

GENERAL AGREEMENT ON

RESTRICTED

TARIFFS AND TRADE

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International Dairy Arrangement

COMMITTEE OF THE PROTOCOL REGARDING MILK FAT

Thirty-First Session

Draft Report

Introduction

1. The Committee of the Protocol Regarding Milk Fat held its thirty-first session on 21-22 September 1987.

Adoption of the agenda

2. The Committee adopted the following agenda:
- A. Adoption of report on the thirtieth 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 products covered by the Protocol
 - E. Review of the level of minimum prices under Article 3:3(b)
 - F. Oral report to the Council
 - G. Date of the next session

Adoption of report on the thirtieth session

3. The Committee adopted the report on its thirtieth session as amended. This was distributed as document DPC/F/51.

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 second quarter of 1987 to do so without further delay. They were also requested to submit information regarding the third quarter of 1987 by the middle of December at the latest.

(b) Summary tables

5. The Committee reviewed the summary tables based on information provided by participants in Tables A and B of Questionnaire 2 in respect of the first quarter. The Committee took note of documents DPC/F/W/27/Rev.1 and DPC/W/73/Add.1.

(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. Data related to the second quarter of 1987 and also gave forecasts for the third quarter of 1987.

7. The Committee was informed that no significant sales had been made under the United States new Dairy Export Incentive Program adopted in February 1987. The secretariat was, nevertheless, closely following the programme and would keep the Committee informed of future developments. The Committee was also informed that the letter sent by the Chairman of the

International Dairy Council to the United States Mission in Geneva concerning the possible disposal of dairy surpluses abroad under the new Dairy Export Incentive Program had reportedly been forwarded to Washington for comments.

8. The Committee took note of the EC statement concerning its shipment of 6,000 tons each of aged butter to Algeria and Egypt. Notification had been made under Article 3, paragraph 7, to keep the members informed of all such transactions (DPC/F/W/31). In reply to a question by New Zealand, it was explained that it was a non-commercial transaction and had no impact whatsoever on the normal commercial sales. The transactions were expected to be completed by October or the middle of November this year. It was also indicated that while exports to Algeria mainly consisted of butter, those to Egypt were essentially of butter oil. No notification had been made to the FAO Consultative Committee on Surplus Disposal because the quantities involved were small, but the requirements of the FAO Principles of Surplus Disposal had been fully respected. In reply to another question by Australia, he mentioned that exports had been made to only these two countries, notwithstanding the requests made by several countries, because of the EC special relations with them and also because exports of such small quantities did not interfere with the normal commercial exports to them.

Sales under derogations

9. The Committee noted that about 300,000 tons of aged butter had already been withdrawn from the EC intervention stocks, of which 230,000 tons had already been shipped to the USSR and the other 70,000 tons was in the process of being shipped by the end of September. As regards the fate of the remaining butter option of 200,000 tons which could not be earlier delivered due to the very heavy cost of the operation amounting to ECU 3 billion, negotiations were still in progress with the purchaser regarding the price level. The operator had asked for the placement of this butter at his disposal, but due to a lack of agreement on the price, the deal was still hanging in the air. Under the derogation agreed by the

Committee, the maximum delivery period was 18 months which did not go beyond 30 June 1988. Replying to an Australian comment, the EC representative explained that the derogation had in principle been applied to exports to the USSR because it offered the single largest market for this kind of butter. Exports to other markets in any case, would have been too expensive to finance for the EC, and also would have interfered with the normal commercial sales to them. In reply to a South African comment that aged butter was not suitable for human consumption, he made it clear that exports to the USSR were essentially for human consumption purposes.

10. The representative of New Zealand informed the Committee that no progress had so far been made in concluding the contract for a sale of 25,000 tons of butter to the USSR. In this connection, he recalled the Chairman's understanding of 2 June 1987, relating to the decision contained in DPC/F/48, that all participants had agreed, depending on the evolution of the market situation, to review some of the provisions of this decision at some later stage and preferably at the regular September or December meetings of the Protocol Committee. His country's position at that stage was far from being satisfactory and would therefore like to review the situation at the next regular meeting. He could, however, confirm that 11,400 tons of fresh butter sold to the USSR in terms of paragraph 4 of the Decision of 31 May 1985 (DPC/F/W/28) had already been shipped. A notification to this effect would soon be made.

11. The Australian delegate said that his country was not in a position to take advantage of the 2 June 1987 decision (DPC/F/48), and was not likely to ship any butter to the USSR by the end of this year. Like the EC, his country was faced with a number of difficulties related to deliveries and consequently would like to reserve its right to revert to the Protocol for an extension in the deadline. Another representative of Australia confirmed that his country's production season only got into full swing in the last quarter of the calendar year. Also, in view of the fact that unsalted butter was produced on receiving specific orders, its current stocks were therefore relatively small. It was, however, imperative that an extension in the deadline for supply of such butter was agreed before the end of this year.

12. The spokesman of the Nordic countries said that serious doubts expressed at the June meeting concerning the alleviation of the situation as a result of this derogation, were now confirmed. The derogation had not functioned properly since the USSR had not imported any butter, irrespective of the price considerations. Finland had accumulated abnormally huge stocks of butter which were now posing serious difficulties. He was, however, not in a position to propose any concrete measures to resolve this particular problem. He was not in favour of increasing the price of butter at this stage. Like New Zealand, the Nordics would like to reserve their right to revert to this question at the next regular meeting of the Committee.

13. Concluding the discussion on this subject, the Chairman summed up that there was a clear need to revert to this question at the next regular meeting in December. If, in the meantime however, the EC were to resolve the question of 200,000 tons of butter option to the USSR, it should be immediately notified to the Committee. It was recalled that the Committee would address itself to the question of the time-limit at its next regular meeting or earlier if considered necessary.

Review of the market situation for products covered by the Protocol

14. The representative of Hungary indicated that butter production in the last few years had been stable at 30-32 thousand tons annually and the level in the first half of this year was 15,000 tons, but consumption of butter on an average had been increasing by 10 per cent annually. The increase in the first half of the current year was 6 per cent. As a consequence, the export availability had progressively diminished and imports had increased to a level of 3,000 tons annually. Imports in the first eight months of 1987 added up to 2,400 tons.

15. The Australian delegate informed that butter output in 1986/87 amounted to 103.9 thousand tons, which was marginally below the level of 104.9 thousand tons in 1985/86. In 1987/88 the level was expected to fall

further to 93 thousand tons, which would be 7 per cent below the level of 1986/87. Total consumption of butter/anhydrous milk fat was provisionally estimated to have declined marginally in 1986/87 to 57 thousand tons compared with 60 thousand tons in 1985/86. In 1987/88 domestic consumption was expected to remain stable at the previous year's level. Exports for 1987/88 were expected to be around 42 thousand tons, with closing stocks at 25.9 thousand tons, compared to actual exports of 34.7 thousand tons and closing stocks of 31.9 thousand tons in 1986/87.

16. With regard to the world situation, he observed that the international market remained weak with prices of both butter and anhydrous milk fat at their respective IDA minimum levels, with some sales at below the minimum price. It was expected that as a result of recent large EC butter sales to the USSR and an extensive domestic disposal scheme, the EC stocks would be significantly reduced. However, the large EC sales had effectively closed the USSR market for butter sales at or near the IDA minimum by other exporting countries. While world stocks of butter/butter oil were gradually decreasing, prices were expected to remain depressed during 1987/88. He went on to express his country's particular concern at the pricing problems of butter oil in the international market. At the March meeting, his country had proposed a comprehensive approach for a lasting solution to this problem. It was made clear that if, notwithstanding the improved observance measures referred to earlier, the Australian butter oil industry found itself in a situation where it was unable to trade or it would be in breach of its domestic legislation by meeting the market, the Australian Government would initiate action within Australia for unilateral withdrawal from the Protocol Regarding Milk Fat. The Australian position continued to remain unchanged. His country was deeply concerned at the re-introduction by the Community of unpublished export refunds which were likely to jeopardize the current improvements in the market. The unpublished refunds were directed against markets in the Far East which were important outlets for Australia. He therefore wanted to put on record that the continued application of such refunds would have to be taken into account when considering a modification of the minimum export price for butter and anhydrous milk fat.

17. Replying to a question by the EC as to why butter consumption had sharply fallen in 1985/86 and again in 1986/87, he mentioned that one element was a consumer shift away from the fat to the non-fat sector. Referring to the comment that Australia would withdraw from the IDA if the price situation did not improve as an exporter, he elaborated that minimum prices ought to reflect market forces and the world market situation. If minimum prices were out of step with market realities, serious difficulties could jeopardize the working of the Protocol. Australia had co-operated in raising the minimum prices of milk powders and cheese because of its commitment to its proper functioning.

18. Elaborating further, another representative of Australia mentioned that Australian consumption of butter was not really going to decline, it was expected in 1986/87 to remain unchanged at the level of 1985/86. In regard to the second question raised by the Community, he endorsed the view of his colleague and said that the strength of the IDA emanated from responsible minimum prices which reflected market forces accurately.

19. Expressing his full support for the Australian view, the representative of New Zealand considered that the unpublished refunds of the EC represented secret subsidies and had a destabilizing influence on a market which was characterized by chronic supply pressures. They also worked against the transparency of the IDA.

20. The representative of Uruguay said that butter output in the second quarter of 1987 at 2,618 tons was 14 per cent smaller than in the first quarter. Exports, however, increased to 1,907 tons as compared to 647 tons in the first quarter. Stocks at the end of the second quarter at 4,312 tons were slightly lower than in the first quarter, but still very large for a small producer. Since domestic production was not subsidized it was more exposed to competition from some of the big suppliers whose production was heavily subsidized. As a result of this, his country was confronted with increased difficulties in the marketing of its relatively small quantities of butter on the international market.

21. The representative of Switzerland informed that production of butter which had shown an increase in the first six months began to taper off in the third quarter of this year and was about 3 per cent lower than last year. Imports during July-August amounted to 1,745 tons and showed a downward trend compared to the previous year. Consumption appeared to have slightly decreased, although there were some indications that consumption on the farms had slightly increased due to a strict enforcement of production controls. Stocks fluctuated around a level of 4,000 tons.

22. The Swedish delegate indicated that butter output fell by 12 per cent in the second quarter compared to the level in the corresponding period of last year. Domestic consumption, however, showed some increase. Exports were also higher, but for the year as a whole were expected to be somewhat lower than in the previous year.

23. The delegate of Norway said that butter production was more or less stable in the second quarter of 1987. As a result of a fall in domestic consumption for butter, increased quantities were diverted into export channels. Earlier in June it was estimated that exports during 1987 would amount to 8,700 tons, this estimate had now been revised downwards to 7,000 tons. Exports during the first quarter totalled 2,100 tons and in the second quarter 3,150 tons. Stocks were somewhat lower and the market situation was better than before.

24. The representative of Finland said that butter production in 1987 was likely to be 70,000 tons instead of 72,000 tons, as anticipated earlier, due to unfavourable weather conditions which particularly had adverse influence on dairy production. The downward trend in domestic consumption had remained unabated and no specific policy measures to encourage domestic consumption were envisaged. The export availability was estimated to be around 19,000 tons for 1987, but in the first six months so far exports had totalled 13,000 tons only. Due to lagging exports more recently, however, butter stocks were increasing, which confirmed the view that the butter situation was still fragile. Average export price in the second quarter was US\$1,039 per ton f.o.b.

25. The delegate of South Africa said that butter output was smaller due to a reduction in milk production. Output in the first half of 1987 was some 30 per cent lower than in the corresponding period of last year. No clear trend could be discerned in the consumption of butter because of the phenomenon of consumer stockpiling with price variations, but could be considered as relatively stable for the year 1987.

26. The Polish delegate observed an improvement in domestic butter production which in the second quarter at 70,677 tons was 5.7 per cent higher than in the same period last year. Domestic consumption also improved during this period. Being a net importer, Poland imported 13,764 tons of butter during the second quarter of 1987.

27. The representative of New Zealand told the Committee that production of butter during 1986/87 was down by 17 per cent to 243 thousand tons. A small increase in butter production was expected next year. Stocks at the close of the second quarter diminished considerably due to a heavy cut in production and a major sale of butter oil to Brazil and a further sale of 36,500 tons of butter to Iran. Domestic consumption was stable at 39,000 tons or in per capita terms was the highest in the world at 12.8 kgs. Average export prices of butter were reckoned between US\$1,000-US\$1,050 and of anyhdrous milk fat at US\$1,200-US\$1,250 per ton f.o.b.

28. The representative of Japan mentioned that production of butter at 81,000 tons in fiscal year 1986 was 11 per cent below the level of the previous fiscal year. There was a further decline in production in fiscal year 1987, but stocks were slowly building up due to a stagnation in butter demand. Imports of butter in 1986 were 3 per cent below the level of 1985 mainly due to the piling up of the stocks. Average import price in 1986 was 13 per cent below the level of the previous year. Imports in the first six months of 1987 were 4.8 per cent more than the level in the same period of 1986.

29. To the comment made by the spokesman of the Community that butter consumption in Japan at about 600 grs. per capita was about the lowest in the world and its consumption had further stagnated more recently, the Japanese delegate was not ready to offer an immediate explanation. The Chairman, however, expressed the hope that such an explanation would be forthcoming at the December meeting.

30. The representative of the EC told the Committee that butter output in the second half of 1987 was expected at 574 thousand tons, which would be 14 per cent down on the level of 668 thousand tons in the corresponding period of 1986. In the first half of 1987, it was down by 16 per cent and for the entire year it was expected to total 1,838 thousand tons, which would be 15 per cent below the level in the previous year. Consumption in 1987 was expected to remain stable at 1.6 million tons. Physical stocks on 10 September were reckoned at 1.071 million tons, of which the non-committed stocks were 947 thousand tons. Stocks in private storage, but financed by public funds, amounted to 165,000 tons. The average export price for butter ranged between US\$1,000-US\$1,200 and for anhydrous milk fat US\$1,250-US\$1,300 per ton f.o.b.

31. In reply to comments made by Australia concerning the re-introduction of unpublished export refunds which obscured the transparency and which were directed against some of the markets in the Far East which hitherto had been important outlets for Australia, he argued that the Community had considerably lost its market share for products for which there was no market intervention and the market had increasingly been taken over by Australia, New Zealand and the United States. To combat a temporary unfavourable situation in certain traditional markets, therefore, export refunds had been introduced as a part of the expensive supply management policies. It was disappointing, however, that Australia and New Zealand were doing nothing to stabilize supplies except to leave to the weather to regulate the supplies of their dairy products. The EC export refunds were essentially aimed at covering the difference between the internal Community price and the lowest world market price, which, however, could not be lower

than the minimum price established under the Arrangement. For butter oil, the Community would adapt the refunds to the needs of the market and change them more often than in the past, in order to fully take into account changes in market prices as a result of fluctuations in currency values. However, the Community had complete freedom to publish or not to publish its export refunds before applying them.

32. The observer of Canada told the Committee that production of butter in 1986-87 was expected to be marginally lower than a year before. Despite the major promotional efforts by the Canadian Dairy Bureau, butter consumption this year was expected to be 5 per cent lower than in the previous year and given the wide price difference between butter and margarine, the trend was not likely to be reversed. In 1987/88, butter production was likely to recede by a further 2 per cent and consumption would also decline by 3 per cent. It was interesting to note, however, that consumption levels were still above the production levels with the result that butter inventories and stocks were continuing to decline for the fourth consecutive year.

33. The Committee took note of the comments made and of the relevant parts of the Status Report (DPC/W/73).

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

34. In accordance with the provisions of Article 3, paragraph 3 of the Protocol, the Committee reviewed the level of the minimum export prices of products covered by the Protocol.

35. Noting some improvement in market conditions for butter and anhydrous milk fat as a result of diminishing stocks and production levels, the EC spokesman proposed that the minimum price should not at present be changed. A certain amount of caution was needed because the market was still very fragile. An increase in minimum prices could be considered at a future meeting when the market situation would have visibly improved for these two products.

36. The representative of New Zealand, however, took the view that minimum prices of butter and anhydrous milk fat should also be changed because the current minimum export prices were far below the level needed to provide the minimum return necessary to sustain the most efficient producers. The situation had become untenable due to a fall in the real value of the minimum export prices as a result of a fall in the value of the United States dollar, the currency in which the minimum prices were denominated. Also, because an underlying goal of the International Dairy Arrangement was to improve the relationship between the minimum prices fixed under the Arrangement and the dairy support levels in the major producing participants. These relationships in the last few years had seriously deteriorated and steps were needed to recover the lost ground. With regard to butter and butter oil, the chronic supply pressures which had dominated the international market over the last three years were now beginning to ease. It was these pressures which had held export prices down at the GATT minimum levels since 1984 and had forced a downward adjustment of minimum prices from June 1985 and had made necessary the adoption of special derogation provisions under the Protocol to facilitate the export disposal of accumulated surpluses of aged butter/butter oil to the USSR, Algeria and Brazil. With the moderation of supply pressures now evident and with further improvement expected, the current market situation provided the opportunity to re-establish a more stable basis for trade and to restore export prices to levels which were more economically sustainable. Butter production in the Community had been considerably reduced and surplus stocks were being systematically eased out. In New Zealand and Australia, production levels were also down and stock levels were diminishing. In the United States, the CCC support purchases of butter had been reduced to negligible levels with the much improved balance restored to the United States domestic market by the whole herd buy-out scheme. Uncommitted CCC stocks of butter had been reduced at an historically very low level. Exports had consequently been reduced. Elsewhere too, supplies were tight and stocks significantly reduced. All these factors provided the necessary basis for an increase in minimum prices.

37. The Committee, however, noted that although certain criteria set out by the Arrangement might warrant an increase in the minimum prices of products covered by the Protocol, the market situation remained too fragile to allow a modification at present. Taking into account the expected improvement in market conditions, the Committee might revert to this issue at a future meeting.

Oral report to the Council

38. 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 the next session

39. The next regular sessions of the Committees of the Protocols will be held on 14 and 15 December 1987. The session of the Committee of the Protocol 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.

40. The Committee took note of a preliminary programme of future meetings up to the end of 1988.