PREM19

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EUROPEAN POLICY

(Agriculture)

(Part 1)

MT

Pt 1

Confidential Filing

Common Agricultural Policy (CAP)

Review of Support for British Agriculture

EUROPEAN POLICY

Pt 1 MAY 1979

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
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PART 1 ends:-

MODBA to PM 26.10.79

PART 2 begins:-

MODBA to MAFF 29.10.79

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
CC (79) 2nd Conclusions, Minute 3 (extract)	17.5.79
OD(E) (79) 12	6.6.79
OD(E) (79) 13	6.6.79
OD(E) (79) 14	7.6.79
OD (E) (79) 3rd Meeting, Minutes	11.6.79
C (79) 20	12.6.79
OD(E) (79) 17	12.6.79
CC(79) 6th Conclusions, Minute 4	14.6.79
OD(E) (79) 4th Meeting, Minute 3	15.6.79
CC(79) 12th Conclusions, Minute 3	26.7.79
CC(79) 16th Conclusions, Minute 2 (extract)	4.10.79
CC (79) 17th Conclusions, Minute 3 (extract)	18.10.79
OD(E) (79) 36	22.10.79
CC(79) 18th Conclusions, Minute 3	25.10.79
OD(E) (79) 14th Meeting, Minutes	25.10.79

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed OWayland Date 19 September 2009

PREM Records Team

I trust the talks will run into the sand. I don't believe N.Z wants a regime. Neither do I. And as we want to change the C.A.P. I can see little point in "undertaking" it. MT.

(2)

PRIME MINISTER

Sheepmeat

You will wish to glance at the attached OD(E) paper on proposals for a common organisation for sheepmeat in the EEC, and at the minutes of the meeting at which the paper was discussed.

The prose is distinctly opaque in places, and you may care to have some background.

Sheepmeat is included in the Treaty of Rome as an agricultural product for which there should be a common organisation of the market. The Community has been discussing a suitable regime for several years. The proposal now under discussion is extremely liberal when compared with the regimes governing other CAP products. There are no variable lev~~els~~ies; only the 20% duty. If New Zealand were asked to limit her sendings voluntarily, this would be in exchange for a tariff reduction. The French have been pressing for some form of intervention, but are being resisted by most other members including the UK. Instead of intervention, a system of premia (or deficiency payments) is proposed.

The Minister of Agriculture's memorandum, attached, suggests a system which would involve a net benefit to the UK under the Community budget. This is because we possess almost half the Community sheep flock, which is of course far more than our share of the Community budget contributions. There would be some extra public expenditure as the result of the scheme. The Chief Secretary has accepted this as tolerable in the context of our general strategy on the Community budget, and as an offset to our commitments under our present national

/ scheme.

scheme.

OD(E) agreed on Thursday that the Minister of Agriculture could indicate readiness to consider Community financing at the next Agriculture Council (on 30 October) provided the French were by then complying in every way with the judgement of the European Court.

Since Mr. Muldoon's return to Wellington, the New Zealand Government has agreed to continue exploratory talks with the Commission. OD(E) also decided on Thursday that the Minister of Agriculture should not concede any changes in the Community's external arrangements which would be unacceptable to New Zealand.

26 October, 1979.

2

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

Prime Minister
Mr Walker has a point here. In any case, it would seem wrong to publish expenditure plans based on the current EEC policies.

From the Minister

CONFIDENTIAL

Rt Hon John Biffen MP
Chief Secretary to the Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

24 October 1979

Thank you for your letter of 22 October about the forecasts in your public expenditure proposals of our net contribution to the Community budget and of expenditure under the CAP by the Intervention Board.

I am glad to have your confirmation that these forecasts assume that the 1% VAT ceiling will be raised so as not to inhibit a continuing increase in our net contribution.

I still regard this as an unrealistic and prejudicial assumption, for the 1% limit can be raised only with our agreement and, as the Prime Minister said in Luxembourg last week, we do not intend to see it raised. I agree of course that the precise effect of maintaining the limit will depend on the policies the Community adopts to ensure that expenditure does not exceed revenue. But I cannot conceive of any realistic assumptions which, if the 1% limit were maintained, would produce a forecast as high as the Treasury figure of £2 billion in 1983-84 for our net contribution to the Community together with expenditure by the Intervention Board.

If in your view there are realistic assumptions consistent with the 1% ceiling which would produce this figure, I would suggest that you might state them so that all our Cabinet colleagues would have an opportunity to examine them. You mention, for example, the possibility of extra revenue being raised in the

/form of new.....

form of new agricultural levies. But this too could only be done with our agreement and I see no likelihood of the sort of levy which would be acceptable to other member countries (that is, which would discriminate in favour of their small producers and be largely offset by a price increase) being acceptable to us.

If, on the other hand, you cannot find realistic assumptions which, with the 1% limit maintained, would produce the levels of Exchequer cost in the Treasury forecast, then it seems to me to be wrong to build those figures into our public expenditure plans. Estimates on a realistic basis would clearly show a substantial saving. That in turn would, I hope, persuade you to withdraw your damaging proposals to halve the incentives to investment in wealth-producing, import-saving agricultural expansion.

I am sending copies of this letter to the Prime Minister, the Foreign Secretary and Sir John Hunt. and to all members of Cabinet

PETER WALKER

Euro Pol

Treasury Chambers, Parliament Street, SWIP 3AG

Rt Hon Peter Walker MP
Minister of Agriculture
Ministry of Agriculture
Fisheries and Food
Whitehall Place
LONDON
SW1A 2HH

22 October 1979

Dear Peter,

At Cabinet on Thursday you queried the reliability of the forecasts of the net contribution to the Community and expenditure within the UK on the CAP in view of the 1% VAT ceiling.

It is true that the forecasts make no assumption about the policy effects of the 1% VAT ceiling. They are based on the best assessment that the Treasury can make in consultation with your Department of likely contributions to and receipts from the Community on the basis of existing trends. I do not accept, however, that a lower or more reliable forecast would be made by imposing the constraint that there would be no increase in the 1% VAT ceiling.

The effect on the total of the UK's net contribution and expenditure within the UK on the CAP of such a constraint would depend on the policies adopted by the Community to enable it to stay within its provision.

One possibility is that Budget expenditure would continue to grow unchecked since extra revenue could be raised in another form eg through levies applied as part of specific policies. These are not regarded as "own resources" and are not subject to a ceiling. Alternatively, the ceiling might act as a brake on Budget expenditure, but the effect on net UK public expenditure would be unpredictable, since this would depend on how the constraint affected different types of expenditure. If, for example, the cost of the CAP were substantially reduced and non-obligatory expenditure, particularly the Regional and Social Funds, remained untouched or even continued to grow, a reduction in net UK public expenditure would indeed be likely because we do relatively well out of these funds, but very badly out of the CAP. If, on the other hand, Agriculture Ministers do not take the necessary policy decisions, CAP expenditure continues to rise and, by virtue of being 'compulsory' expenditure, squeezes out expenditure on the Regional and Social Funds, net public expenditure in the UK could be higher than if the ceiling were raised. Another possibility is that some CAP expenditure could be 'de-budgetised' and fall to be met by member states directly. This might reduce the total of the UK's expenditure on the CAP and its net contribution to the the Community budget, but it would not necessarily do so. Much would depend on the effect debudgetisation had on trade flows in agricultural products between member states.

The above alternatives therefore have vastly different effects on net UK public expenditure. Since they are all quite possible outcomes of a decision to hold to the 1% ceiling, we find it impossible to say that any one of them produces a more realistic picture than the forecasts which we have put forward or that it can necessarily be assumed that such a decision would produce a measurable reduction in public expenditure. Certainly we cannot make our other public expenditure plans on such an assumption.

I am sending a copy of this letter to the Prime Minister, the Foreign Secretary and Sir John Hunt.

Yours

John Biffen

JOHN BIFFEN

File

~~Copy~~ also to PPS
Michael Franklin (C.O.)
pls.
TL
19/10

10 DOWNING STREET

From the Private Secretary

SIR KENNETH BERRILL

CABINET OFFICE

The Prime Minister has received, on a personal basis, the enclosed paper from the Minister of Agriculture. She has asked me to show it to you, also on a personal basis, so that it can be taken into account in the Agricultural Review which you are undertaking. For obvious reasons, she has asked that it should not be circulated to the Review Group.

T. P. LANKESTER

18 October 1979

GB

VB

Euro Pol

MR. VILE
CABINET OFFICE

Support for British Agriculture

The Prime Minister has seen and considered Sir John Hunt's minute of 15 October, and has decided that the composition of the inter-departmental group under Sir Kenneth Berrill's Chairmanship should be as she indicated earlier. If the Secretary of State for Scotland argues that his Department should be represented, she will stand by the earlier decision.

TPL

18 October 1979

1

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

From the Minister

Prime Minister
This argues for additional expenditure!

CONFIDENTIAL

17 October 1979

I suggest you reserve comment until we have the Berrill report. Can I show this to Ken Berrill on a personal basis - ie. not for the group as a whole.?

PRIME MINISTER

AGRICULTURAL STRATEGY

When we spoke about agriculture on 1 October I promised to send you a note, on a personal basis, outlining the situation as I see it and the strategy I think we should pursue. I now do so.

2. This note is not intended to pre-empt the review of agriculture that has been set in hand following the Cabinet discussion of milk prices on 4 October. But I was anxious that you should have an account of the facts before Cabinet resumes discussion of Treasury proposals for expenditure cuts. When you have read the note I am sure you will understand why the cuts in agricultural support that the Treasury are proposing seem to me to be quite unacceptable, and directly contrary to our basic strategy of improving the supply side of the economy.

TL 17/10

PM - yes

3. I hope you will agree that no decisions should be taken on any reduction in aid for agriculture in advance of the review we are now carrying out. I am confident that the review will demonstrate the case for more, not less, support for an industry which, unlike so much of our manufacturing industry, can be relied on to respond to incentives by increasing production, exports and import saving.

PETER WALKER

CONFIDENTIAL

AGRICULTURAL STRATEGY

NOTE BY THE MINISTER OF AGRICULTURE, FISHERIES AND FOOD

1. This note explains why I am so concerned about the prospects for British agriculture, why it is essential that we should carry out the agricultural policies promised in our Manifesto, and why I am resisting proposals which would mean reversing those policies.

The Potential

2. Agriculture is vital to our economy. It contributes over £3bn to gross domestic product, saves £5½bn worth of imports (of which £1bn represents the improvement in performance since 1965), gives employment directly to over 650,000 people and indirectly to many more in its ancillary industries and food processing and distribution, and sustains the whole economy of the countryside.

3. An expanding agriculture could contribute even more. We still import 35% of the types of food we can produce here. If we could reduce this to 25% - which is perfectly feasible - the additional net import saving would be £750m, with further benefits in GDP terms from the spin-off effects on the related manufacturing and processing industries. Agriculture's record of increasing productivity (free from restrictive practices, it has produced productivity increases of 6% per annum) and its international competitiveness - both in dramatic contrast to those of most manufacturing industry - show that it could and would respond to positive policies.

4. If on the other hand we were to depress agricultural production - and already under Labour our beef and pig herds have fallen - then the wealth-producing capacity of the economy

would be diminished, our import bill raised, the consumer's assurance of supply be impaired and the likelihood of sharp consumer price increases be greatly enhanced.

Labour's Record

5. Labour's agricultural policies were negative and depressive. Labour ranked the short-term advantage of holding down food prices through manipulation of the green £ above the longer-term gains of expanded wealth-creating production and secure supplies. With costs rapidly increasing through inflation, this artificial depression of returns meant that net income was squeezed, investment discouraged, production held back. The index of real net farm income since 1973 - our last year of government - shows what has happened:-

1973	123	
1974	100	
1975	100	
1976	106	
1977	104	
1978	85	(provisional)

The Promise

6. The Manifesto stated very clearly the radically different approach of our own Party: "Labour has seriously undermined the profitability of these [the agricultural and food] industries. We must ensure that these industries have the means to keep abreast of those in other countries". Many members of the Shadow Cabinet cogently argued the case for stimulating agricultural production.

The Threat

7. After the years of Labour depression we have a lot of catching up to do. So far we have not done it: in fact, we

are falling further behind. Labour made a green £ devaluation of 5% earlier this year and we added one of 5%. But these devaluations, plus the recent 1% change and the common support price increase (except for milk) of 1½%, will together add at most only £270m to farm revenue in 1979. Input costs (particularly feed, labour, interest, fertilisers and fuels) on the other hand are increasing at the rate of £750-800m. As a result, bank borrowings have increased by over £400m above the already astronomical level of £2000m we condemned Labour for during the Election - and farmers are having to pay 17½% interest on this much larger sum.

8. If we take no further measures, the index of real net farm income for 1979 will fall to about 70. That would be 18% lower than 1978 (the worst of the Labour years), which in turn was 18% lower than 1977.

9. The prospects for 1980, if nothing is done, are far worse. Farming costs generally will probably increase by 11% (assuming a relatively small increase in feed costs).* If we assume a static volume of production - which in these circumstances may be optimistic and no green £ devaluation, no change in retail milk prices and of course no common price increases, then the index of real net farm income would fall to around 50. It would have been halved in our first two years of office, and more than halved from the level (123) at which we left it in 1973. Simply to bring it up to the level in the worst Labour year (1978) would need a green £ devaluation of 12% (assuming sterling's exchange rate against the ECU made this possible) <u>and</u> and increase in the retail milk price of 2½p per pint.

<u>The Sectors</u>

10. The profitability of most commodities is being squeezed, but the livestock sector - representing about two-thirds of our farm production and an even larger proportion of our farmers - is in general being hit harder than the arable. The worst areas of immediate difficulty are <u>milk</u> and <u>hill sheep</u>.

* For other main cost items increases of about 15% have been assumed.

If we do not increase the retail price of milk or devalue the green £, real net margins per dairy cow in 1979/80 will be 28% down on 1978/79. After the losses of a hard winter, hill sheep farmers are now getting lower prices for store lambs, even in money terms, than last year and hill farm incomes this year are likely to have fallen by 35-40%.

The Competition

11. Under the CAP our farmers have to get their return from the market, in direct competition with producers in other Community countries. Our farmers are still in general more efficient than theirs. But theirs are improving fast, with the aid of massive assistance from their Governments.

French agricultural output is 2½ ours in value terms

12. Other member countries not only pay their producers more (the table at Annex 1 shows how prices compare) but also spend far more than we do, relative to the size of their industries, on national aids. The French agricultural budget this year is £2.5bn and in 1980 will be £2.9bn, including £585m (£125m more than my Department's entire budget of £460m!) on subsidised credit alone. (The table at Annex 2 shows how our farmers are already disadvantaged by the much higher rates of interest obtaining here. If we were to subsidise them down to the subsidised level in France and Germany the Exchequer cost would be £300m). The German Federal budget for agriculture was nearly £1650m in 1979, and the Lander Governments add large aids of their own (over £300m each in Bavaria and Westphalia). The Dutch have introduced investment aids through tax allowances, including large handouts to farmers who pay little or no tax. Irish farmers still pay very little tax (£7m in income tax from the entire industry in 1977). Every other member country looks greedily at the British market and will seize any opportunity of increased sales here that we are foolish enough to offer.

The Treasury's Proposals

13. Against this background - declining real income, shrinking profitability, heavy borrowing, falling investment and heavily and increasingly subsidised competition - what do the Treasury propose? They propose that public expenditure on agriculture should be reduced by 18% in 1981/2, 24% the year after and 25% the year after that. They propose:-

(i) to cut capital investment grant rates by 50%;

(ii) to cut hill farm subsidies by 20%;

(iii) to slash research programmes and advisory services (when other countries are extending theirs);

(iv) to withdraw all support for sheep and potatoes; and

(v) to hold down the retail price of milk.

And all this is intended to improve the supply side of the economy!

14. Already I have turned down the farmers' demands for an immediate green £ devaluation. My announcement this week of no increase in the milk price will be very badly received, and when I announce next month the ending of the beef premium scheme (to save administrative costs) this will be a further shock to confidence. If on top of all this I were to agree to the cuts that the Treasury want (and to the staff cuts that the Lord President has proposed), then I believe we would produce the biggest crisis of confidence in British agriculture since the war.

15. Confidence in our agricultural policies has already been shaken by the temporary rise of sterling in August to the point where no further green £ devaluation could have been made, even if we had wanted one. Because of sterling's oil-sustained

strength, the industry are no longer convinced that we shall be able to give them the resources they need through green £ devaluation. To take away part of the direct assistance now available from Government would leave us with no credible policy at all.

The Right Strategy

16. The right strategy for agriculture is the reverse of what the Treasury propose. I do not wish to pre-empt the review of agriculture which we have now agreed to carry out. But in my view the measures we shall need to take will include:-

(i) A further devaluation of the green £. This would help restore confidence in this, the main instrument of our agricultural policy. There are strong arguments for doing it before Christmas, thus leaving us free to take the hardest possible line on common prices in next year's crucial CAP price fixing;

(ii) an increase in capital grants through the introduction of the streamlined system Derek Rayner is proposing, at rates of grant higher on average than those under the present cumbersome scheme and with provision for doing more in fields such as marketing and sheep housing;

(iii) substantial increases in the hill livestock allowances (we pay far less than the maxima allowed under the Community scheme, to which Community funds contribute); and

(iv) an increase at the appropriate time in the retail price of milk.

17. Measures on these lines would not merely show that we were keeping faith with the policies we promised in Opposition: they would also encourage British agriculture to make the increasing contribution to the nation's wealth of which it is fully capable.

17 October 1979

Average Producer Prices in 1978 and 1979 (1st Quarter): £

Per 100 kg

	Germany	France	Italy	Neth.	Belg.	Irish R.	Denmark	UK
Cattle (live)								
1978	86.6	82.4	79.3	90.5	87.0	65.0	73.8	53.5
1979	88.2	81.5	80.6	88.8	85.8	na	71.7	56.5
Pigs (dead wt)								
1978	88.3	83.4	84.3	109.7	87.9	85.9	85.9	77.2
1979 (1st Q)	87.7	84.2	87.4	105.7	88.3	na	83.6	79.0
Milk (3.79 fat)								
1978	14.21	11.21	14.4	13.0	12.1	11.1	12.96	9.41
1979	14.54	12.53	15.0	13.5	13.1	na	13.40	10.12
Wheat								
1978	11.9	9.27	11.35	9.84	10.9	na	10.3	8.7
1979 (1st Q)	12.55	9.75	11.51	11.43	11.7	na	na	9.4
Barley								
1978	10.56	8.05	10.7	10.3	9.77	8.44	9.2	7.98
1979	11.37	8.96	11.0	11.0	10.9	na	na	8.75
Sugar Beet								
1978	2.12	1.8	2.3	2.0	2.04	2.30	1.90	2.03

ANNEX 2

Short-Term Interest Rates in EEC Countries (Sept 1979)

United Kingdom	17.50
France	12.25 **
Germany	9.40 *
Netherlands	11.25 **
Belgium	11.50 **
Luxembourg	8.75 *
Denmark	11.00 **
Ireland	16.40
Italy	16.50 *

Under the provisions for subsidising credit for agriculture, interest rates for the countries marked (*) are reduced to 3-4% and for those marked (**) to 5-6%.

Top Copy on: Euro Pol, Pt 2.
Euro Budget.

Ref: A0446

CONFIDENTIAL

PRIME MINISTER

Community Affairs

You might wish to inform the Cabinet of the main outcome of your talks in Rome on 4th-5th October with the Italian Prime Minister. Signor Cossiga showed himself to be sympathetic to our budgetary objectives but anxious also to ensure that the Dublin European Council did not send Italy away empty-handed. He wants a commitment that more of the Community Budget should be spent on the regional and social funds and support for Mediterranean agricultural producers, and less on price guarantees under the CAP. On Theatre Nuclear Force modernisation he was reasonably encouraging, though he was worried about the timing of NATO decisions.

2. The Chancellor of the Exchequer might be invited to report on the second and final round of discussions at the 15th October Finance Council of the Commission's Reference Paper on the Budget problem. The Germans and others stressed the need to build on the existing Financial Mechanism; the French were predictably negative. The Commission agreed to produce their proposals for a solution in good time before the 19th November Finance Council. You will be talking to Mr. Roy Jenkins on Monday; and OD will be discussing the budget question again on 24th October.

3. The Minister of Agriculture will wish to report on the sheepmeat discussions at the 15th-16th October Agriculture Council, at which he secured the backing of all seven other member states and the Commission for pressing France to comply with the European Court ruling condemning her import restrictions on British lamb and mutton. Agriculture Ministers are to hold a special meeting in the margins of the 29th-30th October Fish Council to take forward the long standing discussions on a possible sheepmeat regime. OD(E) will consider later on 18th October what tactical use can be made of the sheepmeat lever in the Budget context; and Mr. Walker plans to clear his detailed line for the special sheepmeat meeting in OD(E) next week.

JOHN HUNT

John Hunt

17th October 1979

CONFIDENTIAL

Ref. A0423

P/W § briefs for Luxembourg.

MR. ALEXANDER

Cost of the CAP

The Minister of Agriculture sent a copy to the Prime Minister of his letter of 8th October to the Lord Privy Seal about the possible publication of a detailed expert paper on the costs of the CAP. I understand that the Lord Privy Seal will suggest that the publication of this article would not be helpful at this stage when we are seeking, until the run up to the Dublin European Council, to concentrate on the Budget. Unless Mr. Walker contests this advice, I do not think the Prime Minister need intervene.

2. As the Prime Minister knows, the largest part of our excessive net contribution to the Community Budget is due to the CAP. But as she is also aware, the CAP involves resource and balance of payments cost to the United Kingdom in addition to those arising from the Budget transfers. The size of these non-Budget transfers came up in connection with the Prime Minister's visit to Signor Cossiga (letter from the Financial Secretary's office to you of 3rd October). The Prime Minister may find it useful to have the attached note by the European Secretariat of the Cabinet Office which sets out the different elements in the overall cost of the CAP to the United Kingdom. The figures have been agreed with MAFF and the Treasury.

(John Hunt)

16th October, 1979

CONFIDENTIAL

Common Agricultural Policy: Budgetary and non-Budgetary Costs

1. The CAP is financed from the European Agricultural Guidance and Guarantee Fund (FEOGA) which in 1978 absorbed 74 per cent of the Community's Budget. Of the total cost of about £6,000 million in that year, about £250 million went on reform of agricultural structure (the Guidance Section) and the rest on price guarantees in which the main elements were:-

	£m
Milk and milk products	2,670
Cereals	740
Sugar	580
Beef	420
Other products	740
Net cost of Monetary Compensatory Amounts (MCAs)	600

On the other side of the Community Budget, levies on imports of food from third countries amounted to about £1,100 million. These levies accrue to theCommunity Budget and represented about 19 per cent of Community revenue in 1978.

2. The overall cost of the CAP to the UK can be split into three elements:-

(i) the net budgetary cost of the CAP;

(ii) the non-budget transfer cost from importing at higher prices from other member states as measured by the size of the levies;

(iii) a similar transfer cost on products subject to tariffs rather than levies.

These three elements are discussed in paragraphs 3 to 5 below. We estimate that for 1978 they amounted to:-

	£m
Net Budgetary contribution	673
Net non-Budgetary transfer (levies)	110
Net non-Budgetary transfer (duties)	100

In these figures, MCAs have been treated as benefitting the exporting country. If they are allocated to the importing country, the non-budgetary cost in (ii) becomes bigger (£586 million) and the budgetary cost correspondingly lower. The total for the two is unaffected but because we are concentrating on the Budget problem we are sticking to the lower figure for (ii) in our presentation in Brussels. Totals for later years will show an increase in the overall non budgetary transfers: the 1978 figures are untypically low because MCAs were high in that year and agricultural exports unusually large. Costs to the UK on non-budgetary as well as budgetary transfers represent gains to other member states like Denmark, France, Ireland and the Netherlands who are net exporters of food. Italy is a large importer of milk products, cereals and beef from the rest of the Community, has a particularly unfavourable non-budgetary transfer for items subject to levy (£588 million in 1978) but this was partly probably offset by gains from her exports of fruit and vegetables subject to tariffs.

Budgetary Costs

3. The net budgetary cost of the CAP to Britain in 1978 can be reckoned as:

	£m
Gross Contribution to FEOGA[a]	920
Gross Receipts from FEOGA[b]	247
Net Contribution	673

a. Calculated by applying each country's share in financing the total Community Budget to total FEOGA expenditure.

b. UK import MCA attributed to the exporting member state.

This net contribution of £673 m scores in full as UK public expenditure.

Budgetary transfers (products subject to levies)

4. Additional transfers between member states take place outside the Community Budget. This is because the CAP supports the main farm products by managing the market within the EEC at a level well above the world price, through variable levies on non-EEC imports and through buying up domestic surpluses. Thus imports from other member states cost more

because they are made at these managed prices instead of at the world prices which would prevail in the absence of the CAP; and there is a corresponding gain on exports from one member state to another. The average level of the levy on imports from outside the EEC is a convenient measure of this difference. For 1978 the UK figures are:

	£m
extra cost of imports from EEC[a]	383
extra receipts on exports to EEC[b]	273
net non-budgetary transfer	110

a. Calculated after deducting the Monetary Compensatory Amounts on our imports, since these are paid out in the exporting member states and the goods therefore arrive here at an MCA-paid price.

b. Calculated without deducting the MCAs charged on our exports since these are collected in the UK and transmitted to Brussels, thus forming part of our net contribution.

This cost of £110m is not public expenditure, but it represents a drain on our balance of payments and a benefit to our Community partners.

Non-Budgetary transfers (products subject to duties)

5. Some products (notably fruit and vegetables) are protected under the CAP by ad valorem tariffs rather than by variable import levies. The principle is the same but the calculation more uncertain. The balance of payments loss on these tariffs is estimated to be of the order of £100m.

CABINET OFFICE SW1

15 October 1979

Prime Minister

Will you stand by the earlier decision and not include the Scottish Office?

TL 15/10

Yes not.

Ref: A0419

MR. LANKESTER

Support for British Agriculture

In your minute of 8th October you said that the Prime Minister agreed to the proposal for an interdepartmental group under Sir Kenneth Berrill's chairmanship with representatives from the Treasury, MAFF, FCO, Trade and Employment - and with the other Departments affected (Scotland, Wales, Northern Ireland and Industry) being brought in as necessary.

2. Sir William Fraser, the Permanent Secretary at the Scottish Office, has now written to me pressing for full membership of the group for the Department of Agriculture for Scotland and making it clear that if I turn him down he will go to his Secretary of State. A copy of Sir William Fraser's letter is attached. His letter has been supported by the Permanent Secretary of the Ministry of Agriculture who has pressed that the Welsh Office Agriculture Department and the Department of Agriculture (Northern Ireland) should also have representatives on the group throughout.

3. I am clear that it would not be right just to add the Scottish Agriculture Department. It is a case of all three territorial Departments or none. Sir Kenneth Berrill and I would prefer to resist their claims because -

(i) not only would it enlarge the group by three, but there would be four spokesmen for the farming lobby as opposed to one for the consumer;

(ii) on most of the group's work there will not be separate territorial interests. Where there are (e.g. hill farming) the territorial Departments would be invited: and in any case the group's report would be circulated to them in draft for comment before it was finalised.

4. On the other hand, I see little point in turning Sir William Fraser down if the Prime Minister, on broader political grounds, would later feel it necessary to uphold the appeal which would almost certainly be forthcoming from his Secretary of State.

5. I should therefore be grateful if you could let me know whether the Prime Minister would like the group to work on the basis originally approved or if she feels it necessary to add the territorial Departments. It would be very helpful to have an early reply because the group needs to start work.

John Hunt

15th October 1979

1. MODBA
2. TPL · to see
MJS

Foreign and Commonwealth Office
London SW1

15 October 1979

Thank you for your letter of 8 October seeking agreement to publication of the paper "The CAP and Resource Flows between Member States" by K S Warwick and J M Rollo (now with the FCO Economists Department).

I have no objection in principle to publication of such a paper. But I think that there is a risk that publication now would be interpreted in other Member States as evidence that we were preparing to mount a campaign over CAP resource costs as well as over the cost of the budget. While not questioning that we should in due course seek reforms in that quarter, I believe that to be thought to be mounting such an attack now might have a damaging effect on the budget negotiations. I therefore suggest that we postpone publication until after the Dublin European Council at the end of November.

I am sending copies of this letter to the Prime Minister and to Geoffrey Howe.

The Rt Hon Peter Walker MP
Minister of Agriculture, Fisheries and Food
Whitehall Place
London SW1

SCOTTISH OFFICE
WHITEHALL
LONDON SW1A 2AU
01-233 8229 or 7602

W. K. FRASER C.B.
PERMANENT UNDER-SECRETARY OF STATE
Sir William Fraser KCB

11 October 1979

CONFIDENTIAL

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Sir John Hunt GCB
Cabinet Office
Whitehall
London SW1

Dear John,

REVIEW OF BRITISH AGRICULTURE

Your letter of yesterday to Brian Hayes suggests that only the largest of the four agricultural Departments should be represented on the new group to review British agriculture. I know that, like the Prime Minister, you want to cut down the size of groups, committees, working parties, etc; but I really cannot accept the implication that this group will be delayed or become unmanageable unless Departments with a major interest in the subject under review are excluded from it. I am all in favour of saving money, time and travel by having "corresponding members" of committees; but in this case that role is totally inappropriate for the Department of Agriculture and Fisheries for Scotland.

What you propose is, so far as I can discover, without precedent in the agricultural field. Over the years DAFS officials have taken a leading part not only in the annual reviews but in ad hoc exercises such as those leading to the last two White Papers on agricultural policy. This is not simply a parochial or presentational point: the practice, economics and structure of farming in Scotland differ markedly from those in England.

I do not want to bother my Secretary of State with this, but I am obviously not prepared to wait until Ministers are presented with the group's report to tell him that we have been on the periphery of the exercise. He will no doubt wonder, as I do, why his Department of Agriculture has been excluded but the Department of Employment included in a group to consider what is "a matter of direct concern" to him (the words are from X | Tim Lankester's minute of 9 July). I should be very grateful if you would look at this again and agree that R D Cramond of DAFS should be designated a member of the group.

I am copying this to Brian Hayes, Hywel Evans and Ken Stowe.

Yours,
Ken W Fraser.

X But this minute (Flag A) was directed at Ministerial attendance at Ministerial committees.

R. 10/10

Filed on:- Cabinet: Attendance May 1979

cc Mr Vile

The Rt Hon Sir Ian Gilmour Bt MP
Lord Privy Seal
Civil Service Department
Whitehall
London SW1

8 October 1979

I thought I should mention to you that we are thinking of publishing next week in the Government Economic Service's series of technical working papers a paper by two of my economists on the resource flows between member states that result from the Common Agricultural Policy. The paper is strictly technical and concerned with the methodology of measuring these resource flows. It does however apply that methodology, by way of example, to resource transfers in 1977 and 1978, and therefore gives figures for the adverse effects on the UK.

My own view is that it would be helpful to have it published but I would like to have your agreement.

I am sending copies of this letter to the Prime Minister and to Geoffrey Howe.

PETER WALKER

1. ~~Mr Alexander~~

F.C.O. will advise against publication. No need for us to intervene. Michael Franklin goes along with them, (the FCO.)

2. P.A.

THE CAP AND RESOURCE FLOWS BETWEEN MEMBER STATES

INTRODUCTION

The impact of the Common Agricultural Policy (CAP) of the EEC on the balance of payments of member states has been recognised for some considerable time. In the UK, several assessments have been made, notably those published in White Papers prior to 1973 (HMSO (1967), (1969), (1971)). More recently a number of articles by academic economists, both in the UK and abroad, have examined the impact of the CAP on different member states (Attwood (1979), Blancus (1978), Godley et al (1977), (1978), CEPG (1979) and Koester (1978)). Work has also been carried out in the Ministry of Agriculture, Fisheries and Food on various aspects of this problem during the last decade. This Working Paper sets out the basic elements of that work and presents, in some detail, calculations relating to recent years.(1) Before setting out the methodology and results, some of the more important institutional aspects of the CAP and the EEC Budget are described.

(a) Basic Operating Arrangements of the CAP

The system of support and most of the operational details of the CAP were firmly established before the three new member states joined in 1973 and the system of agricultural protection and support now extends across the nine member states. In practice the actual levels of price support, at market rates of exchange, vary between member states as a result of measures introduced to cope with exchange rate fluctuations (ie because of the "green currency" system, brief details of which are

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(1) This work has developed in consultation with colleagues in MAFF and elsewhere. Particular thanks are due to Charles Capstick, Aidan Power, David Roberts, David Hadley and Peter Muriel. Any errors remain the responsibility of the authors, to whom communications relating to this note should be addressed. J M C Rollo is now with FCO.

given in Section II (b)[2]) but the method of support is uniform or "common" throughout the Community.

The support arrangements differ for all agricultural commodities but they include at least some of the following basic features: (i) the maintenance of a minimum price for imports of food from the rest of the world through the imposition of variable levies to bridge the gap between the offer or "world" price and the prescribed minimum import or "threshold" price; (ii) the granting of export subsidies to enable Community supplies to be sold on the lower priced markets of the world; (iii) the provision of "intervention" arrangements to buy-in Community-produced foods at prescribed prices and (iv) the granting of subsidies on domestic markets. Support arrangements along these general lines exist for cereals, sugar, butter, skimmed milk powder and beef. For some products, however, such as poultry and eggs, there are no "intervention" arrangements whilst for others, such as oilseeds, olive oil and tobacco, the producer is aided either by the granting of deficiency payments to bridge the gap between the market price and a prescribed producer price or by production subsidies. In the case of some products such as skimmed milk powder, butter and also wine, export outlets are limited and subsidies are granted to encourage their greater use within the Community either for human consumption, incorporation in animal feeds or for industrial purposes. For some products, notably potatoes and mutton and lamb, common support arrangements have not yet been devised, but some protection is given by the common external tariff.

(b) The Cost of CAP Support Arrangements

Substantial sums of money flow through the Community budget each year

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(2) For a fuller description of the operation and development of green currencies, see Fearn (1978).

in order to finance the storage and disposal of surplus produce and the direct payments made to producers. In 1978, for example, about £6000 m is estimated to have been spent on the CAP. This represents nearly 74% of total expenditure from the Community Budget on all policies of the EEC. Table I shows the composition and development of expenditure by the European Agricultural Guidance and Guarantee Fund (known as FEOGA, the French acronym) on price support and structural measures under the CAP. To finance Community expenditure, member states contribute (i) the money they collect from agricultural import levies and the common external tariff (10 per cent of which is returned to them at a later date) and, to the extent that this revenue is insufficient, (ii) a sum no greater than the equivalent of the yield of a notional 1 per cent harmonised value added tax. These sources of revenue are known as the Community's "own resources". The precise contribution arrangements for member states have changed over the years, particularly in the case of the new member states. It will, for example, not be until the end of 1979 that the United Kingdom completes the transition arrangements, negotiated in 1971, for its financial contributions.

The application of the CAP generates a flow of funds between member states through the Community budget in Brussels. Some member states who contribute large sums receive back even more by way of Community expenditure within their frontiers, whilst others receive relatively little in return. In addition, the fact that consumer prices for many foodstuffs are generally maintained above those of foodstuffs traded on world markets brings about a transfer of resources from consumers to agricultural producers. In the context of an international policy, such as the CAP, this transfer involves flows across the exchanges from consumers in importing countries to agricultural exporters. Given the importance of trade in food for all member states, the impact on export and import bills can be considerable, and together with the flow of funds to and from the Community budget, involves a significant redistribution of resources between the member states of the Community. This redistribution follows from the particular support and financial arrangements devised over the years for the purposes of managing the CAP and is influenced by the varying levels of "self-sufficiency" in food-stuffs of member states. This paper provides some assessments of the scale of these resource flows between member states.

Section II presents a theoretical framework which demonstrates how resource flows between member states arise and suggests how they might be measured; in Section III, some of the assumptions underlying the calculations are made more explicit; Sections IV and V discuss the measurement of the budgetary transfers and food trade effects respectively; and finally, calculations of resource flows arising from the CAP are presented and discussed in Section VI.

II THE NATURE OF THE RESOURCE FLOWS

The CAP has two main features which distinguish it from a national agricultural policy and give rise to international resource flows. The first is common financing of support measures and the second, the preferential prices afforded to Community producers in trade between member states. Common financing entails collective responsibility for expenditure incurred under common measures and met from agreed sources of revenue or direct contributions. Offsetting their contribution to this expenditure, member states receive various payments such as direct export subsidies to enable exports to compete on world markets. Clearly the pattern of receipts is unlikely to coincide with the pattern of contributions and the international redistribution of resources implied is well recognised and documented in eg Commission figures for net contributions and receipts from the EEC budget (Commission 1979b).

Less well recognised is the fact that resource flows over and above those shown by the budget, arise through the operation of the second feature of the CAP, namely Community preferential pricing. By Community preferential pricing we mean the principle whereby importing member states pay virtually the same price to producers in other parts of the Community as to domestic producers, and exporting member states obtain virtually the same price whether they sell at home or in any other Community market. Equivalently, the preference represents the value to Community exporters of being able to sell on the market of another member state without having to face the levy charged on third country supplies. Conversely, the importing country bears the cost of granting that preference, because it represents potential levy revenue foregone.

The conditions under which Community preferential pricing could be said to operate could in theory and practice be fulfilled in a Community with free movement of goods and a uniform level of support prices. Even in the current situation where the operation of green currencies has resulted in different price levels in each member state, the principle of Community preferential pricing as here defined has been preserved by a complex system of border taxes and subsidies known as monetary compensatory amounts (MCAs). The implications of differing national support levels will be considered in Section II(b). For ease of exposition we shall consider first the case where a uniform level of prices prevails throughout the Community.

(a) Community Preferential Pricing with Common Price Levels

Diagram I presents a schematic representation of the Community market for a typical CAP commodity with support given by means of intervention buying together with import levies and export restitutions.

Under an intervention system, price support is given by removing from the domestic market the excess of supply over demand at the given support price. Surplus disposal is assumed to be by means of export subsidy, though in practice other means such as subsidised sale as animal feed are also used. In order to prevent intervention being undermined by imports, a variable levy is imposed to cover the gap between world prices and internal prices.

The diagram is divided into three parts showing two representative member states the first a net importer, with demand and supply curves D_ID_I and S_IS_I, the second a net exporter (D_XD_X and S_XS_X) and finally the Community as a whole with D_cD_c and S_cS_c the horizontal summation of demand and supply curves of all nine member states. World supply is taken to be infinitely elastic at the price P_W and the common support price prevailing throughout the Community is P_S. The effect of intervention buying is to produce a kink in the domestic demand curve which becomes infinitely elastic at P_s (D_cD_c). Export restitutions and import levies are both assumed equal to the gap between the intervention price and the world price $(P_s - P_w)$ (3).

At P_s, $Q_c^s - Q_c^d$ is surplus to EEC needs and is available for export. Thus the Community faces an export subsidy bill of $(P_s - P_w)(Q_c^s - Q_c^d)$ ie the shaded rectangle A. This represents a cost to the budget and the burden of it is borne according to the rules for common financing.

For the importer at P_I the import requirement is Q_I^d. If this is met from third country sources then a levy is charged to bring the world price P_w up to P_s giving rise to the revenue $(P_s - P_w)(Q_I^d - Q_I^s)$ (rectangle B). If there were no EEC, this revenue would accrue directly to the importing country's exchequer. However, under Community common financing rules it belongs to the EEC budget and forms part of the importer's gross contribution to the budget [4].

(3) In practice, minimum import prices used in calculating the import levy are generally above intervention prices. For this and other reasons import levies are generally higher than export restitutions (see Section V(a) below).

(4) In reality, less a rebate of 10% to cover costs of collection.

If the goods are imported from another member state, then the importer pays the price P_s to the exporter, rather than P_w as would have been the case without Community preferential pricing. The potential levy revenue B is foregone by the importer and transferred across the exchanges to producers in exporting member states.

Thus, whether the importer buys from third countries or from other member states, the whole area B is a cost across the exchanges. It is not the full loss to national income implied by the adoption of the price level P_s rather than P_w: there are also the efficiency losses measured by the triangles D and C. But these are not a necessary corollary to EEC membership since the country in question could have chosen to support farm prices at P_s in any case. At that price level, rectangle B represents the additional cost which arises from adopting the provisions of common financing and Community preferential pricing.

The exporter's position is the converse of the importer's. The rectangle (E + F + G) represents a balance of payments benefit of membership brought about by export subsidies on sales to third countries paid by the EEC budget or from selling at P_s on the market of other member states. Once more there are efficiency losses but these are not a necessary part of the common policy.

Diagram I relates only to those products supported by the classical CAP mechanisms of intervention buying, import levies and export subsidies. It does not cover those CAP commodities (e.g. olive oil, tobacco) which, as mentioned earlier, benefit from a different method of support, namely direct production subsidies. However, since trade prices for such products are not greatly affected by the support system, the recorded budget costs provide a reasonable indication of the resource flows involved. Trade costs and benefits derive from those products whose prices are maintained as in diagram I. In those cases the import levies foregone on intra-Community trade by importers and the higher export revenue gained by exporters from trading with other member states form an important part of the resource transfers and must be added to the budget costs or benefits.

(b) <u>Community Preferential Pricing without Common Price Levels</u>

In diagram I equal support prices were assumed for importer, exporter and the Community as a whole. In reality different prices rule in different member states because of the green currency system which allows the exchange rates used to convert common agricultural support prices from units of account into national currencies to diverge from market rates of exchange. Thus prices in national
o a common rrency
currencies differ when converted at market exchange rates and to prevent distortions in trade (eg to prevent all surplus produce in the Community being consigned to intervention stores in the country with the most undervalued green exchange rate and hence the highest support prices) there are compensatory border taxes and subsidies designed to adjust each country's export prices to the common level and import prices to the national price level. These so called monetary compensatory amounts (MCAs) are thus subsidies or taxes on trade but since they also appear as budgetary transactions it is important to define the trade and budget effects very carefully to avoid the danger of double-counting. Diagram II attempts to show an example of how the MCA system works.

Once more the example takes an importing country, an exporting country and the whole Community. The world price is P_W, the common support price at market exchange rates is P_c, the average support price in the Community is P_A, the support price in the importing country, which runs an overvalued green rate, is P_I and P_x in the exporting country with an undervalued green exchange rate. It is essential to view the different prices in a common currency converted at the appropriate rates of exchange. Thus P_I and P_x are converted into their respective domestic currencies at the relevent green rates and then into sterling at market rates and P_A would be the weighted average of support prices in all member states similarly converted. P_c would be converted at the market rate between the agricultural unit of account and sterling.

In trade with third countries, the common levy and the common restitution ($P_c - P_w$) are reduced by $P_c - P_I$ in the case of the importer with the overvalued green rate, and increased by $P_x - P_c$ in the case of the exporter with the undervalued rate. This ensures the appropriate degree of protection for internal price levels. In intra-Community trade, an export from the country with the undervalued green rate to the country with the overvalued green rate would attract a subsidy of $P_x - P_c$ on export and a further subsidy of $P_c - P_I$ on import so that a total subsidy of $P_x - P_I$ is paid to allow the high price exporter supported at P_x to compete on the market of the low price importer. On the reverse transaction the export from the country with the overvalued green rate would bear a charge on export and another on import to close the gap $P_x - P_I$. Thus the exporter obtains P_x whether he sells at home or in another member state and the importer pays P_I whether he buys at home or from an EEC exporter and the condition for Community preferential pricing are fulfilled.

Since the support prices in each country are not P_c but P_x and P_I the amount of levy revenue foregone in the case of the importer is $P_I - P_w$ and the balance of payments gain to the exporter on trade is $P_x - P_w$ rather than $P_c - P_w$ as in diagrams I and II. A problem of accounting arises however since the taxes and subsidies which allow the maintenance of these support price differentials are budget transactions. Since the 'trade effects' are intended to be a measure of the costs and benefits of the CAP over and above those shown by budgetary transfers, it is important to exclude from the trade effect any payments or receipts already included in the budgetary flows. In general, a member state imports and exports at the common price and pays or receives the relevant MCA directly to or from the budget. The effect of Community preferential pricing should then be measured by $P_c - P_w$ to avoid double-counting the MCA. As an exception to the general rule, MCAs on imports by the UK and Italy are paid, not to the UK and Italy, but to the exporting member state - the system known in Community jargon as "exporter pays". Under this system, UK and Italian importers buy at P_I rather than P_c and conversely exporters to these countries only earn P_I from trade, claiming the importer's MCA $(P_c - P_I)$ from the budget in addition to any payment or receipt of their own MCA. Thus, on trade flows into the UK and Italy from other member states, the effect of Community preferential pricing should be measured by $P_I - P_w$.

III THE UNDERLYING HYPOTHESIS

Before proceeding to the measurement of the budgetary and trade effects, it is important to emphasise the hypothesis that underlies the diagrams and analysis in the preceding section. It is that at a point in time and at a given support price level the essential difference between the CAP and a national support policy operated on a similar basis to the CAP lies in the common financing and preferential pricing provision, not in the price level or the nature of the support mechanism.

The particular effects of the CAP which this paper seeks to measure can be isolated by assuming that member states continue to apply all CAP support mechanisms and price levels but without principles of common financing and Community preferential pricing. By assuming no change in support mechanisms it follows that in respect of trade with third countries, import levies would continue to be collected and export restitutions paid, but by national exchequers rather than by the EEC budget. This effect is incorporated in the budget transfers. In addition, assuming the suspension of Community preference, intra-Community trade would no longer take place at preferential prices, exporters would have to subsidise their exports to other member states close to world prices and importers would have to levy charges on all imports to bring the price up to their internal support price level. The same trade flows would take place but at prices close to "world" levels rather than at preferential intra-Community prices. This particular hypothetical arrangement is not intended as a necessarily realistic policy alternative but is assumed simply to provide a means of measuring the food trade costs/benefits of the Community's preferential pricing arrangements. To reiterate, it is not sufficient to consider the suspension of common financing alone. As the Commission themselves have pointed out (Commission (1979b)), the net budgetary flows on their own may be misleading.

As has been mentioned, the measurement of the preferential pricing effect requires an estimate of the gap $P_c - P_w$. Objections are often raised to the use of world prices. It is argued that quantities traded on world markets are small relative to world consumption and in any case result from decisions of government policy rather than market forces. Many products are traded in a series of bilateral, governmental transactions, and world market prices are determined in a volatile residual market. World prices for agricultural products, it is argued, are not an indicator of the resources employed in their production, or of their value in consumption, and hence do not offer a realistic opportunity cost of alternative supplies. Often tied to this argument is the proposition that even if continuous world supply and demand functions were to exist, they would not be infinitely elastic with reference to EEC production and consumption (as assumed above) and hence any change in Community support prices and trade would have significant effects on world market prices, so invalidating any static measure of the gap between world and Community prices. But in the context of this study these arguments are not relevant. Since it has been assumed that there will be no changes in domestic price levels for either producers or consumers, there can be no impact on world supply and demand or on world prices. In addition, it is assumed that the same mechanisms would be used to support internal price levels under a national policy as under the CAP. The levies and refunds which would become payable on intra-EEC trade would therefore be fixed under the same kind of administrative procedures and the same set of world prices as current levies and refunds. In these circumstances, there is no reason to expect that the degree of subsidy/levy required on EEC trade would be different from current rates of restitution/levy on third country trade. Current rates of levy and restitution can therefore be used to measure $P_c - P_w$, regardless of whether world prices are 'representative' or not.

Several advantages therefore derive, for the purposes of this study, from focussing attention on common financing and Community preferential pricing as the essential features of the CAP rather than the price level or the methods of support. This approach (i) enables current levy or restitution rates to be used as a measure of the trade cost or benefit; (ii) abstracts from the impact of CAP price levels on domestic structural efficiency and inflation; and (iii) facilitates the calculation of the trade costs and benefits consistent with and complementary to the published budgetary flows.

IV NET BUDGETARY TRANSFERS

(a) Measurement

The net position of a country with the EEC budget as a whole is relatively easy to determine. It is the difference between gross payments by the budget authorities to the country concerned and the country's gross contribution via 'own resources' (the sum of agricultural levy receipts, common external tariff revenue and a VAT or GNP determined contribution). As part of the transition to the full 'own resources' system of financing, the UK, Ireland and Denmark paid a fixed percentage contribution in 1977, while in 1978 the UK and Ireland's contributions were limited by the financial transition mechanism under Article 131 of the Treaty of Accession. Net budget transfers for 1976, 1977 and 1978 relating to the whole of the Community budget have recently been published by the Commission (1979b).

The agricultural, or FEOGA, component of expenditure by the Community budget in each member state is also readily available from Financial Reports of the European Agricultural Guidance and Guarantee Fund (Commission 1978). The bulk of FEOGA expenditure is made from the Guarantee Section (mainly price support) with less than 5% from the Guidance Section (mainly structural and marketing measures). Figures are usually published one year in arrears but preliminary estimates are available to member states fairly soon after the end of the budget year (Commission 1979d).

Contributions to FEOGA are, however, rather more difficult to estimate. As with most, if not all, budgetary authorities, the EEC Commission does not generally attribute any specific source of funds to any specific expenditure. For instance, import levies collected on cereals are not earmarked to meet expenditure on cereal export restitutions. There is no way of assessing what part of each country's gross contributions goes to meet a particular part of EEC budget expenditure in an individual country. Common financing ensures that all member states are responsible collectively for each and every item of expenditure and their shares are determined by own resources or some other agreed formula. One way to assess notional contributions to FEOGA however is to attribute to each country a share in the funding of FEOGA according to its share in the funding of the total budget. The method chosen in the calculations summarised in tables II and III is to apply each country's percentage share of total EEC budget contributions in the relevant year to the total recorded expenditure by FEOGA in that year.

(b) Results

Tables II and III are set out for 1977 and 1978 gross expenditure by FEOGA (Guarantee and Guidance) in each member state, the average percentage contributions to the budget and the implied contributions of each country to the cost of FEOGA. From these, the net budgetary contributions (positive or negative) to the cost of maintaining the CAP are calculated. It should be stressed that these flows to and from national exchequers represent transfers across the exchanges and are therefore quite unlike the exchequer costs of funding domestic policies which involve a redistribution of resources from taxpayers to producers within the one economy. The CAP on the other hand generates a redistribution between countries.

The full significance of the net budgetary transfers cannot be assessed until they are combined with the trade effects for the reasons given in Section II(a). Moreover, the net contributions to FEOGA are not even a true indication of the direct economic costs or benefits arising from the budget because they do not allow for budget expenditure or receipts which result from production or consumption in one member state but aris in another. For example, maize imported from third countries into the

UK via Rotterdam generates levy revenue, which arises from UK demand but is collected in Holland and recorded as part of their contribution to the budget. Similarly German exports destined to a third country may be sent by road to Rotterdam for shipment. The receipt of export subsidy is attributed to Holland but the economic effect is in Germany. Distortions such as these can be avoided if the intra-Community trade effects are included. The apparent gain of the export restitution by the Dutch would then be cancelled by the cost of paying preferential prices on the import from Germany and the Germans would be seen to be the true beneficiaries.

Another potentially misleading feature of the budgetary flows lies in the treatment of MCAs. The figures in tables II and III are in the form presented in FEOGA Financial Reports ie with UK and Italian import MCAs attributed to the exporting country. It has been argued in some quarters that these MCAs should be attributed as a benefit to the importing country and the Commission have responded by presenting alternative budget figures with MCAs so attributed. In fact, these MCAs can be regarded as either reducing the UK's and Italy's trade costs (and exporters' trade benefits) or as budgetary receipts to the importing country. We have adopted here the former method, but as long as trade costs and budgetary costs are defined consistently and considered together, the overall balance of payments effect will not be affected by the treatment of MCAs.

V INTRA-COMMUNITY TRADE TRANSFERS

a) Measurement

The measurement of the net trade effects presents several difficult problems. From diagram I the relevant cost or benefit per unit of goods traded is the difference between world prices and Community prices. We have seen from diagram II and the subsequent discussion that in the absence of common pricing either the gap between national prices and world prices or the gap between common prices and world prices is the measure of the trade effect depending on the accounting framework. In section III, it was argued that current rates of levy or restitution can be used as a measure of the gap, but in practice, the symmetry between export restitutions and import levies so far assumed does not exist. To explain how they differ, a digression on the administrative detail of certain elements of the CAP is required.

For those products for which levies and export restitutions are relevant there is normally not one but three related support prices. Central is the concept of the target price. This is the price which the Council has agreed producers ought to receive at a given representative market. The target price is protected by the internal intervention price which is some 10% lower and is the price at which national intervention authorities are obliged to purchase from producers. Theoretically market prices should not fall below intervention levels, but the use of quality standards and minimum lot sizes and the cost of transport to intervention centres mean that, in times of glut, market prices can and do move lower. The third price is the frontier or threshold price which is broadly the target price less the costs of transport to inland markets. The threshold price is defended by the use of a variable import levy which bridges the gap between the lowest offer price at Community frontiers and the threshold price. Hence there is a spread of support prices and the one that determines market prices will depend on the degree of self sufficiency. If the market is dependent on third country imports then the threshold price is likely to determine the price of marginal supplies. If the market is more than self sufficient then the intervention price is the probable determinant of the market price.

The levy is strictly the difference between the minimum offer price at Community frontiers and the threshold price but the export restitution is set in a much less mechanical manner. It is the difference between the intervention price (or more correctly the market price) and the disposal price on third country markets. Sometimes this is set by the Commission and exporters take it or leave it. In other cases there is a tender system under which traders offer to export given quantities at given restitutions and the Commission allocates a subsidy to the lowest tenders. Not only are restitutions likely to be lower than the equivalent import levies but there is considerably more discretion built into the system of setting them.

In practice, neither the levy nor the restitution is the ideal measure of $(P_c - P_w)$. Levies may be over-protective or unrepresentative if based on an unrealistic offer price and average export restitutions may be of doubtful validity, given the amount of discretion in setting them. We have chosen to present a range of results with the trade effects valued either at restitution rates or levy rates. In certain cases, the levy has been adjusted to take account of specific factors tending to overstate the trade effects. For the UK, account has been taken of the preferences granted to New Zealand dairy exporters and African, Caribbean and Pacific (ACP) sugar exporters. Under preferential arrangements, about 125000 tonnes of New Zealand butter (and 5000 tonnes of cheese in 1977), are imported at a guaranteed entry price considerably above the price implied by the common import levy. For sugar an annual quota of some 1.2 million tonnes enters the UK from the ACP countries free of levy. The view has been taken that the price of these preferential imports represents the relevant opportunity cost of UK supplies and is thus a better indicator of the levy revenue foregone.

Community-wide difficulties arise on beef and bacon. On beef, the vast majority of trade in 1977 and 1978 took place at concessional rates of levy thus the full levy is probably unrepresentative. The problem has been dealt with by arbitrarily assuming that half the UK net levy represents the level of protection afforded. Levies for other member states have been adjusted correspondingly. The EEC bacon market represents almost the entire world trade in the product (apart from some between Canada and the USA). Thus, it is difficult to assess how far the levies in operation have any relevance for a calculation of this kind. Once more, as an arbitrary adjustment, half of the UK net levy has been taken as an indicator of the relevant level of protection with Danish, Irish and Dutch exports valued accordingly. It should be added that no such adjustments were made to export restitutions since these were the subsidies required to dispose of the relevant quantities in world markets.

The annual average levy and restitution rates used, including appropriate adjustments, are detailed in appendices I and II. Because of lack of data on export restitutions for durum wheat, maize and bacon, the levy rate was used in both sets of calculations for those products. Otherwise, export restitutions tend to be some 20-30% below levy rates, the main exceptions being beef where the levy adjustments brought the two rates close together, and pigmeat where much lower restitution rates in fact resulted in negative entries for the UK after deduction of the UK MCA.

The trade data, summarised in appendices III and IV, comes mainly from Eurostat balance sheets and includes trade in processed products expressed in raw material equivalent. For the UK, the figures come from the Overseas Trade Statistics and relate to 1977 and 1978. The commodity coverage is restricted to the major CAP products (cereals, sugar, carcase meats and milk products) protected by import levy arrangements. The cost of support for commodities covered by deficiency payments / and production subsidies is included in the net budget contributions. Thus the main exclusions are fruit and vegetables and wine. The amount of protection offered by Community support arrangements for these products is taken to be small but it has to be conceded that it is extremely difficult to assess. These exclusions may affect the assessment of Italian trade costs in particular since Italy is a major trader of these products.

Appendices I-IV provide the raw data for the calculation of the effects of Community preferential pricing. It was argued in Section II(b) that all trade should be valued at the common levy/restitution, with the exception of trade flowing into UK and Italy which should be measured at the appropriate national rate. While it is relatively easy to value all UK and Italian imports at the levy or restitution net of MCA, it would be tedious in the extreme to try to identify the element in each exporting country's trade which goes to UK and Italy and value it differently. Fortunately the Commission publish estimates of the/total value of 'exporter pays' MCAs for each country and it is simple to reduce the total benefit of exports valued at common levies or restitutions by these amounts and thus avoid double counting. Accession compensatory amounts which bridged the gap between prices in the new member states and common prices during the transition period (which ended in 1977) were also paid on an 'exporter pays' basis and these too have been deducted in 1977. These adjustments are shown in tables IV and V which also summarise the aggregate trade results.

(b) Qualifications relating to the Results

The relevance of the results is discussed in the next section. At this juncture certain technical points are worth making. The totals do not sum to zero, as might be expected, for two reasons. The first is common to both levy and restitution totals and is that intra community trade does not sum to zero in all cases. Mostly this is minor but in the case of maize it seems to amount to a difference of 2½ million tonnes which is important given that common levies or restitutions amount to £40 to £50 per tonne. The gap is too large to be a recording problem and a probable explanation is that imports of third country maize via Rotterdam or Antwerp are counted by the final importer as extra-Community imports and by Benelux as intra-Community exports. The second problem is restricted to the levy based calculation and arises because the UK imports of butter, cheese and sugar from other member states are valued at lower levies than the corresponding exports and therefore do not cancel. The benefits obtained from the UK market by EEC exporters of butter, cheese and sugar is in part matched by losses by third country suppliers from the trade diversion effect of the CAP — losses which lie outside the scope of the present study.

Secondly, while the trade estimates valued at export restitutions do tend to be lower than those valued using levies, the degree of divergence varies considerably between countries, reflecting varying patterns of trade. The appropriate point of comparison is before deduction of 'exporter pays' MCAs and ACAs. Here we see that the divergence is greater for countries with important trade in pigmeat (Germany, Netherlands) and least for countries with significant trade in beef (Ireland). For the UK in 1978 the trade losses valued at restitutions actually exceed the levy valuations. This reflects the fact that the special levies assumed on butter, cheese and sugar were well below the restitutions for these products.

Finally it is worth pointing out that in 1978, UK exports of butter and barley were well above normal. Butter exports in particular, at 50,000 tonnes were certainly exceptional, possibly reflecting re-exports of butter sent over in 1977 by EEC exporters who misjudged the UK market. Similarly for barley, although, with new high yielding varieties, the trend may be for more exports, it is possible that a level of one million tonnes each year to the EEC alone will not be sustained. If exports to the EEC were to return to more normal levels, then net trade costs for the UK could be some £50m higher.

VI RESULTS AND CONCLUSIONS

(a) Aggregate Resource Flows

The estimated aggregate resource flows between member states attributable to the CAP in 1977 and 1978 are summarised in tables VI and VII. The first set of estimates, with trade effects measured by import levies is in general slightly above the second set using export restitutions but the broad conclusions are the same under both methods. First, the CAP is shown to generate a significant transfer of resources from West Germany, the UK and Italy to Ireland, Denmark, Netherlands and France with Belgium/Luxembourg in a broadly neutral position. Second, although the budget costs alone/generally indicate for the years studied correctly the directions of the flows involved, the true magnitude of the resource flows is in fact much greater.

The net effect on the balance of payments per head of population is shown in table VIII together with, for comparison, agricultural self-sufficiency ratios and national income per head. The ranking of gainers and losers corresponds closely to the ranking of agricultural self-sufficiency ratios. The coefficient of rank correlation between the two is 0.952 in 1977 and 0.905 in 1978 using the levies-based figures. The high correlations cannot be unexpected given that an effect of the CAP, even if not an explicit aim, is to redistribute income from consumers and taxpayers to agricultural producers.

Viewed against broader criteria, the resource flows show a less coherent pattern. There is no identifiable correlation between the ranking of resource flows and income per head. In some cases, the resource flows are perverse in the sense of worsening present inequalities. Italy and the UK, two of the lowest-income countries, feature amongst the top three losers in both years. Among the gainers are Denmark, which has the highest income per head in the EEC, and France and the Netherlands, in both of which incomes are above the EEC average. On the other hand, another high-income country, Germany, was the main loser from the CAP in 1977, although the Germans fared less badly in 1978.

At the other end of the scale, Ireland, the poorest country in the Community, gains more from the CAP per head of population than any other country.

Another indication of the importance of the resource flows to each member state is given in table IX. The 'central' estimates (expressed here in European Units of Accounts) are roughly the mid-points between the levy-based and restitution-based estimates and these are compared with GDP at market prices in each country. For the major economies, the resource effects represent around ½% or less of GDP, but for the Netherlands and Denmark, the effect is more substantial and for Ireland the balance of payments gain represents 7-8% of GDP. But these percentages represent only the direct effects. To the extent that either the trade balance or a target value for the exchange rate is an effective constraint on macroeconomic policy, then the full effect on national income may be greater than the direct effect.

(b) <u>Comparisons with other Estimates</u>

The extent of the intra-Community trade effects of the CAP has been recognised and quantified by Godley et al (1977 and 1978), Blancus (1978), Koester (1978), Attwood (1979) and Godley again in CEPG (1979). It is not possible to make precise comparisons because of the use of different reference periods, valuation methods and concepts of cost or benefit. In particular, none of the studies so far has fully integrated the trade effect estimates with the notional budgetary transfers associated with the CAP. Nonetheless, the same basic conclusions are common to several studies.

The estimates given by Koester and Blancus are not really comparable with those of the present study. Both relate to the early 1970s and to costs and benefits on total trade ie including levy revenue and export subsidies on third-country trade as part of the trade transfer rather than as part of the budgetary transfer. Other budgetary contributions and receipts are not considered. Blancus considers the whole range of agricultural commodities subject to the CAP (including fruit and vegetables, fish, wine and tobacco) and measures the gap $P_c - P_w$ by the difference in average unit values on intra-Community and third-country trade. Obviously, quality or valuation differences distort his results and this together with his wider commodity coverage may explain why his estimates are at variance with Koester's. Whereas Blancus found the UK, Italy and Germany to be substantial losers (mainly to the advantage of France and Netherlands) in each year from 1970 to 1976, Koester found that Germany and Italy in 1974 and the UK in 1975 were in fact net beneficiaries and France was a net loser in both years, reflecting high prices for cereals and sugar on world markets in those years. In 1973 however, Koester's results show the same direction of resource flows as in the present study.

Attwood's work is more readily comparable, but he deals only with Ireland and apparently only considers gross receipts from FEOGA. On this basis, he estimates Ireland to gain by £285m in 1977 and £575m in 1978, the corresponding figures presented here being about £400m (from table VI) and £550m (from table V). The difference in 1977 stems mainly from differing assessments of the extent of the benefit deriving from beef exports.

Finally, CEPG (1979) is the only study to present a set of combined budget and trade estimates for all countries. Differences are immediately apparent however. CEPG consider the total budget position rather than those effects arising directly from the CAP and the budget transfers included are those which would have taken place in 1977 if contributions by the new member states had not been limited by transitional arrangements. Moreover, in the calculation of the agricultural trade effects, there are differences in the valuation of trade and differences in commodity coverage, notably the exclusion of pigmeat, poultry meat and eggs by CEPG. There also appears to be an element of double counting since the net budget receipts used include MCAs but, apparently, the trade effects have been valued using the difference between "world" prices and national support prices. We have argued above that the gap between world prices and common prices should be used (for all countries except UK and Italy) when MCAs are included in the budgetary flows. Nonetheless, the same basic story emerges from both the CEPG study and the estimates presented here. The gainers and losers are the same (with the exception of Belgium whose budget receipts increase sharply with the inclusion of non-agricultural expenditure) but the ranking of the losers is different because of the use of 'unrestricted contributions' to the budget.

(c) <u>The Future Outlook</u>

It is extremely difficult to make reliable forecasts of the trade costs and benefits arising from the CAP over the next few years. These will depend on the size of import levies/export restitutions which in turn are a function of developments on world markets. Forecasts by the EEC Commission are available for EEC budget expenditure up to 1982 (Commission 1979 a) and for member states' net contributions and receipts from the EEC budget in 1979 and 1980. (Commission 1979 e) . These suggest that FEOGA expenditure is on a rising trend from 9 billion EUA in 1978 to 11.3 billion EUA in 1980 and possibly as high as 15.6 billion EUA by 1982 on pessimistic assumptions. Added to this the UK as indicated in the introduction [para 3] will not be contributing fully to the EEC budget until 1980. The combination of increasing expenditure and higher contributions leads us to expect that the total resource cost of the CAP to the UK could rise by substantially ~~about £500 million~~ between 1978 and 1980, assuming trade costs remain constant. The outlook to 1982 is for even greater resource costs unless UK receipts from FEOGA expand at a much faster rate than total expenditure. The sensitivity of forecasts of resource flows to changes in receipts from FEOGA is highlighted by the Commission forecast (Commission 1979 e) of net budget positions in 1980 which shows Italy to be a substantial net recipient rather than, as in 1978, a large net contributor. ~~When combined with the 1978 Italian trade costs the total burden on Italy falls by about £600m.~~

It should be mentioned that for an individual member state, the balance of payments consequences in the future will be determined by decisions on common prices (and thus community production and expenditure on disposal schemes) and also by changes in its own green rate. But the effect on the resource flows as calculated above will not be the only factor which will guide a country in considering the desirability of a change in common prices or a change in its green rate (5). For example,

(5) For a discussion of the economic effects of a devaluation of the green pound see Dickinson and Wildgoose (1979).

under plausible assumptions about supply and demand elasticities for foodstuffs and levels of self-sufficiency, the food trade effects arising from a price increase could prove to be beneficial since reductions in import volume will outweigh the effect of higher prices for importers and both volume and price effects will work positively for exporters. In the case of a common price increase, the benefit may be offset by increased budgetary contributions but for a green rate devaluation, the overall effect may be positive. In considering a change in the real level of agricultural support, the domestic efficiency losses (which may show up in the non-food trade balance) would also be relevant. The resource effects calculated in this paper are additional to any internal efficiency costs but it is the sum of all the economic implications that is relevant when decisions are taken on green rates and common prices.

(d) Summary

Almost without exception, agricultural support policies involve some redistribution of resources in favour of agricultural producers. An 'intervention' policy involves transfers from both taxpayers (to finance the disposal of surplus produce) and consumers (through higher food prices). An international 'intervention' policy such as the CAP causes a proportion of these transfers to be made across the exchanges from food importers to food exporters either in the form of net flows of expenditure through the Community budget or as preferential prices paid and received on intra-Community trade.

In this paper assessments of these resource flows have been presented for each EEC Member State in 1977 and 1978. The detailed methodology and estimation have been outlined and although not all estimation problems have been resolved, the assessments provide a reasonably reliable indication of the broad magnitude of the resource transfers generated by the CAP. The main beneficiaries relative to the size of their economies were shown to be Ireland and Denmark, mainly at the expense of Germany, Italy and the UK. As well as presenting estimates, the purpose of this paper is to stimulate further discussion and study of the issues, including possible economic implications over the next few years.

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Table I

FEOGA Expenditure by Sector[1] 1974-1978

Million EUA[2]

	1974	1975	1976	1977	1978
Cereals - Total	383	589	656	630	1112
of which: Refunds[3]	66	330	403	366	832
Rice	1	3	18	14	18
Milk & Milk Products - Total	1258	1194	2278	2924	4015
of which: Refunds	362	331	766	1417	1565
Storage & Special Disposal of Butter	259	190	246	356	619
Oils & Fats - Total	120	188	247	268	325
of which: Producer aids	119	187	237	267	275
Sugar - Total	106	271	229	598	878
of which: Refunds	98	28	62	409	640
Beef & Veal - Total	322	923	616	468	639
of which: Refunds	54	146	134	132	145
Public and Private Storage	251	407	348	290	413
Pigmeat - Total	70	57	29	37	45
of which: Refunds	60	41	25	29	32
Eggs & Poultry - Total all Refunds	18	9	15	26	38
Fruit & Vegetables - Total	58	73	185	178	101
of which: Refunds	15	29	44	51	48
Wine	41	141	134	90	64
Tobacco	166	200	185	205	216
Fish	1	10	11	9	15
Miscellaneous	50	83	143	193	300
Accession Compensatory Amounts	346	445	402	201	27
Monetary Compensatory Amounts	154	336	438	989	880
Guarantee Section	3095	4522	5587	6830	8673
Guidance Section	173	185	209	292	324
TOTAL FEOGA	3268	4707	5796	7122	8997

(1) Source: Commission (1979d). Guarantee figures are based on expenditure declared by Member Sates. Guidance figures are payments made in each year in respect of individual projects and common and special measures.

(2) Prior to 1978, the Community budget was accounted in budgetary units of account based on national exchange rates declared to the IMF. The 1978 budget was accounted in European Units of Account (EUAs). The figures given in this table are all expressed in EUAs to make them comparable.

(3) The term 'Refunds' covers subsidies paid on sales to world markets.

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Fish	1	10	11	9	15
Miscellaneous	50	83	143	193	300
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Diagram I : Intervention Buying Scheme

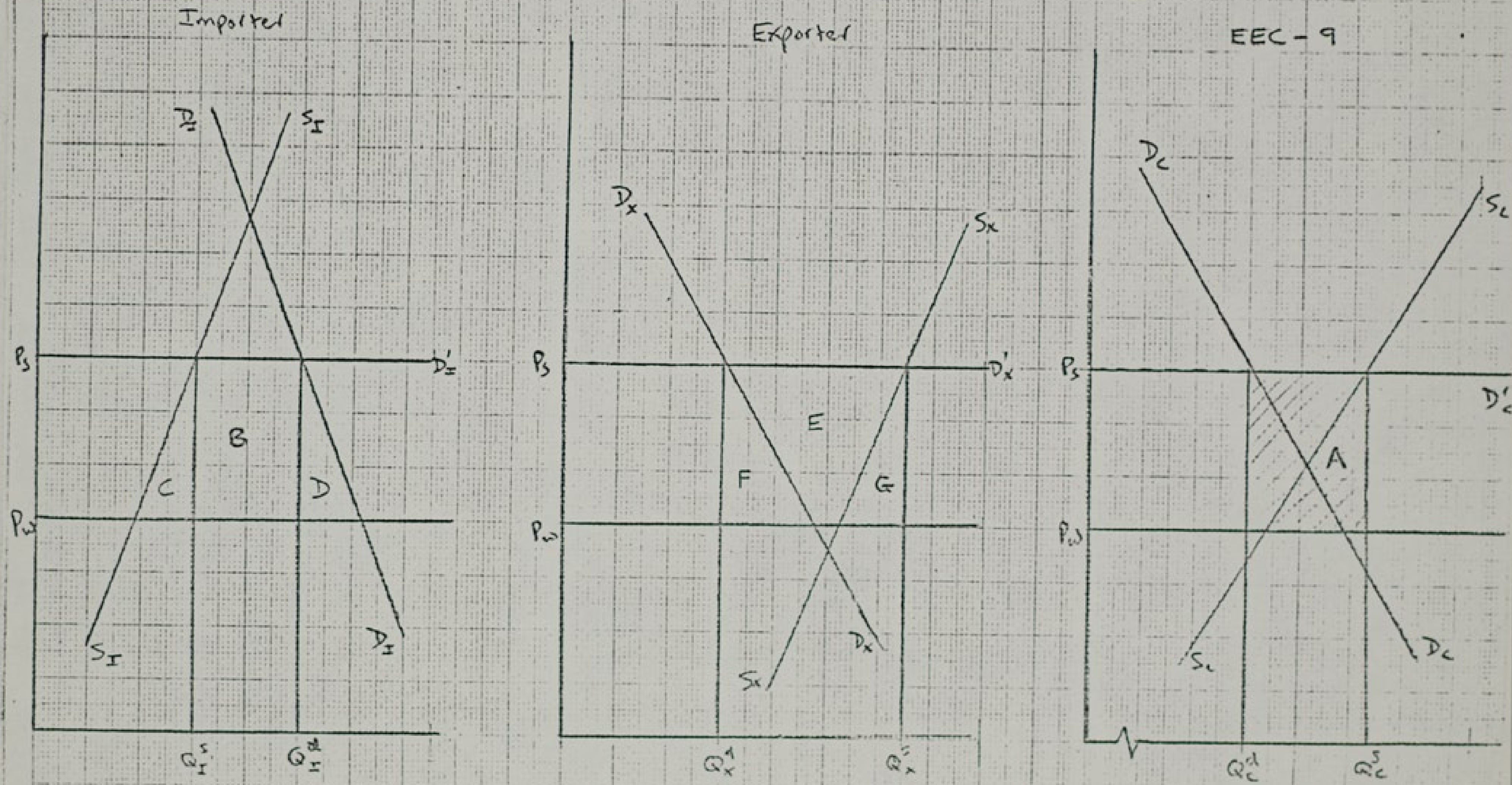

Diagram II : Intervention Buying with Different Support Price Levels

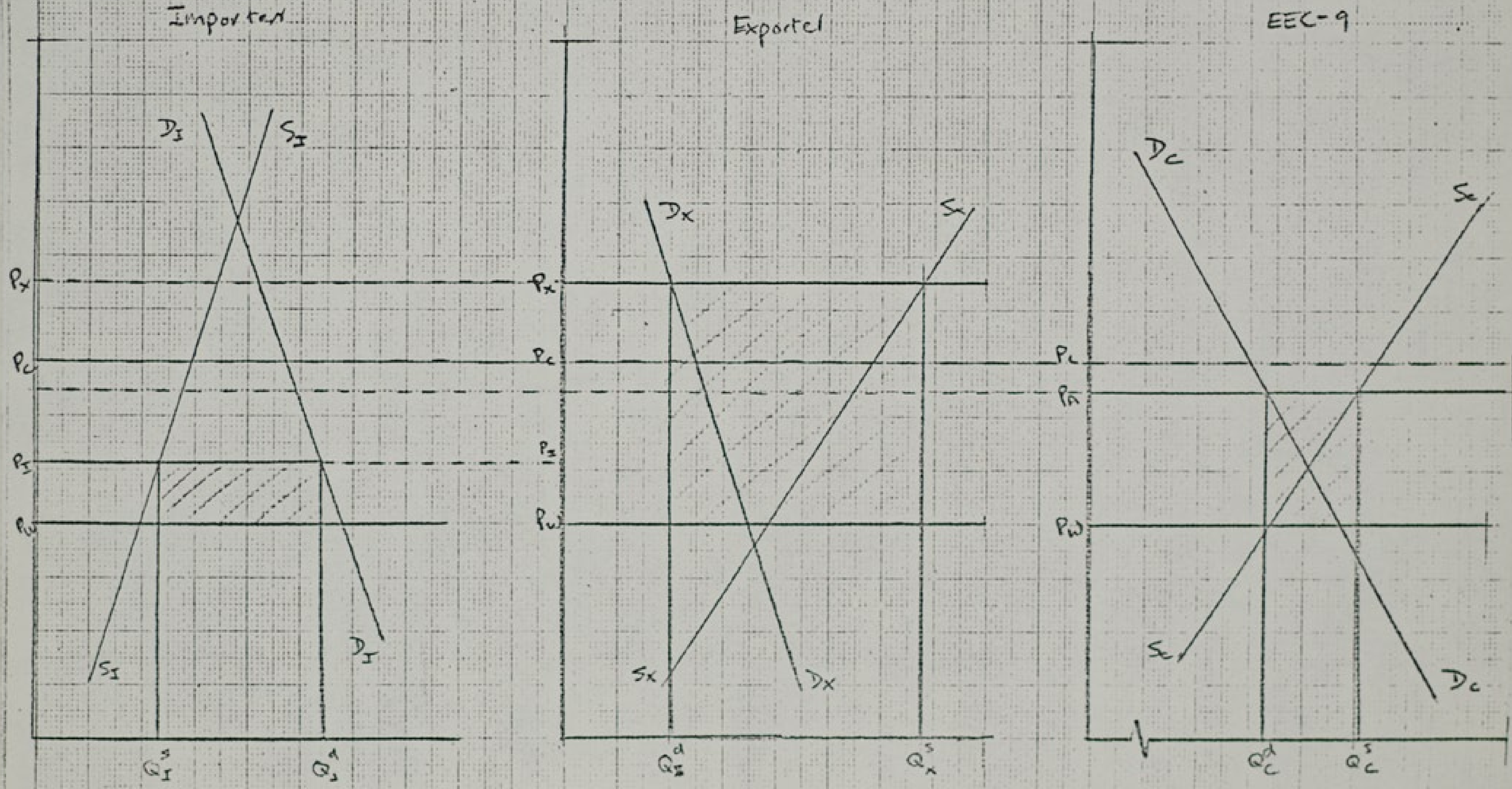

TABLE II

TRANSACTIONS OF MEMBER STATES WITH FEOGA IN 1977

	Units	Belgium/ Luxembourg	Denmark	Germany	France	Ireland	Italy	Netherlands	UK
Total Receipts from FEOGA									
- Guarantee Section(1)	m ua (budgetary)	426.7	624.8	1245.9	1572.4	588.1	965.8	887.3	351.4
- Guidance Section(1)	"	18.7	14.5	69.8	59.3	14.8	34.3	19.9	65.5
- Total	"	445.4	639.3	1315.7	1631.7	602.9	1000.1	907.2	416.9
- exchange rate	EUA/budgetary ua	1.223	1.094	1.382	0.991	0.637	0.621	1.293	0.637
TOTAL	m EUA	544.7	699.4	1818.3	1617.0	384.0	621.1	1173.0	265.6
- deduct MCAs received on ACP sugar(2)	"								-115.2
									150.4
Gross Contributions to FEOGA									
- percentage contribution rates to EEC Budget(3)	%	7.9	2.6	35.6	20.0	0.4	10.3	11.0	12.2
- notional gross contributions to FEOGA	m EUA	562.7	185.2	2535.8	1424.6	28.5	733.7	783.5	869.0
Net receipt (+) from or contribution (-) to FEOGA	m EUA	-18	+514	-717	+192	+355	-113	+389	-719
	£ m	-12	+334	-469	+126	+234	- 74	+255	-470

(1) Commission (1978)
(2) MCAs on ACP sugar imports are paid over to the exporter and not retained by the UK. Source: IBAP (1979)
(3) Taken from MAFF (1978) and converted at exchange rate between EUA and budgetary ua.

TABLE III
TRANSACTIONS OF MEMBER STATES WITH FEOGA IN 1978

	Units	Belgium/ Luxembourg	Denmark	Germany	France	Ireland	Italy	Netherlands	UK
Total Receipts from FEOGA									
- Guarantee Section[1]	m EUA	625.7	806.3	2489.0	1739.4	552.2	747.2	1273.9	439.0
- Guidance Section[1]	"	17.1	16.0	125.1	60.5	16.8	31.3	16.3	40.5
TOTAL	"	642.8	822.3	2614.1	1799.9	569.0	778.5	1290.2	479.5
- deduct MCAs received on ACP sugar[2]	"								108.1
Gross Contributions to FEOGA									371.4
- percentage contribution rates to EEC Budget	%	6.6	2.3	31.1	19.3	0.6	14.4	10.3	15.4
- notional gross contributions to FEOGA	m EUA	593.8	206.9	2797.8	1736.3	54.0	1295.5	926.6	1385.4
Net Receipt (+) from or Contribution (-) to FEOGA	m EUA	+ 49	+ 615	- 184	+ 64	+ 515	- 517	+ 364	- 1014
	£m	+ 33	+ 408	- 122	+ 41	+ 343	- 344	+ 241	- 673

(1) Commission (1979 d)

(2) MCAs on ACP sugar imports are paid over to the exporter and not retained by the UK. Source: IBAP (1979)

TABLE IV
ESTIMATED TRADE TRANSFERS 1977

£million

		Belgium/ Luxembourg	Denmark	Germany	France	Ireland	Italy	Netherlands	UK
Estimated Trade Transfers[1]									
Benefit of Higher Export prices	(a) import levies	406	403	536	1012	355	51	976	63
	(b) export restitutions	303	334	425	775	302	43	733	51
Cost of Higher Import prices	(a) import levies	376	14	758	356	53	533	263	288
	(b) export restitutions	302	10	539	264	42	355	204	251
Adjustments to put export benefit on exporter pays basis									
Add MCA charges levied on UK exports[2]									58
Subract ACAs[3]		10	32	18	21	6	6	38	-
Subract Importers' MCAs paid in exporting member states[4]		32	148	115	172	128	-	130	-
Adjusted Trade Transfers (exporter pays basis)									
Benefits of Higher Export prices	(a) import levies	364	223	403	819	221	45	808	121
	(b) export restitutions	261	154	292	582	168	37	565	109
Cost of Higher Import prices	(a) import levies	376	14	758	356	53	533	263	288
	(b) export restitutions	302	10	539	264	42	355	204	251

(1) UK imports and exports and Italian imports valued at national net levy/restitution: all other trade valued at common levy/restitution.
(2) Source : IBAP (1979)
(3) Source : Commission (1978) conver ted into EUAs at rate implied for MCAs.
(4) Source : Commission (1979b)

TABLE V
ESTIMATED TRADE TRANSFERS 1978

£million

		Belgium/ Luxembourg	Denmark	Germany	France	Ireland	Italy	Netherlands	UK
Estimated Trade Transfers(1)									
Benefits of Higher Export Prices	(a) import levies	437	446	573	1188	378	54	1045	163
	(b) export restitutions	316	381	481	992	351	45	772	173
Cost of higher import prices	(a) import levies	462	12	892	422	54	642	321	383
	(b) export restitutions	382	9	648	321	48	487	266	428
Adjustments to put export benefit on exporter pays basis									
Add MCA charges levied on UK exports(2)									110
Subtract Importers' MCAs paid in exporting member states(3)		29	159	115	191	140	-	119	-
Adjusted Trade Transfers (exporter pays basis)									
Benefit of Higher Export prices	(a) import levies	408	287	458	997	238	54	926	273
	(b) export restitutions	287	222	366	801	211	45	653	283
Cost of higher import prices	(a) import levies	462	12	892	422	54	642	321	383
	(b) export restitutions	382	9	648	321	48	487	266	428

(1) UK imports and exports and Italian imports valued at nationalnet levy/restitutions: all other trade valued at common levy/ restitution.
(2) Source: IBAP (1979)
(3) Source: Commission (1979b)

TABLE VI

EFFECT OF THE CAP ON THE BALANCE OF PAYMENTS OF MEMBER STATES 1977

£million

	Belgium/ Luxembourg	Denmark	Germany	France	Ireland	Italy	Netherlands	UK
Gross Contribution to FEOGA	368	120	1657	931	18	480	512	568
Gross Receipts from FEOGA	356	454	1188	1057	252	406	767	98
Net Receipt (+) from or contribution (–) to FEOGA	– 12	+ 334	– 469	+ 126	+ 234	– 74	+ 255	– 470
Benefit of Higher Export prices								
as measured by (a) import levies	364	223	403	819	221	45	808	121
(b) export restitutions	261	154	292	582	168	37	565	109
Cost of Higher Import prices								
as measured by (a) import levies	376	14	758	356	53	533	263	288
(b) export restitutions	302	10	539	264	42	355	204	251
Net Effect on trade account								
(a) at import levies	– 12	+ 209	– 355	+ 463	+ 168	– 488	+ 545	– 167
(b) at export restitutions	– 41	+ 144	– 247	+ 318	+ 126	– 318	+ 361	– 142
Net Effect on balance of payments								
(a) at import levies	– 24	+ 543	– 824	+ 589	+ 402	– 562	+ 800	– 637
(b) at export restitutions	– 53	+ 478	– 716	+ 444	+ 360	– 392	+ 616	– 612

TABLE VII

EFFECT OF THE CAP ON THE BALANCE OF PAYMENTS OF MEMBER STATES 1978

£million

	Belgium/ Luxembourg	Denmark	Germany	France	Ireland	Italy	Netherlands	UK
Gross Contribution to FEOGA	394	137	1858	1153	35	860	615	920
Gross Receipts from FEOGA	427	545	1736	1194	378	516	856	247
Net Receipt (+) from a contribution (-) to FEOGA	+ 33	+ 408	- 122	+ 41	+ 343	- 344	+ 241	- 573
Benefit of Higher Export prices								
as measured by (a) import levies	408	287	458	997	238	54	926	273
(b) export restitutions	287	222	366	801	211	45	653	283
Cost of Higher import prices								
as measured by (a) import levies	462	12	892	422	54	642	321	383
(b) export restitutions	382	9	648	321	48	487	266	428
Net Effect on trade account								
(a) at import levies	- 54	+ 275	- 434	+ 575	+ 184	- 588	+ 605	- 110
(b) at export restitutions	- 95	+ 213	- 282	+ 480	+ 163	- 442	+ 387	- 145
Net Effect on balance of payments								
(a) at import levies	- 21	+ 683	- 556	+ 616	+ 527	- 932	+ 846	- 783
(b) at export restitutions	- 62	+ 621	- 404	+ 521	+ 506	- 786	+ 628	- 818

TABLE VIII

	Net Effect on Balance of Payments per head (£)				Agricultural Self-sufficiency (%) [1]	Income per head [2] (EEC Average = 100)	
	1977		1978		1976	1977	
	Import Levies	Export Restitutions	Import Levies	Export Restitutions		At Market Exchange Rates	At Purchasing Power Parities
Ireland	+ 126	+ 113	+ 165	+ 159	210	54	68
Denmark	+ 107	+ 94	+ 134	+ 121	226	154	123
Netherlands	+ 57	+ 44	+ 61	+ 46	143	129	110
France	+ 11	+ 8	+ 12	+ 10	101	117	113
Belgium/Luxembourg	- 2	- 5	- 2	- 6	96	135	114
Italy	- 10	- 7	- 16	- 14	89	57	73
UK	- 11	- 11	- 14	- 15	62	71	91
Germany	- 13	- 12	- 9	- 7	81	136	117

(1) Source: MAFF (1978)
(2) Source: Commission (1979c)

TABLE IX

	Balance of Payments Effect Central Estimate million EUA		GDP (Market Prices)[1] billion EUA		Balance of Payments Effects as percentage of GDP	
	1977	1978	1977	1978	1977	1978
Belgium/Luxembourg	-50	-50	71.9	78.3	-0.1	-0.1
Denmark	+800	+950	40.3	42.8	+2.0	+2.2
Germany	-1200	-750	452.4	497.9	-0.3	-0.2
France	+800	+850	333.6	366.3	+0.2	+0.2
Ireland	+600	+750	8.2	9.4	+7.3	+8.0
Italy	-700	-1250	171.8	185.2	-0.4	-0.7
Netherlands	+1100	+1100	93.2	101.2	+1.2	+1.1
UK	-950	-1200	214.1	241.0	-0.4	-0.5

(1) Source : OECD (1979)

APPENDIX I

AVERAGE IMPORT LEVIES AND EXPORT RESTITUTIONS 1977

£/tonne

	Common Levy(1)	Common Restitution(1)	UK Net Levy	UK Net Export Refund	Italian Net Levy	Italian Ne Export Refu
Common Wheat	69	44	34	12	52	27
Durum Wheat	103	-	-	-	85	-
Barley	49	44	22	14	34	29
Maize	53	-	22	-	33	-
Rice	60	61	27	20	49	50
Sugar	179	102	0	47	136	60
Butter	1436	1232	287	582	1190	986
Cheese	990	706	331	218	766	483
Pigmeat	231	117	27	- 82	132	11
Poultrymeat	93	87	82	22	65	59
Beef - full rate	802	535	373	102	597	331
- reduced rate	600	-	136	-	400	-
Eggs	284	84	232	12	244	44
Bacon - full rate	312	-	36	-	-	-
- reduced rate	290	-	18	-	-	-

(1) Converted from units of account at the market rate between sterling and the unit of account: 1.285 ua/£ in 1977.

DH

APPENDIX II

AVERAGE IMPORT LEVIES AND EXPORT RESTITUTIONS 1978

£/tonne

	Common Levy[1]	Common Restitution[1]	UK Net Levy	UK Net Export Refund	Italian Net Levy	Italian Net Export Refund
Common Wheat	68	51	42	28	50	34
Durum Wheat	100	-	-	-	73	-
Barley	66	53	42	29	50	37
Maize	62	-	39	-	46	-
Rice	53	50	40	37	46	42
Sugar	175	133	0	78	139	96
Butter	1530	1306	393	862	1293	1071
Cheese	1028	748	450[2]	348	813	534
Pigmeat	306	128	134	- 42	207	29
Poultrymeat	184	157	133	105	157	130
Beef - full rate	893	624	558	289	700	431
- reduced rate	614	-	279	-	420	-
Eggs	380	126	319	66	340	86
Bacon - full rate	410	-	182	-	-	-
- reduced rate	320	-	91	-	-	-

(1) Converted from units of account at the market rate between sterling and the unit of account: 1.246 ua/£ in 1978.

(2) No New Zealand cheese was imported in 1978 therefore no special levy was set. The figure shown assumes that the relationship between butter and cheese levies in 1977 would have been maintained in 1978.

APPENDIX III

INTRA-COMMUNITY TRADE 1977 (1)

thousand ton

	Belgium/ Luxembourg		Denmark		West Germany		France		Ireland		Italy		Netherlands		UK (2)	
	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Ex- po
Common Wheat	597	331	16	199	1095	594	71	4679	150	19	1594	13	824	627	2400	20
Durum Wheat	53	17	-	-	205	26	17	243	2	2	95	197	13	37		
Barley	979	595	31	424	1422	216	172	2160	57	152	478	1	385	232	600	50
Maize	293	1020	17	1	366	483	86	1547	166	2	51	43	488	2156	900	3
Rice	125	73	8	-	75	83	100	58	6	-	4	179	47	77	100	7
Sugar	108	165	39	108	238	275	208	455	34	69	305	42	124	173	342	
Butter	88	87	-	70	23	114	29	45	1	43	54	-	38	147	189	1
Cheese	63	11	2	64	184	102	46	132	2	37	137	9	19	256	105	
Pigmeat	40	317	-	99	391	44	302	37	3	26	256	10	44	542	155	1
Poultrymeat	34	23	-	20	231	5	9	32	3	5	12	1	17	220	8	
Beef (3)	60	44	1	144	213	204	210	299	31	375	442	3	73	164	290	12
Eggs	7	93	2	1	248	13	34	18	2	-	9	5	19	182	2	1
Bacon	-	-	-	254	-	-	-	-	1	14	-	-	1	26	270	

Notes (1) UK figures are taken from HMSO (1978) and relate to calendar years. Data for other member states comes from SOEC (1978).

(2) UK trade effects were in fact calculated on a slightly broader commodity coverage including lard, skimmed milk powder, and other cereals.

(3) Live and carcase weight equivalent.

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DSG

10 DOWNING STREET

From the Private Secretary

SIR JOHN HUNT

CABINET OFFICE

SUPPORT FOR BRITISH AGRICULTURE

The Prime Minister was grateful for your minute of 5 October.

She agrees to your proposals for an interdepartmental review, except that she would like the Department of Employment to be represented on the Group - along with the Treasury, MAFF, FCO and the Department of Trade. She is happy for the Group to be chaired by Sir Kenneth Berrill.

The Prime Minister is, however, concerned about the timetable which you have set. She believes that the study cannot be done as quickly as you have suggested if it is to be done properly. She would much prefer to have a really thorough paper for Cabinet to consider even if this means putting off consideration of Mr. Walker's paper. She has noted your point about discussions with Schmidt, but again she would prefer not to have the review rushed simply in order to meet this deadline.

T. P. LANKESTER

8 October 1979

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Copied to: Euro Pol: Budget [redacted] : EMS.
Defence: TNF

RECORD OF A DISCUSSION IN PLENARY SESSION BETWEEN THE PRIME MINISTER AND SIGNOR COSSIGA, THE PRESIDENT OF THE ITALIAN COUNCIL OF MINISTERS, AT THE PALAZZO CHIGI AT 1120 ON FRIDAY 5 OCTOBER 1979

Present'

Prime Minister	Signor Cossiga
Foreign and Commonwealth Secretary	Signor Malfatti Minister of Foreign Affairs
HE Sir Ronald Arculus	Signor Pandolfi Minister of the Treasury
Mr. J.L. Bullard	Ambassador Malfatti Secretary-General, Ministry of Foreign Affairs
Mr. M. Butler	Ambassador Ducci Italian Ambassador in London
Mr. M. Franklin	Minister Ruggiero Head of Private Office, Minister of Foreign Affairs
Mr. C.A. Whitmore	Minister Alessi Assistant Under Secretary supervising EEC matters
Mr. H. James	Counsellor Squillante Signor Cossiga's Private Office
Mr. J. Adams	Minister Berlinguer Diplomatic Adviser
Mr. M.O'D.B. Alexander	Signor Zanda Press Attache
Mr. G.G.H. Walden	Signor Santini Economic Adviser

Bilateral Talks

Having outlined the agenda and referred to his tête-à-tête with the Prime Minister the previous evening, Signor Cossiga said that he hoped it would be possible to institutionalise talks between the Italian and British Governments at Head of Government level. The Italian Government already had talks on a regular basis with other members of the Community. It would be appropriate for the talks to take place twice a year. The Prime Minister said that bilateral talks were often more productive than summit meetings. She agreed that the bilateral talks at Head of Government level should be institutionalised on the basis proposed by Signor Cossiga.

/(The Prime Minister

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(The Prime Minister said initially that the talks should be held on an annual basis. But in the subsequent discussion she agreed that the talks should be held bi-annually.) She looked forward to seeing Signor Cossiga in London next year.

EEC

Signor Cossiga said that while there might be some differences in the short-term objectives of the two Governments, their long term interests in the EEC were identical. It should be possible to develop a line of common action. The basis of this would be that the Community could not count on a full contribution from Italy and the United Kingdom if they were not getting satisfaction from the partnership. The Prime Minister said that she was absolutely committed to making Europe function as effectively as possible. However, the grievances of individual members would have to be resolved if it were to work as well as it could.

The Community Budget

Signor Malfatti said that the Italian Government were very critical of the reference document produced by the Commission in response to the directive from the European Council at Strasbourg. The document failed to stress the deterioration in the balance of trade between Italy and the rest of the Community. As compared with 1978, the balance of trade had moved against Italy to the tune of 1,000 MUA. The erosion of the external tariff was also causing major difficulties for the Italian Government. It had a particularly damaging impact on the poorer section of the population. As regards the figures on the budget, the Italian Government did not accept the Commission's forecast. They expected that their net balance would be no more than 150-200 MUA, i.e. much less than the Commission had anticipated.

In explanation of this point, Signor Ruggiero said that the Commission had shown the MCAs as benefitting Italy. The Italians did not accept this. Moreover, the Commission's calculation was based on a payments forecast that was quite unrealistic. In addition, the Commission had failed to produce solutions to the problems created for Italy by the inadequacies of the present

/regional

regional policy; by the CAP; and by the erosion of the external tariff against the import of Mediterranean produce from non-members of the Community. Signor Malfatti said that the Italian Government would await the production of a further document by the Commission before they would be prepared to refine their demands any further. They were looking for a general shift in the balance of CAP expenditure. They wanted action on a number of headings:

(a) the operation of the guarantee section of the FEOGA fund should be changed so that the impact on the Italian balance of payments of the import of agricultural products, e.g. beef, from other members of the Community, was reduced;

(b) the present discrimination against Mediterranean products within the CAP removed;

(c) the present wasteful surpluses in the CAP, particularly dairy products, reduced, perhaps through the use of co-responsibility levies;

(d) aid given to improve the marketing of Mediterranean products within the Community; and

(e) an assurance that if trade concessions had to be made to non-Community producers of Mediterranean products, the European producers, notably Italy, should be compensated.

More generally, Signor Malfatti said that they wanted to see the relationship within FEOGA between the guidance and guarantee sections changed; and to see the relationship between the CAP and other elements in the budget changed. At present 72% of the budget was taken up by the guarantee fund; 12% by structural, regional and social policies; and only 2% by energy, industry and transport. The Italians would like agreement to be reached in Dublin on a three-year programme by the end of which, e.g., 25% of the budget would be being spent on structural policies. There should be specific structural mechanisms to meet the particular situations of member countries.

/The Prime Minister

The Prime Minister said that as she understood it there were three principal Italian complaints. These were that:

(a) too much of the total Community budget was spent on agriculture as opposed to regional, structural and other policies. The British Government agreed on this but considered that the total size of the budget should not go over the 1% VAT ceiling. Any changes in budgetary allocations would have to take place beneath that ceiling;

(b) within the CAP, the balance of expenditure should be changed. Less should be spent on surpluses and more on dealing with other agricultural problems; and

(c) Italy was having to bear too much of the cost of concessions made in the negotiation of trade agreements from which the EEC as a whole was the beneficiary.

Signor Cossiga said that the Prime Minister's summary was accurate. The Prime Minister repeated that the British Government had much sympathy with the Italian Government's complaints. They agreed that less should be spent on surpluses and more on aid to the regions. They accepted that this meant the re-structuring of the CAP. But it was essential that these changes should take place within the 1% VAT ceiling. They would like to see a start made with the reform of the CAP but considered that this would take time to bring to fruition. Signor Malfatti said that while the Italian Government wanted a re-allocation of expenditure, they were less concerned about the total size of the budget. The Prime Minister said that if Governments showed flexibility on the ceiling, the CAP would never be re-structured. The ceiling gave those who favoured reform a lever which had to be used.

Signor Pandolfi said that the broad objective of the Italian and British Governments seemed to him to be similar. Basically both Governments were asking that the requirements of convergence should be given a higher priority in EEC policies. However, in the short term there was a possible conflict in the positions of the Italian and British Governments. The British Government

/had a

had a specific short-term problem, viz that their contributions and receipts were grossly out of balance. The Italian Government understood the necessity for the British Government to secure change in this situation. The Italian Governemnt were less concerned about the budget. Even if the Commission figures were wrong, the Italian position had improved substantially. Their concerns were more general, viz the disproportion between the CAP and the rest of the budget and the imbalance between the guidance and guarantee sections of FEOGA. Given this difference of interest, the Italian and British Governments needed to work out guidelines for common action in ECOFIN and elsewhere. The Italian Government were ready to support the UK but in doing so they would rely on the UK to support them.

Signor Pandolfi said that he had talked to the Germans in Belgrade about these problems. He sensed a disposition on the part of the Germans to be helpful on both the British and Italian requests. But there would be limits on German helpfulness. They were not prepared to go through the 1% VAT ceiling. Signor Pandolfi said that he personally agreed that in present circumstances that ceiling should be maintained. There was in any case a 13% margin in hand. (Signor Pandolfi noted the potential complications of enlargement in this context.) The Germans, secondly, would not be prepared to accept either the British or the Italian position in full. They would propose gradual implementation of any solution in either area.

The Prime Minister said that the British Government were suffering from the operation of the budget in two ways. Britain was contributing more than their GNP share and receiving less. The third poorest member of the Community was the largest contributor. The Prime Minister said that much as she would like to play Lady Bountiful to the Community she could not afford it at a time when the British Government was having to cut back its expenditure on health, education, local government and numerous other areas of great electoral sensitivity. The present situation was grossly unjust. Failing a move on the budget, there would be a serious and hostile reaction in the United Kingdom. The British Government were not asking that

/they should

they should be net beneficiaries from the budget. They did not want money from their partners. They sought instead a broad and reasonable balance. The Community should not underestimate the determination of the British Government.

As regards the longer term, the Prime Minister said that it was of course ridiculous to create and support agricultural surpluses. The CAP would have to be changed. The Italian Government would encounter no difficulties with HMG in its efforts to secure such a change. But perhaps some of the other members would see more difficulties. Perhaps it would suffice for the European Council to declare its intention to seek reform in the CAP. Signor Cossiga questioned the use of the word "intention". The Italian Government would need a commitment, not a statement of intention. The Prime Minister said that the problems identified by the Italian Government were even more complicated than that faced by the British Government. Perhaps the Dublin Council should aim to define the Italian difficulties more clearly; to declare its intention to deal with them; and to commission papers for the following Council. The British Government would support such a programme very strongly. It seemed doubtful whether the Italian Government could get all they were seeking at the Dublin meeting. Signor Pandolfi said said that the Prime Minister's remarks suggested there was some difference of position between the two governments. The Foreign and Commonwealth Secretary said that the British Government sympathised with and would support the general approach put forward by the Italians. They had no wish to ignore the difficulties faced by the Italian Government. However, we needed more details of what the Italians had in mind. It might be that the difficulties of securing movement would not be as great as appeared. The Prime Minister agreed with the Foreign and Commonwealth Secretary's remarks and asked whether the Italians had worked out their ideas in detail and whether a paper could be made available so that it could be discussed in further bilaterals at official level and with other Governments.

Signor Pandolfi said that the Italian Government would be putting specific proposals to the Commission in the following week.

/The proposal

The proposal would seek action under three headings:

(a) that a decision should be taken to reduce gradually but in a definite period (3-5 years) on a year-by-year basis the percentage of the total expenditure of the budget devoted to the CAP. The reduction might be of the order of one or two percentage points per year;

(b) that the same process should take place within FEOGA, re-directing expenditure from the guarantee to the guidance fund; and

(c) that action be taken to diminish the cost to Italy of the import of agricultural products from other members of the Community and to encourage the increased production of some agricultural products, particularly meat, in Italy.

The Prime Minister asked whether Italy would be seeking fixed percentages and timescales in Dublin. Signor Pandolfi said that if precise decisions were not taken in Dublin there would be further delay. It was essential that the Italian and British Governments should not be divided. Both the Prime Minister and the Foreign and Commonwealth Secretary said that it would be easier to get a decision in principle than a decision with figures. Signor Pandolfi said that figures were essential, although he was not dogmatic about what those figures should be. The Prime Minister said that it was essential to have the details of the Italian proposals as soon as possible. The British Government would look at them carefully and sympathetically with the intention of being constructive. The interests of the two Governments were the same. British representatives in forthcoming bilaterals would say that they were studying the Italian proposals sympathetically. The Prime Minister hoped that Italian representatives would say the same about their approach to the British problem.

Signor Cossiga said that Italy's experience had been that the decisions at Strasbourg had not been translated into a paper satisfactory to his Government. The Italians did not want to find themselves after Dublin in the same position as they were now after Strasbourg. It was essential that the problem should

 /be quantified.

be quantified. General political indications would not suffice. Signor Pandolfi said that Monsieur Ortoli would be in Rome the following week and would be given precise details of the Italian proposal. (Officials in subsequent discussions cast some doubt on whether the Italians would in fact hand a paper to the Commissioner.) It was agreed that the discussion would be continued at the forthcoming meeting between Signor Malfatti and the Foreign and Commonwealth Secretary and that in the interim talks at official level would continue.

/European Monetary System

Prime Minister
Agree?
TL
5/1.

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Ref. A0373

PRIME MINISTER

Support for British Agriculture

In your summing up of the discussion at Cabinet on Thursday on the Minister of Agriculture's proposal for an increase in liquid milk prices (CC(79) 16th Conclusions, minute 3) you said that there was a need for an interdepartmental review in which the question of milk prices would be looked at in the broader context of support for British agriculture generally and against the background of the CAP. This is very much what Sir Kenneth Berrill suggested in his minute to Mr. Lankester of 3rd October.

Flag A

2. There is obviously urgency in all this. Mr. Walker is anxious to be able to tell the farming community as soon as possible what is likely to happen to the price of milk: and we know that Mr. Walker and the Chief Secretary are at loggerheads over agricultural support in the years to 1983-84. But more than this, you are likely to discuss the future of the CAP with e.g. Helmut Schmidt on 31st October and you will need to be clear about the implications of our current decisions on British agriculture in relation to our stance on the CAP.

PM not worried about this
TL.

3. We have therefore to work fast. This suggests that the interdepartmental group should consist of a small inner core of main Departments who would call in other Departments as necessary, rather than one large group covering the whole. I think the core of the group should be the Treasury, MAFF, FCO and Trade (for the consumer) and Employment. Other Departments (Scotland, Wales, Northern Ireland, Industry and ~~Employment~~) would be brought in as necessary. I am sure that the chairmanship of this group should be in the hands of the Cabinet Office and that Sir Kenneth Berrill would be the best person. The only alternative is the Treasury and, given the fierce constraints on public expenditure, they would hardly be regarded as neutral.

PM would prefer to put Walker off until a proper account is ready. JH.

4. Finally, there is the question of the paper which Mr. Walker is himself preparing for Cabinet. I get the impression that this paper, which he is writing himself, is a very political one and would not form a suitable basis on which to conduct this review by officials. I think the right course is to let Mr. Walker's paper go ahead independently and to put it on the agenda of the Cabinet later this month when at least an interim report from the official group is available.

5. If you agree with these proposals, which are consistent with the Cabinet's conclusions, I will set the operation in train forthwith.

John

(John Hunt)

5th October, 1979

It can't be done that quickly - there are too many things to be considered and if the paper is not thorough, I shall only send it back

Euro Pol
CAP

Meeting extract PM/Chancellor 4.10.79 at 9.00am.

iii. The Chancellor said that, in relation to the CAP, the UK should try to ensure that in future Agricultural Ministers were to be accompanied at crucial Agricultural Council meetings either by Finance Ministers or by Treasury officials. At present, Agricultural Ministers had it too much their own way, without considering the implications of their proposals for the non-agricultural community.

Prime Minister

I think an inter-departmental assessment is a good idea - either instead of or in addition to Mr. Walker's position paper. Cabinet Office would be better than the Treasury as chairman.

TL
3/10

CONFIDENTIAL

Qa 04286

To: MR LANKESTER

From: SIR KENNETH BERRILL

British Agriculture

1. I read with very great interest your note of the Prime Minister's meeting last Monday with the Minister of Agriculture. If I may say so, I think the points which the Prime Minister made and which you list in paragraph 4 are all very well taken. I note that it was left that Mr Walker would put in a position paper on British agriculture to the Prime Minister.

2. The problem with such a paper coming from MAFF is that I fear that it will be a very partial analysis in that it will present the picture very much from the point of view of the United Kingdom producer. The only way around this would be to have an interdepartmental look at the whole problem under either Treasury or Cabinet Office chairmanship so that a more balanced presentation can be achieved.

3. The CPRS had a go at doing this on its own over five years ago in the early part of 1974. It proved a difficult task even though we had in our team at that time a couple of people who were particularly useful in this area. By contrast we unfortunately lost a week or two ago our economist who came to us from MAFF and who has now gone on to the IMF/IBRD desk in Washington.

4. To repeat, when the Prime Minister received a paper from Mr Walker she would need detailed independent briefing to be able to evaluate it. I do not think the CPRS could offer to do this in the time available and I suggest that consideration should be given to a rapid interdepartmental study.

he hasn't !
R

5. It is not clear from your note whether Mr Walker had withdrawn his suggestion for an increase in the price of milk pending consideration of his paper on the position of British farming generally, but I would hope that that is indeed the case.

6. There is no tearing hurry for this decision and we could give ourselves a month or even two to work on the facts.

7. I am sending a copy of this minute to Sir John Hunt.

KB

3 October 1979

020

Hz,

(2)

Prime Minister

Seen 4 or 1?.

Treasury Chambers, Parliament Street, SW1P 3AG

3/x

3 October 1979

M O de B Alexander
Private Secretary
10 Downing Street
LONDON
SW1

Dear Mr Alexander,

NON BUDGETARY TRANSFERS UNDER CAP

I understand that at this morning's meeting the Prime Minister asked why the non-budgetary transfers made under the CAP by the UK were so much lower than those made by Italy. The Financial Secretary explained the reasons in general terms but thought that further details might be helpful.

The most recent year for which estimates are available is 1978. These show an adverse non-budgetary transfer of £110 million for the UK and £588 million for Italy. There are two main reasons why the UK's adverse resource costs were much smaller than the Italians. Firstly, UK import prices under the CAP were lower than Italian import prices. This is because although both the UK and Italy operated their green currencies in a way which held their import prices below the common EEC price, the UK did so to a greater extent than Italy. Secondly, in the main temperate agricultural commodities on which the calculation is based, the UK was a smaller importer from and a bigger exporter to the rest of the Community than was Italy. This partly reflects differences in UK and Italian agricultural production and partly a greater propensity for UK import to be drawn from third countries. Imports from third countries do not show up in the analysis of non-budgetary transfers because they give rise to levies which form part of budgetary transfers.

The resource costs suffered by the UK as a result of EEC membership could be inflated by attributing the benefit of MCA's on imports to the importing countries: on this basis our non-budgetary resource costs for 1978 amount to £586 million. However, this attribution of MCA's leads to an equivalent reduction in our net budgetary contribution to the EEC. So long as the discussions were based solely on budgetary transfers we have argued against this treatment of MCAs, because by refusing to regard them as budgetary benefits to us we kept the budgetary transfer figure as close as possible to the total of the budgetary and non budgetary figures. The Financial Secretary has asked me to point out, if it needs any emphasis, that it is clearly in our interest to present the figures in the way that maximises the UK's net budgetary contribution. I regret that no later figure of resource costs is available. Given the considerable reduction in MCA's because of green pound devaluations and the strengthening of sterling, the current non-budgetary element in the UK's total resource costs is likely to be bigger.

Yours sincerely,

PC Diggle

P C DIGGLE

Private Secretary

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cc CO
bcc Wolfson
Alexander
Hoskyns

European Policy

VLB

10 DOWNING STREET

From the Private Secretary

1 October 1979

Your Minister called on the Prime Minister at 1430 hours today to discuss the state of British agriculture. They were later joined by Mr. Buchanan Smith to discuss fisheries problems; we will be writing to you separately about that.

Mr. Walker said that he was extremely concerned about the general state of the agricultural industry, and he wanted to be sure that the Prime Minister fully appreciated the seriousness of the position. The Conservative Party had severely criticised Labour during the Election campaign for having undermined the industry - by allowing investment and profitability to decline. In spite of the two Green Pound devaluations this year, and the increase in farm prices, farmers were now faced with the prospect of lower incomes than at any time since 1973. The index of farm incomes was forecast to be down to 76 for 1979, compared with 90 in 1978 and 105 in 1977 - and higher still in the preceding years. As a consequence, bank borrowings by agriculture had risen very considerably; and unless steps were taken to improve the position, there was likely to be a substantial downturn in investment and cutback in production. The political reaction of the farming community, which had been led to believe that the Government would bring about an improvement in its position, would be immense. The reason for the deteriorating position was that costs had risen by more than twice the amount that could be attributed to the Green Pound devaluations and the price increases.

Mr. Walker went on to say that other Governments in the E.E.C. were increasing their budgetary support for agriculture. This was particularly the case with the French. By contrast, it was being proposed by the Treasury that MAFF's budget should be cut - for example, with a reduction in capital grants and hill farm subsidies. If the policy of cutting back U.K. agricultural support were pursued, while other countries' support measures increased, this would almost certainly lead to less production in the UK and larger imports from Europe.

/ The Prime Minister

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The Prime Minister noted what Mr. Walker had said. But she expressed serious doubts about his analysis. In the first place, she questioned the realism of the MAFF forecast for farmers' incomes in the current year - especially given that the harvest was likely to be at least as good as the previous year's. Secondly, she pointed out that, whereas the Conservative Manifesto had indicated that the Government would "devalue the Green Pound within the normal lifetime of a Parliament to a point which would enable our producers to compete on level terms with those in the rest of the Community", the Government had in fact achieved this within months of the Election. It could not therefore be said that the Government were neglecting the farmers' interests. Thirdly, she could not accept that prices should be increased for products which were in surplus. Thus, she would find it very hard to go along with Mr. Walker's proposal to increase the price of milk at a time when a very substantial part of the UK's milk production was going into intervention. Fourthly, she could not accept the argument that, because other countries were increasing their agricultural subsidies, the UK should do the same. Efforts should be made through the Commission to put a halt to the escalation of such subsidies rather than try to match them. Moreover, the argument that MAFF expenditure should be increased ignored the overall budgetary constraints within which the Chancellor was operating. Fifthly, she did not feel that Mr. Walker was giving sufficient weight to the interests of consumers. A major priority for the Government must be to get the rate of inflation down, and policy in respect of agriculture must contribute to this.

Mr. Walker said that he was equally determined to avoid unnecessary price increases or expenditure. At the same time, however, he did not believe that the Prime Minister's strictures were justified, and he remained very concerned about the prospects for the industry. It was clearly essential that the CAP be reformed; but for this he needed the co-operation of other agricultural Ministers. He proposed to submit to the Prime Minister a position paper on the state of British agriculture which he hoped the Prime Minister would be willing to discuss with him. This would include figures on farm incomes, and a commodity-by-commodity analysis. The Prime Minister said that she would be glad to see such a paper, and to have a further discussion with Mr. Walker in due course.

I am sending a copy of this letter to Martin Vile (Cabinet Office).

T. P. LANKESTER

G.R. Waters, Esq.,
Ministry of Agriculture, Fisheries and Food.

Euro Pol

LORD PRIVY SEAL

Foreign and Commonwealth Office
London SW1

27 September 1979

Thank you for your letter of 25 September to Peter Carrington.

You asked for comments on the suggestion that the second Consumer Programme might be used as a means of reinforcing pressure to restrain CAP prices. I agree that increased consumer concern about CAP price levels would play a helpful role at the time of CAP price-fixing negotiations, particularly in other Community countries where the consumer voice has hitherto been remarkably quiet. I must admit to some doubt, however, about whether the Commission as a whole would endorse a review which might appear to be designed to challenge current CAP price levels, and in particular whether the Irish Commissioner would be receptive to the idea.

Given the other major objectives we are pursuing at the present time I think you should be rather guarded in what you say to Mr Burke. I suggest that you concert any line you propose with Peter Walker since it would bear on relations with his colleagues in the Agriculture Council. I myself think it would be preferable to save our fire until we have decided how to handle the 1% VAT ceiling and the broader question of agriculture price support.

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

The Rt Hon Sally Oppenheim MP
Minister of State for Consumer Affairs
Department of Trade
1 Victoria St
London SW1H OET

(2)

Euro Pol

Ref. A0306

Prime Minister

MR. ~~ALEXANDER~~

MS.

Export of Sheepmeat to France: European Court Judgment

You may wish to let the Prime Minister know that, as expected, the European Court ruled on 25th September that France was in breach of the EEC Treaty in applying national rules to restrict imports of sheepmeat from the United Kingdom.

2. The Court say that it is for the competent authorities to take Community measures relating to the market in sheepmeat but that the absence of such measures does not excuse infractions of the Treaty by a member state. They also point out that, if the lifting of restrictions causes difficulties for French sheepfarmers, it is open to France to grant them any form of aid compatible with the Treaty. This accords with our own view.

3. It is now for the French to decide what to do. When the Court ruled against our restrictions on potato imports in March the previous Government announced within 10 days the lifting of the restrictions: the Minister of Agriculture has made clear that he expects a similar response from the French Government on sheepmeat. The National Farmers Union are planning to send a test consignment to France very soon unless an end to restrictions is announced.

for M.J. VILE

26th September, 1979

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10 DOWNING STREET

From the Private Secretary

26 September 1979

Dear Garth,

Green Pound Devaluation

The Prime Minister has seen a copy of the Minister of Agriculture's letter of 25 September to the Foreign and Commonwealth Secretary in which your Minister said that he intended to accept a green pound devaluation of 1.1% if this were proposed by the Commission in Dublin today. The Prime Minister is content that Mr. Walker should accept such a devaluation.

I am sending copies of this letter to the Private Secretaries to the members of OD(E) and to Martin Vile (Cabinet Office).

Yours sincerely

Michael Alexander

G.R. Waters, Esq.,
Ministry of Agriculture, Fisheries and Food.

CONFIDENTIAL

10 DOWNING STREET

Prime Minister.

Mr Walker leaves for Dublin to-morrow morning.

This problem arises from the realignment of currencies over the weekend. I do not think the papers could have been got to you much earlier.

[signature]

25.9.79.

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Prime Minister

Agreed ? ?.

MR. LANKESTER

EXPECTED COMMISSION PROPOSAL FOR A DEVALUATION OF THE GREEN POUND

The Minister of Agriculture's minute sent today to the Foreign and Commonwealth Secretary seeks the agreement of his colleagues that he should accept a 1.1 per cent devaluation of the Green Pound if as expected the Commission propose it at tomorrow's meeting of EEC Agriculture Ministers in Dublin.

This is part of the fall-out from last weekend's realignment of EMS central rates. As the D-Mark has a heavy weight in the European Currency Units (ECU) "basket", and the Danish krone a light one, the net effect of the realignment is to raise the value of the ECU. If nothing were done to compensate for this, the Monetary Compensatory Amounts (MCAs) payable in the positive MCA countries (except Germany) would fall and those payable in the negative MCA countries, including the UK, would increase. The Commission are proposing green rate devaluations so as to prevent any changes in negative MCAs. This is consistent with the general desire to prevent the EMS leading to a further growth of MCAs.

The effect of a 1.1 per cent Green Pound devaluation would be to raise by that amount the support prices payable to farmers; raise similarly the levies paid on our imports of food from third countries and the prices of our imports from the Community. As the Minister points out, the effect on the Retail Price Index is negligible. The public expenditure effect of the Green Pound devaluation alone is slight and possibly (like the devaluation of the Italian lira) favourable. For Denmark, Ireland and France, however, the Commission's proposals are liable to raise Community expenditure and hence, overall, our contribution to the Community Budget; but the amounts are relatively small.

In its Manifesto the Government pledged that it would devalue the Green Pound within the lifetime of a normal Parliament to a point which would enable our producers to compete on level terms

/ with

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with those in the rest of the Community. Acceptance of the 1% adjustment would be consistent with this. The recent fall in sterling has meant that our MCA, which operates as a subsidy on imports and a levy on exports, has begun to grow again (from 3 per cent) to 9 per cent. Without this adjustment, it would go above 10 per cent.

M.J.V.

M. J. Vile

25 September 1979

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

From the Minister

CONFIDENTIAL

The Rt Hon The Lord Carrington KCMG MC
Foreign and Commonwealth Office
Downing Street
London

25 September 1979

D h Dee,

EXPECTED COMMISSION PROPOSAL FOR GREEN POUND DEVALUATION

At the meeting of EEC Agriculture Ministers in Dublin tomorrow afternoon, the Commission is expected to propose devaluations in the green rates of several Member States, including the UK, as a result of the recent re-alignment of EMS currencies.

Each Member State's MCA is broadly the difference between its national, green-rate-determined price level and the common price level, which is tied to the ECU. The revaluation of the D-Mark has increased the value of the ECU, and this would automatically result in the introduction of, or increase in, MCAs for Denmark, Ireland, France, Italy and the UK. In accordance with the resolution of the European Council last December, which "stressed the importance of avoiding the creation of new MCAs", the Commission are likely to propose devaluations in the green rates of these five Member States sufficient to avoid any change in their MCAs. For the UK this would mean a green pound devaluation of 1.1%. Since we claim the right to devalue the green pound when we consider it appropriate, we cannot stand out against the proposals relating to the other four countries.

The National Farmers' Union have asked me to negotiate an immediate green pound devaluation of 5%. I do not propose to accede to this request. But I would find it very difficult to defend a situation in which I agreed to devaluations of between 1% and 3.8% for four other Member States, yet refused to accept a devaluation of 1.1% in the green pound. Farm income fell by 11% in real terms in 1978, and the two 5% devaluations since then, together with the average increase of just over 1% in "common prices" agreed in June, add up to significantly less than our estimates of the current increase in agricultural costs. It is my present view that farm incomes will be lower this year than last in real terms, and probably in actual money terms. This has to be seen against the background of our Election Manifesto in which we criticised the previous Government for the pressure that they had applied to farm incomes.

Taken on its own, a green pound devaluation can be expected to produce a slight reduction in UK public expenditure since the saving on our contribution to the budget (due to lower expenditure on UK MCAs) more than outweighs any contrary effects. The effect on food prices, which would in any case take time to work through, is negligible - theoretically one-twentieth of 1% on the RPI.

For these reasons, assuming the Commission put forward this proposition, I propose to accept it unless you or any of our colleagues sees objection. I must warn colleagues that, in the current state of British agriculture, to be the one country in the Community to decline the Commission's proposals would have a most serious impact on confidence and would, in my judgement, be very damaging politically to the Government.

I am copying this letter to other members of OD(E) and to Sir John Hunt.

PETER WALKER

CONFIDENTIAL

Subject on New Zealand: May 1979. Visit to Britain by Mr Muldoon.

RECORD OF THE PRIME MINISTER'S TALK WITH THE PRIME MINISTER OF NEW ZEALAND AT A WORKING LUNCH AT 10 DOWNING STREET ON 21 SEPTEMBER 1979 AT 1300

Euro Pol.

Present: Prime Minister
The Foreign and Commonwealth Secretary
The Minister of Agriculture
Mr. Timothy Raison, M.P. Minister of State, Home Office
Sir Michael Palliser
Mr. Michael Franklin
Mr. Clive Whitmore
Mr. Michael Alexander

The Rt. Hon. R.D. Muldoon
H.E. The Hon. L.W. Gandar
Mr. B.J. Lynch

Sheep Meat Regime

Mr. Muldoon said that New Zealand did not want a sheep meat regime. They wanted total access to the EEC market and did not see why they should accept regressivity in the trade at which they were best. The problem should in any case be regarded as a bilateral one between the United Kingdom and New Zealand. New Zealand lamb was produced for the UK market. To adapt their product to a different market would involve changing breeding and agricultural practices in New Zealand. It would take New Zealand up to thirty years to adapt. If New Zealand were to lose the lamb trade, it would take the heart out of the New Zealand sheep raising industry. The industry was the largest single element in New Zealand's export trade. The British market for lamb was, literally, vital.

The Prime Minister asked why New Zealand could not sell lamb to the UK without a sheep meat regime. The issue was of real concern to only three members of the Community. The Minister of Agriculture said that there would have to be a sheep meat regime. The terms of the Treaty of Rome made it impossible to argue that there should not be such a regime. Its introduction might be delayed but it would come. But it would of course be possible to call a non-regime a regime. There was already a 20% tariff on sheep meat imports as a result of the GATT agreement to which New Zealand was a party. This would have to be retained. But for the rest, the UK requirement was for free movement of sheep meat within the EEC. Since demand far exceeded supply there was no need for intervention to take place. The French and Irish had

CONFIDENTIAL

/a transitional

a transitional problem: the United Kingdom position was that producers in those countries could be paid a premium for three years at the expense of their own Governments. Since this approach was totally unacceptable to those Governments, there would be no agreement on the question.

Mr. Muldoon said that what was required was an amendment to the Treaty of Rome in the light of intelligent reconsideration. Treaties were not written on tablets of stone. They could be changed if the signatories of the Treaty had the will to do so. The Community would not necessarily last for ever. If it were to break down it might well be over the Common Agricultural Policy (CAP). Economic lunacy could not go on indefinitely.

The Foreign and Commonwealth Secretary said that the CAP was being used to finance the solution to the social problems of some Member States. Sir Michael Palliser pointed out that while it had in the past been used for essentially social purposes, this was no longer the case. But the CAP was politically very popular in a number of countries. It had become part of the political mythology in France and other Member countries. It would have to be retained. But of course a less extravagant way of financing it would have to be found. Mr. Muldoon asked what price the British public was paying for the CAP. The reasoning underlying it was untenable. Sir Michael Palliser suggested that this was not the right way to put the question. The basic problem was to ensure that we extracted the maximum benefit from our membership of the EEC. The other members of the EEC had to be brought to realise the need to take more notice of British concerns. It had been very difficult for the last Government because they were suspected of trying to undermine the Treaty. The present British Government were much better placed to ensure that their interests were taken into account.

The Prime Minister said that member countries should pay for their own social problems. She agreed with Mr. Muldoon that the reasoning underlying the CAP was untenable. Food prices were an important element in inflation and had to be contained. Moreover, the CAP was having a damaging effect on agriculture in non-member

countries.

CONFIDENTIAL

Euro. Pol.

Original filed Euro Pol (Budget) May 79

Ref. A09908

PRIME MINISTER

Cabinet: Community Affairs

Since the Cabinet last met on 20th June the main Community events have been: the Common Agricultural Policy (CAP) price settlement agreed at the end of the 18th June Agriculture Council; the 21st-22nd June European Council; the 25th June Fisheries Council; and the 25th June final negotiating Conference with the African, Caribbean, Pacific (ACP) countries on the renewal of the Lome Convention. (The Community aspects of the Tokyo Summit, notably the national oil import limits to be specified by each Community member state, will presumably be discussed under the preceding agenda item.)

2. The Minister of Agriculture might be invited to report on the outcome of the 18th June Agriculture Council, which - as he acknowledged in his letter of 25th June - departed in some respects from the line endorsed by Cabinet on 14th June, notably in providing for a price increase in sugar.

3. No Minister has so far challenged the justification for accepting the Luxembourg package set out in Mr. Walker's letter of 25th June. Nevertheless I suggest that you ought to take the opportunity of this Cabinet to put on record one point, thought without overtly seeming to criticise Mr. Walker. This is that Ministers negotiating in the Community must stay within the limits of what has been collectively agreed or refer back to the Chairman of the relevant Committee or to you before departing from these limits. Everyone knows that some time some departure may be necessary in order to secure a satisfactory settlement. But a Minister ought not to do this on his own initiative and without clearing his lines.

4. The Foreign and Commonwealth Secretary might report on the outcome of the final EEC/ACP negotiating Conference on 25th-26th June on the new Lome Convention. So far as the Community is concerned the Conference marks the end of the negotiations. The ACP countries will however meet in July before deciding finally on the signature of the new Convention. Except for human rights, on which no agreement was reached and the Community will therefore make a unilateral pronouncement later, the United Kingdom's interests were satisfactorily safeguarded.

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5. Unless you wish to enlarge on your statement to the House on 26th June there should be no need for discussion of the European Council. The Defence and Oversea Policy Committee (OD) will take a paper from the Chancellor of the Exchequer on our tactics on the Community budget on 10th July.

JOHN HUNT

4th July, 1979

Euro. Pol.

Foreign and Commonwealth Office
London SW1A 2AH

3 July 1979

Dear Peter,

N BPM ... 3/7

CAP PRICES

Thank you for your letter of 25 June to Peter Carrington who is abroad. I certainly agree that you achieved a very satisfactory settlement. It was highly regrettable that the initial press comment should have been based on partial accounts by the Commission before the final package had been wrapped up. This inevitably meant that the British press accounts were inaccurately and unfairly critical, with the result that criticism in Parliament, too, has been similarly distorted. While we shall never avoid all criticism it seems to me that the settlement is increasingly being recognised for what it was (Peter Shore was noticeably subdued in the House last week); we shall certainly continue to do all we can to support you and make sure the message gets home.

Meanwhile, I wonder if we might have a further look at the possibility of subscribing to the "Gentlemen's Agreement" on phasing out new MCAs. I am not sure that it will be to our advantage to hold this up until we take a decision on full participation in the EMS. The arguments in your letter of 14 June to Peter Carrington suggested that there could be advantages in subscribing to the agreement and embodying it in a regulation. If there are such advantages, particularly over increased freedom to dismantle existing MCAs, it would appear preferable to

/secure

The Rt Hon P Walker MBE MP
Minister of Agriculture, Fisheries and Food
Whitehall Place
London SW1

secure them now than to link them to a decision to participate in the EMS. This would be consistent with our general wish to avoid positions of isolation against the other eight when they serve no clear national interest. It could also be seen, like our decision to deposit reserves in exchange for ECUs, as a positive gesture towards the EMS, although without any commitment on participation in the exchange rate mechanism.

I am copying this letter to the Prime Minister, the other Members of OD(E) and to Sir John Hunt.

Yours ever

Ian.

countries. There was no overall view of its consequences. The Minister of Agriculture said that the burden of the CAP was excessive. The British contribution was monstrous. But it was important that we should not, in doing a deal to reduce our net contribution to the Budget, commit ourselves to the continuation of the CAP in its present form. The Foreign and Commonwealth Secretary said that one reason why the UK imported food from outside the EEC, thereby pushing up our contribution to the Budget, was that the British consumer wanted products eg hardwheat, not produced within the Community. The Prime Minister said that the CAP had come to such a pass that changes would have to be made. Agreeing with Sir Michael Palliser that the 1% VAT ceiling would in any case precipitate a crunch, the Prime Minister said that there was a risk that because of our requirement for change on the Budget, we should be blamed. It would be wise, therefore, for us to clear our minds about reform of the CAP before the 1% VAT ceiling was reached.

Reverting to the sheep meat question, Mr. Muldoon asked why the French were always able to call the tune. They seemed to have the other members perpetually on the wrong foot. They invariably got their way despite being in a minority of one. The Minister of Agriculture said that this was an over-simplified view. On many occasions the Community did line up against the French. But frequently the French were not in a minority of one. It was not realistic to suppose that the sheep meat regime could be avoided. The Foreign and Commonwealth Secretary said that the previous British Government had frequently been the one that was out of step but that the policy had not paid many dividends. Mr. Muldoon repeated his view that the sheep meat issue should be a bilateral one. Every round in the argument that was lost was a further nail in New Zealand's coffin. If a regime was agreed - and even if it was a non-regime - someone else would built on it at a later stage. The Minister of Agriculture said that the realities of the situation were that there was no problem about New Zealand lamb coming in. The only barrier was the GATT tariff. This would not be deconsolidated. The EEC would not go to GATT and ask for a lower tariff. The only possibility was that the Commission would propose the offer of a fixed volume of imports of New Zealand lamb in exchange for a lowering of the tariff. Mr. Muldoon said that this approach was not acceptable. The Minister of Agriculture said that this was for Mr. Muldoon to decide. But it was important to remember that New Zealand's bargaining position was not strong. The UK would get the best quotas it could in 1981 but New Zealand had no other allies within the EEC.

Rhodesia

On Rhodesia, Mr. Muldoon asked whether there was anything he could do to help with the Rhodesia Constitutional Conference. He would be very happy to tell Mr. Smith that the end of the road had been reached. The Foreign and Commonwealth Secretary took note of Mr. Muldoon's offer.

The discussion ended at 1430.

[signature]

21 September 1979

CONFIDENTIAL Euro Pol

RECORD OF THE PRIME MINISTER'S TALK WITH MR. CHRISTOPHER TUGENDHAT AT 10 DOWNING STREET ON 13 SEPTEMBER 1979 AT 1500 HOURS

Original on:
Euro Pol: Pt 2
Future Policy.

PRESENT

Prime Minister
Chancellor of the Exchequer
Lord President
Sir K. Couzens
Mr. M. Franklin
Mr. M. O'D. B. Alexander
Mr. T. P. Lankester

Mr. Christopher Tugendhat
Miss P. Neville-Jones

Agriculture

Mr. Tugendhat said that there was some suspicion among other members about British intentions on agricultural prices. In the past we had been able to argue for limitations in price rises in the Community while giving our own farmers price rises through the devaluation of the Green Pound. But this escape route was no longer open: a Community price freeze now meant a price freeze in the UK. Since it seemed that HMG wished to expand domestic production, it was being asked in Europe whether we would not in the end follow the Germans in accepting price rises. This suspicion could make for difficulties in Dublin since it would not be understood if we appeared to be attempting to push up overall Budget expenditure in defence of sectoral interests while reducing our own net contribution.

The Prime Minister said that she was ready to tell British farmers that food prices would not be allowed to rise in the next two years. The farmers had done very well in the last two years and her concern was now less for them than for the housewife.

Mr. Tugendhat welcomed what the Prime Minister said and expressed the hope that arrangements would be made to ensure that her views became known. He referred to his intention to try to get the Finance Ministers more involved in the fixing of agricultural prices. He hoped that it would be possible to arrange

/ a "guidance debate"

CONFIDENTIAL

a "guidance debate" in which the Finance Ministers could examine the consequences for the Budget as a whole of any given set of agricultural price proposals, and set a global financial limit within which the Agriculture Council would have to operate. (The Prime Minister commented that this was a very good idea). The proximity of the Budget to the 1 per cent VAT ceiling - which would certainly be reached in 1981 and might on some assumptions be 1980 - provided a good reason for pressing for the involvement of Finance Ministers. While he would not do so before the Dublin meeting, the Commission would have to bring forward proposals for raising the 1 per cent VAT ceiling before the New Year.

The discussion ended at 1645.

17 September 1979

Monday 1/10/79
@ 14.30.

Please file.
CL.
14/9

B/F 28-9-79

10 DOWNING STREET

PRIME MINISTER

Yes MT

Peter Walker has requested an hour with you before the Party Conference. Apparently you agreed to this in Cabinet one day.

The two points he wishes to discuss are:-

(i) Assessment of European agriculture;

and

(ii) Fisheries.

Mr. Walker would be most grateful if you would agree to Alick Buchanan-Smith attending the latter half of this meeting?

CL.

11 September 1979

CONFIDENTIAL

(2)

Prime Minister

Ref. A0175

MR. ALEXANDER

Cost of the 1979 CAP Price Settlement

The minute of 24th August from Bryan Cartledge to Barry Hilton recorded the Prime Minister's question whether the "existing public expenditure provision" within which the price settlement can now be accommodated means the provision after the Government's reductions; or whether it is the case that public expenditure has not been reduced pro rata.

2. The price settlement will affect public expenditure in 1979-80 and 1980-81.

3. For 1979-80 the Minister of Agriculture is saying that the consequences of the price settlement can be accommodated within the provision made in the public expenditure White Paper published by the previous Government last January (Cmnd. 7439).

4. For 1980-81, the Minister is saying that the consequences of the price settlement can be accommodated within the estimate for public expenditure arising out of the CAP which was incorporated in the proposals for public expenditure agreed by the Cabinet in July. This estimate was drawn up on the basis of existing expenditure trends before the price-fixing. It was not subject to pro rata reduction, principally because the cost of the CAP depends on world price levels, how much Community farmers produce and decisions of the Council of Ministers (Agriculture) in Brussels - none directly controllable through the United Kingdom Public Expenditure Survey.

5. The reduction of £102 million in our net contribution to the Community which resulted from the price-fixing does not reduce the total of United Kingdom public expenditure because it was mainly achieved by increasing our receipts from the Community. An increase in receipts reduces our net contribution but if it takes the form of Community reimbursement of additional United Kingdom public expenditure (as for example with the butter subsidy) it leaves the net total of United Kingdom public expenditure unchanged.

M.J. VILE

5th September, 1979

European Policy

10 DOWNING STREET

From the Private Secretary

BF 31.8.79

MR. HILTON
CABINET OFFICE

David Elliott sent me, under cover of his minute of 17 August, the "translation" for which the Prime Minister had asked of the Minister of Agriculture's minute to her of 2 August about the effect of the CAP price settlement on the UK contribution to the Community budget.

The Prime Minister was grateful for this clarification and found it helpful.

On paragraph 2 of David Elliott's minute, the Prime Minister has asked whether "the existing public expenditure provision" within which the price settlement can now be accommodated means the provision after the Government's reductions; or whether it is the case that the public expenditure provision has not been reduced pro rata. I should be grateful for advice on this point.

24 August 1979

GB

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CONFIDENTIAL

Prime Minister

You said that you would like Mr. Walker's minute put into English! [initials] 17/8

Tg 0409

MR CARTLEDGE

EFFECT OF THE CAP PRICE SETTLEMENT ON THE UK CONTRIBUTION TO THE EEC BUDGET

Your letter of 13 August to Mr Hilton asked for a "translation" of the minute the Minister of Agriculture addressed to the Prime Minister on 2 August.

... In Mr Franklin's absence on leave I attach a note which is designed to make the position clearer.

A little clearer.

[signature]

D M ELLIOTT

17 August 1979

[initials].

cc Mr Hilton
Mr Downey
Mr Franklin o/r

CONFIDENTIAL

CONFIDENTIAL

EFFECT OF THE CAP PRICE SETTLEMENT ON THE UK CONTRIBUTION TO THE EEC BUDGET

1. In Cabinet on 5 July the Minister of Agriculture said that the Common Agricultural Policy (CAP) price settlement agreed in the June Agriculture Council would leave the UK with a net benefit in terms of our contribution to the Community budget of some £34 M, and undertook to circulate the details to the Cabinet. This note seeks to clarify his subsequent minute of 2 August to the Prime Minister.

2. The essential message of that minute is first, that because of better information and changed accounting? conventions the net gain to the UK is now put at £102 M and second, that the price settlement can be accommodated within the existing public expenditure provision for 1979/80 and 1980/81. — i.e. the reduced expenditure? Or did it not reduce it - provide.

3. Mr Walker's original remit was to produce a note on the effect of the price fixing on the UK's net contribution. But if he had left the net contribution effect to stand on its own, it would have given the misleading impression that the price settlement had produced a public expenditure saving. His minute accordingly seeks to place the price settlement in the context of the current public expenditure discussions. For this purpose he needs to relate the net contribution figure to the public expenditure position rather than to the Commission's original proposals, and to take into account all the decisions relevant to the public expenditure baseline including those (like the March green pound devaluation) which were agreed before the final package was adopted.

4. Much of his minute is taken up with a justification of this methodology. Thus his para. 2 explains that the calculations in the table accompanying his minute take no account of the higher co-responsibility levy and reduced sugar production quotas that were proposed by the Commission and included in the draft 1980 budget but rejected by the Council. His figures likewise include the full cost to the Community of the butter subsidy agreed for the UK, instead of only the difference between the level of subsidy proposed by the Commission and the higher figure agreed by the Council. In a similar vein his para. 3 explains that, to keep the figures on a consistent full year basis, the table assumes that the UK butter subsidy will

continue for 12 months from its introduction on 1 July although a new Council decision will be needed to extend it beyond 31 March 1980; and that account has been taken of the expenditure reductions stemming from the March green rate devaluations by the UK, France and Italy.

5. Against this background the figures in Mr Walker's table (in which revenue increases are denoted by a minus sign) may be summarised as follows:-

		MEUA	£
(i)	In a full year the CAP price settlement will produce a net increase in agricultural (FEOGA) expenditure from the Community budget of	397.5	266.78
(ii)	But this will be partially offset by a net increase in EEC revenue from agricultural levies of	181.2	121.62
(iii)	Leaving a net budgetary increase of	216.3	145.16
(iv)	The UK share of this increase, of which we pay 16.5%, will be		23.95
(v)	But the green pound devaluations associated with the price settlement will increase the amount we have to pay over to the Community in respect of import levies collected by our Customs. This increase will amount to		28.21
(vi)	The total increase in the UK's gross contribution to the Community budget is thus		52.16
(vii)	Against this, we shall get enhanced receipts from FEOGA amounting to		153.9
(viii)	Leaving the UK with a net gain of		101.74

6. The difference between this new figure of £102 M and the earlier estimate of £34 M is attributable partly to improved data, partly to the use of full year figures for the butter subsidy, but predominantly to a big upward revision of the estimated gain from increased subsidies paid by the Community to the UK on our agricultural exports. These subsidies are abated by the UK's monetary compensatory amounts (MCAs), which were reduced as a consequence of the successive green pound devaluations agreed in March and June of this year. (These are the "net savings in export levies" mentioned at the end of paragraph 3 of Mr Walker's minute.)

!?

7. These receipts, like others mentioned in the table, arise from the reimbursement by the Community of expenditure initially incurred by the UK. As such, their public expenditure effects would not have been fully reflected in a calculation confined to the UK's net contribution to the Community budget. Paragraph 4 of Mr Walker's minute accordingly seeks to compare the effects of the price settlement and related decisions on our net contribution and on CAP schemes operating within the UK with the total provision for the relevant public expenditure programmes agreed for 1979/80 and 1980/81. The satisfactory conclusion, with which the Treasury agree, is that no increase is needed (though, equally, no savings can be claimed).

8. This is not of course the whole story, for the minute makes no attempt to deal with the wider economic implications of the price settlement, including its overall balance of payments effects. The green pound devaluation and the increase in CAP prices will put up the costs of our EEC food imports and will thus represent a significant loss to the balance of payments. But acceptance of this balance of payments cost was implicit in the Cabinet's decision to seek a devaluation of the green pound; and in the paper (OD(E)(79)12) he put to the meeting of the Ministerial Sub-Committee on European Questions which preceded the Cabinet discussion, the Minister of Agriculture argued that the long term benefits to the balance of payments of a competitive, export-orientated farming industry would greatly outweigh the immediate cost.

CABINET OFFICE SW1
17 August 1979

PRIME MINISTER

2.

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

From the Minister

CONFIDENTIAL

Please translate into English

2 August 1979

PRIME MINISTER

At Cabinet on 5 July I undertook to circulate details of the effect of the CAP price settlement on the UK contribution to the Community budget.

2. The revised estimate by the European Commission is that the CAP decisions this year have increased the provision needed for FEOGA expenditure in 1980 by 1311 MEUA (about £880 million) as compared with the figure in the preliminary draft Budget. But this is because of the assumptions they used in drawing up the draft Budget, in particular that a high rate of milk co-responsibility levy would apply and that their proposals on "B" quota sugar would be adopted. The Commission's estimate also includes only the difference between the cost of the butter subsidy agreed by the Council and the increase already provided for in the draft Budget. A fairer estimate would include the full cost of the increase in the butter subsidy but exclude the effect of the decisions on the milk co-responsibility levy and the "B" quota sugar. Figures on this basis are shown in the attached table for a full year together with the effect on Community revenue and on the UK net contribution to the 1980 budget.

3. The figures for UK receipts in the table assume, as do the Commission's estimates, that there is no change in the uptake of the school milk subsidy and that the UK butter subsidy continues on the present basis after the end of the current milk year on 31 March 1980. But the Council decision on 100% Community financing of our butter subsidy was in respect of the current milk year and we shall have to negotiate subsequent arrangements at the 1980 price settlement. When answering Parliamentary Questions on the financial effect of this year's price settlement I have therefore used butter subsidy figures for 9 months only, ie 1 July 1979 to 31 March 1980. We do not want to imply commitment to continue the subsidy if the 100% Community financing expires on 31 March. This is one of the reasons why the figure for the UK net gain which has been used in answer to Parliamentary Questions (£34 million) is lower than the net gain of about £102 million shown in the table. But the main reasons

for the new higher estimate are that figures are now available for our receipts arising from changes in UK MCA's stemming from the price settlement (primarily the net savings on export levies) and that figures for the effect of the devaluations in March have also been included.

4. The figure for the change in the UK net contribution allows for additional receipts arising by way of reimbursement from the Community of payments made within the UK. To assess the full effects on public expenditure as a whole it is necessary, therefore, to take account of these payments, as well as of the reduction in our net contribution to the Community, and to compare the outcome with our existing public expenditure provisions. I am satisfied that as a result of the price settlement and certain other changes arising from discussions on the 1980 Community Budget there is no need to increase the provisions we have made for 1979/80 and 1980/81.

5. I am sending copies of this minute to other Cabinet colleagues and to Sir John Hunt.

PETER WALKER

CONFIDENTIAL

FULL YEAR EFFECT ON UK OF CAP PRICE SETTLEMENT

		MEUA	£million
FEOGA EXPENDITURE CHANGES (full year effect)			
Beef & Veal: Italian Calf premium		+61.6	
Suspension of Intervention		-7.4	
Milk: Butter Subsidy		+288.0	
Non-marketing		+36.5	
1½% common price increase & German and Benelux Green rate changes		+100.0	
Skimmed milk powder subsidy		+31.3	
Further changes in milk sector		+13.0	
Other decisions		+46.7	
Green rate changes:			
UK - 5% devaluation agreed March		-115.5	
- 5% devaluation agreed June		-115.0	
France - 1.4% " " March		+54.3	
- 1.5% " " June		+80.0	
Italy - 9% " " March		-76.0	
	(a)	+397.5	+266.78
EEC REVENUE CHANGES			
Agricultural import levies		-171.0	
Sugar: production levies		-18.1	
storage levies		-10.9	
Isoglucose production levy		-1.3	
		-201.3	
Less 10% refund	(b)	-181.2	
Net effect of expenditure and levy change (a)-(b)		+216.3	+145.16
CHANGE IN UK GROSS CONTRIBUTION FROM:			
Expenditure and revenue change (216.3 x .165)		+35.69	
UK levy revenue change (share of -201.3) less 10% (46.7 x .9)		+42.03	
		+77.72	+52.16
UK RECEIPTS FROM FEOGA		£m	
School milk Subsidy		-8.1	
Butter subsidy		-77.0	
Other (mainly green £)		-68.8	
		-153.9	-153.9
CHANGE IN UK NET CONTRIBUTION			-101.74

CONFIDENTIAL

CONFIDENTIAL

Ref. A047

PRIME MINISTER

Cabinet: Community Affairs

The Foreign and Commonwealth Secretary might be invited to report on the outcome of the 24th July Foreign Affairs Council, the first to take place under the newly installed Irish Presidency. The Council disposed of a long agenda ahead of the summer break in Brussels, in the course of which Mr. Jenkins accepted that the Commission's reference paper on the Budget should be ready in time for the 17th September Finance Council; but nothing arose which is likely to call for substantive discussion by the Cabinet.

2. The Minister of Agriculture might be invited to report on the 24th July Agriculture Council, at which the resumed debate on a sheepmeat regime made little progress in the face of divergent national positions, including insistence by the United Kingdom that any compensation for disadvantaged producers should be limited to France and Ireland, should be degressive, and should be paid from national funds.

(John Hunt)

25th July, 1979

Euro Policy

Foreign and Commonwealth Office

London SW1A 2AH

16 July 1979

C.O. Hd
17/7

The Lord Privy Seal was grateful for Mr Walker's letter of 6 July about the "Gentleman's Agreement" on phasing out new MCAs.

In the light of Mr Walker's further points he does not wish to press the point in his letter of 3 July, but thinks it would be useful to look at the matter again if circumstances change.

I am copying this letter to Private Secretaries to the Prime Minister and Sir John Hunt and Members of OD(E).

S J Gomersall
Private Secretary to the
Lord Privy Seal

G R Waters Esq
Private Secretary to
the Rt Hon Peter Walker MBE MP
Minister for Agriculture, Fisheries
and Food
Whitehall Place
London SW1

17 JUL 1979

Euro Pol NO10 2

BY BAG
SAVING TELEGRAM [FRAME ECONOMIC
FRAME AGRICULTURE]
~~[illegible]~~ FROM: BONN
TO: FCO
NUMBER 26 [UNDATED]
REPEATED TO: UKREP BRUSSELS, OTHER EEC POSTS, WASHINGTON, OTTAWA,
UKDEL OECD, TOKYO, CANBERRA, WELLINGTON, UKMIS GENEVA.

Prime Minister

A very helpful speech by Count Lambsdorff.

FRG AND THE CAP

1. In a deliberately controversial speech to the biennial conference of the German Farmers Union on 7 July, the Federal Minister of the Economy turned the searchlight of free market economics on to the CAP and the German agricultural lobby.

2. Lambsdorff said that prices were only one factor determining the livelihood of farmers. A drop in the one did not automatically imply losses in the other. Taking other advantages of rural life into account the position of German farmers was not that bad. But he viewed with concern developments which could in the long run undermine the position of German agriculture.

3. He was talking about structural surpluses - milk, butter, milk powder, sugar, wine and wheat: with oversupply, not necessarily temporary, in a number of other products. The situation on the milk market was particularly critical; it was tending to deteriorate in other areas. Enlargement would bring the danger of further surpluses. If supply and demand remained out of balance permanently, then the CAP regimes in their present form, and hence farmers' incomes, were threatened. Almost 40% of FEOGA was going on milk support, costing the European taxpayer over DM1 million per hour. 70% of the Community budget was going on the CAP, in the face of growing demands from other sectors: regional and sectoral employment problems, energy, enlargement and aid. For the Federal Government "an increase in community own resources eg. through a higher share of national VAT is out of the question": this would mean higher taxes and more inflation. New tasks in the Community must be covered in the first place by savings and by re-structuring of the budget. In this the Federal Government "agreed with most of its partners". The fact that FEOGA mainly benefitted the economically strong member states was "not understood" in the economically weaker countries and promoted, frequently, a negative attitude to the Community. These countries thus demanded "vehemently"

/and

and with considerable political pressure a restructuring of the budget. In the face of the facts the German line of argument was increasingly hard to sustain.

4. The burdens resulting from surplus agricultural production were politically explosive. No one thought of applying the laws of supply and demand to agriculture in their pure form but it was in the interest of the farmers themselves to exercise moderation over prices, particularly in surplus products.

5. As regards the external agricultural policy of the Community, Lambsdorff said that suppliers like Australia and New Zealand had lost their traditional markets. It was not enough to export surplus production as aid to the developing countries, at the expense of their own production and with distortion of international trade. Nor were artificially high prices for imported cereal substitutes a remedy. Seeking to close the traditional European market to the Community's trade partners or (as the Commission increasingly did) subsidising the dumping of uncompetitive Community products on the world market only exacerbated problems of the Community's external relations. Retaliation could not be ruled out; and it could be directed against both the Community's industrial exports and its access (and in particular the access of the Federal Republic) to important raw materials.

6. Quotas, often suggested as a remedy, gave rise to serious political and administrative difficulties. They increased bureaucracy, distorted the market, reduced managerial options and ossified structures. Imbalances in the market resulted not from the regimes themselves but from the way they were managed. The original intention of the CAP was to avoid fluctutations in prices and incomes. In the course of time the goal of assuring incomes by means of fixed prices and unlimited guarantees had gained increasing significance. If prices policy was primarily used as incomes policy the danger existed that production was encouraged, which often led to surpluses. The other function of prices, to balance supply and demand was thus neglected or forgotten. The CAP regimes would not function in the long term if it was more advantageous to produce for intervention than for the market.

7. Lambsdorff's solution was to loosen the connection between income-oriented prices and unlimited guarantees. More rein must be given to market forces. The Commission had put forward a series of proposals. Most were indigestible fare for German farmers but they ought to be discussed openly. This year's price round had not diminished the problem, or Lambsdorff's concern. No one had grasped the nettle. It was doubtful whether, in a Europe of 12 the CAP could be administered under the principle of unanimity. Majority voting should surely be considered (though not by disregarding questions of true national interest). The European Parliament should look at this question.

8. How in such circumstances could farmers keep pace with the general development of incomes? Lambsdorff had no patent remedy. If prices were relieved in part from their function of sustaining farm incomes supplementary measures would naturally be needed, particularly for the worse off, although it would be wrong to put up new barriers to structural change. It was no service to farmers to promise them the unobtainable. Speaking as Minister of the Economy, he thought that serious consideration should be given to the question of whether direct income subsidies should not be introduced step by step in areas of serious surplus: global instruments were an inappropriate answer to regional problems. The Commission was looking at measures to regionalise agricultural structural policy. More money should go into infrastructure. The farmers themselves should be looking at new areas of activity such as tourism and rural energy production. The flight from the land had earlier opened the way for larger holdings. The process had slowed in the mid-70s but must be continued. He was confident that employment opportunities outside agriculture were growing.

9. In conclusion Lambsdorff said that no responsible politician had it in mind to destroy the CAP. But the policy was threatened by developments in the agricultural sector itself. Under the pressure of acute problems the Commission might see itself compelled to propose a radical change of course with far worse repercussions for farmers than solutions of the middle way. Farmers should adapt in the many ways open to them.

Comment

10. Lambsdorff got a polite reception, but no more, from the 6,000 farmers present. His remarks were highly unpopular as was clear from the response of the President of the Farmers Union and the applause it attracted. Lambsdorff's Ministry have long wrung their hands over the lack of /economic

economic sense in the CAP but this is the first sustained public attack by a Germ... Minister (FDP at that) on its failings; and a direct assault on the sacred cow of German farm incomes. It was a bold throw and an encouraging development. We understand that Ertl (also FDP) saw the speech in draft. He has not reacted substantively and has now retreated for his summer Kur. Lambsdorff's argument is a direct challenge to Ertl's traditional championship of the farmer at all costs, exempt from the normal rules of the economy.

11. Chancellor Schmidt's own views on the CAP are well known but he has stopped short of conflict with Ertl. Schmidt's Office tell us that Lambsdorff's speech was not cleared with them. Be that as it may the political front has been opened up on CAP in a way that cannot be unwelcome to Schmidt; and Lambsdorff spoke for the Government in spelling out their refusal to contemplate an increase in EEC own resources as a solution to the CAP headache.

WRIGHT

FRAME ECONOMIC
FRAME AGRICULTURE

EID

Euro Pol

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

From the Minister

CONFIDENTIAL

Rt Hon Sir Ian Gilmour Bt MP
Lord Privy Seal
Foreign and Commonwealth Office
Downing Street
London SW1

6 July 1979

Thank you for your letter of 3 July and for what you say about the CAP price settlement.

So far as the "Gentleman's Agreement" is concerned, it is true that I said in my earlier letter that turning it into a regulation might increase our freedom to devalue the green pound. This was on the assumption that the regulation would embody not only the arrangements agreed between the Eight in March for dealing with new positive MCAs, but also the resolution adopted by the Council at the same time to the effect that the dismantling of existing MCAs could be accelerated at the initiative of the member state concerned. My thought was that putting that resolution in the form of a regulation would give it extra status and make it more binding.

However two things happened at the Council which lead me now to look at the matter rather differently. First, the Germans and the Commission spoke very strongly against including the substance of the resolution in a regulation; second, the other members of the Council readily accepted my proposal for a green pound devaluation, thus showing that they regarded themselves as fully bound by the resolution. Further, the continued rise in sterling makes it not altogether impossible that we might ourselves acquire a positive MCA in the foreseeable future. If so, accepting the Gentleman's Agreement could result in our being obliged to <u>revalue</u> our green rate even though a subsequent fall in sterling would correct the position. This would result in protests from our farmers. For these reasons I now doubt whether, from my point of view, there are any advantages to be gained.

/Nevertheless I take the ....

Nevertheless I take the point that we do not want to be isolated unnecessarily, and if we are pressed to join, I agree we should reconsider the matter. But I doubt whether, particularly now that the French no longer have the Presidency, the others will raise the subject again until either we take a decision on EMS or the regulation adopting the ECU for the CAP comes up for renewal on 31 March next year. I was certainly not put under any pressure at the last Council, from which I conclude that the others do not attach as much importance to the point as we thought they might do.

I am copying this letter to the Prime Minister, other members of OD (E) and Sir John Hunt.

Peter

PETER WALKER

BGE o/R

MAP 29/vi

Mr. Sanders to see.

my NBAM

29/7

CONFIDENTIAL

QZ 01141

MR CARTLEDGE

1979-80 CAP PRICE SETTLEMENT

PPS with PM

In his letter to the Prime Minister of 26 June the Minister of Agriculture gives some figures (paragraph 6) which differ slightly from those which we supplied for the Prime Minister before her Statement to the House. Mr Walker quotes £75m as the cost to the Community Budget of the $1\frac{1}{2}$ per cent increase compared with £64m in the table attached to my minute of 26 June. The difference is the net effect on the Budget of the German and Benelux revaluations of their green currencies. Mr Walker's figure for the butter subsidy (£65million) includes £5m for the effect of a reduction in levies on imports of butter from New Zealand which was not included in the figures I gave you. Strictly speaking, the £5m is a reduction in our contribution rather than an enhanced receipt, but the point is not of great importance.

2. Meanwhile, the Commission have been revising their own figures and their estimate of the cost as compared with their original proposal is now 1350 muas instead of 1500 muas.

3. I see no need to trouble the Prime Minister further with these figures. Despite the adjustments, she can still maintain that the settlement will give us a net reduction in our contribution of about £30 million.

M D M FRANKLIN

CABINET OFFICE SW1

29 June 1979

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

From the Minister

NGBM
2/7

PRIME MINISTER 26 June 1979

P.a.
2/7

1. Mr Gundelach confirmed yesterday that he has never stated to any journalist, or to anybody else, that Britain let him down in the negotiations.

2. Mr Gundelach confirmed yesterday that Britain was the country that remained insistent on a price freeze on milk, whilst the majority of other member countries wanted to have a price increase on milk.

3. Mr Gundelach confirmed yesterday that Britain alone had remained firm on the need for sugar quotas but he had decided that his proposals for sugar quotas this year would not succeed because other member countries had informed him that they would not agree to quota reductions on this year's crop. It was his decision that it would be impossible this year but he was grateful for the British persistence that was a desirable thing.

4. As far as the Statement that this year's price fixing will cost £1000 million, Mr Gundelach confirmed to me yesterday that the two dominant items in this calculation were his failure to obtain a high co-responsibility levy on milk and the sugar quotas.

5. The final proposal put to the Council for a co-responsibility levy suggested a high rate of 3% for producers producing more than 20,000 litres of production. Under this proposal 48.9% of the production of Germany, 51.5% of the production of France and 67.4% of the production of Italy would have been excluded from the higher levy whilst only 9.3% of the production of the United Kingdom would have obtained such an exemption. This was obviously totally unfair and as far as our payment to the Community were concerned the acceptance of this formula would have resulted in Britain paying to the Community through the co-responsibility levy a sum very much out of proportion to our own dairy production and that of other Member States.

6. Our calculation/

6. Our calculation as to the cost of the 1½% price increase on products other than milk is that this would add to the Community budget by £75 million which, of course, we would pay our share of 16.5% which we calculate would be £12.4 million at our marginal rate of contribution. The butter subsidy will provide a contribution from the Community of about £65 million over the next 9 months.

PETER WALKER

Euro Pol.

QZ 01130

MR CARTLEDGE

CAP COSTS

I attach -

(a) a summary table showing the possible effects on the Community's budget;

(b) a note on the effects on the retail price of butter

(c) a longer note by MAFF which in paragraph 7 gives a figure of £50 million which you can use as our estimate of the lower UK contribution arising from the price settlement. All these figures are agreed with Treasury and MAFF. They are not the same as the UK public expenditure figures which will have to allow for additional expenditure arising in the UK.

H.G. Walsh

for M D M FRANKLIN

26 June 1979

CAP PRICES

A Effects on the Community Budget

		MUAS	£ MILLION
1.	1½ per cent price increase (less German + Benelux revaluations)	+ 100	+ 64
2.	Butter Subsidy	+ 300 (+ 200)*	+ 200 (+ 126)
3.	UK 5 per cent devaluation	− 115 (− 140)	− 73 (− 90)
4.	French franc devaluation	+ 80	+ 51
5.	Miscellaneous changes	+ 100	+ 64
6.	Therefore total net effect as compared with to-day	+ 465 (+ 340)	+ 306 (+215)
7.	Failure to reduce sugar quotas (as proposed by Commission)	+ 150	+ 95
8.	Faulure to increase co-responsibility levy on milk (as proposed by Commission)	+ 880	+ 560
9.	Therefore total net effect as compared with original Commission proposal and the draft 1980 budget	+ 1500 (+1370)	+ 961 (+870)

* These figures are all Commission figures. MAFF estimates where different are in brackets.

BUTTER

Effect on retail prices. Prices in shops now typically (with benefit of existing subsidy of $5\frac{1}{2}$p lb) 68-76 p/lb. Increased subsidy should bring prices down by 6p/lb almost immediately (ie shortly after new rate takes effect on 1 July). By August-September, prices may start to rise again gradually as effects of devaluations start to work through - but throughout the year prices will be 12 p/lb less than they would have been without the benefit of the subsidy now secured, ie by the New Year, prices would have been as high as 85 p/lb, now likely only to be about 73p/lb - roughly the same as their present level.

Retail Indices. A subsidy of 38 ua/100 kg will reduce the Food Index by 0.56 per cent and the Retail Prices Index by 0.14 per cent.

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COST OF THE CAP PRICE SETTLEMENT

1 The Commission have publicised a figure for the cost of the settlement of about 1500 MEUA (£950m at current exchange rates). This represents their tentative estimate of the increase which they will have to make in the FEOGA section of their preliminary draft budget for the calendar year 1980. The preliminary draft budget was based on decisions up to the time it appeared (ie the French, UK, Irish and Italian green rate changes made in March) and the Commission's proposals for all other elements in the price fixing. Their estimate of the co-responsibility levy was that it would apply at an average rate of about 5% during 1980 (starting at about 6½% and falling, due to lower output in the autumn, to about 2½%) bringing in 880 MEUA (about £560m).

2 The breakdown of the 1500 MEUA is as follows:

loss of co-responsibility levy	880
no cut in maximum sugar quotas	150
butter subsidy	300
1½% price increase, plus changes in German and Benelux green rates	100
2½% green franc devaluation	80
5% green pound devaluation	-115
Other (including increased subsidy on skimmed milk powder in pig and poultry feed	100
	1495

3 The figure for the butter subsidy looks excessive, and Mr Hayes (Mr Tugendhat's Cabinet) was not able to explain it. He has promised to look into it.

4 At first sight it seems wrong to include the full 880 MEUA for the co-responsibility levy, given that it is to continue at 0.5%, yielding about 100 MEUA in a full year. The Commission's rationalisation of this is that, under existing arrangements, the revenue from the levy has to be spent on various new schemes (advertising, promotion etc) for the disposal of milk products, whereas the Commission's proposal would have broken this link and simply applied the revenue to offset the cost of the milk regime as a whole.

5 It is, of course, improper accounting practice to treat the yield of the levy as if it were a reduction in expenditure: this is done simply because treating it as revenue would have involved amending the "own resources" decision, a process which takes a considerable time. It means that a reduction in FEOGA due to an increased levy would not have produced a reduction in our net contribution to the budget.

6 A more valid figure is the cost of the settlement compared with no change in prices etc. The Commission will apparently produce such a figure (together with a refinement of their 1500 MEUA) later this week. But, based on the figures in para 2 above, it can be put at about 470 MEUA or some £300m (ie 1500 MEUA less the milk levy and sugar quota items). The UK contribution to this, taking the marginal 1980 contribution rate of 16½%, would be £49m.

7 UK receipts resulting from the price settlement can be put at about:

	£m
Butter subsidy (9 months)	82
School milk	4
green pound devaluation	14
	100

This indicates a reduction in our net contribution of some £50m.

8 In practice there will be other effects on our net contribution resulting from changes in import levies collected (both here and in the rest of the EEC) due to the 1½% price increase and green rate changes. But the main change - lower levies on imports of New Zealand butter from 1 January 1980 - will be favourable, so that our net contribution will probably fall by more than the £50m mentioned above.

9 All the above figures are necessarily calculated on a static basis, ie assuming no change in production and consumption. Nor do they include the effect of the green rate changes agreed in March.

CONFIDENTIAL

MR. CARTLEDGE

CAP Prices

In his letter of 25th June, the Minister of Agriculture set out the reasons why he agreed to the final package in Luxembourg last week. He rightly emphasises the freeze on the milk price, an average common price increase which is much the lowest since we joined the Community and no discrimination against British farmers in the co-responsibility levy for milk. Moreover, his arguments against allowing the negotiations to be prolonged into the autumn, and especially the difficulties of then securing a satisfactory settlement for New Zealand's continued entitlement to send butter, are also strong ones. And we do not know what might have been the effect on the discussions about the Community Budget in Strasbourg had the United Kingdom been held responsible for a breakdown of negotiations last Thursday morning.

2. On the other hand, Mr. Walker had to concede small price increases on sugar, beef and other commodities in surplus which as he acknowledges in the case of sugar went beyond what the Cabinet had endorsed (CC(79) 6th Conclusions, Minute 4). The Germans whose sticking point was no reduction in prices in DM terms, actually secured an increase in prices to German farmers, albeit of only $\frac{1}{2}$ per cent (the increase in common prices being greater than reduction in German MCAs). More important still, by leaving the co-responsibility levy on milk unchanged at $\frac{1}{2}$ per cent, the Council abandoned any attempt on top of the price freeze to get the milk surplus under control.

3. It was clearly the Council's action on the co-responsibility levy for milk which led the Commission to dissociate itself (for the first time ever) from the final package. The co-responsibility levy was devised in 1977 as a less brutal way (and so far the only politically acceptable way) of reducing the profitability

of milk production other than a straight cut in the price. The levy is charged on milk deliveries so reducing the return to the farmer, and the proceeds of the levy are used to meet part of the cost of disposing of the milk surplus. The Commission proposed that the levy should be increased substantially and should subsequently vary with the size of the surplus; this was sensible. But they also proposed that it should discriminate in favour of the small producers and this was unacceptable to us (and the Dutch). Cabinet therefore endorsed the Minister of Agriculture's suggestion that he should "reject a milk levy that discriminates unacceptably against United Kingdom producers". Most other EEC Ministers wanted at least the first 20,000 litres deliveried to be exempt from the levy. This would have excluded only 9 per cent of United Kingdom production but 38 per cent in the rest of the Community. The Dutch compromise referred to in Mr. Walker's letter would have involved a flat rate co-responsibility double the present level i.e. of 1 per cent. This was unacceptable to the Belgians.

4. The disagreement over the effects of the settlement on the cost of the CAP has arisen primarily because Mr. Gundelach was comparing the outcome with his original proposals and Mr. Walker has been estimating the extra cost as compared with present price levels. The Prime Minister has been given separate briefing on this. The short point is that, on Mr. Walker's figuring, the increase in the budget is only about £300-£350 million compared with what it would have been without the settlement; but since the Commission's recent draft budget for 1980 will have been based on their original proposals Mr. Gundelach is entitled to say that the Commission will have to put up their estimate for 1980 by the full effect of the failure to increase the co-responsibility levy. His estimate for this (880 mua's) is large because the levy both produces income for the agricultural fund and, by reducing production, lowers the cost of the surplus.

5. The settlement can certainly be defended on the terms set out in Mr. Walker's letter. United Kingdom farmers will be well content. Dairy farmers, besides the gain from the increase in the retail price and the two devaluations of the Green Pound have escaped an increase in the co-responsibility

levy which they must have been expecting. Other farmers will benefit from the increase in common prices as well as the devaluations. On the other hand, a settlement involving a significant increase in the co-responsibility levy would undoubtedly have been better. Only the Belgians, notoriously sensitive to the pressure from their view but politically powerful small dairy farmers, prevented that happening.

6. The Commission will now argue that this brings nearer the day when the Community Budget will reach the 1 per cent VAT ceiling. This in itself is no bad thing for us since it will provide a powerful lever for us to ensure either the cost of the CAP is cut, or that our net contribution to the Budget is reduced before we agree to any increase to the 1 per cent. The Commission is also bound to come up with new proposals to deal with the milk problem. We must see that, this time, they do not discriminate against the larger dairy farmer so that we can give them our full support. But experience suggests that it will be difficult to get anything done before the next price package i.e. in a year's time.

(John Hunt)

26th June, 1979

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

From the Minister

Prime Minister

CONFIDENTIAL

The Rt Hon Lord Carrington KCMG MC
Secretary of State for Foreign and
Commonwealth Affairs
Foreign and Commonwealth Office
Whitehall
London SW1

25 June 1979

Dear Secretary of State,

CAP PRICES

You and our colleagues may be interested to have a brief account of the CAP price negotiations, which ended in what I regard as a very satisfactory settlement - by any objective measurement the best since we joined the Community.

The first two days of discussion established a number of fixed points which were certain to determine the outcome. First, the Germans and Benelux were not prepared to settle for any solution that reduced prices in terms of their own currencies: in other words, any reduction they made in their MCAs would have to be offset by a corresponding or larger increase in common prices expressed in ECUs. The Belgian Minister went further and insisted that there must be no reduction in the return to Belgian milk producers from a combination of common price, MCA reduction and milk co-responsibility levy. Secondly, the French would not accept any settlement for the marketing year that did not include a reduction in German MCAs. Thirdly, as we had agreed, I was not prepared to see any increase in the common price of milk or any co-responsibility levy on milk that discriminated against British producers.

Given these fixed positions - and it became quite clear that they were fixed - there were only two possible solutions: another postponement of negotiations, with prices frozen temporarily; or a settlement for the year that took account of the fixed positions of the main negotiators. I was prepared for a postponement, and until Thursday morning this seemed the likeliest outcome. But it would not have been a good one: it would have caused a good deal of tension and friction in the Community during the coming months; and it would have made for a much more difficult negotiation in the autumn, when the big increase in production costs would have made other countries more anxious for price increases and the negotiation would have been complicated by the need to deal also with New Zealand butter, the future sugar regime, the Commission's costly structure proposals and sheepmeat. A settlement on satisfactory terms would clearly be better; and fortunately it proved possible to achieve this.

/On Wednesday ...

On Wednesday the Chairman, Mehaignerie, tried to adjourn for a few days, no doubt so as to allow for pressures to be put on us in the European Council. But most of the others were keen to carry on, and on Thursday morning the negotiations came to their real crunch. Van der Stee, the Dutch Minister, had put forward a compromise which looked the only possible basis for further negotiation, if a settlement was to be made for the whole marketing year: it included a price freeze for milk; a 2% price increase for everything else; reductions of 1% and ½% in the MCAs of Germany and Benelux respectively, but with their MCAs on milk excepted from this and frozen; and a co-responsibility levy at a flat rate of 1.0%. We spent all Thursday morning on this, and eventually, in a session limited to Ministers, I was able to get a result that I thought acceptable and satisfactory. The price increase was reduced from 2% to 1.5%; and the co-responsibility levy, was reduced to its existing level of 0.5%.

The unsatisfactory feature of this was sugar, where it would clearly have been better to have the same price freeze as for milk. But this was not possible: Ertl made it absolutely clear that 1.5% on sugar was a sine qua non for him. This was the only feature of the compromise that did not conform with the requirements I set out in my Cabinet paper and which the Cabinet endorsed. But I did not think it would be right to break the whole negotiation on this one point. A 1.5% increase is still a massive reduction in real terms, and effectively only ½% in Germany itself. And the compromise secured all our other major objectives: a freeze on the milk price, for the first time since we joined; and average common price increase of around 1.2%, which is also much the lowest since we joined; and a wholly non-discriminatory co-responsibility levy. Given the pressures for price increases on all commodities and for a grossly discriminatory levy, this seemed to me to be too good a settlement to throw away.

In fact the small price increase for sugar was far less important than the Commission's proposal to reduce the B sugar quotas - equivalent to a price reduction of 10 per cent. Gundelach gave this away on the very first day. I got the Council to agree to consider next year's quotas this autumn, and I shall press for strong action then; but his surrender of the quota cut at the outset made any progress at this meeting impossible.

Gundelach's conduct throughout left a lot to be desired. Apart from giving up the quota cut, he was very wobbly on prices generally, and seemed quite ready, under French pressure, to draft a compromise including price increases on all commodities including milk. At one time 7 out of 9 Ministers were willing to agree to a 2% increase in milk prices and I had to put strong pressure in private on Gundelach so as to retain his support of a price freeze. He would have settled I am sure for a 2% price increase with a bigger co-responsibility levy. His one aim seemed to be to get a big co-responsibility levy on a discriminatory basis. When my opposition to the discriminatory basis, and others' opposition to the size, removed this from the package agreed on Thursday he took offence, and told the Press that he washed his hands of the settlement, that it was a disaster and that it would cost the budget a billion units of account (a nonsensical figure that seems to be made up mainly of the loss of the big discriminatory levy

/he did not ...

he did not get). Unfortunately this story got round the world before any one could correct it, and most of the Press coverage on Friday was quite unjustifiably bad as a result.

The agreement on the main issues still left a lot to be settled, and here I think we did quite well. We secured a UK subsidy of 12p per lb on Community butter (much the biggest ever), paid for entirely by Community funds, with an equivalent subsidy on New Zealand butter covered by a reduction in the New Zealand levy - a very valuable precedent for the future. Altogether this will mean direct or indirect contributions from the Community to our subsidy of about £65m over the next nine months, and it reduces the food price index by 0.56%. We got continued authority for a special subsidy to our Northern Ireland milk producers. We got the 5% devaluation of the green pound, without having to pay anything for it in negotiating terms. I could not get a special 5% devaluation for pigmeat: that pass, as I warned, had been sold by our predecessors; but the general devaluation means that our pigmeat MCA is now only 6.5%, compared with 28.2% only four months ago. We got an increase in the Community contribution to our school milk subsidy to the full level of the target price of 7p per pint. Finally, we avoided having to subscribe to the Gentlemen's Agreement on phasing out new MCAs, thus leaving our hands free for the future, while securing the application of the ECU to the CAP for the whole of the marketing year.

Despite the tough line I took throughout I am glad to say that relations with the other Ministers are good. I think they recognise that we are absolutely determined to get the milk surplus, which accounts for over 40% of the Community's agricultural budget, under control and respect us for this determination, even if they do not share it. They also welcome our willingness to approach Community problems on a co-operative and constructive basis. The test will come next year, when a similarly tough settlement would begin to bite hard on farmers' incomes throughout the rest of the Community, and really begin to get production and the cost of the CAP under control.

I am sending copies of this letter to the Prime Minister, other members of the Cabinet and Sir John Hunt.

Yours sincerely

Frances Thompson.

PETER WALKER

Approved by the Minister
and signed in his absence

Mr. Whitmore
To see. [illegible]

Msg faxed to Chequers 16.00 22.6.79. Euro Pol

~~PRIME MINISTER~~

Mr. Walker's Statement on the Agriculture Council Meeting

Mr. Walker scored a modest Parliamentary success this morning. His statement emphasised the successes of the price freeze for milk, the overall level of price increase of 1.2%, the rejection of the milk co-responsibility levy proposals, the 5% devaluation of the Green Pound and - above all - the butter subsidy of 12p per pound.

He summed up his achievement as the price review with the least increase in average prices and the biggest increase in consumer subsidy since we joined the Community.

Mr. Mason, in his maiden appearance as Shadow spokesman, described Mr. Walker as "the weak man in Europe" and said he had betrayed the Commission and the British housewife and had failed on pig meat, sugar and the proposal for a general price freeze. Mr. Walker pointed out that under Labour the average price increase had been 7.6% per year, while the mountains grew. The effect of the butter subsidy on prices would be twice as great as the effect of the overall 1.2% price increase. Bread would not be significantly affected, sugar would go up by 1p per kilo and the price of butter would immediately go down by 6p per pound.

His statement was generally welcomed by Government backbenchers. Labour backbenchers allowed themselves to degenerate into cheap jibes, which Mr. Walker dealt with in a dignified way. Mr. W. Hamilton called him a "professional con trickster" and was sharply rebuked by the Speaker. Mr. Walker emphasised over and over again the size of the butter subsidy and the generally low level of the price increases.

/In answer

In answer to questions about the net effect on our budgetary contributions, he said that the details had not yet been worked out but that he believed that in total we would be better off.

In response to complaints that he had promised more in the House a week ago than he had been able to deliver, Mr. Walker said that he had achieved a freeze on the major item in structural surplus. He was sorry that it had not been possible to make more progress on sugar, but the sugar in question was already in the ground. He added that last year, when there had been a substantial sugar surplus, the Commission had proposed an increase of 1.16% and the Labour Government had in the end agreed to a rise of 2%.

The overall impression was of a better deal for Britain than Labour had managed to achieve on any single occasion; and the House was, I think, impressed.

MS

22 June 1979

BGC(OR)

to see MS

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

From the Minister's
Private Office

N Sanders Esq
Prime Minister's Office
10 Downing Street
London SW1

22 June 1979

Dear Nick,

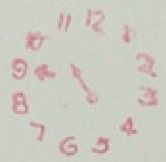
COUNCIL OF MINISTERS (AGRICULTURE): 18-21 JUNE

I attach a copy of a statement which Mr Walker intends to make to the House today.

I am copying this letter to James, Stevens (Lord President's Office), MacClean (Whip's Office - Commons), Cumming-Bruce (Whip's Office - Lords), Vile (Cabinet Office), the other agriculture Departments and to private secretaries to members of OD(E).

Yours sincerely

G R WATERS
Principal Private Secretary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With permission Mr Speaker I would like to make a Statement about a meeting I attended of the Council of Agriculture Ministers in Luxembourg from 18 to 22 June to discuss CAP prices for 1979/80.

The surplus in dairy products has over recent years become by far the heaviest burden on the common agricultural budget and now takes more than 40 per cent of the total expenditure. I was determined to see that this increasing burden was tackled by obtaining a price freeze for milk for the coming year in spite of increasing costs to producers that are taking place throughout Europe. After prolonged discussions I am pleased to say that a price freeze for milk was agreed for the first time since we joined the Community.

The other commodity in substantial structural surplus is sugar, and whilst the cost of financing this surplus is not of the proportions of the cost of the dairy surplus it is nevertheless a significant burden on the budget.

I supported whole-heartedly the proposals of the Commission to reduce the "B" quotas for I believe that this is the most effective way of making significant progress in reducing Europe's sugar surpluses. The Commission decided not to press these proposals for the current year in view of the fact that this year's crop was already being grown. I therefore urged that the Council of Ministers should this autumn consider the quotas for the next growing year and certainly I will be advocating proposals that will make a significant step towards reducing these surpluses.

On prices the Council therefore agreed to a freeze on milk and a $1\frac{1}{2}$ per cent increase in price on other commodities but in the case of Germany the $1\frac{1}{2}$ per cent increase would be reduced to a $\frac{1}{2}$ per cent because the Germans agreed at the Council meeting to reduce their positive MCAs by 1 per cent. In the case of the Benelux countries the increases will be reduced to 1 per cent as a result of $\frac{1}{2}$ per cent reduction in their positive MCAs.

The Commission, with support from some member states, pressed for the introduction of an increased milk co-responsibility levy with a reduced rate for production below a certain level, which would have discriminated heavily against the UK. I was not prepared to accept this proposal and the Council eventually agreed that the co-responsibility levy should remain unchanged on its present flat rate basis of 0.5 per cent thus preventing any discrimination against British farmers.

At my request the Commission put forward a proposal for a 5 per cent devaluation of the green pound. This will take effect on 2 July for milk, beef, pigs and sugar and at the start of the next marketing years for all other commodities. The effect of the devaluation will be to make British agriculture more competitive both at home and abroad.

I argued strongly the case for an additional 5 per cent green pound devaluation in pigmeat MCAs but as I warned the House when we debated the CAP price negotiations last Friday, the Council refused to give a special green currency devaluation again for a specific commodity. However the devaluation that I was able to secure will assist our pigmeat producers and processors in competing with subsidised imports because the devaluation obtained will mean that the remaining monetary compensatory amount is only 6.5 per cent, compared with 28.2 per cent four months ago.

The Council also agreed on small devaluations of the green French franc and the Italian lira. The Council agreed to a regulation confirming the use of the ECU under the CAP.

The FEOGA budget is currently running at £6,650million . The 1½ per cent increase in prices will add £75million to expenditure. But Britain's green pound devaluation will reduce Community expenditure by £90 million.

One of my main objectives at this meeting was to lighten the burden of the CAP on the UK and to bring some substantial benefit to consumers. The Council agreed to a special UK butter subsidy with 100 per cent Community finance at a rate of 38 ua per 100kg. This subsidy which will take effect immediately is equivalent to 12 pence per lb at the retail stage. The Council also agreed with my proposal that the cost of reducing the price of New Zealand butter by the equivalent amount should be brought about by a reduction in the special levy rather than a direct UK Exchequer subsidy. The Council also agreed to an increase in the Community subsidy on school milk to 100 per cent of the full target price of 7 pence a pint.

The butter subsidy is by far the highest one that the United Kingdom has ever received from the Community and more than double the subsidy that ends in June. It will not only more than offset the effect on butter prices of the 5 per cent green pound devaluation but will also meet the increase in butter prices resulting from the devaluation obtained by the last Government in March. A subsidy of 12 pence per lb on butter reduces the food price index by 0.56%.

The Council agreed to authorise for a further year the payment of a special subsidy to Northern Ireland milk producers.

The average price increases of 1.2% are by far the lowest we have ever achieved. The freeze on the milk price is an important first step towards reducing the surplus production which has grown out of hand in recent years. We succeeded in the negotiations in preventing discriminatory arrangements proposed by the Commission as far as the milk co-responsibility levy was concerned. The negotiations produced substantial benefits for our agricultural industry through the green pound devaluation and substantial improvements for the consumers through the doubled butter subsidy.

PRIME MINISTER

1. According to preliminary reports an agreement has been reached at the Agricultural Council involving:-

(a) An increase of 1½% on all prices <u>except</u> milk.

(b) Reduction of German mcas of 1% and Benelux ½% (except on milk).

(c) Non-discriminatory co-responsibility levy on milk of ½%½

(d) Devaluation of Green Pound of 5% as we requested.

2. The Commission are not happy because of the likely effect on the Community budget. (An extra 1 billion ua according to Gundelach.) But it means that the question is unlikely to come up at the European Council.

3. We are seeking urgent confirmation and will let you know.

21 June 1979

cc: Lord Carrington

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Prime Minister

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FM LUXEMBOURG 2Ø1259Z JUNE 79
TO IMMEDIATE FCO
TELEGRAM NUMBER 133 OF 2Ø JUNE
AND TO IMMEDIATE UKREP BRUSSELS
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FOLLOWING FROM UKREP BRUSSELS

COUNCIL OF MINISTERS (AGRICULTURE) - 18/2Ø JUNE 1979

CAP PRICES.

SUMMARY.

1. SERIOUS NEGOTIATION BEGAN IN THE EVENING IN RESTRICTED SESSION. AFTER TWO HOURS OF DISCUSSION MEHAIGNERIE (FRENCH CHAIRMAN) ASKED WHICH DELEGATIONS COULD ACCEPT A PACKAGE INCLUDING A PRICE INCREASE FOR MILK OF 1 OR 1.25 PERCENT: A LIMITED REDUCTION OF POSITIVE MCAS LINKED WITH THIS: AND A MODERATE CO-RESOPINSIBILITY LEVY. ALL DELEGATIONS EXCEPT THE UK AND ITALY ACCEPTED THIS IN PRINCIPLE, AND GUNDELACH SEEMED READY TO DRAFT A COMPROMISE ON THIS BASIS. ITALY AVOIDED ANSWERING THE QUESTION. MR WALKER SAID THAT UNDER NO CONDITIONS COULD WE ACCEPT AN INCREASE IN THE MILK PRICE AND ASKED HOW MANY DELEGATIONS COULD ACCEPT AN ALTERNATIVE APPROACH, WITH NO INCREASE IN THE MILK PRICE AND NO ADJUSTMENT OF POSITIVE MCAS. VAN DER STEE (NETHERLANDS) SAID HE AND HE THOUGHT, GERMANY, BELGIUM AND LUXEMBOURG COULD ACCEPT THIS, WHICHT HE REGARDED AS A MORE ELEGANT SOLUTION. MEHAIGNERIE THEN HASTILY ADJOURNED THE COUNCIL. MOST OF WEDNESDAY WILL BE LEFT FOR BILATERAL CONSULTATIONS, WHILE MEHAIGNERIE AND ERTL RETURN TEMPORARILY TO THEIR CAPITALS. NEGOTIATIONS WILL RESUME IN THE COUNCIL AT 7PM, WITH THE PROSPECT OF AN ALL-NIGHT SESSION.

/DETAIL

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DETAIL.

2. IN RESTRICTED SESSION MEHAIGNERIE SUGGESTED ADJOURNING FOR TWO DAYS OR UNTIL NEXT WEEK, DOUBTLESS TO ALLOW FOR PRESSURES TO BE EXERTED AT THE EUROPEAN COUNCIL. MOST DELEGATIONS WISHED TO CONTINUE NEGOTIATION, HOWEVER, SO AS TO ESTABLISH WHETHER AGREEMENT WAS POSSIBLE OR WHETHER IT WAS NECESSARY TO PROVIDE SIMPLY FOR A CONTINUING STANDSTILL ON PRICES AND OTHER ARRANGEMENTS ON A TEMPORARY BASIS. ERTL (GERMANY) FLOATED THE IDEA OF A CONTINUING STANDSTILL LINKED WITH AN UNDERTAKING TO BEGIN PRICE DISCUSSIONS FOR 1980 IN NOVEMBER, BUT OTHERS OBJECTED. GUNDELACH REJECTED THE IDEA OF FURTHER BILATERAL CONSULTATIONS SINCE POSITIONS WERE NOW CLEAR: THE FUNDAMENTAL QUESTION WAS WHETHER THE COUNCIL WISHED TO INCREASE PRICES ACROSS THE BOARD SO AS TO BE ABLE TO REDUCE POSITIVE MCAS WITHOUT REDUCING PRICES IN NATIONAL CURRENCIES.

3. ERTL THEN SUGGESTED A GENERAL PRICE INCREASE OF 1 PER CENT, WITH CORRESPONDING REDUCTIONS IN POSITIVE MCAS AND A 4 PER CENT DEVALUATION OF THE GREEN POUND. MR WALKER SAID THE HE COULD NOT ACCEPT ANY INCREASE IN THE PRICE OF MILK AND THAT IN CONFORMITY WITH THE COUNCIL RESOLUTION OF MARCH HE WAS ENTITLED, LIKE ANY OTHER COUNTRY WITH A DEPRECITATED CURRENCY, TO DEVALUE HIS GREEN CURRENCY AT HIS DISCRETION. HE WISHED TO DO SO BY 5 PER CENT. ERTL CHALLENGED THE RIGHT OF MEMBER COUNTRIES TO DEVALUE GREEN CURRENCIES AT WILL, AND GAUTHIER SAUVAGNAC (MPRESIDENCY) INTERPRETED THE MARCH RESOLUTION AS MEANING ONLY THAT MEMBER STATES COULD REQUEST DEVALUATIONS, WHICH THE COUNCIL WAS FREE TO ACCEPT OR REJECT. GUNDELACH LENT SOME SUPPORT TO THIS INTERPRETATION, AND IMPLIED THAT HE WOULD PROPOSE A 5 PER CENT GREEN POUND DEVALUATION ONLY BECAUSE THE MARCH RESOLUTION REQUIRED THE COMMISSION TO PUT FORWARD SUCH PROPOSALS IF MEMBER STATES REQUESTED THEM . HE WOULD NOT, HOWEVER, PROPOSE A 5 PER CENT ADDITIONAL DEVALUATION FOR PIGMEAT SINCE IT HAD BEEN WIDELY AGREED THAT THE FRENCH PRECEDENTS FOR DOING SO SHOULD BE CONFINED TO FRANCE. VAN DER STEE AND ERTL AGAIN EMPHASISED

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THE IMPOSSIBILITY OF ANY REDUCTION IN PRICES IN TERMS OF NATIONAL CURRENCIES, AND MR WALKER MADE IT CLEAR THAT HE WAS NOT SUGGESTING THIS BUT ONLY A PRICES STANDSTILL FOR THE STRONG-CURRENCY COUNTRIES.

4. MARCORA (ITALY) THEN SUGGESTED THAT PRICES FOR ALL COMMODITIES EXCEPT MILK SHOULD BE INCREASED BY 2 PER CENT, WITH A 2 PER CENT REDUCTION IN POSITIVE MCAS. FOR MILK THERE SHOULD BE NO PRICE INCREASE AND NO CHANGE IN POSITIVE MCAS. VAN DER STEE AND ERTL SAID THAT DIFFERENT MCAS FOR DIFFERENT COMMODITIES COULD NOT BE ACCEPTED, SINCE THIS WOULD STRIKE AT THE CONCEPT OF COMMON PRICES.

5. ERTL THEN SUGGESTED A PRICE FREEZE FOR EVERY COUNTRY. MR WALKER POINTED OUT THAT THIS WOULD HIT COUNTRIES WITH HIGH RATES OF INFLATION MUCH HARDER THAN THOSE WITH LOW RATES. ERTL THEN WITHDREW THIS AND HIS EARLIER PROPOSALS AND LATER EXPLAINED PRIVATELY TO MR WALKER THAT HE HAD NOT INTENDED THE GENERAL FREEZE TO PREVENT THE 5 PER CENT GREEN POUND DEVALUATION THAT WE SOUGHT.

6. AFTER FURTHER REPETITION OF KNOWN POSITIONS, MAHAIGNERIE SAID IT WAS CLEAR THAT ALL DELEGATIONS WANTED TO CONCLUDE A SETTLEMENT IF POSSIBLE. HE THEN ASKED EACH DELEGATION IN TURN IF IT COULD ACCEPT A PACKAGE INCLUDING A PRICE INCREASE FOR MILK OF 1 OR 1.25 PER CENT. A LIMITED REDUCTION OF POSITIVE MCAS LINKED WITH THIS: AND A MODERATE CO-RESPONSIBILITY LEVY. ALL EXCEPT MARCORA AND MR WALKER SAID THAT IN PRINCIPLE THEY COULD. SUBJECT TO SATISFACTORY RESOLUTION OF THE DETAILS. MARCORA AVOIDED ANSWERING BY ASKING HOW BIG THE CUT IN POSITIVE MCAS WOULD BE, HOW THIS PACKAGE COULD BE RECONCILED WITH THE COMMISSION'S STRONG STATEMENTS ON THE NEED TO AVOID A MILK PRICE INCREASE, AND WHAT THE LEVEL AND ARRANGEMENTS FOR CO-RESPONSIBILITY LEVY WOULD BE. MR WALKER SAID THAT ANY INCREASE IN THE PRICE OF MILK WAS WHOLLY UNACCEPTABLE. HOWEVER, ITS PRACTICAL EFFECT MIGHT BE MITIGATED BY CHANGES IN POSITIVE MCAS AND CO-RESPONSIBILITY LEVY, THE PSYCHOLOGICAL EFFECT OF SUCH AN INCREASE WOULD BE TO SIGNAL TO PRODUCERS AND CONSUMERS THAT THE COUNCIL LACKED THE WILL TO GET THE MILK SURPLUS UNDER CONTROL. THIS WOULD THREATEN THE ENTIRE FUTURE OF THE CAP.

/7. MEHAIGNERIE

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7. MEHAIGNERIE THEN ASKED GUNDELACH TO DRAFT A COMPROMISE PROPOSAL ON THE BASIS OF HIS SUGGESTION AND GUNDELACH SEEMED PREPARED TO DO SO. MR WALKER HOWEVER SAID THAT HIS OWN CONSULTATIONS HAD MADE IT CLEAR THAT AN ALTERNATIVE PROPOSITION WOULD COMMAND EQUAL SUPPORT. THIS WOULD FREEZE COMMON PRICES AND MAKE NO REDUCTION IN POSITIVE MCAS. HE ASKED THAT DELEGATIONS BE ASKED TO SAY WHETHER THIS ALTERNATIVE WAS ACCEPTABLE. VAN DER STEE SAID THAT HE COULD ACCEPT IT AND HE THOUGHT THE OTHER BENELUX COUNTRIES AND GERMANY COULD TOO. HE REGARDED IT INDEED AS A MORE ELEGANT SOLUTION. MEHAIGNERIE THEN HASTILY ADJOURNED THE DISCUSSION UNTIL LATER IN THE EVENING. SUBSEQUENTLY HE INFORMED DELEGATIONS THAT DISCUSSION WOULD RESUME AT 7PM ON WEDNESDAY, TO ALLOW FURTHER TIME FOR BILATERAL CONSULTATIONS. IT EMERGED THAT HE INTENDED TO RETURN TO PARIS (AND THAT ERTL WOULD RETURN TO BONN) ON WEDNESDAY BEFORE DISCUSSIONS WERE RESUMED.

8. IN SUBSEQUENT BILATERAL DISCUSSION MR WALKER SECURED A PROMISE FROM MARCORA TO STAND FIRM IN OPPOSING ANY PRICE INCREASE FOR MILK.

FCO PASS ADVANCE COPIES TO:-

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CAB	FRANKLIN, WALSH
MAFF	PS/MINISTER, PS/MINISTER OF STATE (LORDS)
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EID (I)

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[ADVANCED AS REQUESTED]

4

MR. CARTLEDGE But FCO informed. RA 20/6

The Prime Minister spoke with Peter Walker in Luxembourg at 1045 tonight about Community negotiations on milk prices.

Peter Walker said that he would not give way on the price of milk, and that the Benelux countries stood with the UK. The Italians were sympathetic but could go either way. The Germans might also deal either way.

The French delegation left the meeting after lunch. A meeting scheduled for the afternoon was cancelled. Peter Walker said the French had presumably gone to brief Giscard for the meeting in Strasbourg.

The Prime Minister agreed that it was not possible to go on compromising, and told Peter Walker to stand firm, stressing that we were utterly committed to change milk policies even if a few other points were surrendered.

Peter Walker agreed he would not budge, and confirmed he would not be returning to London tomorrow.

G. Baldwin.

19 June 1979

oio

cc Strasbourg Brief.

2

Foreign and Commonwealth Office

London SW1A 2AH

19 June 1979

Has seen

Prime Minister

Dear Bryan,

I understand that in discussion with FCO and Cabinet Office officials after the lunch for Signor Andreotti on 15 June the Prime Minister asked how many days consumption the existing Community surpluses of butter and beef represented.

We have consulted the MAFF. The answer in March 1979 for butter is 10 weeks and for beef 10 days. The figure for butter does not include stocks already in the process of disposal by subsidy (eg UK butter subsidy, Christmas butter) or by export refunds or food aid: these stocks were equivalent in March to a further 10 weeks consumption. The Prime Minister may like to know the corresponding figures for other commodities which are:

Skimmed Milk Powder	2 years	(1)
Sugar	19 weeks	
Wheat	1½ weeks	
Barley	2 days	
Rye	9½ weeks	
Durum Wheat	2¼ weeks	
Bread-making Wheat	24 weeks	
Olive Oil	10 weeks	(2)
Wine	8 weeks	

Notes

(1) Skimmed Milk Powder

If included food aid, subsidised use in animal feed, export refunds, surplus is equivalent to around 10 years.

(2) Olive Oil

Much of this is likely to be sold at normal market prices next year when Community production is expected to be considerably lower; and therefore expect surplus around 5 weeks consumption.

Yours ever

(G G H Walden)

Bryan Cartledge Esq
10 Downing Street

Ref: A09768

Euro Pol.

CONFIDENTIAL

PRIME MINISTER

CAP Prices and Green Pound Devaluation
(C(79) 20)

BACKGROUND

In his paper C(79) 20 the Minister of Agriculture seeks the Cabinet's endorsement of the line he proposes to take in the 18th June Agriculture Council on Common Agricultural Policy (CAP) prices and on the Green Pound.

2. The House of Commons will be debating the price-fixing and other agricultural matters on 15th June.

3. Although the Minister of Agriculture envisages eventual concessions on some products e.g. cereals, wine, olive oil, and is prepared to trade a price increase for sugar for a cut in the production quota, his general approach (paragraph 3 of his paper) is in line with the Manifesto commitment to insist on a freeze in CAP prices for products in structural surplus and to oppose a discriminatory milk levy. It is also in tune with the views expressed in Cabinet on 17th May, when the political importance to the Government of sticking to its position on a price freeze was stressed (CC(79) 2nd Conclusions).

4. This approach was agreed by the Sub-Committee on European Questions (OD(E)) on 11th June and is put to Cabinet now because of its tactical linkage with the Green Pound and Budget issues rather than for substantive discussion.

5. The French are likely to make a determined push for a general 2 per cent price increase in order to leave room for a reduction in German mcas. If, as Mr. Walker proposes, we stand firm with the Commission in resisting this pressure, we can with Italian support - or in the last resort on our own - block any increases on products in surplus especially milk. But there could be dangers for our Budget objectives at the European Council if President Giscard digs his heels in on a CAP price increase and we stand out against it. Whether any such threat would be real or bluff can only be assessed nearer the time. You might think it prudent, assuming that the

Cabinet endorses Mr. Walker's proposals, to invite him to consult the Foreign and Commonwealth Secretary and yourself if there is a risk of his being isolated, so that our position can be reviewed if necessary during your European Council briefing session on the afternoon of Tuesday 19th June.

Green Pound

6. The Manifesto commitment (page 17) was to "devalue the Green Pound within the normal lifetime of Parliament to a point which would enable our producers to compete on level terms with those in the rest of the Community".

7. The Minister of Agriculture's proposals (paragraphs 6 and 9 of his paper) are for a $7\frac{1}{2}$ per cent devaluation of the Green Pound for all commodities from 2nd July, plus a tactical bid for an additional 5 per cent for pigmeat alone. These proposals are on top of the 5 per cent devaluation proposed by the last Government and agreed in the Council in March. OD(E) was unable to reach agreement on Mr. Walker's proposals, which thus call for a decision by the Cabinet.

8. Mr. Walker justifies the proposed $7\frac{1}{2}$ per cent general devaluation as necessary to restore confidence and profitability to British agriculture, as an appropriate response to the farmers' demand for 10 per cent, and as the amount required to deal with the crisis in the pig industry. (paragraph 7).

9. Discussion is likely to focus on:-

(a) the agricultural case for a $7\frac{1}{2}$ per cent devaluation. Although Mr. Walker's paper (paragraph 5) points out that farm incomes fell by 13 per cent in real terms in 1978, this was partly due to an exceptional fall in potato prices - which are not covered by the Green Pound arrangements. Taken together with the earlier 5 per cent devaluation his proposals would imply an increase of almost 14 per cent in farm support prices in the United Kingdom, even without any increase in common EEC prices.

(b) the 0.5 per cent addition to the retail price index (2.0 per cent on the food price index) coming on top of the recent increase in retail milk prices and the Budget VAT increases.

(c) a 7½ per cent general devaluation now might leave very little scope for further Green Pound devaluations in later years to compensate farmers for rising costs, especially if the Pound remains strong. We might then find that we were forced to press for increases in the common prices even of commodities in surplus in order to satisfy the needs of our farmers. This together with the retail price effect is the main argument against proceeding to an early abolition of mcas. We could however declare our readiness to phase them out and the Foreign and Commonwealth Secretary may argue that such a declaration would be helpful in the context of our Budget contribution. The dispute over the size of our budget contribution because of mcas will then rapidly disappear.

(d) whether by pressing for a Green Pound devaluation we weaken our position in the price fixing. Mr. Walker does not believe that we will, but it may be easier to secure the Commission's help for, say, 5 per cent than 7½ per cent.

HANDLING

10. The Minister of Agriculture might be invited to introduce his memorandum, and the Foreign and Commonwealth Secretary to report on the OD(E) discussion. Thereafter you might find it convenient to take first the proposed approach to the CAP price fixing negotiations, taking account of the point in paragraph 5 above.

11. You might then move on to the Green Pound. The Chancellor of the Exchequer might be invited to say whether the RPI effects of a 7½ per cent devaluation are tolerable in relation to his general economic strategy. He may also want to probe the extent to which our partners might put pressure on us to accept undesirable common price increases in exchange for our devaluation. The Secretary of State for Trade may question the need for so large a devaluation this year, arguing that more should be kept in hand for later years. The Secretaries of State for Northern Ireland and Scotland will wish to support a 7½ per cent devaluation, though the Secretary of State for Wales may be content with something less. The Lord President might suggest a compromise:

12½ car.

to seek a 5 per cent general devaluation plus a tactical bid for a further 5 per cent on pigmeat, but to fall back on a 6 per cent general devaluation if the pigmeat proposal is blocked by the Danes and the Dutch. The Chancellor of the Duchy might be invited to comment on the Parliamentary handling of the debate on 15th June.

CONCLUSIONS

12. Subject to the discussion, you may be able to conclude that the Cabinet -

(a) endorses the proposed approach to the CAP price fixing negotiations, subject to the Minister of Agriculture reporting to you and the Foreign and Commonwealth Secretary on 19th June on the position then reached;

(b) decides that we should go for a 5 per cent general devaluation together with a tactical bid for a further 5 per cent on pigmeat, but should leave the Minister of Agriculture freedom to go up to 6 per cent if the pigmeat bid proves to be unnegotiable and if it can be achieved without prejudice to our negotiating position on CAP prices.

M.A.
14

John Hunt

13th June 1979

Top Copy on: New Zealand, May 79, Visit of Muldoon

SUMMARY RECORD OF DISCUSSION DURING A LUNCH GIVEN BY THE PRIME MINISTER FOR THE PRIME MINISTER OF NEW ZEALAND, THE RT. HON. ROBERT MULDOON, AT 10 DOWNING STREET on 11 JUNE 1979 AT 1315 HOURS

Present:-

Prime Minister

Rt. Hon. William Whitelaw, MP

Rt. Hon. Lord Carrington

Rt. Hon. Peter Walker, MP

Sir Harold Smedley (High Commssioner, Wellington)

Mr. B.G. Cartledge

Rt. Hon. R.D. Muldoon, CH, MP

HE the New Zealand High Commissioner

Mr. Alistair Bisley (Foreign Affairs Adviser to the Prime Minister)

Mr. B.J. Lynch (Deputy High Commissioner

Butter

When the conversation turned to political matters, the Prime Minister asked Mr. Muldoon how he saw the prospects for New Zealand butter. Mr. Muldoon said that the Prime Minister had only to remember one figure: 100,000 tonnes. This was the quota figure which New Zealand wished to agree with the EEC. The proposals put forward by Commissioner Gundelach were in general satisfactory, subject to the insertion in them of the right basic quota figure. The Commissioner's proposals met New Zealand's requirement for a long term agreement with the Community, instead of annual arguments. Mr. Muldoon said that Commissioner Gundelach had told him that he spent more time on the affairs of New Zealand than on those of any other country outside the Community. Mr. Muldoon went on to explain that unless New Zealand could achieve economic growth, she would never be able to overcome the problems created by the world increase in oil prices.

Mr. Walker said that, when he had himself met Commissioner Gundelach a few days before, the Commissioner had mentioned the figure of 90,000 tonnes as a possible target. Mr. Muldoon expressed considerable interest in this and commented that if a compromise were eventually to be reached on a figure of 90,000 tonnes, New Zealand could probably live with this: but in order to achieve it, they would have to put in an opening bid of 100,000 tonnes.

/Mr. Walker

Mr. Walker said that Mr. Gundelach's visit to New Zealand had produced a very good and positive effect. There was, however, a problem in the proposal that supplies of New Zealand butter should be limited to a specified percentage of the British market. Mr. Muldoon confirmed that this would not be acceptable to New Zealand. The Prime Minister said that she could well understand this, since the UK market depended on the fluctuating price relationship between butter and margarine. Mr. Walker pointed out that the other Members of the Community believed that the market for butter would decline; they consequently preferred to establish the New Zealand quota on a percentage basis rather than commit themselves to a fixed quantity. He thought that the Community might be prepared to offer, for example, a figure of 110,000 tonnes, tied to a percentage of the UK market, or alternatively a quota of 80,000 tonnes with no percentage link. The British Government would need advice from the New Zealand Government on the optimum figure between these extremes for which New Zealand could settle. Mr. Muldoon said that New Zealand definitely wished to avoid a percentage link but might be able to settle for a quota of 90,000 tonnes with no such link.

Mr. Walker said that he thought that the New Zealand Government had achieved considerable success in their careful cultivation of EEC Members; they had created an atmosphere in which the Community would feel acutely guilty about any measures which could be represented as ill-treatment of New Zealand. New Zealanders should maintain their diplomatic efforts. Mr. Muldoon commented that he was trying to moderate his public comment on the EEC. Mr. Walker added that the UK would have to work very hard on the Irish.

Sheep Meat

Mr. Walker said that the sheep meat problem would come before the Council of Ministers in July. The kind of sheep meat regime on which the UK was at present insisting would, he was sure, prove unacceptable to the French. The Prime Minister made it clear that

/she had

she had strong reservations about a sheep meat regime in any form. Mr. Walker said that he thought that the UK should be prepared to accept a regime provided that New Zealand's interests were adequately safeguarded and that the regime allowed for the free export of UK lamb to France. If the French were prepared to accept these conditions, well and good; if not, there would be no regime.

Mr. Muldoon said that sheep were New Zealand's single most important product and an integrated industry, for wool as well as meat, had been built around it. If New Zealand could not secure a growth area in her exports, her economy would inevitably go downhill. In answer to a question from Lord Carrington, Mr. Muldoon confirmed that New Zealand had developed a breed of lamb for the UK market and that this type of lamb was unsaleable elsewhere. Mr. Walker said that the UK should be able to make more room in our domestic market for New Zealand lamb if we could export more to the Continent. Lord Carrington said that the French would either have to disregard the European Court's latest ruling or agree to take in UK lamb; he thought that they would, in the end, accept a regime of the sort we had in mind. The Prime Minister said that the trouble with any regime was that its terms might be acceptable initially, but that these could subsequently be modified. Mr. Walker pointed out that this could only be done with the agreement of all concerned, including the UK.

Mr. Muldoon told the Prime Minister that New Zealand had at present a deficit of $250 million on her invisibles account with the UK, although New Zealand had an overall trade surplus. If New Zealand was pledged to accept a sheep meat regime, this would amount to a loss of ground since, as the Prime Minister had said, the terms of a regime could always be tightened. A Bill on beef imports, which would allow the import of beef into the United States only when this was necessary to make up for a domestic shortfall, was currently under consideration by the US Congress and, although modifications might be made to it, the "counter-cyclical" formula had evidently been accepted. Mr. Muldoon went

/on to say

on to say that, in his view, the entire Common Agriculture Policy was a nonsense so far as the UK was concerned: not only did it have the effect of raising prices for the UK consumer but it pledged the British Government to pay for this as well. The Prime Minister agreed and mentioned a possible French proposal under which the countries which produced agricultural surpluses would become responsible for paying for them. Mr. Walker said that he thought the French were talking only about future surpluses: their purpose was to freeze British agriculture at its present level of production, while safeguarding French agriculture which had reached its ceiling. France was using the CAP to defend her social structure. Unfortunately, it was not in the UK's power to achieve a substantial reform of the structure of the CAP. Mr. Muldoon said that he was inclined to question this, in view of the fact that the CAP had already been subjected to significant amendment.

Mr. Muldoon went on to say that he regarded the OECD trade pledge as an exercise in diplomatic hypocrisy. Every year one of the nations which had signed the trade pledge tightened up its restrictions against New Zealand's agricultural exports. He thought there was so wide an understanding of the basic weaknesses of the CAP that change should surely be possible. The Prime Minister commented that Chancellor Schmidt had a clear understanding of these weaknesses but was unable to do anything about it because his Agriculture Minister, Herr Ertl, belonged to the other coalition party. Mr. Walker suggested that the UK and New Zealand should keep in close touch on the tactics to be pursued with the EEC; they clearly shared the same objectives.

Lord Carrington asked Mr. Muldoon whether Australia was holding back from New Zealand's markets. Mr. Muldoon said that there were informal agreements which had this effect; Australia and New Zealand were co-operating in third markets. Negotiations were in train which could result in a run down of Australia's dairy industry. Mr. Muldoon repeated that the 15 per cent gap

/in New Zealand's

in New Zealand's terms of trade could only be made up by achieving growth. The New Zealand fruit industry, for example, was growing fast but not sufficiently fast to pay for increased oil costs; New Zealand's oil imports had cost $193 million in 1973, had risen to $630 million in 1979 and would amount to $730 million in 1980. The New Zealand Government were making slow progress with the Japanese on fish. The Japanese hated to give ground but they had agreed to use New Zealand's agricultural products for their food aid programme, in return for some access to New Zealand's fishing grounds. He had been advised not to embarrass the Japanese in public but he had also been told that he would not make progress unless he did so; in his experience, the second line of advice was the right one. Japan's access to New Zealand's waters would be strictly controlled; New Zealand had already arrested two Japanese fishing vessels, as well as ships from Korea and the Soviet Union. So far as New Zealand's wool industry was concerned, exports were increasing satisfactorily, especially to the West Coast of the United States.

[The discussion concluded with some exchanges on the forthcoming Commonwealth Heads of Government Meeting in Lusaka, which have been recorded separately.]

Bm.

11 June 1979

1

Prime Minister

Agree "X"?

PM/79/53

PRIME MINISTER

1. At their meeting this morning the Sub-Committee on European Questions (OD(E)) considered two papers by the Minister of Agriculture.

2. The first outlined his approach to the forthcoming Common Agricultural Policy price negotiations, which are due to begin at the 18 June Agriculture Council, and was endorsed by the Sub-Committee on the basis of paragraph 4 of his memorandum OD(E)(79)13. (copy attached).

3. The second paper OD(E)(79)12 proposed a 7½% Green Pound devaluation from 1 July together with a further devaluation of 5% on pigmeat. The Sub-Committee were unable to reach agreement on this proposal. This was mainly because such a devaluation would increase the retail price index by 0.5% which would be in addition to any increases attributable to tomorrow's budget; a devaluation of this order would also leave little room for further Green Pound devaluation to offset agricultural cost increases in future years.

X 4. This issue needs to be settled before the Agriculture Council on 18 June. I therefore suggest that the proposed devaluation of the Green Pound be discussed at this Thursday's Cabinet on the basis of a memorandum by the Minister of Agriculture (already commissioned by the Sub-Committee) covering both CAP prices and the Green Pound.

5. I am copying this minute to all members of OD(E) and to Sir John Hunt.

Agreed. MT.

C

(CARRINGTON)

Foreign and Commonwealth Office
11 June 1979

OD

NOTE OF A MEETING BETWEEN THE MINISTER OF AGRICULTURE, FISHERIES AND FOOD AND COMMISSIONER GUNDELACH: 7 JUNE 1979

Euro Pol.

Present:

Minister of Agriculture, Fisheries and Food	Commissioner Gundelach
Minister of State(C)	Mr Villain(Director-General DGVI)
Permanent Secretary	Mr Bauman(Commissioner's Cabinet)
Principal Private Secretary	

P.a. 11/6

NEW ZEALAND

The Commissioner reported that his visits to New Zealand and Australia had both gone well. He had negotiated a satisfactory agreement with the Australians which he hoped would survive official scrutiny.

The Commissioner said that it was clear that New Zealand would collapse without EEC support. It needed the EEC market for its lamb and for a reasonable share of its dairy products. The New Zealand Prime Minister had been in a tough mood when he had arrived, being even more scared of what the EEC would propose for lamb than for butter. The Commissioner had undertaken to continue to import substantial quantities of butter and agreed that it would be best to submit a report to the Council before the Summer Recess on the concept of the arrangements, leaving the figures and other details to be discussed in a restricted Council after the summer. Speaking entirely without a mandate the Commissioner had proposed that New Zealand and the EEC should discuss permanent arrangements for the import of New Zealand butter on a Community basis, rather than, as at present, under a special transitional measure for the United Kingdom. That suggestion had transformed the atmosphere. It had enabled discussion to take place about the modalities. It was clear that New Zealand would now be more co-operative with the Community, having been assured that permanent arrangements were envisaged.

The New Zealanders had indicated that they were prepared to settle on the lines of the Commission proposal for a sheepmeat regime, but that their position would be different if anything further was proposed. The Commissioner had replied that the days of heavy market support arrangements were over. He had emphasised that he was not proposing formal GATT consultations on the reduction of the 20% tariff, but a free deal involving a cut in the tariff in return for restraint on the sendings. The Commissioner thought that New Zealand would be unable to increase its production of lamb because they lacked the financial resources for highly intensive agriculture.

Reverting to butter, the Commissioner said that he had suggested establishing a fixed relationship between the New Zealanders cif price and the EEC intervention price, to avoid annual haggles about price levels. He had warned them that the relationship must be set at the right level at the outset so that New Zealand did not add to other pressures for higher EEC intervention prices. As for the levy, he had proposed that New Zealand should debond regularly during the year so as to avoid squabbles about the amount of the levy. The Commissioner proposed that all these elements should feature in a report to be submitted before July. It would not contain figures, but he was thinking of a cut of 10,000 tonnes in the quotas for 1979 and 1980 with a further degression to 90,000 tonnes. He had warned the New Zealanders that less benevolent EEC Ministers were envisaging annual quotas no higher than 80,000 tonnes. The Minister took note and said that he was pleased that the trip had proved so constructive.

In a short discussion of Australian attitudes towards Europe, the Minister and the Commissioner agreed that Australia now realised that it needed to maintain its European links and could not rely solely on the USA and Japan.

The Commissioner thought that there would be little difficulty with the Australian component of the Multilateral Trade deal and that most EEC Ministers, particularly the French and German, would be more anxious about the US ratification of the outcome of the MTNs.

PROSPECTS FOR PRICE FIXING COUNCIL - JUNE 18

The Commissioner said that his main task at the price fixing would be to tackle the public scandal of the milk and sugar surpluses. He would have to make it clear that he was not prepared to consider other matters until these issues had been settled. The Minister interjected that he was anxious to avoid the development of an atmosphere in the Council which would allow increases elsewhere in return for freezing the price of milk and sugar. The Commissioner agreed and added that he was anxious to avoid the sort of manoeuvring between Ministers which had lead to the unsatisfactory prices settlement last year. The French wanted increases in prices to allow the positive MCAs to be dismantled. They had already made two mistakes in thinking:

(1) that the Germans had agreed to the abolition of their positive MCAs in return for a price increase; and

(2) that the Germans would press for a price increase.

The German attitude was that they would accept a price increase if it was offered, but they would not press for one. Now the French were making a third mistake in thinking that the Germans would cut all their positive MCAs if increases could be negotiated in the prices of some but not all commodities. The Germans would not wear this. Despite being told repeatedly that no increase was possible in the prices of milk and sugar the French would press for one on these commodities and for cereals. Their attempt would founder because the Germans would not agree to abolish all their positive MCAs on this basis.

The Commissioner sensed that the Germans and the Dutch would prefer to leave matters as they were, except that they acknowledged that some action must be taken to reduce the surplus of butter. The French, on the other hand, thought the credibility of the EEC would be damaged if it took no action whatsoever. The Commissioner agreed with the French, and therefore proposed to deal effectively with milk. However, he felt bound, in view of his responsibility to aim at a settlement, to test the atmosphere on cereals.

The Commissioner continued that he did not intend to change his price proposals. He would table figures, in a working paper, on the development/costs since the presentation of the price proposals, but he would not change the proposals themselves. There would then be considerable discussion revealing great differences between the attitudes of delegations towards price increases. The attempt at a Presidential compromise would then ensue, to be met with the usual rejection. The Commission would then propose the usual compromise which would have to cover monetary matters, sheepmeat and the wine package (where he needed EEC agreement on the structural part so as to be able to confront Spain with a fait accompli, forcing her to reduce production). He would have liked to solve the potatoes issue, but the Community had so far failed and the Cyprus potato season was now over. It could, therefore, wait until the autumn. There could be no discussion of alcohol or structural policy and he wished to avoid a major discussion on fruit and vegetables. He indicated that he would not move on sheepmeat.

The Minister replied that he saw a basis for settlement on sheepmeat as prices had begun to converge. The verdict of the European court case was expected in July. The UK was perfectly willing to attempt progress on the lines of the Commission proposal.

Summing up his view of the prospects of the price fixing, the Commissioner said that it must cover effective action on milk, an attempt at resolution of the issue of Monetary Compensatory Amounts, and that this latter would in turn create pressure for an increase in cereal prices from Belgium, France and Holland (though Dutch officials seemed to be more intent on one than the Dutch Minister).

The Minister said that he was opposed to an increase in the price of cereals. As for milk he would prefer a cut in the intervention price. The co-responsibility levy was very unpopular in the United Kingdom and he could not accept exemptions for smaller farmers. The UK was in deficit in dairy products; its liquid milk consumption was higher than elsewhere, and its industry was more efficient, despite operating at lower price levels. It was therefore politically impossible for him to agree with the Commission proposals. The Commissioner replied that the Community would not now face such a disastrous situation in the milk market if his proposals for the suspension of intervention had been accepted last year. But the fact of the matter was that they had not been accepted and that 8 Member States would prefer action through the co-responsibility levy. In his view smaller producers were a dying breed and were producing comparatively little milk. The big increase in production had taken place elsewhere, for example in the United Kingdom, Holand and Ireland. France and Italy had not significantly increased their production and elsewhere it was static or in decline. The big increases had come from soya based production in the Netherlands. France was not seeking to hit the UK in its proposals for wider exemptions for the smaller farmer.

The Minister observed that the French proposals nevertheless would hit the United Kingdom. The new British Government faced a great task in keeping the county pro-EEC. The cost of the CAP was the big issue in the European Election. He could not, therefore, agree to a new device which was loaded against the UK. He had said publicly that the intervention price should be cut. Despite this, he was prepared to consider an increase in the levy which would be unpopular. UK producers' incomes would fall anyway this year and he could not expect producers to accept the Commission levy proposals on top of that. He warned that he would have to dig in his heels over it.

The Commissioner said that he could understand the psychology but not the substance of the Minister's argument against exempting smaller producers. Other Member States would not agree to the French proposal that production under 100,000 kg per year should be exempt. But they would accept a lower level of exemption. The question was whether the levy should be at a flat rate or progressive, accelerating with increases in production. He thought that the Council should have the courage to provide for an automatic increase in the levy so as to guard against a temporary increase in production as producers took evasive action. The Minister thought that the Council would find it hard to agree to an automatic progressive levy. His own position was that he would be prepared to examine the case for further measures if the market imbalance deteriorated next year. But it would be difficult to defend an automatic progressive levy when other options, like price reductions, could be used. It would be better to indicate that a tough policy against surpluses would be pursued over several years, that the range of methods for tackling surpluses was limited, but that Ministers would use one or more of them in their resolve to achieve their objective.
The Commissioner agreed that an automatic progressive levy was not the only mechanism. He did however set his face against quotas. He had argued often with Ralph Howell MP in the European Parliament, who seemed attached to such a solution. He would rather quit the Commission than agree to quotas. Nor would he agree to the removal of the cost of

surpluses from the EEC budget, as Commissioner Tugendhat had reported that the French were proposing. Such a move, which could signal the eventual re-nationalisation of the common milk policy and eventually the entire CAP. Besides, the limit on budgetary expenditure was the only weapon that he could use in forcing the Council to act responsibly before the decisions were taken out of its hands.

OTHER POINTS

During and after lunch the following points were discussed. The Commissioner promised to accelerate the finalisation of the regulation govering the activities of the Milk Marketing Board. The Commissioner re-emphasised his determination to tackle surpluses of foodstuffs this year before the limit on expenditure intervened to take the matter our of the hands of the Agricultural Council. He said that he would resign if he did not succeed. The Minister mentioned that the Government would be considering the position of the green pound next week. He realised that the UK pig industry, which was in a very bad state, could not expect relief from the further recalculation of the pigmeat MCAs. The industry faced a growing threat from Dutch imports based on manioc. The Commissioner reported that he had visited Thailand where manioc production was ruining the land and that he had promised assistance to Thailand to diversify its agriculture. On his return his report had been well received except by the Dutch. His coming report on the development of costs would upset them even more, because it would conclude that northern Europe was wasting energy in heating hot houses. Ample free supplies of solar energy were available in the southern parts of the Community. He indicated considerable personal aversion to the production of milk from cheap imported American soya which he regarded as an unnatural, unreliable and "monstrous" process.

FISHERIES

The Commissioner raised the issue of Britain's reserve on the Senegal Agreement. The Minister replied that he had now decided to lift it as a gesture of goodwill and would be informing the Italians straight away. The Commissioner agreed with the Minister that it would be quite counter-productive to hold a Council in June devoted to discussion of the UK national/measures and promised to make every effort to persuade the Germans, Dutch and Danes to appeal to the French to call it off. He proposed, however, and the Minister agreed, that the UK representative at COREPER should be prepared to allow discussion of the measures for form's sake. He noted the political imperatives that forced the Minister to proceed with the national measures on July 1 and promised that the Commission would agree with the substance of them, though it would have to reserve its position on the timing. He hoped that the Council could agree to move to 90mm mesh sizes by 1981.

Finally, he recommended that the Minister should meet the Danish Fisheries Minister as soon as possible and the Minister informed him that a meeting was planned for 21 June.

G R WATERS
PRINCIPAL PRIVATE SECRETARY

Circulation:

Mr Harding	Mrs Archer	PS to Prime Minister
Mr Perrins	Mr Catford	PS to Secretary of State, FCO
Mr Sadowski	Mr Dixon	PS to Secretary of State, Scotland
Mr Kuyk	Mr Capstick	PS to Secretary of State, Wales
Mr J H V Davies	Mr Hadley	PS to Secretary of State, Northern Ireland
Mr Moss (or)	Mr Atkinson	PS to Secretary to the Cabinet
Mr Evans	Mr Ring + 1	
Mr Kelsey	(For Mr MyersUKREP, via tonight's bag)	
Mr Wilson	Mr Packer	

PM/Giscard Meeting note : 5 June 1979 Original on: France: PM's visit: May 79 Euro Pol.

not for facts, but for ideas on how the position could be corrected. President Giscard said that he could agree to this. The Council could conclude that a problem existed and ask the Commission to suggest ways of correcting distortions in the situation. It would be necessary to work closely with the Germans and to have discussions with them behind the scenes.

CAP

President Giscard said that France had earned a bad reputation so far as the CAP was concerned and he wished to change it. France was the largest producer of agricultural products in the Community, although in some areas such as meat and dairy products she was not the most competitive. France wished to compete on fair terms. The French Government would, he repeated, be glad to see the MCAs eliminated but any such move was blocked by the UK's attitude on the question of a price freeze. It was difficult for any Government to reduce the prices payable to their farmers: Chancellor Schmidt had agreed to reduce the MCAs provided that there was a nominal increase in prices at the same time. An increase of 2%, for example, would reduce positive MCAs to zero. It would be possible for the UK to share this position while opposing any increase in the prices of products which were in surplus. President Giscard said he hoped the British Government could reconsider their attitude on this matter. France, for her part, had no desire to increase the surpluses still further and was, indeed, prepared to contribute to their reduction. France was nevertheless profoundly attached to the principle of a single market in agriculture and to the maintenance of a barrier around the Community against the rest of the world. Although the proposal was still confidential and he did not wish the press to learn of it, the French Government was thinking of suggesting that a system should be devised in which those countries which were responsible for creating the agricultural surpluses should also be responsible for financing them.

/The Prime Minister

All very "Euro"
countries (till they
began to be net
contributors) Funny
that!

The Prime Minister pointed out that the UK was quite capable of engaging in fair competition but could not be expected to compete against subsidised produce. She expected heavy competition from France and Germany in manufactures, an area in which the UK was herself less efficient, but the UK's efficiency in agriculture did not bring a fair reward. President Giscard commented that the UK would encounter problems in endeavouring to change the situation - not from France, but from countries such as the Netherlands, Denmark and Ireland. If the UK were to concentrate her efforts at reform on the problem of agricultural surpluses, she would encounter no adverse reaction from France; there would, however, be a French reaction if the concept of the single market for agriculture were to come under attack. The organisation of the CAP and the method of financing it were different questions.

EMS

Turning to the EMS, the Prime Minister noted that the review of the exchange rate system would be taking place in three months' time. The UK had, at present, a high exchange rate for sterling, not because of the UK's economic performance but because of North Sea oil. The Government needed to keep the rate high for the time being and this would make it difficult to enter the EMS straight away. It might, however, prove possible at the time of the exchange rate review to swap some of the UK's reserves for ECUs. In the longer term, the UK was keen to join the European Monetary System if this was feasible. President Giscard commented that it was not necessary for the UK to reach a final decision on joining the EMS quickly. It would, however, be significant if the UK were to create the conditions for joining; he recommended a progressive approach to entry, which would be better than to attempt to move too fast.

*　　*　　*　　*　　*

/At 1215

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From The Secretary of State for Wales

The Rt Hon Nicholas Edwards MP

22 May 1979

Mr. Sanders

Dear Peter

CAP PRICE PROPOSALS 1979/80

Thank you for sending me a copy of your letter of 16 May to Peter Carrington about the need for a debate in the House on CAP price proposals before the Agricultural Council meeting on 18 June.

I entirely agree that we should have a debate. Apart from the Parliamentary proprieties of the situation, a debate in the House a few days before the Agricultural Council meeting is likely to provide a timely reminder to our partners of the concern felt on all sides about the present CAP and, particularly, its cost to the United Kingdom.

In the meantime, as you know, we are having a Welsh Affairs debate in the House tomorrow. I shall, of course, be making some reference to Welsh agriculture and, in that context, will have to make at least a passing reference to the CAP. However, I shall simply say that we share the Commission's anxiety to attack the Community's structural surplus through the price freeze but will also seek to ensure that the elimination of surpluses and waste is not achieved at the expense of this country's efficient producers, especially, of course, our milk producers.

I am copying this letter to the recipients of yours.

Yours ever

Nick

The Rt Hon Peter Walker MP
Minister of Agriculture, Fisheries and Food
Whitehall Place
LONDON SW1A 2HH

Chancellor of the Duchy of Lancaster

Cabinet Office
70 Whitehall London SW1
Telephone 01-xxxxxxx 233-5826

22 May 1979

M. Sanders
MS

BM
24/5

My dear Peter

CAP PRICE PROPOSALS FOR 1979-80

Peter Walker wrote to you on 16 May about the timing of a debate in the Commons on the 1979/80 CAP price proposals.

I recognise the desirability of fitting in the debate on CAP prices before the Council of Agriculture Ministers on 18 June. We have planned for a debate on 15 June and I will do my best to keep to this date.

I am copying this to the recipients of Peter Walker's letter.

Yours ever
Norman

The Rt Hon Lord Carrington KCMG MC
Secretary of State for Foreign & Commonwealth Affairs
Foreign & Commonwealth Office
Whitehall
Downing Street
LONDON SW1

23 MAY 1979

CONFIDENTIAL

Original on: Euro Pol: Jenkins' visits: May 79.

Note of the Prime Minister's Conversation with the President of the European Commission, Mr. Roy Jenkins, at 10 Downing Street, on 21 May, 1979, at 12 noon

Present:

The Prime Minister

Mr. Michael Franklin

Mr. B.G. Cartledge

The Rt. Hon. Roy Jenkins

Mr. Crispin Tickell

After welcoming the President of the Commission, the Prime Minister said that it would not be necessary to repeat to him the Government's general approach to Europe, which was that inherited by the Conservative Party from Mr. Macmillan and Mr. Heath. There could be no question of the UK ever again standing outside Europe, and the Government was fully aware of the great advantages which accrued to the UK through her membership of a larger group of nations. The UK would continue to fight her corner in the Community vigorously, but this would be done against an overall background of cooperation with her partners. The Prime Minister said that the EMS posed problems for the UK since the Government wished to retain a high exchange rate for the pound for the time being: the outlook on inflation was not good, and it was doubtful that the UK would be able to enter the EMS in September, although she would probably be able to give a demonstration of her good intentions by swopping some of our gold and dollar reserves for ECUs. The Prime Minister said that she was not persuaded that the EMS could in itself bring about the convergence of the EEC economies; this could only be done by the adoption of convergent policies by the member governments.

Mr. Jenkins said that he thought that the argument in favour of UK entry into the EMS in the autumn was that late joiners were apt to suffer disadvantages, just as the UK had done in relation to the EEC as a whole. The Prime Minister agreed, but

/ pointed

CONFIDENTIAL

pointed out that no one could have foreseen that the CAP would have to operate in circumstances of such wide currency differentials, and of such high levels of MCAs. The structure of the CAP made no sense in current circumstances. The Prime Minister said that she did not complain about the fact that, as a result of the UK's lack of competitiveness in the industrial field, Europe enjoyed unchallenged access to the UK market for manufactured goods. She did, however, complain about the fact that in agriculture, where the UK was so much more efficient than her continental partners, the UK was denied an equivalent market for her agricultural produce. At the moment we were losing all ways round, and on fish as well. The present structure of the CAP could not last, and something had to be done about it. Mr. Jenkins said that the budgetary allocation to the CAP was immense: but this problem should not be confused with that of the structure of the CAP itself. It was not possible to solve the problems of the Community budget by way of reforming the CAP, although a further escalation of the cost of the CAP could and should be prevented.

Mr. Jenkins went on to say that the Commission completely stood by its commitment to a price freeze for agricultural products which were in surplus, and wished in addition to do something about milk by means of the co-responsibility levy. If the cost of the CAP were allowed to escalate further, any effort to solve the problem of the Community budget would be neutralised. The Prime Minister told Mr. Jenkins that the UK would stick firmly to the VAT 1% ceiling. Mr. Jenkins expressed some doubt as to whether this could in itself contain the cost of the CAP.

Mr. Jenkins said that everying he had heard from German sources indicated that Chancellor Schmidt's visit to London had gone very well; but he gathered that the Prime Minister had found the Chancellor very hard on the subject of the budget. The Prime Minister said that she had been astonished to find a

/disposition

disposition on Chancellor Schmidt's part to argue about the facts. Mr. Jenkins said that there was good reason to believe that what the Prime Minister had told Chancellor Schmidt about the budget had sunk in, and that the Chancellor was now much more disposed to recognise that there was a problem. The Prime Minister said that she, for her part, was deeply alarmed by the budget situation: partnership implied a just and reasonable deal for everybody, and the UK was not getting one from her EEC partners. Against this background, it was difficult to sell Europe to the British people. The Community approach to fisheries policy also hit the UK very hard: without some give on this issue, as well, it would be difficult to rally the British people to Europe.

Mr. Jenkins said that it had to be borne in mind that the UK was operating against the background of the renegotiation which had produced the present financial terms: there was a disposition to argue that the UK had made her bed, and should lie on it. It would be difficult to achieve the necessary adjustments unless the UK was seen to be co-operative in other fields. The Prime Minister said that it was important that Commissioner Gundelach should stand firm on farm prices. Mr. Jenkins replied that the Commissioner would do so so far as products in surplus were concerned, and also on the co-responsibility levy for milk. The Commissioner's concern was that the UK might destroy his efforts by its attitude to the co-responsibility levy. It would be a mistake to assume that all British agriculture was efficient and all continental agriculture inefficient; in some areas, the difference in efficiency was in fact very small. The Prime Minister said she could not have British dairy farmers paying the co-responsibility levy when less efficient farmers were exempt.

Turning again to the budget, Mr. Jenkins said that it would be important for the UK to avoid giving the impression that the budget was the only focus of interest. The first essential, however, would be to ensure that the budget would be accorded full and serious discussion at Strasbourg. President Giscard, whom the Prime Minister was shortly to meet, would not be keen to

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give ground on budgetary matters, and he, as President of the Council, would have a major say in the Strasbourg agenda. Mr. Jenkins said that he did not think that it would be realistic for the British Government to aim at a solution to the budget problem in June: the right strategy might be to aim at achieving a solution by the time of the December European Council, under the Irish Presidency. The Prime Minister commented that the first essential would be to secure an agreed statement of the facts of the budgetary situation. Mr. Jenkins said that there was no dispute about the broad essentials of the position; it was perfectly possible to demonstrate what had happened in 1978, and also what would have happened in that year under the 1980 rules. The difficult question was to arrive at an agreed assessment of the impact of the MCAs. In the UK, the MCAs benefited the consumer and the Treasury, but worked to the disadvantage of the farmers, whereas in the FRG the situation was reversed. The Prime Minister said that, even on the basis of the method of payment agreed in 1976, ie. that MCAs were paid to the exporting country, the UK remained the second largest net contributor to the Community budget. Mr. Franklin interjected that the UK would, on the same basis, be the largest contributor if it were not for the transitional arrangements. The Prime Minister quoted the figures in her brief for the net transfers by and to EEC Member States in 1978 and Mr. Jenkins confirmed that they agreed with his own. Mr. Jenkins went on to point out that, although it was possible to be clear about the position in 1978, there were a number of uncertainties surrounding the outlook for 1980. It nevertheless looked as if the UK would remain in net deficit, to the order of 1,440 million ecus if MCAs were attributed to exporters and 1,040 million ecus if they were attributed to importers. In 1980, the UK would probably be paying approximately 20 per cent of the Community budget while accounting for only 15 per cent of the Community's total GNP.

/ Mr. Jenkins

Mr. Jenkins said that the collective mind of the Community had been shifted so far as the issue of agricultural prices was concerned but was only just beginning to focus on the problem of the budget. He was bound to say that the approach adopted by the UK to other Community issues in recent years had not helped her case on the budget. Mr. Jenkins said that he would like to offer a word of advice about the position of Italy. Italy, like the UK, was in deficit so far as the budget was concerned - although to a lesser extent than the UK - but the Italian deficit seemed to be more cyclical than structural and could cure itself within the next two or three years as a result of other factors. This meant that the same remedies might not apply to both countries and that it might be more advantageous to the UK to seek a separate solution rather than a joint UK/Italian remedy. The Prime Minister commented that to ask for a separate solution seemed to her to be a bad negotiating position.

Mr. Jenkins said that the other members of the Community were antipathetic to the consideration of the UK as a permanently less prosperous country. They were inclined to take the view that the UK's lack of prosperity was largely her own fault; and the argument that the payment of money across the exchanges, as a result of the budget structure, actually held back the UK's rate of growth was on the whole unpersuasive in the Community. It would be better to argue that the effect of Community policies on the UK should be looked at overall and for a significant period in the future, from which it would be evident that the UK was not being given a fair deal.

The Prime Minister said that she fully accepted that the UK could and should be wealthier: but the new Government would not be able to turn the economy round if they were saddled

/ with a drain

with a drain of public expenditure resulting from the Community budget. She was still a little shocked that the basic facts should not be generally admitted.

The Prime Minister then referred briefly to the dispute between the Commission and the British Government over the order given to Harland and Wolff for a British Rail Ferry. The Prime Minister said that whatever excuses the UK was obliged to offer, Harland and Wolff would certainly get the order. Mr. Franklin asked Mr. Jenkins whether he would be willing to look into the matter with Commissioner Vouel or whether he thought it better that a British Minister should pursue it with the Commissioner. Mr. Jenkins said that he would certainly take the problem up himself but that the British Government could pursue it with Commissioner Vouel in parallel.

The Prime Minister then mentioned the Interest Relief Grant Scheme for offshore supplies. Mr. Jenkins said that he regretted that this matter had been taken up with the Government immediately after the Election: but the Commission had been reluctant to raise it during the Election campaign and Commissioner Vouel had been determined to put the problems on the desks of the last Government before it left office. The Prime Minister said that the Government was watching Mr. Davignon's activities over steel with some circumspection: they were apprehensive lest protectionism should enter the industrial sector as it had the agricultural. Mr. Jenkins assured the Prime Minister that Mr. Davignon did not have a protectionist attitude.

The Prime Minister asked Mr. Jenkins what the UK could do to give the Community evidence of its good intentions. Mr. Jenkins replied that much, but not everything, could be done by using the right words, as the Foreign and Commonwealth

/ Secretary had done

Secretary had done during his first meeting with his European colleagues. More practically, energy was a field in which the UK had both the resources and the experience to make a positive and constructive contribution instead of dragging her feet as she had done in recent years. Secondly, he was convinced that the UK should agree to a settlement on fish; the last Government had been very close to one. The Prime Minister said that she took a very hard line on the fisheries issue. Fish had been declared a common resource just before the UK's entry into the Community despite, or because of, the fact that the UK had the lion's share of the Community's fishing waters and of the Community's fish. When Mr. Jenkins referred to the possibility that a 12-mile exclusive zone combined with a quota system up to a 50-mile limit might provide the basis for a settlement, the Prime Minister said that she was opposed to quotas which were difficult to monitor. There could be no question of allowing Spain to enter the Community unless a settlement had been reached on fish in advance.

Reverting to the subject of energy, Mr. Jenkins said that it was clear that the Economic Summit in Tokyo would be dominated by energy issues. The Prime Minister said that she found it hard to see what specific agreements on energy the Tokyo Summit could reach. She was concerned that the EEC, and the West as a whole, had never played all the cards which they held in order to exert pressure on OPEC. Co-ordinated research needed to be done on this so that the West was in possession of all the facts which could form a basis of her bargaining position. Europe's agricultural surpluses, which were a burden in some respects, could turn out to be an asset in the context of negotiations with OPEC. Mr. Tickell commented that the CIA had produced a study of this subject in 1976. Mr. Jenkins said that this whole subject would be very suitable for discussion after dinner in Strasbourg.

/ The Prime Minister

The Prime Minister told Mr. Jenkins that the UK would need the help of her partners over Rhodesia. Mr. Jenkins said that the reaction to what Lord Carrington had said on this subject at his first meeting with the EEC Foreign Ministers had not been as negative as might have been expected. The other Governments of the Nine would inevitably take some time to adjust to the UK's change of policy but the initial reactions of the French, the Danes and the Luxembourgers had been mildly encouraging. In response to Mr. Jenkins' question, the Prime Minister confirmed that the British Government would not take this issue at a gallop: but the African attitudes were hardening and this caused her concern. Unless Bishop Muzorewa and Mr. Sithole were given some encouragement to make the internal settlement work, the consequences for Southern Africa could be very serious. The UK no longer had any basis for maintaining the illegality of Rhodesia's situation and would need constructive help from others. The Prime Minister said that she was very firmly of the view that it was for the people inside Rhodesia to decide on the Government they wanted and not for those outside the country who wished to settle the issue with guns.

Concluding the discussion, Mr. Jenkins expressed the hope that the Prime Minister would find time to pay another visit to Brussels; the Prime Minister said that she would certainly hope to do so.

The discussion ended at 1315. BGC.

21 May 1979

Conservative Central Office

NEWS SERVICE NB EMBARGO

Euro Pol.

Release time: 13.00 hours/FRIDAY, 18th MAY, 1979. 825/79

Extract from a speech by Christopher Tugendhat, Commissioner of the European Communities, speaking to Humberside European Conservative Committee at Howden, Yorkshire, on Friday, 18th MAY, 1979.

COMMISSION APPEAL TO EURO MP's ON SUPPORT FOR COMMON PRICES FREEZE

A freeze in common prices this year is an essential first step towards restoring a proper balance to the Common Agricultural Policy. On purely budgetary grounds there is a case for even stronger action. The Community is rapidly approaching the limits of its financial resources and it is absolutely vital that agricultural expenditure, which accounts for the greater part of the Community budget, should be curbed.

The Commission and the British Government are in agreement on the need to curb costs and to take the consumer as well as the producer into account. There is also mounting support for this approach in other member states. I am therefore hopeful that a freeze on surplus products will be achieved.

In the past the Council of Agricultural Ministers has too often approved higher prices than the Commission proposed. Attempts have then been made to offset their effects on the consumer by subsidies and other palliatives. This approach however serves both to increase the production of surplus products and budgetary costs. It must not be allowed to occur this year.

Under the Treaty of Rome the European Community has a duty to promote a reasonable standard of living for those living on the land. It takes this duty very seriously. But it should be remembered that in recent years real incomes in agriculture have grown more quickly than those in the rest of the economy. It is against this background that the Commission's proposals this year for a price freeze deserve the support of all who believe in a common agricultural policy that can enjoy support from consumers as well as producers.

The Direct Elections to the European Parliament provide an opportunity for voters to make their wishes clear. The Commission in its battle to hold down prices and to maintain a fair balance between consumers and producers hopes that it will receive strong support from members of the European Parliament, including those elected in the United Kingdom.

END

Europ Pol

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon Lord Carrington KCMG MC
Secretary of State for Foreign and
Commonwealth Affairs
Eland House
Stag Place
LONDON
SW1E 5DH

17 May 1979

COMMON AGRICULTURAL POLICY: PRICE FIXING NEGOTIATIONS

I refer to Peter Walker's letter of 8 May.

In general I go along with his suggested preliminary negotiating line, and would offer only the following comments.

Our major preoccupation is going to be with the budgetary cost of the CAP: ie the cost to the taxpayer and the burden on our economy. Short of reducing our share of the Community budget, which can only be a longer term aim, the immediate way of containing the budgetary cost is, as Peter says, to discourage surplus production. Our initial line must therefore be to insist on a price freeze for products in structural surplus, especially milk.

Further devaluation of the green pound will certainly be needed, especially on livestock products, which are particularly important for Scottish agriculture. However, our precise line must of course be the subject of consultation with colleagues.

The proposed co-responsibility levy on milk producers is quite unacceptable to us in its present form, because it discriminates against the large and efficient milk producer. We in Scotland would be particularly badly hit because of our large average herd size. If levy there must be then, as Peter says, we can accept it only if it applies equally to all producers in all countries.

Copies of this letter go to other members of the Cabinet and to Sir John Hunt.

17 MAY 1979

Euro Pol

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

From the Minister

NBPM
Mr. Sanders
6/5
15

The Rt Hon Lord Carrington, KCMG MC
Secretary of State for Foreign and
Commonwealth Affairs
Foreign and Commonwealth Office
Whitehall
Downing Street
LONDON SW1

16 May 1979

Dear Peter.

CAP PRICE PROPOSALS FOR 1979/80

1. I am writing to you about the date for a debate in the Commons on the 1979/80 CAP price proposals which were recommended for debate by the last Scrutiny Committee. I understand that, until the new Parliament adopts new scrutiny arrangements for EEC proposals, we are expected to work within the spirit of the arrangements adopted by the previous Parliament. CAP prices are on the agenda for the Agricultural Council to be held on 18 June. Had the previous Parliament continued they would certainly have been debated in the Commons before then. So I should like to have them debated before 18 June in prime Parliamentary time.

2. I am assuming that the House will go into recess on 25 May and return on 11 June, that there will be insufficient time for a CAP price debate before 25 May and that the dates after 11 June could well be required for budget debates. On these assumptions I hope that my colleagues could agree that a CAP price fixing debate should take priority over other potential business for the Commons on Monday 11 June. A possible alternative might be Friday 15 June, but I prefer the earlier date.

3. If this date could be agreed Legislation Committee could discuss the general handling of the debate next week. Before then I will write again about the form of motion and the general line to be taken in the debate.

4. I am copying this letter to the Prime Minister, to other members of the Cabinet, to the Chief Whip and to Sir John Hunt.

Yours ever

PETER WALKER

17 MAY 1979

Original filed
Euro Pol May 79

Ref: A09572

CONFIDENTIAL

PRIME MINISTER

Community Affairs

You may wish to refer briefly to the useful talks with Chancellor Schmidt and his colleagues on 11th-12th May.

2. The Foreign and Commonwealth Secretary has already reported to OD on the informal Foreign Ministers Meeting in Cahors on 12th-13th May but, in his absence, the Lord Privy Seal may wish to inform the Cabinet. The Minister of Agriculture might report similarly on the informal Agriculture Ministers Meeting on 14th-15th May.

3. The Chancellor of the Exchequer should be invited to report on the outcome of the 14th May Finance Council, with particular reference to the discussion on convergence and budget transfers.

4. Neither the 15th May Social Affairs Council nor the 17th May Energy Council would seem to call for discussion in Cabinet.

John Hunt

16th May 1979

CONFIDENTIAL

Euro Pol.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

11 May 1979

Dear Peter

N[illegible]
11/5

COMMON AGRICULTURAL POLICY :
PRICE FIXING NEGOTIATIONS

I agree with the line on CAP prices for the forthcoming informal Council proposed in your letter of 8th May to the Foreign and Commonwealth Secretary. I am sure that you are right at this stage to give no hint that we might be prepared to consider increases for any of the major CAP commodities. I think we shall need to consider very carefully whether it would be wise to move from this position in subsequent discussions. The distinction between a commodity like beef which may be in temporary surplus, and milk, which is in structural surplus, may be a difficult one to maintain and taking a more relaxed attitude to one may make it less rather than more easy to maintain a firm position on the other.

I agree too that on the non-price issues you should reserve your position until we have had an opportunity to discuss the detailed papers you have promised. These will need to take account of our determination to restrict public expenditure. As you suggest, this may well affect our line on investment aids for milk producers and on the butter subsidy. But it also calls into question the assumption that the beef premium should continue even if we cannot obtain full Community financing. I recognise that ending the scheme would be unpopular with the UK farmers but, quite apart from savings on the premium itself, it would appear to offer substantial savings in administration costs.

So far as the green pound is concerned, we shall, of course, have to consider whether the Manifesto commitment to make devaluations within the normal lifetime of a Parliament requires a further devaluation this year. This issue is clearly related to the question of whether savings can be made on direct aids to the UK farmers and I agree that you should not raise it in the Community until we have considered it further here.

/I am sending

The Rt. Hon. Peter Walker, MP.

CONFIDENTIAL

CHANCELLOR OF THE EXCHEQUER

I am sending copies of this letter to other members of the Cabinet and to Sir John Hunt.

Y—

Geoffrey

(GEOFFREY HOWE)

European Policy

FCS/79/100

MINISTER OF AGRICULTURE, FISHERIES AND FOOD

Common Agricultural Policy: Price Fixing Negotiations

1. Thank you for your letter of 8 May about the line you intend to take at the informal meeting of Agriculture Ministers in Perpignan next week.

2. I agree that, given our need to cut the cost of the CAP, we should aim for a freeze on products in structural surplus. I therefore think it right that, at your first meeting with your colleagues, you should give no indication of any readiness to concede minor price increases in non-surplus commodities; and that you should stand firm on the line that, as the Commission suggested, there should be a freeze on virtually all commodities.

3. There will be time for us to consider all these questions, including the shape of the overall package which we should ultimately like to see emerge and our main non-price objectives, at greater length before you come to substantive discussion at the Agriculture Council scheduled for 18/19 June.

4. I am copying this minute to the recipients of your letter.

C

(CARRINGTON)

Foreign and Commonwealth Office

11 May 1979

Y SWYDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SWIA 2ER
Tel. 01-233 3000 (Switsfwrdd)
01-233 (Llinell Union)
Oddi wrth Ysgrifennydd Gwladol Cymru

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SWIA 2ER
Tel. 01-233 3000 (Switchboard)
01-233 6106 (Direct Line)
From The Secretary of State for Wales
RT.HON. NICHOLAS EDWARDS MP.

11 May 1979

Dear Peter

NBPM
BW
11/5

COMMON AGRICULTURAL POLICY: PRICE FIXING NEGOTIATIONS

Thank you for sending me a copy of your letter of 8 May to Peter Carrington in which you outline the position you propose to adopt at Perpignon.

My comment is on your proposals for milk, which are tremendously important for farming incomes in Wales, where nearly half the total agriculture output comes from the dairy industry in one way or another. The Commission's proposals for a co-responsibility levy have therefore caused great anxiety in the Principality. Even a two per cent minimum levy would impose a charge on the average Welsh milk producer of about £355 per annum. If there has to be a levy at all, it will as you say be essential that it should be applied across the board, and at a level we can accept.

There is particular concern about the exemption provision in the Commission's proposals. These would apply to five per cent of Welsh producers and two per cent of Welsh production, compared with nearly 30 per cent of community producers and 12 per cent of Community production. This is severely discriminatory against our interests, and the Commission's proposals would help keep in business the small and inefficient Continental farmers who are the very ones who should cease production. So it is important to eliminate the exemptions so far as possible and thus bring pressure on our partners to accept a rate of levy which their own producers can tolerate, as well as ours.

I hope, therefore, that you will feel able to argue very strongly on these lines at Perpignon.

I am sending a copy of thisletter to other members of the Cabinet and to Sir John Hunt.

Yours ever

Nick

The Rt. Hon. Peter Walker MP
Minister of Agriculture, Fisheries and Food
Whitehall Place
LONDON SW1

11 MAY 1979

Extract from the Record of the Plenary Session - PM / Schmidt - 11.5.79

CONFIDENTIAL

Top copy on Germany, May 1979

Government was determined that the UK should be a faithful and good ally: the turn-round in economic strategy would be the Government's major task in achieving this.

Chancellor Schmidt said that, on the financial aspects of the CAP, it would be helpful if the UK were to prepare a first draft of her desiderata in three or four weeks time so that bilateral talks could take place before the UK's proposals were tabled in Strasbourg. Herr Schmidt expressed the view that the importance of these matters went beyond the competence of Minister of Agriculture or even of Finance Ministers; they were of general political importance. Chancellor Schmidt said that he was on the UK's side so far as agricultural surpluses were concerned; there was, for example 5 kilogrammes of milk powder in store for every European. The sales of cheap butter to the Soviet Union spoke for themselves and the Community's sugar policies were not right either. The Chancellor of the Exchequer said that he had not discussed CAP finances in detail with Herr Maffhöfer; but he had to point out that even if the changes in the CAP which the UK wished to see took place and even if the one per cent ceiling on the VAT tranche were adhered to, the UK would still feel strongly that her net contribution to the total Budget of the Community was too large. If Member States were looking to the EEC to achieve greater convergence in the economies of its Members, it was quite wrong that the system of budgetary contributions should actively obstruct this process. The Prime Minister said that the cost of the CAP was at present financed in such a way that the UK, as the seventh poorest Member of the Community, had become the largest net contributor to the Community Budget.

Recalling an earlier remark of Chancellor Schmidt's, the Prime Minister asked him to what extent the UK's attitude towards the EMS would help on other Community issues. Chancellor Schmidt said that he had first to point out that, according to the FRG's figures, the UK was not the largest contributor to the Community's Budget. He suggested that the Prime Minister might check her figures with Mr. Roy Jenkins. On the EMS, he did not wish to ask

/the UK to

Extract from the Record of the PM's talk with Schmidt - 10.5.79

Try copy in Germany, May 1979

Turning to the CAP, the Prime Minister said that it had never been intended to bear the weight of current price levels or of present currency differentials. Chancellor Schmidt said that there was more wrong with the CAP than that: the whole idea of enforcing price levels from above was misguided. It was impossible to guarantee both a steady growth of production from the farmers and, at the same time, the maintenance of a proper supply and demand mechanism. This error was built into the CAP. Herr Ertl, however, would find it very difficult to accept any reduction in Deutschmark prices. The Prime Minister said that she understood the FRG's problems. But food prices in the UK had increased by 150 per cent over the last five years and it was difficult to get the Green currency issue right. It was essential that the Government should be able to point to some progress on the CAP very quickly.

On the Community Budget, the Prime Minister said that it made no sense that the third poorest country in the Community should pay the largest, or according to another calculation, the second largest, Budgetary contribution. Chancellor Schmidt said that the Prime Minister should not be too quick to believe her briefs. The Prime Minister replied that she was quoting, not from her briefs, but from those of the Bundesbank. Chancellor Schmidt said that only a very few people in the FRG really understood the finances of the CAP and the Bundesbank was not among them. The Chancellor suggested that the Prime Minister should ask the President of the Commission for his views on the Budgetary problem, since he took an objective approach to this issue.

The Prime Minister said that despite the three problems of fish, agricultural policy and the Budget, she still believed that she could go before any audience in the UK and win their assent to the view that Britain's membership of the Community was worthwhile. The basic issue was that the free countries of Europe should live together and cooperate. If a fresh referendum were to be held on the UK's membership, the result would still be positive.

/ Covering

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

From the Secretary of State

CONFIDENTIAL

The Rt Hon Peter Walker MP
Minister of Agriculture, Fisheries
and Food
Whitehall Place
London SW1

10 May 1979

Dear Peter.

CAP : PRICE FIXING NEGOTIATIONS

Thank you for copying your letter of 8 May to Peter Carrington to me.

In general I agree with the line which you propose to adopt at next week's informal meeting of Agricultural Ministers at Perpignan. There will be a further opportunity to consider specific proposals, including those for our own domestic milk arrangements, after the meeting. There is, however, one aspect of the price fixing where a different line seems required. I do not see the economic justification for opposing the Commission's proposals to prohibit investment aids: any improvement in efficiency is likely to be matched by the certainty of increased output (and hence surplus). For this reason I hope you will do no more than reserve your position on the Commission's proposed prohibition.

I am copying this to other Members of Cabinet and to Sir John Hunt.

Yours ever

John.

JOHN NOTT

European Policy

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

From the Minister

The Rt Hon Lord Carrington KCMG MC
Secretary of State for Foreign and
Commonwealth Affairs
Foreign and Commonwealth Office
Whitehall
LONDON
SW1

8 May 1979

NBPM

Dear Peter,

COMMON AGRICULTURAL POLICY: PRICE FIXING NEGOTIATIONS

1. The Commission's price proposals for 1979/80 are for a freeze on virtually all commodities and a substantially increased co-responsibility levy on milk producers. The Council was unable to reach agreément and decided to extend the 1978/79 marketing years until 1 July with a view to reaching a price settlement during June. We do not need to settle a final line at this stage. But my colleagues may like to be aware of the line which I intend to take when the subject is discussed at the informal Council meeting in Perpignan next week.

2. The greatest problem arising from the CAP is its cost, of which an excessive burden falls on the UK. The best way to reduce the cost is to cut surplus production. We therefore want a freeze for products in structural surplus. Milk and sugar are certainly in this category, though there is room for argument about cereals, wine and olive oil. Beef, pigmeat, most fruit and vegetables, most tobaccos and other CAP commodities are not in structural surplus.

3. Other member states hope that the UK will be prepared to accept small price increases. In particular, the French Presidency will press hard for general increases in order to give Germany room to make a green mark revaluation without decreasing her prices. We shall need to give early consideration to our line for the price fixing negotiations, beginning on 18 June, and in particular whether we should be prepared to concede minor price increases on non-surplus commodities in order to get a general settlement. For the present, however, I propose to give no indication of any willingness to see increases in common prices. We shall also need to decide what further devaluation we want for the green pound, in fulfilment of the policy we declared in the manifesto. I would not however propose to raise this question in the Community until we have considered it further here, and I shall be consulting colleagues on this shortly.

/4. We shall need to ....

Milk

4. We shall need to take early action at home to sustain returns to our own milk producers, which would otherwise fall sharply. Our producer price would remain far below the EEC common price for milk: it is this price which has led to the production of surpluses whose disposal cost is the biggest single element of CAP expenditure, to which we contribute so heavily. I therefore propose to support the Commission's proposal for a freeze on the common milk price; and I shall support in principle their idea of an increased co-responsibility levy on milk producers, though with important qualifications about its operation. At present it would apply to a far higher proportion of milk in this country than in any other, and we must ensure that it applies equally to all - and at levels we can tolerate.

5. Two other areas we shall need to consider carefully are the Commission's proposals on the general butter subsidy and our attitude to the EEC subsidy on school milk. The butter subsidy is a complicated issue in which we will need to weight the public expenditure implications against the potential benefits to our FEOGA balance and the effect on consumer prices and butter consumption. The same goes for the school milk subsidy and I would propose to put in more detailed papers in due course on both these issues. In the meantime I propose merely to keep our options open.

6. Finally, the Commission have (with certain limited exceptions) proposed a ban on both national and FEOGA-financed investment aids to dairy farmers and to the milk processing industries. Our attitude to this will obviously depend on any wider view we decide to take on investment aids to industry generally, but I would propose at this stage to resist the Commission proposals on the grounds that such a restriction would inhibit more efficient production, which the Community ought to be encouraging.

Sugar

7. Although a price freeze is the first priority I also attach very great importance to the proposal by the Commission to cut the maximum quota, which apart from its longer-term value in restraining surpluses will immediately cut the cost of surplus disposals. I propose that despite strong French opposition, we should firmly support the Commission. On isoglucose I shall insist on a scheme which is fair for our production.

Other Commodities

8. At this stage I intend to argue strongly for a general freeze on cereals prices as the only realistic way of dealing with surplus production. I want to continue the dual support system for beef in the UK which works well. I shall also press for full financing from the EEC budget instead of 25% financing. This is the kind of issue on which we might make progress later as part of a generally agreed package. For pigmeat, the key is a devaluation of the Green Pound and I will be putting forward my proposals shortly.

9. I would be grateful for your agreement to this preliminary negotiating line. I am sending copies of my letter to other members of the Cabinet and to Sir John Hunt.

Peter Walker

END

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