

Rùnaire a' Chaibineit airson Cùisean Dùthchail, Biadh agus an Àrainneachd
Cabinet Secretary for Rural Affairs, Food and the Environment
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Rob Gibson MSP
Convener, Rural Affairs, Climate Change and Environment Committee
c/o Clerk to the Committee
Room T3.40,
The Scottish Parliament
Edinburgh, EH99 1SP



28 October 2015

Dear Rob

Thank you for your letter of 4 September highlighting the RACCE Committee's concerns about the current challenges facing the dairy sector. You asked for an update on a number of issues which I have provided below and in the attached Annex.

I of course share the Committee's concern. The current problems facing Scotland's dairy farmers are complex and result from a combination of factors, both international and domestic. Dairy farmers are competing in a global market place where supply is currently exceeding demand. In addition, the Russian ban on food imports and a collapse in demand from China for dairy products have played a part in causing a fall in milk prices. Moreover, in March of this year the European Union lifted its restrictions on the amount of milk farmers could produce. Taken together these circumstances have created very difficult market conditions for the dairy sector which, in part, has contributed to the recent cuts in farmgate prices.

Figures released by the Department of Food and Rural Affairs (Defra) for June 2015 put the average farmgate price - which is the amount of cash farmers receive - at 23.66 pence per litre (ppl), the lowest for five years and down 25% in the last 12 months. It is generally accepted that the cost of production for a majority of producers is significantly higher than that - with some industry commentators suggesting an average cost of between 30 and 32 ppl.

Dairy Action Plan – see Annex

First Milk

We continue to support First Milk in its work to establish the business on a more secure footing. As previously advised Scottish Government is providing up to £416,000 food processing grant towards upgrading of the key Campbeltown Creamery which provides an outlet for Kintyre's remaining 36 producers – with £311,000 already paid out for the new whey-recovery equipment. First Milk will shortly be installing new boilers to replace the expensive temporary rented ones with Scottish Government again supporting. The grant will also assist with the costs of replacing obsolete packing and block-forming equipment.

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Collectively, these initiatives will deliver an immediate and positive contribution to the plant's efficiency and long-term viability.

In May I launched the Food Processing, Marketing and Co-operation (FPMC) capital grant scheme. The scheme is worth £70 million through to 2020 and my officials stand ready to advise and assist the company with any targeted investment plans aimed at improving the efficiency of the business.

In addition to supporting capital investment at Campbeltown we are also working with Scottish Enterprise, Highland's and Islands' Enterprise, Scottish Development International, SAOS, Argyll & Bute Council and First Milk on a range of "route to market" and business efficiency initiatives.

Transportation Costs and Review of Ferry Freight Fares

In May I made available £65,000 additional support to dairy farmers on Bute for a period of six months. This was done in the light of the exceptional circumstances being faced by dairy farmers on Bute and covers the cost of tankers returning empty on ferries to Bute from the mainland. The intervention was made following concern over First Milk's decision to further reduce the price of milk paid to farmers on Bute, the impact on the local economy and the sustainability of the industry on the Island. The funding is being paid to First Milk to allow the partial-reinstatement of the earlier price cut.

Following a commitment made in the Ferries Plan, Transport Scotland is currently conducting a comprehensive review of ferry freight fares across Scotland's entire ferry network. The aim of the review is to deliver a new freight fares structure that is straightforward and transparent, does not advantage one part of the network over any other part and delivers best value for taxpayers at a time of severe cuts to the Scottish Government's budget. The new freight fares structure will be implemented during future Scottish Government ferry contracts. The exact timing of the introduction of the new freight fares structure has yet to be decided and we need to be sure that any future discounts are state aid compliant. However, now is not the time to be introducing new ferry fare discounts which would undermine the work of the review.

Price Hedging

On price-hedging, there could be benefits from having a futures market as despite some cases where this can create excess volatility, it generally works to improve the efficiency of the market. This can include helping to manage/hedge against future risk. However, it is doubtful that a futures market would solve the numerous challenges which the dairy sector currently faces. Futures will do little to help the structural factors (like ending of quotas, economies of scale in dairy production) that have led to low prices, other than perhaps provide a signal that prices will be low in future and potentially discourage some production (and hence disappointment with low price). Nevertheless my officials are engaged with Defra who are leading on this although it remains to be seen whether such a market could benefit individual producers.

Ring-Fencing of Milk Quotas

The EU milk quota system ended on 1 April 2015 and as a consequence the Scottish ring-fencing arrangements also lapsed then. At some point it will be necessary to revoke the relevant legislation but Scottish Government does not intend to do this at this point as there could be residual enforcement action

Contracts

The operation of the dairy sector Code of Best Practice on Contractual Relationships (known as the “voluntary code” was reviewed by Alex Fergusson MSP in 2014. I previously indicated my support for the Code and for its extension into the retail sector. Progress has been slow but the issue is being considered by the AHDB Dairy Working Group which is considering effectiveness and uptake and intends to report by the end of this year and I look forward to seeing its findings. As an industry-led initiative the Scottish Government’s influence is limited but I continue to raise with industry leaders the need for an open, fair and transparent supply chain as means of creating trust and improving co-operation.

The option of introducing mandatory contracts was made available to Members States following publication of the “Dairy Package” in 2012. The current Westminster administration does not favour introduction and there would be resistance from within the sector – primarily from the processing sector but also a degree of concern from producer representatives over some of the detail in the minimum terms that would have to be incorporated into a compulsory contract. The Scottish Government’s main focus at present is to see and encourage a greater uptake of and enthusiasm for the voluntary code.

Intervention

We have raised this with Defra and at present there is little enthusiasm to address this matter. As a reserved issue any impetus would have to come from Westminster. The NFUS believe that there is some evidence suggesting that targeted raising of intervention prices could act positively to help manage volatility. Raising intervention levels comes of course at a cost and this type of market-support mechanism is not currently supported by Commissioner Hogan.

Producer Organisations

A group of dairy farmers may apply to the Rural Payments Agency (RPA) to become a Dairy Producer Organisation (DPO). Potential benefits include:

- strengthen members’ position in the dairy supply chain, meaning increased bargaining power and development of relationships.
- negotiate a better price for the delivery of raw milk to processors or to a collector (for all their members).
- helps ensure production is planned and adjusted to demand, particularly in terms of quality and quantity
- optimises production costs and operating margins through sharing knowledge and best (dairy farming) practice
- benchmarking and improved individual farm management
- Opportunities to explore different market opportunities
- Give better customer service to milk purchasers

SAOS were involved in helping to establish the Milk Supply Association – the DPO that supplies Lactalis and the Caledonian Cheese Company and are part of the consortium of agencies involved in assisting First Milk with their turnaround programme. It would respond positively to any request from the company or its producer-members for advice on DPOs.

Scottish Dairy Brand

I launched the industry-led Scottish Dairy Brand to the international market at the Anuga food and drink fair on 12 October in Cologne. The brand and its marque, which were unveiled by the First Minister at the Royal Highland Show earlier this year, have been developed to raise the profile of Scottish dairy produce, add value to milk and take advantage of the increasing international demand for products with a strong Scottish provenance.

Scottish Government is doing everything it can to help the industry find new opportunities – that includes introducing overseas customers to the range and quality of what we make, and providing excellent potential for further export growth. The sector can benefit from the growing global appetite for premium Scottish produce with unrivalled provenance, thereby adding significant and much-needed value to Scottish milk production.

To date, a total of 11 producers from across Scotland have signed up to use the Scottish Dairy Brand, with 18 brands using 40 different products across three ranges: heritage, artisan and organic – all of which are made using 100 per cent Scottish milk. The logo will be added to products such as cheese and butter and, in addition to signposting shoppers to Scottish produce, it will also help retailers and overseas buyers boost the profile of Scottish dairy produce. A significant level of interest was shown in Scottish dairy-branded products at Anuga with the strong likelihood of new business being generated as a result.

Scottish Development International, together with Scotland Food & Drink, have invested in a team of food & drink market specialists based in SDI's overseas offices, so we have people already in place to open doors with customers and make connections to Scotland's high quality suppliers.

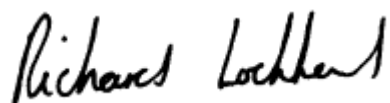
Additional activity

I very much hope that Committee members can appreciate that there is a lot happening in support of the dairy sector and using the levers open to me I am doing everything possible to encourage its development.

In August the First Minister announced a study into the extent of non-Scottish dairy products in Scottish supermarkets. The study is being carried out by Scotland Food and Drink will establish where retailers are sourcing products such as butter and cheese. The results will be used as a basis for working together to achieve a step change, bring more Scottish products to market and improve access for shoppers to Scottish dairy products.

In October I visited an NHS “Aroma” café in Edinburgh to support and encourage local-sourcing of dairy products. There are 25 such outlets throughout the Scottish NHS with all units using exclusively Scottish dairy products - achieved through fair and open competition. I also met recently with food service representatives to remind them of the wonderful range of high quality dairy products available locally.

Despite current challenges I firmly believe the Scottish dairy sector has a bright future – but it needs commitment and endeavour from all involved in the supply-chain to make this happen. This includes ensuring that dairy producers receive a fair return for their efforts as continuity of supply will only be secured if farmers are able to make a reasonable living from milking cows.



RICHARD LOCHHEAD

Scottish Dairy Action Plan – Update**1. Market development**

The Scottish dairy sector boasts a wide range of high quality products and benefits from its position as core to Scotland's booming food and drink industry. It has the potential to grow significantly its market share at home and abroad but achieving this will require focussed and energetic market development activity. The actions already underway, and those that we will pursue are:

1.1: Developing a strong Scottish dairy brand at home and, especially, abroad:

SG has given additional funding to the Dairy Growth Board to develop a Scottish dairy brand and range of products.

Work has begun on the brand, to be presented at the Royal Highland Show in June, and launched for the export market at the Anuga Food Expo in Cologne in October.

The brand will feature strongly in the Showcasing Scotland meet-the-buyer event with retailers, food service and overseas buyers in October. (SDI/SFD)

Update

The Dairy Growth Board, supported by Scottish Government funding created the Scottish Dairy Brand marque which was first introduced by the First Minister at the Royal Highland Show in June.

The Brand which has 11 processors on board, with 18 brands supplying 39 different products over three ranges (heritage, artisan and organic) was launched for the export market in October at Anuga in Cologne.

The Brand also featured at the Showcasing Scotland event at Gleneagles on 7 / 8 October where food-service companies and buyers from across the UK met with a number of Dairy companies.

1.2: Getting more Scottish dairy products on retail shelves, in food service and in export markets

We will engage actively with retailers on dairy products, agreeing the steps needed to encourage a viable local supply base, including wherever possible backing Scottish products in Scottish stores.

Update

The Scotland Food and Drink Partnership have supported the appointment of new food and drink specialists who have already been delivering invaluable in-market support and highlighting opportunities for Scottish dairy companies. A good example of this has been the SIAL Cheese Observatory in Toronto in April where the Canadian in-market specialist identified this opportunity which resulted in three Scottish dairy producers showcasing their products at the event.

The in-market specialist in Japan has also provided market research and support to the Scottish dairy sector.

We will prioritise access to UK retail with public support for a new UK supplier development programme.

Update

The Scottish Government has invested £40,000 in 2015/16 and 2016/17 towards running the ASDA Supplier Development Programme which will support up to 40 businesses to take part in a modular-based development programme. Outcomes include:

- ***5% sales growth for each business participant***
- ***Each business to achieve one new line with Asda***
- ***Deliver 15 new Scottish own-label products***
- ***Deliver extended listings(increased lines in an increased number of stores)***
- ***All suppliers accessing one or more module***
- ***All suppliers accessing specialist advice***
- ***All suppliers upskilled in one or more specialist topic(s)***
- ***Suppliers supported to develop an integrated action plan, where eligible.***

We will open discussions with food service and catering companies to ensure widespread adoption of the food charter and of best practice on labelling, in both cases starting with dairy.

Update

Mr Lochhead hosted the first forum of leading food-service companies in September and where local sourcing was discussed and encouraged.

We will ensure that promotion campaigns give prominence to dairy, in particular supporting the Year of Food and Drink's Delicious Dairy theme in August.

Update

August was the "Delicious Dairy" themed month-of-the-Year of Food and Drink and saw the launch of Scotland's first ever Ice Cream Trail which celebrated and promoted Scotland's ice cream producers and dairies, helping both locals and visitors map their way round one of Scotland's finest treats. Leaflets highlighting over 100 different ice cream businesses, from Kirkwall to Castle Douglas, were made available at relevant outlets, as well as online at Think Local and VisitScotland websites.

Scottish Cheese Trail hosted a delicious and informed tasting of an exceptional range of artisan cheeses from across Scotland. There were individual cheeseboards from 10 artisan cheese-makers.

In addition, an application was launched for Cambus O'May cheese to be granted Protected Food Name (PFN) status at the Aboyne Highland games.

We will promote exports, tasking the newly appointed food and drink in market experts, especially in Japan and Canada, to prioritise dairy opportunities and helping companies maximise the overseas potential of Showcasing Scotland.

Update

The Scotland Food and Drink Partnership have supported the appointment of new food and drink specialists.

The specialists have already been delivering invaluable in-market support and highlighting opportunities for Scottish dairy companies. A good example of this has been the SIAL Cheese Observatory in Toronto in April where the Canadian in-market specialist identified this opportunity which resulted in 3 Scottish dairy producers showcasing their products at the event.

The in-market specialist in Japan has also provided market research and support to the Scottish dairy sector.

We will work with local authorities to increase the consumption in schools of Scottish cheese, butter, yogurt and other dairy products.

Update

Scotland Excel, the local authority procurement organisation, has been asked to encourage support of plan among its local authority members.

In particular Scotland Excel was asked to contact all of the contracted dairy suppliers requesting each supplier to write to their public sector customers highlighting the Scottish dairy products which they are able to supply, and in the correspondence urge caterers to support the Dairy Action Plan by increasing the use of Scottish yoghurts, milk, butter and cheeses.

In addition, as part of 2015 Year of Food and Drink, SG provided Community Food Fund support and worked with ASSIST (the local authorities' catering association) to promote the Year of Food and Drink specifically August , as the month of – 'Delicious Dairy, Yoghurts, milk and cheeses'.

ASSIST expect that there will be an impetus created from this and a legacy going forward.

2. Promoting best practice in dairy farming

Dairy farmers are the bedrock of the sector. The Review of the Scottish Dairy Industry (Ambition 2025) looked at the efficiency and competitiveness of all parts of the Scottish supply chain, including the opportunities for greater collaboration among primary producers. There is clearly scope to spread better best practice in the many areas which contribute to world class dairy farming. Achieving that will require effective measures to provide information services bespoke to dairy farmers and to make it easier for ordinary farmers to benefit from practical advice from both advisers and, crucially, peers. We will therefore:

2.1: Spreading best practice

Give priority access to the dairy sector to whole farm reviews and the new SRDP advisory services and actively encourage farmer uptake.

Update

The Whole Farm Review scheme was re-launched in January 2015. Scottish Government continues to fund over 80% of the cost of consultancy support needed to carry out the Whole Farm Review and further specialist advice needed to implement the action plan developed under the review. However, the maximum level of total support available under this Scheme is £2,500 (as opposed to £2,400 in previous Scheme). The grant is paid direct to the advisory business carrying out the review. Demand for this scheme remains high.

As part of the 2014-2020 Scottish Rural Development Programme, a new advisory service will be launched for farmers, crofters and other land managers. The new service will combine both of the current services – the Veterinary and Advice Service and the Whole Farm Review

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Scheme – and will make access to advice both faster and less complicated through a single service point.

The new service will be funded by the Scottish Government through a service provider and will launch in April 2016, following an open tendering process.

Enhance the role of dairy Monitor farms.

Update

Established in 2013 the grant approved was £128K for the two 3 year projects. These developed on from the previously funded dairy monitor farms.

The 2 dairy monitor farms in South Ayrshire and Lanarkshire now commencing their 3rd and final year of the project.

Both monitor farmers and meeting attendees are utilising information and knowledge gained at the meetings to enhance their businesses, with generally very good feedback being received after each meeting.

Farmers appreciate having access to industry specialists to help them identify areas for potential savings in the current volatility as well as having the opportunity to discuss and debate issues with their peers.

For the future, as the current Monitor Farm projects come to an end in 2016, AHDB Dairy will be looking at the possibility of running a further Monitor Farm project, potentially as part of a cross sector project with AHDN Cereals.

We will continue to support the new Dairy Hub as an effective one-stop shop for advice. Ongoing

Update

Scottish Government continues to financially support the Dairy Hub initiative with match funding from AHDB Dairy.

2.2: Tax Averaging

We have successfully lobbied UK Government to extend the tax averaging provisions from the current 2 years to 5 years for Scottish Dairy farmers. The Chancellor announced in his recent budget that he would allow dairy farmers to average their incomes for tax purposes over 5 years. This will take effect in April 2016.

3. Promoting a transparent and efficient supply chain

As with every part of the economy, it is important that the dairy sector in Scotland has a thriving supply chain. That implies a need for efficient, confident players at every level of the chain and transparency as to the interaction between those different levels. Achieving that will require focused efforts in a number of areas: a). Ensuring sufficient processing capacity in Scotland

3.1: Ensuring sufficient processing capacity in Scotland

We will actively encourage and support investment in new and diverse capacity in dairy processing.

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Update

SDI are in the process of developing a suite of new inward investment material and will develop a proposition document aimed specifically at attracting new dairy inward investment to Scotland. SDI will also work through the current account-team structure with existing dairy inward investors to support them in securing new investment for new value added processing in Scotland.

The £70 million Scottish Government Food Processing, Marketing and Co-operation (FPMC) grant scheme opened to applications in May 2015. Applications from dairy companies – both home-based and inward-investors – are strongly encouraged.

3.2: Safeguarding the transparency of the market

We will discuss with the Grocery Code Adjudicator (GCA) how best to ensure it can perform its role effectively in respect of the Scottish market.

Update

Richard Lochhead met with Ms Christine Tacon (GCA) on 8 October 15 when it was agreed to explore the prospects of a meeting involving Scottish producers and processors who could learn of the work of the GCA in Scotland and discuss / raise particular concerns.

We will agree on the steps needed to be taken in response to the report on the voluntary dairy code, including possible extensions to the scope and substance of the code.

Update

Scottish Government officials have discussed with Defra and NFUS the operation of the Voluntary Code of Practice between NFU/S and Dairy UK and the recommendations flowing from the inaugural review of the Code, chaired by Alex Fergusson MSP. It is generally felt that there has been insufficient interest and take-up and Scottish Government will continue to encourage wider adoption – with the possible extension to the retail element of the supply-chain.

3.3: Encouraging supply chain efficiency

We will assist all parts of the supply chain to remain operationally efficient, competitive and adequately skilled.

Update

Supported by Scottish Government SAOS completed an Market Driven Supply Chain (MDSC) project amongst Fresh Milk Company (Lactalis) and the Milk Suppliers Association (farmer supplier group) identifying opportunities to improve the efficiency of their supply chain. A follow up application to Scottish Government's Knowledge Transfer and Innovation Fund (KTIF) grant scheme is being prepared to support a project to implement the farm aspects of the recommendations, focussing on cost efficiencies, milk quality improvement, and production forecasting.

SAOS has assisted in planning a MDSC project for The Orkney Cheese Company to identify opportunities for improved supply chain efficiencies and is also working with the Milk Suppliers Association to put in place the necessary arrangements to attain RPA recognition as an EU Dairy Producer Organisation (PO).

SAOS continues to work with First Milk and various agencies on the future options for Campbeltown Creamery and participates with NFUS and others in a review of the Dairy Voluntary Code of Practice and to identify ways to accelerate the establishment of EU Dairy POs.

SAOS has also delivered a project commissioned by Scottish Enterprise to identify a model for a Dairy Centre of Excellence to facilitate future innovation in the industry and the development of best practice on farms and in the supply chain. The research looked at provisions in Australia, New Zealand and Ireland.

4. Supporting First Milk in transforming its operation in Scotland

First Milk is a cooperative enterprise whose HQ is in Scotland and which involves a large number of Scottish dairy farmers, many in remote areas. Securing a thriving future for the company is important for the sector as a whole. Achieving that will require actions, not only by the company itself, but by several other players in the chain, such as:

4.1: Supporting business change

Working together with First Milk to ensure streamlined and effective public sector support for the company's plans to transform its business. This will include implementation of an 8 point strategy as laid out by the RACCE Committee.

Provide support for First Milk's revised capital investment plans in Campbeltown. Ongoing

Update

Scottish Government, together with other agencies, continues to work with First Milk on their turnaround strategy – including over £400,000 grant assistance towards the costs of upgrading Campbeltown Creamery, which provides the sole-market for the remaining 36 Kintyre dairy producers. A further £65,000 of assistance towards First Milk's haulage costs for Bute – partially mitigating recent cuts in farmgate prices.

Integrating First Milk products fully into the development of the Scottish dairy brand.

Update

Selected First Milk cheese products were included in the range of products showcased at the recent Anuga food fair where the Scottish Dairy Brand marque was launched by Richard Lochhead.

4.2: Mitigating ferry costs

We will ensure the ongoing comprehensive review of freight fares across Scotland's ferry network takes account of impact on dairy transport costs.
Target: October

Following publication of the research report on 23 June, Transport Scotland, under continued guidance of the working group, is conducting further analysis to consider the favoured options for future freight fares structure identified in the research report and the potential impacts on economic development and future sustainability of the islands.

The new freight fares structure will be implemented during future Scottish Government ferry contracts. The exact timing of the introduction of the new freight fares structure has yet to be decided.

5. Getting the international rules right

Conditions in the dairy sector in Scotland are strongly affected by international events of various sorts. These range from dramatic changes in market prices to EU rules which impact – for good or ill - on market opportunities. It is important that such issues are debated openly with due account taken of the circumstances in the Scottish sector. Achieving this will require activity in a range of forums.

5.1: European engagement:

We ensured that the issue was discussed at the EU Agriculture Council in January – and will do so again, as necessary, at future Councils, in particular so as to monitor actively world markets and the impact of the ending of quotas.

We will explore the scope for EU recognition of local products - in particular from remote areas – as Protected Geographic Names.

Update

An application was launched for Cambus O'May cheese to be granted Protected Food Name (PFN) status at the Aboyne Highland games.

5.2: UK Government:

We will press Defra to accelerate the timetable for extending Country of Origin Labelling to dairy. This will include holding Defra to the agreement in the Smith Commission to argue for EU recognition of “Made in Scotland”.

Update

Scottish Government continues to press for the extension of Country of Origin labelling to dairy products. Our position is supported by Defra but continues to be opposed by the EU. With our encouragement Defra is seeking to gauge and garner support amongst other EU countries.

We will work with Defra and others on exploring the potential role for sole form of hedging to help mitigate price volatility.

Update

Included in letter.

**Scottish Government
October 2015**