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September 29, 1995

Congressional Requesters

In April 1994, leaders from more than 117 countries signed the Final Act of the General Agreement on Tariffs and Trade's (GATT) Uruguay Round negotiations. The Uruguay Round agreement represented the first time that participants had addressed substantial reform of agricultural trade. In an attempt to stabilize the world agricultural market and liberalize trade, the agreement requires member countries to make specific reductions in three areas--market access restrictions, export subsidies, and domestic support--over 6 years, from 1995 through 2000.

To reduce restrictions on market access, the United States and other GATT-member countries agreed to certain provisions. Exporters of dairy products to the United States will gain a 30,992-metric ton increase in the import quota for cheese, from 110,999 metric tons to 141,991 metric tons. For this additional imported cheese, the United States also agreed to increase the proportion of cheese for which exporting countries may select a U.S. importer. In addition, the United States will reduce both the volume subsidized and the level of subsidy offered on exports through its Dairy Export Incentive Program (DEIP).

One issue not resolved by the Uruguay Round agreement was the treatment of state trading enterprises. These enterprises are generally considered to be governmental and nongovernmental enterprises that are authorized to engage in trade and are owned, sanctioned, or otherwise supported by the government. While state trading enterprises are generally subject to GATT provisions, some U.S. agricultural producers are concerned that state trading enterprises, especially those with a monopoly on imports or exports, may operate in ways that bypass the Uruguay Round agreement and adversely affect U.S. agricultural producers. You expressed particular interest in the operations of one state trading enterprise--the New Zealand Dairy Board--and asked us to report on its operations in the United States.

As agreed with your offices, we are providing information on (1) the arrangement agreed to in the Uruguay Round for an increased allocation of cheese to U.S. importers and the effect of this arrangement on the U.S. dairy sector; (2) U.S. trade remedies that are available to protect the dairy sector and the extent to which they have been applied to cheese imports; (3) operations of one state trading enterprise--the New Zealand Dairy Board--in the United States; and (4) ways that DEIP may best be used as export subsidies decline.

In summary, we found the following:

-- The Uruguay Round agreement increased the proportion of total cheese imports for which exporting countries may designate the importer. This agreement allows most exporting countries to designate the importers that the U.S. Department of Agriculture (USDA) will license to import the additional cheese granted access under the Uruguay Round agreement. As a result, these designated importers will be able to sell their additional cheese on the domestic market. For the U.S. dairy sector as a whole, this change is not likely to have a significant impact on prices or market share. Regardless of who imports the cheese, there is no incentive for the importer to sell at less than prevailing prices to increase market share because the quota system limits market access.

-- A number of trade remedies are available to protect the U.S. dairy industry and USDA's milk price support program from import competition. Those laws most applicable to cheese imports--section 702 of the Trade Agreements Act of 1979 and section 22 of the Agricultural Adjustment Act of 1933, as amended--allow for investigations of trade practices that may negatively affect the U.S. dairy industry or USDA's milk price support program and provide certain remedies, such as quantitative restrictions or fees on imports. According to the Department of Commerce, section 702 has been used 14 times since 1979, and according to the United States International Trade Commission, section 22 has been used 3 times since 1979. As a result of the Uruguay Round agreement, section 22 no longer applies to GATT-member countries but still applies to nonmember countries. Also, USDA is rewriting the regulations that currently provide additional protections to importers of "quota cheese."

-- The New Zealand Dairy Board is chartered by the New Zealand government to be the sole exporter of dairy products. It also operates a wholly owned subsidiary in the United States--Western Dairy Products, Inc.--which held the license rights to import 59 percent of New Zealand's quota cheese exports in 1994. By acting as both exporter and importer, the Board can more fully gain the difference between world prices and the higher U.S. prices.

-- USDA has recently made several changes to DEIP to make it a more useful tool in maintaining the level of U.S. dairy exports in the post-GATT environment of declining export subsidies. In particular, USDA now allows exporters to use DEIP in Asian markets, and it makes subsidy allocations on a regional, rather than country-specific basis. Exporters stated that they support these changes but would like some additional changes--such as further regional consolidations--to increase the program's flexibility. Even with these changes, exporters and producers said that the long-range benefits of DEIP for market development will be limited unless domestic prices come more into line with world prices.

BACKGROUND

As part of the market access provisions of the Uruguay Round agreement, the United States has converted nontariff trade barriers (import quotas) into tariffs for selected commodities. The agreement requires that a limited level of imports be permitted at a low tariff rate and that any imports beyond that level be assessed a tariff at a higher rate. (These tariffs are collectively known as tariff-rate quotas.) In the case of cheese, the United States agreed to increase the amount of cheese eligible for the low tariff rate by 30,992 metric tons, from 110,999 to 141,991 metric tons.[1] (Enc. I describes the additional access by country and cheese type under the agreement.) The lower tariff rates start at about 10 percent ad valorem[2] and vary

[1]Total U.S. cheese imports in 1994 were about 151,392 metric tons, representing 4.76 percent of total domestic cheese consumption. About 70 percent of the imported cheese was subject to quota restrictions.

[2]An ad valorem duty is a duty expressed as a fixed percentage of value.

by type of cheese. The second, higher tariff rate is equivalent to about 100 percent ad valorem. The United States will reduce this second tariff by 15 percent over the next 6 years to rates that are equivalent to about 85 percent ad valorem. This is the minimum reduction required under the agreement. According to USDA, this tariff will remain prohibitively high and therefore is not expected to increase market access beyond that allowed by the low tariff rate.

As part of the export subsidy provisions of the Uruguay Round agreement, the United States agreed to reduce its use of DEIP to subsidize U.S. dairy exports. DEIP, established by the Food Security Act of 1985, provides subsidies for certain U.S. dairy products to allow them to compete with subsidized products from other countries. In 1995, USDA allocated DEIP subsidies for sales of milk powder, butterfat, and certain types of cheese in targeted markets. Under this program, an exporter negotiates a sales price with a prospective buyer in an eligible country. The exporter then submits a request (bid) to USDA for a subsidy that would allow the sale to take place at the agreed-upon price. USDA accepts or rejects the exporter's bid, depending on the competitiveness of the sale in that particular country and the level of subsidy requested. An acceptable bid must fall within the minimum sales price and maximum subsidy levels set by USDA. These levels are based on commercial sales activities in that market. The subsidy is paid after the exporter furnishes evidence that the specified commodity has been exported to the targeted country under the terms of the agreement.

URUGUAY ROUND CHANGES TO QUOTA CHEESE ALLOCATIONS AND THE EFFECT ON CHEESE IMPORTERS

The Uruguay Round agreement gave the countries that received increased access to the U.S. cheese market the right to designate the importers that could import this additional cheese. This provision increases the proportion of tariff-rate quota cheese for which the exporting country may designate the importer.

Countries were first given the right to designate importers for the increased cheese exports as a result of USDA regulations that were implemented following the Tokyo Round agreement of GATT. This agreement was signed in 1979. Under these regulations, USDA was permitted to allocate no more than 50 percent of the new tariff-rate quota on cheese created by the agreement among historical licensees.[3] USDA allocated the remainder to importers designated by exporting countries or importers chosen through a random lottery.[4] Before 1979, historical licensees had been the primary beneficiaries of new and increased cheese quotas. Importers not designated by exporting countries to import the additional quota cheese have limited opportunities to increase their imports unless they (1) purchase an existing company that already holds historical licenses or (2) gain access to the limited number of tariff-rate quota cheese licenses that are issued every year as renewable or random lottery licenses. These licenses represented about 16 percent of the pre-Uruguay Round cheese quota. U.S. importers that hold historical licenses to import cheese will not lose their current level of access to the U.S. market by virtue of the Uruguay Round agreement. Any changes that might affect those licensees would be the result of changes made to USDA regulations governing the import of tariff-rate quota cheese.

Exporters that designate their own subsidiaries will be able to earn profits both as exporters and importers of their tariff-rate quota cheese. According to USDA, exporting countries are likely to designate for the additional tariff-rate quota importers that their cheese traders believe will best promote and distribute their products. Some countries, such as Australia and Sweden, are expected to designate U.S. importers that are not subsidiaries of firms located in the exporting countries. Others, such as New Zealand and Norway, are likely to designate subsidiaries of their dairy cooperatives or boards in the United States.

Domestically, the provision to allow exporting countries to designate importers will primarily affect cheese importers. Designated importers will be able to sell more imported cheese in the domestic market, while those that are not

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[3]Import firms holding licenses issued by USDA are known as licensees. These licenses, which are renewed annually, authorize an importer to import a particular type of cheese from a particular country. Those licensees who had imported cheese before the imposition of quotas are known as historical licensees.

[4]Some countries, most notably the European Union, chose to use a lottery system to distribute import rights rather than to designate individual importers.

designated will not gain additional tariff-rate quota share.

Allowing exporting countries to designate importers is not likely to significantly affect prices and market share for the U.S. dairy sector as a whole. Imported cheese would be sold at lower prices only if sellers believed that they could increase market share. The allocation process only changes who sells the cheese, not how it is sold. Because the quota system limits access to the U.S. market, imported cheese is still likely to be sold at prevailing U.S. prices. Furthermore, the additional cheese tariff-rate quota that exporting countries can designate--25,017 metric tons--represents less than 1 percent of U.S. cheese consumption.[5] Therefore, it is doubtful that the change in the allocation process will influence the price of cheese, the price of milk, or the dairy sector as a whole.[6]

TRADE REMEDIES AVAILABLE TO PROTECT U.S. CHEESE MARKET

A number of trade remedies are available to protect the U.S. dairy industry from import competition--principally section 702 of the Trade Agreements Act of 1979 and section 22 of the Agricultural Adjustment Act of 1933, as amended. Section 22 no longer applies to GATT-member countries but still applies to nonmember countries. Other trade remedy laws still available to the U.S. dairy industry are discussed in a report we issued recently.[7]

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[5]Although the total amount of additional cheese granted access was 30,992 metric tons, only 25,017 metric tons will be designated by exporting countries. Exporting countries will not designate the other 5,975 metric tons because the increase in access granted to Mexico, 5,550 metric tons, can be used by unlicensed importers, and the balance will be issued to importers by lottery.

[6]For information on how the dairy pricing system operates, see Federal Dairy Programs: Information on Dairy Pricing and Related 1995 Farm Bill Issues (GAO/RCED-95-97BR, Mar. 27, 1995).

[7]See GAO/OGC-95-24 (July 28, 1995) for a discussion of these other laws. They include sections 201-204 and sections 301-309 of the Trade Act of 1974, as amended; antidumping laws, countervailing duty laws, and section 332 of the Tariff Act of 1930, as amended; and section 232 of

Section 702 is applicable only to cheese subject to tariff-rate quotas. If they believe that an exporting nation's quota cheese exports are subsidized and undercutting U.S. prices, petitioners (such as importers or producers) can request that USDA initiate an investigation. The Secretary of Agriculture and the Secretary of Commerce must complete their investigations within 30 days after receiving a petition. If the Secretary of Agriculture determines that the complaint is valid, the Secretary must advise the U.S. Trade Representative to negotiate with the foreign government. The foreign government has 15 days to eliminate the subsidies or price undercutting at issue or face additional fees. The Department of Commerce reports that it has conducted 14 investigations since 1979. The Uruguay Round agreement did not change the availability of this remedy.[8]

Section 22 of the 1933 act, as amended, enables the Secretary of Agriculture to investigate imports that are believed to interfere with USDA's domestic commodity programs, such as the milk price support program. Under section 22, the U.S. International Trade Commission investigates these charges and reports its findings. On the basis of the Commission's report, the President may impose fees or quantitative restrictions on the imports in question. According to the Commission, it has conducted three investigations for dairy products since 1979. According to USDA, cheese was either not the subject of these investigations or was only the subject of a minor definitional change in the tariff system. In our 1993 report, we noted that agency officials commented that this remedy was more complex and time-consuming than the section 702 remedy. As noted above, section 22 no longer applies to GATT-member countries.

USDA's regulations governing the import of dairy products under the tariff-rate quota contain certain protections for cheese importers. Currently, if an importer cannot use at least 85 percent of its license within a given year, USDA may require the importer to forfeit some portion or all of the license amount. However, USDA can exempt an importer

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the Trade Expansion Act of 1962.

[8]For more information on the trade remedy laws, especially section 702, see Remedies to Counter Dairy Import Competition (GAO/RCED-93-82R, Apr. 21, 1993).

from such reductions if the importer can show that it did not import the required amount because of an exporter's discrimination in making the product available. No importer has formally sought relief under this regulation. Some members of the dairy trade have recommended that USDA clarify these regulations to better identify the types of behavior that constitute discrimination against importers. Since USDA is revising these regulations, the exact nature of the provisions that protect cheese importers from discriminatory treatment by exporters may change.

OPERATIONS OF THE NEW ZEALAND DAIRY BOARD IN THE UNITED STATES

The New Zealand Dairy Board is chartered by the New Zealand government as the sole exporter of New Zealand dairy products. The Board purchases and markets dairy products intended for export and distributes net returns to contributing producers. It sells products in export markets directly through a worldwide network of holding companies and subsidiaries. Its U.S. holding company--Milk Products Holding (North America), Inc.--has a number of operating subsidiaries, including Western Dairy Products, Inc. (Western). This subsidiary is the North American company that handles New Zealand cheese subject to U.S. tariff-rate import quotas. All the cheese New Zealand exports to the United States is cheddar, cheeses similar to cheddar, or other American-type cheese and is generally used in processed cheese products.

Western imports some quota cheese under its own licenses. In 1994, imports by Western accounted for 59 percent of New Zealand's cheese quota of 17,442 metric tons. By the end of 2000, Western is expected to hold licenses to import 69 percent of New Zealand's 22,552 metric tons of tariff-rate quota cheese. The Board also arranges for sales of the remaining New Zealand tariff-rate quota cheese to the other U.S. license holders. The Board prices its cheese exports to the United States on the basis of prices set on the National Cheese Exchange in Green Bay, Wisconsin.[9] Since 1990, the Board's quota cheese sales to the United States have generally peaked in May and June of each year. This

[9]The National Cheese Exchange establishes prices for cheddar cheese in the United States. Traders buy and sell cheese on this exchange every Friday, and the price set through trade that week is an indicator of the supply and demand for cheddar cheese.

is primarily because (1) New Zealand's cheese production is seasonal, (2) New Zealand's dairy marketing year ends in May of each year, and (3) U.S. importers request more New Zealand cheese at this time of the year. These cheese sales generally occurred when prices for cheese in the United States were relatively high but had not yet peaked. (See enc. II for seasonal trends in New Zealand's milk production, cheese sales, customs entries of cheese, and U.S. cheese prices.)

The Board, like exporters in other quota-holding countries, can take advantage of the difference between world and U.S. prices. (See fig. II.5 in enc. II for more information on price differences.) These higher prices are due to the (1) U.S. dairy program, which keeps domestic prices higher than they would otherwise be, and (2) cheese import quota system, which restricts the supply of generally lower-priced imports. The Board's structure--as both exporter and importer of New Zealand cheese--enables it to more fully take advantage of this price difference. As the sole exporter, the Board ensures that the price of New Zealand cheese is not bid down by numerous New Zealand cheese processors competing with one another for overseas sales. When importing through its subsidiary, the Board also gains profits that would otherwise go to unaffiliated U.S. importers.

USES OF DEIP IN THE POST-URUGUAY ROUND ENVIRONMENT

DEIP subsidies will be reduced over the next 6 years as part of the United States' compliance with the Uruguay Round agreement to reduce agricultural export subsidies. The United States will reduce its budget outlays for export subsidies by a total of 36 percent and the volume of products receiving export subsidies by a total of 21 percent. These reductions will occur in six equal annual increments beginning in 1995. (See enc. III for more detailed information on the annual allowable export quantities and expenditures.)

Despite these reductions in subsidies, exporters believe USDA's recent changes will allow easier use of the program. Most notably, exporters stated that the use of DEIP to subsidize sales in growing Asian markets is important because rising populations and rapid economic growth in Asia are fueling demand for dairy products. Exporters were also pleased that USDA had adopted their recommendation to use regional DEIP allocations, rather than country-by-country allocations. They believe that regional allocations provide more flexibility for exporters to meet demand, thus allowing greater use of the allocations. In the past, an individual country's allocation was sometimes not used if demand was too low, while demand in neighboring countries sometimes exceeded allocation levels.

Although exporters support USDA's changes to DEIP, they believe that further modifications are needed to make the program more flexible. They would like to see further regional consolidations and changes to the way USDA approves bids. Exporters stated that USDA's current process of approving each individual bid limits sales. They would prefer that USDA automatically approve a bid as long as the required subsidy is within USDA's maximum allowable subsidy for that destination. USDA is currently evaluating industry comments on changes to DEIP made in response to an Advance Notice of Proposed Rulemaking published on June 26, 1995.

Even with improvements, these exporters and some representatives of dairy producers we spoke with said that the long-term benefits of DEIP for market development are limited. They view the program as a valuable transition tool in the post-GATT world but believe domestic prices must become more in line with world prices if the United States is to expand its dairy exports.

AGENCY COMMENTS AND OUR RESPONSE

We provided a draft copy of this report to USDA for its review and comment. We received written comments from the Acting Administrator of USDA's Foreign Agricultural Service. (See enc. IV.) USDA said that, overall, this report fairly characterizes the framework for importing tariff-rate quota cheese. There were two primary areas in our report that USDA suggested be modified: (1) the idea that the Uruguay Round agreement resulted in a major change in the licensing procedures for tariff-rate quota cheese imports and (2) the treatment of section 22 of the Agricultural Adjustment Act of 1933, as amended, as a remedy for unfair trade practices or for producers seeking import protection. To address the first point, we added clarifying language to explain that the precedent for allowing exporting countries to designate importers was actually set in 1979, following the Tokyo Round agreement. To address the second point, we emphasized that section 22, as amended, is not a remedy for unfair trade practices but rather is used to protect U.S. commodity price support programs from interference by imports. USDA did not comment on the descriptions of the New Zealand Dairy Board's pricing policies or the timing of its sales. USDA suggested several additional specific changes to the draft of this report, which we discussed with USDA officials and incorporated, where appropriate, into the final report.

SCOPE AND METHODOLOGY

To address our objectives, we reviewed legislation and regulations concerning cheese imports, dairy export subsidies, and trade remedies. We interviewed USDA officials to discuss how the Uruguay Round is likely to affect the importation of tariff-rate quota cheese and how regulations governing those imports have changed. We also discussed trade remedies available to protect the domestic cheese market with officials from USDA, the U.S. International Trade Commission, and the Department of Commerce.

We also spoke with several large U.S. importers of New Zealand cheese about how they conduct business with the New Zealand Dairy Board. To obtain information about the Board's operations in the United States, we spoke with, and obtained documents from, representatives of the Milk Products Holding Company and Western Dairy Products, Inc. We also obtained the views of dairy exporters on DEIP and the changes they have recommended to the program's operations.

We obtained aggregate U.S. Customs data on entries of New Zealand cheese, U.S. cheese prices, and Uruguay Round tariff-rate quota allocations from USDA. We obtained world price data from the Food and Agriculture Policy Research Institute and production and sales information on New Zealand cheese from representatives of the New Zealand Dairy Board. All price information in this report is expressed in 1994 constant dollars.

We also discussed the portions of this report that deal with the operations of the New Zealand Dairy Board with one of the Board's officials who represents both Western Dairy Products, Inc. and Milk Products Holdings (North America), Inc. Overall, he agreed with our description of the Board's operations in the United States and provided several clarifying suggestions that we incorporated, as appropriate, in the final report.

We performed our review between July 1995 and September 1995 in accordance with generally accepted government auditing standards.

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We are sending copies of this report to appropriate congressional committees, the Secretary of Agriculture, and other interested parties. We will also make copies of this report available to others upon request.

Please contact me on (202) 512-5138 if you or your staff have any questions.

Michael Gryszkowiec
for John W. Harman
Director, Food
and Agriculture Issues

Enclosures - 4

<u>List of Requesters</u>

The Honorable Pat Roberts
Chairman, Committee on Agriculture
House of Representatives

The Honorable Steve Gunderson
Chairman, Subcommittee on Livestock,
Dairy and Poultry
Committee on Agriculture
House of Representatives

The Honorable David R. Obey
Ranking Minority Member
Committee on Appropriations
House of Representatives

The Honorable Joe Skeen
Chairman, Subcommittee on Agriculture,
Rural Development, FDA,
and Related Agencies
Committee on Appropriations
House of Representatives

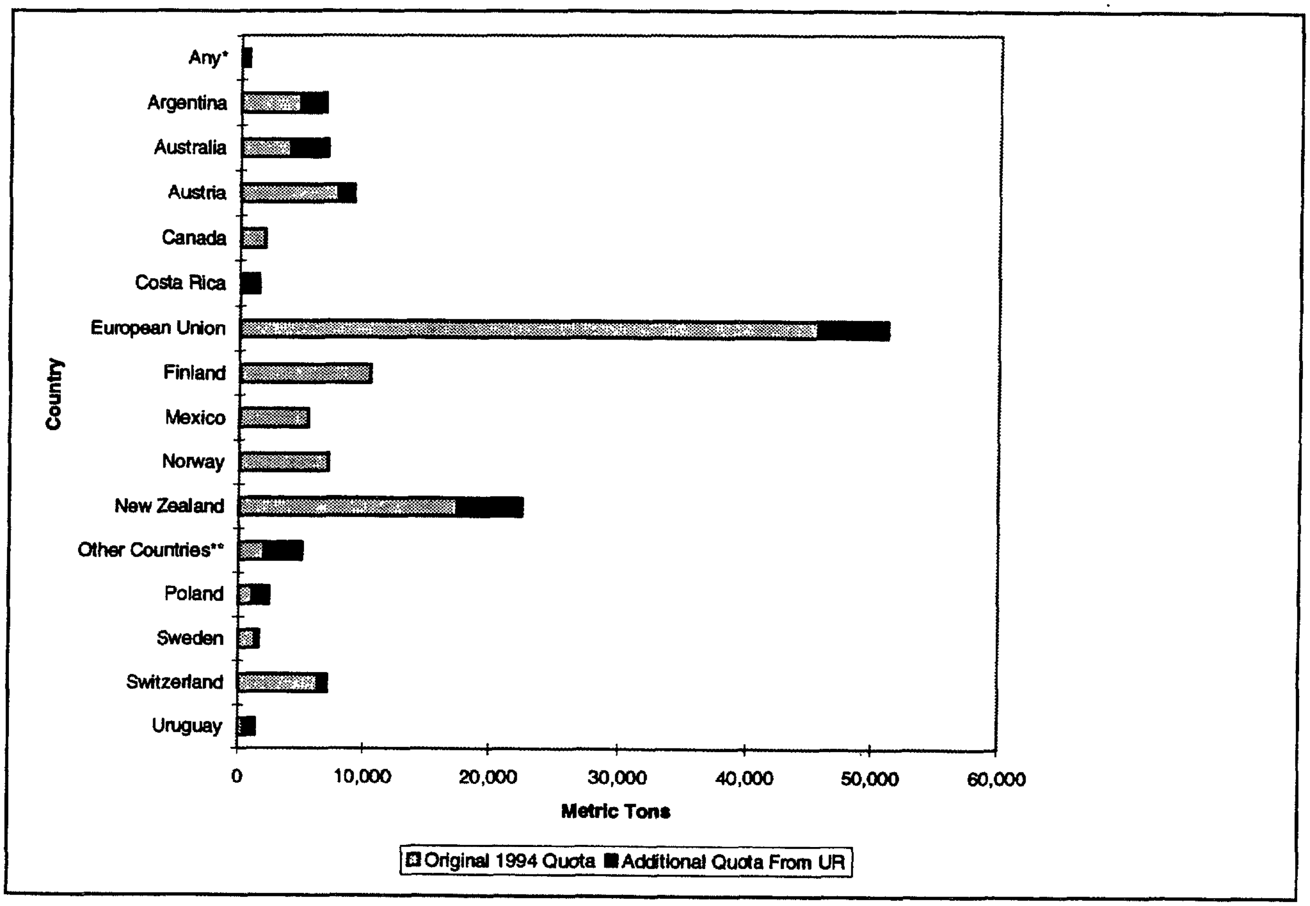
The Honorable Herb Kohl
The Honorable Kent Conrad
The Honorable Larry Pressler
The Honorable Russ Feingold
The Honorable Larry Craig
The Honorable Byron L. Dorgan
United States Senate

The Honorable Tom Petri
The Honorable Tim Holden
The Honorable Robert Borski
The Honorable Sherwood Boehlert
The Honorable John M. McHugh
The Honorable Earl Pomeroy
The Honorable Tim Johnson
The Honorable Doug Bereuter
House of Representatives

INCREASES IN ACCESS TO THE U.S. CHEESE MARKET AS A RESULT OF THE URUGUAY ROUND

In 1994, exporters could export 110,999 metric tons of quota cheese to the United States. By 2000, the tariff-rate quota will increase to 141,991 metric tons. Imports of quota cheese represent approximately 3 percent of the total domestic cheese consumption. New Zealand held a 15.7-percent share of the overall quota cheese imports in 1994, and it will hold a 15.9-percent share in 2000. (See fig. I.1.) The largest percentage increase in access to the U.S. market is for cheddar cheese, from 5,536 metric tons in 1994 to 13,256 metric tons in 2000. (See fig. I.2.) Imports of cheddar cheese, all under quotas, accounted for 0.2 percent of the total domestic cheese consumption in 1994.

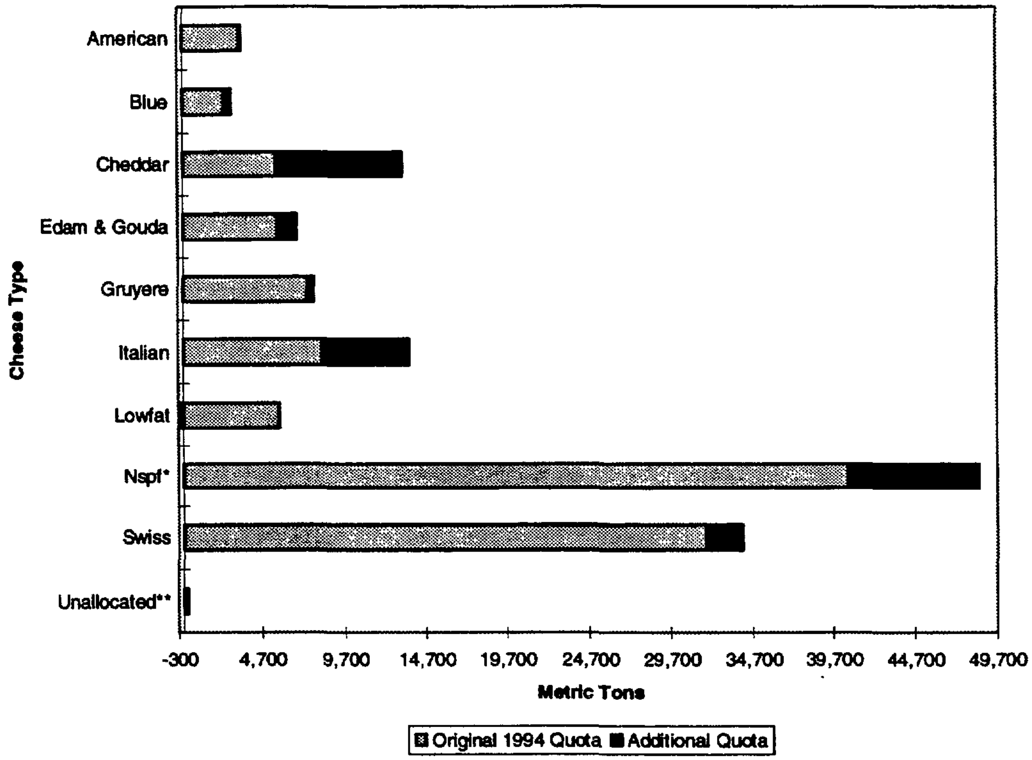
Figure I.1: Distribution of Additional Allocation of Cheese as a Result of the Uruguay Round Agreement, by Country



* "Any" means this total amount of cheese can be imported from any country in the world.
**"Other countries" combines amounts for countries whose specific tariff-rate quota allocation is less than 800 metric tons and a residual for countries that have no specific tariff-rate quota allocation.

Source: GAO analysis of USDA data.

Figure I.2: Distribution of Additional Allocation of Cheese as a Result of the Uruguay Round Agreement, by Cheese Type



*"NSPF" is cheese that is "not specifically provided for" and is the amount of quota cheese that can enter the United States that has not already been specifically mentioned in the other categories.
**"Unallocated" refers to the amount of cheese that had not been allocated to a specific cheese type or to any country as of August 1995.

Source: GAO analysis of USDA data.

NEW ZEALAND DAIRY BOARD'S CHEESE SALES TO THE UNITED STATES

New Zealand's cheese production and sales are highly cyclical, reflecting both the milk production season and the June-May dairy marketing year. In New Zealand, most cows graze on rain-fed grass rather than feed grains. New Zealand's location in the Southern Hemisphere results in a growing season that is opposite to the United States' growing season--New Zealand's spring and summer months correlate to the United States' fall and winter months. Cows calve from August through September, and peak milk production occurs from October to the end of December, when grass is most plentiful. Two-thirds of a season's milk is produced from October through December.

Cheese production generally begins in August and has peaked in November for the last 5 years. (See fig. II.1.) New Zealand's sales of quota cheese to the United States also follow a seasonal pattern. From 1990 to 1994, sales generally peaked in May of each year, the last month of the dairy marketing year. (See fig. II.2.) Board representatives told us that the peak results from year-end sales of the current marketing year's inventory. This allows the Board to provide returns to producers within the year of production.

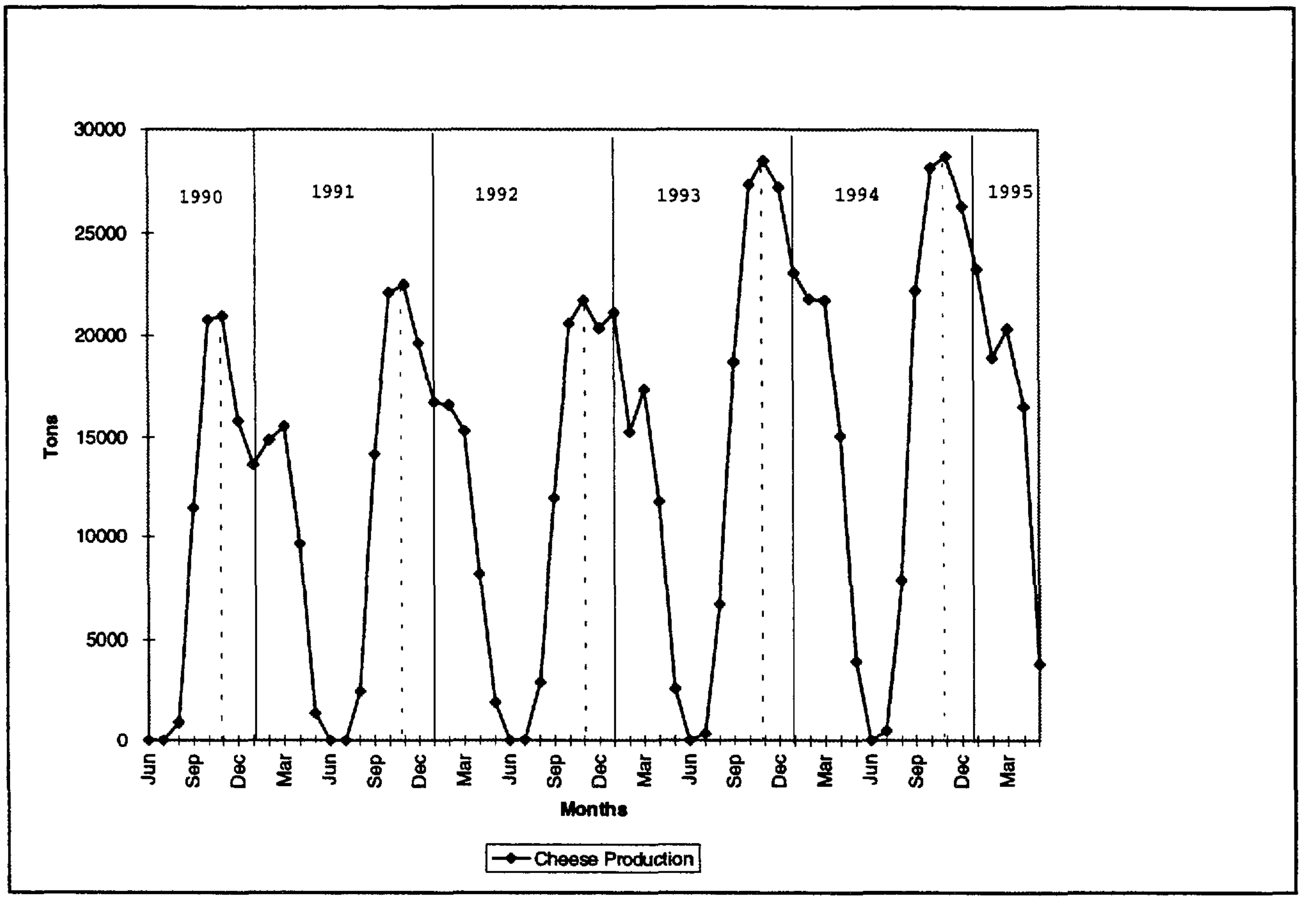
U.S. Customs data indicate a similar pattern for entries of New Zealand quota cheese into the United States. Generally, entries peak in May, with some additional quantities entering the United States in subsequent months.

U.S. cheese prices are cyclical, but the pattern has recently changed. Traditionally, prices started to rise in the spring and peaked in late summer or fall. However, since 1993, prices have peaked twice during the calendar year--in May and in late September/early October. It appears that this new pattern of double peaks is continuing into 1995. (See fig. II.3.) According to an official in USDA's Economic Research Service, it is not clear what factors have caused this change.

As a result of these import and price cycles, sales of New Zealand quota cheese to the United States were high from 1990 to 1994 at the same time that U.S. prices were high. (See fig. II.4.) Before 1993, cheese sales peaked several months before U.S. prices peaked. However, since 1993, sales and price peaks have occurred together.

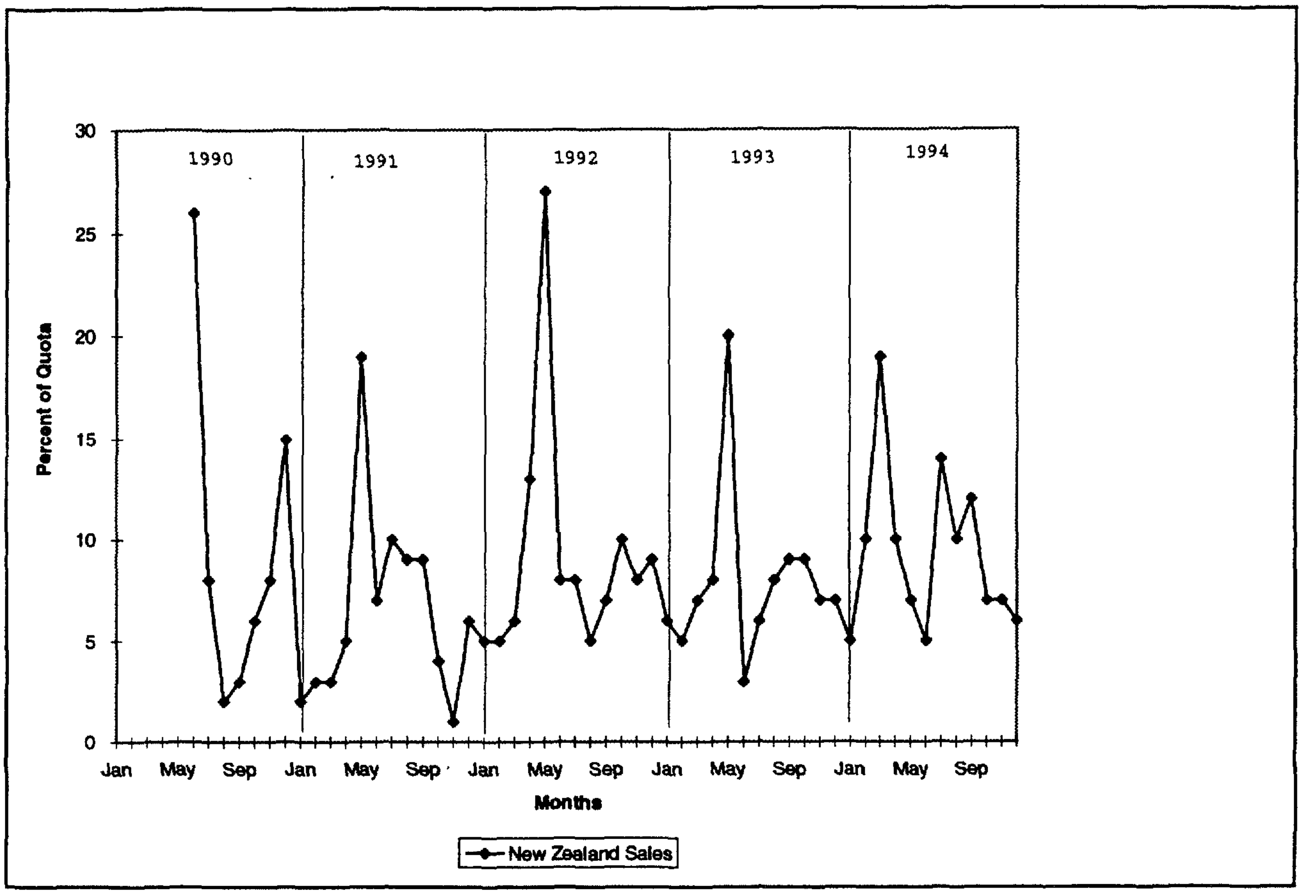
U.S. dairy prices tend to be higher than world prices because the U.S. dairy program keeps domestic prices higher than they would otherwise be, and the cheese import quota system restricts the supply of lower-priced imports. (See fig. II.5.) The New Zealand Dairy Board, like any other exporter to the United States, benefits from this price differential.

Figure II.1: Monthly New Zealand Cheese Production, in Metric Tons, 1990-95



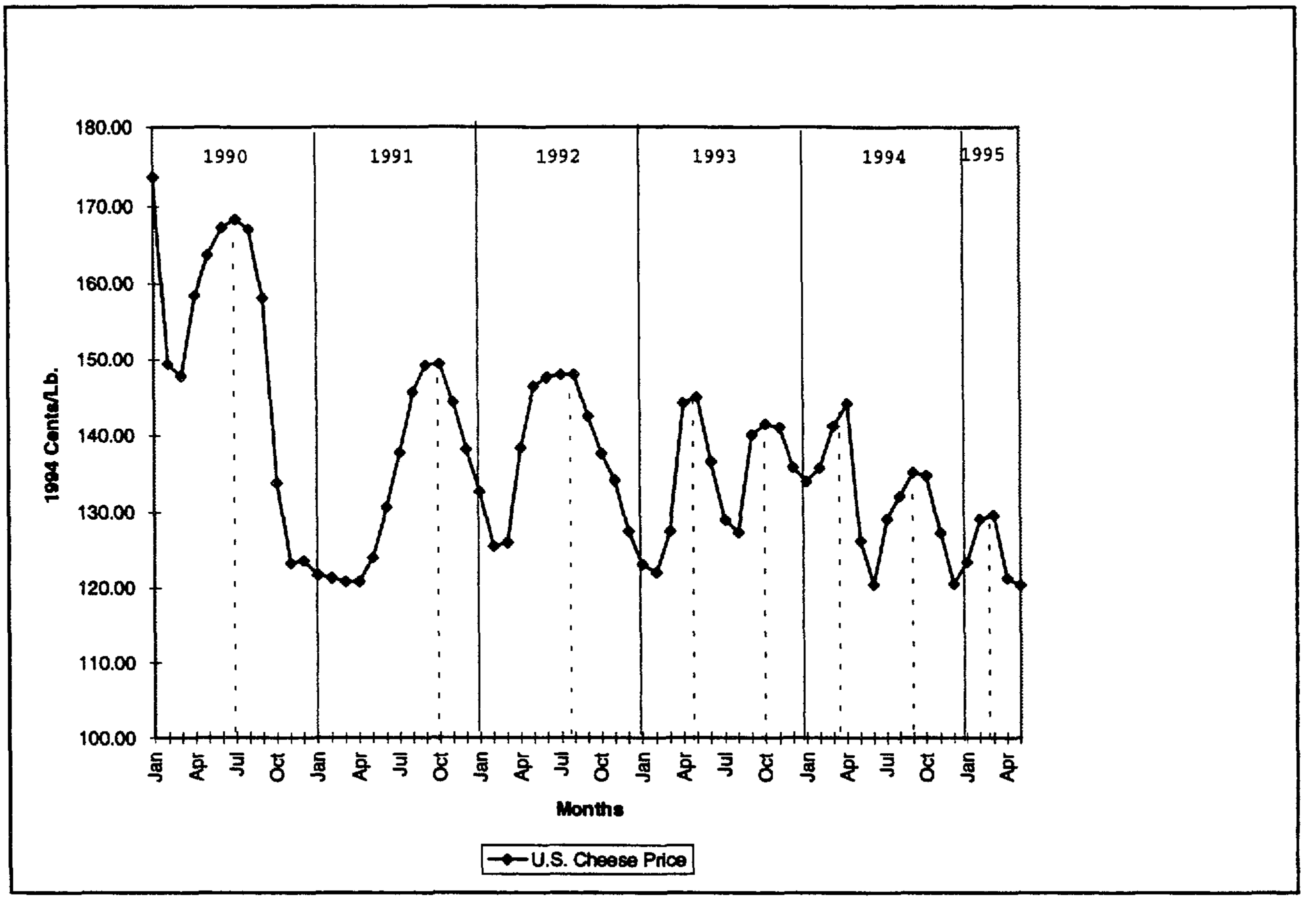
Source: GAO analysis of New Zealand Dairy Board data.

Figure II.2: Monthly New Zealand Quota Cheese Sales to the United States, as a Percent of New Zealand's Annual Quota, 1990-94



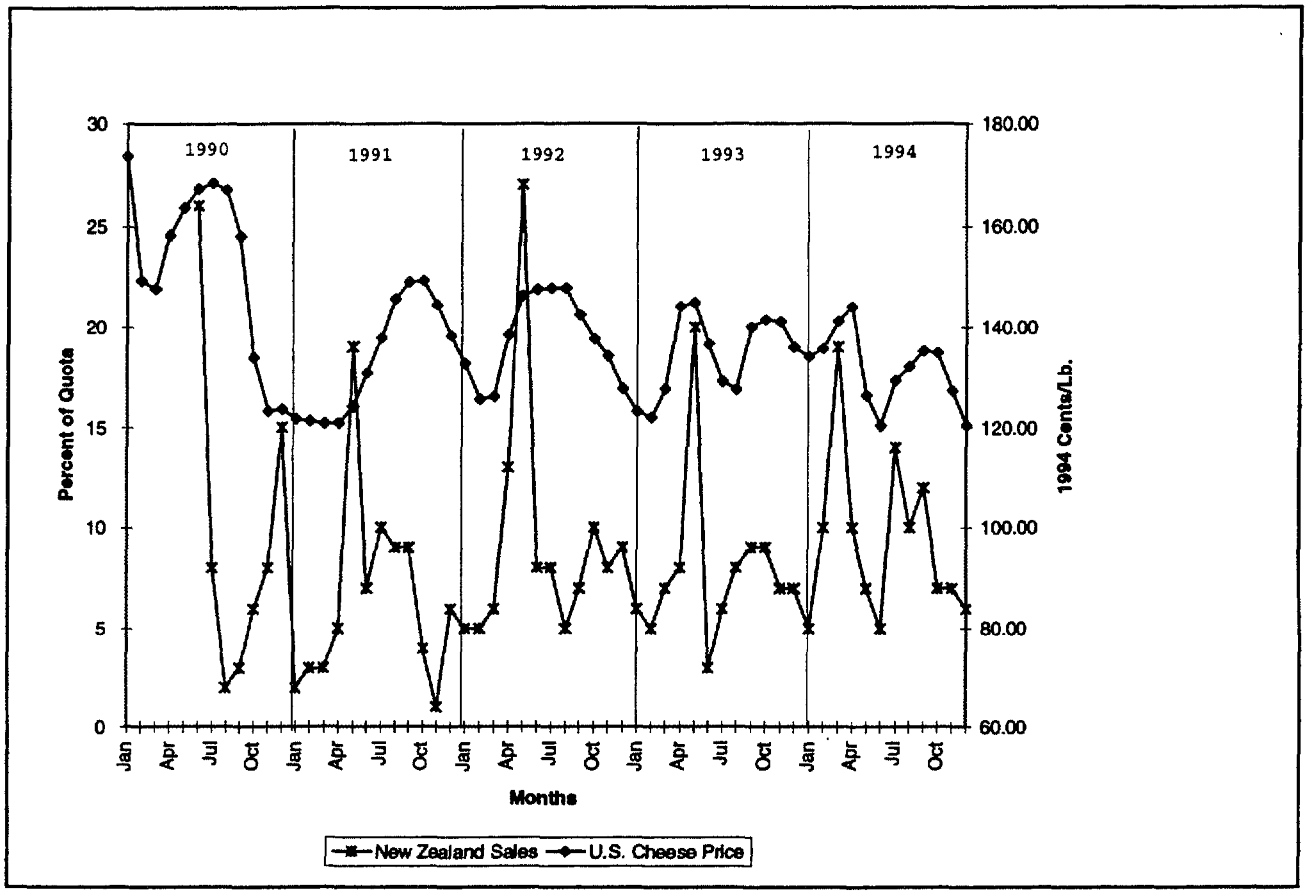
Source: GAO analysis of New Zealand Dairy Board data.

Figure II.3: Monthly U.S. Cheese Prices, 1990-95



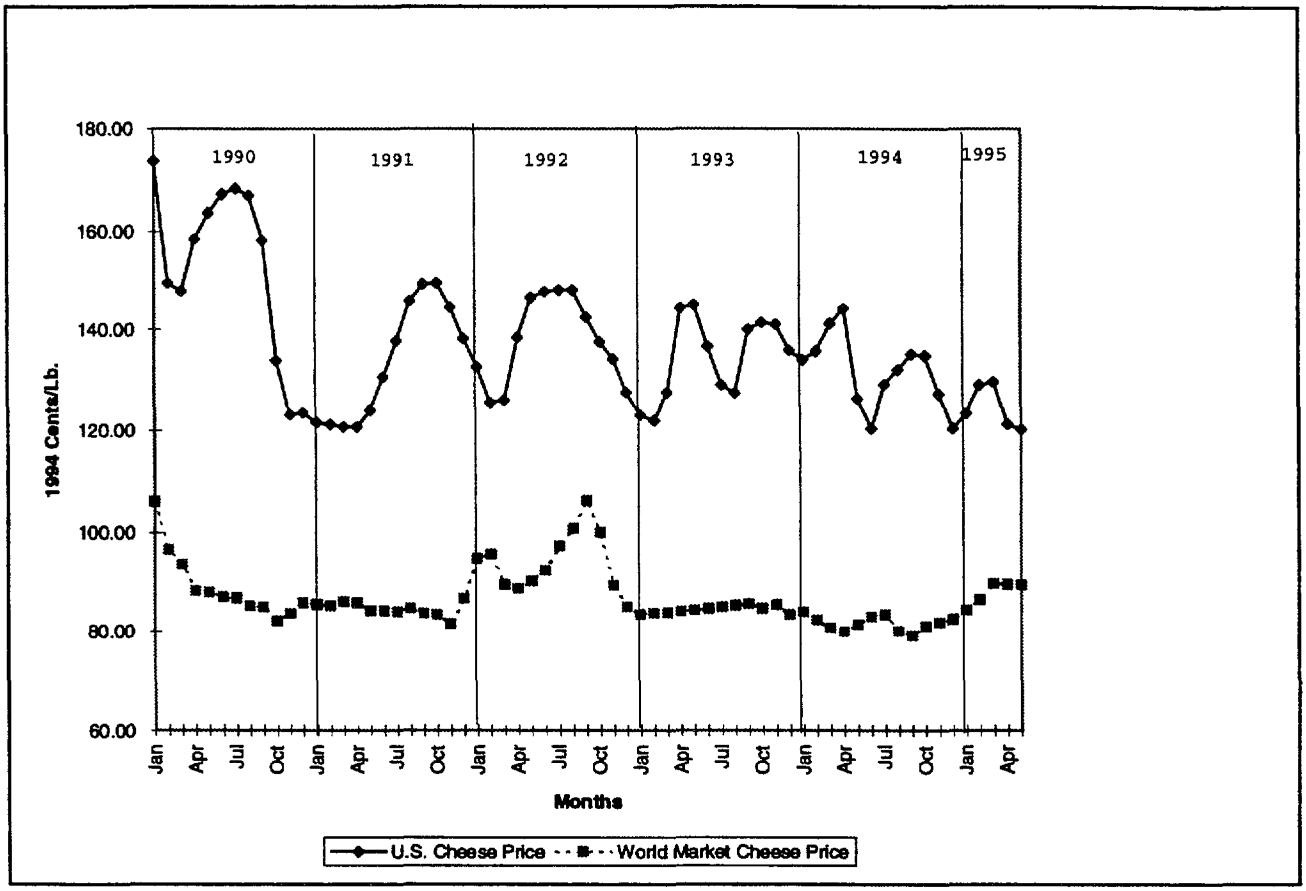
Source: GAO analysis of USDA data.

Figure II.4: Monthly Sales of New Zealand Quota Cheese as a Percent of New Zealand's Annual Quota, Compared to Monthly U.S. Cheese Prices, 1990-94



Source: GAO analysis of New Zealand Dairy Board and USDA data.

Figure II.5: Monthly U.S. and World Cheese Prices, 1990-95



Source: GAO analysis of Agricultural and Food Policy Center, Texas A&M University data.

DEIP'S ANNUAL ALLOWABLE QUANTITIES AND EXPENDITURES FOR DAIRY PRODUCTS

Under the Uruguay Round agreement of the General Agreement on Tariffs and Trade, the United States will reduce budgetary outlays for export subsidies by a total of 36 percent and its quantities of dairy products receiving export subsidies by a total of 21 percent in equal annual increments starting in 1995 and continuing through 2000. These reductions will be based on the average level of export subsidies from 1986 through 1990, although some of the reductions will begin from 1991-92 average levels. Table III.1 shows permitted levels of subsidized export quantities and budget outlays for eligible dairy commodities on an annual basis from 1995 through 2000.

Table III.1: Annual Allowable Quantities (in 1,000 tons) and Expenditures in ($1,000)

Commodity	1995	1996	1997	1998	1999	2000
Butter/butter oil						
Quantity	43.0	38.6	34.2	29.9	25.5	21.1
Budget	$44,793	$41,934	$39,075	$36,215	$33,356	$30,497
Nonfat dry milk						
Quantity	108.2	100.2	92.2	84.2	76.2	68.2
Budget	$121,119	$113,388	$105,657	$97,926	$90,195	$82,464
Cheese						
Quantity	3.8	3.7	3.5	3.4	3.2	3.0
Budget	$5,340	$4,999	$4,658	$4,317	$3,976	$3,636
Other dairy						
Quantity	12.5	10.0	7.5	5.0	2.5	0.03
Budget	$14,374	$11,503	$8,633	$5,762	$2,892	$21

Source: USDA.

COMMENTS FROM THE U.S. DEPARTMENT OF AGRICULTURE

United States Department of Agriculture
Foreign Agricultural Service
Washington, D.C. 20250

SEP 2 2 1995

John W. Harmon
Director, Food and Agriculture Issues
General Accounting Office
Washington, D.C. 20548

Dear Mr. Harmon,

In this letter please find the Foreign Agricultural Service's comments on the draft of your report entitled, "Cheese Imports" (GAO/RCED-95-280). Overall the report fairly characterizes the framework for importing tariff-rate quota (TRQ) cheese. Please note we are not commenting on the descriptions of the New Zealand Dairy Board's pricing policies or the timing of their sales. There are, however, two substantive areas in your report whose presentation we believe should be modified: (1) the notion that the Uruguay Round resulted in a major change in the import licensing procedures for the increases in tariff-rate quota cheese imports; and (2) the treatment of Section 22 of the Agricultural Adjustment Act of 1933, as amended (Section 22), as a remedy for unfair trade practices or for producers seeking import protection. There are also a number of technical or informational changes we are suggesting, including two on the Dairy Export Incentive Program. We have in most cases provided alternative language in the hope of clarifying the issues.

With regard to the effect of the Uruguay Round on import licensing procedures, the changes resulting from the agreement are limited to the proportion of the TRQ for which the exporting countries may choose the importer to be issued license. This provision of the import regulations is not new: it was provided for a portion of the Tokyo Round quota increases (though not as part of the concessions made in the Round). The Uruguay Round bilateral memoranda of understanding provide this option for all country-specific cheese TRQ increments.

With regard to Section 22 as a trade remedy, there is an apparent misperception about its purpose. While its application may result in the protection of U.S. producers from increases in imports, it is *not* a remedy for unfair trade practices, nor one that can be sought by producers unless domestic price support programs are affected by the increased imports. Section 22 is intended to protect the individual commodity price support programs administered by the Department of Agriculture from material interference by imports. We note also that in the three Section 22 dairy investigations since 1979, cheese was either not the subject of the investigation or only the subject of a definitional change which restored pre-Harmonized Tariff System quota treatment to a product.

We would suggest the following specific textual changes:

p. 1, ¶2, modify sentence 3: For this additional imported cheese, the United States also agreed to *expand the quantity of cheese for which exporting countries may select the U.S. importer annually.*

p. 2, ¶2, modify sentence 1: As agreed with your offices, we are providing information on (1) *whether the Uruguay Round made any change* to the process that exporting countries use to allocate increased cheese quota.....

p. 2, ¶3, replace sentences 1 and 2 with: "The Uruguay Round increased the proportion of total cheese imports under tariff-rate quota for which exporting countries may choose the importer. The entire amount of the additional country-specific cheese TRQ can benefit from this provision." Delete "change" in sentence 2.

p. 3, ¶2: see comment regarding Section 22 above. Also Section 702 of the Trade Act of 1979, as amended, applies to a very specific practice: price-undercutting of domestic cheese by imported TRQ cheese which can be shown to have been subsidized. It effectively replaces the countervailing duty law for TRQ cheese.

p. 3, ¶3: reconcile data on Western's percentage of imports with that on p. 10.

p. 4, ¶2, add to explanatory parenthesis: These tariffs *and the in-quota level of imports....*

p. 5, ¶2, add to last sentence: "....sale in that particular country, *and on the level of the bonus requested.*"

p. 6, ¶2, replace sentences 2-5 with: "The bilateral Memoranda of Understanding which are part of the Uruguay Round agreement implementation commitments gave exporting countries the right to designate importers for the total of the countries' additional market access under the TRQ. This effectively increases the proportion of the TRQ cheese imports for which the exporting country may choose the importer. Before 1979 licenses for quota articles were issued primarily to importers who had imported the product prior to the imposition of the quotas (so-called "historical" licenses), with small quantities set aside for new businesses (in the form of a renewable lottery license). No more than 50 percent of the new quota access created by the Tokyo Round was allocated among such historical importers: the remainder was issued either to importers designated by exporting countries or through a random lottery." Modify sentence 6: "...to import the additional *TRQ* cheese, have limited opportunities to increase their imports, *short of purchasing an existing license-holding company, including the assets attendant to the importing business.*" (Also modify footnote 4 to read: About 16 percent of the pre-Uruguay Round quota was issued in renewable or random lottery license.)

p. 7, end of ¶1, add: "...access *by virtue of the Uruguay Round agreements themselves; any changes which might affect those licenses would be the result of a rule-making process.*" This is needed to clarify that the rule-making process can affect these licenses.

p. 7, ¶2, modify: "According to USDA, *the designation provision permits exporting countries to choose importers..... Some countries, such as Australia and Sweden, generally designate a number of U.S. importers. Others, such as..., are likely to designate subsidiaries of their dairy cooperatives or boards in the United States.*" Exporting country governments do the designating, generally following the wishes of their industry. However,

ENCLOSURE IV

there is a new element in the picture--the EC. It is not clear what they will do to allocate a relatively small quantity of TRQ to the potentially very large number of importers who represent requesting exporters in the EC-12.

p. 7, ¶4: the additional amount that can be designated is *25,017 MT* (Mexican TRQ is unlicensed and "Any" or "Other" country allocations are issued under lottery).

p. 8, ¶2: same comment regarding Section 22 as above. Also, the former Section 22 quotas have all been replaced by the TRQ's for WTO members; its application is thus limited to non-WTO suppliers, who are not major dairy producers.

p. 8, ¶3, modify first sentence: "...cheese subject to *TRQ's*."

p. 9, ¶3, modify sentence 2: "some portion *or all* of the license amount."

p. 10, ¶1, modify sentence 1: "No importer has *formally* sought relief..."

p. 10, ¶2, modify last sentence: "All the cheese New Zealand exports to the United States is cheddar, *cheeses similar to cheddar or other American-type cheese*, and is...."

p. 11, ¶2, modify sentence 2: "...(2) the cheese import *TRQ* system, which restricts the supply of *generally* lower-priced imports."

p. 13, ¶1, add to the end of the paragraph: "USDA is currently evaluating industry comments on changes to the DEIP made in response to an Advance Notice of Proposed Rulemaking published on June 26,1995."

p. 14, ¶2, modify sentence 1 to clarify that we did not provide individual entry data (we are prohibited from doing so): "We obtained *aggregate U.S. Customs data on entries of New Zealand cheese*...."

With regard to your tables:

Figure I.1:

--the title could be clarified to reflect that the numbers show all the access for cheese under TRQ, as well as the additional access;

--the definition for "Other Countries" should read: " 'Other Countries' combines amounts for countries whose specific TRQ allocation is less than 800 MT and a residual for countries who have no specific TRQ allocation."

Figure I.2--the same applies to the title for this table.

We appreciate this opportunity to comment.

Sincerely,

Timothy J. Galvin
Acting Administrator

(150915)

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