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