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U.S. DAIRY TRADE SITUATION AND OUTLOOK

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U.S. DAIRY TRADE SITUATION AND OUTLOOK

Edward V. Jesse and William D. Dobson*

Last year was an eventful one in dairy trade circles. Buoyed by strong world dairy markets in general and especially for milk proteins, the value of U.S. dairy product exports in 2004 jumped by 50 percent over 2003. The mountain of nonfat dry milk (NDM) held by USDA's Commodity Credit Corporation was reduced to a more manageable large molehill as world market prices for milk powders promoted record-setting U.S. sales of NDM to foreign buyers. U.S. dairy imports increased by almost the same volume as exports, leaving the U.S. dairy trade balance at approximately negative $900 million.

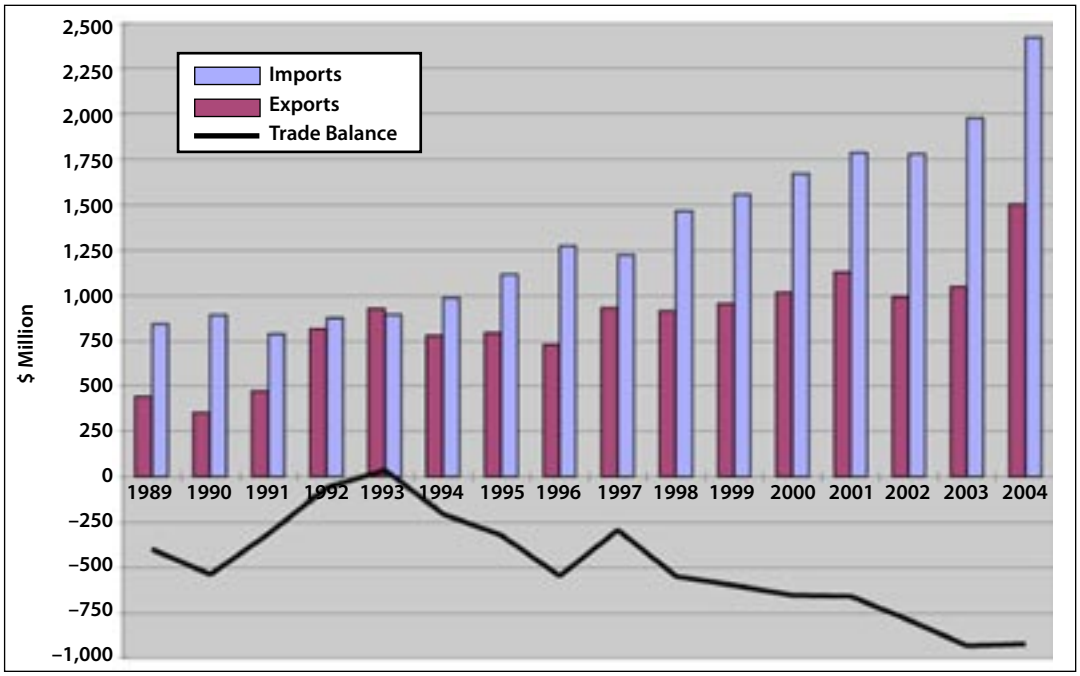
Despite strong opposition from dairy production interests, Congress approved a bilateral trade agreement with Australia, a significant exporter of dairy products to the United States. Another Free Trade Agreement, with Chile, became effective in 2004 and negotiations on other trade agreements with implications for dairy continued. Progress was made on the Doha Round of the WTO multilateral agreement with the publication of a skeleton "framework for modalities" that will focus negotiations during 2005. These negotiations will very likely increase market access for dairy products, reduce export subsidies and constrain the use of domestic price and income support programs for dairy producers.

In this paper, we review the dairy trade situation in 2004 and speculate on dairy trade issues in the near term. We begin by detailing U.S. dairy trade statistics for 2004 by product and commodity. We then summarize current and pending international trade negotiations, both bilateral and multilateral.

TRADE UPDATE[1]

U.S. dairy exports and imports both set records in 2004. Export value totaled about $1.5 billion, up nearly $500 million from 2003 and almost $400 million more than the previous record set in 2001. The value of U.S. dairy imports was about $2.4 billion. This was up from 2003 by about the same as exports, leaving the U.S. dairy trade balance at about $900 million. Last year was the first since 1997 that the difference between dairy imports and exports did not increase (Figure 1).

FIGURE 1. U.S. Dairy Trade Balance



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U.S. Dairy Exports

Record dairy exports in 2004 were led by nonfat dry milk (NDM). NDM export value was $444 million, $264 million (150 percent) more than in 2003. Export volume, at 231 thousand metric tons (MT), was only about twice that of 2003, indicating that part of the record NDM export value was due to higher prices. In fact, the implicit price of NDM exports in 2004 was $0.87 per pound compared to $0.72 per pound in 2003.[2]

FIGURE 2. Composition of U.S. Dairy Exports, 2004

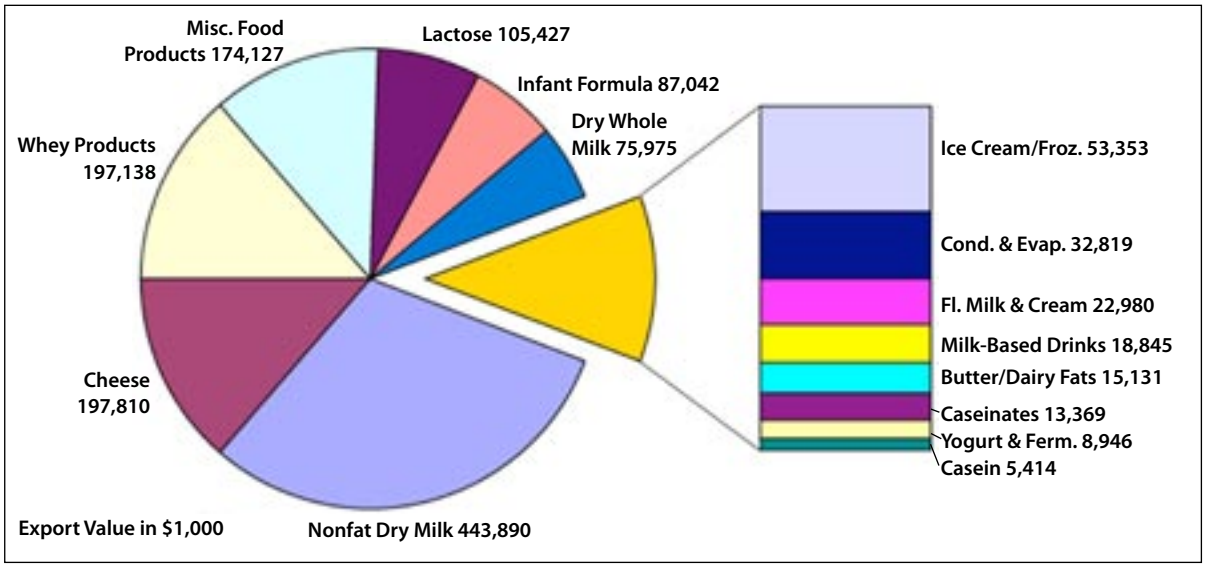


FIGURE 3. Value of U.S. Dairy Exports, 2004 vs. 2003

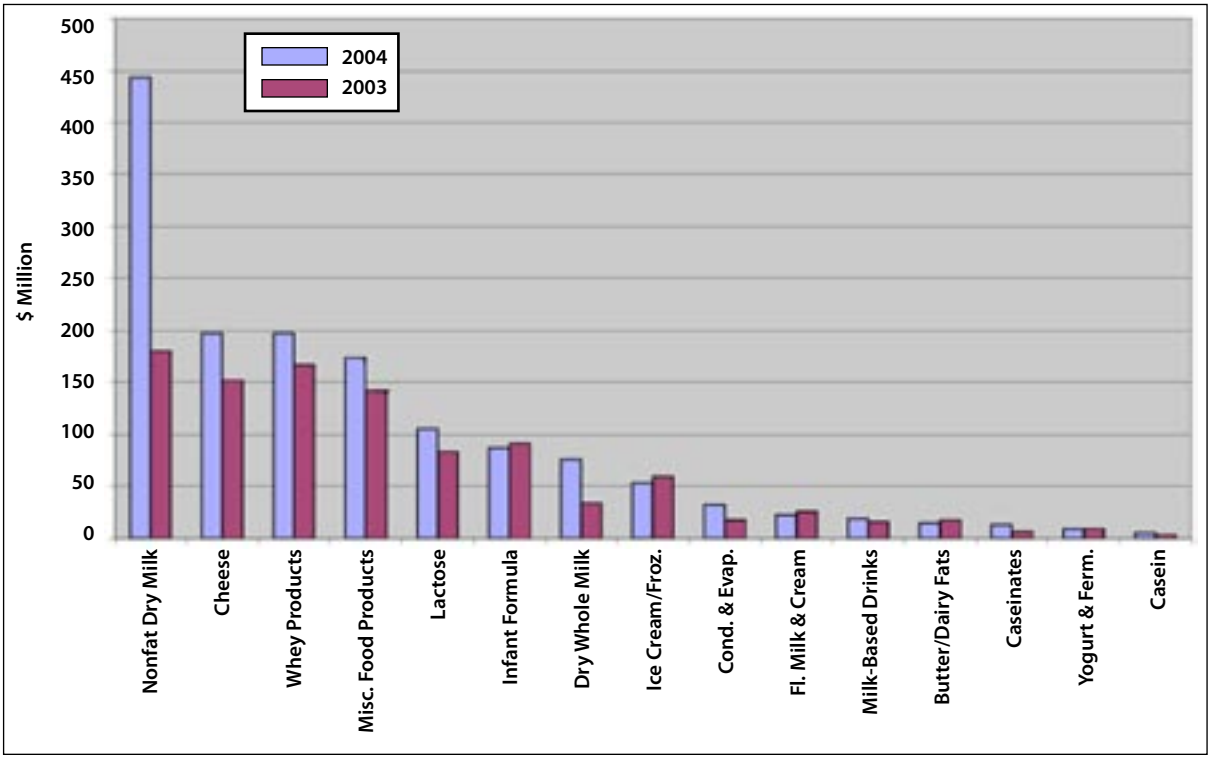
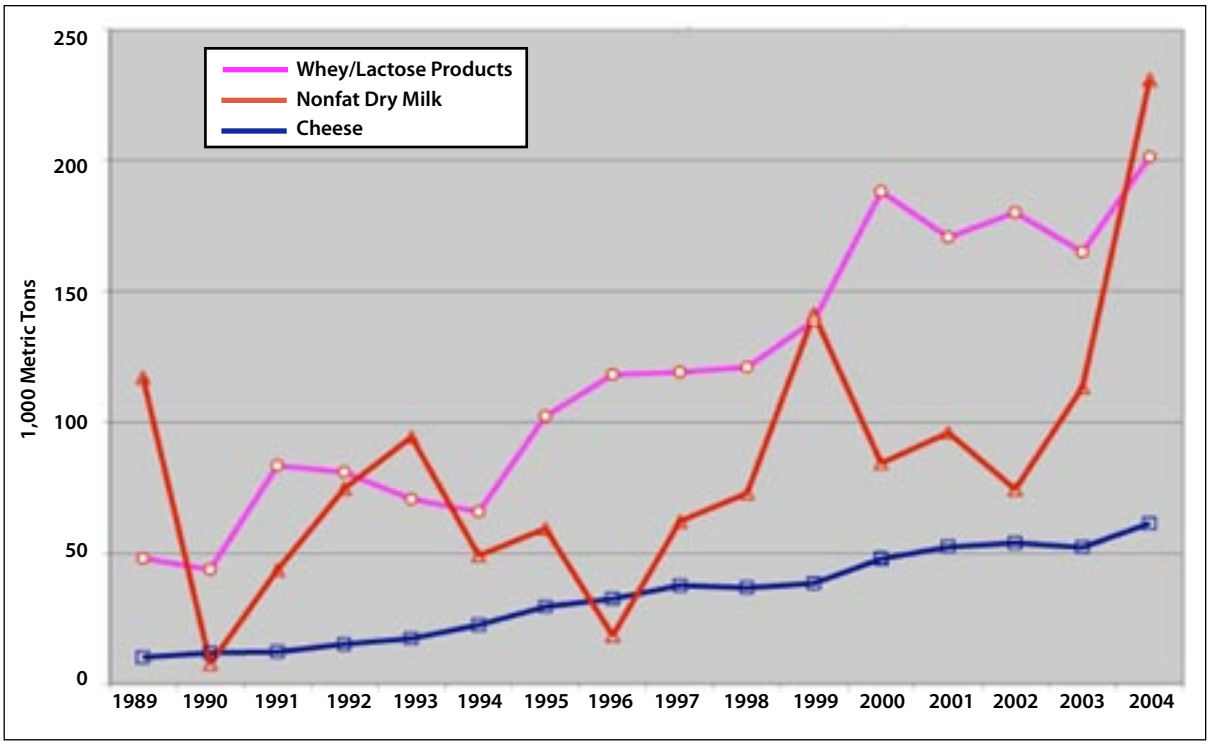


FIGURE 4. Volume of Leading U.S. Dairy Product Exports



Exports of cheese, whey, lactose and dairy-based food preparations were also up in 2004, though not nearly as dramatically as NDM. There was a surprising increase in exports of whole milk powder, which may reflect a definitional change more than an increase. Infant formula and ice cream exports were down slightly in 2004. The export value of each of the other categories was less than $50 million (Figures 2 and 3).

Looking at the leading bulk commodities, NDM export volume in 2004 exceeded whey export tonnage for the first time since 1999 (Figure 4). Note that whey exports have increased fairly steadily in comparison to the more erratic growth for NDM exports.

Cheese export tonnage has shown an even steadier rate of growth than whey. Because of much higher unit value, the value of cheese exports has exceeded whey since 2001 despite a much smaller volume of exports.

The U.S. shipped dairy products to 145 foreign countries in 2004 (Figure 5). Mexico was the largest single market by export value, accounting for more than a quarter of total foreign dairy product sales. Canada and Japan were the second and third largest buyers. Filling out the top ten export markets were six Pacific Rim countries and Cuba, which purchased NDM valued at $26 million in 2004.

Sixty-six countries purchased U.S. NDM in 2004 (Table 1). The top ten countries accounted for 81 percent of total export value. Mexico was by far the largest buyer.

Mexico's purchases of U.S. NDM are highly variable from year to year, depending on domestic production and the availability of NDM from other exporters. Since

FIGURE 5. Destination of U.S. Dairy Exports, 2004

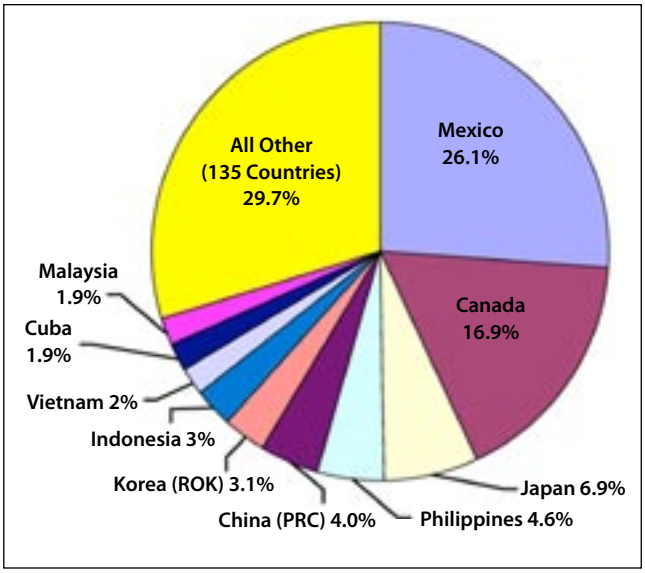


TABLE 1. Top Ten U.S. Export Markets for Nonfat Dry Milk, 2004

Country	$1,000	% of Total
Mexico	172,262	38.8
Philippines	44,632	10.1
Indonesia	27,588	6.2
Cuba	25,692	5.8
Malaysia	23,144	5.2
Vietnam	15,720	3.5
Guatemala	12,209	2.8
Thailand	11,617	2.6
El Salvador	10,353	2.3
China (PRC)	8,143	1.8

TABLE 2. Top Ten U.S. Export Markets for Cheese, 2004

Country	$1,000	% of Total
Mexico	64,766	32.7
Japan	26,790	13.5
Canada	25,066	12.7
Korea (ROK)	16,255	8.2
Philippines	6,081	3.1
Taiwan	3,672	1.9
The Bahamas	3,524	1.8
Egypt	3,100	1.6
Hong Kong	3,091	1.6
Saudi Arabia	2,918	1.5

1995, U.S. NDM exports to Mexico have ranged from less than 2,000 tons (1997) to last year's 90,000 tons.

Among the 87 countries that purchased U.S cheese in 2004, Mexico, Japan and Canada accounted for 59 percent of the total export value (Table 2). In contrast to NDM, U.S. cheese exports to Mexico have shown strong, steady growth, increasing from 4,600 tons in 1995 to 2004's 21,400 tons.

Major export markets for whey (including lactose) in 2004 were Canada, Mexico, China and Japan. These four countries accounted for more than two-thirds of U.S. whey shipments (Table 3). The rest went to 67 other countries.

TABLE 3. Top Ten U.S. Export Markets for Whey Products, 2004

Country	$1,000	% of Total
Canada	32,903	20.4
Mexico	28,291	17.5
China (PRC)	28,236	17.5
Japan	18,906	11.7
Philippines	7,567	4.7
Korea (ROK)	7,209	4.5
Taiwan	5,948	3.7
Thailand	5,751	3.6
Chile	2,940	1.8
Vietnam	2,529	1.6

U.S. Dairy Imports

U.S. dairy imports are more concentrated among products than exports. Cheese, dairy-based food preparations and concentrated milk proteins (MPC, casein and caseinates) made up 89 percent of import value in 2004 (Figure 6).

Cheese imports reached nearly $1 billion in 2004, up $100 million over 2003. Dairy-based food product imports were up almost $200 million. Imports of milk proteins were up a total of $85 million due to higher prices—volume in 2004 was off by 20,000 tons (11 percent). Butter imports in 2004 were more than double year-earlier levels due to very high U.S. prices (Figure 7).

FIGURE 6. Composition of U.S. Dairy Imports, 2004

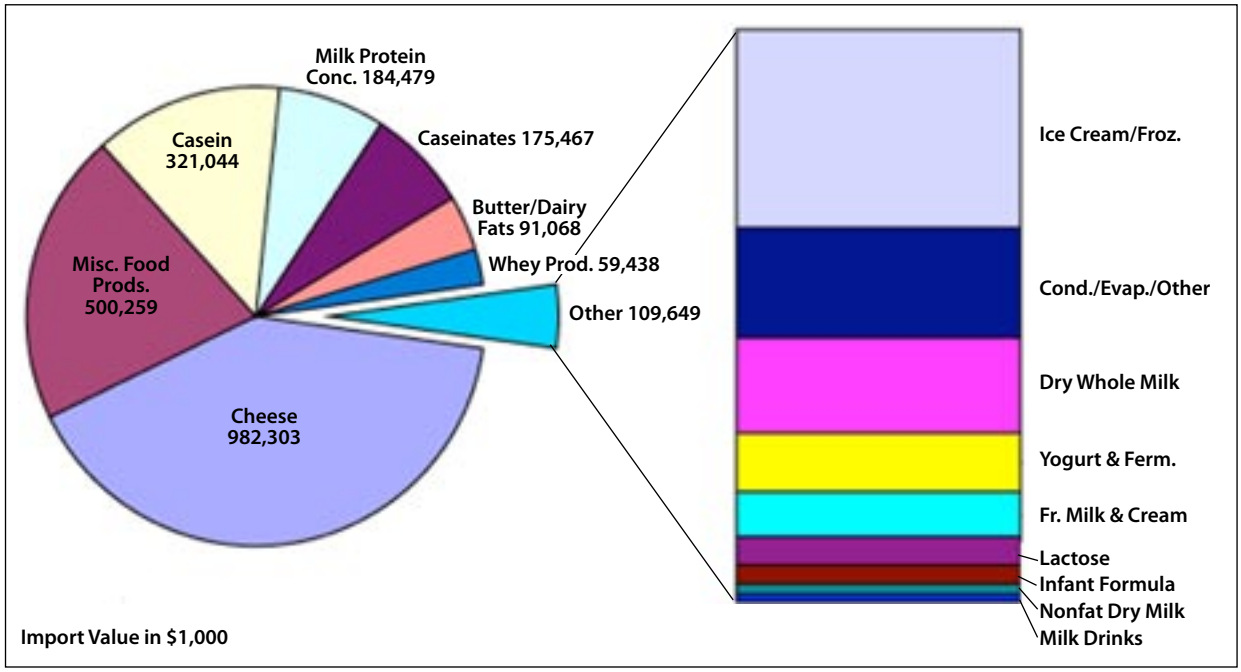


FIGURE 7. Value of U.S. Dairy Imports, 2004 and 2003

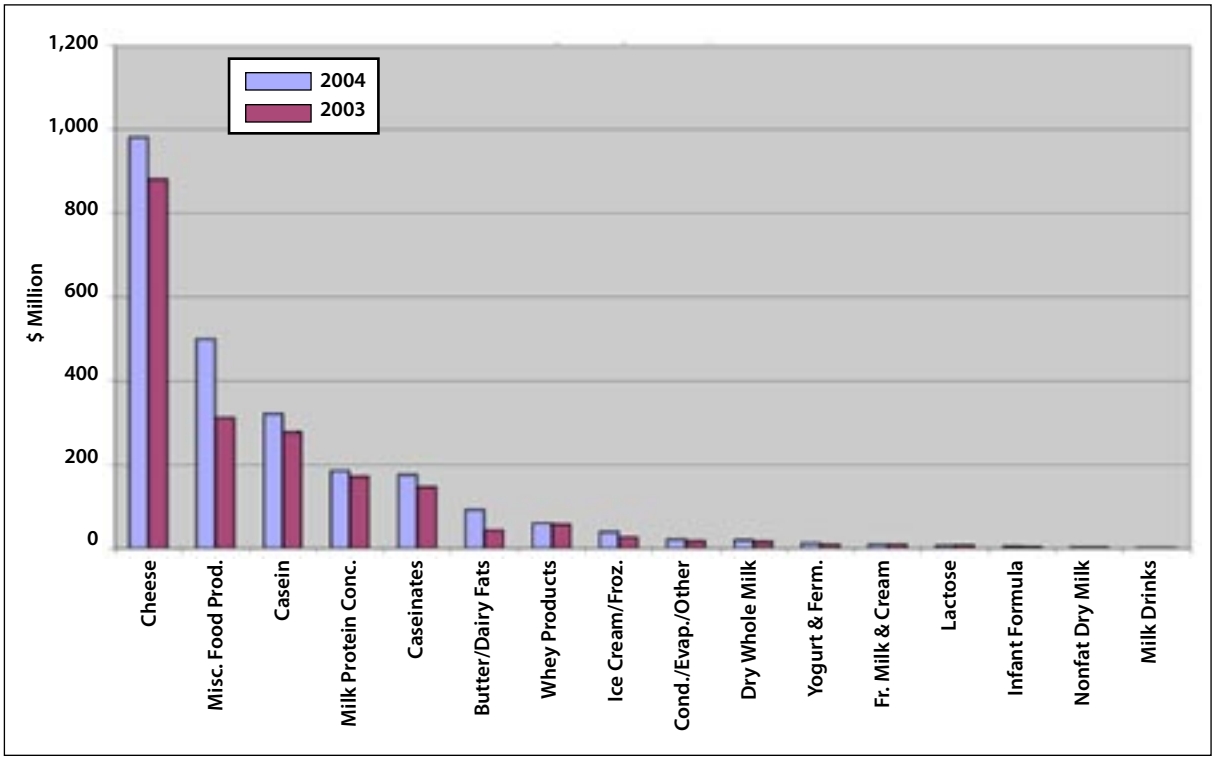
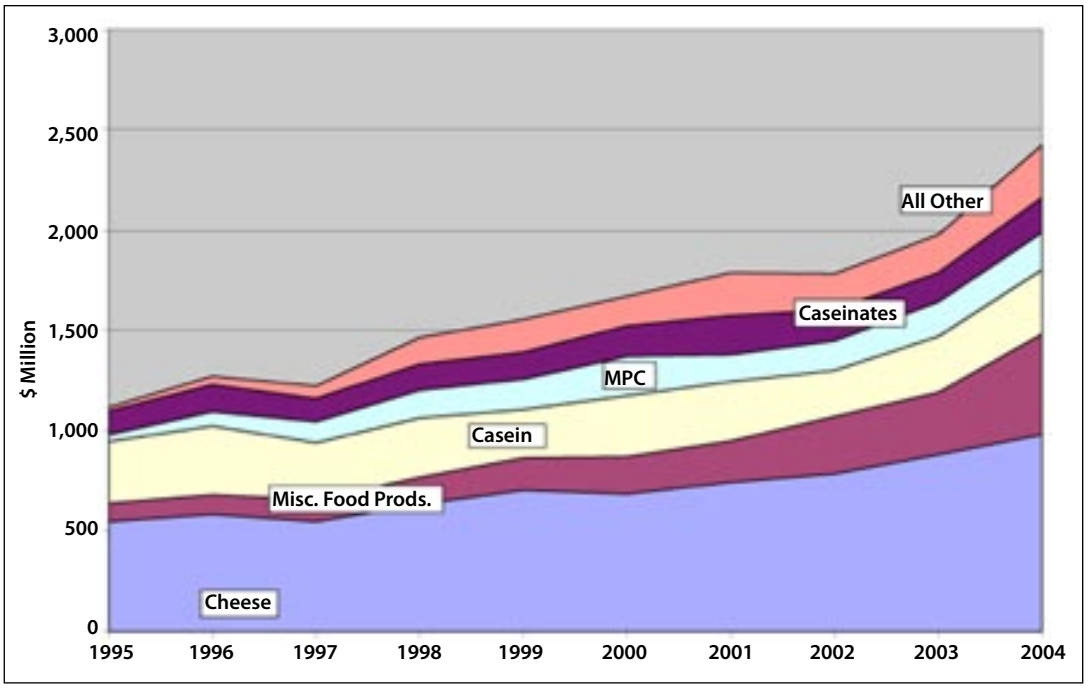


FIGURE 8. U.S. Dairy Product Imports, 1995–2004



Over the last 10 years, the value of U.S. dairy imports increased from $1.1 billion to $2.4 billion. Cheese and dairy-based food imports each grew by more than $400 million. The increase in milk protein imports was $220 million (Figure 8).

In 2004, the U.S. imported cheese from 60 countries. Italy was the top importing country measured by value (Table 4).

New Zealand was the leading source of U.S. cheese imports by volume. European cheese imports tend to have a much higher unit value than those from Oceania. The value per metric ton for cheese imported from Italy, France, Switzerland, Spain and Greece was more than $6,000 (about $2.75 per pound). Cheese from New Zealand and Australia, along with that from Uruguay, Bulgaria and Lithuania, fetched less than $3,000 per ton.

The total volume of cheese imported in 2004 was 214 thousand metric tons, or 472 million pounds. This represents 5.3 percent of the 8.85 billion pounds of cheese produced in the U.S. in 2004.

Milk protein concentrate, casein and caseinate imports come primarily from Oceania. New Zealand accounted for about two-thirds of MPC import value in 2004 and Australia about one-eighth. Sixteen other countries, mostly Western and Eastern Europe shipped the remaining 21 percent (Figure 9).

Casein and caseinate imports are less geographically concentrated than MPC and more were sourced from Europe than Oceania in 2004. Ireland, New Zealand, Australia, India and France were the five leading suppliers of casein, accounting for 92 percent of total U.S. imports. The Netherlands, New Zealand, Germany, Poland and France together supplied 89 percent of U.S. imports of caseinates (Figure 10).

FIGURE 9. Source of U.S. Milk Protein Concentrate Imports, 2004

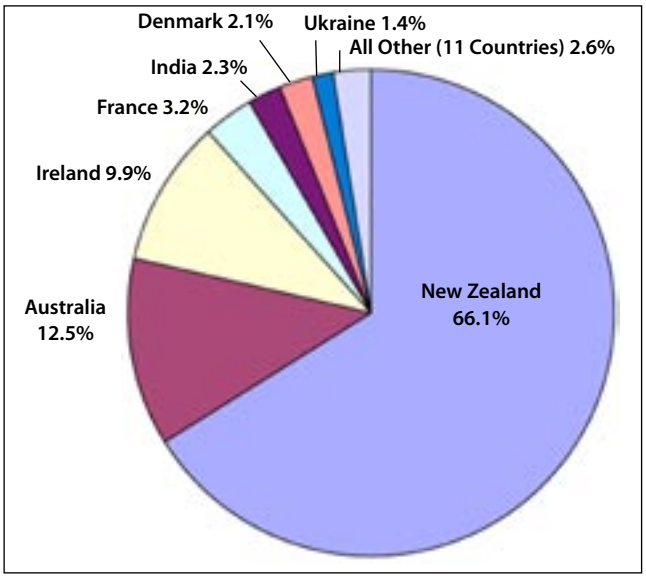
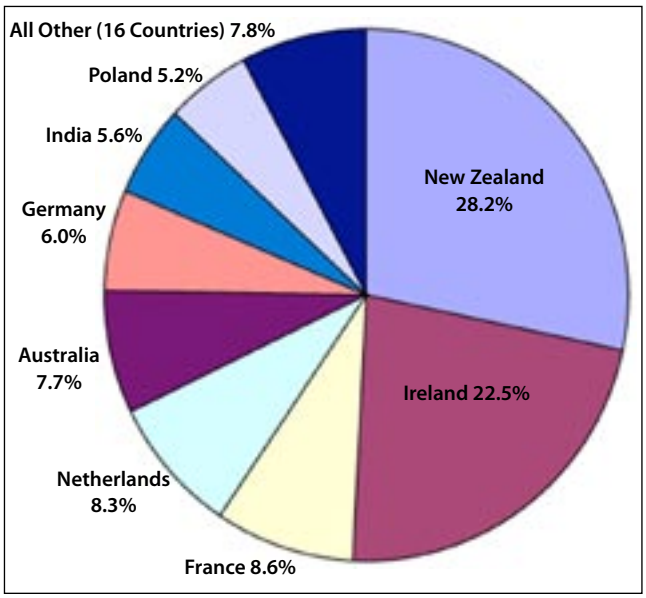


TABLE 4. U.S. Cheese Imports for 2004: Top 20 Country Sources

Country	Volume MT	Value $1,000	Percent of Total Volume	Percent of Total Value	Imputed Value per MT $
Italy	32,080	223,532	15.0%	22.8%	6,968
France	21,741	131,361	10.2%	13.4%	6,042
New Zealand	35,873	97,149	16.8%	9.9%	2,708
Denmark	14,380	70,935	6.7%	7.2%	4,933
Netherlands	12,231	55,715	5.7%	5.7%	4,555
Switzerland	7,108	46,847	3.3%	4.8%	6,591
Norway	7,237	33,840	3.4%	3.4%	4,676
United Kingdom	6,650	33,336	3.1%	3.4%	5,013
Finland	8,618	33,331	4.0%	3.4%	3,868
Canada	5,438	31,750	2.5%	3.2%	5,839
Germany	8,084	28,968	3.8%	2.9%	3,583
Argentina	8,911	28,957	4.2%	2.9%	3,250
Australia	10,111	24,492	4.7%	2.5%	2,422
Spain	2,246	21,377	1.0%	2.2%	9,519
Ireland	5,323	20,972	2.5%	2.1%	3,940
Greece	2,207	14,070	1.0%	1.4%	6,376
Uruguay	4,107	11,820	1.9%	1.2%	2,878
Poland	2,952	11,321	1.4%	1.2%	3,835
Bulgaria	3,409	10,205	1.6%	1.0%	2,994
Lithuania	3,874	10,168	1.8%	1.0%	2,625
Total, All Countries	214,076	982,303			4,589

FIGURE 10. Source of U.S. Casein & Caseinate Imports, 2004

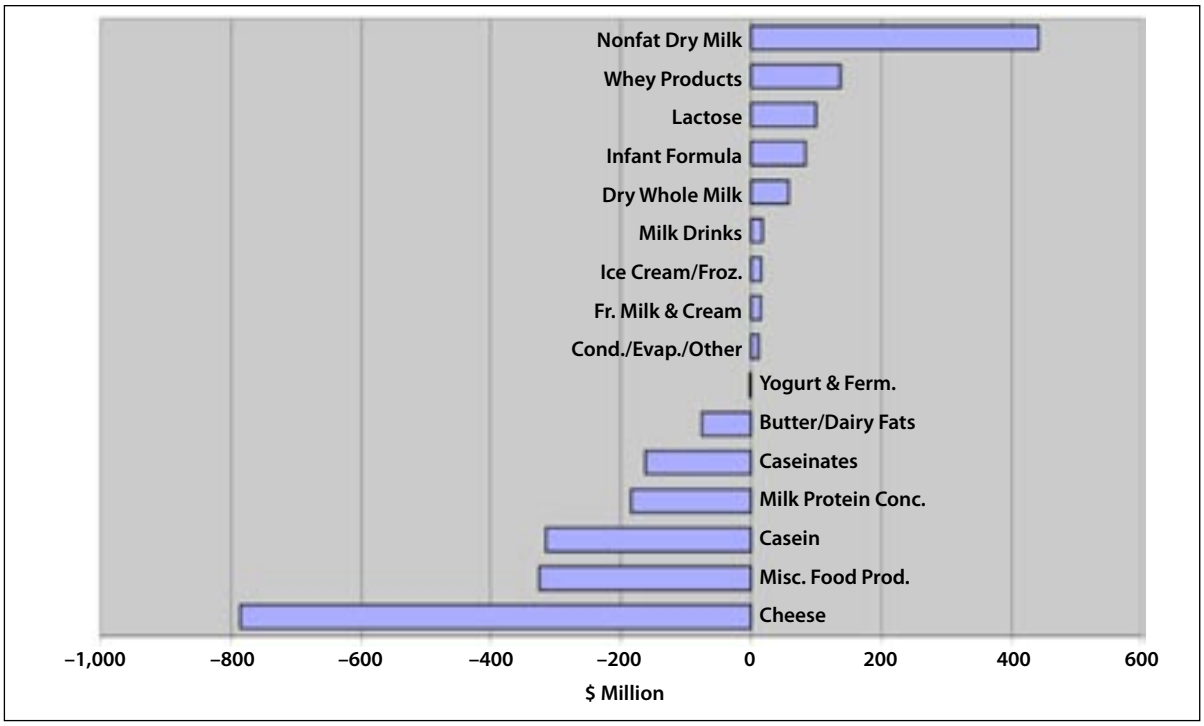


Looking at the U.S. dairy trade balance by product category value shows a strong positive trade balance for NDM, whey and lactose. The largest trade deficits were in cheese, dairy-based food products and milk proteins. The value of cheese imports in 2004 was five times the value of exports (Figure 11).

What Caused Record U.S. Dairy Trade in 2004?

Record U.S. dairy exports in 2004 were primarily the result of strong world markets for skim milk solids, especially NDM. In late 2003, the world market price for NDM rose above USDA's purchase price under the dairy price support program. The price continued to rise throughout 2004, reaching more than one dollar per pound in November. U.S. stocks of NDM at the end of 2003 were nearly half the world total, leaving the U.S. in a very favorable position to take advantage of higher world prices.

FIGURE 11. U.S. Dairy Trade Balance by Product, 2004



NDM was in short supply because of lower milk production in some major countries and only modest gains in others. In the expanded European Union (EU25), the 10 new accession countries collectively increased milk production by about 2 percent.[3] But a decline of 1 percent in the other member countries (EU15) caused a net decrease of 0.6 percent relative to 2003. Australia's milk output continued to suffer from the effects of the 2002–03 drought. Production in Australia's 2004–05 dairy year is expected to be down about 1 percent from last year and 10 percent under the pre-drought 2001–02 level.[4] Recent reports suggest that 2004–05 New Zealand milk production could be down as much as 5 percent from last year compared to 4–5 percent year-to-year gains shown earlier in the decade.[5]

NDM and butter are together a kind of a dairy surge tank, buffering large changes in milk production. Reduced milk production means less milk moving to butter/powder as other, higher-valued demands on the milk supply are filled. For example, EU25 cheese production for 2004 was up 3 percent despite lower milk production. EU25 butter production was down 1.7 percent and NDM production was down 12.7 percent from 2003. EU NDM stocks fell from 225,000 MT to 78,000 MT between 2003 and 2004 as domestic needs were met from storage. Changes in cheese, butter and NDM production in Oceania were similar.

U.S. dairy exports were also helped by the weak U.S. dollar. In 2004, the dollar continued its slide against the Euro and other major foreign currencies that began in mid-2002 (Figure 12). The Euro stayed above $1.20 during all of 2004, rising to as high as $1.36 by yearend. While trade in bulk dairy products is commonly denominated in U.S. dollars, trade in dairy-based food products is probably not. Hence, the lower-valued dollar made these products cheaper to overseas consumers.

By itself, the weak dollar should have discouraged U.S. dairy imports. But there were other factors that more than offset the effect of changing exchange rates. Most important was the very high prices for cheese and butter during most of 2004.

Butter and cheese prices skyrocketed in the spring of the year, with cheddar cheese prices on the Chicago Mercantile Exchange hitting record highs in the month of April and butter prices exceeding two dollars per pound (Figure 13). Prices softened later in the year, but annual averages were well above recent levels. These high prices attracted imports because the difference between U.S. domestic prices and international prices exceeded over-quota tariff rates.

FIGURE 12. Foreign Currency Exchange Rates

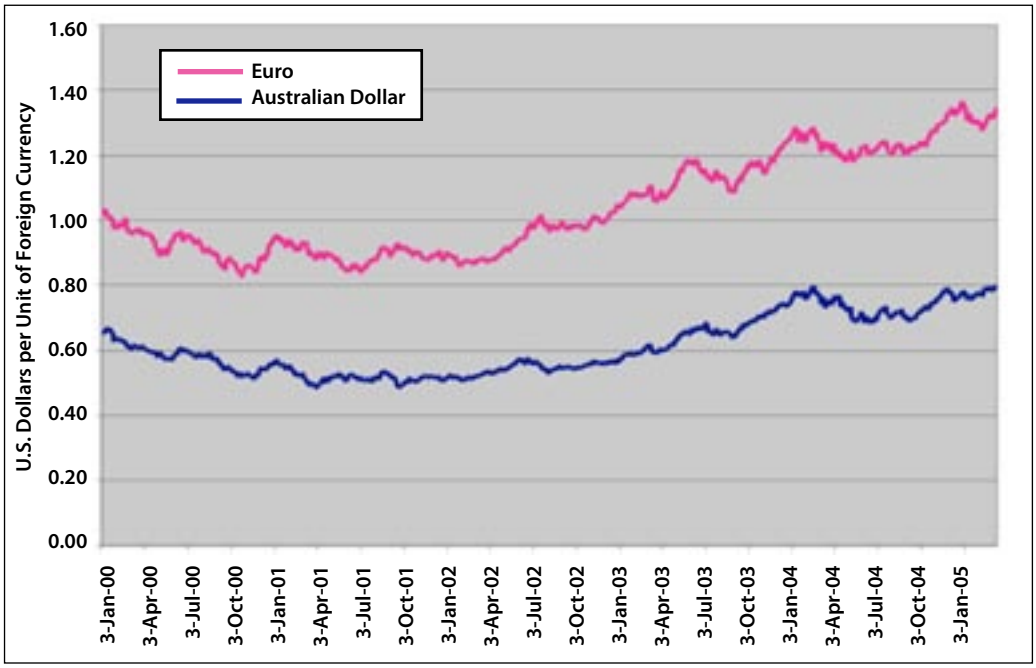
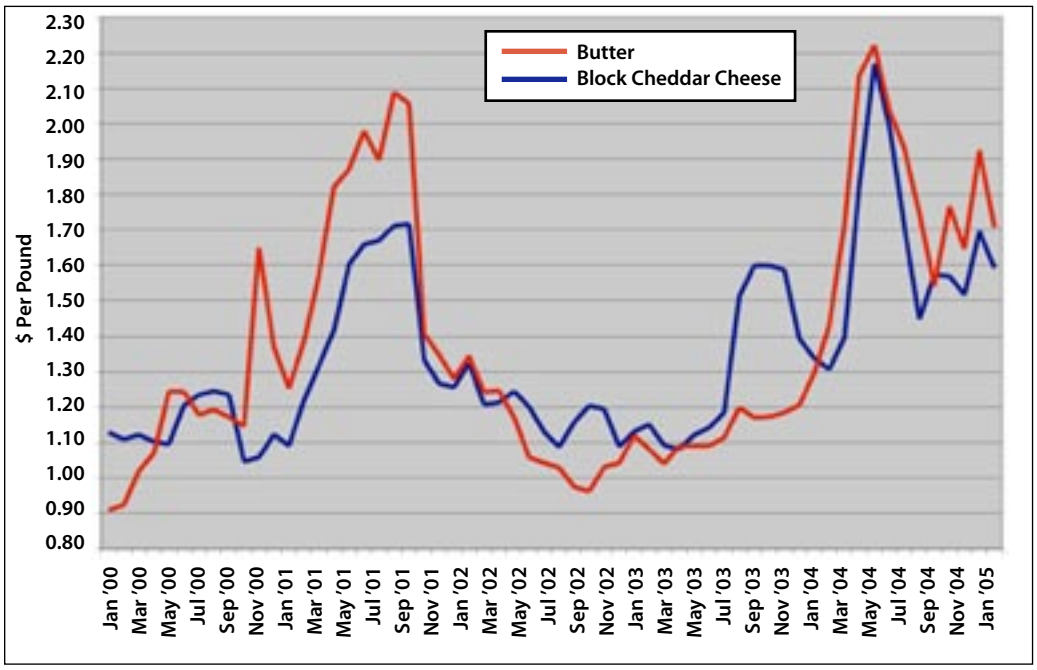


FIGURE 13. Chicago Mercantile Exchange Monthly Prices



U.S. Dairy Trade Outlook for 2005

USDA's Foreign Agricultural Service (FAS) expects world milk production to increase about 3 percent in 2005, compared to a 2.3 percent gain in 2004. While this might appear to be bearish for world dairy prices, much of the marginal gain in production will be used to rebuild very low stocks of butter and NDM, so supplies of these products will not be onerous. Continued growth in cheese demand should take a larger portion of the milk supply, further limiting milk going into butter and NDM. The net effect will be world prices for cheese,

butter, NDM and whole milk powder close to those observed in 2004, at least for the first half of the year.

Strong world NDM prices should allow the U.S. to continue to export NDM commercially, further reducing stocks. January 2005 NDM exports were 28,000 tons valued at nearly $60 million ($0.93 per pound). Volume and value of U.S. NDM exports in January 2005 were more than three times last year's January values, continuing the blistering pace set in 2004.

The weak U.S. dollar should also help promote U.S. dairy exports in 2005. While there is no clear consensus, macroeconomic forecasts generally show a continuing deterioration of the value of the dollar against the Euro, some suggesting a Euro value as high as $1.45 by year's end.

U.S. dairy imports in 2005 are expected to hold near 2004 levels. Cheese and butter prices in the U.S. will not likely reach the high levels they attained in 2004, providing less incentives to import at over-quota levels. The weak dollar should serve to better balance our trade in processed dairy food items, which deteriorated in 2004.

MPC and casein/caseinate imports will likely reach or exceed last year's volume. Strong prices for NDM will prevent wholesale substitution of NDM for MPC in standardizing milk used to make cheeses without an FDA standard of identity. For many dairy and food product uses, NDM is not a good functional substitute for MPC and casein.

NEW BILATERAL AND REGIONAL TRADE COMPACTS[6]

For a variety of reasons, some political and some economic, the U.S. has pursued trade liberalization, partly through individual country and regional free trade agreements (FTAs). Until recently, the North American Free Trade Agreement (NAFTA), which involves preferential trade among Canada, Mexico and the U.S., was the principal FTA affecting U.S. dairy trade.[7] In 2004, an FTA with Chile became effective and an FTA with Australia was approved by Congress and went into effect on January 1, 2005. In addition, negotiations on an FTA between the U.S. and six Central American countries was completed in August 2004 (CAFTA-DR) and negotiations over a broad FTA stretching across North, South and Central America continued.

The U.S.–Chile Free Trade Agreement

The U.S.–Chile FTA was the first FTA entered into by the U.S. with a South American country. Negotiations were prompted by a flurry of FTAs entered into by Chile with other countries that threatened to close out U.S. exports.

Before the U.S.–Chile FTA became effective, U.S. firms faced a 6 percent tariff on dairy exports to Chile. While this was a relatively small tariff, U.S. firms did operate at a disadvantage to dairy firms in Argentina and Uruguay, which had location advantages along with their free trade agreements with Chile.

Under the U.S.–Chile FTA, the 6 percent tariff on dairy products will be phased out over four years for cheese, butter, whey and yogurt products, and over eight years for liquid milk and cream, condensed milk, evaporated milk, whole milk powder and NDM. The U.S. will employ Tariff Rate Quotas (TRQs) to limit access by Chilean firms to the U.S. market. The quotas will be expanded by 7 percent per year and eliminated after 12 years.

The U.S.–Chile FTA will have a limited impact on U.S. dairy trade. The two countries are minor trading partners. U.S. dairy exports to Chile were valued at $7.5 million in 2004 and imports were $3.6 million. This compares with dairy exports to NAFTA countries of $613 million and imports of $423 million. And despite the more favorable tariff treatment that U.S. firms acquired under the FTA, Argentina and Uruguay are likely to remain the principal foreign suppliers of dairy products to Chile. Chilean dairy exports to the U.S. are expected to increase only modestly from 2004 levels, which were equivalent to less than 0.2 percent of all U.S. dairy imports.

The U.S.–Australia FTA

Under the U.S.–Australia FTA, all U.S. exports of agricultural products enter Australia duty-free effective January 1, 2005. This was a very minor conces-

sion on Australia's part since prior to the FTA, the country had imposed TRQs only for cheese and unmanufactured tobacco. Exports of U.S. processed foods, soybeans, other oilseed products, fresh and processed fruits, vegetables, nuts, and alcoholic beverages are expected to increase the most as a result of the FTA.

The FTA expanded Australia's access to the U.S. dairy market by building on the framework established by the Uruguay Round WTO agreement. Under the U.S.–Australia FTA, Australia will receive two types of access to the U.S. dairy market for TRQ items. First, the country-specific dairy TRQs established under the Uruguay Round WTO Agreement will receive duty-free tariff treatment. Second, Australia will obtain additional access to the U.S. dairy market via the establishment of specific FTA duty-free TRQs that will expand over time as noted in Table 5.

TABLE 5. Duty-Free Tariff Rate Quotas (TRQs) for Australian Dairy Products under the U.S.-Australia FTA.*

Product Category	First Year Duty-Free TRQ** metric tons	Yearly Expansion of TRQ %
American Cheese	500	3
Cheddar Cheese	750	3
European-Type Cheese	2,000	5
Goya Cheese	2,500	5
Swiss Cheese	500	5
Cheese, Other (NSPF)	3,500	5
Nonfat Dry Milk	100	3
Other Milk Powders	4,000	4
Condensed/Evaporated Milk	3,000	6
Butter/Butterfat	1,500	3
Creams/Ice Cream	7,500	6
Other Dairy Product	1,500	6
Total	27,350	

*Source: USDA-FAS, U.S.-Australia FTA Commodity Fact Sheet for Dairy.

**TRQ in addition to that provided under the Uruguay Round WTO trade agreement

Analysts for the Office of the U.S. Trade Representative estimate that first-year quota increases for Australia will allow for additional imports valued at $41 million. This represents about 2 percent of the value of all U.S. dairy imports in 2004.

U.S. dairy groups and other agricultural groups lobbied for defeat of the agreement in the U.S. Congress. They pointed to the large and growing U.S.–Australian dairy trade deficit. Australian dairy exports to the U.S. increased steadily from $29 million in 1995 to $94 million in 2004. In contrast, U.S. dairy exports to Australia were valued at only $5.4 million in 2004. Despite opposition from agricultural groups, the FTA received strong support in the U.S. Congress. This suggests that trade agreements carrying large benefits for the manufacturing sector and other nonagricultural sectors of the economy will garner substantial support from the Congress. However, U.S. agricultural groups were able to secure TRQs that limited access to the U.S. market for sensitive products.

The U.S.–Central America–Dominican Republic Free Trade Agreement (Pending)

The U.S. signed the Central America Free Trade Agreement (CAFTA) with Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua in May 2004. The Dominican Republic joined the CAFTA nations in August to form the CAFTA-DR. The U.S. Congress has not yet approved this agreement, and there is some opposition. In particular, the politically powerful U.S. sugar lobby strongly opposes expanded U.S. imports of sugar.

Currently, U.S. dairy exporters face a range of restrictive TRQs and import tariffs in CAFTA-DR countries. Costa Rica and Guatemala, in particular, maintain high tariff protection for their domestic dairy industries. WTO-bound tariffs for the different countries ran as high as 100 percent.

Despite the relatively high border protection used by the CAFTA-DR countries, U.S. dairy exports are significant. The overall trade balance has increased from $14 million in 1995 to $71 million in 2004 (Table 6).

If and when the CAFTA-DR becomes effective, the agreement will provide for a gradual opening of dairy markets over a 20-year period. This will be accomplished through reciprocal duty-free TRQs under which

TABLE 6. U.S. Dairy Trade Balance with CAFTA Countries, 2004

Country	Exports $1,000	Imports $1,000	Trade Balance $1,000
Guatemala	27,264	2,145	25,119
El Salvador	17,593	284	17,309
Dominican Rep.	16,286	446	15,840
Honduras	7,140	700	6,440
Nicaragua	9,488	3,755	5,733
Costa Rica	1,766	1,163	603
Totals	79,537	8,493	71,044

the U.S. and CAFTA countries (but not the Dominican Republic) provide essentially equal amounts of gross access to their dairy markets. In the five Central American countries, the duty-free TRQs will expand at an annual compound rate of 5 percent per year. In the Dominican Republic, the TRQs will grow at a simple rate of 10 percent annually.

The access to the U.S. dairy market provided by the CAFTA-DR would be small in the beginning years of the agreement. For example, the year one TRQ access to the U.S. market for cheese would be only 1.3 percent of total 2004 U.S. cheese imports and 0.1 percent if U.S. cheese consumption. The comparable values for butter are 1 percent and 0.04 percent, respectively. Moreover the safeguard provisions included in the agreement could be used to limit surges in imports. Hence, the impact of the agreement on U.S. dairy product prices and U.S. farm milk prices is expected to be small.

The Free Trade Agreement of the Americas (Pending)

This is an ambitious regional trade agreement that would liberalize trade among 34 Western Hemisphere countries with a combined population of 800 million. FTAA negotiations began in the mid-1990s, and are scheduled to be completed in 2005. However, negotiations appear to be stalled, with strong resistance within both the U.S. and many South American countries.[8]

The latest FTAA draft agreement (November 2003) contains few specifics regarding agricultural trade liberalization. In general, market access within member countries would be increased, export subsidies eliminated and state trading enterprises phased out. Reduction of domestic support is left to WTO negotiations.

The U.S. is by far the largest milk producer among FTAA countries, accounting for 53 percent of combined 2003 production. However, Argentina and Brazil are both significant players and have considerable potential for expanded dairy production and exports. Argentina's milk production has lagged recently with that country's economic turmoil, but Argentine dairy farmers have enviable costs of production because of their low-cost grazing system and exports have been significant in the past. Brazil's milk production is used primarily to feed its large population, but if used for dairy, newly-developed agricultural lands in central Brazil could make the country a significant net exporter.

The U.S. maintains a large positive trade balance with other potential FTAA members in the aggregate. U.S. dairy imports exceeded exports for only four FTAA countries in 2004: Brazil, Uruguay, Argentina and Canada. Canada accounted for more than 70 percent of FTAA country exports to the U.S (Table 7).

UPDATE ON WTO NEGOTIATIONS

The current round of World Trade Organization negotiations (the Doha WTO Round) nearly stalled during the Cancun Ministerial meetings in 2003. However, an agreement regarding a *framework for modalities* for further agricultural negotiations was reached in August 2004. The framework for modalities provides the format, but not the specifics, for eliminating export subsidies, increasing market access and ensuring that domestic farm support programs do not distort trade in agricultural products.

Eliminating Export Subsidies

Within the framework for modalities, firm commitments are made to end agricultural export subsidies by a date to be negotiated. This will spell the eventual end of the U.S. Dairy Export Incentive Program (DEIP) and the much larger and more trade distorting EU dairy export subsidies. The big uncertainty regarding export subsidies is when they will actually end. U.S. negotiators proposed in 2002 that the export subsidies be

TABLE 7. U.S. Dairy Trade Balance with FTAA Countries, 2004

Country	Exports $1,000	Imports $1,000	Trade Balance $1,000
Mexico	385,045	68,926	316,119
Guatemala	27,264	2,145	25,119
El Salvador	17,593	284	17,309
Dominican Republic	16,286	446	15,840
Haiti	12,930	110	12,820
Jamaica	12,743	1,679	11,064
Bahamas	10,537	0	10,537
Honduras	7,140	700	6,440
Peru	6,525	127	6,398
Nicaragua	9,488	3,755	5,733
Trinidad and Tobago	5,782	63	5,719
Guyana	5,816	116	5,700
Venezuela	4,629	248	4,381
Chile	7,451	3,554	3,897
Panama	3,586	0	3,586
Bolivia	2,191	0	2,191
Barbados	1,284	0	1,284
Belize	1,240	0	1,240
Ecuador	1,341	162	1,179
Grenada	1,170	0	1,170
Saint Lucia	1,122	0	1,122
Colombia	3,552	2,938	614
Costa Rica	1,766	1,163	603
Suriname	199	0	199
Saint Vincent/Grenadines	139	0	139
Dominica	111	4	107
Antigua and Barbuda	98	0	98
Paraguay	17	0	17
Brazil	5,084	9,466	–4,382
Uruguay	592	16,704	–16,112
Argentina	1,275	34,606	–33,331
Canada	228,153	353,867	–125,714
Totals	782,149	501,064	281,085

terminated five years after the Doha Round WTO agreement became effective. The French have proposed a phase-out period for dairy export subsidies lasting until 2015 or 2017.

In recent years, significant progress has been made in defining exactly what constitutes a dairy export subsidy. This is important because it will prevent disguised dairy export subsidy programs from emerging to replace those outlawed under the new WTO agreement. It will also signal what are acceptable as dairy export subsidies under the phase-out period.

Much of the progress in defining dairy export subsidies came as a result of U.S.–New Zealand challenges to Canada's dairy export subsidy programs under the WTO. The WTO panel decisions in connection with the Brazil–U.S. cotton dispute in 2004 and 2005 also have implications for U.S. dairy export subsidies.

The WTO decisions with respect to Canada's dairy export subsidies raise questions about whether producer-financed export programs for disposing of surplus NDM could be used by the U.S. dairy industry. In particular the dispute panel determined that Canada's Commercial Export Milk (CEM) program produced indirect, partly-disguised export subsidies that are not WTO legal.[9] While U.S. producer-financed export programs would not necessarily parallel the CEM program, the broadly inclusive definition of export subsidies that emerged in the Canadian case suggests that great care will be required to develop a producer-financed export program that would not attract a WTO challenge. The WTO panel reports and Appellate body reports on the Canada case give some guidance on what is acceptable under the WTO to groups planning to develop producer-financed surplus disposal export programs.

The WTO dispute settlement panels' decisions in 2004 and 2005 relating to Brazil's challenges to the U.S. cotton price support and cotton export subsidy programs also have implications for U.S. dairy export subsidy programs. The panels concluded that USDA's GSM 102 (short-term export credit guarantees), GSM 103 (intermediate-term export credit guarantees) and Supplier Credit Guarantee Program (SCGP) are inconsistent with the WTO's Agreement on Agriculture and Agreement on Subsidies and Countervailing Measures because they provide benefits (guarantees of payment) to private exporters at less than full costs. Hence, they

represent export subsidies. The panels found that this implicit subsidy applies not just to cotton, but to all commodities that benefit from U.S. commodity support programs and receive export credit guarantees. U.S. exporters of certain dairy products are eligible to use these programs.

Increasing Market Access

The framework for modalities states that tariff reductions will be made through a tiered formula that takes into account the different tariff structures of member countries. Each country will be permitted to designate "sensitive products" for special treatment. Lesser-developed countries (LDCs) will have more flexibility in designating sensitive products based on food security, livelihood security and rural development needs. LDCs receive additional preferential considerations related to tariff reductions.

More than other provisions of the framework for modalities for agriculture under the Doha Round, those related to market access suffer from a lack of specificity. In principle, there will be substantial increases in market access and deeper cuts in higher tariffs than made under the Doha Round. However, the uncertainty injected into subsequent negotiations by inclusion of special provisions for sensitive products and preferential treatment for developing countries and LDCs makes the framework for modalities on market access at best simply "a framework for negotiating some more."

Because of the lack of specificity, it is difficult to predict how much the Doha Round will expand foreign access to the U.S. cheese market. Expect some additional increase in U.S. cheese imports from the average imports recorded for 2002–2004. U.S. cheese imports rose by about 51 percent in tonnage terms from 1992–1994 (the three years immediately before the Uruguay Round WTO Agreement went into effect) to 2002–2004. However U.S. cheese imports remained at a relatively modest 5.2 percent of U.S. consumption in the latter period.

Reducing Trade-Distorting Domestic Support

There is more specificity in the framework for modalities regarding domestic support for agriculture. Trade distorting domestic support is expected to be reduced more under the Doha Round Agreement than under the Uruguay Round. Important provisions relating to domestic support are:

- Overall levels of the most trade-distorting domestic support will be substantially reduced.
- A down payment of 20% of this reduction will be made in year one of the implementation period.
- Big subsidizers will make the deepest cuts.
- Blue box (trade-distorting domestic subsidies) cannot exceed 5% of the value of a country's agricultural production during a base period to be negotiated.
- The non-trade distorting Green box subsidies are largely untouched. However, Green box payments will be reviewed to ensure that they have little or no distorting effects on trade or production.
- The *de minimus* loophole will be reduced. This loophole—which has been used by the U.S. to limit its reported Aggregate Measure of Support (AMS) payments under the Uruguay Round Agreement—will be reduced in size.[10]

In the arcane terminology of the framework for modalities, the overall base level of all trade-distorting domestic support, as measured by the final bound total AMS plus permitted *de minimis* level, and the level agreed for Blue Box support will be reduced according to a tiered formula.

The framework for modalities provisions pertaining to domestic support programs are especially pertinent to dairy. Under current WTO rules, the dairy price support program is deemed to be the most trade distorting kind of domestic support program. The WTO position is that price support programs represent a transfer from consumers to producers, whether or not the support prices are binding, and therefore a producer subsidy. In other words, price support programs have a measurable AMS cost even though no treasury payments are actually made. To the extent that price supports are accompanied by restrictive TRQs, they also indirectly limit market access. The U.S. no longer has the authority to impose quotas in order to limit imports of products (and close substitutes for products) purchased under the dairy price support program. However, current TRQs

for dairy products are based on quotas previously applied under Section 22 of the Agricultural Adjustment Act as amended (7 U.S.C. 624).[11]

The current maximum AMS permitted the U.S. is $19.1 billion. In 2001, the last year in which reporting was made, the U.S. reported an AMS (after *de minimis* exemption deductions) of $14.4 billion, $4.7 billion under the cap. The dairy price support program contributed about $4.5 billion to the total AMS. This represents 25 percent of the AMS cap and 75 percent of that portion of the AMS associated with price support programs.

The dairy price support program benefits are calculated by multiplying total U.S. milk production by the difference between the farm milk price support level of $9.90 per hundredweight and a base period world market reference price for milk used for manufacturing. The reference price is $7.25 per hundredweight, resulting in a $2.65 per hundredweight program "cost" irrespective of CCC net purchases.

The Doha Round agreement will significantly constrain farm price and income support programs and further limit exemptions. If AMS calculations under the Doha Round are computed in roughly the same way as under the Uruguay Round, then U.S. dairy price supports appear to be in trouble. However, given the uncertainty surrounding exactly how AMS will be figured under the Doha Round, it is difficult to forecast accurately how much the U.S. dairy price support program will be affected.

NOTES

1. The data used in this section are drawn from USDA's Foreign Agricultural Service's *U.S. Trade Internet System* (http://www.fas.usda.gov/ustrade/). The authors bear full responsibility for any misinterpretation of the data.
2. The implicit price is export value divided by export volume.
3. Production data are primarily from *Dairy: World Markets and Trade,* Circular Series FD 2-04, Foreign Agricultural Service, USDA, December 2004. Data for 2004 is preliminary and data for 2005 is forecasts.
4. Australia reports milk production for the year ending May 31; New Zealand for the year ending June 30.
5. *The Dairy Australian,* Dairy Australia, March–April 2005.
6. This and the following section (Update on WTO Negotiations) are largely a condensation of a more comprehensive analysis of bilateral and multilateral agricultural trade negotiations published as a separate Babcock Institute Discussion Paper 2005-2 entitled *Free Trade Agreements and the Doha Round of WTO Negotiations—Implications for the U.S. Dairy Industry*.
7. Since Canada exempted itself from NAFTA provisions related to trade in dairy products, NAFTA is, in effect, a bilateral U.S.–Mexico free trade agreement as it applies to dairy trade.
8. See, for example, http://www.stoptheftaa.org/ and http://www.getusoutcom.com/.
9. Canada's Commercial Export Milk program involves producers contracting with manufacturers to sell over-quota milk that could only be used to produce dairy products for export. These contract milk prices are usually well below production costs.
10. Basically, the *de minimis* provision allows exclusion from the AMS calculation of agricultural support payments for individual commodities if the amount of support does not exceed 5 percent of the farm value of the commodity. It also allows exclusion of non-product specific payments (e.g., irrigation subsidies, disaster payments) if these payments in total do not exceed 5 percent of the *total* farm value of agricultural production.
11. Section 22 is still on the books, but as part of its commitments under the Uruguay WTO agreement, the U.S. cannot use this authority to impose quotas or fees on dairy products originating from any WTO member country.