Mr faxed to Chequers

Prime Minister ②

S. J. Pike Duty Clerk 12.4.80

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

From the Minister

The Rt Hon Margaret Thatcher MP
10 Downing Street
London
SW1

11 April 1980

The decision as to our position on MCAs was taken in the appropriate Cabinet Committee under the chairmanship of the Foreign Secretary and was, of course, discussed.

The fact is that the French and the Germans, and indeed most of the other countries, are opposed to the reduction of the neutral zone for changing from negative to positive MCAs.

The reason why they are opposed is, of course, that any such reduction gives us a trading advantage over them for the first time since we joined the Community.

It is therefore a useful negotiating point for you at the Summit and you can, for example, as a concession, agree to move to a situation where the neutral zone is at least reduced for us to the same size as it is for them.

If, however, at Tuesday's meetings it is judged that we should show some sign of movement before the Summit, we could do it at the meeting of Agriculture Ministers on 21 and 22 April, but I would personally advise that you keep this as a further negotiating position for your meeting.

There has been a great deal of nonsense written and spoken this week. I enclose a Press handout that I have issued today that summarises the position. The Economist took up the lead given by John Palmer of the Guardian (a person with known International Socialist background). The fact is that what we are doing in no way increases the cost of food and gives us a trading advantage in a sphere where over the last six years Europe's exports to us, due to the MCA system working against us, have increased by nearly £1.7 billion. There is no doubt in my judgement that in economic terms we are wise to try to reverse this trend.

As for the nonsense spoken about the return to farmers, it is only the green pound devaluations that directly benefit their incomes and they do not receive the same direct benefit from appreciations in sterling, which is the reason for us going into positive MCAs.

As for the nonsense spoken about taxes on food, with Sam Brittan and the Guardian saying it is the first tax on food since the Corn Laws, the reality is, as you well know, that we have had enormous taxes on food over the last seven years in the form of the import levies that the CAP requires.

On this occasion there is a Community levy that helps our exports and handicaps their exports and that is why the French and the Germans do not like it.

--- I enclose also a factual note on MCAs which you might find useful.

I am sending copies of this letter to members of OD(E).

D E Jones

PETER WALKER
Dictated by the Minister
and signed in his absence

MINISTRY OF AGRICULTURE FISHERIES AND FOOD

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April 11, 1980

PETER WALKER SPEAKS ABOUT EEC PRICES

The Rt. Hon. Peter Walker, M.P., Minister of Agriculture, Fisheries and Food, speaking in Worcestershire today, Friday, said:

"Over seven years, including the entire period of the last Government, a system operated for food transactions between Community nations which protected them against changes in the currency rates. Now, due to the strength of sterling, Britain has a positive monetary compensatory amount (MCA), which means that exporters obtain a form of benefit enjoyed by countries like Germany, Holland and Belgium for many years past, and EEC exporters to Britain will during this period have a disadvantage, be it a small one, similar in nature to that which British food exporters have had when sterling was weak.

"Some commentators have said in recent days that I am supposed personally to have introduced new taxes on food. They say these will put up the price of food in the shops and that the Government has changed its E.E.C policy.

"I have done no such thing, and prices will not rise in the shops as a result of what has happened. The change that has taken place this week has been brought about by the strength of the British pound - a good thing in itself because it brings confidence and trade to our country. The commentators fail to explain that the Common Agricultural Policy of the E.E.C. works by taxing imports which stabilises prices within the Community and - whether we like it or not - we have been operating this system for over seven years.

"The Regulation which has been introduced this week for MCAs

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was a Regulation agreed by my predecessor. Under the last Government, farm prices were held down far below the average level in the rest of the E.E.C., and British agriculture suffered seriously as a result. The present Government undertook to remove this disadvantage, and has done so, and prices are now about on a level with the E.E.C. on average and, because the pound has strengthened, there is a small Community tax on some imports from some other E.E.C. countries. This is because the Common Agricultural Policy system operates so as to stabilise prices in each member country irrespective of the movements in its currency. But it does not put up the price of food in the shops. On the contrary, the prices of a number of our food imports will be cheaper because of the stronger pound. Even where it does apply, the present level of the tax is very small indeed - representing less than half of 1p in the £, on a limited range of food.

"If the pound were to fall again the tax would disappear. So let us keep this in perspective, and not talk about disasters where there are none.

"In the wider context the Government firmly believes it desirable to hold down common farm prices to reduce the cost of the Common Agricultural Policy and to benefit consumers. At the last E.E.C. farm price fixing, in stark contrast to all previous price fixings, I obtained a freeze on the price of milk, which is Europe's biggest surplus, and it was the first price fixing out of which Britain obtained a net benefit and gained British consumers their biggest ever benefit. The Government is also committed to ensuring that United Kingdom food exporters and food producers can compete on fair terms with those in other countries who at present have captured so much of our market. With the removal of the massive disadvantages which they suffered under the previous Government our food exporters are in a far better position.

"Between 1973 and 1979 Britain's food ~~ex~~imports from Europe increased by nearly £1.7 billion, twice as much as the increase in our food exports to Europe. This is a trend we need to reverse."

LINE TO TAKE

Positive MCAs

In accordance with its Manifesto commitment, the Government has devalued the green pound so that our farmers can compete on level terms with those in the rest of the Community. Because sterling has risen nearly 9% against the other Community currencies since December a small positive MCA of 2.1% has had to be introduced for some commodities. This compares with the huge negative MCAs of anything up to 45% which obtained under the last Government and which put our farmers at a severe disadvantage.

Effect of positive MCA on food prices

Positive MCAs have been introduced due to the strengthening of sterling against other Community currencies. They will not put up UK food prices. The whole purpose of the MCA system is to stablilise prices in national currency terms.

Effect of positive MCAs on budget contribution

All changes in MCAs, whether resulting from green rate changes or merely from currency movements, affect our budget contribution. There is no need to single out positive MCAs in this respect.

Revaluation of green pound to eliminate positive MCA

The Government will of course keep the level of the green pound under review, just as it has done up to now. But a revaluation in response to what might be only a temporary movement in the exchange rate would hardly be appropriate.

MONETARY COMPENSATORY AMOUNTS

Green Rates

1 Support prices under the CAP - which also determine the market prices for the commodities concerned - are set in European Currency Units (ECU), the unit used as the basis of EMS. For the practical operation of the CAP, they have to be converted into national currencies. Properly speaking, they should be converted at each currency's market rate of exchange against the ECU. But this would mean that they would fluctuate with each change in that rate. They are therefore converted at special fixed rates of exchange (called "green rates"), which are set by decision of the Council of Ministers.

2 The price level which would result if CAP prices <u>were</u> converted at market exchange rates is termed the "common price level". If a country's currency appreciates and no corresponding change is made in its green rate, its prices will obviously rise above the common price level: and vice versa if its currency depreciates. Thus countries with historically strong currencies (Germany and Benelux) have acquired high prices and countries with weaker currencies (France, Italy, Ireland and - in the past - the UK) have had lower prices.

3 Countries may, of course, negotiate changes in their green rates. But the convention has been that these changes may only move their prices in the direction of the common price level, never away from it.

4 The table at Annex A shows the present spread of prices. Except for Germany (who has not been prepared to move her green rate by nearly as much as her currency has appreciated over the last 10 years), almost all prices are within a band of 6-7%. This is unusually small: at times in the past the spread has been as much as 50% or even more. It has narrowed for two reasons: first, the annual rises in CAP prices expressed in ECU have been very low recently (3.9%, 2.1% and 1.3% in 1977, 1978 and 1979 respectively) so that countries operating prices

below the common level have had an incentive to raise them by devaluing their green rates; and second, the relationship between most Community currencies has been more stable than in the past so that, once narrowed, the gaps have not tended immediately to widen again.

5 Both these factors have also operated in the case of the UK, with the added points that: the Election Manifesto promised to move UK prices up to the common price level; and sterling has not only not fallen against other Community currencies, as it mostly did from 1973 to 1978, but has risen appreciably against them.

Monetary Compensatory Amounts (MCAs)

6 As soon as farm prices in different Member States first diverged in 1969, it was necessary to introduce levies and payments on farm products crossing Member States' boundaries. Otherwise products from a low-price country would have been sent to a high-price country to be bought into intervention there. These levies and payments are called MCAs. They are broadly equal to the difference between the common price level and the national price level of the country concerned. For a country operating prices above the common price level, they act as levies on imports and subsidies on exports: and vice versa for a country operating prices below the common price level. Levies on imports from, and subsidies on exports to, third countries have to be similarly differentiated.

7 MCAs are expressed as the approximate percentage difference (plus or minus) between each country's green rate and the market rate of its currency against the ECU. They are calculated automatically each week by the Commission according to currency movements. Applying the percentage to the support price of the commodity concerned produces the actual amount to be levied or granted on trade. Current MCA rates are also shown at Annex A.

Recent Developments

8 Ever since accession the UK had operated the lowest farm prices in the Community through not having devalued the green pound by as much as sterling had fallen. Large MCAs were payable on our imports of agricultural goods from other Member States and charged on our exports to them. At its highest (November 1976) our MCA was minus 45%. At the time of the 1979 Election it was minus 13%.

9 Since the Election there have been two 5% devaluations of the green pound in June and December 1979 (and an extra small devaluation of 1.1% for technical reasons in October). The December devaluation applies to most products, but will not take effect for cereals eggs and poultrymeat until 1 August.

10 As a result of the December devaluation, the MCA fell to minus 3.5%. Since then sterling has appreciated by almost 9 % against the other Community currencies. Accordingly the MCA fell to zero on 28 January and a positive MCA of 2.1% was introduced on 7 April. (These are the rates for those products for which the December green pound change already applies; for cereals, eggs and poultry, the current rate of MCA is nil).

Effect of positive MCA on food prices

11 It has been claimed in the press that the introduction of a positive MCA will put up food prices in the shops. This is totally untrue. It will be clear from the above that the whole purpose of the MCA system is to keep farm (and therefore food) prices stable in national currency terms. Because sterling has risen, prices in other Member States have fallen relative to UK prices: hence, where they have become lower, a levy has to be imposed on imports from them to protect the price level here.

12 In fact the strengthening of sterling will tend to reduce farm and food prices: partly because there are some commodities to which the MCA system does not apply (notably lamb, potatoes, fruit and vegetables); and partly because, even where they do apply, MCA changes tend to under-compensate for currency changes.

MCAs and the Budget

13 MCAs are financed from, or accrue to, the Budget. Thus every time the MCA rate changes - whether due to a green pound change or the movement of sterling - our budget contribution is affected. However since MCAs are applied to trade between Member States, they can be paid or collected at either end of the transaction: and to which Member State they should be attributed for budgetary purposes is a question for debate.

14 When MCAs were paid as subsidies on our imports, the Commission claimed they should be treated as our budget receipts (even though they were in practice paid out in the exporting Member State); they thus claimed that our net budget contribution was much lower than it really was. We claimed that, on the contrary, they should be regarded as a subsidy enabling the exporting Member State to compete in our market, and therefore as that Member State's receipts.

15 Now that we have positive MCAs acting as levies on imports from other Member States, they will be collected in the UK and will thus increase the sums handed over to Brussels (the corresponding payments on our exports will, of course, be a partial offset). Using the same argument as above, we could logically claim that these levies should properly be regarded as falling on the exporting Member State and therefore as part of its contribution. But, in present circumstances, it is not to our advantage to minimise our net budget contribution.

The Future

16 The level of support for UK farmers is of course a proper matter for public debate. But there is no reason why this debate should be triggered by the mere fact that, after being easily the lowest for 7 years, UK prices have, owing to the unexpected strength of sterling, moved up to around the EEC

average and marginally above the common price level. Nor is there any reason why this should impel the Government, having weighed up the respective claims of farmers and consumers as recently as December and decided on a green pound devaluation, to reverse that decision at this stage by revaluing the green pound again and thus reducing farmers support prices in sterling terms. Although the strength of sterling may marginally curb the rate of inflation of farm costs, nothing has happened since December which materially affects the outlook: given the accepted need to keep CAP prices down to the maximum extent, farmers face a severe cost-price squeeze -unless sterling should fall to the point where a further green pound devaluation is possible.

17 In fact, although nothing can be based on short term movements in the exchange rate, sterling has fallen over the last two days to a level which, if sustained, would automatically result in the removal of the positive MCA from 21 April.

<u>Method of Calculating Positive MCAs</u>

18. The precise method of calculating positive MCAs - about which the Prime Minister was questioned in the House before Easter - was discussed at the Agriculture Council on 26-27 March. This is a technical matter, concerned with whether the MCA system entirely achieves the intended effect of compensating for price differences between Member States. The point at issue is explained in Annex B.

MCAs AND RELATIVE PRICE LEVELS, WEEK ENDING 12 APRIL 1980

		Rate of MCA %	Relative price level (common price level = 100)(1)
Germany	- milk	+ 10.8	113.4
	- other products	+ 9.8	112.1
Benelux	- milk	+ 2.4	102.6
	- other products	+ 1.9	102.0
UK	- most products	+ 2.1	103.7
	- cereals eggs and poultry(2)	0	98.6
Denmark		0	100.0
Ireland		0	98.7
France	- pigs, milk, beef(3)	0	98.7
	- other products	- 3.7	95.2
Italy	- milk, beef	- 1.3	97.3
	- other products(3)	- 6.7	92.4

Notes

(1) The price spread is somewhat different from the spread of MCAs, largely due to an arbitrary deduction (termed a "franchise") made from the percentage gap between the market rate and the green rate for the purpose of calculating the MCA.

(2) The rate for cereals, eggs and poultry will be aligned with that for other products on 1 August 1980.

(3) The French and Italian rates for "other products" will be aligned with the rates for milk and beef at the start of the various marketing years.

ANNEX B

The "Franchise" Rules

In principle the MCA applied to trade between two Member States bridges the gap between the different price levels in the Member States concerned. In practice, however, the Community regulations provide for a percentage deduction (called a "franchise"). So long as UK prices were lower than those elsewhere, so that MCAs applied as subsidies on our imports and levies on our exports, this deduction meant that imports were not quite as cheap as they would otherwise have been. There was thus less danger of market prices here being pushed down to intervention level; and exports to other Member States were facilitated.

However, now that we have positive MCAs, the deduction has the opposite effect. It makes imports more competitive and exports less so; and it increases the danger that market prices will fall to intervention level with the risk of big purchases into intervention and a consequent addition to public expenditure.

The regulation providing for a deduction from a positive MCA was due to expire on 31 March. At the time of the Agriculture Council of 26-27 March the deduction was preventing the immediate introduction of positive MCAs. There was a danger of increased intervention and also of distortion of trade - for example, an Irish exporter of butter to a non-Community country would have made a profit of about £50 per ton through exporting via the UK instead of direct from Ireland.

Mr Walker accordingly requested the deletion of the provision for the deduction and, when this was not forthcoming, blocked the extension of the Regulation. So far, however, the Commission - illegally, in our view - have continued to act as if the Regulation still existed.