

Ref: A0869

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PRIME MINISTER

Agriculture  
(C(79) 59)

BACKGROUND

There was a preliminary discussion of the Cabinet paper (C(79) 59) at your informal meeting this afternoon.

2. That meeting generally agreed that we should seek a 5 per cent devaluation of the Green Pound at the EEC Agriculture Council next week. Discussion on the other two points for decision - retail milk prices and farm capital grants - did not come to even tentative conclusions; but I think that, apart from the Minister of Agriculture, there were signs of a consensus on 1p on the price of milk and a reduction (not necessarily as large as that suggested by the Chief Secretary) in capital grants.

3. You will want the Cabinet to reach firm conclusions on all three issues, and you will also want to try to reach agreement that these conclusions represent the limit on support to agriculture for the calendar year 1980.

HANDLING

4. You might open the discussion yourself by itemising the three issues for decision - the devaluation of the Green Pound, whether to increase retail milk prices and if so when and by how much, and whether to increase or decrease farm capital grants.

5. You could then inform the Cabinet (or invite the Minister of Agriculture to do so) of the case for seeking a 5 per cent devaluation of the Green Pound at the EEC Agriculture Council next week, and see if anyone wants to object to this. Probably no-one will, though the Chancellor of the Exchequer may indicate that he will want to re-open this issue if the decision goes against him on capital grants.

6. You could then suggest taking each of the other two issues in turn, starting with retail milk prices.

Retail Milk Prices

7. There is scope for decision on two issues, how much of an increase to allow, if any, and when to allow it. The main alternatives on the first issue are 1p and 1½p, and on the second they are 1st January 1980 and any later point in the year.

*Prime Minister*  
*I have done a note*  
*on monthly RPI figures -*  
*in this folder.*  
*See also letter from*  
*Consumers Association.*

*IL*  
*5/16*

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8. You might ask the Minister of Agriculture to start this part of the discussion by making his case for a  $1\frac{1}{2}$ p per pint increase in the maximum retail price of milk, with effect from early 1980. The Cabinet will want to know whether this increase will be the only one during 1980. This affects distributors' margins as well as farmers' incomes, and you might ask the Minister of Agriculture to comment. His letter of 3rd December to the Chancellor of the Exchequer points towards a rise to help distributors. If we are faced with the prospect of another increase later on for this purpose, the Cabinet might prefer to stick to 1p now and to add the other  $\frac{1}{2}$ p to the later increase.

9. I am sure you will want to pursue the case which you were putting at this afternoon's meeting for achieving a price differential between the supermarkets and the doorstep delivery. You might ask the Secretary of State for Trade for his views on this point, followed by the Minister of Agriculture, and then go quickly round the table to see if there is much feeling one way or the other. The Minister's letter stresses the political sensitivity of doorstep delivery, but at the point when this afternoon's meeting broke up he had not convinced his colleagues at the meeting.

10. As to timing - your point at this afternoon's meeting - January will be a bad month for the retail price index, with the increases in mortgage rates and rail fares coming in. April will be a bad month because of rate increases. There should be little to choose between February and March. What about an increase with effect from Monday, 11th February?

11. Against that background, you might suggest that the effective choice is between 1p and  $1\frac{1}{2}$ p either on 1st January or slightly later in the New Year and go round the table again to see which course members of the Cabinet prefer. The increase could be coupled with an announcement of forthcoming action on the retail price structure of milk if the Cabinet is broadly in favour of this, and the nature of the action can be agreed in time. You would need to commission specific proposals from the Secretary of State for Trade in consultation as necessary with the Agricultural Departments.

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Capital Grants

12. A decision is needed in order to complete the current public expenditure exercise. The "base line" figure for the grants is £160 million in 1982-83. The Chief Secretary, Treasury has proposed that this figure should be reduced by £60 million, and the Minister of Agriculture has proposed that it should be increased by £30 million. The political problem is that, because of existing forward commitments, the reduction proposed by the Chief Secretary would mean reducing the rates of new grants by 55 per cent from 1st January 1980.

13. Your handling of this part of the discussion will need to depend to some extent on the outcome of the discussion on milk prices. If the Cabinet have given the Minister of Agriculture most or all of what he wanted on milk prices, they may feel able to be relatively severe on capital grants. Similarly if they have knocked him down on milk prices they may want to be easier on capital grants. But you will want to bear in mind that the cut proposed by the Chief Secretary would be agriculture's only contribution to the current round of public expenditure cuts, so it is almost inconceivable that they should be allowed to get away with no cut at all, still less with the increase which the Minister of Agriculture has proposed. A possible outcome might be a reduction of one-third in the rate of grant, to yield a reduction of £35 million in expenditure in 1982-83.

14. You might ask the Minister of Agriculture to open this part of the discussion with his case for an increase, and the Chancellor of the Exchequer (or, if he prefers, the Chief Secretary, Treasury) to follow with his case for a cut. You might then check briefly that the Scottish, Welsh and Northern Ireland Secretaries agree with the Minister of Agriculture, and then invite other contributions - perhaps starting with the Secretary of State for Industry since one of the points at issue is that agriculture is competing with industry for investment resources.

15. You may feel that, because of the need to cut public expenditure, you need to give the Cabinet a strong steer towards the position adopted by the Chancellor of the Exchequer and the Chief Secretary. Two points to bear in mind are:-

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- (i) Agriculture is more favourably treated than industry over aids to investment. There are some useful figures giving the Treasury view in paragraph 25 (page 9) of the MISC 23 report. They suggest that cutting the grant rate by 55 per cent could well be justified by reference to the grant treatment of industry generally, though precise comparisons are different because industry and agriculture both have different rates of grant in different regions. (NB. also the higher figures in paragraph 25 relate to the Minister of Agriculture's proposals, not to the current grant regime which is more complicated as well as being less generous.)
- (ii) The Minister of Agriculture may well argue that agriculture is justified in getting better treatment than the rest of industry because it gives better value for the grants received. The figures in paragraph 33(ii) on page 11 of the MISC 23 report support this argument as far as average investment is concerned. But investment grants should, by definition, not be supporting average investment but marginal investment, i. e. investment which would not have taken place without them - if they support investment which would have happened anyway they are being wasted. There is no reason to suppose that marginal investment in agriculture is better than marginal investment anywhere else, and a more generous rate of grant for agriculture must mean that the marginal projects it supports are inherently less profitable than the marginal industrial projects which are supported by a lower rate of grant.

CONCLUSIONS

16. You will want to record the Cabinet's conclusions on:-

- (i) The devaluation of the Green Pound (probably in favour of seeking a 5 per cent devaluation at next week's EEC Agriculture Council).

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- (ii) Retail milk prices. (Probably 1p or  $1\frac{1}{2}$ p on the maximum retail price per pint from 1st January 1980, possibly with agreement to announce further action on the structure of retail milk prices. If this second point is agreed you will need to commission a paper making specific proposals from the Secretary of State for Trade in consultation as necessary with the Agricultural Ministers.)
- (iii) Farm capital grants. The maximum cut would be £60 million in 1982-83, equivalent to 55 per cent of grant rates from 1st January 1980, as proposed by the Chief Secretary, Treasury. Examples of other possibilities are set out in paragraph 60, page 21 of the report.

REA

(Robert Armstrong)

5th December 1979