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SECRET

PRIME MINISTER

CAP Prices

At the meeting you had with the Foreign and Commonwealth Secretary on 20th February, it was agreed that officials should produce a note on what it might cost us to accept the CAP price package along the lines proposed by the Commission or, alternatively, what would happen if we blocked it until we secured a settlement on the budget.

2. The attached note has been agreed with the MAFF, Treasury and FCO. I am sending copies to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the Minister of Agriculture.

3. In brief, if we accepted the Commission's proposals as they stand, food prices would go up by 0.3 - 0.7 per cent, there would be a reduction of £50 million in public expenditure (in a full year), of £5 million in our net contribution to the Community Budget and £27 million in farmers' incomes. But these effects depend heavily on the proposals for the milk co-responsibility levy which will not emerge unscathed from the discussions in the Agriculture Council. If less is done to cut the milk surplus in this way and larger price increases are agreed, the costs will go up by £16 million on our net budget contribution for every 1 per cent price increase for all products. But we should then be likely to secure agreement to continue the 100 per cent Community financing of our butter subsidy from which we would gain £23 million. These figures give only the static effect and take no account of how Community production and consumption might be influenced; but they suggest that a CAP price settlement around the area of the Commission's proposals would not be too expensive a concession for a satisfactory budget deal.

4. Conversely, if we were blocking an agricultural price settlement, we should only be foregoing a relatively small reduction in our net budget contribution (and none at all so long as we could retain the present butter subsidy). Farmers in this country would not suffer because although they would not get the price increases they would escape the economy measures at the same time. Farmers

throughout the Community, however, are expecting that in the end the economy measures will be less severe and the price increase will be higher than the Commission propose. They will resent being denied a settlement.

RA

Robert Armstrong

10th March 1980

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NOTE ON CAP PRICES 1980/81

The Commission's proposals

1. The Commission's proposals for 1980/81 involve price increases ranging generally from $1\frac{1}{2}$ per cent (for milk) to $3\frac{3}{4}$ per cent (for cereals). They estimate that their proposal on prices and related measures will increase the cost of the CAP by about 130 meua in 1980 and 290 meua in a full year, compared with the rejected 1980 draft Budget.

2. But their proposals are closely bound up with earlier proposals for achieving economies in expenditure on surplus products notably milk. Indeed the Commission have said that they will reconsider their price proposals unless this "economy package" is adopted. We too have said that the one cannot sensibly be decided without the other. The Commission estimate that the economy package will save 490 meua in 1980 and 1,000 meua in a full year. (However, the increase in the co-responsibility levies on milk account for 427 meua in 1980 and 665 meua in a full year.) They estimate that the recent decisions already taken and market developments will save an additional 460 meua in 1980. Thus, according to the Commission estimates (which they have included in the new draft Budget for 1980 submitted to the Council), the net effect of the two sets of proposals would be to bring 1980 expenditure slightly below the 1979 provision and to save 820 meua on the original draft budget for 1980. In addition, own resources would be increased by 45 meua in 1980 and 160 meua in a full year.

3. The Commission's proposals would, if implemented as they stand, involve a significant reduction in real farm support prices and should go some way towards curbing the production of surpluses. The Commission's estimates, however, do not concern themselves with the effects of real price changes on the volume of production. They cover only the effect of changes in support prices on surplus disposal and other costs assuming an unchanged volume of production. Therefore they understate the difference between a complete price freeze and the price increases they are proposing. They probably also overstate the savings which would result from the economy package even if it were adopted as it stands. But on the assumption that it remains unchanged (and ignoring the decisions already taken and market developments), the Commission's figures would reduce the UK Government's net contribution by £15 million in 1980/81 and about £5 million in a full year; producers' returns in the UK, after

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allowing for the higher feed costs, would fall by about £27 million in a full year; and the food price index would go up by 0.3 per cent (less than 0.1 per cent on the RPI) assuming that the butter subsidy is continued at its present level but with 75 per cent Community financing instead of 100 per cent as at present. On the same assumption about butter, the PSBR would be reduced by £70 - £75 million in a full year and public expenditure would be reduced by about £35 million in 1980/81 and over £50 million in a full year.

The Likely Outcome

4. However, all Member States will be arguing for amendments to the Commission's proposals. The main difficulties will be over:-

(a) the level of prices. The farmers' organisations are asking for about 8 per cent; and most Agriculture Ministers will take the opposite view to us: that the Commission's proposals are too low. On the Commission's estimates (without allowing for production changes), every 1 per cent increase in the average level of CAP prices (assuming this applied across the board) raises the cost of the CAP by about 130 - 140 meua and our net contribution by about £16 million in a full year;

(b) the milk package. The combined effect of the Commission's proposals on the milk levies, even with a 1½ per cent price increase, will be too much for some Member States. They will press for the proposals to be softened, for example, by a larger increase in the price, the abandonment of the supplementary levy, or widespread exemptions for small producers. However, we are only ready to accept a higher basic levy if it is non-discriminatory and not offset by a price increase. The outcome of this complicated and difficult negotiation will critically affect the UK position. If the outcome was no increase in the milk price but no new supplementary levy and no change in the basic co-responsibility levy either, then the cost of the CAP in a full year would be about 560 meua more than the estimates under the Commission's proposals and the UK net contribution would be lower by about £5m; retail prices of milk products would be lower than under the Commission's proposals and UK farmers would be better off. If, on the other hand, greater exemptions were given to small farmers (eg by extending the first 60,000 litre exemption from the less favoured areas to all milk producers), then the CAP cost would go up by 135 meua and the UK net contribution would rise by £8m. (Only about 25 per cent of UK production would be exempted compared with some 70 per cent in the other 8 Member States).

If the outcome was not to proceed with the proposed supplementary levy (a prohibitive tax on extra milk production) but to increase the basic levy say to 3 per cent instead of 1½ per cent, then the cost to the CAP would be some 230 meua more (with the UK net contribution about £5m higher).

(c) The UK butter subsidy. This year, as last year, the net budgetary effect on the UK will be heavily influenced by the fate of the butter subsidy. If, contrary to the Commission's proposal, it were continued in its present form, then, as compared with the estimates in paragraph 3, public expenditure would be reduced by a further £31m and the UK net contribution would be reduced by a further £23m. Changing the method of financing the UK butter subsidy would have no effect on the impact of the Commission's proposals on the food price index - about 0.3 per cent in a full year;

(d) Sugar quotas. The present proposals for the allocation of the reduced quota bear unfairly on the UK and we are pressing for improvement. Given the current high world price of sugar and the fact that farmers are already sowing the 1980/81 beet crop, the Council may want to postpone any action this year to reduce quotas. The Commission's estimate of the saving from this measure is 130 meua in a full year. The financial effects on the Community's budget of postponement would depend on whether world sugar prices remain at high levels. It would still leave unresolved the underlying surplus production;

(e) Beef. The Commission have proposed a beef cow subsidy to be paid on the first 15 cows in a herd. This limit would discriminate against our larger herds and reduce the benefit of the subsidy to the UK. If the Council cannot agree on this subsidy, the Commission will almost certainly propose a higher increase in the beef price, probably 3 per cent;

(f) Monetary compensatory amounts (MCAs): The Commission's proposals involve cutting German MCAs by 1 percentage point and Benelux by ½ percentage point. If this was dropped it would add 50 meua to the cost of the CAP and it would retain the advantage enjoyed by German farmers.

5. It is impossible at this stage to forecast the likely outcome; but it is clear that there will be strong pressure in the Agriculture Council to repeat the traditional pattern of an outcome more favourable to farmers than the original Commission proposal.

Failure to Agree

6. A decision will be necessary at the end of March on the extension of the marketing years for milk and beef. Since the 100 per cent UK butter subsidy is linked to the marketing year for milk, a decision to extend the year would imply a continuation of our subsidy. It would not be unknown for negotiations on agricultural prices to continue into June. If decisions have not been reached by the end of June, the Community would be faced with having to decide on the commencement of marketing years for other major commodities (where there is no provision for extension). In this event there would be strong pressures from other Member States to begin new marketing years. It might be difficult for us to prevent this but we could continue to resist price increases. If this led to pressure to start a new milk year, it might be difficult in these circumstances to be sure of getting agreement to continue the 100 per cent Community-financed butter subsidy.

7. A summary of the figures underlying this note is attached covering the Commission 's CAP and economy proposals, their effect on the UK, and the effects of possible variants of their proposals.

Cabinet Office
5 March 1980

COMMISSION AGRICULTURAL PROPOSALS FOR CAP PRICES AND ECONOMIES

SUMMARY OF FIGURES

Effects of Commission Proposals on the Community Budget

	in 1980 MEUA	in a full year MEUA
Economy package	- 491	- 998
(of which milk levies)	(- 427)	(- 665)
Price proposals and related measures	+ 129	+ 288
Net effect of both packages	- 362	- 710
Savings from decisions already taken and from market developments	- 461	
	- 823	
Total for farm price support in rejected draft 1980 Budget	11,193	
	10,370	

Note: the revised figure of 10,370 MEUA is marginally below the corresponding appropriations for 1979 (10,384 MEUA).

Estimated Effects of Commission Proposals on the UK (based on the Commission's figures, but ignoring the saving from decisions already taken and from market developments)

(1) Reduction in UK net contribution to the EEC:

£15m in 1980-81
£ 5m in a full year

(2) Reduction in UK farmers' returns:

£27m in a full year (0.4% of forecast final output)

(3) Increase in food prices (when all effects have worked through):

	food price index	retail price index
if butter subsidy continued	0.3%	less than 0.1%
if butter subsidy ended	0.7%	less than 0.2%

(4) Reduction in UK public finance (assuming butter subsidy continued):

public expenditure:	- £50m in a full year; £30m in 1980/81
PSBR:	- £70/75m in a full year

Possible variations on Commission's proposals

(a) Commission estimate of effects of each 1% increase in prices:

- On Community Budget (full year) + 130-140 MEUA
- On UK net contribution (full year) + £16m

(But these figures are of limited value since they ignore the effect of price increases on the volume of production.)

(b) Effect of extending exemption from milk levy to all milk producers:

- on Community Budget (full year) +135 MEUA
- on UK net contribution (full year) +£8m

(c) Effect of further 1½% increase in milk CR levy but no milk supplementary levy:

- on Community Budget (full year) + 230 MEUA
- on UK net contribution (full year) + £5m

(d) Effect of continuing UK butter subsidy with 100% EEC financing instead of 75% as proposed:

- on UK public expenditure: reduction of £31m
- on UK net Budget contribution: reduction of £23m