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CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

BUDGET RESTRUCTURING: PREPARATIONS FOR THE NOVEMBER EUROPEAN COUNCIL

GUIDELINES ON THE CAP

Memorandum by the Minister of Agriculture, Fisheries and Food

1. The Foreign and Commonwealth Secretary is circulating a Memorandum which discusses the tactical options open to us at the European Council on budget restructuring, having regard to the progress so far made in the negotiations. We have previously agreed that one of our aims should be to work for the adoption by the European Council of a clear set of guidelines on CAP reform as part of the budget restructuring agreement.

2. Negotiations to date have brought out very clearly how difficult it will be to reach agreement on a meaningful set of CAP guidelines, given the divergent interests of individual Member States. From the point of view of our own domestic public opinion, it will be necessary to include some general statement on a rigorous or prudent price policy, on limiting the open-endedness of the guarantees, particularly on surplus commodities, on state aids and on limiting the future growth of Guarantee Section expenditure.

3. The French, however, have staked out a series of demands for changes in the CAP which include degressive guarantees to favour smaller producers, the reinforcement of Community preference and increased protection, on cereal substitutes and oils and oilseeds, and for the dismantling of the MCA system.

4. There is no way in which we could meet the demands on the CAP which the French are making without severely damaging the Community's relations with third countries and our own national food and agricultural industries. But I recognise that we shall have to make some concessions to the French if we are to get a budget settlement. The only limited moves which I can recommend are:

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a) on the Commission's proposal for multi-annual export agreements we might agree that the Council should be ready to examine specific proposals for the negotiation of agreements with individual importing countries. The main risk here is the possible institutionalisation of surplus production and the additional budgetary costs that could result from such agreements;

b) on cereals substitutes, where the French want a progressive reduction in Community imports, our aim must be to go no further than what we have already agreed on manioc (a voluntary restraint agreement with Thailand and similar agreements or tariff quotas with other suppliers). But we could agree to consider specific proposals from the Commission for exploratory discussions with third country suppliers of individual products competing directly with cereals with a view to limiting imports to present levels. It is difficult to assess what effect this might have on our domestic interests; the Northern Irish would be particularly concerned about any effect on the supply of cheaper feedingstuffs ingredients to their industry. We should also have to expect an immediate adverse reaction from the US who would interpret this as the first steps towards restrictionism in this sector.

5. I have considered also whether we should make some similar move on vegetable oils and oilseeds where the Commission have suggested discussions with overseas suppliers with a view to exploring ways of preserving the present balance between consumption of olive oil and other oils after enlargement. But the risks for us in this sector are substantial given the size of our own oil crushing and processing industry and the possible direct implications for the cost of living. Moreover, there would be a strong reaction from the US and others (including developing countries) to any suggestion by the Community for restricting trade in these commodities. I do not, therefore, think we should give any ground in this sector. Our aim here must be to secure a thorough-going review of the olive oil regime itself.

TACTICS

6. Whatever guidelines are agreed, the detailed implementation will in any case have to be negotiated at the next price fixing. But if

we were to make the concessions to the French in paragraph 4 above now without a good settlement on the budget, we should be open to the criticism that, far from reforming the CAP, we had agreed to changes which would potentially add to the budgetary cost without resolving our budget contribution problem. The guidelines which seem likely to emerge on the non-agricultural policies, while potentially helpful to us, will not be seen as sufficient to offset an unsatisfactory deal on the CAP. In my view, therefore, we should not make any concessions to the French position in November unless we have the prospect of a good deal on the budget.

7. Moreover, we must avoid committing ourselves to pursuing policies in Europe which will be damaging to United Kingdom agriculture. Any such commitments would be impossible to defend to domestic interests whatever the outcome on the budget. This means that we need to resist changes which would disadvantage UK industry vis-a-vis competition from other Member States. This is why we have to oppose the French ideas for further developing the market system so as to favour smaller producers. We must also resist pressure for any commitment on MCAs which would inhibit our freedom to take national decisions on adjustments in the green pound.

8. Some features of the Commission's proposals on milk co-responsibility, which had been strongly influenced by French and German thinking, would also have a long-term damaging effect on the competitive position of our industry. A continued high rate of co-responsibility levy would do less to reduce the surplus than a corresponding price cut. Exemption for the first 30,000kg would seriously weaken any effect on production as well as putting larger producers at a disadvantage. But we should continue to press the case for the supplementary levy and, so far as smaller producers are concerned, be ready only to consider selective income aids if required in the context of a rigorous price policy.

9. Although the Germans are our best ally on the budget issue, we must recognise that their objectives on CAP reform are very different from ours. For example, they would like to see the cost of the sheepmeat regime cut back; and on milk co-responsibility their main priority is simply to have the cost of disposal of increased surpluses put on to the co-responsibility levy. There is a real risk of the German and French making common cause on a co-responsibility package which would be very damaging to us.

CONCLUSIONS

10. I invite my colleagues to agree:-

a) that the guidelines for the CAP, as discussed in the Annex attached, are the best we might be able to achieve at the European Council;

b) that we should be ready to make limited concessions to the French and others along the lines discussed in paragraph 4 above;

c) that, given the nature of the CAP guidelines that seem likely to be negotiable, we should make any concessions to the French demands only in return for an acceptable settlement of our budget contribution problem;

d) that we should avoid commitments damaging to UK agriculture, including the unwelcome features of the Commission's proposals on milk co-responsibility.

P W

6 November 1981

Ministry of Agriculture, Fisheries and Food

DETAILED CONTENT OF GUIDELINES ON THE CAP

This Note discusses the detailed content of the draft guidelines for the CAP which are under discussion for submission to the November European Council.

PRICE POLICY

2. The Commission have backed away from their earlier ideas for a generalised commitment to aligning Community support prices over a period of years with world market prices or with prices in other major competitor export countries. Moreover, they are now referring to a "prudent" rather than a "rigorous" price policy.

3. There is no prospect of securing agreement at the European Council for a generalised formula for aligning support prices with price levels outside the Community. Such price comparisons are (even for cereals) difficult to make and subject to sharp variations with changes in policy, market circumstances and exchange rates. It is clear that Member States would not be prepared to commit themselves to any formula implying progressive adjustment of Community prices to price levels elsewhere. Our domestic opinion, however, will be looking for a general and clear statement on price policy. We should therefore continue to press for agreement on the need for a "rigorous" - or failing this a "prudent" - price policy. We should also aim to link this to a commitment to have regard to market circumstances and the trend of prices on markets outside the Community.

MODULATION OF GUARANTEES

4. The Commission are seeking agreement to the proposition that the guarantees can no longer be unlimited but should relate "to those quantities which it is in the Community's interest to produce within its frontiers, taking account of Community consumption, international trade and the necessary effort to combat hunger in the world". They propose to fix production objectives and introduce mechanisms for reducing the guarantee if production exceeds the objective, thus making producers participate in the cost of disposing the excess.

Although sensible in principle, agreement on production figures and the commodity mechanisms will be difficult and contentious. But as a broad policy aim, we should support the adoption of a guideline in this sense.

5. The French Government are arguing for a differentiation in the guarantees so as to cushion smaller producers from the effects of price policy and the limitation of the guarantee system. Applied to the main northern commodities, this approach would be very damaging to our industry's competitive position because of our generally large farm structure. We must therefore resist any generalised reference to degressive guarantees. The most we should be ready to concede is a willingness to examine selective income aids to support the incomes of certain farmers if this is necessary in the context of implementing a rigorous price policy.

MCAs

6. The French are pressing for a reaffirmation of market unity and a commitment to dismantle existing MCAs rapidly, with arrangements to avoid the growth of new ones. In December 1978 (in the context of the establishment of the EMS) the European Council adopted a statement stressing"the importance of henceforth avoiding the creation of permanent MCAs and progressively reducing present MCAs in order to re-establish the unity of prices of the common agricultural policy, giving also due consideration to price policy." We can accept the reaffirmation of this commitment. We should, however, avoid any elaboration which would limit our flexibility in adjusting the green pound. In particular, we should want to avoid adhering to the Gentleman's Agreement under which new positive MCAs have to be eliminated in two stages provided this does not require a price reduction in national currencies.

CEREALS AND CEREALS SUBSTITUTES

7. The Commission are seeking a commitment to reduce progressively in real terms the gap between cereal support prices in the Community and those in the USA over the years up to 1988. There are problems over

defining the size of the gap (eg exchange rate movements, quality differences). But we should support the Commission's aim of a relative reduction in cereal prices to bring them closer to US prices over the period to 1988.

8. A real reduction in cereal prices would improve the competitive position of Community cereals vis-a-vis imported cereal substitutes. The French are seeking a progressive reduction in Community imports of substitutes, and the Commission's paper speaks of opening negotiations with third country suppliers about arrangements to limit imports to present levels. For manioc which is the most direct substitute for cereals in animal feed, we have accepted a voluntary restraint agreement with Thailand and similar agreements or levy quotas with other suppliers. Provided restraint is exercised on cereal prices, there might be no serious penalty in the livestock sector from holding cereal substitutes at present levels, and there would be benefits to the budget from a lower cost in export restitutions on cereals. But the US and other third country suppliers are unlikely to be co-operative in negotiating restraint arrangements.

9. Our aim should be to limit concessions in this area to those already accepted on manioc. We might, however, be ready to accept that the Commission should open exploratory negotiations on other individual cereal substitutes, on the basis of a mandate agreed by the Council.

10. The French are also pressing (with Italian support) for reinforcing Community preference on oilseeds and vegetable oils in the context of the discussions on enlargement. The US have already made clear their strong opposition to any restrictions on soya or other vegetable oilseeds. Moreover, we have a substantial seed crushing and oil processing industry (annual sales of £850 million) which could be severely damaged if their access to imported raw materials was impeded. There would also be a direct impact on the cost of living. As for cereal substitutes, the Commission are seeking agreement to explore with third countries ways of limiting imports so as to preserve the present balance (after enlargement) between consumption

of olive oil and other oils. We should continue to resist any move towards restrictions on imports in this sector and seek to maintain a common front with Germany and the Netherlands who have also been strongly opposed. Our objective should be to secure a commitment to a thorough-going review of the olive oil regime.

MILK

11. The Commission's proposals on co-reasponsibility for milk are discussed in detail in the Appendix to this Annex. There are elements in them (particularly the exemption of the milk from the first 7 to 8 cows in each herd from the payment of co-responsibility levy and the suggested progressive element in the supplementary levy) which would be directly damaging to the UK industry. Under the suggested co-responsibility levy arrangements, we should be paying some 22 per cent of the total revenue, in other words more than our percentage contribution to the Community budget under the normal rules. We could not accept this. We should also resist the suggested special levy on intensive milk producers because this is objectionable in principle and would have a greater impact on our industry than on French and German producers where milk production is continuing to expand. We should continue to press for the adoption of the supplementary levy applied at the dairy, but leaving the detailed arrangements (including the rules for passing the charge on to individual producers) to be negotiated in the context of the price fixing.

12. There seems little prospect, however, of agreement being reached at the European Council on arrangements for milk. If their co-responsibility ideas are not accepted, the Commission say that a mechanism for reducing the intervention price when the production objective is exceeded should be introduced. We should support this fall-back position, though arrangements for implementing it would also be difficult to agree between Member States.

13. In the discussions on milk, we shall want to avoid any commitments about the future phasing out of the butter subsidy; and any reference to New Zealand access which might prejudice the next review of the New Zealand arrangements due in 1983.

MULTI-ANNUAL EXPORT CONTRACTS

14. The French (with support from a number of other Member States) will press for a commitment from the European Council on the introduction of long-term contracts for exports with individual importing countries. The main problems here are the likely reaction of other exporters to any implication that the Community might seek to increase its share of third country markets through this type of mechanism; and the potential cost of the budget from institutionalising the surpluses and increasing the cost of export restitutions. We are seeking in discussions on the draft framework agreement to minimise the potential risks from these points of view. In the context of a satisfactory budget deal, however, we could be prepared to agree that the Community should be ready in principle to negotiate such agreements with individual importing countries provided the commodity coverage and the detailed terms are subject to detailed examination by the Council.

STATE AIDS

15. As a result of UK pressures for action on state aids, the Commission have included in their Guidelines document a statement of policy aims which re-emphasises the need for stricter discipline and states the Commission's intention to pursue infringements systematically under the Treaty provisions. The Commission also mention the possibilities of requiring reimbursement of incompatible aids by the recipients; and state that they will also use their power to refuse FEOGA contributions to Member States expenditure where the rules are contravened. These paragraphs in the Guidelines document are not the detailed analysis which we have been led by the Commission to expect. We will need to press the Commission to produce a more detailed analysis. In the European Council guidelines, it will be essential to include a firm commitment on state aids, requiring the Commission to ensure that the state aids provisions are strictly observed and to come forward with more detailed arrangements for achieving this.

LESS FAVOURED AREAS

16. The Italians will be looking for commitments from the European Council on the implementation of new structures measures to assist the improvement of farm incomes in less favoured agricultural regions. They see this as an essential prerequisite to the further enlargement of the Community when their producers will face increased competition from Spain. The cost of new guidance measures would fall on the Guidance Fund and we should not therefore be protected from paying our share of these if the Commission's proposed budget mechanisms based on reimbursement of a proportion of our contribution to guarantee expenditure was adopted. But we shall not be able to avoid a reference to new integrated programmes for less favoured agricultural regions including particularly some Mediterranean areas. A formula of this sort would not commit us on the details or the cost.

FINANCIAL GUIDELINES

17. Following our declaration at the last price fixing, we have been arguing for an overall constraint on the growth of guarantee expenditure so that the rate of increase would not exceed a given proportion (we have had in mind two-thirds or three-quarters) of that in the own resources base. The Germans have indicated that they will support this approach but there is no other Member State that will do so. The Commission say that, if the reforms they propose are adopted this would enable the growth of guarantee expenditure to be held below the rate of growth of own resources.

18. For tactical reasons, we should clearly continue to press for our formula to be adopted but we have to recognise that there is no possibility of it being endorsed by the European Council. The best we might hope to achieve is an agreement that the aim should be to hold the growth of guarantee expenditure at below the rate of growth of own resources and that the Council and the Commission should take this into account at the annual price fixing.

6 November 1981

APPENDIX TO ANNEX

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MILK: COMMISSION'S PROPOSALS ON CO-RESPONSIBILITY

1. The Commission propose to modify the present basic co-responsibility levy, and to introduce a supplementary levy linked to production targets and a special levy on intensive producers.

2. On the basic co-responsibility levy, the Commission propose that the existing rate of 2.5% of the target price should continue as long as expenditure on milk absorbs more than 30% of the Guarantee Section. As a new feature of the arrangements, the first 30,000kg of milk delivered by all producers would be exempted from the levy. The UK has consistently argued against the basic co-responsibility levy because it applies to production, whether or not it is adding to the milk surplus. In its effect on producers the levy operates as a substitute for a reduction in the price, and leads to pressure for higher prices, which put an additional burden on consumers, and reduce consumption. The new proposal to exempt the first 30,000kg production (6 or 7 cows) is even more objectionable in that it would discriminate in favour of smaller farmers. Calculations of the effects must be approximate and the results depend upon the method used. As the following table shows, our calculations indicate that this provision would exempt only about 10% of UK production compared, for example, with 50-55% in Italy, 45-50% in Germany and 35-40% in France. In financial terms, the UK would save about £6 million, compared with £34 million for France and £117 million for the Community as a whole (taking account of the relative proportions of production delivered to dairies in each country). As a result, the share of the total co-responsibility levy paid by UK farmers would increase from 16% under the existing system to 22% under these proposals. We should, therefore, be paying a higher proportion than under the usual budgetary rules.

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TABLE

	Existing System		Commission's Proposal		
	C-r levy paid (£ million)	Share of EEC Total paid by each Member State	C-r levy paid (£ million)	Share of EEC Total paid by each Member State	Proportion of each Member State's paid
		%		%	exempt %
UK	58.3	16.4	52.5	22	10
Belgium	11.4	3.2	7.6	3	33
Denmark	18.4	5.2	14.2	6	23
France	91.6	25.7	57.7	24	37
Germany	85.1	23.9	43.4	18	49
Ireland	17.8	5.0	12.3	5	31
Italy	29.3	8.2	14.0	6	52
Luxembourg	1	3	0.7	0.3	26
Netherlands	42.9	12.1	36.0	15	16
EC9	355.8	100	238.4	100	35

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Production targets would be set which would allow deliveries of milk to dairies to increase by 0.5% per annum; a supplementary levy would be imposed on any dairy which increased its deliveries at a rate greater than 0.5%, and regulations would be introduced to enable dairies to pass this levy on to individual producers responsible for the increased deliveries. The rate at which the levy would be set has not been specified. Although we support the concept of a production target and supplementary levy in principle, these particular proposals are unsatisfactory in several respects. First, the production target proposed by the Commission is too generous and, in our view, would preserve or even increase the existing level of the milk surplus. Secondly, the Commission's proposal is for a progressive levy, with the rate graduated according to the size of the increase in the deliveries to dairies. If it were graduated according to the percentage increases, its effect would be equitable as between large and small producers. If, on the other hand, it were related to absolute increases in kilograms in deliveries to dairies, its effect would be to penalise large producers more than small ones. The large average herd size in the UK (about 50 compared with a Community average of about 15), and the high proportion of milk production which is delivered to dairies (97% compared with a Community average of 91%) would mean that the UK would be more severely affected than other Member States. The third unsatisfactory aspect of the proposals is their administrative complexity. In the UK, with all producers being obliged to sell to the Milk Marketing Board, records are available to show the levels of each producer's deliveries in any period. However, in other Member States where there are large numbers of dairies purchasing milk and enormous numbers of producers, the problems of determining what levy would be payable by each producer would be considerable; there would also be substantial opportunities for evasion and avoidance by means of selling to different outlets or direct to the consumer. In all Member States, provision would have to be made for new producers, for mergers of farms and transfers of quotas.

4. One further aspect of the proposal on the supplementary levy is that it would not be applied in cases where the dairy could show that the additional production consisted entirely of products which receive no form of Community support - in practice mainly liquid milk, cream and fresh products. We view this aspect of the proposal with considerable reservations because there is no reason in principle why additional production should be treated differently according to the product which

it is made into: all of it contributes to increasing the Community's surplus. Furthermore, the proposal is arbitrary in its effect, benefitting other Member States more than the UK, where liquid milk consumption is high but declining; and it would be administratively complex, providing considerable scope for evasion and probably leading to distortion of the milk products markets.

5. Finally, the Commission propose a special levy which would apply over and above the basic and supplementary levies, to farms delivering more than 15,000kg of milk per forage hectare; they have not yet proposed a rate of levy. This proposal is also directed at intensive producers and would therefore affect the UK more than the Community average (although probably proportionately less than the Netherlands and Denmark). Although the proportion of UK production affected would not be large (perhaps 2 or 3%), the proposal is objectionable as being discriminatory against intensive production. This is perverse, in that the major production increases in the last couple of years have been in countries where intensive production is less prevalent. There are also compelling arguments against the proposal on grounds of administration. There would be serious problems in the first place over the definition of forage hectares and over the allocation of these hectares to the various types of livestock on the farm. Then there is the fact that not all Member States would have this information available from a recent and comprehensive census. In the UK (and possibly other countries) where such census data is available there is strong opposition to using it for levy purposes. Even where information was available, all farms producing milk in dairying areas would in principle need to be classified according to whether or not they came within the definition. This would involve an administrative cost out of proportion to any possible benefits involved. Finally, there would seem to be insuperable problems of inspection and verification in trying to ensure that cow numbers and forage area were as declared or recorded and that cows were not being moved around in order to evade the levy.

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