

PO-CH/NU/0456

PART A

Past .A.

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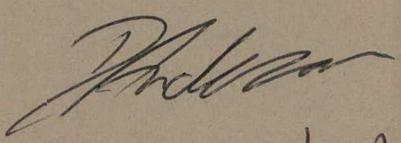
Begins : 11/7/88.
Ends : 22/7/88.

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PO CH | NL | 0456.
PT.A.

Chancellor's (Lawson) Papers:
Drought In the United States
of America.

DD's: 25 Years



7/2/96.

PO CH | NL | 0456.
PT.A.



[Handwritten signature]

✓
12/7

CH/EXCHEQUER	
REC.	12 JUL 1988
APPROV.	Ms Symes
COPIES TO	CST, EST
	Sir G. Lister, Mr. Lancaster
	Mr. Rigby, Mr. H. P. Evans
	Mr. Bugner, Mr. Bomey
	Mr. Tyrie

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FCS/88/129

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11/7/88

SECRETARY OF STATE FOR TRADE AND INDUSTRY

US Drought

1. In Cabinet on 30 June you referred to the current US drought, and suggested that officials might provide some analysis of the possible effects.
2. The attached note, prepared by my officials in consultation with yours, Nigel Lawson's and John MacGregor's, draws some preliminary conclusions for US policy, CAP costs, and GATT negotiations. Such conclusions can only be provisional at this stage, for crops still in the ground could stand a few more weeks or drought, and the US Department of Agriculture will not make their first full assessment until early August. The analysis of the possible effects on the CAP needs to be handled with particular caution at this stage; and it would of course be a serious mistake to refer in public to possible benefits accruing in Europe from current problems in the US Mid-West.

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3. Copies of this minute and enclosure go to the Prime Minister, other Cabinet colleagues, and Sir Robin Butler.

A handwritten signature in black ink, appearing to be 'G. Howe', is written over the typed text.

(GEOFFREY HOWE)

Foreign and Commonwealth Office

11 July 1988

**US DROUGHT: IMPACT ON EC/US RELATIONS IN AGRICULTURAL TRADE****Effects on the US**

Actual and expected drought damage to spring wheat, oilseeds, maize crops in the mid-West has pushed prices very high (Annex A). But rain could still save much production and markets are still very sensitive to weather. Cereal stock levels carried over from 1987/88, together with forecast production, would exceed forecast consumption in 1988/9. If present price levels are held, US deficiency payments will be reduced, relaxing pressure on the 1988 and 1989 US farm budget. However this effect may be largely offset by disaster assistance. Stocks will be run down, which may lead to there being no requirement to "set aside" land for 1989. The livestock sector is suffering first, with herds being reduced, owing to rising feed costs and reduced pasture.

As yet the Administration have not proposed emergency legislation. They plan to wait until the full effect of the drought is known (possibly in August) and seem intent to play down its impact on consumer prices (currently estimated by the US Department of Agriculture at about 1%). Washington attitudes remain bipartisan; but if the drought continues, a political auction in bids for disaster assistance may be unavoidable. Democrats might also seek farm belt support by distancing themselves from the Administration's pitch for zero support by the year 2000, although the US proposal in GATT excludes disaster relief and direct income support from the zero target. Annex B indicates farm belt states which could be winnable by Dukakis in November.

The drought is not a national phenomenon: for example, the electorally very important states of California and Florida, each with high value added agriculture, also happen to have



an agricultural sector largely protected by irrigation. In the mid-West, where there is no such protection, the shoe has not yet begun to pinch in the southern grain growing regions where winter wheat has been safely harvested: the problem is likely to be greater further north. The Republicans could lose politically in electorally important areas of the mid-West if the Administration were seen not to be responding satisfactorily, or if the Democrats were able to produce a politically attractive over-bid with sufficient credibility. But it is too early to judge how this will work out.

Effects on CAP Expenditure

In the Community, sustained sharp rises in the world prices of cereals and of oilseeds and proteins will result in cuts in CAP spending. On the basis of current world prices, estimated full year savings in the oilseeds and proteins sector could be about 2.46 becu; in the cereals sector about 1.7 becu; and for sugar about 0.26 becu, although savings from lower rates of export restitution particularly for cereals could be partially offset by increased export volumes. Total savings to the Community Budget could exceed 4.5 becu (see Annex C), with the dollar's rise also producing CAP savings, but this figure must be treated with great caution since the likelihood of current prices prevailing for a full year cannot be gauged.

Effects on the GATT Negotiations

Overall effects on the GATT negotiations are hard to judge. On the one hand, the immediate pressure for reform will be reduced, as higher world prices mean lower PSEs. EC hard-liners will argue that lower expenditure on support, increased scope for exports, and the need for stockpiles to off-set world market volatility make it inappropriate to reduce market support. Similarly, the Cairns Group may



judge it appropriate in the changed negotiating climate to soft pedal the case for short term reform, and instead put more emphasis on the need for radical longer term measures. They would then move closer to the US position, which might harden the attitude of some EC Member States. But to avoid losing market share, and in order to maintain pressure on the Community, the US is likely to set low or even zero "set aside" requirements for 1989 which, short of a further drought, could result in world prices reverting to earlier levels.

If maintained, high oilseed world prices could improve the position of the Community in the US/EC soya dispute. EC growers' current reliance on support would be very much reduced, and the argument that the EC needs to maintain a certain degree of self-sufficiency would appear stronger.

On the other hand, if a drought opens up a debate in the US on the need for support to agriculture, it may make the US less vociferous in public about zero/2000. On the Community side, if world prices move above EC support levels that might create a breathing space in which consideration of longer term reforms, as well as some short term measures, could be less politically charged. So there may be an opportunity to make progress at the MTM with less political pain, particularly on the framework for longer term reform.

Whatever the effects of the US drought on agricultural budgets in 1988 and 1989 it is important that the GATT negotiations should not lose sight of the high resource costs of agricultural subsidies and trade barriers. The UK GATT aim should remain agreement at Montreal on a clear framework for long term reform and specific early actions consistent with the long term objective of major, multilateral reductions in agricultural support and protection.



Commodity	Unit	Price	Price	Price	3 month
		W/e 24 June 1987	W/e 8 April 1988	W/e 24 June 1988	future price (Sept)
Corn (No 2 yellow)	\$/bushel*	1.79	1.91	3.15	3.51
Sorghum	\$/cwt	3.16	3.14	5.59	
Barley (No 2 feed)	\$/bushel	1.70	1.93	2.55	
Oats	\$/bushel	1.70	1.79	4.00	
Soybeans	\$/bushel	5.40	6.44	9.69	9.63
Soyameal	\$/bushel	5.77	6.53	9.99	
Sunflowers	\$/bushel	7.75	8.55	13.40	
Wheat (No 1 Hard Red winter)	\$/bushel**	2.70	3.14	3.92	4.00
Pigs (for slaughter)	\$/cwt	62.20	42.63	48.25	
Pigs (for fattening)	\$/head	43.13	56.75	24.06	
Steers	\$/cwt	69.04	74.42	67.79	
Cows	\$/cwt	46.62	50.50	40.25	
Lambs	\$/cwt	75.00	-	57.00	

* Target price for corn is \$2.93 in 1988

** Target price for wheat is \$4.23 in 1988



Annex B

Reagan percentage point victory in 1984 Presidential Election

Montana +	22
N Dakota +	31
S Dakota	26
Minnesota	(Mondale Victory)
Michigan +	19*
Wisconsin +	9*
Iowa	7*
Missouri	20
Illinois	13*
Indiana	24
Ohio +	19*
Kentucky	21
Nebraska	42
Kansas	33
Texas +	28
Arkansas	22
Louisiana	23
Tennessee +	16*
Alabama	23
Mississippi +	25
Georgia	20
S Carolina	28

* = Reagan victory of less than 20 percentage points, indicating possible vulnerability for Bush in November.

+ = incumbent Democrat Senator (elected 1982) up for re-election.

POSSIBLE SAVINGS IN CAP FULL YEAR EXPENDITURE

EC Assumed Tonnage Supported, either on production (i) or exports (ii)	Commission Assumed Rate ecu/tonne	Latest Rate (7 July)	Estimate of full year saving (mecu)
Rapeseed 6.3 mt (i)	303	91.9	1458
Sunflower 2.7 mt (ii)	416	246.4	492
Soya 1.7 mt (i)	404	264.0	249
Peas and Bean feed 3.7 mt (i)	142	77.9	259
Sugar 3 mt (ii)	450	368.8	264
Sugar production refunds ** 0.2 mt	380	324	12
Wheat 16.5 mt (ii)	123	79.5	760
Barley 9.5 mt (ii)	126	68.74	577
Durum wheat 2.5 mt (ii)	190	120	186
Other cereals 2.0 mt (ii)	126	68.74	127
Food aid export refund element 1.0 mt (ii)	123	79.75	46
Starch production refunds	190	100	185
			4615*

* Total savings on cereals export restitutions could be partially offset by higher volumes of exports.

** Refunds to enable sugar to be sold to the chemical industry.

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The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State for Foreign and
Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
LONDON
SW1

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Handwritten notes:
JBS PL
28/7
21/7

CH/EXCHEQUER	
REC.	21 JUL 1988
ACTION	Mr SYMES
COPIES TO	CST, EST,
	SIR G. LITTLER
	Mr LANKESTER
	Mr R.I.G. ALLEN
	Mr H.P. EVANS
Mr BURGNER	
Mr BONNEY	
Mr TYRIE	

Direct line 215 5422
Our ref DW3AOZ
Your ref
Date 21 July 1988

Handwritten signature:
New Geoffrey

US DROUGHT

I am grateful for the paper on the implications of the US drought, which you circulated on 11 July. Although the uncertainties are such that no firm conclusions can yet be drawn on the impact on the CAP or the Uruguay Round negotiations, it is still helpful at an early stage to have identified the various possible effects.

It is, as the paper points out, conceivable that the drought could assist the process of agricultural reform rather than hindering it. If that is the case, the Mid-Term Meeting in Montreal in December may prove to be better timed than we had thought. My own guess however, is that a crisis in the Mid-West, with its associated effects on world prices, would be more likely to make progress more difficult, by giving those EC Member States resistant to reform an excuse for further delay and making the US Administration even more reluctant to contemplate short-term measures involving reductions in support levels. I understand indeed that proposals have already been tabled in Congress for additional support for drought affected farmers. The attraction of the zero/2000 option is, of course, that it maintains pressure on the Community, while imposing a low prospective price on US farmers for the immediate future.

The impact of the drought, coupled with a change in Administration, must, in my view, make the prospects for a substantive package on agriculture at Montreal less certain. There is no reason for us to redefine our objectives yet, however. And we must certainly maintain our efforts to

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the department for Enterprise

· persuade the Community to give serious consideration to ideas for short term measures, such as those recently tabled by the Cairns Group.

I am sending copies of this letter to the recipients of yours.

*John
Haw*

the
Enterprise
initiative

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



From the Minister

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State for Foreign
and Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
LONDON

CH/EXCHEQUER	
REC.	22 JUL 1988
ACTION	Ms SYMES
COPIES TO	CST, EST, SIC & LITTLER, Mr LANKESTER, Mr RIS-ALLEN, Mr H.P. EVANS, Mr BURGNER, Mr BONNEY, Mr TYRIE

✓ 22/7

22 July 1988

Dear Secretary of State,

US DROUGHT

Thank you for sending me a copy of your minute to David Young about the US drought and the accompanying paper.

First, may I emphasise again what I said in Cabinet, that I entirely agree with the thought in your minute that we should avoid referring in public to possible benefits for Europe from current problems in the US. I am particularly concerned that this could make things more difficult for us in maintaining pressure within the Community for further CAP reforms. There are already all too many people beginning to contemplate and voice the thought that the pressure is off. So I think it is vital that we do not give any public currency to the figures mentioned in your paper, which as you say need to be treated with particular caution anyway.

Second, paradoxically the drought could make world supply problems worse in a year or two, depending on next year's weather. We still have surpluses, some will feel the pressure is off and they can expand again, some earlier potential takers of set-aside in the Community may postpone any such plans, and a good deal more land may come back into arable production to offset the current effects.

Third, as regards the Community I would be surprised if those Member States (the majority) who have shown themselves resistant to further reform of the CAP up till now were to change their attitude because world prices rise and cut EC budget costs this year or next. Past experience suggests that they are much more

likely to argue /...

likely to argue that the fall in costs reduces the need for further reform and the failure of the US harvest demonstrates the wisdom of maintaining EC production levels and holding surplus stocks.

So I think it is over-optimistic to expect our Community partners to undergo a change of heart because of the US drought. I fear that we shall still find in the autumn that we are steering a rather lonely course in urging the Community towards further reforms on agriculture in the Uruguay Round.

I am therefore myself taking an extremely cautious line in public, and arguing that I see nothing in a one-year climatic occurrence on one continent to cause us at this stage to be deflected from our longer-term strategy.

I am copying this letter to the Prime Minister, other Cabinet colleagues and to Sir Robin Butler.

Yours sincerely

John

JOHN MacGREGOR
(Approved by the Minister
and signed in his absence)