DRAFT

REPORT OF THE
WORKING PARTY ON THE ASSOCIATION OF OVERSEAS TERRITORIES
WITH THE EUROPEAN ECONOMIC COMMUNITY

Commodity Annex No. 3

TEA

PART ONE

THE FACTUAL POSITION UNDER THE TREATY

The detailed information furnished by the Six is reproduced in the table appended to this Annex. The following are the salient features as noted by the Working Party, any discussion of problems of general importance being reported in the Working Party's main report and the economic consequences being considered in Part III of this Annex.

Present Import Duties of the Six

Benelux and Germany provide specific legal rates, the incidence of which has been calculated with 15 and 52 per cent respectively. Italy's legal rate is 80 per cent with a specific minimum while in the case of France this rate is 30 per cent. France and Germany apply the legal rates to the full extent while Benelux and Italy apply specific rates with the incidence of 10 and 50 per cent respectively.

Establishment of the Common Tariff

The duty on tea in the common tariff will be 35 per cent. This rate has been fixed by applying the general rule of the arithmetic average provided for in Article 19, paragraph 1 of the Rome Treaty. Thirty-five per cent is therefore the simple arithmetic average of the applied rates in force on 1 January 1957.

MGT/28/58
The representatives of the non-Six producers expressed their concern about the high level of the rate which, in their view, had a prohibitive effect and expressed the hope that lower rates would be applied. The representatives of the Six remarked that a rate as high as 35 per cent is exceptional in the Common Tariff although quite normal in the tariffs of several countries. Furthermore they denied that this duty could have a prohibitive effect since the production of tea within the Community falls far short of the needs of the Community, so that it can be expected that large imports will be effected in the future. Moreover, they stressed that the application of lower rates would be possible under the provisions of the Rome Treaty.

In examining this tariff the non-Six representatives questioned the basis on which this arithmetic average had been calculated. The arithmetic average had been based on the applied tariffs, the incidence of which, in the case of Benelux, had been computed at 10 per cent, although the incidence of the applied tariff in Belgium and Luxemburg was 6.2 per cent in 1956. To this the representatives of the Six replied that the Benelux are united in a customs union and therefore the incidence has to be calculated for the Union as a whole, for which by definition a common tariff applies. The representatives of the non-Six regretted that the principle of a weighted average had not been applied in computing the incidence of the tariff on tea in the Common Market. Had the principle of a weighted average been applied in computing the common tariff this would have resulted in 26.7 per cent, if calculated on the basis of the year 1956, and not 35 per cent.

The Elimination of Duties on Imports from A.O.T's

The differences between the duties that will apply to imports from A.O.T's and those to be levied on imports from third countries at various stages, are set out in the following table:
(in the case of specific tariffs the figures have been based on their approximate ad valorem incidence)

<table>
<thead>
<tr>
<th></th>
<th>End of 1st stage</th>
<th>End of 2nd stage</th>
<th>End of transitional period</th>
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</thead>
<tbody>
<tr>
<td>Benelux</td>
<td>10%</td>
<td>20%</td>
<td>35%</td>
</tr>
<tr>
<td>France</td>
<td>12.5%</td>
<td>10%</td>
<td>35%</td>
</tr>
<tr>
<td>F. R. of Germany</td>
<td>7.9%</td>
<td>15.8%</td>
<td>35%</td>
</tr>
<tr>
<td>Italy</td>
<td>8%</td>
<td>16%</td>
<td>35%</td>
</tr>
</tbody>
</table>

Fiscal Duties

The Working Party noted that the Benelux, Germany and Italy evidently consider that there is a substantial fiscal element in the applied tariffs.

The Application of Quantitative Restrictions

Imports of tea have been liberalized by the Federal Republic of Germany while the Benelux countries apply a liberal import policy. In effect Italy has also liberalized imports of tea from all countries since the existing limitation of imports from countries in the dollar area does not affect tea. Imports of tea from third countries into France are subject to quotas.

The Applicability of the Agricultural Provisions of the Treaty

Tea is included in Annex II and is therefore subject to the provisions of Articles 39 to 46 of the Treaty.
PART TWO

BACKGROUND INFORMATION ON TRADE AND TRADE PATTERNS OF TEA

General

1. The total export value of tea amounted in 1955 to about £550 million. Of the principal tropical food products entering international trade in 1955, tea accounted for about 10 per cent.

2. Tea exports are of particular importance for several GATT countries as indicated in the following table:

Tea exports from selected countries; quantity, value, and value in per cent of total export value.

'000 tons, million dollars, and per cent

<table>
<thead>
<tr>
<th></th>
<th>1955</th>
<th>1956</th>
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<tbody>
<tr>
<td></td>
<td>'000</td>
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<tr>
<td></td>
<td>tons</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Associated Territories</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Belgian Congo</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>2. Other GATT Members</td>
<td></td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>166</td>
<td>246</td>
</tr>
<tr>
<td>Ceylon</td>
<td>164</td>
<td>250</td>
</tr>
<tr>
<td>Indonesia</td>
<td>29</td>
<td>31</td>
</tr>
<tr>
<td>Pakistan</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>Japan</td>
<td>14</td>
<td>10</td>
</tr>
<tr>
<td>British E. Africa</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Rhodesia and Nyasaland</td>
<td>8</td>
<td>11</td>
</tr>
</tbody>
</table>


1 The total export value of the following commodities: coffee, cocoa, tea, sugar, tobacco, bananas, coconuts and products, and citrus fruits.
For Ceylon and India tea is thus an export product of vital importance.

4. The share in world imports of tea occupied by the Six has slightly increased in recent years, from 2.7 per cent in 1948-52, to 3.3 per cent in 1955 and 4.1 per cent in 1956. The United Kingdom imported in the same years 46.3, 47.2 and 48.4 per cent, respectively, whereas tea imports into North America showed a relative decline from 16.1 to 13.7 per cent in the period.

5. The market of the Six is of special importance to Indonesia, which in 1956 sent about 44 per cent of total exports to those countries, principally to the Netherlands and some to Germany.

6. The general trade pattern of the Six in 1956 was that of their total imports of 20,000 tons, 4,200 tons and 4,300 tons (about 21 per cent each) came from Ceylon and India, respectively. Indonesia supplied 8,500 tons (42 per cent) and minor quantities were imported from Malaya, Japan and Kenya. Belgian Congo supplied 29 tons to Germany and 11 tons to the Netherlands, whereas a large share of the total tea exports from Belgian Congo, 828 tons in 1956, i.e. 221 tons, or 27 per cent of exports, went to the United Kingdom.

7. Within this overall picture the Netherlands took about one half of the total tea imports into the Six (10,200 tons out of 20,100 tons) and Germany most of the rest, i.e. 6,400 tons.

8. Annex Tables I and II indicate the pattern of trade in tea in 1956. Table I shows exports to the Six and other destinations as reported by the main exporting countries, and Table II the imports into the Six and others, as reported by the importing countries.

Varieties

9. About 95 per cent of all tea entering international trade consists of Black tea, and most of the rest of so-called Green tea. Tea production in Africa, mainly in British East Africa, Mozambique
and Belgian Congo only accounts for about 5 per cent of world production, but the fact that it mainly consists of common to good-medium grades, upon which the recent increase in world production has been concentrated, has contributed to making African tea increasingly important in international trade.

Substitution

10. Although there is no direct substitute for tea, this beverage can be to some extent substituted in consumption by coffee and also by soft drinks and even beer. Changes in consumer taste is probably a less important factor in this connexion than the price of tea relative to other beverages.

Entrepôt Trade

11. The United Kingdom and the Netherlands are of importance in the re-export trade in tea. In 1956 the United Kingdom re-exported about 14,000 tons, of which about 5,000 tons to the Six, mostly to the Netherlands and Germany. Of these re-exports about 6,000 tons originated in India and about 5,000 tons in Ceylon. The Netherlands re-exported in 1956 about 11,000 tons (4,000 originating in Indonesia and 2,000 tons in India and Ceylon). Of this, about 2,000 tons went to the Community countries, mainly to Germany.

Prospects of World Supply and Demand

12. Tea prices have fluctuated widely in the last few years. As however consumption responds only slowly to price changes the task of adjusting supply to demand falls primarily on the producers. The response to high prices is clearly quicker than to low prices, but the balance between supply and demand needs more time in both cases. The main producing countries (India, Ceylon, Pakistan and Indonesia) have, through the International Tea Agreement, acted jointly to bring about a balance. The Agreement expired in March 1955 and has not been renewed; but it is possible that structural changes in the main tea producing countries may indicate the need for new types of international co-operation. In the past
it was carried out largely in terms of controlling planting and export. As regards supply prospects in general it should be noted that the expansion in the last few years occurred mainly in common and low-medium teas while production of quality tea rose less, except in Ceylon where it moved in line with the total rise in output. A future increase in demand is to a large extent dependent on the success of the efforts to stimulate consumption, especially of common and medium grades. Whereas, during the period 1951-1953 world consumption of tea increased more rapidly than current annual production, the situation was reversed in 1954 and the excess of supply over demand has since then continued. As regards supply from Belgian Congo, the possibilities for an increase appear to be favourable, as is the case also in the other tea-producing territories in Africa. Attention may in this connexion be drawn to the rapid increase which occurred in the last years in response to the recommendations made in the ten-year development plan for Belgian Congo (Plan décennal pour le développement économique et social du Congo Belge, Ministère des Colonies, Brussels 1949, p. 411).
PART THREE

THE SHORT AND LONG-TERM PROBLEMS WHICH THE ASSOCIATION OF THE A.O.T's RAISED FOR THE TRADE OF OTHER CONTRACTING PARTIES TO THE GENERAL AGREEMENT

I. The New Tariff Régime

A. Effects within the Community and the A.O.T's

1. The Working Party recognized that the common tariff duty of 35 per cent and the duty-free entry of tea from the A.O.T's into the whole market of the Six, under Article 133 of the Treaty, would constitute a new discriminatory tariff in favour of the A.O.T's. This compared unfavourably with the previous position in 1957 when there was no preference accorded to imports into the Benelux from the Belgian Congo which is currently the only tea producer of any importance in the A.O.T's of the Community.

(i) Effects on price levels in the Community and the A.O.T's

2. The representatives of most non-Six producers held that the effect of the 35 per cent external tariff would be a corresponding increase in tea prices within the Community over and above the world price level. The increase would be particularly marked in the Netherlands, the major tea consumer of the Six, since the tariff has hitherto been very low. Recent experience in some of the principal tea consuming countries had shown that increasing tea prices tend to build up stiff consumer resistance. The consumer preferred to sacrifice quality and either was satisfied with a cheaper tea or else would switch to other beverages.

3. The representatives of the Six pointed out that experience in the past had shown that the amount by which an import duty was increased was not always automatically fully reflected in the price to the consumer. Moreover, the tariff was to be substantially reduced in both the Federal Republic of Germany, the second largest tea consumer of the Six, and in Italy. These reductions, particularly in the former instance, would exert some downward pressure on the overall price within the Community. Further, although statistics showed that the Netherlands was the largest tea importer of the Six and had the lowest tariff, it should be borne in mind that a proportion of these imports were held in bond and eventually re-exported to the other higher tariff Member States.
(ii) Effects on Consumption in the Community

4. Representatives of most non-Six producers considered that the 35 per cent increase in prices above world levels which they expected would result from the introduction of the external tariff would lead to a reduction in the demand for tea within the Community, especially in the Netherlands. Further, they pointed out that even in those instances where duties in some Member States had been reduced the possibility existed for any government to compensate for the loss of revenue through the imposition of additional non-discriminatory fiscal duties which would further increase prices and accentuate the decline in demand. In the light of this possibility an increased demand for tea resulting from the lower tariff duty in the Federal Republic of Germany could not therefore be contemplated.

5. Moreover, future demand for tea would be affected by other factors such as its substitution by other beverages, in particular coffee, as a consequence of changes in the price of tea relative to these other beverages. The representatives of the non-Six producers expressed their apprehensions, therefore, that apart from the expected decline referred to above the total consumption of tea in the Community was in fact likely to diminish further in favour of coffee as a result both of the price advantage already enjoyed by coffee being accentuated by the proposed tariffs (viz. 35 per cent for tea and 16 per cent coffee) and of the artificial stimulus to be given to coffee production in the A.O.T's. They felt that under the provisions of the Treaty, Robusta coffee produced in the A.O.T's offered a greater threat to the tea trade of third countries than Belgian Congo tea. As the coffee drinking habit was deep-rooted in Western Europe the switch from tea to coffee consumption would be relatively easy, even in the short period. Viewed against the background of the unlikelihood of any further increases in consumption in the major tea market of the United Kingdom and of the relatively static consumption situation elsewhere, this expected decline in consumption within the Community and increased production of tea in the A.O.T's would result in substantial losses to third countries at present exporting to the Six.

6. The representatives of the Six reasserted the view that prices would not rise to the extent that had been assumed by other members. Moreover, the price factor alone was not the single determinant of demand for tea since the question of consumer preference was especially important. Different teas had specific taste qualities and in this connexion the Food and Agriculture Organization statistics indicated that in the past few years there had been little change in the proportion of total tea imports into the Six from such supplying countries as Indonesia, India and Ceylon. An established taste pattern was of a static nature and, in view of the steady increased demand in tea that has been evidenced in the past decade in the Netherlands and the Federal Republic, which together formed the bulk of the market of the Six, there was nothing which precluded the possibility of further increases in...
consumption. In the light of these considerations, and taking into account excessive price fluctuations in recent years, there was also no evidence of a switch of consumption from tea to coffee. Moreover the representatives of the Six were of the firm opinion that taste was by far a more dominant criterion in the determination of consumption than price. Further they underlined the fact that they could not accept the view of some other Members that possible substitution of import duties by fiscal taxes would accentuate any decline in demand. In the extreme instance the import price, plus duty and tax, would remain the same as it was at present.

7. The representatives of the Six disagreed with the contention that there was little possibility of increasing consumption in the Community and that in fact it would decline. Total imports of tea into the Community (apparent consumption) have shown a substantial increase during the past four years, particularly in the Federal Republic of Germany and the Netherlands, and there was no reason to expect that this trend would level off or be reversed. While consumption of coffee in the Community was of a far greater magnitude than that of tea, there was no justification in assuming that the smaller tea drinking element would suddenly switch their demand to coffee merely because of price considerations. An increase in the price of tea did not weigh as heavily on the household budget as an increase in the price of coffee. This was illustrated by the fact that during the past few years there have been many fluctuations in tea prices, but this had not resulted to any switch to coffee mainly because of the fact that a unit of tea was not as costly to the consumer as a unit of coffee. To further illustrate the point that price did not have a direct influence on the consumption of tea as against the consumption of coffee the situation in the Benelux was cited. Here, despite the fact that the two countries had a common tariff, Belgium had a consumption of 139 times more coffee than tea, whereas the Netherlands' consumption of coffee was only four times more than of tea. The taste factor, therefore, was far more relevant than the price factor.

(iii) Effects on Production in the A.O.T's

8. The representatives of most non-Six producers pointed out that producers of tea in the A.O.T's would be able to sell to the Six at a premium of 35 per cent above the world market price. The substantial stimulus to production that would be provided by this new preference was further emphasized by the fact that the largest producer, the Belgian Congo, had not hitherto enjoyed any preferential treatment for its exports. On the basis of estimates that have been made of the capital cost of extending tea cultivation in the British African Territories the 35 per cent preference would give a 5 per cent return on any investment. The preference alone, therefore, would be a substantial incentive to investment quite apart from the fact that tea in itself was a very profitable crop. There had been rapid increases in production in the A.O.T's in recent years and there was no reason to believe this rate of increase would not be maintained if not increased. The Belgian Congo, in particular, had in the past decade increased acreage under tea from 1,000 to 10,000 acres. Considerable developments were taking place in the tea industry in the British Cameroons and it was logical to assume such progress could also be made under similar conditions in the adjacent French Cameroons.
9. An amount of 10,000 additional tons on the market of the Six could revolutionize marketing conditions for this commodity. In this connexion therefore it was significant to note that this additional production could be obtained from an area of a mere 20,000 hectares; limitations to acreage availability, therefore, were not important considerations. Moreover, capital costs for such development would not be prohibitive and it has been estimated that a unit of 4,000 acres, taken as being an area on which production was economic, could be established with an investment of £2 million (i.e. £500 per acre or £1,250 per hectare). While it was recognized that in the initial stage there would be some difficulty in regard to the assembling of a skilled labour force for plucking tea it was considered that this problem could be rapidly overcome.

10. The representatives of the Six considered that theoretically such deductions were an exaggeration of the potentialities of the A.O.T's and drew attention to many factors which militated against the achievement of increased levels of production. There were in fact limitations to the availability of suitable acreage for the economic production of tea since suitable land in the African A.O.T's was generally located inland distant from means of communication, thus entailing enormous transport problems which would have to be overcome. Moreover, recent estimates have shown that at present the minimum investment requirements for additional production of tea in the A.O.T's amounted to £3,000 per hectare. For rational production a unit of at least 1,000 hectares would be necessary. One such additional unit, factory included, therefore, would require a capital expenditure of £3 million. It was pointed out that these estimates took no account of the transport difficulties that had been referred to. Furthermore, any increased production would require an additional supply of suitable and skilled labour which would be extremely difficult to fill.

11. The representatives of the Six cited a study of the possibility of the commencement of new tea plantations in Africa that had been undertaken by a group of Dutch planters who, up to now, had their plantations in Indonesia. Owing to difficulties they were experiencing in Indonesia, they were endeavouring to spread their risks by commencing production in other regions of the world and to that end the study had been made. It was noteworthy that this group had reached the conclusion that even with a common tariff of 35 per cent in the European Economic Community, and on the assumption that transport problems would in fact be solved, and moreover taking into account world over-production of tea, it would not be profitable to undertake additional tea cultivation in the African A.O.T's. This conclusion was arrived at only after a careful assessment of all relevant considerations; indeed the planters concerned were so pressed that they were prepared to take many risks in investing in these regions.
B. Effects on Trade of Third Countries

(i) Effects of new tariff régime on trade patterns over short and long-term

12. Attention was drawn to the existing pattern of trade (described in Part Two). The bulk of the tea produced in the Belgian Congo at present was exported to the United Kingdom and the Six imported most of their requirements from Indonesia, India and Ceylon. The representatives of most non-Six producers expressed the view that consequent to the introduction of the 35 per cent preference exports from the Belgian Congo would inevitably be diverted to the market of the Six where they would enjoy a 35 per cent price premium over and above world prices. As production in the Belgian Congo developed, as it undoubtedly would, exports from this area would gradually meet more and more of the requirements of the Six at the expense of other suppliers. Accordingly the pattern of trade in this commodity twenty years hence would be entirely different with the Belgian Congo as the dominant supplier to the Six.

13. The representatives of the Six pointed out that the latter observations had been made without reference to the two important criteria of production and consumption. In the first instance there were the limitations, already discussed, that militated against an expansion of production in the Belgian Congo to the extent necessary to satisfy the total import requirements of the Six. Of more importance, however, was the influence of the taste factor in determining demand for tea. In this connexion it was significant to note that the Benelux countries have always had the liberty of introducing a preferential tariff in order to promote tea production in the Belgian Congo for consumption in the Benelux. The fact, however, that this liberty has never been employed showed that the fears of some Members of the Working Party in this field were unjustified.

(ii) Effects on World Markets

14. The representatives of most of the non-Six producers drew attention to the fact that most of the tea imported into consuming countries in Europe was sold by auction, which made this trade highly sensitive to changes in the relation between supply and demand. Any slump in demand in the Community or marginal increase in production in the A.O.T's would have the effect of depressing the prices for tea on world markets.

15. The representatives of the Six (in the light of the argumentation they had put forward) could see no justification for these views and they again pointed to the fact that the Community was an unimportant tea consumer.
II. Non-Tariff Questions

Quantitative Restrictions and Agricultural Provisions

16. It was noted that France imposed quantitative restrictions on imports of tea and that this commodity was included in the agricultural régime of the Treaty of Rome. The points raised in the General Report concerning quantitative restrictions and the "managed market" provisions were therefore relevant in the case of tea. It was further pointed out, however by the representatives of most non-Six producers, that should any difficulties arise in the marketing of any additional coffee from the A.O.T's the Six might be inclined to resort to these non-tariff measures in order to promote consumption of coffee at the expense of tea imports.

17. The representatives of the Six referred to their arguments on this point as set out in the General Report.

III. Summary of Views

18. [Views of the representatives of most of the non-Six producers]

19. [Views of the representatives of the Six]

PART FOUR

CONCLUSIONS

(Draft to be submitted)