How would trade liberalization affect dairy?

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BROWNSTOWN, Pa.—Globalization is a hot topic in the dairy industry. A little known report sheds some light on the subject. Posted Friday, Nov. 6 at the website of the U.S. International Trade Commission (ITC), is the sixth update of "The Economic Effects of Significant Import Restraints."

Within this 220-page document, approximately 25 pages deal specifically with dairy. In fact, "dairy" is second only to "textiles" in terms of the positive impact trade liberalization in those sectors would bring to the "welfare" of the total U.S. economy. At the same time, dairy is second to textiles in terms of the negative impact the sector, itself, would experience if import restraints were removed.

In other words, under "liberalized trade," dairy consumers gain, other sectors gain, but the domestic dairy industry loses, according to U.S. ITC estimates.

"Removing tariffs and TRQs (tariff rate quotas) on imports of dairy products is estimated to increase U.S. welfare by approximately $733 million," the U.S. ITC report concludes. But, at the same, time, the report states that, "Shipments (output) of butter and dry and condensed dairy products are estimated to decline by 10 to 11%. Shipments (output) of cheese, fluid milk and cream, and ice cream decline by less than 1%. The value of imports of butter and dry and condensed dairy products more than doubles, with the other dairy subsectors experiencing smaller increases in imports."

Where does that $733 million in "welfare" to the U.S. economy come from? It comes from the estimated 7% reduction (2005 dollars) in the average cost of all dairy products—per household—by 2013. This would then free up consumer disposable income for other purchases within the overall U.S. economy. In fact, the consumer cost for all dairy products—under liberalized trade scenarios—is projected to decline in every category except for one: Concentrated milk proteins.

The U.S. ITC report shows the effects of trade liberalization on nine broad sectors of the U.S. economy. Two of those sectors that are characterized by the most significant tariffs—agriculture and nondurable manufacturing—are estimated to contract overall, while other sectors expand, in response to liberalization.

Specifically, the report indicates dairy would see a reduction in employment of 1.9% as an effect of liberalized trade. Dairy would also see a 2.2% reduction in output, 77.6% increase in imports and 30.2% increase in exports by 2013 if import restraints are removed.

According to the report, domestic producers of butter, dry dairy products, and condensed and evaporated dairy products currently benefit from significant import restraints.

This means the effect of trade liberalization would result in substantial declines in output for these sectors following the removal of import restraints (see chart E.15). Butter output, for example, is estimated to decline by 10%, dry dairy products by 11%, and condensed and evaporated products by 8%.

When tariffs and TRQs are eliminated, dairy shows the expected patterns of declining domestic production, declining employment, and declining prices, along with increases in imports, and to a lesser degree, an increase in exports, the report states.

Import restraints currently operate in conjunction with a complex system of federal, state, and local laws, the report explains. Influencing trade are the federal price supports, milk marketing orders, and the Dairy Export Incentive Program (DEIP), along with domestic and international food aid programs.

Import classifications count a current total of 392 U.S. 10-digit Harmonized Tariff Schedule (HTS) codes that are considered to be dairy products. Of these, 135 are not currently subject to any tariff rate quotas (TRQs). The other 257 are subject to 27 separate TRQs, many with country-specific in-quota volume allocations. These are primarily cheese, ice cream, butter and yogurt.

In 2007, the U.S. ITC estimates that 51% of the value of imported dairy products were from products not subject to TRQs. This includes MPC, whey protein concentrates, and certain varieties of cheese. These imports currently face low or virtually non-existent tariffs, plus they account for over 95% of domestic consumption within their categories.

In the dairy categories that do have TRQs, these quotas function to keep the U.S. price higher for these products by limiting the amount of lower-priced imports. For example, the U.S. price of butter in 2007 was $1.35, according to the report, which was significantly higher than the price of butter imports at $1.26 per pound, but the over-quota tariffs pushed the price of those imports to $1.46 per pound, which was 11 cents above the U.S. price.

For cheese, the over-quota tariff was also enough to keep imports below the TRQ level, according to the report.

So what happens to dairy when they plug in the “effect” of trade liberalization? By removing the TRQs and duties, the “landed duty-paid” price of imports declines as follows: Butter down 35%; dry dairy ingredients down 35%; and condensed and evaporated products down 22%. As expected, these price declines would lead to increased imports. At the same time, domestic production would decrease, again led by butter and dry dairy products. Employment would decline by roughly similar proportions.

Here’s the kicker... According to the updated projections: Declines in domestic production would follow the increased imports after trade liberalization, but not enough to offset the increased imports. This means exports would actually increase (to a lesser degree of course than the increase in imports) because the imports would drive down the U.S. price for all dairy commodities.

“This is especially true for butter and cheese for which the cost of important input components—fluid milk and dry dairy products—declines as a result of the liberalization of import restraints,” the U.S. ITC report states. “The increase in import volume at lower prices would lead to lower household prices for all dairy products except concentrated milk protein products, with the largest decline of 7% occurring in the household price of butter.”

(It’s a chain reaction. While the estimates show trade liberalization benefits the “welfare” of the total U.S. economy and brings along an increase in exports, it is clear this would come at a significant cost to dairy producers, rural economies, and U.S. food security.)