

# ***The Impact of CAP Reform on Devon's Agriculture***

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## **Introduction**

The 2003 CAP reform agreement and its means of implementation represent a radical change to the system of farm support in England. In choosing to deliver the new single payment on an area basis, DEFRA has adopted a deliberately redistributive approach which will have a significant impact on farming in Devon due to the switch from the historic subsidy system to a flat rate, area-based payment.

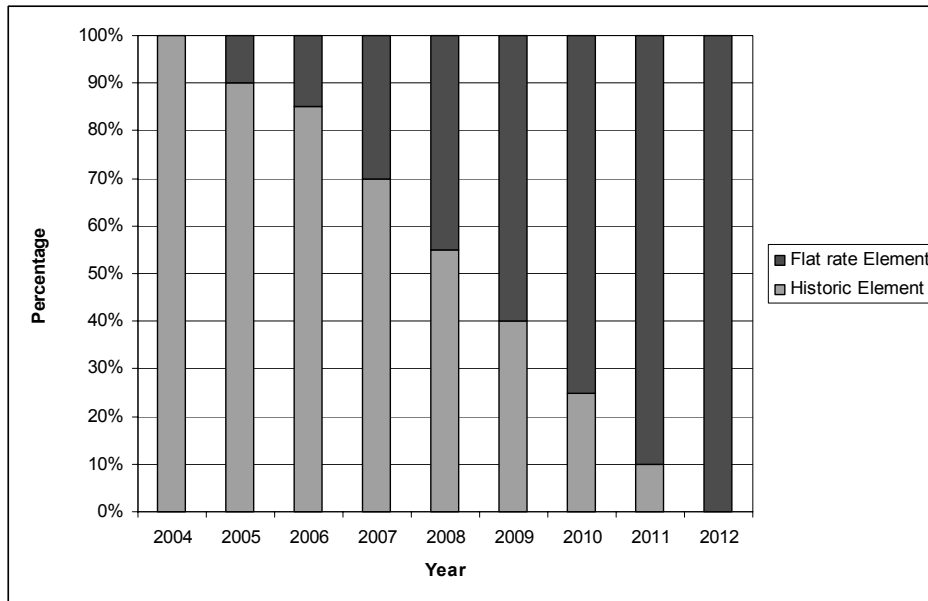
As a follow-up to *The State of Agriculture in Devon* (Lobley et al 2003), Devon County Council commissioned the Centre for Rural Research to undertake a detailed analysis of the possible impact of the 2003 CAP reform agreement on farm incomes in Devon. In order to explore the impacts of the CAP reform agreement, an economic modelling exercise was undertaken and a farmer discussion group convened in order to explore the implications. The data used in the economic model were drawn from the SW Farm Business Survey undertaken annually by the CRR on contract to DEFRA. Within the SW sample, the Devon sub-sample was considered too small to provide a viable basis for the modelling. Therefore, SW data was applied to the farming situation in Devon and validated using agricultural census data (see Lobley and Butler, 2004 for a detailed discussion of modelling methodology and assumptions). In order to explore some of the implications of the CAP reform agreement on farming practices and attitudes to farming, a discussion group was convened with 13 Devon farmers. The discussion group participants were presented with the predicted impacts on NFI for each farm type as a stimulus to discussion. By involving farmers of different ages, operating farms of different types and sizes, the results of the farmer discussion group are indicative of the possible trajectories of change following implementation of the new CAP regime.

## **The Architecture of the New CAP**

From 2005, a 'dynamic hybrid' system for the Single Payment will be implemented as the historic claims element is progressively replaced by a flat rate payment (see Figure 1). The actual payment rates will not be known for some time, but DEFRA estimates that they will be in the following ranges:

- £210-£230 per ha outside Severely Disadvantaged Areas (SDAs)
- £110-£130 per ha within SDAs but excluding land above the moorland line
- £20-£40 per ha for SDA land above the moorland line

**Figure 1: Historic and flat rate elements of the Single Farm Payment**



The levels of flat rate payments given above are **gross** payments as *modulation* is excluded, as well as the deductions necessary to create the *National Reserve*. In addition, further deductions can be triggered by the *Financial Discipline* mechanism designed to control the CAP budget at the EU level. Modulation will impact on the overall Single Payment three ways: UK modulation, EU modulation and through the Financial Discipline. UK modulation rates will be higher than originally envisaged in the Curry Report, in part because of the need to fund the new Entry Level Stewardship (ELS) scheme. In addition, further cuts are likely via the Financial Discipline in order to control overall CAP spending, fund subsidies in the new member states and to fund further CAP reform. Taking EU and UK modulation together, Devon’s farmers can expect a 15% reduction in their single farm payments. However, this reduction may be even greater if the Financial Discipline element of modulation is accounted for. The Financial Discipline is likely to be required from 2008 (if not earlier). Jones (2004) makes a number of assumptions about the need for the Financial Discipline and suggests that it will start to operate from 2008, rising to over 4.5% by 2013. Therefore, the total modulation rate by 2013 could be nearly 20%.

### **The Complex Impact of CAP Reform**

CAP reform will have a complex impact on farming in Devon. In aggregate terms, the impact on farm incomes is likely to be largely neutral or marginally positive. However, this finding is sensitive to certain assumptions and obscures a complex pattern of winners and losers at the farm level. Excluding potential income from the Entry Level Stewardship (ELS) scheme to be launched in 2005, Net Farm Income (NFI) in Devon could fall by 4% from £60.91 million to £58.47 million by 2013 (Table 1). Widespread uptake (80%) of ELS could reverse this fall and lead to an overall increase in NFI of 2.9% by 2013. In reality,

NFI is likely to fall somewhere between the lowest and highest figures, suggesting a largely neutral impact at the county level. This is because an 80% uptake of ELS may not be realistic and because of the ‘dynamic changes’ farmers make in response to the decoupled single payment. In addition, these figures do not take into account possible receipts from other ERDP (England Rural Development Plan) schemes.

**Table 1: The impact of CAP reform on Net Farm Income (NFI) at District level (£m)**

	Average NFI over base years	NFI in 2013 (Excl. ELS)	% change	NFI in 2013 (Incl. ELS)	% change
East Devon	10.49	9.92	-5	10.81	3
Exeter	0.04	0.07	66	0.07	86
Mid Devon	10.17	10.31	1	11.27	11
North Devon	9.78	9.07	-7	9.38	-4
South Hams	6.59	6.59	0	7.19	9
Teignbridge	4.28	4.41	3	4.57	7
Torridge	12.16	11.50	-5	12.60	4
West Devon	7.40	6.60	-11	6.75	-9
<b>Devon</b>	<b>60.91</b>	<b>58.47</b>	<b>-4</b>	<b>62.65</b>	<b>2.9</b>

**Table 2: The impact of CAP reform on Net Farm Income (NFI) in Devon (£m)**

Farm type	Average NFI over base years	NFI in 2013	% change	NFI in 2013 incl. ELS <sup>1</sup>	% change
Cereals	2.47	3.64	47	4.04	63
Lowland livestock	4.12	8.58	108	9.85	139
Mixed	5.00	5.44	9	5.77	15
DA <sup>2</sup> livestock	1.21	1.49	24	1.61	34
SDA <sup>3</sup> livestock	6.08	3.80	-38	2.63	-57
Dairy	34.5	27.97	-21	31.02	-15
Pigs & poultry	7.53	7.60	1	7.72	3
<b>Total</b>	<b>60.91</b>	<b>58.47</b>	<b>-4</b>	<b>62.65</b>	<b>2.9</b>

<sup>1</sup> Entry Level Stewardship. Assumes 80% uptake

<sup>2</sup> Disadvantaged Area <sup>3</sup> Severely Disadvantaged Area

Without additional income from ELS, several districts of Devon will suffer a marginal loss of NFI. In West Devon, with a farm structure dominated by LFA and dairy farms, the loss could be up to 11% by 2013. Such aggregate figures, however, mask the complexity of the impact on farms of different types and sizes.

Within the county, as Table 2 illustrates, some farm types will be clear winners (such as cereal and lowland livestock farms). However, in absolute terms, the NFI of both large and particularly small lowland livestock farms remains bleak, even in the longer term, despite the positive increases resulting from the introduction of the single payment. Moreover, for both farm types, farming remains unprofitable without support payments. For all farm types, the more willing and able farm operators are to embrace the market and base their production decisions entirely on market returns, the more positive the impact on farm incomes.

### *The uplands*

Devon's upland areas will suffer significant reductions in NFI. In particular, the outlook for small farms (85 ha) located in Severely Disadvantaged Areas (SDAs) is bleak, with NFI per farm projected to fall to approximately £7,500 by 2013. Cattle enterprises in the SDA will be more adversely affected than sheep enterprises and the future is likely to see a decline in cattle numbers. The predicted falls in NFI are largely a consequence of high historic levels of support coupled to livestock numbers. The final situation will be influenced by income receipts from the Environmental Stewardship Scheme, in particular, enhanced payments under the Higher Level Scheme. Based on the results of the economic model we have calculated that, on average, a single payment of £160 ha<sup>-1</sup> is necessary to maintain the present pattern and distribution of farming in Devon's SDAs. The impact on Disadvantaged Area (DA) farmers will ultimately be marginally positive. However, NFI is currently very low and will remain so in the early years of the new system, only beginning to rise at the end of the decade. Given incomes possibly as low as £5,500, only rising to £7,000 in the future, the longer term viability of DA farms is questionable in the absence of substantial alternative income sources.

### *Dairy Farming*

Dairy farming is particularly important in Devon, contributing an estimated 57% of the county's total NFI. Overall, dairy farms are likely to experience a loss in income of up to 21% as a result of the reforms. Small dairy farms (average size 47 ha) will experience a decrease in NFI of some 27%. Large dairy farms on the other hand, could see their incomes reduced by a third in 2006 although NFI is still projected to be approximately £35,389 in 2013. However, while the impact of the single payment and modulation is important, it will be the farm gate price of milk that will shape the future of dairy farming in the county.

## **CAP Driven Restructuring**

The reform of the CAP and its impact on incomes *will* drive further restructuring of the county's agriculture, although there will be a time lag before the full effects are felt. In many ways the new support regime will simply reinforce existing trends. However, across the county the reformed CAP will be faced by farms at different stages in the business cycle, different stages in the life cycle, and farms with different endowments of capital, skills, knowledge, etc. Farmers and their households are likely to differ significantly in their ability and willingness to adapt to the new market-oriented policy environment.

At the time of conducting the research (April 2004), there was still considerable confusion and uncertainty amongst the farming community regarding the precise details of the new support system (e.g. value of single payment, cross-compliance conditions, etc.) and rather than rush in to restructuring decisions, many were adopting a 'wait and see' approach. Some indicated that they would simply meet cross-compliance conditions and live off their single payment, while others planned to adopt a more active response, intending to continue farming but simplifying and extensifying their business. Both approaches have implications beyond the farm household, such as for the environment and supply and processing sectors.

In cases where small dairy farmers, for instance, cease active farming and simply meet cross-compliance conditions, the less intensive management of land is likely to be beneficial. Cross-compliance rules allow for land to not be actively farmed as long as thick scrub is not allowed to develop and the land is grazed or cut at least once every five years. While these (and other) conditions are designed to allow land to be quickly returned to agricultural production it could nevertheless create opportunities for 'semi-wilding' which in turn, may cause concern for some if the countryside takes on a less managed appearance. In cases where simplifying the business involves going out of beef production, conservationists would have concerns about sward management if the ratio of sheep to cattle increased (the latter produce a less uniform, tussocky sward which is valuable in conservation terms). Ironically, in the uplands, future concerns could revolve around issues of under-grazing rather than over-grazing, although it will take some time to discern if under-grazing will become widespread.

These strategies also have implications for employment on farms; that is likely to continue to decline. There may be an increase in the use of contract labour, though, which raises concerns about the 'level of care' applied to land management activities. More positively, where farmers decide to withdraw from active farming and only meet cross-compliance conditions, there could be opportunities for new entrants willing to meet the challenge of farming without subsidies. The injection of entrepreneurial, 'new blood' that could result would have positive benefits for the rural economies of Devon.

Not all farmers will simplify and extensify in response to CAP reform and some members of the discussion group saw opportunities for expansion in the future, perhaps managing or, in the longer term, purchasing the land of those who either chose to cease, or are unable to continue active farming. One sector where this is likely to occur is dairying. The environmental implications of a further expansion of dairy farming are complex. Expansion does not necessarily imply intensification, particularly if cross-compliance conditions are met and dairy farms enrol into ELS. However, much depends on what the newly acquired land was previously used for and if, as seems likely, dairy farms expand at the expense of beef; this would represent an intensification of land use.

The other option open to farmers in the face of declining incomes is to seek alternative income sources. Off-farm employment is one option, although many farm spouses already have off-farm employment. Simplifying and down-sizing farming systems should free up some labour and may offer farmers an opportunity to seek additional work, although there appeared little enthusiasm for this among the participants in the discussion group. On-farm diversification is an alternative; but it is far from being an easy option. Those facing declining incomes may find it hard to finance diversification plans and a strong message to emerge from the farmer discussion group was that the Highways Authority can make diversification difficult where it would be associated with increased traffic movements.

## **Conclusions**

The impact of CAP reform on farm incomes is not predictable in a strict sense, the final impact being subject to a myriad of influences. However, the results of the economic modelling exercise provide a useful guide to the probable impact, which, at an aggregate level, is likely to be largely neutral. At a sub-county level, upland areas and dairy farming will, on average, face falling incomes and while the former is a cause for concern, it may also provide new opportunities for the development of different types of upland landscapes.

The results of the farmer discussion group suggest that there is unlikely to be a rapid and large scale exodus from farming in the county. Rather, farmers and their families will adopt a range of strategies in order to remain on the farm. In the longer term, however, as farmers face significant reinvestment decisions some will inevitably decide to retire from active farming. This lagged response means that it will be some years before the full impact of CAP reform on farm structures (the number, size and types of farms) will be revealed.

## References

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