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Report to the Congress; by Elmer B. Staats, Comptroller General.

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Authority: Steagall Amendment (15 U.S.C. 713a-8). Agricultural Act of 1949 (63 Stat. 1051). Agricultural Act of 1949 (63 Stat. 1247). Agricultural Marketing Agreement Act of 1937 (50 Stat. 246). Trade Act of 1974. Agriculture and Consumer Protection Act of 1973.

The need to consider alternatives to the present system of dairy import quotas is discussed. Interrelated programs of price supports, marketing orders, and import quotas have been effective in insuring an adequate supply of domestically produced milk and in stabilizing prices for dairy products. The cost of this self-sufficiency and price stability has been higher prices to the consumer and program costs to the government. Several alternative courses of action are available: (1) continued policy of import quotas for dairy products along with the price support program, (2) free trade in dairy products in the United States and abroad, and (3) open U.S. market policy with no import quotas or price support program.
Findings/Conclusions: A system of free trade for agricultural products would benefit consumers through lower prices for dairy products. Under a system in which the United States would unilaterally open its market to imports, an Agriculture Department study indicates average consumer savings of about $500 million a year over a 6-year period. Recommendations: Viable alternatives or modifications to the present protective system of dairy import quotas should be analyzed and defined. (RRS)

REPORT TO THE CONGRESS

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

U.S. Import Restrictions: Alternatives To Present Dairy Programs

Department of Agriculture and Other Agencies

The U.S. is involved in multilateral trade negotiations authorized by the Trade Act of 1974. As prescribed by the act, U.S. negotiators are seeking reciprocal trade concessions leading to the development of an open, nondiscriminatory, and fair world economic system. This report is one of a series on U.S. import restrictions on industrial and agricultural commodities.

A move toward liberalizing dairy trade could substantially reduce consumer and taxpayer costs of the highly protective dairy programs and also would be consistent with existing international agreements and U.S. efforts to reduce trade barriers. A key consideration in assessing alternative programs is the effect of changes on the welfare and viability of the domestic dairy industry.

In view of possible benefits, the Congress may want to consider alternatives or modifications to the present dairy programs.

ID-76-44

DEC. 3, 1976

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-114824

To the President of the Senate and the
Speaker of the House of Representatives

This report discusses the need to consider alternatives to the present system of dairy import quotas. It is one of a series on U.S. import restrictions on industrial and agricultural commodities. Other reports in the series include:

--Economic and Foreign Policy Effects of Voluntary Restraint Agreements on Textiles and Steel, B-179342, March 21, 1974.

--Review of U.S. Import Restrictions--Need To Define National Sugar Goals, ID-75-80, July 10, 1975.

--Marketing Order Program--An Assessment of Its Effects on Selected Commodities, ID-76-26, April 23, 1976.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We are sending copies of this report to the Director, Office of Management and Budget; the Secretaries of Agriculture, State, and the Treasury; the Chairman of the International Trade Commission; and the Special Representative for Trade Negotiations.

Comptroller General
of the United States

C o n t e n t s

Page

APPENDIX

ABBREVIATIONS

GAO General Accounting Office

GATT General Agreement on Tariffs and Trade

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

U.S. IMPORT RESTRICTIONS: ALTERNATIVES TO PRESENT DAIRY PROGRAMS
Department of Agriculture
and other agencies

D I G E S T

The Trade Act of 1974 authorizes the President to negotiate trade agreements providing for reducing or eliminating nontariff barriers and other distortions of international trade. The act urges the President to obtain equivalent reduction of barriers within the entire agricultural sector.

The U.S. is presently involved in multilateral trade negotiations. U.S. negotiators are seeking to promote the development of an open, nondiscriminatory, and fair world economic system and to stimulate fair and free competition between the U.S. and other trading nations. This report is one of a series on U.S. import restrictions involving industrial and agricultural commodities.

The dairy industry, a significant element of U.S. agriculture, is vital to the American economy and produces one of its most essential foods. The industry has been highly protected from foreign competition, assuring consumers a supply of domestically produced milk and dairy products, while providing producers with adequate and more stable prices.

The cost of this self-sufficiency and the U.S. industry's stability has been borne by consumers and taxpayers in higher prices and governmental program costs.

The Agriculture and Consumer Protection Act of 1973 required the Secretary of Agriculture to conduct a study to determine the effect that increased levels of dairy imports would have on domestic producers, handlers, processors, and consumers. The

Department of Agriculture analyzed three trade alternatives for the period 1975-80: a continued policy of U.S. import quotas, free trade by all countries, and an open U.S. market.

Continuing the present system of price support and a high level of import quotas, Agriculture estimated that consumer prices would range from 16 to 26 percent higher in 1980 than in 1974. Agriculture projected that under this option 181,600 dairy farms would discontinue production as single units by 1980, following a general trend in agriculture toward consolidation into larger, more efficient production entities.

Under a free trade system, Agriculture estimated that annual consumer savings would steadily increase, reaching about $800 million during 1980, with a corresponding reduction in farm-level dairy prices. Agriculture projected that under this option 185,000 dairy farms would discontinue production as single units by 1980, or 4,200 more than if quotas were continued.

Under a system where the U.S. would unilaterally open its market to imports, the Agriculture study anticipated average consumer savings over a 6-year period of about $550 million a year, with an initial substantial adverse effect on the domestic dairy industry. Agriculture projected that under this option 198,900 farms would discontinue production as single units by 1980, or 17,300 more than if quotas were continued.

The severe adverse producer impact of the open market alternative was attributed to an expected surge of surplus and subsidized dairy imports that would cause farm-level milk prices to drop about 22 percent.

The study did not consider the price effects of a gradual increase in quotas, with countervailing duties or other measures available to protect the U.S. market and producers against the importation of subsidized surpluses.

GAO therefore believes that alternatives or modifications to the present dairy program should be explored to insure a balance among the interests of the consumer, producer, taxpayer, and U.S. trade objectives.

In commenting on the GAO report, the Department of Agriculture stated that neither the free trade nor open market options were realistic alternatives. Agriculture said that free trade is not attainable within the foreseeable future and the legislative history of the dairy price support program indicates that favorable consideration by the Congress of an open U.S. market is extremely unlikely.

Agriculture defended the present program by stating it is the most workable of any alternative. It stated that the milk price support program is mandatory and is likely to remain so; the import quotas, for which no satisfactory alternative has been found, are necessary to protect the program's viability.

Agriculture observed that all leading trading nations control their agricultural trade to some degree and that the U.S. is one of the most liberal. Dairy products are particularly subject to government controls; every major producing country controls imports and many also control exports.

Agriculture suggested that, in such a trading environment, complete elimination by the U.S. of its dairy import controls would result in unacceptable costs to the American economy and to the Federal budget. If liberalization is to be achieved, it must be in a multilateral context with necessary safeguards.

In contrast to the Department of Agriculture's views, the Department of State said it would be particularly interested in further studies on possible gradual approaches to reducing or eliminating import quotas. State agreed that eliminating all barriers to trade in dairy products is unlikely and that the unilateral elimination of American restrictions would be disruptive; however, the U.S. may be able to devise a first step which, without harm to American producers, could be instrumental in beginning to reduce barriers internationally. State suggested that the U.S. might consider quotas geared to a certain percentage of annual consumption as an alternative to the present system which sets quotas in fixed amounts.

GAO believes that State's suggestion is a constructive and positive move toward identifying viable modifications or alternatives to the present dairy programs. GAO agrees that complete and sudden elimination of all barriers to dairy trade would be disruptive, and could result in unreasonable adverse impact on producers.

In view of the possible benefits, the Congress should instruct the Secretary of Agriculture, in conjunction with other agencies, to analyze and define viable alternatives or modifications to the present protective system of dairy import quotas and related modifications to the domestic dairy program and have such alternatives or modifications submitted for consideration and possible legislative action.

An important element in assessing alternatives to present U.S. policies and programs is the effect of changes on the domestic dairy industry, which consists of 385,000 producers and has annual retail sales of about $19 billion. Dislocation of or disruption to the producers and the dairy-processing industry and its employees could have an adverse economic impact.

Any future studies on the open market alternative should consider a gradual versus sudden change in import policy with strict U.S. enforcement of its statutes on countervailing duties, antidumping penalties, and unfair competition.

Future studies should also define the cost of price support to the U.S. Government compared with the possible cost to the Government of programs designed to assist communities, industries, and workers to adjust to adverse economic impact attributable to increased imports.

If, after assessing the various policy and program alternatives, the Congress decides to continue the present programs, GAO recommends that the Congress revise the legislative requirement for price support so that the Secretary of Agriculture can base support prices on projected market conditions. The present legislative guidelines require support prices be set between 75 and 90 percent of parity. Since the formula for computing parity does not consider many relevant economic factors, the legislative requirement represents more of a constraint than a constructive guide for determining price-support levels and its application may have encouraged surplus production in some years.

The report also contains two recommendations to the Secretary of Agriculture aimed at providing equity for allocating quotas among countries and licenses to importers. The Department of Agriculture believes the recommendation on country allocations is not feasible and the recommendation for allocating import licenses is not desirable.

CHAPTER 1

INTRODUCTION

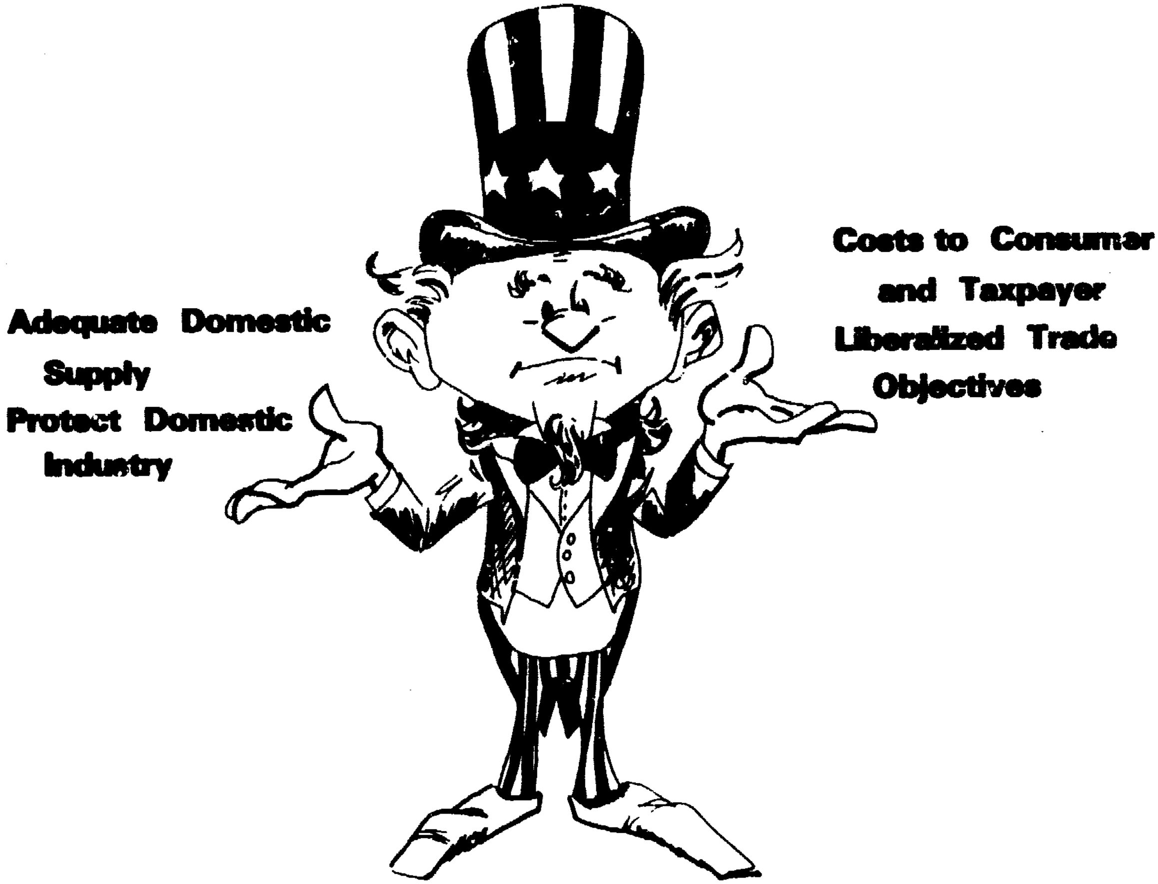
Because domestic milk prices tend to fluctuate dramatically with seasonal production changes, U.S. milk producers have attempted to increase their control over milk prices since the early 1900s. First, they formed cooperatives to enhance their bargaining power with milk dealers and processors. The cooperatives were relatively successful when economic conditions were favorable, but in economically unfavorable times they failed to maintain satisfactory prices. Therefore, producers have recurrently sought Government aid to support and stabilize milk prices.

The Congress has responded through the years by passing legislation that allows U.S. producers to market milk at guaranteed minimum prices. To prevent foreign producers from competing in the domestic market and interfering with the Government-established minimum price, the United States in the early 1950s began using quotas to limit dairy product imports. The cost of these protective policies has been borne by the American consumer and taxpayer through higher milk prices and Government price support expenditures.

While this high degree of protection has continued for the dairy industry, overall U.S. trade policy has moved toward removing barriers to trade. For many years, the United States has worked for liberalized agricultural trade in its negotiations with many countries, particularly those in the European Community, and in the General Agreement on Tariffs and Trade (GATT) and other multilateral forums.

As the United States begins new trade negotiations, U.S. negotiators will be seeking to promote the development of an open, nondiscriminatory, and fair world economic system, as set forth in the purposes of the Trade Act of 1974. A principal U.S. objective in these negotiations is to achieve more open trading for agricultural products.

The U.S. Government, therefore, faces the difficult task of balancing the (1) interests of the dairy industry, (2) interests of consumers and taxpayers, and (3) its trade objective of reducing trade restrictions.



DAIRY INDUSTRY

The United States ranks third in world milk production behind the European Community and the Soviet Union. In 1973 U.S. consumers purchased milk and dairy products having a retail value of $19 billion. Of this amount $9.7 billion represented fluid milk and related sales and $9.3 billion represented manufactured dairy products. The dairy industry, which had about 385,000 dairy farms in 1973, is an important element of American agriculture. It is also important to the industrial sector; for example, in 1973 approximately 3,000 dairy-processing plants employed about 200,000 people.

The importance of dairy products to the American diet underlies the need for an assured supply of milk. In 1973 milk and other dairy products supplied 12 percent of the food energy, 23 percent of the protein, and large percentages of other vital nutrients in the American diet.

Milk production and use

The domestic industry has experienced dramatic changes through the years. Annual milk production per cow has more than doubled since 1945, primarily because of improved feeding and breeding, thus offsetting a decline in the number of dairy farms and cows. The trend has been toward fewer but larger farms and manufacturing plants. Milk production gradually rose to a peak of 127 billion pounds in the mid-1960s but has since declined to 115.4 billion pounds in 1973 and 1974. More than three-fourths of the Nation's milk is sold through cooperatives.

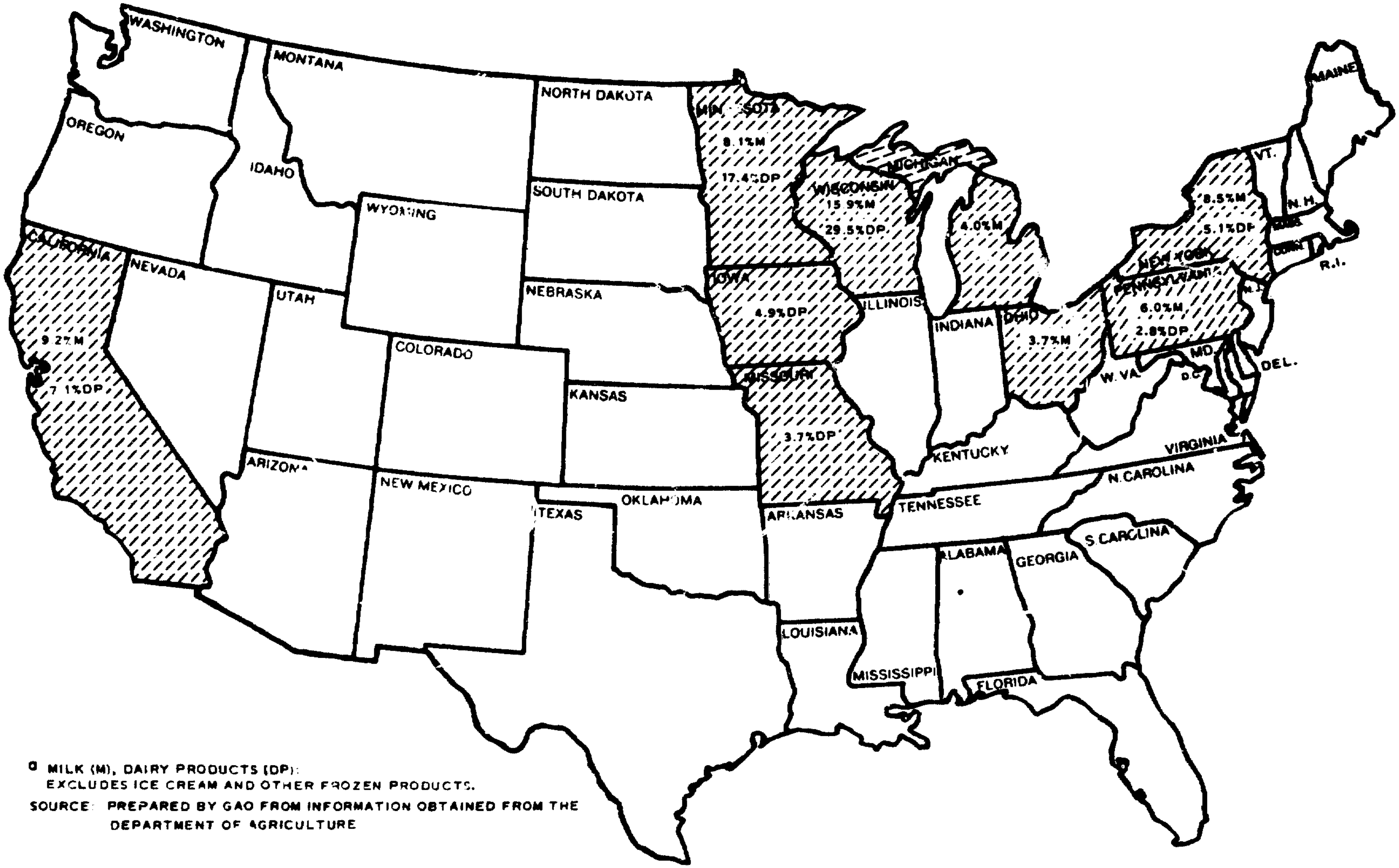
Dairying is a nationwide industry. As noted on the map, seven States produced 55.4 percent of the milk in 1974. During the same year 70.5 percent of our manufactured dairy products were produced by the seven leading dairy product manufacturing States.

Two grades of milk are produced--grade A is eligible for fluid use or manufacturing and grade B may be used only for manufacturing. In Wisconsin and Minnesota, which produce the largest percentages of manufactured dairy products, 41 and 61 percent, respectively, of the milk sold to plants during 1973 was grade B.

Milk is a bulky and highly perishable commodity, subject to bacterial contamination. It must be produced and handled under sanitary conditions and marketed quickly. Thus, milk not consumed in fluid form must be processed to prevent loss. In recent years, about 45 percent of U.S. milk production has been used as fluid milk and 55 percent as manufactured dairy products.

Milk production is seasonal. Production is generally greatest during spring and early summer and lowest in November. Consumption of fluid milk is relatively constant throughout the year, but sales vary throughout the week, with consumer purchases high on Thursday, Friday, and Saturday. This means that, to supply the demand for fluid milk, production must be adequate to meet demand on days of high sales even in fall and winter. Consequently, milk-balancing plants in many areas take the excess production from days of low demand and periods of heavy production and manufacture dairy products.

MAJOR STATES PRODUCING MILK AND MANUFACTURED DAIRY PRODUCTS IN 1974 (note a)



a MILK (M), DAIRY PRODUCTS (DP): EXCLUDES ICE CREAM AND OTHER FROZEN PRODUCTS.

SOURCE: PREPARED BY GAO FROM INFORMATION OBTAINED FROM THE DEPARTMENT OF AGRICULTURE

DAIRY PROGRAMS

To assure adequate supplies of domestically produced milk, the Government has used several interrelated programs, the most important of which are price supports, marketing orders, and import quotas.

--Price support: Guarantees dairy farmers a minimum average price for manufacturing grade milk and supports the level of all milk prices.

--Marketing orders: Allow dairy industry to market milk used for fluid consumption or for manufacturing at regulated minimum prices.

--Import quotas: Prevent import interference with the price support program.

Tariffs are also collected on most dairy imports. Although tariffs may not greatly affect the supply of domestically produced milk, they affect the cost of imports.

Price support

During World War II, the U.S. Government tried to stimulate increased farm production to meet the added agricultural requirements caused by the war. One effort was the Steagall Amendment (15 U.S.C. 713a-8), which provided that, if the Secretary of Agriculture issued an announcement requesting expanded production of certain agricultural commodities, he should provide price support on these commodities until 2 years after the end of World War II. The Secretary did provide for and set goals for increased dairy production, and in the 1940s Agriculture bought some dairy products to help support prices based on authority under the Steagall Amendment.

After World War II, dairy farmers were caught in a cost-price squeeze, with production and living costs increasing faster than milk and butterfat prices. Also, the basic instability of milk prices, caused by seasonal production peaks, still existed. At the same time, the overall demand for milk and most of its products was declining while production was increasing. These factors led milk producer groups to request continuing Government price support.

The Congress passed the Agriculture Act of 1948 (62 Stat. 1247) and the Agricultural Act of 1949 (63 Stat. 1051), providing for continuing Government support of dairy prices.

This support has been based on a parity formula designed to identify the current price level at which a unit of milk would have the same purchasing power it held from 1910 to 1914. The present method of computing parity prices for farm commodities was defined in the Agricultural Adjustment Act of 1938 (52 Stat. 31) and has since been modified by the Agricultural Acts of 1948 and 1949. The formula has the following elements.

$$\text{PARITY} = \overbrace{\text{10 YEAR AVERAGE PRICE OF THE COMMODITY} \div \frac{\text{10 YEAR AVERAGE OF ALL FARM PRODUCT PRICES}}{\text{AVERAGE OF ALL FARM PRODUCT PRICES FOR BASE YEARS 1910-1914}}}^{\text{ADJUSTED BASE PRICE}} \times \overbrace{\frac{\text{ONE MONTH LEVEL OF COSTS FOR ALL FARMERS}}{\text{1910-1914 LEVEL OF COSTS FOR ALL FARMERS}}}^{\text{PARITY INDEX}}$$

In computing the parity price, the ratio of the most recent 10-year average price received by farmers for all farm products to the 1910-1914 average price is divided into the most recent 10-year average price of the commodity. This calculation equals the adjusted base price. The adjusted base is then multiplied by the ratio of the previous monthly level of farm costs to the 1910-1914 level, which is the parity index, to obtain the parity price.

The Congress has required that milk prices be supported at levels between 75 and 90 percent of parity since 1949. After the parity price for all milk has been computed, Agriculture computes a parity price equivalent for the portion of the milk supply used in manufacturing dairy products. Support prices are then based on the parity price equivalent for manufacturing milk. The support price announced on October 2, 1975, was 84.4 percent of the parity price for the beginning of the marketing year.

The Agricultural Stabilization and Conservation Service is responsible for the price support program. To maintain minimum prices, Agriculture's Commodity Credit Corporation purchases any quantity of certain domestically produced dairy products (butter, cheddar cheese, and nonfat dry milk) that is offered. Such purchases, at a price based on the support price, reduce supplies of dairy products on the commercial market and set minimum prices at which they will be sold. This results in higher sales prices to dairy product manufacturers and prevents the average farm level price for milk from falling below the support level.

Marketing orders

The Federal Milk Marketing Order Program began in the 1930s. Current orders, administered by the Agricultural Marketing Service, are based on the Agricultural Marketing Agreement Act of 1937 (50 Stat. 246), as amended.

Milk marketing orders are normally issued by the Secretary of Agriculture after a petition by a marketing area's producers or handlers, an investigation by Agriculture of the need for an order based on the act, a public hearing for all interested parties, and an acceptance of the resulting proposed order by two-thirds of the producers who supply milk to the area.

A milk marketing order requires milk handlers to pay specified minimum prices for fluid quality milk. The minimum prices differ depending on the use of the milk. Grade A milk, if used as fluid milk, is normally priced by the orders at the average grade B milk price plus a differential to cover the extra costs of producing and transporting it and to assure adequate fluid milk supplies. If the milk is used for manufacturing, most orders set the price at the average manufacturing milk price received by farmers in Minnesota and Wisconsin. Thus, producers of grade A milk receive a weighted price based on the overall use of fluid quality milk in their marketing areas.

About 60 percent of all milk marketed in the United States and about 80 percent of milk eligible for use as fluid milk is subject to the provisions of an order. Since marketing order prices are based on the average manufacturing milk price, which is supported by the Government, the programs have normally enabled farmers to receive higher prices for all milk they sell.

Import quotas

Dairy import quotas were established in the early 1950s to maintain the price support program and to prevent any substantial reduction in the manufacturing of milk products. Initially, imports were restrained under section 104 of the Defense Production Act of 1950, as amended (65 Stat. 132), and other temporary legislation dealing with wartime exigencies. When section 104 expired in 1953 (66 Stat. 297), import quotas were continued in modified form pursuant to action taken under section 22 of the Agricultural Adjustment Act of 1933 (7 U.S.C. 624), as amended. Section 22 had previously been amended by the Agricultural Act of 1948 so that imports could be restricted if they interfered with a price support program. These quotas initially limited imports of several types of dairy products and have since been extended to cover most manufactured dairy products except cassein and a few high-price cheeses.

Section 22 requires that the Secretary of Agriculture advise the President when he believes that articles are or are practically certain to be imported that will:

1. Render or tend to render ineffective or materially interfere with programs or operations of the Department of Agriculture or any agency under its direction for any agricultural commodity or product thereof.

2. Reduce substantially the amount of any product processed in the United States from any agricultural commodity or product thereof for which any such program or operation is being undertaken.

The President may then direct the International Trade Commission (formerly the United States Tariff Commission) to investigate, hold a public hearing, and report to him its findings and recommendations. Based on such findings, the President has the authority to impose fees or quotas within prescribed legal limits in addition to the basic duties. In an emergency, the President may take action before receiving a report and recommendations from the Commission.

Most import quotas on dairy products are administered through a licensing system as recommended by the International Trade Commission. Under this system, imports can only be entered by or for the account of a license holder. A license specifies the product and its quantity a holder may import, the product's country of origin, and the U.S. port through which it may enter. The Secretary of Agriculture is required to issue licenses in a manner which will result in an equitable distribution of quotas among importers or users while allocating quotas among supplying countries on the basis of import volume during a representative period. The quota system includes provisions to adjust country allocations if special factors have affected or are affecting trade in the quota products.

The quotas subject to licensing are administered by Agriculture's Foreign Agricultural Service. Remaining quotas are unlicensed and administered by the U.S. Customs Service on a first-come-first-served basis.

Tariffs

Although tariffs on dairy imports were not imposed as part of the overall dairy program, they act as a revenue producer and as a barrier against imports of dairy products for which there are no quotas. The tariff rates, structured on either unit of measure or price, are the same for imports from all major dairy exporting countries and apply to almost all dairy imports. They are administered and collected by the U.S. Customs Service. Those based on units of measure range from 1.5 to 56.6 cents a gallon or from 1 cent to 14 cents a pound, depending on the product and quantity imported; those based on price range from 6 percent to 25 percent of the export price, depending on the product imported.

A few tariffs (tariff rate quotas) are structured on the quantity imported during specified periods; that is the duty increases after a specified quantity has been imported. For example, the basic tariff on butter is 7 cents a pound, but it doubles for all imports exceeding 50 million pounds from November 1 to March 31, all imports exceeding 5 million pounds from April 1 to July 15, and all imports exceeding 5 million pounds from July 16 to October 31.

CHAPTER 2

EFFECTS OF DAIRY PROGRAMS

The interrelated programs of price support, marketing orders, and import quotas have been effective in insuring an adequate supply of domestically produced milk to U.S. consumers and in stabilizing prices for milk and milk products. For more than 20 years, U.S. dairy production has accounted for an average of 99 percent of the dairy supply available for U.S. consumption. However, insuring this high domestic self-sufficiency has been costly to the consumer and taxpayer through higher prices and through Government expenditures for dairy programs.

SUPPLY EFFECTS OF PRICE SUPPORTS AND MARKETING ORDERS

The foundation for carrying out the Government's dairy policy is minimum price guarantees under the price support program. Subject to Agriculture's approval, the milk industry uses the marketing order program to require milk handlers to pay specified minimum prices for fluid quality milk. The minimum prices differ depending on the use of the milk and are based on the Government-supported price for manufacturing milk.

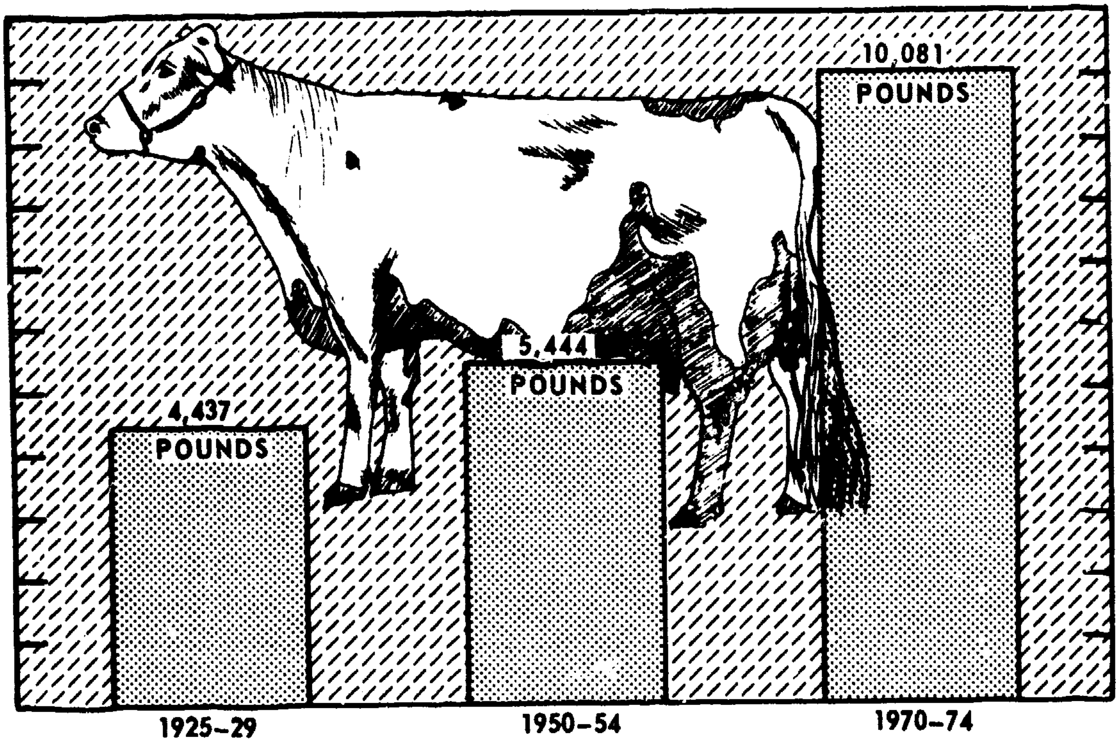
Legislative guidance for the price support program is based on the concept of parity. This concept was developed by the Congress in the 1930s, when severe price disparities existed between the prices of agricultural goods and the prices of other commodities. Parity is based on the rationale that a unit of a farm commodity should presently have the same purchasing power that it had in the period 1910-14.

The Congress has recognized that an adequate supply of milk and producer income normally can be assured without maintaining support prices at 100 percent of parity and, through legislation, has provided for the Secretary of Agriculture to set Government-support prices on milk between 75 and 90 percent of parity. In establishing the price support level within the parity range prescribed by the legislation, the Secretary considers such factors as the farm price of milk, productivity, estimated cost of production, and estimated consumer demand.

Since the parity formula is based on a purchasing power concept, which does not include many of these economic considerations, the legislative requirement that the price support level be set between 75 and 90 percent of parity represents more of a constraint than a guide for determining price support levels. For example, over the past 15 years the Secretary of Agriculture set support prices at the minimum level six times and at the maximum level two times. This means that support prices were set at the upper or lower limit of the legislative range 8 of 20 times (40 percent).

One reason parity is not indicative of the necessary price support level is that it does not consider technological gains and productivity increases that have occurred in dairying since the base period 1910-14. Milk output per cow has greatly increased over the years, as indicated by graph 1, showing average annual production trends since 1925-29.

GRAPH 1 MILK PRODUCTION PER COW



SOURCE: PREPARED BY GAO FROM INFORMATION OBTAINED FROM THE DEPARTMENT OF AGRICULTURE

Although the parity formula adjusts the parity level for increases in farming and living costs, it does not reflect this increase in productivity, which is attributable to improved management, better dairy breeds, more scientific feeding, and other technological advances. On the basis of 1974 prices, increased productivity allowed milk producers to receive about $413 more gross revenue per cow in 1974 than in 1950.

Year	Production per cow		1974 average price (per hundred pounds)		Gross revenue
1974	10,286 pounds	X	$8.30	=	$853.74
1950	5,315 pounds	X	$8.30	=	$441.14
					$412.60

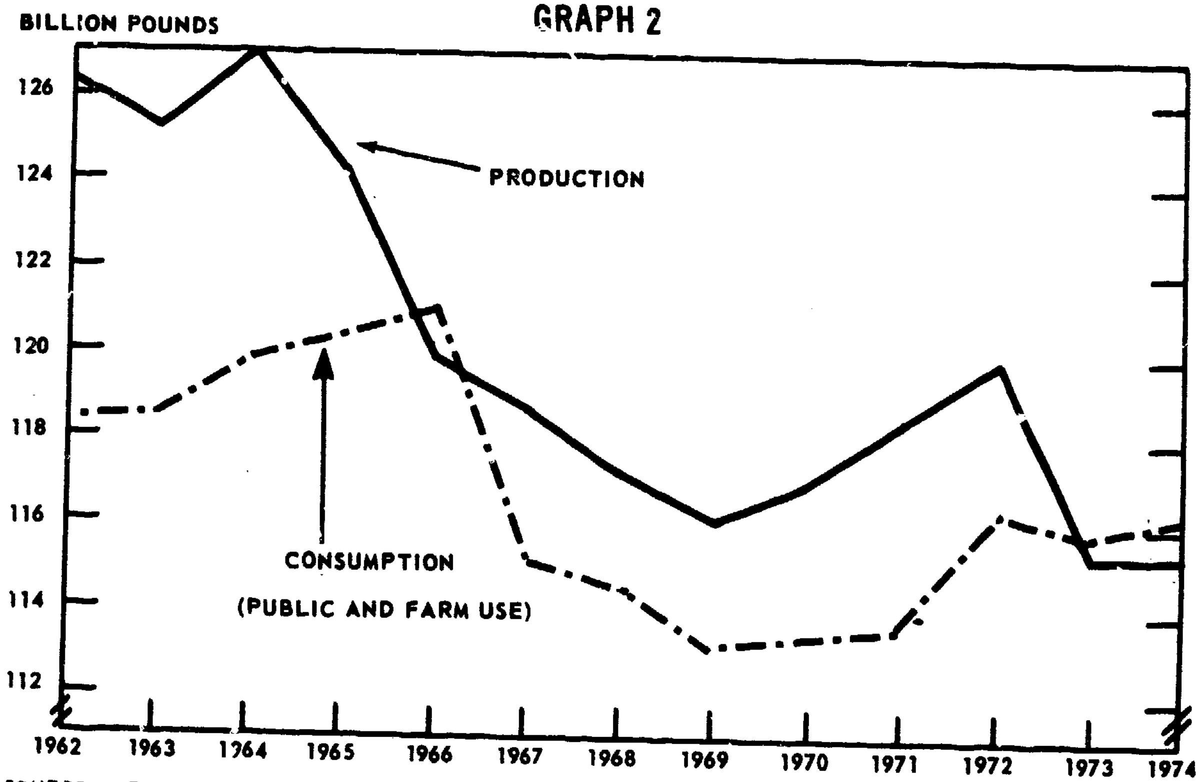
A productivity increase of this magnitude would surely change the price-income relationships that existed between dairy products and other commodities during the parity base period and today. The present parity formula ignores these changes.

Producers, dairy industry representatives, Agriculture officials, and economists agreed that the parity formula is inappropriate in relating production costs to commodity prices. When proposing the price support level for the 1975-76 marketing year, Agriculture officials observed that the long-term effects of a support price at the maximum 90 percent of parity limitation would be highly inflationary to consumers, would likely reduce consumption, and would increase Government purchases and costs to intolerable levels.

Although Agriculture considers various economic factors in setting support prices within the legislative range, it has not successfully balanced milk production and consumption. In 10 of the 13 years from 1962 through 1974, the U.S. dairy industry produced a surplus of milk ranging from 2.3 to 6.3 percent. During 3 of the 10 surplus years, support prices were set at the minimum level. The surpluses over the 13-year period resulted in the U.S. Government purchasing $4.2 billion of dairy products to maintain market prices at the guaranteed level. 1/

1/The $4.2 billion figure represents net expenditures for the dairy price support and related programs during fiscal years 1961-74.

GRAPH 2



SOURCE: PREPARED BY GAO FROM INFORMATION OBTAINED FROM THE DEPARTMENT OF AGRICULTURE

During the 13-year period ended March 31, 1975, Agriculture acquired about 2.9 billion pounds of butter, 1.1 billion pounds of cheddar cheese, and 7.2 billion pounds of nonfat dry milk for price support and related programs. The commodities were used as follows.

	Butter	Cheddar cheese	Nonfat dry milk
Commercial sales:			
Domestic (at domestic prices)	3.4%	0.7%	1.9%
Foreign (at low world prices)	10.5	.8	7.6
Noncommercial sales:			
Foreign school lunches and welfare (at low world prices)	-	.5	9.8
Donations:			
U.S. school lunches and welfare	62.3	84.1	24.0
Foreign school lunches and welfare	12.5	12.0	56.6
Other uses (includes sales or donations to the U.S. military and donations to hospitals and penal institutions)	11.3	1.9	0.1
	100.0%	100.0%	100.0%

During 1973 and part of 1974, changes in the economics of the dairy industry caused production to be less than demand, resulting in tight supplies and high dairy prices. During these years dairy feed prices rose to about 78 percent more than 1972 prices, causing dairymen to use less feed and attain reduced output per cow. The increased feed costs, combined with increased slaughter prices for dairy cows during this period, encouraged dairymen to cull (reduce through slaughter) their herds at a faster rate than normal.

To offset the decline in domestic production and to stabilize milk prices, the Government allowed increased imports. In early 1974 consumers began buying less milk because of the higher prices, and by mid-1974 Agriculture had to resume buying excess milk production. Even with prices set at the minimum, 75 percent of parity, Agriculture projected that it will have to purchase from 3.3 to 3.7 billion pounds of surplus dairy products each year through 1981.

Agency comments and our evaluation

When asked to comment on the need for developing a method of setting milk support prices at a level which would more nearly balance production and consumption, the Department of Agriculture noted the difficulty of predicting dairy marketing conditions. Agriculture said that it regularly projects short, intermediate, and long-run supply and demand conditions for milk and dairy products but that weather, feed crop conditions, and other variables limit the accuracy of its projections. Agriculture observed that a better economic intelligence base and more accurate and timely estimates of developing supply and demand conditions would provide a better basis for policy decisions and that it is continuously endeavoring to improve its analysis and data sources.

Agriculture failed to explain how its efforts to improve dairy market projections can significantly alter the process for setting milk support prices, which according to legislation must be set at between 75 and 90 percent of parity. Agriculture can only establish a support price based on projected market conditions if it falls within the parity range.

Recommendation to the Congress

If, after considering the various policy and program options discussed in chapter 4, the Congress decides to continue a dairy price support program, we recommend that the Congress remove the legislative requirement that support prices be set between 75 and 90 percent of parity. This would allow Agriculture to base support prices on projected market conditions in all situations and make maximum use of its economic intelligence data.

SUPPLY EFFECT OF QUOTAS AND TARIFFS

Dairy import quotas have effectively prevented import interference with the Government's price support program, holding imports to an average of 1 percent of annual production for more than 20 years (from 0.4 percent in 1953 to 2.5 percent in 1974).

Section 22 quotas were initially established for several dairy products in July 1953 but have since been extended to most other manufactured dairy products except casein and a few high-priced cheeses. The extensions have helped maintain the program's effectiveness by limiting imports of newly developed products and increases of products that had not previously been imported in large quantities. For example, 1969 annual import quotas were extended to canned milk, Swiss-type cheese for processing, processed Edam and Gouda cheese, processed Italian-type cheese, and certain other cheeses because of a marked increase in imports that would interfere with the price support program. The increase in imports resulted from rising U.S. prices, large foreign surpluses, and foreign subsidies.

Government and dairy industry officials of several major exporting countries have pointed out that quotas have effectively limited their ability to export dairy products to the United States.

To the extent that import quotas are filled, tariffs have no effect on the quantity of imports. Without a quota on a specific dairy product, a tariff could limit imports depending on its effect on the price of the imported product in relation to the domestic price of the same product.

PRICE AND COST EFFECTS OF DAIRY PROGRAMS

The dairy programs, by maintaining minimum prices and restricting imports, have increased producer returns and resulted in the consumer paying higher prices for dairy products than prices available in world trade. The cost of price support operations and administration of the dairy programs is borne by the U.S. taxpayer.

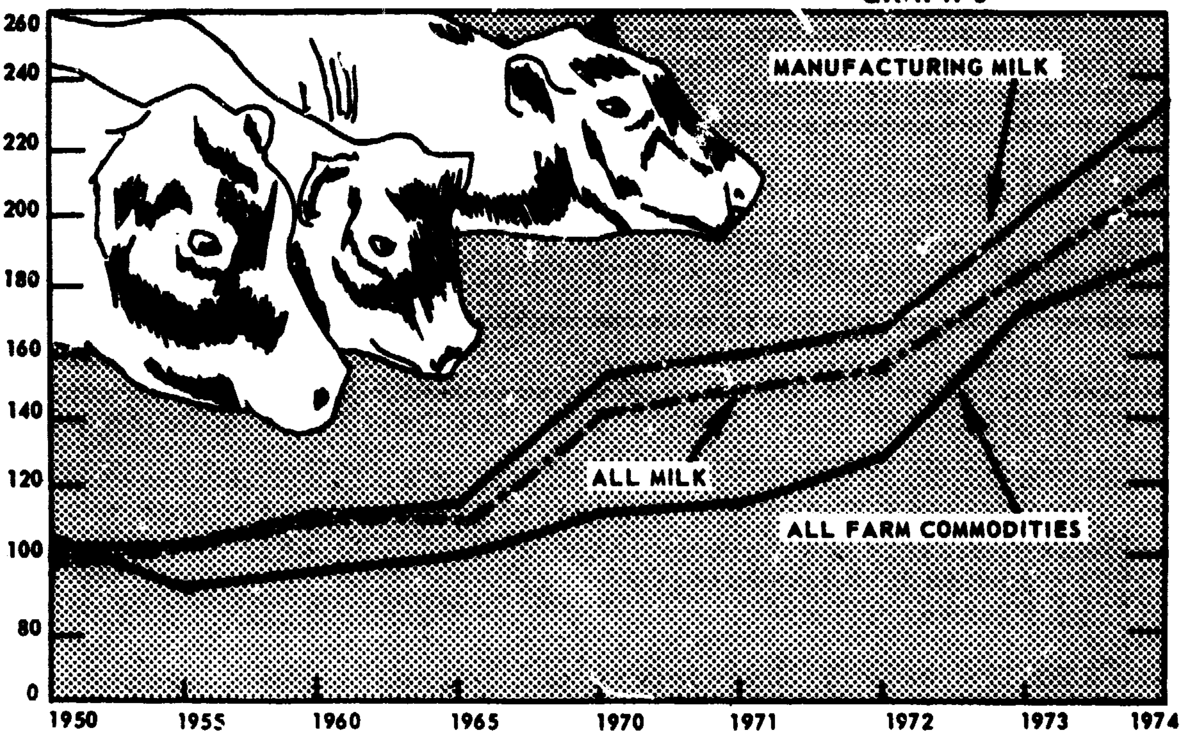
Producer prices

Agriculture officials acknowledge that dairy farmers have received higher prices for milk and cream as a result of the diary programs. However, most officials maintain that no accurate determination of this benefit is possible.

One indicator might be that milk prices at the farm level have increased at a faster rate than average prices for all farm commodities.

INDEX OF PRICES RECEIVED (1949=100)

GRAPH 3



SOURCE: PREPARED BY GAO FROM INFORMATION FROM THE DEPARTMENT OF AGRICULTURE

Since Government agencies have not consistently maintained records on the cost of milk production, projections of the income effects associated with the rising milk prices cannot be reliably calculated.

Consumer costs

Butter, cheddar cheese, and nonfat dry milk accounted for about 74 percent of U.S. manufactured dairy product consumption in 1974. New Zealand's estimated world trading prices for these three products and shipping costs to the United States were 51, 57, and 49 cents a pound, respectively. The U.S. average wholesale prices were 66, 80, and 59 cents a pound. Assuming the same price differential for remaining dairy products consumed in the United States, for which we were unable to obtain comparable world trade prices, we calculate that the U.S. consumer paid about $827 million more during 1974 than if retail prices had been based on the New Zealand world trading price. We recognize that lower priced exporters could not supply total U.S. requirements and that opening the U.S. market to imports would activate many economic variables affecting world trade and its price structure, so we have not attempted to estimate the dairy programs' actual cost to consumers through higher prices.

However, a report by a Brookings Institution economist estimates that the higher U.S. dairy prices have cost consumers about $500 million annually. The Department of Agriculture's December 31, 1974, report, "The Impact of Dairy Imports on the U.S. Dairy Industry," indicates that if the U.S. market had been opened to imports at the beginning of 1975, average short-term consumer savings of about $550 million a year could have occurred over the following 6 years. (See ch. 5.)

Taxpayer cost

The cost of administering the dairy programs is borne by the Department of Agriculture, the International Trade Commission, and the U.S. Customs Service. Costs were available only from the Commodity Credit Corporation, Foreign Agricultural Service (Import Operations Division), and International Trade Commission. In fiscal year 1974, the Commodity Credit Corporation estimated its administrative expenses for the price support program at $450,000. Its 1974 financial report shows a $101.1 million net loss on inventory operations consisting of domestic donations, transportation, storage and handling costs, and inventory adjustments. The Import Operations Division expenses for administering the quotas were $117,230. The International Trade Commission estimated 1974 dairy import investigation expenses at $110,522.

These costs totaled $101.8 million; however, 1974 tariff revenue accruing to the Government was $32.5 million, resulting in an estimated net taxpayer cost of $69.3 million.

CHAPTER 3

TRADE CONSIDERATIONS

Dairy industries in most countries receive government support because of the dietary and economic importance of milk and milk products and, frequently, the political importance of dairy farmers. To protect domestic producers from lower priced foreign supplies, governments use such varied measures as tariffs and quotas to regulate import trade. To dispose of surplus production, many governments have provided export assistance or direct subsidies so that their milk products can be sold in foreign markets.

The commercial dairy world consists basically of Western Europe, North America, and Oceania (Australia and New Zealand). World trade in principal manufactured milk products, butter and cheese, is carried on mainly between Oceania and Western Europe and, to a lesser extent, between Oceania and Western Europe to North America. Australia, New Zealand, Denmark, and the Netherlands export about 70 percent of all milk products (milk equivalent basis) moving in international trade. These countries, however, account for only 15 percent of the milk produced in the 15 major dairy countries.

TRADE BARRIERS

The following chart summarizes dairy programs and trade barriers in major dairy countries. (See note a.)

Country	Support program	Export assistance	Quotas	Licensing	Taxes on imports
United States	X	X	X	X	X
Canada	X	X	X	X	
European Community countries (note b)	X	X	X	X	X
New Zealand	X			X	
Australia	X	X		X	X
Norway	X	X	X	X	X
Austria	X	X	X	X	X
Sweden	X	X	X	X	X
Finland	X	X		X	X
Switzerland	X	X	X	X	X

a/An X following the name of the country indicates that the country uses that form of trade measure but does not indicate the degree to which the measure is used.

b/Belgium, Denmark, France, Ireland, Italy, Luxembourg, the Netherlands, the United Kingdom, and West Germany.

Price support and export assistance

Many forms of price support and export assistànce are used by various countries. For example, European Community countries are governed by that organization's farm support program--the Common Agricultural Policy. This program provides a target price for milk; intervention prices for purchases of butter, skim milk powder, and certain cheeses; and export subsidies.

Austria's support program consists of government-set prices at the production, processing, and marketing levels maintained by subsidies and export funds.

Quantitative restrictions and licensing

Many countries impose quotas, embargoes, or stringent licensing requirements. For example Canada has quotas on butter, cheese, and milk powders; Japan on dairy products, except some fresh milk and natural cheese; Norway on milk, cream, and cheese; Austria and the European Community on fresh milk; West Germany on casein for food or fodder; the United Kingdom on all butter, milk, cream, and cheese from East European countries; Switzerland on milk and cheese; and the United States on most dairy products.

Licenses are also required by many countries for imports of dairy products. Denmark licenses imports of milk, cream, and butter only from certain favored countries. Australia, Canada, Austria, New Zealand, South Africa, the United Kingdom, Ireland, Sweden, India, and Norway require licenses for some or all dairy imports.

Taxes on imports

Many countries tax dairy imports. For example, the European Community, Austria, and Sweden apply variable levies to imports to eliminate international price competition and to limit imports. Turkey uses supplementary charges or levies to increase the prices of dairy imports. Mexico employs a surtax of 3 percent on all dairy imports and the United States has tariffs on dairy imports.

U.S. QUOTA RESTRICTIONS

The United States, recognizing that all participants benefit from expanded trade, has worked for liberalization of trade in negotiations with many countries, particularly the European Community, and under the General Agreement on

Tariffs and Trade and other multilateral forums. However, contrary to the provisions of GATT, the United States in 1953 established import quotas on dairy products based on section 22 of the Agricultural Adjustment Act of 1933, as amended. In 1955 exporting countries restricted by the quotas granted a waiver under GATT which allowed the United States to depart from conditions it had agreed to under articles II and XI of GATT. The waiver was conditioned on the United States seeking a solution to the surplus problem and removing or relaxing the restrictions permitted under the waiver as soon as circumstances requiring such restrictions changed or no longer existed. Despite the terms of the waiver, U.S. quotas not only have been maintained for more than 20 years, but also have been extended to cover more products, as shown below.

Section 22 quotas initially established	Effective date
Butter; dried whole milk, buttermilk, whey, cream, and skimmed milk; malted milk; cheddar, Edam, Gouda, and blue-mold cheese; and Italian-type cheese in original loaves	July 1, 1953
Butter substitutes containing more than 45 percent butterfat and butter oil	Apr. 15, 1957
Some additional articles containing over 45 percent extractable butterfat	Aug. 7, 1957
American-type and natural (aged) cheddar cheese, milk and cream (fluid or frozen), and some articles containing between 5.5 and 45 percent extractable butterfat	June 30, 1967
Evaporated and condensed milk	June 10, 1968
Processed Edam and Gouda cheese; Emmenthaler (Swiss) and gruyere-process cheese; and "other" cheese if priced below a specified f.o.b. price	Sept. 24, 1968
Italian-type cheese not in original loaves and chocolate crumb	Jan. 6, 1969
"Other" low-fat cheese, low-fat chocolate crumb, ice cream, and animal feeds containing milk or milk derivatives	Dec. 31, 1970

Thus, although the intention of the waiver was the ultimate removal or easing of dairy quotas, the United States has often taken additional restrictive actions to protect the price support program.

Foreign government views of U.S. quota system

Foreign government attitudes toward U.S. quotas and the GATT waiver were mostly negative, notwithstanding their own restrictive trade practices, and may be influenced by their desire for greater access to the U.S. dairy market.

Australia and New Zealand

Officials believe that, in view of the domestic production and consumption situation, the annual U.S. quotas are outmoded and need to be reassessed in the light of current world dairy industry and economic conditions. New Zealand officials believe the quotas are outmoded and should be completely removed. Australian officials perfer quota elimination but would accept quotas under certain conditions; they stated that the Australian Government is strongly considering challenging the U.S. right to continue to fail to meet what they consider to be its GATT obligations.

Australia and New Zealand have questioned whether statements by the Secretary of Agriculture that the United States will only negotiate its restrictions on dairy products if other countries do likewise are consistent with U.S. obligations under the GATT waiver. As previously noted, the waiver was conditioned on the United States unilaterally removing or relaxing the restrictions as soon as circumstances requiring such restrictions changed or no longer existed.

United Kingdom

United Kingdom representatives expressed a desire for U.S. quota elimination. This position was based, in part, on a desire for trade liberalization. They feel that the restrictions have damaged the United Kingdom's trade opportunities, are not compatible with the U.S. professed goal of freer trade, and in many cases are not necessary to protect the U.S. price system. In particular, they believe that the U.S. quotas on chocolate crumb are unjustified and in violation of GATT, and they have, through the European Community, taken the issue to GATT for consultation.

Austria and Denmark

Austrian Government representatives felt that their countr ould "live with" the quotas.

Danish industry and exporter representatives were basically satisfied with the U.S. quota system and felt they too could live with the quotas. The industry has been able to export to the United States in satisfactory amounts and prefers the U.S. quota system to any other import control methods or to unrestricted trade. Denmark's satisfaction is based on its large quota allocations, including huge emergency quota increases, and the flexibility inherent in the price-break provisions which permit quota-free entry for certain products. Danish officials believe that the quotas have enhanced stable market development for their products in the United States and have assured Denmark of a major segment of the U.S. imported cheese market.

Germany and the European Community

Community representatives view the quotas as unnecessary protectionism. They criticize the unlimited duration of the GATT exemption, stating that it was intended as a temporary waiver. They contend that, by its continuance, the United States is avoiding its responsibility for promoting free and open trade.

German re tives would like U.S. dairy quotas to be eliminated siton was based, in part, on a desire for more liberal tra They feel the quota system has given an unfair advantage to historical exporters.

Officials at the German Embassy in Washington, D.C., expressed concern over the apparent double threat of quotas and countervailing duties and said other European countries are also disturbed about this situation. (A countervailing duty is an import tax equivalent to the amount the exporter receives as an export subsidy in his country; it negates the value of the subsidy.)

Canada

Most government and industry officials would like to see the U.S. quotas eliminated.

COUNTERVAILING DUTIES

Section 303 of the Tariff Act of 1930 (19 U.S.C. 1303) requires that the Secretary of the Treasury impose countervailing duties on imported products subsidized by foreign governments. The domestic dairy industry favors the duties, while foreign suppliers predict large decreases in their exports to the United States if the duties are imposed. Before passage of the Trade Act of 1974, however, the Government did not usually impose countervailing duties on dairy imports. The Department of the Treasury felt that the domestic industry was adequately protected by quotas, even though some imported dairy products, notably from the European Community, are subsidized.

Since 1968 domestic dairy industry representatives have requested that Treasury enforce the countervailing duty statute. Although Treasury did not deny the applicability of the statute, it did not impose countervailing duties on dairy products. Therefore, the National Milk Producers Federation brought action against Treasury in 1973 seeking a writ of mandamus to compel the Secretary to comply with the requirements of the Tariff Act of 1930. The federation maintained that the requirement to impose and collect countervailing duties against direct subsidies is mandatory and not subject to the Secretary's discretion and that Treasury's inaction resulted in the loss of millions of dollars in revenue to the United States.

In July 1974 the European Community suspended export subsidies on dairy exports to the United States because of the imminent announcement by Treasury of the levying of countervailing duties as a result of the legal action. After the suspension, the federation's case was stayed for 120 days. Before the court rendered a decision on the complaint, the Congress passed the Trade Act of 1974, which gave the Secretary authority to waive countervailing duties under certain conditions.

After the Trade Act was signed by the President in 1975, the European Community resumed export subsidy payments on all cheese except cheddar at lesser amounts than those before the suspension. The Community stated that the new reduced subsidies provided the basis for Treasury to issue a waiver of countervailing duties. U.S. industry representatives were disturbed by the reimposition of any subsidies and reminded Treasury that, before passage of the Trade Act, it had pledged not to exercise the temporary waiver of countervailing duties before consulting the U.S. dairy industry on such an action.

In April 1975, after extensive discussions between representatives of the European Community and the United States, the Community agreed not to reinstitute subsidies for butter and nonfat dry milk exports to the United States and dropped subsidies on all processing and Swiss-type cheeses, but it retained its subsidy program for specialty cheeses. The U.S. Government determined that the criteria providing for a waiver of countervailing duties had been met and granted a waiver for the specialty cheeses. This resolution of the European Community export subsidy problem led to a dismissal in Federal district court of the National Milk Producers Federation action.

As a result of the controversy surrounding the countervailing duty issue and continued requests from the U.S. dairy industry, Treasury during the past year began investigations on cheese imported from Switzerland, Austria, Finland, Norway, and Sweden. It issued preliminary determinations during 1975 that these countries all are subsidizing Swiss-type cheese exports to the United States. In January 1976 waivers of countervailing duties were granted to Switzerland and Austria after Switzerland had agreed to not reduce its cheese export prices and not to exceed its historical export levels to the United States and Austria had agreed to eliminate its subsidy on Emmenthaler Swiss cheese by September 1976. No final determination regarding the Finland, Norway, and Sweden investigations had been made as of January 1976.

CHAPTER 4

EFFECTS OF PROGRAM CHANGES AND ALTERNATIVES

Several alternative courses of action are available for establishing a national dairy policy and programs for its implementation. Each has advantages and disadvantages for the various concerned interests.

A protective policy that includes programs of price support, quota restrictions, and tariffs maintains a higher level of prices for the producer, while shielding him from foreign competition, and tends to assure the consumer of an adequate supply of domestically produced milk. A policy that would eliminate or modify the price support program and allow free access to the U.S. market is consistent with U.S. objectives of freer international trade and would result in reduced costs to consumers and taxpayers.

To avoid supporting world prices at artificially high levels, the United States would have to adjust its price support program under any alternative that allows increased imports. If quotas were removed, increased imports could be expected from some countries, particularly Australia and New Zealand. These countries are major exporting areas and could profitably ship dairy products to the United States without subsidies, primarily due to the low costs of their dairy production, as shown below.

Estimated Cost of Producing and Shipping Selected Dairy Products to the United States (note a)
(U.S. cents per pound, 1974, and U.S. cost of production at plant)

Countries	Butter	Nonfat dry milk	Cheddar cheese
Australia	46.80	44.97	55.84
New Zealand	37.53	38.02	47.24
The Netherlands	80.27	60.95	88.98
Germany	83.18	69.33	90.30
Belgium	83.58	67.65	84.05
France	80.55	63.27	-
United States	64.34	58.26	74.34

a/ Total break-even prices to U.S. east coast.

Source: Agriculture, Economic Research Service.

The potential increase in supply of dairy products from New Zealand and Australia is limited by their production capabilities through 1980. These two exporters produced only 14 billion and 16 billion pounds of milk, respectively, in 1972 on a 3.67-percent butterfat basis. This compares with 119.9 billion pounds produced by the United States and 210.9 billion pounds produced by the European Community that year.

Australian dairy officials said that they could increase production by 25 percent if the U.S. market was available on a constant basis and if new producers were willing to enter the industry. They were unable, however, to estimate the increase in the volume of products that would be exported to the United States. New Zealand officials stated that exporters would greatly increase their shipments to the United States if the quotas were removed.

Estimated Producing, Shipping, and Tariff Costs for Selected Cheeses Compared with U.S. Wholesale Prices January 1975

Country	Cheese type	European cost for cheese imported into U.S. (note a)	U.S. wholesale price for domestic cheeses
		(cents per pound)	
West Germany	Edam	95	140-163
	Gouda	109	104-126
	Blue (Danish origin)	116	107-116
Italy	Parmesan	150	129-165
	Provolone (aged 6 months)	120	120-130
Denmark	Edam	95	93-120
	Blue	116	107-116
The Netherlands	Gouda	109	97-126
	Edam	95	93-120

a/Agriculture's estimate of unsubsidized cost at U.S. east coast.

Although European producers are not cost-competitive with the United States on such dairy products as butter, nonfat dry milk, and cheddar cheese, they appear to be competitive on certain other cheeses. So, in the absence of quotas, they might be in a position to continue exporting some of these products to the United States.

Thus, if quotas were increased and price supports modified over several years, leading toward ultimate removal, dairy imports would increase and U.S. production and consumer prices would probably decrease. The increased imports would cause some dislocation in the domestic industry.

AGRICULTURE'S ANALYSIS OF THREE ALTERNATIVES

The Agriculture and Consumer Protection Act of 1973 required the Secretary of Agriculture to conduct a study to determine the effect that increased levels of dairy imports would have on domestic producers, handlers, processors, and consumers. The study, submitted to the Chairman of the Senate Committee on Agriculture and Forestry on December 31, 1974, analyzed three trade alternatives for the period 1975-80.

1. Continued policy of import quotas for dairy products at the current section 22 level, along with the price support program.

2. Free trade in dairy products in the United States and abroad.

3. Open U.S. market policy with no dairy import quotas or price support program.

Agriculture based its analysis on projected supply and demand and dairy policies in major dairy areas under the three alternatives and made many assumptions in analyzing each alternative. The study cautions that the data is intended to illustrate the direction and magnitude of expected changes under each alternative and that this should be kept in mind when drawing conclusions from specific numbers. The study also noted that the imports likely to enter the United States under any of the three alternatives would not interfere with fluid milk markets.

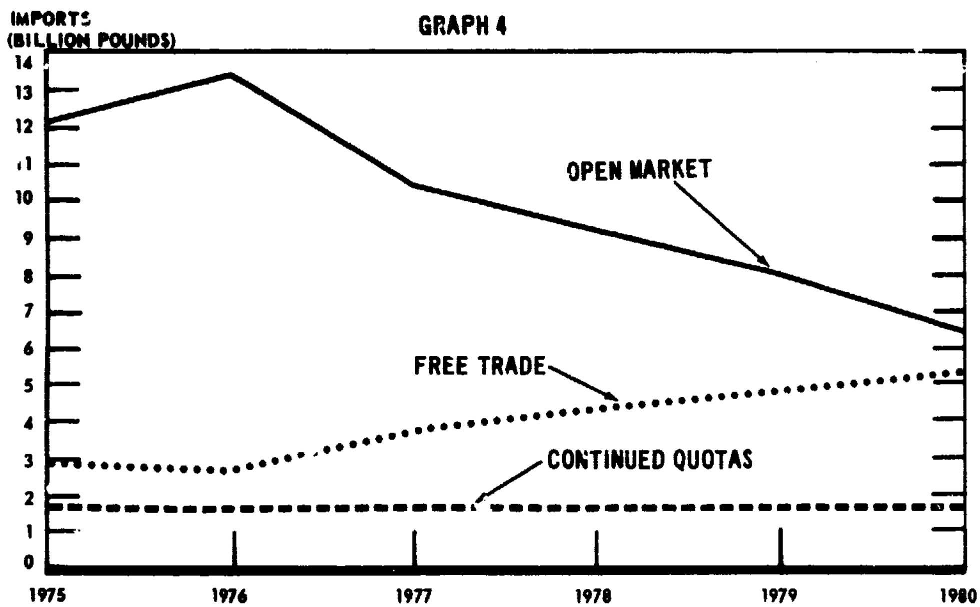
Under the current policy, import quotas would be continued at present levels along with the price support program.

Under free trade, all countries would eliminate trade barriers, subsidies, and price support programs and allow a free flow of dairy products. Dairy prices would move toward a world price.

An open U.S. market policy would eliminate U.S. import barriers while all other countries would be free to pursue their individual dairy policies, including imposing trade barriers and providing export subsidies. Both an open market policy and the free trade alternative would necessitate eliminating the U.S. dairy price support program.

The study indicated that imports under continued quotas would remain at about the current level of 1.7 billion pounds, or 1.5 percent of U.S. production. Under the free trade alternative, imports would rise gradually to 5.3 billion pounds by 1980. With an expected short-term surplus of dairy stocks in the European Community, Agriculture reported that an open U.S. market, which would be the only major unprotected market, would result in an immediate import upsurge to 12.2 billion pounds during 1975. By 1980, due to the reduced European surplus, imports would decline to 6.7 billion pounds. The study states that countervailing duties would have little, if any, effect on the results of the open market analysis. Graph 4 shows the estimated imports in milk equivalents that Agriculture believes would enter the United States under the three trade alternatives.

GRAPH 4



SOURCE: PREPARED BY GAO FROM INFORMATION OBTAINED FROM THE DEPARTMENT OF AGRICULTURE

Impact on domestic prices and production

Under continued quota regulation, Agriculture estimated that farm-level wholesale milk prices would rise 17 percent, from $8.90 a hundred pounds in 1975 to $10.39 in 1980. Because free trade would cause increased world competition for the U.S. market, prices under this alternative would increase at a slower rate, estimated at 11 percent, or from $8.77 a hundred pounds to $9.72, or 67 cents less than the 1980 price under a system of continued quotas. The immediate upsurge of imports under an open U.S. market would lower prices to $6.94 a hundred pounds in 1975. Since such a large price decline would be disruptive and cause many producers to leave dairying, Agriculture believes that a tight supply condition would develop as subsidized imports from Europe declined and that milk prices would rise to $10.90 a hundred pounds, or 57 percent, by 1980; 51 cents a hundred pounds above the 1980 price under a system of continued quotas.

Based on these projected pricing trends, Agriculture estimated that domestic dairy production and consumption would increase under both continued quotas and free trade. Under an open U.S. market system, production would initially drop but would recover somewhat during later years while consumption would initially surge upward and then steadily decrease through 1980.

Estimated U.S. Milk Production and Consumption

Year	Continued quota		Free trade		Open U.S. market	
	Production	Consumption	Production	Consumption	Production	Consumption
	(billion pounds)					
1975	114.8	113.7	114.1	114.2	111.0	120.4
1976	117.0	114.4	116.4	114.8	107.2	116.3
1977	118.0	116.2	116.8	117.2	109.3	116.3
1978	118.6	116.9	117.1	118.0	110.3	116.1
1979	119.0	117.3	117.2	118.7	111.2	115.8
1980	119.0	117.4	116.9	118.9	111.6	115.0

Regardless of import policy, the number of U.S. dairy farms and manufacturing plants is expected to decrease. Even under continued quotas, Agriculture estimated that 181,600, or 47 percent, of U.S. dairy herds existing in 1973 will disappear by 1980 through consolidation into larger herds or culling and that there will be 20 percent fewer cheese plants and 44 percent fewer butter plants in 1980 than in 1972. This follows a general trend in the agricultural sector toward larger, more efficient production entities.

Under free trade, 185,800 dairy farms would discontinue production as single units by 1980, 4,200 more than if quotas were continued, and there would be 20 percent fewer cheese plants and 47 percent fewer butter plants in 1980 than in 1972.

Under an open U.S. market, 198,900 farms would discontinue production as single units by 1980, 17,300 more than if quotas were continued, and there would be 26 percent fewer cheese and 56 percent fewer butter plants in 1980 than in 1972.

Retail price projections for fluid milk, American processed cheese, and butter were estimated for each alternative. Under continued quotas, consumer prices would range from 16 to 26 percent higher in 1980 than in 1974, or about 3 percent greater than under the free trade alternative. Under an open U.S. market, consumer prices would be lower from 1975 through 1978 due to the expected increase in imports. Open market prices would be higher than under continued quotas in 1979 and 1980.

Retail Prices for Selected Dairy Products, Actual 1974 and Projected 1975 and 1980

Product	Actual 1974	Continued quota 1975	Continued quota 1980	Free trade 1975	Free trade 1980	Open market 1975	Open market 1980
	(U.S. cents)						
Fluid milk (half gallon)	78.4	77.8	91.2	77.2	88.3	69.3	93.4
American processed cheese (pound)	145.8	147.8	176.2	146.6	169.5	128.6	181.2
Butter (pound)	94.6	98.1	119.4	97.0	113.7	81.8	123.6

Over the 6-year period covered by the study, however, open market prices would average 2.1 cents per half gallon of fluid milk, 4.9 cents per pound of American cheese, and 4.1 cents per pound of butter less than prices under continued quotas. Based on 1974 rates of commercial consumption for fluid milk, American cheese, and butter and on the average price differentials above, an average annual price saving for consumers of about $382 million a year over the 6-year period would result on these products alone from an open U.S. market.

Overall, compared to projected farm milk pricing trends under continued quotas, the study indicates that annual consumer savings would steadily increase under free trade, reaching about $800 million in 1980 with a corresponding reduction in farm level milk prices. An open market would result in average annual consumer savings of about $550 million a year over a 6-year period.

Analysis of study results

In analyzing the study results, several points must be noted. First, the study examined the direction and magnitude of changes under the three alternatives for 1975-80 only. A 10- or 15-year projection might have produced different results. For example, under the open market policy, the more efficient dairy exporting countries should obtain a greater share of the U.S. market in the long term, causing dairy prices to eventually hover around a lower level than under a continued quota policy.

Department of Agriculture study leaders agreed that if the study had been extended beyond 1980, the long-term average prices under an open market would be lower although less stable than prices under continued quotas.

Second, the U.S. open market alternative was considered under the assumption that the market would be suddenly and completely open to imports, drawing a large percentage of the expected short-run European surplus into the U.S. market in the early years of the 1975-80 period. This initial increase in imports would cause large numbers of dairy farmers to leave the industry. After this adjustment to a higher level of imports, the level would decline in the latter years of the period as the European surplus declined. This would cause a tight market, and consumers would pay higher prices in 1979 and 1980 without quota protection.

The short-run adjustment would be much less than suddenly eliminating quotas if quotas were gradually increased over 5 to 10 years leading to an open market. This observation is supported by the free trade alternative, which indicated that gradually increasing the level of imports would eventually result in lower consumer prices and would only moderately accelerate the trend toward fewer dairy herds and manufacturing plants. Agriculture study leaders agreed with this observation.

Third, the study concludes that the actual quantity of imports in the United States would, in the short run, be about the same under an open U.S. market policy with or without the application of countervailing duties against subsidized imports. The study did not analyze the effects of countervailing duties on farm-level or consumer prices under the open market alternative.

PROGRAM ALTERNATIVES

Within the framework of alternatives, ranging from a high level of protection of the domestic dairy industry to free import access to the U.S. dairy market, we believe several programs warrant consideration. We have assumed that the United States would enforce its countervailing duty laws under any alternative.

Price support

The present price support program supplemented by import quotas is designed to assure an adequate supply of domestically produced dairy products by guaranteeing a minimum price for production.

Advantages

1. Assures the consumer an adequate supply of domestically produced milk.
2. Helps stabilize price of dairy products to the consumer.
3. Protects dairy industry by guaranteeing minimum price for dairy products.

Disadvantages

1. Required import restrictions are inconsistent with U.S. policy of trade liberalization and have negative foreign policy implications.
2. Causes consumers to pay higher prices for products than under less protective programs.
3. Stimulates overproduction at higher support levels.
4. Tends to support some inefficient domestic producers.
5. Incurs Government costs for purchasing dairy products and administering dairy programs.

Agriculture, in commenting on this alternative, stated that the milk price support program is mandatory and is likely to remain so and that the import quotas, for which no satisfactory alternative has been found, are necessary to protect the program's viability. Agriculture believes that the present program is the most workable of any alternative.

However, Agriculture has publicly supported a position that the United States is willing to reduce its dairy restrictions if other countries will also liberalize their restrictive measures during the multilateral trade negotiations. As previously noted, any U.S. action that allows increased imports would necessitate changes in the price support program or the United States would wind up supporting world dairy prices at the artificially high U.S. level.

Supply management

A supply management system would maintain the domestic industry at a desired production level through the use of production limitations and import quotas. The domestic production limitation could be effected by allocating quotas among domestic producers. Global import quotas could be established to allow foreign participation in the U.S. market on the basis of production efficiency.

Advantages

1. Protects and maintains dairy industry at a stipulated level.
2. Helps stabilize prices by controlling supply.
3. Reduces foreign policy complications implicit under the present allocation of quotas by insuring, theoretically, imports from the most efficient foreign sources.
4. Incurs Government costs only for program administration.

Disadvantages

1. Causes consumers to pay higher prices for products than under some other programs due to supply limitation.
2. Has negative foreign policy implications toward exporting countries unable to compete for U.S. market under global quotas, due to their relative inefficiency.
3. Tends to support some inefficient domestic producers causing additional upward pressure on consumer prices.

Disadvantages

4. Requires allocating production quotas among domestic producers, which would be a difficult administrative task and would establish market rights that might be capitalized into the cost of production.

5. Inconsistent with U.S. goal of trade liberalization.

6. Builds rigidities into resource allocation.

Agriculture stated that, although supply management proposals have been discussed in the past, neither the dairy industry nor the Congress has favored these proposals and that supply management is inconsistent with other recently legislated commodity programs.

Price differential subsidy

A price differential subsidy program would establish a desired price level for domestically produced milk. When the market price is below that level, the Government would pay the difference to the producer. Payment limitations could be established to minimize Government costs. A reasonable subsidy program could also eliminate import restrictions, thus allowing U.S. prices to be determined by the market and encouraging greater market flexibility while still protecting producers' income to some extent.

Advantages	Disadvantages
1. Allows U.S. consumers to purchase dairy products at prices dictated by the market.	1. Placed direct liability for program costs on U.S. taxpayers when market prices are below the established price level.
2. A reasonably determined established price would allow consumer demand	

Advantages	Disadvantages
to have greater influence in determining production levels.	2. Could perpetuate inefficient producers.
3. Allows imports to compete in U.S. market with no import restrictions, in line with U.S. trade policy objectives of more liberalized trade.	3. Does not stabilize prices.
4. Protects U.S. producer interests by guaranteeing minimum revenues for products.	

Agriculture commented that:

"Proposals for direct payments to milk producers as a means of income support have never had the support of producers or of the Congress, nor does this Department favor such payments; further, it is unlikely that the authority for such a program could be enacted without concurrent enactment of authority for supply management. If a price differential program were adopted and import restrictions eliminated, the effect of imports on this form of government assistance would be much the same as with the present price support program--the larger the imports, the larger the total federal payments. Thus the accuracy of the statement that 'A reasonable subsidy program could also eliminate import restrictions' is questionable."

Although we do not endorse any specific alternative, the rationale for a price differential subsidy would be to make U.S. dairy products more competitive with foreign products. The lower priced U.S. products would reduce the need for import restrictions.

Tariff

A tariff program would offer price protection to the U.S. dairy industry, especially during surplus periods, but would increase consumer prices. A high fixed tariff would be inconsistent with U.S. trade policy objectives.

A flexible tariff system, however, could alleviate many of these problems. The duty could be adjusted to achieve a desired balance between maintaining the domestic industry and providing reasonable prices to consumers.

Advantages	Disadvantages
1. Requires no Government payment or product purchases.	1. Causes consumers to pay higher prices for products than under less protective programs.
2. Generates revenue to U.S. Government.	2. Contradicts U.S. international trade objectives if variable import levy or high fixed tariff is used.
3. Requires no quantitative import or domestic production restrictions if flexible tariff is used.	3. Does not stabilize prices to any significant degree.
4. Protects producers' interest by increasing the price of imported products.	

Agriculture stated that, as long as the support program remains in effect, this alternative does not merit consideration because tariffs are not a reliably effective means of controlling imports unless they are set at prohibitively high levels.

We agree that a change from quotas to tariffs would require elimination or modification of the price support program.

Open U.S. market

An open U.S. market for dairy products would involve a policy decision not to protect the U.S. dairy industry. Under such a policy, no programs would be in effect. The United States would obtain dairy products from domestic and free world markets at prevailing prices. Domestic producers and manufacturers, if injured by low-cost imports, could seek adjustment assistance under authority granted in the Trade Act of 1974.

Advantages	Disadvantages
1. Eliminates all U.S. trade restrictions on dairy products, thereby promoting more efficient resource allocation in the United States.	1. Does not stabilize prices.
2. Allows U.S. consumers to purchase dairy products at prices dictated by the market and to determine consumption levels based on the market price.	2. Could lead to greater reliance on foreign sources.
3. Minimizes Government costs.	3. Adversely affects less efficient U.S. producers, causing some dislocation and some compensation from the Government.
4. Allows imports to compete in U.S. market, in line with U.S. trade objective of more liberalized international trade.	

Agriculture said the legislative history of the dairy support program indicates that favorable consideration of an open U.S. market by the Congress is extremely unlikely.

International commodity agreement

An international commodity agreement for dairy products could represent a possible framework for regulating and stabilizing dairy trade. It could include a wide range of features, such as supply, access, and price agreements; reduction of tariffs; maintenance of reserves; reduction or elimination of export incentives; and many others. As a major dairy producer, the United States could take the initiative in proposing negotiations for an international agreement on dairy products.

Advantages	Disadvantages
1. Could provide more stable prices for producers and consumers worldwide.	1. Could pose problems in U.S. negotiating stance at upcoming multilateral trade

Advantages	Disadvantages
2. Could provide a measure of assurance of adequate supplies.	negotiations, e.g., trade liberalization versus commodity agreements.
3. Could provide more open and fair trade than currently exists.	2. Could lead to greater reliance on foreign sources.

Agriculture strongly doubts that international dairy trade problems can be solved by imposing global supply management through an international committee or secretariat. Agriculture said that nonobservance of agreement rules by participating countries has been widespread recently, including the Arrangement for Certain Dairy Products (nonfat dry milk and butter oil) originally negotiated in 1970. (The United States was not a participant.)

Worldwide free trade

Worldwide free trade for dairy products would require worldwide policy decisions not to protect the dairy industry. Under such a policy, no country would have support programs, export incentives, or trade restrictions on dairy products. Since the Unites States cannot control dairy policy in other countries, this alternative might be unattainable. U.S. negotiators, however, could try to effect a worldwide free trade policy for dairy through multilateral trade negotiations.

Advantages	Disadvantages
1. Eliminates all trade restrictions on dairy products, thereby promoting more efficient resource allocation worldwide.	1. Could lead to greater reliance on foreign sources.
2. Allows all consumers to purchase dairy products at prices dictated by the market and to determine consumption levels based on the market price.	2. Adversely affects less efficient U.S. producers, causing some dislocation and some compensation from the Government.

Advantages

3. Is in line with U.S. trade objective of more liberalized international trade.

4. Minimizes U.S. Government costs.

Agriculture stated that worldwide free trade is not attainable within the foreseeable future and is not a practical option. At the same time, Agriculture indicated that it believes progress is possible in reciprocal reduction of tariffs and nontariff barriers to trade and in the reduction or elimination of export subsidies and other trade-distorting devices. Agriculture said it is cooperating in the pursuit of these objectives in the Multilateral Trade Negotiations in progress at Geneva, Switzerland.

CONCLUSIONS AND AGENCY COMMENTS

The dairy industry, a significant element of U.S. agriculture, is a vital segment of our domestic economy and produces one of the most essential commodities in our diet. Therefore, the domestic dairy industry has been highly protected from foreign competition, assuring consumers of an adequate supply of domestically produced milk and dairy products while providing producers with adequate and more stable prices.

The costs of these benefits and the industry's stabiity have been borne by the consumer and taxpayer in the form of higher prices and governmental program costs. A move toward liberalizing dairy trade could substantially reduce this cost and also would be consistent with existing international agreements and U.S. efforts to reduce trade barriers.

One of the most important elements in assessing alternatives to present U.S. policies and programs is the effect of changes on the domestic dairy industry, which had retail sales of $19 billion in 1973. Dislocation or disruption of the 385,000 producers and the dairy-processing industry and its employees could have an adverse economic impact. However, Agriculture estimates that, even under the present system of price support and protective import quotas, the number of domestic dairy herds and production facilities will continue to decrease significantly.

The Trade Act of 1974 authorizes the President to negotiate trade agreements providing for reducing or eliminating nontariff barriers and other distortions of international trade. The Congress has urged the President to obtain equivalent reduction of barriers within the entire agricultural sector. As the new round of trade negotiations begin, U.S. negotiators are seeking to promote the development of an open, nondiscriminatory, and fair world economic system and to stimulate fair and free competition between the United States and other trading nations. We recognize, however, that governments have been unwilling to consider substantive liberalization of their dairy trade policies for fear of being unable to stabilize their own supplies, producer incomes, and consumer prices.

A system of free trade for agricultural products would benefit consumers through lower prices for dairy products. Agriculture's December 1974 study indicates that annual consumer savings would steadily increase under free trade, reaching about $800 million during 1980, with a corresponding reduction in farm-level dairy prices to the producer.

Under a system where the United States would unilaterally open its market to imports, the Agriculture study indicates average consumer savings over a 6-year period of about $500 million a year, with an initially substantial adverse effect on the domestic dairy industry. The adverse effect would result from a first year drop in farm-level milk prices of about 22 percent due to imports of a surplus supply of subsidized dairy products. As the surplus was exhausted, producer prices under the open market would rise in the fifth and sixth year to a level higher than under the present system.

The study did not consider the price effects of a gradual increase in quotas, with countervailing duties to protect against selling subsidized surpluses into the U.S. market or the long-range effect of opening the market after the short-term adjustment necessary due to the selling of subsidized surpluses. It appears that, with certain modifications, the economic results of changing to an open market for dairy products would be comparable to those available under free trade.

In commenting on our report, the Department of Agriculture stated that the U.S. policy of trade liberalization is multilateral in concept and objectives, and cannot be realistically regarded as a policy under which the United States would eliminate its import controls while the restrictions and related trade distortions of other countries remained in force. All leading trading nations control their agricultural trade to some degree, and the United States is one of the most liberal. Dairy products are particularly subject to government controls; every major producing country controls imports and many also control exports. In such a trading environment, complete elimination by the United States of its dairy import controls would result in unacceptable costs to the American economy and to the Federal budget. If liberalization is to be achieved, it must be in a multilateral context with necessary safeguards.

In view of the possible benefits to the American consumer and taxpayer and the possibility of moving toward a more liberal trade posture, consideration should be given to altering or modifiying the present dairy policy. We believe the Secretary of Agriculture, in conjunction with other agencies, should analyze and define viable alternatives or modifications which balance the interests of the dairy industry, consumer, taxpayer, and international trade objectives.

Such an analysis should deal with alternatives that could be reasonably instituted under present and projected domestic and international economic conditions. For example, any study of open market alternatives should consider the overall economic effects of gradual versus instant change and actions authorized by the Trade Act of 1974, particularly countervailing duties, antidumping penalties, and provisions relating to unfair competition in third-country markets. Such studies should also examine the cost of price support to the U.S. Government compared with the cost of adjustment assistance to the dairy industry and its employees under free trade or an open market.

In contrast to the views of the Department of Agriculture, the Department of State commented that it would be particularly interested in further studies on possible gradual approaches to reducing or eliminating import quotas. State agreed with the assessment that the elimination of all barriers to trade in dairy products is unlikely and that the unilateral elimination of American restrictions would be disruptive; however, it may be possible for the United States to devise a first step which, without harm to American producers, could be instrumental in beginning to reduce barriers internationally. For example, State suggested that the United States might consider quotas geared to a certain percentage of annual consumption, as an alternative to the present system which sets quotas in fixed amounts.

We believe that State's suggestion is a constructive and positive move toward identifying viable modifications or alternatives to the present dairy programs. We agree that complete and sudden elimination of all barriers to dairy trade would be disruptive, and could result in unreasonable adverse impact on producers.

RECOMMENDATION TO THE CONGRESS

In view of the possible benefits, the Congress should instruct the Secretary of Agriculture, in conjuntion with other agencies, to analyze and define viable alternatives or modifications to the present protective system of dairy import quotas and related modifications to the domestic dairy program, and have such alternatives or modifications submitted for consideration and possible legislative action.

CHAPTER 5

QUOTA ADMINISTRATION

Under the present price support program, there are certain problems relating to the administration of the protective import quotas. If the price support option is considered the most viable for the U.S. dairy program, we believe these administrative matters should be resolved.

Because U.S. prices for many dairy products are substantially above prices prevailing in important world markets, the U.S. market offers attractive profit rates on imported dairy products. Thus, there is a strong incentive to foreign producers to export dairy products to the United States. The price differences also provide opportunities, within the quantitative quota amounts, for high profit margins by the firms holding licenses to import dairy products. License holders also acquire monopolistic control over imported cheese subject to quotas.

Other administrative problems associated with the dairy quota system are:

--Country quota allocations do not provide for changing trade patterns.

--Exporters can avoid some quotas through price manipulation of different cheeses.

--Actions to increase quotas were not responsive to the tight supply condition that occurred during 1973-74.

LICENSING SYSTEM

The Presidential proclamation that established the original section 22 quotas in 1953 provided that the quotas be administered under an import licensing system. The requirement has since been included in part 3 of the appendix to the Tariff Schedules of the United States. Most dairy quotas established since 1953 have been administered under licensing regulations developed by Agriculture's Foreign Agricultural Service.

Under the system, imports can only be entered by or for the account of a license holder. A license specifies the product and quantity a holder may import, the product's country of origin, and the U.S. port through which it may enter. Once a license has been issued, if properly used, it may be renewed each year.

The Secretary of Agriculture is required to issue licenses in a manner which will result in an equitable distribution of quotas among importers or users while allocating quotas among supplying countries based on U.S. imports from them during previous representative periods. Agriculture issues two types of licenses.

--Historical licenses are issued to importers who were importing a quota product during a representative base period. The licensed quota shares are issued to importers in proportion to the volume of their imports during the base period.

--Nonhistorical licenses are issued to other firms under a setaside (10 percent of most quotas) reserved for new business. Such licenses, which have been issued since the late 1960s, are allocated to importers that meet certain requirements.

The difference between the U.S. price and the world market price gives the licenses a significant economic value. This value is transferred by the Goverment to importers without charge. Foreign government and industry representatives say some importers prefer to sell their import rights to another firm and collect an immediate profit in the form of a surcharge on the amount of the product, particularly cheese, that is imported. The officially licensed importer, however, receives credit for the imports and thus maintains the license from year to year. This practice is more prevalent with nonhistorical licensees, whose license amounts are relatively small and, according to Department of Agriculture officials, is actively encouraged by those governments, such as New Zealand and Finland, which have exclusive representatives for sales to the United States.

Foreign representatives stated that the standard surcharge rate is between 2-1/2 and 4 cents a pound and that this charge is usually passed along to U.S. consumers in higher prices. One foreign industry spokesman estimates that license trading involves about half the licensed cheese imported into the United States.

The New Zealand Dairy Board says it has annual quota expenses of about $255,000, of which $150,000 is for purchasing the use of U.S. import licenses. There are about 200 U.S. importers from whom the Board may purchase licenses. Many licenses are for very small quantities of dairy products, and the Board considers this purchase necessary to consolidate shipments and simplify shipping procedures.

Department of Agriculture officials are aware that the use of some licenses has been sold but point out that this is very difficult to prove. In theory, Agriculture can suspend an importer's license if it finds the importer has improperly sold his quota shares. However, if the importer challenges such a decision, it cannot be made effective without a formal administrative hearing, including submission of conclusive proof by Agriculture that the importer may properly be deprived of his rights.

Early in 1974, more than 2,500 dairy import licenses were held by 518 companies. About 44 percent of these were historical and 56 percent nonhistorical licenses.

Some foreign government officials, producers, and exporters have charged that the U.S. dairy quotas and the licensing system give some importers monopolistic control over prices and access to the U.S. market. The system, as shown in the chart below, has resulted in a few companies obtaining licenses for a large percentage of some quota categories. This is because these companies could claim large shares of imports in the base periods for the quotas concerned.

Major License Holders For Selected Quota Categories--1973

Category	Total quota	Number of companies	Percent held
	(pounds)		
American cheese	6,096,600	2	48
Emmenthaler Swiss cheese	20,420,000	3	52
Blue-mold cheese	5,016,999	9	64
Dried skimmed milk	1,807,000	3	100

Under current regulations, the same companies can continue to receive these large historical quotas as long as the program exists. Historical license holders can also sell their license rights along with the sale of their business.

Agency comments and our evaluation

The Department of Agriculture defended the licensing system by stating that licensing prevents domination of the import market by large, financially powerful importers and export monopolies of foreign governments that could eliminate all competition in the dairy import market. Agriculture stated that an alternative to the present method of issuing licenses such as auctioning would not enhance competition or prevent windfall profits.

One of our principal concerns is that import licenses have an economic value and, under the current licensing program, this value accrues to importers and exporters in the form of additional profits. Auctioning of the import licenses should transfer this value to the U.S. taxpayer and thus prevent windfall profits from license use sales.

In our opinion, Agriculture's concern for competition in the dairy import market is paradoxical considering that Agriculture supports the highly regulated dairy programs that limit domestic competition and prevent foreign countries from competing in the U.S. market. Additionally, a small number of importers control a large percentage of the quota allocations.

Recommendation to the Secretary of Agriculture

The Secretary of Agriculture should analyze whether to continue the quota licensing system for importers and, if it is continued, develop methods for issuing licenses (auctioning, for example) that would provide equity to importers and transfer the economic value created by the licenses to the Government.

COUNTRY ALLOCATION METHOD

All quota amounts, except for Canadian aged cheddar cheese, are based on import periods which the President considered to be representative of import trade at the time quotas were imposed. Most quotas were allocated among several countries, while a few were allocated entirely to one country, which was the sole supplier during the representative period.

Some foreign governments, especially those whose production and export trade had been disrupted by World War II, have complained about the allocation method, noting that the representative trade periods are outmoded and give an unfair advantage to historical suppliers. The representative period on which the butter quota is based is for a pattern of trade that existed over 40 years ago, as shown below.

Commodity	Representative period
Butter	1930 to 1934
Certain milks, creams, and cheeses	1948 to 1
Butter substitutes	1956
Cheddar cheese, American-type cheese, and substitutes	1961 to 1965
Milk and cream	1962 to 1966
Cheese or substitutes processed from Edam or Gouda, some Italian-type cheese, and chocolate crumb	1965 to 1967

The General Agreement on Tariffs and Trade states that, in applying import restrictions, countries shall try to distribute trade to approximate as closely as possible the shares the parties might be expected to obtain in the absence of such restrictions. Some countries have complained that U.S. quota allocations do not follow this premise.

Under worldwide free trade conditions, Agriculture has estimated that the most efficient dairy producers, New Zealand and Australia, would supply 80 percent of U.S. dairy imports by 1980. As shown in the table on the following page, however, these two countries receive only 29 percent of the normal U.S. quota.

	Normal U.S. allocation in milk equivalents	Percent of U.S. quotas normally received	Percent of trade in 1980 under free trade
	(million pounds)		
European Community	532	41	15
New Zealand	314	24	50
Australia	61	5	30
Other countries	395	30	5
	1,302	100	100

The present quota shares are expected to remain constant because there are no provisions for altering country allocations on the basis of changes in efficiency or ability to produce and export.

The provisions for reallocations cover only temporary periods within 1 quota year, and reallocations must be made to other historical supplying countries. This provision has limited applicability for meeting changing trade patterns, as shown by an example of the chocolate crumb quota.

Australia requested a partial reallocation of the chocolate crumb quota since countries allotted it had not completely filled the quota in any of the 5 years since it was established in 1969. According to an Agriculture official, Australia was not eligible for a reallocation because it was not a supplier of chocolate crumb during the representative trade period. In 1974 the eligible quota countries filled only 28 percent of the total quota.

Agency comments and our evaluation

Agriculture stated that the purpose of country quota allocations is to be fair and impartial to the supplying countries and also to conform with the relevant provisions of GATT. It observed that supplying countries prefer an allocation system to a global quota and that foreign policy considerations will accordingly continue to favor an allocation system. Although admitting that some foreign countries feel quotas should "recognize trade patterns that would develop in the absence of quotas," Agriculture commented that shares of total world trade cannot logically be equated with ideal shares of U.S. imports.

We agree that allocating quotas among countries is more equitable than having global quotas on a first-come-first-served basis. Therefore, we support Agriculture's view that if quotas are continued, they should be allocated to supplying countries.

We disagree, however, with Agriculture's contention that world dairy trade cannot logically be equated with ideal shares of U.S. imports. Agriculture's economists predicted percentages of trade in 1980 under hypothetical free trade conditions, and we believe they could estimate, in cooperation with supplying countries, import shares of the U.S. market that would develop in the absence of quotas. Although these estimates could not be precise, import quotas based on this concept would accomplish the trade objective of rewarding the more efficient producing countries.

Recommendation to the Secretary of Agriculture

The Secretary of Agriculture should develop methods for allocating quotas among countries that would recognize trade patterns that would develop in the absence of quotas.

PRICEBREAK SYSTEM

Since September 1968, certain cheeses have been allowed to enter the United States without quota restrictions if their price was at or above the pricebreak, the Commodity Credit Corporation's purchase price for cheddar cheese, rounded to the nearest whole cent plus 7 cents. Swiss-type cheeses (Emmenthaler and Gruyere process) and cheeses falling under the large miscellaneous tariff classification of "other" cheese, are the pricebreak cheeses.

The purpose of the pricebreak system is to avoid restricting imports of higher priced quality table cheeses that do not compete with domestically produced cheeses. However, some trade sources contend the system is subject to abuse and Agriculture officials agree and observe that the pricebreak provisions complicate administration of the quota program.

By setting prices at or slightly above the pricebreak, exporters and importers can avoid having their shipments counted against a quota. Various ways of manipulating prices to avoid quota controls are possible. For example, some trade sources observe that exporters may bill importers the pricebreak price for one cheese and then offset this overpayment by lowering the price on another type of cheese. The International Trade Commission in its investigations has also noted that price, as a control mechanism, is subject to abuse.

Agency comments

Agriculture commented that, although the pricebreak rule is the most liberal feature of the dairy import quota system, it has disadvantages; namely, it is more complicated to administer and more difficult to enforce than a system of simple absolute quotas. Agriculture further commented that:

> "In its investigation No. 22-29 completed in July 1971, the U.S. Tariff Commission (now the International Trade Commission) recommended that the pricebreak quotas be replaced with absolute quotas, with appropriate adjustments in the quota amounts. Although this recommendation was not accepted by the President at that time, the Department agrees that, in a future investigation under the applicable Section 22 procedures of possible substantial modifications of the cheese import quotas, elimination of the pricebreak system could appropriately be considered."

EMERGENCY IMPORT QUOTAS

The Department of Agriculture has been slow in relieving tight supply situations, which has resulted in some quota actions being taken after the need for increased imports had passed. For example, butter oil was in tight supply during the summer of 1973 because of depressed domestic production and continuing demands from the ice cream industry; however, the Government did not allow imports to increase until November, after the ice cream season had ended.

The tight dairy supply situation became evident in October 1972 when the Commodity Credit Corporation's uncommitted stocks of nonfat dry milk were exhausted and prices for dairy products were increasing rapidly. A series of eight import actions resulted, all but two on an emergency basis. One action occurred on December 30, 1972, five in 1973, and two early in 1974. Five of the actions increased nonfat dry milk quotas, two increased cheese quotas, and one increased butter and butter oil quotas. In total, the 1973 and 1974 additional import authorizations represented the equivalent of about 3.2 billion pounds of milk.

During this period, Agriculture was hesitant in recommending increases in the quotas and viewed requests for additional supplies from food processors, candy manufacturers, and other using industries with suspicion. The record indicates that Agriculture was also overly optimistic in forecasting domestic milk production and estimating supplies of processed dairy products.

Upon receiving requests for emergency import actions, Agriculture took as long as 3-1/2 months before submitting its formal recommendation to the President for an increase in the quota. A further delay of as long as a month also took place between submission of Agriculture's recommendation and issuance of the Presidential proclamation. Parts of the delays were attributable to disagreements among the executive branch agencies as to the proper course of action. During this period, the dairy import policies of the administration were coordinated by the former Cost of Living Council as part of its economic stabilization program and in at least one instance (1973 cheese quotas increase), it was the Council that initiated section 22 action.

The sequence of events for the enactment of two emergency quota increases is shown below.

<u>First increase in nonfat dry milk quota</u>

<u>1972</u>

October 20	Commodity Credit Corporation's uncommitted stocks exhausted; nonfat dry milk removed from sales list.
Late October to late December	Numerous letters, telegrams, phone calls, and visits received from using industry and its congressional representatives, urging an increase in the quota.
November 22	Internal Agriculture factual analysis formally initiated.
December 18	Staff recommendations submitted to the Secretary.

December 20	Secretary's recommendation submitted to the President.
December 30	Presidential proclamation issued for emergency action.

Increase in cheddar cheese quota

1973

August 15	Kraftco Corporation, the largest cheese processor, urged 100-million-pound increase in quota.
August 20	National Cheese Institute made same request on behalf of the industry.
Early September to early December	Cost of Living Council led interagency review and debate on needs and options; this involved continuing fact-gathering and reporting to the Council by Agriculture.
November 29	Secretary's recommendation submitted to the President.

1974

January 2	Presidential proclamation issued for emergency action.

The emergency increase in the nonfat dry milk quota took more than 2 months. More than 4-1/2 months elapsed before the cheddar cheese quota was increased.

Along with decreased consumption and a recovery from declining production, the untimely increases in dairy imports during 1973 and early 1974 later helped to create an oversupply of dairy products. These factors caused Agriculture to purchase millions of dollars worth of dairy products under the price support program during 1974.

The sudden announcements of quota increases and the method of administering the emergency quotas caused dissatisfaction in some dairy exporting countries, particularly the more distant ones. Dissatisfaction with the sudden quota announcements stemmed from the desire of producers to preplan their dairy production. Exporting countries need to know the market requirements for their products well in advance of the shipping time, but the emergency quotas provided for import entry during an average of 10 weeks immediately following the announcement of the increases. Therefore, products shipped during the emergency must have already been produced and readied for shipment.

At first, foreign dissatisfaction with emergency quota administration centered around the first-come-first-served basis for entry. Because of Australia's and New Zealand's great distance from the United States, they felt this method discriminated against their exporters. During the period of the first nonfat dry milk emergency quotas, totaling 165 million pounds, New Zealand was unable to enter any powder and Australia exported only 551,000 pounds. Under the emergency allocation of 22.6 million pounds of butter oil, Australia was unable to enter any oil and New Zealand entered only 1.9 million pounds.

Agriculture officials say that the overriding consideration in structuring the early emergency quota actions was to bring in the additional supplies as quickly as possible. However, in the latter part of 1973, the quota proclamations began allocating part or all of the emergency quota amounts to certain countries instead of administering them on a first-come-first-served basis. There was then some dissatisfaction because some countries were not allocated a specific share of the quota.

Agency comments

When asked to comment on a proposal that methods be developed for more accurately predicting potential dairy product shortages so that prompt future emergency quota actions may be taken, Agriculture agreed that a better economic intelligence base and more accurate and timely estimates of developing supply and demand conditions would provide a better basis for policy decisions and said that it is continuously striving to improve its analysis and data sources. Efforts are being made to monitor crop and weather conditions and to determine and specify factors affecting supply, demand, and prices of dairy products. Progress in improving present methods and developing new methods will depend largely on the development of better sources of economic information.

CHAPTER 6

SCOPE OF REVIEW

Information and data provided in this report were obtained from extensive domestic and foreign fieldwork. We interviewed and obtained data from:

--U.S. Embassy officials in Australia, Austria, Canada, Denmark, New Zealand, the United Kingdom, and West Germany and officials at the U.S. mission to the European Communities in Brussels.

--Milk producers, fluid milk processors, dairy product manufacturers, and farmers' trade associations in Washington, D.C., and Midwestern States.

--Some major dairy cooperative associations in the Midwest and a large Maryland and Virginia cooperative association.

--Some large dairy product manufacturers in the Midwest.

--Dairy farmers from Maryland, New Jersey, and Pennsylvania.

--Dairy product importers and importers association in New York.

--Several professors of agricultural economics of large midwestern universities.

--Foreign government and industry representatives in Australia, Austria, Canada, Denmark, New Zealand, the United Kingdom, and West Germany.

We reviewed authorizing legislation and other materials pertaining to U.S. dairy policy and programs. We held discussions at the Departments of Agriculture, State, and the Treasury and at the International Trade Commission in Washington, D.C.

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D. C. 20250

June 14, 1976

Mr. J. K. Fasick
Director
International Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Fasick:

We appreciate the opportunity to review the report entitled "Review of U.S. Import Restrictions -- Alternatives to Present Dairy Programs" and enclose the Department's comments and observations. Our response is the result of careful study by the various offices which are concerned with problems of dairy production and trade.

[32-39] In the main, our comments are directed to the "Program Alternatives" set forth on pages 51-56 and to the recommendations specifically directed to the Department of Agriculture (page 60). Certain technical notes and minor corrections are also included. [14, 46, and 49]

One deficiency of the report is the failure to explore all of the possibilities for action afforded by the Trade Act of 1974, particularly the use of countervailing duties, anti-dumping penalties, and provisions relating to unfair competition in third country markets. It is also pertinent to note that the report does use as a base for some of its material a report by the Department which was completed 18 months ago.

We believe that the GAO study, which was conducted during a particularly difficult period, has been useful in highlighting many of the issues in the complex field of dairy policies and programs.

Sincerely,

Dale Sherwin

Dale Sherwin
Deputy Assistant Secretary

Enclosure

GAO note: Page references refer to draft report. Bracketed numbers refer to final report pages. Changes were made in the text by GAO where considered appropriate.

Comments on "Program Alternatives" (beginning on p. 51): [32]

Price Support. "The present price support program supplemented by import quotas is designed to assure an adequate supply of domestically produced dairy products by guaranteeing a minimum price for production." (The report lists three advantages and five disadvantages of this alternative.)

The Department has specific comments only on the first listed disadvantage of the existing price support program as follows:

1. "Required import restrictions are inconsistent with U.S. policy of trade liberalization and have negative foreign policy implications." The U.S. policy of trade liberalization is multilateral in concept and objectives, and cannot be realistically regarded as a policy under which the United States would unilaterally eliminate its import controls while the restrictions and related trade distortions of other countries remained in force. All of the leading trading nations control their agricultural trade to some degree; among them, the United States is one of the most liberal. Dairy products are particularly subject to government controls; every major producing country controls imports and many of them also control exports. In such a trading environment, complete elimination by the United States of its dairy import controls would result in unacceptable costs to the American economy and to the federal budget. If liberalization is to be achieved, it must be in a multilateral context with necessary safeguards. The milk price support program is mandatory and is likely to remain so; the import quotas, for which no satisfactory alternative has been found, are necessary to protect the program's viability.

With regard to the program alternatives generally, our comment is that the present program (support through purchases) is the most workable of any alternative.

GAO "Program Alternative" (p. 52): [33]

Supply Management. "A supply management system would maintain the domestic industry at a desired production level through the use of production limitations and import quotas."

Although there have at various times been proposals and public discussion of supply management programs for dairy, the proposals have not been adopted. Neither the dairy industry nor the Congress have favored such proposals. The Department does not favor this alternative which is totally inconsistent with other recently-legislated Commodity Programs.

GAO "Program Alternative" (p. 53): [34]

Price differential subsidy. "A price differential subsidy program would establish a desired price level for domestically produced milk. When the market price is below the established price, the Government would pay the difference to the producer. Payment limitations could be established to minimize Government costs. A reasonable subsidy program could also eliminate import restrictions."

Proposals for direct payments to milk producers as a means of income support have never had the support of producers or of the Congress, nor does this Department favor such payments; further, it is unlikely that the authority for such a program could be enacted without concurrent enactment of authority for supply management. If a price differential program were adopted and import restrictions eliminated, the effect of imports on this form of government assistance would be much the same as with the present price support program -- the larger the imports, the larger the total federal payments. Thus the accuracy of the statement that "A reasonable subsidy program could also eliminate import restrictions" is questionable.

<u>GAO "Program Alternative" (p. 53):</u> [35]

<u>Tariff.</u> "A tariff program would offer price protection to the U. S. dairy industry, especially during surplus periods, but would increase consumer prices. A high fixed tariff would be inconsistent with U. S. trade policy objectives. A flexible tariff system, however, could alleviate many of these problems. The duty could be adjusted to achieve a desired balance between maintaining the domestic industry and providing reasonable prices to consumers."

The question of achieving the objectives of protection of the dairy support program from import interference by means of tariffs or import fees has been considered on numerous past occasions. The consistent conclusion has been that tariffs or fees are not a reliably effective means of controlling imports, unless set at prohibitively high levels. Tariffs or fees affect the price of the product; and prices are notoriously subject to manipulation. So long as the support program remains in effect, this alternative does not merit further consideration.

<u>GAO "Program Alternative" (p. 54):</u> [36]

<u>Open U. S. market.</u> "An open U. S. market for dairy products would involve a policy decision <u>not</u> to protect the U. S. dairy industry. Under such a policy, no programs would be in effect."

The legislative history of the dairy support program indicates that favorable consideration of this alternative by the Congress is extremely unlikely.

GAO "Program Alternative" (p. 55): [37]

International commodity agreement. "An international commodity agreement for dairy products could represent a possible framework for regulating and stabilizing dairy trade. It could include a wide range of features, such as supply, access, and price agreements; reduction of tariffs; maintenance of reserves; reduction or elimination of export incentives; and many others. As a major dairy producer, the United States could take the 'initiative' in proposing negotiations on an international agreement on dairy products."

International commodity agreements, particularly for agricultural commodities, have been largely unsuccessful and have not achieved their objectives of stabilizing prices and supplies. They have been difficult to negotiate and, when negotiated, to enforce; and they have characteristically broken down when the market pressures they were intended to control have become strong. Commodity agreements tend to freeze production patterns and to act as disincentives to more efficient production methods; consequently, they tend to misallocate resources, causing consumer prices to be higher than necessary.

Among the more recent cases of widespread nonobservance of agreement rules by participating countries is the Arrangement for Certain Dairy Products (nonfat dry milk and butter oil) originally negotiated in 1970. (The United States was not a participant.) The Department strongly doubts that international dairy trade problems can be solved by attempted imposition of global supply management by an international committee or secretariat.

At the same time, the Department believes that progress is possible in reciprocal reduction of tariffs and nontariff barriers to trade, and in the reduction or elimination of export subsidies and other trade-distorting devices. The Department is cooperating in the pursuit of these objectives in the current Multilateral Trade Negotiations now in progress in Geneva, Switzerland.

GAO "Program Alternative" (p. 56): [38]

Worldwide free trade. "Worldwide free trade for dairy products would require worldwide policy decisions not to protect the dairy industry. Under such a policy, no country would have support programs, export incentives, or trade restrictions on dairy products. Since the United States cannot control dairy policy in other countries, this alternative might be unattainable."

The Department agrees that this alternative is not attainable within the foreseeable future. It is not a practical option.

GAO Recommendation (p. 60): [14]

"The Department of Agriculture should develop and recommend to Congress a method of setting milk support prices at a level which would more nearly balance production and consumption."

This recommendation is related to the last recommendation that methods should be developed to more accurately predict shortages and our comments on the last recommendation also apply to this one.

GAO Recommendation (p. 60): [49]

"The Department of Agriculture should evaluate whether country quota allocations should be continued and, if so, develop methods for allocating them that would recognize trade patterns that would develop in the absence of quotas."

Country quota allocations generally reflect country shares of United States imports in representative periods of trade, as determined by the President when proclaiming establishment of the quotas. The purpose of this principle is to be fair and impartial to the supplying countries and also to conform with the relevant provisions of the General Agreement on Tariffs and Trade (GATT); and the practice has been to use, whenever possible, published trade statistics as an objective basis. Although some countries have complained that the trade patterns of the representative periods have subsequently become outdated, there have been no charges that the quotas were unfairly allocated. Discussions with supplying countries have indicated, without exception, their preference for an allocation system rather than global quotas. Foreign policy considerations will accordingly continue to weigh preponderantly in favor of continuance of an allocation system.

In various hearings before the International Trade Commission, spokesmen for foreign countries have occasionally suggested that quotas should "recognize trade patterns that would develop in the absence of quotas." They have, however, been unable to propose practical means of determining such patterns. Shares of total world trade cannot logically be equated with ideal shares of U. S. imports, even in the absence of the gross distortions of the international market because of the widespread use of export subsidies and import restrictions. The nearest realistic approach to implementation of the principle is the technique which has in fact been utilized, namely, allocations on the basis of actual trade in a period during which U. S. imports were not restricted.

GAO Recommendation (p. 60): [46]

"The Department of Agriculture should analyze whether the quota licensing system for importers should be continued and, if so, develop some methods for issuing licenses (auctioning, for example) that would provide equity to importers and prevent windfall profits on the sale of license use."

Licensing of most of the quotas, particularly those for cheeses, was undertaken by the Department because of the strong and persuasive position of the import trade that licensing was necessary to prevent domination of imports by (a) large, financially powerful importers and (b) export monopolies of foreign governments. Although licensing imposes an additional administrative burden, the Department's experience corroborates the validity of these views. If not prevented by the licensing system, many foreign countries would operate through single "exclusive representatives" to dictate prices and distribution, to their narrow advantage. Similarly, large American processors could enter into mutually advantageous contracts with foreign suppliers (in some cases, their own subsidiaries) to monopolize a country allocation and eliminate all competition from buying and utilization.

For the above reasons, auctioning of licenses would not enhance competition or prevent windfall profits. Rather, it would concentrate power in the hands of the financially strongest companies.

GAO Recommendation (p. 60): [50]

"The Department of Agriculture should consider discontinuing the pricebreak system on cheese imports and making appropriate adjustments to import quotas."

The "pricebreak" rule which is applicable to certain categories of cheese is the most liberal feature of the Section 22 dairy import quota system. The suggestion for its discontinuance consequently seems inconsistent with the general thrust of the GAO Report.

The pricebreak system has recognized disadvantages, namely, that it is more complicated to administer and more difficult to enforce than a system of simple absolute quotas. In its Investigation No. 22-29 completed in July 1971, the U. S. Tariff Commission (now the International Trade Commission) recommended that the pricebreak quotas be replaced with absolute quotas, with appropriate adjustments in the quota amounts. Although this recommendation was not accepted by the President at that time, the Department agrees that, in a future investigation under the applicable Section 22 procedures of possible substantial modifications of the cheese import quotas, elimination of the pricebreak system could appropriately be considered.

GAO Recommendation (p. 60): [53]

"The Department of Agriculture should develop methods for more accurately predicting potential dairy product shortages so that prompt future emergency quota actions may be taken."

The Department regularly makes projections of short-, intermediate-, and long-run supply and demand conditions for milk and dairy products. However, milk production is both a biological and economic process with lagged responses to prices that changes as a result of external conditions. Production of milk is subject to random exogenous forces such as weather and crop conditions. In addition, very small changes in either production or utilization have sharp impacts on prices of manufactured dairy products since adjustments in other segments of the industry are strongly reflected in the prices for these products. Even in periods when supply and demand are nearly in balance, random uncontrollable occurrences and/or external forces can cause sharp price movements.

The Department agrees that a better economic intelligence base and more accurate and timely estimates of developing supply and demand conditions would provide a better basis for policy decisions; and the Department is continuously endeavoring to improve its analysis and data sources. Efforts are being made to monitor crop and weather conditions and to determine and specify factors affecting supply, demand, and prices of dairy products. Progress in improving present methods and developing new methods will depend largely on the development of better sources of economic information.

Comments on Particular Passages in the GAO Report:

1. Page iii. The paragraph on the Agricultural Marketing Act of 1937 should be expanded as follows, in order to preclude misunderstanding of the marketing order program:

> U. S. supply and demand conditions for milk determine a manufacturing milk price in Minnesota and Wisconsin. The Milk Order Program does not set the overall level of milk prices in the United States but requires handlers to pay minimum prices (tied directly to the manufacturing milk price described above) for milk actually used as fluid.

2. Page 8, second paragraph. The final sentence should be revised to read as follows:

> The support price announced on October 2, 1975 was 84.4 percent of the parity price for the beginning of the 1975/76 marketing year.

3. Page 13, second paragraph. The final sentence is incorrect. Minimum order prices are not based on the government supported price for manufacturing milk if the free market prices exceed that support rate.

4. Page 15. The final full sentence on this page states that "information was not available on the increased costs associated with this doubling of output per cow." Information is in fact available; the following example is provided:

	Pounds concentrate feed per cow*	1974 corn price	Tons forage fed per cow*	1974 all hay price		
1950	1,629	$.05268	2.2	50.60	=	$197.14
1972	4,298	$.05268	3.9	50.60	=	423.76
				difference		$226.52

*Source: 1972 Ag. Statistics, p. 431
1951 Ag. Statistics, p. 390

5. Page 18, second paragraph. The following supplemental information is offered:

> In mid-1975 market prices for support commodities rose substantially above support prices. Much of the previously purchased product was sold back by the Commodity Credit Corporation. This occurred at prices above 75 percent of parity.

6. Page 21, first paragraph of the "Consumer costs" section. The analysis in the first several sentences seems to overestimate the milk production potential of Australia and New Zealand and to under-estimate the effects on their prices of unrestricted trade. Under free trade, their prices would rise and, to a large extent, wash away the difference on which the $827 million estimate is based. It is noted that this is partially recognized in the immediately succeeding paragraphs.

7. Page 43, second paragraph. The Australian claim that milk production could be increased by 25 percent (presumably without subsidies) assumes that substantial numbers of new producers would enter the industry. Because of the well-known unattractiveness of dairying, this is neither certain nor even likely. Expansion of pro-

duction would probably take the form of expansion of existing herds, and an increase of herds in or near the claimed magnitude seems very doubtful.

8. Page 51, first paragraph. The following should be added to the final sentence:

> however, the analysis of the open market alternative would have yielded about the same results whether countervailing duties were or were not assumed.

DEPARTMENT OF STATE

Washington, D.C. 20520

March 15, 1976

Mr. J. K. Fasick
Director
International Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Fasick:

I am replying to your letter of February 10, which forwarded copies of the draft report: "Review of U.S. Import Restrictions - Alternatives to Present Dairy Programs."

The enclosed comments were prepared by the Assistant Secretary for Economic and Business Affairs.

We appreciate having had the opportunity to review and comment on the draft report. If I may be of further assistance, I trust you will let me know.

Sincerely,

D. Williamson

Daniel L. Williamson
Deputy Assistant Secretary
for Budget and Finance

Enclosure: As stated.

GAO note: Page references in this letter may not correspond to page numbers in the final report. Changes were made in the text by GAO where considered appropriate. The statement copy referred to in this letter is not included.

GAO DRAFT REPORT: Review of US Import Restrictions -- Alternatives to Present Dairy Programs

The Department of State concurs in the recommendations on pages 59 and 60 of the GAO's draft report on import restrictions on dairy products. The Department would be particularly interested in further study on possible gradual approaches to the reduction or elimination of import quotas. We agree with the assessment that the elimination of all barriers to trade in dairy products is unlikely, and that the unilateral elimination of American restrictions would be disruptive; however, it may be possible for the United States to devise a first step which, without harm to American producers, could be instrumental in beginning a process of reducing barriers internationally. For example, we might consider quotas geared to a certain percentage of annual consumption, as an alternative to the present system under which quotas are set in fixed amounts.

Concerning the text of the report, the Department submits the following suggestions:

-- Page 27. Australia did challenge the US quotas at the November, 1975 meeting of the GATT contracting parties (the text of the Australian statement is attached). The last sentence of page 27 should therefore be dropped or revised.

-- Page 29. In the fourth line from the bottom, change "did not usually impose" to "only infrequently imposed."

-- Page 30. In line 4, change "did not impose" to "was reluctant to impose." Drop the last sentence of the second paragraph. In line 2 of the third paragraph, change "again subsidized some of their exports" to "reinstituted previously suspended subsidies on some of their cheese exports."

-- Page 31. At the beginning of the second paragraph drop the words "the controversy surrounding the countervailing duty issue and continued."

-- Page 59. In the fifth line, replace the word "dumping" with "selling." Countervailing duties are not used in dumping cases, and export subsidies do not in themselves constitute dumping.

Joseph A. Greenwald
Assistant Secretary
for Economic and Business Affairs

OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

March 16, 1976

Dear Mr. Becker:

This is with reference to the draft proposed report by the General Accounting Office dealing with the subject of import restrictions regarding dairy programs in the United States.

I would like to suggest several changes under the heading "Countervailing Duties" since this office is responsible for the administration of the U.S. Countervailing Duty Law.

On the next to last sentence on page 29, I would substitute for the word "some" the phrase "practically all". For the final sentence of the second paragraph on page 30, I would substitute the following: "The subsequent resolution of the European Community dairy problem through the new waiver authority granted the Treasury Secretary led to a dismissal of this case in Federal District Court."

For the final paragraph on page 30, substitute the following: "Following passage of the Trade Act and its signing by the President in 1975, the European Community resumed export subsidy payments on all cheese except cheddar cheese at lesser amounts than those prior to the suspension. The Community stated that the new reduced subsidies provided the basis for Treasury to issue the new temporary waiver authority incorporated in the Trade Act. U.S. industry representatives were disturbed by the reimposition of any subsidies and reminded the Department of the Treasury that before passage of the Trade Act, it had pledged not to exercise the temporary waiver of countervailing duties before the U.S. dairy industry was consulted on such an action."

GAO note: Page references in this letter may not correspond to page numbers in the final report. Changes were made in the text by GAO where considered appropriate.

We appreciate this opportunity to make comments on the proposed draft report on dairy programs through the Congress. Please let me know if I can be of any further assistance.

Sincerely yours,

Richard B. Self

Richard B. Self
Acting Director
Office of Tariff Affairs

Mr. Theodore J. Becker
Assistant Director, International Division
U.S. General Accounting Office
Washington, D.C. 20548

cc Mr. Wilbur R. DeZerne

UNITED STATES
INTERNATIONAL TRADE COMMISSION
WASHINGTON, D.C. 20436

THE CHAIRMAN

April 22, 1976

Mr. J. K. Fasick
Director
International Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Fasick:

This letter is in response to your communication of February 10, 1976, to the United States International Trade Commission in which you enclose for our review, comments, and suggestions copies of your draft report to the Congress entitled "Review of U.S. Import Restrictions: Alternatives to Present Dairy Programs."

Your draft report has been reviewed by Commission staff familiar with the present U.S. dairy programs. There is attached hereto a list of general and specific comments prepared by Commission staff after review of your draft.

It is noted that the draft report suggests that, in view of possible benefits to consumers and taxpayers, the Congress may wish to consider altering or modifying present U.S. dairy programs. In this connection, the two basic options suggested in the draft report are (1) free trade in dairy products (i.e., no trade barriers, subsidies, price supports, etc., in any country), or (2) an open U.S. market policy (i.e., no U.S. price-support programs or import quotas; other countries could pursue their own policies). With respect to these two suggestions, we believe it is inappropriate for the Commission to become involved in commenting upon substantive matters of U.S. trade policy. As you are undoubtedly aware, the Trade Act of 1974 delegates broad authority to the President under which he is authorized to enter into trade agreements with foreign countries for the purpose of harmonizing, reducing, or eliminating tariff and nontariff barriers to trade. The agricultural policies of the various nations are within the many topics under review internationally for the purpose of deciding what, if any, trade agreements with respect thereto might be formulated. Should any such agreement be formulated with respect to dairy products, the President would be required to submit it to the Congress for legislative approval in compliance with the procedures provided therefor in the Trade Act.

We hope our comments and suggestions will aid you in preparing your final report to the Congress. Please feel free to call on us if we can be of service to you in any way.

Sincerely,

Will E. Leonard

Will E. Leonard
Chairman

Attachment

Staff Comments on the Draft Report of the Comptroller General to the Congress entitled "Review of U.S. Import Restrictions: Alternatives to Present Dairy Programs."

General comments:

We suggest that, in the draft report, consideration should be given to the possibility that the U.S. dairy sector may well compete in world markets should free trade prevail. This possibility is buttressed by the fact that within the past year or so the Department of the Treasury has determined that a number of the principal countries that export diary products to the United States, including the EC, Switzerland, Austria, Finland, Norway, and Sweden, subsidize their exports of dairy products destined to the United States. Inasmuch as exports of dairy products from those countries to the United States necessitate subsidies in order to compete in the U.S. market, the U.S.-produced products might well compete in the respective foreign markets if given free access.

We would also suggest that the draft report more adequately focus on the waiver granted the United States under the General Agreement on Tariffs and Trade (GATT) in 1955 for the "temporary" maintenance of import quotas. If the United States undertakes liberalization of imports of dairy products, would the quotas be negotiated in the MTN in order to attain free trade in dairy, or would they be suspended or terminated as provided for under section 22? This concern apparently is shared by others. According to an Airgram recently received from the New Zealand Department of Trade and Industry (copy enclosed), New Zealand joins Australia in questioning whether statements from the United States that it (the United States) will only negotiate its restrictions on dairy products in the MTN if other countries do likewise are consistent with United States obligations under the GATT waiver.

On March 26, 1976, the President issued a proclamation (No. 4423) which temporarily established a quota of zero pounds on imports of certain dry milk mixtures. The President also requested the Commission to conduct an investigation under section 22 on that action and to determine related questions. Copies of Proclamation No. 4423 and the President's request to the Commission are enclosed for your information.

Specific comments:

1. <u>Page 11, first paragraph</u>--

The paragraph should more clearly enunciate the recommendations made by the Commission in 1953, when quotas were imposed on certain dairy products under section 22 of the Agricultural Adjustment Act, as amended. A copy of those recommendations (pages 6 and 7 of the Commission's report of June 1953) is enclosed.

Specific comments: (Continued)

2. Page 18, last sentence--

The sentence should point out that the quotas on canned milk, etc., were imposed in accordance with the statutory criteria provided for under section 22 of the Agricultural Adjustment Act, as amended, and not because of reasons listed in the draft report (rising U.S. prices, foreign surpluses, etc.).

3. Page 24 (chart)--

The Department of the Treasury recently made a preliminary determination that Sweden subsidizes exports of cheese to the United States. It appears, therefore, that the export assistance column applicable to Sweden should be marked with an X.

4. Page 27, under the side heading, "Section 22 quotas initially established"--

Perhaps mention should also be made of the fact that some of the U.S. dairy quotas have been enlarged since they were imposed under section 22 in 1953. Also, all of the cheese quotas were enlarged 50 percent in 1973 and various of the dairy quotas have been temporarily enlarged under the emergency provision of section 22.

5. Page 44 (chart)--

For several types of imported cheeses, the cost at U.S. east coast and the U.S. wholesale price for the same types of domestic cheeses are shown. Perhaps the table would be more complete if U.S. retail prices for both the foreign and domestic cheeses were also shown.

6. Page 26, the penultimate sentence before the graph--

The sentence reads, "The study states that countervailing duties would have little, if any, effect on the results of the open market analysis." That conclusion may well be valid. However, in connection therewith, perhaps credence should be lent to the fact that U.S. imports of some nonquota cheeses declined abruptly in 1975 when the Department of the Treasury was examining complaints of subsidies being bestowed on certain imported cheeses.

GAO note: Page references in this letter may not corrospond to page numbers in the final report. The document copies referred to in this letter are not included. Changes were made in the text by GAO where considered appropriate.

PRINCIPAL OFFICIALS RESPONSIBLE FOR ACTIVITIES

DISCUSSED IN THIS REPORT

DEPARTMENT OF AGRICULTURE

	Tenure of office From	Tenure of office To
SECRETARY OF AGRICULTURE:		
John A. Knebel (acting)	Oct. 1976	Present
Earl L. Butz	Dec. 1971	Oct. 1976
Clifford M. Hardin	Jan. 1969	Nov. 1971
ASSISTANT SECRETARY, INTERNATIONAL AFFAIRS AND COMMODITY PROGRAMS:		
Richard E. Bell	July 1975	Present
Clayton K. Yeutter	Mar. 1974	June 1975
Carroll G. Brunthaver	June 1972	Jan. 1974
Clarence D. Palmby	Jan. 1969	June 1972
ASSISTANT SECRETARY, MARKETING AND CONSUMERS SERVICES:		
Richard L. Feltner	Apr. 1974	Present
Clayton K. Yeutter	Jan. 1973	Apr. 1974
Richard E. Lyng	Mar. 1969	Jan. 1973

DEPARTMENT OF STATE

	From	To
SECRETARY OF STATE:		
Henry A. Kissinger	Sept. 1973	Present
William P. Rodgers	Jan. 1969	Sept. 1973
ASSISTANT SECRETARY, BUREAU OF ECONNOMIC AND BUSINESS AFFAIRS:		
Thomas O. Enders	Apr. 1974	Present
Willis C. Armstrong	Feb. 1972	Apr. 1974
Joseph Greenwald (acting)	Dec. 1971	Feb. 1972
Philip H. Trezise	July 1969	Dec. 1971

DEPARTMENT OF THE TREASURY

	From	To
SECRETARY OF THE TREASURY:		
William E. Simon	May 1974	Present
George P. Shultz	June 1972	May 1974
John B. Connally	Feb. 1971	June 1972
David M. Kennedy	Jan. 1969	Feb. 1971

	Tenure of office From	To
INTERNATIONAL TRADE COMMISSION (note a)		
CHAIRMAN:		
Will E. Leonard	July 1975	Present
Catherine Bedell	July 1971	June 1975
Glenn W. Sutton	July 1969	June 1971
OFFICE OF THE SPECIAL REPRESENTATIVE FOR TRADE NEGOTIATIONS		
SPECIAL REPRESENTATIVE FOR TRADE NEGOTIATIONS:		
Frederick B. Dent	Mar. 1975	Present
Vacant	Feb. 1975	Mar. 1975
William D. Eberle	Nov. 1971	Jan. 1975
Carl J. Gilbert	July 1969	Nov. 1971

a/Formerly United States Tariff Commission.