

# WORLD TRADE ORGANIZATION

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Committee on Safeguards

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## NOTIFICATION UNDER ARTICLE 12.5 OF THE AGREEMENT ON SAFEGUARDS OF THE RESULTS OF A MID-TERM REVIEW REFERRED TO IN ARTICLE 7.4

REPUBLIC OF KOREA

The following communication, dated 6 April 1999, has been received from the Permanent Mission of the Korea.

1. Pursuant to paragraph 4 of Article 7 of the Agreement on Safeguards, the Korean Government has reviewed the situation of its domestic industry before the mid-term of the safeguard measure on skimmed milk powder preparations<sup>1</sup> (SMPP) that had been notified by the Korean Government to the WTO Committee on Safeguards.<sup>2</sup> The Korean Government has found that, notwithstanding the safeguard measure, domestic industry is still suffering from injury. The findings of the review are contained in this report. In view of the proven injury that remains, the Korean Government has decided to maintain the current measure, and hereby notifies the WTO to that effect.

### I. BACKGROUND

2. On 31 January 1997, the Government of Korea notified the WTO Committee on Safeguards that it would impose a quota on imported SMPP for four years starting 7 March 1997 through 28 February 2001. On 7 March of that same year, the Government of Korea announced an increase in the quota, from 15,595 to 20,521 tons for the period running between March 1997 and February 1998, and that the quota would be subsequently increased yearly by 5.7 per cent during the following three years. Imports exceeding the quota were and will be prohibited during the said period. The mid-term review of the measure was undertaken from November 1998 to February 1999. The Korean Government published the results of the review in the Government Gazette on 19 March 1999.

<sup>1</sup> SMPP represents four categories under the Harmonized System of Korea (HSK) – 0404.10.2190, 0404.10.2900, 0404.90.0000, 1901.90.2000.

<sup>2</sup> Relevant basis: G/SG/N/10/KOR/1 (27.1.1997), G/SG/N/10/KOR/1/Suppl.1 (1.4.1997)

## II. THE SITUATION IN THE DOMESTIC INDUSTRY

Table 1  
 Demand and Supply of Raw Milk

Year	1996	1997	Growth Rate for 1997	Jan-Oct 1998	Unit ton, % Growth Rate for 1998*
Total Consumption(a) - Consumption of domestic products (b)	2,336,971 1,998,371	2,277,473 2,018,273	-2.5 1.0	1,811,886 1,680,736	-6.4 -1.9
<u>Supply</u> Production	2,041,381	1,984,023	-2.8	1,706,726	1.7
Import (Raw milk conversion) -milk powder -SMPP	33,860 (338,600) 1,618 32,242	25,960 (259,200) 2,358 23,552	-23.4 46.4 -27.0	13,115 (131,150) 1,763 11,352	-40.9 39.9 -45.8
Total	2,379,981	2,243,223	-5.7	1,837,876	-3.3
Stock (Raw milk conversion)	10,866 (108,660)	7,441 (74,410)	-31.5	10,040 (100,400)	36.3
Market share of domestic raw milk (b/a, %)	858	88.6	-	92.8	-

Source: Ministry of Agriculture and Forestry (MAF) and Korea International Trade Association (KITA)

\* In comparison to the same period of the previous year.

3. The total consumption<sup>3</sup> of raw milk decreased from 2,336,971 metric tons in 1996 to 2,277,473 metric tons in 1997, and again to 1,811,886 metric tons in 1998 (by October). This represents a 2.5 per cent reduction in 1997 and a 6.4 per cent reduction in 1998 compared to the same period of the previous year. The volume of raw milk production was 2,041,381 metric tons in 1996, 1,984,023 metric tons in 1997, and 1,706,726 metric tons in 1998 (by October), representing a 2.8 per cent decrease in 1997 and a 1.7 per cent increase in 1998 (by October).

4. 32,242 metric tons of SMPP were imported in 1996, 23,552 metric tons in 1997, and 11,352 metric tons in 1998 (by October), representing a reduction of 27.0 per cent in 1997 and 45.8 per cent in 1998 (by October).

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<sup>3</sup> Total domestic consumption is the sum of the consumption of domestic raw milk, imported milk powder and SMPP, and the stock of domestic milk powder.

Table 2

Imports of SMPP

Unit: ton US\$1,000, %

Year	1996	1997	Growth Rate for 1997	Jan-Oct. 1998	Growth Rate for 1998*
Quantity	32,242	23,552	-27.0	11,352	-45.8
Value	78,906	49,977	-36.7	22,537	-49.3

Source: KITA

\*In comparison to the same period of the previous year.

5. Accordingly, the market share of domestic raw milk widened from 85.5 per cent in 1996 to 88.6 per cent in 1997 and to 92.8 per cent in 1998 (by October).

6. The number of dairy households declined, from 21,129 farm households in 1996, to 17,419 in 1997, and to 16,136 by September 1998.

Table 3

Number of Dairy Farms

Unit: household, %

Year	1996	1997	Growth Rate for 1997	Jan-Oct 1998	Growth Rate for 1998*
Number of dairy households	21,219	17,419	-17.6	16,136	-12.1

Source: MAF

\*In comparison to the same period of the previous year.

7. Because it was impossible to review the incomes of individual dairy households scattered across the country, the incomes of livestock cooperatives were examined instead. Since the livestock cooperatives, which are comprised of dairy households producing raw milk, distribute their profits to their members, the livestock cooperatives' profits and losses are directly linked to the raw milk producers' income. According to the profit and loss statements of thirteen livestock cooperatives<sup>4</sup>, the sales profits from milk processing business sections of the cooperatives were W xxx,xxx million in 1996, W xxx,xxx million in 1997 and W xxx,xxx million in 1998. The ratio of sales profits to sales was 17.9 per cent in 1996, 17.6 per cent in 1997 and 16.3 per cent in 1998.

8. The operating profits were Wxx,xxx million in 1996, W xx,xxx million in 1997, and Wxx,xxx million in 1998. The ratio of operating profits to sales was 4.1 per cent, 4.4 per cent, and 5.5 per cent for the respective periods. The ordinary profits worsened from W -x,xxx million in 1996 to W -x,xxx million in 1997 but improved to W xxx million in 1998. The ratio of ordinary profits to sales was 0.6 per cent, -1.0 per cent, and 0.0 per cent for the respective periods.

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<sup>4</sup> Seoul Dairy Cooperative, Kangwon Dairy Cooperative, Chuncheon Livestock Cooperative, Taebak Livestock Cooperative, Chungju Dairy Cooperative, Chunju Livestock Cooperative, Imsil Dairy Cooperative, Kwangju-Cheonnam Dairy Cooperative, Taegu-kyungbuk Dairy Cooperative, Kyungbuk Dairy Cooperative, Pusan-Kyungnam Dairy Cooperative, Kyungnam Dairy Cooperative and Cheju Dairy Cooperative.

Table 4

Profit and Loss Statement of Livestock Cooperatives  
 (Milk Processing Operation)

Year	1996	1997	1998
Net sales value (a)	xxx,xxx	xxx,xxx	xxx,xxx
Sales profit (b)	xxx,xxx	xxx,xxx	xxx,xxx
Operating profit (c)	xx,xxx	xx,xxx	xx,xxx
Ordinary profit (loss) (d)	-x,xxx	-x,xxx	xxx
Gross profit rate (b/a)	17.9	17.6	16.3
Operating profit rate (c/a)	4.1	4.4	5.5
Ordinary profit rate (d/a)	-0.6	-1.0	0.0

Source: NLCF

9. There were fourteen livestock cooperatives operating milk-processing businesses in 1996, fifteen in 1997, and thirteen in 1998. Of those cooperatives, seven saw their paid-in-capital depleted both in 1996 and 1997, and eight experienced the same situation in 1998.

10. The total consumption of milk powder was 52,619 metric tons in 1996, 46,485 metric tons in 1997, and 30,334 metric tons by October 1998, implying that consumption decreased by 11.7 per cent in 1997 and 24.0 per cent in 1998<sup>5</sup> (January-October).

Table 5

Milk Powder Demand and Supply

Year	1996	1997	Growth rate for 1997	Jan.-Oct. 1998	Growth rate for 1998*
Total consumption (a)	52,619	46,485	-11.7	30,334	-24.0
- Domestic raw milk (b)	18,759	20,565	9.6	17,219	-2.9
<u>Supply</u>					
Production	23,060	17,140	-25.7	19,818	38.9
Import	33,860	25,920	-23.4	13,115	-40.9
- milk powder	1,618	2,368	46.4	1,763	39.9
- SMPP	32,242	23,552	-27.0	11,352	-45.8
Total	56,920	43,060	-24.3	32,933	-9.7
Stock	10,866	7,441	-31.5	10,040	36.3
Market share of domestic milk powder (b/a, %)	35.7	44.2	-	56.8	-

Source: MAF and KITA

\*In comparison to the same period of the previous year.

<sup>5</sup> The total domestic consumption of milk powder comprises domestic milk powder, imported milk powder and SMPP.

11. Domestic production of milk powder was 23,060 metric tons in 1996, 17,140 metric tons in 1997, and 19,818 metric tons in 1998 (by October), representing a growth of -25.7 per cent in 1997 and 38.9 per cent in 1998 (by October) compared to the same period of the previous year. The decrease in production of milk powder in 1997 is attributable to the 2.8 per cent decrease in raw milk production. The increase in milk powder production in 1998 can be explained by the fact that while domestic raw milk consumption decreased by 6.4 per cent, production of raw milk increased by 1.7 per cent. The market share of domestically produced milk powder increased from 35.7 per cent in 1996 to 44.2 per cent in 1997 and to 56.8 per cent by October 1998.

12. The inventory of domestically produced milk powder decreased from 10,866 metric tons at the end of 1996 to 7,441 metric tons in 1997 and then increased to 10,040 metric tons by the end of 1998.

13. Throughout the period of review, the sales price of domestically produced milk powder was below the production cost. The production cost of milk powder increased from W 5,906 per kg. in 1996 to W 5,978 in 1997 and then up to W 6,484 in October 1998. In contrast, the sales price of milk powder was W 4,083 per kg. in 1996, W 4,146 in 1997 and W 4,061 in October 1998. Accordingly, the difference between sales price and production cost per kg. of domestically produced milk powder was W -1,823 in 1996, W -1,832 in 1997, and W -2,423 through October 1998.

14. The Korean Government reviewed the profit-and-loss statements of the milk powder operations of Seoul Dairy Cooperative, Pusan-Kyungnam Dairy Cooperative, Namyang Dairy Co., Maeil Dairy Co., Haitai Dairy Co., and Lotte Ham and Milk Co.<sup>6</sup> The sales losses of the six companies were W -x,xxx million in 1996, W -x,xxx million in 1997, and W -xx,xxx million in 1998. The ratio of sales losses to sales was 24.8 per cent in 1996, 22.6 per cent in 1997, and 32.6 per cent in 1998.

15. The operating losses increased from W -x,xxx million in 1996, to W -x,xxx million in 1997 and W -xx,xxx million in 1998. The ratio of operating losses to sales was 40.3 per cent, 32.7 per cent and 43.3 per cent for the respective years.

16. Meanwhile, the ordinary losses increased, from W -x,xxx million in 1996 to W -xx,xxx million in 1997 and W -xx,xxx million in 1998. The ratio of ordinary losses to sales was 48.3 per cent in 1996, 39.7 per cent in 1997, and 51.5 per cent in 1998.

17. As a facility industry, the milk powder industry uses very little labour input. The fact that the workers producing processed milk products are involved in the manufacturing of milk powder as well makes a labour input analysis difficult in the milk powder industry. Milk powder production is also an auxiliary industry that simply processes surplus raw milk for storage purposes. For these reasons, analysis of capacity utilization and productivity of the milk powder industry has been omitted from this review.

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<sup>6</sup> The six companies account for 66.4 per cent of total domestic production of milk powder (as of the end of October 1998). Therefore, it can be said that the companies are representative of domestic milk powder producers.

### **III. REVIEW ON THE NEED FOR WITHDRAWAL OR ACCELERATION OF LIBERALIZATION**

18. In reviewing the necessity of withdrawing the safeguard measure or increasing the pace of its liberalization, the Korean Government considered, among other factors, the level of the domestic industry's recovery, the possibility that withdrawal of the safeguard or the acceleration of its liberalization would threaten to cause injury to the domestic industry, and the level of adjustment made by the domestic industry.

#### **A. LEVEL OF THE DOMESTIC INDUSTRY'S RECOVERY**

19. Since the application of the safeguard measure, the market share of domestic raw milk has increased from 85.5 per cent in 1996 to 88.6 per cent in 1997 and 92.8 per cent in 1998 (by October). For domestic milk powder, the market share increased from 35.7 per cent in 1996 to 44.2 per cent in 1997 and 56.8 per cent in 1998 (by October).

20. Inventories of domestic milk powder fell from 10,866 metric tons in 1996 to 7,441 metric tons in 1997, and then rebounded to 10,040 metric tons by the end of October 1998. The increase in inventory in 1998 is partly attributable to shrinking domestic demand.<sup>7</sup> The Korean Government deems the inventory level of milk powder still high since the 10,040 metric tons of milk powder in inventory as of the end of October 1998 was as high as 2.4 times the average yearly inventory of 4,200 metric tons from 1993 to 1995.

21. The sales price of domestic milk powder increased from W 4,083 per kg. in 1996 to W 4,146 per kg. in 1997 and then dropped to W 4,061 by October 1998. The decrease in sales price in 1998 is partly attributable to shrinking domestic demand.<sup>8</sup> Considering the fact that the sales price of domestically produced milk powder was W 5,354 per kg. in 1993, it is evident that the price has not recovered.

22. While the sales prices largely stagnated, the production costs of milk powder increased from W 5,906 per kg. in 1996 to W 5,978 in 1997 and W 6,484 during the first 10 months of 1998. Therefore, the gross loss per kg., that is, the deficit that arises from the deduction of production costs from sales revenues, increased from W 1,823 in 1996 to W 1,832 in 1997 and up to W 2,423 by October 1998.

23. The profitability of livestock cooperatives improved slightly. Yet it still falls behind the average profitability of the food processing industry. By the end of 1998, of the thirteen livestock cooperatives reviewed, eight cooperatives operating milk processing businesses had depleted their paid-in-capital. Furthermore, losses incurred by milk powder producing companies have worsened.

24. The overall review of the domestic industry situation since the application of the safeguard measure suggests that injury to the domestic industry has been partially relieved; the market share of domestically produced products has increased and the profitability of the livestock cooperatives representing dairy households has improved. However, the sales of milk powder at prices below production cost continues, which has taken a heavy toll on the profitability of the milk powder industry. By the end of October 1998, the milk powder stock exceeded the reasonable level; the profitability of livestock cooperatives were still far behind the average profitability of the food

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<sup>7</sup> But for the impact of shrinking consumption, the stock reduction rate in 1998 would have been 31.5 per cent, or the same rate as in 1997. Thus, the total inventory in 1998 would have been 5,097 metric tons.

<sup>8</sup> But for the impact of shrinking consumption, the rate of increase of the sales price in 1998 would have been 1.5 per cent, or the same as in 1997. Thus, the sales price for 1998 would have been W 4,208 per kg.

processing industry; and of the thirteen livestock cooperatives, eight cooperatives operating milk processing depleted their paid-in-capital. In light of the above factors, it is difficult to assume that the overall injury of domestic industry has been remedied.

#### B. THREAT OF INJURY TO THE DOMESTIC INDUSTRY

25. The Korean Government has reviewed whether the withdrawal of the safeguard measure or the acceleration of its liberalization would threaten to cause injury to domestic industry.

26. The import price of SMPP declined from \$2.45 per kg. in 1996 to \$2.12 per kg. in 1997 and \$1.99 per kg. through October 1998.

27. Although domestically produced milk powder was sold at prices below production cost, the sales price of imported SMPP was still lower than that of domestically produced milk powder by W 1,164 per kg. in 1996 and W 1,162 in 1997. The situation changed at the beginning of 1998. As a result of a drastic devaluation of the Korean currency against the US dollar<sup>9</sup>, the sales price of imported SMPP became higher than that of domestically produced milk powder by W 60 per kg. This loss of price competitiveness of imported SMPP was the major reason why the import quota for SMPP was not filled.

28. However, from late 1998, the Korean won began to recover its value. If the won maintains its current value<sup>10</sup>, it is expected that imported SMPP will regain price competitiveness against domestically produced milk powder. It is estimated that, if the safeguard measure were lifted under this situation, the import surge of SMPP would threaten to cause injury to domestic industry again.

#### C. ADJUSTMENT OF THE DOMESTIC INDUSTRY

29. Since the application of the safeguard measure, the Korean Government has taken several measures to facilitate the adjustment of the domestic industry. It has (1) encouraged the use of a contract-based production system for raw milk so that demand and supply can be adjusted; (2) improved the system for collection of raw milk; (3) encouraged quality improvements through the adoption of a tiered pricing system for different grades of raw milk; and (4) provided commercial farmers with loans for facility improvements (as much as W xx,xxx million in 1996, W xx,xxx million in 1997 and W xx,xxx million in 1998).

#### D. CONCLUSION

30. As mentioned earlier, even though the Korean Government has endeavoured to facilitate adjustment of its domestic industry, the overall injury to domestic industry has not been remedied since the application of the safeguard measure. Under such circumstances, the withdrawal of the safeguard measure or the acceleration of its liberalization could threaten to cause injury to domestic industry. Therefore, the Korean Government has decided to maintain the safeguard measure.

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<sup>9</sup> The average annual exchange rates of the Korean won against the US dollar was 805 in 1996, 951 in 1997, and 1,399 in 1998.

<sup>10</sup> As of January 1999, the average exchange rate was W 1,177 per US\$. At this rate, the sales price of imported SMPP was 17 per cent less than domestically produced milk powder. The major economic institutions at home and abroad forecast that the 1999 exchange rate will be W 1,150-1,200 per US\$, implying that imported SMPP will remain more competitive than domestic SMPP in terms of price.