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MINISTRY OF AGRICULTURE, FISHERIES AND FOOD  
WHITEHALL PLACE, LONDON SW1A 2HH



From the Minister

*For the time being, no.*

27 May 1980

*Dear Minister*

*This paper argues - fairly compellingly I think - that there is no mileage in a green pound revaluation.*

*Are you content to let this idea rest?*

PRIME MINISTER

*De la main*

REVALUATION OF THE GREEN POUND

Your Private Secretary's letter of 2 May 1980 asked for a paper "discussing whether or not the impact of the farm price package on the housewife could not be moderated by an adjustment in the green rate of the pound".

*12 30/5*

I enclose a paper giving the factual position, but I must emphasise that, in my judgement, there is no way in which this Government could make a decision to see that British farmers were prevented from obtaining any increases that were finally agreed.

*Tell it to the minister!*

The simple fact is that British farmers had a fall in real terms in their incomes of 11% in 1978, 17% in 1979 and, even with the package available in Brussels, will have a further fall in their incomes in 1980.

As the paper indicates, our farmers are paying the highest interest rates, meeting the worst inflation and the highest increases in energy costs of all the farmers in Europe, added to which the strength of sterling is a severe incentive to their competitors' export to this market and a severe handicap to them in their efforts to export abroad.

We have used the CAP as a negotiating position. If we had been using it as other countries have used it to try and maintain farm incomes, we would have been making the bid for the highest increases. I am copying this letter and enclosure to Geoffrey Howe, Peter Carrington, Robert Armstrong, Nicholas Edwards, George Younger and Humphrey Atkins.

*[Handwritten signature]*

PETER WALKER

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REVALUATION OF THE GREEN POUND

Memorandum by the Minister of Agriculture, Fisheries and Food

INTRODUCTION

1. This memorandum discusses the suggestion that the Green Pound should be revalued when the CAP price settlement takes effect.

IMPLICATIONS OF A GREEN RATE REVALUATION

2. The effect of a green rate revaluation would be to reduce the price support levels in the UK in terms of sterling below what they would otherwise be. At last week's exchange rate, the maximum scope for revaluation measured by the gap between the green and market rates for sterling was some 2.2 per cent. If a revaluation of this amount were to be implemented, the CAP prices and the various payments to farmers and traders resulting from a CAP price settlement would be reduced by the amount of the revaluation. Thus, if the 5 per cent increase agreed by the Eight were implemented, the net increase in the UK would be around 3 per cent.

EFFECT ON FARMING INDUSTRY

3. The impact on the farming industry of a decision to revalue has to be considered in relation to the severe erosion of farming net incomes over the last 2 years. These fell by 11 per cent in real terms in 1978 and by a further 17 per cent last year. Although it is not yet possible to make any firm assessment of the prospects for 1980 (among other things this will depend on the growing season), the industry is going to face another year of severe cost/price squeeze. Input costs are expected to rise on average by 16 per cent. Bank advances continue at a very high level (about £2.6 billion) on which farmers are having to pay 20 per cent interest. Even after allowing for the effect of a 5 per cent average price increase, net farm incomes are expected to fall in real terms. The industry therefore faces a further decline in profitability and in its ability to generate resources for investment.



4. The implications will be most serious in the livestock sector. The net effect of the price increase and the co-responsibility levy will be to increase milk producers' returns by only about 0.5 per cent when the full effects have worked through. If there is no further increase in the retail price this year, average net margins of dairy farmers are expected to decline again by as much as 35 per cent in real terms. A decision to revalue by 2 per cent would leave milk producers with a reduced return in money terms while their competitors in other Member States will be receiving increases of 1 to 2 per cent (after payment of co-responsibility levy and after allowing for the effects of revaluation in Germany and the Benelux). The proposed curtailment of investment aids to milk producers will further reduce the resources available in this sector.

5. The following table of current interest rates to farmers shows the current disadvantage in the United Kingdom:

		<u>Interest Rate</u>
UK	(Overdraft rate)	20%
Germany	) After deducting the interest rate subsidy applying under the structure directive.	9.25%
France		10%
Holland		10%
Italy		12.5%

6. Current inflation rates (1980 compared with 1979) of major agricultural producing countries:

UK	18.9%
Germany	5.0%
France	12.1%
Holland	6.8%
Italy	17.1%

7. All Member States support their agriculture from national funds. The French Agricultural Budget, for example, is £2.9 billion in 1980 and the German Federal Budget in 1979 was nearly £1,650 million. Some of this is spent on schemes which are not comparable with assistance to UK agriculture (eg social security payments to farmers). But after allowing for this, their national support for agriculture, relative to the sizes of their agricultural sectors, is still over a third larger than ours.

8. A decision to revalue would reduce the returns to UK producers relative to those in other Member States who would receive the full advantage of the price increases. With the prospect of continuing surpluses on the Community markets, the UK industry faces severe competition both at home and in export markets. The high rate of inflation in the UK relative to that in most other Member States reduces the real value of output price increases and thus already places our producers at a competitive disadvantage. As the figures in Annex A show, the UK producer faces a higher net reduction in real output prices than producers in all other Member States except the Irish Republic. The UK reduction is four times that for Germany, three times those for France and Italy; and more than two and a half times for the Benelux and Denmark. A decision to revalue would make this comparison even worse.

*Added to  
by Jan  
with increase*

#### EFFECT ON CONSUMERS

9. The effect on consumer prices in the UK of a 5 per cent average price increase agreed by the Eight would be to increase the Food Price Index by about 0.8 per cent and the Retail Price Index by less than one-quarter of 1 per cent in a full year when the full impact had worked through. Other influences are having a much greater effect on the rate of inflation. The year on year increase in the Food Price Index in March was 14 per cent of which nearly two-thirds (about 8 per cent) was attributable to higher wages, fuel and other costs borne by the food processing and distributing sectors. Thus, a 5 per cent price settlement, which would work through gradually over the next few months, would itself have a very small impact on the trend of inflation.

10. The effect of a 2 per cent revaluation would reduce the price increases in the CAP prices package by less than 0.4 per cent on



the FPI and less than 0.1 per cent on the RPI. Spread over a number of months, this effect would have no noticeable impact on the underlying trend. It would have little value in presenting the prices package to UK consumer interests. Producers, on the other hand, would contrast the effect of a revaluation on their net incomes (which have to finance future investments as well as current incomes) with the large pay increases to workers in food processing, distribution and other sectors of the economy. A paper that I have already submitted indicates that increased wages and distribution costs are by far the biggest factor affecting food prices at the present time.

#### EXCHANGE RATE CONSIDERATIONS

11. Although scope for revaluation at present is some 2.2 per cent, this amount will certainly vary from week to week as the market rate for sterling moves. Since the market rate moved above the green rate in early March, the gap moved from -0.1 per cent on 17 March to 4.0 per cent on 14 April since when it has tended to narrow.
12. If a decision to revalue was followed by a weakening of sterling, against the ECU, a negative gap would open up again. There would be immediate pressures for a further devaluation to increase the sterling value of support prices. It would be impossible to resist such pressures given the Manifesto commitment.
13. A decision to revalue could, therefore, lead to a succession of circumstances in which further green rate changes had to be considered if the market rate of sterling was fluctuating around the green rate. It has always been Government policy to avoid too frequent changes in green rates because of the uncertainties which these create on domestic markets. The possibility of a succession of revaluations and devaluations would have a very damaging effect on producer confidence.

#### CONCLUSION

14. Even with a 5 per cent price increase, farming net incomes are likely to decline again in 1980. A decision to revalue would cast

doubts on the Government's commitment to enable the industry to compete effectively with producers in other Member States for a larger share of domestic and export markets.

15. The effect of a 5 per cent price settlement on the FPI and RPI, spread over a number of months, would be very small and have no discernible effect on the trend of inflation. A decision to revalue would have little value in presenting the prices settlement to consumer interests; but would be strongly resisted by producers who would contrast the trend in their incomes with those of other groups.

16. A revaluation, followed by a weakening of sterling, would lead to pressures for a further devaluation. The possibility of a succession of green rate changes could have a very damaging effect on the confidence of producers in the support system.

Minister of Agriculture, Fisheries and Food  
27 May 1980

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