003i). The enhancement element does have stocking rate criteria but, since nearly all farmers meet the levels, it is unlikely to be very effective in addressing the issue of overgrazing. In Wales, high stocking triggers off inspections and this has at least the potential to be a more effective approach. The Scottish enhancement is mainly designed to redistribute support to suckler cow owners but may offer some incentive to retain mixed farming practices.

The revised payment structures in England and Scotland no longer make the highest levels of payment to the most disadvantaged (least productive) land. Where such hill and moorland has a high environmental value that depends on continued farming there could be a case for allocating more LFA support to such land. Some redistribution in favour of the least heavily stocked farms has occurred but it may well be that the opportunity for some stronger targeting of payments to the benefit of nature conservation has been missed.

Overall, neither the switch to area-payments or the environmental enhancements are likely to have much impact on farming practices since much larger incentives to keep stock are offered under the livestock premium schemes (see Table 2.2).

This is very much the conclusion from other EU states where little change on farming practices was expected from the shift to LFA area-based payments. The conclusion was that a re-focussing of the schemes and increase in payments may assist in preventing under-use of land and abandonment. Some benefits were also expected from the adoption of GFP. This latter benefit would also be expected in GB although much will depend on how the rules are interpreted operationally. Given the strong social motives in agricultural policy it is difficult to envisage GFP being applied so rigorously that it will have much impact on the main biodiversity concerns.

5.5.1 Overgrazing

No dramatic changes in land management are to be expected from the switch to an area basis for compensatory allowances. As a contribution to income, the LFA payment is still dominated by the livestock headage payments, and this is the same in other contexts where overgrazing is an environmental issue (e.g. Mediterranean regions). Placing tighter conditions on eligibility or on environmental payments may appear to provide a solution. There may be a case for tighter limits on stocking rate if this is actually translated into changes in stock levels. However, the LFA measure has created a market in forage rights as forage hectares are transferred in order to allow claimants to meet stocking rate conditions. Such responses on the part of farmers will reduce the effectiveness of the schemes and may reduce the ecological benefits.

The Tir Mynydd has a near automatic assessment of grazing conditions if claims are made in excess of 1.8 LU per ha. This would seem to be a useful measure, with the potential to be effective in reducing overgrazing. Much depends on its implementation.

6 Mid Term Review of the CAP

6.1 January proposals

The Commission produced revised proposals for reform of the CAP in January 2003 (Commission of the EC, 2003). Under these proposals most price support now delivered through area and headage payments would be converted into an annual payment to individual farmers based on historic payments, the payments being subject to conditions. It was proposed that a farmer would obtain income in part from this decoupled single farm payment (SFP), and in part from production. Production, apart from dairying, would be without commodity price support (although market support through intervention, quotas and tariffs will remain, as will the scope for RDR measures).

Defra commissioned a series of impact studies by SAC/Harper Adams (2003), ADAS (2003) and CRER (2003). Defra (2003d) itself undertook an assessment of the predicted welfare impacts of decoupling in the UK. GFA-RACE (2003) has assessed the implications for the environment. We are not aware of any comparable studies that refer to agriculture in Wales or Scotland.

The impacts on farmers' costs and returns are difficult to model because impacts on markets are not easily predicted and there is uncertainty about the way in which farmers will respond to the new price and support context. This is particularly so in the livestock sector where much of the modelling has either excluded market response or modelled it with substantial caveats.

The aspects of the January proposals of most relevance to LFAs are (i) the impact on LFA agriculture, and (ii) the funding of Pillar 2 rural development which includes the LFA measure. These are examined in turn.

6.1.1 Impact of total decoupling on LFA farming

SAC/Harper Adams produced linear programming models of LFA Cattle and Sheep farms and concluded that there would be a movement away from beef finishing, and that suckler cow production would be more extensive. No changes were expected in sheep systems mainly because of a lack of other opportunities for land use. The results are not presented in a way that identifies impacts on stock numbers or on enterprise margins. It is not clear from the report whether sheep remained profitable or whether stocking constraints in the linear programme forced its continued entry into the optimal plan.

Net farm income fell from £5,953, in the base year on the modelled farm, to £-7,487 without the SFP (£5,816 with the SFP of £13,303). The direct livestock subsidies (mainly LFA payments) contributed £7,855 to income after decoupling. It is difficult to determine what was forcing the continued operation of the loss-making farm unless HFA or SFP conditions, or a lack of low stocking rate alternatives, dictated the optimal plan.

The ADAS study used budgeting methods and reported much greater impacts on LFAs. On all SDA farms there was a financial incentive to reduce stocking (by 60-76%) to the LFA (HFA) minimum but no incentive to go beyond that. On DA farms the response was similar with a 50-75% reduction in stock numbers. These results seem more credible than those of SAC/Harper Adams. In both cases we see the continuation of farming but at a substantial loss with income maintained by the SFP.

We conclude that much of the LFA production may become unprofitable under total de-coupling. This is despite an expectation of some increase in output prices. Some farms will respond by diversifying business outputs and aiming for quality and niche markets including organic production. Even so, unprofitably will characterise most hill farms currently operating with very low gross margins.

What will be permitted in practice must depend critically on the conditions attached to the SFP and LFA payments. Much of the land may operate at minimal stocking rates dictated by HFA or SFP conditions. Typically framers will shed employed labour and re-organise systems so as to reduce fixed costs. In practice this could mean effective abandonment of land that is less productive and costly to manage, with stock tending to use more easily managed and productive pastures. This has particular relevance for hill farms where hill land is more likely to be abandoned or lightly stocked before changes are made to the use of in-bye.

6.1.2 Funding for RDR activities

Defra (2003d) has made an economic assessment of the impacts of the Commission's proposals in the UK. It calculates an average rate of degressivity of 12.1% based on the distribution of direct payments across the UK farm population. The proposals adversely impact on the UK because of the quite different size distribution of direct payments in the UK, where 18% of farms receive more than €50,000 per as compared to an EU average of 2%.

Table 6.1 gives the Commission's estimates the effect on degression and modulation on the FEOGA budget.

Table 6.1 Estimated effect of degression and modulation on the FEOGA budget (€ million)

	2007	2008	2009	2010	2011	2012	2013
Net proceeds from degression	228	751	2030	2420	2810	3200	3343
Of which for RDR	228	475	741	988	1234	1481	1481

Defra (2003d) point out that the rate of degression will vary from year to year because both the level of direct payments and the rate of degression are changing over time. Defra (2003e) estimate the available transfer from FEOGA through modulation to the UK as €485m (14.5%) of the total degressed funds of €1.48b in 2012. Of this only €145m is available for the UK RDR implementation. This is small fraction of the requirement.

There were thus two major RDR funding problems for the UK that arose out of the Commission's proposals – the short-term shortfall in 2007 onwards, and the longer-term limitation on funding that would limit rural development activity beyond 2012. Since the LFA payments are part of Pillar 2 these issues have implications for LFA funding.

6.2 Council agreement

The Agriculture Council on 26 June 2003 agreed a revised set of proposals. At this stage no legal text is available, only a summary of the main points (Defra, 2003c). The Council agreement (Defra, 2003c) introduced changes to the Commission's proposals. The main points of relevance to LFAs are listed below.

6.2.1 Single farm payment

In principle, all the major farm subsidies will be replaced by the new SFP, which Member States will be able to introduce from January 2005, but may, if they wish, delay this until 2007 under certain conditions.

Those Member States who choose may, at national level or in specific regions, maintain the link to production for:

- Seeds;
- up to 25% of arable payments except that a Member State which does not maintain the link elsewhere in the arable sector may do so for up to 40% of its durum wheat payments;
- up to 50% of sheep and goat premia;
- for cattle up to either -
  - 100% of the suckler cow premium and 40% of the slaughter premium; or
  - 100% of the slaughter premium; or
  - 75% of the Beef Special Premium.

Member States (MS) can choose to base the value of the entitlement for payment on average annual historic receipts in the reference years (2000-2002) allocated normally to farmers eligible for direct support in those years. Alternatively, if a Member State opts to implement the SFP regionally, as will be the case in the UK, it can opt to limit the value of per hectare entitlements in a region or to allocate entitlements across all land in a region (i.e. not just to those who were previously eligible for direct payments).

The dairy premium will remain linked to quota until dairy reform is completed - except in cases where the Member State opts for regionalisation of the SFP. In these circumstances, the Member State also has the further option of including the dairy premium in the SFP from the outset.

Member States or regions will also have the option to retain 10% of payments in each sector to establish a national envelope to address potential negative impacts of decoupling or to improve marketing or encourage specific types of farming. The 10% limit counts towards the other limits mentioned above for Member States which opt for them.

6.2.2 Modulation

Reduction of direct payments and transfer of the money to Rural Development expenditure (Pillar 2) through compulsory modulation will start in 2005: earlier than originally proposed (2006) and at a higher rate for the earlier years. The new rates are given in Table 6.2.

Table 6.2 Comparison of compulsory modulation proposals

	As agreed (%)	January Proposals (%)
2005	3	0
2006	4	1
2007	5	2
2008	5	3
2009	5	4
2010	5	5
2011 and after	5	6

Subject to a national ceiling, up to the first €5,000 of direct payments for each farmer will be returned to the farmer (in effect, no cut is applied to that element of the subsidy).

In the EU as a whole, this level of compulsory modulation will increase funding for the Rural Development Regulation. It will switch just under €9 billion of CAP funding to agri-environment schemes and rural development between now and 2013, compared with €6.6 billion in the Commission's January proposals. However, it will not increase funding in the UK which already applies voluntary modulation. As part of the overall package, transitional rules will apply in the UK enabling the government to impose an additional level of voluntary modulation, and to retain the proceeds to ensure that there is no interruption in spending plans for UK Rural Development Programmes.

6.2.3 Cross compliance

Receipt of payment under SFP will be conditional on compliance with EU standards covering the environment, public and animal health and animal welfare. Farmers also have to maintain land in good agricultural and environmental condition as defined by the Member States guided by the framework provide in the new Regulation. Member States will have to inspect a sample of farms each year on a systematic basis to ensure that standards are met.

By 2007 Member States must set up a Farm Advisory Service that will be available to farmers to help them meet their cross-compliance obligations.

6.3 The LFAs after de-coupling

The Minister has announced the intention to implement full decoupling in England. It is not yet known how the rest of the UK will choose to implement the flexibilities for decoupling contained in the agreement. The least that can happen in the LFAs is conversion of 50% of the sheep premium into the SFP along with retention of the suckler cow premium. The most is total decoupling.

In terms of UK economic welfare there is likely to be a preference for full decoupling. This would radically change the economic environment in which livestock farming operates and produce considerable uncertainty over the implications for land use. Overall, the environmental assessment of decoupling by GFA-RACE indicated significant environmental benefits but also highlighted a number of environmental threats. Positive impacts included reduced greenhouse gas emissions from fewer livestock and associated benefits to semi-natural vegetation and related species from grazing extensification and reduced inputs from fertilisers and pesticides. However, a loss of suckler cows and an increase in sheep *'would make it more difficult to achieve environmentally sensitive grazing regimes'*. This could make it difficult to maintain habitats such as heather moorland or prevent further loss of upland habitats including hay meadows.

6.4 Implications for LFA measures

The Council agreement has increased the level of compulsory modulation and allowed Member States to create national envelopes from up to 10% of support expenditure. Transitional measures allowing additional voluntary modulation mean that, in the short term, the UK should have enough funds to maintain planned spending on RDPs. However, it does not solve the longer term funding problems in the UK which are due to the UK's low overall share of the RDR budget. The funding for the existing RDR measures and the new Entry Level Scheme in England (Defra, 2003f) is now assured. It is unclear what implications the new SFP will have for agri-environment payment levels and budgets. Some savings may be possible in payments rates since payments will no longer have to compensate for loss of area payments or livestock premia. However, there could be additional costs in areas where farmers need an incentive to continue to farm in an environmentally desirable way or to resume such farming This would occur where valued habitats or landscape were at risk through changes to the CAP, and were not protected by the SFP and HFA conditions.

Key issues for the LFA measure are:

- the extent to which LFA payments continue to be necessary and justifiable as a support for farmers' incomes, and
- the degree to which LFA payments offer value for money in relation to environmental objectives and in relation to possible alternative, more targeted, RDR measures.

There are expected to be income gains from increased beef and lamb prices but these effects will be small (SAC/Harper Adams, 2003). Decoupling will not radically change the 'social' case for LFA payments as a contribution to income. Since this dominates policy it provides a case for the continuation of payments.

The economic case for LFA payments rests mainly on whether the payments deliver additional public goods - in terms of maintaining communities, landscapes and wildlife. However, the evidence that these are being delivered is very limited. Decoupling raises some fundamental questions about the precise aims and structure of the LFA measure in what will be a radically changed context for land use. The European Court of Auditors (2003) was critical of the LFA measure, the lack of information on the impact of the measure, justification for compensation, and the lack of an overall evaluation of the scheme. A review is long overdue to establish its impacts and effectiveness across the EU.

6.4.1 Environmental implications

The main environmental issue with regard to the LFA and agri-environment measures (Defra, 2003f) will be how to modify the elements of these schemes to meet the changed context of the LFAs. Under total de-coupling, the ADAS (2003) study suggests that many LFA farms, and especially specialist sheep farms, will have little incentive to farm. This implies that stocking rates will fall to the minimum permitted by SFP cross compliance or LFA payment conditions. The conditions will be critical to how land is used. These changes are not easy to predict, but this might lead to the effective abandonment of some LFA land as stock are concentrated on preferred grazings. This might help address current overgrazing concerns but the redistribution of stock might not be uniform. In the longer-term grazing may be necessary at some locations to maintain the conservation interests. The role of LFA payments in this context will need to be re-examined. Key questions beyond the scope of this study to answer are:

- To what extent will the function of LFA allowances change under total de-coupling? With the significant changes likely to arise from implementing the June CAP package, is it realistic to use the LFA mechanism to support farm income, maintain farming and address environmental problems?
- How will the SFP and LFA conditions need to be specified, and relate to each other and to agri-environment prescriptions, in order to protect the environment in the hills and uplands?

7 Conclusions

Objectives

The objectives for the LFA measure are only defined in very general terms in the national RDPs within GB. It is difficult to infer objectives from the new structures of payment rates and conditions because the transparency that linked mechanisms to objectives in the HLCA schemes has been lost. The apparent opportunity that the re-design offered for greater targeting of the schemes (e.g. in relation to local socio-economic fragility or environmental benefits) has only been used to a limited degree.

LFA Payments and differentiation

The re-design of the LFA measures in Scotland and England has been driven by the need to minimise the payment re-distribution implicit in the switch to an area-based system. This has been achieved by a careful re-differentiation of payments according to land type, coupled with payment capping in England, and location and historic stocking rate criteria in Scotland. In Wales, the SDA/DA distinction had been maintained but payments have been capped by tapering.

Conditions

The GB schemes impose relatively few conditions on applicants. The merits of imposing income and/or maximum age criteria as in some other Member States merit further investigation.

The absence of tight stocking rate limits will minimise benefits from reduced grazing pressure. However, tighter stocking limits may not be as effective as is supposed. They may have the perverse effect of encouraging trade in forage hectares, and limitations on LFA payments will not necessarily lead to a reduction in stocking. The inspection regime within Tir Mynydd is a compromise approach that could be more widely adopted. It is potentially a powerful mechanism but its effects depend on its implementation.

Environmental benefits

It seems unlikely that the change to an area-based system of payments will deliver significant changes in land use whilst subsidy to LFA farms is dominated by sheep and cattle premia. This is reinforced by a re-design in Scotland and England that has minimised the loss of payments to highly stocked farms.

Limits imposed on stocking rates are also not very restrictive. Hence, impacts on stocking rates will be minor. This is much the same conclusion found in the study of other Member States (CJC Consulting, 2003) where it was similarly difficult to find any impacts of the area-based payments on stocking rates.

Enhancement

All three GB schemes pay slightly higher rates to farms which meet environmental enhancement criteria. In other Member States there is no payment discrimination by environmental criteria, with the exception of Germany where payment levels are strongly linked to environmental criteria and priorities. There is thus a slightly greater weight given in the GB payments rates to the support of sustainable farming than elsewhere. Even so, enhancement is a weak mechanism for addressing major environmental concerns such as overgrazing.

The HFA enhancement criteria have barely discriminated between claimants. In Scotland, the high rate of enhancement is in essence a re-distributive mechanism to retain beef production. The extent to which this will deliver environmental benefits is unclear. However, it is difficult to amend the enhancements in any meaningful way to address environmental issues because they cannot duplicate any agri-environment prescriptions.

Good Farming Practice

In the study of LFA implementation across other Member States, it was GFP that provided the main mechanism for positive environmental impacts. In practice it was too early for possible effects to be evaluated. In the GB countries, the application of GFP is a desirable step for limiting clearly damaging practices. However, implementation has been slow and it is too early to draw conclusions on the likely benefits.

All the GB schemes contain over and undergrazing clauses in their GFP conditions. Previous experience indicates that these are not easy to implement and have not been very effective as a means of reducing damage from ecological overgrazing. This issue may continue to be important in the future even when the CAP mechanisms are modified.

Mid term review of the CAP

Full decoupling will be applied in England but it is not yet known how other parts of the UK will apply the options available under the June Council agreement. Total decoupling has major implications for the operation of LFA farms but the available consultancy studies differ markedly in their conclusions. Further research is required to assess how LFA farms are likely to respond in land management to the policy options specified in the June agreement. This needs to be done across the range of LFA farm types found in Scotland, Wales and England.

The conclusion drawn here is that under total decoupling, much of LFA farming will cease to be profitable (excluding the SFP). The conditions attached to the SFP will assume a major role in determining how such land is managed.

LFA reviews

The MTR of the CAP will have far-reaching impacts for the LFAs and LFA policy. Much will depend on how countries choose to select the options available, but the greater the extent of de-coupling the greater will be the impact. It will take additional research to assess the changes needed in RDR mechanisms following the June agreement.

Under full decoupling not much is to be gained by arguing for a tightening of the eligibility conditions (e.g. maximum stocking rate) or environmental enhancement conditions when a more wholesale assessment will be needed of the future role of LFA policy in a decoupled CAP. What would be valuable, however, is to lobby for a tightening of regulatory procedures that relate to overgrazing and unsuitable feeding. Such regulation will have a critical role in protecting habitats and landscapes under the reformed CAP.

Under partial decoupling, this case for tightening regulatory mechanisms still holds. But there may be an argument for other changes to the LFA mechanisms. Without more detailed analysis it is difficulty to comment on the case for changes in the maximum/minimum stocking rates. Much depends on how such changes would impact on over and undergrazing issues. There could be a case for reviewing the environmental enhancement elements to make them more effective, but as stated above, it is difficult to do so without duplicating agri-environment prescriptions.

Further investigation

A more detailed study of the implications of the MTR for the LFAs is required in order to address the issues raised above. In particular the following questions are posed:

- How will different types of LFA farm respond to decoupling in terms of farm and land management, and what implications does this have for environmental priorities and the structure of rural development measures?
- To what extent will the function of LFA allowances change under the new CAP package? With the significant changes likely to arise from implementing the June CAP package, is it realistic to use the LFA mechanism to support farm income, maintain farming and address environmental problems?
- How will SFP and LFA conditions be best defined in relationship to each other, to agri-environment prescriptions, and to the need to protect the environment in the hills and uplands?

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