Regionalization vs. Globalization of the World Dairy Economy: Conflict or Complementarity?

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Take Home Message

- This communication addresses the issue of globalization vs. regionalization of the world dairy economy through international trade in dairy products on the one hand, through internationalization of dairy and food companies on the other.
- In the end, the Marrakech Agricultural Agreement had little effect as such on development of international trade in dairy products and on market shares held by the various countries. This development can be explained mainly by trends and political decisions that preceded the Agreement, by the multiplication of regional free-trade agreements, and last but not least, by companies' own strategies.
- Apart from EU and other free-trade zones' internal trade, international trade in dairy products weighs less than 5% of world production.
- To maintain the viability of the world's dairy sector, governments should realize that promoting regional policies for the development of the dairy sector is of greater importance than promoting systematically and endlessly free-trade as the ultimate booster for the prosperity within the sector. But the focus must be on how to reconcile the need to remove distortions to trade with that of providing policy measures for dairy sector at regional level.
- Flows of consumer-ready products increasingly obey a regional logic with relatively little trade from continent to continent. Adjustment between raw milk deficit and surplus zones is achieved mainly through "semi-processed" raw materials, commodities or more sophisticated ingredients.

It is a real pleasure for the President of the International Dairy Federation, where Canada is one of the most active members, to be with you today. We are just a little more than a year away from the 2005 edition of our IDF World Dairy Summit to be held 12 to 16 September next year in Vancouver. It is also an honor in view of the excellent reputation your Seminar enjoys, even beyond the borders of your vast country.

But it is also a pleasure because the subject I have been asked to address is a very interesting and really up-to-date one. It has been on the agenda of the International Dairy Federation's Standing Committee on Dairy Policies & Economics for many years. From the angle of "internationalization" of dairy companies, it was the subject of a one-day Symposium at the Federation's last Congress, Congrilait 2002, in Paris two years ago. And this is the subject that will be addressed next June in Winnipeg at the FAO's Dairy Outlook Conference. However, on this sensitive subject, I hope you will understand that I ask you to consider that what I have to say to you today is no way binding on the International Dairy Federation whose experts and work have nevertheless been a constantly renewed source of inspiration for me over for the past 20 years and more.

I propose to examine first what is conventionally referred to as international trade in dairy products and, then, to take a look at internationalization and globalization of some companies that are totally or partially involved in milk and dairy products.

▪ International Trade in Dairy Products: What is meant By This?

The world dairy sector is important to millions of farmers and workers as well as thousands of companies all over the world. Millions of tonnes of milk are processed every day into dairy products and ingredients. Compared to the world dairy milk production, the volumes and value of dairy products traded on the world market are small, but with a tendency to grow. This being said, this international market is big for some products (for instance wmp and whey products), some specific dairy economies (for instance Oceania), some companies. Depending on the milk-equivalents used (and as IDF work shows, one should be cautious with milk equivalent figures as, in particular, the fat and protein content of raw milk varies greatly throughout the world, but also as for some dairy products, cheese in particular, the range of products is enormous), it is estimated to be at 6 to 7% of worldwide production. In the latest IDF World Dairy Situation presented last September, world milk production was, for 2003, estimated at 600 million tonnes (of which 501 mt of cow's milk and 73 mt of buffalo's milk), 7 mt or 1.1% more than the year before. This same World Dairy Situation underlines the fact that after the sharp decline in 2001, world trade in dairy products increased only slightly since.

Some studies, in particular those conducted by the Centre Français du Commerce Extérieur (CFCE / French Center for Foreign Trade), have shown that the direct impact of the 1994 Marrakech Agreement on international trade in dairy products was rather limited, as the main factors determining evolutions were changes in farm policies that had already been decided at that time, but also, and especially, the implementation and/or development of free-trade zones. In fact, the real impact of the Marrakech Agreement is that it enabled Australia and New Zealand to develop their share in trade at the expense of the European Union. On the other hand, as far as poor and developing countries, other than India and Pakistan, are concerned, milk production has developed little and, ten years later, those countries are still short on milk and dairy products.

Overall, since 1996 growth in milk production in low-income countries has been nil except - and this is a big exception – for South Asia, i.e. India and Pakistan. In India, which at present accounts for nearly 15% of world milk production, the production dynamic goes back to the early 1970's. In high-income countries, there has been sustained production development in Oceania (+34%), relatively sustained development in the United States (+7%) and stagnation in the EU (-1%), Japan and Korea. European production has declined since introduction of quotas in the mid 1980's and American production has progressed regularly since the 1970's. In Oceania, the Marrakech Agreement has upheld a rising trend that began back in the early 1990's.

As already mentioned, the FAO will be holding a Conference this coming June in Winnipeg. At its previous Conference, in 2002 in Rome, the FAO presented income and milk production development prospects for a certain number of countries up to 2010. Differences in milk production development are still big, but the present income level does not seem to constitute a discriminating factor. The variability of the per capita milk production level is even tending to increase in both high and low income countries. According to the FAO, the only thing one can be sure about is that Australia and New Zealand, which already produce a surplus of dairy products in relation to their consumption, will do so even more.

And what about long-term development of international trade in dairy products? It has tripled since 1970, going from 24 to 72 million tonnes of milk equivalents (FAO data), intra-EU trade included. During that same time, world production increased by 50%. Conversion to an annual growth rate gives 3.7% for trade, 1.3% for production. The increase in trade appears to be independent of the Marrakech Agricultural Agreement: +19% from 1991 to 1996, +17% from 1996 to 2001.

When one takes a closer look, development of international trade in dairy products is, to a large extent, the result of regional free-trade agreements. In a few years we will be celebrating 50 years of European Union and EU internal trade alone accounts for more than 40% of total international trade in dairy products. For liquid milk and cream, it is more than 80%, for fresh dairy products 70%, for cheese nearly 60%, for condensed milks 50%, butter 40%, skimmed milk powder 30%, full cream powder 13%.

But the phenomenon is more general: international trade is essentially progressing through regional trade. Even if the weight of Mercosur, Nafta, the Gulf Cooperation Council, Asean, all considerably younger than the EU, is still by far less than the latter, the premises of their role in international trade of dairy products can already be felt. And for certain types of dairy products their weight is already quite big, the best example being Nafta for skimmed milk powder. But one could also mention Mercosur for full cream powders. Within the Gulf Cooperation Council, in addition to re-exportation of powder and butteroil, trade in fresh dairy products like fermented milks and yogurts is developing strongly. Asean, a free-trade zone made up of ten countries, is also the theater of important regional trade in dairy products, which is not made up exclusively of re-exportation.

Apart from EU internal trade and trade within the zones just mentioned, intercontinental trade represents less than 5% of world milk production.

In the end, the major event since 1996, that is to say since actual implementation of the Marrakech Agreement, is the establishment of Oceania's indisputable domination of world trade: at present it exceeds the EU of 15 in terms of dairy surplus, but also in exports! According to the FAO, the dairy surplus in Australia and New Zealand will be more than 25 million tonnes in 2010, five times greater than the EU. Even without an unexpected liberal push in the WTO negotiations, which are supposed to resume shortly … Who would have imagined that ten years ago?

Bearing in mind that the dairy industry is only one among others it competes with, to contribute to the supply of food products avidly vying for the consumer's favor; many of those industries feel that to maintain the viability of the world's dairy industry, governments should realize that promoting regional policies for the development of the dairy sector, in the international sense of the term, is of greater importance than promoting systematically and endlessly free-trade as the ultimate booster for the prosperity within the sector. But, obviously, no one will contest that the focus must be on how to reconcile the need to remove distortions to trade with that of providing policy measures for dairy sector at regional level. Although no one will contest that dairy policies in the EU and the USA have had and still have a big effect on market conditions, they are not the only determinants. Regional political measures like limited access, especially in countries that import a great deal of dairy products, have also a significant impact on the world dairy trade (as is the case these days for example with the import quota threat in Russia).

Finally, may I mention that without getting into polemics with my colleagues and friends at OECD who made our excellent dairy colleagues and friends in New Zealand the reference for their famous calculation of the Producer Subsidy Equivalent (PSE), one must nevertheless note that the intellectual merits of this approach are far from unanimous … The Canadian Professor Maurice Doyon has become quite well-known on this topic over the last few years, including in the context of the IDF Congress in 2002 in Paris.

▪ Internationalization and Globalization of Dairy Companies (Not all of Which are Involved Exclusively with Milk)

For a variety of reasons, obviously including the very nature of the raw material milk (unequaled wealth for the food industry, but also highly fragile and, finally, of a cost that will remain high as compared to other raw materials available for this industry) the dairy sector will continue to be highly localized, with most dairy products consumed in the country or region where they are produced. Consequently, companies that produce for the local market will also in the future play an important role in every country or region.

But the dairy industry obviously also participates in the major economic and social developments, both at regional level and at international level, in a world on its way to globalization.

The internationalization of activities in dairy companies has intensified considerably over the past few years, as it has done in other sectors. In particular, it is no longer the monopoly of the biggest dairy groups, whether private or cooperative. Its main features are that it proceeds from an overall increase in trade, as detailed previously, from a warmer welcome for foreign investments in an ever increasing number of countries and, finally, from the necessity for dairy companies to follow their clients, regardless of whether that is in "business to business" (B to B) or, via mass distribution, if these clients are the final consumers of consumer-ready dairy products.

The warmer welcome for foreign investors has not fallen off for the past twenty some years and the open or favorable space for investors is now considerable, even if continent-countries like Russia or China still have a way to go. Today a foreign company can control the majority of the capital of a dairy in Saudi Arabia or India and this is relatively new. Similarly, where Central and Eastern Europe was a zone that used to be closed and self-sufficing, these past few years it has welcomed dozens foreign dairy investments, sometimes big, but also sometimes modest. At present internationalization is proving to be a reasonable bet for a majority of companies. It often even becomes a necessity, as the idea of "hunting reserve" on the local market is vanishing. In this respect, internationalization is becoming a strategic option among others. Thus, after the pioneers Nestlé and Kraft, the avant-garde showed up beginning in the 1970's with, among others, Bongrain, Yakult, the cooperative group from the northern part of the Netherlands that has since become Friesland-Coberco, MD Foods that has since become Arla Foods, and, let's not be afraid to say it, Parmalat. Then, during the 1980's, at least in Europe, most of the leaders internationalized. This internationalization process in the dairy industry then spread to Latin America. Today, this means that, when one really wants to understand developments, some of which are extremely fast and strong, one needs to have an eye less on structural development of such and such a country or region, and more and more on the strategic choices of such and such a dairy group. Such a group located in Canada might, a few months later, decide to deliver condensed milk to Libya from its German subsidiary, for its own reasons.

The increased competition leads dairy companies to diversify their product range, to try to boost brands where possible (but manufacturers are no longer the only ones to have nice brands, distributors and also the big names in food-service have gotten into the game too) and to work into their products more and more of that famous added value that we always hear about when future strategy is mentioned. This brings to the center stage the importance of investments to be made in Research & Development on the one hand, in brand creation, management and perpetuation on the other. And if one wants to get something out of the necessary investments in order to survive in a world that has become more competitive than ever, this leads to spreading the costs on broader bases, in terms of both products and consumers. When it comes to products, this leads for example, to using the same active principle (for example probiotics) in several types of dairy and food products. When it comes to consumers, it leads the companies to follow their consumers, distributors and operators in food-service, and to internationalize increasingly.

In their internationalization strategies, dairy companies can seek either proximity to the consumer, whomever that might be, or proximity to the raw material (and by raw material one should understand not only raw milk but also basic dairy preparations or mixes for further processing). The former strategy is definitely in favor right now. As some recent examples show, beyond groups already installed in competitive production regions (Australia, Argentina, …), it is now the size or the potential of the local market or the market accessible via a free-trade zone or a "cultural or even religious proximity", that prevails. Proximity to the consumer is the priority since accessibility to raw material no longer really seems to be a problem. For many dairy products, existence of locally organized milk production and collection are no longer prerequisites for their manufacture, as access to imported raw materials suffices. As an example, one can mention the French company, Bel, whose biggest processed cheese production site is located in Morocco. As far as the Nestlé group's biggest production site for condensed milk is concerned, it is located in Thailand.

Seeking to keep as much added value as possible on local ground has led a number of countries that are short on milk to encourage implantation of foreign investors, to boost local production of consumer products at the expense of imported products, even if that manufacture depends on imported raw material. This development obviously contributes to structuring international dairy trade differently than in the past: consumer-ready product flows increasingly obey a regional logic with relatively little continent-to-continent trade. The adjustment between raw milk deficit and surplus zones occurs mainly in the form of "semi-elaborated" raw materials, commodities or more sophisticated ingredients.

▪ Conclusion

In conclusion, I would like to stress that dairy companies are no exception to the rule: for most of them, growth is an will remain a necessity, along with mergers, acquisitions and strategic alliances, regardless of whether they are private companies or co-op groups. But this in no way means that milk will be produced and processed in only a few specialized places worldwide: the largest companies will continue to grow but will maintain the local aspect of their operations. But obviously, big is not always beautiful and every merger or acquisition is not wonderful by definition. We all know of dairy processors, small or medium-size in relation to niches or markets where they are active, who get very satisfactory results. The thing they all have in common is their good appreciation of the key success factors to be implemented when boxing in this category and their secret is that they do not forget them mid-way down the road … Local jewels are more attractive than ever in a globalized world !