

## LAND MANAGEMENT CONTRACT WORKING GROUP

### REPORT TO AGRICULTURE STRATEGY IMPLEMENTATION GROUP

#### Introduction

1. A central recommendation of “*A Forward Strategy for Scottish Agriculture*” (the Agriculture Strategy) is the development of a whole farm system of support for Scottish agriculture - Land Management Contracts (LMCs). The Strategy envisaged building on the whole farm support provisions implicit in the Rural Development Regulation, and committed the Scottish Executive to developing a system of LMCs, with a view to introducing the new scheme in two to three years’ time.

2. To give substance and practicality to the LMC concept, the Agriculture Strategy Implementation Group (ASIG) set up a Steering Group with the following objectives:-

“The Steering Group will provide, by 30 September 2002, a report to the ASIG that:

- proposes a viable model for Land Management Contracts in Scotland that takes into account socio-economic, environmental, legal and financial issues;
- is sufficiently detailed to permit further detailed technical work as necessary; and
- establishes an action plan and timetable for the consultation on, development and introduction of Land Management Contracts in Scotland.”

The membership of the Steering Group is listed at Annex A.

3. This report fulfils the remit as set out in paragraph 2. It contains the following sections:

- The Land Management Contract Concept
- Pre-requisites for LMCs: LMC Model
- Existing Legislative and Financial Context
- Mid Term Review Possibilities
- Proposed Forward Strategy on LMCs
- Regional Involvement
- Forward Work Plan
- Conclusions.

## The Land Management Contract Concept

4. The vision of the Agriculture Strategy is for a prosperous farming industry which should

- be focused on producing food and other products that the customer wants;
- play a major role in sustainable rural development and help to maintain the prosperity of our rural communities;
- be a leading player in the protection and enhancement of our environment; and
- embrace change and new opportunities.

5. LMCs are a **whole farm system** of support where farmers **contract** to deliver the outputs implicit in this vision - **multi-functional** farming which delivers a range of **economic, environmental and social** benefits in return for support payments. LMCs should recognise the farm as a whole business and make it easier for farmers to take market-orientated business decisions rather than having to meet the requirements of a series of disjointed subsidy schemes. This would be achieved by rewarding farmers, through combinations of base payments and top-ups, for delivering different combinations of outputs that provide the economic, social and environmental benefits that society wants.

### Pre-requisites for LMCs: LMC Model

6. In the Working Group's view, the LMC structure of support payments might involve the following tiers:-

- (i) **Tier 1: an annual base payment paid to all producers.** This would be a payment for farmers delivering a broad range of benefits from farming in accordance with Good Farming Practice (GFP). The benefits would reflect the existing multi-functional contribution of farming in different areas - dictated by the range of different natural conditions across Scotland. These benefits include the production of high quality food, employment in parts of Scotland where there are few alternatives and high local multipliers, with consequent benefits for rural communities; and compliance with environmental regulations and good environmental practice as defined in GFP;
- (ii) **Tier 2: a further annual payment available to all farmers** for delivering different combinations of economic, environmental or social benefits. The benefits would be additional to GFP and farmers would choose from a menu of options suitable for their particular circumstances. These would be built into a plan tailored to meet the circumstances of individual farms;
- (iii) **Tier 3: top-ups.** This tier is designed to reward more specific, possibly farm specific, benefits than Tier 2. It would involve both one-off capital payments and annual ones. The tier would be available to all farmers who could choose from a menu of options - again covering the full range of economic, environmental and social benefits.

However, given the likely constraints on total financial provision these top-ups would need to be discretionary and competitive. Farmers could build them into their farm plans and contracts, but could not assume that they would automatically receive funding. Under such discretionary arrangements, systems for resubmitting applications in subsequent years would be incorporated.

7. The above model implies the following:-
  - (a) the legislative provision to make annual base payments across Scotland to all producers;
  - (b) sufficient funding, and distribution of funding between the tiers, to provide an appropriate incentive for delivery of different outputs;
  - (c) a clear formulation of GFP;
  - (d) well-designed menus for the benefits under Tiers 2 and 3, together with appropriate mechanisms and levels of reward.

The Working Group recognises that (a) and (b) are especially important to the introduction of an LMC system on their preferred model.

#### Existing Legislative and Financial Context

8. The existing system of support involves substantial amounts of money paid under the main generic CAP schemes - some £400 million in Scotland. These are the Pillar I payments. EU legislation is specific and requires Member States to operate these schemes and to pay applicants who comply with the scheme requirements - as set out in the legislation. Member States are not able to add (or subtract) provisions except at the margins with the relatively recent introduction of 'national envelopes' which allow some Member State discretion.

9. Pillar II support paid under the Rural Development Regulation (RDR) allows Member States some additional flexibility and it is expressly designed to support certain specified economic, environmental and social objectives. Again, however, support cannot go to actions which are not covered by the express provisions of the Regulations.

10. Schemes that deliver the objectives of the RDR measures are either funded through their inclusion in the Scottish Rural Development Plan (SRDP) or the Highlands & Islands Special Transitional Programme (H&ISTP) or they are funded domestically. In the case of both the SRDP and the H&ISTP, this funding is a mixture of domestic and EC sources. The total spend under the RDR is some £130 million per annum (2003/04 to 2005/06). Of this, £61 million is for LFASS (which covers 83% of Scotland), leaving the non-LFASS total at around £70 million. However, this includes some £4-6 million on the Processing and Marketing Grant Schemes which in the main do not pay out money to farmers. This leaves some £65 million comprising mainly agri-environment (£23-25 million), forestry (£25 million) and business development (£13 million). Many of these schemes involve forward year commitments. The amounts of money freely available to spend on new schemes or new recipients in any one year (once LFASS is taken out the account) is therefore

even lower than this balance of £65 million - perhaps £20 million or so in the first year, rising as commitments run out.

11. While the RDR general measures are wide-ranging, money raised from modulation can only fund a subset of these measures - the so-called “Accompanying Measures” (support to Less Favoured Areas, agri-environment schemes, forestry schemes and early retirement schemes). In Scotland, we currently use modulation to help fund the agri-environment and forestry schemes within the SRDP. The rate of voluntary modulation in the UK is currently 3% and is scheduled to rise to 4.5% by 2005/06.

12. Funding for Pillar II can be increased further as current EU provisions permit the rate of modulation to rise up to 20% of Pillar I payments but UK Ministers have chosen not to use this flexibility. 20% modulation would transfer around £75 million from Pillar I to Pillar II and the UK Treasury has made available domestic match funding up to a 10% modulation rate from 2005/06 if Ministers wish to use. A 10% modulation rate would result in a transfer of some £35-40 million from Pillar I to Pillar II with matching funding of a further equivalent amount for Pillar II. **No decisions will be taken on any new modulation rates until after the outcome of the MTR is settled.** Any decision would need to take account of the Commission’s proposals for compulsory modulation, any changes to national co-financing rates, the redistributive effect on the rural economy of modulation and the question of whether modulated money could be spent on the right things.

13. While the RDR provides some flexibility compared with the sectoral schemes, it does not provide the full flexibility required for the LMC model noted above. There are also clear limitations in the funding possibilities under the current arrangements. The main inflexibilities are as follows:-

- (a) there is no provision for a multi-functional base payment to farmers across Scotland (either under the RDR or Pillar I) that could be used to make a base payment;
- (b) the administration of the RDR is highly inflexible. This applies both to the auditing of the RDR measures (currently each of the 22 measures have to be accounted and audited separately, which complicates the implementation of them in combination - central to LMCs) and there are limitations on the use of modulation receipts (as noted at paragraph 11 above);
- (c) the range of activity that can be rewarded under the RDR is restrictive and activities like advice to farmers and quality food production are not covered;
- (d) the amounts of money available for expenditure under the RDR (without further modulation and/or a sharp increase in the UK share of RDR resources) are relatively modest - rising over time to around £65 million on the assumption that LFASS is incorporated unchanged into LMCs, as the Group prefers. This presumes that all other RDR schemes paying money to farmers (including RSS, forestry and business development) will stop. Existing scheme commitments would be honoured and the general objectives of these schemes would be reflected in the more widely based LMC arrangements.

14. In summary, moves in the direction of the LMC model of paragraph 6 would be possible, but there would be clear constraints. In particular, if the MTR proposals do not yield an acceptable foundation for a base payment, then there is a major barrier to the implementation of an LMC model which assumes that there must be a general payment to all farmers.

#### Mid Term Review Possibilities

15. There are three elements to the MTR proposals, which potentially influence the development of LMCs:-

- (a) **decoupling:** the proposal is that, effectively, all Pillar I payments would be paid as a single lump sum, linked to a historical base year, and (at this point) without the requirement for the applicant to produce anything. In return the producer would be required to maintain the land in good agricultural condition. The details of “good agricultural condition” are as yet unclear, but it seems highly likely that, at the least, the terms of Good Farming Practice (GFP), as currently applying to Pillar II schemes, will apply. There is a good deal of uncertainty about how exactly this proposal will evolve;
- (b) **compulsory modulation:** the proposal is that a system of compulsory modulation would be introduced across the EU, with rates rising in steps of 3% up to 20% within six to seven years - starting in 2004. A range of exemptions, including franchise and ceilings, and various other details are part of the proposal. A crucial feature of this compulsory modulation is the proposal that the amounts collected would be paid into a central EU pot and distributed according to a key that has so far only been defined in general terms. The amounts which would be available to the UK (and Scotland) are not yet clear but on present proposals could lead to our receipts falling rather than rising. There are also proposals to change the co-financing rates, but again more clarification is awaited. In the circumstances, it cannot be assumed that an increase in the modulation rate would increase the funding available for RDR measures.

The proposals also extend the range of the RDR to include two new chapters - food quality and meeting standards. These are classified as Accompanying Measures, for which modulation receipts can be used;

- (c) **whole farm audits:** the introduction of a system of auditing for commercial farms (all receiving €5,000 or more) to help farmers become aware of material flows and on-farm processes relating to environment, food safety, animal health and welfare and occupational safety standards. The details, as yet, are lacking but the strong implication is that this auditing system involves farm planning (to some unspecified level) and the checking or auditing of outcomes. The implication is that it will replace the IACS system - although in point of fact, arrangements as complex as the IACS system would be required to administer the decoupling and modulation proposals, if agreed.

16. These elements of the MTR proposals hold some potential for developing LMCs beyond that which would be permitted under existing legislative provisions. But there are also drawbacks. The main points are as follows:-

- (a) the decoupling proposals, if implemented, hold the prospect of accessing the whole of existing Pillar I payments for a base payment under LMCs. The decoupled payment would recognise the current benefits afforded by farming - and impose broadly the requirements of good farming identified under paragraph 6(i). However, it would be calculated on a historic base and paid only to those farmers previously in receipt of Pillar I payments (not to all producers); could be vulnerable to degressivity over time and may act as a disincentive to production. The wording of the proposals implies some ability to adjust the allocation of decoupled payments - but the degree of flexibility here is uncertain;
- (b) while the RDR would be extended - including the proposals to add food quality and meeting standards chapters, both in line with LMC objectives - beyond the decoupling proposal, there is no provision for a general payment to farmers such as would be required for a base payment. The Commission naturally regards their decoupling proposal as the mechanism through which farmers should continue to receive general, direct subsidy;
- (c) the modulation arrangements are complex and it is not clear that they would result in more money available to Scotland for RDR measures. The collection of modulation receipts into a central EU pot and their reallocation from that pot carries very significant risks on availability of funding to Scotland.

17. As mentioned above, we would need to secure amendments to existing EU regulations in order to provide a basis for the development of LMCs in the model preferred by the Group. There are three areas to be considered:-

- the need to make provision for a multi-functional base payment either through legislative changes to Pillar I or the RDR;
- broadening the scope of the RDR in order to allow it to address a wider range of issues, such as food quality; and
- reducing the administrative burden of the RDR, in particular to make it easier to construct LMCs, which will address a number of components of the RDR within a single contract.

18. The MTR negotiations have a long way to go and it cannot be assumed that changes in these areas will be achieved. MTR outcomes will not be known until the first half of next year (possibly April/May at the earliest).

## Proposed Forward Strategy on LMCs

19. Given this situation and the above background, the Working Group propose the following arrangements for developing LMCs:-

- (a) that the model of LMCs as set out in paragraph 6 should be our goal - but that the final possibilities for developing LMCs in the short to medium term will be determined by the outcome of the MTR;
- (b) that work should be set in hand now to inform implementation of the model;
- (c) that the MTR negotiations should be used to develop the legislative base and financial position to facilitate the implementation of LMCs - in ways as close as possible to the paragraph 6 model;
- (d) if the MTR provides for a general payment to farmers, forming an acceptable base payment under the model, then we should discontinue existing RDR schemes (which pay money to farmers), other than LFASS, and allocate the funding to the LMC model. Given the importance of LFASS to some of the poorest farm businesses and the fact that it has been subject to three very substantial reviews in as many years, the Group thinks LFASS should remain essentially intact. The Executive has deliberately designed the new LFASS scheme to be consistent with LMCs, with a base payment and menu of top-ups and this could be integrated into the LMC model without major alterations. The objectives of the other non-LFASS RDR schemes would be incorporated more widely and flexibly into the benefits under the LMC tiers;
- (e) if the MTR outcome does not provide for an acceptable base payment under the model, then we should **not** introduce LMCs as such - though this would be the long-term goal. However, we should seek to progress the objectives of the Forward Strategy by developing a more integrated whole farm approach to the use of the RDR. This would entail reviewing all the potential uses of the RDR, not just those measures currently used. It would mean discontinuing the non-LFASS RDR schemes, which make payments to farmers, and, building on the work at (b), seeking to develop more integrated rural development schemes which benefit wider groupings of farmers and which reward multi-functional farming - as a stepping stone to the LMC model of paragraph 6.

20. On (b), the Working Group proposes that detailed modelling work be carried out - on specific farms - to inform the implementation process, to identify appropriate payment mechanisms and the relevant menus of options for Tiers 1, 2 and 3.

21. On (c), the Working Group has identified the following needs:

- within the MTR negotiations, provision to permit acceptable base payments, eg one way would be through decoupling with appropriate conditions;

- more flexibility in the measures available under the MTR and in the administration of the RDR so that it facilitates the operation of combinations of RDR measures and top-up menus;
- monitor negotiations on the MTR and, if decoupling looks likely to be agreed, ensure that the conditions that might be attached to a decoupled payment recognise the economic, environmental and social benefits of farming and can support the introduction of LMCs. In case decoupling does not run, to also develop alternative negotiating positions on what would deliver acceptable base payments;
- if MTR modulation agreed - maximise the proportion of modulated funds reallocated to Scotland, and seek to maximise flexibility, consistent with value for money, in the use of modulated funds for farmers; and
- influence the Commission's MTR proposals on farm audits so that they result in an inspection and audit regime which is as simple and effective as possible, and which is consistent with our developing ideas on whole farm business plans.

### Regional Involvement

22. The Working Group proposes that regional input is required in setting the strategic direction for the menus of options available for Tiers 2 and 3 of the LMC model.

23. The regional groupings provisionally agreed are as follows and are based on the partnership arrangements for implementing current schemes under the current RDPs:-

- Highlands and Islands
- Aberdeenshire and East Moray
- Perth & Kinross, Angus, Fife and the Lothians
- Borders, Dumfries and Galloway
- Ayrshire and Clyde Valley.

24. Further work is required to identify appropriate regional groups of people; the aim is for this work to run in parallel with the modelling work.

### Forward Work Plan

25. The above implies a number of areas of further work, as follows:

- review current specification of GFP (in-house - by end March 2003);
- carry out modelling work on some 15-20 farms spread across the regions noted at paragraph 23. A key output from this work will be two sets of menus for options under Tiers 2 and 3, together with appropriate payment mechanisms and rates of payment, see the remit at Annex B (contracted work but under in-house control - set up as soon as possible with results available by end March 2003);

- obtain regional input to the menus of options available for Tiers 2 and 3 of the LMC model;
- proceed to seek changes in the MTR as detailed at paragraph 17;
- formulate a detailed plan on how to proceed as soon as the MTR arrangements are agreed.

### Conclusions

26. This report, which has been agreed by the Working Group, has identified a model of LMCs which the Group feels should be the longer-term aim. It also identifies the legislative and financial barriers which prevent moving directly to this model immediately. It highlights the opportunities that the MTR provides in removing at least some of these barriers and proposes a way forward, subject to the outcome of these negotiations.

27. A key proposal from the Group is the need to move forward immediately with modelling work based on real farm situations designed to inform the implementation process. Construction of clear menus of options for Tiers 2 and 3, together with payment mechanisms and levels of payment to provide appropriate incentives, are viewed as important outputs from this work. Regional input is proposed to ensure that appropriate strategic regional direction is given to this modelling work.

28. The Agriculture Strategy Implementation Group is invited to endorse this work and agree that the Forward Work Plan be implemented.

**LAND MANAGEMENT CONTRACT STEERING GROUP**

Chairman - David Crawley, SEERAD

Members - Bob Stubbs, Highlands & Islands Enterprise  
Sarah Bradburn, NFU Scotland  
Jim Walker/Jan Polley, Quality Meat Scotland  
Fiona Newcombe, SE Link  
Donald Maclellan, Scottish Crofting Foundation  
Gilbert McBride, Scottish Enterprise  
Rob Morris, Scottish Environment Protection Agency  
Jonathan Hall, Scottish Landowners' Federation  
Peter Pitkin/Alan Hampson, Scottish Natural Heritage

Other SEERAD officials also in attendance

## REMIT FOR MODELLING WORK

### Introduction and rationale

1. This work is designed to inform the implementation of Land Management Contracts (LMCs). The aim is to use individual farm information and decision-making possibilities, across a range of typical farm types, to identify key issues in operating the three-tier LMC model.
2. The key issues include identification of the menu of measures to be included for Tier 2 and Tier 3 payments, the most appropriate means of delivering the payment and the appropriate level of reward. An important ancillary output from the work, in relation to the construction of the Tier 2 and 3 menus, will be to identify the nature of the benefits which the measures are designed to deliver.

### Number of farms for modelling

3. The aim here is for about 20 farms spread across the regions as follows:-

Highlands and Islands  
Aberdeenshire and East Moray  
Perth & Kinross, Angus, Fife and the Lothians  
Borders, Dumfries and Galloway  
Ayrshire and the Clyde Valley.

### Output from the work

4. This will consist of the following:-
  - (i) for each farm, a model LMC, detailing the measures under each tier, and the payments under these;
  - (ii) a menu of applicable measures under Tiers 2 and 3 for each region, based upon the evidence of the modelled farms, seeking strategic direction from local groupings as appropriate;
  - (iii) the incorporation of the regional results at (ii) into an all-Scotland system - with single, all-embracing menus, delivery mechanism and levels of reward.

### Resources and working arrangements

5. The work would be carried out in-house, led by a PAO and with support from the Agricultural Staff in the various regions. The work would be steered internally by a group chaired by AP Division, the LMCWG acting as the external grouping with oversight of the work.

6. If appropriate, consideration should be given to appointing consultants to assist with the preparation of reports and providing uniformity and consistency checks.

7. Subject to the advice of the LMCWG, the regional work will be informed by local expertise. The internal steering group will propose appropriate regional groupings after consulting the LMCWG. This local expertise is likely to prove most helpful at the time the regional reports are being constructed.

#### Issues that must be taken into account in the work

8. These are as follows:

- that the elements of Good Farming Practice (as currently defined - or as being reviewed) should **not** form part of the menus for payment in Tiers 2 and 3, since this will be a requirement for payment under Tier 1;
- that in constructing Tier 2 and 3 menus, account would be taken of the range of benefits being delivered under existing RDR schemes which might be replaced by LMCs;
- that the menus, mechanism for delivery and levels of payment must permit the LFASS 2003 system to continue, ie that LFASS 2003 recipients must be able to obtain the same money for delivery of the same things under that scheme - but that this would not rule out additional flexibilities to do something different, particularly on top-ups, under the more general model should recipients so choose;
- that the final Tier 2 and 3 payments will have to operate within a pre-specified budget. The expectation that the Tier 2 payment will tend to be a general one, available to most if not all farmers for delivery of a grouping of measures within the Tier 2 menu, and that the Tier 3 payment might be discretionary.

#### Timing

9. The work would commence as soon as possible (mid-October 2002) and be completed by end-March 2003. An interim report on emerging findings would be available by end-January 2003.

#### Reports and reporting arrangements

10. LMCWG would receive the interim report by end-January 2003, the final report by end-March 2003, and would issue the final version to ASIG by end-April 2003.