



Moving away from Direct Payments

Agriculture Bill: Analysis of the impacts of removing Direct Payments

September 2018



Department
for Environment
Food & Rural Affairs



Government
Statistical Service

Contents

[Summary](#) pages 4-9 provide an overview of all the evidence in this document, with statements linked to detailed pages, indicated by an accompanying page number. The analysis is based around the following 5 questions:

What are Direct Payments and why do we want to remove them?	How much do Direct Payments contribute to farm revenue and profit?	What are the potential impacts of removing Direct Payments without a transition?	How can farms offset the removal of Direct Payments during the transition period?	What are the options for moving away from Direct Payments?
Section 1 Pages 10-16	Section 2 Pages 17-22	Section 3 Pages 23-29	Section 4 Pages 30-40	Section 5 Pages 41-45

Data sources and photo credits for each page can be found on pages [46-47](#).

Some photographs may be subject to copyright and you will need to obtain permission from the copyright holders concerned.

Agricultural Policy is devolved. The Agriculture Bill will be England focused, with common UK frameworks only being sought where needed, to make sure we can meet our trade and international obligations. As the evidence is England focused, all figures quoted in relation to farm profit are for England only.

The research and analysis in this evidence pack is taken from a variety of disciplines – scientific research, statistics, economics, social research or operational research, and geographical information. For more information on Defra's evidence strategy please visit:

<https://www.gov.uk/government/organisations/department-for-environment-food-rural-affairs/about/research>

For any enquiries please contact: farming-statistics@defra.gsi.gov.uk

Please note that due to rounding, the summation throughout the compendium may not appear correct.

Why is the Government moving away from Direct Payments?

Evidence suggests that Direct Payments are a poor tool for income support and can introduce distortionary incentives that inhibit productivity.

Reform of Direct Payments policy through a new agriculture and land management policy framework provides the opportunity to move towards a farming sector that provides high-quality food while enhancing our environment.

How will the Agriculture Bill affect Direct Payments?

The Agriculture Bill will give the government the power to transform agricultural policy and reform Direct Payments.

Direct Payments in England will be gradually phased out from 2021, and farms will be supported over a seven year transition period, giving them time to adjust. All farms will see some reduction to their payments from the start of the transition, although those who receive the highest payments will see bigger reductions initially. This will free up funds to invest in public goods.



What are Direct Payments and why do we want to remove them?

What are Direct Payments and how much do farm businesses currently receive?

Direct Payments are paid to farm businesses based on the amount of agricultural land they maintain. In England in 2016, £1.65bn of payments were made across 85,000 farms and 10% of claimants received half of this total. 33% of farms received less than £5,000 each.

11

Why are Direct Payments not an effective means of income support?

From 2012/13 to 2014/15, farm households with incomes over £45,000 received an average Direct Payment of £24,400, 37% higher than the average subsidy paid to farm households with household incomes of £15,000 or less, who received an average Direct Payment of £17,800.

14

What is the history of Direct Payments?

The Common Agricultural Policy (CAP) was established in 1957 and decoupled Direct Payments were introduced in 2005 as part of ongoing reforms to make support under the CAP less distorting.

12

How have Direct Payments impacted farm rents?

There is evidence that Direct Payments inflate farm rents, meaning some of the payment supports the income of the landowner, not the tenant farm. 37% of farmed area in England is rented, and for those that rent all or part of their farm, any fall in rent would help to offset reduction of subsidy.

15

What is the rationale for removing Direct Payments?

Evidence suggests that Direct Payments offer poor value for money and introduce distortionary incentives, which inhibit the development of a productive and competitive agricultural sector that delivers optimal environmental outcomes.

13

How can Direct Payments undermine farm efficiency and productivity growth?

Direct Payments can hinder productivity growth by undermining incentives to adopt best practice and by encouraging suboptimal investments that impact profitability.

16

How much do Direct Payments contribute to farm revenue and profit?

How does the contribution of Direct Payments to revenue vary by sector?

On average, over the period 2014/15 - 2016/17, Direct Payments made up 9% of revenue across all farm types. Direct Payments were a greater factor in revenue for some sectors, such as Less Favoured Area Grazing Livestock farms, where they made up an average of 21% of total revenue.

[18](#)

How does the contribution of Direct Payments to profit vary by tenancy/land ownership status?

Over the period 2014/15 to 2016/17 Direct Payments were equivalent to 83% of Farm Business Income for tenanted farms, more than all other land ownership groups.

[21](#)

How is Farm Business Income calculated and what was the average for all farms in England in 2014/15-2016/17?

Farm Business Income (FBI) is a measure of net profit, calculated as Farm Business Outputs (revenue) minus Farm Business Inputs (costs). Between 2014/15 to 2016/17 the average profit for all farms was £37,000.

[19](#)

How does the contribution of Direct Payments to profit vary by region?

Direct Payments were equivalent to 98% of Farm Business Income in the North East over the period 2014/15 to 2016/17, the highest of any region. This is due to farm characteristics, such as a high prevalence of Grazing Livestock and tenant farms, rather than the location itself.

[22](#)

How does the contribution Direct Payments make to farm profit vary depending on farm type?

Across all farm types, over the period 2014/15 to 2016/17, Direct Payments were equivalent to 61% of Farm Business Income (profit), but this varies greatly by sector, being most significant for Grazing Livestock and Mixed farms.

[20](#)

What are the potential impacts of removing Direct Payments without a transition?

What may be the impact of removing Direct Payments immediately?

Over the period 2014/15 to 2016/17, 16% of farms had costs exceeding their revenue including Direct Payments, and without them this rises to 42%. However, costs include the depreciation of assets which in the short term do not need to be paid out. Excluding both Direct Payments and depreciation, only 19% of farms would not have been able to cover production costs.

24

How much would loss making farms need to reduce costs by in order to break even without Direct Payments?

On average, farms who would have made a loss without Direct Payments in their accounts had £90 in outputs for every £100 they spent on inputs. In order for them to break even without Direct Payments they would need to reduce their costs by 10% to £90 to match their output, or increase output as well as reducing costs.

25

How profitable are farms without Direct Payments?

Grouping the bottom 10% of farms who would have made the greatest losses, they received £69 for every £100 they spent on inputs over the period 2014/15 to 2016/17. To break even they need to reduce costs by 31% to £69, or increase output as well as reducing costs.

26

How much would different farm types need to reduce costs by in order to break even without Direct Payments?

Loss making Less Favoured Area Grazing Livestock farms have the biggest challenge in reducing costs to break even. Half of these farms require cost reductions of less than 16% and half require cost reductions of more than 16%, based on the period 2014/15 to 2016/17.

27

What factors need to be taken into account to decide the length of a transition period?

Without Direct Payments, the 10% of farms making the biggest losses (losing on average £20 for every £100 of inputs) would need to reduce costs by 31%, on average, in order to break even (make £0 for every £100 of inputs). These farms may require a longer transition period to adjust than those that make smaller losses.

28

What do some farmers think about Direct Payments/ moving away from Direct Payments?

During farmer led discussion groups undertaken by Defra, many farmers told us they would prefer to farm without direct support, and that removal of Direct Payments is not a threat to business survival as long as issues affecting farm profitability are also addressed, and there is a clear transition period.

29

How can farm businesses offset the removal of Direct Payments during the transition period? (Part 1)

What routes are there for farm businesses to offset Direct Payments?

Removal of Direct Payments may be offset in a number of ways, including farm efficiency improvements (reducing inputs or improving outputs) and diversification, although this will vary by type and location of farm.

31

How does output relate to costs for the top 20% and bottom 20% of Lowland Grazing Livestock farms?

The bottom 20% of Lowland Grazing Livestock farms spent £764 per hectare for £673 of total output whilst the top 20% had slightly lower costs to produce £1161 of output, showing a large productivity difference.

34

Farms can become more profitable by reducing costs, but what are the costs of production for farms?

By reducing costs, less profitable farms can adjust to the removal of Direct Payments. Around half of costs to farms are variable, changing depending on the level of production, and the other half are fixed, of which machinery is the largest.

32

How can better investment improve profitability?

The majority (86%) of the most profitable farms (top 20%) made a positive return on their investment. Almost all farms in the bottom 20% made a loss on their investments. However, differences in what farms are investing in varies by sector and size, rather than by profitability.

35

How can better input management help to reduce variable costs?

Crop and livestock inputs represent 84% of variable costs to farms. Costs can be reduced by practices such as improving feed efficiency, selective breeding of animals and/or following a detailed crop nutrient management plan developed with a qualified advisor.

33

How can farms maximise their outputs?

Farms can maximise their outputs by responding to the market. Knowing processor safety requirements and quality specifications can reduce wastage and increase prices achieved.

36

How can farm businesses offset the removal of Direct Payments during the transition period? (Part 2)

How might improved animal and plant health help to safeguard/maximise outputs?

Poor animal and plant health reduces productivity, however 25% of livestock farms do not have an animal health plan, and crop breeding for sustainability and resilience are not well incentivised.

37

How might Environmental Land Management systems help to offset the removal of Direct Payments?

Under a new Environmental Land Management system, farms may be able to consider using some of their agricultural land, particularly less productive land, to deliver environmental benefits.

39

How can diversification help to increase farm income?

In 2014/15 to 2016/17, half of farms (55%) in the bottom 10% by profitability undertook a diversified activity, compared with three quarters (73%) in the top 10%. Of those farms who had a diversified activity, the bottom 10% made, on average, £26/ha, compared with £161/ha for farms in the top 10%.

38

How do farm business management practices vary between the top and bottom performing farms?

To maximise farm inputs and outputs, it is important to undertake management practices. In 2016/17, only 1/3 farms undertook practices such as producing budgets, gross margins, cash flows or in depth profit and loss accounts. The top 25% of farms were 2.5 times more likely to engage in such management practices compared to the bottom 25%.

40

What are the options for moving away from Direct Payments?

What options are there to transition away from Direct Payments in England?

The Future for Food, Farming and the Environment consultation set out two proposals for applying reductions to Direct Payments during a transition period: progressive reductions and capping. A flat rate reduction for all farm businesses was also identified as an option by respondents.

42

What might the average reduction per business be in year 1 under a progressive reduction with no threshold?

A progressive reduction may apply up to a 5% reduction for the smallest subsidy, rising incrementally by payment band to up to 25%. For example, for a claim worth between £30,000-£40,000, if a 5% reduction was applied to the first £30,000, and a 10% reduction applied to the next £10,000, the subsidy would be reduced by an average of £2,000 in year 1.

44

What are the advantages and disadvantages of the different options for moving away from Direct Payments?

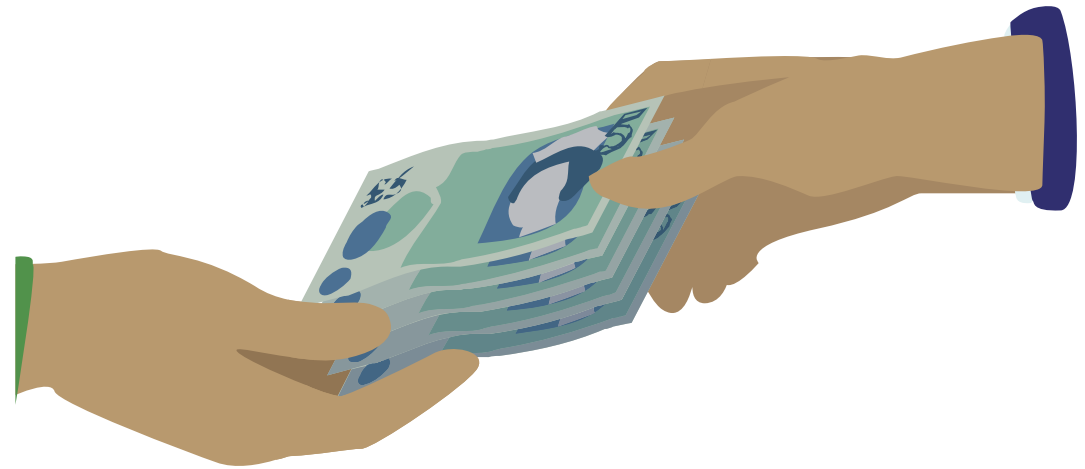
A progressive reduction starting for all farms in year 1 offers the greatest advantages for transitioning away from Direct Payments. This option signals change to all farms in the early years and does not concentrate reductions on a small number of farms.

43

What are the reasons for delinking Direct Payments from the land?

Delinking offers the opportunity to provide a clear signal that Direct Payments will cease, and may encourage more rapid structural change, while at the same time simplifying the payment process for recipients.

45



Section 1

What are Direct Payments and why do we want to remove them?

(pages 10-16)

What are Direct Payments and how much do farm businesses currently receive?

Direct Payments are paid to farm businesses based on the amount of agricultural land they maintain. In England in 2016, £1.65bn of payments were made across 85,000 farms and 10% of claimants received half of this total. 33% of farms received less than £5,000 each.

Under the EU's Common Agricultural Policy, it is often argued that Direct Payments are primarily justified as 'income support'. They are part of a policy framework where the stated goals are to: improve agricultural productivity; tackle climate change and manage resources sustainably; preserve rural areas and landscapes, and boost the rural economy. However, there is evidence to suggest these goals are not being achieved.

How are Direct Payments made up?

The **Basic Payment** is based on land area. Certain animal and public health, welfare and environmental standards must be met (known as Cross Compliance).

The **Greening Payment** (30% of total budget) is conditional on meeting certain broad requirements. Greening was meant to enhance the environmental performance of the Common Agricultural Policy (CAP), but a report from the European Court of Auditors concluded that the mechanism - as currently implemented - is unlikely to significantly enhance the CAP's environmental and climate performance.

Farmers aged under 40 can also claim a **Young Farmer** payment, although this makes up a very small portion of total payments.

How much do Direct Payments cost?

£1.65bn

total payments
in England, 2016

£70m

Administrative cost
per year in England

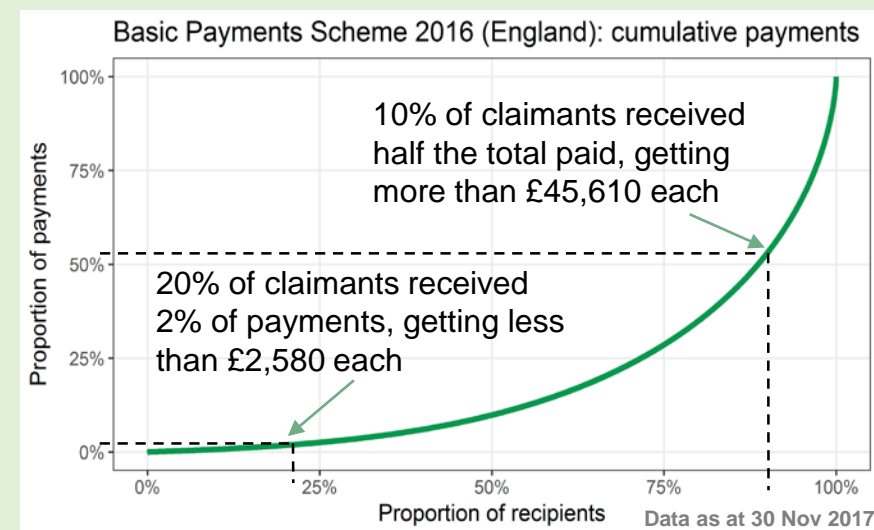
£8,939

Median Payment in 2016
(half of recipients had less
and half had more)

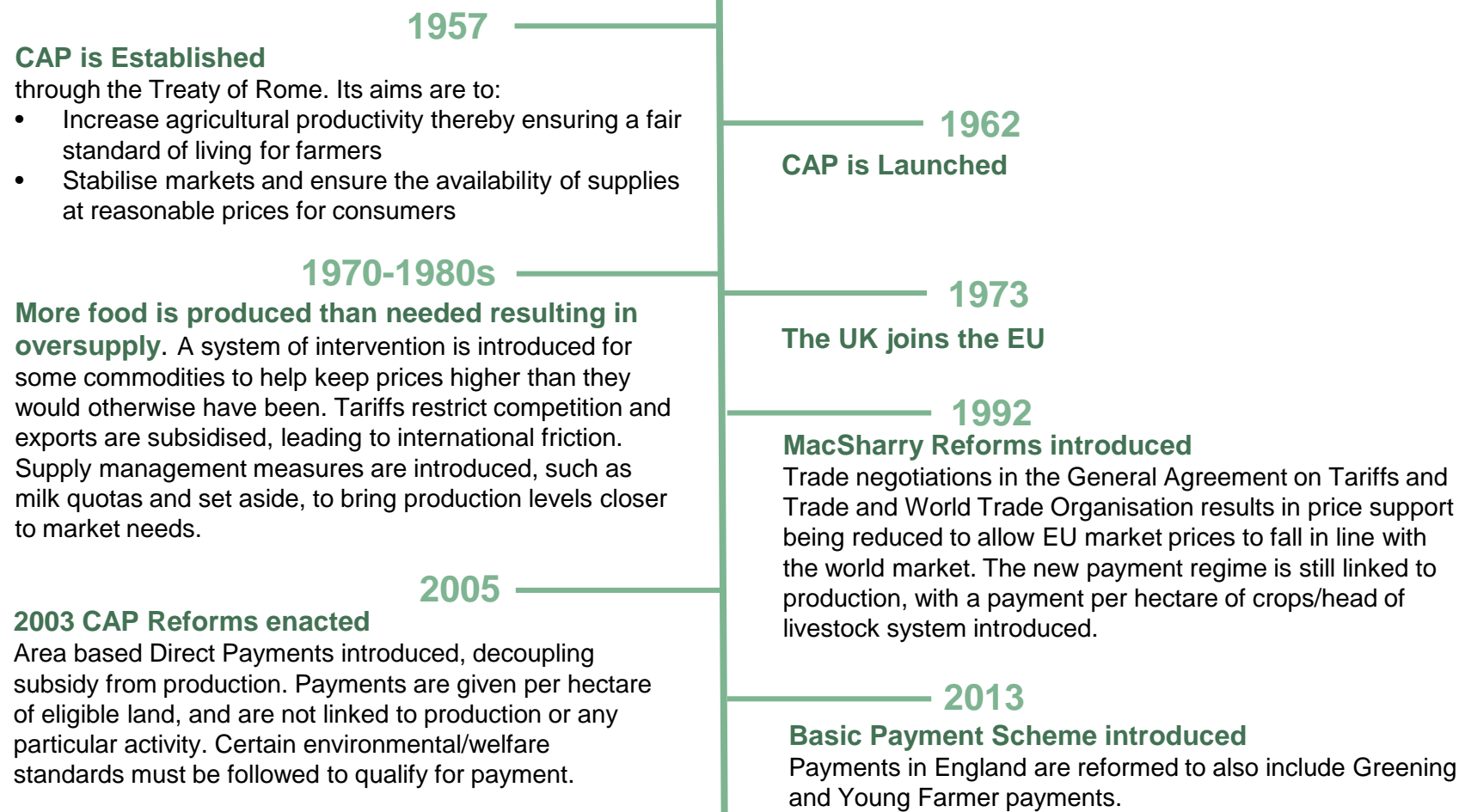
How are Direct Payments allocated?

Farms must farm at least 5 hectares of land to qualify for Direct Payments, meaning many small farms are not eligible.

Recipients of the largest amounts are typically farms with large land areas. Of the total payments under the CAP, almost 50% is given to 10% of farms, while the bottom 20% of recipients receive just 2% of the total payments.



The Common Agricultural Policy (CAP) was established in 1957 and decoupled Direct Payments were introduced in 2005 as part of ongoing reforms to make support under the CAP less distorting.



What is the rationale for removing Direct Payments?

Evidence suggests that Direct Payments offer poor value for money and introduce distortionary incentives, which inhibit the development of a productive and competitive agricultural sector that delivers optimal environmental outcomes.

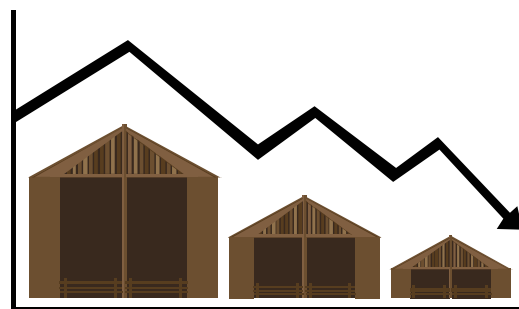
Untargeted Income Support

Direct Payments provide income support, but lack a system of means testing. Instead, the amount received is largely dependent on the land area of the farm, providing support to many high income households.



Undermine efficiency and productivity growth

Direct Payments can dampen the focus of some farm businesses to seek out and adopt best practice to optimise performance. Direct Payments can also hold back structural change and exert upward pressure on land prices and rents.



Fail to deliver optimal environmental outcomes

Around 30% of the Direct Payment depends on Greening, however a report into Greening from the European Court of Auditors concluded that the mechanism was unlikely to significantly enhance environmental and climate performance.



Why are Direct Payments not an effective means of income support?

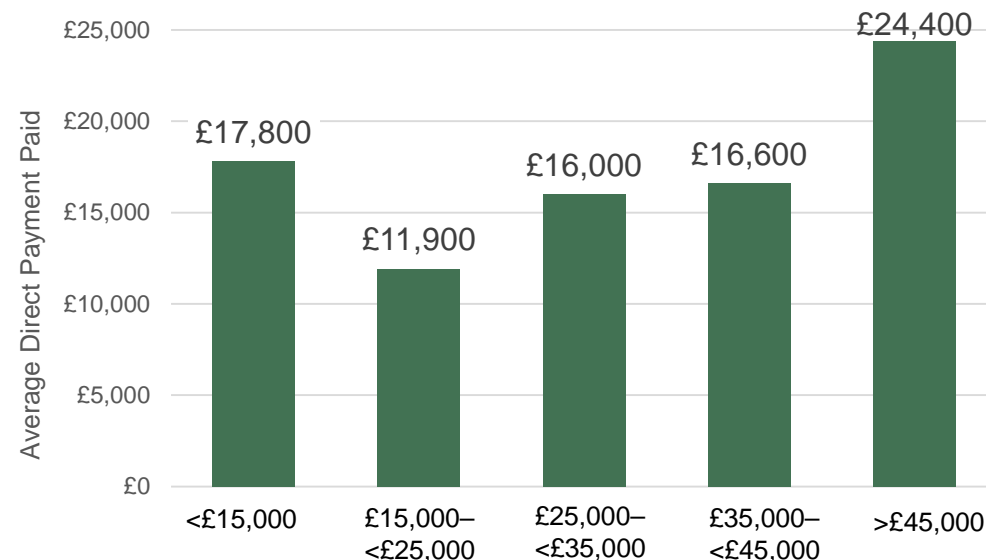
From 2012/13 to 2014/15, farm households with incomes over £45,000 received an average Direct Payment of £24,400, 37% higher than the average subsidy paid to farm households with household incomes of £15,000 or less, who received an average Direct Payment of £17,800.

Some low income farm households are supported by the current system

From 2012/13 to 2014/15, those with a collective farm household income of less than £15,000 had an average income of -£1,200 without Direct Payments. The farm businesses associated with these households received an average Direct Payment of £17,800, pushing their average household income up to £16,600.

However, many of the lowest income farm households are also among the least profitable farms. Improvements in the farm business may therefore improve household income.

Average Direct Payment received by household income band (excluding Direct Payments), 2012/13 to 2014/15



Direct Payments lack any system of means testing/targeting

Direct Payments are paid to farms based on the amount of agricultural land they maintain and are not targeted in any way. Farm households with incomes over £45,000 received an average Direct Payment of £24,400, 37% higher than the average subsidy paid to farm households with household incomes of £15,000 or less.

If an income support scheme is to improve equity, payments should go to farm households with an income lower than the average UK household income. However, a significant amount of Direct Payments go to households with incomes above average UK household incomes.

Means testing would also take into account wealth or assets, including ownership of property, when assessing eligibility. However Direct Payments do not take this into account. On average, between 2014/15-2016/17 the wealth of those who received Direct Payments was higher than that of the average GB household.

Median GB household wealth (net, June 2014-June 2016):

£0.26m

Farm business wealth (net, 2014/15-2016/17):

£1.73m

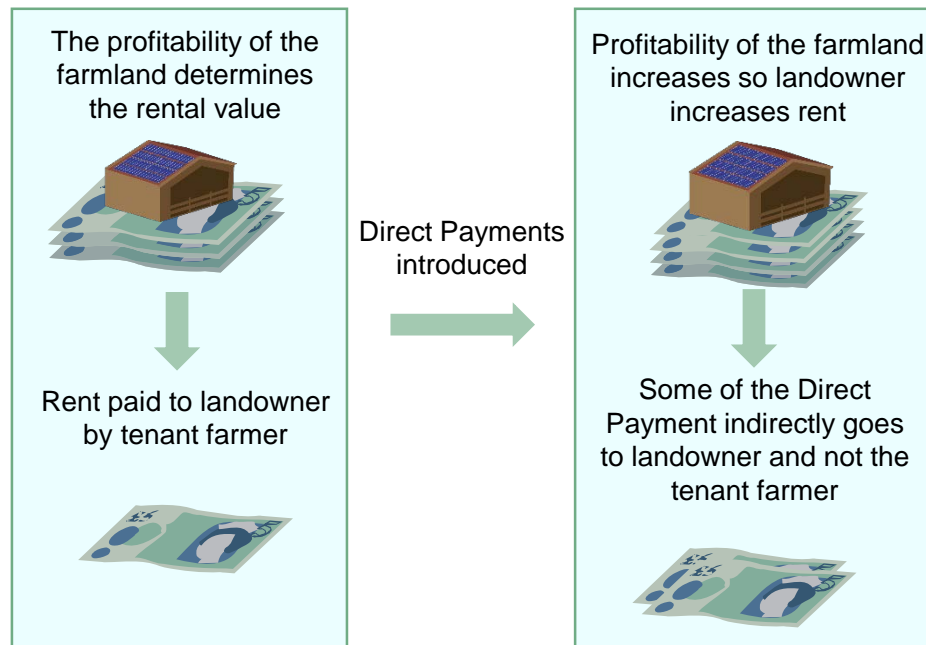
How have Direct Payments impacted farm rents?

There is evidence that Direct Payments inflate farm rents, meaning some of the payment supports the income of the landowner, not the tenant farm. 37% of farmed area in England is rented, and for those that rent all or part of their farm, any fall in rent would help to offset reduction of subsidy.

Direct Payments have led to rent inflation

The introduction of Direct Payments increased the amount of money a farm could obtain from using that land, therefore increasing the expected agricultural return.

As a result of this, landowners who wanted to rent their land rather than farm it themselves were able to increase farm rents due to the increased return it provided. This means that some of the Direct Payment is indirectly paid to the landowner through inflated rent prices, rather than to the farm business:

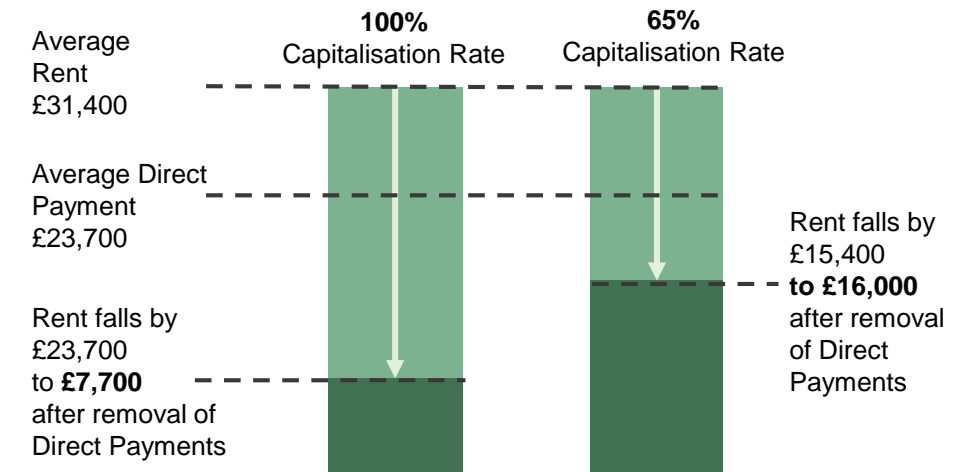


How might removing Direct Payments influence rent prices?

As Direct Payments have led to an increase in rents, their withdrawal will see the reversal of this impact. The capitalisation rate is how much each pound of subsidy inflates farm rents. Estimates of the capitalisation rate range widely and will vary depending on farm type and region, and so the extent to which rents have increased in relation to the subsidy will vary from farm to farm.

For illustrative purposes, the chart below uses the average Direct Payment and rent payments of wholly tenant farms, between 2014/15 to 2016/17, to show how much rents may be reduced for capitalisation rates of 100% and 65%, using the following formula:

$$\text{Rent reduction after removal of Direct Payments} = \frac{\text{Capitalisation Rate} \times \text{Direct Payment}}{100}$$



How can Direct Payments undermine farm efficiency and productivity growth?

Direct Payments can hinder productivity growth by undermining incentives to adopt best practice and by encouraging suboptimal investments that impact profitability.

Direct Payments can provide an incentive for the lowest performing farms to continue

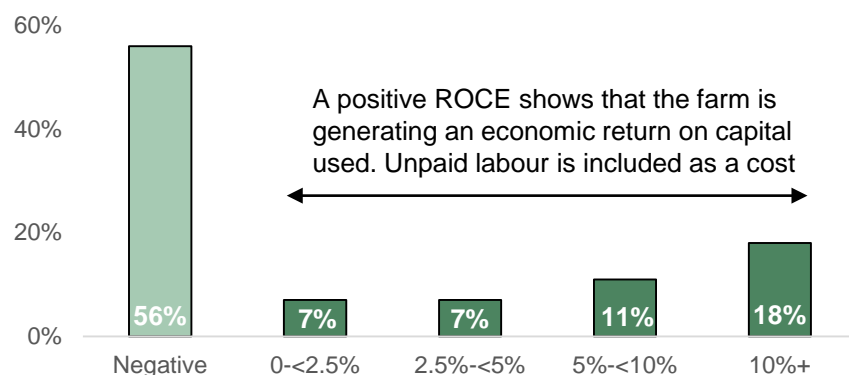
Across all farms types in England in 2016/17, the average economic performance of the top 25% of farms was 1.8 times better than the bottom 25%. The largest gap was among Horticulture and Grazing Livestock farms, and smallest within Poultry and Dairy. This suggests there is scope for improvement among the lowest performing farms, but with Direct Payments providing a guaranteed income it can reduce the need to focus on being more profitable.

Direct Payments may encourage sub-optimal investment

Direct Payments increase farm cash-flow, giving a farms greater opportunity to invest in items such as machinery.

In 2016/17, after excluding land value, more than half of farms (56%) in England did not make a financial gain from their capital assets. This suggests that Direct Payments could be one factor facilitating over-investment, which may not be improving farms' returns on capital.

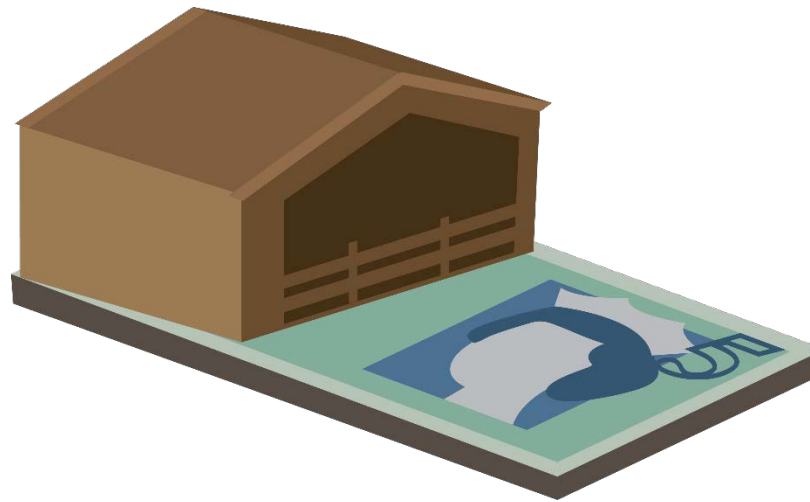
% of farms and their Return On Capital Employed (ROCE) excluding the value of land, 2016/17 in England



More farmers agreed they are farming for way of life rather than to maximise profits

Approaches to farming vary – some focus on the business, others on the lifestyle (individual and family heritage). In a survey conducted for Defra (in 2008) to understand different attitudes to farming, 93% agreed that the farming lifestyle is what they really enjoy, compared to 79% saying farming is about maximising profit.

Data from 2016/17 suggests that only 1 in 3 farms regularly produce budgets, gross margins and cash flows or carry out in depth analysis of their profits and losses. If farmers do not monitor and analyse costs, yields and revenues from different parts of their business, it makes it more difficult to know which aspects of the business are profitable.



Section 2

How much do Direct Payments contribute to farm revenue and profits?

(pages 17-22)

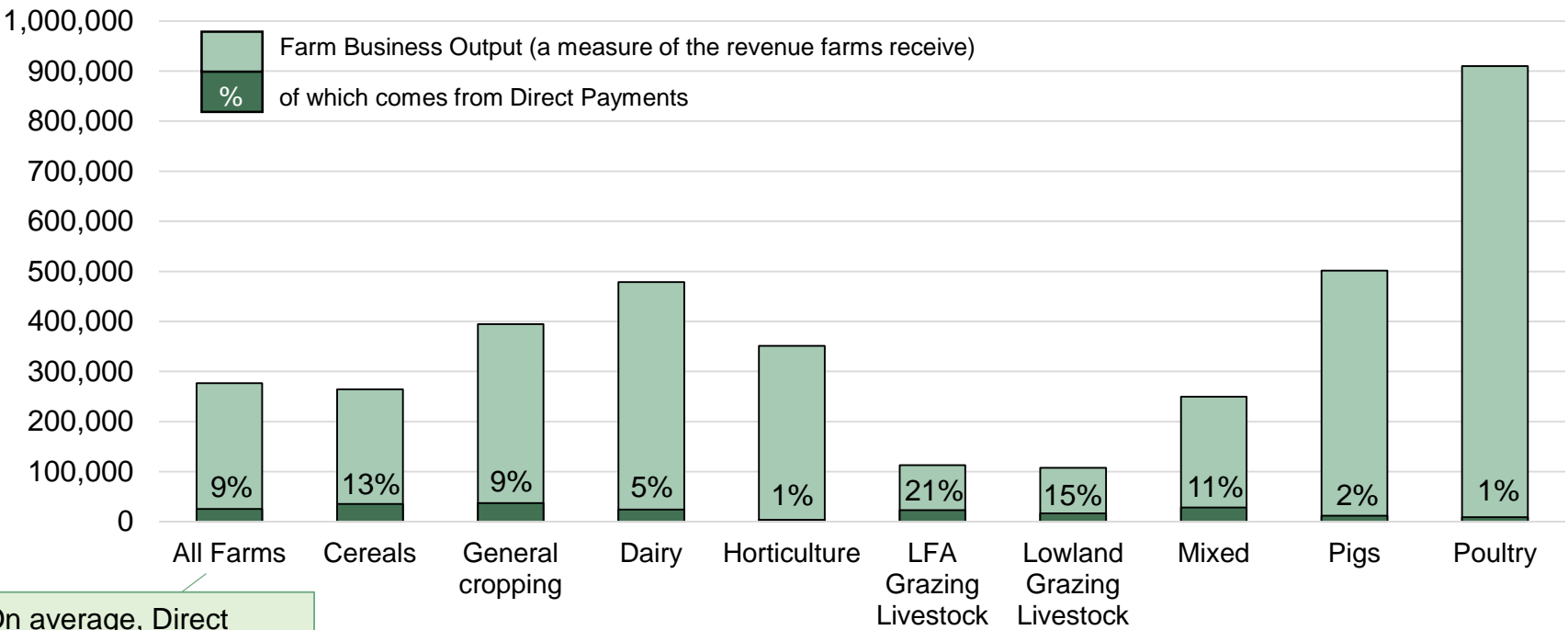
How does the contribution of Direct Payments to revenue vary by sector?

On average, over the period 2014/15 - 2016/17, Direct Payments made up 9% of revenue across all farm types. Direct Payments were a greater factor in revenue for some sectors, such as Less Favoured Area Grazing Livestock farms, where they made up an average of 21% of total revenue.

Revenue (Farm Business Output) is the total sales generated by a farm business.

The importance of Direct Payments varies across sectors: Direct Payments made up the largest proportion of revenue for Less Favoured Area Grazing Livestock farms (21%) and Lowland Grazing Livestock farms (15%), Cereals (13%) and Mixed Farms (11%).

Average Farm Business Output and the proportion that comes from Direct Payments by 2016 farm type (based on 3 year matched dataset 2014/15 to 2016/17)



On average, Direct Payments made up **9% of revenue across all farm types.**

For Poultry, Horticulture and Pig farms, only a very small proportion of revenue comes from Direct Payments. Fewer of these farms claim Direct Payments than other farm types as they tend to be smaller, and are more likely to have land that is ineligible for Direct Payments.

How is Farm Business Income calculated and what was the average for all farms in England in 2014/15-2016/17?

Farm Business Income (FBI) is a measure of net profit, calculated as Farm Business Outputs (revenue) minus Farm Business Inputs (costs). Between 2014/15 to 2016/17 the average profit for all farms was £37,000.

Farm Business Income = Farm Business Outputs - Farm Business Inputs

Output values include the total value of crops produced, livestock enterprise output, by-products, forage and cultivations, and miscellaneous output.

Inputs are resources used in the production process, such as feed, materials, labour and machinery, measured in physical or financial terms.

Average inputs and outputs for all farms from 2014/15 – 2016/17

Agriculture (£227,500)

Main measure of the value of crop and livestock outputs.

Diversification (£17,800) Non-agricultural work of an entrepreneurial nature, on or off farm, but utilising farm resources.

Agri-environment (£6,600) Payments to deliver environmental outcomes, compensating for income foregone in providing them.

Output value

Agricultural Output
£228k

Input costs

Total variable costs
£122k

Total fixed costs
£119k

Direct Payments (£25,200)

Direct Payments contribute, on average, £25,200 to the revenue of the farm, but also have costs (£2,500) associated with them, such as the application process and cross compliance. This means that the average net income from Direct Payments was around £22,700.

Costs (£141,000) Around half of costs to farms are variable, changing depending on the level of production, and the other half are fixed, of which machinery is the largest.

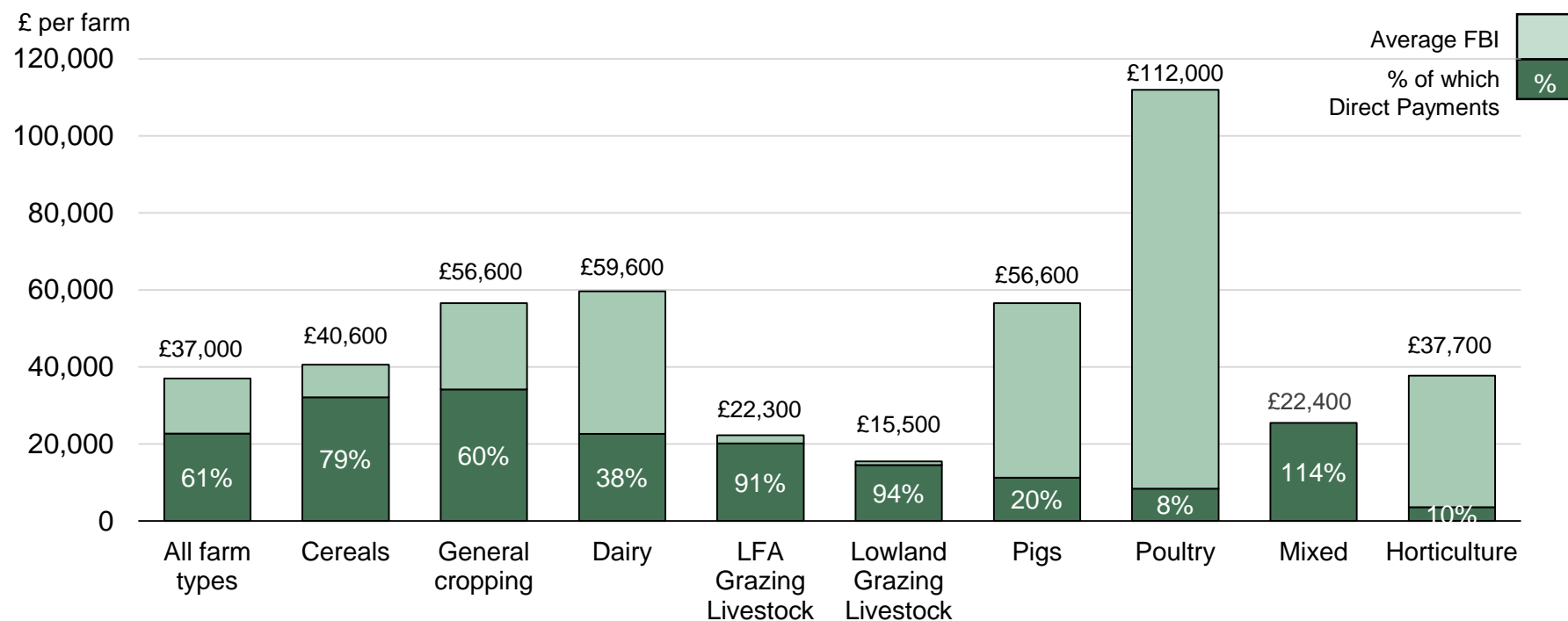
Farm Business Income (£37,000)

The amount that a farm business has left after costs to invest, pay taxes and pay salaries.

How does the contribution Direct Payments make to farm profit vary depending on farm type?

Across all farm types, over the period 2014/15 to 2016/17, Direct Payments were equivalent to 61% of Farm Business Income (profit), but this varies greatly by sector, being most significant for Grazing Livestock and Mixed farms.

Direct Payments as a proportion of the Average Farm Business Income (FBI) by 2016 farm type, based on 3 year matched dataset 2014/15 to 2016/17



For Grazing Livestock farms, Direct Payments received were equivalent to almost all of their average Farm Business Income.

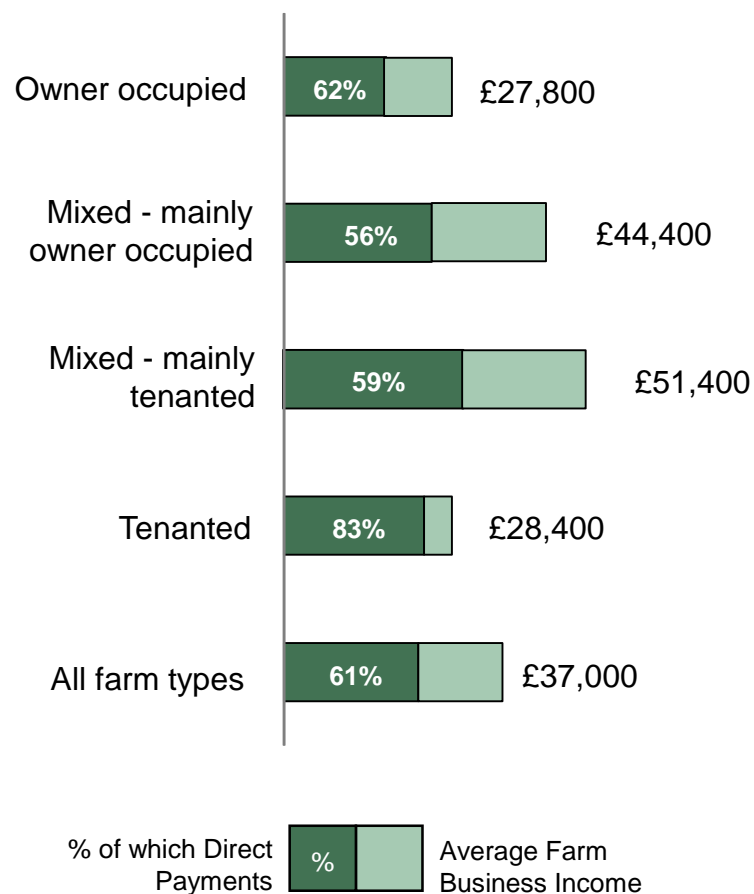
For Mixed farms the amount received from Direct Payments was greater than their Farm Business Income.

Fewer Pig, Poultry and Horticulture farms claim Direct Payments than other farm types. These farms tend to be smaller, and are more likely to have land that is ineligible for Direct Payments.

How does the contribution of Direct Payments to profit vary by tenancy/land ownership status?

Over the period 2014/15 to 2016/17 Direct Payments were equivalent to 83% of Farm Business Income for tenanted farms, more than all other land ownership groups.

Average Farm Business Income (FBI) and the proportion that comes from Direct Payments by tenancy type, based on 3 year matched dataset 2014/15 to 2016/17



In 2016...

37%

of farmed area in England was rented.

13%

of farm holdings were wholly tenanted in England (14,100 farms), accounting for 15% of farmed area (1.4million ha).

33%

of farms were mixed tenure (partly owned and partly tenanted). These accounted for 50% of farmed area (4.6million ha).

£219

average rent for Farm Business Tenancy (FBT) agreements per hectare.

£181

average rent for Full Agricultural Tenancy (FAT) agreements per hectare.

FAT, or 1986 Act tenancies, were agreed before 1 September 1995. Generally, these tenancies have lifetime security of tenure.

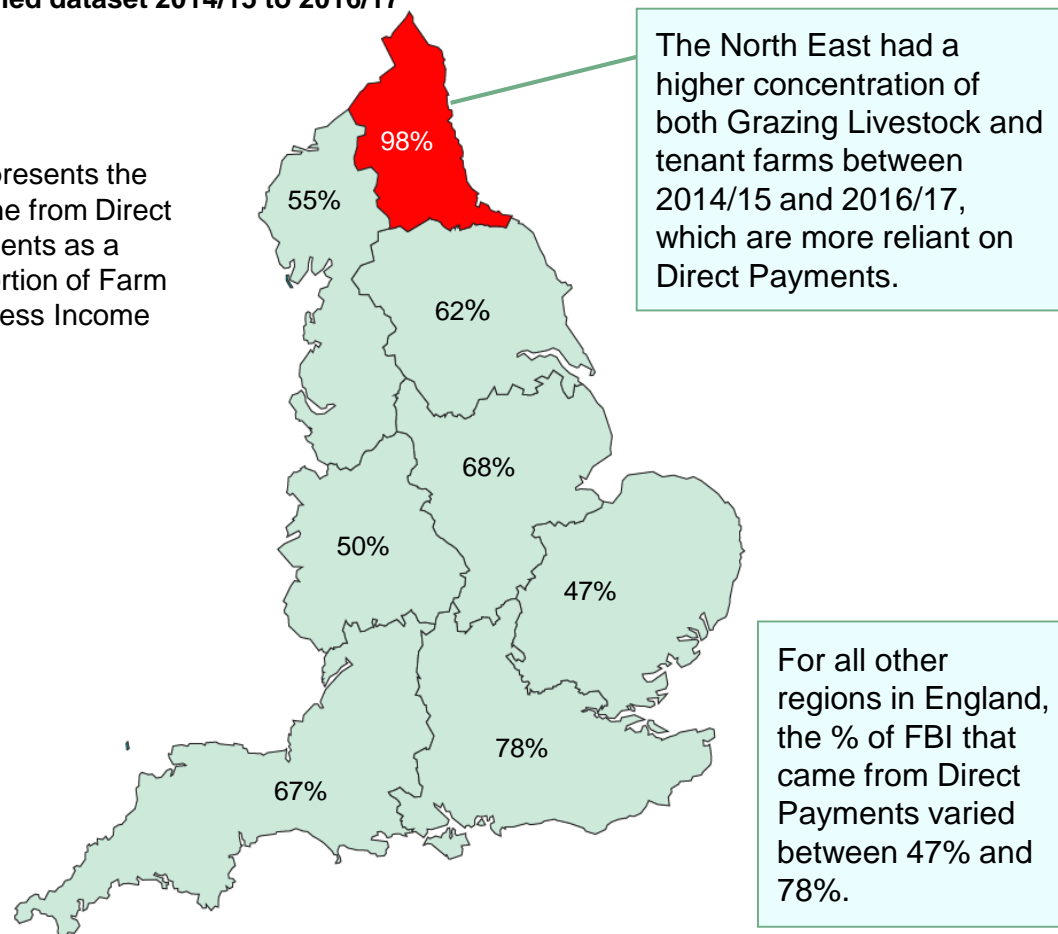
FBTs are those agreed since 1 September 1995 under the Agricultural Tenancies Act 1995. These can be formal and informal.

How does the contribution of Direct Payments to profit vary by region?

Direct Payments were equivalent to 98% of Farm Business Income in the North East over the period 2014/15 to 2016/17, the highest of any region. This is due to farm characteristics, such as a high prevalence of Grazing Livestock and tenant farms, rather than the location itself.

Proportion of Farm Business Income (FBI) that comes from Direct Payments, based on 3 year matched dataset 2014/15 to 2016/17

% represents the income from Direct Payments as a proportion of Farm Business Income



Certain farm characteristics can determine reliance on Direct Payments

Over the period 2014/15 to 2016/17, farms in the North East had Direct Payments equivalent to 98% of Farm Business Income, the highest of any region in England.

However analysis of farm characteristics showed that region was not a statistically significant factor when assessing the reliance on Direct Payments, but tenant farms and Grazing Livestock were found to be more reliant. The North East has a high proportion of Grazing Livestock and tenant farms and it is these characteristics that explain the higher reliance, not the location itself.



Section 3

What are the potential impacts of removing Direct Payments without a transition?

(pages 23-29)

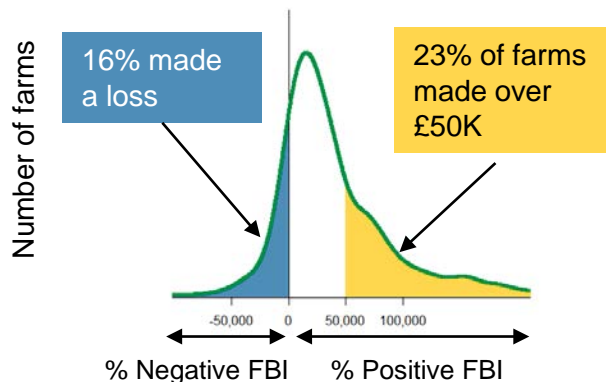
What may be the impact of removing Direct Payments immediately?

Over the period 2014/15 to 2016/17, 16% of farms had costs exceeding their revenue including Direct Payments, and without them this rises to 42%. However, costs include the depreciation of assets which in the short term do not need to be paid out. Excluding both Direct Payments and depreciation, only 19% of farms would not have been able to cover production costs.

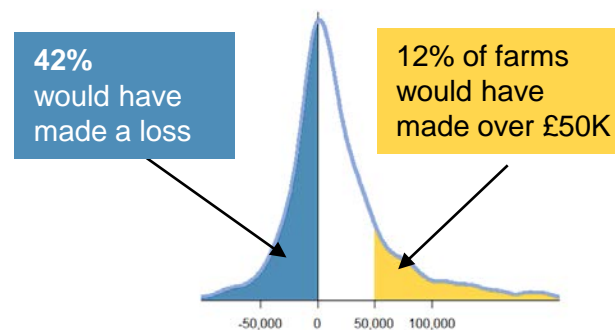
Distribution of all farms by Farm Business Income (FBI) (2014/15 to 2016/17)

The area under the curve represents the total number of farms and how they are distributed by FBI.

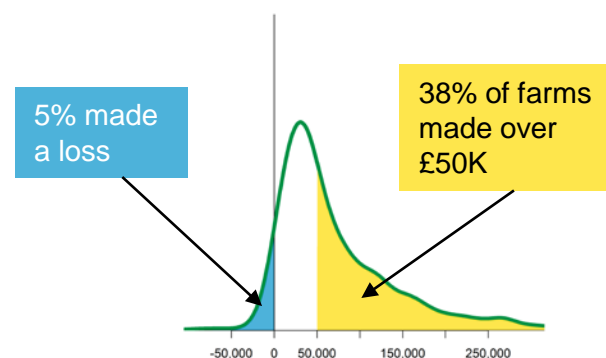
...with Direct Payments and depreciation



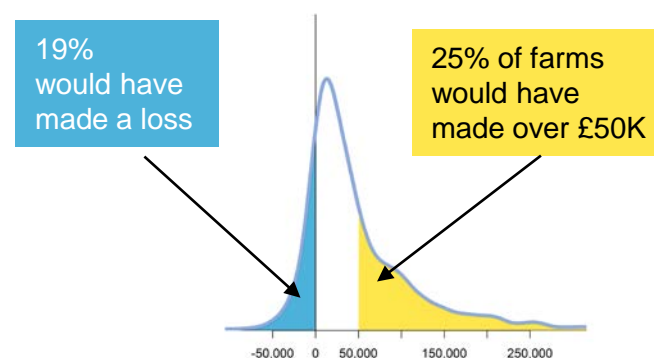
...without Direct Payments, with depreciation



...with Direct Payments, without depreciation



...without Direct Payments, without depreciation



Long term vs. short term impacts of removing Direct Payments

Depreciation is used to account for declines in value of a tangible asset, by allocating it a cost over its useful life. It does not alter the day to day cash flow of a business.

Therefore in the **short term**, when looking at the impact of instantly removing Direct Payments, depreciation costs can be excluded, and so only 19% of farms would not be able to cover their production costs.

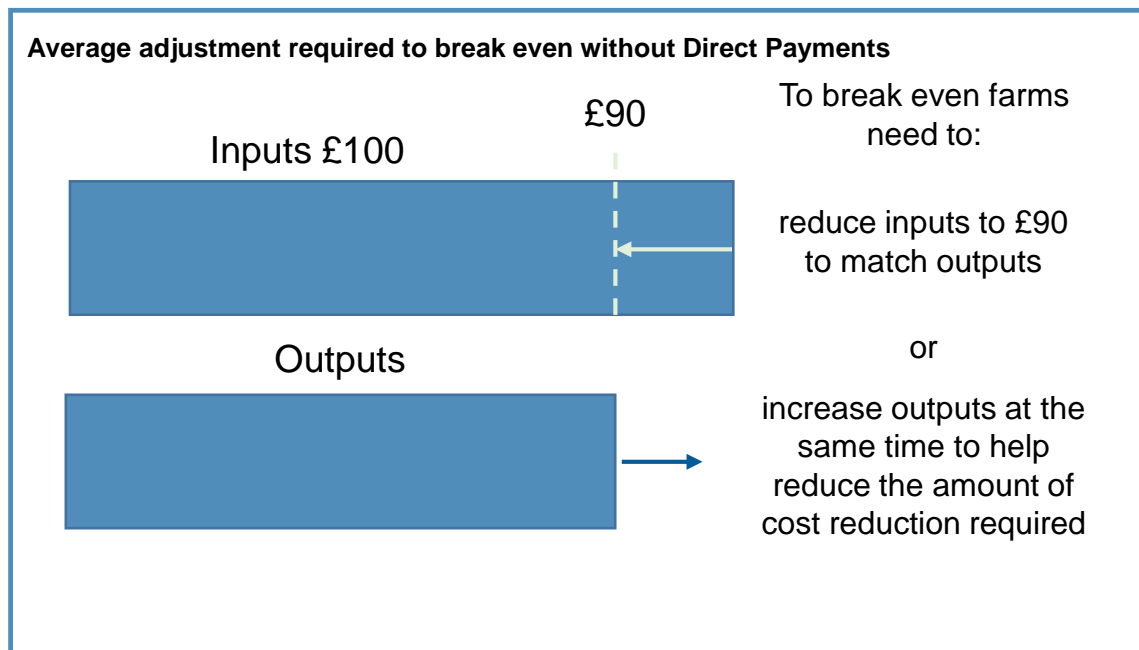
In the **long term** farm businesses need to consider their depreciation costs as they will need to replace and maintain machinery and buildings. Therefore on [page 25](#) we will consider the necessary adjustments for the 42% of farms that make a loss on their accounts without Direct Payments but with depreciation.

The total depreciation cost of assets for England was £3bn in 2016, greater than the amount farms paid out in wages, rent and interest on loans.

How much would loss making farms need to reduce costs by in order to break even without Direct Payments?

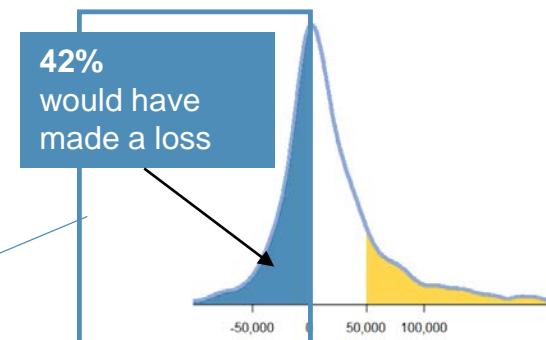
On average, farms who would have made a loss without Direct Payments in their accounts had £90 in outputs for every £100 they spent on inputs. In order for them to break even without Direct Payments they would need to reduce their costs by 10% to £90 to match their output, or increase output as well as reducing costs.

Improvements to break even based on cost reductions alone might be beyond some farms. Other routes to breaking even include maximising prices received for outputs, or undertaking a diversified activity (see [page 31](#)).



The average adjustment required to break even masks a wide range of adjustments needed. For the bottom 10% of farms by profitability, their average cost reduction would be three times larger than the overall average, requiring a 31% reduction in costs (see [page 26](#)).

Distribution of all farms by Farm Business Income (2014/15 to 2016/17) without Direct Payments, with depreciation



Volatility and Profitability

Of those farm businesses who made a loss on average over the period 2014/15 to 2016/17, when looking at individual years, not all farm businesses made losses every year.

In some cases, farms may have made a loss only in one year because they unexpectedly lost output, for example through disease. In these instances returning to average levels of output may see them return to profit rather than necessarily needing to reduce costs.

How profitable are farms without Direct Payments?

Grouping the bottom 10% of farms who would have made the greatest losses, they received £69 for every £100 they spent on inputs over the period 2014/15 to 2016/17. To break even they need to reduce costs by 31% to £69, or increase output as well as reducing costs.

Farm Profitability (profit for every £100 inputs)

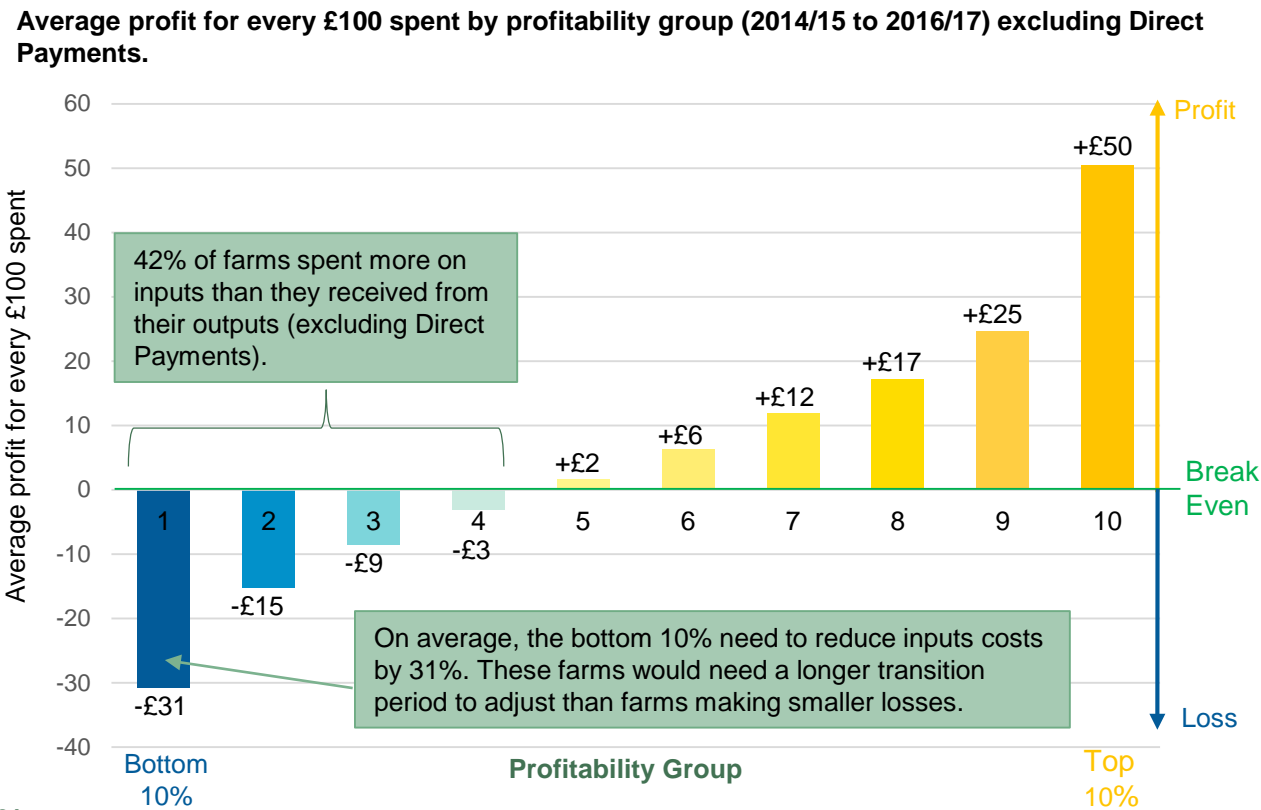
Profitability groups are defined by lining up farms in order of profitability from 1-100 (with 1st position being least profitable and 100th position being most profitable) and dividing these up into 10 groups, meaning that 10% of all farms fall within each group.

Farms with a greater profitability will produce more output for every £100 of input. Unlike farm performance, this measure does not include unpaid labour as a cost. On average across all farms, for every £100 spent, farms received £106 in outputs, making a profit of £6.

Most farms have the potential to be profitable. However, when looking at farm profitability by farm characteristic (such as farm type, economic size, land ownership status and farmer age), some characteristics are more prevalent in the bottom 10% than the top 10%. For example, 65% of farms in the bottom 10% are Grazing Livestock or Mixed farms compared to 36% in the top 10%.

Farm characteristics of the top 10% and bottom 10%

Top 10%	36%	are Grazing Livestock or Mixed farms	42%	very small economic farm size	5%	are wholly tenanted	34%	are aged at least 65 (farmer)
Bottom 10%	65%		58%		15%		43%	



How much would different farm types need to reduce costs by in order to break even without Direct Payments?

Loss making Less Favoured Area Grazing Livestock farms have the biggest challenge in reducing costs to break even. Half of these farms require cost reductions of less than 16% and half require cost reductions of more than 16%, based on the period 2014/15 to 2016/17.

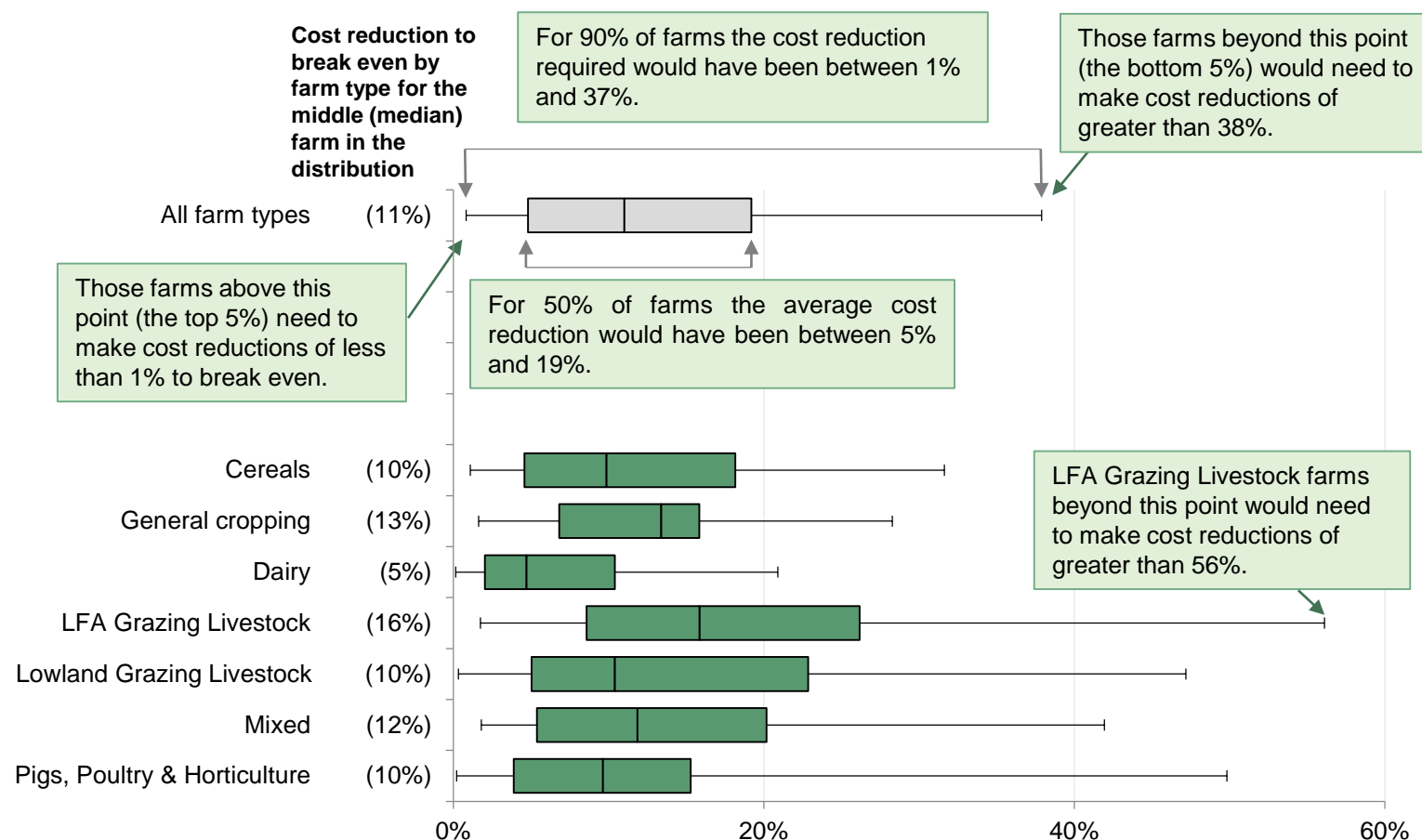
This chart shows the wide range of cost reductions required to break even by those farms that would have made a loss without Direct Payments over the period 2014/15 to 2016/17.

The line within the middle of each box shows the cost reduction required by the middle (median) farm: half of farms require a cost reduction less than this value and half require a greater cost reduction.

The median values are shown in brackets for all farms and for each farm type. Across all farms, half of those effected would require a cost reduction of less than 11% and half above 11%.

Farms can also reduce costs in conjunction with increasing their output.

Reduction in costs needed to break even without Direct Payments by farm type, based on data 2014/15 to 2016/17



What factors need to be taken into account to decide the length of a transition period?

Without Direct Payments, the 10% of farms making the biggest losses (losing on average £20 for every £100 of inputs) would need to reduce costs by 31%, on average, in order to break even (make £0 for every £100 of inputs). These farms may require a longer transition period to adjust than those that make smaller losses.

Cost reductions will be a challenge for some farms and it will take time

Some farms and sectors will require significant cost reductions to account for the loss of Direct Payments, which would be challenging with rapid withdrawal. For example, the bottom 10% of farms need an average cost reduction of around 31% ([page 26](#)) and there are some farms requiring cost reductions well in excess of 50% ([page 27](#)). For those farms making the greatest losses, a transition period of between 5 and 7 years would give them a greater chance of success than a shorter transition of say 3 years.



Business Cycles

Agricultural business planning tends to involve long timescales. A transition that considers these business cycles could better enable farmers to make proactive changes (e.g. reducing costs, changing enterprises or investments), and mitigate against significant economic, social and environmental impacts.

Existing Financial Commitments

Farmers may have made financial commitments, such as purchasing decisions, on the basis of receiving Direct Payments. A transition period long enough to account for these may help with farm financial planning.



Length of Rental Agreements

As explained on [page 15](#), the removal of Direct Payments should see a reduction in the value of the rent a tenant farmer pays to the landowner. However, rental agreements may not be up for a renewal immediately after the withdrawal of Direct Payments. Rent reviews will vary by type of farm and tenancy.

What do some farmers think about Direct Payments/moving away from Direct Payments?

During farmer led discussion groups undertaken by Defra, many farmers told us they would prefer to farm without direct support, and that removal of Direct Payments is not a threat to business survival as long as issues affecting farm profitability are also addressed and there is a clear transition period.

Between October 2017-June 2018 Defra listened to farmers' thoughts on farming at over 40 farmer hosted discussions. All main sectors of the farming industry were involved. We spoke with large estates, contract graziers, young farmers and those who began farming pre-CAP.

Discussion participants were self-selecting – individuals and groups who were more able and willing to respond were more likely to have participated.

*Basic Payment Scheme

What do farmers say?

'No-one owes us a living'

They would prefer to farm without direct support, but need them now due to low prices and margins.

Removal of Direct Payments is not a threat to business survival in itself as long as other issues are addressed: reasonable adjustment period, market equivalence, measures to help enhance profitability and support for environmental outcomes that provide real economic value.

'BPS is wrong - propping up inefficiency'*

Most, but not all, farmers say change is needed in the industry and Direct Payments have inhibited change. Some farmers highlighted that costs have been higher as a result of Direct Payment support.

Some sectors are more confident about farming without Direct Payments, but all acknowledge the need to ensure a clear and pragmatic transition period.

'evolution not revolution'

A transition period is required given the lack of clarity on trade and future support arrangements. The transition period should start when farmers know the end state of the transition (e.g. what future ELM scheme and trade arrangements will look like). Some wanted a transition as long as possible (10 years), others just wanted the ability to plan their business over a shorter timeframe.

Capping was seen as undesirable for many as anything that creates complexities does not help change. Equal adjustment is fairer and encourages farmers to take-up replacement schemes and build resilience.

Traditional producers i.e. Grazing Livestock and those with most changes required i.e. larger estates, were keenest to see a long transition.

Sectors and groups not accessing Direct Payments were keenest to see a speedy transition i.e. young farmers, contract graziers and pig farmers (with indoor units).

More market-orientated/added value businesses did not see removal of Direct Payments as a threat i.e. dairy producers, horticulture/diversified businesses.



How can farm businesses offset the removal of Direct Payments during the transition period?

(pages 30-40)

What routes are there for farm businesses to offset Direct Payments?

Removal of Direct Payments may be offset in a number of ways, including farm efficiency improvements (reducing inputs or improving outputs) and diversification, although this will vary by type and location of farm.

Reducing Inputs

Monitoring Inputs

Feed efficiency, selective breeding and nutrient management can all help reduce costs.

Rent Reductions ([page 15](#))

As Direct Payments act as an inflationary pressure on rents, their removal should see a fall in rents.

Machinery

Many farm businesses may become more financially resilient by optimising investment decisions.

Efficiency Improvements/Reducing Input Costs

There are often large variations in input costs for farms. In some circumstances, they can work together to create a purchasing cooperative for greater buying power.

Cash flow will impact on the ability to do this as some farm businesses may not have the capital to buy in advance. Also transport costs are higher for farms in more remote areas, impacting both on costs of inputs and delivery of their outputs.

Alternative Options

Environmental Land Management System

Farms may be able to consider using some of their agricultural land, in particular the less productive land, and use the new Environmental Land Management system to deliver environmental benefits.

Diversification

Between 2014/15 to 2016/17, 70% of farms undertook some diversified activity. Around a quarter of all farms made a greater income from diversified enterprises (e.g. such as running an on-farm B&B) than from the rest of their business.

The ability to diversify will depend on the characteristics and location of the farm. However, if more farms diversify, for example into tourism, this would increase the supply and thus in turn may lower the return to the farmer.

Increasing Outputs

Improving Animal & Plant Health

Improving Marketability of Outputs

Business Management Practices

Whilst reducing inputs and maximising outputs could help offset the reduction of subsidies, business management practices could also be used to make improvements.

Farms can become more profitable by reducing costs, but what are the costs of production for farms?

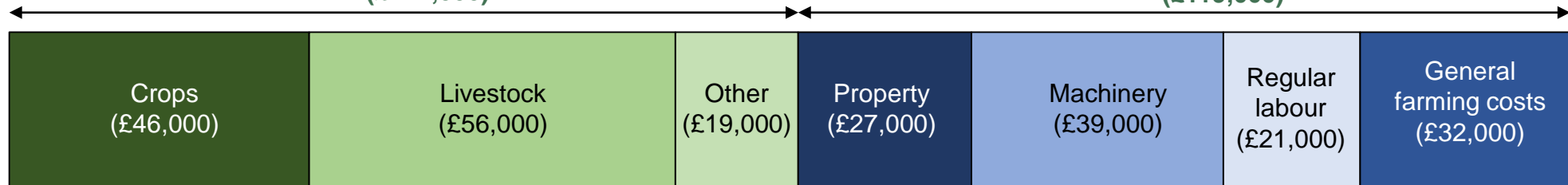
By reducing costs, less profitable farms can adjust to the removal of Direct Payments. Around half of costs to farms are variable, changing depending on the level of production, and the other half are fixed, of which machinery is the largest.

Variable costs change as the level of output varies. For example if a farmer plants more crops they need to purchase more seed or might need more casual labour for harvesting.

Fixed costs are constant in the short term meaning they are the same regardless of how much the farmer produces. In the longer term these can vary, for example, through negotiation of lower rent or purchasing of cheaper machinery.

Total variable costs (£122,000)

Total fixed costs (£119,000)



Other variable costs

These are mainly contractor costs and casual labour, which increase or decrease depending on the amount produced by the farm.

Rents

On average for all farm types, rent contributed 44% (or £12,000) to total property costs, or 5% of all input costs between 2014/15 and 2016/17.

Many farms have no rental costs as they are owner occupied. For wholly tenanted farms, rental costs made up 12% (or £31,000) of their total costs.

General costs

This group includes items such as bank charges, professional fees, water, electricity, net interest payments, bad debt write off.

Water and electricity comprise around a half of these costs.

How can better input management help to reduce variable costs?

Crop and livestock inputs represent 84% of variable costs to farms. Costs can be reduced by practices such as improving feed efficiency, selective breeding of animals and/or following a detailed crop nutrient management plan developed with a qualified advisor.

Reducing livestock costs

Feed Efficiency

Animal feed is expensive for farmers, and inefficient conversion to a product for human consumption (meat, eggs and dairy) is costly. The feed conversion ratio (FCR) is the amount of feed required to produce 1kg of live weight. Since 2010, FCR has improved for poultry and pigs, indicating greater feed efficiency and increased productivity in these sectors.

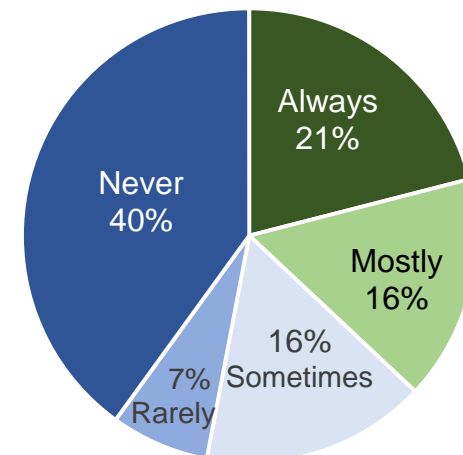
Choosing the most appropriate feeds and ensuring the right balance of protein and nutrients can help farmers reduce costs and optimise production.

Breeding

Selecting traits in livestock can improve productivity and efficiency. Estimates from the Beef Feed Efficiency Programme suggest profits could increase by 39% if feed efficiency was incorporated into breeding programmes.

The estimated breeding value (EBV) measures the genetic worth of an animal for traits like meat production. However, in 2018 nearly half of holdings rarely or never used bulls with high EBV when breeding beef cattle.

% holdings using bulls with high EBVs when breeding beef cattle in 2018



Reducing crop costs

Nutrient Management

Farmers need to make decisions on input use in advance, without having information on the conditions, future yield, or the price that the product will be sold at. Because of this, farmers may input standardised amounts, or apply excessive amounts to try and secure a better yield.

However, excessive use of inputs reduces profits because the cost of inputting more than is optimal will exceed the revenue gained. Farmers can optimise inputs so every unit of input increases profit made.

Nutrient management practices such as changing the timing/application of fertiliser could reduce the amount of fertiliser needed, reducing costs.

However, nearly

1/2

of holdings do not have a nutrient management plan.

The majority of holdings spread manure, slurry or fertilisers, and limiting the use of nitrogen rich fertilisers to economically efficient levels can save money. However,

1/3

of relevant holdings do not have a manure management plan.

Measuring soil fertility allows farmers to determine the type and amount of fertiliser that needs to be applied, minimising unnecessary fertiliser application.

However, nearly

1/3

of relevant farms do not test the nutrient content of their soil.

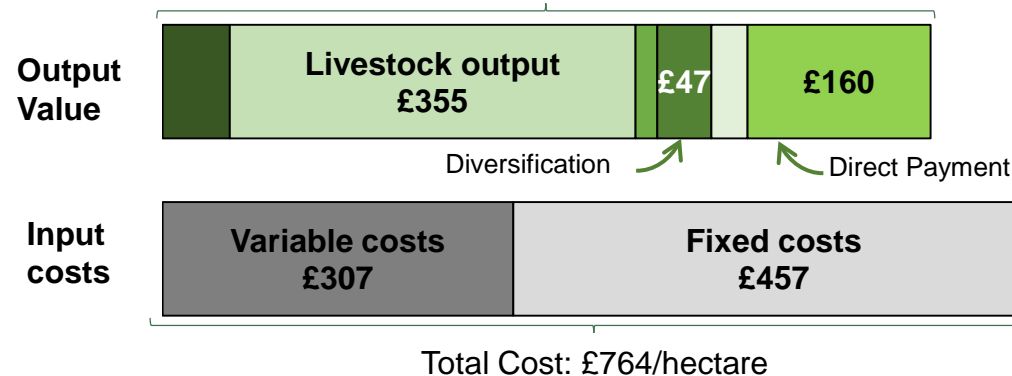
How does output relate to costs for the top 20% and bottom 20% of Lowland Grazing Livestock farms?

The bottom 20% of Lowland Grazing Livestock farms spent £764 per hectare for £673 of total output whilst the top 20% had slightly lower costs to produce £1161 of output, showing a large productivity difference.

Difference in input costs and output values per hectare for Lowland Grazing Livestock Farms between the top and bottom 20% by profitability.

Bottom 20%

Total output: £673/hectare

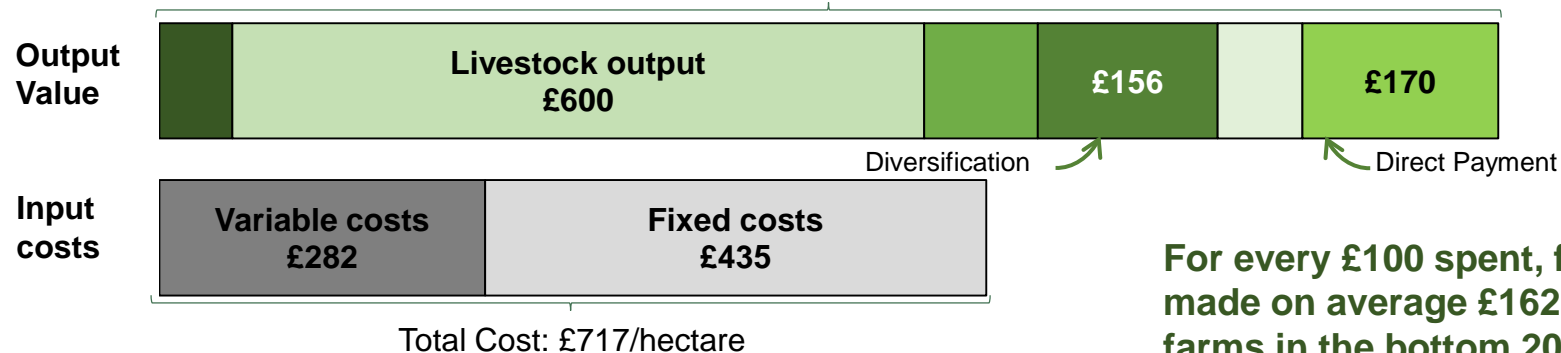


Fixed and variable input costs are slightly higher per hectare for the bottom 20% than the top 20% of farms. However, the top 20% achieved a greater revenue per hectare for their livestock and made more from diversification.

Across all farm types, 70% of farm businesses in England had some diversified activity in 2014/15 to 2016/17. The main diversified activity was letting out buildings for non-agricultural use; when this is excluded, half of farms had some other diversified activity. More information on diversification can be found on [page 38](#).

Top 20%

Total output: £1161/hectare



For every £100 spent, farms in the top 20% made on average £162 compared to £88 for farms in the bottom 20%.

How can better investment improve profitability?

The majority (86%) of the most profitable farms (top 20%) made a positive return on their investment. Almost all farms in the bottom 20% made a loss on their investments. However, differences in what farms are investing in varies by sector and size, rather than by profitability.

In good years, farm businesses will invest, for example in machinery (such as tractors), buildings or land. This investment should help to generate future profit.

Return on Capital Employed (ROCE) is a measure of return on investments. ROCE increases as profitability increases. It is calculated using the following equation:

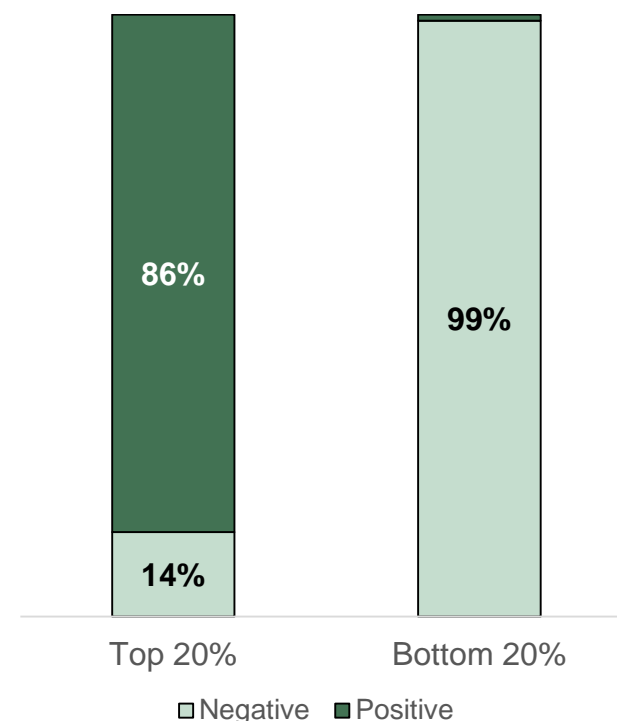
$$\text{ROCE} = \frac{\text{Earnings before Interest and Tax}}{\text{Assets (minus land value) excluding Debt}}$$

Almost all (99%) of farms in the bottom 20% by profitability had a negative ROCE, indicating that these farms are not achieving an economic return on the capital employed.

Almost all (86%) of those farms in the top 20% by profitability had a positive ROCE.

However, an analysis of machinery investment for 2016/17 suggests that sector, farm size and farmer age were greater determinants of a farms likelihood to buy machinery than farm performance.

Distribution of ROCE minus land value, by profitability decile (excluding Direct Payments and unpaid labour), 2016/17.



(a) The data used for this chart is only from those farms that had complete returns for their assets and liabilities.

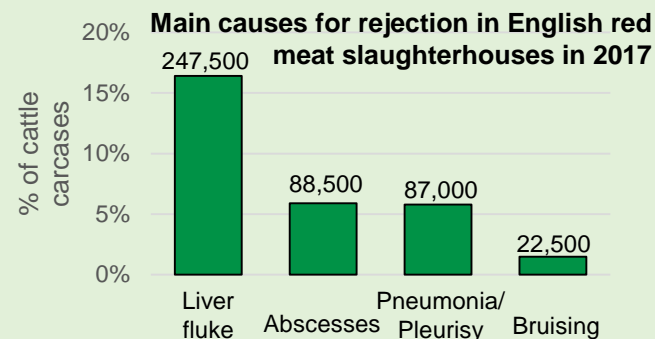
How can farms maximise their outputs?

Farms can maximise their outputs by responding to the market. Knowing processor safety requirements and quality specifications can reduce wastage and increase prices achieved.

Safety requirements

Farm businesses can maximise their returns by minimising the loss of saleable products.

Livestock sold for slaughter must be fit for human consumption. Anything that doesn't meet safety requirements will be rejected, resulting in reduced returns and possible non-payments to farmers. Many losses are avoidable through disease management and welfare practices. For example, liver fluke (parasitic worms) can be avoided through vaccination programmes and bruising avoided through taking greater care of animals during transit.



Losses can also be avoided in other sectors. For example, knowing the hygiene requirements of a dairy contract can avoid hygiene deductions, and following protocols to ensure mycotoxin levels are low enough in cereals can ensure standards are met.

Understanding the market

Meeting quality specifications can maximise the price of the product.

Abattoirs require animals that satisfy certain fat and weight specifications to meet consumer demands. However, **49% of prime beef fails to meet target market specifications**. Knowing the market means that cattle of the appropriate breed, weight and specification can be reared to maximise returns.

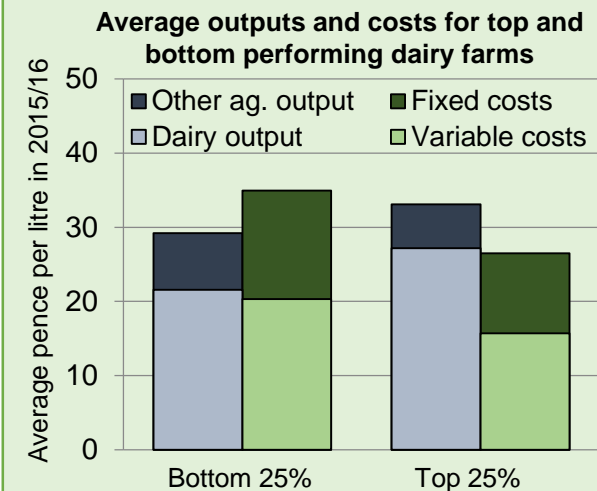
Dairy contracts can have different standards for fat and protein levels, affecting the price by up to 0.75p/litre.

Crop loss at harvest, out-graded material and spoilage in storage accounts for 2-25% of yield. Losses can be avoided by investing in machinery to minimise potato damage, or ventilation systems to improve grain drying.

Greater transparency in the food chain increases information flow, enabling farms to better respond to market signals and increase efficiency. This could be through **vertical integration**, where a farm business becomes involved in the processing, retailing or catering of their produce. Alternatively, seeking feedback from processors can help farms monitor and improve.

Contracts

Top performing dairy farms have lower input costs and achieve higher milk prices.



Securing more favourable contracts may help maximise prices paid or highlight problematic clauses, to ensure the farmer gets the best deal. 12 month notice periods can also make it difficult to leave a contract. Researching how new or unfamiliar processors treat their farmers before signing contracts can help avoid these situations.

How might improved animal and plant health help to safeguard/maximise outputs?

Poor animal and plant health reduces productivity, however 25% of livestock farms do not have an animal health plan, and crop breeding for sustainability and resilience are not well incentivised.

Controlling livestock diseases improves animal health, welfare, and increases productivity.

Disease	Livestock	Costs to industry incurred
Sheep scab	Sheep	Loss of condition, secondary infections, death £11mil per annum
Bovine tuberculosis	Cattle	More frequent testing, movement restrictions, culling £56mil per annum
Mastitis	Cattle	Reduced milk yield, low fertility, culling £241mil per annum

Figures converted to 2018 values

Farm health planning can help prevent disease and improve livestock performance through helping animals to reach their finishing weight quicker, and achieve better feed conversion rates. 75% of livestock farms have a Farm Health Plan. Out of those that had a Farm Health Plan, only half used it on a routine basis to inform disease management decisions.

Over half (57%) of farms with livestock undertook training for animal health and welfare and disease management. Nearly a third (29%) of holdings believed training was unnecessary.

Tracking and controlling crop pests and disease can reduce productivity losses and costs to landowners and foresters.

5-20%

annual loss of UK cereal productivity caused by pests and pathogens

Breeding programmes:

Resistance to biotic and abiotic stresses can be improved through breeding, reducing the risk of crop failures. The Vegetable Genetic Improvement Network (VeGIN) has screened more than a thousand non-commercial varieties to identify resistance to pests, diseases and drought. These traits are used in commercial breeding programmes, providing long-term solutions to increasing environmental pressures and increased productivity.

Identifying and tracking potential pests and diseases:

The increasingly variable weather conditions experienced in the UK are causing significant fluctuations in the prevalence of crop pests and diseases. Tracking pests and diseases along with how farmers are managing and applying treatments helps predict future risks. Online tools like **Cropmonitor** identified yellow rust as a new emerging threat, able to reduce untreated wheat yields by 50%. Detection enabled rapid control response.

How can diversification help to increase farm income?

In 2014/15 to 2016/17, half of farms (55%) in the bottom 10% by profitability undertook a diversified activity, compared with three quarters (73%) in the top 10%. Of those farms who had a diversified activity, the bottom 10% made, on average, £26/ha, compared with £161/ha for farms in the top 10%.

What are Diversified activities?

Diversified enterprises are non-agricultural work of an entrepreneurial nature on or off farm, but which utilise farm resources. This includes letting buildings for non-farm use, the processing or retailing of farm produce, sport and recreation, tourist accommodation and generating renewable energy.

£540m
Total income from
diversified activities

26%
Equivalent contribution of
diversified activities to total
farm business income

70%
Of farms undertook
some diversified activity

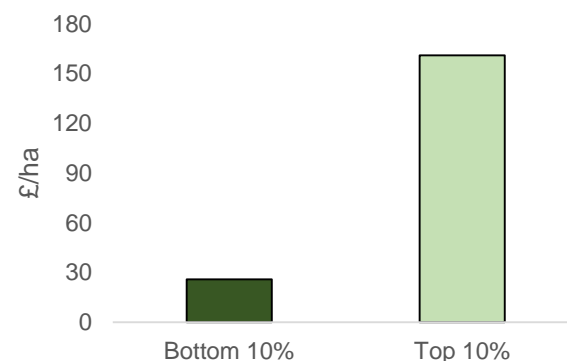
48%
Of farms let out farm
buildings for non farm use,
generating on average
£13,500

Averaged over 2014/15 – 2016/17

For those farms with diversified activities, the income from that activity was the equivalent to almost a third (32%) of profit. For around a quarter (24%) of businesses, the income from diversification was higher than the income from the rest of the farm business.

Diversified activities by farm profitability

A greater proportion of farms in the top 10% by profitability (73%) undertook a diversified activity compared to the bottom 10% (55%) between 2014/15 and 2016/17. Of farms in the top 10% and bottom 10% who did diversify, there was little difference in the type of diversified activity they undertook. However, farms in the bottom 10% made on average £26/ha, compared with £161/ha for farms in the top 10%.



There may be scope for the bottom 10% to improve profitability by undertaking more diversified activity. However, the ability to diversify will depend on the characteristics and location of the farm. Supply and demand may also affect the profitability of the activity. For example, if more farms diversified into tourism this would increase the supply and may in turn lower the return to the farmer.

How might Environmental Land Management systems help to offset the removal of Direct Payments?

Under a new Environmental Land Management system, farms may be able to consider using some of their agricultural land, particularly less productive land, to deliver environmental benefits.

What impact does agriculture have on the environment?

Agriculture has a significant impact on England's natural environment, both positive and negative, through land management decisions.

Farmers and foresters play an important role in managing the land. Sustainable land management activities can secure and increase the provision of public goods and other environmental outcomes with social and economic benefits (wildlife habitats, clean water, clean air, healthy soils, mitigation of flood risk, and carbon storage and sequestration). However, agriculture can have significant negative impacts on the environment, for example through water pollution and greenhouse gas emissions. Land has to be effectively managed to mitigate these impacts.

What are Environmental Land Management (ELM) systems?

Environmental Land Management (ELM) systems (previously known as agri-environment schemes) were introduced in the 1980s to secure non-production natural capital benefits from the farmed landscape.

What might a new ELM system look like?

The government will work with farmers and land managers who wish to improve the environment by entering into contracts that could span several years. These will be based on a land management plan developed by the farmer or land manager, setting out how they intend to deliver the environmental benefits identified, based on guidance and specialist advice.

These agreements will make sure that the environmental benefits farmers help deliver, but which cannot be sold or bought, are paid for by the public purse.

Rewarded environmental benefits will include:

Helping to deliver high air and water quality

Protecting and enhancing biodiversity

Preventing, reducing and adapting to climate change and other environmental hazards

Providing public access and contributing to the public's understanding and enjoyment of nature

Protecting our rural historic environment and distinctive landscape features

Previous ELMs have been beneficial to habitats and species, landscape character and water quality, with at least £3.20 of public goods returned for every £1 put in.

How do farm business management practices vary between the top and bottom performing farms?

To maximise farm inputs and outputs, it is important to undertake management practices. In 2016/17, only 1/3 farms undertook practices such as producing budgets, gross margins, cash flows or in depth profit and loss accounts. The top 25% of farms were 2.5 times more likely to engage in such management practices compared to the bottom 25%.

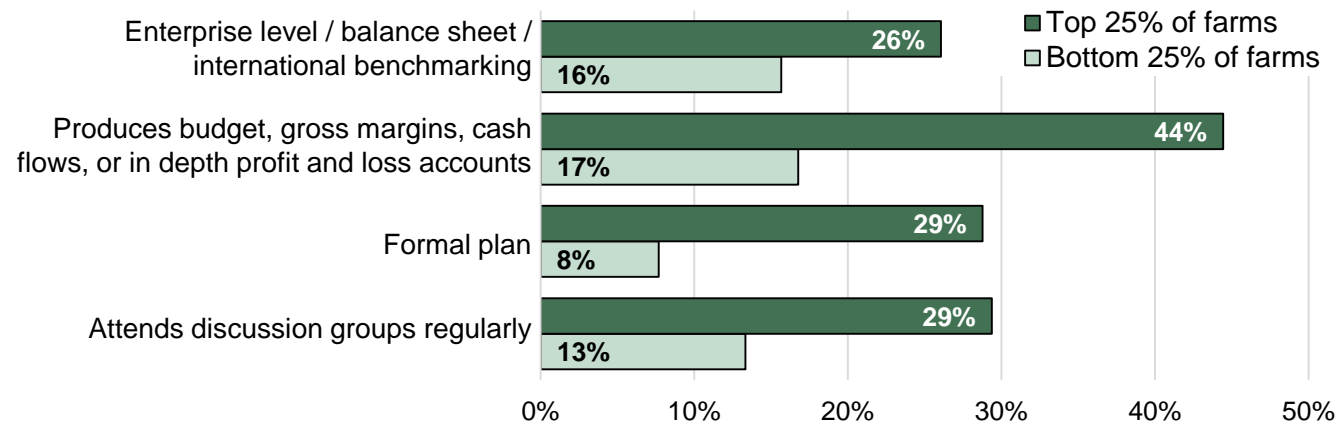
Whilst reducing inputs and maximising outputs can help to offset the reduction of subsidies, business management practices can also be used to make improvements.

Farms with higher economic performance are more likely to engage in farm business management practices such as business planning and benchmarking.

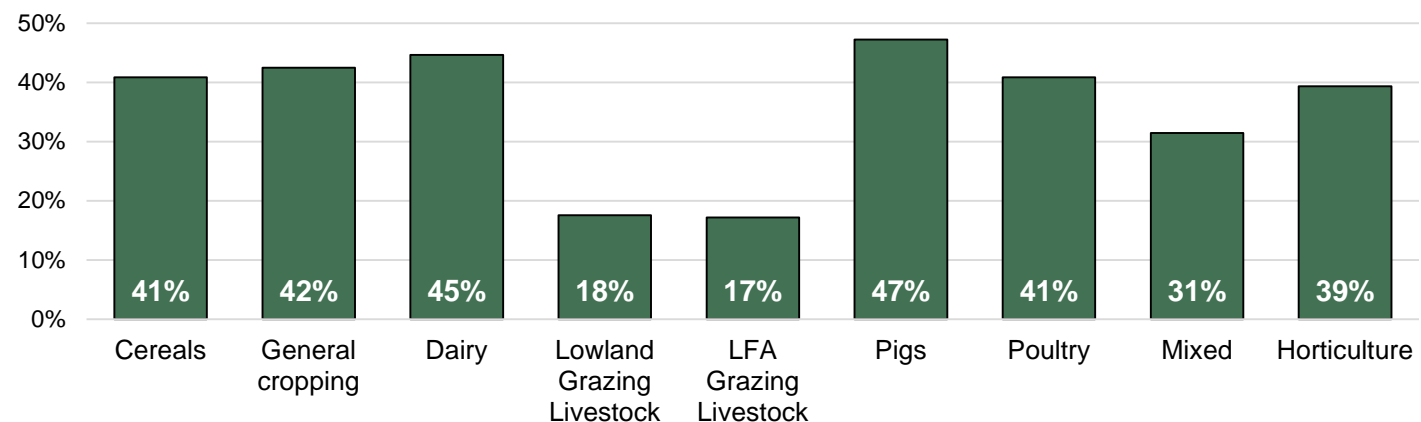
However, even for the most profitable farms, the majority still do not engage in farm management practices, suggesting room for more improvement across the sectors.

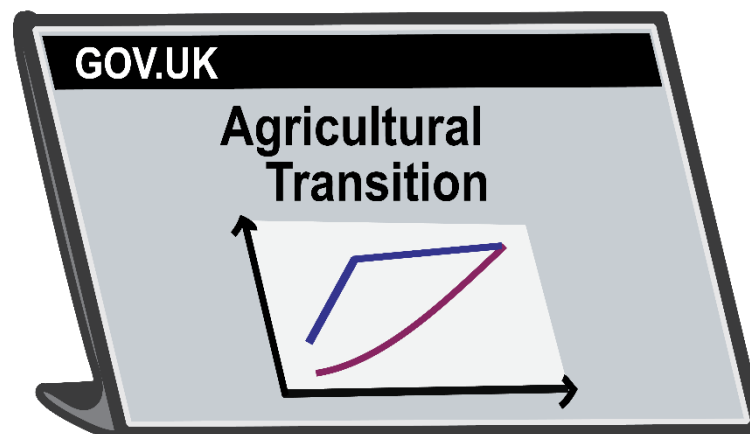
Grazing Livestock farms were the least likely to produce budgets and in depth profit and loss accounts. These farms also tended to have the lowest Farm Business Income.

% of farms carrying out various farm management practices by farm economic performance, 2016/17



% of farms that produce budgets, gross margins, cash flows, or in depth profit and loss accounts by farm type





Section 5

What are the options for moving away from Direct Payments?

(pages 41-45)

What options are there to transition away from Direct Payments in England?

The Future for Food, Farming and the Environment consultation set out two proposals for applying reductions to Direct Payments during a transition period: progressive reductions and capping. A flat rate reduction for all farm businesses was also identified as an option by respondents.

Options:

Progressive reductions

Each applicant's payment is split into a series of bands, with higher percentage reductions applied to the amounts in higher bands (as with income tax).

The consultation suggested starting to reduce payments for those getting more than £25,000.

A cap on the largest payments

A cap on payments would mean no payment is made above a certain Direct Payment band threshold.

The consultation suggested applying a £100k cap in the first year.

Flat rate reduction

Reduce all Direct Payments by the same amount and increase this rate of reduction through the transition.

From an economic perspective, the form reductions take during a transition period should:

1

Provide a clear signal to farm businesses that Direct Payments are coming to an end.

2















Appropriately target payment reductions at those who benefit from Direct Payments the most. (see [slide 14](#) for more details).

3

Reduce the risk of farm businesses having to exit or restructure due to a lack of time to adjust.

What are the advantages and disadvantages of the different options for moving away from Direct Payments?

A progressive reduction starting for all farms in year 1 offers the greatest advantages for transitioning away from Direct Payments. This option signals change to all farms in the early years and does not concentrate reductions on a small number of farms.

Reduction Option	Advantages/Disadvantages		
	Clear signalling that Direct Payments are ending	Appropriate targeting of payments (see p14)	Reduces the risk of businesses having to exit or restructure
Progressive Reductions with £25K threshold	 <p>Reductions starting for those receiving £25K or more, 78% of farms would not receive the signal to act in year 1.</p>	 <p>Ensures better allocation of Direct Payments.</p>	 <p>Removes more from those who may have greater flexibility to adjust their businesses.</p>
Capped Reductions	 <p>With a cap starting at £100k, 98% of farms would not receive a signal to act in year 1.</p>	 <p>Ensures better allocation of Direct Payments.</p>	 <p>Minimises the impact on small farms that may have low incomes.</p> <p> While larger farms may have greater scope for adjustment, changes may risk the viability of farm businesses with Direct Payments well in excess of the cap.</p>
Flat Rate	 <p>Reductions start for all farms from year 1 of the transition.</p>	 <p>Does not rapidly ensure better allocation of Direct Payments.</p>	 <p>Would prevent a shorter, steeper transition for smaller farms.</p> <p> Smaller farms would have the same reductions as larger farms, but may not have the same scope for adjustment.</p>
Progressive Reduction with no threshold	 <p>Reductions for all farms from year 1, but the rate of reduction varies depending on the Direct Payment band.</p>	 <p>Ensures better allocation of Direct Payments.</p>	 <p>Reduces risk the most as it distributes reductions across all farms, while staggering the rate means more is still removed from those that may have greater flexibility to adjust.</p>

What might the average reduction per business be in year 1 under a progressive reduction with no threshold?

A progressive reduction may apply up to a 5% reduction for the smallest subsidy, rising incrementally by payment band to up to 25%. For example, for a claim worth between £30,000-£40,000, if a 5% reduction was applied to the first £30,000, and a 10% reduction applied to the next £10,000, the subsidy would be reduced by an average of £2,000 in year 1 .

Under a progressive reduction with no threshold, reductions will be shared across all farms from the start of the transition, although those who receive the highest payments will see bigger reductions initially. This has been selected as the preferred policy option.

For the first year of the transition, 2021, this option would reduce Direct Payments by up to the percentages shown next to the table (right), and could free up to around £150million to reinvest into the delivery of public goods.

Based on these rates, a progressive reduction with no threshold could reduce payments by up to 5% for those receiving the smallest subsidy and incrementally rise to up to 25% applied to payment amounts over £150k in Direct Payments. For example, for a claim worth between £30,000- £40,000, if a 5% reduction was applied to the first £30,000, and a 10% reduction applied to the next £10,000, the subsidy would be reduced by an average of £2,000 in the first year .

Figures in the table are illustrative based on 2016 payment data

Illustrative profile of reductions to reduce Direct Payments in year 1 of the transition.

Payment Reductions are staggered between the following bands:

5% rate applied to all farms, up to £30k of payments.

10% rate applied to subsidy amount between £30k - £50k

20% rate applied to subsidy amount between £50k - £150k

25% rate applied to subsidy amount above £150k

2016 Direct Payment (£)	Number of farms in each group	Average reduction per business (£)
0 to 5k	30,300	100
5 to 10k	15,300	400
10 to 15k	9,500	600
15 to 20k	6,800	900
20 to 25k	4,900	1,100
25 to 30k	3,600	1,400
30 to 40k	4,800	2,000
40 to 50k	3,000	2,900
50 to 75k	3,700	5,600
75 to 100k	1,600	10,700
100 to 125k	800	15,800
125 to 150k	400	20,800
150 to 200k	500	28,500
200k to 250k	200	41,300
250k to 300k	100	54,200
over 300k	100	108,800

What are the reasons for delinking Direct Payments from the land?

Delinking offers the opportunity to provide a clear signal that Direct Payments will cease, and may encourage more rapid structural change, while at the same time simplifying the payment process for recipients.

What is Delinking?

Delinking breaks the link between the land and the Direct Payment, meaning people would continue to receive payments regardless of production levels, land area or if they decide to stop farming altogether. Instead, how much an individual receives would depend on a reference period, and the payments would taper to zero at a fixed end point. This would allow greater flexibility during a transition phase, which should help people to adjust to removal of Direct Payments.

Simplify the payment process for recipients

Delinking Direct Payments would mean that all those who qualify based on a reference period would receive payments that would no longer be linked to the land or farming. These payments would be made for each year of the agricultural transition.

The Government will look to give farmers the option of taking a one-off lump sum payment in place of all their annual Direct Payments.

Signal to the sector that Direct Payments are to cease

Delinking payments would represent a marked change in the policy framework, governing the agriculture sector and influencing future decision making by farm businesses, as the sector adjusts towards a new policy framework.

At the extreme, delinking would allow an individual to treat the payments as an exit grant, and leave farming. For others, it means they may take fully business-focussed decisions about how much land to farm each year, how much to rent, and how much to rent out, without the incentives being skewed by an area based payment.

Facilitate more rapid restructuring of the agricultural sector and to offer choice to farmers

Direct Payments based on land area are at least partially capitalised into land values and rents ([page 15](#)). Removing the link between Direct Payments and land during a transition may encourage a faster adjustment in distorted land markets and increase the ease with which farms could transition away from the business structures Direct Payments have incentivised. This may be more apparent for rents, as there are many other factors that influence the demand for purchasing land. Additionally, delinking removes the need to farm the land so it may encourage those who choose to leave to accelerate this decision. This could increase the ease with which new entrants and expansionary farms could acquire land area for farming.

Data sources and Photographs used in this publication (1 of 2)

Front Cover. Photo Credit: iStock

4. Photo Credit: Defra

5. Photo Credit: Defra

6. Photo Credit: Getty Images

7. Photo Credit: ThinkStock

8. Photo Credit: iStock

9. Photo Credit: iStock

11. Defra analysis of Rural Payments Agency data (as of Nov 2017).

12. [CAP Reform 2014-20: EU Agreement and Implementation in the UK and Ireland](#).

13. [Special Report n°21/2017: Greening: A More Complex Income Support Scheme, Not Yet Environmentally Effective](#).

14. Defra Analysis of [Farm Business Survey](#).

15. Trade Impacts of Agricultural Support in the EU (Matthews, Salvatici & Scoppola, 2017, International Agricultural Trade Research Consortium, Commissioned Paper No 19) and Defra Analysis of [Farm Business Survey](#).

16. [Balance Sheet Analysis and Farming Performance, England 2016/17](#),

Farm Practices Survey 2008,

[Farm Business Management Practices in England 2016/2017](#),

Defra Analysis of [Farm Business Survey](#)

18. Defra Analysis of [Farm Business Survey](#).

19. Defra Analysis of [Farm Business Survey](#).

20. Defra Analysis of [Farm Business Survey](#).

21. Defra Analysis of [Farm Business Survey](#) and [June Survey of Agriculture 2017 – UK](#).

22. Defra Analysis of [Farm Business Survey](#).

24. Defra Analysis of [Farm Business Survey](#) and [Aggregate Farm Accounts for England and the Regions – First Estimate for 2017](#).

25. Defra Analysis of [Farm Business Survey](#).

26. Defra Analysis of [Farm Business Survey](#).

27. Defra Analysis of [Farm Business Survey](#).

28. Defra Analysis of [Farm Business Survey](#), Agricultural Holdings Act (1986), CAAV (2017): The Annual Agricultural Land Occupation Surveys for Great Britain 2016, Central Association of Agricultural Valuers (June 2017) and Defra Analysis of [Agricultural Tenancies](#) data.

29. Farmers' Voices, Government Listening Internal Report by Defra.

31. Diversification analysis: Defra Analysis of [Farm Business Survey](#).

32. Defra Analysis of [Farm Business Survey](#).

33. Defra Analysis of [Farm Business Survey](#), [GHG Indicators Framework Summary](#), [Beef Feed Efficiency Programme AHDB](#), [Greenhouse Gas Mitigation Practices– England Farm Practices Survey 2018](#) and

Farmers' Spending on Variable Inputs Tends to Maximise Crop Yields, Not Profit (Reader, Revoredo Giha, Hodge, Lawrence & Lang, 2017).

34. Defra Analysis of [Farm Business Survey](#).

Data sources used in this publication (2 of 2)

35. Defra Analysis of [Farm Business Survey](#).
36. [Minimising Carcase Losses for Better Returns AHDB](#),
[Guidelines to Minimise the Risk of Fusarium Mycotoxins in Cereals AHDB](#),
[Marketing Prime Beef for Better Returns AHDB](#),
[Saving Money by Reducing Waste Defra](#),
Defra Analysis of [Farm Business Survey](#) and
[Farmers Weekly – Milk Contracts: What Farmers Need to Check](#)
(September 2016).
37. [Greenhouse Gas Mitigation Practices– England Farm Practices Survey 2018](#),
[Economic Impact of Health and Welfare Issues in Beef Cattle and Sheep in England \(ADAS\)](#),
[The Direct Costs of Livestock Disease: The Development of a System of Models for the Analysis of 30 Endemic Livestock Diseases in Great Britain](#) (Bennett R, 2003, Journal of Agricultural Economics, Vol 54, Issue 1),
www.cropmonitor.co.uk,
[The Vegetable Genetic Improvement Network \(VeGIN\)](#).
38. Defra Analysis of [Farm Business Survey](#).
39. [The rural development programme for England 2014 to 2020: Final Impact Assessment](#).
40. [Farm Business Management Practices in England 2016/2017](#) and
Defra Analysis of [Farm Business Survey](#).
42. The Health and Harmony Summary of Responses.
43. Defra analysis of Rural Payments Agency data (as of Nov 2017).
44. Defra analysis of Rural Payments Agency data (as of Nov 2017).