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New Canadian Dairy Pricing Regime Proves Disruptive for U.S. Milk Producers

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A new pricing regime—the National Ingredient Strategy—that was introduced in Canada in February 2017 for certain dairy product ingredients is creating negative spillover effects for some U.S. dairy product exports and for certain milk producers in border states whose milk deliveries to processors are dependent upon this trade.

Press reports indicate that some 75 dairy farms in Wisconsin have been advised that their milk delivery contracts with a local milk processor will not be renewed as of May 1, 2017, because of the new pricing regime in Canada. Some dairy farmers in Minnesota have been similarly affected, while processors in New York State that produce ultra-filtered (UF) milk for the Canadian market also stand to be affected.

Canadian milk producers operate under a supply management system that supports prices of milk—and by extension milk products—at levels well above U.S. prices and prices that prevail in international trade. Under the National Ingredient Strategy, certain Canadian milk product ingredients are to be priced by provincial milk marketing boards at or below internationally competitive levels, potentially curtailing U.S. exports of such products, particularly UF milk to Canada.

$100 Million Export Market at Risk

UF milk is a high-protein liquid product that results from separating and concentrating certain milk proteins for use in the production of dairy products, such as cheese and yogurt. U.S. UF milk found a market among Canadian cheese makers after Canada revised its compositional standards for cheese in 2008, significantly reducing the use of several milk products that U.S. processors had been supplying to Canadian food manufacturers, although UF milk usage was not limited under the revised standards. Also, U.S. UF milk is not subject to import quotas or high duties that Canada imposes on most dairy product imports. As such, U.S. sales of UF milk to Canadian processors have expanded rapidly in recent years. According to the U.S. Census Bureau, Canada ranked as the largest U.S. export market for UF milk in 2016, with sales of about $102 million. In 2016, total U.S. dairy exports to Canada amounted to $733 million and totaled $5 billion to the world.

Canada's supply management system for its dairy sector supports milk prices at high levels relative to world market prices through quotas on domestic production together with high tariff levels and tariff-rate quotas that restrict imports of dairy products. It has long been a source of concern for the U.S. dairy industry. In addition, U.S. dairy interests are now concerned about an ingredient pricing strategy the Canadian dairy industry is pursuing, a strategy the U.S. industry contends is aimed at further discouraging imports of certain U.S. milk product exports to Canada, including UF milk. An additional concern is that the pricing strategy will facilitate exports of surplus Canadian skim milk products that would not otherwise be price competitive in international markets, potentially displacing similar U.S. product exports.

In recent years, increased demand for butterfat from milk has led to an increase in milk production quotas in Canada, resulting in a surplus of skim milk supplies. To address the surplus of high-priced skim milk powder, in 2016 the province of Ontario adopted a special pricing program (Class 6) that allowed for the sale of various domestic dairy ingredients at international market prices rather than the typically higher prices that otherwise prevailed under Canada's supply management system. A broadly similar approach to pricing milk protein products was introduced on a temporary basis across Canada last year. In February 2017, this pricing strategy, known as Class 7, was implemented by provincial dairy marketing boards on a longer-term basis with the expectation that the program will operate nationwide.

Class 7 milk is comprised of skim milk components, including milk protein concentrates, skim milk and whole milk powders, edible casein, rennet casein, and various powders derived from milk products. Despite the U.S. government's request, specific details governing the program, including how prices for these commodities are to be determined, have not yet been made public. Such information would be important for determining whether this pricing strategy violates Canada's trade commitments, as the U.S. dairy industry and its counterparts in other major dairy exporting countries have asserted.

U.S. Dairy Industry Sees Trade Agreement Violations

U.S. dairy interests contend that this program is designed to favor Canadian milk products at the expense of imports, including U.S. milk product exports such as UF milk. U.S. dairy participants also assert that the Class 7 initiative will facilitate dumping of Canadian skim milk ingredients on world markets.

In a letter of September 12, 2016, to government trade officials, major U.S. dairy market stakeholders—together with their counterparts in several dairy-exporting competitor countries—contended that the Canadian dairy industry's ingredients pricing program that was agreed to in principle (the basis for Class 7) violates Canada's commitments under the North American Free Trade Agreement (NAFTA), the World Trade Organization, and the EU-Canada Comprehensive Economic and Trade Agreement.

In a letter dated April 18, 2017, Canada's ambassador to the United States rejected assertions that Canada's dairy policies are causing financial loss for U.S. dairy farmers and that they violate Canada's international trade obligations, asserting that the U.S. dairy industry is more protectionist than is Canada's. The ambassador further points out that the National Ingredient Strategy is an industry initiative representing an agreement among Canada's dairy producers and processors. Separately, Canadian dairy industry officials contend that the dilemma facing U.S. farmers whose supply contracts are not being extended reflects excess U.S. milk production, not Canada's dairy pricing policies.

In a letter of April 13, 2017, U.S. dairy industry groups requested that President Trump intervene directly with Canadian Prime Minister Justin Trudeau to halt the Class 7 program. In addition, several Members of Congress from Minnesota have asked President Trump to explore whether Class 7 pricing violates Canada's WTO obligations. In a recent speech, President Trump vowed to "stand up" for Wisconsin dairy farmers. Renegotiating NAFTA, as President Trump has advocated, could provide a construct for addressing Canada's dairy pricing ingredient strategy.