The Use Of Marketing Boards To Expand Exports

RONALD D. KNUTSON

Materially increased interest has developed in the potential usefulness of marketing boards as a means of expanding the exports of dairy products.

In fact, the passage of the 1996 Farm Bill included a mandate for the USDA to assist the U.S. dairy industry in creating one or more export companies.

According to the Farm Bill, "The secretary (of agriculture) shall, consistent with the World Trade Organization (which administers the General Agreement on Tariffs and Trade), provide necessary advice and assistance to the U.S. dairy industry to establish and maintain one or more trading companies for the purpose of facilitating international market development and exports of dairy products."

But even without that, this increased interest in developing a New Zealand-type dairy board comes from several issues:

• Reductions in support levels have made U.S. butter and nonfat dry milk prices more nearly competitive in international markets. As a result, the potential for export has been enhanced.

• Questions have arisen regarding the legality under GATT of the proposed "self-help" plan, which called for the establishment of assessments for producers who increased production and the use of those assessments to dispose of products on the world market.

• Questions have also arisen regarding the potential for increased competition from foreign dairy products within U.S. domestic markets resulting from reductions in the effectiveness of Section 22 provisions under the GATT tariffication policy. The spirit of GATT indicates that the long-run level of tariff protection may be gradually reduced, forcing the U.S. dairy industry to operate in an international market environment.

• The effectiveness of DEIP as an export enhancement tool has demonstrated the effectiveness of market promotion in expanding markets. Yet, the GATT outcome mandates reductions in export subsidies through programs such as DEIP.

• Concern has arisen that the U.S. dairy industry, despite being the largest of any nation, has not been a significant factor in the world market except in periods when the CCC has been willing to subsidize exports through either direct sales, under programs such as DEIP, or during unusual periods such as 1988-1989 when world nonfat dry milk supplies became short. This concern was highlighted in a recent GAO report titled Dairy Industry: Potential for and Barriers to Market Development.

• Philosophically, the United States' policy has changed in the direction of favoring market solutions to problems and more direct exposure of producers to market forces.

The purpose of this article is to explore the potential consequences of utilizing a marketing board to export dairy products. This approach is employed by the New Zealand Dairy Board (NZDB). Therefore, the leaflet begins with a description of the NZBD. It then proceeds to describe alternate ways a comparable structure might fit into the U.S. dairy industry. It ends by pointing out areas of compatibility and conflict with U.S. dairy policy, the impact on the world dairy market, and the spirit of the GATT accord.

New Zealand Dairy Board

The NZDB is the exclusive exporter for the New Zealand dairy industry. It markets the products manufactured from 85-90 percent of New Zealand's milk production.

New Zealand generally is recognized as being the lowest cost producer of milk in the world. While producing only about 1.5 percent of the world's milk supply (roughly equivalent to California's production), New Zealand has an export share of approximately 25 percent of the world's market.

The New Zealand Dairy Board is a quasi-government corporation in that it is explicitly created under statutory law, giving it exclusive export authority. It is governed by 13 board members, 11 of whom are directors of New Zealand's cooperatives and two of whom are appoiinted by the government.

The 11 cooperative NZDB members are elected by their approximately 17 cooperatives whose votes are based on the volume of their members' production.

As the sole exporter of 85-90 percent of the nation's milk production, the NZDB is in a unique position to guide the products manufactured by the cooperatives.

It does this through a differential system of premiums and penalties designed to encourage the manufacture of products forecast to be in greatest export demand and discourage those that are in surplus.

In other words, it adjusts the quantity of manufactured products processed through its own internal pricing system. Payments are made to the cooperatives on the 20th day of the month following purchase in the form of an advance price which is adjusted regularly according to market conditions.

Before the pool is closed, final payments are made to the cooperative to reflect the differential premiums and penalties for specific products during the course of the season.

The NZDB places a high priority on exports of branded and specialty products which constitute about 35 percent of its product mix. The development of this market, which has been a major goal, is dependent on integration of product research, processing, quality control, transportation, packaging, and shipping.

In other words, the NZDB has substantial influence on what, when, and how the product is produced.

The NZDB operates in the world dairy market through a network of wholly-owned subsidiaries, joint ventures, affiliated, and associated companies. These companies deal in New Zealand dairy products as well as other New Zealand products, and the products of other countries. For example, the NZDB has imported European cheese into the United States.

The NZDB is not without controversy. Some New Zealand cooperatives have, from time to time, desired to export on their own. Moreover, New Zealand government officials have proposed removing the board's export monopoly in order that it might have a better guide to its performance in a more competitive market context.

Application To The United States

This section deals only with how an export marketing board (hereinafter USDB) might operate in the context of the U.S. dairy industry.

Issues relating to how the USDB might operate in the context of U.S. dairy policy is not discussed in detail. Rather, the focus is on the concept of a producer-controlled export agency.

Three operational alternatives for the USDB will be discussed:

• Exclusive exporter.

• Nonexclusive exporter.

• Clearing house for exports.

Each of these options will be discussed without the USDB having the power to control production. A broader array of marketing board and "self-help" concepts are discussed in leaflet P-15.

Exclusive Exporter

A USDB could be authorized as the exclusive exporter of U.S. dairy products by the U.S. Congress, making the board a government-sanctioned monopoly.

This would mean that no other cooperative or proprietary firms would be allowed to make export sales without the approval or involvement of the USDB.

Opposition could be anticipated from companies that are currently involved in the dairy product export business, from companies anticipating becoming involved, or from companies who see a dairy board as an undesirable precedence for similar developments in other commodities.

Some of this opposition from within the dairy industry might be stifled by the potential for current exporters becoming joint ventures, affiliates or associates with the dairy board. Opposition might also be curbed by limiting USDB exclusive export authority to certain products — such as manufactured hard products and their derivatives.

The USDB could be either an extension of the current dairy promotion board or an entirely separate entity. It could contract with cooperatives (or potentially proprietary processors) for the production of specific products considered to have market potential.

Payment to the cooperative would be based upon the price the USDB could obtain in the world market. The USDB could take over the functions currently performed by the CCC and the acquisition of products for domestic food assistance programs (school lunch, WIC, etc.).

While DEIP is in existence, the USDB could handle export decisions under it. In the absence of price supports, the USDB would be the exclusive interface between domestic and international markets.

An exclusive USDB would need to have the authority to establish marketing offices in other countries. Such offices may, like the NZDB, be wholly owned subsidiaries, joint ventures, or affiliates.

Such agents would have exclusive authority for handling export sales on behalf of the USDB in the country involved. Such a system would have the potential for being highly efficient in that it would be the sole U.S. operator in the export market.

It could be more competitive than current U.S. exporters in that it would have pricing authority or latitude not enjoyed by current U.S. companies operating in the export market.

Therefore, it would meet traders, such as the NZDB, on a one-for-one basis in markets such as Mexico or Japan. As the exclusive exporter, it should be in a better position to develop markets for all types of products.

If the USDB agent was not performing in a particular country, the USDB would need to have the authority to shut it down and/or switch affiliates.

The USDB would have the power to set guidelines for the terms of sale and to determine the sourcing of supply for the product.

Therefore, even if a particular cooperative or proprietary firm was awarded the exclusive USDB agency for sales in a particular country, the source of the product sold would be determined by the USDB based on competitiveness, product quality, and performance criteria.

To be effective and equitable, the USDB would have to have the authority to operate a pooling system that spreads the receipts from exporting across the entire U.S. dairy industry.

Such a mechanism could involve either a system of assessments or the operation of an export pool whereby all costs and returns from export operations would be shared equally. As a result, producer returns would be directly affected by the returns that the USDB achieves in the export market.

Nonexclusive Exporter

Without exclusive export authority, cooperatives and proprietary firms could continue to operate in the export market but would do so in competition with the USDB.

The terms of competition could be influenced by the board as a matter of policy by the board having the power to influence raw milk costs. Once again, a system would need to exist for pooling to spread costs and receipts across all producers in all markets.

In any particular country, the USDB could be selling U.S. dairy products as well as proprietary or cooperative concerns. The tradeoff would be between the influence and effectiveness of the sole exclusive agent (previous option) and the value (positive or negative) of competition and product diversity in the international marketplace.

Potentially, the USDB could end up selling only commodities to the least advantageous markets.

As indicated previously, the issue of nonexclusivity has surfaced in New Zealand. The NZDB views this option as undermining their effectiveness and efficiency. The proponents of nonexclusivity believe that competition provides a yardstick by which efficiency and performance may be most effectively judged.

Clearing House

The USDB could simply act as a clearing house for facilitating the movement of dairy products into the world market.

Such a clearing house would have promotional activities (much like the current Dairy Promotion Board). It would not be a direct sales agent.

Instead, sales would be made through proprietary and cooperative firms based on the prices paid for raw milk, their efficiency, and their performance in the export market.

The primary roles of the USDB under this option would be to promote the utilization of U.S. dairy products internationally and ensure equitable pooling arrangements.

The difference between this option and the current system is that U.S. dairy cooperatives and proprietary companies would not have their hands tied in the export market.

That is, there would be a mechanism for all producers sharing in the costs and benefits of exporting.

Relationship To U.S. Dairy Policy

The GAO, in its recent report on dairy exports, finds that the U.S. dairy industry is unable to compete in international markets for four primary reasons:

• The milk price support program maintains U.S. raw milk prices at sufficiently high levels so that manufactured products are priced out of the world market.

• The industry lacks an international market-oriented mindset and strategy. There are many possible reasons for this mindset or lack of strategy. For example, U.S. dairy firms have not had to be competitive with a relatively high milk price support (which no longer exists). Additionally, the structure of major proprietary dairy companies which have plants in most major milk-producing countries with policies designed to encourage self-sufficiency inherently discourages the development of export markets.

• Moreover, GAO finds that the NZDB has been exceedingly effective at penetrating international markets not only because of its cost advantage in producing milk, but also because of its international marketing skill — something it finds lacking in U.S. dairy cooperatives and proprietary firms. Part of the NZDB's success in international marketing lies in its ability to sell internationally at competitive prices. Therefore, the NZDB is a very effective competitor in Mexico in the face of the U.S. dairy export incentive subsidies (DEIP) and EU export restitutions. New Zealand is competitive in Mexico and in other markets because its costs are low and because it has marketing skill, but also because, as a marketing board, it has the pricing power to lower its price on sale to Mexico to meet the competition. In lowering its price, there is no explicit subsidy paid but there is an implied subsidy in that markets are being cross-subsidized to maintain them. Such pricing power is also implied by the grain marketing boards in Canada and Australia.

• The trend toward lower price supports and the developments in GATT designed to liberalize trade and guarantee market access has forced rethinking of current U.S. dairy policies and should cause U.S. dairy companies to rethink their international operational structure.

U.S. Dairy Programs And GATT

The Uruguay Round Agreement (URA) of GATT has significance for both existing U.S. dairy policies and for the operations of a USDB.

The philosophy of the URA extended into the future implies that the burden for any export price concession falls directly on producers in the form of lower product prices. Therefore, a marketing board selling in the export market at a lower price than in domestic markets is legal where producers bear the full impact of the lower price and there is no subsidy from the government.

The issues from a U.S. dairy policy perspective is whether a USDB could accomplish the same discretionary pricing power in the presence of CCC purchases under the price support program and still not violate the trade liberalization regimen of GATT.

(Turn to Page A33)