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Dairy Trade Flows between the United States and Canada

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Report Highlights:
One of the most common questions asked of the Foreign Agricultural Service (FAS) office based in the United States Embassy in Ottawa, Canada is why Canada is able to restrict the entry of U.S. dairy products into Canada, and yet Canada is able to export dairy products to the United States. This report attempts to provide a clear explanation using yogurt trade as a case study.

The Canadian Supply Management System in Dairy

Since 1970 Canada's dairy industry has been operating under a supply management system by which supply is matched with domestic demand. In the process of controlling the supply the amount of imports are made predictable through a system of tariff rate quotas. Canada annually allows in a pre-determined amount of dairy products in various categories duty free from the United States, but once the volume limit has been reached (quota), anything over that amount is subject to tariffs of a minimum of 200% and up to 313.5%.

Dairy Import Restrictions

A list of dairy products that are on Canada's import control list can be found at the following URL address: http://www.international.gc.ca/controls-controles/prod/index.aspx?menu_id=1. For the yogurt category, Canada negotiated a quota limit of 332 metric tons (MT) in its trade agreements. Anything above this amount is subject to an over-quota tariff of 237.5%. For a U.S. yogurt manufacturer to export to Canada, the company would need to find a company in Canada that holds import quota for yogurt. A list of companies that hold yogurt quota for 2011 is available at the following URL address: http://www.international.gc.ca/controls-controles/prod/agri/dairy-laitiers/yogurt-11-yoghourt.aspx?lang=eng. A Canadian importer with yogurt quota would be permitted to import a set amount of yogurt at the within-quota rate which, in the case of yogurt of U.S. origin, would be an applicable tariff of zero.

Yogurt above the quota limit at the within-quota rate can be brought into Canada using supplemental import permits. Supplemental import permits are issued by Canada's Department of International Trade. Some of the most common reasons why supplementary permits are issued are if a product is not being produced in Canada, or if there is a shortfall in Canadian production of that product for some reason. For example, in 2010, yogurt imports that entered the Canadian domestic market under supplemental import permits were approximately 3,510 MT.

More information on supplementary import permits for dairy products on the import control list can be found at the following URL address: http://www.international.gc.ca/controls-controles/prod/agri/dairy-laitiers/notices-avis/783.aspx?lang=eng

The Import for Re-Export (IREP) Program

Another way that dairy products on Canada's import control list enter Canada is through the Import for Re-Export Program (IREP). Products coming in under IREP do not enter the Canadian domestic market. Yogurt imports in 2010 under the IREP were approximately 39,000 MT.

The IREP is a program that is limited to Canadian processors which import dairy products for processing in Canada, and subsequently re-export the products. These IREP imports must be used exclusively to manufacture products that are subsequently exported, and the diversion of the imported product under IREP to the Canadian market is prohibited. Typically, the condition under which food processors have access to these imports is that the imports must be re-exported within six months. The

IREP is a very popular program for both Canadians and Americans as this is the main vehicle through which U.S. dairy exports enter Canada (outside the quota).

One example is butter imported into Canada from the United States. Canada has a quota on butter of 3,274 MT. Any butter imported above that amount is subject to a tariff of 289.5%. For dairy year (August 1-July 31) 2009/2010, Canada's Department of Foreign Affairs and International Trade (DFAIT) reported issuing import permits for 9,681 MT of butter. The butter imports under the IREP program accounted for 65% of this total or 6,291 MT, nearly double the quota. Butter from the United States likely accounted for more than half of the IREP butter imports. One of the most common uses for this butter is for use in manufacturing cookies and crackers which are subsequently exported.

Another example is fluid milk. Canada has an import quota of 64,500 MT for fluid milk, which the Government of Canada considers "filled" through cross-border shopping, e.g. Canadian travelers returning across the border to Canada with milk for personal consumption. As a result, all milk commercially imported into Canada arrives under IREP with nearly all of it coming from the United States. In dairy year 2009/2010, DFAIT reported milk imports under the IREP totaling 30,780 MT.

A list of the companies in Canada that used the IREP in 2009 (latest data available) can be found at the following URL address: http://www.international.gc.ca/controls-controles/prod/agri/IREP2009-PIR2009.aspx.

Yogurt Export Restrictions

Some elements of the Canadian milk supply management system are considered to be cross subsidized due to the fact that a price floor for the dairy products is set by a Crown Corporation known as the Canadian Dairy Commission. As a result, dairy products produced within the supply management system and exported from Canada are subject to certain restrictions. Canada must sell its product in foreign markets at the full Canadian domestic price (which is usually much higher than U.S. or world prices), otherwise the exports are considered subsidized and are subject to certain disciplines. Canada is permitted a limited amount of subsidized exports. The limit of subsidized exports permitted in "other dairy products" (which is the category kefir and yogurt would fall into) for Canada is 30,282 MT or $C 22,505,000. For the 2008/2009 marketing year (most recent data available) Canada reported exports valued at C$ 22,382,000 totaling 6,584 MT for the "other dairy products" category.

More on Canada's World Trade Organization obligations is available at the following URL address: http://www.wto.org/english/tratop_e/agric_e/ag_work_e.htm

Canadian Dairy Exports to the United States Using the Import for Re-Export Program

It should be noted that dairy products being manufactured using dairy ingredients obtained under the IREP program would not be subject to export subsidy disciplines under current trade laws. This is best explained using an example.

There currently is a Canadian yogurt company that is manufacturing yogurt in Canada and selling it into the United States market. This yogurt is not subject to the export subsidy disciplines due to the fact that it is being made with United States grade A milk. The company is importing the U.S. milk into Canada, turning it into yogurt, and then exporting the milk back to the United States in the form of yogurt via the IREP. This means that this production, because it is being manufactured with milk produced ***outside*** the supply management system, is ***not*** subject to the export restrictions imposed on dairy products that are produced with milk generated ***inside*** the supply management system. Also, what constitutes grade A milk in Canada and the United States is a little different in each country and so the production lines are kept separate. Due to the Canadian supply management system, the Canadian company must account for all its milk usage to the Canadian Dairy Commission which conducts audits to make sure that none of the U.S. milk is being diverted into the Canadian system, and vice versa. This company has plans to eventually build a plant in the United States to supply the U.S. market.

More information on the IREP program is available at the following URL address:

http://www.international.gc.ca/controls-controles/prod/agri/dairy-laitiers/notices-avis/663.aspx?lang=eng