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How Might Our Trade Policy Impact Dairy Ingredient Pricing Domestically?

What happens with import and export dairy business has a significant effect on domestic dairy product pricing. Trade policy determines much of the commercial framework and rules under which this business is conducted in relation to products coming into the United States and opportunities for selling US products in overseas markets. Both sides of the import/export equation influence the outcome for market conditions at home.

Imports and Trade Policy

Looking at the role of imports and their effect on prices, it's helpful to begin by dividing the market into two parts. The first part consists of an extensive list of dairy products whose importation is regulated by Tariff Rate Quotas (TRQ's), the second group comprises everything else that is dairy and not subject to import control under TRQ regulations. A background note* on the origins of the TRQ system is provided below.

Imports on which TRQ requirements apply include fluid milk, cream, butter, milk powders, condensed milk and many cheeses along with several other dairy products. Where these products are concerned imports up to a certain volume (the tariff quota) are permitted at a low level of duty but after that any additional imports are subject to onerous tariffs that usually raise prices to prohibitive levels. The second list comprises materials such as milk protein concentrates, whey proteins concentrates, caseins and lactose. These are not subject to quotas and are generally imported at low rates of duty.

In total, annual imports of the two groups amount to about 3.5-4.0% of US milk production expressed in milk equivalent terms. This level has not changed much over an extended period and is divided about equally between TRQ and non-TRQ product groups.

The import control provisions under the TRQ system provide a large degree of protection for domestic manufacturers of the products concerned. The two elements of control that apply i.e. quantitative restrictions and duties, essentially limit access from imported sources. The actual volumes imported are small relative to the domestic production and so have a modest influence on pricing. This is not the case for products in the second group for which there are no volume limits resulting in quantities imported which, in some cases, are substantial relative to local sources. This includes many milk protein and some whey protein ingredients which are sold in the domestic market at price levels determined by prevailing international rates.

The effective division of the market into these two categories is the result of legacy factors that long predate the 1995 introduction of TRQ arrangements. In response to concern about the impact of MPC imports, several legislative initiatives over the past fifteen years have sought to reclassify and set TRQ limits on MPC's. None of these were completed and to some extent concerns receded with the commencement of significant domestic MPC production around 2005. Nevertheless milk protein ingredient manufacturing and whey processing are among the most exposed sectors of the dairy industry because of the trade rule arrangements outlined above. In addition to resulting pricing pressure, ongoing international innovation and product development activity in these areas will contribute to tough competitive conditions, especially where MPC is concerned.

Exports and Trade Policy

To fully gauge the effect on domestic market prices, the role of trade policy in facilitating export business has also to be considered. On a mechanistic basis this plays out along connected tracks relating to how trade policy influences overall export activity and helps determine dairy's trade balance from import and export transactions:

- The volume of foreign trade which multilateral or bilateral trade agreements generate for US dairy exporters in overseas markets
- Resolution of non-tariff barrier issues to realize the full potential of trade agreements
- The extent of competition from imports in the domestic market in terms of quantities and delivered prices after duties plus shipping costs

In effect it's all about relative market access afforded by trade policy and the resulting equilibrium established for the supply of product in the domestic market. Export trade is positive and enables supplies of dairy products that exceed domestic US demand to be marketed offshore. Imports of course have an opposite effect adding to the volume of product and level of competition in the home market. As noted above the import impact of TRQ controlled products is modest but is more significant for ingredients not subject to volume control such as MPC.

The balance between opposite import/export drivers has a determinant effect on product supply sold domestically and consequently on price levels prevailing in the market. Against this background it's essential that export trade policy is aligned with dairy industry development objectives and growth in milk supply. As actions in Washington and national discussion about trade issues during 2017-2018 have demonstrated, assuring a good match between dairy goals and trade policy is not always easy in an economy as large and as complex as the United States, taking account of all interests that have to be accommodated.

The principal trade tool available to encourage dairy exports now consists of trade agreements between countries on a bilateral or multilateral basis. Previously it was possible to incentivize international business through the use of financial subsidies such as the Dairy Export Incentive Program (DEIP), this is no longer possible. The conclusion of the multilateral WTO negotiations in 1995, which gave rise to the TRQ system

outlined above, provided the foundation on which these agreements are based. In the interim the Unite States has gone on to negotiate some twenty or so free trade agreements (FTA) with individual partner countries which have expanded market access and exports for the US dairy industry.

Major examples include FTA's with Mexico, Canada, Singapore, Australia and South Korea. The exports gains that have been made are substantial and need to be sustained, something which can be easier said than done looking at the difficulties that have arisen with sales of MPC to Canada. Going forward, the process of further FTA development needs to continue and establish enhanced market access with revised quotas, reductions in tariff levels and solutions for non-tariff barriers.

Summary

- Trade policy relating to import access into the United States and the development of export business for US processors plays a significant role in shaping domestic market conditions and corresponding prices for dairy products and ingredients.

- For product sectors such as milk protein ingredients (MPC etc.) where trade is not restricted, domestic manufacturers are exposed to full international competition as a result of legacy factors. For other dairy products where trade is controlled within TRQ arrangements, the level of imports is low relative to domestic production and the corresponding effect on the domestic market remains muted for the moment. If developments in trade policy ultimately result in increased market access, these changes will lead to an enlarged impact on market conditions for this group of products.

- The development and enhancement of Free Trade Agreements and parallel resolution of non-tariff barrier restrictions constitute the primary tools for trade policy support for the dairy industry and its export business. The balance between import/export drivers has a determinant effect on product supply sold domestically and consequently on price levels prevailing in the market. It's essential that conditions for export trade are optimized to ensure a positive outcome for continued export growth.

***Tariff Rate Quota System**

The Tariff Rate Quota (TRQ) system was put in place in 1995 following the completion of the Uruguay round of trade negotiations. This agreement instituted market access provisions and tariff benchmarks for member countries of the World Trade Organization (WTO). The resulting framework established the transactional basis for international dairy trade which continues in effect today. It looks as if these arrangements will likely represent the high water mark for multilateral agreement for some time to come. Efforts to further develop multilateral pacts have foundered for one reason or another e.g. the Doha round globally and the Trans Pacific Partnership regionally.

Going forward this reality means that legacy TRQ provisions determining (a) product access for foreign suppliers into the US market and (b) product access for US exporters into foreign markets will constitute the primary framework governing trade in dairy products between the United States and global partners. Where the US has subsequently entered into free trade agreements with individual partner countries, the original TRQ criteria for import quotas and tariffs have been modified. These changes have so far not had a material effect on US import levels because most of the partners to date are not major dairy producers. This situation could change in the future depending on the partners concerned.

Additional Information

Economic Impact of Trade Agreements Implemented Under Trade Authorities Procedures – USDEC
http://blog.usdec.org/usdairyexporter/free-trade-agreements-produced-8-billion-for-u.s.-dairy-industry-from-2004-2014?hs_preview=N0xhoJTH-3691126253

Dairy Import Licensing Program – USDA
www.fas.usda.gov/programs/dairy-import-licensing-program

Contributor

Michael Culhane
Dairy Advance Business Consulting LLC
Phone 608 325 4543
Email: mculhane@dairyadvance.com

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