ENVIRONMENT AND RURAL DEVELOPMENT COMMITTEE

Wednesday 1 February 2006

Session 2

£5.00

Produced and published in Scotland on behalf of the Scottish Parliamentary Corporate Body by Astron.

CONTENTS

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ENVIRONMENT AND RURAL DEVELOPMENT COMMITTEE
4th Meeting 2006, Session 2

CONVENER

*Sarah Boyack (Edinburgh Central) (Lab)

DEPUTY CONVENER

*Mr Mark Ruskell (Mid Scotland and Fife) (Green)

COMMITTEE MEMBERS

*Mr Ted Brocklebank (Mid Scotland and Fife) (Con)
*Rob Gibson (Highlands and Islands) (SNP)
*Richard Lochhead (North East Scotland) (SNP)
*Maureen Macmillan (Highlands and Islands) (Lab)
Mr Alasdair Morrison (Western Isles) (Lab)
*Nora Radcliffe (Gordon) (LD)
*Elaine Smith (Coatbridge and Chryston) (Lab)

COMMITTEE SUBSTITUTES

Alex Fergusson (Galloway and Upper Nithsdale) (Con)
Trish Godman (West Renfrewshire) (Lab)
Jim Mather (Highlands and Islands) (SNP)
Jeremy Purvis (Tweeddale, Ettrick and Lauderdale) (LD)
Eleanor Scott (Highlands and Islands) (Green)

*attended

THE FOLLOWING ALSO ATTENDED:

Mr Andrew Arbuckle (Mid Scotland and Fife) (LD)
Alex Johnstone (North East Scotland) (Con)

THE FOLLOWING GAVE EVIDENCE:

Kevin Bellamy (Milk Development Council)
John Cumming (Farmers for Action)
Alistair Donaldson (Scottish Association of Meat Wholesalers)
Martyn Evans (Scottish Consumer Council)
Wilma Finlay (Cream o'Galloway Dairy Company Ltd)
James Graham (Scottish Agricultural Organisation Society)
Kevin Hawkins (British Retail Consortium)
Sarah Mackie (Tesco plc)
Peter Nicholson (Robert Wiseman Dairies plc)
James Withers (NFU Scotland)

CLERK TO THE COMMITTEE

Mark Brough

SENIOR ASSISTANT CLERK

Katherine Wright

ASSISTANT CLERK

Neil Stewart

LOCATION

Committee Room 2

Scottish Parliament

Environment and Rural Development Committee

Wednesday 1 February 2006

[THE CONVENER *opened the meeting at 10:04*]

Food Supply Chain Inquiry

The Convener (Sarah Boyack): I welcome everybody to our meeting. I am sorry for the slightly late start, but as it is nice to put faces to names, I allowed a couple of extra minutes for networking. It is unusual for us to have round-table sessions such as this, but we wanted to invite a range of stakeholders. Several big issues arise in connection with the food supply chain and we thought that, rather than invite everybody in a queue over a series of weeks, it would be better to have an exchange of information. We are using the round-table format because we are keen to get some discussion going rather than have a question-and-answer session. Everyone has been split up equally round the table, so there are no camps.

This is the first of our oral evidence sessions in our inquiry into the food supply chain. We want to examine how sustainable relationships can be encouraged to support our rural economy. The inquiry is not about any particular food sector, although we have tried to ensure that we hear from a range of different interests on the production side. We are keen to consider everybody's perspective. The key issues that we will consider are: the current issues in the supply chain and their impact on different elements in the chain; the distinctively Scottish perspectives on those issues; how relationships in the Scottish food supply chain can be developed in a way that will sustain our rural economies; and how the review of the Executive's agriculture strategy can encourage that.

As I said, we are keen to have a discussion, so members and witnesses can ask questions of one another, pose questions to the whole meeting and make general contributions—although I warn everybody that, if somebody goes on for too long, I will chop them off. All contributions should be made through me so that I can introduce the speaker; that will enable the microphone operator to switch on the right mike. Everything is recorded and the meeting will be webcast live.

I welcome members of the public and the press. We are discussing a big issue, in which we know that there is a lot of interest.

I ask everyone round the table to introduce themselves in turn. MSPs should say which party and area they represent, and witnesses should say which organisation they represent and describe their individual role. Everybody will then know who is who. The clerks have helpfully prepared a list of who is who.

I am the committee convener and I represent Edinburgh Central. I am a Labour Party MSP; I am also a member of the Co-operative Party.

Mr Mark Ruskell (Mid Scotland and Fife) (Green): I am a Scottish Green Party member for Mid Scotland and Fife, and I am the deputy convener of the committee.

The Convener: Next to Mark Ruskell we have two members of the official report staff, who will record for posterity every word that is said.

Wilma Finlay (Cream o'Galloway Dairy Company Ltd): I am the managing director of Cream O'Galloway Dairy Company Ltd, which is a farm-based diversification that makes ice cream. We also have a visitor centre.

Nora Radcliffe (Gordon) (LD): I am the Liberal Democrat MSP for Gordon, which is a constituency in the north-east of Scotland.

James Graham (Scottish Agricultural Organisation Society): I am the chief executive of the Scottish Agricultural Organisation Society, which is interested in the development of farmers' co-operatives and related policy issues. We are also interested in the development of collaborative supply chains and related issues.

Peter Nicholson (Robert Wiseman Dairies plc): I am the milk procurement director for Robert Wiseman Dairies.

Alex Johnstone (North East Scotland) (Con): I am a Conservative member for North East Scotland. In another life, I am a dairy farmer and a contracted supplier to Robert Wiseman Dairies.

Kevin Bellamy (Milk Development Council): I am the chief executive of the Milk Development Council. The council is a non-departmental public body that was established to raise a levy from farmers to provide services for milk promotion, market information and services to help production efficiency.

Alistair Donaldson (Scottish Association of Meat Wholesalers): I am the executive manager of the Scottish Association of Meat Wholesalers, which is a trade association that represents more than 90 per cent of the red meat slaughtering and processing sector in Scotland.

Rob Gibson (Highlands and Islands) (SNP): I am a Scottish National Party MSP for the Highlands and Islands. I am also a member of the Scottish Crofting Foundation.

Sarah Mackie (Tesco plc): I am from Tesco in Scotland. I head up our small Scottish office, which has the responsibilities of a small team replicating key departments from down south in commercial marketing, merchandising and technical issues.

Maureen Macmillan (Highlands and Islands) (Lab): I am a Labour MSP for the Highlands and Islands.

James Withers (NFU Scotland): I am the deputy chief executive of NFU Scotland. As a trade association we represent approximately 10,000 farmers, crofters, growers and other rural businesses across the country.

Richard Lochhead (North East Scotland) (SNP): I am an SNP MSP for North East Scotland.

Kevin Hawkins (British Retail Consortium): I am the director general of the British Retail Consortium, which includes the Scottish Retail Consortium. We represent most of the leading food retailers and also many small retailers, including the Scottish Grocers Federation.

Mr Ted Brocklebank (Mid Scotland and Fife) (Con): I am a Conservative MSP for Mid Scotland and Fife.

Martyn Evans (Scottish Consumer Council): I am the director of the Scottish Consumer Council, which is a policy development and research organisation focused on consumers in Scotland.

Elaine Smith (Coatbridge and Chryston) (Lab): I am the Labour MSP for Coatbridge and Chryston and a member of the Co-operative Party and the Transport and General Workers Union.

The Convener: I will explain the structure of the meeting. I plan to break at 11 am for coffee. If the discussion has become too hot by then, the break will give witnesses time to reflect for the last session.

There are four key areas in our inquiry. I intend to kick off with consideration of the current issues in the supply chain and their impact on the different elements in it. I then want to pick up on specific Scottish issues. After the coffee break, we will move on to examine how we can develop better relationships in the Scottish supply chain and how the Executive's agricultural strategy can encourage the development of those relationships and tackle the issues that arise before coffee.

I welcome our last witness, who has made it through the Edinburgh traffic; I think that it has taken him 40 minutes to get here from the bypass.

John Cumming (Farmers for Action): I am from Farmers for Action Scotland.

The Convener: What are the current issues in the supply chain and their impact on different elements in the chain? That is one of the issues that prompted the committee to hold this inquiry. We received reports from different farming organisations and direct representations from farmers concerning farming costs, links to food processors and relationships with supermarkets. Who wants to kick off the discussion?

Mr Ruskell: I will kick off on the issues surrounding the dairy industry in Scotland. In recent years, many hundreds of dairy farmers have gone to the wall, making a large impact on the rural economy and environment. One reason that has been cited for dairy farmers going under is that they are being paid less than their production costs. Last year Kevin Hawkins claimed that the increases in milk prices had not found their way back to farmers because, in his words, they had stuck to the sides of the supply chain. Why is that money sticking to the sides of the supply chain? Why are dairy farmers not paid a price that reflects their production costs? I direct the question initially to James Withers.

James Withers: That question goes right to the heart of the issues that we are considering. It is in everyone's interests, including consumers', that we have a supply chain that benefits every link in it. Our concern with the milk market and elsewhere is that it is not working. Where does the money go in the milk supply chain? There are only two figures to hand. What price is milk sold at on the supermarket shelf? What price do farmers get? Over the past five years, the supermarket shelf price of milk has gone up by about 17p, or around 50 per cent, whereas the farm-gate price has fallen. Supermarkets are not the only outlet for milk and in some ways milk producers will always be hostage to the commodity markets. The ruthless economic view is that if farmers are not efficient, they will not survive.

Although I understand that view, there are several factors that suggest that the market is not working. While political intervention in the market is usually a measure of last resort, perhaps it is required in this case. The Scottish dairy herd is one of the most efficient in Europe. December's milk production figures were the lowest for 10 years and we have the highest retail prices in the country.

10:15

However, Scottish farmers have been bottom of the farm-gate price league table for 10 straight years now, for a couple of reasons. First, dairy farmers, and the whole farming industry, have a responsibility to be as efficient as possible and the suggestion is that the dairy industry needs to do that. To be efficient, however, dairy farmers need to co-operate and the current interpretation of competition law prevents farmers from doing that. Milk co-operatives such as Arla Foods in

Scandinavia and Frontera Foods in New Zealand have about 80 to 100 per cent of their own domestic market share, yet they are not deemed to be anticompetitive because they also work in the European Union or in a global market. In effect, the competition authorities in this country have come down on the industry like a ton of bricks, although it has a mere 25 per cent market share. We need to be able to work on a level playing field from that point of view. I am aware that competition policy is reserved, but it has a huge impact on rural sustainability. I urge the committee to consider competition policy, despite its not coming within the Parliament's devolved powers.

The second reason for the low farm-gate prices is the issue of supermarket power. The competition authorities' interpretation of competition law as it affects farmers has been overrigorous and we are concerned that the supermarkets have avoided the same scrutiny. The supermarket code of practice has been in force for four years, but in our view it has been a waste of time. Farmers have to work with supermarkets, but they cannot afford to work with supermarkets at any price. Last summer we did a lot of work on the supermarket code of practice to see whether there were still abuses of power between supermarkets and suppliers, and the answer was a resounding yes.

We need to put some trust back into relationships that have broken down. Some relationships between supermarkets and suppliers work well, but where that relationship has broken down, we need a mechanism—a check in the system, if you like—that allows genuine complaints about abuses of power to be investigated properly and then allows the complainants to be protected from any reprisals.

The Convener: I would like Kevin Hawkins from the British Retail Consortium to comment on some of those points. Sarah Mackie from Tesco might also want to comment. Next week, we will speak to Ross Finnie and Allan Wilson, the two ministers, about competition, so we can pass on some of those matters to them even though they are reserved. I know that Ross Finnie has spoken out on competition before, so we shall try to pick up the issues that need to be taken beyond today's meeting.

At the moment, however, we shall stick to the issue of prices and the relationship between producers and retailers. Kevin Hawkins has an overview of that from a United Kingdom perspective, so perhaps he will comment.

Kevin Hawkins: I shall kick off, but I think that Kevin Bellamy from the Milk Development Council will also wish to comment. A year or two ago the MDC published a quite detailed report on prices, profits and costs in the supply chain. Kevin Bellamy also made a judgment about what was happening to the extra revenue that was being generated by price increases at the retail end, on the understanding that that revenue would go back to the farmers in the form of a higher farm-gate price. I shall let him present his conclusions in his own words.

I have to choose my words rather carefully, because that sequence of events, going back to 2000, is now under investigation by the Office of Fair Trading. As you well know, raising prices to consumers on anything like a collaborative basis is contrary to competition law, even if the result is not to fatten retailers' margins but to improve farmers' income. For that reason, I shall say little more about that.

The general problem with the liquid milk market, going back over many years, is that the UK market is much more dependent on liquid milk than is the case in Europe. Fifty per cent of the total output of liquid milk is consumed as liquid milk in this country, compared with an EU-15 average of about 20 to 25 per cent. That reflects the traditional weakness of the added-value part of the dairy chain, namely products such as cheese and yoghurt. Cheese consumption in the UK has not been going anywhere for the past 20 years, and our cheese offer is much more limited and is not growing to the extent that it is growing in other parts of the EU.

The other problem is that, over the past 30 years, the total consumption of liquid milk in this country has declined by something like 38 per cent. In the past 10 years alone, it has decreased by about 12 per cent. There are various reasons for that. The problem, for which I make it clear that I do not blame farmers, is that the common agricultural policy has encouraged not just dairy farmers but farmers in a range of supported industries to produce more, because of how the subsidy is paid. The result has been that the UK has produced its EU quota of 14 billion litres of milk per year at a time when domestic consumption has decreased. Liquid milk is not appropriate for importing or exporting in bulk, because it is very perishable, so it must stand or fall in the home market. In any industry in which supply consistently outruns demand, prices will be weak, whatever attempts are made by various parties in the supply chain to improve the situation.

I will leave my comments at that and ask Kevin Bellamy to speak, but I would like to return later to the points that James Withers made about the code of practice.

The Convener: We will stick with milk for a bit.

I should have said at the start that just about everybody submitted a written submission, for which I thank them. The submissions do not all agree, but they are all well written and useful for sparking off some of our questions.

Kevin Bellamy: It would be useful to consider the recent history of the past 10 years or so, since deregulation of the milk market. On deregulation in 1994, the farm-gate price was about 24.5p per litre, the processor gross margin was about 16.3p per litre and the retail margin was relatively low, at about 1.3p per litre. In the past 10 years, there has been a massive consumer trend away from doorstep-delivered liquid milk towards purchase via retailers, which has led the marketplace. Processors have naturally wanted to conserve their market share in their business and, as we would expect, they have tendered for retailer business. Those tendering exercises have produced a downward pressure on price, which has naturally been one factor that retailers have considered in their purchasing behaviour.

Supermarkets have undertaken several price initiatives to feed more money back down the chain, but each tendering exercise has eroded the price to similar levels. Last year, for liquid milk, the farm-gate price was 18.4p per litre, the processor margin was 16.1p per litre and the retailer margin was about 15.6p per litre. Retail margins have risen, not necessarily because of any campaign by retailers to exert power on the chain, but because of normal business behaviour.

It is fair to comment on why farm-gate prices have fallen. We have done work at the University of Portsmouth that suggests that farm-gate prices are influenced more by commodity price changes than by retail prices and that the price transmission from the commodity market is greater than that from retail markets. In the past 10 years, currency fluctuations have also occurred, but more recent developments that will have a bigger impact on the chain are the removal of support mechanisms in the form of intervention prices and the removal of export subsidies that was agreed in Hong Kong.

Milk is being sold into commodity markets—for commodities such as butter, skimmed milk powder or mild cheddar—and the prices in those markets are falling. That affects the substitution of products, because raw milk that is produced on farms in Scotland can go into either retail markets or commodity markets. The prices in commodity markets will continue to undermine prices in other supply chains. We have to consider the whole spectrum and not only the supply chains to the retail sector.

The Convener: As a result of all those comments, four people now want to join the discussion. Three of them are committee members, but I will move first to Peter Nicholson from Robert Wiseman Dairies.

Peter Nicholson: Deregulation significantly changed the way in which raw milk is valued. Under regulation, the price of milk to the liquid market could be ring fenced; the price was determined separately from the price of milk for manufactured products. After deregulation, that separation disappeared. As a result, it was no longer possible to ring fence the price of milk for the liquid market.

As both Kevin Hawkins and Kevin Bellamy suggested, we moved into a free market at that point. It was a free market in which supply exceeded demand and in which the pricing chains to the liquid market and to other markets were all linked. The only difference in the value of milk in one product or another lay in the service or the level of production profile required. Because of the intrinsic link between the value of milk for the liquid market and the value of milk for the manufacturing market, there was volatility and a link between CAP-intervenable products and the liquid itself.

Despite various attempts to do so, we were no longer able to ring fence the price of milk for the liquid market. As a result, the value of milk for the liquid market has always fallen back to its market level.

The Convener: I will bring in my colleagues Alex Johnstone, Rob Gibson and Ted Brocklebank.

Alex Johnstone: I have some first-hand experience of the issues, on which I would be interested to hear the witnesses' opinions.

It is a bit naive to suggest that deregulation in itself reversed the direction of milk prices. After deregulation on 1 April 1994, milk prices increased strongly for almost three years. Only after that period of increase, and then a short plateau, did prices begin to come down again. Prices have been coming down since late 1997.

I would not for a moment say that deregulation was not the trigger, but it did not in itself undermine milk prices. Deregulation affected the marketplace initially, but only after those effects had worked through the system did prices begin to fall. I would therefore like our witnesses to analyse a little more closely what the changes were and how they undermined milk prices in the late 1990s, because deregulation actually increased milk prices at first.

Rob Gibson: I would like to explore the changes since deregulation in milk marketing, and to relate those changes to what has happened in other countries. Here, we have moved from regulation to the maelstrom of the free market, but Denmark, France and New Zealand have moved steadily to strengthen co-operation and to have vertical integration within that. It is important to consider the experience of other countries, because we have to find out how to bridge the gap that is caused by the change in consumer tastes from milk into products such as cheese and yoghurt.

Also, how do prices at farm gates in Denmark, France and New Zealand compare with prices in the supermarkets there?

10:30

Mr Brocklebank: I preface my question with the observation that, certainly in our group, no single topic in the environmental brief has caused more controversy and raised more interest than that of the disparity between the price that farmers are paid for milk and the price for which the supermarkets sell it. We have received a number of delegations privately on the issue from people who have identified what they see as a scandalous distortion in the prices in relation to what farmers receive and what the supermarkets sell for.

I have two questions. First, when supermarkets put up the price—which is now about 53p or 54p per litre, or perhaps more—why does the corresponding increase not filter down the chain to the producer at the farm gate? Why is it that the supermarkets' profits go up, but the farmers' margins go down? My second question is more general. With more and more dairy farmers going out of business, how do the retailers see their ultimate responsibility? Will they simply continue to squeeze farmers so that their profits go up? What do the retailers see as the outcome of the game? Where will they go eventually for their milk supply? [*Interruption.*]

The Convener: Somebody's mobile phone is ringing. Will everyone check that their phones are switched off?

Two big issues have just been raised. Rob Gibson asked about competition and co-operative working and Ted Brocklebank asked what will happen if prices in the shops continue to go up, but those for farmers do not.

Kevin Bellamy: I would like to clarify Peter Nicholson's comment that we have a surplus in the marketplace that allows product from other supply chains to undermine prices. There is a market for all the milk that is produced but, at times of the year when there is peak production, because the supply is particularly high, the market prices are depressed. A market exists for all the milk that is produced; the issue is that some commodity supply chains have lower values and the prices in those supply chains are pressured by the removal of support. I do not want the committee to think that we have a surplus of milk; in fact, one problem that we might face is a loss of processing and production capacity, which would lead to erosion of the Scottish industry. Given the efficiencies in the Scottish industry, it ought to be expanding.

On the analysis of the late 1990s and why prices went up immediately after deregulation, the commodity prices that were arrived at then were greatly affected by the support prices. The difference between the pound and the euro meant that support prices were high in the marketplace. It took a couple of years for the people who were procuring milk to get used to the situation after the ending of the regulated marketplace. It took us all a long time. Some of the issues that we have with current contracts are a hangover from that period. We should not underestimate the time that it has taken to establish a deregulated marketplace; indeed, we are not there yet.

I will let some of the other people around the table talk about the difficulties that competition law imposition has caused for co-operation and consolidation in the sector. We must see the consolidation of the supply chain in Scotland as part of the worldwide consolidation of supply chains. We should not minimise the stifling effect on that of competition rules.

I agree that, while prices in the raw milk sector are being depressed as a result of commodity prices, the more milk that we can get going into added-value products—yoghurts, branded cheddars and branded liquid milks, which we are seeing more of—the less will be the effect of the commodity prices on the overall marketplace. We should, therefore, stimulate activity that encourages innovation in the marketplace.

Over the past 10 years, farm prices have been about 10 per cent higher in the rest of Europe than in Scotland. That is because, as Kevin Hawkins said, in the rest of Europe there is a predominance of cheese markets rather than liquid milk markets. Historically, there has been a strong emphasis on liquid milk in this country, compared with other European markets. Other European countries have developed their added-value sectors much earlier than we have.

The Convener: A couple of committee members want to comment, as does James Withers.

Mr Brocklebank: Convener, I do not think that we got an answer to Rob Gibson's question or to mine about why the profits are not forced down the line.

The Convener: I intended to ask James Graham about producers who have linked together to form co-ops. I hope that he will be able to answer your question.

James Graham: I cannot analyse why the market has fallen over the past few years; there are other people here who are better qualified to do that. However, everybody seems to be describing a marketplace in which values are declining or have declined. Given that circumstance, the question is whether the industry is able to respond and change to improve its financial viability.

The important issue is competition—we cannot get away from that. Unless we are able to pursue consolidation, we will never create global businesses like those that we are increasingly competing against in the UK market. Many of those businesses are farmers co-operatives. I have surveyed the situation around the world, and in other countries, farmers co-operatives are generally given the opportunity—provided that farmers can join and leave them voluntarily—to create a market share of up to 100 per cent. They are not allowed to abuse that power: if they are found to have done so, steps of redress are taken against them. In this country, we do not follow that convention with farmers co-operatives. Before any consolidation has taken place, there seems to be an assumption of guilt based on the fear that it might be adverse to consumer interests, although the whole intention is to take cost out of the chain and to create more efficiency. Not being able to consolidate is an obstacle to improving the viability of the industry in the UK, and we must do something about it. A raft of policy issues need to be considered with regard to the development of co-operatives.

In 2002, I conducted a study in the United States of America that looked specifically at the measures and policies that are in place there to support the development of farmers co-operatives. There is a very different starting point in the USA, which is that farmers need to be able to create their own countervailing force in the market, especially when they are selling a highly perishable product. For that reason, in 2002, farmers co-operatives in the USA had an 89 per cent market share in the sale of dairy products.

I will not go into all the other policy issues now, but among the issues that we may put on the table later is the need for investment to exploit new opportunities and to enable farmers to transfer out of producing commodity raw milk to producing more value-added products. I am not saying that they are all right for the UK, but a raft of measures exist elsewhere that support farmers in their efforts to achieve that. Those things are simply not available to us in the UK.

One issue that I will put on the table is that of collaborative supply chains. As I say in my written submission, we need to give much more priority to considering what we mean by collaborative supply chains and how we can ensure that all parties in the chain understand what that means. We must take steps to create collaborative supply chains in which there is much more pre-agreement about how development will take place, about how the benefits of that will be shared and on other issues surrounding that. There is a raft of issues to discuss that are perhaps more pertinent to the second part of the meeting. However, co-operation is definitely one solution, provided that we enable it to work.

The Convener: You said that many measures are being adopted elsewhere to which we do not have access. What measures were you thinking about? Did you mean training or marketing measures? What are we missing out on in Scotland?

James Graham: Just about everything.

The Convener: Will you list those measures for the *Official Report*?

James Graham: I will put flesh on what I said by giving a short list.

In the USA, there are federally funded centres for co-operatives that are based in universities. Those centres produce academic research and map out a role for farmers co-operatives. The United States Department of Agriculture's Rural Development agency implements rural business and co-operative programmes. There is a farm credit banking system that raises money in the stock markets, specifically to help to finance agriculture and farmers co-operatives. There is no equivalent system here.

There is a range of other support programmes in the USA. Perhaps most important, it has a loan guarantee programme that provides $25 million of loan guarantees to co-operatives to enable them to invest. A loan guarantee programme enables farmers to invest up to $400,000 in their co-operative to enable it to invest. So much support is available that trying to co-operate is a no-brainer for farmers—they are given a lot of support and help. We have nothing like that level of support in the United Kingdom policy environment, and I do not expect there to be such support. However, our treatment with respect to competition, for example, is simply indefensible.

The Convener: You have mentioned many issues to which we can perhaps return in the second half of the session. Members are agitating to get back in again, but it might be worth getting NFU Scotland or John Cumming to comment first. Prices and what we pay have been discussed, but we have not quite pinned the issue down. I invite James Withers to say something about that.

James Withers: Quite a few accusations have been made about the farming industry on the basis that comparing supermarket shelf prices with farm-gate prices is oversimplistic. However, because of the lack of transparency in the market and the murky environment within which that market operates, those are—unfortunately—the only figures that we have. We have shelf prices and farm-gate prices.

Rob Gibson asked what happens elsewhere in Europe and how that benchmarks with what happens here. We have been rock bottom of the league table of farm-gate prices for 10 years and our retail prices are among the highest in Europe. The gap in this country between farm-gate prices and retail prices is as high as it is anywhere else.

Ted Brocklebank asked why the money does not go back to farmers if supermarket prices increase. Many farmers ask that question, too. Farmers are realistic enough to know that if Tesco puts up its milk prices by 2p per litre next week and the other three major supermarkets follow suit, the farm-gate price of milk will not suddenly increase. However, there is a difference between knowing that and knowing that there is no correlation whatever between the prices, and that in fact there is an opposite trend. I think that the MDC did work on supermarket margins a couple of years ago that concluded that the supermarket margin for milk had gone up by between 8p and 10p per litre and the farm-gate price had gone down by 6p per litre. If the current supermarket margin is 15.6p per litre and the profit on a litre of milk is between 8p and 10p, the idea that milk has historically been a loss leader is blown out of the window. On those figures, Tesco will have made around £80 million on liquid milk alone.

I appreciate that the context and history of how the milk market has reached where it is through deregulation and the powers of the World Trade Organisation must be discussed, but we must consider the current evidence on what we can do. There is no doubt that liquid milk is at the premium end of the market. There is a huge retail margin and a small processing margin, but losses are being made at the farm gate. If there was more communication, discussion, transparency and dialogue in the supply chain, we could ensure more equitable shares of the margins down the chain. Farmers are being told to be efficient and to produce quality, and that they will consequently get a return. John Cumming and his 1,400 colleagues who are left in the dairy industry are being efficient and producing quality, but they are going out of business hand over fist.

The Convener: This might be a good point at which to bring in John Cumming.

10:45

John Cumming: Peter Nicholson spoke about oversupply and how it is reflected in the marketplace, and James Withers mentioned Tesco's supposed margin on milk and farmers losing money.

Output for the average British producer is rising on 1 million litres. That means that every time I get out of bed in the morning, I give Tesco money. During the last financial year I gave Tesco alone £100,000. It also means that I have lost money. Now, these fellows say, at this level of debate, that they cannot say where all the money has gone, yet last week they increased the price of milk to the consumer by 2.2p per litre. Within 24 hours, one of the major processors in the country dropped the price to his producer by 0.9p per litre. A statement from Robert Wiseman Dairies, I think, says that it will hold its price for February, which is very good and I take my hat off to it. However, if we cannot address what happened with Arla this week, Robert Wiseman Dairies will drop its price—probably by about 1.2p per litre—to balance its books.

It is not hard to see who controls the money in the milk and food chains: it is certainly not the farmer. The money is paid by the housewife. The average doorstep price for milk is 80p a litre, and the average price in a supermarket is 65p. However, the average producer in Scotland—unless they are on a Wiseman special contract through First Milk Limited—could suffer, as I might, a price of 13p a litre from April.

I ask the committee to find out what happens between my producing milk at 13p a litre and Robert Wiseman Dairies charging 80p or 90p for it in a small shop or on the doorstep. That is a simple question; there is nothing complicated in it. The housewife pays the money, but I do not get it. I am sure that there are enough educated people round the table to give me a realistic, honest answer without waffling on about world markets. I am not in the world; I am in Scotland.

Peter Nicholson: James Withers' point related to milk being sold through the liquid retail sector. Kevin Hawkins pointed out that only 50 per cent of the milk in the country goes into that sector and returns to dairy farmers vary depending on where their milk goes. The average return for dairy farmers who sell their milk to the liquid sector is between 19p and 19.7p a litre, although the return will go down, depending on what market other producers sell their produce into. John Cumming mentioned 13p a litre. I would not have thought that it would go as low as that, although a return of 15p or 16p a litre is possible.

A huge variety is hidden within the average return, although farmers who sell into the liquid sector get returns at the higher end of the range. There is a huge difference in what farmers receive, depending on the market into which their milk goes. It is not a simple matter of Tesco getting 100 per cent return on its shelves.

Elaine Smith: Can I ask for clarification on something that John Cumming and Peter Nicholson mentioned? They talked about the difference between what the consumer pays on the doorstep and what they pay in the supermarket for a litre of milk. First Milk's submission said that the doorstep delivery of milk has virtually disappeared. However, the submission from Robert Wiseman Dairies gave us the market shares by sector, and doorstep milk still appears. What is the difference between what the consumer pays for getting milk delivered to their doorstep and what they pay in a supermarket?

Peter Nicholson: I will let Tesco speak for itself on the price that it charges on the retail shelf. Obviously, there is a difference in price between what is sold in the supermarket and what is sold on the doorstep, which is a result of the cost of servicing those outlets. With supermarkets, we are selling large volumes of milk to single stores; however, selling on the doorstep incurs an additional cost because it requires, for example, employing people to drive the delivery trucks.

Elaine Smith: So doorstep milk is more expensive for the consumer.

The Convener: It must be if it is being delivered. If you go to the supermarket for milk, you pay your own travel costs. If you have it delivered to your house, you need to pay for the person in the delivery truck, the fuel and so on.

Supermarkets have been mentioned a couple of times. I wonder whether Sarah Mackie from Tesco has any comments.

Sarah Mackie: I want to address some points that James Withers, Kevin Bellamy and John Cumming have raised—I hope that I manage to tackle all of them.

Earlier, someone wondered whether Tesco was trying to put farmers out of business. I can categorically say that we are not trying to put anyone out of business either in the dairy industry or in the meat, fruit, vegetable and other agricultural sectors from which we buy produce.

On the Competition Commission's conclusions with regard to squeezing suppliers, the results of a recent survey showed that our suppliers believe that their negotiations with Tesco are fair. Interestingly, the majority of suppliers also said that dealing with Tesco had improved their products and their understanding of consumers and had allowed them to expand their business.

I cannot discuss milk margins, partly because of the OFT inquiry and partly because I am not that knowledgeable about it, but most importantly because we create the price with our processors. We do not set prices with farmers.

I should also point out that we work with our processors to sell as much of the product as possible in our stores. Taking milk as an example, we have increased our shelf space in order to push 27 extra Scottish-specific cheeses. With Wiseman, we have launched Pure extended shelf life milk; with Rowan Glen, we have launched a range of probiotic milk; and we have also launched some flavoured milks.

Someone also pointed out that retail is not the only outlet for liquid milk. We should take into account the volume of milk that is sold in hospitals, prisons and schools.

I hope that that answers some of the points that have been made.

The Convener: Does the Milk Development Council have a sense of how much milk does not go to supermarkets?

Kevin Bellamy: I do not have that figure to hand, but I will supply the committee with that information.

The Convener: I am conscious that it is 10 minutes to 11. Does the committee wish to broaden the discussion? As far as milk is concerned, I feel that, although a couple of questions have been left unanswered, we have explored some of the issues and now have a bit more insight into the matter.

Kevin Bellamy: I am aware that I have not answered one of Mr Brocklebank's questions. I wonder whether I can try to answer it now.

The Convener: Do you think that you can? The fact that it cannot be answered might be symbolic.

Kevin Bellamy: Mr Brocklebank asked why consumers are paying more for supermarket milk when farmers are not getting the money and why farm prices are going down when supermarket prices appear to be going up. Indeed, Mr Cumming's comments echoed the frustration that many farmers feel about the matter. I think that the answer has to be, "Because they can."

Peter Nicholson said that the returns from the liquid market have traditionally been higher. Indeed, that market still returns a slightly higher price to farmers than some other market sectors, including farmers in the commodity sectors that have been affected by deregulation. If a farmer receives 16p per litre for selling their milk to a processing plant for butter or skimmed milk powder, a liquid milk supplier has to offer them only a small increase in that price to make it worth while for the farmer to change and sell to that liquid milk supplier—for example, Robert Wiseman Dairies. While there are farmers supplying the lower-value sectors, there will always be milk on the raw milk market that people such as Peter Nicholson can procure at a lower cost. Not that they necessarily should do that, but the process of competition will lead them to do so because they can. That is not surprising; it is just natural business practice.

The committee must ask what we can do to make the relationships and profitability along the chain more sustainable. Clearly, farmers are being forced out of business because the price for their product is being forced down. The commercial process is passing on the pain to farmers, who are the people in the chain who are least able to sustain the risk in their businesses, being mainly small businessmen. We must consider why that is and what we can do about it. We believe that it is important to consider the contractual nature of the relationships along the chain. Most farmers sign up to contracts that have a long notice period and that do not mention price. The basic relationship is that a farmer contracts to sell all their product and agrees to give six or 12 months' notice if they want to stop doing that. However, the contract does not mention a price, so the following day, week or month an adjustment in price might make the contract unsustainable for the farmer. Because such a deal is in place when a deal is being done further up the chain between, for example, processors and retailers, the supply is secure. The processor does not feel threatened at that point by the possibility of the supply not being available, because contracts are in place that will sustain the supply.

The answer to Mr Brocklebank's question is that prices can be forced down to the lowest level in the marketplace, which is either the price at which the European Union chooses to intervene or the price at which world markets set the lowest level, which is lower than prices across the rest of the European Union. The question is whether prices should be forced down. Clearly, the answer to that is no, if we want a sustainable dairy industry in Scotland. What do we need to do about that? We need to change the relationships along the chain so that they are driven by sustainability and a fair and equitable contractual relationship.

Mr Brocklebank: My question was rhetorical, but what Mr Bellamy said demonstrates that, although the Tesco representative said earlier that of course it was not in the business of putting farmers out of business or of forcing down prices, Tesco is in that business.

Kevin Bellamy: We have considered retailers across the EU over the past 12 months and the picture in other states across Europe is the same as it is for UK retailers, which is that retail margins have been increasing.

Mr Brocklebank: They are higher.

Kevin Bellamy: Yes—in Scotland. Germany, in comparison, has a heavy presence of discounted retailers and retail margins there have, in fact, been shrinking. It could be argued that Scottish consumers are willing to pay more for food and services from Scottish retailers than are consumers in other EU states from their retailers.

The Convener: Another difference is that farming communities organise differently in Germany. That issue arose in our CAP reform inquiry last year. There are many more co-operatives in Germany.

Kevin Bellamy: That kind of organisation has led to different contractual relationships along the supply chain. The contractual relationships between retailers and the larger co-operatives in Europe are different from those that have developed in the UK since deregulation.

Mr Ruskell: Ted Brocklebank and I are essentially asking the same question, but I do not feel that I have had an answer to my initial question about where the money from the milk price increase is sticking in the supply chain and why it is not getting back to the farms. People have talked about the need for co-operation within the sector, value adding and the linkage to the commodity price, but it is still not clear where the money from the price increase is going—or being lost—in the supply chain. Before we move off this topic, I would like to hear from the farmers about where they believe that that money is going. Where is it getting lost in the relationships between the supermarkets and the processors, and the processors and the farmers? Clearly, that is the issue.

Kevin Bellamy: Can I give you a straight answer to that?

Mr Ruskell: I would like to get the farmers' perceptions first.

11:00

John Cumming: I do not see that there is anything complicated about the issue. I have already said that the consumer price was put up by 2.2p per litre last week. I spoke to Tesco and Safeway—or rather Morrisons. I had a good discussion with Sarah Gallacher, who is Sarah Mackie's senior, I think. I also discussed with Asda's Andy Adcock all the things that are going on.

Sarah Gallacher told me that Tesco cannot be seen in any shape or form to influence the milk price. If Wiseman asks for a price increase that must be discussed and if Wiseman has not included farmers' costs in the increase then farmers must go back to whoever we supply. At that time I went back to First Milk and discussed the increase. First Milk said that it had included farmers' costs. I went back to Sarah Gallacher at

Tesco. She said, "John, no costs for the farmer have been included in Wiseman's increased costs." I went back to Asda and Andy Adcock said, "John, Arla has not included any costs for the farmer; it is going for an increase based on its oil and plastic costs." I said, "Listen for a minute. You do not need to be a rocket scientist to understand that everybody in the industry, including the farmer, has the exact same costs—farmers' costs are probably higher. How do we get those costs included?" I was told, "Basically, you have to come back in and ask for them to be included."

I told the supermarkets that in nine months the consumer price had been put up by between 6p and 8p per litre. That is not fantasy; it is fact. Farmers have received less than 0.3p of that increase. In fact, we have had no increase in nine months. In six years the retail price of milk has gone up by more than 17p per litre and the farmers have got less than 2p of that. If these fellows want to defend that by hiding behind what they believe is justification based on commodity markets, world markets or whatever market they want, that is fine. That is their job. Peter Nicholson, who is a very educated man, is here to represent Wiseman Dairies and Mr Hawkins is here to represent his group of sellers, if we want to call them that. He is a very educated man and he probably has more experience of this food chain than anybody. However, a direct question and a direct answer are all that are needed. He knows where the money is; the committee knows where the money is; everybody knows where it is and it is not in my pocket. It is split between the Wisemans and the Tescos of the world. Anyone who wants to dispute that can start now.

Mr Ruskell: I would like to hear from James Withers about how he thinks the money is getting locked up in the middle of the supply chain.

James Withers: I am not convinced that it is locked up in the middle of the supply chain; it is locked up at the retail end. The processors are protecting their margin, which is probably about 2p per litre, but they are busy scrabbling for their lives to secure supermarket contracts. Ultimately, the likes of Pete Nicholson's business, Dairy Crest and Arla will live or die according to their contracts with supermarkets. Supermarkets know that and are able to negotiate a price that means that processors can just about make a living and can protect their margin, but the processors pass the pain of the negotiation of that contract down to the farm-gate end. A variety of MDC evidence shows that that is the case. The margin has been held and is increasing at the retail end and the pain has been passed on down the chain. The one thing that the processors have in their favour is that they have somewhere to pass the pain on to, but farmers do not.

The Convener: I said that I would stop at 11 o'clock. I apologise to Richard Lochhead and Maureen Macmillan, who have been desperate to get in for half an hour. I will let them lead in the second half.

We can capture a couple of issues for our next set of discussions. One is about relationships and contracts. The idea of having fixed costs, feed costs and contracts in which there is an agreement to provide something but not necessarily at a specified cost will be an interesting concept to come back to after the break. Another issue is how farming is organised and what relationships there are between farmers, processors—we have not yet talked to a processor—and supermarkets. How do those relationships work in practice? Another issue is how the markets work in Scotland and how that affects rural communities. We can come back to several issues in the second session—those are the obvious ones.

Kevin Hawkins wants to come back in. I ask him to make a brief comment; I suspect that his comments might not close off the discussion.

Kevin Hawkins: I want to answer Mark Ruskell's initial question, which was about where the money is going. It is not with the retailers.

I answer from my experience at Safeway. When we indicated to our suppliers that we wanted to increase the retail price to ensure that the farmers got a higher farm-gate price, they simply invoiced us for the additional price that we indicated, which was 2p, or whatever it was, per litre. The money left Safeway and went down the chain. What happened to it thereafter was beyond our control. I do not suggest for a moment that processors pocketed the difference. What we have to remember is that there are many more parties in the supply chain than just the big four supermarkets; not all the smaller retailers participated in individual initiatives.

Then there is the problem of the co-operatives. The farmers who supply co-operatives, as distinct from supplying direct to dairies such as Wiseman, have traditionally received less money per litre. The difference is now at least 2p per litre, but probably more.

Not all the processors have the same sort of business. Wiseman is predominantly a liquid milk dairy whereas others, such as Dairy Crest, have half their business in cheese and other added-value products. The way that Dairy Crest treats its farmers is rather different from the way that Wiseman treats them when it comes to passing the money on, as it were. There is no simple, straightforward explanation of the situation, and I am sorry if it sounds complicated. Somewhere along the line, the money has run into the sand or it has been offset by competition for contracts.

Nobody has yet mentioned the importance of scale economies, either in dairy farming or the processing of milk. It is a scale business. For example, Wiseman is building a new plant in the south-west and it needs to ensure that its plant runs at full capacity, as indeed does every other dairy processor. That is how the business model works and from where whatever margin it makes comes.

Of course there will be competition between the processors to supply retailers. Supermarkets do not need to go out, rattle sabres and threaten to de-list. It is a process of competition because it makes sense for Wiseman to run its plant at or as near full capacity as it can. Sometimes that means that it has to trade gross margin, but it makes sense for Wiseman to do that.

It is great to talk about more collaboration and all the rest of it, but the problem with that is competition law, which is hostile in some respects to the institutional consequences of greater collaboration, as James Graham rightly pointed out.

Scale economies drive dairying as much as they do any other commodity business. Back in the early 1950s, there were a quarter of a million dairy farmers in this country. That number started to diminish long before supermarkets came on the scene because the smaller dairy farmers simply could not compete, even under a regulated system such as that of the milk marketing boards. Whatever the institutions, we cannot defy the economics of processing and competition in a highly competitive market.

I am sorry—I meant my comments to be a lot shorter.

I can give another reason for the gap between the retail and the farm-gate prices. Two years ago, I gave some figures to the Environment, Food and Rural Affairs Committee in Westminster. I was able to disclose those figures not only because I had left Safeway, but because it no longer existed. When I left, I asked our category dairy manager at the time how much we were paying our two or three big suppliers per litre of liquid milk and he said, "It's between 42p and 44p a litre." That is on the record; it is not new information and it can be accessed by looking at that committee's report. Safeway was then selling its milk, on average across all pack sizes, at 49p a litre, so that was the gross margin that we were making at that time.

When I gave that evidence at Westminster, I hedged it with qualifications. I said that it was one particular set of supply terms and conditions that applied to one retailer at one point in time. I did not generalise across the whole supply chain to say that the figures were necessarily typical. Needless to say, everybody ignored the qualifications and my evidence was blown up out of all proportion. Nonetheless, those were the figures.

In case you think that somebody was telling me fibs, the chairman of one of our big dairy suppliers was quoted in *Farmers Weekly* confirming that those figures were substantially correct.

The Convener: If I were to open this up for further discussion, you would all volunteer. I will not do that. I said that we would break for coffee at 11 o'clock; it is 10 minutes later than that now. I would like people to network and reflect on the first evidence session as well as on the fact that we have touched only on milk as an exemplar. There are other issues to discuss, such as arable, and we have beef producers here as well. Some issues are particular to milk, but some apply to all sectors. I will let you all go for a coffee and invite you to come back in five or 10 minutes.

11:10

Meeting suspended.

11:33

On resuming—

The Convener: I have a sense that the real discussion was happening in all the informal conversations during the break rather than around the table during the formal session. We will try and capture some of those thoughts.

Before the break, we were talking about relationships and where the money goes. It was pointed out to me that the Environment, Food and Rural Affairs Committee spent months examining that issue and still could not come up with a straight answer. I will not try to get us to do in the space of two hours what it could not do in months.

When we kicked off the session, I said that I was keen to focus the second half of our discussion on how the food supply chain relates to the rural economy, how we get long-term stability in some of our rural communities and how the Executive's agriculture strategy could assist in that process. We have spent a lot of time analysing where we have got to and what has been happening in the food chain. Different views have been expressed around the table and I suggest that people go back and examine the written evidence that has been submitted.

It would be useful to focus on the long-term relationships, contractual issues and the ways in which things such as CAP reform will change the agenda. Previously, farmers got paid for producing certain goods, but they will now be paid for having a farm and for being environmental stewards of that farm. That means that they will choose what they grow on that farm, rather than meeting quotas. The world is changing. We have also talked about how competition will begin to kick in across Europe. How do we equip our farming communities, our processors and our rural communities to deal with those issues in a way that suits Scotland? That is quite a difficult set of issues.

Maureen Macmillan: I want to throw a stone into the pool by asking how sustainable contracts are for the producer and the processor. I have heard a lot of anecdotal evidence from farmers and contractors about the way in which contracts are made. Someone may have a contract with a supermarket, but the supermarket can phone them and say, "By the way, we want to do a two-for-one offer this month," and it will not be the supermarket but the producer—of the apples, the pears, the bananas, or the cheese—whose profits will be hit. Another issue is tied up with that because the processor does not know how much of the commodity will be sold under the two-for-one offer and might suspect that the supermarket is selling it at the full price without giving the processor as much as they would otherwise receive.

There are extra pressures that come out of the contracts. Another issue that has been raised with me relates to packaging. Apparently, all of a sudden, the supermarket will say to the processor, "I want my fish packaged differently and it will be at your cost."

I do not know whether anyone here would be willing to speak about those issues. One of the difficulties is that people will speak about them privately but not in public.

The Convener: A couple of witnesses have not yet been brought into the discussion: Alistair Donaldson, from the Scottish Association of Meat Wholesalers, and Wilma Finlay, the managing director of Cream o'Galloway. Perhaps they would like to come in at this point.

Alistair Donaldson: As you hinted, I would like the debate to be widened out a bit further. Milk, rightly, has had a fair old hearing, but I would like to remind everyone that we should be considering the sustainability of Scottish agriculture plc. There is a heap of issues that need to be addressed.

The red meat sector accounts for 44 per cent of agricultural output in Scotland, which makes it the biggest sector. Some specific issues and needs have to be addressed in relation to it. The important one is the maintenance of critical mass. We produce 167,000 tonnes of beef a year in Scotland. If we add pig meat and sheep meat to that, the total is 250,000 tonnes. The total for those three commodities in Europe is 35 million tonnes a year. How will we position ourselves in that market? As far as the red meat sector is concerned, we will have to position ourselves on the basis of differentiation. We must seek ways in which to capitalise on what is a premium product and try to add value in whatever way we can.

In terms of market share, which was discussed in the debate that we have just had, the retail end accounts for under 50 per cent of the red meat market and there are other important segments, including catering, the food service sector and manufacturing. We need to look at the issue in the round rather then focusing on only one aspect.

The export side is crucial to the red meat sector. We have gone round the houses to a fair degree trying to restore exports, but we are still not there yet. We are tantalisingly close, however. For example, our beef is a premium product. The Scottish values are well recognised around the world. We need to capitalise on that. In the world marketplace, meat consumption is predicted to rise by 35 per cent over the next 10 years.

We need to get some passion into what we are doing. We need a commitment to maintaining production, to maintaining a viable processing sector and to finding the right mechanisms to add value. One of the major barriers to doing that is regulation, with which we have serious problems. The Government says that we should have better regulation and be more competitive, but we are going nowhere. We interpret some of the European legislation to the letter; we do not take the approach that is taken in France and elsewhere in Europe, where what matters is the spirit of the law as opposed to the letter of the law. That has direct cost implications that are a burden on the whole industry. Those cost implications affect the whole chain and, regrettably, too much of the cost lands back at the farm end. How do we maintain sustainable farming production? Since reform of the common agricultural policy, the SAMW has argued consistently that maintaining production is a key element. If we do not do that, we lose our standing completely—and we are small players already.

The Convener: Going back to Maureen Macmillan's question, do you think that long-term contracts are an issue in the industry?

Alistair Donaldson: I think that that should be explored a bit more, but I want to make a point about collaboration and co-operation. There is a lot of informal collaboration in the supply chain. In the red meat sector, abattoirs have formal or informal groupings with a range of producers. There is feedback of information on market requirements and market signals and a serious attempt by farmers to respond to that. That could be built on. It is not as formal as a co-operative, but it is a mechanism for getting a better understanding of the supply chain.

In the context of the supply chain, and without repeating everything that has been said, I note that the lack of communication is a serious issue. The lack of understanding in the supply chain is horrendous. I have worked in the industry for 40 years and can say that the level of trust is no better now than it was 40 years ago. As Kevin Hawkins said, we cannot avoid rationalisation. It would be naive to say that the rationalisation of the past 40 years will not continue. The issue is how we use the opportunities that that provides to make the industry sustainable.

The Convener: We very much agree with that—it is one of the drivers of the inquiry.

There is a changing landscape in financial support. What can we say to the Scottish Executive to help you to retain and develop the market and to develop relationships? That is one of the issues that we wanted to address in the second half of the discussion. It leaves Maureen Macmillan's question hanging somewhat. Wilma Finlay, did you want to come in at this point?

Wilma Finlay: Yes, but not specifically to answer Maureen Macmillan's question. We should look forward—

The Convener: Do we just leave Maureen's question lying there? It has been raised with her by farmers. Does anyone want to engage in that or will it simply not be covered?

James Withers: If Maureen Macmillan's question is about issues such as the two-for-one offers, that is almost a taboo subject in the food supply chain. It is shrouded in a great deal of secrecy. The Office of Fair Trading carried out an audit on the supermarket code of practice last year and said that there was no evidence of supermarkets breaching the code of practice. Short of some specific examples about Safeway demanding lump sum loyalty payments, there was no evidence of any wrongdoing in the food supply chain. We did not believe that; as the OFT recognised, the fear factor in the industry prevented suppliers from complaining of mistreatment.

We carried out our own inquiry last summer, in which we spoke to 14 of the main food and drink processors in the country. For reasons of strict confidentiality, I cannot divulge which processors or supermarkets were involved, or even which commodity was involved. However, we received clear evidence of breaches of the code of practice. Some examples of that were demands for lump sum payments simply to secure business; supermarkets redesigning artwork and charging suppliers the cost of that without negotiation; and two-for-one offers of which suppliers were informed the day after the offer had begun and for which they had to pay the cost. I do not have a handle on how widespread such breaches are, nor do I have a handle on which are the good and bad supermarkets from that point of view. However, in order to improve trust in the supply chain, which Alistair Donaldson mentioned, we must have a mechanism that will weed out when and where those breaches are happening and prevent them in future.

We have a code of practice, but it is not working; it has not been used once in four years because suppliers are scared stiff of reprisals. With all due respect to the Tesco survey that Sarah Mackie talked about, if I were a supplier to Tesco and my business relied on that contract, on my survey form I would talk in glowing terms about how great Tesco was. We need an independent mechanism, such as an ombudsman, to do the job, because it is not being done at the moment.

11:45

Sarah Mackie: I omitted to say that the survey was totally anonymous, so we were not able to see exactly which supplier was saying what.

We would never tell a supplier that we were going to put a product on a two-for-one offer and then not honour that. If we say that something is going to be on promotion, the supplier can go into the store and see it for themselves. It would be silly of us to try to do anything that was not—

The Convener: I just want to clarify that, so people will know what we are talking about. If two goods are offered for the price of one, who takes the reduction in price? Does the supermarket absorb it? It has been suggested that the producers or farmers end up having to absorb the price cut.

Sarah Mackie: That depends completely on the product and the time of year and the seasonality of the product.

The Convener: So it would be possible for a supplier to produce something for a chain, for which they expected a certain price, and for the chain to phone them and tell them that the product was going to be sold two for one, so the supplier would be paid less.

Sarah Mackie: No. I cannot comment on every case.

The Convener: We have heard from one or two different sources over the past few weeks that that has happened to producers and farmers.

Sarah Mackie: There would be different negotiations for all the different commodities that we are talking about. I cannot comment on how they would all work. When I have negotiated with a supplier, I have ensured that what is agreed is absolutely fair and agreeable to them as well as us. It is to their benefit if we increase the volume that we sell.

We get involved in other promotions to sell more products. Wilma Finlay can comment on some of the work that we have done. That links into the point about communication that was made earlier. Promotions can be communicated through literature that we produce or through *Scotland on Sunday* or *The Herald*. There can be tastings in store. There are many promotions other than just two-for-ones.

A point was made about different packaging. An example that I know of is that we changed the packaging on some biscuits from card to tin. Obviously there was a significant difference in packaging costs, so we changed the price of the product to reflect that. I can speak only for myself, but I know that packaging is taken into account in negotiations with suppliers; indeed we are in negotiations with a supplier on that very subject at the moment.

Richard Lochhead: Given that there are dozens of two-for-one offers every other week in Tesco and other supermarkets, I find it hard to believe that different circumstances apply in negotiations with each supplier for each two-for-one offer. Is there not an internal document in your supermarket that you must use for such negotiations? Are you saying that negotiations for every two-for-one deal start from scratch and that you do not use guidelines about who should pick up the tab for the promotion?

Sarah Mackie: There is no rule book on promotions.

Richard Lochhead: We have heard from the suppliers that they have to pick up the tab for the offers. Are you saying that that is not the case and that Tesco takes the hit in its own profits?

Sarah Mackie: I cannot comment on every category, but in some categories there will be a price reduction for the suppliers as well as a margin reduction for us in order to promote the product.

Richard Lochhead: Are there circumstances in which the supplier takes the biggest hit?

Sarah Mackie: Each category is different and each product is different. It all depends on the retail price and the promotional price.

The Convener: I am conscious that we are just asking Tesco. Kevin Hawkins is keen to contribute.

Kevin Hawkins: I will try to put this matter to bed. There are different price elasticities across the 35,000 products that a supermarket stocks. Years of experience will tell us which products will respond to a promotion—for example, 25 per cent off or two for one—with increased volume. As I said earlier when we were talking about milk, suppliers, especially of commodity products, have a strong vested interest in moving more volume through their retail customers. When I was with Safeway, most of our promotions were with some of the heavyweight suppliers in the sector that produce some very well-known brands. We also did promotions with suppliers on products such as poultry that have tremendous price elasticity. If 30 per cent or 40 per cent were knocked off the price of packaged chicken, including wings, legs and breasts, the volume of sales would rise by 200 per cent or 300 per cent very quickly.

There is clearly a big incentive for suppliers in certain categories. However, milk is not one of those categories. A lot of nonsense is talked about milk being a loss leader, but the only time that Safeway put milk on promotion, farmers got very cross because they said that we devalued the product. That promotion did not work because if we cut the price of milk, people do not buy any more of it. That is not the case with other categories, in which suppliers will make a lot of money from a promotion, particularly if it increases volume by 200 per cent or 300 per cent. Given that, we felt that it was not unreasonable to ask suppliers for a contribution to help to offset the margin loss that our supermarket would have sustained to run that promotion. Normally, suppliers were keen to do that, because in a static or declining commodity market, extra volume is very valuable to any supplier.

The Convener: I see that several people want to comment on this point. As Alistair Donaldson kicked off the discussion, perhaps he would like to add something. I would then like to get a consumer's perspective.

Alistair Donaldson: I apologise. I was trying to widen the discussion, rather than get bogged down in one or two day-to-day—albeit important—issues, as I was conscious of the time and the fact that one of the specific topics for this session is the forward strategy. The questions and answers demonstrate that a better understanding is needed of what happens in the chain. That is the problem; the papers submitted demonstrate the gap in the industry. It is fundamental to ask how we can address that.

The forward strategy makes an overall commitment to sustainable and profitable farming production. We must be clear about getting the right balance between the needs of the farming industry and environmental concerns. We are concerned that we are heading too much down the environmental route, which will ultimately not sustain Scotland plc. Therefore, the mix between farming and the environment must be near the top of the agenda, so that we can maintain a viable industry.

The Convener: What does that mean in practical terms?

Alistair Donaldson: It means that the focus, first and foremost, should be on sustainable and profitable farming. We hope that that is clear. How do we get there? The issues that we need to address are to do with regulation, rather than the motherhood-and-apple-pie statements of the forward strategy. What serious efforts are we making to cut red tape? There have been red-tape initiatives in this country for goodness knows how long, but what progress have we made and how can we make more? Very little progress has been made and we are merely seeing more regulation and greater cost. The impact that that has on businesses should not be underestimated.

We should pay more attention to collaboration. How do we physically encourage that? How does that manifest itself as something real and meaningful? How do we reduce costs? There has not been a lot of talk about that today, but efficiencies can be gained in the whole industry. The red meat sector would be the first to admit that it could gain efficiencies. It has an initiative called the red meat industry forum, which does some excellent work. There is no funding to support it in Scotland, so we are barred from being members. However, the forum gives England and Wales a competitive advantage. Those specific questions should be more detailed in any forward strategy.

The Convener: Okay. Those are some practical suggestions.

Nora Radcliffe: I would like to be even more practical and specific. People talk about red tape and regulation. What questions should we ask the minister next week about which regulations?

Alistair Donaldson: I will readily give you a topical example. The European Union directive on the incineration of waste came into effect in the UK on 28 December 2005. It bars the use of tallow as a fuel in steam-raising boilers, which is what renderers use in a closed-loop recycling system. From an environmental point of view, that means that they will have to revert to heavy fuel, which dramatically increases carbon emissions. Tallow is a carbon-neutral fuel. Worse than that, because of the dilly-dallying on getting some definition of how the regulation will be applied, slaughterhouses are heading towards a 50 per cent increase in rendering costs, from £40 to £45 per tonne to £80 to £90 per tonne. That is an overall increase in costs of about £10 million a year.

We have made the point that other member states are not implementing the directive. The Government's response is that it has hard evidence that other member states are implementing the directive. We have asked to see the evidence, as we speak to European renderers who say, "We're not doing that." There is a conflict of opinion that takes us nowhere; meanwhile, the industry faces additional costs.

Nora Radcliffe: That is helpful. That gives us one line of inquiry. Are there other issues that we should pursue?

Alistair Donaldson: You might consider regulation overall. New food hygiene regulations have just been introduced. They are good regulations, as they tidy up much of the regulation that has developed over the past 30 years. Nevertheless, there is a perception in Scotland that the new regulations are being implemented more heavily in Scotland than in England and there is a perception in Britain that they are being implemented more heavily here than in the rest of the EU. I accept that that is hard to define and that much of the evidence is anecdotal, but we need to examine the issue in more detail. There is also anecdotal evidence that the Pollution Prevention and Control (Scotland) Regulations 2000 are being implemented more heavily than the corresponding regulations in England and Wales, with a resulting cost barrier.

The Convener: Those are all things that we can take up with the minister next week. His officials may be monitoring our discussions as we speak, so they may be ready with answers.

That is the view from the meat sector. We have lots of ideas about what we need to do for the Executive's forthcoming agriculture strategy. Do any of the producers around the table have any other issues that should be on the agenda for our meeting with the minister?

Wilma Finlay: We are now in a global food market. The discussion has focused on what we can do here in Scotland, but imports are coming in and attacking that all the time.

Although we operate primarily in the dairy sector, I can give an example of what is happening in the organic red meat sector. Certainly on the beef side, farmers have the luxury of selling in a market that is undersupplied. However, because farmers are not co-operating—the infrastructure is not in place to get them to work together—Tesco is sourcing its organic beef from Argentina. I do not blame Tesco for doing that, as that is the only way in which it can guarantee its supply. In Britain, we have a culture of not co-operating, which needs to be reversed.

It is not just about co-operating; it is about added-value processing. I might be unpopular for saying this, but it is not just about the farming community; it is about the rural communities. We need to get some other industries into the rural communities, especially ones that add value to the products that are produced there. The problem is that such industries are becoming concentrated in specific areas.

We should be thinking about how we can get farmers to co-operate. We have heard about that from SAOS, and I am sure that James Graham can give the committee much more detail on that.

12:00

Richard Lochhead: On the subject of beef imports, I am not picking on Tesco, but it is the one supermarket represented today.

I am delighted to hear of Tesco's support for regional cheeses. Last week, in Sainsbury's in Edinburgh, I noted that out of the 15 cheeses on offer, only one was Scottish.

I have protested several times at Tesco's store in Inverurie over the presence next to Scottish beef of South American beef, particularly sandwich beef. The consumer can tell its origins only from the tiny print on the back of the packet. If I remember correctly, some steaks on sale were also not Scottish. Understandably, concerns have been expressed by the Scottish beef sector. Ironically, Inverurie is the largest beef producing area in the UK, yet South American beef is for sale in local stores. We are relying more on cheap beef imports that do not meet the same welfare standards as beef produced in Scotland. Information received by the consumer is not very clear for the reasons I have already outlined. I suspect that Sarah Mackie will produce statistics about how much Scottish beef Tesco orders, but how does it help the supply chain in Scotland when supermarkets in the largest beef producing area in Scotland and the UK stock beef from South America? It is also very difficult for the consumer to know from where the beef has come.

The Convener: Wilma Finlay raised an issue germane to that, on beef producers working together. How is it that the largest beef production area in Scotland has cheap imports from Argentina in its supermarkets and why are Scottish products not getting on to the shelves? I will allow Sarah Mackie and Kevin Hawkins in briefly on this issue; then I want to go on to what we can do differently to make things work, which goes back to Alistair Donaldson's points about protecting our markets and enabling producers to get their produce on to the shelves.

Sarah Mackie: On the organic produce issue raised by Wilma Finlay, Tesco, through its meat supplier, McIntosh Donald, has a producers club in Scotland involving 1,200 farmers. We are actively seeking information about how much more organic meat we can take in through our stores in Scotland.

The Convener: What is the obstacle to Tesco doing that?

Sarah Mackie: The obstacle is sheer volume—not enough organic meat is available in Scotland for Tesco. Although we can still buy some organic meat from Scotland, we must also import it to satisfy demand.

On imported meat, only 4 per cent of our meat in Scotland is imported. The benefit of what we do for Scottish meat is that Tesco's consumption of Scottish meat is 10 per cent, but it purchases 20 per cent from Scotland. Tesco is therefore a net exporter of Scottish beef, which is fantastic.

I am familiar with Inverurie as it is my local store. I am a farmer's daughter. I heard that there was some promoting of beef—as it was described—outside the Inverurie store, but I understand that we actually helped and that the store manager offered those involved more beef to assist the marketing of the product to customers.

Tesco imports beef for a couple of reasons. One is to do with the carcase balance. In the height of summer—I know that, due to the weather, in Scotland we are less influenced by this—there is a huge demand, driven by barbecues, for steaks. I worked at Safeway in London for a wee while. There is a huge difference between Inverurie and London in relation to the dominance of sales of steak meat in the summertime in London. At the same time, we have a changing climate—exactly as the convener said—as a result of which, fewer people eat roasting joints and mince. That means that Tesco sells many steaks but few roasting joints and meat from the shoulder or front quarter, so we need to purchase more products from abroad to level the carcase balance.

Another reason is that Tesco's big thing is our obsession with the customer. If we can ensure that we have all the products available to all the customers who want to shop in our stores and if we can help low-income families to purchase red meat, that is good.

We label clearly our products that are Scottish. The briefing packs that the committee received show that we are doing a huge amount to label Scottish meat at the point of sale and in signage in stores, to highlight Scottish products throughout the whole range. I hope that I have answered some of the questions.

The Convener: The consumer has been mentioned quite a few times, but we have yet to hear from Martyn Evans—every time that I was about to call him, we veered on to something else. Martyn has listened patiently for nearly two hours. What are the key points for the Scottish Consumer Council?

Martyn Evans: The evidence from "Public Perceptions of Food and Farming in Scotland: Final Report", which was published by the Scottish Executive in 2003, is that Scottish consumers have genuine sympathy for Scottish farmers and trust them, but they trust English farmers less, so consumers apply a premium to produce from

Scotland. Consumers generally have the same interest that the NFU argued for in being supplied competitively, efficiently and honestly. We agree about the basic principles and consumers' trust in farming.

What has been said about the Office of Fair Trading is a myth. After the Curry commission published its report on agriculture, which was the mirror of the strategic look at agriculture up here, it asked the Office of Fair Trading to produce a report on competition and farming, which was published in July 2004. It is clear that vertical and horizontal integration in production is acceptable within some boundaries, but it is not taken up, for a variety of reasons, to which I will return. On reconsidering the 2004 report about the competition issues in farming and the supply chain, one would say that the process is open and that the Office of Fair Trading has not in practice intervened in it negatively—as far as I can see, and I looked at its website just yesterday. The myth about competition law as interpreted by the Office of Fair Trading must be addressed directly.

When Milk Marque was found to be anti-competitive and was broken up in 1999, that was a key development for consumers, because milk prices for them reduced. The competition authorities were right to intervene to stop price fixing by a player in the field.

The difference between farm-gate and retail prices is central to the discussion. All this morning's discussion has been about whether we can identify an amount of money in the retail price that we can return to farmers or others somewhere down the supply chain. We have not discussed whether the retail price is right. If cost can be taken out of the supply chain, in an efficient market, the saving should be given back to the consumer. We do not want a non-market price to be added to the retail price and earmarked for farmers. That is the old and unsustainable world of farming subsidy.

There are questions about efficient co-operatives. James Graham mentioned a raft of interventions for farmers in America. We would support the interventions that he mentioned to establish efficient supply chains, co-operation and horizontal and vertical integration. However, we see no reason why such intervention cannot be paid for from the £750 million of public money that currently goes to farming and farmers in Scotland. That is a huge amount of public money for an industry. The readjustments that must be made in moving from the CAP to a market-led position should be paid for from the significant public investment that is already made.

Much has been said about supermarkets. We are worried about matters such as price flexing and below-cost selling, which the Competition Commission has identified as issues in supermarkets. The commission has said that although those activities are not in consumers' interests, the interventions to prevent them would be worse than the activities themselves. We must recognise that.

My next point is on regulation. Like Alistair Donaldson, I worry greatly when I hear that there is discussion about deregulating. That applies to the beef industry in particular. The beef industry is lucky that it has the confidence of consumers that it currently has. The things that have happened to the beef industry in the past—BSE and its consequences—could have destroyed the long-term confidence of consumers in that industry in general. Current farming and food regulations are a consequence of a variety of food scares. For example, the hazard analysis and critical control point came about essentially because of the E coli deaths in Wishaw. We must be very careful when we talk about taking out consumer-focused regulation.

Broadly, however, I agree in principle with people who call for deregulation. Regulation costs consumers money and reduces consumer choice, so there has to be a reason for it. If we can find and take out inappropriate regulation, that is good, but we must remember that it is critical to maintaining the trust that people have in farmers—I refer again to the 2003 survey. The regulatory regime maintains that trust to a certain level and is necessary because of past mistakes made by farmers and their advisers.

That is my broad outline of issues around consumption. There are myths that must be addressed, and some of the issues are reserved. The issue of vertical and horizontal integration is key, but it should be paid for out of existing public subsidies for farming.

The Convener: I said earlier that I would come back to James Graham, who tried to take us where we would like to be now. The committee has previously discussed issues around farmers co-operating with one another, securing good prices for good products and marketing those good products. Would you like to help us to set the agenda for next week as regards what we should expect from the forward strategy for agriculture? One or two people around the table have been talking about that. It is quite right for us to dig away at some of these issues, but I would like to end by discussing what we can look for that is positive for the future. I invite you to start to set that agenda.

James Graham: There are three areas that I would like to discuss and make suggestions about. The first is to do with policy on and assistance towards the development of co-operatives to give farmers the means to become more efficient in their participation in the market. Competition is part of that, because it impacts on broad decisions that are being made now. Judging from the size of the legal fees that are being run up, there is something there to defend. It is a matter of trying to change what is going on. From the evidence that I have seen, I can tell you that there is an issue there, but that is only one aspect of the matter.

There are a whole raft of co-op development issues. We wrote to the Minister for Environment and Rural Development last January, soon after he first announced that he was reviewing the forward strategy. We told him that, for a number of reasons, he should be much more explicit in his support for the development of co-operation among farmers and that he should introduce measures to support that. We got into a discussion about land management contracts and possible assistance that could be included through that route. However, that did not come to anything, because, I gather, it could not be included. We still think that the point is valid, however, and that there needs to be a more explicit policy on assisting the development of farmer co-operation and overcoming some of the issues that Wilma Finlay highlighted.

There is a question of priority in co-op development. Perhaps co-operation did not have the same priority 25 years ago. It did not need to have, because we had other market management arrangements. Now, however, it is a priority. Our organisation is a micro-organisation, and we receive a tiny amount of support from the Scottish Executive Environment and Rural Affairs Department, which reflects the level of priority that seems to have been afforded to co-op development.

The second area that I wish to discuss is that of collaborative chains. I refer the committee to the paper on the subject that I submitted. It is clear that everybody here is not happy with the current position. Everybody has defended their own position, as they were bound to do, of course, and as they have every right to do. We have to find a way forward from that. We have been trying to establish what collaborative supply chains are, how they have developed in other industries, what the parameters around them are and what the circumstances around them have been. Let us try to understand what a collaborative supply chain is from the points of view of the farmer, the retailer and the processor.

We have been doing quite a lot of research on the matter. We found some very interesting developments in New Zealand, where attempts were being made to describe a collaborative supply chain according to three dimensions. The first was information sharing along the chain; the second was decision synchronisation, or joint agreement of decisions, along the chain; and the third was incentive alignment along the chain, which was about planning and determining how the benefits of changes in the chain would be shared.

12:15

I found the description so interesting that I took it to people at one of our member co-ops—a successful supplier of multiple retailers. I talked them through the approach and asked them to score their own experience of being in a collaborative supply chain. Their chain is very integrated—from farm to retailer. They scored their information sharing as eight out of 10, their decision synchronisation as five out of 10 and their incentive alignment as two out of 10. That suggested a huge potential for improvement in the creation of collaborative supply chains. We have suggested to the Executive that the forward strategy has to give more priority to collaborative supply chains. We have to realise the potential. I refer members to my submission for a fuller description of collaborative chains, and I would be happy to discuss it further.

I come now to the third area that I would like to talk about. We have not talked about local foods today but our organisation thinks that that is a really interesting development in Scotland. We have been involved in the creation of farmers markets; we have assisted producers to work together on processing and marketing; and we are currently providing secretarial services to the Scottish Association of Farmers Markets.

We have the opportunity to create much more of a local food economy in Scotland—an economy in which food is produced and consumed in Scotland. Such an economy would meet many Scottish Executive policy objectives. I am concerned that neither the forward strategy nor the Scottish food and drink strategy recognises the opportunity to grow a local food economy. It would not just be an opportunity to sell through the multiples; it would also be an opportunity for tourism and an opportunity for farmers to retail directly to consumers, and possibilities in that area are growing all the time. There is also a market in the public sector for local foods—in schools and all kinds of other places.

We have suggested to the Executive the need for an overarching policy that is dedicated to local foods and the development of a local food economy. Research is needed on the scale of the opportunities; on how supply chains might work; and on the development needed to realise the opportunities.

Those were my three suggested areas for consideration: co-operative development, collaborative supply chains and a local food economy for Scotland.

The Convener: That chimes well with other comments that have been made round the table on promoting links between farming communities and rural communities. In the past, we have talked about support for local finishing and local facilities. Could such things be part of the agenda?

Wilma Finlay: Yes. The profit comes from adding value—

The Convener: So we produce foods locally, turn them into good food products locally, and then get them on to the market.

Wilma Finlay: Yes. The one thing that I would be cautious about is the definition of the word "locally". I would define "locally" as "in Scotland". However, we seem to be saying that we will have Aberdeenshire food in Aberdeenshire, Galloway food in Galloway and Shetland food in Shetland; we are not recognising that good food from all those areas can be marketed as such throughout Scotland.

The Convener: Does anyone else have suggestions to add to our list of what would make a positive difference in the future?

Kevin Bellamy: We must consider how situations are developing. The deregulation of the common agricultural policy and the effects of World Trade Organisation agreements—the direction of which is pretty clear even if some have yet to be reached—will continue to erode commodity markets.

I would suggest three areas to concentrate on, the first of which is efficiency measures. Scottish producers tend to be larger—certainly in the dairy sector—and they can achieve the economies of scale that Kevin Hawkins mentioned. Production in the UK is drifting towards Scotland, so we are seeing an increase in the amount of milk that is produced in Scotland, but we need to continue to encourage that. The competitor is no longer the guy next door; it is now the dairy farmer in southern Ireland or in Denmark, because those are the states that are restructuring as fast as we are and will be able to pump product on to our market. Efficiency efforts and support for activities that will continue to help the efficiency gains and restructuring that are taking place will be essential over the next couple of years.

The second area is something that we have talked about already: the effect that commodity products have had on our marketplace. They undermine supply chains that are profitable and undermine the provenance of local supply chains, so we need to innovate. We need to get more products into higher-value markets such as local-provenance markets, but we must also look at branded products or products that add value in some way and which can bring in more money, and that means taking product out of the commodity markets.

The third area on which we need to concentrate—again, we have talked about it a number of times—is relationships along the supply chains. Any measures that can be suggested to aid relationships, allow people to see different points of view and help contractual relationships to develop in the supply chain should be considered. There is no point in one part of the supply chain putting measures in place if the rest of the chain is not co-operating, so we need to get our supply chains operating efficiently together.

Kevin Hawkins: Taking on board the points about efficiency, co-operation and collaboration, I would like the committee to ask the minister next week to put some Scottish Executive money into supporting the work of the red meat industry forum, and particularly into the application of value chain analysis to what goes on in processing. I have been involved in the forum for four years now—it was set up after the outbreak of foot-and-mouth disease—and evidence to date from south of the border shows that something like 10 to 25 per cent of cost can be taken out of the processing part of the supply chain, let alone the farming part of the chain, simply by eliminating waste and inefficiency, by finding new ways of doing things and by applying lessons that have been learned in other industries. That is a relatively painless way of finding extra margin for farmers and processors without everybody talking all the time about the price that supermarkets pay.

I agree with virtually everything that James Graham said about local and regional food. That is a good idea, but we should beware. Most consumers will not buy something just because it is local or regional; the product must meet their established standards of value for money, taste and quality. The problem for the Scottish food supply chain, over many years, has been its weakness in the middle when it comes to processing added-value products. I am talking not about commodities, but about the added-value part of the supply chain; much of the product has to be processed south of the border before it comes back again to Scotland. The minister will be well aware of that issue, but I think that the committee should raise the issue with him.

Alistair Donaldson: The red meat industry forum has made a funding application to SEERAD to drive through the very issues that have been mentioned, so it would be wrong to imagine that the minister is not aware of the forum's work.

James Withers: If I were writing the forward strategy, I would want to add a couple of action points. First, there is general agreement on competition policy. Farmers should be able to co-operate when they can. We need the structure to be able to do that and we are almost unanimously agreed—Martyn Evans is perhaps the exception—that we do not have that structure at the moment.

Secondly, unless you ask someone who is independent you will not get an answer on the subject of two-for-one offers. I could spend all day telling you my version of events and Kevin Hawkins and Sarah Mackie could tell you theirs.

I will quickly mention three other things. First, Alistair Donaldson's point about regulation is crucial. In this country, we gold plate regulation, particularly environmental regulation. Jim Wallace is conducting an inquiry into that subject for the European and External Relations Committee, and it would be well worth feeding his report into the Environment and Rural Development Committee's inquiry. There are a number of examples of gold plating, such as the EU waste incineration directive, in which costs to the industry have been added on without there necessarily being a benefit in return.

Secondly, we can sort out the problem for beef and other imports if we have a clearer and better-enforced labelling policy. If the committee wants, I can give a number of examples of loopholes in the current labelling system. We must trust consumers. We should give them information on where the product comes from and the standards to which it has been produced and allow them to make the choice. There is not enough clear labelling at the retail end.

Thirdly, there is the public procurement of food. We need a clear definition of best value for procurement in schools, hospitals, prisons and organisations such as the Parliament. Councils are expected to buy food according to best value, but that does not mean buying it at the cheapest price; it means taking into account the health benefits of local sourcing and the environmental benefits of sourcing closer to home.

Martyn Evans: We are moving from commodity-based production to consumer-focused production. Many of the suggestions that have been made have been focused on the supply side, but a demand-side focus is also required. James Withers mentioned public procurement. That would be an easy win. A lot of work is going on with the demand side of public procurement, but unless the demand side has a voice at the table—there is a large and dominant producer voice there—it will not be invested in, so the customers will not be there for what is produced. There must be a much clearer analysis of what investment there will be on the demand side if we are to encourage farmers to be consumer focused.

SEERAD has produced good work on conjoined analysis, to which Kevin Hawkins referred. Consumers consider price, quality and locality when they make consumption choices, but broadly they consume on the basis of price. Whatever they say, that is what they do. We must understand that and know the demand-side interventions that can increase their recognition of locality and quality. One of the reasons why consumers do not recognise quality is that their trust for farming is undifferentiated, which is a good thing: they think that every product is a quality product. They do not make a significant distinction based on locality, because it is not clear where the product comes from. There is a challenge with regard to labelling. Australia has started to address that, but it has run into significant difficulties in respect of audit and fraud. Those issues must be addressed.

Peter Nicholson: I endorse everything that has been said about communication in the supply chain. It is obvious from what has been said that there is a lot of misunderstanding. I would be in favour of any work that could be done in a forum-type organisation to improve the situation in the supply chain.

Martyn Evans stated that the competition situation that was described was a myth. There needs to be more discussion with the competition authorities. As a company, we have been at the sharp end of the OFT's decisions a number of times and I assure Martyn that the OFT's role is not a myth. Recently, our expansion was curtailed when we made an offer to buy a very small dairy in the central belt of Scotland, which represents only 2 per cent of the liquid dairy industry in Scotland and 0.2 per cent of the whole of the liquid industry in the country. Our offer was referred to the OFT and it failed as a result of the referral. That is an example of the OFT's actions with regard to competition. There should be further dialogue with the OFT.

The Convener: Does John Cumming have a last word on what ideas we should take to the minister to help to improve the situation?

John Cumming: I have sat here from the early morning into the afternoon, but I have still not got an answer to the question of where the money is. Let us hope that I get an answer at some point.

Scottish agriculture and Scotland's rural communities must be protected for future generations; the future of Scotland's rural communities is important. If we do not get some form of regulator in place to answer the questions that we have asked today, consumers will not get the choice of Scottish milk and Scottish beef. We cannot sustain an industry when we are not making money. I challenge anybody who is sitting round the table to bring any farmer, be they a beef or a milk producer, to the committee to disprove the sums that I have put to you today. There needs to be a regulator who will make the men who are paid big wages to protect the companies answer the questions fluently and honestly rather than hide behind bureaucracy.

Sarah Mackie explained why Tesco imports beef. There is a market for certain cuts of beef and for certain other products, but whatever the product there is always a bottom line and the product is still paid for. It is all to do with proportional representation: we are not being proportionally represented in the industry in relation to beef, sheep or milk. Proportional representation means equal terms for every viable person in the industry. Ten years ago, the dairy industry was split 30:30:30 between producers, processors and retailers. Today, the industry is split 60 per cent to retailers, 35 per cent to processors and 5 per cent to farmers.

Does the Scottish Consumer Council honestly think that farmers are getting a price that is based on the market and what the housewife buys? I repeat that farmers do not negotiate food prices; that is left up to organisations such as food processors and consumer associations. We do the work and they make the money. I want to know why that is. I want to know what the Scottish Consumer Council and the Scottish Government will do to protect rural communities in Scotland. That is the fundamental question. I want to know what legislation will be passed in the future to protect the rural economy in this country and the children who are growing up in it.

The Convener: That is the sort of issue that we are considering in the inquiry, which is why I invited people to give me their checklist of issues that they want us to chase. We do not have agreement round the table, but we did not expect that, because different interests are represented. However, members now have a lot of questions and issues to explore further with the ministers when we meet them next week.

Mr Ruskell: I have a brief supplementary about consumer issues.

The Convener: We cannot start another debate.

Mr Ruskell: It is on the back of Martyn Evans's comments.

The Convener: No. If I allow that, I will be swamped by people wanting to speak. That does not mean that you cannot raise the issue next week. In no sense have we fixed the issues today. The aim of the meeting was to get a range of views from the people round the table. I hope that they feel that their voice has been heard, although they will not feel that they have had all their questions answered—that is a matter for another day. However, they have got the issues on the table. It is our job as MSPs to try to ensure that we bring the right issues to the ministers' attention next week and beyond.

I thank everybody who has taken part. I know that some of you have taken time out of your businesses to come here. I also thank those who submitted papers, on which we will want to reflect after today's meeting. Please do not leave the issue there, but follow up next week's discussions in the *Official Report* of the meeting. When we produce our report, if you like what we have come up with, tell us; equally, get in touch if you do not like it. The report will not be the end of the discussion—we will return to the issues. I thank everybody for taking part.

12:32

Meeting continued in private until 13:04.

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