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PRIME MINISTER

LIQUID MILK PRICES

E(81)128

BACKGROUND

In E(81)128 the Minister of Agriculture, Fisheries and Food recommends an announcement before Christmas that the maximum retail price of milk will be increased in England, Wales and Northern Ireland by $1\frac{1}{2}$ p to 20p a pint from 3 January 1982; that the present premiums on Channel Islands and sterilised milk should be increased at the same time by $\frac{1}{2}$ p a pint; and that changes, broadly as recommended by Binder Hamlyn, should be made in the distributive costing system and in the dairy trade's target rate of profit.

Binder Hamlyn proposals and amount of price increase

2. The Committee agreed on 19 March (E(81)11th Meeting) that the present system of liquid milk price controls, whereby the Government set the maximum wholesale and retail prices, should be continued subject to implementation where practicable of Binder Hamlyn's report on the milk costing system. The Minister of Agriculture, Fisheries and Food proposes the introduction of a revised costing system incorporating nearly all Binder Hamlyn's recommendations. This would apply from October 1980 and as a result the trade will lose about £40 million which would have been due to them under the old system. He further recommends that for the retail part of the trade the target rate of profit should be 2 per cent on turnover and expressed as 0.66p a litre. This would be updated annually by reference to changes in milk prices with reviews at 3-yearly intervals. The Minister of Agriculture, Fisheries and Food, supported by the other Agriculture Ministers, regards the negotiation of this package with the dairy trade as a success. He will argue that anything more rigorous could lead to the breakdown of the present control system with the risk that milk prices would soar and that door-step delivery of milk might be discontinued.



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3. He proposes that the retail price should be raised by $1\frac{1}{2}$ p per pint to 20p with effect from 3 January 1982 (compared with $13\frac{1}{2}$ p when the Government took office). This increase of 8 per cent would add to the Retail Price Index about 0.15 percentage points. The wholesale price would go up to 18.13p per litre from 1 January. Of the $1\frac{1}{2}$ p retail increase, 0.4p would go to the distributors and 1.1p to the producers in 1981-82. The Agriculture Ministers regard this increase as essential to raising producer incomes - see paragraphs 4 and 5 of E(81)128.

4. Treasury officials were first sent the detailed figures and proposals on 2 December and while they accept the broad thrust of Binder Hamlyn's recommendations they are not content with a number of important details. They believe that the calculations could allow too high a return, in terms of capital employed, to the dairy trade; in part because of the particular way in which the CCA depreciation charge is calculated. They do not agree that the target rate of profit, initially set at 0.66p per litre, should be indexed for 3 years. They do not think it necessary to increase the price, to the extent proposed by the Agriculture Ministers, to help milk producers' incomes. This leads them to call for some modification to the proposals, and to the accompanying draft statement, and to recommend an increase in the retail price of 1p rather than $1\frac{1}{2}$ p. The Chief Secretary will speak to these points.

5. The Minister of Agriculture, Fisheries and Food may well argue that, while it is possible to criticise some particular points in the proposals, they should be seen as a package which has been successfully negotiated with the trade. You will not want the Committee to get into any detailed discussion of the methodology of the Binder Hamlyn proposals, but the technicalities are important: they will have an effect on milk prices not only in January but later and the new system must be introduced on a firm footing. Even if it were possible for the Committee to decide on the January 1982 price increase on the information before them, you might ask the Minister of Agriculture, Fisheries and Food and the Chief Secretary to look further at the details of the system with the aim of reaching agreement on what should be said in the statement.



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Timing of implementation and of announcement.

6. The Minister of Agriculture, Fisheries and Food discusses in paragraph 7 of E(81)128 your view that there should be no increase in the retail price before the school holidays are over. You will wish to consider his view that in practice housewives do not spend more on milk in the school holidays. He points out that the changes were made at the corresponding time in 1977, 1978 and 1981 and that the delay of a week would lose the industry £3 million in revenue.

7. Whether the increase is to be on 3 January or 10 January the Minister would wish to announce it, and his proposals on the Binder Hamlyn report, before the Recess. This has been the practice with previous increases in the price, and is particularly necessary for the introduction of the new system.

European Community Aspects

8. The year on year price increase proposed (8 per cent) is less than the increase in the milk target price (9 per cent) agreed at the 1981 price fixing. The Chancellor of the Exchequer might argue that we should be looking ahead to restraint at the 1982 price fixing and demonstrate this approach with a much more stringent price increase now. Against this it can be argued that the price set for liquid milk is not directly related to the Community price, which is of immediate significance only for butter and skim milk powder. The main concern may be to separate the announcement of the liquid milk price increase from the Community negotiations: the present proposals would do this.

9. There remains the longer term prospect that milk imports could damage the UK pricing arrangements. A case in the European Court may result in a relevant judgement in mid-1982.

HANDLING

10. After the Minister of Agriculture, Fisheries and Food has introduced his paper you will wish the Chief Secretary, Treasury to speak. The



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other Agriculture Ministers will then want to comment - the Secretaries of State for Wales, Northern Ireland and Scotland (as explained in paragraph 9 of E(81)128 the arrangements in Scotland will be somewhat different, though they will take account of the increases elsewhere). The Secretary of State for Employment will want to comment on the timing of the increase and of its impact on the RPI.

11. It may well be that further work by the Ministry of Agriculture and the Treasury will be necessary and that the Committee will not be able to come to a final view until their meeting on Thursday 17 December. Subject to this, the main points with which you will wish to deal are:-

(i) The Binder Hamlyn recommendations.

- You will wish to ask the Minister of Agriculture, Fisheries and Food and the Chief Secretary, Treasury to reach agreement on the details.

(ii) The amount of the retail price increase.

- The effective choice seems to be between 1p and 1½p.

(iii) The timing of any increase in the retail price.

- 3 January or 10 January?

(iv) Whether the premiums on Channel Islands and sterilised milk should be increased by ½p per pint.

- The argument in paragraph 8 of E(81)128 is that this is necessary to ensure sufficient production to meet consumer demand.

(v) The timing of the announcement to the House of Commons.

- This should be before Christmas but there are no overriding technical reasons why it should not be after 17 December.



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CONCLUSIONS

12. You will wish to sum up with reference to the 5 questions listed above. If possible, any outstanding points on the Binder Hamlyn changes should be settled bilaterally between the Minister of Agriculture, Fisheries and Food and the Chief Secretary, Treasury. There seems no reason why agreement should not be reached on the timing of the increase; if, because of disagreement over the underlying facts, agreement cannot be reached on the amount, the Committee will need to consider this further at their meeting on 17 December.

PLG

P L GREGSON

9 December 1981