

PO - CH / NL / 0078
PART B

Part B.

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Begins: 27/7/87
Ends: 28/10/87.


 PO -CH /NL/0078

 PART B

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PART B

Chancellor's (Lawson) Papers:

**REFORM OF THE COMMON
AGRICULTURAL POLICY
WITHIN THE EUROPEAN
COMMUNITY**

Disposal Directions: 25 years

Andrew

26/7/95.



FROM: A P HUDSON
DATE: 27 July 1987

Handwritten signature

HUDSON
✓
CHX
27 July

CHANCELLOR

AGRICULTURE AND CAP REFORM

I read these papers (quickly) to see if there were any proposals for what you might say on Agriculture in Washington. Nothing.

... 2. Basically, the Byatt paper (Paper B) deals with principles of agricultural reform, much along the lines you have taken in ... previous international meetings. The Edwards paper (Paper A) deals with the CAP over the next few months. The two are linked only by the annotated agenda. At times, it seems as though the authors haven't met!

3. I am no expert on these topics. But it does seem to me that, from a policy standpoint, it may be unwise to separate changes to the CAP and long-term reform too far.

- The present time may be a rare window for achieving a major reform of the CAP. As Paper A says, our main leverage is the need for unanimous agreement in the current discussions on own resources.
- Other countries (eg Australia) will not be impressed if we make radical noises at the international meetings, but do not tie them in to the one area of the world agricultural system over which we have some direct influence, namely the CAP.

So we want to see Washington as part of the strategy for reform of the CAP, both in the short and the long-term.

4. What would be useful would therefore be an initiative which helps our cause both within Europe and more widely within the GATT negotiations.

PERSONAL AND CONFIDENTIAL



5. One possibility would be to move from exposing the failures of the present policy - which are now well worn - to bringing out:

- that it does not meet even its original objectives (well documented in Paper B);
- and what a more sensible form of agricultural policy might look like.

6. The Americans will no doubt rerun their GATT initiative to abolish all subsidies within 10 years. This got a dusty reaction from the EC, perhaps because it was so sweeping and implied that there was no need to give farmers any sort of special treatment. That may be right in principle, but was too much for most of the EC to swallow. But our EC partners - and the Japanese - might find it harder to resist a suggestion that there should be a discussion of the fundamental objectives of an agricultural policy, and how these might best be met. This could either be a discussion within GATT, or on a faster track.

7. As with debt, there may be the bones of an initiative in Paper B. But it will take some teasing out!

A handwritten signature in black ink, appearing to be 'A P HUDSON'.

A P HUDSON



fmj

Ch

PCC considered the 2nd of these papers — the Byatt paper — a couple of weeks ago, and concluded that you needed a meeting to discuss reform of the CAP.

The 1st paper — by Andrew Edwards — has only just been produced: hence the delay in holding the meeting.

I'm afraid there is an awful lot of paper here. However, Roger Lavelle

PTO

has produced a helpful annotated agenda.

See also

[redacted] Andrew Hudson's ideas for a CAP "initiative"; and John Kerr's objections to the Edwards paper.

Jonathan will do the note of this meeting.

DWK
27/7

PS/Chancellor

FROM R J BONNEY
DATE 27 JULY 1987

cc PS/CST
PS/PMG
Sir P Middleton
Sir G Littler
Mr Lavelle
Mr Monck
Mr Byatt
Mr Edwards
Mr H P Evans
Mr Cropper

Ch
Papers on your
meeting folder
done
28/7

PMG

CAP REFORM: MEETING ON 28 JULY

I regret that there were some errors in the papers circulated under Mr Lavelle's minute of 24 July. I attach revised versions of the following pages:

- Paper A page 7
- Paper A, Annex A
- Paper A, Annex B, first page of table

Could you substitute these for the original versions please?

RB

R J BONNEY

PMG

BONNEY
↓
PS/CST
27 July

cent. We may wish at a later stage in the negotiation to oppose any increase in the guideline limit which would involve a higher ratio of agricultural expenditure to available own resources, provided that the ratio is improved by keeping down the agricultural guideline limit rather than increasing other elements in expenditure.

14. As implied above, three important technical issues which will also affect the level of the guideline are (a) the arrangements for depreciating stocks, both past and present, (b) the provisions for exceptional circumstances (where the Commission have proposed a monetary reserve to deal with the consequences of currency fluctuations) and (c) the definition of expenditure covered by the guideline, which at present nets out the proceeds of co-responsibility levies. Officials are working on these aspects as well.

15. In addition, we shall need to consider the scope for building on the European Council conclusions to make the current budget discipline conclusions on agriculture more binding and effective. Possibilities include turning the current Council "conclusions" and supplementary Commission statement into legally binding Regulations; improving and clarifying the drafting as far as possible and incorporating the procedural changes (ie the Commission's undertaking to make its price fixing proposals within the guideline and the need for prior agreement of ECOFIN to exceed it) proposed in the paper circulated by the UK in Brussels.

Income aids

16. Although production-neutral income support could have a part to play in the final settlement, as the European Council conclusions note, the UK has in general no interest in such measures except as a quid pro quo for changes which we do want to see such as price cuts and the introduction of stabiliser mechanisms. We should certainly not be demandeurs for income aids.

17. The Commission's rather incoherent proposal for part-EC funded aids has been generally attacked and it is quite possible that a new and simpler proposal from the Commission would

AGRICULTURAL POLICY COSTS TO THE UK

	1986-87 (i)	£ million 1987-88
1 Total expenditure on agriculture in UK		
(a) Domestic agriculture	895	856
(b) CAP market support UK prefunded	266	543
(c) CAP market support EC prefunded	903	1058
(d) Total (a) + (b) +(c) (rounded)	2050	2450
2 Community Budget items		
(a) UK's share of FEOGA -guarantee	1355	1163
(b) UK's share of FEOGA -guidance	65	72
(c) UK's gross contribution to FEOGA	3350	3450
(d) UK net contribution to FEOGA (after allowance for Fontainebleau abatements) ⁽ⁱⁱ⁾	650	750
3 Total public expenditure effects 1(d) + 2(d)	2700	3200
4 UK net losses outside Budget on intra- Community trade in CAP products (1985 figure)		375

Assumptions:

1. UK spending on domestic agriculture as in PEWP
2. UK spending on CAP market support as in latest IBAP forecast
3. FEOGA receipts as in PEWP except Guarantee in 1987-88
4. Guarantee receipts in 1987-88 are 7% of average current guideline expenditure in 1987 and 1988
5. UK contribution is 20% of FEOGA budget
6. £1= 1.38 ecu

Notes:

- (i) UK intervention expenditure in 1986-87 was untypically low due to exceptional factors (notably bad weather in Spain leading to high UK cereals exports.)
- (ii) For convenience, Fontainebleau abatements are scored in the same year.

EC INDICATORS

1. GA Guarantee Expenditure trend

	1980	1981	1982	1983	1984	1985	1986	1987 Budget	1987 unconstrained forecast	1988 PDB	1988 Unconstrained forecast
becu	11.3	11.0	12.4	15.8	18.3	19.7	22.1	23.0	27.0	27.0	30.3
% growth		-3%	13%	27%	16%	8%	12%	4%	21%	17%	32%
% EC Budget	-	62.6%	59.7%	63.1%	67.3%	69.8%	62.9%	63.3%	66.9%	68.1%	70.5%

1984-85 base

Guideline				18.3	19.7	21.2	23.0	-		22.8	
% growth					7.7%	7.6%	8.5%	-		-0.8%	

2. Annual changes in CAP support prices

	1980	1981	1982	1983	1984	1985	1986	1987 ⁽¹⁾
(i) % in ecus	4.6	9.0	10.2	4.1	-0.8	0.1	-0.5	-0.2
(ii) % in national currencies	8.7	10.1	9.3	6.3	1.5	1.7	3.1	2.6
(iii) % in national currencies in real terms	-2.0	-0.4	-0.8	-1.3	-4.1	-3.5	-2.2	-1.1

(1) Because of non-price measures (eg. cuts in period for which intervention is open) effective support was cut by 1.9% in ecus at the 1987 Price Fixing.

3. CAP/world price ratio trends

	1980	1981	1982	1983	1984	1985	1986
Wheat	1.48	1.41	1.56	1.31	1.11	1.29	2.38
Barley	1.59	1.34	1.50	1.48	1.17	1.19	2.87
Sugar	0.92	1.42	2.34	2.15	3.24	3.84	3.66
Butter	1.86	1.52	1.54	1.72	1.68	1.94	2.44
SMP	1.53	1.40	1.41	1.59	1.84	1.89	2.04
Beef	3.62	14.51	5.27	3.97	3.75	3.56	3.27

1. MR EVANS *seen in draft*
2. CHANCELLOR

FROM SUSIE SYMES
DATE 29 JULY 1987

cc Chief Secretary
Paymaster General
Sir Peter Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr Lavelle
Mr Burgner
Mr Mountfield
Mr Mortimer
Miss O'Mara
Mr Culpin
Mr Pickford
Mr Bonney
Mr Hudson
Mr Redley

MP

Ch Relevant to tomorrow's CAP meeting. 28/29/87

[Handwritten scribble]

Who's she?

AGRICULTURE: STATE OF PLAY IN GATT

You asked for a note of the current state of play in GATT negotiations on agriculture, and what public comments you might make, following the American initiative launched earlier this month.

2. Agriculture is a major, and contentious, item in the Uruguay round. The objectives are, inter alia, to improve market access and impose more discipline on the use of direct and indirect subsidies which affect agricultural trade. The round is due to finish by 1991. Negotiations so far lack clear direction. There is, however, a growing recognition that fundamental adjustments to domestic agricultural policies will be required, and not merely relaxation of specific trade measures.

US proposal

3. The US were the first to table a comprehensive negotiating proposal, in Geneva on 6/7 July. It argues for:

- complete elimination over ten years of all agricultural subsidies directly or indirectly affecting trade;

- direct payments to producers 'decoupled' from production

would be permitted, to provide a safety net. Bona fide foreign and domestic aid programmes would also be allowed to continue;

- the ending of all import barriers over ten years;
- harmonisation of health and sanitary regulations.

4. The proposal emphasises, as has the UK, that it is the overall package of support to producers, not just border measures, that creates trade problems and requires change. A measure of total support is needed, and the US suggest the OECD Producer Subsidy Equivalent (PSE) measure could be a useful approach.

5. The proposal is tough and ambitious. Reactions in the US itself have been mixed. Some US farm groups are predictably flatly opposed. Reaction on the Hill has been sceptical but broadly supportive; it is possible reactions would become more negative if it looked as if the proposal were getting anywhere. On the other hand, negative responses from outside the US are grist to the mill of the protectionists in Congress.

EC and other countries' reactions

6. At the GATT negotiating group meeting, the Cairns group of major exporters, principally Australia, New Zealand, Canada and Argentina gave a clear welcome to the proposal. Some were more cautious on points of detail and all emphasised the need for short term measures also, as signalled in the OECD Ministerial Communique.

7. Switzerland, Austria, the Nordics and Japan were less enthusiastic. All insisted on the special characteristics of agriculture which argued against extreme measures. Japan was particularly critical of the PSE concept. A short paper by Japan on negotiating principles was so hedged about with references to food security, specificity etc., that its claimed objective

of returning to market forces seemed close to meaningless.

8. The EC Commission was polite, low key and cautious: but questioning the realism of the US objectives and reciting the special factors of food security, historical government intervention, and so forth. CAP reform measures were quoted as a concrete sign of the EC commitment to tackle agriculture. The EC would table its own proposals before the end of the year.

9. In private, all members of the EC apart from the UK have been hostile to the proposals. They are seen as asking for too much, too fast, and going too far beyond the requirements of the Punta del Este declaration. It will be extremely hard for the Commission to make any progress towards getting agreement within the Community, and there seems little chance at present that they will be able to table proposals for the next meeting in October. The French have argued that no-one else believes the Community will get its act together by October, and so there will be no loss of face if proposals are not tabled until the expiry of the initial negotiating phase on 31 December 1987. Nevertheless the EC President said after his recent visit to Washington that the EC must make realistic proposals in the Autumn.

UK views

10. Of course we would not necessarily agree with everything in the US proposals. But the general thrust follows the line that you have set out in successive speeches to the Development Committee. The Prime Minister has said to President Reagan that we fully share the objective of making agricultural markets responsive to market forces, without offering support for the proposals as such.

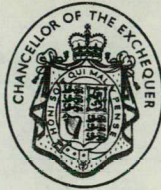
11. As yet there is no agreed UK line within Whitehall. In Community coordination the UK has been mildly welcoming - in part because of Treasury prodding - but has so far agreed that

the ten year timetable is unrealistic. Your meeting tomorrow will help to define a Treasury line.

Susie Symes

SUSIE SYMES

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NOTE OF A MEETING HELD IN HM TREASURY
AT 9.30 am ON MONDAY 3 AUGUST 1987

Present:

Chancellor of the Exchequer
Paymaster General
Sir Peter Middleton
Mr Byatt
Mr Bonney
Mr G White
Ms Symes
Mr Corry
Mr Cropper

REFORM OF CAP

Papers: Mr Lavelle's minute and enclosures of 24 July.

The Chancellor said the previous meeting had considered the points in paragraph 1 of Mr Lavelle's annotated agenda. Paragraph 2 asked three specific questions. The answers were straightforward: agriculture should be treated more like other sectors of the economy; the resource costs as well as the budgetary costs of the CAP should be considered in judging proposals for reform; and we should stress the importance of getting progressive reductions in agricultural prices to get closer to world market prices. The question of resource costs needed to be brought into our judgement and into our arguments about the CAP, but it should not form a part of any proposal for post-Fontainebleau solutions to budgetary imbalances. Sir Peter Middleton said a way needed to be found to communicate these points. The material should be worked into a form suitable for the negotiators and as background for speeches. The Chancellor said that the propositions were linked. Bringing



support prices closer to world prices was one way in which agriculture could be made more like other sectors in the economy. Our presentation should focus on prices and especially the current gap between community and world prices. This presentation was clear; it appealed to the consumer; and it did not necessarily represent an attack on the CAP. Ms Symes said that the essence of the CAP had been guaranteed prices above world prices. The Chancellor said that it should not be assumed that guaranteed prices need be above world prices; furthermore if supports were abolished world prices would rise.

2. The Chancellor said that he had found the argument that the CAP had not achieved its objectives the least convincing part of Mr Byatt's paper. For example, the paper said that one example of this failure was many farmers were on low incomes. But there would always be marginal farmers whatever the system in which they operated. Mr Byatt said that different support mechanisms could be envisaged that would reduce this effect. The CAP had achieved some of its objectives. But in terms of improving farmers' living standards, the story was mixed. The objectives of security^{of} supply, often interpreted as self sufficiency, had only been achieved, and EC markets been stabilised, at enormous cost. We should take the position that we were not quarrelling with the objectives, but that they could be more properly achieved by different approaches.

3. The Chancellor said that we must hold the high ground. We should not reject proposals that in a narrow sense discriminated against the UK, but consider the costs and benefits of any package as a whole. The burden was becoming insupportable. This latter argument was increasingly acceptable to the French. Suggesting that the CAP was failing to achieve its objectives would gather no support, though an argument based on alternative means towards meeting those objectives might. The burden on consumers, through higher prices, should also be emphasised. It would need to be first demonstrated that they were paying unnecessarily high prices for food; most consumers were unaware of this.



4. The Paymaster General said mobilising consumers was difficult unless the same was happening in other Community countries. How far was it clear in EPC that there was unanimity for the approach set out in the EPC paper? How much was there a similar split between the finance and the agriculture Ministries in the Member States?
5. Mr Byatt said that in Denmark, Ireland, and possibly Greece the benefits of the CAP were so great that the finance and agriculture ministries were as one. Germany was the strongest opponent of the EPC paper, although in private the finance ministry took a very different view from the agriculture ministry. The French were generally supportive. The position in Italy varied, but in the EPC they were in favour of reform. The Dutch were strong allies. The Chancellor said that the Dutch were the only firm allies. The French were moving towards our position, but placed importance on maintaining the form of the CAP. The Germans should be the most helpful; in fact they were amongst the least. The Italians were unreliable. The Paymaster General noted that Spain might be potential allies; Mr Byatt agreed Spain had been quite positive at EPC.
6. The Chancellor said that we should, as agreed, seek to persuade France to table the EPC paper. We should also work up our own paper, based on Mr Byatt's, which would serve as a brief for our negotiators. It would set out the intellectual background, and link the more general economic arguments relating to agriculture to the specific negotiations in the CAP. A paper would need to be circulated at Ministerial level. He would want to return to agriculture himself at this autumn's IBRD/IMF meetings, and point to our efforts in relation to the CAP.
7. Mr Byatt said that the Foreign Secretary intended to put a paper to the Prime Minister on agriculture. We should consider how to play this. It might not be necessary to table a paper of our



own, and we could instead try to influence the Foreign Secretary's paper. Mr Bonney said this risked diverting the MAFF's attention from the immediate need to secure our objective for stabilisers. Sir Peter Middleton suggested this was unlikely to be a problem, indeed it would be important for MAFF to ensure short and longer term objectives were consistent.

8. The Chancellor noted that if any change was to be achieved something must be done to deal with the problems of the small farmers. In the past, any such proposals had been resisted by MAFF on the grounds that they were disproportionately costly to the UK. This produced a complete impasse. MAFF would need to be encouraged to look at such proposals more objectively. As far as the Foreign Secretary's paper was concerned, we should try to get alongside the FCO.

9. Ms Symes noted that the FCO paper was on similar lines to Mr Byatt's, but over-emphasised income aids relative to other possible measures. The Chancellor said that our long-term objective was to bring Community prices in line with world prices. Our short-term objective was to make this transition. Income aids were part of this. Other measures, for example, directed towards the environment, might be needed but there should not be too many. We must present our case convincingly. Ms Symes said that some Member States argued that agriculture was sufficiently distinct from other industries to require permanent support. The Chancellor said that this pointed up the need to ensure that support measures were nationally financed. More generally, the tide of opinion was moving in our direction. He also noted that it was helpful to our endeavours to seize the high ground that we now might appear to

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have, post-Fontainebleau, less direct pecuniary interest in CAP reform.

10. Summing up, the Chancellor invited Mr Byatt to work up his paper and to seek to influence the FCO paper.

A handwritten signature in black ink, appearing to be "J M G TAYLOR".

J M G TAYLOR

Distribution:
Those present
Sir G Littler
Mr Lavelle
Mr Edwards

Anderton has pps.

FROM: I C R BYATT
DATE: 13 AUGUST 1987

42718

CHANCELLOR OF THE EXCHEQUER

*Man Rank. Good
The same (I have met a
at the same time)
v. the marginal comment
about the comment of Lavelle & Edwards.
However, it is clear that for public
concern, whether a speaker or not
John Smith must be kept
plain English will be kept.
M.*

- c Chief Secretary
- Paymaster General
- Sir P Middleton
- Sir T Burns or
- Sir G Littler
- Mr Lavelle or
- Mr Monck
- Mr A Edwards or
- Mr H P Evans or
- Mr Bonney
- Mr Culpin
- Mr G White
- Mr Corry
- Ms Symes
- Mr Cropper

PRINCIPLES OF AGRICULTURAL REFORM

-minutes attached.

At your meeting on 3 August, you asked me to work up a paper on the reform of the CAP, developing the approach from the "high moral ground".

*X
no
any
advice
needed*

2. I enclose a draft, which is largely the work of Mr White. The first part sets out 10 one line principles for reform. The second part sets out the costs of the CAP and argues that the objectives of the CAP would be met more cheaply and effectively in other ways than by price support at current levels. It aims to be tough but not unreasonable. It has benefited from comments by Mr Bonney, but Mr Lavelle and Mr Edwards are away. But I thought you would want to see it at this stage. It would greatly help us to know whether you think we are on the right lines.

3. If we are to use our window of opportunity well, we will need to think how best to handle these principles in Whitehall, the Community and the GATT. You will also want to consider what role your own speeches should play (we are assuming you will want to say something about agriculture at the Development Committee).

4. As far as Whitehall is concerned, I think there is much to be said for pressing ahead as soon as possible in September. An alliance between you and the Foreign Secretary could be very

important. I have spoken to the FCO about their paper, making the point that it is too exclusively concerned with income aids. They know that you think that the time is right for an initiative. But they are (mostly) on holiday and nothing will happen until early September.

5. I have also spoken to M. Milleron about the EPC paper. He was proposing to consult M. Ballandur on Ecofin tactics. I will have a further word with him when I am in Paris at the end of the month and then report back.

IB

PRINCIPLES OF AGRICULTURAL REFORM

A. Ten principles

1. Set out below are ten principles for the reform of agricultural policies. They are intended to be both principles for negotiations and themes for Ministers when they take the high ground about the economic, social and international advantages of reform.

2. It is acknowledged that what can be achieved in terms of reforms consistent with these principles will depend on what other countries and Community Member States can be persuaded to accept. The UK has consistently advocated a lower price policy for the CAP with only limited success. But recent international meetings have shown a growing awareness of the need to reform agricultural policies in most developed countries broadly on the lines suggested and the current budgetary crisis in the Community offers an immediate opportunity to make progress towards these objectives.

3. The principles set out below are designed to provide the necessary link between the tactics for reform over the short and medium term and the long term aim with which the tactics should be consistent and to which they should contribute.

(i) Reform of agricultural policies, and the CAP in particular, must be seen in the wider international context.

Agricultural policies in developed countries distort world trade and impoverish third world countries. Progress on CAP reform is ^{also} a necessary condition for obtaining parallel reforms in other countries (notably the US and Japan), but it cannot be delayed until the substantive stages in the current GATT Round negotiations.

(ii) Reform of the CAP must be consistent with Treaty of Rome objectives and implemented within a Community framework.

The CAP is a central feature of Community policy. But

*Caravan
& products*

*While reform
x should be
in the
minds.*

its form needs to be adapted to today's circumstances. Some national measures may be needed (particularly to deal with the social consequences of reform), but they should be consistent with Community objectives and subject to Community rules.

(iii) The costs to the consumer and to the economy more generally are as important as the budgetary costs in justifying reform.

In addition to its budgetary costs, the operation of the CAP keeps prices to customers well above those prevailing in world markets. Opportunities should be taken to demonstrate to the wider audience (eg the consumers) the magnitude of these costs, their incidence and their causes.

(iv) The long term aim of reform must be to treat agriculture much more like other sectors of the economy and make it much more open to market forces.

Interventions to secure Treaty and other objectives with regard to agriculture and the rural community must be judged against the principle that the allocation of resources is generally best left to market forces.

(v) Reform should seek progressively to reduce guaranteed prices much nearer to the levels which would then prevail on world markets.

This is the surest way to curb surplus production and to reduce the costs falling on budgets and consumers (including other farmers). Resources need to leave agriculture in a balanced way - reducing labour and capital inputs as well as diverting land to other purposes. Reforms which work with the grain of market forces are preferable to administrative controls. The primary long term purpose for guaranteed prices should be as a smoothing device rather than income support. Any quotas and set-aside proposals should be time-limited and existing quotas should become redundant as prices are progressively reduced.

(vi) Necessary action to control budgetary costs and improve in-year budget discipline should be consistent with making the support system more market orientated.

J. J. J.
Stabilisers which operate through in-year price reductions are to be preferred. Those which work through other mechanisms should be judged in terms of their market orientation, as well as their likely effectiveness. Limitation or suspension of intervention buying can have similar effects as a reduction in institutional support prices. Revenue raising devices likely to increase prices to the consumer or conflict with the Community's GATT obligations are to be avoided.

(vii) Adjustment costs arising from reform should be met by transitional arrangements linked to price reductions.

In order to achieve significant reductions in prices, it may be necessary to provide other forms of support to those currently engaged in agriculture. Such arrangements, of which direct income aids linked to total incomes are to be preferred, should be decoupled from production, degressive and time-limited. They should [preferably] be financed by ^{Member States} Member States within a Community framework.

(viii) In the longer term, policies should be specifically tailored to cope with inadequacies in market mechanisms.

Guaranteed prices should smooth fluctuations at levels much more closely related to the then prevailing world prices. They should not be the primary source of income support but a means of smoothing income variance. Any income support should be decoupled from production and related to total incomes of those least well-off engaged in agriculture. Risk sharing through insurance and futures markets should no longer be inhibited by the mechanics of CAP intervention. Agricultural policies should be adapted to meet the needs of environmental protection.

(ix) The preservation and development of rural economies are more likely to be achieved in cost-effective and self-sustaining ways by a diversification of economic activity outside agriculture.

The prospects of alternative economic activity in rural economies are improving with advances in communications and the changing nature of manufacturing and other businesses. Sustained support to agriculture is more likely to hinder than enhance the exploitation of these opportunities.

(x) Individual countries should assess the benefits of any package of reform proposals in terms of its wider impact on their economies and the Community as a whole; they should not focus exclusively on any single component.

To assess only the immediate and direct effects of any single proposal for reform would be to neglect the significant wider benefits available from adopting a package of proposals.

4. In assessing particular proposals on the CAP or on agricultural reform more generally, the UK should have regard to the principles enunciated above. They should be drawn on when the UK publicly makes the case for reform. The principles have been drawn up from an assessment of the costs associated with current policies and the benefits available from the reform. The next two sections set these out in more detail.

B. The Costs of the CAP

5. The economic and budgetary costs of the CAP arise because the prices of Community agricultural produce are held above world price levels (Annex 1). A vicious spiral is set up by the primary reliance of the CAP on guaranteed prices well in excess of world prices. This provides an incentive for increased output. It also increases the prices of agricultural inputs (notably land). This squeezes the incomes of the small and

medium sized farms. As a consequence, whilst most agricultural output is produced at a profit, most farmers operate at a loss. This increases the demand for higher guaranteed prices. And so the vicious spiral continues.

6. At the same time, demand for agricultural produce is growing only slowly. Advances in agricultural technology, in part prompted by the protection afforded to the sector in most of the developed world, have proceeded rapidly. Stomachs are growing less quickly than our ability to fill them; and market prices fall. So, the produce from protected agriculture can only be sold on world markets below cost. Hence, the economic and budgetary costs of protection increase.

7. These consequences are not the result of the particular form of the CAP. Economic and budgetary costs will be incurred to a significant extent by any policy which holds Community prices above the level that would prevail if Community (producers) (consumers) had (to compete in) (had access to) world markets.

8. The budgetary costs of the current policy include the export restitutions, internal subsidies and intervention storage and disposal costs required to support CAP guaranteed prices. In 1986 total EC budgetary costs stood at 23 billion ecu, some two-thirds of the Community's total budget. The figure is spiralling upwards: the cost in 1988 could be over 30 billion ecu. In 1986 about three-quarters of this expenditure were attributable to storage and disposal costs (ie half the total EC budget). (The preponderance of agricultural expenditure in the EC budget is the main factor responsible for the UK's disproportionate budgetary contribution to the Community.)

9. In addition to the Community's expenditure the Member States are responsible for the initial costs of intervention buying and for national support programmes. Total expenditure by the Member States in the early 1980s was estimated to be broadly equivalent to the level of Community expenditure. Overall, according to OECD figures, the total contribution made by Community taxpayers to the agricultural sector in the 1980s was about 40% of the sector's value-added and about 1% of Community GDP.

10. The consumer also foots the bill through higher food prices. The excess costs (over current world prices) to the consumer were estimated by the OECD to amount to 60% of Community agricultural value-added and 1.8% of Community GDP (some 65 becu or £550 a year for a family of four). The comparison with current world prices tends to exaggerate the costs somewhat because liberalisation would cause world prices to rise from current levels.

11. On these estimates of costs, almost all Community agricultural value-added is made up of transfers from the taxpayer and excess costs to the consumer.

12. These transfers involve a loss to the real economy in terms of consumers' standards of living, output and jobs. There are various ways in which this comes about (Annex 2). A policy which sustains resources producing almost zero value-added must mean that alternative more economic activity is starved of resources. International trade effects from agricultural protection have an adverse impact on the non-agriculture economy of developed economies and exacerbate trade tensions.

13. Recent estimates suggest that, through these wider effects, Community agricultural support has reduced GDP by up to 1%. With the estimates of taxpayer and consumer costs quoted earlier, this means that for every £100 transferred to the farmers, there could be a loss to Community GDP of £35 (some estimates are even higher). This could represent a loss of 1 million jobs in the Community, about 40% in the UK.

C. The Benefits from Reform

14. The benefit to be sought from reform is the cost-effective achievement of Treaty of Rome objectives with a significant reduction in the damage to output and jobs elsewhere in the economy. This means more than reducing and controlling budgetary costs as important as these are. It requires more than reducing surpluses and avoiding surplus production. It means tackling the root causes of which surplus production and excessive budgetary costs are only symptoms.

15. The full benefits of reform will come when agriculture is treated much more like other sectors of the economy and market forces are allowed to work. The objectives for reform with this as the long term aim would be as follows:-

a. The gradual and progressive reduction, year on year, of guaranteed prices relative to the world market prices then prevailing, such that the smoothing of price fluctuations rather than income support becomes their primary purpose:

b. The reduction of other forms of agricultural support and protection to allow the allocation of resources within the Community and internationally to be determined to a much greater extent by the force of the market:

c. Proposals for stricter control of Community expenditure should preferably involve in-year price cuts and weakening of intervention, ie working with the grain of market forces:

d. Insofar as other transitional measures are called for (eg revenue-raising devices, income aids, set-asides, quotas) they should as far as possible be time-limited, degressive and clearly linked to the necessary action on price reductions:

e. Interventions to secure Treaty objectives should be tailored to cope with specific inadequacies in market mechanisms.

16. There are three reasons for reform along these lines. First a number of Treaty objectives will be much better served.

- It will deliver lower (and hence more reasonable) prices to the consumer. Clearly, world prices are likely to be somewhat higher under a liberalised regime but not significantly compared with the current divergence between CAP and world prices.

insurance?

- It would deliver better use and allocation of agricultural resources. It is unlikely to depress productivity in the sector since it would permit fuller exploitation of scale economies.

17. Second, the other objectives of the Treaty could be met by specific and targeted policies:-

- A 'fair' standard of living for agricultural communities could be secured by methods ^{other} rather than price support (decoupled from agricultural production) and related to the total income of those least well-off engaged in farming. They should encourage the diversity of land use currently inhibited by inflated land prices. They should also contribute to the development of self-sustaining rural economies.

subsidies

- Stable markets in world terms are more likely to be achieved the more open is world trade. Producers within the Community may have to confront greater risks, although it is not obvious that agricultural prices would be as unstable as they are now; fluctuations in world prices are currently exacerbated by interventionist measures. There are several ways in which risks can be reduced, shared and transferred. Guaranteed prices could be used primarily to smooth fluctuations at levels much more closely related to the then prevailing world prices. Their objective would be to reduce income variance rather than to support incomes. Risk sharing through insurance and future markets should no longer be inhibited by the operation of CAP intervention. There could be a role for time-limited, pump-priming encouragement of these and other forms of risk-sharing within a Community regulated framework.

- Security of supplies does not require generalised self-sufficiency. A more active and stable world market would of itself improve security of supply. Access to world markets ensures supplies except in extreme warfare conditions. Making allowance for the possibility of war does not mean having to produce at war-time levels.

18. Third, the tactics and negotiations for reform need to be consistent with and contribute to an agreed long term aim. Proposals for reform have tended to focus on the reduction and control of expenditure and production, may not necessarily do much for the root causes nor for the economic costs imposed on the economy in terms of lost output and jobs, and in some cases may exacerbate them. Such measures tend to increase the complexity of the CAP and render it even less transparent.

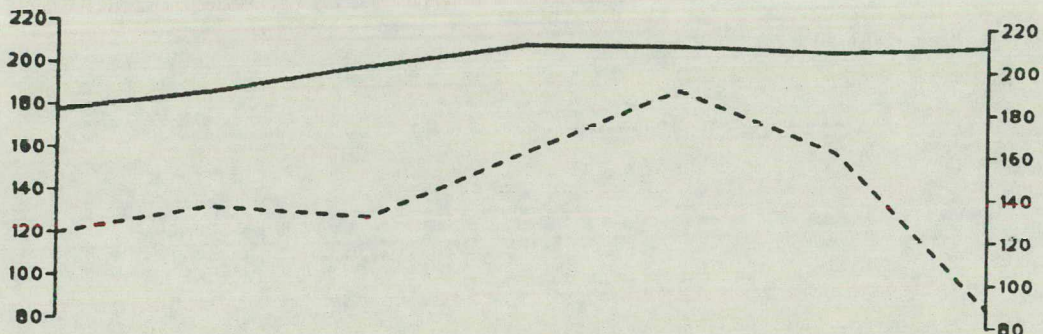
19. There are bound to be adjustment costs associated with reform. Income aids linked to total incomes and for those least well-off are the most preferable means to cope with such costs, as long as they were decoupled from production. They should be primarily financed by national authorities but within a clear Community framework of regulation to prevent distortion of competition between the Member states. It would be preferable in negotiating terms to be persuaded that nationally funded income aids could be useful adjunct to others' policy rather than to act as principal demandeur for their introduction. That the UK would not be favoured by any form of Community funded or regulated income aids should not be a decisive consideration if they are made conditional upon price reductions from which the UK would benefit. The net consequences for any one country should be assessed for a package of proposals, not confined to any single component of it, and should take account of wider benefits.

D. Conclusion

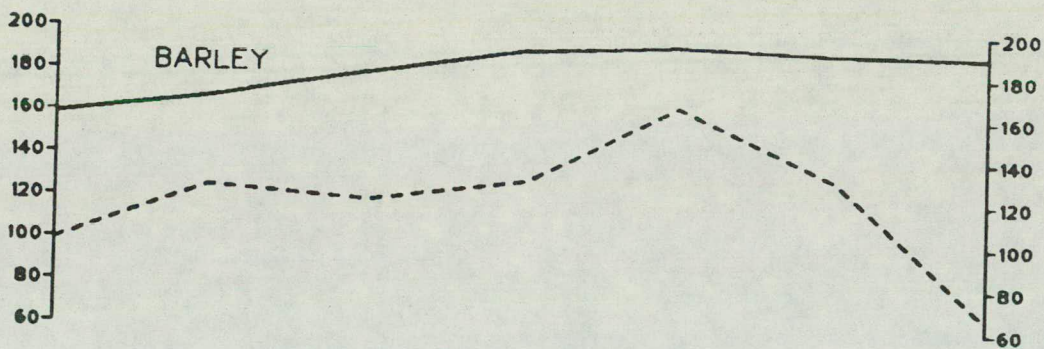
20. Short term actions to reduce CAP budgetary costs and surpluses should be consistent with the aim of reduced prices and a more market orientated CAP. In the long term it would be desirable for agriculture to be treated more like other sectors of the economy where public sector intervention is treated as a departure from market principles rather than as a natural state of affairs. The Community has far too long treated prices principally as a means of supporting farm incomes, ignoring the costs to the taxpayer, the consumer, the Third World and the non agricultural economy.

ANNEX 1
COMMUNITY PRICES AND NOTIONAL WORLD PRICES

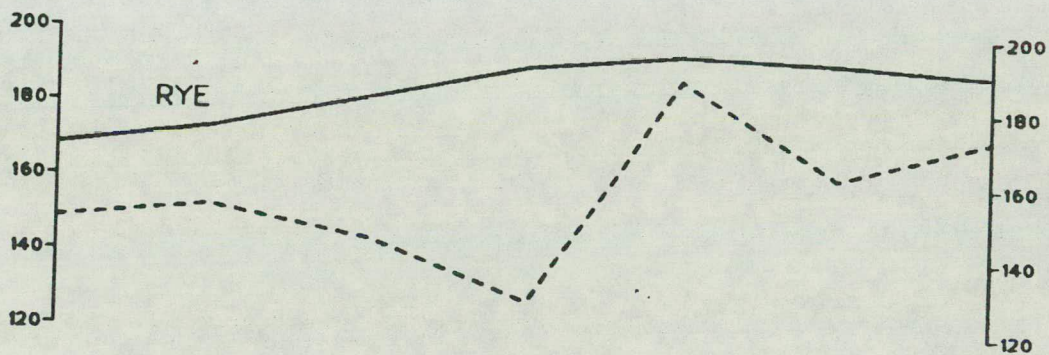
COMMON WHEAT



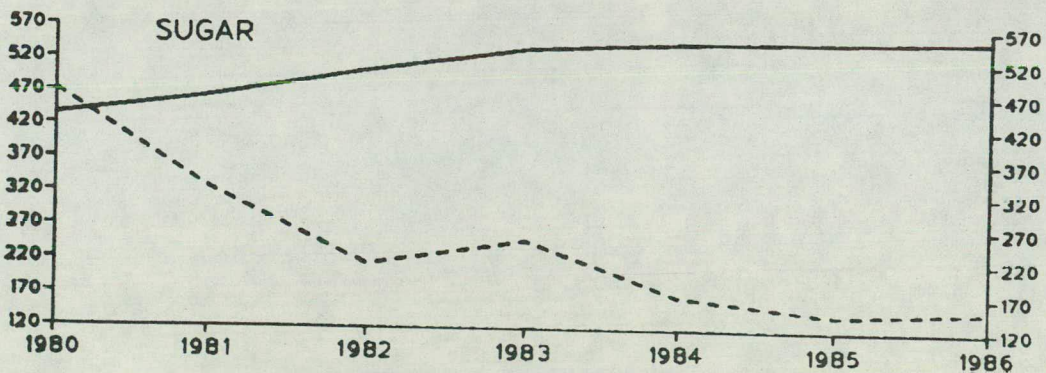
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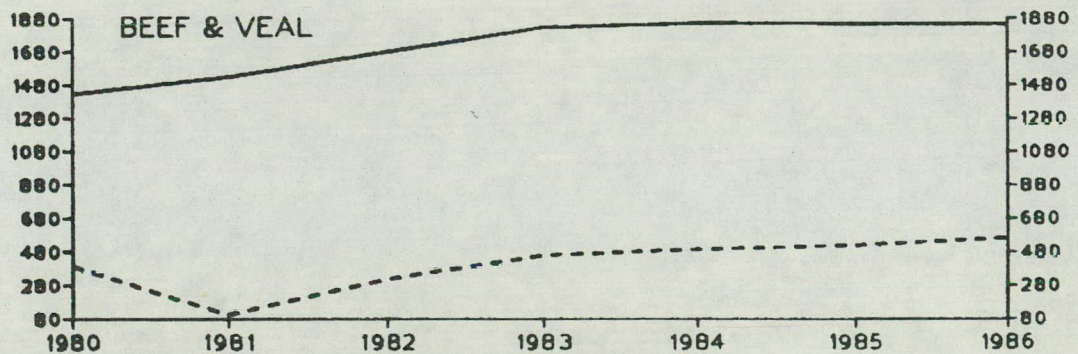
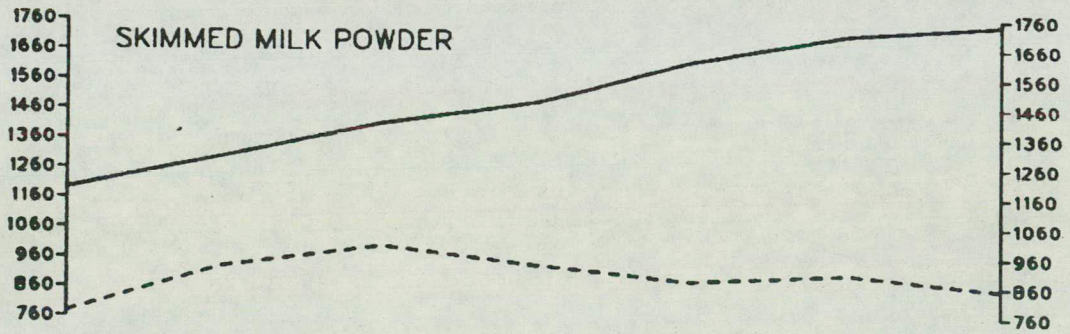
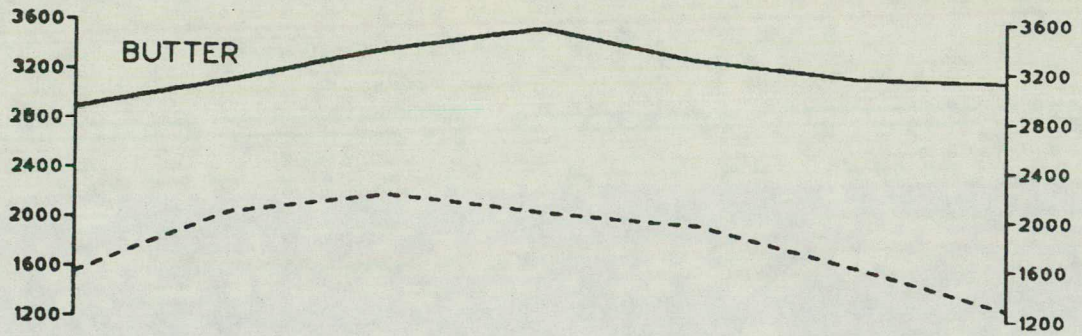
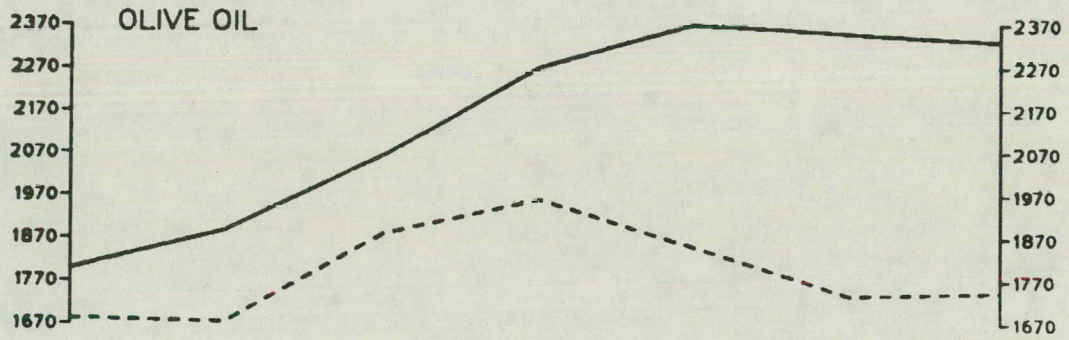


SUGAR



— Reference or Intervention Price
 - - - World Price
 Nominal ECU/Tonne

COMMUNITY PRICES AND NOTIONAL WORLD PRICES



— Reference or Intervention Price
 - - - World Price
 Nominal ECU/Tonne

THE IMPACT ON OUTPUT AND JOBS FROM THE CAP

1. The CAP sustains agricultural resources producing approximately zero value-added. Alternative more economic productive activity does not take place. Estimates suggest that this could amount to a full 1 per cent of Community GDP and perhaps 1 million Community jobs.

2. These effects come about in the following ways:-

a. Higher output prices hold resources in the agricultural sector. They induce higher prices for inputs, above all land. This displaces other uses and development of rural land and employment opportunities (an increasingly important consideration as the urban-rural shift of economic activity continues). Capital and R&D get locked into agriculture which could be better used elsewhere.

b. Higher prices for agricultural products adversely affect those industries using them as inputs (eg food-processing). More generally, a regime which maintains high prices and tends to increase them (the political pressure from the large number of marginal farmers) increases inflationary pressures.

c. Upward pressure on the real exchange rate, ie lower competitiveness, brought about by the positive shift in the balance of trade in agricultural products (induced by agricultural support) will reduce the balance of trade in non-agricultural products. Consequently we forfeit the benefits of comparative advantage and Community manufacturing has suffered.

d. Third World countries' incomes are reduced both by the downward pressure on world prices from Community and other countries' surpluses and by lack of access to Community markets. This exacerbates debt problems with implications for world growth and stability. It undermines demand for manufactured goods of the Community in developing countries.

e. Higher agricultural output and intensification generates environmental costs and displaces other rural development and activity and other non-agricultural output more generally. Not only is this a cost in its own right, but it also increases pressure for the public sector to intervene in these areas to compensate for the distortions introduced by its interventions in agriculture. Subsidies breed subsidies.

UNCLASSIFIED

BF to Jonathan
8/9

FROM: A C S ALLAN

DATE: 1 September 1987

MR BYATT

cc Chief Secretary
Paymaster General
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Lavelle
Mr Monck
Mr A Edwards
Mr H P Evans
Mr Bonney
Mr Culpin
Mr G White
Mr Corry
Ms Symes
Mr Cropper

PRINCIPLES OF AGRICULTURAL REFORM

The Chancellor was most grateful for your minute of 13 August and the attached paper. He would be grateful for any comments from Mr Lavelle and Mr Edwards.

2. He had a few questions on the papers:

- (i) is it true that "most farmers operate at a loss" (paragraph 5)?
- (ii) do the estimates in paragraph 13 of a loss of 1 million jobs in the Community, about 40 per cent in the UK, really stand up?

A handwritten signature in black ink that reads 'A C S Allan'.

A C S ALLAN

Handwritten initials/signature at top right.

FROM: R G LAVELLE
3 September 1987

MR BYATT or

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Monck or
Mr A Edwards
Mr H P Evans
Mr Bonney or
Mr Culpin
Mr G White
Mr Corry
Ms Symes
Mr Cropper

Handwritten notes in red ink:
I agree with Mr Lavelle's comments. I also, as you know, made a number of comments on Mr Byatt's paper, which you did not take on board. On further reflection, I believe the paper needs to be changed to some extent.

PRINCIPLES OF AGRICULTURAL REFORM

Handwritten notes in red ink:
No change
I indicated @X.

On return from leave Mr Edwards and I have seen your paper of 13 August.

2. On the general shape of the paper I had a slight doubt whether the layout quite came off. The third section, on the benefits from reform, seemed to me to revisit quite a number of points covered in the first section. The general theme of the third section, that a reformed approach would better serve Treaty objectives, might be put quite briefly in an introductory paragraph or a covering letter. Indeed, if you wanted to highlight the principles, the costs of the CAP section might itself be put in an annex.

3. However, this is very much for you and others to judge. When you have a final text we perhaps could consider further together what else might need to be said in a covering letter and the latest position on an FCO paper. On the latter, my own impression before the holiday was that they had come off the idea of a jumbo production.

Handwritten initials 'RL'.

R G LAVELLE



FROM: J M G TAYLOR
DATE: 7 September 1987

Ans

MR BYATT or

cc PS/Chief Secretary
PS/Paymaster General
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Monck or
Mr Lavelle
Mr A Edwards
Mr H P Evans
Mr Bonney or
Mr Culpin
Mr G White
Mr Corry
Ms Symes
Mr Cropper

PRINCIPLES OF AGRICULTURAL REFORM

The Chancellor has seen Mr Lavelle's minute of 3 September, with which he agrees.

2. He has commented that the final draft of the paper - which will be for public consumption, in speeches or in some other form - will need to be pithier. He has a number of detailed drafting suggestions which I am passing on to Mr White.

JTG

J M G TAYLOR



FROM: J M G TAYLOR

DATE: 7 September 1987

MR G WHITE

PRINCIPLES OF AGRICULTURAL REFORM

As my minute of today's date to Mr Byatt recorded, the Chancellor had a number of drafting suggestions on the paper enclosed with Mr Byatt's minute of 13 August.

2. These were:

Paragraph 1: This should explain more fully the intentions behind setting out the ten principles.

Paragraph 3(i): Second sentence to read: "Progress on CAP reform, while necessary and desirable on its own merits, is also a necessary condition"

Paragraph 3(vi): The first two sentences should be expressed more simply.

Paragraph 3(vii): Last sentence to read: "They should be financed by individual Member States within a Community framework."

Paragraph 6: Last sentence is unclear.

Paragraph 7: In last sentence the word "producers" and the phrase "to compete in" could also be in parentheses.

Paragraph 8: Last sentence should be in parenthesis.

Paragraph 10: The substance of the last sentence could be amplified.



Paragraph 11: Sentence should read: "On these (somewhat unrealistic) estimates" More generally, the sentence needs to be recast in plainer English.

Paragraph 16: Last sentence is unclear.

Paragraph 17: Replace "rather" with "other" in first sentence. Second tire~~t~~ could be shortened.

3. Some of these points will, of course, be subsumed in more general revision along the lines suggested by Mr Lavelle and endorsed by the Chancellor. Please have a word if that would be helpful.

A handwritten signature in black ink, appearing to be "J M G Taylor".

J M G TAYLOR

pur

FROM: I C R BYATT
DATE: 18 SEPTEMBER 1987

CHANCELLOR OF THE EXCHEQUER

- c Chief Secretary
- Financial Secretary
- Paymaster General
- Economic Secretary
- Sir P Middleton
- Mr F E R Butler
- Sir T Burns
- Sir G Littler
- Mr Lavelle
- Mr Monck
- Mr Burgner
- Mr A Edwards
- Mr H P Evans
- Mr Spackman
- Mr Bonney
- Mr Culpin
- Mr Mortimer
- Mr G White
- Mr Corry
- Ms Symes
- Mr Tyrie

Ch,
 Content with revisions?
 If so, should it go, as suggested, to
 members of OD(E); and should it
 the EPC paper also be enclosed?

*OK (+ EPC paper)
 with cover memo
 shortly*

18/9

PRINCIPLES OF AGRICULTURAL REFORM

We have now revised the paper, taking account of your comments and those of Mr Lavelle. The ten principles now stand on their own following a short introduction. The section on the cost of the CAP has been put in the form of a supporting annex.

2. We suggest you could now circulate this to colleagues. You may want to do this before going to Barbados and Washington, especially if you want to use the principles in any speeches you make while you are there.

3. The FCO have gone off the idea of sending round a long analytic paper of their own. But the Foreign Secretary might be expected to write supporting your paper and he may use it as a peg to suggest further work in Whitehall on income aids.

4. You will want to consider how widely you will want to circulate this paper at this stage. Perhaps the most apt recipients would be the principal members of OD(E) plus the Prime

Minister: and also perhaps Mr Ridley because of his responsibilities for the countryside.

5. I think it would also be useful to draw attention to the attached EPC paper on the CAP, which you have already seen. It adds wider support.

IB

P2e type / 23

DRAFT MINUTE FROM THE CHANCELLOR TO THE FOREIGN SECRETARY

AGRICULTURAL REFORM

We will shortly be resuming discussion in OD(E) of our negotiating objectives in the EC future financing review. Agricultural reform lies at the heart of this exercise. But reform has also to be set in its wider international context - notably the GATT negotiations but also continuing debate in groups such as the Development Committee, *the IMF & IBRD.*

2. I thought it might be useful to step back a little from detailed on-going work to consider what broad principles we should have in mind in the process of agricultural reform. I enclose a paper written in the Treasury which sets out ten principles which put agricultural policy in the wider context of improving the performance of the whole economy. They are designed to provide a link between immediate tactics and the long-term aim of reform.

They should also assist us in occupying the ~~top~~ ^{high} ground in the agricultural debate, rather than simply stay silent as pursued a UK budgetary interest.

3. I suggest that these principles might guide our negotiating strategy and, subject to any reflections you and others might have, be drawn on as appropriate in speeches on the subject.

Under French chairmanship,

4. The Economic Policy Committee of the Community has recently produced a helpful paper on the CAP, which has much in common with these ten principles. *It is attached for convenience.*

5. I am copying this minute to the Prime Minister, the Minister of Agriculture, the Secretary of State for Trade and Industry and the Secretary of State for the Environment.

PRINCIPLES OF AGRICULTURAL REFORM

1. The problem of excess agricultural production is becoming increasingly serious. It has damaging consequences for budgets and for other sectors of the economy. Yet consumers do not gain from low prices.

2. There is a consensus that reform is necessary, but less agreement on what form it should take. If, however, the fundamental problems are to be tackled, reform must work with the grain of market forces. Agriculture must be treated much more like other sectors of the economy.

3. To be fully effective, policies should be reformed at world level. But the priority for the UK is reform of the CAP. Its objectives need to be achieved in more cost effective ways. The Community has for too long treated prices principally as a means of supporting farm incomes, ignoring the costs to the taxpayer, the consumer, the third world and to jobs in the non-agricultural economy.

4. The annex sets out the overall economic costs of the CAP taking account of the wider economic effects as well as the budgetary consequences.

5. The ten principles set out here should underlie the UK approach to the reform of the CAP. They do not cover immediate negotiating objectives, but are designed rather to provide the necessary link between the tactics for reform over the short and medium term and the long term aim of reform. As such they should provide a consistent framework both for the UK negotiations and for Ministerial statements on the long term objectives.

TEN PRINCIPLES

(i) Reform of agricultural policies, and the CAP in particular, must be seen in the wider international context.

Agricultural policies in developed countries distort world trade and impoverish third world countries. Progress on CAP reform, whilst necessary and desirable on its own merits, is also a necessary condition for obtaining parallel reforms in other countries (notably the US and Japan), but it cannot be delayed until the substantive stages in the current GATT Round negotiations.

(ii) Reform of the CAP must be consistent with Treaty of Rome objectives and implemented within a Community framework.

The CAP is a central feature of Community policy. But its form needs to be adapted to today's circumstances. Some national measures may be needed (particularly to deal with the social consequences of reform), but they should be consistent with Community objectives and subject to Community rules.

(iii) The costs to the consumer and to the economy more generally are as important as the budgetary costs in justifying reform.

In addition to its budgetary costs, the operation of the CAP keeps prices to customers well above those prevailing in world markets. Opportunities should be taken to demonstrate to the wider audience (eg the consumers) the magnitude of these costs, their incidence and their causes.

(iv) The long term aim of reform must be to treat agriculture much more like other sectors of the economy and make it much more open to market forces.

Interventions to secure Treaty and other objectives with regard to agriculture and the rural community must be judged against the principle that the allocation of resources is generally best left to market forces.

(v) Reform should seek progressively to reduce guaranteed prices much nearer to the levels which would then prevail on world markets.

This is the surest way to curb surplus production and to reduce the costs falling on budgets and consumers (including other farmers). Resources need to leave agriculture in a balanced way - reducing labour and capital inputs as well as diverting land to other purposes. Reforms which work with the grain of market forces are preferable to administrative controls. The primary long term purpose for guaranteed prices should be as a smoothing device rather than income support. Any quotas and set-aside proposals should be time-limited and existing quotas should become redundant as prices are progressively reduced.

(vi) Necessary action to control budgetary costs and improve in-year budget discipline should be consistent with making the support system more market orientated.

Measures to increase annual budget discipline (ie, stabilisers) through price reductions are to be preferred. Those which work through quantity controls, taxes or other means should be judged in terms of their consistency with market forces, as well as their likely cost-effectiveness. Limitation or suspension of intervention buying can have similar effects as a reduction in institutional support prices. Revenue raising devices likely to increase prices to the consumer or conflict with the Community's GATT obligations are to be avoided.

(vii) Adjustment costs arising from reform should be met by transitional arrangements linked to price reductions.

In order to achieve significant reductions in prices, it may be necessary to provide other forms of support to those currently engaged in agriculture. Such arrangements, of which direct income aids linked to total incomes are to be preferred, should be decoupled from production, degressive and time-limited. They should be financed by Member States within a Community framework.

(viii) In the longer term, policies should be specifically tailored to cope with inadequacies in market mechanisms.

Guaranteed prices should smooth fluctuations at levels much more closely related to the then prevailing world prices. They should not be the primary source of income support but a means of smoothing income variance. Any income support should be decoupled from production and related to total incomes of those least well-off engaged in agriculture. Risk sharing through insurance and futures markets should no longer be inhibited by the mechanics of CAP intervention. Agricultural policies should be adapted to meet the needs of environmental protection.

(ix) The preservation and development of rural economies are more likely to be achieved in cost-effective and self-sustaining ways by a diversification of economic activity outside agriculture.

The prospects of alternative economic activity in rural economies are improving with advances in communications and the changing nature of manufacturing and other businesses. Sustained support to agriculture is more likely to hinder than enhance the exploitation of these opportunities.

(x) Individual countries should assess the benefits of any package of reform proposals in terms of its wider impact on their economies and the Community as a whole; they should not focus exclusively on any single component.

To assess only the immediate and direct effects of any single proposal for reform would be to neglect the significant wider benefits available from adopting a package of proposals.

6. In assessing particular proposals on the CAP or on agricultural reform more generally, the UK should have regard to the principles enunciated here. They should be drawn on when the UK publicly makes the case for reform. It is acknowledged that reform will depend on what other countries and Community Member States can be persuaded to accept. Recent international meetings have shown a growing awareness of the need to reform agriculture policies on the market oriented lines consistently advocated by the UK. The current budgetary crisis in the Community offers an immediate opportunity to make progress consistent with the above ten principles.

ANNEX 1

The Costs of the CAP

1. The economic and budgetary costs of the CAP arise because the prices of Community agricultural produce are held above world price levels (see charts). A vicious spiral is set up by the primary reliance of the CAP on guaranteed prices well in excess of world prices. This provides an incentive for increased output. It also increases the prices of agricultural inputs (notably land). This squeezes the incomes of the small and medium sized farms. As a consequence, whilst most agricultural output is produced at a profit, most farmers in the Community operate uneconomically. This increases the demand for higher guaranteed prices. And so the vicious spiral continues.

2. At the same time, demand for agricultural produce is growing only slowly. Advances in agricultural technology, in part prompted by the protection afforded to the sector in most of the developed world, have proceeded rapidly. Stomachs are growing less quickly than our ability to fill them; and market prices fall. So, the produce from protected agriculture can only be sold on world markets below cost. This increases the economic and budgetary costs of protection.

3. These consequences are not the result of the particular form of the CAP. Economic and budgetary costs will be incurred to a significant extent by any policy which holds Community prices above the level that would prevail if Community producer had to compete in, or consumers had access to, world markets.

4. The budgetary costs of the current policy include the export restitutions, internal subsidies and intervention storage and disposal costs required to support CAP guaranteed prices. In 1986 total EC budgetary costs stood at 23 billion ecu, some two-thirds of the Community's total budget. The figure is spiralling upwards: unless action is taken the cost in 1988

could be over 30 billion ecu. In 1986 about three-quarters of this expenditure were attributable to storage and disposal costs (ie half the total EC budget). (The preponderance of agricultural expenditure in the EC budget is the main factor responsible for the UK's disproportionate budgetary contribution to the Community.)

5. In addition to the Community's expenditure the Member States are responsible for the initial costs of intervention buying and for national support programmes. Total expenditure by the Member States in the early 1980s was estimated to be broadly equivalent to the level of Community expenditure. Overall, according to OECD figures, the total contribution made by Community taxpayers to the agricultural sector in the 1980s was about 40% of the sector's value-added and about 1% of Community GDP.

6. The consumer also foots the bill through higher food prices. The excess costs (over current world prices) to the consumer were estimated by the OECD to amount to 60% of Community agricultural value-added and 1.8% of Community GDP (some 65 becu or £550 a year for a family of four). The comparison with current world prices tends to exaggerate the costs somewhat because liberalisation would cause world prices to rise from current levels but to nothing like the level of guaranteed prices.

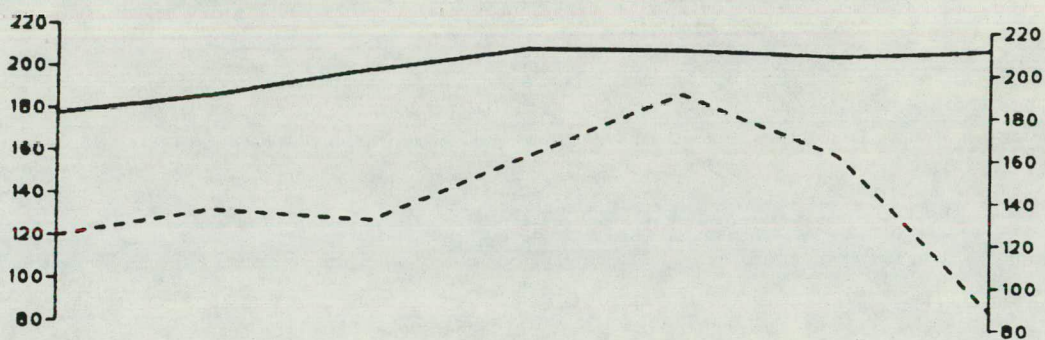
7. On these (somewhat unrealistic) estimates, almost all the income of Community farmers is provided by the taxpayer and the consumer in excess prices.

8. This involves a loss to the real economy in terms of consumers' standards of living, output and jobs. There are various ways in which this comes about (see Note 1). A policy which sustains resources producing almost zero value-added must mean that alternative more economic activity is starved of resources. International trade effects from agricultural protection have an adverse impact on the non-agriculture economy of developed economies and exacerbate trade tensions.

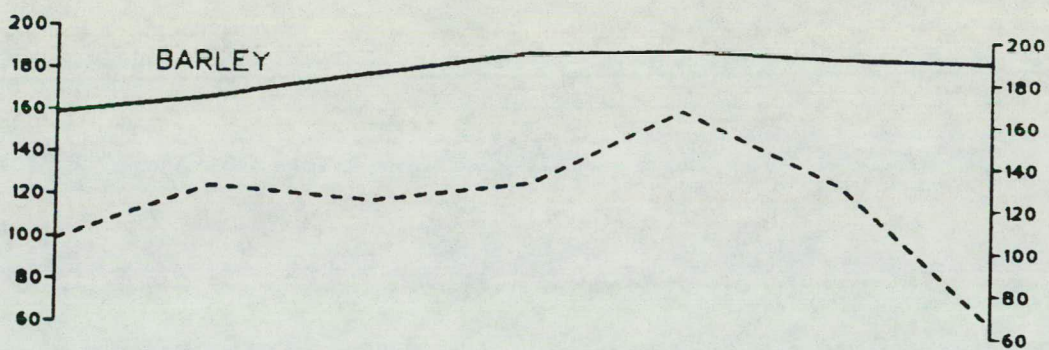
9. Recent estimates suggest that, through these wider effects, Community agricultural support has reduced GDP by up to 1%. With the estimates of taxpayer and consumer costs quoted earlier, this means that for every £100 transferred to the farmers, there could be a loss to Community GDP of £35 (some estimates are even higher). This could represent a significant loss of jobs in the Community, primarily in manufacturing and many of them in the UK.

COMMUNITY PRICES AND NOTIONAL WORLD PRICES

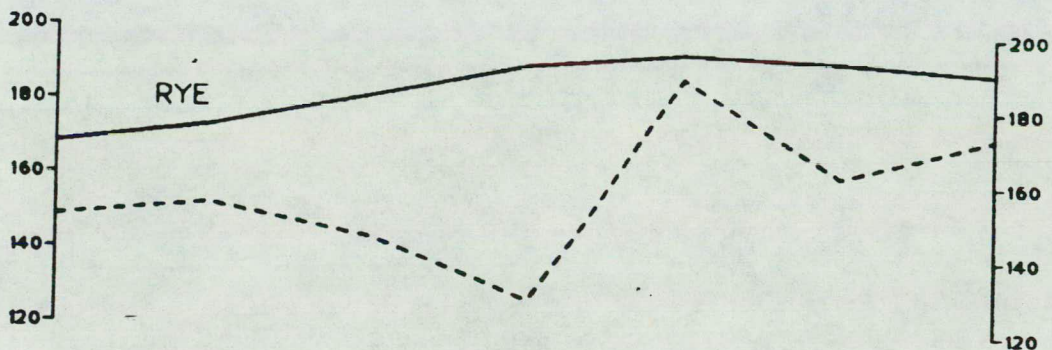
COMMON WHEAT



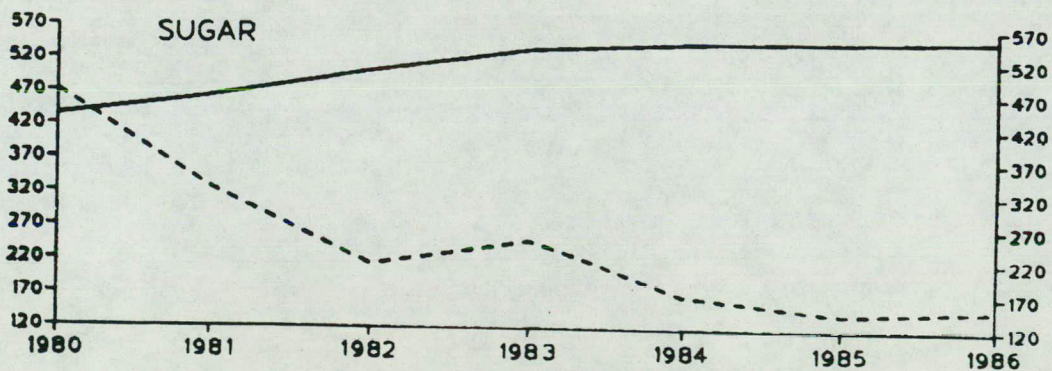
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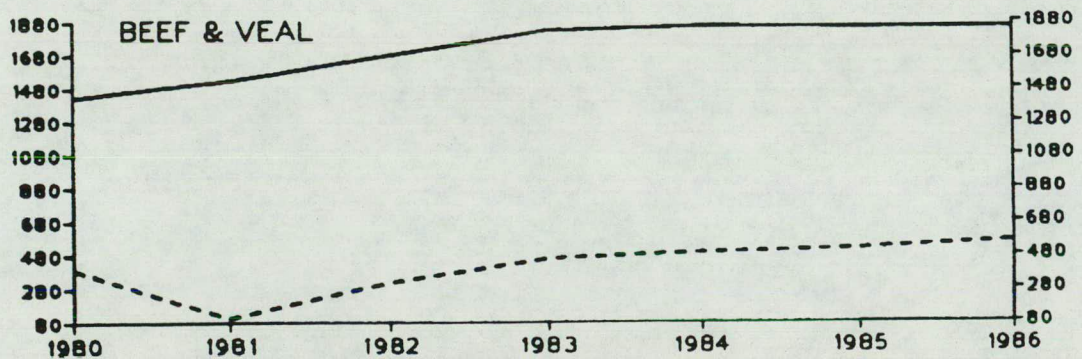
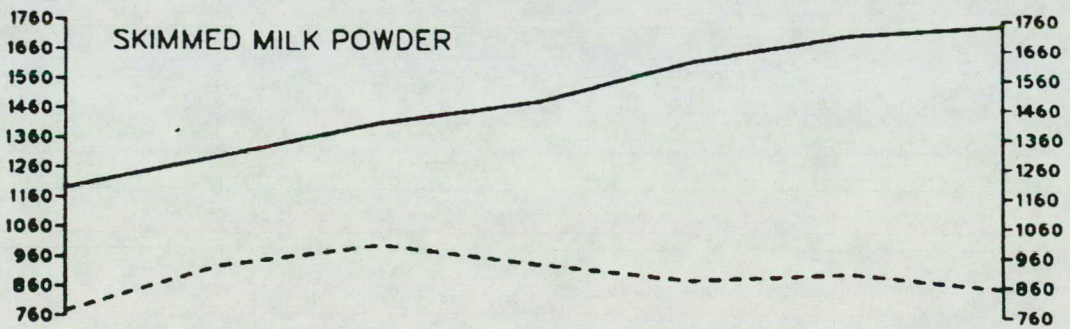
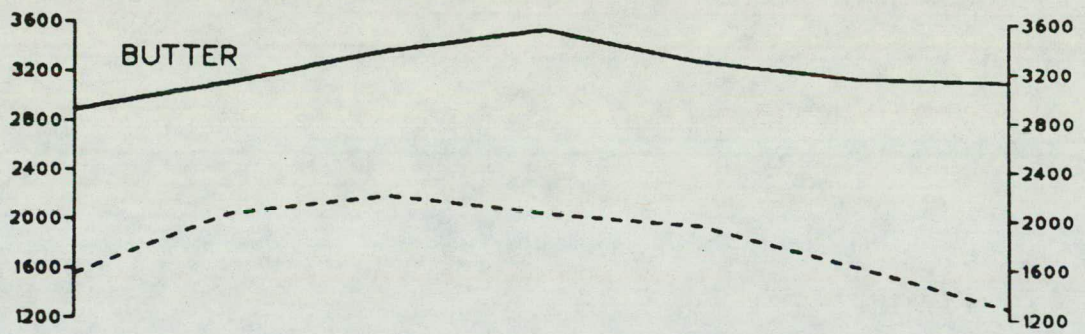
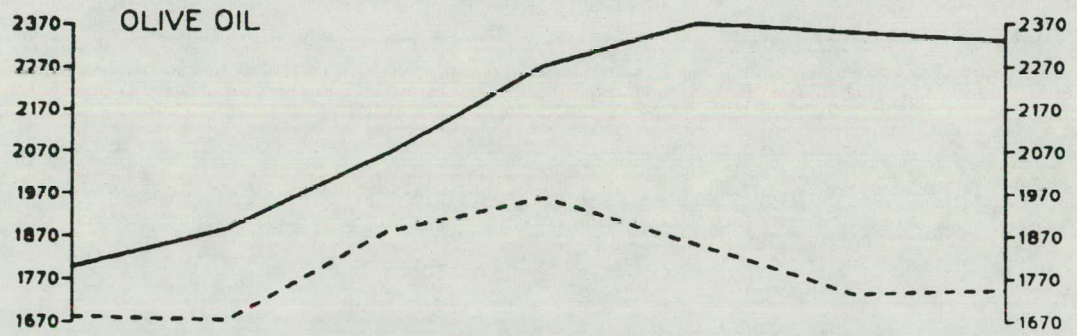


SUGAR



— Reference or Intervention Price
 - - - World Price
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COMMUNITY PRICES AND NOTIONAL WORLD PRICES



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b. Higher prices for agricultural products adversely affect those industries using them as inputs (eg food-processing). More generally, a regime which maintains high prices and tends to increase them (the political pressure from the large number of marginal farmers) increases inflationary pressures.

c. Upward pressure on the real exchange rate, ie lower competitiveness, brought about by the positive shift in the balance of trade in agricultural products (induced by agricultural support) will reduce the balance of trade in non-agricultural products. Consequently we forfeit the benefits of comparative advantage and Community manufacturing has suffered.

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21/9/87cc



pmp

CST
 FST
 PMG
 EST
 Sir P Middleto
 Mr F E R Butle
 Sir T Burns
 Sir G Littler
 Mr Lavelle
 Mr Monck
 Mr Burgner
 Mr A Edwards
 Mr Evans
 Mr Spackman
 mr Bonney
 Mr Culpin
 Mr Mortimer
 Mr White
 Mr Corry
 Ms Symes
 Mr Byatt
 Mr Tyrie

Treasury Chambers, Parliament Street, SW1P 3AG
 01-270 3000

FOREIGN SECRETARY

AGRICULTURAL REFORM

We will shortly be resuming discussion in OD(E) of our negotiating objectives in the EC future financing review. Agricultural reform lies at the heart of this exercise. But reform has also to be set in its wider international context - notably the GATT negotiations but also continuing debate in groups such as the Development Committee of the IMF and IBRD.

I thought it might be useful to step back a little from detailed on-going work to consider what broad principles we should have in mind in the process of agricultural reform. I enclose a paper written in the Treasury which sets out ten principles which put agricultural policy in the wider context of improving the performance of the whole economy. They are designed to provide a link between immediate tactics and the long-term aim of reform. They should also assist us in occupying the moral high ground in the agricultural debate, rather than simply being seen as pursuing a UK budgetary interest.

I suggest that these principles might guide our negotiating strategy and, subject to any reflections you and others might have, be drawn on as appropriate in speeches on the subject.

The Economic Policy Committee of the Community, under French chairmanship, has recently produced a helpful paper

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on the CAP, which has much in common with these ten principles. It is attached for convenience.

I am copying this minute to the Prime Minister, the Minister of Agriculture, the Secretary of State for Trade and Industry and the Secretary of State for the Environment.

A handwritten signature in dark ink, appearing to be "N.L." with a flourish.

N.L

21 September 1987

PRINCIPLES OF AGRICULTURAL REFORM

1. The problem of excess agricultural production is becoming increasingly serious. It has damaging consequences for budgets and for other sectors of the economy. Yet consumers do not gain from low prices.

2. There is a consensus that reform is necessary, but less agreement on what form it should take. If, however, the fundamental problems are to be tackled, reform must work with the grain of market forces. Agriculture must be treated much more like other sectors of the economy.

3. To be fully effective, policies should be reformed at world level. But the priority for the UK is reform of the CAP. Its objectives need to be achieved in more cost effective ways. The Community has for too long treated prices principally as a means of supporting farm incomes, ignoring the costs to the taxpayer, the consumer, the third world and to jobs in the non-agricultural economy.

4. The annex sets out the overall economic costs of the CAP taking account of the wider economic effects as well as the budgetary consequences.

5. The ten principles set out here should underlie the UK approach to the reform of the CAP. They do not cover immediate negotiating objectives, but are designed rather to provide the necessary link between the tactics for reform over the short and medium term and the long term aim of reform. As such they should provide a consistent framework both for the UK negotiations and for Ministerial statements on the long term objectives.

TEN PRINCIPLES

- (i) Reform of agricultural policies, and the CAP in particular, must be seen in the wider international context.

Agricultural policies in developed countries distort world trade and impoverish third world countries. Progress on CAP reform, whilst necessary and desirable on its own merits, is also a necessary condition for obtaining parallel reforms in other countries (notably the US and Japan), but it cannot be delayed until the substantive stages in the current GATT Round negotiations.

- (ii) Reform of the CAP must be consistent with Treaty of Rome objectives and implemented within a Community framework.

The CAP is a central feature of Community policy. But its form needs to be adapted to today's circumstances. Some national measures may be needed (particularly to deal with the social consequences of reform), but they should be consistent with Community objectives and subject to Community rules.

- (iii) The costs to the consumer and to the economy more generally are as important as the budgetary costs in justifying reform.

In addition to its budgetary costs, the operation of the CAP keeps prices to customers well above those prevailing in world markets. Opportunities should be taken to demonstrate to the wider audience (eg the consumers) the magnitude of these costs, their incidence and their causes.

- (iv) The long term aim of reform must be to treat agriculture much more like other sectors of the economy and make it much more open to market forces.

Interventions to secure Treaty and other objectives with regard to agriculture and the rural community must be judged against the principle that the allocation of resources is generally best left to market forces.

(v) Reform should seek progressively to reduce guaranteed prices much nearer to the levels which would then prevail on world markets.

This is the surest way to curb surplus production and to reduce the costs falling on budgets and consumers (including other farmers). Resources need to leave agriculture in a balanced way - reducing labour and capital inputs as well as diverting land to other purposes. Reforms which work with the grain of market forces are preferable to administrative controls. The primary long term purpose for guaranteed prices should be as a smoothing device rather than income support. Any quotas and set-aside proposals should be time-limited and existing quotas should become redundant as prices are progressively reduced.

(vi) Necessary action to control budgetary costs and improve in-year budget discipline should be consistent with making the support system more market orientated.

Measures to increase annual budget discipline (ie, stabilisers) through price reductions are to be preferred. Those which work through quantity controls, taxes or other means should be judged in terms of their consistency with market forces, as well as their likely cost-effectiveness. Limitation or suspension of intervention buying can have similar effects as a reduction in institutional support prices. Revenue raising devices likely to increase prices to the consumer or conflict with the Community's GATT obligations are to be avoided.

(vii) Adjustment costs arising from reform should be met by transitional arrangements linked to price reductions.

In order to achieve significant reductions in prices, it may be necessary to provide other forms of support to those currently engaged in agriculture. Such arrangements, of which direct income aids linked to total incomes are to be preferred, should be decoupled from production, degressive and time-limited. They should be financed by Member States within a Community framework.

(viii) In the longer term, policies should be specifically tailored to cope with inadequacies in market mechanisms.

Guaranteed prices should smooth fluctuations at levels much more closely related to the then prevailing world prices. They should not be the primary source of income support but a means of smoothing income variance. Any income support should be decoupled from production and related to total incomes of those least well-off engaged in agriculture. Risk sharing through insurance and futures markets should no longer be inhibited by the mechanics of CAP intervention. Agricultural policies should be adapted to meet the needs of environmental protection.

(ix) The preservation and development of rural economies are more likely to be achieved in cost-effective and self-sustaining ways by a diversification of economic activity outside agriculture.

The prospects of alternative economic activity in rural economies are improving with advances in communications and the changing nature of manufacturing and other businesses. Sustained support to agriculture is more likely to hinder than enhance the exploitation of these opportunities.

(x) Individual countries should assess the benefits of any package of reform proposals in terms of its wider impact on their economies and the Community as a whole; they should not focus exclusively on any single component.

To assess only the immediate and direct effects of any single proposal for reform would be to neglect the significant wider benefits available from adopting a package of proposals.

6. In assessing particular proposals on the CAP or on agricultural reform more generally, the UK should have regard to the principles enunciated here. They should be drawn on when the UK publicly makes the case for reform. It is acknowledged that reform will depend on what other countries and Community Member States can be persuaded to accept. Recent international meetings have shown a growing awareness of the need to reform agriculture policies on the market oriented lines consistently advocated by the UK. The current budgetary crisis in the Community offers an immediate opportunity to make progress consistent with the above ten principles.

ANNEX 1

The Costs of the CAP

1. The economic and budgetary costs of the CAP arise because the prices of Community agricultural produce are held above world price levels (see charts). A vicious spiral is set up by the primary reliance of the CAP on guaranteed prices well in excess of world prices. This provides an incentive for increased output. It also increases the prices of agricultural inputs (notably land). This squeezes the incomes of the small and medium sized farms. As a consequence, whilst most agricultural output is produced at a profit, most farmers in the Community operate uneconomically. This increases the demand for higher guaranteed prices. And so the vicious spiral continues.

2. At the same time, demand for agricultural produce is growing only slowly. Advances in agricultural technology, in part prompted by the protection afforded to the sector in most of the developed world, have proceeded rapidly. Stomachs are growing less quickly than our ability to fill them; and market prices fall. So, the produce from protected agriculture can only be sold on world markets below cost. This increases the economic and budgetary costs of protection.

3. These consequences are not the result of the particular form of the CAP. Economic and budgetary costs will be incurred to a significant extent by any policy which holds Community prices above the level that would prevail if Community producer had to compete in, or consumers had access to, world markets.

4. The budgetary costs of the current policy include the export restitutions, internal subsidies and intervention storage and disposal costs required to support CAP guaranteed prices. In 1986 total EC budgetary costs stood at 23 billion ecu, some two-thirds of the Community's total budget. The figure is spiralling upwards: unless action is taken the cost in 1988

could be over 30 billion ecu. In 1986 about three-quarters of this expenditure were attributable to storage and disposal costs (ie half the total EC budget). (The preponderance of agricultural expenditure in the EC budget is the main factor responsible for the UK's disproportionate budgetary contribution to the Community.)

5. In addition to the Community's expenditure the Member States are responsible for the initial costs of intervention buying and for national support programmes. Total expenditure by the Member States in the early 1980s was estimated to be broadly equivalent to the level of Community expenditure. Overall, according to OECD figures, the total contribution made by Community taxpayers to the agricultural sector in the 1980s was about 40% of the sector's value-added and about 1% of Community GDP.

6. The consumer also foots the bill through higher food prices. The excess costs (over current world prices) to the consumer were estimated by the OECD to amount to 60% of Community agricultural value-added and 1.8% of Community GDP (some 65 becu or £550 a year for a family of four). The comparison with current world prices tends to exaggerate the costs somewhat because liberalisation would cause world prices to rise from current levels but to nothing like the level of guaranteed prices.

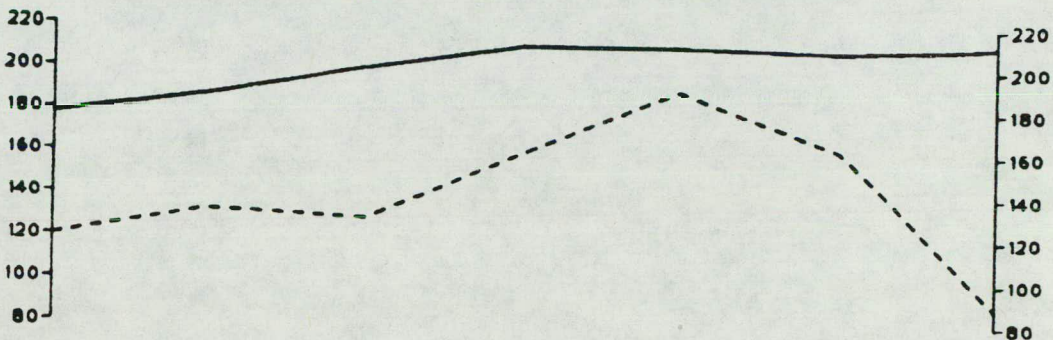
7. On these (somewhat unrealistic) estimates, almost all the income of Community farmers is provided by the taxpayer and the consumer in excess prices.

8. This involves a loss to the real economy in terms of consumers' standards of living, output and jobs. There are various ways in which this comes about (see Note 1). A policy which sustains resources producing almost zero value-added must mean that alternative more economic activity is starved of resources. International trade effects from agricultural protection have an adverse impact on the non-agriculture economy of developed economies and exacerbate trade tensions.

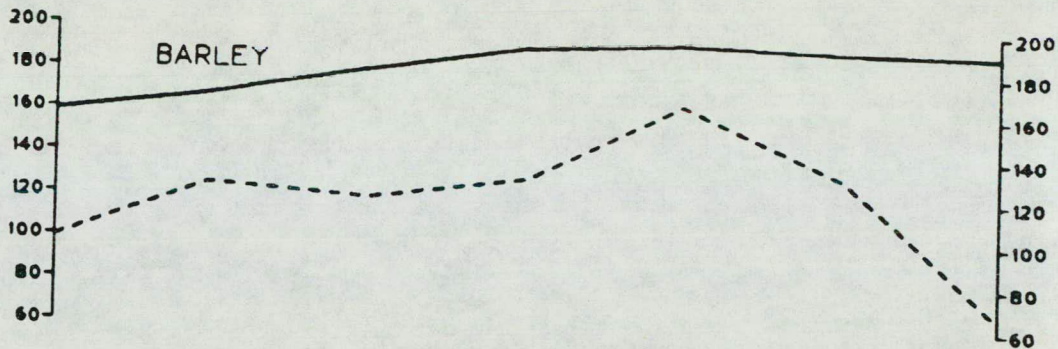
9. Recent estimates suggest that, through these wider effects, Community agricultural support has reduced GDP by up to 1%. With the estimates of taxpayer and consumer costs quoted earlier, this means that for every £100 transferred to the farmers, there could be a loss to Community GDP of £35 (some estimates are even higher). This could represent a significant loss of jobs in the Community, primarily in manufacturing and many of them in the UK.

COMMUNITY PRICES AND NOTIONAL WORLD PRICES

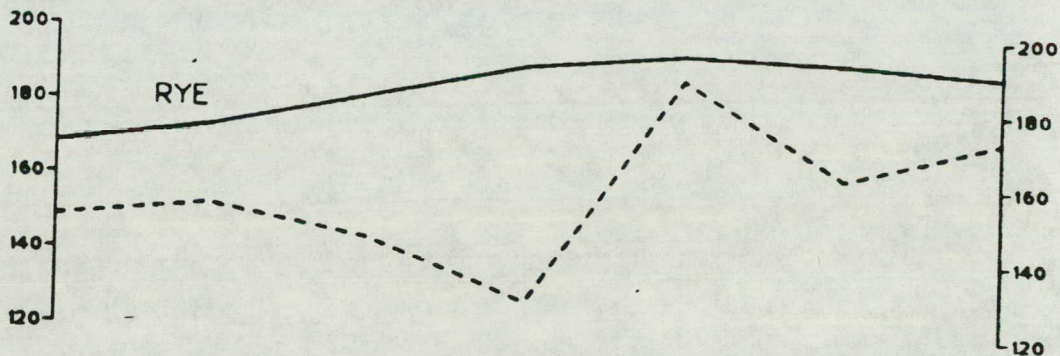
COMMON WHEAT



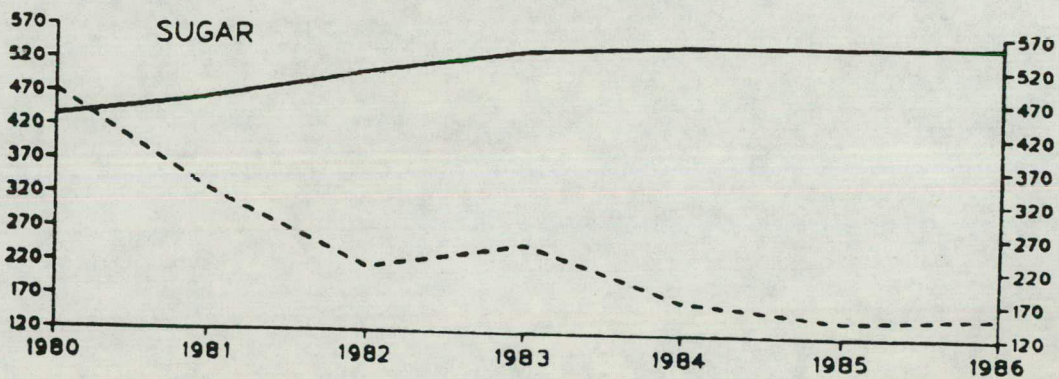
BARLEY



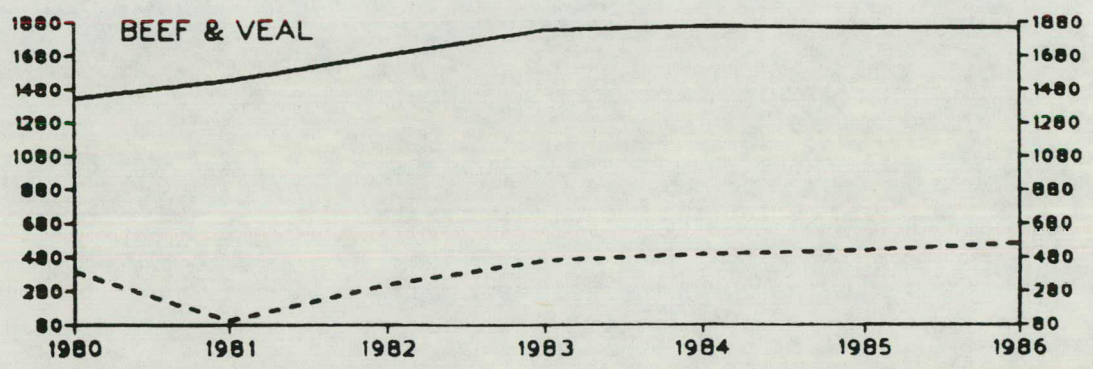
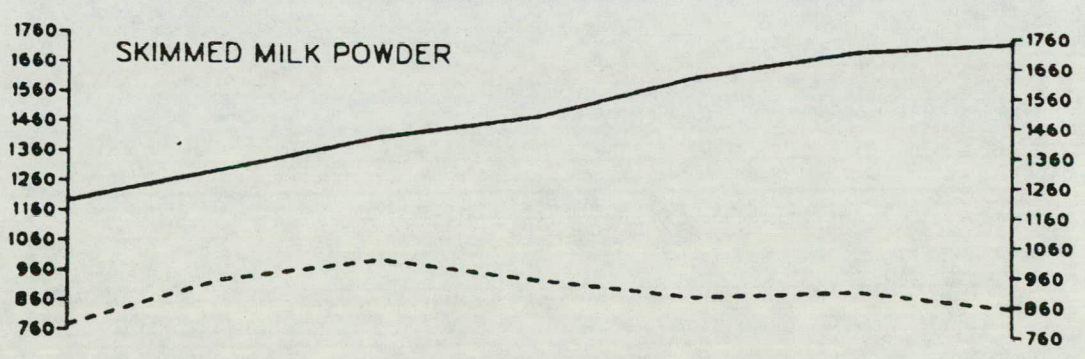
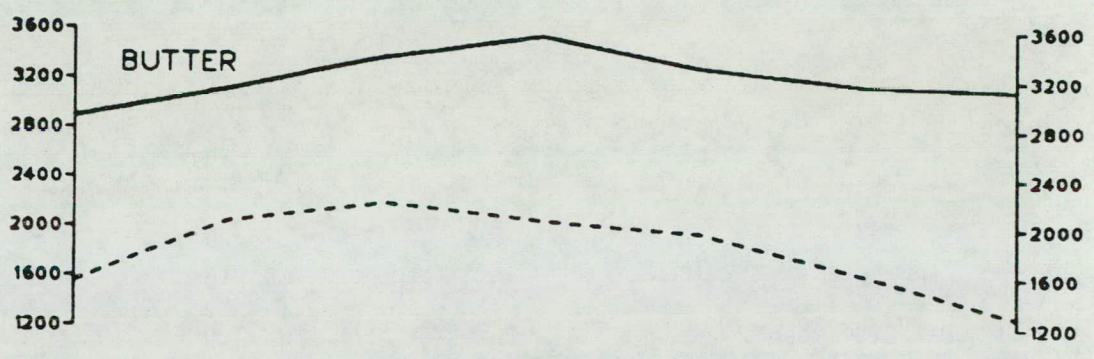
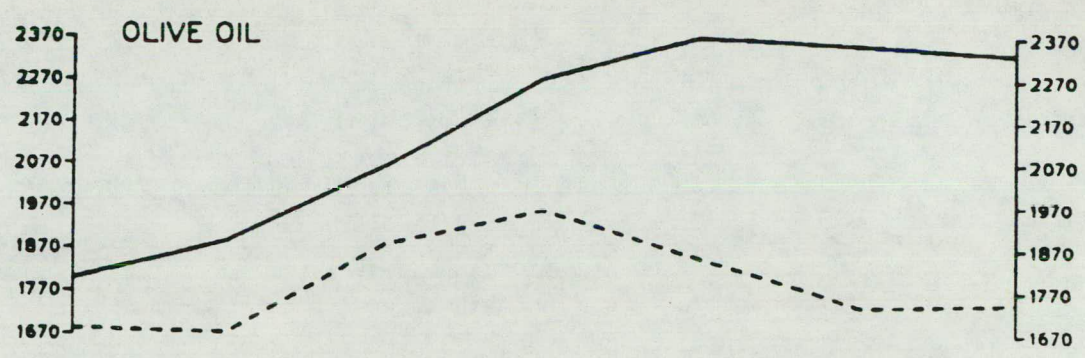
RYE



SUGAR



— Reference or Intervention Price
 - - - World Price
 Nominal ECU/Tonne



— Reference or Intervention Price
 - - - World Price
 Nominal ECU/Tonne

THE IMPACT ON OUTPUT AND JOBS FROM THE CAP

1. The CAP sustains agricultural resources producing approximately zero value-added. Alternative more economic productive activity does not take place. Estimates suggest that this could amount to a full 1 per cent of Community GDP and perhaps 1 million Community jobs.
2. These effects come about in the following ways:-
 - a. Higher output prices hold resources in the agricultural sector. They induce higher prices for inputs, above all land. This displaces other uses and development of rural land and employment opportunities (an increasingly important consideration as the urban-rural shift of economic activity continues). Capital and R&D get locked into agriculture which could be better used elsewhere.
 - b. Higher prices for agricultural products adversely affect those industries using them as inputs (eg food-processing). More generally, a regime which maintains high prices and tends to increase them (the political pressure from the large number of marginal farmers) increases inflationary pressures.
 - c. Upward pressure on the real exchange rate, ie lower competitiveness, brought about by the positive shift in the balance of trade in agricultural products (induced by agricultural support) will reduce the balance of trade in non-agricultural products. Consequently we forfeit the benefits of comparative advantage and Community manufacturing has suffered.
 - d. Third World countries' incomes are reduced both by the downward pressure on world prices from Community and other countries' surpluses and by lack of access to Community markets. This exacerbates debt problems with implications for world growth and stability. It undermines demand for manufactured goods of the Community in developing countries.

e. Higher agricultural output and intensification generates environmental costs and displaces other rural development and activity and other non-agricultural output more generally. Not only is this a cost in its own right, but it also increases pressure for the public sector to intervene in these areas to compensate for the distortions introduced by its interventions in agriculture. Subsidies breed subsidies.

—
The Chairman

ECONOMIC REFLECTIONS
ON THE COMMUNITY'S AGRICULTURAL POLICY

REPORT TO THE COUNCIL

The Economic Policy Committee sees it as one of its tasks to take a position on pressing questions of economic policy in order to assist and orient policy-makers in their decisions. It therefore considers it appropriate to comment on agricultural policy from a general economic point of view. It is clearly not the business of the Committee to present detailed specific proposals for the reform of the Common Agricultural Policy.

The Committee has asked me to report to the Council (Economic and Financial Affairs) on the outcome of its discussions on agricultural policy. This could be useful in view of the deliberations on this matter which will follow the European Council of the end of June 1987.

* * *

The current situation and fundamental problems

1. The Common Agricultural Policy (CAP) has certainly achieved most of the aims listed in the Treaty of Rome. But in recent years it has itself resulted in serious imbalances. As long as the Community had a shortage of most of the main agricultural products, supporting farm incomes via prices - the salient feature of the CAP - meant that the cost was paid for essentially by the consumer. This helped to disguise budgetary and other problems. As the Community became increasingly self-sufficient in food, however, substantial production surpluses also came into existence since year

by year supply was on average increasing far more sharply than demand. This led to the build-up of huge stocks, placing an ever-heavier burden on the Community budget. The CAP also led to a distorted allocation of economic resources and intensified certain trade conflicts. At the same time it still failed to prevent large sections of the agricultural population from regarding their incomes as unsatisfactory. Besides the Community, almost all the other industrialized nations share responsibility for the present situation on the agricultural markets. World-wide protectionism in agricultural policy led to a collapse of world market prices and to distortions in international agricultural trade.

Budgetary and macroeconomic aspects

2. It is true that reform of the CAP has become a pressing need as a result of the high costs and the financing difficulties besetting the Community budget. However, reform should not be confined to this one aspect of the situation, however important it may be. It should be geared to reducing progressively the present distortions without at the same time creating new ones.

3. Prolonged maintenance of support or guarantee prices above their equilibrium level has the effect of retaining too many workers and too much capital in agriculture and produces excessive costs for the other sectors of the economy. This results in distortions between agriculture and these other sectors. Moreover, if some products are afforded greater protection than others, it also results in distortions even within agriculture.

4. When agricultural prices are held above equilibrium levels, they also directly impair the competitiveness of the industries processing agricultural products. High prices and support costs place a burden on other sectors, reducing the competitiveness of the economy as a whole. As a result of the

wider effects of agricultural protection on international trade, agricultural policy has also had an adverse effect on producers of other tradeable (especially manufactured) goods.

Guidelines for reform

5. The main pillar of the reform of the CAP must be to make agriculture once more subject to the rules of the market economy. Prices which do not reflect the market situation give rise to the misallocation of resources. This is why genuine market signals must again, and to an increasing degree, determine farmers' decisions, and the conditions for this must be established. Price policy should not be the only tool of ensuring proper incomes for those engaged in agriculture. A more market-oriented policy is needed to bring about a balanced relationship on a lasting basis between the supply of and demand for agricultural products and the more efficient allocation of resources. Such a policy requires certain transitional arrangements and should be accompanied by appropriate socio-structural measures.

The adjustment process

6. The existing imbalances have built up over a long period. They are so great that they cannot be corrected in the short term. Because prices on world agricultural markets have been distorted by manifold interventions, internationally concerted action is necessary so that the conditions for market equilibrium can gradually be restored. The distorting elements of the policy of agricultural intervention must be eliminated step by step. This applies to the Community but also to other countries which determine world trade in agricultural products.

7. The reform of the agricultural policy will require an adjustment process stretching over several years. During this phase it will very probably be difficult to avoid measures working in the same direction as the necessary shift of

official prices such as a limitation of intervention obligations and the introduction of co-responsibility levies. In cases where supply takes too long to respond to the gradual adjustment of prices, and surpluses build up, temporary recourse to instruments of administrative control may be justified, such as measures restricting the output of products qualifying for price guarantees (quotas), or the use of certain factors of production (setting aside of land). In doing so, special situations in Member States should be taken into account.

8. When products are subjected to quotas, a gradual alignment of producer prices on equilibrium prices is also necessary. Views differ on the most appropriate way to relate the process of price adaptation to the phasing out of quotas.

The policy of setting farmland aside requires the utmost caution because it distorts factor prices. It boosts the value of the agricultural land which is allowed to be used and prevents land from being used for alternative purposes (agricultural or otherwise). It can also lead to more intensive use of the land remaining in production, and partly frustrate the objective of reducing production.

9. As regards the adjustment of prices, two further considerations should be taken into account:

On the one side, it would be desirable gradually to harmonize the degree of protection enjoyed by the various agricultural products, so as to reduce the distortions within the agricultural sector. This would mean that, as far as possible, the most heavily protected products should be dealt with first.

On the other side, price differences resulting from monetary compensatory amounts should be gradually reduced and disappear altogether with the completion of the internal market. The European Council has introduced a system which goes in this direction.

Social and structural policy

10. The reform of the CAP by a gradual transition to a policy more reliant on market forces must be accompanied by measures, dealing with the following in particular :

- greater mobility of the factors of agricultural production;
- social welfare measures to support this reorientation;
- an appropriate policy on agricultural structures.

The Committee is aware that structural adjustment in agriculture, as in other sectors of the economy, is easier to undertake in an environment of economic growth and high employment.

a) Factor mobility

11. Labour mobility could be encouraged by an improved training policy, backed up by appropriate aid for conversion and restructuring. These aids should not, wherever possible, be linked to the quantities produced, or to farm inputs. They need not depend on whether or not the farmer leaves the sector. Non-agricultural jobs should be created by encouraging the expansion of other industries or services.

Moreover, care should be taken to ensure that there is no further distortion of relative factor costs in the agricultural sector and that there are no artificial and short-sighted incentives favouring the use of capital rather than labour, such as aids to investment or for the more intensive use of land following set-asides.

b) Aids of a social nature

12. The Committee acknowledged the value in principle of such aids for an appropriate transitional period. Aids should be person-related. The basis for determining aid should be the total income of persons employed in agriculture (including subsidiary earnings) and not only their income from agricultural activity. The Committee felt that it is not part

of its remit to express a detailed view on the manner in which, or the level at which, such aids could be granted. Given the diversity of farmers' situations in the Community, implementation by national authorities within a Community framework would be most appropriate. This should not be seen as a step towards the renationalisation of the CAP. These measures should not be such as to increase agricultural output.

c) Policy on agricultural structures

13. Policy on agricultural structures should, as a general rule, be designed to be consistent with a policy directed towards reducing distortions and surpluses. Above all it should not encourage investments designed to increase production when this is inappropriate. This basic stance should not rule out social or other policy measures insofar as these seem necessary for reasons to do with the structure of society, the environment and regional development. In this context, the Committee pointed to the need to take account of the problems of regions which would be particularly affected by the adjustments in agriculture.

Incorporation of new objectives

14. In recent years, increasing importance has been attached to concerns such as the protection and improvement of the environment and of landscapes. In these respects farmers may perform a service to society without receiving payment via producer prices. New tasks could properly be defined for them for which they would be paid - insofar as this is not already the case. Compensation could be envisaged in cases where the permanent abandonment of farmland or its conversion to other uses is entailed. If, for ecological reasons or for the purposes of landscape improvement, it seems desirable to preserve agricultural activities in specific areas, provision should be made for the appropriate measures.

15. In order to prevent over-intensive use of the soil, ecologically undesirable production methods, the inadequate rotation of crops or high-density stockfarming from entailing risks and costs to the environment, the same principles should as far as possible be applied to agriculture as are applied in environmental policy generally, among which the principle that "the polluter pays" plays a key role.

Summary

16. The main considerations are the following:

- It is essential to obtain a better adjustment of supply to demand through measures enabling the market to play a greater role.
- A more strongly market-related pricing policy should be the central pillar of the reform of the CAP. In particular, pricing policy must gradually be detached from the objective of income support; other instruments should be used to ensure proper incomes for those engaged in agriculture. Prices should again be more strongly determined by the aim of balancing supply and demand than they are in the present system. This would help to ensure the better allocation of resources whilst reducing the overall budgetary burden. It can only be brought about by an adjustment process stretching over several years.
- Since the reorientation of agricultural policy requires radical adjustments on the part of farmers, it requires corresponding back-up measures. These could in particular comprise aids for restructuring and conversion as well as social measures, the overall budgetary costs of which should be lower than the savings obtained by the price reductions.

- New or broader tasks in the field of environmental and landscape protection and improvement might provide employment and reduce the extent of the necessary structural adjustment.

- World agricultural markets are at present characterized by distortions caused by various interventions in most countries. The progressive removal of interventions which work against a more balanced relationship between supply and demand is thus also a matter for international negotiations and will call for contributions from all participating in them.

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29/9/87.

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH



From the Minister

*I have not yet
had time to prepare
a response.*

CHANCELLOR OF THE EXCHEQUER

CH/EXCHEQUER	
REC.	30 SEP 1987
ACTION	MR BUATT.
COPIES TO	CST FST PMG EST SIR P. MIDDLETON MR FER BUTLER SIR G. LITTLER SIR T. BURNS MR LABELLE MR MONCK MR BURGER MR A. EDWARDS MR H. BYANS MR SPACKMAN MR BONNEY MR WILPIN MR MORTIMER MR WHITE MR COLKY MS SYMES MR TYRRE

AGRICULTURE REFORM

Thank you for copying to me your minute of 21 September to the Foreign and Commonwealth Secretary.

I agree broadly with the ten principles attached to your minute. But as you suggest that the principles, and presumably the explanations of them in the paper, might guide our negotiating strategy and be drawn on as appropriate in speeches, I am enclosing some reactions and drafting alternatives which I hope we could discuss. Most are points of presentation, designed from the point of view of achieving our negotiating objectives more easily. One or two are points of substance.

I have three main comments. First, I agree that we need to explain clearly why reform of agricultural policies is necessary, referring particularly to their undesirable effects on the economy as a whole. It is helpful that the Economic Policy Committee has produced a paper on the subject, even though most of its conclusions are considerably qualified.

But second, in presenting these arguments we must be conscious of the presentation, tactics and to some extent policies which will help us to achieve results in reducing the surpluses and the budgetary costs. In my experience there has been a shift in the outlook of other Member States; recent decisions on the CAP would have been unthinkable a few years ago. We have to continue and accelerate this process. But we cannot expect sudden overnight conversion.

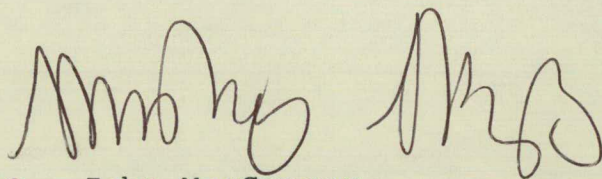
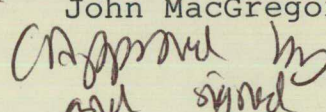
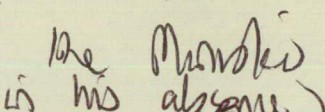
At present we have two immediate tasks. One is to get further changes in the CAP, particularly in the context of discussion of budgetary stabilisers, which will reduce surpluses and the economic cost of the policy; and to achieve this in ways which rely to the maximum extent on market forces. The other is to ensure that the Commission is left free to negotiate for sensible objectives in the GATT Round, not illusory ones such as sharing out the world market.

I doubt whether coming out point-blank with the statement that the aim is to expose EC agriculture to world market prices with simply some modest mechanism to smooth their fluctuations will help us in these tasks. The reaction from other Member States will be that they always knew that the UK wanted to do away with the CAP and here is the proof. The risk is that we will get left on one side, our views will be discounted and the reform agenda will be set by others. It is with that problem in mind that I have suggested some drafting changes.

Third, I do feel that we cannot count on reduction in price support alone to get the costs under control. You know how keen I am to reduce budgetary costs and to establish budgetary disciplines. But it is not politically realistic to think that other key Member States will go along with the decisions which would be necessary to achieve this. I do therefore believe that, certainly in the period immediately ahead, we ought to make it clear that we are prepared to accept the continuance of dairy quotas and to argue positively for schemes to take land out of agriculture production such as set-aside in cereals as complementary measures. They will both help us to cut costs and also, I think, give us a better chance of achieving our negotiating objectives.

I am copying this minute to the Prime Minister, the Foreign and Commonwealth Secretary, the Secretary of State for Trade and Industry and the Secretary of State for the Environment.

29 September 1987


for  John MacGregor
and signed in his absence 

PRINCIPLES OF AGRICULTURAL REFORM

Paragraph 1: Plenty of consumers are benefitting from low world prices, even in the EC so far as oils and fats are concerned. I propose:

"The problem of excess agricultural production is becoming increasingly serious. It means that other sectors of the economy are contributing massively to agriculture either through taxes or food prices or both. This has damaging consequences for those sectors."

Paragraph 2: Here and elsewhere the implication is that no reform at all has yet happened, and that the picture is one of unrelieved lack of realism. But both the EC and the US have taken important steps to cut support levels over the last few years. The reforms in the CAP for milk and beef achieved under our own Presidency are now bearing fruit. I think it would be counter-productive in our public presentation, particularly in an EC context, not to acknowledge this. We must of course add that much more needs to be done.

Ten Principles

(i) The first part of the second sentence could be interpreted as implying that the US and Japaness would only be justified in reforming their farm policies if the EC does so. I am sure that that is not what is meant. I suggest a redraft as follows, the last two sentences of which are important presentationally as far as other member states are concerned.

"It is crucial that the GATT Round Negotiations shall secure major reform of other developed countries' support systems, notably the US and Japan, as well as our own in the EC. But further CAP reform is urgent and cannot be delayed until the substantive

phase of those negotiations. There is no reason to suppose that this will take the pressure off other developed countries. The principle that countries can claim credit for actions taken since the launch of the negotiations is widely recognised."

(iii) Your principle refers to costs for both consumers and the economy in general, but the following two sentences seem to concentrate only on the first of these. Consumer representatives are constantly documenting the cost to the consumer. I believe that greater emphasis should be placed on the wider economic effects, and suggest rewording as follows:

"Under the CAP transfers to agriculture from the rest of the economy come via the budget and, to an even greater extent, via consumers who pay prices well above world prices. These transfers adversely affect the rest of the economy. Opportunities should be taken to demonstrate the magnitude of the total costs, their incidence and their causes, so that these can be fully understood as we press reforms.

(v) I have several comments:

First, it should be specified that a reduction in inputs is likely to mean less intensive use of land. This is a helpful presentational point.

Second, in the context of forthcoming negotiations on CAP reform, at least in the next two or three years, I do not think that it is realistic politically, nor helpful from a negotiating point of view, to suggest that any quotas and set-aside proposals should be time limited or that existing quotas should become redundant as prices are progressively reduced. In the discussions coming up on the future of the dairy regime, we will not get anywhere in arguing this line

and may therefore undermine our own objectives; and from the point of view of containing budgetary costs, keeping supply and demand in balance through the quota system is almost certainly the only negotiable route. In cereals, we are going to need complementary measures on top of price reductions to get support costs down. It is also important to make a distinction between set-aside proposals and quotas.

I therefore suggest the following for the last four sentences:

"Resources need to leave agriculture in a balanced way - reducing labour and inputs so as to use land less intensively as well as diverting land to other purposes. Reforms which work with the grain of market forces are always to be preferred, and our emphasis must continue to be strongly in that direction; though complementary measures such as set-aside, which will also help to reduce budgetary support costs, may be necessary in some sectors for transitional reasons in the short to medium term. Intervention buying, by creating an artificial outlet, works against market forces and its role should be diminished so that it reverts to a safety net wherever possible."

(vi) I am concerned with the conclusion of "taxes or" in the third line. In general we should be against taxes, co-responsibility levies and similar revenue raising devices as not being the way to tackle expenditure problems. This point is recognised in the last sentence, but I do not think that we are simply looking at revenue raising devices which are likely to increase prices or conflict with the Community's GATT obligations; they are the wrong method in themselves. I suggest:

"Levies or taxes, whether on farm output on or consumption, are in effect borne by consumers and must be avoided, especially if they conflict with the Community's GATT obligations."

(vii) I cannot accept that direct income aids are the best form of transitional measure to accompany price cuts. Aids which directly

get resources out of agricultural production must surely be better than those which are merely decoupled from it. There are few or no signs yet that other EC Member States see transitional income aids for poorer farmers as a method of making reductions in support politically acceptable. The UK is unlikely to benefit; and, however much we say they should be nationally financed, this will be very difficult to achieve when the Commission has already proposed a Community contribution. I suggest:

"In order to assist the process of price reduction, it may be necessary to offer other forms of support. Preferably these should be directly linked to reductions in output: for example, aids to divert land to other purposes, including forestry; to convert to more extensive forms of agriculture; and to leave land unused (set-aside). Schemes of this sort will not only speed up the supply response to lower prices but can also bring environmental benefits. Direct income aids for poorer farmers should only be contemplated if they are manifestly necessary to achieve agreement on price cuts. They should be related to total income, production-neutral, degressive, and financed by Member States within a Community framework."

(viii) It seems unnecessary to repeat what has been said about income aids under (vii).

I suggest the following:

"Guaranteed prices should be set in relation to the actual need for security of food supplies for the Community. They should not be tailored to providing a given level of income but should be related much more closely to prevailing world prices and permit market forces to operate. The operation of future markets to help insure against unexpected price fluctuations should not be inhibited by support mechanisms. Agricultural policies should be adapted to meet the needs of environmental protection."

(ix) I suggest instead of the last sentence:

"The argument that lower farm support will lead to rural unemployment is thus losing its force."

(x) After "as a whole" add "and the need to avoid unnecessary disputes with third countries."



DEPARTMENT OF TRADE AND INDUSTRY
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Secretary of State for Trade and Industry

30 September 1987

The Rt Hon Nigel Lawson QC MP
 Chancellor of the Exchequer
 Treasury Chambers
 Parliament Street
 London SW1P 3AG

Nigel Lawson

CH/EXCH/110	
REC.	01 OCT 1987
ACTION	MR BYATT
COPIES TO	CST FST PMG EST SIR P. MIDDLETON SIR G. LITTLER MR F. E. R. BUTLER SIR T. BURNS MR LAVELLE MR MONCK MR BURNER MR A. J. C. EDWARDS MR H. PEHANS MR SPACKMAN MR BONNEY MR CULPIN MR MORTIMER MR G. WHITE MR CORY MS SIMES MR TYRIE

AGRICULTURAL REFORM

Thank you for copying to me your minute of 21 September to the Foreign and Commonwealth Secretary. I have also seen John MacGregor's minute of 29 September to you on this subject.

below

Like John I broadly agree with the ten principles attached to your minute. Equally like him I do not think we should forget the wider context. Of course the reduction and control of the budgetary cost of the CAP is an immediate priority. But even if we are successful in securing substantial reforms, the CAP will still involve a substantial measure of external protection against competitive producers as well as internal intervention to raise prices. This combination means that consumers as well as taxpayers suffer that EC GDP growth is restricted and that many third world producers are denied access to one of the largest food markets in the world. I therefore agree with you that the long term aim of reform must be to treat agriculture much more like other sectors of the economy and make it more open to world market forces. Many other EC members will have difficulty in agreeing to this but the subject has to be faced in the GATT Uruguay Round.

So far the subjects of EC budgetary control and the Uruguay Round have tended to be dealt with as separate issues. I think it is now important that the two are brought together. In particular I want to ensure that when the EC tables its negotiating offer in Geneva before the end of the year we secure a commitment, even if couched



in general terms, that the Community will work towards a genuine measure of liberalisation in return for parallel action by other countries. I hope there will be occasion in the course of EC budget debates for this point to be registered by you or other colleagues.

I am copying this minute to the Prime Minister, the Foreign and Commonwealth Secretary, the Secretary of State for the Environment and the Minister of Agriculture.

*Lord
Young*

LORD YOUNG OF GRAFFHAM

5/10/87

Bf 8/10
Cp me to ask
to ICRB in this
(same)



FCS/87/207

MINISTER OF AGRICULTURE

CH/EXCHEQUER	
REC.	05 OCT 1987
ACTION	MR BHATT
COPIES TO	CST FST PMG EST SIR P. MIDDLETON MR FER BUTLER SIR G. LITTLE SIR T BURNS MR LAVELLE MR MONCK MR BURGNER MR A. EDWARDS MR P. EVANS MR SPACKMAN MR BONNEY MR CULPIN MR MORTIMER MR G. WHITE MR CORY MS SYMES MR TURIE

*(I assume I was short
gms & submission
on all their response)*

Agricultural Reform

1. I think the ten principles for agricultural reform circulated by the Chancellor of the Exchequer on 21 September are a valuable statement of our objectives. The lessons to be drawn from them are already being applied in our approach to agriculture in the future financing negotiations and the Uruguay Round.
2. I agree with the comments in your minute of 29 September, with the proviso that we should not rule out some form of short term market sharing (eg EC/US) if that is the price of real reform in the longer term.
3. I also go along with all but three (nos vi-viii) of the amendments which you proposed. I do not believe that we should rule out completely measures such as co-responsibility levies which already play a role and which may have to do so in future. Clearly, they are very much second best and, if offset by price increases, only exacerbate the problem. But I would prefer to see farmers having to bear some of the cost of disposal of eg surplus cereals, without compensating price increases, than to see no reform at all with all the spiralling costs borne by the consumer and taxpayer. I would therefore prefer to stick to the Chancellor's wording.



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Handwritten signature in red ink

4. I also prefer to stick to the Chancellor's wording on income aids. The essence of the CAP problem is that prices are held far above world levels in an attempt to maintain farm incomes. The result is excessive supply and burgeoning budget costs. The high prices paid to farmers under the CAP mean massive subsidised profits for large farmers (agriculture is the only sector where the aggregate level of direct subsidy increases with economic success). Many farmers operate at a loss while most output is produced at a profit. The cost of inputs - especially land - is pushed up. This in turn squeezes small farmers. The net result is a vicious circle.

5. I know that you recognise all this, and that we need to break out of the vicious circle. The key to reducing costs must remain a reduction in prices. We should not delude ourselves that policies which act directly on supply do more than deal with the symptoms. Indeed there are many in the Community who see quantitative controls as a justification for increasing prices. We must be aware of that danger when dealing with proposals for quotas and set-asides, valuable as these are as an adjunct to price reductions.

6. Our present policy of modest price cuts, combined with other measures such as stabilisers to curb production, has already achieved some success. But it may not be enough on its own. Because yields are likely to go on rising with improved technology, we still need large price reductions (at least 20% for cereals and milk) to bring production down to marketable levels. But cuts on that scale would come right up against the social and political commitment of governments to small farmers reflected in the present high price levels.



7. Given our manifesto commitments both to uphold the interest of the efficient small farmer and to oppose a two tier price policy, and given the difficulty of negotiating large-scale price cuts within the Community, we need to consider other ways of achieving our objectives. One way would be to build on existing Commission proposals for a Community system of income aids for farmers. If built on top of existing CAP subsidies, this would only add to costs; but if introduced as a substitute for support via the price mechanism, it could facilitate the major price cuts needed to get the market back into balance.

8. The elements of a possible package are in the attached paper. The best outcome would be a scheme in which aids would be nationally financed within an agreed Community framework. But such a scheme would be blocked by the Southern Member States. So some element of Community finance will have to be involved. But what matters most is to ensure that costs overall are reduced. The package would therefore have to be binding over a number of years, with a once and for all agreement on price levels at the outset, and any subsequent fine tuning via the system of stabilising mechanisms we are now trying to get in place. The income aids too should be time-limited and degressive.

9. Such a package would have a number of attractions:

(i) Efficient agricultural economies such as the UK's would increase their European market share at the expense of the inefficient.

(ii) A shift in the basis of CAP support from the price mechanism to income aids would reduce overall costs, and would make it easier to abolish the MCA system, an objective we share with the French and the Commission.

/(iii)



(iii) By acting on the principles of agricultural reform agreed at the OECD Council of Ministers in May (and at the Venice Summit) the Community would gain substantial "credit" in the Uruguay Round negotiations and would be in a position to seek matching concessions from the Americans and the Japanese, as you - and David Young - have pointed out.

10. I do not underestimate the difficulty of achieving such a far-reaching reform on an acceptable basis. But I think we should try, and I hope you and our other colleagues will agree. Commission ideas on income aids which are already on the table are not satisfactory; but they give us a peg on which we could hang ours. Informal and exploratory contacts, with the French first, might be in order.

11. We must of course take care not to overload the Brussels circuits in an autumn where our main aim is to back the Commission on stabilisers, and so bring the present CAP support system under better financial control. An income aids scheme could be useful in defusing German hostility to effective stabilisers, but I suspect that the ideas in the attached paper are more for 1988 than for the pre-Copenhagen debate - unless the Germans dig in firmly at an early stage.

12. I am copying this minute to the Prime Minister, the Chancellor of the Exchequer, the Secretaries of State for the Environment, Employment and Trade and Industry, and the Secretary to the Cabinet.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
5 October 1987

CAP REFORM

CONSEQUENCES OF THE CAP

1. The objectives of the CAP are defined in the Treaty of Rome as:

- (a) To increase agricultural productivity.
- (b) To ensure a fair standard of living for the agricultural community, in particular by increasing farm earnings.
- (c) To stabilise markets.
- (d) To assure the availability of supplies.
- (e) To ensure that supplies reach consumers at reasonable prices.

2. Taken together these objectives are reasonable. In practice, however, the overriding aim has been to assure supplies and ensure a fair standard of living for farmers. The aim of ensuring a reasonable price for the consumer has tended to be ignored. Nor do the objectives take into account factors which have now become important such as preserving the environment and the need to aim for quality as well as quantity of production.

3. The CAP support mechanisms, in so far as intervention is rigidly applied, tend to work so that the higher the output the higher the volume of support. This means that farmers can increase their incomes by raising output. But as farm prices and output increase, so does the demand for agricultural inputs and their prices (particularly agricultural land). This in turn means that small and medium sized farms find that their incomes are squeezed despite receiving high output prices. Young farmers find it impossible to break into the industry because of the cost of land. Production tends to be more and more concentrated on large, capital-intensive farms which require high prices partly to service the debt which has been built up.

4. The paradox today is that most farmers are operating at a loss while most output is produced at a profit.

5. Moreover, in today's world, effective demand is growing only slowly. But agricultural technology is advancing at a break-neck speed. This means that output can only be disposed of in world markets at below cost: adding simultaneously to budget and consumer costs as well as trade tensions.

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6. These distortions are the predictable results of public intervention in the market place. The outcome has been:

- (i) Stable prices to consumers; but at levels higher than would otherwise be the case;
- (ii) Security of supply; but only at the cost of an expensive over-supply;
- (iii) Massive and growing budgetary costs;
- (iv) The distortion of world markets as production has increased, exacerbating global trade tensions.

7. Despite the disadvantages to the consumer and taxpayer, the benefits to farmers from the CAP are declining. Incomes in farming, relative to the rest of the economy, have hardly increased since 1964. The CAP has meant that more resources have been kept in agriculture than would otherwise have been the case, at incomes lower than could be obtained elsewhere in the economy.

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REFORMS SO FAR

8. Attention has been focussed on the symptoms of failure (above all the escalating budgetary costs) rather than the causes. EC member governments have been willing to :

- freeze prices or cut them by small amounts;
 - use other devices to discourage production such as cutting off aid at a certain output level (such as for oil seeds);
 - make producers share in the costs of surplus disposal (such as coresponsibility levies for milk and cereals);
 - build in disincentives to over-produce above pre-determined quotas by introducing penal taxes (such as for milk);
 - make intervention support less attractive (for example by setting higher eligible quality standards for cereals).
- But, so far, reforms have not been enough to overcome the impact of increased production, often caused by advancing technology. Thus, notwithstanding restrictive prices plus the introduction of a

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coresponsibility levy, UK cereals production has risen significantly, from 14.6 million tonnes in 1975-77 to 24.4 million tonnes in 1986. Milk production has been cut (from 16 million litres in the UK in 1982 to 15.6 million litres in 1986) but the dairy industry has learned to live with milk quotas as a guarantee of support (offsetting the penal impact of taxes by pooling arrangements and cutting input costs), and milk quota has become a saleable asset. The cost of oilseeds support expenditure has increased five-fold between 1980 and 1987, because of lower world prices but also because Community production has virtually doubled.

A new policy

9. An agricultural policy designed for today would:

- (i) Allow the disciplines of the market to apply as far as possible;
- (ii) Encourage commercially viable farms to depend more on the market;
- (iii) Allow the social income problems of poor farmers to be tackled directly (rather than by price support);

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- (iv) Be Community-wide (since the alternative of wholly national support schemes would be incompatible with a Common Market and would lead to extra costs through competitive subsidies).
- (v) Encourage diversification of the rural economy without leading to the breakdown of rural society or damage to the environment.

10. The conflict between maintaining a standard of living for the agricultural Community and reasonable prices for consumers cannot be resolved through a price support mechanism which is directed to the needs of the poorest producers in the Community (where incomes range from 45,000 ecu per farm per year in the UK at the top to 8,000 ecu per year at the bottom). That conflict can only be resolved at the cost of some combination of the three groups concerned (consumers, taxpayers and farmers).

11. The fact that output and budget costs are too high would suggest that farmers and landowners should bear most of the cost of adjustment. It has, however, been politically and socially unthinkable to allow farming

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to operate completely according to free-market rules. (Politically, because of the power of farm lobbies throughout Europe and because of the general acceptance that a viable farm industry is vital to every country. Socially, because although farming accounts for only 8% of Community employment and 4% of GDP, the preservation of the landscape and the rural society and economy are seen as important public objectives).

12. The simplest, and most direct, method of reducing production would be to cut prices for all surplus commodities. However:

- (i) Massive cuts would be needed to make substantial inroads into production (at least 20% for cereals and milk);
- (ii) Cuts at that level would put small farmers out of business; they would be unnegotiable in the Community unless accompanied by compensatory action to sustain farm incomes.

- The Annex illustrates a number of alternative options available. Fundamentally, there is a choice between:

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(i) Insisting on non-discriminatory measures which are tough enough to curb all production but which in so doing would put some farmers out of business. Or:

(ii) Measures which, cutting the open-ended nature of support, differentiate between large, commercially-adaptable farmers and small farmers by allowing a relatively greater degree of support to the latter.

- It is politically difficult to defend measures which appear to penalise large, efficient farms more than small farms by reducing the relative volume of support they receive. We have hitherto opposed such an approach as discriminatory. It is, however, economically difficult to defend giving public subsidies to farm enterprises irrespective of their real need. In no other sector does the aggregate level of direct subsidy increase with economic success.

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POSSIBLE SOLUTIONS

13. We need to continue with the current mix of reform measures (price restraint, quotas, coresponsibility levies, etc) enhanced by measures to keep agricultural costs within planned targets, such as:

- (i) Allowing the FEOGA Budget as a whole to grow no faster than the growth in own resources;
- (ii) Providing for mechanisms to ensure that costs above budgeted targets are met by automatic, within-year price reductions, changes in the availability of intervention or coresponsibility payments by farmers. At UK prompting, the Commission has now put forward proposals to this effect (stabilisers). These need to involve cuts in support triggered by objective criteria like the volume of production, stock levels, intervention intake or cost or some combination of both.

14. To help achieve this (and to reduce the degree of political interference by the majority of other member states who favour small farmers) the Commission should

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be delegated more authority by the Council to manage CAP market support levels as necessary within rigorous fixed criteria. (Experience in recent years has been that other member states dilute Commission reform proposals - most of which we support).

15. We could further depoliticise agricultural support by moving away from a situation where the annual price fixing determines developments in the CAP on the grounds that this has become a pay bargaining round for farm lobbies. Instead, support regimes would be determined solely by the amount of money available in any given year's budget. Another approach could be to fix the various regimes at different times in the year.

16. We could also suggest moving to less than 100% Community financing ie toward some national financing if, despite the efforts made, there was clearly still a structural imbalance in a sector (with full Community financing to be restored when the sector is corrected).

17. The green currency system could also be simplified and eventually scrapped, on the grounds that it cocoons farmers from exchange rate variations and market

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signals obtaining elsewhere in the economy and frequently allows individual countries to offset common reform decisions by changing national support price levels.

18. In parallel with cutting back the political control over markets, we could aim to create a more favourable climate for the private sector in agricultural markets. In principle futures markets can provide a degree of commodity price stabilisation by allowing hedging against price variations. Futures markets do exist for cereals, sugar, some vegetable oils and potatoes but they are not widely used since there is insufficient price variation to allow them to work properly. The London commodity markets may be well placed to take on extra European-wide business. Start up assistance to futures markets in other CAP sectors like meat and dairy products could be worth exploring.

19. We could encourage the transformation of large, commercially adaptable farms into businesses integrated more into the marketing and food chain and weaned from public support. We should look for ways to encourage smaller British farms to participate in the commercial

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success of larger enterprises.

20. More rational use could be made of national and Community structural expenditure, breaking the link between such aids and productivity (possibly instead linking aids to less intensive farming). "

A move from price support to income support?

21. Many of the above ideas are worth pursuing in their own right. But to bring about the radical reduction in prices which is required will probably require the introduction of compensating income aids. And a move from price support to income support would make sense.

22. The objective of an income aids scheme would of course be to maximise price cuts, Community-wide, while minimising the income support required to make the cuts politically feasible, in the EC as a whole.

23. There are a number of ways in which an income aids scheme could be operated. Eligibility could extend to all Community farmers, or only to farmers in certain regions or with low income. A scheme could be wholly

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financed by national budgets or be part nationally, part Community financed. Some degree of Community financing would probably be necessary to make any scheme negotiable.

24. One solution might be a scheme under which all farmers would be able to apply for financial support up to a cut-off point, defined in income, not output, terms and fixed at a proportion (set Community-wide) of current average farming income in each country (or region).

25. Those farmers now earning less, from all sources of income, than the support ceiling would of course receive support only sufficient to compensate for loss of income due to the price cuts. Those with earnings above the ceiling would in practice receive no support. In other words, the system would include an element of means testing. The residual element of discrimination against larger farms would be defensible since the parallel price cuts would bear most harshly on smaller, less efficient, units.

26. Because of the real danger that an income aids scheme could become very expensive (through eg annual

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pressures to top it up) it is essential that it be time-limited, degressive, tightly ring-fenced and linked to support price cuts. Moving away from annual price fixings may help negotiate a multiannual package whose aim would be to allow farmers time to adopt to market forces and to diversify. Any member state which wanted to maintain income support to farmers on a permanent basis should do so through its own national budget but within an agreed framework to avoid distortion of competition.

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CONCLUSION

27. There are plenty of radical solution to the problems of the CAP. It is more difficult to find radical and negotiable solutions.

28. Nonetheless, the trend towards allowing greater market forces within the CAP is desirable in its own right and the direction in which others are already going. We cannot, however, force all member states to accept complete freedom of market forces because of differing levels of farm structure. We may have to accept that small farmers should continue to receive support as the price for cutting expensive surplus production. We should not reject policies simply because they favour small farmers, if only because it makes sense in UK politics too.

29. To the extent possible, we should reduce prices to market-clearing (ie world price) levels. To make this politically feasible (eg for the Germans) may require the introduction of an income-aid scheme, mainly nationally financed within a Community framework. Such

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a scheme must however be income-related not output-related.

30. In the short term we should concentrate on:

- effective cash limits on CAP support through a budget discipline mechanism linked to automatic stabilisers, and greater management autonomy for the Commission to react to threats of overspending (which will be more easily detected with a reimbursement payments system.)
- Protecting ourselves against the worst effects of continued high EC expenditure, principally through the continuation of the Fontainebleau mechanism.
- But in the longer term we should work for a shift in the basis of support, from support through the price mechanisms, to direct support for incomes.

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CAP REFORM AND DISCRIMINATION**Problem**

1. How can EC maintain incomes of farmers at a "reasonable" level (income objective) without producing surpluses (output objective).

Diagnosis

2. Community uses price support to achieve both objectives. This is impossible. To maintain incomes of small farmers on poor land it is necessary to maintain prices at levels so high that large, capital intensive farms can make a comfortable profit. Paradox that majority of farmers cannot make a living from the land alone while vast majority of output is produced at a profit.

Possible Prescriptions

<u>Policy</u>	<u>Pros</u>	<u>Cons</u>
Non-discriminatory		
a. Cut prices	Reduces surpluses favours consumers eases trade problems administrative easy	Makes incomes problem worse
b. Quotas	Reduces surpluses; eases budgetary costs and trade problems	Prices remain high reduces incomes but not as much as (a); freezes out- put patterns; favours large over small producers; administratively difficult; incentive to raise prices
c. Saleable quotas	Cuts surpluses allows small farms to get out with compensation; unfreezes production patterns; eases budget and trade problems	Leaves prices high favours large producers; makes it difficult to change policy because of market value of quotas; administratively difficult; incentives to raise prices
d. Set-aside	Cuts surpluses; can be slanted to give greater incentive to cut production to marginal farmers	Uncertain effect; may simply take worst land out of production and concentrate resources (plus

d. Set-aside

extra subsidy) on land that remains; costly to police; difficult to justify paying people to do nothing

e. Co-responsibility

If support prices unchanged reduces incentive to produce; improves budget

No effect on consumption; tendency for Council to raise prices to compensate therefore little effect on output; have to be very large levies to have an impact; administratively difficult

Discriminatory

f. Cut prices and direct income subsidies to small producers

Reduces surpluses; favours consumers; tackles small farmers problems direct

Administratively difficult; budgetary cost if EC funded; political resistance from small poor states if nationally financed

g. Co-responsibility levies with exemptions for small producers

If support prices unchanged reduces incentive to produce; improves budget; protects small producer

No effect on consumption; tendency for Council to raise prices to compensate therefore little effect on output; have to be very large levies to have an impact; administratively difficult

h. Limits on support payments eg premia on first 50 head; or support limited to first x tonnes or output from first y ha

Effectively a price cut; lower surpluses; aid concentrated on smaller producers

Administratively difficult but people could opt in; budget cost (in effect a shift from intervention to direct payments) but could be nationally financed

i. Two-tier pricing

Effectively a price cut; lower surpluses; aid concentrated on small producers; Administratively difficult, may be budget costs if implies direct payments to farmers

j. National financing

Cuts EC budget costs; may reduct output if national subsidies not linked to production; If national subsidies linked to production leads to competitive subsidisation and could destroy common market

of with advice or 89/100



2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
SW1P 3AG

My ref:

Your ref:

6 October 1987

CH/EXCHEQUER	
REC.	07 OCT 1987
ACTION	MR BYATT
COPIES TO	EST PST PMG EST SIR P. MIDDLETON MR FER BUTLER SIR G. LITTLE SIR T. BURNS MR LAVELLE MR MONCK MR BURNER MR A. EDWARDS MR BONNEY MR MORTIMER MR H. P. EVANS MR SPACKMAN MR CULPIN MRS G. WHITE MR CORRY MS SUMES

Dear Nigel

AGRICULTURAL REFORM

Thank you for copying to me your minute of 21 September to the Foreign and Commonwealth Secretary. I have also seen the minute of 29 September from the Minister of Agriculture, Fisheries and Food.

MR MORTIMER
MR CORRY
MS SUMES
PARTY

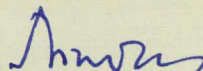
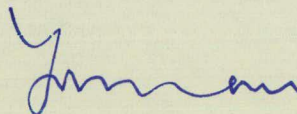
In view of the wide ramifications of agricultural reform, I fully support the idea of reaching agreement on a set of principles to guide our negotiating strategy. I am in broad agreement with the principles you propose, subject to the detailed amendments John MacGregor has suggested, and two further points.

The Treasury paper implies, especially under principle iii, that current world food prices are a criterion by which we could test the correctness of agricultural policies within the Community. We have to bear in mind that world food prices are themselves seriously distorted by subsidies and dumping, to the detriment of both developed and less developed countries. The only really valid criterion is the price level that would operate in a world without protection or national aids, even though we have obvious difficulties in determining what that price level would be.

Secondly, I welcome what is said in paras 14-15 of the Economic Policy Committee paper about environmental objectives. This is consistent with the UK approach, and ought to be recorded explicitly in our list of principles, especially if we are aiming to occupy the moral high ground within the Community. The key point in para 14 is that new forms of support might have environmental benefits as their primary objective, not simply a by-product. I suggest the third sentence of John MacGregor's redrafted section of your principle vii should be omitted and the second sentence amended to being: 'These should be directly linked to reductions in output or to the protection and improvement of the environment and landscape: for example,'. To correspond to para 15, I suggest the following additional principle should be included:

Agriculture should, as far as possible, be subject to the general principles which are applied in environmental policy, including the 'polluter pays' principle.

I am copying this letter to the Prime Minister, the Foreign and Commonwealth Secretary, the Secretary of State for Trade and Industry, and the Minister of Agriculture, Fisheries and Food.



NICHOLAS RIDLEY

CONFIDENTIAL

COMMISSION
DES
COMMUNAUTÉS EUROPÉENNES

Secrétariat général

SEC(87)1520 final

Brussels....., le 8 October 1987.....

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10

CONFIDENTIEL
VERTROUWELIJK
RISERVATISSIMO

URUGUAY ROUND / NEGOTIATIONS ON AGRICULTURE

(Commission Communication to the Council)

CONFIDENTIAL
EMHIELTYIKO
VERTROUWELIJK
FORTROLIGT

Ci
Commission
Communication
to
Council

SUMMARY AND EXPLANATORY MEMORANDUM

Negotiations on agriculture have been opened in the framework of the Uruguay Round. They are of considerable importance to both the Community and the majority of other countries.

The negotiating plan, adopted on 28 January 1987 in Geneva, envisages two phases of negotiations on agriculture. The initial phase which is to finish at the end of this year includes the presentation and initial examination of negotiating proposals.

The United States presented its proposals in early July of this year. The Community, which had joined its partners at the Venice Summit in June in committing itself to making comprehensive proposals for the agricultural sector in the coming months, has accordingly announced its intention to present its own proposals at the fourth meeting of the Negotiating Group on Agriculture scheduled for the end of October. Other countries, including those belonging to the "Cairns Group", have done the same.

This communication comprises two texts; the first one explains what is at stake in the negotiation and the second one contains the negotiating proposals which the Commission intends to present to GATT.

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EMITTETIKO

VERTROUWELIJK

FORTRÖLIGT

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COMMUNICATION

1. Introduction

1. The Punta del Este Declaration of 20 September 1986, which launched the new round of multilateral trade negotiations, placed important emphasis on agricultural negotiations, and none of the Contracting Parties doubts that the success of these agricultural negotiations will be a determining factor for the success of the overall negotiations.
2. Alongside the traditional aspects of market access, export competition and problems linked to animal and plant health regulations, the Punta del Este Declaration for the first time identified internal agricultural support as a topic for agricultural negotiations.

The need to reduce the structural imbalances of markets by means of a concerted, gradual and balanced reduction of support levels was also emphasized in the Final Communiqué of the OECD ministerial meeting on 13 May, at which it acknowledged that collective responsibility exists for the current situation and that the main reason for the imbalances is excessive support for production in many countries. Consequently, ministers stressed the need to negotiate a reduction of agricultural support and protection in the Uruguay Round.

This approach was confirmed by the Heads of State or Government at the Venice Summit on 10 June.

3. The imbalances on world markets for agricultural products are indeed a matter of concern.

In the cereals and sugar sectors, for example, stocks held worldwide are now approximately double the level of annual world trade, and prices on the international cereals market are lower than ever. In fact, price levels are particularly low not only for these products but also for others such as oilseeds.

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In these conditions, a greater liberalization of world trade in agricultural products and a strengthening of GATT disciplines on subsidies and import measures, in accordance with classical negotiating rules, are likely doomed to failure, unless more drastic measures are taken for achieving, in the context of the negotiations, a better balance between supply and demand.

4. In addition to primary products, the agricultural negotiations will cover products of first-stage and second-stage processing.

II. Basic elements of the Community position

5. The Community is the world's largest importer of farm and food products and the second largest exporter. It has a major interest in restoring order to international markets by establishing a better balance between supply and demand and more stable and realistic price levels. This should enable the Community to maintain its presence on markets, as importer as well as exporter, in better conditions than at present.

In order to contribute to such a restoration of sound world market conditions, the Community has for several years been in the process of reforming its agricultural policy by means of:

- a reduction of guaranteed prices;
- a limitation of guarantees for the marketing of products;
- associating producers to the risks encountered on world markets.

However, it will be able to continue and complete this process only if its partners follow the same course with the same determination so that order can be restored to markets by joint action.

The new round of negotiations should therefore lead to a joint approach which will in turn result in rules and disciplines intended to prevent the reappearance of new imbalances.

6. The elimination of structural imbalances on the world market will make it easier to bring about a greater liberalization of trade through agreement on stronger, more effective rules and disciplines for measures affecting import access and export competition.

Such a liberalization would be important, inter alia, for Community exports of processed and other high-value agricultural products. It is clear that the Community can only expect its partners to open up their markets if it is ready to make appropriate concessions itself.

7. International discussion of the policies and principles to be pursued in the context of international negotiations on agriculture has often taken the form of an "ideological" confrontation. However, it is obvious that economic and social interests are what determine in the long run negotiating positions, and it is only by reconciling those interests that it will be possible for the agricultural negotiations of the Uruguay Round to achieve a satisfactory outcome.

Food security, the optimum use of natural resources, environmental protection, preservation of sound infrastructure, rural development and the protection of consumers and producers against the excessive risks of world price fluctuations are all legitimate concerns of which agricultural policies must take account. This is why most countries operate a double pricing system in one form or another.

During negotiations on improving GATT rules and disciplines, the Community, for its part, will insist on preserving a model of agriculture capable of ensuring the survival of a rural economy which it regards as vital. This implies that the Community must insist on maintaining its double pricing system together with the related fundamental mechanisms. The Community will also defend the right of the European food-processing industry to be compensated for the repercussions of official support granted in respect of the raw materials which form its input.

8. The preservation of the basic mechanisms of the CAP does not, however, mean that these mechanisms should not be adjusted. Such adjustments, sometimes even substantial ones, can be made all the more easily as balance is being restored between world supply and demand. Moreover, the Community has a major interest in the achievement of a greater balance between the support scheme it operates in the various agricultural sectors.

High levels of protection for certain crop and livestock sectors, coupled with non-existent or low levels of protection for, inter alia, cereal substitutes, oilseeds and high-protein crops, give rise to distortions both within the Community and in international trade. The elimination of such distortions, which also exist in other countries, should be one of the Community's main objectives in the new round of agricultural negotiations.

III. Conduct of the negotiations

9. The negotiations would take place in two stages. They should concentrate, in the short term, on the concerted, balanced and converging adjustment of existing agricultural policies. Negotiations will therefore be concerned initially with how and under what conditions it will be possible to consolidate in the GATT framework the effects of measures already taken or to be taken with a view to obtaining undertakings of equivalent value from the Contracting Parties to reduce support and curb production. These negotiations will have to take account of the adjustments already made by some countries since 1984.

At the same time, emergency measures will have to be negotiated in order to ease the situation, at least partially, on the worst-affected markets. The Commission therefore considers it imperative that the main exporting countries agree on immediate, pragmatic temporary measures to bring to halt the deterioration of the most disrupted markets, e.g. cereals, sugar and dairy products.

10. This initial phase of negotiations would, in a second phase, be followed by negotiations on substantial reductions in support or equivalent measures, coupled with a restoration of balance in the overall conditions of support. The Community will therefore have to enter into negotiations with its partners, especially in order to achieve greater balance in the support schemes it operates in the various agricultural sectors.

Thereafter, the negotiations would deal with the drafting of rules and disciplines which would, as far as possible, prevent the recurrence of new imbalances, and search for stronger, more effective GATT rules on market access and export competition.

IV. Short-term measures

11. In order to ensure that the GATT agricultural negotiations make good progress, all the Contracting Parties should undertake to restrict the support they grant to products which are in world surplus and harmonize the effects of the market reform measures necessary to avoid a further worsening of existing imbalances.
12. The Community began its reform of the CAP without waiting for the Uruguay Round. In order to reduce surplus production, it has either introduced production quotas and/or co-responsibility mechanisms, reduced official prices and/or toned down the guarantees it offers for marketing both inside and outside the Community. The products affected by these measures have especially included cereals, sugar, oilseeds, dairy products and beef/veal.

The Commission's communication to the Council of 30 July 1987 (COM (87) 410 final) reviews the measures taken since 1984 to bring agricultural markets under control and lists further measures which the Commission considers necessary for the "completion of the modernization of the common agricultural policy", while expecting comparable efforts from other countries. It therefore believes that the first stage of negotiations must lead to the implementation by its partners of measures equivalent to those which the Community has already taken or proposes to take.

13. Alongside this, a commitment to immediate and transitional emergency measures aimed at stabilizing the worst-hit markets, to be agreed between the main countries concerned, could be made on a temporary (lasting one marketing year) but renewable basis, focussing on prices and/or the quantities released onto the world market as well as the transparency of operations.
14. - As regards cereals, the situation can be improved only if the export subsidies war is ended. To this end, the main cereal-exporting countries should undertake not to charge export prices below reference prices to be agreed for comparable qualities and delivery terms. Such undertakings might be supplemented by undertakings on market shares to be agreed taking account on the one hand of each party's exports in a recent representative period and on the other of world market forecasts.

However, for the Community to agree to an undertaking on market shares, its partners would have to accept certain limitations on imports of cereal substitutes.

- As regards international sugar trade, the main exporting countries should agree on a reduction of quantities exported during the following marketing year. At the same time, main importing countries participating in the negotiations should undertake to maintain during the following marketing year their sugar imports at least at present levels. This discipline could be extended annually until a broader and more permanent agreement is found.

15. As regards trade in dairy products, all the major exporting countries, including those Contracting Parties not signatories to the International Dairy Arrangement, should undertake to comply with the disciplines which that Arrangement lays down.

V. Longer-term measures

16. In order for the international markets to be made suitably predictable and stable in the long term, it is essential for any further reduction in support or any equivalent measures which could reverse present trends and pave the way towards a permanent restoration of sound world markets to be tackled in tandem with another major cause of disruption: the present imbalances in the protection of agriculture in many countries, for example, in the Community, in the United States, certain EFTA countries and also Japan.

The Community must therefore open negotiations with the partners concerned in order to achieve greater balance in the support arrangements it applies to the various agricultural sectors. At the same time, it should encourage other partners experiencing similar imbalances to follow suit.

17. The hallmark of these imbalances is strong protection for one group of products and little (or even none) for another.

They lead to distortions not only in domestic production and in consumption but also, as a consequence, in import and export trade. This gives rise to an inefficient allocation of resources, a delay in the multilateral process of adjusting agricultural policies, and increasing strains in international trade.

The Contracting Parties should therefore pay particular attention to removing, or at least significantly reducing, such imbalances in protection in the countries involved.

As regards imbalances resulting from discrepancies in the level of concessions, as in the case of the Community, efforts should be made to restore the balance by exchanging concessions among the Contracting Parties concerned.

However, in the case of imbalances resulting from exceptions to, and derogations from, the rules normally applicable under the GATT, appropriate formulas should be worked out to enable these to be gradually removed without requiring concessions from other partners.

18. As an integral part of the multilateral negotiations on the level of support, the Community should therefore, in exchange for better protection for cereals substitutes and oil and protein crops, offer a significant reduction in the overall protection at present enjoyed by certain sectors.

The reduction margins to be offered by the Community should be differentiated by sector, in accordance with the counter-concessions offered by its partners on the one hand and their interest in a particular concession on the other.

The rate of the necessary reductions would also depend on the size of the remaining imbalances and on the degree of readjustment which the Community is seeking.

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19. The Commission is of the opinion that the balance should be restored as far as possible, account being taken of production conditions in the various sectors, so that Community agriculture can then progress on a sound and lasting basis.

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The Commission is, however, aware that the adjustments advocated above can only be introduced in so far as perennity is assured for stabilization measures taken in the first phase.

The Commission also stresses the need to accompany these adjustments, when the time comes, by direct aid to producers to make the inevitable changes easier for them. Such aid could be financed by the savings which the adjustments would bring the agricultural budget in particular and the Community as a whole.

20. The undertakings required for the implementation of the above guidelines must be followed by negotiations on the improvement of GATT rules and disciplines concerning market access and export competition.

21. As regards access to markets, the Commission considers that, in addition to matters connected with the readjustment described above, and animal and plant health issues, which form a separate subject in the Punta del Este Declaration, the negotiations should cover the practices of state agencies and boards, and the problems and inequalities resulting from the discrepancy in the scale of concessions accorded by the various countries for imports of agricultural products.

22. Over the last few years, export competition aided by direct or indirect subsidies has been particularly fierce and has led to serious friction in international relations. A balanced multilateral reduction in agricultural support and reduction of the imbalances in agricultural protection, as advocated by the Commission above, should ultimately lead to a better balance between supply and demand and consequently to a substantial improvement in trading conditions.

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In these circumstances, the Commission considers that any improvement in GATT rules and disciplines concerning export competition should be aimed at greater predictability and stability at international level, and better surveillance of the measures taken by the various Contracting Parties.

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To that end, the Contracting Parties should, among others, endeavour to define more clearly the conditions for applying direct and indirect export subsidies, including credit and credit guarantees, the criteria governing food aid, the practices to be observed by boards and state agencies, and the disciplines which could apply to the financing of exports with contributions from the private sector.

23. Lastly, with regard to the animal and plant health aspects, the Punta del Este Declaration stresses the need to reduce to a minimum the negative effects which related rules and barriers can have on trade in agricultural products. It also states that in this context account should be taken of the relevant international agreements.

24. In the light of experience, the Commission considers that the Code on technical barriers to trade is not properly suited to the particular case of animal and plant health regulations and barriers.

It is therefore advisable to negotiate a specific framework of rules which should lay down criteria for the harmonization of regulations at international level. This framework of rules should also cover production methods and processes.

VI. Assessment method and its scope

25. Coordinated, balanced and lasting reduction cannot be obtained without a method of measuring the overall support for agriculture which is acceptable to all the Contracting Parties.

The Producer Subsidy Equivalent (PSE), as worked out by the OECD, could provide such a measurement provided certain adjustments were made to it.

In order to avoid excessively complicating the negotiations, certain measures would have to be kept out, such as income subsidies where they do not affect production, and only support measures which have a significant, direct effect on farmers' production decisions should be taken into consideration, for example, market price support, production-related income support and the various forms of subsidies for means of production. In addition, support for research and for training for farmers, and also for the modernization of production and marketing would have

to be excluded from the PSE, since such support measures are aimed at the long-term viability of agriculture and constitute important ways for many countries of catching up with the progress already made in other countries.

In addition to the adjustments to the coverage of the PSE, particular problems such as fluctuations in world prices and exchange rates should be dealt with.

As regards the fluctuations in world prices, the use of reference prices could be considered. In addition, the risk of a change in exchange rates could be avoided by expressing reference prices in the national currency of the Contracting Party concerned, if necessary adjusted by the appropriate deflator.

As regards the various measures of production containment, parameters should be worked out to enable the limiting or cutting-back of production to be translated into the appropriate support reduction equivalent.

Such parameters could be either the use of elasticity coefficients or the expression of support in terms of its absolute value for a given product.

The work on the method of assessing overall support should begin with the first stage of negotiations.

26. Negotiations on the reduction of support should cover only those sectors which fall within the remit of the Negotiating Group on Agriculture.

As regards the sectors which are strictly speaking agricultural, the negotiations, of the type described above, should focus on those sectors with structural imbalances and on sectors where serious disturbances can be expected; they would therefore cover cereals, rice, sugar, oilseeds and oleaginous fruit, milk products, and beef and veal. The rates of the adjustments required should be decided on in the light of the situation and particular features of each sector concerned. The traditional type of negotiations based on lists of offers and requests could be held later for other sectors.

VII. Contribution of the Contracting Parties and Implementation of the results of the agricultural negotiations

27. The participation by the Contracting Parties in the efforts to improve the conditions of international trade in agricultural products should take account of the Parties' level of development and their development requirements. Special and differential treatment should therefore be provided for the developing countries according to their needs. This applies for the rules and disciplines applicable to the agricultural policies of these countries and also to the conditions of access for their products to the markets of the other Contracting Parties. As regards the latter aspect it is recalled that the Commission has already submitted proposals on tropical products to the Council.

The countries which stand to gain more especially from the improvement of the world market should explore how to enable the least developed countries to benefit too without awaiting the long-term advantages inherent in the reform of world markets.

28. The Commission attaches particular importance to the need for all the matters covered in this Communication to be dealt with in a balanced, equitable way in the Uruguay Round negotiations. It is on this basis only that the Commission can fully assume its role of negotiator for the Community and also obtain the results which it considers essential if the Uruguay Round is to be a success in the longer term.

29. At the same time, the Commission stresses that the negotiations have been agreed upon as a global undertaking regarding their initiation as well as their conduct and the implementation of negotiation results. Therefore, results of the agricultural negotiations cannot be implemented unless the Uruguay Round negotiations in other sectors have also produced satisfactory results. The agricultural negotiations as a whole form an integral part of the overall negotiations and cannot be dissociated from them.

Brussels, 6 October 1987

DRAFT EUROPEAN COMMUNITIES PROPOSAL FOR
MULTILATERAL TRADE NEGOTIATIONS
ON AGRICULTURE

To achieve the objectives set out by the Contracting Parties at Punta del Este, the negotiations on agriculture will have to tackle the root problem affecting world agricultural markets, i.e. the imbalance between supply and demand, while allowing the maintenance of agricultural activity adapted to a changing environment and taking account of the development needs of the various parties to the negotiations.

A substantial reduction of structural imbalances is fundamental to the more efficient functioning, in practice, of stronger rules and disciplines on market access and export competition. Such rules and disciplines must prevent the resurgence of these imbalances.

The reduction of the uncertainty, disequilibria and instability prevailing on world agricultural markets will entail the balanced implementation of concerted farm policy reforms including:

- better control of production by appropriate means including the phased reduction of support which directly or indirectly affects trade in agricultural products;
- an increase in the sensitivity of agriculture to market signals;
- a change in methods of income support for farmers to make greater use of direct aids not linked to output.

The return to a better balance between supply and demand for agricultural products, concerted along these lines and subject of reciprocal equivalent undertakings, will reduce the strains on international markets, which in turn will function better and resume greater importance in guiding production decisions. This would render possible and actual a significant, balanced reduction in import barriers within a global context and the establishment of sound conditions for competition within the framework of GATT rules, which then would be reinforced and supplemented as need may be.

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Naturally, this presupposes that the negotiations will be based on the legitimately acquired rights of Contracting Parties and aimed at concerted additional undertakings.

As regards supplementing the existing framework, the drafting of suitable rules to lessen the negative effects of animal and plant health regulations on trade in agricultural products should be put in hand immediately.

It is consequently proposed that the Contracting Parties negotiate in accordance with the approach outlined below.

MULTILATERAL TRADE NEGOTIATIONS: BROAD OUTLINES OF NEGOTIATIONS ON AGRICULTURE.

1. Scope

The negotiations will cover all agricultural products, raw and processed, giving priority to sectors in structural surplus and those where serious disruptions are foreseeable.

2. Method of negotiation

- 1) In addition to exchanges of concessions (schedules of offers and requests will be lodged at a later stage of the negotiations), it is proposed that for the main agricultural commodity sectors a phased reduction be negotiated of the negative effects of support on international markets.
- 2) The reduction would be in two stages:
 - a first stage which would be based on existing policies and would include, in addition to efforts to ease the situation on worst-affected markets, a concerted reduction of support aimed at halting the rising trend in existing imbalances and thereby initiating the process of restoring healthy market conditions;
 - a second stage which would be designed to create the conditions for a lasting reversal of the present trend towards structural disequilibria and permanent instability.

3)

Stage 1 would comprise two parallel and complementary types of short-term actions, one in the form of emergency measures to bring about an easing of the strain in certain markets, and the other in the form of other measures designed to bring about a concerted improvement in the balance between supply and demand.

a) The emergency measures would consist of individual undertakings valid for a single marketing year, applicable from the next marketing year, but renewable by common agreement. The undertakings would relate to:

- price discipline for cereals and corresponding arrangements for cereal substitutes;
- disciplines aimed at reducing the quantities of sugar put on the world market and at least maintaining present access to traditional import markets;
- compliance by non-member Contracting Parties who are significant exporters of the products concerned with the disciplines of the International Dairy Arrangement.

b) The other measures would consist of undertakings concerning reduction of support resulting from internal or external measures, which the Contracting Parties would undertake to maintain or adopt so as to prevent the exacerbation of existing imbalances. Such undertakings would have to be of equivalent scope.

Given the interest in using certain elements of work already done by International bodies and the fact that some Contracting Parties have already put in hand programmes designed to make an impact on production, an evaluation of support should be carried out beginning with the 1984/85 marketing year, which immediately preceded the commitment to hold multilateral trade negotiations. On that basis, action already taken unilaterally and measures resulting from subsequent concerted decisions which have a positive effect in bringing production under control would be taken into account. To ensure satisfactory progress in the negotiations, equitable burden-sharing and maximum impact, undertakings should be given in the following sectors, where the problems are particularly serious: cereals, rice, sugar, oilseeds, dairy products and beef/veal.

The Contracting Parties would undertake to carry out, in a second stage, a significant, concerted reduction in support coupled with a readjustment of their external protection in order to achieve a reduction of the distortions which are the source of, or contribute to the present world market disequilibria. Such twofold action which would lead to an elimination of imbalances in internal production, would substantially reduce production incentives out of line with what the markets were able to absorb. It could be backed up by aid to farmers designed to offset the loss of earnings occasioned by the new arrangements; such aid would have to be framed and administered so as not to produce unwanted effects on output.

Under those conditions the stabilization of major world markets would then be possible and negotiations could take place with a view to later GATT bindings, taking into account world price and currency fluctuations, of the maximum levels of support, protection and export compensation where such measures were necessitated by the existence of a double pricing system.

- 5) Implementation of the plans set out above would allow the GATT rules and disciplines applicable to agricultural trade to become genuinely operational; however, they would need to be improved and supplemented to establish the progress made in negotiations on a lasting basis. More detailed rules should apply inter alia to:
- conditions for the application of subsidies, including those for agricultural products which are incorporated in processed products;
 - treatment of measures to increase demand for agricultural products;
 - conditions of access and competition resulting from the existence of state agencies and marketing boards;
 - tighter surveillance of measures taken by the various parties pursuant to their undertakings.
- 6) In the field of animal and plant health regulations, it is proposed that an appropriate framework of rules be drafted comprising basic principles, criteria for harmonizing regulations at international level, and the necessary disciplines for dealing with production methods and processes.

3. Instruments

To enable GATT undertakings on support to become operational, agreement will be needed on how to measure the various forms of aid to agriculture by Contracting Parties. The measurement devised by the OECD for analytical purposes, the producer subsidy equivalent (PSE), could be taken as a basis for a unit of measurement, provided it was suitably adjusted for use as a negotiating instrument. The adjustments would involve essentially (a) taking account only of measures with a significant incidence on trade, (b) including a method of quantifying production restraints, and (c) considering how to accommodate problems related to world price and currency fluctuations.

4. Developing countries

Involvement by Contracting Parties in efforts to improve the conditions for international trade in agricultural products should match their level of development and development requirements. It will consequently be necessary to allow for special and differential treatment for the developing countries according to their needs.

5. Conduct and Implementation of negotiations

Negotiations in Stage 1 and 2 are part of a single package which must be approved within an overall framework. Stage 1 should be relatively short, and the timetable for the implementation of Stage 2 should enable the changes negotiated to have an impact within a reasonable period.

It is on the basis of such an approach, which will be developed and expanded in the course of the negotiations, that the Community considers it possible to create the conditions conducive to a realistic liberalization of agricultural markets, providing a sounder framework for continuation of the agricultural activity necessary to economic stability, social cohesion and the environment.

Furthermore, the Community attaches importance to recall that the negotiations are a whole regarding the initiation of the negotiations as well as their conduct and the implementation of negotiation results. Agreement regarding the results of agricultural negotiations can therefore only occur if overall negotiations have also produced satisfactory results.

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MINISTER
OF
AGRICULTURE
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13/10/87.

From the Minister

SECRETARY OF STATE FOR FOREIGN AND COMMONWEALTH AFFAIRS

URUGUAY ROUND: AGRICULTURE - COMMISSION PROPOSALS

1. You and other colleagues will know by now that on 7 October the Commission made known their draft of the Community's proposals on agricultural reform for the GATT negotiation. They took the opportunity to elicit early reactions from other countries by holding press conferences in Brussels and Geneva. The proposals will, of course, have to be endorsed by Member States through the Foreign Affairs Council before they can be tabled as a Community position in Geneva.

2. From our point of view the Commission document is a very mixed bag. In general the second section designed for tabling in Geneva is more positive and open in tone than the longer introduction prepared for Member States (which is equally likely to become public). On the positive side, there is a clear commitment to significant long term reductions in support and protection, and an endorsement of the value of the Producer Subsidy Equivalent (PSE) as a measurement tool. On the other side there is, first, an unwelcome emphasis on the need for increased protection against imports of cereal substitutes, oilseeds and proteins if the EC is to liberalise elsewhere. Secondly, there are proposals for short term measures to improve markets - as called for by OECD Ministers - but which include the suggestion of a market sharing arrangement on cereals. Both these ideas will be key points of disagreement for the US and, no doubt, a number of other major participants. Thirdly, it is proposed that the Community should claim credit for CAP reforms since 1985, call for matching efforts by other countries, and continue to seek matching concessions for any further internal reforms. There is the suggestion that the EC cannot proceed much further with CAP reform unless others do similarly.

3. Much of this, of course, is predictable given the well-known views of many Member States and inside parts of the Commission. We will need to consider carefully the extent to which we should seek improvements in the text, given the danger that others - probably a large majority - may push for an even more restrictive line. The Commission obviously need a mandate that Member States can accept but which leaves them sufficient room for manoeuvre in negotiation.

/4. The Commission.....

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4. The Commission aim to move their proposals ahead quickly, with a view to Foreign Affairs Council agreement on 19 October and tabling in Geneva on 26 October, though they also evidently have approval at the November Council in mind as a fallback. Our officials met on Friday to consider what the United Kingdom approach should be in Community discussions over the coming weeks, up to and including the Foreign Affairs Council. They took the view that we should certainly register our opposition to some of the measures that might be taken under cover of the Commission's document and warn of the reactions that the Community would be courting; but that it was difficult to judge how far to press these points without (at the end of last week) having much information on which to gauge what play our Community partners may make with the document - or how strongly countries outside the Community may react.

5. We should have more information to go on in the course of this week. We and our officials will need to assess the position in the light of that. Clearly there will need to be further contact between our Departments in preparation for the Council of Ministers.

6. I am copying this minute to the Chancellor of the Exchequer, the Secretary of State for Trade and Industry, the Secretary to the Cabinet and the Prime Minister.

JM

13 October 1987

MINUTE
S/S P&C AFFAIRS

DRAFT [LETTER] FROM THE CHANCELLOR TO [SIR GEOFFREY HOWE]

Like ^{the Minister of Agriculture,} [John MacGregor] in his minute to you of 13 October, I find the Commission's proposals and draft text for the GATT negotiations on agriculture a very mixed bag. I agree that we should take the opportunity, at both official and Ministerial level, to register our opposition to the ~~negative~~ ^{undesirable} elements in the Commission's communication to the Council. I know you will want to press for fundamental and lasting reform of agricultural support and protection, primarily through progressive reduction of the gap between world and domestic prices. In particular, I suggest you draw attention to the need for a credible overall target for phased reductions in support, over a clearly stated timetable.

In addition I hope you and other colleagues will register our reluctance to enter into any short term market sharing arrangement - which will create further distortions and run the risk of becoming permanent - unless there is a clear commitment to specific offsetting actions to reduce support in the medium and longer term with demonstrable net benefits.

I do not underestimate the negotiating task ahead of us, both within the Community and with other GATT contracting parties. Some shift from our opening position will be inevitable. As regards the Commission's draft text for tabling, I am persuaded that on balance we have more to lose than our European colleagues from attempts to amend the text. Therefore we should not seek to delay tabling the proposals in Geneva provided that we register our reservations at this stage.

I am copying this ^{minute} [letter] to the Prime Minister, ^{the S/S TR 1, the Minister / Ag} [Lord Young], ^{the Secretary to the Cabinet} [John MacGregor] and [Sir Robert Armstrong].

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DRAFT LETTER
TO
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Foreign and Commonwealth Office

London SW1A 2AH

14 October 1987

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Dear Shirley

Uruguay Round: Agriculture - Commission Proposals

As you know the Foreign Secretary is away in Vancouver and will not be able to respond before the Foreign Affairs Council to your Minister's undated minute which we received on 13 October. In the circumstances you may like to see the enclosed copy of my letter of 9 October to Charles Powell, which the Foreign Secretary saw before departing for CHOGM but which I regret was not copied to you at the time.

Meanwhile I know that officials of the Departments concerned have been in close touch about the briefing for the official level meetings in Brussels today and the Foreign Affairs Council itself.

I am sending copies of this letter and its enclosure to Alex Allan (HM Treasury), Timothy Walker (DTI), Trevor Woolley (Cabinet Office) and Andy Bearpark (No 10).

Yours sincerely,
L Parker

(L Parker)
Private Secretary

Shirley Stagg
PS/Minister of Agriculture

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Foreign and Commonwealth Office

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London SW1A 2AH

9 October 1987

REFERENCE

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Dear Charles,

CHOGM: Trade and Agriculture

As part of their commitment to table proposals on agriculture in the GATT by the end of the year, the Commission have this week produced and published a draft EC proposal for the GATT negotiations. This has received considerable press coverage, and the Prime Minister may well be asked about it at CHOGM.

The Commission and Presidency hope that the Foreign Affairs Council will agree on 19/20 October that the proposal can be tabled in Geneva on 27 October. If a text is not approved at the October Council, the Community proposal will be tabled in December.

The draft proposal contains a number of positive elements. It gives a clear commitment to reductions in support, both in the short and longer term; it ensures that the Community will claim credit for reforms already implemented (in order to press others - eg US and Japan - to take action as well); it endorses the use of an aggregate measuring device to assess the extent of cuts; and it recognises the need for short term action (which the US proposal in July, calling for the elimination of all support by 2000, did not do).

Some aspects of the proposal are however unwelcome to us and unlikely to prove negotiable in the GATT. The most conspicuous of these is the suggestion that the EC, in exchange for reducing some barriers, should actually raise new barriers against cereal substitutes and oils and fats.

The paper is, however, not likely to be considered as a formal negotiating mandate. The Commission and Presidency will - as we we have done - argue that it is most important for the Community to be seen to make an early constructive

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contribution to the GATT negotiation, so that it is not on the defensive against US and other proposals. We shall seek to deal with the major defects in the draft; but the risk of the best becoming the enemy of the good is real, for a prolonged debate - which we may not be able to avoid - would give the French and others a chance to worsen the text. We also need to avoid impact on the internal EC debate on stabilisers, the introduction of which some member states would like to make dependent on reciprocal reductions in support by other main producers. Discussion of the draft in Brussels is, of course, only just starting.

If the matter were raised with the Prime Minister at CHOGM, we suggest that she might take the line that:

- It has been a long-standing British objective to ensure that the Community tables a constructive proposal as soon as possible.
- While we are not happy with all points of the draft proposal, it contains positive elements on which we should seek to build, notably the all-important principle of reductions in support.
- In addition, it recognises that the problem is urgent and needs action in the short term.
- The UK is determined to secure effective reform of the CAP. Some progress has already been made, eg in the milk sector, and we shall insist on more. It makes no sense, (for consumers, taxpayers, farmers, or trading partners) for us to pile up surpluses while others go hungry.

Yours ever,

(L Parker)
Private Secretary

C D Powell Esq
PS/10 Downing Street

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FROM: S SYMES

DATE: 15 October 1987

These points are worth putting

1. ~~MR EVANS~~
2. CHANCELLOR

on the record. HIDE 15/10

cc Chief Secretary
 Paymaster General
 Sir Peter Middleton
 Sir Terence Burns
 Sir Geoffrey Littler o/r
 Mr Byatt
 Mr Monck
 Mr Burgner
 Mr Edwards
 Mr Mountfield
 Mr Bonney
 Mr White

*Chy Content to write us**drafted (Annox B)? (I have turned the draft into a minute, for consistency).**2. The PS/Foreign Sec. letter at Ref. A (i) is not referred to in this note. But it does not alter IF's advice - indeed, its text was agreed with us.**25 15/10***URUGUAY ROUND: AGRICULTURE - COMMISSION PROPOSALS**

Mr MacGregor's minute to the Foreign Secretary (13 October, Annex A) reports that the Commission have produced and published a draft EC proposal for the GATT negotiations on agriculture.

2. The EC document is in two parts: a communication to the Council (Annex Ci) and a short draft for tabling in GATT (Annex Cii).

3. The Foreign Secretary will be attending the Foreign Affairs Council on 19/20 October that will have to endorse the draft EC proposal before it can be tabled in Geneva on 27 October. There is no question of tabling the covering communication.

4. Officials of the Departments concerned have been in close touch about briefing for official level meetings in Brussels yesterday and for the Foreign Affairs Council itself. While officials are in broad agreement, we have some reservations about the FCO's proposed line which gives insufficient weight to your 'Ten Principles of Agricultural Reform'. The weaknesses in the Commission documents, identified in Paragraph 8 below, follow directly from the 'Ten Principles'.

"Endorsing" does not mean that it is a formal negotiating mandate. (There are precedents for this in other Commission papers tabled in GATT)

25 15/10

5. The Foreign Secretary is going to place UK concerns on record at FAC. We want to ensure that full weight is given to the need for price reductions; for an overall target for reduction in support; and that we do not encourage market sharing arrangements. I suggest (and EC and IAE agree) that you now write to the Foreign Secretary, agreeing with the general strategy of tabling the draft paper in Geneva as soon as possible but also noting where you expect him to draw attention to the UK's serious reservations on the Commission's interpretation in its Communication of specific proposals. I attach a draft (Annex B).

The Commission Proposals

6. The Commission document is in two parts. The second section, designed for tabling in Geneva, is relatively bland and only superficially less objectionable than the covering explanatory memorandum for Member States (Annex Ci, pages 1-13). The draft proposals themselves (Annex C ii) contain good and bad points.

7. The good points, in summary, are:

- commitment to phased reduction of support and protection;
- commitment to use (amended) Producer Subsidy Equivalent (PSE) measure;
- recognition of need for short term action (lack of which we criticise in the US proposals)

8. But major points of concern, where we want our reservations read into the record, are:

- vagueness of reference to support reduction, in particular failure to mention price reduction or to suggest specific timing of real action;
- only a weak and vague reference to the use of market signals;

- proposals for "rebalancing" or "readjustment" of protection (i.e. higher protection on cereal substitutes and oilseeds) are contrary to whole spirit of negotiations aimed at trade liberalisation, and will exacerbate protectionist pressures in US Congress;

- we oppose suggestion (Paragraph 2.4) of "coupling" reduction of support with "readjustment" of external protection. It is clear that the process of reducing CAP support must continue: and should not be contingent on similar action by other countries;

- while supporting the need for short term measures, we oppose proposals for market sharing (Paragraph 3), not least because we think them unsustainable and unacceptable to others (eg US, Australia);

- failure to propose overall target for reductions in support and protection, albeit a more realistic target than the US 'zero option'.

- in this connexion the PSE measure will be useful, but Commission seem to be unduly limiting its coverage (Paragraph 3).

- apparent two phase approach covers a multitude of stages that give the impression EC wants to put off reform into next century.

9. The draft proposal falls short of our ambitions. Even so, officials believe this document is the best we can expect from the Commission at this stage. Despite our serious reservations about the Commission interpretation of the proposals and the possible reactions of others such as the US and Australia, delaying the proposals, or insisting upon textual changes, will disadvantage the UK by allowing others in the Community to weaken further the draft.

10. Our objective therefore is to get the proposal through the Foreign Affairs Council, on the understanding that it is not a formal negotiating mandate but an opening statement, and that Member States are not committed at this stage to supporting specific proposals in it.

Cf. my marginalia
at para 3, above

25
15/10

SUSIE SYMES

S SYMES



16/10/87.

cc

Chief Secretary
Paymaster General
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Byatt
Mr Monck
Mr Burgner
Mr Edwards
Mr Mountfield
Mr Evans
Mr Ronney
Mr White
Ms S Symes

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

SECRETARY OF STATE FOR FOREIGN AND COMMONWEALTH AFFAIRS

Like the Minister of Agriculture, in his minute to you of 13 October, I find the Commission's proposals and draft text for the GATT negotiations on agriculture a very mixed bag. I agree that we should take the opportunity, at both official and Ministerial level, to register our opposition to the undesirable elements in the Commission's communication to the Council. I know you will want to press for fundamental and lasting reform of agricultural support and protection, primarily through progressive reduction of the gap between world and domestic prices. In particular, I suggest you draw attention to the need for a credible overall target for phased reductions in support, over a clearly stated timetable.

In addition I hope you and other colleagues will register our reluctance to enter into any short term market sharing arrangement - which will create further distortions and run the risk of becoming permanent - unless there is a clear commitment to specific offsetting actions to reduce support in the medium and longer term with demonstrable net benefits.

I do not underestimate the negotiating task ahead of us, both within the Community and with other GATT contracting parties. Some shift from our opening position will be inevitable. As regards the Commission's draft text for tabling, I am persuaded that on balance



we have more to lose than our European colleagues from attempts to amend the text. Therefore we should not seek to delay tabling the proposals in Geneva provided that we register our reservations at this stage.

I am copying this minute to the Prime Minister, the Secretary of State for Trade and Industry, the Minister of Agriculture and the Secretary of the Cabinet.

A handwritten signature in black ink, appearing to be "N.L." with a horizontal line underneath.

N.L.

16 October 1987

(1) CEREALS

(A) <u>Figure to be set</u>	(B) <u>UK Preferred Figure</u>	(C) <u>Commission Proposed Figure</u>
1. MGQ	155m tonnes	155m tonnes
2. Max % by which prices and/or coresponsibility levy can be adjusted	5% 1988/9 7½% 1989/90 10% 1990/91	5% 1988/9 7½% thereafter
3. Trigger point for operation of adjustment	1% over MGQ	1% over MGQ
4. Co-efficient relating by which MGQ exceeded to % adjustment in prices/levy	1 (to be set by Council now)	Would be fixed by Commission in October before opening of intervention
5. Period by which intervention could be reduced if MGQ exceeded	Acceptable as alternative to (2) and (4) provided increment is postponed. 1 month's reduction is broadly equal to a 1% price cut.	No precise proposal

(2) WINE

(A) <u>Figure of date to be set</u>	(B) <u>UK Preference</u>	(C) <u>Commission Proposal</u>
1. Date for abolition of GDBF	From 1989-90 with reduction to 5% of production for 1988-89 (from 10% for 1987-88)	GDBF to be abolished 'in a short period'
2. Date for abolition of restorage aid	No further restorage aid beyond that agreed for 1987-8	No further restorage aid beyond that agreed for 1987-8
3. Extent to which % price should be reduced when more than 12.5 mhl under-goes OD.	Reduction from 40% of guide price to 15%, phased in as follows: 1987-88 40% 1988-89 30% 1989-90 20% 1990-91 15%	Commission has not indicated its preferences. It proposes that (a) replacement figure for 40% would be decided by Council <u>later</u> and (b) phasing in figures would be determined by Commission.
4. Extent to which % price should be reduced in range 0-12.5 mhl of OD	All percentages to be decided now, not later. Reduction from 50% of guide price to 40%. Ideally this should be immediate (ie take effect from 1988-89), but could be phased in three equal steps.	Commission proposes to leave 50% figure untouched.

(3) FRUIT AND VEGETABLES (FRESH)

(A) <u>Figure to be set</u>	(B) <u>UK Preference</u>	(C) <u>Commission Proposal</u>
1. Level of withdrawal threshold for:		
(a) Satsumas Clementines	8% [†]	8%
(b) Nectarines	Should not be included in withdrawal system.	8%
(c) Mandarins	65% reducing to 8% over next 5 years (1987/8 to 1992/3)	65% reducing to 8% over next 5 years (1987/8-1992/3)
(d) Oranges Lemons Peaches	8%	No proposal. Likely to suggest 8%
(e) Apples Pears Apricots	About 4.5%	No proposal
(f) Cauliflowers	About 2%	No proposal
(g) Aubergines Table grapes	About 0.1% (Aubergines) About 0.01% (Table grapes)	No proposal

† All % on this page are of average production over last 5 years

(3) FRUIT AND VEGETABLES (FRESH) (CONTINUED)

(A) <u>Figure to be set</u>	(B) <u>UK Preference</u>	(C) <u>Commission Proposal</u>
2. Maximum % by which prices can be reduced for:		
(a) Satsumas Clementines Nectarines Mandarins	20%	20%
(b) Other products	20%	No proposal
3. Trigger point for operation of price reduction for:		
(a) Satsumas Clementines Nectarines Mandarins	5 tonnes over threshold 2,000t 2,500 t	5 tonnes over threshold 2,000t 2,500t
(b) Other products	c. 2,000t over threshold	No proposal
4. % reduction in prices when threshold exceeded for		
(a) Satsumas Clementines Nectarines Mandarins	1% for every 5t over threshold " " " 2,000t " " " " " 2,500t " " " " " " " "	No proposal
(b) Other products	1% for every c.2,000 t over threshold	No proposal

(4) FRUIT AND VEGETABLES (PROCESSED) (EC 10)
PART (1): AIDED PRODUCTS NOT SUBJECT TO STABILISERS

(A) <u>Figure to be set</u>	(B) <u>UK Preferred Figure</u>	(C) <u>Commission Proposal</u>
	[Based on 3 year production average 84/5-86/7]	
1. MGQ for Prunes	Range 37,000- 44,000 tonnes*	To be formulated (1986 production 37,000 tonnes)
2. MGQ for Peaches in syrup	492,000 tonnes	To be formulated (1986 production 515,000 tonnes)

PART II: AIDED PRODUCTS SUBJECT TO STABILISERS WHERE FURTHER ACTION REQUIRED

3. MGQ for Williams pears in syrup	83,000 tonnes	Existing limitation 102,305 tonnes
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* 37,000 tonnes is 1986 figure, 44,000 average of last 3 years. If we establish principle that MGQ should be based on 3 year average for other commodities in this sector it is not likely that we shall be able to achieve agreement to less than 44,000 t for prunes.

(5) TOBACCO

(A) <u>Figure to be set</u>	(B) <u>UK Preferred Figure</u>	(C) <u>Commission Proposed Figure</u>
1. Overall MGQ	350,000 tonnes	350,000 tonnes
2. MGQs for individual varieties	See annex	See annex
3. Maximum % by which prices/premia can be adjusted.	5% 1988/9 10% 1989/90	5% 1988/9 10% 1989/90
4. Trigger point for operation of adjustment	MGQ + 1%	Commission will probably propose MGQ + 1%.
5. Coefficient relating % by which MGQ exceeded to % adjustment in prices/premia	<u>1988/9</u> : Coefficient of 1 up to 5% excess, 0.95 over 5% excess. <u>1989/90</u> : Coefficient of 1 up to 10% excess, 0.90 over 10% excess	<u>1988/9</u> : Coefficient of 1 up to 5% excess, 0.95 over 5% excess. <u>1989/90</u> : Coefficient of 1 up to 10% excess, 0.90 over 10% excess

(5) TOBACCO (ANNEX)

(A) Figure to be set

(B) UK Preferred Figure
(tonnes)

(C) Commission Proposed
Figure

MGQ for individual varieties:

Group I

3.	Virginia D	5,695	No Commission Proposal yet
7.	Bright	31,916	
17.	Basmas	18,806	
18.	Katerini	17,151	
25.	Virginia Gr	1,369	
31.	Virginia E	8,089	
33.	Virginia P	2,499	

Group II

2.	Badischer Burley E	7,172
8.	Burley H	44,133
9.	Maryland	2,402
25.	Burley Gr	23,901
32.	Burley E	4,968
34.	Burley P	942

Group III

1.	Badisher	6,706
4.	Paraguay	25,794
5.	Nijkerk	136
6.	Missionero	208
10.	Kentucky	9,697
16.	Round Tip	7
27.	Santa Fe	588

23.	Burley Fermentable	21,603
29.	Havana E	739
30.	Round Scafati	25

Group IV

13.	Xanti-Yaka	9,566
14.	Perustitza	8,738
15.	Erzegovina	5,254
19.	Kaba Koulak Classic	27,434
20.	Kaba Koulak Non-Classic	5,203
21.	Myrodata	5,948
22.	Zichnomyrodata	901

Group V

11.	Forscheimer Havana	21,573
12.	Benventano	45
23.	Tsebelia	20,310
24.	Mavra	8,808

TOTAL		348,326
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(7) OILSEEDS

(A) <u>Figure to be set</u>	(B) <u>UK Preferred Figure</u>	(C) <u>Commission Proposed Figure</u>
1. Timescale and Nature of degressive steps in phasing out of cut-off for price reductions	15% cut-off in 1988/89 marketing year 20% cut-off in 1989/90 marketing year Unlimited cut-off from 1990/91 marketing year forward	15% cut-off in 1988/89 marketing year 20% cut-off in 1989/90 marketing year Unlimited cut-off from 1990/91 marketing year forward.
2. Coefficient relating % by which MGQ exceeded to % adjustment in price/aid.	If coefficient altered should be 0.7 in place of 1.0 at present	Commission may make proposal to alter coefficient.

(8) PROTEIN CROPS (Peas, Beans, Lupins)

(A) <u>Figure to be set</u>	(B) <u>UK Preferred Figure</u>	(C) <u>Commission Proposed Figure</u>
1. MGQ	3.3m tonnes	3.3m tonnes
2. Maximum % by which prices/aid can be adjusted.	Unlimited	Unlimited
3. Trigger point for operation of adjustment	MGQ + 1%	No proposal, but on precedent of cotton and oilseeds sectors is likely to be MGQ + 1%.
4. Coefficient relating % by which MGQ exceeded to % adjustment in <u>prices</u> .	0.5 (results in % MGQ/ <u>aid</u> coefficient of about 1)	No proposal (but Commission have indicated that will be less than 1)

(9) DRIED FODDER

(A) <u>Figure to be set</u>	(B) <u>UK Preferred Figure</u>	(C) <u>Commission Proposed Figure</u>
1. MGQ	2m tonnes	No proposals
2. Maximum % by which prices/aid can be adjusted.	Unlimited	No proposals
3. Trigger point for operation of adjustment.	MGQ + 1%	No proposals
4. Coefficient relating % by which MGQ exceeded to % adjustment in prices/aid.	0.5	No proposals

(10) COTTON

(A) <u>Figure to be set</u>	(B) <u>UK Preferred Figure</u>	(C) <u>Commission Proposed Figure*</u>
1. MGQ	752,000 tonnes	752,000 tonnes
2. Maximum % by which prices/aid can be adjusted	1987/88 15% 1988/89 20% 1989/90 25% 1990/91 Unlimited	1987/88 15% 1988/89 20% 1989/90 25% 1990/91 Unlimited
3. Trigger point for operation of adjustment	1.6% (12,500t) over MGQ	2% (15,000t) over MGQ
4. Coefficient relating % by which MGQ exceeded to % adjustment in prices/aid	0.6	0.5

* The figures in column (C) are those currently in operation in this sector. The UK is proposing an adjustment of the coefficient (4) and the trigger point (3).

(11) SHEEPMEAT

(A) <u>Figure to be set</u>	(B) <u>UK preferred Figure</u>	(C) <u>Commission Proposed Figure</u>
1. MGL	1987 EC Flock* No separate MGL for GB	1987 EC Flock* Separate MGL for GB
2. Maximum % by which prices can be adjusted	Unlimited	Unlimited
3. Trigger point for operation of adjustment	MGL	MGL
4. Coefficient relating % by which MGL exceeded to % adjustment in prices/	1	1

* Commission intends flock size to be estimate of total sheep numbers (it suggests 87m for 1987). We would prefer more accurate and appropriate calculation based on ewe numbers.

28/10/87.



CHANCELLOR

FROM R J BONNEY
DATE 28 OCTOBER 1987

*The most
was cut out
Voluntary
com.*

cc PS/CST
PS/PMG
Mr Edwards
Mr Burgner
Mr Mortimer
Mr Mercer
Mrs Imber

EC FINANCING REVIEW: AGRICULTURAL STABILISERS

I understand that at this morning's meeting with the Foreign Secretary the Minister of Agriculture referred to a paper by his officials setting out detailed UK objectives on agricultural stabilisers. We have just received a copy of this (attached) but have not had the opportunity to study it in detail. On past precedent it would be surprising if MAFF's views wholly coincided with our own.

X/ 2. I recommend that at this afternoon's meeting with the Prime Minister you should advocate urgent discussion by officials of Mr MacGregor's paper so that an agreed UK opening position and fallback for each of the commodity stabilisers can be established as soon as possible. Speed is essential if we are to be able to feed in our ideas to the Commission and the Presidency before the next meeting of the Agriculture Council on 16-17 November.

*PSB for X @
Office
or attached
we have a rough letter
sent Mr MacGregor*

R J BONNEY



Bf 30/10

CH/EX	29/10
REC.	29 OCT 1987
ACTION	MR A. J. L. EDWARDS
COPIES TO	CST DM G SIR P. MIDDLETON SIR G. LITTLE MR FER BUTLER MR CONNER MR MELZER MR MOLTIMER MR DONNELLY
From the Private Secretary	
MR CONNER	
MR MELZER	
MR MOLTIMER	
MR DONNELLY	

10 DOWNING STREET

LONDON SW1A 2AA

28 October 1987

From the Private Secretary
 MR CONNER
 MR MELZER
 MR MOLTIMER
 MR DONNELLY

John Syn.

EUROPEAN COMMUNITY: FUTURE FINANCING

The Prime Minister had a meeting this afternoon to take stock of the negotiations on the future financing of the European Community. The Foreign Secretary, the Chancellor of the Exchequer, the Minister of Agriculture, Sir David Hannay and Mr Lavelle were present. Unfortunately, the meeting had to be cut short and very little ground was covered. We will make alternative arrangements as soon as possible.

The Foreign Secretary said that it would be essential to get the detail right if there was to be a satisfactory outcome at the European Council in Copenhagen. The chances of such an outcome were not particularly good, but it was not to be excluded. The prospect of entering 1988 without agreement on additional own resources was not a comfortable one for other member states. There would be additional pressure from the current instability in markets. We were working together well with the French and the Commission. The right course for us was to work hard for a solution and make sure that everyone understood that we were doing so. It would be fatal to give any impression that the pressure was off. Unfortunately, the Presidency were veering away from toughening up conclusions in our direction and were instead looking for compromises between the Commission's position and those of other member states. This was unhelpful.

In discussion of agricultural issues, it was agreed that we needed agreement on enforceable stabilisers for all the main commodities, with figures, at the European Council although it might be necessary to concede that details of such stabilisers for commodities of lesser importance could be settled later. There would have to be a proviso that a new own resources ceiling would not actually come into effect until stabilisers for all commodities were in place. There must be no room for circumvention.

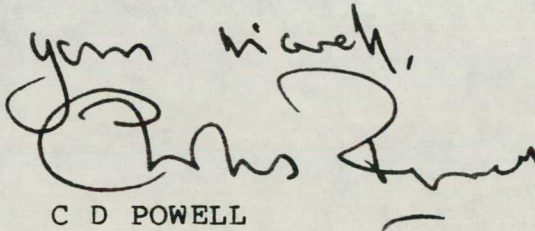
It was noted that the cost of introducing arrangements for depreciation of agricultural stocks was likely to be a major issue at Copenhagen. One possibility would be to propose that this cost should be borne on national budgets, although this was unlikely to be widely acceptable.

It was reported that there were some slight signs of willingness on the part of the French to consider alternatives to an oils and fats tax.

There was a brief exchange on the Commission's proposal for a new Fourth Resource. It was noted that a Commission proposal was on the table and we should have to take a position on it. The Fourth Resource seemed likely to offer us some small benefit. Against this, it was argued that, if we agreed to any variation in the way in which the Community raised its resources, this might encourage those who wished to challenge our abatement and undermine the Fontainebleau mechanism. No decision was reached.

The Prime Minister concluded that a further meeting would be needed. She had only two general comments. First, there were a number of key points such as legally enforceable system of budget discipline on which we should not compromise. Second, she did not think that negotiation on detailed points at the Copenhagen meeting was feasible. The prospects of success there would depend on the extent to which agreements could be arrived at in advance.

I am copying this letter to Alex Allan (HM Treasury), Shirley Stagg (Ministry of Agriculture, Fisheries and Food) and Roger Lavelle (Cabinet Office).

Yours sincerely,

C D POWELL

Lyn Parker, Esq.
Foreign and Commonwealth Office



prop

FROM: J M G TAYLOR

DATE: 28 October 1987

MR BONNEY

cc PS/Chief Secretary
PS/Paymaster General
Mr Edwards
Mr Burgner
Mr Mortimer
Mr Mercer
Mrs Imber

EC FINANCING REVIEW: AGRICULTURAL STABILISERS

Thank you for your minute and enclosure of 28 October.

2. In the event, the Prime Minister's meeting was cut short and there was no time for the Chancellor to advocate urgent discussion by officials of the paper. He would be grateful, therefore, if this could simply be taken forward at official level. He is willing to write to Mr MacGregor if you think that is necessary - if so, I should be grateful for a draft.

A handwritten signature in dark ink, appearing to be 'J M G Taylor'.

J M G TAYLOR