Prime Minister.

CONFIDENTIAL I thought you might welcome an explanatory note on MCA's.

AR 2/3.

Qz.03615

MR COLES

Monetary compensatory amounts

Under the Community's agricultural arrangements the farmers' support and other institutional prices are fixed in ecu and converted into national currencies by using "green rates". If all green rates were in line with commercial exchange rates, there would be a common market and no problem. Where, however, a member state's green rate is either overvalued or undervalued by comparison with its commercial rate of exchange, there would be speculative and artificial flows of trade in agricultural products across frontiers unless there were a compensatory system at the border. This system consists of positive monetary compensatory amounts (charges on imports, subsidies on exports) or negative monetary compensatory amounts (subsidies on imports, charges on exports). A member state such as Germany with a positive compensatory amount is holding its farmers' support prices in national currency above the Community level; hence the abolition of a positive mca would mean a fall in farmers' support prices in national currency. A member state such as France with a negative compensatory amount is holding its farmers' support prices in national currency below the Community level; hence the abolition of a negative mca would mean an increase in farmers' support prices in national currency in the member state in question. The French invented this system and are now regretting it.

2. The Community has had very great difficulty in dismantling positive mcas because they involve a price reduction for farmers in national currency. The present positive mcas

/for

for most agricultural products are -

Germany	+ 9.8%	(fixed)
Netherlands	+ 5.8%	(fixed)
Denmark	+ 1.0%	(fixed)
United Kingdom	+ 6.2%	(variable)

President Mitterrand will no doubt say again at his meeting with the Prime Minister on 5 March that significant movement by Germany on the removal of positive mcas is an essential element of the post-Stuttgart package for France; that the latest German suggestions made by Chancellor Kohl to him on 24 February are a good step forward; and that he has not yet finally decided whether France can agree to them. The latest German suggestion which is more fully described in the attached note by the Ministry of Agriculture, Fisheries and Food, comprises four elements:-

(i) 3 percentage points of the existing German mca would be removed in the agricultural price package by adjusting the value of the agricultural ecu. This would result in an equivalent increase in negative mcas for the member states with weaker currencies. The elimination in due course of these newly created percentage points of negative mca would lift farmers' support prices in national currency in those countries (which include large agricultural producers such as France and Italy) with some consequential effect on production and on the Community's budget cost;

(ii) 5 percentage points of the existing German mca would be removed by simply reducing German farmers' prices in national currency and compensating them from the German national Treasury (eg by adjusting the application of VAT to farmers). This would not lift support prices elsewhere in the Community. The timing of this proposed change is not certain; it might take place or begin to take place on 1 January 1985. It could not be introduced immediately, as the Germans say that it would need national legislation;

/(iii)

(iii) the remaining percentage points of the existing German mca would be phased out under the existing gentleman's agreement;

(iv) if there were further currency realignments in the Community, positive mcas would be avoided by adjustment of the agricultural ecu, so that only negative mcas were created (the so-called "link with the strongest currency"). This would solve the political problem but would have the same economic disadvantages as point (i).

3. The latest German ideas are better than some of the earlier suggestions, because a bigger element of German positive mca is being phased out without affecting support prices elsewhere in the Community. Nonetheless, it is strongly recommended that the Prime Minister should continue to object and to assert our own interest in this matter, because -

(i) the French desperately want an mca settlement and should be made to pay dearly for it;

(ii) we need to protect our own position on our variable mcas and on other elements in the agricultural package.

4. I am sending copies to Roger Bone (FCO), John Kerr (Treasury), Ivor Llewelyn (MAFF) and to Sir Robert Armstrong.

DF Williamson

D F WILLIAMSON

2 March 1984

MONETARY COMPENSATORY AMOUNTS (MCSs)

Background

1. Institutional support prices under the CAP are set at a common level in European currency units (ecus) and converted to national currency prices using "green" rates of exchange which may differ from the market or central rate. When these green rates do so differ, the levels of CAP prices will be different in real terms in that member state from the "real" common price. MCAs are applied to trade involving that member state to avoid distortions in trade. When a green rate is undervalued, prices are above the common level and "positive" MCAs are applied as a subsidy on exports and as a charge on imports. For countries with overvalued "green" rates negative MCAs apply in the reverse way.

2. The French have made the elimination of a reduction in MCAs, and especially the German positive MCA, a major objective in the post-Stuttgart discussions. The Commission are also committed to seeking to phase out as quickly as possible the MCA system in order to restore the single market. Most member states accept that a commitment on reducing MCAs will need to be part of the post-Stuttgart settlement. The Commission put forward a proposal under which existing and new MCAs (the latter resulting from future EMS alignments) would be phased out automatically over two price fixings. This has never been acceptable to the Germans who are refusing to accept any commitment to reduce German farmers' price support levels in DM terms.

German proposal

3. The Germans have put forward their own counter-proposal which would involve the removal of their existing MCA in three stages. The first step at this year's price fixing would be a reduction in all positive MCAs by 3 percentage points with an equivalent increase in negative MCAs. This would be achieved by revaluing the European Currency Unit (ECU) for CAP purposes, and thus creating a Green ECU. The second stage would involve a green mark revaluation on 1 January 1985 to produce a 5 percentage point reduction in German MCAs. The adverse effect on German farmers' incomes would be offset through the German VAT system. The Germans have indicated that this would involve reducing VAT charged to the farming industry by 2 billion German marks per annum for an indefinite period and that they would be looking for some contribution from the Community budget. The third stage would involve further green rate revaluations over subsequent years with the proviso that German support prices were not reduced in DM terms. The Germans envisage new positive MCAs would be avoided by basing farm prices at future EMS realignments on the strongest currency. The effect would be to revalue the Green ECU as in the first stage for dismantling existing MCAs.

Budgetary effects of the German proposal for eliminating MCAs

4. The first stage of the German proposal has been estimated by the Commission to have the following costs. The figures are given for 1984 and 1985 when the full effects would be felt :

	1984	1985
Increase in EAGGF expenditure	+ 128	+ 401
Change in own resources revenue	+ 2	- 32
Net effect	+ 130	+ 369

5. These costs arise from the subsequent removal of the new negative MCAs through green rate devaluations which would increase national support prices. The effects on own resources revenue relate to changes in the level of import levies resulting from changes in green rates. No allowance is made for the costs resulting from the extra production that could be brought about by these higher prices.

6. The second stage of the German suggestion envisages national aids to compensate for the price cuts resulting from green rate revaluations. The 5.0% cut in the German MCA would according to the German figures reduce farm income by about 2 billion German Marks. The green rate revaluation by the amount necessary to reduce German MCAs by 5 percentage points would benefit the EC budget by about 175 mecu.

2 March 1984

A.J.C.
MR 1/3.

Members' Brief

No. 3
CONFIDENCE IN AGRICULTURE 1.3.84

The Prime Minister recently made clear that the Government's commitment to the health and prosperity of British agriculture is rock solid. In the last nine months, the Government has given new money to the glasshouse and potato industries, forced through hill livestock allowances, extended aid to 28,000 farmers in marginal areas, increased milk prices whilst delaying their effect on consumers and continued to give financial support. This commitment is compatible with the Government's conviction that there will have to be reforms in the costly Common Agricultural Policy of the European Economic Community.

The Prime Minister was replying in the House of Commons to Sir Peter Mills, who asked: 'Will (the Prime Minister) bear in mind the fact that there is great uncertainty in British agriculture, especially because of the Community and also because of the so-called enquiry into the privileges of British agriculture? Will she explain the position and express her confidence in an industry that has served Britain well, both consumer and producer?'

Mrs Thatcher replied:

> 'The Government are determined to reduce the surpluses that are produced under the Common Agricultural Policy. The reason for that is well understood by all farmers in the Community, although we all recognise that it will cause painful adjustments. However, people realise that it must come about. The Government also believe that people realise the need for support for British agriculture - support that is offered by every Western industrialised country to its agricultural services. They recognise the need for that support and they recognise, as do the Government, the need for a healthy agricultural industry.
>
> 'When all that has been said, it is natural that every Government should examine the amount of public support given to any industry, and keep that carefully monitored and scrutinised in the ordinary way of public expenditure. I should make it clear, because there have been reports to the contrary, that, as was said in the White Paper, we do not propose to re-open the question of rating agricultural land and buildings' (Hansard, 23rd February 1984, Col. 972).

There is no basis for the story that the Prime Minister has called upon her staff at No. 10 to carry out a special appraisal of farmers' 'privileges', over and above the normal and established surveys which the Government is obliged to carry out as part of the system for controlling public expenditure.

The Problem of the Common Agricultural Policy

The Common Agricultural Policy (CAP) has underpinned the prosperity of European agriculture by giving farmers unconditional guarantees of good prices for what they produced, whether or not there was a market for it. This regime has stimulated the production of food so successfully that surpluses are now at record levels in milk products, cereals, wine and beef, all of which are produced in the UK. British agriculture, by great advances in productivity, has reached the point where it now produces 76 per cent of all temperate food consumed in the United Kingdom, compared with 61 per cent when we joined the Community in 1973.

But the CAP has become the victim of its own success. Spending on agriculture now takes over two thirds of the EEC budget and is running out of control. The Community is spending up to the limit of its revenue. The crunch has come. The British Government has taken the lead in pressing for a solution. As Mr Michael Jopling, Minister of Agriculture, said in January:

'The fact is that the Community has avoided for too long facing up to the home truth that we cannot go on generating additional surpluses of foodstuffs, for which there is no market, and where the costs of intervention and disposal are out of all proportion to what can be justified to Community taxpayers" (26th January 1984).

At the last Conservative Party Conference, Mr Jopling also said:

'At the root of our problem is the fact that eight of the ten Member States of the Community make no contribution - or a minimal one - to the Community...They have, therefore, no great desire to see the cost of the policy brought under control...The CAP was set up to provide housewives with reasonably sure food supplies at prices that gave farmers fair returns within a stable and increasingly efficient industry. It has done that and we support it. But we must save it from itself. It has grown obese. We need to slim it down, to make it fitter' (13th October 1983).

The Government recognises the benefit brought to Europe, and to Britain, by the CAP. Security of food supply is an inestimable boon, and so is the stability of prices that has increasingly become a feature of the European market in foodstuffs. But it is just as important for public expenditure to be kept under control in the Community as it is at the national level. The British Government believes that it is possible to reform the CAP without undermining agriculture. But it is well aware of the damage that can be done by uncertainty. For that reason British Ministers have been urging as speedy an agreement as possible on the CAP reforms.

Mr John MacGregor, Minister of State for Agriculture, has summarised the position:

'First, the Budget crunch has come... That is because there really is a limit on the funds available for agriculture in 1984 and we have to recognise and accept that. Because for the future the Budget problem for Agriculture Ministers remains and will not go away when conclusions are reached on the issue of Britain's Budgetary refunds and any increase in resources. Because fundamentally what we are dealing with is not only a cash crisis but a market crisis, namely that in the critical sectors the Community is producing simply far too much for the market place.

'Second, while facing up to this challenge, British Ministers are in there fighting to reach a settlement which is wholly fair to British farmers and which does not discriminate against our interest. The Government is determined to maintain a healthy farming industry, satisfying as large a share of the Community market as it can, and competing on fair terms.

'Third, we recognise that this will mean a period of adjustment and difficulty for some sectors and some individual farmers. So let me state firmly that this is in no way the time to snipe at our highly successful and productive agriculture, as in the ill-considered attacks over recent months in certain sections of the media' (24th February 1984).

This is the background to the crucial negotiations which will be taking place in the Council of Ministers at Brussels on March 19th and 20th. The Conservative Government will be standing up for British interests, the interests of consumers and producers alike.

Conservative Research Department
32 Smith Square, S.W.1.

PJC/RBC/ACS