PO-CH/NL/0212

PART A

Part. A.

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Begins: ~~20/5/88~~ 21/9/87
Ends: ~~21/12/88~~. 22/2/88

PO -CH /NL/0212

PART A

Chancellor's (Lawson) Papers:

AGRICULTURAL REFORM

Disposal Directions: 25 Years

12/9/95.

PO -CH /NL/0212
PART A

CONFIDENTIAL

cc CST
FST
PMG
EST
Sir P Middleto
Mr F E R Butle
Sir T Burns
Sir G Littler
Mr Lavelle
Mr Monck
Mr Burgner
Mr A Edwards
Mr Evans
Mr Spackman
mr Bonney
Mr Culpin
Mr Mortimer
Mr White
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Mr Byatt
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Treasury Chambers. Parliament Street. SW1P 3AG
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FOREIGN SECRETARY

AGRICULTURAL REFORM

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

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

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

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

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

N.L

21 September 1987

PRINCIPLES OF AGRICULTURAL REFORM

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

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

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

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

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

TEN PRINCIPLES

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

ANNEX 1

The Costs of the CAP

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

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

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

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

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

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

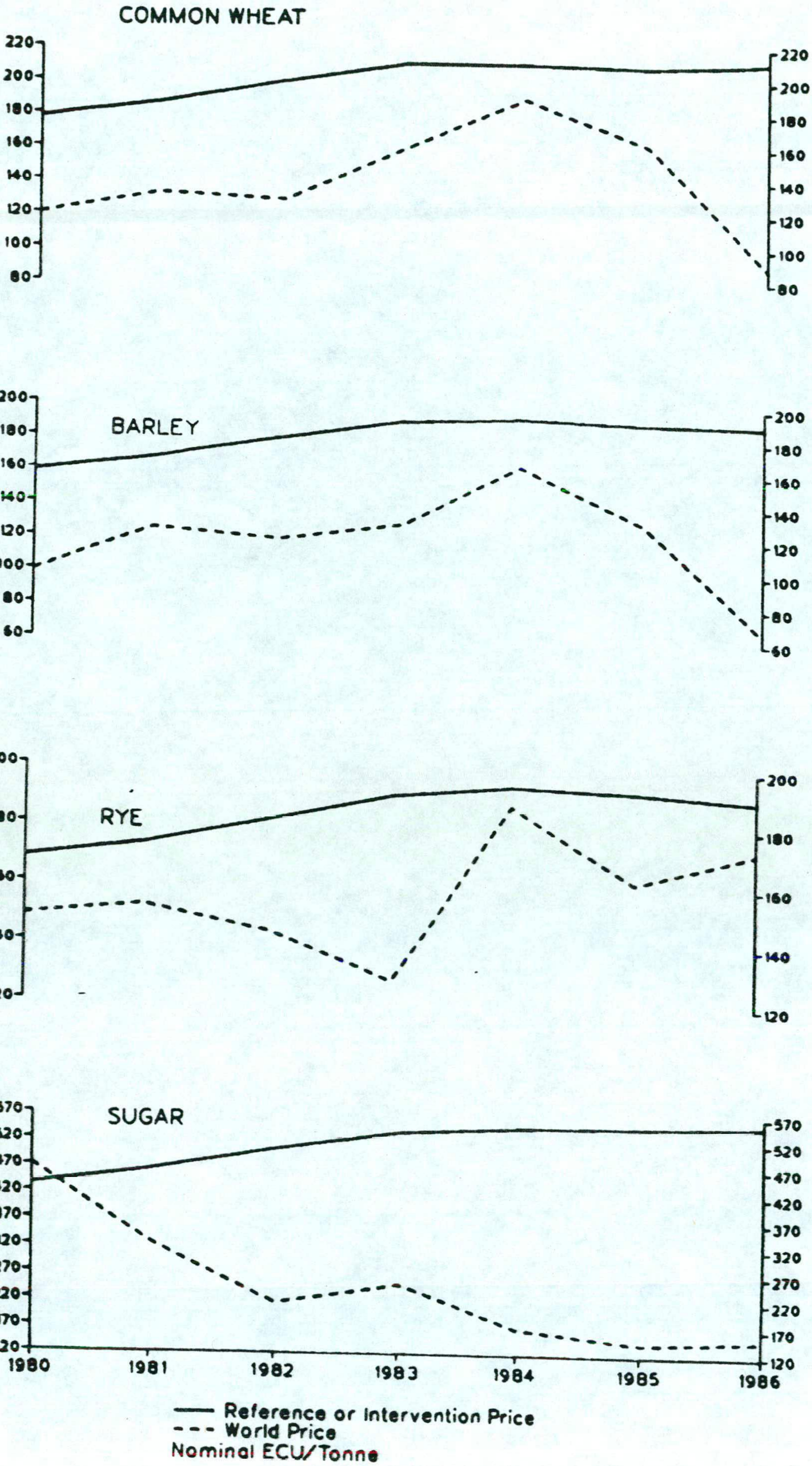
6. The **consumer** also foots the bill through higher food prices. The excess costs (over current world prices) to the consumer were estimated by the OECD to amount to 60% of Community agricultural value-added and 1.8% of Community GDP (some 65 becu or £550 a year for a family of four). The comparison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

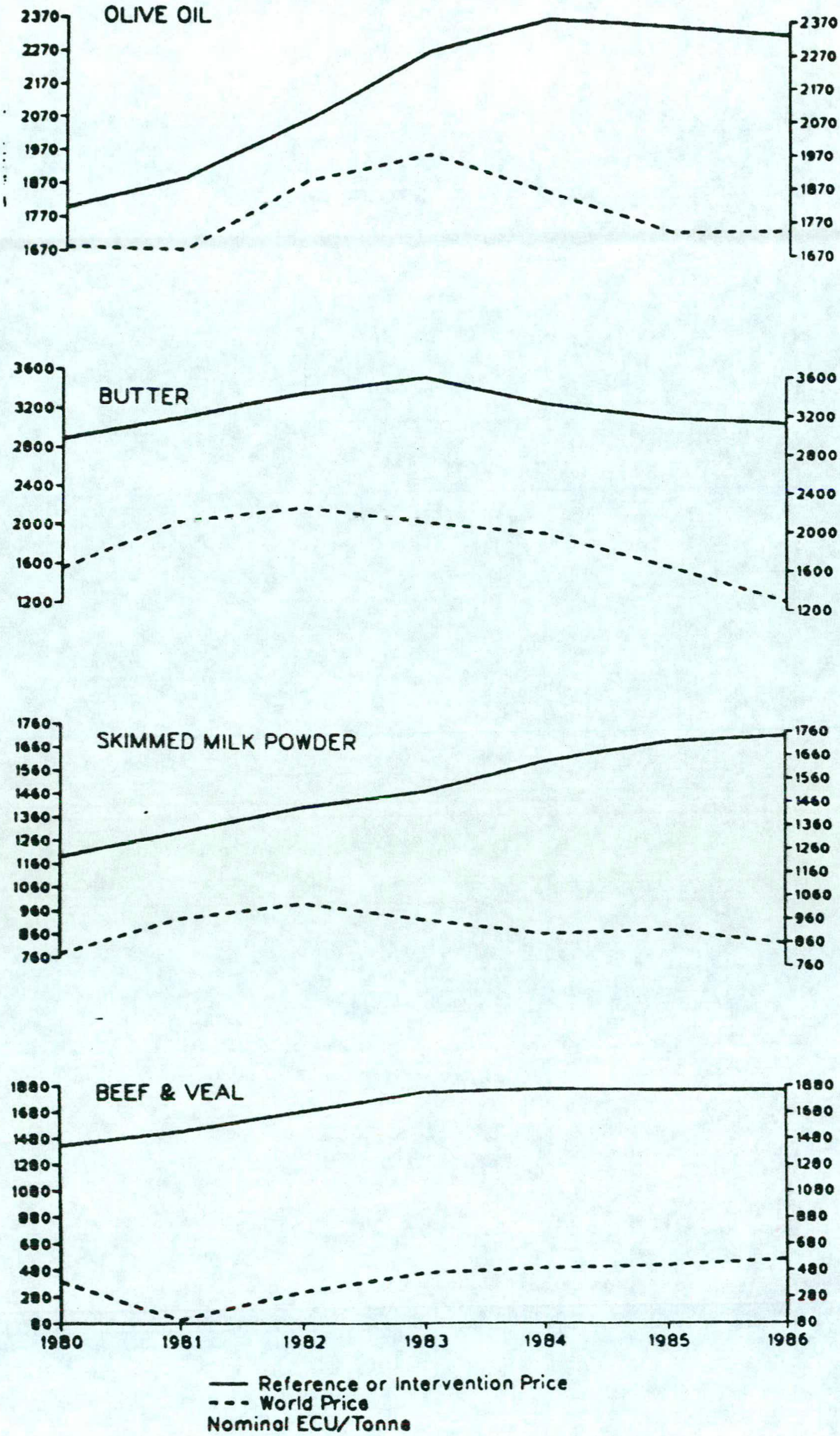
7. On these (somewhat unrealistic) estimates, almost all the income of Community farmers is provided by the taxpayer and the consumer in excess prices.

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

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

COMMUNITY PRICES AND NOTIONAL WORLD PRICES




OLIVE OIL
2370
2270
2170
2070
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1870
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BUTTER
3600
3200
2800
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2000
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1200
SKIMMED MILK POWDER
1760
1660
1560
1460
1360
1260
1160
1060
960
860
760
BEEF & VEAL
1880
1680
1480
1280
1080
880
680
480
280
80
1980
1981
1982
1983
1984
1985
1986
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.

EUROPEAN COMMUNITIES

ECONOMIC POLICY COMMITTEE

The Chairman

Brussels, 8 July 1987

ECONOMIC REFLECTIONS
ON THE COMMUNITY'S AGRICULTURAL POLICY

REPORT TO THE COUNCIL

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

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

*

* *

The current situation and fundamental problems

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

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

Budgetary and macroeconomic aspects

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

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

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

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

Guidelines for reform

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

The adjustment process

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

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

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

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

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

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

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

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

Social and structural policy

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

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

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

a) Factor mobility

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

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

b) Aids of a social nature

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

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

c) Policy on agricultural structures

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

Incorporation of new objectives

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

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

Summary

16. The main considerations are the following:

- It is essential to obtain a better adjustment of supply to demand through measures enabling the market to play a greater role.

- A more strongly market-related pricing policy should be the central pillar of the reform of the CAP. In particular, pricing policy must gradually be detached from the objective of income support; other instruments should be used to ensure proper incomes for those engaged in agriculture. Prices should again be more strongly determined by the aim of balancing supply and demand than they are in the present system. This would help to ensure the better allocation of resources whilst reducing the overall budgetary burden. It can only be brought about by an adjustment process stretching over several years.

- Since the reorientation of agricultural policy requires radical adjustments on the part of farmers, it requires corresponding back-up measures. These could in particular comprise aids for restructuring and conversion as well as social measures, the overall budgetary costs of which should be lower than the savings obtained by the price reductions.

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

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

cc Mr Byatt o.r.
Mr Monck
Mr Bonney
Mr G White
Ms Symes

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

9 November 1987

Mrs S Stagg
Private Secretary to the
Minister of Agriculture, Fisheries and Food

Dear Shirley

AGRICULTURAL REFORM

... I attach our latest version of the 'ten principles' paper. This seeks to take account of the points made by your Minister on the original paper. It has also been discussed with MAFF officials.

The Chancellor would like to put this forward to the Prime Minister as soon as possible. I should be grateful to know that you are content.

Yours sincerely

Jonathan Taylor

J M G TAYLOR
Private Secretary

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.

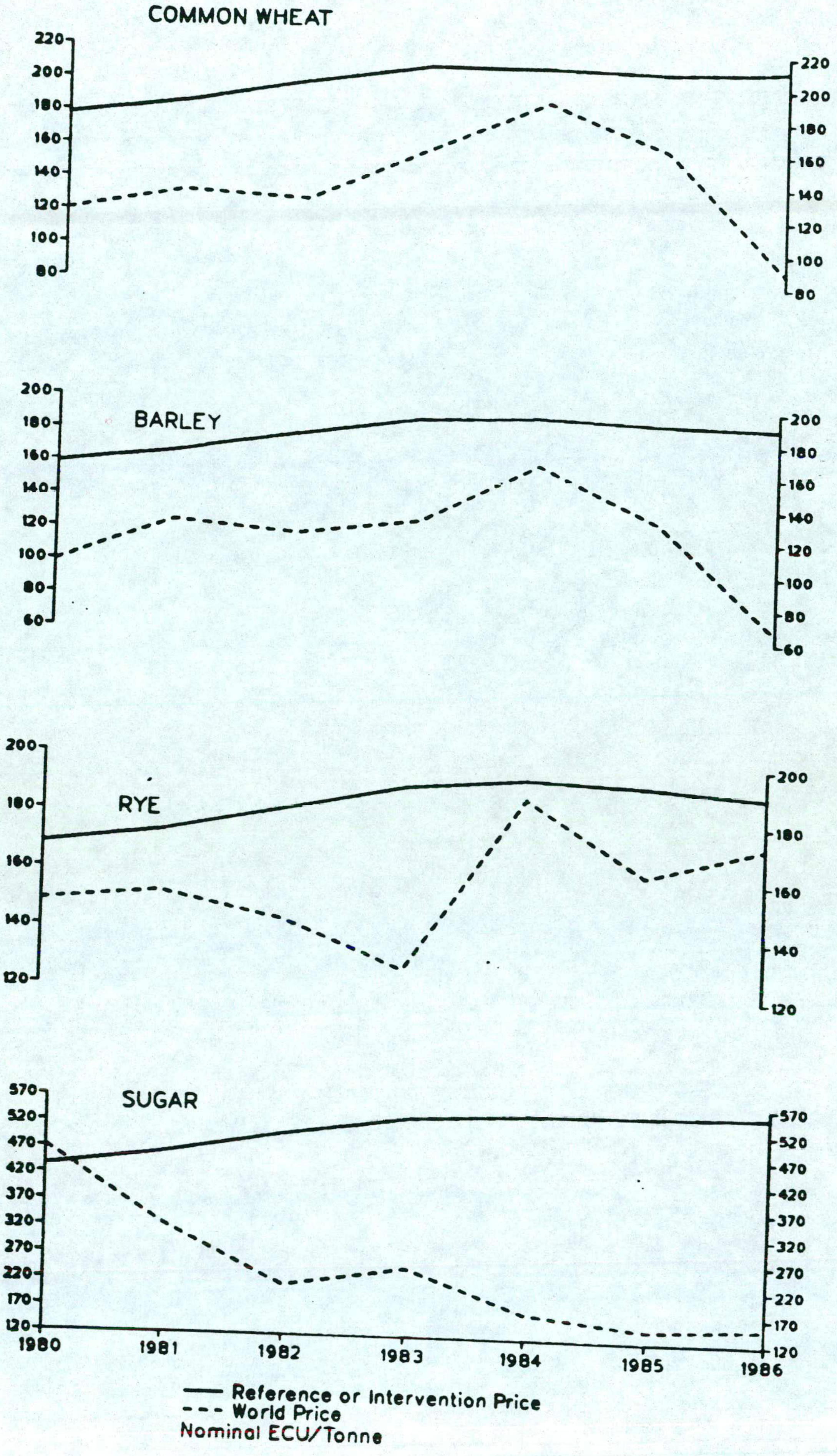
6. The **consumer** also foots the bill through higher food prices. The excess costs (over current world prices) to the consumer were estimated by the OECD to amount to 60% of Community agricultural value-added and 1.8% of Community GDP (some 65 becu or £550 a year for a family of four). The comparison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

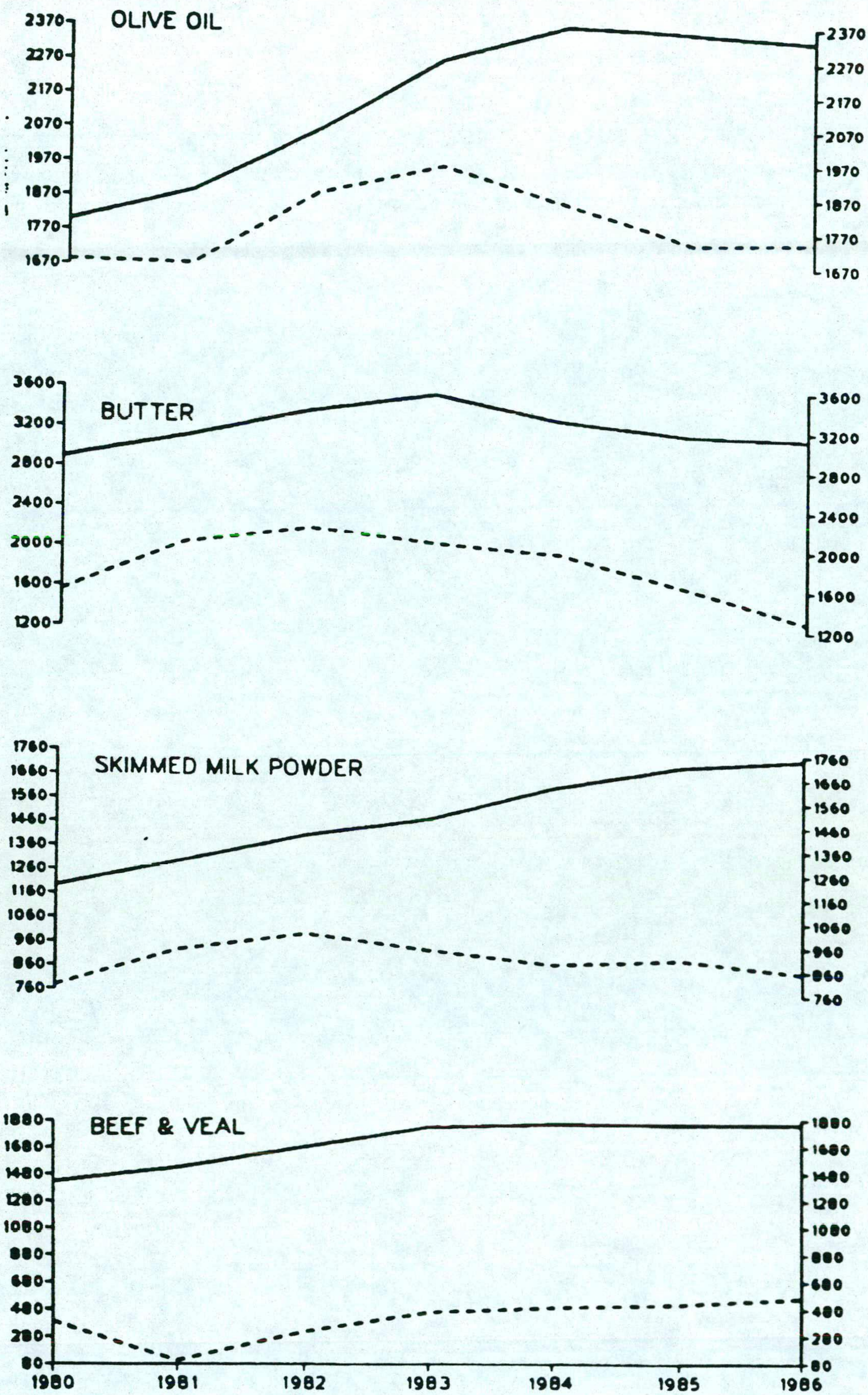
7. On these (somewhat unrealistic) estimates, almost all the income of Community farmers is provided by the taxpayer and the consumer in excess prices.

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

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.

pmp

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

10 November 1987

Dear Tim,

THE COMMON FUND

The Prime Minister held a meeting this morning to consider policy towards the Common Fund, on the basis of the paper circulated under cover of your Secretary of State's letter of 29 September to the Foreign Secretary. There were present the Foreign Secretary, the Chancellor of the Exchequer, your Secretary of State, the Minister for Agriculture, Fisheries and Food, the Attorney General and Mr Lavelle.

The Foreign Secretary said that the conditions required to bring the Common Fund into effect were likely to be met shortly. The situation had changed since the United Kingdom had ratified in 1981 and we now saw no need for the Fund. We had objections in particular to the First Account, whose intended function was to support the international buffer stock operations of international commodity organisations. There were grounds to think that our objections were shared by a good number of developed countries, as well as several developing countries, although they would be reluctant to speak up. The most straightforward course would be for the United Kingdom to de-ratify the Common Fund agreement or give notice of intention to withdraw. However, in both cases there were serious risks that the Commission of the European Communities would institute legal proceedings against us in the European Court. Legal advice was that we would probably lose, in which case we would be back where we started, with the additional risk that the Court's judgement might explicitly extend Community competence to Commodity Agreements. He recommended therefore a less direct approach. As a first step, we should approach selected European Community governments to see whether any of them would contemplate joining us in de-ratification. Assuming as was likely that they refused, we would then seek to enlist their support for steps designed to thwart the operation of the First Account.

The Trade and Industry Secretary supported this approach.

The Attorney General confirmed that, if we were to de-ratify, the Commission would be likely to institute legal proceedings, on the grounds that our membership of the Common Fund was an aspect of the Common Commercial Policy of the European Community. The same would apply in the event of an attempt by the United Kingdom to withdraw. The Court would be likely to say that, because member states had agreed that the Community should participate alongside them, they had accepted a fetter upon their right to withdraw.

The following points were made in discussion:

- it had probably been a mistake to ratify the Common Fund Agreement in 1981. It was unclear to what extent Ministers had appreciated at that time the degree to which all future options for dissociating ourselves from the Common Fund would be constrained by agreement that the European Community should ratify as well as the member states.

- particular concern was expressed about the uncertainty over the precise extent of our financial obligations under the Common Fund.

- the only course fully consistent with the Government's deregulatory approach was to de-ratify or withdraw. That would be our first choice and we might still have to invoke one of these options. But the legal difficulties were a very serious constraint, as was the risk that the outcome of European Court proceedings would be to extend Community competence;

- this suggested that as a first step we should work to ensure that the First Account was still born or indefinitely frozen. There should be ample opportunity to delay implementation and press for substantial changes, provided we could enlist the support of others;

- were this to fail, we would still have the option of withdrawal. If a number of European Community member states were to make clear their intention to withdraw, the Commission would be less likely to institute legal proceedings.

- experience with the Common Fund should reinforce the Government's policy of avoiding further commodity agreements where possible. At the same time, a note should be prepared for the information of Ministers setting out the precise extent of our financial and legal obligations under the International Cocoa and Rubber Agreements.

Summing up the discussion, the Prime Minister said that Ministers were concerned to discover the extent to which our freedom of manoeuvre in relation to the Common Fund was constrained. It would be helpful for them to have a summary of the advice tendered at the time of the decision to join and ratify the Common Fund Agreement to see what lessons it offered for the future. A further and fuller analysis of the legal aspects of withdrawal should also be prepared, as well as the note which had been requested on our obligations under existing Commodity Agreements. At the same time, approaches should be made to selected European Community governments to seek to persuade them to join us in de-ratifying the agreement. This seemed unlikely to succeed, but would prepare the ground for the second stage of seeking their co-operation in working to freeze the Fund's First Account. Much should be made in this approach of the risk of unquantified contingent liabilities under the Agreement, and it should be directed to Finance as well as Trade and Foreign Ministers. The Trade and Industry Secretary should circulate a draft text which, subject to comments, could act as the basis for our representations.

I should be grateful if your Department would co-ordinate the various studies and drafts requested above.

I am copying this letter to Tony Galsworthy (Foreign and Commonwealth Office), Alex Allan (H.M. Treasury), Shirley Stagg (Ministry of Agriculture, Fisheries and Food), Michael Saunders (Law Officers' Department) and Trevor Woolley (Cabinet Office).

Yours sincerely,

Charles Powell

C D POWELL

Timothy Walker, Esq.
Department of Trade and Industry

BF 24/11

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

PS/ Secretary of State for Trade and Industry

RESTRICTED

20 November 1987

C D Powell Esq
Private Secretary to the Prime Minister
10 Downing Street
London SW1

CH/EXCHEQUER
REC. 20 NOV 1987
ACTION MR MORAN
COPIES TO CST FST PMG EST
SIR P MIDDLETON
SIR G. LITTLER
MR H P EVANS
MR MOUNTFIELD
MR PGF DAVIS MR WALSH
MS SYMES MISS PRESTON
MR TURIE

Dear Charles,

THE COMMON FUND

In your letter of 10 November, recording the meeting on the Common Fund, one of the points for action was that my Secretary of State should circulate a draft of a letter to selected Community governments, seeking to persuade them to join us in de-ratifying the Agreement.

I enclose a text which has been prepared in conjunction with officials of all those departments whose Ministers attended the discussion. I am also enclosing the list of EC Ministers whom we recommend should be approached.

There is to be a meeting of officials in Brussels on 26 November to discuss the Community's position on the Common Fund. It would be helpful if the proposed letter could be sent early next week, so that the governments concerned were aware of our views.

The other action requested is in hand and I will forward the results as soon as possible.

I am copying this letter and enclosures to Tony Galsworthy (FCO), Alex Allan (HM Treasury), Shirley Stagg (MAFF), Michael Saunders (Law Officers' Department) and Trevor Woolley (Cabinet Office).

Yours sincerely

Stephen Ratcliffe

STEPHEN RATCLIFFE
Private Secretary

JG4BMF

DRAFT LETTER TO SELECTED EUROPEAN MINISTERS ON THE COMMON FUND

1. The announcement at UNCTAD VII by the USSR and certain other countries of their intention to ratify the Common Fund Agreement has brought closer the prospect that it will now come into force. Yet a number of countries, including some developing ones and even the UNCTAD Secretariat, have privately expressed scepticism about the continued relevance of the Fund, at least in its present form. Community colleagues at the Conference also indicated that they shared the view advanced by the British delegation that in the current circumstances the Fund does not make economic sense. The British statement in the closing Plenary Session suggested that, before steps were taken to bring the Common Fund into operation, all aspects of it should be examined very carefully. I am writing to you and some other colleagues now to seek your views on how we in the Community should respond to the new situation.

2. I think you are already familiar with the British position. Negotiations on the Fund began some ten years ago when attitudes towards market intervention commodity agreements were different and it was thought that a significant number of these agreements operating through the mechanism of buffer stocks could be negotiated. In the light of the performance of such agreements over the past decade, and in particular of our shared experience of the Tin Agreement, we are all more aware of the risks and the market distortions that are likely to result from their operation. Moreover, my Government no longer accepts the earlier view that the best way to help commodity-dependent countries is

to intervene in the operation of commodity markets. Rather, such countries need efficient markets, help in producing and marketing their commodities and, in many cases, assistance in diversifying out of over-reliance on one or two products, thus broadening the base of their economies. These considerations prompt the question whether the Common Fund, and the First Account in particular, still has any relevance.

3. There are other problems which would have to be faced if the Fund came into operation. First, although the Fund Agreement gives members considerable protection from contingent financial liabilities beyond the liability to pay the callable element of directly contributed capital, it does not safeguard members against the possibility of litigation by third parties for liabilities incurred by the Fund. Secondly, the Fund may come into operation and not be used - although even then its existence and the build-up of financial reserves could lead to undesirable continuing pressure for new agreements with buffer stocks. Only the Cocoa and Rubber Agreements have operational buffer stocks and are eligible therefore for association with the Fund, but to date neither of the relevant organisations has shown any specific interest in so doing. In that event a sizeable amount of capital will be tied up for the sole purpose of meeting the administrative and headquarters costs of the Fund. This would serve no-one's interests.

4. I do not see any realistic possibility of amending the Fund Agreement itself to remove these problems. Fundamental change would require a 75% majority and is unlikely to be achievable.

We could perhaps aim for an informal agreement severely restricting the way in which the First Account might be used, while looking closely at the basic conditions for borrowing and disbursement of money, and the drafting of financial control regulations. However, this would not provide a fully secure solution.

5. Against this background, the best way forward would, in our view, be for those countries that no longer feel that the Common Fund is likely to serve any real purpose to withdraw their instruments of ratification of the Agreement before the Fund comes into force. We would need to explain to the developing countries why we were taking this action, and pledge our continued support for their development in other ways. I suggest that we would wish to maintain in some form the voluntary pledges made to the Second Account which is of potential value to many commodity producing countries, as was implicitly recognised by the Council in the Community mandate for UNCTAD VII.

6. It seems to us that the arguments for deratification of the Fund Agreement are strong. It would also give a general signal that price intervention agreements are no longer considered desirable.

7. I would very much welcome your observations and would like to know your present attitude towards the Common Fund, in particular your view of deratification. In view of the wider aspects of the problem, I am sending copies of this letter to your colleagues in Ministries of Finance and External Affairs.

EUROPEAN MINISTERS

BELGIUM	M Herman de Croo*	Minister for External Trade
	M Guy Verhofstadt	Dep. Prime Minister & Minister of the Budget
	M Leo Tindemans	Minister for External Relations
	(Cabinet will continue until Dec.13 election)	
DENMARK	Mr Nils Wilhjelm*	Minister of Industry
	Mr Palle Simonsen	Minister of Finance
	Mr Uffe Elleman-Jensen	Minister of Foreign Affairs
FRANCE	S Alain Madelin*	Minister of Industry
	S Edouard Balladur	Minister of Economy, Finance and Privatisation
	S Jean-Bernard Raimond	Minister of Foreign Affairs
FRG	Dr Martin Bangemann*	Federal Minister of Economics
	Dr Gerhard Stoltenberg	Federal Minister of Finance
	Herr Hans-Dietrich Genscher	Federal Minister of Foreign Affairs
ITALY	On A Battaglia *	Minister for Industry
	On R Ruggiero	Minister for Foreign Trade
	On Giuliano Amato	Minister for the Treasury
	On Giulio Andreotti	Minister for Foreign Affairs
NETHERLANDS	Drs Rudolph de Korte*	Deputy Prime Minister & Minister for Economic Affairs
	Dr H O C R Ruding	Minister for Finance
	Mr H van den Broek	Minister for Foreign Affairs
PORTUGAL	Mr Luis de Mira Amaral*	Minister for Industry & Energy
	Mr Joaquim Martins Ferreira do Amaral	Minister for Trade & Tourism
	Dr Miguel Cadilhe	Minister for Finance
	Prof Joao de Deus Pinheiro	Minister for Foreign Affairs

*Principal addressee

BF 24/11

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

21 November 1987

Dear Stephen,

THE COMMON FUND

Thank you for your letter of 20 November enclosing a draft letter to selected Community governments, seeking to persuade them to join us in de-ratifying the Common Fund Agreement. Subject to the views of colleagues, the Prime Minister is content with the draft.

I am copying this letter to Tony Galsworthy (Foreign and Commonwealth Office), Alex Allan (H M Treasury), Shirley Stagg (Ministry of Agriculture, Fisheries and Food), Michael Saunders (Law Officers' Department) and Trevor Woolley (Cabinet Office).

Yours sincerely,

Charles Powell

C. D. POWELL

CH/EXCH ✓23/11

REC. 23 NOV 1987

MR MOLAN
PS/CST PS/FST PS/PMG PS/EST
SIR P. MIDDLETON
SIR G. LITTLER
MR HP EVANS
MR MOUNTFIELD
MR PGF DAVIS
MR WALSH
MS SYMES MISS PRESTON
MR TYRIE

Stephen Ratcliffe, Esq.,
Department of Trade and Industry

12/028

RESTRICTED

FROM: R MOLAN

DATE: 23 November 1987

PS/CHANCELLOR

cc PS/CST
PS/FST
PS/PMG
PS/EST
Sir Peter Middleton
Sir Geoffrey Littler
Mr H Evans
Mr Mountfield
Mr P G F Davis
Mr Walsh
Ms Symes
Miss Preston
Mr Tyrie

Ch/ Content for me to let Lord Young's office, (+ No 10) know we are content?
23/11

OK

THE COMMON FUND

The letter of 20 November from Lord Young's Private Secretary to Charles Powell at No 10 attaches for approval a draft letter for Lord Young to send to selected EC governments inviting them to join us in deratifying the Common Fund Agreement. It was agreed at the Prime Minister's meeting held on 10 November that EC governments should be lobbied in this manner.

2. The draft, which has been agreed inter-departmentally at official level, makes all the right points. It reminds others of the lessons of the tin crisis, highlights the considerable drawbacks of the Fund (particularly those arising from the First Account) and sets out a strong case for deratification. Copies of the letter will go to the Governments in seven member states (only Eire, Greece, Spain and the Netherlands are excluded) and within the countries approached copies will go the Trade, External Affairs and Finance Ministers. This is a satisfactory coverage.

3. DTI would like to get the letter out early this week as a meeting of officials is being held in Brussels on Thursday to discuss the Community position. A telephone call to Lord Young's private office advising that the Treasury is content should be sufficient.

R MOLAN

CONFIDENTIAL BF 25/11

Ministry of Agriculture, Fisheries and Food
Whitehall Place London SW1A 2HH

From the Minister's Private Office

J M G Taylor Esq
Private Secretary to the Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1P 3AG

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

23 November 1987

Dear Jonathan,

AGRICULTURAL REFORM

Thank you for your letter of 9 November enclosing a redraft of the "ten principles" paper. My Minister has seen this and is content with it subject to the following points:

1. Principle (iv): Mr MacGregor feels that the following words should be added at the end: "though its contribution to the preservation and the enhancement of the environment also needs to be taken into account".

2. Principle (vii): He would like to see the following minor change in the last sentance: "If income aids are to be considered, they must be degressive, time-limited, decoupled from production, related to ....".

3. Principle (viii): We cannot think of any sort of insurance, other than through futures markets, which would be inhibited by support mechanisms and therefore suggest deleting "insurance and".

4. Annex 1, paragraph 1: It is difficult to know what is meant by the statement that "most farmers in the Community operate uneconomically". We suggest that the 4th, 5th and 6th sentences should be replaced by:

"It also increases the prices of agricultural inputs, land prices and rents. As a result many small producers find their income squeezed. This increases ....".

In his minute of 29 September to the Chancellor Mr MacGregor emphasised that, in using the material in the note publicly, particularly in the EC context, we would need to suit the presentation to the audience. He attaches importance to this point and hopes it is accepted.

CONFIDENTIAL

/On a point of ....

CONFIDENTIAL

On a point of detail, any reference to the estimate that the CAP may have resulted in the loss of one million Community jobs should be tentative. As with all such estimates, the results are highly dependent upon the precise assumptions underlying them.

/ I am copying this letter to the Private Secretaries to the Prime Minister, Secretaries of State for the Environment, Employment, Trade and Industry and Secretary to the Cabinet.

Yours sincerely,

Debbie Harris

pp MRS S STAGG
Private Secretary

CONFIDENTIAL

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 futures markets should not be so inhibited by support mechanisms. Agriculture can contribute to the preservation and enhancement of the environment. Agricultural policies should be consistent with the objectives and principles of environmental protection.

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

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

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, land prices and rents. While most agricultural output is produced at a profit, many small producers in the Community find their agricultural incomes squeezed. 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.

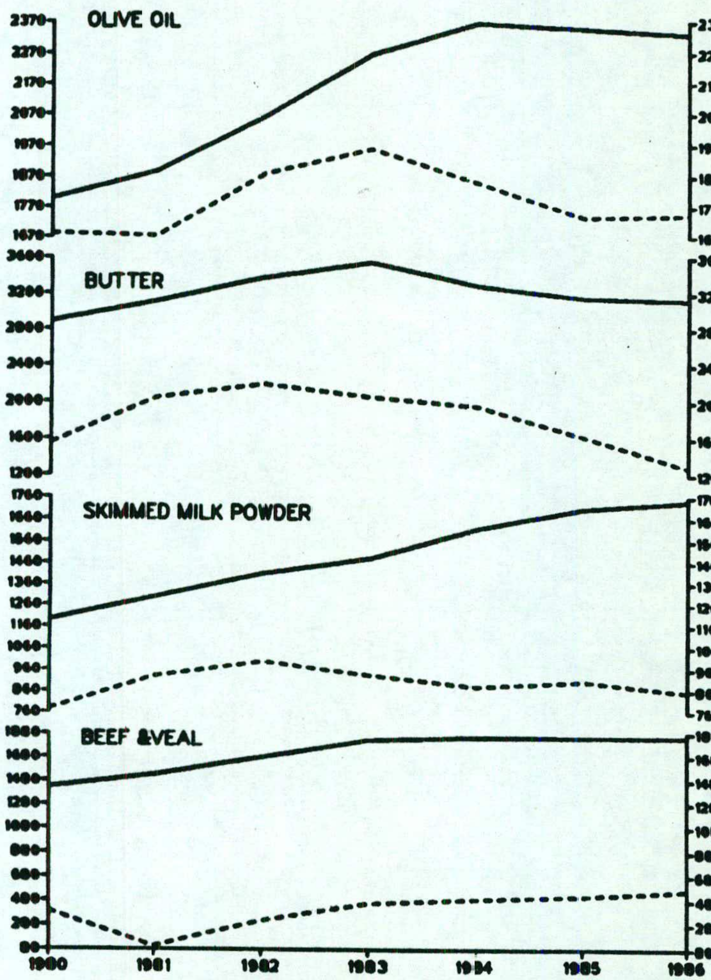
6. The **consumer** also foots the bill through higher food prices. The excess costs (over current world prices) to the consumer were estimated by the OECD to amount to 60% of Community agricultural value-added and 1.8% of Community GDP (some 65 becu or £550 a year for a family of four). The comparison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

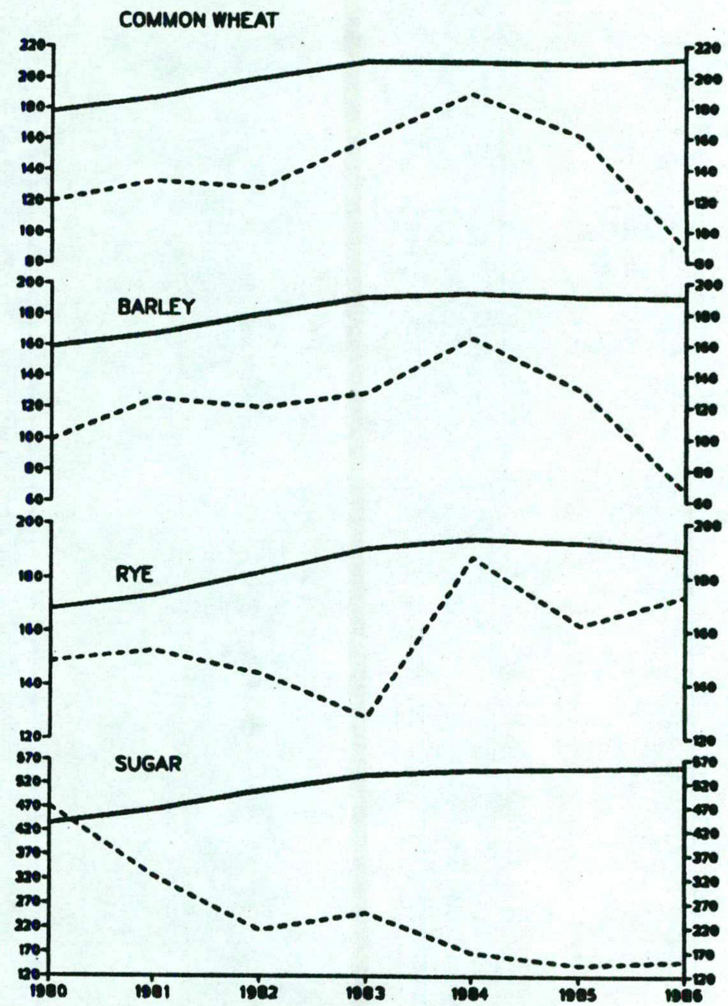
8. This involves a loss to the real economy in terms of consumers' **standards of living**, **output** and **jobs**. There are various ways in which this comes about (see Note 1). A policy which sustains resources producing almost zero value-added must mean that alternative more economic activity is 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 WORLD PRICES



REFERENCE OR INTERVENTION PRICE
WORLD PRICE
NOMINAL ECU/TONNE



REFERENCE OR INTERVENTION PRICE
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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.

4-25.11

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

Ch/ Content with draft? (a few amendments) 26/11

OK.

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)

Amendment telephoned through by MrB.

3. We think that the way is now open for you to send the principles to the Prime Minister. We have had requests from No 10 about progress. I enclose a draft minute and the new version of the principles.

4. The Minister of Agriculture has also written to the Foreign Secretary concerning income aids and set aside. The burden of his argument is that the approach via set asides is more likely to be successful than that via income aids. I do not think you need enter into this argument at the moment. For us I think the key point is that either income aids or set aside must be clearly linked with price reduction - and this is already in the draft minute we have prepared for you to send to the Prime Minister. Mr MacGregor agrees that set aside should be linked with price reduction but we will have to be careful to ensure that this takes place. If set aside is linked with the use of in-year stabilisers there are circumstances in which set aside could grow without a permanent reduction in prices. Therefore we think it is necessary to monitor the situation as well as to link set aside closely with progressive reduction in prices.

5. I think it quite likely that the Foreign Secretary in any reply he makes to the Minister for Agriculture will stress the need to link set aside with price reductions. And as you said in your minute of 16 October to the Foreign Secretary it is always necessary to see shorter term measures in the context of a clear commitment to reducing prices. So I suggest you should wait to see what response the Minister for Agriculture gets from the Foreign Secretary.

IB

I C R BYATT

1-3.11

Pse type final for Ch. sig.

DRAFT MINUTE for Chancellor to send to the Prime Minister

I am grateful to colleagues for their comments on the ten principles of agricultural 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, as the Minister of Agricultu~~e~~re rightly emphasises, 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 and 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 feel bound to 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.

and

[NL]

MR 2/21

CONFIDENTIAL

cc: CST
FST
PMG
EST
Sir P Middleton
Mr Anson
Sir T Burns
Sir G Littler
Mr Monck
Mr Burgner
Mr A Edwards
Mr Byatt
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

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

PRIME MINISTER

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

N.L.

N.L.
30 November 1987

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

PS/

Secretary of State for Trade and Industry

RESTRICTED

9 December 1987

C D Powell Esq
10 Downing Street
London SW1A 2AA

CH/EXCHEQUER
REC. 10 DEC 1987
ACTION MR R. MOLAN
COPIES TO PS/CST, PS/FST PS/PMG PS/EST
SIR P. MIDDLETON
SIR G. LITTLER
MR H P EVANS
MR MOUNTFIELD
MR PGF DAVIS
MR WALSH MS SYMES
MISS PRESTON MR TYRIE

Dear Charles,

THE COMMON FUND

Following my letter of 20 November, I am now able to let you have the results of the other work which was commissioned at the earlier meeting of Ministers on the Common Fund.

I enclose a note setting out the main steps leading to the signature and ratification of the Common Fund Agreement, indicating the main issues which arose at each stage. As you will see, signature was a relatively formal step taken after some 4 years of detailed negotiation. By then, the UK was effectively committed to the Agreement, having participated fully in the special conferences and committees called to settle the terms under which the Fund would be created.

The context in which the final decisions were taken is important. The opportunity which the government had, on taking office in May 1979, to review the position and come to conclusions was even by then severely constrained. Most of the basic principles of the Fund had already been settled at a special negotiating conference. Furthermore, the change of government and the opening of UNCTAD V virtually coincided, putting pressure upon everyone for urgent decisions both on the continuation of the UK's commitment to the Fund in general and on the specific issue of making a voluntary pledge to the Second Account.

But timing apart, the decision to honour the previous commitment is understandable in the circumstances of the time. First, every other developed country, including the United States, had declared

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their support for the Fund. Secondly, although market intervention commodity agreements were viewed with suspicion because of their wider economic effects, no serious problems had been encountered in their operation. The tin buffer stock, for example, had been eliminated in 1976/77 and during the subsequent period, up to 1981, the market price for tin was consistently above the agreed intervention level. Had we then known what we have subsequently learnt from the painful experience of the tin crisis, in particular about the possibility of claims for contingent liabilities arising from alleged injuries to third parties, no doubt our decision and possibly that of other signatories would have been different. But that is with the advantage of hindsight. Even so, a number of problems and risks were foreseen and it is for that reason that the First Account is hedged about with substantial safeguards.

Community competence was a matter which gave rise to concern in connection with the future management of the Fund, rather than in relation to the possibility of unilateral deratification or withdrawal outside a common agreed EC position. However by the point at which it was proposed that the Community should sign the Common Fund Agreement, the European Court had already held that the Community had a measure of competence in relation to commodity agreements. That was clearly a factor which could not be ignored. But it would have been difficult, if not impossible, for the UK to have blocked Community participation at that time, the more so because by 1980 all member states had themselves signed and had effectively been acting as a group for some while. Nevertheless, the formula adopted, "participation alongside the member states" was seen as helpful to the extent that it could be used to defend the freedom of the UK and others to express separate views and to exercise their voting rights if the Fund came into operation.

I am also enclosing a note on the legal aspects of withdrawal from the Common Fund Agreement prepared by legal advisers in interested Departments. This sets out in more detail, and confirms, the considerations which led to the view expressed in my Secretary of State's letter to Sir Geoffrey Howe of 29 September that, if the Commission were to challenge a UK withdrawal in the European Court of Justice, then the Court would be likely to rule in their favour. The note also considers the wider aspects of such proceedings.

Also attached are notes on our financial and legal obligations under the Cocoa and Natural Rubber Agreements. It will be seen

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that these are now much more circumscribed as a result of the changes which we were able to obtain in the renegotiation of both agreements earlier this year.

I am copying this letter and enclosures to Tony Galsworthy (FCO), Alex Allen (HM Treasury), Shirley Stagg (MAFF), Michael Saunders (Law Officers Department) and Trevor Woolley (Cabinet Office).

Yours ever

Stephen Ratcliffe

STEPHEN RATCLIFFE
Private Secretary

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THE COMMON FUND : STEPS LEADING TO SIGNATURE AND RATFICATION

The Common Fund was conceived as the central element in the Integrated Programme for Commodities (IPC), a comprehensive framework for commodities, launched at UNCTAD IV in 1976.

2 After prolonged argument, during which the US position changed from opposition to the Fund to support, agreement on the basic terms was reached on 20 March 1979 at the third session of a UN Negotiating Conference. The Conference was specifically intended to settle the issue in advance of UNCTAD V. The settlement included provision for compulsory contributions to a First Account of $400m. to support the financing of international buffer stocks and a voluntary Second Account to fund commodity development measures. The Conference established an Interim Committee open to all States Members of UNCTAD to draft the Articles of Agreement. The final Act was signed by the US, the nine member states of the EC and all other developed Group B countries.

The UK attitude

3 The change of government, following the election in May 1979, effectively coincided with the opening of UNCTAD V. The steering brief for the UK delegation was immediately put to incoming Ministers for approval. They were also advised of the results of the earlier negotiations on the Fund, of the likely size of the UK contribution to the First Account and of the need for an urgent decision on a contribution to the Second Account, to be announced at the Conference.

4 After discussion with officials, the Secretary of State for Trade said in a letter to the Foreign Secretary that he considered that the Common Fund was "quite erroneous in its conception" and would "fail in a wave of recriminations after a number of years", but that he accepted that it was a commitment which the Government should keep. He concluded that refraining from making a contribution to the Second Window would be politically unacceptable. The Chancellor of the Exchequer and the Secretary of State for Industry shared his scepticism but accepted that that the Government had to uphold the decision of its predecessor to contribute to the First Account and that there was no choice but to pledge a contribution to the Second. The Prime Minister and other Ministers endorsed the recommendations, with a reservation that no indication should be given of the size of the UK's contribution to the Second Account before the conclusion of an expenditure review.

Community involvement

5 Community involvement in the Common Fund was an issue raised in connection with the Interim Committee discussions which followed UNCTAD V. A material factor was considered to be the judgement by the European Court in October 1979, in relation to the International Rubber Agreement that such an agreement fell within the Common Commercial Policy and therefore necessarily involved a degree of Community competence. In a review of UK policy on International Commodity Agreements, in January 1980, Ministers were advised that British participation in a commodity agreement could no longer be considered in isolation from the participation of the Community as a

whole and that "in practice Community participation in any agreement with economic provisions will commit the United Kingdom".

6 Although the Common Fund was not itself the subject of the review, it was recognised that the establishment of Community competence in the rubber case had clear implications for the Fund. The Minister for Trade was advised that it was likely that the Community had acquired a measure of competence in relation to the Fund, which meant that the Community as such could become a member in addition to the member states. In Ministerial correspondence initiated by the Minister for Trade in April 1980, Ministers accepted that the Community could join but agreed that its rights and obligations as a member should be limited in ways which would discourage attempts by the Commission to extend competence. In particular, it was agreed that the Community should not be permitted to hold voting rights or to make contributions to either Account of the Fund. The essential concern was that member states should be able to continue to express their own views in Group B and in all matters relating to the Fund.

The Final Conference

7 The Minister for Trade headed the delegation to the Special Common Fund Conference held in June 1980 to settle the "Articles of Agreement". The main outstanding issues were the timing of contributions, the distribution of votes and a special clause to allow the US to join the Fund but to defer its payments until Congressional approval had been given. He reported the outcome in a letter of 1 July 1980 to the Lord Privy Seal. He said that what had emerged was relatively inexpensive financially and confirmed that decisions on the creation and operation of commodity agreements would continue to be taken by interested consuming and producing countries and not by the Fund administration alone.

Signature

8 Agreement on the text of the Treaty [illegible] announced in Parliament on 2 July 1980. The UK signed the Agreement on 16 December 1980, following signature by the US and a number of other EC member states.

9 The Community signed the Agreement on 21 October 1981, reflecting a Council decision that the Community should participate alongside the member states.

Ratification

10 Following the making of an Immunities and Privileges order under the International Organisations Act, which was approved by both Houses in December 1981, the Agreement was ratified by the UK.

EEP Division
Department of Trade and Industry
November 1987

LEGAL ASPECTS OF WITHDRAWAL FROM THE COMMON FUND

1. The purpose of this note is to set out, in more detail, the legal arguments and considerations relating to the possible withdrawal (which term here covers both deratification and withdrawal under Article 30 of the Common Fund Agreement) by the United Kingdom from the Common Fund. It expands upon Annex II to the Secretary of State for Trade and Industry's letter of 29 September and takes account of the legal advice in the Note on Community Competence included in the Review of Commodity Policy prepared last year. It is the firm opinion of UKREP that, should the UK withdraw, the Commission would take proceedings against the UK in the European Court of Justice. This note is structured to reflect how the arguments might be presented, and the Court may react, in those proceedings.

Background

2. The salient features of the Common Fund Agreement for the purposes of this note are these:

OBJECTIVES. The objectives of the Fund are:

(a) to serve as a key instrument in attaining the agreed objectives of the Integrated Programme for Commodities;

(b) to facilitate the conclusion and functioning of international commodity agreements, particularly concerning commodities of special interest to developing countries (Article 2).

FUNCTIONS. The functions of the Fund are:

(a) to contribute, through its First Account, to the financing of international buffer stocks and internationally co-ordinated national stocks, all within the framework of international commodity agreements;

(b) to finance, through its Second Account, commodity measures other than stocking;

(c) to promote co-ordination and consultation through its Second Account with regard to commodity measures other than stocking, and their financing, "with a view to providing a commodity focus" (whatever that may mean) (Article 3).

MEMBERSHIP. Membership is expressly open to intergovernmental organisations such as the EEC, but they "shall not be required to undertake any financial obligations to the Fund; nor shall they hold any vote" (Article 4 - inserted at the request of the EEC).

In addition to the shares in the Fund subscribed by the states parties to it on a compulsory footing, provision is made for voluntary contributions, both from states parties and intergovernmental organisations such as the EEC (Article 13).

MANAGEMENT. The Fund is managed by an executive board, reporting to the Governing Council in which all the powers of the Fund are vested (Article 20 and following). Voting on the Governing Council is confined to the states parties.

WITHDRAWAL. Members may withdraw on not less than twelve months' written notice (Article 30).

RATIFICATION. Ratification is possible up to eighteen months after entry into force of the Agreement, but not thereafter (Article 54).

ACCESSION. After the entry into force of the Agreement, states may accede to it not as of right, but only "upon such terms and conditions as are agreed between the Governing Council and [the relevant state]" (Article 56).

Withdrawal

3. The legal issues to be considered arise out of the relationship between the Common Fund and the Common Commercial Policy of the Community, exclusive competence for which is vested in the Community by Article 113 of the EEC Treaty; the obligations, if any, devolving on the Member States following the adoption of the 1981 decision that the Community should participate alongside Member States; and the extent to which the very general obligations prescribed by Article 5 of the EEC Treaty can be made to bite on membership of the Common Fund. The text of Articles 5 and 113 is attached.

4. The relevant jurisprudence of the Court is contained in Opinion 1/78, Rubber Agreement and Opinion 1/75, OECD Costs. The Court has held that commodity agreements are instruments of commercial policy within Article 113; a highly developed commercial policy cannot be restricted to measures of trade

liberalisation but must extend to measures, whatever their form, aimed at regulation of the world market, including the mechanism of buffer stocks. To the extent that the objectives of the relevant agreement as a whole fall within the concept of the Common Commercial Policy the Community will be exclusively competent. To the extent that the Member States are responsible for financial contributions, they may also be competent and can participate in the agreement together with the Community. But the mere fact that financial obligations are imposed on the Member States does not by itself imply their competence; the nature of the obligations and their place in the structure and objectives of the agreement have to be determined in each case.

5. The danger, as identified in the previous papers on this subject, is that the Community, through the agency of the EC Commission, would challenge the UK's withdrawal from the Common Fund Agreement by way of an application before the ECJ under Article 169 of the EC Treaty for failure to fulfil its obligations under the Treaty. Before commencing proceedings the Commission would give the UK the opportunity to submit its observations; if not satisfied with the response, the Commission would deliver a reasoned opinion setting a time limit for compliance by the UK with the conclusions of the opinion; failing compliance, proceedings would be launched. Since it could take between eighteen months and two years to bring the proceedings to a conclusion, the Commission might apply for interim measures to prevent the UK from withdrawing pending the final decision of the Court, in an attempt to obviate any need for the UK to <u>negotiate</u> the terms of its accession to the Agreement under Article 56,

following an adverse judgment delivered more than eighteen months after the entry in force of the Agreement.

The Commission's Case

6. The Commission can be expected to argue that participation by the Community in the Common Fund Agreement is part of the Community's Common Commercial Policy. The Court has held in its Opinion on the Rubber Agreement that the Common Commercial Policy includes participation by the Community in commodity agreements (with regulatory provisions including buffer stocks): the Common Commercial Policy is not limited to measures which control trade, such as customs tariffs and restrictions.

7. The Commission's likely line of argument can be seen from the position it has taken in the past. It has argued that the Community had to participate in the Common Fund under Article 113, because the Fund, having regard to its obligations and functions, would constitute a specific financial and co-ordinating instrument concerned with the regulation of international trade in commodities (stock financing via its First Account, financing of certain other measures via its Second Account). The Fund would support the commodity agreements of which by virtue of its Common Commercial Policy and in certain cases also of its Common Agricultural Policy the Community is or might become a member.

8. During the negotiations on the Agreement the Commission maintained that although the Fund was a purely financial institution, it was also indisputable that the dividing line

between what was and what was not a matter of commercial policy could not depend solely on the financial nature of the instrument in question. The Common Fund and the commodity agreements were complementary parts of a single structure (the Integrated Programme on Commodities), the essential purpose of which was to regulate commodity markets. The Commission also contended that since the respective powers of decision under the commodity agreements and the Fund were distinct, this was further justification for accepting, in order to make it practically effective at the operational level, the need for Community participation in the Fund.

9. The absence of financial contributions by the Community as such to the Common Fund is not a bar to Community competence, as the Court's Opinion on the Rubber Agreement indicates. Where a commodity agreement has been funded solely by Member States, the Court has held that Member States retain a degree of competence and are entitled to participate together with the Community. The Commission would argue that in the case of the Common Fund the Member States could not participate in the Agreement without the Community and vice versa. The Community has no votes under the Agreement, but the Member States do. Therefore Community action in relation to the Common Fund has to be on the basis of a common position. That position will only be effective, or its effectiveness maximised, if all the Member States are parties, so that their aggregate voting power can be marshalled in support of the Community position. The Commission would say that as part of the Common Commercial Policy the Community can therefore <u>in effect</u> compel Member States to join. Given the mixed and

arguably indivisible nature of the competence the act of the United Kingdom in withdrawing from the Common Fund would jeopardise the attainment of the objectives of the Common Commercial Policy contrary to Article 5 of the Treaty.

10. The Commission could also point to the Council decision of 16 September 1981 concerning the signing of the Common Fund Agreement by the Community (a copy of the Report relating to this decision is annexed). The Council agreed that the Community should participate alongside the Member States.

11. The Commission would argue that the decision was evidence of the intention that Member States and the Community participate in the Agreement together. The decision envisages that the Community will participate together with all the Member States, though it does not in its terms oblige any Member State to sign or ratify or not to withdraw since the decision is not directed to the Member States. It is in effect a precondition of Community participation that the Member States shall also themselves participate. In that sense, the decision, read together with Article 5, obliges the UK not to withdraw, even if the Common Fund falls outside the common commercial policy, so long as Community participation in the Agreement can be regarded as one of its tasks.

The UK's Response

12. The UK does not accept that the Common Fund Agreement is part of the Common Commercial Policy. It would not dispute that commodity agreements are such a part - this is history - but

would draw a distinction between commodity agreements and the Common Fund Agreement. The Common Fund is a financial institution and although related to commodity agreements is of a different character and purpose. The Fund does not as a matter of course play a part in the regulation of trade in the products for which the commodity agreements have responsibility. The provision of finance to international organisations which inter alia may fund commodity agreements does not itself regulate trade nor does it have as an objective the regulation of the world market, whether towards liberalisation or otherwise. The UK would argue that it is too remote from trade to be part of the Common Commercial Policy. The UK would also point out that the ratification of an international agreement was a sovereign act and even the Commission has acknowledged that Member States retain some competence in relation to the Fund. That competence is severable from the competence of the Community and other Member States. In order to have any substantive effect that competence must leave Member States free to conclude or stay out of an agreement.

13. As regards the decision of 16 September 1981 the UK would point out that the provision relates to signing, not ratification, was limited to the Community's participation and not Member States, and even that was "subject to its subsequent conclusion". While not denying that a measure of Community competence must exist in relation to the Common Fund - this must flow from the adoption of the decision - the UK would argue that this was limited to mere membership of the Fund; in particular, it does not extend to the making of voluntary contributions out

of the EC budget, unless competence to make such contributions can be derived from Article 113 (which we deny) or is specifically conferred by decision based on Article 235. As regards any argument concerning the continued participation of the UK in the Common Fund, the UK would reiterate its point that there is no decision of the Council requiring continued participation, and that it is not, as a matter of Community law or under terms of the Common Fund Agreement, necessary for all Member States and the Community to be parties to the Agreement. The respective powers of the Community and the Member States are parallel and divisible, and all the obligations of the Agreement within the respective competences of the Member States and the Commission may be undertaken without the necessary presence of the Member States.

14. The UK would argue that any financial contribution on the part of the Community must be agreed to unanimously, ie not under the formal budgetary procedures or as part of the Common Commercial Policy (under Article 113) but implicitly under Article 235. The extent of the Community's competence in the Common Fund is limited to voluntary contributions and even then to the extent unanimously agreed by the Member States. That competence is merely a nominal one at present though it can be increased (in parallel, and without decreasing Member States' competence). In support of its argument, the UK would refer to a Council statement of 1980 to the effect that the Council would have to decide upon any financial contribution and its decision should respect the position of all delegations.

The Court's Likely Response

15. The Court has not shown any disposition to limit the scope of the Common Commercial Policy, as recent case law demonstrates. It is more likely to build upon rather than restrict the notion of regulation of trade as it relates to commodity agreements. The Court will have regard to the reasons for setting up the Common Fund and its purpose being related to the commodity agreements (ie the Integrated Progamme) and the operational links in practice. It would probably not regard the funding arrangement provided by the Agreement as being too remote from the regulation of trade or the commodity agreements.

16. As regards the decision of 16 September 1981, it is more likely that the Court would give this a broad interpretation, and in particular would want to make meaningful the expression "participation in the Common Fund <u>alongside</u> the Member States". Such an interpretation might be supported by reference to the background and negotiation of the Common Fund Agreement. As regards the question of continued participation of Member States, if the Court holds that the Common Fund is part and parcel of the Common Commercial Policy, albeit with a remnant of Member States' competence, it is likely to find an obligation on the part of Member States to continue participation in the Common Fund in order to give effect to that policy. Member States must facilitate the achievement of the Community's tasks and must abstain from any measures which could jeopardise the attainment of the objectives of the Treaty.

Consequences of an Adverse Judgment

17. The view of legal advisers of interested Departments remains that it is likely that the Court would rule against the UK and that there is a substantial risk that the question of the extent of the Common Commercial Policy and consequent exclusive Community competence will be discussed by the Court.

18. As regards the Common Fund itself, it is possible that the Court would equate the position of the Fund to that of certain commodity agreements, to the effect that although Member States retain some competence the extent of that competence is in practice very little. Implicit in this statement is a recognition of the possibility that the Court will expand upon its Opinion in the Rubber case to particularise the respective competences to the detriment of Member States.

19. But officials do not consider that the Court's Opinion would prejudice our position on voluntary contributions. Even if the Court held that the Common Fund is as a whole part of the Common Commercial Policy and requires participation of both Member States and the Community, it would not remove from Member States the competence over their voluntary contributions to the Second Account. If however the Court held that the Common Fund was part of the Common Commercial Policy, the decision to make Community voluntary contributions could fall under Article 113 and therefore be decided by qualified majority.

20. It is unlikely in the present context that the Court would

need to deal expressly with the practical arrangement operating under PROBA 20. PROBA 20 provides for the joint participation of the Community and the Member States in commodity agreements without prejudice to the legal position on competence. It does not apply to the Common Fund. But it is necessary to consider to what extent any ruling on competence, by virtue of its application of the legal position, might affect the political compromise reflected in PROBA 20. It is essentially a political question whether or not the Commission would feel obliged or wish to continue to apply the PROBA 20 instrument in the face of a favourable and positive judgment from the Court. So far as the UK is concerned, there are advantages and disadvantages in the PROBA 20 arrangement depending on the particular subject matter. It is understood that the political view is that on balance PROBA 20 is advantageous, in practice allowing the UK to speak for itself.

21. It is conceivable that if the Court found that financial/funding arrangements, such as the Common Fund, were capable of being part of the Common Commercial Policy, the Commission might push to extend its new found powers in the direction of other international financial agreements. Such agreements would have to be considered in the light of their own objectives and effects. But the UK would seek to restrict any adverse findings of the Court in the context of the Common Fund to financial agreements which were closely related to trade regulation matters.

Mr Bretner/CA
Mr Enden/CRO

60117

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EUROPEAN COMMUNITIES
THE COUNCIL

Brussels, 23 September 1981
(24.09)

9145/81

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PROBA 56

REPORT

from : Permanent Representatives Committee
dated: 16 September 1981
to : Council

No. prev. doc. 8945/81   No. Cion prop. 10766/80

Subject: COMMON FUND
- signing of the Agreement by the Community

1. Following the conclusion of the UNCTAD negotiations on a Common Fund for commodities and the agreement reached within the Council on the arrangements for possible Community participation in the Fund (1), the Commission submitted in October 1980 a Recommendation to the Council on Community participation in the Fund alongside the Member States and on the signing by the Community of the Agreement establishing the Fund.

2. In the light of the proceedings of the Working Party on Commodities and having noted that all Member States had already signed the Agreement, the Committee agreed to suggest that, as an "A" item on the agenda for a

(1) Council Decision of 9 June 1980 (7647/80).

.../...

forthcoming meeting, the Council:

- signify its agreement to Community participation in the Common Fund alongside the Member States as from the start of the Fund's operations;

- accordingly decide on the signing by the Community of the Agreement setting up the Common Fund, subject to its subsequent conclusion;

- anthorize the President of the Council to appoint the person empowered to sign the Agreement in question, with the same proviso as above.

INTERNATIONAL NATURAL RUBBER AGREEMENT

FINANCIAL AND LEGAL OBLIGATIONS

Current Position

1. The International Natural Rubber Agreement 1979 (INRA I) terminated on 23 October 1987. There is currently an interim period of unknown length during which certain of the financial rules of INRA 1979 will be implemented, ie sales are to be made from the Buffer Stock, but there will be no purchases. The Buffer Stock Manager (BSM) has been authorised by the INRO Council to dispose of rubber on a month-by-month basis to cover INRO's administrative costs during that period. If the price enters the "may sell" level, the BSM is empowered to sell additional rubber and he has to sell if the price reaches the "must sell" price.

2. The UK has contributed £5.735m towards buffer stock purchases, of which around £700,000 is to be refunded from recent sales under INRA I. It has also paid £155,000 in Administrative costs over the seven year existence of INRA I.

Alternatives for the Future

I) No INRA II

3. If INRA II does not enter into force, the Organisation will continue in existence merely to dipose of the remaining stock. Administrative costs will be financed from residual savings from the last year's contributions to the Administrative Account of the 1979 Agreement and sales from the Buffer Stock. There will therefore be no additional liability on the UK during the interim period. The level of subsequent refund to the UK will depend on prevailing market prices during the liquidation period.

II) INRA II

4. INRA 1987 (INRA II) could enter into force at any point from now, but this event is unlikely to occur before mid-1988.

5. If INRA II does enter into force the UK's obligations are as follows.

6. The maximum total size of the Buffer Stock under INRA II is 550,000 tonnes, including any carry-over from INRA I, and is a "real" asset as the BSM is empowered to buy only physical rubber, ie. no futures trading. Contributions to the Buffer Stock must be in cash, and the UK is obliged to make its payments as calculated in line with its world market trade share.

7. At UK insistence INRA II contains a new clause limiting the liabilities of members to the organisation or third parties to the extent of their contributions to a) the Administrative Account and b) the Buffer Stock Account. The obligations for the financing of these are clearly delineated.

8. The Council is also expressly barred from entering into contracts other than for physical rubber and from borrowing,

except in relation to the Common Fund. However in the latter case the Articles relating to contributions to the Buffer Stock clearly specify these must be in cash from members. Legal advice is that INRA II cannot, given the appropriate amended Articles in the new Agreement, take advantage of the First Account of the Common Fund.

Financial Estimates for INRA II

9. On the assumption that INRA II enters into force definitively after mid-1988, and taking the worst case scenario of rubber prices dropping into the may/must buy area and staying there for 5 years, the maximum cost to the UK, using current exchange rates is calculated as:

£2.500m for the purchase of additional rubber; But in the event of subsequent liquidation of INRA II sales of the Buffer stock will be refunded to members on a proportional basis;

£2.435m storage/insurance costs;

£0.110m administrative costs (estimated at current levels).

Contingent Liabilities for INRA II

10. There are no significant foreseeable contingent liabilities in INRA II.

11.(a) Any member might fail at any time to pay its contribution to the Administration Account. There is no reason to believe the UK is ever likely to be forced to pay any contribution in excess of its due amount, though in practice, members might agree to cover a shortfall in the Budget pro tem.

(b). Within the Buffer Stock Account there appear to be no contingent liabilities as the BSM must receive contributions from members before purchasing as he is empowered only to purchase physical rubber on cash terms.

(c) Potential Ultra Vires activity is covered legally as far as possible by the articles limiting members liability to contributions to the Administrative and Buffer Stock Accounts. The BSM must report all activity 30 days after the end of the month in which it takes place. In practice the UK trade always tells us when the BSM is entering the market, leaving little room for illegal trading.

CTPS Division
Department of Trade and Industry
November 1987

<u>INTERNATIONAL COCOA AGREEMENT (ICCA '86)</u>

Financial and Legal Obligations

1. The ICCA '86 entered into force on 20 January 1987 following completion of Parliamentary Procedures in sufficient countries, including the UK and other EC Member States, to fulfil the membership requirement. The European Community is also a member in its own right. Under the compromise arrangements for participation in international agreements the UK participates in the ICCA '86 on the basis of a co-ordinated EC position.

2. The UK's financial liability to the ICCA '86 is limited to its obligations towards the financing of the Administrative Budget and the Buffer Stock. As a result of the UK's initiative during the negotiations of the Agreement, there are no contingent liabilities.

3. The UK's contribution to the Administrative Budget is currently assessed at £43,000 for the 1987/88 cocoa year. The level of contributions is reviewed and fixed annually by the Cocoa Council which is the governing body of the Agreement.

4. Financing of the Buffer Stock is provided by imposition of a levy on trade with members, currently $45 per tonne, reducing to $30 per tonne from 1 January 1988. Importing members are responsible for applying the levy on first import of cocoa from non-member countries.

5. In the event of the ICCA '86 being terminated, any remaining buffer stock funds would be distributed among exporting and importing members.

Tropical Foods Division
Ministry of Agriculture,
Fisheries and Food

November 1987

10 DOWNING STREET

LONDON SW1A 2AA

CH/EXCHEQUER
REC. 14 DEC 1987
ACTION Mr R. Molan
COPIES TO PS/CST PS/FST PS/PMG PS/EST
Sir P. Middleton
Sir G. Littler
Mr H.P. Evans
Mr Mountfield
Mr IPGF Davis
Mr Walsh Ms Symes
Miss Preston Mr Tyrie

From the Private Secretary

14 December 1987

THE COMMON FUND

Thank you for your letter of 9 December and accompanying papers dealing with the background to our ratification of the Common Agreement, with the legal aspects of withdrawal from it and with our financial and legal obligations under the Cocoa and Natural Rubber Agreements. The Prime Minister has noted these carefully and is grateful.

I am copying this letter to Tony Galsworthy (Foreign and Commonwealth Office), Alex Allan (HM Treasury), Shirley Stagg (MAFF), Michael Saunders (Law Officers' Department) and Trevor Woolley (Cabinet Office).

(C.D. POWELL)

Stephen Ratcliffe, Esq.,
Department of Trade and Industry.

312/036

FROM: R MOLAN

DATE: 16 December 1987

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr H P Evans
Mr Mountfield
Mr P G F Davis
Mr Walsh
Ms Symes
Miss Preston
Mr Tyrie

THE COMMON FUND

The letter of 9 December from PS/Lord Young to Charles Powell attaches the results of certain tasks which were commissioned at the meeting held on 10 November at No 10 to discuss the Common Fund. These consist of a historical note setting out the steps leading to the UK signature and ratification of the Common Fund Agreement, a full note on the legal aspects of withdrawal from the Agreement and notes on the UK's financial and legal obligations under the Cocoa and Natural Rubber Agreements.

2. The note on the legal aspects spells out in some detail the likely line of argument which the European Commission would pursue if it were to take proceedings against the UK in the European Court of Justice should the UK withdraw from the Agreement. It brings out that there are various counter arguments which the UK could put forward but concludes that it is likely that the Court would rule against the UK. This view was made known to Ministers when they decided to try and persuade other Member States to join the UK in deratifying the Agreement.

3. Powell replied on 14 December indicating that the Prime Minister had noted the papers. In the circumstances, there is no need for the Chancellor to pass comment.

Lord Young has written to Ministers in selected Member States asking them to consider deratification and replies are beginning to come back. Once the reactions become known of all the countries approached, consideration will then have to be given to the UK's future position.

R Molan

R MOLAN

B.F. 4/1

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

From the Minister

CH/EXCHEQUER
REC. 18 DEC 1987 18/12
ACTION MR BYATT
COPIES TO CST FST PMG EST SIR P. MIDDLETON MR ANSON SIR T. BURNS SIR G. LITTLER MR MONCK MR BURGNER MRA EDWARDS MR H P EVANS MR SCHOLAR MR SPACKMAN MR BONNEY MR RICKALLEN MR MORTIMER MR HUGHES MS SYMES MR PICKARD MR TYRIE

Ahrt, ps.

CONFIDENTIAL

CHANCELLOR OF THE EXCHEQUER

PRINCIPLES OF AGRICULTURAL REFORM

I have seen your minute of 30 November to the Prime Minister, with a revised statement of the principles of agricultural reform.

I agree that it would be useful to seek an early discussion in ECOFIN of the EPC paper. Subject to the text being cleared with my officials, I am also content with your suggestion for an article in the Economic Progress Report containing a cautious presentation of the thinking behind the principles. But I have reservations about publishing the text of the principles themselves which, in your original minute, you suggested should be drawn upon as appropriate for use in speeches.

For example the last sentence of point (vi) would spark off a lot of questions about our current policy on milk quotas: there is no practical alternative to extending these, as is proposed in the current "stabilisers" exercise. There would, I think, be criticism that we had made too little of the role of agriculture in enhancing the environment: and it would be noted that more prominence is given to income aids, which we do not yet have, than to incentives to take land out of production, on which I have just published a consultative document.

On this last point, I entirely agree that any form of set-aside must be complementary to, and not a substitute for, reductions in support. But I am not so confident as you that signing up for a programme of income aids will actually achieve these reductions in any sort of automatic way. The scheme for income aids now on the table was put forward by the Commission as a free-standing proposal, not as part of a package of support-reducing measures. I have the impression that, to the extent that other Member States support it (and there is not all that much support), they tend to see it as a compensation for action already taken rather than as justifying more. They also see it as a way of getting hold of more Community funds. I feel sure we should only accept income aids if the conditions set out in point (vii) of your note are fulfilled.

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

JM

JM
18 December 1987

CONFIDENTIAL

BF with advice by 11/1

JM/GT
~~THERE WILL BE NOTHING SPECIFICALLY ON THESE EPISTLES~~
MR BYATT + MS SYMES WILL, HOWEVER BE FOLLOWING UP WITH SOMETHING IN NEXT COUPLE OF WEEKS FOR ECOFIN

4497

TL 11/1

SECRETARY OF STATE FOR THE ENVIRONMENT

CH/EXCHEQUER
REC. 30 DEC 1987
ACTION MR BYATT
COPIES TO CST FST PMG EST SIR T. MIDDLETON MR ANSON SIR T BURNS SIR G LITTLER MR MUNCK MR BURGNER MR A EDWARDS MR H P EVANS MR SCHOLAR MR SPACKMAN MR BONNEY MR RIGALLEN MR MORTIMER MR HUGHES MS SYMES MR PICARD MR TYRIE

BF 18/1 (Ms Symes will do a short note).

Pse find out (from Ms Symes) when we are going to get advice on this and, more importantly, on the Macgregor minute behind. 25

Prime Minister

PRINCIPLES OF AGRICULTURAL REFORM

I endorse the ten principles enclosed with the Chancellor of the Exchequer's minute of 30 November, and am in general agreement with his proposals about basing our negotiating positions on them and disseminating the thinking behind them widely both at home and in the Community.

He is entirely right to emphasise the central importance of price reductions. This means that in the short term the main factor determining whether any other specific reforms are adopted must be whether their adoption contributes to an agreement on price reductions. In implementing any complementary reforms however it is important that we try to maximise the environmental benefits. The Minister of Agriculture and I are already discussing how best to do that in the context of the extensification scheme for cereals. In the longer term there is the possibility mentioned in paragraph 14 of the EPC paper and in my letter of 6 October that any new forms of support for farmers that are necessary could well have the protection or improvement of the environment as a primary objective. What this "jargon" means is that rather than pay farmers to grow less, or grow nothing, we should pay them to protect places where wildlife of all sorts can flourish, or to protect the landscape and visual beauty of the countryside. Since we are going to spend money anyway, we might as well get some benefit from it.

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

NR

N R

24 December 1987

9-15.1

FROM: I C R BYATT
DATE: 15 January 1988

CHANCELLOR

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

Ch/ Content with this advice; esp. X (para 2), Y (para 8) and Z (para 11)?
25 15/1

Yes – but wd @ some stage want to make a speech on it

PRINCIPLES OF AGRICULTURAL REFORM

The Minister of Agriculture and the Secretary of State for the Environment have replied to the your minute of 30 November to the Prime Minister that enclosed a revised statement of the ten principles.

2. Both Mr MacGregor and Mr Ridley are content with the ten principles as they now stand, and with our proposals for a cautious presentation of the thinking behind the principles - although Mr MacGregor has reservations about publishing the text of the principles themselves. Your minute to the Prime Minister took account of this point, but you may like your office to confirm to the Minister's Private Office that we do not propose to publish the principles themselves (although of course Ministers might agree to do so some time in the future).

X

3. Mr MacGregor also agrees that it would be useful to seek an early discussion in ECOFIN of the EPC paper.

4. We now have to consider how to use the principles to advance our objectives at both the UK and the Community level. We shall have failed if they gather dust on the shelf.

5. For general home consumption we are planning an EPR article - which will draw on the ten principles as appropriate.

6. As far as ECOFIN is concerned, the question is when the discussion of the EPC paper should take place. Provided UKREP know by early next week we could ask for a place on the agenda of the meeting of 9 February. But that is only two days before the Brussels European Council; too late to be helpful and arguably counter productive. And you are not planning to attend yourself.

7. If not the February ECOFIN, when? There is no predictably good time in relation to the GATT negotiations. It is also difficult to think of a good time from the point of view of the agricultural negotiations - although only too easy to think of bad times. To some extent it turns what happens at the European Council. There is also the problem of the impending French Presidential election and the rerun of the Schleswig-Holstein election. There are difficult political issues here, whose resolution turns in part on whether you want to have a relatively low key discussion at ECOFIN about the longer term economic issues concerning agriculture or if you want to raise the profile.

8. It would be very helpful to have a preliminary view from you on the politics. We can then let you have some further advice. But my instincts are to wait until after the French Presidential elections before asking for a ECOFIN discussion of the EPC paper. Y/

9. Within Whitehall we need to ensure that the ten principles are adequately reflected in briefings for major meetings - including the European Council meeting at Brussels. I have asked EI and IF to pay particular attention to this.

10. The Prime Minister's position is, of course, crucial. I have spoken to Professor Griffiths, who told me that he greatly welcomed the ten principles and the EPC paper. He also told me

that he felt that if he raised the issue further with the Prime Minister. she would simply say that she had made proposals for disposing of the surpluses. I find the implication that she is not also concerned about forces leading to a build up of new surpluses, a little strange.

11. When we come to an ECOFIN discussion of the EPC paper , you might like to write again to the Prime Minister, telling here what line you will be taking, as a way of reinforcing your message on the economics of agriculture.

2

I C R BYATT

FROM: J M G TAYLOR
DATE: 18 January 1988

MR I C R BYATT

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Sir G Littler
Mr Monck
Mr Burgner
Mr Edwards
Mr H P Evans
Mr Odling-Smee
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 Chancellor has seen your minute of 15 January. He is content with your advice, in particular that:

(a) I should confirm to the Minister of Agriculture's Private Office that we do not propose to publish the principles themselves (I have now done so);

(b) we should wait until after the French Presidential Elections before asking for a ECOFIN discussion of the EPC paper;

(c) when we come to a ECOFIN discussion, he might write to the Prime Minister telling her what line he will be taking as a way of reinforcing his message on the economics of agriculture.

2. He has commented that he will also at some stage make a speech on this.

J M G TAYLOR

FROM: ELEANOR EDWARDS
DATE: 22 JANUARY 1988

RNA 22/1

1. MR ALLEN

2. ECONOMIC SECRETARY

cc Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Sir P Middleton
Sir G Littler
Mr Byatt
Mr H P Evans
Mr A J C Edwards - Allan
Mr S Matthews
Mr Pickford
Mr Bonney
Mr Bush
Ms Symes
Mr Turnbull
Mr Gieve
Miss Noble - EDI
Mr Devereux
Mr Cropper
Mr Tyrie
Mr Call

Ch/ We shall need to make sure that MAFF, FCO and No 10 are content before going to press on this ('X' + 'Y' below).
JR 22/1

I have had a brief word with the Min: of Agric.. He is content for us to go ahead with this in the EPR on 10/2, subject to his drafting pts from the ... will be communicated to us. (The purpose will be to position his posn: vis-a-vis UK farmers).

EPR - FEBRUARY ISSUE

The next issue of the Economic Progress Report is due to be published on 10 February. Copy is therefore due to go to the printer on Tuesday, 2 February.

2. I attach drafts for articles intended for this issue.

Agricultural Protection

3. It is hoped to publish as the leading article The Challenge of Agriculture, in which the Chancellor may wish to take particular interest. The draft is mainly the work of Ms Symes.

4. The draft explains the concern of the UK, and many other countries, about agricultural policies worldwide. It sets out the background to international negotiations in the GATT and the Community. It incorporates, as agreed, a cautious presentation of the thinking behind the Chancellor's ten principles. It is

a sequel to the earlier EPR article on agricultural protection in the September-October 1986 issue.

5. The text has been carefully drafted to accommodate the Minister of Agriculture's view (his minute to the Chancellor of 18 December) that he is content with the suggestion for an EPR article containing the cautious presentation referred to above, but has reservations about publishing the text of the principles themselves. We understand that FCO and MAFF are broadly content with the draft.

behind X

X ||

6. It seems likely that MAFF (but not FCO) will raise doubts about timing of publication. EPR's publication date is 10 February, the day before the special EC Summit on 11 and 12 February. Treasury officials, including Mr Byatt, Mr A J C Edwards, and Mr H P Evans, recommend going ahead in February, given the careful drafting of the piece to reflect longer-term thinking and Government concerns with the current negotiations on the future financing package. IDT are, of course, anxious to go ahead.

X ||

7. If Ministers are content to proceed, we should clear with No.10 at some point, in view of the Prime Minister's situation with regard to the EC talks. Some further polishing of the text can be carried out next week as necessary, and one or two gaps remain to be filled.

Other items

8. Other items for this issue include a short piece with charts on historical trends in public expenditure, based on the PEWP chapter and the Treasury article in the October Economic Trends; a box containing brief details of the PEWP (the public expenditure main news having been covered in the last, Autumn Statement, issue); and a box on the announcement of the decision on the new coins, and withdrawal of the £1 note.

Ellen Edwards

ELEANOR EDWARDS

The Challenge of Agriculture

Nowhere are the damaging consequences of Government interference more apparent than in the massive surpluses in the agricultural markets of the world. A recent OECD report* shows that OECD countries' support for their agriculture imposes burdens on taxpayers and consumers, distorts world trade and depresses agricultural prices in the rest of the world. It says that current problems have reached critical proportions: substantial reform is urgently needed. This article summarises the main points from the report, and sets out some principles which should guide agricultural reform in the European Community and in the GATT. UK Ministers are exerting pressure for reduced levels of support worldwide, to allow market forces to play a greater role.

Most industrial countries provide substantial support for their agriculture. Governments frequently buy domestic produce at prices far above prices on world markets, impose tariffs and quotas on imports of cheaper foodstuffs, and subsidise exports that could not otherwise compete internationally. In consequence OECD countries' farm output has grown faster than their stomachs can absorb it: surpluses accumulate in the notorious mountains and lakes; or have to be sold on world markets at subsidised prices, further depressing world prices.

The OECD report draws on detailed studies of policy in seven major countries or country groups: Australia, Austria, Canada, the EC, Japan, New Zealand and the United States. The report shows that for 1979-81 their agriculture assistance accounted for over one-third of the value of agricultural output. Around one half of this assistance came directly from government budgets, and one

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* National policies and agricultural trade, OECD 1987. Obtainable from HMSO or OECD, 2 rue Andre Pascal, 75775 Paris Cedex 16, France.

half out of consumers' pockets. Since then assistance has continued to grow, with severe consequences for consumers and taxpayers alike.

The report emphasises that too many resources are employed in agriculture. Agriculture has been isolated from free market signals. All countries must reduce assistance and intervention, to promote efficient allocation of resources and bring overall supply into line with demand. The report stresses that if all OECD countries cut support together, national adjustments will be quicker and easier than if countries act alone, because the consequent rise in world prices would partly offset lower national prices and subsidies.

A key priority for the UK is reform of the CAP. In common with other industrial countries, the Community has for too long imposed high prices as a means of supporting farm incomes, without regard to their costs to taxpayers and consumers, the resultant loss of jobs in the non-agricultural economy and the damage done to the third world. The Community has made a start on reform, but much more remains to be done.

The UK government is determined to secure reform of the CAP and effective budgetary discipline in the Community. The European Council meeting at Copenhagen in December was unable to agree on specific stabilisers that would link excess production levels with automatic cuts in support. Nevertheless, EC leaders are committed to tackling surpluses and introducing stabilizer mechanisms. The UK will be working with others in the Community to reach specific agreements.

Europe: The costs of the CAP

The EC operates a complex system of price support measures which have generally held the prices of Community produce above world price levels. High prices encourage increased output from producers, far beyond that which can be consumed within the Community, and drive up prices of agricultural inputs, land prices and rents. Large farmers can benefit, often producing at even higher profit. Small farmers find their margins squeezed, which increases their pressure for higher prices and greater protection and so continues a vicious circle of increased support.

An obvious consequence is the direct budgetary cost incurred in operating the policy. This includes export refunds, which bridge the gap between internal prices and the lower prices that can be obtained for exports to the rest of the world; costs of intervention; and direct or indirect subsidies to output, research and development, and farm restructuring. In 1987 total EC budget expenditure on agriculture stood at £[30] billion, some two-thirds of the total EC budget. Individual Member States also operate national support programmes and bear the initial costs of intervention. Total EC public expenditure was around £[50] - £[60] billion in 1986.

Consumers have to pay much higher prices for food. These additional costs have been estimated at up to £550 a year for a family of four (The Political Economy of International Agricultural Policy Reform, 1986, Department of Primary Industry Australia).

Even these heavy costs borne by consumers and taxpayers do not tell the whole story. Far from preserving employment and output, the effect of the CAP is to reduce employment in other sectors and in the Community overall. Resources - labour, investment, but above all land - get locked into agriculture, although they could produce far more value added elsewhere. Productivity and competitiveness of other sectors suffer. Food processing output and employment are lower because of higher input prices. More generally, high food prices increase inflationary pressure.

Recent estimates suggest that these wider effects of the CAP could have reduced Community GDP by as much as 1 per cent with associated loss of jobs outside farming . Also of great importance are the growing tensions in international trade caused by agricultural support policies, including the CAP.

Agriculture in the OECD

The EC is by no means the only contributor to the world agricultural crisis. All OECD countries protect at least some agricultural sectors, at a cost of more than $50 billion in loss of national income. It is the major advanced countries - the United States, Japan and the European Community countries - whose protection and support policies have the greatest impact on world agriculture. To give some idea of the distorting effects of their policies*:

- Japanese rice producers have been paid over 8 times the world price, and large surpluses have had to be sold as animal feed.

- US farmers receive around 3 times the world price for sugar and butter; in the EC farmers are paid some 3 times world prices for wheat, barley, butter and sugar.

- In the EC the subsidy from consumers and taxpayers to dairy farmers is some $410 per cow, greater than the personal income of half the people in the world; in the US these subsidies account for around $835 per cow.

- In extreme cases EC farmers have paid more for imported feed for their cows than they could have received on the world market for the cows' milk.

- US sugar policies depressed world sugar prices to 4c/lb in 1985 compared to an estimated 11c/lb if the US supports had not been in place.

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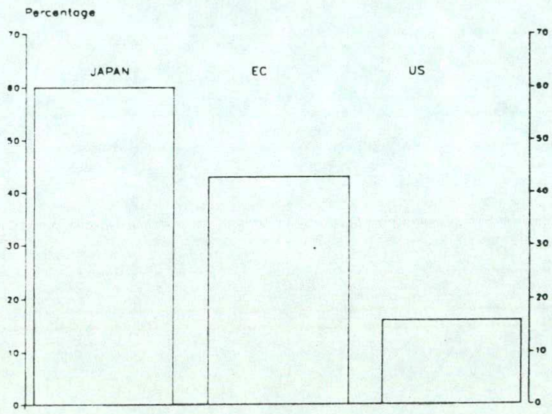
* Examples are drawn from <u>The World Development Report 1986</u>, OUP, and <u>The Political Economy of International Agricultural Policy Reform</u>, Australian Government Publishing Service, Canberra 1986.

Dramatic as these examples are, they do not give a full picture of overall levels of assistance to agriculture as a whole.

Public expenditure on agricultural policy measures would be one indication of the extent of support, but a very imperfect one. Some forms of intervention, such as quotas, have no budgetary cost; others, such as import tariffs, may actually raise government revenue. Probably the single most useful measure of support is the Producer Subsidy Equivalent (PSE). This is calculated by the OECD, adding together the value to farmers of all the different forms of support that receive. The table below shows the total value of assistance to producers as a percentage of their total incomes, as an average for 1979-81. The OECD is currently updating these figures to 1987 for publication later this Spring.

Producer Subsidy Equivalents
as a percentage of producer incomes,
all commodities
1979-1981



Consequences for the Less Developed Countries

[2 paragraphs to be inserted]

International commitment to reform

Successive international meetings have increasingly recognised the need for international co-operation to tackle subsidies and agricultural trade reform. Agriculture is a vitally important issue in the latest round of GATT negotiations, launched at

Punta del Este in September 1986 (see Economic Progress Report, September-October 1986, for more information on the current 'Uruguay' round of trade negotiations).

The UK Government has played a leading role in bringing agriculture to centre stage. UK Ministers have highlighted the problems of agricultural policies, and within the Community are exerting pressure for CAP reform. The Chancellor of the Exchequer, in his speech to the IMF/World Bank Development Committee in April 1987 emphasised that open agricultural trade would benefit developing and developed countries alike.

OECD Ministers agreed in May on a set of principles to guide reform, later endorsed by the Venice Economic Summit of the seven major industrialised countries in June. The main points on which OECD Ministers agreed were:

- to allow market signals to influence agricultural production through a progressive and concerted reduction of agricultural support;

- the immediate need to prevent yet greater market imbalances, by reducing guaranteed prices and other production incentives;

- any production restrictions or other interventions in markets should be implemented in ways that allow markets to work better;

- low income farmers would best be helped through direct income support rather than price guarantees or output related assistance;

- to promote the earliest possible progress in the GATT negotiations, so as to achieve reductions in support and protection.

Most recently, the Commonwealth Heads of Government Meeting in Vancouver in October issued a declaration on World Trade that reaffirmed the need for reform of trade-distorting agricultural policies. The Vancouver Declaration expressed hopes for early action in the GATT round so as to reduce uncertainty, imbalances and instability in world markets.

Agriculture in GATT

GATT has made a significant contribution to the expansion of the open trading system since the Second World War. Traditionally concerned mainly with tariffs and formal quotas on manufactured goods, the GATT now faces one of the most challenging rounds of trade negotiations in its forty-year history.

Protectionist pressures have been growing and as a result agriculture is more central to the negotiations in this round than in the past. Services are included in the negotiations for the first time. And the developing countries have a much greater stake in the negotiations than in earlier rounds: market access in general is important for them, and industrialised countries' agricultural policies are of especial concern.

The agriculture negotiations are a major element in the Uruguay round as a whole. The negotiations aim to establish "strengthened and more operationally effective GATT rules and disciplines" to cover "all measures affecting import access and export competition".

As the OECD report emphasises, domestic policies such as production subsidies and guaranteed prices have an important impact on international trade and competition. There is a growing consensus that reform of agricultural trade will be ineffective without parallel reform of domestic agricultural policies. Detailed negotiations in GATT will begin this year, and the United States, the European Community, Canada and the Cairns Group of major exporters have submitted initial proposals that emphasise the need to reduce all forms of support, not just trade measures. These countries agree that a measure of aggregate support provided by diverse policies - related to the OECD PSE measure - would aid negotiations.

More needs to be done to build on these common elements, and there are still differences between the major industrialised countries.

- US proposals are the most radical, calling for complete elimination over ten years of all agricultural support directly or indirectly affecting trade, but would permit income aids for farmers provided these were not linked to production.

- The Canadian and Cairns Group proposals also aim to eliminate measures affecting trade, without specifying when, and call for a major reduction in all subsidies and barriers to access to be phased in over some five years.

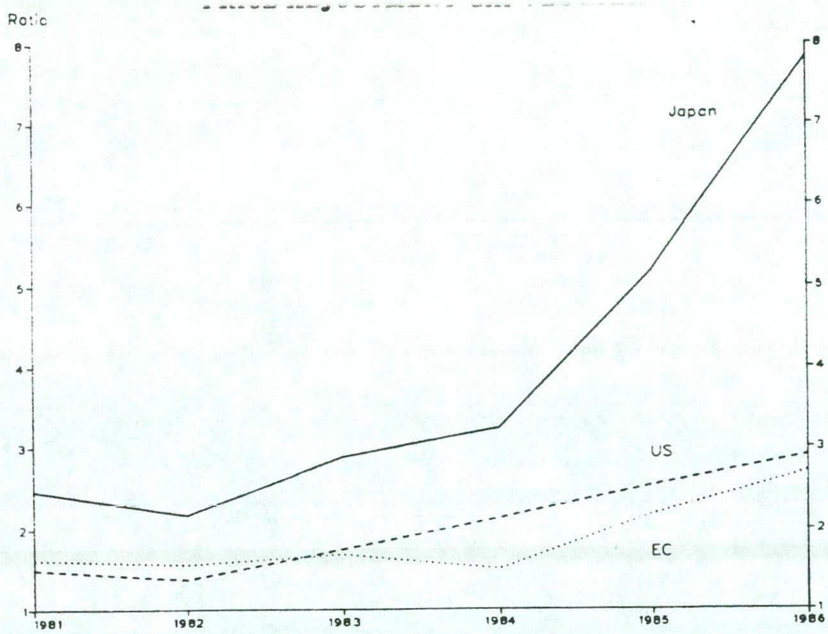
- The EC proposals emphasise the need for short term measures in the cereals, sugar and dairy sectors and an immediate reduction in support. They have been ~~much~~ criticised - especially by the US and Australia - for their relative neglect of longer term objectives and failure to propose a timetable for reductions in support, although further reductions in support and protection are contemplated.

- The importing countries, Japan in particular, have also been criticised for failing to recognise that their own restrictions on imports contribute to trade problems just as do the heavily subsidised exports of others.

The way forward

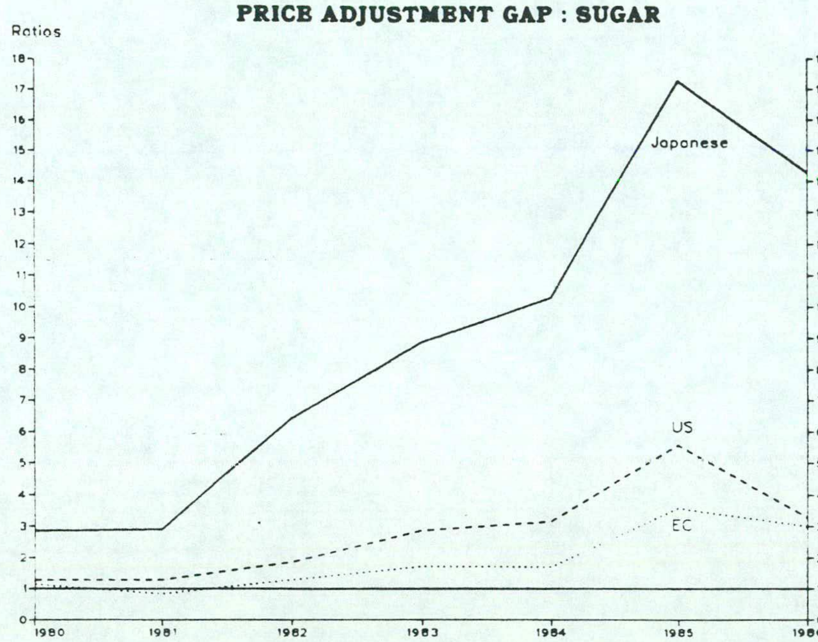
It is only in the multilateral forum of the GATT that the necessary agreements will be reached to put world agriculture on to a sound footing. But the European Community has already taken steps to cut prices, and further reform ought not to be delayed until the substantive phase of GATT negotiations. The EC will be able to take credit for action taken now, and so increase pressure on other developed countries to implement parallel reform.

- The Common Agricultural Policy is a central feature of the Community. It will, however, be important to ensure that the Community's Treaty and other objectives with regard to agriculture are met in the best possible way. Policies have to be judged against the principle that the allocation of resources is generally best left to market forces. Support should not be given indiscriminately through unnecessarily high prices. If special provisions are needed these should be carefully targeted so as to minimise distortions and benefit the least prosperous farmers or protect wildlife and the countryside.



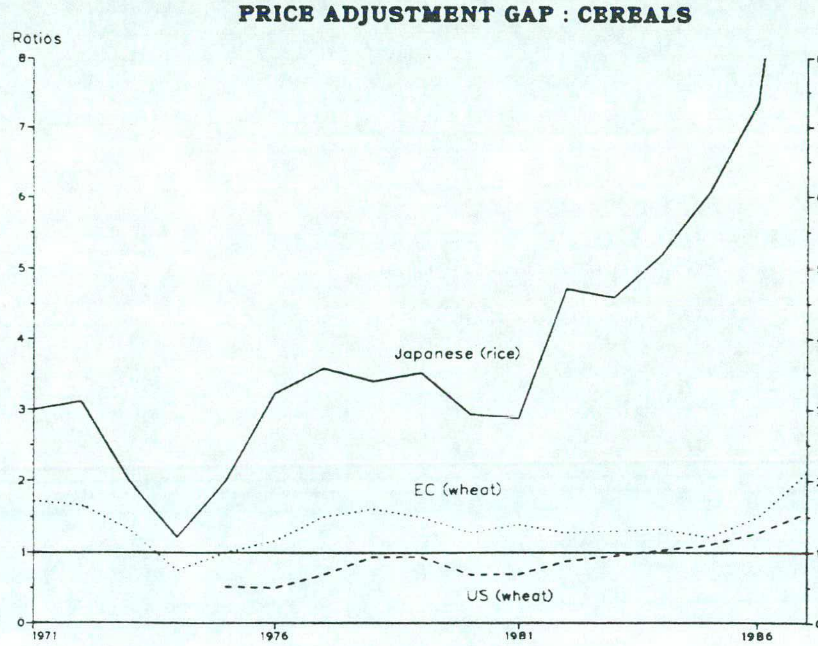
—— RATIO OF JAPANESE STABILISATION INDICATIVE PRICE TO INDICATIVE WORLD PRICE
- - - RATIO OF US WHOLESALE PRICE, GRADE A CHICAGO TO INDICATIVE WORLD PRICE
······ RATIO OF EC INTERVENTION PRICE TO INDICATIVE WORLD PRICE

PRICE ADJUSTMENT GAP : SUGAR



—— RATIO OF JAPANESE TARGET PRICE TO WORLD PRICE
- - - RATIO OF US MARKET STABILISATION PRICE
······ RATIO OF EC INTERVENTION PRICE TO WORLD PRICE

PRICE ADJUSTMENT GAP : CEREALS



—— RATIO OF JAPANESE PRODUCER PRICE TO WORLD PRICE
······ RATIO OF EC SUPPORT LEVEL TO WORLD PRICE
- - - RATIO OF US TARGET PRICE TO WORLD PRICE

Box 1

AGRICULTURAL POLICIES: A CHALLENGE FOR THE NEXT DECADE

'Above all, agriculture needs to be properly exposed to market forces .... A freer market for farm produce is crucial for development, and above all for the development of the poorer countries, whose growth - as the World Bank has shown - has lagged so conspicuously behind that of those developing countries with a manufacturing base.

'Action is needed by developing countries and industrial countries alike. Developing countries can make major gains by not overtaxing their farmers and by paying them the world market price for their produce. But it is above all essential that the excessive levels of support for agriculture in OECD countries are cut back sharply.'

The Chancellor of the Exchequer, Mr Nigel Lawson, to the Development Committee of the International Monetary Fund and the World Bank on 28 September 1987.

'It is often supposed that agricultural subsidies are different, and that unlike other forms of protection they preserve employment in the long run. They don't. They only do so at the expense of other sectors of the economy, reducing efficiency and incomes overall.'

Sir Geoffrey Howe, to the OECD Ministerial Council on 12-13 May 1987.

'The alternative to CAP reform is what I have described as "a disorderly descent into chaos", and that is in no-one's interest, least of all the farmers.'

John MacGregor, the Minister of Agriculture, Fisheries and Food, to the Royal Show on 6 July 1987.

Box 2

DOMESTIC AGRICULTURAL POLICIES

Some of the measures applied to the domestic agricultural sector are:

Support buying: governments offer to buy produce at a fixed price. When the intervention price is set above the world price (and it is not effective otherwise), this encourages farmers to produce yet more output, unless they are constrained by other mechanisms such as quotas, deficiency payments or input controls.

Production quotas: farmers are granted the right to produce or sell only a specified quantity of their produce at a guaranteed price.

Deficiency payments: governments give subsidies to producers to top up the market price.

Input controls: the most common restriction is that on land. Both the US and Japan have used acreage controls extensively.

Box 3

THE COMMON AGRICULTURAL POLICY

The Common Agricultural Policy (CAP) applies price supports and controls to agricultural production throughout the European Community (EC). Its framework was established by the Treaty of Rome in 1957 between the original six members states, comprising France, the Federal Republic of Germany, Italy and the three Benelux countries - Belgium, the Netherlands and Luxembourg. In 1973 the UK, Denmark and the Irish Republic became members. Greece joined in 1981, followed by Spain and Portugal in 1986.

The CAP supports the market price for agricultural produce in the EC through target and intervention prices, and controls production by stipulating threshold prices, levies and refunds. It also makes direct payments to producers in the form of grants and subsidies.

[Paragraph on Community financing]

Box 4

THE GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT)

Ninety-five countries are members, accounting for some 80 per cent of world trade. Many other countries maintain a de facto application of the GATT. Major non-members include China, the USSR and Taiwan.

The GATT aims to maintain open trade and ensure that national governments take into account the effects of their policies on other countries, as well as to extend the GATT framework and bring down overall levels of protection.

GATT rules constrain the extent to which countries can raise tariffs, restrict imports, or treat some member states differently from others. But agriculture has always held a special position, and a wider range of measures - particularly export subsidies and import restrictions - has been permitted for agriculture than for industrial goods.

THE CAIRNS GROUP

The Cairns Group of thirteen major agricultural exporting countries comprises: Argentina, Australia, Brazil, Canada, Chile, Colombia, Hungary, Indonesia, Malaysia, New Zealand, Philippines, Thailand and Uruguay.

Public expenditure - long term trends

Last month the Treasury issued the latest in its annual series of public expenditure White Papers (see box on page 00). As usual this White Paper gives a great deal of information about public spending in recent years, and plans for the future. This year, for the first time, there is a chapter dealing with historical trends, going back as far as 1890, when conditions were very different, and general government expenditure was only about 9 per cent of gross domestic product (GDP). Some knowledge of how public spending has behaved over a long period of years helps to put more recent trends into focus.

2. This article considers these long term developments. In addition to the latest public expenditure White Paper it draws on a Treasury article published in Economic Trends, October 1987, "Long term trends in public expenditure" by Graham White and Helen Chapman.

3. Long term trends in government spending are considered in two ways - first as changes in real terms (see notes on sources) shown from 1950 onwards in chart 1, and then as a percentage of output, or GDP, from 1890, as shown in chart 2. These are two key measures, used by the government in policy analysis and formulation.

General government spending in real terms

4. For the most part, as chart 1 shows, government spending increased inexorably during the 1960s and 1970s, in spite of recurrent attempts by successive governments to check it. After the minor peak in 1968 the government of the day secured a temporary dip following such measures as faster withdrawal of British troops from east of Suez, and postponement of increases in social security benefits and the raising of the school leaving age to 16. The next larger peak in the mid-1970s was sharply reduced in 1977-78, following measures imposed after the negotiation of an IMF loan in 1976. The effect of spending cuts across the board was reinforced by the more effective control by cash limits introduced on a wide range of spending in 1976.

E
ng term
rends

5. After this, as the chart shows, spending resumed its rise, but at a much reduced rate. The main increases were on employment measures, defence, social security, law and order and the health service. However, spending in other areas, for example public sector housing and subsidies to trade, industry and energy programmes, fell substantially.

6. During the 1950s general government expenditure rose by about 2¾ per cent a year in real terms. In the 1960s it rose by 4½ per cent a year and in the 1970s by 3 per cent a year. Since 1980, it has fallen to 1¼ per cent a year. Even after excluding privatisation proceeds, to show the underlying trend, the average rate of increase since 1982-83 has been only 1¾ per cent a year, much lower than in the 1950s, 1960s, and 1970s.

Expenditure as a percentage of GDP

7. General government spending as a percentage of GDP is used to compare public spending growth with growth in the economy as a whole. It represents the extent to which the government has to raise taxation and borrow to finance its activities. As it includes transfer payments (social security benefits and other grants, and subsidies),it does not represent the share of GDP consumed by government.

8. Chart 2 shows percentages of GDP for both general government expenditure only, and for spending on goods and services, which does represent the government's consumption of GDP. As it goes back to 1890 the early part of the chart necessarily relies to some extent on approximations. But the general picture is clear, in that the major peaks are obviously associated with the two world wars. Smaller peaks occur at the time of the Boer War of 1899 to 1902, and the Korean War of 1951 to 1952. Again there were smaller peaks in 1966 and the mid-1970s, and another one in 1982, since when the percentage has fallen continuously.

Notes on sources

9. Chart 1. The Central Statistical Office (CSO) has a consistent series of general government expenditure figures going back to the late 1940s. The real terms figures are the cash figures adjusted to 1986-87 price levels using the GDP deflator.

10. Chart 2.

Up to 1947 the expenditure data have been taken from The growth of public expenditure in the United Kingdom by A T Peacock and J Wiseman, and the output data from C H Feinstein's National Income, expenditure and output of the United Kingdom 1855 to 1965. After 1947 CSO figures are used.

Long term trends in public expenditure

Graham White and Helen Chapman, HM Treasury

Introduction

There are a number of different measures of public spending. A key measure is general government expenditure (the combined spending of central and local government including both capital and current spending plus net lending). This is useful for analysing overall trends in public spending, and in the formulation of macro-economic policy. It is broadly a measure of the amount which the Government has to raise by taxation and borrowing and is the key public spending aggregate used in the Medium Term Financial Strategy.

2. General government expenditure differs in a number of respects from the public expenditure planning total, the other key public spending aggregate which is used by the Government in its annual review of detailed public expenditure plans and forms the basis of the control totals set each year. The main differences in coverage are the inclusion in general government expenditure of gross debt interest and the finance which public corporations raise directly from the market rather than from Government. Other differences are explained in more detail in an Annex to Part 2 of the *1987 public expenditure White Paper (Cm 56-II)* and in the *Financial Statistics Explanatory Handbook*.

3. This article discusses long term trends in public expenditure and concentrates on general government expenditure. The national accounts include detailed figures of government spending, which comprises a number of different elements. General government expenditure on goods and services is the government's direct contribution to the expenditure measure of GDP; total current and capital expenditure also includes interest payments and transfer payments such as subsidies and grants; and general government expenditure in total also includes net lending. Figures for general government expenditure are published in the *Blue Book (United Kingdom National Accounts)* and *Financial Statistics*.

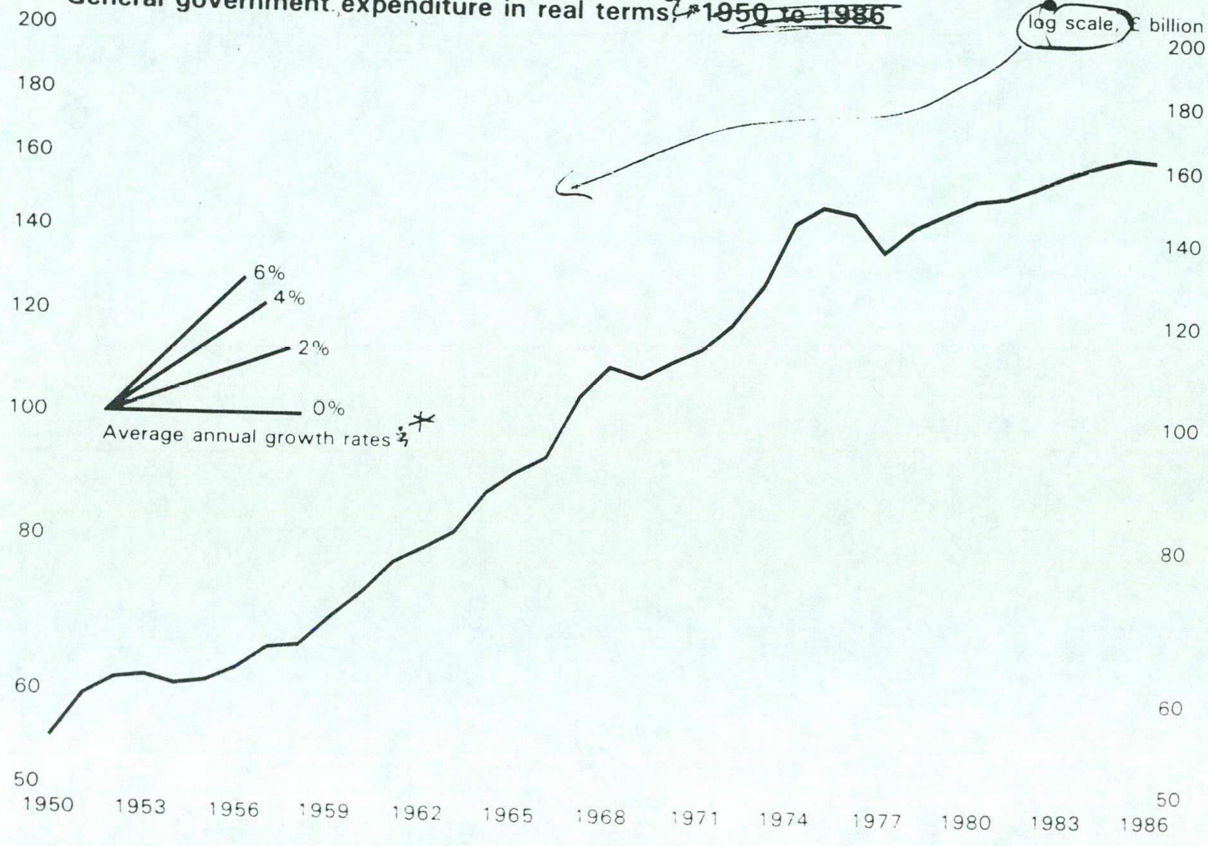
General government expenditure since 1950

4. The Central Statistical Office (CSO) has a consistent series of general government expenditure figures back to the late 1940s. Chart 1 shows general government expenditure from 1950 to 1986 in real terms. Real terms figures are the cash figures adjusted to 1986 price levels by excluding the effect of general inflation as measured by the GDP deflator.

1986

CHART 1

General government expenditure in real terms‡ ~~1950 to 1986~~



‡ ~~1. Real terms figures are the cash figures adjusted to 1986 price levels by excluding the effect of general inflation as measured by the GDP deflator.~~

* 2. The different slopes of the lines represent different rates of annual growth. The steeper the gradient the greater the growth rate. By comparing the slopes with particular sections of the graph the reader can determine the appropriate rate of annual growth over that period.

general increase in social security benefits, and deferment by two years of the raising of the school leaving age. As a result government expenditure fell in real terms, but soon started to follow an upward trend again to reach a peak in the mid-1970s. Following negotiations with the International Monetary Fund (IMF) in the latter half of 1976, public expenditure plans for 1977-78 were revised downwards by £1 billion and it was announced that £500 million of government-owned shares in the British Petroleum Company were to be sold in 1977-78. (The proceeds from the sale counted as negative expenditure.) The planned reductions were spread across most public expenditure programmes but actual expenditure in 1977-78 was even lower than expected - about £4 billion below the revised plans set in January 1977. Much of this was due to underspending which was difficult to forecast in advance. This reduction in spending coincided with the introduction of cash limits in 1976.

6. Since the reduction in the late 1970s general government expenditure continued to increase in real terms, but at a slower rate. Over this period the main increases have been on employment measures, defence, social security, law and order and the health service. In other areas there have been reductions. Spending on public sector housing and subsidies to the trade, industry and energy programmes have fallen substantially. This is a reflection of Government policies for sales of publicly owned houses and for a greater share of housing needs to be provided by the private sector, and for support to both private and public sector industry to be reduced as profitability increases.

7. During the 1950s general government expenditure rose in real terms by about 2¾ per cent a year. This increased to 4½ per cent a year in the 1960s and 3 per cent a year in the 1970s but has now fallen to 1¼ per cent a year since 1980. Since 1982-83 the average annual growth rate has been about 1¼ per cent a year and even after excluding privatisation proceeds, in order to show the underlying trend, the rate has been 1¾ per cent a year, lower than the corresponding rates in the 1950s, 1960s and 1970s.

GDP [illegible] transfer payments, such as grants and loans, which transfer spending power to the private sector. The government's own consumption is measured by public spending on goods and services only. However, the wider measure shows the extent to which the government has to raise taxation and borrow on financial markets to finance its activities and is the statistic most widely used in discussion of public spending comparisons with GDP.

9. The definition of public expenditure used in the comparison with GDP has varied over the years. The different definitions which have been used in Treasury documents are discussed in an article in the August 1985 edition of *Economic Trends*. General government expenditure was introduced as the numerator of the GDP percentage in the 1984 Green Paper on long term spending and is now the measure of expenditure used in Government publications.

10. There are also alternatives for the denominator of the percentage. In the past GNP has often been used, by both the Treasury and outside commentators, rather than GDP. Whether GNP or GDP is adopted there are a number of alternative measures. For example, GDP can be measured in three ways, the expenditure based measure, GDP(E), the income based measure, GDP(I), and the output based measure, GDP(O), and both GNP and GDP can be measured either at factor cost or at market prices. The three measures of GDP are combined to give an average measure, GDP(A), which is the preferred measure for assessing medium and long term changes. The current practice, introduced in the 1984 Autumn Statement, is to use GDP(A) at market prices in the calculation of the percentage. **Appendix 1** gives more detail about the different ways of measuring GDP and GNP.

11. **Chart 2** compares general government expenditure with GDP over the period 1890 to 1986. It also compares general government expenditure on goods and services with GDP. The expenditure figures for the early years (1890 to 1920) are necessarily approximate and some interpolation has been necessary to derive

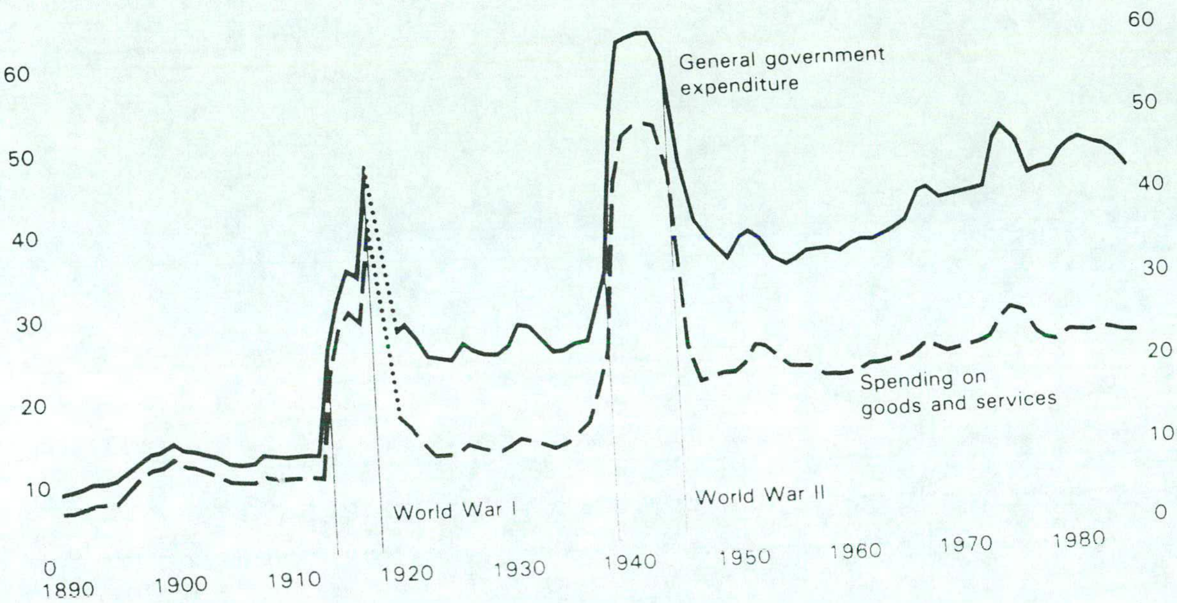
CHART 2

General government expenditure as ~~a percentage of GDP~~

~~1890 to 1986~~

% of GDP

~~Per cent~~



DRAFT

EPR BOX

PUBLIC EXPENDITURE WHITE PAPER

The 1988 Public Expenditure White Paper (The Government's Expenditure Plans 1988-89 to 1990-91 (Cm 288-i £9.80 and Cm 288-ii £22.00 HMSO) was published on 20 January 1988. It confirms the planning totals of £156.8 billion in 1988-89, £167.1 billion in 1989-90 and £176.1 billion in 1990-91 announced by the Chancellor of the Exchequer in his Autumn Statement on 6 November 1987 (see Economic Progress Report December 1987). The plans for government spending should allow growth in real terms of an average of about 1¼ per cent per year, well below the expected growth in national income. As a result government spending will continue to fall as a proportion of national income. General government expenditure excluding privatisation proceeds has fallen from 46¾ per cent of GDP in 1982/83 to about 42½ per cent in 1987-88 and is planned to fall to 41¼ per cent in 1990-91, lower than in any year since 1972-73.

2. Compared with the 1986 White Paper extra resources have been allocated to the Government's priority services including health, education, law and order, defence and inner cities. Provision for social security and local authority current spending has also increased. Extra provision of about £1½ billion in 1988-89 and 1989-90 has been made for capital spending, including large increases for the nationalised industries, for housing, and for education. The reductions in the burden of debt interest, in unemployment and in subsidies to industry have helped to make room for these increases within a declining path for government spending in proportion to national income. The Government are improving the value for money from public expenditure; the White Paper contains examples of what is being achieved.

DEWP

94/2/sm/3103/71

Box

NEW COINS

In July last year the Royal Mint issued a pamphlet "The United Kingdom Coinage" which set out four options for reducing the weight of the coinage. Comments were invited from the general public and from people with a special need, such as the blind and elderly; handlers of large amounts of coin; and manufacturers and users of coin-operated machines (see Economic Progress Report, July 1987). The Chancellor of the Exchequer announced in December (Hansard: col 652, 17.12.87) that option 4, involving the introduction of new 5p and 10p coins, had proved the most popular. The new 5p coin will probably be introduced in 1991, and the new 10p coin two or three years later. The new coins will be smaller and lighter, but the design and the cupro-nickel alloy used will be unchanged.

The Chancellor also announced that Bank of England £1 notes will cease to be legal tender from 11 March 1988. This does not affect the status of £1 notes issued by Scottish banks.

mjd 2/89Jn

UNCLASSIFIED

FROM: J M G TAYLOR

DATE: 25 January 1988

PS/ECONOMIC SECRETARY

cc Chief Secretary
Financial Secretary
Paymaster General
Sir P Middleton
Sir G Littler
Mr Byatt
Mr H P Evans
Mr A J C Edwards
Mr R I G Allen
Mr S Matthews
Mr Pickford
Mr Bonney
Mr Bush
Ms Symes
Mr Turnbull
Mr Gieve
Miss Noble
Miss E Edwards
Mr Devereux
Mr Cropper
Mr Tyrie
Mr Call

EPR - FEBRUARY ISSUE

The Chancellor has seen Miss Edwards' minute and enclosure of 22 January.

2. He has had a brief word with the Minister of Agriculture. The Minister is content for us to go ahead with the agriculture article in the 10 February issue, subject to some 'drafting points' which he will communicate to us.

J M G TAYLOR

53/2/LPD/3749/041

mvp -

FROM: G R WESTHEAD
DATE: 25 January 1988

MISS EDWARDS

cc PS/Chancellor 2
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Sir P Middleton
Sir G Littler
Mr Byatt
Mr H P Evans
Mr A J C Edwards
Mr S Matthews
Mr Pickford
Mr Bonney
Mr Bush
Miss Symes
Mr Turnbull
Mr Gieve
Miss Noble
Mr Devereux
Mr Cropper
Mr Tyrie
Mr Call

ECONOMIC PROGRESS REPORT - FEBRUARY ISSUE

The Economic Secretary has seen and was grateful for your minute of 22 January attaching a draft of the February issue of the EPR.

2. As I mentioned on the telephone the Economic Secretary's only comment on the substance of the articles is that he would prefer to replace "it" with "expenditure growth" in line 4, paragraph 6 of the Public Expenditure article. The Chief Secretary may, however, wish to comment further on the article as may the Paymaster General on the coinage article. I have drawn this to the attention of the other Private Offices concerned.

Guy Westhead

GUY WESTHEAD
Assistant Private Secretary

674/39

H M Treasury

Parliament Street London SW1P 3AG

Switchboard 01-270 3000

Direct Dialling 01-270 4420

R I G Allen
Press Secretary and
Head of Information Division

Mr Bernard Ingham
Press Secretary
10 Downing Street
London SW1A 2AA

28 January 1987

Dear Bernard,

ECONOMIC PROGRESS REPORT: ARTICLE ON "THE CHALLENGE OF AGRICULTURE"

You might like to know that the next issue of the Economic Progress Report (to be published on 10 February) will include an article on world agricultural support systems, their economic effects and the way forward. It will be useful background material for the European Council meetings on 11/12 February. A copy of the article is attached for information.

The piece is a sequel to an earlier article on agricultural protection in the September-October 1986 of EPR. With the forthcoming Brussels meetings in mind, it has been carefully drafted to convey the flavour of the Government's longer-term thinking on the subject, but avoids any substantive discussion of current negotiations in the EC or GATT context.

The text has been agreed with FCO and MAFF, both as to content and timing of publication.

I am copying this letter to Christopher Meyer (FCO) and Jim Coe (MAFF).

Yours ever,

Robin

R I G ALLEN

Blind copies (letter only)

PPS
PS/EST
Mr Byatt
Mr A J C Edwards
Mr H P Evans
Mr Bonney
Miss Edwards

94/2/sm/3105/42

Pup

FROM: ELEANOR EDWARDS
DATE: 8 FEBRUARY 1988

Art. 8/2

1. MR ALLEN

2. ECONOMIC SECRETARY

Ch/ To note. (MAFF + FCO are content with the article as it now stands). 8/2

OK

cc Chancellor
PMG
Mr H P Evans
Mr A J C Edwards
Ms Symes
AC
B

ECONOMIC PROGRESS REPORT PRESS NOTICE

The next issue of EPR, containing the article on agricultural reform, is being published on Wednesday afternoon. I attach a draft press notice. Are you content?

2. The final text needs to be sent over to COI as soon as possible tomorrow.

Eleanor Edwards

ELEANOR EDWARDS

It is the policies of Japan, the EC countries, and the US which have the greatest impact.

ECONOMIC PROGRESS REPORT - FEBRUARY ISSUE

Industrialised countries' support for their farmers on the present scale causes huge surpluses, burdens taxpayers and consumers, distorts world trade, and depresses agricultural prices in the rest of the world. In the OECD as a whole an estimated $50 billion a year of national income is lost as a result of farm policies. In the European Community alone:

- total EC budget spending on agriculture is estimated at £20 billion for 1987, about two thirds of total budget spending. If individual countries' national spending is included, this rises to £35 to £40 billion.

- consumers have to pay much more for food - up to £550 a year for a non-farming family of four, according to one estimate.

- GDP may have been reduced by as much as 1 per cent.

In both EC future financing negotiations and in the GATT round, the UK is pressing for reduced levels of support and freer play for market forces. These are themes pursued in the leading article in today's EPR, <u>The Challenge of Agriculture</u>. The article draws on ~~summarises points made in~~ an

OECD report published last year, and sets out some principles to guide reform.

Public expenditure - long-term trends

The other main article, starting on page 6, describes historical trends in public spending, going back as far as 1890.

Notes to editors

The OECD report mentioned is National Policies and Agricultural Trade, OECD 1987. Obtainable from HMSO or OECD, 2 rue Andre Pascal, 75775 Paris Cedex 16, France.

670/32

FROM: R I G ALLEN
DATE: 9 FEBRUARY 1988

MR BYATT

cc PS/Chancellor
PS/Economic Secretary
Mr H P Evans
Mr A J C Edwards
Mr Pickford
Mr Bush

EPR ARTICLE ON AGRICULTURE

Jim Coe (MAFF) and I have agreed some Q/As which may arise - particularly from the farm lobby - in response to the EPR article which is being published tomorrow. These are attached.

Copies of the briefing are being sent to No.10 and FCO.

R I G ALLEN

Q1. Why publish in the EPR? Is the Treasury now in the lead on agricultural policy?

A. The EPR regularly carries articles on a wide range of national and international economic issues. This particular article discusses a number of issues of agricultural policy in a world context and, where relevant, reflects the policy of the UK Government. Questions concerning the economic implications of agriculture are clearly not exclusively a matter for MAFF and are discussed between the relevant departments.

Q2. Why publish now? Is it an attempt to apply pressure on the EC Council?

A. No great mystery about the timing of publication. The article has been in preparation for some little time. Other member states are well aware of the UK Government's position on the need for agricultural reform.

Q3. Is the article a warning that the Government is intending to adopt a tougher approach on agricultural reform?

A. The article contains no new statements of policy. It is simply a restatement of the Government's position. The farming industry knows it is vital in the long term interests of agriculture to reform the CAP.

FROM: P EDMONDS 4505
DATE: 11 February 1988

MR HUTSON

EPR ARTICLE ON AGRICULTURE

I attach a copy of the publication from which the figure for the cost of the CAP per family was taken - $900 is approximately equivalent to £550.

2. You may also like to know that these figures have been used by the Adam Smith Institute before and have appeared in the press - see second attachment.

P. Edmonds

P EDMONDS

REFERENCE

Extract from "The Political Economy of International Agricultural Policy Reform"

Department of Primary Industry, Australia.

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some 16 per cent greater
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and stocks for **feed grains**
for wheat. **Cotton** stocks
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programs

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estimates are as follows.
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35 and up to US$30 billion
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1985 legislation was US$52
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ver 8 per cent from 1985.
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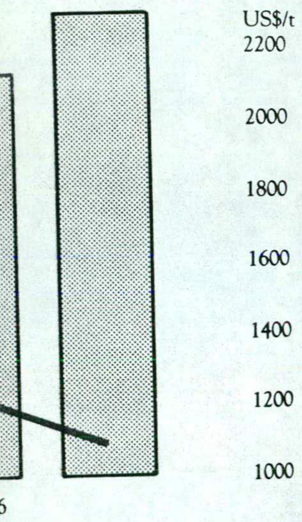
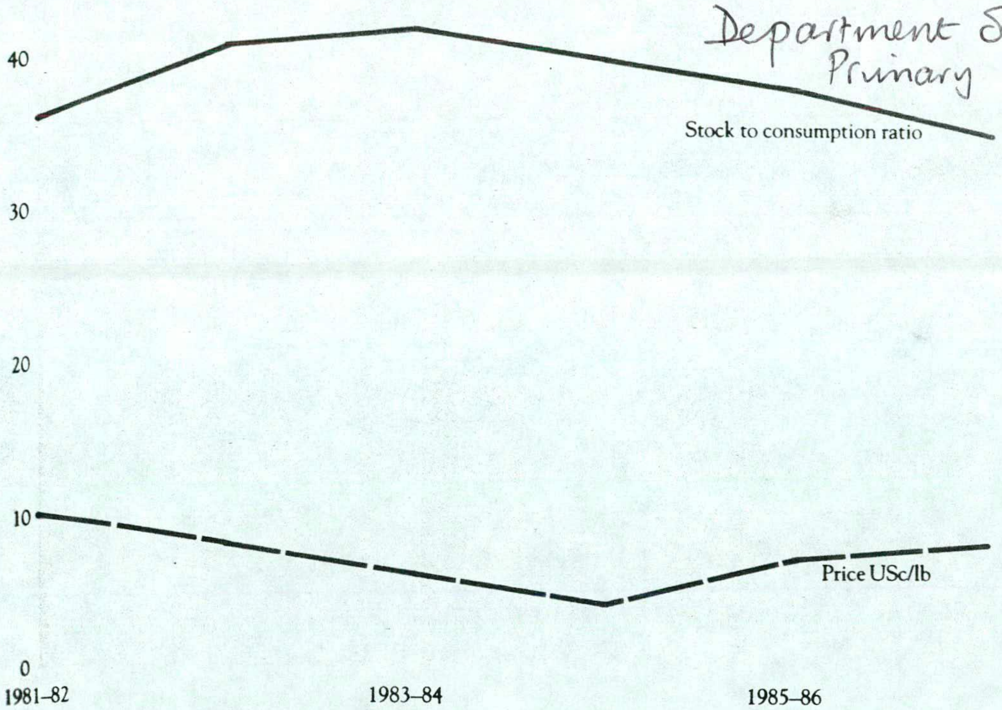


Chart II.3: World price and stocks : sugar



Note: Stocks are at the end of year; sugar price is fob Caribbean.

paid much more for a number of farm products (for example, sugar and dairy) than they otherwise would have paid. The cost of consumer transfers was estimated at an additional US$5.7 billion a year in 1985.

Over recent years, expenditure in the EC under the Common Agricultural Policy (CAP) has shown a consistently strong tendency to overrun its budget. In 1984, the EC was forced to increase the maximum proportion of the value added tax (VAT) base which could be devoted to agriculture from 1.0 per cent to 1.4 per cent, effective from the beginning of 1986. Despite this, it is virtually certain that this ceiling will have to be increased further, possibly to 1.6 per cent, in the very near future.

EC subsidies and other farm support measures are costing around US$23 billion in 1986–87, more than double the level five years ago. Furthermore, the disposal of farm surpluses will cost member states another US$2–3 billion.

National support from member governments to their farmers is an additional amount of around the same magnitude as Community support.

In addition, consumer transfers to producers through artificially maintained domestic prices under the CAP were estimated to be up to US$40 billion a year in 1984. Because of the failure of EC intervention prices to reflect the severe decline in world prices, consumer transfers have since increased substantially.

The total taxpayer and consumer transfers to EC farmers are equivalent to an annual contribution of more than US$900 from each non-farm family in Europe. X

In Japan, the aggregate cost of agricultural protection to taxpayers in 1985 was US$10.5 billion.

The cost of transfers from Japanese consumers is several orders of magnitude higher than the taxpayer transfers.

Consumer transfers in Japan have been increased substantially by the recent strong real appreciation of the yen. Domestic food prices are now some 60 per cent higher than would have been the case if the yen appreciation since the latter part of 1982 had been allowed to be reflected in agricultural prices.

ADAM SMITH INSTITUTE

Enlightenment

GROWING INSANITY

THE EFFECTS OF THE COMMON AGRICULTURAL POLICY

The common agricultural policy is a direct contributory factor to third world poverty. It also impoverishes Europe both by the high taxes it demands and by the higher prices charged to the consumer. On both accounts, it represents an astonishing waste. In the UK for example, prices of beef are twice as high as on the world market: the average British family pays £11.50 in direct and indirect EEC subsidy per week, and the average Briton pays 84p per week just to pay the costs of storing surplus.

The economic consequences are not merely confined to subsidies, surpluses and shortages. The common agricultural policy severely distorts patterns of European employment. Its losses could be invested profitably in the expansion of manufacturing industry and creation of real jobs. It is ideally designed to conserve an impoverished peasantry in Southern Europe. Nor does the small European farmer benefit greatly, as shifts and lurches in EEC policy ruin his careful planning and investment. The sole beneficiaries of the common agricultural policy are the large farmers, proprietors of the latifundias and agri-business merchants, and large institutions which have had the shrewdness to invest in agriculture.

The CAP is disadvantageous to the citizens of Europe: but to those of the third world it is ruinous. The average third-world dweller is not urbanized: he is a peasant proprietor. The fact that he is locked out from an affluent market of 250 million, along with other large western markets where he is similarly excluded, means the difference to him between subsistence and starvation. No incentives exist to create surpluses, improving his and his nation's condition. His rulers are encouraged to invest in costly, subsidized and unsocial industries. Since agriculture can only generate low tax and low living standards, they equate it with impotence and subservience. Moreover, EEC dumping policies also act as a disincentive to agricultural investment and development.

They contribute to the exponential growth of third world cities, whose ill-nourished inhabitants crowd together in shanty towns. The sole defenders of this are ironically, the very third world leaders whose denunciation of the common agricultural policy has been so muted. With large cities they can instantaneously create the following on which their power depends, using the city to bludgeon the rest of the country, and forming rootless masses dependent on government.

In addition, price/revenue instability affects the taxation base of the third world. But the effects of CAP do not stop here. It also helps to force the semi-developed second world countries into investing rapidly in industrial growth, stunting their own agriculture. The cheap-labour industries thus created are competition for Britain's own dear-labour manufacturers, which have declined massively under the impact of second world competition. And the detrimental effects of CAP on the countries of the old commonwealth have been well-documented.

CAP does not only inflict losses on the British consumers. It also ruins their countryside. Excessive use of fertilizers has damaged UK agriculture, while hedgerows and the like have been cut down to reduce parts of England to the likeness of a mid-western prairie. In this process, large tracts of land are protected by their owners from all public leisure pursuits, even mere walking. The consequences for the southern housing market of land reservation have been severe, pricing houses at levels that prevent the necessary movement of skilled workers from the north.

The CAP is a negative force. It leads to constant argument and irritation within the EEC, corroding its purpose and idealism, diverting energy from other areas. The actual corruption engendered by such a system is substantial. Twenty per cent of EEC subsidies allegedly go in fraud, £30 million a year in beef fraud alone. Channel Four exposed major deceit on food exports to the third world, with a case history of a £3/4 million fraud. None of this is surprising, given the opportunities presented by such a cumbersome mechanism for state intervention. Political will is needed to reform it and the system that such corruption encourages. In effect, the CAP subsidizes farmers to impoverish rich and poor nations alike, with justice to neither.

THE FARM LOBBY - ITS POWER, ITS CASE

The power of the farm lobby is vast, and acts as a veto on progress. But while 10% of the EEC population is involved in agriculture, only 3% of the British population is. Although a minority, they have been able to exploit their disproportionate political influence to protect and fortify their position. Thus some of the MPs on the EEC's crucial agriculture committee depend for their seat on farming votes.

Because of the influence of farming interests, the EEC puts out biased information. The public are beguiled into believing that the current agricultural policy is a just reward for a public good: and there are no electoral opportunity costs for a pro-agriculture policy stance. The strategy of the farmers is to deflect consideration away from reform to the annual price review, except in the wine and diary sectors. Farmers also deflect criticism by pointing to the abolition of intra-EEC agricultural protectionism.

The claims of the EEC itself are insinuating, but fallacious. Its CAP supporters claim that food prices have risen less than the rate of inflation - an extraordinary defence, given the high growth of production. They assert that if we brought food on world markets "this would reduce supply and raise prices". Why? The most insane defence has it that because European farmers are smaller they ought to receive higher than world prices. In other words, if an economic entity is inefficient it ought to be subsidized. They add that it would be "unwise" for [...]e to be dependent on the Third World for much of its food sin[...] "we would become hostage to currency fluctuations, political problems and the possibility of failure of supply owing to local problems", an argument that ignores the impact of diversified sources of supply and the availability of substitutes. Only world war could realize the danger they claim. They even cite India as an example of a country that has solved its hunger problems through state subsidies, an assertion that it is hard for anyone who has actually been to India to believe.

THE DIMENSIONS OF THE SUBSIDY

The scale of subsidies to the CAP would challenge the descriptive powers of the English language. Since 1978 there has been a fourfold increase in expenditure to buy and store surpluses. In 1984 69% of the community's budget was spent on agriculture, and while this represented a decline from 80% in the nineteen-seventies, this was due to increases in EEC expenditure elsewhere and not a fall in agriculture's total receipts. In the decade 1974-1984 expenditure on agriculture rose 426% (the budget ceiling was reached in 1985); the cost was borne by Germany, Britain and Italy. The 1984 price reductions are actually price increases in national currency because of the operation of monetary compensatory amounts.

The politically invisible costs to consumers conceal the budgetary outlays for stockpiling, and the export subsidies which enable farmers to compete internationally and which rose faster than the rate of inflation. Indeed, in 1985 half of the EEC budget of £23,000 million was spent on the storage and disposal of surplus: in the strange world of the CAP, it would be better to destroy the surpluses than store or dump them, since the latter depresses international prices and affects third world agriculture.

The case histories of certain individual agricultural products make this saturnalia even more contemptible. The cost of dairy farmers rose from $184 million in 1973 to £2.5 billion in 1983, by which time it accounted for one quarter of EEC agricultural expenditure. The community's response to booming production was not to lower prices and thereby benefit the consumer, but instead to reduce supplies of milk. In the case of sugar, European farmers got 18c per pound for sugar sold internationally at 5c, which the community was also importing at 18c. The cost of this common agricultural policy stood at $15.4 billion in 1986.

These costs should be seen relative to other national priorities such as health and defence. In 1985 the British Government spent nearly £2 billion on agriculture and $5.6 billion on energy and trade. Considering the diminutive numbers employed in agriculture, and the limited relevance of subsidy to their continued employment, this really does represent an extraordinary distortion of national priorities. Yet, the Treaty of Rome (article 39) proclaims the necessity of ensuring "a fair standard of living for the agricultural population". It is debatable whether it should be at such cost to everybody else, or by methods whose help to farmers is dubious over the long term. Predictably perhaps, heavy state support of farmers was originally the handiwork of the 1945 Labour government. In 1947 their legislation underwrote markets and prices for farmers; the stated objection being to conserve rural living standards. Now, like the sorcerer's apprentice, government seems engulfed by its own creation.

IMPACT ON DEVELOPING COUNTRIES

World food prices are falling; and agriculture in developing countries is under threat. Food aid destroys indigenous agriculture, yet the higher the EEC price, the greater the equivalent export subsidy as surpluses grow. Quotas are imposed and food is sold within the EEC to reduce prices and consequently the budget costs. LDCs are bound by the higher prices guaranteed to European farmers, and their substitutes are forced out of the market. In consequence, the EEC loses trade and strategic support. In fact, while the Lome convention was a trade and aid agreement for free access for certain African, Caribbean and Pacific countries, there was a significant exception. Products affected by the CAP, and especially sugar, were excluded. Such market distortions lead to many absurdities. The EEC actually buys food from one third world country to send to another third world country. The Soviet Union, a big potential market for third world agriculture, is contented with the cheap and stale produce of the EEC and so yet another continental market is barred from developing countries.

Much of the harm is perpetrated by the incompetent agricultural policies of those developing countries. In 1982 the World Bank reported that a major cause of hunger in Africa was the compulsory containment of food prices to appease urban populations. A consequence of this is high food imports.

Yet, these self-inflicted wounds are deepened by the subsidized agriculture of the industrial countries. In the case of sugar for example, it has been claimed that our policies cost third world countries $7.4 million in lost revenue in 1973 alone. World sugar markets continue to be depressed in consequence of EEC policies, a significant fact given the importance of sugar to many economies, particularly the Caribbean.

Suppose industrial countries were to cut their tariffs on 99 commodities by half. One study which looked at the year 1977 calculated that poor countries would have gained $922m in income, and their export revenue would have been boosted by nearly $6 billion: and this was before the protection reached the ultra-high levels of today (World Bank Report). Trade liberalization would create the following bonus:

Efficiency gains caused by liberalization of selected commodities, by country group, 1985. (billions of 1980 dollars):

Country group	Industrial country liberalization	Developing country liberalization	Industrial and developing country liberalization
Developing countries	-11.8	28.2	18.3
Industrial market economies	48.5	-10.2	45.9
East European non-market ecconomies	-11.1	-13.1	-23.1
Worldwide	25.6	4.9	41.1

Note : Data are based on the removal of the rates of protection in effect in 1980-82
Source: Tyers and Anderson (background paper)
From : The World Bank Global Report 1986

importance of prosperous agriculture to developing countries' future prospects cannot be overstated: "Agriculture is the [illegible] industry of the world's poorest countries." It employs roughly 70% to 80% of the labour force in low-income developing countries (World Bank Report). In the lopsided world of the CAP, the irony is that we grow food where it is most expensive.

The rural sector holds the key, then, to third world economic development. Structural solutions such as freer trade are much preferable to direct aid. The best way to give peasant farmers an incentive to grow in the 1990's is the certainty of sales afterwards.

CONSEQUENCES OF CAP

The central irony of the Common Agricultural Policy is that over the long term its influence on farming income is only marginal, since its contributions are bonded into the price of land. Farmers buying new land or a new farm benefit not at all. It is the same for those farmers who rent their property. The exclusive beneficiaries are those owning land at the time of the introduction of the generous policy: and even for them, expansion is made more difficult. Indeed, one study has claimed that the higher the protection, the lower is agricultural income comparative to other sectors of the economy.

The World Bank Global Report (1986) makes both these and other points about agricultural protection:

1] It is an extravagant method of income transfer. In Japan, taxpayer and customer forfeited $2.58 for every dollar gained by the producer. The loss to the one is never a commensurate gain to the other.

2] Protection can take from the poor to give to the rich. The poor carry an inequitable burden of support, since more of their income is spent on food. Generally protection favours landowners. Indeed, the United Kingdom has what has been described as a unique Ducal welfare system.

3] "Investment that generates even more output of a product that already costs more than it is worth, is not progress."

4] Production quotas inflate prices and benefit incompetent producers: but once awarded it is politically difficult to remove them since they aquire the status of a property right.

5] Subsidies are insidious, since they hide the true cost of protection from the customer and thus help legitimize it.

6] Protection policies add the additional costs of administrative expenses, and the diversion of resources from industrial investment and research - ie from a strategically critical area to an irrelevant one.

7] The haphazard evolution of protectionist policies becomes fixed and frozen in time: the structure is continually added to as its unsoundness emerges, but it is never re-built.

8] Liberalization would allow countries to benefit when they had good harvests, and vice-versa. Even though liberalization could create scarcity, it would be better to pay high prices occasionally than pay them every year.

9] Those who gain most from protectionist policies are East European countries: liberalization by OPEC countries would make them poorer by eleven billion dollars, and by thirteen billion if developing countries liberalized.

THE FUTURE

The future programme for the EEC and its agricultural policy is sombre indeed. With low stagnant population and inelastic demand for agricultural products, a growth in exports that is more than proportionate to a growth in production can be expected. With Portugal, Spain and Greece in the EEC, structural costs and income support in agriculture will grow enormously.

The growth in output is likely to continue as unexploited and available technology is fully employed in the EEC. Many new techniques, widely publicized, are becoming available. Cheap credit is on offer, and individual farmers do not perceive any impact from increased output in terms of lower prices. There has been no attempt at reform. Instead, Britain and Germany in particular look at the budgetary implications of the Common Agricultural Policy. The UK is deflected from reform by looking at the budgetary position as a whole, and the prospect of repayments. In many areas the EEC is now a large net exporter of products (dairy and wine for example), and in the case of wheat and wheatflour, is damaging the US producers - hence subsidy wars or complaints to GATT. The Fontainbleau Council of 1984 agreed a budgetary discipline, and this together with the agreement for a balanced community budget, may yield long overdue reform: but the hope is slight.

Community propaganda claims that Britain's share of CAP funding will fall but "whether the overall contribution will rise, however, is a subject of some debate." This is elegant sophistry: Britain's share will fall, but its contribution could rise.

POLICY PROPOSALS

The economic case for liberal trade is impregnable: the strongest arguments against it are all really political. Unilateral freeing of agricultural trade would gain $48.5 billion to the west; the third world could make $28.2 billion if it acted similarly. An apparently selfless act would therefore bring immense material returns. In the case of individual products the consequences would be even more striking. If all countries liberalised their wheat constraints its price variability could drop 48%. Much of the costs of international agricultural subsidy and protection are in fact concentrated on a limited range of products - milk, beef, sugar, cereals - so that positive policies in these areas could make a great difference.

Reformist endeavour might begin with the EEC's own political institutions. There is no organisation of consumer interests to assess policy alternatives and outcomes; while it is too costly for private individuals to obtain the information. The Council of Ministers could be strengthened, and the Council of Agricultural Ministers reformed. The European Parliament could be used more, even though it has tended to support the farmers. There is still excessive autonomy of decision for national governments and hence further competitive distortions (taxation, investment etc). There has to be a move to majority voting to avoid the price raising which is the inevitable concomitant of unanimity voting.

More generally, the Economic and Social Committee of the EEC must be strengthened to articulate customer interests; issues should be decided in full council and not by sectional groupings such as the Council of Agricultural Ministers. The institutional and politically underdeveloped nature of the institutions of the EEC are responsible for agriculture gaining an overwhelming position of power; farm politicians have a surfeit of power and independence within Europe. The Comite des Organization Professionelles Agricoles also has unbounded influence and resources.

Policy initiatives must move to guarantee high prices for a smaller output, and hence less production in the short run. In the long run prices must be limited until they are nearer world prices. A return to world prices would in fact increase them because of higher demand for products, thereby benefitting farmers in the third world and motivating them to produce.

Thus support should be reduced, as should the volume of production which qualifies for support. Production and consumption efficiency are impaired unless output falls with prices. Quotas negate any notion of free trade and common market, and production efficiency is lost when small units are kept in production. The market should determine the level of production and prices, and the EEC could give aid to poor farmers, or income supplement through a social and regional policy. There should be a switch to national support as an interim measure while the CAP is reformed.

The emphasis will be on gradual reform. It would be too much to enforce self-reliance on farmers overnight. The long term objective is clear: negligible state support for farmers, and commensurate reductions in third world aid apart from famine relief, since their gains from fresh trade would outpace their losses. A further way of achieving this would be the incremental reduction of subsidies and tariff barriers over, say, a seven year period, so that agriculture could make the necessary adjustments.

All of this demands a political and communications strategy to stimulate and maintain a high level of public support in what would be a sustained effort. Europe's farmers will respond petulantly, at the very least, and Britain can only secure reform if it finds European allies: Germany is the best candidate, and the strategic coalition partners could then use their power as leverage. Statesmanship and will of a high order are necessary, for without them all prospect of change is illusory.

The British government must recognize that farmers have few votes and little political weight in the UK, and any residual public sentimentality towards them is diminishing. Farming is the most subsidized of all the "nationalized" industries, and the arguments of its leaders simply echo self-interest. In this regard the Ministry of Agriculture does not help; its hand-in-glove existence with the farmers long ago undermined its claim to be an independent department of state.

It constitutes an example, rare in the annals of British history, of how an independent ministry become a dependent lobby. This has been well documented, for instance by the beef hormone treatment it sponsored, which was harmful to public health. This ministry should be abolished, since it forfeited its real independence long ago. It should be merged with the Department of the Environment. Political leadership cannot ignore the frequent ministerial conflicts of interest in this area. The landed group has disproportionate power within parliament.

CONCLUSION

A wanton act is made to seem acceptable when perpetrated by a gigantic bureaucracy of sleek middle aged men, fortified by the remembrance of rural peace. That such sedate Eurocrats should be capable of one of the largest eccentricities in history is surprising. But history will pass an accusing verdict: we poured dinners into dustbins as the beggars sat at our gate. A freer market would be an expression of self-interest, as well as an act of altruism.

Nigel Allington, Department of Business and Economics, University of Wales Institute of Science and Technology.

Nicholas O'Shaughnessy, Department of Management, Loughborough University of Technology.

The authors are indebted to The World Bank Global Report (1986), on which some of the arguments and statistics used in this essay are based. The authors wish to thank Mr Ian Thomson of the European Documentation Centre, University College, Cardiff, for his assistance.

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FT 22 June 1987

'Families pay £11.50 a week in farm subsidy'

By David Blackwell

THE AVERAGE British family pays £11.50 a week to finance European Community farm subsidies, according to a report by the Adam Smith Institute.

The huge surpluses produced by the Common Agricultural Policy cost the average Briton 84p a week just to store, the Institute says in the pamphlet entitled Growing Insanity.

The authors — university lecturers Nigel Allington and Nicholas O'Shaughnessy—conclude that the Ministry of Agriculture should be abolished because its independence is undermined by its close ties with farmers.

The report also finds that the CAP impoverishes Third World countries by restricting their markets. European farmers, for example, have been getting 18 US cents per pound for sugar, while it has been sold at 5 cents per pound internationally

THE TIMES 22 June 1987

UK families pay price of EEC farm subsidies

The average British family pays £11.50 every week to finance EEC farm subsidies, according to a report by the Adam Smith Institute, published today (Our Agriculture Correspondent writes).

The report says that the Common Agricultural Policy (CAP) severely distorts patterns of European employment and puts the cost to Britain of storing surpluses alone at 84p a week per head of population.

The report says that CAP benefited only big farmers, and not the smallholders that it was intended to aid.

In Britain, the CAP leads to countryside ruin and the excessive use of fertilizers, the report says.

Mr John MacGregor, the new Minister for Agriculture, warned his fellow farm ministers in Luxembourg last week that he would not allow decisions to be made which placed an unfair burden on British farmers.

He also made it clear that he would press for an early and substantial devaluation of the green pound, which has led to farmers in Scotland receiving about 20 per cent less for their cattle than in Europe.

hpe18/9.2

FROM: HUW EVANS
DATE: 11 FEBRUARY 1988

MR HUTSON

Ch,
This is briefing for Mr Wakeham, this p.m. Content?

cc Mr Bonney
Mr Matthews
Mr Mortimer
Ms Symes (o/r)
Miss Edwards

OK ~~subject to deletions~~ 11/2

EPR ARTICLE ON AGRICULTURE

I attach a line to take, mainly on the £550 estimate headlined in The Telegraph today, together with a background note from IDT on the timing of the article.

2. Number 10 have asked for this ASAP for this afternoon's PM's questions.

HPE

H P EVANS

1. **<u>Estimate of £550 a family a year cost of CAP?</u>**

Covers cost to consumer of higher food prices, and cost to taxpayer of subsidies, storage and disposal.

Estimate refers to an average non farm family in Europe. No separate figure available for UK, though likely to be broadly similar.

<u>Not</u> UK Government estimate but Australian Government estimate, as EPR article made clear. Very difficult to estimate costs to consumer accurately, but no doubt whatever that, with CAP prices well above world prices, costs are very high.

2. **<u>EPR article doesn't give credit to EC for reform efforts to date?</u>**

On the contrary, article recognises start has been made. Much more remains to be done.

3. **<u>EPR article timed to coincide with European Summit?</u>**

Article sets out Government's long term thinking on agricultural reform. ~~All been said before. Surprised at fuss~~.

But agriculture clearly key issue at European Summit.

Background note

EPR ARTICLE - CHALLENGE OF AGRICULTURE

The Treasury's bimonthly publication Economic Progress Report was published yesterday, containing as leading article a piece describing the problems presented by governments' farm policies worldwide, and the UK Governments' views on the problems and what should be done about them. This has attracted considerable attention in the media, and elicited a statement yesterday from Simon Gourlay, NFU President, at the NFU annual meeting. (Copies attached).

2. The article was written to set out the Government's long term thinking on agricultural reform, and not specifically in connection with the EC summit or any other international negotiations, though it is regarded as providing helpful background to these. But agriculture is clearly the key issue at the EC summit. ~~The article has been planned for several months, and might have been published in either of the two previous issues.~~

3. The article, which draws heavily on a recent OECD publication, National policies and agricultural trade, is a sequel to a previous EPR article , Agricultural protection in industrialised countries, in the September-October 1986 issue. It is a factual background piece.

cc: Mr Byatt
Mr H Evans
Mr R I G Allen
Ms Symes
Mr Hughes

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

12 February 1988

Ralph Howell Esq MP
Weyndling Grange
Dereham
Norfolk

Dear Ralph

You asked about the figure of £550 a year in extra costs for a European family because of the CAP, that was quoted in the recent EPR article on agriculture together with other measures of the distortions created by agriculture support and protection policies.

The EPR article draws on a recent OECD report, published last year, which highlights the extent and effect of the OECD countries' support for their agriculture. This OECD work, together with studies prepared for the World Bank, has presented a strong case for significant reform of agricultural support policies. The UK Government has long been pressing for reform worldwide, as well as within the European Community, in the long term interests of the agricultural community as well as those of consumers and taxpayers. The EPR article reports the Government's thinking on the principles that should guide reform over the longer term; principles that I have drawn on in several speeches in recent years to audiences at home and abroad.

The costs of current policies go well beyond the direct costs to government budgets. Consumers bear a heavy burden in supporting the CAP, through higher food prices, higher taxation and the adverse consequences for other sectors. Some of the burden on consumers benefits farmers, but there is a cost to the economy as a whole because resources are used inefficiently. It is extremely difficult to estimate the costs to consumers accurately, but the Government has asked the National Consumer Council to look at the effects of the CAP on consumers. Its report is expected early in the summer.

The EPR article made it clear that the estimate of up to £550 a year in higher food prices together with higher levels of taxation for an average non-farming family in Europe was an Australian Government estimate. The estimate refers to the average effect on a non-farming family in Europe. The Australian study does not provide separate figures for the UK or any other individual EC country. The derivation of the Australian figures is summarised in pages 12-13 of the Department of Primary Industry Publication, The Political Economy of International Agricultural Policy Reform, and is based on Australian estimates of the total cost of EC subsidies, farm support measures and disposals at around US $25-26 billion in 1986-87, and estimated national support from member governments of a similar magnitude. The study further estimates consumer transfers to producers through domestic prices being higher than world prices at up to US $40 billion in 1984. (Total EC-10 population in 1986 was over 270 million).

As the EPR article said, the Australian estimates did not take into account the effect of a liberalised CAP on world prices, suggesting that the true figure could be somewhat lower. But there are many other uncertainties in the calculation. It is interesting to note that Professor Alan Winters in a recent survey of various estimates of the costs and benefits of agricultural support, published in OECD Economic Studies, Autumn 1987, comments that earlier estimates, using similar methodology, by the Australian Bureau for Agricultural Economics of some 810 ecu per person at 1982 prices (£572 for a family of four at 1987 prices based on 1983 support levels) were based on 'fairly conservative assumptions ..... unlikely to over-estimate the costs'.

You will recall what John MacGregor said when addressing the National Farmers' Union earlier this week: support for farmers and the CAP has increased by 28 per cent in real terms since 1979-80, and agriculture receives 17 times more than the average public spending on manufacturing industry. I am in no doubt that, whatever the very real difficulties of measurement, there are substantial costs to consumers and taxpayers. There is widespread agreement on the need for reform. We must now convince other industrial countries to take action.

Yours ever
Nigel

NIGEL LAWSON

35/3ic 3602/12

Ch/
Content?
AK 12/2

OK w

FROM: SUSIE SYMES

DATE: 12 February 1988

PS/CHANCELLOR

cc Mr Byatt
Mr Evans
Mr Hughes
Mr R I G Allen

TELEPHONE CALL FROM MR RALPH HOWELL, MP

You asked for a draft letter for the Chancellor to send to Mr Howell in reply to his questions about the figure of £550 a year, in extra costs of higher food prices and higher taxation, for a non-farming family of four in Europe, quoted in the EPR article.

2. I think that the reply ought to emphasise the importance of taking account of the costs to ~~commers~~ consumers and taxpayers, rather than become embroiled in details of any one estimate. Mr Evans has seen the attached reply in draft, and is content.

Susie Symes

SUSIE SYMES

DRAFT LETTER FROM CHANCELLOR OF THE EXCHEQUER TO MR RALPH HOWELL MP
WEYNDLING GRANGE
~~DERE~~ DEREHAM
NORFOLK

You asked about the figure of £550 a year in extra costs for a European family because of the CAP, that was quoted in the recent EPR article on agriculture together with other measures of the distortions created by agriculture support and protection policies.

The EPR article draws on a recent OECD report, published last year which highlights the extent and effect of OECD countries' support for their agriculture. This OECD work, together with studies prepared for the World Bank, ~~have~~ has presented a strong case for significant reform of agricultural support policies. The UK Government has long been pressing for reform worldwide, as well as within the European Community, in the long term interests of the agricultural community as well as those of consumers and taxpayers. The EPR article reports the Government's thinking on the principles that should guide reform over the longer term; principles that I have drawn on in several speeches in recent years to audiences at home and abroad.

~~We all know that~~ The costs of current policies go well beyond the direct costs to government budgets. Consumers bear a heavy burden ~~for~~ in supporting the CAP, through higher food prices, higher taxation and the adverse consequences for other sectors. Some of the burden on consumers benefits farmers, but there is a cost to the economy as a whole because resources are used inefficiently. It is extremely difficult to estimate the costs to consumers accurately, but the Government has asked the National Consumer Council to to look at the effects of the CAP on consumers. ~~Their~~ Its report is expected early in the summer.

The EPR article made it clear that the estimate of up to £550 a year in higher food prices together with higher levels of taxation for an average non-farming family in Europe was an Australian Government estimate. The estimate refers to the average effect on a non-farm family in Europe. The Australian study does not provide separate figures for the UK or any other ~~individual~~ EC country. The derivation of the Australian figures is summarised in pages 12-13 of the Department of Primary Industry publication, The Political Economy of International Agricultural Policy Reform, ~~which suggests a contribution of 'more than US$900 from each non-farm family of in Europe'. This figure~~ and is based on Australian estimates of the total cost of EC subsidies, farm support measures and disposals at around US$ 25-26 billion in 1986-87, and estimated national support from member governments of ~~an additional amount of~~ a similar magnitude. The study further estimates consumer transfers to producers through domestic prices being higher than world prices at up to US $40 billion in 1984. (Total EC-10 population in 1986 was ~~just under~~ ~~around~~ over ~~274~~ 270 million).

As the EPR article said, the Australian estimates did not take into account the effect of a liberalised CAP on world prices, suggesting that the true figure could be somewhat lower. But there are many other uncertainties in the calculation. It is interesting to note that Professor Alan Winters in a recent survey of various estimates of the costs and benefits of agricultural support, published in OECD Economic Studies, Autumn 1987, comments that earlier estimates, using similar methodology, by the Australian Bureau for Agricultural Economics of some 810 ecu per person at 1982 prices (£572 for a family of four at 1987 prices based on 1983 support levels) were based on 'fairly conservative assumptions ... unlikely to over-estimate the costs'.

You will recall what ~~the Minister of Agriculture~~ John MacGregor) said when addressing the National Farmers' Union ~~on Tuesday~~ earlier this week: ~~between 1978-79~~ support for farmers under the CAP has increased by 28 per cent in real terms since 1979-80, and agriculture ~~received~~ receives 17 times more than the average public spending on manufacturing industry. I am in no doubt that, whatever the very real difficulties of measurement, there are substantial costs to consumers and taxpayers. ~~We have got to convince other major industrial countries to undertake reform~~ There is widespread agreement on the need for reform. We must now convince other industrial countries to take action.

dti
the department for Enterprise

The Hon. Alan Clark MP
Minister for Trade

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Our ref L01AHG
Your ref
Date 18 February 1988

CH/EXCHEQUER
REC. 19FEB1988
ACTION Mr MOLAN
COPIES TO CST, FST, PMG, EST, Sir G. LITTLER, Sir T. BURNS, Mr MONCK, Mr MOUNTFIELD, Mr H.P. EVANS, Mr BURGNER, Mr WALSH, Mr PGF DAVIS, Mr MATTHEWS

Dear Geoffrey

I am writing about the International Jute Agreement (IJA) which expires on 9 January 1989. A decision has to be taken by the International Jute Council (IJC) whether to extend and/or renegotiate this UNCTAD 'other measures' (ie non price stabilisation) Agreement. I believe the UK should accept the line taken by the Commission and other Member States to agree to enter renegotiations on the basis that it will accept a new Agreement similar to the existing one, ie one that will not allow interference with the operation of the market, by such measures as Buffer Stocking arrangements, or does not move away from the concept of voluntary funding for projects; in short an Agreement in which the extent of members' obligations remains limited, as currently, to a contribution towards administrative costs.

The UK is constrained in its freedom of action by the participation of the Community in the Agreement. The IJA is a 'mixed Agreement' where both the Community and Member States have competence. It is subject to the PROBA 20 arrangement which requires the EC to negotiate from a common position, arrived at if necessary by qualified majority. Other Member States have already signified agreement to negotiating a new IJA and there are no prospects of blocking a Community mandate to renegotiate. The UK should therefore use its influence to ensure that any new Agreement does not operate against UK interests, remains modest in aims and costs, and does not introduce any contingent liabilities.

The administrative costs of the International Jute Organisation (IJO) set up under the Agreement have, since its inception in 1984, amounted to US$ 800,000 to US$ 900,000 per annum, funded equally by producers (5 members) and consumers (25), of which the UK contribution (based on trade shares) has averaged US$ 17,000. Staffed to the full complement agreed by the present IJC costs would probably be around US$ 1,100,000 a year (a UK share of around US$ 22,000). If a new Agreement is ratified ~~our~~ objective would be to seek to ensure no significant increase in this complement or costs. We beleive that other Member States and importing countries would share this objective. We would seek too to ensure no contingent liabilities under any new Agreement (there are none at present).

The IJA was the first 'other measures' Agreement to be implemented under the UNCTAD Integrated Programme for Commodities. The objectives of the current Agreement are to improve structural conditions in the jute market, improve its competitiveness, enlarge its markets, develop its quality and to develop production and trade to meet the requirements of world demand and supply. These are to be achieved through agricultural and industrial research and development and market promotion projects. The objectives also include the collection and dissemination of market information and the consideration (with no commitment to action) of such issues as the question of stabilisation of supply and demand and of competition with synthetics. When the organisation came into being it was expected to be able to take advantage of the Second Account of the Common Fund, but has had to rely for its projects on voluntary contributions. The resulting shortage of finance, as well as the necessity of developing good organisational procedures, led to a slow start to project work. The IJO, based in Dhaka, has not so far shown much result as agricultural projects, regarded as a first priority, have only got underway in the last year. We have made no contribution to project costs.

Nevertheless producers, primarily Bangladesh and India, but including Thailand, Nepal and China, pay high regard to the existence of the Agreement. Bangladesh was still dependent on jute for 56% of its export earnings in 1984/85, although its reliance on this has decreased over the period of the current Agreement.

The UK originally became involved largely as a damage limitation exercise, and this factor persists. Other EC Member States take a similar view, that although the IJO holds few, if any, benefits for them, the minimal costs of membership are outweighed by the political consequences of withdrawing. Other consumers (USA, Canada, Australia and the Nordics) are thought to share these views.

dti

the department for Enterprise

Rt Hon Sir Geoffrey Howe QC MP February 1988

During negotiation on the first Agreement some producers (notably Bangladesh) pressed strongly for the introduction of market stabilisation measures, ie Buffer Stocking. This was resisted by the consumers and there is no reason to believe any have softened their opinion. Belgium and the UK are by far the largest EC importers of jute and jute products. The UK retains only a very small manufacturing industry but has considerable merchanting interests. The IJC also provides a forum for addressing UK (and EC) concerns about infringements of trading rules by suppliers.

The approach outlined in my first two paragraphs is in line with the Inter-Departmental Review of Commodity Policy which concluded that existing Agreements without market intervention provisions should continue to be treated on their merits, as long as they did not provide a pretext for the introduction of market intervention measures.

I should be grateful if you would let me know by 23 February if you disagree with this approach.

I am copying this letter to the Prime Minister, Nigel Lawson, John MacGregor and Sir Robin Butler.

Yours ever

ALAN CLARK

RESTRICTED

Pse

10 DOWNING STREET

LONDON SW1A 2AA

CH/EXCHEQUER
REC. 18 FEB 1988
ACTION Mr Bonney.
COPIES TO CST, PMG, Sir P. Middleton, Sir G. Littler, Mr Anson, Mr Lankester, Mr Burgner, Mr Mercer.

From the Private Secretary

18 February 1988

Dear Lyn.

BRUSSELS EUROPEAN COUNCIL: NON-ARABLE AGRICULUTRAL STABILISERS

The Prime Minister has seen Paris telegram no. 197 dealing with French indications on the other agricultutral stabilisers which are due to come to the Foreign Affairs Council on 22 February.

While the indications that the French will not hold up adoption of the package as it stands at the Foreign Affairs Council are on the face of it satisfactory it is quite clear that they have every intention of trying to unpick it subsequently in the Agriculture Council. The Prime Minister wants to know what assurances we can have that they will not succeed. If individual parts of the overall agreement reached in Brussels can be unpicked subsequently the Government's whole position on the legally binding nature of these conclusions will look risible. The Prime Minister would like some early advice on how we can be sure that no parts of the package can be changed. Obviously we have leverage while the Own Resources decision still requires ratification but thereafter we shall have less hold. Can we, for instance, get a statement that the non-arable stabilisers, like every other part of the Brussels package, can only be changed by unanimity? So far as she is concerned it would be a complete breach of faith and of the assurances given by the Presidency at the European Council. It may therefore be something which we should discuss with the Germans.

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

Yours sincerely,
Charles Powell

(CHARLES POWELL)

Lyn Parker, Esq.,
Foreign and Commonwealth Office.

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sy9

PPS p! Pmp

FROM: SUSIE SYMES
DATE: 18 February 1988

PS/CHANCELLOR

cc: Mr Byatt
Mr A J C Edwards
Mr Evans
Mr R I G Allen
Mr Bonney

Ch/ Content for me to write as proposed (I have suggested a few amendments).
JT 19/2

OK

AGRICULTURAL REFORM

In the agriculture debate in the House of Commons on Monday 15 February a number of references were made to the figure of £550 a year in extra costs for a European family because of the CAP (see attached extracts from Hansard). Responses from Mr Gummer were not helpful (and not consistent with the Chancellor's ten principles).

2. It is particularly irritating that MAFF Ministers have failed to take a robust line on this figure because:

- the EPR article was agreed at official level between Departments, and personally by Mr MacGregor;

- Mr Bonney gave MAFF a line to take the afternoon before the debate, a line which was included in briefing. I also gave MAFF officials the same general line following Mr MacGregor's recent radio interview.

3. As we discussed, it would be helpful if you could deal with this through a private office letter, not least because the Prime Minister could face similar questions. The attached draft has been agreed with EC and IAE1.

Susie Symes

SUSIE SYMES

dti

the department for Enterprise

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PRIME MINISTER

THE COMMON FUND

Following your meeting on 10 November on the Common Fund, I wrote to a number of EC Ministers seeking their views on the possibility of deratification. All except Portugal have now replied and a summary of their reactions is attached.

2 None would be prepared to take the step of deratification. That confirms our concern that if the UK were to do so, we should be isolated in the Community and that, in turn, would make it very probable that the Commission would mount a challenge in the European Court.

3 Nevertheless, the consultation was useful in eliciting declarations from our main Community partners that they shared in some degree our scepticism about the continued relevance of the First Account. The generally expressed preference for putting more emphasis on the Second Account, providing assistance for development and diversification, would not solve all the problems. But there does appear to be a shift towards a more cautious approach on which we can build further.

4 It now seems probable that the required level of ratifications to bring the Fund into force will be reached this Summer. Before then, there will be discussions in the EC and OECD on how the Community and Group B should respond. It is impor t ant that we should have a clear strategy from the outset.

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5 First, there are a number of basic principles to which we should seek as wide agreement as possible:

- both Accounts should be subject to stringent rules as regards eligible expenditure and operating procedures.
- calls for contributions should be kept to the minimum.
- tight limits and rigorous supervision should be applied to the expenses of administration.
- the operation of the Fund should be so drawn as to avoid contingent liabilities falling upon its members.

Not only are such principles desirable in themselves, their application would mean that the process of negotiating and agreeing the rules for the operation of the Fund would inevitably be lengthy.

6 Secondly, we must aim, with the help of sympathetic partners like the Germans, to neutralise the First Account. To freeze it formally would require 75% of eligible votes for a change in the Agreement. Since the developing countries will have some 60% of the votes that is unlikely to be possible but there are ways in which the First Account might be kept in abeyance. We can seek to defer discussion of the detailed operating rules without which the Account cannot become active until there is an agreed need for them. If it came to a vote on establishing rules for the ocnduct of business we can try to ensure that the necessary 75% was not reached. In parallel, we can use our membership of commodity agreements to dissuade them from associating with the Fund or seeking assistance. In practice only two Agreements, Cocoa and Rubber, are at present eligible and neither has so far shown any interest. Over and above this, we can encourage other Community colleagues to transfer to the Second Account all of the

limited number of shares which the Articles of the Fund permit them to transfer from the First, thereby reducing its borrowing capacity.

7 Thirdly, in the case of the Second Account, we can seek to ensure not only that the merits of proposals for expenditure should be fully scrutinised but that activities should not duplicate those of other agencies.

8 There is nothing which we can do to prevent the Fund from coming into being. We can, however, try to ensure, as I have indicated, that it will be some time before it can operate, that its activities will be heavily circumscribed and that the First Account will not be used. In time, it may be more possible to persuade others to accept that the arrangements should be changed in a direction more acceptable to us or even brought to an end. We should also resist any attempts to extend Community competence in relation to the Fund.

9 I should mention that soon after our ratification of the Agreement, London was offered informally as a candidate for the site of the Common Fund headquarters. I propose that we now let that offer lapse. No formal action is required.

10 I am sending copies of this letter to the Foreign Secretary, the Chancellor, the Minister of Agriculture, the Attorney General and Sir Robin Butler.

DY

19 February 1988

Department of Trade & Industry

V4MAEW

Annex

SUMMARY OF REPLIES RECEIVED FROM EUROPEAN COMMUNITY GOVERNMENTS TO THE SECRETARY OF STATE'S LETTER OF 30 NOVEMBER ON POSSIBLE DE-RATIFICATION OF THE COMMON FUND AGREEMENT

France

France cannot consider withdrawal from the Fund Agreement, "for legal, constitutional and political reasons". The government accords very special importance to internal co-operation in the commodities field and the Common Fund remains a priority for them.

They accept that International Commodity Agreements have not taken sufficient account of long-term market trends in the past. But they wish to support future co-operative efforts to make commodities markets transparent, predictable and stable.

However, they acknowledge that the First Account of the Fund cannot now play the part originally envisaged in the Integrated Programme for Commodities, and believe that there will be a consequently more important function for the Second Account in supporting the economies of the poorest developing countries. They even propose that all of the Fund's resources should be allocated to the Second Account. [Note: This would require amendment of the Agreement which is unlikely to command the necessary majority].

Italy

Italy still considers international co-operation in the commodities' field relevant. If approached sensibly, commodity agreements can foster growth in developing countries and help with debt problems. The Italian government does not wish to give any sign of unwillingness to assist developing countries and feels that the Common Fund Agreement represents an important moment of understanding in the North-South dialogue.

They appreciate the difficulties over operation of the Fund's First Account, but hope for a "swift functioning of the Second Account".

Netherlands

Agree with some of the UK's criticisms of the Fund, but believe that deratification would harm our credibility with the developing countries, leaving aside legal implications of "such an unprecedented step".

Agree that the operative value of the First Account is limited and favour a shift in emphasis to the Second Account which is important "for projects in ... research, development, market promotion and diversification".

Denmark

The Danish government continue to see the Common Fund as an important political and financial commitment to international co-operation in the field of commodities and, on a wider scale, to the economic and social development of the developing countries. They welcomed the Final Act of UNCTAD VII, which reaffirmed the validity of the Integrated Programme for Commodities, and in that context could not question the concept of the Common Fund. However, they do share UK doubts about the possible use - if any - for the First Account of the Fund and favour a switch in emphasis to Second Account-type operations, which they feel would be more attractive to developing countries.

West Germany

In discussion with the Secretary of State for Trade and Industry, the West German Economics Minister privately conceded that the best solution would be withdrawal. Since this would cause a political storm, the best solution was to ensure that the First Account was starved of funds.

Belgium

Shares the UK view on the profound changes in the world economy since the Common Fund Agreement was negotiated. These "call in question" the suitability of the First Account of the Fund for dealing with problems experienced by commodity producing countries in the Third World. They would, however, not welcome the political repercussions resulting from de-ratification of the Agreement.

cc Mr Byatt
Mr A J C Edwards
Mr Evans
Mr R I G Allen
Mr Bonney
Ms Symes

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

22 February 1988

Mrs S Stagg
Private Secretary to the
Minister of Agriculture, Fisheries and Food

Dear Shirley

AGRICULTURAL REFORM

The Chancellor has seen the references in the agriculture debate on 15 February to the figure of £550 a year in extra costs for a European family because of the CAP, including contributions from your Minister of State. As this figure has gained some currency and is likely to be raised again, it may be helpful if I suggest a line which all Ministers could use.

The EPR article drew on various sources for measures of the distortions created by agricultural support and protection policies throughout the world. It made clear that the estimate of up to £550 a year in higher food prices together with higher levels of taxation for an average non-farming family in Europe was an Australian Government estimate and not our own. The figure is based on estimated expenditure and prices, and if the calculations were updated there could be differences in detail. But updated figures, in all probability, would be higher rather than lower.

In the Chancellor's view it would be unfortunate if Ministerial comments on the source or accuracy of the detailed calculation left the impression that the Government did not accept that current CAP policies impose very substantial costs to consumers and taxpayers. Indeed, his paper entitled the 'Ten Principles of Agricultural Reform', which was endorsed by your Minister in November last year, emphasised that the costs to the consumer and to the economy more generally are as important as the budgetary costs in justifying reform. In that context our Ministers agreed that opportunities should be taken to demonstrate the magnitude of the total costs so that they can be better understood, and more recently your Minister agreed - No.10 and FCO were also aware - that the EPR article should be published last week with this in mind.

The Chancellor therefore considers that when this question is raised again the most appropriate line to take would be to acknowledge frankly that there are very substantial costs to consumers and taxpayers; as with all such estimates, the

Australian figure of £550 is an approximation that gives an indication of the broad order of magnitude involved, but it is not out of line with the results of other studies. The Government's long term strategy is to reduce these costs. The agreement that has been reached on stabilisers should make a contribution to this.

If your Ministers have serious difficulties with the Australian work, the best solution in the medium term might be for MAFF officials to produce their own estimates of these costs in consultation with Treasury and FCO economists. I understand, however, that the National Consumer Council already have work in hand for their study of the costs of the CAP that was commissioned by DTI.

I am copying this letter to the Private Secretaries to the Prime Minister, Secretaries of State for Foreign and Commonwealth Affairs, Environment, Employment, Trade and Industry and Secretary to the Cabinet.

Yours sincerely

Jonathan Taylor

J M G TAYLOR
Private Secretary

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CH/EXCHEQUER
REC. 23 FEB 1988
ACTION Mr BONNEY,
COPIES TO CST, PMG, Sir P. MIDDLETON, Sir G. LITTLER, Mr ANSON, Mr LANKESTER, Mr BURGNER. Mr MERCER

23/2

1 Jamaltra (weeded) 2 [illegible]

Foreign and Commonwealth Office

London SW1A 2AH

22 February 1988

Dear Charles,

Brussels European Council: Non-Arable Agricultural Stabilisers

Thank you for your letter of 18 February.

The Foreign Secretary agrees with the Prime Minister's interpretation of French intentions. He had already sent further instructions to Paris and to other Posts (copy enclosed) making clear that, once the text on non-arable stabilisers is approved by the Foreign Affairs Council, it cannot subsequently be unpicked in the Agriculture Council.

The legal regulations implementing the stabilisers package will be adopted by the Agriculture Council by qualified majority. Where the stabiliser texts do not themselves make clear provision for action we can expect arguments about what the regulations should say. For example, the wine stabiliser refers to the phasing out of the special price support guarantee for long-term storage (the garantie de bonne fin). But, despite our efforts before Copenhagen to secure greater precision, it does not set a date by which that is to happen.

We believe we can rely on the Commission to bring forward the necessary draft regulations to implement the stabiliser package in satisfactory form. The French would thereafter have to secure unanimity to change the Commission proposals. We would clearly block any such attempted change. Moreover, as your letter says, there can be no question of our adopting the own resources decision (which requires unanimity) unless we are satisfied that all the regulations have been adopted in a way which faithfully implements the European Council conclusions.

Because the regulations implementing the stabilisers are adopted under Article 43 it would be possible subsequently to change them by using the same Article. We believe that the Commission are unlikely to propose any weakening of the regulations:

(i) it would go against the whole trend of Commission proposals towards controlling agricultural spending.

(ii) Any proposal to weaken the controls inherent in the regulations (eg through the price fixing) would risk breaching the guideline. The Commission have committed themselves to keep their price fixing proposals consistent with the guideline. They would be reneging on

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this commitment if they were to propose changes in the regulations which implied price proposals inconsistent with the guideline.

Annex 1 of the European Council conclusions allows recourse to the agriculture and budget articles of the Treaty (43 and 203) as well as to Article 113 (trade measures). But this can only happen under certain conditions, notably if a third country fails to meet its international commitments and this causes serious repercussions on world markets. The Council could vote additional expenditure by qualified majority but there would first have to be a Commission proposal to do so.

(iii) the cereals stabiliser will last until 1992, ie throughout the period covered by the European Council conclusions.

(iv) In the absence of a Commission proposal to change or override the regulations there is no way in which they can be diluted, ie there is no way in which the member states by themselves can initiate action.

Short of Treaty amendment (which would itself require unanimity) we cannot have absolute legal certainty that the regulations incorporating the stabilisers will not be amended during the lifetime of the own resources decision once it has been adopted. But paragraph 19 of the European Council conclusions says that the decisions on budgetary discipline are legally binding and that corresponding legal texts will be adopted which will remain in force for the duration of the Own Resources Decision. This provision, combined with the provisions of the stabiliser texts themselves, eg that the cereals stabiliser will operate up to and including the 1991/92 marketing year, gives us as much certainty as is possible short of Treaty amendment. The very precise wording we have secured in the Conclusions represents a better assurance that the stabilisers will not be weakened during their lifetime than would any further Council statement.

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

Yours ever,

Tony Galsworthy

(A C Galsworthy)
Private Secretary

C D Powell Esq
PS/No 10 Downing Street

101750
MDHOAN 8980

CONFIDENTIAL
FM FCO
TO DESKBY 180830Z PARIS
TELNO 124
OF 172100Z FEBRUARY 88
INFO IMMEDIATE OTHER EC POSTS

FRAME ECONOMIC/AGRICULTURE

YOUR TELNO 197 : BRUSSELS EUROPEAN COUNCIL : NON-ARABLE AGRICULTURAL STABILISERS

1. GAUTIER-SAUVAGNAC'S REMARKS IMPLY THAT THE FRENCH HOPE TO AVOID FURTHER ARGUMENT AT THE FAC WHILE EFFECTIVELY RESERVING THEIR RIGHT TO REOPEN OR KEEP OPEN TWO ISSUES IN THE NON-ARABLE STABILISERS PACKAGE. BUT THE TERMS OF THE ANGLO-DUTCH RESERVATION MEAN THAT THERE CAN BE NO SUCH LATITUDE FOR SUBSEQUENT AGRICULTURE COUNCIL CONSIDERATION OF THE FRENCH POINTS ON WINE/MILK: UNLESS ALL EIGHT STABILISERS ARE CONFIRMED, IN THEIR PRESENT FORM, IN THE FAC, THE OVERALL BRUSSELS AGREEMENT FALLS.

2. THOUGH THE POINT IS THEREFORE ACADEMIC, WE DO NOT AGREE WITH THE FRENCH INTERPRETATION OF THE 1986 MILK REGULATION. IT PROVIDES FOR THE COUNCIL TO DECIDE BEFORE 1 APRIL 1988 ON THE COMPENSATION FOR THE ONE AND A HALF PER CENT QUOTA CUT DUE TO TAKE EFFECT FROM 1 APRIL 1988 (IN ADDITION TO THE 4 PER CENT ALREADY IN OPERATION) AND ADDS THAT THE COUNCIL MAY DECIDE NOT TO APPLY THE CUT ON THE BASIS OF A COMMISSION PROPOSAL, TAKING ACCOUNT OF THE MARKET OUTLOOK AND THE STOCK POSITION. THE TEXT ON MILK IN SN 461/88 COVERS THE FIRST POINT BY PROVIDING FOR COMPENSATION UNTIL 1991/92 FOR THE FULL 5 AND A HALF PER CENT QUOTA CUT. THE SECOND POINT DOES NOT APPLY SINCE THE COMMISSION HAS MADE NO PROPOSAL TO WAIVE THE ADDITIONAL CUT. WE THEREFORE CONSIDER THE TEXT OF THE STABILISER FULLY COMPATIBLE WITH THE REGULATION.

3. ON WINE, THE TEXT REFERS TO THE COMMISSION'S INTENTION GRADUALLY TO REDUCE THE VOLUME OF WINE ELIGIBLE FOR GDBF, WITH A VIEW TO PHASING IT OUT. THIS IS A CLEAR STATEMENT OF COMMISSION INTENT WHICH IS AN INTEGRAL PART OF THE PACKAGE AND MUST BE COMPLIED WITH.

4. IN YOUR FURTHER CONTACTS WITH THE FRENCH YOU SHOULD DRAW ON THE ABOVE POINTS, PARTICULARLY THE SECOND SENTENCE OF PARA 1. OTHER POSTS MAY ALSO DRAW ON THE ABOVE AS NECESSARY.

5. FOR YOUR OWN INFORMATION. ONCE THE NON-ARABLE STABILISERS PACKAGE HAS BEEN ADOPTED BY THE FAC, IN ACCORDANCE WITH THE EUROPEAN COUNCIL CONCLUSIONS, THE AGRICULTURE COUNCIL WILL OBVIOUSLY HAVE A ROLE IN CONSIDERING THE VARIOUS COMMODITY REGULATIONS TO GIVE EFFECT TO IT. BUT THIS WILL BE A ROUTINE, CONSEQUENTIAL, TASK: AND WE MUST NOT GIVE THE FRENCH ANY GROUNDS FOR HOPING THAT CHANGES TO THE SUBSTANCE OF ANY ELEMENT IN THE PACKAGE MIGHT BE ANY MORE FEASIBLE THEN THAN IN THE FAC NEXT WEEK. THE WHOLE PACKAGE - AND THE OVERALL AGREEMENT - STANDS OR FALLS NOW.

HOWE

YYYY

DISTRIBUTION 281

MAIN 280

FRAME ECONOMIC/AGRICULTURE ECD (I) (-)

ADDITIONAL 1

FRAME

NNNN

From: Teddy Taylor, M.P.

22nd February, 1988.

ECONOMIC SECRETARY
REC'D 25 FEB 1988
ACTION Mr Jefferson-Smith C+E
COPIES TO PS/Chancellor 2
PS/CST PS/FST PS/PMG
Mr Culpin
Miss Sinclair
Mr Michie
Mr P R H Allen C+E
Ms Barrett C+E
PS/C+E

Peter Lilley Esq., M.P.,
Minister,
The Treasury.

Dear Peter,

I much appreciated the courteous way in which you dealt with the questions on Nigel Spearing's PNQ today.

I was, however, surprised at your specific statement about the power of veto after 1992. While it is, of course, true that the Single Act does not specify any time limit in relation to the unanimity rule, the clause does state specifically that the Council shall produce a harmonisation plan consistent with the completion of the market by 1992. It would therefore appear to me that if the Council have not produced such a plan by 1992 (perhaps because of Britain's use of the veto), the Commission would be entitled to take the Council to the

This does not imply any particular scheme of tax approximation, & tax scheme requires unanimity.

Court/

Court and that the Court could then make a ruling on what was required.

What do the excellent Treasury solicitors consider will be the status of the veto and the power of the Commission to go to court if the Council doesnot produce an agreed plan by 1992- a situation which now appears inevitable in light of the UK's stated position on zero rating?

Any advice you could give would be greatly appreciated.

Yours,

Teddy

M436/031

Ch: Effectively we have no choice. I have suggested an amendment. (See also Sir G Howe's minute, behind).

Ch/ Content?

FROM: R MOLAN

DATE: 22 February 1988

1. MR P G F DAVIS
2. CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir G Littler
Sir T Burns
Mr Monck
Mr Mountfield
Mr H P Evans
Mr Burgner
Mr Waller
Mr Walsh
Mr Matthews
Ms Symes
Mr Stevens
Miss Preston o/r
Mr Tyrie

INTERNATIONAL JUTE AGREEMENT

Mr Clark's letter of 18 February to the Foreign Secretary seeks the agreement of colleagues that, subject to certain conditions, the UK should accept the line taken by the European Commission and other Member States that the EC should enter into negotiations on a new International Jute Agreement.

BACKGROUND

2. The current Agreement contains no provision for market intervention. Its objectives are to improve structural conditions in the jute market, improve its competitiveness, enlarge its markets, develop its quality and to develop production and trade to meet the requirements of world supply and demand. These objectives are achieved through agricultural and industrial research and development and market promoting projects. Members of the Agreement are only obliged to make a contribution towards the cost of administration. Projects mounted under the agreement are funded through voluntary contributions. The Agreement expires on 9 January 1989. So far very little project work has been carried out largely due to a shortage of finance. The UK has made no contribution to project costs. Despite the Agreement's

lack of impact producers heavily dependent on jute exports pay high regard to its continued existence. If and when the Common Fund comes into operation, money might be borrowed from the Second Account for projects promoted under the Agreement.

3. The UK is constrained in its freedom of action here as, like in the case of other commodities, the Community is required to negotiate from a common position arrived at if necessary by a qualified majority. Other Member States are happy to enter negotiations and there is no prospect of the UK blocking a Community mandate. Mr Clark argues that the UK should use its influence to ensure that any new agreement does not interfere with the operation of the market and does not introduce any contingent liabilities. (So far consumer countries have firmly resisted producer pressure for market stabilisation measures to be introduced.) Also, funding for projects should remain voluntary thus limiting the UK's obligations to a contribution towards administrative costs.

RECOMMENDATION

4. As Mr Clark says, we effectively have no option but to go along with the Community in agreeing to the Agreement being renegotiated. The line which he proposes that the UK take on the exclusion of market intervention provisions in any new agreement and the need to avoid contingent liabilities is fully in line with the deregulatory policy on commodities agreed collectively in 1986. The maintenance of project funding on a voluntary basis is also an important objective. We recommend therefore that you agree to the line proposed. I attach a short draft reply. Mr Clark has asked for replies by tomorrow (23 February). IAE2 are content.

R Bennett

R MOLAN

DRAFT LETTER TO:

The Hon Alan Clark MP
Minister for Trade
Department of Trade and Industry
1-19 Victoria Street
LONDON SW1H 0ET

INTERNATIONAL JUTE AGREEMENT

Thank you for copying to me your letter of 18 February to Geoffrey Howe. I have seen Geoffrey's reply of 23 February

2. As there is no prospect of blocking a Community mandate, I am reluctantly prepared to agree to ~~In the circumstances I am content with~~ your proposal that the UK should ~~agree~~ go along with the proposal that the EC enter renegotiations on the basis that any new agreement will not contain any provisions for market intervention and that contributions for projects will remain voluntary. I also agree of course that we should use our influence to ensure that no new contingent liabilities arise from any new agreement.

3. I am copying this letter to the Prime Minister, Geoffrey Howe, John MacGregor and Sir Robin Butler.

NIGEL LAWSON