Dairy Farmers of Canada

Les Producteurs laitiers du Canada

PRESENTATION BEFORE:
THE STANDING COMMITTEE ON AGRICULTURE AND AGRI-FOOD

PRESENTED BY: CAROLINE EMOND
Executive Director, Dairy Farmers of Canada
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On behalf of Dairy Farmers of Canada (DFC), I'd like to thank you for the invitation to appear before the Standing Committee on Agriculture and Agri-Food in view of its study on milk protein. Specifically, I will speak about the improper use of certain milk protein substances (such as diafiltered milk) under the cheese compositional standards for Canada – and the negative impact this has on Canadian dairy farmers.

DFC is the voice of all farmers on each of the 11,350 dairy farms from coast to coast. Our organization strives to create stable conditions for the Canadian dairy industry today – and in the future. We work to maintain policies that foster the viability of Canadian dairy farmers, and promote Canadian dairy products and their health benefits.

We care deeply about our country, and are active participants in our local communities. A vibrant dairy industry means more jobs, and improved access to infrastructure. It also means economic benefits for other industries ranging from banking, to feeds, to parts and machinery sales, to veterinarians, and much more.

It is important to emphasize that the Canadian dairy sector makes a huge contribution to the Canadian economy. It contributes $18.9B to the GDP, and $3.6B in tax revenues, every year. It sustains 215,000 full-time equivalent jobs across the country. Dairy is either the top or second agricultural sector in 7 out of 10 provinces. Furthermore, unlike other jurisdictions where farmer's incomes are heavily subsidized, Canadian dairy farmers derive their income from the marketplace; a marketplace which will be further diminished by the access granted in the CETA and TPP agreements.

As you probably know, the dairy farming sector in Canada operates under a Canadian agricultural policy known as supply management, the objectives of which are to:

- Ensure farmers receive a fair return, derived from the marketplace, for their work and investments;
- Provide processors with a stable supply of milk, so that they can properly plan their production year after year; and
- Provide consumers with a consistent supply of milk and milk products of the highest and safest quality, at a fair price.

The system achieves these objectives by enabling Canadian dairy farmers to act collectively to negotiate prices and adjust milk production to meet consumer demand. In so doing, supply management ensures Canadian prices for both farmers and consumers remain relatively stable and less subject to the volatility of the global market.

The fact is, in countries where milk production has been deregulated, such as in New Zealand, the United Kingdom and Australia, farmers have at times received less for their milk - when consumer prices have gone up. For example, in New Zealand throughout 2014, although the farmgate price for milk decreased by 42%, the retail price for milk increased by 2.2%[1].

[1] Statistic New Zealand (2015); and DFC calculations

The government of Canada put in place a supply management system in the early 1970s in an effort to reduce the surplus in production that had become common in the 1950s and 1960s, and ensure a fair return for farmers. Canadian dairy was the first commodity to operate under supply management, a system that egg and poultry farmers would later adopt. For the dairy sector, the supply management system is administered by the Canadian Dairy Commission (CDC).

The basic idea behind supply management is simple, the goal is to manage production so that supply is in balance with demand. The farm gate price enables farmers to cover the costs of milk production, including a fair return on labor and capital. In other words, we only produce as much milk as is required by the Canadian marketplace - while limiting surpluses that would otherwise end up on the world market at dumping prices.

Supply management is a stool that rests on three equally important pillars.

The first pillar is Producer Pricing, which ensures that the milk price received by dairy farmers takes into account both the costs of production, including capital and labor costs, and the overall conditions of the Canadian economy. It is important to note that the CDC and provincial milk marketing boards do not set the retail price, and neither do the farmers. The price that consumers pay at the grocery store or in a restaurant has always been set by the retailers or the restaurant owner themselves.[2]

The second pillar is Production Discipline, which ensures that the supply of Canadian milk equals the demand from consumers. Each dairy farmer in Canada owns quota (a share of the market), that allows him to produce a certain amount of milk. Depending on consumer demand, the amount that a quota allows a farmer to produce can increase or decrease; upward and downward quota adjustments are made on an as-required basis.

The third pillar is Import Control. For supply managed commodities, imports are controlled using tariff rate quotas, or TRQs. They allow a pre-determined quantity of dairy products to be imported at preferential tariff rates (generally duty free), while maintaining control over how much is imported. The over-quota tariffs are set at levels that meet the objective of ensuring that only the quota agreed to in trade agreements is imported. Other than exceptional cases, TRQs for dairy products are fully filled every year. In 2015, the total value of dairy products imported into Canada (including both TRQ, and non-TRQ) reached more than $824 million[3]. As you can see, Canada imports a significant amount of dairy every year.

Without any controls on what is imported, it is impossible to manage supply to match demand; a lack of import controls will inevitably lead to overproduction and instability within the system. Futhermore, it's more than just having the right rules in place; the auditing and validation process and the enforcement of the rules are equally as important. Currently, those who would exploit the rules are well aware that when it comes to dairy, Canada's enforcement and consistent application of our existing border measures is inconsistent. Adequate audits and enforcement are essential in discouraging those who would exploit loopholes

[2] Note: In both Quebec and Nova Scotia, the price of fluid milk is regulated by the respective provincial governments.

[3] "Dairy Imports". http://www.dairyinfo.gc.ca/pdf/imp_CY_YTD_e.pdf

People can be very creative in order to circumvent tariffs and quotas. The pizza food topping preparation issue is a great example: between 2009-2013, farmers lost an estimated $62.6 million due to the importation of these preparations. We also had the butteroil-sugar blend issue, and more recently, it was the case of salt being added to cream. The list goes on and on.

The government is responsible for the enforcement of Canada's border measures, and must act quickly to limit damages caused to Canadian industry. This role will be even more important when a surge of imports enters into Canada as a result of CETA and TPP. The role of the CBSA is to ensure that the products that are crossing the border are well classified, and that the products that are coming in are verified to ensure that they fit the definition of the tariff line. Let's be clear: all we are asking is that the government enforce existing rules, and allow only the amount that has been agreed to in trade agreements into the country.

We also need more transparency, especially as it pertains to the process CBSA uses to issue advanced rulings. Currently, descisions that impact our industry may or may not be consistent with our understanding and interpretation of the rules. CBSA issues advanced rulings at the request of importers; however, there is no formal process to know whether a ruling has been issued, or even to find out whether the CBSA is investigating a complaint about a ruling. There is no industry consultation. When CBSA issues advanced rulings, it should be done through a transparent process so stakeholders are aware, and can offer input and respond when appropriate.

When the three pillars of supply management are functioning as intended, it enables the dairy industry to weather any economic storms, remain sustainable, and achieve a high level of self-sufficiency. However, if any of those three pillars become unstable, then it risks putting the entire system in jeopardy.

This brings me to the reason we are here today: milk protein.

Canadian milk used to be used as the main source and base component in making dairy products. However, while some cheese and yogurt makers still use 100% milk, more and more are adding ingredients (such as: Milk Protein Isolates, Milk Protein Concentrates, and Diafiltered Milk) in substitution of milk. These ingredients can either be produced in Canada or be imported. When imported, these ingredients are not classified under Chapter 4 of the *Customs Tariff Schedule* (which includes dairy products), they are classified under Chapter 35 (which includes ingredients such as milk protein substances). Originally, these milk protein substances were imported in a dry form. Over the past five or six years, we've seen a change of pattern; the amount of milk protein imported in liquid form under the same tariff line has increased significantly. These milk protein substances[4] are then used as ingredients in the making of cheese and yogurt.[5] Where the situation becomes more complex is when the same product is not treated in the same way by two different government agencies. For example: when one agency treats a product as "ingredients", and another treats it as "milk", you have a problem.

[4] For more background information on the history of the importation of milk protein substances, see the Appendix

[5] There are no federal compositional standards for yogurt. There are compositional standards in Quebec.

Under the cheese compositional standards for Canada, when making cheese, it is required that a minimum percentage of the protein used in the cheese making be sourced from milk. The percentage required varies from cheese to cheese (for example, cheddar is required to derive a minimum of 83% of its casein content from milk, and a limit of 17% of the percentage of its total protein content can be derived from ingredients, including milk protein substances)[6]. The Canadian Food Inspection Agency (CFIA) is responsible for enforcing the cheese compositional standards; which means verifying that the required milk to ingredient ratio defined under the cheese compositional standards for each cheese has been met.

Because milk protein substances are ingredients that can be less costly, some processors have taken to using milk protein substances as part of their required minimum percentage of "milk" when making cheese – instead of using it as a part of their allowable percentage of added ingredients. This is also inconsistent with its classification at the border where the ingredients are not even being considered under the dairy chapter (i.e. chapter 4) of the *Customs Tariff Schedule*, entering the country tariff free, and with no quota for the US.

As previously mentioned, the CFIA is responsible for the enforcement of the cheese compositional standards. From 2011-2016, DFC has had 60 meetings with government officials on this issue, and has sent 19 letters to various Ministers. Unfortunately, despite the fact that government officials are well aware of the issue, CFIA has not been adequately auditing and enforcing the cheese compositional standards. As a result, more ingredients are being used in cheese making than are allowed under the cheese compositional standards, resulting in less Canadian milk being used and in lost revenue for Canadian farmers . The solution to this problem is for CFIA to delegate the responsibility for the audit of the cheese compositional standards to the CDC. The CDC is aware of the issue, has the resources, and is ready and willing to help. This is a simple administrative change that would go a long way to assist in resolving the enforcement problem.

To be clear – we are simply asking that the existing rules be enforced in the manner they are intended to be enforced. There is no question of blocking imports. Right now, there is no cohesion in the manner that the rules are enforced; you have two agencies, the CBSA and CFIA, that are treating the same product differently. Dairy farmers play by the rules, and there are rules in place. The inaction and delays in properly addressing this issue have led us to where we are today.

In addition to that, DFC estimates that the combined effects of the CETA and TPP trade deals will amount to between 4.85% and 5.8% of the 2016 milk production forecast by Agriculture and Agri-Food Canada. This will mean between $282 million and $357 million in lost revenue. These are perpetual lost revenues that the dairy industry will bare in order to secure these trade deals for Canada.

Canadian dairy farmers are focused on serving our domestic market – it is where we make our living, free from government subsidy. We are a part of Canada's rural fabric and play an important role across the country as consumers, purchasers, job creators, taxpayers, and as active participants in our local communities. The erosion of our domestic market, combined with the lack of enforcement of Canadian

[6] Cheese Compositional Standards of Canada.
http://www.lop.parl.gc.ca/content/lop/researchpublications/prb0741-e.htm

domestic regulations impedes our ability to continue to make positive contributions to the Canadian economy. Canadian milk matters, and we need your help. Something must be done. Enough is enough.

Appendix

Background on the history of the importation of Milk Protein Substances into Canada

1. Imports of MPI were classified as "other protein substances" in chapter 35 of the *Custom Tariffs* at the end of the 1990's and early 2000's. CBSA, subsequently, attempted to correct the classification of imported MPI (i.e. reclassifying it under Chapter 4). However, this reclassification was challenged by Advidia, a dairy product company, in 2003.

2. The Canadian International Trade Tribunal ("CITT") ruled in Advidia's favour, declaring that the product in question was an "other protein substance" and, therefore, should be classified under Chapter 35 and not Chapter 4 (dairy). Two points of interest are noted in the conclusion of the CITT decision[1] as follows:

   > (a) it was not material that product qualifies as either a milk protein concentrate or a milk protein isolate; the characterization of the product was not relevant. The product would be classified under tariff line 35.04 as long as the product consist of 87.5 percent protein on a dry matter basis, and
   >
   > (b) The fact that the Explanatory Notes to chapter only referred to "[p]rotein isolates obtained by extraction from a vegetable substance" in the illustrative list, this did not not raise any presumption that other unlisted protein substances are excluded.

3. The introduction of the cheese compositional standards in 2007 slowed down the growth in imports of MPI as the cheese compositional standards were supposed to be reflective of Canadian cheese manufacturing practices. However, right after the introduction of these standards, DFC and its provincial members found many "cheese products" appearing on the market place.

4. In 2008, under the Article XXVIII of the GATT, the Canadian government created a TRQ of 10,000 tonnes of imported milk protein substances coming from all countries, except those which Canada already had bilateral trade agreements such as the United States under the NAFTA.

5. After the implementation of the TRQ, the level of imports was close to 10,000 tonnes. This roughly represented the amount of MPI permitted under the cheese compositional standards at that time. However, there was a subsequent increase in imports from the US, while the TRQ was less filled over time. The US imports were not counted against the TRQ of 10,000 tonnes for that specific product. This has led to a global increase in imports of MPI.

6. Thus, with the combination of a non-binding TRQ from the US and the technology permitting to keep MPI in liquid form, imports of MPI increased exponentially.

[1] Canadian International Trade Tribunal. (March 8, 2005). Decision and Reasons.