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Hearing of the U.S. International Trade Commission on
Investigation No. 332-607
Nonfat Milk Solids: Competitive Conditions for the United States and Major Foreign Suppliers

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Good morning, Chair Karpel and Members of the Commission. My name is Becky Rasdall Vargas and I am the Senior Vice President for Trade and Workforce Policy at the International Dairy Foods Association. As you may know, IDFA represents the nation's dairy manufacturing and marketing industry, which supports more than 3.05 million jobs that generate $52 billion in direct wages and $779.45 billion in overall economic impact. IDFA's diverse membership ranges from multinational organizations to single-plant companies, from dairy companies and cooperatives to food retailers and suppliers. Together, they represent most of the dairy products and ingredients produced and marketed in the United States and sold throughout the world.

On behalf of IDFA, I wish to express our support for the investigation you are undertaking into the competitive conditions for U.S. suppliers of non-fat milk solids (NFS). Today, I am going to first review what products are encompassed in NFS and their global markets, then I will review global policies impacting their pricing, and offer a summary of some of our economic analysis of the impact of those pricing policies, and finish with a discussion on the impact of USMCA on the competitiveness of NFS.

Globally, dairy production is concentrated among five major markets: the United States, Canada, the European Union, New Zealand, and Australia. Production of NFS, generally referring to the materials that remain after removing the water and fat from milk, is no different. NFS are produced primarily in those markets, and, for the purposes of this testimony, we consider the following products to best represent the category of NFS: non-fat dry milk (NFDM) and the related product skim milk powder (SMP);[1] whey protein concentrates (WPC) and modified whey;[2] whey protein isolates (WPI);[3] casein and caseinates;[4] and milk protein concentrates (MPC)[5] and milk protein isolates (MPI).[6]

Policy environments within major dairy-producing markets vary greatly when it comes to pricing policies for NFS. The European Commission does not involve itself in NFS prices

[1] HS chapter 0402.01.
[2] HS chapter 0404.10.
[3] HS chapter 3502.20.
[4] HS chapter 3501.
[5] HS chapter 0404.90 and 3504.
[6] HS chapter 3504.

outside of an intervention program for buying excess SMP at a fixed price to support price stability. Presently, the sole role of the New Zealand government in setting the price is an ancillary review of pricing methodology established by the private sector. Australia does not have pricing policies established by the government.

Importantly, the United States and Canada are the only two major markets in which the government has a primary role in setting the price of NFS products, albeit these policies function completely differently. In the United States, the U.S. Department of Agriculture sets minimum prices for milk components using methodologies that can be and were recently updated with input from producers, processors, academics, and market analysts across the dairy supply chain. These regulations were intended to ensure a balanced milk supply and prices across the United States, including the many regions with virtually no milk production.

In Canada, the government established a supply management system that sets prices and production quotas in Canada's dairy industry based, in part, on demand for butterfat. Butterfat is a key ingredient used to produce butter, cheese, ice cream, and other products. As demand for butterfat has increased, Canada has adjusted milk production quotas to meet this demand. However, demand for butterfat in Canada has far outpaced demand for NFS, which are a necessary byproduct of butterfat production. Thus, by setting production quotas to meet Canada's demand for butterfat, Canada has created and maintained a consistent surplus of NFS. This surplus has steadily increased in recent years and, as confirmed by the government of Canada, is projected to continue to grow. Thus, the surplus will increase as long as Canada's supply management is designed to satisfy domestic butterfat demand.

Such a surplus leaves Canadian processors in the difficult position of having to find an outlet for a product or risk losing all profits by dumping the product. Therefore, to clear its surplus of NFS, Canada's supply management system has maintained artificially low, below-market prices. Canada's milk class pricing system, which assigns national farmgate prices for dairy products based on their end uses, had categorized skim milk components, including MPC and SMP produced, under classes that impose below-market price, which has effectively eliminated the demand for higher-priced U.S. NFS within Canada. Additionally, because these low prices are cross-subsidized by above-market prices for other dairy products, Canada's supply management system essentially subsidizes NFS production and NFS exports to the United States and third countries. As a result, cheap Canadian NFS products also displace U.S. products in third country markets.

Given the wide spectrum of differences in policy structures, we also conducted an economic evaluation of the Canadian NFS market relative to the global market, to determine whether the clear differences in policies indeed have an impact on pricing and therefore competition – a concern IDFA members have expressed. While we intend to submit a more extensive report in our post-hearing submission, there are some key findings worth highlighting here:

- When reviewing a like-for-like comparison of farmgate milk prices paid in each major dairy producing region, Canadian producers are paid a 38% higher price for their product than the average producer in the US, EU, or New Zealand since 2021.

- In particular, Quebec's prices are consistently the highest, while U.S. Class IV prices tend to be the lowest of those evaluated.
- Similarly, Canadian exports of milk protein products overall have risen dramatically since 2021, enabled by lower protein input costs.
- And finally, Canada doubled its exports of MPC 80+ between 2021 –2024, most of this product going to the U.S.

As a final matter, it is important to discuss four key policies prescribed by the U.S.-Mexico-Canada Agreement (USMCA) that were intended to support NFS competitiveness in North America, but which ultimately have not achieved their objectives.

The first is the USMCA pricing formula, which attempted to eliminate the artificially low prices for NFS within Canada, achieved the net result of tying U.S. and Canadian prices for NFS together in a single pricing formula. Yet remarkably, even with the prescription of USMCA ensuring U.S. Class IV prices are connected to Canada's NFS pricing (called "Class 4a" pricing), Canada still manages to sell milk to NFS processors at the lowest price in the world, while paying Canadian producers far more than others for the same products. Canada achieved this by manipulating factors within the formula to maintain artificially low prices for NFS prior to entry into force of USMCA.

The second is Canada's tariff-rate quota (TRQ) administration, which Canada uses to further maintain its control over domestic dairy pricing and production by strictly limiting imports of dairy products, including NFS imports, into the country. The United States had negotiated access to the Canadian dairy market under the USMCA via TRQs. However, Canada's administration of its dairy TRQs has been problematic, resulting in chronically under-utilized quota allocations. The NFS quotas are particularly under-utilized, rarely exceeding 10% utilization of the available quota allocation across NFS product quotas. Based on input of our member companies, low utilization is a result of both Canada's poor administration of the program as well as poor competitive conditions for U.S. NFS within Canada, which deter potential exporters and reduce demand for U.S. NFS within Canada.

The third is the export thresholds established by USMCA, which were imposed on Canadian exports of MPC, SMP, and infant formula (all NFS products). However, in the period since the USMCA was implemented, Canadian exports of milk protein products that are not classified under the HS codes captured by the USMCA export thresholds have significantly increased. These products include higher-concentrate MPCs and milk protein isolates, ultra-filtered (UF) milk, SMP blends, bulk infant formula or nutritional powder, and whey protein products. Exports of these products, which are derived from Class 4a products, have greatly increased since the passage of the USMCA and far exceed the export thresholds established for Class 4a products.

Finally, the fourth set of USMCA policies designed to facilitate NFS competitiveness, but which have not, are transparency. Canada's implementation of new price classes prior to entry into force and lack of transparency related to its NFS exports are just two examples, but more importantly, enforcement of Canada's international commitments has long been hindered by a lack of transparency surrounding the administration of its supply management system. To

address USTR's request, we believe the Commission will need to gain insight into, and report on, the obfuscated aspects of Canada's supply management system, including pricing protocols, TRQ allocation, and export threshold avoidance or evasion.

In conclusion, based on our years of research and experience, we believe the greatest single threat to the competitiveness of NFS are Canadian supply management policies (meaning both pricing and TRQ administration). These policies ensure Canadian NFS prices are not tied to global market pricing as other countries' prices are. The ongoing and persistent threat of Canada's oversupply of NFS creates not only an imbalanced, distorted global marketplace for NFS, but critically, the incentive for Canada to continue its distortive policies as a prop to its NFS sector. They also supplant imports and allow Canada to export far greater amounts of milk protein than was designed by USMCA. At best, U.S. NFS processors must work all the harder to overcome such distortions of NFS in the global marketplace; at worst, they lose market share and are supplanted entirely by subsidized Canadian processors. We therefore urge the Commission to focus its investigation on obtaining transparency related to Canadian NFS policies, clarifying their market manipulations, and demonstrating the detrimental impacts of such policies on global NFS markets.

Thank you again for the opportunity to testify and I welcome any questions you may have.