Explanatory Memorandum to The Common Agricultural Policy Basic Payment Scheme (Provisional Payment Region Classification) (Wales) Regulations 2014.

This Explanatory Memorandum has been prepared by Sustainable Futures and is laid before the National Assembly for Wales in conjunction with the above subordinate legislation and in accordance with Standing Order 27.1

Minister's Declaration

In my view, this Explanatory Memorandum gives a fair and reasonable view of the expected impact of **The Common Agricultural Policy Basic Payment Scheme (Provisional Payment Region Classification) (Wales) Regulations 2014.**

I am satisfied that the intervention is justified by the outcomes

Rebecca Evans
Deputy Minister for Agriculture and Fisheries under authority of the Minister for Economy, Science and Transport, one of the Welsh Ministers
11 July 2014

1. Description

To lay secondary legislation to define payment regions in Wales and to permit persons in Wales to appeal the classification of land for payment purposes under the new Basic Payment Scheme.

2. Matters of special interest to the Constitutional and Legislative Affairs Committee

None.

3. Legislative background

In accordance with Article 23 of Regulation (EU) No 1307/2013 establishing rules for direct payments to farmers under support schemes within the framework of the Common Agricultural Policy (CAP), where a Member State (or in the case of the UK, the devolved administration of Wales) has decided to apply the basic payment scheme at regional level, those regions must be defined in accordance with objective and non-discriminatory criteria.

The proposed Regulations will extend the definition of a relevant determination contained in the Agricultural Subsidies and Grants Schemes (Appeals) (Wales) Regulations 2006 to include a provisional payment region classification as a relevant determination. This will enable those farmers who wish to appeal their payment region classification to access a technical review process culminating, if required, in a final decision by an expert panel.

The Welsh Ministers are designated for the purposes of section 2(2) of the European Communities Act 1972 in relation to the Common Agricultural Policy of the European Union by virtue of S.I. 2010/2690. This designation allows Welsh Ministers to make Regulations for the purpose of implementing any EU obligation in exercise of the powers contained in section 2(2).

The proposed Regulations would be made by the negative procedure.

4. Purpose & intended effect of the legislation

Reform of CAP direct payments from January 2015 will see the introduction of 3 payment regions in Wales with different payment rates applied to each. Farmers will be notified of which payment region(s) their land falls in by letter in July 2014. Legislation confirming the definitions of each of the payment regions therefore needs to be in place in advance of the notification.

It is evident from correspondence and press comment that many farmers with Moorland are concerned about the low payment rate attached to this payment region and so they are likely to seek means to have their land reclassified. Since the having a Moorland payment region was proposed, the Welsh Government has recognised that it would be contentious and that farmers should have the opportunity to appeal their land being classified as Moorland or any of the other payment regions for the purposes of the Basic Payment Scheme.

All farmers in Wales will be affected by CAP direct payments reform and those with any mix of payment regions are able to appeal. In practice it is expected that some with Moorland and a small number of those with SDA/DA land will decide to appeal.

The proposed Regulations will extend the definition of a relevant determination contained in the Agricultural Subsidies and Grants Schemes (Appeals) (Wales) Regulations 2006 to include a payment region classification decision. This will enable those farmers who wish to appeal such a decision to access a technical review process which will include an independent panel of experts established solely for this purpose.

5. Consultation

As this is a continuation of long standing policy development, which has been subject to extensive on-going consultation, stakeholder's views on this matter are well known. The proposals for payment regions were consulted on from July – November 2013 and discussed with a stakeholder group. The detailed proposals in the draft Statutory Instrument have been developed following further consideration of issues raised by stakeholders. A full assessment of why the payment regions were decided on will be done prior to the full SI for CAP Reform which is due to come into force in January 2015.

6. Regulatory Impact Assessment (RIA)

A RIA has been prepared as below.

PART 2 – REGULATORY IMPACT ASSESSMENT

Options

The options available are to:

(a) define the payment regions and introduce the new basic payment system without any means for claimants to appeal how their land is categorised other than through judicial review; or to
(b) define the payment regions and provide a means to appeal under a review process that ultimately, if not resolved at an earlier stage, would lead to a final decision by an independent panel.

Costs & benefits

Currently there are around 16,000 claimants of the Single Payment Scheme. The number who will claim the Basic Payment Scheme in 2015 is not known, as new eligible farmers may claim, but is anticipated to be similar. Statistical modelling of the land regions carried out on 2012 data shows the following about the proposed payment regions:

Land region	Number of claimants	Total hectares of land
SDA land only	2755	138,000
DA land only	2990	112,000
Lowland only	2641	153,000
DA and Lowland	1509	125,000
DA and SDA	1967	142,000
Other (no Moorland)	1306	122,000
Moorland and SDA	1506	233,000
Other land with Moorland	1374	303,000

Claimants will be able to appeal their land classification under Moorland if they considered their land to be wrongly assigned to that region because of administrative error or if they believe the land does not fit the prescribed description by being agriculturally improved. This option is open to claimants in 2014 only – it is not proposed to have a long standing technical review process. The proposals are most likely to be of interest to the 2,880 claimants who have some Moorland, and in particular those 75 claimants spread over 790 hectares who have improved their Moorland are likely to appeal the classification.

Under option (a) there would be no appeals process once a payment region classification has been made. This may result in large costs being incurred by the Welsh Government defending judicial reviews if claimants were only able to seek reclassification via judicial review proceedings. Where such cases were lost, there would be a further financial risk to the Welsh Government were they to be made liable for the legal costs of the other party. There would be reputational damage for the Welsh Government and large amounts of staff time to deal with the work arising from this.

Under option (b) there would be a two stage process:

- Stage 1, a query stage where the claimant would submit evidence that their land should not be classified as it has been provisionally. This might include documentary evidence such as aerial or other photographs of field parcels which would be examined by Welsh Government officials/field officers/technical colleagues to determine whether the land classification should stand or not. Claimants would have 30 days to submit their query after the Welsh Government writes to them to tell them their provisional land classification.

- Stage 2, if the claimant is unsatisfied with the outcome of Stage 1 they may exercise Stage 2 which would require them paying for an independent technical assessment to be submitted to the Welsh Government within 60 days of the Stage 1 decisions a for an independent panel of experts to consider. If the panel finds in favour of the claimant then the cost of the assessment would be reimbursed up to a maximum of £1700.

Allowing 16,500 farmers to appeal their land classification could, in theory, produce queries from all farmers but as the appeal is based on objective criteria it is unlikely we will receive many SDA/DA land queries; these queries are expected, in the main, to be resolved by checking maps or occasional farm visit. This would mean the costs for the Welsh Government would not change. There would be reputational benefits given there would be a defined appeal process for claimants to follow if they were unhappy with their payment region allocation. There would also be a cost benefit for the farmer as the appeal costs are set and unlikely to rise. The only risk financially to a farmer would be when an appeal failed and further redress was sought via judicial review proceedings.

For those who chose to go through Stage 2 there would be costs for the Welsh Government. These are based on the existing Independent Review Panel which already considers farm related matters running costs include payment of panel members fees, travel and subsistence and training events. An average cost per each stage 2 appeal is in the region of £650.

Appeal hearings are normally run in succession during the course of a day. The estimated cost per day varies between £900 and £1,400. This equates to an estimated average cost per case heard by the Panel of up to:

- £280 where 5 appeals are heard in one day;
- £350 where 4 appeals are heard in one day;
- £467 where 3 cases are heard in one day; and
- £700 where 2 cases are heard in one day.

How many cases are heard in any one day would depend on the complexity of each case. Five per day could be achievable if the cases being heard were all written appeals (where the appellant does not attend) but if they were oral cases (where in the region of 1 hour is allowed for the appellant to present their case to the Panel – plus additional Panel discussion time) a maximum of 4 per day is more realistic. Currently the Welsh Government receives around 250 appeals per year. We have 75 current claimants who have improved their Moorland; it is expected that over half of these could be resolved at stage 1, and then the other half would proceed to stage 2. We would aim to arrange the appeals on a 5 per day basis and this would incur panel costs of £10,640. If half of those who proceeded to stage 2 were successful in their appeal then the Welsh Government would reimburse their technical assessment fee incurring further costs of £32,300. This would leave a total cost to the Welsh Government for the entire process of £42,940 although we do expect in practice that a large majority will be dealt with under stage 1 thus these costs are a worst case scenario.

The cost to the farmer would be nil to query their land classification and nil to take this to stage 1. Costs for progressing to stage 2 would be around £1700for the technical assessment which would be reimbursed if they were successful. If the farmer progressed to a judicial review they would be liable for their court costs if they were unsuccessful.

Consultation

As this is a continuation of long standing policy development, which has been subject to extensive on-going consultation, stakeholder's views on this matter are well known. The proposals for payment regions were consulted on from July – November 2013 and discussed with a stakeholder group. The detailed proposals in the draft Statutory Instrument have been developed following further consideration of issues raised by stakeholders. A full assessment of why the payment regions were decided on will be done prior to the full SI for CAP Reform which is due to come into force in January 2015.
This process is explained in **Annex B**.

Competition Assessment

The competition filter was negative for each question; therefore there will be no impact, positive or detrimental on the competitive position of Welsh agriculture as a result of continuing the appeals process.

Post implementation review

These Regulations will be reviewed in light of developments by the European Commission regularly. Any amendments will be implemented by the Welsh Government when required.

APPENDIX A

The Competition Assessment

The competition filter test

The competition filter test	
Question	**Answer yes or no**
Q1: In the market(s) affected by the new regulation, does any firm have more than 10% market share?	No
Q2: In the market(s) affected by the new regulation, does any firm have more than 20% market share?	No
Q3: In the market(s) affected by the new regulation, do the largest three firms together have at least 50% market share?	No
Q4: Would the costs of the regulation affect some firms substantially more than others?	No
Q5: Is the regulation likely to affect the market structure, changing the number or size of businesses/organisation?	No
Q6: Would the regulation lead to higher set-up costs for new or potential suppliers that existing suppliers do not have to meet?	No
Q7: Would the regulation lead to higher ongoing costs for new or potential suppliers that existing suppliers do not have to meet?	No
Q8: Is the sector characterised by rapid technological change?	No
Q9: Would the regulation restrict the ability of suppliers to choose the price, quality, range or location of their products?	No

Annex B

Consultation process to define land regions

Background

The reform of the Common Agricultural Policy (CAP) requires direct income support for farming to start to move to a payment system based on the area of land actively farmed by claiming farmers. Presently payments in Wales are based on entitlements that were allocated historically on the basis of the numbers of livestock farmers kept and/or production quotas that have since been converted into entitlements. There have also been sales and purchases of entitlements. Together these mean that the entitlements farmers currently hold and claim may have little, if any, relationship with the farming activity they undertake or the area or type of land they farm.

Since the broad direction of the European Commission's proposals for CAP reform have been apparent, the Welsh Government has worked on proposals for a new payment system based on the area of land farmed. It has shared these proposals with the farming unions and other stakeholder bodies for comment and the proposals have evolved and been tested as the shape of the European Commission's proposals have developed. Throughout this development the Welsh Government has repeatedly sought comment from farmers by publishing consultation style documents and public meetings. It is a widely held opinion in the farming industry that change should be managed to minimise the level of change to payments that current claimants might experience when the changes are introduced. Minimising disruption has thus been a principle at the heart of the Welsh Government's data modelling work and proposals for a new payment system.

Land regions in the reformed Pillar 1 system in Wales

The new regulatory framework for a reformed CAP Pillar 1 dictates the shape of the system the Welsh Government may put in place. There is the option to put in place the same system for the whole of Wales, irrespective of land type (the 'Flat Rate' system), or alternatively Wales may be split into regions based on objective, non-discriminatory criteria such as agronomic characteristics, the agricultural potential of land, or administrative structures. In Wales' case it would make no sense to have a payment system based on administrative structures such as County Council boundaries because within most local authorities there is a mix of land and farming types. This is true of administrative units at all levels. The regulations rule out a payment system based on bespoke arrangements for individual farms – the same objective, non-discriminatory rules have to be applied to all farms. This has left a choice between using a 'Flat Rate' system or one based on regions of different agricultural character / potential.

Much of Wales' farmland is classified in European terms as 'less favoured' and within the UK it is well established that within this broad label there is variation which has led to the long recognised sub-classifications 'severely disadvantaged area’ (SDA) and ‘disadvantaged area’ (DA). The best quality agricultural land is outside these regions and is the ‘lowland’. Within the SDA there is also much variation with highly improved land but also semi natural vegetation of grassy, shrubby or boggy character which is mainly at higher altitudes and is often unenclosed rough grazing.

Data modelling

The Welsh Government has modelled several scenarios of area based payment systems. A fundamental choice is whether to have a flat rate system or one based on land regions. The former would cause significantly more disruption to current claimants’ payments than a land region system and did not receive much support from stakeholder bodies or public consultation. For these reasons it was rejected as a policy option, leaving a choice between different land region systems incorporating two, three or four different land regions.

Defining which land types could be used, in what combination, and at what payment rates in a new payment system has been the subject of extensive data modelling. The work was subject to comment by a group of farming stakeholder bodies. The work first identified the land regions were available at a sufficient level of detail (land parcel level) and to sufficient accuracy and concluded that these were moorland, SDA, DA and Lowland.

It was apparent that a fixed and limited budget would mean that some farms would see significant changes to payment. In line with the objective to minimise the level of change across all claiming farms a range of statistical measures were used to determine the statistical "best fit" between different area based payment systems and current claimants’ payments. The modelling work showed that having a moorland region with a low payment rate significantly reduced the level of disruption across all farms in Wales. Without a moorland region, or with a moorland payment rate similar to the SDA, the level of disruption to current claimants’ payments increases markedly. The reason for this statistical outcome is that a low payment rate moorland region recognises the low agricultural productivity of land which, although not matching perfectly with the original allocation of historical entitlements, does crudely reflect the fact that moorland would not have attracted high levels of historical entitlements because it could not support high stocking densities unlike the SDA. It is for this reason of minimising disruption to current claimants’ payments across all of Wales that the decision was taken to have a low payment rate moorland region in the payment system. The decision does mean that a small number of claimants will experience large falls in their CAP payments but this is only true of some claimants with some or a lot of moorland, others stand to gain higher overall payments (ie <u>it is not the case that having a lot of moorland automatically means that a claimant will get lower payments under an area based payment system</u>). It is also the case that in every permissible system there are similar numbers of claimants who stand to gain or to get less. The difference between the three region model chosen by the Welsh Government (ie moorland, SDA and a combined DA/lowland region) and the others is that the level of disruption to current claimants’ payments is less compared with any of the other regional systems that could be put in place.

<u>The over-riding factor in determining whether a current claimant gains or loses is the level of payment derived from the entitlements they currently hold</u>: in short, persons holding lots of entitlements that generate a large payment are likely to get less, unless they have very large area farms; whereas persons who have few or no entitlements are likely to receive bigger payments, even if they have small farms.

Table 1 below shows the best-fit payment rates (€ per hectare) for the different land regions under different payment systems modelled.

Table 1: best fit € per hectare payment rates for payment system models where moorland is restricted to 400m

	Land region			
Model	**Moor**	**SDA**	**DA**	**Lowland**
4 regions	27	178	255	272
3 regions (DA=low)	27	176	265	265
3 regions (DA=SDA)	14	204	204	280
3 regions (moor=SDA)	*125*	*125*	*292*	*296*
2 regions (moor & other)	3	221	221	221
2 regions (SDA/moor & DA/low)	*126*	*126*	*292*	*292*
2 regions (low & others)	*163*	*163*	*163*	*338*

Source: SPS claimants for 2012

In terms of minimising disruption to current claimants' payments the four region model is only slightly better than the three region model in which the DA and lowland are combined into one region. A four region system is administratively more complicated and risky and so as it only offered a marginal advantage in return the Welsh Government rejected it as an option in its consultation paper published in July 2013. There was very little support for a four region model in the subsequent consultation responses. When the consultation was published the Welsh Government slightly favoured a two region model with moorland in its own category and all other land regions grouped together. At that time the proposal was on the basis of a much larger moorland region, not restricted to land at 400 metres or higher. Earlier data modelling based on a larger moorland region had pinpointed different target funding rates as being optimum in terms of minimising disruption to current claimants' payments as shown in **Table 2**.

Table 2: best fit € per hectare payment rates for payment system models where moorland is as mapped as moorland vegetation in 1992 and is <u>not</u> restricted to 400m

	Land region			
Model	**Moor**	**SDA**	**DA**	**Lowland**
4 regions	49	215	245	265
3 regions (DA=low)	49	215	255	255
3 regions (DA=SDA)	49	225	225	270
2 regions (moor & other)	49	237	237	237

Source: SPS claimants for 2010

Table 1 shows that the moorland funding rate is lower for all the options, other than those that merge moorland with another land region, than modelled using earlier data shown in **Table 2**. The data modelling work was initially done using 2010 claim data but latterly the Welsh Government was able to use more up to date data from 2012. What is apparent on comparison of the models is that there are considerable differences between the best funding rates (ie best in terms of causing the minimum disruption to current claimants' payments) when the models are run using different years' data. One reason for this is that claimants' claims vary from year to year. The other reason was the decision to restrict and reduce the moorland region to a small body of land (the original proposal consulted on in July 2013 was 287,000 ha of moorland, the moorland region restricted by altitude is 157,000 ha of claimed land).

It has already been explained why the Welsh Government decided that the payment system must include a moorland region. The decision to restrict the moorland region to only land at 400 metres or higher, supporting moorland vegetation, was taken in response to considerable feedback from farmers and their representative bodies that the original moorland proposal included too much improved land. The knock-on effect of restricting the moorland region is that the land removed from it must be added to another region. With the exception of 1,000 ha this was the SDA which increased considerably to be 46% of all the claimed farmland in Wales. The outcome of this increase in a relatively better funded land region was that the money available for payments shifts, with a greater proportion also going to the SDA and a fall in the money available for the moorland region.

Having decided to restrict the moorland region to a much small area of land the Welsh Government's previous preference for a two region model of moorland and all other land types combined together no longer made sense because in effect it would not have been very different from a flat rate model with the disadvantages of that model and it would also have resulted in a very low moorland funding rate (as shown in **Table 1**). A model in which DA and SDA are combined would also have meant a low moorland funding rate and is more disruptive in terms of the effect on current claimants' payments. This meant that the best option was a three region model comprising moorland, SDA and DA/lowland combined.

Table 1 shows the optimum payment rates, in terms of minimising disruption to current claimants' payments, but it does not show that there is very little difference between these and a wider range of possible payment rates shown in **Table 3**. The stand-out point from **Table 3** is that any one of a range of similar payment rates would be possible for the different models and result in similar levels of disruption to current claimants' payments – there is no ideal set of payment rates.

Table 3: payment rate ranges (€ per hectare) for the 'top 30' options that cause the least disruption to current claimants' payments.

Model	Moorland	SDA	DA	Lowland
4 region	24-31	176-180	251-258	269-277
3 region (DA=low)	20-35	172-180	260-268	260-268
2 region (moor, others)	0-28	218-222	218-222	218-222

Source: SPS claimants for 2012.

Critically **Tables 1&3** show that the SDA rate in the three region model would be less than an all Wales flat rate of €196 a hectare. In view of the SDA being 46% of the claimed farmland in Wales it is very important for many farms. The Welsh Government is of the view that the SDA payment rate should not be less than the notional flat rate. Reworking the data to peg the SDA rate was done and this led to the published indicative funding rates of moorland €20 per ha, SDA €200 per ha, DA/lowland €240 per ha. These are the optimum payment rates for moorland and DA/lowland (in terms of minimising disruption to current claimants' payments) when the SDA rate is pegged.

Modelling data from different claim years shows that the optimum payment rates differ depending on the claim year data used to do the data modelling. The first claims under the reformed payment system will not be made until 2015. It is not possible to know who will claim and what they will claim and the situation is complicated further by the creation of a reserve, the introduction of the active farmer test of eligibility to claim, and the mandatory top-up payments for qualifying young farmers. In view of all these factors the payment rates published so far can only be indicative and in reality are likely to be different when the new system is introduced. It is also the case that the payment rates modelled are for when the new system is completely in place in 2019. In the period 2015-19 there will be a transition with all claimants migrating from an initial payment value per hectare to the target rates. To take account of this complexity and degree of known but unknown factors the Welsh Government decided to express the payments to the different regions by ratio instead, in the order of 1:10:12, because it is clear that any payment rate declared now might in reality be different on receipt of the 2015 claims and application of the new payment system. The ratio is based on the policy decision that the payment rates should peg the SDA to be at least the same as a flat rate payment and that the payment rate for DA/lowland should be appreciably higher than SDA to recognise the greater agricultural potential of that region. Moorland has considerably lower agricultural potential than the SDA and DA/lowland and so is set much lower.