California Dairies, Inc.

Testimony before the Committee on Ways and Means Subcommittee on Trade
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Advancing the U.S. Trade Agenda: Benefits of Expanding U.S. Agriculture Trade and Eliminating Barriers to U.S. Exports

Overview

Exported products from the U.S. have become an increasingly important component of the U.S. economy, supporting over 11 million jobs in 2013. One sector of the U.S. economy, the dairy industry, has only recently started to capitalize on the benefits of participating in the world market and is undergoing a transformation from an inward-looking industry to one that is positioned to be a dominant international exporter. International markets are demanding more dairy products, an outgrowth of increases in disposable income and population growth. Over the next ten years, the opportunities presented in world markets seem particularly well-suited for the U.S. dairy industry with its extensive dairy farm and processing plant infrastructure, potential for future growth of its safe and reliable milk supply, and its strategic geographic position to provide a consistent supply of nutritious dairy to any country in the world. Free trade agreements will facilitate this industry-wide evolution by providing a welcome opportunity for the U.S. to strengthen its economy, bolster the creation of jobs domestically and abroad, and increase the level of food security in foreign countries by delivering high-quality, nutrient-dense dairy products. To achieve this success, the U.S. must maintain the goal of achieving comprehensive, zero-tariff access and ensure that unjustified non-tariff barriers and regulatory requirements do not block trade.

California Dairies, Inc. (CDI) has built a strategy around the goal of becoming the "leading source of dairy nutrition for a healthy world" and is actively aligning itself to the fundamental changes in world market demand. By exporting dairy products and developing new market outlets that require higher product specifications or more stringent food safety protocols, CDI can increase its profitability by marketing products with higher margins, and its member-owners can increase the investments made in their dairy farms to provide more of the safe, high-quality milk that customers are seeking. CDI is uniquely positioned geographically by being located in California and has easy access to several nearby sea ports, greatly reducing its transportation costs to ship dairy products to international customers.

Economic Importance of U.S. Exports and of the U.S. Dairy Industry

The Office of Trade and Economic Analysis of the U.S. Department of Commerce reported that 11.3 million jobs were supported by exports in 2013, up 1.3 million since 2009 and the highest level in the last ten years. Every billion dollars of U.S. exports supports over 5,500 jobs, but U.S.

agricultural sectors do even better - every billion dollars in U.S. agricultural exports supports about 6,800 jobs.[1]

The 47,000 dairy farms and more than 1,000 milk processing plants in the U.S. play a critical role in providing and supporting hundreds of thousands of jobs, a large portion of which require skilled labor and support this country's manufacturing sector. Dairy farm receipts alone contribute approximately $40 billion a year to the U.S. economy, primarily in rural areas. The industry's counterpart, the milk processing plants, contribute over $100 billion annually to the U.S. economy, employ 132,000 people and generate over $5 billion in wages, according to U.S. Department of Agriculture's National Agricultural Statistical Service.

U.S. dairy products, made from nature's most perfect food, provide a high-quality and nutrient-dense food source for customers worldwide. However, the contribution and importance of exports to the U.S. dairy industry have been recognized only recently as the industry is undergoing a remarkable transformation due to changing market forces. Dairy product exports have grown a phenomenal 44% per year since 2002.[2] Currently, the U.S. ranks as the third leading country in the world to export dairy products. Furthermore, dairy product exports have accounted for approximately two-thirds of the milk growth in the U.S. over the past decade. The U.S. went from exporting less than $1 billion of dairy products in 1995, a time when a large portion of those sales were government-assisted, to exporting a record 15% of U.S. milk production valued at $6.7 billion last year, none of which used export subsidies.[3]

As good as 2013 was for U.S. dairy product exports, 2014 appears to be taking the high points even higher. The value of U.S. dairy exports topped $700 million in March 2014, and exports of cheese, whey proteins, lactose and milk protein concentrate all reached new records.[4] The U.S. is now the world's leading single-country exporter of skim milk powder, whey products, and lactose; it is second only to the EU for cheese exports. These record figures are not aberrations; they are driven by fundamental changes in global dairy markets, such as changes in EU and U.S. dairy support programs, demand in Asia and increases in global dairy product prices. With greater alignment between U.S. and international prices, export opportunities for U.S. dairy products are on the rise.

For the last several years, CDI has placed a high priority on the importance of expanding export opportunities for our farmers' milk. CDI has grown its milk powder export business so that half of the milk powder products that we manufacture are now exported. Butter and butterfat products exported to international customers are also increasing, more than doubling since 2008.

The Future of U.S. Dairy Exports

In 2009, the Innovation Center for U.S. Dairy commissioned Bain & Company to assess global opportunities for U.S. dairy products. That analysis, "*The Impact of Globalization on the U.S. Dairy Industry: Threats, Opportunities, and Implications*", was "refreshed" in 2011, but the

[1] USDA Economic Research Service
[2] USDA Economic Research Service
[3] US Dairy Export Council
[4] US Dairy Export Council

conclusions did not change – there is worldwide demand for dairy products that current global production cannot meet, and the U.S. is ideally positioned to produce the dairy products needed to fulfill this demand. Furthermore, U.S. exports are forecasted to continue to grow, with expectations for expansion on a value basis of approximately 40% over the next five years. This means that dairy farmers must continue to expand their milk production capabilities and milk processing companies must strive to produce dairy products that meet the specifications demanded by customers. However, these efforts will require significant capital investments on the part of dairy farm operators and milk processing plant owners. It is extremely important for dairy producers and milk processors to receive assurances that U.S. trade negotiators are seeking maximum market access for all dairy products. Those assurances will help to convince them to make investments necessary to take advantage of all international trade opportunities.

Barriers to U.S. Dairy Export Growth

Despite the promising outlook for international trade of dairy products, trade barriers in the form of government protectionism of dairy sectors are among the highest for any of the traded agricultural commodities. It is critical that these inequities be rectified so that the U.S. dairy industry has a level playing field with its competitors to access those markets where dairy products are sought. Free trade agreements (FTAs) such the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (T-TIP) represent comprehensive opportunities to break down the obstacles that restrict market access, which can be generally categorized as tariff and non-tariff barriers. Also, not all barriers to freer trade are exogenous; some U.S. laws, regulations and policies present internal obstacles that must be navigated by exporting companies in their quest for greater participation in world markets.

Tariff Barriers

Many of the world's largest dairy consuming countries, such as Canada, Japan and the EU, set high tariffs on imported dairy products. For example, two of the TPP member countries, Canada and Japan, maintain the most tightly guarded dairy markets in the world by imposing astronomically high tariffs on imported dairy products. Canadian dairy tariffs typically range from 250% to 300%.[5] Tariffs levied by Japan on milk powders and butter fall within a similar range and are effective in restricting market opportunities.[6] The tariffs levied by the EU are not of these magnitudes but are still far higher than U.S. dairy tariffs for comparable products, frustrating any focused efforts by U.S. exporters to expand into those markets.

Ultimately, elimination of dairy tariffs across all dairy products without exception is essential for increasing the flow of trade. The increase in dairy trade activity between the U.S. and South Korea is directly attributable to reductions in tariffs and exemplifies the point. Before the U.S.-South Korea FTA was completed, the U.S. had a 29% share of imported dairy products in that market. After the FTA was implemented and tariffs were eliminated for some U.S. dairy exports, the U.S. import market share grew to 37%.[7] Establishing reasonable transition periods to eliminate tariffs on all dairy products or develop innovative solutions to address trade barriers

[5] World Trade Organization notifications
[6] World Trade Organization notifications
[7] Korea Customs and Trade Development Institution via GTIS Global Trade Atlas

such as tariff-rate quotas may be acceptable as long as the resulting market access is real, measureable and equitable.

Non-Tariff Barriers

Non-tariff barriers can be further broken down into sanitary and phytosanitary (SPS) measures and geographical indications, both of which are intentionally obstructive and pose sizable challenges to U.S. exports in fast-growing markets.

SPS Measures – SPS measures are not without basis and do provide a means for foreign governments to protect humans, animals, and plants from certain health risks; CDI strongly supports this right of governments. However, governments have pushed beyond the original intent of SPS measures to erect unscientific, unduly burdensome, and discriminatory barriers to trade that protect domestic or favored foreign products. An example will underscore the point. Under its requirements for dairy product imports, the EU restricts the number of somatic cells permissible in raw milk used to produce imported dairy products.[8] The U.S. Food and Drug Administration (FDA) considers somatic cell levels to be a milk quality issue rather than a legitimate criterion for food safety and allows raw milk to be sold in the U.S. with higher somatic cell counts. Thus, this requirement imposed by the EU presents a burden for some U.S. exporters.

The World Trade Organization's (WTO) SPS agreement, developed during the Uruguay Round, establishes limits on policies relating to food safety, but it is clear that updates are needed to ensure that international SPS commitments keep pace with the evolving nature of international trade. The TPP and T-TIP provide logical and timely platforms to build upon the existing WTO SPS agreement to help ensure that sudden and unjustified regulatory requirements do not block trade.

Geographical Indications – Occasionally, a government will attempt to protect a name or symbol used on certain products which corresponds to a town, a region, or a country. These are termed "geographical indications" or GI, and they may act as a certification or verification that the product possesses certain qualities, is made according to traditional methods, or enjoys a certain reputation due to its geographical origin. CDI supports the use of legitimate, properly defined GIs. However, U.S. exporters are finding inexplicable applications of GIs at increasing rates in an apparent effort to impede imports of dairy products or carve-out market access for a country's own producers. The EU is among the more abusive in its interpretation and application of GIs, maintaining that terms which originated in Europe should be reclaimed, no matter how widespread the use of the terms today. We are opposed to efforts by the EU to protect generic terms that are not linked to specific locations (e.g., "feta") or to protect terms in translation (e.g., "parmesan"). We applaud those members of Congress who agree with this stipulation and signed the letter to this effect, dated May 9, 2014 and sent to Secretary Vilsack and Ambassador Froman.

[8] US Trade Representative, "2013 Report on Sanitary and Phytosanitary Measures"

Internal Barriers

Much of the industry’s attention has been focused on negotiating FTAs that result in a level playing field with competitors. However, it would be an oversight to not mention that some of the factors that limit the ability of the U.S. to participate in more international trading opportunities are endogenous, i.e., impediments that have been created and exist internally. In the report issued to the Innovation Center for U.S. Dairy, Bain & Company highlights several factors that may hinder the U.S from becoming an emerging force in dairy product exports. These include items that should be eliminated or reformed, like the U.S. regulated milk pricing programs, as well as items that need to be improved, such as risk management tools, product innovation, processing capabilities, (to meet customer product specification requirements), pursuit of beneficial trade treaties and market/competitive analysis.

Why Trade Should be Embraced, Not Feared

Government policies that lead to protectionism ignore the very real fact that with successful trade negotiations come opportunities for growth and prosperity. Negotiated FTAs should be enforceable, follow international trade laws, and establish terms of trade that will make the agreement relevant for years if not decades. More specifically, FTAs should be structured such that agriculture is neither an afterthought, nor a sector to be sacrificed in favor of better terms of trade for other industries. The agreements should not contain discriminatory “carve-outs” for specific sectors. Furthermore, a proper FTA should specify dispute resolution for agriculture, just as would be found in the chapters that pertain to other industries. Because of its prominence and ambitious intent, the TPP and T-TIP negotiations offer prime opportunities to set forth an appropriate standard for agriculture in these and future FTAs.

Use of Trade Agreements to Address Issues

The U.S. dairy industry firmly supports an ambitious trade agenda, starting with negotiations for TPP and T-TIP. The TPP is a once-in-a-lifetime opportunity to relax the constraints that are restricting consumers in the fastest growing markets of the world. A successful outcome would be the elimination of tariffs in the key markets of Japan and Canada across all dairy products without exception. As an auxiliary function of the agreement, TPP can be used to establish a precedential framework for dairy tariff commitments in future FTAs, including T-TIP. Basically, a successful effort that provides comprehensive access to the Canadian and Japanese dairy markets will create a standard for other countries that join TPP as it expands. Several potential key dairy markets, including Indonesia, Thailand, Philippines, and even China have expressed an interest in joining TPP.

TPP negotiations promise to be carefully watched with a host of strategies being discussed among representatives from participating countries. Some countries have already noted that they will consider taking their sensitive categories “off the table,” both in market access and in concessions, if other countries are seen to be protecting their own sensitive categories. It is easy to see how quickly an FTA can deteriorate if the goal of comprehensive, zero-tariff access to each other’s markets is not maintained. Ensuring that Japan and Canada commit to real, significant, meaningful and comprehensive market access is critical to the success of TPP.

There are high expectations for the results of T-TIP negotiations as well, and an agreement must be reached in which the EU makes a serious attempt to remove existing barriers to trade. Both the TPP and T-TIP need to be mindful of the future as well and should contain the foresight to prevent tomorrow's problems from arising as soon as the ink has dried on the agreements.

Well-negotiated FTAs will provide clear and positive benefits for the U.S. dairy industry, an outcome that is very much achievable in TPP and T-TIP. But countries other than the U.S. stand to gain as well. In fact, all dairy exporters in the TPP negotiations should be encouraged to join forces and push for an ambitious outcome. Reaching a critical mass of support for maximum market access will apply the pressure necessary to break down the tariff and non-tariff barriers in these markets. A point to note in these negotiations is that the U.S. market access provided to other countries must be in a fair and balanced relationship to the access the U.S. gains in the world market.

Finally, if the U.S. is to take its place as an initiator of future FTAs and participate in world markets as a preferred supplier in high-quality dairy products, Trade Promotion Authority (TPA) must be renewed. The agricultural provisions of the two bills that seek to renew TPA i.e., S.1900 and H.R.3830, provide clear direction to U.S. negotiators about critical priorities that should be pursued in trade negotiations. We strongly support their inclusion and urge the Committee to move forward with consideration of this legislation that is critical to the approval of balanced trade agreements.

Point of View

CDI supports the inclusion of the dairy category, the inclusion of all dairy products and the complete elimination of dairy tariffs in all FTAs. The TPP and T-TIP are likely the most important trade agreements in a generation, and, if properly negotiated for the dairy industry, they may individually and collectively accomplish all of these goals. Both agreements promise significant economic benefits for American businesses, workers, farmers, ranchers, and service providers if negotiated market access is real and barriers to trade are reduced. CDI fully supports all efforts to get TPP and T-TIP signed into law, provided that our concerns on dairy are addressed satisfactorily. CDI also supports two Congressional bills (*S. 1900: Bipartisan Congressional Trade Priorities Act of 2014 – Baucus (D – MT); H.R. 3830: Bipartisan Congressional Trade Priorities Act of 2014 – Camp (R – MI)*) which would re-enact TPA, a critical tool for establishing a strategic vision of U.S. trade policy and shaping the goals for future U.S. trade negotiations.

About California Dairies, Inc.

California Dairies, Inc. (CDI) is the largest member-owned milk marketing and processing cooperative in California producing 47 percent of California's milk. Co-owned by more than 410 dairy producers who ship 18 billion pounds of milk annually, CDI is a manufacturer of quality butter, fluid milk products and milk powders, which are available in all 50 United States and in more than 50 foreign countries. CDI has an ownership position in DairyAmerica and in Challenge Dairy Products, Inc. (a wholly owned subsidiary of CDI).

CDI Key Facts:

- CDI represents 12% of US dairy exports
- Produces 385 million pounds of butter per year – 21% of U.S. supply
- Produces 775 million pounds of milk powder per year – world's leader in Skim Milk Powder
- Exports 50 million pounds of butter/AMF to 31 countries – 13% of U.S. milkfat exports
- Exports 375 million pounds of milk powders per year to 51 countries – 48% of U.S. milk powder exports
- Began exporting cream cheese in March 2014

Andrei Mikhalevsky is the president and CEO of California Dairies, Inc. (CDI). Andrei joined CDI at the start of 2012 bringing more than 35 years of leadership experience to the role. Previously, he held the position of managing director of global ingredients and foodservice at Fonterra Cooperative Group Ltd., (NZ), the world's largest dairy exporter, responsible for developing and building Fonterra's global business to business partnerships. Andrei's career began at Campbell Soup Company and progressed to Georgia Pacific Corp. and Symrise Inc., (DE). He is a graduate of Stetson University with a Bachelor of Business Administration in finance. In addition, he has attended the Food Executive Program at the University of Southern California.