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International Dairy Arrangement

COMMITTEE OF THE PROTOCOL REGARDING CERTAIN CHEESES

Twenty-Second Session

Draft Report

Introduction

1. The Committee of the Protocol Regarding Certain Cheeses held its twenty-second session on 17 June 1985.

Adoption of the agenda

2. The Committee adopted the following agenda:
 1. Adoption of report on the twenty-first session
 2. Information required by the Committee:
 - (a) Replies to Questionnaire 3
 - (b) Summary tables
 - (c) Other information
 3. Review of the market situation for products covered by the Protocol
 4. Adoption of report to the Council
 5. Communication from the Permanent Mission of New Zealand
 6. Adjustment of minimum prices according to exchange rate fluctuations
 7. Date of next session

Adoption of report on the twenty-first session

3. The Committee adopted the report on its twenty-first session. This was distributed as document DPC/C/33.

Information required by the Committee

(a) Replies to Questionnaire 3

4. The Committee reviewed the replies to Questionnaire 3 and requested members who had not communicated such information in respect of the first quarter of 1985 to do so without further delay. Participants were also requested to submit information regarding the second quarter of 1985 by 15 September at the latest.

(b) Summary tables

5. The Committee reviewed the summary tables based on the information provided by participants in tables A and B of Questionnaire 3 in respect of certain cheeses. The Committee took note of document DPC/C/W/1/Rev.24.

(c) Other information

6. No additional information was requested or provided.

Review of the market situation for products covered by the Protocol

7. The representative of the EEC communicated the prices that the Council of the European Community had set for milk, butter and skimmed milk powder for the 1985/86 marketing year (beginning 27 May 1985). The target price for milk had been fixed at ECU 27.84 per 100 kg., delivered to dairy, on the basis of 3.7 per cent fat content. The intervention price for butter had been reduced from ECU 319.7 per 100 kg. to ECU 313.2 per 100 kgs. The intervention price for skimmed milk powder had been raised from ECU 165.88 per 100 kg. to ECU 174.04 per 100 kg. These intervention prices took account of an adjustment in the fat

content/non-fat solid content ratio from 50/50 to 48/52. Milk deliveries to dairies had been 6.5 per cent lower in the first five months of 1985 than in the same period of 1984. During the same five-month period, production of butter and skimmed milk powder had declined by 13.5 per cent and 15 per cent respectively, while output of cheese had increased by 1 per cent. Milk production and deliveries to dairies for the whole of 1985 were expected to be 1.1 per cent and 2.2 per cent respectively lower than in 1984. Production of butter and skimmed milk powder could decline by 4.5 and 5.2 per cent respectively in 1985. Output of cheese could rise by 1 to 1.5 per cent in 1985, while production of whole milk powder could increase by 1.4 to 1.5 per cent. With respect to international cheese prices, taking into account the new refund that was to take effect from 19 June 1985, Cheddar cheese prices could be in the bracket between US\$1,400 and US\$1,430 per ton/f.o.b.

8. The representative of Australia reported that national milk production during January-March 1984/85 was 1,426 million litres, which was 3.9 per cent more than in the corresponding period of the previous season. This increase brought cumulative milk production for the first nine months of the 1984/85 season to 5,112 million litres, up 1.5 per cent on the July-March period 1983/84. A marginal increase in milk yields coupled with an increase in cow numbers, were mainly responsible for the increased milk production. Estimated milk production for the 1984/85 season was 6,000 million litres, which was marginally above the 1983/84 level. Production of leviable (Cheddar type) cheese in the July-March 1984/85 period was 8.2 per cent below the 1983/84 production level. This reduced production was in line with the Australian Dairy Corporation estimate of 1984/85 production at 110,000 tons, which was 7 per cent below 1983/84 production and was primarily due to high surplus stock levels in 1983/84. In response to promotional activity and stable retail prices, some growth was anticipated in domestic consumption of Australian retail type Cheddar cheese; while export availability was expected to be around 60,700 tons, given objective closing stocks of 10,000 tons. Prices for cheese on the international market were stable and in the range of US\$1,100 to US\$1,300 per

ton/f.o.b. In reply to the question from the EEC representative how the production of different types of cheeses was evolving, she undertook to refer the question to her authorities for a more detailed answer. At that point she could only indicate that non-Cheddar type cheese production during July-March 1984/85 period had increased by 70.3 per cent over the 1983/84 period. Domestic sales of the same types of cheeses were up by 25 per cent to a level of 43,000 tons in 1984/85 compared to 1983/84 period.

9. The representative of Hungary said that the situation in the first quarter of 1985 had not changed in any respect. In sum, production was 12,600 tons, exports at 1,800 tons were higher by 300 tons and domestic consumption had remained unchanged at 10,500 tons in the first quarter of 1985. The main destinations of Hungarian exports during this period were Saudi Arabia, Austria and the Netherlands; and the export prices were well above the GATT minimum.

10. The representative of Japan mentioned that the guaranteed price of raw milk for dairy products in the fiscal year 1985 was fixed at the same level as that of last year. This price had remained unchanged in the last three years. It was raised in the fiscal year 1976 by 4 per cent from 86.4 yen to 90.1 yen. He further observed that the number of dairy farms was continuously diminishing and the number of dairy cows had remained unchanged for several years under the production restraint programme. The production of raw milk in the fiscal year 1984 was 7.2 million tons, almost the same as in the preceding year. The production of butter increased by 5.4 per cent and that of skimmed milk powder by 2.4 per cent. However, the market situation was different for these two products. While the market for milk powders was relatively good, the market for butter was stagnating. Imports of dairy products in 1984 increased by 4 per cent; the imports of natural cheese increased by more than 10 per cent to a level of 79,000 tons. The domestic production of cheeses was about 19,000 tons in 1984, which was 4 per cent less than in the preceding year. Average import price for natural cheese in April 1985 was US\$1,513 per ton/c.i.f. Japan imported

mainly from the EEC, New Zealand, Australia, Norway, Sweden and the United States. Imported price for 1984 from the EEC worked out at US\$1,592, from New Zealand at US\$1,419 and from Australia at US\$1,503 per ton/c.i.f.

11. The representative of New Zealand described the 1984/85 season (ending 31 May 1985) as one of exceptionally good weather. Following the ample rainfall and warm temperatures of spring and summer, cows were dried off earlier than usual due to dry conditions. These dry conditions were expected to have an adverse impact on cow conditions going into new season. Assuming normal weather conditions for 1985/86, milk production was expected to decline on 1984/85 levels. Estimates suggested that milk output for 1984/85 season was 2.5 per cent up and cheese production was 6.8 per cent up over the levels of 1983/84. Despite continued growth in the world cheese market, prices of cheese had remained relatively stable during the second quarter of 1985 and were in the range of US\$1,150-1,250 per ton/f.o.b.

12. The representative of South Africa said that cash flow and credit problems of farmers had kept milk production at relatively high levels and thus increased dairy production. The policy of the Government was to process most of the increase in milk production into skimmed milk powder. With regard to cheese, he noted that in spite of an increase in domestic consumption in the first quarter of 1985 production was higher, which resulted in a high level of stocks of 15,000 tons. As a result of promotional efforts on the domestic markets, however, consumption was expected to increase during the second quarter of 1985 leading to a fall in stocks to around 8,000 tons. Referring to his country's notification under Article 7:2 of the Protocol Regarding Certain Cheeses (DPC/C/W/25), he informed that so far 200 tons of very low quality cheese had been sold at US\$400 per ton/f.o.b. Further details regarding such sales would be provided at a later date.

13. The delegate of Finland referred to the revised estimates of milk production, which showed a reduction of 2 to 3 per cent for the output in 1985. The reason for the fall in milk production was the deliberate

government measures to curtail excess production. One of such measures was the introduction of the two-price system for milk from the beginning of 1985. An exceptionally cold winter also had an effect on the overall production for 1985. With regard to cheeses, he noted that production in the first quarter of 1985 was 12,000 tons, consumption was higher at 9,000 tons but exports were somewhat lower at 8,000 tons. Stocks at the end of this period were 13,000 tons. In May 1985, estimates of cheese exports for 1985 were revised upwards from 3,500 tons to 3,700 tons.

14. The representative of Norway reported a decline of 1.5 per cent in milk deliveries during the first quarter of 1985 as compared to the level last year. During the same period, however, goat milk production had increased by 7.8 per cent, with an effect on overall cheese production. Exports of cheese to traditional markets had remained stable; but export prices realized were generally lower, except for those in the United States market. Domestic production as well as consumption of cheeses had increased rather slowly. Stocks at the end of the first quarter of 1985 had, however, increased from 18,000 to 20,000 tons.

15. The representative of Sweden indicated that deliveries of milk to dairies in the first quarter of 1985 were 2 to 3 per cent lower than in the corresponding period of last year. Cheese production was more or less the same as in the previous year. While consumption of cheese increased by 1,700 tons, exports declined from 1,300 tons to 1,100 tons and imports increased by 500 tons in the first quarter of 1985. Average export prices recorded for cheese during the first quarter were slightly above US\$2,000 per ton/f.o.b.

16. The representative of Switzerland indicated that milk deliveries to dairies in the period from January to May 1985 had been 1.4 per cent lower than in the corresponding period of 1984, due to an increase in the number of cows slaughtered since November. Because of the reduction in the dairy herd, milk production for the remainder of 1985 would not exceed that of 1984. Although milk deliveries to dairies had declined at the beginning of 1985, individual producer quotas had been exceeded

by an average of 1 per cent. The quota year ended in April. The Swiss authorities had recently decided not to increase the producer price for milk nor to raise the price supplements on imported cheese, despite the increase in prices of domestic cheese. In addition, there would be no changes in the price supplements on imported oils and fats. Regarding cheeses, production of principal varieties was being cut back by 6.5 per cent in April, May and June 1985. As a result of that measure, production was being held down to the 1984 level. The limitation on production, however, would be removed as from August 1985 because of the decline in milk deliveries. Imports and exports were expected to be about 2 per cent higher in 1985 than in 1984. Consumption had remained virtually unchanged.

17. The representative of Uruguay apologized for not being able to provide the latest data on cheese production. He indicated, however, that in spite of a deterioration in the general economic situation, consumption of cheeses was steadily increasing in his country. Export prices of hard cheeses were around US\$2,700 per ton, which was well above the GATT minimum.

18. The observer of Canada said that milk production during the 1985 calendar year was expected to be less than in the previous year. This was despite the fact that milk/feed price ratio was likely to decline by 5 to 6 per cent in the course of the current year. Data relating to production, consumption, trade and stocks had been provided in Canada's reply to Questionnaire 3. In response to a question, he indicated that trends for consumption of cheddar cheese to 1990 foresee growth of 1 to 2 per cent per year, while specialty cheese consumption could grow by 3 to 5 per cent annually. A shift in production occurred in 1983 and 1984: cheddar production increased from 99,500 tonnes to 101,200 tonnes whereas specialty cheeses rose from 80,800 to 90,500 tonnes; he recalled that the Committee's attention had previously been drawn to the unusual pattern of growth in 1984. He noted that the shift in emphasis among cheese types was superimposed on a shift in consumption of dairy products to the benefit of cheese, which was taking place against the background of static or declining industrial milk production.

Adoption of report to the Council (DPC/C/34)

19. In conformity with Article VII, paragraph 2(a) of the Arrangement, the Committee adopted the report of the twenty-second session. This was distributed in document DPC/C/34.

Communication from the Permanent Mission of New Zealand
(DPC/C/W/26/Add1)

20. The Committee noted that in accordance with Article 7:2 of the Protocol Regarding Certain Cheeses, New Zealand had sold during the 8 February and 12 June 1985 period, cheddar cheese of lowest manufacturing quality displaying fruity, rancid flavours with some parcels contaminated by foreign matter. Sales amounting to 72,406 tons had been made to Portugal at a price of US\$413,90 per ton/f.o.b. In reply to a remark by the spokesman of the EEC that the sales of such poor quality cheeses would become difficult next year when Portugal was integrated in the EEC market, the representative of New Zealand noted that Portugal had a good use for this type of cheese.

Adjustment of minimum prices according to fluctuations in the dollar exchange rate

21. Opening the discussion at the joint meeting of the three Protocol Committees, the Chairman recalled that a communication relating to automatic adjustment of minimum prices according to fluctuations in the dollar exchange rate had been received from the delegation of Australia on 31 May 1985, and had been circulated in document DPC/W/46 in the three languages. Comments were now invited from all participants on this subject.

22. The representative of South Africa, while supporting the idea that a continuous examination of the currency fluctuations in the adaptation of minimum prices would be useful, drew attention to the complications involved in any such exercise. He could only make some preliminary remarks at that stage, since the Australian paper was still being reviewed by his authorities. Referring to the last sentence "that these increases would have occurred at a time when IDA participants have been holding special meetings to consider proposals for a price reduction in the light of market place pressures" was in his view somewhat misleading, since the relative base of calculation was very different. The reduction in the minimum price which was being considered by the participants was from the artificially high level which had existed since September 1981; whereas the increases which would have been triggered by the automatic mechanism would have been from the already reduced level. Therefore, the levels were not really comparable. The difficulty could be overcome by envisaging a greater change, i.e. 5 to 10 per cent, and by the use of a basket of currencies of major traders in dairy products instead of merely the European Currency Unit.

23. The representative of Australia stated that although her country was opposed to the concept of trigger mechanism it was, nevertheless, willing to examine the problem in depth. It was, however, unfortunate that none of the other participants had submitted a paper on this subject. Australia's particular concern was that given the nature of the international dairy market, it did not make sense to try to fine-tune IDA minimum prices through any formula let alone one based on exchange rates. Changes in the minimum prices needed to be negotiated on the basis of judgments about future market conditions. One of the arguments in favour of minimum prices was the stability that it gave to the market. Frequent changes would not only negate that benefit, but would tend to destabilize the market through speculation by both buyers and sellers about future changes. Frequent changes would also reduce the transparency of the market and, with the prefixation system of the EEC, would make it virtually impossible to monitor observance. A change away from United States dollar to ECU or SDR would also reduce the transparency of the minimum price. The Australian delegate observed

that there was no need for either an automatic or even a non-automatic trigger, (i.e. one where consultations would be triggered). Under the existing arrangements, prices could always be discussed at any of the quarterly meetings and not just the September meeting. Moreover, a member could always have a special meeting convened to consider any issue, including the minimum price levels, if the market conditions so warranted it. She pointed out that her country wished to pursue the question of the adequacy of measures to ensure observance of minimum prices at future meetings and in particular at the September meeting. She believed that the willingness of members to ensure rigid observance, as her own country did, was a measure of their political commitment to the pricing disciplines of the International Dairy Arrangement. A reaffirmation of that commitment was therefore urgently needed to maintain the credibility of the Arrangement.

24. The spokesman of the EEC observed that stability of minimum prices was essential given the erratic fluctuations in the US dollar exchange rate. The EEC member countries had discussed this problem at length without reaching any definitive conclusions. However, some guidelines were developed which favoured pragmatism and a closer scrutiny of the trends. The EEC realized that an automatic adjustment mechanism, providing for 5 per cent, 10 per cent or 15 per cent adjustment in one direction or another, could be dangerous, because there were many other non-monetary factors which also played a part in the formation of prices. Not only fluctuations in the value of major currencies had to be closely watched, but other non-monetary elements influencing prices also had to be considered. These other elements included level of stocks, sales on credit and food aid operations, and the working of these operations could sometimes be contradictory with each other. Negotiations were in progress on monetary issues and in particular the reform of the International Monetary Fund; there was a possibility that SDR as an international currency reference might be replaced by a more stable basket of currencies. This would also affect the deliberations of the Committees. In the final analysis therefore, the Committees might have to adopt an automatic adjustment mechanism, which would take several other factors influencing prices into consideration. The EEC

was not thinking of a modification of Article 3:3(b), because it would involve protracted discussions and lengthy procedures, but was in favour of a continuous study of this problem in the light of all relevant elements. The participants could contribute their own position papers, while the secretariat could collect more quantitative information on fluctuations in the value of the US dollar and the SDR to facilitate deliberations in the Committee. The EEC would support the idea of setting up a small Working Group to study this question in depth.

25. At the outset the representative of New Zealand made it clear that his views at that point were of a preliminary nature and that his authorities had taken no final position on that subject since it would most probably require a modification or an addition to Article 3:3 of the Protocols. He was, furthermore, interested in hearing the views of other participants. Discussing the background of his basic approach to this question, he recalled that the United States dollar had been chosen as a reference currency for the International Dairy Arrangement minima because it was virtually the only standard measure of the value in international dairy trade and also because it represented a currency in which the bulk of international dairy trade was transacted. In accepting the United States dollar as a bench-mark of value, it was also accepted that variations in the value of the currencies of individual participants against the dollar would be accommodated by those individual participants rather than by adjustments to the Arrangement. This consideration was fundamental to the effective operation of the Arrangement. The appreciation in the value of the United States dollar over the last three years had, however, substantially increased the real value of the minimum export prices, at least in terms of the currencies of some of the major dairy exporting participants. Expressing his appreciation for the Australian paper on that subject, he, however, noted that it focused rather on the negative aspects of an automatic trigger and no alternative solutions had been offered. While he shared many of the concerns identified in that paper, he did not agree with the manner in which certain conclusions had been reached. The basic assumption of their approach was that changes in minimum price levels would be totally automatic with no reference to either Council or

Protocol Committees. He, however, took the view that the minima could not be changed without considering developments in the market place. The Committee pursued the argument that adjustments to the minima became necessary in response to wide fluctuations in the US dollar value; but he felt that where other prices, particularly those of the EEC, were close to the GATT minimum, and the recent change in the EEC restitutions had led to this effect, participants would continue to face problems. Therefore, New Zealand was of the view that any adjustment to minimum prices should not be solely by means of an automatic trigger mechanism. A significant movement in the US dollar value would rather "trigger" a review of minimum price levels by the participants. Obviously currency movements would be a major factor in assessing the need for adjustment, but these would not be considered in isolation. The reservations expressed in the Australian paper regarding an automatic trigger were therefore quite valid. He was inclined to favour a semi-automatic rather than an automatic trigger. He continued to believe that the problem of currency movements was a serious one but thought that a review initiated by a trigger mechanism could not replace the provision for annual reviews as set out in Article 3:3 of the Protocol. It only provided an additional method of assessing the situation in response to exceptional circumstances. Of the various approaches, one could be a completely automatic adjustment with the secretariat monitoring movements in the value of the reference currency and announcing changes in the minimum prices when the agreed trigger point had been reached. This approach would, however, create many extreme problems and his country would not favour it. In this connection he wondered what would happen if, in the middle of a negotiation with a buyer, the minimum price was adjusted. Even the Australians could not be expected to adjust their EPRs as soon as the minimum prices were changed. On the other hand, the movements could be semi-automatic with the trigger operating merely to signal the need for the minimum price to be reviewed and adjusted. This was necessary not only for practical reasons but also to retain the inherent flexibility and consensus nature of the Arrangement. However, he had an open mind as to the standard against which movements in the reference currency were to be measured. Regarding the trigger, he noted that a 2 per cent trigger was too small

and a 5 per cent trigger was more reasonable. He also believed that the trigger should be permanent, with an amendment to the Protocols. He had noted the EEC proposal regarding a small Working Group and would transmit it to his authorities for a firm position at the next meeting of the Protocol Committees in September.

26. The Nordic representative said that his comments at that stage could only be tentative since the question was still being examined in the capitals. He agreed with the conclusion of the Australian paper that an automatic trigger mechanism would contribute to instability on the market, which was not the purpose of the Arrangement. The Nordics were in favour of an in-depth study on this subject and would co-operate in discussing the issues more concretely. The study should also explore the possibility of changing the "reference" currency instead of introducing a trigger mechanism.

27. The representative of Argentina also made it clear that his views were preliminary and he would discuss the matter more positively after his authorities had examined the Australian paper. He recalled that when the proposal was made early this year, his delegation was rather reticent on the question of adjusting minimum prices on an automatic basis with fluctuations in the dollar exchange rate. They believed that market prices did not fluctuate in the same degree as variations in the value of the United States dollar. He was favourably impressed by the conciliatory tone of discussions in the Committees, and particularly by the fact that both the EEC and New Zealand recognized that minimum prices could also be influenced by factors other than monetary variations. Furthermore, he agreed with the representative of New Zealand that there would be considerable difficulties in adopting any other reference currency and that the consensus nature of the Arrangement could not be ignored. It was therefore necessary that all elements affecting prices were considered. It was equally important to examine how the prices of other commodities were affected by fluctuations in the US dollar exchange rate.

28. Summing up, the Chairman noted that even though the discussions had been of a preliminary nature, some interesting ideas had emerged which could be further pursued at the next meeting in September. He urged that all participants should consider the issues more concretely and submit as soon as possible their own position papers which could be discussed at subsequent meetings of the Protocol Committees.

Date of next session

29. In accordance with the preliminary time-table adopted at their twentieth session the Committees decided to hold their next regular sessions on 23-25 September 1985, subject to confirmation by the secretariat.