

Dairy Tariffs in the USA

Assessment of the United States import quotas and tariffs for a select range of dairy products.



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Report Overview:

Overview

As part of broader research into exploring ,exploring market access for markets that are of interest to New Zealand's exporters, the EIU assessed dairy import tariff and quota rates for a selection of dairy products in the United States market.

Notes:

The following dairy products were analysed for this report:

Liquid milk and creams

Dried milk

Whey

Butter

Butter substitutes (usually high fat dairy products)

Cheese products were not included for this report but may be analysed in the future.



Understanding the background to Milk Standards in the USA is important for developing a good framework for understanding the key findings.

Milk from New Zealand can only be used for Grade B dairy products.

- New Zealand does not currently have access to make or supply grade A dairy products.
- Grade A standards established by the FDA were designed to ensure interstate milk and imported milk met consistent levels of quality across the entire dairy product supply chain for liquid dairy products.
- In order for a dairy farmer to be classified as a Grade A producer, the producer's facilities and milk must meet more stringent health and sanitation requirements than those of a manufactured grade milk producer (commonly called Grade B).
- Only Grade A milk can be used for fluid consumption. This is broken down into different classes with further requirements for each class. Grade B products can be manufactured from Grade A milk.
- Grade B can be used only in manufactured dairy products such as cheese, butter, and non-fat dry milk.
- Some products can be either Grade A or B depending on what standards the supplier chooses to be assessed under.
- Strategic recommendations in this report assume Grade A status for New Zealand milk will be unlikely.

Grade A Examples:

- Grade A - Class 1
 - Fluid milk products (flavoured or natural, whole, skim etc.)
 - Cultured milk drinks (e.g. kefir).
 - Yoghurt drinks (e.g. smoothies)
- Grade A – Class 2
 - Cream products
 - Yoghurts
 - Ice cream
 - Cottage cheese
- Grade A – Class 3
 - Cream cheese
 - Other hard manufactured cheese
- Grade A – Class 4
 - Butter
 - Any milk in dry form

Grade B Examples:

- Butter
- Cheese
- Condensed milk
- Evaporated / dried milk and milk powder concentrates

US Quota System

An overview of how the United States quota system works.

Each product is given a low tariff rate with a quota to be filled, or a tariff rate with no quota.

- Quota volumes are highly variable between individual product formats as well as the fat composition within each product.
- Tariff rates for products entering under a quota vary between 1 to 2% of the export price of the product.
- Quota allocations are administered by the USDA using import licences.
- An import licence is required to import at the in-quota tariff rates.
- Some countries have exclusive access to some components of the category quota – known as a country-specific quota.

Once this quota is filled, the tariff rate increases but with no quota limit.

- Tariff rates for out-of-quota products are highly variable, with some tariffs approaching 30% of the product's export price.
- Full utilisation of the quota system is crucial for ensuring product success.
- No licence is required to import products at the out-of-quota tariff rate.

How import licensing works in the US

- Individuals must apply between 1 September and 15 October for an import licence, with licences issued in late December for the following calendar year.
- Quota allocation is issued under a historic, non-historic or designated licence system.
- The historic licence system means an importer has access to a fixed amount of quota each year. By having a fixed amount each year, it is thought greater focus can be placed on building a long-term, high-value product, without the threat of variable import volumes. Historic licences can only be obtained from purchasing a company that has already been allocated a historic licence. Once a licence is lost, it is very difficult to get it back.
- Non-historic licences are allocated year-on-year under a lottery system. These products are often sold as commodity products, as the lack of security of supply means that they are unable to develop a long-term brand.
- Designated licences are when country specific quotas are managed by the exporting country. Some of New Zealand's cheese quota exports to the US operate under this system.

Other Considerations:

The US can restrict out-of-quota trade

In the past, the US has imposed the Special Agricultural Safeguard (SSG) on out-of-quota trade. The SSG allows member countries from the Uruguay Round Agreement on Agriculture to impose additional tariffs on agricultural products if their import volume exceeds defined trigger levels, or if prices fall below specified trigger values. SSG trigger values for volumes are imposed if the volume of imports of an article exceeds the average of the most recent 3 years for which data is available by 5, 10, or 25 percent, depending on the article.

While it is not currently applied, it is worth being aware of these limits if butter or other dairy imports continue to surge (see pages 16 and 17 for more information and volume limits). This most recent trigger level applied was for butter in 2016

Grading systems for milk may impact product development strategies moving forward

Butter, smoothies and dairy-based nutrition bars were outlined as products of interest and will be studied further in subsequent reports. Based on US milk standards, butter and dairy-based nutrition bars appear better suited for further product development in the short term, with milk collection for products such as smoothies better suited for US based, Grade A milk supply pools.



Key Findings:



To offset the non-historic import licence system risks, successful products will need to thrive under high tariff rates, as historic licences may be unavailable.

Butter or high-value whey formats demonstrate potential to export large volumes of milk solids

- Both whey powder and butter can be imported from New Zealand under Grade B milk guidelines.
- Tariff rates for butter are approximately 12.8% of the 2017 export price once the supply quota is met, while modified whey protein concentrate is only 8.5% of the import price.
- Irish butter exports to the US have demonstrated that substantial quantities of butter can be exported outside the quota amount. Exporting large quantities of whey protein out-of-quota limits is also possible. The US is New Zealand's third largest export destination for dried whey products, often in high value formats as the US is a major exporter of low-value whey product.
- The most tariff-efficient method to sell butter in the US is to manufacture the product in New Zealand and export rather than export the raw ingredients in powder form.



Quota is available to export milk powder.

- In 2017, 24% (810,135kg) of the whole milk powder (WMP) and 93% (4,893,075kg) of the skim milk powder (SMP) quotas were left unfilled.
- This represents 0.06% and 1% of New Zealand's respective WMP and SMP exports. These are reasonable volume gaps with low in-quota tariff rates (1-2% of export unit value) of Grade B dairy products.
- Once quotas are filled, tariff rates rise to US\$0.865 per kg for SMP and US\$1.092 per kg for WMP.
- Administration issues in securing enough import licences to build a commercially viable import quota volume could be problematic, due to the high amount of historic licence holders with small import quotas.
- Whey powder and SMP are currently oversupplied in the US in their commodity forms. Importing milk products to the US offers an opportunity only if the products have a unique value proposition.

Dried ingredients will likely need to be in products that offset high tariff costs. This could be achieved by having a unique product ingredient value proposition, or having dairy ingredients as a minor component of the final product such as a protein bar.

Butter Overview

Butter Quotas are large and affordable, but at capacity.

Butter quotas are large and affordable, but at capacity:

Butter:

- The import quota for butter is currently at 6,977,000kg per year.
 - This is approximately 12,700,000kgMS.
- In 2017, 98% of the butter import quota was filled, 10.2% of this was from New Zealand.
- In-quota tariff rates for butter are reasonable at US\$0.123 per kg or 1% of the 2017 export price (\$US10.52 per kg).

Butter Substitutes (used for dairy based spreads):

- The import quota for butter substitutes is currently 6,080,000kg per year
 - This is approximately 11,100,000kgMS.
- In 2017, 98% of the butter substitute quota was filled.
- There are two tariff rates for this quota, US\$0.154 per kg for dairy spreads and 10% for other butter spreads.
- 78% of exports under this quota come from New Zealand.

Exporting butter to the US would incur an expected tariff rate of approximately 12.7% in addition to export prices due to current quota capacity. Any product exported in this format would need to offset this cost. Ireland is the only country to successfully achieve this.

Out-of-quota tariff rates are significant but not a barrier for some

Out-of-quota tariff rates for butter increase to US\$1.541 per kg, or 12.7% of the current New Zealand butter export price.

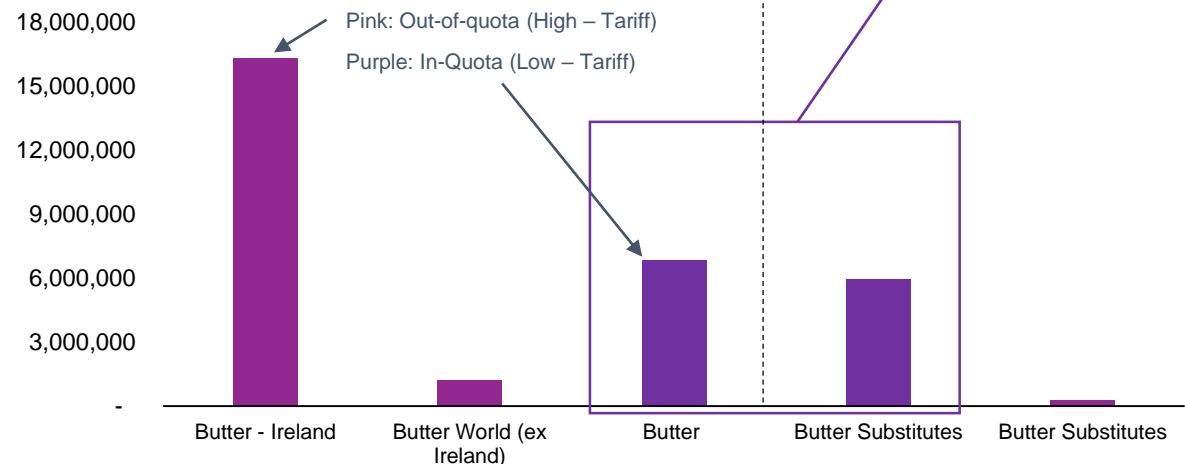
Ireland is the only country to export significant quantities over the quota limit, exporting 16,200,000kg of high-tariff butter in 2017. This was 93% of the total of high-tariff butter imported to the US in 2017.

In contrast, New Zealand out-of-quota butter exports accounted for only 0.8% of the total amount of high-tariff butter imported into the US.

No countries export significant quantities of high-tariff butter substitutes (the total was 266,000kg in 2017).

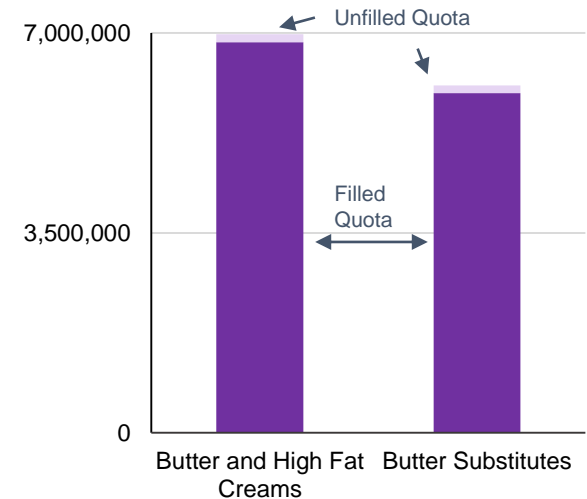
Butter out-of-quota-tariff rates are 22.7% less than butter substitutes. Unless butter SGG trigger limits are applied, preference towards butter will likely remain.

Graph title



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Quote Tilt



Milk and Whey

Quota capacity due to excess US supply or subdued demand means milk powders will need to be unique

Powder Products in Context

- There is a limited current domestic market or production of products relating to whole milk powder (WMP). Total supply for WMP was only 85,000 MT in 2017 (only 11 percent of the EU's 2017 supply). Work is required to build a market for the product with US food manufacturers.
- The US produces significant quantities of whey as a by-product of its large cheese production. Between 150,000 and 250,000 tonnes of whey powder was exported to China in the past five years. Approximately three quarters of the US skim milk powder (SMP) production is exported. Products exporting in a whey or SMP format would need to be a niche product able to attract premiums.
- The above points outline why there is available quota across both WMP and SMP however it should also be noted that low quota fill rates may also be due to tariff administration issues with securing agreements with importers who hold import licence allocations. There are 37 SMP and 58 WMP importers listed with import licence allocations. This may require dealing with a range of importers to build a commercial volume to export.

WMP has low demand, while SMP has excess supply.

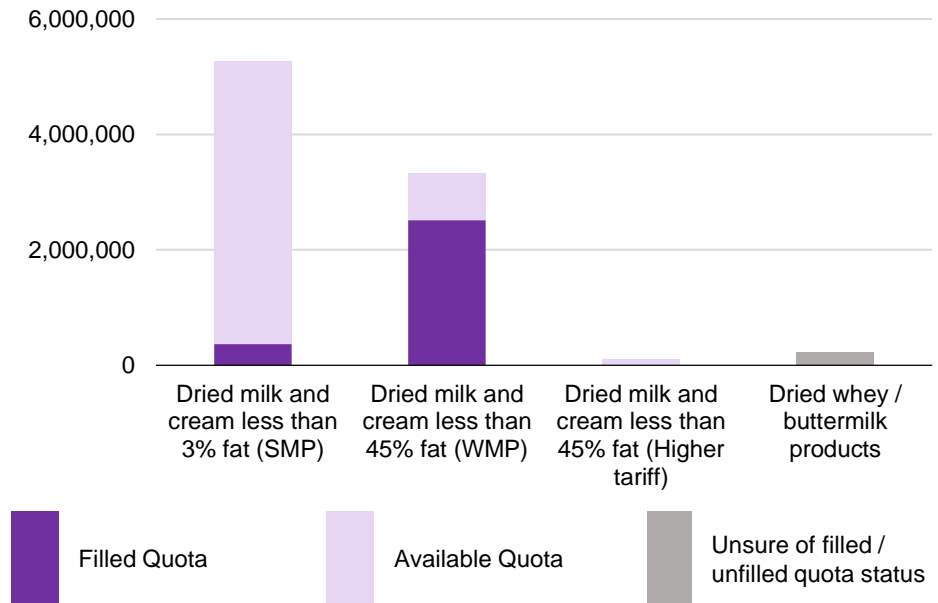
Whole Milk Powder (WMP)

- The import quota for WMP is currently at 3,321,300kg per year at US\$0.068 per kg with an additional 99,500kg at US\$0.137 per kg. Of this, 24% (810,135kg) of the initial quota was left unfilled, with no additional use of the higher tariff quota.
- The five year average export price from New Zealand of WMP to the US is US\$2.88 per kg. Tariff rates increase to US\$1.092 per kg or 27.8% of the total export price of WMP once quotas are filled.

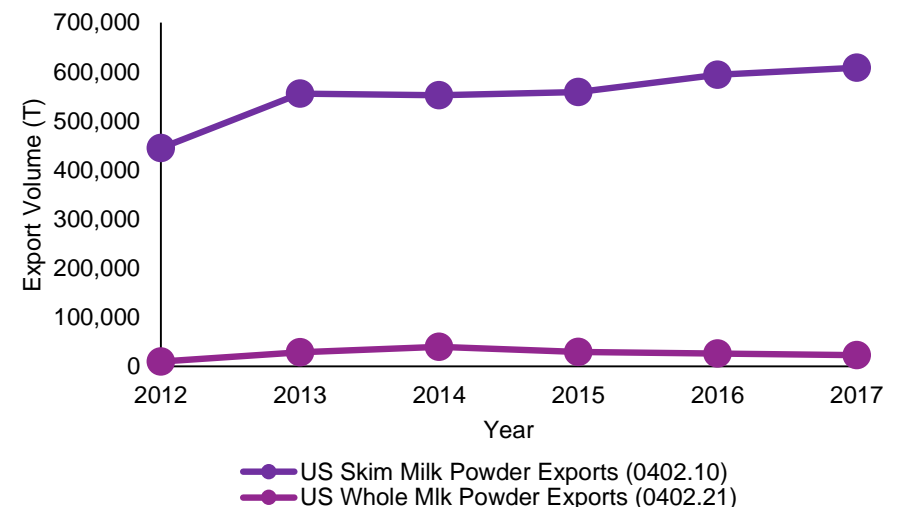
Skim Milk Powder (SMP)

- The import quota for SMP is currently 5,678,117kg per year. Of this 93% (4,893,075kg) of the quota was left unfilled.
- The five year average export price from New Zealand of SMP to the US is US\$7.46 per kg. Tariff rates increase to US\$0.865 per kg, or 10% of the total export price of SMP once quotas are filled.
- Note:** the likelihood that the SMP product would need to have a high value proposition to succeed in the US SMP export markets as well as its small export volume (134,000kg) are potential contributors to its current 160% unit price premium over WMP exports to the US.

2017 Dried Milk and Dried Whey Import Quotas to the US.



US Exports of whole milk powder and skim milk powder.

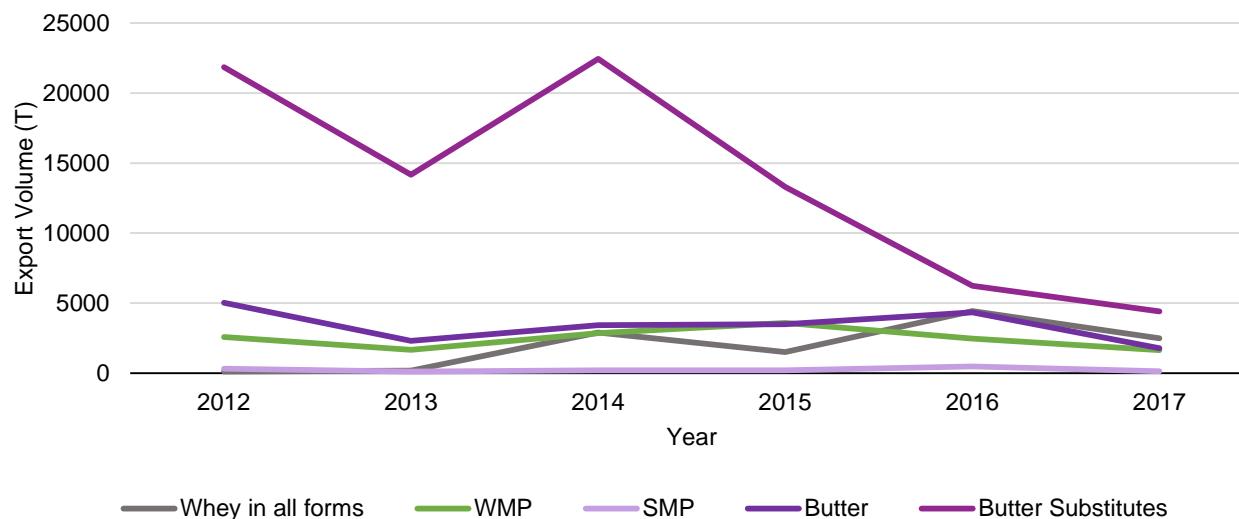


Whey Powder

Whey Powder offers good potential to export raw ingredients at reasonable tariff rates

- There are multiple tariff rates for whey powder. Modified whey protein concentrate has a tariff rate of 8.5% of the import price with no quota limit. Australia has a special rate of 1.8%.
- Modified whey that is not whey protein concentrate has a tariff rate of 13% of the export price, with a quota limit of 4,105,000kg, however, this quota also includes multiple other product categories. See Note 10 of Chapter 4 of the US tariff Schedule for more information on this limit.
- Non-modified dried whey tariff rates increase to US\$0.0876 per kg, or 11.8% of the total export price of whey powder once quotas are filled.
- The import quota for dried whey (non-modified) or buttermilk powder that is greater than 6% fat is currently 224,981kg per year at UD\$0.033 per kg.
- New Zealand's five year average for exports of whey powder is 2,296,200kg at an average import price of US\$6.53 per kg. The US was the third largest importer of New Zealand whey powder in 2017.

US Exports of Key Milk Products to the US from New Zealand by volume. .



Whey powder also demonstrates significant volumes of exports with good tariff rates.

In particular modified whey protein concentrate offers a reasonable tariff rate of 8.5% with no apparent limit to import quantities.

Liquid Milk

Small quota limits, uncompetitive tariff and Grade A supply issues make liquid milk a limited opportunity

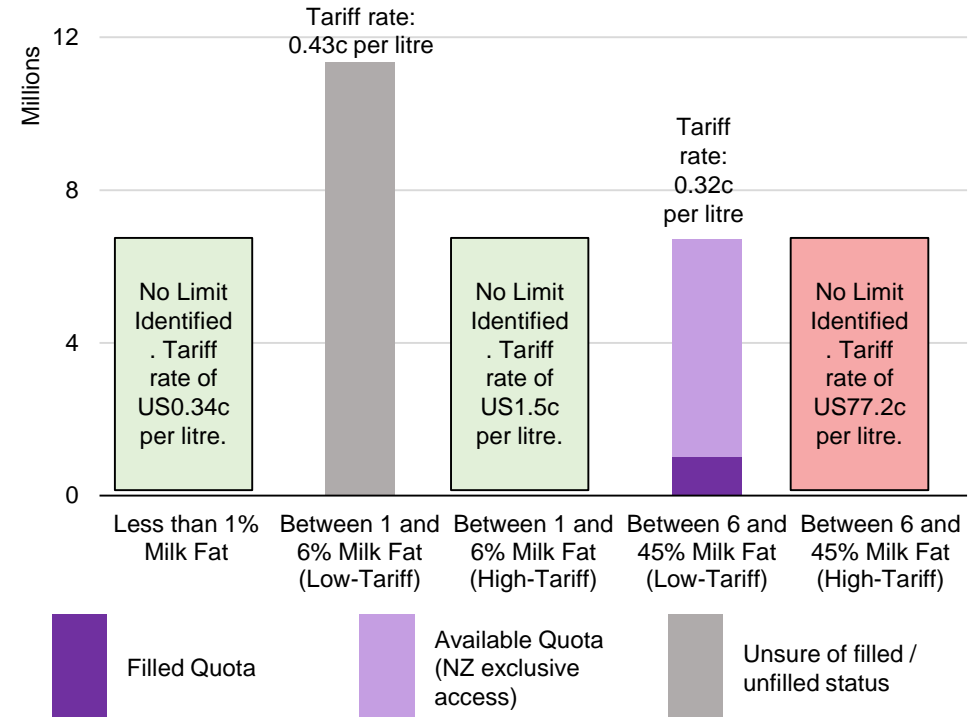
Whole Milk (6 – 45% milk fat)

- The import quota for whole liquid milk and cream is currently 6,694,840 litres per year (or approximately 590,000kgMS).
- Of this, New Zealand has access to 5,678,117 litres, none of which was filled in 2017, likely due to Grade A export access issues.
- In 2017, the US only imported 22 million litres of liquid milk and cream (approximately 0.01% of total US milk consumption). Canada and Mexico make up 68% of this due to their close location and lower out-of-quota rates compared to New Zealand (Mexico has duty-free access into the US).
- 58% of US imports of liquid milk and cream are whole milk greater than 10% milk fat.

Skim Milk (0 – 5% milk fat)

- Despite low tariff rates for skim milk, import volumes remain low at 32% of the US total imports. Import tariffs for milk 0 to 1 % fat is US\$0.34 per litre, 1 to 6 % fat has an in-quota amount of 11,356,236 litres, with an out-of-quota tariff of US\$0.015 per litre.

2017 Liquid Milk (Fresh and Frozen) Imports to the US



Currently milk from New Zealand can only be used for Grade B dairy products, Liquid milk is classed as Grade A. As a result this is the driver of the unfilled quota.

58%

Percentage of US liquid milk imports over 10% in milk fat content.

1.5c

Skim milks low tariff rate of 1.5c per litre an opportunity if products can differentiate.

Final Thoughts

Other considerations to factor when seeking to establish long term trade in the United States

The US has the ability to restrict out-of-quota trade, and has done so in the past.

- The US has in the past imposed the Special Agricultural Safeguard (SSG) on out-of-quota trade. This happened most recently for butter in 2016. While it is not currently applied – it is worth being aware of the possibility that US industry will lobby for it if butter imports continue to surge.

Meeting US milk quality standards will need to be considered throughout the product value chain

- Selecting products to develop further will be influenced by both tariff and quota restraints as well as meeting US milk quality guidelines, which currently is only possible as a Grade B milk supplier from New Zealand based farms.
- It is unlikely that the cost to move to Grade A supply (should it become available) will require significant additional investment above current New Zealand milk supply standards.
- A close working relationship with MPI's Market Access team will ensure that both these components are adequately updated as access requirements change over time.

Australia's dairy relationship with the US is a good place to determine market potential

- A key outcome of the Australia – US Free Trade Agreement was for zero in-quota rates for Australian exports and for all country specific quotas relating to Australia to be administered in Australia. These are ideal quota administration conditions.
- Under these conditions, Australia filled the below amounts of their country specific quota:
 - 88% for butter,
 - 83% for other dairy quotas,
 - 13% for whole milk powder,
 - 0% for skim milk powder,
 - 0% for cream.
- From these quota fill rates it is apparent that exports of SMP and cream will require a unique premium value proposition to become viable, exportable product formats while butter can also rely on commodity demand assuming it meets US milk quality standards.



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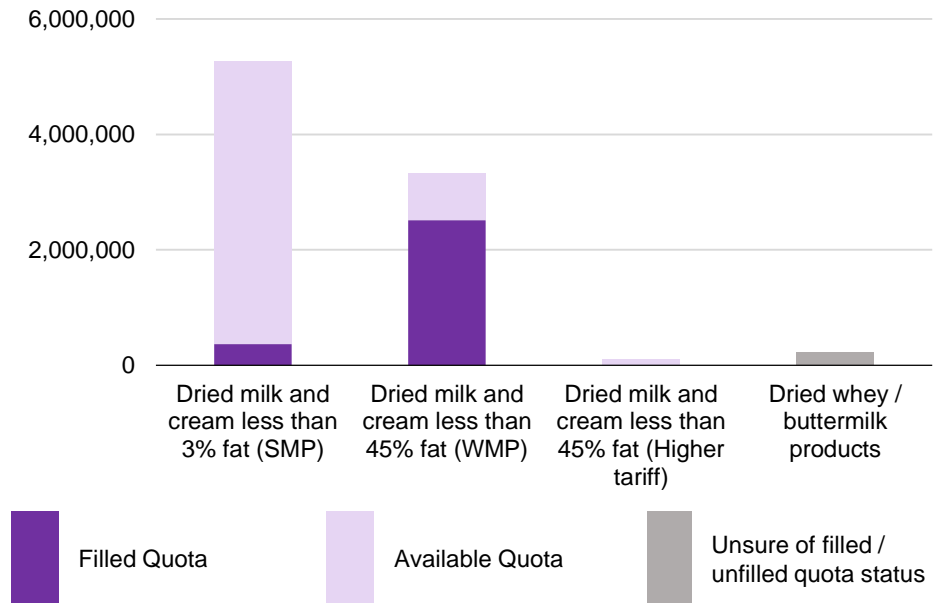
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2017 Dried Milk and Dried Whey Import Quotas to the US.



US Exports of whole milk powder and skim milk powder.

An overview of the Special Agricultural Safeguard

- The Special Agricultural Safeguard (SSG) is a provision in the Uruguay Round Agreement on Agriculture. It allows member countries to impose additional tariffs on agricultural products if prices fall below specified trigger levels or their import volume exceeds defined trigger levels. Its purpose is to prevent disruption of domestic markets due to import surges or abnormally low import prices.
- Countries have the option to activate the SSG whenever trigger volumes or prices are exceeded.
- SSG trigger values for volumes are imposed if the volume of imports of an article exceeds the average of the most recent 3 years for which data are available by 5, 10, or 25 percent, depending on the article.
- SSG trigger levels are important to be aware of should a product that has been chosen to be exported to the US is likely to cause a trigger level to be reached and therefore may risk the commercial viability of the product.

New Zealand's designated quotas in the US market.

- Quota allocation is issued under a historic, non-historic or designated licence system.
- Designated licences are when country specific quotas are managed by the exporting country. New Zealand's exports to the US that operate under a designated licence system are outlined in the adjacent table.
- Quota is allocated by MPI and is based on an applicant's share of total milk solids collected from dairy farmers in New Zealand. Schedule 5B of the Dairy Industry Restructuring Act 2001 sets out these rules in detail.

SSG trigger levels for the US for a selection of relevant dairy products for 2017

Product	Trigger Level	Unit
Cream	1,426,324	Litres
Evaporated or Condensed Milk	2,228,725	Kilograms
Nonfat Dry Milk	564,347	Kilograms
Dried Whole Milk	4,493,172	Kilograms
Dried Cream	8,319	Kilograms
Dried Whey / Buttermilk	19,366	Kilograms
Butter	22,242,567	Kilograms
Butter Oil and Butter Substitutes	9,693,967	Kilograms
Dairy Mixtures	26,136,023	Kilograms

New Zealand's designated 2018 licence allocations for dairy products to the US

Product	New Zealand Quota Access	Unit
Cheddar Cheese	5,403,532	Kg
American Type Cheese	283,001	Kg
Low fat Cheese	1,000,000	Kg
Not Specifically Provided For (NSPF) Cheese	6,506,528	Kg

