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IMPORTATION OF BUTTEROIL/SUGAR BLENDS

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IMPORTATION OF BUTTEROIL/SUGAR BLENDS

ISSUES RELATED TO THE IMPORTATION OF BUTTEROIL/SUGAR AND OTHER DAIRY BLENDS

The volume of butteroil/sugar blend imports increased 488% in just over 18 months between 1995 and 1997; as a result, it is hardly surprising that political interest in the issue grew by almost the same degree in several weeks. At first glance, it might seem that an increase in imports from $3 million in 1995 to roughly $20 million in 1997 would not normally generate so much attention; however, the sudden interest in this waxy, granular, semi-processed and rather unappetizing food product is only an indication of a very complex political and economic reality. The growth in imports of blends made up of 49% butteroil and 51% sugar is of concern because such blends can enter Canada under tariff line 2106.90.95, and, chiefly for this reason, allows manufacturers of ice cream and processed cheese to reduce their production costs.

The swift reaction of the Dairy Farmers of Canada (DFC) to increased imports of butteroil blends shows that they completely understand the gravity of the issue. Used in principle as a substitute in the manufacturing of ice cream, this "dairy product" is sweetened so that not only does it cease to qualify as a milkfat, but it also ceases to enjoy the tariff protection normally extended to true dairy products. However, these imports are now replacing a portion of the domestic output of milkfat, and thereby interfering with the market. Their unimpeded entry into Canada is a good illustration of how, since markets have been opened up, the dairy sector does not have the same protection as it did before the Uruguay Round negotiations.

Politically, the debate prompted by Canadian producers' opposition to the imports of butteroil/sugar blends revealed that it was not only a question of supply management. Other issues were: the application of international rules to trade policies; food safety; and labelling.

From the economic point of view, it should be pointed out that, as markets open up, producers, processors and consumers will be presented with more and more choices that will shake up their respective worlds.

Four federal departments are involved in various trade aspects of butteroil/sugar blends: the Department of Finance for general trade policy; Canada Customs and Revenue Agency (CCRA) for import classification and control; the Department of Foreign Affairs and International Trade for the administration of tariff-rate quotas; and Agriculture and Agri-Food Canada, whose expertise is crucial in determining the classification of the products. All it took was a simple administrative decision by CCRA based on international rules to trigger a wave of barriers not unlike those applied to imports of raw-milk cheeses. Consequently, it can be said that, although the stakes in this issue are high, its origin was quite mundane and bureaucratic.

No one is challenging internationally negotiated Canadian tariff-rate quotas or the levels of protection they afford dairy products; on the other hand, the development and importation of imitations or innovative products leads to administrative decisions that do not please everyone, primarily because of the economic impact they can have on some industries. Various aspects of this problem are discussed in the following sections of this paper.

FROM THE IMPORT CONTROL LIST TO TARIFF-RATE QUOTAS

The problem with importing butteroil/sugar blends to replace milkfat in ice cream goes back to long before the tariff system established by the Uruguay Round.

A. Before the Uruguay Round

Prior to the Uruguay Round agreements, the *Export and Import Permits Act* provided for the establishment of an Import Control List (ICL). The importation of dairy products was thus governed by permits limiting the entry of products through import quotas.

Most of the primary dairy products were specifically identified in the ICL, while unspecified dairy products were covered by a general provision controlling the entry of all forms of fat. Products on the ICL were identified by name only; they were not described in detail, as they are on today's tariff-rate quota lists. The legal interpretation provided by the Department of Justice was that any product with a dairy content of at least 50% could be considered a dairy product.

Dairy products, as well as products composed entirely or primarily of milk, were covered by the *Canadian Dairy Commission Act* but, because the ICL was also covered by the *Export and Import Permits Act* and the *Agricultural Stabilization Act*, the Dairy Farmers of Canada, realizing that different interpretations were possible, requested that the definition of "dairy products" be narrowed, particularly with respect to the word "primarily."

In 1988, after the Canada-United States Free Trade Agreement was signed, the federal government added three dairy products to the ICL: ice cream, yogurt, and dairy blends containing at least 50% skim milk, casein, caseinate, buttermilk or whey, used alone or in combination (ICL Item 21). For the first time, the threshold of 50% for dry dairy blends became a set rule.

The United States challenged the addition, arguing that yogurt and ice cream were too far down the production line to be considered as dairy products that should be protected in order to preserve supply management. A special General Agreement on Tariffs and Trade (GATT) group ruled in Canada's favour, however.

Subsequently, the Canadian government blocked various attempts to import into Canada dry blends containing less than 50% dairy products. One importer tried to bring into Canada a blend containing 49% skim milk powder (SMP) and 51% coarse salt, which was then sifted so that the SMP could be extracted and used. Even though in principle the ICL made no mention of products containing less than 50% dairy products, this blend was deemed to have been manufactured deliberately to circumvent the regulations and was therefore banned.

B. After the Uruguay Round

As a result of the multilateral trade agreements signed during the Uruguay Round, dairy product import quotas were replaced with tariff-rate quotas, i.e., tariffs (in some cases prohibitive) that were associated with different levels of market access, thereby making it possible to protect specific markets.

Canada's tariff-rate quota (TRQ) for ice cream was 347 tonnes in 1995, and the tariff was 15.5%. According to the Notice issued by Canada on the TRQ, the quota is now 484 tonnes and is subject to a tariff rate of 6.67%. Any imports beyond those tariff-rate quotas are subject to a tariff ranging from 277% to 326%; i.e., between $1.16 and $1.36 per kilogram.

In 1993, as it was developing its final tariff lines for GATT, the federal government had to describe the products, not just name them, to ensure that they would fall

under the correct tariff line. Many dairy products that had not been on the old ICL were now described under a tariff line. Although some blends used in preparations such as processed cheese were not specifically described under a tariff item, this was the case for most dairy blends likely to be imported and used as a substitute for milkfat produced in Canada in the manufacture of dairy products.

When the tariff lists were first tabled, the dairy industry and government negotiators knew how complicated it was to describe dairy blends, not only because of their very nature, but also because many different tariff lines applied to various blends. For example, milk and cream powders, whether or not they contain added sweeteners, are covered by tariff line 0402; dairy blends with less than 50% dairy content are covered by line 2106.90.33/34; and products consisting of natural milk constituents, whether or not they contain added sweeteners, are covered by line 0404.90. This last line actually covers products not specified elsewhere: "products consisting of natural milk products, whether or not containing added sugar or other sweetening matter, not elsewhere specified or included."

In early 1994, during the final phase of the Uruguay Round, Canada submitted its final tariff lines. The Canadian dairy industry was convinced that by including tariff line 0404.90, which no longer referred to the 50% dairy content threshold, the Government of Canada was serving notice of its determination to fight any attempts to import dairy blends manufactured specifically to circumvent the regulations.

The DFC's confidence in the tariff protection against blends increased further when a special NAFTA group, following a challenge by the United States, reviewed the conversion of import quotas to tariff-rate quotas. In its 19 August 1996 response to the special group, the Government of Canada referred specifically to dairy blends:

> 43. Tariff Subheading 0404.90 is a residual category that covers products not specified elsewhere. The removal of the fifty percent threshold from the portion of this Tariff Subheading that was formerly subject to ICL Item 21 allowed Canada to respond to a problem that had developed contemporaneously with the Uruguay Round: concerted efforts by some private firms to import mixtures specifically designed to circumvent the import controls on dairy products.(1)

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(1) Dairy Farmers of Canada, legal brief submitted to the Honourable Lyle Vanclief, Ottawa, November 1997.

The future would reveal what the players in the Uruguay Round already knew: some tariff items, no matter how well written they might be, will never be as airtight as import quotas and will always be vulnerable to contentious administrative descriptions.

CLASSIFICATION OF BUTTEROIL/SUGAR BLENDS

In the early 1990s, some quantities of butteroil/sugar blends with a 49%/51% composition were imported (without restriction, as stipulated in the ICL). These imports did not really attract the attention of the dairy industry, probably because of their marginal value, estimated at $2 million a year. Further, because dairy blends consisting of milk solids had been subject to import controls since 1988 and some blends with less than 50% dairy content had earlier been denied entry, it was possible that a new butteroil/sugar blend could have been imported under the same "umbrella."

Some Canadian ice cream manufacturers who had attempted to import dairy blends under the ICL, however, looked at the new list of Canadian TRQs and decided that they might be able to use an escape route. Imported dairy blends that contained more sugar than milkfat (that is, 49% butteroil and 51% sugar) would not be subject to the same high tariffs as dairy products; blends containing proportionally more sugar than fat were not specifically considered "butter substitutes," even though they contained enough milkfat (by weight) to be used in making ice cream.

After the TRQs came into force in 1995, one importer of butteroil/sugar blends asked Revenue Canada to confirm that the blend was indeed classified under tariff item 2106.90.95. Revenue Canada (later the Canada Customs and Revenue Agency) confirmed that the department had classified these blends under that tariff item; thus, the product could be imported without an import licence and was not subject to a tariff-rate quota.

The tariff classification system is based on a complex hierarchy that comprises a four-digit heading, a six-digit subheading, and a tariff number with eight or more digits depending on the country. This method, known as the "Harmonized Commodity Description and Coding System" (HS), was developed by the World Customs Organization (WCO); it uses explanatory notes and classification notices to describe and classify products. Internationally, all signatory countries use the basic six-digit HS code, which provides a common classification system. Domestically, to classify a product under an eight-digit number, Revenue Canada has to

describe the product according to specific criteria. Before it can decide whether a butteroil/sugar blend can be considered a butter substitute, Revenue Canada must first determine whether or not the butteroil/sugar blend can be marketed as butter, which it cannot be. Further, to be considered a butter substitute, the blend must be "spreadable," and capable of being used as cooking fat and a cooking ingredient. When the classification system was being established for the TRQs in 1995, Revenue Canada looked first at the six-digit classification, i.e., number 2106.90, used for "other food preparations not elsewhere specified or included." For greater accuracy, it was suggested that the classification system move to an eight-digit description; it was at that point that Revenue Canada's administrative decision to classify butteroil/sugar blends under the eight-digit number 2106.90.95 rather than 2106.90.33/34 became a bone of contention between dairy farmers and dairy product importers.

Before proceeding to an analysis, Revenue Canada had come to the conclusion that such blends cannot be spread, do not caramelize when used as cooking fat and, although called for in some recipes, are severely limited as cooking ingredients because of their high sugar content. Revenue Canada therefore ruled that despite their name, such blends were not a butter substitute and could therefore not be classified under item number 2106.90.33/34. According to Revenue Canada, butteroil/sugar blends match tariff line 2106.90.95 and can be imported under that line, which does not impose a specific tariff-rate quota.

The problem posed by blends containing dairy products stems in large part from a problematic interpretation at the national level: when they go through Customs, butteroil/sugar blends are not considered "dairy enough" and are therefore not viewed as butter substitutes; however, when they are mixed into ice cream, manufacturers have to describe them as "milk components." It is as if, between the tariff description and being processed into a food form, butteroil/sugar blends become "more dairy."

PARLIAMENTARY ACTION ON THE ISSUE OF BUTTEROIL/SUGAR BLEND IMPORTS

In early 1996, the Dairy Farmers of Canada realized that butteroil/sugar blends were being imported into the country. Preliminary data from Revenue Canada at the time showed that such imports stood at approximately 600 tonnes a year and were worth the equivalent of $1.6 million in milkfat.

In October 1996, Revenue Canada reported that imports for the current year had already reached 3,148 tonnes, compared with 1,349 tonnes for the whole of 1995. Imports from the United States, Mexico, New Zealand and, to a lesser degree, Europe came to far more than the estimate of about 600 tonnes a year.(2) It should be noted that before the introduction of tariff-rate quotas, most dairy blends were imported from the United States; according to Revenue Canada, no blends came in from New Zealand when the ICL was in force.

In early 1997, the DFC was still lobbying Revenue Canada, the Department of Finance, the Department of International Trade and Agriculture, and Agriculture and Agri-Food Canada to have blends imported under tariff item 2106.90.95 reclassified under tariff item 2106.90.33/34. Staff in the various departments found dangers in such reclassification of butteroil/sugar blends, ranging from a challenge before the World Trade Organization (WTO) to a direct challenge from the United States. Blend importers said that a new classification would immediately result in a challenge before the Canadian International Trade Tribunal.

Later in 1997, the DFC, with advice from their legal counsel, refined their demands and came to the conclusion that, even if a review of the classification under tariff item 2106.90.33/34 (butter substitute) were still an option, the best approach would be to classify butteroil/sugar blends under item 0404.90, the classification initially created to limit imports of dairy blends sometimes developed to circumvent the rules. This approach is consistent with the arguments made by the Government of Canada before the special NAFTA group in 1996.

In April 1997, pressured by arguments from producers and importers, Revenue Canada undertook a comprehensive analysis of the classification of butteroil/sugar blends as established by the department for the 1995 tariff-rate quotas.

Their new descriptive analysis of the product eliminated any doubts on the part of officials at Revenue Canada about whether butteroil/sugar blends should indeed be classified under tariff item 2106.90.95. In July 1997, the department submitted its review to the DFC and importers for comment. According to Revenue Canada, the importers supported the new classification analysis, while the DFC made no comment. However, the DFC continued to apply pressure through political channels, a move that on 20 November 1997 led to a special meeting of the House of Commons Standing Committee on Agriculture and Agri-Food.

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(2) The figures vary depending on the source; please see the section giving statistical data. In 1999, Belgium became a butteroil supplier. In 2001, imports came primarily from New Zealand, followed by Belgium, England, Mexico and, to a smaller extent, the Netherlands.

During that meeting, the Revenue Canada representatives specifically said that the World Customs Organization (WCO) – which oversees the Harmonized Commodity Description and Coding System that countries use as a base in developing their own systems – had already explored the possibility of classifying butteroil/sugar blends under item 0404 as requested by the DFC. According to Revenue Canada, in a decision released on 7 November 1997, the WCO had decided that butteroil/sugar blends "[were] not natural milk constituents because they're processed to get butter and butter oil. So it's not a basic constituent if you separate it in the normal fashion."(3)

The Dairy Farmers of Canada made no attempt to disguise their surprise and disappointment at learning of the WCO's decision, mainly because they had not been made aware of the review or the role played by Canadian bureaucrats in the WCO examination.

The Canadian *Customs Act* contains a number of dispute resolution mechanisms. Section 59 allows importers to appeal the classification of a product they import by contacting a designated officer. Sections 63 and 64 allow any person to directly contact the Deputy Minister of Revenue Canada to request a review of a re-determination.

If, following the deputy minister's review, a requesting party that still believes the classification to be inappropriate can appeal to the Canadian International Trade Tribunal (CITT), the Federal Court, and ultimately the Supreme Court (section 67).

Section 70 of the *Customs Act* allows the Commissioner to ask the CITT for an opinion on any question relating to the tariff classification.

On 17 December 1997, faced with the continuing impasse, three ministers – Paul Martin, Minister of Finance; Lyle Vanclief, Minister of Agriculture and Agri-Food Canada; and Sergio Marchi, Minister of International Trade – announced that the Governor in Council would ask the Canadian International Trade Tribunal to review the issue of imports of product blends containing dairy ingredients.(4)

In its request to the CITT, the government revealed, in the fact sheet accompanying its release, the primary characteristic of dairy blends:

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(3) House of Commons, Standing Committee on Agriculture and Agri-Food, *Evidence*, 20 November 1997, Ottawa, pp. 19-20.

(4) Government of Canada, "CITT Review of Imports of Dairy Blends," Press Release, 17 December 1997.

> Dairy blends are mixtures of dairy products and other food substances for use in the preparation of products such as ice cream, confectionery and bakery goods. In the context of imports into Canada, dairy blends are often created in a manner intended to avoid entering under tariff-rate quota descriptions covering the importation of most dairy products.

In view of this statement, it was hardly surprising that the CITT devoted several pages of its report (pp. 5-8) to defining and deciding on the blends relevant to its inquiry.

DECISIONS ON DAIRY BLENDS BY THE CANADIAN INTERNATIONAL TRADE TRIBUNAL

A. Inquiry into Imports of Dairy Blends outside the Coverage of Canada's Tariff-Rate Quotas

The *Canadian International Trade Tribunal Act*, assented to on 13 September 1988, contains general provisions that allow the federal government or the Minister of Finance to request the CITT to inquire into economic, trade or tariff matters. The Tribunal acts strictly as a consultant with a mandate to conduct research, receive presentations, find facts, and hold public hearings. Upon completion of an inquiry, the Tribunal must report to the Governor in Council or the Minister of Finance and, if so requested, make recommendations.

In the case of the "Inquiry into the Importation of Dairy Product Blends outside the Coverage of Canada's Tariff-rate Quotas," the CITT was not given a mandate to make recommendations.

More specifically, the inquiry's terms of reference directed the tribunal:

(a) to inquire into the matter of the importation of dairy product blends outside the coverage of Canada's TRQs by:

(i) examining the factors influencing the domestic market for such imports and the implications of these imports for the Canadian dairy producing and processing industry and other segments of the Canadian food processing industry, including production and revenue levels;

(ii) reviewing the legal, technical, regulatory and commercial considerations relevant to the treatment of imports of these products, as well as Canada's international trade rights and obligations under the *North American Free Trade Agreement* (NAFTA) and the World Trade Organization (WTO) Agreement;

(iii) identifying options for addressing any problems raised by this issue in a manner consistent with Canada's domestic and international rights and obligations; and

(b) to hold a public hearing with respect to the inquiry.

In the course of its inquiry, the CITT produced a number of documents on various aspects of butteroil/sugar blends, in particular: the Canadian and international legal framework; the impact of the imports on milk production in Canada; and the need for blends and their use in the manufacturing of ice cream. Because the Tribunal's mandate was not making recommendations, but rather "identifying options," it is sometimes necessary to "read between the lines" of its documents. For example, in its report to the Governor in Council on 3 July 1998, the Tribunal raised a number of interesting facts but without completely resolving the issue of the importation of butteroil/sugar blend imports.

Ice cream manufacturers contended that the dairy blends offered technical advantages and helped stabilize stock, but the Tribunal's hearings showed that the price advantage of the fat component in the imported butteroil blends was the most important factor influencing the demand for them in the domestic market.(5)

The CITT inquiry also determined that the use of butteroil/sugar blends is not limited to the manufacture of ice cream; a growing quantity of such blends is used in making processed cheese. It should be noted, however, that in a typical processed cheese recipe, only 5% of the total volume consists of milkfat or butterfat that can be "replaced." According to the data compiled by the Tribunal, ice cream and processed cheese producers used 6.3 million kilograms of butteroil blends in 1997, the equivalent of 3.1 million kilograms of milkfat.(6) Canadian requirements for fat used in manufacturing ice cream and "replaceable" fat for processed cheese totalled 25.639 million kilograms in 1997. In other words, the 3.1 million kilograms of fat from the 6.3 million kilograms of butteroil/sugar blends represented 12% of the fat requirement for ice cream and replaceable fat for processed cheese.

Although the Dairy Farmers of Canada believe that the replacement of this fat with imported dairy blends resulted in revenue losses totalling $50 million in 1997, the Tribunal put the losses at between $12.8 million and $30.9 million depending on whether production had

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(5) Canadian International Trade Tribunal, Report, *An Inquiry into the Importation of Dairy Product Blends outside the Coverage of Canada's Tariff-Rate Quotas*, 3 July 1998, p. 15.

(6) The milkfat (MF) content of butteroil/sugar blends is calculated using the following formula: quantity of blend x 49% x 99.3% = quantity of milkfat.

been maintained and surpluses exported or whether milk production had decreased through the dairy year in proportion to the fat equivalent in blend imports.

Based on the different scenarios it considered, the Tribunal felt that the penetration level of butteroil could eventually rise to a maximum of 25% of the fat requirement for ice cream production and replaceable fat for processed cheese. Applying that maximum penetration level to the 1997 fat requirement for these two dairy products suggests that 6.4 million kilograms of milkfat were replaced by imported blends. While agreeing that the use of blends will continue in the years ahead, the Tribunal does not anticipate a recurrence of the strong growth of recent years.

Because it was not given a mandate to make recommendations, the Tribunal proposed in its report a series of solutions that stand as more or less viable options from which the government can choose. An initial group of six options was considered but rejected by the Tribunal because the options "are inconsistent with Canada's domestic or international rights and obligations or because they do not represent a viable option."(7) That group includes:

- reclassification by the government;
- imposition of an excise tax;
- bilateral negotiations with New Zealand;
- removal of anti-dumping and countervailing duties on refined sugar;
- an increase in milk prices; and
- a change in labelling requirements.

Another group of options was deemed by the Tribunal to have greater potential because they are consistent with Canada's obligations. The fact remains that the vast majority of these options are not supported unanimously within the dairy industry. The group includes:

- an appeal to the Tribunal by the DFC of the classification of butteroil blends;
- an inquiry into safety measures by the Tribunal;
- a special class price for butterfat to be used in ice cream and processed cheese;
- a special class price for butterfat for domestic butteroil blends;
- compensation for dairy farmers; and
- a new tariff item for butteroil blends negotiated under Article XXVIII of GATT.

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(7) CITT report (1998), p. 51.

The Tribunal also clearly stated with some emphasis that maintaining the *status quo* was a possible option.

In response to the CITT report, the DFC stated that with the exception of an appeal to the Tribunal and an inquiry into safety measures, it rejected all other options identified by the Tribunal, considering them to be not viable.(8)

Finally, the following statement in the CITT report clearly illustrates the almost insoluble problem politicians are now facing:

> It is clear to the Tribunal that there is no option available that comes without a cost to one or more of the stakeholders. The dilemma is that there are economic consequences for the dairy farmers from imports of butteroil blends, and yet the international rules limit the types of action now available.(9)

The Government of Canada ultimately rejected all the options put forward in the CITT report and solved the dilemma by taking a way out that will let it stall for a while. In its analysis, the CITT quietly threw the government a lifeline:

> [. . .] a reference to the Tribunal by the Deputy Minister concerning that same question [the tariff classification of butteroil blends] would be consistent with Canada's domestic and international rights and obligations. Moreover, it would be consistent with Canada's domestic and international rights and obligations for the Tribunal to issue a decision classifying butteroil blends within the schedule to the *Customs Tariff* on the basis of the General Rules, the applicable rules, the Explanatory Notes and the Classification Opinions.(10)

On 10 August 1998, the government announced that the Deputy Minister of National Revenue had asked the CITT to review the current tariff classification of butteroil blends.(11) Although such a review would meet their initial demands, Dairy Farmers of Canada felt that the entire process of blocking blend imports takes too long and would allow their financial losses to continue to mount. It should be remembered that a reference to the Tribunal

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(8) Dairy Farmers of Canada, "Press Release on the Lingering Problem of the Tariff Classification of Butteroil Blends," Lethbridge, Alberta, 8 July 1998.

(9) CITT report (1998), p. vi.

(10) *Ibid*., p. 67.

(11) "Government of Canada's reaction to the Canadian International Trade Tribunal Report," Press Release, Ottawa, 10 August 1998.

by the Deputy Minister of National Revenue is provided for in section 70 of the *Customs Act* and could have been made as soon as the imports became an issue, in 1996.

In its 3 July 1998 report on its inquiry into blend imports, the CITT had considered, but rejected, the option of having the Deputy Minister explore the reclassifying of butteroil blends, going so far as to say, "In light of the fact that Revenue Canada has already considered the question of the classification of butteroil/sugar blends on four previous occasions, the Tribunal considers that it would be fruitless for the Government to direct Revenue Canada to 'look into' that same question a fifth time." The CITT report continued: "[given] the fact that, prior to and after the conclusion of the Uruguay Round, Revenue Canada issued classification opinions regarding the blends, the Tribunal is of the view that, if the Government of Canada were to reclassify the butteroil blends under a tariff item subject to a TRQ, such action could frustrate the reasonable expectations of Canada's trading partners and, as a result, be subject to the process of negotiation under Article II:5 of GATT."(12)

Even if it is more "appropriate" for the CITT, rather than the Deputy Minister of National Revenue, to review the current tariff classification of butteroil blends, the CITT will have to deal with the four analyses from Revenue Canada and, more important, the decision of 7 November 1997 by WCO, which found that the blends were not milk constituents and therefore could not be classified under tariff item 0404. Government decision-makers are often the architects of their own dilemmas, and a second initiative in under six months by the CITT on the issue of butteroil/sugar blends suggests that the debate has become a dead end.

B. Inquiry into the Tariff Classification of Certain Butteroil Blends

Revenue Canada classifies butteroil/sugar blends under tariff item 2106.90.95, deeming them not to be butter substitutes. That opinion is challenged by the DFC, which argues that, because they are used to make ice cream, these blends are indeed butter substitutes and would therefore be better classified as dairy blends under tariff item 2106.90.33 (butter substitutes) or, better yet, tariff item 0404.90, the tariff classification initially created to limit imports of dairy blends.

On 10 August 1998, the Deputy Minister of National Revenue requested that the CITT "review the current tariff classification of butteroil blends." The CITT handed down the following decision on 26 March 1999.

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(12) CITT report (1998), p. 53.

> Butteroil blends comprising less than 50 percent butteroil and more than 50 percent sugar (sucrose) are classifiable under tariff item No. 2106.90.95. Blends comprising less than 50 percent butteroil and more than 50 percent glucose are also classifiable under tariff item No. 22106.90.95.

This CITT decision, which supports Revenue Canada by maintaining that butteroil/sugar blends are not butter substitutes, is hardly surprising; it reflects the four previous Revenue Canada analyses and upholds the WCO decision of November 1997. What is surprising, however, is that, contrary to Revenue Canada's expectations, the CITT handed down "a decision, as opposed to a non-binding opinion."[13]

The CITT handed down a binding decision even though the Deputy Minister of Revenue had expected only an "opinion" and Revenue Canada counsel had also argued for that option.[14] According to the CITT, a reference to it under section 70 of the *Customs Act*, as was made by the Deputy Minister of National Revenue, is, ''once initiated, in the nature of an appeal under section 67 of the *Customs Act* and [. . .] its disposition in such proceedings is a decision, as opposed to a non-binding opinion."

One of the three CITT members wrote a minority dissenting opinion favouring the DFC, however, arguing that the blends under consideration can be used as butter substitutes and should therefore be classified under tariff item 2106.90.33 if they are imported within the market access limits, and under tariff item 2106.90.34 if they exceed those limits. In the latter case, the applicable tariff for the year 2000 is 212%.

The CITT decision merely intensified the claims by the DFC, which decided on 24 June 1999 to appeal the CITT decision to the Federal Court.

On 20 March 2001, having heard the DFC's appeal, the Federal Court of Appeal rejected its application to review the CITT decision on the classification of butteroil blends.

The next step for the DFC would have been to appeal to the Supreme Court; however, its board of directors decided instead to pursue a strategy of lobbying importers and/or to request special labelling for butteroil-based products. In 2002, the DFC concentrated their efforts more on promoting a supply management system designed among other things to regulate milk blends imported into Canada. The ministers of Agriculture and International Trade made a

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(13) CITT, *Unofficial Summary*, decision on the tariff classification of certain butteroil blends, Ottawa, 26 March 1999, p. 1.

(14) CITT, p. 3.

commitment in August 2002 to establish a task force that would seek solutions to the supply management problem.(15) The task force, composed of representatives from Agriculture and Agri-Food Canada, Foreign Affairs and International Trade, Finance, Canada Customs and Revenue Agency, and the Canadian Food Inspection Agency, is expected to report on the butteroil/sugar blends issue by the end of December 2002.

ANALYSIS – DAIRY BLEND IMPORTS AND SUPPLY MANAGEMENT IN CANADA

The economic importance of imports of butteroil/sugar blends under tariff item 2106.90.95 goes far beyond the displacement of 3.086 million kilograms of fat (roughly 2% of the Canadian market sharing quota (MSQ)). Even if the value of those imports, approximately $20 million, is viewed in relation to producers' total revenue of $3.8 billion in 1997, the numbers do not reveal the real problem underlying dairy blend imports.

Butteroil blend imports are the first tangible impact of the tariff system put in place as a result of the Uruguay Round in order to open up markets and liberalize trade. The ultimate goal is to clear the way for better distribution of the world's agri-food resources but, before that can be achieved, there is a necessary transition phase that tariffs help to make more progressive. All countries know the rules of the tariff game and its potential impact on domestic markets, but some industries in some countries are finding the impact to be harder to deal with than they had anticipated.

Whether or not the classification of butteroil imports under tariff item 2106.90.95 rather than 0404.90 or line 2106.90.33 is the result of an administrative error by Revenue Canada employees, as some observers seem to be claiming, the fact remains that a growing number of imported dairy products or blends will be on the Canadian market in the future. The Canadian International Trade Tribunal's prediction that the penetration by butteroil blends could reach 25% of the fat requirement for ice cream and replaceable fat for processed cheese illustrates only one facet of what might lie ahead for the dairy industry.

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(15) Dairy Farmers of Canada, *DFC Update*, September 2002, and Barry Wilson, "Dairy farmers give up butteroil fight," *Western Producer*, 31 January 2002, (http://www.producer.com/articles/20020131/news/20020131news13c.html).

For processors of dairy products, the value of dairy blends is still primarily economic; i.e., they allow dairy products to be manufactured at the least cost, whether for the domestic market or for export. For Canadian dairy farmers, this means they will have to constantly evaluate the flexibility of supply management and their willingness to provide milkfat at a competitive price. The optional export program, which gives exporters access to milkfat at competitive prices, has been a qualified success among producers. Further, the proceedings taken by the United States before the WCO against Canadian tariffs applicable to Class 5 milk products, whose pricing system aims to help exporters and processors stay competitive on world markets, could very well make dairy farmers less inclined to provide milkfat on the basis of a dual pricing system.

For government decision-makers, the challenge will be to support a viable form of supply management that can be reconciled with growing imports (itself a contradiction) and at the same time get Canadian consumers to agree to "subsidize" a dairy industry export strategy that forces them to pay higher domestic prices. Finally, as far as consumers are concerned, the debate over butteroil/sugar blends shows that with the increasing development of new products, there may be a lack of product information and a need to review and amend the regulations governing the labelling of agri-food products. Substituting butteroil for cream is certainly valid from the standpoint of an ice cream manufacturer who wants to stay competitive, but where labelling regulations require nothing more than the words "dairy content" to describe the butteroil substitute, it can be asked whether consumers are really able to make an informed choice.

Even though the tariff and market access system will continue to provide a buffer against massive imports of dairy products, there will be other cases where imported dairy blends manufactured (whether deliberately or not) to circumvent the tariff-rate quotas will compete with milkfat produced in Canada. Moreover, the development and penetration of new dairy or "dairy-like" products will increase as markets open up. The next wave of "dairy products" to create a stir could well be butter blends, i.e., butter substitutes containing up to 70% vegetable oil. Such blends are tremendously popular in the United States, where they are sold as dairy products, even though they are more closely related to margarine. Butter blend imports are subject to a tariff-rate quota of more than 200%, but their production in Canada, already permitted in some provinces, could well take off.

This new instalment in the history of butteroil/sugar blend imports opens one more crack in the structure of supply management and again raises the question "where is the balance between the intrinsic rigidity of supply management and the flexibility needed for it to grow?"

OVERVIEW OF BUTTEROIL/SUGAR BLEND IMPORTS

A. Statistical Data

Butteroil/sugar blend imports:	1994 = 1.735 million kg 1997 = 8.752 million kg 1999 = 6.340 million kg 2000 = 8.400 million kg
Apparent use of blends:	1994 = 1.735 million kg 1997 = 6.343 million kg

Conversion of butteroil/sugar blend quantities to milkfat equivalent:
(quantity x 49% x 99.3%)

Apparent use of milkfat equivalent:	1994 = 0.844 million kg 1997 = 3.086 million kg
National market sharing quota for milkfat:	1997 = 157.9 million kg
MSQ displacement by imported blends as a milkfat equivalent:	1997 = 2%
• Domestic milkfat price:	1997 = $6.25/kg
• Weighted milkfat price in butteroil blends:	1997 = $5.20/kg
• Savings realized by ice cream and processed cheese producers:	1997 = $3.2 million
Estimated revenues foregone by dairy farmers because of butteroil/sugar blend imports:	1997 = between $12.8 million and $30.9 million, according to the various scenarios examined by the CITT

Source: CITT and Dairy Farmers of Canada.

B. Definitions

Tariff Item 2106.90.95:	Other preparations that contain in the dry state over 10% by weight of milk solids but less than 50% by weight of dairy content
Tariff Item 2106.90.34:	Preparations, other than tariff item No. 2106.90.31 or 2106.90.32, containing greater than 15% by weight of milkfat, suitable for use as butter substitutes, over access commitment
Tariff Item 0404:	Whey, whether or not concentrated or containing added sugar or other sweetening matter; products consisting of natural milk constituents, whether or not containing added sugar or other sweetening matter, not elsewhere specified or included
Tariff Item 0404.90:	Other products consisting of natural milk constituents, whether or not containing added sugar or other sweetening matter, not elsewhere specified or included