NATIONAL MILK PRODUCERS FEDERATION

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On Foreign Subsidies in Agriculture
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Chairman Conaway, Ranking-Member Peterson, and members of the Committee, thank you for inviting me to testify on foreign subsidies in the dairy sector. My name is Jaime Castaneda and I am a Senior Vice President of the National Milk Producers Federation (NMPF).

In addition to my role for NMPF, I also lead trade policy issues for the U.S. Dairy Export Council in order to pursue policies that help advance the interests of the broader dairy industry. In this capacity, I serve as a cleared trade advisor for Ambassador Mike Froman and Secretary Tom Vilsack.

NMPF develops and carries out policies that advance the well-being of dairy producers and the cooperatives they own. The members of NMPF's 31 cooperatives produce the majority of the U.S. milk supply, making NMPF the voice of more than 30,000 dairy producers on national issues. International trade is one of those issues and in recent years it has been one of the most important to our industry.

Our nation has gone from exporting less than $1 billion in dairy products in 2000 to exporting a record $7.1 billion in 2014, an increase of 625%. It is not a coincidence that the enormous growth over this period occurred as the U.S. began negotiating market-opening free trade agreements. These agreements lowered and ultimately removed tariff barriers to trade, and in many cases gave our products an advantage over other dairy exporting countries. In many cases, they also helped remove technical and regulatory barriers to our trade.

However, these agreements have done little to constrain the use of domestic or export subsidies in the international dairy sector globally, or the agricultural sector as a whole. The reason is obvious: reducing domestic supports in an FTA would be a concession to an FTA partner country and to all other countries competing in the global market without any reciprocal benefits. The non-FTA countries would get a free ride. The negotiation of limits to such subsidies has and should only occur as part of multilateral trade deals, the most recent of which is the Doha Round of trade negotiations in the World Trade Organization.

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Regrettably, the Doha Round, which began 14 years ago, has been essentially comatose since 2008. Recent negotiations on how to revive the talks have focused largely on domestic supports in agriculture. Several important developing countries have pushed for an agreement in this area based on the state of play in 2008.

Those terms call for substantial reductions in supports, mainly by the United States. They fail to take into account the declines in U.S. agricultural subsidies since 2008. At the same time, some developing countries are seeking to protect their own growing domestic supports. In addition to direct domestic subsidies, many developing countries, including Brazil and India, use non-tariff barriers to keep foreign dairy products from reaching their markets. Additionally, less transparent subsidies are used to bolster domestic dairy markets. Developed countries also remain heavy supporters of their dairy sectors.

All this is an important backdrop to our testimony on trade-distorting forms of support to dairy sectors around the world. We appreciate the committee holding this hearing. It is clear that, while the United States has reduced its dairy subsidies and support mechanisms, other countries have maintained and expanded theirs.

Let me begin with the European Union.

Structure of EU Support

Milk is one of the most important agricultural products in the EU, accounting for approximately 15% of agricultural output. Around 148 million tonnes of cow's milk was delivered in 2014 across all EU Member States. The milk quota regime introduced in 1984 to address surplus production expired on April 1. Despite this, several publically supported safety net measures remain.

For example, all EU farmers, including dairy farmers, are supported through the EU's Common Agricultural Policy (CAP), which accounts for 37.8% of the EU budget and is equivalent to €362.8 billion through 2014-2020[1]. For each EU Member State, the total value of all allocated direct payments entitlements and rural development payments are shown in Table 1.

[1] In 2011 prices; EU Budget period runs for 7 years, current period 2014-2020

Table 1: Amounts assigned to Member States for the CAP

in million Euro

	Common Agricultural Policy** (6)		
	Direct payments (1)(2)(3)(4)(5)	Rural development (7)	Total CAP
Belgium	3.603	648	4.251
Bulgaria	5.106	2.367	7.472
Czech Republic	5.985	2.306	8.291
Denmark	6.044	919	6.963
Germany	34.534	9.446	43.980
Estonia	839	823	1.663
Ireland	8.507	2.191	10.697
Greece	14.808	4.718	19.526
Spain	34.634	8.297	42.931
France	51.354	11.385	62.739
Croatia	1.482	2.026	3.508
Italy	26.850	10.444	37.294
Cyprus	351	132	484
Latvia	1.452	1.076	2.527
Lithuania	3.104	1.613	4.717
Luxembourg	234	101	335
Hungary	8.932	3.431	12.362
Malta	37	97	134
Netherlands	5.223	765	5.988
Austria	4.850	3.938	8.787
Poland	23.313	8.698	32.010
Portugal	4.105	4.058	8.163
Romania	11.638	8.128	19.766
Slovenia	960	838	1.797
Slovakia	3.016	1.560	4.576
Finland	3.662	2.380	6.042
Sweden	4.866	1.764	6.630
United Kingdom	22.283	5.200	27.483

** Amounts are subject to change due to the flexibility to shift amounts between direct payments and rural development payments.*

Source: [EU Multiannual Financial Framework]

As referenced above, the European Union subsidies to its dairy sector under the Common Agricultural Policy (CAP) include 1) direct payments or "basic payments" (previously known as the Single Payment), 2) *ad hoc* subsidies for the private storage of dairy products, 3) dairy price support programs, and 4) most recently, a substantial package of nearly €500 million euros in emergency agricultural financial aid. In addition, there is support under the auspices of Rural Development, due to low domestic dairy prices.

Taken collectively, EU subsidy programs for dairy farmers provide a substantial assistance package aimed at ensuring profitability. For instance, it is estimated that one third of the total income for British dairy farmers comes from subsidy programs.[2] With the EU made up of 28 nations, all of which produce milk, the scope of the support is substantial.

Despite this high level of support, these subsidies are not likely to result in a WTO domestic subsidy violation because the EU's limit on domestic subsidy spending is a massive €72 billion ($84 billion), with notified subsidy levels below €7 billion ($8.2 billion).

<u>The Basic Payment Scheme</u>

EU farmers, including dairy farmers, are provided a basic payment (prior to 2015 referred to as "The Single Payment") based on their historical farming area. Since these payments are not directly tied to the type of agricultural production or to prices, the EU treats these subsidies as non-trade distorting "Green Box" subsidies for purposes of its subsidy notifications to the World Trade Organization. The receipt of the basic payment is contingent on farmers complying with environmental, sanitary, and animal welfare requirements. In 2014, the European Union provided €40.5 billion ($47.6 billion) in basic payments to EU farmers.

<u>Dairy Premium</u>

In addition to basic payments, EU dairy farmers are eligible for a dairy premium based on historical production quantities. In its most recent WTO subsidy notification, covering marketing year 2011/12, the EU reported the subsidy level for this program at €176 million ($207 million).[3]

Although the EU shifted away from production aid to per hectare payments, some products, such as dairy, can still be supported by coupling payments to production. This means that the profitability of producing milk does not depend only on the price, but also on the amount of the direct payment that is paid for milk. Nineteen out of 28 Member States are supporting the dairy sector in this way, particularly in areas with difficult economic or environmental factors (e.g. mountain farming). For instance, France allocated €135 million of its CAP payments in 2015 to coupled

[2] "Quick Facts: Dairy Subsidies", AF News Agency, March 9, 2015.
[3] EU WTO Subsidies notification for MY 2011/12, October 22 2014. G/AG/N/EU/20.

support for dairy farmers, Poland €152 million, Spain €94 million, Italy €89 million, Romania €78 million[4]. Voluntary coupled support can amount to only up to 8% of the Member State's envelope. Just the payments to these five member states this year under this specific program amount to 548 Euros.

The EU also allocates a payment system for **small farmers**, with payments of up to €1250/year/farmer.

Private Storage Aids

The EU operates an *ad hoc* system of private storage aid (PSA), which is activated when dairy commodity prices are low. The subsidy levels are based on storage costs, quality, depreciation and any relevant market price increases. The PSA system operates for butter, cheese, and skim milk powder and many GI products. Stocks under the PSA program at the end of 2014 were 32,000 MT for cheese, 22,000 MT for butter, and 17,000 MT for skim milk powder. PSA subsidy levels were established at €18.9 per MT ($22.2 per MT) for butter, €8.86 per MT ($10.4 per MT) for skim milk powder and €15.5 per MT ($18.2 per MT) for cheese.

EU Support Price Programs

The EU operates a price support program for butter and skim milk powder. The price support for butter is set at €2,217.5 per MT ($2608 per MT), and for skim milk powder at €1,698 MT ($1,997 MT). EU price support levels for butter and skim milk powder have been lowered in recent years, and as a consequence the program has been less active. However, because of recent lower market prices, the EU did begin to intervene by purchasing skim milk powder in 2015. The EU notifies these price support programs as trade distorting "Amber Box" subsidies to the WTO, and correctly uses full production rather than the amount of product procured under the program as the basis for the price support subsidy calculation.

Special Subsidy Programs

Due to low domestic prices for dairy and meat products in 2015, the EU Council agreed to provide dairy farmers and livestock producers with a €500 million ($588 million) package of subsidy assistance in the fall of 2015. €420million ($494 million) of that total was slated to go to EU dairy farmers. In addition, EU Member States have the opportunity to provide matching funds under the program, providing potential total subsidies of over €800 million ($941 million) to EU dairy producers.

Baltic Region Aid

[4] Information from European Commission on voluntary coupled support - http://ec.europa.eu/agriculture/direct-support/direct-payments/docs/voluntary-coupled-support_en.pdf

Following the Russian ban on imports of EU dairy products in 2014, the EU in 2015 provided $36 million in special subsidy assistance to dairy farmers in Lithuania, Latvia and Estonia.

EU Export Subsidies

The EU is allowed under WTO rules to subsidize the export of up to 411,000 MT of butter, 323,000 MT of skim milk powder, and 331,000 MT of cheese. The total permissible level of subsidies in value terms is over €1 billion ($1.18 billion). When the EU makes use of export subsidies it causes massive distortions in world dairy markets.

Geographical Indications

It would be negligent not to mention the matter of geographical indications (GIs) in this discussion. Support to farmers can take many forms, including the use of import barriers to minimize competition and prop up prices. Tariffs and tariff rate quotas are sanctioned under international rules, but when they fail to provide sufficient protection, or when they have been removed in trade agreements, governments sometimes resort to novel approaches to provide compensating protection to their producers.

This is what the EU has undertaken in recent years in its effort to block the use of many commonly used product names by any producer outside prescribed areas of the EU. What better way to impede or block imports of a given product than to ban the use of its name? An American producer of feta or parmesan cheeses, for example, can no longer sell such products in the EU, despite the fact that those names have been widely and generically used around the world for many years. There is no question that the EU's effort to "claw back" the use of such names is a form of support to its producers.

To make matters infinitely worse the EU is insisting in its free trade deals that its trading partners prohibit the use of such names except by EU producers. The EU's actions therefore also serve as a form of export support that puts at risk hard-won U.S. market access opportunities in markets around the world. Products employing Geographical Indications also benefit significantly under the EUs promotional programs (referenced below), thereby employing EU policies not only to block competition but also to help support the replacement product from the EU.

Milk Programs

Other subsidies in the dairy sector include a School Milk Scheme, through which preschools as well as primary and secondary schools can claim subsidies if they supply their pupils with dairy products. The EU and the national governments jointly fund this scheme. The EU is limited to a maximum of 0.25 liter of milk equivalent per pupil, per day.

The Commission also earmarked €30 million to fund the distribution of dairy products to refugees. This money will come out of the €500 million package to support European dairy and livestock farmers which was agreed upon in September 2015.

Delayed Penalty on Dairy Quota Payments

As part of the quota regime that was in place until March of this year, EU milk producers had to pay a surplus levy when exceeding the national dairy quotas. However, in view of the end of the milk quotas on the 31st of March 2015 and at Member States' request, the Commission adopted new measures to allow the EU milk producers, who will have to pay a surplus levy for 2014/2015, to make their payments over a maximum of three years in zero interest installments. The measure aimed to alleviate the financial burden on those producers that exceeded their quota threshold as they struggle with cash-flow problems amid a drop in prices. This was not a traditional subsidy, but 'de minimis' aid[5], compatible with WTO rules, which applies to aid granted to undertakings active in the primary production of agricultural products, including dairy products.

State Aids

Member States have the possibility of providing national funding under the **de minimis rules** (below €15,000 for agricultural primary production or €200,000 for marketing and processing activities over 3 years). Even outside Rural Development Programs, Member States may use **state aids**, for example: aid for investments, agri-environment-climate or animal welfare commitments, organic farming, and the participation in quality schemes, etc. Under certain conditions, state aids can also cover promotion, the closure of production capacity and, under strict conditions, rescue and restructuring aid for companies in severe financial difficulties.

EU Promotion Programs

The Commission has developed a promotion policy[6], which was last reviewed in 2014. Its objective is to enhance the competitiveness of the EU's agricultural sector. More specifically, the information provision and promotion measures aim to increase consumers' awareness and the consumption of EU agricultural

[5] The total amount of 'de minimis' aid granted per Member State to a single undertaking shall not exceed €15,000 over any period of 3 fiscal years, provided that the global amount of such aid does not exceed 1% of the annual agricultural output as provided in *Regulation No 1408/2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid in the agriculture sector* Link

[6] Latest revision of the Regulation on promotion measures of agricultural products was adopted in 2014 and it will apply as of 1 December 2015 Link

products, raise their profile both inside and outside the Union and increase the market share of those products. In the event of serious market disturbance, loss of consumer confidence or other specific problems, those measures should help restore normal market condition.

Under the promotion policy, the EU approved different programs to promote agricultural products. **In 2015, there are six new information and promotion programs for the dairy sector. All six are targeting third country markets - worth nearly €12.2 million from the EU budget over three years**. They are 50% co-funded by public or private funds. These new programs come in addition to 14 ongoing multi-annual programs for the dairy sector, which were launched between 2011 and 2014.

Starting December 1, 2015, the new rules agreed upon in last year's reform of the EU promotion policy will enter into force. In addition to a gradual increase in the EU budget contribution to €200 million per year, the new regulation will adjust the co-funding rules (no national co-financing and higher rate of EU-funding), and introduce simpler procedures such as a single approval process, wider scope of beneficiaries and eligible products, annual work program and calls for proposals.

Rural Development

The EU's rural development policy[7] is a policy that aims at co-financing of Member State budgets. France (€11.4 billion), Italy (€10.4 billion), Germany (€9.4 billion) and Poland (€8.7 billion) are the four biggest beneficiaries of the rural development policy (see Table 1 for more details). If national contributions from co-financing are included, the funding available under the second pillar of the CAP amounts to €161 billion over the period as a whole.

Each Member State develops its own rural development program taking into account four out of six of the EU's priorities for rural development, which focus on knowledge transfer and innovation; competitiveness of agriculture; food production chain; animal welfare and risk management in farming; agricultural and forest ecosystems; efficient use of resources and a low-carbon economy; and finally social inclusion, poverty reduction and economic development.

While the European measures for rural development do not cover specifically the dairy sector, there are more general measures, which can be applied to dairy. For instance: physical investment, such as processing of farm products, which can be dairy products, investment in infrastructure, and improving the performance and sustainability of holdings can be applied to the dairy sector. There are also measures on setting up producer groups and organizations to increase the competitiveness of the dairy sector. There are also payments to areas facing natural or other specific constraints, such as mountain regions or protected

[7] Regulation No. 1305/2013 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD) Link

areas (e.g. Danube Delta). Other measures include subsidies for organic farming, environmentally friendly practices, and animal welfare.

The measures also include a risk management toolkit, which includes **insurance premium subsidies** for crops, livestock, and plants (financial contributions to premiums for crop, animal and plant insurance against economic losses to farmers caused by adverse weather events, animal or plant diseases, pest infestation, or an environmental incident); a **mutual fund** to respond to adverse weather events, animal and plant diseases, parasite infestations and environmental incidents (with a view to the payment of financial compensation to farmers for the resultant economic losses); and an **income stabilisation tool**, in the form of financial contributions to mutual funds, providing compensation to farmers following a severe drop in income. This income stabilization tool supports farmers facing a severe drop in income (minimum 30% loss compared to the three previous years). Nevertheless, only a few Member States (e.g. Italy, Hungary and Spain) have activated and allocated sufficient resources to make the instrument workable, probably due to its complexity and lack of available historical income data, as well as the rigidity of the threshold of the drop in income.

Canada Structure Support

Many of the world's largest dairy consuming countries maintain high tariffs on imported dairy products. Canada, for example, maintains one of the most tightly guarded dairy markets in the world by imposing astronomically high tariffs on imported products. Canadian dairy tariffs typically range from 250% to 300%.[8] A 300% tariff means the price of an imported good is quadrupled when imported. The purpose of tariffs of such magnitude is to protect Canada's supply managed price support system. The support program and the tariff regime are inseparable and Canada has maintained them through the Canada-U.S. FTA, North American Free Trade Agreement (NAFTA), and now the Trans Pacific Partnership.

As in the case of GIs in the EU, Canada has found ways to restrict the limited amount of access it has already agreed to provide through its NAFTA and WTO commitments to date. Collectively, these reflect an effort by the Canadian government to use regulatory tools to provide further protection to its dairy support regime. Here are several examples:

- Politically-driven legislation to change an objectively-determined customs classification ruling to prohibit imports of a food preparation product containing mozzarella (and pepperoni, oil and spices). The effect of the action was to commercially nullify all imports of the relevant food preparation products from the U.S. by reclassifying the cheese portion of them into a category where they would be subject to a commercially nonviable duty of more than 200%.

[8] World Trade Organization notifications

- Creation of new milk classes designed specifically to thwart imports: One of the more troubling developments in the past few years has been an increasing level of creation of new special milk classes that are specifically targeted and designed to compete against imports of products that have made in-roads into the Canadian market, such as chocolate milk.
- Implementation of revised cheese standards that restricted opportunities for U.S. dairy imports of both cheese and dairy ingredients. The revised standards permit the use of dried dairy ingredients (which tend to be imported) only after the minimum casein content established in the regulations is met with fluid milk products. Internal discussions leading up to this change made it clear that the revisions were intended to limit the growth in the use of imported ingredients, particularly those from the U.S., in Canadian cheese-making.
- Consideration of additional restrictions on the use of ultra-filtered milk in Canadian cheese-making. Reports suggest that the Canadian government may be contemplating additional regulatory steps that would negatively impact U.S. sales of this product.

These are just a few examples of the continue attempt by Canadian officials to prevent exports of U.S. dairy products into Canada.

<u>Japan</u>

Japan is a relatively small dairy producer, but has a disproportionate impact on world markets, because it is one of the world's largest dairy importers.

Japan provides direct payments to dairy farmers for production within government designated production quotas. In 2015, the direct payment was set at 12,800 yen ($107.62) per farm for production falling within the national quota of 1.8 million metric tons. This translates into nationwide dairy payments to farmers of 22.9 billion yen ($193 million). While the production quota has decreased over time, the direct payment to dairy farmers has increased over time. Ten years ago, in 2005, the direct subsidy level was 10,400 yen per MT.

Japan notifies the direct payment as a trade distorting "Amber Box" subsidy to the WTO. In its last available WTO notification, for 2012, Japan notified direct subsidy payments at 27 billion yen. Japan's has a WTO Amber Box spending limit of 3.9 trillion yen, and total notified spending, including dairy and other agricultural products, was 608 billion yen in 2012, far below the 3.9 trillion yen subsidy ceiling.

In addition to the direct subsidy payment, the Japanese government subsidizes insurance for Japanese farmers, including dairy farmers, through partial payment of insurance premiums. In its 2012 WTO notification, Japan notified the insurance program as a non-product specific subsidy (meaning it covers a range of agricultural products) at a level of 19.3 billion yen ($162 million).

Another major component of Japan's support to its domestic dairy farm and processing sector stems from a tariff-rate quota for natural cheese used for further processing. In this TRQ, Japan suspends its sizeable tariff for natural cheese only if it intended to be used as an ingredient for domestic manufacture of processed cheese in a prescribed ratio with domestic natural cheese. Through this TRQ, combined with a high ad valorem tariff for processed cheese (0406.30), Japan creates an implicit subsidy for its domestic manufacturers of natural cheese, processed cheese, and the farm milk serving that market.

India

India is the world's second largest producer of fluid milk, behind only the European Union, and the world's largest producer of butterfat. Given the size of the Indian dairy market, Indian subsidies to the dairy sector are capable of having a significant impact on world markets.

The National Dairy Development Board

The National Dairy Development Board (NDDB) was established by the Indian government in 1965, and has been credited with helping India become one of the world's largest dairy producers. On its website, NDDB says that it was created by the government to "promote, finance and support producer owned and controlled organizations." The NDDB derives its funding from government sources.

The NDDB, in partnership with the Government of India, has developed a National Dairy Plan to increase dairy productivity, enhance links between dairy producers and processors, and assist in the development of dairy cooperatives. The first phase of the plan has allocated $416 million to fourteen dairy producing states in India, which account for 90% of milk production. Elements of the project include improving cattle genetics, replacing 20 million low producing dairy cows with genetically superior animals, addressing animal diseases, and improving the artificial insemination industry. (Source: FAS GAIN reports)

National Bank for Agriculture and Rural Development

The National Bank for Agriculture and Rural Development (NBARD) is a state supported bank established by the Indian Parliament in 1982. Its role is to provide credit and subsidy programs in rural areas. NBARD will cover 25% of the costs in the form of "back end" credit subsidies, related to 1) startup outlays for small dairy producers, 2) costs associated with rearing small heifers, for up to 20 calves, 3) outlays for milking machines, and 4) outlays for cold storage facilities. (Sources: India Department of Animal Husbandry, Dairying and Fisheries, India Filings, "How to Get NABARD Subsidy for Dairy Farming")

Non-Tariff Barriers Sheltering Market from Competition

In addition, the U.S. dairy industry has faced significant and long standing non-tariff market access barriers in the Indian market. Since late 2003, the vast majority of U.S. dairy exports have been blocked from the Indian market due to unjustified India's dairy certificate requirements. This significant non-tariff barrier has historically operated in a way that shields India's dairy industry from the full extent of outside competition.

New Zealand

The monopolistic structure of New Zealand's dairy industry, where one company, Fonterra, controls approximately 85% of the milk produced in that country, poses a significant concern to the U.S. dairy industry. Both producers and a number of processors believe this situation poses a serious challenge to fair trading relationships both between the U.S. and New Zealand and in dairy markets throughout the world. This monopolistic structure grants an immense advantage to New Zealand dairy product exports. Moreover, very few companies in any economic sector have the level of market share that New Zealand has obtained through domestic policies. Such concerns present a serious challenge to our industry as we strive to compete against this international dairy powerhouse in world markets.

Conclusion

In closing I would like to thank this committee for the opportunity to testify today on this important issue and hope this information has been informative.