sc Bingham

Prime Minister
You will wish to see this minute & Mr Walker's comment. I am not sure they take us much further forward!
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PRIME MINISTER

CAP REFORM: NEXT STEPS AFTER THIS YEAR'S PRICE SETTLEMENT

I have been reflecting on the outcome of this year's CAP price fixing and considering whether there are any particular lessons to be learnt from this year's experiences, which might provide us with pointers to action both in the short and longer term. I thought it would be helpful to set down some conclusions before we become caught up in the UK Presidency in general and the budget restructuring negotiations in particular.

2. The starting point should perhaps be the objectives we set ourselves for this year's price negotiations. All of us involved in the discussions in OD and OD(E) recognised that for a number of reasons - for example, the French Presidential elections, cost pressures on farmers throughout the Community and not least in the UK - this year's price negotiations were bound to be difficult and that we were unlikely to make much immediate progress towards our longer-term objectives for reducing the surpluses and the costs of the policy. Moreover, once it became known that there was plenty of headroom available in the 1981 Community budget, it was clear that the Agriculture Council's decisions would not be significantly affected by the approach of the 1 per cent VAT ceiling. We therefore accepted, as early as February, that we might have to be prepared to concede somewhat higher prices than the Commission had initially proposed, but that in return for this we should insist on progress in the Common Fisheries negotiations, the acceptance of the main Commission proposals for CAP economies, in particular the super-levy on milk, and agreement that an effective limit should be set on the rate of growth of CAP guarantee expenditure.

/If we

3. If we look at the outcome of the 1 April settlement in the light of this general negotiating strategy, the picture is rather mixed. On the one hand the increase in Community target prices at 9 per cent did not go beyond the level we had felt obliged to regard as acceptable in February and March. Although it was well below the more extravagant demands made by the farmer's organisations and by one or two member states, it seems to have been reasonably well received by UK farm producers. Consumer representatives were more critical, notwithstanding the fact that the effect on the UK consumer was mitigated in particular by the continuation of the butter subsidy, which Peter Walker was able to secure.

4. On the other hand, the 9 per cent was only achieved with the help of an EMS realignment, which meant that the increase in farm prices in terms of some national currencies was higher. Even if the overall impact is to leave agricultural prices broadly unchanged in real terms, at this level of real prices production will continue to increase faster than consumption and accordingly the level of surpluses will over time tend to increase. Any disincentive effect which may have been building up following the low price increases in the last two years may now have been eroded.

5. In other respects we clearly ended up short of our initial objectives. In particular, there was little progress on the economy measures needed to curb the growth of agricultural expenditure. As a result of the Commission's last minute volte-face, we not only failed to get agreement to the super-levy on milk, but were faced with a further increase in the linear co-responsibility levy, which it had been our agreed policy to oppose. On the credit side it was most helpful that Peter Walker was able to line up the Germans and Dutch in support of our formula for limiting the future growth of CAP guarantee expenditure to markedly below that of own resources. This is a platform on which we must build in the forthcoming restructuring discussions.

/Probably

6. Probably the most disappointing outcome of the negotiations was that we found ourselves obliged to accept the higher settlement on prices, while at the same time leaving the problem of the Common Fisheries policy unresolved. I understand, of course, how difficult it became to sustain a link between the two negotiations after the Fisheries Council on 27 March, but the result, as we all realise, is that we have made ourselves more vulnerable to French pressure and in particular to the risk that they may seek to establish a link between fish and the budget restructuring negotiations later on.

7. In the light of all this, there are a number of conclusions to be drawn about the line we should take in the coming months. First, on fish we must clearly seek, during our Presidency, the earliest possible agreement on the CFP. I have no doubt that when you meet President Mitterand at the forthcoming European Council, you will do all you can to encourage him to get an impetus towards an early settlement on fish. The record of Peter Carrington's conversation with Cheysson suggests that there may be some grounds for hoping the new French Government will be receptive to this line of argument. An early settlement is desirable not only because of the budget restructuring timetable, but also because of the possible repercussions of further delay on our relations with Chancellor Schmidt. The longer the fisheries negotiations are protracted the greater the risk that the new EC-Canada agreement will once again become a live issue. We should in any case be thinking hard whether we cannot find some acceptable accommodation with the Germans on the Canada agreement to avoid the risk of a further confrontation with them at the end of this year, if the CFP negotiations cannot be quickly concluded.

8. As regards the CAP itself clearly the best strategy is to continue with the present three-pronged approach:-

- price restraint-
- effective non-price changes in the individual commodity regimes to reduce surpluses and limit costs;

- the firm application of the formula to keep the growth rate of FEOGA guarantee expenditure "markedly below" that of own resources.

9. Price restraint is bound to present us with something of a dilemma. On the one hand unless the prices of surplus products are reduced in real terms it will be a major problem to prevent the surpluses growing even further, let alone reduce them. On the other hand we cannot ignore the effect on the income of UK producers. But it is important that the real price should be moved steadily towards an equilibrium level. If, as I understand is quite possible, the Commission include in their restructuring paper a proposal that Community prices should be gradually moved towards world price levels, it is essential that we should be able to respond positively. Looking a little further ahead, the 1982 CAP price fixing could well become linked with the latter phases of the budget restructuring negotiations. With this in mind we will need to be ready to put the case for a tough stance on prices to the Commission well before they have formulated their 1982 price proposals.

10. As regards other economy measures, the main lesson of this year's negotiations is that we must make it clear at an early stage that we are not prepared to countenance any further increases in the linear co-responsibility levy. Otherwise there are real dangers that the Commission and the Agriculture Council will regard this as being the obvious way round either the 1 per cent VAT ceiling or any other form of expenditure constraint. I propose we make our position on this clear as soon as the Commission's paper on budget restructuring comes out. Given the widespread opposition to the super-levy on milk, however, we may need to look at other ways of restraining expenditure in this sector.

11. On all these issues we must develop a clear position well in advance of next year's price fixing negotiation and be prepared to stick to it.

/Finally,

12. Finally, I suggest that we should invest a lot of diplomatic effort in cultivating relations with the Germans with the aim of getting the Schmidt faction within the Government to prevail over Ertl and the farm lobby. In particular, we must follow up the agreement we have reached with them on the formula for limiting the growth of CAP expenditure with a view to ensuring that it will be applied in practice. This is a point to which we may well need to return in the context of the 1982 Community budget.

13. I am sending copies of this minute to the Foreign Secretary, the Minister of Agriculture and other members of OD(E) Committee, the Secretaries of State for Scotland and Wales and Sir Robert Armstrong.

P.S. Jenkins

for (G.H.)

June 1981

(Approved by the Chancellor and signed in his absence).