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cc Mr Redwood

MR. TURNBULL

LIQUID MILK PRICES

We question the case for increasing milk prices. Although the traditional costings exercises point in this direction, wider considerations - CAP reform and our negotiating position on it, and the need for more competitive arrangements in milk production and distribution - argue for a break with this price-fixing tradition, as a prelude to a fundamental change in the milk sector.

How Badly Off is the Dairy Farmer?

1983/84 has been a poor year for the dairy farmer. A wet Spring reduced yields and raised feeding costs. The estimates shown in Appendix 1 of Mr Jopling's paper suggest that, following an excellent year in 1982/3, the net margin per cow is lower in real terms this year than it has been in the previous poor years (1976/77, 1980/81 and 1981/82).

This trend is of no particular relevance. What matters to any business is whether or not it is profitable. MAFF's own survey data suggests that the average dairy farmer, with 68 cows, will make a net profit on his dairy business this year of £5,800 (68 x £86), after allowance for all costs, including the farmer's own pay, and imputed rent on land, but not interest. There are also the proceeds from other activities on the typical farm. 1981/82 survey data suggested that these add another 40% or more to net profit, bringing it up to £8,200. The typical farmer in the survey has assets worth around £120,000, excluding land, in respect to which a rent is imputed. He therefore earns a return on his assets of 7%, in addition to his attributed wages (and other benefits from living on a farm often chargeable as business expenses).

This may explain why the dairy industry has not as yet responded to this decline in margins. The cow population is increasing slightly and the market price of in-milk heifers (£856 in December 1983) was only 6% down on a year earlier.

A decline over time of net margin per cow is probably to be expected. Average herd size is increasing by around 3% a year. Over time, farmers could survive on lower margins per cow, by spreading overheads over larger herds.

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Changes Facing the Milk Sector

The marketing and pricing arrangements which have suited the industry for over 50 years in some cases are becoming increasingly less appropriate:

i. the stabilisation of the dairy farmers' income has been taken over (for better for worse) by the CAP;

ii. the stabilisation of farm incomes cannot be pursued regardless of demand, and efficiency, when the rest of the economy is having to make major adjustments;

iii. the cosy arrangements to maintain dairies' margins will break down in the face of competition from imports and are, in any case, difficult to reconcile with our approach to competition generally.

Mr Jopling argues that one should not terminate the arrangements, nor suspend their operation while price controls are in place, because this would deprive the industry of the advantages of the system without giving them the benefits of a free market. We agree that the price control arrangements cannot be terminated now, not because of "uncertainty", but because the MMB, with its statutory monopoly, is too powerful to be left unchecked.

It does not follow from this that the present system need be suspended. Mr Jopling could announce that he has decided not to raise wholesale prices because he had also to have regard to the industry's operating context. This must include wider considerations than maintenance of farm incomes and distributors' margins, for example, budgetary implications and the industry's need to respond more competitively to the threat from imports.

The following points are relevant:

i. the demand for liquid milk is declining at 1-1½% a year;

ii. supermarkets are expanding their market share, doubling it to 16% over the last four years, by setting prices at (at least) 2p per pint lower than the doorstep price;

iii. imported UHT milk has made little inroads as yet, but the recent French consignments were no more than tests of the new legislation. UHT could take a growing market share because its taste is improving. Efficient continental cooperatives might get it into UK supermarkets at 15p per pint, or even less; and the growing milk surplus in the Community will be looking for any outlet which is more profitable than intervention.

Since the marketing arguments all point towards price restraint for liquid milk, a decision to allow price increases would encourage the industry to move in precisely the wrong direction.

The dairies have not yet come to terms with these changes; they benefit from the cost-plus Binder-Hamlyn arrangments which in effect set a common price throughout the country; they have established restrictive agreements, they have not deployed much marketing flair in adding other products to the milk round.

The Review of Present Arrangements

Mr Jopling's review of pricing arrangements needs to go much wider than pricing and should involve Departments other than his own. The existence and behaviour of the MMB itself must be considered. By offering farmers a uniform "pooled" price, irrespective of their location, the MMB encourages and perpetuates a geographical pattern of dairy farming which is ineffecient. Its licensing policy towards farmers who might wish to develop into processing and retailing needs a review. Its discriminatory pricing policies (eg charging 3p per pint more for raw milk retailed as liquid milk than for raw milk used for processing) must damage milk users and it requires a large staff to police.

Conclusions

Although precedent encourages the industry to expect price increases, based on costings surveys, wider considerations argue against price increases at either the retail or the wholesale level.

1. Dairy farmers' margins are probably historically low, but they do not seem to be disastrous for the average farmer. In any case,

/income support

income support can no longer be the overriding consideration, given our support for draconian measures to curb CAP excesses (nominal price reductions, the super-levy).

2. Milk distributors' paramount need is to adopt a more competitive approach, in order to counter the potential threat from imports and the decline in milk consumption. (It might be difficult in any case to allow an increase for them and not for the farmer.)

4. The review of milk marketing must be widened to include the future of the MMB. After consultation with Mr Lawson and Mr Tebbit (and their officials), Mr Jopling should be asked to bring his review back for collective discussion.

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