Agriculture

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
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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.

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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 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.