

**GENERAL AGREEMENT ON
TARIFFS AND TRADE**

RESTRICTED

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International Dairy Arrangement

COMMITTEE OF THE PROTOCOL REGARDING MILK FAT

Twenty-Sixth Session

Report

Introduction

1. The Committee of the Protocol Regarding Milk Fat held its twenty-sixth session on 16-17 June 1986.

Adoption of the agenda

2. The Committee adopted the following agenda:
 - A. Adoption of report on the twenty-fifth session
 - B. Information required by the Committee:
 - (a) Replies to Questionnaire 2
 - (b) Summary tables
 - (c) Other information
 - C. Sales under derogation
 - D. Review of the market situation for products covered by the Protocol
 - E. Adoption of report to the Council
 - F. Date of next session

Adoption of report on the twenty-fifth session

3. The Committee adopted the report on its session. This was distributed as document DPC/F/42.

Information required by the Committee

(a) Replies to Questionnaire 2

4. The Committee reviewed the replies to Questionnaire 2 and requested participants who had not communicated such information in respect of the first quarter of 1986 to do so without further delay. They were also requested to submit information regarding the second quarter of 1986 by 15 September at the latest.

(b) Summary tables

5. The Committee reviewed the summary tables based on information provided by participants up to the end of 1985 and issued in document DPC/F/W/22/Rev.1. It also took note of the fact that a further revision of these tables would be undertaken by the secretariat as soon as the data for the first quarter of 1986 were available.

(c) Other information

6. The Committee took note of the statistical information which the secretariat had compiled on production, trade (including food aid), stocks and consumption of dairy products in the United States.

Sales under derogations

7. The Committee took note of the information furnished by New Zealand regarding its butter deliveries of 8,000 tons to Algeria under the provisions of the Resolution of 16 November 1984 and noted that all deliveries of butter and anhydrous milk fat under sales notified prior to 1 June 1985, according to the Resolution of 16 November 1984 (DPC/13) and the Decision of 31 May 1985 (DPC/20), had been completed.

8. The Committee also took note of the notification from the EEC (DPC/F/W/23/Add.1) under the Decision adopted on 31 May 1985 (DPC/F/35) in which the EEC had accepted a tender, in pursuance of EEC Regulation No. 765/86, for a sale of butter from public stocks, not less than 18 months old, in an amount of 100,000 tons to the USSR, at an f.o.b. selling price below the GATT minimum price of US\$1,000 per ton. In this connection, the Australian delegation wished to know the actual price paid by traders for the intervention stock and whether the option of an additional 50,000 tons of butter represented a part of the total sale of 150,000 tons or a discreet second sale with a different time-frame for shipment. It was not clear from the notification whether the shipment of 150,000 tons of butter was to take place as a single operation during the April-November 1986 period or two separate sales with separate schedules of delivery. The Committee had given the Community a derogation for a sale of 100,000 tons or more of butter and the option for sale of 50,000 tons of butter with no clear delivery schedule

appeared to be a separate second sale in contravention of the provisions of the derogation. Answering these two questions, the EEC spokesman said that the price to be paid to the EEC operators for shipments to the USSR was ECU 330 or US\$450 per ton. In regard to the second question, he made it clear that an option to sell 150,000 tons of butter had been accepted by a consortium of EEC operators. It was one single operation which was, however, to be carried out in two stages. The first stage of this operation had been carried out involving the shipment of 100,000 tons of butter. The second stage would not necessarily be between now and next November considering the special difficulties encountered in sales and shipments to Russia. However, the derogations permitted the EEC to sell 150,000 tons within a period of 15 months. The sale of an additional 50,000 tons would be notified as soon as a firm deal was hammered out.

9. In discussing the register of sales (DPC/W/50/Rev.4), the representative of Australia provided some corrections to the figures furnished earlier and insisted that the revised document should not bear the same heading. The EEC sales of butter, as shown in the document, gave the erroneous impression that they were also in accordance with the Resolution of 16 November 1984. The fact of the matter, however, was that while sales by other participants shown in the register were in accordance with this Resolution, the EEC sales were in breach of the International Dairy Arrangement. In order to reflect upon the situation correctly, therefore, either the EEC sales should be deleted from that document or the heading should appropriately be changed. In response to the intervention of the EEC that the sales notified in the register were quite in conformity with the Resolution, she maintained that they were blatantly outside the scope of this Resolution and could not be legitimized by their inclusion in the register. If the EEC persisted in its demand to include them in the register, it would amount to a mockery of the International Dairy Arrangement. She asked the secretariat for a legal opinion regarding the coverage of the EEC sales under the Resolution of 16 November 1984. In any case the secretariat was responsible for preparing the document and rectifying the mistake.

10. The representative of New Zealand suggested that the matter could usefully be pursued in the Council since no acceptable solution was emerging from prolonged discussions in the Committee.

11. The Committee took note of all the comments made and asked the secretariat to prepare and circulate a relevant register of sales, after consultations with the delegations mainly concerned.

Review of market situation for products covered by the Protocol

12. While resuming discussion on the general market situation the Chairman proposed that participants could at the same time deal with problems facing butter trade, since these two items were closely inter-linked and there was no need to keep it as a separate agenda item in the future also.

13. The representative of Uruguay mentioned that while production of butter during the first quarter of 1986 had increased, consumption had somewhat declined as compared to the first quarter of last year. Exports amounting to 3,000 tons, which were previously being sent to the USSR and Iran, had now to be redirected to Brazil, because the EEC sales of fresh butter at US\$800 per ton made it impossible for Uruguay to sell into those two markets. Since butter production was not subsidized in Uruguay, it was becoming extremely difficult to sell into its own traditional markets at below the minimum price. The EEC spokesman, however, did not agree with this remark and informed that no sales of fresh butter had been made to the USSR in the last six months and the minimum price at which any fresh butter had been sold was US\$1,095 per ton f.o.b. In any case, no sales of fresh butter had been made to the USSR at US\$800 per ton as suggested by Uruguay.
14. The Swedish delegate said that production of butter at 8,500 tons during the first quarter of 1986 was 2,900 tons less than the level in the corresponding period of 1985. The decline was expected to continue during the rest of the year. Domestic consumption increased somewhat in the first quarter, but was anticipated to fall during the year. Exports were also on the downtrend. Average export price was US\$1,060 per ton f.o.b. at reference point. Concluding his statement, he wished to answer the question raised by the EEC at the March meeting of the Committee regarding the consumption of "Bregott" and other butter in the Swedish market. He was now in a position to inform that in 1970 the Swedish consumption of butter was 43,900 tons, while the consumption of Bregott was only 2,700 tons. In 1985, butter consumption amounted to 28,300 tons, while the consumption of Bregott was 23,700 tons. Thus the total combined consumption of these two types of butter had increased from 46,600 tons to 62,000 tons during this period. In reply to another question by the EEC in regard to the wholesale and retail prices of butter, he said that they were SEK 19/kg. and SEK 31.8/kg. respectively.
15. The representative of Norway informed that at end-March 1986 butter stocks were 32 per cent lower than their level a year before. Exports of butter during 1986 were expected to total 2,700 tons as compared to 6,300 tons in 1985.
16. The representative of Finland told the Committee that consumption of butter, which seemed to have substantially picked up in the last quarter of 1985, was by and large due to purchases by a big retail group with a view to saving on taxes. These purchases were disposed of in the first half of this year at a discounted price. Production of butter in 1986 was expected to be between 70,000 to 72,000 tons and export availability was likely to be between 17,000 and 18,000 tons. As a result of this, stocks which had come down to 5,000 tons at the end of 1985, increased to 10,000 tons at the end of March 1986 and were now believed to be around 50,000 tons.
17. The representative of South Africa said that despite increased consumption during the first quarter of 1986, the end-March stocks had increased to about 10,000 tons which was almost three-quarters of total annual domestic consumption of butter. The South Africa Dairy Board was currently studying ways and means of disposal of the surplus stocks on the domestic market.

18. Commenting on the butter situation in his country, the Polish delegate stated that production in the first quarter of 1986 at 41,573 tons compared unfavourably with an output of 47,000 tons in the first quarter of last year. Domestic consumption at 62,460 tons in the first quarter was 2.5 per cent higher than the level in the corresponding period of last year. Imports were only 1,582 tons and the average import price was US\$1,159 per ton c.i.f. Stocks of butter, which were 29,041 tons at the beginning of January, came down to 7,801 tons by the end of March 1986.

19. The representative of New Zealand informed that stocks of anhydrous milk fat at the end of March 1986 were just about normal at 10,000 tons. Exports during 1986 were expected to be between 35,000 and 40,000 tons, the same level as in the previous two years. Price situation was stable at around US\$1,200 per ton f.o.b., although offers below this level had also been received. In regard to butter, he said that even though the first quarter output at 79,000 tons was slightly more than the level in the same quarter of last year, exports of butter had considerably lagged behind and stocks had substantially increased. The forecast for exports during 1986 was not good since the huge EEC stocks were potentially threatening the world market. Prices were generally below the GATT minimum, as a consequence of which the New Zealand farmers had suffered a cut of 43 per cent in real returns compared to the level last year. Despite the derogation given to the EEC to ease pressures on the fats market, the situation had deteriorated further and the EEC stocks still at around 1.15 million tons posed a serious problem. It was therefore imperative that participants should consider either a termination or a modification of the EEC derogation since it had not achieved the objective for which it had originally been given. The Committee should review the situation at its next meeting in September and see what other possible solutions could be found to resolve the critical problems of butter trade. At this stage, he could only spell out the essential elements of a possible solution which had for some time been floated around in his country. In essence, the proposal was that since the EEC derogation had effectively failed in reducing stocks and achieving a reasonable balance between supply and demand, the excess stocks should be legally transferred to a common pool, the management and costs of which would be shared jointly by the major producers and exporters like the EEC, New Zealand and Australia. Others could participate in this venture if they so desired. The joint venture, which would be only for a limited period, would convert surplus butter into butteroil for disposal or for animal feedstuff. Stocks, which would not be a part of the joint venture, would be destroyed. The disposal of butteroil and other by-products would be carried out with the consensus of all the participants in this joint venture in such a way that regular commercial sales were not disrupted. In this connection, he observed that the world market for butter and butteroil at the moment was limited. About 450,000 tons of butter and 150,000 tons of butteroil per annum were internationally traded, and this market had remained relatively constant at this level since 1979 when the Russians began purchasing around 200,000 tons of butter a year. The international market, therefore, was too small to absorb all the stocks currently held by major suppliers.

The steep fall in prices bears witness to the existing imbalance between supplies and demand. Another important factor to reckon with was that more than 80 per cent of butter and butteroil came from three major suppliers, i.e., the EEC, New Zealand and Australia. The United States had also recently entered the international market as an exporter, but that was only for exports to Egypt. In terms of overall supply and demand balance in all dairy products, international demand was equivalent to some 20-25 million tons of milk a year. The present availability of fresh production from all exporters was quite close to that figure. The recent sharp increase in the United States' milk production was, of course, of some concern, but its impact on the international market at the moment was rather limited. As far as New Zealand was concerned, any significant increase in milk production was unlikely in view of the substantially reduced price to farmers and the moratorium clamped on new dairy farms. In his view, therefore, the major producers could now take certain steps to achieve a reasonable balance between the overall milk supply and demand. As far as butter was concerned, the possibility of liquidating the existing huge stocks (1.15 million tons) domestically or on the international market was remote. The derogation given to the EEC had not been particularly successful. The EEC domestic disposal schemes had not worked effectively to clear the market. The situation, therefore, warranted some major initiatives to restore the supply and demand balance. One major step in this direction was a reduction in stocks. The proposal to set up a joint venture of major exporters to manage and to process the surplus butter into butteroil was to alleviate supply pressures on the world market. The expected quantities to be contributed by the major exporters under this scheme would be Australia 20,000 tons, New Zealand 60,000 tons and the EEC 500,000 tons. These quantities were merely indicative and in approximate relation to their production levels. The idea was that stocks should be liquidated to the extent that prices could once again move up and confidence in the market could be restored. The participants in this joint venture would have to accept very low prices for their butter oil so that all the quantities unloaded could be immediately sold in the market. At the same time, the participants would undertake to maintain their existing schemes of domestic disposal and consumption. Once the venture was launched, the unloading of the stocks to the extent of 500,000 tons of butter was expected to boost the butter prices up by about 20 per cent. The EEC could save up to ECU 400 million annually which it was currently spending on export restitutions. For New Zealand, the cost of writing down the value of some 60,000 tons of butter would fall directly on the dairy farmers. This burden would be more preferable for them than to see the collapse of the IDA with the concomitant results. The anticipated 20 per cent increase in international prices would not fully compensate the farmers in recovering fully the level of last season, which was \$4/kg. milk fat. A similar situation could be expected in the case of Australia. Concluding, he expressed the hope that the participants would carefully study his proposal and soon make their initial reactions known. Further technical details would be provided at a later date, but an outline of the proposal would soon be sent to the secretariat for circulation to all participants.

20. In his comment, the spokesman of the EEC said that the New Zealand proposal was not entirely new, but it did contain some elements which required detailed consideration. In the autumn of 1984, when the EEC was looking for alternative markets for its excessive stocks of butter, it was suggested that old butter could not as such be sold in the international market but there were certain other markets outside the circuit where this could be done. The Community had been trying to achieve in the past two years just what New Zealand had proposed. The proposal was, nevertheless, interesting and merited careful consideration. Certain institutional and substantive matters required further study and elaboration. The Community would, therefore, study this proposal with a great deal of interest and would come back with its comments at the next session of the Committee. The representative of Australia considered the proposal as a positive contribution in dealing with the current butter situation. There were a number of technical and other details which required careful consideration. It was also necessary to consider the effects of such sales on the vegetable fat sector and the scope for guaranteeing sales from the normal commercial market sales. Australia was in favour of a controlled reduction in stocks, but long-term structural measures to bring supply and demand in equilibrium were also required. The representative of Uruguay wondered if sales of butteroil by the joint venture would not have damaging effects on normal commercial sales of butter by other participants. In the past, sales of butter by the Community to Soviet Russia and Iran had serious repercussions on Uruguayan sales to these two markets and therefore any other proposal to unload huge stocks of old butter by the major participants had to be carefully studied by his authorities. The delegate of Japan also expressed his support for New Zealand proposal, which he would recommend to his authorities for careful consideration. However, he had some sympathy with the view expressed by the delegate of Uruguay that the interests of not only the major participants, but all the participants should be kept in the forefront while considering any such proposal.

21. Commenting on the butter market situation in his country, the representative of Japan said that domestic production during the fiscal 1985 at 91,000 tons showed an increase of 13 per cent over the level in fiscal 1984. The output in the first quarter of 1986 continued to rise and was 4 per cent higher than the level in the same period of last year. The increase was due to increased deliveries of milk for processing relative to drinking milk consumption. Domestic market for butter had continued to be weak. The stabilization indicative price of butter for fiscal year 1986 had been lowered by 4 per cent to 1,225 yen/kg from 1,276 yen/kg in 1985. In reply to a question by the EEC he confirmed that c.i.f. import prices indicated in Questionnaire 2 (page 7) were for fresh butter.

22. The spokesman of the Community said that the guaranteed intervention price for butter had been kept unchanged at ECU 3,132 per ton. Production of butter in the EEC was constantly declining, from 2,287 thousand tons in 1983 to 2,108 thousand tons in 1984, 2,021 thousand tons in 1985 and an estimated 2,097 thousand tons in 1986. Consumption, on the other hand, which was heavily subsidized, increased rather modestly to 1,570 thousand tons in 1983, 1,601 thousand

tons in 1984 and 1,622 thousand tons in 1985. In 1986, domestic consumption was expected to decline by 1 per cent to reach a total of 1,616 thousand tons. On the export front, however, the Community was not doing too well. While exports of butter in 1983 totalled 220 thousand tons, they dwindled to 200 thousand tons in 1985. Indications were that exports would continue their downtrend in 1986. With regard to butter oil, however, the situation was relatively better. EEC exports in 1982 totalled 216 thousand tons, in 1983 311 thousand tons, in 1984 430 thousand tons and in 1985 153 thousand tons. Average export price for butter was US\$1,095 per ton f.o.b. and for butter oil US\$1,340 per ton f.o.b. (exchange rate being US\$1 = 0.9633336 ECU). Public stocks of butter, however, continued to be problematical, rising from 853 thousand tons on 1 January 1984 to 950 thousand tons on 1 January 1985 and to 1,124 thousand tons on 1 January 1986. They had further increased to 1,274 thousand tons on 12 June 1986, excluding 70 thousand tons with private agencies. In reply to a question by New Zealand whether anhydrous milk fat was sold at below the indicated price of US\$1,340 per ton since the EEC was manufacturing it directly from cream, he said that he was not aware of any offers below that level in any of the markets. The matter could, however, be discussed bilaterally in the light of more specific details. Replying to Australian question concerning the age of butter sold to the USSR under the 31 May 1985 derogation, he referred to EEC's notification which clearly indicated that the butter sold to Russia was 18 months' old. Unfortunately, however, he had no recent information on the overall age structure of stocks held by the Community, but he would be prepared to supply this information directly to the Australian delegation.

23. The Australian delegate informed the Committee that the combined output of butter and butteroil in the first quarter of 1986 at 24,219 tons was 9.9 per cent lower than the level in the same period last year. Output for 1985/86 was expected to aggregate 6.1 per cent lower at 107,000 tons as compared to the level in 1984/85 due mainly to increased production of cheese and whole milk powder. Exports were likely to add up to 56,100 tons in 1985/86 compared to 55,000 tons in 1984/85, and domestic sales would be marginally higher at 62,000 tons as against 61,741 tons in the previous year. Average export prices recorded for butter were US\$1000 per ton f.o.b. and for anhydrous milk fat US\$1200 per ton f.o.b. Reviewing the general world market situation, she remarked that the milk fat sector had remained depressed with the world market prices of butter and butteroil close to the IDA minimum. With substantial EEC stocks and the increasing United States' CCC stocks, on the one hand, and limited market prospects, on the other, prices were likely to remain depressed in 1986. Rising United States stocks were likely to cause some serious problems depending on both the CCC purchases and the United States export disposal programme. The 1985 US Food Security act covered the export disposal of a minimum of 100,000 tons of butter a year from the CCC stocks. The CCC butter stocks on 2 May 1986 at 128,096 tons, compared to 62,511 tons a year before, had more than doubled. The CCC purchase of butter during 1985/86 (October to May) were 125,269 tons, as compared to 81,619 tons in the same period of 1984/85, thus showing a substantial increase.

Turning to the Australian proposal tabled at the March meeting of the Council, she reiterated that participants should endeavour to provide more detailed information on their measures taken to alleviate the critical butter situation, and the observance of GATT minimum prices, in their submissions of Questionnaire 5. Concern was continually being expressed that minimum prices were not being observed in all the cases. Therefore, Australia was going to raise this question again at the next meeting in September. In reply to a remark by the EEC, she reaffirmed that butter was not being exported to any destination at a price less than US\$1,000-1,020 per ton f.o.b.

24. The observer of Canada reported that production of butter during the first quarter of 1986 totalled 22,715 tons, which was 4.9 per cent lower than the level in the corresponding period of last year. Consumption at 21,850 tons was also lower than last year's level. Stocks at the end of the first quarter of 1986 were 21,123 tons, which represented a slight increase over the level at the start of the year. Forecasts revealed that butter production during 1986 would remain stable at 97,000 tons. Consumption would add up to 103,000 tons, as a result of which stocks at the end of the year would be reduced to 13,800 tons.

25. The observer from the Economic Commission for Europe, informed that East European milk production slightly declined in 1985, but it registered a modest increase in the case of the USSR. Butter output fell by about 3 per cent in Eastern Europe, but increased by 2 per cent in the USSR. Cheese output rose by 1 per cent in Eastern Europe and by 2 per cent in the USSR. The forecasts for 1986 showed that milk production would remain unchanged in Eastern Europe, although with unfavourable weather conditions and reduced cow numbers (2 per cent less at the beginning of 1986) a decline of 1 to 2 per cent was feasible. In the case of the USSR, however, the situation was more optimistic as deliveries of milk during the first five months of 1986 were 6 per cent up and milk yields had increased by 7 per cent. Butter production during the first five months of 1986 increased by 6 per cent, margarine by 5 per cent and wholemilk powder products by 6 per cent. Generally speaking, butter production in Eastern Europe (excluding the USSR) was expected to remain stagnant or even to decrease, but cheese production was likely to increase.

Problems facing butter trade

26. The Chairman recalled that since last September both the Protocol Committee and the International Dairy Council had been preoccupied with the question of possible measures to resolve the critical situation facing the butter trade. During the discussions it was agreed that the Australian proposal would be kept on the agenda for the next meeting of the Council, it being understood that all participants would be invited to provide as complete information as possible for inclusion in the inventory of measures affecting trade in dairy products.

27. The Committee had now decided that so long as the specific problems of butter trade could be discussed under the market situation, there was no need to keep it as a separate agenda item. As far as New Zealand's proposal (see paragraphs 19 and 20 for the proposal and the preliminary comments thereon) in regard to a joint venture for the disposal of butter stocks was concerned, the Committee could decide the modalities at its September meeting.

Report to the Council

28. In accordance with Article VII:2 of the Arrangement and Rule 22 of the Rules of Procedure, the Committee adopted its report to the Council. This was distributed in document DPC/F/43.

Date of next session

29. The next session of the Committees will be held on 22-23 September 1986, subject to confirmation by the secretariat. The session of the Protocol Committee Regarding Milk Fat will be followed by the session of the Committee of the Protocol Regarding Certain Cheeses and then the Committee of the Protocol Regarding Certain Milk Powders.