House of Commons
Environment, Food and Rural Affairs Committee

Dairy prices:
Government response to the Committee's Fifth Report of Session 2014–15

Sixth Special Report of Session 2014–15

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The Environment, Food and Rural Affairs Committee

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The current staff of the Committee are David Weir (Clerk), Clementine Brown (Assistant Clerk), Sarah Coe (Senior Committee Specialist), Sara Priestley (Committee Specialist—Environment), Emma McIntosh (Senior Committee Assistant), Lisa Stead (Committee Assistant), Holly Knowles (Committee Support Assistant) and Nicholas Davies and Rosie Tate (Media Officers).

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Sixth Special Report

The Environment, Food and Rural Affairs Committee reported to the House on Dairy prices in its Fifth Report of Session 2014–15, published on 20 January 2015 as HC 817. The Government’s response to the Report was received on 20 March 2015 and is appended below. Each recommendation made in the Committee’s Report is set out in a bold paragraph with the Government’s response directly beneath it.

Appendix: Government response

Introduction

1. The Government welcomes the Committee’s report of its inquiry on dairy prices. We share the Committee’s view that some of our dairy farmers are struggling with the current low prices for milk. We have asked HMRC and the banks to take a sympathetic stance with dairy farmers in this period, and we have ensured that farm payments for dairy farmers have been prioritised by the Rural Payments Agency (RPA). The Government wants to build a competitive and resilient world leading dairy industry that can take advantage of increasing world demand for dairy products. Exports are at record levels topping £1.4 billion last year, a 51% increase since 2009.

2. The Government also welcomes the opportunity to clarify the jurisdiction and powers of the Groceries Code Adjudicator (GCA).

The way forward

Given that the major opportunities to tap into increasing world demand for dairy will arise outside the EU in China, Russia and Africa, the need for a strategy for greater export is clear. Defra must explore with the industry practical steps to ensure that export opportunities are identified for the industry to tap into.

3. The Government strongly endorses the Committee’s findings about the positive long-term prospects for the UK dairy industry with worldwide demand expected to continue to grow. The Government is working hard to promote our world class food and drink industry in key overseas markets. In the past year, the Government has opened new markets for UK dairy which supported a 25% year on year growth in non-EU dairy exports in 2014. Our strategy is to focus on the most lucrative opportunities such as trade with China and the US and on opening markets in the economies of the future—including dairy markets in Latin America and sub-Saharan Africa.

4. Defra will continue to organise meetings of the Dairy Export Users Group. This brings Government and industry together on a regular basis to discuss challenges and
opportunities, prioritise market access negotiations, and encourage a successful and thriving UK dairy export sector.

We welcome the commitment given by the Secretary of State to explore with farmers the creation of producer organisations. We agree with the Government that it is a matter for farmers themselves whether they see opportunity in combining to increase their collective bargaining power and influence. We note the reluctance that exists among farmers and their representative organisations, and recommend that the Government identify reasons for that caution and the barriers that may exist to prevent farmers taking this course.

5. The Government has taken a number of steps to encourage and support the creation of dairy producer organisations (POs) and we will continue to discuss this with the NFU and other industry leaders. We have implemented the relevant provisions of the EU “Milk Package” to allow POs to form. The RPA has published guidance on the procedure for setting up dairy POs in the UK and the requirements that need to be met. In addition, the Government has provided £5m of funding to help producers explore opportunities for collaboration.

6. As the Committee has recognised, the creation of dairy POs and the organisation of collective negotiations, require time and a strong dynamic from farmers themselves. On 26 February 2015, the RPA formally recognised Dairy Crest Direct Ltd as a dairy PO. DCD represents 1,050 dairy farmers in England and Wales supplying 1.5 billion litres of milk. This development may encourage other dairy farmers to consider the advantages of a PO model.

We recommend that Defra seek a commitment from the EU Agriculture Commissioner Phil Hogan that the current intervention price for milk of around 17 pence per litre be reviewed before the end of milk quota arrangements in April 2015, and ask the Secretary of State to work with counterparts to keep under regular review thereafter.

7. This was the subject of detailed discussion by Ministers at the EU Agriculture and Fisheries Council on 26 January 2015. Commissioner Hogan made clear that it would not be appropriate, in his view, to raise the intervention price for dairy products and it is more important to pursue long-term solutions like developing new export opportunities. Higher intervention prices could also serve to undermine the development of a dairy futures market. None the less, the Commission has taken steps to provide immediate “safety net” support for the EU dairy industry; for example, private storage aid schemes for butter and skimmed milk powder have been extended until 30 September 2015 in response to the Russian trade ban. The Commission is also considering how the EU Milk Market Observatory could be further strengthened to provide better quality, more accurate and timely information for businesses to work with. The Government is sceptical about increasing the intervention price since it is likely other countries would benefit most, whilst the cost of implementing it would fall on UK farmers.

We strongly support the Secretary of State in seeking clearer EU regulation on labelling of ‘country-of-origin’ products. Country of origin should imply that the raw materials
contained in a product were born or grown within that country, and not simply processed there.

8. The Government is grateful for the Committee’s support on country of origin labelling. Improvements are needed so shoppers know when they are buying quality British dairy products. The Secretary of State has raised this issue with the EU Agriculture and Health Commissioners. The Commission is due to publish a report on the feasibility of mandatory labelling of milk and milk products soon.

**The voluntary code**

We recommend that the dairy industry code of best practice remain voluntary in order to retain the flexibility and scope it presently offers. The current crisis affecting dairy farmers is, however, a significant test for the arrangements introduced after the 2012 price crunch. The code is subject to annual review and we expect the 2015 review to take full account of the lessons learned from the present market conditions.

Neither a statutory nor a voluntary code can set or regulate prices in an open market. None the less, the instability of current pricing within the dairy industry in general and for milk in particular implies that closer attention is needed in the next review of the code to the damage that sharp and rapid shifts in price do to the industry, not least in forcing the exit of producers for whom short-term market fluctuations may prove fatal. Greater guarantees of likely future income are required if farmers are not to continue to depart.

9. The dairy code of practice has been successful in helping farmers get fairer contracts with their milk buyers, and we agree with the Committee’s view that a voluntary approach is preferable. Having said that, the Government believes that it is important to build on the code’s success and broaden its adoption. Ministers discussed this with the NFU, Dairy UK and other industry figures at a roundtable meeting on 11 February 2015. It was agreed that a new industry-led group should be established to explore the recommendations of Alex Fergusson’s review and what more can be done to support our farmers during periods of uncertainty about prices, such as the creation of a futures market in dairy products.

**Review of the GCA**

We believe that the terms under which the Groceries Code Adjudicator may operate are too restrictive and that a means must be found to protect suppliers of products to major retailers whether or not they are direct suppliers, as under the current arrangement. We note that the Government is committed to review the operation of the GCA in 2016 but we recommend urgent consideration of how the GCA remit can be extended to incorporate suppliers throughout the supply chain.

10. The GCA’s jurisdiction is tightly defined by the Groceries Supply Code of Practice. The Groceries Code pre-dates the creation of the GCA, and reflects the findings of an investigation of the supermarket sector by the Competition Commission from 2006-08. This established that the most significant problems in the sector were focused on the
commercial relationships between the ten largest supermarkets and their direct suppliers. There are no powers within the Groceries Code Adjudicator Act 2013 that would allow Ministers to extend the GCA’s jurisdiction. Changes to the GCA’s remit would require either a decision by the Competition and Markets Authority to conduct a further investigation into the sector or primary legislation to amend the 2013 Act.

11. The provisions in the GCA Act for reviews of the Adjudicator by the Secretary of State focus on how effectively the Adjudicator has exercised her powers and enforced the Code. They permit the Secretary of State to make changes to the GCA’s *modus operandi*; but not to amend the Groceries Code itself. Ministers have no power to conduct this statutory review before 2016.

12. The Government believes that concerns about fairness and transparency in the dairy supply chain should be addressed through an industry-led approach. Defra has established and is facilitating a dairy industry group to look at contracts in the dairy sector and build on progress under the existing voluntary dairy code of practice. BIS and the GCA will participate as required in the Industry Group. Its findings will be considered as part of the statutory review of the GCA in 2016.

We repeat the recommendation we made when the Groceries Code Adjudicator was created that she should be able to accept complaints from indirect as well as direct suppliers.

13. The GCA’s own statutory guidance, published in 2013, makes clear that the Adjudicator can take account of wider evidence beyond that submitted by direct suppliers. It states that reasonable grounds for suspicion of a breach of the Groceries Code might be based on evidence supplied by direct or indirect suppliers; third parties, such as trade associations; other retailers; whistle-blowers; or information that is already in the public domain.

14. In practice, the GCA has been pro-active in building relationships with stakeholders throughout the supermarket supply sector. BIS has recently approved the GCA’s request for an increase from £800,000 to £1.1m in its levy funding for 2015–16 to help to further its industry engagement; and will continue to work with the GCA to ensure that the extent of the Adjudicator’s evidence-gathering powers is understood.

We note that the GCA has not yet conducted an investigation. Following our own pre-legislative scrutiny of the Bill which created the Groceries Code Adjudicator, we recommended that she should have the power to launch pro-active investigations as well as respond to complaints, and we repeat that recommendation now.

15. Ministers have welcomed the announcement by the GCA on 5 February 2015 that she has launched a formal investigation into suspected breaches of the Groceries Code by Tesco Plc.

16. The Government does not accept the view that the Adjudicator cannot pro-actively launch investigations, and must rely on receiving complaints from suppliers before she may act. This is not an accurate reflection of the GCA Act or the GCA’s own statutory
guidance on investigations. Section 4 of the 2013 Act gives the Adjudicator wide powers to investigate where she has **reasonable grounds** to suspect a breach of the Groceries Code. It is for the Adjudicator alone to satisfy herself when there are reasonable grounds and whether to carry out an investigation. Ministers are confident that the Adjudicator will continue to use these powers to be an active and visible guardian of the Groceries Code. BIS will work with the GCA to promote greater understanding of the Adjudicator’s powers of investigation.

**The powers of the GCA**

We find it extraordinary that the Government has left the Groceries Code Adjudicator for more than a year with no practical ability to use her legal powers. We recommend that a statutory instrument setting out the level of fine the Groceries Code Adjudicator may levy be laid within the remainder of the present Parliament. We seek a clear explanation of why the GCA has been left so long without the teeth she needs to do her job.

17. The Government understands the Committee’s frustration about the delay in bringing forward legislation to give the GCA the power to impose financial penalties for breaches of the Groceries Code.

18. BIS Ministers laid the Groceries Code Adjudicator (Permitted Maximum Financial Penalty) Regulations 2015 on 28 January 2015. The Regulations, which set the GCA’s maximum penalty at 1% of UK turnover, have been assented to by Parliament and will come into force on 6 April 2015.

**Conclusion**

19. Some of our farmers are struggling with low prices and we are doing everything we can to help them through this period. However, there is great potential for significant long-term growth in the UK dairy sector. UK milk production is at a 10-year high and exports are at record levels. The global market is expected to grow at a rate of more than 2% a year for the next 10 years. To meet such an enormous increase will require the equivalent of bringing on-stream an extra New Zealand dairy industry every year. There are opportunities at home too. The UK is self-sufficient in liquid milk, but we are importing significant quantities of dairy products such as ice cream, yoghurt and cheese which could be produced in the UK.

20. At the dairy roundtable on 11 February, the industry agreed to work together to develop actions to end the current trade deficit in dairy products and increase exports. Defra is facilitating an industry-led group to look at contracts in the dairy sector, the findings of which will feed into the statutory review of the GCA in 2016. Through the new Countryside Productivity Scheme, the Government will be helping farmers to develop world class production and supply chains, improve skills and start up new business ventures. Through the Rural Development Scheme additional support will be available to help dairy farmers invest in new equipment, fund start-ups and support young farmers entering the industry.