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Dairy Policy of Pacific Traders: Potential for Conflict with the United States

by

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Abstract. A large proportion of U.S. agricultural trade flows to Pacific areas. Agricultural policy adjustments create conflict among Pacific traders of dairy products. Dairy policies of four major actors in Pacific dairy trade are reviewed and their implications for U.S. entry into the international dairy market are presented.

Introduction

Agricultural trade has gained considerable attention in recent years. The keystone of the current round of GATT (General Agreement on Tariffs and Trade) multi-lateral trade negotiations is the removal of trade distorting agricultural programs and trade barriers by nations around the world. To date the agricultural issues have led to rather acrimonious debate but there has been no movement to shift attention from agreement on agricultural trade as a measure of the negotiations' success.

Because many of the agricultural trade issues involve stances taken by the United States and the European Community (EC-12), there is a tendency to view the problems in a trans-Atlantic

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context. It is a mistake to focus too much attention on these issues given that a large proportion of U.S. trade, including agricultural products, flows in the opposite direction-- toward the Pacific Rim countries,(particularly Japan, South Korea, Taiwan, and Hong Kong). The main competitors for the United States in the Pacific Rim markets are Australia, New Zealand, and Canada, countries that are major exporters of agricultural commodities to the United States. There is clearly potential for agricultural trade conflict between/among these nations, a major cause being the potentially large Japanese import market.

A commodity market where conflict could arise relatively quickly is dairy products. Dairy trade is a very small part of total U.S. agricultural trade but it is quite important to other countries of the Pacific Rim. This paper presents very brief overviews of the dairy policies of Australia, Canada, Japan, and New Zealand. The international dairy "market" is more dependent on policy decisions than any other agricultural commodity market, except perhaps sugar. A basic understanding of the components of the dairy exporting and importing polices implemented around the world is valuable for current and future economic analysis of international dairy trade.

Dairy Policies of Traders

Australia. Milk production in Australia was about 14 billion pounds in 1987. Approximately 30 percent of production enters the fluid sector. Manufacturing milk production is centered in the states of Victoria and Tasmania. The responsibility for fluid milk policy is vested in state level authorities while manufacturing milk policy (which more directly affects trade) is formulated at the national level.

Manufacturing milk programs cover several products and both the domestic and the international markets are involved. Three program elements are: 1) the levying (taxing) of products sold on the domestic market, 2) pooling of export returns so that exporters receive the same average return regardless of when or in which export market the product is sold, and 3) returning the proceeds as an equalization payment over all production. The procedure essentially subsidizes exports from the revenues provided by the tax on domestic consumption of taxed product groups.

The Australian Dairy Corporation (ADC) controls the export of dairy products. An export price is fixed prior to production of the products for export. The funds from taxes on prescribed product groups plus any excesses derived from exports are, after deductions of pooling costs, distributed over total production of product groups. The government operated an underwriting plan which placed a floor under the gross pooled return from sales of

products entering both export and domestic markets. This plan was eliminated in 1986 as part of a policy revision.

Australia's interest in the international dairy market is as an exporter. Manufacturing milk policies provide an implicit export assistance program. On the import side, the most important tariffs do apply to dairy products, in particular concentrated or sweetened milk and cream, butter, and cheese and curd. Other nontariff measures affecting these products include preferences, generalized special preferences likened to most favored nation policies, and quarantine requirements.

Canada. Canadian milk production is divided into two markets--a fluid market and an industrial milk market. Production in Canada in 1987 was about 18 billion pounds. Fluid milk is tightly regulated by Provincial governments. Both production and pricing are controlled, production by quotas and pricing by formulae based on costs of production. Industrial milk market policies are determined nationally and implemented by the Canadian Dairy Commission, established in 1966.

A target return for milk producers was determined by a formula which included consumer price changes, input costs, and judgement. In January of 1988 the formula approach was replaced by a mechanism based on costs of production information. A combination of direct subsidy payments and purchases of products at support prices are used to achieve the target return. Strict supply management of both the fluid and industrial milk sectors is used to maintain support prices. Provincial milk marketing boards determine milk production quotas and allocate the production among producers. Entry or expansion requires the purchase of quotas by producers.

Industrial milk supplies are limited by the Market Share Quota. An annual estimate of the requirements for industrial milk is made by the Canadian Milk Supply Management Committee. The estimated total is in turn allocated at the provincial and farm level by Provincial marketing authorities. Penalties for over-quota production are a reduced direct subsidy plus a producer levy. Every province in Canada, except Newfoundland, has marketing authorities for dairy products.

Tariffs exist on butter, cheeses, and nonfat dry milk and several nontariff barriers exist for dairy products. A fixed (since 1978) import quota for cheese, state trading of butter and nonfat dry milk and import licensing exist. There is also a ban on the importation of margarine into Canada. Direct export assistance for cheeses and nonfat dry milk is provided through subsidies financed by producer levies.

New Zealand. New Zealand milk production in 1987 totaled about 16 billion pounds, of which around 90 percent is used for

manufactured dairy products. Usually, approximately 80-85 percent of the manufactured products are exported. The high degree of dependence on exports has encouraged efficiencies in milk production, processing, and marketing.

The New Zealand Dairy Board (NZDB) was established in 1961 and vested with the responsibility for administration of the industry and exporting all dairy products. The NZDB is a state trading company which has sole authority for acquiring products for export, selling the products overseas, and returning the proceeds to the manufacturing companies.

Prices of manufactured dairy products are fixed by the NZDB. In setting purchase prices for export products, the Board uses prices for the milkfat and solids-not-fat components of milk at the farm-gate as determined by the Dairy Product Prices Authority (DPPA). The DPPA prices are based on expectations of export earnings and the financial status of the dairy industry. The NZDB prices take into account average processing costs of each product and encourages production of products seen as appropriate for market demands. The DPPA prices and the NZDB export purchase prices are fundamental elements determining dairy industry income.

The NZDB also operates in the domestic markets for butter and cheeses. Government regulations cover distribution and marketing of the products and the pricing of butter. There is no control of cheese prices. Domestic and export prices need not be equal.

Import policies of New Zealand applying to dairy products are minor given the export orientation of the industry. Low tariff rates on dairy products apply to fresh and processed milk and cream, butter, cheddar and other cheeses, and curd. A global quota also applies to the imports of both fresh and processed milk and cream.

Japan. Japanese milk production in 1987 was approximately 16 billion pounds, the same level as in New Zealand. A majority of the milk produced enters fluid use in Japan, about 61 percent. Price support for dairy is based on three linked measures: deficiency payments to manufacturing milk producers, market intervention for certain dairy products, and state trading of dairy products. The Livestock Industry Promotion Corporation (LIPC) administers the components of the dairy program.

The "deficiency" payment to producers of manufacturing milk is the core of the price support program. The payment depends on the guaranteed price and the standard trading price for manufacturing milk, two government administered prices. The deficiency payment is the difference between the guaranteed price and the standard trading price. The grants are paid to eligible milk producers' associations for milk used for specified milk

products but for a limited quantity. The specified milk products are butter, skimmed milk powder, sweetened condensed whole milk, sweetened condensed skimmed milk, whole milk powder, sweetened milk powder, condensed whole milk, skimmed milk for animal feeding, and natural cheese. The first four products are further classified as "designated milk products".

The guaranteed price maintains production of raw milk in districts where most of the milk enters the manufacturing sector. The cost of production in Hokkaido has served as the base for this price in recent years. The standard trading price is based on the sale price of milk products after deductions are made for average manufacturing and handling costs. For the designated product group, the standard trading price is called the "stabilization indicative price". The stabilization indicative price is assumed to be the market price for the designated products.

The second component of price support for the industry, market intervention by the LIPC, is directed toward designated milk products. If the market price of designated products were not maintained at least at the stabilization indicative price, manufacturers would have no incentive to buy raw milk at the standard trading price.

Intervention in designated product markets is based on deviations of market prices from the stabilization indicative prices. The LIPC is expected to purchase designated products at the price equal to 90 percent of the stabilization indicative price when manufacturers or milk producers associations offer to sell them at those prices. There are some conditions when these purchases may not be required. The LIPC may sell its stocks of designated products when market prices for them are 104 percent of the stabilization indicative price.

Finally, state trading by the LIPC constitutes the third component of Japanese dairy policy. The LIPC has the exclusive (monopoly) authority to import designated milk products plus some others (whole milk, buttermilk , and whey powders). The import quota system applies to almost all dairy products, the major exception being natural cheese (there is no state trading of cheese).

A customs duty of 25 to 35 percent is generally applied to dairy products entering the country, except for powdered products for school lunches and for stock feeds. The situation pertaining to natural cheese deserves special note. There is a quota tariff of 35 percent applied to imports of natural cheese over and above those required for the processed cheese requirements.

Changes in the Japanese dairy sector have occurred as a result of decisions under GATT dispute settlement procedures and

internal policy decisions. The guaranteed price for manufacturing milk was reduced after 1985 and a steady decline in deficiency payments since 1983 has occurred. In early 1988 a decision by GATT resulted in planned elimination of some dairy product quotas, e.g. processed cheese.

Implications for U.S. Dairy Trade

Strengthening international dairy product prices since mid-1987 resulted in an almost unheard of event, commercial exports by the United States of nonfat dry milk. The potential for the U. S. to enter the international dairy markets in a more aggressive fashion clearly exists as long as international prices remain strong. If such a movement is made, the United States will face formidable competitors in Australia and New Zealand. The Canada Free Trade Agreement could reduce potential friction with Canada but dairy products received special treatment in the agreement so this could create some problems.

New Zealand and Australia enjoy cost advantages in production due to widespread reliance on forage-based milk production practices. Long term participation by these countries in dairy trade is also an advantage. Both are active trading nations with a large network of world-wide contacts. In addition, there has been some nurturing of markets in Japan which could be advantageous. The existence of state trading agencies (also in Canada) which can negotiate with greater ability to control production is useful in the international arena as importers look for stable, reliable sources of supply.

Japan, as the major importing nation in the Pacific Rim area, has long been recognized as a highly protected market. The existence of the LIPC as a state trading authority provides the Japanese with advantages similar to those enjoyed by Australia and New Zealand. The desire to maintain agricultural self-sufficiency (at least to some degree) will continue to condition Japanese trade negotiations.

Dairy trade by the United States in the Pacific Rim could increase if international conditions continue strong. The United States could export nonfat dry milk to the Japanese and possibly some cheeses. Another potential Pacific Rim market for nonfat dry milk is Taiwan. However, the U.S. must be prepared to engage in markets where it has little experience to begin with and very formidable competitors. Even though trading by national commodity boards with monopoly characteristics might be viewed by the United States as contradictory to the tenets of liberalizing trade, there is little negotiating room since New Zealand and Australia are already among the least assisted agricultural economies in the world. The Japanese are slowly opening agricultural markets under pressure from the U.S. and others. The special treatment afforded dairy by the Canada Free Trade

Agreement does not offer a basis for negotiated reductions in assistance there. The productive dairy farmers of the western United States could be in a position to take advantage of U.S. entry into Pacific dairy trade in particular, and international dairy trade in general.

Imports of dairy products into the United States from the Pacific countries would likely remain fairly constant, even if a freer trade regime were implemented. It is difficult to assess possible shifts of trade patterns for dairy products since domestic manufactured products industries have differing capacities and technological characteristics. Decision-making for production of one product versus another involves these factors in addition to economic factors related to the international dairy market.

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