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CONFIDENTIAL

PRIME MINISTER

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

BACKGROUND

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

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

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

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

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

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

Green Pound

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

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

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

9. Discussion is likely to focus on:-

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

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

(c) a $7\frac{1}{2}$ per cent general devaluation now might leave very little scope for further Green Pound devaluations in later years to compensate farmers for rising costs, especially if the Pound remains strong. We might then find that we were forced to press for increases in the common prices even of commodities in surplus in order to satisfy the needs of our farmers. This together with the retail price effect is the main argument against proceeding to an early abolition of mcas. We could however declare our readiness to phase them out and the Foreign and Commonwealth Secretary may argue that such a declaration would be helpful in the context of our Budget contribution. The dispute over the size of our budget contribution because of mcas will then rapidly disappear

(d) whether by pressing for a Green Pound devaluation we weaken our position in the price fixing. Mr. Walker does not believe that we will, but it may be easier to secure the Commission's help for, say, 5 per cent than $7\frac{1}{2}$ per cent.

HANDLING

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

11. You might then move on to the Green Pound. The Chancellor of the Exchequer might be invited to say whether the RPI effects of a $7\frac{1}{2}$ per cent devaluation are tolerable in relation to his general economic strategy. He may also want to probe the extent to which our partners might put pressure on us to accept undesirable common price increases in exchange for our devaluation. The Secretary of State for Trade may question the need for so large a devaluation this year, arguing that more should be kept in hand for later years. The Secretaries of State for Northern Ireland and Scotland will wish to support a $7\frac{1}{2}$ per cent devaluation, though the Secretary of State for Wales may be content with something less. The Lord President might suggest a compromise:

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

CONCLUSIONS

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

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

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

John Hunt

13th June 1979