(2)

PRIME MINISTER

THE GREEN POUND

You should be aware of the attached exchange between MAFF and the Treasury, about a possible devaluation of the Green Pound, which will be discussed in OD(E) on Monday.

Mr. Gummer points out that our negative MCAs are now at a level which means that common prices are some 20% higher in the Community than in the UK. He wants us to follow the Irish in seeking an 8% devaluation of the Green Pound.

The Chief Secretary points out the serious implications for public expenditure in the UK as well as for EC expenditure, and the consequent increase in food prices and the RPI. He believes that we should lobby against an Irish devaluation and not seek one ourselves now (while keeping open the possibility in the next price-fixing).

I suspect that the Chief Secretary will win in OD(E): or just possibly there may be agreement that, if the Irish are granted a devaluation, we should seek a much smaller one.

CDP

CHARLES POWELL

5 September 1986

VC4AIO

Personal for Mr Powell

bc: Mr Stark
Mr Holroyd
Mr Jay, o/r
Mr McAdam

CONFIDENTIAL

Qz.05287

MR BUDD, APS/FOREIGN AND COMMONWEALTH SECRETARY

DEFENCE AND OVERSEA POLICY COMMITTEE SUB-COMMITTEE ON EUROPEAN AFFAIRS: 5pm, 8 SEPTEMBER 1986

The Minister of Agriculture, Fisheries and Food (letter from Minister of State, Ministry of Agriculture, Fisheries and Food, to Chief Secretary, Treasury of 28 August) has requested agreement to devalue the green pound by up to 8 per cent on a corresponding basis to a possible devaluation of the Irish green punt. The Irish Government is pressing for this point to be decided at the Agriculture Council on 15-16 September. In his letter of 4 September the Chief Secretary has rejected this request.

I attach a Chairman's brief for a meeting of OD(E) at 5pm on 8 September. This meeting will, in fact, have the same cast as we discussed earlier: the Agricultural Ministers, the Chancellor of the Exchequer and the Chief Secretary, Treasury, the Secretary of State for Trade and Industry and the Minister of State, Foreign and Commonwealth Office (Mrs Chalker) under the chairmanship of the Foreign and Commonwealth Secretary.

D F Williamson

D F WILLIAMSON

5 September 1986

CONFIDENTIAL

DEFENCE AND OVERSEA POLICY COMMITTEE SUB-COMMITTEE ON EUROPEAN AFFAIRS: 5pm, 8 SEPTEMBER 1986

CHAIRMAN'S BRIEF

PROPOSED DEVALUATION OF THE GREEN POUND (OD(E)(86) 15)

PURPOSE OF DISCUSSION

1. To consider the proposal from the Minister of Agriculture, Fisheries and Food that the green pound be devalued in line with any devaluation agreed for the Irish green punt at the Agriculture Council on 15-16 September.

CONCLUSIONS

2. The issue is a difficult one. The best course of action for the United Kingdom might be:

i. to resist, by lobbying the Commission not to make a proposal, any change in the Irish green punt and, if a proposal is made, to try to minimise the change;

ii. if, however, the Commission does make a proposal on the Irish green punt which is agreed by the Council, it is for decision whether -

(a) we should make no move to have the green pound devalued;

or (b) we should seek to have the green pound devalued but only by a limited amount, eg not more than 3 per cent.

3. You will wish to be guided by the discussion in the Sub-Committee but may be able to conclude that:

- The United Kingdom should resist any devaluation of the Irish green punt before the 1987 price fixing. We should attempt to stiffen up the Commission, pointing out that the United Kingdom would come under pressure to give equal treatment to its farmers and that the French might also get in on the act, with serious consequences to FEOGA;

- a full devaluation of the green punt alone would have a considerable effect on the Community's budget (an estimated 190 million ecu in a full year). A corresponding green pound devaluation must be considered unacceptable. It would undermine our arguments for tight budgetary control. Equally undesirable would be its public expenditure consequences in the United Kingdom (an estimated £200 million in 1987/88) and its impact on the RPI (about 0.25%);

- it is recognised that an increase in the disparity in support prices between the Republic of Ireland and the United Kingdom would provoke greater illegal cross-border traffic and affect the viability of meat processing plants in Northern Ireland. But this consideration cannot override the wider arguments;

<u>and possibly</u> - if, however, despite our views the Irish punt were wholly or partly devalued, we should be prepared to devalue the green pound but <u>not</u> by more than a very small percentage (3% would be the same change as in the last price package).

BACKGROUND

<u>The problem</u>

4. On 2 August the Irish punt was devalued by 8% as part of the realignment of the EMS. This produced negative mcas of -7.2% for dairy, beef and other animal products and -8.8% for crops. There was no immediate request for devaluation of the green punt to remove the negative mcas but following protests from the agriculture sector and the damage wreaked by Hurricane Charley the Irish Government has decided to seek urgently a full devaluation to assist their farming sector.

5. The Irish request has prompted MAFF Ministers to seek a corresponding devaluation in the green pound. After a devaluation of the green pound at the price fixing in April of 3% UK mcas stood at -7.1% for livestock products and -10.7% for crops. Since then mcas have increased to a current level of -17.3% for milk and other livestock products and -19% for crops. Mr Gummer wrote to the Chief Secretary on 28 August on behalf of Mr Jopling to seek agreement to a devaluation of the green pound to match a green punt devaluation. The Chief Secretary replied on 4 September, turning down the request. Any decision on green rate changes has to be taken by the Council of Agriculture Ministers on a proposal by the Commission. The Council is to meet next on 15/16 September and our line needs to be agreed before then.

6. Green rates - which are applied to trade in agriculture and food products only - are the rates at which Community prices, which are expressed in terms of ecus, are converted into national currencies. The effect of the recent situation in which the pound has weakened against other European currencies but no adjustment of the green rate has been made is -

(1) in terms of competition, the United Kingdom agricultural industry has not got the advantage which other sectors of industry have obtained from the change in the value of the pound. Most agricultural products are receiving, on import into the United Kingdom, a Community-funded import subsidy (the mca) of 19% on crop products and 17.3% for livestock products. Exports of United Kingdom products are being charged a similar amount. The consumer is benefitting from prices lower than they would otherwise have been;

but (2) United Kingdom farmers still have available support prices in pounds at exactly the levels agreed in the price fixing.

DISCUSSION

7. Four main points will have to be considered:

i. Our approach to proposed devaluation of the Irish green punt.

ii. The possibility of other member states seeking devaluations.

iii. Budgetary implications.

iv. What our approach on the green pound should be.

i. **Irish green punt**

The UK's position is that where a member state with negative or positive mcas requests a green currency change it is normally agreed in an effort towards removing mcas. However this usually occurs at the annual price fixing. In seeking a 'mid-year' devaluation the Irish have queered the pitch. Although their request for devaluation preceded Hurricane Charley (when the Irish might have settled for 4%; half the devaluation sought), the effects of the storm have added pressure on the Irish Government to seek a full devaluation. There has yet to be a firm request for weather aid from the Irish but it is still possible for the consequences of storm damage to be met this way, eg by subsidized grain sales from intervention, rather than through devaluation. Moreover any Irish devaluation would have a major impact on meat processing plants in Northern Ireland. Currently, Northern Ireland producers find it more attractive financially to sell cattle in the Republic. This attraction would increase with an increase in support prices there. The degree of illegal cross-border traffic is such that mcas are ineffective and the viability of meat plants in Northern Ireland would accordingly suffer. There is therefore a good case for our resisting an Irish devaluation until the next price fixing.

ii. Other member states' green currencies

Apart from the Republic of Ireland and the United Kingdom, other countries with negative mcas are Greece (-27%), Spain (-1%), Italy (-1%) and France (up to -4.8%). There has been no indication to date from Spain, Italy or Greece of a desire for a devaluation of their green currencies; but France might, despite Mr Gummer's views, seek a devaluation. At the price fixing this year France sought and obtained agreement to a two-stage devaluation (and our devaluation then was designed to keep us in line with them). The timing of the second stage was unspecified and, while it is assumed that the second devaluation would be left until the next price fixing, the French government might see an earlier devaluation as aid to their restive farmers. A request from the French cannot be ruled out and this risk would be increased if we too go for a devaluation.

iii. Budgetary implications

Devaluation is costly. Full Irish devaluation would add some 190 mecu to the FEOGA budget in a full year (48 mecu for 1986). A UK devaluation of 8% would add a net further 74 mecu (18.5 mecu in 1986). A French move to parity could add an additional 430 mecu in a full year. The costs on the EC budget are therefore significant and would add to the demands on FEOGA, on which there is already tremendous pressure and a likely overspend in 1986. The effect on UK public expenditure is calculated in Mr Gummer's letter to be £40 million in 1986/7 and £120 million in 1987/8. The Treasury estimate the costs to be nearer £80 million and over £200 million respectively. Such figures could lead to a claim on the Reserve in 1986/87.

iv. UK green pound

Mr Gummer's case for a devaluation is made out on two grounds. First, the need to raise farmers' incomes which fell 43% in

1985. He calculates that a full devaluation would benefit the UK farming industry by between £500 and £600 million in a full year. On the other hand, the UK industry itself has been almost silent in calling for a devaluation of the green pound, although that could change if the Irish succeed. The benefit to the industry would come through the increase in support prices which could well lead to an increase in intervention purchases and stocks in the United Kingdom. The provision of additional expenditure for farmers now on top of that provided through the devaluation at the price fixing, without any major reform of the CAP in compensation, is a major presentational disadvantage. Second, it is represented that a devaluation of the pound in line with a devaluation of the Irish punt would minimise the damage to meat plants in Northern Ireland, which are important employers in the province. There is substance in this argument - though there is already a 10% gap between support prices in Northern Ireland and the Republic. Also he argues that in tactical terms there is value in seeking a change in our green rate outside the price fixing.

8. The Chief Secretary's reasons for turning down the request are as follows:

i. The suggested Irish devaluation would impose a considerable cost on the EC budget. Given the need to secure substantial savings in order to respect budget discipline and the 1.4% VAT ceiling our primary objective should be to resist (or at least minimise) the impact of any Irish devaluation and not magnify the risk by action of our own, which might provoke action by the French;

ii. other member states would not regard a UK devaluation as equivalent to the Irish proposal, as sterling is outside the EMS exchange rate mechanism and our variable MCAs can go down as well as up;

iii. pressing for a UK devaluation would destroy our credibility in seeking the necessary policy reforms in the CAP and the necessary savings to respect budget discipline;

iv. the devaluation suggested would substantially increase MAFF's PES bids and threaten a claim on the Reserve in 1986/7;

v. there would be an unwelcome effect on domestic food prices and on the RPI at a time when it is likely to be under pressure from price increases in other sectors.

The Chief Secretary suggests that we should concentrate on lobbying the Commission on the desirability of delaying or at least minimising any Irish devaluation and not follow suit ourselves at this stage.

HANDLING

9. You will wish to invite the Minister of Agrculture, Fisheries and Food to introduce the correspondence and set out his case for devaluation. The Secretaries of State for Northern Ireland, Scotland and Wales might wish to comment. The Chief Secretary might then respond. The discussion could then focus on the points in paragraph 7.