

December 2016

## Leaving the EU - Submission of Views to Scottish Government

### Agricultural Co-ops' Considerations and Proposals - Prepared by The Scottish Agricultural Organisation Society<sup>1</sup>

#### Summary of Key Factors of Concern to Agricultural Co-operatives

1. In this submission, we focus on concerns, needs and policy opportunities relating to agricultural co-operation and co-operatives and to their participation in supply chains, as voiced by the members of SAOS Council in November 2016. The over-arching concerns in the current period prior to the start of Brexit negotiations arise from the consequences of uncertainty. We deal with those in paragraph 2 to 2.7. In paragraphs 3 to 6 we report the views expressed by our Council at its meeting in November 2016. Thereafter, we discuss future policy needs and possibilities when the UK is outside the EU. Although some time away, it is important that we begin now to prepare policy proposals that will enable agriculture to adapt, compete and become more resilient in future, and that will deliver alignment with Scotland's food and drink industry and its growth plans.
2. Agricultural co-ops are extensions of farm businesses and their interests are essentially the same as those of their farmer members. However, in this submission we focus on the future opportunities and potential of agricultural co-operation and supply chain collaboration. We make proposals for more effective alignment of future policy across farming, food and drink to accelerate the development of a more competitive and resilient industry in which farmer co-operation enables more effective participation in supply chains. The main uncertainties at the time of writing arise from:
  - 2.1. **Trade Effects on Industry Stability and Growth:** There is a risk of significant disruption and change in markets for domestically produced food and drink as a consequence of the re-imposition of customs barriers, including tariffs, in trading with the EU. So called 'hard' Brexit would result in the imposition of significant reciprocal barriers affecting many food and drink products (raw and processed). It seems inevitable that severe disruption of Scotland's farming, food and drink industry would result from 'hard' Brexit and growth targets would become unattainable. In addition, new trade arrangements with other countries could further contribute to disruption
  - 2.2. **Agriculture Policy:** There is also potential for severe disruption and change as a consequence of change in agriculture policy. Production support is important. The priority and budget that might be afforded to agriculture and rural development in future is a cause of uncertainty and concern. 84% of Scotland's land is classified as Less Favoured Area (LFA). Scotland's important beef and sheep farming takes place for the most part in

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<sup>1</sup> SAOS is the membership and development organisation of 65 agricultural co-operatives which generate combined annual sales of £2.2 billion. Further details about SAOS can be found in the appendix (page 8). 16 agricultural co-ops participate in SAOS Members' Council.

the LFA and requires financial support. A reduction in support in the absence of increased market returns will drive farmers out of business and output will decline.

- 2.3. **Scientific Research:** If the perceived risk of reduced investment in scientific research materialises, it has potential to disadvantage Scotland's farming and agricultural co-ops. Agriculture's adaptation to change, its performance improvement actions, skills development and climate change response are all science based, with co-ops able to transfer research knowledge to farming practice across multiples of farms.
- 2.4. **Input Costs and Labour Supply:** Increases in input costs are expected due to the prevalence of supplies from the EU of input products and machinery, some of which will fall subject to additional costs resulting from customs arrangements and tariffs. Restricted availability of non-UK seasonal and permanent labour would limit output and uptake of new opportunities.
- 2.5. **Currency:** Currency fluctuations and volatility has increased and is expected to remain unpredictable. They have the potential to introduce rapid change in the financial dynamics in the market, and to amplify commodity price cycles.
- 2.6. **Geo-Political Instability and Change:** Statements emanating from the USA and several European countries suggest the possibility of political changes that have the potential to change market access and arrangements and bring unpredictable consequences.
- 2.7. **Threat to Business as Usual in Dealing with Government:** Although governments have emphasised that "it is business as usual" until the UK leaves the EU, there is some concern that decision making in the meantime may be subject to deferral or delay, as government itself deals with the uncertainties created by Brexit and diverts resources to preparing for the future.

### **Views Expressed by SAOS Members Council at November 2016 Meeting**

3. Agricultural co-ops lead and increase the competitiveness and resilience of Scotland's agriculture. They clearly identify their future contribution in partnership with their farmer members, acting as:
  - 3.1. **Conduits for farmers to markets** - informed and equipped to respond to changing market circumstances and opportunities, competitive, responsive and delivering value for their members, supply chain partners and consumers.
  - 3.2. **Conduits to innovation and agri-tech** - skilled technology translators and adopters introducing knowledge services to give their members a competitive edge utilising research advances, the power of data and new business models that enable them to be efficient, competitive, and environmentally responsible.

3.3. **Risk managers** – collectivising risk to reduce the risk profile for any individual farmer within the co-op in myriad ways, managing weather related production and harvest risks, shared investment and innovation, access to finance, securing supply chain collaborations and access to market risk management tools.

3.4. **Being farmer-focussed** – governed by farmers, for farmers, in accordance with principles of co-operation, generating greater farmer participation through plans and achievements that deliver opportunities and value back to each farm, and which appeal to the next generation. Co-ops are responsible contributors and partners in rural communities.

4. Each co-op satisfies a purpose defined by, and shared amongst, farmer members. The purpose of any agricultural co-operative is not expected to change as a consequence of leaving the EU. Co-op leaders accept their role and responsibility to provide direction and leadership to farmer members in respect of the markets they serve and the services they deliver. Co-op directors and managers fully expect that changes in business strategies will be required as part of their adaptation, along with their members, to new circumstances. The task of formulating strategy in response to change factors is not new. It is a core role in co-op governance and will be approached as such.
5. At a meeting in November 2016, the Council of SAOS (which includes representatives of 16 agricultural co-ops) voiced optimism about prospects for the medium and longer terms. The co-ops acknowledge that the high level of uncertainty about arrangements after the UK leaves the EU, will be a medium term phenomenon, and they expect positive opportunities to emerge as the future market and policy environments become clearer. Agricultural co-operatives accept the responsibility to lead commercial adaptation amongst farmers in response to a dynamic environment, with changing threats and opportunities.
6. However, the environment of increased uncertainty makes planning and decision making for the future more difficult, particularly confidence in decisions concerning capital investment and longer term commitments. Agricultural co-ops request that the level of uncertainty is reduced as soon as possible to enable planning and investment with acceptable levels of confidence and risk. This requires open channels and regular communications with Government. SAOS welcomes dialogue with the Scottish Government on any of the points that are summarised in this paper.

## **Key Needs and Proposals in Preparation for Leaving the EU**

7. Irrespective of the decision to leave the EU, agriculture is already subject to change drivers that require immediate and continuing responses: competition and concentration in supply chains, commodity price cycles, climate change, new agri-technologies and skills needs, capital requirements and pressures, etc. The period until the UK leaves the EU provides an opportunity of at least two years in which to set in place policies and actions to strengthen the competitiveness and resilience of agriculture, equipping it to be globally successful as a part of Scotland's food and drink industry. Professionally managed co-operatives provide a delivery route to these outcomes through partnership with Scottish Government SAOS and Scotland Food & Drink.

8. Co-ops intend to manage change towards and into exit from the EU to sustain farmer members' ambition, and to enable them to be innovative and successful. Government is requested to act to reduce uncertainty where it can and to recognise the roles and needs of agricultural co-operatives as policies and positions are formulated. The key areas of need we identify are in respect of; a) deeper industry/government alignment and consistency of objectives and strategies; b) future trade arrangements to maximise opportunities; and c) agriculture policy that accelerates innovation and adaptation, as summarised below:

**8.1. Deepening Policy Alignment and Partnership via Scotland Food & Drink:** The objective should be to maximise opportunities and capabilities of the agri-food industry, and their contribution to the economy of rural Scotland. To agree and deliver against this objective will require deeper alignment and collaboration in policy and strategy formulation and in implementation actions. Better alignment of policies and strategies for the primary sector with food and drink manufacturing will be essential. Scotland Food & Drink provides an effective space in which alignment can be created and coordinated, and we support implementation of recommendations made in the Overton Report, identifying how deeper collaboration can be achieved. Several of the proposals we present in this submission are intended to contribute towards closer alignment and consistency of strategy and actions, particularly amongst agriculture and supply chains. The business of agricultural co-ops, and the supply chain development work of SAOS, align with Scotland's food and drink industry strategy.

## 8.2. Trade:

**8.2.1. Maintaining EU Trade and Labour Mobility:** After the UK market, the EU will remain the largest, most sophisticated and closest target market. Consistent with the object of maximising opportunities for the industry, we propose that 'leave negotiations' aim for there to be no disadvantage through customs and tariff barriers in trade with the EU single market, retaining as much as possible of current arrangements. Also, provisions should be made for the seasonal and permanent labour needs of Scotland's agriculture and food industry, which currently requires non UK labour. These are factors in retaining a viable industry and 'level playing field' with EU farmers and food manufacturers and to avoid disrupting supply chains for inputs and exports.

**8.2.2. Increased Trade Development in the UK:** We propose increased activity in maximising the position and value of Scottish produced goods in UK markets, particularly products manufactured from the output of Scotland's primary farming sector. Assistance should encompass potential opportunities for new investment in manufacturing in Scotland to displace imported food and drink. A co-ordinated UK-wide food and drink campaign could over-arch currently fragmented initiatives.

**8.2.3. Developing Trade with Rest of the World:** We propose increased emphasis and partnership with Government in identifying and developing new export opportunities and opening new markets, particularly for premium value Scottish products that are manufactured from the output of Scotland's primary farming sector. Government should ensure there is easy access to advice and assistance concerning tariff and non-tariff market access criteria and regulations. Export credit guarantees should be available.

- 8.2.4. **Maintaining the Protection of PGI, PDO and TSI Designations:** Protected Geographic Indication, Protected Designation of Origin, and Traditional Speciality Guaranteed provide important legal protections for Scottish products that must be retained. They generate premium value and help to build and enhance Scotland's food and drink 'brand' in all markets. There remains potential for more products to be registered for the protections they provide.
- 8.2.5. **Access to Capital and Non Capital Grants:** Government should make available capital and non-capital grants to assist research, development and investments that would expand Scotland's production and markets, with emphasis on development that has potential benefit for the primary sector. Grants help to inform and de-risk investment decisions enabling investment plans to proceed that would otherwise be dropped or deferred. Grants should favour innovation at any point in the supply chain, and resource efficiency.
- 8.2.6. **No Trading Off of Agriculture in Trade Negotiations:** There is a perceived threat of favourable access to the UK food market potentially being granted to third countries in return for access by UK financial service providers to their markets. Reassurance should be provided that this trade-off outcome will be prevented.

### 8.3. Agriculture Policy:

- 8.3.1. **Evolving Financial Support for Primary Production:** We anticipate that current financial support arrangements for agriculture will remain unchanged until 2020. In the period up to that time, it is necessary to review and re-target farm support towards increasing productivity, efficiency and resilience. Farmer co-operation is a proven delivery route for developing skills, farming systems and markets. There should be more direct alignment relating market opportunity and marketing action with increased farm innovation and productivity through farmer co-operation and co-operatives. Dialogue and negotiation will be necessary to determine how most appropriately to apply this approach.
- 8.3.2. **Access to Grants for Innovation Via POs and Co-ops:** We propose that Government should channel funding for innovation via Producer Organisations. Currently, co-operatives that attain recognition as Producer Organisations (POs) in accordance with the EU Fruit and Vegetable Regime attract grants targeted at efficiency improvements, innovation, orderly marketing and environment measures. The recipient groups have been highly innovative and commercially successful. Approved "operational programmes" designed by each PO attract grant at a rate of either 50% or equivalent to 4.1% of the value of marketed produce. An additional 0.5% is available for crisis prevention and management measures (based on 4.1% of the value of produce sales). This sets a precedent and exemplar for how to channel and target grant funds to agriculture in future. In post Brexit policy, we propose that this approach be extended across all sectors, enabling highly targeted grant support that is aligned with achieving innovation through co-operation.

**8.3.3. Knowledge Transfer and Facilitation to Increase Farmer Co-operation:** The Government should continue to support the expansion of agricultural co-operation, as this is consistent with the objective of maximising opportunities and capabilities in the industry. Scale and risk management benefits of co-operating are easy to identify, and it is widely recognised that there is considerable potential for wider and deeper co-operation in farm production. Aligning large volumes of produce of many farms together with customer needs in supply chain collaborations helps to shorten supply chains, improve transparency and implement market driven improvement programmes consistent with food and drink industry strategy. The advantages of co-operation are many. The following are important enabling components:

**8.3.3.1. Expert Facilitation:** We request that the Scottish Government continues to invest in the expert knowledge transfer and facilitation that is necessary to increase levels of co-operation particularly in the most challenging sectors. Expert co-operative support should continue to be available to farmer non-executive directors of co-ops as they research and formulate strategies for the post Brexit era.

**8.3.3.2. Global Knowledge:** We request that the Scottish Government partner with SAOS in investing in knowledge acquisition of farmer co-operation around the world, where many different applications and structures operate successfully. Consideration should be given to supporting a 3 year position at one of Scotland's university business schools for this purpose, incorporating research and knowledge transfer provisions with appropriate universities around the world and with SAOS. This would build on SAOS's network of co-op academics in key countries, and help to accelerate our proactive transfer of knowledge to practice in Scotland's agricultural co-operative businesses.

**8.3.4. Clarifying Agricultural Co-operatives' Position re Collective Negotiations and Competition Law:** Notwithstanding the current consultation into the remit of the UK Groceries Code Adjudicator, we make two specific proposals consistent with better aligning policy and action, aimed at empowering farmers when they act collectively to improve the equity and transparency of their negotiating position in supply chains. We welcome dialogue with Government on both proposals.

**8.3.4.1. A Legal Right for Farmers to Negotiate Collectively.** A legally backed obligation should be introduced on large scale buyers of farm crops and livestock to recognise the right of farmers to negotiate terms collectively with them, when organised in appropriate forms of producer organisation or co-operative. The possibility of farmers collectively and co-operatively negotiating with buyers has been denied in important sectors where there is imbalance in negotiating positions, closing off opportunities for fairer terms and increased transparency. The absence of a legally backed obligation is acting as a constraint to supply chain improvements. This might be achieved by extending the role of the Groceries Code Adjudicator to the trading relationships between farmers and large scale buyers, backed by powers to review and impose sanction where poor practice is found to be evident.

8.3.4.2. **Clarifying Competition Law.** Competition law should be amended to remove continuing ambiguity concerning whether or not it is legal for farmers to sell their produce collectively via a co-operative. Current guidance published by the Office of Fair Trading in 2011 identifies breach of the law as being generally unlikely due to the small market share of an individual co-op, and the fact that any market effect is unlikely. However, the guidance also refers to co-ops collective negotiation as potentially “price fixing” and collaborations as potential “cartels”. Whilst the guidance seeks to be helpful, it refers in several scenarios to their being “no presumption of illegality under competition law”, although a possibility of their being breach of the law, suggesting that OFT approval is required to remove risk of illegality. The perceived risk of illegality, although low, has been used to deter farmer co-operation. This ambiguity should be removed.

8.3.4.3. The same ambiguity persists in European law and was identified as requiring remedial action by the EU Agricultural Markets Task Force which published a report in November 2016 on Enhancing the Position of Farmers in the Supply Chain. In the report they note that: “Stakeholders are not only confronted with rules that are ambiguous but also with the absence of any procedure which would afford them legal clarity up-front”. The Task Force notes that this has a “chilling effect on business” and that “the risk of incurring a fine is one that farmers cannot afford to take”.

8.3.5. **Facilitating Supply Chain Improvement:** We call for continued investment in facilitating supply chain improvement programmes through vertical collaborations across links in the supply chain, and by horizontal collaborations across food companies. This is consistent with the objective of maximising opportunities and capabilities in the industry. There is outstanding potential to realise more value by further expanding and deepening collaboration through deploying expert facilitators. The Scottish Government / Scottish Enterprise funded Market Driven Supply Chain Programme has demonstrated significant impact and payback within a relatively short period by attracting companies towards collaboration and assisting them with collaboration projects. It is necessary in the context of future competitiveness that collaboration extends to more businesses and becomes embedded in business practice.

8.3.6. **Equipping for Volatility / Farm Resilience:** Price cycles for commodity farm outputs have become more prevalent as trade has globalised. Future agriculture policy should include measures that assist farmers to manage periodic price troughs, and we draw attention to the role of co-operation and co-operatives in this context. We envisage public sector / private sector partnership in the provision of mitigation tools, and actions that enhance farm resilience to price ‘shocks’. We also draw attention to the fact that agricultural co-operation presents strategic opportunities for risk management and enhanced farm resilience in a wide variety of ways. Within a single co-op, farmers may currently access ‘futures’ contracts (in some products), participate in long term customer contracts, accumulate mutually held funds to use as necessary, participate in supply chain improvement programmes, identify and develop new markets, manage harvest risks, introduce innovation on farm, forward

purchase inputs, diversify, etc etc. We welcome dialogue on policy formulation to address price volatility and farm resilience.

**8.3.7. Link Capital Grants with Supply Chain Improvement:** We propose that Government should continue to provide grants towards capital investment in buildings and plant (and associated feasibility studies) in the food and drink industry. An obligation to engage in supply chain improvement programmes including the primary sector should be a condition of all grant awards where Scottish primary produce is to be used in the resulting plant and processes. This would enhance the alignment of strategy amongst the primary and food manufacturing sectors. The current SRDP Food Processing, Marketing and Co-operation Grant scheme (open to all food and drink businesses) and its predecessors have enabled critically important investment to proceed, helping to mitigate investment risk and reduce investment pay-back times. A dynamic and successful food processing sector utilising Scotland's livestock and farm produce is necessary for a vibrant farming industry.

**8.3.8. Inward Investment and Joint Ventures:** Government should work in close partnership with the primary sector, including agricultural co-ops, to identify market related investment opportunities and assist where appropriate in attracting and assisting potential inward investment. Scotland's primary sector is vulnerable to investment in food manufacturing being sited elsewhere in the UK or globally. Securing future supplies of primary product from farmers is frequently a critical factor in decision making. This can be addressed by partnership with agricultural co-ops, as we have demonstrated by facilitating joint venture with external investors. We envisage new opportunities for partnerships of this type emerging.

**8.3.9. Supporting Rural Communities:** Government should continue to invest in rural communities. In Less Favoured and remote areas of Scotland, public sector investment is essential and should continue to be a priority pre and post Brexit in hard and soft infrastructure: schools, hospitals, roads, internet connectivity, expertise, community initiatives and enterprise, etc. Deficiencies in these diminish opportunities for viable business development that can help to sustain communities. Co-operatives take seriously their role in Scotland's rural communities, providing services where others reduce or withdraw them, and investing in facilities and employment that make important contributions to rural infrastructure and to social capital.

## APPENDIX

**About SAOS – see also [www.saos.coop](http://www.saos.coop)**

9. The Scottish Agricultural Organisation Society - SAOS - is the membership and development organisation of agricultural co-operatives trading in Scotland (some with operations in England) and we are responding on their behalf. We have represented, promoted and advised agricultural co-operative businesses, and those interested in forming co-operatives in farming, food and rural industries in Scotland, for more than 100 years.

10. SAOS's functions and work streams include:
  - 10.1. Facilitating new forms of co-operation amongst farmers and delivering governance services to agricultural co-ops;
  - 10.2. Facilitating and managing supply chain improvement and collaboration programmes and advising SME 'local food' enterprise;
  - 10.3. Researching and operating livestock electronic traceability in Scotland (ScotEID);
  - 10.4. Providing a collective voice for our agricultural co-op members and promoting co-operation in agriculture.
11. SAOS is a founder member and full participant in Scotland Food & Drink, and our work aligns with the food and drink industry strategy.
12. SAOS partners with numerous government, public sector agencies, and industry organisations in identifying common aims and implementing development actions.
13. SAOS has approximately 65 member co-ops, which in turn have more than 600 directors and more than 27,000 farmer members. The financial throughput of the membership in 2014/15 was £2.2 billion. As such they comprise a significant agri-business sector and are important players in the farming and rural economy. Some are capital intensive, vertically integrated businesses, while others are horizontally integrated with little capital employed. Capital intensive co-ops are found in dairy processing, red meat processing, cereals / potatoes / vegetables processing and storage, and farm supplies. Co-ops are engaged in UK, EU and global supply chains.
14. Agricultural co-operatives are different from the prevalent company business forms found in that they are consortia of farmers working together for mutual advantage in accordance with co-operative principles of self-help, democracy, transparency and equitability, as reflected in the Co-operative and Community Benefit Societies Act 2014, under which almost all agricultural co-ops are registered. Each has a purpose directly related to members' farm business needs, and they report success related to the farm business benefits delivered.
15. The main activities of agricultural co-ops enable farmers to secure scale benefits not attainable by individual farmers. Co-ops may be engaged in one or more of the following:
  - 15.1. Farm inputs – collective purchase and delivery of seeds, fertilisers, spray chemicals, fuels, animal feeds, animal health products, machines. This is a selection of a wide range products for which co-ops negotiate special terms and services on behalf of farmers
  - 15.2. Farm product handling (primary processing) - aggregating farm product through shared investment in grain and potato stores, fruit, flowers and vegetable pack houses and incorporating logistics, quality management to meet supply chain volume and specification requirements
  - 15.3. Preparing consumer products (secondary processing) – examples include shared investment in food processing such as cheese manufacturing, shellfish ready meal preparation, freezing and packing peas for direct sale to retailers.

- 15.4. Farm product marketing – securing and servicing customers for farm product whether ex- co-op store facility, ex-farm, or via auction markets. Customers may be others in the food supply chain, including retailers, and may be in export markets.
- 15.5. On-farm and inter-farm services – such as relief and seasonal labour provision, machinery contracting, inter-farm trade in crops, inter-farm livestock trade, crop trials, knowledge transfer and advice, research and development programmes (EU Fruit and Vegetable Regime)
- 15.6. Risk management – long term contracts through track record of satisfying customer needs, export market access and new market opportunities, provision of grain futures trading, harvest management and services, access to additional finance, managing supply chain relationships and improvement programmes.

**End**