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U.S.-Mexico-Canada Agreement:
Likely Impact on the U.S. Economy
and on Specific Industry Sectors
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Good morning. My name is Michael Dykes. I am the CEO and President of the International Dairy Foods Association. IDFA represents the nation's dairy manufacturing and marketing industry, which supports nearly 3 million jobs and has an overall economic impact of more than $628 billion. IDFA members range from multinational organizations to single-plant companies. Together they represent 90 percent of the milk processed and marketed in the United States.

Transformation to a Global Competitor

After being a net importer of dairy products roughly a decade ago, the United States now benefits from a dairy trade surplus of more than $2 billion and sends American dairy products to over 140 countries around the world.

Free trade agreements like the USMCA that open markets and lower trade barriers are crucial to continuing this trend of growing U.S. dairy exports. Maintaining and expanding access to international markets is essential for the future success of the U.S. dairy industry.

U.S.-Mexico-Canada Agreement (USMCA)

I would now like to highlight the principal benefits that the USMCA will provide to U.S. dairy exporters, beginning with the provisions that apply to our neighbor to the south.

Mexico

Mexico is an indispensable partner for the U.S. dairy industry, thanks to the market access achieved in NAFTA. Mexico imported more than $1.3 billion of U.S. dairy products and ingredients in 2017 compared to only $250 million in 1993 before NAFTA.

U.S. dairy exports to Mexico now account for one quarter of total dairy exports supporting nearly 30,000 American jobs.

We're pleased that the new USMCA preserves the duty-free market access for U.S. dairy products to Mexico. We're also pleased that the USMCA contains geographical indication provisions within the intellectual property chapter. As you may know, the European Union uses broad geographical indication definitions in their trade agreements to block U.S. cheesemakers from key markets like Mexico. That's unfair because U.S. cheese companies have been working in Mexico for years to build the market for a diverse range of cheeses, specifically asiago. The GI provisions contained in the USMCA will protect U.S. cheesemakers by enhancing transparency for opposition and cancellation proceedings; establishing a consultation mechanism; and allowing for additional factors when determining whether a term is a common name instead of a GI. In addition, Mexico agreed not to restrict market access for prior users of certain U.S. cheeses such as parmesano, gouda and mozzarella. We were hoping the GI provisions would go further and protect more cheese names. Unfortunately, the fate of asiago and many other cheeses remains unclear.

Moreover, U.S. cheese is on the list of products now subject to a 25 percent tariff in retaliation for U.S. tariffs on steel and aluminum imports. We've seen sales decline 10 percent for cheese in July, August and September due to the tariffs. Until the Section 232 tariffs are lifted, U.S. dairy's access to the Mexican market is at risk.

Canada

Turning northward, a number of Canadian dairy policy measures that have severely restricted market access for imported dairy products appear to be addressed in the USMCA. I'd like to commend USTR for negotiating strong transparency provisions that hold Canada accountable for publishing data and notices on a public website in a timely manner. This is critical for monitoring and enforcing the USMCA. However, my members have raised a few concerns surrounding the elimination of Class 6 and 7 and the market access outcomes.

Class 6 & 7 Ingredients Strategy

In 2016, the Class 6 pricing program was designed specifically to curb imports of ingredients entering duty-free from the United States. As a direct result, U.S. exports of ultra-filtered milk to Canada virtually stopped, effectively destroying a $150 million market for U.S. dairy processors. The following year, the Class 7 program enabled Canada to export its surplus of skim milk powder at prices below the cost of production. In 2017, Canadian SMP exports rose to 72,000 metric tons, up from 24,000 metric tons in 2016 and we expect Canada to export 157,000 metric tons of SMP by 2021. At a U.S. average of 234 cows per farm, this Class 7 growth in Canadian milk protein will displace 641 U.S. dairy farms and two significant milk powder processing plants by 2021.

The USMCA states that Canada's Class 6 & 7 ingredients strategy will be eliminated. Canada agreed to use its oversupply of skim milk domestically as animal feed and price its skim milk solids used to produce nonfat dry milk, milk protein concentrates, and infant formula no lower than a level based on the United States price for nonfat dry milk. The new pricing formula derives a nonfat solids price based on three variables: 1) the USDA nonfat dry milk price, 2) Canada's applicable "make allowance" or processor costs, and 3) Canada's yield factor. Prior to this agreement, Canada indexed their nonfat solids price to the lower of three world prices. In this way they were able to always take market share away from the U.S. Under this agreement, Canadian processors are able to use their own internal "make allowance" or processor cost that is nearly double the U.S. version, allowing large processor margins that drive expansion and provide Canadian dairy protein processors a competitive advantage relative to the U.S.

Furthermore, the cross subsidization of class prices which offset lower Class 7 pricing created a two-tiered price system. It provides both an incentive to substitute domestic ingredients for their imported counterparts and allows Canada to shift market share internally. For example, a Chinese dairy processor is building an infant formula plant in Ontario with plans to export 51,000 metric tons of infant formula to China by using Canadian Class 7 milk as their base cost of ingredients.

The USMCA also includes provisions that cap the exports of infant formula, SMP and MPC under specific tariff codes. However, exports of milk protein isolates in Chapter 35 and infant formula in bulk packaging are not subject to any export caps. Canada could take this opportunity to aggressively prioritize MPI and infant formula exports under different tariff codes.

In the event that Canada exceeds the export caps, there are penalties paid to the Canadian government, but they could be used as a rebate back to the Canadian dairy industry.

Finally, we believe the intent of the agreement is that liquid ingredients, such as ultra-filtered milk protein concentrates used by Canadian yogurt and cheese producers, should be classified and priced in those higher priced end product classes and not in a re-engineered quasi-class 7. Creating another new low-priced class would continue the cross subsidization from other classes and perpetuate anti-competitive dairy trade with the U.S.

Market Access
The new USMCA will provide duty-free quotas for the majority of U.S. dairy products. These TRQ's should be filled each year since our price of milk is much lower than Canada's. We're concerned that the Canadian dairy industry will find ways not to fill these quotas. For example, given the U.S. farm gate milk price is just 60% of the Canadian farm milk prices, and our make allowance is half that of Canada's, any cheaper Canadian alternatives to our lower cost imports would be one way not to fill the quota. Another good example would be the Canadian Special Class 5 program that allows Canadian processors to apply for a permit that entitles them to buy Canadian dairy ingredients at equal to U.S. prices.

There's precedent for Canada not to fill quotas. Several WTO quotas are routinely left unfilled for milk protein substances and products of natural milk constituents. Similarly, the European Union's quota for cheese under CETA year to date, shows only 42 percent of the quota has been filled.

For these reasons, we believe that actual market access for the U.S. dairy industry to the Canadian market could be much lower than what was negotiated.

Closing Remarks
In closing, NAFTA has created many opportunities for U.S. dairy exporters since its implementation in 1994. Overall, my members are very pleased that the USMCA negotiations are complete but the concerns I laid out regarding Canada's make allowance and the quota fill rates may erode what our negotiators were able to achieve.

Thank you, Commissioners, for the opportunity to testify at today's hearing. I look forward to answering your questions.