Ref. A04443

PRIME MINISTER

CAP Prices 1981

(OD(81) 16 and (81) 18)

PURPOSE OF DISCUSSION

In November last OD(80) 22nd meeting agreed that in bilateral contacts leading up to the 1981 CAP price fixing the United Kingdom should argue for severe price restraint especially for commodities in surplus and that we should seek to reach agreement with the Germans on an approach to a financial ceiling on CAP expenditure. It was agreed that we should keep open the possibility of a revaluation of the green pound at the time of the price settlement but should avoid commitment to it. Ministers subsequently agreed that we should urge the Commission to propose price increases of about 4-5 per cent and supplementary measures to reduce surpluses.

2. The Commission has proposed price increases mainly in the range 6-9 per cent with a cut of 5 percentage points in the United Kingdom's positive mca's. The proposals will be substantively discussed at the Agriculture Council on 16 March, and there will be pressure to try to reach agreement by the end of March. The purpose of this OD meeting is therefore to agree on our objectives and tactics for these negotiations, including prices, economy measures, the green pound and a ceiling on agricultural expenditure. The possibility of linkages with other issues may also need consideration.

BACKGROUND

3. There are two papers before the Committee. The memorandum by the Minister of Agriculture (OD(81) 16) argues that the reductions in United Kingdom farm incomes and net margins for particular commodities which have become sharper in 1980 point to an urgent need for improvement in profitability if we are to avoid long term damage to the industry. Mr Walker proposes that he should argue against any price increase higher than the Commission's proposals and press for lower increases for cereals, oilseeds and Mediterranean products

and that he should resist any revaluation of the green pound which, if applied as the Commission propose, would leave United Kingdom farmers with a net increase of only 1.4 per cent. On the proposed economy measures, he would support the super levy for milk but sees difficulties in full support of the co-responsibility measures proposed for cereals and beef. He also wishes to maintain and improve the United Kingdom beef premium scheme.

4. The note by the Chancellor of the Exchequer (OD(81) 18) suggests that the financial squeeze on United Kingdom agriculture may be less severe than the Minister of Agriculture suggests and, in particular less than the recent squeeze on manufacturing profits. The Chancellor proposes a more stringent line on agricultural prices: an average increase of no more than 5 per cent, with cereals (but not milk) held close to a standstill; support for the economy measures, especially the super levy on milk, as a first step to CAP reform; eventual agreement to a green pound change if the Community go up by more than 5 per cent, so as to keep prices in the United Kingdom at 5 per cent; and pressure in both the Ecofin Council and Agriculture Council for a commitment that in future CAP expenditure would not absorb more than half of the increase in own resources.

5. In negotiating terms we shall be in a minority even if we take the line proposed by the Minister of Agriculture. The French and Germans have agreed to settle at around 10 per cent (the Italians and the Irish want even more) and everyone will want us to make some reductions in our mca's. Given the imminence of the French elections, there will be strong pressure to go for a quick settlement on prices and put off the difficult decisions on the economy measures until the budget restructuring exercise. Unless we intend to block decisions until after the French elections, we shall have to concede higher price increases, and to agree to some revaluation of the green pound. But in return for that, it would be reasonable to insist on some real economy measures. A 10 per cent price rise with 2-3 per cent revaluation (ie 7-8 per cent for the United Kingdom) might be a presentable outcome, provided that the Community had agreed some first steps like the super levy on milk and the new arrangements for cereals. But if New Zealand butter and fisheries are still blocked they may need to be brought into the package too.

6. Now that the Fisheries Council has failed to agree, and will resume on 6-7 April, the question arises whether we should use our position on agricultural prices in order to push the French for a satisfactory settlement on fisheries; and if so how this could best be done.

HANDLING

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7. You will wish to invite the Minister of Agriculture to introduce his paper and then let the Chancellor of the Exchequer speak to his. It will probably be better to discuss the two papers together. You might remind the Committee that it has already agreed (OD(80) 20th meeting) that cutting the cost of the CAP is an essential part of our budget restructuring exercise; that we should use price restraint as a weapon; that we should try to get financial responsibility for surpluses shifted to those who produce them; and that we should go for a ceiling on financial expenditure on the CAP. While the two papers are addressed to the immediate question of the line to take at the next Council, you will want to get the mind of the Committee on what we could ultimately settle for. That will affect tactics.

8. You might next invite the Foreign and Commonwealth Secretary to give his general comments before focussing discussion on:

(i) the state of United Kingdom agriculture;

(ii) what our starting point in prices should be;

(iii) what price rise we might finally agree to and on what terms;

(iv) tactics on the green pound;

(v) our attitude to the milk super levy and other economy measures;

(vi) the beef premium scheme;

(vii) financial guidelines;

(viii) linkage.

(i) State of United Kingdom Agriculture

The dispute between Treasury and MAFF is less over figures than over what constitutes a valid comparison. The Minister of Agriculture has presented the position in a way which possibly overstates the problem, and it is debatable whether agriculture is suffering more than manufacturing industry. But there is no dispute that farm incomes have been squeezed; or that the position in Scotland and Northern Ireland is worse than the rest of the United Kingdom. There is, however, no need for the Committee to make a precise judgement. You may wish to give the Secretary of State for Scotland and the Secretary of State for Northern Ireland the opportunity to state their views at this point.

(ii) Price Increase

You might seek to establish how far the Committee agrees that arguing for an average increase of 5 per cent is a realistic tactic. The Chancellor of the Exchequer may argue that it is needed in order to counter the inflated requests of other member states. But the Agriculture Ministers may argue that it is unrealistic in the existing negotiating environment and that eventual agreement to a significantly higher figure would damage our credibility.

(iii) Final Agreement on Price Level

Could we go to 10 per cent in the context of a satisfactory package?

(iv) Green Pound

There will probably be agreement that we should initially resist a green pound revaluation, but that we will have to make some adjustment in the end. The dispute will be over how much. If the Chancellor's net figure for the United Kingdom of 5 per cent is thought to be too severe, given that the United Kingdom industry has experienced a higher rate of inflation of input costs than in most other Community countries, what figure would be acceptable? It is not essential to resolve this point at this meeting.

(v) Milk Super Levy and Economy Measures

There may be disappointment with the Minister of Agriculture's critical approach to the proposed economy measures, which is likely to leave our partners with the impression that we are not really serious about CAP reform or cutting the cost of surpluses. If we are going to move on prices, we should at least press for the super levy which is designed to penalise surplus milk production. But should we make it a sticking point? And, subject to detailed discussion, should we not support the Commission's proposals for controlling cereals and reducing beef intervention?

(vi) Beef Premium Scheme (Annex VIII paragraph 6)

This scheme operates in the United Kingdom and is 25 per cent Community financed. The Commission propose that it should lapse. The Minister of Agriculture regards it as important that it should be continued and even improved. But the Chancellor is likely to oppose it on cost grounds. The Chancellor and the Minister of Agriculture might discuss bilaterally, but we ought not to expend too much negotiating capital on its retention.

(vii) Financial Guidelines

The Chancellor of the Exchequer (Annex B to his paper) wants to restrict the growth in CAP expenditure for future years to one half of the growth in own resources. This was the formula which the Federal Chancellor mentioned to you last year but, in the Ecofin Council, the Germans are already showing signs of yielding to French pressure. The Minister of Agriculture says it would not be realistic to go for anything more restrictive than that the growth in CAP expenditure should be lower than the growth of own resources. We should at least try for the Chancellor's formula. He would like it to be part of the price package, but it will only be possible to negotiate on this point in the Ecofin Council.

(viii) Possible Linkage with Fisheries

You will want to have the advice of the Foreign and Commonwealth Secretary and the Minister of Agriculture. The French have not yet responded to the approach we made in February. Should we renew the approach but in a more threatening way? The Germans may in any case raise fisheries at Maastricht.

CONCLUSIONS

9. Depending on the discussion, you might conclude that:

(a) we should argue that the Commission price proposals should not be exceeded and that for commodities in surplus, the increases should be lower than proposed;

(b) we might finally be prepared to accept an average price increase of not more than 10 per cent but only if other satisfactory elements are included: the Minister of Agriculture will need to report back before a final settlement;

(c) we should avoid commitment to revalue the green pound, but be prepared to do so as part of an acceptable package;

(d) we should press hard for economy proposals, especially the super levy for milk, as elements in the reform of the CAP and as a necessary part of an acceptable package;

(e) we could argue for continuation of the beef premium (subject to agreement with Treasury of how the public expenditure is met) but not at the expense of other objectives;

(f) the financial guidelines proposed by the Chancellor of the Exchequer to be pursued in the Ecofin Council;

(g) the Foreign and Commonwealth Secretary should warn the French that although time is running out, we are still ready to talk bilaterally on fish.

RTA

ROBERT ARMSTRONG

11 March 1981