RESTRICTED

MTN/DP/W/10
16 October 1975

Special Distribution

GENERAL AGREEMENT ON TARIFFS AND TRADE

Multilateral Trade Negotiations

Group "Agriculture"
Sub-Group on Dairy Products

Original: English

ANALYSIS OF THE CHARACTERISTICS, OF THE STRUCTURE AND THE PROBLEMS OF WORLD TRADE IN DAIRY PRODUCTS

Statement by the Representative of New Zealand
on 13 October 1975

To understand the characteristics and problems of international dairy trade it is essential to have appreciation of its structure, the most significant aspect of which is the extremely small proportion of world production traded internationally.

World milk production in the three years 1971-73 totalled around 400 million tons - of which two thirds was produced in five countries where traditionally and characteristically the bulk of production is intended for domestic consumption - i.e. USSR, United States, India, the EEC and Poland. Correspondingly, in the same three years, total recorded world exports amounted to around 1.25 million tons of milk solids, or around 10 million tons of milk. Making due allowance for technical conversion factors, and for unrecorded trade, total net exports may have been as high as 12 million tons of milk - i.e. not more than 3 per cent of total world production.

These figures emphasize that the dairy industry world wide exists mainly to supply internal markets, and make it clear that the international market is too small to absorb fluctuations in either production or consumption in the major dairying nations.

For example, a fluctuation of 1 per cent in world milk production, or consumption, would amount to 4 million tons of milk. This is equivalent to 40 per cent of recorded international trade, and it is clearly unrealistic to expect that international demand could expand or contract to this extent. Similarly, a 4 per cent variation in production or consumption in the largest producer, the European Community, is also equal to 40 per cent of international trade.

Dairy prices and supply on the international market have fluctuated severely over the last decade. Minor fluctuations in dairy output in the United States or in the EEC, when exported or withdrawn from the international market, have had a large

multiplier effect on price and supply, causing considerable instability on the international market. Unlike other internationally traded commodities, for dairy products it is uncommon for non-traditional markets to emerge as significant - although sporadic - buyers. Similarly, the growth of traditional developing country markets while steady is undramatic, and is subject to the constraints of their volatile balance-of-payments situations. While the demand for milk products as food aid is significant and can be expected to continue to expand, as with consumption generally, food aid demand cannot be raised or lowered at will to match whatever level of production may have emerged in any particular year.

The consequences of this situation for New Zealand as the world's largest dairy exporter are considerable. First, although New Zealand supplies around one third of the total volume of dairy products traded internationally, this amounts to less than 1 per cent of total world production. Correspondingly, New Zealand's marketing activities must reflect a recognition that it is unable itself to influence the level of prices or demand on international markets. Rather, it is the major producers of the northern hemisphere whose influence is the more significant, and New Zealand is necessarily and seriously affected by the domestic dairy production conditions and agricultural policies in those countries.

When these nations countries are in over supply, as they are at present, New Zealand dairy production cannot be channelled into either the northern hemisphere markets themselves, or new or secondary markets at profitable prices. Unless New Zealand is able to enjoy secure access to the traditional northern hemisphere markets, at prices which afford economic returns, there can be no confidence in the long-term future of New Zealand's dairy industry.

New Zealand regards the present state of the world dairy market with particular concern. The fluctuations in production, consumption and trade over the past few years, and the price instability which has accompanied these fluctuations have been in the interests of neither producer nor consumer, and only reinforce the need for the major dairy producing and importing countries to work towards a stabilizing framework.

Product diversity

Also important to an appreciation of the characteristics and structure of world dairy trade, is a recognition of the diversity of products which may be derived from milk, and of the end-uses for these products.

Milk comprises milk fat, water and milk protein or non-fat solids. The fat can be extracted to produce butter, or butter oil - the latter being used for recombination into milk, or for industrial applications, such as the baking and confectionery industries. In each of these forms, milk fat is sensitive to competition from vegetable oils - in the form of margarine, as regards butter, or as a

direct constituent in the case of recombined "filled milk" or the baking and confectionery industries.

Milk solids non-fat, similarly, have a variety of applications - for recombination into liquid milk for consumption; or as a form of protein, for example, in the manufacture of animal feed compounds. In the latter application particularly, the demand for the product is influenced by the availability and price of competitive proteins - fish meal, soyabean meal, meat meal and so on.

Various combinations of milk fat and solids non-fat can be transformed into cheese, the demand and markets for which are influenced by taste traditions, dietary habits and transport and storage facilities.

Each of these factors is reflected in the market pattern which has evolved for the principal dairy product forms. By and large, butter and cheese are consumed as such predominantly in the developed country markets of the northern hemisphere. While animal feedstuffs are a significant outlet for solids non-fat in the main producing countries, the demand for solids non-fat in international trade, as for butter oil, is principally from developing countries for recombination into liquid milk.

The world dairy problem, however, is one of milk - fat and protein - and while market buoyancy for one product can counteract relative depression for another over a limited period, the introduction of stability into the world dairy economy will involve the establishment of secure market opportunities and remunerative prices for all milk derivatives.

National measures

Given the predominant influence on the international market of domestic production decisions and policies of the major producing nations, an appreciation of national dairy policies is also integral to an understanding of the characteristics and structure of the world dairy market.

The most significant feature in this regard is the existence of producer price support policies in both Europe and North America. While the techniques vary, the elements of these policies are much the same - first, the establishment of price support levels which, while intended basically as a guarantee to the producer, may also operate to encourage or discourage production in a manner unrelated to the impact of those price levels on consumption; secondly, the establishment of measures at the frontier designed to protect the support system, and hence the domestic market from the influence of international competition; thirdly the possibility of government intervention in the market to purchase products when market prices fall below the support levels; and fourthly, the availability of

assistance measures whereby surplus production purchased through government intervention can be off-loaded onto the international market at prices below those prevailing in the domestic market.

The limited capacity of the international market to absorb additional quantities of product has already been noted. The important points in the present context are twofold. First, the manner in which domestic support policies can operate to restrict international trade in a period of surplus domestic production, both by limiting the quantities which may enter the supported markets themselves; and, through non-commercial transactions, by limiting the scope of the international market.

Secondly, it will be noted that the producer-price support policies tend to concentrate and channel the problem of surpluses when these emerge. Where government intervention is involved, this logically encompasses storable products, which concentrates the surplus into a narrow product range - mainly butter and skim milk powder. It is these products, for which the international (as opposed to domestic) demand is restricted, rather than alternative milk products for which better market opportunities may exist, that enter world trade at governmentally assisted price levels. Thus what may often be a marginal and potentially manageable difficulty is magnified, and becomes a potentially unmanageable one, causing exaggerated fluctuations in international prices.

While techniques might be evolved to stabilize or rationalize the situation it is implicit that the policies which create market distortions and artificial surpluses should also be subject to modification if any enduring solution is to be cast.

While it is not the intention of this analysis to suggest the manner in which such modifications might be made, it will be apparent that supporting farm incomes by price supports backed by government intervention buying, has artificially lifted consumer prices and dampened demand. It has, on occasions, stimulated uneconomic production, and, in such instances particularly, constituted a significant financial burden. Direct income supports, on the other hand, reduce the need for consumer prices fully to support farm incomes, and do not have the same potential for a negative effect on consumption. Similarly, they provide the opportunity for internal prices to respond more effectively to competition, both from competing products, and from competing international suppliers. Correspondingly, the opportunities for establishing internal equilibrium, and for liberalizing frontier measures should also increase.

The importance of consumption in the evolution of world dairy production and trade cannot be undervalued. The past twenty years or so have been characterized by tendencies to foster and protect milk production while consumption has been, to

a degree, neglected by producers. The contraction of consumption in certain important areas is evidence of this trend.

The consequence is, however, that the burden of adjustment has been thrust to an unrealistic extent onto the small sector represented by international trade.

Access opportunities

The foregoing observations are not intended to imply that access to the major developed country markets is completely prohibited. The range of frontier provisions, however, is all embracing extending from discretionary licensing, quotas and variable levies, through to outright embargoes. Both the volume of access relative to consumption varies considerably from market to market, as do the conditions under which such access is extended. Continuing mutual review of access levels, for example, is not a widespread feature of import policies.

Prices

The significant feature about price in world dairy production and trade is the relative stability and overall upward trend of support prices in the major producing countries, contrasted with the prices for the small proportion of production traded internationally, which have been consistently of a lower order, and subject to several fluctuations in response to the extremes of shortage and surplus generated by the domestic support policies.

International co-operation

It would be misleading if this paper were not to refer to the numerous international arrangements participants in the world dairy trade have concluded in an endeavour to introduce some stability into this volatile sector. These have been covered in the documentation prepared by the secretariat and I do not propose to traverse their provisions now, except to say that they are incomplete in their coverage and no longer reflect current market realities.

Trends in 1974/75 and outlook for 1975/76

It seems to the New Zealand delegation that a narrative of the characteristics and structure of world dairy production and trade is in itself an incomplete basis for the Dairy Sub-Group's work. Of significance to this work also is an assessment of recent developments in production and trade, and of likely trends in the immediate future. To this end the New Zealand delegation would offer the following observations.

Total milk production in 1974 in the main dairying countries did not increase on 1973 levels. In the EEC, 1974 output was only 0.6 per cent up; in Oceania production declined, and in North America it was the same as in 1973. Trends so far in the first half of 1975 show a marginal 1 per cent decline in Western Europe and no significant growth in milk production in the United States on 1974.

Despite stable milk production, supplies have tended to exceed commercial requirements. In general, demand for milk products has been adversely affected by world-wide recession and by further increases in support prices in North America and Europe.

Cheese production in Western Europe expanded this year, but weakening demand has resulted in increased stocks. Despite only a moderate increase in skim milk powder production in the EEC, a decline in internal consumption, especially for animal feed, has contributed to the serious growth in intervention stocks of skim milk powder. These stocks now stand at around 1 million tons, 0.7 million above normal requirements and well above the level traded annually on the international market. The existence of these stocks exerts considerable pressure on prices in the international market.

In the United States, during 1974/75, internal consumption of dairy products declined while milk production remained at year earlier levels. The result was a steep decline in the imports of cheese, while imports of butter and skim milk powder, which were at high levels in 1973/74 virtually ceased in 1974/75. This withdrawal from importing by the United States has had a significant multiplier effect on the supply and price situation on the international market, especially for skim milk powders.

In the case of butter, consumption in the world's largest importing country, the United Kingdom, in 1974 expanded due to increased consumer subsidies and rising margarine prices. But between now and 1975, the butter support price in the United Kingdom is planned to rise by nearly 30 per cent to over £1,100 sterling per ton, to harmonize with the support price level in the Six. To date, the United Kingdom has absorbed heavily increased quantities of butter from the Six and this has kept intervention stocks at moderate levels. But a significant drop in consumption within the EEC as a whole could cause a persistent Community stock build-up of butter unless the price to the consumer is held in reasonable relationship with that for margarine.

In general, the international dairy situation in 1974/75 deteriorated compared with the previous year with new imbalances being induced by changes on the demand side. Although producer support prices were raised substantially in developed countries, milk output rose only slowly. However, the resulting increase in the price to consumer reinforced the dampening effects of the economic recession on world demand for milk products.

Export receipts

The trading prospects for some dairy products, notably SMP and casein, deteriorated considerably during the twelve months ended June 1975. The total value of New Zealand dairy exports during this period was $290.4 million as compared with $333.2 million in the year 1973/74. The drop of about $43 million mainly resulted from greatly reduced volume of SMP and casein exports from New Zealand. For the year ended June 1975 SMP exports from New Zealand amounted to 113,680 tons as compared with 215,500 tons for the previous year. Total SMP exports in the month of July 1975 was 5,163 tons as compared with 13,800 tons in July 1974. Because of the greatly reduced volume of exports New Zealand stocks of SMP are currently running at high levels.

As with SMP the demand for casein has been depressed in the 1974/75 trading year because of the prolonged recession in the main industrial countries. Casein exports in the year ended June 1975 totalled $14.6 million compared with $28.6 million in 1973/74. In terms of volume the decline was even more apparent with exports dropping from about 40,000 tons to 17,000 tons. The conditions for butter and cheese were firm during 1974/75 despite fewer opportunities for sales in North America. With the sharp decline in United Kingdom dairy production the demand for New Zealand butter and cheese was maintained.

Outlook for 1975/76

Production - present indications are for a slight increase in world dairy production in the 1975/76 year. In most of the developed regions there has been a decline in dairy cow numbers although the rate of decline has slowed as a result of high unemployment, fewer off-farm job opportunities particularly in the United States and the depressed market for beef. Furthermore, in many developed countries governments have increased the support prices for dairy products and have thereby improved the relative profitability of dairy farming.

Demand - the demand for dairy products both for human consumption and stock feeding purposes is expected to remain relatively stagnant. This assumes that the consumer subsidy on butter in the United Kingdom is retained and that subsidies for livestock feeds are not increased.

With the greatly improved milk supply and stock position United States import demand for dairy products in general and SMP in particular is likely to be small.

As far as developing countries are concerned their commercial demand will be curtailed for balance-of-payments reasons, or through marked improvement in the domestic milk supply position.

Market outlook - the short-term outlook for dairy products is very much dominated by the virtual stagnation of the market for solids-not-fat products. The EEC countries are currently holding a substantial part of last season's production. In light of this there is likely to be a continued imbalance in the world trade of SMP with no appreciable reduction in world stocks occurring in the near future.

Unlike SMP, there are likely to be fewer problems with regard to butter and cheese. With the substantial decline in United Kingdom dairy production the strong demand for butter and cheese is likely to be maintained over the next twelve months. Outside the United Kingdom the market for butter and cheese is unlikely to be large mainly because of the improvement in the United States milk supply position. Overall the outlook for dairy trade in the 1975/76 season is for only slow growth.

Conclusion

If one endeavours to summarize the characteristics and structure of the world dairy market one might say that:

there is some access to the major consumption markets, but under tightly controlled conditions;

there is a basically stable and rising domestic price situation in the major producing countries but a highly volatile price situation for the 3 per cent of world production traded internationally;

there are producer support policies which may inhibit consumption, and generate surpluses which in turn may be off-loaded onto a limited world market at subsidized prices; and

a degree of responsibility, discipline and co-operation in marketing policies and practices.

If the negotiations are to result in the steady expansion of world dairy trade under secure trading conditions, they must produce more access; a closer relationship between internal support prices and world market prices at levels which promote consumption; and more marketing responsibility, discipline and co-operation.