

Free Trader vs Protectionist?: Understanding US-Canada Dairy Market Access

Independent Agri-Food Policy Note
June, 2018
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The Issue

Trade in dairy products has long been a source of friction, and an occasionally a trade irritant between Canada and the United States. This dates back to 1990's trade disputes regarding Canada-US trade in ice cream, butteroil-sugar blends, and Canadian pricing of dairy exports. This dialogue has gone from simmering in the background to demands from the US in NAFTA renegotiation for Canada to eliminate Class 7 pricing, reduce tariffs, and to eliminate supply management altogether. This must be taken as a serious threat to milk supply management in Canada.

In making its demands on dairy, the US positioned itself as the victim of Canadian protectionism. President Trump has identified Canadian tariff levels for dairy products as "very unfair" and detrimental to the US. Most recently, in a tweet, the President expressed frustration regarding tariffs of 270 percent protecting Canadian dairy products.

The US concerns reflect its interest as a major dairy exporting country, increasingly dependent upon exports for its growing milk production. Canada seems to have accepted this narrative in which the US casts itself as a victim of Canadian dairy protectionism, and in so doing finds itself in a defensive posture with the US.

But is the US really victim, or is it a protectionist itself? The nature of US protection of its dairy industry has received much less scrutiny or attention. This policy note examines the nature of US dairy

import protection. The note focuses on US rules for the importation of cheese (HS Chapter 4) as an indicator of US dairy protection. Imports of cheese under HS 0406 have accounted for about 69 percent of the total value of US dairy imports since 2007.

Overview of Cheese Trade and Protection in the US and Canada

The US has a highly regulated milk marketing system, with many similarities to Canada's, and a protected cheese market. Table 1 below provides a summary of selected metrics. Total US imports of cheese in 2017 were just over six times that of Canada. The US is a major exporter of cheese; according to data compiled by worldexports.com, the US was the sixth largest cheese importer in 2017.¹ Canada is a much smaller exporter of cheese. The US is a net exporter of cheese, and Canada is a net importer.

Table 1: Selected Metrics of Trade and Support, 2017

	US	Canada
Cheese Imports (tonnes)	183,264	27,593
Cheese Exports (tonnes)	341,085	10,076
Cheese TRQ/Production	2%	4%
Within-quota tariff Cheddar cheese	12%	1%
OECD Market Price Support Estimate, Milk (\$ billion, own currency)	4.43	2.79

Sources: USDA GATS database, Statistics Canada, and OECD². OECD data are for 2016

¹ <http://www.worldstopexports.com/cheese-exports-country/>

² For additional detail see

<http://www.oecd.org/tad/agricultural->

[policies/producerandconsumersupportestimatesdatabase.htm#country](http://www.oecd.org/tad/agricultural-policies/producerandconsumersupportestimatesdatabase.htm#country)

Both the US and Canada have Tariff Rate Quotas (TRQ) for cheese. These define volume limits within which product enters at relatively low or zero tariff. Compared with cheese production, the US allows in about 2 percent under its TRQ in aggregate. Canada allows in about 4 percent. The tariffs charged by the US on imports within the TRQ are broadly higher than comparable Canadian tariffs. The table illustrates the situation for cheddar cheese (US HS code 0406.90.08 for the US and HS 0406.90.11 for Canada). The US within-TRQ tariff is 12 percent *ad valorem*, while Canada's (on an *ad valorem* equivalent) is about 1 percent. Tariffs in excess of TRQ volumes are more complex and are discussed below.

The most recent OECD estimates of market price support for US dairy are \$US 4.4 billion; in the case of Canada, estimated market price support is \$2.79 billion.

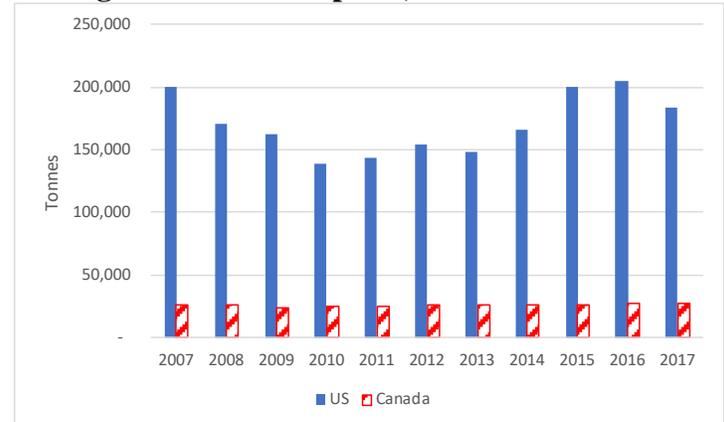
Elements of Protection in the US and Canada

Figure 1 below presents an overview of cheese imports in the US and Canada. Over the last ten years, US cheese imports have ranged around 170,000 tonnes, with little trend evident; US cheese imports are essentially flat. Canadian cheese imports have ranged in a tight band at around 25,000 tonnes, with imports largely flat. Figure 2 presents US and Canadian imports of cheese relative to cheese production. Since 2012, the US has imported the equivalent of around 3 percent of cheese production. Over the same period, Canada imported 5-6 percent of domestic cheese production.

Both the US and Canada protect their domestic cheese industries as an element of dairy industry protection. Both countries employ tariff rate quotas, with both

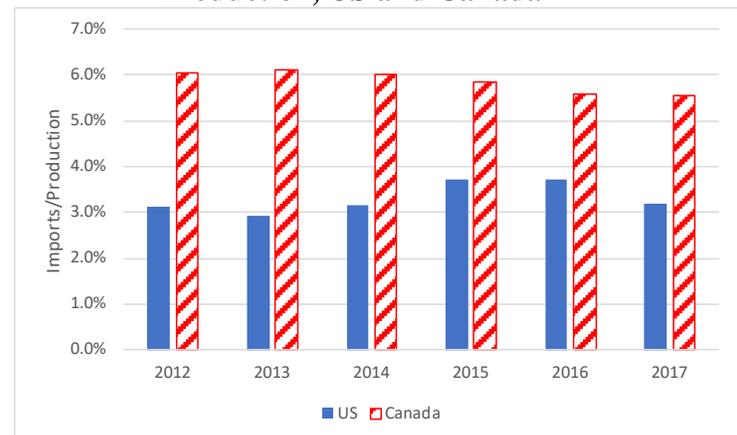
³ As NAFTA member countries, the US and Canada do not levy within-quota tariffs against one another, and the US

Figure 1 Cheese Imports, US and Canada



Source: USDA GATS database, HS 0406 General Imports, and Statistics Canada

Figure 2 Cheese Imports as Share of Cheese Production, US and Canada



Source: USDA GATS database, HS 0406 General Imports, USDA-NASS, and Statistics Canada

within-quota and over-quota tariffs.³ The US levies within-quota tariffs, on a Most Favoured Nation (MFN) basis, ranging from a low of 2.7 percent for Roquefort (HS 0406.40.20.00) to a high of 25 percent for Goya cheese (HS 0406.90.28.00). Most within-quota tariffs levied by the US appear to be in the range of 8-15 percent, *ad valorem* basis. Canada uses a specific tariff on cheese within-quota. They are

exempts Canada from its safeguard provisions for dairy products.

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either 2.84 ¢/kg or 3.32¢/kg. To interpret these on an *ad valorem* basis, consider HS 0406.90.11 which contains cheddar cheese. The MFN within-quota tariff is 2.84¢/kg, or \$28.40/tonne. The most recent Global Dairy Auction cheddar cheese prices have ranged around \$US 4,000/tonne. At this rate, the Canadian within-quota tariff on cheddar cheese is less than one percent.

Over-quota tariffs for cheese used by both countries are large and material- and complex. The US uses a mix of *ad valorem* and fixed per unit tariffs on its cheese imports. For example, the US assigns an over-quota tariff on cheddar cheese imports (HS 0406.90.12.00) of \$1,227/tonne; using the above global cheddar price this is the equivalent of an *ad valorem* tariff about 30.7 percent. Canada also places its over-quota cheddar cheese imports in HS 0406.90.12.00, subject to a tariff of 245.5 percent, but not less than \$3,530/tonne.

In addition, the US applies safeguard measures, set forth in various sections of HS Chapter 99, that apply to cheese imports under HS 0406 as well as cheese-containing imported products in other chapters.⁴ Their structure is such that they apply inversely proportional to product value according to a schedule contained in US tariff schedule under HS 9904, in addition to the over-quota tariff.

For example, sections 9904.05.59 to 9904.05.73 set forth safeguard duties that apply to cheddar cheese and cheese and substitutes for cheese containing or processed from cheddar cheese (including HS 0406.90.12.00 noted above). The safeguard duties (added to the general duty rate) range from \$572/tonne for products valued at less than \$650/tonne, decreasing to \$35/tonne for products valued at \$1,750-\$1,850/tonne, with the additional safeguard duty rate of zero applied to products valued at greater than \$1,850/tonne.

To illustrate an extreme case of the safeguard, consider a cheese product made from cheddar cheese entering the US at a value of \$640/tonne in HS 0406.90.12.00. The duty applicable to this product would be the general rate of duty, over-quota, of \$1,227/tonne, plus the safeguard duty of \$572/tonne, or \$1,799/tonne. Converted to an *ad valorem* basis, this amounts to \$1,799/\$640, or 281 percent.

Finally, both the US and Canada have cheese imports that are free of tariff. For example, Pecorino cheese made from sheep's milk (HS 0406.90.54 and 0406.90.56) is entirely free of tariff. In Canada, some cheeses enter Canada under supplementary import permits, and under the Import for Re-Export Program, or the Duty Relief Program.

Key Observations

US protection of cheese is broadly more complex than that in Canada; however, the following is clear:

- In comparison with its market size, the US allows for much less cheese market access within its tariff rate quota. Canada allows in about double what the US does, on a relative production share basis.
- What the US does import under its within-quota tariff, it applies higher tariffs than Canada does. Canada's tariff based on cheddar (a relatively low value cheese) is less than one percent.
- The US employs safeguard measures that Canada does not. These safeguard duties can be quite material, and generally have the impact of raising the domestic prices of lower valued product- thereby narrowing the price spread within the US between fine cheeses and the lower quality cheeses such as

⁴ A number of countries, including NAFTA members, are exempt from the safeguard measures. The exempt countries are those with bilateral/plurilateral agreements with the US but

are not significant exporters of dairy products, except Australia. For the most part, EU countries notably are not exempt from US safeguards.

cheddar, Colby and Monterey (the dominant cheeses produced in the US).

- Protection leads to cheese market distortions in both the US and Canada. However, because Canada is not a major cheese exporter and its production is bound by quotas, its distortions from protection are contained internally. However, the US is a large exporter and does not limit its production with quotas, so the distortionary effects have a global impact.

What is clear is that both the US and Canada have highly protected cheese and dairy industries. This is perhaps not surprising as both countries employ domestic policies intended to support producer milk prices. Indeed, prior to the Uruguay Round Agreement on Agriculture, both countries utilized binding import quotas, which set a firm ceiling on imports. Under the Agreement on Agriculture, countries converted binding import quotas to tariffs and tariff rate quotas on cheese and dairy products. It was seen as in the interest of both the US and Canada to do this in such a way that the over-quota tariffs and associated instruments would be essentially prohibitive to imports beyond levels established in the binding import quotas to support established domestic policy instruments. The two countries have gone about this in different ways but both have been effective in sharply limiting imports.

An important point is that, since the high tariffs in excess of TRQ in both countries are intended to be prohibitive, there is very little imported volume that is actually assessed the over-quota tariff. Canada could increase its over-quota cheese tariff from 246 percent to 2000 percent, with little actual effect; the same is true of the US.

Conclusion

The ongoing narrative in which the US casts itself in the role of victim to protectionist interests of Canadian dairy is highly simplistic and inaccurate. It could just as easily be argued that other countries are victims of US dairy protection- based on within-quota access levels allowed by the US, US within-quota tariffs, and the combination of over-quota and safeguard tariff levels. While Canadian over-quota tariff levels have been targeted as exceptionally high, by getting into the details the US over-quota and safeguard tariffs, examples of US cheese tariffs at similar levels can easily be found. Cheese is only one component of the dairy complex; the analogous conclusions apply to milk powders, yogurt, and the broader dairy complex.

This was recently highlighted in an article by Noll and Litan at the Brookings Institution in Washington.⁵ They observe that the US dairy exports to Canada occur within tariff rate quotas, not over-quota, so the US doesn't really pay the tariff rates President Trump has complained about. Moreover, the above shows that the Canadian tariff-rate quota is about double that of the US on a proportional basis and will only expand under the Canada-EU Comprehensive Economic and trade Agreement.⁶ It underscores the fundamental point observed here- the US is not a victim of Canadian dairy protection; the US is highly protectionist itself. This understanding undermines the narrative of "unfair" trading practices alleging that Canada is hurting the US.

Both Canada and the US have interests in protecting their dairy industries, given the domestic policy instruments they have deployed. The US dairy industry has evolved to have a significant interest in exports and expanding dairy market access; Canada has not moved in this direction and is domestically

⁵ <https://www.brookings.edu/blog/up-front/2018/06/13/a-trumped-up-charge-against-canadian-dairy-tariffs/>

⁶ Under CETA, Canada provided the EU with additional cheese market access via tariff-rate quota amounting to almost 18,000 tonnes when fully implemented

focused. As such, the US has scrutinized Canada and been an aggressive critic of Canadian protection for dairy, but Canada has not had the same interest in scrutinizing the US. But the point must not be lost that the extent of dairy protection is really similar in both countries- with examples of very high levels of protection in the US buried in the details of its tariff schedule.

Discussions would be improved by a more pragmatic dialogue that acknowledges profound similarities in Canadian and US milk marketing policy, and that significant barriers to trade were erected to protect them. Ignoring this invites the prospect of countervailing challenges to dairy protection, potentially weakening both systems. At the same time a fundamental difference should be acknowledged- the market effects of Canadian dairy policy are contained internally, bound by quotas; the effect of US dairy policy flow out into the global market.

As Canadian dairy policy continues to evolve to a range of factors, such as market access provided in new trade agreements and the coming full elimination of subsidized exports, it will be necessary to understand the full elements and detail of dairy market protection in other countries- in a pragmatic fashion, engaging all of the requisite detail.

Finally, the nature of protection for cheese as a proxy for the broader complex of dairy products in the US should raise a note of caution to the US. In NAFTA renegotiation, the US is asking what it claims is a protectionist country to lower its trade barriers, and further to remove its supply management system. As Bozic has recently argued,⁷ the US “should be careful what it asks for”. Removing supply controls would place Canada in much the same position as the US- in terms of requiring significant exports to market its production, and thereby creating a new dairy export

market competitor to the US. Presumably, the US wishes to avoid this.

⁷ <http://www.thebullvine.com/news/professor-blames-full-fat-trend-for-dairy-trade-spat/#>