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Nick Owen is

drawing up a draft PS
with 15 commissioners a note
from M. J. Owen 23/5

PRIME MINISTER

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Prime Minister

You may also like to see
some Dutch idles, which I
attach.

The problem of launching a study
is that we don't want to
under the budget discipline
route to control of costs.

23 May 1985

REVIEW OF THE COMMON AGRICULTURAL POLICY

Agree to informal
discussion among colleagues as
a first
step.

Michael Jopling raised this subject last December. He
proposed an initiative in the Community to launch an
independent review. You saw no need for such a review, and MJ
did not pursue it.

before
deciding to
launch a
study?

In the event, the Commission launched a study of its own,
concerned mainly with supply and demand prospects in the
Community and in the world over the next 5 years, and with
alternative crops and alternative uses for existing crops.

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23/5

These studies ought to underline the need for policy
changes. The German refusal to accept price reductions under
the present arrangements points in this direction. Ought we
not, therefore, to begin thinking ourselves about the changes
in policy which are both politically feasible and technically
capable of containing the CAP, if budgetary discipline fails
to do so.

I attach some thoughts on the direction in which the CAP
might go. If you see any merit in pursuing ideas of this
kind, you could invite Michael Jopling to prepare a paper on
this subject.

Nicholas Owen
NICHOLAS OWEN

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THE COMMON AGRICULTURAL POLICY

The defects of the CAP are well known. It is a burden on consumers and taxpayers; it damages other economies; it fails to create a genuinely common agricultural market because of "green" currencies; it divides Europe more than it unites it; it can harm the environment. Is there any possibility of reforming it?

The CAP is, at heart, a social policy, not a food policy. There never was a danger of food shortages, any more than there is a danger of a steel shortage. The CAP's basic objective is to bring the income of even the smallest (full-time) farmer up to that of the average wage in the community at large. The CAP's difficulty with this objective is that, as presently constructed, it is bound to fail to achieve it, and at disproportionate cost.

Farming is one of those satisfying activities, like acting and freelance journalism, or politics come to that, which always attract people at rewards less than they could obtain in other occupations. Since there is no restriction on entry into the industry, other than into dairy farming, there will always remain many farmers at the margin whose incomes remain below the average community income, whatever support is offered.

Price support is a grossly inefficient way of helping the poorest farmers; most of its benefits accrue to the larger, efficient farmers.

CONFIDENTIAL

- 2 -

The CAP divides its support roughly as to 95% price support and 5% for investment aid to small farmers (the so-called "structural" measures). The latter are not well focused on income support. A cost-effective, "social" CAP would reverse this emphasis, and focus support on raising the incomes of the smallest, or disadvantaged farmers to some minimum specified level, by direct means, rather than indirectly by investment grants. Larger, efficient farmers, situated on productive land, who could survive at prices close to the world market level, would receive a tapering degree of price support.

The main problems with refocusing assistance towards the least-efficient are:

1. It would enrage the Germans, who are wedded to price support and consider that they pay more than their share to sustain it.
2. It runs counter to all notions of economic efficiency. Economic efficiency entails larger farms, on the more productive land, rather than small farms on less productive land. However, it is in the nature of social welfare systems that they temper economic efficiency. Agricultural efficiency is of limited value if it yields surpluses.
3. It poses the administrative problem of identifying the recipients who would qualify for income support. Which

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regions would be singled out? What type of farms? Is the "family farm" a desirable end in itself, and if so, why? Should the income support be related to production, and if so, to what types of production? Should support be accorded to new farmers or should it be restricted to existing farmers? Should support be related to animals, like the headage payments made to upland farmers in Britain, or to individuals?

Many ideas have been advanced to deal with surpluses. The table overleaf sets out the advantages and disadvantages of some of them. The only solutions which seem remotely feasible in political terms, and likely to constrain surpluses, are the last two - multiple pricing and price reductions plus income supplements. They would both have three themes:

1. Gradual alignment of intervention prices towards the world price: the so-called guarantee threshold mechanism, which is causing the Germans so much trouble on cereals when it actually threatens to bite, is unlikely to achieve this. Its weaknesses are:
 - There is no reference to world prices, even indirectly by reference to the costs of dumping community surpluses.
 - It doesn't give clear and relevant signals. Prices are set after farmers have planted their crops. Any

OPTIONS FOR REDUCING/CONTAINING AGRICULTURAL SURPLUSES

OPTIONS	ADVANTAGES	DISADVANTAGES
1. Price reductions	Economically efficient, administratively straightforward.	Politically difficult, slow to have desired effect (initially may even be perverse) unless clear signals given
2. Quotas	Quick-acting, preserves regional distribution, could provide outgoers with compensation if market in quotas permitted, at no budgetary cost.	Fossilises industry structure, administratively demanding, many hard cases to resolve.
3. Co-responsibility levies	Easy to administer.	Passed on to consumers, so does nothing to reduce surpluses.
4. Deficiency payments	Combines income support and low prices, possibly related to world market prices.	Difficult to apply once surpluses have emerged; substantial price reduction required; unpopular in other Member States (even though system has already been applied - oil seeds, olive oil, tobacco). Budgetary costs can be higher than under intervention system because <u>all</u> production supported and burden is shifted from consumer.
5. Multiple pricing, as in sugar regime	Provides basic income from "quoted" acreages or tonnages; could leave remainder to find market level.	Administrative problems in defining entitlements to higher price(s).
6. Price reductions & fixed income supplements, & compensated retirement scheme	Achieves social objectives, regional and environmental balance, and economic realism.	Substantial administrative problems in identifying beneficiaries, handling new farmers.

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- 4 -

price reduction triggered by surpluses starts from whatever new price is set each year, so the mechanism can be overridden.

What is needed, though is unlikely to be accepted, is an automatic price mechanism which tells the cereal farmer this Summer what price he can expect next Summer. It could, for example, be based on the weighted average of this year's intervention price and this year's world price. The weighting could be chosen so as to provide a gradual an alignment towards world prices as is desired. But it would need to be fairly rapid, otherwise farmers would never mentally adjust to world competition.

2. A minimum income support for existing farmers: This could be provided in the form of headage payments, but in respect to a limited number of animals, and not, as now, to all livestock; and price support at existing levels in respect to limited acreages, or tonnages. The advantage of this kind of occupational safety net is that it is unrelated to output and would not contribute systematically to surpluses. Allied to it, would be the option of withdrawing from farming, with compensation, enjoyed by dairy farmers now.
3. Gradual nationalisation of farming aid: Member States are said to provide more (direct) support to agriculture than the CAP itself. We should encourage this trend. It would allow each Member State to judge, and pay for, its

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own social objectives. Community support under the structures directive could be limited to a given percentage of each country's acreage, or farming employment. This would deal with the fact that the average UK farm is considerably greater than that on the Continent.

It will be objected that this third element is fundamentally at odds with the Community, which restricts state aids in the interests of securing common markets.

However, there is no effective common market in those products to which the CAP applies. The green currency system fragments the market; internal trade is said to involve more paperwork than external trade. The incentive to export to other Members' markets is reduced if the easy option of selling into intervention is available. Thus it is only in the non-supported products, such as poultry, bacon and horticultural products that there is genuine competition and market dynamism. Anything lost by insulating a limited proportion of output from competition would be offset by the creation of a more competitive market for the balance.

Conclusion

The CAP is at heart a social policy, but is the most inefficient form of social policy imaginable. Perhaps the only way in which it will be politically possible to reform it, and bring food prices closer into line with world levels, would be to provide direct minimum income guarantees to

farmers, combined with retirement schemes. We should go Dutch on paying for them. Though difficult to administer, a solution of this kind could be considerably cheaper for Europe's taxpayers and consumers.

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