



USDA Foreign Agricultural Service

GAIN Report

Global Agriculture Information Network

Template Version 2.09

Voluntary Report - public distribution

Date: 2/9/2007

GAIN Report Number: CA7007

Canada

Dairy and Products

Canada Invokes GATT Article XXVIII Measure to Limit Milk Protein Concentrate (MPC) Imports

2007

Approved by:

Lisa Anderson
U.S. Embassy

Prepared by:

Darlene Dessureault

Report Highlights:

On February 7, 2006, Canadian Agriculture Minister, Chuck Strahl, announced that Canada will be initiating negotiations under Article XXVIII of the General Agreement on Tariffs and Trade (GATT) to restrict imports of milk protein concentrates. This trade action by the Canadian government is in response to Canadian dairy industry concerns regarding the increasing use of these concentrates in cheese-making and other dairy products. This decision comes after a year-long effort by a government-facilitated technical working group, comprised of dairy producers and processors, failed to reach a consensus on long-term solutions to the challenges facing the industry. Although not specifically addressed in the announcement, the Article XXVIII provision does not appear to be applicable to Canada's NAFTA partners. As such, industry sources contend that this could create some new export opportunities to U.S. dairy producers and processors. The measure is expected to negatively impact the future growth of MPC imports from New Zealand.

Includes PSD Changes: No
Includes Trade Matrix: No
Unscheduled Report
Ottawa [CA1]
[CA]

EXECUTIVE SUMMARY

On February 7, 2006, Canadian Agriculture Minister, Chuck Strahl, announced that Canada will be initiating negotiations under Article XXVIII of the General Agreement on Tariffs and Trade (GATT) to restrict imports of milk protein concentrates. This trade action is in response to Canadian dairy industry concerns about the increasing use of these concentrates in making cheese and other dairy products. This decision comes after a year-long effort by a government-facilitated technical working group, comprised of dairy producers and processors, failed to reach a consensus on long-term solutions to the challenges facing the industry. Minister Strahl had previously stated that if a consensus could not be reached, then the government would take action on behalf of the industry. Although not specifically addressed in Strahl's announcement, reliable government sources have indicated that the Article XXVIII would not be applicable to Canada's NAFTA partners. Minister Strahl also announced that he would be asking the Canadian Food Inspection Agency (CFIA) to launch a regulatory process to determine compositional standards for cheese. Compositional standards regulations are another key issue of concern for the Canadian dairy industry, and one which industry contacts are fearful could take the form of a non-tariff barrier.

The measure is expected to negatively impact the future growth of MPC imports from New Zealand.

Why GATT Article XXVIII?

The MPC issue is part of an increasing problem of a growing number of dairy components being able to enter Canada through non-TROed lines that have low or no tariffs. For dairy processors, the value of these dairy components is economics as it gives them access to cheaper imported ingredients and allows them to reduce their costs. For Canadian dairy producers, it results in more domestic milk being displaced, and increased pressure to lower their prices in some milk classes in order to remain competitive with the imported ingredients (world market). The high tariffs and market access limits provide a buffer against most of the major finished dairy products and allow dairy processors in Canada preferential access to the domestic market, while, at the same time, due to advances in technology, to have increased access to cheap dairy components in the form of dairy blends.

Following an unsuccessful and protracted effort to get all MPCs reclassified in an HS chapter with higher tariffs which would afford a greater level of protection from MPC imports, Canadian dairy producers, as represented by the Dairy Farmers of Canada (DFC), sought to address this issue on several fronts including lobbying for stricter labeling requirements, more explicit definitions of dairy terms, defined compositional standards and, of course, Article XXVIII. In April 2006, DFC accepted a government invitation to join with dairy processors in a working group to try to reach a consensus on long-term strategies for addressing the increasing challenges facing the Canadian dairy industry. When this year-long effort failed, the Canadian government stepped up, as promised, to take action. Government action has come in the form of an announcement to enact the Article XXVIII provision of the GATT and to launch a regulatory process on compositional standards for cheese. In his announcement, Strahl also expressed the Conservative Government's continued strong commitment to supply management – part of the platform the minority Conservatives campaigned on.

Use of the Article XXVIII provision has always been strongly supported by DFC, which argues that predictability in imports is one of the three essential pillars that allow supply management to work effectively in Canada. Industry sources indicated that DFC pushed government to enact the Article XXVIII provision on several other non-TROed dairy blends

and dairy ingredients in addition to the tariff lines affecting MPCs. These lines include 35.01.10.90.00 (Casein, other), 35.01.90.90.10 (Caseinates (excluding glues), and other casein derivatives), and 21.06.90.95.00 (Food preparations, nes, containing a dry state more than 10% by weight milk solids and less than 50% by weight dairy content)). However, the government announcement contained no details with regard to the specific tariff lines that would be renegotiated. Post expects that MPCs found in chapter 35, currently listed under HS 35.04 will be addressed, but at a more detailed level in order to target the specific subset of protein substances in question. The MPCs under chapter 35 are those of a concentration greater than 85% that are currently entering Canada under a MFN tariff of 6.5%.

Understanding Article XXVIII

GATT Article XXVIII provides a mechanism for member countries to renegotiate their tariff concessions in the WTO, allowing increased tariffs and setting new tariff rate quotas. In exchange for withdrawing a concession, compensation must be given to affected members. A formula for compensation is included in the GATT provision and suggests a guarantee of access 10% above the current highest level of imports for the tariff item in question. Since the negotiations are to take place with each affected member separately, quota would be distributed in a country-specific manner. One of the issues of significant concern for the processing side of the industry will be quota distribution. The bigger players who have been the major users of MPC would likely demand a quota distribution based on historical usage since they will want to maintain the quantities needed to take advantage of the economies of scale. A first-come, first-serve basis would likely cannibalize the supply as many smaller players would seek their share of the cheaper ingredients.

Compositional Standards

The government's announcement to take regulatory action on compositional standards for cheese is quite nebulous. The impact on the industry as a whole will depend on how prescriptive the compositional standard will be. Industry contacts are fearful that, depending on the compositional standards for cheese developed, these regulations could take the form of a non-tariff barrier. Reaching consensus on compositional standards will prove to be exceptionally difficult if the aim is to limit the usage of MPC in cheese making to an "acceptable" level for all stakeholders since each processor is at a different stage in the technological arc. Industry sources also contend that another hurdle would be designing trade compliant compositional standard regulations that limit MPCs in cheese making.

At this time, there is no single set of federal compositional standards for dairy products and dairy processing. The Canadian Food Inspection Agency is the agency responsible for the administration and enforcement of the regulations. Dairy product regulations can be found in two places, under the Canadian Agricultural Product Act (CAPA) and under the Food and Drug Act. The regulations as laid out in the CAPA can be found at the following website: <http://laws.justice.gc.ca/en/showtdm/cr/SOR-79-840//?showtoc=&instrumentnumber=SOR-79-840>. Identity and compositional standards for dairy products including cheese are also found in Division 8 of the Food and Drugs Regulations of the Food and can be found at the following website: http://laws.justice.gc.ca/en/showdoc/cr/C.R.C.-c.870/bo-ga:l_B-gb:l_8/en#anchorbo-ga:l_B-gb:l_8. The processing industry favors the standards set out in the CAPA, while the producers favor the regulations as set out in the Food and Drug Act. Processors argue that the CAPA standards, which are less prescriptive, are more current and reflective of market conditions, while producers favor the Food and Drug Act due to its narrower definition of "milk" and by extension its more prescriptive usage of milk in dairy products.

In his press release announcing the trade actions, Minister Strahl states that CFIA will work with stakeholders and take into account relevant international standards, including the Codex Alimentarius standards. These standards were developed by the Codex Alimentarius Commission, an organization established by the World Health Organization (WHO) and the Food and Agricultural Organization (FAO). Established in 1963, its purpose is to develop international food standards that protect consumer health and facilitate trade practices. Both Canada and the U.S. are among the members. A standard for “cheese” was first developed in 1978 and amended in 1999 and again in the year 2006. These standards are less prescriptive however, than what has been at the center of discussions within the Canadian dairy industry in recent months.

Trade Impact

Reliable government sources have indicated to Post that the Article XXVIII action will not be applicable to Canada’s NAFTA partners. If that is indeed the case, a renegotiation of tariff concessions with only non-NAFTA trading partners may represent only a short-term solution for shoring up the import control pillar. Industry sources assert that such a scenario could create incentives and export opportunities for U.S. manufactured MPC made from U.S. and/or third country fluid milk, if the latter is substantially transformed enough to jump chapters and confer U.S. origin. It should be noted however, that despite Canadian government assurances of a NAFTA exemption, it remains unclear as to how watertight the legal arguments really are and whether or not they could withstand any challenges from disaffected parties, like DFC, who stand to gain from the revocation of this exemption. In addition, as stated in the previous section, industry sources are fearful that the new regulations in compositional standards may take the form of non-tariff barriers.

The processing side of the Canadian dairy industry has long fought the imposition of further compositional standards to create standardized products, arguing that this is an out of date concept that stifles innovation and renders them less able to meet the changing demands of consumers. They also make the point that decreasing their competitiveness leaves dairy products more vulnerable to non-dairy based substitutes competing for consumer dollars. Dairy Farmers of Canada argue for stricter compositional standards on the basis of consumer protection and a type of Canada brand recognition that strict standards could generate. This type of branding would sensitize Canadians to products made with 100% Canadian dairy ingredients and help buffer the impact of increased dairy imports.

Chapter 35 is a chapter that includes albuminal substances, modified starches, glues and enzymes. It is difficult to gauge the amount of MPC trade going on under HS heading 35.04 since it is a broad category that makes no distinction between protein substances originating from milk and protein substances derived from other sources. Trade numbers from Statistics Canada show imports under 35.04 from the U.S. remaining fairly steady since 1998, with an average quantity of eight thousand tons a year and a reported value in 2005 (the most recent full year of available data) of 27 million U.S. dollars. However, industry contacts in the U.S. suggest that little if any of the imports under this category originating from the U.S. are in the form of milk protein concentrate. New Zealand, which is importing a form of MPC under this heading, shows an enormous increase in imports under chapter 35.04 since 1997. In 1997 imports from New Zealand were .301 tons (valued at 0.002 million dollars U.S.) and had exceeded 2.5 thousand tons (valued at 17 million dollars U.S.) by 2005. Germany and France, who are likely also importing some form of MPC under this tariff line, rank a more distant third and fourth, with the values of imports under chapter 35.04 reported at 8.4 and 1.3 million dollars U.S. respectively.

Find FAS on the World Wide Web:

Visit our headquarters' home page at <http://www.fas.usda.gov> for a complete listing of FAS' worldwide agricultural reporting.

Recent Reports from FAS/Ottawa:

Report Number	Title of Report	Date
CA7004	Organic Regulations	02/06/07
CA7003	This Week in Canadian Agriculture, Issue 2	01/19/07
CA7002	This Week in Canadian Agriculture, Issue 1	01/12/07
CA7001	Strawberry Market Update	01/09/07
CA6061	This Week in Canadian Agriculture, Issue 35	12/21/06

VISIT OUR WEBSITE: The FAS/Ottawa website is now accessible through the U.S. Embassy homepage. To view the website, log onto <http://www.usembassycanada.gov>; click on Embassy Ottawa offices, then Foreign Agricultural Service. The FAS/Ottawa office can be reached via e-mail at: agottawa@usda.gov