

PRIME MINISTER16 December 1983AGRICULTURAL EXPENDITURE SEMINAR

The Treasury paper explains the privileges enjoyed by agriculture, of almost every conceivable kind - protection, grants, free technical advice, lavish R&D, zero-VAT, derating, excise duty exemptions. The MAFF paper, far from exploring "longer term options for reducing the resources which the Government devotes to agriculture" as enjoined by Michael Scholar's letter of 28 September, defends these aids, and even anticipates increases in some of them.

You could begin by explaining the reason for the Seminar in the following terms:

in future, the Government will have to take account of a number of new, and mutually reinforcing pressures.

There is a mood now, as there has never been before, that agriculture's time has come. The agricultural lobby itself seems prepared to accept that they have had it too good for too long. This is surely the moment for a fundamental review of the whole, hitherto unquestioned philosophy underlying support for agriculture. There are three main aspects:

(i) Economic: the growing public indignation that farmers are shielded from pressures which the rest of the economy has to face. On the topic of the protection and the guaranteed prices of the CAP, agriculture receives assistance worth twelve per cent of its value added. Manufacturing industry, with little protection and no price support, receives only one third as much, and this is likely to decline;

(ii) The CAP: our first, and possibly unique opportunity to reform the CAP, and to limit our budget contributions, will put pressure on us to review our national policy towards agriculture. If we do secure the safety net, it will no longer be so important to adopt community programmes in agriculture, and elsewhere, as a means to reduce our net contribution. Second, the mechanisms which the Commission will need to adopt to restrain agricultural surpluses (the super-levy, or threshold guarantees) will penalise over-production. This

will raise a question mark against support for agriculture: for example, what purpose will support for the dairy sector serve in future if the increased yields realise only twenty five per cent of the intervention price?

(iii) The Environment: farmers are no longer seen as custodians of the environment. Many who grew up in the country can now scarcely recognise the landscape of twenty years ago. The uprooting of hedges, filling in of ponds, the drainage of water meadows, all on a heavily grant-aided basis, has made way for the two hundred horsepower tractor and combine. The substantial environmental lobby are not predominantly composed of cranks, harbouring nineteenth century notions of rural idylls. The bulk are probably ramblers and week-enders who simply want access to something they recognise as countryside. They would find it easier to accept that changes in agriculture have to take place, as they have to in all industries, if they did not have to pay for farmers' worst excesses out of their own taxation, and through inflated food bills. Where farmers have been restrained, under provisions of the Wildlife and Countryside Act, they have been compensated outrageously. Lord Cranborne has applied for £350,000 a year as compensation for not felling sections of Cranborne Chase. Other large applications are in train.

Political Aspects

Up to now, serious consideration of agricultural support has been politically unthinkable. This is no longer the case. Agriculture, forestry and fishing now employ only 2.2 per cent of the working population. Even where they are concentrated geographically, they are a) not numerous; b) the Conservative majority is so large that it would be little affected even by a considerable swing in the agricultural vote.

There are 99 seats in which agriculture accounts for more than 5% of the working population; in only 39 is this percentage greater than 10; in only 10 it is greater than 15.

Of these 99 seats in which agriculture accounts for more than 5% of those employed, only four are held by the Conservatives with a clear majority over the nearest rival party (in each

case the SDP) of less than 10 per cent (Clwyd South West, Hereford, North East Fife, North West Norfolk).

Discussion

In the discussion, Mr Jopling may invoke a number of arguments in support of existing policies:

- improved performance of agriculture due to support;
- the need to support agricultural incomes;
- the need to ensure "fair competition";
- the reform of the CAP
- "strategic" arguments.

Responses to these points are attached in the Annex.

Summing Up

You might attempt to sum up the meeting along the following lines:

(i) in view of the changed circumstances we find ourselves in today (public unrest about agriculture's privileges, environmental issues, the Government's paramount need to reduce long-term public expenditure, the growing recognition by the farming community itself that changes are now overdue), you expect Mr Jopling to bring forward proposals for substantial reductions in expenditure over the next four years;

(ii) what we want to do is simply to bring agricultural support within the ambit of the main strands of Government policy towards its expenditure - securing greater value for money from Government expenditure through greater selectivity, efficiency, privatisation wherever possible. In view of the changed political climate, MAFF cannot stand aside from these important initiatives.

You look forward to proposals in respect of each of the major MAFF items:

(i) Capital Grants: the initial objective would be to bring down the average level of grant (30 per cent at present) fairly rapidly to around the average level for the rest of industry, with a view to eliminating them altogether;

(ii) Rural Drainage: MAFF should come forward with proposals for charging farmers for the cost of drainage undertaken mainly for the benefit of agriculture, or discontinuing this provision;

(iii) Research and Development: this expenditure is grotesquely swollen (2 per cent of agricultural output) It should be reviewed in the light of:

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- the degree of support provided elsewhere (one half per cent of output in manufacturing). You could point out that economies are being made in the R&D-intensive defence area;
 - the capacity of the supplying industries (ICI, Fisons) to fund their own research. (The fragmented nature of farming itself is not a convincing argument for such high Government expenditures, since it is the supplying industries which drive this research forward.)
 - the prospective value of additional output likely to emerge from this research, within a reformed CAP, where surpluses will be penalised, in order to restrain them.

(iv) Advisory Services: you look forward to seeing proposals for charging for these services (which, as the MAFF paper points out, farmers "value highly"), with a view to early privatisation. (This is the one area in which the MAFF paper hints at prospects of reduced expenditure.) MAFF should also consider privatising its many quangos;

(v) Livestock Subsidies: MAFF should consider alternative, more cost-effective ways of relieving the relative hardship of hill farmers, in ways which identify genuine, full-time (as opposed to hobby) farmers.

These proposals should strengthen our position in negotiating down the CAP. If our own national support were less generous, we would be in a better position to argue for economies in the CAP.

We do not suggest that we should bring an end to the tax exemptions enjoyed by agriculture. This Government's concern is with reducing taxes, not increasing them. We suggest that farmers would resent tax increases more than withdrawal of assistance. It would be legitimate, however, to remind Mr Jopling of the value of these exemptions.

NICHOLAS OWEN

ANNEX DISCUSSION POINTS

- 1) "Thanks (partly) to Government support, agriculture has improved its performance, in terms of its contribution to the balance of payments and its rising productivity."

Comment:

- (i) the balance of payments argument is not relevant, as it was in the 1960s when, with a fixed Sterling parity, the balance of payments was a constraint on economic growth. The problem may recur when North Sea Oil runs out, but we are not subsidising other industries with this prospect in mind;
- (ii) there is no economic virtue in improving the balance of payments in any particular industry, whether it be agriculture, car manufacture, as an end in itself. What matters is whether, at the margin, the extra resources absorbed by an industry justify the marginal return;
- (iii) neither is productivity growth an end in itself. What matters is whether an industry satisfies real demands in an economic way. Productivity gains are valuable in so far as they contribute to this. In a market environment they automatically do so but in a contrived, CAP world, there is no assurance that they do. If they simply add to the surpluses they are of little value (even though the payments mechanism disguises this);
- (iv) the achievements of agriculture are less impressive when one remembers that farmers can in the last resort accept whatever grants and technical advice which are thrust at them, confident that in the last resort intervention funds will dispose of their output. In a sense, these achievements resemble those of Eastern European economies which have cranked out increased production which has not in many cases corresponded to what people actually want;
- (v) we can improve our standard of living by specialising in things we do best, but only up to the point where the return justifies additional resources involved. But we must be well beyond that point. The yields on marginal land,

for example, which is brought into production only as a result of massive grants for drainage, land improvement, rooting out of hedges, technical advice, cannot justify the additional resources involved, even accepting the inflated CAP price as a basis for valuing it. Without the taxpayer's contribution, farmers wouldn't bring this land into cultivation.

- 2) "We need to ensure that British agriculture enjoys conditions of fair competition within the improved CAP."

Comment:

(i) what is "fair"? The MAFF paper mentions other countries' aids, but does not quantify their aggregate effect; it would be difficult to do so;

(ii) the textbook answer to this familiar problem is: if foreigners want to waste their resources, let them do so; we will enjoy whatever benefits emerge;

(iii) our partners' agricultural sectors contain many small inefficient, almost peasant farmers, which pose problems for those countries. The fact that our partners - for the most part wealthier than ourselves and better able to indulge in these policies - choose to provide substantial support to solve this social problem, is no reason for us to match their aids, often to the benefit of millionaire "Barley Barons".

- 3) The CAP

The CAP dominates this whole subject. MAFF will attempt to play the CAP card in favour of support, whether the CAP, and the budget, are reformed or not. Under the present arrangements, MAFF can argue that increased productivity, and hence production is to our national benefit, since our partners will contribute 80% of the cost of disposing of surpluses.

Hence, there is no point in reducing our surpluses if others don't as well. The CAP can therefore be used as a justification for throwing resources at agriculture.

But if the CAP were reformed, MAFF would be quick to argue, as they do in the conclusions of their paper, that this may lead to the expansion of national support schemes, in other member states, and hence in Britain, to ensure "fair competitive conditions".

Comment:

The generous level of intervention prices removes the need to provide aid for most of agriculture: farmers are assured of profitable markets. If, as we hope, the CAP is reformed, this will:

(i) deal with our budget problem in a way which relieves us of the need to support dubious programmes mainly or partly as a means of recovering our money;

(ii) will impose, of necessity, such tight mechanisms on each commodity that surpluses will no longer be disposed of in ways which cost us little. To illustrate, if the "Super-Levy scheme" is introduced for milk, any surplus production in excess of some threshold will yield us only 25% of the intervention price. The significance of this has not sunk in at MAFF who are already talking in terms of "helping" the dairy sector to cope. The Super-Levy means that the grant and research-aided investment in milk production, undertaken in recent years and from now on, will yield very little indeed as they feed through into increased production. At a stroke, the Super-Levy would undermine what little economic point there currently is for support for the dairy sector;

(iii) the same argument will apply, with perhaps less dramatic effects, to all other sectors. If, as we hope, super-levies or automatic guarantee thresholds are introduced elsewhere, any increases in production will drive down the price.

4) "Self Sufficiency in Food is a Strategic Asset"

Although this consideration is not mentioned in the MAFF paper, Mr Jopling may suggest that self sufficiency would be of strategic value, in the event of our being blockaded, as we were in the two World Wars.

Comment:

(i) this view has not been credible for many years.

We prepare for an engagement of 30-60 days, such is the range, accuracy and power of modern weapons. There is no question of our being able to fight longer than 30 days unless we are reinforced across the Atlantic. If we are "blockaded", there is no question of us sustaining a serious conflict, let alone reaping several harvests in order to keep going;

(ii) we no longer recognise "strategic" industries. Even within the defence equipment industries, only five are judged to be "essential to defence". If shipbuilding, aircraft, tanks, ordinance are not "strategic", why on earth should agriculture be?

(iii) to the limited extent that we need to plan for food reserves, it is cheaper to stockpile than to maintain an artificially bloated agricultural industry.

5) "Farmers incomes have declined in real terms over the last ten years"Comment:

(i) we do not recognise the maintenance, or growth of incomes of any other private sector activity as a policy objective. Aggregate incomes in a number of sectors have fallen sharply. The time has come to pay less attention to farmers' incomes.

(ii) aggregate farm income is in any case a poor guide in a welfare context; it embraces millionaires, hobby farmers, and hill farmers. It disregards income from other sources.

6. "Research and Development is needed to maintain competitiveness."

Comment:

Yes, but the implications need to be understood. Yields in farming have increased rapidly in the last ten years. We will need fewer acres and cows to feed a stable population. We will not need to bring more marginal land into cultivation. Between 1972 and 1981, the yield of wheat per acre rose by 25%; that of oats by 23%; and of barley by 19%. The average dairy cow produced 21% more milk in 1981 than ten years before. As our grasp of biotechnology increase, these rates of increase could accelerate.

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