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PRIME MINISTER

Cap Price Fixing 1981

When OD discussed our general strategy for the budget restructuring exercise on 13 October, it was agreed that the committee needed a further paper from the Minister of Agriculture on the approach to next year's agricultural price fixing (OD(80) 20th Meeting). Mr Walker's paper (OD(80) 62) says that we shall need to bear in mind the forthcoming French election, the wishes of most other Member States for substantial price increases (at least as expressed by Agriculture Ministers), the Commission's objectives, and the interests of our own agricultural industry. On the last point, the Chancellor of the Exchequer's paper (OD(80) 63) argues that the CAP tends to insulate the farming industry from the disciplines of the market and that we cannot unduly protect one section of the economy when others are suffering. He is therefore firing a warning shot (paragraph 9) on support for agriculture, although he does not dispute the need for some price increases. There is no need for the Committee to decide now what level of price increase might ultimately be acceptable to us, or what we should do about the green pound. Officials have to agree (before the end of the year) on what the true income position of British agriculture is; and any decisions on the green pound will be affected the movement in sterling between now and next spring. The immediate decision to be taken is what indication we should give, before the Commission makes its proposals about our attitude on prices for next year. The question then arises: if we are prepared to agree to some increase, can we extract some quid pro quo. The Minister of Agriculture proposes that for this purpose we should press the Commission to bring forward, at the same time as its price proposals, suggestions for reforming the system (including a penal levy on extra milk production). The Chancellor and other Ministers, while agreeing with this, will also attach importance to getting a financial ceiling put on agricultural expenditure, first for 1981 and subsequently in the form of a limit on the proportion of the budget devoted to agriculture.

2. The immediate focus of the discussion is your forthcoming meeting with the federal Chancellor and the prospect of being able to reach some understanding

with him on CAP which, without ignoring President Giscard's political needs, will nevertheless prevent the French from blocking all real progress towards reducing surpluses and the cost of the CAP next year. The Treasury and FCO are more sanguine than MAFF, but all take the view that nothing would be lost by the attempt, given the Federal Chancellor's constant pleas to us to shoulder the burden of CAP reform. In this connection, you will recall your agreement with the Federal Chancellor that personal representatives should explore how we could work together with the Germans on CAP reform and other means to restructure the Community Budget. Mr Franklin is having a first meeting with the Chancellor's representative, Dr Dieter Hiss, on the evening of Monday 3 November, and would be able to follow up in the light of the Committee's discussion (only you, the Foreign Secretary and the Chancellor are aware of this contact). You can decide how you should handle the meeting with the Federal Chancellor in the light of these soundings. We must obviously, as Mr Walker said in Cabinet last Thursday, show our awareness of French political problems, but not at the expense of our real interests. It would be premature to decide now that in all circumstances we want to settle prices before the French elections.

HANDLING

3. You will wish to invite the Minister of Agriculture to introduce his paper, and then let the Chancellor of the Exchequer speak to his. It will probably be better to discuss the two papers together. You might remind the Committee that it has already agreed (OD(80) 20th Meeting) that cutting the cost of the CAP was an essential part of our budget restructuring strategy; that we should use price restraint as a weapon; try to get financial responsibility for surplus shifted to those who produce them; and go for a ceiling on financial expenditure on the CAP. Since the meeting, officials have agreed on a line to take in bilateral discussions (the relevant extract on the CAP is attached).

4. You might then see if the Lord Privy Seal wishes to make any general comment before focussing the discussion on -

(i) our attitude to prices for 1981;

(ii) additional measures to cut the cost of the CAP and reduce surpluses;

(iii) the nature of any financial ceiling on CAP expenditure;

(iv) tactics with the Germans.

(i) Prices

The Committee will probably agree that, in spite of the Manifesto commitment to freeze the prices of products in structural surplus, it would be unrealistic to take this line for 1981. If so, should we use Mr Walker's phrase of 'severe price restraint' or, because the French figure of 10% is already being widely bandied about, we should be more specific and say eg. "5% with less for products in surplus". A precise figure of that kind, if it became generally known (as we must assume it would) could no doubt be more difficult for the French, and might force the French government into naming a precise (and considerably higher) figure for its objective.

(ii) Other Reforms

The Committee can probably agree that we should press eg. for the super levy on milk (but resist a straight increase in the levy on existing output) and the other change detailed in the MAFF paper (paragraph 20); and that the Commission should be encouraged to put proposals forward soon.

(iii) Financial ceiling

You might ask the Chancellor to put the case for a strict ceiling based on the Commission's estimate for 1981 (12.92 billion eua) which contains no allowance for price increases and the Minister of Agriculture to explain why he thinks this is unrealistic. A 5% price increase would put only 200 meua on the 1981 budget (but much more for a full year); so it seems reasonable to insist at least at this stage on the Commission figure and looking for economies to offset the cost of higher prices.

(iv) Tactics

You will want to hear the views of the Lord Privy Seal and the Lord President. Is it agreed that we should explore the scope for agreement with the Germans (and perhaps subsequently with the French), before deciding finally how we handle the price-fixing negotiations themselves?

CONCLUSIONS

5. The points to cover in your summing up might be -

(a) the formulation agreed for our attitude on prices;

(b) endorsement of the other proposals for reform in the MAFF paper which we should seek to get included in the price package;

(c) the financial ceiling for agriculture in the 1981 Budget; and how to impose such a ceiling in future years

(d) we should seek to make common cause with the Germans on these lines while assuaging French susceptibilities.

D.J. Wright

ROBERT ARMSTRONG

(approved by Sir R Armstrong and signed on his behalf).

31 October 1980

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Agriculture

6. An essential element in restructuring of Community expenditure must be cutting the cost of the CAP. In recent years expenditure on agriculture has been growing far faster than own resources (roughly 23 per cent per annum against 10-12 per cent per annum and the latter figure in future more likely to be 8-9 per cent per annum). At same time massive structural surpluses in certain sectors have undermined political support for CAP and impose resource costs on Community economy which already faces hard times. So we must look for measures which will improve the agricultural policy so as to reduce the surpluses and the costs.

7. We do not question the basic objectives and principles of the CAP. But the founders of the CAP never envisaged that it would create structural surpluses. The problems of the CAP as it has developed are evident and must be tackled. To do that is the best way to sustain the policy; to refuse to do it is to condemn it to eventual collapse.

8. In our view the broad objectives of CAP reform should be -

a. to eliminate structural surpluses especially in the milk sector;

b. to reduce agricultural expenditure as a proportion of the total budget;

c. to move towards prices for agricultural products which will not generate structural surpluses. This will benefit consumers and reduce the resource costs and inflationary effects of the present system;

d. to preserve a healthy European agricultural industry.

9. A central element in our approach must be to continue a policy of severe restraint on prices. Over time this should lead towards a price level which does not encourage the production of surpluses. We would not exclude making price restraint more acceptable by combining it with direct aids not related to production which would augment the income of those categories of farmers on whom restraint would bear most heavily.

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10. But a policy of restraint on institutional prices is unlikely to be sufficient by itself to produce adequate improvement within a reasonable time-scale. Need therefore to consider how it can be supplemented by other measures which would bear directly on the surpluses. Council are already committed to implementing a supplementary levy (the "super levy") on milk. This must operate so as to penalise those producers who are continuing to add to the dairy surplus. For cereals, measures relating intervention prices to the volume of production might be envisaged. For beef the amount of intervention should be reduced. For other commodities including Mediterranean products limitations on the volume of produce to which support applies should be considered particularly in relation to enlargement.

11. Critical of any further development of the across the board co-responsibility levy principle as an instrument for CAP reform. Simply a means of producing more funds without tackling the central problems. Indeed, tends in our view to generate demands for larger price increases to offset the impact of the levy. Thus the outcome is to add to the resource costs of the CAP without tackling the surplus problems.

12. We noted with interest the statement by the German cabinet on 5 June that the increase in agricultural expenditure should be held below the increase in own resources of the EC. We believe the Community should go further and set an ambitious medium term target for the reduction of the proportion of the overall budget which goes to agriculture. If that is to mean anything we will need to make progress year by year on the cost of agriculture to be borne on the budget, with no supplementary budget loopholes. Finance Ministers should be asked to consider this approach urgently; it has relevance for 1981. At the minimum, should hold FEOGA expenditure to levels agreed in 1981 draft budget. The implementation of this approach might be helped by synchronising the decisions of the Agriculture Ministers on prices and those of the Budget Ministers on available funds.