STATEMENT BY MR. TUGENDHAT TO FINANCE MINISTERS

MONDAY, 14 FEBRUARY

The Commission has asked that I should come here this afternoon so that I can explain some of the thinking that lies behind the proposals for agricultural prices for the coming year, which we adopted last Friday.

In the past you and your Budget colleagues have often expressed a strong desire for the establishment of more far reaching budgetary control over the Community's decision making procedures. The new Commission is determined to develop further its budgetary controls, and has made a start with the agricultural prices package which is one of the major budgetary decisions of the year.

We therefore felt that it would be appropriate for me as the Commissioner responsible for the Budget to make this presentation to you at the same time as my colleague, Mr. Gundelach, is presenting the proposals to your Agriculture colleagues. This is the first time such a procedure has ever been followed.

As you know our proposals involve an average increase in farm prices of about 3 per cent. In some sectors the increase

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is greater, but in others, where there are structural imbalances, lower increases are proposed. There are also a small number of related proposals, mainly concerning MCA's and milk.

The proposals for a Milk Action programme, which is already before the Council, are designed to curb the massive increase in stocks that would otherwise take place in this sector. Certain modifications and improvements are now proposed by the Commission in the light of the discussions which have taken place.

My colleagues and I know that the farming industry regards this as a harsh package. Even so it will, of course, lead to price increases for the consumer.

We decided that this year our principal task must be to keep those increases to a minimum.

We are deeply conscious of the importance of maintaining a strong farming industry, and we are dedicated to upholding the Common Agricultural Policy. But in view of the economic problems at present facing the Community, especially inflation, we felt it right to ask the farmers to make a major contribution to the battle against rising prices.

Those of us responsible for formulating policy, and those groups in society who will benefit from that contribution must now ensure that it will not be in vain.

But economic and budgetray pressures point in the same direction. In present economic circumstances, public expenditure as a whole, and the Community budget in particular, have to be adapted to economic realities. The present package is coherent from a budget point of view.

The annual review of agricultural prices is from the budgetary point of view one of the major decisions which the Community takes each year. Agricultural expenditure is nearly 70% of the budget. [redacted] Most of this spending is open-ended and affected by factors which are totally outside the control of the Commission and the Council (e.g. the state of world markets and monetary developments). Nevertheless, the framework within which this spending occurs is determined by the annual prices decision. This is much the most important point at which to exert budgetary and economic control of agricultural expenditure. It is no use complaining that the CAP is too expensive unless we show now our determination to do what we can to control that expenditure.

I turn now to the paper itself. I do not intend to enter into the details of it, which are self-explanatory, but I would like briefly to outline the main policy points with budgetary consequences.

Firstly, I would like to stress that it is not common organisation of agricultural markets as such that are inherently expensive, as some imagine. Where there is a proper balance between supply and demand, costs are relatively low. The large costs arise when there are surpluses. It is only when we have to export large quantities onto a lower-priced world market or take into stock surpluses which can subsequently be sold at only a fraction of their buying-in price that the costs of market organisations begin to escalate. Thus it is that the milk sector, which accounts for under 20% of the value of agricultural production in the Community, represents more than 40% of total

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agricultural expenditure (excluding agri-monetary expenditure) from the Community budget, that is to say that more than a quarter of the whole Budget is spent on milk. It also follows from these considerations that price increases for products such as milk are vastly more expensive than for products with a proper market balance. This is a crucial point to be borne in mind in the prices debate.

The second point to bear in mind is that the true financial incidence of the prices decision must not be assessed purely in terms of the cost for the 1977 budget. This is in fact very low (at under 40 million u.a.) The full year effect has to cover the impact for all the marketing years, which start at very different dates and will give rise to an extra cost of about 250 million u.a. But even then, there is still something missing, namely the built-in cost of existing and future surpluses, the bill which is waiting like a sword of Damocles to be paid to reduce these stocks whenever we can dispose of them. It is cheap to build up surplus stocks; the only costs are storage and interest, and these are in part offset by the increase in book value which occurs every time the intervention price increases. The full cost is only felt when the stocks are run down and have to be sold by various means at a fraction of their notional book value. Take the example of milk powder alone. We have about a million tonnes in stock. If we keep them in stock it costs us a little under 100 million u.a. a year minus whatever increase there is in book value (e.g. 100 - 30 million = 70 million in the case of a 3% price rise). To reduce these already existing stocks to the level of 3 months consumption, however, would cost no less than 500 million u.a. at today's prices. Much of this is not yet a cost for

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today, since alas it is unrealistic to think of reducing stocks on this scale. But it is a warning of the extra hidden cost of prices decisions which allow further stocks to accumulate. It is in this light that the Commission is proposing only a modest increase in milk and not before 16 September. Furthermore even this modest increase is only proposed in the overall context of the milk Action Programme, without which any price increase for milk would have serious medium term repercussions.

The third point is the need to take further action on MCA's. These have been the means of maintaining a common market in a period of monetary disturbance. But they allow economic distortion, both in the form of extensive subsidies which cost the budget a great deal, and in the form of concealed protection at the frontier which do not affect the budget directly but which have a major economic impact. The Commission is determined that this situation should be corrected, although clearly a long term solution is needed. Meanwhile it has proposed balanced adjustments in MCAs as an essential step in this direction. On this aspect also budgetary and economic factors must be carefully borne in mind in reaching decisions on the prices package.

In conclusion, may I stress that the Commission has made a special effort to present the budgetary aspects of its prices package this year. In doing so, it has responded to criticisms from the Council in the past. We very much hope that the Council in its deliberations on the prices package will take advantage of the Commission's efforts and for its part also ensure that this year the budgetary and economic aspects of this major decision are as fully weighed as the agricultural.