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E(80)35

14 April 1980

COPY NO 56

CABINET
MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

ENERGY AID TO THE HORTICULTURAL AND
FISHING INDUSTRIES

Note by the Central Policy Review Staff

Introduction

1. Ministers have before them the Minister of Agriculture's letter of 21 March which contains proposals for special assistance to the 'protected' sector of the horticultural industry (i.e. the glasshouse industry producing mainly tomatoes, cucumbers, mushrooms) and to the fishing industry. The Prime Minister asked officials to consider the background to the proposals, and this note by the CPRS has been prepared after consultation with other Departments.

Background to the industries

2. The two industries together produce less than one-tenth of the total output of the agriculture, forestry and fishing sector (itself some 3 per cent of GDP). In 1979 the total output of protected edible crops was £150m., with tomatoes and mushrooms at around £50m. each the largest single crops. The value of landings of fish by British vessels was £215m.

3. The United Kingdom glasshouse industry employs about 20,000 full and part-time workers (out of some 349,000 workers in agriculture as a whole - excluding 293,000 farmers and owners). In 1978, 16,500 fishermen were regularly employed and 5,700 partly employed.

4. The production area of the glasshouse industry has been unchanged for a number of years but output has been rising steadily. For example, taking the annual output of tomatoes between 1968 and 1970 as 100, output had risen to 120 by 1975 and 131 by 1979. Over the same period home production has increased as a proportion of total supplies from about 30 per cent to over 40 per cent; imports from the Channel Islands and Third Countries have fallen; imports from the rest of the EC (some 19 per cent of

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total supplies in 1979) also fell during the mid-seventies but have risen sharply (by 27 per cent) between 1978 and 1979.

5. The value of imports of fresh, chilled and frozen fish has risen in current price terms by 85 per cent since 1977. 39 per cent of imports came from the EC, 47 per cent from EFTA, and the remainder from Third Countries; over the period 1977/79 there has been some shift towards an increased EC share of imports. Landings in the United Kingdom by British vessels have been declining through the seventies and the 1979 value was $4\frac{1}{2}$ per cent below the 1977 value, in spite of inflation.

6. Energy is an important input in both industries. But more so in the glasshouse industry where fuel costs are estimated now to constitute over 40 per cent of operating costs, than in fishing, where fuel costs represent a maximum of a quarter of the total costs of running a fishing vessel. The amount of fuel used in fishing depends among other things on the weather and the time and distance travelled to take a catch. The major fuels used in the protected crops sector are diesel and heavy fuel oil. In the 12 months to mid-January 1980 the United Kingdom price net of duties and taxes rose by 70 per cent and 65 per cent respectively. Although these industries are major users of energy there are many other industries which are even more energy-intensive.

7. Inflation, and in particular the increase in fuel costs, has had a major effect on the profitability of the 'protected' horticultural sector in the last four years. In the period 1975 to 1978 market prices, which are set largely by supply and demand rather than by a system of support, offset most of the cost increases, but 1979 was substantially less profitable, particularly for tomatoes, where there was a slump in prices due to an over-supply in the high season.

8. There are no reliable figures for the profitability of the fishing fleet as a whole. However, in March 1979 the British Fishing Federation, which represents mainly the deep sea fleet, forecast that in 1979 its members would lose a total of almost £2m. even before allowing for depreciation. (The turnover of the fleet was some £60m.) Since this forecast was made, all costs including fuel have risen considerably, while at the beginning of 1980 market prices were below 1979 levels for species like cod and haddock.

9. The problems of the United Kingdom fishing industry go wider than the cost of energy. Our reduced access to traditional fishing grounds as a result of the extension of the fishing limits of Norway and Iceland is

already being reflected in a substantial reduction in the numbers of deep sea vessels. The effect of catch restrictions on some of the main commercial species has been to make it harder for some vessels to pay their way. Depletion controls can involve vessels in increased effort and so greater energy consumption, while unrestricted species are generally of low value. Other Governments have conservation policies, but the United Kingdom industry contends that these are not effectively applied. Thus they suggest that while United Kingdom catches are restricted and imports are freely available, they have no scope for increasing output and the only way of reducing the loss would be to cut costs.

10. It can be argued that the United Kingdom fleet, and most clearly the deep sea part, is still too big. But since the same is true of the fleets of other Member States, the problem of restructuring the various fleets will need to be tackled in the light of a Common Fisheries Policy (CFP) settlement.

11. To summarise: both these industries face increasing import penetration from Europe, though the effect on the United Kingdom industry has been much more severe for fishing than for horticulture, and mainly for reasons other than a differential energy price advantage. Profitability of both industries has clearly been affected by high energy costs, though this is not a problem peculiar to these industries. The effects of high interest and exchange rates have also been felt in other parts of British industry. The particular problem identified by the Minister of Agriculture is the competition the two industries face from competitors in some other EC countries who can obtain either cheap or subsidised energy. Again, it is plainly not the case that these two industries are the only ones facing such competition.

Measures of assistance

12. In the United Kingdom special Government assistance is already available for both industries. For horticulture these measures include capital grants (for both building and plant), tax allowances on investment, and full repayment of excise duty on oil used for heating or soil sterilisation. VAT does not apply to fuel oil used on farms. For fishing the assistance (£14m. in 1979/80) includes grants and loans for vessel construction and improvement and to the processing industry, aid for exploration voyages, grants to producer organisations, tax allowances on investment, and the rebate of fuel duty. The short term aid measures announced on 13 March will put an extra £3m. into the fishing industry between now and the end of September.

13. The fishing industry is also assisted by systems of price support run both by the EC and by producer organisations. The EC scheme provides for purchase of fish for the industrial market (fishmeal, pet food) whereas the producer organisations are empowered to maintain autonomously determined withdrawal prices for any species. In practice neither scheme is of great benefit to the industry since the prices set tend to be well below those which would provide an economic return.

14. The United Kingdom's existing support for protected horticultural crops and fishing is closely paralleled by the measures taken by other EC members. All Member States have systems of aid for investment through a combination of tax allowances, capital grants and credit subsidies which, though differing widely in form, have broadly similar effects. They also apply favourable regimes with respect to excise duties on fuel and, with the exception of Denmark, in relation to VAT. In addition, however, as pointed out by the Minister of Agriculture, some of this country's EC competitors operate regimes which temper fuel costs for horticulture and fisheries.

15. In Holland the glasshouse industry, like the rest of Dutch industry, obtains supplies of natural gas at well below the equivalent price of a gallon of fuel oil, i.e. 24p. compared with the 37p. United Kingdom growers pay for fuel oil and the 60p. they pay for diesel oil. (90 per cent of the fuel used for glasshouse heating in the United Kingdom is oil.) This is not a specific subsidy, but it does act to worsen the competitive position of the United Kingdom growers. There is some indication that the Dutch Government is itself becoming concerned about the cheapness of natural gas, and they are committed in principle to bringing their gas prices into line with oil prices. Indeed, they worked to narrow the gap between 1977 and early 1979. However, with the sharp increase in the price of oil last year, the gap has reopened. There is some scepticism in other Member States whether the Dutch are wholehearted in their attempt to re-establish parity.

16. Denmark, Germany and the United Kingdom have all expressed strongly in the Agricultural Council of Ministers the view that the Dutch gas prices have introduced considerable bias into the competitive environments of Member States' horticulture industries. The German Government has responded to complaints from their growers about the effects of Dutch competition, by introducing a 'one-off adaptation aid' for 1980 of approximately £13.5m. to

enable the glasshouse industry to 'finance its light heating oil purchases for one year without the strain of additional interest payments'.

17. The EC Commission have approved the German aid, and in doing so have informed Member States of the criteria against which it was considered and which will be applied should similar schemes be under consideration. These are -

- (a) the purpose of any measure should be to enable horticulturists to adjust to the new energy market situation, to stay in business meanwhile and to convert to less costly forms of energy;
- (b) the measure should fit in with other structural measures for conversion to alternative heating systems determined at national or regional level; and
- (c) the aid is granted for one year only and its level does not exceed 30 per cent of the increase in pre-tax prices for the heating oils in question between January 1978 and January 1980.

The Commission have also promised the Council a report on Member States' aids to horticulture and comparative energy costs. This is not, however, expected to affect their attitude to new adaptation measures which are consistent with their criteria.

18. Since the circulation of the Commission's guidelines the French Government have announced the allocation of about £4.75m. to assist investment in energy saving equipment by their glasshouse industry.

19. A number of EC countries, including the United Kingdom, give operational subsidies to the fishing industry. But in two cases only are they based on fuel costs. Thus France pays an aid ostensibly to maintain employment in the fishing industry, but ties the aid to fuel consumption, which it is argued is an effective index of a vessel's activity. Actual rates vary but the effect on average is a subsidy equivalent to 10/15 per cent of fuel costs. The Italians pay an operating subsidy based on fuel costs to all Sicilian fishermen; information on the effective rates is not available. In addition, the Germans are known to be considering the extension to their fishing industry of their horticultural adaptation aid. Canadian fishermen are also said to receive a subsidy which means that they can buy fuel at approximately half the world market price.

Possible UK measures

20. From the foregoing it can be seen that in two EC countries (Holland and Germany) horticulture receives some energy cost relief. At present only France gives a significant energy subsidy to the fishing industry. In response to the Minister of Agriculture's preferred proposal would bring the cost of the heavy fuel oil mainly used by UK glasshouse growers into line with the current price of gas to Dutch growers and effect an equivalent reduction in the price of gas diesel oil, for as long as the present price imbalance remained. He proposes to extend the same relief to the fishing industry. It would mean a reduction of about 12½% in the costs of the protected crops sector and of a maximum of 7½% in those of the fishing industry. The Minister's alternative proposal would meet 15% of the cost of operators' 1979 fuel usage for the financial year 1980-81. It would reduce the costs of the protected crops sector by about 6% and those of the fishing industry by a maximum of 4%. The mechanics of the two schemes are outlined in the Annex.

21. Both proposals would have to be notified to the EC Commission and, so far as their application to horticulture is concerned, justified against the Commission's criteria. The preferred proposal could be presented as compatible with the first criterion since its purpose would be to enable operators to remain in business and to give them time to adapt to the changed energy market. MAFF suggest that it would also conform to the second criterion, since it would not conflict with existing UK measures to encourage energy conservation, but this view is open to some doubt. It would not, however, be consistent with the third criterion if prices to these sectors were held down for more than a year; and the rate would exceed the specified 30% of the 1978-80 price increase for the oils in question. The Minister's alternative proposal has been tailored to fit the guidelines, and should therefore encounter no problems with the Commission.

Implications of the proposals for the rest of industry

22. If the energy costs of the protected horticultural industry and the fishing industry were to be subsidised, then representatives of the other major users of oil within manufacturing industry would be likely to waste no time in asking the Government for similar assistance for their own oil or feedstock costs, even though the arguments will of course vary in detail from case to case. It is clear from the limited consultations that have been possible in the time available that the most vulnerable oil users show very poor or no profitability and that they also face increasing pressure from imports.

23. Major users of oil within manufacturing industry can be roughly split into two sections; those who are high energy users eg iron and steel, paper, glass, pottery manufacturers etc; and those who also use large quantities of oil-based

feedstocks or raw materials, namely synthetic and certain other man-made fibres, plastics, and petrochemicals manufacturers. Most of these major users have at some time or another sought to make a case for cheaper or subsidised oil or feedstock costs; and in the case of man-made fibre producers the case has been largely based on the artificial advantages enjoyed by their American competitors as a result of US Government controls on the price of oil and natural gas. As early as 1976-77, the man-made fibres manufacturers argued that in the absence of a change in American energy policy North Sea Oil should be priced below world prices to compensate for the artificial advantages enjoyed by the Americans. Since then the problem has become more acute. The steel industry sought unsuccessfully to persuade Customs and Excise that their use of fuel oil in blast furnaces was as a chemical reducing agent rather than a fuel and this should be exempt from the excise duty imposed on fuel oil as a conservation and competitive measure.

Implications of the proposals for energy policy in general

24. The proposed fuel subsidies would directly contradict a central strand of the Government's energy policy. That is to move towards fully economic energy pricing for all fuels based on the long-term cost of providing additional supplies. This policy is designed inter alia to lead to increased conservation and to encourage companies and individuals to make sensible energy choices. The days of cheap energy are over. Prices must give accurate signals about the future costs of supply so as to ensure the best allocation of scarce energy resources and to encourage the development of new methods of utilising and saving energy. As was fully realized when the decisions were taken they will inevitably add to industrial costs and will almost certainly give rise to pleas for subsidies from a number of industries affected.

Implications for public expenditure

25. No PESC provision for the cost has been made, and no scope exists for offsetting savings elsewhere in the Agricultural Departments' Votes. Finance would therefore have to be provided from the Contingency Reserve. The cost would be £12m for horticulture and £13m for fishing on the Minister's preferred scheme; and half these for his alternative scheme.

Implications for current EC negotiations

26. If it were decided to adopt either of the Minister of Agriculture's proposals there would be no obviously adverse effects on our negotiations with EC partners about the Budget, the CAP, or the Common Fisheries Policy (CFP). The Minister's preferred proposal is, however, not consistent with the Commission's guidelines, so if it were adopted it would be desirable to give the Commission pre-notification. A fuel subsidy for the fishing industry would improve the

competitive position of the UK fleet but it would be a matter of domestic policy to which the EC would not object if we chose further to sustain the fishing industry during the course of negotiations about the CFP.

Possible alternatives to a subsidy

27. There are two possible alternative courses of action. First, it would be open to the UK to press the Dutch Government to move more quickly to achieve their stated objective of achieving approximate parity in oil and gas prices, at the same time pressing the Commission not to extend for a further year the guidelines under which other countries are providing energy subsidies. (But it is not at all clear that gas prices are in any way "unfair" in terms of the Treaty of Rome.)

28. Secondly, there is in principle the alternative of protecting these industries by a system of import quotas. But international obligations make it impossible for the UK to introduce quotas against either EC countries or countries with whom we have special trading arrangements. These two industries already receive some protection against foreign competition (eg from Eastern Europe in the case of horticulture).

Issues for Consideration

29. In the light of the foregoing it is suggested that Ministers may wish to bear in mind the following points when considering the Minister of Agriculture's proposal:-

(i) The Government's basic economic policy is that industries should, as far as possible, face economic realities and be sheltered as little as possible by favourable interventions such as subsidies, and then only when the effect on the industrial base or the social consequences of not intervening would be unacceptable.

(ii) The 'consequence of failing to intervene' is the only sensible test of the need to do so. Whether the need arises from 'unfair' action by competitor countries or from other causes is not relevant to the question of whether or not intervention is desirable. However, it is relevant to the question of whether intervention could be justified to other countries if it is decided to pursue it.

(iii) The Government's energy policy includes moving towards fully economic energy pricing for all fuels based on the long term cost of providing additional supplies. As in (i) above, this principle should only be breached if the social or industrial consequences of not doing so are unacceptable.

(iv) The prime test therefore of whether to introduce some additional subsidy towards the energy costs of either horticulture or fishing lies in assessing the consequences of failing to do so. The relevant questions are:

- (a) will the absence of an additional subsidy permanently damage the industry and, if so, to what extent?
- (b) If there is likely to be significant permanent damage, will that be of a size and nature that matters in terms of Britain's total social and industrial situation?

In determining (b), it is necessary to consider:

- (c) the cost of the subsidy, and within the concept of a fixed total of public expenditure the sort of project that will have to be sacrificed to make way for it.
- (d) The nature and extent of other claims for which this may be regarded as a precedent, and its importance and priority compared with such other claims.

(v) Horticulture and fishing probably need to be considered separately against the above criteria. If in either or both instances an energy cost subsidy appears justified, it will be necessary to consider whether it should be on the lines of the Minister of Agriculture's preferred option (effective competition with the Dutch on energy costs) which may cause problems with the EC Commission, or his alternative proposal (costing about half as much) which would follow the EC Commission guidelines. It may also be relevant to consider whether the scale of assistance with the second alternative would be sufficient significantly to assist the problems and to justify an exception to basic policies.

CPRS VIEW

30. The view of the CPRS is that in the present instances, although there is clear evidence that the horticulture and fishing industries will be meeting stiff competition from their opposite numbers in some other EC countries, the extent and consequences of any disadvantage (e.g. reduction in long term capacity, additional numbers unemployed and other social and industrial effects) has not yet been demonstrated sufficiently to justify an exception to the fundamental economic and energy policies. (Both industries are, of course, already extensively subsidised.) If this view is correct, Government emphasis should be on persuading other countries and the EC Commission not to extend their subsidies but to eliminate them and cheap energy prices as soon as possible. Realistic costing if universally applied need do no harm to an international industry, and is less inflationary than apparently lower energy costs and product prices achieved through subsidies. (However, the long term structural problems of the fishing industry which are not the result of the price of energy, might still remain.)

Cabinet Office
14 April 1980

ANNEX

HOW WOULD THE SCHEMES OPERATE?

1. The Ministry of Agriculture envisage that arrangements for the preferred scheme might take the form of issuing tokens to eligible operators equivalent in value to 12 pence per gallon of their certified fuel bills for 1979 which could be used in the purchase of fuels and redeemed from the oil companies by the Ministry. Some might prefer to improve their cash flow more quickly by trading the tokens with other operators, and this would not be inconsistent with the objectives of the scheme. Tokens would be issued to all horticulturalists and those fishermen who claim the rebate of fuel excise duty from Customs and Excise; alternative means would need to be devised to identify those fishermen who at present purchase their fuel duty free.
2. The Ministry of Agriculture see the alternative scheme as being paid in the same way as the previous fuel oil subsidy to the protected crops sector in 1974; horticulturalists and fishermen reclaiming fuel excise duty would forward a second claim form to Customs and Excise supplied by local Ministry offices, which would be certified by Customs and passed to the Ministry for payment. As in the case of the first proposal, special arrangements might be necessary for fishermen who do not at present apply for duty repayment.
3. Powers to pay a subsidy to the fisheries industry exist in section 49 of the Sea Fishing Act 1970, but since no parallel powers exist in relation to agriculture and horticulture, payments to the protected crops sector would have to be made under the authority of the Appropriation Act.