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Canada

Dairy and Products Annual

2014

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Report Highlights:
Milk, cheese, butter and skim milk powder production is forecast to increase in 2015 due to the need to build stocks. Imports of these products will remain close to average levels due to the import controls in place. The need to gain efficiencies through lowering production costs will keep imports of milk protein substances strong (TRQ not applicable to US trade). The CETA has been signed, though not ratified, and there are several elements of the agreement that could affect the competitiveness of U.S. dairy products in the Canadian market.

EXECUTIVE SUMMARY

- The Canadian dairy sector functions under a supply management system, based on planned domestic production, administered pricing and dairy product import controls.

- Production, trade and consumption trends have stayed relatively stable over time, due to the factors stated above, compiled with the fact that there are not significant changes in GDP or population growth to drive increases in demand.

- In 2015, milk production is forecast to increase slightly from 2014 estimated levels to 8.535 million metric tons (MMT) in order to maintain butter stocks and meet demand. The 2014 estimate for milk production (including on farm feed use) is 8.409 million metric tons (MMT). This is marginally below 2013 levels (0.5 percent).

- Post forecasts butter production to increase in 2015 to 90 thousand metric tons (TMT) to meet the steady demand and maintain stock levels. Post's estimate for butter production in 2014 is 85 TMT, 10 percent lower than 2013 levels.

- Cheese production has been slowly increasing over time in response to consumer demand. In 2015, cheese production is forecast to reach 390 TMT, a slight increase from 2014 estimated levels of 389 TMT.

- Skim milk powder production in 2015 is forecast to rise to 80 TMT in response to increased butter production. Skim milk powder production in 2014, is expected to reach 77 TMT, this represents a 4.5 percent increase over 2013 levels. This increase is the result of a return to more average (lower) levels of butterfat in the milk.

- Import controls and export subsidy limitations mean that trade in milk, butter, cheese, and skim milk powder stay relatively stable over time. Trade under certain products (dairy ingredients) not covered under tariff rate quotas has been increasing over time due to Canadian manufacturer's trying to gain efficiencies through investments in technologies that lower production costs. Exports of milk protein substances to Canada under 3504.00.11 and 3504.00.12 was nearly $129 million in 2013, with US trade accounting for $78 million (60 percent share of the trade). In 2014, the value of trade had already surpassed 2013 levels by the end of October when it reached $142 million, with U.S. exports accounting for $84 million dollars (67 percent share of trade).

- In the fall of 2014, Canada submitted its 2011/2012 marketing year export subsidies notification. Canada reported subsidized exports totaling 9.3 TMT ($31.2 million) for skim milk powder, 4.8 TMT ($14.4 million) for cheese, and 22.5 TMT ($6.8 million) for other milk products. Canada reported no subsidized exports of butter.

- For 2013, the Canadian dairy trade balance remained at a deficit of over $470 million (CDN$ 490 million), an 11 percent increase over the previous year's level.

- In late September 2014, the Comprehensive Economic Trade Agreement was signed by Canada and the European Union and the draft consolidated text has been made public. The EU has been granted concessions on dairy that will allow the EU even greater cheese access into the Canadian market (expanding of the cheese quota and elimination of in-quota tariffs). There are some elements of the agreement that could impact U.S. competitiveness of cheese and milk protein substances into the Canadian market.

SNAPSHOT OF CANADIAN DAIRY INDUSTRY

- The Canadian dairy sector functions under a supply management system, based on planned domestic production, administered pricing and dairy product import controls.

- In 2014, the first seven month of data show total cash farm receipts having increased 3 percent above 2013 levels for the same time period. (source: Statistics Canada, table 003-008) In calendar year 2013, total net cash farm receipts from milk and cream sold off farms reached $5.7 billion (CND$ 5.91). This is unchanged from year 2012 levels.

- For 2014, the first 6 months of data shows sales of milk and dairy products 4 percent above year 2013 levels for the same time period. In 2013, manufactured shipments (sales) of milk and dairy products reached $15.6 billion and represents 17.6 percent of Canada's total food and beverage sector. This represents an increase of 7 percent over year 2012 levels. (Source: Statistics Canada, table 304-0015)

- The dairy industry ranks third in terms of value in the Canadian agricultural sector following grains and red meat (http://www.dairyinfo.gc.ca/index_e.php?s1=cdi-ilc).

- Better feeding, disease control and genetic advancements have increased the amount of milk produced per cow resulting in needing fewer dairy cows to meet Canada's domestic requirements. For example, since the year 2000, the Canadian dairy herd has fallen to 959,300 head, which represents a 13 percent decrease. (Source: Canadian Dairy Information Center)

- The number of dairy farms has decreased nearly 40 percent since the year 2000. The number of dairy farms has dropped to 11,962 in 2013 from 19,363. (Source: Canadian Dairy Information Center)

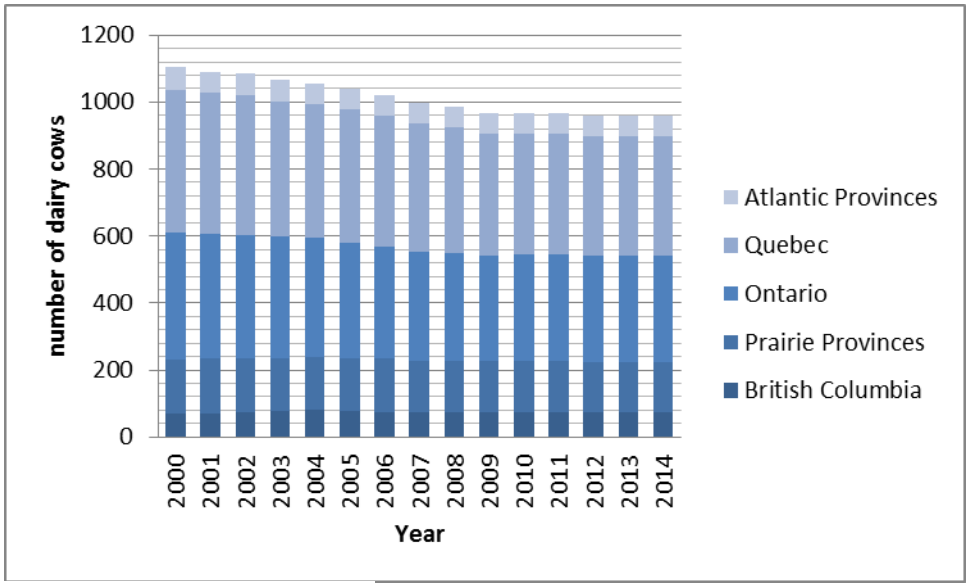
- Consequently, farming units have grown in size and have become more efficient in operation. The number of dairy cows per farms has risen from an average of 57 dairy cows per farm in the year 2000 to an average of 80 dairy cows per farm in 2014. This represents an increase of over 40 percent. (Source: Canadian Dairy Information Center)

- The provinces of Quebec and Ontario are the provinces were dairy production is most concentrated. Quebec accounting for 37 percent of the dairy cows in 2014, followed by Ontario with 33 percent. The province of British Columbia had the next largest number of dairy cows and accounted for 8 percent of the total number of dairy cows (see figure 1 on next page).

- The typical Canadian dairy farm is quite specialized, with most of its revenue coming from milk production and the sale of dairy cattle. It is a family-owned operation. The farm owners are in their mid-forties and have built up considerable equity in their operation. The typical family farm is accustomed to using advanced technology in practices such as artificial insemination, breed selection and labor-saving milking systems. Computerization of feeding and herd management systems, and equipment innovations are also rapidly changing the way things are done on the farm. The industry has experienced a 36 percent decline in the number of dairy

farms over the past decade. However, individual farming units have grown in size and have become more efficient in operation.

Figure 1: Number of Dairy Cows per Province (Years 2000 – 2014)



Source: Canadian Dairy Information Center

The dairy processing sector is relatively concentrated. The latest statistics show that the three largest processors in the country (Saputo, Agropur and Parmalat) process approximately 75 percent of the milk produced in Canada. The fluid milk market represents almost 40 percent of milk utilization, while the market for manufactured dairy products such as butter, cheese, yogurt and ice cream accounts for more than 60 percent of utilization. (Source: Canadian Dairy Commission)

PRODUCTION, CONSUMPTION, TRADE AND STOCKS FOR MILK, CHEESE, BUTTER AND NON-FAT DRY MILK

MILK:

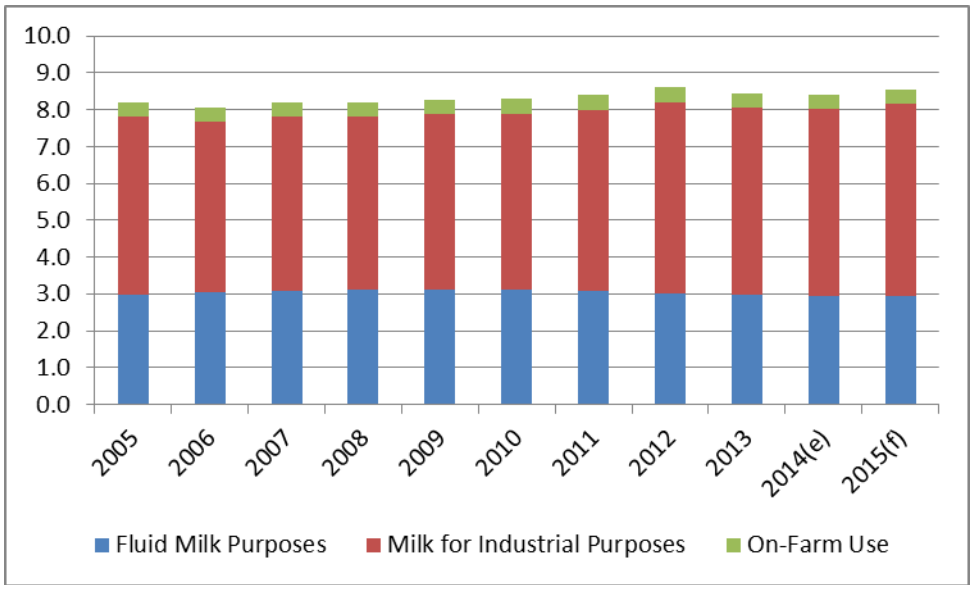
Production:

In Canada, provincial milk marketing boards maintain responsibility for setting production limits of its own fluid milk, pricing formulas, quota policies and other regulations. Industrial milk production levels are allocated using a national management tool called the Market Sharing Quota (MSQ). Quota is allocated on a butterfat basis. It is set by the Canadian Milk Supply Management Committee (CMSMC), which applies the terms of the National Milk Marketing Plan (a federal-provincial agreement) to establish each province's share of the MSQ. The provinces are then responsible for distributing shares of the quota to producers according to provincial policies and in accordance with pooling agreements.

More on the system can be found at the following URL address: http://www.cdc-ccl.gc.ca/CDC/index-eng.php?id=3806

Milk production in Canada supplies two markets. The fluid milk market includes creams and flavored milks. The industrial milk market is milk used to make products such as butter, cheese, yogurt, ice cream and milk powders. In 2013, the fluid milk market accounted for 35 percent of total milk produced in Canada, and the industrial milk market 60 percent. On farm use is estimated to account for approximately 4 to 5 percent of total milk produced.

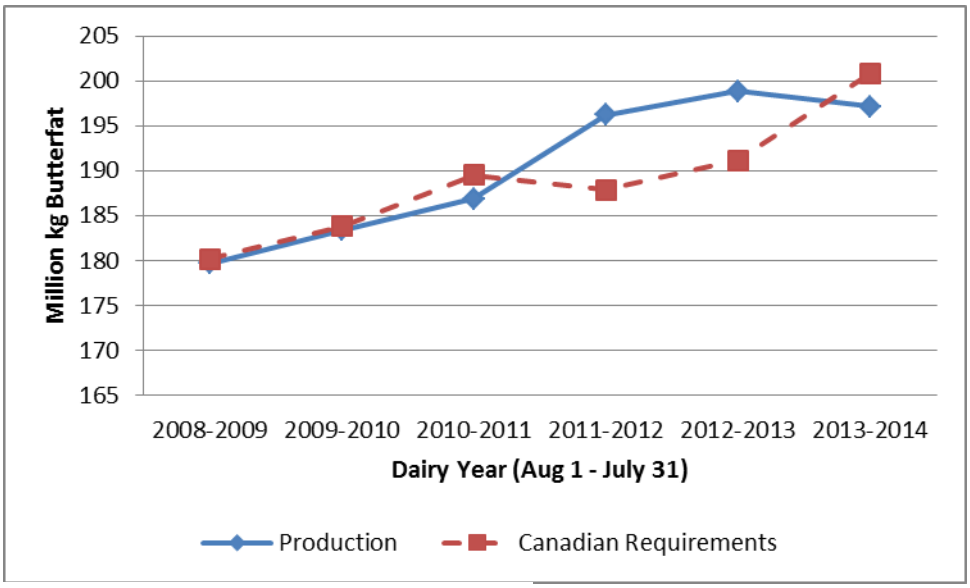
Figure 2: Milk Production in Canada, 2005-2015(f), in million metric tons



Source: Statistics Canada, Milk production and utilization, http://www5.statcan.gc.ca/cansim/pick-choisir?lang=eng&p2=33&id=0030011

The CMSMC sets the MSQ based on the recommendations of the Canadian Dairy Commission (CDC). The CDC monitors the trends in Canadian dairy requirements (demand) and makes recommendations on the necessary adjustments to reflect changes in demand for milk for industrial dairy products. ***Figure 3*** below illustrates the changes in Canadian dairy requirements and milk production for industrial purposes over time by dairy year.

Figure 3: Canadian Dairy Requirements and Production for Industrial Milk Market



Source: Canadian Dairy Commission; Market Bulletins
http://www.cdc-ccl.gc.ca/CDC/index-eng.php?link=112

For dairy year 2013-2014 (August 1, 2014 – July 31, 2014), milk production in butterfat equivalent has fallen below the dairy industry requirements. This drop in production was preceded by several years where production overshot domestic requirements of butterfat. The higher-than average percentage of butterfat in the milk was due to the availability of high quality forage and good weather conditions. In dairy year 2013-2014, butter-fat content returned to more average levels.

Due to the supply management system in place, significant changes in milk production from year to year due to changing international market conditions do not occur. In 2015, milk production is forecast to increase slightly from 2014 estimated levels to 8.535 million metric tons (MMT) in order to maintain butter stocks and meet demand. Based on 9 months of production data of milk produced for the fluid milk market and for the industrial milk market, the 2014 estimate for milk production (including on farm feed use) is 8.409 million metric tons (MMT). This is marginally below 2013 levels (0.5 percent).

Trade:

The fluid milk access level is set at 64,500 metric tons (MT), however there is no commercial quota available for fluid milk, as it is assumed to be filled through cross border shopping. Milk imports enter Canada under personal use exemptions (General Import Permit No. 1 - Dairy Products for Personal Use) or through the imports for re-export program (IREP) and therefore are limited. Cream, unlike fluid milk, has a small commercial quota, which is determined on a dairy year (August-July) basis rather than an

annual calendar year (CY) basis. The cream access level is 394 MT. Cream imports continue to increase due to the increased usage of the Import for Re-Export Program.

Milk imports in 2015 are expected to remain at 2014 levels of 48 TMT. Trade numbers on milk coming into Canada as part of cross border shopping are not reliable as it is not tracked very closely. Despite a weaker Canadian dollar expected for the next eighteen months, the volume of milk purchased through cross border shopping is not expected to change due to ingrained shopping habits as well as the attractiveness of US milk prices compared to Canadian prices despite the difference in exchange rates. Due to market proximity and the perishable nature of fluid milk and cream, the United States is the primary source for imports of milk and cream into Canada.

Milk exports from Canada are very small, in part due to export subsidy limitations, but for the most part due to the structure of the supply management system and provincial regulations which limits the ability of milk producers to transport the milk across the border. Milk exports in 2015 are forecast to remain at the same levels as expected for 2014: 4 TMT.

Consumption:

The Canadian dairy sector functions under a supply management system, based on planned domestic production, administered pricing and dairy product import controls. Due to these factors, as well as fact that there are not significant changes in GDP or population growth to drive demand for dairy products means that milk production levels have stayed relatively stable over time. Statistics released in September of 2014 puts Canada's growth rate at 1.2 percent. The overall population growth rate has shown little variation in 30 years, ranging between 0.8 percent and 1.2 percent. The statistics also reveal that much of this growth occurs through immigration, which does not necessarily translate into increased demand for dairy products. In addition, the popularity of milk substitutes from other product groups (almond milk, soy milk, margarines etc.) has meant increased competition.

BUTTER:

Production:

Post forecasts a production increase in 2015 to meet the steady demand and maintain stock levels. Based on 9 months of production data and the fact that according to the Canadian Dairy Commission, for most of 2014 butterfat production has fallen short of industry requirements, Post's estimate for butter production in 2014 is 85 TMT, 10 percent lower than 2013 levels.

Trade:

Total butter imports are comprised of three HS codes: 0405.10.00 for butter, 0405.90.00 for fats and oils derived from milk, and HS 0405.20.00 (zero TRQ access) for dairy spreads, which contain butter. Similar to cream imports, the butter import access level is determined based on the dairy year, rather than the calendar year. The access quota is set at 3,274 MT and applies only to the butter and fats and oils from milk. Nearly two thirds of the TRQ is allocated to New Zealand (2,000 MT).

More than half of the butter imports into Canada enter under the import for re-export program (IREP), the demand for which often fluctuates with the Canadian exchange rate. With a weaker Canadian dollar forecast for the next eighteen months, there is likely to be a decrease in IREP usage. Imports of butter are forecast to decrease to 8 TMT in 2015 from 2014 forecast levels of 10 TMT tons. The 2014 estimate of 10 TMT is based on 9 months of trade data and the fact that with Canadian butterfat content below industry requirements, increased imports were needed to meet the industry demand.

Due to its proximity to the Canadian market and the popularity of the import for re-export program, US butter imports (040510) account for between 25 percent and 59 percent of butter imports into Canada.

Canadian exports of butter are limited by its export subsidies commitments for butter of 3.5 TMT or $11.025 million (which ever limit is hit first). However, in 2015, butter exports will be limited by lower than average supplies due to low carry-in stocks. Exports of butter for 2015 are forecast to reach 2 TMT, the same level estimate for 2014 levels. Exports of butter for 2014 are based on 9 months of trade data and lower than average supplies due to the fact that production of butterfat has not kept up with industry requirements.

Consumption:

Butter consumption has been growing slowly over time, but is forecast to decrease to 96.0 TMT, a marginal decrease from estimate 2014 consumption levels of 96.6 TMT. This forecasted decrease is attributed to a weaker Canadian dollar which is likely to result in lower butter consumption as other goods become more expensive. Butter is still considered a luxury good by many and therefore increases in food costs (fruits and vegetables, meat etc) and well as other non-food goods have a detrimental effect on butter sales. Domestic consumption for 2014 is estimated based on nine months of trade and production and consumption data, and the fact that butter sales, which are traditionally high around the holidays, may be lower due to the impact of the weaker dollar on consumer goods.

Stocks:
Stocks are forecast to remain level in 2015 as increased production will be off-set by the low carry-in stocks and steady demand. Stocks in 2014 are estimated to fall be drawn down to 7 TMT due to low supplies resulting from production of butterfat falling below targets.

CHEESE:

Production:

Cheese production has been slowly increasing over time in response to consumer demand. Most of this increase has been driven by an increase demand for specialty cheeses, and an increase in usage of cheddar cheese in further processed products (convenience foods). In 2015, cheese production is forecast to reach 390 TMT, a slightly increase from 2014 estimated levels of 389 TMT. The increase in

production in 2014 and 2015 is also being driven by a need to maintain stocks which were drawn down significantly in 2013 when demand significantly outstripped supplies.

Trade:

The commercial quota on cheese is 20,411,866 kilograms. Most cheese enters Canada either through the import quota system, which is filled every year, or through the import for re-export program which goes into further processed products which are then exported. The European Union has country-specific access to 66 percent of the global quota, the rest of the quota is non-EU cheese which is mostly filled by the United States. Due to the tariff quota system, imports remain relatively stable and are forecast to reach 23.5 TMT in 2015, and 23.8 TMT in 2014. The forecast decrease in 2015 is due to a minor decrease in IREP usage resulting from a decrease in the value of the Canadian dollar. Nevertheless, IREP usage is expected to remain strong as historically, cheese trade under IREP is not as effected by the exchange rate as other products. Exports for Canadian cheese containing processed products will likely increase and off-set the negative impacts of the weaker Canadian dollar on IREP cheese imports. Cheese exports are partially limited by export subsidy commitment levels of 9 TMT tons and outlays of $16 million. In 2015, cheese exports are forecast to remain at levels similar to year 2014 levels of 10 TMT. Year 2014 cheese exports estimated are based on 9 months of trade data. A weaker Canadian dollar is expected to help support Canadian cheese exports.

Consumption:

Cheese consumption in Canada has been growing slowly but steadily. In 2015, cheese consumption levels are forecast to remain close to 2014 estimated levels of 403 TMT. The 2014 estimated levels of 403 TMT, which are based on 9 months of supply and demand data, represent a 2 percent decrease from 2013 levels. This decrease is anticipated due to the weaker Canadian dollar which may curb Canadian's expenditure on cheese if it is viewed as a luxury good and not a staple good.

Stocks:

Cheese stocks in 2015 are forecast to be drawn up slightly in response to increased production. Cheese stocks in 2014 are expected to remain level.

SKIM MILK POWDER:

Production:

Skim milk powder production in 2015 is forecast to rise to 80 TMT in response to increased butter production. Skim milk powder production in 2014, based on 9 months of production data, is expected to reach 77 TMT. This represents a 4.5 percent increase over 2013 levels. This increase is the result of a return to more average (lower) levels of butterfat in the milk.

Trade:

Skim milk powder comes into Canada under the import for re-export program and volumes vary between 3 and 5 TMT per year. Skim milk imports in 2015 are forecast to be 3 TMT which are average levels. Nine months of trade data for 2014 suggests that skim milk powder imports may reach 4.6 TMT in 2014 which suggests a strong demand from the processing sector.
Skim milk powder exports are partially limited by annual export subsidy commitment levels of 45 TMT, and outlays of $31 million. The fact that there is a higher demand for butterfat that skim milk powder in Canada has led to a structural surplus which results in Canada trying to maximize skim milk powder exports while respecting its export subsidies commitments. The high domestic price for skim milk powder means that Canada hits the financial limit before it hits the volume limit. A weaker Canadian dollar in 2014 and 2015 will support increased exports. Post forecasts that skim milk powder exports in 2015 will be close to those estimated for 2014 at 14 TMT.

Consumption:

The use of skim milk powder in the Greek yogurt which has proven very popular with Canadian consumers has helped maintain a steady demand for skim milk powder. Domestic consumption of the skim milk powder is forecast to reach 70 TMT, similar to estimated levels for 2014.

Stocks:

The higher butterfat content in the milk the past several years has help reduce stocks. In 2015, stocks are anticipated to be drawn down marginally as a result in a slight decrease in imports and strong exports. In 2014, nine months of trade data shows strong exports helping offset increased production resulting in a small decrease in stocks.

TRADE

Import Controls:
Quantitative restrictions in ten categories of dairy products were converted to TRQs to support supply management of industrial milk under the Canadian Dairy Commission Act and as a result of the agreement at the World Trade Organization (WTO) in 1994. Canada undertook an Article XXVIII action in 2008 to create a new TRQ for milk protein substances in chapter 35. Due to the North American Free Trade Agreement, the TRQ cannot be applied against U.S. trade.

Information on the tariff utilization rates and quota holders for various dairy products can be found at the following URL address: http://www.international.gc.ca/trade/eicb/agric/milk-en.asp

The legislation and regulations that underpin the import controls can be found at the following URL address: http://laws.justice.gc.ca/en/E-19/index.html (Export and Import Permits Act)

The market access given to dairy products in Canada are presented in the table below.

Table 1: Market Access Given to Dairy Products

Dairy Product Description	Access in tons	Tariff Item Number (to 6-digit)
Milk Protein Substitutes	10,000	3504.00.11, 3504.00.12
Fluid Milk[1]	0	0401.10, 0401.20
Cream, not concentrated, no sugar, (heavy cream)	394	0401.30
Skim Milk Powder	0	0402.10.10
Whole Milk Powder, whether or not Sweetened	0	0402.21, 0402.29
Concentrated and Evaporated milk	12	0402.91, 0402.99
Yogurt	332	0403.10
Powdered Buttermilk	908	0403.90
Liquid Buttermilk, Sour Cream	0	0403.90
Dry Whey	3,198	0404.10
Products consisting of natural milk Constituents	4,345	0404.90
Butter, fats and oil from milk	3,274	0405.10, 0405.90
Dairy Spreads	0	0405.20
Cheese	20,412	0406
Ice cream mixes	0	1806.20, 1806.90
Ice Cream and other edible ice	484	2105
Milk cream and butter subs.	0	2106.90
Non-alcoholic beverages containing milk	0	2202.90
Complete feeds and feed supplements	0	2309.90

[1] There is no commercial TRQ for fluid milk. However access of 64,500 tons of fluid milk is allowed and considered filled by cross-border shopping.
** not applicable against countries with which Canada has a FTA

Export Limitations:

The 2002 ruling by the World Trade Organization (WTO) capped subsidized exports of dairy products from Canada. As a result, given the high domestic price for dairy products in Canada, exports opportunities for the Canadian dairy industry are limited and results in a negative trade balance. Export subsidies for butter, skim milk powder, cheese and "other milk products" are subject to caps of 3.5 TMT ($11.0 million), 45 TMT ($31.2 million), 9.1 TMT ($16.2 million), and 30.3 TMT ($22.5 million), respectively. The most recent notification by Canada for export subsidies was made in September of 2014 for marketing year 2011/2012 and reported subsidized exports totaling 9.3 TMT (31.2 million dollars) for skim milk powder, 4.8 TMT ($14.4 million) for cheese, and 22.5 TMT ($6.8 million) for other milk products. Canada reported no subsidized exports of butter. The dairy division of Agriculture Canada calculates that for 2013, the dairy trade balance remained at a deficit of over $470 million ($C490 million), an 11 percent increase over the previous year's level. Dairy imports in 2013 were valued at $794 million, an increase of 7 percent over 2012.

Figure 4: Dairy Trade Balance 2005-2013

Source: Canadian Dairy Information Center http://dairyinfo.gc.ca/index_e.php?s1=dff-fcil&s2=imp-exp&s3=bal

More information on Canada's commitments and notifications to the WTO can be found at the following URL address:
http://www.wto.org/english/tratop_e/agric_e/ag_work_e.htm

While trade of dairy products under the TRQ lines is often the focus of dairy trade analysis with Canada, it is important not to underestimate the trade in dairy ingredients under lines that are not covered by TRQs. In 2013, the volume of imports of dairy products covered by TRQs into Canada reached nearly 96.0 TMT. The U.S. share of that trade was 76 percent and is valued at $176 million. In comparison, total dairy imports under lines not covered under TRQs reached nearly 90 TMT, with the US share accounting for 72 percent and valued at $245.3 million. ***Appendix 2*** at the end of this report provides a snapshot of dairy product imports divided into lines covered by TRQs and lines not covered

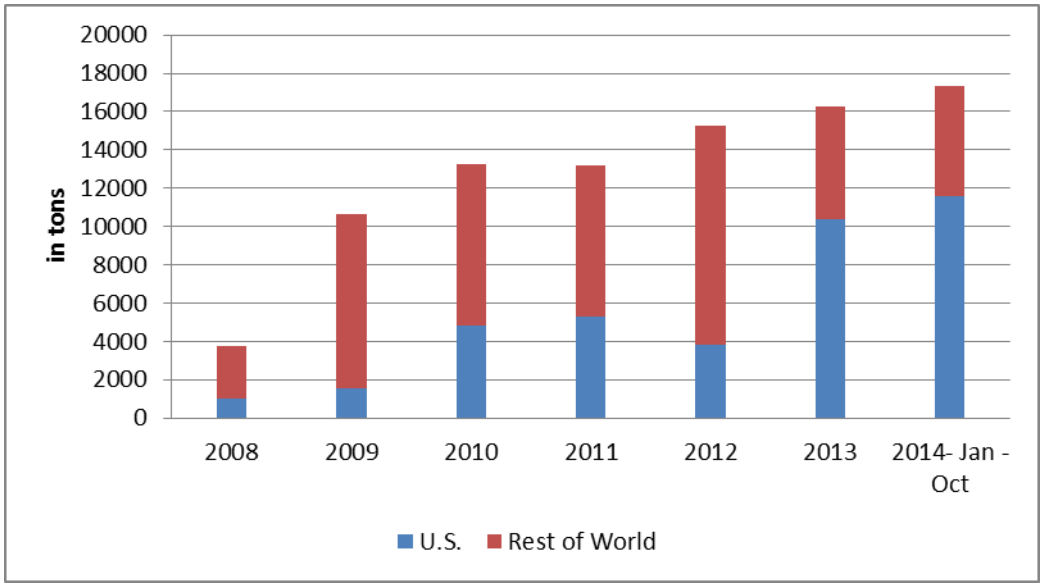
by TRQs. This is not an exhaustive list as some products such as feed and ice-cream mixes are not included however some products not represented by the Canadian Dairy Information Center are included in the non-TRQ trade (from a US perspective) such as milk protein substances (chapter 35), chocolate milk, etc.. Please see the ***Appendix 2*** for more detail.

POLICY

UF85 Milk:

As mentioned previously, the TRQ created in 2008 under chapter 35 for milk protein substances milk is currently not applicable against U.S. exports to Canada. The supplemental note in chapter 35 states that "milk protein substances with a milk protein content of 85 percent or more by weight, calculated on the dry matter, are classified in tariff item number 3504.00.11 or 3504.00.12. Milk protein substances with a milk protein content of less than 85 percent by weight, calculated on the dry matter, are classified in Chapter 4 (subheading 0404.90)". The quota limit for the rest of the world in 10,000 tons and the over quota tariff is set at 270 percent.
There is a strong lobby push by the Canadian Dairy Farmers to change this supplemental note to reflect their belief that milk protein substances with a milk protein content of 85 percent protein or more is diafiltered milk, which would be prohibited in the Canadian compositional standards for cheese. Such a change would severely impact U.S. export of ultrafiltered milk 85 to Canada. Advancements in manufacturing technology that reduce cost and increase flexibility in manufacturing has led to a growing demand for U.S. UF85. Data for trade under 3504.00.11 and 3504.00.12 is available as of 2008 when the TRQ was created and is presented in the table below. The value of trade under 3504.00.11 and 3504.00.12 was nearly 129 million in 2013, with US trade at 78 million. In 2014, the value of trade had already surpassed 2013 levels by the end of October when it reached 142 million $US, with US trade accounting for 84 million dollars.

Figure 5: Imports of Milk Protein Substances under 3504.00.11 and 3504.00.12

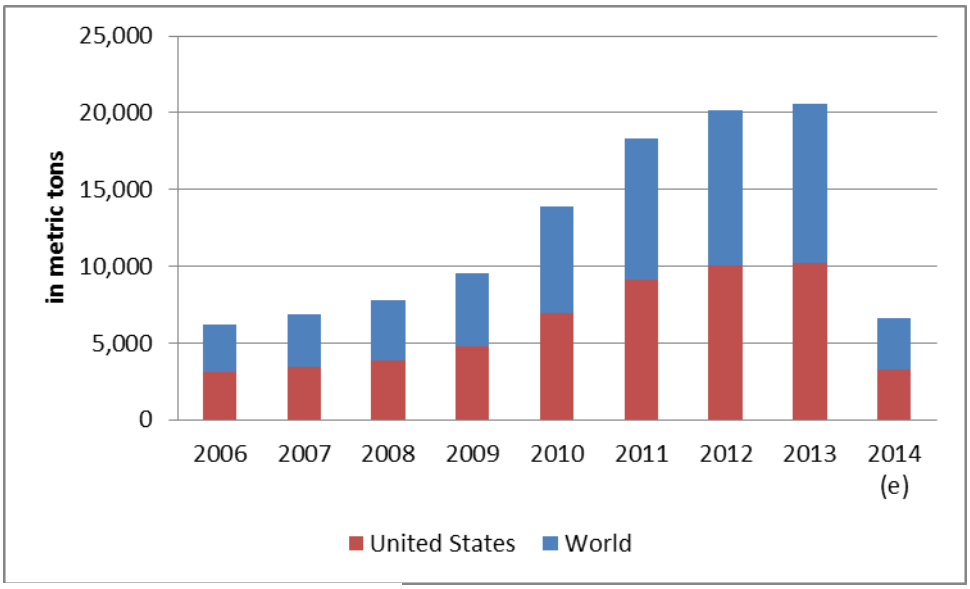


Source: Global Trade Atlas, Statistics Canada

Pizza Toppings Kits:

The impact of Canada adding a supplemental note to chapter 16 in late 2013 which creates an additional tariff for products that contain cheese can be demonstrated clearly in the year-to-date trade data (January – October) of 2014. Trade in pizza toppings kits were cut off as the 245.5 percent tariff applied to the cheese portion of the product made continued exports to Canada economically prohibitive. Year to date trade data (January to October) suggests that trade under 1601.00.90.99 and 1601.00.90.90, which are the lines that pizza topping kits came into Canada under, will fall 60 below year 2013 levels. Almost all trade under this line is from the US. This is estimated to represent a loss of close to $30 million in trade. The Canadian government action was taken without consultations with its trading partners and maintains that this trade action was taken as a measure to address an issue of circumvention. The US government has raised the legitimacy of this allegation in several forums in 2014 including at the World Customs Organization, the WTO Committee on Agriculture and the Consultative Committee on Agriculture.

Figure 6: Impact of Canadian Government Intervention on Trade Flows under 1601.00.90.90



Source: Global Trade Atlas. Statistics Canada

Comprehensive Economic Trade Agreement (CETA):

In late September 2014, the Comprehensive Economic Trade Agreement was signed by Canada and the European Union and the draft consolidated text has been made public. The EU has been granted concessions on dairy that will allow the EU even greater cheese access into the Canadian market (expanding of the cheese quota and elimination of in-quota tariffs). The preferential quota access is being expanded to nearly 32 TMT from 13.5 TMT, and the over-quota tariff on the milk protein substances (35.04.00.12) is being eliminated completely. The amount of additional EU cheese access will increase over a six year period, from 2,667 MT in year one to 16,000 MT by year six. The EU has also been granted additional cheese access for "industrial cheese" which is defined in the text as "cheese used as ingredients for further food processing (secondary manufacturing) imported in bulk (not for retail sale)". According to the draft text, the quota for industrial cheese the first year will be 483 MT, and will graduate up to 1,700 MT by year six. In addition to expanded quota, Canada has agreed to give

the EU an additional 800 MT of cheese quota, to be taken out of the current global quota of 20,412 MT. The justification for this is to account for the EU enlargement and is a tariff administration procedure. Should the CETA be ratified, the EU share of the global quota will be 70% of the global quota. Non-EU cheese will fall to 6,140 MT from 6,940 MT. Details on how the quota will be administered (who will get the economic rent) are still under discussion. What has been agreed to so far on tariff quota administration can be found in **Appendix 3** of this report.

Table 2: Gains for EU through CETA on Market Access for Cheese into Canada

Global Quota: 20412 tons		
Market Access Pre-CETA in MT:		**Share of Global Quota**
EU Reserve:	13,472	66 percent
Non-EU Reserve:	6,940	34 percent
Market Access Post-CETA in MT		**Share of Global Quota**
EU Reserve Post CETA:	14,272	70 percent
Non-EU Reserve Post CETA:	6,140	30 percent
Additionnel EU Market Access outside global quota	17,700	

Source: CETA consolidated text, Global Trade Atlas, Statistics Canada

In addition to the increased market access to cheese, Canada accepted over a hundred Geographical Indications (GIs). The impact on the Canadian dairy industry is that use of names covered by a geographical indication will have restrictions imposed on them. Most generic cheese names currently in use in Canada will continued to be used as they are now (example brie, gouda). However, there are some names such as Asiago and feta that are currently produced and marketed in Canada that will be affected. Canadian manufacturers currently using the names will have a grandfathered right to use the name without any qualifiers, however any new Canadian producers of the cheese will have to use qualifiers such as "style" or "kind".

There are several elements of the CETA that have could negatively impact on U.S. cheese exports to Canada. The decrease of the non-EU reserve by 800 tons will reduce US access to the Canadian market. In 2013, trade data shows that cheese imports from the U.S. into Canada were equivalent to 25 percent of the global quota (5,167 MT) and nearly 75 percent of the non-EU reserve. Total cheese imports into Canada from the US in 2013, including IREP were 8,490 MT.

The access the EU has been given for "industrial cheese" will directly compete with cheese that the United States exports to Canada under the import for re-export program. U.S. exports of UF85 milk may also face additional competition from the EU once the tariff rate quota on 3504.00.12 is no longer applicable against EU exports to Canada.

The impact of geographical indications is still unknown although Canada has given assurances that it will remain in compliance with all its trade partners.

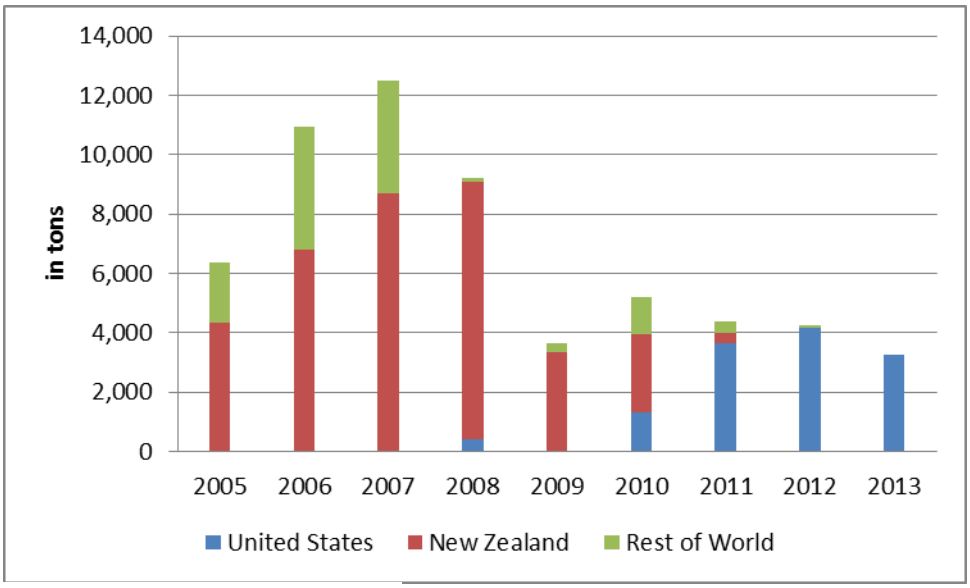
Both countries have begun proceedings with legal checks and translations in hopes that it could be wrapped up in the first half of 2015. The ability to meet this deadline is uncertain as there may be some issue with whether or not EU trade deals that have investment provisions, as CETA does, can be simply

approved by EU institutions or if they require ratification by each of the 28 states. If the latter is the case, ratification of the CETA may be much further off.
The draft text is available at the following URL address: http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/ceta-aecg/text-texte/toc-tdm.aspx?lang=eng

Domestic Dairy Policies/Strategies:

The trend in dairy products manufacturing is shifting from traditional methods to using new technologies that use dairy ingredients to reduce costs while encouraging product innovation. This shift in manufacturing trends has led to problems for the Canadian dairy farmers who find that current import controls do not cover some of the dairy ingredients that are now in demand. A growing structural surplus of skim milk powder is the costly result. For this reason, Canadian milk producers are trying to reposition themselves as dairy ingredient suppliers and have put forth several strategies that would render them more competitive with imports not covered by TRQs. In very general terms, the strategies focus on trying to recapture the ingredients market by providing a certain percentage of the milk for a price competitive with the United States' price, and providing the balance of the milk at domestic prices if a contract is signed that only Canadian-origin dairy ingredients would be used in the production of the dairy products. Using only Canadian dairy ingredients would also give processors the ability to use the "little blue cow" license. The Little Blue Cow is a marketing brand that the Dairy Farmers of Canada have built up and that has gained considerable consumer recognition in Canada. There are significant challenges to getting processors, and all provincial marketing boards, to accept such a model. However, if successful, this model could have significant detrimental effects on the competitiveness of U.S. product into Canada. A proposal has been put forth at the Canadian Supply Management Committee (CSMC) by the milk marketing board of Ontario to apply such a type of program to cheese manufacturing, but there has been, as yet, no consensus from the other provinces, nor from the manufacturing industry. This type of model however proved quite successful in cutting off imports of butter oil sugar blends from New Zealand for use in ice-cream. A 100 percent dairy ingredients program was made available to Canadian ice-cream manufacturers and the impact of the program is demonstrated in the figure on the following page.

Figure 7: Canadian Imports of 2106909510, Food Preparations of Butter Oil and Sugar Blend



Source: Global Trade Atlas, Statistics Canada

Trans Pacific Partnership:

There is nothing to report on Trans Pacific Partnership negotiations at this time with regards to movement from Canada on opening its supply managed industries.

STATISTICS

Dairy, Milk, Fluid Canada	2013		2014		2015	
	Market Year Begin: Jan 2013		Market Year Begin: Jan 2014		Market Year Begin: Jan 2015	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Cows In Milk	961	961	955	955		955
Cows Milk Production	8,535	8,443	8,450	8,409		8,535
Other Milk Production	0	0	0	0		0
Total Production	8,535	8,443	8,450	8,409		8,535
Other Imports	40	48	40	48		48
Total Imports	40	48	40	48		48
Total Supply	8,575	8,491	8,490	8,457		8,583
Other Exports	4	3	4	4		4
Total Exports	4	3	4	4		4
Fluid Use Dom. Consum.	3,014	2,982	3,000	2,946		2,946
Factory Use Consum.	5,151	5,104	5,136	5,107		5,244
Feed Use Dom. Consum.	406	402	350	400		389
Total Dom. Consumption	8,571	8,488	8,486	8,453		8,579
Total Distribution	8,575	8,491	8,490	8,457		8,583
1000 HEAD, 1000 MT						

Dairy, Butter Canada	2013		2014		2015	
	Market Year Begin: Jan 2013		Market Year Begin: Jan 2014		Market Year Begin: Jan 2015	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	17	15	16	11		7
Production	92	95	88	85		90
Other Imports	7	7	8	10		8
Total Imports	7	7	8	10		8
Total Supply	116	117	112	106		105
Other Exports	5	4	3	2		2
Total Exports	5	4	3	2		2
Domestic Consumption	95	102	95	97		96
Total Use	100	106	98	99		98
Ending Stocks	16	11	14	7		7
Total Distribution	116	117	112	106		105
1000 MT						

Dairy, Cheese Canada	2013		2014		2015	
	Market Year Begin: Jan 2013		Market Year Begin: Jan 2014		Market Year Begin: Jan 2015	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	72	61	77	52		52
Production	550	388	545	389		390
Other Imports	25	24	25	24		24
Total Imports	25	24	25	24		24
Total Supply	647	473	647	465		466
Other Exports	10	9	9	10		10
Total Exports	10	9	9	10		10
Human Dom. Consumption	560	412	565	403		403
Other Use, Losses	0	0	0	0		0
Total Dom. Consumption	560	412	565	403		403
Total Use	570	421	574	413		413
Ending Stocks	77	52	73	52		53
Total Distribution	647	473	647	465		466

1000 MT						

Dairy, Milk, Nonfat Dry Canada	2013		2014		2015	
	Market Year Begin: Jan 2013		Market Year Begin: Jan 2014		Market Year Begin: Jan 2015	
	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	31	33	30	25		24
Production	78	74	76	77		80
Other Imports	3	3	2	5		3
Total Imports	3	3	2	5		3
Total Supply	112	110	108	107		107
Other Exports	11	13	10	14		14
Total Exports	11	13	10	14		14
Human Dom. Consumption	70	71	70	68		69
Other Use, Losses	1	1	1	1		1
Total Dom. Consumption	71	72	71	69		70
Total Use	82	85	81	83		84
Ending Stocks	30	25	27	24		23
Total Distribution	112	110	108	107		107
1000 MT						

Appendix 1

Dairy Items on Import Control List:
http://laws-lois.justice.gc.ca/eng/regulations/C.R.C.,_c._604/page-1.html#h-1

- **117.** Milk and cream, neither concentrated nor containing added sugar or other sweetening matter, of a fat content, by weight, not exceeding 6 per cent, that are classified under tariff item No. 0401.10.10, 0401.10.20, 0401.20.10 or 0401.20.20 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.
- **117.1** Cream, neither concentrated nor containing added sugar or other sweetening matter, of a fat content, by weight, exceeding 6 per cent, that is classified under tariff item No. 0401.40.10, 0401.40.20, 0401.50.10 or 0401.50.20 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.
- **118.** Milk and cream, containing added sugar or other sweetening matter, in powder, granules or other solid forms, of a fat content, by weight, not exceeding 1.5 per cent, classified under tariff item No. 0402.10.10 or 0402.10.20 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.
- **119.** Milk and cream, in powder, granules or other solid forms, of a fat content, by weight, exceeding 1.5 per cent, not containing added sugar or other sweetening matter, classified under tariff item No. 0402.21.11, 0402.21.12, 0402.21.21, or 0402.21.22 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.
- **120.** Milk and cream, in powder, granules or other solid forms, of a fat content, by weight, exceeding 1.5 per cent, containing added sugar or other sweetening matter, classified under tariff item No. 0402.29.11, 0402.29.12, 0402.29.21 or 0402.29.22 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.
- **121.** Preparations (other than preparations classified under tariff item No. 2106.90.31 or 2106.90.32 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*) containing more than 15 per cent by weight of milk fat, but less than 50 per cent by weight of dairy content, and suitable for use as butter substitutes, not elsewhere specified or included, that are classified under tariff item No. 2106.90.33 or 2106.90.34 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.
- **122.** Milk and cream, not in powder, granules or other solid forms, concentrated (whether or not containing added sugar or other sweetening matter) or not concentrated (containing added sugar or other sweetening matter), that are classified under tariff item No. 0402.91.10, 0402.91.20, 0402.99.10 or 0402.99.20 in the List of Tariff Provisions set out in the schedule to the*Customs Tariff*.
- **123.** Powdered buttermilk, whether or not containing added sugar or other sweetening matter or flavoured or containing added fruit, nuts or cocoa, that is classified under tariff item No. 0403.90.11 or 0403.90.12 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.
- **124.** Buttermilk (other than powdered buttermilk), curdled milk and cream, kephir and other fermented or acidified milk and cream, whether or not concentrated or containing added sugar or other sweetening matter or flavoured or containing added fruit, nuts or cocoa, that are classified under tariff item No. 0403.90.91 or 0403.90.92 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.

- **125.** Products consisting of natural milk constituents, whether or not containing added sugar or other sweetening matter, not elsewhere specified or included, that are classified under tariff item No. 0404.90.10 or 0404.90.20 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.
- **125.1** Powdered whey, whether or not containing added sugar or other sweetening matter, that is classified under tariff item No. 0404.10.21 or 0404.10.22 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.
- **125.2** Milk protein substances with a milk protein content of 85 percent or more by weight, calculated on a dry matter basis, that do not originate in a NAFTA country, Chile, Costa Rica or Israel and that are the subject of two commitments signed by the Government of Canada on June 12, 2008, one with the European Communities and the other with the Government of Switzerland, relating to the modification, in Canada's schedule of concessions pursuant to the Agreement Establishing the World Trade Organization, to Canada's concession on tariff item No. 3504.00.00 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff* with regard to those substances.
- **126.** Mixes and doughs, for the preparation of bread, pastry, cakes, biscuits and other bakers' wares classified under heading No. 19.05 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*, containing more than 25 per cent by weight of butterfat and not put up for retail sale, that are classified under tariff item No. 1901.20.11, 1901.20.12, 1901.20.21 or 1901.20.22 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.
- **127.** Milk, cream or butter substitutes containing 50 per cent or more by weight of dairy content, not elsewhere specified or included, that are classified under tariff item No. 2106.90.31 or 2106.90.32 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.
- **128.** Food preparations of goods of heading Nos. 04.01 to 04.04 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff* (other than ice cream mixes or ice milk mixes), containing more than 10 per cent but less than 50 per cent on a dry weight basis of milk solids, not in retail packaging, that are classified under tariff item No. 1901.90.33 or 1901.90.34 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.
- **128.1** Food preparations of goods of heading Nos. 04.01 to 04.04 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff* (other than ice cream mixes or ice milk mixes), containing 50 per cent or more on a dry weight basis of milk solids, not in retail packaging, that are classified under tariff item No. 1901.90.53 or 1901.90.54 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.
- **129.** Food preparations, not elsewhere specified or included, containing 50 per cent or more by weight of dairy content, that are classified under tariff item No. 2106.90.93 or 2106.90.94 in the List of Tariff Provisions set out in the schedule to the*Customs Tariff*.
- **130.** Non-alcoholic beverages containing milk (other than chocolate milk) and containing 50 per cent or more by weight of dairy content and not put up for retail sale, that are classified under tariff item No. 2202.90.42 or 2202.90.43 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.
- **131.** Complete feeds and feed supplements, including concentrates, containing 50 per cent or more by weight, in the dry state, of non-fat milk solids (other than preparations classified under tariff item No. 2309.10.00, 2309.90.10 or 2309.90.20 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*), not elsewhere specified or included, that are classified under tariff item No. 2309.90.31 or 2309.90.32 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.

- **132.** Chocolate ice cream mix and ice milk mix that are classified under tariff item No. 1806.20.21, 1806.20.22, 1806.90.11 or 1806.90.12 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.
- **133.** Ice cream mixes and ice milk mixes, being food preparations of goods of heading Nos. 04.01 to 04.04 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*, containing more than 10 per cent but less than 50 per cent on a dry weight basis of milk solids, that are classified under tariff item No. 1901.90.31 or 1901.90.32 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.
- **133.1** Ice cream mixes and ice milk mixes, being food preparations of goods of heading Nos. 04.01 to 04.04 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*, containing 50 per cent or more on a dry weight basis of milk solids, that are classified under tariff item No. 1901.90.51 or 1901.90.52 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.
- **134.** Ice cream and other edible ice, whether or not containing cocoa, other than flavoured ice and ice sherbets, that are classified under tariff item No. 2105.00.91 or 2105.00.92 in the List of Tariff Provisions set out in the schedule to the *Customs Tariff*.

Appendix 2

Trade Under Lines Subject to TRQs					
Quantity in Tons	**2013**	**2012**	**2011**	**2010**	**2009**
World	95,942	87,453	91,328	92,021	86,378
U.S.	72,656	59,881	63,977	66,395	56,454
US Share	**75.73 percent**	**68.47 percent**	**70.05 percent**	**72.15 percent**	**65.36 percent**
Value in $US	**2013**	**2012**	**2011**	**2010**	**2009**
World	406,602,985	404,417,030	403,467,811	388,631,315	347,869,931
U.S.	176,108,080	151,117,884	153,519,107	151,846,870	114,845,471
US Share	**43.31 percent**	**37.37 percent**	**38.05 percent**	**39.07 percent**	**33.01 percent**
Trade Under Lines Not Subject to TRQs					
Quantity in Tons	**2013**	**2012**	**2011**	**2010**	**2009**
World	89,665	69,109	64,300	83,533	233,158
U.S.	71,671	44,999	44,729	61,992	213,335
US Share	**79.93 percent**	**65.11 percent**	**69.56 percent**	**74.21 percent**	**91.50 percent**
Value in $US	**2013**	**2012**	**2011**	**2010**	**2009**
World	386,973,583	332,888,027	299,665,012	249,995,120	197,894,556
U.S.	245,337,539	209,160,015	150,335,415	113,650,867	74,113,959
US Share	**63.40 percent**	**62.83 percent**	**50.17 percent**	**45.46 percent**	**37.45 percent**
Total Trade					
Quantity in Tons	**2013**	**2012**	**2011**	**2010**	**2009**
World	185,607	156,562	155,628	175,554	319,536
U.S.	144,327	104,880	108,705	128,387	269,789
US Share	**77.76 percent**	**66.99 percent**	**69.85 percent**	**73.13 percent**	**84.43 percent**
Value in $US	**2013**	**2012**	**2011**	**2010**	**2009**
World	793,576,568	737,305,057	703,132,823	638,626,435	545,764,487
U.S.	421,445,619	360,277,899	303,854,522	265,497,737	188,959,430
US Share	***53.11 percent***	***48.86 percent***	***43.21 percent***	***41.57 percent***	***34.62 percent***
volume data for cream and milk from Agriculture Dairy Information website					
value data for milk is also from Agriculture Canada Dairy Information network so is in Canadian					

dollars	
All other data is generated from the GTA and value are reported in US$	
Non-TRQ trade includes milk protein substances, pizza topping kits trade (estimate), chocolate milk, and milk beverages (not elsewhere specified)	

Appendix 3

http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/ceta-aecg/text-texte/37.aspx?lang=eng

Declaration on tariff rate quota administration

Canadian TRQ Administration for cheese under CETA

General overall principle that tariff quota administration should be as conducive to trade as possible. More specifically, it must not impair or nullify the market access commitments negotiated by Parties, it must be transparent, predictable, minimize transactional costs for traders, maximize fill rates and aim to avoid potential speculation.

The eligibility criteria/allocation method should result in the quota going to those that are most likely to use it and must not create barriers to imports.

Structure of Import Licensing system

- 1) The annual TRQ access quantity will be allocated each year amongst eligible applicants.
- 2) The TRQ allocation method will allow for new entrants each year. During the implementation period, at least 30% of the TRQ will be available to new entrants every year. After that period, at least 10% of the TRQ access quantity will be available for new entrants.
- 3) The TRQ will be allocated on a calendar year basis. Applications from all interested parties will be received and processed according to the provisions of the Bali Declaration, with a period of four to six weeks to submit applications. Imports will be able to start from the first day of the year.
- 4) In the event that the TRQ is not fully allocated following the application process, available quantities will immediately be offered to eligible applicants on the basis of a prorata of their allocation, or on demand if quantities still remain after the first offer.

Eligibility criteria

- 5) To be eligible, an applicant would at a minimum have to be a Canadian resident and be active in the Canadian cheese sector regularly during the year.
- 6) During the implementation period, a new entrant would be an eligible applicant who is not an allocation holder under Canada's WTO cheese TRQ.
- 7) After that period, a new entrant would be an eligible applicant who is not an allocation holder under Canada's WTO cheese TRQ or did not receive an allocation of the CETA TRQ in the preceding year. A new entrant would be considered as such for a period of three years.
- 8) Once an applicant is no longer considered to be a "new entrant", he would be treated on an equal footing as all other applicants.
- 9) Canada may consider capping the size of the allocations to a specific percentage if it is deemed necessary to foster a competitive, fair, and balanced import environment.

Use of import allocations and Import permits

- 10) Allocations will be valid for a year (from January 1 to December 31).
- 11) To ensure that imports are aligned with domestic market conditions and to minimize barriers to trade, allocation holders will normally be free to use their allocation to import any product covered by the TRQ at any time during the year.
- 12) On the basis of their allocation, importers will submit an import permit request for each shipment of product covered by the TRQ that they wish to bring into Canada. Import permits are normally issued automatically upon request through the Government of Canada electronic permitting system. Under current policies, import permits may be requested up to 30 days before the planned date of entry and are valid for a period of five days before and 25 days from the date of entry. Permits are not transferable. Permits may be amended and/or cancelled.
- 13) Transfers of allocations may be authorized.
- 14) A company that uses less than 95% of its allocation in any one year may be subject to an underutilization penalty in the next year, whereby it will receive an allocation which reflects the actual level of use. Those companies affected will be advised prior to the final allocation of the TRQ.
- 15) Allocation holders will be able to return any unused portion of their allocation up to a given date. Returned quantities are considered used for the purpose of the application of the underutilization penalty. Chronic returns may be penalized.
- 16) Returned quantities will normally be made available to interested allocation holders who have not returned the day after the return deadline. If quantities remain after that, they may be offered to other interested parties.
- 17) The return deadline will be set at a date that is early enough to give sufficient time for use of the returned quantities, while being late enough to allow allocation holders to establish their import needs until the end of the year (potentially around the middle of the quota year).