PREM 19/389

Retail and Wholesale Milk Prices.

PART I

AGRICULTURE

May 1979

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~23.5.79~~		~~31-7-80~~					
~~24.5.79~~		~~5-8-80~~					
~~1-6-79~~		~~6-8-80~~					
~~4.6.79~~		~~8.9.80.~~					
~~11.6.79~~		~~29.9.80~~					
~~13.6.79~~		~~10-10-80~~					
~~4-7-79~~		~~14.10.80~~					
~~6-8-79~~		~~27.11.80~~					
~~9.8.79~~		~~3.12.80~~					
~~25-9-79~~		~~4.12.80~~					
~~27.9.79~~		~~9.12.80~~					
~~1.10.79~~		~~5-1-81~~					
~~3.10.79.~~		~~16.1.81~~					
~~4.10.79~~		11.3.81					
~~5.10.79~~		— Pt I Ends —					
~~16.10.79~~							
~~23.10.79~~							
~~5.12.79~~							
~~6.12.79~~							
~~10.12.79~~							
~~24.3.80~~							
~~19.5.80~~							
~~29.7.80~~							

PART 1 ends:-

MAFF to TL 11/3/81

PART 2 begins:-

E(81) 30 11/3/81

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
E(EA)(79) 45	25/09/79
E(EA)(79) 14th Meeting, Minutes	28/09/79
C(79) 41	02/10/79
CC(79) 16th Conclusions, Item 3	04/10/79
C(79) 59	04/12/79
CC(79) 24th Conclusions, Item 5	06/12/79
E(80) 88	04/08/80
E(80) 89	04/08/80
E(80) 30th Meeting, Item 2	06/08/80
E(80) 43rd Meeting, Item 3	04/12/80

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed J Wayland Date 28 January 2011

PREM Records Team

c.c.

CONFIDENTIAL

Agriculture

Ministry of Agriculture, Fisheries and Food
Whitehall Place London SW1A 2HH

From the Minister's Private Office

Tim Lankester Esq
Private Secretary
10 Downing Street
London SW1

11 March 1981

Dear Tim,

PM 11/3

PRICE CONTROLS FOR LIQUID MILK

A meeting of E Committee has been arranged for 19 March to discuss the recommendations of the Binder Hamlyn Report and future policy for liquid milk price control.

I understand that in preparation for this meeting the Prime Minister has asked to have a copy of the Report a week
--- beforehand. I enclose a copy of the Report and its appendices and for completeness a copy of their earlier Report of February 1980. A paper by officials setting out the result of the review commissioned by E Committee will be circulated today by the Cabinet Office: the Annex to this paper contains a summary of the Binder Hamlyn recommendations and the action it is proposed to take on them.

Yours sincerely,

Kate.

KATE TIMMS
Principal Private Secretary

CONFIDENTIAL

Agri.

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON S.W.1

From the Minister

The Rt Hon George Younger MP
Secretary of State for Scotland
Dover House
Whitehall
London
SW1

14/1

14 January 1981

LIQUID MILK PRICING POLICY

Thank you for your letter of 19 December. I am quite content that officials should examine the issues you have raised, but in the meantime I would like to make the following comments of my own.

First, I think we would all agree on the importance of maintaining a viable doorstep delivery system as a service to the consumer and as a means of sustaining liquid consumption.

Secondly, whilst I agree that maintaining price controls is a thankless task, my own view is that, so long as our industry remain monopoly suppliers of the liquid market in this country, any odium we incur through continuing to impose those controls is certainly not less than that we should incur if we were to relinquish that role. This would be particularly the case of course if we were to pull out altogether: but I believe that our difficulties would scarcely be any the less if we followed the course you appear to be advocating and exercised control over the dairy trade only at the point where the milk leaves the creamery.

Indeed, whilst the potential political drawbacks of such a step are clear enough, I am far from convinced that these would be balanced by offsetting practical advantages. There is evidently a considerable difference in circumstances between Scotland and the rest of the UK, as evidenced by the greater spread of prices in Scotland than in England and Wales, and since the price controls provide maximum but fixed prices these differences must depend on other considerations rather than on the existence or otherwise of price controls, which of course you apply in the same way as we do. The removal of those controls would not therefore necessarily bring about the sort of price reductions you are assuming and indeed might have the opposite effect, with the damage to liquid consumption and the doorstep delivery system that this would imply.

/The fact.......

The fact that different circumstances appear to obtain north and south of the border thus makes me wary of setting too much store by the Scottish experience. This has in any case evolved over a long period of years, whereas in the event of decontrol the industry in England and Wales could well have to adapt to new circumstances very rapidly. In those circumstances I don't think anybody can say with certainty what would happen to our doorstep delivery service - I personally believe it would suffer: but what is undeniable is that, if removal of controls did lead to a rapid (and irreversible) decline in that service, those who claim to set greatest store by the availability of cheap milk would doubtless be the first to lay the blame at our door.

I am copying this letter to the Prime Minister and Members of E Committee, the Secretaries of State for Northern Ireland and Wales and to Sir Robert Armstrong.

14 JAN 1981

Peter

PETER WALKER

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

Agriculture.

PB
JK(O/A)
to cc
MS
6/1

From the Secretary of State

The Rt Hon Peter Walker MBE MP
Minister of Agriculture
 Fisheries and Food
Whitehall Place
London SW1A 2HH

5 . January 1981

Dear Peter.

LIQUID MILK PRICING POLICY AND IMPORTS

I have seen George Younger's letter to you of 19 December on this subject. As you know I too have grave doubts about our continuing to regulate this market, and I share his view and that of Humphrey Atkins in his letter to you of 3 December, that the time has come to re-examine all aspects of the present system of controls. My own preference is for complete decontrol.

I strongly support George Younger's suggestion that officials should look at both the issues of retail price competition and of free negotiation of wholesale prices in the inter-departmental review which they are to undertake.

I have also seen your letter of liquid milk imports. As you will appreciate there are broad trade arguments against the course you recommend. But I think it is politically desirable that we continue to resist liquid milk imports with vigour. If we do so, however, it strengthens my view that, whilst this matter is fought in the European Court, we should move swiftly to de-regulate within our own internal market (not least, pending the possibility that we might be forced to accept milk imports in due course).

I am copying this to the Prime Minister and members of the E Committee, the Secretaries of State for Scotland, Northern Ireland and Wales, and to Sir Robert Armstrong.

Yours ever
John

JOHN NOTT

Agriculture

NEW ST. ANDREWS HOUSE
ST. JAMES CENTRE
EDINBURGH EH1 3SX

SECRETARY OF STATE FOR SCOTLAND

The Rt Hon Peter Walker MBE MP
Ministry of Agriculture, Fisheries
and Food
Whitehall Place
LONDON
SW1A 2HH

19 December 1980

PL
23/12

Dear Minister,

LIQUID MILK PRICING POLICY

When we discussed liquid milk prices at E Committee last week, I did not seek to raise the wider question of whether we should continue to control milk prices. Nevertheless, as you know, I share Humphrey Atkins' doubts and wonder why the Government should continue to incur the odium of this role, especially when we may face liquid milk imports in the not too distant future.

I share the desire to adapt our producers and distributors to a future situation in which we may have to accept liquid imports. I also want to maintain consumption of milk both as an important item in diet and as an essential outlet for agricultural production.

To secure these objectives we are, I am sure, going to have to move to a freer market. However, I do not see decontrol of the wholesale price, as a step taken in isolation, as necessarily the right first move. If it then co-exists with continued retail price control and a squeeze on distributive margins, we shall simply reduce the premium which producers receive for milk for liquid use. This may be desirable, if they are going to have to learn to live without it. However, the producer is a weak negotiator, as you saw last August, when distributors refused to pay the wholesale price which you had set. This form of decontrol should therefore be accompanied by some form of incentive to distributors to compete on price, and to make milk genuinely available at the lowest possible cost to the consumer instead of simply passing their costs on to him.

This could be achieved by decontrolling part or all of the distributive process. I should in principle be in favour of considering complete decontrol, but lest this be thought to work against the interests of the consumer, in the absence of competing imported milk, we might consider controlling the retail price only at the point where the milk leaves the creamery, leaving competition and market forces to operate from there on. Both John Nott and I put this point to you earlier this year.

It might be argued that such a system would lead to a decline in milk consumption, following on a withering away of the doorstep delivery. All I can point to here is our experience in Scotland where, despite the continued existence of present controls, half our total liquid milk consumption is bought in shops; there is widespread availability of milk at prices well below the maximum level and the average price of milk is certainly below that in England and Wales; forty per cent of households choose not to have milk delivered; yet the delivery system is still in being. Ninety six per cent of the urban population (and much of the rural population) have a delivery service (frequently more than one) available to them, and delivery charges are very uncommon. Yet ten years ago, when over three-quarters of Scottish milk was sold doorstep delivery, we drank 10 per cent less than the national average: today the figure is only 5 per cent below that average.

I believe that the lesson to be drawn is that we must make our distributors compete more on retail price, in selling their product, as well as encouraging them to negotiate freely with producers on the wholesale price, and I suggest that, in the inter-departmental review which E Committee instructed, our officials should examine both issues, before drafting the report which we shall have to consider in January.

I am copying this to the Prime Minister and members of E Committee, the Secretaries of State for Northern Ireland and Wales and to Sir Robert Armstrong.

Yours sincerely,

[signature]

Approved by the Secretary of State
and signed in his absence.

Agriculture

CONFIDENTIAL

Qa 05198

To: MR LANKESTER

From: J R IBBS

R 3/12

Liquid Milk Prices

1. Mr Walker's note to the Prime Minister on liquid milk prices is on the Agenda for tomorrow's meeting of E Committee. I suggest that in the discussion the Prime Minister may want to satisfy herself on the answers to the following three questions:

(i) Bearing in mind the pressures which all small businesses will be facing in the coming year, does the proposed increase ensure roughly comparable treatment for farmers (and distributors), or does it let them off too easily, with too little emphasis on efficiency?

(ii) Does it really make sense to go on supporting present levels of production of a commodity which is in substantial surplus within Europe as a whole?

(iii) Does the proposal adequately acknowledge the interest of the consumer in lower prices; particularly since if the United Kingdom loses the present case before the European Court we will then be obliged to let in imports which will be cheaper than home production? It might be worth enquiring what is now thought to be the likely outcome of the case.

2. I am sending a copy of this minute to Sir Robert Armstrong.

3 December 1980

CONFIDENTIAL

CONFIDENTIAL

Agriculture

Ref. A03731

PRIME MINISTER

E: Liquid Milk Prices

BACKGROUND

In his letter to you of 27th November the Minister of Agriculture, Fisheries and Food proposes that the maximum retail price of liquid milk should be increased by 1½p per pint from 21st December. Since January 1978 the Government have fixed maximum wholesale and retail prices: the difference between them being the distributive margin which is intended to cover the costs of processing and distributing liquid milk, plus a target rate of profit for the dairy trade also determined by the Government.

2. His proposal is on the agenda for tomorrow's meeting because, on present plans, E will not meet again until Tuesday, 16th December. Depending on the line taken by the Chief Secretary, Treasury, it is probable that agreement can be reached on the proposed December increase without any lengthy discussion. The Secretaries of State for Wales (1st December), Scotland (2nd December) in minutes to you and the Secretary of State for Northern Ireland in a minute to the Minister of Agriculture (3rd December) have all said they agree. We do not know what is the Chief Secretary's line, but his officials may advise him to question whether the increase should be less, on the grounds that while the producers may need something more the distributors' case is weaker. Some Ministers may also raise longer-term issues which will be relevant to further increases in 1981; and the Secretary of State for Northern Ireland has raised the fundamental question whether there should be a phased withdrawal from Government control by ceasing to control the wholesale price.

3. At their meeting on 6th August the Committee approved an increase of ½p in August rather than the 1½p then proposed by the Minister of Agriculture (E(80) 30th Meeting, Item 2). They agreed that any further increases should be considered after the Binder Hamlyn report on the liquid milk costing system had been considered and in the light of any action which the Monopolies and Mergers

CONFIDENTIAL

Commission (MMC) might propose if there were a referral of milk distribution. It was also agreed that the timing of the increase would have to take account of the timing of CAP price fixing negotiations and of movements in the RPI.

4. The increase now proposed is less than the industry wants but would generate additional revenue of £45 million this financial year in England and Wales. It is held that this is necessary to help both the producers (and check further falls in the size of the dairy herd) and the distributors who might otherwise have to cut services.

5. The Minister of Agriculture would argue that it is for other EC members to reduce their milk surpluses. We are not self-sufficient and all the proposed price increase will do is to check a further fall in production at a cost to the balance of payments. It would lead to an increase of 0.15 per cent on the RPI and of 0.7 per cent on the Food Price Index. 21st December is proposed, after consultation with the Department of Employment, so that the increase would be in the January RPI which should be lower than that for December.* Some savings should emerge from the second Binder Hamlyn report which is now being received, but these will have to be negotiated and MAFF think that they will not have much impact in the present financial year. The Director General of Fair Trading is considering a reference to the MMC on milk distribution. He will not make proposals until January, and it will then be for decision whether the Secretary of State for Trade should allow such a reference to go ahead. Milk prices are usually increased twice a year and further consideration of the Binder Hamlyn report, and of any report by the MMC, together with examination of any other longer-term issues, will therefore be relevant to the proposals which will be coming forward for increases in 1981.

6. The present proposal does not appear to raise European Community issues. An increase on 21st December would be well clear of negotiations on the Commission's 1981 price proposals. Any effect of this proposal on FEOGA expenditure (see paragraph 2 of the Annex to the letter) would be trivial in relation to total FEOGA expenditure. Officials are looking separately (in EQO (legal)) at the Commission's challenge to our health restrictions - the Chief Secretary's letter of 2nd December refers.

*The Secretary of State for Employment now proposes 3rd January (cf. his minute to you of 3rd December).

7. As in August, the Minister of Agriculture has not consulted the other Ministers directly concerned, or authorised any general discussion at official level, before minuting you. If he had undertaken such prior consultations, he would then be in a position to advise whether his proposals commanded general support and to bring out any differences of view; and it might not have proved necessary to discuss the issue in E. You may like to say, for the record, that in future he should undertake prior consultations with the other Ministers directly concerned before coming to E (or Cabinet).

HANDLING

8. There will probably be little time left for discussion of this item. I suggest that you put two main questions to the Committee:

(i) Does any member dissent from the proposal that there should be an increase of $1\frac{1}{2}$p on 21st December? Mr. Prior thinks that it should be on 3rd January.

(ii) What points should be registered for the longer term and in preparation for proposals for increases in 1981?

The question of a reference to the MMC will be considered in January.

Departments may wish to discuss with the Ministry of Agriculture the implications of the Binder Hamlyn report.

These further discussions could also take account of any other proposals for changes in the arrangements, including that by the Secretary of State for Northern Ireland, for phasing out the system of price controls. Other Ministers will wish to give their reactions to the latter but it should not be necessary to go into these longer-term issues in any detail tomorrow. They could be looked at later on the basis of a full analysis.

9. The Minister of Agriculture might be invited to arrange for interdepartmental discussion of the longer-term issues before he comes forward with his next proposal for an increase.

CONCLUSIONS

10. In the light of the discussion you will wish to record conclusions:-

(i) Endorsing the proposed increase of $1\frac{1}{2}$p per pint on 21st December, or any alternative agreed.

(ii) Commissioning further work on any longer-term issues identified and requiring this to be completed before the next proposal for an increase.

(iii) Inviting the Minister of Agriculture to arrange for full interdepartmental discussion of both longer-term issues and particular price proposals prior to submission of recommendations to the Committee.

RtA

ROBERT ARMSTRONG

3rd December, 1980

CONFIDENTIAL

SECRETARY OF STATE FOR EMPLOYMENT

PRIME MINISTER

LIQUID MILK PRICES

I refer to Peter Walker's minute of 27 November.

Whilst appreciating the case presented for increasing prices I feel that to do this on 21 December, just before Christmas, could lead to unnecessary criticism of the Government.

I am also a little disturbed at the rather obvious attempt to maximise the effect on households whilst minimising the impact on the RPI (prices are collected for the December RPI on the 16th of the month). This might well lead to accusations of index rigging. For these reasons I should prefer that we go for an increase in price on a date which looks a more neutral choice, for example, Sunday 3 January.

I am copying this to other recipients of Peter Walker's minute of 27 November.

J P

3 December 1980

CONFIDENTIAL

cc Abingwell

NORTHERN IRELAND OFFICE
GREAT GEORGE STREET,
LONDON SW1P 3AJ

SECRETARY OF STATE
FOR
NORTHERN IRELAND

Tim,
Copy to E folder?
A.

✓ yes.

The Rt Hon Peter Walker MBE MP
Minister of Agriculture, Fisheries
and Food
Whitehall Place
London SW1 2HH

3 December 1980

Prime Minister

x would be worth following up.

Dear Minister,

LIQUID MILK PRICES

I have seen your letter to the Prime Minister on this subject, and it may be useful to set my views on record in preparation for our discussion at E Committee.

TL 3/12

While I support the need for an increase in returns to dairy farmers in the UK I feel I should point out that the measures you propose would not be anything like as beneficial in Northern Ireland because of the lower proportion of milk going to the liquid market here in comparison with Great Britain. The suggested increase in the liquid premium would further widen the gap in producer returns between Northern Ireland and Great Britain and would increase the pressure on both of us for the restoration of milk aid.

It must be noted that an increase of 1½p per pint in the retail price of milk would have an adverse effect on consumption and would also provide an added incentive for liquid milk imports. The receipt of the Commission Reasoned Opinion (questioning our thoughts on the prevention of milk imports on health grounds) would seem to bring the possibility of liquid milk imports even nearer and this is something which would have very serious effects in Northern Ireland because of the land border with the Irish Republic.

It occurs to me that now may be the time to prepare the industry for the situation which will arise when we can no longer prevent imports of liquid milk and that we should commence a phased withdrawal from Government involvement in control of milk prices by ceasing to control the wholesale price. Such a move would be in line with our general philosophy.

x

The question also arises as to why there should still be a need for an artificial premium on liquid milk in the UK. Now that the Green Pound is no longer over-valued UK milk producers have the same

/opportunity as

CONFIDENTIAL

opportunity as producers in other Member States where there is no liquid premium.

I suggest that it would be useful to discuss these wider issues at E Committee, and I am copying this letter to its members and to Sir Robert Armstrong as well as to George Younger and Nicholas Edwards.

Yours sincerely

M Stephens

(Signed on behalf of
the Secretary of State
in his absence)

E Folder

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Peter Walker MBE MP
Minister of Agriculture
Fisheries & Food
Ministry of Agriculture
Fisheries & Food
Whitehall Place
London SW1A 2HH

cc Mr Ibbs
Mr le Cheminant
Mr Moore
Mr Niles
Mr Franklin
Mr Elliott

2 December 1980

Dear Minister,

LIQUID MILK PRICES

I have seen a copy of your minute of 27 November proposing a 1½p per pint increase in retail milk prices from 21 December.

There is a meeting of E Committee on Thursday at which we could decide this issue.

Could I suggest that before then officials should have the opportunity to run over the underlying data and also of providing an assessment in the light of the latest information on the Commission's challenge to our health restrictions, of whether adopting your proposal would significantly increase the vulnerability of our markets to imports.

I am sending copies of this letter to the Prime Minister, the other members of E Committee and the Secretary of State for Scotland, Wales and Northern Ireland and Sir Robert Armstrong.

Yours sincerely

T. Mathews

for JOHN BIFFEN

[Approved by the Chief Secretary
and signed in his absence]

For E Cttee

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

CONFIDENTIAL

Prime Minister

LIQUID MILK PRICES

I have seen a copy of Peter Walker's minute of 27 November to you, and I understand that his proposal is to be discussed at E Committee on Thursday of this week.

He argues for a 1½p/pint increase in the maximum retail price from 21 December, and justifies this by referring to low and declining dairy incomes and significant under-recoupment of distributors' costs. I support him because the position, particularly for producers, is even worse in Scotland.

Production of milk is down over the year as a whole, and this decline has accelerated as autumn has progressed: in the last two months, the fall in output in Scotland was over 5 per cent. Our dairy herd was in June 4 per cent smaller than in June 1979. But perhaps more worrying is the longer term trend - heifers in calf for the first time were 8 per cent down in June 1980 as against June 1979. As in England and Wales, net margins are half what they were last year - even in money terms - and unless we take action on prices now, there could well be a flight from dairying. Indeed, there are signs that in the north and north-east of Scotland, this may already have begun.

Distributors are also considerably under-recouped. Even on a target rate of profit which has not been raised since 1978/9, I estimate that Scottish distributors will be owed some £3 million in the year ending 31 March 1981 unless we increase their return.

The arithmetic points inexorably to an increase in the maximum retail price, and I believe that 1½p/pint from 21 December is the least which we could reasonably offer to producers and distributors. There is a real risk of an exodus from dairy farming in Scotland if we do not curtail the fall in incomes.

I am copying this to the members of E Committee, to the other Agriculture Ministers and to Sir Robert Armstrong.

G.Y.

2 December 1980

PRIME MINISTER

LIQUID MILK PRICES

I have seen Peter Walker's letter of 27 November seeking approval to proceed with an increase of 1½p per pint in the retail price of milk effective from 21 December 1980.

I fully support the case made. Milk producer margins are such that we must, in my opinion, take action now if we are to avoid a serious decline in the industry. This would hit livestock areas of rural Wales particularly hard because dairying accounts for 45% of Welsh agricultural production.

Copies of this go to Peter Walker and to the other recipients of his letter.

RNE

1 December 1980

/Joint Announcement by the Ministry of Agriculture, Fisheries and Food, The Welsh Office and the Department of Health and Social Security/

December 1, 1980

UNTREATED MILK

In a Written Reply to a Question by Mr. David Knox, M.P., in the House of Commons today asking whether he will make a statement about the new measures for untreated milk, the Rt. Hon. Peter Walker, M.P., Minister of Agriculture, Fisheries and Food said:

"A Milk Pasteurisation Equipment Grant Scheme is being introduced today to assist those producer-retailers who wish to pasteurise their milk, with the cost of installing the appropriate plant. Grant will be paid at the rate of 22½ per cent of eligible expenditure, or on standard costs for certain items. The Scheme rests on the authority of the estimates and the Appropriation Act; the necessary enabling legislation will be introduced as soon as possible. Leaflets will shortly be available in the Ministry's Divisional Offices in England and the Welsh Office Agricultural Department.

"From January 1, 1982 all retail containers of untreated milk will have to be clearly labelled "Raw Unpasteurised Milk"; for bottles this means the words will have to be enamelled in coloured lettering on the side or shoulder of the bottle; the distinctive green cap embossed with the words "Untreated Milk" and with the address of the premises at which the milk was bottled, will be retained.

"The 1p per pint premium which can at present be charged on farm-bottled milk in England and Wales will be removed from December 27, 1981.

NOTES FOR EDITORS

1. These measures, together with those announced on August 7 (Press Notice No. 298) completes the measures to be implemented following the Minister's statement of March 7 (Press Notice No. 103 refers).

2. An explanatory leaflet (Form PEG1) for the Milk Pasteurisation Equipment Grant Scheme gives details of the conditions of eligibility for grant and the equipment, works and facilities for which grant is available.

3. The present labelling conditions for untreated milk are laid down in the Milk (Special Designation) Regulations 1977 (S.I. 1977 No. 1033).

4. The current maximum retail prices for milk are specified in the Milk (Great Britain) (Amendment) Order 1980 (S.I. 1980 No. 1295). Under this Order the maximum retail price of untreated farm-bottled milk is 18p per pint; that is, 1p per pint more than for ordinary pasteurised milk.

M

No. 435

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

From the Minister

CONFIDENTIAL

PRIME MINISTER

27 November 1980

LIQUID MILK PRICES

You will recall that on 6 August we discussed economic strategy on the question of liquid milk prices at a time when both sides of the industry had put in a joint request for an increase of 1½p per pint from 3 August.

It was clear that if we were going to maintain to a tolerable degree incomes in the dairy sector this was a reasonable request, but knowing the pressures that existed, the Committee decided only to allow an increase of ½p with a further increase later in the financial year at a time to be agreed with the Department of Employment as being the most suitable time in terms of the retail price index.

In our discussions in economic strategy I pointed out that in order to sustain incomes at a tolerable level it would probably mean a further increase of 2p in January.

It was also felt that by that time we would have the opportunity of knowing more about the recommendations of Binder Hamlyn.

We now have the second Report of Binder Hamlyn which contains a number of useful suggestions which I am urgently pursuing with the dairy trade, and I am confident that we can reach agreement with them. But even if we make all of the modifications they have recommended, the effect on a distributive margin will be very small. Binder Hamlyn's own provisional assessment is that it would reduce the present figure of £900 million in England and Wales by no more than £25 million in a full year.

It is evident therefore that the underlying problem we faced in August will persist. Specifically, this means that, unless we increase the retail price, the costs of the dairy trade - who have had no increase in their target rate of profit since October 1978 - will be under-recouped by £35 million in the period up to 31 March 1981; and the average producer net margin will be only £55 per cow. This indeed would be the optimum outcome for producers. If the trade were to seek recoupment by paying the MMB less than the maximum wholesale price - and legally there is nothing we can do to stop them - the net margin would be as low as £42 per cow.

/The .....

The inadequacy of these figures 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	75.0	80
1980/81	55.0)	49)
	42.0)	37)

In other words, if we take no action on the retail price, the net margin in 1980/81 could in money terms be barely half what it was last year; and in real terms it would be by some way the lowest in the last decade or so, and between one-third and one-half the average figure during the years of the Labour Government.

The effect of this can be seen in all the economic indicators for the dairy sector. In June, the dairy herd was some 2% smaller than in June 1979; slaughterings have persisted at a high level; and dairy inseminations continue to decline. Perhaps most important of all, there are clear signs that this contraction is beginning to affect milk production in that the last two months have seen a 4% fall in output compared with the corresponding months last year.

Is not this what we want?

I have discussed the timing of an increase with the Department of Employment and I believe the ideal date for an increase would be 21 December, which would enable the increase to be shown in the January RPI, which is due to show a sharp fall, rather than that for December where the projection is less optimistic. It would also be better for the trade to retain the market in the run-up to Christmas rather than to leave it until the more depressed period of January.

As to the amount of the increase, if we were to try to recoup distributors' costs and to bring producers' net margins in real terms within striking distance of those in 1979/80, which was the lowest year since 1970/71, we would need to generate over £100 million between now and the end of next March. This would require an impossible increase of 3½p per pint in the retail price immediately. If, however, we go for an increase of 1½p per pint on 21 December, which is what I recommend, it would mean that the trade were getting £13 million less than what their present costing figures suggest they need and it would give the producer a net margin for 1980/81 of £63 per cow.

/I attach....

--- I attach a factual paper on the financial and wider implications and would be grateful if I could have approval to proceed with this as soon as possible, as the longer it is delayed the more unrest there will be and the bigger the increase will have to be when we make the decision.

I am copying this minute to members of 'E' Committee, the Secretaries of State for Scotland, Wales and Northern Ireland and Sir Robert Armstrong.

PETER WALKER

ANNEX

FINANCIAL AND WIDER IMPLICATIONS

1. An increase of 1½p per pint in the retail price would increase the RPI by 0.15%; the effect on the Food Price Index would be 0.7%. The present year on year forecasts for the RPI are understood to be as follows :

October (actual)	November	December	January 1981	February
+ 15.4	just over + 15	+ 15	+ 13-13½	just under + 13

Any price increase before 16 December would be counted in the December index and published in January so there would be a risk, in increasing the price of milk before then, of causing an increase in the index in December, so breaking the present declining trend. An increase on Sunday 21 December, will thus appear in the January RPI figures.

2. A price increase of 1½p per pint on 21 December would be expected to result in a fall in consumption up to the end of March 1981 of about 20 million litres. On the assumption that all of this 20 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 £1.6 million. This direct cost does not take account of extra storage and finance costs. However, it should be noted that the full cost is reimbursed to the UK from FEOGA when the produce is sold; the UK contribution on this FEOGA expenditure would be under £½ million. 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 £1.6 million and there would be no Exchequer costs.

Agriculture

10 DOWNING STREET

Tim / PM.

As the D.G. Fair Trading has already issued draft terms of reference the Government has missed the chance to try to influence him had E so decided.

Therefore better to leave discussion of the case (if any) for a week, until the terms are issued formally to S/S Trade. (See RTATO MAP 13.10.80)

Teresa
14.10.80

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

CONFIDENTIAL

From the Secretary of State

M A Pattison Esq
Private Secretary
10 Downing Street
Whitehall
SW1

14 October 1980

Dear Mike

MILK

David Jones' letter of 13 October asked for this subject to be considered at E on Thursday. Things have moved forward a little from the position set out in my letter of 9 October to Garth Waters (circulated by David Jones). I understand that the Director General has now written to the various branches of the milk trade setting out the terms of a possible reference and seeking their comments on it within the next three weeks. He will then consider whether to proceed to a formal reference to the Monopolies and Mergers Commission.

The occasion to consider whether my Secretary of State should intervene would arise when the Director General actually makes a reference. That is - at a minimum - about a month in the future, when the dairy industry's comments have been received and considered. In the meantime, I attach for the information of the Prime Minister and other members of the Committee a short note describing the procedure for making such a reference and for using the veto.

I am copying this letter to the Private Secretaries to other members of E Committee and to David Wright (Cabinet Office).

Yours sincerely,

Stuart Hampson

S HAMPSON
Private Secretary

ANNEX

MONOPOLY REFERENCE UNDER THE FAIR TRADING ACT 1973

1. A monopoly reference under the Fair Trading Act 1973 is essentially a direction to the Monopolies and Mergers Commission to investigate and report on a possible monopoly in the supply of a specified description of goods or services in the UK or part of the UK. A reference usually also requires the Commission to consider the question whether the monopoly or any particular aspect of it is against the public interest, in which case the Government has statutory powers of control; this question is of course in no way prejudged by the act of making a reference.

2. Where the Director General makes a reference he must publish it in the Gazette and send a copy to the Secretary of State. Within 14 days of publication in the Gazette the Secretary of State may veto the investigation by instructing the Commission not to proceed with it; this veto must also be published in the Gazette.

3. The veto has never been used before; and its use could be expected to provoke a good deal of comment. There are no statutory criteria to be met for using it; nor does the Act require reasons to be given for doing so. But the Secretary of State would have to defend it in public and of course in Parliament; and the arguments used would need to be suitably powerful.

Ref. A03223

MR. PATTISON

PM

Milk

The Assistant Private Secretary to the Minister of Agriculture wrote to you today to say that Mr. Walker wants to discuss at E on Thursday the proposal of the Director-General of Fair Trading to make a reference to the Monopolies Commission on the supply of milk for retail sale.

2. I understand that the Department of Trade now believe that it is almost certain the Director-General of Fair Trading will issue draft terms of reference for consultation tomorrow. If he does so, there may be little value in a discussion at E, when there is in any event little time for it. The opportunity will have passed for the Government to try to influence the decision of the Director-General of Fair Trading, had E so decided. The consultations on the draft terms will now take three or four weeks and it is only when terms of reference are formally issued that the Secretary of State for Trade could issue a statutory veto. Discussion on the case for a veto could therefore wait, avoiding the need for discussion in E this week.

3. If, contrary to the Department of Trade's expectations, the Director-General does not act tomorrow a very short discussion of the problem might have to be squeezed in at the end of Thursday's E.

D.J. Wright

(D.J. Wright)

13th October, 1980

Ministry of Agriculture, Fisheries and Food
Whitehall Place London SW1A 2HH

From the Minister's Private Office

CONFIDENTIAL

M A Pattison Esq
Prime Minister's Office
10 Downing Street
London SW1

13 October 1980

P.

Dear Mike

... I enclose copies of recent correspondence which my Minister has had with the Secretary of State for Trade on the question of reference to the Monopolies and Mergers Commission of the terms on which the dairy companies supply milk for retail sale.

The matter needs to be resolved this week because the Director General of Fair Trading has said that he proposes to take the preparatory steps towards making a reference very soon. My Minister would therefore like the matter to be taken at E on Thursday. Previous reference is E(80)30th Meeting, Item 2.

I am copying this letter to the Private Secretaries to members of E Committee and Sir Robert Armstrong.

Yours sincerely

David Jones

D E JONES
Assistant Private Secretary

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

From the Minister

CONFIDENTIAL

2 ~~10~~ October 1980

The Rt Hon John Nott MP
Secretary of State for Trade
1 Victoria Street
LONDON
SW1H OET

~~Prime Minister~~

To note that Mr Walker is strongly opposing a MMC reference on milk distribution

cc Mr Ingham

Dear Secretary of State,

Not in C/F

MONOPOLIES AND MERGERS COMMISSION : RETAIL MILK DISTRIBUTION

You will remember that I wrote to you on 4 September to say how strongly I was opposed to the proposal that the Director General of Fair Trading should refer to the Monopolies and Mergers Commission the terms on which the dairy companies supply milk for retail sale. I said then that I should be grateful for a chance of discussing this with you before any further action was taken. We have not yet been able to meet to talk about this, though I understand from your Private Office that you were hoping to have a word at Brighton. Meanwhile I have been appalled to learn from a letter yesterday from your Private Office that the Director General proposes to go ahead with this reference on Monday.

I must express the strongest objection to this. Although formally the proposed reference as drafted falls within the Director General's area of discretion, it concerns a particularly sensitive area of my responsibilities, one in which the Government is deeply involved, and one which is already the subject of independent inquiry by the accountants Binder Hamlyn. I appreciate the action the Director General has taken in deferring his decision, but I must express profound concern that he should consider going ahead with it before we have even been able to discuss i

There are in my view totally compelling arguments against making a reference now. We have just received some of the results of the latest Binder Hamlyn investigation, the dairy trade will soon be coming forward with their comments and there will need to be a searching Ministerial discussion of Binder Hamlyn's Report and the present price arrangements with which it deals. I do not of course know what will come out of this. But it makes no sense whatever to superimpose a Monopolies and Mergers Commission investigation just as we are getting to grips with the results of the present inquiry. It would not be fair to the industry to do so; and it would give the strongest impression of muddle and delay by Government.

/I must therefore ask again ....

I must therefore ask again that we should meet to discuss this before any decision is taken. I attach so much importance to the issue that I shall wish if necessary to raise it in Cabinet.

I appreciate that this is not an easy matter for you, and no doubt you have not been helped by the grossly misleading press notice put out by the Consumers Association. You may be interested to see the enclosed letter which I have sent to them about it.

I am sending copies of this letter to the Prime Minister and to the Director General of Fair Trading.

Yours sincerely,

Kate Timms

PETER WALKER

Approved by the Minister and signed in his absence

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

From the Minister

Peter Goldman Esq
Director
Consumers Association
14 Buckingham Street
London WC2N 6DS

10th October 1980

Thank you for your letter of 30 September enclosing an advance copy of the October issue of Which? and its accompanying Press Release.

I understand that a draft of the article on milk was sent to my officials, and other organisations with expert knowledge of the dairy industry, several weeks ago. And I am told that, as a result of the comments which were made to you, you have eliminated most of the factual errors from the published version of the article. This makes it all the more surprising to me that the article is still not entirely accurate and that your press release conveys an impression which is less accurate still.

Your article contains a table which appears to demonstrate that the price of milk is higher in Britain than anywhere else. However, the references which the article makes to the difficulty of making comparisons, to the level of exchange rates, and to the different fat contents of the milk, reveal that you are as well aware as we are of the impossibility of making a valid comparison of this type. Yet, despite, this, the first sentence of your press release, which was inevitably the point which received most coverage in the media, contains the unqualified statement that the price of milk is now higher than anywhere else in the EEC.

The passages in both the article and the press release on the price of milk for sale in liquid form are also misleading. The press release says that the price fixed by Government; but it is not: the Government fixes only a maximum price. The article and the press release both say that the dairies haven't challenged the prices that they have to pay; but they have dairies paid the MMB less than the maximum wholesale price from April through to August this year. The press release states that the Government guarantees a certain level of profit to the dairies; we do not: the system which we used to operate was designed to make sure (as your article explains) that the difference between the dairies' buying and selling prices was great enough, on average, to allow a certain level of profit. But I have not operated that system for nearly a year now and dairies have no guarantee at present of any particular level of profit. I have tried instead, over the past year, to divide the revenue from the retail price as fairly as possible between the two sides of the industry.

However, the aspect of your report and press release which disturbs me most is your attitude to the doorstep delivery service. You report that the vast majority of people seemed extremely satisfied with the service they got from the milk round; that nearly 90 per cent of the customers in your survey said that they would not switch to a supermarket or any other shop; and that, of those who said they would consider doing so, most said milk in shops would have to be at least 2 pence a pint cheaper first. You point out that on the evidence of your survey many people regar doorstep deliveries as an institution worth preserving. And you admit that you do not know what effect cheaper milk in shops would have on the doorstep delivery. Yet, despite this, you are advocating a move towards a higher level of milk sales through shops and it appears to be for this reason that you are calling for an investigation by the Monopolies and Mergers Commission. It seems amazing to me that you can so lightly ignore the declared views of the consumers you claim to represent.

PETER WALKER

c/91(

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

From the Secretary of State

Garth Waters Esq
Private Secretary to the
Minister of Agriculture, Fisheries and Food
Ministry of Agriculture, Fisheries and Food
3 Whitehall Place
London, SW1A 2HH

9 October 1980

Dear Garth

MILK

Your Minister wrote to my Secretary of State on 4 September about this subject; and his letter has gone unanswered pending a discussion between them, which they have arranged to try to have in Brighton this week.

Your Minister's letter was copied to the Director General, who has not taken any further action in the intervening period. But we now understand from his officials that despite the matter being the subject of correspondence between Ministers he feels that he cannot any longer defer making clear the steps which he is taking. If he is to proceed towards a reference, his next step would be to notify the various branches of the milk trade that he is considering a reference. Given the current speculation, he feels that he must take this step no later than Monday 13 October.

The Director General is, as you know, independent in matters of this kind; and, if he decides upon a reference, the only means by which his decision can be overturned is by a formal veto by my Secretary of State under the Fair Trading Act. A veto would be a public act; and it goes without saying that the reasons for it would need to be suitably powerful. But that is a matter for the future, if and when a reference were made: at the present time there is no basis on which this Department can deter the Director General from proceeding towards a reference if he considers it right to do so.

I am sending a copy of this letter to the Deputy Director General of Fair Trading.

Yours sincerely

Stuart Hampson

S HAMPSON
Private Secretary

-Ch:

NEW ST. ANDREWS HOUSE
ST. JAMES CENTRE
EDINBURGH EH1 3SX

SECRETARY OF STATE FOR SCOTLAND

M Pattison Esq
10 Downing Street

29 September 1980

Dear Mike

On 8 September you sent Godfrey Robson a copy of a telegram addressed to the Prime Minister by the Caithness NFU when she was in Orkney.

I attach a copy of the reply which I have now sent to the Area Secretary.

Yours sincerely

David Reid

D N G REID
Private Secretary

pls. check 2nd carbons
for 8 Sep.

SECRETARY OF STATE FOR SCOTLAND

NEW ST. ANDREWS HOUSE
ST. JAMES CENTRE
EDINBURGH EH1 3SX

E H Macdonald Esq
Area and Branch Secretary
National Farmers' Union of Scotland
6 Sir John's Square
THURSO
Caithness

29 September 1980

The Prime Minister has asked me to thank you for the telegram from the Caithness Branch of the National Farmers' Union of Scotland which she received on 5 September during her visit to Orkney and to reply to the points you raised in it.

Ministers are very much aware of the dismay among farmers about the uncertainty about the date of implementation of the EEC sheepmeat regime. In the negotiations on this subject the UK has consistently stressed the urgent need to introduce the regime in order to safeguard the interests of our producers. At the Council of Ministers meeting in July Vice-President Gundelach stated that he was confident the Commission would be able to complete the import agreements with third countries involved, for final consideration at the next Council meeting, which as you no doubt know takes place this week. This would permit the Council to finalise both internal and external aspects of the regime by early in October.

The Government are taking every possible step to persuade France, the only Member State strongly opposed to the settlement negotiated with New Zealand, to accept the majority view on this matter.

As regards the Suckler Cow Premium, the Agriculture Departments are re-examining a number of aspects of the Regulations. In particular, urgent guidance is being sought from the EC Commission on the income, replacement and recovery provisions of the scheme. The Department of Agriculture for Scotland will get in touch with your Union Headquarters as soon as there is anything to report.

D N G REID
Private Secretary

File

DSG

22 September 1980

Thank you for your letter of 19 September enclosing notes on the modernisation of the Orkney creamery and on the possibility of changing the base of the guaranteed milk price.

The Prime Minister has seen these notes. She does not intend to write further to the Orkney branch of the Scottish National Farmers Union unless they approach her again.

MAP

John Wilson, Esq.,
Scottish Office.

NC.

1.

SCRETARY OF STATE FOR SCOTLAND

SCOTTISH OFFICE

WHITEHALL, LONDON SW1A 2AU

Prime Minister
Comments on the issues raised by Orkney farmers.
Agree that you do not need to write to the Orkney NFU?
MAP

Mike Pattison Esq
No 10 Downing Street
LONDON SW1

19 September 1980

Yes mt

Dear Mike,

Thank you for your letter of 8 September recording the discussion between the Prime Minister and a delegation from the Orkney NFU on the occasion of the Prime Minister's recent visit to Orkney and Shetland.

As you requested, I enclose notes on the modernisation of the Orkney creamery, and on the possibility of changing the base of the guaranteed milk price.

Yours ever,

John Wilson

JOHN S WILSON
Private Secretary

NOTE FOR THE PRIME MINISTER

MILK PRICES: CONTROL AT WHOLESALE LEVEL ONLY

1. The Prime Minister was asked by the Orkney Branch of the Scottish NFU whether it would be possible to set a wholesale price guaranteed to producers, leaving distributors to compete in setting retail prices which the consumer would pay. They recognised that this might present a challenge to the doorstep delivery, but argued that it was the present gap between the price received by the producer and that paid by the consumer which might encourage continental supplies.

2. Two points should be made straightaway on the premise behind this suggestion. First, the Government only has power to fix maximum wholesale prices for liquid milk. It would not therefore be possible to guarantee that price to producers. Moreover, as only half the milk produced in the country is sold in liquid form, the average producer price will depend also on the price of milk products, which the Government does not control in the same way. Thus, irrespective of what we do, producer returns will continue to depend to a large extent on the market. Secondly, the potential competitiveness of continental supplies is not simply a function of the amount received by the dairy trade: the price the milk boards receive for liquid milk is substantially above the manufacturing price, and this too is bound to have an effect.

3. The question of whether Government should continue to control liquid milk prices at both wholesale and retail levels is however one which Ministers will wish to consider later in the year in the light of the recommendations of the firm of independent accountants (Binder Hamlyn) which is currently considering the costings system used to determine the distributive margin for the dairy trade. It would of course be perfectly possible in theory to control only the maximum wholesale price leaving retail prices to be set by competition, but this is only one of a range of potential options. In particular, it would be necessary:-

(a) to consider whether it would really be in producers' interests to confine control to the MMB selling price, whilst leaving the dairy trade free to set its own price:

(b) to assess whether decontrol would be detrimental to the doorstep delivery service, bearing in mind that this could bring about fairly rapid changes in England and Wales (in contrast to the more gradual process by which the present balance has been arrived at within Scotland):

(c) to bear in mind that, insofar as the existing controls merely establish a <u>maximum</u> retail price, there is nothing in this system at present to prevent dairies from competing with each other by selling below that price.

4. If therefore the Prime Minister wishes to respond at this stage to the Orkney NFU's suggestions, she might merely say that this is one of the options the Government will be considering later in the year in the light of the Binder Hamlyn Report.

DAFS
18 September 1980

E.R.

ORKNEY CREAMERY

1. 87 per cent of the milk produced in Orkney is used for milk product manufacture because, while Orkney is highly suitable for milk production, it is uneconomic to transport milk to the mainland for manufacture, as Mr Joughin will have emphasised to the Prime Minister. The North of Scotland Milk Marketing Board have therefore concentrated their efforts on producing a branded Orkney cheese, a full fat Cheddar type aimed at a premium market. Unfortunately the cheese-making equipment used is now outworn and outdated. Modernisation and expansion is required for the factory to remain economic.

2. Over recent months, representatives of the North of Scotland Milk Marketing Board have discussed with the Department of Agriculture and Fisheries for Scotland (DAFS) the Board's still tentative proposals for modernising and expanding this facility. They have been assured of our fullest co-operation and support in their preparation and presentation of the application for FEOGA assistance for the project to the Commission of the European Community. The application is expected to arrive very soon.

3. Applications for FEOGA assistance for UK projects far exceed the amount of money available and responsibility for selecting the projects to be helped rests with the EC Commission. Because milk is in surplus, projects involving dairy products, including increased cheese manufacturing capacity, generally command a low priority. However, in examining UK applications, the Commission tend to favour projects situated in remote and disadvantaged areas of the UK. DAFS will stress this aspect of the Orkney project to the Commission, together with the great importance of a viable cheese-making plant to the Orkney farming economy.

4. It is a condition of the FEOGA grant scheme that a minimum financial contribution towards the cost of a project must be made by the Member State. Orkney is not an assisted area under the Industry Act and in consequence the project will not qualify for aid under that Act. The Board will be submitting proposals for aid to the Highlands and Islands Development Board (HIDB), which has expressed an interest in the project. If the appropriate level of aid is not forthcoming from the HIDB, the necessary Member State contribution (8 per cent) would, if the FEOGA application succeeds, be available under the Agricultural Products Processing and Marketing (Improvement Grant) Regulations 1977.

DAFS

File

Agriculture ...

cc MAFF
Master set.
BF 22.9.80

10 DOWNING STREET

From the Private Secretary

8 September 1980

Dear Godfrey

As you know, the Prime Minister's visit to Orkney and Shetland included a meeting with a delegation from the Orkney NFU. The team of three - Messrs. Wood, Bain and Burgher - were augmented by the Chairman of the North of Scotland Milk Marketing Board.

The Prime Minister talked to the delegation for half an hour. She listened carefully to their presentations, and came away with the message that their prime concerns were the level of interest rates, the collapse of the market for their main products, and ever increasing costs, especially in labour, fuel, and transport.

I enclose notes left with the Prime Minister by the NFU team and by the North of Scotland Milk Marketing Board Chairman. I am sure that most of the representations set out here were entirely predictable. The Prime Minister was particularly asked to put her personal authority behind the farmers' efforts to secure maximum assistance for the modernisation of the Claymore creamery. I understand that both Scottish Office and FEOGA assistance is being sought. It would be helpful to have a note about prospects for this project.

The Prime Minister was also much interested in the discussion about the milk price. The producers were arguing that the recent ½p increase had put too much of a squeeze on them. The Prime Minister countered that this was a price sensitive product, but that she was also much concerned about distribution costs. The farmers agreed, and argued that the gap between producers' incomes and retail prices was what might tempt continental suppliers to try to break into the UK market. They asked about the possibility of changing to a system whereby the wholesale price would be guaranteed to the farmers, whilst the distributors would be left to compete amongst themselves. They recognised that this would be a challenge to doorstep delivery, but claimed that recent experience in Scotland had shown that growing shop sales had actually helped to boost doorstep sales.

On sheepmeat, the farmers were concerned about delay in implementation of the European Community Regime, and asked whether the Government would be prepared to operate this scheme unilaterally in this country in the event of Community negotiations not being completed this month. The Prime Minister responded that this was not likely to be possible in Community law, but she firmly believed that we would be successful in formalising arrangements at the September Agriculture Council in view of the pressure from other countries to get the scheme under way. She noted that the Orkney sheep farmers would be in real difficulty if this was not achieved.

/I am

I am sending a copy of this letter and enclosures to Garth Waters (Ministry of Agriculture, Fisheries and Food). In addition to the note which I have requested on the Claymore creamery modernisation, it would be helpful to have a joint MAFF/Scottish Office note on the possibility of changing the base of the guaranteed milk price. Perhaps we could have something by 22 September.

I also enclose (to you only) a copy of a telegram addressed to the Prime Minister by Caithness NFU whilst she was in Orkney. Could you please arrange for a suitable reply to be sent on her behalf, with a copy to us for our records.

M. A. PATTISON

Godfrey Robson, Esq.,
Scottish Office.

NFU OF SCOTLAND - ORKNEY AREA

Farming in Orkney

Current Position

Due to low prices for cattle, sheep and milk and high costs of feed, fertiliser, machinery repairs and fuel coupled with high interest rates, farming in Orkney is in a precarious position. Many farmers do not know how they are to exist over the next winter. There is no doubt that the Banks would be forcing many to sell their farms now if these farms could be sold at a realistic price.

With inflation running at about 20% and prices remaining static the position would be serious. However, prices have decreased considerably. Some farmers have suffered a decrease of about £70 per head on 8-cwt store cattle but the local auctioneers estimate that the average decrease is in the region of £40 per head. This is disastrous.

Agriculture is the basic industry of Orkney with the whole population being more or less dependent on farming. Already several firms have had to reduce staff and, unless quick remedial action is taken, the whole economy of Orkney will be in ruins.

Action Required

1. Interest Rates must be reduced considerably at the earliest possible date.

2. Beef Prices: The Target Price of beef should be raised substantially and the maximum Variable Premium payable should be increased. Intervention Buying of beef should not be restricted in the UK more than in any other country.

3. Hill Livestock Compensatory Allowances should be raised to their maximum as a matter of urgency (for cows from £35 to £59.83, for upland ewes from £4.25 to £8.97 and for hill ewes from £5.50 to £8.97).

4. Sheepmeat: The EEC Sheepmeat Regime should start on 1st October but, if it does not, the UK Government must introduce a scheme of its own to give prices equivalent to those already announced by the Minister of Agriculture for the EEC regime (rising to a peak of 199.6p/kg).

5. Suckler Cow Premium Scheme: This premium, while it is welcomed, is at too low a rate. The rules of the scheme are not suitable for island farmers. Fresh milk will no longer be available in the remoter islands, and the 50% working and earning rule means that smaller part-time farmers do not qualify.

6. Milk: Prices must be increased. The whole industry agreed some time ago that 1½p per pint from 1st August was needed but an award of only ½p per pint was given. Farmers are going out of milk at an alarming rate and the future of our Creamery is in jeopardy.
   Assistance is required to update the Orkney Creamery.

7. Road Equivalent Tariff: A full RET system of charging for sea transport should be introduced at the earliest possible opportunity.

8. Agricultural Development Programme for the Highlands and Islands: It has been proposed that the West of Ireland be given £167.8m, Italy £282.9m and the Western Islands of Scotland £11.2m by the EEC for agricultural development. The proposals for the Western Isles should be extended to include the whole of the Highlands and Islands of Scotland and assistance from the EEC should be increased.

Conclusion

The whole future of Orkney is in jeopardy. Speedy and effective government action is required to prevent irreparable damage to our economy.

GSB/MK 3/9/80

Prime Minister,

The North of Scotland Milk Marketing Board operates from the Spey to Orkney. Mainland production goes largely to the high priced liquid doorstep market. 87% of Orkney's milk goes into cheese and butter at low prices, made lower by the cost of crossing the Pentland Firth and the long haul to the southern markets.

Oil has brought additional revenue to Orkney and some well paid jobs, but the basis of the Islands economy was and will be agriculture. Unusually for an Island, milk has played a large part in the Islands farm output. Milk brought in £1,800,000 last year and our creamery employs 46.

Our hand filled cheesemaking demands labour to make it and buttermaking leaves skim milk which demands oil to dry it. Both labour and oil used to be cheap in Orkney, but as a side effect of the world oil situation and the competition from local oil jobs both are now expensive and the creamery upon which Orkney milk production depends has therefore become uneconomic.

If Orkney milk producers stood alone that would be the end of the story and the creamery would have to close to the detriment of Orkney. But they did not - they voted in the E.E.C. referendum along with their Mainland colleagues to remain part of the North of Scotland Milk Marketing Board. I might add it is the only case I know of any organisation this side of the Iron Curtain where 100% of the members voted and everyone voted in support.

As a result their fellow dairy farmers on the Mainland not only help to carry these creamery losses but also - through the pooling of milk prices - ensure that Island producers get the same price as the Mainland - considerably above the price earned by Orkney cheese and butter (1.8p/litre).

Such pooling is, of course, within the principles of our Milk Marketing Boards and so long as our Mainland price is not dragged down too far will continue. Meanwhile we are submitting plans to Government and F.E.O.G.A. to modernise with a mechanised cheese line to cut labour costs extended to take all Orkney milk and thus stop butter and powder making and oil hungry skim milk drying.

For Orkney I ask two things:

1. To ask the Scottish Office to accept that subsidisation of Orkney milk prices should not be a permanent burden on the small number of Mainland producers.

2. Would you support the present willingness of Mainland farmers to help the Islands with investment in their creamery. Support from you would ensure that Scottish Office and H.I.D.B. officials, who we always find helpful, bend the rules to allow the maximum permissible grant aid.

On the wider milk front, I would ask that when you and your Cabinet again consider milk prices in the Autumn, you remember Orkney and the North of Scotland where self-interested pleading is unnecessary for our figures demonstrate the milk price to have been inadequate.

In the last year producers have dropped out dramatically, 5% in our Mainland area and 17% in Orkney. In July 1980 production in Orkney fell by 13% and now we find that surviving milk producers no longer take over the cows of outgoing producers. We have 13% fewer cows in Orkney than last year. 22% down on two years ago.

In the North Board we are not given to gloom and are proud of our record. Almost thirty years ago we were 500 producers, today we number 140. Two years ago our then 170 producers milked 15% more cows than the 500 and produced 92% more milk and even now when down to 140, they are producing 68% more milk from the same number of cows as the original 500. If British industry could tell the same story your problems would be solved.

But our success story has faltered over the last 2 years - largely as a result of an over-valued Green £ working against us. You have corrected that, but restricting the doorstep rise to only a ½p was squeezing us too hard. We know what you are trying to do in the country, many of us admire your courage, but please use the wealth creation of agriculture to help us all.

75185 HPOFX G
727691 PO EH G

J52 GWO X40 0926 THURSO GW 61

RT HON MARGARET THATCHER PRIME MINISTER
KIRKWALL HOTEL
KIRKWALL

CAITHNS BUST

KIRKWALL
5-9-80
TELEGRAMS

75185 HPOFX G
727691 PO EH G

J52 GWO X40 0926 THURSO GW 61

RT HON MARGARET THATCHER PRIME MINISTER
KIRKWALL HOTEL
KIRKWALL

CAITHNESS NFU WELCOMES YOU TO THE LESS FAVOURED AREAS
AND URGES YOU 1 TO INTRODUCE THE NEW SHEEP REGULATIONS WITHOUT
FURTHER DELAY 2 TO URGENTLY REVIEW MANY OF THE DISTURBING
FEATURES IN THE SMALL PRINT OF THE NEW SUCKLER COW PREMIUM
REGULATIONS . A DECLINING AGRICULTURAL AND CROFTING
ECONOMY DEMANDS NO LESS

COL 1 2 .

727691 PO EH G
75185 HPOFX G

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

From the Minister

The Rt Hon John Nott MP
Secretary of State for Trade
Department of Trade
1 Victoria Street
London SW1H OET

4 September 1980

RETAIL MILK DISTRIBUTION

I am very concerned at the proposal, which has been discussed at official level, that the Director General of Fair Trading should make a reference to the Monopolies and Mergers Commission under the Fair Trading Act concerning the terms on which the dairy companies supply milk for retail sale. I do really think that we need to consider very carefully before we put the dairy industry through the rigours of yet another investigation. Not only are they already subject to more Government involvement than virtually any other part of the private sector, but they have just undergone one examination by the House of Commons Agriculture Committee, and of course we are still in the process of the in-depth study by Binder Hamlyn of the costings arrangements. I do not see that we have anything to gain by further investigations, particularly at a time when the industry is having the greatest difficulty in maintaining the doorstep delivery service in the face of current economic pressures.

I do not think there are any serious consumer complaints against the present system which is highly welcome to most people. The complaints seem to be vague, to be provoked by self-appointed consumer representatives and they have all been answered very fully by my officials to representatives of the OFT.

The main complaint now seems to be the price at which dairies sell milk to shops. This seems a strange complaint to want to investigate, to say the least, when Sainsburys, for example, have only just negotiated an arrangement which has allowed them to sell cartoned milk in their supermarkets at ½p a pint below the price at which bottled milk was delivered to the doorstep even before the recent price increase.

I should, of course, be very happy to discuss all this with you after the holidays, but I must stress that I would be totally opposed to the OFT initiating a reference in the meantime. First, we really must wait for any investigation until we have the results of the Binder Hamlyn exercise. We shall need to look at the whole basis of our price controls in the light of its recommendations. I know you have strong views on this. The trade would never be able to understand why we had started up another investigation before we had come to any conclusion on the current one - and nor would anyone else.

Secondly, the House of Commons Agriculture Committee has recommended that there should be a wide-ranging Government inquiry into the whole structure and economics of milk distribution. Whilst I would obviously not be in favour of such an inquiry, we have yet to decide upon our reply to that recommendation and, although the OFT may regard a reference to the MMC as being an appropriate response, this must be a matter for the Government itself to decide. It would be quite wrong, therefore, for that decision to be effectively pre-empted by the OFT embarking on a reference now and I am sure you would agree that no action ought to be taken at least until we have had a chance to consider this together.

I am sending a copy of this letter to the Director General of Fair Trading.

PETER WALKER

Ref. A02817

PRIME MINISTER

Liquid Milk Prices

(E(80) 88 and 89)

BACKGROUND

The Minister of Agriculture proposes in his paper E(80) 88 to accept in its entirety a joint claim by the milk producers and distributors for 1½p on a pint of milk from now (i.e. giving a 9 per cent increase from 16½p to 18p for ordinary pasteurised milk). This follows increases of 1½p in May 1979 and again in February this year. He justifies this proposal by pointing to what would otherwise be very low producers' and distributors' margins (see the table on the first page of his paper). On his proposal the extra revenue to next March of £96 million would be split equally between producers and distributors. This would bring producers' and distributors' margins closer to last year's level, although still below it in real terms.

2. The Chief Secretary in his paper proposes instead that no increase should be awarded until the end of the year, on the grounds (a) that it would impinge on the coming wage round: the RPI effect is only 0.16 per cent, but he thinks that in terms of perceptions the effect could be much greater; (b) it would prejudge the second Binder Hamlyn report, on milk distribution, due in the autumn; (c) if it means a further increase in the spring it could make it harder for us to resist CAP milk price increases next spring; (d) there is no sign yet of any collapse in the dairy industry, and even if there were they have no more right to automatic protection from inflation than other industries.

3. The Minister of Agriculture proposes a uniform increase for the United Kingdom, and the other Agricultural Departments agree with this. But the industry's position is reported to be rather better than average in Scotland and rather worse in Northern Ireland. The Secretary of State for Northern Ireland was considering earlier a separate milk aid scheme for Northern Ireland but under public expenditure constraints has decided to drop it.

HANDLING

4. After asking the Minister of Agriculture and the Chief Secretary to introduce their papers, you might suggest the main issues are -

Binder Hamlyn

(a) Timing in relation to the wage round. Would an August increase have a more damaging effect than a possibly bigger increase in (say) January? (It probably would, if only because by January the general level of wage increases would already have been set).

Amt. £96 m.

(b) The seriousness of the milk producers' problems. Could they not wait till January, or at least (say) November, since their costs are lower in the summer? If there is a risk of slaughterings in the meantime, could the Government, in rejecting a price increase now, encourage the producers by referring now to the likelihood of an increase by January?

(c) Binder Hamlyn - Monopolies etc. The Minister of Agriculture implies that one reason for not waiting for the Binder Hamlyn report (as suggested in Mr. Lankester's letter of 31st July) is that it will not propose anything very radical.

You might ask for views on a more far-reaching enquiry into the milk pricing system. The Select Committee on Agriculture called for this last week; and the Director General of Fair Trading has spent some months considering a reference to the Monopolies Commission. Does the Secretary of State for Trade think an announcement of the next price increase could be tied in with an announcement of a reference to the MMC?

(d) European implications. Do colleagues accept the Chief Secretary's argument that a December/January increase is preferable in order to head off pressure for a further increase during the price-fixing negotiations? Whenever the increase is made, the Government should make clear to the producers that it expects them to accept its tough line on the CAP price in return for its consent to an increase in the liquid price.

CONCLUSIONS

5. You will want to reach conclusions on:-

(i) Whether to allow a price increase now, or wait till the turn of the year: if the latter should anything be said now about a later price rise to encourage the producers?

(ii) If an increase now, how much? $1\frac{1}{2}$p, as the Minister of Agriculture proposes, or a smaller amount? There is no need to decide now on the size of any winter increase.

(iii) Whether the Minister of Agriculture should be asked to bring forward proposals in the autumn on milk costings in the light of the Binder Hamlyn report, and the Secretary of State for Trade to bring forward proposals on the possibility of a reference to the Monopolies Commission.

RtA

(Robert Armstrong)

5th August, 1980

CONFIDENTIAL

B12

file

cc: CO
D Wright

Agriculture

10 DOWNING STREET

From the Private Secretary

31 July 1980

Dear Garth,

Liquid Milk Prices

The Prime Minister has seen your Minister's further minute of 25 July about the procedure for considering liquid milk prices.

– She remains of the view that this matter needs to be further considered by officials under Cabinet Office chairmanship before coming to Ministers. She would then like to take it in E Committee, at the meeting arranged for 6 August, or possibly at a further meeting on 7 August, n the basis of a paper from your Minister. She would like officials to consider, among other things, the implications of an increase in liquid milk prices for our approach to next year's CAP price fixing and the relationship of the timing of any such increase to the Binder Hamlyn Report, which I understand is now due in mid-September.

I am copying this letter to the Private Secretaries to members of the Cabinet and to David Wright (Cabinet Office).

Yours ever

Tim Lankester.

Garth Waters, Esq.,
Ministry of Agriculture, Fisheries & Food

CONFIDENTIAL

Northern Ireland Office
Stormont Castle
Belfast BT4 3ST
Telephone Belfast 63011

T P Lankester Esq
10 Downing Street
LONDON SW1

3 July 1980

Dear Tim,

LIQUID MILK PRICES

The Minister of Agriculture sent a minute to the Prime Minister on 18 July on this subject, setting out a number of possible options. At the end of the paper enclosed with his minute, he drew attention to the problem of returns for Northern Ireland farmers, and the risk of loss of production and employment. He concluded that it would be necessary to make public funds available to top up the market returns to Northern Ireland farmers.

Since this matter is due to come to Cabinet shortly, my Secretary of State thought it would be useful to record that, after careful consideration of the competing priorities, a milk aid scheme did not feature in the bid which he has submitted against the Contingency Reserve, on which the Chief Secretary will be circulating a minute to members of the Cabinet. In other words, that part of Mr Walker's paper which relates to Northern Ireland may be regarded as overtaken by events.

I am sending a copy of this letter to Garth Waters and Alistair Pirie, to the Private Secretaries to other members of the Cabinet, and to David Wright.

Yours ever,

Roy Harrington

R A HARRINGTON
Private Secretary

JC

May I see the Binder Hamlyn report?

CONFIDENTIAL

Prime Minister

Agree that we should insist on this being considered under Cabinet Office chairmanship before going to Ministers?

Ref. A02770

MR. LANKESTER

Yes

Liquid Milk Prices

Flag A

In his minute of 25th July to the Prime Minister the Minister of Agriculture urges that the question of an increase in liquid milk prices should now go direct to Cabinet or a Ministerial Committee, without prior discussion in an official committee of the kind suggested by the Chief Secretary, Treasury in his minute of 23rd July and endorsed by the Prime Minister in your letter to Mr. Waters of 24th July. This last letter also records the Prime Minister's view that it will be very difficult to consider any further increase in liquid milk prices until Ministers have considered the findings of the Binder Hamlyn Report on milk distribution arrangements and costs.

Flag B

2. The preliminary meeting of MAFF, Treasury and Department of Trade officials proposed by the Chief Secretary as the first step has now taken place, and the background figures have been clarified between the Departments concerned. There remains a need for fuller interdepartmental discussion at official level: to bring out any Community implications (e.g. the relationship between a price increase for our dairy farmers and the stance we take on next year's CAP price fixing), to establish whether other options exist besides those put forward by Mr. Walker, and to consider how far it might be possible to reach a decision on this issue without prejudice to the recommendations in the forthcoming Binder Hamlyn Report. If the Prime Minister agrees, I hope she will be ready to insist on a further meeting at official level, even at the cost of missing the 3rd August date that Mr. Walker has in mind as the earliest of his options for introducing a higher milk price.

3. Thereafter it would be normal for this question to come to E(EA). But the Prime Minister may feel that she would wish to chair this discussion herself, in which case E Committee might be preferable to Cabinet. If this is her view, I would suggest that despite E's crowded agenda some time be found for this subject before the summer break. Allowing for urgent official

CONFIDENTIAL

consideration, a possibility would be the meeting of E Committee scheduled for Wednesday, 6th August. The alternative is either yet another meeting of E before or after Cabinet on 7th August; or to take this in full Cabinet on that day. It might be necessary to resume discussions after the Recess when the Binder Hamlyn Report is available.

4. I attach a draft reply to the Minister of Agriculture in this sense.

RtA

(Robert Armstrong)

30th July, 1980

CONFIDENTIAL

DRAFT LETTER FROM MR. LANKESTER TO MR. WATERS

Liquid Milk Prices

The Prime Minister has seen your Minister's further minute of 25th July about the procedure for considering liquid milk prices.

2. She remains of the view that this matter needs to be further considered by officials under Cabinet Office chairmanship before coming to Ministers. She would then like to take it in E Committee, at the meeting arranged for 6th August, or possibly at a further meeting on 7th August, on the basis of a paper from your Minister. She would like officials to consider, among other things, the implications of an increase in liquid milk prices for our approach to next year's CAP price fixing and the relationship of the timing of any such increase to the Binder Hamlyn Report, which I understand is now due in mid-September.

3. I am copying this letter to the Private Secretaries to members of the Cabinet and to David Wright, Cabinet Office.

A

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

From the Minister

PRIME MINISTER

LIQUID MILK PRICES

I have seen John Biffen's minute of 23 July to you about the procedure for considering liquid milk prices.

I would of course have no objection to a meeting between my officials and those of John Biffen and John Nott to consider the factual background to the note I sent to you on 18 July. My Officials have already circulated a paper to the Treasury, Department of Trade and Cabinet Office, and they will, as a matter of urgency, be arranging a meeting with those concerned. However, I would hope the question could then be considered either in Cabinet or in a Ministerial Committee. I do not see that a further meeting at official level in a Cabinet Office Committee would serve any useful purpose, and, as I indicated in my original note to you, the longer the delay, the greater the price change that becomes necessary in order to achieve any given effect. I hope therefore that we can proceed in the way I have indicated.

I am copying this minute to members of the Cabinet and to Sir Robert Armstrong.

PETER WALKER
25 July 1980

CONFIDENTIAL

c.c. D/E
SO
WO
NIO
DHSS
Duchy
D/T
DES
Chief Sec.
P.Gen.
HO
LCO
FCO
HMT
D/I
MOD
LPO
D/M
LPS

Agriculture

10 DOWNING STREET

From the Private Secretary

24 July, 1980.

Liquid Milk Prices

The Prime Minister has read your Minister's minute of 18 July and the note which he enclosed with it, and also the Chief Secretary's minute of 23 July.

The Prime Minister agrees that Mr. Walker's proposal should be handled in the way suggested by the Chief Secretary. As to the substance, the Prime Minister feels it will be very difficult to consider any further increase in liquid milk prices until Ministers have considered the findings of the Binder Hamlyn Report on milk distribution arrangements and costs.

I am sending copies of this letter to the Private Secretaries to Members of the Cabinet and David Wright (Cabinet Office).

T. P. LANKESTER

Garth Waters, Esq.,
Ministry of Agriculture, Fisheries and Food.

CONFIDENTIAL

CONFIDENTIAL

B.

Prime Minister

This is as expected. Agree with Mr Biffen's proposals for handling?

Treasury Chambers, Parliament Street, SW1P 3AG

Yes mt

PRIME MINISTER

23/7

LIQUID MILK PRICES

I have seen Peter Walker's minute to you of 18 July suggesting a discussion of liquid milk prices either in Cabinet or an appropriate Committee.

2. This is clearly a major matter, involving a number of important policy issues, which will need careful consideration. But, before we meet at Ministerial level, I would like to suggest that we initially remit the subject to officials to consider the detailed factual background, for example the implications for farmers' and distributors' incomes. I think it is important that, if we are to be able to focus on the key points of policy, the factual position should first have been cleared between officials, as has been done in the past. You will recall that I made a similar suggestion for an initial remit to officials earlier this month when Peter wrote to you about the problems of the fishing industry.

3. If you agree with this approach I would suggest that my officials should first meet with those of Peter Walker and John Nott, and that there then might be a meeting in an appropriate Cabinet Office Committee at official level. I recognise that this may mean it will not be possible for us to implement any decision by 3 August, the date proposed by the dairy trade and included in Peter's possible options. But I do not see that we need to be constrained by that date.

4. I am copying this minute to members of the Cabinet and Sir Robert Armstrong.

W. J. B.

JOHN BIFFEN 23 July 1980

CONFIDENTIAL

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

From the Minister

Prime Minister

Another direct approach from Mr Walker before there has been any discussion with the Treasury. I have told MAFF that this won't do. I suggest we hold fire until we have the Chief Secretary's comments (and Mr Nott's).

What has happened to the reports - distributors' costs? We must have that before considering this

18 July 1980

PRIME MINISTER

LIQUID MILK PRICES

I know you will have seen the Press reports that the two sides of the dairy industry have jointly requested us to increase the retail price of milk by 1½p per pint on 3 August. They have argued that this is the minimum that must be done if both sides of the industry - the farmers and the dairy trade - are not to run into severe financial problems.

I do, however, recognise how crucial it is to the Government in these coming months to keep any increases in the retail price index to the minimum. But I am certain that we must take some action and as quickly as possible, for I think you will see that the attached paper explains that without it there would be this year the most disastrous fall in producers' returns - down in fact to half of the lowest income in the last ten years.

But rather than purely comment upon the implications of giving the 1½p increase on 3 August, I have tried to set out a series of options as to what would actually be available to us if we wished to try and maintain producers' returns at something near their low level of last year.

I hope that you will agree that this should be discussed either in Cabinet or an appropriate Committee.

I am copying this minute and the paper to the members of the Cabinet and to Sir Robert Armstrong.

PETER WALKER

CONFIDENTIAL

MEMORANDUM ON LIQUID MILK PRICES

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)

It will be seen that if we take no action on prices, the net margin for 1980/81 will be £27. Even in money terms, this would be the lowest figure in the whole of this period; and in real

The increase required to maintain producer returns at a level somewhat lower than that of last year would be:-

$1\frac{1}{2}$ pence on 3 August or
2 pence on 5 October or
$2\frac{1}{2}$ 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 $1\frac{1}{2}$ pence on 11 January.

The dairy trade and Binder Hamlyn

6. Any final assessment of the dairy trade's position will depend upon the decisions we take later in the autumn following the further work being done by Binder Hamlyn. In the meantime, they have had no increase in their target rate of profit since October 1978, and, on the basis of the system that has operated since January of that year, even the proposal advanced by the industry would leave their measured costs 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.

Scotland and Northern Ireland

7. 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. If a serious loss of production and employment is to be avoided in Northern Ireland it will be necessary to make public funds available to top up the market returns there.

terms, it would be less than half the next lowest year of 1974/75 and less than one quarter of the average figure during the years of the Labour Government.

3. I do not believe this would be tolerable in political terms, or indeed in the national interest. In June, the dairy herd was some 65,000 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 options before us

4. 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 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).

5. 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, it is clear that an increase of the sort requested by the industry will be necessary. I am sure we will need to provide this. It is also clear that the sooner we act, the smaller the increase that will be needed to achieve any given effect. Thus:-

Agriculture

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

From the Minister

The Rt Hon John Nott MP
Secretary of State for Trade
1 Victoria Street
London SW1H OET

19 May 1980

REVIEW OF LIQUID MILK DISTRIBUTIVE COSTINGS SYSTEM

Thank you for your letter of 21 March.

I have less confidence than you that the views expressed by certain consumer organisations are truly representative of those held by the great majority of consumers who, I believe, greatly value the doorstep delivery service and would wish us to do everything possible to retain it. Moreover, if we add into the reckoning the implications for producer returns and for those employed in the liquid milk processing and distribution sectors - not to mention the social benefits of the doorstep system for the aged and the sick - my conclusion is that we should be devoting our energies to defending it for the benefit of the many rather than seeking to cut the price for the benefit of the relatively few who would both be able and might actively prefer to buy milk in shops. In this, I very much agree with the comments in John Biffen's letter of 9 May. However, as you say, that is something we can consider further in the summer once we have the results of Binder Hamlyn's further studies.

I am copying this letter to the Prime Minister, Geoffrey Howe and Sir Robert Armstrong, and also to George Younger, Humphrey Atkins, Nicholas Edwards and John Biffen.

PETER WALKER

CONFIDENTIAL

Agriculture

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Peter Walker MBE MP
Minister of Agriculture
Ministry of Agriculture
Fisheries & Food
Whitehall Place
London SW1A 2HH

9 May 1980

Dear Peter,

REVIEW OF LIQUID MILK COSTINGS SYSTEM

John Nott sent Geoffrey Howe a copy of his letter to you of 21 March about further work to be commissioned from Binder Hamlyn following completion of their initial report. I offer the following comment after discussion with Geoffrey.

I am sure it is right to ask Binder Hamlyn to do further work in the areas which they were not able to cover adequately in their initial report, to enable us to arrive at a more thorough understanding of the consequences of present restrictions on market forces. But I think we should move with caution. Any changes in the doorstep delivery system would be politically sensitive, and I am sure we are all mindful of the recent controversy over sub-Post Offices.

In the long run it may well be that the doorstep delivery system will come under challenge through competitive pressures. In particular, the EC challenge on the health regulations which at present inhibit imports of cheaper liquid milk may prove difficult to resist indefinitely, and such imports, sold more cheaply through supermarkets, etc., would represent a threat to doorstep deliveries. With that thought in mind, I suggest that the aim of the further work should be to encourage the continuing viability of a doorstep delivery system by ensuring that the distributive margin is not set so high as to give a strong incentive to supermarkets to price out doorstep deliveries by selling cheap imports of liquid milk once these become available. In other words, the consumer's interest in obtaining milk as cheaply as possible must be given considerable weight, but there are also other factors, which we would ignore at our peril.

I am sending copies of this letter to the Prime Minister, to John Nott and to Sir Robert Armstrong.

Yours
John Biffen

JOHN BIFFEN

File

DS

Agriculture

10 DOWNING STREET

From the Private Secretary 24 March 1980

Review of Liquid Milk Costings System

The Prime Minister has read the letter of 21 March from the Secretary of State for Trade to your Minister on the above subject. She is very interested to see that Binder Hamlyn's report on distributors' margins confirms that milk could be available through the shops at lower prices than on the door-steps, and she strongly supports Mr. Nott's proposal that they should now be asked to recommend how the system of controlled prices can be improved in the interests of the consumer.

I am sending copies of this letter to John Wiggins (HM Treasury), Stuart Hampson (Department of Trade) and David Wright (Cabinet Office).

I. P. LANKESTER

SP

Garth Waters, Esq.,
Ministry of Agriculture, Fisheries and Food.

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

1

From the Secretary of State

Prime Minister
This is encouraging, and suggested course of action at X on page 2 seems sensible. Content?

Yes - excellent
M.
21/3

The Rt Hon Peter Walker MBE MP
Minister of Agriculture, Fisheries
and Food
Whitehall Place
SW1

21 March 1980

Dear Peter

REVIEW OF LIQUID MILK COSTINGS SYSTEM

In Cabinet on 6 December, we agreed to look again at the retail distribution system for milk, once Binder Hamlyn's report on distributors' margins was available (CC(79)24th Meeting: Item ~~6~~5). The Prime Minister had argued that the housewife should be able, as in other countries, to buy milk at a lower price in the shops than through the door-to-door delivery system. As you know this is my view also: consumers' organisations are understandably questioning a pricing system which makes our milk prices apparently the highest in the Community in spite of our efficiency in milk production. I believe this will become increasingly hard to defend.

Now Binder Hamyln's report is available, I see that it confirms that milk could be available through the shops at lower prices than on the doorstep, and that the cost of doorstep delivery accounts for some !!! 60% of the difference between the price the consumer pays and the price the producer gets. But they remark that the lower costs of selling through shops are totally excluded from the present costing system, and recommend a further study of ways of incorporating them, including the possibility of a separate, and presumably lower, maximum price for shop sales.

From the Secretary of State

This is encouraging. I understand you have asked them to continue their work; and no doubt this aspect of their findings will be followed up. Although more competition in the dairy trade might eventually make dairies readier to sell to the shops at genuine arm's-length prices, and obviate the need for price controls, with the present state of competition we have to ensure that the regime of controlled prices gives a fair deal to those who buy milk in the shops as well as to those who buy it at the doorstep. One way to do this would be to set a lower maximum price for shop sales, as Binder Hamyln suggests: but as there is plenty of competition between food shops it would seem more logical to set a lower maximum on the price at which the dairies sell to the shops.

X We should need the Accountants' advice on the level at which this should be set, and I suggest that this should be included among the questions on which we seek their further advice. If you agree, and if the Prime Minister is content, I would therefore suggest that, rather than bring the issue back to Cabinet at this stage, the best way to meet the concern she expressed in December would be to ask the accountants to recommend how the system of controlled prices can be adapted to protect the interests of the customers of dairies who buy milk other than through their own doorstep deliveries: and that this should include advice on the appropriate level at which a maximum price might be set for their sales to shops. This advice would put us in a better position to decide collectively how to proceed. If you agree, our officials can determine the detailed terms of reference.

I am copying this letter to the Prime Minister, Geoffrey Howe and Sir Robert Armstrong.

Yours ever
John.

JOHN NOTT

CONFIDENTIAL

Agriculture

DSG

File

bc Mr. Ingham

10 DOWNING STREET

From the Private Secretary

10 December 1979

MAXIMUM RETAIL PRICE OF MILK

It was agreed in Cabinet last week that the maximum retail price of milk should be increased by 1½ p per pint with effect from a date not earlier than 1 February 1980, and that the precise date should be decided between the Prime Minister and the Minister of Agriculture.

The Prime Minister and Mr. Walker have now considered the timing point, and have agreed that the new price should come into operation on Sunday 17 February. They have also agreed that the increase should be announced shortly before the House rises for the Christmas Recess.

I am sending copies of this letter to the Private Secretaries to members of Cabinet including the Minister of Transport, and to Martin Vile (Cabinet Office).

T. P. LANKESTER

John Chilcot, Esq.,
Home Office.

CONFIDENTIAL

DSG

File

CONFIDENTIAL

10 December 1979

Thank you for your letter of 7 December which I have shown to the Prime Minister. She agrees that the 1½ p increase in the maximum retail price of milk should take effect from Sunday 17 February, and that this should be announced just before the House rises for the Christmas Recess.

I am sending a copy of this letter to Martin Vile (Cabinet Office).

T. P. LANKESTER

Garth Waters, Esq.,
Ministry of Agriculture, Fisheries & Food.

CONFIDENTIAL

1

CONFIDENTIAL

Ministry of Agriculture, Fisheries and Food
Whitehall Place London SW1A 2HH

From the Minister's Private Office

Prime Minister

Agree?

TL 7/12

Yes - I hope that at least the farmers will be pleased. No-one else will

T P Lankester Esq
Private Secretary
10 Downing Street
London SW1

7 December 1979

Dear Tim,

Thank you for your letter of 6 December about the increase in the maximum retail price of milk.

Mr Walker would have no objection to this taking place as suggested by the Prime Minister - though, as milk roundsmen keep their books and bill their customers on a Sunday-to-Saturday basis, we would for purely practical reasons like to see the new price come into operation on Sunday 17 February. He suggests that the best time to announce the increase would be shortly before the House rises for the Christmas Recess - say 20 or 21 December. This would be after next week's by-Election, and with people preoccupied with the run up to the holiday season, would tend to minimise any critical reaction in the Press and elsewhere.

Yours sincerely

Geoffrey Waters

G R WATERS
Principal Private Secretary

PM seen in Cab. bundle.

Agriculture

CONFIDENTIAL

Qa 04371

To: PRIME MINISTER

From: SIR KENNETH BERRILL

Milk Prices

1. After this afternoon's meeting I said that I would let you have a further note on the milk price question. There are two issues:

(i) the immediate one of whether the price of milk should be increased by $1\frac{1}{2}$p. (mainly to benefit the farmers but also in part to compensate the distributors for the cut they took in October); and

(ii) the longer term one of the future of the British system of milk distribution.

2. Now is not the right time for Ministers to consider the milk distribution system. MAFF have commissioned a review of the formula used to determine distributors' margins. This will have been completed in the New Year. It is then that it will be appropriate to ask more fundamental questions about our system of distribution and the scope for greater competition from supermarkets, etc.

3. However, Ministers may get on to the question tomorrow and if they do the Minister of Agriculture will no doubt want to argue that nothing should be done to endanger doorstep deliveries. These are the 'social' arguments for the daily milkman but he will also suggest that total milk consumption will fall if the delivery system is reduced in the face of competition from the shops. Against this -

(a) in both Scotland and Eire doorstep deliveries have continued in the main urban areas despite competition from shops (54 per cent and 51 per cent respectively of milk is still delivered to the door);

(b) in countries where the consumption of liquid (whole) milk has fallen this is partly because people now consume more low fat milks and fresh dairy products (yoghurts, etc.) - the range of which is limited in this country. (In Holland consumption of whole milk fell by 40 per cent between 1960 and 1974 but consumption of liquid milk and fresh dairy products together remained constant.)

(c) Even the basic assumption that the decline where consumption has declined has been due to the delivery system can be questioned (e.g. in Holland consumption of whole milk had been on a declining trend for many years).

4. The immediate issue to concentrate upon is whether the price should be increased to help the producer now. If it is not then real margins will fall to a low level in real terms (a 5 per cent devaluation increases returns from manufactured milk only after a time lag and not by very much). The $1\frac{1}{2}$p. increase proposed raises the net margin on milk in 1980/81 to roughly the same level in real terms as in 1979/80.

5. In discussing this $1\frac{1}{2}$p. claim Ministers should bear in mind that it is most unlikely that even an increase of $1\frac{1}{2}$p. will remove the need for further increases in 1980. More money will be sought for the distributors in April, and by October the farmers will be asking for their 'normal' annual increase. (Indeed, this is a certainty if less than $1\frac{1}{2}$p. is given now.)

6. All the above suggests that interdepartmental work on these issues needs to continue - particularly in view of the line we shall be taking on the CAP and the effects that this will have on our agriculture.

7. I am sending a copy of this minute to Sir Robert Armstrong.

KB

5 December 1979

CONFIDENTIAL

ie Master set

Original filed Euro Pol - CAP. Pt 2

10 DOWNING STREET

From the Private Secretary

5 December 1979

Dear Garth,

The Prime Minister held a meeting at 1450 hours today to discuss various proposals relating to agriculture. The following were present: your Minister, Chancellor of the Exchequer, Chief Secretary, Secretary of State for Trade, Sir Robert Armstrong and Sir Kenneth Berrill.

The Prime Minister said that the purpose of the meeting was to reach a preliminary view in advance of Cabinet the following day on three issues: first, whether or not to undertake a devaluation of the green pound in the immediate future; second, whether, and if so by how much, to increase the maximum retail price of milk; third, what to do about farm capital grants. The paper prepared by the official group under the chairmanship of Sir Kenneth Berrill provided a very helpful background. It was necessary to devise a package which would balance the interests of the farming community against the need to restrain public expenditure and consumer prices - taking into account also our EEC interests. She herself was disposed to a five per cent green pound devaluation immediately, and some increase in the price of milk which she hoped could be kept to no more than 1p per pint. But she wanted to have other Ministers' views on these two issues, and also on the question of capital grants.

The Secretary of State for Trade said that he was in favour of a five per cent devaluation immediately, a 1p increase in the price of milk, and a reduction in the level of grants as proposed by the Treasury. He favoured an immediate devaluation on non-agricultural grounds. It was important for our negotiating stance in the EEC that we take action now rather than in the New Year when we would be pursuing a strong line with the EEC to reduce Community surpluses. It would be damaging if at that time the farming lobby were to be complaining that more needed to be done for them. As regards capital grants, he recognised that subsidies in Europe were generally greater than in the UK. But agricultural investment in the UK had been at a very high level. There was some evidence that grants had encouraged more investment than was necessarily desirable. Production of milk in particular had been over-stimulated, and so indirectly had borrowing from the banks. As for milk prices, some increase was clearly necessary, and this should take place immediately; but the increase should be no more than 1p.

/The Chief Secretary

CONFIDENTIAL

The Chief Secretary then commented on the question of grants. There were in his view four arguments in favour of the reduction which he was proposing. First, Government grants to industry were being cut back, and to be equitable, the same should happen in respect of agriculture. Second, as a matter of principle, it was inappropriate for farmers to derive their incomes from grants; it was better that they should obtain their income from adequate prices. Third, the extra capital expenditure which resulted from grants stimulated agricultural production at a time when we were intent on reducing surpluses. Fourth, there was some evidence - while our agriculture was generally efficient - that we were having to pay a high price for extra production. Marginal costs of UK agriculture were higher than in other EEC countries because our production at the margin was highly capital intensive.

Your Minister said that the need for a five per cent devaluation, a 1½p increase in the milk price, and an increase in capital grants, was borne out by the table in paragraph 61 of the official group's report. This showed that, even with the devaluation and the milk price increase, farmers' net income would be lower in 1980 than it was this year; and it had to be borne in mind that the level of incomes this year was substantially lower than it had been in 1978. The Tory Party had strongly criticised the previous Government for allowing incomes to fall as far as they had done in 1978. To do less than he was proposing would be highly damaging politically. The farming community would take particular offence at any cutting of capital grants at a time when other countries in Europe were increasing their subsidies to agriculture. The increase in grants which he was proposing was needed partly to compensate farmers for the reduction in income which they would suffer even with the five per cent devaluation and the 1½p milk price increase. There was also a strong economic argument for assisting agriculture at this time. In contrast to industry, agriculture was almost totally free from restrictive practices and could be depended upon to respond to extra incentives; this would benefit national output and the balance of payments.

As regards milk, Mr. Walker pointed out that if the price increase were held back, this would simply mean that a bigger increase would be necessary at some later date. Producers were going to be hard hit by the recent award by the Agricultural Wages Board, and the dairies' costs were likely to be rising fast too. The Prime Minister questioned whether the distribution of milk was as efficient as it might be. The official group's report suggested that the dairies' distribution costs were unnecessarily high. Moreover, there was the question of whether milk ought not to be available in the shops at a lower price than it was on the doorstep. The housewife should surely, as in other countries, be able to buy milk at a lower price in the shops than through the door-to-door delivery system. She understood that in Scotland more milk was sold in the shops and at a cheaper price than on the doorstep.

/Mr. Walker responded

Mr. Walker responded that milk buying habits in Scotland had long been different from what they were in England. There was nothing to stop the food retailers from buying milk direct from the Milk Marketing Board in England and bottling and retailing it themselves. However, it did not appear to be economic. More generally, he had to warn colleagues that if any action was taken which might put an end to the door-to-door delivery system, this would have very damaging effects on milk consumption and hence production - with important political implications. If a significant number of people switched to purchasing milk in shops, the door-to-door system would no longer be viable. The Prime Minister commented that she could not accept that the present distribution system would necessarily collapse if more milk were sold in shops; and in any case, she could not see that the Government and consumer should necessarily support production of milk at its current level. Finally, the timing of the next price increase ought, if possible, to take into account prospective month-to-month fluctuations in the RPI.

Summing-up, the Prime Minister said that it was generally agreed that there should be an immediate devaluation of the green pound, though of course this would need to be endorsed by Cabinet. No agreement had been reached on milk prices and capital grants: these questions would need to be discussed further in Cabinet.

I am sending copies of this letter to Tony Battishill (Treasury), Alistair Pirie (Chief Secretary's Office), Stuart Hampson (Department of Trade), George Walden (Foreign and Commonwealth Office) and Martin Vile (Cabinet Office).

Yours ever,

Tim Lankester.

G.R. Waters, Esq.,
Ministry of Agriculture, Fisheries and Food.

Original on CAP Pt 2

Ref: A0869

CONFIDENTIAL

PRIME MINISTER

Agriculture
(C(79) 59)

BACKGROUND

There was a preliminary discussion of the Cabinet paper (C(79) 59) at your informal meeting this afternoon.

2. That meeting generally agreed that we should seek a 5 per cent devaluation of the Green Pound at the EEC Agriculture Council next week. Discussion on the other two points for decision - retail milk prices and farm capital grants - did not come to even tentative conclusions; but I think that, apart from the Minister of Agriculture, there were signs of a consensus on 1p on the price of milk and a reduction (not necessarily as large as that suggested by the Chief Secretary) in capital grants.

3. You will want the Cabinet to reach firm conclusions on all three issues, and you will also want to try to reach agreement that these conclusions represent the limit on support to agriculture for the calendar year 1980.

HANDLING

4. You might open the discussion yourself by itemising the three issues for decision - the devaluation of the Green Pound, whether to increase retail milk prices and if so when and by how much, and whether to increase or decrease farm capital grants.

5. You could then inform the Cabinet (or invite the Minister of Agriculture to do so) of the case for seeking a 5 per cent devaluation of the Green Pound at the EEC Agriculture Council next week, and see if anyone wants to object to this. Probably no-one will, though the Chancellor of the Exchequer may indicate that he will want to re-open this issue if the decision goes against him on capital grants.

6. You could then suggest taking each of the other two issues in turn, starting with retail milk prices.

Retail Milk Prices

7. There is scope for decision on two issues, how much of an increase to allow, if any, and when to allow it. The main alternatives on the first issue are 1p and 1½p, and on the second they are 1st January 1980 and any later point in the year.

8. You might ask the Minister of Agriculture to start this part of the discussion by making his case for a $1\frac{1}{2}$p per pint increase in the maximum retail price of milk, with effect from early 1980. The Cabinet will want to know whether this increase will be the only one during 1980. This affects distributors' margins as well as farmers' incomes, and you might ask the Minister of Agriculture to comment. (His letter of 3rd December to the Chancellor of the Exchequer points towards a rise to help distributors. If we are faced with the prospect of another increase later on for this purpose, the Cabinet might prefer to stick to 1p now and to add the other $\frac{1}{2}$p to the later increase.

9. I am sure you will want to pursue the case which you were putting at this afternoon's meeting for achieving a price differential between the supermarkets and the doorstep delivery. You might ask the Secretary of State for Trade for his views on this point, followed by the Minister of Agriculture, and then go quickly round the table to see if there is much feeling one way or the other. The Minister's letter stresses the political sensitivity of doorstep delivery, but at the point when this afternoon's meeting broke up he had not convinced his colleagues at the meeting.

10. As to timing - your point at this afternoon's meeting - January will be a bad month for the retail price index, with the increases in mortgage rates and rail fares coming in. April will be a bad month because of rate increases. There should be little to choose between February and March. What about an increase with effect from Monday, 11th February?

11. Against that background, you might suggest that the effective choice is between 1p and $1\frac{1}{2}$p either on 1st January or slightly later in the New Year and go round the table again to see which course members of the Cabinet prefer. The increase could be coupled with an announcement of forthcoming action on the retail price structure of milk if the Cabinet is broadly in favour of this, and the nature of the action can be agreed in time. You would need to commission specific proposals from the Secretary of State for Trade in consultation as necessary with the Agricultural Departments.

Capital Grants

12. A decision is needed in order to complete the current public expenditure exercise. The "base line" figure for the grants is £160 million in 1982-83. The Chief Secretary, Treasury has proposed that this figure should be reduced by £60 million, and the Minister of Agriculture has proposed that it should be increased by £30 million. The political problem is that, because of existing forward commitments, the reduction proposed by the Chief Secretary would mean reducing the rates of new grants by 55 per cent from 1st January 1980.

13. Your handling of this part of the discussion will need to depend to some extent on the outcome of the discussion on milk prices. If the Cabinet have given the Minister of Agriculture most or all of what he wanted on milk prices, they may feel able to be relatively severe on capital grants. Similarly if they have knocked him down on milk prices they may want to be easier on capital grants. But you will want to bear in mind that the cut proposed by the Chief Secretary would be agriculture's only contribution to the current round of public expenditure cuts, so it is almost inconceivable that they should be allowed to get away with no cut at all, still less with the increase which the Minister of Agriculture has proposed. A possible outcome might be a reduction of one-third in the rate of grant, to yield a reduction of £35 million in expenditure in 1982-83.

14. You might ask the Minister of Agriculture to open this part of the discussion with his case for an increase, and the Chancellor of the Exchequer (or, if he prefers, the Chief Secretary, Treasury) to follow with his case for a cut. You might then check briefly that the Scottish, Welsh and Northern Ireland Secretaries agree with the Minister of Agriculture, and then invite other contributions - perhaps starting with the Secretary of State for Industry since one of the points at issue is that agriculture is competing with industry for investment resources.

15. You may feel that, because of the need to cut public expenditure, you need to give the Cabinet a strong steer towards the position adopted by the Chancellor of the Exchequer and the Chief Secretary. Two points to bear in mind are:-

(i) Agriculture is more favourably treated than industry over aids to investment. There are some useful figures giving the Treasury view in paragraph 25 (page 9) of the MISC 23 report. They suggest that cutting the grant rate by 55 per cent could well be justified by reference to the grant treatment of industry generally, though precise comparisons are different because industry and agriculture both have different rates of grant in different regions. (NB. also the higher figures in paragraph 25 relate to the Minister of Agriculture's proposals, not to the current grant regime which is more complicated as well as being less generous.)

(ii) The Minister of Agriculture may well argue that agriculture is justified in getting better treatment than the rest of industry because it gives better value for the grants received. The figures in paragraph 33(ii) on page 11 of the MISC 23 report support this argument as far as average investment is concerned. But investment grants should, by definition, not be supporting average investment but marginal investment, i.e. investment which would not have taken place without them - if they support investment which would have happened anyway they are being wasted. There is no reason to suppose that marginal investment in agriculture is better than marginal investment anywhere else, and a more generous rate of grant for agriculture must mean that the marginal projects it supports are inherently less profitable than the marginal industrial projects which are supported by a lower rate of grant.

CONCLUSIONS

16. You will want to record the Cabinet's conclusions on:-

(i) The devaluation of the Green Pound (probably in favour of seeking a 5 per cent devaluation at next week's EEC Agriculture Council).

CONFIDENTIAL

(ii) Retail milk prices. (Probably 1p or $1\frac{1}{2}$p on the maximum retail price per pint from 1st January 1980, possibly with agreement to announce further action on the structure of retail milk prices. If this second point is agreed you will need to commission a paper making specific proposals from the Secretary of State for Trade in consultation as necessary with the Agricultural Ministers.)

(iii) Farm capital grants. The maximum cut would be £60 million in 1982-83, equivalent to 55 per cent of grant rates from 1st January 1980, as proposed by the Chief Secretary, Treasury. Examples of other possibilities are set out in paragraph 60, page 21 of the report.

ROBERT ARMSTRONG

(Robert Armstrong)

5th December 1979

Original a CAP Pt2

CONFIDENTIAL

Ref. A0845

PRIME MINISTER

Agriculture

Brief for informal meeting, 2.45 pm, Wednesday
5 December 1979

BACKGROUND

Cabinet on 4th October considered the Minister of Agriculture's proposal for a $1\frac{1}{2}$p per pint increase in the maximum retail price of milk. It decided not to agree to an increase at that stage, and called for a report by officials putting milk prices in the broader context of support for agriculture generally, against the background of the Common Agricultural Policy (CAP) and the subsidies which other members of the EEC give to their agricultural industries.

2. The report by officials (MISC 23 chaired by Sir Kenneth Berrill) has now been circulated. It does two things -

(i) It brings together three issues on which early decisions are either necessary or desirable: milk prices, capital grants to agriculture, and the Green Pound.

(ii) It puts these issues into the context not only of support to agriculture elsewhere in the EEC, but also of support to other industries at home. This is important because although United Kingdom agriculture is competing for <u>markets</u> with agriculture in the rest of the EEC, it is competing for <u>resources</u> with other industry at home. The United Kingdom's aid to agriculture proves to be ungenerous by the standards of European aid to agriculture, but generous by the standard of United Kingdom aid to the rest of industry.

3. The fact that there are three issues for discussion gives an opportunity to construct packages, and I give two possibilities in the Annex to this brief, together with comments on each of the three items separately. They also have a bearing on forthcoming decisions on the CAP. If those decisions are likely to hit our farmers (along with the rest of the Community), domestic action to increase farm incomes will act as some compensation. OD(E) will be considering

the latest Commission proposals on milk and sugar on Thursday morning, after this meeting but before the Cabinet discussion.

HANDLING

4. You will want to let the Minister of Agriculture state his case. Next I suggest that you ask the Lord Privy Seal to comment on the EEC aspects, particularly the feasibility of a 5 per cent devaluation of the green pound in present circumstances. If he raises no difficulties, you might see if the meeting will take a provisional decision in favour of the 5 per cent devaluation, and then see what others present think should be done about the other two proposals.

5. On these, you may like Sir Kenneth Berrill to speak first, as the Chairman of MISC 23, or you may prefer to leave him to the end. I suggest that you next invite the Chancellor of the Exchequer to speak, then the Secretary of State for Trade (particularly about milk distribution), then the others present.

CONCLUSIONS

6. There is no need for the meeting to take any decisions. It is simply to prepare the ground for Cabinet on Thursday. But you may find that a consensus emerges in favour of a particular package, perhaps on the lines of one of those described in the Annex.

7. You will want to record any consensus that is reached, as an effective starting point for the Cabinet discussion on Thursday.

(Robert Armstrong)

4th December, 1979

ANNEX

The Three Issues and Possible Packages

Green Pound

This is the issue to which the Minister of Agriculture attaches the greatest importance. He proposes a 5 per cent devaluation. Anything more might be difficult to negotiate with the Commission because of the risk that further appreciation of the £ would create positive MCAs. Sir Kenneth Berrill feels that the case is strong. I expect other Ministers will want to agree. If so, the best time to go for it is at the Agriculture Council on 11th December (when the Danes may be seeking a devaluation of the Danish krone). In this way, we keep the devaluation separate from the forthcoming price fixing. There we shall want to take a tough line; and our farmers should be told that the green pound devaluation is to prepare us - and them - for just that.

Capital grants

2. These are the one outstanding item on the current public expenditure exercise. The base line is £160 million in 1982-83. The Chief Secretary has proposed a reduction of £60 million, which would be the Minister of Agriculture's only contribution to the public expenditure cuts. The Minister of Agriculture has proposed an increase of £30 million. To allow this increase, or even to allow no cut, would be to put agriculture into the same category as defence and law and order, which Cabinet did not do at the start of the public expenditure exercise. You may feel that the need to contain public expenditure is such that the agriculture budget will have to give the Chief Secretary at least some of what he is looking for.

3. The problem is that, because of existing commitments, to reduce expenditure in 1982-83 by £60 million, as proposed by the Chief Secretary, would require a 55 per cent cut in rates of grant for all schemes agreed after 1st January 1980. You may feel that this cut is politically too much. Other possibilities are set out in Table 4 of page 60 of MISC 23's report. A reduction of 33⅓ per cent in grant rates from 1st January 1980 would save about £35 million in 1982-83.

Milk prices

4. On milk, the immediate issue is whether to allow all, part, or none of the $1\frac{1}{2}$p per pint increase which the Minister of Agriculture is seeking with effect from 1st January 1980. This obviously bears on the question of whether we should be encouraging more or less domestic milk production. Sir Kenneth Berrill suggests that the long-term aim must be less, but that a unilateral move in this direction on the scale implied by a nil price increase would not be acceptable. This leaves the question of how much of the $1\frac{1}{2}$p should be allowed, and when. The EEC must do something to reduce the milk surpluses. The Commission's current proposals present difficulties for us, but if milk production in Europe is to be cut, returns will have to be squeezed. We could insulate our own farmers by raising the retail price. An increase of $1\frac{1}{2}$p on milk would increase farm incomes by £195 million. Every 1 per cent increase in the co-responsibility levy of milk would reduce United Kingdom farm income by about £17 million but lower the cost of the CAP by about £110 million to the benefit of our budgetary objectives.

5. There are two longer term issues - the structure of milk distribution and the maintenance of Government price control.

6. It is striking that milk in supermarkets costs the same as milk delivered to the doorstep. The Department of Trade think this happens because the larger dairies sell to supermarkets at artificially high prices so as to protect their own milk rounds. This point is under investigation by the Office of Fair Trading.

7. The Agriculture Departments pointed out to MISC 23 that, if there were large profits to be made out of milk processing and distribution, there is nothing to stop the supermarkets from getting in on the act by setting up their own processing plants and buying milk direct from the Milk Marketing Boards. They suggested that the reason why this had not happened was that Government price control had prevented the dairies from abusing their monopoly position, so that the dairies were not making excess profits.

8. All this suggests that if Government price control were removed now, the short term result would be a sharp increase in milk prices on the doorstep and in the shops, followed by a decline in shop prices, at least in real terms, as the profit motive induced supermarkets to set up their own bottling plants. This is unattractive, at least in the short term. A more attractive possibility is that, if the OFT investigation reveals the existence of anti-competitive practices by the dairies, action might be taken to force the dairies to sell to the supermarkets at lower prices - if you were prepared to take the risk that this would severely reduce or eliminate the doorstep milk delivery and thus reduce total milk consumption. At the same time you might feel able to get away from Government price controls, though you would want the views of the Secretary of State for Trade and the Minister of Agriculture on this. The latter may well argue that the Milk Marketing Board monopoly is regarded by dairy farmers as the cornerstone of their defences. The Government will have enough trouble with United Kingdom agriculture in the context of reform of the CAP without starting unnecessary fights.

Packages

9. Obviously there are a whole range of options, from giving the Minister of Agriculture everything he wants to giving him nothing and reducing the capital grants. But there are two packages near the middle of the range which you might want to consider in more detail. Both would include the 5 per cent devaluation of the green pound. The first package would make the full cut in the capital grants programme as proposed by the Treasury, and would soften the blow to farmers by allowing the full 1½p per pint on milk. The second would be about half-way between the base line and the Treasury position on grants (say a cut of one-third in rates of grant from 1st January 1980, saving £35 million in 1982-83) but would allow only 1p per pint on milk. Of course there are other variations.

10. From the consumer's point of view, a 1½p per pint increase in milk prices might be more acceptable than otherwise if -

(i) it was the only milk price increase throughout 1980; and/or

(ii) there was a real prospect of action towards greater competition in milk distribution. You would want the Secretary of State for Trade's views on the possibilities here.

11. From an EEC point of view, the more we do help United Kingdom farmers, the easier it will be for us to take a tough line on CAP prices and proposals (like a non-discrimination co-responsibility levy) to cut the cost of surpluses. But either the changes must be synchronised or the farming leaders warned in advance that these are our tactics. Whatever package is chosen it should be made clear that this is all that United Kingdom agriculture is going to get in 1980 and that we shall have to take a tough line in the coming EEC agriculture negotiations even if it is not always to the benefit of United Kingdom agriculture.

4th December, 1979

2

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

From the Minister

Prime Minister

The Rt Hon Sir Geoffrey Howe QC MP
Treasury Chambers
Parliament Street
London SW1

3 December 1979

4/12

Dear Chancellor,

I think it right that I should draw to your attention and to the attention of other Cabinet colleagues the strength of feeling that is now building up as a result of our decision not to increase milk prices in October.

Milk producers are naturally deeply concerned for, as an official Committee appointed by the Prime Minister has pointed out, there is a substantial drop in the incomes of milk producers this year which in itself would cause them deep concern, but now that the Agricultural Wages Board has agreed an increase of more than 20%, which will affect dairy farmers more than any other section of agriculture, and the borrowing rate at the bank has gone up to 20%, the dairy farmers are becoming very alarmed.

On Friday representatives of the Farmers' Unions from England, Scotland, Wales and Northern Ireland came to see me and all stated that they considered the current position was worse than at any time for many years.

As far as the dairymen are concerned, they are naturally in a greater state of hostility and turmoil than has ever previously been the position because we are the first Government in more than 30 years to violate the cost adjustment mechanism that has been agreed between Governments and the industry.

They argue that unless speedy action is taken, milk distribution in the London area will run into a loss-making position, that the recoupment of increased energy costs is vital and that as far as the current wage round is concerned, as always their settlement will be largely dictated by the settlement made by the road haulage industry as a whole, which on present indications is likely to be very substantial.

At the present time they are talking of refusing to pay the producers the increase that I allocated to them as from November. They have a legal right to do this, when the matter then goes to arbitration.

A number of the larger firms have also announced a review of current investment programmes and are generally talking about substantial cuts in investment. The bigger dairies are also talking about the encouragement now being given to them to switch their investment programmes to Ireland and to reduce the doorstep delivery services.

!

If our policies do result in a considerable breakdown of doorstep services I must warn you and the Government that not only would this have a devastatingly adverse effect on British agriculture, but also I think would be immensely politically unpopular with the majority of people who would like to continue with the doorstep delivery services but would find it was no longer available.

I must also point out that the longer we defer a decision upon this question the higher will be the eventual increase that will be required. I cannot see any moment in the coming twelve months when it will be likely that an increase in the price of milk will be welcomed, but I can see very many moments when a very large increase will be particularly embarrassing.

Yours sincerely

Carter Water

for

PETER WALKER

(Dictated by the Minister
and signed in his absence)

Original on
CAP Pt 2

Prime Minister
Robert Armstrong will send round a covering note to the report on Monday. That note can cover the points made by Ken Berrill below. (Cabinet Office brief next week will cover EEC tactical points). It would be helpful
JL 30/

CONFIDENTIAL

Qa 04368

To: MR LANKESTER

From: SIR KENNETH BERRILL

Agriculture

1. The Prime Minister will be getting in her box tonight the report of MISC 23, the Official Group on British Agriculture which I have chaired.

2. This has been (inevitably) a difficult and contentious subject with widely differing departmental views. It has also been a rushed job with the Group working against the clock until late yesterday to try to get a draft for circulation before the weekend.

3. Now that I have read the draft which has been circulated, I am conscious that it would have been much better if we had only had another few days. In particular, it finishes rather in mid-air with no summary of the arguments for and against the three increases proposed by the MAFF - but getting agreement on such a summary in the Group would have been extremely difficult.

4. My own views are -

(i) the case for a 5 per cent devaluation of the Green Pound is strong;

(ii) the case for an increase in capital grants is very weak indeed - in the medium term we shall have to reduce agricultural output in the EEC and capital investment is aimed in precisely the opposite direction. The Treasury's proposal for a cut in capital grants is sensible but whether it is politically acceptable to reduce the present rate of grant by 55 per cent in one jump is another matter.

(iii) the increase of 1½p. in the milk price is the most difficult issue. If there is no increase in the milk price, the profit margin on milk will fall very sharply indeed (1975 100; 1979/80 54; 1980/81 18).

The British consumer would gain from having his milk that much cheaper; the British balance of payments would lose to the extent that we

CONFIDENTIAL

imported more butter; the British Treasury would gain its share of the savings to the EEC of less butter being sold into intervention.

5. At some stage, milk output in the EEC will have to be cut and a step by the United Kingdom in attempting to reduce its own output by lowering the profitability of milk production could be presented as a move in this direction. But it is extremely doubtful whether it would be acceptable for Britain to take this step alone and such a very large step at that. In practice I think the issue is what proportion of the 1½p. is to be allowed.

6. The MISC 23 report has a great deal of extremely useful and essential data but is not, I realise, a very 'easy read'. If the Prime Minister thought it valuable, I could put a CPRS note round on Monday along the lines of the above to help the discussion.

7. I am sending a copy of this minute to Sir Robert Armstrong.

KB

30 November 1979

Agriculture

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

From the Minister

The Rt Hon John Nott MP
Secretary of State
Department of Trade
1 Victoria Street
LONDON
SW1H OET

23 October 1979

Dear John,

R. 23/10

LIQUID MILK DISTRIBUTION

Thank you for your letter of 16 October.

My department is now working on a paper on agricultural support policy for discussion in the inter-departmental group which the Secretary to the Cabinet was instructed to set up. That paper will of course deal with milk prices, but will be doing so, as the Cabinet asked, in order to enable the case for an early increase to be considered in the broader context of support for agriculture generally.

The future of the milk pricing and distribution system is a quite separate and longer-term question and, as you know, some aspects of the arrangements are currently under independent review. So far as my note is concerned, I shall ask my officials to get in touch with you about a meeting to discuss it. But I must warn that a Tory Government that undermined the door-to-door milk distribution system would deserve the turmoil that it would have created. I would play no part in such a policy.

I am copying this letter to the members of E Committee and Sir John Hunt.

Yours ever,
Peter

PETER WALKER

Agriculture

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

From the Secretary of State

The Rt Hon Peter Walker MP
Minister of Agriculture, Fisheries and Food
Ministry of Agriculture, Fisheries and Food
Whitehall Place
London, SW1A 2HH

16. October 1979

Dear Peter.

LIQUID MILK DISTRIBUTION

Thank you for your letter of 1 October in reply to mine of 6 August. I am very grateful for this careful response to the questions that concerned me: I agree with you that the next step should be for our officials to go over the note enclosed with your letter to see how far it answers my doubts about the present distribution system. At present I still feel that we should be looking hard for ways of increasing competition in this field.

However, we have now agreed in Cabinet on 4 October that the future of the milk pricing and distribution system should form part of a wider inter-Departmental review of agricultural support policy which the Secretary to the Cabinet was instructed to set up. It therefore seems sensible for further consideration of the points raised in my letter and in your reply to take place in that context.

I am copying this letter to the members of E Committee and Sir John Hunt.

I would like a word sometime about milk prices - an informal chat (with no briefs)!

Yours ever

John.

JOHN NOTT

Top Copy European Policy CAP
May 79

Agriculture

CONFIDENTIAL

Ref. A0373

PRIME MINISTER

Support for British Agriculture

In your summing up of the discussion at Cabinet on Thursday on the Minister of Agriculture's proposal for an increase in liquid milk prices (CC(79) 16th Conclusions, minute 3) you said that there was a need for an interdepartmental review in which the question of milk prices would be looked at in the broader context of support for British agriculture generally and against the background of the CAP. This is very much what Sir Kenneth Berrill suggested in his minute to Mr. Lankester of 3rd October.

2. There is obviously urgency in all this. Mr. Walker is anxious to be able to tell the farming community as soon as possible what is likely to happen to the price of milk: and we know that Mr. Walker and the Chief Secretary are at loggerheads over agricultural support in the years to 1983-84. But more than this, you are likely to discuss the future of the CAP with e.g. Helmut Schmidt on 31st October and you will need to be clear about the implications of our current decisions on British agriculture in relation to our stance on the CAP.

3. We have therefore to work fast. This suggests that the interdepartmental group should consist of a small inner core of main Departments who would call in other Departments as necessary, rather than one large group covering the whole. I think the core of the group should be the Treasury, MAFF, FCO and Trade (for the consumer). Other Departments (Scotland, Wales, Northern Ireland, Industry and Employment) would be brought in as necessary. I am sure that the chairmanship of this group should be in the hands of the Cabinet Office and that Sir Kenneth Berrill would be the best person. The only alternative is the Treasury and, given the fierce constraints on public expenditure, they would hardly be regarded as neutral.

CONFIDENTIAL

4. Finally, there is the question of the paper which Mr. Walker is himself preparing for Cabinet. I get the impression that this paper, which he is writing himself, is a very political one and would not form a suitable basis on which to conduct this review by officials. I think the right course is to let Mr. Walker's paper go ahead independently and to put it on the agenda of the Cabinet later this month when at least an interim report from the official group is available.

5. If you agree with these proposals, which are consistent with the Cabinet's conclusions, I will set the operation in train forthwith.

JOHN HUNT

(John Hunt)

5th October, 1979

Agriculture

10 DOWNING STREET

Figures you require
taken from 1975 Farm
Classification

England and Wales.

206,000 farms of
which 62,000 or 30%
had Dairy Cows. Of
these 43,000 were
Mainly Dairy ie
21% More than half
of their output came
from Dairy enterprise

30,000 or 15%

Were Specialist Dairy farms ie at least 3/4 of output was from Dairy enterprise

CONFIDENTIAL

Ref. A0359

PRIME MINISTER

Liquid Milk Prices

(C(79) 41)

BACKGROUND

This paper is about the Minister of Agriculture's proposal to increase the retail price of milk by 1½p from 18th November in England, Wales and Northern Ireland and from 21st October in Scotland. Sir Keith Joseph minuted you on 1st October following an inconclusive discussion in E(EA). You discussed the state of British agriculture generally with Mr. Walker on Monday and expressed serious doubts about these particular proposals.

2. About 50 per cent of United Kingdom milk production is sold to consumer in liquid form; the remainder is made into cheese, butter, etc. Liquid milk is the more profitable. All milk produced by farmers is bought by the Milk Marketing Board and that part which goes to the consumer is sold through milk distributors. There is no import or export of liquid milk at present. The variable elements within the Government's control are the distributors margin and the retail price. These two between them determine the profit which the farmer gets for his liquid milk. The rest of his return depends on the price he gets for milk sold for dairy products, and this is governed in turn by CAP arrangements. Unless he is solely a dairy farmer his income will also vary with the return on his other activities. Since last March farmers have benefited from three devaluations of the Green Pound, amounting in all to 11 per cent. There is a case for reconsidering the whole system of regulated milk prices; Mr. Nott argued it strongly in July. But this would take time. Meanwhile, prices for this winter have to be settled now, within the existing framework.

3. The Government decided in May upon an increase in the retail price of milk of 1½p. The previous Government's deliberate postponement of a price decision meant that virtually the whole of this 1½p had to go to the distributors

to meet sharp increases in their costs and make good the two months' delay. You were reluctant to concede an increase of more than 1p at that time but agreed on an assurance from Mr. Walker that "it is to our benefit to do the $1\frac{1}{2}$p now, rather than be faced with the almost certainty of 1p now for which our predecessors will be blamed and at least 1p in October for which we will be held clearly responsible, with the October increase coming at a very sensitive time as far as the wage round is concerned". In the event distribution costs since May have increased more than expected. The second $1\frac{1}{2}$p increase now would mean a total increase of 22 per cent since May. It is argued that failure to give milk producers a sufficient profit margin will lead to reduced dairy herds and to a substantial increase in milk imports.

4. The Government is committed by the Manifesto to some improvement in farm incomes, but there is nothing specific about dairy farming. The exact quotation is "Labour have seriously undermined the profitability of these industries without protecting consumers against rising food prices which have more than doubled during their term of office. We must ensure that these industries have the means to keep abreast of those in other countries". The Minister of Agriculture is currently preparing a paper on the state of British agriculture which (if you agree) will probably come to Cabinet on 18th October, along with the reports on the public expenditure bilaterals.

5. There is a wider EEC dimension. The surplus of milk products is the most serious problem of the CAP, accounting for 37 per cent of CAP expenditure, and the Government has argued continually that the Community intervention prices are too high. But it is questionable whether this argument, which is also dependent on the strength of the pound, could be effectively maintained if our own producers' milk prices are increased. The return to milk producers in the United Kingdom was the lowest in the EEC in 1978 but this position is very sensitive to exchange rates. In short our milk producers get the lowest return because we choose not to devalue the Green Pound.

HANDLING

6. The memorandum is in the name of the Minister of Agriculture but the figures, over which there had been some disagreement, have now been agreed by the Treasury and the Department of Trade. You might ask the Minister of

Agriculture to introduce it. The Secretaries of State for Scotland and Wales support the proposed price increase and you might ask if they have anything to add. The Secretary of State for Northern Ireland might be asked to comment; he broadly supports the proposal that producers incomes should be increased but suggests an alternative approach; a 1p increase in milk prices plus a devaluation of about 7½ per cent of the Green Pound, (which would have to apply to all products not just milk). He will also argue the continuation of the present milk aid scheme in Northern Ireland to offset the disadvantage Northern Ireland farms have vis-a-vis their Great Britain counterparts. If he presses the milk aid scheme, you might ask him to pursue it separately with the Chief Secretary; Cabinet need not spend time on it.

7. Thereafter you might invite the Secretary of State for Trade to speak. He is opposed to the increase on the grounds of the expected effect on the food and retail price indices and of possible adverse effects on the forthcoming wage rounds. He may additionally make the important political point that a second increase this year of the magnitude proposed may undermine the credibility of the Government. The Chief Secretary might also be invited to join in; he is likely to support Mr. Nott and will probably make the additional point that since Mr. Walker's main concern is with farm incomes, it would seem right to look at the retail milk price alongside other forms of support for farmers, notably the review of capital grants. On this, which is one of the Chief Secretary's bids for public expenditure reductions, you might like to know that there has been a complete deadlock in the bilateral discussions with the Minister of Agriculture. This explains Mr. Walker's intention (noted above) to circulate a Cabinet paper about agriculture. On the question of the EEC you might ask the Minister of Agriculture how a price rise can be justified when milk is in surplus, a substantial part of United Kingdom production is going into intervention, and the effect will be to reduce consumption.

8. The choices before Cabinet are:-

(a) To recommend increases of nil, ½p, 1p, or 1½p in the retail price of milk.

(b) To postpone a decision until milk prices can be considered alongside other forms of support for farmers in the paper being prepared by MAFF.

The subsidiary questions of the distributors margin and of the premium for sterilised milk are secondary and have to be fitted in to whatever is settled for the main increase. Clearly Mr. Walker will be reluctant to accept a nil increase but there are strong reasons for holding prices for the time being. The timing of the proposed increase would allow further consideration of milk prices alongside other forms of farm support at a subsequent Cabinet before reaching a final decision.

9. I suggest you deter the Cabinet from wandering into other attractive by-ways: they include:

(a) Future distributive arrangements for milk. There is an independent review going on at present and it would be a mistake to anticipate this.

(b) School milk, etc. Any increase in the retail price throws an additional cost on the Education budget, but this is not a major factor in determining the increase.

(c) Liberalisation. It sounds attractive and, under EEC rules, it may soon be necessary to open the market to imports of milk from Europe. But it would upset the doorstep delivery system and might put some British producers out of business. If the point is pressed you could ask officials of the Departments concerned to produce a report on the implications of abandoning price control for milk for consideration in E(EA).

CONCLUSIONS

10. In view of the political sensitivity of an increase in milk prices of the magnitude proposed and the milk surplus in the EEC there is a good case for holding milk prices at their current level for the time being (and you have favoured this course in private discussion). But the pressures from the agricultural lobby will be strong and you will need to be guided by the way discussion goes. The alternative conclusions available are:-

EITHER

(i) to agree now that there should be no further increase in milk prices this year;

OR

(ii) to agree now to a small price increase ($\frac{1}{2}$p, 1p?);

OR

(iii) to postpone a decision at least until the issue can be considered in the context of farm support generally. The position paper to be submitted by Mr. Walker to Cabinet shortly on the state of British agriculture, which would include figures on farm incomes, would provide the basis for a discussion - on 18th October - in which milk prices would be seen in context of other forms of farm support. This would still allow an announcement to be made in November (October for Scotland) if an increase was agreed.

11. In any event the issues of Northern Ireland milk support, the distribution margin and sterilised milk should be remitted for separate consideration in the light of Cabinet decisions on the main issue.

John

(John Hunt)

3rd October, 1979

Top Copy:
European Policy - CAP 3 May 79

1

Prime Minister

I think an inter-departmental assessment is a good idea - either instead of or in addition to Mr. Walker's position paper. Cabinet Office would be better than the Treasury as chairman.

TL 3/10

CONFIDENTIAL

Qa 04286

To: MR LANKESTER

From: SIR KENNETH BERRILL

British Agriculture

1. I read with very great interest your note of the Prime Minister's meeting last Monday with the Minister of Agriculture. If I may say so, I think the points which the Prime Minister made and which you list in paragraph 4 are all very well taken. I note that it was left that Mr Walker would put in a position paper on British agriculture to the Prime Minister.

2. The problem with such a paper coming from MAFF is that I fear that it will be a very partial analysis in that it will present the picture very much from the point of view of the United Kingdom producer. The only way around this would be to have an interdepartmental look at the whole problem under either Treasury or Cabinet Office chairmanship so that a more balanced presentation can be achieved.

3. The CPRS had a go at doing this on its own over five years ago in the early part of 1974. It proved a difficult task even though we had in our team at that time a couple of people who were particularly useful in this area. By contrast we unfortunately lost a week or two ago our economist who came to us from MAFF and who has now gone on to the IMF/IBRD desk in Washington.

4. To repeat, when the Prime Minister received a paper from Mr Walker she would need detailed independent briefing to be able to evaluate it. I do not think the CPRS could offer to do this in the time available and I suggest that consideration should be given to a rapid interdepartmental study.

CONFIDENTIAL

he hasn't !
R

5. It is not clear from your note whether Mr Walker had withdrawn his suggestion for an increase in the price of milk pending consideration of his paper on the position of British farming generally, but I would hope that that is indeed the case.

6. There is no tearing hurry for this decision and we could give ourselves a month or even two to work on the facts.

7. I am sending a copy of this minute to Sir John Hunt.

KB

3 October 1979

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

From the Minister

NBPM
JL
2/10.

CONFIDENTIAL

The Rt Hon John Nott MP
Secretary of State for Trade
1 Victoria Street
LONDON SW1H OET

1 October 1979

Dear John,

LIQUID MILK DISTRIBUTION

When you wrote to me on 6 August, you attached an annex setting out a number of questions on our liquid milk distribution system. Insofar as circumstances can vary from area to area, it is difficult to give a concise answer to some of these points, but I have tried in the enclosed note to summarise the position as we see it in England and Wales. I agree with you that it would be helpful for you, Geoffrey Howe and I to have a word together about it after our officials have made sure it covers the points which concern you.

In the meantime, I was glad to see that you and Geoffrey Howe now agree that we should go ahead with a review by independent accountants of the way we measure distributors' costs. We have accordingly appointed Robson Rhodes to undertake the job, and made an announcement to this effect last week.

I am copying this letter, as you did yours, to members of E Committee and Sir John Hunt.

Yours

PETER WALKER

MILK PRICING AND DISTRIBUTION

1. Maximum Retail Price: is it effective in holding prices down or does it in fact act as a minimum price? If so, is it justified?

The first part of this question can only be answered by reference to what might happen if the present controls were removed. This is dealt with more fully in the answers given to questions (b) and (c); but, given (i) the dominant position of the Milk Marketing Board and of the large dairy companies, and (ii) the protection which our liquid market currently enjoys against imports, there would clearly be a strong temptation for both parties to push up the price of liquid milk as far as possible. This would be particularly the case if the level of sterling were to limit the scope for producers to recoup costs through price increases on the manufacturing side arising as a result of green pound devaluations. Conversely, there is no evidence to suggest that the maximum price in practive acts as a minimum price. Within the limits laid down by Government at both wholesale and retail levels, the industry remains free to set any price it likes, and there is already considerable price competition where milk is delivered to large-scale outlets, such as canteens and catering establishments. In general, however, the prevailing prices are a reflection of the costs which producers and distributors face respectively, and the fact that even the maximum price allows them only a modest rate of return on capital invested.

(a) Milk sold in shops is generally priced at least 1p per pint above the statutory maximum, although it might be expected to sell more cheaply in view of the greater consumption betwenn shops than between delivery rounds. Does the apparent lack of interest on the part of shops in competing in selling milk result from unfair practices on the part of their suppliers?

There could be a number of reasons for any apparent lack of interest on the part of shops in selling milk. Price clearly has a part to play, and can in fact arise in one of two ways. The 1p per pint differential referred to occurs because most milk sold in shops - at least in England and Wales - is now available in non-returnable containers for which a packaging charge may be imposed. However, it also has to be borne in mind that homogenised, sterilised and UHT milks may in any case be sold for ½p per pint more than ordianry pasteurised milk. Since a large amount of the milk sold in shops corresponds to one or other of these 3 types, this would accentuate the impression that higher prices are charged in the shops.

There are however other factors at work here. Milk is a heavy, bulky product which provides a relatively low return for a large area of shelf space; if pasteurised milk is sold, it must be cleared within a day or two as it is a very perishable product; and whilst the shelf life of UHT milk is of course much longer, the indications are that most consumers consider it to have an inferior taste to pasteurised milk (and purchase it essentially for its keeping quality and as a back up to their regular supply). If one adds to that the inconvenience of having to collect and carry it themselves, plus the fact that a recent survey has shown that many housewives believe milk in shops to be less fresh than delivered milk, it seems clear that many shops have concluded that, in order to overcome these disadvantages, they would need to offer the milk at a price which would cut into their margins to an unacceptable degree.

In other words, it is a combination of these various considerations rather than any unfair practices on the part of suppliers which contribute to any lack of interest on the part of the shops. And, whilst the dairy companies may well see advantages in confining shop sales to cartonned milk in order to maintain the price differential and the link in the public's mind between doorstep delivery and the milk bottle (which most seem to prefer), their main reason for doing so lies in the very high losses of glass bottles they sustain when these are sold through shops. For example, the average 'trippage' per bottle for sales via shops is only 3, whereas for doorstep sales, it is 28 over the country as a whole(and very much higher than that even in certain parts of the country).

(b) What is the extent of charges for doorstep delivery? If there were no control over retail prices, is competition between delivery rounds, and between retailers and delivery rounds, so limited that higher prices would result?

Delivery charges are allowed by the Ministry only where milk is delivered over difficult terrain or in rural areas where a roundsman might have to travel a considerable distance to deliver only a small amount of milk. Their incidence is therefore by definition limited - it is estimated that about 1-2% of milk deliveries in England and Wales are subject to a delivery charge - and any dairyman imposing such a charge must do so on the understanding that the charge must be "reasonable" and that it could be challenged in the courts.

The question of what would happen if there was no control over retail prices is thus a much wider one. The present distribution of retail milk rounds derives to some extent from the last war, when rationalisation was compulsory as a means of conserving energy and labour and minimising distribution costs. The patterns established at that time have continued, and rationalisation has been furthered by the normal buying and selling of rounds and companies. However, the growth of shop sales does mean that consumers already have an option as between buying their milk from that source and having it delivered to their doorstep; the finely balanced economics of the doorstep delivery system make it extremely unlikely that the dairy companies would simultaneously cut their prices and incur the additional cost of extending their rounds merely to try and increase sales at each other's expense; and, as has already been observed, there are limits to the extent to which retailers may be willing to reduce their margins in order to increase milk sales. Removing the maximum price control is unlikely therefore to lead to any reduction in price, bearing in mind also that all the parties are currently free to compete on price (or any other grounds).

Whether - and to what extent - the price of milk would actually increase in the event of decontrol clearly depends upon the likely reaction of producers, processors and retailers to the removal of statutory constraints. The response of the first 2 groups will of course influence the price of milk irrespective of its final outlet; and, given the features already referred to in paragraph 1(a), there will be a strong temptation for both to take advantage of their dominant position and seek the highest possible return. The essential point, therefore, is whether retail stores would cut their margins to an extent likely to influence the tendency of dairies delivering to the customer's doorstep to pass on their cost increases. The evidence available to date suggests that this is unlikely - and that in the particular circumstances of the milk industry, competition would be less of a protection for consumers than maintenance of price controls.

2. Distributors' Margins: It is agreed that the technique used in establishing the distributors' margin needs to be examined; but are the consequences of this cost-plus system acceptable?

The system used for remunerating the dairy trade is not strictly a cost-plus system. The margin is set so as to give the distributors on average a pre-determined rate of profit on top of the average level of costs in the industry. However, each individual firm operates in the normal commercial way. If it cuts its costs or improves its sales, its profits will increase; whereas, if its costs rise or sales decrease, its profits will fall. There is thus nothing in the system to prevent an individual firm from making a loss or going out of business.

(a) <u>In collective wage negotiations the distributors have little incentive to avoid high settlements, knowing their profits remain guaranteed. How can proper commercial incentives be restored?</u>

The first thing to be said here is that, in contrast to the implication conveyed by the question, wage rates in the dairy industry have historically been on the low side. This in turn has exacerbated the recruitment problems which arise as a result of the "unsocial" hours which the job involves. Recent wage increases have therefore in part reflected a need to correct that situation. Secondly, it must also be remembered that the position of the dairy trade negotiators has been weakened by the close relationship that exists between milk tanker drivers and those employed in the road haulage industry. In the last 2 wage rounds, they were obliged by a decision of the Central Arbitration Committee to pay equivalent rates to those forced through the Road Hauliers' Association by the TGWU. These in turn then set the tone for their negotiations on other groups of employees, such as roundsmen. Despite this, the industry's negotiators do have an incentive to hold down wage increases. This item accounts for about 70% of the cost of processing and distributing the milk, and the industry know that high settlements will tend to force up the retail price and reduce sales. Even though its <u>costs</u> may be reimbursed, falling sales will affect overall profit, which depends upon throughput. Moreover, at individual dairy level, each company has the normal commercial incentive to improve labour productivity and so to reduce wage costs.

(b) The Government guarantees distributors that if their costs increase by more than the projection on which the gross margin in a given period is based, the excess can be covered retrospectively from consumers. Is there any scope for arrangements which might make the trade more responsible in drawing up and keeping to forecasts?

This question seems to embody a misapprehension about the nature of the forecasts of costs. These are drawn up by the Government, albeit after consultation with the trade, and there is no suggestion that they are in any way guidelines or targets which the trade should keep to. They are simply our best estimates of the way costs are likely to move, and on which we base decisions about the appropriate level of the wholesale and retail prices. The key issues raised by the question are whether costs are measured accurately and realistically by the costings system, and whether the trade has sufficient incentives to hold down those costs. If the costing system does not provide an accurate reflection after the event of the costs actually incurred by the industry it is unlikely that forecasts before the event, based on economic indicators and known future increases in real costs, will provide any more certain indicator. This of course is the central issue to which the costings review is directed, and it could be expected that once the costings are put on to a more accurate basis, forecasts will as often prove to be on the high side as on the low side.

3. Fixed Wholesale Prices: With the removal of the constraints imposed by the green pound, is there scope for extending the Milk Marketing Boards' commercial freedom in negotiating liquid milk prices?

(a) Does the Government still need to intervene to establish the MMBs' prices for milk for liquid consumption? The policy of devaluing the green pound to give equality of competition with continental producers seems to remove the case for enforcing a premium price for liquid milk in order to maintain producers' returns; would it therefore be possible for the boards to negotiate directly with the dairy trade to establish the price on a commercial basis as they do already for milk for manufacture?

Any question of increasing the Milk Marketing Boards freedom to negotiate the liquid milk price involves 2 distinct considerations. As has already been indicated, the fact that the Boards are in effect monopoly suppliers of milk, and the dairy trade dominated by a small number of large concerns, is a good reason for maintaining control over prices for liquid milk at both retail and wholesale levels. Secondly, whereas the nature of the market for milk products with its high level of imports means that prices are negotiated on the basis of what the market will bear, this is not the case with the liquid market, at least at present, whilst imports are effectively precluded. Thus, irrespective of recent devaluations of the green pound, there would continue to be a strong temptation both for the Boards to force up the wholesale price and for the dairy trade to reflect this increase, plus their other costs increases, in the retail price. Indeed, if the level of sterling leaves little scope for increasing manufacturing prices through green pound devaluations, that is likely at a time of high inflation to have the paradoxical effect of <u>increasing</u> the temptation for the boards to recoup producers' cost increases through increases on the liquid side. There would therefore still be a strong case for maintaining a statutory control over the wholesale price (and of course the retail price as well).

(b) <u>There is a strong possibility that imports of liquid milk from the continent cannot now be excluded for more than a couple of years. Would the price at which they might sell mean that the Government was no longer in a position to guarantee UK producers a particular level of return by adjustment to wholesale liquid prices? If this were the case, could the retention of a system which guaranteed returns for distributors but not producers be defended: What considerations stand in the way of preparing the UK industry for the conditions of a common EEC market for milk?</u>

If imports of milk were to take place, the price at which they could be landed in the UK would depend on the level of intervantion prices; the strength of sterling, the level of the green pound (and of the MCA); and the price which the producer or importer was prepared to accept. However, the likelihood is that they could be landed at prices which compare favourably with that of home-produced milk, and so put considerable constraints on the Government's ability to adjust the price of liquid milk in order to influence producers' returns. In that event, the present system of determining the distributors' margin might well be inappropriate, particularly as its principal aim - the defence of the doorstep delivery system - would already have been undermined if imported pre-packed milk had by then made substantial inroads into our market. As for preparing the UK industry for the conditions of a common EEC market for liquid milk, this would presumably mean in practice squeezing the returns of producers or distributors (or both) in order to maintain the retail price at a competitive level. However, quite apart from the fact that we do not know what the conditions of a common EEC market would be, the effect would be to hit prematurely on the one hand at the incentive to producers to fulfil our aims for greater self-sufficiency in the milk sector, and on the other hand at the prospects of maintaining the doorstep delivery system in the short run. It is hard to see what would be gained by such a step.

MINISTRY OF AGRICULTURE, FISHERIES
AND FOOD

20 September 1979

CONFIDENTIAL

Prime Minister
You have agreed to take this in Cabinet on Thursday. It seems to me there are two issues not considered here:
i) Do we need to stimulate milk production when less than half is being sold as liquid?
ii) Is the distributors' margin sacrosanct? Why not wait for the current study by accountants to be completed before future price increases?
TL 1/10

PRIME MINISTER

MILK PRICES

As you know, the Minister of Agriculture, with the support of the Welsh and Scottish Agriculture Ministers, is seeking to increase the retail price of milk by 1½p this October to assist the milk producers whose profit margins have been severely squeezed this year. It is argued that failure to give milk producers a sufficient profit margin will lead to reduced dairy herds and to a substantial increase in milk imports. The price increase proposed would leave the target rate of profit for distributors unchanged but would increase the maximum wholesale price of milk. It would also allow the ½p premium per pint of sterilised milk to be increased to 1p. Northern Ireland Ministers broadly support the proposal that producers' incomes should be increased but suggest an alternative approach; a 1p increase in milk prices plus a devaluation of about 7½ per cent of the Green Pound. They also urge the continuation of the present Milk Aid Scheme in Northern Ireland. The increase proposed comes, however, on top of a 1½p increase in May which the Minister argued, at that time, would prevent the need for further increases this year. In the event distribution costs since May have increased more than expected and the planned increase to the wholesale price at the expense of the distribution margin, leaving the retail price unchanged, is not now possible. The second 1½p increment now would mean a total increase of 22 per cent since May. The Minister of State for

/Consumer ...

Consumer Affairs opposed the increase on the grounds of the expected effect on the food and retail price indices, and of possible adverse effects on the forthcoming wage round. There is, additionally, the important political point that a second increase this year of that magnitude may undermine the credibility of the Government. The Government is committed by the Manifesto to some improvement in farm income but there is nothing specifically about dairy farming. In this context Treasury argue that the decision on the increase of milk prices should be postponed and considered alongside other forms of support for farmers in a paper being prepared by MAFF on the agriculture industry generally. Discussion at E(EA) on Friday failed to resolve these issues and you might consider whether this could be taken at Cabinet next Thursday. The Minister of Agriculture has undertaken to prepare a paper for Cabinet, on a factual basis agreed with other Departments, setting out his proposals.

I am copying this to members of E(EA), to the Secretary of State for Northern Ireland and to Sir John Hunt.

KJ

K J
1 October 1979

Department of Industry
Ashdown House
123 Victoria Street
LONDON SW1

Agriculture

VMS

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

9 August 1979

Dear Peter

ENQUIRY INTO MILK DISTRIBUTION

I have seen a copy of John Nott's letter of 6th August. I support his suggestion that officials should produce a paper of the kind he has outlined. An agreed statement of the facts of the situation is surely a necessary background for the discussion on the merits of continuing the present system which you have already said you would be happy to hold.

If we then conclude that there is conclusive evidence that the system is in the national interest or alternatively that it must be radically changed I would not insist on an outside inquiry. My support for John Nott's original proposal was based on the assumption that if major changes were to be made you would wish to prepare the industry for them by the kind of public discussion such an inquiry would produce.

I understand that you wish to proceed urgently with an accountants' study. I would not object to this provided we are all agreed that this does not foreclose the option of a wider study if we consider one to be needed in the light of our consideration of the official paper and of any further information produced by the accountants themselves.

I am sending copies of this letter to the members of E Committee and to Sir John Hunt.

Yours

(GEOFFREY HOWE)

The Rt. Hon. Peter Walker, MBE, MP

CONFIDENTIAL

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

✓ MS

Agriculture

From the Secretary of State

The Rt Hon Peter Walker MP
Minister of Agriculture, Fisheries
and Food
Whitehall Place
LONDON SW1

6 August 1979

Dear Peter.

ENQUIRY INTO MILK DISTRIBUTION

Thank you for your letter of 30 July in reply to mine of 16 July.

I still have some fundamental doubts about the weakness of competitive pressures in milk distribution, which need to be answered before I can accept that no more is needed than a technical review by accountants of the way distributors' costs are measured. I agree there is now some urgency because we agreed as long ago as May, in discussing the 1½p per pint increase in the retail price, that the system needed to be looked at, and I indicated in my letter of 21 and 23 May the sort of issues which required investigation. You will remember that I was especially concerned that a price increase of this magnitude became unavoidable partly because the milk distributors had conceded pay increases up to 35% in the knowledge that their guaranteed rate of profit would remain as fixed by the Government. Geoffrey Howe also made similar points in his letter of 1 and 13 June. In deference to the political difficulties which you foresaw if the remit extended to the constitution and powers of the Milk Marketing Board, we subsequently agreed they should

contd...

CONFIDENTIAL

From the Secretary of State

be excluded from its scope. But there remain a number of basic questions relating to the distribution of milk after it has left the hands of the MMBs including the setting of wholesale and retail prices, where we need to be sure that such a non-competitive arrangement is really still in the public interest. They are set out in the attached note: underlying them all is the question of whether we can introduce more competition into this trade.

It may well be, as you maintain, that all the necessary information is available in your department to satisfy my concern on these questions. Naturally if they can be answered in that way I should be happy to agree that there is no need for an outside enquiry of the sort Geoffrey Howe and I have been pressing for. Might I suggest therefore that your officials provide a paper addressed to the questions I have set out, which Geoffrey Howe and I can consider after officials have discussed it to ensure that it covers the points which concern us? This may enable us to reach agreement: if not it will help to narrow and clarify any issues that need to be brought before our colleagues for a collective decision.

I am sure you will understand that these questions affect the interests of consumers as well as producers.

I am copying this letter to the members of E Committee and Sir John Hunt.

Yours ever

John

JOHN NOTT

ANNEX

MILK PRICING & DISTRIBUTION: POINTS FOR CONSIDERATION

1. Maximum Retail Price: is it effective in holding prices down or does it in fact act as a minimum price? If so, is it justified?

(a) Milk sold in shops is generally priced at least 1 p per pint above the statutory maximum, although it might be expected to sell more cheaply in view of the greater competition between shops than between delivery rounds. Does the apparent lack of interest on the part of shops in competing in selling milk result from unfair practices on the part of their suppliers?

(b) What is the extent of charges for doorstep delivery? If there were no control on retail prices, is competition between delivery rounds, and between retailers and delivery rounds, so limited that higher prices would result?

(c) If the statutory maximum retail price is in effect a minimum price, are the conditions which bring this about desirable? Would total sales of liquid milk fall if shops sold milk more competitively, particularly if increases in the price of milk on the doorstep cause patterns of consumption to change.

2. Distributors' Margins: it is agreed that the techniques used in establishing the distributors' margin need to be examined; but are the consequences of this cost-plus system acceptable?

(a) In collective wage negotiations the distributors have little incentive to avoid high settlements, knowing their profits remain guaranteed. How can proper commercial incentives be restored?

(b) The Government guarantees distributors that if their costs increase by more than the projections on which the gross margin in a given period is based, the excess can be receovered retrospectively from consumers. Is there any scope for arrangements which might make the trade more responsible in drawing up and keeping to the forecasts?

3. Fixed Wholesale Prices: with the removal of the constraints imposed by the green pound, is there scope for extending the Milk Marketing Boards' commercial freedom in negotiating liquid milk prices?

(a) Does the Government still need to intervene to establish the MMBs' prices for milk for liquid consumption? The policy of devaluing the green pound to give equality of competition with continental producers seems to remove the case for enforcing a premium price for liquid milk in order to maintain producers' returns; would it therefore be possible for the Boards to negotiate directly with the dairy trade to establish the price on a commercial basis, as

/ they

they do already for milk for manufacturing?

(b) There is a strong possibility that imports of liquid milk from the continent cannot now be excluded for more than a couple of years. Would the price at which they might sell mean that the Government was no longer in a position to guarantee UK producers a particular level of returns by adjustments to wholesale liquid prices? If this were the case, could the retention of a system which guaranteed returns for distributors but not producers be defended? What considerstions stand in the way of preparing the UK industry for the conditions of a common EEC market for milk?

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON S.W.1

From the Minister

VMS

The Rt Hon John Nott MP
Secretary of State for Trade
Department of Trade
1 Victoria Street
London SW1H OET

30 July 1979

My thanks for your letter of 16 July.

There really is no point in officials meeting to discuss the form and scope of the review for that is a matter for Ministers to decide and not officials. At any such meeting my officials would be instructed to agree to look into the method of calculation of the distributive margin for the dairy trade.

All other facts are known to me. I am satisfied with the existing arrangements which I believe to be of fundamental importance to British agriculture.

If there is any further information that your Department requires concerning the Milk Marketing Board or producers' costs margins, we will be only too pleased to provide you with them.

As to the basis and structure of milk marketing in Britain, this is essentially not just a political matter, but a very major political matter for my Department, and it is not for some outside firm to make what are essentially political judgments.

The inquiry into the costing arrangements of the dairy trade are now urgent and I am asking my officials to contact yours to try and agree a name of a firm within the next few days.

PETER WALKER

DEPARTMENT OF TRADE
1 Victoria Street
London SW1H 0ET

Telephone Direct Line 01-215
Switchboard 01-215 7877

Duty Clerk

As requested.

With the Compliments

of the

Secretary of State's
Office

CS 57

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

V/MS

From the Secretary of State

The Rt Hon Peter Walker MP
Minister of Agriculture, Fisheries and Food
Whitehall Place
London, SW1A 2HH

16 July 1979

Dear Peter.

MILK PRICES

Thank you for your letter of 4 July. Now that Geoffrey Howe and I have written suggesting the kind of review of the present milk pricing and distribution arrangements which we think is necessary, and you have indicated the matters which in your view merit investigation, I agree with you that our officials should meet to discuss the form and scope of the review.

I am copying this letter to Geoffrey Howe and Sir John Hunt.

Yours

John.

JOHN NOTT

Folio

Agriculture

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

From the Minister

The Rt Hon John Nott MP
Secretary of State for Trade
Department of Trade
1 Victoria Street
LONDON
SW1H 0ET

4 July 1979

cc. Mr Vile

NBOM

Dear John.

Thank you for your letter of 25 June on the question of milk prices.

I am anxious that we should urgently look into the milk distributors' costs and the manner in which we assess these costs so as to fix maximum retail and wholesale prices.

I would like speedily to agree with you the name of an independent firm with the ability to make a judgment of the system we operate, and thereafter would want to discuss with you and your officials the implications of their report.

I am pleased that you do not want to enquire into the Milk Marketing Board for, as you know, this Department is totally acquainted with its operation and can inform you on any points where you would like us to do so. This country has long fought for the preservation of the Milk Marketing Boards and we hope to continue this successfully vis-a-vis the Community.

Naturally, I have no objection, at any time in the future, to discussing the principle of the Government's fixing maximum retail or wholesale prices. What I am sure of, however, is that these are matters for political judgment and decision on which Ministers should be capable of making up their minds without recourse to independent enquiry. All the facts related to this policy are available and known, and they are facts that may vary in the future, depending upon the milk policies applicable throughout Europe.

I am therefore asking my officials to contact yours to seek agreement upon an independent firm to look into the costing arrangements. I believe that we will find some important changes are necessary here.

Yours,
Peter

PETER WALKER

CONFIDENTIAL

NBAM

Ref. A09861

MR. LANKESTER

R. 1.7

Milk Marketing

In his minute to you of 15th June Sir Kenneth Berrill recommends that any decision on a possible review of the milk marketing system should be deferred until the European Court has ruled on the legality of our milk hygiene import regulations.

2. There is little doubt that a wide-ranging review announced now would be widely criticised as undermining Mr. Silkin's "success" last year in securing Community agreement to the maintenance of the Milk Marketing Boards and hence daily doorstep deliveries. The situation might be different if the Court's ruling opened the door to liquid milk imports, in which case such an enquiry could be seen as a necessary consequence of factors outside the Government's control.

3. However, it is far from clear that the Court's judgment will have this effect. The Opinion of the Advocate General (the senior officer of the Court who investigates the case and proposes the terms of the eventual judgment), delivered since Sir Kenneth Berrill's minute, is that the United Kingdom is entitled to maintain its milk hygiene restrictions so long as no harmonised Community regulations exist. The Court is likely to give its own judgment in July. It is not obliged to follow this Opinion, but if it does the threat from liquid milk imports will be lifted until agreement is reached in Brussels on Community legislation in this field. There has been no progress on the relevant Directives since January and there is no reason yet to believe that the Irish will seek to give them a high priority during their forthcoming Presidency.

4. This points to Mr. Walker going ahead with his proposed internal study of the distributive margins for liquid milk, which should as he suggests include looking into "all the costing arrangements and the whole of the present system of milk pricing" (his letter of 16th May to the Chancellor of the Exchequer). A study of this kind ought anyway to be conducted before the next retail milk price review in the autumn. It would not have the same alarmist effect on public opinion as the more radical enquiry some Ministers want, yet it should throw up a good deal of

CONFIDENTIAL

information relevant to such an enquiry if in the light of the Court's judgment or for other reasons the Government were later to decide to go the whole hog.

5. If the Prime Minister agreed she might therefore suggest to her colleagues that Mr. Walker should proceed with an enquiry into the immediate issue of the distributors' margins, without prejudice to the possibility of a more fundamental study at a later stage if the circumstances made it necessary.

JOHN HUNT

25th June, 1979

DEPARTMENT OF TRADE   1 VICTORIA STREET LONDON SW1H 0ET   Telephone 01-215 7877

RESTRICTED

From the Secretary of State

Rt Hon Peter Walker MP
Minister of Agriculture, Fisheries and Food
Whitehall Place
London, SW1

25 June 1979

26/6

Dear Peter.

MILK PRICES

I have followed with interest the correspondence between yourself and Geoffrey Howe on my proposal that there should be an enquiry into the milk pricing system.

You will of course realise that I very much agree with what Geoffrey Howe has said. I accept that the primary concern ought not to be the milk marketing boards themselves, but the system for setting maximum wholesale and retail prices for liquid milk and for dealing with milk distributors' costs.

I therefore hope that officials of the Departments concerned can get in touch with one another to prepare agreed draft terms of reference for such an enquiry and suggestions for possible members. I would like officials of my Department to be involved in this exercise.

I am copying this letter to the recipients of the previous correspondence.

Yours ever
John.

JOHN NOTT

RESTRICTED

[Sw]YDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switsfwrdd)
01-233 6106 (Llinell Union)
Oddi wrth Ysgrifennydd Gwladol Cymru

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switchboard)
01-233 6106 (Direct Line)
From The Secretary of State for Wales

The Rt Hon Nicholas Edwards MP

21 June 1979

Dear Geoffrey

PR 26/6

MILK PRICES

I have seen Peter Walker's letter dated 4 June about milk prices and support his view that any inquiry into milk prices should concentrate on the reimbursement of distributor costs.

I am sure that an inquiry now into MMB prices and practices would be damaging to the dairy industry which is already under considerable pressure not least in Wales.

I am copying this letter to those who received Peter Walker's

Yours ever

Nick

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

C.O. — Say they'll take the Court.
C.F.

CONFIDENTIAL

PM pls.

R

Qa 04145

Does C.O. agree?

To: MR LANKESTER

From: SIR KENNETH BERRILL

Milk Marketing

1. The Prime Minister has received copies of the correspondence between the Minister of Agriculture, the Chancellor of the Exchequer, the Secretary of State for Trade, and the Secretary of State for Scotland on a possible review of the system of marketing milk in this country. Broadly, Mr Walker is in favour of a study confined to the narrow issue of the method of calculating the distribution margin for liquid milk. Some of his colleagues argue for a much wider (though unspecified) review.

2. How wide the review should be depends on whether one takes the system as it now is and looks only at one obvious abuse (the cost-plus system of calculating the distributors' margin which means that they can pass any wage increase straight through to the consumer - this is Mr Walker's approach) or whether one takes a more wide-ranging review, in part because increases in imported milk threaten to undermine existing arrangements. The European Court may give judgement next month on the legality of the United Kingdom Milk Hygiene Import Regulations. If the decision is adverse there may be little alternative but to have a look at the system as a whole. In the view of the CPRS there is much to be said for waiting until that judgement is received before taking decisions on the scope of any review.

The Present Milk Marketing Board System

3. The Milk Marketing Board (MMB) operates in the United Kingdom as a monopoly with sole rights over the sale of milk both to distributors and to the manufacturers of dairy products. This Government supplements this with an effective control (through hygiene regulations) over milk imports. UK dairy farmers regard the MMB as having provided countervailing 'producer power' to match the power of the large distributors and manufacturers. They view

the MMB as an essential mechanism to provide them with adequate and stable returns. UK Governments have also found it useful as a machinery for importing low cost produce (particularly Commonwealth dairy products).

4. Membership of the EEC poses a potential threat to the traditional role of the MMB. EEC membership means that we cannot import large quantities of cheap dairy produce and the European Court may limit control over liquid milk imports from the EEC. Such imports, together with increased UK liquid milk production, could well present the Board with much bigger problems over liquid milk sales than it has had to face in the past.

5. There is a contrast between the position on liquid milk and that of dairy products. The range of dairy products available to the UK consumer is continuously increasing and this, together with rising incomes, means rising consumption of most dairy products. In contrast the range of choice of liquid milk is very limited (e. g. low fat milk is hard to get) and the consumption of liquid milk is falling, at a time when total UK production is rising. Substantial imports of fresh milk could complicate the picture, with large food chains in the UK negotiating direct contracts with EEC suppliers quite outside the MMB system. This would undermine the door-step delivery now universal in England and Wales.

6. In such a situation a wide review would be needed. The Treasury and the Department of Trade want a wide review though they have not indicated the terms of reference they have in mind. One obvious area for study would be the effect of increased milk imports on our institutions and attitudes. The case for allowing UK milk producers to sell liquid milk directly to food stores to be sold alongside imported milk; the case for allowing UK milk producers to sell a wider range of 'standardised milk' and 'as it comes from the cow' to compete with the range of imported milk; how the MMB would adapt to all this.

7. Quite apart from the scope of the review there is the issue of who should conduct it. The Treasury and the Department of Trade believe that on all past experience an internal review would be heavily producer orientated and not provide an impartial consideration of the options.

8. In the view of the CPRS the best course would be to postpone a decision on the form of the review until we have the judgement of the European Court and can see more clearly the problem of increased import of liquid milk. If the problem appears a major one then there is a strong case for an external and wide-ranging review of the system for distributing liquid milk in the United Kingdom. If the Prime Minister agreed, she might put this view to her colleagues.

9. I am sending a copy of this minute to Sir John Hunt.

KB

15 June 1979

DEPARTMENT OF AGRICULTURE,
DUNDONALD HOUSE,
UPPER NEWTOWNARDS ROAD,
BELFAST,
BT4 3SB.

14th June 1979

The Rt. Hon. Peter Walker, M.P.,
Minister of Agriculture, Fisheries & Food,
Whitehall Place,
LONDON,
SW1A OAA.

Dear Peter

MILK PRICES

I have seen the letters you received from John Nott on 23rd May and the Chancellor on 1st June both of which indicate a preference for a wide-ranging enquiry into all aspects of milk pricing. I have also seen your reply to Sir Geoffrey and I support the views expressed in it.

I am influenced by the violent adjustments which it was necessary to make to the Northern Ireland distributive margin at the recent review and would be anxious to be in a position to avoid a recurrence of this at the earliest possible date. While I am not opposed to the idea of a wider enquiry I would be concerned that such an investigation would need to be differently constituted and would take too long to provide an answer to the immediate problem. I feel that a more direct and shorter enquiry into the function of the existing margins and costings system ought to be conducted before considering a more prolonged and wider review.

I am copying this letter to the Prime Minister, the Chancellor, John Nott, George Younger, Nicolas Edwards and Sir John Hunt.

Yours
Giles

GILES SHAW, M.P.
Parliamentary Under-Secretary of State
Northern Ireland

LB

Agriculture

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

13 June, 1979

PL 15/6

Dear Peter

Thank you for your letter of 4th June.

I recognise that producers hold the MMBs in high regard and the degree to which we are politically committed to supporting them. Whilst I do not accept that this commitment prevents us from reconsidering their detailed operations from time to time, my immediate concern is not the Boards or their monopoly selling powers but the arrangements which we have inherited from the previous administration under which we are committed to determining maximum wholesale and retail prices so as to guarantee a rate of return to the milk distributive industry. This is a situation in which the industry itself is free to incur costs, e.g. in wage negotiations, and the Government bears the responsibility for deciding how they are to be recouped. On the face of it this seems an unsatisfactory arrangement and it does not accord with our general approach to private industry. Even if, in present circumstances, it is a necessary arrangement to preserve the daily milk delivery system - and this is a proposition which itself seems to me to merit inquiry - it is surely questionable whether it can or should be continued when liquid milk imports begin. I recognise that such imports are not imminent but I understand that they could begin within a year if a case currently before the European Court goes against our current import restrictions.

/Therefore it seems

The Rt. Hon. Peter Walker, M.P.

Therefore it seems clear to me that we need to take a wider look at the current arrangements and not simply obtain an accountants' report on costings, although I would not, of course, object to costings figures being obtained as part of the review. This is why I continue to support John Nott's proposal. I hope that, on reflection, you will see merit in proceeding with it. As a first step perhaps officials of the Departments concerned and the CPRS should be asked to meet to prepare draft terms of reference which we could then consider.

I am sending copies of this letter to the recipients of yours.

(GEOFFREY HOWE)

12 Downing Street,
Whitehall,
London, S.W.1

With the Compliments

of the

Chief Whip

FROM: THE RT HON MICHAEL JOPLING MP

1.

Government Chief Whip

12 Downing Street, London SW1

R 15/6

12 June 1979

Peter Walker sent me a copy of his letter of 4 June to you about milk prices.

Whilst I am personally committed to the same view as Peter Walker takes you might like to know that we shall receive very strong pressure from within the Party if we embark on a course which appeared to be aimed at dismantling the powers of the Milk Marketing Board. I doubt if we could carry changes of that sort.

I am copying this letter to the recipients of Peter Walker's letter.

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
SW1

Agriculture

SECRETARY OF STATE FOR SCOTLAND

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1

11 June 1979

R 12/6

MILK PRICES

I have seen your letter of 1 June to Peter Walker, as well as earlier correspondence on milk prices with Peter Walker and John Nott.

I am not convinced that an independent study of the whole milk marketing system would get the quick, informed and comprehensive report on milk distribution margins with the circumstances warrant. We have already, within central government, the necessary professional and administrative expertise supported by experienced independent accountants (Peat, Marwick and Mitchell). This, with the co-operation of both the MMBs and the representative trade organisations should, under a strong Chairman, provide a forum for a comprehensive and objective inquiry into distribution margins, their fairness to producers and distributors, and the way decisions are taken and disseminated, within a much shorter timescale than a review of the whole system which started from scratch.

I entirely support Peter Walker in believing there is no justification for a further review of the milk marketing boards. The MMBs have already been subjected to overmuch examination by Community Institutions and to denigration by competitors in other Member States whose prime motive was to secure a clear market in the UK for their subsidised milk products, which are in chronic surplus. The Council of Ministers exacted a high price in 1978 for conceding the rights of the MMBs to sole purchase of all milk and to paying a common price to producers regardless of the use made of each particular producer's milk. After all, the discipline on producers in other Member States is in reality every bit as stringent as in the UK because in practice Continental producers who opt out of a co-operative have little prospect of getting an outlet for their milk.

The MMB arrangements constitute a supremely efficient milk collection and primary distribution network which guarantees supplies for the liquid market throughout the UK every day of the year; provides manufacturers with the milk they can use; and acts as residual buyer when there is a surplus; so stabilising the market despite seasonal fluctuations. Prices are now negotiated jointly by each MMB and the representative Trade organisations, with provision for compulsory arbitration when there is disagreement. I do not see what we should achieve by apparently threatening to upset this.

I should accordingly deplore any further investigation of the MMBs: we are in process of negotiating with the Commission detailed provisions implementing the Council Regulation governing the status and producers of the MMBs and a UK review would give credibility to the suspicions and allegations of our competitors and would unnecessarily erode our producers' confidence.

I am copying this letter to the Prime Minister, Peter Walker, John Nott, Nicholas Edwards, Humphrey Atkins, Michael Jopling and Sir John Hunt.

Agriculture

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

From the Minister

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

4 June 1979

NBPM

R 5/6

Dear Geoffrey,

MILK PRICES

Thank you for your letter of 1 June. I think it would be disastrous to have an independent enquiry into the whole future of milk marketing in this country.

For the last 4 years, in speech after speech, John Peyton, Michael Jopling and many others, made it perfectly clear that the Conservative Party were totally behind the concept of the Milk Marketing Board. Indeed the Conservative Party went out of its way to assure farmers that they were, if anything, more keen than John Silkin on the retention of this stabilising factor in their industry.

The fact is we do have a highly efficient Milk Marketing Board and a distribution of milk, on a house to house basis, which is unique. There is no need for an independent enquiry to ascertain that, if you allowed undiluted competition in this sphere, the system of delivery would disappear with the same speed as it disappeared in other countries. People will buy their milk, doubtless at lower costs, at the supermarkets. Liquid milk consumption could drop by 40% as it did in Holland. Such a drop would be crippling to British agriculture.

I well remember reading Linda Whetsone's IEA pamphlet and being shocked at its lack of recognition of some of the realities of the milk industry in Britain. I have discovered since that my Parliamentary Secretary, Jerry Wiggin, was equally shocked and with a view to providing Miss Whetstone with a teach-in on the subject organised for her to lunch with the Chairman of the Milk Marketing Board and I am assured that at the end of the lunch she knew more about the realities of the milk industry than when she wrote her pamphlet.

To throw into a position of uncertainty the future of milk marketing in Britain at the present time would, I believe, be incredibly damaging to confidence amongst British farmers

and I/

and I think it would also have considerable repercussions within the Conservative Party.

The immediate task is, I believe, to examine very speedily the current arrangements for measuring and meeting costs, for I have reason to believe that they should be thoroughly revised before any further reviews of milk pricing. I am copying this letter to the Prime Minister, John Nott, George Younger, Nicholas Edwards, Humphrey Atkins, Michael Jopling and Sir John Hunt.

PETER WALKER

Agriculture

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

1 June 1979

Dear Peter

P 1/6

MILK PRICES

Thank you for your letter of 22nd May. I have also seen John Nott's letter to you of 21st May.

I agree that it would be sensible to have an independent review of the milk pricing arrangements. I would, however, see some disadvantages in a review by a firm of accountants. This would provide useful evidence to guide future decisions on the maximum retail price but would at the same time give the industry the impression that we were committed to continuing something like the current cost plus arrangements. Like John Nott I think the question needs wider consideration.

With the prospect of free import of liquid milk we should surely be preparing for a situation where the distributive industry's margins depend on the efficiency of the firms involved and consumers are protected by competition within the industry and from abroad rather than by Government control over pricing. I recollect that the whole subject was constructively discussed, some years ago, in an I.E.A. pamphlet by Linda Whetstone. This was written, of course, in a somewhat different world, but it posed some of the basic problems which still need to be asked.

I am copying this letter to the Prime Minister, John Nott, George Younger, Nicholas Edwards, Humphrey Atkins and Sir John Hunt.

Geoffrey

(GEOFFREY HOWE)

The Rt. Hon. Peter Walker, MP

Agriculture

Ministry of Agriculture, Fisheries and Food
Whitehall Place London SW1A 2HH

From the Minister's
Private Office

Tim Lankester Esq
10 Downing Street
London SW1

24 May 1979

Dear Tim,

MILK PRICES

Thank you for your letter of 23 May. As you know from our subsequent conversation, my Minister will now be announcing the 1½p increase in the retail price of milk on Friday.

I am sending copies of this letter to Tom Harris (Department of Trade), John Wilson (Scottish Office), George Craig (Welsh Office) Joe Pilling (Northern Ireland Office), Tony Battishill (HM Treasury) and Martin Vile (Cabinet Office).

Yours sincerely

Frances Thompson.

Miss F H Thompson
Assistant Private Secretary

Ministry of Agriculture, Fisheries and Food
Whitehall Place London SW1A 2HH

From the Minister's
Private Office

Tim Lankester Esq
10 Downing Street
LONDON
SW1

24 May 1979

Dear Tim

MILK PRICES

... Further to my letter of earlier today I attach a copy of the written PQ reply which will announce the $1\frac{1}{2}$p increase in the retail price of milk.

I am sending copies of this letter to Tom Harris (Department of Trade), John Wilson (Scottish Office), George Craig (Welsh Office), Joe Pilling (Northern Ireland Office), Tony Battishill (HM Treasury) and Martin Vile (Cabinet Office).

Yours sincerely

Frances Thompson.

Miss F H Thompson
Assistant Private Secretary

To ask the Minister of Agriculture, Fisheries and Food if he has carried out a review of the maximum wholesale and retail prices for liquid milk, and if he will make a statement.

REVISED DRAFT REPLY

Increases in milk prices are required under a system established by the previous government in 1977. The government then decided to set the distributive margin (the gap between the retail price and the wholesale price) at a level which reimburses the dairy trade for the expected average costs of processing and distributing liquid milk in the forthcoming 6 month period (together with any adjustments to take account of variations in costs from those expected in earlier periods). The processing and distributing costs are based upon independent costing investigations. The last review should have taken place on 1 April but was deferred. The delay in making this review results in a steeper rise being necessary now than would have been the case if the decision had been taken at the customary time.

The government have reviewed the increases that are now needed in the maximum wholesale and retail prices for liquid milk by the established methods. The increases required are very much affected by wage settlements made in the first 4 months of this year.

The result of this review is that the maximum retail price for liquid milk will now have to be increased by 1½p per pint so that the price of ordinary pasteurised milk will be 15p per pint. These increases will take place in England, Wales and Northern Ireland on 3 June and in Scotland on 15 July. The increase is what is necessary to meet the additional calculated costs whilst maintaining returns to milk producers at acceptable levels.

In order to reflect the lower costs of summer milk production, maximum wholesale prices will be reduced on 1st June to the following levels:-

	p per litre
England and Wales (except London)	12.943
London	12.747
Scotland	12.891
Northern Ireland (except Belfast)	11.349
Belfast	11.258

Orders to give effect to the new maximum prices will be laid before Parliament as soon as possible.

SCOTTISH OFFICE
WHITEHALL LONDON SW1A 2AU

The Rt Hon Peter Walker MBE MP
Minister of Agriculture Fisheries & Food
Ministry of Agriculture Fisheries & Food
Whitehall Place
LONDON
SW1A 2HH

23 May 1979

R

MILK PRICES

Thank you for your letter of 22 May.

I can agree to your suggestion that the retail price in Scotland should rise by 1½p per pint six weeks later than in England and Wales, (ie on 15 July). I also agree that we should seek to announce this tomorrow if possible.

Perhaps I can however make a more general point which arises from our colleagues' letters. We should make it clear that this increase is needed because of increases in distribution costs, as you said in your initial letter. The price to producers will in fact decrease slightly over the summer as a result. Geoffrey Howe mentions a 2 per cent co-responsibility levy and green pound devaluation. I agree that these are factors which we shall have to take into account when we look again at the situation in the autumn. But we should be clear that the present increase is not in fact offering a great deal to the producer.

I am copying this letter to the Prime Minister, Geoffrey Howe, John Nott, Nicholas Edwards, Humphrey Atkins and Sir John Hunt.

CONFIDENTIAL

cc D/T
SO
WO
NIO
HMT
CO

HS

Agriculture

10 DOWNING STREET

From the Private Secretary

23 May 1979

Milk Prices

The Prime Minister has considered your Minister's further letter of 22 May on the above subject, and has now agreed - in the light of the additional arguments put forward - that the increase in the retail price of milk should be 1½p as your Minister originally proposed. She is also content that the announcement should be made on Thursday.. I should be grateful if you would ensure that this is after Prime Minister's Questions and not before.

I am sending copies of this letter to Tom Harris (Department of Trade), John Wilson (Scottish Office), George Craig (Welsh Office), Joe Pilling (Northern Ireland Office), Tony Battishill (H.M. Treasury) and Martin Vile (Cabinet Office).

T. P. LANKESTER

Miss F.H. Thompson,
Ministry of Agriculture, Fisheries and Food.

CONFIDENTIAL

JM

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

From the Secretary of State

R 24/5

The Rt Hon Peter Walker
Minister of State for Agriculture,
Fisheries and Food
WHITEHALL

23 May 1979

Dear Peter.

MILK PRICES

I have seen your letter of 22 May to the Prime Minister, in which you suggest that the independent enquiry which we both agree should be made into the arrangements for pricing milk, should be carried out by accountants. It was agreed that our officials should discuss suitable candidates for an enquiry but I think that we should consider the scope of the enquiry before we can define who is to do it, or the best man to chair it.

I agree with you that the present basis of the dairy costing system should be covered. This will clearly require an accounting input. But this should form only part of the wider study which I described in my letter of 21 May. This should surely embrace wider questions of efficiency; the actual performance of retail distributors under the price control system, and the consequences of their behaviour for the prices charged to consumers. In particular, the enquiry should consider how these arrangements will be affected by the direct import of liquid milk that is expecte

From the Secretary of State

once the hygiene regulations fall in; and what changes are required to enable our industry to respond to the challenge. These questions go considerably beyond normal accounting issues, and I should like to see an enquiry chaired by an independent person of analytic mind, who shares our own beliefs in the need to promote greater efficiency - not least because imported liquid milk will raise a host of questions about the existing mechanism. It will not be easy to find someone who both combines these qualities and is also acceptable to the industry, but I am sure that this is what we should seek.

I will see if I can come up with a few suitable names.

I am copying this as before.

Yours ever
John.

JOHN NOTT

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

From the Minister

The Whitelaws & I had a talk with Peter Walker last evening & because the 1½ will have to go ahead now so [illegible]

Prime Minister
Do you wish to stand firm on 1p? (½p is worth 0.07%. on the RPI)
TL 22/5

22 May 1979

I don't know where Mr Healey got his figure of ½ p from. The last administration had not considered this question of a further increase.

The Prime Minister
10 Downing Street

Dear Prime Minister

I hear that you are concerned at the announcement of an increase of 1½p a pint on milk which I would like to make this Thursday.

--- I enclose a copy of the reply I have sent to the Chancellor of the Exchequer to his letter and I am sure that it is to our benefit to do the 1½p now rather than be faced with the almost certainty of 1p now for which our predecessors will be blamed, and at least 1p in October for which we will be held clearly responsible, with the October increase coming at a very sensitive time as far as the wage round is concerned.

we get a large increase in October was not.

If we purely gave an increase of 1p now with no adjustment in October, producers' incomes in real terms would be 23% less than last year, which was considered to be a poor year, and if with no further cost increase taking place , which is unlikely, we gave 1p now and 1p in October there would still be a drop of 4% in real terms.

This assumes no green pound devaluation

I did point out in my original letter that even providing the 1½p increase I am advocating, there would still be a drop in producers' incomes of something like 6% in real terms compared with 1978/79.

With the drop in farm incomes that took place last year , of which we made a great deal in the election campaign, I feel it is essential to quickly restore confidence and I remain convinced that my proposal of 1½p a pint now would help to achieve this and also help the Chancellor's general strategy.

I have spoken to the Secretary for Trade and agreed with him to an independent review of the margins of the distributive trade and this will be done by an independent firm of accountants.

I hope therefore on reconsideration you will agree to my announcement being made on Thursday.

Yours ever
Peter Walker

PETER WALKER

pps

Northern Ireland Office
Stormont Castle
Belfast BT4 3ST

NBPM

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

R 22/5

22 May 1979

LIQUID MILK PRICES

Peter Walker has sent me a copy of his letter to you about liquid milk prices. Although it is his responsibility to fix these for Northern Ireland I think I should comment because of the implications for the industry in Northern Ireland.

Firstly I agree with him about the importance of maintaining producers' confidence and in the short-term I see no alternative other than increasing the retail price by 1½p per pint. An increase of this magnitude is fully justified and preferable to a smaller increase now with the inevitability of a further increase in the autumn. The large increase now will bring home to both workers and employers in the dairy trade the consequences of large wage settlements.

I am however worried about the large liquid milk premium which will continue. This makes the UK liquid milk market very attractive to other Member States. Although our health regulations give protection at present from such imports we would be naive to think that we can retain these mechanisms for much longer. I am of course particularly worried about imports into Northern Ireland from the Irish Republic where we do not even have the physical protection afforded by a stretch of water.

I am also concerned about the financial and negotiating implications of this increase for Northern Ireland. MAFF officials have estimated that the disadvantage to Northern Ireland producers will increase by £3m which is equivalent to setting the Northern Ireland Milk Aid 0.26 ppl above the maximum of 1.4 ppl approved by the EEC Council for the current Community milk year. While I can see no escape from this problem at present I think we must in the longer term aim to place more reliance upon Green Pound devaluations than on liquid milk price increases to keep producers' returns at a reasonable level. This would be in keeping with the Green Pound devaluation policy stated in our Election Manifesto and since then by Peter Walker. Such an approach would have the added advantage of keeping liquid milk relatively cheap and therefore encouraging consumption. It would also reduce the requirement for Northern Ireland Milk Aid.

We should examine the costings arrangements and the present system of milk price fixing as soon as possible. It does seem to me that a system under which the distributive margin can fluctuate as much as it has in the space of a few months, requires an overhaul at the very least and for a start I agree with Peter Walker that there is merit in moving to an average figure for the UK as a whole.

I am copying this letter to recipients of yours.

JMcC

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

From the Minister

The Rt Hon George Younger MP
Scottish Office
Dover House
Whitehall
London SW1A 2AU

22 May 1979

Dear George,

RETAIL AND WHOLESALE MILK PRICES

Thank you for your letter of 18 May in which you propose that the retail price in Scotland should be increased by ½p per pint on 3 June and by a further 1p per pint on 15 July. I appreciate that, in making this proposal, you had in mind that it would be helpful in reducing the initial difference between the retail prices in Scotland and the rest of the UK. But I believe that this course would be likely to give rise to considerable confusion on both sides of the border - and I should also have thought that two increases in such quick succession would have involved more criticism on the part of consumers and greater risk to the level of consumption. I would therefore strongly favour the course originally proposed in my letter of 16 May to Geoffrey Howe and, as I trust that this (though perhaps with the date for the increase in Scotland being brought forward by a week or so from 15 July) is now acceptable to you, I hope we can proceed on that basis.

I wish to make an announcement on Thursday.

I am copying this letter to the Prime Minister, Geoffrey Howe, John Nott, Nicholas Edwards, Humphrey Atkins and Sir John Hunt.

Yours ever,
Peter

PETER WALKER

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

From the Minister

22 May 1979

The Chancellor of the Exchequer
HM Treasury
Parliament Street
SW1P 3AG

P
24/5

Dear Geoffrey

Thank you for your letter of 21 May. In making the suggestion of an increase of $1\frac{1}{2}$p I very much had in mind the possibility of avoiding a further increase in the Autumn which I am sure would be of benefit to your economic strategy.

If we only make an increase of 1p now I am certain that we will need a further increase of another 1p in October for which we will be held totally responsible.

I have also agreed with the Secretary for Trade that we will appoint an independent firm of accountants to look into the costings which I am sure you will welcome.

Yours ever
Peter

PETER WALKER

CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary

21 May 1979

Dear Garth

MILK PRICES

The Prime Minister has considered your Minister's letter of 16 May proposing an increase in the retail price of milk of 1½p per pint. She has also seen the letters from the Private Secretaries to the Chancellor of the Exchequer, the Secretary of State for Scotland and the Secretary of State for Trade.

The Prime Minister's view is that a 1p increase is the maximum that is politically feasible. She would have preferred a lower figure, but in view of the arguments put forward in your Minister's letter, she is willing to go along with an increase of this amount. The Prime Minister believes that a 1½p increase would mean much too large an addition to the housewife's budget, and it would further limit the Chancellor's room for manoeuvre in the Budget.

I am sending copies of this letter to Tom Harris (Department of Trade), John Wilson (Scottish Office), George Craig (Welsh Office), Joe Pilling (Northern Ireland Office) and Martin Vile (Cabinet Office).

Yours ever,

Tim Lankester

G.R. Waters, Esq.,
Ministry of Agriculture, Fisheries and Food.

Spares.

cc Treasury (Ch of Ex)

CONFIDENTIAL

GB

CONFIDENTIAL

PRIME MINISTER

Milk Prices

Mr. Walker's letter (Flag A) proposes an increase in the retail price of milk of 1½ p on 3 June in England, Wales and Northern Ireland; and a similar increase in Scotland on 15 July.

This is quite complex. The essence of the problem is as follows. The distributors enjoy a cost-plus system under which they are guaranteed a minimum return. The last retail price increase was last autumn, but this was based on the assumption that distributors' wages would increase by no more than 5 per cent. In the event, they have risen by 15 per cent. So, without an increase in the retail price, the guaranteed distributors margin can only be maintained by a cut back in the price to the farmer. It is to prevent such a cut back that Mr. Walker is proposing the 1½ p increase. The distributors margin has been eroding for several months, and MAFF had hoped to announce the increase from 1 April; but a decision was postponed because of the Election. Without an increase now, they argue that either the Government will be undermining the guaranteed margin to the distributor and this will in turn cause the distributors to cut back on their sales - as well as undermining confidence in the Government's handling of milk; or it will mean a lower price to the farmer - and this will mean a cut back in milk production - as well as causing discontent in the farming community.

The Chancellor (Flag B) and Mr. Younger (Flag C) support Mr. Walker. However, Mr. Nott (Flag D) dissents. He would like a ½p increase now; and, if necessary, a further increase in September.

Mr. Nott's arguments are:

(i) a big increase now will undermine our negotiating position on the CAP;

(ii) a 1½p increase is not altogether expected by the farming community; and

(iii) it would make it seem as if the Government were satisfied with the existing cost-plus system: Mr. Nott proposes a radical review of the whole system (Mr. Walker also proposes a review, but not an independent study as suggested by Mr. Nott).

Mr. Nott's approach certainly does appeal, not least because it would mean saving something on the RPI. However, I am not sure there is enough in his letter to justify your opposing the Treasury and the two Ministers responsible for Agriculture, at least not without a discussion.* I suggest you either agree to Mr. Walker's proposal, or ask that the matter be resolved in E Committee next week. The latter will not please Mr. Walker; but a week's delay can hardly make that much difference.

TL.

*MAFF do not think there is anything much in Mr. Nott's argument that we will be undermining our position on the CAP if we go for the bigger increase now.

21 May 1979

CONFIDENTIAL

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

From the Secretary of State

Rt Hon Peter Walker MP
Minister of Agriculture, Fisheries and Food
Whitehall
London
SW1

21 May 1979

Dear Peter.

MILK PRICES

Thank you for copying to me your letter of 16 May on your proposals for milk price increases. The proposed increase of 1½p per pint raises issues of considerable importance.

I accept, of course, that we must stand by our commitment to the health of British farming. But I believe that the proposed increase conflicts directly with our most vital objective namely a reform of the CAP and the elimination of the milk surplus. The medium-term outlook for our producers will only improve if we take a firm line in the EEC. In this respect it will surely undermine our negotiating position if the UK appears to be taking action to maintain our own milk producers' margins at the very time when we are seeking greater reductions for those of dairy farmers elsewhere in the Community. For this reason, it seems to me essential that we should be able to defend whatever price increase is agreed for June as the minimum necessary for British agriculture.

For this reason, I should favour confining the price increase to be made in June to a minimum, but to make it clear that we shall review the situation in September. I have read this weekend's farm press - for relaxation rather than for knowledge - and I do not find a universal expectation of an 1½p increase (please note the editorial comment in Big Farm Weekly). At this stage it is recognised that there are many

CONFIDENTIAL

From the Secretary of State

uncertainties still to be settled: the milk co-responsibility levy, the action we may decide to take on the green pound, and the eventual outcome of the price fixing in Brussels. I should therefore prefer the increase to be confined to ½p per pint. This would still make it possible, if events required it, for dairy farmers' returns to be increased in September by a further increase if you fail to achieve your wider objectives in the EEC farm negotiations.

It is still more important that we should look as soon and as hard as possible at the arrangements for milk. It is intolerable that we should be faced with the task of automatically funding inflationary wage settlements through retail price increases. I realise that the MMB is the sacred cow of British agriculture but it is still essential to consider how we can introduce more competition into the system, to face those responsible for decisions with their consequences. I therefore favour a review, but of a nature radically different from that you propose. First it would be wrong to suppress competition still further by submerging differences in costs and efficiency in different parts of the UK by adopting a UK costing system. Secondly instead of a review by officials from Agricultural Departments alone, I would favour a totally independent study, designed to introduce an element of competition (for the benefit of the consumer) into this area and a study of how we can adjust to the stimulus of liquid milk imports. This is just the sort of industry where our recent decision to strengthen the Office of Fair Trading and the Monopolies and Mergers Commission should be translated into practice.

As you will appreciate there are other short-term political considerations concerned with the impact on the RPI but these weigh far less heavily with me than the need to achieve the fundamental reforms which are essential in this field.

I am copying this letter to those who received your letter.

Yours ever
John.

JOHN NOTT

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

2~~0~~1 May, 1979

Dear Peter

Thank you for your letter of 16th May proposing an increase of 1½p per pint in the retail price of milk from 3rd June.

I recognise that the wage increases in the distributive industry make some increase necessary and I support your view that the change should be made quickly so that it can be firmly linked with the wage increase itself. This will forestall unfair allegations that it arises from our policies or from the abolition of the Price Commission and should bring home to the distributive industry itself the consequence of its wage decisions.

Naturally, however, I would not want us to sanction a bigger increase than is strictly necessary, particularly if, as you imply, you may wish to add further to food price increases by devaluing the green pound shortly. On the figures you have presented I see a case for an increase of 1-1½p. I should be prepared to accept the higher figure on the understanding that it will help us to avoid a further increase in the autumn. In particular this means that I regard the 1½p as covering the potential cost of a 2% co-responsibility levy and taking no account of the gains to milk producers if we and the Council agree to a further green pound devaluation. If, in the event, there is no levy or there is a devaluation the effects can be taken into account in the autumn review.

I hope too, that Humphrey Atkins will agree that the 1½p increase will assist Northern Irish milk producers, although possibly not to the same degree as milk producers in GB, that it should help him to contain the cost on the NI milk producer subsidy and that it is, therefore, of some indirect help to him in finding the resources needed to assist the meat plants in Northern Ireland.

I am copying this letter to the Prime Minister, John Nott, George Younger, Nicholas Edwards, Humphrey Atkins and Sir John Hunt.

(GEOFFREY HOWE)

The Rt. Hon. Peter Walker, MBE,

O10.

SECRETARY OF STATE FOR SCOTLAND

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1

18 May 1979

RETAIL AND WHOLESALE MILK PRICES

You will have seen Peter Walker's letter of 16 May, proposing an early increase in retail and wholesale milk prices. I endorse fully his assessment of the situation, and support his conclusion that to maintain producers' and distributors' incomes at a reasonable level over the summer, an increase now of 1½p a pint on the retail price is inevitable.

You will see that he proposes that for Scotland, the increase should be delayed for six weeks. This is our best estimate at present (the 1977/78 Scottish distribution costings results will not be completed until mid-June), but the difference reflects a side effect of the transition from the milk guarantee system to the present milk pricing arrangements rather than any significant difference in the actual costs of distributors in each country.

What I propose for Scotland is that we should have a ½p a pint increase in the retail price on 3 June, so keeping the prices rather more nearly in line, and that we should announce that there will be a further 1p increase, no more than six weeks later (15 July). I think that this would be the fairest means of dealing with the slightly different requirements in Scotland.

I welcome the proposals for a review of milk pricing procedures, in which my officials will participate, and the possibility of our moving to a single GB or UK costings procedure for milk distribution.

I am copying this letter to the recipients of Peter Walker's.

Approved by the Secretary of State
and signed in his absence.

J S WILSON
Private Secretary

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

~~Prime Minister~~

To note. Subject to the Chancellor's views, the proposed 1½ p per pint rise

From the Minister
CONFIDENTIAL

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

16 May 1979

Dear Geoffrey,

RETAIL AND WHOLESALE MILK PRICES

I find we have inherited from the Labour Government a difficult situation in relation to the retail and wholesale prices of milk. This has been made more serious by the delay in taking action. Unless action is taken now, there will be a serious reduction in returns for both producers and distributors of milk. I am therefore writing to seek your urgent agreement to the price changes which need to be made.

When announcing the present retail price of milk, John Silkin indicated that, "short of a natural disaster", no further retail price increase would be necessary until next autumn. But this assumed that wage increases would be kept within the Labour Government's guide-line , whereas in practice the milk processing and distribution industry agreed wages of over 15%. The additional cost of this extra 10% on wages is about £55 m, which is equivalent to the extra revenue generated by adding 1½p per pint to the price of milk over a four month period. We shall therefore be able to demonstrate quite clearly that the need to make the increase now, rather than in the autumn as John Silkin prophesied, is entirely due to the wage settlements.

After the ending of the milk guarantee at the end of 1977, the Labour Government introduced new pricing arrangements for liquid milk under which the Government sets the distributive margin (the gap between the retail price and the wholesale price) at such a level as to reimburse the dairy industry for the expected average costs of processing and distributing liquid milk in the forthcoming six-month period (together with any adjustments to take account of variations in costs from those expected in earlier periods), plus a fixed rate of profit. My officials' calculations - which so far as processors' and distributors' costs are concerned are based upon independent costings investigations, and which have been discussed with the interests concerned and with officials in other

/departments - show that

departments - show that on this basis the distributive margin ought to have been increased by about 1.9 pence per litre (ppl) (or about 1.1 pence per pint) from 1 April. But no change was made and, if the distributors are now to be able to get what is due to them by the end of September, the distributive margin in England and Wales needs to be increased by 2.97 ppl for the four months from 1 June.

So far as producers are concerned, the present wholesale price in England and Wales (the price paid to the Milk Marketing Boards by the dairy companies for milk to be sold on the liquid market) is 13.274 ppl. If the margin increase discussed above were to be made without any change in the retail price, the wholesale price would be cut drastically, to a level which would be below the price of milk for butter going into intervention. This would have serious consequences for marketing but even more serious ones for producers.

If, for instance, we were to keep the retail price at its present level until March 1980 producers' net margins would fall from £99 to £50 per cow in 1979/80, 55% lower in real terms than in 1978/79 and 72% lower than the relatively good year of 1977/78. It needs an increase in the retail price from the beginning of June of 1½p per pint (2.64 ppl) to bring producers' net margins up to a reasonable level and even this would only achieve an estimated £103 per cow for 1979/80, still 6% in real terms below 1978/79 which was a relatively poor year. (These figures incidentally assume no increase in the EEC co-responsibility levy: if the levy were to be raised to 2% from July the net margin would be reduced by about £7 per cow.) In this connection, I should stress the vital position which milk production occupies in agriculture. It is important not only for its own sake but for the fact that two thirds of our supplies of beef come from the dairy herd. I find dairy farmers' confidence at a critical point after their very difficult winter and, if we do not act quickly, I fear that the whole industry will begin to doubt the strength of our commitment to ensuring the health of farming.

In the light of these considerations - my conclusion is that we must increase the retail price of milk by 1½p per pint from 3 June (the first Sunday in the month) and stand ready to look at the position again later in the year to see whether any further adjustments are necessary. The alternative of a smaller increase now, of 1p per pint, would mean that a further increase of 1p per pint would be necessary in the autumn, and even then producers' returns would be well short of last year's level. And a devaluation of the green pound is of little help here since a 5% change would add only £3 per cow to producers' margins in 1979/80.

There are, of course, disadvantages in increasing the retail price by 1½p per pint. The first concerns the attitude of the distributive industry, who are likely to be critical of such an increase because of the possible adverse effects on sales. But it is a fact that the 1p per pint increase made in November has had little if any effect on consumption and, especially in view of the recent rate of wage increases and the expectation of tax reductions, I would hope that the increase now proposed would have an equally small effect. Secondly, consumers will be critical, particularly bearing in mind John Silkin's undertaking last autumn, but we should be able to make it clear that the increase is necessitated by wage and cost increases which took place under the last Government. Finally, we need to consider the possibility of liquid milk imports. Certainly we may in future need to watch out for the effect of price increases

/on imports, ...

on imports, especially of packaged milk; but for the moment our health regulations protect us in this area and I am confident that we can retain these at least until the end of the year. (I would point out, however, that even after this increase the prices received by our milk producers would be lower than the target price for milk set for the EEC.)

So far as Northern Ireland is concerned, corresponding examination of processing and distribution costs indicates that the retail price should be increased by the same amount as in England and Wales and the wholesale price reduced by slightly more. In Scotland, the position is complicated by the fact that the costings figures are not yet available and that a preliminary assessment shows that distributive costs there may not have increased by quite as much as in the rest of the UK. To deal with this discrepancy, George Younger and I are agreed that we should follow the precedent established last November (when a similar position arose) and delay the price increase in Scotland for a short period, ie until 15 July. In principle however neither George Younger nor myself feel that it is right to have different retail prices in different parts of the UK - even for relatively short periods. We are therefore agreed that we should move on to a combined costings and price system as soon as possible, and I understand that DANI would wish that Northern Ireland too should be included in this. I am therefore asking my officials, in consultation with officials from the other agricultural departments, to consider how best this could be done and to report to me. I shall also be taking this opportunity of looking into all the costings arrangements and the whole of the present system of milk pricing. When I have been able to do this, I shall let my colleagues have the results of my consideration, together with my proposals for future action.

In the light of the above I should be grateful for your early agreement to:

(1) an increase in the retail price of milk of $1\frac{1}{2}$p per pint on 3 June in England and Wales and Northern Ireland;

(2) an increase in the retail price of milk in Scotland of $1\frac{1}{2}$p per pint on 15 July;

(3) suitable corresponding adjustments to the wholesale prices in the different countries on 1 June.

I am copying this letter to the Prime Minister, John Nott, George Younger, Nicholas Edwards, Humphrey Atkins and Sir John Hunt.

Yours ever
Peter

PETER WALKER

I don't believe such a large increase is possible politically. $1\frac{1}{2}$p is a great increase to the housewife's budget. 1p. is all she will bear. However there is the other political point — I abolished school milk in schools!

Further I fear $1\frac{1}{2}$p. would limit the Chancellor's room for manoeuvre on [illegible]