



March 26, 2019

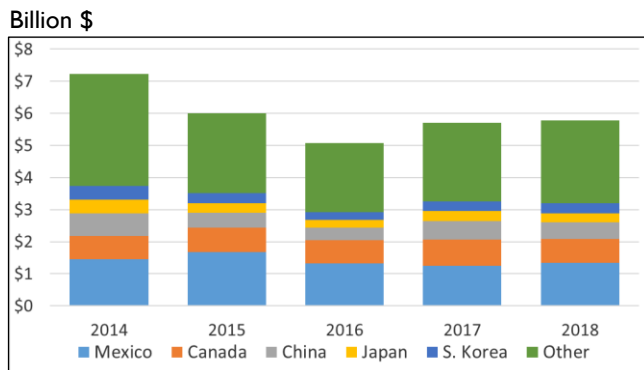
## Dairy Provisions in USMCA

On November 30, 2018, the heads of state of the United States, Canada, and Mexico signed the U.S.-Mexico-Canada Agreement (USMCA) to revise the North American Free Trade Agreement (NAFTA). The legislative bodies in each country must now ratify the agreement for it to come into force.

Mexico and Canada are two of the largest markets for U.S. dairy product exports. In recent years, the two USMCA partners have accounted for more than a third of the total value of U.S. dairy product exports. In 2018, U.S. dairy exports to Mexico were valued at \$1.4 billion and to Canada at \$731 million (**Figure 1**) out of total dairy exports of \$5.9 billion. Mexico is the leading market for U.S. cheese and nonfat dry milk exports. Canada is the leading export market for butter and processed dairy products (e.g., infant formula, milk drinks, and ice cream).

USMCA would preserve duty-free access for U.S. dairy products in Mexico. The agreement with Canada includes two key provisions: the elimination of the Canadian Class 7 milk price and increased market access for selected dairy products (both discussed below).

**Figure 1. Leading Markets for U.S. Dairy Exports**



**Source:** USDA, Global Agricultural Trade System, Foreign Agricultural Trade of the United States, dairy category.

**Note:** Dairy totals are adjusted to include protein isolates. Ultra-filtered (UF) milk is classified as a protein isolate (HTS code 3504001000). It is not included in the USDA dairy categories.

### Mexico

Under NAFTA, U.S. dairy product exports enter Mexico duty free. U.S. dairy exports to Mexico totaled \$193 million in 1994 when NAFTA was implemented and have steadily risen to \$1.4 billion in 2018. Mexico has been the leading market for U.S. dairy exports since 2004, and the United States is the leading source of dairy imports in Mexico. One concern for the U.S. dairy industry was that its access to Mexico be preserved, especially as Mexico negotiates other free trade agreements (FTAs). In April 2018, Mexico signed an FTA with the European Union that includes new rules for agricultural goods, and Mexico has been exploring

agreements with Australia and New Zealand. All three are major global dairy exporters.

Under USMCA, Mexico's zero tariffs for U.S. dairy product exports are preserved. In addition, in a side letter, Mexico confirmed that U.S. market access for 33 cheeses will be protected under USMCA (see box). Some cheese producers have noted that the list is not comprehensive of all cheese varieties exported to Mexico, and additional work may be needed to preserve access.

#### Recognized U.S.-Mexico Cheese Names

Blue, Blue vein, Brie, Burrata, Camembert, Cheddar, Chevre, Colby, Cottage, Coulommiers, Cream, Danbo, Edam, Emmental, Emmentaler, Emmenthal, Gouda, Grana, Havarti, Mascarpone, Monterey Jack, Mozzarella, Pecorino, Pepper Jack, Provolone, Ricotta, Saint-Paulin, Samsø, Swiss, Tomme, Tome, Toma, and Tilsiter

### Canada

Although Canada is the second-leading export market for U.S. dairy products, some dairy analysts believe U.S. exports could be higher but for Canadian import restrictions. The Canadian dairy sector operates under a supply management system that limits production, sets prices, and restricts imports. Canadian imports of dairy products are restricted through tariff-rate quotas (TRQs), with high over-quota tariffs of up to 315.5%.

In recent years, strong demand for butter in Canada resulted in increased Canadian milk production and, consequently, surplus skim milk supplies. To address the surplus, Canada adopted the Class 7 milk price classification in 2017 (Class 6 in Ontario). Class 7 is comprised of skim milk components, primarily milk protein concentrates (MPC) and skim milk powder (SMP) used to process dairy products. Under the Class 7 regime, domestic skim milk products became cheaper for domestic producers, Canada expanded global exports of SMP, and U.S. producers lost exports of high protein ultra-filtered (UF) milk to Canadian cheese and yogurt processors.

UF milk was not covered under a dairy TRQ negotiated under global trade agreements or NAFTA. This allowed U.S. UF milk duty-free access to the Canadian market. According to the U.S. Department of Agriculture (USDA), the value of U.S. UF milk exports to Canada peaked at nearly \$107 million in 2015 but declined sharply after the Class 7 regime was implemented in 2017 from \$102 million in 2016 to \$49 million in 2017 and \$32 million in 2018. At the same time, Canada's total exports of SMP more than tripled in 2017 to \$133 million compared with \$42 million in 2016 before the Class 7 price regime was implemented. Eliminating Canada's Class 7 pricing regime was a priority for the U.S. dairy industry for NAFTA negotiations.

### Class 7 and Transparency

Under USMCA (Chapter 3, Annex 3-A), Canada agrees to eliminate Class 7 pricing six months after USMCA enters into force. Its Class 7 products are to be reclassified according to their end use. They would be priced based on a formula that uses the USDA reported nonfat dry milk price minus a Canadian processing margin (i.e., the cost of converting raw milk into specific products), multiplied by a yield factor (the ratio of the volume of nonfat solids needed to produce a certain volume of SMP). This price would apply only to milk products for human consumption.

Under the agreement, Canada is required to monitor its exports of MPC, SMP, and infant formula. If MPC and SMP exports exceed 55,000 metric tons (MT) in year 1 and 35,000 MT in year 2 of the agreement, Canada is to impose an export surcharge of Canadian dollar (CAD) \$0.54 per kilogram of exports for the remaining dairy year (August 1–July 31). If infant formula exports exceed 13,333 MT in year 1 and 40,000 MT in year 2, a CAD \$4.25 surcharge will be added to the export price. After year 2 of the agreement, the export quantities are increased 1.2% each year. Canada is to report on monthly exports of MPC, SMP, and infant formula at the tariff level on a monthly basis.

In addition, the agreement requires Canada to publish information on laws and regulations on milk class pricing, including components (butterfat, protein, and other solids), processing margins, and yield factors in the interest of greater transparency. After the agreement goes into force, data on milk utilization by milk class—including quantities sold, prices and revenues for milk and for each component—is to be published, excluding confidential business information. Once in force, the United States and Canada are to revisit the agreement after five years and then every two years to determine if any modifications or termination of the agreement is required.

### Market Access

Under USMCA, Canada agrees to reduce certain barriers for U.S. dairy exports, a key demand of U.S. dairy groups. Canada maintains its supply management system but expands TRQs for U.S. exports of milk, cheese, cream, skim milk powder, condensed milk, yogurt, and several other dairy categories. In addition, USMCA includes broader provisions on transparency for the implementation of TRQs, such as requirements for advance notice of changes to the quotas and making details on quota utilization rates publicly available.

The agreement between the U.S. and Canada establishes TRQs specifically for 14 categories of U.S. dairy products (**Table 1**), which cover 51 tariff lines as classified in the Harmonized Tariff System. The TRQ amounts are established for year 1 and doubled in year 2 and would then increase by 50%, 33%, 25%, and 20% in years 3–6. After year 6, the quantities of each category increase at a compound growth rate of 1% for the subsequent 13 years. After year 19, the quotas would be fixed at the year-19 level. Whey powder is the exception: Its TRQ climbs to 4,303 MT by year 10, after which it would be eliminated. U.S. dairy products exported under the TRQ would enter Canada duty free. U.S. exports above the TRQ quantities would be subject to the Canadian most-favored-nation tariff rate.

**Table 1. TRQs for U.S. Dairy Exports to Canada**

| Metric tons              |        |         |         |
|--------------------------|--------|---------|---------|
| Dairy Category           | Year 1 | Year 6  | Year 19 |
| Milk                     | 8,333  | 50,000  | 56,905  |
| Cream                    | 1,750  | 10,500  | 11,950  |
| Skim Milk Powder (SMP)   | 1,250  | 7,500   | 8,536   |
| Butter, Cream Powder     | 750    | 4,500   | 5,121   |
| Cheese, Industrial Use   | 1,042  | 6,250   | 7,113   |
| Cheese, All Types        | 1,042  | 6,250   | 7,113   |
| Milk Powders             | 115    | 690     | 785     |
| Concentrated Milk        | 230    | 1,380   | 1,571   |
| Yogurt, Buttermilk       | 689    | 4,135   | 4,706   |
| Powdered Buttermilk      | 87     | 520     | 592     |
| Whey Powder              | 689    | 4,135   | NA      |
| Products of Natural Milk | 460    | 2,760   | 3,141   |
| Ice Cream, Mixes         | 115    | 690     | 785     |
| Other Dairy              | 115    | 690     | 785     |
| Total                    | 16,667 | 100,000 | 109,103 |

**Source:** USTR, *Appendix C – USMCA Agriculture TRQs Between Canada and the United States*. **Note:** NA=not applicable.

Several restrictions would apply to certain U.S. dairy products. For example, 85% of the milk and cream TRQs are reserved for bulk shipments to be used for food processing. The remaining portion may be for any use, including retail sales. Also, 85% of the butter quota is reserved for bulk shipments during year 1, and that percentage is reduced to 50% over the following five years. U.S. exports under the “Cheese, Industrial Use” TRQ are for bulk shipments for further food processing. “Cheese, All Types” are for any use. The types of cheese (tariff code) are the same for both of the cheese TRQs.

Canada is to administer the agreed-upon dairy TRQs through its import licensing system for each quota year. Quota will be allocated to eligible applicants active in Canada’s food and agriculture sectors. The quota year for milk, cream, SMP, butter, milk powder, and whey is August 1 to July 31. The other dairy products are to be administered on a calendar basis.

The United States also limits dairy imports through TRQs for certain dairy products. Under USMCA, the United States would establish Canada specific TRQs with duty free access for eight categories of dairy products (e.g., cream, butter, cheese, SMP, whole milk powder, dried yogurt, and concentrated milk). The TRQ amounts are similar to the access amounts Canada granted to the United States and expand at the same rates through year 6. Thereafter, the TRQ volumes increase 1% each year through year 19.

If USMCA comes into force, the U.S. dairy sector may gain more than other agricultural sectors. But USMCA’s benefits may not be realized until agreement is reached on Section 232 retaliatory tariffs, particularly on U.S. cheese exports to Mexico. Enforcement of the agreement with Canada will be of key interest to the U.S. dairy sector going forward.

**Joel L. Greene**, Analyst in Agricultural Policy

IF11149

---

## Disclaimer

This document was prepared by the Congressional Research Service (CRS). CRS serves as nonpartisan shared staff to congressional committees and Members of Congress. It operates solely at the behest of and under the direction of Congress. Information in a CRS Report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to Members of Congress in connection with CRS's institutional role. CRS Reports, as a work of the United States Government, are not subject to copyright protection in the United States. Any CRS Report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS Report may include copyrighted images or material from a third party, you may need to obtain the permission of the copyright holder if you wish to copy or otherwise use copyrighted material.