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From the Minister

SECRET

PRIME MINISTER

21 November 1979

Prime Minister

EEC BUDGET AND CAP REFORM

John Nott sent me a copy of his minute of 14 November to you about the line we should take in the Community if we fail to secure an adequate reduction in our net contribution to the budget. I was sorry not to have had the chance of commenting when the question was discussed in OD, as of course the great majority of Community decisions concern agriculture and food.

John Nott's conclusion - that we should in effect abandon our aim on budgetary contributions, declare that we were instead going to seek major savings on expenditure, particularly the CAP, and aim for a shift in the bulk of CAP expenditure from the Community to national budgets - seems to me to be based on two mistaken assumptions. The first is that it would be easier to secure agreement to the sort of CAP reform he has in mind than to get what we want on the budget. I believe the opposite to be the case. There will be resistance enough to correcting the manifest unfairness of the budget. But that could at least be done in a way which would distribute the cost between other countries according to their capacity to pay. To shift the cost of the CAP on to national budgets would hit selectively at the agricultural net exporters - particularly the Netherlands, Denmark and Ireland. I see no chance whatever of their agreeing to it on a scale which would go anywhere near meeting our budgetary problem. For them the retention of common financing of the CAP, at least at present levels of expenditure, is a major national interest and they will defend it accordingly.

The table I attach illustrates this very clearly. If, for example, 50 per cent of the cost of the CAP were switched from the Community to national budgets, the Danes and the Irish would lose about a third of their current benefit from the CAP. But Germany is a net contributor to the cost of the CAP and so would gain; and France is more or less in balance on the budget (most of her gain from the CAP comes from selling at high prices to other member countries) and so would not be much affected. It is therefore wrong to suppose that debudgetisation of this kind would make the Germans or the French alter their policies, as John Nott seems to believe, so as to make them bear more hardly on their farmers.

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The second mistaken assumption, in my view, is that there is an easily identifiable and negotiable way of securing an early reduction in CAP expenditure affording us benefits in any way approaching what we are seeking on the budget. Again, if half the current Community expenditure on agriculture were switched to national budgets, our net contribution would be reduced by only about 550 MEUA (taking the figures in the Commission's reference paper for 1980), compared with the 1600-1800 MEUA needed to put us in broad balance. But the point goes wider than this. On my instructions, my Department is doing a great deal of work on how we can best alter the CAP to our advantage. You and our colleagues may find it interesting to glance at the enclosed paper, which was prepared as a basis for discussion with me. We are making a number of follow-up studies and I shall be circulating my conclusions in due course. But we should not delude ourselves into thinking that there is a simple and easy answer. The fact is that most other member countries have done well out of the CAP, as again the table shows. Only two other member states have done badly; and of those, the Italians see the way ahead as special deals for their own agriculture, which will soon make them net budgetary beneficiaries; and the Germans will not do anything to disadvantage their farmers - especially before an election. With all its difficulties, budgetary reform is much easier for the rest of the Community to swallow than any really drastic reform of the CAP.

Whatever the answer, I am quite sure that it does not lie in the device that John Nott suggests - Wallace Day's proposal for headage payments on dairy cows, coupled with a big reduction in milk prices. This would in fact greatly increase the total cost of the milk policy: the headage payments alone would cost nearly twice the present bill for the whole policy, and there would still be some surplus to dispose of as well. If it is argued that headage payments could more readily be switched over to national financing, I can only say again that it seems to me quite unrealistic to expect the net exporters to agree, first to a massive cut in their export earnings through the price reduction and then to a further massive loss from having to finance the headage payments themselves. They would be far better off with the price freeze which John Nott sees as a means of getting them to accept such a policy. Even our own Treasury might fight shy of the annual expenditure of £675m that Wallace Day proposes for headage payments in the UK.

This does not mean that we should not stand firm on prices in 1980, or not seek a gradual switch to the national financing of agricultural support. But in my view it would be more realistic, and potentially more productive, to regard insistence on a price freeze in the Agriculture Council as a lever for securing movement on budgetary reform, rather than as a means of securing a rapid reform of the CAP and massive reduction in its cost. A firm stand on agricultural prices could not legitimately be attacked as unreasonable - quite apart from its being right in principle - since it is the agricultural expenditure that lies at the root of our heavy net contribution. In order that we can hold out for a price freeze throughout 1980 without doing irreparable damage to British agriculture, we should devalue the green pound before the price fixing negotiations begin. I hope Sir Kenneth Berrill's Committee on support for agriculture will propose precisely that.

This is like Peter Carrington's line in some ways, but it does not go to the point of saying we would block all major Community decisions of whatever kind. If we were to go to that extreme, I suspect the result would be that nothing to our advantage, including the green pound change, would get done by any Council, and that a good many things to our disadvantage that can be done without unanimity - like choking off New Zealand's butter imports by changing

/the levy - would be ....

the levy - would be pushed through against us. My own view therefore is that we should decline to regard an unfavourable outcome at Dublin as final; say that we shall carry on the fight for budgetary reform; and take a tough line in the 1980 price-fixing so as to put maximum pressure on others to agree to what we want.

I am sending copies of this minute to the members of OD and to Sir Robert Armstrong. Copies also go to George Younger, Humphrey Atkins and Nicholas Edwards.

PETER WALKER

ESTIMATED TOTAL BALANCE OF PAYMENTS GAINS AND LOSSES FROM THE CAP, 1978

	1 Net budgetary receipt from or contribution to CAP	2 Estimated net gain or loss on agricultural trade	3 Total gain or loss (1 + 2)	4 Total gain or loss if 50% debugetisation of CAP expenditure (½ of 1, + 2)	5 Net benefit (+) or disbenefit (-) of 50% debudgetisation (3 - 4)
	£m	£m	£m	£m	
BELGIUM/LUXEMBOURG	+ 33	+ 54	+ 87	+ 70	- 17
DENMARK	+ 408	+ 275	+ 683	+ 479	- 204
GERMANY	- 122	- 434	- 556	- 495	+ 61
FRANCE	+ 41	+ 575	+ 616	+ 595	- 21
IRELAND	+ 343	+ 184	+ 527	+ 355	- 172
ITALY	- 344	- 588	- 932	- 760	+ 172
NETHERLANDS	+ 241	+ 605	+ 846	+ 725	- 121
UK	- 673	- 110	- 783	- 447	+ 336

Notes:

1. The estimated net gain or loss on agricultural trade is calculated from the difference between EEC prices and world prices on the volume of trade with other Member States. The calculation is confined to products subject to import levies under the CAP. The same effect arises with products protected by ad valorem tariffs, but it is less easy to arrive at a reliable figure for these items. However, the omission overstates Italy's net trade losses, since she is an exporter of these products to other Member States.

2. The figures for gains and losses with a 50% debudgetisation must be treated as only approximate since no allowance has been made for the difference between overall and marginal rates of budgetary contribution.