JOURNAL OF AGRIBUSINESS FEBRUARY 1989

POTENTIAL IMPACT OF TRADE NEGOTIATIONS ON THE U.S. DAIRY INDUSTRY

Dale H. Carley

In the Uruguay Round of international trade negotiations begun in 1986, under the auspices of the General Agreement on Tariffs and Trade (GATT), agriculture is a major item on the agenda. Several proposals were made in the negotiation procedures which if and when implemented, would have substantial implications for the USA dairy industry.

Protection of agriculture has increased around the world. Relatively high support prices and various types of subsidies have stimulated agricultural production, reduced imports, and created surpluses. Surplus disposal practices in international markets have resulted in increasing tensions, especially between the USA and the European Community (EC). The cost of agriculture protection through taxes and higher consumer prices has been estimated in a World Bank study to exceed $120 billion in 1980 dollars (1).

A report published in 1987 by the Organization for Economic Cooperation and Development (OECD) concluded that all countries should gradually reduce their agricultural support. The report concluded that the cost of adjustment for each country would be less because world prices would increase. The OECD report estimated that world prices for dairy products could increase by as much as 45% (1).

The major trading countries (United States, EC, and Oceania) have extended proposals during the course of negotiations for agriculture. The EC proposal includes short-term measures to relieve trade distortions in several affected markets and longer-term plans to stabilize markets by reducing support and reducing incentives to agricultural over-production. The EC plan would continue to subsidize agriculture, but it would reduce problems generating major trade distortions by agreement between countries.

In contrast to the EC, the U.S. proposal contains more drastic changes. The proposal is to phase out all direct and indirect subsidies to agriculture by the year 2000. It calls for open market-oriented agricultural trade among all countries of the world.

A third group of countries that are non-subsidizing agricultural exporters, called the Cairns group, proposes measures that are somewhat of a compromise between the USA and EC positions. Both the Cairns and USA proposals would phase out all trade distorting policies that affect all commodities in all countries. The Cairns group did not specify a final deadline, but its proposal emphasizes an immediate rollback of agricultural price support levels and increases in import quotas.

CURRENT: USA TRADE IN DAIRY PRODUCTS

Price support levels for milk in the United States have resulted in milk product prices above world prices. Import restrictions are necessary to prevent or limit the volume of milk products imported into USA markets. The Section 22 amendment to the Agricultural Adjustment Act of 1933 provides for import limitations whenever imports of a product render ineffective or materially interfere with agricultural programs, or reduce substantially the amount of any product processed in the USA (2). Import restrictions are imposed on butter, cheese, and nonfat dry milk. Each exporting country has an annual quota assigned to it by the USA for specific milk products.

The USA must make concessions on its import quotas on milk products in exchange for concessions from other countries on such items as export subsidies. Opening the USA market to more imports of dairy products means that the USA dairy industry may force lower prices to enhance competition. In order to determine the impact of trade liberalization in dairy products on the USA dairy industry, the current export-import situation is evaluated.

USA import quotas on several types of cheese amount to 240 million lbs annually. Import quotas for other dairy products are quite small (table 1). Annual cheese imports under the quota scheme were near the quotas permitted for 1985 and 1986, but were about 35 million lbs less than the quota for 1987. Imports of non-quota cheese types average about 60 million lbs annually. Imports of other products are near the quotas permitted each year.

Casein is the most important non-quota product imported into the USA with imports of 238 million lbs in 1986 and 1987. The USA dairy industry was successful in changing the classification of casein from an industrial to a food product in the Trade Act of 1988.

Under the reclassification, dairy interests were hoping to obtain Section 22 import restrictions. However, in view of 1988 GATT discussions, import quotas for casein are less likely.

Under price supports in effect, product prices in the USA have been above world prices making it an excellent market for most milk products. The imports of milk products into the USA in 1985 and 1986 amounted to 2.7 billion lbs of milk equivalent on a milkfat basis. Imports in 1987 were down about 8% to 2.5 billion lbs consisting mostly of lower cheese imports. One reason for lower cheese imports, especially from the EC, is the change in value of the dollar. This makes some types of imported cheese more costly relative to cheese produced in the USA. Another reason that may be affecting imports of some special cheese types is that they are being manufactured in the USA.

Prospects of exports for USA milk products remain almost nil under current price supports, with the exception of donations and concessionary sales to foreign countries of primarily Commodity Credit Corporation (CCC) purchased products. Until 1988, most of the surplus nonfat dry milk was given away or sold at very low prices to foreign countries. Table 2 shows the import and export balance of USA dairy products. The USA international trade in dairy products is largely nonfat dry milk and cheese imports -- especially cheese types other than American cheese. As nonfat dry milk is exported and cheese imported, an accounting of both fat and nonfat solids is needed. On a milkfat equivalent basis, exports and imports balanced in 1987.

One of the interesting export occurrences in 1988 was that the USA become a net commercial exporter of nonfat dry milk. In July world prices for nonfat dry milk were greater than the USA support price of $1,604 per metric ton (table 3). With the reduction of world milk surpluses in 1986-88 (particularly in the EC and the USA attributed to production management policies) the world production of nonfat dry milk has fallen. World prices for nonfat dry milk increased in 1988 to $2,000 per metric ton in November, resulting in continued bids for USA produced nonfat dry milk. As nonfat dry milk increased in price, casein prices also increased to a range of $2.10 to $2.45 per lb, which is $1.00 over 1987 prices.

Even though world prices of cheddar cheese and butter have not reached USA support price levels, butter was up about 20 cents per lb and cheese was up about 30 cents per lb in November 1988 over January (table 3). If world milk production continues to decrease, it is likely that world cheese prices may rise to near the USA support price for cheese of $1.1125 per lb (November 1988).

IMPACT OF SPECIFIC POLICY PROPOSALS

Changes in the world dairy situation have an impact on the USA dairy industry. The EC decision to reduce its milk surplus and to discontinue subsidizing exports led to world price increases for dairy products, especially for nonfat dry milk. When the EC approached the bargaining table at the Montreal session of GATT in December 1988, pressures were placed on the USA by the EC to decrease support prices. Policymakers insisted that some agreement should be reached on short-term measures in order to ensure continuation of discussions on agriculture.

The Cairns Group proposal may be considered a compromise between the USA and EC positions. The near-term rollback of price supports may be the beginning of the longer term goals of phasing out all trade-distorting policies. One multilateral rollback proposal calls for a 3% reduction per year in 1989 and 1990 in all administered commodity prices and an increase of 10% in each of the two years in import quotas. Also, there would be an immediate increase in quotas to a minimum of 3% of domestic consumption of any commodity (3).

Based on the current information, adoption of the Cairns short-term rollback proposals in 1989 and 1990 would have a substantial and immediate impact on the USA dairy industry. Assuming the proposals would become effective April 1, 1989, the impact on the USA dairy industry is estimated for marketing years beginning Oct. 1 1988/89 and 1989/90.

Based on a continuation of the 1988 dairy policy through marketing year 1989/90, USA milk marketings are expected to be in the range of 141 billion lbs (table 4). With an expected increase in commercial use, removals by CCC are expected to decrease to 3.7 billion lbs in 1989/90 at a cost of $379 million. Adoption of the Cairns proposal would have some effect on prices, primarily in the first six months of 1989. The support price reduction of 3% would decrease the average support price for fiscal 1988/89 by 17 cents, and the milk price by an estimated 25 cents compared with 1988 dairy policy. Imports would increase about 800 million lbs, milkfat equivalent.

For the full marketing year 1989/90, the support price would decrease to $9.92 and the all milk price would decrease to an estimated $11.47. Milk production would be expected to decrease about one billion lbs as a result of the lower price. Imports would increase to 4.5 billion lbs, milkfat equivalent. With a lower price, commercial use would increase about 2.3 billion lbs over 1988/89.

Cash receipts to dairy farmers under the Cairns proposal for 18 months would decrease an estimated $955 million. CCC purchase costs would increase $103 million, mostly because of the increase of imports of 2.2 billion lbs milkfat equivalent of products.

Consumers of milk products would benefit from lower prices for domestically produced milk products as well as increased imports. The imports would be mostly some types of cheese products which may enter the USA at prices lower than domestic cheese. The increased cheese imports would have a depressing impact on the Minnesota-Wisconsin (M-W) price. In fact, the projected prices shown in the analysis may be higher than actual prices. The M-W price was projected to average above the support price, but it could decrease to the support price level.

Even though the support price in 1990 under the Cairns proposal would decrease to $9.80, the CCC price for butter and cheese would remain higher than current world prices. Placing two-thirds of the support price reduction on butter, the CCC butter price would be $1.20 per lb and the nonfat dry milk price would be $0.695 per lb. The cheese price would be $1.03 per lb. Current (1988) world prices per lb at the high end of the range in early December were $0.77 for butter, $0.93 for cheese and $0.9075 for nonfat dry milk.

The USA GATT proposal is to phase out all agricultural and import subsidies barriers by the year 2000 which would mean decreasing the support price and eliminating dairy product import quotas by year 2000. Gradually eliminating support prices may be accomplished through a decoupling policy in which dairy farmers would be assured of receiving a certain level of income through an equity payment for producing a base amount of milk. The equity payment would be gradually reduced. The quotas for milk products would be eliminated and replaced with import tariffs, which then would be reduced over the targeted time period.

Decreasing support prices would lower prices received by dairy farmers, but the equity payments could ease the adjustment. Lower support prices would decrease the price of milk products to consumers. Tariffs on imports would increase the price of imported cheese, but there would be no limits on quantities. The world price plus tariffs may be near domestic prices. Government purchases of milk products would decrease. The net results of such a program would be a transfer of costs from taxpayers under the current program to a cost to consumers of dairy products. However, free trade prices of dairy products for consumers could become lower than under current policies.

One other issue is important in terms of the import-export price relationships. At the mid-point of the range of December 1988 world prices for the major dairy products of butter, nonfat dry milk, and cheese, the support price for fluid milk would need to decrease to $9.23 for the butter-powder combination and $8.13 for cheese in order to compete in current world markets for those products. Price decreases of these magnitudes would be disastrous to dairy farmers, especially in the short-term.

CONCLUSIONS

The USA has continued to play a small role in the export-import business for milk products. Support levels have been high enough to keep milk products at a price well above the world market. However, in 1988 world prices for nonfat dry milk increased above USA price supported levels resulting in the USA dairy firms exporting on the world commercial market rather than through government subsidized programs.

Current (1989) trade negotiations among members of GATT could result in sweeping changes in world trade of agricultural commodities. Proposals to eliminate production subsidies (support prices) and import restrictions (quotas) would open the USA to increasing imports of milk products. It would also decrease the price that dairy farmers would receive for their milk. Estimates indicate that blend prices could decrease in the range of $0.40 to $0.80 per hundredweight in the short-term. The USA dairy industry may be forced to adjust to lower prices and world competition in dairy products should trade liberalization prevail.

It is estimated that in the longer-term world prices for dairy products would increase. Therefore, the critical issue for the dairy industry is to develop a policy in which the transition from one level of prices to a lower level allows the dairy industry to make a smooth adjustment.

Removal of price supports, via elimination of surplus removal by governments and other measures to stabilize prices, would likely create highly volatile markets. This subsequently creates a high risk environment for dairy farmers. Reaction to the higher risk is uncertain. However, over-adjustment to both favorable and unfavorable price signals would likely prevail creating highly variable supplies and higher unit costs in the marketing system. Highly variable prices and unreliable supplies would also be detrimental to consumer interest world wide. Government intervention in milk markets was initially promulgated by highly volatile prices, unreliable supplies, product adulteration and health hazards to consumers. Dairy farmers, and those engaged in processing and distribution of dairy products, require some degree of protection against volatile markets to ensure safe and reliable supplies of products to consumers. The key issue is the degree of protection that is consistent with the best interests of all segments of the dairy industry, taxpayers and consumers.

A deadlock on agriculture proposals at the Montreal GATT meeting in December resulted in all proposals being placed "on hold" until April 1989. Meetings will be held with individual countries in an attempt to resolve agricultural and other issues. In the longer

term, the negotiations will eventually impact on agriculture.

Dale H. Carley is Professor, Department of Agricultural Economics, University of Georgia, Griffin, GA.

REFERENCES

(1) Blandford, D. "The GATT Trade Negotiation and the U.S. Dairy Industry," Dairy Marketing Notes. Dept. Agr. Econ., Cornell Univ. Fall 1987, p. 4.

(2) Carley, D. H., and W. A. Thomas. "Interregional and International Competition in the Dairy Industry." J. of Agribusiness (1986):4:1:43-47.

(3) National Milk Producers Federation. "GATT Talks Turn to Cairns Proposal: Issues and Potential Impact on the U.S. Dairy Industry." Economic Report. 1988 3:10:5-7.

Table 1. Dairy products: U.S. imports, quota and nonquota, 1985, 1986 and 1987

Product	Calendar year quota	1985	1986	1987
		mil lbs		
Cheese				
All quota types	240.4	241.0	236.0	205.0
Nonquota types	-	61.5	59.3	59.9
Total cheese	240.4	302.5	295.3	264.9
Other quota products				
Butter	.7	2.2[a]	2.5	3.3
Butter oil	1.2	1.2	1.2	1.2
Butterfat mixes	2.6	3.8	4.4	4.9
Ice cream	3.4	0	.1	.1
Frozen cream	12.5	14.7	14.1	12.3
Nonfat dry milk	1.8	2.8	1.9	2.7
Dried buttermilk	.5	.6	.4	.6
Evaporated milk	1.3	6.3	5.6	4.5
Condensed milk	4.1	4.1	4.3	4.0
Chocolate crumb	25.1	21.3	17.0	22.3
Animal feed	16.3	15.1	14.9	15.6
Nonquota products				
Casein	-	231.4	238.0	238.4
Lactose	-	2.7	1.8	1.4
Total all products (milkfat basis)	2,234.3	2,777.5	2,733.2	2,490.0

Source: Dairy Situation and Outlook Report, ERS, USDA, DS414 Apr. 1988.
a. Any product shown in excess of quota is a probable error in reported data.

Table 2. U.S. exports and imports for dairy products, by major product, annual, 1985 to 1987

Year	All products[a]		Butter		American cheese		Other cheese		Nonfat dry milk	
	Expt	Impt	Expt	Impt	Expt	Impt	Expt	Impt	Expt	Impt
	-mil lbs-									
1985	4,805	2,776	180	4	70	20	16	283	984	3
1986	1,970	2,733	55	4	51	23	8	272	901	2
1987	2,434	2,489	85	5	36	15	8	250	847	3

Source: Dairy Situation and Outlook Yearbook, ERS, USDA, DS-416, Aug. 1988.
a. Milk-equivalent, fat basis.

Table 3. World prices for major dairy products, FOB Northern European and selected major world ports, monthly, 1988

Month	Butter 82% butterfat	Cheddar cheese	Nonfat dry milk spray process
	dollar/lb		
January	.4075 to .5225	.5000 to .5675	.4650 to .5450
February	.4525 to .5225	.5000 to .5675	.5000 to .5900
March	.4775 to .5225	.5000 to .5675	.5000 to .5900
April	.5225 to .5900	.5675 to .6350	.5000 to .6125
May	.5675 to .6125	.5675 to .6350	.6350 to .7250
June	.5900 to .6350	.6350 to .7250	.6350 to .7250
July	.5450 to .6350	.6075 to .7250	.7250 to .7950
August	.5325 to .6125	.7250 to .7950	.7250 to .7950
September	.5400 to .6125	.7250 to .7950	.7475 to .8175
October	.5550 to .6125	.7475 to .8150	.7950 to .8400
November	.6800 to .7250	.8850 to .9300	.8625 to .9075
December	.6800 to .7700	.8850 to .9300	.8625 to .9075
Support price, U.S.	1.3200[a]	1.1125[b]	.7275[c]

Source: Dairy Market News, AMS, USDA, weekly issues.
a. Bulk.
b. 500 lb barrel.
c. Nonfortified, spray process.

Table 4. Dairy outlook under current dairy policy and under Cairns trade proposal, U.S. fiscal years

Item	Fiscal years				
	Under current dairy policy			Under Cairns proposal[c]	
	1987/88[a]	1988/89[a]	1989/90[b]	1988/89[d]	1989/90
			dollars/cwt		
Support price	10.73	10.73	10.23	10.56	9.92
All milk price	12.09	12.15	11.83	11.90	11.47
			bil lb		
Milk production	144.7	144.0	143.6	143.8	142.8
Milk marketings	142.5	141.8	141.4	141.6	140.6
Imports	2.5	2.5	2.5	3.3	4.5
Commercial use	136.0	138.5	140.3	138.5	140.8
CCC removals	9.7	5.1	3.7	5.7	4.3
			mil dollars		
Cash receipts[e]	17,200	17,200	16,730	16,850	16,125
CCC cost[f]	1,040	547	379	602	427

a. From Dairy Market News, AMS, USDA, (1988) 55:46:2.
b. Based on continuation of current policy, decrease in support price to $10.10 Jan. 1, 1990.
c. Proposal provisions obtained from Fact Sheet, Nat. Milk Prod. Fed. Oct. 1988.
d. Assumes proposal would become effective April 1, 1989.
e. Obtained by multiplying milk marketings by all milk price.
f. Obtained by multiplying CCC removals by support price.