FILE

bc: Mr. Williamson
Cabinet Office

MR. BLACKWELL

CAP REFORM PAPER

The Prime Minister has read your paper. She has commented: "the proposed reforms aren't worked out enough".

She is also not convinced that the notion of an initiative with the French and Germans to launch drastic reform reflects the realities of the way in which the European Community works. Reform is a continuous process, and pressure for it tends to reach regular peaks at the time of the annual price fixing.

The best course might be for you to remain in close touch with MAFF to ensure that proposals for reform are given full weight and that we do not miss any opportunities.

C. D. POWELL
17 November 1986

CAJAJP

SRWAMH

PERSONAL AND CONFIDENTIAL

PRIME MINISTER

CAP REFORM

David Williamson and I both have considerable reservations whether the Policy Unit paper on the CAP offers a feasible way forward. We think that there is an element of rediscovering the wheel; and that the notion of a grand diplomatic initiative with the French and Germans to embark on drastic reform does not reflect the realities of the way in which the European Community works. Reform is a continuous process, closely bound up with the cycle of annual price-fixings. In the end, it will be the cash limits approach which is most likely to reform the CAP; and there are some signs that it is beginning to bite in the dairy and beef sector.

David and I do not think, therefore, that you should agree to the Policy Unit's proposed approach as such. But you might suggest that they continue to monitor MAFF policies closely to make sure that they are consistent with the goal of cutting the cost of the CAP.

C.D.P.

The proposed reforms aren't worked out enough

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(C. D. POWELL)
14 November 1986

PERSONAL AND CONFIDENTIAL

PRIME MINISTER 14 November 1986

CAP REFORM PAPER

The reaction to the current proposals for cuts in milk quotas, and the discussion yesterday on ALURE, have raised yet again the importance of untangling the CAP mess.

Following the work done this spring, you may feel that the ground here has been fairly well tilled. The conclusion then was that there was little alternative but to carry on a gradual process of attrition, using the budget constraints to force change. However, after discussions with a number of officials close to the scene, the Policy Unit believe that the current pressures on CAP and the emerging EEC budgetary storm now offer an opportunity to get agreement to a far more comprehensive restructuring of CAP than has previously been contemplated.

The note sets out the framework on which an acceptable restructuring might be based and suggests the possible tactics for getting it on the agenda. The ideas are not new, but their linkage together into a complete package could provide a fresh approach that might get around traditional German objections.

Because a restructuring on the scale required would imply overturning some community sacred cows, there would be little chance of making progress through public discussion in meetings of agricultural ministers. The only realistic route is to introduce the ideas privately in informal, bilateral discussions between yourself, Kohl and Chirac. We believe the best timing for this would be early next Spring after the German elections in January and in the context of the ex-Novo review - although Mr Jopling (with whom this has also been aired) would prefer any initiative to be delayed until after a UK election.

The purpose of the attached note is therefore to give you an opportunity to consider these ideas now and to recommend that you put in hand the necessary staff work to develop these ideas to the point where you could decide whether or not to engage in preliminary discussions. If you agree, we would suggest setting up a team outside of MAFF, perhaps chaired by the Cabinet Office.

Norman Blackwell

NORMAN BLACKWELL

14 November 1986

CAP REFORM - AGAIN

Despite continuing efforts to get CAP under control, the prospects still look horrific. Expenditure is increasing at a rate that outstrips budget resources and stockpiles are continuing to rise. Current negotiations are likely to agree no more than a temporary sticking plaster. While previous attempts at major reform have always been resisted by our partners, the seriousness of the emerging budgetary problems may open a window early next year to get agreement to a far more comprehensive restructuring of CAP than has previously been contemplated.

The issues on CAP were extensively debated by Ministers this Spring, but the changed situation makes it worthwhile considering a new and more radical approach. This note suggests a framework for such reforms which could be developed for use in informal, bilateral discussions with other Heads of Government early in the New Year.

The Pressures for Reform

A number of factors are bringing to a head the basic budgetary problems of CAP as currently operated. The officials involved believe that these pressures are helping to create a greater recognition amongst our partners that continuation along current lines is untenable. In this environment, there may therefore be a greater openness to consider more fundamental reforms that provide a viable long-term structure.

- Overspending on CAP means that EEC finances could be almost 3 billion ecu short in 1987 unless savings are achieved - leading to immediate demands for additional finance above the 1.4% ceiling and pushing still higher the likely revenue proposals for subsequent years.

- Proposals to achieve additional savings on milk, beef and cereals through non-price measures are proving difficult to agree. Existing milk quotas have failed to reduce production as much as planned and the proposals for further cuts have brought home the message that quotas cannot provide a painless solution. It never was painless

- The extension of the community has exacerbated these strains and increased the prospective cost of the policy to existing members.

- Failure to control CAP expenditure is meanwhile limiting the scope for expenditure on other community programmes that many states would wish to develop.

- The discussions in GATT have highlighted that agricultural overproduction is now a worldwide problem - not just a temporary local anomoly. As a result, the costs of disposing of surplus stock on world markets will continue to increase.

With technology developments promising further improvements in productivity, there appears to be increasing recognition that major reforms are unavoidable if complete collapse is to be avoided. The commission have warned that they will be bringing forward "drastic" new proposals for the next price fixing, and ECOFIN approved a bracing statement of principles in October, asserting that prices should more closely reflect market conditions. The European Parliament this week has also underlined its determination to press for CAP reform.

In this situation, there could be a window of opportunity early next year to sound out other Heads of Government on the possibility of more radical reforms.

No discussion of these issues is likely to be useful until after the German elections in January, but preliminary contacts could then take place in the context of the 1987 budget measures, the discussions on the Ex-Novo review and the publication of the Commission's own promised proposals. However, the window might close again if these discussions patch together temporary compromises without tackling the fundamental issues.

A Framework for Reform

It has long been recognised that the fundamental plank of any permanent reform must be a return - over some transition period - to market clearing price levels within the community. However, commitment to continued price reduction on the scale required is inhibited by the political difficulties in every country of agreeing policies that would drive many marginal farmers out of business.

Nevertheless, the current system of maintaining price support on all output to protect the marginal farmers is an extremely costly and wasteful way of tackling the problem. The wastage is not just the cost of storing and disposing of unwanted surpluses - although that is bad enough. It is also the poor focus of the support that does get through to farmers.

Although exact figures are difficult to obtain, it appears that across Europe a small number (20%) of large farmers are producing the bulk (over 60%) of the output. These farmers therefore get the majority of the subsidies - even though these efficient operators are the ones who could continue to operate profitably under a lower price régime if they had time to adjust their crops, employment and cost structure, and adopt less intensive farming practices. Only a small proportion of the total subsidy actually goes to the marginal farmers whom the policy is designed to protect.

It is therefore possible to construct a much lower cost system that withdraws subsidies from the bulk of the market supplied by competitive, efficient producers and focuses support much more effectively on the small share of production supplied by the numerous and politically sensitive marginal farmers. The proposed framework would thus have three elements:

1. A public commitment to phase out intervention buying as a mechanism for price support over a defined period with prices allowed to drop to market clearing levels within Europe (although still within tariffs).

2. A complementary decision to set up a separate support scheme to cushion the impact on small farmers, which would primarily be financed as a national commitment - although probably co-ordinated and topped up by a common European fund. It would also be desirable to limit the level of subsidy in each country.

3. A temporary rôle for quotas and set-aside to control excess production until the required adjustment takes place and current stocks are disposed of.

In essence this reform, though radical in its impact, would do no more than return CAP intervention to its original rôle as a market-smoothing mechanism instead of using it as an inefficient mechanism for income support. The social costs of changing farm structures would then be dealt with direct at much lower cost and with much less market distortion.

It is, of course, essential that such a reform should be implemented in a way that does not damage UK interests. If special measures for the support of small farms were introduced within the current CAP funding structure - and on a common definition of what a 'small' farm entailed - they would severely disadvantage the UK because of our larger than average farm size. The UK has opposed them for this reason. Yet continuing support for each country's marginal farmers is likely to be an essential condition for gaining the commitment of other members to across the board price reductions. For this reason, it would be a crucial part of the package that a large part of the income support costs were financed directly by each country to avoid a major transfer of resources.

The nature and level of the safety net could then be set separately by each country to match its own circumstances and priorities - so long as there was some limit on the total level of subsidy in each country to avoid the "subsidised" sector growing at the expense of the unprotected producers. We would thus avoid the conflict inherent in trying to provide the level of income expected by wealthy German farmers in a community that also includes the agricultural structure and peasant society of Italy and Portugal.

This possibility of separating and nationally financing the social subsidy element of CAP has in fact already been hinted at by the Commission in recent discussions. We believe that the main objections it raises could be overcome within unfettered negotiations.

- Small farmers would object to being paid to be park keepers. There are many alternative ways of providing support other than as a direct social security cheque - for example, by granting premium payments on top of market values up to a specified level of output. However, such schemes would need to be carefully scrutinised to ensure they did not lead to too great a distortion of the market against efficient producers. At the end of the day, sensibilities may have to be overridden - uneconomic farmers cannot have their cake and eat it.

- The less developed states would not accept the loss of contribution to CAP they currently receive from the UK and Germany. But under the current CAP structure, most of the money that countries get out is the money that they themselves pay in. The net flow from North to South could still be maintained, if desired, by richer countries agreeing to contribute a similar amount to a fund that reimbursed some part of the social costs. And, given the huge potential savings, it ought to be possible to have an "all gain" negotiation between member states that enables every country to achieve its objectives at lower costs.

- We would risk conceding a commitment to income support without succeeding in gaining subsequent price reductions. The risk is clear, but an open discussion about the long-term structure of CAP provides the best opportunity to link income support to a public commitment to continued price adjustment, underlined by a steadily reducing budget allowance for CAP intervention.

- The cost of support would shift from the consumer to the taxpayer. If significant, this could be overcome by raising the revenue from consumers through a small levy on agricultural output (as with co-responsibility levies). But the total cost to consumers and taxpayers together would reduce so much that prices could still be much lower than they would have been.

While it would require some sacred cows to be abandoned, reform along these lines - staged over a suitable time period - could be in the interests of all EEC Governments by allowing the objective of support to marginal farmers to be met at much lower costs than through intervention buying, while also bringing the benefit of lower consumer prices. The adjustment to lower prices in the majority of the market would be painful, but - as quotas have shown - there is no way of avoiding it in the long run.

Domestic Considerations

For the UK, the financial benefits of such a reform are clear cut and the political impact - while needing serious consideration - need not be wholly unfavourable.

The Autumn Statement shows domestic CAP expenditure rising from £1.5 billion in 1986/87 to £1.96 billion in 1988/89. On top of this, our net contribution to the community is running at £700m-800m a year - although depressed in 1988 by late receipts on prior abatements. However, this rate of contribution assumes that the 1.4% VAT ceiling is held. The Treasury estimate that a 0.2% rise in the VAT rate could raise our net contributions to Europe by £120m a year.

In addition, gaining agreement to a major reform of CAP that reduces consumer prices would be a major political triumph for the majority of the electorate. Most see food mountains as a European absurdity and regard CAP as a policy for subsidising foreign farmers.

In the farming sector, we have already incurred the political downside of bearing the bad news on price reductions. Many UK farmers would now welcome a clearer statement of future policy which gave them time to adjust their employment, crops and fixed costs to the new situation. This view was emphasised in a recent discussion with the Director of the NFU. The worst situation is continued uncertainty, with sudden shocks - such as the severe cuts in milk quotas - forced by banging against the budgetary ceilings. Marginal farmers could also be reassured by a CAP reform that provided the funds to allow a continued level of special support. Finally, our current bank of negative MCAs means that price adjustments in the UK could be buffered initially to avoid rapid falls in income.

While domestic considerations need to be carefully considered, we do not believe they need inhibit the UK from pursuing these needed reforms.

Tactics

There is a clear tactical question as to whether the UK is more likely to get results by continuing a process of gradual attritition - using the annual budgetary pressure to force incremental changes and using quotas and other measures to limit the immediate surpluses - or by going full bloodedly for a radical reform. However, in our view, these approaches are not mutually exclusive - we should continue to press for sensible changes in public forums (such as the agricultural council) while sounding out the more radical solutions in private at Head of Government level.

The problem with the incremental approach alone is that, without radical plans for restructuring the CAP, the UK cannot afford to put the proposal for special support for small farmers on the table; yet without it, the prospect for our partners to agree to a commitment to continued price adjustment on the scale needed is minimal. Unless we simply wait for CAP to disintegrate, it must be worthwhile to try to gain concensus around a fuller blueprint for reform.

The Way Forward

Given the political sensitivities of any retreat on CAP, discussions on a commitment to a complete restructuring could only be initiated at Head of Government level. The German attitude is obviously key, but if they perceive that current CAP policies are untenable they may welcome a viable long-run solution that gives them the freedom to continue their own domestic support programmes. The French are also known to be concerned about the prospect of becoming significant net contributors to CAP. To take advantage of the window next Spring, we suggest that these proposals should be developed to the level where they could be used to sound out Chancellor Kohl and Prime Minister Chirac soon after the German election in January.

N.B.

NORMAN BLACKWELL

ANNEX EXCERTS FROM RECENT MEETING REPORTS

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Oct 86 4. DELORS (COMMISSION) SAID REAL AGRICULTURAL PRICES HAD FALLEN 12% SINCE AGRICULTURE MINISTERS STARTED TAKING 'COURAGEOUS DECISIONS' IN 1984. BUT THE SITUATION WAS STILL NOT TOLERABLE AND THEREFORE THE COMMISSION WOULD PUT FORWARD NEW PROPOSALS BEFORE THE END OF THE YEAR.

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FARMERSWEEKLY

WANTED: PARTY POLICIES THAT WILL EARN FARMING'S VOTE

While it may be premature, there is the scent of an early general election in the air.
Perhaps the first agricultural hustings were the Farmers' Union of Wales's conference on the day after the Chancellor announced increased public spending.
If this is the case, farmers face a confusing choice because the policies expounded by the main party representatives at Aberystwyth were long on problems but extremely short on solutions.
There was some pretty straight talking about the deepening common agricultural policy crisis and the need to separate food production from social policies. Gloom was spread thickly, like the 1·5m tonnes of surplus butter in store, cuts in milk quota, the end of beef variable premiums and tougher intervention rules.
Seldom has any malaise been better diagnosed than that which affects Europe's farm policy. Even if a suitable treatment is prescribed by Britain, a cure that guarantees the long-term survival of our industry requires parallel action throughout the Community, which, on past experience, is a forlorn hope.
If an election is on the cards, those who seek farmers' votes must come clean on the question of how they would cure the ills of the CAP without killing the patient. There can be no place for placebos or piecemeal treatments.
Farming is a long-term business, but how can investment be planned when the market is in chaos and increasingly vulnerable to the effects of political tinkering? Candidates and parties must be forced to spell out how they would sort out the current shambles, with or without the co-operation of their EEC partners.
A day may be a long time in politics, but a five-year government term is a lot longer for farmers. The agricultural vote could be crucial and it should not be handed over for what might be a pig in a poke.

Farmers Weekly, November 14, 1986 Vol 105, No 20

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