Written Testimony by the

National Milk Producers Federation

to the International Trade Commission

Concerning ***the U.S.-Trans-Pacific Partnership Free Trade Agreement: Advice on Probable Economic Effect of Providing Duty-Free Treatment for Imports Investigation***

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The National Milk Producers Federation (NMPF) appreciates this opportunity to provide testimony on the proposed Trans-Pacific Partnership (TPP) trade agreement between the United States, New Zealand, Australia, Peru, Chile, Vietnam, Singapore and Brunei. NMPF is the national farm commodity organization that represents dairy farmers and the dairy cooperative marketing associations they own and operate throughout the United States.

Our position seeking exclusion of U.S.-New Zealand trade in dairy products from the TPP is not a reflection of our overall trade beliefs and agenda. NMPF has been and remains a strong supporter of balanced trade initiatives. Rather, our position here is a unique response to a unique situation. It is important to make clear that NMPF is not opposed to the overall TPP FTA concept. Although we do not believe this is the best avenue to bring about expanded trading opportunities with the most significant Asian economies, we do not oppose the attempt to pursue new trade relationships in an area of the world where FTAs involving other countries are rapidly proliferating.

It is particularly unfortunate, however, that at this stage the vast majority of significant markets involved in the TPP FTA are ones with whom the U.S. already has an FTA. This is the case for Australia, Chile, Singapore and Peru, leaving only New Zealand, Vietnam, and Brunei as the countries with which we would be creating new trade agreements. If anything, this agreement therefore has the potential to undermine the gains made in some areas of U.S. trade agreements.

For instance, currently the U.S. has an FTA with Peru, but New Zealand and Australia do not. Certainly efforts on our part to help the major dairy exporting powers of Australia and New Zealand gain access to the Peruvian market only undermines the benefits granted to the U.S. as part of the U.S.-Peru FTA. This eroding of U.S. preferential access into the Peruvian market should be clearly accounted for in ITC's analysis.
For example, in May 2006, the ITC estimated that the U.S.-Peru FTA would nearly double Peruvian dairy imports from the U.S., from $8.1 million to nearly $15 million. However, had this ITC analysis included equal access for Peruvian imports from Oceania as afforded imports from the U.S., the results would likely have been significantly different. Moreover, in years prior to implementation of the U.S.-Peru FTA, U.S. market share on a product weight basis increased from 7 to 17 percent during 2004–08. However, in 2009, the first year of implementation of the U.S.-Peru FTA, U.S. share dropped to 10 percent. This demonstrates that changing market conditions can rapidly erode benefits of a bilateral FTA when the differences in market access between the U.S.

Importance of U.S.-New Zealand Dairy Trade Exclusion and Dairy Market Dynamics

In order to avoid dramatic economic harm to the U.S. dairy industry, it is vital that all U.S.-New Zealand dairy trade be excluded from the TPP. Our industry faces a very unique anti-competitive situation in New Zealand. One company, Fonterra Co-operative Group Limited (Fonterra), controls over 90% of the milk produced in that country, meaning that we are essentially pitted against a monopoly power.

New Zealand as "Forced" Exporter:

New Zealand's dairy industry is extremely export-driven. Per the most recent FAS GAIN report on New Zealand's dairy industry, its milk production in the most recent marketing year (MY 2008/2009) was a record 16.6 million metric tons, up 9% over the prior marketing year. Although such strong gains in milk production do not occur every year in New Zealand, its industry clearly continues to expand over time and that same FAS report notes the country's potential for continued milk expansion over the next 10 to 15 years.

In addition, storage capacity constraints, pooled payment procedures, and capital constraints incentivize New Zealand's exporters to maximize sales of each season's production within the current accounting year. The impact of these constraints on global prices was demonstrated during the 2008/09 milk production season. As New Zealand's milk production rapidly recovered from drought, soft global demand slowed sales. Company owned storage capacity was insufficient to handle the increasing inventories and additional storage space had to be leased. So, rather than continue to incur increased storage costs, production was aggressively priced to increase sales and maximize the amount of the 2008/09 season's production that would be sold during the current accounting year.

Historic Preferences Created Current Global Power Position:

Further exacerbating this lopsided competitive position, Fonterra has had the benefit of being created less than a decade ago from the ashes of New Zealand's old State-Trading Enterprise, the New Zealand

These investments enhance Fonterra's near monopolistic control of New Zealand milk supplies to the global dairy market. As a result, its ability to increase revenue at the expense of U.S. dairy producers via monopolistic-style price discrimination by shifting products from low-value markets to the high-value U.S. market is likely to increase under a TPP FTA that provides New Zealand with increased access to the U.S market. Fonterra's ability to price discriminate stems specifically from its operating practice of making export sales to a wide variety of international buyers at a variety of returns per unit of milk utilized, with additional sales being made for increasingly lower returns, to the extent necessary to sell all of its members milk production during any specific year. The returns from these sales are then paid to its member producers at an average, uniform rate per unit of milk production. Thus no particular volume of milk production controlled by Fonterra competes with any other volume within its entire operating control. In contrast, U.S. companies producing dairy products are much more atomistic with respect to selling those products in world markets. None can afford to export products for much less than the competing price in the U.S. domestic market, and so excess production and inventories can only be cleared at the margin through a reduction in the domestic price, which reduces prices received by all dairy farmers.

Review of average unit values of New Zealand exports adds further support to the claim that Fonterra's nearly monopolistic control of New Zealand raw milk supplies provides it with the ability to use monopolistic-style price discrimination in the global market. During 2009, the export unit value of New Zealand's exports to the U.S. averaged $4,065 per metric ton. Among the top 20 destinations for New Zealand dairy exports, only exports to Japan had an export unit value greater than $4,000 ($4,051 per metric ton) and only exports to Vietnam exceeded an average export unit value of $3,000 per metric ton (these export unit values exclude fluid milk exported under HTS 0401). Increased access to the U.S. market via a TPP FTA would allow New Zealand access to additional U.S. product categories. As discussed earlier, evidence strongly indicates that Fonterra would use this new opportunity to shift product from low-value markets to the high-value U.S.

the replacement rate drops to 43 percent. Therefore, analysis that evaluates the benefits of increased U.S. exports to replace New Zealand exports diverted to the U.S. market resulting from a TPP FTA should be carefully considered.

New Zealand's range of control over dairy markets world-wide could only be expected to grow further beyond its already dramatic levels if it is granted access to one of the world's largest markets for dairy products.

The level to which the early advantages given to New Zealand's largest dairy company and their remaining influence have altered global dairy trade, as well as the ability of Fonterra to control dairy product sourcing from a wide range of countries, is extremely troublesome to the U.S. dairy industry as U.S. negotiators consider expanding access to the U.S. dairy market for New Zealand. Fonterra's ability to make sure strong use of its preferences in order to leverage a strong global supplier position is also a detriment to U.S. exports as our industry seeks to compete in other markets against such an unnaturally strong player.

Dim Prospects for Significantly Improved New Zealand Competition:

New Zealand is currently reviewing this bedrock competition legislation for its dairy industry, the Dairy Industry Restructuring Act, which helps foster at least some small degree of competition from other dairy companies in New Zealand. A proposal currently exists to tilt the requirements under DIRA further against competition, however, by increasing the payment rates required of independent processors to Fonterra, the dominant industry player. In addition, recent FAS reports estimate that – if certain competitive benchmark provisions are left unaltered – DIRA is likely to expire entirely within roughly the next two years. So even the minimal regulatory measures that New Zealand currently has in place to help stimulate some limited level of competition in that country's dairy sector will likely soon be abolished.

dramatic trade imbalance would only be further exacerbated by the inclusion of U.S.-New Zealand dairy trade in the TPP FTA.

Some have suggested that because the U.S. dairy industry has become a significant exporter, that therefore it is in its own interest to avoid seeking an exclusion in an FTA. We agree that the U.S. has expanded exports and became more competitive in recent years when we faced relatively high global prices and an environment undistorted by the European Union's dairy export subsidies. Last year our industry also did an admirable job under the circumstances of maintaining exports against heavy European export subsidies (with much more limited assistance from the U.S.'s Dairy Export Incentive Program) and considerably lower global prices throughout most of 2009.

However, the uniquely anti-competitive situation in New Zealand whereby one single company is permitted to control over 90 percent of the country's milk production and more than 40% of global dairy trade in key product areas creates a unique market advantage. Given that situation, our industry believes there is simply no alternative to address these exceptional circumstances aside from a total exclusion of all U.S.-New Zealand dairy trade under this TPP.

Impact of Inclusion of U.S.-New Zealand Dairy Trade in TPP

The negative impact of these additional imports from New Zealand on the U.S. dairy industry would be tremendous. Our estimates are that milk prices received by producers would drastically drop and gross revenues received by U.S. dairy farmers would plunge by a cumulative $20 billion over the first 10 years of the FTA if U.S. dairy restrictions on exports from New Zealand are fully phased out in the TPP FTA.

These negative impacts would result from increased imports from New Zealand of the principal dairy products whose importation is currently restricted by tariff-rate quotas (TRQs), including nonfat dry milk (skim milk powder), dry whole milk (whole milk powder), butter, anhydrous milk fat (AMF), and various

A large quantity of dairy farmers, totaling several thousands of them, mostly smaller and medium family farms, would be forced out of business by the end of this period, and the industry would undergo very significant consolidation. Following a period of adjustment, the U.S. domestic market would be supplied by considerably fewer, larger farms and by a greatly expanded volume of imports from New Zealand.

This major adjustment will also adversely affect manufacturers, which use raw milk as their main ingredient. The lack of milk supply and the large quantities of already processed products will force hundreds of processors out of business with the consequently loses of jobs primarily in rural areas of the United States. It is noteworthy that many dairy processors – particularly those relying most strongly on fresh U.S. milk for their production of dairy products as opposed to imported ingredients – are also strongly opposing expanding U.S. trade with New Zealand.

End users of dairy products will be the primary beneficiaries by simply importing large quantities of dairy products for further processing. And in fact, within the realm of dairy processors, the inclusion of U.S.-New Zealand dairy trade would have additional important negative repercussions through the defacto encouragement of greater usage of imported dried dairy products instead of the use of fresh, U.S. milk. This would disadvantage those sectors of the American dairy processing industry that have made a commitment to sourcing fresh milk as a key quality ingredient in their dairy products.

Bottom Line: U.S.- New Zealand Dairy Relationship

Although we would certainly very much like to see a different situation, it's simply a reality that nothing can be done to make the New Zealand market as large and as appealing to U.S. exporters as the U.S. market is to New Zealand's exporters. The inclusion of U.S.-New Zealand dairy trade within the TPP FTA would only give New Zealand access to the richest and one of the largest dairy markets in the world.

Chilean FTA is largely phased-in at this stage with many dairy tariffs already at zero and only one year remaining before the rest are ultimately eliminated. The Peru FTA was only very recently negotiated and we firmly believe that our negotiators obtained the best possible outcome on dairy products that was to be had while maintaining an adjustment period to allow for gradual industry adjustments to a situation of ultimately open trade. We are very satisfied with the terms of the Peruvian FTA and believe its first year in effect, 2009, operated smoothly.

Finally, the construction of the Australian FTA was very carefully considered and arrived at in order to be able to secure its approval by the body charged with ultimate responsibility for our trade agreements – Congress. NMPF is extremely opposed to altering its agricultural provisions – or those of any of the other existing U.S. FTAs – in any way as part of this exercise. We strongly urge our negotiators to respect the good work that has already been done on the existing U.S. FTAs by leaving their market access provisions untouched.

Maintenance of the Existing Country-Specific Agriculture Rules of Origin

Since NAFTA, the U.S. has used the same rules of origin (ROO) for dairy products in its FTAs. These rules of origin are a critical piece to ensuring that the concessions negotiated through and FTA flow solely to the countries participating in the agreement and not to third-party countries. Essentially, the dairy ROO require dairy products benefiting from the terms of the FTA to be made from milk produced in the FTA partner country. There are a few exceptions to this simplistic description, but they are extremely limited and primarily within the processed products category areas such as products falling into HTS Chapters 18 and 19.

It is vitally important to ensure that these standard dairy ROO are used in the TPP FTA **and** that the precedent of applying these on a country-specific basis be maintained. It would dramatically undermine the effect of the unique concessions granted in each U.S. FTA party to the TPP if dairy ROO were to be applied as a whole to the entire TPP group of countries rather than to each individual trading partner within the regional pact.

Points Regarding the Additional Two New Trading Partners:

Vietnam:

While NMPF welcomes the addition of Vietnam to the TPP group of countries, and looks forward to full elimination of tariffs on dairy trade with Vietnam, it is questionable whether the TPP would create any significant additional net trade preferences for U.S. dairy exports to the attractive Vietnam market. This is because most of Vietnam's dairy product imports come from TPP member countries. In 2008, the United States, New Zealand and Australia accounted for 39 percent, 22 percent and 14 percent, respectively, of Vietnam's total imports the major dairy products, measured on a milk equivalent basis. Thus, about three quarters of all dairy imports are from TPP member countries, who would all enjoy the same negotiated tariff preferences.

Exports of U.S. dairy products to Vietnam totaled $85 million in 2009, the last full year of data. Although sales last year were down significantly, reflecting the challenging global dairy dynamics of last year, Vietnam remains an important market for U.S. dairy exports. Products of particular importance in this country include skim milk powder, lactose and the range of various whey products. However, we would also hope to see improved access for U.S. cheese exports, as well as the remainder of U.S. dairy products, in an agreement with Vietnam.

Vietnam's applied tariffs for products of greatest export interest to the U.S. are relatively low, generally ranging from 0% - 20%. However, Vietnam does have leeway currently to increase its rates up to higher bound levels in many cases. In the case of other products such as ice cream, rates can range as high as 40%. Clearly, both the rates of most economic importance and the much higher rates on the remainder of Vietnam's dairy products would need to be an issue of focus in a TPP FTA negotiation. However, in terms of significant positive impact, the prospect of greater exports is not anticipated to be extremely large given the advantageous rates currently applied to the products of greatest U.S. export importance and – as stated above – the fact that the TPP would also open access in that country for two of our largest others that typically play key roles in FTA approval discussions.

Thank you for the opportunity to provide comments on this issue of such considerable importance to U.S. dairy producers.

Sincerely,

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