PART TWO

MT

A/4

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Confidential Filing

Agricultural Expenditure.

AGRICULTURE

Part 1: September 1983

Part 2: November 1985

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
7.11.85		4.11.87					
11.11.85		10.11.87					
25.11.85		11.11.87					
28.11.85		1.12.87					
31.1.86		11.11.87					
11.2.86							
21.3.86							
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26.10.87							
2.11.87							

PREM 19/2014

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TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
CC(86) 38th Meeting minutes, item 4	20/11/1986
CC(85) 33rd Meeting minutes, item 4	16/10/1986
CC(85) 31st Meeting minutes, item 3	18/09/1986

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 [signature] Date 06/05/2016

PREM Records Team

NOTE FOR THE FILE

'REVIEW OF FORESTRY'

Any papers, relating to the above, which precede the Chancellor's minute of 4 November must not be copied to any other department without seeking permission from the Treasury.

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PART 2 ends:-

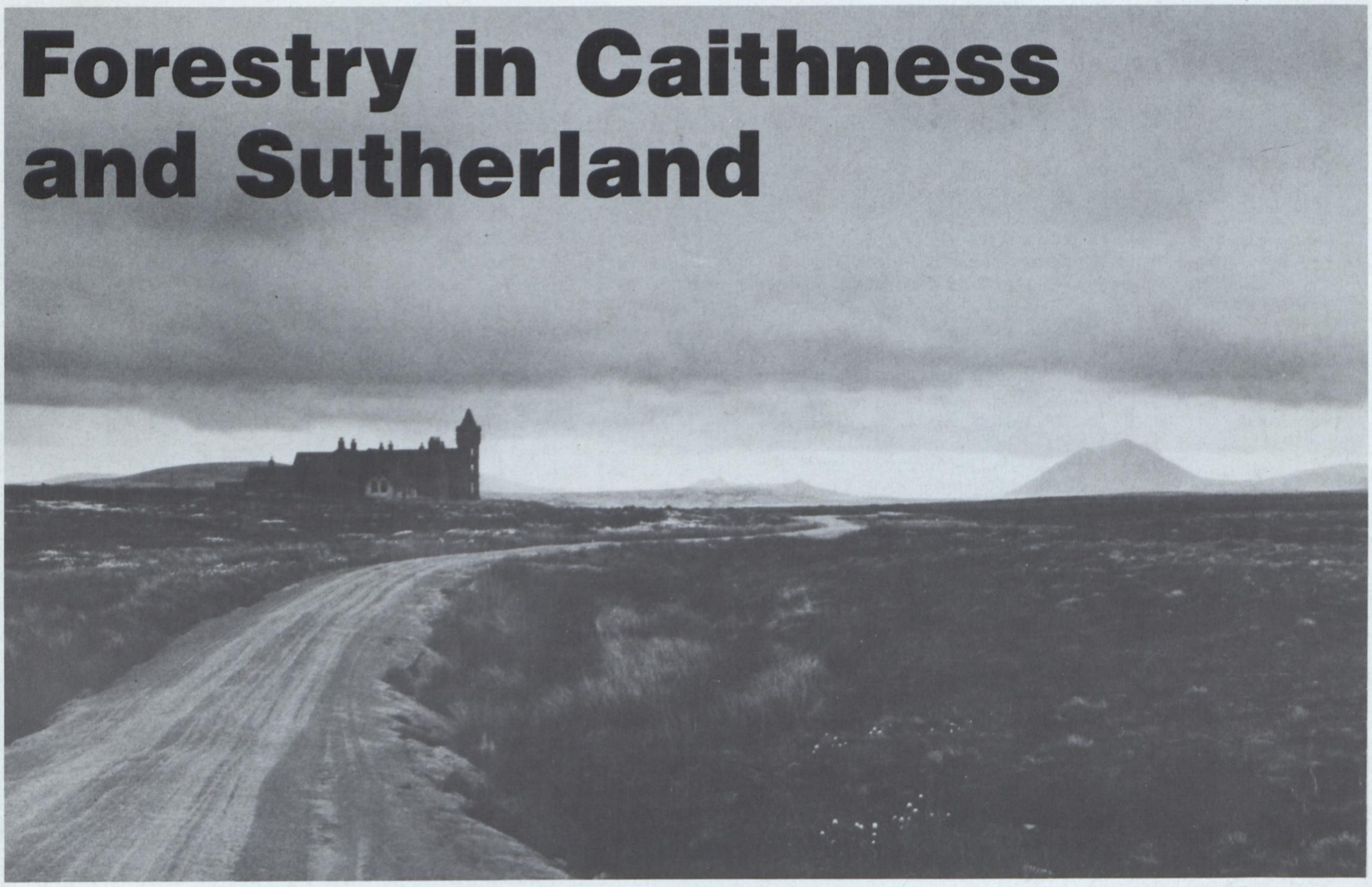
TIMBER GROWER EXTRACT 11.11.97

PART 3 begins:-

HMT TO DAW 1.12.97

pl. Dew I thought this would interest you. NRB. 11/11/87

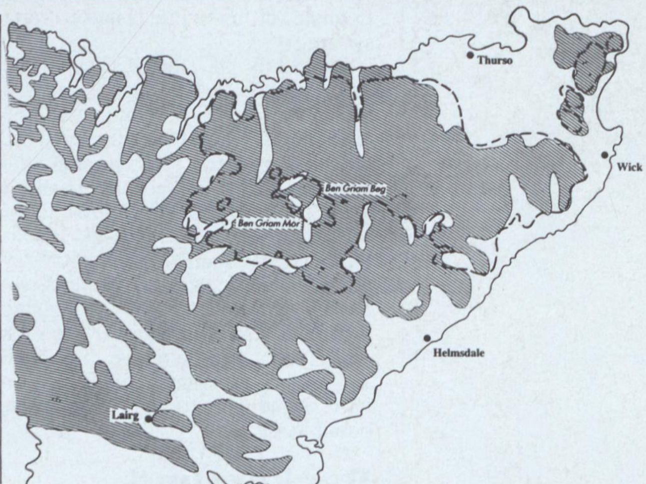
Forestry in Caithness and Sutherland



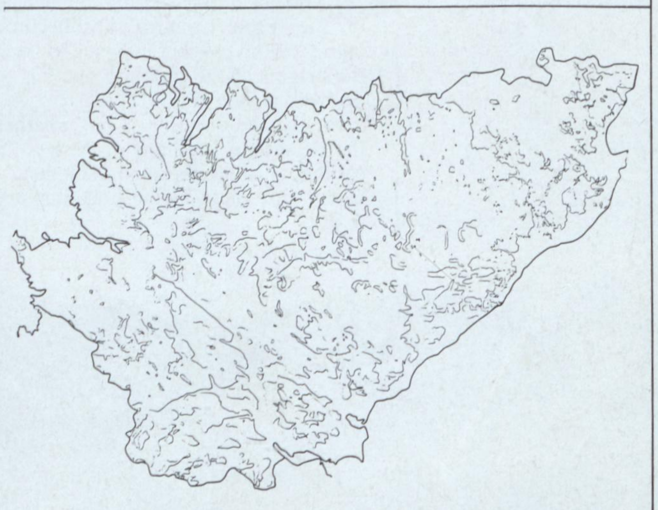
"Blanket mireland of major international importance"; "a rare and fragile ecosystem"; "the last great wilderness in Europe": these are some of the terms which have been used to describe that area in the north of Scotland which is generally referred to as the 'Flow Country'.

During the last six months a number of TGUK office-bearers and officials (from Scotland, England and Wales) have visited the region in order to acquaint themselves more fully with the situation and the factors underlying the present debate.

This article collates their general findings.



Map 1 RSPB



Map 2 NCC

Firstly: what is the 'Flow Country'? — a necessary beginning because there is some confusion. The title itself seems to have originated out of the Macaulay Research Institute's investigations into the peatlands during the 1950s, and the 'Flows' are an ecological feature (essentially bog systems) found in those areas. The title was adopted by the Royal Society for the Protection of Birds (RSPB) in defining an area of some 184,000 hectares (ha) in Caithness and Sutherland (see area bound by dotted line, map 1).

The Nature Conservancy Council (NCC), however, uses the term 'blanket bog' which covers an area of some 400,000 ha (map 2).

As against this, the counties of Caithness and Sutherland comprise some 760,000 ha altogether. The population is approximately 40,000 (declining over the last 100 years) largely made up of scattered communities (population density is under 14 persons per square mile). Unemployment is relatively high (20 per cent in Sutherland and 13 per cent in Caithness). Employment opportunities are limited (despite the availability of land and natural resources) and the principal employer is the nuclear power station at Dounreay.

The different approaches (in terms of size of land area) adopted by the RSPB and the NCC can lead to confusion insofar as statistics quoted (particularly percentages) may refer to either.

To clarify therefore: taking the RSPB 'Flow Country' of some 184,000 ha — forestry (planted or with Forestry Grant

". . . the question is not whether there should be any forestry in Caithness and Sutherland . . . it is already there with the potential to become a very viable local industry."

Scheme (FGS) approval) covers some 35,000 ha (Forestry Commission 18,000 ha, private sector 17,000 ha). In addition, private forestry interests own about 20,000 ha of non-forestry land. (Thus within the 'Flow Country', 29 per cent of the land is in forestry ownership, but only 17 per cent is afforested.) Aside from the afforested land, 18,750 ha are unplantable; 6,750 ha are agricultural land; 49,000 ha are given to grazing; 19,250 ha are crofting land; 4,000 ha are peat-core and 17,250 ha are SSSIs and National Nature Reserves (NNRs) (although these last can be expected to increase).

Taking the NCC's wider area of 'blanket bog' (ie some 400,000 ha): forestry covers 68,082 ha; SSSIs and NNR's 98,366 ha and National Scenic Areas 104,000 ha. In forestry terms, the Forestry Commission's Highland Conservancy, within which this area falls, still has the lowest percentage of land under afforestation in comparison with other conservancies in the UK.

In its reports on the 'Flow Country' the RSPB has expressed concern over the possible effect of afforestation on the population of breeding birds — particularly greenshanks, dunlin, golden plovers and rarer species such as the common scoter, the arctic skua and the blackthroated diver, and recommends that the region should be designated an Environmentally Sensitive Area (ESA).

The NCC approach is broader-based, with concern also for the area as an example of an entire blanket mire system.

On 23 July 1987, the NCC called for a moratorium on new planting within the entire area. This prompted the Highland Regional Council to convene a working party, comprising the principal statutory agencies involved (NCC, Countryside Commission for Scotland and the Highlands and Islands Development Board) with the Forestry Commission attending as observers.

This working party is also taking evidence from all the other interests concerned. The initiative has been endorsed by government ministers who have called for a report as soon as possible.

Background

As reflected in the media, the debate on the 'Flow Country' has become highly emotive — but in trying to trace the origins of the problem one has to go back a long way.

Firstly, the question is not whether there should be any forestry in Caithness and Sutherland. The fact — and the problem facing both forestry interests and the Highland Regional Council — is that it is already there with a potential to become a very viable local industry. The first ever Forestry Commission forest was planted in the region in 1919, and the Commission has since managed substantial areas, including a number of trial plots from which considerable experience has been gained. While the pace of afforestation has certainly increased during recent years, forestry is therefore not a new phenomenon in the area.

Prior to the 'outbreak' of the present debate, there was comparatively little indication until 1983 of the size of the problem that would arise. In the *Nature Conservancy Review* published in 1977, the blanket mire system was described, but within the peatlands only five sites appear to have been listed — and only two of these were recorded as being of 'international importance'. The global significance of the Flows was not then emphasised to the present degree, but the Review concluded that "blanket mires . . . are interesting as the nearest equivalent to the tundra of the Arctic".

Damage by commercial afforestation was referred to, but there seemed scope for compromise through sensitive management in a qualifying statement: ". . . though in places where particularly wet areas have been left undisturbed among the new forests, they now have a greater degree of protection than before . . ." (as at Kielder).

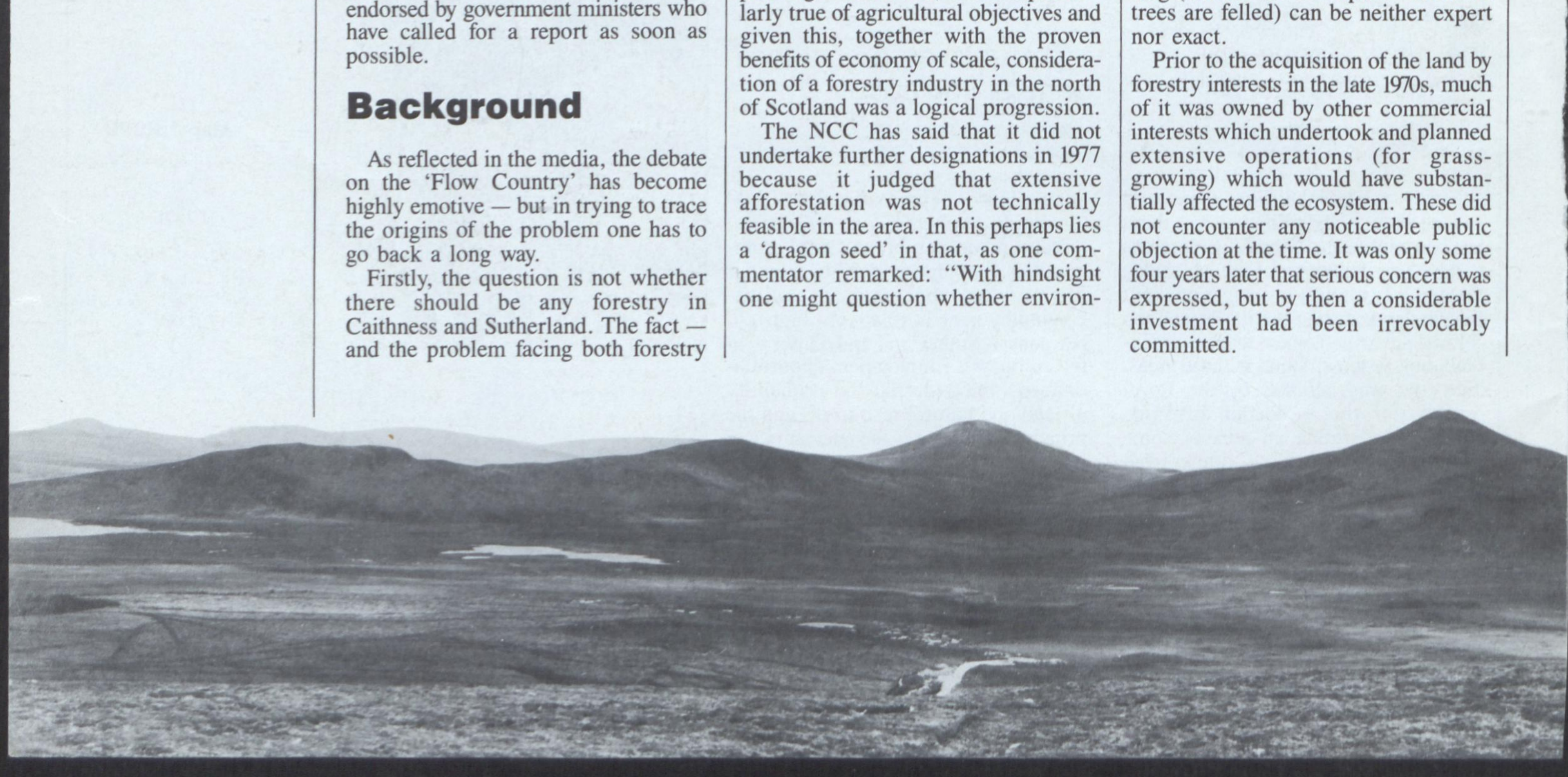
While surveys of the fauna, flora and birds were undoubtedly carried out, the dependence of those bird species on the Flows as their primary breeding site was not then claimed. By cross-reference, nor did the British Trust for Ornithology's *Atlas of Birds Breeding in Britain and Ireland* (1976) give such an emphasis.

There was no question therefore of commercial forestry attempting to flout or confront conservation interests. Indeed, these are accepted by the industry as a necessary constraint — as also are other policy objectives which can affect the availability of land for tree planting. In Scotland, this was particularly true of agricultural objectives and given this, together with the proven benefits of economy of scale, consideration of a forestry industry in the north of Scotland was a logical progression.

The NCC has said that it did not undertake further designations in 1977 because it judged that extensive afforestation was not technically feasible in the area. In this perhaps lies a 'dragon seed' in that, as one commentator remarked: "With hindsight one might question whether environ-

mental scientists — however expert in their own field — may be qualified to make valid judgements on likely technological developments in an industry of international dimensions." This lesson has present application insofar as other environmental bodies such as RSPB have expressed judgements on the likely return on the forestry investment, even though their knowledge of the subject, its important industrial dimension, the presently developing technologies (e.g. for countering windthrow), together with others relating to harvesting, transport and processing (which will be in place when the trees are felled) can be neither expert nor exact.

Prior to the acquisition of the land by forestry interests in the late 1970s, much of it was owned by other commercial interests which undertook and planned extensive operations (for grass-growing) which would have substantially affected the ecosystem. These did not encounter any noticeable public objection at the time. It was only some four years later that serious concern was expressed, but by then a considerable investment had been irrevocably committed.



A forestry industry in the north of Scotland

In observing the forestry operations themselves, TGUK visitors were impressed by the overall planning, design and technology deployed. A significant proportion of the land in private ownership is managed by Fountain Forestry Ltd — and because much of the area purchased is unsuitable (or not allowable) for planting, the company is also involved in alternative land uses, including sheep farming, stalking, fishing and tourism. These other activities therefore form part of an overall managed forestry complex.

In strategic terms, because of the geographic location and the relative concentration of ownerships, it has been possible from the outset to conceive an afforestation operation with the subsequent marketing and processing in mind, and the potential therefore exists for developing a genuinely integrated forestry industry in the north of Scotland.

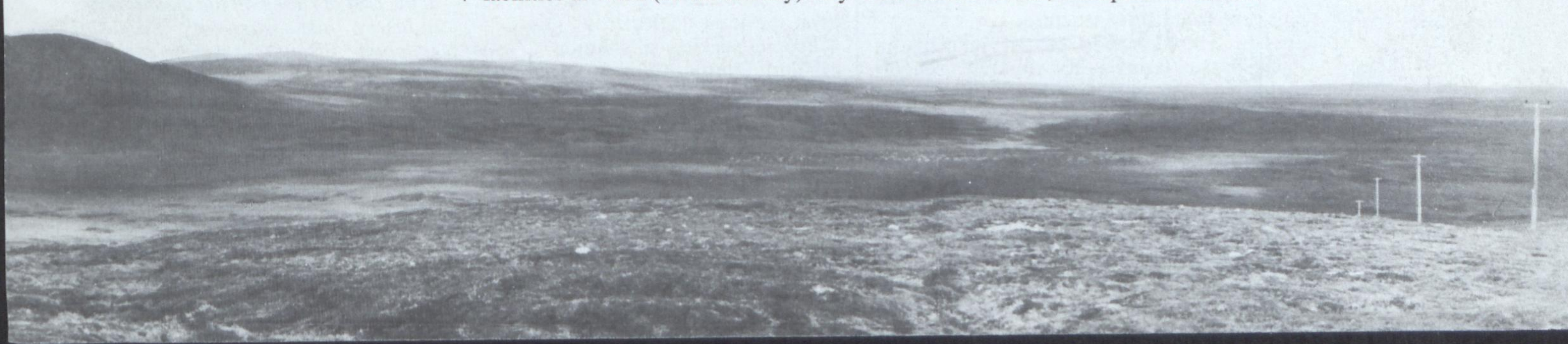
Whereas in most parts of the country timber flows in and out of a region according to supply, demand and the location of processing units, in Caithness and Sutherland it is both practicable and sound planning sense that the forestry system — as a 'wood chain' — can be enclosed within an identifiable, administrative geographic area. Social and economic benefits to the region accruing from this 'wood chain' could also be assessed on these terms.

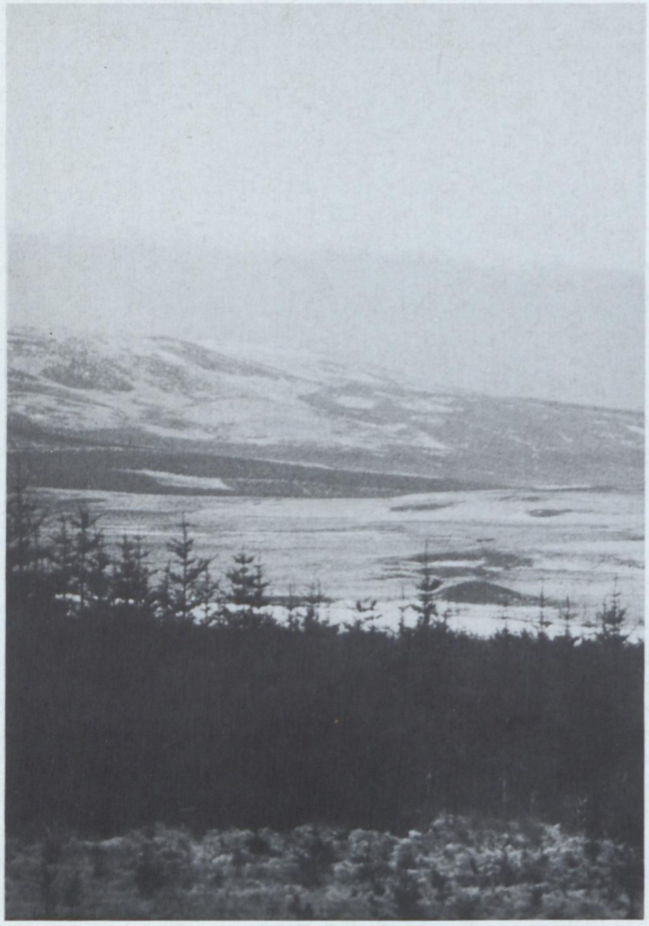
If, eventually, sufficient timber can be made available from these forests on a *sustained yield basis,* it will be possible to attract investment into a number of processing units which can be located either within or on the edge of the forestry complex itself. The several parts of the Fountain Forestry managed holdings are connected by an internal road system. A large proportion of the forest is located around the railway line. These factors offer the opportunity for the establishment of internal timber depots and whole tree harvesting (i.e. market selection and maximising the raw material).

In transport terms the burden of traffic will fall on forestry roads and not public ones. The railway enables timber to be moved quickly to the mills and the eventual product to be exported efficiently to the market. Harbour facilities at Wick (on the railway) may

George McRobbie of Fountain Forestry demonstrating the growth potential of sitka.

also facilitate the movement of processed material to the south. In investment terms, transport distances





(i.e. costs) may be minimised and in social/economic terms (i.e. local jobs) benefit would be maximised.

TGUK observers were not competent to comment on alternative opportunities for work in the area since the necessary expertise and planning rests with those local agencies whose responsibility this is. However, experience — based on other research — shows that a number of direct jobs both initially during planting (and for as long as this can be sustained) and latterly during harvesting are 'fixed' by the location of the plantations (which cannot like some inward investments be closed down and moved away). This offers a measure of stability, but it could be greatly extended if the processing sector — with all the other consequent inter-linkages — is also co-located.

In addition to purely forestry jobs one might reasonably expect to create employment on the railway, in haulage, road and machine maintenance, construction, service industries and other areas supplying (directly or indirectly) the forestry industry. Because the bulk of costs is made up of wages and salaries, this will inject money into the local economy, as most of it will be spent in the region and thus impact on local trade, shops, services and the regional infrastructure.

The demands of the industry in human terms — for children's schooling, medical facilities, transport, housing, food and commodities or in industrial terms for electric power, fuel, machine maintenance, hardware supplies etc, — also contribute to the general economics of the community. It has been estimated that, if the forest resource can achieve a rotation basis, between 1,500-2,000 jobs could be sustained. The value of this contribution is relative to the size and strength of the existing community, but in remoter areas the significance of its impact can be greater than mere numbers might suggest.

The NCC's call for a complete moratorium has therefore posed a serious problem. If all planting stops, then about half the existing forestry jobs will be lost immediately. Taking a longer view, the loss of potential jobs may be far greater. This means that more planting is necessary if the target of a 'sustained yield' is to be achieved.

If it is not achieved, then it is unlikely that investment in a local processing sector will be forthcoming since processors have to be assured of a consistent and continuous level of timber supply and there will be a consequent reluctance to invest in a location which risks dependence on a forest resource which cannot provide this. If therefore, the northern Scottish forests are insufficient to attract processing investment, the timber will have to be transported south; the cost eroding the value of the investment, and the opportunity lost for an integrated industry in the north.

The last four years have seen a major renaissance in the UK processing sector, with nearly £1,000 million of inward investment involving the latest technologies available in the world. Due to its remote location, Caithness and Sutherland cannot fully share in the advantages which this has brought to UK forestry further south. An integrated forestry industry in the north, however, would redress that balance of advantage to the south.

So the question is not whether there should be forestry in the north at all. It is already there, and depending on whether a solution can be found there is much to be gained — or equally a great deal to be lost.

HRC working party

As against this, the working party of the Highland Regional Council is obliged to consider the extent and significance of the conservation case. This must in turn depend on the scientific evidence presented and be examined on its merits.

However, any balance between conflicting environmental and development objectives needs also to be set against the requirements and aspirations of the local community, as expressed through those agencies (both administrative and democratic) whose responsibility it is to represent them. (And in the heat of the debate there is a tendency for this crucial aspect to be generally ignored, or at the least neglected.)

People seeking a solution to this difficult situation have therefore welcomed the initiative of HRC in introducing a structured and disciplined approach towards the resolution of what inevitably had become a highly emotive debate. The parameters of adjudication will require that emotive and irrelevant arguments are stripped away (and in so doing there will be some who might question the motive for their introduction in the first place) in order to discover whether or not a practical balance can be struck — which may in turn be recommended to government.

There are, however, certain new elements of the debate on which only government itself can decide. When the NCC called for a moratorium in the north of Scotland, it opined also that whereas a balance between conservation and development is the general objective (and is now embodied in statute), there are cases where — in conservation terms — 'absolutes' must prevail. The concept once stated, may demand resolution on a higher level and involve other arguments of precedent, accountability, the balancing of national objectives or the process of democracy itself. Thus, while the Highland Regional Council working party must seek a solution in the north of Scotland, there will remain other broader issues that can only be dealt with in the national dimension.

TGUK view

Throughout the great debate on the 'Flow Country', TGUK has advocated the need to find a 'middle way' if this can possibly be achieved without the extremity of a moratorium. This view was summarised in a short statement made by TGUK on 23 July when the NCC published its report *Birds, Bogs and Forestry* which formally recommended the moratorium.

"Everyone, including the forestry interests, recognises the ecological importance of the Flows as a feature in northern Scotland, and that their conservation should be a major concern.

'At the same time, forestry has come to the area (indeed it has been in the region for many years) and a great deal of money has been invested and benefits brought to the local community.

"When that forestry reaches rotation, it will form the basis of an important local industry, creating up to 1,500 stable jobs and supplying a number of mills which can be located in the area. To stop all forestry at this stage would be a 'blunderbuss' approach. We need surely to be selective and to try to achieve the optimum balance for all interests — and with particular regard for the local economy.

"There will be areas outwith the Flows where further forestry could take place without environmental damage — and the better, more rational approach is to identify those areas and how they should become available. To achieve a sustained timber yield that will fuel a local processing industry, some more planting is necessary. A practical, working balance will not be achieved at the cost of killing off the local forestry industry just when its potential economic advantages can be realised. It is not in anyone's interest to impose a sterilisation that will result in the loss of employment when we are concerned to create jobs.

"There must be room for a wider range of land uses (existing and potential) to co-exist with safeguards for conservation in Caithness and Sutherland."

CHANCELLOR OF THE EXCHEQUER

David,

Bedtime reading (for you, not PM!). Sensitivity is that we're not involving Rifkind @ this stage.

You'll see we hope to announce something in the Budget (probably exemption). But Ch firmly of view that conifers / broadleaf issue has to be handled via grant system not tax system.

Alex

CONFIDENTIAL

INLAND REVENUE
CENTRAL DIVISION
SOMERSET HOUSE

Ch/ See also note from Tom Burgner (below) AWK

FROM: M A JOHNS
DATE: 24 JULY 1987

CHANCELLOR OF THE EXCHEQUER

FORESTRY

FORESTRY

1. I attach an aide memoire for your meeting with the Environment Secretary and Minister of Agriculture on Monday. Miss Long's note of 20 July refers. It has been agreed with Treasury officials who have contributed the line to take on grants and privatisation.

2. We suggest that your key objectives for the meeting should be as follows:

(i) acceptance of the need to reform the tax regime for forestry;

(ii) recognition that this is bound to involve general review of forestry policy (as envisaged by the Prime Minister's ALURE group earlier this year);

(iii) agreement that first step should be joint paper by Treasury, DOE and MAFF (<u>not</u> at this stage consulting the other agriculture and forestry Departments) which could be sent to the Prime Minister and others on the ALURE group this autumn;

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cc	Chief Secretary	Mr Painter
	Financial Secretary	Mr Beighton
	Mr Burgner	Mr McGivern
	Mr Scholar	Mr Houghton
	Mr Bonney	Mr Elliott
	Miss Sinclair	Mr Johns
	Mr Cropper	Mr Pattison
	Mr Tyrie	Mr Streeter
		PS/IR

CONFIDENTIAL

(iv) paper should cover:

(a) tax reform;

(b) the consequentials for the grant regime and environmental objectives; and

(c) the scope for privatisation;

(v) the overall constraint should be no net increase in Exchequer costs and no hypothecation of putative privatisation receipts to the forestry programme.

This is spelled out more fully in Tim Burr's note behind. AK

3. As you know, the last objective is likely to be the most difficult to achieve because it implies that any increase in grants consequential on the tax changes should cost no more than £10 million a year. This could well not be enough to achieve the current planting target of 33,000 a year, particularly if the Government wishes to encourage a higher proportion of broadleaves (which already attract higher planting grants). We would not advise you to concede anything at this stage on the public expenditure figures until the implications of Exchequer neutral changes have been fully considered. In our view there is no need to feel particularly attached to the current planting target and the removal of tax reliefs could well have a significant effect on land prices which will need to be assessed. We recognise, however, that some concession in this area may be necessary at a later stage in the review process, particularly if the Scots are to be persuaded to accept tax reform.

M. A. Johns

M A JOHNS

CONFIDENTIAL

FORESTRY

AIDE MEMOIRE FOR MEETING WITH SECRETARY OF STATE FOR THE ENVIRONMENT AND MINISTER OF AGRICULTURE

Why a review now?

1. Manifesto commitment to tax reform. Ideal is to reduce rates of tax and get rid of reliefs which distort market signals. Tax treatment of forestry clearly anomalous.

2. Environmental lobby getting increasingly vocal about environmental, scenic and ecological objections to some types of forestry.

3. Before election Mr Ridley proposed to ALURE group of Ministers a radical review covering objectives of forestry policy, tax, grants and privatisation of the Forestry Commission. Ministers decided in January that the time was not then appropriate for a general review of forestry policy (David Norgrove's letter of 14 January). Reviews of this type are easiest to conduct shortly after an election so the time seems ripe to revive idea.

The present regime

4. Tax. An occupier of woodlands can opt for Schedule D treatment so that the expenses of planting can be set against other income; by engineering a change of occupation before receipts come in from felling he can secure a purely nominal charge on the receipts through Schedule B, a unique tax schedule just for forestry.

5. Tax therefore provides a net subsidy to forestry. The present cost of tax relief on planting is around £10m; when present forests are eventually cut down the tax foregone through Schedule B will cost over £100m a year at today's prices.

? abolish grant for conifers

6. Grants. The Forestry Commission provides grants at varying rate depending on the size of plantation and type of tree. (The lowest rates £240 per ha - about 25% of planting costs - are for large areas of conifers; the highest (£1200 per ha) for small areas of broadleaved trees). Planting is rarely carried out without grant aid but the grant represents a smaller proportion of total support than the tax reliefs.

7. Public ownership. The Forestry Commission established in 1919 now owns some 43% of the forest area in Great Britain (down from about 50% in 1980). The net operating costs of the Commission's estate (the Forestry Enterprise) are running at £30-40 million a year and are likely to continue at about that level for another 15 years until a larger proportion of its plantations have matured. Since 1980 the Government's policy has been to

encourage further private sector planting; to reduce the Commission's new planting to around 5,000 ha a year and to encourage it to "rationalise" its estate: disposals since 1980 have virtually reached the original £100 million target and some £44 million are planned for 1987-88 and the Survey years. The proceeds are credited to the privatisation programme not to the Forestry Commission in PES. There has as yet been no detailed study of full scale privatisation, although Mr Jopling proposed this in 1985 (and we suspect that Mr MacGregor would now favour one).

Criticisms of present regime

8. These were spelt out in Cabinet Office note of 12 December to Prime Minister and ALURE as follows:

a) economic justification for subsidy to limit imports not easily reconcilable with general trade policy,

b) social value of forestry as creator of jobs doubtful: new employment not necessarily located in areas where needed (and cost per job high),

c) environmental criticisms of scenic monotony, diminished wildlife diversity and loss of other habitats from large scale coniferous planting,

d) institutional appropriateness of Forestry Commission with multiple role as policy advisor, regulator and commercial forestry enterprise questionable. Last role may not be necessary,

e) fiscal arrangements give questionable advantage to owners with high tax brackets (frequently absentees).

Objectives for changes

9. Treasury Ministers' objectives are:

a) An end to the subsidies and major distortions in the tax system and a simpler system (while recognising there are special features in forestry compared with other businesses).

b) No increase in total Exchequer cost, i.e. grants should not increase by more than the £10m saved in tax relief.

c) A system which (through grants) encourages environmentally desirable planting, i.e. more broadleaves, fewer conifers. (Though this is principally for other Ministers and is only an objective if there is no increase in overall Exchequer costs).

d) If practicable, clear way for privatising Forestry Enterprise (though this is probably a long term objective).

10. Other Ministers may see as objectives:

a) Sustaining published ALURE target of 33,000 hectares a year planting. Treasury Ministers sceptical about economic and employment case for this.

b) Encouraging farmers to plant trees as means of reducing surplus agricultural production. (Treasury position reserved: cost effectiveness not yet demonstrated. Premature to propose major extension until ALURE farm woodland scheme evaluated after 3 year review (in 1991?) but current scheme should not be very much affected by tax changes).

<u>**Tax options**</u>

11. Treasury Ministers have considered a number of options. Treating forestry on all fours with other businesses would be very harsh (costs of planting would not get relief against other income because planted trees would be valued as "work in progress" in accounts). Charging to Schedule D and allowing (same) sideways relief has same effect on profitability as complete exemption. Ministers have concluded exemption is best: it abolishes subsidy element but still treats forestry more favourably than other businesses. Simple and yields £10 million fairly quickly. Effects on profitability shown in Annex.

12. <u>Inheritance tax</u>. There is a special relief for inheritance tax which enables tax on woodlands to be deferred. But this is second order issue, best left out of review.

13. <u>Differentiation between conifers and broadleaves</u>. Tax not a good instrument for differentiation. Rules would have to be crude. If discretion needed, best to use grants.

<u>**Grants**</u>

14. Grant consequentials will need careful thought. Should <u>not</u> simply assume that same level of incentives (or current 33,000 ha planting target) needs to be maintained (this would imply doubling or tripling current grant rates). Forestry undertaken solely for tax avoidance reasons likely to cease. No bad thing, as much of it damages environment for no economic benefit. Objectives for future forestry support will need careful definition. Economic case for supporting commercial forestry very weak. Could be case for more differentiated approach within overall expenditure constraint. DOE and MAFF should consider practical options and discuss costings with Treasury.

<u>**Privatisation**</u>

15. Right to consider privatisation of Forestry Enterprise as desirable long term objective. First step might be to separate commercial from regulatory functions of the Commission (i.e. split Forestry Enterprise from Forestry Authority). Then

commission merchant bank study of options for privatising Enterprise as going concern or piecemeal. Policy bound to be controversial (particularly in Scotland) and may not be achievable in short term given current operating losses and withdrawal of tax relief. No question of hypothecating any proceeds to increase forestry grants programme.

Handling of a review

16. Next step would be for three Ministers to agree a paper to put to Prime Minister and other Ministers in ALURE. If can't agree Treasury Ministers may need to put in such a paper anyway but more sensible to try and agree a joint line.

17. Accept that it will be difficult to have conclusions in time for 1988 Budget (but don't give up the possibility of an announcement of intention at this stage in order to keep pressure up). Must start soon if we are even to meet 1989 Budget.

18. Suggest officials of three departments try to work up a paper by mid-October.

ANNEX

EFFECT OF TAX OPTIONS ON RATES OF RETURN FROM PLANTING

The following figures should be regarded as broad approximations only (especially for broadleaves). They ignore the cost of land and assume the price of timber is constant in real terms:

Internal rate of return % (real)

	Conifers	Broadleaves
Before Tax (equal to return on forestry exempt from tax)	5.0	2.9
Present regime (without grants)	7.1	3.8
Present regime (with grants)	7.8	4.5

2182/009

SECRET AND PERSONAL

PWP

FROM: N MONCK

DATE: 13 August 1987

MR BURGNER

cc Mr Bonney
Miss Sinclair
Mr Corry
Mr J Taylor (Personal)

Mr M Johns, IR

FORESTRY

The following points emerged from a useful brief talk I had with the Chancellor on Wednesday evening:

(a) The Chancellor gave a little more detail than we have had so far about his talk with Messrs Ridley and MacGregor. They did not dissent from his proposition that the package should be Exchequer neutral, though he would not go so far as saying they were definitely signed up. The Chancellor was hoping for a joint paper. His own locus in sending it in the first instance to the Prime Minister would be based on a number of factors: his role as the senior ALURE Minister, his direct responsibility for tax, and his co-ordinating role on privatisation.

In practical terms this means that the draft circulated for the meeting on 9 September should not contain in the heading either a single attribution to the Treasury or to all departments. I will then at the meeting press officials to agree - probably at a later stage in September - to consult their Ministers before maintaining their line that the paper must be attributed to the Treasury alone.

(b) As you envisaged, the paper should be based on maintaining the constraint of Exchequer neutrality. If MAFF or DOE want to spend more we can explore that with them but omit it from the paper. The only exception to this policy of omission would be if MAFF can demonstrate a convincing case that increasing forestry expenditure by more than £10 million could be financed by CAP savings.

Thought it was more than this? Tell NM 13/8

(c) The Chancellor was strongly in favour of spending most or perhaps all of the £10 million on increasing the incentive to plant broad-leaved trees with the objective of winning the support of the environmental lobby. I reminded him of the new target for new planting announced earlier this year. He will want the paper to question the objective of planting on this scale, primarily by pointing out that it had little or no actual connection with ALURE and secondly that it would add to eye-sore problems. It would also not be justified by the passage on objectives which we agreed to insert into the paper yesterday.

(d) He wants the paper to be more positive than we had envisaged on privatisation. We should certainly not take the line that broad decisions on it can be deferred. We can argue for relocating the advisory/regulatory function and assert that privatisation of the enterprise side of the Forestry Commission can and should go ahead, though the precise timing and method may need further work. He agreed that this would probably be subject to getting some positive receipts out of the sale. But he is not envisaging the sale of the forestry enterprise as a single entity. The profile of the cash flow for the forestry enterprise as a whole may not therefore matter except insofar as the series of sales may need to be spread over quite a long period unless packages can be devised to shorten it. As I understand yesterday's discussion, there should be no problem about selling parcels of standing timber under the Chancellor's preferred tax regime, though land with very young trees (first two or three years) may not be sellable on its own. He will be happy to reflect the ideas of MAFF and DOE - he thought Mr Ridley had some concrete ideas - in our paper on the way in which privatisation should be achieved.

Although in some respects the Chancellor's emphasis differs a little from the outline we discussed yesterday, I think these can be taken care of in the Treasury editing or drafting of the paper to be discussed on 9 September.

Other Points

2. I will arrange for Mr Bonney and me to see Mr Lewis of DOE next week. Perhaps Mr Bonney could send him the outline we discussed yesterday, pointing out its amendment in some respects, on Monday morning, providing Mr Lewis has actually arrived!

3. As I mentioned, I hope Treasury and Revenue economists can for our own purposes work out a comparison of a "typical" CAP subsidy and the forestry subsidy under the old and new regimes.

4. Also for our own internal purposes, I wonder if we need some information about the treatment of forestry, whose characteristics are presumably similar in most parts of Europe, in other major European countries. If such information is helpful to us, we might circulate it outside the Treasury and Revenue. If not, not. But in any case it would be useful to be prepared for questions about this.

NM

N MONCK

CONFIDENTIAL

FROM: T U BURGNER
DATE: 10 July 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Scholar
Mr Bonney
Mr Cropper
Mr Tyrie
Mr Painter - IR

Thanks. A fair pt. But it has to be borne in mind that the ALURE package is meant to be a counterpart of CAP reform, which will save money.

TAXATION OF FORESTRY AND INTER-DEPARTMENTAL REVIEW

There is one additional point arising out of the conclusions of your meeting yesterday which you should have in mind when you see Mr Ridley and Mr MacGregor. At the meeting you expressed a wish to reduce the current distortions in the tax regime, even though this would involve additional public expenditure through larger planting grants. In fact in order to maintain the present rate of return (as would be necessary if people are to continue planting voluntarily) the level of planting grants would have to increase by a factor of 2 or 3 times. We assume, though this did not come up explicitly at the meeting, that you would be looking for a broadly Exchequer - neutral deal, ie an increase in public expenditure no greater than the additional tax collected by the Revenue. If a further environmental aim is added - namely to increase broadleaf planting at the expense of conifers, this will inevitably mean that the total area of new planting will fall and that the new target of 33,000 hectares a year announced as part of the Alure package will not be met. This is because the differential in the grant for broadleaf planting over conifers will have to be increased even further.

2. From the Treasury's point of view, a reduction in the total acreage of new plantings would not be a matter for concern. Forestry is basically an uneconomic activity subsidised by the Government and its wider benefits in terms of employment generation, public

recreation, tourism etc are questionable. But Mr Rifkind (once he is involved) will certainly challenge any reduction in forestry activity as a whole. Even Mr MacGregor may not want to act in a way which might be thought inconsistent with Alure. Treasury efforts to limit the increase in public expenditure could therefore have the effect of raising the question of the rationale for forestry in the inter-departmental review. That could lengthen the discussion in a way that would make the prospects of early action on the tax side unlikely.

3. Of course one could argue that any increase in public expenditure would be more than offset if at the same time the Forestry Enterprise were being privatised in whole or in part. But the Treasury does not normally accept privatisation proceeds as an argument for relaxing control over public expenditure: hence the proceeds are scored on a separate public expenditure programme. Moreover until more detailed work, including a merchant bank assessment, has been done, we cannot regard privatisation of forestry as being in the bag.

TUB

T U BURGNER

ps3/5K

CONFIDENTIAL

FROM: A W KUCZYS
DATE: 13 July 1987

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Burgner
Mr Scholar
Mr Bonney
Miss Sinclair
Mr Cropper
Mr Tyrie

Mr Painter - IR
Mr Johns - IR

TAXATION OF FORESTRY

The Chancellor discussed the Financial Secretary's minute of 3 July, and earlier papers, with the Chief Secretary, the Financial Secretary and others on Thursday, 9 July. The meeting considered first the substantive issue, of the most appropriate tax treatment for forestry; and then the question of how to proceed.

2. On the first question, the Chancellor said that the choice lay between option 3 (abolition of Schedule B with sideways relief available on the Schedule D charge) and option 4 (tax exemption). He was attracted to option 4. If anything, it was marginally tougher for the industry; and it had the great advantage of simplicity. Mr Painter pointed out the presentational objections to option 4: it would look like a handout to forestry, even though it was actually the opposite. It would probably be more contentious from the forestry industry's point of view. On the other hand, it would not be easy for forestry interests to complain publicly about exemption. Mr Scholar argued for option 2 (CGT treatment). However, the Chancellor felt that this would be too complicated.

3. Summing up this part of the discussion, the Chancellor said that it was agreed that the present tax treatment of forestry had

to change. Option 1 (Schedule D treatment) was the most "natural" approach, but it had to be accepted that this was not on. Of the others, option 2 was too complicated; options 3 and 4 had very similar economic effects, but option 4 was much the simplest. However, a final decision did not have to be taken now.

4. Mr Scholar noted that none of the options distinguished between conifers and broadleaves. The Chancellor said that it was agreed that we wanted to encourage broadleaves at the expense of conifers, on environmental grounds, but this was a task for the grants system, not the tax regime.

5. On the second question, of how best to proceed, the Chancellor said that this was one subject where we had to accept that tax changes would have to come about as part of the inter-departmental review. It would be very difficult to reach agreement on objectives with the Scottish Office. But we should try and achieve trilateral agreement between Treasury Ministers, the Environment Secretary, and the Agriculture Minister. The three Departments might put a joint paper to the inter-departmental review. Failing that, we should at least be able to secure agreement with Department of Environment. The paper should cover tax, grants (and securing environmental objectives) and privatisation of the Forestry Commission. We should seek to reach agreement as quickly as possible. To this end, the Chancellor would hold a meeting with Mr Ridley and Mr MacGregor in the near future.

6. The Chancellor thought it should be possible to reach agreement amongst the three Departments on tax and privatisation of the Forestry Commission without too much difficulty. But there might have to be "horse-trading" on the public expenditure side. The level of grants might have to be left unresolved between Treasury Ministers and the Minister of Agriculture in the joint paper.

7. The aim would be to make the tax changes in the first available Finance Bill after agreement was reached inter-departmentally. Realistically, that probably meant the 1989 Finance Bill. Mr Painter said that it would be helpful to announce the agreed package in advance of the 1989 Budget, to provide certainty and reassurance to forestry interests. The Chancellor said it was important to keep the three elements together as a package.

8. Following the Chancellor's discussion with the Environment Secretary and the Minister of Agriculture, discussions between the three Departments should proceed as quickly as possible. Within the Treasury, although the subject covered both tax and public expenditure, it would be appropriate for the Financial Secretary to take the lead.

AWK

A W KUCZYS

CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

FROM: FINANCIAL SECRETARY
DATE: 3 July 1987

CHANCELLOR

cc: Chief Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Burgner
Mr Scholar
Mr Bonney
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Painter I/R
PS/IR

TAXATION OF FORESTRY

I have now had the opportunity of discussing with officials the various options outlined in Mr Johns' note of 29 June and explained more fully in his note of 6 May. Although it is not necessary to decide now, my preliminary view is that the Revenue's Option 3 (Tax on Profits with retention of Sideways Relief) is the best of those available.

2. I was somewhat concerned about the transitional problem where the choice seemed to lie between an immediate capital loss or an enormously long transitional period (perhaps over one hundred years in some cases). I was assured, however, that the problem ought to be superable, if relief were given on a straight line basis from the date of the change. However, in my view this is something which clearly needs further examination.

3. I think that there is a strong argument for taking action in this area, and I am personally convinced by the environmental arguments. There are too many conifers at present and not enough broadleaved trees. I am also of the view, that it would be hideously complicated to have two separate tax regimes, one for conifers and another for broadleaved trees. I accept the argument that one must therefore seek to encourage the planting of broadleaved trees through the use of grants rather than via the tax system, (indeed there are already differential grants in existence to do this.) I am sceptical whether farmers will plant broadleaved trees for commercial reasons.

4. It is worth noting that the short term yield from Option 3 would be nil, while the long term yield would be some £100-£125m. It is clearly not primarily for reasons of yield, therefore, that we would take action. The real argument for action is to remove the present distortion in the tax system. (It is, of course, ironic that exempting commercial woodlands completely from tax would actually <u>increase</u> the tax charge).

5. I do not think that it would be politically realistic to take action unilaterally on this matter, since the Scots dimension alone would prevent us from doing that. It does seem sensible to me, however, to press for the inter-departmental review agreed by ALURE to start soon, probably in the early Autumn. The aim would therefore be to take action in the 1989 Budget. If we were to proceed on this basis, it was suggested you might announce your intentions in the Budget Speech of 1988. I think, however, that this would seem rather odd given that the final outcome would at that stage still be uncertain, and I would recommend against that.

N Williams

pp NORMAN LAMONT

4372/047 Note

CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

NOTE OF A MEETING IN FINANCIAL SECRETARY'S OFFICE, HM TREASURY ON WEDNESDAY 1 JULY TO DISCUSS TAXATION OF FORESTRY

Those present:	Mr Painter	IR
	Mr Beighton	IR
	Mr Johns	IR
	Mr Burgner)	
	Mr Bonney)	HMT
	Mr Haigh)	
	Mr Cropper	
	Mr Tyrie	

The meeting discussed Mr John's notes of 29 June and 6 May and also had before it Mr Bonney's note of 30 June.

2. Mr Painter briefly outlined and expanded upon the various options that had been set out in Mr Johns' note, and set this against the background of a special forestry relief which was in place because of the uniquely long forestry cycle and also the 'lumpiness' of profits in the industry.

3. Option 1 involved the abolition of Schedule B and the taxation of the occupier of commercial woodlands as a business under Schedule D. This was the treatment comparable with other industries but would be severe in its effects. Option 2 (Capital Gains treatment) would undoubtedly be difficult to operate over a long time-span and if capital gains indexation were to be abolished there would be the difficulty of having a special regime for forests. There could also be a long-term compliance cost and it would be very difficult for the Revenue to police. Mr Painter did not see this as a very workable or attractive option since it would in effect mean being locked into an awkward indexation regime.

4. Option 3 involved the addition of Schedule B with sideways relief available on the Schedule D charge. This would probably be the strongest runner in Mr Painter's view. Mr Johns said that the addition of front-end relief made it less severe than Option 1.

On purely presentational grounds alone Mr Painter thought that Option 4 would have to be ruled out since it would be very difficult to explain to the outside world that exemption would actually make the forestry industry worse off than at present.

5. Discussion moved on to the transitional problems that would be experienced if Option 3 were to be pursued. If there were no transitional relief and there was an immediate imposition of full income tax rates on s ales of timber there would be an immediate fall in the value of woodland. If, on the other hand, one were to make the change applicable only to trees planted in the future there would be a 100 year transitional period. Mr Johns said that there was a possible middle route which could give relief on a straight line basis. Mr Painter said that a system could be operated which would, in effect, follow the normal tax procedure with the forest owner putting in a claim and only when it looked to be dubious would the Revenue challenge it. If Ministers were prepared to be fairly generous here in order to gain added simplicity it should be possible to work up some system of this nature.

6. Turning to the subject of environmental differentiation, Mr Haigh remarked that all the options here, taken in isolation, would be detrimental to forestry. Mr Johns said that the present tax regime increased the rate of return on forestry by 50%. If Option 3 were pursued it would reduce the rate of return to 5% (the same as the pre-tax return) rather than the current 7.8%.

Mr Painter said that we must start from the basic premise that reform would be on the basis of a stiffer tax regime. If there were therefore to be a big tax differential to encourage broadleaves it would be necessary to penalise conifers excessively. The Financial Secretary said that he was reluctantly convinced that this would not be realistic.

7. Mr Painter said that the Chancellor had said that he wanted to look at the tax treatment of forestry on three grounds; its place in an overall tax reform strategy, the creation of a level playing field and the environmental angle. If we were to encourage broadleaved planting and also to achieve the Chancellor's first two objectives it would have to be done by way of differentially large grants. Mr Bonney said that this was already the case - in fact grants were twice as much for broadleaved trees.

8. As to the various options for future action, Mr Painter said that one route would be to impose a virtual 'fait accompli' on other departments while another would be to accept the need for an inter-departmental review. This could not start until the early autumn. Mr Burgner said that other Departments would be pressing on other grounds for the inter-departmental review to start in the Autumn and it should therefore not be difficult for tax to become a part of that review.

Mr Painter thought that this was the best route to follow. He also raised as a point for consideration the possibility of the Chancellor referring to forestry reform as part of a broader tax reform package in next year's Budget.

N Williams

NIGEL WILLIAMS
(Assistant Private Secretary)

3 July 1987

cc: PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir Peter Middleton
Mr Burgner
Mr Scholar
Mr Bonney
Miss Sinclair
Mr Haigh
Mr Cropper
Mr Tyrie
Mr Painter/IR
Mr Beighton/IR
Mr Johns/IR
PS/IR

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In principle there is a good case for a wide-ranging review, but the trade off between a more sensible tax regime and higher public expenditure via increased grants make the decision a tricky one for the Treasury. It will not be easy to contain the terms of reference as at the end of para. 4 [redacted]

MB 30/6

1. MR ~~BURGNER~~
2. FINANCIAL SECRETARY

FROM R J BONNEY
DATE 30 JUNE 1987

Copies attached for
Chancellor
Chief Secretary
Paymaster General
Economic Secretary

cc Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Scholar
Mr Turnbull
Miss Sinclair
Mrs M Brown
Mr G M White
Mr Fletcher
Mr Donovan
Mr Johns I/R
Mr Cropper
Mr Tyrie

FORESTRY POLICY

You are due to discuss Mr Johns's submissions on Forestry Taxation of 6 May and 29 June on 1 July. This note offers some comments on the implications for public expenditure and privatisation policy.

2. We fully agree with the Revenue that the present anomalous arrangements for forestry taxation seem a prime candidate for reform. But we also agree with them that the Chancellor would not be able to persuade Forestry Ministers to agree to forestry tax reform in advance of a more general review of Government policy in this area. It would certainly be claimed that correction of the current tax anomalies would effectively make private sector forestry uneconomic. The illustrative statistics on rates of return before and after tax quoted in Mr Johns's submission of 6 May would tend to confirm this. Thus, unless the level of overall support were restored by a substantial increase in public expenditure on grants, reform of the tax regime would effectively undermine the present policy of encouraging an expansion of private sectory forestry (see 1980 policy statement at Annex A).

Case for a Review

3. In addition to the taxation anomaly there are, as Mr Johns

85/188.

cognises, several strong arguments for a general review of forestry policy. These include:

(i) the doubts expressed by the National Audit Office amongst others about the economic case for a continued expansion of forestry: the current import saving objective is not recognised as a justification for public sector support in other sectors; and forestry seems to create relatively few jobs at a relatively high unit cost;

(ii) the question of whether the expansion of forestry and woodlands (as recommended in the ALURE context) is the most cost-effective solution to the problem of reducing agricultural surpluses by taking land definitively out of agricultural production and whether further incentives would be necessary to encourage tree planting on more productive land;

(iii) the criticisms of the environmental impact of current policy which has tended to encourage block planting of single species conifers on poor quality hill and moorland. The environmental lobby would claim that this tends to destroy landscape and wildlife habitats and would prefer incentives to be targetted on smaller areas of broadleaved trees; and

(iv) institutional questions about the dual role of the Forestry Commission which combines a regulatory function (sc.Forestry Authority) with running its own forestry estate (Forestry Enterprise), and the possibility raised by Mr Ridley that the Forestry Enterprise should in due course be privatised.

4. There is clearly a risk that a general policy review addressing these questions might conclude that the present public expenditure costs of the forestry programme (see the attached fact sheet) would need to be increased. This risk would be particularly strong if Ministers wished to:

(i) substitute grant support to compensate fully for the removal of present ta. concessions; and/or

(ii) encourage greater planting of native broadleaved species for environmental reasons (as these take twice as long to grow and already benefit from higher planting grants); and/or

(iii) encourage a substantial increase in tree planting on better quality agricultural land (going beyond the current ALURE proposals) as a means of reducing agricultural surpluses.

Any Exchequer savings on the revenue side from ending or reducing the current tax reliefs are difficult to calculate; would not be reflected in the PES planning total and might in practice be dissipated if higher rate taxpayers were able to make use of alternative tax shelters. Moreover, any increase in grants to compensate for the removal of tax reliefs would tend to have a more immediate impact on the Exchequer than the putative long term savings from tax reform. For these reasons, although there is a good objective case for a review, it would be important to ensure that its terms of reference were constrained to reassessing the validity of the objectives of current forestry policy and considering ways of achieving them more cost effectively by reallocating priorities within the existing level of government support.

Privatisation

5. A general review would need to address the institutional role of the Forestry Commission and the prospects for privatising the Forestry Enterprise. There is already a disposals programme which began with a £100 million target in 1980. Although these receipts are scored in the privatisation programme, the subsequent statement in 1984 made clear that the stated objective of the programme is to 'rationalise' the Forestry Commission's own estate. The previous Minister of Agriculture proposed a study leading to full scale privatisation (although he was not fully supported by the Secretary of State for Scotland who is the lead forestry Minister). Any privatisation proposal would be likely to involve contentious primary

gislation. It is not clear what sort of sales price could be obtained but it would certainly be substantially below the nominal asset value of £1.2 billion (based on a 3% discount rate) shown in the Commission's accounts, as any purchaser would need to make good operating losses (currently running at some £30 million a year) for several years until a larger proportion of its current plantations reach maturity. Clearly any changes to the tax regime would have major implications for the likely level of receipts from privatisation and indeed from the current more modest disposals programme. But failure to reform the tax arrangements could substantially increase Exchequer costs after privatisation in the longer term.

Timing

6. On the timing considerations in Mr Johns's minute of 29 June we doubt whether action in 1988 Budget is a realistic possibility, given the likely reaction of Forestry Ministers (including now, we suspect, Mr MacGregor) to a unilateral decision on tax changes. Any general review of forestry policy would be bound to take a considerable time to reach conclusions because of the wide range of interests involved (the last review in 1979/80 took over a year). If you are persuaded of the case for a general review and wish to be in a position to make changes to the tax legislation in the 1989 Finance Bill, it would probably be desirable to set the process in motion this year. You or the Chief Secretary would no doubt wish to confirm that Mr Ridley and Mr MacGregor still wish to proceed with the review before formally making the suggestion. The Prime Minister would need to be consulted and it would also be desirable to stipulate that any review should be under independent (Cabinet Office) chairmanship because of the number of interested departments which would need to be involved. Mr Johns's third option would in practice probably involve putting off tax decisions until the 1990 Finance Bill at the earliest, while allowing the pressure for increased expenditure on grants for more attractive trees and ALURE type projects to build up ineluctably in the meantime.

RB

R J BONNEY

055 1152

FORESTRY: BACKGROUND FACTS

£ million

	1987-88	1988-89	1989-90	1990-91
1. PUBLIC EXPENDITURE				
<u>Baseline</u>	53.8	54.2	55.1	56.5
Of which				
Grants to private sector	8.3	8.8	9.6	9.8
Other Forestry Authority expenditure	13.7	14.6	15.2	15.6
Forestry Enterprise net expenditure	31.8	30.8	30.3	31.0
planned receipts from disposals	-13.0	-12.0	-12.0	-
<u>Likely 1987 survey bids (related to ALURE proposals)</u>				
Grants:				
traditional forestry		2.3	2.4	2.4
farm woodlands		2.2	4.6	4.8

2. FORESTRY AREA (GB)

Thousand hectares

	1980			1986		
	Conifers	Broad-leaves	Total	Conifers	Broad leaves	Total
Forestry Commission	834	50	884	838	51	889
Private sector	521	344	865	623	548	1171
Total	1355	394	1749	1461	599	2060
(% of total)	(77.5)	(22.5)		(70.9)	(29.1)	

3. FOREST PLANTING

Thousand hectares

	1980		1986	
	new planting	Restocking	New Planting	Restocking
Forestry Commission	15.8	5.7	4.3	7.3
Private sector	8.6	3.1	19.9	4.3
Total	24.4	8.8	23.3	11.6

target for new planting 1980-1986: 30,000 ha per year
1987- : 33,000 ha per year.

056 1152

4. FORESTRY EMPLOYMENT

	1980	1986
Forestry Commission	8,000	6,000
Private Sector	11,000	12,000
related processing	33,000	27,000

5. RATE OF RETURN FROM FORESTRY

Forestry Commission
financial target (1982-87) 2.25%
expected outturn: 2.9%

		conifers	broadleaves
private sector	before tax:	4.9%	2.7%
	after tax:	6.7%	3.7%
	after tax and grant:	7.3%	4.3%

(Source: Mr Johns's submission of 6 May)

057 1152

ANNEX A

Forestry Policy (Review)

The Secretary of State for Scotland (Mr George Younger): The Government have now completed their review of forestry policy and with your permission, Mr. Speaker, I should like to make a statement.

With the projected rise in demand for timber into the next century and with the world's forests likely to come under increasing pressure, the Government believe that long-term confidence in both forestry and wood-processing industries in this country is fully justified. We look for a steadily increasing proportion of our requirements of timber to come from our own resources. A continuing expansion of forestry is in the national interest, both to reduce our dependence on imported wood in the long term and to provide continued employment in forestry and associated industries.

Recent difficulties in the pulp and paper sector, which represents only one-eighth of the market for wood grown in this country, do not change that conclusion. Forest owners have adjusted to the changed markets. Export opportunities in Europe for small roundwood are being successfully exploited. Looking further ahead, our industries, with the more advanced processes being developed in this country, are expected to be capable of absorbing the rising production from our existing forests, and of enlarging their present 9 per cent. share of the home market.

There should be scope for new planting to continue in the immediate future at broadly the rate of the past 25 years while preserving an acceptable balance with agriculture, the environment and other interests. We see a greater place for participation by the private sector in new planting, but the Forestry Commission will also continue to have a programme of new planting, in particular where it will contribute to the rational management of its existing plantations, and also in the more remote and less fertile areas, where afforestation will help maintain rural employment.

The main basis of policy for the future must remain the successful and harmonious partnership between the private sector and the Forestry Commission. In accordance, however, with the Government's support for private enterprise and our policy of reducing public expenditure, a determined effort will be made, by making better use of the capital invested in its existing assets, to reduce that part of the commission's grant-in-aid which finances the forestry enterprise. We therefore propose to provide opportunities for private investment in these assets, including the sale of a proportion of the commission's woodlands and land awaiting planting, with lease-back arrangements where it is important to maintain continuity of management to meet wood supply requirements or to preserve environmental interests. In planning its broad implementation of this policy, the Forestry Commission will take account of the views of the organisations concerned. We will seek an early opportunity to take the necessary powers for private investment in commission assets on these lines.

Following a review of the administration of grant-aid and felling licensing, carried out under the auspices of Sir Derek Rayner, we propose to make these less complex and less costly to administer. A single new scheme will be introduced at the start of the next forest year on 1 October 1981, of which the main features will be planting grants, a simplified plan of operations and a minimum of legal formalities. The basis III dedication scheme and the small woods scheme will accordingly be closed as from 1 July 1981.

Existing dedication schemes will continue for present participants, although some procedures will be simplified and individual dedication agreements will not be renewed on a change of ownership. The felling licensing system will be simplified to recognise the change in circumstances since this was introduced. Copies of a consultative paper, on which the various interested parties are being invited to comment, have been placed in the Vote Office.

As my right hon. and learned Friend the Chancellor of the Exchequer has already informed the House, the Government intend to continue the current income tax arrangements for forestry in order to maintain confidence in the private sector.

CONFIDENTIAL

INLAND REVENUE
CENTRAL DIVISION
SOMERSET HOUSE

FROM: M A JOHNS
DATE: 29 JUNE 1987

You may feel it would be helpful to focus on the questions of timing, rather than the technical tax options, at this stage, particularly in the light of Mr Johns's para. 12.
[redacted]
29.6

1. MR PAINTER

2. FINANCIAL SECRETARY

TAXATION OF FORESTRY

We are discussing my note of 6 May on 1 July. You may find it helpful to have this shorter note summarising the state of play and the options as they now appear following the election. The issues which have to be decided are whether

- to work up any of the options for change with a view to action in the 1988 Budget, without at this stage consulting other departments,

- or to suggest to your colleagues in other departments that the interdepartmental review of all aspects of forestry (including tax) which was suggested by the ALURE group of Ministers before the election should now be put in hand,

---

cc Chancellor of the Exchequer
Chief Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Burgner
Mr Scholar
Mr Bonney
Miss Sinclair
Mr Cropper
Mr Tyrie

Chairman
Mr Isaac
Mr Painter
Mr McGivern
Mr Houghton
Mr Beighton
Mr Lawrance
Mr Elliott
Mr Battersby
Mr Cayley
Mr Pattison
Mr Johns
Mr Streeter
PS/IR

- or to wait until the 1988 Budget is out of the way before taking further action.

2. The ALURE group decided on two immediate measures connected with forestry and one which was to be deferred. The immediate steps were an expansion of traditional forestry (which has no tax implications apart from an increase in the cost of the existing tax reliefs for forestry) and a new farm woodlands grant scheme to encourage farmers to convert parts of their farms to woodland. These two measures were announced in a consultative document in March; Agriculture Ministers are now considering the responses and the next step will be for them to put proposals for implementation to their colleagues. It is agreed between departments (and was made clear in the consultative document) that the new farm woodlands grants would be taxable. We think specific legislation (a clause of not more than half a page at most) will be necessary to ensure this. We will put a submission forward on this in the normal Autumn Finance Bill Starters exercise unless MAFF ask for an announcement on the precise tax treatment to be accelerated, in which case we will have to come back sooner.

3. The third proposal, which was endorsed by ALURE but deferred for action until after the election, was for an interdepartmental review of the whole basis of government support for forestry. The present system consists of a mix of grants and tax reliefs. it is very effective in producing a high volume of planting of trees but it is frequently criticised for a number of reasons;

- the reasons for subsidising planting at all are questionable. Support started for strategic reasons but timber is no longer a key strategic resource. Other arguments are import saving (but we do not have a general policy of supporting import saving), boosting jobs in remote areas (but the cost per job appears high), and environmental (but some forests are criticised as spoiling wildernesses, and as being poor ecologically). The case for support has been periodically examined in the past but Mr Ridley in particular felt that a new look was desirable.

- The methods of support encourage block afforestation by conifers (since this is generally the most economic form of planting). Mr Ridley wanted to see the emphasis change to broadleaved trees with greater environmental sensitivity on where planting took place.

- Much of the country's woodlands are still public sector and Mr Ridley wanted to see the Forestry Commission privatised.

- Much of the support for the private sector is by tax relief which is most beneficial to top rate taxpayers. This leads to forestry being criticised as a tax shelter exploited by City and entertainment personalities.

4. My note of 6 May explains the present tax system in detail, but in any tax reform programme which is aiming at simplifying the system and removing shelters and reducing rates, the special forestry rules look very obvious candidates for review. Effectively existing tax rules give a subsidy taken up by top rate taxpayers: foresters would be worse off if woodlands were exempt from tax. And there is a special tax Schedule (Schedule B) retained solely for forestry which is at a nominal rate on receipts (while most of the costs get relieved against other income).

5. Indeed there is a risk that the present position cannot be maintained indefinitely without change if there is no review. Schedule B is based on the annual value of the land on which trees are planed; historically we have always used values from the last time agriculture was valued for rates which was in the 1920's (after which agriculture was derated). We are having to look again at our practice in calculating annual values for a variety of purposes for income tax now that domestic rates and valuations for rates are to be abolished. It could be difficult to maintain a wholly out of date basis of valuation for forestry while updating valuations, e.g. for the taxation

of benefits in kind on housing provided by employers. We can defer action if there is to be a review but may have to come back to Ministers either to legislate to enshrine 1920's values or to modernise if there is no review.

6. On the other hand, any change will be controversial with the Agriculture departments and the forestry interests. Unless there was a substantial increase in grants at the same time as reform of the tax system the volume of planting could fall off dramatically. This would be at a time when the thrust of the Government's agricultural policy is to encourage farmers to diversify away from CAP-supported activities, where forestry is an obvious alternative.

7. The previous Chief Secretary was considering the possibility of our working up tax reforms for the 1988 Budget. If we are to do so we need early decisions because the subject is complex and technical. And even if a full review of forestry did not take place we assume you would want to consult your agriculture colleagues rather than present them with a fait accompli in the budget. They could be expected to argue that there should be no action without a full review covering objectives of forestry policy, public sector involvement, and grants as well as tax.

8. There is a problem on interaction with wider proposals for tax reform. It would be difficult to analyse the effects of the options when the background against which they would operate had not finally been settled. This would be particularly so if other departments were involved in a review where they could not be shown the whole picture. Legislation in Finance Bill 1988 might well be squeezed out by pressure of space and by the need to have other proposals firmed up before forestry could be fitted in. You might feel no more could be done than for the Chancellor to announce his intentions in the Budget Speech but legislate in detail in 1989 (possibly with a consultation document in between).

9. A decision is now needed on whether:

a) to start work unilaterally within the Revenue to keep open the option of a detailed announcement in Budget 1988 and legislation in Finance Bill 1988; or

b) to press for the interdepartmental review agreed by ALURE to start soon; or

c) to wait until after Budget 1988 before taking further action in order to let the general outline of tax reform be settled first.

10. The first course would fit into the Chancellor's strategy for a tax reforming Budget in 1988 but it will be difficult to look at tax in isolation and difficult to resolve the non-tax consequentials by Budget 1988. You would need rapidly to turn to the subsidiary questions set out in paragraph 48 of my note of 6 May.

11. The second course would get forestry moving across the board but to a slower timetable. There would be a risk of confusion until next Spring as other departments would not know what was in hand on tax reform generally but meanwhile progress could be made in other areas. If you are attracted by it, the best approach might be for you or the Chief Secretary to sound out Mr Ridley who was the main advocate of a comprehensive review of forestry previously. There are public expenditure implications in any review and Mr Bonney in the official Treasury will advise on these.

12. The third course involves the slowest timetable of all and you would no doubt want to consider carefully how it would mesh in with the opportunity offered by the Government's first post-election period of tax reform. It carries the least risk of confusion.

13. The public expenditure aspects of forestry are within the Chief Secretary's field of responsibility whereas tax is within yours and you may want to consider with him how you want the interactions handled.

J.A. Harris

p.p. M A JOHNS

CONFIDENTIAL

The C.G.T. option (para 23.) is a new idea. Mr Johns has already identified in the paper some of the problems with it and it would look very different unless a radical reform of C.G.T. itself. I have argued in earlier minutes that retention of Sch. B in a 'reformed' regime looks distinctly unattractive: that remains my view.
J 16-5

INLAND REVENUE
CENTRAL DIVISION
SOMERSET HOUSE

[Mr Brooker ✓ copy]

FROM: M A JOHNS
DATE: 6 MAY 1987

1. MR PAINTER ✓

2. CHIEF SECRETARY

THE TAX TREATMENT OF FORESTRY

1. In my note of 13 April I promised you a submission on the options for a radical change in the tax treatment of forestry. A provisional package had, as I explained, been agreed by Treasury Ministers as the objective to pursue in the inter-departmental ALURE discussions. But in the event, Ministers decided in ALURE that there was a strong case for a fundamental review of forestry policy including the tax incentives but that the time was not ripe. In this note we have gone back to first principles to consider the options which could be pursued rather than restrict our analysis to the package provisionally agreed last year.

2. This note does not address the possibility of Inheritance Tax changes. At present standing timber in a forest run on commercial lines is entitled to the IHT relief for business assets and there are in addition special rules to allow deferment

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cc	Chancellor of the Exchequer	Chairman Mr Isaac
	Financial Secretary	Mr Painter
	Economic Secretary	Mr McGivern
	Minister of State	Mr Houghton
	Sir Peter Middleton	Mr Beighton
	Mr Burgner	Mr Elliott
	Mr Scholar	Mr Battersby
	Mr Bonney	Mr Cayley
	Miss Sinclair	Mr Pattison
	Mr Cropper	Mr Johns
	Mr Ross Goobey	Mr Streeter
	Mr Tyrie	PS/IR
		Mr Lawrence

of the tax until the timber is cut down and sold. It would be possible to remove the special deferment rules and treat timber like any other illiquid asset (i.e. with tax payable in instalments over 10 years) or, indeed, to remove business relief as well and treat timber like passive investments such as shares which are subject to the tax in full. If you were interested in pursuing either option we could let you have a further note but you may prefer at this stage to concentrate on the major issue of the income tax treatment.

OBJECTIVES FOR CHANGE

3. There are three main issues about the objectives of any change which need to be settled before the options can be assessed.

Neutrality or support for forestry?

4. The first issue is whether forestry should be put on all fours with other industries and investments or whether there is a case for encouraging new planting of trees beyond what market forces would produce under a neutral tax regime. The arguments usually advanced for Government support for forestry are:

a) The UK imports over 90% of its timber and a subsidy is needed to build up a strategic reserve, especially in view of a likely worldwide shortage of timber in the next century as forests abroad are cut down. Timber is, however, no longer an obvious strategic material militarily. And as far as an economic reserve is concerned, if the private sector foresees a shortage it should be prepared to invest in the expectation of rising prices without Government support. And against the likelihood of reduced supply of timber has to be weighed the possibility of substitute materials for wood emerging especially if prices start to rise. Only if the Government believes that "short-termism" in what is inevitably a very long-term market is likely to lead to under-investment should it intervene.

b) Benefits to rural employment. Forests provide jobs in parts of the country where other work is scarce (both directly and through associated industries such as paper). A full scale study of cost per job would be necessary to assess whether assistance to forestry is the most cost-effective way of providing jobs but previous studies have tended to cast doubt on this.

c) Amenity benefits. Forestry enhances scenery and provides amenity to holiday makers and this justifies a subsidy. Again there is an issue of priority as opposed to other environmental expenditure on which other departments' views would have to be sought. Moreover, it is not all gain: there is widespread criticism from the environmental lobby that <u>some</u> forests detract from both scenery and ecology.

d) An argument that weighed quite heavily in the ALURE context was that the level of subsidy on woodlands was actually less than if the same land was used for agriculture so long as the Common Agricultural Policy remains unchanged. The correct solution is, of course, to reduce agricultural subsidies and not to increase forestry subsidies to compensate. However, the Government may be forced onto second best solutions by what is practical.

<u>Should support be by tax break or grant</u>?

5. If it is felt that some support is necessary the next question is whether it should be provided through the tax system or directly by grant (or, as at present, by a mixture of both).

6. The major disadvantage of giving support by tax relief is that it provides a disproportionate tax break for those with high incomes which can be criticised as inequitable. The general thrust of the Government's tax policy has been to get away from special tax reliefs for favoured activities and instead to reduce

rates of tax generally. Forestry reliefs have been widely criticised as providing unjustified tax shelters to City and entertainment personalities. Forestry did not show up as one of the most important shelters in our survey of high earners' tax shelters (my note of 17 October 1986 on Minimum Tax) but it is widely advertised as a medium for tax saving and, unlike many alternatives such as BES, there is no limit on the extent to which any one individual can take advantage of it. Tax reliefs also have the disadvantage of not being transparent: while the cost is published in the Public Expenditure White Paper, they are not subject to the same scrutiny and control as public expenditure support while being equally a drain on the Exchequer.

7. Against this, the main advantage of tax relief is that it involves less bureaucratic interference with individual investors' decisions than a typical grant system. With a grant the investor has to get individual decisions approved; with tax relief he merely has to satisfy general conditions set out in statute. It might be felt that another advantage of grants it that the cost of support does not add to public expenditure totals; but this is the other face of the lack of transparency. mentioned above. Finally, it is easier potentially to defer the cost of tax relief to the Exchequer; tax reliefs can be concentrated at the end of a forest's life by reducing the tax on receipts from felling, whereas grants are more naturally given at the front-end when the decision to plant is taken. Again this is not all gain - the costs of tax relief are hidden by the deferment and are a substantial bill which will have to be met by the Exchequer in the next century.

Environmental considerations: the case for differentiating between woodlands?

8. The third issue, regardless of whether grants or tax reliefs are employed, is whether the regime should differentiate between different types of woodlands on environmental grounds.

9. The environmental lobbies are by no means united in their approach to forestry but there is a general thread of criticism of existing tax policy that it leads to afforestation of land which would otherwise be left bare with large blocks of conifer forests which are unsightly, discourage wild life and pollute water by acidification. In areas like the Scottish "flow country" they are criticised as spoiling a unique wilderness habitat. This is not because the tax system positively favours this sort of forestry: tax does not discriminate by type or location of forests. Rather, conifer forests in large blocks on poor land show the highest rates of return compared with alternative uses of the same land. They are more profitable than broadleaves because of their shorter life-cycle. So a tax system which encourages forests leads to conifers disproportionately being planted. There have been some suggestions that as the tax system encourages planting by top rate taxpayers it encourages planting by absentee landlords who are less sensitive to the environment than locals would be. We have, however, seen no firm evidence on the point and the Forestry Commission in discussions with us were sceptical.

10. If some differentiation were thought to be desirable, it would be necessary to decide whether it should be by a broad-brush approach of "conifers bad, broadleaves good" or by a more subtle approach of "the right tree in the right place". While generally there appears to be a predisposition to regard broadleaved woodlands more favourably than conifers on environmental grounds, it is arguable that the environmental problems are not caused by conifers as such but the wrong sort of conifers in the wrong places. In the right places conifers may be as deserving of support as broadleaves.

<u>Conclusions on objectives</u>

12. In the Revenue, we are not in a position to assess the weight of these arguments without the sort of inter-departmental consultations envisaged by ALURE and one approach would be to defer your final decision until this is possible. Alternatively

you may feel that a broadly neutral tax regime - consistent with the thrust of tax policy generally for neutrality - should be settled first and then the grant structure (if any) constructed to encourage whatever planting is desired over and above what market forces would produce. Certainly a clear view by Treasury Ministers on the proper tax system would help to focus the attention of other Departments on the need for achieving a more rational overall regime.

THE PRESENT REGIME

13. At present an occupier of woodlands managed on a commercial basis with a view to profit is taxed under Schedule B. This is in principle a tax on one-third of the value of the land in its natural state but, in practice, because the valuations on which it is based date back fifty years, it is a purely nominal charge (on average about 15p an acre). In addition the taxpayer has an option to elect for Schedule D. The normal practice is for an occupier in the early stages of a woodland when costs are heavy and there are no receipts to elect for Schedule D. He is then able to claim the expenditure as a loss and set it sideways against other income for tax purposes. An ordinary commercial firm would probably not show this as a loss in its accounts because it would carry forward the planting. Most probably the expenditure on planted trees would be shown as work in progress or stock in trade and be shown as an asset in the accounts at cost. However, under case law it has been held that for the purposes of the Schedule D option standing timber does not constitute stock in trade and so for tax purposes the forester is able to claim a loss.

14. An occupier cannot change his election so it is normal when a woodland reaches maturity and starts to produce receipts to engineer a change of occupation. (This can be an arm's length sale or just a transfer to a family trust or another member of the family). Consequently, although the expenses have received tax relief (at 60% if, as is usual, the first occupier is a top rate taxpayer), the receipts are effectively exempt. If timber

was treated as stock in trade, the old occupier would be liable to income tax at his marginal rate on the increase in value of his timber to the date of disposal. But because of the case law mentioned above he escapes income tax. The new occupier will be liable to Schedule B and effectively pay no tax on the receipts.

15. The Annex to this note sets out our understanding of the economics of a typical conifer plantation and a typical broadleaved plantation. The figures are derived from information provided by the Forestry Commission but the Commission have not vetted them in detail and they may well need considerable revision on discussion with other departments. Figures for individual plantations will in any case vary according to position, quality of soil, etc. It can be seen that the pre-tax internal rate of return on the conifer plantation is increased by tax from 4.9% to 6.7% and that on the broadleaved plantation from 2.7% to 3.7%.

16. In addition there are substantial grants available from the Forestry Commission provided they approve the plans for planting; these further increase the rates of return to the investor to 7.3% for conifers and 4.3% for broadleaves.

WHAT WOULD NEUTRALITY CONSIST OF?

17. So far I have spoken of a neutral tax system as if this were an unproblematic concept. However, even if it were agreed that no special support should be given for forestry there would be room for disagreement on what the proper tax treatment ought to be. Forestry is somewhat of a hybrid between a business activity and a passive investment (like investment in fine art or equity shares). It would in principle be possible to differentiate between investors for whom forestry was run on business lines (e.g. farmers who combined farming with growing trees) and those for whom it was an investment (e.g. entertainers or City businessmen). And some thought was given last year to distinguishing between working farmers and others. But in practice the dividing line would be arbitrary and contentious.

It would seem preferable for all commercial woodlands to be treated the same way. A decision has to be taken on whether to align it broadly with the Schedule D Case I rules for businesses or with one of the various regimes for passive investments.

18. Forestry is also unusual in its very long life cycle between initial expenditure and eventual receipts from felling. So, if it were regarded as a business, it would raise questions about whether initial expenditure should be allowed to create losses which can be carried sideways and set against other income or whether such expenditure should be carried forward treating the expenditure on the planting and maintenance of the trees as well as the expenditure on the trees themselves as being in the nature of stock in trade and work in progress. As explained above the Courts have held the former, but in economic and accountancy logic there is a lot to be said for the latter view. But if the latter view is taken, forestry would suffer compared with other businesses because of the very long time it would have to wait for relief for expenditure, during which time even modest inflation would substantially erode the value of the relief. There would be a case for special relief for forestry to compensate for this (at the risk of creating precedents for other businesses with fairly long life cycles such as whisky distilling). There is also a problem that receipts are lumpy and could push taxpayers into higher rates of tax without some measure of spreading.

19. If, by contrast, forestry is regarded as a passive investment there are a variety of different tax treatments for savings with which it can be aligned. The most obvious, probably would be to treat it like, say, fine art: to allow no relief on the initial expenditure but to treat any increase in value over cost as a capital gain. But an alternative would be to continue to regard the receipts from felling as income. If no privilege at all were given to forestry this would imply giving no income tax relief for the initial expenditure and charging receipts less expenditure in full to income tax. But there is a range of other investment media which receive some degree of privilege and an

alternative would be to align forestry broadly with one of these. There are two main models: the pensions fund type of treatment where relief is given on the initial investment but eventual receipts are charged in full and the PEP's type of treatment where no relief is given on the initial investment but the receipts are exempt.

20. This means that even within normal tax principles there are a variety of options which could be justified. Four are considered further here, in decreasing order of severity on the industry.

THE OPTIONS

Option 1 - Treatment as a Business on Normal Accountancy Principles

21. Schedule B would be abolished and the occupier of commercial woodlands would be taxed as a business under Schedule D Case I. In addition timber would be treated as stock in trade. This would mean that a forester no longer made large losses in the early years and so was unable to take advantage of sideways relief against other income. On selling the timber (either felled or standing) he would be taxed on the difference between receipts and expenditure during his occupation. (A broadly similar result could be achieved by continuing not to treat timber as stock in trade but legislating directly to stop sideways loss relief for woodlands and to charge disposals of standing timber to tax).

22. This would be the most onerous basis of taxing forestry (more onerous than has been proposed in previous reviews) but would put forestry on all fours with other business activities. However, as explained above, it could be argued that the special features of forestry would justify some amelioration. The lumpiness of receipts could be dealt with by some form of spreading provision. But the effect of inflation in eroding the real value of tax relief for expenditure could only be met within

this approach by the revival of some form of stock relief which would expose Ministers to claims for similar treatment by other industries adversely affected by inflation. (The whisky industry has been pressing strongly for the last 3 years). Another corollary of this option would be that tax exempt institutions such as pension funds would be liable tax on forestry (as trading activities are not exempt) so reducing its attractions for institutions compared with other investments. There could be a specific exemption for institutions if Ministers wished, though there is no particular need to extend the privileges of pension funds.

h/ See Terry Painter's manuscript note at head of this minute. CWK

Option 2 - Capital Gains Tax Treatment

23. The commercial occupation of woodlands would be taken out of income tax completely and put within the capital gains tax regime (i.e. treating it as a passive investment). This would mean that there was no immediate relief on expenditure but when timber was sold (either standing or felled) the deduction for expenditure in the capital gains computation would be enhanced by indexation relief. And the problems of lumpiness of receipts would be less serious because capital gains tax is charged at a maximum flat rate of 30%. Special rules would need to be laid down for computing the eligible expenditure as the present CGT rules are not easily applicable to the sort of expenses incurred in forestry. These would be detailed and complex. And there might be problems over defining what the asset disposed of was. Moreover the difficult question would be raised of how far in principle the tax system should be indexed, in particular whether some sectors and not others should qualify for what would effectively be a form of stock relief. The charge would also be only partial in its impact. There is a large annual exemption, retirement relief and total exemption on death. The logic of this approach would also involve pension funds and similar bodies being exempt as they are on other passive investments (though again this could be explicitly overridden if so desired).

Option 3 - Tax on Profits but retaining Sideways Relief

24. Schedule B would be abolished and the occupier of commercial woodlands would be liable to Schedule D Case I as a business. Unlike Option 1, timber would not be treated as stock in trade, so the forester would have tax losses in the early years which he could set sideways against other income. It would, however, be most desirable to introduce a charge on the sale proceeds of standing timber when that timber was sold with the land. At present this escapes charge but when the trees are subsequently felled the purchaser (if liable to Schedule D - which he normally is not) is liable to tax on the full value of the timber without any deduction for the price he paid for it. Under this option the purchaser would not be able to opt for Schedule B and so long as institutions were also taxed on the profits from woodlands, the price the purchaser paid for standing timber would reflect the (discounted) cost of the tax which would eventually be due. The seller would therefore indirectly bear some tax on the increase in value of the woodlands. But the more direct and straightforward way of ensuring that tax was paid (rather than replicate the present position where relief is given on expenditure but no tax paid on receipts) would be to impose a charge on the value of standing timber disposed of.

25. This option would treat forestry more favourably than other businesses (but less favourably than at present). The privilege could be justified by reference to the special features of forestry in particular the long lead times. Sideways relief for initial expenditure (since it follows long-established case law) would probably expose you to less pressure for similar reliefs than indexation.

Option 4 - Exemption

26. Commercial woodlands would be completely exempt from tax. There would be no relief on initial expenditure and no charge on eventual receipts. If thought presentationally preferable, an equivalent effect could be achieved by withdrawing the Schedule D

option and taxing woodlands to Schedule B throughout their life. Because the present regime effectively subsidises forestry (see paras 13-16 above), exemption would paradoxically be more onerous than the present position. But it would be more favourable than that enjoyed by other industries and the privilege would be very apparent and difficult to defend.

EFFECT ON NEW PLANTING

27. The Annex sets out the effect of the various options for the tax regime on the expected rate of return for model conifer and broadleaved plantations. The cost of land is ignored and the price of timber is assured constant in real terms. In summary the position (ignoring inflation) is as follows:

Internal rate of return % (real)

	Conifers	Broadleaves
Pre tax	5.0	2.9
Present regime (without grants)	7.1	3.8
Present regime (with[out] grants)	7.8	4.5
Option 1 (without grants)	4.2	2.1
Option 2 (without grants)	4.5	2.6
Option 3 (without grants)	5.0	2.9

Option 4 (without grants)	5.0	2.9

28. Under the present regime about 20,000 acres of new woodlands are planted a year, nearly all conifers. The Government's express target (reiterated in the recent ALURE consultative paper) is to increase this to 30,000. Any of the options discussed in this paper would be likely to lead to a substantial reduction in the area of new planting unless there was a compensating increase in grants. Option 1 would have the greatest effect: indeed it might well lead to very little new planting being undertaken as the rate of return on a typical conifer plantation (ignoring the cost of land) would be around 4% and that on broadleaves around 2% (if no grants at all were given). And even with the other Options the effect is likely to be significant: rates of return without grant would be 5% or less for conifers and below 3% for broadleaves. Quite apart from the effect on expected returns there could be damage to confidence merely in the fact that the Government was altering a regime which had been unchanged for 70 years. The forestry organisations could be expected to make a great point of this. But these effects are, of course, indicators that market forces unaided by government support would probably lead to very little planting. Whether there is a case for a higher level of planting depends on the arguments touched on in paragraph 4 above.

29. In principle, increases in grants could offset this effect within the total of support given by the Exchequer at present. But in practice two points need to be borne in mind. Much of the tax relief does not accrue until the final felling; the cost of grants to the Exchequer would typically arise much earlier (at present on planting, though they could be spread over the life of the woodlands). And because of the effect on confidence the new regime might have to be more generous than the old one to achieve the same level of investment to overcome the fear that if the Government had once changed the regime a future Government might make further adverse changes.

30. In considering the appropriate grant regime it would be necessary to consider also the tax regime to be applied to the grants.

EFFECT ON EXISTING FORESTS (THE TRANSITIONAL PROBLEM)

31. Because investors have made their decisions in the expectation that eventual receipts will only be charged to Schedule B, there would be strong pressure on Ministers to exempt existing woodlands from any change (except in the case of Option 4 where receipts would remain exempt). This would mean an enormously long transitional period (over a century in the case of broadleaves) and it would involve difficult problems of identification where parts of forests were felled and replanted at different times. There should, however, be no significant adverse effects on existing forests as their occupiers could continue to expect the same returns as at present. (There could be some adverse effects if the general contraction of new planting repercussed on the expertise available to service existing woodlands).

32. With shorter transitional periods, not only would there be criticisms of undermining the basis on which investments were made (investments which were in line with the then prevailing Government policy) but there would be risks of adverse effects on the management of existing woodlands depending on how the transition was implemented.

33. Taking first the options which withdraw or defer relief for expenditure (Options 1, 2 and 4), there would almost certainly need to be a let-out for the first two years of expenditure on woods already planted because expenditure is heavy over this period. Thereafter, if relief is removed there could in principle be some reduction in maintenance at the margin and a disincentive to incur heavy capital expenditure (though under Option 1 expenditure qualifying for capital allowances could continue to be carried sideways). But with the bulk of costs being sunk, there should be a continuing incentive to look after

the forests. It would be possible either to give expenditure relief for a fixed period of years or so long as the woodlands stayed under the same occupation.

34. On the options which impose a charge on receipts (Options 1, 2 and 3) a fixed period (or a period linked to occupation) would provide a strong incentive to fell trees before the period expired (or occupation was transferred) even if it was more economic pre-tax to let them grow longer. A limit linked to occupation would probably be less distortionary than one with a fixed time-limit. Occupiers liable under Schedule D would not be able to escape tax by felling before disposal because Schedule D imposes a charge on felling: so they would not have an incentive to fell early. Occupiers liable under Schedule B would have an incentive to fell before they disposed of the woodlands, but these woodlands would be mainly mature ones anyway.

35. Even if existing occupiers were allowed to retain the present rules they would not get effective protection from the tax change unless forests were exempt until felling. This is because the sale price of standing timber would immediately fall to reflect the increased tax charge on purchasers and this fall in the value of standing timber would be borne by existing occupiers. How large the reduction in wealth would be is hard to estimate but in principle imposition of full income tax rates could effectively cut the value of forests (apart from the land) by up to 60% or the imposition of CGT by up to 30% unless there were grants to compensate. In practice these would be very much upper limits but the effects would be severe and complaints could be expected. While no taxpayer can expect as of right that tax on his activities will be unchanged for a century or more, effects of this magnitude might be felt to be unacceptable.

36. An alternative approach would be to exempt from tax on eventual felling the value of woodlands accrued to the date of the change. This would involve applying some formula which approximated to the rate of growth of timber and charge only a fraction of final receipts which related to growth after the date

of change. This would be complex but would involve less criticism of retrospective confiscation of wealth.

ENVIRONMENTAL DIFFERENTIATION

37. If you wished (as discussed at paragraphs 8-10 above) to differentiate between forests on environmental grounds you would need to decide whether the differentiation should be through the tax system or by grant.

38. Under the present rules the Forestry Commission can exercise some influence on the location and type of planting through grants which depend on their detailed approval of plans. Very few planters in practice proceed with afforestation without a grant as well as tax relief (though there have been a couple of cases which caused considerable protests). However, the Commission have not succeeded in stemming the criticism from environmental bodies. If grants were made a larger feature of the new regime the Commission's influence would be greater but to achieve a change in the type of forests being planted it would be necessary to change their terms of reference to give greater weight to the factors which are bothering the environmental lobby.

39. Alternatively it would be possible to introduce a measure of discrimination within the tax system by giving a more generous regime to favoured woodlands rather than unfavoured ones. It would not be possible for the Revenue to operate a discretionary system so the discrimination would have to be very crude, e.g. one regime for broadleaves and a less favourable one for conifers. There would be considerable problems of definition at the margin for mixed forests (including cases where the bulk of the woods was of one type but a windbreak of a different sort was planted). And the discrimination would be very crude: it is arguable that the environmental problems are not caused by conifers as such but the wrong sort of conifers in the wrong places and that in the right places conifers are as deserving of support as broadleaves.

40. Another option would be for the tax treatment to depend on the discretion of the Forestry Commission or some other environmental body. At one time CTT relief was only available to woodlands dedicated under Forestry Commission schemes but in 1977 the condition was removed retrospectively after representations from the private forestry interests. It was felt that there was no fiscal case for retaining a link and that it was wrong to exclude large areas of forests outside the dedicated woodlands scheme. But these arguments are not necessarily decisive. On the whole Treasury Ministers have tried to avoid tax reliefs depending on discretion, especially by bodies outside the Revenue. But there are examples such as the Secretary for Trade and Industry's role as final arbiter on what constitutes scientific research for scientific research allowance. And if the object was to encourage particular types of woodlands it would be in the nature of things that woodlands which did not meet the criteria did not qualify for relief.

41. If the discrimination were through the tax system it would be necessary to adopt a fairly tough option like Option 1 for conifers (or woodlands not certified by the Forestry Commission) merely in order to provide sufficient differentiation between the favoured and the unfavoured regime to have any effect. It would probably be necessary to superimpose grants if either sort of forest were to be attractive financially (broadleaves look fairly unattractive whatever the tax regime and conifers do not look attractive under Option 1). That being so it is for consideration whether it would not be simpler and allow better targeting to employ a uniform tax regime and differentiate (as at present) through grants.

EFFECT ON TAX YIELD

42. We estimate the short-term yield at £10-15m a year from Options 1, 2 and 4 and nil from Option 3; the long term yield from Options 1 and 3 is around £100-£125m , while that from Option 2 would be some £10s of millions (particularly uncertain) and from Option 4 there would be no increase over and above the

short term yield. These figures are very approximate and ignore changes in behaviour. They are highly dependent on what people would do who at present invest in forests. If there was a compensating increase in grants so that existing planting volumes were maintained the yield in tax would correspond with those above but there would be a substantial increase in public expenditure (which we cannot cost) from extra grants. If there was no increase in grants (or a reduction) then the volume of planting would fall off steeply, and tax savings would depend on what people did with their money instead. If they invested the money in non tax privileged investments then the Exchequer would save the £10-15m short term cost of tax relief and would earn tax on the profits from the alternative investments in the long term. To the extent that the present tax system is encouraging sub-optimal investment in forestry the yield could well be more than the £100-£125m directly foregone on forestry and come earlier.

43. But the forestry lobby and the agricultural departments argue that in practice the sort of people who invest in forestry would find alternative tax shelters or would avoid or evade tax so the Exchequer would not benefit by anything like this amount. To the extent that they invested in alternative tax shelters like BES or enterprise zones Government policy in these areas would be correspondingly benefited. To the extent that they evaded or avoided tax (e.g. by shifting money offshore) there would be less gain or even a loss to the UK economy and the Exchequer.

44. It is not easy to tell where between these extremes the reality would lie. It is, however, rather pessimistic to assume that there is a fixed proportion of income that will be sheltered by fair means or foul whatever the tax law. If a strategy of lower tax rates and less tax shelters and reliefs is worthwhile one has to assume that a considerable proportion of the tax foregone on forestry would in fact be regained if the regime were rationalised.

EFFECT ON ADMINISTRATIVE AND COMPLIANCE COSTS

45. The present system of forestry taxation involves very little cost either to the Revenue or the taxpayer. Complete exemption (Option 4) would remove even that cost. But the other options would require taxpayers to submit computations of profit on felling and disposal of woodlands which are not at present necessary. Where disposals are not arm's length there would be valuations to be made of the arm's length value of the timber. This would cause both us and taxpayers some additional work. But the cost would be small and build up very slowly if there was a long transitional period and, for taxpayers, we assume that most of the necessary records are kept for their own purposes anyway.

HANDLING

46. In view of the gaps in the above analysis which can only be filled in through consultation with other departments and given the interaction with grants, it would not be possible to implement any of these Options in the 1988 Budget without Treasury Ministers consulting their colleagues. In the light of the ALURE discussions other departments will be expecting no proposals for change in advance of an interdepartmental review. But you indicated that you might want to negotiate for tax changes as a quid pro quo for agreeing to legislation to implement the farm woodlands scheme as published in the ALURE Consultation Document. In any case you had in mind inter-Ministerial soundings well in advance of next year's Finance Bill.

47. If you want to keep open the possibility of legislation in the 1988 Finance Bill we need to work out a scheme over the summer which would not be radically changed in consultations with other departments. It would not, for example, be possible to start discussions in November, obtain by February a consensus in favour of a scheme which we had not worked up and hope to have workable legislation in next year's Finance Act. On the other hand, there is a limit to the number of different options which

we could fully work up on a contingency basis. One possibility would be for Ministers to indicate now which option they prefer, for us to work it up and attempt to agree it with other departments in the Autumn. If we were successful it could be introduced in the 1988 Budget though this would give very little time for departments to agree a common line on grants which would need to be announced at the same time. If we were unsuccessful and Ministers collectively decided on a totally different approach it would be necessary to defer legislation to 1989. Alternatively, Ministers could set that as their target in any event and press for a review immediately after the election which could be followed by a consultation document on both grants and tax together. In this case we need a Ministerial steer on their preferred outcome from the review but it does not have to be worked up in so much detail.

POINTS FOR DECISION

48. There are two main objectives of Government policy which are to some extent in conflict:

i) the agricultural departments' objective of encouraging diversification from agricultural production and, as part of that objective, to increase the amount of new forestry from 20,000 to 30,000 acres a year; and

ii) your own objective of putting the present antiquated tax regime on a more rational basis for the future which necessarily involves a restriction in the existing reliefs (though these could be matched by an improvement in grants).

Against this background, the points for decision are:

a) Do Ministers want to keep open the possibility of legislation in Finance Bill 1988?

If so

b) Which of the options 1-4 would they like worked up?

c) Would they like a further paper on the transitional problems?

d) Do they want a paper on possible inheritance tax changes or should this be put on one side for the time being.

e) Do they agree that consultation with other Departments is necessary and when do they see that being set in hand?

If not

f) Do they agree we should press for an interdepartmental review immediately after the election?

g) Do they want further work done on any of the Options in advance of the review to enable them to give us a steer on their preferences?

49. We are ready to discuss this with you and/or the Financial Secretary if you wish.

M. A. Johns

M A JOHNS

ANNEX BASIC FORESTRY ECONOMICS

In 1984 the Treasury and Forestry Commission agreed figures for a typical hectare of Sitka spruce, as a benchmark case for calculating the effects of the tax and grant regimes.

These figures have been updated to 1986 prices, with revised estimates of initial costs (agreed with Forestry Commission in January 1987) assuming good quality land. At current prices (before taking account of future inflation) they are:

SITKA SPRUCE - 54 year cycle

Costs			Returns		
Annual	Maintenance	10	Year 29	Thinning	230
Year 1	Plough/scarify	80	Year 34	"	435
	Fence	120*	Year 39	"	550
	Plant	200	Year 44	"	645
Year 2	Beat up	50	Year 49	"	740
	Weed	80	Year 54	Felling	7925
Year 3	Weed	80			
Year 4	Weed	80			
Year 8	Clean	50			
Year 15	Fertilise	40			
Year 21	Brash	5			

* Agricultural buildings and works allowances are available on this item at a straight line rate of 4% in each of years 1 to 25.

The equivalent figures for a typical broadleaf wood, (on which the figures for returns are less reliable) are estimated as:

BROADLEAF - minimum 108 year cycle

Costs	Returns		
as above	Year 58	Thinning	390
	Year 68		740
	Year 78		940
	Year 88		1100
	Year 98		1260
	Year 108	Felling	13470

Grants are available on new planting at rates for 1986 of

£240 per hectare for conifers
£470 per hectare for broadleaves

where the area planted exceeds 10 hectares. 80% is paid in the first year and 20% four years later. A higher rate of £600 is paid for broadleaf plantations which meet special requirements as to nature conservation, recreation, sporting facilities, etc.

Effect of different tax regimes Ignoring the cost of land, the internal rates of return on the basis of these figures are shown in the table below.

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		With grant	Without grant				
		Present tax regime	Present tax regime	Option 1	Option 2	Option 3	Option 4
ITKA SPRUCE	Zero inflation	7.8%	7.1%	4.2%	4.5%	5.0%	5.0%
	3% inflation	"	"	4.0%	"	"	"
	5% inflationn	"	"	3.9%	"	"	"
ROADLEAF	Zero inflation	4.5%	3.8%	2.1%	2.6%	2.9%	2.9%
	3% inflation	"	"	1.9%	"	"	"
	5% inflation	"	"	1.9%	"	"	"

NOTES ON TABLE

Effects of different tax regimes

Under option 1 for income tax considered in the paper, expenditure incurred in the early years could only be carried forward to set against later receipts from thinning and felling. Under option 3 the expenditure could be set sideways against other income of the year. In both cases receipts would be taxed under schedule D instead of schedule B.

A 60% tax rate is assumed throughout the cycle.

Option 2 would charge receipts to capital gains tax, with expenses offset in the year of receipts, after indexing for inflation.

Grants

Figures for the various options are shown without taking account of grants, because it is at present unclear what system of grants might be adopted in the face of these tax changes.

Effects of inflation

All the calculations so far are in real terms, that is, before taking account of inflation. Inflation affects the figures in two ways.

First, because capital allowances are given in nominal terms, their value is eroded by inflation over the 25 years for which 4% of the fencing costs is allowed. This affects all the income tax systems (the present regime and options 1 and 3) similarly, but is not significant.

Secondly, under income tax option 1, expenditure in the early years would have to be carried forward in nominal terms only, so that when the losses came to be offset against proceeds from thinning, they would have been eroded by inflation. Of course this problem does not arise under the present tax regime or option 3. Again the effect is not very significant.

The capital gains tax route, option 2, is completely unaffected by inflation, because all expenses are indexed.

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cc BG

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

David Norgrove Esq
10 Downing Street
LONDON
SW1A 2AA

NBMN at this stage.

10 November 1987

Dear David,

OILSEEDS RESEARCH

My Secretary of State has seen the exchange of letters between yourself and Shirley Stagg at MAFF about the proposal for the establishment of an Oilseeds Development Council put before the members of E(A) Committee by the Minister of Agriculture in his letter of 26 October.

Scottish cereal producers regard themselves as being particularly vulnerable to the consequences of the coming changes in the arrangements for the EC oilseeds regime and I write to say therefore that we strongly support the case that has been advanced by Shirley Stagg in favour of amending the 1947 Act and proceeding thereafter towards the establishment of a Council.

I am copying this letter to the Private Secretaries to the other members of E(A) Committee, Mike Eland, Tim Walker and Trevor Woolley.

Yours sincerely

David Crawley

DAVID CRAWLEY
Private Secretary

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HMP31420

AGRICULTURE : Expenditure Pt2

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON S.W.1

From the Minister

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~~SECRET AND PERSONAL~~ Downgraded 26.4.88

CHANCELLOR OF THE EXCHEQUER

REFORMING THE INCOME TAX REGIME FOR FORESTRY

Thank you for sending me a copy of your report on the forestry tax regime.

I am very sympathetic with the approach you outline. But I am sure that the proposed changes in the tax regime for forestry would be saleable only if the tax savings were used to improve the grant arrangements.

I am copying this minute to the Prime Minister, Willie Whitelaw, Peter Walker, Nicholas Ridley and Malcolm Rifkind.

JM
10 November 1987

Ministry of Agriculture,
Fisheries and Food

AGRICULTURE: Expenditure Pt. II

2184/002

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~~SECRET AND PERSONAL~~

DOWNGRADED 26.4

cc BDp

B/F Tuesday please.

6/11.

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

PRIME MINISTER

REFORMING THE INCOME TAX REGIME FOR FORESTRY

I am anxious to push ahead with reforming the present forestry tax regime in time to include it in next year's Budget, in line with our Manifesto commitment to a continuing programme of tax reform. You will recall, of course, that the ALURE Group also recognised the desirability of this after the election.

I have therefore arranged for the attached paper to be prepared. From my point of view the priority is to end the present bizarre and over-generous tax regime, which serves principally as an avoidance vehicle for top rate taxpayers. Instead the paper proposes exempting forestry completely from income tax. This would mean that revenue would not be taxed and costs would not be allowed. Because the present tax regime provides a subsidy, which makes the rate of return higher after tax than before tax, the Exchequer would actually benefit from this change.

One result of this tax reform, however, would be to reduce the rate of return on new planting. Whatever the merits of the tax reform, this might run into criticism on the grounds that it was inconsistent with the aim, announced earlier this year, of planting 33,000 hectares a year. There are arguments against maintaining the present level of Exchequer subsidies, but I recognise that there is a political case for taking advantage of the resulting revenue gain to finance increased grants for forestry. I would be reluctant to do this, especially as there would be a transitional net cost to the Exchequer. But if my colleagues think it politically necessary, I would prefer that course to leaving the present tax regime unreformed.

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If we went down that road it would be sensible to redesign the grant scheme and the conditions attached to grants so as to get more environmental benefits. The report therefore outlines how this might be done. The figuring was based on earlier Forestry Commission papers, but it may need to be up-dated and refined.

I believe that reform on these lines would be a big step forward and politically attractive. It would be an answer to criticisms that the present regime gives too much to higher rate taxpayers and also to the strong pressure from the Nature Conservancy Council and environmental pressure groups against large scale planting of conifers.

I would not normally propose such a procedure for an issue involving tax alone, but in this case there are a number of colleagues with responsibilities for forestry and for public spending on forestry grants. I suggest that the next step might be for you to chair a meeting to discuss my proposals. We need to take decisions quickly if the necessary preparatory work is to be ready in time for announcement in the Budget.

I am copying this minute and the attached report to Willie Whitelaw, Peter Walker, Nicholas Ridley, John MacGregor and Malcolm Rifkind.

NL.

N.L.

4 November 1987

007/920

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~~SECRET AND PERSONAL~~.

REFORMING THE TAX REGIME FOR FORESTRY

TABLE OF CONTENTS

REFORMING FORESTRY POLICY

I INTRODUCTION

1. The purpose of this paper is to outline a set of proposals for a major reform of forestry policy. The process of reform would not be painless and the result would not be perfect since there would still be a number of anomalous features. But the policy proposed would be based on more up-to-date objectives on taxation and the environment. There would still be subsidies for forestry but they would be better targeted.

2. When presenting these proposals publicly, the Government would need to explain the reasons for the proposed changes. Government policy towards forests appears to be inconsistent with general policy on industrial support. In particular, Exchequer assistance is difficult to justify in relation to a rationale for intervention based on market failure, although the long production cycle for timber arguably raises some special considerations. Nonetheless there remains strong regional interest in continued support for forestry and there is widespread concern about the role of forests in the general environment. Yet, the current support mechanisms involving heavy reliance on tax relief, and favouring top rate tax payers, sit uneasily with the Government's general policy towards taxation while at the same time failing to satisfy these environmental concerns. It is at the latter issues that these proposals are aimed.

3. The main proposals are

(a) income exemption for forestry, replacing the present regime;

(b) re-designing and, if necessary, enhancing the grant schemes to increase the environmental benefits of the considerable exchequer costs incurred in present forestry policy.

These are discussed in parts III-IV of the paper.

4. This paper has been prepared without consultation with the Forestry Commission or the Scottish Office. Thus, although the quantification provided mostly derives from material provided by the Commission on earlier occasions, it may need to be refined and updated.

OBJECTIVES

5. The current objectives of Government forestry policy stem from the Acland Committee report of 1917. They were restated in 1980 by the then Secretary of State for Scotland as "to reduce our dependence on imported wood" with a secondary objective of stimulating rural employment. In March 1986 a further statement set a general aim of planting 30,000 hectares (ha) a year against the 25,000 ha in the 1980 statement. This was raised to 33,000 ha following the ALURE group discussions earlier this year. On neither occasion was the figure presented as a firm commitment.

6. Forestry expansion has been promoted by the activities of the Forestry Commission itself and by grants and tax incentives to the private sector. The cost of these measures in 1987-88 is expected to amount to about £50 million: public expenditure of £32 million on the costs of the Forestry Enterprise, £14 million on the Forestry Authority, £8 million in grants to the private sector receipts from planned disposals of £13 million plus about £10 million in revenue currently foregone from tax concessions. The private sector now accounts for more than 80% of total new planting compared with 35% in 1980. The policy has undoubtedly been a success in terms of new planting: the woodland area of Britain has increased from 1.2m ha in 1924 to 2.2m ha now. Some key background facts are set out in Annex A.

7. The present policy is, however, open to a number of criticisms. It was against the background of these that the ALURE group recognised the desirability of pursuing a fundamental re-appraisal of forestry policy after the General Election.

(i) the historic economic justification for a subsidy aimed at limiting imports is not easily reconcilable with the Government's general trade policy; nor is there any clear justification for assistance in the context of the general market-failure rationale for Government intervention and industrial support;

(ii) the social value of forestry as a creator of jobs is doubtful: new employment is not necessarily located in areas where it is most needed, jobs only emerge to any significant degree fairly late in the forestry cycle, after a period of some 35-40 years at the earliest; and in the North of Scotland, where most planting occurs, costs per direct job are estimated at £8000 per year, which after appropriate adjustments yields a cost per job nearly double that achieved by the Highlands and Islands Development Board, the development agency for the area;

(iii) there is widespread criticism of new plantations on environmental grounds, because the losses of wildlife outweigh the gains, because they can damage water quality, and because of the scenic monotony of unrelieved masses of conifers;

(iv) the fiscal arrangements run counter to the Government's aim of removing from the tax system features which distort commercial judgements; present arrangements allow very high rates of subsidy to investors in the highest tax brackets who have no real link with the land;

8. On the other hand there is a strong body of opinion in favour of Government support for forestry.

(i) It is argued that the very long life of forestry investment might discourage investors, who are often averse to the risk associated with waiting a long time for returns, and lead to under-investment. It is also argued that the benefits of tree planting for nature conservation, amenity, recreation, sporting and shelter justify a subsidy in appropriate cases;

(ii) More sensitive planting techniques are now being devised and adopted, and the considerable recreational potential of forests is being exploited. As a result of these trends forests can often be environmental assets;

(iii) As for employment creation, while it is difficult to make a case on cost-effectiveness grounds, it can be argued that the contribution of forestry to income and employment in many scarcely populated and fragile rural areas argues for some caution when considering withdrawing Exchequer support. In certain areas it may take a considerable time to offset the income and employment consequences of a halt to new planting.

(iv) While the present fiscal arrangements are anomalous, bringing them to an end will not necessarily result in higher revenue or more productive investment; some taxpayers will always seek to shelter their income from tax and ending this shelter may mean no more than a switch of resources from one shelter to another;

(v) There is also an "insurance" angle. Although there is no clear evidence about market trends there are longer term uncertainties about the availability of imported timber. Other Community countries apparently consider the possibility of a future world timber shortage sufficient to justify a considerable degree of support for domestic production anticipating an average level of self-sufficiency of some 50% by the turn of the century compared to 25% in prospect for the UK. Those supporting these European decisions, consider that existing UK levels of subsidy can similarly be justified as an insurance premium against future world timber shortages. The House of Lords report on EEC Forestry Policy in the 1985/86 Session in supporting continued but carefully managed expansion of forestry emphasised balance of payments considerations.

III TAX REFORM

The present regime

9. The present income tax regime for forestry is unique and curious, not least because it provides a net Exchequer subsidy for investment in planting trees: foresters would be worse off than they are now if forestry were exempt from tax altogether. An occupier of woodlands managed on a commercial basis with a view to profit is taxed under Schedule B, an archaic income tax schedule now confined exclusively to forestry. This results in a purely nominal charge which works out on average at about 15p per acre per year. In addition the tax payer has an option to elect for Schedule D (the schedule under which businesses generally are taxed).

10. The normal practice is for people in the early stages of a woodland, when costs are heavy and there are no receipts, to elect for Schedule D so as to be able to claim the expenditure as a tax relief against their other income. Someone opting for Schedule D cannot subsequently revert to Schedule B. They can, however, contrive a change of occupation. This can be done by selling the woodlands or giving them away (often to a family trust or another member of the family). This has the result of returning the woodlands to Schedule B. There is no CGT charge on the sale of trees.

11. The result is that the expenses receive tax relief under Schedule D (at 60 per cent if, as is usual, the first occupier is a top rate taxpayer) while the receipts are effectively exempt. This regime appears to be more generous to forest owners than those applying in France, West Germany and the USA.

12. These arrangements provide an attractive tax shelter for higher rate tax payers particularly as there are also favourable inheritance tax rules for woodlands. A number of commercial forestry companies have been established to market these and to manage the woodlands on behalf of the investors who receive the tax reliefs and the Forestry Commission grants (see paragraph 21 below). The companies concerned do not themselves own the land or invest shareholders funds directly.

Annex B sets out the economics of a typical conifer plantation and a typical broadleaved plantation. The figures are derived from information provided by the Forestry Commission but should only be regarded as broad estimates of typical returns: figures for individual plantations will vary. The internal real rate of return on the conifer plantation is increased by tax from 5 per cent pre-tax to 7.1 per cent post-tax; comparable figures for the broadleaved plantation are 2.9 per cent and 3.8 per cent. In other words the tax system is actually providing a subsidy to planting. Grants further increase the internal rate of return to 7.8 per cent for conifers and 4.6 per cent for broadleaves.

14. The present cost of tax relief on planting is around £10 million a year.

15. Continuation of this regime sits uneasily with the Government's general position on taxation. The underlying direction has been to reduce rates of direct tax but also to reduce or eliminate special reliefs or shelters which distort economic decisions.

Options for reform

16. There are three options. The first is to put forestry on the same fiscal basis as other businesses. Income would be taxed and the expenses would be allowable but not until the income was received. Because of the long life cycle of the crop and the lumpiness of the receipts this option would create major problems for the industry. Woodland owners would have to wait 30 years or more for their relief and the income would almost invariably be taxed at the highest rate. Some arrangement would be necessary for spreading the income over a number of years. Moreover, as Annex B shows, the effect would be to reduce the rate of return on conifers from 5 per cent (pre-tax) to 4.2 per cent (after tax) with no inflation and to 3.9 per cent (after tax) with inflation at 5 per cent. The rate of return on broadleaves would fall from 2.9 per cent to 2.1 per cent with no inflation and 1.9 per cent with 5 per cent inflation. This option would be strongly criticised by forestry interests and looks the least attractive of the three.

17. The second would be to abolish Schedule B, to tax all receipts under Schedule D but to allow relief for planting expenditure to be set against other sources of income as and when the expenditure is incurred. Post-tax rates of return would be very close to pre-tax rates of return. The Exchequer would eventually receive an extra £100 million a year from the abolition of Schedule B but initially there would be no Exchequer saving. Moreover, as would also be the case with the first option, arrangements for spreading would be necessary.

18. The third and by far the simplest option would be to exempt forestry entirely from tax. Receipts from the sale or felling of timber would not be charged to tax and the costs would not be allowed. After a short transitional period there would be a tax saving of around £10 million a year. Tax considerations would no longer distort commercial judgements, though the regime would be more favourable than for business generally.

19. Under all three options transitional arrangements would be required. With the third option (the exemption option), for example, it would be difficult to defend cutting off relief for expenditure overnight. But because the bulk of expenditure takes place in the first 2 or 3 years the transitional period with this option could be quite short. A 4 year period might be sufficient. On this assumption the tax savings as they would be published on Budget Day might be of the order of:

	£m
Year 1	0
Year 2	+1.5
Year 3	+4
Year 4	+6
Year 5	+7.5
Year 6	+10

With both the other options it would be difficult to justify a charge to income tax on receipts from forests which have been planted in the expectation that the present regime would continue. A very long transitional period stretching ahead for decades would therefore be required.

20. The present tax subsidy would be removed under both these options. The exemption option ie (option 3) would require careful presentation and would need to be firmly related to the peculiar features of forestry and the need for simplicity. But with that proviso it seems preferable to option 2 because it is simpler, yields savings quickly and avoids the need for long transitional arrangements. **It is the option we recommend.** Forestry management companies should still be able to operate successfully on much the same basis as now but with a wider range of investors particularly if the grants payable were at the same time somewhat increased, (see below). But forestry would no longer be seen as the preserve of top rate tax payers.

IV CHANGING THE GRANT REGIME

21. Changing the tax regime as proposed above would reduce the rate of return on new planting and would therefore be likely to reduce the volume. This might be felt to be inconsistent with current forestry policy and hence to raise political difficulties despite the economic arguments for lowering the present degree of Exchequer subsidy. If so, it would be possible to finance a higher level of grants by using part or all of the exchequer savings resulting from the tax changes. At the same time it would make sense to try to achieve environmental aims.

21a. There are at present several schemes under which grants are paid for afforestation. The main one is the Forestry Grant Scheme under which grants are paid for conifer and mixed plantations. Almost all the major plantations which receive the special tax allowances qualify for grant under this scheme. There is also the Broadleaved Woodland Grant Scheme, introduced in 1985, under which higher rates of grant are paid for woodland comprising only broadleaved trees. Rates of grant for these two schemes are as follows:

RATES OF GRANT (£ per ha)

Area of Woodland ha	Forestry Grant Scheme (1) Conifers	Broadleaved	Broadleaved Woodland (2) Grant Scheme
0.25- 0.9	630	890	1,200
1.0 - 2.9	505	735	1,000
3.0 - 9.9	420	630	800
10 and over	240	470	600

NOTES (1) Grants are paid pro rata to the proportion of conifers and broadleaved trees. 80% is paid on completion of planting and 20% five years later subject to satisfactory establishment.

(2) 70% is paid on completion of planting and 15% each five and ten years later subject to satisfactory establishment and maintenance of trees.

In addition to these two schemes, a proposed Farm Woodland Scheme was announced in March this year. Under this scheme, to supplement the planting grants, there would be annual payments to compensate for loss of income from farm crops.

22. An illustrative grant scheme is set out in paragraph 26a. Any new grant structure would be intended to replace the Forestry Grant Scheme. However, it would be sensible also to subsume the Broadleaved Scheme in the new structure since the grant rates would be more favourable. The new planting grants would in principle also apply to the Farm Woodland Scheme although some adjustments might be necessary.

23. It is proposed that any changes it was decided to make in the grant regime would be announced at the same time as the tax changes. The grant increases would apply immediately whereas the tax savings would not begin to accrue until the following year. However, the aim must be

over the transitional period as a whole for the increase in grants [illegible] no more than match the tax saving and preferably to fall below it, by phasing in the increased grants and particularly by reducing the proportion of grant paid in the first year. However, in the first 5 years extra public expenditure will exceed the tax saving (see Annex C).

24. As a result of switching from tax relief to grants, it will be possible to devise a regime which is much more effective in achieving environmental objectives, as set out in Annex D. It would be important to formulate at the outset an evaluation plan for assessing the success of the revised grant scheme in achieving its specific objectives. The new grant rates should be cash limited and also subject to an early review, which could involve reductions in rates if demand turns out to be higher than anticipated.

25. For illustrative purposes, it is assumed initially (paragraph 26a) that the £10m saved (after a transitional period) of several years from the tax changes could <u>all</u> be used to increase grants. This is the most generous option and is thus the upper limit of what could be done on this approach. The Treasury would prefer an alternative option - of using only half this sum, which is examined briefly (paragraph 29). Several cautionary points need to be made. First, the figuring is based on partial information and must be regarded as tentative. The main data lacking are a size structure analysis of new plantings and figures such as cost per ha by size and type of plantation which are necessary in drawing up an appropriate scale of grants and would help in assessing possible response rates to grants at various levels. Second, while higher grants could increase incentives to non and low rate tax payers, many potential farming investors - unlike the current high tax paying investors whose primary aim is to save tax and convert that into a capital asset - may not be able to afford the loss of income from their land. The present analysis assumes that grants would contribute only to costs of planting and would not compensate for income forgone. Under this assumption, only a limited increase in investment by non and low rate tax payers could be expected.

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26. The changes in grants would be designed to blend environmental needs and commercial considerations. The new regime would encourage smaller plantations and the planting of more broadleaved trees (either on their own or to break the monotony of conifer plantations) by:

i. requiring all plantations above a certain size to contain at least a minimum proportion of broadleaved trees, except where climate and geography make this impossible. A reasonable threshold would be 3 ha and a reasonable proportion 15%. These broadleaved trees would of course attract the higher rate of grant

ii. extending the existing grant differential in favour of smaller and medium size plantations.

On the illustrative expenditure assumption in paragraph 25 the pattern of grants could be such as to sustain a high rate of new planting and thereby maintain steady growth in jobs in rural areas and, over future decades, enable the production of timber to expand.

26a. The following table illustrates how these principles might be embodied in a grant schedule. It is based on the most generous option of using the whole of the £10m tax saved. The figures are tentative at this stage because the choice of actual figures will require careful study in the light of more refined and up to date estimates of planting costs, and of the existing and expected size distribution of plantations. But preliminary calculations indicate that, following exemption from taxation, the internal rate of return from both conifers and broadleaves could be maintained at around existing levels, if grant rate for conifers were increased by some £300-£350 per ha and for broadleaves by some £350 and £400 per ha. These are illustrative figures related to plantations in the medium-size range.

Possible pattern of Grant Rates

£

	Present Grants		New Grants	
	Conifer	Broadleaved	Conifer	Broadleaved
0.25 - 0.9	630	890	800	1200
1.0 - 2.9	505	735	750	1100
3.0 - 9.9	420	630	700	1000
10 and over	240	470	600	900
50 - 100 ha			500	800
100 - 500 ha			450	700
500 and over			400	600

27. As in the present grant regime, grant would be refused if it was concluded, after consultation with the relevant statutory authorities, that a proposed plantation would not be environmentally acceptable. Refusal of grant would be a much more effective sanction in future because tax relief would no longer be available and the grant would represent a higher proportion of the costs of planting. It might also be desirable to widen the circumstances in which grant is refused, for example to protect moorland areas, (preferably, given the higher grant levels, without creating rights to compensation). Precise guidelines and how they would be implemented would require consultation with the Forestry Commission and other interests. Where grant was forthcoming, the condition about a minimum 15% of broadleaved trees would normally apply, as described above, and the grant structure would provide financial incentives for more scenically attractive forms of planting, which would also safeguard wildlife. These

features of the new regime would make it broadly acceptable to environmental bodies, and enable the Government to resist pressure to make afforestation subject to planning control or a new system of planting licences.

28. It would also be desirable to reduce the workload involved in examining and consulting about individual grant applications. One possibility would be to formulate a comprehensive code of practice containing clear criteria for the environmental impact of forestry operations and to require applicants for grant to certify that their proposed scheme complies with a code of practice. But this would similarly require extensive consultation and could not therefore be introduced at the outset.

29. An alternative approach, which the Treasury would prefer, would limit the increase in cost of grants to £5m. Adjusting the rates for particular categories of woodland would enable environmental objectives to be achieved but at the expense of bigger cuts in incentives to commercial forests. It is hard to say what could be achieved by spending £5m annually on higher grants; but if the above schedule were lowered by a little over £100 per ha, it might achieve planting of around 20,000 ha. This is not much different from the current planting rate of 23,000 ha in 1986.

30. The tentative conclusion is that subject to a more detailed study it should be possible through additional spending of £5-10m to devise a system of grants resulting which would:

(a) achieve an environmentally more favourable pattern of afforestation which would be acceptable to the main environmental bodies;

(b) give a pattern of incentives which it could be demonstrated were only slightly below present levels for higher rate taxpayers (and to other than highest rate tax payers were higher).

Given the change in the form of the incentive, and particularly [the] differential effect on high and low tax payers, it is not possible to be certain how the level of planting would be affected.

31. An improved grant scheme would initially involve some Exchequer cost, but this would be relatively small (in the example in Annex C £7.0m over 5 years). The use of a cash limit, in contrast to current demand led schemes, would also help to avoid additional costs. A more modest scheme, at around £5m a year, would probably achieve the environmental benefits described and would be more consistent with the Government's general approach to industrial support in other sectors. But it may be difficult to present it as coming close to achieving planting of 33,000 ha a year, and to this extent a higher level of grants - up to a maximum of £10m - may need to be considered. There is certainly no case at all for raising the overall level of Exchequer support for commercial forestry above its current level.

V TIMING AND NEXT STEPS

32. There is a strong case for announcing the reform of the tax regime in the 1988 Budget and including the changes, which would take effect from Budget Day, in the Finance Bill. If implementation were later, there would be a forestalling problem which would be difficult to solve. If Ministers decided that the tax change needed to be accompanied by changes in the grant schemes, early action would also be desirable. It would be a response to the strong pressure on the Government from the Nature Conservancy Council and environmental pressure groups, especially over the large-scale planting of conifers by high-rate tax payers in Caithness and Sutherland.

33. But to meet this timetable and in particular to ensure that the Finance Bill clauses and any changes in grants could be ready in time, decisions would have to be taken urgently. Further work would be needed on the detailed design of any new grant regime to maximise the benefits within the upper limit of £10m a year or whatever lower figure Ministers decided on.

28.10.87

ANNEX A

FORESTRY: BACKGROUND FACTS

1. PUBLIC EXPENDITURE	1987-88	1988-89	1989-90	£m 1990-91
Baseline	53.8	54.2	55.1	56.5
Of which				
Grants to private sector	8.3	8.8	9.6	9.8
Other Forestry Authority expenditure	13.7	14.6	15.2	15.6
Forestry Enterprise net expenditure	31.8	30.8	30.3	31.0
planned receipts from disposals	-13.0	-12.0	- 12.0	- 7.0
1987 Survey bids (related to ALURE proposals)				
Grants:				
traditional forestry		2.3	2.4	2.4
farm woodlands		2.2	4.6	4.8

2 FORESTRY AREA

	Conifers		Broadleaves and Coppice		Total	
	'000ha	% privately owned	'000ha	% privately owned	'000ha	% privately owned
England	395	50	461	91	856	72
Wales	175	26	61	90	236	43
Scotland	891	42	77	95	968	45
Great Britain	1461	43	599	91	2069	57

3 FORESTRY PLANTING

	England	Wales	Scotland	Great Britain	
	'000 ha	'000 ha	'000 ha	'000 ha	% privately owned
1978	2.1	1.4	17.1	20.6	32
1982	1.5	1.3	20.8	23.6	53
1986	1.2	0.8	21.3	23.3	82

4. FOREST EMPLOYMENT

	End March 1980	End March 1986
Forestry Commission	8,000	6,000
Private Sector	11,000	12,000
related processing	33,000	27,000

5. RATE OF RETURN FROM FORESTRY

Forestry Commission
financial target (1982-87) 2.25%

expected outturn: 2.9% (Average: rate of return on some new planting in remote areas estimated at 1.5%)

Annex A contd

6. UN[illegible] KINGDOM COMPARED WITH OTHER EC COUNTRIES

	Total forested area '000 ha	Forested area as % of total land area	% of area privately owned	Self Sufficiency % Sawnwood	Self Sufficiency % Wood pulp
UK	2.2	9	57	21	14
France	15.2	28	74	79	54
Germany	7.3	30	44	69	46
Italy	8.1	27	60	32	28
EC(10)	55.5	25	54	51	39
Norway	8.6	28	85	Not available	Not available
Sweden	27.9	68	73	Not available	Not available
Finland	23.2	76	71	Not available	Not available
USA	301.1	33	61	Not available	Not available
Canada	440.0	48	6	Not available	Not available

NOTE Figures in first three columns include unproductive woodland.

BASIC FORESTRY ECONOMICS

In 1984 the Treasury and Forestry Commission agreed figures for a typical hectare of Sitka spruce, as a benchmark case for calculating the effects of the tax and grant regimes.

These figures have been updated to 1986 prices, with revised estimates of initial costs (agreed with Forestry Commission in January 1987) assuming good quality land. At current prices (before taking account of future inflation) they are:

SITKA SPRUCE - 54 year cycle

Costs

		£
Annual	Maintenance	10
Year 1	Plough/scarify	80
	Fence	120*
	Plant	200
Year 2	Beat up	50
	Weed	80
Year 3	Weed	80
Year 4	Weed	80
Year 8	Clean	50
Year 15	Fertilise	40
Year 21	Brash	5

Returns

		£
Year 29	Thinning	230
Year 34	"	435
Year 39	"	550
Year 44	"	645
Year 49	"	740
Year 54	Felling	7925

* Agricultural buildings and works allowances are available on this item at a straight line rate of 4% in each of years 1 to 25.

The equivalent figures for a typical broadleaf wood, (on which the figures for returns are less reliable) are estimated as:

BROADLEAF - minimum 108 year cycle

Costs

as above

Returns

		£
Year 58	Thinning	390
Year 68		740
Year 78		940
Year 88		1100
Year 98		1260
Year 108	Felling	13470

Grants are available on new planting at rates for 1986 of

£240 per hectare for conifers
£470 per hectare for broadleaves

where the area planted exceeds 10 hectares. 80% is paid in the first year and 20% four years later. A higher rate of £600 is paid for broadleaf plantations which meet special requirements as to nature conservation, recreation, sporting facilities, etc.

Effect of different tax regimes Ignoring the cost of land, the internal rates of return on the basis of these figures are shown in the table below.

		With grant	Without grant			
		Present tax regime	Present tax regime	Option 1	Option 2	Option 3
SITKA SPRUCE	Zero inflation	7.8%	7.1%	4.2%	5.0%	5.0%
	3% inflation	"	"	4.0%	"	"
	5% inflation	"	"	3.9%	"	"
BROADLEAF	Zero inflation	4.6%	3.8%	2.1%	2.9%	2.9%
	3% inflation	"	"	1.9%	"	"
	5% inflation	"	"	1.9%	"	"

Option 1 is the normal business basis (para 16 of the text)

Option 2 taxes receipts and relieves expenses as they arise (para 17 of the text)

Option 3 is tax exemption, the preferred option (para 18 et seq of the text)

~~SECRET AND PERSONAL~~

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ANNEX C

PROFILE OF INCREASED GRANT EXPENDITURE

Assume grant of £500 per hectare half payable in first year and one quarter in second and again in fifth year; supplements of £50 in year 8 and again in year 15 as contribution to annual maintenance, clearing and fertilising. (Note: present grant is £240, 80% payable in year 1 and 20% in year 5). The calculations are based on annual planting of 30,000 ha.

	NOW		AFTER CHANGE		CHANGE IN EXPENDITURE	
	£ per ha	£m	£ per ha	£	Gross	Net of tax saving
Year 1	240	7.2	298	8.9	+ 1.7	+1.7
2	As above		423	12.7	+ 5.5	+4.0
3			423	12.7	+ 5.5	+1.5
4			423	12.7	+ 5.5	-0.5
5			500	15.0	+ 7.8	+0.3
6						-2.2
7						-2.2
8-14			550	16.5	+ 9.3	-0.7
15+			600	18.0	+10.8	+0.8

NOTE: Increase in expenditure net of tax saving in years 1 to 7 totals to -£2.6m.

This annex illustrates the 'upper limit' option (see paragraph 25 of main report)

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~~SECRET AND PERSONAL~~

ENVIRONMENTAL IMPACT

Adverse impact of current practices

1. At present, the dominant pattern of afforestation, which has been widely criticised on environmental grounds, is large plantations of a single species of conifer of a single age. Large-scale monoculture is the most profitable approach commercially because it utilises the species which will grow most rapidly in a particular location, and allows a plantation to be felled in one operation. The present tax concessions make it financially very attractive to use hill land for this kind of forestry: land sold with consent for afforestation commonly fetches three times or more the price it would fetch if sold for sheep-farming.

2. Large-scale afforestation, especially with conifers, can be seriously damaging to the landscape, especially where the scenic beauty of an area depends on its openness. It also destroys wildlife habitats on open ground and reduces the diversity of species. Although the Forestry Commission has done much to develop leisure opportunities on its own and, afforestation often reduces recreational opportunities by restricting public access. And it can damage water quality and aquatic flora and fauna over a much wider area by changing drainage patterns and causing alterations in soil chemistry which lead to acidification of streams. These impacts are matters of serious concern to the Nature Conservancy Council (NCC) the Countryside Commission, the water authorities and to DOE.

Environmental objectives

3. The aim must be to devise future arrangements for forestry which achieve the following environmental objectives:

i. to <u>prevent</u> any afforestation in certain particularly sensitive areas. These might include sites of special scientific interest designated by the NCC; and archaeological sites which would either be physically destroyed by forestry or else seriously damaged in terms of visual impact and public appreciation

ii. to <u>ensure</u> that afforestation takes place in national parks or designated areas of outstanding natural beauty only if all the statutory bodies agree that it is environmentally acceptablein the proposed location

iii. to <u>avoid</u> encouragement to afforestation of areas which will give poor yields because of adverse geographical factors (very poor soil, high winds etc)

iv. to <u>ensure</u> that, wherever large-scale afforestation takes place, it is carried out in an environmentally sensitive way, is attractive visually, and avoids damage to water quality

v. to <u>encourage</u> environmentally more favourable forms of afforestation, involving smaller plantations, more diversity of species (especially the inclusion of native broadleaved trees), and multiple use, especially for recreation.

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10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

2 November, 1987.

Dear Shirley,

OILSEEDS RESEARCH

The Prime Minister has seen your letter to me of 29 October about the proposed Oilseeds Development Council. She remains firm in her view that the Government should not seek to increase R&D through compulsory levies, but only by persuasion.

I am copying this letter to the Private Secretaries to the other members of E(A) Committee and to Mike Eland (Lord President's Office), Tim Walker (Department of Trade and Industry) and Trevor Woolley (Cabinet Office).

Yours,
David.

(David Norgrove)

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

DG

CBG

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

From the Minister's Private Office

Prime Minister!
But what protection is there for growers who do not want to contribute? How representative are the people who ask for these levies? What is to stop the R&D becoming self-perpetuating?
This is not convincing. Agree?

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David Norgrove Esq
10 Downing Street
LONDON
SW1A 2AA

29 October 1987

Dear David

This is too familiar words. We are NOT in the business of financing R&D by COMPULSORY LEVIES. Only by PERSUASION. DRN 30/10.

OILSEEDS RESEARCH

Thank you for your letter of 26 October. I should perhaps explain how the proposed Oilseeds Development Council fits in with the agreed policy which we have been following.

It is of course Government policy, as most recently endorsed by EST, that we should encourage industry to fund a greater share of R & D from which it directly benefits in particular that nearest to the market. The present proposal emanates directly from the campaign we launched two years ago to achieve this objective in the agricultural sector in the context of major cuts in Government funded R & D.

In the agricultural industry there is no way in which most individual producers can in practice take advantage of the generous tax treatment available in order to secure the necessary investment in R & D. There are for example some 10,000 farmers growing oilseeds and over 90,000 growing cereals. To be effective, their contribution to R & D has to be organised collectively. That is why we have already resorted to the statutory levy arrangements to give effect to the Government's policy on R & D in areas where the industry wished to participate. Thus, in its last session Parliament approved a new levy scheme for cereals on lines agreed by growers, traders and processors; and we set up in 1986, following a poll of growers, the Horticultural Development Council, using the provisions of the 1947 Act.

What about the Co's who purchase the oil-seed rape. Don't they do any research?

There is thus no new principle or precedent involved in providing for the levy for oilseeds R & D. The problem is only that it would be much more economic and simple to collect the levy through a few traders than to do so from many thousands of growers. To do this we need to make the same amendment to the 1947 Act as Parliament made in the Agricultural Act 1986 to the Cereals Marketing Act of 1965.

As the Minister explained in his letter of 23 October, rapeseed is our third largest crop, covering 16% of our arable area, and there is an urgent need to adapt this production to the changed market requirements which will obtain from 1991/92 when new Community regulations will make it necessary to grow types of rapeseed not currently cultivated in the UK.

Against this background we have been asked by the growers and the oilseed trade to facilitate the formation of an Oilseeds Development Council by amending the 1947 Act. Government policy on R & D would lack credibility if we were to refuse to help them.

I am copying this letter to recipients of yours.

Yours Shirley

SHIRLEY STAGG (MRS)

AGRICULTURE

[illegible]

PTL

Attached to Sunday Times Supplement - October 2. 87.

10 DOWNING STREET

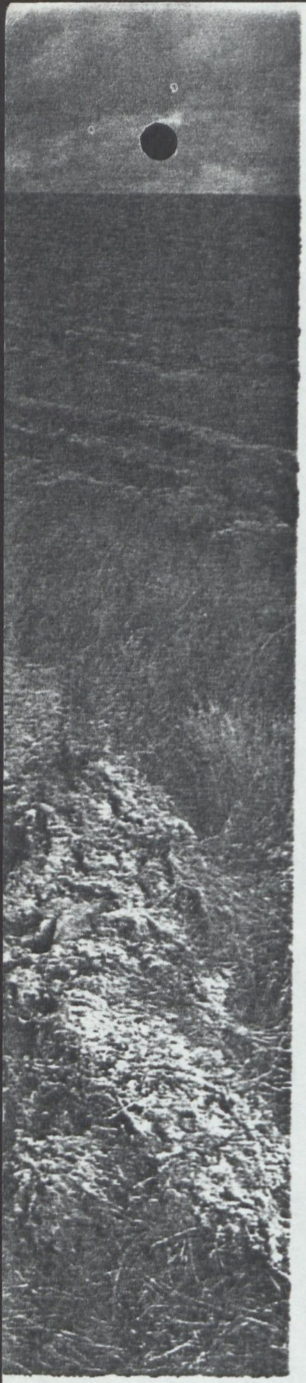
Prime Minister[2]

The article inside (clipped) shows some of the reasons for concern about forestry in Scotland.

It claims that at present 40 people are employed in forestry in Caithness and Sutherland, and ~~throughout~~ the Highland region 1500 in forestry and saw-milling.

DR
26/10

Thank you it



IAN YEO

gins

Occupation: the march of the conifers

**gland Flow country of
d Sutherland is the improbable
e most bitter land dispute
since the Clearances. On one side
ervationists and crofters,
reserve the integrity of one of
angest and most fragile
Against them are the investors
rs panning for gold in the
sh timber rush. Report by
bey. Photographs by Ian Yeomans**

The string of coastal towns that circle the Caithness and Sutherland Flows do not give the impression of being the gateway to 1500 square miles of primeval bogland. There are bright golfing and fishing resorts at Golspie, Brora and Tongue; a nuclear reactor at Dounreay. Country-and-western music vies with ceilidh on the holiday entertainment programmes.

But there is a perceptible atmosphere of some kind of edge here, and it is not being melodramatic to say that the battle over the afforestation of these bogs – already the most bitter conservation debate of the past decade – has all the classic ingredients of a land feud in frontier country. There is the immense tract of barely exploited land; foresters with the speculative zeal of prospectors and bounty hunters; guardians of the land and its ancestral inhabitants; the whiff of new money and dreams of a jobs bonanza. And, in the background, the celebrities and the scandals.

Like all feuds it has deep roots. On a high promontory near Golspie there is a statue of the first Duke of Sutherland, aptly clad in an imperious red sandstone robe. Early last century the English-born duke was responsible for another massive local clash between tradition and development – the notorious Sutherland Clearances. Between 1814 and 1820 he evicted a third of the entire population of Sutherland from their homes – by burning them down in most cases – to make way for sheep ranching and shooting, and to provide cheap labour for his factories on the coast.

His agent James Loch's defence of the purge has an ironic ring in the present circumstances. They hoped, he said, "to render this mountainous district contributory as far as it was possible to the general wealth and industry of the country, and in the manner most suitable to its situation and peculiar circumstances".

★ ★ ★ ★ ★

The Clearances are an ineradicable part of Highland folk memory, a symbol of all misappropriations of the land, and it is a measure of how deep feelings are running that each side is accusing the other of initiating "the New Clearances".

What is at stake is the largest remaining concentration of blanket bog in the world, a series of rain-drenched plateaux with one of the most remarkable collections of breeding birds in Europe: waders like greenshank, dunlin, golden plover; loch haunters like red-throated divers – birds whose very survival depends on expanses of remote, wet wastelands. As an ecosystem it is ancient and irreplaceable.

But even describing it in these terms brings on a guilty memory of that dark past. For thousands of years the Flow country has also been the habitat of marginal farmers, who have grazed cattle and cut peat on the bogs, and raised crops in the valleys in ways that were entirely compatible with the bird life. But since the Clearances these farmers have borne the brunt of land-use changes in the Highlands, and deserve consideration themselves.

Land agent Colin Scott at the Dunbeath estate: trying to work with local resources rather than against them

Trees, until recently, played no significant role in the crofting life. The persistent high winds and rainfall made it all but impossible to grow them, except in sheltered valleys. The Forestry Commission was a latecomer to the region, and most private forestry companies would not touch it.

But in 1979 the Perth-based Fountain Forestry glimpsed a coincidence of opportunities that was too good to miss. Land was dirt cheap (as little as £100 a hectare in places), government planting grants and tax incentives were favourable, and machines were at last available that could tackle even the most intractably wet bogs. Fountain began buying up estates in the Flows and selling them off to investors (mostly southerners: 72 of the 76 listed in the Scottish land registers have English addresses). By the beginning of 1987 Fountain had acquired 40,000 hectares and had earned its investors in excess of £12 million in grants and tax exemptions for 12,000 hectares of planting.

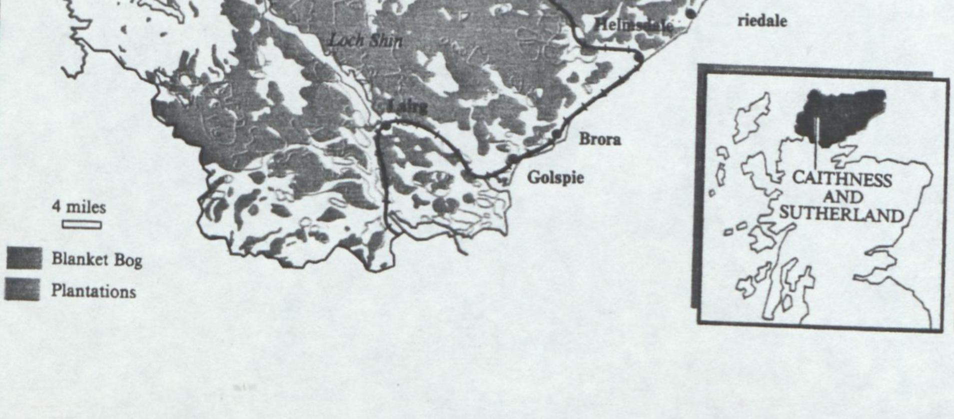
Fountain's expansion into the Flows coincided with an upsurge of interest in nature conservation, and in the scientific and cultural value of waste places.

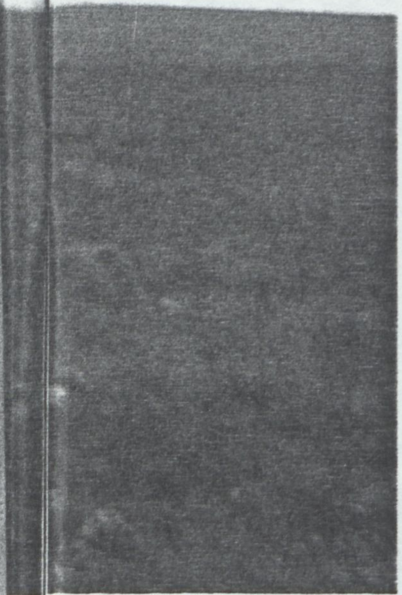
From the early Eighties the Nature Conservancy Council (NCC) and the Royal Society for the Protection of Birds (RSPB) began to notice drastic changes in the ecology of the afforested areas of the peatlands. The outcome of their petitions to government was an agreement by the Forestry Commission in February 1987 to refer all planting grants in the Flows to the NCC.

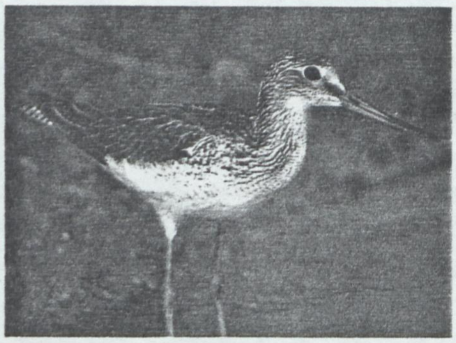
The row broke in earnest in July, when the NCC published a report giving its scientific evidence on the threat to bird life and making a plea for a moratorium on further planting over the whole of the 400,000 hectares of peatland.

The report has been met with almost universal hostility by the Scottish Establishment. Robert Cowan, chairman of the Highlands and Islands Development Board (HIDB), said that it had been drawn up "without consultation or regard for the delicate economic and social fabric of the northern Highlands". Robert Maclennan, SDP MP for Caithness and Sutherland, described its scientific conclusions as

DAVID HART







BRUCE COLEMAN AGENCY

CASUALTIES OF WAR?

The insect-eating sundew (left) is one of many wet-loving plants supported by the moist sphagnum base of the Flow country's blanket bog – a landscape so fragile that it can take years to eradicate the marks of even minor human disturbance. Among the bird species whose habitat is threatened are (clockwise from top left) the greenshank, the peregrine, the meadow pipit and the golden eagle

"preposterous" and predicted its proposals would lead to the loss of "2000 jobs in the long term".

The forestry lobby accuses the conservationists of valuing birds above people and of meddling in affairs way beyond their remit. The conservationists retort that it is not they but the alien conifers that are driving out – at public expense – both indigenous crofters and new tourists. Each side (it is the shadow of the Clearances again) accuses the other of "sterilising" the Flows, showing, to anyone who needed convincing, what a flexible and subjective concept the productivity of the land is.

It is a bemusing spectacle for an onlooker. This is confrontation on a scale that is usually a convenient continent or two away, and a far cry from the normal land-use squabbles of our small and intensively settled islands. Beyond the revelations of Terry Wogan's investment portfolio and the intricacies of government forestry policy, it has stirred ancient unresolved questions and conflicting assumptions about what we value land for. Are the Flows a priceless natural wilderness or a man-made wasteland, ripe for restitution; a tradable commodity or a global asset? And is it right to make that facile assumption that employment and conservation are intrinsically opposed?

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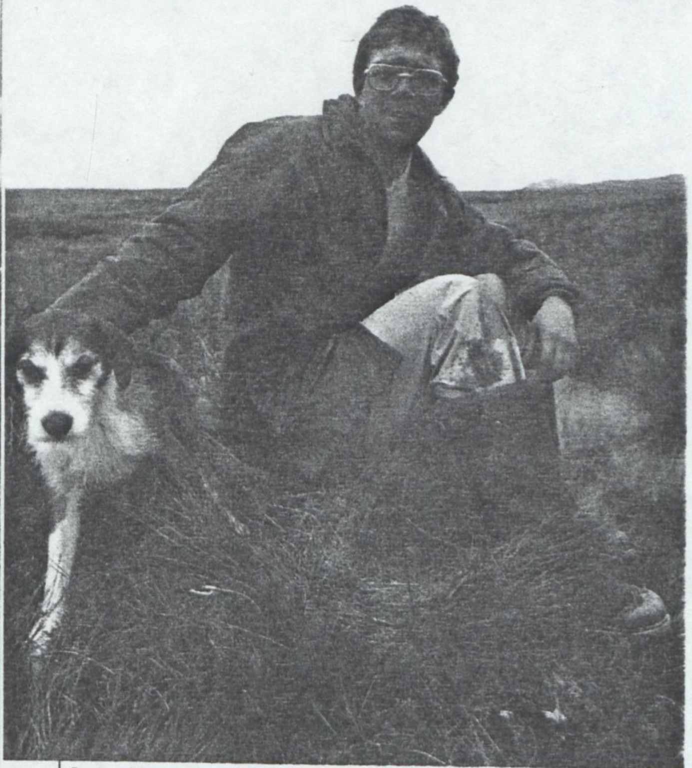
It is ironic that these arguments should have come to such a head not over some exquisite English beauty spot but over a quagmire, usually the pariah among landscapes; and that the cause should be Scottish forestry, which seemed almost on the point of becoming acceptable – if only because it is out of most people's sight. From the air the dark patchwork of plantations that now stretches from the Borders to Inverness still looks as unnatural, as uncomfortably grafted, as a mosaic of Velcro. But from the ground they are beginning to merge into the background in much the same ways as wet telegraph poles and dozing sheep, with a kind of glum rootedness. Better than a bog, anyway, most people who have never been in one might feel.

But to glimpse forestry in the Flows is another matter. The severe stripes and diagonals, visible miles away, seem to have been constructed out of a substance from another universe, which hasn't the slightest connection with the qualities of this northern landscape.

Two things strike you about the unplanted Flows when you drive in from the south. One is the sense of immense space, of a gently undulating flatness in which there are no straight lines, no harsh colours and, unless you look for them, very few foregrounds. On clear days you can often see the peaks of Sky Fea and Genie Fea in the Orkneys, 40 miles to the north. The other is what I can only describe as a kind of plasticity. The swell of the peat hummocks, the honey-coloured tussocks of sedge, the dark pools all seem, if you stare at them long enough, actually to be moving.

It may not be altogether an optical illusion. It is certainly no figure of ➳



Dogged by controversy – Fountain Forestry is the company at the sharp end of this fierce debate. Above: area manager Andrew Martin

speech to call blanket bogs "alive". They are composed of a living skin of sphagnum mosses, a vast, intricate carpet of plants, unrooted except for their own mutual entanglements. Sphagnum is honeycombed with capillary tubes, and is twice as absorbent as cotton wool. In the very high rainfall of this region the mosses become permanently waterlogged, and swell sufficiently partially to blanket other sections of moss that are dying back. This moribund sphagnum becomes part of the underlying layers of peat, and both live and dead moss become a permanently moist groundbase for other plants – heather, sedges, orchids, insect-eating sundews, even lichen.

Throughout the Flows, for reasons that are not yet fully understood, the sphagnum "sponge" seems to become saturated and pools – the dubh lochans – form. There are many thousands of these ranged in place like ladders, elsewhere in concentric arcs. From the air they have the look of pool clusters on a beach at low tide, or the pitting in limestone rocks.

But it is at ground level that you become aware of the most striking association. The Flows are really a kind of tundra. During the short, intense subarctic summers, they buzz with life as only tundra can, with a myriad insects and the shrill calls of wading birds: 4000 pairs of dunlin (35 per cent of the European population) nest close to the lochans, where they winkle out insects with their toothpick bills. So do the same number of golden plovers (17 per cent of Europe's total) and smaller numbers of greenshank, sandpipers and snipe. There are huge populations of meadow pipits and skylarks and, feeding on these and the abundant voles, are hen harriers and merlins, and hunting peregrine falcons and eagles that nest on the high ground adjacent to the bogs.

The full richness of the birdlife is only being fully appreciated after eight years of survey work by both the NCC and the RSPB. The foresters have a point when they say it would have saved a great deal of misunderstanding if this information had been available earlier, before the planting programme was seriously under way. But the remoteness and sheer extent of the land has made surveying a slow and laborious business and no match for the speed of the new machines.

Roy Dennis, who directs the RSPB's operations in the Highlands (and is a crofter himself) pointed at a map and said wistfully: "The land is so flat you could start a bulldozer in Wick and drive it straight to Bettyhill."

And that, more or less, is what happened. Out of approximately 65,000 hectares owned by Fountain and the Forestry Commission, roughly half has already been drilled into order with a gusto that would have done credit to the 17th-century fen-drainer, Cornelius Vermuyden. Giant excavators have dragged out drainage ditches in the peat, 8ft deep in places, and raised cultivation ridges for the rows of spruce and lodgepole pine seedlings. There are aerial spraying programmes of both pesticide and fertiliser, and hundreds of miles of deer fencing. Extraction roads have been built whose width is often double that of the local highways. Up in the vast emptiness of the Flows these broad tracks, linking the strange rectilinear furrowings of the plantations, seem as incongruous and incomprehensible as those Peruvian desert trackways.

But as Roddy Williams of the forestry trade association, Timber Growers UK, assured me, there is a plan behind it all. The original intention was to construct an integrated forest, big enough to be economically self-sustaining and to support at least two new saw-mills (at the moment the nearest mill is at Inverness). The key is the Lairg-Wick-Thurso railway. The new plantations have been sited as close as possible to this line, to minimise transport costs when felling comes round. This, Williams stressed, is why the industry is so anxious to continue its planting programme up to the original target of about 100,000 hectares. Only then can the planned economies of scale be realised.

Looking at the map you can see some logic in this. The railway does meander past many of the plantations – the older blocks round Loch Shin; Strathy Forest, where a sizeable chunk of a National Nature Reserve was accidentally ploughed up; Wogan's woods near Broubster. But the line is economically precarious, the sawmills still a figment of an economist's imagination, and the whole operation less like an unfolding plan than an elaborate exercise in opportunism, a kind of Timber Rush.

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Even scientific fact is regarded as negotiable currency here. The most frequent demand I heard from Scottish authorities was for a "court of appeal" against the NCC. Not just against its proposals (which are only recommendations, after all) but against its evidence, which it is felt should be open to compromise. It is a relief that nobody has any illusions about ecology being an exact science; but alarming that the age of a tree, say, or the nesting territory of a breeding bird, should be regarded as open to something approaching plea bargaining.

The debate about bird populations is rife with such nimble legalistic footwork. It is still argued, for example, that plantations *increase* the number and diversity of breeding birds – which, of course, they do, though only of those species that are abundant in woods and gardens throughout Britain and, temporarily, a few birds of prey. The specialist birds of the wet peatland are completely unable to adapt. But, the foresters argue further, surely these birds can "bunch up a bit", be more sociable, in the gaps between the plantations. As Michael Ashmole, director of Fountain, said of the greenshank, the Flow's third commonest but still somewhat expansive wader: "If a bird cannot thrive on 650 acres, then it doesn't bloody well deserve to survive." (His own company's productivity, incidentally, is one forester per 1000 acres of plantation.)

A decade of intensive research had shown that the greenshanks do try to bunch up for a year or so. Then the stresses of competition and overpopulation start to show. The birds lose weight, lay sterile eggs, lose chicks by drowning in the drainage ditches or to crows patrolling out of the new plantations, and start the inexorable decline into local extinction.

Most serious perhaps is the persistence of the argument that forestry is simply restoring a landscape destroyed by early farmers. Although some of the area's prehistory is still obscure, fossil pollen and pine stump fragments show that the last time native woodland (chiefly hazel, birch, rowan and Scots pine) grew on the open plateaux was 4000 years ago. A decisive wettening of the climate after that meant that young tree growth could not compete with the expansion of sphagnum, and woodland survived only in the better-drained valleys. Yet a writer in a recent article in *Shooting Times*, describing a conducted tour with Fountain's executives, talks of a "foul ... bankrupt land ... a denuded wilderness through man's intrusion".

This is not to say that conservationists have not indulged in some thoughtless glamorisation of history themselves. Lesley Crenna, NCC's representative in Caithness and herself a Highlander, says that what distresses the locals most is to have their homeland repeatedly described as "the last wilderness", or compared, as it has been, with "Serengeti and Amazonia".

Up here this is not seen as a compliment, but as an insult to the work they and their ancestors have put into the land. It makes them feel like savages. Certainly even the remotest part of the Flows shows the marks of hard, subsistence farming. Lonely homesteads, a few small plots of barley and oats, thin channels cut in the peat to provide fresh water.

These are difficult times for crofters, and a few have already sold out to Fountain. But what is alarming the Crofter's Union is a move towards speculative trading in crofting land. The holdings in this part of the Highlands are much bigger than those in the west, often several thousand acres in extent. Some have been purchased by outsiders, and there have been attempts to amalgamate and apportion the common grazing so that this can be sold off for forestry. (One such case in Caithness involves 4500 acres.) This is within the law of the 1976 Crofting Act, giving crofters the right to buy their holdings from the landlord for 15 times their annual rental, but quite against its spirit.

But the majority of crofters are still hostile to forestry. Andrew Cumming, who owns a prime bogland holding near Badlibster, compares afforestation quite explicitly with the Clearances. "They burned us then, now they are blanketing us," was his curt verdict.

The land round Cumming's holding, the Dubh Lochs of Shielton, shows how thin the line between wildness ⋙→

and habitation is here. The moorland along the edges of the roads is lined with narrow peat diggings, each with a handwritten sign giving the owner's name. Close to what was once the homestead, now a feed store, men are fencing a new winter stock-pen. Nearby is a more ancient stockade, knitted together out of waste metal and old farm machinery – a frugal way of recycling rubbish that no one would ever venture this far to collect.

But beyond the homestead, on the bog itself, the marks of nature and humans are less easily distinguishable. It is late July, and most of the breeding waders have left. But the dark piratical shapes of arctic skuas skim across the swaying plumes of cotton-grass, adding to that persistent impression that the entire landscape is shifting.

It is, in this oppressive rainforest humidity, a queasily disorientating sensation. The sodden sphagnum rocks under your feet. It has a tremulous, blubbery feel, like jelly. Thin sheets of rain swirl in from the north-west, blotting out first Sky Fea, and then the high Sutherland peaks to the west, until you have not the slightest idea which way you are facing. Every square yard of the bog in front of you is different, a constantly reshuffled mix of stagshorn lichens, sedge tussocks, and a dozen kinds of sphagnum, speckled with the sticky scarlet jaws of insectivorous sundews.

Every pool is different, too. Some encrusted with moss, others full of bogbean, or edged with the golden stars of bog asphodel. And winding through the landscape is a network of cryptic trails, thin ribbons of seepage water, as if the sphagnum had cracked. They may be natural, but the bog's skin is so fragile that it can show traces of damage for years. One is the unmistakable track of an otter, a darting, decisive run that plunges into a pool, parts the bogbean, and slithers out through the edges at the far side. But another is a human trackway, the old post trail that was still the postman's route across the bog until quite recently.

A few years ago a group of crofters walking home along this trail in winter became benighted. When they eventually arrived at a croft one of them was suffering badly from exposure. The others revived him by pressing hot stones against his feet, but succeeded in burning him in the process and in the end he had to be carried off the bog on a stretcher – again along the post trail. This story – better than any abstract definition – shows just where on the scale between wilderness and wildness the Flows lie.

It is against the working of "this delicate economic and social fabric" that the impact of afforestation has to be assessed. Its damaging side-effects on other sectors of the local economy have been considerable, especially because of the changes to the natural movement of water. Croftlands have been flooded as a result of the diversion of water down drainage ditches. Silt from ploughing has been washed into salmon spawning areas. Pesticide and fertiliser run-off is polluting watercourses and streams.

Whether it is worth growing trees at this kind of cost begins to look doubtful, especially when you add the danger of windthrow on this exposed plateau, and the ravages of the pine beauty moth, an endemic pest on peaty soils that can chew alien pines (not natives) to ribbons. Some of the trees here are growing better than has been painted by conservationists, but only because of the forestry equivalent of intensive care; and the National Audit Office, costing-out the whole operation last year, was scathing in its criticism. The real increase in value of the trees was little more than 1 per cent, which hardly justified the public subsidies being lavished on them.

At the moment each hectare of land costs an investor about £1000 to drain, plant and fence. Government planting grants are £240 per hectare, and the remaining expenses are allowable against the investors' profits from other sources. In 10 or so years the trees can be sold for probably between £700 and £1100 per hectare, and are exempt from capital gains tax. The annual pre-tax return to an investor, thanks to public subsidies, is likely to be between 15 and 30 per cent.

The *principle* that tree-planting should be eligible for government subsidy is obviously a commendable one. It means, for instance, that a conservation trust can obtain comparable grants and subsidies for establishing an amenity oakwood in an inner city. But from any political point of view it is a preposterous waste of public money if no public good accrues.

What conservation benefit, one wonders, is seen in Fountain's operations by Timothy Colman, ex-member of the Countryside Commission and of an

THE BATTLE OF THE BOGS continued

NCC advisory committee, in his 790 acres of afforested bog? What good works does London Tory Councillor Shirley Porter believe will spring from her 1700 acres? Lady Porter is founder of the Westminster Against Reckless Spending Campaign, but there is no sign yet of a cap on the £500,000 she is eligible for in planting grants and tax relief.

Even the generation of jobs in the forestry sector begins to look like another part of a gambler's dream. At the moment Fountain employs some 40 people in Caithness and Sutherland. The much-publicised figure of 2000 jobs turns out to be a projection 40 or 50 years hence, when the first rotation is due for felling and processing. Over the whole Highland region only 1500 people are employed in the forestry and saw-milling industries, and a good deal of work is done by contract labour, sometimes from as far afield as Germany.

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Whatever the outcome of the current battle, there will be a massive job of reconciliation to be done between the conflicting parties (at the moment, extraordinarily, there is not even an official forum where they can meet). The Peterborough-based NCC must learn to be more diplomatic in its dealing with a region 500 miles away, and to make it clear that it is not opposed to all development in the Flows. The foresters and Highland authorities must stop dismissing facts they do not enjoy and accept that there are alternative routes to job-creation. All must accept the historic presence in the Flows.

Yet there already are models of benign development programmes which respect the wildlife and crofting traditions of the peat plateau, but are encouraging alternative agriculture and new industries in the valleys. Two large estates on the eastern Flows, for example, have turned their back on conifer forestry altogether.

At Berriedale, north of Helmsdale, they have instead broadleaf woodland, a spring-water bottling plant and an experimental wind generator (the local authority wanted this to be conifer green but it remains a defiant airy cream above the moors).

On the 33,000-acre Dunbeath estate, the American millionaire Stanton Avery has established a conservation trust. His agent, Colin Scott, explained how they are trying to work with the local resources rather than against them, building a complex of fishing, deer farming, scientific research and tourism with the local community.

But I hope that we are wise and generous enough as a society not to regard land as "sterile" even if some of it has no clear economic use. Barry Lopez, in his celebration of northern landscapes, *Arctic Dreams*, suggests that the question wild places force us to ask is, "What does it mean to grow rich?" The Flow country is already rich beyond accounting. It is one of the great landscapes of the imagination, one of the engines of natural life of the northern hemisphere. Perhaps only a lucky few will ever see its wading birds, even as they fly through our southern estuaries and reservoirs on their migration flights to Africa. But that does not stop us thinking of them in their tens of thousands, displaying on the long sub-arctic summer evenings.

If the foresters are unimpressed, it will do them no harm to wait a decade or two till the arguments are settled. The peatlands have no such alternative. They are the product of thousands of years of evolution, and could never be recreated in our time ●

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bc BG

10 DOWNING STREET

LONDON SW1A 2AA

26 October 1987

From the Private Secretary

Dear Shirley,

OILSEEDS RESEARCH

The Prime Minister has seen your Minister's letter of 23 October about a possible provision which would allow a levy on purchasers or suppliers to help finance research and development of rapeseed. The letter implied that the provision could also in future be used to help finance R&D in other sectors of agriculture.

The Prime Minister would be strongly opposed to such a provision. This could too easily become a form of taxation which would replace public expenditure on agriculture R&D, pushing up agricultural production and slowing down the shift in R&D resources which may well be required. The Prime Minister believes there should be no compulsion to contribute to R&D, particularly in view of the generous tax treatment which is available for investment in R&D.

I am copying this letter to the Private Secretaries to the other members of E(A) Committee and to Mike Eland (Lord President's Office), Tim Walker (Department of Trade and Industry) and Trevor Woolley (Cabinet Office).

Yours,

David.

David Norgrove

DTS

Mrs Shirley Stagg
Ministry of Agriculture, Fisheries and Foo

EL3CFP

PRIME MINISTER

OILSEEDS RESEARCH

No — why should people be compelled to diminish their returns in this way

John MacGregor says that the "oilseeds industry" want to increase research and development on rapeseed, through a Development Council. This would be financed probably by a levy on a small number of purchasers or suppliers, which would require legislation. The legislation needed could also then be used to make similar arrangements for funding of R & D in other sectors of agriculture. This makes me uneasy. (and dangerous)

There is a case for such an arrangement where a discovery made at some expense by someone immediately and inevitably will become available to everyone without payment. Because the researcher will not in those cases capture the benefit of his research, that research is less likely to take place, and a levy system may be the right way of achieving a proper level of funding.

But how do we know this is so in this case? Mr. MacGregor says that the "industry" want such a levy and arguably research on "agronomic factors" falls within the category where a levy would be appropriate. But on the other hand this could become a means of raising taxes on farmers and others to finance research and development which is cut out by E(ST), pushing up agricultural production and slowing down or stopping a shift in R & D resources.

I suggest you ask for an urgent note on the principles which would be followed if this legislation is allowed, before agreeing to what appears on the face of it such a potentially far-reaching mechanism.

Content?

DRN

DAVID NORGROVE
23 October 1987

There can be no question of going ahead on a levy basis. Those industries which want to do research can go ahead and do it. The tax provisions are generous [illegible] dio

CCB

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD

WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

The Rt Hon Lord Young of Graffham
Secretary of State for
Trade and Industry
Department of Trade and Industry
1 Victoria Street
LONDON
SW1H 0ET

23 October 1987

Dec David

OILSEEDS DEVELOPMENT COUNCIL

On behalf of Agriculture Ministers in Great Britain, I am writing to you and other colleagues on E(A) Committee to propose seeking an amendment to the Industrial Organisation and Development Act 1947. We have already corresponded about this in respect of your Departmental responsibilities for that Act.

Who are they?

The oilseeds industry are anxious to secure an immediate increase in research and development on rapeseed, which they are willing to finance and implement through a Development Council under the 1947 Act. The urgent desire for this stems from the prospective withdrawal in 1991/92 of European Community support for the type of rapeseed currently grown here. Rapeseed is our third largest crop (1.3 million tonnes estimated for the current season) and we are the second largest producer in the Community. Both growers and traders are deeply concerned about the need for R & D on agronomic factors which would affect the ability of UK growers to adjust to the new varieties of rapeseed, in which their European competitors have a substantial lead.

Industry funded research would be fully in line with current Government philosophy on the need for industry to take greater responsibility for research and development. For logistic reasons, however, the work would need to be funded by a levy on growers and first buyers, but collected by the latter.

/Unfortunately, our legal...

Unfortunately, our legal advice is that we could not arrange the collection of the levy by this route in the absence of specific provisions in the Industrial Organisation and Development Act analogous to those incorporated in the Cereals Marketing Act 1965 as amended by the Agriculture Act 1986. Since the most economical means of collecting levies is often via a small number of purchasers or suppliers rather than directly from all producers, the proposed amendment to achieve this could also facilitate industrial funding of research and development in other sectors of agriculture.

The necessary amendment to the Industrial Organisation and Development Act could be achieved by a short, probably single clause, Bill. Given the wide degree of support the idea of establishing an Oilseeds Development Council has received, this amendment should not prove controversial. It is almost certainly too late for this to be a Private Member's Bill this year. But I have briefly discussed the matter with the Lord President and if we were to get policy clearance he feels that it might be appropriate for introduction in the House of Commons as a Back of the Chair Bill. There are no direct EC or manpower implications or budgetary consequences.

I should be grateful for colleagues' early approval to our seeking these amendments, and to the Lord Privy Seal's agreement to our doing so by way of a Private Member's Bill. We will be clearing our lines with the Commission at the appropriate stage in the usual way. In view of the urgent need for increased R & D in the oilseeds sector we would aim to launch the Bill as soon as possible, with a view to having the Council in operation, if at all possible, in time for next year's harvest.

I am copying this letter to the Prime Minister and other members of E(A) Committee, to the Lord President and to Sir Robert Armstrong.

Yours ever,

John

JOHN MacGREGOR

~~SECRET AND PERSONAL~~

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DOWNGRADED 26.4.88 file DG2CIL

SUBJECT: cc-MASTER

3 bc. BG

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

23 October 1987

Dear Jonathan,

FORESTRY: TAX REFORM, THE ENVIRONMENT AND PRIVATISATION

The Prime Minister this afternoon discussed with the Chancellor of the Exchequer his minute and paper of 19 October about forestry. The Secretary of State for the Environment and the Minister for Agriculture were also present, together with Professor Brian Griffiths of the No. 10 Policy Unit.

It was agreed after a brief discussion that the proposed four year transitional period under the third option would probably be adequate. However, it might perhaps be increased by a year or two if there were great pressure for this.

It was agreed that the Chancellor of the Exchequer should send a revised paper to the Prime Minister, copied to the Lord President, the Secretary of State for the Environment, the Minister for Agriculture and the Secretaries of State for Wales and Scotland, with a view to a meeting under the Prime Minister's chairmanship. The paper should not discuss the possibility of reforming and privatisating the Forestry Commission. The Chancellor would consider how the new grants regime should be presented in the paper. He would also make contingency plans for an early announcement, before the Budget, to prevent forestalling if news of the discussions were to leak.

Yours,

David.

David Norgrove

Jonathan Taylor, Esq.,
H.M. Treasury.

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CONFIDENTIAL Downgraded 25.4.88

PRIME MINISTER

FORESTRY

Your meeting tomorrow is with the Chancellor, Mr. Ridley and Mr. MacGregor.

The decision needed is whether you are sufficiently in agreement with the Chancellor's proposals to allow them to be put to Malcolm Rifkind and Peter Walker for a discussion, again under your Chairmanship. You do not need to decide tomorrow that the proposals are fully acceptable. You also do not need to decide tomorrow whether the Forestry Commission should be reformed and privatised.

At present the tax system is such that the expenses of planting can be offset against income and the returns from felling can be treated as a capital gain. The result is that the post-tax rate of return is higher than the pre-tax rate of return. The Chancellor's proposal is to exempt forestry from tax. After a few years this would yield a tax saving of £10 million a year. This saving would be used to finance a new grant scheme which would be designed to produce more environmental planting. During the transitional period the grants would cost more than the tax saved. (The transition is discussed in paragraph 19.)

The Treasury believe that the grants could be such as to sustain a high rate of new planting, with increasing production of timber.

You will be familiar with the arguments for and against support for forestry. These are set out in paragraphs 7 and 8. However, on the basis of the paper such arguments are largely irrelevant: continued support is not in question; the only argument is over the form of the support. A shift towards broad leaved planting would have no doubt some effect on where trees were planted, with a shift towards lowlands.

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~~SECRET AND PERSONAL~~

DRN

22 October 1987.

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~~SECRET AND PERSONAL~~

DOWNGRADED ON 26.4.88

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Prime Minister

To be aware. (I am arranging a meeting as the Chancellor asks.)

DGN 20/10.

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

PRIME MINISTER

FORESTRY : TAX REFORM, THE ENVIRONMENT AND PRIVATISATION

The ALURE Group recognised the desirability of reappraising forestry policy after the election and I am anxious to push ahead with reforming the present forestry tax regime in time to include it in next year's Budget.

I have therefore arranged for the attached paper to be prepared. It has been agreed with both Nicholas Ridley and John MacGregor. It outlines a comprehensive set of reforms which looks beyond the 1988 Budget. The main proposals in the report are:

(a) ending the present bizarre tax regime, which serves principally as an avoidance vehicle for top rate taxpayers and has also become an obstacle to privatisation; and instead exempting forestry from income tax completely, so that revenue would not be taxed and costs would not be allowed. Because the present tax regime provides a subsidy, the exchequer would benefit from this change;

This will mean that Jones's who started on the basis that costs will be allowable will quite suddenly not be able to continue — transitional provisions?

(b) using the resulting revenue gain to finance increased and redesigned grants for forestry. The effect would be to get more environmental benefits for the considerable exchequer costs already incurred in existing forestry policy;

(c) separating, probably at a later stage, the Forestry Authority role of the Commission from the Forestry

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Enterprise; and privatising the enterprise side probably over a period of years.

I believe these reforms would be a big step forward and politically attractive. They would be an answer to criticisms that the present regime gives too much to higher rate taxpayers and also to the strong pressure from the Nature Conservancy Council and environmental pressure groups against large scale planting of conifers. But because (c) would be resisted by the Forestry Commission and its supporters, I propose that we should handle this in two stages. We would pursue (a) and (b), which are the urgent parts of the proposal, immediately; and come back to (c) after the Budget.

Nicholas Ridley, John MacGregor and I all favour moving quickly in this direction. The Treasury and Inland Revenue have drawn on advice from DOE and MAFF officials in preparing the report I commissioned, but I have not at this stage consulted Malcolm Rifkind or Peter Walker. Although the report's figuring is based on earlier Forestry Commission data, it may well need to be up-dated and refined.

It would be helpful if you could discuss these proposals and their handling with the three of us. If you find them attractive, I suggest the next step would be for me to send a paper covering the tax and grant proposals but <u>not</u> privatisation etc to Malcolm Rifkind and Peter Walker. If you agree, I would propose a discussion of that paper under your chairmanship. I hope that the meeting can be held soon. If we are to announce the proposed tax changes in the Budget, we ought to announce a new grants regime (which will need further detailed work) at the same time. But this should be possible provided we take decisions rapidly.

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I am sure the security classification of these papers will be self-explanatory.

I am sending copies to Nicholas Ridley and John MacGregor.

N.L.
19 October 1987

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~~SECRET AND PERSONAL~~

REFORMING FORESTRY POLICY

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L/A

REFORMING FORESTRY POLICY

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I INTRODUCTION

1. The purpose of this paper is to outline a set of proposals for a major reform of forestry policy. The process of reform would not be painless and the result would not be perfect since there would still be a number of anomalous features. But the policy proposed would be based on more up-to-date objectives especially on taxation and reducing the State's direct participation in productive activities. There would still be subsidies for forestry but they would be better targeted.

2. When presenting these proposals publicly, the Government would need to explain the reasons for the proposed changes. Government policy towards forests appears to be inconsistent with general policy on industrial support. In particular, Exchequer assistance is difficult to justify in relation to a rationale for intervention based on market failure, although the long production cycle for timber arguably raises some special considerations. Nonetheless there remains strong regional interest in continued support for forestry and there is widespread concern about the role of forests in the general environment. Yet, the current support mechanisms involving heavy reliance on tax relief and favouring top rate tax payers, sit uneasily with the Government's general policy towards taxation and make privatisation difficult, while at the same time failing to satisfy these environmental concerns. It is at the latter issues that these proposals are aimed.

3. The main proposals are

(a) income tax exemption for forestry, replacing the present regime;

(b) re-designing the grant schemes to increase the environmental benefits of the considerable exchequer costs incurred in present forestry policy;

(c) separating the Forestry Authority role of the Commission from the Forestry Enterprise which would be privatised as soon as practicable, probably on a piecemeal basis and over a period of years.

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4. This paper has been prepared without consultation with the Forestry Commission or the Scottish Office. Thus, although the quantification provided mostly derives from material provided by the Commission on earlier occasions, it may need to be refined and updated.

II OBJECTIVES

5. The current objectives of Government forestry policy stem from the Acland Committee report of 1917. They were restated in 1980 by the then Secretary of State for Scotland as "to reduce our dependence on imported wood" with a secondary objective of stimulating rural employment. In March 1986 a further statement set a general aim of planting 30,000 hectares (ha) a year against the 25,000 ha in the 1980 statement. This was raised to 33,000 ha following the ALURE group discussions earlier this year. On neither occasion was the figure presented as a firm commitment.

6. Forestry expansion has been promoted by the activities of the Forestry Commission itself and by grants and tax incentives to the private sector. The cost of these measures in 1987-88 is expected to amount to about £50 million: public expenditure of £32 million on the costs of the Forestry Enterprise, £14 million on the Forestry Authority, £8 million in grants to the private sector; receipts from planned disposals of £13 million; plus about £10 million in revenue currently foregone from tax concessions. The private sector now accounts for more than 80% of total new planting compared with 35% in 1980. The policy has undoubtedly been a success in terms of new planting: the woodland area of Britain has increased from 1.2m ha in 1924 to 2.2m ha now. Some key background facts are set out in Annex A.

7. The present policy is, however, open to a number of criticisms. It was against the background of these that the ALURE group recognised the desirability of pursuing a fundamental re-appraisal of forestry policy after the General Election.

(i) the historic economic justification for a subsidy aimed at limiting imports is not easily reconcilable with the Government's general trade policy; nor is there any clear justification for assistance in the context of the general market-failure rationale for Government intervention and industrial support;

(ii) the social value of forestry as a creator of jobs is doubtful: new employment is not necessarily located in areas where it is most needed, jobs only emerge to any significant degree fairly late in the forestry cycle, after a period of some 35-40 years at the earliest; and in the North of Scotland, where most planting occurs, costs per direct job are estimated at £8000 per year, which after appropriate adjustments yields a cost per job nearly double that achieved by the Highlands and Islands Development Board, the development agency for the area;

(iii) there is widespread criticism of new plantations on environmental grounds, because the losses of wildlife outweigh the gains, because they can damage water quality, and because of the scenic monotony of unrelieved masses of conifers;

(iv) the fiscal arrangements run counter to the Government's aim of removing from the tax system features which distort commercial judgements; present arrangements allow very high rates of subsidy to investors in the highest tax brackets who have no real link with the land; and they hinder privatisation;

(v) the institutional appropriateness of the Forestry Commission with its multiple role as policy adviser, regulator and commercial enterprise is questionable.

8. On the other hand there is a strong body of opinion in favour of Government support for forestry.

(i) It is argued that the very long life of forestry investment might discourage investors, who are often averse to the risk associated with waiting a long time for returns, and lead to under-investment. It is also argued that the benefits of tree planting for nature conservation, amenity, recreation, sporting and shelter justify a subsidy in appropriate cases;

(ii) More sensitive planting techniques are now being devised and adopted, and the considerable recreational potential of forests is being exploited. As a result of these trends forests can often be environmental assets;

(iii) As for employment creation, while it is difficult to make a case on cost-effectiveness grounds, it can be argued that the contribution of forestry to income and employment in many scarcely populated and fragile rural areas argues for some caution when considering withdrawing Exchequer support. In certain areas it may take a considerable time to offset the income and employment consequences of a halt to new planting.

(iv) While the present fiscal arrangements are anomalous, bringing them to an end will not necessarily result in higher revenue or more productive investment; some taxpayers will always seek to shelter their income from tax and ending this shelter may mean no more than a switch of resources from one shelter to another;

(v) There is also an "insurance" angle. Although there is no clear evidence about market trends there are longer term uncertainties about the availability of imported timber. Other Community countries apparently consider the possibility of a future world timber shortage sufficient to justify a considerable degree of support for domestic production anticipating an average level of self-sufficiency of some 50% by the turn of the century compared to 25% in prospect for the UK. Those supporting these European decisions consider that existing UK levels of subsidy can similarly be justified as an insurance premium against future world timber shortages. The House of Lords report on EEC Forestry Policy in the 1985/86 Session in supporting continued but carefully managed expansion of forestry emphasised balance of payments considerations.

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III TAX REFORM

The present regime

9. The present income tax regime for forestry is unique and curious, not least because it provides a net Exchequer subsidy for investment in planting trees: foresters would be worse off than they are now if forestry were exempt from tax altogether. An occupier of woodlands managed on a commercial basis with a view to profit is taxed under Schedule B, an archaic income tax schedule now confined exclusively to forestry. This results in a purely nominal charge which works out on average at about 15p per acre per year. In addition the tax payer has an option to elect for Schedule D (the schedule under which businesses generally are taxed).

10. The normal practice is for people in the early stages of a woodland, when costs are heavy and there are no receipts, to elect for Schedule D so as to be able to claim the expenditure as a tax relief against their other income. Someone opting for Schedule D cannot subsequently revert to Schedule B. They can, however, contrive a change of occupation. This can be done by selling the woodlands or giving them away (often to a family trust or another member of the family). This has the result of returning the woodlands to Schedule B. There is no CGT charge on the sale of trees.

11. The result is that the expenses receive tax relief under Schedule D (at 60 per cent if, as is usual, the first occupier is a top rate taxpayer) while the receipts are effectively exempt. This regime appears to be more generous to forest owners than those applying in France, West Germany and the USA.

12. These arrangements provide an attractive tax shelter for higher rate tax payers particularly as there are also favourable inheritance tax rules for woodlands. A number of commercial forestry companies have been established to market these and to manage the woodlands on behalf of the investors who receive the tax reliefs and the Forestry Commission grants (see paragraph 21 below). The companies concerned do not themselves own the land or invest shareholders funds directly.

13. Annex B sets out the economics of a typical conifer plantation and a typical broadleaved plantation. The figures are derived from information provided by the Forestry Commission but should only be regarded as broad estimates of typical returns: figures for individual plantations will vary. The internal real rate of return on the conifer plantation is increased by tax from 5 per cent pre-tax to 7.1 per cent post-tax; comparable figures for the broadleaved plantation are 2.9 per cent and 3.8 per cent. In other words the tax system is actually providing a subsidy to planting. Grants further increase the internal rate of return to 7.8 per cent for conifers and 4.6 per cent for broadleaves.

14. The present cost of tax relief on planting is around £10 million a year.

15. Continuation of this regime sits uneasily with the Government's general position on taxation. The underlying direction has been to reduce rates of direct tax but also to reduce or eliminate special reliefs or shelters which distort economic decisions.

Options for reform

16. There are three options. The <u>first</u> is to put forestry on the same fiscal basis as other businesses. Income would be taxed and the expenses would be allowable but not until the income was received. Because of the long life cycle of the crop and the lumpiness of the receipts this option would create major problems for the industry. Woodland owners would have to wait 30 years or more for their relief and the income would almost invariably be taxed at the highest rate. Some arrangement would be necessary for spreading the income over a number of years. Moreover, as Annex B shows, the effect would be to reduce the rate of return on conifers from 5 per cent (pre-tax) to 4.2 per cent (after tax) with no inflation and to 3.9 per cent (after tax) with inflation at 5 per cent. The rate of return on broadleaves would fall from 2.9 per cent to 2.1 per cent with no inflation and 1.9 per cent with 5 per cent inflation. This option would be strongly criticised by forestry interests and looks the least attractive of the three.

17. The second would be to abolish Schedule B, to tax all receipts under Schedule D but to allow relief for planting expenditure to be set against other sources of income as and when the expenditure is incurred. Post-tax rates of return would be very close to pre-tax rates of return. The Exchequer would eventually receive an extra £100 million a year from the abolition of Schedule B but initially there would be no Exchequer saving. Moreover, as would also be the case with the first option, arrangements for spreading would be necessary.

18. The third and by far the simplest option would be to exempt forestry entirely from tax. Receipts from the sale or felling of timber would not be charged to tax and the costs would not be allowed. After a short transitional period there would be a tax saving of around £10 million a year. Tax considerations would no longer distort commercial judgements, though the regime would be more favourable than for business generally.

19. Under all three options transitional arrangements would be required. With the third option (the exemption option), for example, it would be difficult to defend cutting off relief for expenditure overnight. But because the bulk of expenditure takes place in the first 2 or 3 years the transitional period with this option could be quite short. A 4 year period might be sufficient. On this assumption the tax savings as they would be published on Budget Day might be of the order of:

	£m
Year 1	0
Year 2	+1.5
Year 3	+4
Year 4	+6
Year 5	+7.5
Year 6	+10

With both the other options it would be difficult to justify a charge to income tax on receipts from forests which have been planted in the expectation that the present regime would continue. A very long transitional period stretching ahead for decades would therefore be required.

20. The present tax subsidy would be removed under both these options. The exemption option ie (option 3) would require careful presentation and would need to be firmly related to the peculiar features of forestry and the need for simplicity. But with that proviso it seems preferable to option 2 because it is simpler, yields savings quickly and avoids the need for long transitional arrangements. **It is the option we recommend.** Provided the grants are sufficient to enable plantings to be maintained at broadly their present levels, forestry management companies should still be able to operate successfully on much the same basis as now but with a wider range of investors. But forestry would no longer be seen as the preserve of top rate tax payers.

IV CHANGING THE GRANT REGIME

21. There are at present several schemes under which grants are paid for afforestation. The main one is the Forestry Grant Scheme under which grants are paid for conifer and mixed plantations. Almost all the major plantations which receive the special tax allowances qualify for grant under this scheme. There is also the Broadleaved Woodland Grant Scheme, introduced in 1985, under which higher rates of grant are paid for woodland comprising only broadleaved trees. Rates of grant for these two schemes are as follows:

RATES OF GRANT (£ per ha)

Area of Woodland ha	Forestry Grant Scheme(1) Conifers	Forestry Grant Scheme(1) Broadleaved	Broadleaved Woodland(2) Grant Scheme
0.25- 0.9	630	890	1,200
1.0 - 2.9	505	735	1,000
3.0 - 9.9	420	630	800
10 and over	240	470	600

NOTES (1) Grants are paid pro rata to the proportion of conifers and broadleaved trees. 80% is paid on completion of planting and 20% five years later subject to satisfactory establishment.

(2) 70% is paid on completion of planting and 15% each five and ten years later subject to satisfactory establishment and maintenance of tress.

In addition to these two schemes, a proposed Farm Woodland Scheme was announced in March this year. Under this scheme, to supplement the planting grants, there would be annual payments to compensate for loss of income from farm crops.

22. The new grants structure proposed in paragraph 26a is intended to replace the Forestry Grant Scheme. However, it would be sensible to subsume the Broadleaved Scheme in the new structure since the grant rates would be more favourable. The new planting grants would in principle also apply to the Farm Woodland Scheme although some adjustments might be necessary.

23. It is proposed that changes in the grant regime would be announced at the same time as the tax changes. The grant increases would apply immediately whereas the tax savings would not begin to accrue until the following year. However, it should be possible

over the transitional period as a whole for the increase in grants to no more than match the tax saving, by phasing in the increased grants and particularly by reducing the proportion of grant paid in the first year. However, in the first 5 years expenditure will exceed the tax saving (see Annex C).

24. As a result of switching from tax relief to grants, it will be possible to devise a regime which is much more effective in achieving environmental objectives, as set out in Annex D. It will also be easier to defend the new system if the grant structure is broadly consistent, subject to inevitable uncertainty about take-up, with the aim of 33,000 ha of new planting a year announced in March with the ALURE package. It would be important to formulate at the outset an evaluation plan for assessing the success of the revised grant scheme in achieving its specific objectives. The new grant rates should be cash limited and also subject to an early review, which could involve reductions in rates if demand turns out to be higher than anticipated.

25. For illustrative purposes, it is assumed initially that the £10m saved (after a transitional period) of several years (see paragraph 19) from the tax changes could all be used to increase grants. The possible effects of using only half this sum are also examined briefly. Several cautionary points need to be made. First, the figuring is based on partial information and must be regarded as tentative. The main data lacking are a size structure analysis of new plantings and figures such as cost per ha by size and type of plantation which are necessary in drawing up an appropriate scale of grants and would help in assessing possible response rates to grants at various levels. Second, while higher grants could increase incentives to non and low rate tax payers, many potential farming investors - unlike the current high tax paying investors whose primary aim is to save tax and convert that into a capital asset - may not be able to afford the loss of income from their land. The present analysis assumes that grants would contribute only to costs of planting and would not compensate for income foregone. Under this assumption, only a limited increase in investment by non and low rate tax payers could be expected.

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26. The changes in grants would be designed to blend environmental needs and commercial considerations. The new regime would encourage smaller plantations and the planting of more broadleaved trees (either on their own or to break the monotony of conifer plantations) by:

i. requiring all plantations above a certain size to contain at least a minimum proportion of broadleaved trees, except where climate and geography make this impossible. A reasonable threshold would be 3 ha and a reasonable proportion 15%. These broadleaved trees would of course attract the higher rate of grant

ii. extending the existing grant differential in favour of smaller and medium size plantations.

On the illustrative expenditure assumption in paragraph 25 the pattern of grants could be such as to sustain a high rate of new planting and thereby maintain steady growth in jobs in rural areas and, over future decades, enable the production of timber to expand.

26a. The following table illustrates how these principles might be embodied in a grant schedule. The figures are tentative at this stage because the choice of actual figures will require careful study in the light of more refined and up to date estimates of planting costs, and of the existing and expected size distribution of plantations. But preliminary calculations indicate that, following exemption from taxation, the internal rate of return from both conifers and broadleaves could be maintained at around existing levels, if grant rate for conifers were increased by some £300-£350 per ha and for broadleaves by some £350 and £400 per ha. These are illustrative figures related to plantations in the medium-size range.

Possible pattern of Grant Rates

£

	Present Grants		New Grants	
	Conifer	Broadleaved	Conifer	Broadleaved
0.25 - 0.9	630	890	800	1200
1.0 - 2.9	505	735	750	1100
3.0 - 9.9	420	630	700	1000
10 and over	240	470	600	900
50 - 100 ha			500	800
100 - 500 ha			450	700
500 and over			400	600

27. As in the present grant regime, grant would be refused if it was concluded, after consultation with the relevant statutory authorities, that a proposed plantation would not be environmentally acceptable. Refusal of grant would be a much more effective sanction in future because tax relief would no longer be available and the grant would represent a higher proportion of the costs of planting. It might also be desirable to widen the circumstances in which grant is refused, for example to protect moorland areas, (preferably without creating rights to compensation). Precise guidelines and how they would be implemented would require consultation with the Forestry Commission and other interests. Where grant was forthcoming, the condition about a minimum 15% of broadleaved trees would normally apply, as described above, and the grant structure would provide financial incentives for more scenically attractive forms of planting, which would also safeguard wildlife. These

above, and the grant structure would provide financial incentives for more scenically attractive forms of planting, which would also safeguard wildlife. These features of the new regime would make it broadly acceptable to environmental bodies, and enable the Government to resist pressure to make afforestation subject to planning control or a new system of planting licences.

28. It would also be desirable to reduce the workload involved in examining and consulting about individual grant applications. One possibility would be to formulate a comprehensive code of practice containing clear criteria for the environmental impact of forestry operations and to require applicants for grant to certify that their proposed scheme complies with a code of practice. But this would similarly require extensive consultation and could not therefore be introduced at the outset.

29. The possibility of limiting the increase in cost of grants to £5m would not assume that the present degree of Exchequer subsidy should be maintained or improved. Halving the increases in the above schedule would be seen as producing incentives inadequate to achieve the aim of 33,000 ha of planting annually. Adjusting the rates for particular categories of woodland would enable environmental objectives to be achieved but only at the expense of bigger cuts in incentives to commercial forests. It is hard to say what could be achieved for £5m but if the above schedule were lowered by a little over £100 per ha, it might achieve planting of around 20,000 ha. (This is not much different from the current planting rate of 23,000 ha in 1986).

30. The tentative conclusion is that subject to a more detailed study it should be possible through additional spending of £10m to devise a system of grants resulting which would:

(a) achieve an environmentally more favourable pattern of afforestation which would be acceptable to the main environmental bodies;

(b) give a pattern of incentives which it could be demonstrated were only slightly below present levels for higher rate taxpayers (and to other than highest rate tax payers were higher).

given the change in the form of the incentive, and particularly the differential effect on high and low tax payers, it is not possible to be certain how the level of planting would be affected.

31. The suggested grant scheme would initially involve some Exchequer cost, but this would be relatively small (£7.0m over 5 years - see Annex C). The use of a cash limit, in contrast to current demand led schemes, would also help to avoid additional costs. A more modest scheme, at around £5m a year, would probably achieve the environmental benefits described and would be more consistent with the Government's general approach to industrial support in other sectors. But it seems unlikely that any pattern of grants based on this figure could be presented as coming close to achieving planting of 33,000 ha a year, and to this extent a higher level of grants - up to £10m - maintaining or improving existing Exchequer subsidies - would clearly be easier to defend in these terms. There is certainly no case for raising the overall level of Exchequer support for commercial forestry above its current level.

V TIMING AND NEXT STEPS

32. If Ministers approve a reform package on the lines set out in this report, there would be a strong case for announcing it in the 1988 Budget and including the tax changes, which would take effect from Budget Day in the Finance Bill. If implementation were later, there would be a forestalling problem which would be difficult to solve. Early action is also desirable because of the strong pressure on the Government from the Nature Conservancy Council and environmental pressure groups, especially over the large-scale planting of conifers by high-rate tax payers in Caithness and Sutherland.

33. But to meet this timetable and in particular to ensure that the Finance Bill clauses can be drafted, decisions would have to be taken urgently. Further work would also be needed on the detailed design of the new grant regime to maximise the benefits within the upper limit of £10m a year or whatever lower figure Ministers decided on.

33. Whatever Ministers decide on the future of the Enterprise (see below) there is a case for a more formal separation of the two arms of the Commission. Such a separation would in any case be essential for large scale privatisation. The functions of the Forestry Authority, which would need to continue in the public sector, include:

- advice to the Government on forestry policy;

- implementation of policy through the administration of grant schemes, plant health and felling controls;

- research and advisory services (preferably funded as far as possible by the private sector);

- statistics and public information.

In 1985 the Commission calculated that these functions could be carried out by a staff of 450-500 (including about 200 inspectors), less than 10% of its present total, at an average cost of around £20m a year before assuming any increase in grant expenditure.

34. The Forestry Authority could be reconstituted as a separate small Government department to fulfil these functions, but it would probably make better sense and be more economical to integrate these functions into existing Departmental structures. The Authority's functions would fit naturally into the three Agricultural Departments (as in Northern Ireland at present), although on many matters the Departments would need to act in close consultation with the Department of the Environment. Under this arrangement the Secretary of State for Scotland would continue to be the lead Minister for forestry matters. Further consideration may be necessary on the most cost effective administrative arrangements.

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Privatisation

35. The Forestry Enterprise runs the 43% of the national forestry estate in public ownership (nearly two-thirds of which is in Scotland) broadly on commercial lines: its principal objective is to achieve a prescribed (albeit low) financial rate of return (3% in real terms), although it has subsidiary objectives of preserving the environment, maintaining rural employment which a fully commercial company would not be obliged to pursue. The Enterprise also ensures public access and recreation. Because most of its forests have been planted since the second world war it requires a continuing subsidy towards net operating costs of around £30m a year and these costs are likely to continue to fall on the Exchequer for another ten to twenty years if there is no change in the status of the Commission.

36. Since 1980 the Government's policy has been to encourage private sector planting; the proportion of new planting by the private sector has risen from about 35% to 85% over the intervening years within a broadly similar total of some 24,000 ha a year. A disposals programme was introduced at the same time, initially to provide opportunities for private investment and reduce the Commission's net call on public expenditure. A subsequent statement in 1984 changed the objective to one of estate rationalisation. Under this programme the Commission has reduced its holdings by some 60,000 ha (5%) producing receipts of around £100m in the years up to 1986-87. Further disposals worth £42m are planned for the period 1987-88 to 1990-91 inclusive. Receipts are credited to the privatisation programme and are not available for redeployment by the Commission.

37. There was some preliminary consideration of the prospects for privatising the Enterprise in the autumn of 1985 following a paper which proposed its incorporation as a PLC by one of the independent Forestry Commissioners, Mr Ian Coutts. The issue was

discussed at a meeting between Forestry Ministers and the Financial Secretary in February 1986 but not pursued thereafter. More recently, the Secretary of State for the Environment proposed that the prospects for privatisation should be considered in the context of the ALURE group discussions. N M Rothschild and Sons have sent an informal paper to the Financial Secretary suggesting that privatisation could be achieved by a combination of piecemeal sales and the introduction of competitive tendering for the management of any residual estate. In the past a major objection to privatisation has been that it would amount to selling future tax breaks (ie the Schedule B/D option for which the private sector but not the Commission is eligible under the present arrangements) and the risk that despite the conventions that one Government cannot bind another successive Governments would effectively be obliged to maintain the present tax system unreformed after privatisation. The proposals for reforming the tax position earlier in this paper would remove that objection. The proposals for a reformed grant structure with much stronger environmental objectives together with other public interest safeguards (see below) should do much to overcome the objections of the forestry lobby to privatisation.

38. In determining the strategy for privatisation a number of political and technical issues would need to be resolved. These would include:

(i) <u>public interest aspects</u>, ie ensuring that privatised forests are managed in such a way as to protect flora and fauna and provide continued public access for recreation. It would have to be accepted that the relevant safeguards will reduce the proceeds from privatisation. The private companies would be subject to general legislation for the protection of water supplies and sites of special scientific interest, but it might be necessary to prevent them qualifying for compensation under the latter heading. Protection of the landscape would be secured by applying the new grant regime to restocking. To protect access, companies might be required to enter into satisfactory access agreements with the local authority prior to sale. It might also be necessary to consider giving statutory backing to the code of practice envisaged in paragraph 28 above. Excessive regulatory requirements would deter potential investors: for a limited number of "heritage forests", such as the New Forest, continued public ownership might be the best solution.

(ii) Profitability: the likely continuing cash deficit of the Enterprise for the next ten to twenty years suggests that early privatisation would mean splitting the Enterprise and selling the most mature forests first.

(iii) Industry structure and Competition: A progressive series of sales as in (ii) would probably fit better with the structure and scale of existing private forestry companies. The extent of competition would in practice be fairly limited - in the Commission's view competition tends to be highly localised within timber market catchments which typically have a radius of 100 miles or so.

(iv) Proceeds: merchant bank advice would need to be commissioned on the proceeds which might be achieved. In 1985 the Commission calculated that the proceeds might fall in the range £200m to £500m (compared with the book value of the assets of some £1.3 billion).

(v) Public Expenditure: Complete privatisation would initially relieve the Government of the net operating costs of the Enterprise of about £30-40m a year for ten to twenty years. (After that it would forego the expected cash inflow from increased felling). There would be a continued need to fund the Forestry Authority at some £20-30m a year. (A full assessment of public expenditure costs would need to include increased grant expenditure on restocking and new planting, for which the Enterprise is not currently eligible; and the operating costs of any residual parts of estate which may have to be retained (e.g. heritage forests).

(vi) Legislation: Selling off separate forests would not require primary legislation: the powers exist under the Forestry Act 1980. Legislation would only be required if the Enterprise were privatised as an entity or if major changes were made in the responsibilities of the Authority.

39. Once Ministers have announced their decisions on the future tax and grant regimes, it would be necessary to commission a merchant bank study of the best way of privatising the Enterprise. Draft terms of reference are at Annex E. Final decisions on how best to proceed with privatisation could be taken in the light of their report and further analysis of the other issues outlined above.

VI TIMING AND NEXT STEPS

40. If Ministers approve a reform package on the lines set out in this report, there would be a strong case for announcing it in the 1988 Budget and including the tax changes, which would take effect from Budget Day in the Finance Bill. If implementation were later, there would be a forestalling problem which would be difficult to solve. Early action is also desirable because of the strong pressure on the Government from the Nature Conservancy Council and environmental pressure groups, especially over the large-scale planting of conifers by high-rate tax payers in Caithness and Sutherland.

41. But to meet this timetable and in particular to ensure that the Finance Bill clauses can be drafted, decisions would have to be taken urgently. Further work would also be needed on the detailed design of the new grant regime to maximise the benefits within the upper limit of £10m a year or whatever lower figure Ministers decided on.

ANNEX A

FORESTRY: BACKGROUND FACTS

	1987-88	1988-89	1989-90	£m 1990-91
1. PUBLIC EXPENDITURE				
Baseline	53.8	54.2	55.1	56.5
Of which				
Grants to private sector	8.3	8.8	9.6	9.8
Other Forestry Authority expenditure	13.7	14.6	15.2	15.6
Forestry Enterprise net expenditure	31.8	30.8	30.3	31.0
planned receipts from disposals	-13.0	-12.0	- 12.0	- 7.0
1987 Survey bids (related to ALURE proposals)				
Grants:				
traditional forestry		2.3	2.4	2.4
farm woodlands		2.2	4.6	4.8

2 FORESTRY AREA

	Conifers		Broadleaves and Coppice		Total	
	'000ha	% privately owned	'000ha	% privately owned	'000ha	% privately owned
ngland	395	50	461	91	856	72
ales	175	26	61	90	236	43
cotland	891	42	77	95	968	45
reat Britain	1461	43	599	91	2069	57

3 FORESTRY PLANTING

	England	Wales	Scotland	Great Britain	
	'000 ha	'000 ha	'000 ha	'000 ha	% privately owned
1978	2.1	1.4	17.1	20.6	32
1982	1.5	1.3	20.8	23.6	53
1986	1.2	0.8	21.3	23.3	82

4. FOREST EMPLOYMENT

	End March 1980	End March 1986
Forestry Commission	8,000	6,000
Private Sector	11,000	12,000
related processing	33,000	27,000

5. RATE OF RETURN FROM FORESTRY

Forestry Commission
financial target (1982-87) 2.25%

expected outturn: 2.9% (Average: rate of return on some new planting in remote areas estimated at 1.5%)

BASIC FORESTRY ECONOMICS

In 1984 the Treasury and Forestry Commission agreed figures for a typical hectare of Sitka spruce, as a benchmark case for calculating the effects of the tax and grant regimes.

These figures have been updated to 1986 prices, with revised estimates of initial costs (agreed with Forestry Commission in January 1987) assuming good quality land. At current prices (before taking account of future inflation) they are:

SITKA SPRUCE - 54 year cycle

Costs		£
Annual	Maintenance	10
Year 1	Plough/scarify	80
	Fence	120*
	Plant	200
Year 2	Beat up	50
	Weed	80
Year 3	Weed	80
Year 4	Weed	80
Year 8	Clean	50
Year 15	Fertilise	40
Year 21	Brash	5

Returns		£
Year 29	Thinning	230
Year 34	"	435
Year 39	"	550
Year 44	"	645
Year 49	"	740
Year 54	Felling	7925

* Agricultural buildings and works allowances are available on this item at a straight line rate of 4% in each of years 1 to 25.

The equivalent figures for a typical broadleaf wood, (on which the figures for returns are less reliable) are estimated as:

BROADLEAF - minimum 108 year cycle

Costs

as above

Returns		£
Year 58	Thinning	390
Year 68		740
Year 78		940
Year 88		1100
Year 98		1260
Year 108	Felling	13470

Grants are available on new planting at rates for 1986 of

£240 per hectare for conifers
£470 per hectare for broadleaves

where the area planted exceeds 10 hectares. 80% is paid in the first year and 20% four years later. A higher rate of £600 is paid for broadleaf plantations which meet special requirements as to nature conservation, recreation, sporting facilities, etc.

Effect of different tax regimes Ignoring the cost of land, the internal rates of return on the basis of these figures are shown in the table below.

		With grant	Without grant			
		Present tax regime	Present tax regime	Option 1	Option 2	Option 3
SITKA SPRUCE	Zero inflation	7.8%	7.1%	4.2%	5.0%	5.0%
	3% inflation	"	"	4.0%	"	"
	5% inflation	"	"	3.9%	"	"
BROADLEAF	Zero inflation	4.6%	3.8%	2.1%	2.9%	2.9%
	3% inflation	"	"	1.9%	"	"
	5% inflation	"	"	1.9%	"	"

Option 1 is the normal business basis (para 16 of the text)

Option 2 taxes receipts and relieves expenses as they arise (para 17 of the text)

Option 3 is tax exemption, the preferred option (para 18 et seq of the text)

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ANNEX C

PROFILE OF INCREASED GRANT EXPENDITURE

Assume grant of £500 per hectare half payable in first year and one quarter in second and again in fifth year; supplements of £50 in year 8 and again in year 15 as contribution to annual maintenance, clearing and fertilising. (Note: present grant is £240, 80% payable in year 1 and 20% in year 5). The calculations are based on annual planting of 30,000 ha.

	NOW		AFTER CHANGE		CHANGE IN EXPENDITURE	
	£ per ha	£m	£ per ha	£	Gross	Net of tax saving
Year 1	240	7.2	298	8.9	+ 1.7	+1.7
2	As above		423	12.7	+ 5.5	+4.0
3			423	12.7	+ 5.5	+1.5
4			423	12.7	+ 5.5	-0.5
5			500	15.0	+ 7.8	+0.3
6						-2.2
7						-2.2
8-14			550	16.5	+ 9.3	-0.7
15+			600	18.0	+10.8	+0.8

NOTE: Increase in expenditure net of tax saving in years 1 to 7 totals to -£2.6m.

ANNEX D

ENVIRONMENTAL OBJECTIVES FOR FORESTRY

i. to prevent any afforestation in certain particularly sensitive areas. These might include sites of special scientific interest designated by the NCC; and archaeological sites which would either be physically destroyed by forestry or else seriously damaged in terms of visual impact and public appreciation

ii. to ensure that afforestation takes place in national parks or designated areas of outstanding natural beauty only if all the statutory bodies agree that it is environmentally acceptablein the proposed location

iii. to avoid encouragement to afforestation of areas which will give poor yields because of adverse geographical factors (very poor soil, high winds etc)

iv. to ensure that, wherever large-scale afforestation takes place, it is carried out in an environmentally sensitive way, is attractive visually, and avoids damage to water quality

v. to encourage environmentally more favourable forms of afforestation, involving smaller plantations, more diversity of species (especially the inclusion of native broadleaved trees), and multiple use, especially for recreation.

ANNEX E

FORESTRY ENTERPRISE PRIVATISATION - MERCHANT BANK REMIT

1. To consider the feasibility of privatisation of the Forestry Enterprise having regard particularly to:

   (i) the anticipated profile of cash and profitability over different time-scales (and the sensitivity of key assumptions such as demand for timber and price);

   (ii) the effect of overcoming any temporary cash deficit by commercial borrowing or sales of parcels of woodland;

   (iii) the tax regime currently in operation for private investment in woodland and its importance for potential investors in Forestry Enterprise;

   (iv) the effect on timing and proceeds of ensuring by legislation or alternative means appropriate standards for conservation, recreation and public access.

. To estimate the likely proceeds of a sale under different iming options.

. To consider how far the conclusions under 1 and 2 above oncerning timing and proceeds of sale would be affected if he Forestry Enterprise were divided into separate units with ne more profitable forests being sold earlier.

. To advise generally on the form of privatisation eg flotation, trade sale of individual forests etc) in the ights of 1, 2 and 3 above.

ote: Guidance would need to be given on the assumptions to be made about subsidies and about the regulatory regime following privatisation.]

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ccBy

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THE CHANCELLOR OF THE DUCHY OF LANCASTER
AND MINISTER OF TRADE AND INDUSTRY

THE RT HON KENNETH CLARKE QC, MP

Rt Hon The Viscount Whitelaw CH MC
Lord President of the Council
Privy Council Office
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LONDON
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N BPM

20 July 1987

Dear Willie,

WILL REQUEST IF REQUIRED

I have seen Malcolm Rifkind's letter to you of 3 July in which he sought policy approval for a clause to be included in the Farm Woodland, Forestry and Diversification Bill to repeal Section 2(3) of the Forestry Act 1967.

Since it would appear that the National Committees are no longer carrying out the functions for which they were originally established, I agree that an early opportunity should be sought to amend the Forestry Act 1967.

I am copying this letter to other members of H, and to Sir Robert Armstrong.

Yours ever,
Ken

KENNETH CLARKE

JY3ACS

999-36

PERSONAL AND CONFIDENTIAL

SRW

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

8 July 1987

Dear Tony,

FORESTRY COMMISSION

The Chancellor at his bilateral with the Prime Minister last week mentioned that he and the Minister for Agriculture were enthusiastic about the possibilities for privatising the Forestry Commission. Privatisation would be given a stronger impetus if lead responsibility for the Forestry Commission rested with the Minister for Agriculture.

The Prime Minister has considered carefully the organisation of Ministerial responsibilities for forestry and has decided that she does not at present want to make any change. She has noted that it is in any case open to the Chancellor and the Minister for Agriculture to work up proposals for privatisation of the Forestry Commission to be put to colleagues in due course. She would wish to be consulted about the timing of circulation of any such proposals inn view of their sensitivity.

I am copying this letter to Sir Robert Armstrong.

Yours,

David.

(DAVID NORGROVE)

Tony Kuczys, Esq.,
HM Treasury.

PERSONAL AND CONFIDENTIAL

CCB/G

Ref. A087/1976

MR NORGROVE

Forestry Commission

Your minute of 26 June requested advice on Ministerial responsibility for the Forestry Commission.

2. Ministerial responsibility for forestry in England, Scotland, and Wales rests with the Minister of Agriculture, Fisheries and Food, the Secretary of State for Scotland and the Secretary of State for Wales respectively. The Forestry Commission is a Government Department which operates throughout Great Britain. It reports to all three Ministers with forestry responsibilities and this is reflected in the current legislative provisions on the Commission and its relationship with Ministers (the Forestry Act 1967 as amended).

3. Under the present Administration the practice has been for the Secretary of State for Scotland to take the lead on Forestry Commission matters relating to Great Britain as a whole. This is an informal arrangement, in as much as the legislation does not single out any one of the three Forestry Ministers as taking a lead. But the arrangement was reflected in the attached Parliamentary Answer by the Prime Minister on 4 February 1985, and so far at least has been accepted by MAFF and the Welsh Office. Practical considerations pointing to a particular Scottish interest in the Forestry Commission are that most (in 1985/86 some 64 per cent) of the land planted by the Commission is in Scotland, and that the Commission's headquarters are located in Edinburgh.

4. It would be possible, if the Prime Minister so decided, to transfer this informal lead role from the Secretary of State for

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Scotland to the Minister for Agriculture, Fisheries and Food by administrative action, though an announcement would be needed to inform Parliament of the change. The Secretary of State for Scotland, and indeed the Secretary of State for Wales, would, however, remain responsible for Forestry Commission matters in Scotland and Wales and would retain their present statutory roles under the Forestry Act. They would still expect to be involved at an early stage of any consideration given to privatisation of the Forestry Commission.

5. A more fundamental change would be to concentrate all responsibilities for the Forestry Commission, and the associated statutory powers, under the Minister of Agriculture, Fisheries and Food. This would require a Transfer of Functions Order (negative resolution). It would no doubt be unwelcome to Scottish members, since it would take forestry activities in Scotland out of the responsibility of the Secretary of State for Scotland into that of the Minister of Agriculture, Fisheries and Food, whose writ does not otherwise run into Scotland. If such a transfer was made, the Minister of Agriculture, Fisheries and Food might then develop a proposal to privatise the Forestry Commission. I imagine, however, that any such proposal would require collective consideration (in partiuclar because privatisation would require legislation), and that the Secretaries of State for Scotland and for Wales might be expected to express their views at that stage.

6. I doubt whether either of these possible changes would succeed in side-stepping the difference of view perceived by the Chancellor of the Exchequer, given the doctrine of collective Ministerial responsibility. There could also be difficulty in presenting the reasons for change to Parliament and in public, since a difference of view between Ministers could hardly feature in the public explanation of a change.

7. Equally I would have thought that the present lead role of the Secretary of State for Scotland need not prevent the Minister of Agriculture, Fisheries and Food pursuing the possibility of privatisation if he so wished. Once he had developed his proposal it would be natural for him to discuss this with the Secretaries of Scotland and Wales; if the three Forestry Ministers could not then reach agreement, there would be no bar to the Minister of Agriculture, Fisheries and Food putting his proposal forward for wider collective consideration, including which Minister should lead the privatisation and take charge of the associated legislation. The Prime Minister might prefer to determine that in the light of the circumstances at the time, rather than to embark now on a transfer which could be difficult to present in public, not effective as a means of getting round any difference of Ministeral views, and unnecessary if the difference of views perceived by the Chancellor of the Exchequer were to be resolved in further discussion.

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ROBERT ARMSTRONG

6 July 1987

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PRIME MINISTER

FORESTRY COMMISSION

The Chancellor at a recent meeting said that he and John MacGregor were keen on privatising the Forestry Commission, but that Mr. Rifkind, who has lead responsibility, was being obstructive. He asked whether it would be possible to transfer lead responsibility to Mr. MacGregor.

Robert Armstrong's minute below knocks firmly on the head any thought of transferring lead responsibility. But it points out that there would be no bar to Mr. MacGregor putting his proposal forward for wider collective consideration, including which Minister should lead the privatisation and take charge of the associated legislation.

For Mr. MacGregor to make a proposal about lead responsibility would be to push himself forward in a way that neither he nor his colleagues would wish to see. I suggest that you tell the Chancellor that you would not wish to change lead responsibility at this stage, that you would be content for Mr. MacGregor and the Chancellor to work up proposals for privatisation of the Forestry Commission to be put to colleagues in due course, but that you would wish to be consulted about the timing of circulation of any such proposals in view of their sensitivity.

Content?

DRN (The possibility of changes in the tax regime for forestry is of course very relevant to this.)

DN

6 July, 1987.

Yes mt

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10 DOWNING STREET

LONDON SW1A 2AA

CC BG

From the Private Secretary 26 June 1987

SIR ROBERT ARMSTRONG

FORESTRY COMMISSION

The Chancellor of the Exchequer in a meeting today with the Prime Minister said that the Treasury and the new Minister of State for Agriculture were both enthusiastic about the possibility of privatising the Forestry Commission. The Secretary of State for Scotland, however, was opposed to the idea, and he appeared de facto to be in the lead on the Forestry Commission. It would be a great help if lead responsibility could be transferred to the Minister for Agriculture.

I should be grateful to know whether there is any formal basis for the role which the Secretary of State for Scotland plays in relation to the Forestry Commission and for your views on the question of transferring lead responsibility to the Minister for Agriculture.

DRN

D R NORGROVE
26 June 1987

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AGRICULTURE COUNCIL 17-18 NOVEMBER: FRENCH REACTIONS.

SUMMARY

1. PRESS REFLECTS DISAPPOINTMENT AT COUNCIL'S FAILURE TO ACT ON SHEEPMEAT. PARIS DEMONSTRATION BY PRODUCERS. THOUGH RECEPTION FOR GUILLAUME IN NATIONAL ASSEMBLY.

DETAIL

2. THE FRENCH PRESS REFLECT IN FAIRLY MUTED TERMS THE DISAPPOINTMENT FELT AT THE FAILURE TO ACHIEVE A DEAL FOR FRENCH SHEEP PRODUCERS AT THE AGRICULTURE COUNCIL ON 17-18 NOVEMBER. THE BLAME IS PUT AT THE DOOR OF THE COMMISSION WHO, ACCORDING TO LE MONDE, FAILED IN THE EVENT TO SHOW THE DETERMINATION AND AUTHORITY NECESSARY TO SETTLE THE ISSUE. THE UK IS NOT SPECIFICALLY BLAMED, THOUGH EXPLANATIONS OF THE CAUSES OF THE SHEEPMEAT CRISIS IN FRANCE DO NOT FAIL TO INCLUDE MENTION OF THE SO-CALLED UNFAIR COMPETITION OF BRITISH SHEEP PRODUCERS: AND THE PRICE BEING PAID BY FRENCH FARMERS FOR THE FALL IN VALUE OF STERLING. A SUBSTANTIAL ARTICLE IN LIBERATION (LEFT WING DAILY) ON 19 NOVEMBER GIVES A HISTORY OF THE NEGOTIATION OF THE EC SHEEPMEAT REGIME THROUGH FRENCH EYES, DESCRIBES THE POLITICAL PRESSURES ON FRENCH MINISTERS (INCLUDING CHIRAC, IN VIEW OF THE LIVESTOCK INTERESTS OF HIS POLITICAL BASE IN CORREZE), AND SUGGESTS THAT NATIONAL AIDS MAY BE NEEDED TO SUPPLEMENT THE LIMITED MEASURES TAKEN BY BRUSSELS.

3. SHEEP PRODUCERS DEMONSTRATED IN PARIS YESTERDAY TO BRING HOME THEIR PLIGHT TO THE FRENCH PUBLIC. THEY EMPHASIZED NOT ONLY THEIR OWN DIFFICULT SITUATION BUT ALSO THE RISKS TO THE SOCIAL EQUILIBRIUM OF RURAL AREAS IF PRODUCERS WERE FORCED OUT OF BUSINESS. SIMILAR DEMONSTRATIONS WERE HELD ON TUESDAY AND WEDNESDAY IN CENTRAL FRANCE. GUILLAUME CAME UNDER CONSIDERABLE PRESSURE WHEN QUESTIONED IN THE ASSEMBLY YESTERDAY ABOUT THE ADEQUACY OF SUCH MEASURES AS HAVE BEEN AGREED IN BURSSELS IN SOLVING THE CRISIS.

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4. ELSEWHERE IN THE PRESS THERE IS COMMENT ON THE FAILURE OF THE COUNCIL TO MAKE ANY PROGRESS ON THE MILK DOSSIER IN TERMS WHICH REFLECT A GROWING AWARENESS OF THE BUDGETARY COSTS OF THE PRESENT SURPLUS. THE ISSUE IS SEEN AS EXPLOSIVE FOR GUILLAUME IN VIEW OF THE DIFFICULTIES EXPEERIENCED THIS SUMMER WHEN PENALTIES FOR OVERPRODUCTION WERE IMPOSED.

5. FCO PLEASE PASS DESKBY 201800Z TO PS/MR JOPLING AND ANDREWS (MAFF).

FRETWELL

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PRIME MINISTER

TALK WITH MR. JOPLING

You are having a 45 minute general chat with Mr. Jopling at 1600 hours on Monday 16 June.

Mr. Jopling is one of your loyalist of lieutenants, somewhat at the periphery of Whitehall business. Your main objective at the meeting might be therefore to let him know that you value his support. In this connection, you could seek his views on political developments generally.

My impression from here is that MAFF is a well run Department, though with all the typical characteristics of a Department who sees its main task as producer protection. But by and large it keeps a low profile and avoids trouble.

My impression is that Mr. Gummer gives very able support to his Minister.

There have been hints once or twice about friction between MAFF and DOE regarding environmental issues. DOE, specially Mr. Waldegrave, seek a more active countryside policy while MAFF, naturally enough, look to the protection of the farmers' interest. The press tried to manufacture a row between Mr. Jopling and Mr. Waldegrave a few months ago on these lines. But a quick statement by Mr. Jopling snuffed that out. You might, however, enquire about relations with DOE on environmental issues.

I attach a note by David Williamson which sets out some discussion points on British agriculture generally as background.

N.L.W.

(N.L. WICKS)

13 June 1986

CONFIDENTIAL

Qz.05124

MR WICKS

You asked for some points for the Prime Minister's meeting with Mr Jopling on 16 June. I attach a note.

I am sending a copy to Sir Robert Armstrong.

D F Williamson

D F WILLIAMSON

13 June 1986

CONFIDENTIAL

AGRICULTURE: POINTS FOR THE PRIME MINISTER'S

DISCUSSION WITH MR JOPLING, 16 JUNE

(1) Last year British agriculture did a good job for the nation

- produced 60% of all food for British consumers (ten years ago 49.6%)

- produced 80% of temperate foodstuffs (ten years ago 61.9%)

- reduced its output prices by 2 1/2% and thus contributed to restraint on inflation.

(2) Last year was not a good year for farmers themselves

- farming income fell by 43% (after rising by 35% in the preceding year)

- farm business income, perhaps a better indicator, fell by 25% following a substantial increase in the preceding year

but (a) principal cause was clearly the weather (cereal production -16%, sugar yields -13%, potato production -7%) plus the pressure of surplus production on prices

(b) contrary to many forecasts, dairy farm incomes showed little change despite the introduction of milk quotas, and subsequent falls have not been great. Farmers are more adaptable than they are usually given credit for: they largely offset the fall in milk output by reducing purchased feed - a sensible commercial decision which is also in UK national interest.

(3) What are the future prospects?

(a) clearly farmers' incomes are going to be under pressure as a result of the price squeeze which is itself the result of the production explosion. But wrong to be too pessimistic. Farmers live on their margin, not their total income. Animal products most important part of UK agriculture, and some livestock farmers will rely more on grass and less on purchased feeding stuffs (last year UK farmers' expenditure on feeding stuffs, after rising for years, fell back)

(b) only sane policy now is to restore a better market balance for those products where the taxpayers' bill (Community budget) for storage and disposal has got out of control in the last few years. This means price restraint (insufficient alone) plus a mix of limits on the quantity or cost of the guarantee (quotas or guarantee thresholds in one form or another) **or** making the support system less rigid (eg limits on intervention, thus allowing the commercial market more play) **or** taking some land out of production ("set-aside"). Difficulties are real but widely held assumption that budget savings must mean a reduction in farmers' incomes is completely false (in 1981, for example, Community expenditure on agriculture fell and UK farming incomes rose by 17 per cent in real terms). Total farm revenue comes dominantly from the markets, so that a better return from the market (including exports) can both cut budget costs and benefit the producer. Moreover, most of the Community budget expenditure on agriculture only benefits the farmer indirectly. As a generalisation one could almost say that Community cheques are made payable to traders, not to farmers

(c) as well as policy decisions, the Commission's day to day decisions in managing the agricultural markets are also of crucial importance in keeping down costs and keeping up incomes.

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4. Action needed and protection of British interests in the melée -

(a) last price package was rigorous. Agriculture Council has undertaken now to deal with reform of the beef regime (3rd most expensive after milk and cereals) and with structural measures. Within structural measures we must get our "set-aside" scheme for cereals moving. This is first task. One of best approaches to beef regime might be simply to limit total volume going into intervention (fair administration could be difficult but budgetary saving certain). Throughout all discussions must follow principle (Prime Minister's NFU speech) of opposing and removing, as Mr Jopling did successfully this year, market differentiation by size of farm

(b) must look for agricultural budget savings, selecting those measures which do not affect UK farm incomes. Examples:

- transfer further part of cost of technical and interest costs of intervention storage to national budgets

- cease to make advance payments from Community budget for agricultural guarantee expenditure

- put financial limit on aid for olive oil

- maintain constant pressure on Commission over market management and, in particular, need to get better return from export markets (deterioration in recent years very marked - see facts in annex)

(c) reassure British farmers that market balance can and will be restored; that there will be adequate time for adaptation; and that we do not intend to pull out the rug completely from under their feet.

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The costs of market management: butter

(1) Community milk production in 1985 was almost exactly the same as in 1982. In 1986 milk production is expected to be lower than in 1982

(2) Community butter production in 1985 was almost exactly the same as in 1982. In 1986 butter production is expected to be lower than in 1982

(3) the volume of international trade in milk products has hardly altered since 1982

(4) present availability of milk products from current production of all exporters is quite close to being in balance with international demand

(5) the Community, New Zealand and Australia together provide more than 80 per cent of all the world trade in butter, the Community being the predominant supplier **but**

(6) in 1982 the Community milk regime cost 3.3 billion ecu, in 1985 it cost 6.6 billion ecu and it is expected to cost over 6 billion ecu in 1986. This increase of about 3 billion ecu is far greater than the sums (eg the potential overruns in the 1986 and 1987 budgets) which are giving rise to other budgetary difficulties; indeed it is not far short of the total revenue which would arise from an increase in the VAT ceiling to 1.6 per cent

(7) in 1982 the prevailing world price for butter was $2400 a tonne, following Commission decisions to cut the export refund. In 1986 it is $1000 a tonne, following Commission decisions to increase the export refund

(8) this unsatisfactory situation largely reflects the overhang effect on world markets of the massively higher intervention stock of butter in the Community in 1986 by comparison with 1982

(9) key objective of market management ought to be to dispose ruthlessly of some of the butter stock (eg in competition with vegetable oils) and to seek to lift world prices for butter and other milk products by cutting export refunds.

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(2)

Prime Minister
This is the article which the Chancellor mentioned. I have underlined the main points.
CDP
13/6

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

12 June 1986

David Norgrove Esq
10 Downing Street
LONDON
SW1

CDP

Dear David,

"A WORLD AWASH IN GRAIN"

... I attach an article by Barbara Insel on "A world awash in grain" which the Chancellor thought the Prime Minister might be interested to see.

Yours, Cathy

CATHY RYDING
Assistant Private Secretary

Please file
CDP
16/6

(2)

Prime Minister
This is the article which the Chancellor mentioned. I have underlined the main points.
CDP
13/6

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

12 June 1986

David Norgrove Esq
10 Downing Street
LONDON
SW1

CDP

Dear David,

"A WORLD AWASH IN GRAIN"

... I attach an article by Barbara Insel on "A world awash in grain" which the Chancellor thought the Prime Minister might be interested to see.

Yours,
Cathy

CATHY RYDING
Assistant Private Secretary

Barbara Insel

A WORLD AWASH IN GRAIN

This is a strange and painful year to talk about grain. Our televisions bring us pictures of starving African children, but world grain stocks exceed 190 million tons—a record surplus. Federal subsidies for agriculture will total nearly $19.5 billion in 1985, but U.S. farming is in a historic recession. Ironically, the most important customer for U.S. grain exports is the Soviet Union; the United States and its allies now must compete for the privilege of selling to our chief adversary. It is a curious year indeed.

It is time to put to rest many of the myths we have long cherished about agriculture. We had come to believe that America could feed a hungry world, and we debated how much leverage this power would give us. We believed that we not only should, but could, protect farm incomes and rural lifestyles through public policies that manipulated supplies and demand. We believed, moreover, that these differing goals could be achieved at the same time—and, with little effect on our other interests, economic, financial and diplomatic.

What happened is that American agriculture—and that of many of our friends and neighbors—has succeeded all too well. The heartbreaking scenes of famine in the Sahel notwithstanding, the world is learning how to feed itself. And, like the United States, the world has also learned how to protect its farmers by supporting grain prices artificially, stimulating still higher levels of production. As a consequence, we have entered an era of permanent grain surpluses, of a buyer's market for grain exports, where the United States can no longer set the rules. We now find ourselves in a world awash in grain, with ever-increasing bills for producing, maintaining and storing the unwanted product of our labors.

How did we get here? Why is the world's new ability to feed itself not an opportunity but a crisis? What does this mean for the United States and its allies? One thing is certain: agricul-

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Barbara Insel is an International Affairs Fellow at the Council on Foreign Relations. The author wishes to thank David Swanson of the Continental Grain Company for his assistance in the early stages of this study.

tural policy will never again be only a domestic issue—or only an agricultural issue.

II

To begin to understand the problem, let us see what has happened to world agriculture over the last decade.

Table I tells much of the story. It gives us a picture of a growing number of exporters, a shrinking set of food-importing nations and, despite repeated efforts to reduce them, a growth of surplus stocks to nearly insupportable levels. What is most interesting about these trends is not the absolute change in numbers but the market shifts they imply: a redistribution of who produces, who buys, who sells and who holds stocks. The United States is essentially competing with its close friends to sell to a smaller number of less-good friends. We are losing, perhaps inevitably, in that competition, and as a result are paying the bills for the world's grain surplus.

Worldwide production of wheat and feed grains has grown 20 percent since 1974, 100 percent since 1964. Between 1960 and 1980, food production grew slightly faster than population, yielding a net increase in food supplies per person of 0.8 percent per year in the first of the two decades and 0.5 percent in the second. The major source of this growth has been improvements in technology, which have led to a 60-percent increase in average yields. Also important have been policy reforms—principally in the form of price guarantees for producers and improved domestic marketing environments—which have provided new incentives for production.

Probably EXCLUSIVE!

Some examples are striking. In China, the introduction of market incentives has produced a 15-percent expansion in corn production, a 20-percent expansion in rice production and a 40-percent expansion in wheat production just since 1982. Chinese wheat production grew from 41 million metric tons in 1977 to 85 mmt in 1984—and yields doubled from 1.46 metric tons per hectare to 2.90 tons. By comparison, total U.S. wheat production in 1984 was 70 mmt, at average yields of 2.57 tons/hectare. In 1985 China is expected to produce the largest wheat crop in the world. China's total production of feed grains, aided by improved yields, increased from 71 mmt in 1977 to 95 mmt in 1984—about 40 percent of U.S. feed grains output.

The situation in Western Europe is equally instructive. If there were ever any doubt that agricultural production re-

TABLE I

WORLD WHEAT AND COARSE GRAINS TRADE 1974/75 TO 1984/85
(totals in millions of metric tons)

	1974/75	1979/80	Estimated 1984/85
TOTAL WORLD PRODUCTION	976.8	1164.7	1295.1
United States (as % of total)	20.4%	25.5%	23.4%
Other major exporters[1]	9.8	7.9	8.7
Western Europe	14.5	12.6	14.6
U.S.S.R.	18.8	14.7	12.3
Eastern Europe	9.3	7.8	8.4
China	10.0	12.5	13.9
Others	17.1	18.9	18.8
TOTAL WORLD CONSUMPTION	987.0	1184.9	1273.9
United States (as % of total)	14.2%	15.4%	14.6%
Western Europe	15.8	13.8	12.5
U.S.S.R.	19.5	18.1	16.4
China	10.5	13.2	14.9
Others	39.9	39.4	41.4
CUMULATIVE SURPLUS STOCKS	115.1	172.0	190.6
United States (as % of total)	23.5%	44.9%	43.9%
Foreign	76.5	55.2	56.0
TOTAL TRADE (in mmt)	127.6	186.8	206.0
EXPORTS:			
United States (as % of total exports)	48.9%	58.2%	49.9%
Other major exporters[1]	34.4	29.7	30.6
Western Europe	10.0	8.9	13.9
U.S.S.R.	3.9	0.3	0.5
Others	3.4	2.8	5.0
IMPORTS:			
Western Europe (as % of total imports)	25.7	16.4	7.3
U.S.S.R.	4.1	16.3	23.8
Japan	14.5	13.1	13.1
Eastern Europe	8.7	9.4	3.7
China		5.8	5.0
Others (who?)	46.9	39.0	47.1

[1] Other major exporters are Argentina, Australia, Canada, South Africa, and Thailand.
SOURCE: U.S. Department of Agriculture.

sponds to price increases, the Common Agricultural Policy of the European Economic Community should forever banish those doubts. The CAP has dramatically increased farm incomes; in Great Britain, for example, participation in the CAP has brought about an estimated 40-percent increase in prices received by British farmers. As a result, the EEC farmers now produce 75 mmt of wheat, as compared with 40 mmt in 1977; EEC wheat yields have increased from 3.66 mt/ha to 5.52 mt/

ha this year, substantially above U.S. levels. Although European feed grain production has increased more slowly, from 67 mmt to 74 mmt in the period, yields have grown from 4.1 mt/ha to 5.24 mt/ha, the only region to approach U.S. levels. The United Kingdom has gone from being a net importer of wheat and barley to a major net exporter in little more than four years. Those who have concluded that Europe is not a competitive producer need think again.

There are many comparable if less dramatic cases. India is now effectively self-sufficient, thanks to the technological advances of the so-called Green Revolution, and Pakistan is almost so. Argentine wheat production has nearly doubled, Thailand's feed grain output nearly tripled, and both Canada and Australia have had major output increases.

In producing countries, with the exception of China, this recent growth in output has brought with it only small increases in grain consumption, focusing new attention on export markets. A country which produces more than it can consume is the proud proprietor of an agricultural export industry. Not only have the numbers of exporters multiplied, but the importance of these exports in both domestic economies and trade accounts has increased.

The importance of agricultural trade for the United States is obvious. Agricultural exports make up one-fifth of overall U.S. foreign exchange earnings, and produce one-fifth of total U.S. farm income. At least one-third of U.S. farmland is harvested to provide grain for exports. Figures for other producing countries are equally striking. Thirty-five percent of EEC wheat is exported—and, if French wheat exports to its EEC neighbors are included, exports claim nearly two-thirds of the French wheat harvest. Canada and Australia continue to export the great bulk of their grain, and neither Argentina, which exports two-thirds of its grain, nor Brazil, for whom soybean exports alone constitute almost 12 percent of its foreign exchange earnings, could meet their foreign exchange obligations without the "green account."

As the number of exporting nations has grown, the grain importing market has become increasingly concentrated. The Soviet Union now consumes 20 percent of all imports, with China consuming 5 percent. Western Europe, which for years was the American farmer's best overseas customer, has become nearly self-sufficient, and the traditional South Asian markets are no longer growing. Japan, a major U.S. market, has hardly increased imports in several years. Uneasy with dependence on foreign grain, Japan has begun to invest directly in production projects, particularly in Brazil, and has also begun to look to its East Asian neighbors for some of its supplies.

The only other significant markets for the United States are in the Middle East, and in developing countries, which now claim about one-third of all grain imports. Many developing nations, however, are increasingly unable to pay for their needs. Imports by sub-Saharan African states, for example, have barely increased over the decade, despite rising population and declining local production.

Not surprisingly, competition in the grain export market has become increasingly aggressive. Weapons in the competition include a variety of export incentives and subsidies, such as differential export taxes, tax rebates, direct support payments to allow lower export prices, subsidized domestic credits, subsidized export credits and "food aid." Agricultural subsidies and other aggressive trade practices have become a regular feature of international trade: Argentine and Brazilian soybean export incentives, EEC export subsidies ("restitution," in the language of the Community), and various forms of import constraints and preferences. While the Europeans long had a special celebrity for manipulating export credit terms to attract markets, fiscal constraints forced the reduction or elimination of most of these programs in recent years. And the United States, long a minor player in the great export subsidy war, has now become the principal source of subsidized agricultural export credits.

U.S. agricultural policy has for 50 years focused on supply management and demand development in order to support higher farm prices. Generous financing was provided for storage on farms and by third parties, to allow farmers to hold their crop off the market until they received an attractive price, with the option of selling it to the government if no better alternative presented itself. Such support was supplemented by "deficiency payments," paying the farmer directly for the shortfall in prices below an agreed "target price."

These policies soon built up large American surplus stocks: total U.S. grain stocks reached a high of 115.7 mmt in 1961–62, falling to as low as 27 mmt in 1975–76, before rising again to 136 mmt in 1983–84. The expense of maintaining such surpluses thus became a major new incentive for the development of "food aid" programs aimed at disposing of accumulated grain through concessional sales to needy countries.

The single most important U.S. surplus-disposal effort has been the "Food for Peace" program, known as PL-480, which since 1954 has provided very long term interest-free loans, and a lesser amount of grants, to foreign countries for acquisition of grain from U.S.-owned stocks. A sister program, the so-called GSM credits, provides for partially subsidized, three-year renewable export financing. Despite the high cost to the United States of such concessional arrangements, they are still less expensive than the alternative of storing the surplus.

Such programs also earn the United States substantial political and charitable benefits, although their long-term effect on recipient countries is a matter of serious debate. The expansion of these schemes—which are almost always negotiated at the governmental level—often undermines emerging local agricultural markets and discourages local production. More important, both PL-480 and GSM credits are explicitly political in their orientation, giving priority to shipment of aid to countries considered friendly to the United States, and posing serious obstacles to aid for such nations as Ethiopia. In fact, of the sub-Saharan African countries most vulnerable to the current drought and food crisis, only the Sudan and Zaïre are included on the list of congressionally approved PL-480 beneficiaries.

Still, such programs do accomplish their primary objective of developing markets for the U.S. grain surplus. And the United States is certainly not alone in such practices. As a budget category, food aid falls under the general heading of "surplus disposal" for the EEC as well—as do export development programs. PL-480 loan and grant allocations have grown from \$1.1 billion in 1970 to \$1.8 billion in 1984–85. GSM credits in 1984–85 total \$5 billion, as compared with \$1.4 billion in 1982. EEC food aid in 1984 totaled approximately \$465 million and is forecast to be larger in 1985.

III

The U.S. share in world grain trade grew throughout the 1970s, from 40–41 percent in 1970 to more than 58 percent of total world exports by 1979–80. Between 1980 and 1984, however, the U.S. share fell sharply to less than 49 percent of world exports, and is expected to rise only slightly to about 51 percent in 1985. Part of the U.S. loss is explained by the 1980–81 embargo on sales to the Soviet Union, but that business has largely been reclaimed, and is largely responsible for the small recovery expected in 1985. The more significant causes for the loss of U.S. markets are structural: 1984–85 U.S. grain prices are at least 20 percent higher than those of foreign competitors, and there are many more competitors in the market than there were five years ago.

It is frequently argued that U.S. prices only appear higher, because of competitors' export subsidies and dumping practices. But such assertions are not supported by the evidence. In early March 1985, U.S. hard red winter wheat was selling for $144 a ton, EEC wheat for $120, and Argentine wheat for $114. Canadian and Australian wheat prices, which are generally determined through long-term sales agreements, are less easy to compare, but both countries will match U.S. prices if market conditions permit. EEC prices, without any export subsidy and measured in U.S. dollars, have been significantly below U.S. prices since September 1984. These price disparities were responsible for the startling picture in December 1984 when China sold corn it had bought from the United States, replacing it with Argentine corn whose low price, even after all transaction and logistics costs, netted China a significant saving.

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Underlying the high relative prices of U.S. agricultural goods are several important elements, including unfavorable exchange-rate trends, high domestic support levels, and shrinking technological advantages. By their nature, price comparisons imply a given set of exchange rates, and the rise of the dollar on foreign currency markets has severely damaged U.S. grain exports. The level of domestic price supports paid by the U.S. government has also played a major role in keeping U.S. export prices high. The "loan value" determined by Congress (the price at which U.S. farmers can store their grain and receive federal financing) has set a floor under U.S. prices, allowing farmers to take crops off the market as world prices in dollars declined, and creating what is generally called an "umbrella" for U.S. competitors. Legislation adopted in 1981 significantly increased both the "loan value" and target price supports for American farmers. The United States has also begun to lag behind its most aggressive competitors in technology and efficiency—a difference which cannot be attributed solely to lower costs for land and labor in competing countries. Both China and the EEC have higher grain yields than the United States; Brazilian yields in soybeans and corn, where they are grown with modern techniques, also often exceed those in the United States.

The area in which the United States is unquestionably more efficient is in its system of domestic logistics—transport, communications, storage management, organization, paperwork—which moves the crop from the farm to the shipping port. Differentials in these costs, in the highly competitive world market, have an enormous impact. For example, to move a bushel of French wheat from a Paris Basin farm to the port of Ghent or Rotterdam costs about 90¢. To move a bushel of U.S. wheat from Minnesota to New Orleans—nearly twice the distance—costs about 34¢. The U.S. Department of Agriculture several years ago estimated that it cost Brazilian farmers about eight times what it would cost their U.S. counterparts to move a bushel of soybeans from farm gate to port.

The superior U.S. logistics system cannot forever be expected to protect declining U.S. agricultural efficiency from having its impact on U.S. export sales. Awareness of the importance of infrastructure development and logistical management is rising among competitors. Anyone in doubt need only observe the Chinese organization of their exports—or the priority being accorded to their infrastructure renewal. The French have deregulated rail rates to improve export logistics. Massive grain infrastructure investments are underway in the United Kingdom, and the Brazilians are discussing a grain export rail line.

Two other major factors in competition for grain sales are location and international freight costs. China's substantial advantage in shipping freight to Japan can overcome, to a significant degree, a competitor's initial price advantage. The United States needed to offer substantial credit concessions to overcome France's freight advantage in shipping wheat to the countries of North Africa. The proliferation of exporters with such advantages challenges the oft-repeated assumption that the United States would be the least-cost supplier in nearly all markets if competitors did not pursue unfair trade practices.

The net effect of the market shifts described thus far has been a redistribution of stocks. As production has grown and U.S. export opportunities have shrunk, the United States has become the repository of the world's grain surplus. In 1974, the United States held less than 25 percent of total stocks; in 1984, it held 45 percent. The United States is now storing and financing about 46 million tons of coarse grains and 38 million tons of wheat—about 35 percent of its total annual grain production. The second-largest stockholder is the European Economic Community, which, by the end of this crop year, will hold almost 8 million tons of feed grain and 14 million tons of wheat—more than double its 1981–82 levels, and nearly 18 percent of its yearly production. Total world stocks are expected to reach 105 million tons of wheat and 86 million tons of feed grains by the end of the 1985 crop year.

The cost of this accumulation and its associated subsidy programs is staggering. U.S. agricultural subsidies, which averaged about $3 billion a year in the 1970s, averaged $19 billion a year over the last three years. EEC subsidies—export subsidies, deficiency payments, public stocks—totaled $16 billion in 1984, or 79 percent of the European Community's entire budget.

$19 b U.S.

$16 b EEC.

IV

The kind of market shifts implied in these figures are not likely to be reversed. Indeed, aside from small distortions due to bad weather or other temporary problems, future grain markets are likely to be characterized by continued increases in world supply, with relatively minor growth in demand.

In the past, the key to America's prominence was its almost unique status as a surplus producer in a world of countries with major grain deficits. As we have seen, changes in technology and policy have begun to correct that imbalance and, over time, fewer and fewer countries will depend on the United States to feed their people and livestock.

Advances in agricultural technology will continue to increase grain yields. The Green Revolution grew from the identification of new wheat and rice varieties capable of absorbing and responding to fertilizer increases to improve yields dramatically. Adoption of such varieties in the uniform, controlled ecological environments of large irrigation projects, such as in India's Punjab province, ultimately allowed India to end years of famine and to cut its massive import bills. Further research is underway to develop comparable varieties of grains for the more ecologically varied rain-fed and semi-arid regions, although commercial results in those areas are perhaps ten or more years away.

Developments in biogenetic engineering, the newest area of plant research, are expected to further accelerate the growth of crop yields, leading to new refinements in fertilizer and herbicide use, and to improvement of protein content and other crop qualities. In perhaps 20–30 years, bioengineering may allow the development of crop varieties that are more resistant to poor weather and soil conditions, helping to expand production in what are now marginal regions such as the African Sahel.

Technological improvements are now largely built into the cycle of production expansion. Investment in new technologies and yield-improvement practices is especially stimulated by public policies which ensure high, stable prices for farm output. But even without—or in spite of—government intervention, the expansion of productivity seems destined to continue or even accelerate, as the European Economic Community learned this past year.

Like the United States, the EEC has been seeking to reduce its farm budget without provoking an excessive political or social backlash. For the first time in the Community's history, the nominal prices guaranteed to European wheat producers were actually reduced in 1984 in an effort to discourage production—but technology overcame policy. The effects of the price reduction were outweighed by an unexpected 30-percent increase in yields, producing record output levels and a net increase in most farm incomes. Unless European farmers come to believe that these productivity increases are a short-run phenomenon—and that their governments will persevere with price reductions, even to the extent of reducing incomes of key political groups—planting will continue to expand.

The EEC dilemma is compounded by another important paradox common to grain production sectors in many industrial countries. Many EEC farmers—particularly the smaller, more traditional producers, the French and German equivalents of "family farms"—are marginally efficient and deeply in debt. As lower prices begin to force them out of business, their land is not generally taken out of production; it is merely transferred to more efficient users, with a net increase in productivity and output. The newer farms are large enough to take advantage of economies of scale and expensive new technologies, and as a result are efficient enough to operate profitably, and compete internationally, at much lower price levels than their predecessors. Such structural change is already evident in southwest England, in the Paris Basin, in Landes in southwest France. Thus it is incorrect to assume that reduced price supports, in themselves, will lead to dramatic production

Good Pt.
(If true)

cuts. On the contrary, after a brief period of adjustment, they may lead to just the opposite result.

In contrast to the relentless growth of production, the demand side of the world grain market is likely to be characterized by only modest increases in overall imports, unless income increases far more quickly than agricultural production in several of the larger developing countries.

or prices fall

World population growth will, of course, remain a key variable in determining aggregate demand, although, as mentioned earlier, production growth has outpaced population growth over the last 20 years. Technological breakthroughs on the horizon could accelerate this trend, especially if the "delivery system" for this technology—agricultural services, infrastructure, credit, fair-pricing policies—is improved at an equal pace in developing countries.

The relationship between population growth and increases in effective demand is complex. Population growth does not necessarily bring with it an increase in either food-production capabilities or the means to finance food purchases from outside suppliers. From the standpoint of world agricultural markets, the practical effects of population growth on demand are limited. Indeed, in the poorest countries, the growth of population may actually reduce effective food demand by straining local resources and draining the foreign exchange necessary for food imports, thus setting the stage for tragedy.

Income growth, on the other hand, will play a more direct role in shaping future demand. Here the distinction between food grains (primarily wheat) and feed grains (corn, rye, barley and oats) becomes essential. As a basic staple, wheat is especially important in low-income diets. But demand for wheat is quickly saturated; as income increases, consumption moves toward higher-cost, higher-protein meat products—which are produced with feed grains. Wheat consumption is thus likely to increase only as fast as population, while feed grain demand is closely linked to income. (However, if feed grain prices rise sufficiently, wheat regains interest as a feed grain substitute.)

The industrialization of poultry production has accelerated this movement from bread to higher-protein meat products by introducing a low-cost major protein source that can be produced almost anywhere. The extraordinary worldwide expansion of the poultry industry has been the engine behind the growth of feed grain trade—especially corn, proteins and processed protein substitutes. Forecasts of feed grain demand become forecasts of poultry and beef consumption as income increases, and feed grain imports are thus determined by the extent to which domestically produced output will satisfy that demand.

In assessing future demand trends, it seems clear that the Soviet Union will remain the single most important market for U.S. grain exports. Soviet production levels are expected to continue to deteriorate, and long-term improvement is unlikely without major agricultural policy reforms, including production incentives such as those that have proved effective in some East European nations. But even with such reforms, Soviet agriculture will remain hindered by technological backwardness and poor soil and climate conditions, and is not likely to keep pace with domestic demand.

Nearly all Soviet grain imports are negotiated through long-term purchase agreements, under which the U.S.S.R. tends to be a very price-conscious and professional customer. Aware of their nation's status as the largest single buyer in a surplus market, Soviet buying agents are sensitive to their impact on the market and distribute their purchases among several sellers. Their return to the U.S. market, despite high U.S. price levels, has been interpreted as an effort to keep commercial ties open, but also may reflect a recognition that a stable, long-term relationship with the world's largest exporter is essential in view of the U.S.S.R.'s enormous requirements. Sales to the Soviets now represent 15 percent of all U.S. grain exports, while purchases from the United States represent about one-third of Soviet grain imports. Other principal sources of Soviet crop imports are Argentina, France, Canada and Australia.

The European Economic Community, as shown above, can no longer be seen as a major market for U.S. grain production. Imports into the Community have been essentially limited by CAP protective barriers to proteins (soybeans, corn gluten and other products), feed compounds and certain varieties of corn. The international farming and trading community has proved itself enormously creative in working around the rigidities of EEC regulation to find markets for new products, and potentially profitable niches in this business will probably continue to be found. However, Europe is not likely to become a major import growth area.

All the major exporters are looking to the developing countries as a major outlet for their surpluses—particularly the growing populations and economies of East Asia. Those expectations, however, must be tempered by a realistic appreciation of the growing agricultural potential of the East Asian region. Reasonable production policies and improved farming practices should turn many of these countries into net exporters—particularly of corn—in the reasonably near term. Relatively few developing countries are now using the higher-yielding corn varieties, hence their adoption could rapidly expand output. Increased production will, however, be offset to some degree by increases in local consumption, spurred by income growth, and improvements in local infrastructure and logistical management.

Within East Asia, China could, with improved internal logistics, absorb its entire corn and soy production even as output continues to grow, and may therefore choose not to export, except for political or foreign-exchange reasons. Korean consumption will continue to exceed production, bringing it closer to Japanese importance as an importer. Indonesia, on the other hand, could approach self-sufficiency in some products, and the Philippines could become a major corn exporter. Thailand can also be expected to increase its feed grain export sales.

Thus, it is possible to imagine that within five to ten years the entire East Asian market will be served primarily by exports from Asian producers—with Thailand, China and the Philippines filling the import needs of Japan, Korea, Taiwan, Singapore and others hovering close to self-sufficiency. Such market arrangements would not only reflect freight and cost advantages but also local political realities. However, Japan's continuing efforts to diversify its sources of production suggest not only further exploitation of the Chinese export market, but also that of Brazil and other countries.

In South Asia, India and Pakistan could be—and are from time to time—significant exporters, thanks to Green Revolution technologies. Although there is enormous potential to expand the Indian internal market, income, marketing and political constraints make that unlikely. Bangladesh will remain a major, and dependent, importer.

In Latin America, reasonable internal policies could lead to dramatic expansions in production of some grains, especially corn, in Brazil and Argentina. Brazil and Argentina will also continue to seek to expand their low-cost soy exports, and Argentina its low-cost wheat.

North African grain consumption is growing steadily, but while policy reform and agricultural development can expand production significantly, this region will also probably remain a significant importer for some time.

Sub-Saharan Africa, where famine persists despite surpluses elsewhere, is the most painful case, illustrating the continuing importance of political and logistical questions in determining food availability. The entire shortfall in Sahelian grain this year has been estimated at three to four million tons, while the world holds grain surplus stocks of nearly 190 million tons. The African famine, while an enormous human tragedy, is by no means an international agricultural production crisis. With a world almost as afloat in subsidized grain export credits and food aid as in grain, it should not even have become a financial issue. Financing the whole shortfall would cost perhaps $500 million, barely a footnote to U.S. export credits and food aid totaling $7 billion, and to comparable European programs now approaching $1 billion yearly.

Glut
Stocks 190 m

Sahel shortfall
3-4 m tons

As a long-term problem, the famine must also be seen as a local planning, policy and management failure of enormous proportions. Local policies discouraged production. Essential agricultural services were ineffective or unavailable. Local marketing arrangements had been repressed or undermined by inefficient bureaucracies. Policymakers did not respond quickly enough when localized food deficits became evident, and were unable to organize the movement and release of food supplies efficiently or plan for likely future needs. As the scale of both human migration and emergency crop distribution requirements grew, the long neglect and mismanagement of basic infrastructure and public services brought them to collapse.

An end to the current drought may reduce the scale of suffering in Ethiopia and other affected areas, but it will not solve the long-term crisis, which will require far-reaching institutional reform, infrastructure development and the development of human capital. Many sub-Saharan countries are therefore likely to remain dependent on imports of foreign grain for many years to come, although continued poverty and low foreign-exchange reserves will ensure that for most affected nations those imports will have to come in the form of humanitarian aid rather than market purchases.

V

The combination of growing international competition and weakening demand has dealt a body blow to the American farm sector, which is now experiencing one of its worst recessions in memory. Since one of every five American jobs is linked to farming, that recession has become a national problem of major proportions.

The numbers tell the story. Farm income averaged $23 billion in 1983 and 1984. Farmers' debt service during those years averaged $21 billion. Federal farm subsidies averaged $19 billion in the same period, with most of these funds directly or indirectly supporting farm income. At some points, farm income would have been negative in the absence of federal subsidies. Farm bankruptcies more than doubled from 1983 to 1984, and are now occurring at an even faster rate.

Compounding the changes which have occurred in international markets is the growing debt burden of the farm sector. Agriculture in the United States, as in most of the world, is characterized by large capital assets—land and equipment—and a very meager cash flow. The financial return on farming assets is often not very attractive relative to other sectors, but the government has used subsidies in an attempt to make income flows reasonably stable, and the farmer's rural way of life has often been viewed as a compensating benefit.

In the mid-1970s, stirred by the apparently permanent export boom and a seller's market in farmland, some banks began to make major loans based on farming assets rather than cash flow. Farm debt rose from $50 billion in 1970 to $132 billion in 1979 to $216 billion in 1983. Farmers who either bought land or borrowed for major capital investments based on high nominal land values found themselves with large debt service bills just as interest rates began their climb and the export market for U.S. grain began to slump. Land values that rose from an average $374 per acre in 1970 to $1717 per acre in 1981 have fallen by nearly one-third nationwide, and will be further depressed by the accelerating farm recession. New planting credit is being denied to many small producers—possibly as many as 13 percent of all producers.

U.S. policymakers are under enormous pressure to find some way to rescue the farmer from the deepening crisis, either through debt relief, price improvements or a combination of both. The motivations for such efforts are not just political, but stem from a deeply felt desire to protect America's rural traditions, and to help hard-working individuals who are faced with grave economic distress. For more than 50 years, in response to similar concerns, farm prices have been subsidized; storage, equipment and exports have been financed on subsidized terms; credit has been subsidized; and lending resources have been expanded. And Congress' most recent actions to subsidize, liberalize and guarantee credit, to protect beleaguered small farmers so they may further expand our grain stocks, is entirely consistent with the history of American farm support policies.

However attractive they may seem, such traditional approaches to our farming problems have lost their economic justification. Even though the recipients of such support work hard for their livelihood, the decision to sustain their income and way of life in the face of overwhelming market forces can no longer be viewed as an economic investment—it has become a social welfare program of enormous proportions.

VI

There are almost no policy scenarios—for any of the major exporters—that allow one to escape certain inevitable conclusions. World grain production will continue to grow, export competition will increase, price levels will continue to fall. Thus, surpluses in those countries that continue to apply traditional policies to try and protect domestic producers from world prices will continue to grow as well, along with the cost of such policies. The producers will in the end benefit very little—unless policymakers consciously attempt to stop the cycle, define their objectives more clearly and find new means to achieve them.

It is fashionable these days in some agricultural circles to talk of the four- to five-year farm cycle. The boom days, we are told, will come back in a year or two if we can just hang on. One gets the impression that many in the U.S. farm sector are waiting to re-live 1974–81, when world grain trade grew by 60 percent and U.S. exports increased by 80 percent, with prices keeping pace, helped by the weakness of the U.S. dollar.

But the lesson of that era is not that prices rise, that agriculture is "green power." The lesson is more subtle and universal: when prices rise, production eventually rises, almost everywhere and probably too much. The system is dynamic, if a little clumsy and given briefly to over-reaction. As soon as everyone sees the winning trick, the game has probably changed. Competition is relentless.

Thus, any unilateral action to try to manipulate the global market is almost certain to be self-defeating. This includes all the usual strategies of unilateral production controls or price cuts. Production controls do have the advantage of controlling domestic surplus stocks. But efforts to use production controls to force prices up will have only a negligible impact because of the scale of surplus stocks overhanging the market. Moreover, any perceived price movement or shortfall in product that might affect the market will quickly induce expansion by other producers or even encourage new players to enter the market, absorbing any price effect that was achieved.

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The most common production control technique, especially as productivity improves, is to reduce planted acres, usually through acreage control programs. However, the history of acreage control programs suggests that they have only marginal effect on long-term output, as farmers put their lowest-value land under control and production continues unabated. Ironically, the most effective means of production control may be the withholding of planting credits by bankers attempting to control their exposure on heavily indebted farms.

Allowing domestic price levels to fall on a short-term basis is also likely to do little to solve the production problem. As marginal producers are forced out of business, as demonstrated earlier, average yields are likely to improve. Lower prices will reduce output only if they are maintained long enough to change farmers' long-term intentions and if price declines exceed productivity increases. Thus, domestic prices would have to decline severely to affect production.

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A decline in U.S. export prices—if only through lower exchange rates—would somewhat assist the U.S. agricultural sector by spurring U.S. grain export sales and reducing U.S. subsidy bills. It would, however, be a fantasy to presume that permitting U.S. prices to fall would, in itself, automatically allow the United States to recover, or even increase, its export market share—or to retain any short-term market growth that did occur. Competitors would inevitably respond: several could sell below U.S. prices, others would increase or introduce subsidies or other export incentives. Lower prices, moreover, will not re-open markets in nations that have little hard currency to spend for imports, or that have recently arrived at self-sufficiency and are determined to protect their internal markets. Lower prices would increase the European Economic Community's cost of competing with the United States or excluding U.S. imports, but they have the similar option of reducing prices. And lower prices would be only one factor in political marketing arrangements—as the United States, which has long been a high-price seller, has frequently proved.

An effort to organize international production along the lines of the once-successful oil-producers' cartel would be self-defeating as well. It is impossible to organize any cartel without major constraints against entry into the business, a means of enforcing discipline and some common interests among the producers. World grain producers are far too numerous and diverse to allow development of such an organization. Nearly every country either is already in the grain business or, with emerging technologies, soon will be.

What is remarkable in looking at today's agricultural situation is the degree to which the interests of the wealthy surplus producers diverge from those of the new, developing-country exporters. Notable as well is the degree to which interests other than economic ones are involved in this relationship. The agricultural policies of wealthier producers—the United States, the EEC, Canada and Australia—are really driven more by the need to protect a major domestic economic, social and political interest than by the need for foreign exchange produced by these exports, no matter how significant those trade earnings may be. The new producers often must export these crops to survive, or they see agricultural expansion as their only feasible vehicle for development or link to a world economy.

The United States has serious national interests in the political and social stability of many poor producing nations, and also has major economic concerns other than agricultural trade—banking and other economic interests, as well as exports of other products, and imports of raw materials. A strategy based on coercing poorer countries to restrain their own production to protect American social interests will not only provoke hostility and conflict, but will almost certainly backfire. A reduction in Brazilian or Argentine grain exports, for example, would reduce the foreign exchange those nations so badly need to repay their debts to American banks. Similarly, China's exports to Japan are a critical part of a new political as well as economic relationship with Japan—a relationship with important implications for the whole of Asia.

Rural traditions and values are important non-economic issues in most countries, just as they are in the United States. There is, moreover, a widely held, perhaps fundamental, conviction that access to food is too critical to a society's survival to be left entirely to market forces. Agriculture is a strategic good, and there is no country that is willing to be entirely dependent on another for its sustenance. As a long-term surplus producer, we often forget this essential reality—and the fact that our own very efficient market, and those of most wealthier producers, operate in a very fortunate and protected context. It was, of course, this reality that ultimately made our expectations of "green power" so illusory.

The questions with which we are then left are quite different from the questions we are accustomed to facing in our agricultural policy making: to what degree must the larger exporters accommodate the new, poorer producers? How are we to adjust our own policies and resolve our domestic agricultural conflicts? What price are we willing to pay for these social values? What are the common interests among the more prosperous exporters? Does that commonality suggest any direction for resolution of our problems or alternatives to our conflicts?

We have clearly underestimated the extent to which our principal competitors—particularly the European Community, which is emerging as our most powerful competitor—share our problems. We have let our battles over agricultural trade often obscure our mutuality of interests. The cost of the EEC's agricultural subsidy is at least as insupportable as our own. The constant debates over its cost can continue to dominate the EEC agenda only at great expense to other critical problems. The attachment to a nostalgic agrarian idealism is perhaps even stronger on the eastern side of the Atlantic; the demise of a deeply loved culture and society is at least as wrenching. What does a society do when faced with unacceptable and critical social, political and economic changes, and not only finds it difficult to continue to pay the price for protecting itself from those changes but discovers that, despite the enormous price being paid, those changes are coming anyway?

Multilateral discussions are underway, through the Organization for Economic Cooperation and Development and the General Agreement on Tariffs and Trade, to begin acknowledging the domestic implications of, and constraints on, international agricultural trade policies. If we are genuinely to seek resolution of these issues, however, we must at the same time acknowledge the international constraints on our domestic agricultural policy making and the international implications of the policies we have pursued for so long. There will obviously be major domestic, social, political and economic consequences to such a change in policy direction. And we will have to determine how great a share of our limited national resources we are willing to invest in protecting our rural values.

The point of this discussion is not to insist on any specific strategy, but rather to force a clear look at the underlying dilemmas of today's agriculture. These problems and choices are universal. Agriculture in the United States, in the EEC, and in most of the world has long been treated as a domestic political issue. But the fundamental changes which have taken place in world agriculture must now be matched with equally fundamental changes in world agricultural policy.

COPIED TO EURO POL: CAP, PT14.

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CDP 24/6.

CONFIDENTIAL

The Rt Hon Kenneth Baker MP
Secretary of State for the Environment
2 Marsham Street
London
SW1 3EB

24 April 1986

You wrote to me on 18 March about the consequences in the countryside of possible changes in agricultural support. You have also had a comment on the same subject from David Young in his letter of 4 April. I have been giving some thought as to how we might carry these matters forward.

It is relevant that, since you wrote your letter but before I had received it, the Prime Minister held a meeting to discuss our longer term strategy for reforming the operation of the Common Agricultural Policy. A note of that meeting appears in the Prime Minister's Private Secretary's letter of 19 March which I am circulating with this letter to those who have not already seen it. As you will see, the Prime Minister asked me to prepare a paper consolidating proposals on alternative uses for some agricultural land as well as the encouragement of alternative employment in the countryside.

In the second place, the Commission has now presented to the Agriculture Council a series of proposals. They include a pre-pension scheme for farmers over 55, schemes to encourage young farmers, amendments to the existing Less Favoured Area provisions, a development, of the environmentally sensitive area proposals and other measures relating to forestry, marketing, training and research and development. Clearly we shall need to consider these proposals. To the extent that they move in directions which we would find attractive here, it will be sensible for us to incorporate them into our own thinking. Indeed, it will be important to ensure that we neither put our own producers at a competitive disadvantage nor find ourselves carrying the burden of adjustment on behalf of the rest of the Community.

There are of course a number of inter-woven strands. We have been doing much work on possible set-aside schemes for taking land out of cereals production, and a paper on this subject has been circulated at official level. In addition the Forestry Commission and we have been working on the role of afforestation and farm woodlands for land no longer required for agriculture; and similarly work is going on on alternative crops of agricultural commodities not in surplus. There is also the implementation of the concept of "environmentally sensitive areas" contained in the Agriculture Bill. The impact on rural employment which all this might have must be considered, together with the encouragement both of diversification of on-farm employment and of alternative employment in rural areas.

Some of this work will have to proceed on the basis of timetables already laid down or the exigencies of the Brussels machine. But it clearly would be useful for us to have an overview as envisaged at the Prime Minister's meeting. What I intend to do, therefore, is to ask Ted Smith, one of our Deputy Secretaries here, to chair a working party which will proceed on the basis of the paper which the Prime Minister has called for. I envisage including in the working party representatives of the other Agricultural and Forestry Departments, the Treasury, your own Department and the Department of Employment. Mr Smith will be in touch with the appropriate officials as soon as possible. He will aim to complete a report which we can then consider by the end of July.

I do not think it would be right, as David Young has suggested, for us to say anything in public at this stage. Quite apart from the obvious Treasury objection to any indications which might have public expenditure consequences, we really do not know what is likely to emerge from Brussels which would have a bearing not only on the extent of future changes in land use, but also on what Community measures might be available.

I am copying this letter to the Prime Minister, David Young, Malcolm Rifkind, Nicholas Edwards, John MacGregor and Sir Robert Armstrong.

MICHAEL JOPLING
(Approved by the Minister
and signed in his absence)

Agriculture: Expenditure
PE 2

CB/C84

CC [illegible]

SECRETARY OF STATE FOR EMPLOYMENT

CUP

7L.

Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-213 6460

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The Rt Hon Kenneth Baker MP
Secretary of State
Department of the Environment
2 Marsham Street
London
SW1

4 April 1986

Dear Kenneth,

Thank you for your letter of 18 March with which you enclosed your letter of the same date to Michael Jopling about examining the problems of surplus agricultural land.

Whilst I accept your view that the studies proposed cannot be completed by the end of April, I do think that we should by then have terms of reference agreed by Ministers that could be announced. As I pointed out in my letter of 4 March to Michael Jopling, a study of this kind might best be presented as part of the deregulation exercise in the forthcoming White Paper rather than leave it exposed as a CAP issue. The terms to reference might include a requirement that officials report back within six months. I would certainly expect to see results on the tourism, employment and deregulation aspects within this timescale.

I am copying this letter to the Prime Minister, Paul Channon, Michael Jopling, Malcolm Rifkind and Nicholas Edwards.

Yours,

David

AGRICULTURE Expenditure Pt2

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10 DOWNING STREET

From the Private Secretary

26 March 1986

Dear Robert,

MEETING OF E(A) ON 27 MARCH

As you will know by now the meeting of E(A) scheduled for tomorrow, Thursday 27 March, has been cancelled.

The Prime Minister has seen Jill Rutter's letter to me of 25 March about forestry and would be grateful if the forestry departments could discuss E(A)(86) 14 with the Treasury, and prepare a revised paper or a supplementary note which would set out the proposal to encourage increases in private forestry and woodlands.

The Prime Minister hopes it will be possible to agree in correspondence a way forward on the plan for Post Office counters set out in E(A)(86) 15. Telephone conversations with Departments suggest that this should be possible, but of course the item would be brought back to E(A) after the Recess if this proved not to be the case.

The discussion of the proposed review of competition law and policy (E(A)(86)16) is postponed until after the Recess.

I am copying this letter to Private Secretaries to other Members of E(A) and Michael Stark (Cabinet Office).

Yours,

David.

DAVID NORGROVE

Robert Gordon, Esq.,
Scottish Office

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CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

David Norgrove Esq
Private Secretary
10 Downing Street
London
SW1

25 March 1986

Dear David,

PRIVATISATION OF THE FORESTRY ENTERPRISE AND ENCOURAGEMENT OF WOODLAND AS AN ALTERNATIVE CROP

E(A)(86)14, which is on the agenda for E(A) on Thursday, invites Ministers to agree that "this statement of a feasibility study of privatising the Forestry Enterprise should include confirmation that we are pressing on with consideration of ways of encouraging substantial increases in private forestry and woodland as an alternative land use."

Although this idea has been touched on in various recent discussions about CAP reform and the future of British agriculture, the Chief Secretary is concerned that there has been no discussion with the Treasury of these ideas or their potential public expenditure and tax costs. Most importantly, E(A)(86)14 was not cleared with Treasury officials, in clear breach of Cabinet rules of procedure. Although the Chief Secretary is concerned to expedite progress on this issue, he believes it would be wrong to ask E(A) on Thursday to agree to an announcement on the above lines, which would involve a considerable degree of commitment, before the implications, especially financial, of "encouraging substantial increases in private forestry and woodlands" have been examined further with Treasury officials and reflected in a revised paper for E(A). In the circumstances he believes that it would be better to postpone the discussion for a couple of weeks.

I am copying this letter to the Private Secretaries to other members of E(A) and to Michael Stark (Cabinet office).

Yours

Jill

JILL RUTTER
Private Secretary

CONFIDENTIAL

010 MM CONFIDENTIAL CC

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref: B/PSO/11364/86

Your ref:

CDP

CDP 19/3.

18 March 1986

Dear Michael

will request if req.

Thank you for your letter of 6 February enclosing a copy of the paper prepared by Agriculture Ministers last autumn on "The Consequences of Price Restraint for British Agriculture".

I found this a most interesting exposition of problems ahead. I have, of course, noted the Prime Minister's view that it would be premature to work up proposals for new measures of special assistance to farmers at this stage. I think, however, that there remains a real need to examine further exactly what possible changes are likely and to discuss their environmental implications which could be both highly sensitive and far-reaching.

What I should like to suggest is that we work together by setting up a joint inter-Departmental working party at official level to consider this topic, including the matters to which I referred in my letter to you of 29 January. The assumptions underlying your paper of last autumn could be usefully considered in that forum, together with any findings of the various related research studies to which my letter of 29 January referred.

To be useful the discussion needs to be wide-ranging and I do not think that it will be practicable for the working party to report, as David Young suggested in his letter to me of 20 January, by the end of April. I suggest instead that the working party should, if colleagues are content, propose terms of reference and a timetable for its work for approval by Ministers within 6 weeks.

/ I am sending copies of this letter to the Prime Minister, David Young (as a reply to his letter of 20 January), Malcolm Rifkind, and Nicholas Edwards.

Yours

Kenneth

KENNETH BAKER

The Rt Hon Michael Jopling MP

CONFIDENTIAL

Agree Pol

PRIME MINISTER 11 February 1986

MEETING WITH RALPH HOWELL - 10 FEBRUARY 1986

Ralph Howell (a neighbour in Norfolk) has a policy initiative which is very interesting. It would require farmers to set aside or not use 5% of their current acreage. This unused land would be used for tree planting and conservation pursuits by unemployed youths. He thinks that the used land would produce so much less that the EEC food glut would be reduced and prices would soar, so compensating the farmers for the loss of their set aside land.

He believes that there would be:

- exchequer savings;

- a solution to the EEC food mountains; and

- an employment benefit.

We feel the exchequer should cost his scheme. I believe it will cost about £100 million, but might save in the order of £88 million. The Economists in the unit are sceptical!

HB

HARTLEY BOOTH

CONFIDENTIAL

Pete

CC BG

10 DOWNING STREET

From the Private Secretary

31 January 1986

Thank you for your letter of 29 January conveying your Minister's suggestion that the paper entitled "Consequences of Price Restraint for British Agriculture" should be shown to Mr Baker and Lord Young, together with my letter setting out the Prime Minister's comments on it.

The Prime Minister would be content for Mr Jopling to do this on a strictly confidential basis.

C D POWELL

Ivor Llewelyn, Esq.,
Ministry of Agriculture, Fisheries and Food

CONFIDENTIAL

(1)

CC/BG

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

From the Minister's Private Office

Prime Minister
Agree to let Mr. Baker & Lord Young have copies of this paper?
CDP 29/1

Yes

CONFIDENTIAL

Charles Powell Esq
10 Downing Street
London SW1

29 January 1986

Dear Charles

You will recall that my Minister sent to the Prime Minister, under cover of a minute dated 30 September, attached a paper entitled "The Consequences of Price Restraint for British Agriculture". The Prime Minister had commissioned this paper at her meeting on 26 June last. On 7 October you wrote to me saying that the Prime Minister had considered the paper, and that she thought that it would be better to postpone working it up in more detail for the time being.

You may also know that this same subject - the likely reduction in the area of land required for agriculture - also came up at the Prime Minister's lunch with conservationists on 25 November. My Minister had warned the Prime Minister, in his letter to her of 21 November, that this was bound to arise, since the matter was very much subject to public discussion, and reminded her of his earlier paper (but noting that the DOE Ministers attending the lunch were not aware of its existence).

The matter continues to be the subject of much public debate, and the Government is regularly asked what its policy is. The Prime Minister's lunch with conservationists sparked Mr Kenneth Baker to write to my Minister on 16 December; my Minister replied on 30 December; and Lord Young has also written, on 20 January. I enclose copies of the three letters.

In these circumstances, my Minister considers that he must let Mr Baker and Lord Young have copies of his original paper, together with your letter setting out the Prime Minister's comments on it, on a strictly confidential basis. I should be grateful if you could obtain the Prime Minister's authority for him to do so.

Yours ever

Ivor Llewelyn

C I LLEWELYN
Private Secretary

DC Mr Smith – for advice, please 27.23.1
cc Private offices
Mr Andrews
Mr Anderson
Mr Hadley
Mr Capstick

SECRETARY OF STATE FOR EMPLOYMENT

Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-213 6460

Switchboard 01-213 3000

The Rt Hon Kenneth Baker MP
Secretary of State
Dept of Environment
2 Marsham Street
LONDON SW1

20 January 1986

Dear Kenneth,

Thank you for copying to me your letter to Michael Jopling of 16 December about the follow up to the Prime Minister's lunch with a group of conservationists. I have also seen Michael Jopling's reply of the 30 December. Your proposal that officials should prepare a joint paper to examine the implications of anticipated changes in the level of agricultural production is most welcome. I believe that it should be pursued sooner rather than later so that all the relevant information requirements can be quickly assessed, with the results of the research being incorporated when they are ready. I look forward to discussing the outcome in due course. I should imagine that a considerable amount of information is already available and even a comprehensive review should not take too long. Given how easy it is to let things slide, I wonder if you would be prepared to set a firm deadline for a report back to ministerial colleagues - say end-April.

The paper might follow up as far as possible the points made at the No. 10 meeting about tourism and manpower that are of interest to this Department. In view of your suggestion that there would be implications for the planning system it would also be helpful if a connection could be made with other issues affecting the future of planning controls which have been taken up in the context of our work on deregulation.

I am copying this letter to Michael Jopling, Malcolm Rifkind and Nicholas Edwards.

Yours,

David

R Smith's minute to Miss Rawling dated 23-12-85 [illegible] cc private offices Mr Andrews Mr Hadley Mr Boswell Mr Anderson Mr Capstick

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD

WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

The Rt Hon Kenneth Baker MP
Secretary of State for the Environment
2 Marsham Street
London
SW1P 3EB

30 December 1985

Thank you for your letter of 16 December. There is indeed a widespread view that the new agricultural situation might well lead to substantial quantities of land coming out of agricultural production over the next ten to fifteen years; though the extent, speed and incidence of this could vary considerably, and be influenced especially by how determined we can persuade our European partners to be in tackling over-production, and whether it is done primarily through price discipline or in other ways, such as quotas.

First we must establish the factual base. As a major contribution to this my Department is funding a research study, headed by my former Chief Agricultural Officer who has now become a Senior Visiting Fellow at the Department of Land Economy at Cambridge, precisely on this subject. A wide range of other aspects of the matter is being studied under the aegis of the integrated research programme of your Department, mine, and the ESRC under the title "Research on the Changing Countryside". Submissions on this were made to Ministers in your Department and in mine a few months ago. I know that a number of other bodies, such as the NCC, are also commissioning research into various aspects of the matter.

The first thing to do therefore is for our officials to ensure that this research is pressed forward in a consistent and complementary way. As the factual basis becomes firmer, we can ask them to work up the range of policy options.

I am copying this letter to George Younger, Nicholas Edwards and David Young.

MICHAEL JOPLING

SG

7/12/12

1 c Private Office 2 Minister
Mr Boswell
Mr Andrews
for — Mr Smith
advice Mr Anderson
please. Mr Hadley

R Rawling 17/12

DHM 28/11/85

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB

01-212 3434

My ref: W/PSO/38807/85

Your ref:

16 December 1985

Dear Michael,

You will have seen the notes of the discussions which took place at the Prime Minister's recent lunch with conservationists, circulated under cover of Mark Addison's letter of 26 November to Robin Young.

As recorded in those minutes Derek Barber raised the prospect that substantial quantities of land at present used for food production might come out of agricultural use over the next ten to fifteen years as a result of likely changes in the CAP, and he called for a wider debate about how this problem should be addressed and its implications for rural areas. Sir Arthur Norman supported the need for a clear policy.

The possible extent and pace of such changes is clearly a matter open to argument. However, it seems likely that at least some land may come out of agricultural production in the medium-term - particularly land farmed with low profit margins by the smaller farmer. This may well have very considerable implications for the environment and for pressures on the planning system. I think it would therefore be useful to set in hand some structured consideration of possible scenarios, and the range of options open to government and others in that situation. I am sure your Department has done a lot of work on this already.

If you agree, perhaps as a next step we might instruct our officials to prepare a joint paper for discussion by interested colleagues.

I am copying this letter to George Younger, Nicholas Edwards and Lord Young.

Yours

Ken

KENNETH BAKER

The Rt Hon Michael Jopling MP

AGRICULTURE PT2

Expenditure

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

From the Minister's Private Office

Tim Flesher Esq
No 10 Downing Street
London SW1

28 November 1985

Dear Tim

I enclose a draft of the statement that my Minister intends to make this afternoon on assistance for farmers affected by the weather and Hill Livestock Compensatory Allowances.

It is not yet complete, as it still lacks a sentence on the public expenditure implications, which the Treasury is to provide. I would, however, be grateful for preliminary comments as soon as possible.

I am copying this to Bernard Ingham (No. 10), David Morris (Lord Privy Seal's Office), Murdo Maclean (Chief Whip's Office), David Beamish (Chief Whip (Lords) Office), Michael Stark (Cabinet Office), Andrew Lansley (Chancellor of the Duchy of Lancaster's Office), Joan MacNaughton (Lord President's Office), Richard Broadbent (Chief Secretary's Office), and to Private Secretaries to other Agriculture Ministers.

Yours ever

Ivor

C I LLEWELYN
Private Secretary

Tim,
Awful - much too long.
But nothing for us to object to.
Nigel.

Draft Statement

I announced on 8 October that the government intended to provide some help for those livestock farmers who had been most seriously affected by the exceptionally bad weather conditions earlier this year and, in agreement with my agricultural colleagues, I am now in a position to announce the details.

Payments will be available to farmers with suckler cows and sheep in certain specified parts of the Less Favoured Areas, and to farmers with dairy cows in certain more limited areas.

So far as suckler cows and sheep are concerned, the rates of payment will be £14 and 35p per animal respectively and the areas concerned will be the LFAs in Scotland and in Northern Ireland; in England the LFAs in Cumbria, Durham, Lancashire, Northumberland, North Yorkshire (excluding the North Yorkshire Moors), West Yorkshire and Tyne and Wear; and in Wales the original LFA areas in the counties of Gwynedd, Dyfed, West Glamorgan and Mid Glamorgan and parts of the counties of Gwent, Powys and Clwyd. So far as dairy cows are concerned, the rate of payment will be £4.50 per animal which will be paid to dairy farmers in Cumbria (including the areas outside the LFAs) in England; in Scotland in the three regions of Strathclyde, Central, and Dumfries and Galloway; and in Northern Ireland.

These payments will be made to farmers in respect of the number of suckler cows and breeding ewes they expect to have on 1 January 1986, and on the number of dairy cows they have on 1 December 1985. The farmers concerned are being invited to put in their claims as soon as possible (and in any event by 13 January). The Agriculture Departments will endeavour to deal with them as quickly as possible and will hope to pay a significant proportion before Christmas.

My colleagues and I recognise that the farmers in these specified areas are not the only ones badly affected by this year's adverse weather but we believe that we have, in broad terms, selected for assistance those areas and enterprises where the situation is the most serious. In all, these payments are estimated to amount to some £16.9m. Because of the need to pay the aid to farmers as quickly as possible, this money will be made available in the first instance from the Contingencies Fund but a Supplementary Estimate will be presented to the House in due course.

As to the Hill Livestock Compensatory Allowances, the Agriculture Departments have now completed the annual autumn review of economic conditions in the hills and uplands. In the light of that review, my colleagues and I are proposing, subject to Parliamentary approval, to increase the rates of Hill Livestock Compensatory Allowances with effect from 1 January 1986. In the old LFA, the increases will be £10 for suckler cows, 50p for ewes of mountain breeds and 25p for other ewes; and in the new LFA £5 for suckler cows and 13p for ewes.

In addition, we are proposing to increase the maximum payment per hectare from £60 to £62.48 in the original LFA, in accordance with the revised maximum specified in the new EC Structures Regulation and to make a corresponding increase (from £45 to £46.86 per hectare) in the new LFA. We are also proposing to introduce some changes in the detailed rules of the scheme in the light of the new EC Regulation, including a provision which will enable an HLCA applicant (subject to checks to prevent over-grazing) who afforests part of his land to take the afforested area into account for the purpose of calculating his allowances for up to 15 years.

We shall shortly be laying before Parliament a draft Statutory Instrument giving effect to these proposals, which are also being notified to the European Commission.

My agricultural colleagues and I are also aware that, following the exceptionally bad weather earlier this year, many LFA farmers are facing cash flow problems. To help with this, we are proposing to introduce special procedures for the 1986 HLCA payments, under which all claimants will receive about 75% of their claim very shortly after submitting their application, with the balance being paid as soon as possible after 1 April 1986.

The additional HLCA payments are expected to cost £10.9m in a full year and will represent an increase of some 11 % on the existing annual HLCA payments which are currently running at about £98m per annum. This represents a significant increase in the government's support for the hill and upland areas of the United Kingdom.

In due course a Supplementary Estimate will be presented to the House.

I am pleased also to be able to announce certain other changes which will be of help to livestock farmers who are facing difficulties as a result of the bad weather.

In England and Wales, farmers in the areas where the special weather assistance will be payable will be exempted, until the end of March 1986, from the charges normally made by ADAS for the analysis of hay and silage samples. In Scotland, the suspension of charging will apply throughout the country.

Agreement has also been reached in Brussels on arrangements which will enable us to make early advance payments of sheep annual premium to LFA farmers in respect of the current marketing year; and we shall hope to be able to make most of these payments before Christmas. Advances will be paid to LFA farmers who have ten or more eligible sheep at the rate of £2.10 per ewe in Great Britain and £4.70 per ewe in Northern Ireland. This early payment will clearly be very welcome to the farmers concerned.

In addition, we have been able to obtain the European Commission's agreement to some changes in the rules relating to the Suckler Cow Premium Scheme which will be helpful to farmers who may find themselves in difficulties over maintaining their cow numbers throughout the winter because of fodder problems or abnormal losses. A separate announcement about this is being made today.

cc CDP
PC

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

From the Minister's
Private Office

Tim Flesher Esq
No 10 Downing Street
London SW1

28 November 1985

Dear Tim

I now enclose the final version of the Statement my Minister will be making this afternoon. I am copying this to the recipients of my earlier letter this morning.

Yours ever

Ivor

C I LLEWELYN
Private Secretary

cc Press
Quest
D.C

With permission, Mr Speaker, I would like to make a statement.

I announced on 8 October that the Government intended to provide some help for those livestock farmers who had been most seriously affected by the exceptionally bad weather conditions earlier this year and, in agreement with my agricultural colleagues, I am now in a position to announce the details.

The Government intends to make exceptional payments to farmers with suckler cows and sheep in certain specified parts of the Less Favoured Areas, and to farmers with dairy cows in certain more limited areas.

So far as suckler cows and sheep are concerned, the rates of payment will be £14 and 35p per animal respectively and the areas concerned will be the Less Favoured Areas in Scotland and throughout Northern Ireland; in England the Less Favoured Areas in Cumbria, Durham, Lancashire, Northumberland, North Yorkshire (excluding the North Yorkshire Moors), West Yorkshire and Tyne and Wear; and in Wales the original Less Favoured Areas in the counties of Gwynedd, Dyfed, West Glamorgan and Mid Glamorgan and parts of the counties of Gwent, Powys and Clwyd. So far as dairy cows are concerned the rate of payment will be £4.50 per animal which will be paid to dairy farmers in Cumbria (including the areas outside the Less Favoured Areas) in England; in Scotland in the three regions of Strathclyde, Central, and Dumfries and Galloway; and in Northern Ireland.

These payments will be made to farmers in respect of the number of suckler cows, breeding ewes and dairy cows they expect to have on dates which will be specified. The farmers concerned are being invited to put in their claims quickly; the Agriculture Departments will endeavour to deal with them as rapidly as possible and will hope to pay a significant proportion before Christmasc.

My colleagues and I recognise that the farmers in these specified areas are not the only ones badly affected by this year's adverse weather but we believe that we have, in broad terms, selected for assistance those areas and enterprises where the situation is the most serious. In all, these payments are estimated to amount to some £16.9m.

I am also in a position to announce the determination for Hill Livestock Compensatory Allowances for 1986. The Agriculture Departments have now completed the annual autumn review of economic conditions in the hills and uplands and, in the light of that review, my colleagues and I are proposing, subject to Parliamentary approval, to increase the rates of Hill Livestock Compensatory Allowances with effect from 1 January 1986. In the old Less Favoured Areas, the allowances for suckler cows will be increased by £10 to £54.50, for ewes of mountain breeds by 50p to £6.75 and for other ewes by 25p to £4.50. In the new Less Favoured Areas the allowances for suckler cows will be increased by £5 to £27.50 and the allowance for ewes will be increased by 13p to £2.25.

In addition, we are proposing to increase the maximum payment per hectare from £60 to £62.48 in the original Less Favoured Areas, in accordance with the revised maximum specified in the new EC Structures Regulations and to make a corresponding increase (from £45 to £46.86 per hectare) in the new Less Favoured Areas. We are also proposing to introduce some changes in the detailed rules of the scheme in the light of the new EC Regulation, including a provision which will enable an HLCA applicant (subject to checks to prevent over-grazing) who afforests part of his land to take the afforested area into account for the purpose of calculating his allowances for up to 15 years.

We shall shortly be laying before Parliament a draft Statutory Instrument giving effect to these proposals, which are also being notified to the European Commission.

The additional HLCA payments are expected to cost £10.9m in a full year and will represent an increase of some 11% on the existing annual HLCA payments which are currently running at about £98m per annum. This represents a significant increase in the Government's support for the hill and upland areas of the United Kingdom.

The combined cost of the weather relief measures and the increase in HLCA rates in the current financial year will be £25.3 million. £5.3 million of this will be found from savings in programmes within my responsibility and that of my Rt Hon Friends, the Secretaries of State for Scotland, Wales and Northern Ireland. Detailed changes to cash limits will be announced later. The remaining £20 million will be a charge on the Reserve. Following an announcement in October that the Government was considering these matters expenditure on such measures was in prospect and can therefore be met within the estimated out-turn for the Agriculture programmes in 1985-86. The cost in future year's of the HLCA up-rating will also be met within the totals for the Agriculture programmes published in the Chancellor's Autumn Statement.

Because of the need to make payments to farmers urgently, expenditure for weather relief estimates at £16.9m will be met by repayable advances from the Contingencies Fund pending approval of the necessary Spring Supplementary Estimates.

I am pleased also to be able to announce certain other changes which will be of help to livestock farmers who are facing difficulties as a result of bad weather.

In England and Wales, farmers in the areas where the special weather assistance will be payable will be exempted, until the end of March 1986, from the charges normally made by ADAS for the analysis of hay and silage samples. In Scotland, the suspension of charging by the colleges will apply throughout the country.

Agreement has also been reached in Brussels on arrangements which will enable us to make early advance payments of sheep annual premium to Less Favoured Areas farmers in respect of the current marketing year; and we shall hope to be able to make most of these payments before Christmas. Advances will be paid to Less Favoured Area farmers who have ten or more eligible sheep at the rate of £2.10 per ewe in Great Britain and £4.70 per ewe in Northern Ireland. This early payment will clearly be very welcome to the farmers concerned.

In addition, we have been able to obtain the European Commission's agreement to some changes in the rules relating to the Suckler Cow Premium Scheme which will be helpful to farmers who may find themselves in difficulties over maintaining their cow numbers throughout the winter because of fodder problems or abnormal losses. A separate announcement about this will be made shortly.

Chancellor of the Duchy of Lancaster

CONFIDENTIAL

cc BG

2

Prime Minister

to see; Mr Tebbit's office say he is not expecting a reply.

N.L.W.

26.11

Prime Minister

ADDITIONAL HELP FOR LIVESTOCK FARMERS

I have seen Michael Jopling's minute of 22 November to you, John MacGregor's minute of the same date, and your reply.

My principal concern is with the political difficulties which will arise in the hill and upland areas if we do not press ahead quickly with a package of emergency measures to offset in part the effects of the very damaging weather conditions of this summer. I believe that the Agriculture Ministers have made an ample case for support: broadly and at the levels proposed in Michael's minute.

On HLCA's in later years, however, I too am reluctant to accept the case for a continuing increase in the extent of structural support for agriculture; within existing subsidy, I feel sure that we should put priority on the hill and upland farmers. I would therefore hope that the Agriculture Ministers would be able to re-examine the priorities in their programmes and aim to meet revised rates for the HCLA's on the basis of only the limited extra provision for agriculture overall as proposed in John's minute.

I am copying this letter to Willie Whitelaw, George Younger, Nicholas Edwards, John Biffen, Michael Jopling, John MacGregor, and to Sir Robert Armstrong.

NT

N.T.

26 November 1985

26. XI. PM 85

RESTRICTED

JA/ADU

CC NIO

10 DOWNING STREET

From the Principal Private Secretary

25 November 1985

Dear Ivor,

ADDITIONAL HELP FOR LIVESTOCK FARMERS

The Prime Minister has seen your Minister's minute of 22 November in which he proposes extra expenditure for certain livestock farmers. She has also seen the Chief Secretary's minute of the same day.

The Prime Minister is well aware of the serious effect of the almost unprecedented bad weather on the fortunes of the agricultural industry and she is glad to see from your Minister's minute that some extra provision has been agreed between the Agricultural Department and the Treasury. But the Prime Minister attaches the highest importance to maintaining public expenditure within the levels published in the Autumn Statement. She therefore cannot agree to any additions to spending which would breach these allocations. Therefore, if your Minister, and the other Agricultural Ministers wish to incur expenditure above the levels proposed by the Chief Secretary in his minute they should find them from savings within their spending blocks.

I am sending a copy of this letter to Joan MacNaughton (Lord President's Office), Andrew Lansley (Chancellor of the Duchy of Lancaster's Office), Richard Broadbent (HM Treasury), Robert Gordon (Scottish Office), Colin Williams (Welsh Office), David Morris (Lord Privy Seal's Office) and Michael Stark (Cabinet Office).

Yours sincerely

Nigel Wicks

N. L. WICKS

C. Ivor Llewelyn, Esq.,
Ministry of Agriculture, Fisheries and Food.

RESTRICTED

SRW

F R

PRIME MINISTER

ADDITIONAL HELP FOR LIVESTOCK FARMERS

Agricultural (Flag A) and Treasury Ministers (Flag B) are in disagreement on help for livestock farmers.

1985/86

Agricultural Ministers want the following above the Autumn Statement totals:

	£m
Special Weather Assistance	18.5
Hill Livestock Compensatory Allowances	12.9
	31.4

Treasury have offered

Special Weather Assistance	16.9
Hill Livestock Allowances	8.4
	25.3

of which £5.3 million would come from savings volunteered by the Agricultural Departments and £20 million from the Contingency Reserve.

For Later Years

Agricultural Ministers want £12.5 million (though there is a hint in the Chief Secretary's minute that they would settle for £10.9 million).

The Treasury has offered £5 million. This would not add to the Autumn Statement totals since it could be found by adjusting rounded figures.

/For Parliamentary

LO3AP2

For Parliamentary reasons, the matter needs to be decided by 29 November.

The Chief Secretary has suggested that the Agricultural Ministers should find any remaining expenditure above what he has offered from the combined resources of their spending programmes (MAFF, £0.8 billion, Scotland £7.4 billion and Wales £2.9 billion).

You have recently insisted in the Social Security Review that Mr. Fowler keep his expenditure within Autumn Statement totals, and you deflected Lord Young's bid for extra expenditure to the 1986 Budget discussions. I would, therefore, recommend, in view of the importance of maintaining the integrity of the Autumn Statement totals, that you support the Chief Secretary's approach. As a former Agriculture Minister, he will be well aware of the political problems of the farming community.

Shall I therefore ask the Agricultural Ministers to find savings from within their blocks for any additional expenditure above that offered by the Chief Secretary, which they think necessary?

Yes mrs

N.L.W.

N. L. WICKS

22 November 1985

(A) CC B9.A

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

From the Minister

PRIME MINISTER

ADDITIONAL HELP FOR LIVESTOCK FARMERS

You are already aware of the very serious effect which the almost unprecedentedly bad weather last summer has had on the fortunes of the agricultural industry. The problem is especially acute for the hill and upland farmers who are wholly or largely dependent on livestock for their livelihood. These farmers have for the most part been able to get in only a very small proportion of the fodder (silage and/or hay) on which their stock-feeding throughout the winter depends and are faced with the prospect of either having to sell their animals or spend substantial extra sums on feeding them if they can somehow raise the necessary money. As you know, these farmers are for the most part in a relatively small way of business and there is no question that many of them are right up against it as a result of what has happened.

With the Chief Secretary's agreement, I announced at the Party Conference that, in recognition of this very serious situation, the Government would be making new money available to provide some assistance to the worst affected areas; and I also referred to the fact that we were about to embark on our annual review of economic conditions in the hills and uplands as a prelude to determining the 1986 rates of Hill Livestock Compensatory Allowances (HLCAs), which form the backbone of the support arrangements for agriculture in the hills and uplands.

My agricultural colleagues and I have now completed that review and made our assessment of what payments should be made to the industry, both by way of emergency weather aid and through the HLCAs. I am sorry to have to report however that, despite extensive discussions, we have been unable to reach agreement with the Treasury. It is however imperative that we should be in a position very shortly to make an announcement: the continued delay has already led to a lot of criticism.

The attached note sets out the details. As you will see, we are now seeking only a total of some £31m (some £18½m for the special weather assistance and some £12½m to top up the HLCAs) against the £51m which we judged would adequately respond to the industry's problems. We have thus made a major step towards recognising the Treasury's difficulties - to the point where, frankly, we now risk criticism on the grounds that the help we are offering would be regarded as altogether too small in relation to the size of the problem. We are for instance proposing to offer "weather aid" of only £15 per beef cow and £5 per dairy cow (and confined in both cases, and especially so far as the dairy cows are concerned, to strictly limited geographical areas) against estimated additional costs of the order of £140-£200 per animal; and in the case of sheep only 50p towards additional costs which will in many cases amount to £18-20 per animal.

As regards the HLCAs, these have remained substantially unchanged since 1981, and during the intervening five years their real value has of course fallen substantially. While this has naturally been disappointing both to our supporters and to the farming community (especially since the sector of agriculture concerned is so highly dependent on these allowances for its viability), they have shown understanding of our position against the general background of financial constraint and the need to give priority to even more pressing calls on the public purse. But this means that, in a year when it is clear that the case for substantial extra support for the farmers concerned is overwhelming, they will expect us to recognise this. In this context, I should explain that future provision for the HLCAs was specifically set on one side when we discussed the agricultural PES with the Treasury before the Autumn Statement. I made it clear that the impending economic review of the hills was likely to show a need for increased provision for HLCAs; and I drew specific attention to the fact that these matters were still under consideration when announcing the Agriculture Departments figures at the time of the Autumn Statement.

In recognition of the pressures on this year's Reserve, we have offered to find between us £5.3m towards the extra expenditure in 1985/86 which our proposals would involve. Moreover, we have been able to assure the Treasury that the cost of cereals intervention this year will be some £35-£45m below the figures assumed for the Autumn Statement, because of the lower harvest. While the Chief Secretary will no doubt wish to look at these figures in detail, our discussions suggest that against this background it should not be too difficult to reach agreement on the amounts to be paid out in the current financial year.

It is the continuing cost through the Survey period of an increase in HLCAs next January which has proved to be the principal difficulty in our discussions with the Chief Secretary. But quite apart from other difficulties in justifying a "one-off" payment in this context, the EC Commission would not accept such an approach since they consider HLCAs to be a measure of continuing structural support to the farmers concerned; to make short-term variations would thus put the Community contribution at risk. Our proposals would require additional annual provision of £12.5m for 1986/87 and each of the two succeeding Survey years. Given the very severe cuts we made in the 1984 Survey, and a further rigorous scrutiny this year, it is simply not possible for my colleagues and I to find off-sets for any of this additional provision.

Finally, I should stress the political importance which I and my agricultural colleagues consider attaches to this matter. We are about to put through the House an Agriculture Bill which contains a number of provisions which will be highly unpopular with the farming community and with many of our supporters, and will be seen by them as indicating a major weakening in the degree of support which this Government is prepared to give to the industry. We are ready robustly to defend the change of emphasis which the Bill enshrines;

but it will be extremely difficult to do so if we are at the same time having to face criticism for having produced a wholly inadequate response to the extremely grave situation faced by the hill and upland farmers. As I have said above, the package we propose of £31m (£18½m for the weather and £12½m for the HLCAs) represents the minimum we believe we could defend in this context. And we must ask for a very speedy decision.

I am copying this minute to my agricultural colleagues and to the Chief Secretary; and also to the Lord President, the Chancellor of the Duchy of Lancaster and the Lord Privy Seal (all of whom have expressed particular interest in this matter) and to Sir Robert Armstrong.

C Llewelyn

for **M J**
(Approved by the Minister and signed in his absence)
22 November 1985

THE WEATHER SITUATION

1. Many parts of the United Kingdom have been particularly badly affected by the exceptionally prolonged bad weather of the summer and early autumn. As a result, the aggregate income of the agricultural sector will be greatly reduced and some farmers will be particularly hard hit.

2. The most serious effects will fall on livestock farmers, and especially those in the hills and uplands, who depend for the bulk of the winter feed for their animals on the fodder (hay and/or silage) they gather from their farms during the summer and early autumn. This year however the weather has been such that they have been able to get in only very limited quantities of fodder, and much of what they have gathered is of very poor quality. Farmers in this situation are faced with having to sell some of their animals; or buying in feed from outside (if they can raise the money to do so); or some combination of the two. To make matters worse, the available fodder supplies are very expensive (due to the shortage) and the market prices for the animals concerned are likely to be relatively depressed over the winter months.

3. The Agricultural Departments' advisers estimate that the additional costs faced by the farmers over the coming winter in the worst affected areas will be of the order of £140-200 per cow (beef and dairy) and up to £18-20 per sheep.

Proposed Level of Assistance

4. With the aim of concentrating aid when it is most needed, and bearing in mind the need to limit the total overall cost of any government assistance while providing support at levels which would not appear derisory in relation to the levels of additional costs set out in para. 3, the Agricultural Ministers decided to make their approach strictly selective, both geographically and as to species.

They therefore approached the Treasury with proposals along the following lines :-

Beef cows in LFAs*	@	£20.00 per head
Sheep in LFAs	@	50p " "
Dairy cows in	@	£10.00 " "

(i) Northern Ireland
(ii) Dumfries and Galloway Strathclyde and Central Regions of Scotland
(iii) Wales, old LFA
(iv) Northern England LFA and lowland area of Cumbria

Beef cows in (ii) and in lowland areas of Cumbria	@	£10.00 per head

This package was estimated to cost £31.5m in all.

5. Subsequently, after the Chief Secretary insisted that the cost must be substanially reduced, the Agricultural Ministers put forward a second and significantly reduced package as follows:

Beef cows in	@	£15.00 per head

(i) LFAs in the Northern Region of England (excluding North York Moors)
(ii) LFAs in Northern Ireland and Scotland
(iii) About half the original LFA in Wales

*LFAs = Less Favoured Areas (see para 6 below)

Sheep in the area covered by beef cows	@	40p per head
Dairy cows in areas to be specified in Scotland, Northern Ireland and England	@	£ 5.00 " "

It was estimated that this would cost £18.5m.

HLCAs

6. Unlike the "weather aid" (which would take the form of a set of "one off" payments), hill livestock compensatory allowances (HLCAs) form a permanent part of the support arrangements for UK agriculture. They are paid (under the EC Structures Regulation) to livestock producers in those hill and upland areas of the UK which have been defined as Less Favoured Areas (LFAs.) The objective is to ensure the continuation of livestock farming in the areas concerned, thereby helping to maintain a minimum population in the LFAs and to conserve the countryside there. Allowances are paid on beef cows and ewes and the rates are settled annually after an autumn review of economic conditions in the hills and uplands. These allowances are subject to limits on the amount payable per animal and per hectare; in the latter case the current limit is £60 but this is due to be increased to £62.48 from 1986 in line with a change in the EC regulation. On average, HLCAs account for about 60% of LFA net farm incomes and are thus of crucial importance to the farmers concerned.

7. Apart from a marginal increase in one rate in 1982, there have been no changes since 1981 and the real value of the allowances has accordingly declined significantly over the intervening years. The government has defended the series of "no change" decisions largely on the grounds that the economic situation of the hill and upland areas - though not perhaps always as good (particularly in relation to suckler cow enterprises) as the government would wish - has not been such as to justify increases in the allowances given the constraints on public expenditure.

8. The review which has been carried out this autumn has however revealed that the economic position of the hill and upland areas this year (1985/86) is expected to be extremely serious. Net farm incomes in the UK's original LFAs (which account for almost 90% of the whole) are expected to be 57% down on last year, with those in Scotland down by 99%, NI down by 75%, England by 47% and Wales by 23%. While a substantial part of this decline can clearly be attributed to the adverse effects of the weather, this year's problems will have a number of long-term effects on the economies of the areas concerned. There will be long-term effects on the livestock - where the size, fertility and productivity of the breeding flock will be adversely affected, on the land, which will take a number of years to recover from the damage caused by this year's conditions; and on the level of indebtedness of the farmers concerned which is bound to rise substantially. It is clearly appropriate to take account of these longer-term effects in settling the level of the HLCAs for 1986. In global terms, net incomes in the LFAs in 1985/86 are estimated to be of the order of £90m lower than in 1984/85. Of this decline, the Agricultural Departments reckon that between one half and two-thirds can be attributed to the "temporary" effects of this year's poor weather and the remaining one-third to a half (or something between £30m and £45m) to the longer-term effects which can be expected to remain with the areas concerned for a number of years ahead.

Proposals for Increases

9. Against this background, the Agricultural Ministers sought the Treasury's agreement to changes in the HLCAs as follows:

"Old" LFAs

	Existing Rate	Proposed Increase
Beef Cows	£44.50	£15.00
Mountain Sheep	£ 6.25	£ 1.00
Other Sheep	£ 4.25	£ 0.50

"New" LFAs (ie those included wef 1/1/85 as a result of changes in the area designated by the EC)

Beef Cows	£22.25	£10.00
Sheep	£ 2.12	£ 0.38

The total cost of these proposals was estimated at £19½m.

10. Following discussion with Treasury Ministers, the Agricultural Ministers adjusted these proposals, as follows:

"Old" LFAs

	Existing Rate	Proposed Increase
Beef Cows	£44.50	£10.00
Mountain Sheep	£ 6.25	£ 0.60
Other Sheep	£ 4.25	£ 0.30

"New" LFAs

Beef Cows	£22.25	£ 6.00
Sheep	£ 2.12	£ 0.18

The total cost of these proposals was estimated at some £12½m.

Total Cost

11. The total cost of the Agricultural Departments' "bids" is therefore some £31m (ie approximately £18½m for the "weather aid" and approximately £12½m for the HLCAs). Of this, some £28½m would be spent in the current financial year with the balance of some £2½m (relating to that proportion of the HLCA payments which are customarily paid after the end of March) falling in 1986/87. Towards this £28½m, the Departments have offered to find £5.3m from savings elsewhere on their votes.

PES Position

12. The cost of the increased HLCAs (but not the weather aid) would carry through into 1986-87 and beyond. The current PES provision for HLCAs over the Survey period is £101m. At the conclusion of the 1985 Survey, it was agreed to set aside for later consideration future provision for HLCAs pending the completion of the autumn economic review of the hills. Accordingly, the Agriculture Ministers agreed to surrender revaluations of £2.4m in 1987/8 and £5.0m in 1988/9, which would have flowed from the application of the normal cash factors to the PES baseline. If the HLCA rates for 1986 are increased as proposed by the Agriculture Departments, this would require an increase of £12½m in the annual PES provision for the 3 years 1986-87 to 1988-89.

Agriculture Departments
22 November 1985

22. XI PM 85

008/107

(B) cc B

FROM: CHIEF SECRETARY
DATE: 22 November 1985

PRIME MINISTER

ADDITIONAL HELP FOR LIVESTOCK FARMERS

Michael Jopling has minuted you about his proposals on emergency relief for farmers and an uprating of hill livestock compensatory allowances (HLCAs). As he records I have not been able to agree to accommodate the full costs of his proposals although I have tried hard to find room for slightly more modest proposals. I have had to consider these proposals in the light of the serious position on this year's Reserve (which I minuted you about on 31 October) and the fact that we have only just announced our expenditure plans for 1986-87 to 1988-89 in the Autumn Statement.

2 There is one point I must deal with at the outset. Michael mentions in his minute a possible reduction of £35 - 45 million in expenditure on cereals intervention. This reduction is an estimating change. The IBAP programme was previously forecast to overrun by £343 million this year. It is now forecast to overrun by slightly less (and even this latest forecast is uncertain). Even if we were not still faced with a considerable overrun, I do not think it would be right to regard an estimating change as relevant in considering policy changes involving new expenditure.

3 As Michael says, we have had extensive discussions and we have come close to agreement, particularly as regards the current year. On the basis that Agriculture Ministers would reduce the cost of the emergency relief package to £16.9 million and of the HLCA up-rating to £8.4 million (£10.9 million in subsequent years), and that they could

find the off-setting savings of £5.3 million referred to in Michael's minute, I was prepared to find £20 millions from this year's Reserve. This compares to a figure of "well below £10 million" for weather alone which I suggested to Michael before the Party Conference.

5 The major outstanding problem is the cost of the proposed HLCA up-rating in subsequent years. Michael's proposal would increase the domestic agriculture programme by some £12.5 million a year. I have serious difficulties with a proposal on this scale.

6 On merits, I am not yet persuaded that there is a strong case for a large uprating of HLCA's. Half to two-thirds of the fall in incomes is due to this year's exceptionally bad weather. That is why we are contemplating an emergency relief package. I think we must avoid building in a continuing increase in farm incomes because of adverse conditions in one year. I think too that we should bear in mind that estimates of net farm income made at this time of the year have been too pessimistic in 4 out of the last 6 years.

7 Moreover, while I am very conscious of the problems for the farming community that Michael outlines, we have to keep them in perspective. Farm incomes in the areas affected have been fairly stable over the last 3 years, and some year to year variations are to be expected in any industry. The recent bad weather, for example, has adversely affected the tourism as well as other industries.

8 My other major concern is to avoid an increase in programme totals over the Survey period so soon after the Autumn statement. We should have to explain in announcing

any HLCA uprating how the cost was to be met. A figure of £12.5 million cannot be disguised. An admission that we were adding to programme totals even before the financial year 1986-87 has begun runs the risk of further complicating our task of maintaining the credibility of the published plans and hence market confidence.

9 I could with great difficulty find a sum approaching £5 million for each year without departing significantly from the published figures, which are rounded. This was the size of the bid which Agriculture Ministers made in this year's Survey and which we agreed to set aside. I have suggested that Michael together with George Younger and Nicholas Edwards should seek offsetting savings for any remaining expenditure they consider necessary from the combined resources of their spending programmes.

10 I am copying this minute to Willie Whitelaw, Norman Tebbit, Michael Jopling, George Younger, Nicholas Edwards, John Biffen and to Sir Robert Armstrong.

for JOHN MacGREGOR

[Approved by the Chief Secretary]

CC BG

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Michael Jopling MP
Minister of Agriculture, Fisheries and Food
Ministry of Agriculture, Fisheries and Food
Whitehall Place
London
SW1A 2HH

11 November 1985

Dear Michael,

EMERGENCY RELIEF FOR FARMERS AND HLCA REVIEW

AT FLAP PART 1

Thank you for your letters of 25 October on emergency relief and 1 November on HLCAs. I have also seen George Younger's and your minutes to the Prime Minister of 24 and 25 October respectively. We are now due to meet to discuss these issues on Thursday 14 November. But you may like to have an advance indication of my views.

On your proposals for emergency aid, I should start by making the fairly obvious point that it would not be consistent with the way we treat other sectors of the economy when they face unforeseen problems, including many types of small business with income levels and risks comparable to farmers, nor with our general economic policy, to offer generous compensation to farmers for any adverse change in their circumstances. Farmers, particularly in the hill areas of the country, expect to live with variable and often severe weather conditions. A shortage of fodder supplies in a given season will of course reduce that year's farm income but many other eventualities occur which equally affect margins and for which farmers have to find one way or another of covering themselves. I understand that Departments are not predicting a major increase in farm failures.

Having said that, I recognise that the problems faced by farmers in certain parts of the country are particularly severe this year and I have already indicated that I am prepared to contemplate a bid on the 1985-86 Reserve for the purpose of a carefully targetted scheme of emergency relief. As you will recall, the amount I mentioned in my letter of 4 October was "well below £10 million". You will have seen my report to the Prime Minister and Cabinet colleagues of 31 October reporting the very serious state of the year's Reserve and her subsequent endorsement, in a minute and again in Cabinet last week of my

CONFIDENTIAL

proposition that any unavoidable bids on the Reserve which colleagues put forward in the remainder of this year must be matched by off-setting savings. With that in mind I must reaffirm that the sort of sums which you are now proposing (some £50 million for emergency relief and the HLCA uprating together) are just not available. As I see it, our task when we meet will be to decide how the scale of your proposals can be reduced to fit within the resources available, whilst still enabling us to announce a package of measures which responds to those in greatest need.

There are a number of ways in which such a package could be devised. In the first place, the statistics you quote in your letter and in the memorandum on the HLCA uprating reveal wide regional variations in the extent of the fodder shortage and the consequent income loss. Even without the constraint on expenditure, there would seem to be a strong case on the evidence for limiting any emergency relief to Scotland and Northern Ireland and perhaps Cumbria.

Second, I see little evidence in your letters of any need to make emergency relief payments to sheep farmers, who are in any case likely to benefit from an earlier than usual payment of annual ewe premium next year because of the change in the EC sheepmeat marketing year. You could reduce the cost of your proposals by £5.2 million simply by deleting the special payments for sheep.

Third, I am very sceptical about the proposal to make special payments in respect of dairy cattle (at a cost of £7.4 million). In the past we have deliberately excluded dairy farmers from the benefit of HLCAs in the hill areas and there are, as we know, restrictions on the availability of national aids for the dairy sector under the EC Farm Structures Regulation.

These means are not by themselves sufficient to reduce the cost to an acceptable level and it will be necessary to examine the further options of reducing the payment for beef cattle below the £20 per head you propose, or placing a ceiling on individual entitlements.

In addition to direct payments from national funds I very much agree with George Younger that we should make the most of any assistance we can obtain from the Community. You have already succeeded in negotiating the release of intervention grain stocks at a favourable price in Northern Ireland and a helpful modification to the rules on payment of the suckler cow premium. I understand that you are not now likely to seek Commission agreement to a transfer of wheat stocks from England to Scotland but if there were ways of releasing intervention stocks in the affected areas which would benefit livestock farmers and not merely result in a corresponding increase in intervention from this year's cereals harvest, we should certainly consider them. I should be grateful if your officials would cooperate with mine in putting a monetary value on these various Community concessions so that they can score in the package which is to be announced.

I would have no objection to your proposal to provide free testing of conserved fodder in the worst affected areas, provided that the cost can be absorbed within your existing programmes. I cannot, however, accept any extension to the timelimit for making claims under the Agriculture and Horticulture Grant Scheme, at a time when we are already threatened with an overspend of up to £30 million on capital grants.

To sum up on the emergency relief proposals, it should in my view be possible to construct a package of measures within the level of resources which I have already indicated are likely to be available. If you continue to wish to press for a more extensive package you and the other Agriculture Ministers will have to volunteer offsetting savings from within existing programme totals to cover the additional costs. I have therefore asked my officials to discuss the scope for offsetting savings with the four Departments.

On HLCAs, as they are intended to compensate for "permanent natural handicaps" affecting farmers in particular regions of the Community, it would be quite wrong in assessing the appropriate level of HLCA rates to place much weight on factors (such as severe weather conditions) which affect mainly one year. The memorandum on the HLCA review states that the weather is responsible for some half to two thirds of the estimated income loss this year. Excluding this factor the fluctuation in income in the UK LFAs as a whole is not widely out of line with the reduction in, for example, 1982-83. I note too that forecasts of net farm income in the autumn review are normally pessimistic compared with the eventual outturn.

I remain therefore to be convinced that any uprating is required in terms of a change in the <u>underlying</u> conditions. Insofar as you can show that an increase in rates can be justified I will be bound to ask you to consider the scope for financing it by some form of redistribution within the existing provision for HLCAs, either by changing the balance between cattle and sheep rates, or introducing a greater degree of differentiation by degree of natural handicap or by imposing a ceiling on individual entitlements. I have asked my officials to seek further information from yours on the available options in this area.

I am prepared to consider your proposal for changes in the payment arrangements for HLCAs providing that they can be shown to have a neutral effect on public expenditure. But I see this as an exceptional measure, which might usefully be included in the emergency relief package, rather than as an arrangement which we would wish to repeat year after year.

Finally, the present system of deciding HLCA rates after the Public Expenditure Survey decisions have been taken is not satisfactory. The timing of the HLCA review is itself awkward and, while I recognise the difficulties I wonder whether it could not be brought forward, so that we can in future take at least a preliminary view of the likely outcome in time for the PES bilaterals in September. I also recall your objections to the present PES convention under which the HLCA provision is not uprated each year(but under which estimating increases are accepted without question). Perhaps we might discuss whether in future we should reverse this convention by allowing annual uprating of the provision by the factor agreed for public expenditure generally. This would, however, be on the understanding that in future the cost of any estimating increases or future increases of HLCA rates should be kept within the revalued PES provision. I should be glad to have your views on this proposal when we meet.

I am sending copies of this letter to the Prime Minister, Willie Whitelaw, George Younger, Nicholas Edwards and Tom King.

Yours ever,

John

JOHN MacGREGOR

AGRICULTURE
EXPENDITURE
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RM

10 DOWNING STREET

From the Principal Private Secretary

7 November, 1985

Dear John,

EMERGENCY AID FOR FARMERS

The Prime Minister has seen your Secretary of State's letter of 24 October about emergency aid for farmers. She has also seen the Minister of Agriculture's minute of 25 October on which he comments on your Secretary of State's minute.

The Prime Minister understands that the Agricultural Ministers will shortly be meeting the Chief Secretary to discuss emergency aid for farmers and the questions raised in the minutes will no doubt be considered then.

I am sending a copy of this letter to Ivor Llewelyn (Ministry of Agriculture, Fisheries and Food), Colin Williams (Welsh Office), Jim Daniell (Northern Ireland Office) and Richard Broadbent (Chief Secretary's Office).

Yours sincerely

Nigel Wicks

(Nigel Wicks)

EA

J. Graham, Esq.,
Scottish Office.

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cc: Mr Owen

PRIME MINISTER

EMERGENCY AID FOR FARMERS

I have delayed putting in to you the papers attached in the hope that I would be able to report some Treasury reactions to the Agriculture Ministers' petitions for emergency aid for farmers. But as discussions between departments are still continuing, you should see the papers now.

The papers are:

Flag A: a minute to you from Mr Younger which stresses the particular difficulties of Scottish farmers, and makes oblique criticism (presumably of MAFF) that not enough has been done to make our case to the Community for help.

Flag B: a riposte from Mr Jopling defending MAFF's action in pressing the Community.

Flag C: Mr Jopling's letter to the Chief Secretary asking for £31.5 million extra help for farmers.

Flag D: a Policy Unit analysis of Mr Jopling's bid.

My own view is that you should not intervene at this stage in the discussions between the Agriculture Department and the Treasury. If the departments can settle, so much the better. If they can't, the Agriculture Ministers will no doubt appeal to you. So probably best to await the outcome of the discussions with the Chief Secretary.

Agree to proceed in this way?

N.L.W.

Yes me

N L WICKS

6 November 1985

10 DOWNING STREET

Nigel

The PU advice.

On

1. If so, so be it

2. Good idea. But don't bring HLCAs back beyond April 1986 (from Jan 1987) because that would increase costs this year.

3. OK.

Jopling is writing a letter to the CST about the annual review of HLCAs. Emergency aid needs now to be considered alongside this, according to R. Bardent.

DRN

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CC BG

CHIEF SECRETARY TO THE TREASURY

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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Michael Jopling MP
Minister of Agriculture, Fisheries and Food
Ministry of Agriculture, Fisheries and Food
Whitehall Place
London
SW1A 2HH

6 November 1985

Dear Michael,

AGRICULTURE BILL

NIL REQUEST IF REQUIRED

Thank you for your letter of 30 October.

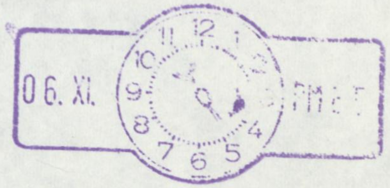
I agree with you that officials should consider urgently the means of charging for work under the Radioactive Substances Act and that Departments should look for an appropriate alternative legislative vehicle for making this change once the details are settled.

I am sending copies of this letter to H and QL Committees and Sir Robert Armstrong.

Yours ever,

JM

JOHN MacGREGOR

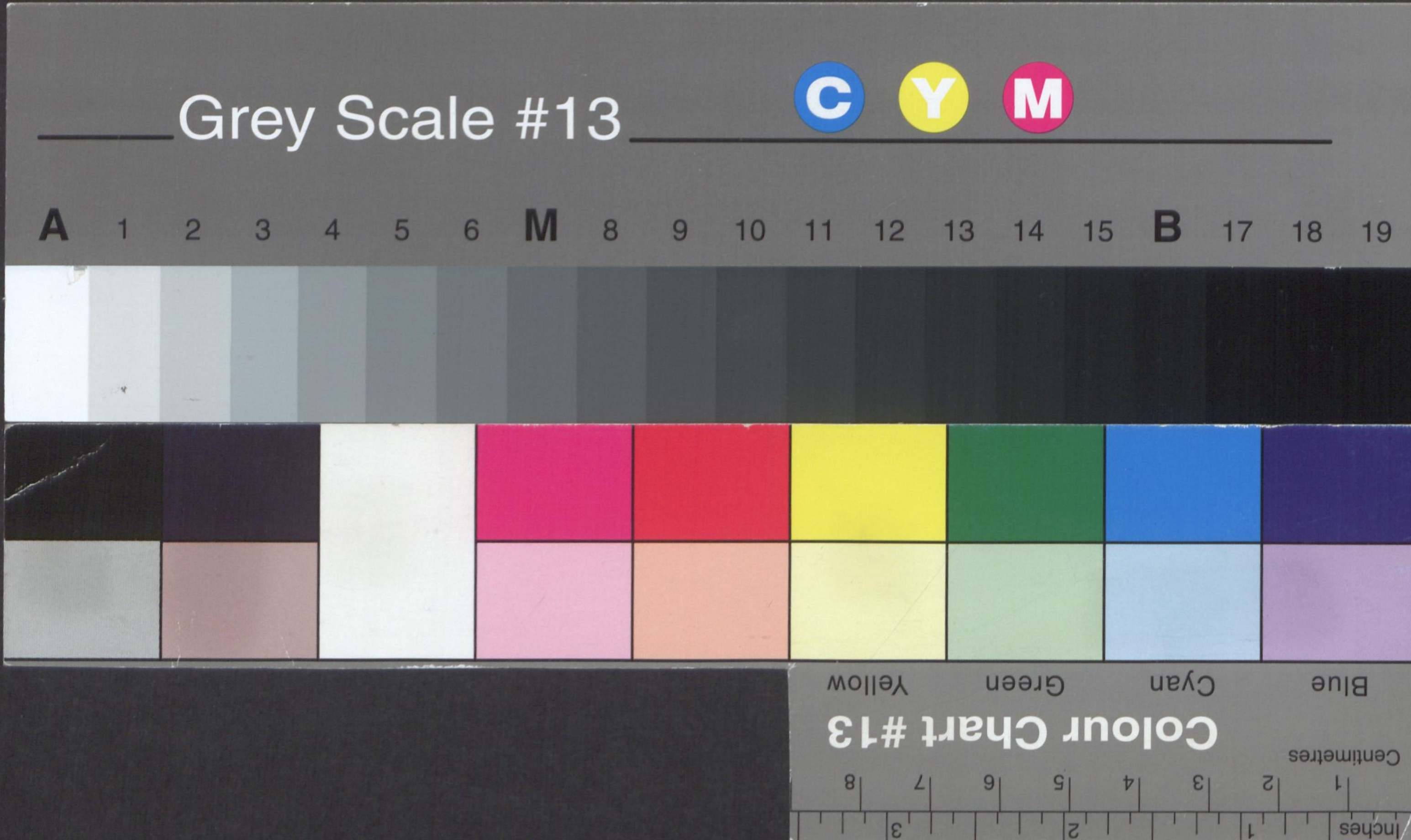

06. XI.

PART 1 ends:-

Scottish Office to FERB 31.10.85

PART 2 begins:-

CST to Min/MAFF 6.11.85.


Grey Scale #13
C Y M
A 1 2 3 4 5 6 M 8 9 10 11 12 13 14 15 B 17 18 19
Blue Cyan Green Yellow
Colour Chart #13
Centimetres
1 2 3 4 5 6 7 8
Inches
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