

# GENERAL AGREEMENT ON TARIFFS AND TRADE

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International Dairy Arrangement

COMMITTEE OF THE PROTOCOL REGARDING CERTAIN MILK POWDERS

Twenty-Fifth Session

Draft Report

Introduction

1. The Committee of the Protocol Regarding Certain Milk Powders held its twenty-fifth session on 17 March 1986.

Adoption of the agenda

2. The Committee adopted the following agenda:
1. Election of the Chairman and Vice-Chairman
  2. Adoption of report on the twenty-fourth session
  3. Information required by the Committee:
    - (a) Replies to Questionnaire 1
    - (b) Summary tables
    - (c) Other information
  4. Sales under derogations
  5. Review of the market situation for products covered by the Protocol
  6. Adjustment of minimum prices according to exchange rate fluctuations

7. Oral report to the Council

8. Date of next session.

Election of the Chairman and Vice-Chairman

3. The Committee re-elected Mr. G.A. Stünzi (Switzerland) as the Chairman, while no Vice-Chairman was elected.

Adoption of report on the twenty-fourth session

4. The Committee adopted the report on its twenty-fourth session. This was distributed as document DPC/P/40.

Information required by the Committee

(a) Replies to Questionnaire 1

5. The Committee reviewed the replies to Questionnaire 1 and requested participants who had not communicated such information in respect of the fourth quarter of 1985 to do so without further delay. They were also requested to submit information regarding the first quarter of 1986 by 15 June at the latest.

(b) Summary tables

6. The Committee reviewed the summary tables based on information provided by participants in tables A and B of Questionnaire 1 in respect of certain milk powders. The Committee took note of document DPC/P/W/32, which would be revised taking account of more recent information submitted.

(c) Other information

Sales under derogations

8. The Committee took note of the fact that no new information regarding the sales of milk powders in accordance with Article 3:5 of the Protocol Regarding Certain Milk Powders had been received since about the issue of DPC/P/W/30 in October 1985, in which such sales had been reported by Australia, New Zealand, Poland, South Africa and Switzerland.

Review of the market situation for products covered by the Protocol

9. In describing the various proposed changes in the Community's dairy policy the EEC spokesman mentioned that in order to redress the surplus the Commission had first of all proposed to the Council not to increase the price of milk. Taking into account the increase in production costs and inflation it actually implied a drop in the real price for the farmers. Secondly, the relationship between fat and nitrogenous matter was changed from 50/50 some two years ago to 48.27 to 51.78 and then to 46.13 to 53.87. The price of butter was to be reduced in relation to the price of non-fatty products. Thirdly, while the levy system was still in place, the farmers would now be required to pay in half year units rather than in year units so that they do not overstep their quota limits and refrain from over-production. The co-responsibility assessments were being maintained at 2 per cent and the Commission was proposing further to reduce milk production by purchasing initial quantities of 3 per cent of the production under quotas. As a result of the quota system, the production of butter had decreased by 7.8 per cent in 1985 as compared to a decrease of 4.1 per cent in 1984. The reduction was expected to be 3.2 per cent in the current year. For powdered non-fat milk the figures showed a drop of 16 per cent, 7.2 per cent and 2 per cent respectively for the same periods. The production of whole milk powder, after having increased by 23.7 per cent in 1984, dropped by 2.8 per cent in 1985, but was expected to increase by 2.3 per cent in 1986. As regards cheese, production was up by 4.4 per cent in 1984, 1.3 per cent in 1985 and was expected to be 1.6 per cent higher in

1986. Production of condensed milk was 1.2 per cent higher in 1984, but was only 0.4 per cent more in 1985 and was likely to be 0.5 per cent higher in 1986. Production of liquid milk used for casein manufacture, which was up by only 0.7 per cent in 1984, increased by 21.6 per cent in 1985 and was expected to be reduced by 4.2 per cent in 1986.

Consumption of milk cream and yoghurt had increased. Exports of skimmed milk powder from the EEC at 305,000 tons (including food aid) in 1985, compared very unfavourably with exports of 634,000 tons in 1979. The EEC share of total world exports had dropped from almost 60 per cent in 1979 to 27 per cent in 1985. As regards the whole milk powder, the Community accounted for 73.4 per cent of total world exports of 715,000 tons in 1980, but in 1985 the share had dropped to 65.8 per cent, i.e., 480,000 tons out of world exports of 730,000 tons. Average export price, based on the existing level of restitutions was US\$1,050 per ton f.o.b. for whole milk powder and US\$812 per ton f.o.b. for non-fat powdered milk. In reply to a question by Canada whether the restitutions were established on a bid basis and why a new system was adopted, he elaborated in more general terms that a drop in the dollar exchange rate in effect meant an increase in the market price level. This, however, worked differently for the Community when other suppliers successfully maintained their prices at around the minimum price level irrespective of the fall in the dollar exchange rate, but exports from the Community sharply declined because of its high prices. In order to maintain its position the Community had to find a new method which would permit fair competition with other suppliers in terms of market prices. Like other suppliers, the EEC decided not to publish its bids on other markets until the contract had been completely finalized. In adopting this commercial expedience, the Community still respected the minimum price level. In reaction to another question by Argentina and New Zealand he observed that other suppliers had been equally non-transparent in that they concealed their bids on third markets. While he was not prepared to describe how the EEC refunds were worked out for each destination or market, he could only indicate that the level of refunds was not as important as the level of sales price and in any case the EEC sales price was not below the GATT minimum price.

10. The representative of Argentina said that the consumption of skimmed milk powder had decreased with a decrease in processing for specific products. As regards the whole milk powder, production during the first three quarters of 1985 was up by 40 per cent compared to the level in the corresponding period of 1984. Imports were not significant, while exports totalled 2,000 tons in 1984, but were significantly down in 1985. The domestic consumption of whole milk powder had significantly increased.

11. The Australian delegate stated that total output of skimmed milk powder/butter milk powder during the July-December 1985/86 period was 6.4 per cent below the level of production in the corresponding 1984/85 period. This decline was due to the decline in butter production and an increase in casein production. The Australian Dairy Commission estimates showed that skimmed milk powder production in 1985/86 would be about 7.8 per cent below the 1984/85 production level. Domestic consumption of skimmed milk powder/butter milk powder was expected to decline marginally in 1985/86 to around 38,500 tons. Export availability of these two products was therefore expected to be 104,000 tons, given desirable closing stocks of 10,000 tons. As a result of the EEC's new restitutions policy the prices on the international market had recently plunged by US\$200 per ton. Prices were currently being quoted in the range of US\$820-860 per ton f.o.b. As regards the whole milk powder production in the July-December period was 6.4 per cent above the corresponding period in 1984/85. The Australian Dairy Commission estimated that production during 1985/86 would increase by around 7.5 per cent in response to an increase in export orders. International prices for whole milk powder were currently being quoted in the range of US\$990-1,020 per ton f.o.b.

12. The representative of Bulgaria informed that his country was neither an importer nor an exporter of milk powders. The production of this product was earmarked exclusively for the domestic market. Total output of skimmed milk powder in 1985 at 1,600 metric tons was chiefly used for animal feed. This trend was expected to continue in 1986 also.

As regards the wholemilk powder, he observed that a similar trend could be discerned in its production which followed closely on the heels of domestic consumption. At 3,700 metric tons in 1985, it was 9 per cent lower than the level in 1984 and the decline was mainly attributable to unfavourable weather conditions. Stocks at the end of the last quarter of 1985 amounted to 100 tons.

13. The representative of Japan observed that the domestic skimmed milk powder market had recently shown signs of weakness as a result of an increase in domestic production of skimmed milk powder and an increase in milk production. Production during April 1985-December 1985 period amounted to 137,000 tons. Imports of skimmed milk powder during 1985 totalled 104,000 tons, i.e. 15.5 per cent higher than in the previous year, partly due to 8,000 tons of imports by LIPC and partly due to a 9 per cent increase in imports for animal feed purposes. Of this total, 76,000 tons were specifically for animal feed purposes. Replying to a question by the delegate of New Zealand whether the quantities of milk qualifying for deficiency payments had increased from 2.2 million tons to 2.3 million tons during 1985/86 period, he said that a decision regarding the support prices for dairy products and the quantities eligible for deficiency payments was taken by his government in March, every year. He was not in a position at that time to provide the exact figures on quantities qualifying for deficiency payments, but he would more generally indicate that such quantities had been increasing every year mainly due to an increase in domestic consumption.

14. Commenting on the specific skimmed milk powder situation the delegate of New Zealand said that production in 1985 was down by 29,000 tons on a calendar year basis as compared to the level in 1984. However, exports were 5,000 tons more than in calendar 1984. Stocks were 25,000 tons higher than in the previous year. Prices of skimmed milk powder were in the range of US\$820-850 per ton f.o.b., until a few weeks ago prior to the adoption by the EEC of a new restitutions system. As regards the whole milk powder, production during 1985 was 10,000 tons higher than in 1984. Exports increased by nearly 28,000 tons, and the major source of this increase was increased sales to the USSR. Stocks

were, however, 6,000 tons lower than at the end of 1984, but were still reasonably comfortable. Prices ranged between US\$990 and US\$1,025 per ton f.o.b. Turning to the general outlook, the representative of New Zealand agreed with the observation made in secretariat's document DPC/W/54 that the outlook for milk powders and, in particular, for skimmed milk powder, was positive. The secretariat report had correctly indicated that global skimmed milk production had declined by 1 per cent in 1985 as compared to 1984 when output was already down by 7 per cent over the level in 1983. Total stocks at the end of 1985 were around one-third less than a year-earlier and that prices had strengthened significantly during 1985 to levels of US\$750-US\$800 per ton f.o.b. in the fourth quarter. This firming of the market continued during 1986 and prices improved further on those levels. Recently, however, a dramatic turn-around took place with the introduction of EEC's policy of flexible refunds for exports of different dairy products. The purpose of this system appeared to be the targeting of EEC's sales in large quantities of specific products into specific markets. This had serious repercussions on the international market for skimmed milk powder in particular. Since about the middle of February, the positive developments had suddenly turned into depressed market conditions. An illustration of this was the tender opened for the supply of skimmed milk powder to Mexico. Prior to the introduction of the targeted refund system, any pressures to lower prices in this market would have come from the United States and, in normal circumstances, would have been contained. An immediate effect of EEC's policy of flexible refunds had been to reduce prices to a level far below what was necessary to achieve the desired level of sales. There was also no alteration in the allocation of market shares between the main suppliers, only a decrease in the overall level of prices. The refunds had been extended to an increasing number of destinations, and were not related to specific tenders. As a result, the prices had come down to the level of US\$650 per ton. In the case of Japan, refunds for exports of skimmed milk powder for both stock feed and human consumption purposes enabled EEC traders now to offer prices of US\$650 per ton. While prices for stock feed purposes might have been that low, skimmed milk powder sold in Japan for human consumption purposes had been at prices around

US\$830 per ton. More recently, the EEC system of flexible refunds had been extended to a number of South East Asian markets, including Thailand, the Philippines and Hong Kong. Thus, in markets where skimmed milk powder had so far been traded comfortably at well over US\$800 per ton f.o.b., EEC traders were now able and willing to offer at prices just above the GATT minimum. This was likely to force other suppliers to adjust their offer prices accordingly. New Zealand had no intention of being forced out of markets into which it had had diversified over recent years. These developments were disturbing and had no beneficial effect. The flexible refund system was not resulting into increased sales and was not likely to force EC competitors out of the traditional markets. His country had already drawn the EEC's attention to the serious consequences the new system was likely to have on the international market for dairy products. He wished to know from the Community what particular benefits it expected from the adoption of this system and whether restitutions on such a big scale would continue to be granted to a wide range of destinations and at such potentially disruptive levels.

15. Expressing his serious concern at the EEC's refund system the delegate of Australia drew attention to its destabilizing effect on international prices of skimmed milk powder. Offers were now being made in Thailand at around US\$660, whereas Australia had sold to that market at US\$850 per ton prior to the introduction of EEC's new system of refunds. The EEC offers therefore had the effect of depressing other prices by nearly US\$200 per ton. In the light of the prevailing situation the Australian delegate addressed three specific questions to the representative of the EEC. First, how did the refund system operate and what was its period of validity. Second, how successful had been this system in regard to destinations, volume of exports and prices. Three, did the EEC still believe that this scheme was in keeping with the spirit of Article III of the Arrangement which called for full transparency in member country's dairy policies.

16. The spokesman of the EEC replied that in view of the drastic reduction experienced in the share of EEC's exports of skimmed milk powder, from 60 per cent in 1979 to 27 per cent in 1985, special measures had to be adopted to maintain a reasonable share of the world market. In view of the fact that shipping costs were lower for certain destinations, the EEC preferred to sell in those markets. They did not wish to be left out of their traditional markets. So special amounts of restitutions were fixed for special destinations. Referring to sales of skimmed milk powder to Mexico, he observed that the major tender was at around US\$800. But to meet competition the EC had to grant differential refunds in order to be commercially viable in those markets. The EC did not wish to pull the prices down, it only adjusted its level of refunds in accordance with the intensity of competition in certain markets. He was not willing to provide full details as to how the system operated because such details had always been published in the EEC official bulletin. In reply to the comments made by Argentina and Uruguay, he once again made it clear that the EEC had always been transparent in its policies and was not in violation of the spirit of Article III of the Arrangement. In order to match world market prices the EEC was now providing refunds to its exporters on an individual or a general basis. There was no change in the system of refunds except that specific refunds were being provided for specific destinations. The EEC was not in any way under cutting other suppliers on the international market, it was only matching its prices with the other offers made on the world market. Henceforth, the EEC offer prices were not likely to be disclosed until the deal had fully materialized.

17. The representative of South Africa mentioned that a slow down in the total milk production had a bearing on the skimmed milk powder output, which served as a balancing product in his country's dairy production. The output of skimmed milk powder, although up by some 11 per cent for the year 1985, showed a drop of 9 per cent in the fourth quarter of 1985 as compared to the same period of 1984. A further 20 per cent decrease was expected in the first quarter of 1986 over the corresponding period in 1985.

18. The Finnish delegate indicated that production of whole milk powder during 1985 at 34,000 metric tons was almost 10 per cent more than in 1984. Exports added up to 33,000 metric tons, leaving a surplus of 1,000 tons for domestic consumption. In 1986 production was expected to total 31,000 metric tons and exports 30,000 metric tons. Production of skimmed milk powder in 1985 was 42,000 metric tons as compared to 58,000 metric tons in 1984, i.e., 38 per cent lower. In reply to a question by the EEC, he informed that his country being a traditional supplier, shipped its entire exports of whole milk powder to the USSR at an average unit price of US\$962.5 per ton f.o.b.

19. The delegate of Norway reported that production of skimmed milk powder in 1985 at 7.3 thousand tons was marginally above the level in the previous year. Domestic consumption was, however, 8 per cent lower mainly due to a decline in consumption for animal feed. No exports or imports were being made.

20. The representative of Sweden indicated that production of skimmed milk powder in 1985 was 6.7 per cent lower than the level in 1984. A further decrease was expected in 1986. Domestic consumption at 25,400 tons was also considerably lower than in the previous year. While exports were 300 tons smaller, imports showed an increase by 200 tons in 1985. Average export price in March 1986 was US\$790 per ton f.o.b. reference point.

21. The representative of Switzerland said that production of skimmed milk powder during 1985 at 30,500 tons was 10 per cent lower than the level in 1984. Exports at 7,600 tons in 1985 were expected to jump to a level of 11,000 tons in the first six months of the current year. Domestic consumption was constantly on the way down. Notwithstanding the fact that farmers were using whole milk powder on the farm to feed calves, stocks at end of February at 13,000 tons were expected to soar further in the course of 1986.

22. The observer of Canada told the Committee that production of skimmed milk powder in 1985 totalled 97,740 metric tons, which was 24.8 per cent below the level in 1984. Total exports added up to 60,580 metric tons or 13.5 per cent below the level of 1984. Stocks at 15,210 metric tons in December 1985 were half of what they were at end-September and about 26 per cent lower than their level in 1984.

23. The observer from the OECD drew attention of the Committee to the substantial increase in the United States milk production following the termination of the diversion programme. A further boost to production could be expected with the adoption of new policy measures. Regarding the skimmed milk production, indications were that the level in the last quarter of 1985 was 50 per cent up on previous year's level. In the first quarter of 1986, however, it increased only by 30 per cent. Stocks at end-December totalled 485,000 tons compared to 565,000 tons a year-earlier. Stocks at end-March 1986 were believed to be 500,000 tons, a level almost identical to stocks in the corresponding period of the previous year. As regards the whole milk powder, output in the fourth quarter of 1985 was 16 per cent up to a level of 14,500 tons, giving an increase of 18 per cent over the entire year. This rate of increase was not expected to continue in the first quarter of 1986. In regard to production of whole milk powder in Austria, which was another important producer of this item, forecasts suggested an output of 18,800 tons for 1985, i.e., 20 per cent below the level of 1984. No significant change was expected in the level of production during the first quarter of 1986.

Adjustment of minimum prices according to exchange rate fluctuations

24. The discussion on this subject was held at the joint meeting of the three Protocol Committees, a resumé of which is given in the report of the Committee of the Protocol Regarding Milk Fat (Spec(86)22, paragraphs 29 to 30).

Oral report to the Council

25. The Committee agreed that an oral report giving an account of its discussions at the present session would be submitted to the Council.

Date of next session

26. The next session of the Committees will be held on 16-17 June 1986, subject to confirmation by the secretariat. The session of the Protocol Committee Regarding Certain Cheeses will be followed by the session of the Committee of the Protocol Regarding Certain Milk Powders and then the Committee of the Protocol Regarding Milk Fat.