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REFERENCE C

EUROPEAN COUNCIL, BRUSSELS
19/20 MARCH 1984
MONETARY COMPENSATORY AMOUNTS (MCAs)
Brief by the Ministry of Agriculture, Fisheries and Food

Objectives

1. To resist a change in the rules for the establishment of green exchange rates and MCAs except in the context of a satisfactory overall settlement.

2. Subject to 1 above, to secure rules on phasing out newly created MCAs stemming from the adoption of the German proposals on the table so as to limit the adverse budgetary consequences of this approach.

3. Our other important objectives, the need to limit the duration of the "strongest currency solution" and to protect our special position arising from the status of sterling as a floating currency, are adequately covered in the present text. But these points may need to be defended.

[4. If not resolved in the Agriculture Council on 16/17 March we should also set out as a condition for accepting the MCA arrangments the dropping of a Commission package of changes to the detailed rules for setting MCAs].

Points to Make

5. Recognise that dismantlement of MCAs is a priority for some delegations, though the UK is not one of them. It will not help

to secure CAP savings - quite the opposite.

6. The policy in the document before us, - that is basing MCAs for a period on the strongest currency - is inflationary and will increase budgetary costs. This will result in extra price increases in most Member States beyond what would have been expected despite the apalling state of CAP finances and the desperate market situation for many products.

7. Proposals for MCA dismantlement are therefore clearly linked to the <u>strict financial guideline</u> and <u>budgetary imbalances</u>. Cannot agree to new rules on green rates and MCAs except as part of an overall settlement dealing satisfactorily with budget imbalances and budget discipline.

8. However, I am prepared to examine what might be done in this area if progress were made on other matters. To constrain the costs of the proposed system to a reasonable level we must agree that the new negative MCAs created as a result of the change, both those created immediately and also those created at future EMS realignments, must be phased out over a period. We have proposed three equal steps over three years. I should stress that the treatment of negative MCAs that would in any case have been created at realignments under our present system would be unaffected.

9. Even if our suggestions for phasing were accepted the cost of the dismantlement of the German MCA by three percentage points in the 1984/85 alone would be 174 mecus in 1985. If there were to be a realignment before then there would be extra costs. These figures are "static". They take no account of the dynamic effects on production of extra price increases.

10. All this is very worrying, but we are prepared to consider the German system with the modifications we have suggested in the context of a satisfactory overall financial package.

[11. Negative MCA countries would gain considerably from the change proposed and it would, on this ground alone, be wrong to proceed with the Commission's proposals to give them further advantages by changing the detailed rules for calculation MCAs proposed in document COM (83) 586].

[<u>If necessary</u>: Fallback 1]

12. I am prepared to agree that the new negative MCAs created by the change in system both now and at future EMS realignments could be phased out in two instead of three stages.

[<u>If necessary</u>: Fallback 2]
13. To meet my colleagues' concerns I am prepared to allow the new MCAs created by the immediate three point reduction in German MCAs to be dismantled as proposed in the text. But I must insist that at <u>future</u> realignments the extra increases in negative MCAs be phased out as we propose in the footnote to paragraph 1.1.

<u>Background</u>

14. Institutional support prices under the CAP are set at a common level in European Currency Units (ecus) and converted to prices in national currencies using "green" rates of exchange which may differ from the market (or central) rates. If the green and market rates are different, the levels of CAP prices in the Member State concerned will be different in real terms from that implied by converting the common price in ecus into the national currency at the market rate. Consequently, MCAs need to be applied to agricultural trade involving that Member State to avoid distortions. When a green rate is under-valued, CAP prices in that Member State are set above the "common" level and "positive" MCAs are applied as a subsidy on exports and as a charge on imports. For countries with overvalued green rates negative MCAs apply in the reverse way.

15. The French, with support from the Commission and other Member States have made the elimination of MCAs, and expecially the German positive MCA, a major objective in the post-Stuttgart discussions.

16. Earlier attempts to resolve the issue foundered on a German refusal to revalue the "green" mark (thus reducing German positive MCAs) because of the resulting decrease in German national prices in DM terms.

17. Unlike the Member States which are full members of the EMS and whose MCAs are fixed on the basis of their central rates, the United Kingdom is in a special position in that our MCAs can vary from week to week because of the floating of sterling. We are concerned that any new rules should take full account of this factor.

18. The Germans have put forward a package for eliminating positive MCAs and this forms the basis for the text before the European Council (Appendix I). It has two components:-

(a) the existing German MCA will be dismantled in three stages. First, three percentage points will be dismantled by turning positive into negative MCAs. This amounts to revaluing the ecu for CAP purposes, ie it increases the common price to which Member States can move through green rate devaluations. (The implications for other Member States are shown in Appendix II). As a second stage five percentage points will be dismantled from the German MCA on 1 January 1985 by revaluing the "green" mark but compensating national aids will be permitted via the German VAT system, these to be partly reimbursed by FEOGA. As a third stage the (small) remaining German MCA would be dismantled by 1987 through normal revaluations of the the green rate. (The text at Appendix I envisages comparable treatment for the Netherlands which also has a fixed positive MCA);

(b) the creation of new positive fixed MCAs would be avoided for three years by basing CAP prices at any EMS realignments occurring during this period on the "strongest" currency. In its effect this is similar to the first stage of the dismantlement specified at (a) above.

From April 1987 the present system would be re-established unless the Council decides otherwise.

[19. There is also on the table a set of Commission proposals for changes to the detailed rules for calculating MCAs. These proposals are described in more detail in Appendix III. Broadly speaking they are deliberately designed to make the MCA system less effective. Some of these changes would hit our food manufacturers and exporters.

United Kingdom Interest

20. Ideally we would wish to see no change in the existing system. But we must recognise that the issue is of vital importance to the others. The problem with the German ideas is the potential budgetary cost. Recourse to the strong currency solution amounts to increasing the level of "common" prices in the CAP and it is odd to say the least to do this at a time of such budgetary stringency and market imbalance. The budgetary costs arise from the devaluations of the negative MCAs created by the adoption of the system. For example, if the negative MCAs created by the three point switch proposed for 1984/85 were to be devalued at the start of the 1984/85 marketing years for the different commodities the extra cost in 1985 would be 401 mecu. Similar costs could arise at future EMS realignments. The 401 mecu quoted is entirely "static" and ignores the "dynamic" effects of any production response to the resulting higher prices.

21. On the other hand increases in national prices that could result from these green rate devaluations could be expected to offset to some extent the pressure for increases in common prices

in ecu terms at subsequent CAP price fixings. The balance would depend on the relevant weight of these conflicting factors. but it would be realistic to expect there to be a net cost.

22. We should not agree to the adoption of this costly system except in the context of major gains for the United Kingdom elsewhere in the same package. Logically, because of the financial implications, new arrangements for green rates and MCAs are linked to discussions on a financial guideline (and budgetary imbalances). As a matter of tactics we should make as much negotiating use as we can of the desire of the French and others for a settlement on MCAs.

23. The potential cost of the new system could be limited if restrictions were placed on the rate at which the newly created negative MCAs were removed. For example, if the three point switch proposed for 1984/85 were phased in by devaluations of green rates in three equal steps at the 1984/85 and two subsequent marketing years as we have proposed, the net cost in 1985 would be 174 mecus (compared with 401 mecu). The Irish, (for different reasons) are known to favour a degree of phasing also. But the text at Appendix I only records UK reserves (at 1.1. fourth sub-paragraph and 1.3 (a) second sub-paragraph).

24. The text specifies that the new system would only be introduced for a period of three years. Adequate provision is made for variable MCAs in 1.3 (e). These two points, which are important, are therefore adequately covered by the present text.

25. The other outstanding issues relate to the proposed German (and Dutch) national aids. The Germans have refused to commit themselves to phasing out the aid and this has now been accepted. We would wish the FEOGA contribution to national aids to be low and degressive but we need not take the lead on this issue since other delegations also have a major interest. The five point reduction in German MCAs proposed for 1985 represents a saving of 175 mecu for the 1985 EC budget and it seems to be generally

envisaged that the FEOGA contribution would be significantly less than this: (at a meeting of Foreign Ministers on 13 March, Genscher spoke of FEOFA contributions over 3 years of 150 mecu, 100 mecu and 50 mecu. We could probably accept the majority view on this aspect.

Tactics

26. It is unlikely that the European Council will agree to the precise suggestions we have put forward for the phasing out of new negative MCAs. Initially we will wish to record our concern on the budgetary aspects. The line we take later in the meeting will depend on developments. If little progress is made on other issues of importance to us we should take a hard line, despite the fact that this would leave us isolated. We should point out that the proposed changes to the MCA system entail significant extra expenditure and must be considered in the context of discussions on budgetary discipline as a whole.

27. If progress is made on other issues we may wish to move on phasing. Possibilities we might float in decreasing order of attractiveness might be:-

(i) to suggest that the new extra negative MCAs resulting from the adoption of the new system be dismantled in two (not three) stages at the beginning of the two following marketing years;

(ii) to allow the negative MCAs resulting from the three point switch in 1984 to be devalued immediately as provided for in the text (paragraph 1.3(a)). This would mean dropping our reservation on this paragraph. We would however maintain our demand that the extra new negative MCAs created through the operation of the "strongest currency solution" should be phased out over three (or two) years. This would mean maintaining our reservation on the fourth sub-paragraph of 1.1.

[28. It is in our interest in any event to secure the withdrawal of the Commission's proposals on the detailed MCA rules.]

Ministry of Agriculture, Fisheries and Food
March 1984

CONFIDENTIAL

PROCEEDINGS OF THE AGRICULTURE COUNCIL

on the dismantling of monetary compensatory amounts

M.C.A's

NB: All the delegations entered general reservations on this text linked to the discussion of the overall problem of the adjustment of the common agricultural policy and of its financing.

1. Positive MCAs

1.1. As regards the future MCAs, the Council will adopt the necessary provisions to ensure that until the beginning of the 1987/1988 milk year no changes in monetary parities may under any circumstances entail the creation of fixed positive MCAs.

The foregoing should be effected by application of a corrective weighting to the central rates used in the context of the ECU.

The Commission will take the necessary measures to prevent the negative MCAs thus created from leading to distortions at export refunds level.

The negative MCAs thus created will be dismantled on a proposal from the Commission in the light of the Member States' economic situation. [1]

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[1] The United Kingdom proposed that this subparagraph be replaced by the following:

"That part of the negative MCAs created at an EMS realignment which results from the application of the first and second subparagraphs of this paragraph shall be phased out for the commodities concerned in three equal stages at the beginning of the next three marketing years after the realignment. Other negative MCAs created at an EMS realignment shall be dismantled on a proposal from the Commission in the light of the Member States' economic situation".

1.2. Before 31 December 1986, the Commission will submit to the Council a report on the application of these arrangements and will make proposals having regard to the Community's economic and monetary situation and the trend in farm incomes and in the light of experience acquired.

Should the Council not adopt decisions before the beginning of the 1987/1988 milk marketing year intended, in the light of the above report, either to extend the system in force or to set up another, the arrangements applicable prior to the 1984/1985 marketing year will be re-introduced.

1.3. As regards the existing positive MCAs:

(a) At the beginning of the 1984/1985 marketing year for each product, part of the positive MCAs of all the Member States concerned will be dismantled by applying a corrective weighting enabling them to be converted into negative MCAs; the weighting shall be calculated in such a way as to reduce the German MCAs by 3 points. The negative MCAs thus created will be eliminated [1] at the beginning of the 1984/1985 marketing year for each product. [2]

(b) The German positive MCAs will be dismantled by 5 points on 1 January 1985. In return the Federal Republic of Germany will be authorized by the Community to grant special aid by means of a paymant mentioned in the VAT invoice and/or declaration. The amount of such aid shall be equal to 3% of the price exclusive of VAT paid by the purchaser of the agricultural product.

The Community will make a contribution towards the financing of this aid on a decreasing scale amounting to /¯x_7 MECU in 1985 and /¯x-y_7 MECU in 1986. A contribution from the Community may be decided on in 1987 in the light of the trends in the national compensation which the Federal Republic of Germany will have effected.

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(1) The United Kingdom proposed that the sentence end as follows: "In three equal stages at the beginning of the next three marketing years."

(c) As regards the Netherlands, on 1 January 1985 0,6 points of MCA on milk, 0,7 points on cereals and 0,8 points on the other products will be dismantled in such a way that Dutch MCAs are equal to German MCAs. If at their request the Netherlands are authorized to take national measures similar to those taken by the Federal Republic of Germany, they will be able to benefit from Community measures similar to those to be decided for the Federal Republic of Germany.

(d) Positive German and Netherlands MCAs existing after 1 January 1985 shall be eliminated at the latest by the beginning of the 1987/1988 marketing year for each product.

(e) In the case of the United Kingdom, the status of the pound sterling will not allow any positive MCAs to be dismantled under any other schedule than that provided for in (a). Provision for dismantling will therefore be made beyond that provided for in (a) if necessary at the time of the Community's annual price proposals.

2. Negative MCAs

Existing negative MCAs will be eliminated following a proposal from the Commission.

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This document refers exclusively to the proceedings of the Agriculture Council on the dismantling of MCAs; the United Kingdom nonetheless requested that the following paragraph be added:

"The Commission and the Council agree that the proposals for changing the rules governing the calculation of MCAs mentioned in COM(83) 586 will not be adopted."

The Council has not yet taken a decision on this matter which has still to be discussed.

APPENDIX. II

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EFFECT ON MCAs OF STAGE ONE OF GERMAN IDEA FOR DISMANTLING EXISTING POSITIVE MCAs

		EXISTING POSITION	REVISED POSITION
		MCA %	MCA %
GERMANY	Milk	+ 10.8	+ 7.9
	Cereals	+ 10.3	+ 7.4
	Others	+ 9.8	+ 6.8
NETHERLANDS	Milk	+ 6.6	+ 3.5
	Cereals	+ 6.2	+ 3.1
	Others	+ 5.8	+ 2.6
UK	All	+ 3.7*	+ 1.0*#
FRANCE	Pigs/Wine	0	- 3.4
	Milk	- 3.4	- 6.9
	Others	- 4.4	- 8.0
BEL/LUX	All	0	- 1.9
DENMARK	All	+ 1.0#	- 1.0#
IRELAND	All	0	- 1.9
ITALY	All	- 1.8*	- 5.2*
GREECE	All	- 11.9*	- 15.7*

* MCA applicable from 19 March.

The above table has been drawn up by applying to the calculation of all MCAs the coefficient necessary to reduce the German MCA of + 9.8 to + 6.8.

Figures near parity (0) can be affected by detailed MCA rules, in particular the non-cumulation rule which applies in the cases marked (#) above.

EC I Division
March 1984

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PROPOSED CHANGES TO THE RULES FOR CALCULATING MCAs

Background

1. Ideally the MCA system should be such that the competitive position of traders was unaffected by their geographic location in the Community. Marginal reductions in the effectiveness of the MCA system do not normally affect most farmers, but the competitive position of traders and processors of foodstuffs in strong currency countries can be affected with potentially serious consequences for profitability and employment in the food processing industries. The cost of the CAP also rises because expenditure tends to be concentrated in the Member States with highest support prices.

2. The Council has long accepted that MCAs can ignore insignificant monetary differences. MCAs are therefore set taking account of an arbitrary deduction called a neutral margin (or "franchise") of 1% for positive MCAs and 1.5% for negative MCAs in calculating the active MCA percentage. "Unnecessarily" frequent changes in MCAs are also avoided by a "de minimis" provision that MCAs should not normally be changed except by at least one full percentage point. Another rule, the "non-cumulation" rule, provides for the introduction of an MCA of one point as soon as the monetary gap moves outside the franchise zone. Once the basic MCA percentage has been set by the Commission the actual MCAs on individual products are calculated by applying that percentage to the intervention price. Some of the rules for doing this are set in Commission rather than Council regulations and are therefore subject only to Management Committee procedure where individual Member States have less influence.

3. The changes to the MCA system proposed by the Commission are intended to reduce the effect of MCAs and run the risk of distorting competition in favour of weak currency countries. The main proposals are:-

(a) Larger franchises

The Commission recognises that franchises cannot be increased for intervention products, but believes that they could be raised to two percentage points for other products. This would mean that processors in positive MCA countries would have to accept lower margins than their competitors elsewhere. UK manufacturers of processed foods already suffer from the consequences of additional special rules for MCAs on these products and this proposal would exacerbate this situation and extend it to other sectors of our food industry. The Commission proposal would allow decisions to extend franchises to be taken by Management Committee procedure. It is clear that the Commission's proposals there would be adverse to our interests, and given the built in majority of weak currency Member States they would be able to force their ideas through.

(b) <u>Dropping the non-cumulation rule</u>
This would return the Community to the previous situation when the Commission decided arbitrarily when to reintroduce small MCAs when currencies change. Overall, given the Commission's strong antipathy towards MCAs our expectation would be that they would not introduce MCAs in cases where the non-cumulation rule forces them to do so at present, which would damage our competitive position while we have a strong currency.

(c) <u>Pigmeat MCAs</u>
The pigmeat MCA would be halved by calculating it on the basis of cereals inputs and not the pigmeat intervention price. The pigmeat sector is not doing well and a difficult situation would be made worse if the basis for calculating the MCAs was changed.

(d) A new rule in the Commission MCA regulations that MCAs worth less than 0.5 ECU/100 kg for intervention products or 1 ECU/100 kg for other products should not be applied. The 1 ECU per 100 kg rule already applies for some processed foods but these are more valuable by weight than basic agricultural products where applying this rule would lead to substantial price differences being ignored. Liquid milk, flour and cereals would be particularly badly affected.

(e) A number of changes to the detailed rules for calculating MCAs on other products. Most are unfavourable.