December 20, 2018

Ms. Lisa R. Barton
Secretary to the Commission
United States International Trade Commission
500 E Street SW
Washington, DC 20436

Submission by the U.S. Dairy Export Council and the National Milk Producers Federation Regarding *United States-Mexico-Canada Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors* (Investigation No. TPA-105-003)

Dear Secretary Barton:

The U.S. Dairy Export Council (USDEC) and National Milk Producers Federation (NMPF) appreciate the opportunity to provide this written submission in connection with the United States International Trade Commission's assessment of the likely impact of the United States-Mexico-Canada Agreement (USMCA) on the U.S. economy as a whole, on selected industry sectors, and on U.S. consumer interests. (See 83 Fed. Reg. 52,232.)

USDEC is a non-profit, independent membership organization representing the global trade interests of U.S. dairy farmers, dairy processors and cooperatives, dairy ingredient suppliers and export trading companies. Its mission is to enhance U.S. global competitiveness and assist the U.S. industry to increase its global dairy ingredient sales and exports of U.S. dairy products. USDEC and its 100-plus member companies are supported by staff in the United States and overseas in Mexico, South America, Asia, Middle East and Europe.

NMPF develops and carries out policies that advance the well-being of dairy producers and the cooperatives they own. The members of NMPF's cooperatives produce the majority of the U.S. milk supply, making NMPF the voice of dairy producers on Capitol Hill and with government agencies. NMPF provides a forum through which dairy farmers and their cooperatives formulate policy on national issues that affect milk production and marketing. NMPF's contribution to this policy is aimed at improving the economic interests of dairy farmers, thus assuring the nation's consumers an adequate supply of pure, wholesome, and nutritious milk and dairy products.

Summary

The U.S. dairy industry welcomes the conclusion of the trilateral, modernized USMCA, particularly in light of the improved certainty this will restore to U.S.-Mexico trade relations as well as the improvements the agreement makes in dairy trade with Canada. The North American Free Trade Agreement (NAFTA) has been essential to the U.S. dairy industry's success in Mexico – it is now our top export market, valued at $1.3 billion last year – and the conclusion of the USMCA should lay the groundwork for continuing that success. Although USMCA has not addressed the full range of Canada's vast and complex web of dairy tariff and problematic nontariff policies, it has made important advances on both of those fronts.

We appreciate the hard work that went into finalizing the agreement, but important work still remains.

- As detailed below in the section on Canadian market access and dairy policy disciplines several areas will be of critical importance during the stage of preparation for USMCA implementation and once the agreement has been put in place. These critical implementation matters, elaborated on in the subsequent section, include concerns pertaining to:
  - Avoiding the prospect of TRQ administration in a manner that discourages full utilization of the market access quantities granted to the U.S.
  - Ensuring that market access granted under USMCA by Canada is provided in addition to that already extended under earlier agreements and programs including Canada's WTO commitments and its existing levels of dairy imports under Canada's Duties Relief Program and Import for Re-export Program.
  - The need to ensure that the reclassification of products Post Class 7 based on end use is appropriately carried out in keeping with the intent to ensure that pricing for input products (e.g. ultrafiltered milk) is determined based on the pricing of the product in which it will be used (e.g. cheddar cheese, classified in milk class 3B; or yogurt, classified in milk class 2A, etc.).
  - Export surcharges on skim milk powder, milk protein concentrate and infant formula are implemented in a manner designed to effectively discourage exports above the volumes specified in USMCA and that the proceeds are not redistributed to the Canadian dairy industry.
  - Transparency and consultation requirements are utilized to the maximum extent possible to effectively oversee Canada's compliance with both the letter and the spirit of USMCA dairy disciplines.

- In addition, the U.S. dairy industry and the nearly 3 million jobs it supports will not see the full benefits of the USMCA until metal tariffs on Mexico are lifted and Mexico ends its retaliatory tariffs on U.S. cheese exports. The longer Mexican duties remain in place, the larger the opening for our competitors in the EU to get their foot in the door in this market and the greater the harm to farmer's prices as they bear the brunt of the lower margins required to retain this market in the face of retaliatory tariffs. Mexico accounts for 28 percent of total U.S. cheese exports, and it is essential that the unimpeded access that the U.S. has enjoyed under NAFTA be restored.

- Likewise, we hope that conclusion of an agreement on the USMCA will enable the Administration to focus on an agreement with China. China imported $577 million of U.S. dairy products last year, but is now levying retaliatory tariffs against these imports.

  Retaliatory tariffs by Mexico and China have already cost U.S. dairy farmers an estimated $1.5 billion this year, with 2019 losses forecasted to exceed more than $3 billion, according to a 2018 Informa Agribusiness study.

- We also appreciate that agreement on USMCA will free up the administration to focus on the pursuit of bilateral negotiations with high-potential markets like Japan and, post-Brexit, the United Kingdom, as well as Vietnam, nations in Southeast Asia and other important agriculture importing markets. In that connection, we commend the Administration for new language incorporated into USMCA that establishes strong and useful precedents in key rules-based areas important to agricultural trade that will not only help lend greater predictability and openness to North America trade but will also serve as a benchmark from which to build upon further in future U.S. FTA negotiations. Particularly notable accomplishments in this area include those relating to sanitary and phytosanitary measures and geographical indications.

Key Dairy-Relevant Provisions of USMCA

Sanitary & Phytosanitary Measures

The WTO SPS Agreement was ground-breaking at its time and continues to be an essential part of the WTO Agreement. USMCA includes valuable new provisions aimed at bringing greater transparency and a strong scientific grounding to countries' SPS measures. This is an extremely important accomplishment and our exporters would benefit from its applicability in additional markets in future agreements as well.

Geographical Indications

Due Process Disciplines for Geographical Indications.

The intellectual property chapter of USMCA establishes a critical framework for beginning to introduce more transparency and due process procedures to the area of GI consideration and should help to mitigate against the inappropriate future registration of unwarranted GIs, including by providing those opposing a GI with greater tools to object to a term's restriction. This would avoid future scenarios like that in the Canada-EU FTA in which Canada simply acquiesced to a long list of GIs proposed by the EU without any public notice or input. USMCA contains numerous positive elements that collectively establish a basic structure on the topic of GIs from which the U.S. can build further in FTA negotiations to come. Monitoring of USMCA commitments will be essential to prevent registration of GIs that restrict the use of commonly used terms in a manner that is contrary to either the letter or spirit of the agreement provisions.

Government to Government Consultations on GIs.

USMCA includes an important new commitment in clause 2(e) of Article 20.B.3 specifying that the Committee on Intellectual Property Rights shall, upon request, "endeavor to reach a mutually agreeable solution before taking measures in connection with future requests of recognition or protection of a geographical indication from any other country through a trade agreement". This requirement for consultations and the directive to work to arrive at solutions of mutual interest to the Parties is a much-needed and very welcome addition to the Administration's ability to defend the interests of U.S. stakeholders against the predatory efforts of non-Parties to use trade treaties to erect barriers to trade in common product categories under the guise of GI protections.

Non-exhaustive List of Commonly Used Cheese Names.

A side letter to USMCA establishes an impressive and ground-breaking precedent by providing clear market access assurances on a non-exhaustive list of commonly produced products that Mexico may not restrict moving forward, including terms such as mozzarella, cheddar, swiss, and others. However, other names will remain restricted as part of the Mexican-EU agreement or through Mexico's participation in the WIPO Lisbon Agreement. Collectively, these impact U.S. producers of asiago, feta, fontina, gorgonzola, gruyere, munster and neufchatel. These terms, as well as other generic terms, should be incorporated in future U.S. lists of commonly used cheese names.

US-Mexico Side Letter on Prior Users of GIs.

Another valuable commitment secured in USMCA is a second side letter with Mexico regarding which portions of the supply chain qualify as "prior users" under the updated GI provisions of the EU-Mexico FTA. Those provisions reportedly establish restrictions on the use of certain common names and in some of those cases provide temporary or permanent allowances for the continued use of the term by prior users of the term in Mexico. By clarifying that the term "prior users" includes all elements of the supply chain, namely producers, distributors, marketers, importers and exporters, the letter maximizes the ability of U.S. companies to continue to export their products to this important market and of Mexican companies to maintain wider supply source options.

Canada-Specific

Canada's sustained and long-standing efforts to undermine access to its market and impair the value of trade concessions granted in NAFTA and the WTO for products containing dairy have posed a very deep concern to our industry. USMCA makes important progress in tackling some of those concerns. Notably, the agreement will expand U.S. dairy access to the Canadian market and will introduce new disciplines on Canada's use of its dairy pricing programs to intentionally distort trade.

Market Access.

The market access provisions of the USMCA would effectively preserve the bilateral free access to each other's dairy markets that the United State and Mexico have enjoyed achieved under the North American Free Trade Agreement.

USMCA delivers some additional export market access in Canada for U.S. dairy products across a diverse range of product categories, similar in scale to that under the TPP but exclusive to the United States. This expansion of access to the very tightly constrained Canadian market is welcome and will create some new opportunities for the U.S. dairy industry in Canada's trade-restrictive market. The agreement also provides relatively reciprocal opening of access to U.S. dairy markets for Canadian dairy products. Under these provisions, our initial in-house estimate of the amount the United States could anticipate gaining is an additional 23,000 tons of net dairy product exports into Canada, with a value of about $70 million annually, following full implementation of the agreement.

<u>TRQ Administration:</u>

As the agreement is implemented, it will be critical to monitor Canada's TRQ administration practices to ensure that procedures are not wielded to dampen TRQ fill-rates. Past actions under Canada's other trade treaties suggest a dispensation towards administering TRQs in a manner designed to discourage utilization; this must not be the case under USMCA. In addition, it will be important to ensure that the end-use restrictions on certain TRQs do not unduly thwart the ability of U.S. exporters to fully fill the established TRQs.

<u>Additive Nature of USMCA Market Access Commitments:</u>

Another important implementation oversight area lies in the need to ensure that dairy market access granted under USMCA by Canada is provided <u>in addition to</u> that already extended under earlier agreements and programs including Canada's WTO commitments and its existing levels of dairy imports under Canada's Duties Relief Program and Import for Re-export Program. We support the language in USMCA's Agriculture Chapter (Article 3.A.6. paragraph 1) that is clearly intended to avoid a situation whereby Canada "pays" for the new market access commitments established for dairy under USMCA by simply cutting back on the scope or volume of dairy products allowed under DRP and/or IREP. Such a result would clearly run counter to the intent of the agreement and must be avoided.

New Dairy Policy Disciplines.

Overview:

USMCA requires the elimination of Canada's highly trade-distortive Classes 6 and 7 milk pricing schemes six months after implementation of USMCA. Following that, Canada will reclassify the products and establish prices based on their end use (see details below) except for SMP, MPC and infant formula, for which Canada will establish new pricing structures based on a formula set out in the agreement. A particularly critical additional element of USMCA in this area is the export surcharge that is intended to discourage exports of Canadian SMP, MPC and infant formula beyond specified quantities. Properly administered, this provision will be an essential tool in constraining Canada's ability to dump unlimited quantities of dairy products onto global markets. USMCA also sets out additional transparency and consultation requirements that will play an important role in policing compliance with the agreement.

Background:

Canada has, for decades, maintained a strict supply management system, under which milk production by individual Canadian dairy farms is limited by farmer-owned milk production quotas, which are marketable. Milk produced in excess of a farmer's quota receives no market return. The system permits the remittance of a relatively high and stable milk price to Canadian dairy farmers, paid for by Canadian consumers, which consistently exceeds comparable milk prices in the United States and in international markets.

The overall level of milk production permitted under Canada's supply management quotas is maintained under government authority at a level that is intended to meet total commercial demand plus a modest reserve supply to accommodate normal fluctuations in demand relative to supply. Canadian milk, like milk produced in the United States, contains a relatively fixed ratio of milkfat to skim solids (protein, lactose and minerals) components, which gives rise to a relative surplus of skim solids being produced in relation to demand for skim milk solids in all products in the Canadian domestic market, compared with the corresponding supply-demand balance for milkfat. Accordingly, the total level of milk production quotas in Canada is set and adjusted with respect to producing sufficient milkfat for Canadian market requirements, which results in significant production of surplus skim solids. Therefore, the Canadian milk supply management system also requires a complex set of arrangements for disposition of this skim solids surplus in a manner that will also not undermine its high domestic price.

Disposal of Canada's structural surplus of skim solids is conducted through a system of 23 milk classes, or separate systems for pricing raw milk, of identical composition, based on the products into which that milk is processed or manufactured and/or the marketing channels in which those products are sold.

The basic classes, consisting of most of the subclasses of classes 1 through 4 are for products (1 for fluid milk, 2 for soft manufactured dairy products like yogurt and ice cream, 3 for cheese, and 4 for butter and milk powders) sold in regular commerce in the Canadian domestic market, both retail and food service. Other classes, primarily the class 5 Special Milk Permit classes as well as class 1Bii, are designed to enable Canadian uses of milk as a major ingredient for producing food products that are not subject to import controls, such as bakery, confectionery and cheese-containing products, to pay for milk at the equivalent of lower, United States-equivalent prices on a volume-limited basis, under the terms of permits issued by the Canadian Dairy Commission (CDC). The purpose of these classes is to maintain food manufacturing capacity, and the jobs and other economic benefits it generates, in Canada – capacity that would otherwise have a substantial financial incentive to relocate to the United States and ship those products into Canada. Other classes are intended to provide an incentive to produce new products, to ship liquid milk products to the Yukon or other outlying parts of northern Canada, or to use more Canadian-produced mozzarella cheese in pizza restaurants.

And finally, there are the milk classes used for the disposal of surplus milk or milk components in marketing channels that do not compete with regular Canadian domestic commerce. These include class 5D, for milk used to process milk products that are exported within the current limits for subsidized exports set out in Canada's Schedule to the World Trade Organization's Agreement on Agriculture, and class 4M, for milk used to process milk products that are not exported within Canada’s WTO export subsidy limits, including animal feed products. Both of these classes have been in place for many years and the volumes of milk classified under them is also limited by the CDC under the Special Milk Class Permit Program.

These various Canadian milk classes based on product marketing channels have no counterparts in the U.S. Federal milk marketing order or analogous state milk price regulatory systems, which only classify milk based on the products produced, not on how or where they are sold.

Canadian milk classes 4M and 5D had sufficed to handle Canada’s structural surplus of skim milk solids up until a few years ago. But then Canadian consumers, like those in the United State, Europe and other developed countries, expanded their demand for milkfat in their diets, following reassessment of the health implications of dietary consumption of animal fats. Since its domestic production of milkfat was limited by milk production quotas, Canada was required to import increasing volumes of butter and cream from the United States to meet this growing demand. When this increased demand proved to be sustainable and those milkfat imports had grown to substantial volumes, Canada increased its milk production quota volumes in order to reclaim this lucrative increased domestic milkfat demand for Canadian dairy farmers. However, this action would also swell the volume of domestic skim solids production, for which domestic demand had not increased and whose surplus disposition was already at capacity through milk classes 4M and 5D.

Milk classes 6 and 7 were accordingly created, and implemented in 2016 and early 2017 respectively, as components of its National Ingredients Strategy, as the Canadian “solution” to deal with this “problem”, as well as the perceived “problem” caused by imports of ultra-filtered milk from the United States. This is milk processed for use as an ingredient, primarily in the production of cheese and yogurt, but other products as well, but whose importation into Canada was not constrained by a tariff-rate quota, like most other dairy products.

These classes were intended to expand Canadian exports of skim milk powder, infant formula and other dairy ingredient products in dried form by enabling Canadian manufacturers to purchase milk for their production at prices so low that they could export them at a lower price than those offered by their U.S., European, New Zealand or Australian export competitors. Classes 6 and 7 also had in import substitution intent, namely to reclaim the use of U.S. ultra-filtered milk imports (in the liquid form that is effectively required for cheese production) for Canadian-produced ingredients.

These actions accomplished their intended effects. They significantly reduced Canada's need to import butter and cream due to the increased production of milkfat by Canada's dairy farmers permitted under the quota expansion. They significantly reduced Canadian processors' imports of U.S.-produced ultra-filtered milk because they could then purchase this ingredient at the lower class 6 and 7 price. And they significantly expanded Canada's exports of skim milk powder as a means of dealing with the increased domestic production of skim milk solids in excess of domestic Canadian market needs generated by the quota expansion. Canada's skim milk powder exports rose from 13,670 tons in 2015 and 23,687 tons in 2016 to 71,880 tons in 2017. They have continued at approximately their 2017 level during the first nine months of 2018.

<u>USMCA Disciplines</u>

Paragraph 3 of Article 3.A.3 of USMCA's Agriculture Chapter, which requires the elimination within six months after entry into force of the USMCA, of milk class 6 and milk class 7, including their associated milk class prices, is a critical component of the agreement.

With that said, how effective this provision will be will depend on how the dairy provisions of USMCA are implemented in practice.

End Use: Paragraph 4 of the same section requires that "Canada shall ensure that products and ingredients formerly classified under milk classes 6 and 7 shall be reclassified and that their associated milk class prices shall be established appropriately <u>*based on end use*</u>" (emphasis added). This means, for example, that ultrafiltered milk that is used, in either liquid or dried form, in the production of cheddar cheese must be classified in milk class 3B. Similarly, this ingredient must classified in milk class 2A if used in the production of yogurt. Such ingredient uses can currently be classified in the much lower-priced classes 6 and 7 categories. Any alternate interpretation would not be in keeping with the intent of this provision.

Post Class 7 Pricing for SMP, MPC and Formula: Paragraph 5 of the same section requires that "Canada shall ensure that the prices for non-fat solids used to manufacture milk protein concentrates, skim milk powder, and infant formula shall be no lower than the applicable price determined by the following formula: **(The USDA nonfat dry milk price – Canada's applicable processor margin) x Canada's yield factor.**

Based on Canada's processor margin and yield factors at the time its National Ingredients Strategy was implemented, and the USDA nonfat dry milk price for October 2018, this formula would be: **(US$0.8739/pound – CD$0.9191/kg) x .98 = CD$1.5334/kg, at the U.S.-Canada exchange rate on October 31, 2018.** The price for non-fat solids used to manufacture the same products under the U.S. Federal milk marketing order system for October 2018 was: **(US$0.8739/pound – US$0.1678/pound) X .99 = US$0.6990/pound = CD$2.0343/kg, at the U.S.-Canada exchange rate on October 31, 2018.** Canada's Class 7 price for non-fat solids for October 2018 was

CD$1.4849/kg. In other words, the price that Canadian processors of would be required to pay for milk protein concentrates, skim milk powder, and infant formula under this provision of the USMCA would still be less than that paid by U.S. processors for milk used to produce the same products, and would be much closer to its current class 7 price.

Export Surcharge: This dynamic regarding pricing for SMP, MPC and infant formula makes it all the more essential to ensure that Canada faithfully implements the required export surcharges of CAD 0.54/kg for SMP/MPC volumes exceeding the agreement's specified thresholds and of CAD 4.25/kg for infant formula volumes exceeding USMCA's specified threshold for that product. Those volume levels are as follows: SMP/MPC – 55,000 MT in year 1; 35,000 MT in year 2 (with 1.2% growth thereafter); infant formula – 13,333 MT in year 1; 40,000 MT in year 2 (with 1.2% growth thereafter).

Canada must ensure that these surcharges function as intended to discipline the export expansion of these product areas and that the proceeds are not in turn redistributed to industry.

Transparency and Consultation Requirements: To aid in the oversight of Canada's compliance with its USMCA commitments and in the resolution of issues that may arise in the future related to the agreement's dairy provisions, the U.S. secured several important transparency and consultation commitments, namely those in Paragraphs 7, 10, 11, 12, 13, 14, 15 and 16. Given Canada's entrenched track record of intentionally using policy tools to undermine trade commitments, these represent vital elements to ensuring the U.S. is able to fully realize the benefit of the pricing policy disciplines introduced by USMCA.

<u>Closing</u>

On behalf America's dairy farmers and dairy manufacturers, we appreciate the opportunity to provide comments on these important issues, and we remain available to provide any further clarification as needed.

Sincerely,

Shawna Morris

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