The Outlook For Dairy Product Trade

A good presentation would begin with a listing of "10 simple steps" the U.S. dairy industry must take to establish itself as the world's leading exporter of dairy products. Unfortunately, there are more than 10 steps, none will be easy and all are necessary. This paper outlines what steps are necessary, why they are important, and how to take them.

As recently as a few years ago, this paper would have been written much differently. The orientation of the dairy industry has changed, from a view of world markets as a "dumping" ground for products that could not be "disposed of" in the U.S. market to somewhat of a marketing orientation. Structural changes in the U.S. dairy industry have all greatly affected the outlook for world competitiveness. Important changes are productivity increases, reductions in cost of production, ongoing consolidation of industry, and a pronounced shift of production to the west and southwest where production costs are lowest.

Why Should Milk Producers Be Interested In Export Markets?

The simple answer is, you have no choice. You will soon be compelled to look overseas to find markets for dairy products if the U.S. industry is to grow.

The Federal Agricultural Improvement and Reform Act of 1996 bill phases down and terminates the dairy price support program after 1999. Absent federally-established price "floors", U.S. firms will have a much stronger incentive to find and build overseas markets. The earlier the U.S. begins to develop those markets, the more effective will be the efforts.

It is unlikely that the U.S. will succeed by trying to be the first supplier in many markets. The U.S. effort lagging behind the competition, by two generations, for example, in the case of the New Zealand Dairy Board, founded 1924.

And export tools that have been used successfully in the past to boost exports will be phased out. DEIP is fading away – the same DEIP that added about 50¢ per cwt. to every producers' milk check in 1993.

Under the Uruguay Round (UR) GATT agreement, the U.S. must reduce the quantity of product exported with a subsidy and reduce the aggregate subsidy funding for DEIP bonuses every year through 2001. By the end of this decade, the U.S. will be able to export, using DEIP, only about two-thirds of the average export volume authorized for subsidy-impelled export in 1992-94. The limits are product specific and, for some products like whole milk powder, export subsidies will virtually disappear.

The implication is clear: firms in the U.S. must learn to export without subsidies, and begin exporting in earnest.

At the same time the U.S. is looking for overseas markets, the U.S. domestic market will also be a target for overseas competition. Under the UR GATT Agreement, the U.S. is obligated to provide increasing access to U.S. markets. Under the agreement, countries were required to convert all quotas or other non-tariff barriers to imports and further required to reduce those barriers by some 36% over six years, with a minimum reduction of 15% from 1986-88 levels. In addition, each country must provide, by the year 2000, a minimum access to its markets of at least 5% of estimated consumption.

This minimum access provision could result in a substantial increase in imports of dairy products into the U.S., most significantly, for cheese. Cheese imports will increase by as much as ?0 million pounds, from a base level of about 245 million pounds. While this amount is small compared to the more than 3.1 billion pounds of American cheese produced in the U.S. each year (the cheese category where import competition is most likely to be felt), it represents about 13% of the total increase in at-home consumption achieved by producer-funded advertising expenditures in the 11-year period 1984-1996. In other words, the increased volume of imports adds to available supplies that essentially "displace" consumption of U.S.-produced cheese. To maintain the supply-demand balance that would prevail without imports, exports are necessary.

Aggressively exporting is a good strategy in any case – U.S. suppliers should find export opportunities attractive. Virtually every analysis of overseas markets reaches the same conclusion: Growth in consumption will take place as populations and incomes grow in overseas areas, primarily in Asia and Pacific nations. New Zealand, Australian, Ireland, and Argentina, collectively, are unlikely to be able expand production to meet the anticipated demand. And, as European subsidies are phased down, world prices will become increasingly attractive to US producers.

Where Are The Foreign Markets For Dairy Products?

Market demand for dairy products is increasing in many parts of the world. Prospects are especially good for exports to Asia and Mexico, while policy changes will be necessary to open up European and other western hemisphere countries, such as Canada.

Strong economic growth in Asian countries with large populations is boosting demand for many western foods, including dairy products, and Asia represents about one-third of world imports to emerging markets. Rapidly developing, high population, milk deficit countries such as China and India represent strong growth possibilities. However, market development efforts will be important because, in the past, these countries have preferred to forego dairy products rather than import products to cover shortfalls.

Japan is already the largest market for unsubsidized sales of U.S. dairy exports, ranking first for cheese, ice cream, whey products, and lactose. The "westernization" of the Japanese diet has made dairy products much more important, but consumption is still low by Western standards with more growth possible.

Dairy import growth in the rest of Asia – Taiwan, Hong Kong, Thailand, Malaysia and the Philippines – grew about 6 % per year in 1990-93. Import demand for cheese, butter, and whey grew at more than 10%.

Mexico is the largest export market for U.S. dairy products and export volume will grow further. Even with optimistic projections of increased milk production in Mexico, consumption growth will be even greater, spurred on by demographic factors: an estimated 50% of Mexico's 93 million people are less than 20 years old. As this market grows, it is vitally important for the U.S. to grow its exports, and the share of total supply in the Mexican market. There is no reason why the U.S. should not, as U.S. companies have advantages of physical proximity (and therefore short shipping times) and a consuming population familiar with U.S. foods.

What Stands In The Way?

A realistic assessment of the prospects for U.S. dairy exports helps to place the market opportunities and costs in perspective.

What limits the exports of U.S. dairy products? The limitations can be grouped into four areas: market access barriers; export subsidies paid by the European Union; internal pricing issues; and, a late start.

Market access barriers. Many major markets remain effectively closed to U.S. dairy exports because of high tariffs or less-than-full compliance with GATT/WTO rules. As one example, access to EU markets for U.S. dairy products continues to be almost zero, despite agreements to allow importation of at least minimum quantities because of unworkable import licensing requirements. Europe represents the largest, most attractive market for U.S. dairy products, but, absent a radical change in trade barriers, will remain closed.

Closer to home, Canada last year imposed new tariffs on dairy products – an action which is illegal under NAFTA. These tariffs, added after the UR GATT agreement eliminated Canadian import quotas, double or triple the cost of U.S. goods, effectively blocking U.S. exports. These tariffs cost U.S. milk producers access to a market of 29 million people, with the income and inclination to purchase dairy products. In dollar terms, the cost is some $1 billion annually.

In 1996, a "NAFTA court", made up of academics, submitted its ruling on a dispute over dairy issues between the U.S. and Canada. Despite the expectations of most trade experts, both south and north of the border, that the U.S. would win, the panel ignored the iron-clad U.S. argument and ruled that Canada could maintain its illegal trade barriers. The result is not only detrimental to important U.S. industries – dairy and poultry – but it also calls into question the workability of the NAFTA dispute process. Harsher critics say the ruling proves that international panels cannot be impartial when the U.S. is a plaintiff, because international panels are siding against the major economic power, and with economic "under-dogs". If so, the scales of justice are rigged and need to be fixed.

Even with solid customers, trade barriers still limit sales. U.S. exporters are currently unable to sell nonfat dry milk, Mexico's leading dairy import, to any Mexican buyer other than the state trading enterprise CONASUPO, an organization roughly equivalent to USDA's Commodity Credit Corporation.

Subsidies and schemes. European subsidies continue to be a major distortion in world trade, despite ongoing reductions negotiated during the UR talks. Under the UR GATT agreement, all agricultural export subsidies are quantified and limited. WTO member countries agreed to reduce both the volume of product subsidized and the funding allocated to export subsidies. In addition, no new subsidies can be instituted, nor can subsidy programs be extended to cover products not previously subsidized. The dollar value of EU subsidies dwarfs the funding level available from the U.S. Reduction in EU subsidies would be the single most beneficial change that would enhance export possibilities for the U.S. During a project last fall, USDEC and NMPF estimated that eliminating these EU subsidies would free up some $750 million of market share (1994 dollars), which could represent more than $1 billion of market opportunity by 1998. An increase in the general level of world prices would likely result and higher prices would discourage consumption somewhat, with the overall demand for the higher priced products may be less. Also, increased dairy production in importing nations could also be expected to increase.

However, expanding this estimate to represent all dairy import markets could mean as much as $1.5 billion of new dairy exports. The U.S. could expect to benefit – and could be the primary beneficiary of the additional market for higher priced dairy products.

Unfortunately, the trade rules have been re-interpreted by the EU and others nations with an existing advantage in world markets. The benefits realized from trade have lagged significantly behind the benefits promised and it remains to be seen just how effective the export subsidy disciplines – the centerpiece accomplishment of the UR Agreement – will be.

Much work lies ahead to make the trading environment more receptive to U.S. marketing efforts.

Closing The Price Gap.

How much increase in world market prices would be necessary to make U.S. products competitive, at current U.S. market prices? Measuring competitiveness by relative cost of milk production, the U.S. should fare quite well. U.S. dairies are usually thought of as the third or fourth lowest cost producers in the world - behind the grass-based systems of New Zealand, Australia, and Ireland. Argentina is a major unknown, with ample capacity for production increases, but much more limited processing and distribution infrastructure. In short, cost per se should not be a limitation to expanding world-wide sales.

The gap varies by product, from about 30¢ per pound of cheese, about 20¢ per pound of nonfat dry milk, and about 35¢ per pound of butter. These differences in product prices translate into between $2.45 to $3.35 per cwt. [1] for milk used in cheddar cheese production, or for butter/powder. [2]

One of the interesting and important points to remember is that these gaps are not the result of the government support prices – market prices in the U.S. are well above support prices. U.S. prices are driven by consumer demand – what your customers are willing to pay for milk. An economic loss would occur if U.S. prices, across the entire domestic market, were adjusted downward solely to capture new markets abroad. In effect, U.S. consumers would be charged less than they are able and willing to pay for dairy products.

The U.S. Is Late Getting Started.

U.S. firms are behind international competitors in market development activity. For example, in January the New Zealand Dairy Board reportedly secured a major contract to supply mozzarella to Pizza Hut outlets in 30 countries, including the Middle East and five new markets in Asia. The new contract will give the NZDB about one-third of all cheese sales to Pizza Hut outlets outside the U.S.

Most other nations – our competitors – have a strong centralized effort to support dairy exports. The U.S. does not. However, a strong, focused effort can propel the U.S. dairy industry ahead during the five year "transition" period we face under GATT. The U.S. Dairy Export Council is one attempt, as discussed below.

What should the U.S. dairy industry – and milk producers – be doing to capture a share of the markets? What will it take to make the U.S. a major, reliable and profitable supplier of dairy products to world markets? Some changes will have to occur across the entire dairy industry. First, the overseas markets will have be seen as integral to the overall marketing scheme of cooperatives and milk processors. To find and keep new customers in foreign countries will require commitment, creativity, adaptability, and a businesslike view toward world markets. Commitment because market development is an expensive long term process. The only thing that makes the process worthwhile is, there is no substitute. Creativity is necessary because the U.S. will be dealing with different customers, who want slightly different products, packaged differently. New sales strategies may be required. Adaptability will be important because no two overseas markets will be the same.

Maintaining a businesslike view of export markets is important because, despite every effort, the U.S. will not be able to sell everything to everyone. The competition is tough and U.S. companies will not always be low-cost suppliers. Where the U.S. firms can be the low-cost suppliers, companies must demonstrate that they will be reliable – not in-and-out of the market, depending upon the U.S. supply situation. Where U.S. suppliers have an advantage – for example, in Mexico – all the resources of the industry and the U.S. government should be used to exploit it.

What Can You Do?

Quality maintenance efforts are crucial. Product quality issues and international food standards are important and will become more important. Increasingly, sanitary and phytosanitary standards will be a battleground for market penetration and perhaps even market share.

Quality assurance must be absolute. Reliable supplier of quality products. Treat overseas customers just like the best customers in the U.S.

Product quality is always a make-it-or-break-it issue for food companies. One bad customer experience will outweigh 10 positive experiences. International food standards will be important determinants of whether or not a product can enter a nation. In 1993, a process began to review, simplify, and harmonize all standards related to health and safety matters related to food. Ten of 50 existing international standards for dairy products have been revised through a complex, technical and arduous process. The other 40 are at various stages of review. In addition, food additives and food labeling standards will affect dairy products moving in international trade.

What is at stake? International food standards have been used in the past to restrict imports even more severely than the limitations imposed through tariff or quota barriers. With the UR Agreement, measures taken to protect human health and animal health must be based on scientific principles, and must not be maintained against available scientific evidence. Essentially, a standard must be created using sound science and cannot be enforced if it is not.

Which sounds great – until we recall that these international standards are created by committees. And committees are composed of people with points of view on how to help or hinder the export trade from their nation. The U.S. must work with these committees to accomplish at least two general goals: first, provide more realistic categorization of risk and biosecurity protections associated with animals and animal products entering the U.S. from high-risk areas, countries or "regions" of the world; second, assure international animal health standards and practices are harmonize so as to be equitable to U.S. dairy producers under/WTO and assure U.S. access to international markets.

A Few Recommendations:

You know best about how to manage your farm. Keep doing what you do best. Adopt the new cost saving technologies that come on line, pay attention to animal and financial management, explore ways to improve the quality of the milk you produce.

There are other actions you can take in the larger dairy community. For example, you might want to become an advocate at least two. The first is, push for a quality and animal health assurance program. The U.S. needs a program that can proactively address basic public and animal health concerns which potentially threaten the ability to market milk and dairy beef both domestically and internationally.

To make sure that consumers in the U.S., or anywhere in the world, never have a reason to doubt the safety or quality of dairy products produced in the U.S., a Total Quality Assurance protocol [3] should be developed, tested, and followed. The protocol should be effective in minimizing, and come as close as possible to preventing, the introduction of zoonotic diseases (for example, brucellosis and TB); in improving biosecurity and vaccination regimes to protect herd health; in reducing therapeutic costs, avoiding chemical and physical residues, minimizing risks from emerging pathogens and parasites. The protocol would drive use of cost-effective on-farm sanitation and milking practices with self-imposed monitoring and control, to meet Grade "A" Pasteurized Milk Ordinance requirements. It should utilize HACCP principles to permit independent monitoring outside of the current NCIMS rating program.

Other segments of animal agriculture are investing in total quality assurance programs using producer promotion ("check-off") funding. The dairy industry should be in the forefront of such efforts, not lagging behind.

The second action is, make sure your co-op is a member and its management is involved in the work of the U.S. Dairy Export Council (USDEC). USDEC, formed in 1996, works with all segments of the dairy industry to increase the volume and value of dairy exports from the U.S. It is a concentrated effort, funded mostly by milk producers, to overcome many years of ignoring dairy export sales possibilities in foreign markets. USDEC has a mission to work with the U.S. dairy industry directly, to "play catch-up" in the area of foreign trade, where the U.S. is decades behind our foreign competitors in market development.

USDEC provides a broad range of services that will be increasingly important in the future – trade education, buyer contact and qualification, in-country assistance, including work to achieve or widen access to country markets. USDEC has a Washington, DC based staff and foreign offices in important export markets, such as Japan, Mexico and Korea.

USDEC is working with the National Milk Producers Federation to see that the U.S. dairy industry is well represented in international organizations where sanitary and phytosanitary standards can be set or adjusted to the advantage, or disadvantage, of the U.S. industry.

Conclusion:

Export trade development will be a long process, and the outcome of individual trade actions will always be somewhat uncertain.

The U.S. may have to take some short-term lumps in trade negotiations to win in longer term. For example, extending NAFTA to include Chile and Argentina without including of Brazil will probably not bring any benefit to the U.S. milk producer. The question for consideration is, can we keep our collective eyes on the prize – the long term benefits that accrue from fair trade – while many distractions and frustrations occur.

The U.S. and its trade partners have entered a new era with far-reaching agreements such as NAFTA and GATT. Increasingly, nations must rely on international dispute panels to resolve disagreements honestly if we are to avoid costly trade wars and reprisals.

The U.S. government must pay attention to the proper implementation of the UR GATT agreement. We see an enormous amount of "back-sliding", that is, attempts to exclude agricultural trade from trade negotiations. The U.S. must be "hard nosed" and proactive. The World Trade Organization (WTO) disciplines are all that exist to work for expanded exports and, if the U.S. abides by those disciplines, so must all other nations.

The U.S. must be more diligent with respect to sanitary/phytosanitary issues, which means constant involvement and monitoring of international organizations such as Codex Alimentarius and the Office of International Epizootics. Without a history of involvement in the international markets, the U.S. has not paid sufficient attention to these important issues that will affect the future competitiveness of dairy farmers.

The U.S. must begin to work now for the next GATT round talks. The next round of talks will not cover as broad a front as the 1985-93 round. Agricultural issues are likely to stand alone and not be imbedded in a comprehensive GATT negotiation. During the talks, the U.S. negotiators should guard against "special treatment for agriculture" positions. The chief danger will be an attempt by major agricultural product importing nations of Asia (Japan, China, and South Korea) to exclude agriculture from the treaty. If they succeed, the potential growth of the U.S. dairy industry will be severely curtailed.

The U.S. must maximize activity use of permitted activities, such as Market Promotion Program funding and DEIP, for example, while preventing the European Union from circumventing limits on export subsidies.

Endnotes & Glossary:

[1] These estimates are based on a comparison made in early January 1997. The estimates are based a comparison of U.S. prices with reported Oceania prices. The following were used: Oceania prices of US$2,100 to US$2,300 per metric ton for cheddar cheese, compared to $2821 per metric ton ($1.28 per pound) at the National Cheese Exchange for 40 pound blocks; nonfat dry milk at US$1,850 to $1,950 per metric ton, compared to the Midwest price of $2,435 per metric ton ($1.105 per pound); and Oceania butter at US$1,300 to US$1,450 per metric ton, compared to Chicago Mercantile prices of $1984 per metric ton ($0.90 per pound). CCC yields and make allowances were used in all conversions of product value to milk prices.

[2] No adjustments were made to account for world butter containing 82% milkfat, compared to the CCC standard of 80 percent milkfat.

[3] Most ideas in this section were suggested by John Adams, Director, Milk Safety and Animal Health, National Milk Producers Federation, who has been an advocate for a Total Quality Assurance Plan to safeguard the U.S. dairy industry.

Glossary:

***CCC –** Commodity Credit Corporation (U.S. Dept. of Agriculture)*
***DEIP –** Dairy Export Incentive Program*
***EU –** European Union*
***GATT –** General Agreement on Trade and Tariffs*
***NAFTA –** North American Free Trade Agreement*
***NZDB –** New Zealand Dairy Board*
***USDA –** U.S. Department of Agriculture*
***USDEC –** U.S. Dairy Export Council*
***WTO –** World Trade Organization*

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U.S. Cooperative Success Story:

Sunsweet Sells The World On Prunes

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