The paper reveals an appalling state of affairs. We must make a major effort on this front with the European Council. MT

Prime Minister

None of your colleagues have yet commented on this paper.

Agree to propose discussion in OD(E), chaired by the Foreign Secretary, to see how far the proposals can be taken up in our approach to next year's price fixing?

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Qz.04657

MR POWELL (10 Downing Street)

Yes MT

THE COMMON AGRICULTURAL POLICY: BUTTRESSING A POLICY OF PRICE RESTRAINT

The Minister of Agriculture, Fisheries and Food submitted to the Prime Minister on 30 September a note on the consequences of price restraint for British agriculture. The Cabinet Office was asked to produce a paper on practical ways in which we might seek to buttress our policy of price restraint. This is now attached.

I am sending copies to the Private Secretaries to the Lord President of the Council, the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Secretaries of State for Scotland, Wales and Northern Ireland , the Chancellor of the Duchy of Lancaster and to Sir Robert Armstrong.

D F Williamson

D F WILLIAMSON

8 October 1985

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THE COMMON AGRICULTURAL POLICY: BUTTRESSING A POLICY OF PRICE RESTRAINT

Note by the European Secretariat, Cabinet Office

1. This paper sets out various ways which could be used to buttress the United Kingdom's main objective of price restraint within the common agricultural policy.

2. It takes as its assumptions that the budgetary cost of the common agricultural policy is to be decreased; that this is to be achieved in a manner which is not discriminatory against United Kingdom farmers; and that some further pressure on farm incomes can be accepted. This latter point raises the separate issue whether it is either desirable or negotiable to ease the effect of lower support on certain farmers by some form of income aid; this question has been tentatively raised by the Commission in its latest paper ("Perspectives for the Common Agricultural Policy, COM(85) 333 of 15 July 1985).

3. It is possible that during this autumn a more fundamental debate will begin in the Community about

(i) whether it would be politically possible to achieve greater or longer-lasting price restraint by specific schemes of income aid for certain categories of smaller farmers (for example, those farmers who could not otherwise make the adjustment to lower prices). Some of the options put forward

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by the Commission, eg a pre-pension scheme, look like a straightforward waste of money. But a degressive, self-eliminating scheme tied to some structural changes should at least be examined, at first in relation to cereals. It has to be recognised that once adopted of cereals this approach could have wide implications for public expenditure for other sectors (eg Mediterranean products;

(ii) whether, in the interest of the smaller farmers, there could or should be a higher return for the first part of production eg the products of the first X acres or the first X tons. This could be done by a direct payment on this proportion of area or production - probably with considerable administrative difficulties - or by a differentiated levy on larger producers. Differentiation would be likely to be least favourable to United Kingdom farmers. The United Kingdom has about 82 per cent of its agricultural area in large holdings (50 hectares or more) and only about 2 per cent in small holdings (10 hectares or less). At the other extreme Greece has only 8 per cent of its agricultural area in large holdings and 66 per cent in small holdings. The average United Kingdom farm size is about 68.7 hectares; in France it is about 25.4 hectares, in Germany about 15.3 hectares and in Italy about 7.4 hectares.

4. The prospect of Community discussion on these points should not, however, divert us from the agreed objective of price restraint, including indirect price restraint by introducing a greater market element or other cost-saving measures into the actual operation of agricultural support. This paper examines some possibilities.

5. Community support prices, expressed in national currencies, are now about 6.5 per cent in real terms below the level prevailing when the United Kingdom joined the Community. In the annual price-fixings in the early years of the common agricultural policy support prices were

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generally being increased in real terms, and there is widespread agreement that the initial support level, at least for cereals, was already too high. In the late 1970s, however, it became apparent that production was rising or likely to rise strongly and that greater restraint on agricultural support was called for. Thus, between 1977/1978 and 1980/81, the gains in real terms made in the early 1970s were almost completely reversed. From 1977/78 to 1985/86 the average level of common support prices in national currencies has been cut in real terms in every year but one; in 1980/81, the reduction was as much as 6.2 per cent and in 1985/86 it was about 3.7 per cent. It is, however, apparent that the increase in farming efficiency, associated in the early years with a huge outflow of labour, has outpaced the cuts in real terms in support prices. The acreage under cereals has not increased, the number of dairy cows is almost unchanged but production has increased substantially and the Community's level of self-sufficiency has been rising in almost every agricultural sector.

6. The Council has not been ready to accept substantial direct cuts in support prices. For this reason, the Council decided to tackle the milk surplus situation through a quota scheme, despite the political difficulty of that scheme also. The following paragraphs set out under five headings ways in which, within a policy of continued direct price restraint, the cost of the main agricultural market organisations might be reduced indirectly -

(i) limiting more effectively the open-ended guarantees

(ii) reducing the role of public intervention

(iii) a producer's contribution to the cost of export

(iv) making the buyer in third countries pay more

(v) import arrangements.

Some of these methods are already under way, but some strengthening may be possible over a period of time. The annexes to this note set out some possible applications to the more important products.

Limiting more effectively the open-ended guarantees

7. In 1980 the Commission advocated that a general principle of co-responsibility should be introduced whereby all or part of the cost of production in excess of a certain quantity - to be fixed in the light of internal demand in the Community and its external trade - should be borne by farmers themselves. In 1981 the concept of "guarantee thresholds" (ie support prices or aids reduced in proportion to excess production over a threshold level) was elaborated. In 1984 the Agriculture Council accepted more widely the principle of guarantee thresholds not only for products in surplus but also for products for which budgetary expenditure is liable to increase rapidly. Guarantee thresholds apply to cereals, rapeseed, sunflower seed and processed fruit and vegetables but not to some important products such as olive oil, fresh fruit, beef and tobacco. Quotas apply to milk and sugar.

8. It is essential to maintain pressure to implement each year the existing guarantee thresholds and to follow through the 1984 agreement of the Agriculture Council on the wider application of guarantee thresholds. Otherwise the objective may be lost in the debate which is about to begin on income aids and differentiated support.

9. Despite German obstruction, the cereals price resulting from this year's price fixing discussions is

lower than it would have been in the absence of the guarantee threshold. It is a step forward that almost all member states were ready to agree to price reductions for cereals and rapeseed, although the German Minister resisted fundamentally the operation of the threshold for cereals and rapeseed. The Commission is now thinking of altering the present threshold mechanism. Our concern must be to keep the best possible threshold mechanism in place.

Reducing the role of public intervention

10. This remains an area for potential savings, particularly in those cases where the Commission might conclude that it could act after consulting the Management Committee and without the need for a further proposal to the Council. The main methods are:-

(i) shortening the period of intervention, so that it does still ease the worst seasonal fluctuations but does not provide a floor in the market throughout the year. The biggest saving would come if it were possible to restrict cereals intervention to a clearing operation at the end of the marketing year: this could avoid the cost of taking grain into intervention merely to release it again in the same crop year and would almost certainly result in an overall lower price level in the market;

(ii) greater replacement of public intervention by private storage aid, the essential difference being that the public authority does not take over the

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ownership of a product subject to private storage aid. This has been actively considered in the past, eg for skimmed milk powder. An additional advantage in general is that for some products (eg beef) private sto rage aid can be associated with conditions eg that the product must be exported on being withdrawn from storage;

(iii) tighter quality standards so that the volume eligible for intervention is reduced. It is important, however, that they should not lose touch with commercial reality and, in particular, with the characteristics of the United Kingdom product;

(iv) maintenance and possibly wider application of delays in payment for intervention stocks, thus making this outlet less attractive to manufacturers and traders;

(v) abolition or reduction of Community payments to member states (storage and interest charges) for holding intervention stocks. In 1984 these payments cost the Community budget over 1000 million ecu. This change, which would be strongly opposed by some other member states, would reduce pressure for price rises as the cost of intervention would bear more directly on national exchequers. On the other hand, it could reduce the pressure of the financial guideline.

A producer's contribution to the cost of export

11. The role of exports in the common agricultural policy has changed substantially since the policy was first framed. For most commodities (eg cereals, beef, pigmeat, wine, olive oil) exports - and the system of export refunds - were seen as a necessary but occasional method of balancing supply and demand. The Community is now the world's

largest exporter of animal products and the world's second largest exporter of agricultural products overall. This means that, through the export refunds, the taxpayer is providing a much more significant benefit to farmers' (and some manufacturers' and traders') incomes and is carrying it alone. The insulation against the effect of low prices in world markets is more important. The very large scale of the Community's agricultural trade - even for the Federal Republic of Germany agricultural exports are worth more than steel exports - has also generated pressures not to disturb the system. Nonetheless, there would be merit in an arrangement under which prices in export markets were reflected, even if only partially, in Community producers' returns. There would, of course, be strong resistance to this from those who would see it as a price cut.

12. Among the ways in which this might be done are:

(i) a levy on production or sales of the product related to export sales. This could not be easily distinguished from the co-responsibility levy approach to which we are opposed. Moreover, the administrative costs would be very high and it would be very difficult to enforce such a levy if farmers refused to pay;

(ii) a charge on sales to intervention. Since the seller of, for example, butter or beef, to intervention would receive the intervention price less the charge, the basic level of support in the Community's own market would be lower and would reflect to some degree the effect of lower prices in export markets. The principal objective of such a scheme would be to provide some disincentive to intervention purchasing and to production when surpluses were being exported to low priced world markets. There would be strong resistance from agricultural interests on grounds of weakening support to producers.

Making the buyer in third countries pay more

13. Despite the Community's importance in world agricultural trade products, it is not a price-setter for many products. In some sectors, however, for which the Community is important as an exporter, such as milk products, beef or poultry the following factors can be identified:-

(i) heavy subsidisation, principally that of the Community itself.

(ii) an important role for centralised export marketing by state or semi-state bodies (eg the New Zealand Dairy Board, the Argentine Junta de la Carne) which enables export prices to be controlled to a considerable degree.

(iii) a preponderance of state or semi-state bodies as buyers (eg for milk products, beef and poultry in the Soviet Union, for dairy products in Iran or Algeria). These bodies do not act like buyers in a free market: their resources depend on government decisions (and on such factors as Soviet income from oil and gold), they tend to buy in large quantities but can decide that their consumers should wait for supplies or go without. When supplies are plentiful and prices low, their position is strong, but, if world stocks start to fall and prices to rise, they can be under strong pressure to buy because no trade official wishes to explain to his political masters that he had misjudged the market.

14. The Commission does have a responsibility to try to reduce these distortions in informal discussions with other major suppliers. If and when it is judged that some increase in returns from export markets (eg for dairy products or beef) might be obtained, we should encourage the Commission to lead the market up by cutting export refunds and to discuss

/informally

informally with other major suppliers such as the New Zealand Dairy Board the indicative price levels which we might aim to sustain. With total expenditure on export refunds (1984) of about £3,650,000,000 and with about 44 per cent of all agricultural guarantee expenditure concentrated on milk products and beef, the potential budget saving from apparently modest changes in export refunds is very great.

Imports

15. The Community is the world's biggest importer of agricultural and food products but its import arrangements are, for historical reasons, unbalanced. This is particularly marked in the cereals and animal feed sector. For basic cereals such as wheat and maize the import barriers are normally very high but for the so-called cereal substitutes and for the protein element of animal feed there are no or very low barriers to imports. As a consequence, artificial trade develops in direct response to the import arrangements, for example the creation by European animal feed and trading companies of an enormous trade in manioc because it was not subject to levy and, when combined with soya (also not subject to levy), could provide an alternative source of animal feed. It is, to say the least, unusual in a managed market system that millions of tons of manioc (although subject to voluntary restraint agreements with major suppliers) are being imported into the Community for animal feed when public stocks of Community cereals suitable for animal feed are at an historically high level (almost a million tons of British barley has been offered to the intervention agency in August alone).

16. The low import barriers for certain so-called cereal substitutes and proteins are the result of tariffs bound in GATT and could not be increased without granting compensation to the countries which would be affected. The right way to tackle this problem, while respecting international trade commitments, is to make feed cereals cheaper in the Community

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and thus to provide more direct competition with the various cereal substitutes. In the immediate future it is also of major importance not to exacerbate international pressures in the United States by bringing up such sensitive issues as the Community's liberal import regime for soya, which in the present depressed state of United States agriculture is a lifeline for United States' producers. In the longer term, however, we should not rule out a radical look at protection for cereals, the so-called cereal substitutes and protein, with a view to a better balance and possibly a more liberal regime for cereals (including imported maize).

Conclusion

17. The proposals in paragraphs 7 - 16 are an indication of ways in which, under certain circumstances and for certain products, we might be able to reinforce our main objective of a tight price policy. They are not a substitute for it. We have to recognise that there will be strong opposition. In pursuing these objectives we should take account of effects on United Kingdom agricultural interests in domestic and export markets. The applications of some of these suggestions to particular products are annexed.

30 September 1985

ANNEX 1	:	The pattern of Community agricultural guarantee expenditure by product - 1984
ANNEX 2	:	The pattern of Community agricultural guarantee expenditure by type of support - 1984
ANNEX 3	:	Specific objectives for major products

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ANNEX 1

THE PATTERN OF COMMUNITY AGRICULTURAL GUARANTEE EXPENDITURE BY PRODUCT - 1984

mecu

	Total	(£m)#	Total as % of Guarantee Section Expenditure
CEREALS	1,649	(970)	8.9
OILSEEDS	655	(385)	3.5
OLIVE OIL	1,095	(644)	6.0
SUGARμ	1,632	(960)	8.8
FRUIT AND VEGETABLES	1,454	(855)	8.0
TOBACCO	777	(457)	4.2
WINE	1,223	(719)	6.6
MILK	5,442	(3,201)	30.0
BEEF	2,547	(1,497)	13.8
SHEEPMEAT	434	(255)	2.3
OTHER PRODUCTS	1,066	(627)	5.8
	17,970	10,570	

Notes: # Converted at 1.7 ecu/£1.

μ The costs of storage and disposal of sugar surpluses are partly recouped by levies from producers which form part of the Community's Own Resources. The amount entered for production and storage levies in the 1984 budget as amended is 1,225 mecu.

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ANNEX 2

THE PATTERN OF COMMUNITY AGRICULTURAL GUARANTEE EXPENDITURE BY TYPE OF SUPPORT - 1984

mecu

	Total	(£m)#	Total as % of Guarantee Section Expenditure
EXPORT REFUNDS	6,204	(3,650)	33.8
INTERNAL DISPOSAL	4,540	(2,670)	24.7
PUBLIC INTERVENTION	2,397	(1,410)	13.0
PRIVATE STORAGE	765	(450)	4.1
PRODUCTION SUBSIDIES	4,486	(2,638)	24.4
OTHER	- 421	(- 248)	- 2.2
TOTAL	17,970	10,570	

Converted at 1.7 ecu/£1.

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SPECIFIC OBJECTIVES FOR MAJOR PRODUCTS

Milk products

1. Limiting the quantity which could be sold into intervention or the period during which intervention is available would be possible routes to weakening market support, but the effect would tend to fall more heavily on the United Kingdom which remains relatively highly dependent on intervention while member states which rely more on export refunds would be less affected. It would not be sensible to raise quality standards for intervention since they already realistically reflect the commercial market.

2. At the 1985 price fixing the Commission has under its own powers provided that the minimum delay for payment for intervention purchases of butter should be reduced from 120 to 90 days for 1985/86. Not all member states have taken advantage of this (the United Kingdom, for example, has not) but for those that have a reversion to 120 days would imply a price cut of about 0.5 to 1.0 per cent.

3. In the past the Commission has considered the possibility of reducing costs by providing for tendering arrangements for export refunds or for sales out of intervention for export. However, the world market even for bulk milk products is not structured around clear world prices and futures markets which facilitate tendering in some other sectors; and when tendering for export sales of butter from intervention was tried in 1982 it was not successful.

4. The greatest improvements could be found (other than by cutting prices directly) by acting on the quota system, for example by reducing the overall level of quotas. The

Commission are expected to come forward with proposals to buy up quota.

Beef

5. It would be possible to limit intervention by further restricting the periods during which full carcasses may be offered or the qualities eligible for intervention. The Commission adopted such an approach for carcass intervention this autumn and significant reductions in intervention should thereby be achieved. It could also be useful to harmonise the qualities eligible for intervention in the different member states: this should now be possible given that the common intervention grid is now in place. There could also be advantage in making greater use of private storage provided that this was at the expense of public intervention.

Cereals

6. One of our prime objectives must be to maintain or improve the guarantee threshold. We would prefer a mechanism which operated automatically but there is little chance of negotiating this at present. It would be possible to act directly on the intervention system by limiting access to intervention to the final months of the marketing year only. In this way intervention purchases would cover only the genuine surplus (at present such grain is taken into intervention after harvest only to have to be sold out again later in the crop year) and the market would find its own level during the other months.

7. There is also a case for tightening quality standards for intervention, which could reduce the total quantity eligible for support and lower support prices for particular qualities remaining eligible. We would need to advocate that idea cautiously, since markets can be disrupted by standards which do not reflect commercial reality and some ideas could discriminate against the United Kingdom.

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8. On 31 July the Commission introduced, on its own responsibility, carry-over payments for wheat and rye only. During the price-fixing negotiations themselves, they indicated their intention of not proposing any carry-over payments at all in 1986. It remains to be seen whether they will do this.

Sugar

9. The Community's sugar regime is currently facing serious financial difficulties. Although the regime is supposed to be self-financing, the production levy/export refund account is in practice running into increasing deficit, which is estimated at about 600 million ecu up to the end of the 1984/85 marketing year. There is little scope for savings through market management measures in the sugar sector, where intervention plays only a minor role and where reasonably ordered marketing is assured by the self-financing storage levy/refund scheme.

10. Certain elements of the present sugar regime expire in June 1986. When this is discussed we should support increases in the maximum rate of production levies so as to enable the regime to become genuinely self-financing again, provided that this is done in a way which does not discriminate against the United Kingdom industry.

Fruit and vegetables

11. It should be our aim to reduce the buying-in price for citrus, peaches, apricots and table grapes to the same percentage of the basic price (40 to 55 per cent) as is the

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case for other fruit and vegetables. (At present those percentages are between 60 and 70 per cent). A reduction of the coefficients used in calculating withdrawal compensation (presently under review by the Commission) could also be helpful. Improvements will not be easy to negotiate, though it is possible that such changes will be easier to negotiate than cuts in the basic price.

12. It would be desirable to obtain guarantee thresholds in this sector (eg price cuts if production exceeded the specified level), at least for those products which entail considerable Community expenditure. So far, however, the Commission has shown no disposition to propose them partly because of major fluctuations in output from year to year, and there would be strong resistance from other member states.

13. We should oppose the continuation of support for certain processed fruits, in particular canned cherries (cost in 1984 about 10 mecu). We should continue to press for the formulation of separate quality standards for processed sultanas and raisins. Better standards should help to improve prices for Greek sultanas thereby enabling the processing aid to be reduced.

Wine

14. In view of the major reform of the wine regime which has just been negotiated, prospects for further improvements or economies in the short term must be limited. Nevertheless, we should continue to press for reductions in aids for long-term storage and for the use of must for enrichment and in aid to compensate distillers for the cost of distilling wine surpluses. The earlier triggering of aids for compulsory distillation might be expected to lead to smaller quantities qualifying for the higher rates of distillation aids payable in respect of wine coming out of long-term storage. ("Garantie de Bonne Fin".)

Oilseeds : Olive Oil

15. The accession agreement with Spain and Portugal provides for a reform of the oils and fats sector as soon as possible after enlargement and Council discussions are likely to take place early next year. There have been many attempts in the past at such reforms and these have not been notably successful against the opposition of the producer member states, and it will again be difficult to secure improvements. In a Community of 12 we shall find it more difficult to resist changes in the oils and fats regime which could make the situation worse rather than better.

Tobacco

16. In principle the best reform for this sector would be to set a guarantee threshold for tobacco eligible for premiums taking account of the marketability of different varieties. For example, support for the less marketable varieties should be limited to a quantity certainly no greater than current production levels. On the same lines we could continue to press for increased price and premium discrimination against varieties which are most difficult to market and/or limiting the grant of full premium to cases when contracts had been concluded between growers and processors (which is presently less than 20 per cent of production).