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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

LIQUID MILK PRICES

Memorandum by the Minister of Agriculture, Fisheries and Food

Background

1. The returns of our milk producers depend upon the prices they receive from the liquid and milk products markets. The latter are determined essentially by decisions taken in Brussels on EEC support prices, but we ourselves fix maximum wholesale and retail prices for liquid milk. Because of the strength of sterling, there is no prospect at present of our improving returns from the products market through a green pound devaluation, so the only way in which we can boost milk producers' incomes this year is to increase the liquid price.

2. The need for such an increase can be seen clearly from the following table showing the net margin per cow in real and money terms since the first year of the last Conservative Government -

Year	£	Index (1970/71 = 100)
1970/71	29.9	100
1971/72	54.6	167
1972/73	61.0	174
1973/74	37.2	96
1974/75	27.4	60
1975/76	78.3	138
1976/77	52.2	80
1977/78	101.7	136
1978/79	95.1	118
1979/80	74.6	80
1980/81	27.0	24 (without taking further action on the price)

3. These figures, and those in the Annex setting out the RPI and financial implications of the proposals in this paper, have been agreed by officials. It will be seen from them that, if we take no action on prices, the net margin for 1980/81 will be below £30. Even in money terms, this would be as low as any figure in the whole of this period; and in real terms, it would be less than half the next

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lowest year of 1974/75 and less than one quarter of the average figure during the years of the Labour Government.

4. I do not believe this would be tolerable in political terms, or indeed in the national interest. In June, the dairy herd was some 60,000 head below the equivalent month last year. Applications under the EEC's Non-Marketing Scheme are running at record levels, those received already this year being equivalent to a further 160,000 cows. And, although the increase in the target price that was agreed as part of the recent CAP price package will add £19 million to producer returns in 1980/81, this will be more than offset by the £22 million they will lose from the increase in the co-responsibility levy. There can therefore be no doubt that action is urgently needed.

The proposed solution

5. The seriousness of the position has led the two sides of the dairy industry to make a joint request for an increase of 1½p per pint in the retail price on 3 August, with the additional revenue of £96 million thus generated being divided equally between producers and distributors. Even this would fall some way short of meeting their needs. It would, for example, still leave the producer net margin 10% below that of 1979/80 (which, together with 1976/77, was the second lowest in real terms in the last 10 years). Likewise, the £48 million which the dairy trade would receive would leave their costs, as measured by the present system, under-recouped by some £30 million. Therefore, unless we take action, they too will be in real difficulties this winter, and the viability of the distribution system, particularly in London, will be seriously at risk.

6. I appreciate the sensitivity of an increase in the price of a basic commodity such as milk at the present time. However, even if we are

merely to retain net margins this year within striking distance of the modest levels achieved in 1979/80, and at the same time to provide an adequate reward for distributors (who have had no increase in their target rate of profit since October 1978), it is clear that an increase of the magnitude requested by the industry will be necessary. I am sure we will need to provide this, and that we should not seek to inject less than the £96 million implied by their proposal.

Timing considerations

7. It is also clear that the sooner we act, the smaller the increase that will be needed to achieve any given effect. Thus the increase required to maintain producer returns at a level somewhat lower than that of last year would be :-

1½ pence on 3 August or

2 pence on 5 October or

2½ pence on 2 November or

3 pence on 7 December or

1 penny on 3 August and another 1 penny on 7 December
or another 1½ pence on 11 January.

8. These considerations clearly have to be weighed against other factors. In the first place, there is the outcome of the Binder Hamlyn review. I recognise that there would be some advantage in deferring a decision until after Binder Hamlyn have reported. However, even if we were to receive the report by the early autumn, it will clearly take us some considerable time to reach conclusions on what is a highly complex and sensitive subject. I do not believe we can wait that long to take action on the price; nor do I believe we need do so as the 50/50 split proposed would be a provisional one, without prejudice to Binder Hamlyn's conclusions. Secondly, there is the possible

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impact of a price increase on our approach to next year's CAP price fixing. I am not convinced this would have more than a marginal effect, but, insofar as it might, that again points towards making an increase sooner rather than later. Finally, the EEC's Non-Marketing Scheme ends on 15 September. An early increase would help to minimise the last-minute rush of applications that will otherwise occur.

Conclusion

9. It is important that an early announcement should be made so as to provide some confidence over the coming months to the producers, and it is clear from paragraph 7 of this paper that the longer an increase is left, the greater the amount of that increase, which in turn is likely to adversely affect consumer sales. If there are, however, other factors outside my department which make it advantageous to stage this increase, this would be acceptable to me.

Scotland and Northern Ireland

10. Although the figures above relate to England and Wales, the position in Scotland and Northern Ireland is broadly similar. It should, however, be noted that in Northern Ireland (where a relatively large proportion of production goes to the less remunerative manufacturing market) the increase proposed in the wholesale price will leave returns there approximately 1.45 ppl or over 10% below those in GB. This is equivalent to over 50% of the net profit margin. This fall in the profitability might well lead to lower production and employment in Northern Ireland.

P W

Ministry of Agriculture, Fisheries and Food
4 August 1980

ANNEX

FINANCIAL AND WIDER IMPLICATIONS OF PROPOSED INCREASES

The effect which various increases proposed in the retail price would have on the RPI and the Food Index are as follows :

Price Increase (p per pint)	Increase in RPI (%)	Increase in Food Index (%)
+ 1½	0.16	0.72
+ 2	0.21	0.96
+ 2½	0.26	1.20
+ 3	0.31	1.44

A price increase of 1½p per pint at the beginning of August would be expected to result in a fall in consumption up to the end of March 1981 of 49 million litres. The larger increases mentioned above, and applied at a later date, could be expected to have a similar effect on consumption over that period. However, a larger increase would produce a larger percentage fall in consumption which would then carry over into 1981/82. Each 1p per pint added to the present price of 16½p per pint is expected to result in a fall in consumption of 1%.

On the assumption that all of this 49 million litres of milk went to butter manufacture, and that all of the extra butter was sold to intervention, the direct extra cost to the Exchequer in 1980/81 would be £4 million. This direct cost does not take account of extra storage and finance costs. However, it should be noted that when the produce is sold FEOGA reimburses the UK in full for the costs of storage and finance and for any loss incurred in the sale. Inasmuch as the UK contribution to FEOGA is 18%, the cost to the UK would be of the order of £½ million (although this does not take account of this year's EEC Budget settlement). If, however, the butter were sold on the open market, which is equally possible, the import savings on the balance of payments would be about £4 million; and there would be no Exchequer costs.

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