MILK: THE DIFFICULT FORMULATION OF A COMMERCIAL POLICY

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ABSTRACT

The objective of this article is to evaluate the consequences of the "opening" of the Brazilian economy, established during the 1990's, for the milk production sector. The article's endeavor is to show that this new and positive insertion of the Brazilian economy in the international market has been conducted incorrectly with respect to fiscal policy, interest and exchange rate policies, and trade policy (import rules), particularly with the introduction of the *Plano real*. Milk and dairy product's imports have increased substantially as a consequence of the economic policy mistakes, specially during the 1995 to 1998 period. This started to change with the recent exchange rate devaluation.

Key words: milk and dairy products, economic policy, commercial liberalization, imports, exchange rate.

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1. Introduction

This decade was marked by an extraordinary change in the Brazilian economic policy. That is, since 1990, the country's economy, which was extremely closed, has been open to the international market (in financial, technological, commercial and investment terms). This is usually called "globalization". The Mercosur agreement fits in this opening process and is, in our opinion, the right move, which must not be considered as a mistake. Brazilian economy remained closed for a long period of about 40 years. The consequences for farming were evaluated in a series of surveys[2]. On one hand, there is a lack of surveys on the "opening" of the Brazilian agricultural economics. On the other hand, this new and positive behavior was conducted in a completely inaccurate way, regarding the contexts of fiscal, interests, currency exchange, and foreign trade (import rules) policies. Farming - and most particularly the milking sector, which will be analyzed in this article - was affected by this error. This unfavorable situation started to change in the beginning of 1999, with the sharp exchange devaluation after January 15. This important change in the macroeconomic policy is likely to start the recovering of the farming sector, including the milking sector.

2. Some effects of the unfavorable variables in the decade

The 1990's and, mainly, the years of *Plano real*, had the following unfavorable features to our agricultural sector[3]:

a) High real interest rates, the monetary "anchor" of *Plano real*;

b) strong rise of the real exchange rate, the exchange "anchor" of *Plano real*;

2 An evaluation-survey can be found in Homem de Melo (1979).

3 For a more detailed analysis see Homem de Melo (1998).

4 For an analysis of the prices-effects of commercial liberalization, see Goldin et al (1993).

c) excessive decrease on import tariffs of agricultural goods, including milk and dairy products; the term "excessive" is used in the context of not taking into account the agricultural protectionism in industrialized countries and consequent negative price-effect on the international markets;[4]

d) to financed imports, through financial gains to importers;

e) Low economic growth from 1996 on, with a foreseen fall of the GDP in 1999; this limits the domestic market, mainly of the goods which presents higher income-elasticity values (milk and dairy products, for example)[5].

Most of the problems in farming have started with the high interest rate policy. The production chain of milk was not able to be free from the effects of this policy. Real interest rates between 20-25% a year were the basic Central Bank's rates. A recent survey by economist Lauro Vieira de Faria, from Fundação Getúlio Vargas, shows the core of such problem: between 1994/98 the basic real interest rate was 20.2% in Brazil, 6.6% in Argentina, 8.3% in Colombia, 6.8% in Chile and 1.5% in Peru. One of the consequences of this long lasting policy of high interest rates on the financial market (besides the assistance to imports) lies in the bigger concentration on the milk output (industrial segment), through assistance to those agents which have more access to international financial markets (lower interest rates, mainly by multinational enterprises). For instance, Bortoleto and Chabaribery (1998) cite the following points:

1) "Companies, from the production to the distribution sectors, have been going through some dramatic reorganization changes towards concentration, selection and specialization."

2) "More than 50% of the big dairy companies existing in 1981 were purchased by other groups or made strategic alliances."

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[4] For an analysis of the prices-effects of commercial liberalization, see Goldin et al (1993).

[5] For values of income-elasticities of food products, see Homem de Melo (1998); milk and its products had the highest value, of 1.10.

The big problem is that the combined effect of these five unfavorable variables resulted in the weakening of national milking cooperatives and companies and the facilitation for foreign companies to purchase the formers, specially through low interest rates of the international market, with a broad and prosperous domestic market. The domestic industrial and distribution sectors have been affected lately by harmful effects of the policies aforementioned. The milk chain has changed its "face". In Timmer's words (1995), *"political discrimination frequently made the domestic value of agriculture in developing countries lower than its market value on the border"*. Maybe the milk chain after *Plano real* is a typical example of such discrimination.

3. Sharp fall on the producer's real price

On the other hand, milk producers had a hard time caused by the same combination of the five unfavorable variables. More debts and lower prices undermined competition in the productive sector. Some more favorable expectations, despite not magical and instantaneous, arose with exchange devaluation which took place in January 1999. By checking the performance of real prices in the course of this decade, one is able to feel this (Agroanalysis, February 1999 and FGV)[6]:

	R$/ liter		R$/ liter
1989	0.436	1994	0.328
1990	0.399	1995	0.341
1991	0.375	1996	0.301
1992	0.352	1997	0.263
1993	0.365	1998	0.248

Between 1989 and 1998, there was a 43% fall of the real average price paid to milk producers: a considerable percentage in such a short period. The most dramatic falls occurred between 1993 and 1998. One reason is that the commercial opening in the period of 1990-1992 came

[6] The average price for 1989 was obtained from a special listing of the Fundação Getúlio Vargas.

along with a devaluation of the real exchange rate, which offset the fall of the producer's prices. Since 1994, however, we have had the commercial opening and a strong exchange valorization, although several analysts do not always mention these facts. This was an extremely unfavorable combination to milk producers. By calculating the coefficient of correlation between the price paid to producers and the real exchange rate, we find 0.76, for the period of 1989-1998, which is quite different from zero, indicating a close relation between both variables.

4. Some compensating variables and milk production

Some important variables changed to the advantage of Brazilian farm products in this decade. For instance, between 1994-1997 several products - such as soybean, coffee, cocoa and sugar - had higher prices in the international market. Moreover, ICMS exemption on imports (known as Kandir Law) benefited the exports of domestic farm products. Milk producers were granted with the following advantages: a) reduction in the real prices of inputs used in the production process (for example, medicines), due to the commercial opening and the exchange rate appreciation itself; b) access to modern imported equipment, again due to commercial opening; c) higher productivity levels; and d) securitization of previous debts.

The first three changes caused lower average production costs, tougher competition and made the milk sector face its problems without reducing output. This has been very well pointed by Sebastião Teixeira Gomes of Universidade Federal de Viçosa.

The Brazilian milk output had an outstanding growth until 1996, notably in 1993-1996. Prices paid to producers did not drop much(-17.5% from 1993 to 1996), costs declined due to higher productivity, and the domestic market grew with the higher incomes enabled by *Plano real*. The figures for the milk output are as follows (Balde Branco, 1998 and our estimates for 1998):

	Millions of liters
1989	13,095
1990	14,484
1991	15,079
1992	14,784
1993	15,591
1994	15,784
1995	17,694
1996	19,021
1997	20,352
1998 (est.)	20,100

However, the milk output growth showed depletion in 1997 and 1998. In 1998, the forecasted output was lower than the one in 1997. There are no signs that the situation may change in 1999, mainly because of a prospective 1-2% fall of the GNP. Considering an income-elasticity of 1.10 for milk demand and by-products (Homem de Melo, 1998), we may have a fall of 2.34% in the domestic consumption of these products this year.

5. Milk import and the mistaken commercial policy

The combination of lower customs tariffs for milk and by-products, appreciation of the exchange rate and a slight growth of the domestic demand encouraged imports. This was the way to adjust the milk and by-products markets. Obviously, imports in Mercosur have one advantage: no tariff. However, in our opinion, the increase in the exchange rate is a more important variable to explain these imports. The figures of imports (kindly given by Professor Marcos S. Jank of ESALQ-USP) are as follows (SECEX-MICT basis):

	US$ Millions
1987/1989	138.9
1990	160.5
1991	203.7
1992	72.1
1993	154.5
1994	262.0
1995	620.1
1996	539.2
1997	466.9
1998[7]	523.4

In 1998, before the beginning of our commercial opening process, the customs tariff for milk was 40%. In 1993, it went down to 20%. The effect on imports was small, as there was some exchange rate devaluation

7 Information from DECEX/GEREST, Ministry of Development, Industry and Commerce (includes eggs). Such value corresponded to an import of 389.7 thousand tons.

between 1990 and 1992. Most imports took place from 1994 on, which coincides with the appreciation of our real exchange rate and the economic growth right after the implementation of *Plano real*. We reached US$ 620.1 million in 1995.

The big problem of our milk commercial policy lies on the fact that reductions on customs tariffs have not been performed having in mind protectionism measures of industrialized countries, including subsidy to imports by the European Community. These measures reduced about 35% of the international equilibrium price of milk according to OECD and World Bank (Goldin et al, 1993). This could justify a compensating tariff on Brazilian imports of milk and by-products of around 53%, much above the current one. This percentage would make the import price (in Reais) similar to the price without protectionism measures by industrialized countries. CET – Common External Tariff – is 33% for milk and 19% for by-products. The best solution, of course, would be eliminating these protectionism measures.

We must not forget the following: Brazil has been importing plenty of milk and by-products, about 10-15% of the domestic consumption. This indicates that domestic consumption is bigger than domestic output. How could this be explained? If there is a prospective domestic market available, how come milk production does not grow in order to supply the demand? In our opinion, it does not grow due to the very low price paid to producers. This occurs because the value of the exchange rate has increased excessively and also due to the fact that the average import tariff has been very low. The increasing productivity and the reduction of production costs make (or made) the production grow until 1996 and 1997. This scenario changed in 1998. Of course, some imports could either exist or not, even if restrictions on exchange and tariffs were extinguished.

After the government's passiveness towards the problems of agriculture after *Plano real*, some positive changes began to take place in 1997. These changes continued in 1998, which are the following:

a) reduction in financing terms for imports (up to a maximum of 30 days);
b) increase of import tariffs to:

milk	:	33%
yogurt, butter, cottage cheese and cheese	:	19%

c) previous authorizations to import; and
d) laboratory inspection of imported products: equivalent to sanitary inspections in exporting countries.

The amount and value of imports of milk and by-products dropped from 556 thousand tons to 320 thousand tons (CONAB, 1998) partly because of these measures. In 1998, however, it rose, again, to 390 thousand tons. These measures, taken by the federal government, are not perfect. For instance, there is no plausible explanation for lower tariffs for by-products. In some cases, they can be understood as non-custom restrictions to imports. They try, however to restrict subsidized imports, mainly from industrialized countries.

Despite these restrictive measures aforementioned, Brazilian milk and by-products imports were higher in 1998. These data obtained at DECEX – Foreign Trade Department – (Secretary of Development, Industry and Commerce) show the following variations:

Value	:	12.1%
Tonnage	:	20.6%
Average price	:	-7.0%

That is, there was a sharp reduction of the average price of milk and by-products imports. It nearly offset the exchange depreciation. Nogueira Neto and Mustefaga (1998) point the rising protectionism, via higher subsidies to imports of industrialized countries, as one of the reasons for lower international prices. Here, again, we have the commercial problem: distortions in the international market.

Of course, the problems faced at some steps of milk production are also faced by other products and at other stages. The cause of all these problems lies in the five unfavorable variables previously mentioned, particularly the high interest rates and appreciated exchange rate. The exchange policy began to be altered on January, 13. On January 15, the exchange rate started to float. The depreciation of about 45-50% would benefit the milking output, in spite of rising prices of some raw materials and other remaining problems (high interest rates and recession). However, there is still the trade policy, in the sense of fitting it better into the reality of the international trade, at least while WTO (World Trade Organization) – Rodada do Milênio negotiations do not have the desired effect. Yet, we think it is necessary to take one of the following measures:

a) increase of import tariffs of milk and by-products to 53% or to the WTO authorized maximum limit and; b)introduction of reference prices for imports.

Obviously, these measures would have to be in accordance with all Mercosur countries, so that "triangulation practice" can be prevented.

6. Final comments

Brazilian agriculture played an important role to the anti-inflationary success of *Plano real*. The expression "green anchor" was correctly applied. However, due to distortions and errors in the macroeconomic strategy of *Plano real*, bad consequences took place in the farming sector.

It must be remembered that a positive process of commercial opening of the Brazilian economy is quite different from an impressive value on imports of milk and by-products. This paper tried to show that these imports stem from economic distortions in this decade, mainly after the implementation of *Plano real*. This unfavorable situation started to be reversed with exchange depreciation after January 1999. Lower imports are evidence of this (-15% in tonnage in the period January-April 1999), as well as rising prices paid to producers.

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