

# GENERAL AGREEMENT ON TARIFFS AND TRADE

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International Dairy Arrangement

COMMITTEE OF THE PROTOCOL REGARDING CERTAIN CHEESES

Twenty-Eighth Session

Draft Report

Introduction

1. The Committee of the Protocol Regarding Certain Cheeses held its twenty-seventh session on 15 December 1986.

Adoption of the agenda

2. The Committee adopted the following agenda:
- A. Adoption of report on the twenty-seventh session
  - B. Information required by the Committee:
    - (i) Replies to Questionnaire 3
    - (ii) Summary tables
    - (iii) Other information
  - C. Sales under derogations
  - D. Review of the market situation for products covered by the Protocol
  - E. Adoption of report to the Council
  - F. Date of the next session

Adoption of report on the twenty-seventh session

3. The Committee adopted the report on its twenty-seventh session. This was distributed as document DPC/C/42.

Information required by the Committee

(i) Replies to Questionnaire 3

4. The Committee reviewed the replies to Questionnaire 3 and requested participants who had not communicated such information in respect of the third quarter of 1986 to do so without further delay. They were also requested to submit information regarding the third quarter of 1986 by 13 March at the latest.

(ii) Summary tables

5. The Committee took note of document DPC/C/W/30/Rev.3 which contained information up to the third quarter of 1986. It also took note of information up to June 1986 incorporated in the seventh annual report on the world market for dairy products.

(iii) Other information

6. The Committee took note of the statistical information which the secretariat had compiled on production, trade (including food aid), stocks and consumption of dairy products in the United States. This information was updated in the light of comments made by the observer from the OECD.

7. The Committee also took note of the document DPC/W/63 which the secretariat had prepared on the United States Export Sales of Dairy Products under Section 1163 of the Food Security Act of 1985. No new information had been received since the distribution of this document.

Sales under derogations

8. The Committee took note of the information provided by New Zealand concerning its sales of cheese notified in relation to Article 7:2 of the Protocol Regarding Certain Cheeses in the third quarter of 1986 (DPC/C/W/26/Add.6). The Committee also took note of the register of sales made under derogation in document DPC/C/W/27/Rev.3. The register would be revised in the light of recent information provided by New Zealand and issued soon as document DPC/C/W/27/Rev.4.

9. The Committee had before it a communication by New Zealand relating to exports under Article 7:2 of the Protocol Regarding Certain Cheeses (DPC/C/W/31).

10. Referring to the communication from New Zealand (DPC/C/W/31) the spokesman of the EC noted that New Zealand was requesting the Committee to agree to the amendment of the Interpretative Note so as to increase substantially the annual quantities of its exports under Article 7:2; the present quantities were 1,000 tons and, in exceptional circumstances, could be as high as 2,000 tons; yet, New Zealand was requesting an increase to 4,000 tons and, in exceptional circumstances, to 5,000 tons per year. Referring to the register of sales effected under that derogation, the spokesman of the EC noted that New Zealand had made extensive use of that provision; indeed, taking into account the last notification, it had since June 1983 exported some 9,000 tons of cheese under that derogation which, according to the provisions of Article 7:2 itself, should be used only in exceptional circumstances. In view of the increasing amounts that New Zealand was exporting on a very regular basis under that derogation, the exceptional nature of such sales might well be questioned. Moreover, an examination of the communication from New Zealand (DPC/C/W/31) revealed that apparently a certain proportion of the cheese regularly produced by that participant was consistently of so-called bad quality. That situation was a source of concern to the Community, because the derogation had been granted only in respect of exceptional circumstances, namely, it should apply essentially to quantities of cheese which, as a result of an accident, were in a bad state of conservation and justified sales below the minimum export price. However, the communication from New Zealand

indicated that that participant could not produce cheese without also producing a small amount (3 per cent of its total annual production) which did not satisfy quality standards. In view of the advances in cheese-making methods, he wondered whether it was normal that a certain proportion (3 per cent in the present case) of production should be of bad quality. His delegation considered that, on the contrary, as technological progress was made, the proportion of unsound cheese in relation to total production should decline steadily. In point of fact, the problem that was being raised through that request was of a more substantial nature, namely, whether a participant could regularly sell relatively modest quantities - but which eventually amounted to a lot - particularly when they were concentrated on certain very specific destinations. His delegation therefore considered that the use made of that provision by New Zealand went beyond the original intention of the authors of the Arrangement when the derogation had been negotiated. In any event, the Community was not in favour of the Interpretative Note contained in the appendix to the Arrangement being amended upwards to reflect the quantities requested by New Zealand. He added that that derogation and the Interpretative Note which restricted the possibility of its use constituted, for the Community, an essential condition for the sound operation of the Arrangement and specifically of the Protocol Regarding Certain Cheeses. Consequently, unilateral amendments would be regarded by the Community as modifying the balance of rights and obligations which had led it to subscribe to the Arrangement.

11. The representative of New Zealand in presenting the communication DPC/C/W/31 said that his country wanted to alter a unilateral interpretation advanced by it under Article 7:2 of the Protocol for aged and redundant cheese. He argued that the limit of 2,000 tons indicated in 1979 was now unrealistic. His delegation believed that this limit ought to be replaced as a unilateral indication on the part of New Zealand by a higher indicative limit of 4,000 to 5,000 tons. Since 1979, New Zealand cheese production had grown from 85,000 tons to around 130,000 tons, an increase of 50 per cent. The range of cheese specifications manufactured had increased from 19 to 41. As a consequence, the volumes of aged

redundant and off-specification cheese had also grown. Only a small proportion of this cheese could be absorbed domestically, since his country had limited capacity to produce processed cheese. The bulk of New Zealand cheese was produced for the export market, and this was the only outlet for aged and redundant cheese. Until 1983, the New Zealand Dairy Board had not required recourse to the provisions of Article 7:2 because cheese prices had been well above the minimum export price of US\$1,000 per ton f.o.b. Since then cheese prices had dropped much closer to the GATT minimum. The price decline had inevitably been reflected in the prices processors were willing to pay for downgraded cheese for processing. Since June 1983, New Zealand exports under derogation had gradually risen in line with the increased production of cheese as a whole. In the past, much of the New Zealand low-quality downgraded cheese exports had gone into Western Europe for processing; the last year and a half had seen an increasing amount going into Eastern Europe. New Zealand's trade in low-quality or aged cheese for processing was well established and had not been disruptive for Community cheese trade for processing. It should be noted that it was not a question here of any new venture. What New Zealand was requesting was that the IDA accommodate slightly larger volumes of this ongoing trade. It should also be noted that the Community, for example, did not face a similar problem in disposing of redundant cheese for processing as it had its own large processing operations to absorb much of this low-quality cheese. New Zealand's total output of processed cheese was currently of the order of 6,500 tons for 1985/86. This figure simply did not compare with total EC processed cheese production of 325,000 tons in 1984. These figures gave a measure of the situation faced by his country in terms of its ability to dispose internally of aged and redundant cheese. It was expected that the New Zealand cheese production would grow to 150,000 tons in the near future. The projected growth in production combined with the ongoing increase in the range of cheese specifications meant that New Zealand would be likely to have a requirement to export slightly greater amounts of downgraded cheese in the future. Because the production of this low-quality cheese was not planned or budgeted for, it was not possible to forecast its exact availability in the future. However, given the planned levels of cheese production, New Zealand anticipated that a unilateral

expectation which had been advanced in 1979 ought reasonably to be changed to a limit of between 4,000 and 5,000 tons. Clearly, the intent of the drafters of the Arrangement had encompassed the idea that there would be off-specification cheese for disposal; otherwise they would not have provided for the derogation in the first place. Other participants also had taken advantage of this disposition but they had not given in 1979 an indication or an interpretation. New Zealand had chosen to do this on a unilateral basis. As indicated in the communication DPC/C/W/31 New Zealand requested the Committee to agree that the interpretative note contained in the appendix would be amended. He reiterated that the limit of 2,000 tons indicated in 1979 ought to be replaced as a unilateral indication on the part of New Zealand by a higher indicative limit of 4,000 to 5,000 tons. He would convey to his authorities the statement made by the representative of the EC. His delegation would be interested to hear the views of the other participants.

12. The representative of Finland speaking on behalf of the Nordic countries said that the Nordic countries were not in a position to give a definitive reply to the New Zealand proposal in this meeting. This question should be discussed with the experts in the respective capitals. However, the first rather preliminary reactions received from each of the Nordic countries seemed not to be too favourable to the proposal by New Zealand. Evidently, the suggestion by New Zealand went quite far as compared to the quantities of 1,000 to 2,000 tons indicated in 1979. The Nordic countries had understood that the derogation had been a part of a package in 1979 and had expected that the quantities indicated in 1979 would be sufficient for New Zealand. The Nordic countries had also noted with some concern that what had been intended to be an exception had become rather a routine operation and had implied, especially in 1986, certain transactions of relatively big volumes to certain countries evidently having a price-depressing effect on the market situation. He said that the Nordic countries would consider further this proposal and he suggested to revert to this question at the March meeting of the Committee.

13. The representative of South Africa said that as one of the few countries that had made use of this derogation he could give a preliminary reaction to the New Zealand request. His delegation's understanding of Article 7:2 of the Protocol was that it was open to unilateral interpretation. Consequently, his delegation did not see an upper limit and did not see also that New Zealand was necessarily bound by the interpretative statement of 1979. His delegation had not any problems of principle with the New Zealand request. However, his delegation had some difficulties with the figure of 3 per cent of the total production proposed by New Zealand but that question could be looked at.

14. The spokesman of the EC wondered what would be the legal feasibility of amending the Interpretative Note of New Zealand. The secretariat might provide the Committee with information on that subject. He emphasized that he was not requesting the secretariat to adopt an official position on the question of legal interpretation. The Community reserved its right to make its own interpretation of a possible amendment of the interpretative statement of New Zealand, in view of the fact that the matter had been the subject of intensive negotiations when the Arrangement had been drafted. The Community considered that it was for participants, either individually or as a group, to provide a legal interpretation. In the meantime, the Community understood that New Zealand would in any case continue to be bound by the interpretative statement of 1979, in other words, that it would continue to be restricted to a limit of 2,000 tons per year in exceptional circumstances.

15. The representative of New Zealand said that he had taken careful note of all statements made. His delegation had no problem on the secretariat providing a note on legal interpretation for consideration by the Committee at its next regular meeting. New Zealand also as the EC reserved its rights to any legal interpretation of this Arrangement. He hoped that participants would give serious consideration to this question so that the Committee could have a further discussion on this matter in its March 1987 meeting.

16. The Committee took note of the communication from New Zealand (DPC/C/W/31) as well as the statements made, and decided to revert to the question at its next regular meeting. It requested the secretariat to prepare a note on the legal aspects of the question with a view to providing the Committee with information.

17. Referring to the register of sales effected under Article 7:2 (DPC/C/W/27/Rev.3), the spokesman of the EC noted that Poland had sold 1,000 tons of cheese to the EC in 1984. However, according to the Community's statistics, cheese imports from Poland had amounted to only 542 tons in 1984. He asked the representative of Poland whether he could provide clarification and also indicate the country of destination and the type of cheese exported.

18. The Committee took note of the Community's question and hoped that Poland could clarify the matter at the Committee's next meeting.

Review of the market situation for products covered by the Protocol

19. The representative of Switzerland said that cheese production during the first three quarters of 1986 had amounted to 98,200 tons as against 95,100 tons during the corresponding period of 1985, reflecting an increase of 3,200 tons. That trend had been maintained in October and November 1986, although it was expected that production would decline slightly in 1987. Cheese imports had also increased during the first nine months of 1986 and had amounted to 16,300 tons as against 15,500 tons during the corresponding period of 1985, reflecting an increase of about 5 per cent. That trend, too, had continued during the last months of 1986. Exports, on the other hand, had declined slightly during the first three quarters of 1986 (by about 1 per cent). It was anticipated that exports would decline by 1 to 2 per cent during 1987 as compared with 1986. Estimates indicated that consumption had increased by 1 to 2 per cent in 1986. Stocks at the end of September 1986 had declined slightly below their level at the end of September 1985. In October and November 1986 they had remained at normal levels. As a result of the increase in the base price of milk, cheese prices had risen in the summer of 1986. Export prices had also increased.

20. The representative of Norway said that in the first three quarters of 1986, production had increased by 4 per cent and that consumption had remained stable as compared to the corresponding period of 1985. It was estimated that exports in 1986 at 19,000 tons would remain unchanged as compared to 1985. It was anticipated that exports in 1987 would remain stable.

21. The representative of Finland estimated that production of cheese in 1986 at 79,000 tons would remain unchanged as compared to 1985. Export availability was likely to remain stable in 1986. Domestic consumption was increasing.

22. The representative of Sweden said that production, imports and exports of cheese were stable. Per capita consumption of cheese had increased to 15.0 kg. in 1985 as compared to 9.2 kg. in 1970. It was estimated that consumption would continue to increase.

23. The representative of South Africa said that a rather heavier than normal production of cheese for the third quarter, and a normal consumption level for this time of the year pushed stocks up to around 6,400 tons from the unusually low level that resulted after the promotional campaign and stockpiling that occurred in the second quarter of the year.

24. The representative of Poland informed that his authorities had taken steps to increase domestic consumption of cheeses. In reply to a question by the EC regarding export availability of cheese he said that he would furnish this information at the next meeting of the Committee.

25. The representative of New Zealand said that cheese production for export was forecast at 80,000 tons for 1986/87 as compared to 95,000 tons in 1985/86. Exports in the first three quarters of 1986 totalled 77,200 tons, the main destination still remaining Japan. It was estimated that domestic consumption in 1986/87 would increase slightly and reach 28,000 tons. Prices of Cheddar cheese in international trade were between US\$1,030 and US\$1,130 per ton f.o.b. In reply to a question by the EC regarding prices of cheese exported to Australia he said that he had no information with him on this subject but he would try to provide this information soon on a bilateral basis.

26. The delegate of Japan told the Committee that cheese output in the fiscal year 1985 was at the same level as in the previous year. Imports of natural cheese in 1985 were 3.2 per cent more than in the previous year. During the first nine months of 1986 imports were at the same level as in the corresponding period of last year. Average import price of natural cheese during 1985 was US\$1,532 per ton c.i.f. In more recent months import prices were in the range of US\$1,579 and US\$1,645 per ton c.i.f.

27. The representative of Australia said that her country understood that the Japanese Government was contemplating significant increases in assistance for its domestic cheese-producing industry in the period to 1991 as a means of using surplus milk production. The major feature of the five year program in Japan was the establishment of a 20 billion yen national cheese production program. It was proposed that funds would be diverted from LIPC's profits on imported beef. As a major supplier of both cheese and beef to Japan, Australia was concerned at this sort of approach which was based in effect, on levying imports of Australian beef in order to subsidize Japanese milk and cheese in a way which was calculated to damage Australian cheese trade. Another element of the scheme was the payment of a subsidy to ensure a stable price. A further element was the setting of a level for the quantity of milk to be included in the scheme. Australia understood that the Japanese Government was currently considering proposals along these lines in its 1987 budget proposals, which were due to be completed by 31 December 1986. As an efficient cheese exporter to Japan, Australia was concerned that Japanese proposals to provide additional long-term assistance to the domestic industry would lead to increased domestic production and would threaten Australia's trade in natural cheese including cheese destined for the Japanese-cheese processing industry. Australia requested the Japanese Government to take fully into account the interests of its suppliers when formulating further assistance measures for Japanese dairy farmers and the dairy processing-industry.

28. The representative of New Zealand said that his delegation could endorse the concerns just outlined by the delegate of Australia. This was an extremely serious matter for New Zealand. The consequences of the new scheme would in effect mean a considerable increase in domestic cheese

production in Japan in 1987 and further steady increases planned to a level around double the current production by 1991. Imports of natural cheese would suffer as a result of this very large increase in domestic production. The implementation of this new régime would pose a direct threat to an existing trade and would be contrary to the commitments of the Ministerial Declaration on the Uruguay Round relating to standstill and rollback.

29. The representative of Japan had no information on the matter and was not in a position to answer those questions. He would, however, convey the comments made to his authorities and ask for information for the next meeting of the Committee.

30. The representative of the EC estimated that cheese production would increase by 1.2 per cent in 1986 to 4,345,000 tons. Domestic consumption was expected to increase by 1.9 per cent in 1986 to 4,045,000 tons. Exports during the first nine months of 1986 had decreased by 6.6 per cent in relation to the corresponding period of 1985. The situation in the domestic market was quite good while the situation in the world market was rather weak. The Community did not hold public stocks of cheese, but some 123,000 tons of Italian-type cheeses were in private hands and financed by the Community budget. Prices for Cheddar cheese were around US\$1,100 per ton f.o.b.

31. The representative of Australia said that production of cheese in the July-September 1986 period of 39,100 tons had been about 1.5 per cent less than that for the same quarter in 1985 (39,700 tons). Production of Cheddar-type cheese for the July-September 1986 period of 25,800 tons had been down 9.8 per cent on the corresponding period in 1985. The decline in production had been due to reduced export orders; non Cheddar-cheese production increased by 19.3 per cent from 11,100 tons to 13,200 tons. Production of cheese for 1986/87 was expected to be 167,000 tons, which was a decline of almost 2 per cent compared with the previous year's production of 170,300 tons. Cheddar cheese production for 1986/87 was forecast at 115,000 tons, down 6.9 per cent from the 1985/86 level of 123,500 tons;

non-Cheddar cheese production for 1986/87 was forecast at 52,000 tons, an 11.2 per cent increase over 1985/86 level of 46,700 tons. Export availability of cheese for 1986/87 was estimated to be around 70,700 tons (63,900 tons Cheddar and 6,800 tons non-Cheddar) leaving desirable closing stocks of 70,000 tons. This compared with exports in 1985/86 of 61,900 tons (55,500 tons Cheddar and 6,400 tons non-Cheddar). With regard to world situation, she said that cheese production was increasing as producers switched from butter and skimmed milk powder. The price of Australian cheese for general export was steady at around US\$1,100 per ton f.o.b. Cheese continued to represent one of the few dairy products where international demand was expected to steadily increase in the future.

32. The representative of Finland inquired whether the representative of Australia could inform the Committee on Australian plans to establish tariff quotas for cheese. His delegation had some doubts that these plans would fit in with the commitments on standstill.

33. The representative of Australia replied that the legislation providing for tariff quotas on dutiable cheeses had passed through both Houses of the Australian Parliament. However, the legislation had not been proclaimed and the date for that had not been fixed. The legislation to introduce tariff quotas on dutiable cheeses had been introduced for two related reasons. One of the reasons had essentially been to protect Australian producers from highly subsidized imports. Following the introduction of new dairy marketing arrangements in Australia, market assistance to the cheese industry would decline by 45 per cent over the six-year period of the Arrangement. The scheme was proposed to be introduced in order to inject some stability and predictability into the dairy industry in a period in which this industry was being faced with quite extreme restructuring measures. She noted that the Australian cheese régime was currently the most open régime of cheese producing and exporting countries and that access to the Australian market of imported cheese was highest amongst comparable countries. The latest 1984 OEC and FAO figures showed quite an impressive comparison for cheese imports as a proportion of total consumption; for Australia which was on the top of the list, the percentage was 19 per cent. In Australia's view, other major dairy industries were highly protected and assisted with a variety of arrangements on quantitative restrictions. The new proposed tariff measures would not alter markedly the openness of the Australian import

régime and were not considered by her authorities in contravention with the standstill arrangements. She added that the access for non-dutiable fancy cheeses would not be affected at all by the proposed measures.

34. The spokesman of the EC said his delegation understood, from the information provided by the representative of Australia, that one of the reasons that had led Australia to impose quotas was the problem of highly subsidized imports. His delegation assumed that Australia did not include New Zealand among subsidized exporters. More specifically, his delegation would like to know whether the new tariff régime which was proposed would apply to imports from New Zealand or not. He also asked the representative of Australia whether she could provide a breakdown of cheese imports, showing imports from New Zealand and elsewhere. Lastly, he asked whether the representative of Australia could indicate the import prices of New Zealand cheeses.

35. The representative of Australia said that she had no information on the prices of cheeses imported from New Zealand. On the breakdown of imports, she replied that in 1985/86 imports from New Zealand had amounted to 6,923 tons and imports from the EC had reached 8,557 tons. In reply to a question about treatment of imports from New Zealand, she said that New Zealand supplies of cheese would not come under the proposed scheme.

36. The representative of Finland said that his delegation understood that Australia might have had reason to react somehow to subsidized imports. His country had gone through a process with Australia regarding the subsidization of its own exports, a process which had resulted in a price undertaking. He wondered what would in the present situation be the relation between existing price undertakings and the new scheme. Moreover, his delegation still had some difficulties to see what, in the present market situation in Australia really had led to the need to take such a measure at this stage. According to available statistical information, imports of cheese by Australia had recently decreased. At the same time, it did not seem that Australia was facing an immediate crisis in the domestic production of cheese. Therefore, his delegation was not quite convinced that there had been objective reasons necessitating the introduction of the scheme.

37. The representative of Australia pointed out that the new tariff quotas scheme had not been implemented yet and that her authorities were conducting a number of bilateral consultations with interested parties including those that had arrangements at the moment. Her authorities had proposed the scheme because they had anticipated a significant surge of subsidized imports against the background that the Australian dairy industry had been restructured.

38. The spokesman of the EC requested information about the economic and legal reasons that enabled Australia to apply tariff quotas to all imports with the exception of those from New Zealand.

39. The representative of Australia replied that the answer could be found in the Free Trade Agreement between Australia and New Zealand.

40. The spokesman of the EC pointed out that the representative of Australia had not provided information on the import prices of New Zealand cheeses. He noted that Australian imports of cheeses from New Zealand were considerable and wondered - if Australia was afraid that imports would create difficulties for its cheese production - how it could consider that imports from New Zealand would not create such difficulties. It was to be assumed that price levels were satisfactory. He repeated his question concerning the import prices of New Zealand cheeses.

41. The representative of Australia reiterated that she was not in possession of import prices of New Zealand cheeses.

42. The spokesman of the EC referred to Australia's statement that discussions were under way. At the present stage, without prejudice to the course of those discussions, the Community intended to reserve its rights in respect of the new régime that Australia was thinking of introducing and, specifically, in respect of its conditions of application.

43. The observer from the OECD said that, according to estimates, cheese production in the United States should have increased by 5 per cent in 1986. Consumption had increased by 5 per cent in 1985 and by a further 8 per cent in the first half of 1986. It was anticipated that stocks on 31 December 1986 would reflect a sharp decline as compared with their level

on 31 December 1985; stocks at the end of 1986 might therefore be estimated at 358,000 tons (of which 177,000 tons were public stocks) as against 428,300 tons (of which 246,000 tons were public stocks) at the end of 1985.

Adoption of report to the Council

44. In accordance with Article VII:2 of the Arrangement and Rule 22 of the Rules of Procedure, the Committee adopted its report to the Council. This was distributed in document DPC/C/43.

Date of the next session

45. The next sessions of the Committees will be held on 16-17 March 1987, subject to confirmation by the secretariat. The session of the Committee of the Protocol Regarding Certain Cheeses will be followed by the session of the Committee of the Protocol Regarding Certain Milk Powders and then the Committee of the Protocol Regarding Milk Fat.