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Michael Scholar Esq
No 10

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Dear Michael,

If time allows, the Chancellor hopes to have a word with the Prime Minister, during their meeting at 9.30 am tomorrow morning, about the 1983 CAP price fixing, and the green pound. He has asked me to send you in advance the attached background note, which sets out our - Treasury - understanding of some of the factors relevant to the decisions on the UK's negotiating strategy which will have to be taken fairly soon.

Yours ever,
Jo Kerr
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THE 1983 CAP PRICE FIXING AND THE GREEN POUND

The UK approach has to be considered in the light of our overall aims and prospects on inflation, and recent growth in the incomes of UK farmers.

2. Farm incomes have risen sharply throughout Europe. In the UK, the initial signs are that net farm incomes may have risen this year by over $\frac{1}{2}$ in real terms.

3. Community surpluses of cereals, milk, sugar and wine are at record levels.

4. The case for very low 1983 price increases, particularly for these products, is therefore very strong. And very low price increases would help substantially on inflation.

5. But high inflation community countries - eg Italy and Greece - will press for high price increases. And some commission officials apparently envisage increases of some 5%-7%.

6. However, the chances of resisting these pressures may be quite good, provided the UK, France and Germany act together. President Mitterand confirmed that France wants a moderate price settlement, given their concern about inflation, and the fact that their farmers have additional price increases in the pipeline as a result of the 5% green franc devaluation at the last EMS realignment.

7. The Germans will almost certainly not settle before their elections in March. Ertl will seek increases of 5/6% as a price for agreeing to any revaluation of the green mark (something for which the French will press hard).

8. UK's initial priority must be to secure a very low settlement. Mr Walker was right to propose - at the 21 October meeting - that



he should negotiate toughly, commodity-by-commodity.

9. But MAFF have also proposed that any revaluation of the green pound should again be resisted. This needs to be considered in relation to the likely outcome of the price fixing. Even with French and German support, we could face a settlement of more than 5%: a partial green pound revaluation, removing part of our 10% positive MCA, would then be highly desirable to dampen the impact on prices at the shop counter, and to keep down the RPI increase. Even a 2% green pound devaluation knocks 0.5% off the food price index, and 0.1% off the RPI.

10. And a green pound revaluation would be popular not only with housewives. Food manufacturers are concerned about the effect of the present MCA on their costs.

11. There is therefore a strong case for seeking collective ministerial agreement that, in addition to negotiating for low price increases, Mr Walker should be ready to revalue the green pound to the extent necessary to keep the impact of the 1983 price settlement to less than 5% on UK farm prices.