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Pàrlamaid na h-Alba

Official Report

RURAL AFFAIRS, CLIMATE CHANGE AND ENVIRONMENT COMMITTEE

Wednesday 28 January 2015

Session 4

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RURAL AFFAIRS, CLIMATE CHANGE AND ENVIRONMENT COMMITTEE
4th Meeting 2015, Session 4

CONVENER

*Rob Gibson (Caithness, Sutherland and Ross) (SNP)

DEPUTY CONVENER

*Graeme Dey (Angus South) (SNP)

COMMITTEE MEMBERS

*Claudia Beamish (South Scotland) (Lab)
Sarah Boyack (Lothian) (Lab)
*Alex Fergusson (Galloway and West Dumfries) (Con)
*Jim Hume (South Scotland) (LD)
*Angus MacDonald (Falkirk East) (SNP)
*Michael Russell (Argyll and Bute) (SNP)
*Dave Thompson (Skye, Lochaber and Badenoch) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Dr Judith Bryans (Dairy UK)
Kenneth Campbell
Nigel Evans (First Milk)
Robert Graham (Graham's Family Dairy)
Graeme Jack (Müller UK & Ireland Group)
George Jamieson (NFU Scotland)
Robert Macintyre
David Stewart (Highlands and Islands) (Lab) (Committee Substitute)
James Withers (Scotland Food & Drink)

CLERK TO THE COMMITTEE

Lynn Tullis

LOCATION

The Robert Burns Room (CR1)

Scottish Parliament

Rural Affairs, Climate Change and Environment Committee

Wednesday 28 January 2015

[The Convener opened the meeting at 10:03]

Interests

The Convener (Rob Gibson): Welcome to the fourth meeting in 2015 of the Rural Affairs, Climate Change and Environment Committee. Before we move to the first item, I remind everyone present to switch off their mobile phones, as they could affect the broadcasting system. Some members may use tablets for work during the committee's business, and that is quite understandable.

I have received apologies from Sarah Boyack. David Stewart is attending the committee in her place. I welcome him and invite him to declare any relevant interests.

David Stewart (Highlands and Islands) (Lab): I have no relevant interests to declare.

The Convener: Thank you, David.

Decision on Taking Business in Private

10:03

The Convener: The first item on the agenda is a decision on whether to take in private agenda item 4, which is consideration of the evidence heard this morning and of our future plans for our inquiry on the dairy industry. The committee is also asked to decide whether to consider its European Union priorities in private at a future meeting. Are we agreed?

Members *indicated agreement.*

Subordinate Legislation

Conservation of Salmon (Annual Close Time and Catch and Release) (Scotland) Amendment Regulations 2014 (SSI 2014/357)

10:04

The Convener: Agenda item 2 is subordinate legislation. There are three negative Scottish statutory instruments to consider, as listed on the agenda.

SSI 2014/357 was drawn to the attention of Parliament because of some mistakes. The instrument did not comply with the 28-day rule. However, the Delegated Powers and Law Reform Committee has deemed the instrument to be acceptable on the ground that the Scottish Government is seeking to make corrections to satisfy that committee's report on a previous instrument. I refer members to the paper on the regulations.

Are there any comments? If not, are we agreed to make no comment on the regulations?

Members *indicated agreement.*

Designation of Nitrate Vulnerable Zones (Scotland) Regulations 2014 (SSI 2014/373)

The Convener: Are there any comments on the regulations?

Alex Fergusson (Galloway and West Dumfries) (Con): The nitrate vulnerable zones were introduced in 2002 and I notice that, once we approve the statutory instrument, the total area that is currently covered by NVZs will decrease by 24 per cent. I remember a heated debate at our predecessor committee in 2002, in which I argued that the zones as proposed were far too big. I want to put on record how delighted I am that, some 12 years later, somebody agrees with me.

The Convener: Thank you for that. There are no further comments on the regulations. Are we agreed?

Members *indicated agreement.*

Sea Fishing (Points for Masters of Fishing Boats) (Scotland) Regulations 2014 (SSI 2014/379)

The Convener: Are there any comments on the regulations? I have some of my own.

I would like to get some detail from the Government about how the register of masters is kept and how it is made available, as well as about how people who have broken the EU fishing rules are pursued. We need to know about that—while agreeing to the regulations, which allow for the register to be updated. It would be useful to get some detail from the Government, by way of a letter, about what the provisions do. The matter is germane to our future planning of the seas and to our discussions on the national marine plan.

Are we agreed on that?

Members *indicated agreement.*

The Convener: Do we agree to make no comments on SSI 2014/379?

Members *indicated agreement.*

Dairy Industry

10:07

The Convener: We move on to agenda item 3. The committee will take evidence on the dairy industry from stakeholders in a round-table session. I refer members to the paper on the subject.

I ask the witnesses to introduce themselves. I am the convener of the committee, and I am the MSP for Caithness, Sutherland and Ross. My name is Rob Gibson—just in case you cannot read my name on the sign.

Once we get past the clerks and the official reporters, I ask everyone to say who they are.

Robert Macintyre: I am a dairy farmer from the Isle of Bute, and I am a member and supplier of First Milk.

David Stewart: I am a Labour member for the Highlands and Islands.

George Jamieson (NFU Scotland): I am milk policy manager for NFU Scotland.

Claudia Beamish (South Scotland) (Lab): I am a South Scotland MSP and shadow minister for environment and climate change.

Robert Graham (Graham's Family Dairy): I am from Graham's Family Dairy. We are a dairy business based in Bridge of Allan, and we are also dairy farmers.

Dave Thompson (Skye, Lochaber and Badenoch) (SNP): I am the MSP for Skye, Lochaber and Badenoch.

Kenneth Campbell: I am a dairy farmer from Castle Douglas.

Michael Russell (Argyll and Bute) (SNP): I am the member of the Scottish Parliament for Argyll and Bute.

James Withers (Scotland Food & Drink): I am chief executive of Scotland Food & Drink. It might be relevant for this discussion to mention that I chaired a review of the dairy sector in 2013.

Alex Fergusson: I am the MSP for Galloway and West Dumfries. I declare a slight interest, in that I chaired a review of the voluntary code of practice last year, which reported in October.

Dr Judith Bryans (Dairy UK): I am the chief executive of Dairy UK.

Jim Hume (South Scotland) (LD): I am an MSP for South Scotland.

Graeme Jack (Müller UK & Ireland Group): I am corporate affairs director of Müller UK & Ireland Group.

Angus MacDonald (Falkirk East) (SNP): I am the MSP for Falkirk East.

Nigel Evans (First Milk): I am vice-chairman of First Milk. I am also a dairy farmer and a board director—I am the farmer director.

Graeme Dey (Angus South) (SNP): I am the MSP for Angus South.

The Convener: Thank you all.

Let me kick off with a general question. This inquiry has been triggered by low prices for milk and First Milk's decision about its delayed payments and so on, but I want to ask first—because we will come into the detail quite soon—why there seems to be a particular problem in Scotland at this time with milk supply prices. If anyone would like to comment on that, it would be helpful to us.

George Jamieson: First, it is not just Scotland; this is a global situation. Prices for farmers in New Zealand have dropped more than for anybody else because they are more exposed to global commodity markets. Nobody expected the globalisation of dairy that has occurred since 2007. Across the United Kingdom and Europe, the prices for all farmers have dropped to a similar level.

On the particular problems in Scotland, the 40 per cent of producers in Scotland who supply First Milk have their own distinct problems, which are caused by the global situation and their own particular markets. The worry in Scotland going forward is the lack of processing investment and farmers losing confidence. The problem is not unique to Scotland—it is definitely a global issue—but we can differentiate Scotland in some ways and try to identify ways to militate against the problem in the short, medium and long terms.

The Convener: I am looking at a table sourced from Dairy UK that suggests that the situation in Scotland is not developing as well as in England, Wales or Northern Ireland. It seems to me that there is a specific issue with Scotland that needs to be explored further.

George Jamieson: Yes, there is a particular lack of modern investment in Scotland. One thing that Scotland can do is produce milk—we have the rain, the grass and the farmers. I agree that in Scotland dairy is not developing as much as we would like. It seems that there is investment across the UK, especially in big liquid-processing plants, but there is a lack of investment in processing and marketing in Scotland.

There should not be a great deal of difference in prices, because Scottish farmers supply the same companies as English and Welsh farmers and they tend to get the same prices.

Robert Graham: As a family business, our 20-year track record for our milk price is second to none. However, I absolutely agree with what George Jamieson says about processing investment. It is critical. We have a situation in Scotland in which our biggest brand for butter is Danish, our biggest brand for yoghurt is English and our biggest cheese brand is English. We need processing investment.

We have plans for what we would like to do in processing investment, and we would like to see Government strategy on sustainable economic development being translated across all of national Government and into local government. There are a few challenges around that, but there are a lot of opportunities to add value with that investment.

Let us look at spreadable butter. If spreadable butter is not Graham's, it is not Scottish. That means that 96 per cent of all spreadable butter sold in Scotland at retail is not Scottish. Three quarters of that is Danish. That alone is £60 million of lost opportunity for the economy, the dairy industry and farmers.

That is something that we are working on. We have new products coming out, but it takes time, energy and investment.

Dr Bryans: I would like to support George Jamieson in what he says. We have seen that this is very much a global issue and not just a UK or Scotland issue. We know that volatility is inherent to the milk market and has been for a number of years. The Global Dairy Trade auction trends for the last 10 years show that about every two and a half years we hit a cyclical dip.

In this country we have not been as resilient as some people have been; New Zealand farmers, for example, have had more experience of the volatility. At the moment there are not the private mechanisms to deal with what we are seeing. In 2014 we had good weather, people had grass and silage, and cereal costs went down, but we also had a Russian trade ban. We were already expecting more milk than there was global demand for, but we could not have anticipated the Russian trade ban.

10:15

People will ask how that affects this country because not too much product goes to Russia. We have had members have containers turned around. Beyond that direct impact, that product rebounds on to the EU market, where it is then in excess. China's buying in of dairy products also slowed down very much, and that was huge for the dairy market.

On top of that, there is a slight misconception that, because the UK has a rather unique liquid milk market, it should not be affected. Of course, a lot of milk in this country also goes into cheese and butter, which is internationally traded. However, in the liquid milk market, when we produce low-fat milk we take off the butterfat. That goes into the cream market, and cream is affected by the global butter price. Over 2014, therefore, there was a confluence of events that created a perfect storm.

On Scotland in particular, it is difficult for many cheese makers to have resilience because, sometimes, the costs for a mature cheese do not translate over the market dips and peaks. The industry in the whole UK—Scotland, England, Wales and Northern Ireland—must develop somewhat more resilience.

The Convener: We will explore that a bit further.

Graeme Jack: I will speak from the Müller UK & Ireland perspective. We are part of a privately owned company that is owned by a sole shareholder in Germany who is able to look across Europe and the rest of the world at markets that offer opportunities for him. His view is that the UK market offers opportunity.

The reason for that is that—to speak to a point that George Jamieson made—the UK suffers from a historical and chronic lack of investment in added-value processing capability. The measure of that, as far as Müller UK & Ireland is concerned, is that the UK currently imports £2.2 billion-worth of dairy products every year. The UK has given away a share of its domestic market to companies in Europe and Ireland.

We see that as an opportunity. Our view is that we are part of the solution rather than the part of the problem in that we are investing. We have invested around £500 million in the UK in the past three years, and we are alive to opportunities to continue doing that.

That is our assessment of the market. There is not enough added-value processing and the UK is giving away too much of its home market to overseas competitors. In addition to that, there is a deficit between importing and exporting. The UK exports only about £1 billion-worth of products. We see that as an opportunity, too.

The Convener: Thank you for that insight.

Robert Macintyre: I am here to talk about the circumstances of milk producers on the periphery—that is, Bute and Kintyre. We are all members of First Milk.

I will give the committee an illustration of price dive. In January 2014, I received 32.35p a litre for my milk supply to First Milk, and I am a less-than-average producer for First Milk. From that 32.35p, every producer made a 0.5p capital contribution. In January 2015, our price has dived to 20.98p and, from that, we now make a capital contribution of 2p a litre. Therefore, the committee can see that our net price is an appalling 18.98p, which is way below the cost of producing a litre of milk. NFU Scotland says that it takes 30p to produce a litre of milk. My college adviser says that we might be able to do it for 27p or 28p, but that would be difficult on the periphery because we have extra haulage costs.

As far as processing goes, First Milk shut our creamery in Bute in March 2010. At that time we had 13 milk producers left, producing 15.5 million litres. We still have 13 producers producing that same amount of milk, and you can understand that many of them are now totally disillusioned.

Where do we go from here? We are depending on First Milk for our survival. That is the case—I mean survival. We are faced with the summer and with buying fertiliser to make next year's silage. Where is the money coming from?

There are 13 producers on the island of Bute. To project a year forward, £2 million will come off our bottom line. That £2 million is essential for all tenants to pay a rent to Bute estate and buy all our inputs: fuel, feed and fertiliser. It is a very worrying situation, which some of us are losing sleep over.

The Convener: Thank you very much. We will come specifically to First Milk questions in a moment, but that was a good tee-up on the particular Scottish situation. Around 40 per cent of our milk in Scotland is dealt with by First Milk, as far as I understand.

James Withers: I will echo some of the comments so far.

For the past 15 or 16 years the Scottish dairy industry's story has been one of peaks and troughs. I suppose that the industry has become more volatile and the gap between the tops and the bottoms of milk pricing have become more extreme. Robert Macintyre's figures have demonstrated that the current drop has been particularly noticeable because of the steepness of its curve and how deep it has gone. It is a more concerning position than we have been in for a while.

It is a global situation; I can see nothing that can be done in Scotland that will change the global dynamic, but we absolutely can be better prepared to deal with it and—picking up Judith Bryans's point—be much more resilient. The reality in Scotland is that we are overexposed to the global peaks and troughs, and we should be underexposed. Many other sectors of our food and drink industry are underexposed because they have invested in strong brands. The premium end of the market always holds up well and has even held up particularly well in the last few years of tough economic times globally. We have seen that in other sectors.

There has been a chronic lack of investment generally across the UK and in Scotland in added value and processing, and that must change. If the committee can send out one message, it should be that, if any dairy company in Scotland is looking to invest in added value and extra capacity, we need local planning authorities to fall over themselves to support that. That is critically important.

Scotland is good at producing milk and we have a growing national identity for food and drink. I am hugely optimistic about the dairy industry's future, but we must invest in added-value brands. There are real opportunities in the UK around import substitution, as Robert Graham outlined, and there are real opportunities overseas. Some 92 per cent of the dairy products that we produce in Scotland are sold in the UK. We have a hopelessly small number of customers, and we need to get into overseas markets to balance out the risk that the industry faces.

The Convener: Does anyone who has not yet spoken wish to come in? Do not worry; not everyone has to answer every question, but do not feel shy about coming forward.

That was a general start. We need to think about the reasons for First Milk's decision and its implications for First Milk members and other dairy farmers in Scotland. That issue has been teed up by a dairy farmer who is tied to First Milk, as the rules have it.

Nigel Evans: It might be useful to go back a little and look at what First Milk is, where it has come from and how it operates. We are 100 per cent owned by our members, who are farmers—I am a farmer myself. We operate with an element of farmer equity capital in the business and we also operate with a level of bank debt, which, along with the market conditions, were the reasons for the decisions over the past couple of weeks.

To expand on that, we had a direct trading issue in the spring in that milk prices started falling away. With the benefit of hindsight, my view is that we could have cut prices a month earlier but not much more than that, because the market signals were quite slow in coming through to the main market at that point. However, the underlying commodity market was actually falling away quite rapidly, which allowed a loss-making situation to arise in the early part of the year.

Although that was significant, it was not threatening to the business. A bigger issue for the business was the fact that the cheese stock value started to fall rapidly in the autumn. As Judith Bryans mentioned, that is significant because the process for cheese is that we purchase milk today and lay the cheese down, and it then takes time for the cheese to mature before we can market it. In effect, we are paying a price for cheese today without really knowing what the market value will be six, eight, nine or 12 months out.

Additionally, the business is funded with a level of bank debt, and it was secured against the cheese stock. As the value of that fell away, the loan facility to the business dropped as well. In that scenario, we could have borrowed more money or raised money from members. Five farmer directors sit on the board, and when we looked at the situation we tried to assess what choice would be more beneficial for members to structure the business better and secure a long-term future for members' milk. We took the decision to raise further capital from members. We also reversed part of a price cut that we had announced, although we had anticipated using that money to take additional lending.

Rob Macintyre's statement about the milk prices is quite right, because those are typical prices across the membership at the moment. Having made the decisions that we have made, the fact is that the capital retention will last until August, when it will revert to the halfpenny a litre that we have traditionally contributed as members to the business. Following that point, because of a reduction in debt levels and so on and there being more equity capital in the business, the milk price will rise by about 0.6p per litre.

The big issue for us was the deferral of the milk cheque. It was determined to defer that by 14 days in order to allow an immediate injection of cash into the business and remove any need for additional borrowings, and thereby to create a scenario in which members supplying the business would ultimately be much better off.

That is the basic outline.

The Convener: Graeme Dey has a supplementary question first, then Mike Russell.

Graeme Dey: I want to explore the island issue. I recognise that there is a huge issue for the whole of Scotland, but I want to look at the islands. We can take the example of Gigha, which I very much enjoyed visiting a couple of years ago. A written submission tells us that the farmers in Gigha are faced with a situation whereby, in addition to the cut in the milk price and the capital figure increasing, they now have their milk collected only every second day; they were told to put in bigger tanks—I presume that they had to meet the cost of doing that; and they have to pay for the carriage of the milk tankers on the ferry. As a layman, I am left asking just what benefit the farmers on Gigha and other islands actually derive from being part of First Milk.

Nigel Evans: It is the same benefit that all farmers get. On the specific issues that you raised about milk tanks, collections and so on, we all pay for those as members—all those elements are attributed to us as members. There is no differential in that respect.

You asked why any farmer would wish to be a member of First Milk, and it comes back to some of the fundamentals that are happening in the market. By that, I mean that we have unprecedented market conditions and we are seeing a number of farmers—about 360 or 370, I am told—who are out of contract or about to go out of contract. That means milk that is not being picked up by anybody but being traded in a spot market; some of it is picked up only Monday to Friday and is dumped on a weekend, because of oversupply.

Being a member of the co-operative that is First Milk means that, wherever we farm, we have a guarantee that our milk will be picked up and that we will be paid for it. In the current situation, those are two critical things for farmers. One farmer described it to me as First Milk being the mothership that underpins his business, and it is the same for each of the 1,300 members who supply First Milk.

Graeme Dey: I want to be clear on this. Are you saying that the farmers in Gigha did not, between the four of them, have to bear the cost of putting in the bigger tanks and that it is not just the four of them who are paying for the carriage on the ferry?

10:30

Nigel Evans: On your specific point about the tanks, every farmer supplies his own milk tank or vat—every one of us as a farmer has to do that. Our business has had every-other-day collection, and that has happened in the industry for 20-odd years or more. Every farmer bears that cost.

On the cost of carriage, what happens is that in the milk pools and the markets that those guys go into, that carriage forms part of their transport cost, and different milk pools have different elements of transport cost. Those farmers will be part of the Kintyre and Gigha volume milk pool, which will have a transport cost element applied to it.

Michael Russell: I would like to push this point, convener, before I move on to a wider one. To be absolutely honest, First Milk is not just a mothership—there is no other ship. If someone is a producer in Kintyre, Gigha, Bute or Arran, there is no alternative.

Nigel Evans: That is true.

Michael Russell: In essence, you have a captive market for those who are providing for you.

I speak unashamedly as the member for Argyll and Bute, and it seems to me that there are two issues. First, my constituents who are dairy farmers are getting a pretty awful deal from First Milk, which, from the outside, looks like a very badly run company that is making its members suffer.

Secondly, there is a wider issue, which I was struck by when reading the meeting papers. Everyone round the table who has submitted evidence on the problem knows the answer—it is partially to do with world prices, but that is used as a bit of an excuse in the newspapers—which is that there needs to be a better focus on promoting, marketing and selling milk products, nationally and internationally. The person who put that best—I do not want to embarrass him—is Robert Graham, whose submission, at the end of a very long reading session, was the only one that I enjoyed. He gets the point and he wants to do that work.

I have a couple of questions for First Milk. In that context, do you agree that your stewardship in Kintyre, of the Mull of Kintyre brand, has been pretty awful? On Saturday, I went looking for it in Tesco in Oban—you may wish to blame Tesco for this—and I found only one type of this premier Argyll product lurking at the back of the shelf. That is the situation in Argyll itself. As the custodian of such brands, what will you do to ensure that you are selling them and helping the farmers who are producing milk for you? What will you do in Campbeltown, particularly with the creamery?

Nigel Evans: There has been a submission for some time in terms of what we do to develop the site in Campbeltown. Michael Russell is right to say that part of that is about marketing. It has to be about marketing, because there is no point in producing a product that does not have a market, and part of that comes down to developing a market. A marketing spend is required.

You make a valid point about not finding the product in local stores. Why is that happening? It is partly to do with what is happening in the marketplace in general and what is happening to cheese marketing in the UK. In the UK market there are something like 70-odd brands of cheddar alone. Creating elbow room for a brand in that marketplace requires significant effort and expense. Have we put sufficient effort towards it? Probably not, because the market is changing very rapidly.

I keep returning to the same point. We are a farmer-owned business. The capital for all that work comes from farmers. When the market situation means that prices are really under pressure—as they are at the moment—where does the capital spend come from?

Michael Russell: Are you saying that you are not capable of taking the brands and making them work?

Nigel Evans: No, I am not saying that. I am saying that it needs more effort.

Michael Russell: Are you capable of that effort?

Nigel Evans: Yes.

Michael Russell: Are you telling your members that that effort will produce results? They do not see that because they are now the poorest paid of all the suppliers. When will they see the benefits of their faith in you and your management team?

Nigel Evans: You ask the question in a way that suggests that the farmers are not seeing the benefit, but I say that they are seeing the benefit. They are seeing the benefit in a number of ways, for example in the investment in the creamery, which is a function of the co-operative—it comes from all members.

Michael Russell: Which creamery?

Nigel Evans: The creamery in Mull of Kintyre.

Michael Russell: So there will be investment in Campbeltown creamery.

Nigel Evans: There is investment, there has been investment and there will be continuing investment in the creamery.

Michael Russell: When will the installation of the new cheese vats, for which the Scottish Government has offered money, take place?

Nigel Evans: Elements of that work have already taken place. We have invested £1.5 million in the whey process, and we are now looking at the boiler section. We have planned a £6 million capital spend over the next few years, as well as further efficiencies in the whey process.

Michael Russell: I am sorry to press the point, but even if I accept that what you describe will produce a more efficient use of resource, I note that you have not said anything about how the product will be pushed and marketed. You are presently selling the product as bulk cheese, not as Mull of Kintyre cheddar. I am sure that James Withers from Scotland Food & Drink will want to come in on this point. How do you make a virtue of your product?

For example, Gigha used to produce Gigha cheese, but there is currently no small cheese producer on the island. Given the success of Gigha halibut, that strikes me as an issue that should be considered. The Isle of Bute produced cheese, but the milk now goes to Cowdenbeath.

How will you make the best of those resources? I am not hearing the detail on that.

Nigel Evans: As James Withers said, if we are going to make the best of the resource that is Mull of Kintyre cheese, it must be done through exports. If we try to carve out a place in the UK marketplace, we are not likely to succeed, because the UK market is dominated by very large brands, but we can gain significant traction in the export market.

Mull of Kintyre has a great provenance in the US and in the middle east. We are continuing to develop those markets as we speak—one of our staff members has just attended a trade fair in California. That is where we get traction and added value for Mull of Kintyre cheese, and that is where the effort has to go.

The process is not easy, but we have to pursue it. It takes cost, time and effort; the results will not happen overnight, but they will happen over time.

Michael Russell: I want to make a final point. As time goes on, there will be fewer and fewer dairy producers in Kintyre, Gigha and Bute because, to quote the book of Proverbs:

"Hope deferred maketh the heart sick."

People cannot go on forever expecting that things will be better this month or next month. There are bills to pay, as Robert Macintyre has just said. There is a heavy responsibility on your company, and—to be honest—I think that you are letting a lot of people down at the moment.

Nigel Evans: I disagree. We are actually supporting an awful lot of people at present in what is a very difficult market, as highlighted by the fact that a number of people who are out of contract are not getting their milk picked up. At least our membership has that as a stopgap.

I agree that prices need to be better, but again that is a function of what is happening in the global markets and how that impacts on us all as dairy farmers. It is interesting that, when one compares prices within the UK and in countries across Europe—particularly with our nearest neighbours across the Irish Sea and in western Europe—one can see that they are going through every bit as much pain as we in the UK are right now.

Michael Russell: Are their prices higher?

Nigel Evans: Their prices are significantly lower. In fact, we heard from Northern Ireland yesterday that prices there are already under 20p a litre. A lot of Irish farmers are being told to expect prices to go under 20p a litre come the spring.

That is a function of the market, and every company that operates in the market has to face that. We, as a farmer-owned company, are no different.

The Convener: We will be trying to find out about comparative prices in further questions. I want to move on to the prices that some supermarkets charge for milk. Dave Thompson has a question.

Dave Thompson: Good morning, everybody, and thank you for coming to the committee meeting. I would like some comments from witnesses round the table on a couple of points. One point concerns the comparison between the farm-gate price and the cost of production. People are getting a lot less than what it costs them to produce.

The second point concerns retailers' margins. I have a graph here and some figures that show that the retailers' margins have increased from 5 per cent in 1996 to 35 per cent in December 2014. That strikes me as a massive increase, and farmers and processors have been squeezed. Again, I would like people to comment on why that is happening and what we can do to redress things a wee bit and get some of the profit pushed back down the line to producers.

Graeme Jack: On the question of how we determine the milk price that we pay, the price that we offer is based on a number of factors, which include the returns that we achieve on the products that we sell and our competitive positioning. Our returns, particularly for cream and butter, have been badly affected by the oversupply of milk and the impact of weakening demand. The value of cream and butter has slid by between 30 and 40 per cent, which has had a significant impact. However, because we continue to add value to farm-gate milk through a range of branded and unbranded products, we are still able to pay a leading price regardless of the overall market situation. That will not necessarily equate with the cost of production, which is an entirely different metric. We have to work with the market that we have, and we consider it our job to present a competitive price within that market.

As for the question of retail prices, my response is very simple: as far as we are concerned, retail prices are a matter for retailers. They are a function of competition between retailers, and we as a business would simply not get involved in the setting of a retail price.

Graeme Dey: What price do you pay at the moment?

Graeme Jack: We pay 25.9p, which is almost 5p higher than the price paid by First Milk.

George Jamieson: I will try to comment on both of Dave Thompson's questions. With regard to the cost-of-production model, about 15 per cent of farmers will get a price based on the cost-of-production formula that is used by retailers such as Sainsbury's, Tesco, Marks and Spencer and Waitrose. The formula is slightly different for each, but the price that they pay is set according to the cost of production. To the retailers' credit, they also factor in family labour, and at the moment, the price is about 30p, 31p or 32p.

I should, however, note a juxtaposition between our organisation and our sister union, the National Farmers Union. It is very keen on these formulas, while we are slightly more circumspect, because we are talking about a minority here. We also believe that we have to be market oriented, and the fact is that there will be times when the market just cannot support a price of 32p.

Before I get the sack, I should point out that price movements lack symmetry. As has been proven in independent university studies, wholesale and retail prices do not go up as quickly as they come down. NFU Scotland has put a lot of time and effort into an objective pricing mechanism, which is actually based on the returns for commodity dairy products such as butter, milk powder and mild cheese. The graphs for that are quite symmetrical; our prices follow it, but the UK prices do not.

There was a bit of a change in 2012 after the code of practice was signed and the mass demonstrations broke out, and our graphs coincided with the European graph for the first time in 15 years. There was a shift from processors and retailers; that took a lot of movement, but there is still a lack of symmetry in pricing. The kind of transparency that we are talking about gives farmers the confidence that the price that they are being paid is reacting to the market. Farmers are realists, and they will work with that if they know why the price is where it is.

Our actual milk price equivalent and milk for cheese value equivalent—or AMPE and MCVE, as we call them—which are the market indicators at commodity level, should be the floor in the market. As James Withers—and, I think, everyone—will agree, adding value through export and import substitution should raise us above that floor. We would have the wherewithal to do that if we had more transparency and a more collaborative supply chain, and we are pressing for both.

There is a real lack of transparency in the liquid market, and I have a great deal of sympathy for processors. We just do not know what is going on; DairyCo, the organisation that collects the data, has given up on liquid milk margins. However, we know that with cheese 50 per cent of the end price goes to the retailer and only a very small proportion goes to the processor, who, I would suggest, is taking more risk. Because of his lack of power on pricing, the farmer is at the bottom of the heap. Transparency is important.

I know I get into retail kicking, but there are some good retailers out there as well as the bad ones, and the code of practice adjudicator needs more powers to look into such things.

10:45

As Graeme Jack said, the wholesale price of cheese and butter has dropped 35 to 40 per cent year on year. The retail prices index on butter has gone up 4.6 per cent year on year, and on cheese it has gone up 1.2 per cent year on year. It has gone down 2 per cent for milk because of the supermarket price wars, but they already take a massive margin on cheese and that has not shifted. That takes us back to price symmetry. With cheese, and to a lesser extent with butter, there is a price lag; I accept that, but wholesale prices have dropped 35 to 40 per cent year on year while retail prices have not moved.

Do not get me wrong: we do not want to devalue cheese or butter, because if the price keeps dropping people will think that they are not quality products. However, in the current situation, when we are having difficulty shifting dairy products and we have too much milk, lowering the price of cheese for the family might shift more of it. There is a question to be answered there, but I do not want the excuse to be that it is all the retailers' fault because it is much more complex than that.

The Convener: You have our support for making sure that a clear message about transparency is central and the committee will pursue that point. Are you concerned about particular supermarkets? You said that you were not talking about all supermarkets.

George Jamieson: We meet retailers and their public relations people. Occasionally we meet their buyers and all the rest of it—I am sure that the processors will have a story to tell there. *The Grocer* has done some really good investigative work. I would not point the finger at anybody in particular, because we see good practice and bad practice.

Tesco, Sainsbury's and Marks and Spencer pay around 32p on liquid milk, which is way ahead of the market. On other branded milk, the farmer does not have that guarantee. The supermarkets could be buying Robertson's milk and its farmers could be getting paid 26p or 27p because that is what the business can afford to pay at the moment. The supermarkets are doing the right thing on liquid milk but, on branded liquid milk, cheese, butter and yoghurts, they drive as hard a bargain as anybody else. There is a bit of smoke and mirrors, because there is good practice and bad practice.

We hear that Aldi and Lidl are difficult companies to work with, but they are straightforward. A lot of what I say could be perceived to be anecdotal, and it probably is. We hear stories of farmers having to pay to bid for a big supermarket contract and buy shelf space. Small cheese companies in places such as Orkney and Kintyre cannot compete in that market.

I would not point the finger at anybody in particular.

The Convener: It sounds as though the little dark back shelf in the supermarket in Oban was not paid for. The company might have got more if it had been able to pay for something more prominent—who knows?

We go to Robert Graham for more answers to Dave Thompson's question.

Robert Graham: Our business purchases about 12 to 13 per cent of all the milk that is produced in Scotland, from approximately 10 per cent of all the farmers. It is interesting that George Jamieson talked about the cost-of-production model, but that applies only to liquid milk and not to cheese, yoghurt or butter. Of the butter that is sold in the UK stores of some of the retailers that have cost-of-production models, 75 per cent comes from Denmark.

We are a private business and we pay 26.5p to our farmers, which is the highest price paid by any of the dairy companies in Scotland. Our family business has existed since deregulation and our record is second to none. The price that private businesses such as ours pay to our farmers versus the position of farmer-owned businesses—there are two main operators in Scotland—is significantly different. As a private family business, we do not ask our farmers for capital investment on top of paying a lower price.

We invest our own money and take on risk ourselves. Our margin last year was less than 2 per cent—that is a profit of 2p in the £1. It is good that we are making a profit, but this year we will put three times what we make back into capital investment in new product development and new product capability and into investment in our brand. It is a question of having the right management and working hard—as our farmers do—to deliver on all the opportunities, whether in processing or through investment in building brands.

What Mr Russell said about our business was very kind. It takes a long time for a family business to build a brand. It involves a lot of firepower and a lot of hard work, which we put in. We invest our money and we try to look after farmers as best we can in tough retail times.

I cannot talk specifically about retail prices, but I think that retailers do not have much margin on milk because of the ferocity of the competition between all the retailers. There has been a seismic shift in the retail world because of new entrants and because of consumers changing their shopping habits and switching from large stores to smaller stores. Unfortunately, we are seeing the effects of that seismic shift in the retail aggression that is evident.

Jim Hume: I will follow up on what George Jamieson said about DairyCo. It still produces a league table, albeit that it does not put in what the margins are. There is quite a large variation across the UK. As of November 2014, Dairy Crest paid producers 36.54p per litre, whereas Dale Farm in Northern Ireland paid 22.93p per litre. That is a 59 per cent difference across the UK. Why is there such a disparity in what farmers across the UK are being paid for their milk?

Robert Macintyre: My view is—I am sure that everyone in the room agrees—that the supermarkets are extremely powerful. They control what happens. We have heard the views of George Jamieson and Robert Graham on the supermarkets, and we heard from a gentleman—I do not remember who it was—who said that the supermarkets used to have a margin of 5 per cent but that it has gone up to 30-odd per cent. They will have such margins as long as we produce the milk.

However, we are now in a situation in which it does not pay us to produce milk. If Robert Graham's producers are receiving 26p, it will not pay them to produce milk, either. The NFU Scotland submission says:

> "For clarity and context the current cost of producing a litre of milk is in the region of 30ppl".

How long will it be before we go bust and the bank says that we cannot write cheques at the end of the month? For many of us, that time is with us.

George Jamieson was one of the commentators from the NFU who encouraged us to produce more milk over the past 18 months. We produced more milk, but that is causing a huge problem. We got no advice on where that milk was going.

We are in a critical situation. If farmers go out of business wholesale, where will the milk come from? We have a huge surplus at the moment, but in a short time there could be a downturn. The vice-chairman of First Milk, whose farm is in a better part of the UK for producing milk, said that his cows will be out grazing grass in February. If there is bad weather, my cows will not be out grazing grass until the beginning of May, so I face extra costs, as do other Scottish farmers. It is an ill-divided world.

The Convener: Does Kenneth Campbell have a view from his neck of the woods?

Kenneth Campbell: George Jamieson mentioned the cost of production. There is no question but that that cost is about 30p for most people. My cost of production is a good deal higher than the milk price that I get, but I am dead against cost-of-production models for pricing milk. As producers, we need to be fit to operate in a global market. If we are not fit to do that, we need to rationalise until we are ready to do so. If we cannot do that, there is no good in what we are doing.

It has been said more than once that the clarity of milk pricing is the most important thing. Cost-of-production mechanisms are cloudy and are difficult to measure and understand. We have a far fairer milk price now than we perhaps had before the voluntary code and before Arla got so involved in the United Kingdom.

In essence, I do not like cost-of-production mechanisms. We need to live by the market a wee bit. Some things could be done in the short term, but I do not think that we want knee-jerk responses that artificially increase the milk price.

Michael Russell: I will press Kenneth Campbell a little. Is it acceptable if the global market dictates that there should be no milk production in Bute, Gigha or Kintyre?

Kenneth Campbell: That is an issue for the Scottish Government. To go back to the question that was asked earlier, there is a limit to how much the other Scottish milk producers can subsidise people—with respect to them all—in Gigha, Kintyre and Bute. I wish them every success, and they are in a terrible position just now, but if their cost of production is going to be 3p higher than everyone else's for ever and a day, it will be up to them—and up to the Scottish Government, to a degree—whether they produce milk.

Michael Russell: Do you not think that we have got this rather wrong? The end point of your argument is that those who can produce milk cheapest, wherever they are in the world, will be the ones who produce milk, and those who have higher costs of one sort or another—no matter what the quality of the product is and no matter what can be done with it or is not being done with it that could be done with it—will go out of business. Frankly, if we apply that model to agriculture and to rural life, it will not just be an ill-divided world, as Robert Macintyre said—it will be a world that not many people wish to live in. It is a little unfortunate for economic determinism to be absolutely the only way in which we can decide how to organise our agricultural and rural industries.

Robert Graham's submission—if you have read it—projects a very different view, whereby we can have imaginative, fleet-of-foot businesses that want to compete globally and can do so with different cost bases, because they are better at doing it and are selling a valuable product. Is that an equally valid alternative?

Kenneth Campbell: Entirely—I could not agree more. However, such an approach takes time and a great deal of money.

Michael Russell: It takes a lot of imagination and persistence. The one issue on which I might agree with you is that the Scottish Government and local authorities require to be flexible to support such an approach. For example, for Bute, introducing a system whereby empty tankers do not pay full ferry fares when they return to the island would be a very small adjustment to our overall policy that could make a difference.

The Convener: Many people want to come in on quite a lot of questions, but I invite Alex Fergusson and then George Jamieson to speak on this point.

Alex Fergusson: I can save you a little time, convener, because we have moved on from what I was going to ask about.

George Jamieson: I will cover Jim Hume's query on the diversity of pricing and chip in on Mike Russell and Kenny Campbell's spat.

Michael Russell: Our discussion. [*Laughter*.]

11:00

George Jamieson: There is certainly a place for all the things that have been mentioned. For years, Finland and Italy have had the highest milk prices in Europe. They have the highest production costs in Europe and they get the highest price for their milk because they have developed brands with protected geographical indication and protected designation of origin. They have worked hard at that.

I spoke to a chap in Parma in Italy who sells a bespoke cheese. He met 100 customers in the UK, from corner shops to Asda. I asked how he sold the cheese to Asda, and he said, "I just told them what I wanted, because they can't get the cheese anywhere else."

We have failed miserably to compete at that level. We have a liquid-milk market that is the envy of the world, but we have abused it. The retailers use it as a wee badge of honour, but we do not get the benefits of it, and neither does the supply chain.

To go back to the point about diversity in prices, one reason why the retailers are prepared to pay for a cost-of-production model is that those guys need a flat profile, which is a much more expensive way to produce milk than spring calving. The same level of milk has to be produced all the time, which means that the animals must be fed at the same levels in summer and winter. Kenneth Campbell's costs will be higher than those for a lot of people on grass-based systems, but the retailers want that profile.

In 2007, there was a massive spike in dairy products. The retailers knew that the British housewife needed fresh milk, so they introduced cost-of-production models and ring fenced a lot of the more efficient flat-line producers to produce liquid milk.

On Mike Russell's point, I absolutely agree that we cannot afford to be without peripheral milk fields, because they are so important for the local economy. There are good farmers in Bute, Kintyre and Orkney, and I have been there several times to help with things. More collaboration is needed between the farmers, between the factory and the farmers, and in the marketing. We need to put a lot of effort into that. The Scottish Government can help, as it can help Robert Graham, but investment is needed.

Paul Grant and James Withers are working on that, but more is needed. I argue that match funding is needed. If Robert Graham is prepared to put £300,000 into a television advert, can we get some money to entice him to double that? We can do both the things that have been mentioned.

Where Kenneth Campbell is farming, he is getting an Arla price, which is a European price. To move on to Jim Hume's comment, the big difference is that the price for the retail-aligned producers is 32p, and they have since 2007 consistently had the highest milk price. There was a period in 2013-14 when the market price overtook the cost-of-production model, which was because the market was working. The code of practice had been produced, and processors had put in place different pricing systems.

To reply to Robert Macintyre's comment about asking people to produce milk, in 2013-14 we never asked anybody to produce more milk. The review by James Withers, which we are fully behind, said that we can grow our industry by improving our marketing and investing in processing, and production will react to that.

The reason why there was too much milk around the world in 2014 was that everyone was getting good prices because the market was strong, and every region in the world had good weather. If cows are turned out, they will—even if someone is the worst farmer in Scotland—produce more milk in good weather than in bad weather.

The issue is alignment. We need to market, process and milk, and those elements have to be in line. In terms of price variation, cost of production is at the top, but since 2012 there has been a change in attitude and processors have put in formulaic pricing that reacts to the market. Dairy Crest has a formula that is based on cost of production and the markets, and the price is still sitting at around 28p. Dairy Crest Direct, which represents the farmers, has acknowledged that that is slightly higher than the market can stand, and it is prepared to take a penny off the price in the company's interests. That is collaboration.

Müller Wiseman offers a pricing formula that is similar to NFU Scotland's formula, which is based on the AMPE and MCVE model. For a good part of two years, that formula paid more than the standard litre, and now it is paying below the standard litre.

There are different areas. Arla is paying a European price: it is a co-operative price that is agreed by the farmers. The mechanism by which Arla pays its price is agreed by all the farmers in Europe. Basically, it is set according to how much money Arla brings in and how much it spends every month. The rest goes to the farmer, minus the capital retention. That price is now around 24p to 25p, but that is what Arla is making.

Twelve months ago, Arla's price was around 34p to 35p, because that was what Arla could afford to pay. The co-operatives are paying as much as they can. First Milk cannot pay as much because its business is not returning as much at present—that is because of the particular circumstances. The public limited companies are taking their profit and paying as much as they can.

Robert Graham's price at the moment is higher than that of Müller Wiseman Dairies, and the Dairy Crest formula price is higher. That is a good thing because, in the past, all the liquid processors paid the same. If one price dropped, they all dropped, and if one lifted, they all lifted. We now have diversity, which tells me in one of my optimistic moods that the processors are starting to pay as much as they can.

The Convener: We have a lot of questions to deal with, but that was a very good explanation. I thank you very much for the detail.

We need to round things up, as we are on our second question out of around 10.

James Withers: I have a couple of quick points to make. I feel compelled to support where I think Kenny Campbell was heading. I, too, have a problem with cost-of-production models. I do not know of many industries in the world in which the buyer of a product would guarantee to cover its supplier's production costs, irrespective of what they were.

Farmers need to be able to compete in the marketplace. The key is picking the right battles and the right markets. Let us not take on cheap value cheddar from Ireland or cheap commodities. We need to forget Scotland as a producer of dairy commodities. We should no longer consider ourselves a dairy commodity producer. As I said, it is about picking the right markets.

The challenge that we have is that we have peripheral milk fields and plants. The huge advantage that they bring is their strength of provenance. It is almost the case that, the more peripheral it is, the better the brand can be and the better the provenance story can be. I refer to Gigha and the Mull of Kintyre. We have not talked about Orkney. There is a great island brand with a creamery up there that needs to forge a future for itself. We need to pick the right markets to compete in. Farmers then have to structure things properly.

One issue is to do with farm efficiency and technical operations. The gap between the top performers and the bottom performers in Scotland is too wide. That is a personal view; others in the room can decide whether it is right.

I will join George Jamieson's wave of optimism for a second. On market development, individuals in Tokyo, Toronto and the middle east are as we speak working on behalf of the industry and Scottish Development International to look jointly at dairy opportunities and speak to importers, distributors, brokers, retailers and the food service and catering sector. We in Scotland have more support than we have ever had for international export development to drive into the new markets. The answer lies in having that and a balance with the added value in local markets.

On Dave Thompson's point about supermarket pricing, my plea to the committee is not to spend too much time trying to work out supermarket pricing and margins, because that is a road to nowhere. Most of the committees that I have seen trying to do that have given up. I think that DairyCo has given up. The pricing is what it is. As Robert Graham said, a fundamental shake-up is happening in the UK retail sector such as we have not seen for probably a generation. That means that the cost cutting and price cutting to drive footfall in stores will be remarkable. I do not think that we will change that dynamic, but we can be better at building brands, attacking the right part of the retail market and going international.

The Convener: We hear what you say, but obviously we have a wider interest in ensuring that Scotland has an opportunity to sell our premium products. We may well have to ask the supermarkets about some of that, because it is clear that their margins are not helpful to the producer in many cases. Sarah Boyack, Richard Lochhead and I have a long history on the matter going back to the early stages of the Competition Commission's inquiries. We do not yet have any leverage over the supermarkets because Christine Tacon does not have powers in relation to indirect producers. It is crazy that, after 10 years, we do not have some sort of handle on the matter—we still have voluntary codes, for example, which we know do not work in many cases.

That is my little rant over.

James Withers: I would like to respond briefly to the rant. I understand the point. I think that a greater impact could be made by focusing on areas such as brand, market development and investment in processing. People have spent many years trying to tackle the supermarket question, but that has done a bit of a disservice to the industry, as it has distracted from the real issues around farm efficiency, brand development and export development.

The Convener: I do not know whether we have avoided the question of investment; we will probably come back to that in a wee while. We must move on. Judith Bryans is first, and then Alex Fergusson and Robert Macintyre.

Dr Bryans: I will be very quick. On the cost of production, we would reiterate some of the things that other people have said. The cost of production is not market oriented and there is a great diversity in it. Variables change, and it can be very difficult for a processor to accommodate that and still be competitive in the national and global markets.

I was delighted to hear James Withers mention the food service sector. We have talked about retail and we recognise that retailers are the route to market for most dairy products, but the food service sector and public procurement are another big route through which dairy products can reach people's stomachs, if I can put it like that. One thing that could be quite helpful for the dairy industry would be more procurement by hospitals, schools, prisons or whatever of Scottish and British products. That would be quite helpful and useful.

My point is that the dairy industry is not just producer, processor and retailer. It is far more complex than that.

The Convener: We have to think about diet as well, which is an interesting sideline in the year of food and drink.

Alex Fergusson: The NFUS included in its written submission a floor price for milk. It suggested that the Scottish Government and the UK Government should make representations in Europe for an increase in the intervention price for milk, which is currently very low—it is something like 12p a litre. Will you explain, in one short sentence, what practical difference increasing it to 17p a litre—or 14p, 15p or whatever—would make to the current situation?

George Jamieson: Can I have three sentences? [*Laughter*.]

In 2007, there was a bit of a sea change. The McSharry and Fischler reforms moved all agriculture away from market support, as far as that was possible. The Commission reduced the reference price for intervention for skimmed milk powder and butter. The ballpark figure for skimmed milk powder in the 10 years up to 2007 was around €2,000 a tonne. In 2007, it dropped to €1,740. In recompense, farmers were given a 2p to 3p dairy premium, which became part of the single farm payment, as an acknowledgement that Europe could not afford all that market support; the plan was also to drop the price so that Europe could compete in a growing world market.

In 2007, there was a perfect storm—in a good way—for the industry, because prices rose hugely, to $5,000 per tonne. Since then, the average price of commodities has gone below $5,000. There was an expectation that it would not go below $3,000, but this year it has gone below that.

My point is that the reference price for intervention is at €1,740, which is equivalent to about £1,400 a tonne, and the UK price for skimmed milk powder is around £1,400 a tonne just now. Therefore, for me, the intervention price is too low in the context of the current cost of production and the value of commodities, which have risen considerably since 2007. Bear in mind that the intervention price was meant to be a floor in the market. In effect, you could take 250,000 tonnes of skimmed milk powder off the market: 109,000 or 110,000 tonnes at the intervention price, with the rest tendered. In 2009-10, 250,000 tonnes of skimmed milk powder were brought into intervention; that is about 2.5 million litres of milk equivalent. That worked; it stopped the decline in 2009. Not only that, but the Commission made money out of every kilo of skimmed milk powder, because it very carefully leaked it out on to the market at an increasing price level.

We have been calling for a review of the reference price for months, and everybody is joining us now. Why is it still at €1,740 a tonne, and where should it be?

We are the last to ask for too much market intervention. We were quite in favour of most of the soft-landing agreements in Brussels, but the reference price is now too low. I would like the boffins in the Commission to reconsider the level that it should be. I argue that it should be about €2,000, which would take us back a few months. We could have intervention now. We could have powder in store, which would take the pressure off First Milk's powder price, for example.

11:15

There is a bit of doubt in the Scottish Government about how quickly the price can be changed. It has to go through certain processes. I read an article on this yesterday. The Commission seems to think that it has control, and the Parliament thinks that it has a say. I want some clarity on that—I will try to find out myself. There is a bit of a debate about who can change the reference price, but I believe that some effort should be put into looking at increasing it.

Mr Hogan believes that we should leave the reference price alone, but he is from Ireland and he might want to put everyone else out of business and keep the Irish, who have low costs, in business. We need to examine the issue. It is an issue not just for Scotland and the UK, because there are a lot of farmers in Europe who cannot afford £1,400, which works out at 12p or 13p per litre.

The Convener: We will speak to the cabinet secretary next week about the matter and any others that relate to the next agriculture council. We believe that he has already asked the UK to raise the matter, so that is in hand.

We will hear next from the two farmers—I know that there are more than two farmers here—Robert Macintyre first and then Kenneth Campbell.

At least we have dealt with question 10.

Robert Macintyre: Convener, am I allowed to take issue with other points of view?

The Convener: Yes.

Robert Macintyre: Well, I take issue with George Jamieson. He talked about Tesco and Sainsbury's signing up farmers because they are the most efficient, but I would say that they sign them up not because of their efficiency but because of where they are geographically placed.

George Jamieson: I agree.

Robert Macintyre: Judith Bryans said that we need to do this and that, but those things are in the future and they will take time. We do not have the time. Our backs are right against the wall. The general view on our island, and probably in Kintyre, is that the actions that Nigel Evans and First Milk—of which we are all members—had to take in delaying payments may have stabilised First Milk's business, but they have jeopardised many of its members' businesses.

As I have already said, where we go from here is a huge worry. I ask Nigel Evans whether I am right to say that, last March, we lost a Wiseman contract for 200 million litres a year. Since First Milk lost that contract, we really do not have that lucrative market in liquid sales. That 200 million litres of milk was diverted to powder and cheese, which attract a much lower price. Now we face the loss of the Russian market. The Russians took £350 million-worth of dairy products from this country. All those factors combine to put us in a position where we get up at 5 o'clock every morning to work for nothing—no one else in the UK does that.

The Convener: Michael Russell reads his meeting papers at 5 o'clock in the morning—you are not the only ones who get up at that time.

Robert Macintyre: Yes, but he's not working for nothing. [*Laughter*.]

The Convener: I take your point.

Michael Russell: Robert Macintyre is right—I am paid to do that.

The Convener: We can raise with the cabinet secretary the issues that have been brought to our attention, particularly around what the Scottish Government can do to help at this time.

Kenneth Campbell: I agree entirely with George Jamieson about raising the intervention price for commodities in the short term. I talked earlier about the rationalisation of the dairy industry, but this spring we will not see rationalisation; it will be far worse than that. It will take out many farming businesses that hitherto thought that they had, and deserved, a good future in the dairy industry. They will be caught out of contract or get taken out of business for various other reasons. We will lose not just the weak, but a cross-section of the whole industry. That is very worrying. A rise in the price of skimmed milk powder could go some way towards preventing that.

The Convener: That is helpful. We must move on.

We have a general question from Jim Hume, which I hope will not take up too much time.

Jim Hume: It might do.

The Convener: I hope not.

Jim Hume: To be honest, I have not been convinced by the supply-and-demand argument so far. According to the facts that we have, production in Scotland has stayed fairly stable over the past 30 years. I wonder whether this is just a blip. We have heard about the peaks and troughs in supply and demand and prices throughout the years. We already know that the Royal Association of British Dairy Farmers thinks that the Russian ban, which might not be around for ever, has cost dairy farmers 2p to 2.5p per litre. Arla has stated that there has been a change in the growth in demand in China, but growth is still taking place; it has just changed from 10 to 2 per cent. It is not as if the Chinese market has collapsed.

What are people's views? Is the glass half full or half empty? Is this simply a blip? Is it something short term, medium term or longer term? If you can survive, might you be looking at a rosier future?

Dr Bryans: We know that global demand for dairy is still growing, but what that growth actually is depends on who you listen to. According to the Food and Agriculture Organization of the United Nations, demand is growing by 2 to 2.5 per cent every year in south-east Asia alone, and with that desire to consume dairy products, it is predicted that there will be 125 per cent growth by 2030. We are also aware that demand will increase not only in south-east Asia but in China, sub-Saharan Africa and Latin America. These things are going to happen in the future as quota ends and as more European milk production heads north and west towards countries such as the UK and Ireland. There are, therefore, opportunities for the future.

I do not like to talk the dairy industry into the ground, because I think that its future has potential bright spots. However, it will always have areas of volatility. At the moment, for example, Chinese farmers engaged in joint ventures with European countries are making their own profit warnings, and some of them are throwing away milk. China is still sitting on and using up a lot of stock, and some have said that, because of the oversupply of milk, it will use up that stock until the prices drop. Then it will come back into the market and start sweeping up the supply of powder again. When some of the production equalises, we will be back on a good footing. That is why institutions such as Rabobank are predicting that we will be on the incline again towards the second half of the year.

Of course, none of us has a crystal ball, and given what happened last year, we are loth to make too many predictions, but we think that the industry has a bright future. Global demand is increasing; the difficulty is that we had so much excess production in 2014 that supply is still outstripping demand.

Our organisation is bringing the European Dairy Association congress to Edinburgh in October to allow the industry to talk about investing in British dairy. We definitely do not want to talk the industry into the ground, but we certainly recognise all the hardships. I have 200 members; most are small to medium-sized businesses, but some are the very large organisations that are the household names, and across the board—from farmers to processors—things are tough out there at the moment. However, the future is bright.

I am sorry, convener—that took a while.

The Convener: It is helpful to be concise, but it is also important that we understand the detail.

Graeme Jack: I just want to give you our take on Jim Hume’s question. I think that, as far as the industry is concerned, there will certainly be short-term pain but there is also cause for optimism in the medium to long term.

Perhaps I can put some metrics around what I have termed the short-term pain. With regard to the impact of the ramping up of milk production in the UK over the past year, I was struck by the statistic that every week an additional 825 milk tankers-worth of milk is being produced in the UK. That is an awful lot of milk and, quite simply, the UK does not have the processing capacity to deal with that volume of milk right now. Therefore, the reality is that, of necessity, some of it has to be diverted into the low-value-base commodities.

In the medium to long term, the Scottish and British public want to buy products that are made in Scotland and Britain from milk that is produced by Scottish and British farmers. As we have said, there is a deficit, but I can give a good example of how that demand can be satisfied. We spent a fair amount of money on a butter plant, which was commissioned about a year ago. It is now working at full capacity and producing about 40,000 tonnes of butter a year, 30 per cent of which is being exported to Europe and to places as far afield as Egypt and north Africa.

At a national level, we and Arla and, in Scotland, Robert Graham are investing because there is an opportunity. However, no processor can buck the market. We are having to deal with severe overproduction and a weakening in demand. I understand Jim Hume’s cynicism, but the short-term reality that we have to work through at the moment is that the value of the commodities has collapsed and the returns are not there.

Müller UK & Ireland would err on the side of optimism and ambition for the UK dairy industry, because that is how we see it.

The Convener: We must try to be concise and not continually repeat points about investment, the details of which we quite clearly have now.

George Jamieson: I agree with everything that Judith Bryans says—that will save a lot of words.

There is general optimism. I do not like the word “blip”. I mean no offence, but George Eustice used it and it infuriated me. Kenny Campbell and Robert Macintyre will tell the committee that it is not a blip but a longer period of very low prices that needs exceptional measures to be taken. If that happens, we will get the benefit of all the prospects that Judith Bryans mentioned. It is more than a blip; it is really serious. For George Eustice to use the word was a wee bittie disrespectful to the farmers who are having a really hard time.

I agree to a certain extent with what has been said about the extra 800 tankers-worth of milk, but this is not the biggest milk production year that we have had in UK history. In May and June, we produced something like 42 million litres a day and now we are down to 37 million litres a day. I suggest that there is processing capacity; it is just that we do not have it in the right markets. The extra milk that an individual company cannot handle is being put on to the spot market and nobody is picking it up to add value to it. The problem is not the extra milk but our inability to put it into products that have a strong market. There is definitely potential there.

The way forward is to develop more collaboration between farmers, processors and marketers. I am repeating myself, but that is the key to it all. The code of practice is fundamental to that. Everybody should buy into it; if it is not what people want it to be, we will change it. However, we need to get collaboration because the countries that are successful have been collaborative. FrieslandCampina, Arla and Fronterra all involve collaboration. It does not need to be done through co-ops; it can be done through public limited companies that work well with their farmers.

Nigel Evans: I will reiterate one or two points and put a bit of colour around them.

As Robert Graham said, when increased production starts to come through the marketplace, we get tankers of milk floating around. Where does that milk go? It does not go into added-value markets or existing reasonable-value markets; it goes straight to the bottom of the market. That is the issue.

When the market is on the way down, it drops incredibly rapidly but, when it starts to rise, it rises very slowly. In fact, we could argue that it rises twice as slowly as it falls. That creates a problem. The issue is how long it stays down, because that, ultimately, affects the sustainability of anybody who is in the industry. The longer it stays down, the harder it is.

Will the market go up again? Yes, it absolutely will. I think that the long-term price trend for the industry is upwards, but each peak will be higher than the last peak and each trough will be slightly lower than the last trough. The volatility that has resulted in a 40 to 50 per cent drop in price is here to stay because of the lack of support in the marketplace.

11:30

Robert Graham: I agree with a lot of what George Jamieson said about farmers and processors working closely together. We must work together to increase milk production and to increase sales, but we need more investment in more products. On average, our 90 farmers were up 9 per cent on milk on the year before, which represents 10 articulated lorry-loads or 300,000 litres of milk a week.

The voluntary code has been mentioned a few times.

The Convener: We are about to come on to that.

Robert Graham: Okay—I will leave that for now.

The commodity markets tend to overcorrect at the top and the bottom. When the commodity markets were high, there was a lot of talk about that being the place to be. Some farmers were encouraged to join First Milk not as co-op members but as commodity contract suppliers. Come the end of March, many of them will not have a business, because they are not needed as commodity suppliers. That is concerning.

We must remain focused on what we are trying to do, which is add value. The commodity markets will correct themselves, but as far as opportunities are concerned, whether with butter, cheese or yoghurts, there is a lot to go at. As a business, we just want to have the chance to crack on with that.

The Convener: Claudia Beamish has a question—let us hope that it is not a long one.

Claudia Beamish: It is a quick question, for Judith Bryans.

I seek reassurance about the medium and long-term picture. If I heard you right, you seem fairly confident that the Chinese market will improve. What do you base that on? Some economists would say that there are many question marks over that. When we are talking about the global situation, to be frank, I think that it is dangerous to make statements about the future when there are arguments on both sides.

Dr Bryans: For sure. As I said, none of us has a crystal ball. After what happened last year, we cannot predict what the situation will be, but we must look at what other people who are in the business of predicting are predicting.

As I said, the Chinese have had profit warnings in relation to some of their joint ventures and some Chinese farmers are throwing their milk on the ground, but the Chinese have large stocks, which they are progressively using up. Rabobank and others that are in the business of analysing what China is doing, looking at how its stocks are and assessing when it might come back into the market have predicted that that might happen in the second half of 2015.

We think that the next few months will continue to be difficult, but we have seen some small positive signs. I would not bet my house on those small positive signs, but we must recognise that milk is an aspirational product in many countries. There is global growth. New lives are coming into the world and, as people's economic situation improves, they want more dairy. In addition, we have a growing ageing population, which presents opportunities for the dairy industry. We need to maintain consumption in the UK. The massive growth will be in other areas of the world, but we see a bright future for dairy from the predictions of those who do the analysis.

The Convener: Jim Hume has a final point on this area.

Jim Hume: I want to sum up the points that have been made in response to my question. What has come out from what Graeme Jack, Robert Graham and George Jamieson have said is that there is a lack of capacity for processing. Milk is not just milk; it can be made into many things. However, if it is not possible for it to be made into those many things, that causes problems for liquid milk. For me, that came out of that question quite strongly.

The Convener: We will now hear from James Withers.

James Withers: You said that rather reluctantly.

I have a point to make about the global situation. Nigel Evans said that the peaks will be higher and the troughs will be lower. I think that that is true of the global market, but it is important that we do not view that as being Scotland's destiny. We can get off that rollercoaster. I do not see a future in which we will be exporting a huge amount of product to China. Even if we exported all our cheese, we would barely feed a suburb of Shanghai.

I think that our opportunities lie in targeted markets. Other sectors have done well by following that model. Salmon is a good example. In China, Scottish salmon producers are not competing with Norway at retail level; instead, because of the amount of product that they have, they have gone to the top-end hotel chains—the Shangri-Las and Ritzes. There will be a global up and down, but I do not think that that is Scotland's future. We can avoid the global peaks and troughs by targeting the premium end, which will hold up even in the toughest markets.

The Convener: We are going to have to support our producers in the meantime because we are not aiming at making the kind of cheese that they have in America that is only for pizzas or burgers. We are at the quality end. We will explore those issues in due course.

The problem that we face is that we have a voluntary code of practice that was introduced in 2012 and, in 2014, we agreed that it should continue. It covers 85 per cent of UK milk production. Should it continue as a voluntary code? Are some producers, processors and retailers not covered by the code? In light of recent experience, are further changes to the code needed?

Robert Graham: We have a huge issue with the voluntary code. When I started in the family business, fewer people were working in it than are sitting round this table. The dairy was a fraction of the size of the room that we are in. We compete with other private businesses and with co-ops in the market and for the supply of milk. Co-ops such as Arla, which is a global £25 billion behemoth, pay a European price. They still pay 2p a litre less than we do, but we will compete against them in the contracts that we will tender for this year.

The voluntary code is biased towards co-ops such as First Milk and Arla and against Scottish private family businesses. A Danish co-op can hold on to farmers for 12 months according to the voluntary code, but I can hold on to mine for only three months. That brings us a whole lot of challenges for maintaining our supplier base. Of course, we pay a great price and our suppliers deal with us personally.

It is not right for such a bias to be in place. First Milk has challenges and is of huge importance to peripheral areas. However, even though there is a massive difference in price per litre and capital levy, farmers cannot leave First Milk with less than 12 months' notice, and they cannot get their capital back for goodness knows how long. It is not fair that the voluntary code should be biased against a private family business that works hard.

Graeme Jack: Our business's feelings about the voluntary code are similar in some ways. The code is a source of some frustration, but we comply with its spirit and intent. We give our farmers one month's notice of any price change and, if they are unhappy, they can give us 12 weeks' notice and move to another buyer. Our contract is characterised by simplicity and flexibility. It is as simple as that.

It seems to be acceptable in the UK dairy industry that farmer co-operatives can send their members new prices by text with two or three days' notice but can insist on a farmer giving 12 months' notice if they are unhappy. That is not a level playing field and it is a matter of some frustration, but we have decided that we will continue with our approach because it is part of our offering.

In Scotland, we have 263 farmers supplying us, and we had 23 new starts in the year up to 1 April 2014. I suspect that we would have had considerably more than that had freedom of movement been applied across the industry.

Nigel Evans: The code of practice has been useful, because it has brought a lot of issues out into the open and everybody has dealt with them. Is it perfect? From our perspective, it is not, because some elements of it cause the business difficulties. One example is the fact that we announce a price at least 30 days before we implement it. Having to do that when we are in a falling market situation creates difficulties, such as in trying to match income against what we are actually paying. Quite often, we are up to 10 to 12 weeks out by the time that we have got cash in for the milk that we have paid for.

To answer the criticisms or, I should say, comments on the 12 weeks versus the 12-month rule, the 12-month rule was an EU function that it was agreed should sit in the code. Why does it sit there? Why was it felt to be of use to farmers? A co-op is owned and managed by its members, and we have a governance structure that allows members to appoint people to the board and to have a say in how the business is run. Ultimately, the farmers help to set the price in the business. However, with a business that is a private company, farmers do not have any insight into or ability to influence the price; they are simply given or dictated a price. That situation creates a differential in the leaving terms for farmers.

As farmers in a co-op, we put cash into the business, so we have a right to control it. We do not tip up at board meetings at Müller Wiseman or Graham's and we do not have any say in how those businesses are run, but the farmers in First Milk control the business. That is why there is a differential in the leaving terms.

Graeme Dey: To make an obvious observation, what you say might well be the case, but those other companies are paying a better rate than you are at the moment, so perhaps it works better with them.

Nigel Evans: The operative words that you just used are "at the moment". When we look at prices over periods of time, we see a lot more commonality of pricing. The truth is that, because of product mix and the different markets that companies work in, there will always be differentials in pricing. Taking as an example the skimmed-milk powder pricing that we have talked about, it is trading at a price equivalent to 14p a litre, but 12 months ago it was trading at a price that was nearer 40p a litre. That kind of situation has a substantial impact on the pricing of different elements of the market.

Graeme Dey: So if we were to look back over the past three years and analyse the price that was being paid by the private companies as set against the co-operative's price, are you telling me that the co-operative would be performing better in how it responded to its members or worse?

Nigel Evans: Do you mean in terms of our price relative to that of our competitors?

Graeme Dey: Yes.

Nigel Evans: We would be performing a lot better.

Graeme Dey: Okay.

The Convener: We will find out.

Michael Russell: We should get that analysis, convener.

The Convener: Yes, that would be a good idea. We could do with seeing some of the figures, given that we have been talking about transparency. It would be good to have the figures for the past two or three years. We will hear from Robert Macintyre now on this point, then finally from George Jamieson.

Robert Macintyre: Going back to what Jim Hume said about utilising the capacity that we have in Scotland, I was glad to hear Nigel Evans say earlier that First Milk is going to proceed with new vats and boilers for the refurbishment of the Campbeltown creamery. I am told by farmers in Kintyre who I am very friendly with that the Campbeltown creamery has capacity to utilise 80 million litres a year. Given that 30 million litres a year is being produced in Kintyre, the 15 million litres from the island of Bute could be taken down to Campbeltown to start making "Isle of Bute" cheese again, which was a winner but was stopped in its tracks about six years ago.

First Milk is going to have a facility in Campbeltown that can produce a cheese with the magical name "Mull of Kintyre" and another with the magical name "Isle of Bute". You will have a place to utilise for making top-quality cheese, so I urge you to do that, Mr Evans.

11:45

George Jamieson: On the code of practice, I had the dubious pleasure of being involved in the high-level working group on the dairy package and the code. The dairy package identified two key issues: one was producer organisations and more collective power for farmers and the other was compulsory contracts. Jim Paice and the industry decided that they did not want compulsory contracts. The reason for that was the minimum requirements within those contracts, which they were uncomfortable with—in effect, they meant zero days' notice from both parties. We asked the Government to consider that, to see if it could be made more flexible.

Be that as it may, Jim Paice decided at the time to go for a voluntary code of practice. All parties willingly came to the table, including Dairy UK, the NFU and NFU Scotland. Six people sat through that—sadly—for 14 months. We had a huge amount of discussion back and forward.

Far too much emphasis is placed on the three-month termination clause. If there is a good working relationship, that is not necessary. Müller Wiseman Dairies has had a three-month contract from the word go, and it has one of the best retention policies. Lactalis is similar. They did not need to change that.

For Dairy Crest, another private company, the termination clause was 12 months. It switched to three months almost immediately it signed the contract, and that has not hurt the company; it has helped it. In Dairy Crest, an independent farmer organisation has developed, and it will be applying to become a PO—a producer organisation. Dairy Crest has benefited from that independent farmer organisation, because it is funded by the farmers, and it has full-time members of staff who understand the dairy industry. They can sit beside the Dairy Crest executives and discuss the formula that they have developed, for instance.

Judith Bryans will agree with me that the big impasse involves the difference between the co-ops and the PLCs. On the subject of prices, those of FrieslandCampina and Arla consistently tend to be among the best in Europe. The Arla price in the UK has been higher than everybody else's, but it is now lower, because it is a European price, and it has dropped in that European context.

The high-level working group on compulsory contracts exempted co-ops only if they could pass a governance audit. It was NFU Scotland that pushed that in Europe. We wanted co-ops to be co-ops and to prove that they were co-ops—in other words, that they were run by the farmers. NFU Scotland got the job, under the code of practice, to audit the co-ops. It did so willingly. We spent days with the executives and farmers of Arla and other co-ops. I am not pro co-op or pro PLC; I am totally objective. The code is not being used as effectively as it could be.

When Alex Fergusson chaired the review, we went through the matter in great depth. Both Arla and First Milk have a governance structure that gives the farmers the ability to set pricing and pricing mechanisms. I am not precious about the 30-day notice. Arla sets a price every month based on an objective formula, which is agreed by the council of representatives, who are all farmers. That mechanism can be changed only slightly month on month. After 12 months, it has to be reconciled with the formula. The farmers of Arla want that reconciliation, because it holds management to account. They know that Arla is paying as much as it can. At 12 months, it has to give everything that the farmer is due. It is a farmer decision. If First Milk changes its price, that has to go through the board of directors, a majority of whom are farmers. The structures are there.

I have some criticism—which applies to PLC groups and co-op groups—about the lack of communication back and forward to members. That is a real challenge—we have it, too. However, the structure is in place for farmers to run both those types of business.

Within the review process, we looked very hard at how we could help PLCs. Under the original code of practice, if the farmers democratically say that they would rather have three months, six months, nine months or 12 months, they are perfectly at liberty to do so—they have that option. The farmers supplying PLCs can agree with the company to have a longer termination clause.

Beyond that, although we have not got this into the code yet, we strongly recommended that, where PLCs feel that they do not need a producer group, when the farmer signs the contract, there must be a clear understanding that the farmer fully understands what he is signing up to. The company has to say that it has made the farmer fully aware of what he is signing up to. Especially in 2013, when there was real competition for milk—there was desperation, like when people buy a new car—many farmers signed contracts without looking at them. You might say, "Hell mend them," but that is where we are.

We would like a clause in the contract whereby, if there is no producer group and a farmer signs up, they know very clearly that it is a 12-month contract. There should be clarification about that. There are ways through the situation, and it is not helpful for companies to nitpick at other companies. The co-op has a derogation because the farmers can dictate. A PLC has discretionary pricing, so Robert Graham can change the price without consulting his farmers. That works, as he says, and there is historical evidence that he pays a decent price, so his farmers will generally be happy.

We need to get through this impasse, and there is a way for us to do so if folk will just see that there is a benefit. The opening lines of the code of practice talk about improving supply chain relationships for all parties, and that is crucial.

The Convener: Would it be possible for the Scottish Government to introduce a compulsory contract in Scotland? If so, should it do so? If not, should it call on the UK Government to do so? We have reached the point of another crisis, which is one of many.

George Jamieson: The explanation is quite technical and detailed; I will let Judith Bryans speak on this point too. The technicality is that member states can opt for a compulsory contract, for which there is a very clear minimum standard.

We have asked the Department for Environment, Food and Rural Affairs to do an impact assessment on a compulsory contract, because we do not believe that it is as bad as it may appear. The fear—Judith can correct me if I am wrong—is that, as things stand with the European dairy package, if a price changes at all, the change has to be negotiated and, until that time, the contract is broken.

If we are to go down the route of compulsory contracts, we would like an impact assessment to be done first, but we would far prefer that the voluntary code worked. If an impact assessment was done and there was some flexibility, we would look at that. We would argue that there must be negotiation on a price change, but a change should not mean that the contract is broken—it should mean only that the specific clause has to be negotiated. That is what I would want to ask of the European Commission.

Dr Bryans: If we are to look at the idea of a compulsory code, there are, as George Jamieson said, things in the EU package that are a minimum. DEFRA has consistently interpreted what is in the EU package to mean that, every time there is change, a new contract must be given over.

When there is an oversupplied market, that would mean lack of security for the farmer. Farmers could lose contracts because a new contract would have to be put in place, so a compulsory code could be counterproductive.

Alex Fergusson: I will add to that briefly, if I may. In my view, the beauty of the code remaining voluntary is that it allows flexibility—the word that George Jamieson used—to be maintained for the parties who are negotiating a contract. That flexibility also allows any PLC, whether it is a family company or otherwise, to negotiate 12-month contracts with its producers if it wishes to do so.

I have discussed the issue with Robert Graham in the past, but I am not totally convinced by his accusation of bias, which is a little bit strong. The flexibility in the code allows for differentiations of contract to be negotiated. That is part of the beauty of it, and I think that such flexibility would be under threat if the code were to become compulsory.

The Convener: We will mull over those points.

Dave Thompson: I have a small point. I notice that 12 member states have gone down the road of compulsory contracts. Is there any evidence that they are doing better or worse because of that? Perhaps we could get a bit more information on that; I do not know whether anyone round the table has any such information.

The Convener: Does anyone have any information about the 12 countries that have compulsory contracts?

George Jamieson: I do not have any.

Dr Bryans: We have looked at those countries to see what is happening. They all seem to have interpreted things slightly differently, but it is clear that the code as it stands was never put in place to address pricing. No compulsory code that could be put in place would address pricing or volatility.

The Convener: Thank you for that. David Stewart has a question.

David Stewart: Earlier this morning, we touched on how we develop an export market for Scottish milk. Can the panel give us more detail on that point?

James Withers: Almost exactly a year ago, a new export strategy for Food Scotland was launched. It was the product of a partnership through Scotland Food & Drink with most of the main trade associations, covering seafood, salmon, bakery, red meat, dairy and whisky, to determine what our priority markets would be. Fifteen key markets were identified and in the top seven—North America, France, Germany, the middle east, Japan, Hong Kong/China and south-east Asia—new dedicated food and drink specialists will be put on the ground. That was modelled on what some other countries, such as New Zealand, Ireland and Scandinavia, had been doing for years.

The delivery model was developed through Scottish Development International. Scottish ministers and SDI put money in, as did industry bodies—about £400,000 over a five-year plan. The team of 10 specialists, which builds on six that are already in place, will be phased in over two years. Their job is very simple. They do not sell products; they build relationships across retailers, the food service sector, the supply chain, distributors and importers to look for opportunities to develop exports.

The seven markets were identified because they had the most cross-sectoral opportunity. Across seafood, salmon and whisky we are building Scotland as a brand overseas, but there are also real opportunities in dairy in many of those markets. As I mentioned earlier, the first two new specialists are in Canberra and Tokyo and are specifically looking at dairy opportunities at the moment.

The Convener: Does anyone else want to make a point on that or have any questions?

Michael Russell: It seems to me that we are at the nub of the matter. If we are to have a sustainable future for the Scottish dairy industry then it has to speak to the same quality of production and quality of product as other successful Scottish food and drink industries. We will not be able to compete in volume, because, by definition, we are a small country and no matter how big our output, it will not compete with the volume from much bigger countries.

I want to know, from those who are tasked with the work, what they are doing specifically to make sure that the quality and niche nature of the product are being promoted on the international markets. That goes for processors too. I am keen to hear what their role is. How does that work relate to the domestic market?

Again, I am struck by Robert Graham’s submission. Getting a strong presence in the domestic market is part of solving the problem. It seems that neither getting that domestic position nor getting an international position has been prioritised by, for example, First Milk. I am keen to hear what is happening.

Robert Graham: Talking about milk and football in the same sentence is a bit weird, but for me it is a bit like football, in that we have to win home games. I will talk about spreadable butter in particular: 150 tonnes of non-Scottish spreadable butter a week is sold in Scotland. We have to win the home games. The number 1 cheddar cheese brand in Scotland is not Scottish, but it should be. How do we win that game? It is about stepped investment in processing capacity and in the right type of capacity, and investing in non-profit distribution and marketing. They are big numbers, but we have to win the home games.

How do we get the relevance, the right products, and identify the products that consumers will be buying in three, five or 10 years’ time? One of the fastest growing products in chill cabinets just now is chilled coffees. They are stocked in supermarkets and come from Switzerland and Denmark. How do we identify such products?

We need to win home games by being relevant and making sure that retailers are giving us, as Scottish companies, enough space on Scottish shelves.

Michael Russell: Are retailers taking your spreadable butter because it is cheaper, because it is Scottish, because people ask for it or for all three reasons?

Robert Graham: As a business, we feel that people buy our products because they are Scottish, because they are family produced and because we are a farming business. We are more affordable compared to the brand leader, which is also good.

Getting that shelf space, having the retailers give us enough space, the right space, access to promotional activity and not getting wiped out with a UK national overlay from a cheese brand, for example—when that is all that sells when it is on offer—is important.

How do we get relevance going into England? In an English supermarket someone can buy Welsh butter, Irish butter, French butter, Danish butter—lots of Danish butter—and English butter, but you cannot buy Scottish butter. You can buy all of those again in Scotland. We need to win the home games. Export is important, but there is a huge volume to go for in Scotland for kick-off, and it is right at our doors.

Export is important—I have been to Shanghai and Tokyo, and I have seen what the opportunities are—but it all takes time. It is also not just about time but about what we do for NPD and about having the right products. Also, some of the products that we make now might need to be slightly changed. We might need different packaging to go with products that are more super premium than what we already make—and we make some great products. It is not only a question of time spent out with the sales team, but what we do for product development.

12:00

Jim Hume: New Zealand has been mentioned. Having been in Ireland, it seems to me that New Zealand is like two Irelands stuck out in the middle of the Pacific. Its exports have grown rapidly from about 2 billion New Zealand dollars in 1990 to 16 billion New Zealand dollars in the recent figures. A lot of the export has been to China. Chinese imports of powdered milk from New Zealand in the last 10 years have gone from about zero to about 3.5 billion US dollars. Sorry for mixing up the types of dollar, but those are the statistics in front of me.

I heard what James Withers said about just going for premium products, and that is right, but how come a small island nation stuck out in the middle of the Pacific with half the population of Scotland has done so well where we have not?

The Convener: Because it is independent. It is a simple answer.

Graeme Dey: The domestic market is hugely important. How optimistic are panel members who have experience of dealing with the supermarkets that they would play ball in this regard? I ask with the backdrop of hoping to have the supermarkets in front of us next week.

Every time I walk into a supermarket, I see two brands of cheese heavily promoted and given the prime shelf locations. How confident are you that supermarkets will be receptive to promoting high-quality Scottish cheese?

Robert Graham: What we see from retailers varies. Some have big Scottish teams, some do not. They realise that it is important to support Scottish products, but that support varies. Some retailers have big teams and are really on it, giving the products good displays and the local teams lots of authority; some are less so. It is about what the consumer wants but also about the Government making sure that retailers keep it relevant and keep it front of mind. It is important to our whole economy that they are giving us enough oxygen.

The Convener: I have a couple of points to make from people who want to go back to the Groceries Code Adjudicator and producer organisations. Claudia Beamish, is there anything further on producer organisations that we need to ask?

Claudia Beamish: Briefly, yes. George Jamieson touched on producer organisations, but I would like to get the views of the panel on the comments by the UK Government, which

"believes that forming a Producer Organisation could give dairy farmers 'greater clout in the marketplace'. The farming Minister suggested that Producer Organisations might help the imbalance in a market in which a small number of major retailers are the significant buyers but the majority of sellers are comparatively small-scale producers."

The Scottish Government also highlighted its support in 2012 in its five-point dairy action plan, saying that it sought to ensure that

"the Scottish Agricultural Organisation Society (SAOS) have sufficient resources to accelerate their existing work on producer organisations and co-operatives."

Does anyone on the panel have comments on the clout of producer organisations, beyond what George has already said?

The Convener: We have heard that producer organisations play an important part, but it would be helpful to hear specific comments about them.

Dr Bryans: Initially, there was no vast interest in putting producer organisations together, perhaps because of the difficulties in making them legal entities, the red tape and the reporting that people would have had to get involved with and the requirement to work through the Rural Payments Agency. We know of about six organisations that are looking at and are getting close to registering as producer organisations, but whether they will or not is a matter for the future.

As for countries that have had more producer organisations around and on the ground for a while, I guess that they have not been on the ground long enough for us to see whether they have been of any benefit with regard to what is happening in the global market. However, I have to say that those countries do not seem to be doing any better on milk prices. Perhaps that is because there has been no time to assess anything or because there have not been enough volatility cycles, but we have seen no benefit.

George Jamieson: The issue of producer organisations came up in the high-level working group, but only at the basic level of getting farmers together. The issue is slightly more complicated in the UK. There were already a number of producer groups—for example, Müller Wiseman and Dairy Crest had them—but what caused the uncertainty with POs was the legislation. Although the high-level working group on the dairy package said that POs should be introduced, there was very little guidance to look at. We knew what scale they could grow to, but we did not know what the terms of reference were until DEFRA and the RPA worked them out.

Farmers fear joining a producer organisation that handles only supply, because in the current situation they have nowhere to sell what they produce. The idea was that you would have enough milk and several customers, and you could organise sales for yourself, but POs in this country will probably grow a bit like the Dairy Crest Direct operation, which involves an existing producer group that people trust. The RPA agreed that we could write our own criteria as long as they covered what Europe wanted. At the very base of it, a producer group could apply to be a PO, but it would agree to deal with only one company and, crucially, the contracts would be between the farmer and that company.

However, the benefit of a PO is professionalism. It is not just about how much milk you can pull together; it is about having people who are employed to represent farmers and who can sit down, have meaningful discussions and agree common actions, including volume control, with them. For example, if Dairy Crest Direct were to tell its members to dry off thin cows and cull cows with mastitis, 5 per cent could be immediately pulled back without it having any effect on a chap’s business 12 months down the line. For me, the benefit of POs is not leverage, but having a more professional farmer representation that can deal better with processors.

Robert Graham: It is important that farmers and processors work together, but I am concerned about POs. We are a family business; our first two farmers joined in 1994, and the feel of the relationships that we have, in which we sit around the kitchen table in front of the Aga, is very important to us. Indeed, it is important that we keep that sort of relationship with the 90 farmers and their families with whom we work. Having that direct connection between us as a family business and them as farmers instead of having to go through different farm or PO liaison people is really important to our business, because it is all about family. No matter whether we are talking about farmers, those who work in the business or customers, they should be able to phone us directly instead of having to go through some legislated-for structure that would take away from the important feel that our business and our relationships have.

Jim Hume: Does anyone want to address the point that I made about how New Zealand has been successful in marketing its products?

George Jamieson: It is basically because New Zealand, like Ireland, exports 85 per cent of its milk. In New Zealand, they took the subsidies away overnight and, crucially, the Government allowed Fonterra to grow to an enormous size, so it basically had total control. New Zealand also invested heavily in powder in the markets. New Zealand’s tariff negotiation with China is massively advantageous because, being good salesmen, the New Zealanders convinced the Chinese that there is no milk powder like New Zealand milk powder—to be fair, it is probably better than American milk powder. They put in place infrastructure, the farmers became efficient and all got involved in the same production pattern and they built investment in skimmed-milk powder in particular, which is where the market was.

In Ireland, they mostly have co-ops, and 85 per cent of Irish milk is exported. All the wee co-ops are under the umbrella of the Irish Dairy Board, which does a fantastic job and looks after the majority of their marketing. The board has hunners of young folk out selling Ireland and Irish products.

We are behind the curve, although that is not to say that we cannot catch up. Both of those countries have majored in skimmed-milk powder but, interestingly, as James Withers has said, they are now looking at other markets. We need to diversify. We need added value.

Those countries are involved in all sorts of joint ventures to try to get the cream as well as the cake. We relied on our liquid, but we need to get out there and sell other products, too.

Jim Hume: I thought that that would be the answer, but that is useful to hear.

The Convener: That is one of the answers; they are not all equal answers, but marketing is obviously important.

Michael Russell: Another similarity that has been discussed and which is worth thinking about, although the subsidies issue would not be as enthusiastically embraced in this regard, is a focus on local food and drink and the importance of that in the local market.

I was in New Zealand last year, and it is noticeable that there is high-quality local food and drink being sold to a population that is not very different from Scotland's. People want to buy New Zealand products and they think highly of those products. Similarly, in Ireland, there is a fondness for Irish products and they are marketed in such a way that buying them seems to be the right thing to do. We need to learn the lesson in Scotland that buying Scottish produce actually preserves and develops Scottish jobs.

Graeme Jack: Ireland and New Zealand do not have the opportunities in their home domestic markets that we have in Scotland and the UK. Export certainly has its place, but there is a big impact that can be made by taking care of and nurturing our home market. I sometimes feel that the notion of exporting is seen as being sexy and attractive, but it is obviously important to take care of the home front.

The Convener: I think that that message is coming through.

George Jamieson: I agree with Graeme Jack. We have a big market here. However, Germany and France have massive populations and their export market and added value are huge. You can get the best of both worlds. Export has to be a sort of added value—the cream of the crop, if you like—but we can have both.

Graeme Jack: Yes, to be fair, we can have both.

Michael Russell: But if your home market is controlled by retailers who are often based outside your country, that leads to the issue that Robert Graham has raised. You can buy Irish, English and New Zealand butter in England but you cannot buy Scottish butter. We have to define the home market issue much more clearly and we have to acknowledge the fact that it is the home market that leads to a cheddar produced in Cornwall being the number 1 seller on Scottish supermarket shelves. Let us talk about the home market accurately and let us promote our produce into the home market in a way that gives us an advantage.

The Convener: We will take some of that forward.

Angus MacDonald: Earlier, the convener mentioned the Groceries Code Adjudicator, Christine Tacon. Recently, there have been discussions about the fact that the powers of the Groceries Code Adjudicator are quite limited, and we know that the House of Commons Environment, Food and Rural Affairs Committee has recommended changes to her remit, including giving her the power to launch proactive investigations.

The NFUS backs up that proposal in its submission, which says:

> "we consider it essential that the Grocery Code Adjudicator is given the power to receive complaints from indirect as well as direct suppliers, as inevitably it is the primary producer who is impacted during periods of volatility. It would also be valuable if the GCA were able to levy fines in cases where unfairness has prevailed in the supply chain."

Do panel members agree that the GCA's remit and powers should be improved or increased and, if so, how should we go about that?

12:15

The Convener: We will speak to Christine Tacon, possibly at the end of next week, so your views are very relevant to us. Would anyone like to kick off on the Groceries Code Adjudicator?

Dr Bryans: From where I sit, I do not see an awful lot of farmers who are direct suppliers to retailers, so although an extension of the GCA's powers sounds nice it could be quite nebulous. In most of the relationships with processors—whether they are PLCs or farmer co-operatives—the primary producer already has a mechanism through which to talk to the supplying processor about what is happening in the market and the price that it is receiving. When people talk about extending Christine Tacon's powers, we are not exactly clear what they see her doing.

George Jamieson: I take Judith Bryans's point, but in a lot of cases it is the farmer who ultimately suffers. Processors have been unfairly treated by retailers—however well you define "unfairly treated"—but the impact inevitably falls on farmers most of the time, because they are the lowest common denominator. If processors are getting squeezed, farmers are getting squeezed, so the impact falls on the whole industry. Understandably, processors are unwilling to raise issues with retailers, because retailers can be huge. If a processor loses a contract it is a major issue, so they are not going to hold up their hands and complain.

I would like to think that no complaints are needed. There have not been any complaints since the adjudicator was set up, yet there is clearly some bad practice out there, so something needs to be done to make the adjudicator more relevant. I would like to highlight the retailers who are doing a good job and doing the right thing. Low prices put pressure on the whole supply chain. Milk sold cheaply is fine for a while, but it becomes the norm and you cannot produce milk sustainably at those low prices. It is a similar case with cheese. Something needs to be done to make the adjudicator more relevant to the whole supply chain.

Graeme Dey: I return to something that George Jamieson said earlier. I do not want to put words in his mouth, but I think that he said retailers were charging for shelf space, or something along those lines. If they are, that would be in contravention of the grocery supply code, which states:

> "A Retailer must not directly or indirectly Require a Supplier to make any Payment in order to secure better positioning or an increase in the allocation of shelf space for any Grocery products of that Supplier within a store unless such Payment is made in relation to a Promotion."

That is an area where the Groceries Code Adjudicator could get involved. Are panel members aware of such breaches taking place?

Robert Macintyre: When I was on the board of Scottish Milk, I was also on the board of a company that had Scottish Milk products and sold cheese from Arran, Bute and Kintyre creameries. When Scottish Pride went bust, we had a contract with the Irvines of McLelland—the Seriously Strong people—to sell our cheese. They were always on about shelf space and having to stump up for it. That was very common practice then, and I do not know whether that has changed in the past five or six years.

The Convener: Does George Jamieson want to come back on Graeme Dey's question?

George Jamieson: Yes. Nobody will admit to what he asked about. It is highly unlikely that processors will admit that they bought shelf space in a prime location. They want that shelf space, and if they have to buy it, they have to buy it. The evidence is all anecdotal.

There is also anecdotal evidence that, when one of the big supermarkets tendered for a cheese contract that was worth a lot of money, both companies involved had to pay for the right to tender—and we are talking millions. A small company cannot do that; it is not fair play. We also hear of processors who are going through a thin time and need a volume throughput who will offer cheese to retailers at a knock-down price, which unsettles the market.

All those situations are happening. It is not the retailer's fault—if someone is offering cheap cheese, they will probably take up the offer—but we want to see processors get longer-term and more sustainable cheese contracts. I know that that is happening, and more of it would help the market gain stability.

To return to peripheral milk fields, the small companies are at a disadvantage if the practices that have been described are going on.

Graeme Dey: Anecdotal or otherwise, the examples are important to us, because we will have the supermarkets in front of us and we will be speaking to the Groceries Code Adjudicator. It is important that the examples are on the record, so that we can take matters forward. Are other panellists of the view that such practices are going on?

The Convener: Or is there a wall of silence? I hope not.

Robert Graham: We have pretty much not come across that. The closest that we have come to that is a listing fee, but the amount has been very small. We see payments made for promotional support, which can vary depending on whether it is just a UK promotion or we are promoting products more widely. That is our experience.

The Convener: As no one else wants to respond, Alex Fergusson has a wrap-up question about dairy development.

Alex Fergusson: This is almost an attempt to end on an optimistic note, if we possibly can, because a fair share of understandable pessimism and difficulty has been raised around the table.

I think that we are all aware of the 2013 Scottish dairy review report "Ambition 2025", with the ambition to double milk production. It also recommended the establishment of a Scottish dairy growth board.

My question to the two dairy farmers is: are you planning to expand in view of the recommendations or are you battening down the hatches? What has the dairy growth board done since its establishment?

Kenneth Campbell: I can only speak from a personal perspective. I remain entirely enthusiastic about dairy farming, and I would very much like to expand my business. There are obvious environmental restrictions with land—you cannot milk cows without land. Over the past generation or so, we have seen great growth in herd sizes, and I think that there is a limit to how big the herds can go. That is related not so much to the food that needs to be produced for the cows but to getting rid of the slurry at the other end. There is great cost involved in hauling something with such a low dry matter any great distance.

In principle, we will see the average size of a dairy herd in the UK grow. I do not know how many years it took to double in size, but there is no question but that it will double again—and that will probably happen just as quickly as it did the previous time. I would certainly like to be part of that growth, but I cannot see myself spending a whole lot of money in the next six months.

Robert Macintyre: Last year, when my son decided to come home after working away in a different job, we took the decision that we had to expand. We were fortunate enough to get extra land from the Bute estate to make the farm around 260 all-grass acres.

To immediately get going, we purchased some extra cows and we put up an extension to our cubicle shed. All the costs went on to the overdraft. We did a four-year budget with SAC Consulting, which was based on a price of 30p a litre of milk. You can see that that budget has been blown to hell.

We went from only 80 to 100 cows, and we look after the cows as if they are part of the family. I am sorry if I am disagreeing with Mr Campbell in this, but what I do not like about the dairy situation is that, all along the south of Scotland, there are what we in Bute describe as factory farms where there are 400, 500 or 600 cows. The poor brutes never see any grass because they are under a roof 365 days a year. We hear stories about such places, but I have never been to one. To my mind, that is not dairy farming but factory farming.

Alex Fergusson: I think that you would have to agree that it is also the market.

Robert Macintyre: Well, the expansion of such farms has been startling and many of them have contributed to the surplus that we cannot handle. George Jamieson will not agree with that, but it is a fact.

The Convener: James Withers can respond first and then George Jamieson. I hope that we will end up on an optimistic note. That is some hope.

James Withers: I will answer Alex Fergusson's question about what has happened with the dairy growth board, because it is important.

I will quickly give some context. "Ambition 2025" talked about the potential for a 50 per cent increase in production—going from 1.1 billion litres to 1.6 billion litres. It is important to state that that was never a target and it was debated for a while whether that figure would be used. It was designed as a statement of potential—that we should move from talking about managing decline in the Scottish dairy industry to being optimistic and thinking about growth.

The second key point about that 50 per cent growth figure is that it had to be market-driven growth. It would be suicide to produce more and hope that we could find a home for it. Growth has to be market driven or else we end up with a real challenge, for some of the reasons that we have talked about.

The dairy growth board is now established and is chaired by Paul Grant, who is the chairman of the jam makers Mackay's. That is someone from outwith the dairy sector who has taken a business from producing a commodity to being a strong brand. I do not know whether the committee is looking for any further evidence, but I imagine that evidence from him about what he is doing might be useful.

The Scottish dairy hub has been launched and is now up and running. It is funded by DairyCo—the levy board—and the Scottish Government, and it is designed to provide a one-stop shop for farmers who are looking for advice and support. There is a requirement for a bit of a culture change in the use of advisers in Scotland in comparison with our Scandinavian counterparts, and the dairy hub is designed to make that easier. The advice is independent; it is not provided by someone who has something to sell. There are no vested interests; the hub just points farmers to where the best source of advice might be.

On the international agenda, Paul Grant is working closely with a number of Scottish dairy processors and looking to enter three to five new markets this year after having done research last year. Fingers crossed, we are heading towards the launch of a new Scottish dairy brand in international markets at the back end of this year at one of the world's big food and drink shows.

The Convener: So the milk bottle is half full.

George, is the milk bottle half empty?

George Jamieson: Not at all. I am a half full man.

I ask the press not to quote me on this because I will be accused of making excuses again. I repeat that there is potential to grow the dairy industry in Scotland. There is absolutely no doubt about that. If we can market more products of the right value and get investment and processing, farmers will react.

To answer Robert Macintyre's criticism, I was a farmer for 25 years with 150 cows and then I was a consultant for a number of years. I assure him that there are many farmers with only 100 or 150 cows who are just as efficient as the big guys. I do not like the term factory farming because I have been on many such farms and advised many people who have 500 or 1,000 cows. Those cows are looked after fantastically well. There is room for everybody in the industry, and that is the approach that we need to take.

I will put the matter into context. Last year, we had good weather and good prices. One litre a day from the 165,000 animals in Scotland equates to about 500 million litres. That is 40 or 50 new farms. The average herd size rose by four over the

1,000 herds. That is another 300,000 litres. That is where the extra milk came from. The guys in the south-west who have grown have just taken up the space that others have left for obvious reasons, mostly economic.

We must not split the industry between big guys and wee guys. It is about efficiency and being fit for purpose. Small family farms can be incredibly efficient—I ran one, so I know.

12:30

The Convener: We will finish with Nigel Evans. Before we tackle next week's panels, there will be a lot of interesting reading in the evidence that we have heard today.

Nigel Evans: I have a comment on the industry, in Scotland and the wider UK, and where it is heading. It is for us as an industry to be very positive about the future. We have talked about New Zealand a few times this morning, and we can compare ourselves with New Zealand and learn lessons.

In New Zealand 20 years ago—it may have been more than 30 years ago—the subsidies were removed from the market. What was the effect on the industry? In the short term it was catastrophic—many people went out of business—but if we look at the industry over the period since then, we see that the volume, production and value to the New Zealand economy has grown by three times.

There is a future out there and it is a positive future. As an industry we need to understand where we add true value. Value is not what we say it is but what the consumer says it is: at the end of the day, it is the customer who determines the value. New Zealand considered it from the perspective of asking where the value was. It went out there and addressed that market. The same applies to us in Scotland and across the wider UK. The value is there and it is there for the taking.

What are some of the lessons that we can learn? We have talked about cost of production. I think that a cost-of-production formula, applied to dairy or any other commodity, is a route to a diminution of value, rather than an increase. It stifles innovation. One thing that we have to do is look at not growing herd sizes and factory farms but—again, this happens across New Zealand and the US—the number of people who are employed in the totality of the industry. We need to look at that as it demands innovation, which is true value creation.

My view of the industry is very optimistic. There is huge scope out there and huge opportunity to create value.

The Convener: I thank everyone for their evidence. It has been very valuable to have this round-table discussion, which has given us a wide variety of views and a particular focus, as the Scottish Parliament, in looking at the future of the Scottish industry in all its geographical diversity. We will tackle various other panels in due course.

One or two witnesses offered to provide further information, and the clerks will remind them of that at the end of the meeting.

As we agreed earlier, the committee will take the last two agenda items in private. Our next meeting will be on 4 February, when we will continue the inquiry on the dairy industry and hear from the Cabinet Secretary for Rural Affairs, Food and Environment.

12:33

Meeting continued in private until 12:55.

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