PO-CH/NL/0078
PART C

Part. C.

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(Circulate under cover and notify REGISTRY of movement)

Begins: 29/10/87

Ends: 16/12/87

PO -CH /NL/0078

PART C

Chancellor's (Lawson) Papers:

REFORM OF THE COMMON AGRICULTURAL POLICY WITHIN THE EUROPEAN COMMUNITY

PO -CH /NL/0078

PART C

Disposal Directions: 25 Years

26/7/95

CONFIDENTIAL

B/F JT
30/10

MR J M G TAYLOR

FROM R J BONNEY
DATE 29 OCTOBER 1987

pmp

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

EC FINANCING REVIEW: AGRICULTURAL STABILISERS

Thank you for your minute of 28 October.

2. We are, as suggested, taking this forward at official level. I attach for your information the detailed comments which I have sent to MAFF this afternoon. We see no need for Ministerial intervention at this stage but, if we are unable to resolve the outstanding issues at official level, there may need to be further Ministerial correspondence early next week, as MAFF are anxious to be in a position to reveal their ideas to the EC Commission and the Presidency next week.

3. As my letter suggests, we fear that MAFF's present paper goes too far in weakening the Commission's own proposals in a number of respects. Even if MAFF's proposals were accepted without amendment by the Council (itself highly unlikely), they would have little significant impact in terms of expenditure savings in 1988 when the Commission's latest forecast suggests that unconstrained expenditure could exceed their rebased guide line ~~limit~~ by some 4 billion ecu. I will submit a further report after our meeting with MAFF tomorrow afternoon.

RJB

R J BONNEY

010 1151

CONFIDENTIAL

H M Treasury
Parliament Street London SW1P 3AG
Switchboard 01-270 3000
Direct Dialling 01-270 4650

29 October 1987

R Carden Esq
MAFF
Whitehall Place East

Dear Richard

EC FINANCING REVIEW AGRICULTURAL STABILISERS

1. At Roger Lavelle's meeting yesterday, we undertook to let you have our comments on your paper setting out the UK position on agricultural stabilisers. This letter has been discussed and agreed with Andrew Edwards.

2. While we fully understand the need for realism in specific UK suggestions, we remain of the view that they need to be pitched at a relatively robust level as they will inevitably be seen as our opening position by the Commission. In particular, we should on no account suggest weakening the Commission's own proposals.

3. It has now been agreed, I think, that the paper should be comprehensive, giving the UK position on all commodities. As we said at yesterday's meeting, it should cover not only our preferred outcome, to be revealed to the Commission, but also acceptable fallbacks for each commodity. You have kindly agreed to provide some analysis of the financial effects of each of the stabilisers both on the Community Budget and in terms of UK Public Expenditure. It would be helpful if your Finance Division could let Valerie Imber have their calculations underlying this analysis. From the material to hand it looks unlikely that your proposals would have a significant impact on expenditure in 1988. This reinforces our view that we need to make some rather more foreceful suggestions.

4. Whatever we say on individual commodities should be fully consistent with the paper circulated in July. We have used that as the starting point for the following comments, which lie behind our suggested detailed revisions to your paper (enclosed).

Cereals

5. If we wish to continue to oppose the use of the co-responsibility levy as one of the stabilisers in this

sector, then it is essential that we are more ambitious in terms of our position on the maximum price cut triggered by the MGQ. This would be entirely consistent with the Commission's position, as Andriessen pointed out at the October Agriculture Council (UKREP telegram 3300, paragraph 17). If we are to go for price cuts alone, we should be prepared to suggest limits of 10%, 15% and 20%, which would at least be consistent with what the Commission propose on oilseeds, although in budgetary terms a 1 per cent cut in prices, saving 66 mecu, is not as effective as a 1 per cent increase in the co-responsibility levy applying to all production, bringing in 150 mecu.

6. We are glad to see that something has been included in the paper to control access to intervention, but reducing the intervention period should be additional (not an alternative) to the price cuts triggered by the MGQ system. Another approach might be to consider modulation of the buying in price in relation to the level of intervention stocks, along the lines introduced for butter by the December 1986 Agriculture Council.

7. As a fallback, we should be prepared to accept a non discriminatory coresponsibility levy, based on, say, acreage and average regional yield, as supplementary to a lesser price cut triggered by the MGQ, with the limits proposed by the Commission for 1988-89 and 1989-90 but retaining the idea of some progressivity in later years.

Oilseeds

8. We cannot accept the idea that the existing stabilisers be weakened by a reduction in the coefficient from 1.0 to 0.7, such a change would only be conceivable if there were no butoir at all.

9. Nor can we agree that we should drop the UK proposal for flat rate aid as a counter to the oils and fats tax. We should argue that the Council should commit itself to adopting in the 1988 Price Fixing flat rate aids consistent with what can be afforded within the guideline. This would not only be more effective in achieving budget discipline but would weaken the impact of falling world prices on expenditure. As a minimum fallback we should include a sentence to the effect that there should be an urgent study of the scope for flat rate production aids within the MGQ for oilseeds. We should suggest that the study should also cover the case for flat rate aids in the protein, textiles and dried fodder regimes and for olive oil.

Milk

10. We should clearly offer suggestions for further stabilisers in the dairy regime given its impact on the Budget, and their effect should be no less stringent than the Commission's own proposals which are based on what we are agreed are rather optimistic assumptions about the impact of the December 1986

package. We should continue to advocate:

i. the temporary suspension of quota should be converted into definitive quota cuts, (although as a fallback we might accept continuation of temporary suspension);

ii. quota should be set as a function of EC consumption and net third country trade (this would be particularly important if quotas are to be prolonged for a further five years);

iii. reduced rates of compensation for quota cuts or temporary suspension, and the ending of all compensation from 1991.

11. While we agree that we need not support the proposal to change the milk quota year, which is universally disliked, we cannot accept that we should oppose the Commission's proposal to abate compensation to those producing in excess of quota. We can see no logic in your position on this unless you were prepared to advocate some additional reduction in the total EC quota but I imagine that you would regard that as unrealistic in the present circumstances. There would of course be a substantial budgetary cost in failing to abate the compensation payments as the Commission suggest.

12. We should also press for further adjustments to the system to modulate the intervention buying in price in relation to the level of intervention stocks. This is particularly important if, as your briefing suggests, the December 1986 package is unlikely to reduce surplus production to the extent originally envisaged.

Beef

13. In view of the impact of last December's package for milk on the beef sector and the prospect that surplus production will fall off, we accept that the details of stabilisers for this regime should be covered by the review scheduled for the end of 1988. We should continue to advocate the reduction of intervention to a safety net role and pick up the scope for further restrictions in that review.

14. I assume that you will be adding sections on the rice, sugar and olive oil regimes but I doubt whether there is much of substance between us on these.

15. We have inevitably had to base these comments on reactions to your paper and the Commission's proposals. In the absence of the financial assessment we have been unable to consider the extent to which the stabilisers proposed are likely to be fully efficient in clawing back expenditure arising from production in excess of MGQ etc. It could well be that in many cases fully effective stabilisers would require coefficients in excess of 1 to achieve this fully, setting

aside any additional effect from falling world prices. In addition to specific proposals for the individual regimes, it would seem desirable to suggest that the Commission should be given management powers to adjust the coefficients within clearly defined limits to ensure that the expenditure consequences of excess production are as far as possible recovered in the same budget year.

Yours sincerely

Bob Bonney

R J BONNEY

cc	Sir D Hannay)	UKREP
	D Bostock Esq)	"
	R Lavelle Esq)	Cabinet Office
	J Holroyd Esq)	" "
	J O Kerr Esq	FCO
	D. Hadley Esq	MAFF
	Mr Edwards)	
	Mrs Imber)	HMT

ANNEX

Detailed amendments to MAFF paper

(1) Cereals

Column B line 2: substitute 10%/15%/20% for maximum price reductions in 1988-89, 1989/90 and 1990/91

line 5: substitute: Acceptable provided that monthly increment postponed. (on this basis 1 month's reduction is broadly equal to a 1% price cut). Also provide for further adjustment to intervention buying in prices if stocks exceed level assumed in Budget.

UK Fallback could be:

1. MGQ: 155 m tonnes
2. price cuts: 5% 1988/89
   7½% 1989/90
   10% 1990/91
3. trigger point: 1% over MGQ
4. co-efficient: 1
5. intervention: reduction in intervention period as alternative to price cuts; general statement on possibility of further adjustment to buying in prices if circumstances require.
6. co-responsibility levy: to be used as supplementary stabiliser if maximum price cuts and reductions in intervention insufficient to bring expenditure back within provision. Levy to be raised at end of marketing season on all producers (on area x regional average yield basis) subject to limits of 5%/7½%/10% in 1988/89 1989/90 and 1990/91 respectively.

(7) Oilseeds

column B, line 2: coefficient: 1.0

line 3: Council to introduce flat rate aid payments within maximum guaranteed quantity in 1988 Price Fixing.

Fallback

As amended column B, except line 3: Commission to report urgently on scope for introducing flat rate aid payments for oilseeds and in other comparable sectors (i.e. olive oil, textiles, protein crops, dried fodder) in time for consideration in 1988 Price Fixing.

Milk

UK Preferred Figures

1. 5½% quota suspensions agreed in 1986 to be converted into definitive cuts.

2. compensation for suspensions to be reduced to 6 ecu/100Kg in 1989 - 1991 inclusive; no compensation thereafter.

3. compensation to be abated for producers who exceed individual quota (including any leased quota)

4. total EC quota level to be reviewed in light of EC domestic consumption and normal trade flows.

5. Council to note need for further modulation of intervention trigger system if surplus production and/or stocks fail to fall as envisaged in 1986.

Fallback

1. accept continued quota"suspensions" provided that compensation reduced.

2. question of compensation after 1991 left open; permissive power for Member States to top up compensation to 10 ecu/100Kg at their own expense.

3. accept no abatement if general compensation rate under (2) further reduced to cancel out any increased costs.

4.)
No fallback.
5.)

2361/14/PP

CONFIDENTIAL

FROM: R J BONNEY
DATE: 30 October 1987

PS/CHANCELLOR ✓

cc. PS/CST
PS/PMG
Mr F E R Butler
Mr Edwards
Mr Burgner
Mr Mortimer
Mr Mercer
Mrs Imber
Mr Tyrie
Mr Call

Noted. 2. For LL we have a worry on the desirability & emphasis of the PM's Third Part the proposal on multi-annual stock write-offs should be nationally financed & not fall on the Community Budget.

EC FINANCING REVIEW: AGRICULTURAL STABILISERS

Further to my note of yesterday, we have now discussed the substance of MAFF's paper on stabilisers with other interested Whitehall Departments. MAFF have agreed to modify their draft somewhat to accommodate the points which we have made. There remains, however, one major difference of view on the level of price cuts we should propose for cereals, which may need to be resolved by Ministerial correspondence on Monday. MAFF wish to be able to use the paper as representing an agreed UK position in discussions with the Commission and the Presidency on Tuesday and later in the week when Mr MacGregor meets his Danish opposite number.

Issue

2. The Commission have proposed that the stabilisers for the cereals regime should include:

(i) in year price cuts subject to a limit of 5% in 1988/89 and 7.5% in 1989/90;

(ii) an increase in the co-responsibility levy on producers subject to a limit of 5% in 1988/89 and 7.5% in 1989/90;

(iii) shortening the period of intervention buying (currently October-May).

MAFF are proposing that the UK position paper on stabilisers should support the Commission proposals for price cuts and limits on the intervention period, and should further suggest that the price cut limit in 1990/91 should be increased to 10%. They wish, however, to reject the stabiliser based on the co-responsibility levy out of hand on the (respectable) arguments that the present basis of the levy is discriminatory (cereals consumed on farm for animal feed are exempt), that it tends to get passed on to consumer prices, and that, therefore, an increase in the levy does not have the same disincentive effect on production as a straight price cut.

3. We have argued that, if MAFF wish to continue to oppose increases in the co-responsibility levy, they should be prepared to suggest larger price cuts to compensate by raising the limits to 10%, 15% and 20% in 1988/89, 1989/90 and 1990/91. The arguments for this position can be summarised as follows:

(i) price cuts by themselves have a relatively small effect on expenditure (saving some 66 mecu per 1% in a full year compared with 150 mecu per 1% increase in the co-responsibility levy applied on all marketed production). A 5% price cut would be nowhere near sufficient to offset the additional expenditure from the 17 million tonnes production in excess of the maximum guaranteed quantity of 155 million tonnes which the Commission expects next year;

(ii) if we continue (justifiably) to oppose the increase in co-responsibility levy, it is entirely logical to suggest higher price cuts. (The Commission itself took this position at the last Agriculture Council);

(iii) the Commission proposes price cut limits of 10%/15%/20% in the oilseeds sector, and many will argue that all the main arable crops should be treated in the same way (ie if we suggest lower price cuts for cereals, we will get lower price cuts for oilseeds too);

(iv) the cereals regime is one of the main sectors where expenditure has been rising faster, and it has always been regarded as the cornerstone of the CAP. So a soft position on cereals will inevitably read across to other products.

4. We believe that MAFF officials see the force of these arguments, and they have undertaken to put them to their Minister. Unfortunately, Mr MacGregor has already mentioned the MAFF figures of 5%/7.5%/10%, both in Brussels and domestically, without consulting colleagues (and in the knowledge that the Treasury has disputed them). Despite this, we think that the arguments for proposing higher figures are overwhelming, and Mr MacGregor has at least two colourable excuses for slightly modifying his position, namely:

(i) the position taken by Commissioner Andriessen at the last Agriculture Council that price cuts would have to be higher if there is no increase in the co-responsibility levy; and

(ii) the recent slide in the dollar, which will once again increase EC budgetary costs, particularly on export subsidies for cereals.

5. Unless we hear on Monday that Mr MacGregor has accepted our figures, we will wish to recommend that the Chancellor should write advocating a more robust approach on this issue. You may wish to show him this minute by way of advance warning.

RJB

R J BONNEY

CONFIDENTIAL

b.f. 9/11

FROM: J M G TAYLOR
DATE: 2 November 1987

MR BONNEY

cc: PS/CST
PS/PMG
Mr F E R Butler
Mr Edwards
Mr Burgner
Mr Mortimer
Mr Mercer
Mrs Imber
Mr Tyrie
Mr Call

EC FINANCING REVIEW: AGRICULTURAL STABILISERS

The Chancellor has seen and noted your minute of 30 October.

2. He would be grateful for a note on the desirability and implications of the Prime Minister's idea that the proposed once-for-all stock write-offs should be nationally financed, and not fall on the Community Budget.

J M G TAYLOR

MR J M G TAYLOR

FROM R J BONNEY
DATE 3 NOVEMBER 1987

cc PS/CST
PS/PMG
Mr F E R Butler
Mr Edwards
Mr Burgner
Mr Mortimer
Mr Mercer
Mrs Imber
Mr Tyrie
Mr Call

EC FINANCING REVIEW: AGRICULTURAL STABILISERS

Further to my minute of 30 October I now attach the paper which MAFF intend to give to the Commission setting out UK ideas for the quantification of agricultural stabilisers. This takes on board many of the points in my letter of 29 October and in particular accepts the Treasury position on price cut limits in the cereals sector.

2. I will submit separate advice on the Chancellor's question on national financing of stock write-offs (your minute of 2 November refers).

RJB

R J BONNEY

023 1151

UK PAPER: QUANTIFICATION OF STABILISERS

The European Council in June noted action already taken on stabilisers and requested the Council to adopt the additional regulations necessary to keep the level of expenditure within the budgetary framework, so that final decisions on the future financing package could be taken at the December European Council meeting in Copenhagen.

The Commission's proposals in COM 452 are currently under discussion in the Council. With a limited number of exceptions, the UK has welcomed them. However, in certain cases the UK has not accepted that the Commission's proposals are sufficiently rigorous to ensure their effectiveness. Moreover, the work on stabilisers will not be complete, and cannot be implemented or properly costed, until the appropriate figures are agreed, setting the levels of MGQs, the size of price adjustments etc.

The UK therefore believes there is an urgent need for the Commission to complete its proposals for all commodities, so that the European Council mandate can be met and progress facilitated on the future financing package as a whole.

In order to contribute to this process, the UK puts forward the attached suggestions, which relate only to points where, in the UK view, the Commission proposals, which are otherwise accepted, should be elaborated and/or quantified.

LONDON
NOVEMBER 1987

UK SUGGESTIONS FOR COMMODITY STABILISERS

Cereals

- The maximum adjustments if the MGQ of 155 MT is exceeded should apply solely to prices and should be:

  10% 1988/89
  15% 1989/90
  20% 1990/91

- The coefficient relating the price adjustment to the extent to which MGQ + 1% is exceeded should be set now by the Council at 1.

- If the intervention period is to start later than 1 November, monthly increments should be similarly postponed.

Oilseeds

- The cut-off figures for price reductions as proposed by the Commission with coefficient of 1.

- An urgent study should be undertaken of a flat rate aids system within the MGQ for this sector, in time for consideration in the 1988/9 price fixing.

Wine

- GDBF should be limited to 5% of production for 1988/89 and abolished from 1989/90

- When more then 12.5 mhl undergoes OD, price reductions should be as follows:

1987/88	40%
1988/89	30%
1989/90	20%
1990/91	15%

- When quantities of less than 12.5 mhl undergo OD, the price payable should be reduced to 40% of the guide price.

Tobacco

- Separate MGQs should be set for different varieties, with strictest limits on those least marketable.
- premia should only be payable, and intervention only available, when a cultivation contract has been concluded in advance.

Sheep

- The MGL should relate to the EC ewe flock and not to total flock numbers.
- There should be no separate MGL figure for the UK.

Protein Crops and dried Fodder

- The coefficient relating the price adjustment to the extent to which MGQ plus 1% is exceeded should be 0.5 for both commodities.
- The MGQ for dried fodder should be set at 2MT.

Olive Oil

- Consumption aid should be stabilised to the same extent as production aid, preferably by cutting the production target price and the intervention price by the same percentage as the production aid.

Cotton

- The trigger point for operating the existing price adjustment mechanism should be MGQ + 1.6%.
- The coefficient relating the price adjustment to the extent to which MGQ plus 1.6% is exceeded should be 0.6.

Fresh Fruit and Vegetables — For products where threshold arrangements are not yet agreed, there are two figures which need to be set:

- the proportions of the average of the last 5 years' production (4 years for cauliflowers) constituting the withdrawal thresholds, and

- The quantities triggering 1% price reductions when the threshold is exceeded.

UK suggestions are:

	Threshold as proportion of production	Quantity to trigger each 1% price cut
Oranges	8%	10,000 tonnes
Peaches	8%	10,000 tonnes
Lemons	8%	5,000 tonnes
Apples and pears	5%	10,000 tonnes
Apricots	5%	2,500 tonnes
Cauliflowers	2%	2,500 tonnes
Aubergines	0.1%	Immediate 20%
Table grapes	0.1%	reduction

- The maximum price reduction for all products could be 20%.

Processed Fruit Vegetables - The MGQs for prunes, peaches in syrup and William's Pears in syrup should be equivalent to the three years production average 84/5-86/7, giving figures of 44,000 tonnes, 492,000 tonnes and 83,000 tonnes respectively.

Milk - There should be no compensation for quota suspension after March 1991.

Rice - MGQ of 1.2 MT

- Mechanism as for cereals, including maximum price adjustments of:

10% 1988/89
15% 1989/90
20% 1990/91.

1-3.11

BF 5/11

FROM: I C R BYATT
DATE: 3 November 1987

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr F E R Butler
Sir T Burns
Sir G Littler
Mr Monck
Mr Burgner
Mr A Edwards
Mr H P Evans
Mr Scholar
Mr Spackman
Mr Bonney
Mr R I G Allen
Mr Mortimer
Mr G White
Mr Corry
Ms Symes
Mr Tyrie

Ch/ Content to write as proposed? (Shall I check with PS/Mr MacGregor that he would be content not to have a discussion – para 3, below?)

JT 5/11

Content with para 15 immediately.

AGRICULTURAL REFORM

Responses to your 'ten principles' paper were received from the Minister of Agriculture, the Foreign Secretary and the Secretaries of State for Trade and Industry and Environment. Generally the reaction was positive. There was agreement that there was value in setting down a statement of our objectives for reform. There was also a broad measure of agreement with the content of the paper.

2. We have revised the paper to incorporate comments so far as possible. I suggest that you circulate the revised paper, at the same time responding to points made which run somewhat wider than the paper itself and suggesting what use should now be made of the paper and the principles.

Revising the Paper

3. The Minister of Agriculture expressed the hope that you and he could discuss his proposed amendments. I understand from his officials that he was personally involved with the drafting. But we have discussed the changes with his officials (hence the delay)

Are you surprised?

and hope we have now achieved a version of the paper which is likely to be acceptable to Mr MacGregor and other colleagues. Unless you want to take up Mr MacGregor's suggestion of a meeting, we think it could be circulated without much risk of further substantive comment - and that this would be the simplest way of proceeding.

4. There are two points of substance in the revised version to which you might want to give particular attention.

- <u>The role of guaranteed prices</u> (principles (v) and (viii)); Mr MacGregor wanted to use the term safety-net to describe the longer term role of intervention buying and to relate guaranteed prices to security of food supplies in the EC. It is not clear what precisely is meant by these formulations. They have been incorporated in the revised paper in a way which tries to make clear that guaranteed prices and intervention buying should not be designed to provide income support and that prices must be much closer to prevailing world prices. This is a weaker formulation than you suggested in our discussion in August when your preference was for a long term aim of bringing Community prices in line with world prices. But MAFF would be unhappy with such a formulation and I think it would be very difficult to sell it in the Community, where ideas of some Community protection for agriculture are deeply ingrained. This is something you will wish to consider.

- <u>Set-aside and income aids</u> (principle (vii)): There is a division of opinion about the desirability of these measures as transitional arrangements; the FCO support income aids (partially community funded if necessary) whilst MAFF favour voluntary set-aside. The redraft points out the conditions necessary for either to be acceptable, notably production neutrality or reduced output and linked to price reductions.

Other Comments

5. Ministers used the opportunity presented by your paper to make more general points. Most notably, the Foreign Secretary with an eye to the GATT negotiations expressed the view that market-sharing arrangements, co-responsibility levies or income aids should not be ruled out if they are the price for real reforms in the longer term. Whilst we have some sympathy with the case for income aids, the fact remains that all the short-term measures involve some disadvantages and are only really acceptable if they are made conditional on price reductions. So, there are two tests which ought to be applied to short-term measures, namely:-

- How significant are the budgetary and economic costs likely to be associated with them, how long can they be expected to last and how transparent and reversible are the measures likely to be?

- How easily can they be associated with and what incentives are there for significant price reductions?

6. Market sharing arrangements are like quotas on these two tests. They create further distortions on output and trade; they are difficult to negotiate and administer and hence, once in place, there is not much incentive to dismantle them; and if anything they are likely to provide an incentive to increase prices. Co-responsibility levies share some of these characteristics. Set-aside arrangements can operate much as quotas. Voluntary set-asides are difficult to administer, are uncertain in their effect and are targeted not directly at output, only indirectly at inputs. The advantage of direct income support is that it cannot be justified for any other reason than compensating the least well-off for loss of income support through reduced prices; so, it is much more necessary to link the two.

7. You have already made clear to the Foreign Secretary your reluctance to accept the Commission's market sharing proposals without some specific conditions. Mr MacGregor has also

registered his view that any such arrangements, involving increased protection for some commodities, are not welcome. Therefore, you may not want to elaborate on these points.

8. Mr Ridley responded with a suggestion for an eleventh principle making organisations subject to the "polluter pays" principles. I know you are concerned with the interface between environmental and agricultural policy. But we think we are going far enough with the statement in principle (viii) about "consistency with and contribution to environmental policies" and the addition of the sentence on the 'polluter-pays' principle at the end of principle (ix).

Dissemination

9. Only Mr MacGregor addressed the question of what presentational use should be made of the ten principles. His concern was that publicising the principles in speeches or print risked isolating the UK and leaving the reform agenda to be set by others. We have accommodated some of the redrafting suggestions he made with this in mind, especially principle (v) - see paragraph 4 above. For this reason we have referred to the need not to make enemies in the draft minute we suggest you should send to the Prime Minister. We see no advantage in watering down the paper further because of European views and would prefer simply to suggest that presentation outside Whitehall should be suitably cautious. The Foreign Secretary indicated that the ideas on income aids in his paper were more for 1988 than pre Copenhagen.

10. We recommend that you argue that the ten principles are given a high profile within Whitehall as a benchmark against which to assess all proposals and negotiating positions within GATT and the community; building on them and interpreting them more precisely; and ensuring that public statements are at least consistent with the ten principles.

11. There are three possibilities for wider dissemination:

- A mainstream speech by you or other Ministers before 1988;

- emphasis on the thinking behind the ten principles in an EPR article provisionally planned for the December issue following up the OECD work and subsequent developments;

- A more cautious exposure of the themes of the paper, eg, in your informal talk in the City on 1 December, followed by a mainstream speech or publication later in 1988.

12. We do not recommend deploying the ten principles in a way likely to antagonise the Commission. In particular, it is not easy to see a way to use them directly in the Community this side of the Copenhagen Summit. But between that and the GATT round there will be a window of a few months as the Community settles its line. We could try to lead with the EPC paper, as it is agreed among Finance Ministry officials and has been sent to ECOFIN.

13. You had hoped the French might be persuaded to ask for a discussion. But although I think the French Ministry of Finance would be happy to partake in a general discussion on agriculture - provided it was not in the context of fixing the budget this autumn - I doubt if they can be persuaded to ask for the paper to be put on the ECOFIN agenda. In these circumstances would you be prepared to make such a request? There is no guarantee that the ECOFIN discussion would go well - the Germans will drag their feet and the Danes, Greeks, Irish and possibly the Portuguese would be critical of the EPC paper. But that officials have signed up to it, and with friends like the Greeks ..... And the Dutch would support the EPC Conclusions; they regard the paper as having made too many concessions already and I am told that the Dutch Minister of Agriculture supports the EPC line.

14. We could use the ten principles in any discussion at ECOFIN on the EPC paper and in subsequent press briefing.

Recommendations

15. On the paper I suggest you should circulate the present version, as a compromise which you trust is acceptable to colleagues, with a recommendation that those principles should be used widely in Whitehall. You might do this in the form of a minute to the Prime Minister (an alternative would be to write to the Minister of Agriculture). On the issue of wider dissemination at home, I would recommend the second and third options in paragraph 11, combined with the use of the paper within Whitehall. On the EC side I suggest you should no longer wait for the French but take the initiative and ask for a discussion on the EPC paper at the December or February ECOFIN. (The January meeting is normally cancelled).

16 I attach the revised version of the paper and a draft minute to the Prime Minister.

IB

I C R BYATT

CONFIDENTIAL

DRAFT MINUTE for Chancellor to send to the Prime Minister

I am grateful to colleagues for their comments on the ten principles of reform I circulated on 21 September. Following these constructive reactions, I think we have now achieved a useful statement of our strategic objectives which should guide our thinking on both short term and long term negotiations. I enclose the revised version.

2. As Lord Young's letter~~s~~ suggests, it is important that the subjects of EC budget control and the Uruguay Round are not dealt with as wholly separate issues. We must ensure that our line in informal bilaterals, price fixing and internal policy reviews, as well as in negotiations on the EC budget and in GATT is consistent with the ten principles.

3. I suggest that the ten principles be given a high profile within Whitehall for this purpose. A cautious presentation of the thinking behind the principles, if not the principles themselves, would be appropriate for a wider audience at home, perhaps through an article in the Treasury's Economic Progress Report. On the EC side, it is important that we should not be too strident and antagonise our allies and potential allies, especially the Commission. Nevertheless, I suggest we should take the initiative and ask for a discussion on the EPC paper at the December or February ECOFIN.

4. One important conclusion seems to me to arise from this work. We have always argued that reductions in Community prices are the best way of dealing with surpluses. But I think we must go further also conclude that other policies, such as voluntary set-aside and income aids, will be acceptable only so long as they are made contingent on price reductions. The Foreign Secretary's paper was particularly interesting in this respect. The one attraction of income aids (if we find we go that way), is that they cannot possibly be justified for any other reason than compensating the least well-off for loss of income support through reduced prices. So, it is much more necessary to link the two. The problem with other measures is that they are often seen as alternative ways of reforming agricultural policy rather than as a complement to price reductions.

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

PRINCIPLES OF AGRICULTURAL REFORM

1. 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 inflated food prices or both.

2. There is a consensus that further reform is necessary, though there is 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. It is crucial that the GATT Round Negotiations secure major reform of agricultural support systems, notably in 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. Because the EC will be able to take credit for it, action taken now will increase pressure on other developed countries to implement parallel reforms.

(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.

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 those that would prevail on world markets in the absence of intervention. 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.

(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 so as to use land less intensively as well as diverting it to other purposes. Reforms which work with the grain of market forces are always to be preferred to administrative controls. Intervention buying, by creating an artificial market, works against market forces and its role should be reduced to a safety net and not used for income support.

(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. Limitation or suspension of intervention buying can have similar benefits. Levies or taxes on farm output or inputs are often borne by the consumer and should be avoided, especially where they are not made contingent on price reductions or if they conflict with the Community's GATT obligations. Quantity controls are inconsistent with letting the market work. New quota arrangements should be avoided; where quotas already exist, prices should be reduced to the point where the quotas can be removed without causing an increase in output.

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

Other forms of support to ease adjustment costs may be desirable as long as they are linked to price reductions. Incentives to take land out of production may ease problems for marginal farmers. Income aids should be degressive, time-limited and decoupled from production. They should be related to the total income of those least well-off engaged in agriculture and 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.

Whilst guaranteed prices should take account of the Community's need for security of food supplies, they should not be tailored to provide income support. With intervention buying reduced to a safety net role in the longer term, the operation of insurance and <u>futures markets</u> should not be so inhibited by support mechanisms. Agricultural policies should be consistent with and contribute to the objectives and principles of <u>environmental protection</u>.

(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. The argument that lower farm support will lead to rural unemployment is thus losing its force. Agriculture should be subject to the general principles applied to environmental policy, including the 'pollutor-pays' principle.

(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 and the need to avoid unnecessary disputes with third countries; 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 and the GATT negotiations offer an immediate opportunity to make progress consistent with these 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 <u>any</u> 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.

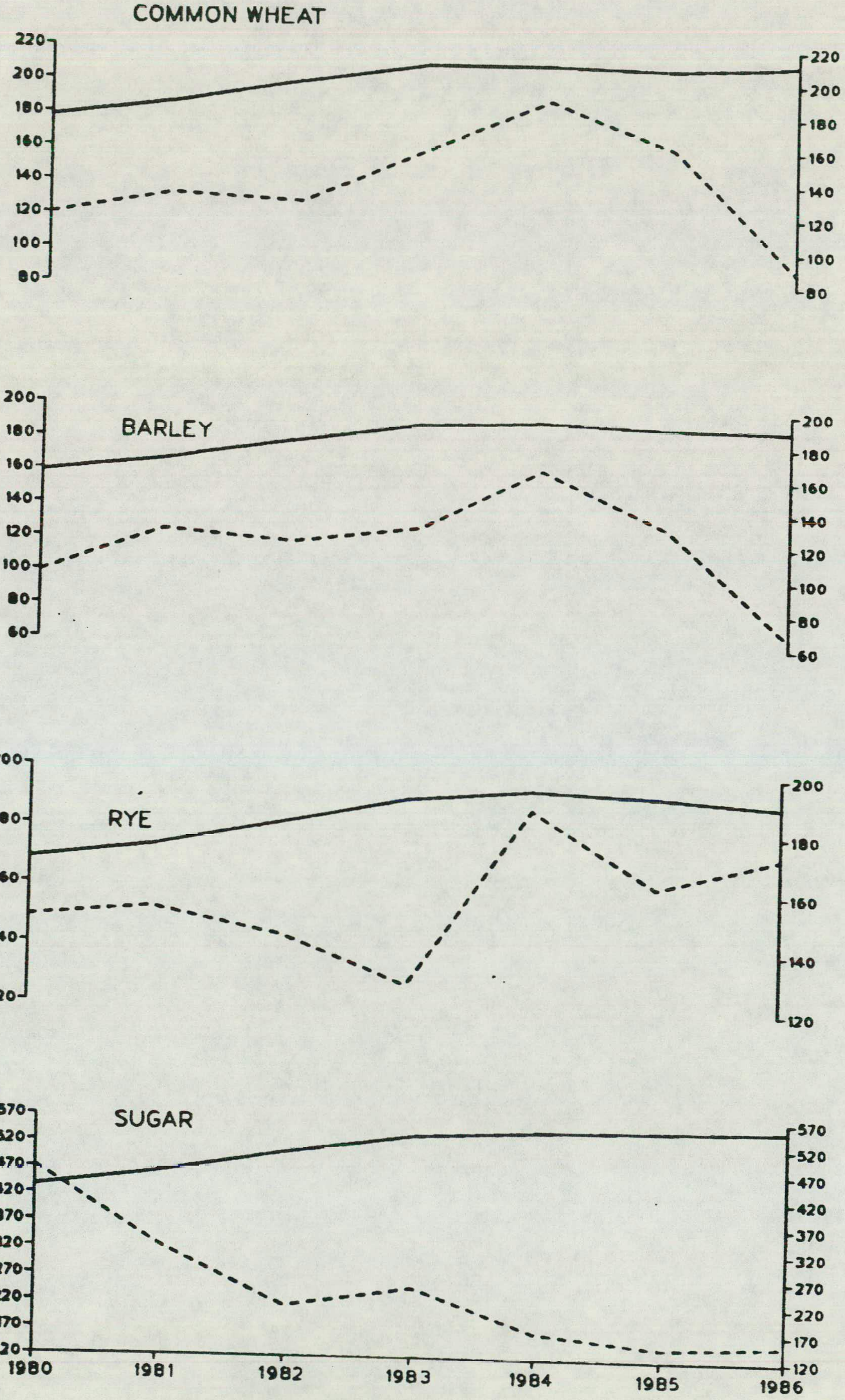
6. The **consumer** also foots the bill through higher food prices. The excess costs (over current world prices) to the consumer were estimated by the OECD to amount to 60% of Community agricultural value-added and 1.8% of Community GDP (some 65 becu or £550 a year for a family of four). The comparison 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.

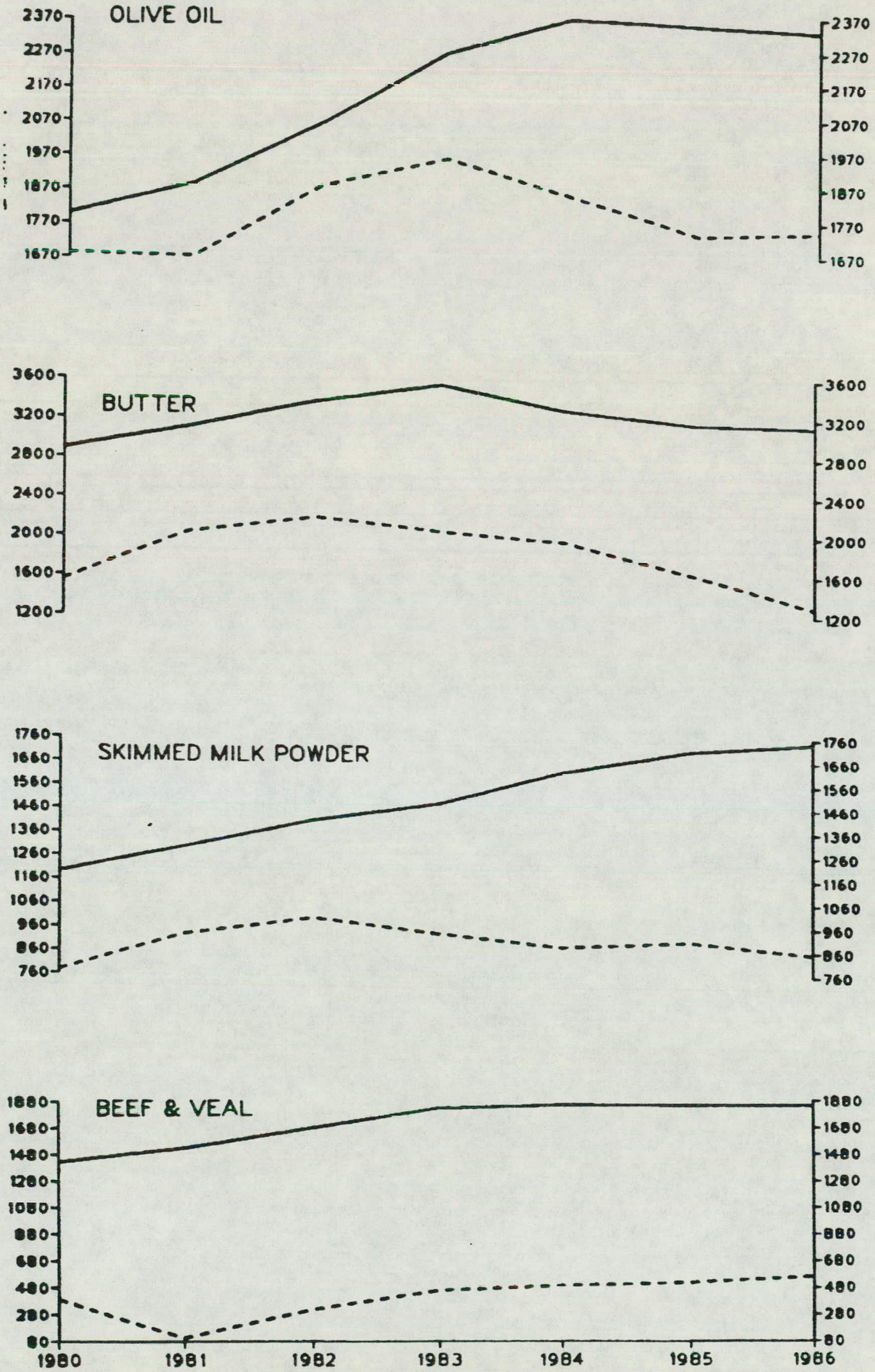
9. Recent estimates suggest that, through these wider effects, Community agricultural support has reduced GDP by up to 1%. With the estimates of taxpayer and consumer costs quoted earlier, this means that for every £100 transferred to the farmers, there could be a loss to Community GDP of £35 (some estimates 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



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

COMMUNITY PRICES AND NOTIONAL WORLD PRICES



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

NOTE 1

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 <u>world</u> 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.

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

From the Minister

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State
for Foreign and Commonwealth Affairs
Foreign and Commonwealth Office
Whitehall
LONDON
SW1A 2AH

13 November 1987

Dear Secretary of State

AGRICULTURE STABILISERS

I know that colleagues wish to have my assessment of the state of negotiations on agricultural stabilisers and the likely outcome of next week's Agriculture Council.

I and my officials have been engaged in a great deal of activity over the past few weeks, both in formal sessions in Brussels and in bilateral contact. Colleagues will be fully informed about the recent work of the High Level Group on the stabiliser proposals through the telegrams from UK Rep, and reports on my own recent bilateral contacts with the Danish Presidency and the French have also been circulated.

I would much have preferred the Commission's original proposals for stabilisers to have been tougher in some respects. Some products were omitted altogether. In most cases the proposals only provided a framework mechanism, leaving the essential figures to be filled in later.

The latest discussions at official level have been on the basis of a working document prepared by the Presidency. I attach a copy for ease of reference. The same document, with minor amendments, will be before next week's Council.

The Commission have not formally endorsed the Presidency's reworking of their proposals, and in some cases will probably continue to argue for somthing different. But this is likely to be mainly tactical on their part. All the signs are that the Presidency and Commission have co-operated closely in preparing the document.

The Presidency document marks a useful step forward because, in many cases, it inserts figures where these were lacking in the Commission's proposals. But it does not insert as many of the figures as I would have liked; the Commission's original ideas have been weakened in some respects; and we have made no progress in getting the missing products inserted.

The Dutch have been supporting us in wanting the most stringent possible decisions. But all other Member States are trying to weaken the proposals in the Presidency's document. The French have made proposals which would result in higher guarantee thresholds and less price adjustment in the arable sector, and several Member States, particularly the Germans, have expressed interest. The Southern Member States are seeking various special deals, and the exemption from stabilisers of as many Mediterranean commodities as possible. There is great emphasis, especially from the Germans, on a land set-aside programme sufficient to minimise the risk of production levels triggering price cuts.

The Presidency say that their aim is to keep next week's Council in session until it reaches agreement on the stabilisers package. But at present the signs are that agreement could only be reached on the basis of a compromise of the traditional sort, which represents a substantial weakening of what is currently on the table. If that proves to be the situation, I am sure that you and colleagues would agree that I should stand firm on our existing position.

But if it seems likely that an acceptable outcome can be achieved, I shall almost certainly have to indicate some movement if we are to reach agreement. The following analysis sets out where I see the strongest case for a move towards the Presidency's position and where I think we have to stand particularly firm.

<u>Cereals</u>

This sector is central to the negotiations, and the most important issues arise here. The Commission's proposal was for a stabiliser involving both reduction in prices (including the possibility of further restrictions in intervention), and increases in the existing coresponsibility levy. I have argued against using the levy as a stabiliser, on the grounds that it is wrong in principle to solve the budgetary problem by devices which mean higher prices to consumers (and depress demand), and the coresponsibility levy in this sector involves serious distortion for parts of the cereal industry, which will get worse if the levy rate is increased. I still hold to those arguments and you will know of the strong opposition in the UK industry to the concept of a coresponsibility levy, which would be intensified if the rates were to be increased in this way.

The Presidency's formula is in one respect better than the Commission's, in that any over-production would be met first by reducing prices, with an increase in levy applied too only if the over-production went beyond a certain point; but I shall still regard this as unsatisfactory. I am therefore not inclined to agree. I may however have to be prepared to reconsider this as a last resort and only in the final negotiating stages if it were judged to be necessary to reach agreement on an otherwise satisfactory package. My aims will remain to minimise any additional impact of the coresponsibility levy on our own market.

Another major issue in the cereals sector is set aside. It now looks as thought the Germans (with appreciable support from others) want a commitment on set aside out of Copenhagan. The Commission, we know, are working up some ideas, though they do not appear ready to let the Council have any specific project on paper next week. We may have to see this as an acceptable part of the eventual package, and certainly much more so than any other income-aid scheme which in my judgement, and on the basis of current discussions, would be quite unacceptable. We are pressing the Commission to come forward with a definite proposal.

We shall have to judge this when it comes. I suggest our aims should be to look for a cost-effective formula which will be effective across the Community as a whole, and for a scheme which is voluntary at the farm level. A compulsory scheme could too easily turn into the equivalent of national quotas.

<u>Oilseeds</u>

We have been supporting the Commission in arguing that there should be no limit on the potential price cut for oilseeds. The Presidency now propose a cut-off of 20%. I propose to try and improve on this. The Commission are still arguing for no limit and I shall certainly stay with them as long as they do so. It is unlikely that agreement will be reached on that, but I aim to secure an improvement on the Presidency proposal on this point.

It remains a firm objective in this sector, of course, to resist an oils and fats tax.

<u>Olive Oil</u>

The UK note to the Commission and Presidency proposed that stabilisation arrangements should bite not only on production aid, as proposed by the Commission, but also on consumption aid which is costly too. I shall be pursuing this objective.

<u>Protein Crops</u>

The Presidency have helpfully inserted some figures into the discussion. This is not a high cost sector and the important thing is that we should obtain firm stabiliser arrangements of some kind.

Sugar

Our major objective here is to avoid any shift in the levy burden from B to A quota sugar. The Commission proposals, which the Presidency have taken over, would satisfy us on this and I shall therefore support the document firmly.

Wine

We must keep up pressure for real action to cut costs in this sector (some action has been drifting since the last Dublin Summit). There is fierce resistance from the producer countries to much that is on the table. The Presidency document falls short of what we have been arguing for, in particular in lacking many of the essential figures. In my judgement our essential objective should be to obtain a package of measures that will cut costs. It is rather less important how that package is made up. We should therefore agree to be open to discussion of some of the ideas that have been introduced in the High Level Group over the past week or so, whilst seeking to ensure that they at least have equivalent effect to the Commission's proposals, and that the Council arrives at specific, quantified terms to ensure against further procrastination of the kind that occurred after Dublin.

Fruit and Vegetables

The Presidency have helpfully injected some figuring into the stabiliser proposals. Their figures are less stringent than those we ourselves floated, and I hope to move them further in our direction.

Tobacco

The Presidency proposals go a long way towards our own suggestions. They will meet strong resistance from producers, particularly over the setting of the maximum guaranteed quantity. I shall support the Presidency over this.

Milk

One issue that arises here is that of compensation to producers for the 5½% cut in quotas on which the Council agreed in 1986, where the Presidency put forward higher rates than we have been arguing for. I shall seek to make further headway on that.

Sheep

I face two very difficult issues here, in that the Commission proposals included - and the Presidency have carried through to their document - two points directly discriminating against the UK; a separate maximum guaranteed level for Great Britain (which would cut producers' returns in Great Britain more than in other

Member States) and a limit on the number of animals per flock on which premium could be paid (limits which would have much the largest impact in this country). I cannot defend to producers agreeing to discrimination of this kind and intend to carry on resisting strongly, though I shall also be exploring the possibility of resolving the problem through arrangements that go some way in the direction of the Commission's proposals.

Products not covered by Presidency

I shall continue to work for the inclusion on the stabiliser list of minor products not covered by the Presidency: cotton, processed fruit and vegetables, and rice. We must recognise that it will be extremely difficult to get detailed arrangements on these into a package in December, or to firm up the arrangements on olive oil as we would wish. If the rest of the package appeared satisfactory we should, I think, need to consider whether it would be enough to have these products covered by way of a declaration that carried a clear commitment to future action.

Conclusion

It will be clear to colleagues that the Presidency text falls quite some way short of what we should have liked to see. I shall be working at next week's meeting to make headway on the basis of this letter. The prospects do not look encouraging and there will certainly be some who will be working to whittle down the Presidency proposals. It looks as though the meeting will run on beyond Tuesday and, depending on progress, I shall wish to make contact with you and possibly other colleagues from Brussels as the week goes on.

Finally, I should just mention that the Danish Agriculture Minister mentioned to me privately when we met recently that he could not commit himself to agreement on stabilisers until the Danish Government was sure that there was a satisfactory agreement on other elements of the Summit, in particular future financing. I suspect that other Member States, including the French, will be in a similar position. We shall need to consider how to handle this.

+ Copies go to the Prime Minister, other members of OD(E), the Secretaries of State for Wales, Northern Ireland and Scotland, and Sir Robert Armstrong.

Yours sincerely

[signature]

for JOHN MacGREGOR

(Approved by the Minister and signed in his absence)

GENERAL SECRETARIAT
OF THE COUNCIL

cc Perm Sec, Mr Carsten, Mr Thomas, Mr Hudson, Mr J.E. Lawson, Mr Hollis, Mr Myers, Mr Wentworth, Mr Murphy, Mr Griffiths, Mr Jupe, Mr Llewelyn, Mr Nash, Mr Bodwell, Mr Scollen, Miss V. Smith, Mr Lawson, Mr Byrne, Mr Camp, Mr Lambert, Mr Irving, Mrs Gower

Brussels, 9 November 1987
(10.11)
(OR.f)

SN 3525/87

PRESIDENCY WORKING DOCUMENT
for the High-level Working Party
(meeting on 11 November 1987)

Subject: Agricultural stabilizers

I. GENERAL CONSIDERATIONS

1. In its conclusions on budgetary discipline, the Brussels European Council emphasized that EAGGF Guarantee expenditure must not progress at a rate exceeding that of the own resources base. Having noted that various production-stabilization arrangements within the market organizations had already been adopted, the European Council requested the Council - with a view to its next meeting in Copenhagen - to adopt the additional provisions which would enable the Commission, in the context of the management of the market, to keep the level of expenditure within the budget framework.

2. For a number of years considerable efforts have been made in the agricultural sector to combat the growing imbalances between supply and demand: the Council has had

For discussion at today's High Level Group.

1. cc Sir D Hannay, Mr Elliott, Mr Gowden, Mr Bostock, Mr Westcott.

2. pl refer to Mr Thomas (MAFF), Mr Wall (FCO), Mr Bonney (HMT) and Mr McLelran (Cab Off)

1.2/11

.../...

to carry out a more restrictive policy with regard to prices, the adjustment of intervention mechanisms, the strengthening of producers' co-responsibility and the development of product quality. Despite these efforts, the markets and agricultural expenditure have still not been brought under control.

3. The purpose of the work being carried out in the agricultural sector, in accordance with the European Council's instructions, is thus to make a further contribution to the current exercise of budgetary expenditure control; this work has centred on the determination of agricultural stabilizers, while remaining within the overall framework of the present exercise, which is also concerned with budgetary discipline and reform of the structural funds.

4. The aim in the agricultural field is to supplement already existing stabilization mechanisms and to extend them to all sectors subject to organization of the market by introducing guarantee thresholds coupled with penalties if the thresholds are exceeded, applicable chiefly to the level of prices and taking effect, in principle, in the same year as they are decided.

All of these mechanisms will thus help to achieve stability in production and on the markets and thereby to ensure budgetary discipline in the common agricultural policy.

5. The measures advocated and listed in II below are based on a more market-orientated approach. They should be accompanied by reinforced quality criteria. Achievement of the desired objectives involves the delegation, in certain areas, of responsibility to the Commission within limits defined by the Council.

6. Furthermore, in view of the impact of such measures on farmers' incomes, it should be noted that the European Council in June 1987 pointed out that they could be accompanied by aids to income: these aids should be selective, should continue to be subsidiary to the prices policy, should have no effect on production levels and should have a Community framework. Work carried out to date has also established that such aids should be of a temporary nature. In this respect, examination of the Commission's proposals must press ahead, keeping in mind the need to avoid renationalization of the common agricultural policy.

7. Similarly, as a result in particular of the trend to increased production and productivity, account should also be taken, in addition to measures on prices, of the possibilities offered by development of a policy of limiting supply by recourse to measures to ensure the cessation of farming and to encourage the temporary abandonment of land (set aside), for which the Commission proposals are pending.

8. These measures to ensure market control were conceived with close reference to the external aspects of the common agricultural policy and in line with the negotiating directives in the context of the Uruguay Round.

9. In conclusion, and as has already been pointed out, all these agricultural stabilizers should enable the principles of budgetary discipline to be respected; should agricultural expenditure exceed or threaten to exceed the appropriations available in the budget, the Commission will either take the appropriate measures under the "Management Committee" procedure or submit the necessary proposals to the Council in accordance with the arrangements for budgetary discipline.

II. STABILIZATION MEASURES

Bearing in mind the various considerations outlined in I above, and after consulting the Commission, the Presidency hereby submits the following guidelines to the High-Level Working Party:

1. Cereals

(a) A maximum guaranteed quantity of 155 million tonnes would be fixed for three marketing years.

(b) In the event of this quantity being exceeded, the penalties would be as follows: within a cut-off of 5% for the first marketing year and of 7,5% for the second and third marketing years, the intervention price would be reduced by 1% for each 1% production overrun.

.../...

(c) If, however, production were to exceed the maximum guaranteed quantity by a percentage above the cut-off, an additional co-responsibility levy could also be introduced according to the rule that there would be a 1% levy for each 1% overshoot of the cut-off, within the limits of a ceiling of 5% for the first year and 7,5% for the second and third years.

This additional levy would be applied solely during those marketing years in which production exceeded the cut-off level.

The Commission would take the decisions referred to at (b) and (c) above under the Management Committee procedure.

(d) Acceptance of the system initially proposed by the Commission for the co-responsibility levy (payment by the first buyer).

(e) It would be understood that at the beginning of each marketing year, when prices were fixed, producers would be informed of all the possible consequences of a production overrun (price reduction; if appropriate, introduction of an additional co-responsibility levy, etc.)

In any event, by 15 September at the latest the Community should establish whether a production overrun has occurred and adopt the relevant penalty measures.
If the final figure differs significantly from that adopted, account will be taken of this in the following marketing year. ([1])

(f) Action should also be taken on the potential production supply: the Council would undertake to act as quickly as possible on the Commission proposals concerning land use and the encouragement of a temporary freeze on land (set aside), as soon as it receives them.

(g) Specific measures concerning intervention ("B" intervention) should be taken to allow for early harvests in the southern Community countries.

([1]) An arrangement of this sort would apply in other similar cases where it is not yet laid down by the relevant regulations (see protein products).

2. Oils and oilseeds

Without prejudice to the follow-up to the Commission proposal on the stabilization mechanism for the prices of vegetable oils and fats, the following measures might be taken into consideration:

(a) the maximum guaranteed quantities already decided on by the Council for the various oils and oilseeds would be fixed for three marketing years.

(b) in the event of an overrun, the penalties would be as follows: within a 15% cut-off for the 1st and 20% for the 2nd and 3rd marketing years, there would be a 1% reduction in the target price for each 1% production overrun.

3. Protein products

(a) A maximum guaranteed quantity of 3,3 million tonnes would be set for the three marketing years.

(b) In the event of an overrun, the penalties would be as follows: within a 15% cut-off for the 1st and 20% for the 2nd and 3rd marketing years, there would be a 1% reduction in the guide price for each 1% production overrun.

4. Sugar

Acceptance of the Commission proposals on stabilizers.

5. Wine

(a) The Council would take note of and approve the Commission's intention to make the compulsory distillation price more dissuasive;

(b) The Council would also take note of the Commission's intention to discontinue recourse to aid for wine relocation and gradually to reduce the volume of wine eligible for the special price support guarantee for long-term storage contract holders;

(c) The Council would ask the Commission to examine the question of introducing a co-responsibility levy and report back to it;

(d) As regards the limitation of replanting rights, the Council would implement the conclusions of the Dublin European Council as follows:

- restriction of replanting rights would not apply to quality wines p.s.r.;

- the right to replant would be accorded only within the framework of a restructuring programme worked out by a collective group of producers;

- a certain percentage would be deducted from the area to be replanted. Producers losing some area would receive compensation.

The Council would also advocate a stronger grubbing-up programme.

.../...

6. Fruit and vegetables

(a) The Council would take note of and approve the Commission's intention to introduce a threshold for quantities of fresh fruit and vegetables eligible for intervention; if the threshold were overrun, the basic and buying-in prices for the following marketing year would be reduced or the compensation paid to producers' organizations during the marketing year concerned would be reduced, where such organizations could offset the reduction in compensation against the withdrawal prices as from the beginning of the marketing year.

(b) The Council would point out that stabilization mechanisms have already been adopted for a number of products, firstly for tomatoes and most recently for satsumas, mandarins, clementines and nectarines;

(c) As a general rule, the intervention threshold for products scheduled for a stabilization mechanism would be equal to 10% of the average consumption production of the previous 5 marketing years.

(d) Where this threshold is exceeded, basic and buying-in prices would be reduced according to conditions to be determined for the various products; this would not however result in a reduction of more than 20%.

7. Tobacco

(a) A maximum guaranteed quantity of 350 000 tonnes would be fixed for a period of three marketing years.

(b) Within that maximum quantity, specific thresholds would be fixed for each of the varieties listed in Annex IV to the annual regulation fixing prices and premiums; these varieties would be determined on the basis of criteria proposed by the Commission in its communication concerning the implementation of agricultural stabilizers (see Volume I of 8761/87).

(c) If the threshold is overrun, penalties would be as follows: within the limit of a cut-off of 5% for the 1st and 10% for the 2nd and 3rd marketing years, the intervention price and the premiums would be reduçed by 1% for each 1% production overrun.

(d) The Council could ask the Commission to submit a study of the possible means of encouraging a contractual policy, accompanied, if appropriate, by suitable proposals.

8. Milk

(a) Extension of the quota system for a period of three years until 31 March 1992; the 6-month extension of the 5th period proposed by the Commission would not be adopted.

In addition, the Commission proposal to make the reduction in quotas permanent would not be adopted and the suspension arrangements would remain.

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(b) Compensation would be set as follows:

- 10 ECU for 1987/1988
- 10 " " 1988/1989
- 8 " " 1989/1990
- 7 " " 1990/1991
- 6 " " 1991/1992

41 ECU

9. Sheepmeat and goatmeat

(a) A guarantee threshold corresponding to the number of ewes in the Community in 1987 ([1]) would be fixed, and a specific guarantee threshold would be fixed for the United Kingdom ([2]), linked with the application of the variable premium arrangements.

(b) If the threshold is overrun, the basic price and the derived price would be reduced by 1% for each 1% overrun.

(c) Acceptance of the Commission proposal to restrict the granting of the premium to the first 500 ewes (1 000 in less-favoured regions).

(d) External aspect: the Council would ask the Commission to submit draft terms of reference for negotiations with third countries as soon as possible.

([1]) 43 000 000 ewes.
([2]) 18 000 000 ewes.

1155/3

16

CONFIDENTIAL

FROM: R J BONNEY

DATE: 13 November 1987

CHANCELLOR

cc Chief Secretary
Paymaster General
Mr Anson
Mr Monk
Mr Edwards
Mr Burgner
Mr Turnbull
Mr Mortimer
Mr Mercer
Mrs Imber

Mr Tyrie
Mr Dodds

Ch/ Mr MacG's minute is the one you suggested he write. Content to respond as proposed?
JT 13/11

OK - put on two min changes.

AGRICULTURAL STABILISERS

1. The Minister of Agriculture's letter of today to the Foreign Secretary sets out the line he proposes to take at next week's Agricultural Council on the Commission proposals on agricultural stabilisers which form a key element of the EC financing review.

Procedure

2. The Danish Presidency has indicated that they intend to keep the Council sitting until it reaches decisions. Whether this tactic will succeed, given the widely divergent views of the Member States, remains to be seen. There may need to be further Ministerial consultations during the course of next week if Mr MacGregor takes the view that an acceptable compromise package could be agreed. The Minister says that he intends to stand firm on the agreed UK position if the Council indulges in the usual process of significantly weakening the Commission's proposals. That is clearly the correct course: for the UK to sign up on a weak agreement on stabilisers would seriously prejudice the Prime Minister's negotiating position at the European Council.

Substance

3. The latest Presidency paper which will form the basis of the Council's discussions is annexed to Mr MacGregor's

letter. As Mr MacGregor says, this is in some respects an improvement on the Commission's original proposals as it has filled in some of the necessary details. However, there are also some areas where the Commission's original proposals have been weakened, notably on the price cuts limits for oilseeds. The UK position on the individual commodities was set out in an agreed note which was given to the Commission and the Presidency earlier this month (Annex A). It is in general rather tougher than the Commission/Presidency proposals.

4. There are strong indications that the French and the Germans have been cooking up a deal on a very much weakened form of stabilisers (linking any price cuts solely to increases in crop yields rather than total production - ie area x yield - as proposed by the Commission). To placate the Germans this would be associated with a new set aside scheme, on which the Commission have undertaken to circulate a report. We have insufficient detail to assess the expenditure impact of these Franco-German ideas but in MAFF's view they are likely to represent an unacceptable weakening of the Commission/Presidency proposals. It may be difficult to avoid including new set aside proposals in any final package but this should be conceded only in the context of an agreement on effective stabiliser mechanisms. It would be highly desirable in budgetary terms for any set aside scheme to be based on the existing "extensification" Regulation which provides for 75% national financing.

<u>Particular commodities</u>

5. Mr MacGregor's line looks unexceptionable on most of the individual commodity areas, although it is couched in a way that will give him maximum discretion. We would suggest, however, that you might comment on the following specific issues:

(i) <u>cereals</u>: the agreed UK line is to seek price cut limits of 10%/15%/20% in the 1988, 1989 and 1990 seasons respectively if production exceeds the maximum guaranteed quantity of 155 m tonnes. The

Presidency have proposed maximum adjustments of 10% and 15% in 1988 and 1989 but with half the adjustment taking the form of an increase in the co-responsibility levy on producers. We should encourage Mr MacGregor to be prepared to compromise on inclusion of the co-responsibility levy as a stabiliser, not least because it will tend to have a larger impact in budgetary terms;

(ii) oilseeds: the Presidency proposal for a 20% price cut limit is a serious weakening of the Commission proposal (ie to remove the limit altogether) but this is one of the main regimes where expenditure is spiralling out of control. If Mr MacGregor sees the need to accept some relaxation of the Commission proposal, he must continue to argue for urgent study of a flat rate aid system (which within a maximum guarantee quantity would provide an effective budgetary stabiliser by removing the present link between oilseed production aids and world prices);

(iii) milk: as milk remains one of the major areas of EAGGF spending Mr MacGregor should continue to press for recognition (a) that total EC quotas should be set in line with unsubsidised consumption and net trade (currently they are 20% in excess of consumption) and (b) that further adjustments should be made to the intervention trigger system agreed last year if stocks begin to rebuild; and

(iv) sheep: this is the main area where we have difficulty with the Commission's proposals on agricultural grounds. We should encourage Mr MacGregor to consider acceptable compromises rather than allowing our objections to the current proposals to be turned into sticking points.

Financial Implications

6. The table at Annex B prepared by MAFF sets out their assessment of the EC Budget and PES implications of the UK's position and the Commission's original proposals. MAFF are still working on the Presidency compromise and (at our request) on a table of ready reckoners of the effects of possible changes to the proposals.

7. In EC Budget terms the effects in 1988 are disappointingly small at around - 260 mecu. This is mainly because of two unavoidable factors:

(i) the switch from advance payments to reimbursements this year means that expenditure in the 1988 Budget year will be composed of 2 months' actual expenditure in 1987 and 10 months in 1988; and

(ii) the stabiliser mechanisms will begin operating only at the start of the next marketing year for the various products (eg April for milk and beef; July for cereals and oilseeds, etc).

This reinforces the need both for the additional mechanisms for the monitoring and control of agricultural expenditure by commodity which are currently under discussion in COREPER <u>and</u> for tough decisions in next year's Price Fixing. (The Commission's unconstrained forecast for expenditure in 1988 is some 2.6 becu above their own increased guideline limit of 28.2 becu).

8. The UK PES figures combine the effects on the agriculture programme (3.1) and the net contribution (2.7). In principle the savings on programme 3.1 should relate to the latest forecast in the Autumn Statement. However the "savings" on programme 2.7 are a comparison with what would otherwise happen rather than strictly deductible from the present forecast for programme 2.7 which is constrained by the 1.4% VAT ceiling. It should be noted that the savings shown in the UK position on Mediterranean products (eg wine, tobacco and olive oil)

which affect programme 2.7 only, look unrealistically high in relation to the Commission's proposals and are unlikely to be negotiable.

9. I attach a draft letter making these points for you to send to Mr MacGregor. It should if possible issue first thing on Monday morning (16 November).

RJB

R J BONNEY

1155/4

CONFIDENTIAL

Please type for signature

DRAFT LETTER

FROM: CHANCELLOR
TO: MINISTER OF AGRICULTURE

COPIES TO: Prime Minister
Members of OD(E)
Secretaries of State for Wales, Northern Ireland & Scotland
Sir R Armstrong

AGRICULTURAL STABILISERS

Thank you for sending me a copy of your more helpful letter of 13 November to Geoffrey Howe.

2. I very much agree with your assessment that your main objective at next week's Council should be to prevent any significant weakening of the impact of the Commission's proposals on stabilisers. I fully endorse your view that you should stand firm on our present position as set out in the two UK notes on stabilisers if the Presidency shows any signs of embarking on the usual process of watering down the Commission's proposals with a view to securing a consensus. For the UK to sign up to a weak agreement on stabilisers on the lines which now seem to be emerging from the recent Franco-German bilaterals would seriously undermine the Prime Minister's position at the Copenhagen European Council. I should be grateful if you could consult ~~us~~ me as well as Geoffrey Howe before agreeing to any compromise.

3. I have no difficulty with the general line you propose to take on the main commodity sectors, although I think

that it could be reinforced in one or two places. My particular comments are set out in the following paragraphs.

4. On cereals, which, as you say, ~~is~~ are likely to be central to the negotiations, we should in my view concentrate on preserving the main elements of the Commission proposals (ie the 155 million tonne maximum guaranteed quantity (MGQ); the in-year price adjustment of at least 10% in 1988/89 and 15% in 1989/90 and preferably 20% in 1990/91, and shortening the intervention period). I agree that we should be prepared to reconsider our opposition to using the coresponsibility levy as a supplementary stabiliser, if this is necessary to achieve agreement to a 10%/15% adjustment. Anything much less than this is likely to have a negligible effect in terms of offsetting the expenditure increase arising from production exceeding the MGQ.

5. I would not exclude agreeing to some concession on set aside in the context of an otherwise acceptable package. But it must be indissolubly linked to effective action on prices and substantially nationally financed to be cost effective in EC Budget terms. To achieve this it would seem most sensible to build on the existing provision for national "extensification" schemes in Regulation 1670/87 which already provides for 75% national financing.

6. On ~~Oilseeds~~ oilseeds, the latest Presidency proposal for a 20% price cut limit represents a serious weakening of the Commission's original proposal. I am sure that you are right that we should resist it. If you see the need to make a concession in this area, it would be sensible to link it with a Commission commitment to an urgent study of the feasibility of a flat rate aid system for oilseeds and similar commodities. Flat rate aids subject to a MGQ and constrained by the budget provision would be a fully effective stabiliser and represent our best answer to those who say that only an oils and fats tax could effectively stabilise expenditure in this sector.

7. On milk, I agree that we should press for much lower rates of compensation for quota suspensions than the Presidency and the Commission currently envisage. We should also seek some form of recognition from the Council that in the next review quotas should be reduced to reflect current unsubsidised consumption in the Community and normal trade flows. It is unreasonable to perpetuate a system which institutionalises 20% surplus production. In the meantime it may be necessary to introduce further improvements into the trigger system for intervention if stocks fail to fall as envisaged in the December 1986 Council decisions. It would be useful if the Council acknowledged this fact.

8. I welcome your willingness to explore the possibility of adapting the Commission's unsatisfactory proposals

in ways which meet our concerns without turning these into absolute sticking points, if the other elements of the package are acceptable to us. I am sure that this is the right policy.

9. Finally, on a more general point, I am grateful that your officials have sent mine their provisional assessment of the financial implications both of the Commission's proposals and the UK's desired position. I understand that they are also working on ~~our~~ ready reckoners for possible changes in the proposals. I am sure that these will provide an essential tool for assessing whether any revised package is acceptable to us. I have therefore asked my officials to circulate this information to other interested Departments.

10. I understand the reasons why the effect of the stabilisers on EC expenditure in 1988 is so disappointingly small (a saving of about 260 mecu). As you know the Commission are now forecasting that agricultural expenditure next year could exceed their increased guideline by ten times that amount. This reinforces the need for us all to make clear that we do not regard the current stabilisers proposals as the ~~final~~ last word on CAP reform and improvements to budget discipline. I am sure that you would agree that we will need to give equal emphasis to the proposals on

improving in~~-~~year monitoring and control of expenditure by budget cha~~nges~~ pters which are currently under consideration in ~~by~~ COREPER. In addition we will certainly need to consider all the available options for securing expenditure savings, particularly in 1988, both through management decisions and in the 1988 Price Fixing.

11. I am sending copies of this letter to the Prime Minister, Geoffrey Howe and other recipients of your letter.

N L

ANNEX A

MINISTRY OF AGRICULTURE FISHERIES AND FOOD
WHITEHALL PLACE LONDON SW1A 2HH
DIRECT LINE 01-270
OR SWITCHBOARD 01-270 3000

J Holroyd Esq
Cabinet Office
70 Whitehall
London
SW1

6 November 1987

Dear John

AGRICULTURAL STABILISERS: NOTE BY THE UNITED KINGDOM

I attach the final version of the above document, which our Minister has now sent to Mr Andriessen

Copies go to John Kerr, Stephen Wall and Ralph Publicover in the FCO, and to Bob Bonney in the Treasury. Also to David Roberts in UKREP.

Yours sincerely

Richard

R S THOMAS

Mrs Imber cc Mr Edwards
Self –
Mr Mortimer
Mr Mercer
Mr Dodds

I think this makes the 3rd final version we've seen.

JB 6/11

8/6/4

STABILISERS : NOTE BY THE UNITED KINGDOM

The European Council has called for stabilising mechanisms which will ensure that expenditure is kept within the budgetary framework, so that final decisions can be taken at the Copenhagen meeting. With limited exceptions, the UK has welcomed the Commission's proposals in COM 452. But it considers that:

- in some cases they should be made more rigorous;
- they should apply to all products;
- they should be completed by the figures necessary to ensure their practical operation : without these figures, the UK considers that it will not be possible to take decisions at Copenhagen which fulfil the mandate from the European Council.

The attached note contains the UK's views on the way in which the stabilisers should be extended and quantified.

As will be seen, the note is mainly based upon the Commission's own proposals or extensions of them. It is not a statement of all the points on which the United Kingdom disagree with the Commission's proposals. In particular, of course, we remain totally opposed to the oils and fats tax.

The UK believes that it will be necessary to monitor the operation of the stabilisers carefully and take further action if they prove inadequate to achieve budgetary discipline.

CEREALS

Price adjustment : Reduction of 1% for each 1% by which the maximum guaranteed quantity of 155 m tonnes is exceeded.

Maximum price reduction : 10% 1988/89
15% 1989/90
20% 1990/91

Explanation : member states are generally opposed to the option of adjusting the coresponsibility levy. Mr Andreissen indicated that, if this option is deleted, the maximum price reduction would have to be greater than that originally envisaged by the Commisssion.

Delay in opening intervention : this option should be retained but it should be specified that the monthly increments will be delayed correspondingly.

OILSEEDS

Limits on price reduction : as proposed by the Commission (1988-15%; 1989-20%; 1990-no limit).

The Commission should urgently study the possibility of operating a flat rate aid in this sector.

WINE

/of Garantie de bonne fin : limit of 5%/production for 1988/89; abolish from 1989/90.

Obligatory distillation:

- price applicable to quantities in excess of 12.5 mhl :

1987/88	40% of guide price
1988/89	30% of guide price
1989/90	20% of guide price
1990/91	15% of guide price

- price applicable to quantity up to 12.5 mhl :
  40% of guide price instead of 50%.

TOBACCO

Within the total of 350,000 tonnes, a separate maximum guaranteed quantity should be set for each variety, with the strictest limits for the least marketable varieties.

Premia should be payable, and intervention should be available, only when a cultivation contract has been concluded in advance.

SHEEP

The maximum guarantee limit should be set on the basis of the total number of ewes (and not the total number of sheep). There should be no separate MGL for GB.

Price adjustment : reduction of 1% for each 1% by which the MGL is exceeded.

PROTEINS

Maximum guaranteed quantity :

3.3 m. tonnes for peas, beans and lupins
2 m. tonnes for dried fodder.

Price adjustment: reduction of 0.5% for each 1% by which MGQ is exceeded.

OLIVE OIL

The existing mechanism should be amended so that the % reduction applied to the production aid applies also to the production price and to the intervention price. In this way expenditure on consumption aid will be stabilised, as well as expenditure on production aid.

COTTON

Since the aid for cotton is currently 60% or more of the guide price, in order to stabilise expenditure the existing system should be amended so that the guide price is reduced by 1% for each 12,500 tonnes by which the maximum guaranteed quantity is exceeded (instead of 15,000 tonnes).

FRESH FRUIT AND VEGETABLES

For products where threshold arrangements are not yet agreed, there are two figures which need to be set:

- the proportions of the average of the last 5 years' production (4 years for cauliflowers) constituting the withdrawal thresholds, and

- the quantities triggering each 1% price reduction when the threshold is exceeded.

The UK considers that the appropriate figures would be:

	Threshold as proportion of production	Quantity to trigger each 1% price cut
Oranges	8%	10,000 tonnes
Peaches	8%	10,000 tonnes

/Lemons

Lemons	8%	5,000 tonnes
Apples and Pears	5%	10,000 tonnes
Apricots	5%	2,500 tonnes
Cauliflowers	2%	2,500 tonnes
Aubergines	0.1%)	Immediate 20%
Table grapes	0.1%)	reduction

The maximum price reduction for all products could be 20%
In all cases the price reduction should be applied in the year in which the threshold is exceeded.

PROCESSED FRUIT AND VEGETABLES

Maximum guaranteed quantities should be set as follows:

prunes	44,000 tonnes
Peaches in syrup	492,000 tonnes
Williams pears in syrup	83,000 tonnes (instead of 102,305 tonnes).

RICE

Maximum guaranteed quantity : 1.2 m tonnes

Mechanism of adjustment : as for cereals, including limits on price reductions of

10% 1988/89
15% 1989/90
20% 1990/91

MILK

There should be no compensation for quota suspension after the 1990/91 marketing year.

In the marketing years 1989/90 and 1990/91 compensation should be no higher than 6 ecu/100 kg.

ANNEX B

STABILISERS: PROJECTED ANNUAL SAVINGS

	UK PREFERENCE						COMMISSION PROPOSAL					
	EC BUDGET (MECU)			UKPES (£m)[2]			EC BUDGET (MECU)			UK PES (£m)[2]		
	1988	1989	1990	1988/9	1989/90	1990/1	1988	1989	1990	1988/9	1989/90	1990/1
Cereals	- 50	-479	-595	- 28	- 80	- 98	-118	-1148	-1449	-109	-189	-233
Oilseeds[3]	-121	-449	-1305	- 35	- 89	- 201	-121	- 449	-1305	- 35	- 89	- 201
Wine	- 46	-128	- 237	- 10	- 16	- 20	- 4	+ 61	+ 61	+ 2	+ 7	+ 3
Tobacco[2]	0	-372	- 396	- 14	- 44	- 22	0	- 42	- 83	- 2	- 6	- 7
Sheepmeat	- 13	- 82	- 82	- 9	- 15	- 13	- 16	- 79	- 79	- 9	- 16	- 15
Peas & Beans	0	0	0	0	0	0	0	0	0	0	0	0
Dried Fodder	- 6	- 13	- 13	- 1	- 1	- 1	0	0	0	0	0	0
Olive Oil	0	-158	- 158	- 6	- 19	- 10	0	0	0	0	0	0
Cotton	- 2	- 7	- 7	- 1	- 1	0	0	0	0	0		0
Fruit & Vegetables (Fresh)	- 16	- 51	- 53	- 4	- 5	- 4	0	- 1	- 3	0	...	...
Fruit & Vegetables (Processed)	0	- 8	- 8	0	- 1	0	-	-	-	-	-	-
Milk	0	-154	- 558	0	- 85	-119	0	-32	- 497	0	-68	-112
Rice	-	-	...	-	-	....	0	0	0	-	-	-
	-264	-1901	-3412	-108	-356	-488	-259	-1690	-3355	-153	-361	-565

1. Calculations for cereals are based on current forecasts of production levels over next 3 years. For all other commodities the latest available forecast for production next year has been used as the basis for the calculations for all 3 years. Actual savings in years 2 and 3 may thus be greater than shown.
2. All UK PES savings would be savings on current PES forecasts, with the exception of Milk, where PES forecasts already assume the savings accruing from consolidation of quota suspension.
3. Calculations assume MGQ will continue at present levels. This is not clear on current Commission proposals.

- = No assessment possible.
0 = No saving.
... = No significant saving.

CONFIDENTIAL

10 DOWNING STREET

LONDON SW1A 2AA

Also note to Frey. See below. AB

16 NOV 1987

MR BONNEY
CST PMG
MR ANSON MR MONCK
MR MCEDWARDS
MR BURGNER
MR TURNBULL
MR MORTIMER
MR MERCER
MRS IMBER
MR TYRIE
MR DODDS.

From the Private Secretary 16 November 1987

Dear Shirley,

AGRICULTURAL STABILISERS

The Prime Minister has not yet had time to consider the Minister for Agriculture's letter of 13 November to the Foreign Secretary about agricultural stabilisers or the latter's reply. I am sure, however, that she would not want to see any significant weakening of our existing position and would therefore very much agree that Mr. MacGregor should not subscribe to any attempt at the Agriculture Council to reach a compromise of the traditional sort. In case of doubt, you will no doubt want to contact me so that the Prime Minister's views can be ascertained.

I am copying this letter to the Private Secretaries to the other members of OD(E) and to Sir Robert Armstrong.

Yours sincerely
Charles Powell

(C. D. POWELL)

Mrs. Shirley Stagg,
Ministry of Agriculture, Fisheries and Food.

CONFIDENTIAL

Papers please noted re letter.
16/11/87.

FCS/87/235

MINISTER OF AGRICULTURE, FISHERIES AND FOOD

Agricultural Stabilisers

1. Thank you for your letter of 13 November setting out your assessment of the prospects for next week's marathon session of the Agriculture Council. Progress in the Council will determine whether there is a realistic chance of agreement in Copenhagen on the overall complex of future financing issues. Realistically, the Council's results will therefore be ad referendum to heads of government, and Toernaes' linkage point (your final paragraph) does not surprise me.

2. We all agree that the basic UK requirement is for precisely quantified stabilisers for each agricultural regime, with particular emphasis on cereals, oil seeds, olive oil, wine, tobacco and proteins (I accept that on certain minor products - eg cotton - one might at the end of the day settle for a clear commitment to sufficient future action). I very much agree with you that the proposals in the Presidency paper are insufficiently rigorous. I hope that you will press those in our own paper, especially on cereals.

/3.

3. Another deficiency which needs to be corrected is the absence in the Presidency paper of any proper costings. We need to see the savings that would be likely to result from the stabilisers regime, given that it will be the key to our ability to enforce the agricultural guideline, and so control CAP spending, in future.

4. I am sure that you are right to expect to come under strong Presidency pressure to make concessions. But, unlike the price fixing, this negotiation is to be settled by unanimity; and I agree with you that we should make it plain that we shall not settle for a compromise of the traditional (price fixing) sort, but will stand firm for what we believe the Community needs.

5. I agree with what you say about the individual commodities, and in particular that you should, on sheepmeat, explore arrangements which go some way in the direction of the Commission's proposals. We cannot, while calling for stabilisers on all commodities, demand a preferential exemption for sheepmeat. That does not of course mean that we should not argue against measures which would discriminate against the UK. But we need to balance our particular interest in this sector against our strong general interest in securing a satisfactory overall stabilisers regime.

6. On the oils and fats tax, the UK aim must be to ensure that the French and the Commission realise, before Copenhagen, that there still is a firm blocking minority, and that time spent by heads of government on the issue would therefore be time wasted. I believe that the

/blocking

blocking minority is fairly firm: the Germans seem solid, and the Danes and Dutch are again likely to stay with us (perhaps with the Italians and even the Spanish). Anything you can do to stiffen the resolve of your counterparts from these countries (not all of whom are as sound on the issue as are their Foreign Ministers) will be useful.

7. Finally, I note that you envisage that some commitment on set-aside may have to be part of the eventual package. I agree that the Germans will certainly press hard for this: but my hope would be that they would be prepared to settle at Copenhagen for no more than a commitment to further study. It is therefore not inconvenient that the Commission have not yet produced any quantified and costed proposal.

8. Copies of this minute go to the Prime Minister, and members of OD(E), the Secretaries of State for Wales, Northern Ireland and Scotland, and Sir Robert Armstrong.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
16 November 1987

STABILISER

C1/19 CONFIDENTIAL

cc CST
PMG
Mr Anson
Mr Monck
Mr Edwards
Mr Burgner
Mr Turnbull
Mr Mortimer
Mr Mercer
Mrs Imber
Mr Bonney
Mr Dodds
Mr Tyrie

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

16 November 1987

The Rt. Hon. John MacGregor OBE MP
Minister of Agriculture, Fisheries and Food

Dear Minister,

AGRICULTURAL STABILISER

Thank you for sending me a copy of your most helpful letter of 13 November to Geoffrey Howe.

I very much agree with your assessment that your main objective at this week's Council should be to prevent any significant weakening of the impact of the Commission's proposals on stabilisers. I fully endorse your view that you should stand firm on our present position as set out in the two UK notes on stabilisers if the Presidency shows any signs of embarking on the usual process of watering down the Commission's proposals with a view to securing a consensus. For the UK to sign up to a weak agreement on stabilisers on the lines which now seem to be emerging from the recent Franco-German bilaterals would seriously undermine the Prime Minister's position at the Copenhagen European Council. I should be grateful if you could consult me as well as Geoffrey Howe before agreeing to any compromise.

I have no difficulty with the general line you propose to take on the main commodity sectors, although I think that it could be reinforced in one or two places. My particular comments are set out in the following paragraphs.

On cereals, which, as you say, are likely to be central to the negotiations, we should in my view concentrate on preserving the main elements of the Commission proposals (ie the 155 million tonne maximum guarantced quantity (MGQ); the in-year price adjustment of at least 10% in 1988/89 and 15% in 1989/90 and preferably 20% in 1990/91, and shortening the intervention period). I agree that we should be prepared to reconsider our opposition to using the corresponsibility levy as a supplementary stabiliser, if this is necessary to achieve agreement to a 10%/15% adjustment. Anything much less than this is likely to have a negligible effect in terms of offsetting the expenditure increase arising from production exceeding the MGQ.

I would not exclude agreeing to some concession on set aside in the context of an otherwise acceptable package. But it must be indissolubly linked to effective action on prices and substantially nationally financed to be cost effective in EC Budget terms. To achieve this it would seem most sensible to build on the existing provision for national "extensification" schemes in Regulation 1670/87 which already provides for 75% national financing.

On oilseeds, the latest Presidency proposal for a 20% price cut limit represents a serious weakening of the Commission's original proposal. I am sure that you are right that we should resist it. If you see the need to make a concession in this area, it would be sensible to link it with a Commission commitment to an urgent study of the feasibility of a flat rate aid system for oilseeds and similar commodities. Flat rate aids subject to a MGQ and constrained by the budget provision would be a fully effective stabiliser and represent our best answer to those who say that only an oils and fats tax could effectively stabilise expenditure in this sector.

On milk, I agree that we should press for much lower rates of compensation for quota suspensions than the Presidency and the Commission currently envisage. We should also seek some form of recognition from the Council that in the next review quotas should be reduced to reflect current unsubsidised consumption in the Community and normal trade flows. It is unreasonable to perpetuate a system which institutionalises 20% surplus production. In the meantime it may be necessary to introduce further improvements into the trigger system for intervention if stocks fail to fall as envisaged in the December 1986 Council decisions. It would be useful if the Council acknowledged this fact.

I welcome your willingness to explore the possibility of adapting the Commission's unsatisfactory proposals in ways which meet our concerns without turning these into absolute sticking points, if the other elements of the package are acceptable to us. I am sure that this is the right policy.

Finally, on a more general point, I am grateful that your officials have sent mine their provisional assessment of the financial implications both of the Commission's proposals and the UK's desired position. I understand that they are also working on ready reckoners for possible changes in the proposals. I am sure that these will provide an essential tool for assessing whether any revised package is acceptable to us. I have therefore asked my officials to circulate this information to other interested Departments.

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I am sending copies of this letter to the Prime Minister, Geoffrey Howe and other recipients of your letter.

Yours sincerely
Alex Allan

pp NIGEL LAWSON

[approved by the Chancellor
and signed in his absence]

RA3.59 CONFIDENTIAL

cc CST
PMG
Mr F E R Butle
Mr Burgner
Mr Mortimer
Mr Mercer
Mrs Imber
Mr Dodds
Mr Edwards
Mr Bonney
Mr Tyrie

16/11/87

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

PRIME MINISTER

1. J [illegible]
2 [illegible]

EC FINANCING REVIEW: AGRICULTURAL STOCKS

You suggested recently that one option for dealing with the problem of the excessive levels of the Community's agricultural stocks would be to propose a once and for all write-off at national expense so that no costs fall on the Community Budget. I have asked officials to look at this and ... the attached paper (not obligatory reading) discusses at some length this option along with others for dealing with agricultural stocks in the context of the future financing negotiation.

I think that I can best summarise the position as follows. A national write off would have considerable attractions from the UK's point of view:

- First, on the most plausible assumption that a write off would be confined to existing stocks (excluding the butter disposals for which special financing arrangements were agreed last year) the UK would stand to lose 522 mecu in EC receipts from a write off but our gross VAT contribution would be 746 mecu less giving a one for all net benefit of some £155 million before and £50 million after the Fontainebleau abatements.

- Secondly, relieving the Community Budget of some 4.4 becu expenditure in this way (most of which would normally fall in 1988 and 1989) would strengthen our arguments for a lower base and/or growth rate for the financial guideline on agricultural expenditure in future years.

- Thirdly, it would make some sense to start off the new guideline with a clean sheet excluding the costs of past excesses, provided of course that the Commission stands by its stated intention of preventing stocks rebuilding to excessive levels in the future.

On the other hand, we need to recognise that a number of our partners would not find the idea very attractive. As the note by officials indicates, stock holdings are very unevenly distributed between the Member States. Spain and Portugal would welcome a write off, as this would relieve them of contributing to the costs of stocks acquired before they joined the Community. Otherwise the main beneficiaries would be ourselves and Italy and to a lesser extent Belgium, France and Greece. The major losers would be Ireland (because of their very low share of budget contributions) and Germany (because of their disproportionately high share of stocks due to the high DM intervention prices) and to a lesser extent the Netherlands and Denmark. I fear that the losers would be bound to attack the suggestion as breaching the fundamental CAP principle of common financing: they would be asked, in effect, to foreswear their right to receipts at present properly due to them. Although there would undoubtedly be rough justice in making the Germans pay for both their insistence on the present agrimoney agreement and their refusal to allow the CAP to be reformed, it would be more difficult to defend the differential impact on Ireland as one of the poorest Member States (although it might be possible to find a way of buying them off in some way).

On balance therefore I would conclude that, while the idea of national write off is (sadly) unlikely to be a serious runner, we should certainly keep in mind the possibility of arguing for it at the European Council or elsewhere if the context seems propitious.

As regards what we should be aiming for in this area, the note by officials attempts to fill out the analysis in paragraphs 22-29 of the long Treasury paper which my office sent to yours on 20 October. First we should aim to get into the European Council conclusions a clear commitment that the Council and the Commission will do what is necessary to reduce stocks to normal levels before 1992. As the paper indicates, this should be reinforced by a clear statement of the Commission's plans for running down stocks and explicit recognition in the Agriculture Council's conclusions on stabilisers of the need to improve the system of automatic adjustments to intervention buying-in prices in the light of the development of stocks where it is already applied (e.g. for butter) and to extend it to other sectors.

Secondly, we need to press for specific amendments to the EAGGF Financing Regulation to provide for the systematic depreciation of new stocks to their disposal value at the time of purchase, with subsequent annual adjustments to reflect market values. The aim would be to prevent the present overhang of expenditure commitments and save on reimbursements of the Member States' financing costs.

Thirdly, we need to ensure that expenditure on depreciation of new stocks is included within the financial guidelines for agricultural expenditure in the future. We should for the time being keep a more open position on whether the future guideline should also cover the costs of disposing of existing stocks. My present view is that inclusion of this expenditure within the guideline is likely to be preferable unless either we succeed in getting a national write off or else we secure a full compensating reduction in the guideline base for growth factor. My officials calculate that it would be worth considering excluding this expenditure from the guideline, only if we could reduce the base by some 1 becu or the growth rate by 66 per cent of GNP (or a combination of the two: say, a reduction of 500 mecu in the base and of 33 per cent in the growth rate). In view of the pressures on expenditure in 1988, it will probably be necessary to find some way of smoothing the expenditure on existing stocks (using the precedent of the 1986 decisions on butter stocks) in order to keep this expenditure within a reasonable guideline limit.

I hope that you and other colleagues will be content with this approach.

I am sending copies of this minute to Geoffrey Howe and John MacGregor.

A C S Allan

pp N.L.

16 November 1987

[approved by the Chancellor & signed in his absence]

RP3. p1.

CHANCELLOR

FROM R J BONNEY
DATE 18 NOVEMBER 1987

cc Chief Secretary
Paymaster General
Mr Anson
Mr Monck
Mr Edwards
Mr Burgner
Mr Turnbull
Mr Mortimer
Mr Mercer
Mrs Imber
Mr Dodds
Mr Hughes
Mr Tyrie
Mr Call

Thanks. I agree with X:

AGRICULTURE COUNCIL: 16-18 NOVEMBER

The Minister of Agriculture will no doubt be reporting the outcome of this week's Agriculture Council at tomorrow's Cabinet. In brief we understand that the council broke up this afternoon without taking any decisions on stabilisers. Despite some pressure from the Presidency to resume its deliberations over the weekend, the Council will not be meeting again until next Monday at the same time as the Foreign Affairs Council.

2. We have not yet seen the final reporting telegrams but it would appear that the main reason for the breakdown was the concerted action by the French and German Ministers (foreshadowed in my submission of 13 November) to water down the Commission and Presidency proposals. The French and Germans are also (predictably) arguing that no decisions can be taken on stabilisers until the European Council has decided on the volume of expenditure on agriculture. This is of course the exact reverse of the UK's position and could (if there is a genuine will to negotiate) be readily resolved by taking decisions in principle subject to overall agreement on the financing review generally.

3. The Commission have so far taken a commendably tough line, even improving somewhat on the severity of their proposals for cereals and oilseeds. The Presidency have not significantly changed the terms of their compromise but may issue a further paper before the Council resumes on Monday. Mr MacGregor has

stood firm by the agreed UK position.

4. We see no reason to advise you to change the line set out in your letter of 16 November on the substance. When the Council resumes Mr MacGregor's objective must be to persuade the Commission and the Presidency to stand firm on their present proposals. The Foreign Secretary will no doubt wish to make it clear at FAC that, if the Agriculture Council so demonstrably fails to bite the bullet on stabilisers, Heads of Government are unlikely to be in a position to take overall decisions at Copenhagen.

5. If a negotiation develops in the Agriculture Council next week, you will wish to repeat that Mr MacGregor should consult you (as well as the Foreign Secretary and No.10) before agreeing to any compromise. If MAFF think this is likely, you may feel that it would be desirable to have a Treasury official in attendance at the Council.

X

6. I attach the latest assessment of the financial effects of the Commission, Presidency and UK positions on stabilisers which we are circulating to other interested Departments. These reinforce the points in your letter about:

(i) the need for the UK to be prepared to accept use of the co-responsibility levy as well as price cuts for cereals (budgetary effect 226 mecu per 1 percentage point as opposed to 58 mecu per 1 per cent price cut);

(ii) the optimism of the UK suggestions on "Mediterranean" products; and

(iii) the need for urgent consideration of the scope for additional expenditure savings particularly in 1988.

Free Food

7. Mr MacGregor may also mention his presentational difficulties

in continuing to oppose the Commission's proposed new (permanent) free food scheme. He has spoken to the Paymaster General on this point. Given the UK's strong reservations about the merits of the proposal on grounds of limited cost-effectiveness, lack of financial control and woolly objectives and the reluctance of UK charities to get involved in operating the scheme, we see little advantage in the UK doing other than vote against, whether the issue comes up again at the (official level) Special Committee for Agriculture or at next week's Council. Mr MacGregor could quite reasonably take the line that it is bizarre that the Council should be spending time on an ill thought out proposal for additional expenditure at a time when it ought to be concentrating on the real problems of CAP reform and expenditure control, as it was instructed to do by the June European Council. We will be submitting a draft letter to the Paymaster General on these lines.

RJB

R J BONNEY

ESTIMATED EFFECTS OF CAP STABILISERS

850460 Stabilis 18-11-87

1988 (EC) 1988-89(UK)	EC BUDGET (mecus)			UK PES (£m.) PROG. 3.1			PROG. 2.7			NET PES		
	Comm	Pres	UK	Comm	Pres	UK	Comm	Pres	UK	Comm	Pres	UK
cereals	-118	-104	-60	-104	-84	-23	-5	-6	-5	-109	-90	-28
oilseeds	-452	-109	-109	-68	-18	-18	-47	-14	-14	-115	-32	-32
wine	-4		-46				2		-10	2	0	-10
tobacco	0		0				-2		-13	-2	0	-13
sheepmeat	-16	-19	-13	-18	-22	-14	8	8	6	-9	-14	-9
protein crops	0	0	0							0	0	0
dried fodder	0		-6	0		0	0		-1	0	0	-1
olive oil	0		0	0		-1	0		-5	0	0	-6
cotton	0		-2						-1	0	0	-1
fruit & veg												
fresh	0	-6	-16			0		-2	-3	0	-2	-3
processed			0						0	0	0	0
milk	0	0	0	0		0	0		0	0	0	0
TOTAL	-590	-239	-252	-190	-123	-56	-43	-14	-46	-233	-137	-102
Net saving against current PES provision				-169	-102	-35	0	0	0	-169	-102	-35
1989 (EC) 1989-90(UK)												
cereals	-1148	-962	-479	-178	-122	-58	-11	-15	-22	-189	-137	-80
oilseeds	-1215	-402	-403	-86	-32	-45	-55	-27	-32	-141	-59	-77
wine	61		-128				7		-16	7	0	-16
tobacco	-42		-372				-6		-45	-6	0	-45
sheepmeat	-79	-104	-82	-18	-22	-14	1	1	-1	-16	-21	-15
protein crops	0	0	0							0	0	0
dried fodder	0		-13	0		0	0		-1	0	0	-1
olive oil	0		-158	0		-4	0		-15	0	0	-19
cotton	0		-7						-1	0	0	-1
fruit & veg												
fresh	-1	-30	-51			0		-4	-5	0	-4	-6
processed			-8						-1	0	0	-1
milk	-32	-32	-154	-62	-62	-75	-7	-7	-10	-68	-68	-85
TOTAL	-2456	-1531	-1855	-344	-238	-196	-70	-52	-149	-413	-289	-344
Net saving against current PES provision				-185	-79	-37	0	0	0	-185	-79	-37
1990(EC) 1990-91(UK)												
cereals	-1449	-1045	-595	-225	-184	-82	-8	-11	-15	-233	-196	-98
oilseeds	-1215	-585	-1053	-86	-38	-101	-29	-22	-59	-115	-60	-160
wine	61		-237				3		-20	3	0	-20
tobacco	-83		-396				-7		-22	-7	0	-22
sheepmeat	-79		-82	-18		-14	2		1	-15	0	-13
protein crops	0	0	0							0	0	0
dried fodder	0		-13	0		0	0		-1	0	0	-1
olive oil	0		-158	0		-4	0		-6	0	0	-10
cotton	0		-7						0	0	0	0
fruit & veg												
fresh	-3	-30	-53			0		-1	-3	0	-1	-3
processed			-8						0	0	0	0
milk	-497	-497	-558	-96	-96	-102	-17	-17	-17	-112	-112	-118
TOTAL	-3265	-2157	-3160	-424	-318	-304	-55	-51	-142	-479	-369	-445
Net saving against current PES provision				-151	-45	-31	0	0	0	-151	-45	-31

Note: savings of £21m, (1988-89), £159m (1990-91) and £273m (1990-91) built into PES.
PES provision for programme 2.7 assumes 1.4% VAT and is compatible with FEOGA spending of around [illegible]23 becu.

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TELNO 3877
OF 181900Z NOVEMBER 87

FRAME ECONOMIC/AGRICULTURE

SPECIAL COREPER 18 NOVEMBER
FUTURE FINANCING: PROCEDURE

ESPER LARSEN (PRESIDENCY) ANNOUNCED THAT THE PRESIDENCY'S REVISED REPORT WOULD BE READY LATE ON 19 OR EARLY ON 20 NOVEMBER. THE PRESIDENCY WERE REFLECTING ON THE ORDER OF DISCUSSION AT THE FAC IN THE LIGHT OF THE DECISION TO RECONVENE THE AGRICULTURE COUNCIL EARLY ON 23 NOVEMBER. THERE WOULD HAVE TO BE A REPORT TO THE FAC COVERING (IN A WAY NOT YET ESTABLISHED) THE REPORT FROM THE HIGH LEVEL GROUP AND DEVELOPMENTS IN THE LAST 3 DAYS.

2. I COMMENTED THAT THE DELAY IN RESUMING THE AGRICULTURE COUNCIL, WHICH WE DEPLORED, WAS BOUND TO HAVE IMPLICATIONS FOR THE WORK OF THE FAC. THOSE WHO HAD INSISTED ON SUCH A LONG BREAK WOULD HAVE TO BEAR RESPONSIBILITY FOR THE CONSEQUENCES. SCHEER (FRANCE) OBSERVED THAT THE ORDER OF SUBJECTS IN COM 100 (AGRICULTURAL REFORM, STRUCTURAL FUNDS, OWN RESOURCES, BUDGET DISCIPLINE/MANAGEMENT) WAS THE LOGICAL AND COHERENT WAY TO PLAN DISCUSSION AT THE FAC, THOUGH THE FEASIBILITY OF THIS COULD NOW BE QUESTION AS A RESULT OF THE DELAY IN RECONVENING THE AGRICULTURE COUNCIL.

HANNAY

YYYY

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FRAME ECONOMIC/AGRICULTURE ECD(I)

ADDITIONAL 1

MR I SNEDDON SCOT OFF

NNNN

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

20 November 1987

Dear Lyn,

EUROPEAN COUNCIL

PRIME MINISTER'S MEETING WITH MR. WILLIAMSON

The Prime Minister had a talk this morning with Mr. David Williamson, Secretary-General of the Commission of the European Communities. Sir David Hannay and Mr. Lavelle were also present.

European Council

Mr. Williamson said that the Commission remained convinced that a solution to the future financing of the European Community could be reached at the Copenhagen Council. They were not unduly depressed by the recent unsuccessful meeting of Agriculture Ministers. The key issues on which the Heads of Government would need to take ad hoc decisions were the level of own resources, the agricultural guideline and the size of the structural funds.

Agricultural Stabilisers

Mr. Williamson said that he had recently drawn up proposals for significant savings in the CAP for 1988, amounting to 1.4 billion écus. These were now before the Commission. But unless agricultural stabilisers could be agreed, inexorable upward pressure on agricultural spending would continue. The Prime Minister said that the United Kingdom fully suggested effective agricultural stabilisers. She hoped that the Commission would stick to their proposals. Mr. Williamson said that the Commission would not retreat. The possibility had not even been contemplated. They intended to put their proposals to the European Council on a take-it or leave-it basis.

Own Resources

Mr. Williamson said that Community expenditure in 1987 was likely to be 1.16 per cent GNP (1.85 per cent VAT). Against that background an increase to 1.3 per cent (sic) GNP by 1992 was not unreasonable, especially with the built in restraint of sub-ceilings. The Prime Minister made clear that there was no possibility of Parliament agreeing to an increase of this scale.

The Prime Minister said that she still hankered after a system of contributions based on GNP share with a safety-net. Mr. Williamson said that there would be a lot of resistance in the Community to any system based on measuring net contributions. But it would be possible to alter the structure of own resources, so that a higher proportion of them was based on GNP share and a lesser proportion on VAT share. By his calculations this method would always yield a result favourable to the United Kingdom. The Prime Minister commented that she would not budge from Fontainebleau except for something better. Mr. Williamson said that if the United Kingdom stuck to Fontainebleau, the other member states would probably reject the proposed Fourth Resource.

Agricultural Stocks

The Prime Minister said that she favoured once-for-all action to eliminate surplus stocks, rather like a bank writing off non-performing loans. She saw considerable attractions in using national financing to achieve this, but recognised the difficulties for some other member states. One advantage would be that we could then press for a lower agricultural guideline. Mr. Williamson said that such an approach would be open to objections on grounds of principle. But there would probably be support for financing disposal of stocks off-guideline.

Structural Funds

Mr. Williamson said that it would be essential for Britain, France and Germany to reach a common position on the Structural Funds if an increase was to be kept within reasonable bounds.

Mr. Williamson said that the President of the Commission would be ready to discuss these issues with the Prime Minister before the opening of the Council in Copenhagen.

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,
Charles Powell

(C. D. POWELL)

Lyn Parker, Esq.,
Foreign and Commonwealth Office.

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

20 November 1987

Dear Alex,

EUROPEAN COUNCIL

The Prime Minister discussed a number of points about the European Council with Sir David Hannay and Mr. Lavelle this morning.

Agricultural Stabilisers

The Prime Minister noted the backsliding by the French and German governments on agricultural stabilisers at the recent Agriculture Council. It was suggested that the French were concerned that we would pocket stabilisers and still refuse to provide sufficient funds to finance the CAP through to 1992. The Prime Minister might consider offering M. Chirac some reassurance on this point when they meet on 22 November.

Agricultural Stocks

The Prime Minister said that she saw considerable attractions in the notion of national write-off for surplus agricultural stocks. The Government would anyway face considerable problems in Parliament if we had to agree to a higher guideline for agricultural spending. The problem would be even worse if we had to contribute to disposal of the surplus stocks held by others. A once-for-all operation to wipe the slate clean by national financing had clear advantages. No doubt it would be necessary to find a way to compensate countries which would be disadvantaged, principally Ireland. She would like further work done to work up a possible approach on these lines, including ways of meeting the objections of others.

It was noted that there was no disagreement in the Community about the need to dispose of surplus stocks and to devise a scheme for depreciating future stocks. The differences concerned the means and in particular whether stock disposal should be financed on or off guideline. The tentative conclusion of studies by officials was that it would suit us better to see this done within the guideline but no final view on this was yet required. National financing would be difficult to negotiate and might run into legal objections. But there could at the least be tactical advantages in proposing it.

I should be grateful if the Treasury could put in hand the further work requested by the Prime Minister.

Fourth Resource

The Prime Minister repeated that our highest priority must be to preserve the Fontainebleau abatement. We should not pursue any proposals which might make this more difficult to achieve. She saw some difficulty in explaining the concept of a Fourth Resource to public opinion, but understood that it could in some circumstances have benefits for us. We should not ourselves press for it, although if others agreed on it there would be no reason for us to object.

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

Yours sincerely,
Charles Powell

C. D. POWELL

Lyn Parker, Esq.,
Foreign and Commonwealth Office

Pse chase Ms Symes 4497

BF 25/11

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

23/11/87.

CH/EXCHEQUER
REC. 23 NOV 1987
ACTION MR GIATT
COPIES TO PS/CST PS/FST PS/PMG PS/EST SIR P. MIDDLETON SIR G. LITTLER MR ANSON SIR T. BURNS MR MONCK MR BURGNER MR A.J.C. EDWARDS MR H.P. EVANS MR SPACKMAN MR BONNEY MR R.I.G. ALLEN MR MORTIMER MR G. WHITE MR CORRY MS SYMES MR TURIE

From the Minister

THE FOREIGN AND COMMONWEALTH SECRETARY

CONFIDENTIAL

AGRICULTURAL REFORM

1. I am sorry to have been slow in responding to your minute of 5 October. But, in the context of the immediate problems facing us on the future financing of the Community, we did recently have some discussion on income aids, which is the main subject of your minute. I should also like to comment here on set-aside, and to respond to one of the points in your minute of 16 November.

2. We are all agreed that our aim is to get CAP support prices down and that this is extremely difficult to achieve. The question is whether any ancillary measures will make its achievement easier. Judging by your note, you take it for granted that a scheme of income aids (with some essential conditions: aid divorced from production, time-limited, degressive, and nationally financed to the greatest degree possible) will automatically help us towards this end. I do not believe that such a scheme of income aids will prove to be negotiable on the basis of the discussions we have had in the Agriculture Council so far. Nor on the substance of the policies am I convinced that it is necessarily the best way forward in any case. I believe that voluntary land set-aside schemes, which are dismissed too briefly in your note, could equally or better help to achieve our objective.

3. In an actual negotiating situation we have to ask ourselves two basic questions about any supplementary measure, whether it be income aids, set-aside or something else. First, how much CAP reform will it buy? Second, is it negotiable on the terms we seek?

4. As I have mentioned to you, in the present negotiations to secure satisfactory budgetary stabilisers, the overall scheme of income aids proposed by the Commission does not seem likely to buy anything. Most, or even all, Member States are hostile to various parts of it. As I have said, it does not look at all likely that we could achieve agreement on the conditions you set, which I agree are essential. Moreover, in my judgement, the measures would easily lead to actual increases in production because they envisage individual producers following a farm plan intended to raise their income to an adequate level.

5. Some of the objections are to the particular scheme for income aids put forward by the Commission: but many are to the concept itself. I do not think this is altogether surprising. If Member States were attracted to paying income aids to farmers, they could be doing so already. It is difficult to see how assistance related strictly to income levels would fall foul of the State Aid provisions of the Treaty.

6. A Community scheme would of course entail a contribution from Community funds. This would run into different objections. It might be attractive to Member States such as Ireland, Italy and Greece who have large numbers of low-income farmers. Other Member States, who would have to find the money, would find it deeply unattractive. (The Commission have specifically proposed that spending should be skewed heavily towards the poorest regions; and Ireland and the southern Member States are pressing for the Community to cover the whole cost to them). This is no doubt one reason why the Germans do not in fact favour the Commission proposals, and why these do not seem to have value in defusing German hostility to reform. On the other hand, the same Member States would strongly resist schemes which were mainly nationally financed.

7. Some Member States (including ourselves) dislike income aids because they involve

- Classifying farmers in general as social security recipients;

- drawing difficult distinctions between those who will be eligible and those who will not;

- setting up a special social security system for farmers, superior to that (if any) available to the rest of the population;

- complicated procedures for verifying the farm and non-farm income of claimants.

Some - especially France - do pay large national aids to their farmers; but, in the main, they do not tailor these aids to the smallest and poorest. They could only welcome a Community scheme obliging them to do so, presumably, if they saw a prospect of net budgetary gain.

8. From our own point of view much the most important consideration must be how much CAP reform a supplementary measure such as income aids would buy, and therefore whether the benefits outweighed the cost. Even if they did, we would first need to reflect on the fact that the Community would for the first time be involving itself in and helping to finance Member States' social security systems, and we would need to decide whether that might set an unhelpful precedent for similar involvement outside agriculture. Finally we would have to decide - assuming the measure was permissive - whether to pay these aids in the UK. There would undoubtedly be pressure to do so. But, apart from the cost to national funds that would be involved, it would require us to answer the awkward questions raised in paragraph 7 above.

9. I believe that a logical alternative to income aids would be a voluntary land set-aside scheme. This should be positively helpful to CAP reform. It offers an alternative to the marginal - ie less profitable - producer who would by definition be most affected by price cuts. It would also have several advantages of its own compared with income aids:

- it would directly reduce production, and thus expenditure, while income aids would at best be production neutral (and I do not see how they could be made so in practice, on the Commission's terms);

- it would work with the grain of market forces, by taking out marginal land;

- it would not have awkward implications for overall social security policy and EC involvement therein;

- it would benefit marginal farmers in the UK as well as elsewhere, whereas income aids would go essentially to farmers in other Member States;

- being less of a new departure for the CAP, the Commission may be inhibited from proposing such skewed contribution rates as feature in their income aid proposal (these last two points would, of course, reduce the adverse affect on our net budget contribution).

10. On the other hand set-aside has one major danger: it could be seen as a substitute for, rather than a reinforcement of, price policy. This is something we must guard against during the stabiliser discussions.

11. In the Agriculture Council it has become clear, especially last week, that set-aside now has much greater attraction for most of our partners than income aids. The Germans place great emphasis on it (they have a little direct experience, having operated a small-scale set-aside scheme on a national basis). In response to requests both from them and from most other Member States, the Commission has produced an outline of how they think a Community scheme might be run.

12. We ourselves have been encouraging the Community since last year to look more seriously at set-aside as an adjunct to strict price policy for cereals. I therefore welcome these developments, although we must obviously try to minimise the rate of budgetary contribution. I will also want to ensure under any Community scheme that all Member States should be obliged to apply it but individual producers should be free to choose whether or not to take it up. The economic sense of this would be that a voluntary scheme should result in marginal land and perhaps marginal producers being taken out of grain, whilst the more efficient producers and productive land would not need to do so. This should allow our more efficient producers to continue to exploit their lead.

13. When the Council discussions resume my aim will be to try and develop the concept of set-aside further in this direction. The Commission's paper gives us a good basis for doing so. I am bound to say, in response to paragraph 7 of your minute of 16 November, that I see no prospect of the Germans being bought off with a mere commitment to further study. They have emphatically stated that this is an essential part of the final package for them, on which they will want details settled at Copenhagen.

14. Whilst referring to your minute of 16 November I think I should say that I found the terms in which you refer to our aims on sheepmeat most surprising. It is not, of course, the case that we are seeking any preferential exemption. I have made clear throughout the Council discussion that I think it quite right that stabiliser arrangements should be extended to sheepmeat (even though the UK derives more advantage than others from that regime). But the particular form of stabiliser proposed by the Commission would involve clear discrimination against producers in Great Britain for which there is no objective justification. The same goes for the proposed limit on payment of annual premium to individual farmers. I am resisting strongly and I hope you and other colleagues agree that it should remain our firm aim to dislodge those features of the sheep proposals.

15. To sum up:

1) No one can be for or against income aids in themselves: they can only be a means to an end, namely CAP reform;

2) Like any other measure, their costs and benefits have to be assessed: and, since the benefit is how much further reform Member States can be induced to swallow than would otherwise be the case, this assessment can only be made in relation to a specific proposal and in a specific negotiating situation;

3) Income aids must also be assessed against other supplementary measures capable of having the same effect on recalcitrant Member States, in particular set-aside;

4) The Commission's current income aids proposals have little or no support and will thus not buy anything. There are also inherent objectives of principle and practice to them.

5) Set-aside could have several advantages compared with income aids;

6) On economic grounds it should take the form of a scheme that is voluntary at the farm level;

7) As Council discussions have developed it seems that the Germans will insist on set-aside featuring in the final package on stabilisers;

8) We can go along with this but must make sure the scheme meets our main interest (above);

9) This will be my aim at the Council.

16. 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 of the Cabinet.

pp JM
Minister of Agriculture
Fisheries and Food
23 November 1987

(Approved by the Minister and signed in his absence)

Mr Taylor - 12/2
In case it arises you may like to be aware of (x)

FROM: I C R BYATT
DATE: 25 November 1987

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Anson
Sir T Burns
Sir G Littler
Mr Monck
Mr Burgner
Mr A Edwards
Mr H P Evans
Mr Scholar
Mr Spackman
Mr Bonney
Mr R I G Allen
Mr Mortimer
Mr Hughes
Ms Symes
Mr Picard
Mr Tyrie

PRINCIPLES OF AGRICULTURAL REFORM

The Private Office letter from the Ministry of Agriculture indicates that Mr MacGregor is happy with the principles of agricultural reform subject to some small amendments. We feel there is no difficulty in taking account of these amendments. We have incorporated the amendments to principles vii and viii as Mr MacGregor suggests. We agree that the contribution of agriculture to the preservation and enhancement of the environment should be taken full account of but think that it belongs in principle viii rather than iv and have amended the text accordingly. We have adopted the suggestion for Annex 1 paragraph 1 but kept the point about agricultural output being profitable as a whole.

2. We have taken account of Mr MacGregor's point about publicity and inserted a reference into the draft minute to go to the Prime Minister. Incidentally the reference to the loss of 1 million Community jobs was never in the version of the ten principles that you sent out (although referred to in a note to the Annex).

(x)

AGRICULTURAL STOCKS

CONFIDENTIAL

cc: CST
PMG
Mr Anson
Mr Monck
Mr Edwards
Mr Burgner
Mr Mortimer
Mr Mercer
Mrs Imber
Mr Bonney
Mr Dodds
Mr Bostock - UKREP
Mr Tyrie

Treasury Chambers, Parliament Street, SW1P
01-270 3000

Charles Powell Esq
10 Downing Street
LONDON SW1

26 November 1987

Dear Charles,

FUTURE FINANCING: STOCKS AND AGRICULTURAL GUIDELINE

The Treasury has been giving some further thought to problems of stocks expenditure and its relationship to the guideline limit for future agricultural expenditure. The Chancellor has asked me to send you the attached paper by Treasury officials which considers a wide range of options including the clean slate approach suggested in your letter of 20 November.

Discussion in Brussels has so far been focussed on the choice between dealing with expenditure on existing stocks inside or outside the guideline. Sadly the idea of writing down the value of existing stocks at national expense has met with little enthusiasm and some downright hostility and the Chancellor takes the view that, although it is clearly the best solution we must now conclude that it is most unlikely to run. The alternative of a once off depreciation exercise funded from the Community Budget has not yet been raised in the negotiation: although it should not encounter the same objections in principle as the national financing suggestion, it could well be that others will be unwilling to focus on a new idea of this sort at this stage in the negotiation, although it would be a pity to drop it altogether simply on this account.

In the Chancellor's view the range of options listed in the officials' paper can be narrowed realistically to a choice of three:

(i) a one off depreciation exercise in 1988 for all existing stocks other than the special butter disposals for which we made financing provision in 1986. This would need to be financed by the Community through an Inter Governmental Agreement (IGA). (This is option 3B in the table);

(ii) spreading the costs of depreciation of existing stocks over the period until 1992 on the model of the 1986 butter agreement, but taking these costs outside the guideline (Option 4 in the table); and

(iii) the same as option (ii) but keeping all the costs within the guideline.

The first of these has many attractions in terms of wiping the slate clean of past mistakes and should make it easier to achieve a lower guideline limit for future years. For the UK there are also financial attractions, particularly if an IGA is financed on the so-called "diff" tax key (where our marginal contribution would be some 13%) rather than through VAT. Against that the financial benefits to us (and more markedly to the Germans and the Irish) will be parallelled by financial disbenefits to others (notably the Italians) and the idea of a substantial addition to Community spending above the new own resources ceiling in 1988 is unlikely to attract unanimous agreement. An IGA of perhaps 2-3 becu higher than otherwise would be needed to implement this option.

The other two options are precisely equivalent to each other in financial terms and are not too far removed from the Commission's own thinking to judge from the papers they have circulated on stocks expenditure. Clearly there would be presentational benefits in achieving a lower guideline limit (whether this comes off the base or the growth rate), if we agree to take expenditure on existing stocks outside. But this will depend on the size of the reduction in the Commission's figures we can negotiate. If we cannot achieve the sort of adjustment suggested in paragraph 8 of the officials' paper, then we would be better off with stocks expenditure inside the guideline effectively exerting a tighter constraint on other agricultural expenditure.

Others will no doubt argue that it is unreasonable even to consider a reduction in the guideline provision when on the Commission's latest reckoning unconstrained expenditure in 1988 at 30.8 becu is likely to be some 2.6 becu higher than their own rebased guideline proposal of 28.2 becu. The Commission lose no opportunity to point out that part of the reason for this is that the Council has failed to adopt the proposal for an oils and fats tax which on the Commission's reckoning would net some 1.3 becu in receipts next year if adopted immediately. We will of course continue to oppose the adoption of an oils and fats tax for all the reasons with which we are familiar, but we will need to be able to marshall some persuasive arguments to demonstrate that the rejection of the tax need not imply any addition to the guideline numbers which the Commission have proposed.

Treasury and MAFF officials have drawn up a considerable list of options for reducing the Commission's estimates for 1988. The main categories and the financial effects can be summarised as follows:

	becu
Commission unconstrained forecast	30.8
Potential reductions	
(i) estimating savings (based on views of MAFF commodity divisions including allowance for decline in dollar)	-1.5
(ii) stabilisers (Commission proposals) (first year effect)	-0.6
(iii) management savings (within Commission competence)	-0.5
(iv) 1988 Price Fixing (first year effect subject to Council decision)	-0.5
(v) reduction in reimbursements for storage costs	-0.5
	-3.6

Although some of these estimates may prove to be rather ambitious, I suggest that they provide a reasonable basis for arguing that the Commission should at least be able to live within their new guideline provision in 1988 (28.2 becu or 27.8 becu on a growth rate of 2/3 GNP) and preferably within the provision already in the PDB (27 becu) based on the (COM(87)101) proposals.

There is currently some 4.1 becu within the Commission's estimates for 1988 for expenditure on stocks. Officials reckon that some 2.1 becu of this will be needed to operate the policy of depreciating new stocks on entry (less, if the decision is delayed until part way through 1988). That leaves a potential further saving of 2 becu in 1988 if expenditure on existing stocks is taken outside the guideline either by a one off depreciation or by a smoothing exercise. If stocks expenditure is kept within the guideline but spread forward the additional saving might be 1 becu.

On the basis of these calculations the main options for stocks expenditure and the guideline might look as follows:

		base	growth rate	1988	treatment of stocks
(i) Community write off (excluding butter)	(a)	26	GNP	27.2	outside
	or (b)	26.5	66% GNP	27.4	outside
(ii) phasing (outside guideline, including special butter)	(a)	25.5	GNP	26.7	outside
	(b)	26	66% GNP	26.8	outside
(iii) phasing (inside guide-line = current Commission proposal)		26.9	GNP	28.2	inside

In the Chancellor's view any outcome on the guideline which is consistent with these parameters would be reasonable, assuming of course that we have made satisfactory progress on stabilisers, budgetary control and our other key objectives. In fact the pressures from virtually all the other Member States, except the Netherlands are likely to be in favour of higher guideline figures.

The Chancellor has concluded that, if we are able to insert the idea of a Community financed one off depreciation exercise into the discussions at this stage, it would have considerable merit both in political terms (i.e. the clean slate approach) and also financially, particularly if we succeed in achieving the Commission's fourth resource proposal, even though it would involve an IGA in 1988 of perhaps 2-3 becu higher than would otherwise be necessary. If, however, others are not prepared to accept this more imaginative approach, we should fall back to the options involving phasing expenditure <u>either</u> outside the guideline (if by so doing we can achieve the reductions suggested above) <u>or</u> inside the guideline (if we are unable to negotiate a reduction in the Commission's figures). We should continue to resist any suggestion by others than the Commission's figures are themselves too low by drawing on the examples of potential savings listed in paragraph 7 above.

I am copying this to Lyn Parker (FCO), Shirley Stagg (MAFF), Trevor Woolley (Cabinet Office), Roger Lavelle (Cabinet Office) and Sir David Hannay (UKREP).

Yours,

Moira Wallace

pp **J M G TAYLOR**
Private Secretary

CONFIDENTIAL

EC FINANCING REVIEW: AGRICULTURAL STOCKS

1. The Prime Minister has asked for further work to be done on the scope for a once for all operation to wipe the slate clean on existing agricultural stocks. (Mr Powell's letter of 20 November refers). This note considers various options for dealing with the problem. The financial implications both in EC Budget and UK PES terms are set out in the Annexe.

2. As explained in the Chancellor's minute of 16 November, in any discussions of the stocks problem we must distinguish carefully between three separate aspects:

(i) the necessary reduction in physical stocks to "normal" levels which the Commission have undertaken to achieve by 1992;

(ii) the systematic depreciation of new stocks on entry to prevent an overhang of expenditure commitments building up in the future; and

(iii) the treatment of the costs of disposing of existing undepreciated stocks.

This note is concerned with only the last of these, as any one-off write off should logically be confined to the accumulated costs of past policies not the ongoing costs of the new depreciation policy. Moreover, there is no necessary link between liquidating the costs of existing stocks and their physical disposal, which should remain for the Commission to organise in accordance with market factors.

Options

3. Under the present financing conventions the costs of depreciating existing stocks will fall to be paid to the Member States from the Community Budget as and when the stocks are sold or otherwise

disposed of. The only exception to this rule so far agreed relates to the costs of the special disposals of 1 million tonnes of butter in 1987 and 1988 which will be paid off in equal tranches over the four years starting in 1989. This special arrangement was agreed by the Agriculture Council in 1986 as part of the package of reforms in the dairy sector in recognition of the fact that the reduction in milk production then agreed would not result in significant savings to the Community Budget until 1989. Option 1 in the Annex sets out the financial implications of the traditional financing pattern at the time of physical disposal but taking account of the special arrangements for butter.

4. The other main options for dealing with this expenditure include:

(i) one-off depreciation at national expense (national write off);

(ii) one-off depreciation financed through the Community budget (Community write off); and

(iii) phased depreciation financed through the Community budget.

The following paragraphs consider each of these main options and a number of variants of each in turn.

National write off

5. The Foreign Secretary referred to the possibility of a national write off of existing stocks at the Foreign Affairs Council on 23 November. The suggestion did not meet with much enthusiasm from other delegations and, as foreshadowed in the Chancellor's minute of 16 November, was attacked by the Commission as being contrary to the principle of common financing of the CAP. Whilst the idea of a national write off has considerable attractions for the UK (not least in terms of financial savings compared with the alternative hypothesis of Community financing if this continues on the basis of VAT contributions), the financial attractions are

significantly reduced if special butter disposals are included (we have a relatively high share of butter stocks) and if (as we could hardly avoid) we have to find some way of compensating the Irish for their loss of receipts (perhaps through a special programme funded through the EAGGF Guidance Section). Moreover, pursuing this option further after its hostile initial reception at the Foreign Affairs Council would risk antagonising both the Dutch and the Danes, whose support we will need to retain on other aspects of the financing review, without much hope that we will in the end succeed in achieving our objective.

Community write off (Off-guideline)

6. Although the suggestion of national financing has not received a very encouraging reception, this does not exhaust the possibilities of wiping the slate clean. An alternative approach would be to agree to write down the value of the existing stocks at Community expense. The winners and losers in financial terms from a Community write off would be the reverse of those benefitting/losing from a national write off. The Spanish and Portuguese would gain somewhat from having the expenditure on existing stocks brought forward to 1988 as their gross contributions are abated by 55% in that year (but by lower percentages in later years), although they might still cavil at bearing any part of the cost. The Irish and Germans would gain substantially from increased EC receipts in 1988.

7. The major problem involved in a Community write off would be to find sufficient resources in the Budget. The one off costs in 1988 would amount to some 4 becu if special butter disposals are excluded and 7.2 becu if they are included. In practice given the foreseeable pressures on agricultural expenditure in 1988 the necessary finance could only be provided through an Intergovernmental Agreement (IGA) in addition to whatever own resources ceiling is agreed. Although an IGA for stocks would be presentationally unattractive, it need not perhaps be ruled out totally on that account: an IGA will almost certainly be needed in 1988 (as in 1985 following the Fontainebleau agreement) pending the ratification

of any new own resources decision. The financing key for an IGA would depend on the outcome of the financing review: if there is no change in the make up of own resources, VAT contribution rates would be the normal choice but, if the Commission's proposals for a fourth resource are accepted, the "diff tax" key would be the logical choice (as the marginal source of Community revenue). The choice of financing key is important in assessing the financial implications for the UK. As Annex A shows our preference, if we go down this route, should be for an IGA to cover the costs of depreciating stocks (excluding butter) on the diff tax key.

8. We should not of course consider the option of a write off at all, unless we are able to secure an appropriate reduction in the size of the financial guideline for future years. This reduction can be secured through an adjustment either to the base (of 26.9 becu) proposed by the Commission or to the GNP growth rate or a combination of the two. Officials have calculated that the adjustments required to justify a full write off of expenditure on all existing stocks (ie some 7.2 becu) either at national or Community expense would be as follows:

	base (becu) +	growth rate
Commission proposal	26.9	GNP growth
	- 1.5	GNP growth
	- 1.0	66% GNP
	- 0.75	50% GNP
	- 0.50	30% GNP

Similarly, for a partial write off excluding the special butter disposals the trade offs would be:

Base +	growth rate
- 1.0	GNP growth
- 0.75	85% GNP
- 0.5	66% GNP

We should arguably attach more importance to reducing the base for the guideline rather than the growth rate as this will have a greater effect on expenditure over the period to 1992. There is in any event a strong case for making a sizeable adjustment to the base for future years, if we are taking a significant element of expenditure outside the guideline. We should certainly start by suggesting a reduction of at least 1.5 becu in the 1987 base pointing out that by writing off expenditure on existing stocks it should be possible to reduce the Commission's unconstrained forecast of agricultural expenditure in 1988 by some 2 becu even after providing for the first year costs of the new depreciation policy for new stocks.

Phased depreciation (inside or outside guideline)

9. The third main option is to phase the costs of writing down existing stocks over the period to 1992. This has already been agreed in 1986 for the special butter disposals. The simplest approach would therefore be to extend this principle to all other existing stocks but to leave the present arrangements for butter to stand. The main advantage of this approach is that it would help to smooth out a peak of expenditure in 1988 which will arise under any of the other options. For this reason it should also make it more realistic to finance this expenditure within the guideline. It would also be possible to take a fixed profile of expenditure outside the guideline under this option, provided that we achieve the necessary adjustments to the guideline base and growth rate set out in paragraph 8 above.

10. The Spanish and Portuguese would object (with some reason) to further smoothing of this sort as their own resources refunds decline as the transitional period progresses and they would therefore be contributing more to stocks accumulated by others if this expenditure is deferred. Some sweetener would probably be needed. All member states would expect reimbursement of interest costs (at the current standard rates of 6% for Germany and the Netherlands and 7% for the rest), as was agreed for the butter disposals programme. This increases the cost of this option in undiscounted terms by comparison with the once off write off

approach. However, from the UK point of view spreading the costs is little different from the traditional financing profile over the period.

Conclusions

11. We conclude that our immediate priority should be to press the Commission for an adequate assessment of the financial implications for the Community Budget of the alternative options for dealing with expenditure on existing stocks. We should keep an open position with regard to the various options at this stage. Our final choice will depend crucially on the trade offs which may be negotiable with the base and growth rate for the guideline for any of the options which involve finance outside the guideline. Provisionally, however, our financial interest would seem to be best served by advocating

- a Community funded write off of existing stocks in 1988 provided that the guideline base is reduced by 1 becu (if butter disposals are included) and by 500 mecu (if butter is excluded) and the growth rate reduced to 66% GNP;

- taking a fixed profile of stocks expenditure outside the guideline if the same adjustments to be guidline limit can be achieved;

- financing existing stocks within the guideline by spreading the costs over a five year period.

HM Treasury
25 November 1987
015 1155

ANNEX A

OPTIONS FOR EXPENDITURE ON EXISTING STOCKS

	FEOGA expenditure (becu)					UK net contribution (£ million)	
	1988	1989	1990	1991	1992	VAT	Diff tax after abatements
Option 1 (traditional financing and 1986 butter disposals programme)	2.6	2.3	1.2	1.0	.9	75	-65
Option 2 (National write off)							
2A (all stocks)	.0	.0	.0	.0	.0	0	0
2B (all stocks & special programme for Ireland)	.8	.0	.0	.0	.0	35	30
2C (stocks excluding butter)	.0	1.0	.9	.9	.8	0	-70
2D (stocks excluding butter & special programme for Ireland)	.3	1.0	.9	.9	.8	15	-55
Option 3 (Community write off)							
3A (all stocks)	7.3	.1	.0	.0	.0	65	-55
3B (stocks excluding butter)	4.0	1.1	.9	.9	.8	65	-70
Option 4 (phasing)	1.0	2.0	1.9	1.9	1.8	95	-65

Key assumptions:

UK share of VAT contributions : 19%
diff tax contributions : 13%
existing stocks including butter : 17%
existing stocks excluding butter : 13%

NB (i) precise rate of diff tax will be variable depending on overall own resources total and the limit on VAT contributions and the abatement methodology has yet to be decided.

(ii) UK PES figures show cumulative effect on net contribution over the period 1987-88 to 1992-93 discounted by 5 per cent per year.

8.1

FROM: A J C EDWARDS
DATE: 26 November 1987

CHANCELLOR

cc: Paymaster General
Sir P Middleton
Sir G Littler
Mr Bonney
Mr Mortimer
Mr Mercer
Mr Donnelly
Mrs Imber
Mr Tyric

Ch
OK? OK
AA

EXCEPTIONAL CIRCUMSTANCES

Since your report to Cabinet of Delors' support during the recent ECOFIN lunch for limiting exceptional circumstances to fluctuations in the value of the ecu, the Prime Minister has told Chirac that the only circumstances which could justify any relaxation of the guideline would be if there were rapid and substantial changes in the ecu/dollar rate. In the light of this, I imagine that the Prime Minister would be prepared, at the appropriate time, to go along with some tightly circumscribed exceptional circumstances provision.

2. We have not so far given Ministers any note about exceptional circumstances. In the light of this latest development, therefore, I think it would be useful for you to send a short note to the Prime Minister discussing in particular the key issues of how any such provision would need to be specified and how any extra expenditure which it might trigger would be financed, bearing in mind the likelihood that Community expenditure will in practice be at or close to the own resources ceiling.

3. I attach a note accordingly, which reflects discussion with the Cabinet Office, FCO and MAFF, and a draft minute from yourself to the Prime Minister.

AJCE

A J C EDWARDS

8.3

Please type for signature (Get Mr Edwards' secretary to provide a clean version of the enclosure).

FROM: CHANCELLOR
DATE:

PRIME MINISTER

AGRICULTURAL BUDGET DISCIPLINE:
EXCEPTIONAL CIRCUMSTANCES

In the light of Delors' remark at ECOFIN and your own comment to Chirac at the weekend, I have asked Treasury officials to consider what form an exceptional circumstances provision limited to rapid and substantial changes in the ecu/dollar rate might best take and what potential problems there might be. The attached note sets out the results of their analysis.

2. My own view is that, if we find that we again have to go along with some form of exceptional circumstances provision - and the signs are that this will be a sticking point for several of the other member states - then one along the lines sketched in the attached note would be the best buy. I also find it difficult to see how we could agree to anything more widely drawn than this.

3. In presenting such a device domestically, the provision for symmetrical upward and downward revisions of expenditure would, I believe, be a bull point, as well as the limitation of exceptional circumstances to movements of more than 10 per cent in the ecu/dollar rate.

4. As the note points out, the detailed specification would be immensely important. My chief concern relates to how any expenditure beyond the guideline limit would be financed and any reductions sterilised. I think that the note correctly analyses how best to deal with these problems.

5. As to tactical handling, I suspect that our existing line (that the correct solution is <u>no</u> exceptional circumstances and that if there were any excesses over the guideline limit they would anyway have to be nationally financed) remains [~~pertinent~~] the one to follow for the time being. The exceptional circumstances which most other member states currently envisage would go far beyond the circumscribed model described in the attached note. It seems to me, therefore, that we must continue to play hard to get on exceptional circumstances. More generally, ~~I think that~~ [~~movement of position~~] we cannot reasonably be expected [~~of~~] to move [~~us~~] so long as the stabilisers remain in their present unsatifactory state.

6. I am copying this minute and the Treasury note to Geoffrey Howe and John MacGregor and to Sir Robert Armstrong.

AGRICULTURAL BUDGET DISCIPLINE: EXCEPTIONAL CIRCUMSTANCES

The Issue

1. In the Brussels discussion on future financing, the UK has been on its own in arguing against any clause permitting agricultural guarantee expenditure to exceed the guideline limit in the event of exceptional circumstances. The Eleven agreed by implication at the June European Council that there should be an exceptional circumstances provision, while noting that its "effect.... will have to be neutralised in both directions". More recently, the Dutch and the Portuguese, and likewise M Delors, have seemed prepared to envisage a tightly circumscribed provision whereby exceptional circumstances would be limited to large movements in the ecu/dollar rate, and the Prime Minister has indicated privately to M Chirac that the only circumstances in which she could see any justification for relaxing the guideline would be if there were rapid and substantial changes in the ecu/dollar rate. Other member states would like the exceptional circumstances provision to be more widely drawn so as to include the effects of other monetary changes and preferably non-monetary changes as well. The French have recently suggested that failure by countries outside the Community to respect their international obligations in agricultural trade might also be deemed an exceptional circumstance. The French and several other member states appear genuinely to see the retention of some exceptional circumstances provision, albeit limited, as a sticking point.

2. The question arises, therefore, how an exchange rate related ~~whether there is any~~ exceptional circumstances provision~~, and in particular one limited to large movements in the ecu/dollar rate, which might be acceptable in the context of an otherwise satisfactory deal, and how such a provision~~ might best be defined and circumscribed. There are two specific groups of issues:

(i) how would exceptional circumstances best be specified?

(ii) how would any permitted excesses of expenditure over the guideline limit be financed (and reductions below the guideline sterilised)?

Specification

13. In the light of the Brussels discussion, it seems clear that the best we could hope for (and it is not clear whether even this would command agreement) would be a definition of exceptional circumstances limited to movements in the ecu/dollar rate of more than 10 per cent, compared with a reference period, on the basis that the guideline limit could be exceeded by 80 mecu per 1 percentage point depreciation of the dollar in excess of 10 per cent, with a symmetrical reduction in expenditure below the limit for appreciation of the dollar in excess of 10 per cent. On this approach, the permitted level of expenditure would effectively vary with large movements in the ecu/dollar rate rather than being a fixed limit.

14. As the previous paragraph indicates, there are five key issues of specification.

- First, the exceptional circumstances indicator. If the objective were to identify an indicator which best reflects the pressures on agricultural spending, the natural choice would be a composite index of world prices rather than the ecu/dollar rate. But discussion in Brussels has centred on the ecu/dollar rate, and this rate, though but one element in possible pressures on agricultural spending, has the great merit of being an exogenous influence, not affected by such factors as oversupply in agricultural markets, and of being easy to monitor. The rate in question should be the market exchange rate, not the agricultural ecu: we would not wish changes in the latter following EMS currency realignments to qualify as exceptional circumstances.

- Second, the <u>reference and measurement periods</u> which would be used to measure variations in the ecu/dollar rate. To judge by past data, the choice of reference and measurement periods is likely to have a major influence on whether exceptional circumstances are triggered. Since the level of expenditure in (say) 1988 is influenced by the ecu/dollar rate between August 1987 and July 1988 rather than by the rate between January and December 1988, our provisional view is that circumstances would best be considered exceptional in 1988 if the average rate over the (measurement) period 1 August 1987 to 31 July 1988 varies by more than 10 per cent from a "reference" rate based on the actual rate in the second or (better) third quarter of 1987. The two accompanying tables illustrate what variations in expenditure a formula on these lines would have triggered over the past eight years.

  To judge by past data, choice of a reference period longer than this before the measurement period would be likely to result in exceptional circumstances being triggered in most years.

- Third, the <u>minimum percentage change (or threshold)</u> which would have to occur before circumstances would be considered exceptional. As the accompanying tables illustrate, the adjustments to expenditure triggered by a threshold of a 5 per cent movement could be quite sizeable, especially with a second quarter reference period. A 10 per cent threshold would be considerably more satisfactory. 10 per cent is probably also the highest threshold rate that could realistically be negotiated.

- Fourth, the rate of adjustment in agricultural expenditure. The Commission have recently estimated that agricultural expenditure is increased or reduced by 80 mecu for each one percentage point variation in the dollar/ecu rate. The best we could hope for would be to stick with this figure on the basis that it would be applied only to variations in excess of 10 per cent and not in any circumstances to the first 10 per cent of any exchange rate movement.

- Fifth, symmetrical upward and downward adjustments to expenditure, depending on whether the dollar has depreciated or appreciated. Subject to the concerns discussed below, the provision for reducing expenditure in the event of a dollar appreciation could be a valuable feature distinguishing this approach from the exisiting budget discipline agreement. Much preferably, such reductions in expenditure would be mandatory, while increases (in the event of a depreciation) would be permissive. But several member states would be likely to resist this. The next best option would be for all adjustments to be permissive (an objective best secured by stealth).

Financing of excesses/sterilisation of reductions

65. The second group of issues concerns how expenditure excesses over the guideline limit would be financed, and how reductions below it might be sterilised.

76. So far as excesses are concerned, the important thing from the UK's point of view would be to minimise the risk that, in the all too likely event that expenditure was at or close to the own resources ceiling, the Commission and other member states would be able to insist that the UK was obliged, along with other member states, to provide an IGA in order to finance the additional expenditure.

[illegible]. The most fool proof way of doing this would be to secure an agreement that excesses over the guideline limit would be financed either nationally or by temporary reductions in payments from the budget to member states (as in the current year), to be made good within the guideline limit over the two following years. There seems little prospect, however, that such agreement would be forthcoming.

8. In the absence of such provisions, the pressures to exceed the own resources ceiling could best be contained by:

(a) a slower growth of the guideline limit than GNP (thus leaving some leeway within the own resources ceiling);

(b) a satisfactory specification of exceptional circumstances, particularly as regards the definition of what is exceptional, the reference period and the threshold percentage (see paragraph 5), thus reducing the amounts of any potential excesses; and

(c) a permissive provision (best secured by stealth) whereby expenditure <u>could</u> in exceptional circumstances be increased beyond the guideline limit rather than a mandatory provision that it <u>must</u> be.

If provisions along these lines could be secured, the problem of financing excesses on account of exceptional circumstances ought not in practice to be too serious, though it could still be a serious problem generally in a context of inadequate stabilisers and other control systems. The UK could make clear in the discussion at the European Council that in no circumstances would we agree to an IGA to finance any excesses.

9. So far as <u>reductions</u> in expenditure below the guideline limit are concerned (an appreciating dollar), the danger would be that the Council and the Parliament between them might decide

to use the resources so released to increase non-obligatory expenditure. Such an increase would then be ratcheted forward under the Community's budgetary procedures to all future years. It would therefore be important to secure agreement, if possible, that such reductions would not be used to increase expenditure elsewhere: Such a provision would be a symmetrical counterpart of the provision which southern member states will seek whereby non-obligatory expenditure should not be raided to finance agricultural excesses. One could not be sure that a sterilising provision of this kind would necessarily work in practice. It should at least help, however, to stiffen the northern qualified majority on future budgetary occasions.

Conclusions

10. Some conclusions which might be drawn from the above analysis are:

(i) If, as seems likely, other member states will not accept a guideline limit which admits of no exceptional circumstances, the best alternative would seem to be a symmetrical exceptional circumstances provision based exclusively on the ecu/dollar rate.

(ii) The precise specification of such a provision would be immensely important. It might best provide that, if the ecu/dollar market rate between August of the previous year and July of the current year departs by more than 10 per cent from the reference rate in the second or (better) third quarter of the previous year, expenditure would be permitted if necessary to exceed, or would be reduced below, the guideline limit by an amount of 80 mecu for each 1 per cent variation in excess of the 10 per cent threshold.

(iii) How could expenditure above the guideline limit, triggered by the exceptional circumstances provision, be financed without creating massive pressure for IGAs? On the assumption that other member states would not agree in advance to national financing or spreading forward of any such excesses, this potential problem would best be contained by means of a guideline limit growing more slowly than own resources, a satisfactory specification of the exceptional circumstances provision itself, and agreement that adverse exceptional circumstances would permit rather than require increases in expenditure provision. [~~The UK could make clear at the European Council that in no circumstances would we contemplate an IGA to deal with this or other excesses~~.]

(iv) It would also be important to secure agreement that reductions in agricultural guarantee expenditure on account of favourable exceptional circumstances would not be available for use elsewhere in the budget.

(v) If other member states sought to insist on a wider definition of exceptional circumstances, unsuitable reference and measurement periods, a lower threshold, or no symmetrical arrangements for reducing expenditure if the dollar appreciates, ~~or mandatory increases in expenditure in the event of adverse circumstances,~~ it would clearly be difficult to acquiesce in such a provision. Ministers would need to decide, in the light of what exactly was on offer and of all the other elements in the negotiation, whether they could accept an exceptional circumstances provision which was less than satisfactory in one or more of the ways described.

HM Treasury
26 November 1987

Table 1 : Q2 case

Increased (+) or reduced (-) expenditure arising from an exceptional circumstances system based on a Q2 reference period and an August/July measurement period.

(mecu)

	Threshold		
	5%	10%	15%
1980	0	0	0
1981	-460	-170	0
1982	-210	0	0
1983	-240	0	0
1984	-400	0	0
1985	-860	-370	0
1986	1490	940	390
1987	590	170	0

Note : expenditure in (say) 1987 mainly reflects transactions made between August 1986 to July 1987 and is therefore deemed to be influenced by exchange rates in that period.

Table 2 : Q3 case

Increased (+) or reduced (-) expenditure arising from an exceptional circumstances system based on a Q3 reference period and an August/July measurement period.

(mecu)

	Threshold		
	5%	10%	15%
1980	0	0	0
1981	-600	-320	-30
1982	0	0	0
1983	0	0	0
1984	0	0	0
1985	-90	0	0
1986	710	200	0
1987	160	0	0

Note : expenditure in (say) 1987 mainly reflects transactions made between August 1986 to July 1987 and is therefore deemed to be influenced by exchange rates in that period.

EXCEPTIONAL CIRCUMSTANCES

CONFIDENTIAL

PMG
Sir P Middleton
Sir G Littler
Mr A J C Edwards
Mr Bonney
Mr Mortimer
Mr Mercer
Mr Donnelly
Mrs Imber
Mr Tyrie

MP

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

PRIME MINISTER

27/11/87

AGRICULTURAL BUDGET DISCIPLINE: EXCEPTIONAL CIRCUMSTANCES

In the light of Delors' remark at ECOFIN and your own comment to Chirac at the weekend, I have asked Treasury officials to consider what form an exceptional circumstances provision limited to rapid and substantial changes in the ecu/dollar rate might best take and what potential problems there might be. The attached note sets out the results of their analysis.

My own view is that, if we find that we again have to go along with some form of exceptional circumstances provision - and the signs are that this will be a sticking point for several of the other member states - then one along the lines sketched in the attached note would be the best buy. I also find it difficult to see how we could agree to anything more widely drawn than this.

In presenting such a device domestically, the provision for symmetrical upward and downward revisions of expenditure would, I believe, be a bull point, as well as the limitation of exceptional circumstances to movements of more than 10 per cent in the ecu/dollar rate.

As the note points out, the detailed specification would be immensely important. My chief concern relates to how any expenditure beyond the guideline limit would be financed and any reductions sterilised. I think that the note correctly analyses how best to deal with these problems.

CONFIDENTIAL

As to tactical handling, I suspect that our existing line (that the correct solution is no exceptional circumstances and that if there were any excesses over the guideline limit they would anyway have to be nationally financed) remains the one to follow for the time being. The exceptional circumstances which most other member states currently envisage would go far beyond the circumscribed model described in the attached note. It seems to me, therefore, that we must continue to play hard to get on exceptional circumstances. More generally, we cannot reasonably be expected to move so long as the stabilisers remain in their present unsatisfactory state.

I am copying this minute and the Treasury note to Geoffrey Howe and John MacGregor and to Sir Robert Armstrong.

pp. **N.L.**

27 November 1987

[Approved by the Chancellor and signed in his absence]

AGRICULTURAL BUDGET DISCIPLINE: EXCEPTIONAL CIRCUMSTANCES

The Issue

1. In the Brussels discussion on future financing, the UK has been on its own in arguing against <u>any</u> clause permitting agricultural guarantee expenditure to exceed the guideline limit in the event of exceptional circumstances. The Eleven agreed by implication at the June European Council that there should be an exceptional circumstances provision, while noting that its "effect.... will have to be neutralised in both directions". More recently, the Dutch and the Portuguese, and likewise M Delors, have seemed prepared to envisage a tightly circumscribed provision whereby exceptional circumstances would be limited to large movements in the ecu/dollar rate, and the Prime Minister has indicated privately to M Chirac that the only circumstances in which she could see any justification for relaxing the guideline would be if there were rapid and substantial changes in the ecu/dollar rate. Other member states would like the exceptional circumstances provision to be more widely drawn so as to include the effects of other monetary changes and preferably non-monetary changes as well. The French have recently suggested that failure by countries outside the Community to respect their international obligations in agricultural trade might also be deemed an exceptional circumstance. The French and several other member states appear genuinely to see the retention of some exceptional circumstances provision, albeit limited, as a sticking point.

2. The question arises, therefore, how an exchange rate related exceptional circumstances provision might best be defined and circumscribed. There are two specific groups of issues:

(i) how would exceptional circumstances best be specified?

(ii) how would any permitted excesses of expenditure over the guideline limit be financed (and reductions below the guideline sterilised)?

Specification

3. In the light of the Brussels discussion, it seems clear that the best we could hope for (and it is not clear whether even this would command agreement) would be a definition of exceptional circumstances limited to movements in the ecu/dollar rate of more than 10 per cent, compared with a reference period, on the basis that the guideline limit could be exceeded by 80 mecu per 1 percentage point depreciation of the dollar in excess of 10 per cent, with a symmetrical reduction in expenditure below the limit for appreciation of the dollar in excess of 10 per cent. On this approach, the permitted level of expenditure would effectively vary with large movements in the ecu/dollar rate rather than being a fixed limit.

4. As the previous paragraph indicates, there are five key issues of specification.

- First, the exceptional circumstances indicator. If the objective were to identify an indicator which best reflects the pressures on agricultural spending, the natural choice would be a composite index of world prices rather than the ecu/dollar rate. But discussion in Brussels has centred on the ecu/dollar rate, and this rate, though but one element in possible pressures on agricultural spending, has the great merit of being an exogenous influence, not affected by such factors as oversupply in agricultural markets, and of being easy to monitor. The rate in question should be the market exchange rate, not the agricultural ecu: we would not wish changes in the latter following EMS currency realignments to qualify as exceptional circumstances.

- Second, the reference and measurement periods which would be used to measure variations in the ecu/dollar rate. To judge by past data, the choice of reference and measurement periods is likely to have a major influence on whether exceptional circumstances are triggered. Since the level of expenditure in (say) 1988 is influenced by the ecu/dollar rate between August 1987 and July 1988 rather than by the rate between January and December 1988, our provisional view is that circumstances would best be considered exceptional in 1988 if the average rate over the (measurement) period 1 August 1987 to 31 July 1988 varies by more than 10 per cent from a "reference" rate based on the actual rate in the second or (better) third quarter of 1987. The two accompanying tables illustrate what variations in expenditure a formula on these lines would have triggered over the past eight years.

To judge by past data, choice of a reference period longer than this before the measurement period would be likely to result in exceptional circumstances being triggered in most years.

- Third, the minimum percentage change (or threshold) which would have to occur before circumstances would be considered exceptional. As the accompanying tables illustrate, the adjustments to expenditure triggered by a threshold of a 5 per cent movement could be quite sizeable, especially with a second quarter reference period. A 10 per cent threshold would be considerably more satisfactory. 10 per cent is probably also the highest threshold rate that could realistically be negotiated.

- Fourth, the rate of adjustment in agricultural expenditure. The Commission have recently estimated that agricultural expenditure is increased or reduced by 80 mecu for each one percentage point variation in the dollar/ecu rate. The best we could hope for would be to stick with this figure on the basis that it would be applied only to variations in excess of 10 per cent and not in any circumstances to the first 10 per cent of any exchange rate movement.

- Fifth, <u>symmetrical upward and downward adjustments</u> to expenditure, depending on whether the dollar has depreciated or appreciated. Subject to the concerns discussed below, the provision for reducing expenditure in the event of a dollar appreciation could be a valuable feature distinguishing this approach from the existing budget discipline agreement. Much preferably, such reductions in expenditure would be mandatory, while increases (in the event of a depreciation) would be permissive. But several member states would be likely to resist this. The next best option would be for all adjustments to be permissive (an objective best secured by stealth).

Financing of excesses/sterilisation of reductions

5. The second group of issues concerns how expenditure excesses over the guideline limit would be financed, and how reductions below it might be sterilised.

6. So far as <u>excesses</u> are concerned, the important thing from the UK's point of view would be to minimise the risk that, in the all too likely event that expenditure was at or close to the own resources ceiling, the Commission and other member states would be able to insist that the UK was obliged, along with other member states, to provide an IGA in order to finance the additional expenditure.

7. The most fool proof way of doing this would be to secure an agreement that excesses over the guideline limit would be financed either nationally or by temporary reductions in payments from the budget to member states (as in the current year), to be made good within the guideline limit over the two following years. There seems little prospect, however, that such agreement would be forthcoming.

8. In the absence of such provisions, the pressures to exceed the own resources ceiling could best be contained by:

(a) a slower growth of the guideline limit than GNP (thus leaving some leeway within the own resources ceiling);

(b) a satisfactory specification of exceptional circumstances, particularly as regards the definition of what is exceptional, the reference period and the threshold percentage (see paragraph 5), thus reducing the amounts of any potential excesses; and

(c) a permissive provision (best secured by stealth) whereby expenditure could in exceptional circumstances be increased beyond the guideline limit rather than a mandatory provision that it must be.

If provisions along these lines could be secured the problem of financing excesses on account of exceptional circumstances ought not in practice to be too serious, though it could still be a serious problem generally in a context of inadequate stabilisers and other control systems.

9. So far as reductions in expenditure below the guideline limit are concerned (an appreciating dollar), the danger would be that the Council and the Parliament between them might decide to use the resources so released to increase non-obligatory expenditure. Such an increase would then be ratcheted forward under the Community's budgetary procedures to all future years. It would therefore be important to secure agreement, if possible, that such reductions would not be used to increase expenditure elsewhere: such a provision would be a symmetrical counterpart of the provision which southern member states will seek whereby non-obligatory expenditure should not be raided to finance agricultural excesses. One could not be sure that a sterilising provision of this kind would work in practice. It should at least help, however, to stiffen the northern qualified majority on future budgetary occasions.

10. Some conclusions which might be drawn from the above analysis are:

(i) If, as seems likely, other member states will not accept a guideline limit which admits of no exceptional circumstances, the best alternative would seem to be a symmetrical exceptional circumstances provision based exclusively on the ecu/dollar rate.

(ii) The precise specification of such a provision would be immensely important. It might best provide that, if the ecu/dollar market rate between August of the previous year and July of the current year departs by more than 10 per cent from the reference rate in the second or (better) third quarter of the previous year, expenditure would be permitted if necessary to exceed, or would be reduced below, the guideline limit by an amount of 80 mecu for each 1 per cent variation in excess of the 10 per cent threshold.

(iii) How could expenditure above the guideline limit, triggered by the exceptional circumstances provision, be financed without creating massive pressure for IGAs? On the assumption that other member states would not agree in advance to national financing or spreading forward of any such excesses, this potential problem would best be contained by means of a guideline limit growing more slowly than own resources, a satisfactory specification of the exceptional circumstances provision itself, and agreement that adverse exceptional circumstances would permit rather than require increases in expenditure provision.

(iv) It would also be important to secure agreement that reductions in agricultural guarantee expenditure on account of favourable exceptional circumstances would not be available for use elsewhere in the budget.

(v) If other member states sought to insist on a wider definition of exceptional circumstances, unsuitable reference and measurement periods, a lower threshold, or no symmetrical arrangements for reducing expenditure if the dollar appreciates, it would clearly be difficult to acquiesce in such a provision. Ministers would need to decide, in the light of what exactly was on offer and of all the other elements in the negotiation, whether they could accept an exceptional circumstances provision which was less than satisfactory in one or more of the ways described.

HM TREASURY
27 November 1987

Table 1 : Q2 case

Increased (+) or reduced (-) expenditure arising from an exceptional circumstances system based on a Q2 reference period and an August/July measurement period.

(mecu)

	Threshold		
	5%	10%	15%
1980	0	0	0
1981	-460	-170	0
1982	-210	0	0
1983	-240	0	0
1984	-400	0	0
1985	-860	-370	0
1986	1490	940	390
1987	590	170	0

Note : expenditure in (say) 1987 mainly reflects transactions made between August 1986 to July 1987 and is therefore deemed to be influenced by exchange rates in that period.

Table 2 : Q3 case

Increased (+) or reduced (-) expenditure arising from an exceptional circumstances system based on a Q3 reference period and an August/July measurement period.

(mecu)

	Threshold		
	5%	10%	15%
1980	0	0	0
1981	-600	-320	-30
1982	0	0	0
1983	0	0	0
1984	0	0	0
1985	-90	0	0
1986	710	200	0
1987	160	0	0

Note : expenditure in (say) 1987 mainly reflects transactions made between August 1986 to July 1987 and is therefore deemed to be influenced by exchange rates in that period.

CONFIDENTIAL

Mr A C S Allan

From: R J Bonney
Date: 1 December 1987

cc Mr Edwards
Mrs Imber

EC FINANCING: STABILISERS

1. I understand from Mr Lavelle that the Foreign Secretary may try to speak to the Chancellor and the Minister of Agriculture in the House this evening about the procedure for dealing with stabilisers for commodities other than cereals, oilseeds and proteins which are likely to be the main focus of the agricultural discussion at Copenhagen. The Chancellor may wish to glance at the attached note which Mr Lavelle

has prepared.

2. We are still considering the details of the latest stabiliser proposals (including their financial implications) with MAFF. Our current view is that the latest proposals on cereals and oilseeds are the minimum we should be prepared to accept. The other products (except for milk) have a relatively small budgetary impact. If the European Council is able to take decisions on cereals and oilseeds which we would regard as acceptable, in practice the remaining commodities will have to be remitted for detailed decisions by the Agriculture Council by a formula on the lines of Mr Lavelle's paragraph 7. The

reference to keeping expenditure within the agreed budget framework would clearly be essential in this context.

3. In practice the latest Presidency compromise is almost certain to form the basis for future discussion whatever the exact terms of the remit. Apart from DAFF's objections to the separate maximum guaranteed quantity for sheep in GB, there is nothing in it which is wholly objectionable, although much which could be improved. The suggested deadline of 31 December 1987 is the Commission's current position, which we should certainly not undermine. In fact there is

every advantage in trying to get decisions through before the Germans take over the Presidency of the Agriculture Council in January.

RJ BONNEY

CONFIDENTIAL

Mr. J. MG. Taylor. 14/2.

H M Treasury

Parliament Street London SW1P 3AG

Switchboard 01-270 3000
Direct Dialling 01-270 4650

2 December 1987

R J D Carden Esq
MAFF
Whitehall Place

Dear Richard

BRIEFING FOR EUROPEAN COUNCIL: STABILISERS

We discussed the points raised in my letter of 30 November on the telephone yesterday evening. In view of the need to issue revised briefs last night it did not prove practicable to arrange a meeting. This letter is intended to record our conversation for the benefit of copy recipients.

Cereals

2. You said that you had no problem with my revised formulation of a fallback position on the starting date for intervention. Your Minister now took the view that the various other fallbacks should be offered in the following order:

(i) price adjustments as in Presidency compromise (ie 10/15/15% instead of 10/15/20%;

(ii) remove Commission discretion to shorten intervention period as stabiliser;

(iii) accept use of coresponsibility levy as one of the stabilisers;

(iv) accept increase of 2.3 million tonnes in MGQ (to take account of Spanish imports).

3. I said that we could not agree to this hierarchy. For the reasons set out in the Chancellor's letter of 16 November and my letter of 30 November we consider that the correct order should be:

(i) acceptance of the use of the co-responsibility levy as a stabiliser in conjunction with price cuts (but taking the price cuts first) (this is necessary in order to achieve adequate budgetary savings); and

(ii) acceptance of the Presidency's total price adjustment of 10/15/15%.

We consider it important not to make any specific concession on the use of the intervention period as a stabiliser both because the Commission have recently stated that they attach importance to retaining this possibility and because it is difficult to see how in practice cereals intervention stocks will ever be reduced to "normal" levels if we rule out any action to modify the present open-ended intervention system. For this reason we must at all costs avoid any specific decision by the European Council to rule out future adjustments to the intervention system. It would be better, if necessary, to let the question be passed over in silence so that the Commission do not feel precluded from raising it on a future occasion. The suggested increase in the MGQ which would cost on the Commission's estimates some 327 mecu a year should also be firmly resisted.

Oilseeds

4. We discussed the latest Commission compromise on oilseeds which is calculated to save 355 mecu in 1988 and 936 mecu in a full year by comparison with the present position. We agreed that this would be an acceptable outcome although significantly less stringent than the Commission proposal floated last week which would have saved 460 mecu in 1988 and 1233 mecu in a full year. However in order to achieve this outcome, I suggested that we would need to argue initially that it is regrettable that the Commission have proposed increases in the various MGQs for oilseeds and that a higher price cut co-efficient than 0.5 would be justified. (Your earlier briefing suggested that 0.7 would be the ideal figure). A co-efficient of 0.5 would of course be totally unacceptable if other Member States insist on reintroducing the idea of price cut limits (butoirs) in this sector. You agreed to reflect on the presentation.

Sheepmeat

5. We agreed that the question of flexibility on sheepmeat could only be resolved by Ministers.

Wine

6. You wished to retain the reference to the effect of a ban on sugar enrichment on the English wine industry but were prepared to rephrase it to make it sound less like a key UK objective.

Milk

7. You continue to be reluctant to reflect in the speaking notes the Chancellor's points about the continuation of the intervention trigger system and the need to adjust total EC quotas to the level of unsubsidised EC consumption and normal trade flows. You did not however dispute that both objectives remained part of the Government's policy in this sector. I suggested that the reference to the UK policy on the need to adjust total EC quotas at the next review and the level of surplus production (20%) allowed under the existing quota system should at any rate be included in the background section of the brief. It is surely at least as important for the Prime Minister to be reminded of this (and the fact that the dairy sector remains

the most expensive FEOGA regime) as about the interests of English wine producers. The reference to continuing the intervention trigger system should be included in the speaking notes: there can be no objection to this, as it is part of the latest Presidency compromise.

8. We agreed that we would both need to reflect these points in briefing our Ministers for today's meeting with the Prime Minister. If for any reason the substantive issues are not resolved then and you wish to oppose the Treasury's suggestions, I suggest that the proper course would be for your Minister to reply to the Chancellor's letter of 16 November and explain why he takes a different view. In the meantime other Departments will wish to note that the briefing line on these issues has not yet been agreed with the Treasury

Yours sincerely

Bob Bonney

R J BONNEY

cc Mr Lavelle Cabinet Office
Mr J O Kerr)
Mr J S Wall) FCO
Mr R Publicover)
Mr Hadley)
Mr Hollis) MAFF
Sir D Hannay)
Mr Bostock) UKREP
Mr Edwards)
Mr Mortimer) HMT
Mrs Imber)
Mr J M G Taylor)

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FRAME ECONOMIC

MIPT

FUTURE FINANCING.
TEXT AS FOLLOWS:

CEREALES
SEUIL DE GARANTIE: - 160 MILLIONS DE TONNES

AJUSTEMENT EN CAS DE DEPASSEMENT DU SEUIL.
1) REMPLACER LE 1) PAR :
'' - EN CAS DE DEPASSEMENT, L'EFFET DU STABILISATEUR EST LIMITE A UNE BAISSE DE PRIX EGALE EN POURCENTAGE A LA HAUSSE MOYENNE DE LA PRODUCTIVITE PHYSIQUE DE LA CEE APPRECIEE SUR LES TROIS DERNIERES ANNEES, Y COMPRIS L'ANEE EN COURS.
- LES MODALITES D'APPLICATION DE CETTE MESURE SERONT ARRETEES PAR LE CONSEIL.''
- POUR LA PARTIE DE L'ACCROISSEMENT DE PRODUCTION QUI EST LIEE A L'AUGMENTATION DES SURFACES, LE CONSEIL, SUR PROPOSITION DE LA COMMISSION, EN TIRERA LES CONSEQUENCES, TELLES QUE, ENTRE AUTRES, L'ABAISSEMENT DES PRIX, EN TENANT COMPTE DE CET ACCROISSEMENT DE PRODUCTION, DE LA SITUATION DES MARCHES ET DU REVENU DES AGRICULTURE, LORS DE LA DECISION ANNUELLE SUR LES PRIX.

2) METHODE
REMPLACER LE 2) A. ET B. PAR:
'' CREATION EN DEBUT DE CAMPAGNE D'UN PRELEVEMENT SUPPLEMENTAIRE PROVISIORE DE CO-RESPONSABILITE, DONT LE NIVEAU DEPEND DE LA HAUSSE DE PRODUCTIVITE ATTENDUE, COMPTE TENU DE LA MOYENNE DES HAUSSES DE PRODUCTIVITE DES TROIS DERNIERES ANNEES. CE PRELEVEMENT EST CONVERTI EN FIN DE CAMPAGNE PAR UNE DIMINUTION DE PRIX CORRESPONDANT A CETTE HAUSSE MOYENNE DE PRODUCTIVITE.

SUPPRIMER LE C.

REMPLACER DE D PAR:
''LA COMMISSION PRENDRA LES DECISIONS D'APPLICATION DU SYSTEME SUIVANT LA PROCEDURE DU COMITE DE GESTION.

LE RESTE (E, F, G, H,) : SANS CHANGEMENT.

OLEAGINEUX ET PROTEAGINEUX
SEUILS DE GARANTIE

- COLZA	4,7	MT
- GRAINES DE TOURNESOL	2	MT
- SOJA	1,3	MT
- PROTEAGINEUX	3,3	MT

AJUSTEMENTS EN CAS DE DEPASSEMENT DE SEUIL
MEME BUTOIR ET MEME PROCEDURE QUE POUR LES CEREALES (APPLIQUEE A L'ORGANISATION DE MARCHE DE CES PRODUITS)

POLITIQUE DE HIERARCHIE DEX PRIX
D'ORES ET DEJA, LE CONSEIL DECIDE QUE LE PRIX INDICATIF POUR LA PROCHAINE CAMPAGNE EST BAISSE DE X PERCENT.

SYSTEME DE STABILISATION POUR LES HUILES ET MATIERES GRASSES
LES DELEGATIONS SONT EN DESACCORD.

AUTRES PRODUITS.

5. HUILE D'OLIVE
REMPLACER ''MAINTIEN DES STABILISATEURS ACTUELLEMENT EN VIGEUR'' PAR : ''DES MESURES D'EFFET EQUIVALENT A CELLES RELATIVES AUX GRANDES CULTURES (CEREALES ET OLEO-PROTEAGINEUX) SONT ADOPTEES PAR LE CONSEIL.''

7. SUCRE :
PAS D'ACCEPTATION DES PROPOSITIONS DE LA COMMISSION.
LES DELEGATIONS PROPOSENT L'AMENDEMENT SUIVANT :
'' L'AUTOFINANCEMENT DE L'ORGANISATION COMMUNE DU MARCHE DU SUCRE EST ASSURE PAR UNE AUGMENTATION UNIFORME DES COTISATIONS FRAPPANT LE SUCRE DE QUOTAS A ET B''.

8. VIN :
(B) NON A LA SUPPRESSION DE L'AIDE AU RELOGEMENT ET A LA GARANTIE DE BONNE FIN. L'UTILISATION DE CES INSTRUMENTS DEVRAIT ETRE RESERVEE AUX PRODUCTIONS DE BONNE QUALITE.

040510
MDHIAN 9810

11. LAIT

LA DELEGATION ALLEMANDE ENTEND MAINTENIR LA COMPENSATION A 10 ECUS POUR TOUTE LA PERIODE DE 5 ANS.
DELEGATION FRANCAISE NE SOUHAITE PAS S'ENGAGER SUR CE MONTANT, POUR TOUTE LA PERIODE, ~~NOUS~~ MAIS PROPOS~~ONS~~ES DE FIXER DES MAINTENANT LES MONTANTS A (~~?~~ 10) ECUS POUR LES 2 PREMIERES ANNEES, EN LAISSANT OUVERTE LA QUESTION DU MONTANT POUR LES 3 ANNEES SUIVANTES. LA DELEGATION FRANCAISE SOUHAITE EGALEMENT QUE L'AUGMENTATION DE LA QUANTITE DE REFERENCE A SUSPENDRE NE SOIT PAS DECIDEE AVANT LE PRINTEMPS PROCHAIN (LES 5.5 PERCENT SONT DEJA APPLIQUES EN ALLEMAGNE CONTRE 4 PERCENT EN FRANCE).

UTILISATION DES TERRES.

L'ANNEXE II, PAGE 33, DU DOCUMENT DU 5 DECEMBRE 1987 (SN 39/9 /2/87) COMPORTERAIT LES MODIFICATIONS SUIVANTES

- 3EME PARAGRAPHE, 4E TIRET :
  ''LE MONTANT DE L'AIDE OCTROYEE AU FINANCEMENT SERA ATTRACTIF ET MODULE EN TENANT COMPTE...

- 3EME PARAGRAPHE, 5EME TIRET :
  ... AU MOINS 10 PERCENT POUR CHAQUE EXPLOITATION

- 3EME PARAGRAPHE, 6EME TIRET :
  ... ET LES POSSIBILITES BUDGETAIRES DES ETATS

IL Y A SUR CE TIRET UNE DISCORDANCE ENTRE LES DELEGATIONS SUR LE NIVEAU DE LA PARTICIPATION COMMUNAUTAIRE (25 PERCENT MAXIMUM POUR LES FRANCAIS, 50 PERCENT POUR LES ALLEMANDS...)

PAGE 34, 2 EME ALINEA :
SUPPRESSION DE LA PHRASE QUI EVOQUE LES PRODUCTEURS LES PLUS COMPETITIFS.

HANNAY

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FRAME ECONOMIC ECD (I)

ADDITIONAL 1

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A V. sad development, [illegible] relevant to [illegible] mtg with Balladur.

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TO IMMEDIATE FCO
TELNO 4237
OF 091920Z DECEMBER 87
INFO PRIORITY EUROPEAN COMMUNITY POSTS

FRAME ECONOMIC

FUTURE FINANCING

1. THE DANES HAVE GIVEN US, ON A STRICTLY PRIVATE BASIS, A FRANCO-GERMAN PAPER PROPOSING SUBSTANTIAL CHANGES IN THE TEXT ON STABILISERS (IN PARTICULAR FOR CEREALS. OILSEEDS AND PROTEINS) AND SET-ASIDE. THIS PAPER REACHED THE DANES ON AGRICULTURAL CHANNELS AND THEY DO NOT HAVE IT OFFICIALLY. THE DANES BELIEVE THAT IT WAS AGREED AFTER THE EUROPEAN COUNCIL AND THAT IT IS NOW BEING PEDDLED ROUND SOME MEMBER STATES BY KITTEL AND GAUTIER-SAUVIGNAC.

2. THE TEXT, WHICH SHOULD NOT BE MENTIONED TO OTHER MEMBER STATES, IS IN MIFT.

HANNAY

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FRAME ECONOMIC

ECD (I)

ADDITIONAL 1

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MP

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FM UKREP BRUSSELS
TO DESKBY 101200Z FCO
TELNO 4258
OF 101120Z DECEMBER 87
INFO PRIORITY EUROPEAN COMMUNITY POSTS

FRAME ECONOMIC

UKREP TELNOS 4238 AND 4239 (NOT TO ALL): FUTURE FINANCING

1. THE DANES HAVE TOLD US PRIVATELY THAT, IN ADDITIONAL TO THEIR AGREEMENT ON MAJOR MODIFICATIONS TO THE STABILISERS (IN TURS), THE FRENCH AND GERMANS HAVE ALSO REACHED AGREEMENT ON THE FOLLOWING MODIFICATIONS TO THE REST OF THE PRESIDENCY PACKAGE:

I). AN AGRICULTURAL GUIDELINE FIGURE FOR 1988 OF AT LEAST 30 BECU (INCLUDING OLD STOCKS):

II). AN INCREASE IN STRUCTURAL FUNDS OF NO MORE THAT 40 PER CENT IN REAL TERMS:

III). AN OWN RESOURCES CEILING OF 1.25 PER CENT GNP (WITH THE UK ABATEMENT WITHIN THE CEILING).

WE HAVE NO COLLATERAL FOR THIS INFORMATION, WHICH HAS PRESUMABLY REACHED THE DANES VIA THE COUNCIL SECRETARIAT.

HANNAY

YYYY

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FRAME ECONOMIC ECD (I)

ADDITIONAL 1

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CONFIDENTIAL

JT

FROM: J M G TAYLOR
DATE: 14 December 1987

MR A J C EDWARDS

cc Sir G Littler
Mr Bonney

EC FUTURE FINANCING

The Chancellor has seen UKREP Telnos.4237, 4238 and 4258.

2. He has commented that this is a very bad development. It is highly relevant to his forthcoming bilateral with Balladur.

J M G TAYLOR

RESTRICTED

FROM: A J C EDWARDS
DATE: 16 December 1987

CHANCELLOR

cc: Chief Secretary
Paymaster General
Sir P Middleton
Sir G Littler
Mr Anson
Mr Bonney
Mr Mercer
Mr Mortimer
Mr Tyrie

AGRICULTURE: POSSIBLE FRANCO-GERMAN DEALS

You saw over the weekend the UKREP telegrams, based on leaked material, reporting Franco-German attempts to do a deal on agriculture which would involve (a) expenditure of more than 30 becu in 1988 as against the maximum of 28.2 becu which we have been prepared to contemplate, and (b) emasculating the stabilisers package, particularly on cereals, oilseeds and milk.

2. From two points of view this was, as you have said, a very bad development.

3. First, Franco-German steam roller tactics are always unsavoury. We must clearly do all we can to prevent a repetition of what happened on the agrimonetary system.

4. That said, it is doubtless inevitable that the French and Germans will try to mend the fences after what they both saw as a breakdown of collaboration at Copenhagen. Questioned privately by Sir David Hannay last week the French permanent representative said that he himself was against trying to thrust a Franco-German deal down the throats of other member states but admitted by implication that this was one of the tactics

which would be discussed in Paris. In a separate exchange, Herr Trumpff of the Auswaertiges Amt told Mr Kerr not to pay much attention to rumours of Franco-German deals on agriculture. The contacts had been between agricultural experts: no deal had been struck, because on neither side were the experts empowered to strike one. This is mildly reassuring, but not much more. The ideas discussed between the experts bear more than a passing resemblance to ideas which the French and Germans have put round openly.

5. The second reason for concern relates to substance. Mr Bonney and his team have attempted, at my request, to evaluate the implications of the Franco-German ideas as reported in the telegram, together with those in the Danish Presidency's revised conclusions at Copenhagen. The results of this assessment
... are attached.

6. The main points which emerge are:

(i) The Copenhagen Presidency compromise proposals would probably knock approaching 1 becu off the 3 becu of estimated savings in 1990 and the following years from the pre-Copenhagen package.

(ii) The Franco-German ideas which we are not supposed to have seen could well result in an increase in expenditure, compared with present policies, not savings, because of the proposed increase in the maximum guaranteed quantities for cereals and oilseeds and the limiting of any price reductions to the amounts justified by changes in yield.

(iii) Even the stabilisers package which we and the Commission had in mind before Copenhagen would be unlikely of itself to bring expenditure within the guideline limit which we have so far been prepared to contemplate (27 becu in 1988, with an extra 1.2 becu for disposal of old stocks, and 60 per cent of the GNP growth rate thereafter).

7. As to next action, we cannot directly take the French and Germans to task for trying to hatch up deals which we know about only from leaked information. Neither, I fear, would there be any future in trying to drive a wedge between the French and the Germans: the French would resist and resent any attempt to persuade them to switch alliances.

8. What we can do in the course of the many contacts arranged for early next year, and not least your own projected bilateral with M Balladur, is to make clear to French and German colleagues that we mean business on stabilisers and agricultural budget discipline. The Prime Minister's recent letter to Kohl has already sounded this message. We shall need to sound it again and again between now and the February European Council. The strategy should be to persuade the Germans, and to encourage the French to persuade the Germans, that, while they can have a set-aside scheme (provided that it yields net savings to the budget), there will quite simply be no agreement to raise the own resources ceiling if they persist in trying to emasculate the stabilisers and budget discipline packages.

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Annex

STABILISER PROPOSALS: COMPARISON OF COSTS AND SAVINGS

Overall Position

1. Current forecasts of production of the major commodities suggest that, if there is no change in policy, overall expenditure on the FEOGA Guarantee Section will reach about 31 becu in 1988 compared with the Commission's estimate of "real needs" in 1987 of 27 becu and the guideline limit on the current 1984/85 base of some 23 becu. Past experience suggests that without a significant change in policy agricultural expenditure can be expected to grow by at least 5 per cent per annum in real terms. (i.e. twice as fast in real terms as permitted by the Commission GNP growth factor). It is against that background that the "savings" from the various stabiliser packages should be assessed. They do not represent savings by comparison with the current level of expenditure or even against the Commission's proposal for a rebased financial guideline growing at the rate of growth of GNP.

2. On this basis our current estimate of the savings from the various stabiliser packages under consideration is as follows:

mecu

	1988	1989	1990
UK position (pre Copenhagen)	- 507	- 2067	- 2741
Commission proposals (pre Copenhagen)	- 493	- 2170	- 2973
Presidency proposals (SN 3919/2/87)	- 424	- 1485	- 2074
Franco/German ideas (UKREP telno 4238 on 9 December)	+ 154	+ 204	+ 82

3. On the main commodities the relative costings are as follows:

A. cereals

	1988	1989	1990 (mecu)
Cost of expected production in excess of MGQ on current policies	+ 234	+ 1864	+ 2337
(i) UK position (155 mt MGQ; price cuts only subject to limits -10/15/20%	- 60	- 487	- 605
(ii) Commission proposals pre Copenhagen (155 mt MGQ: mix of price cuts and co-responsibility levy increases; -10/15/15% limits)	- 116	- 1123	- 1418
(iii) Presidency revised proposals at Copenhagen (SN 3919/2/87) (158 mt MGQ: price cuts -6/8/10% limited to yield increase)	- 47	- 378	- 502
(iv) Franco/German ideas (Telno 4238) (160 mt MGQ: price cuts -5/7/9% limited to yield increase)	- 37	- 300	- 422

NB 1. the budgetary savings from co-responsibility levy increases are about 3½ times those for comparable price reductions

2. all options exclude cost of set aside

B. oilseeds

	1988	1989	1990
cost of expected production in excess of MGQ on current policies (MGQ 6.3mt: 10% limit on price cuts)	+ 531	+ 1420	+ 1420
(i) UK/Commission/Presidency position (7 mt MGQ: unlimited price cuts 0.5% per 1% over MGQ)	- 355	- 936	- 936
(ii) Franco/German ideas (8 mt MGQ; automatic price cuts limited to yield increase, other action subject to Council decision: net increases result from higher MGQ and assumed fall from record 1987 yield)	+ 191	+ 504	+ 504

C. wine

(i) UK position pre Copenhagen	- 46	- 128	- 237
(ii) Commission/Presidency proposals	savings imprecise and unquantified		
(iii) Franco/German ideas (continuation of restorage aid and GDBF)	0	0	0

D. milk (compensation for quota suspensions: current policy is 10 ecu/100 kg for 1987 and 1988 only paid one year in arrears)

(i) UK position (6 ecu/100 kg in 1989; 0 thereafter)	-	- 154	- 558
(ii) Commission/Presidency (10 ecu declining to 6 ecu)	-	- 32	- 497
(iii) German position (10 ecu throughout)	0	0	0
(iv) French position (10 ecu in 1988/1989; subsequent years subject to later decision)	0	0	to be decided

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