House of Commons

Environment, Food and Rural Affairs Committee

EU proposals for the dairy sector and the future of the dairy industry: Government Response to the Committee's Eighth Report of Session 2010–12

Seventh Special Report of Session 2010–12

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Environment, Food and Rural Affairs Committee

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Seventh Special Report

The Environment, Food and Rural Affairs Committee reported to the House on *EU proposals for the dairy sector and the future of the dairy industry* in its Eighth Report of Session 2010–12, published on 29 July 2011. The Government response to the Report was received on 28 September 2011.

Government response

Introduction

The Government is grateful to the Committee for its Eighth Report of Session 2010–12 concerning 'EU proposals for the dairy sector and the future of the dairy industry'. UK dairying is an important and iconic industry and it is a priority for the Government to support and develop British farming and encourage sustainable food production.

This document sets out the Government's response to the Committee's examination of the dairy sector. It has been compiled by the Department of Environment, Food and Rural Affairs. We have carefully considered all of the recommendations made by the Committee.

The Government aims for a profitable, thriving, and competitive sector that protects natural resources and safeguards animal welfare. The Government can take steps to help, but the dairy industry itself has a significant responsibility for its own future and is far better placed than Government to lead change in many respects. In this response to the Committee, the Government highlights the role of the industry and Government in maximising the potential of the sector. Between Government and the industry, much is being done to support the sector, including, but not limited to, the actions listed below:

- The industry is producing a voluntary code of practice on contractual relationships.
- The industry has developed country of origin labelling principles.
- The industry is working to establish an action plan to secure long-term industry sustainability as the key outcome of the Dairy 2020 project.
- The industry and the Government are working together in the Dairy Supply Chain Forum.
- The industry and the Government are both investing substantial sums in research in the sector.
- The Government is responding to the recommendations of the Farming Regulation Task Force.
- The Government has launched the Government Buying Standards.

- The Government is introducing a Groceries Code Adjudicator to monitor and enforce the Groceries Supply Code of Practice.

This response expands on each of these actions and others in reply to the Committee's recommendations.

Remarks

This response is focused on the Committee's recommendations and conclusions. There are, however, four points in the main body of the Committee's report on which we make additional remarks to the Committee. These are contained in the annex to this response.

Response to Conclusions and Recommendations

The state of the UK dairy industry

1. We are confident that the future prospects of the UK dairy sector are positive, but this depends on Government and the dairy industry resolving certain issues. Despite having one of the most efficient production systems in the world, UK dairy farmers are unable to cover their costs and dairy processors are outcompeted by imported products. Farmgate prices have recently become decoupled from both commodity market indicators and farmers' production costs, indicating that farmers are not consistently able to recoup sufficient value from the supply chain. We conclude that Government action is justified as the substantial drop in the number of dairy producers that would be required to increase farmgate prices through market forces alone would have undesirable consequences for rural communities, landscapes and tourism, and consumer choice. Consolidation in the industry must be driven by confidence, innovation and investment.

2. We call on Government to take action to resolve this situation through addressing the structural imbalances that result in low farmgate prices; encouraging increased investment in processing, particularly in value-added products; and exerting influence on retailers to establish dedicated supply chains for processed dairy products, such as butter and cheese.

The Government welcomes the Committee's positive assessment of the UK dairy sector and its future prospects. As the Committee's report noted, there are also serious concerns within the industry and challenges that need to be addressed. As a result of large variations in input costs and farmgate prices, some farmers are making strong profits, but others are struggling to survive or are leaving the industry. Although the Government does not accept the blanket conclusion that "UK dairy farmers are unable to cover their costs", the Government agrees that the industry has untapped potential, on both domestic and export markets.

The Government is taking steps to support a sustainable UK dairy industry. However, regulation and Government intervention cannot and should not form the whole solution and the industry has a crucial part to play.

Reinforcing Best Practice

The Government has strongly encouraged the industry to produce its own voluntary code of practice on contractual relationships and progress is now being made—led by the NFU and Dairy UK. This type of approach should offer quicker and more substantial results than relying on the EU regulation.

The industry has already generated voluntary principles for labelling and, in May, the Government published a survey to assess their uptake. This will provide a benchmark to assess future progress. The Government will continue to work with the industry to explore ways to provide better information that will allow consumers to identify more easily the origin of their food. At EU level, through the proposed new Food Information Regulation, the Government has pressed for improved origin labelling provisions including, subject to Commission review, the potential to extend mandatory origin labelling to dairy products.

Supporting Industry Collaboration

The Dairy 2020 project is an industry-led initiative which is helping processors, retailers and producers to develop a common understanding of what has to happen to ensure a successful, thriving and truly sustainable industry. The project will produce a plan of action and communicate to others the steps that are needed to secure a sustainable domestic dairy sector in environmental, economic and social terms. The project is supported by the Government, and Defra is represented on its Steering Group.

Dairy 2020 reported on progress at the last meeting of the Dairy Supply Chain Forum. The Forum challenges senior sector representatives to discuss issues and opportunities, the health and future of the dairy sector, and how the industry might address the trade balance and secure its own sustainability and long-term British milk supply. The reinvigorated Dairy Supply Chain Forum will continue to achieve important results by recognising the value of industry and Government working together in this manner.

Improving the Way the Industry Works

Both the industry and Government are investing substantial funds into research for the sector. For 2009/2010, Defra research programmes representing a combined spend of about £16m were of relevance to the dairy sector.

The Government is responding to the report of the Task Force on Farming Regulation, which contains several recommendations with application to dairy farmers. The Government will make an initial response in the autumn.

A Level Playing Field for Sellers

The Government wants to ensure that food procured by Government departments meets UK standards of production wherever this can be achieved, without increasing overall cost. Government Buying Standards are now mandatory for central Government and its executive agencies, and will be promoted to the wider public sector. This is not about telling public bodies to 'buy British', which would be contrary to existing UK and EU procurement legislation. It is about ensuring a level playing field where the best and most efficient British producers will be able to compete for, and win, public sector contracts.

The Government is introducing a Groceries Code Adjudicator to monitor and enforce the Groceries Supply Code of Practice. The Department for Business, Innovation and Skills (BIS) is leading on the establishment of the GCA. BIS published the draft Groceries Code Adjudicator Bill on 24 May and invited Parliament to undertake pre-legislative scrutiny. That scrutiny has now been completed and the Committee has published its recommendations. The report from the BIS Select Committee will help the Government to present a strong Bill to Parliament. The Government will carefully consider their recommendations and respond to them in full.

Recommendation on Dedicated Supply Chains

The Committee calls on Government to exert influence on retailers to establish dedicated supply chains for processed dairy products, such as butter and cheese. Like the Committee, the Government welcomes the development of dedicated supply chains which improve the efficiency of the supply chain, provide included farmers a higher price, and often include greater standards for public goods such as environmental performance and animal welfare. The extension of dedicated supply chains must, however, be within the commercial interests of both those offering and accepting such contracts. The next meeting of the Dairy Supply Chain Forum on 23 November will enable Government to discuss with retailers, processors, and farmers any barriers to extending these initiatives.

European Commission proposals for the dairy sector

Raw milk contracts

3. We conclude that contracts should provide certainty and clarity to give both parties the confidence to invest—the current system fails to achieve this. Our view is that the Commission's proposals offer considerable scope for Defra and the industry to jointly establish a more effective system of raw milk contracts.

4. We recommend that raw milk contracts should include the four elements specified by the Commission—price, volume, timing of deliveries, and duration. In addition, the contract should make it clear under what conditions the contract can be terminated by either party. Exclusivity clauses should be discouraged to allow farmers to respond to market signals following the abolition of quotas. We do not suggest that all contracts must contain an explicit price or price formula as these could be overly restrictive, but contracts should set out the principles underpinning price and mutually agreed tolerances. Given that the majority of dairy contracts do not contain these elements, in order to effect the change that we think is needed, Defra should make it compulsory for producers to be offered a written contract containing the elements specified above.

The EU Commission's proposals on contracts in the dairy sector would limit the extent to which the Government could require elements to be included. If the Government made contracts compulsory in England we would not, under the proposals, be able to add any conditions to those set out in the proposals. The details of contracts would be for free negotiation. The Government could not, therefore, prescribe in any way how elements such as price should be determined. We could not, under the proposals, address through regulation the issue of exclusivity clauses, nor could we determine that notice periods should be longer or shorter.

Ultimately, if the Commission's proposals allow EU Member States to choose to make contracts compulsory, the Government will consult on this. An industry-led code of practice, however, is much more likely to deal quickly with the concerns about current contractual arrangements than relying on the European legislation.

5. The European Parliament Agriculture and Rural Development Committee's proposal that milk contracts should stipulate a milk price fixed for no less than one year is, in our view, overly restrictive and could hinder processors and producers from responding to market signals. We recommend that the UK Ministers and MEPs do not support this proposal.

The Government agrees that one-year fixed milk prices would be overly restrictive and would harm the industry. We have opposed this amendment in Council and, in June, wrote to relevant MEPs explaining our opposition to this point.

Producer Organisations

6. Dairy farmers are particularly disadvantaged in that they are selling a perishable product in a highly consolidated market with often little choice, at regional level, to whom they sell. We welcome the Commission's proposals, which will make it considerably easier for dairy farmers to collaborate over prices and so increase their bargaining power, without fear of investigation from competition authorities.

7. We note concerns that the proposed size limit of 33% of national milk production risks creating regional producer monopolies. On the other hand, lack of a clear threshold size risks creating uncertainty and deterring participation among farmers. To clarify the situation and bring it in line with existing competition law, we recommend that Producer Organisations be able to cover up to 20% of national milk production and above that limit, be subject to a case-by-case analysis by the National Competition Authority until the 33% limit is reached.

The Government has encouraged farmers to consider forming producer organisations, which may help to improve their efficiency, returns, and bargaining power. Farmers may form producer organisations under existing law.

The Commission's proposal seeks to establish a special exemption from competition law for producer organisations in the dairy sector. The Government considers that there should not be such an exemption and has instead called for clarification of what producers may do under existing law. Raising the thresholds of competition law seems particularly inappropriate in this case because there is no evidence that farmers are being constrained by the thresholds applied under present legislation.

The Commission's proposal ignores the concept of the relevant market and instead limits the size of producer organisations on the basis of national production. The relevant market for raw milk, because of the expense of transporting raw milk and its perishability, may be sub-national. There is therefore a very real risk that a producer organisation may develop monopolistic or oligopolistic power in a particular region, yet remain under the 33% limit prescribed by the proposed EU regulation.

For this reason, it is important that national competition authorities may intervene in cases where competition is significantly distorted. The present proposal would allow competition authorities to intervene only when competition is excluded. Distortions of competition may lead to reduced investment and innovation, provide a bad deal for consumers, and render our industry uncompetitive on world markets.

The Committee's proposal would not bring the Milk Package in line with existing competition law which is based on the concept of the relevant market. We consider it very unlikely, given the attitude of other member states, that we would be able to achieve the Committee's amendment in the European legislation.

The Government considers that the best means of ensuring that the Milk Package supports the competitiveness of our industry is to argue for wording allowing national competition authorities to intervene to prevent competition being "significantly distorted".

We agree with the Committee that competition law should be clarified. The Office of Fair Trading has committed to updating its guidance on co-operation among farming businesses. This task is now underway.

8. In light of the substantial disallowance incurred through Defra's misadministration of the Fruit and Vegetable Producer Organisation regime, Defra must ensure that the criteria for recognising Dairy Producer Organisations are clearly and unambiguously agreed between itself, its agencies and the European Commission, before implementation.

The Government agrees with the need for clear, simple, and unambiguous rules and criteria for recognition of dairy producer organisations.

The UK Government co-sponsored a note in March, 'Simplification of the Common Agricultural Policy beyond 2013', that highlighted important principles for simplification of the Common Agricultural Policy. Three of these principles were especially relevant for the recognition of producer organisations in the dairy sector and we asked the Presidency to respect these in its rules and criteria for the recognition of producer organisations in the dairy package.

Our requests were:

- Provisions for implementation of the CAP that are simple and inexpensive for national authorities to administer and administrative costs for member states and for farmers that are kept low.

- Discretion and flexibility for member states to define the detailed controls and monitoring of producer organisations in a manner appropriate to their particular circumstances, providing they can demonstrate that the policy measures taken are effective.

- Proportionality in controls, and penalties that are proportionate to the risks involved.

We were pleased to see the Presidency adopt our suggestions in drafting changes to the text. These changes set out the main conditions for recognition of producer organisations in the Milk Package legislation, rather than leaving it entirely to the Commission through delegated powers. This will ensure a much greater degree of clarity and agreement.

The Government has recently issued clarified guidance for the fruit and vegetable producer organisation scheme and the Rural Payments Agency (RPA) has worked with industry to help growers benefit from the scheme. This guidance was developed by a working group which included representatives from the NFU, the RPA, Defra and all parts of the fruit and vegetable industry. The clarified guidance has been used as a basis for a review of the whole scheme which should reduce the risk of further disallowance.

Other elements of the 'Milk Package'

9. The Commission's proposals on transparency offer little benefit to the UK as the relevant data is already published. We encourage the Government to pursue greater transparency across the dairy supply chain to improve market awareness and reduce volatility.

The Commission's proposals on transparency extend reporting requirements that would otherwise expire in 2015. The Commission's proposals on inter-branch organisations envisage these organisations, where they are established, being able to improve transparency and information dissemination in the industry.

Apart from the volumes of milk collected, a wealth of public data is already available. Much of this is accessible through DairyCo (www.dairyco.net/datum). We have asked the NFU what additional data they would find useful to improve the transparency and functioning of the market.

We support the aims of transparency, but the benefits of additional reporting would need to be greater than the additional costs and burdens placed on farmers. In some cases there may also be legitimate issues of commercial confidentiality.

We would welcome any input from the industry or the Committee as to specific information that is lacking but that may be useful for the sector.

10. The forthcoming lifting of quotas adds weight to the argument for proactive action to bolster the industry before the window of opportunity to expand production has passed.

The Government welcomes the Committee's emphasis on rapid progress. This is why we are also encouraging non-legislative action led by the industry, rather than relying on regulatory solutions, which take longer.

It is unclear when the Commission Milk Package will come into force. It may be agreed this autumn, or it may take many more months to conclude negotiations with the European Parliament. Even then, it may take a significant period of time for the Commission to generate implementing regulations and for necessary domestic legislation to be prepared and be passed in the UK and national parliaments. There may then be a lag before the regulation has effect.

Actions for Government

11. Defra's domestic action programme for the dairy sector offers little of real benefit for dairy farmers. We are surprised and disappointed that the Minister was not able to offer more concrete and proactive suggestions to improve the situation in the dairy sector. We trust that Defra's response to this report will set out how their commitment to support and develop British farming will be realised for the dairy sector in time for the abolition of quotas in 2015.

Supporting and developing British farming and encouraging sustainable food production is a commitment in the Department's Business Plan. The industry and the Government are taking action to support the dairy sector as set out in the introduction to this response and in reply to recommendations 1 and 2 above.

Key steps include the development of a voluntary code of practice on contractual relations and work in progress to support a sustainable industry through Dairy 2020 and the Dairy Supply Chain Forum. These actions are both concrete and proactive and are likely to produce results more quickly than relying on EU regulation, which is particularly important given the abolition of quotas in 2015.

Increasing the profitability of the dairy processing sector

12. The Government should facilitate investment in dairy processing as part of its wider strategy to promote growth in the manufacturing sector and increase exports and Defra's business plan commitment to promote increased domestic agricultural production. We recommend that Defra review the accessibility to the dairy industry, particularly SMEs, of existing private and public funds for increasing growth and competitiveness and take steps where necessary to improve access. The review should include finances available through the Common Agricultural Policy, but also funds that are not specific to agriculture, such as the Business Growth Fund and Enterprise Capital Funds.

The Government considers that there is no reason why SMEs in the dairy sector should not be able to access either the Enterprise Capital Funds programme, or the Business Growth Fund. These funds are sector-blind. Both of these funds are managed by the private sector and are equity funds. For some business owners, who may be unwilling to sell equity in their enterprise, these may not be attractive means of raising finance, but for others, these may be a way to help their business reach its full potential.

Phase 2 of the Growth Review announced in June 2011 builds on the *Plan for Growth* paper. This will focus on six topics: the Rural Economy, Infrastructure, Logistics, Mid-sized businesses, Education and Skills, and Open Data. Opportunities from the green economy, and the impact on SMEs, will be themes across all Phase 2 projects.

The Rural Economy Growth Review is led by Defra, and will identify the actions that Government can take to enable sustainable, diversified economies in rural areas which are able to contribute to green growth and to rebalancing the national economy.

Eight lines of enquiry have been identified which will be the subject of detailed work during the Review to identify policy measures with the potential to deliver the greatest contribution to growth. These include the agri-food sector which has unrealised potential to add economic value and improve competitiveness.

13. Defra should develop a strategy with UK Trade and Investment and the Foreign and Commonwealth Office to promote UK dairy products and increase exports.

The UK Trade and Investment Corporate Strategy sets out 18 priority sectors where efforts will be focused, including agrifood. The Strategy also sets out a commitment for UKTI and Defra to work together to ensure that the agrifood sector is able to take full advantage of the potential for growth through overseas trade. Defra and UKTI are working closely with industry, including representatives from the dairy sector, to look at how agrifood and drink exports can be maximised. As set out in the Defra Business Plan, this project is due to report in December 2011.

As part of this work the Minister of State has established an Agrifood and Drink Export Forum, composed of senior representatives from companies, to provide first hand commercial experience to advise and challenge the direction of the work. This group is co-chaired by the Minister of State and Paul Grimwood, Chair of the Food and Drink Federation's Competiveness Steering Group and Chairman and Chief Executive Officer of Nestlé UK Ltd. and Nestlé (Ireland). In addition, Defra Ministers are committed to the promotion of outward trade and the Minister of State for Agriculture and Food will attend the international food and drink show Anuga in October to show his support for the hundred or more UK companies exhibiting.

14. Other than that conducted within commercial concerns, dairy-related research in the UK is focussed on animal welfare and environmental sustainability. This has resulted in a lack of research into innovative ways of adding value in the dairy sector through novel processes, markets or uses. Defra should use the Dairy Supply Chain Forum to identify who is best placed to deliver this research and how it should be funded, which should include the retail and processing sectors, with the ambition of establishing a new research arm within one of the existing industry or government-sponsored programmes.

The Government considers research spending on animal welfare and environmental sustainability to be very important. Improving our knowledge base in these areas is a key part of the Government's policy to promote an industry that protects the natural resources it depends on and ensures the highest standards of animal welfare. Government-funded research also tends to be focused on environmental sustainability and animal welfare, which are important public goods.

In addition to Government-funded research in these areas, the industry has also shown significant leadership. The retail sector and producers are increasingly taking responsibility for improving the welfare of dairy cows within their marketing schemes. The overwhelming majority of dairy farmers (95%, 2010) have Farm Health Plans in place, and the efforts of DairyCo and retailers have been important in driving this progress. Additionally, some retailers have established centres of excellence in dairy research. The industry has recently published a report on progress one year after publishing its Dairy Cow Welfare Strategy. The proper role of Government is to support these industry efforts by investing in research as necessary to provide the evidence of what works, so that industry can extend the precision and reach of its initiatives.

The Committee has helpfully stressed the importance of innovation as a way to add value to the sector and ensure its future. Research into new products and techniques can help to deliver a competitive advantage, but this is primarily for the industry itself to progress. The Technology Strategy Board Sustainable Agriculture and Food Innovation Platform provides support for industry-led research.

Research on environmental sustainability and animal welfare, and improving the value in the sector through novel processes are not mutually exclusive. DairyCo is investing £5m over the next 5 years in cross-cutting innovative R&D. This will help improve the competitive position of the dairy sector as well as reducing its environmental impact.

The Government will (as the Committee suggests) discuss with senior figures from all parts of the supply chain at the next meeting of the Dairy Supply Chain Forum opportunities for future research, including priorities for targeting and funding.

Reducing production costs on dairy farms

15. We welcome the assistance with business management provided by DairyCo's Planning for Profit workshops, but note that the cost may deter the businesses that are most in need from attending. Defra should proactively encourage this project and investigate whether workshops can be provided at a lower or no cost through funding from retailers and the Rural Development Programme. We recommend that Defra set an ambitious target of 30% dairy farmer participation in the programme and report back within one year.

Defra is discussing with DairyCo the benefit of the Planning for Profit workshops and any barriers to participation. We will investigate what can be done to reduce the number of businesses that are deterred from attending.

Defra recently announced[1] that DairyCo would receive funding remaining from the Residual Milk Marketing Board for an accredited continuous professional development programme. This will improve standards of business performance as well as recruitment and retention within the industry.

16. Stimulating technological development in the dairy production and processing sectors through business-led innovation would be a useful focus for the Technology Strategy Board's Sustainable Agriculture and Innovation Platform. Defra must make the case for directing funds to this area to the Platform's steering group.

The BIS-sponsored Technology Strategy Board supports collaborative research and development and exploitation of technology and innovation for the benefit of UK businesses.

1 http://www.defra.gov.uk/news/2011/09/06/dairy-industry-funding/

The Sustainable Agriculture and Food Innovation Platform will provide R&D funding for industry over the next five years. The Platform includes areas such as sustainable livestock production, waste reduction and management, and greenhouse gas reduction.

The R&D priorities of the Platform are determined by the industry, not by the Government sponsors. Competitions run so far have included crop protection and sustainable protein production, but those currently under discussion include food processing and should have a greater focus on dairy interests.

17. Anaerobic digestion (AD) on dairy farms has considerable potential to reduce costs and greenhouse gas emissions, yet uptake so far has been negligible. The Government's Anaerobic Digestion Strategy and Action Plan were published after our evidence sessions had been completed, preventing us from giving it full consideration. We recommend that Defra review its plan and explain how it will achieve the targets on AD uptake set out in Dairy Roadmap.

The Anaerobic Digestion Strategy and Action Plan were developed by Defra and DECC and an extensive group of stakeholders, including the NFU, the Country Land and Business Association (CLA) and the Anaerobic Digestion and Biogas Association (ADBA). The Strategy and Action Plan were published in June and include 56 actions put forward by the industry stakeholders to tackle the barriers to increasing energy from waste from anaerobic digestion, including barriers to investment, regulatory issues, and skills. Each action has an owner in Government, its agencies or in industry. Defra is establishing a Steering Group to oversee delivery of the action plan. The NFU, CLA and ADBA have all been invited to sit on that Group. The very positive co-operation between interested parties that produced the Strategy and Action Plan will continue to be necessary to increase substantially the energy from waste that we produce from anaerobic digestion.

The Strategy does not include specific targets for the number or capacity of AD plants in England. It does, however, estimate that the potential for AD deployment for heat and electricity could reach between 3 and 5 terawatt hours by 2020. This is based on the assumption that real and perceived barriers are overcome through the actions identified in the Strategy.

Since the Dairy Roadmap was adopted in 2008, the Government has further incentivised renewable energy. Feed in tariffs (FITs) were introduced from April 2010 for small scale projects producing electricity such as on-farm anaerobic digestion plants. The Government announced in June changes to FITs which include an increase in rates for anaerobic digestion to 14p/KWh for installations with a capacity up to 250 KW and 13p KW/h for installations between 250 KW and 500 KW capacity. The rate increases will be introduced once state aid clearance has been given.

There has been a slow but steady increase in the uptake of the scheme in recent months. Up to the end of February 2011 only 700KW of installed capacity joined the scheme. From March to the end of June, a further 4.3MW joined. In July alone, a further 3MW joined, giving an overall total for the scheme of 8MW. DECC is carrying out a wide ranging review of FITs and will be consulting stakeholders later this year. Any changes resulting from the review are likely to be made in April 2012, unless the review indicates the need for greater urgency.

In March 2011, DECC announced the details of the Renewable Heat Incentive (RHI). The RHI is designed to provide financial support that encourages individuals, communities and businesses to switch from using fossil fuel for heating to renewables. AD will receive a tariff of 6.5p/KWh over a 20 year period for bio-methane injection into the gas grid and for biogas combustion in installations below 200 KWh. This will provide an additional incentive for the development of the AD sector. Subject to Parliamentary and state aid approval, the scheme is expected to open on 30 September 2011.

Stimulating co-operation and collaboration

18. We heard that increased co-operation among farmers was hindered by a lack of awareness of the available opportunities. Defra and the Office of Fair Trading should update the guidance on co-operation among farming businesses following the principles set out by the Farming Regulation Task Force. Defra should review the utility of the Office of Fair Trading's 'short form opinions' tool to agricultural businesses.

The Office of Fair Trading has committed to updating its guidance on co-operation among farming businesses. This task is now underway. The OFT will work with farming organisations and farmers to ensure the guidance is fit for purpose.

Any group of farmers or their advisors who are seeking advice on prospective arrangements may apply to the OFT for a short-form opinion. Details can be found at www.tinyurl.com/shortformopinion.

19. We request an update on the following commitments set out in the Government's Response to the Environment, Food and Rural Affairs Committee's 2010 report on Dairy Farmers of Britain: a Financial Services Authority-led code of best practice for co-operatives; an examination of ways to overcome constraints on capitalising UK co-operatives; the implementation of the Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2010, and its implications for agricultural co-operatives.

In June 2011, Defra hosted a meeting to examine progress and to place key stakeholders (affected by, or involved after, the collapse of Dairy Farmers of Britain) in direct contact with those leading on the changes sought, to ensure that lessons learnt could be taken into account.

HM Treasury led on the Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2011, which was laid in Parliament for its final period of scrutiny in July 2011. It is expected to come into force in early 2012. The draft Order sets out proposals to remove the capital limits on all shares that cannot be withdrawn, enabling further avenues of investment for all co-operatives. A further proposal would allow co-operatives to change their accounting year-end from that prescribed by the Financial Services Authority (FSA). This will be particularly welcomed by agricultural co-ops who will be able to move their year-end into line with their usual business patterns. Changes in respect of shares that can be withdrawn are more complex and further work is continuing.

The FSA functions as the registering authority[2] for co-operatives, but its role does not include the promotion or leadership of the co-operative movement. Co-operatives UK plays a key role in that regard and it is for the co-operative movement itself to determine an appropriate form of governance for its societies. As part of the Government response to the 2010 Efra Committee report the FSA undertook to facilitate the drafting of a Code of Best Practice on the governance of co-operatives, which depended upon the support of key stakeholders to develop appropriate models. Co-operatives UK has agreed with the FSA that their existing Code, *'Corporate Governance: The Code of Best Practice for Consumer Co-operatives',* should be adapted for use by the agricultural sector. Co-operatives UK is currently reviewing this Code and, as a membership organisation, it is bound to consult its members on the text. Agreement on the text is expected to be reached in early 2012 and the drafting of an additional section of the Code specifically for agricultural co-operatives will commence shortly afterwards.

Large-scale Dairying

20. It is absolutely essential that the environmental, animal health and welfare, and social impacts of large-scale dairy farms are quantified and we welcome the fact that research is currently under way. We conclude that large-scale dairy farming presents an opportunity whose potential merits further exploration. The Government has significant power to disseminate the evidence-base on the impact of particular technologies, and if appropriate, to promote them. We do not accept that approvals for large-scale agricultural holdings are purely an issue for planners. As soon as evidence on the impacts of large-scale dairying is available, Defra must establish its policy position on this issue and then take a proactive stance in explaining the rationale behind its decision.

Policy

The Government has a clear policy position on this issue: that there is a place in UK agriculture for all sustainable production systems that meet welfare and environmental standards. This is necessary to enable the industry to be competitive on UK, EU and global markets. Ministers have repeatedly stated this position and that increasing the size of herds does not mean reducing welfare. More important factors are the design and construction of the units; and the level of management and skill of the stockmen.

While it is right that the Government has a view on the principle of large-scale dairying, it cannot adopt a position in respect of individual dairy developments that are going through the planning process. That would generate complaints of inappropriately influencing the planning approvals process and the assessment of the Environment Agency, which is a statutory consultee on all such developments.

Research

The Government has funded a three-year project by the Scottish Agricultural College which investigated the management and welfare of continuously housed cows. Work on

2 Under the Industrial and Provident Societies Act 1965.

this research has now been completed and the report is due to be published at the end of the year.

Further, in spring 2011, Defra invited tenders for a research project to identify best practice for large-scale dairying and the impacts of increased scale on economics, animal health and environmental impacts. The project was also to assess the potential of intensive units to increase production in the UK.

Unfortunately, none of the submitted bids fully met the Department's thorough evidence requirements, and we are considering how best to move this forward.

Conclusions on the European Commission's proposals

21. We welcome the analysis presented by the European Commission and the High Level Group on Milk, which has successfully highlighted the problems facing the European dairy sector. We support the key elements of their proposals but conclude that more will need to be done to address the structural problems in the UK dairy industry and have set out what additional action is needed. We were disappointed by the weakness of the Department's proposals to improve the state of the dairy sector and call on Defra to take more a more proactive stance, commencing by implementing the recommendations set out in this report.

The Government is grateful to the Committee for its recommendations.

The actions taken by Government to support the UK dairy sector have been set out in the introduction to this response and in reply to the recommendations above. The Government does not accept that its programme of action is weak. Between Government and the industry, much is being done to support the sector.

The Government will continue to work with the industry to improve the position of the UK dairy sector, address its concerns, and ensure its long-term success.

ANNEX—Additional Remarks

- In paragraph 10, the Committee states,

"Farmgate milk prices have not covered production costs for over a year, threatening some dairy farmers' ability to continue farming. Independent research commissioned by the NFU found that between April 2010 and March 2011, UK farmgate prices were approximately 4 pence per litre (ppl) below the cost of production."

The Kite Consulting reported cited by the Committee at this point does not appear to make the claim ascribed.

Statistics on this topic mask a huge variation in both costs and farmgate prices.

The weighting used to calculate the average costs of production for milk within the NFU report did not include any adjustment for the volume of milk produced on each farm. Every farm was given an equal weight (of one), so that the average taken was per litre per farm rather than per litre across all farms.

The average cost of producing a litre of milk across all farms in 2009/10 using Farm Business Survey data was 22.44 ppl compared with 27.35ppl in the NFU survey. This was derived by aggregating the cost of producing each litre of milk and dividing it by the total litres of milk produced. The average price received according to the FBS was just under 24 ppl (24.37ppl in the NFU report).

A summary of costs of production is below:

Cost of Production	Proportion of milk produced in 2009/10
Less than 20ppl	22%
20ppl to less than 22.5ppl	25%
22.5ppl to less than 25ppl	27%
More than 25ppl	26%

Source: Farm Business Survey, England 2009/10

- In paragraph 11, the Committee states,

"However, Farm Business Income is not an accurate reflection of the profitability of the farm if it does not account for the cost of unpaid family labour."

For non-corporate businesses, which the majority of farm businesses are, Farm Business Income represents the financial return to all unpaid labour (farmers and spouses, non-principal partners and their spouses and family workers) and on all their capital invested in the farm business, including land and buildings. For corporate businesses it represents the financial return on the shareholders' capital invested in the farm business. In essence therefore, Farm Business Income is the same as Net Profit, which as a standard financial accounting measure of income is used widely within and outside agriculture. This allows income from farm businesses to be compared with businesses in other sectors and avoids any confusion regarding the inclusion of imputed costs for labour and land ownership. Defra still publishes Net Farm Income which includes a cost for unpaid family labour, including the manual labour of the farmer and spouse.

- Further, in paragraph 11, the Committee states,

"In addition, the subsidy provided by the Common Agricultural Policy (the Single Farm Payment) currently adds approximately 1.5–2.5 ppl to farmgate prices. Reforms to the Common Agricultural Policy after 2013 could cause this to fall to around 0.5 ppl."

The Kite Consulting analysis that suggests UK dairy farmers could see the implicit subsidy of the Single Farm Payment fall to 0.5ppl by 2020 does not say this is caused by CAP reform. Rather, there is a combination of factors at work, not least that the analysis assumes the UK dairy industry will experience rising dairy prices and expand production (with a similar-sized national herd and higher yields per cow). In such circumstances it would be surprising if the implicit subsidy did not decline.

- In paragraph 40, the Committee states,

"The Groceries Supply Code of Practice already sets a precedent for regulation of terms and conditions between food suppliers and buyers in cases where there is deemed to be an imbalance of bargaining power."

The Groceries Supply Code of Practice was introduced using legal powers under the Enterprise Act, following a two year investigation which found that the imbalance in bargaining power might damage competition and harm the consumer.

The Competition Commission, in the course of its investigation, gathered evidence from the whole of the supply chain including some under subpoena. This is evidence that would not normally be available to Government or others.

The Groceries Supply Code of Practice does not regulate prices or determine 'fair' prices. It was put in place to improve the relationship between larger retailers and their suppliers by preventing the unfair practices identified by the Competition Commission's groceries investigation.