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MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

CONFIDENTIAL

Prime Minister
This argues for additional expenditure!

17 October 1979

I suggest you reserve comment until we have the Berrill report. Can I show this to Ken Berrill on a personal basis - ie. not for the group as a whole?

TL 17/10

PM - yes TL.

PRIME MINISTER

AGRICULTURAL STRATEGY

When we spoke about agriculture on 1 October I promised to send you a note, on a personal basis, outlining the situation as I see it and the strategy I think we should pursue. I now do so.

2. This note is not intended to pre-empt the review of agriculture that has been set in hand following the Cabinet discussion of milk prices on 4 October. But I was anxious that you should have an account of the facts before Cabinet resumes discussion of Treasury proposals for expenditure cuts. When you have read the note I am sure you will understand why the cuts in agricultural support that the Treasury are proposing seem to me to be quite unacceptable, and directly contrary to our basic strategy of improving the supply side of the economy.

3. I hope you will agree that no decisions should be taken on any reduction in aid for agriculture in advance of the review we are now carrying out. I am confident that the review will demonstrate the case for more, not less, support for an industry which, unlike so much of our manufacturing industry, can be relied on to respond to incentives by increasing production, exports and import saving.

PETER WALKER

CONFIDENTIAL

AGRICULTURAL STRATEGY

NOTE BY THE MINISTER OF AGRICULTURE, FISHERIES AND FOOD

1. This note explains why I am so concerned about the prospects for British agriculture, why it is essential that we should carry out the agricultural policies promised in our Manifesto, and why I am resisting proposals which would mean reversing those policies.

The Potential

2. Agriculture is vital to our economy. It contributes over £3bn to gross domestic product, saves £5½bn worth of imports (of which £1bn represents the improvement in performance since 1965), gives employment directly to over 650,000 people and indirectly to many more in its ancillary industries and food processing and distribution, and sustains the whole economy of the countryside.

3. An expanding agriculture could contribute even more. We still import 35% of the types of food we can produce here. If we could reduce this to 25% - which is perfectly feasible - the additional net import saving would be £750m, with further benefits in GDP terms from the spin-off effects on the related manufacturing and processing industries. Agriculture's record of increasing productivity (free from restrictive practices, it has produced productivity increases of 6% per annum) and its international competitiveness - both in dramatic contrast to those of most manufacturing industry - show that it could and would respond to positive policies.

4. If on the other hand we were to depress agricultural production - and already under Labour our beef and pig herds have fallen - then the wealth-producing capacity of the economy

would be diminished, our import bill raised, the consumer's assurance of supply be impaired and the likelihood of sharp consumer price increases be greatly enhanced.

Labour's Record

5. Labour's agricultural policies were negative and depressive. Labour ranked the short-term advantage of holding down food prices through manipulation of the green £ above the longer-term gains of expanded wealth-creating production and secure supplies. With costs rapidly increasing through inflation, this artificial depression of returns meant that net income was squeezed, investment discouraged, production held back. The index of real net farm income since 1973 - our last year of government - shows what has happened:-

1973	123	
1974	100	
1975	100	
1976	106	
1977	104	
1978	85	(provisional)

The Promise

6. The Manifesto stated very clearly the radically different approach of our own Party: "Labour has seriously undermined the profitability of these [the agricultural and food] industries. We must ensure that these industries have the means to keep abreast of those in other countries". Many members of the Shadow Cabinet cogently argued the case for stimulating agricultural production.

The Threat

7. After the years of Labour depression we have a lot of catching up to do. So far we have not done it: in fact, we

are falling further behind. Labour made a green £ devaluation of 5% earlier this year and we added one of 5%. But these devaluations, plus the recent 1% change and the common support price increase (except for milk) of 1½%, will together add at most only £270m to farm revenue in 1979. Input costs (particularly feed, labour, interest, fertilisers and fuels) on the other hand are increasing at the rate of £750-800m. As a result, bank borrowings have increased by over £400m above the already astronomical level of £2000m we condemned Labour for during the Election - and farmers are having to pay 17½% interest on this much larger sum.

8. If we take no further measures, the index of real net farm income for 1979 will fall to about 70. That would be 18% lower than 1978 (the worst of the Labour years), which in turn was 18% lower than 1977.

9. The prospects for 1980, if nothing is done, are far worse. Farming costs generally will probably increase by 11% (assuming a relatively small increase in feed costs).* If we assume a static volume of production - which in these circumstances may be optimistic and no green £ devaluation, no change in retail milk prices and of course no common price increases, then the index of real net farm income would fall to around 50. It would have been halved in our first two years of office, and more than halved from the level (123) at which we left it in 1973. Simply to bring it up to the level in the worst Labour year (1978) would need a green £ devaluation of 12% (assuming sterling's exchange rate against the ECU made this possible) <u>and</u> and increase in the retail milk price of 2½p per pint.

<u>The Sectors</u>

10. The profitability of most commodities is being squeezed, but the livestock sector - representing about two-thirds of our farm production and an even larger proportion of our farmers - is in general being hit harder than the arable. The worst areas of immediate difficulty are <u>milk</u> and <u>hill sheep</u>.

* For other main cost items increases of about 15% have been assumed.

If we do not increase the retail price of milk or devalue the green £, real net margins per dairy cow in 1979/80 will be 28% down on 1978/79. After the losses of a hard winter, hill sheep farmers are now getting lower prices for store lambs, even in money terms, than last year and hill farm incomes this year are likely to have fallen by 35-40%.

The Competition

11. Under the CAP our farmers have to get their return from the market, in direct competition with producers in other Community countries. Our farmers are still in general more efficient than theirs. But theirs are improving fast, with the aid of massive assistance from their Governments.

French agricultural output is 2½ ours in value terms

12. Other member countries not only pay their producers more (the table at Annex 1 shows how prices compare) but also spend far more than we do, relative to the size of their industries, on national aids. The French agricultural budget this year is £2.5bn and in 1980 will be £2.9bn, including £585m (£125m more than my Department's entire budget of £460m!) on subsidised credit alone. (The table at Annex 2 shows how our farmers are already disadvantaged by the much higher rates of interest obtaining here. If we were to subsidise them down to the subsidised level in France and Germany the Exchequer cost would be £300m). The German Federal budget for agriculture was nearly £1650m in 1979, and the Lander Governments add large aids of their own (over £300m each in Bavaria and Westphalia). The Dutch have introduced investment aids through tax allowances, including large handouts to farmers who pay little or no tax. Irish farmers still pay very little tax (£7m in income tax from the entire industry in 1977). Every other member country looks greedily at the British market and will seize any opportunity of increased sales here that we are foolish enough to offer.

The Treasury's Proposals

13. Against this background - declining real income, shrinking profitability, heavy borrowing, falling investment and heavily and increasingly subsidised competition - what do the Treasury propose? They propose that public expenditure on agriculture should be reduced by 18% in 1981/2, 24% the year after and 25% the year after that. They propose:-

(i) to cut capital investment grant rates by 50%;

(ii) to cut hill farm subsidies by 20%;

(iii) to slash research programmes and advisory services (when other countries are extending theirs);

(iv) to withdraw all support for sheep and potatoes; and

(v) to hold down the retail price of milk.

And all this is intended to improve the supply side of the economy!

14. Already I have turned down the farmers' demands for an immediate green £ devaluation. My announcement this week of no increase in the milk price will be very badly received, and when I announce next month the ending of the beef premium scheme (to save administrative costs) this will be a further shock to confidence. If on top of all this I were to agree to the cuts that the Treasury want (and to the staff cuts that the Lord President has proposed), then I believe we would produce the biggest crisis of confidence in British agriculture since the war.

15. Confidence in our agricultural policies has already been shaken by the temporary rise of sterling in August to the point where no further green £ devaluation could have been made, even if we had wanted one. Because of sterling's oil-sustained

strength, the industry are no longer convinced that we shall be able to give them the resources they need through green £ devaluation. To take away part of the direct assistance now available from Government would leave us with no credible policy at all.

The Right Strategy

16. The right strategy for agriculture is the reverse of what the Treasury propose. I do not wish to pre-empt the review of agriculture which we have now agreed to carry out. But in my view the measures we shall need to take will include:-

(i) A further devaluation of the green £. This would help restore confidence in this, the main instrument of our agricultural policy. There are strong arguments for doing it before Christmas, thus leaving us free to take the hardest possible line on common prices in next year's crucial CAP price fixing;

(ii) an increase in capital grants through the introduction of the streamlined system Derek Rayner is proposing, at rates of grant higher on average than those under the present cumbersome scheme and with provision for doing more in fields such as marketing and sheep housing;

(iii) substantial increases in the hill livestock allowances (we pay far less than the maxima allowed under the Community scheme, to which Community funds contribute); and

(iv) an increase at the appropriate time in the retail price of milk.

17. Measures on these lines would not merely show that we were keeping faith with the policies we promised in Opposition: they would also encourage British agriculture to make the increasing contribution to the nation's wealth of which it is fully capable.

17 October 1979

FILE

~~Copy also~~ to PPS
Michael Franklin (C.O.)
Ms.
PL
19/10

10 DOWNING STREET

From the Private Secretary

SIR KENNETH BERRILL

CABINET OFFICE

The Prime Minister has received, on a personal basis, the enclosed paper from the Minister of Agriculture. She has asked me to show it to you, also on a personal basis, so that it can be taken into account in the Agricultural Review which you are undertaking. For obvious reasons, she has asked that it should not be circulated to the Review Group.

T. P. LANKESTER

18 October 1979

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