



ENVIRONMENT AND RURAL DEVELOPMENT COMMITTEE

Mr Peter Freeman
Chairman, Competition Commission
Victoria House
Southampton Row
London
WC1B 4AD

9 June 2006

Dear Mr Freeman

Competition Commission inquiry into the grocery market

The Environment and Rural Development Committee has recently conducted a short inquiry into issues in the food supply chain, focusing on how sustainable relationships in the chain can be encouraged.

During the course of that inquiry, the Office of Fair Trading announced its intention to refer the grocery market for a full market inquiry by the Competition Commission. Much of the evidence heard by the Committee related to matters which are the devolved responsibility of the Scottish Ministers, and the Committee directs a number of recommendations to them. However, the Committee also heard substantial evidence relating to competition issues and the way in which collaboration and market power in the food supply chain has been affected by the regulation of competition. The Committee considers that its findings on these issues are relevant to the Commission's current inquiry and, therefore, agreed to submit its report to the Commission. I hope that the Commission will be able to consider it and will find it useful.

All of the written and oral evidence submitted to the inquiry is publicly available on the Committee's web-page at:

<http://www.scottish.parliament.uk/business/committees/environment/inquiries/fsc/env-fsc-home.htm>

I am grateful to your colleagues for indicating that you would be willing to accept this submission after your deadline. The Committee's report is due to be published on the

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morning of Monday 12 June, and I would be grateful if you could, therefore, keep this submission private until then.

Yours sincerely

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Convener

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Environment and Rural Development Committee

8th Report, 2006 (Session 2)

Report on an Inquiry into the Food Supply Chain

The Committee reports to the Parliament as follows—

INTRODUCTION

1. In December 2005 the Committee agreed to conduct a short inquiry into issues in the food supply chain. The Committee was aware of anecdotal evidence of concerns at the effects that some issues in the supply chain were having on farmers and the viability of farm businesses. The Committee agreed to examine how sustainable relationships in the supply chain can be encouraged in order to support Scotland's rural economy. While the regulation of competition is a reserved matter, policy and funding support for sustaining the rural economy is devolved. The Committee agreed that the inquiry would focus on:

- 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 rural economies.
- How the review of the Executive's agricultural strategy can encourage those relationships.

2. On 1 February 2006 the Committee took oral evidence from a range of farmers, food processing businesses, supermarkets, consumer representatives and business development agencies in order to get a picture of the issues throughout the supply chain. On 8 February the Committee took evidence from Ross Finnie MSP, Minister for Environment and Rural Development, and Allan Wilson MSP, Deputy Minister for Enterprise and Lifelong Learning. The Committee also received written submissions from these and other witnesses, and is grateful to all who contributed to the inquiry.

3. At its meeting on 22 February, the Committee agreed that, before concluding the inquiry, it would write to the Office of Fair Trading and the UK Minister in the Department of Trade and Industry with responsibility for competition issues.
4. All of the written material submitted by the various witnesses, and the *Official Report* transcripts of the oral evidence sessions, are available on the Committee's web-page.¹
5. Shortly after that meeting, the Office of Fair Trading announced its intention to refer the grocery market to the Competition Commission for a full market inquiry. Following a consultation period, this decision was confirmed, and an inquiry was launched by the Competition Commission on 9 May.
6. In this report the Committee makes a number of recommendations to the Scottish Executive on areas of devolved responsibility. The Committee also makes a number of recommendations which it considers are relevant to the Competition Commission's inquiry. The Committee submits these to the Commission. It also submits them to the Scottish Executive and to the UK Minister responsible for competition issues, and requests that they pursue them with the competition authorities.

BACKGROUND

7. The Committee has examined some issues relating to this inquiry in its previous work on rural development, on Common Agricultural Policy reform and on scrutiny of the Scottish Executive rural affairs budget. Relevant recommendations in this previous work focused on the assistance which is available for farmers to develop their businesses as agricultural support moves away from production subsidies. The Executive's *Forward Strategy for Agriculture* (2001) sought to focus on supporting the development of a "prosperous farming industry". A revised version of this strategy was published during the course of the Committee's inquiry.
8. Food and drink production and processing is said to be the second biggest manufacturing sector in the Scottish economy, representing about one-fifth of all manufacturing employment. The Executive's Scottish Food and Drink Strategy (1999) identified six action areas, including developing an effective and efficient supply chain. The Executive has said that the agriculture and food strategies are intended to work together.
9. During the inquiry the Committee heard detailed evidence about the market difficulties faced by farmers. A lot of evidence focused on the milk market. This is a sector in which price pressures and the structure of the market are creating particularly difficult circumstances for farmers. However, the Committee also heard evidence about problems in other sectors, such as red meat and vegetable production.
10. For all sectors, the evidence focused on two main themes:

¹ <http://www.scottish.parliament.uk/business/committees/environment/inquiries/fsc/env-fsc-home.htm>

- Firstly, a set of issues emerged about how the agriculture industry is developing post-CAP reform, and how the whole approach of Scottish public policy (on agriculture and rural development, but also over a range of other sectors) seeks to support farm businesses in fulfilling a vision of what Scottish agriculture should deliver.
- Secondly, a related but distinct set of issues emerged on the way in which relationships and the distribution of power in the food supply chain affect the sustainability of Scottish agricultural production and, consequently, the rural economy.

11. On the first, the Scottish Executive has devolved responsibility for a range of measures, including agricultural and rural development support funding, public procurement, environmental objectives, and so on. On the second, the issues are common to other parts of the UK and some of the suggested solutions apply across the UK. However, the evidence to the Committee also suggested that there are distinctively Scottish elements to the relationships and competition issues in the supply chain because of the balance of primary products grown in Scotland and the structure of the farming and processing industries here.

PRICE PRESSURES

12. Much of the evidence to the Committee centred on the downward price pressures which are felt by farmers, and the reasons for these. Farmers gave evidence on the impact these are having on the viability of their businesses. Some witnesses provided analysis on the structure of the global milk market and the difference between the relatively lower price of milk-based commodities and the higher price of liquid milk, and the particular pressures this has exerted in Scotland following deregulation of the milk market.

13. More generally, others focused on the interaction between processors and retailers in the supply chain and relative strengths of bargaining power enjoyed by different elements in the chain.

14. There was also a wide range of views on whether there is a problem in matching supply and demand in some product sectors, and the effect that has on prices. However, this varies considerably among producers of different sizes and sectors, and among retailers of different sizes and specialities. Some witnesses suggested that there is a need for structural problems in some sectors to be resolved naturally by the market before there will be significant change in profitability for remaining farmers.

15. Evidence suggested that the current situation of persistent price pressure on farmers is putting extreme strain on the sustainability of some farm production, and decoupling of CAP support removes the incentive for farmers to produce at a loss. Although particular evidence was presented on milk and red meat, the Committee heard evidence that farmgate prices for many products can be below the cost of production. However, the retail price of these products is comparatively high in the UK. Also, several witnesses gave detailed evidence that when retail

prices rise, increased returns in different parts of the chain do not appear to be passed on to farmers.

16. There was a range of views on where the problem lies. Some witnesses argued that farmers are victim to the pressure created by processors trying to maintain small margins and others that major retailers have a very dominant position and are not passing an appropriate share of their margin down the chain. Some detailed evidence was presented to the Committee on the way in which the largest supermarkets use their market power, and the difficulty of gaining any transparency about how that power influences the complex relationships in the supply chain.

17. Proposals for how to address these problems focused on issues under two main themes.

DEVELOPING FARM BUSINESSES

Increasing the value of production

18. A very strong emphasis in evidence was on the need for farmers and food processors to create more market power and increase margins by adding value to the primary product. Many witnesses argued that this should be a focus for the revised agriculture strategy, and for creative use of CAP funds where possible. In previous reports the Committee has commented on the need to use rural development funding to strengthen the infrastructure of the agriculture and food industries, and to assist in improving the supply chain.

19. Evidence to the current inquiry highlighted that this is still an issue. Several witnesses stated that many products, including dairy products, leave Scotland to be processed elsewhere before being re-imported. There was a general view that there is a relative lack of integration and focus on the need to add value in the milk sector. However, some witnesses stated that a stimulus is needed to achieve this as current returns to farmers do not provide sufficient income to allow investment. Evidence indicated that even some farmers who have invested significant funds in modern efficient milk production systems are leaving the business. While there are some successful major businesses, overall the evidence suggests that there is a high-quality, but relatively small, processing sector in Scotland. There is clearly a need to improve and extend best practice and examine how the sector can be supported effectively. **The Committee has made recommendations on these issues previously, and requests that the Minister explain in detail how the revised agriculture strategy will contribute to this.**

Support for local food economies

20. Witnesses representing all parts of the supply chain focused on the need for high-quality Scottish produce to be marketed as such rather than attempting to compete on price in global commodity markets. Many claimed that consumers recognise Scottish produce as high quality and are willing to pay for locally-produced food. However, retailers argued that there may be some mismatch between this consumer recognition and the apparent unwillingness by consumers to purchase on anything other than price grounds. A number of witnesses

commented on a need to develop a stronger 'local food economy' - with the locality being Scotland as a whole (rather than smaller districts of Scotland).

21. Many witnesses argued that there should be a much greater focus on the additional marketing benefits that may be achieved (in terms of sales volume as well as price premium) by products being recognised as Scottish, and on continuing brand development. Some also suggested that the focus on marketing generally needs to improve. There is a need to continue to look at the regulation of labelling to support sales of Scottish brands. Labelling that identifies country of origin is a recognised means to support Scottish farming.

22. Local food branding enables farmers to differentiate their produce. Support for the development of farmers' markets was also suggested as a very positive element which offers farmers an alternative market for their products to avoid total dependence on supermarket contracts.

23. It was also suggested that the Executive should explore the idea of a 'food surplus agency' to use food for public benefit. This could provide an outlet for produce that is edible but rejected by supermarkets - perhaps on standardised appearance grounds - and for which their contracts currently may not allow farmers to seek an alternative market.

24. The development of local food economies also contributes positively to a wide range of other public policy priorities - including sustaining the distinctive economic character and viability of small towns in accessible rural areas, and reducing food miles (and, therefore, transport costs and emissions).

25. The Scottish Association of Meat Wholesalers (SAMW) emphasised that retail sales of meat account for less than 50% of sales, with other sectors such as catering, food service industries and manufacturing also being very important outlets. A number of witnesses focused on procurement of Scottish food by the public sector as a direct and important way in which the Executive can support Scottish farming. As an illustration, First Milk cited the loss of the sale of milk to schools as a factor in the reduction of consumption in the milk sector. Ministers emphasised other public activity which works to bring suppliers and purchasers together to promote Scottish produce.

26. Ministers stated that public procurement already specifies Scottish produce where appropriate, but has to work within EU procurement rules. The Committee sought further information from the Minister for Environment and Rural Development on the constraints imposed by these rules. He explained that guidance allows award criteria to include factors such as membership of appropriate quality assurance schemes or freshness and delivery frequency, provided these factors are not used as a means for discriminating against non-local suppliers. The Minister also explained that 'use of resources' is one of five award criteria for identifying the most economically advantageous tender, but that it has a relatively low weighting in the process.

27. The Committee believes that the increased development of local food economies offers huge potential and must be supported as vigorously as possible. It considers that the Executive must use every avenue to promote procurement of

local produce. There are examples of good work in some local areas in Scotland, and elsewhere. However, there is no sense that the Executive has a robust strategy for rolling this out.

28. The Committee believes that the Executive must think creatively about procurement, and produce clear objectives and procurement guidelines to ensure that locally-produced food is used locally. The Executive must find a way to apply existing procurement rules as robustly and favourably as possible and must ensure this is applied throughout the public sector. The current review of the Executive's procurement strategy offers a perfect opportunity to do so.

29. Improving sustainable resource use, and reducing transport emissions and other environmental impacts are important EU-wide public policy objectives. The Committee considers that it is contradictory for the EU to seek to prioritise the environment and yet constrain so tightly the extent to which environmental objectives can influence procurement. The Committee considers that the procurement process must allow the carbon cost, as well as the basic monetary cost, of goods to be taken into account. **The Committee requests that the Executive reports to it on how it can work to secure further emphasis on local sourcing in EU procurement rules in the longer term so as to ensure sustainable food production.**

30. The Committee also requests that the Executive reports to it on the contribution it considers that farmers' markets and other direct marketing to consumers can make to local food economies. The Committee requests information on what the Executive is doing to support and co-ordinate the development of farmers' markets and ensure their quality and contribution to town centre viability.

Other regulation

31. In assessing the difficulties of sustaining farm businesses, some witnesses also focused on how other regulation impacts on the costs to farmers. Some witnesses suggested that regulation is a barrier to production, particularly if EU law appears to be interpreted more strictly in Scotland and the UK than in other countries. Examples of such regulation cited include those relating to animal health and welfare, the rendering industry, pollution control and new hygiene regulations. Witnesses suggested that these should be examined carefully to minimise costs to farmers and to ensure that Scottish farmers are not being put at competitive disadvantage.

32. In general, the Executive is committed in its agriculture strategy to implementing EU regulations without 'gold plating'. However, the Scottish Consumer Council argued that a high standard of environmental and food safety regulation in the agricultural sector is an essential part of maintaining consumer confidence in Scottish farm produce and should not be undermined. Some witnesses also suggested that imports from non-EU countries which may not have the same level of animal welfare, environmental or food safety controls mean that Scottish consumers are not being given the opportunity to compare like-for-like.

33. The Committee considers that farmers' concerns about the cost and competitive impact of regulation are, to some extent, a symptom of the price pressures they are facing and the fact that already-tight margins are constantly being squeezed further. The Committee is concerned that the eventual result of these pressures will be poorer quality food. **However, the Committee requests information from the Executive on how the regulatory costs imposed on producers compare to the costs faced by farmers elsewhere in the UK and Europe. The Committee requests assurances from the Executive that it has ensured that Scottish farmers are not economically disadvantaged, and that the regulation is not disproportionate to the need to secure consumer confidence.**

Business support

34. As well as the specific work of the food strategy group seeking to improve cohesion and vision in the industry, the Ministers emphasised that generic business support is available to farmers and the processing sector through the enterprise networks. Some evidence indicated that this is still disconnected from farming. A number of witnesses suggested that there is a need for the agriculture and food strategies to be much more closely linked than at present.

35. The Committee has made a number of recommendations on support for farm business development in previous reports. The Committee has particularly suggested that the Executive should focus in the Scottish Rural Development Plan on funding measures which will assist the farming industry in repositioning itself to meet the requirements of the new CAP regime, and providing more training and advice for farmers to develop appropriate business models. Evidence to the current inquiry suggested that many farmers feel they do not have the skills to negotiate effectively.

36. The Committee believes that, at present, the opportunities are not being grasped as fully as possible. These are areas in which the Executive has wide devolved control, and **the Committee recommends that the Executive re-examines how it can support farm diversification and development and incentivise local food chains more effectively.**

INFLUENCING THE OPERATION OF THE MARKET

37. Alongside evidence on how the farming industry can be supported to develop its products and businesses, the Committee also heard a substantial amount of evidence on the need to alter or regulate the structure of the market. This evidence fell into two broad areas.

The dominance of supermarkets

38. A significant amount of evidence emphasised the need for improved regulation of various aspects of competition in order to underpin farm business development. A particular focus in the inquiry was on the dominant role of supermarkets in UK retailing, and the power this gives them in the supply chain. The main supermarket chains are said to control over 70% of food retailing, with this dominated by the four main chains.

39. Witnesses emphasised that supermarkets are the main purchasers of farm produce and so have a very important role in the viability of farm businesses. However, a wide range of concerns were expressed to the Committee about how the effects of supermarkets responding to natural business pressures to maximise profit impact on the rest of the supply chain, and ultimately on farmers. Some argued that, while supermarkets say they are not trying to put farmers out of business, they must take more responsibility for the sustainability of suppliers or else that will be the long-term implication.

40. The Ministers indicated that they have regular meetings with supermarkets and emphasise the need for the market to support the sustainability of the primary producers. However, the evidence heard by the Committee indicated a tremendous sense of imbalance of power in the market and of insecurity felt by primary producers.

41. The Committee heard detailed evidence that contracts negotiated by farmers often do not contain price information and have long notice periods, with all the insecurity being borne by farmers as supermarkets and processors change prices and volumes on a regular – sometimes weekly - basis. This does not correspond at all to the timeframes over which farmers have to work to make investment, staffing and production decisions. Thus the supply to processors is secure but farmers are exposed to changes in price. Changes in price may be, for example, the result of new market conditions or promotional offers. All the risk appears to fall on the one side, with farmers having incurred all their costs before the point at which prices for them are set. There was also evidence that farmers may be working on the basis of what they think is an agreed price and incur costs on that basis, only to find that buyers will force the price down by harvest time.

42. Tesco stated that it does not set prices directly for farmers. However, evidence to the Committee in regard to the milk sector in particular indicated that harsh competitive tendering processes have driven down milk prices. While contracts may not be between supermarkets and producers, the supermarkets' influence on processors, and on all on-going negotiations in the complex supply chain, is immense. The Committee also heard evidence that the lack of transparency in the system affects the ability of farmers to negotiate their contracts with processors.

43. It was also suggested that the structure of competition in the supermarket sector means that, when a chain such as LIDL offers basic quality produce at a low price, other chains are seeking to force the price of higher quality produce down to a similar level regardless of the higher costs of producing it.

44. One example of the kind of risk and its impact on farmers is 'two-for-one' offers and similar promotions by retailers. The NFU Scotland argued that such promotions were generally based on farmers carrying the price reductions. However, Tesco argued that such offers are of benefit to farmers because they increase the volume of product sold. The British Retail Consortium suggested that the price elasticity of a particular product would dictate a supermarket's approach to sharing out the costs of a 'two-for-one' promotion. For example, it was suggested that a two-for-one offer could mean that the volume of poultry sold would vastly increase (by 300% was quoted), and therefore vastly increase the net

return to producers even if they were subsidising the offer. By contrast, there is no price elasticity in the milk sector – consumers would not buy more milk simply because the price was lower. The Committee is sceptical as to whether these promotions operate across-the-board in the manner which retailers said, or that producers have any choice in the matter. The Committee considers that forcing producers to carry all the risk further undermines any prospect of stability and viability in the agricultural sector.

45. The Committee was also concerned to hear evidence on the exclusivity of some supermarket contracts, limiting the ability of producers to sell food to other outlets which has been rejected by supermarkets as being of less than standardised appearance.

46. The Committee recommends that the Executive considers how it can use its contacts with supermarkets to influence their contract practices. In particular, the Executive should examine how it can help to ensure:

- **that the risk of promotions is more evenly spread and transparent, and**
- **that contracts allow edible produce which might be rejected by supermarkets to find other suitable markets and avoid discards.**

47. Many witnesses agreed with the Ministers that there are highly complex relationships in the supply chain, and that it is wrong to focus solely on supermarkets as the problem. A repeated emphasis throughout the inquiry was the need for far greater transparency throughout the chain from farmers, processors, suppliers, and retailers at all levels. As an illustration, the Committee notes with frustration that it was not able to get a clear answer to critical questions such as exactly where the retail price of milk is shared out between elements in the supply chain, and where retail price rises end up if they do not appear to reach the farm gate. While it acknowledges the need of producers, processors and retailers for commercial confidentiality in certain respects, the Committee was struck by the deep reluctance of farmers and producers to comment on the record, due at least in part to a fear of losing business.

48. To a degree, some of the interests in the system are masked by the fact that price statistics are usually presented on the basis of averages. However, the lack of transparency ensures that the polarised views of different parties cannot be reconciled in the interests of ensuring sustainable food production. The Committee notes that the House of Commons Environment, Food and Rural Affairs Committee reported in May 2004 on an inquiry into 'Milk Pricing in the UK' and faced exactly the same problem. Sustainability for producers will depend on policy or regulation being able to secure improved transparency.

49. Generally, many witnesses argued that there should also be greater direct regulation of supermarkets' influence on the supply chain. Supermarkets have adopted a Code of Practice, which deals with issues such as the relationships with suppliers. Studies conducted by the Office of Fair Trading on its operation have found no evidence of concern, implying that the lack of complaints indicates that few problems exist. However, the Committee heard repeated argument that the Code is simply ineffective because farmers are afraid to complain in case their

contracts are jeopardised. Tesco stated that its anonymous survey indicated that its suppliers were happy with their contractual relationship.

50. Many witnesses, however, agreed with the NFU Scotland's call for an independent statutory supermarket regulator to be appointed. Others argued that a regulator should extend its influence right through the supply chain to try to improve transparency and trust at all levels.

51. Previous inquiries into supermarkets by the UK competition authorities found no evidence of anti-competitive collaboration, and found that the intense competition between the major chains tended to work to the benefit of consumers. It is not yet known how wide the current inquiry into the grocery market by the Competition Commission will be, but the main concern of witnesses was that the competition authorities focus solely on the effects on consumers rather than on farmers. The Scottish Consumer Council (SCC) indicated that it supports the focus solely on consumers.

52. The Committee considers that this focus on the prices consumers face in the immediate term presents far too narrow an interpretation of 'the consumer interest', and is not an adequate basis on which to judge whether collaboration and integration in the supply chain, or wider competition factors in the sector, are in the public interest. The Committee believes that both the SCC and the competition authorities require to take a wider and longer-term view - which is also clearly of concern to the consumer - about what kind of indigenous agricultural sector will result from their narrow focus. Allowing a short-term focus solely on the current prices faced by consumers risks undermining the viability of farm businesses, which will have long-term effects on the choice, freshness, quality and price of food available to consumers. It will also have a profound effect on the rural economy, society, environment and landscape. Protecting consumers in the short-term should not be seen in complete isolation from these wider public interest considerations.

53. The Committee also considers that the Office of Fair Trading's view of how the supermarket Code of Practice should work is unrealistic and contributes to the current system being ineffectual. The Committee does not accept that the current system is working well, and believes that a different form of regulation is required. The Committee notes that the two key proposals suggested by witnesses are the establishment of an extended Code of Practice, with the objective of ensuring transparency and fairness throughout the supply chain, and the creation of an independent supermarket regulator. The Committee recommends that the Competition Commission gives serious consideration to both these proposals.

Promoting collaboration and co-operation in the supply chain

54. Substantial evidence also focused on the need to enhance farmers' position by promoting collaboration. Many witnesses agreed with the Ministers that there is a need for greater transparency and collaboration throughout the supply chain. The Scottish Agricultural Organisation Society particularly highlighted efforts to develop collaborative supply chains - those where all the partners in the chain

work together for mutual benefit. The Committee heard evidence that other countries have developed co-operatives and collaborative supply chains and offer greater support to farmers than is available in Scotland. For example, the loan guarantee programme in the USA was said to have assisted farmers' co-operatives to invest and become more competitive. Collaborative supply chains in New Zealand involve farmers in information sharing, decision synchronisation and incentive alignment. **The Committee considers that it is essential for the Executive to examine the lessons which can be applied from these examples.**

55. The Scottish Association of Meat Wholesalers identified informal collaboration in the meat industry and other examples were noted. However, some witnesses suggested that, while there has been a culture of informal co-operation between farmers in Scotland, there has been no real development of large-scale collaboration on marketing and organisation. In previous reports the Committee has noted that business development may require farmers to take a more co-operative approach than has been the case in the past, and that there is a need for policy to encourage this. There was some suggestion that CAP funds should be used specifically to promote co-operatives, and that co-op development has so far been given relatively low priority and funding support. Such support would also need to comply with EU state aid rules.

56. However, the Committee has previously noted the significant success of the co-operative approach in food production in other European countries such as Germany. This has been achieved under the same state aid rules. **The Committee urges the Executive to consider and apply the lessons of approaches adopted in other countries. The Committee has previously concluded that there is scope for significantly more development of agricultural co-operatives. In the context of improving the sustainability of relationships in the food supply chain, the Committee requests that the Executive provides a specific response to this.**

57. Many witnesses agreed with the Ministers that there is a need for significant development of consolidation and integration in the supply chain. Farmers and processors regard integration and collaboration as important in order to counter the power wielded by supermarkets. Witnesses agreed with the Minister for Environment and Rural Development that recent regulatory decisions on this by the competition authorities have been unhelpful. The Scottish Consumer Council stated that supply chain integration within certain boundaries was acceptable to the Office of Fair Trading, but that collaboration should return savings to the consumer rather than the farmer and should not be allowed to affect prices to the consumer adversely.

58. The Committee heard that some decisions on the milk market have relied on interpreting a supposedly anti-competitive percentage of market share in terms only of the internal Scottish market. Many witnesses, including the Minister, argued that this is unrealistic and reduces integration opportunities for Scottish farmers and companies, who operate within the European and global market place. It was suggested that such an interpretation prevents farmers from forming co-ops to increase their negotiating position and prevents processors from

combining to increase their market share and allowing them to compete with international processors.

59. The Committee wrote to the Office of Fair Trading on this point. The Committee believes that its response on this point is disappointingly weak. The Committee considers that there is no reason to define Scotland as a separate market for fresh milk. The Committee accepts the evidence to it that the market is at least UK-wide, and that pricing of fresh milk in this market is heavily influenced by the global milk commodity market. **The Committee considers that the competition authorities must examine how they approach the definition of the market, and the regulation of proposed collaboration in the market should be considered in this context.**

60. Evidence suggested that such restrictive views of competition law are not applied in other EU countries. Regulation of competition is a reserved matter, but the Minister indicated that he is making representations to the UK Government on the effects of this interpretation on Scottish interests. The Committee welcomes this and recommends that the Minister continues to pursue this vigorously in the context of the current Competition Commission inquiry.

SUMMARY OF RECOMMENDATIONS

61. This inquiry has raised a set of interesting, and extremely complex, issues. The Committee's recommendations are summarised below. The Committee makes the following recommendations to the Scottish Executive and looks forward to the Minister's response.

- The Committee has previously made recommendations on the need for farmers and food processors to create more market power and increase margins by adding value to the primary product. The Committee requests that the Minister explain in detail how the revised agriculture strategy will contribute to this.
- The Committee considers that the Executive must use every avenue to promote procurement of local produce. The Committee believes that the Executive must think creatively about procurement, and produce clear objectives and procurement guidelines to ensure that locally-produced food is used locally. The Executive must find a way to apply existing procurement rules as robustly and favourably as possible and must ensure this is applied throughout the public sector. The current review of the Executive's procurement strategy offers a perfect opportunity to do so.
- The Committee requests that the Executive reports to it on how it can work to secure further emphasis on local sourcing in EU procurement rules in the longer term so as to ensure sustainable food production.
- The Committee requests that the Executive reports to it on the contribution it considers that farmers' markets and other direct marketing to consumers can make to local food economies. The Committee requests information on what the Executive is doing to support and co-ordinate the development of farmers' markets and ensure their quality and contribution to town centre viability.

- The Committee requests information from the Executive on how the regulatory costs imposed on producers compare to the costs faced by farmers elsewhere in the UK and Europe. The Committee requests assurances from the Executive that it has ensured that Scottish farmers are not economically disadvantaged, and that the regulation is not disproportionate to the need to secure consumer confidence.
- The Committee recommends that the Executive re-examines how business support can assist farm diversification and development and incentivise local food chains more effectively.
- The Committee recommends that the Executive considers how it can use its contacts with supermarkets to influence their contract practices. In particular, the Executive should examine how it can help to ensure:
 - that the risk of promotions is more evenly spread and transparent, and
 - that contracts allow edible produce which might be rejected by supermarkets to find other suitable markets and avoid discards.
- The Committee considers that it is essential for the Executive to examine the lessons which can be applied from examples of organised collaboration amongst farmers in other countries.
- The Committee has previously concluded that there is scope for significantly more development of agricultural co-operatives. In the context of improving the sustainability of relationships in the food supply chain, the Committee requests that the Executive provides a specific response to this.
- The Committee welcomes the assurances from the Minister that he is making representations to the UK Government on the effects on Scottish interests of restrictive interpretations of the market effects of collaboration in the Scottish food industry. The Committee recommends that the Minister continues to pursue this vigorously in the context of the current Competition Commission inquiry.

62. The Committee also submits the following points to the Competition Commission's inquiry into the grocery market, and to the UK Minister responsible for competition issues at the Department of Trade and Industry. The Committee also requests that the Scottish Executive pursues them with the competition authorities.

- The Committee considers that a focus on the prices consumers face in the immediate term presents far too narrow an interpretation of 'the consumer interest', and is not an adequate basis on which to judge whether collaboration and integration in the supply chain, or wider competition factors in the sector, are in the public interest.
- The Committee believes that both the Scottish Consumer Council and the competition authorities require to take a wider and longer-term view - which is also clearly of concern to the consumer - about what kind of indigenous agricultural sector will result from their narrow focus. Allowing a short-term focus solely on the current prices faced by consumers risks undermining the viability of farm businesses, which will have long-term effects on the choice, freshness, quality and price of food available to consumers. It will also have a

profound effect on the rural economy, society, environment and landscape. Protecting consumers in the short-term should not be seen in complete isolation from these wider public interest considerations.

- The Committee also considers that the Office of Fair Trading's view of how the supermarket Code of Practice should work is unrealistic and contributes to the current system being ineffectual. The Committee does not accept that the current system is working well, and believes that a different form of regulation is required. The Committee notes that the two key proposals suggested by witnesses are the establishment of an extended Code of Practice, with the objective of ensuring transparency and fairness throughout the supply chain, and the creation of an independent supermarket regulator. The Committee recommends that the Competition Commission gives serious consideration to both these proposals.
- The Committee considers that the competition authorities must examine how they approach the definition of the market, and the regulation of proposed collaboration in the market should be considered in this context.