MILK in SCOTLAND
A CONSUMER VIEW.
MILK IN SCOTLAND

The attached brief (Annex 1) by the Consumers in the European Community Group (CECG) already submitted to the Select Committee on Agriculture expresses the views of the Scottish Consumer Council, a member organisation.

However, Scottish experience has particular bearing on one of the main issues in this discussion - whether increased sales of milk in shops may lead (a) to the diminishing of door-step deliveries to a point where such deliveries are no longer viable; (b) to lower consumption of milk.

Background

It appears to be the view of the dairy trade that the high level of milk consumption in England is due in large part to door-step deliveries. It would follow that any decrease of deliveries would decrease milk consumption.

The dairy industry justify a high maximum price of milk (which becomes the norm in an uncompetitive situation) by the argument that it includes a margin to cover the cost of door-step deliveries. This is the price that we pay, it is argued, for the convenience of deliveries and the nutritional benefits of milk consumption.

The over-riding importance of maintaining consumption therefore justifies, it is said, a restrictive policy regarding shop sales. If shop milk were widely available and cheaper than delivered milk the danger would be aggravated as no-one denies that consumers normally gravitate to cheaper sources of supply. The argument now links with whether or not imported liquid milk should be admitted to the UK since it follows that if imported milk is to be available in British supermarkets at lower prices than domestic, consumers may choose low price rather than convenient delivery. This brings the argument full circle to the question whether imports (cheap shop milk) will reduce door-step deliveries so far that this service will no longer be viable.
Scottish experience refutes the validity of the argument at two vital points. We believe that cheaper milk in the shops will not necessarily either reduce consumption or destroy the door-step deliveries. Note the 'necessarily'. Of course it is possible that both dire consequences would follow if the dairy trade refused to adapt to a new competitive situation and to devise enterprising marketing practices to meet it. We see no reason why this should happen. Milk Marketing Boards and the dairy trade have a wealth of consumer support for their product and marketing experience which would give them every advantage in competing with importers. Moreover the Scottish experience shows all is not lost when shop sales rise.

1. Liquid milk consumption can remain steady while door-step deliveries fall and shop sales rise.

In Scotland, milk sales have remained broadly steady at the same time as shop sales have increased, and Scottish milk consumption has on the whole been rising in relation to consumption in England. An overall balance has been struck between shop and door-step sales, and this balance seems steady at present.

2. Cheaper milk in shops does not necessarily cut out door-step deliveries.

Many Scottish shops charge less than the maximum price for milk. This is a welcome option for some consumers, particularly those who use a lot of milk. Now some dairies are starting to cut prices for door-step deliveries, presumably still able to make a profit, though a smaller one.

3. While door-step deliveries remain popular with a large proportion of people, the normal pattern is to 'top up' their door-step deliveries with shop milk.

Statistics provided by Scottish Milk Marketing Board show the wide extent of 'mixed' purchases in Scotland. Most consumers buy their basic milk from door-step deliveries (where these are available) but top these up with shop milk as available. This is particularly so when the high price of milk discourages over-
ordering. Door-step deliveries and shop sales therefore need to develop side by side.

4. Consumers in disadvantaged urban areas often have no deliveries. It is a hardship for them that they must nevertheless pay a price for their milk determined by a maximum which includes a margin to cover the cost of door-step delivery.

Conclusion

We believe that the dairy trade is unduly pessimistic about the effect of increased milk sales in shops. Many consumers will continue to prefer door-step deliveries and if the price is right will order in sufficient quantities to make these viable. Payment for door deliveries should be one choice which consumers are free to make - not have imposed upon them.

Patterns of purchase are changing in regard to milk as with every other commodity. Minorities of consumers are concerned for health to drink less milk or less high-fat milk. Others are deterred by its high price (the highest in Europe) from buying more than the minimum - and prefer to buy, like bread, in the shops. Others increasingly prefer milk products to milk.

The Milk Marketing Board have been enterprising and effective in selling milk. We see no reason why they should not maintain the sales of British milk in straight competition with imported milk particularly if the removal of the "liquid milk premium" brings the UK price down to the EEC intervention price. They have the advantage of a hard core of consumers who are devoted to high quality British milk and will only be deterred from buying it by an arbitrarily high price.
COMMENTS BY CONSUMERS IN THE EUROPEAN COMMUNITY GROUP (UK) ON
THE EEC MILK MARKET

Introduction

Consumers in the European Community Group (UK) is the umbrella organisation which co-ordinates the research and representation of the main UK organisations interested in UK consumer affairs. It deals specifically with EEC policies.

In 1979 the dairy sector accounted for 30% of the total EEC budget. Put another way, the EEC was spending over £1/3 million an hour supporting dairy farming. At the same time dairy output, already 17% ahead of demand, is growing whilst consumption is forecast to remain stagnant.

In this paper we explain why the current situation has arisen. We examine the various options open to policy makers seeking to bring the sector back under control. Finally we look at the milk market in the UK where, it will be seen, special circumstances obtain.

The EEC Milk Market

1. Production and Consumption

As can be seen from the graph overleaf, EEC milk production is rising and forecast to continue doing so. Consumption is also increasing, but it is not keeping pace with production. Consequently, the 'gap' between the two is widening. Milk output is currently 17% ahead of demand with intervention stocks of butter standing at 262,000 tonnes and skimmed milk powder at 218,000 tonnes.

Graph 1 shows the increasing imbalance between supply and demand in the milk sector and the resulting surplus.

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GRAPH 1.


These stocks would be much larger had not the Community sold off considerable quantities at subsidised prices on world markets. In 1979, 350,000 tonnes of butter and 357,000 tonnes (including 270,000 for food aid and special measures) of skimmed milk powder were disposed of in this way. 1,300,000 tonnes of SMP was subsidised for use in animal feedstuffs and 157,000 tonnes of butter was sold with a subsidy within the Community.

The sale of butter and SMP on world markets is extremely expensive given the substantial difference between world and EEC prices. The original 1980 budget foresaw expenditure of £1.317 million on export refunds in this sector. By contrast, £936m was allocated for animal feeding stuff subsidies and £281m for consumer subsidies. In terms of budgetary expenditure, the EEC gives priority to non-EEC consumers rather than Community consumers.

The budgetary costs of this policy are easier to measure than the price effects but, quite clearly, consumers in the EEC are paying a high price for their milk and dairy products. In Australia butter retails at about 53p a lb, whereas in Brussels it costs £1.16 a lb. Admittedly Community consumers could not expect to buy butter on world markets at such a low price. Were the Community to import more, the world price would be forced up. However, it would not rise to anything like current EEC prices.

Also often overlooked is the question of resource costs. Large quantities of the Community's resources are being devoted to the production of dairy products for which there is no market. The German consumer organisation AGV estimates, for example, that one million tonnes of oil have to be used each year in the process of drying milk for SMP production.

2. Causes

At the simplest level the cause of the dairy surplus is the artificially high level of support prices for dairy products. These prices are such that milk production is over-encouraged whilst consumption is depressed.

The deeper-rooted cause of the surpluses, however, is the fact that the price mechanism is being used to maintain the incomes of dairy farmers for social and other reasons. Clearly, there is no logical reason why the price level designed to maintain farm incomes should be the price level at which supply and demand are balanced. Indeed it can be seen from the situation with milk, that there is every reason to conclude that farm prices set for social reasons are incapable of balancing supply and demand.

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① USDA
④ Arbeitsgemeinschaft der Verbraucher
1. Tackling the problem

The political pressure on the Commission over the escalating budgetary costs of the CAP has led it to propose solutions which raise revenue rather than lower prices. The 'super-levy' and the co-responsibility levy are examples. They reduce farmers returns without lowering market prices. The consumer interest, of course, would be better served and farmers would be no worse off if the Commission simply cut institutional prices by an equivalent amount.

The 'levy' solution has a second political advantage from the Commission's point of view. Exemption can be permitted for small farmers who, the Commission argues, are not responsible for over-production. In a sense, this is perfectly true. 30% of dairy farms in the Community have 5 or fewer cows but these account for only 15% of milk output. Keeping them in business through a two-tier milk price is desirable for social reasons, so the argument runs.

However, we do not believe social policy issues should be confused with an agricultural and food policy. If it is decided to maintain small dairy farmers in production it seems fairer to do so through direct income aids rather than through what amounts to a tax on food.

Quotas

Like the 'levy' solution, quotas tend not to be in the consumer interest for they enable market prices to be kept artificially high. Whether they have a favourable impact on the budget depends on the level at which they are set. The experience in the sugar sector, where quotas operate, is not encouraging, however. Sugar supplies in the Community exceed demand by 25% with enormous consequent costs of disposal through subsidised exports.

Quotas need not work in this way. Even within a quota system prices could be set at a level which balanced supply and demand. But of course if prices were set at this level, quotas would be superfluous. In other words there is no point in setting quotas if price levels are sensible.

4. Conclusion

For all these reasons CECG, in common with consumer organisations in the rest of the Community, supports straight price cuts rather than clumsy and bureaucratic alternatives like levies and quotas. A
sustained freeze, implying price cuts in real terms, has been applied before and, as can be seen from the graph below, it had the desired effect. If farmers are convinced that sustained pressure is likely to be brought on prices, they will begin to move out of milk.

The UK Milk Market

Milk support arrangements in the UK are unlike those in other Member States. We therefore devote the next section of our paper to a description of how the marketing scheme works. In the subsequent sections we examine the effects of the scheme on farmers, distributors and consumers and look at the case for changing certain aspects of it.

1. How the system works

The Milk Marketing Boards (MMBs) have a statutory monopoly over all milk produced on UK farms. This, together with an import ban on milk, enables them to operate a two-tier pricing system whereby milk for liquid consumption is wholesaled at a higher price than that for manufacturing milk. This difference is commonly known as the 'liquid premium' and is currently about 25%. The Board, after deducting administrative and other costs, pays its members a 'pool price' being the average return from the manufacturing and liquid markets. At the end of last year the pool price was the equivalent of just under 7p a pint.

The manufacturing price is negotiated between the Boards and the Dairy Trade Federation (DTF) and, at the end of last year, was just under 6p a pint. Negotiations between the Boards and the DTF are influenced by the level of EEC support prices for butter and SMP. But this does not appear to mean that the boards minimum negotiating price is fixed by the so-called 'milk equivalent intervention price' (MEIP). In fact, it sells milk for conversion into butter at less than the MEIP. This can be used to help UK manufacturers retain a foothold in the home market.

The wholesale liquid price is not negotiated between the Boards and the DTF but is set by the Ministry of Agriculture Fisheries and Food (MAFF). MAFF also sets the maximum retail price and thus controls the dairies' aggregate margins on liquid milk. To ensure that the dairies receive a fair rate of return MAFF allows a profit margin on top of the costs of processing and distribution when setting the gap between maximum wholesale and maximum retail price. How this 'target rate of profit' is set is unclear but the actual costs and margins are regularly monitored by MAFF through a sample survey of dairies. If the target rate of profit is not achieved, or forecasts suggest it will not be achieved, the 'gap' is re-set either by raising the maximum retail price or by reducing the maximum wholesale price.*

2. Effects of the system

2.1. Producers

The Board's monopoly combined with the import ban enables it to charge...
the 'liquid premium' and thus keep UK farmers' returns from milk higher than they would be if market support were based solely on EEC intervention prices for butter and skimmed milk powder. As about half the milk produced on UK farms goes for manufacturing and half for liquid consumption the Board's returns on milk are roughly 10% higher than they would be otherwise.

One effect of the scheme has thus been to give UK farmers a greater incentive to produce milk than would be implied by EEC support prices (converted in the past at the green rate obtaining at any one time). Now that the green £ is at parity the liquid premium will bring UK farmers' returns from milk above the common price.

2.2. Distributors

(a) The Costing System

The target rate of profit guarantees, at least in aggregate terms, the dairies' margins. The system could, therefore, reduce resistance to industry-wide cost increases such as pay rises. For individual dairies, the incentive to 'beat the average' remains.

(b) Retail Competition

Although not directly related to the scheme, it is worth noting at this point that dairies are not subject to price competition from supermarkets. Paradoxically, it costs more for the consumer in England and Wales to buy milk and then carry it home himself than it does to have it delivered. It is, of course, in the collective interest of the dairies, who run doorstep delivery services and also supply shops with their milk, not to supply supermarkets with milk at a price which would encourage them to undercut the delivered price.

A second point to note in this context is that, as far as we are aware, it is virtually impossible to buy milk in England and Wales at less than the maximum retail price. We do not know to what extent the 'target rate of profit' system precludes price cutting as we do not have full access to the MAFF costings data.

2.3. Consumers

The existence of the liquid premium means that consumers pay more for their milk than they would do if farm support rested solely on EEC intervention prices for butter and SMP. The fact that, for one reason or another, most milk is sold through a doorstep delivery system adds even more to the retail price. It is difficult to say exactly how much these two factors raise prices but, as the table below shows, the UK's milk is now the most expensive in the Community.
TABLE 1

Milk Prices in the EEC (1)

<table>
<thead>
<tr>
<th>Country</th>
<th>p per pint</th>
</tr>
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<tbody>
<tr>
<td>UK</td>
<td>16½p</td>
</tr>
<tr>
<td>Ireland</td>
<td>12p</td>
</tr>
<tr>
<td>Denmark</td>
<td>14p</td>
</tr>
<tr>
<td>Belgium</td>
<td>14p</td>
</tr>
<tr>
<td>France</td>
<td>15p</td>
</tr>
<tr>
<td>Germany</td>
<td>15½p (2)</td>
</tr>
<tr>
<td>Holland</td>
<td>14p</td>
</tr>
<tr>
<td>Italy</td>
<td>15½p</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>15p</td>
</tr>
</tbody>
</table>

(1) Pasteurised milk at or around 3.5% fat content at exchange rates obtaining on 4/1/80.

(2) Prices appear to vary quite widely however; from 7p to 17p. We have taken 15½p as the top end of the general range of prices given to us by the British Embassy in Brussels.

3: Effects of changing the system

3.1 The Liquid Premium

The original aim of the liquid premium was to secure supplies of milk for liquid consumption all year round, the remainder being sold off to UK manufacturers at whatever price the Board could get for it. Prior to accession to the EEC this may have made sense. It gave the consumers the benefit of secure supplies of liquid milk, whence most UK output went, as well as low priced imports of dairy products like butter and cheese. Since accession, however, things have changed. EEC support for the dairy sector is based on relatively high intervention prices of butter and SMP plus levies on imported dairy products. Even so, because the liquid premium has been retained, we have still had to pay a high price for our milk. Additionally, it is worth pointing out, only half UK milk output now goes to the liquid milk market. Farmers are increasingly getting their returns from the manufacturing sector and we are forced to conclude that the situation feared by the Consumers Committee of GB (ConCom) in 1970 that 'we could become a country with both dear milk and ... dear dairy products' has now come about. As far as consumers are concerned then, the effects of the premium are clearly adverse.

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There are even more fundamental arguments against retaining the premium. The EEC has a chronic and expensive surplus of milk which it is seeking to bring under control. By retaining the liquid premium the UK is actually working against these efforts despite the fact that the present Government is pledged to the elimination of structural surpluses. With a sizeable green £ gap it could perhaps have been argued that UK farmers were not responsible for the surplus problem since their returns from milk were markedly below the level implied by common support prices. But the green £ is now virtually at parity and it is extremely difficult to see the justification for a policy which could mean supporting UK dairy farmers at a level higher than that implied by EEC common prices.

3.2. The Import Ban

It may be that the premium will disappear anyway if, as seems inevitable, milk imports are eventually permitted. Under these circumstances with imported, but probably UHT, milk selling in supermarkets at perhaps 2p a pint less than the maximum retail price, the Boards would be forced to lower the price for liquid milk to a level which more accurately reflected the costs of collection and supply for pasteurisation.

Once UK supermarkets could buy milk from foreign farmers, UK farmers would soon, we imagine, wish to compete for the business. This would be particularly true of those situated close to the main population centres who might see the chance to earn a higher return from supermarket sales than from the pool price. Naturally this would tend to put pressure on the Board’s monopoly buyer status.

It is very difficult to argue against the lifting of the import ban whilst we remain members of a Community one of whose aims is the elimination of barriers to trade. Indeed, if the results of lifting the ban are as we have described them, the UK consumer would have a lot to gain in terms of price and choice. It is worth noting though that these results could be achieved in other ways. It is within the Government’s power to lower the maximum wholesale liquid price (and thus abolish the premium) and the question of milk supplies to supermarkets could be examined under UK competition law.

3.3. Price Control

Our general view, that the long term consumer interest is better served by vigorous competition than price controls, applies equally to milk. But quite clearly there is currently little competition at the wholesale level. In these circumstances we would not favour the lifting of price controls at that level. Instead, while imports are banned, we would like to see the wholesale liquid price lowered.

Once imports of milk were permitted, the actual liquid price would be forced down below the maximum level by market forces. In this situation there would seem to be little point in retaining control of the maximum wholesale liquid price.

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The competitive situation at retail level is rather less clear. We would, therefore, wish to see a more detailed investigation of retail competition in the milk sector before advocating the removal of retail price controls and we would therefore strongly recommend an Office of Fair Trading/or Monopolies and Mergers Commission investigation into retail competition. An investigation into milk retailing was requested by CECG members as long ago as 1977.

Again, the case for retail price controls would be much weakened by the lifting of the import ban. As we have argued above, the arrival of imports would be likely to mean the appearance of cheaper milk in supermarkets. In either circumstance one is forced to examine the argument that the doorstep delivery system would not survive supermarket competition.

We remain unconvinced that doorstep delivery would collapse in the face of retail competition. Consumers value the convenience of having fresh milk delivered and we doubt whether many would forgo this convenience for the sake of saving a few pence per pint, particularly if the lifting of the import ban caused only cheap UHT milk to arrive in the shops. The case of Scotland would seem to support our argument. There shops and supermarkets selling milk at lower prices have about half the retail market whilst a doorstep delivery system continues in parallel. In Scotland, therefore, consumers can choose between price and convenience. In England and Wales they do not have that choice and the true cost of the delivery system is concealed from them.

4. Summary and Conclusions

(a) The EEC milk sector is in chronic surplus and in need of urgent change. We favour acting on the surplus through straight price cuts rather than levies or quotas.

(b) The UK liquid premium is now unjustified on two grounds. Firstly, it means consumers are faced with both expensive milk and expensive dairy produce (the outcome feared by ConCom in 1970). Secondly, now the green £ is virtually at parity, it cannot be reconciled with this Government's policy of acting on the milk surplus through the price mechanism. As the existing common price level is causing supply to run 17% ahead of demand there would seem to be no justification for raising UK milk prices above that level.

(c) It is difficult to argue in support of the UK's import ban on milk whilst we are members of a Community one of whose aims is free trade between Member States. Indeed, if the results of lifting the ban are as we have described them, the consumer would have a lot to gain. We note though, that these gains could be achieved in other ways.

(d) We believe that vigorous competition is generally preferable to price control. But since competition is virtually non-existent at the wholesale level for milk we would not favour the lifting of control. Instead, whilst imports remain banned, we would like to see price control at the wholesale level used to reduce the liquid premium.