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SCOTLAND'S DAIRY SECTOR – CURRENT AND ONGOING ISSUES.

Current Issues.

1. Looking ahead to the fast approaching winter, where costs, particularly feed, become ever more significant it is clear that these costs may rise by as much as 3p per litre (ppl). Feed is the largest variable cost to dairy producers and the main ingredients such as wheat, soya, rape, distillery by-products, have all seen significant rises. Feed manufacturer BOCM has estimated a rise in compound feed of 20%. Other major inputs to dairy farmers are also rising - fertiliser is up 20%, oil is up 25% and the price of straw will see similar increases. Volatile input costs are a reality, but even the most efficient and organised dairy producers will be unable to significantly reduce the impact of these price increases on key inputs.
2. Tesco are the only major milk buyer who have a pricing formula for liquid milk that reflects both the cost of production (as calculated by an independent consultant Promar) and dairy market indicators. Tesco deserve credit for this initiative. The prices paid to Tesco direct suppliers are reviewed twice a year, in the spring and the autumn. The cost of production figure as calculated in the spring by Promar for Tesco stood at 26.4 ppl, down from 26.9p the previous autumn. Those farmers fortunate to have a direct liquid supply contract (around 12-15% of producers have a direct supply contract with a major retailer) are receiving a price at or around that level. However, the average milk price paid to all dairy farmers (those supplying liquid milk contracts, cheese companies, co-operatives, milk brokers etc) as calculated by DEFRA for the first six months of this year stood at 24ppl. This clearly indicates that the vast majority of dairy farmers are still being paid less for their milk than the true cost of producing it on farm.
3. The Tesco liquid price review, due in the coming weeks, is eagerly awaited as an important price indicator. Given that costs to dairy farmers have risen and the market indicators for milk and dairy products are all positive, we are hopeful that the Tesco pricing formula will encourage all milk buyers to acknowledge that producers need a price that reflects the cost of producing milk. A fairer price paid at the farmgate is justified, regardless of whether that milk is processed for the liquid market, cheese or another dairy product.

On going Issues

4. A recent Defra funded study (report on agricultural efficiency at the farm level 1989 to 2008) on the technical efficiency of UK and EU farmers indicated that Scottish dairy farmers are amongst the most efficient dairy farmers in the EU. However, the imbalance in the supply chain results in an unreasonable share of the supply chain margins being passed to dairy farmers. The majority of producers still find it difficult to cover the real costs of producing milk.

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5. All UK wholesale market indicators for dairy products are significantly higher than last year. The same is true for European and global prices. UK butter and cream, for example, are 60% and 50% up on last year yet prices paid to producers have risen by only 0.19ppl to 24ppl (a rise of only 0.8%) according to DEFRA figures. These facts clearly illustrate that the market is not functioning and needs to be addressed.
6. The reasons for the lack of progress on price are many, but mostly are unjustified. Milk and milk products are consistently subject to heavy discounting by retailers as part of a strategic policy in the ongoing retail price wars. Large processors in the liquid and cheese sectors also continue to attempt to undercut competitors by offering products at heavily discounted values. Neither of these strategies significantly raises overall sales of dairy produce but merely affects individual retailer or processor share of the market. It does, however, take money and value out of the supply chain and is largely funded by paying lower prices to producers as the lowest and weakest link in the supply chain.
7. There are many recent examples of savage liquid milk discounting. ASDA reduced the price its 4-pint (2.27 litre) poly-bottles from £1.53 to £1.25 (an 18.3% reduction in price equivalent to a cut of 12ppl). Tesco reduced the price of own label One-Percent fat milk to the equivalent of 25ppl, while Sainsbury's put its One-Percent fat milk on temporary promotion at £1 for 4 pints. These current discounts appear to be a direct consequence of losing market share to the so-called 'discounters'.
8. The exodus from dairy farming in Scotland is continuing, with latest figures showing acceleration in the number of dairy herds giving up. The Scottish Dairy Cattle Association recently reported 38 herds were dispersed in the first half of 2010, against 41 for the whole of last year. The fall in dairy cow numbers was smaller, with milking cows at 158,240, a fall of 1,330 since January, in 1,070 herds. Average herd size was up three to 148. The reason for leaving the industry varies, but few give up because they dislike dairy farming. While there is some evidence of progressive producers taking advantage of rural development grants, for many the poor returns over more than a decade have convinced them that the best option is to get out of dairy.

Progress

9. In the very short term, we believe that Tesco will stand by their commitment to pay a price that recognises the cost of producing milk, and that other retailers and processors must follow their example.
10. Longer term there are opportunities, which must be taken. The EU High Level Group (HLG) on dairying has clearly stated that the dairy supply chain is not working and that producers are suffering as a result. Most significantly, the HLG identifies the need for effective milk contracts; more equitable power distribution and more transparent and fairer distribution of supply chain margins.

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11. Crucially, the HLG recommends that milk contracts must include price formulation, volumes and contract length. NFU Scotland will argue for price formulation to be enshrined in contracts and that the agreement must be reasonable to both buyer and seller. To achieve this the negotiating position of producers must be presumed to be equal to that of the buyer. On volumes, producers must recognise that they also have a responsibility to adjust volumes to market demand. None of this will be achieved without opposition. NFU Scotland is working with the Scottish Government and Defra in advance of the Commission's response to the recommendations of the HLG with the objective of achieving tangible results. We believe this is in the long-term interest of the entire supply chain and the consumer.
12. Improvement in contract terms is achievable. Tesco's liquid contract is an example of how a pricing formula can work. The co-operative Milk Link has a cheese formula, which has worked well in delivering better returns from the market place back to its members. NFU Scotland believes that although price formulas will vary depending on the sector and circumstances, and will need to be reviewed if either the buyer or seller is being disadvantaged, they offer an opportunity to formalise a fairer and reasonable pricing structure.
13. In addition to better contractual agreements the HLG and the Commission believe there is a need to increase the bargaining power of producers and their representatives. Currently producer representatives have little opportunity or power to influence or negotiate on behalf of their farmer groups. There is hope that this can be enhanced and we await with great interest the conclusion of the Commission and hope to influence any national interpretation, which is likely to be available. In the interim, NFUS is developing its own initiative in this area.
14. The enhanced Grocery Supply Code of Practice is now in place and the recommendation of the OFT that an Ombudsman should be initiated too oversee this code has now been accepted, all be it in the form of an 'adjudicator'. As we understand it, the adjudicator will primarily be responsible for overseeing the Code of Practice, but NFU Scotland and others will lobby to ensure that the post is as proactive as the remit allows. Draft legislation on the adjudicator is expected in November 2010, with a draft bill timetabled for parliamentary progress in April 2011 and completed by October 2011.