PRIME MINISTER 5 February 1986

FUTURE OF THE COMMON AGRICULTURAL POLICY

We have not sorted out our approach to CAP reform:

1. We favour price reductions ("restraint") but our European partners won't accept them; they might (just) settle for a price freeze.

2. The Commission is proposing a price freeze, plus co-responsibility levies, ie a contribution from farmers for each tonne sold off the farm, with exemptions for small farms, to help pay for disposing of stocks. MAFF object to levies because:

   a. They attack the problem from the supply side only; they don't help to get rid of surpluses by offering the consumer lower prices.

   b. Small farms would be exempted from the levies; this favours our partners' agriculture because they have proportionately more - in some cases very much more - small farms than we have. Conversely, levies would penalise us for having a more efficiently-structured agriculture.

3. It is unlikely that the Commission's proposals will solve the CAP problem.

The CAP is an economic time-bomb, as the attached table shows, using the cereals régime as an illustration. Option I - carrying on as we have been, increasing prices by 2½% a year - is the most explosive of all. Stocks increase sixfold, to 130 mt, by 1991, reaching 280 mt (double the current level of production) by 1995.

Option II - a nominal price freeze - is probably the most severe across-the-board price reduction which would be politically acceptable to all. Stocks still rocket, to 100 mt by 1991. Even a drastic price reduction, of 15% in 1986 (Option III) will fail to prevent production and stocks from rising. However, it would reduce support costs by 1991 - the only option which achieves this. Option IV is a variant of II, is preferred by the Commission, and asks farmers to pay a levy on sales of their farms to cover export costs. Stocks will still quadruple by 1991. The only option which reduces production, and eventually stocks, is quotas (Option V), although costs still rise under this option, partly because farmers would be "compensated" for their loss of output by price increases.

Most Likely Outcome

Cereals, and some other products too, will probably be subjected to quotas within 5 years. Continental Governments, elected on the basis of proportional representation, haven't the nerve to go for Option III; so the Community will go for Option IV, price freeze plus the levy. This will fail to restrain production, finally driving the Community into adopting quotas. Indeed, the inevitability of quotas may itself frustrate all half-hearted price-restraint options. Farmers will produce more (and in some cases, already do) in anticipation of quotas, since quotas would be allocated on the basis of recent production levels.

Merits and Drawbacks of Quotas

Does this matter? Philosophically, it would be a matter for regret that large parts of an industry pass out of the market economy and into an administered system, in which entry will be almost impossible; changes in output and in land use will be matters for bureaucratic decision; the displacement of less efficient and dynamic farmers by more efficient farmers will be limited. The industry will undoubtedly become less efficient than it could be, and possibly than it currently is.

If the choice lies between an efficient agriculture which bankrupts the Community, or a less efficient, but less expensive system, the latter may be preferable. Efficiency in agriculture has lost much of its value, in so far as the industry produces unwanted surpluses. Quotas actually suit existing farmers pretty well, once their teething problems have been resolved. The dairy industry is learning to love its quotas. Because the Community will not dare to dismantle quotas, once they are in place, they confer a kind of property right on the farmer. Quotas can periodically be sold off, either to national Governments, or to the Commission, when "outgoers" schemes are devised to reduce production. Quotas also guarantee the preservation of the geographical pattern of agriculture, which is of concern to the environment lobby and to those who wish to see rural communities preserved. They would, for example, preserve agriculture in those lowland areas of low grade land, mainly to the West of the country, which would be threatened by substantial price reductions.

The drawback of quotas is that they will, in time, push up food prices in real terms; Europeans would pay even more as consumers, on top of their payments as taxpayers, to support the CAP. Farmers will demand that their real incomes rise not too far behind those of the rest of the economy. But because they would be under reduced pressure to improve their efficiency, and volume would be controlled, higher food prices would be the main way to increase farmers' real incomes. Rising real food prices would be a new and politically explosive factor.

UK Attitudes

MAFF's stance of price restraint, without exemptions to small farms, is logical and correct. It is also good domestic politics: why should our agriculture be penalised for being efficient? Unfortunately, this stance excludes us from serious consideration by all other member countries. Drastic price reductions will never be politically acceptable without tempering their effects on the small, and often geographically disadvantaged family farm.

Income aids to small farms, along with drastic price cuts, were proposed late last year by the Commission in a Green Paper ("Perspectives on the CAP") as one solution to this problem. The UK opposed them on grounds of discrimination and administrative complexity. Our opposition was not decisive. German farmers, along with our own, resent the idea of being explicitly subsidised as "park keepers". Co-responsibility levies, with exemptions for smaller farms, are conceptually very similar to income aids and we are opposing these, too.

Conclusion

In 1986, we may well be outvoted and have to accept co-responsibility levies on the basis proposed by the Commission.

But over the next few years, our choices are difficult: recognising continental opposition to large, across-the-board price reductions (of 15-20% or so):

1. either we may have to accept some measure of discrimination against British farmers, by virtue of the above-average size of their holdings, in order to secure price reductions which are large enough to restrain output; or

2. we must anticipate, even if we cannot propose ourselves, or even mention, the adoption of quotas on cereals and some other sectors.

If we feel we can opt for the former, we should propose that the Community develops a policy for the smaller farm, partly to be financed nationally, as a social measure. We should try to minimise discrimination against British farming by arguing that member states should be given discretion to look after their small farmers. "Small" farms could then be defined in relation to the national average sizes of farm holdings in each member state, rather than according to a universal community formula. After all, a 100 acre farm in Cardigan is as important to the local economy as a 10 acre farm in Central France.

If we decide that quotas are inevitable, we should urge that they be adopted soon in order to prevent stocks mounting further. We should try to ensure that they assume a form which provides both for a) some flexibility between producers and b) quotas' gradual liquidation, because production, even under quotas, will still substantially exceed demand. A Policy Unit idea which combines both these features is a transferable quota which is partially surrendered upon transfer, ie farmers can sell their quotas on the open market but would surrender, say, 25% of the quota whenever they are transferred. In this way, market forces could be harnessed to reduce surpluses.

An alternative idea, proposed by the NFU, is annual quotas, plus set-aside. Farmers put in bids for quotas before each marketing year. Quotas would be allocated as a percentage of all farmers' bids. Land for which a quota is sought, but which doesn't receive one, must be set aside, ie to fallow, for a year. Farmers might be compensated for fallowed land. It would be cheaper than intervention buying.

You may wish to discuss these ideas with Michael Jopling. If we don't prepare the ground for our own ideas long in advance, we will end up having to accept those of other people.

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Euro Pol: CAP pt 13.