Irish Co-operative Organisation Society Ltd

Pre-Budget Submission 2017

September 2016

Executive Summary

Budget 2017 offers the Government a real opportunity to address one of the most consistent and damaging issues affecting Irish dairy farmers – price volatility. An imbalance in the global demand-supply equation for dairy products has resulted in a sharp decline in milk price since August 2014. The prolonged nature of the current price trough requires a fresh approach and urgent rethink from policy makers at an EU and National Government level. The European Commission has introduced two support packages – September 2015 and July 2016. While welcome, it must also be acknowledged that the Irish co-ops have supported their members significantly over the last two years, way in excess of the direct aid packages provided by the EU.

It is vital for the Government to recognise the contribution made by rural co-operative enterprises and their members, through the provision of employment, but also through the use of a range of direct and indirect inputs, creating a multiplier effect within the rural economy. Put simply, co-ops are the backbone of many rural towns and villages throughout Ireland.

However, volatility remains a significant threat to the achievement of the Government's Food Wise strategic vision for the agri-food sector, as it is increasingly difficult for a sole trader, family farm run dairy enterprise to cope with price volatility ranging by plus or minus 24c/l.

While ICOS acknowledges that there is no silver bullet to the issue of volatility, we strongly believe that a suite of measures are needed. ICOS has extensively engaged with Government Departments and stakeholders over the previous 12 months on this issue. As a result, ICOS is proposing the introduction of an Income Stability Tool – a co-op structured measure that would allow a farmer to voluntarily defer up to 5% of his income during a year, to be drawn down anytime within 5 years, allowing a farmer to draw upon additional revenue when needed most.

In addition, the reality of Brexit and its consequences for the Irish agri-food sector needs to be fully understood by the Government before the beginning of formal negotiations between the EU and the British Government. In 2015, Ireland exported €5.1 billion worth of agricultural products to the UK market, including €970 million in dairy products and €1.1 billion in beef products. A range of issues will require careful consideration by Government at the highest level, including market access, administration and customs, equivalence of standards and the impact on the EU budget. Fundamentally, the Irish Government must ensure that the impact of Brexit is kept at the very minimum.

The ICOS Pre Budget Submission is proposing a range of initiatives that at its heart aims to support and maintain the economic wellbeing of the rural economy. Our submission includes a range of measures dealing with dairy market volatility, the development of a co-operative investment scheme the provision of EIB loans, the cost burden imposed on livestock marts, an audit exemption for smaller co-ops and the promotion of renewable energy.

Martin Keane

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Martin Keane
President

1. Dairy Market Volatility Needs Urgent Attention – ICOS Proposal for an Income Stability Tool

ICOS, together with its member dairy co-operatives, is extremely concerned at the prospect of ongoing dairy market volatility, and the damage that it continues to inflict on farmers and the entire dairy supply chain. While, volatility is not a new phenomenon; it has been a constant feature of European dairy markets since the removal of comprehensive market support measures, in the 2004-06 period. Indeed, we are possibly in our fourth significant price trough, with very weak markets in 2006, 2009, 2012, and again in 2015-16, a more prolonged downturn than on previous occasions.

It is clear that the volatility cycle has worsened in recent years. Prior to 2006, the extent of volatility stood at plus or minus 10c/l. A decade later, the volatility range is now in the region of plus or minus 24c/l. This is extreme price volatility, and is correctly recognised in the Food Wise 2025 strategy as a significant threat to the sustainability of our family farm model of production.

While there may be some predictability to the 3 year cycle which seems to have been established, in reality, external forces such as weather, geopolitical, animal disease, currency, and macroeconomic events can conspire to lengthen or deepen the volatility curve. Many of these factors such as the Russian trade ban are completely outside the control of primary producers.

Short of reintroducing the whole historic package of dairy supports, export refunds, and disposal aids, together with quotas, there is no existing structure which can effectively cope with volatility. Accordingly, ICOS believes that a suite of measures needs to be developed and introduced, which used appropriately, could allow farmers to cope with volatility, and plan for profitable, sustainable expansion. ICOS strongly believes that the following should be included within a suite of measures:

1. Fixed price schemes have been developed over recent years, and are being more widely offered. All parties should continue to encourage farmers to consider them seriously and use them to de-risk their positions.
2. In cases where processors are not in a position to physically lock in a back to back contract for a portion of their production, tools should be available to allow them to enter into a financial hedge. However, the current European futures market lacks liquidity, and because the Eurex index is not based on prices achieved for Irish product, it doesn't provide complete risk cover here. All parties need to work to establish a fully liquid, functioning European futures market, reflective of the nature of the Irish dairy industry.
3. The cost of credit available to farmers is significantly above the EU average, despite recent industry led initiatives which ICOS strongly welcomes. ICOS calls on the Government to capitalise on available EIB funding as proposed by Commissioner Hogan to ensure the availability of long term and affordable finance for farmers and the wider agri-food sector.
4. Even if all the above measures are in place and operational, Irish dairy farmers will still be exposed to income volatility which could significantly damage their sustainability. <u>The Department of Agriculture, together with Finance, need to re-examine the introduction of innovative tools such as an income deferral tool, which can allow farmers to use periodic high prices to sustain them in weaker markets.</u>

ICOS acknowledges that the agri-taxation review has delivered significant benefits to the farming sector. However, we strongly believe that an opportunity was missed in terms of addressing market volatility. For example, the extension of income averaging to 5 years is of benefit in ensuring that some farmers aren't forced into paying excessively high rates of tax in one year, while possibly having literally no income the following year. This is not without merit, and ICOS welcomes it, but it has undesirable consequences for a farmer's overall cash flow when his income declines following a slump in markets, as with income averaging farmers can end up paying high levels of tax in years when cash flow is impaired. This can actually exacerbate income volatility. Fundamentally, 5 year income averaging is a misnomer of sorts; it is tax averaging. ICOS believes that separate tool is needed to truly deliver income stability for farmers who have to contend with the unpredictably of global market forces.

ICOS Recommendation: ICOS is calling on the Government to support the development and introduction of an income stability tool. The proposed measure would allow farmers, through their co-op, to voluntarily defer up to 5% of their milk receipts in any given year. The money would be retained in their names in a recognised, interest bearing fund, which would be managed by their co-op, as a loan-stock-type instrument. The money can be drawn down at any time, and subject to income tax at the time of draw down, but in any case, the funds must be drawn down within 5 years. ICOS is of the view that the proposed Income Stability Tool can be implemented as a co-op structured volatility measure. The proposed measure provides a template for the development of a voluntary "cap and collar" milk pricing arrangements, between a farmer and his co-op/milk purchaser. The deferral of a modest amount of 5% is to ensure compliance with EU State Aid Rules, and in theory the scheme can be made available to all farming sectors. The fundamental advantage that the ICOS proposal offers is income stability, and our proposal can operate alongside the current or an improved tax averaging system.

2. Establishment of a Co-operative Enterprise Investment Scheme

The co-operative model is a structure that is unique in its adherence to self-help and self-responsibility principles. Access to capital is an ongoing issue for start-ups, particularly in community based organisations as the co-operative would have no direct history of managing finance so would be deemed high risk by lending institutions. The co-operative model has the potential to raise funding through the sale of shareholding to users and supporters of each co-operative enterprise and subsequently minimise the level of state intervention to provide services and supports to marginalised rural enterprises and fledgling social enterprises.

To incentivise further investment by people in their own local co-operative, ICOS is proposing the establishment of a co-operative investment tax relief.

Building on the precedent of the Employment and Investment Incentive (EII), ICOS is seeking the development of a scheme where the co-operative can claim the income tax that was already paid by investing members, to increase the value of the investment into the new venture. This additional investment into co-operatives, which would have similar qualifying criteria as the EII Scheme, would allow for greater initial impact for newly establishing co-operatives.

This scheme can build on the blueprint that already exists in terms of incentives for companies and charities and this measure would incentivise co-operative actions, subsequently minimising state interventions on many levels.

ICOS Recommendation: The development of and implementation of a co-operative investment tax relief Scheme

3. The introduction of EIB loans for the agri-food sector

On 14 July 2014, the EIB and the European Commission signed a Memorandum of Understanding on agriculture and rural development. Subsequently, a "model guarantee instrument" for agriculture was launched. This financial Instrument will provide security for up to 80% of a loan, which will significantly reduce the cost of finance and will be of most benefit to new entrants to farming, who may not have security or built up a track record with a bank.

The European Commission has urged Member States to give greater emphasis to using financial instruments in their Rural Development Programme, as for every €1 a Member State provides to the guarantee through its Rural Development Programme, the EIB will provide €5. Funding will be provided for investments in farm performance, processing, marketing and business start-ups, with local banks acting as financial intermediaries. Unfortunately, the Government has failed to prioritise the drawing down of EIB funding under this initiative, which is extremely disappointing.

ICOS Recommendation: ICOS is urgently calling on the Government to complete an ex ante assessment into market failure, and amend without further delay the Rural Development Programme to ensure the provision of long term and low cost finance for farmers and the agri-food sector.

4. A fairer system of rates collection for livestock marts

ICOS suggests that the current model of rates levy on livestock marts needs to be changed. Many livestock marts are only open for business, one or two days per week, yet are charged for the full business week of trading. Additionally, the typical mart premises has a very large footprint but in reality only the sales ring is where the commercial business activity of livestock sales takes place. Large areas of car parking and cattle/sheep pens make up the majority of space.

ICOS suggests a pro rata basis calculating rates to be levied on marts based on the number of days trading annually rather than the standard method, which presumes a commercial activity will be ongoing 5 days per week, every week.

ICOS Recommendation: ICOS recommends the introduction of a fairer model for the collection of rates from livestock marts, on a pro rata basis calculating rates to be levied on marts based on the number of trading days per annum.

5. The Introduction of an Audit Exemption for small co-operatives

Under the current Industrial and Provident Societies Acts 1893 to 2014 it is mandatory for a co-operative to have an annual audit of its financial statements. For smaller co-operatives the obligation to have an audit can result in an undue financial burden. Critically, It is ICOS's view that if there continues to be no change to the Acts in relation to audit exemption then fewer of such small community type organisations will incorporate as a co-operative society.

The audit fees they incur would account for a large percentage of their expenditure. Moreover, audit fees are increasing due to increased regulation placed on auditors. The current average audit fee of €1,500 to €2,000, is a disincentive for many groups to establish themselves as a legal co-operative as their income in many cases just about covers these costs.

Auditing standards acknowledge the delicate balance between the benefit and cost of an audit. The legislation should allow certain societies the freedom to choose whether or not an audit is of benefit to them in order to avoid the unnecessary administrative burden and cost. The Society's focus should be on the objectives of the society and the needs of the members. The members should have the option of determining the frequency of audit requirement for their particular society, a choice that is available to societies in other countries.

We would propose that an option is made available to societies under amended IPS legislation to avail of audit exemption, similar to that of a company. The exemption would be available to Small Societies with the similar criteria as for small companies. ICOS would suggest that the option to avail of audit exemption be approved by the co-operatives own shareholders with a majority vote and the option to avail of audit exemption being subject to a confirmatory resolution at the Societies AGM. ICOS is aware that members may insist on an audit and in this instance the number of member (s) who can insist on an audit is one or more member(s) representing at least 10% of the Voting rights.

ICOS Recommendation: ICOS recommends that the audit exemption be available to small Industrial and Provident Societies with similar conditions to that currently for a private company.

6. Implementation of incentives towards clean, green electricity and heat production

ICOS participated fully during the wide and detailed consultation with the Department of Communications, Climate Change and Environment on the development of an Energy Policy for Ireland. During this process at many stages ICOS along with many other organisations and individuals called for the implementation of a Renewable Heat Incentive and a Renewable Electricity Incentive. This has not happened throughout this time despite repeated requests and repeated promises that the incentives were being developed and soon to be announced.

In the intervening time, any interested individuals or communities who are looking towards investing in a piece of renewable electricity or renewable heat technology are, understandably, unwilling to move until any such incentive will be announced. This has led to a standstill in investment and progression in adopting new technologies and in usage of clean, green energy sources.

The renewable electricity and renewable heat sectors in Ireland have a wide ripple of effects on the Irish economy given the amount of people involved in each sector. Biomass alone generates increased activity for crop growers, planters, harvesters and processors. Also to be considered in the biomass sector are the manufacturers, suppliers, installers and maintenance of biomass technology. These businesses are currently working in limbo due to a lack of speed in confirming the detail of the incentives to be announced. We would further maintain that when the announcement is made, that similarly to the scheme in the UK, the incentive be paid retrospectively to those who will invest from the time between the announcements are made to the opening of the scheme.

ICOS Recommendation: ICOS recommends the swift implementation of incentives for the installation of renewable heat and renewable electricity technologies

About ICOS

ICOS serves and promotes commercial co-operative businesses and enterprise, across multiple sections of the rural economy. In total, ICOS represents 130 co-operatives with a combined turnover of €14 billion and a membership of 150,000 people, with ICOS affiliated co-ops employing 12,000 people in Ireland and a further 24,000 abroad.

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