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Canadian Dairy Industry Faces USMCA Challenge

Under the new USMCA agreement, which will replace NAFTA, Canada and Mexico have each agreed to certain new measures that will affect U.S. trade in dairy products. Canada will eliminate certain price classes in its dairy support program, and will allow new market access for U.S. dairy products. The United States will make similar market access allowances for Canadian dairy products.

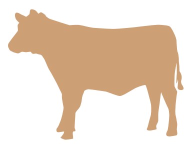
Canada's supply management program determines how much dairy farmers produce

Canada maintains a dairy supply management program to determine which farmers are allowed to produce and sell raw milk. "In order to sell into the domestic market, a producer needs to have a production quota," said Danny Le Roy, associate professor of economics at the University of Lethbridge. "You need to have a permit to sell this raw milk, and the only legal buyer of raw milk in Canada is the provincial milk marketing board in each province."

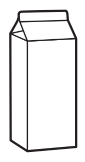
The government sets quotas to align domestic production with domestic demand. Farmers must hold quota to operate dairy farms, which can come at considerable expense. A 2016 publication from the Canadian government estimated that quota — permits required to bring milk to market — for a 60-cow dairy in Quebec would cost about $1.5 million.

QUOTA PROCESS TO PRODUCE MILK IN CANADA

1. The Canadian government sets a national production level for milk.



2. Canadian dairy farmers purchase quota to produce raw milk. The quota is based on the butterfat one cow produces each day.



3. Farmers sell milk to central processors at a predetermined price.

IMPORTING MILK AND DAIRY

International dairy farmers may import a certain amount of dairy products; once they reach their quota, imports are subject to high tariffs.

Concession: Canada to eliminate milk price classes 6 and 7 and allow new access

Under the USMCA, Canada will eliminate milk price classes 6 and 7. Class 7 is a class of skim, a milk product, used to make cheese and yogurt. Canada created class 7 in 2017, limiting the amount of skim that was imported from the United States.

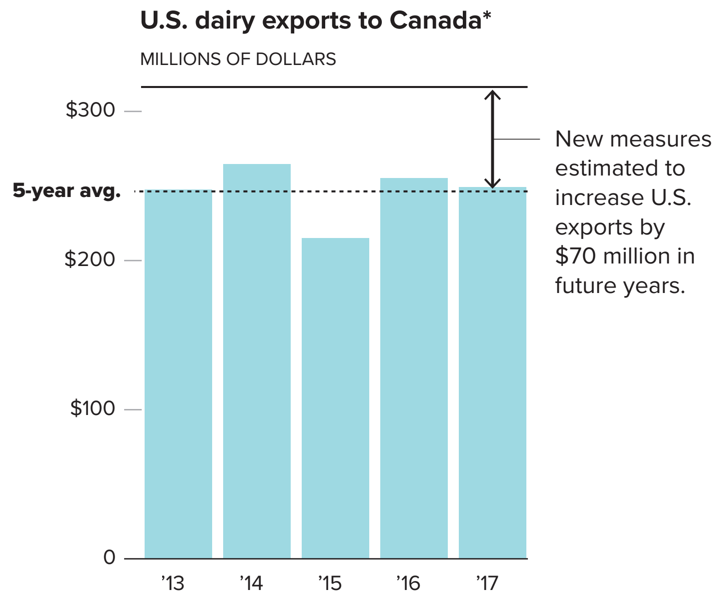
Canada will also allow a larger amount of U.S. dairy products into Canada under tariff rate quotas, increasing the amount of each product the U.S. may sell to Canada before qualifying for tariffs. U.S. farmers will now be able to access 3.59 percent of the Canadian market. A Bank of America Merrill Lynch Global Research report estimates the new measures will increase U.S. exports by $70 million.

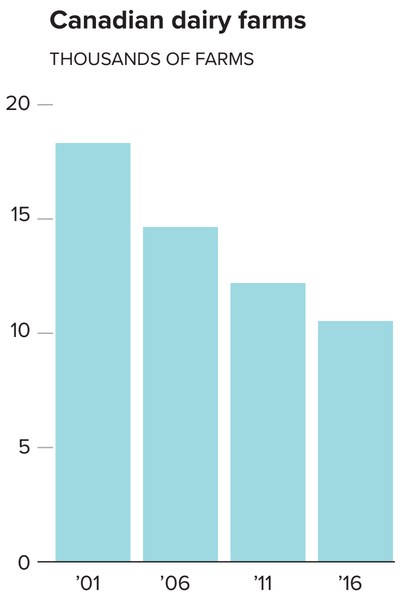
Given the relatively small amount U.S. exporters have won in the USMCA provisions, it's unclear that the U.S., which pushed for the provisions, is the largest beneficiary of the new policies.

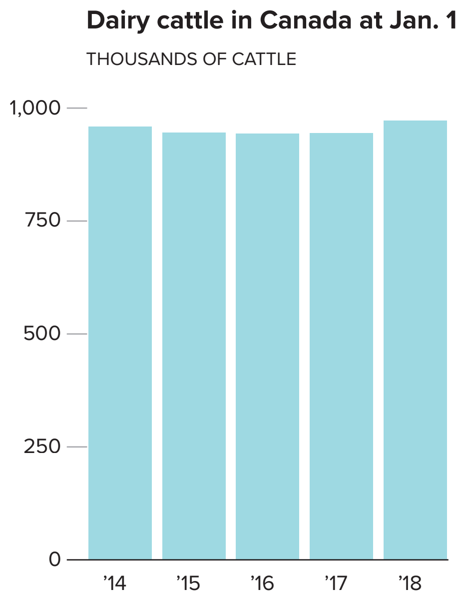
"In terms of access to the Canadian market … and the phase-in period, which is quite lengthy … it's really the Canadian consumer who stands to gain, or the ones that have the ability to import these products," explained Le Roy. By opening up even a small amount of the market to imported products, Canadian consumers may see lower prices for dairy products.

There's an irony in all of this, right?" said Peter Loewen, professor of political science at the Munk School of Global Affairs and Public Policy at the University of Toronto. "The thing that the government was really reluctant to give up is a thing that's going to make most Canadians better off."

However, Canadian dairy farmers have criticized the dairy provisions.







Between the lines: "The government has said repeatedly that it values a strong and vibrant dairy sector – they have once again put that in jeopardy by giving away more concessions," said Pierre Lampron, president of the Dairy Farmers of Canada, a policy and lobbying group, in a statement after the USMCA was announced.

Loewen explained the industry's concerns are likely over the symbolic value of the compromise.

"It's really not big. Still, you know, 97 percent of the market, 96 and a third percent of the market, is going to be protected," Loewen said. "If you're the dairy farmers, your concern is that … the government is going to use it as a template to say, 'we actually now are going to be in the practice of protecting consumers,'" who he explained pay higher prices for dairy products because of the quota system.

However, Le Roy said the provisions may not signal future threats. The day the USMCA was announced, the Canadian government also announced that affected dairy farmers would be compensated. According to Le Roy, that is in line with how the Canadian government has previously handled trade agreements that opened the Canadian dairy market to additional exports, such as TPP or the Canada-EU trade agreement.

"It might be conceived as maybe a small threat," he said, "but the reality is that if any dairy farmer is going to be forced out of their business because of a four percent reduction of their output, you know, these people are going to be out of business anyway."

Loewen added the quotas are primarily owned by larger farms. "The average dairy farmer sits on about $3 million worth of quotas," he said. "That's not your uncle Elmer, going out there, hoping the bank will give him a loan to buy one more head of cattle."

The number of Canadian dairy farms decreased 40 percent from 2001 to 2016, while the number of dairy cattle has increased in recent years. In 2016, each dairy farm had, on average, about 90 cows.

As the agreement moves forward in the review process, the Canadian dairy industry may continue to lobby against the agreement. Dairy farmers and interests have proven an important political interest in the past. However, it is unclear whether they will continue to hold such sway.

"There's a good chance that actually, these farmers are not that powerful," said Loewen, who posited that someone could argue that "the people who are most affected by this are consumers … the government could make up for whatever loss it incurs on this."

New tariff rate quotas for U.S. dairy exports to Canada

Under the USMCA, tariff rate quotas will increase to a certain level by year six of the agreement, then by a set percentage in later years.

	QUOTA BY YEAR SIX OF USMCA, IN METRIC TONS	QUOTA INCREASE AFTER YEAR SIX
Fluid milk	50,000	+1 percent for an additional 13 yrs.
Cheese	12,500	+1 percent for an additional 13 yrs.
Cream	10,500	+1 percent for an additional 13 yrs.
Skim milk powder	7,500	+1 percent for an additional 13 yrs.
Butter and cream powder	4,500	+1 percent for an additional 13 yrs.
Yogurt and buttermilk	4,135	+1 percent for an additional 13 yrs.
Whey	4,134	+1 percent for an additional 4 yrs.; quota tariff ends in 10 yrs.
Products of natural milk constituents	2,760	+1 percent for an additional 13 yrs.
Concentrated/condensed milk	1,380	+1 percent for an additional 13 yrs.
Ice cream/ice cream mixes	690	+1 percent for an additional 13 yrs.
Other dairy	690	+1 percent for an additional 13 yrs.
Powdered buttermilk	520	+1 percent for an additional 13 yrs.
Margarine	Tariffs to be eliminated in five years.	N/A

*Includes: 0401: Milk and cream, not concentrated or sweetened; 0402: Milk and cream, concentrated or sweetened; 0403: Buttermilk, yogurt, kephir etc., flavored, etc. or not; 0404: whey and milk products, sweetened etc. or not, not elsewhere specified; 0405: Butter and other fats and oils derived from milk; and 0406: Cheese and curd

Sources: USA Trade database, U.S. Census Bureau, USTR, Department of Agriculture and Agri-Food (Canada), United States Department of Agriculture, USDA Foreign Agricultural Service, CIGI, Reuters

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