

# GENERAL AGREEMENT ON

## TARIFFS AND TRADE

RESTRICTED

L/6568

27 September 1989

Limited Distribution

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### CANADA - IMPORT RESTRICTIONS ON ICE CREAM AND YOGHURT

#### Report of the Panel

#### INTRODUCTION

1. On 7 September and 7 October 1988, the United States and Canada held consultations pursuant to Article XXII on quantitative restrictions imposed by Canada on imports of various ice cream and yoghurt products. As these consultations did not result in a satisfactory resolution of the matter, the United States, in a communication dated 8 December 1988, requested the CONTRACTING PARTIES to establish a panel to examine the matter under Article XXIII:2 (L/6445).

2. The Council, at its meeting on 20 December 1988, agreed to establish a panel on the matter with the terms of reference indicated below. It also authorized the Chairman of the Council to designate the Chairman and members of the panel in consultation with the parties concerned (C/M/227).

#### Terms of Reference

"To examine, in the light of the relevant GATT provisions, the matter referred to the CONTRACTING PARTIES by the United States in document L/6445 and to make such findings as will assist the CONTRACTING PARTIES in making the recommendations or in giving the rulings provided for in Article XXIII:2."

3. On 3 April 1989, the Council was informed that agreement had been reached on the following composition of the Panel (C/164):

#### Composition

Chairman: Mr. Lars E.R. Anell

Members: Mr. Hugh W. Bartlett  
Mrs. Carmen Luz Guarda

4. The Panel met with the parties to the dispute on 11 May and 17 July 1989, and with interested third parties on 11 May 1989. It submitted its report to the parties to the dispute on 12 September 1989.

FACTUAL ASPECTS

5. On 28 January 1988 Canada amended the Import Control List by adding the following products:

2104.00.00.10	8301	Ice Cream Novelties
2105.00.00.20	8302	Ice Cream
2105.00.00.90	8303	Other Ice Cream
2105.00.00.90	8304	Ice Milk Novelties
2105.00.00.90	8305	Ice Milk
2105.00.00.90	8306	Other Ice Milk
2105.00.00.90	8501	Products Manufactured Mainly of Ice Cream or Ice Milk
2106.90.90.00	8401	Ice Cream Mix
2106.90.90.00	8402	Ice Milk Mix
0403.10.00.00	0000	Yoghurt

With the exception of the last product (yoghurt), the other items will hereinafter be referred to as "ice cream".

6. A notice to importers, dated 25 March 1988, stated that import permits were required for any imports of ice cream and yoghurt. The notice was issued pursuant to the Canadian Export and Import Permits Act. It required importers seeking permits for any of the restricted products for the remainder of 1988 to document their import performance with respect to these products in 1984, 1985, 1986 and 1987. No quota levels were established for 1988. Permits were requested for 3,536 tons of ice cream and for 2,279 tons of yoghurt. Permits were issued for 349 tons of ice cream and for 1,212 tons of yoghurt.

7. On 17 January 1989, a Notice to Importers was issued which established annual global quotas for calendar year 1989 as follows:

- (a) ice cream, ice milk, ice cream mix, ice milk mix or any product manufactured mainly of ice cream or ice milk - 345 tons
- (b) yoghurt - 330 tons

The notice further stated that the main criterion for determining the size of quota allocated to individual importers would be the documented level of their imports during 1985, 1986 and 1987. Some quantities could, however, be made available for new importers. Individual import permits are required for each shipment and are issued through an on-line automated system. Permits normally have a validity period of 30 days around the date of arrival specified by importers (5 days prior to and 24 after), but are charged to the importers' quota allocations only if they are used.

Milk Supply Management in Canada

8. Canada restricts the importation of a number of dairy products in conjunction with its domestic milk supply management programme. This

supply management programme has two distinct elements, provincial measures with respect to the production and marketing of fluid milk (raw milk from the cow used for processing into fresh table milk and fresh cream) and joint federal-provincial programmes with respect to industrial milk (raw milk used for processing into other dairy products).

9. The market for fluid milk, which accounts for approximately 38 per cent of total Canadian raw milk production, is administered by each province. At the beginning of each year, an estimate is made of the total quantity of fluid milk needed to ensure adequate fluid milk availability in each province on a daily basis. Individual fluid milk quotas are allocated to those farmers authorized to produce milk for fluid use.

10. The industrial milk market is administered nationally under a joint agreement between the federal government and nine (of Canada's ten) provinces. (Newfoundland produces milk only for its fluid market and has no industrial milk processing plant.) At the beginning of each year, an estimate is made of the anticipated domestic demand for industrial milk products to which is added planned exports of dairy products minus anticipated imports. This net demand for dairy products is converted to milk equivalents. This is the national Market Share Quota (MSQ); it is then shared among provinces who in turn distribute the provincial share among all farmers producing milk.

11. In Canada all milk production is subject by law to supply management programmes, and sales of milk outside the system are liable to prosecution. Farmers can sell milk only through their provincial milk marketing boards or agencies. Deliveries of raw milk are first channelled to meet fluid milk requirements; milk delivered in excess of the fluid milk requirement is considered industrial milk and is counted against the farmer's individual industrial milk quota. A farmer receives a higher return for fluid milk than for industrial milk. The provincial milk marketing boards oversee allocation of the milk to processors. The receipts from the marketings are assigned to two separate pool accounts - a fluid pool account and an industrial pool account. Each month a farmer receives a statement from the board showing the part of his deliveries under his fluid quota which have been used in the fluid market and the part of his deliveries which have been charged to his industrial quota. If any of the raw milk delivered by the farmer is also in excess of his industrial quota, it is not eligible for direct federal payments and an over-quota levy is imposed on this milk. The marketing board deducts the levies and transport and administration charges, and pays the net amounts from both pools to the farmer.

12. Canadian production of total raw milk, industrial milk, ice cream and yoghurt, as well as import levels of ice cream and yoghurt, are given in the following table. The United States is the principal foreign supplier of ice cream and yoghurt to Canada.

TABLE

Canada: Milk, Ice Cream & Yoghurt Production and Imports  
(metric tons)

	1982	1983	1984	1985	1986	1987	1988
Ice cream Imports <sup>1</sup>	808	471	315	496	297	243 <sup>2</sup>	411 <sup>3</sup>
Ice cream Production <sup>4</sup>	165,947	175,319	169,499	175,891	185,237	179,341	183,075
Yoghurt Imports <sup>5</sup>	115	118	194	158	192	330	1,141 <sup>6</sup>
Yoghurt Production <sup>7</sup>	42,736	47,180	53,193	61,243	70,255	87,567	89,726
Industrial Milk Production <sup>8</sup>	5,119,502	4,775,264	5,013,281	4,789,424	4,762,176	4,783,873	5,006,795
Total Raw Milk Production <sup>8</sup>		7,448,541	7,688,667	7,479,167	7,522,065	7,589,522	7,826,916

<sup>1</sup>Source: Statistics Canada, Imports by Commodities and Countries CITC Detail, for 1982-1987. Includes ice cream, ice cream novelties, ice cream mix liquid, ice cream mix dry.

<sup>2</sup>Published by Statistics Canada as 457 tons. All customs entries were audited and it was found ice cream mix imports were overstated by 214 tons.

<sup>3</sup>Statistics Canada Imports by Commodity and by Country of Origin (H.S. 2105.00.00.10 and H.S. 2105.00.00.20). Special Trade Relations Bureau import permits issuance for Jan. 29 - Dec. 31 1988 amounted to 349 tons.

<sup>4</sup>Source: Agriculture Canada, Dairy Market Review 1986, 1987 using Statistics Canada Data. Statistics Canada confirms that ice cream mix production is best measure of ice cream production in Canada. Conversion factor 1 litre ice cream mix = 1.10 Kg.

<sup>5</sup>Source: Statistics Canada, Imports by Commodities and Countries, CITC Detail, for 1982-1987

<sup>6</sup>Statistics Canada Imports by Commodity and by Country of Origin indicates 1141 tons (H.S: 0403.10). Special Trade Relations Bureau import permit issuance for Jan. 29-Dec. 31, 1988 amounted to 1,212 tons.

<sup>7</sup>Source: Agriculture Canada, Dairy Market Review 1986, 1987 using Statistics Canada data. Conversion factor 1 litre yoghurt = 1 Kg.

<sup>8</sup>Source: Agriculture Canada, Dairy Market Review 1986, 1987 using Statistics Canada data. Conversion factor 1 litre milk = 1.02969 Kg.



## MAIN ARGUMENTS

### General

13. The United States considered that the Canadian restrictions on imports of ice cream and yoghurt were inconsistent with the obligations of Canada under the General Agreement. The permit system and quotas violated in particular the prohibition of import restrictions in Article XI:1, and could not be justified as an exception under Article XI:2. In addition, the implementation of the restrictions was inconsistent with Articles X and XIII. This infringement of the provisions of the General Agreement constituted prima facie a case of nullification or impairment of benefits accruing to the United States under the GATT. The United States requested the Panel to suggest to the CONTRACTING PARTIES that they recommend to Canada that it eliminate its quotas and permit scheme on imports of ice cream and yoghurt.

14. Canada maintained that the actions it had taken to place quantitative import restrictions on ice cream and yoghurt were consistent with Canada's rights and obligations under Article XI:2(c)(i). The administration of these restrictions was fully consistent with Articles X and XIII. Thus, Canada's actions did not nullify or impair any benefits accruing to the United States. Canada requested the Panel to find that the quantitative restrictions on ice cream and yoghurt were consistent with Canada's rights and obligations under Article XI, as well as Articles X and XIII.

### Permit System

15. The United States recalled that Article XI:1 prohibited the restriction of imports regardless of whether such restrictions were made effective through quotas, import licences or other measures. The Canadian import permit scheme thus fell within these provisions. The permit scheme established by the Export and Import Permits Act and the Notices to Importers operated to restrict imports. Permits were not freely granted to all qualified importers, but only to traditional importers who could document their status. The permits were valid for a limited time, and only for 5 days prior to entry. Depending on the means of transportation involved, importers sometimes could not obtain a valid permit until the goods were in transit. The uncertainty and limitations imposed by the scheme could deter exporters from undertaking the planning, promotion and investment activities necessary to develop and expand markets in Canada for their products. The permits thus had restrictive effects on trade in addition to those caused by the quota, and in the absence of justified quotas, could not be reconciled with Article XI.

16. Canada maintained that the permit system was not trade restrictive and was simply the administrative instrument to effect the draw-down of the quota allocations by each quota holder. The permits themselves were not restrictive, and the Canadian mechanism, which was the same for all products subject to import quotas, resulted in quota utilization rates approaching 100 per cent. Although the permits had a 30 day validity period, they could be amended or reissued at any time, and were charged to

the importer's quota allocation only if they were actually used. It was left to the judgement of the individual importers when and how they used their quota shares.

17. Canada indicated that quota levels were not established in 1988 because bilateral consultations with the major supplier of ice cream and yoghurt to the Canadian market (the United States) were continuing and Canada preferred to await the outcome of the consultations before setting the quota levels. However, import permits were readily granted to applicants who qualified by meeting certain criteria, the principal one being historical import performance and reasonable allowance was made for new entrants. Permitted imports in 1988 exceeded the import level of the previous year.

Article XI:2(c)(i)

18. The United States stated that the language of Article XI:2(c)(i), its interpretive note, the relevant drafting history, and prior panel reports adopted by the CONTRACTING PARTIES made it clear that the exception for products subject to a domestic supply management system was very narrow. It was designed to provide for the limited use of otherwise outlawed measures, such as quotas and licenses, in circumstances where the restrictions on imports of like products were necessary for the enforcement of governmental measures to protect unorganized producers from the vagaries of the weather. It was not intended to, and did not, provide a blanket derogation for the agricultural sector generally or the dairy sector in particular; nor did it authorize policies of agricultural self-sufficiency or permit contracting parties to protect domestic producers or processing industries from international competition.

19. Canada argued that Article XI:2 was not an exception to the General Agreement in the sense of Article XX, but rather that it defined a number of circumstances under which contracting parties had the right to apply quantitative restrictions. One of the purposes of Article XI:2 was to permit a government to organize its market for particular agricultural products so as to avoid the problems of surplus production. Unlike Article XI:2(c)(ii) which specifically referred to temporary surpluses, Article XI:2(c)(i) did not specify any time frame and could thus cover either temporary or systemic surpluses.

20. The United States observed that the burden of providing evidence that all the requirements of an exception under Article XI:2(c)(i) had been met rested on the contracting party invoking that provision. The conditions which had to be met could be summarized as follows:

1. The measure had to constitute an import restriction rather than a prohibition.
2. The import restriction had to be on an agricultural or fisheries product.

3. There had to be a governmental measure which operated to restrict the quantities of a product permitted to be marketed or produced.
4. The import restriction had to apply to the "like" product restricted by the domestic supply management system (or to a directly substitutable product if there was no substantial production of the like product) or to a product processed from the like product which:
  - (a) was in an early stage of processing, and
  - (b) was still perishable, and
  - (c) was directly competitive with the fresh product, and
  - (d) if freely imported, would tend to make the restriction on the fresh product ineffective.
5. The import restriction had to be necessary to the enforcement of the domestic supply restriction.
6. Public notice had to be given of the total quantity or value of the quota for each product.
7. The restriction on imports could not reduce the total of imports relative to the total of domestic production, as compared with the proportion which might reasonably be expected to rule between the two in the absence of restrictions, with due regard to special factors affecting or which might affect the trade in the product.

21. Although the United States agreed with Canada that its measures were restrictions rather than prohibitions, it maintained that Canada could not demonstrate that all of the other Article XI:2(c)(i) requirements had been satisfied.

22. Canada agreed that it had to provide evidence that it had fulfilled the conditions of Article XI:2(c)(i). Canada had fulfilled this obligation and considered that there was a burden on both parties in this case. The Canadian milk supply management system was a comprehensive one which relied on the interrelationship of various components, including production controls, price supports and levies, and import controls. The system was designed with the requirements of Article XI:2(c)(i) in mind, and met all of the criteria for this provision.

23. Canada did not consider that the conclusions of the Japanese agricultural panel report<sup>1</sup> provided a clear or valid precedent on issues such as "perishability", "early stage of processing" and "like products", nor did that report override the previous interpretation agreed by the Contracting Parties in the EC Tomato Concentrates case.<sup>2</sup> At the time of adoption of the Japanese agricultural panel report Canada had expressed its concern that that panel had, in some respects, given insufficient consideration to the economic and other linkages which existed between processed and fresh products. In particular, Canada had noted that:

"... a definition which limits the concept of "like product" to "fresh or primary" products alone fails to take account of the operational realities related to the marketing of fresh products in other forms. This is particularly evident, for instance, in world trade in the dairy sector, where industrial milk is almost always traded in a further processed form. It is our view that, in interpreting Article XI:2(c)(i), an excessive and overly rigid differentiation between primary products and their derivatives would, in certain cases, render inoperable the general application of the Article as intended by the drafters." (summarized in C/M/217).

Canada's position at that time had been supported by a number of other contracting parties. The facts in the Japanese case were significantly different from those in this case, and Canada indicated that the rulings in that panel report had no relevance to this case. Each case had to be examined on its merits.

24. The United States contested Canada's claim that the Japanese agricultural panel report was an invalid or irrelevant precedent. That case involved import restrictions on the same or similar products. The Japanese panel report had recently been adopted by the Council by consensus, despite Canada's misgivings. Canada was seeking to abandon the limitations agreed to in the interpretative note to Article XI:2, at least with respect to the dairy sector, by stretching their interpretation to include almost any imported processed dairy product that could displace sales of domestic milk.

#### Governmental Measures to Restrict Domestic Production

25. Canada maintained that it effectively managed the supply of all domestically produced milk, through the provincial controls on fluid milk and the joint federal provincial market share quota system for industrial milk. It was an agreed interpretation of the General Agreement that "in

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<sup>1</sup>Report of the Panel on "Japan - Restrictions on Imports of Certain Agricultural Products", L/6253, adopted 2 February 1988.

<sup>2</sup>Report of the Panel on "EEC - Programme of Minimum Import Prices, Licences and Surety Deposits for Certain Processed Fruits and Vegetables", BISD 25S/98-103.

interpreting the term "restrict" for the purposes of paragraph 2(c), the essential point was that the measures of domestic restrictions effectively keep output below the level which it would have attained in the absence of restrictions" (Havana reports, page 89). The Canadian programmes restricted production to a level less than would be the case without the governmental controls. Farmers' participation in the supply management programmes was mandatory. Production quotas were ultimately established at the individual farm level, and the imposition of severe financial disincentives for overproduction assured the effectiveness of the system. The level of return received by producers for over-quota industrial milk was lower than the cash cost of production. The over-quota levy thus effectively restricted production above the quantitative level established by the quotas. Over the last decade there had been under-production of milk in some years, and over production in others. In the most recent six years, over-quota production of milk averaged only one per cent of total milk production. While it could not be directly demonstrated that production would be higher in the absence of the programmes, there was considerable indirect evidence that it would be. Each province fully utilized its Market Share Quota (MSQ) and applications for increased MSQs indicated that farmers had the capacity and willingness to produce more milk at the current prices if not restricted by the over-quota levy. Canada further cited recent econometric analyses which indicated that milk production would be 31 to 39 per cent higher in the absence of restrictions.

26. The United States argued that Canada had failed to demonstrate that it effectively restricted domestic production of milk. The differentiation between "fluid" and "industrial" milk was an artificial one for administrative purposes; with regard to GATT obligations, the product at issue was raw milk from the cow, regardless of what further use was made of it. The use of the word "permitted" in Article XI:2(c)(i) required that there be a limitation on the total quantity of milk that domestic producers were authorized or allowed to produce or sell. The provincial controls on fluid milk did not restrict the quantities permitted to be produced; rather dairy farmers could produce and market as much milk as could be sold as beverage milk or table cream. There were no penalties for delivering more than a farmer's fluid milk quota, it was only if deliveries exceeded actual fluid milk usage or sales that it counted against his industrial milk quota. At least one province did not participate in this voluntary system, and another province had considered leaving it. Furthermore, Canada did not even prohibit the production or sale of milk that exceeded the Market Share Quota. The method used to calculate direct support payments on within-quota deliveries assured that most dairy farmers would completely recover all of their fixed and variable costs on their within-quota deliveries. The farmer was permitted to produce and market milk in excess of the quota, and perhaps had an economic incentive to do so.

27. The United States noted that in the past six years total industrial milk production had consistently exceeded the established Market Sharing Quota, and concluded that the Canadian system was a regulation of production but not a restriction of production. Proposals to amend

Article XI:2(c)(i) to replace the word "restrict" with "regulate" had been defeated; what was required was the reduction of production. The results of the econometric analyses cited by Canada provided no indication of what would happen to milk production in the absence not only of the production quotas, but also of the accompanying high price guarantees which operated as incentives to produce. According to the official publication of the Canadian Dairy Commission, a key element of Canada's national dairy policy was to promote self-sufficiency in milk production. The effectiveness of the government supply controls had to be compared to what the situation would be in the absence of all government measures.

#### Like Products Imported in Any Form

28. Canada indicated that raw milk was not normally traded internationally, but rather processed into another form to be used or traded. In fact all raw milk had to be processed to be marketed commercially in Canada including for sale as beverage milk. Ice cream and yoghurt were simply milk in a tradeable form. Ice cream and yoghurt were not like products to raw milk. Article XI:2(c)(i) allowed import restrictions on agricultural products "imported in any form". Ice cream and yoghurt were industrial milk "in any form" within the meaning of this Article. As demonstrated in the drafting history (EPCT/A/PV/19 page 21), by controlling the production of raw milk, Canada ipso facto controlled the production of ice cream and yoghurt. The Canadian Dairy Commission Act defined a dairy product as a product manufactured wholly or mainly from milk. Both ice cream, which was made up of approximately 65-85 per cent milk and cream, and yoghurt which was 90-99 per cent milk, were dairy products. The addition of non-dairy ingredients during the production of ice cream and yoghurt did not disqualify them from being considered as like products "in any form" to industrial milk, nor did their tariff classification.

29. The United States maintained that milk, even "industrial" milk, was not the "like domestic product" of ice cream or yoghurt under any definition of the term. Canada maintained no restriction on the production or marketing of the "like domestic product", which was its domestically produced ice cream or yoghurt. Although Article XI:2(c)(i) permitted application to the like product "in any form", its interpretive note made it explicit that this meant "the same products when in an early stage of processing and still perishable, which compete directly with the fresh product and if freely imported would tend to make the restriction on the fresh product ineffective." Ice cream and yoghurt were not the "same products" as raw milk; they had both been processed to such an extent as to have completely lost any identity with fresh milk. Furthermore, ice cream was often not even made from fresh milk but rather from a wide variety of intermediate processed milk products.

#### Early stage of processing

30. Canada argued that ice cream and yoghurt met all the conditions of the interpretative note to Article XI:2(c)(i). The drafters viewed "in an early stage of processing and still perishable" to be a single concept.



The provision was extended to "those earlier stages of processing which result in a perishable product". (EPCT/A/PV/19 page 43) The extension of this Article to cover the product "in any form", as well as the product under direct control, was necessary to avoid undermining the effectiveness of the domestic production restrictions. The drafters cited kippers as an example of a product "in any form". There was a direct parallel between the processing of fresh herring into kippers, and the processing of raw milk into ice cream and yoghurt. Kippers, like ice cream and yoghurt, were in their final form of processing ready for commercial sale. The process of transforming raw industrial milk into ice cream and yoghurt was a simple, direct and continuous process. Raw milk entered the dairy processing plants, and any one of a number of products, including ice cream and yoghurt came out. Once the raw milk began the process to convert it into ice cream or yoghurt, it was not possible to change it into any other product. Although production of commercial quantities involved sophisticated equipment, the processes they performed were essentially very simple. There was no storage of industrial milk prior to its production into ice cream or yoghurt, and there were no intermediate forms produced in the process which could be placed into storage for later use or sold commercially. Given the perishable nature of ice cream and yoghurt, for health reasons they were packaged immediately after the completion of processing. They had thus undergone the stage of processing which resulted in a product ready for commercial sale, but that did not negate the fact that they were in an "early stage of processing".

31. The United States indicated that ice cream and yoghurt were not in an early stage of processing, but were products which had undergone the final stage of a multistep production process. A significant number of additional ingredients had been added, the products had been adapted for distinctly different uses, and processed into finished, packaged retail products. They were prepared foods and bore virtually no resemblance to the raw commodity from which they were primarily derived. Article XI:2(c)(i) was a narrow exception to the prohibition of import restrictions and was not intended to permit the protection of domestic food processors. The wording of the phrase made it clear that the exception was limited to only those agricultural products that were at or near the beginning step of the series of operations undertaken to convert the raw agricultural commodity into a processed product. Such highly processed, consumer ready, finished foods as ice cream and yoghurt could not be characterized as being "in an early stage of processing."

#### Still perishable

32. With regard to perishability, Canada observed that few other products were as perishable as raw milk, which had to be processed within hours of its receipt and was incapable of being stocked. It was also the common understanding that ice cream and yoghurt were perishable products and they were treated as such by the industry and by consumers. Without constant, specialized handling they would spoil within hours. Under appropriate storage conditions the shelf life of yoghurt was approximately three weeks and that of ice cream produced to Agriculture Canada specifications, only three months. There was no basis for the US argument that the processed



product had to be as perishable as the primary product in order to be considered as "still perishable". In the Canadian view, to accept the US argument would be to deny the application of the term "in any form" to virtually all the dairy sector, thus effectively denying the industrial milk sector coverage under Article XI:2(c). The EC Tomato Concentrates Panel considered that "tomato concentrate was still perishable because after a certain time it would decline in quality and value".<sup>3</sup> Kippers were less perishable than fresh herrings.

33. The United States recognized that all agricultural products and all prepared foodstuffs were to some extent perishable. However, the United States argued that the phraseology of the interpretive note, limiting application to "the same products ... when still perishable", was intended to exclude not only shelf stable foods but also those which had been processed in such a way as to reduce their perishability when compared to the restricted domestic fresh product, and which were capable of being stocked. As the Panel on Japanese Agricultural Restrictions had noted, "one of the purposes of Article XI:2 (c)(i) was to allow governments to intervene in situations in which there was an unexpected excess of supplies of agricultural products that could not be stored under normal conditions until the market had improved" (L/6253, page 62). The drafters of the provision had stated that what they had in mind was "the perishable kind of processed product, not the kind which is capable of being stocked" (EPCT/A/PV/19). Such a situation of unexpected excess supply rarely occurred in the dairy sector because milk output was largely a function of the number, breeds, and ages of the cows and was not closely related to the weather or other factors that varied widely on the short term. To the extent that governments withdrew excess supplies - normally stored as non-fat dry milk, butter, and cheese - from the market, such measures were usually undertaken to achieve long-term domestic price and producer income objectives rather than to remove short-term excesses resulting from the "capricious bounty of nature". Accordingly, the purposes of the exception would not be advanced by giving the words "still perishable" a broad meaning in the context of the dairy sector.

34. The United States observed that ice cream and yoghurt were not "still perishable" in comparison to raw milk and could be stored, if necessary, for extended periods. Under modern production techniques, ice cream and yoghurt could be manufactured from intermediate stage products previously processed from milk - such as butter oil, plastic cream, non-fat dry milk, caseinates, whey powder, and the like - many of which themselves were highly shelf stable products. Unexpected excess supplies of raw milk would not cause ice cream and yoghurt to flood the market and depress prices. Moreover, some of the ice cream and yoghurt products subject to Canada's import restrictions, such as frozen yoghurt and certain hard-frozen ice

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<sup>3</sup>Report of the Panel on "EEC - Programme of Minimum Import Prices, Licences and Surety Deposits for Certain Processed Fruits and Vegetables", BISD 25S/100, paragraph 4.10.

cream novelty items, could be stored for one year or more. These products were thus not "still perishable".

Directly competitive

35. Canada considered that imported ice cream and yoghurt, if uncontrolled, would displace domestically produced ice cream and yoghurt. This in turn would result in a lower demand for industrial milk. What had to be examined was the effects of the imports on the producers. Imported ice cream and yoghurt competed directly with raw milk in the effect that they had on the supply control programme under which the producers operated. Industrial milk was not available to consumers in its raw state but only in its processed forms. A consumer purchasing imported ice cream or yoghurt was thus purchasing a product which was directly competitive with that produced by the Canadian industry from industrial milk, leading to a reduction in demand for industrial milk from Canadian farmers. This was the same situation as fishermen experiencing decreased demand for fresh fish due to imports of kippers, or farmers selling fewer tomatoes due to imports of tomato concentrates. Canada rejected the US argument that products such as cakes, cookies and confectionary items made from milk would also be covered under Article XI:2(c)(i). Milk was not the primary component of these products, but rather a secondary component.

36. The United States replied that the condition under Article XI:2(c)(i) was that the processed imported product had to "compete directly with the fresh product" subject to domestic production, in this case, fresh milk. Products which competed directly were those which came into rivalry in a market without any intervening step or diverting factor. Imported ice cream and yoghurt competed directly with domestically produced ice cream and yoghurt, and were all consumed as snacks and desserts. They did not compete directly with the fresh product - raw milk - at all. These products did not even compete in the same markets; fresh milk was marketed to creameries for processing, whereas ice cream and yoghurt were normally marketed to retail outlets.

37. Further, the United States noted that the language of the interpretive note to Article XI:2(c)(i) was explicit with regard to "compete directly with", which did not mean the same as "compete with", "compete indirectly with", or much less "displace". As the importation of every processed food product could arguably result to some extent in a decline in demand for the commodities used as ingredients, virtually all processed food products would qualify under Canada's displacement argument. The drafting history made it clear that the exception could not be used with respect to indirect competition such as between apples and bananas, much less, the United States argued, could it embrace such indirect competition as existed between prepared foods and the raw agricultural commodities from which they were processed.

Would make the restrictions ineffective

38. Canada noted that it was not historical levels of trade which were relevant, but rather the potential for unrestricted imports to displace domestic production of ice cream and yoghurt, which accounted for 11 per cent of industrial milk production on a butterfat basis. Uncontrolled imports could cause a domestic surplus of raw milk, and would require either a scaling back of production during the year and/or increased payments by farmers for disposal. Farmers accepted restrictions on domestic milk production, but expected that as part of the arrangement imports should not be allowed to take unfair advantage of the situation. As uncontrolled imports of ice cream and yoghurt would allow other countries to circumvent the governmental measures restricting domestic milk production, this would threaten the effectiveness of Canada's supply management programme for industrial milk.

39. The United States found no reason to believe that if ice cream and yoghurt were permitted to be freely imported they would tend to make ineffective the Canadian production restriction on industrial milk. These products had been freely imported over the many years Canada had a supply management system for industrial milk without any Canadian claim that they caused any problem whatsoever for the milk supply programme. Unrestricted imports of ice cream and yoghurt had not even gained three tenths of one per cent of the market share during any of the 5 years prior to the imposition of import restrictions. Even if imports were to register a sudden and dramatic increase, it was hard to believe that they could eliminate all the domestic competition. Unrestricted imports of ice cream and yoghurt combined during the five most recent years had not even approached the amount of oversupply Canada tolerated under its Market Share Quota. The United States further noted that Canada had failed to present any evidence to substantiate its argument. Acceptance of an hypothetical, worst-case scenario without supporting evidence would render this criterion meaningless.

Necessary

40. Canada stated that its supply management system was comprehensive and its effectiveness relied on an interrelation between production controls, over-quota production penalties, and an accurate measure of total supply to the market. Imports were one of the essential elements used in the calculation of the Market Sharing Quota. In order to maintain the system, it was necessary to monitor the level of imports and to bring imports under control when the levels become high enough to threaten the system. Prior to 1987, Canada had no reason to anticipate that United States exports of ice cream to Canada would exceed traditional levels. Since that time, however, the situation had changed considerably as changes in the United States dairy support programme included in the Food Security Act of 1985 encouraged the expansion of US dairy exports. This Act provided for continued unlimited support purchasing of surplus product by the US government. Export opportunities were further promoted by the US government's Targeted Export Assistance Programme for ice cream and other high value products. These developments, along with the widening

differential between United States and Canadian milk support prices and the scheduled elimination of the tariffs on ice cream and yoghurt under the Free Trade Agreement, led to the determination, as part of a continuing review of imports, that continued uncontrolled access for imports of these products would threaten the Canadian system. Expectations of greatly increased ice cream and yoghurt imports were substantiated by the large requests for quotas for these products after controls were instituted. Furthermore, Canada noted that while imports of specific types of products might be relatively small, the accumulation of uncontrolled imports of many different products would render the system ineffective, making their restriction necessary. It was accepted in the GATT that relatively small amounts of imports had the potential of disrupting markets. The Working Party on Canadian Egg Quotas (BISD 23S/91) had found that import quotas of less than one per cent of domestic production met the requirements of Article XI.

41. The United States recalled the statement of the Working Party on Quantitative Restrictions that "it would be an abuse of intent of the provisions under paragraph 2(c)(i) of Article XI if the contracting parties were to apply restrictions to processed products exceeding those "necessary" to secure enforcement of the actual measure restricting production or marketing of the primary product" (BISD 3S/190). Canada had established quota amounts for imports of ice cream and yoghurt (processed products) equivalent to approximately 0.0001 per cent of the quantity of domestic production of raw milk (the primary product) authorized by the MSQ even though Canada had permitted over-quota domestic production of approximately 4.0 per cent. The United States also objected to Canada's attempt to justify its import quotas by reference to the reductions in US dairy price support levels pursuant to the Food Security Act of 1985. These unilateral reductions of domestic price supports might have the incidental effect of making US exports of dairy products more price-competitive on the world market, but a Contracting Party should not invoke such desirable and progressive attempts to reduce trade-distorting domestic price supports as a justification for imposing protectionist trade barriers. The United States also pointed out that the Targeted Export Assistance Programme, with one exception, had not been used to promote the marketing of ice cream, and the sole instance in which it was so used did not involve exports of ice cream to Canada. Moreover, the United States noted that the official publication of the Canadian Dairy Commission declared: "Canada's dairy policy is based on national self-sufficiency in milk production on a butterfat basis. This means the domestic market is essentially supplied from Canadian milk production ..." <sup>4</sup> This assertion of the true policy of Canada undermined the undocumented explanations based upon changes in the United States dairy programme. Finally, the United States maintained that the Report of the Working Party on Canadian Import quotas on Eggs was irrelevant. It also noted that the Working Party did

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<sup>4</sup>The Canadian Dairy Commission Annual Report, 1987-1988, page 4.

not render any conclusion with respect to whether the quotas on imports of eggs met the requirements of Article XI:2(c)(i).

#### Public Notice

42. Canada stated that the decision to place ice cream and yoghurt on the Import Control List was announced on 19 January 1988 by the Ministers of International Trade and Agriculture. The changes to the Import Control List were published on 28 January 1988 and details were sent to importers and foreign missions in Canada, and the contracting parties were officially notified (L/6462). Quota levels were not announced in 1988 due to ongoing consultations with the largest supplying country - the United States. The levels for 1989 were announced in a Notice to Importers circulated 17 January 1989. One quota was established for the various ice cream products as this provided the importer with greater flexibility in determining exactly which items to import, thus encouraging a fuller utilization of the quota.

43. The United States observed that the requirement in Article XI:2(c) was for "... public notice of the total quantity or value of the product permitted to be imported ...". Canada had failed to provide such notification of the total amount of ice cream and yoghurt permitted to be imported during 1988. The notification for 1989 was of a "basket" quota for ice cream. The United States recalled that a previous panel had found that the establishment of "basket" quotas could not satisfy the requirements of Article XI:2(c) (L/6253, p.68, paragraph 5.3.1.3).

#### Proportionality of Imports

44. In establishing the level of quotas, Canada indicated that it had considered the import levels during the three-year period immediately preceding the introduction of import restrictions. It had set the quota for ice cream at 345 tons, which was the average for this three-year period. In determining the level for yoghurt, Canada had noted an increasing trend in imports and had decided to set a level of 330 tons to accommodate this rising trend. This resulted in a higher level than if an average over a three-year period had been used.

45. In determining the levels of imports of ice cream and yoghurt in future years, Canada stated its intention of maintain proportionality with domestic production of industrial milk. If domestic industrial milk production increased, so would import levels. Similarly, if domestic production fell, import levels would also be lowered. Canada was not asking other contracting parties to assume a greater burden than it was asking of its own dairy farmers. Nor could Canada ask its dairy farmers, whose production was being restricted, to suffer further penalties due to uncontrolled imports.

46. The United States argued that whereas Canada had frozen the volume of imports at an historical level (between 1984 and 1987 for some importers and between 1985 and 1987 for other importers), Canada had undertaken no action to similarly freeze the volume of milk allowed to be produced and



marketed and had placed no restriction whatever on its production or marketing of ice cream or yoghurt. Furthermore, Canada had made no provision which would allow the importation of ice cream and yoghurt to increase as domestic demand and supply increased. Canada had also failed, in determining the quota amount, to give due regard to the most salient special factor affecting trade in these products: the reduction and eventual elimination of customs duties on these products resulting from the United States-Canada Free Trade Agreement (FTA). The undoubted effect of the removal of these barriers to trade would have been to increase the volume of imports of these products into Canada, in particular from the United States.

#### Articles X and XIII

47. The United States indicated that Canada had failed to observe the procedural obligations of Article X:1, Article X:2 and Article XIII:3(b). These provisions of the General Agreement created distinct obligations in addition to the requirement of public notification arising under Article XI:2(c). In brief, any contracting party undertaking to impose quantitative limitations had to provide prior notification to interested governments and traders of the total quota amount. Canada had implemented its quota on imports of ice cream and yoghurt before it provided any official notice, even to Canadian importers, and maintained its quotas for one year before providing any public notice of the total quota amount. In doing so, Canada had breached its obligations under these provisions of the General Agreement.

48. Canada stated that the Notices to Importers regarding import controls on ice cream and yoghurt had been widely distributed in advance of the application of restrictions. Whereas Article XIII:2(a) recommended, whenever practicable, that quotas be fixed and notice given of their amount, paragraph 2(b) of that Article recognized that in some cases quotas were not practicable and that restrictions could be applied through permits. Because of the ongoing consultations with its major supplier, it had not been practicable for Canada to fix quotas in 1988; however the quotas for 1989 had been fixed and announced in accordance with Article XIII:2(a).

49. In addition, Canada observed that Article XIII:4 gave authority for the initial selection of a representative period and appraisal of special factors to the country imposing import restrictions under Article XI:2(c)(i). This provision required this country to consult promptly with other contracting parties on their request. Canada had held both formal and informal consultations with the United States on a number of occasions, and considered its actions to be fully consistent with this provision. Canada further noted that it used the same permit system for all products subject to import quotas, with standard forms and procedures. The utilization rate for these quotas approached 100 per cent.

### Nullification and Impairment

50. The United States maintained that Canada's import restrictions on ice cream and yoghurt were inconsistent with Article XI:1 and were not justified by Article XI:2(c)(i). These actions had resulted prima facie in a nullification or impairment of benefits accruing to the United States under the General Agreement.

51. Canada maintained that the actions it had taken to place quantitative import restrictions on ice cream and yoghurt were consistent with Canada's rights and obligations under Article XI:2(c)(i) of the General Agreement, as well as Articles X and XIII. As such, Canada's action did not nullify or impair any benefits accruing to the United States. Without these controls, unlimited imports of these products would circumvent the domestic restriction on the production of industrial milk. This would make it impossible for Canada to maintain the effectiveness of its supply management programme for industrial milk.

### SUBMISSIONS BY OTHER CONTRACTING PARTIES

#### The European Community

52. The European Community considered that the measures applied by Canada on imports of ice cream and yoghurt were incompatible with its obligations under the General Agreement, in particular Article XI. It observed that Canada must provide the proof that it had fulfilled all the necessary conditions for an exception under Article XI:2(c)(i), and did not believe that Canada had met the requirements that: (a) the domestic measures and import restrictions applied to like or directly competing products; (b) that ice cream and yoghurt were covered by Canadian governmental measures; or (c) that the import restrictions were necessary to the enforcement of domestic measures.

53. With regard to the first point, the Community noted that industrial milk, and yoghurt and ice cream, were not like products. Although the latter were usually manufactured from milk, they included many other components, such as sugar, fruit, cocoa and so forth. The tariff classification for yoghurt included it with "dairy products", whereas ice cream was considered under "miscellaneous edible preparations", further reflecting the fact that, for the consumer, these products were not interchangeable with milk in their use. The Community also observed that ice cream and yoghurt were final consumption goods, ready to be marketed, and were thus not products "in an early stage of processing". In addition, there was no evidence that consumers might replace purchases of milk by purchases of yoghurt or ice cream, and so these products could not be considered as directly competitive with milk.

54. As ice cream and yoghurt were not like products "in any form" to milk, Canada could invoke the exception under Article XI:2(c)(i) only if it were restricting its domestic production of ice cream and yoghurt, but there were no such domestic restrictions. Canadian production restrictions



applied only to raw milk, not to any of its processed products. Finally, the Community observed that given the low level of imports and the favorable conditions of the Canadian markets for ice and yoghurt the restrictions on imports were not necessary. It cited official Canadian publications which reported rising sales for Canadian-made ice cream and yoghurt as growing demand for these products allowed for increased sales prices.

#### Japan

55. Japan observed that the term "like product" had different meanings under various provisions of the General Agreement and that the scope of "like product" in Article XI:2(c) had never been fully established. Fresh milk was almost always traded in its processed forms. Some dairy products could be easily reconverted back into milk. Therefore it was reasonable to consider that some dairy products, and in particular those that could be reconverted, should be considered "like products" under Article XI:2(c). The ruling of the Panel on Japanese Restrictions on Imports of Certain Agricultural Products (L/6253), that "like product" was confined to the product in its original form, was not necessarily appropriate in that it did not address the actual mode of trade in fresh milk and dairy products.

56. Furthermore, although generalized criteria had not been established with regard to perishability, Japan recalled that the Panel on the EEC's Processed Fruits and Vegetables (L/4687) had concluded that tomato concentrate was perishable on the grounds that "after a certain time it would decline in quality and value". The conclusion was not based upon the perishability of fresh tomatoes. It would thus not be reasonable to require the same degree of perishability as that of the fresh product in deciding the perishability of a processed product under Article XI:2.

#### FINDINGS

##### Introduction

57. The Panel noted that the issue before it concerned restrictions maintained by Canada on imports of yoghurt and various ice cream products. The Panel observed that the quotas applied by Canada were prohibited by Article XI:1. This was not contested by the parties; at issue was whether these measures could be justified under Article XI:2(c)(i), and if so, whether the restrictions were administered in conformity with the provisions of Articles X and XIII. A further issue raised by the United States was whether the permit system per se operated as a restriction on imports in contravention of Article XI:1.

58. The Panel proceeded to examine whether Canada's import restrictions on ice cream and yoghurt could be justified under Article XI:2(c)(i). The text of this paragraph provides that:

"2. The provisions of paragraph 1 of this Article shall not extend to the following: ....

(c) Import restrictions on any agricultural or fisheries product, imported in any form, necessary to the enforcement of governmental measures which operate:

(i) to restrict the quantities of the like domestic product permitted to be marketed or produced, or, if there is no substantial domestic production of the like product, of a domestic product for which the imported product can be directly substituted;"

and further (in last sub-paragraph) that:

"Any contracting party applying restrictions on the importation of any product pursuant to sub-paragraph (c) of this paragraph shall give public notice of the total quantity or value of the product permitted to be imported during a specified future period and of any change in such quantity or value. Moreover, any restrictions applied under (i) above shall not be such as will reduce the total of imports relative to the total of domestic production, as compared with the proportion which might reasonably be expected to rule between the two in the absence of restrictions. In determining this proportion, the contracting party shall pay due regard to the proportion prevailing during a previous representative period and to any special factors which may have affected or may be affecting the trade in the product concerned."

59. The Panel recalled that it had previously been concluded that a contracting party invoking an exception to the General Agreement bore the burden of proving that it had met all of the conditions of that exception.<sup>5</sup> It also noted, as had previous panels, that exceptions were to be interpreted narrowly and considered that this argued against flexible interpretation of Article XI:2(c)(i).<sup>6</sup> The Panel was aware that the requirements of Article XI:2(c)(i) for invoking an exception to the general prohibition on quantitative restrictions made this provision extremely difficult to comply with in practice. However, any change in the burden of proof could have consequences equivalent to amending Article XI, seriously affecting the balance of tariff concessions negotiated among

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<sup>5</sup>Report of the Panel on "Canada - Administration of the Foreign Investment Review Act", BISD 30S/140, 164; Report of the Panel on "Japan - Restrictions on Imports of Certain Agricultural Products", L/6253, p. 64; and Report of the Panel on "European Economic Community - Restrictions on Imports of Dessert Applies - Complaint by Chile", L/6491, p. 37.

<sup>6</sup>See, for example, Report of the Panel on "Japan - Restrictions on Imports of Certain Agricultural Products", L/6253, p. 65 and Report of the Panel on "EEC - Restrictions on Imports of Apples - Complaint by the United States", L/6513, p. 33.

<sup>7</sup>See, e.g., Report of the Panel on "EEC - Restrictions on Imports of Dessert Apples - Complaint by Chile", L/6491.

contracting parties, and was therefore outside the scope of the Panel's mandate.

60. The Panel also noted that there existed dissatisfaction with Article XI:2(c)(i) and that its revision was under discussion. The focus of this provision was limited to a fresh product restricted by the domestic measures and the competition this product faced from imports. The provision was not designed to address the difficulties of a domestic processing industry that, as a consequence of the domestic restrictions on the fresh product, faced higher raw material costs, making it less competitive with imports. To the extent that Article XI:2(c)(i) could be applied to imports of processed products, it was solely on the basis of their relationship to the fresh product under domestic restriction. This was evident from the text of the provision and its interpretative notes. The drafters had expressly indicated, with regard to the application of the exception to processed products that "... [i]n particular, it should not be construed as permitting the use of quantitative restrictions as a method of protecting the industrial processing of agricultural or fisheries products" (Havana Reports, ICITO/I/8, p. 94). Although the Panel recognized that there could be concern over the practicability of applying the criteria of Article XI:2(c)(i) with respect to processed products, it was not the function of panels to propose changes to the provisions of the General Agreement but to make findings regarding their interpretation and application.

61. The Panel considered the arguments presented by the parties with regard to the relevance of previous panel reports, and in particular that on Japan - Restrictions on Imports of Certain Agricultural Products (L/6253). That panel had also examined the application of quantitative restrictions to various processed dairy products. The Panel recognized that although the circumstances of the cases were quite different, some of the Japanese Agriculture Panel's considerations were relevant to this case. At the same time, however, on some issues of particular importance before this Panel, the report of the Japanese Agriculture Panel was useful but could not provide definitive guidance. The Panel thus thoroughly examined the questions before it in light of the relevant provisions of the General Agreement, taking account of all relevant previous panel findings.

62. As the party invoking an exception, it was incumbent upon Canada to demonstrate that the measures applied to imports of ice cream and yoghurt met each of the conditions under Article XI:2(c)(i) and XI:2(c) last sub-paragraph, in order to qualify in terms of these provisions for exemption from Article XI:1.

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<sup>8</sup> Ministerial Declaration of 1982, BISD 29S/16

These conditions are:

- the measure on importation must constitute an import restriction (and not a prohibition);
- the import restriction must be on an agricultural or fisheries product;
- the import restriction and the domestic marketing or production restriction must apply to "like" products in any form (or directly substitutable products if there is no substantial production of the like product);
- there must be governmental measures which operate to restrict the quantities of the domestic product permitted to be marketed or produced;
- the import restriction must be necessary to the enforcement of the domestic supply restriction;
- the contracting party applying restrictions on importation must give public notice of the total quantity or value of the product permitted to be imported during a specified future period; and
- the restrictions applied must not reduce the proportion of total imports relative to total domestic production, as compared with the proportion which might reasonably be expected to rule between the two in the absence of restrictions.

63. The Panel concurred with the two parties that the first of these conditions had been met: Canada's measures constituted a restriction and not a prohibition of trade.

The Import Restriction must be on an Agricultural or Fisheries Product

64. The Panel observed that the Parties had not made detailed arguments with regard to this criterion of Article XI:2(c)(i). The term "agricultural product" is not defined in the General Agreement. The long-standing practice of the GATT, as evident in past rounds of trade negotiations and previous panel reports, was to accept that products falling under Chapters 1 to 24 in the Customs Cooperation Council Nomenclature could in principle be regarded as agricultural products.<sup>9</sup> The Panel further noted that ice cream and yoghurt were food products generally regarded by consumers and the industry to be agricultural products. The Panel thus found that ice cream and yoghurt were agricultural products within the meaning of Article XI:2(c).

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<sup>9</sup> See, e.g., Report of the Panel on "Japan - Restrictions on Imports of Certain Agricultural Products", L/6253, p. 61

Like Products Imported in any Form

65. The Panel then proceeded to examine whether the import restrictions and the domestic production restrictions applied to "like" products "in any form". The first issue was to determine the relevant "fresh" Canadian product. Although Canada maintained that it effectively restricted the production of all milk, its arguments had primarily made reference to industrial milk. Yet the differentiation of "fluid" milk (raw milk used for processing into table milk and cream) and "industrial milk" (raw milk used for processing into other dairy products) was recognized to be merely an administrative differentiation, based on the intended use of the milk and not on any intrinsic differences.

66. The Panel recalled that in the drafting of the General Agreement, it was argued that Article XI:2(c)(i) was necessary due to "... the capricious bounty of nature, which will sometimes give you a huge catch of fish or a huge crop ..." and because of the existence "... of a multitude of small unorganized producers that cannot organize themselves" (EPCT/A/PV/19). It was clear, therefore, that the domestic product subject to restrictions had to be the product produced by farmers. In this case the farmers were producing raw milk, not "industrial" or "fluid" milk. The Panel found that the relevant Canadian "fresh" product subject to restriction was total raw milk.

67. The Panel next considered whether ice cream and yoghurt were "like" products to raw milk. In the drafting of this provision it had been stated that the words "like products" in Article XI:2(c) "... definitely do not mean what they mean in other contexts - merely a competing product" (EPCT/C.II/PV.12). The Japanese Agriculture Panel had observed that Article XI:2(c)(i) and the note supplementary to it regarding "in any form" established different requirements for (a) restrictions on the importation of products that are "like" the product subject to domestic supply restrictions and (b) restrictions on the importation of products that are processed from a product that is "like" the product subject to domestic supply restrictions.<sup>10</sup> The Japanese Agriculture Panel had considered that this differentiation would be lost if a product in its original form and a product processed from the original one were to be considered to be "like" products within the meaning of Article XI:2(c). This Panel concurred with that observation. It further noted that there was virtually no international trade in raw milk.

68. The Panel therefore considered whether ice cream and yoghurt were "like" products "in any form" to raw milk. It was recognized in Article XI:2(c)(i) that it might be necessary to restrict not only the fresh product, but also some of its processed forms. However, the scope of

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<sup>10</sup>Report of the Panel on "Japan - Restrictions on Imports of Certain Agricultural Products", L/6253, p. 62.

this exception from the general prohibition on quantitative restrictions was limited by the interpretative note Ad Article XI:

"Paragraph 2(c)

The term "in any form" in this paragraph covers the same products when in an early stage of processing and still perishable, which compete directly with the fresh product and if freely imported would tend to make the restriction on the fresh product ineffective."

Thus, the exception could not be extended to all processed forms of the fresh product but only to those which met the specified criteria.

69. In the Havana Charter this provision had been redrafted to read:

"... imported "in any form" means the product in the form in which it is originally sold by its producer and such processed forms of the product as are so closely related to the original product as regards utilization that their unrestricted importation would make the restriction of the original product ineffective" (Note to Article 20, emphasis added).

It was this close relationship with regard to use that justified extension of the exception to some forms of processed products. While the interpretative note to the General Agreement focused more on defining the acceptable forms of the processed product, i.e. those that were in an early stage of processing and still perishable, the concept of a close relationship in terms of use was nonetheless retained in the requirements that the processed product compete directly with the fresh one to the extent that its free importation would render ineffective the restrictions on the fresh product. There was no evidence in either the drafting history nor the texts of the General Agreement itself that the exception was ever meant to apply to all, or even most, of the processed forms of any particular fresh product.

70. In light of these considerations, the Panel examined whether ice cream and yoghurt met all the conditions for "like" products "in any form": that they were in an "early stage of processing", "still perishable", "directly competitive" with raw milk and if freely imported would "make the restriction on the fresh product ineffective". The exception to Article XI:1 could be applied only to those processed products which met all of these conditions.

Early Stage of Processing

71. With regard to "early stage of processing", the Panel did not find sufficient the Canadian argument that products resulting from a direct continuous processing method should be considered ipso facto as in an early stage of processing. "Continuous" processing could theoretically be continued until a highly processed product (e.g. powdered cake mix) resulted. Neither could the Panel accept the implication of the US argument that any consumer-ready processed product could not be considered



as in an early stage of processing. Drinking milk, having been pasteurized and homogenized, was a "processed", consumer-ready product, yet it would be difficult not to consider drinking milk to be "in an early stage of processing". The Panel noted that not all ice cream and yoghurt products were at the same stage of processing. For example, it appeared that fresh yoghurt was less processed than frozen yoghurt mix, and bulk ice cream less processed than individually packaged, chocolate-coated, moulded ice cream bars. A finding with respect to the "early stage of processing" criterion would thus require an examination of the processing of each type of product subject to the import restrictions. Given the variety of modern production methods and the rapid changes in technology, the Panel also had doubts whether the concept "early stage of processing" could provide much guidance as to the interpretation of Article XI:2(c). In light of its findings on the other requirements of Article XI:2(c)(i), the Panel did not consider it necessary to make a finding in this regard.

#### Still Perishable

72. With regard to "still perishable", the Panel observed that both parties agreed that ice cream and yoghurt required special handling and storage conditions, and that the shelf life of fresh yoghurt was approximately three weeks. Canada had stated that ice cream made according to Agriculture Canada standards had a three-month shelf life. The United States had provided evidence that the ice cream it exported could be stored for 12 months. The United States further argued that a product which had undergone processing to make it less perishable than the raw product could no longer be considered to meet the requirements of this provision. The Panel did not agree with this interpretation; the interpretative note required only that the product be "still perishable", not "as perishable as the fresh product". The Panel recognized that there were considerable differences in perishability between products such as fresh yoghurt with its two to three week shelf life, and frozen yoghurt mix or some ice cream products which could be stored for up to one year. The Panel observed that there was no agreed definition of perishability in the General Agreement and little guidance provided by the drafting history. The drafters had stated that "... what we have in mind here is the perishable kind of processed product, not the kind which is capable of being stocked" (EPCT/A/PV/19). A previous panel had found that a product was still perishable because it would decline in quality and value after a certain time.<sup>11</sup> However, as virtually all agricultural products declined in quality and value after a certain time, the Panel did not believe that this previous finding provided sufficient guidance for clearly distinguishing between perishable and non-perishable items. As with the concept "early stage of processing", the Panel observed that rapid changes in technology since the General Agreement was drafted raised doubts as to the practicability of using the concept of "still perishable" to distinguish

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<sup>11</sup>Report of the Panel on "EEC - Programme of Minimum Import Prices, etc." BISD 25S/100.



the items that fell within the scope of Article XI:2(c) from those that did not. The Panel recalled that compliance with Article XI:2(c)(i) required that all of its conditions be met. The Panel did not feel that it was therefore necessary to make a finding with regard to perishability.

#### Directly Competitive

73. The Panel then proceeded to examine whether ice cream and yoghurt "compete directly" with fresh raw milk. Canada argued that imported ice cream and yoghurt competed directly with Canadian produced ice cream and yoghurt and thus displaced the raw milk which would have been processed into these products. The United States argued that ice cream and yoghurt were neither substitutable for nor destined for the same markets as raw milk. The Panel considered that the term "compete directly with ..." imposed a more limiting requirement than merely "compete with". As stated in the US arguments, the concept of "displacement" was apparently not intended by this provision. The essence of direct competition was that a buyer was basically indifferent if faced with the choice between one product or the other and viewed them as substitutable in terms of their use. Only limited competition existed between raw milk and ice cream and yoghurt. Their marketing was quite different, and as was implied in the Canadian arguments the competition which did exist was related to displacement of raw milk used in Canadian ice cream and yoghurt production. The Panel recalled that this provision was not designed to protect the processing industry. It further recalled its consideration concerning the narrow interpretation of exceptions (paragraph 59 above). The Panel did not consider it appropriate to broaden the scope of this requirement to include the concept of displacement or indirect competition. The Panel thus found that imports of ice cream and yoghurt did not compete directly with raw milk in terms of Article XI:2(c)(i).

#### Would Make the Restrictions Ineffective

74. The exception to Article XI:1 is further limited by its application only to those processed products whose free importation would render ineffective the restrictions on the fresh product. The drafters agreed that the exception "... should not be construed as permitting the use of quantitative restrictions as a method of protecting the industrial processing of agricultural or fisheries products" (Havana Reports, ICITO/I/8, p. 94). Canada argued that developments in the United States dairy situation encouraged the expansion of US exports. Uncontrolled imports of these products could displace close to 11 per cent of its industrial milk production (on a butterfat basis). As the United States had pointed out, the current Canadian dairy restriction programme had been in force since 1976, and although many other dairy products had been subject to quotas since that time, it had not previously been considered necessary to restrict imports of ice cream and yoghurt. Unrestricted imports of ice cream and yoghurt in the five years previous to the 1988 imposition of restrictions averaged, respectively, two-tenths of one per cent and three-tenths of one per cent of Canadian production of these products. Their impact upon total raw milk production in Canada could only be considered as minuscule.

75. The Panel recognized that Canada's concern was with regard to potential import levels, rather than historic ones, and with the accumulated effects of imports of various dairy products and the consequential effects on its domestic milk program. Prior to the imposition of the quantitative restrictions, imports of ice cream and yoghurt into Canada had been very small compared to Canadian production of these items, and these imports amounted to less than ten one-thousandths of one per cent of Canadian raw milk production. The factors cited by Canada could potentially lead to an increase in this import level; however, Canada had not provided evidence sufficient to convince the Panel that there existed an immediate threat of imports at such significantly increased levels as could render ineffective the Canadian dairy supply program. Article XI:2(c)(i) did not provide for the imposition of quantitative restrictions on imports at current levels merely on the basis of some hypothetical future situation. The Panel did not find that the evidence submitted by Canada justified the conclusion that unrestricted imports of ice cream and yoghurt would presently render ineffective the Canadian domestic restrictions on raw milk production.

76. The exception to Article XI:1 can be applied only to those processed products which meet all the conditions for "like" products "in any form" of the interpretative note Ad Article XI:2(c)(i): are in "an early stage of processing", "still perishable", "compete directly" with the fresh product and if freely imported would "make the restriction on the fresh product ineffective". The Panel found that ice cream and yoghurt did not compete directly with raw milk, and that their free importation would not render ineffective the Canadian production measures for raw milk. The Panel did not find it necessary to make findings with regard to the criterion of early stage of processing or perishability.

#### Governmental Measures to Restrict Domestic Production

77. The raison d'être of Article XI:2(c)(i) is to permit the operation of governmental measures that restrict the quantity of some fresh agricultural product permitted to be produced or marketed. The drafters indicated that "to restrict" means to "... keep output below the level which it would have attained in the absence of restrictions".<sup>12</sup> Proposals to make the regulation of production, through price stabilization programmes, an accepted criterion were rejected.<sup>13</sup> The Panel further observed that other than requiring a governmental measure, Article XI:2(c)(i) did not specify how the production or marketing restriction was to be imposed.

78. Canada had described in detail its domestic milk marketing programmes, noting that the programmes covered all producers and all milk produced in Canada. Canada argued that over quota levies, which resulted in returns below the farmer's cash cost of production, ensured that production did not

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<sup>12</sup>Havana Reports, ICITO/I/8, p. 89, para. 17

<sup>13</sup>EPCT/A/PV/19

exceed the established market sharing quota. According to Canada, existing excess capacity for production indicated that in the absence of the government restrictions production would be higher. It presented econometric analyses indicating that the increase in production would be on the order of 31 to 39 per cent. The United States argued that the only limitation on fluid milk sales was what the market could bear, and there was no penalty for producers exceeding their fluid milk "quota". Furthermore, the United States contended that the method of calculating support payments on in-quota milk was such as to perhaps provide some financial incentive to overproduce. In fact, in the past six years total industrial milk production had consistently exceeded the established Market Sharing Quota.

79. The Panel recalled that the requirement was for the effective restriction of production, not merely its regulation. A major element of the requirement of restricted production was that the measure, regardless of how operated, had to reduce production below the level it would otherwise have attained. The Panel observed that this concept was difficult to apply in practice. In situations such as the Canadian one, where the government measures had been in place for many years and were interrelated with price support and other production incentives, it was virtually impossible to determine what production levels would be in their absence. This determination would be necessary in order to have an objective basis for comparison with current production levels. In light of its findings in paragraphs 73 to 76 above, the Panel did not consider it necessary to further examine this issue. The Panel, therefore, did not make a finding with regard to whether the Canadian dairy management scheme constituted a government measure which effectively restricted total raw milk production in Canada.

#### Necessary

80. A further requirement of Article XI:2(c)(i) is that the import restrictions be "necessary to the enforcement" of the supply-restricting governmental measures. The Panel observed that although the term "necessary" had never been defined, the 1955 Working Party on Quantitative Restrictions had concluded "it would be an abuse of intent of the provisions under Article XI:2(c)(i) if the contracting parties were to apply restrictions to processed products exceeding those necessary to secure enforcement of the actual measures restricting production or marketing of the primary products".<sup>14</sup> There were also further interpretations with regard to seasonal restrictions. When restrictions on processed products were involved, the Panel found it difficult to separate completely the criterion of "necessary to the enforcement" from that regarding "... would render ineffective the restriction on the fresh product". If unrestricted imports would render a government measure ineffective, it would be difficult not to conclude that some restriction of

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<sup>14</sup> BISD 3S/189, 190

the imports was necessary. The arguments of the parties had essentially been the same for these two criteria. Canada had expressed concern that potential future imports could replace Canadian production of ice cream and yoghurt, and thus displace that proportion of Canadian milk normally used in their processing. The United States stated that ice cream and yoghurt had been freely imported over the many years during which Canada had a supply management system without causing any apparent difficulties to the operation of that programme. Furthermore, unrestricted imports of these products had attained a very limited market share, amounting to a minuscule proportion of total Canadian milk production.

81. The Panel recognized the merits of Canada's argument that for a product which is traded almost exclusively in its processed forms, such as milk, restrictions on the imports of the processed products might in some sense be "necessary" to ensure that the restriction on the production of the raw material was not undermined. This consequential result was, as the Panel had previously noted (paragraph 73), indirect. Canadian processors, whose access to dairy ingredient inputs was limited to higher priced domestic supplies, might not be able to compete effectively with imported processed products, and subsequently would reduce their production of these processed goods and hence their demand for the raw milk input. At this time, however, there was not sufficient evidence to believe that future imports of ice cream and yoghurt would achieve such levels as to significantly affect Canadian producers ability to market raw milk. In the past, unrestricted imports had gained less than a half a percent share of the Canadian ice cream and yoghurt market, and accounted for less than ten one-thousandths of one per cent of total raw milk production. Against this background and in the absence of an imminent threat to the Canadian dairy system, the Panel found that the criterion of "necessary" to the operation of the governmental restrictions could not be met.

#### Public Notice, Level of Imports

82. The Panel observed that the remaining provisions of Article XI:2(c), as concerned public notice and the level of imports, as well as those contained in Articles X and XIII, concerned the operation of the quota. As the Panel had found that the Canadian import quotas for ice cream and yoghurt could not be justified under Article XI:2(c)(i), it did not consider it necessary to examine whether the administration of these quotas was in conformity with the General Agreement.

#### Permit System

83. The Panel considered the United States arguments that the permit system operated as a quantitative restriction in addition to the quotas, as permits were not freely available and had limited validity. Given the Panel's findings that the quotas could not be justified under the General Agreement, to the extent that the permit system was a mechanism for the administration of the quota system, it had no justifiable basis and the Panel did not consider it necessary to further examine its operation. The Panel was aware that in 1988, having announced the restriction of imports of ice cream and yoghurt, Canada had not established a quota but had

nonetheless required import permits. The Panel recognized that this was an exceptional measure, which had been taken in the past and not repeated since 1988, and did not consider it necessary to further examine its conformity with the General Agreement. It did observe, however, that restrictions applied through discretionary licensing could not meet the requirement in Article XI:2(c) of prior public notice of the quantity or value permitted to be imported.

#### CONCLUSIONS

84. In light of the considerations set out in paragraphs 57 to 81 above, the Panel concluded that Canada's restrictions on the importation of ice cream and yoghurt are inconsistent with Article XI:1 and cannot be justified under the provisions of Article XI:2(c)(i). In particular, the Panel found that ice cream and yoghurt do not meet the requirements of Article XI:2(c)(i) for "like products" "in any form" to Canadian raw milk because they do not compete directly with raw milk nor would their free importation be likely to render ineffective the Canadian measures on raw milk production. The Panel found further that the restriction of imports of ice cream and yoghurt is not necessary to the enforcement of the Canadian programme for raw milk.

85. The Panel, therefore, recommends that the CONTRACTING PARTIES request Canada either to terminate these restrictions or to bring them into conformity with its obligations under the General Agreement.