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

From the Minister

The Rt Hon Lord Carrington PC KCMG MC
Secretary of State for Foreign and
Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
London SW1A 2AL

12 February 1981

(2)

Prime Minister

Expressing

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Rmt

[Handwritten signature]

EXPORTS OF FLOUR TO THE USSR

You may wish to be aware of the reports that flour millers in the Community are converting US wheat into flour and exporting it to the USSR, in order to circumvent the embargo. I enclose two extracts from the Public Ledger. These confirm rumours which my officials have picked up in Brussels recently. You will see that there is no suggestion that any of the milling is taking place in the UK.

The operation is clearly being carried out under the "inward processing arrangements", which allow raw materials to be imported free of levies and other charges from third countries on condition that an equivalent amount of processed goods is exported to third countries. There is thus no question of a Community subsidy being granted as there would be if Community raw materials were involved.

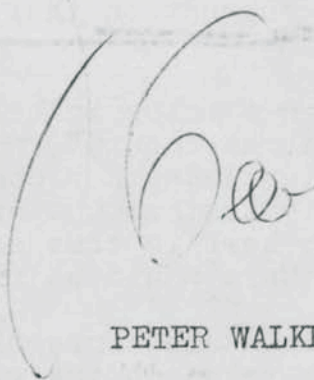
If US officials are correctly reported, they are resigned to no action being taken on the grounds that the processing takes place outside Community jurisdiction. This is not strictly correct. The conditions for inward processing are laid down in a Community Directive and it appears from this that Member States may authorise it or not, as they think fit. There is also a provision in the CAP regimes, including that for cereals, permitting the Council to prohibit, in whole or in part, the use of inward processing to the extent necessary for the proper working of the common organisation of the market.

The Community's policy on food exports to Russia following the invasion of Afghanistan has been laid down by the Foreign Affairs Council, and if you consider that something should be done about this new development, the only possibility would be to get that Council to look at it. Certainly we should get nowhere in the Agriculture Council.

/Even if you decide ...

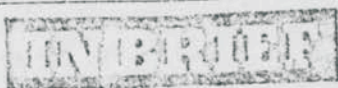
Even if you decide to bring the matter up in the Foreign Affairs Council, the prospects are poor, especially at a time when President Reagan is known to be considering the future of the embargo. We could not claim that the Community was subsidising the exports; and it would be argued that they did not fall within the scope of the original Council resolution since the flour, being made from US wheat, could not be called a Community product. It could also be pointed out that a restriction on inward processing in this case would not be necessitated by "the proper working of the common organisation of the market" and would therefore be outside the terms of the provision I have referred to above.

I am sending copies of this letter to the Prime Minister, members of OD(E) and Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to read 'Peter Walker', is written over a large, faint circular stamp or watermark. The signature is fluid and cursive.

PETER WALKER

No. 68,456



**-MID EAST LINER
TRADE GROWS**

Page 6

**US denies
knowledge of
EEC/Soviet
flour sales**

US Agriculture Department officials denied having any knowledge of European millers' sales to the Soviet Union of 700,000 tonnes of flour made from 1 mln tonnes of imported US hard wheat. They were commenting on news reports from Paris quoting French trade sources that the sales are being made with the knowledge of the US and the EEC Commission (see PL 3/2/81).

If the sales are taking place, the USDA officials said, the wheat is being processed into flour at 'in-bond or customs-free' areas located near the ports.

These customs-free areas are outside the jurisdiction of the EEC and thus make it difficult, if not impossible, for the Common Market to restrict the flour sales, in line with EEC support for a partial embargo on shipments to the Soviet Union, they said.

"We do not welcome the sales in the least," one USDA official said, adding that the US still stands by the partial grain embargo.

They reasoned that the flour sales appear to be another loophole in the embargo being exploited by the Soviets. They cited the widespread rumours last summer that EEC crushers were buying US beans and then shipping the meal to the USSR.

The officials also expressed surprise that the Soviet Union would need as much as 700,000 tonnes of flour, especially since the Soviet wheat crop last year was sufficient to meet domestic needs.

151

GRAINS and OILCAKES

European millers selling flour to USSR

LONDON, February 2.—French trade sources report that millers in Europe are currently working on contracts to provide the USSR with more than 700,000 tonnes of flour made from 1 mln tonnes of imported US wheat. The US and the EEC Commission are apparently both aware of the sales which, sources said, do not directly infringe the embargo on sales to the Soviets.

The US is happy to sell its wheat to European millers although Community wheat exporters would prefer Commission rebates on EEC flour sales, allowing their own wheat to be used instead, the sources said.

This system of importing US wheat and exporting flour is known as "improved perfection traffic" and the trade avoids EEC import/export duties because the nature of the product changes.

West Germany is where most of the milling is done although Italy, the Netherlands and Belgium are also involved.



172 FEB 1984

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