

Regulatory Triage Assessment

Title of regulatory proposal	Changes to the Cattle Compensation Scheme
Lead Department/Agency	Defra
Expected date of implementation	Spring/Summer 2018
Origin	Domestic
Date	17.07.2017
Lead Departmental Contact	carol.hawke@defra.gsi.gov.uk
Departmental Triage Assessment	Low-cost regulation (fast track)

Rationale for intervention and intended effects

The Cattle Compensation Orders provide powers for Defra to compensate herd owners when it requires the compulsory slaughter of TB infected animals. Compensation is currently paid at the market price of the animal as defined in the cattle compensation valuation tables.¹ There are three situations where the existing compensation regime could be enhanced and which the changes proposed here seek to address.

Firstly, a small number of infected cattle (less than 1%) are individually valued rather than using compensation table values i.e. average market prices. This happens when insufficient market sales data have been collected and/or a previously determined table value cannot be used. Unlike in other TB affected countries (e.g. Wales and Ireland) there is no limit specified in the Compensation Order on the amount of compensation payable for an individually valued animal – and this exposes the general taxpayer to the risk of paying compensation to an excessive level. Unlimited compensation payments also crowds out the private insurance market for high value cattle.

Secondly, full compensation is currently payable for disease free cattle brought into a TB infected herd which subsequently become infected. In this situation a herd owner is knowingly exposing healthy cattle to a significant disease risk and so should share the burden of TB control costs with the general taxpayer. The department recognises that owners of such herds need to re-stock for business sustainability reasons, but it is not right that the general taxpayer takes on all of the financial risk if compensation needs to be paid for healthy cattle brought into herds with a known and long-standing disease problem. Reducing compensation paid for these cattle would protect the general taxpayer and pass the costs of the increased risk these cattle represent to herd owners. This policy has already been implemented in Wales.

Thirdly, full compensation is currently payable even if the animal sent to the slaughterhouse is not fit to enter the food chain (referred to as being condemned) because it is unclean due to owner action/inaction. Animals cannot enter the food chain if they have not been appropriately cleaned. In order to not provide a free disposal service for farmers who do not adequately prepare their animals for slaughter, and to dis-incentivise this behaviour, the cost of condemning these animals should be passed onto the animal owner.

Viable policy options (including alternatives to regulation)

Policy Option 1: Do nothing:

Takes no action on existing limitations of compensation regulations. The general

¹ <https://www.gov.uk/government/publications/bovine-tb-historical-compensation-value-tables>

taxpayer is still exposed to the risk of paying excessive compensation when individual valuations are used. Farm businesses with TB restricted herds have less incentive to account for infection risk when restocking their herd.

Policy Option 2: Introduce three changes to compensation to address the issues identified.

- Introduce a cap on individual TB compensation rates of £5,000 per reactor (an animal that is found to be infected with TB), replacing the current no upper limit.
- Reduce compensation paid to 50% of current value for cattle brought into a breakdown herd which subsequently test TB positive while the herd is still under TB restrictions.
- Introduce a charge by APHA in the form of 50% compensation reduction to cattle owners for the processing and disposal of unclean cattle sent to the slaughterhouse and for which the condemnation is as a result of owner action/inaction.

Initial Assessment of Business Impact

Introduction of a £5,000 cap on compensation per reactor (an animal that is found to be infected with TB)

The introduction of a £5,000 cap on compensation per reactor will only affect a small proportion of those animals that are subject to individual valuation and in turn an even smaller proportion of infected cattle. Individual valuation occurs when there is not enough market sales data to generate an average price for the category the animal falls into (none of the table valuations exceed £5,000). On average between 2012 and 2016 there were only 8.8 reactors a year (0.03% out of an average 29,273 compensation payments a year) which were valued higher than £5,000. If these payments had been capped the reduction in compensation would have been £31,790 a year.

Reduce compensation paid for reactors or direct contacts brought into a herd before the breakdown is resolved by 50%

In 2016 brought in reactors accounted for 5% of all reactors in England. Eligibility for full compensation for these cattle means the herd owner lacks incentive to account for risk appropriately because they do not pay the cost if those animals contract TB. A 50% reduction in compensation will increase the costs herd owners face when they have 'brought in reactors' and they are therefore more likely to take this risk into account.

The total cost of compensation for brought in reactors in 2016 was £1,508,986, but this has been falling consistently for the past five years as shown in Table 1 (a reduction of 38.78% between 2012 and 2016). However the fall in compensation paid has been driven by falling cattle prices, the number of brought in reactors has increased between 2014 and 2016. Assuming the total compensation paid for brought in reactors remained at the 2016 level a 50% reduction in compensation would result in a £750,000 saving p.a. However, given the compensation paid has dropped by an average of 11% a year over the past 4 years this is likely to be an overestimate of the true impact.

A reduction in compensation should better encourage impacted herd owners to reduce their TB risks through, for example, good bio-security.

Introduce a charge by APHA in the form of 50% compensation reduction to cattle owners for the processing and disposal of unclean cattle sent to the slaughterhouse and for which the condemnation is as a result of owner action/inaction.

In 2016 APHA disposed of 20 cattle condemned due to arriving at the slaughterhouse unclean. These cattle were condemned by Official Veterinarians, not the slaughterhouses. The average compensation payment in 2016 was £936.50 per reactor so a cut to 50% would be a reduction of £468.25 per reactor. If we were to assume no behavioural change and use the 2016 compensation values the maximum cost to industry of this charge would be £9,365. However, the introduction of a charge will dis-incentivise this behaviour and so the actual cost to industry will be lower. The avoidance of this behaviour will reduce the deadweight loss to society.

One-in, Three-out status

Changes to the compensation scheme are considered fees and charges under the Better Regulation Framework and so are out of scope of the BIT. The EANDCB of the proposed options is £0.7m and the Business NPV is -£6.81m (standard 10 year appraisal period).

Rationale for Triage rating

The measure is low cost and will fall below the £1m (gross per annum) threshold for Fast Track approval.

Departmental signoff (SCS):

Economist signoff (*senior analyst*):

Better Regulation Unit signoff:

Estimated Impact on Business of Policy Changes

The department is proposing three policy changes as a package in option 2:

1. Introduce a cap on individual TB compensation rates of £5,000 per reactor, replacing the current no upper limit.
2. Reduce compensation paid for reactors or direct contacts brought into a herd while it is still in breakdown by 50%.
3. Introduce a charge by APHA in the form of 50% compensation reduction to cattle owners for the processing and disposal of unclean cattle sent to the slaughterhouse and for which the condemnation is as a result of owner action/inaction.

1. Introduce a cap on individual TB compensation rates, replacing the current no upper limit

While most animals are compensated according to a table valuation based on market prices, where there is not enough data to generate a table valuation an individual valuation is carried out by an independent auditor. This will generally only occur for pedigree cattle as there is always enough sales data for non-pedigree cattle to use the table valuations.

There is currently no limit on compensation paid as a result of individual valuations in England. As a result there have been rare cases where the Department has had to pay compensation exceeding £200,000 for a single animal. In cases of extremely high value animals the department is currently providing a zero cost insurance service for these animals against TB, despite a market for insuring high value animals existing in the private sector. Introducing a cap would protect the general taxpayer from this financial risk and encourage owners of very high value cattle to engage with the private sector insurance markets.

A cap of 5,000 would only affect a very small proportion of payments each year. Analysis of five years' compensation data (June 2011 – July 2016) showed that during this time period there were an average of 8.8 individual valuations over £5000 a year (out of an average 29,273 compensation payments a year, 0.03%), with a total of 44 over the entire period. If a £5000 individual compensation limit would have been in place over this period the reduction in compensation paid would have been on average £31,790 a year. The highest individual valuation payment over the five year period was £93,000, with the second highest being £15,000. **Table 1** summarises the analysis and shows the average is driven up by the £93,000 valuation between July 2013 and June 2014.

Table 1: Analysis of compensation payments over £5,000 for July – June

	11/12	12/13	13/14	14/15	15/16	Mean
Number of Valuations £5000+	10	18	11	0	5	8.8
Highest Valuation	£11,000	£8,500	£93,000	£4,200	£15,000	£26,340
Value of all valuations £5000+	£71,750	£109,000	£141,200	£0	£42,000	£72,790
Compensation reduction from £5,000 cap	£21,750	£24,000	£96,200	£0	£17,000	£31,790

Estimated cost to industry: £31,790 p.a.

2. Reduce compensation paid for reactors brought into a herd while it is still in breakdown.

Herd owners can bring new cattle into an infected herd while it is still in breakdown under licence from APHA. Bringing new cattle into a herd that is known to be infected with bTB poses a significant disease risk to the new cattle introduced to the infected herd. As a result cattle brought in to an infected herd are at risk of infection themselves.

The department is proposing to pay 50% compensation for cattle brought into breakdown herds that then subsequently become infected with TB. Bringing cattle into these herds voluntarily exposes them to a major infection risk and the general taxpayer should not have to compensate reactors who become infected as a result of this. This is in line with the approach taken by the Welsh Government.

In 2016 brought in reactors accounted for 5% of all reactors in England. Some of the costs associated with the slaughter and replacement of these cattle could have been avoided if farmers brought fewer healthy cattle into breakdown herds. While there are situations where it is necessary to restock a herd while in breakdown the current system does not provide an incentive against doing so. As a result breakdown herds are restocked in situations where it would be better to wait for restrictions to be lifted. A cut in compensation will increase the costs herd owners face when they create brought in reactors, both through not restocking during a breakdown and to have restrictions lifted sooner (through improved bio-security).

The total cost of compensation for brought in reactors in 2016 was £1,508,986, but this has been falling consistently for the past five years as shown in Table 2 (a reduction of 38.78% between 2012 and 2016). The fall in compensation has been driven by falling cattle prices, there were more brought in reactors in 2016 than in 2014. Assuming the total compensation paid for brought in reactors remained at the 2016 level a 50% reduction in compensation would result in a £750,000 saving p.a. However, given the compensation paid has dropped by an average of 11% a year over the past 4 years this is likely to be an overestimate of the impact.

Table 2: Brought in reactor compensation 2012-2016

	<i>Number of brought in reactors</i>	<i>YoY Change</i>	<i>Total Compensation paid</i>	<i>YoY Change</i>	<i>Average Compensation per reactor</i>
2012	2026		£2,465,036		£1,217
2013	1728	-14.71%	£2,115,334	-14.19%	£1,224
2014	1485	-14.06%	£1,813,135	-14.29%	£1,221
2015	1630	9.76%	£1,752,008	-3.37%	£1,075
2016	1530	-6.13%	£1,508,986	-13.87%	£986

The £750,000 annual reduction in compensation payments is likely to overestimate the cost to farmers of this change. This figure is the impact if farmers took no action as a result of this change. In reality this cut in compensation will incentivise farmers to not bring in replacement healthy cattle while in breakdown in certain situations. Additionally this policy is likely to incentivise investment in bio-security measures. Both of these behavioural changes will lead to less brought in reactors and so benefit farmers and the general taxpayer.

In terms of the £1m p.a. Fast Track RTA threshold, a very extreme set of circumstances would have to occur for this policy to result in a £1m p.a. cost. Based on the average number of brought in reactors 2014-2016 the cattle price would need to completely reverse its current trend and rise by 31% from its 2016 level and in addition there would have to be no behaviour change by farmers. It is very unlikely that either of these situations would occur, especially at the same time.

Estimated cost to industry: £750,000 p.a.

3. Introduce a charge by APHA in the form of 50% compensation reduction to cattle owners for the processing and disposal of unclean cattle sent to the slaughterhouse and for which the condemnation is as a result of owner action/inaction.

Cattle carcasses are usually condemned due to having generalised TB (having TB lesions in multiples sites), but can also be condemned due to negligence on the part of the animal owner in the form of the carcasses being so unclean the slaughterhouse won't accept them.

Currently FSA processes all condemned cattle (commissioned by APHA) at the expense of the taxpayer. However, where cattle are condemned due solely to action/inaction by the owner the cost of disposing of these carcasses should be passed onto the owner. If these costs are not passed on some cattle owners will continue to see APHA as a free carcass disposal service for cases where they do not want to take the required action to appropriately prepare cattle for slaughter.

Introducing a charge in the form of paying 50% compensation in this situation would dis-incentivise owners from sending cattle to slaughter without

undertaking the required preparations. It would also offer better value for money for the taxpayer as they are currently picking up the bill for farmer negligence for no wider benefits.

In 2016 APHA disposed of 20 cattle condemned due to owner negligence. The average compensation payment in 2016 was £936.50 per reactor so a cut to 50% would be a reduction of £468.25. If we were to assume no behavioural change and use the 2016 compensation values the maximum cost to industry of this charge would be £9,365. However, the introduction of a charge will dis-incentivise this behaviour and so the actual cost to industry will be lower. The avoidance of this behaviour will reduce the deadweight loss to society.

Estimated cost to industry: £9,365.