

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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International Dairy Arrangement

COMMITTEE OF THE PROTOCOL REGARDING MILK FAT

Twenty-Seventh Session

Report

Introduction

1. The Committee of the Protocol Regarding Milk Fat held its twenty-seventh session on 29-30 September 1986.

Adoption of the agenda

2. The Committee adopted the following agenda:
- A. Adoption of report on the twenty-sixth session
 - B. Information required by the Committee:
 - (i) Replies to Questionnaire 2
 - (ii) Summary tables
 - (iii) Other information
 - C. Sales under derogations
 - D. Review of the market situation for production covered by the Protocol
 - E. Review of the level of minimum prices under Article 3:3(b) for products covered by the Protocol
 - F. Report to the Council
 - G. Future meetings

Adoption of report on the twenty-sixth session

3. The Committee adopted the report on its twenty-sixth session, as amended. This was distributed as document DPC/F/44.

Information required by the Committee

- (i) 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 second quarter of 1986 to do so without further delay. They were also requested to submit information regarding the third quarter of 1986 by 10 December at the latest.

(ii) Summary tables

5. The Committee reviewed the summary tables based on information provided by participants up to the first quarter of 1986, which was issued in document DPC/F/W/22/Rev.22. It also took note of information up to August 1986 incorporated in the annual Status Report on the world market for dairy products (DPC/W/62) and in an addendum to this document DPC/W/62/Add.1.

(iii) 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. Data related to the second quarter of 1986 and also forecasts for the third quarter.

7. The Committee also took note of document DPC/W/63 prepared by the secretariat at the request of the participants on the United States Export Sales of Dairy Products under Section 1163 of the Food Security Act of 1985.

Sales under derogations

8. The Committee took note of the information provided by New Zealand regarding its intention to sell 50,000 tons of butteroil to Brazil during the coming fifteen-months' period between October 1986 to December 1987, under the derogation provided for in Article 7:1 of the Protocol Regarding Milk Fat, and in accordance with the provisions of paragraph 1 of the decision adopted on 31 May 1985 (DPC/F/35). This notification was distributed to participants in document DPC/F/W/25 on 29 September 1986.

9. The Committee also took note of New Zealand's undertaking to notify prices and other appropriate details as soon as this particular deal was finalized. In reply to a question by the EC whether there was a linkage between this sale and the barter deal negotiated with INTER-BRAZ (Brazil) concerning the export of 13,000 tons of skimmed milk powder and 6,000 tons of whole milk powder and 3,000 tons of orange juice (totalling US\$50 million), the representative of New Zealand explained that except for some sales of whole milk powder which took place quite a while ago, there was no barter deal on orange juice. However, he could more positively confirm that there was no direct linkage between the sale of the butteroil and the barter deal.

10. In reply to a question by Australia, the spokesman of the EC confirmed that of the 50,000 tons of the butter sales option to the USSR, the secretariat had already been informed of additional sales amounting to 10,000 tons. An additional 8,000 tons had been sold in September 1986, but had not been notified because there had not yet been a prefixation of refunds by the EC. However, there was no clear indication whether the 50,000 tons of butter option would be fully utilized.

Review of market situation for products covered by the Protocol

11. The representative of Switzerland informed the Committee that the base price of milk had been increased by 5 centimes to 97 centimes a kilo with effect from 1 July 1986. Certain other parallel measures had been taken,

for example the concession of increased number of margins for manufacturing, resale and distribution. Production quotas were to be reduced in two stages. First reduction was implemented last summer and it had been decided to cut production quotas further in May 1987. As far as the milk sector was concerned, he indicated that while charges at the border had been increased for imports of oils and fats, tax on cheese imports had not been increased even though the price of local cheese had increased. Furthermore, the producers in the pork industry were encouraged to use more skimmed milk powder in liquid form. Regarding milk deliveries he said that the situation had not changed much. In May 1986, milk deliveries amounted to 299,000 tons, dropping to 270,900 tons in June and then rising to 281,300 tons in July, and once again falling back to 264,400 tons in August 1986. Overall, the figures showed a slight increase of 0.4 per cent compared to levels in the corresponding period of the previous year. Butter production had declined slightly; as regards imports which had declined considerably during the previous year, a slight increase was discernible in the third quarter and it was expected that the levels would remain stable from the fourth quarter onwards. Imports during the current year had increased by 1,000 tons in contrast to some imports in 1985. Prior to the increase in milk prices, some speculation on the part of housewives had led to increased sales of butter for stocking purposes, but the pressures had soon fizzled out. Consumption, therefore, had remained more or less stable. Stocks of the order of 5,600 tons were also stable at previous years level. Butter prices had, however, slightly gone up due to an increase in the base price of milk.

12. The representative of Sweden indicated that milk production in the first months of 1986 was 4.7 per cent lower than its level in the corresponding period of 1985. For the whole of 1986, output at 3,406,000 tons would be 5 per cent smaller than in the previous year. Butter output in the first half of 1986 at 20,100 tons was 4,400 tons less than in the same period of last year. It was expected that the total for 1986 would be at least 15 per cent less than in 1985. Consumption in 1986 was, however, likely to remain unchanged at the level of 1985. Exports during the first six months showed a significant drop by 2,600 tons to a level of 5,300 tons and it was expected that altogether there would be a drop of 30 per cent by the end of the year. Average export price recorded in August was US\$1,200 per ton f.o.b. at the reference point.

13. The delegate of Norway informed that milk deliveries during the first half of 1986 were 2 per cent lower than in the same period of last year. For the whole of 1986, milk deliveries were expected to be 1 to 2 per cent smaller due mainly to the effective implementation of quotas. Due to the quota system, it was possible to increase the producer milk prices in the framework of the Agriculture Agreement valid for the period from 1 July 1986 to 30 June 1987. Regarding butter production, he indicated that the level in the first six months of 1986 had declined by 9 per cent compared to the level in the same period of last year. Consumption had also declined by as much as 15 per cent. Exports during this period were, however, 2,005 tons compared with 1,314 tons in the corresponding six months of 1985. In the second half of 1986, exports were estimated to be between 1,700-1,800 tons. Average export prices remained at the level of the GATT minimum prices.

14. The Finnish delegate said that milk deliveries to dairies during the first 6 months of 1986 were reduced by about 1.6 per cent compared to their level in the same period of last year. With the anticipated level of

production in the second half of the year, total output in 1986 would be 2,780 million litres, which would be 1 per cent less than in 1985. Milk deliveries were expected to be further reduced by 1 per cent in 1987. Butter output in the first 5 months of 1986 aggregated 8 per cent lower than in the corresponding period of last year. Exports were reduced by almost one-fifth, thus resulting into an increase in stocks which amounted to 13.9 million kilograms in June 1986. Butter output for the whole of 1986 was estimated to be between 70-72 million kilograms. Consumption was expected to total 53 million kilograms, giving a surplus of 17-18 million kilograms. Average butter export prices between January-March 1986 were US\$1,089 per ton f.o.b.

15. The representative of South Africa informed that overall the milk production was down by 3 per cent in 1986, reflecting a decrease of 10 per cent in industrial milk deliveries and 2 per cent increase in fresh milk production. This downward trend was expected to be accelerated in the coming year. With regard to butter, he referred to the seasonal low in consumption in the second quarter. In order to reduce the persistent butter stocks, the Dairy Board had reduced the price of butter significantly with effect from 1 July and at the same time had launched an active campaign to promote the consumption of butter. It was expected that as a result of an increase in the overall sales, butter stocks would recede to more reasonable levels.

16. The delegate of Poland described 1986 as the worst year for his country's dairy industry. As a result of a very cold winter, milk production had drastically fallen. His country had become a net importer of dairy products since domestic supplies had fallen short of domestic requirements. Exports of skimmed milk powder had also dropped sharply as a result of the Chernobyl incident. About 400 tons of whole milk powder was being imported to meet the domestic shortage. Similarly, some 4,000 tons of butter was being imported from certain countries to cope with domestic requirements. Due to a change in Government policy, milk production had dropped from 15 billion litres to 1 billion litres. In reply to a question by the EC whether a barter deal had been signed under which New Zealand would supply 10,000 tons of butter to Poland in exchange for skimmed milk powder of equal value in the next two years, confirming the purchase he said that his country had some difficulties in selling the milk powders which were alleged to be contaminated following the Chernobyl accident. The price of butter imported from New Zealand was above the GATT minimum. Similarly, the price of skimmed milk powder sold to New Zealand was above the GATT minimum. He, however, made it clear, and it was confirmed by the representative of New Zealand, that it was not a barter deal since butter was being purchased from New Zealand on the same commercial terms as from the EC.

17. Commenting on the milk production situation in his country, the representative of New Zealand said that weather and pasture growing conditions had a strong influence on the level of total output. Thus, favourable weather in late summer and autumn in almost all dairying areas led to increased production in the 1985/86 season, with milk fat processed at 349.4 million kilograms which was 17 million kilograms or 5.1 per cent more than the level of 332.4 million kilograms in the 1984/85 season. In response to changing international market conditions, the New Zealand dairy industry had successfully altered the mix of manufactured production, while

the output of skimmed milk powder had decreased by 13 per cent during 1985/86, cheese and whole milk powder production had increased significantly and that of butter and anhydrous milk fat had increased by just under 3 per cent and casein production had expanded by some 10,000 tons. During the first four months of the 1986/87 season, cold temperatures and heavy rainfall had continued to suppress pasture growth throughout the country and it was therefore estimated that milk fat production for the current season would be 355 million kilograms. The increase was accounted for by 2 per cent increase in cow number, 0.5 per cent improvement in productivity and the assumption that climatic conditions would continue to be normal. Under the Milk Limitation Scheme, introduced by New Zealand early this year, a reduction of 5.8 million kilograms or 1.7 per cent was expected in the milk fat processed. In regard to butter and anhydrous milk fat prices, he mentioned that due to continued extreme pressure from surplus stocks they had remained hard on or below the GATT minima. Discussions with the EC were therefore being held to improve the situation and to alleviate the pressure of excessive stocks.

18. The delegate of Japan informed that milk production during the fiscal year 1985 at 7.4 million tons was 3.3 per cent more than in the previous year. Of this total, 4.3 million tons was used as milk for drinking, which was 0.5 per cent less than its level in the previous year. The remaining 3.0 million tons was used as milk for processing, marking an increase of almost 9 per cent over the previous year. More effective production controls had resulted into a slowing down in the rate of increase in milk output in fiscal year 1986. On the other hand, the increasing stocks of butter and skimmed milk powder had led to a decline in prices. Imports of dairy products, in terms of milk equivalent in 1985 were 6 per cent higher than in 1984. Imports during the first half of 1986, however, were 5.6 per cent less than their level in the same period of the previous year. With regard to butter, he indicated that domestic production in fiscal year 1985 at 91,000 tons was 13 per cent more than in 1984. Production had considerably slowed down in 1986, and in June the level was 2.6 per cent less than in the same month of last year. Imports of butter in 1985 were at the same level as in the previous year, but in the first half of 1986 they had declined by 9.5 per cent compared to their level in the same period of last year. Butter stocks had gradually increased and at the end of June 1986 amounted to 35,000 tons. Average import price of butter during 1985 was reckoned at US\$1,615 per ton, c.i.f, as against US\$1,322-1,537 per ton, c.i.f. in more recent months of 1986.

19. The delegate of Australia indicated that milk production in the April-June 1986 period at 876,000 tons was 5.3 per cent below the level of the corresponding period in 1984/85 season. The major reason for this decline was the unfavourable autumn seasonal conditions. Cumulative milk production for 1985/86 added up to 6.038 million litres, the same level as in 1984/85. During 1986/87 season, given normal seasonal conditions, a decline in cows numbers partially offset by improved yields, milk production would be slightly reduced to a level of 6.000 million litres. Regarding butter, including anhydrous milk fat, he indicated that production in 1985/86 was 104,900 tons, almost 8 per cent down on the level of 1984/85 at 114,000 tons. The downward trend reflected the international market pressures resulting in low prices for these commodities and the substitution to cheese and whole milk production. Production in 1986/87 was expected to fall further to 100,000 tons showing a decline of 4.7 per cent over the 1985/86 level. Total domestic consumption of

butter/anhydrous milk fat was provisionally estimated to have declined marginally in 1985/86 to 60,000 tons compared with 61,700 tons in 1984/85. Domestic consumption in 1986/87 was expected to return to the 1984/85 level. Export availability for 1986/87 was estimated to be around 46,000 tons, given desirable closing stocks of 10,000 tons, e.g., actual exports in 1985/86 of 54,400 tons and in 1984/85 of 55,000 tons. Actual exports in 1986/87 were likely to be below availability.

20. Referring to the world market situation, he expressed some doubt regarding the market outlook which was characterized by weak international demand. Unless stocks could be run down mainly through production restraints, the situation was expected to remain pessimistic. International prices for butter/anhydrous milk fat were currently being quoted at their respective IDA minimum levels of US\$1,000 per ton and US\$1,200 per ton f.o.b. It appeared that world butter production would be marginally up from 6,718,000 tons in 1985 to 6,740,000 tons in 1986. Production in 1985 was 10 per cent above average production for 1977-81. Stock levels in 1986 were well above the levels for comparable dates in 1985. Australia viewed with concern the estimate that the EC production in 1986 would increase following two years of decreasing production when EC dairy policies were geared to limit milk production. Australia was also concerned at the increase in EC export subsidies which were likely to push its exports by 21 per cent to a level of 381,000 tons. Concern was also expressed that despite aggressive approach to exporting, EC intervention stocks (public and private) were continuing to increase and were expected to total 1.5 million tons by the end of 1986, marginally below the actual stock level of 1.5 million tons on 28 August. The EC Commission seemed to be aware of the fundamental cause of the stock build-up, which was over-production and they appeared to be considering to cut back on production, rather than to rely on stock disposal. His country would, in this connection, like to seek an elaboration of the EC's proposals to reduce stocks levels, including derogation for butter and butteroil, welfare disposal within the Community, and sale of aged butter as stock feed.

21. The representative of Argentina said that milk production in 1985 at 5,381 million litres was 8 per cent more than in 1984. One of the factors responsible for this increase was the increase in real prices as a result of the price convention negotiated between producers and industry in 1984. Compared to some other agricultural products the prices obtained by dairy farmers were relatively more remunerative and enabled them to target production accordingly. Consumption increased only moderately, and the historical trend of per capita use of 165-180 litres was maintained. Stocks were high, but were not of serious proportions. Another factor contributing to an increase in production was the government purchases for the National Food Plan, which absorbed part of the stocks. In 1986 an increase of 25 per cent was conceded for the price per kilo of fat. The objective of these increases was two-fold. The first was to increase the productivity which in November-December 1985 had deteriorated and, secondly, for the summer months in the Southern hemisphere clear signals to producers were given so that they could carry out the necessary productive investments for the purpose of growing pastures for the winter months and maintaining the necessary production levels. Towards the end of June, a new price agreement between producers and industrialists was negotiated for another 6 months to keep the milk fat prices constant for the remainder of the year. With regard to butter, he indicated that in 1986 almost 6,000 tons had been sold to the United States at prices above the IDA minimum.

22. The spokesman of the EC expressed his satisfaction at the results of some of the measures taken to curb milk production. The number of dairy cows had declined by 1.5 million head or by 5.8 per cent between December 1983 and December 1985. A further decrease of 1 million head was expected until the end of 1987. Deliveries of milk in 1986 were provisionally estimated to increase by 770,000 tons over the level in 1985. It was quite possible in the light of the actual experience of the first nine months, that quotas fixed for 1986 would be exceeded. In respect of the butter sector, however, in common with other producing countries, the Community was faced with some serious difficulties. Output of butter was expected to increase by 5 per cent from 2,028,000 tons in 1985 to 2,124,000 tons in 1986. In 1987, a decline of 4.6 per cent was forecast, when production would recede to a level of 2,028,000 tons or to the same level as in 1985. After some positive increases in consumption in 1984-85, the aggregate level was expected to taper off by 0.7 per cent from 1,627,000 tons to 1,616,000 tons in 1986. A further decline of 0.6 per cent to a level of 1,606,000 tons was expected in 1987. Despite an elaborate and costly system of subsidies on concentrated butter, butter for bakeries, armed forces and animal feed, consumption had somehow not picked up. The Community was again not doing too well in regard to exports of butter and butteroil. In the first half of 1986, 64,000 tons of butter was exported as compared to 172,000 tons in the same period of 1985. Similarly, 65,000 tons of anhydrous milk fat (including food aid) was exported in the first half of 1986, as compared to 96,000 tons in the same period of 1985. As regards prices, the Community was fully respecting the GATT minimum fixed prices. They were reckoned to be slightly above this minimum. The situation, however, was not too cheerful with regard to stocks, which on 11 September 1986 were 1,240,000 tons in the public sector and 151,000 tons in the private sector, giving a total of 1,391,000 tons. One of the measures taken in July this year to correct this abnormal situation was the introduction of the payment delay for 240 days for the butter made available to the intervention stocks. Another measure adopted in this connection was the provision of subsidized butter for animal feed. Also, subject to the approval of the Council, another proposed measure was the provision of cheaper butter for the poor and the unemployed segment of the population. In reply to the Australian question regarding the age and condition of old butter, the EC representative said that the oldest butter in the Community dated back to January 1983 when intervention stocks totalled 360,000 tons, mostly United Kingdom salted butter. These stocks totalled 361,800 tons as of July 1985. Subsequently, with the increase in intervention stocks, 420,000 tons could be deemed to be older than 18 months, of which 90,000 tons was the United Kingdom butter.

23. The representative of New Zealand spoke again to express his serious concern at the burgeoning EC butter stocks. Despite various internal disposal schemes, the stocks had remained unabated causing serious difficulties for other butter producers. He sincerely hoped that measures would soon be adopted to alleviate the butter situation. His country was prepared to co-operate in any search for a satisfactory solution.

24. Highlighting the main points in his country's dairy situation, the observer of Canada said that despite a 2 per cent reduction in cow and heifer numbers during 1985-86, milk shipments decreased only by 0.1 per cent. Shipments of fluid milk increased by 2.1 per cent while industrial milk fell by 1.4 per cent and industrial cream fell by 3 per cent. Despite

those decreases and substantial over quota levies, production quotas were exceeded by 0.67 per cent. Due to lower than expected feed/milk price ratios, particularly good seasonal conditions in Ontario and Quebec and the poorer prospects for alternative production, the trend of changing consumption pattern in the industrial milk sector had continued to lead to decreasing emphasis on production of butter, powdered milk and evaporated milk. Butter production fell by nearly 5 per cent in 1985-86, following a drop of 7.5 per cent in the 1984-85 dairy year. While butter retail prices increased only marginally by just over 1 per cent, margarine prices dropped by nearly 4 per cent. The dairy industry was striving to reduce butter stocks as the Federal Government discontinued absorbing storage and marketing costs for butter required to meet domestic demand. The reduction in butter production, combined with a shift toward low-fat fresh and industrial products, had reduced skimmed milk production as well. He mentioned that the target price for the 1986-87 dairy year had been increased by 1.4 per cent in August 1986 in accordance with return adjustment formula. That formula was currently being reviewed. Aggregate quota for industrial milk production remained at the level of 46.6 million hectolitres. It was quite possible that in the light of the evolving domestic and international market conditions, the production quota for 1986/87 might be reduced. In regard to butter production, he indicated that the level in the second quarter of 1986 at 29,728 metric tons was slightly more than the level in the same period last year, although considerably more than in the first quarter of 1986. Domestic consumption was the same as in the previous year but was expected to be slightly lower on the calendar year basis. Stocks on 30 June 1986 aggregating 22,244 tons were, however, 28 per cent lower than on the same date last year. Trade in butter was negligible.

25. The observer from the OECD provided an update of the information contained in document DPC/STAT/United States/86/Q.II which the secretariat had compiled on the basis of United States' national sources. Regarding the most important changes, he indicated that United States' exports had substantially dropped, by nearly one-half. As a result of the new programme the production of dairy products in the United States was expected to fall by 2 to 4 per cent in 1986, especially in the case of farmers who were participating in the new programme. In certain States, farmers not participating in this programme, could in fact show some rises since the current ratio between milk prices and cattle feed prices was quite favourable. As far as consumption was concerned, an increase was expected in 1986 over 1985, despite the increase in retail prices. In 1987, however, consumption was likely to level out. In reply to an observation by the representative of New Zealand that consumption of butter in the United States rose because of the freezing of the support price which had the effect of reducing the retail prices, he reiterated that the rise in consumption was in spite of a slight rise in retail prices. No definite reasons could be given for this phenomenon. However, one possible explanation could be that there had been a reversal in the existing consumption pattern for butter and whole milk in the United States. Old people both in Canada and the United States were beginning to worry about the consequences of low calcium and vitamin content milk on their health. This might be a temporary phenomenon, but the rise in consumption was, nonetheless, real and despite of the rise in prices. The representative of New Zealand, however, still took issue with the explanation given and observed that the 6 per cent rise in consumption (in milk equivalent) was relatively smaller compared with the rise in consumption for other competitive products and therefore it could only be due to a reduction in retail prices.

Review of the level of minimum prices under Article 3:3(b)

26. The Committee carried out a review of the levels of the minimum export prices of products covered by the Protocol, on the basis of the criteria laid down in the Arrangement.

Oral report to the Council

27. The Committee agreed that an oral report on its discussions at the present meeting would be presented to the Council.

Future meetings in 1987

28. In accordance with Rules 3 and 16 of its Rules of Procedure, a tentative schedule of regular meetings of the Protocol Committees was adopted for 1987. It was, however, understood that any special session would be in addition to this schedule and that all dates would remain subject to confirmation by the secretariat (DPC/W/64).

29. The next session of the Committee will be held on 15-16 December 1986, subject to confirmation by the secretariat. The session of the Protocol Committee Regarding Certain Milk Powders will be followed by the session of the Committee of the Protocol Regarding Milk Fat and then the Protocol Regarding Certain Cheeses.