Approved: February 4, 2004
Date

MINUTES OF THE HOUSE AGRICULTURE COMMITTEE

The meeting was called to order by Chairman Dan Johnson at 3:30 p.m. on January 21, 2004, in Room 423-S of the Capitol.

All members were present.

Committee staff present:
Raney Gilliland, Legislative Research Department
Gordon Self, Revisor of Statutes Office
Kay Scarlett, Committee Secretary

Conferees appearing before the committee:
Patty Clark, Director, Agriculture Marketing Division, Kansas Department of Commerce
Sheila Frahm, Chairperson, Kansas Natural Resources Legacy Alliance
Chris Wilson, Kansas Dairy Association

Others attending:
See attached list.

Greg Foley, Assistant Secretary, Kansas Department of Agriculture, requested introduction of a committee bill to remove sunset dates from fee funds in four of their department programs. Representative Faber, seconded by Representative Miller, moved to introduce this request as a committee bill. The motion carried.

Assistant Secretary Foley also requested introduction of a committee bill concerning grain warehouse bonding. Representative Gatewood, seconded by Representative Ostmeyer, moved to introduce this legislation as a committee bill. The motion carried.

Patty Clark, Director, Agriculture Marketing Division, Kansas Department of Commerce, presented the division's Fiscal Year 2003 Annual Report, as well as an update for 2004. She discussed the division's current agriculture value added projects, the *From the Land of Kansas* trademark program, international trade activities, the Ag Innovation Center Grant received from USDA, their joint agri-tourism strategy, and how the Economic Revitalization Plan can positively impact agriculture and rural communities in Kansas. (Attachment 1)

Sheila Frahm, Chairperson, Kansas Natural Resources Legacy Alliance, summarized and reviewed the findings and recommendations presented in the Alliance's final report. The 2002 Kansas Legislature in **SB 504** charged the Alliance to "develop a vison for using the state's natural resources to assure economic development, a healthy environment, proper protection of natural resources, opportunities for natural resource and environmental education, and quality of life for Kansas families and individual citizens."

The Alliance believes an intentional and ongoing plan for coordination of all natural resources will be needed to assure the most effective use of Kansas resources; therefore, the establishment of a Kansas Natural Resources Authority (KNRA), to replace the Kansas Water Authority, was recommended. KNRA would be charged with planning responsibility for all areas of natural resources. It was further recommended that a mediation type process be established to assure a voice for all interests. It was noted that Governor Sebelius has already created a Natural Resources Sub-Cabinet. The Alliance recommended a House, Senate or Concurrent Resolution encouraging "next step" planning by Governor Sebelius with her natural resources officials, designated legislative leaders, and private sector leaders to fully develop the options and strategy for a Kansas Natural Resources Authority to be considered by the 2005 Legislature. Steve Irsik, Joe Harkins, Tracy Streeter, and Vice Chairman John Strickler discussed specific recommendations and strategy issues identified in the report. A complete copy of the report can be accessed on the internet at www.kdwp.state.ks.us/alliance/alliance.html or from the State Conservation Commission.

Chris Wilson, Kansas Dairy Association, presented the Kansas Dairy Marketing Advisory Board's annual report. She reported that although the number of dairies in Kansas continues to decrease, milk production is up. Increased production increases the state's chances of attracting a processing plant with jobs and economic benefits. Also, several smaller producers are developing ideas to produce cheese or bottled milk for niche markets. She asked that the legislature continue to monitor the impact of volatile prices on the Kansas dairy industry. Included with her report was some information on federal dairy industry issues. (Attachment 2)

Chris Wilson also reported on the first Kansas Food Industry Roundtable session, "From Farm Gate to Food Plate," at Kansas State University, on July 30, 2003. The Kansas Food Industry Roundtable was created through a grant from the Kansas Health and Nutrition Fund to the Kansas Dairy Association to bring together representatives from the many organizations and companies involved in the food industry in Kansas to identify ways to work together to improve the nutritional quality and value of the food provided to consumers. Ron Wilson reviewed the panel discussion on perspectives from various segments of the food industry. Breakout sessions–*From Steer to Steak, From Seed to Sandwich,* and *From Moo to Milkshake*–were also discussed. A copy of the complete report can be obtained from the Kansas Dairy Association.

The meeting adjourned at 5:05 p.m. The next meeting is scheduled for January 26, 2004.

HOUSE AGRICULTURE COMMITTEE GUEST LIST

DATE: January 21, 2004

NAME	REPRESENTING
Ken Rahjes	KS Dairy Assn.
Ron Aller	Pawnee Watershed Dist
Don M Rezac	KACD
Jim Hewes	Pawnee Watershed
Roy Hammarlund	KDOC
Ron Wilson	Huck Boyd Institute
Allen Shafer	Legislative Intern
Carole Jordan	KDA
Leslie Kaufman	Ks Coops
BRAD HARRELSON	KFB
Jared Holste	Rep. Johnson
Doyle Rahjes	Huck Boyd Institute
Charles V. "Cy" Moyer	" " "
Eric King	K-Feed
Chris Wilson	KS Dairy Ass'n
Ruth Smerchek	Commerce
Jesse McCurry	Commerce
Janna Dunbar	Commerce
Jerry Dudley	Ks Dept of Commerce - Ag Mk. Div.

HOUSE AGRICULTURE COMMITTEE GUEST LIST

DATE: January 21, 2004

NAME	REPRESENTING
Gabe Schlickau	KDOC-Ag. Marketing
Beth Riffel	Grass \ Grain
Steve Swaffar	Ks Farm Bureau
Mary Jane Stankiewicz	KGFA/ KARA
[illegible]	Ks Livestock Assoc
John Strickler	KS Natural Resources Legacy Alliance
Sheila Frahm	KNRLA " " " "

House Committee on Agriculture

Kansas Department of Commerce
Ag Marketing Division
Patty Clark, Director

January 21, 2004

Good afternoon, Chairman Johnson. I am Patty Clark, Director of the Ag Marketing Division of the Kansas Department of Commerce, and I want to thank you for the opportunity to brief you on the Division's activities and priorities.

Today I would like to provide an overview of our current value added projects, initiatives for the Trademark Program, international trade activities, a review of the Ag Innovation Center Grant we received from USDA, our joint agri-tourism strategy, and an overview of how the Economic Revitalization Plan can positively impact agriculture and rural communities.

Value-Added Projects Funded in FY 03:

KSU Meat Science and Food Science Pilot Plants:

$70,000 was provided to the K-State Research & Extension Value Added program to serve meat and poultry processors, food companies and entrepreneurs. This program assists small businesses with nutritional analysis, improving safety and quality of processed foods, development of value added products, and commercialization of new products. This is the seventh consecutive year our Division has provided this grant to KSU, and this year that investment saved 925 clients a total of nearly $500,000.

Jason Wiebe Dairy – Marion Co.

Our division provided a $30,000 equipment loan to Jason Wiebe to move from milk production (125 cow herd) to on-farm cheese processing in an inspected plant. We also have assisted Jason with market expansion, and his cheese varieties are now carried in 20 locations in central Kansas. He is presently working on expanding to the KC Metro area.

Prairie Pride, Inc – Butler Co.

Prairie Pride, by partnering with Silver Creek Dairy, was provided a $60,000 loan, which has helped establish a mini-dairy plant and retail store utilizing new technology imported from Europe. This venture, which begins operation this week, will produce cheese, yogurt, sour cream, and other processed dairy products, with the hope of incorporating goat cheese manufacturing at some point in the future.

Davenport Orchards & Vineyard – Douglas Co.

Our $75,000 loan helped this family-owned winery increase its production capacity to meet a growing demand. Loan funds were used to upgrade the grape harvesting and wine production facility to increase production capacity from 2,500 gallons per year (12,500 bottles) to 10,000 gallons per year (50,000 bottles).

Smoky Hill Vineyard & Winery – Saline Co.

Smoky Hill utilized a $102,900 loan to construct a grape harvesting and wine production building to increase their capacity from 8,500 gallons per year to 25,000 gallons per year. The expansion plans include a crush pad and an ozone processor to maintain quality control in a cost effective and environmentally friendly manner.

Dinah's Noodles – Cloud Co.

The Division provided $131,500 for frozen noodle production equipment and a CO2 tank to allow for expansion of this plant in Clyde, and to begin production and marketing of a line of salad dressings to augment the seasonality of egg noodle sales.
Our interaction with the small rural business continues in the form of technical assistance with market and business development.

Rainbow Organic Farms – Franklin, Johnson & Bourbon Co's.

In FY 01, our division helped launch Newhouse Dairy Processing, LLC in Wellsville. Our $12,500 loan to Rainbow Organic Farms funded the purchase of glass milk bottles and a collaborative marketing effort between the two small business entities to expand Newhouse bottled milk sales through Hen House and Price Chopper stores in the Kansas City region.

Cooperative Agricultural Services, Inc. – Gove Co.

CO-AG is a 2,400-farmer member cooperative covering five counties in northwest Kansas. The $90,986 value added loan helped fund the construction of a soybean crush facility. Previously, CO-AG was transporting soybeans a considerable distance for further processing and then returning the processed beans for use in feed rations. The new facility cuts out the transportation cost, allows greater flexibility in use of locally grown beans, and greater quality control of rations produced. KIT and KIR funds through our Business Development Division were also made available to CO-AG.

"From the Land of Kansas Trademark Program"

Our initiatives for this fiscal year include updating the database of FLOK members and making it available and cross-referenced on our website. We will also initiate a system whereby government agencies, Kansas organizations and associations, hotels, restaurants and convention facilities have current listings of qualified FLOK companies from which they may more easily procure Kansas food products for banquets, receptions and meals. We will specifically work with farmers markets, wineries, nurseries, fruit and vegetable growers, and Christmas tree growers to effectively market their products using the FLOK logo and program, while continuing to reinvigorate the program and consumer awareness of Kansas grown and produced products.

Agri-tourism Initiative:

Our Division is collaborating staff and resources with the Division of Travel and Tourism to help develop a coordinated, strategic and sustainable agritourism plan. Our approach breaks down into three primary phases. The first phase is Education, Assessment, and Inventory, and will include the creation of a multi-agency, public-private steering committee, which will develop and implement the agritourism plan. The culmination of phase one will be a statewide agritourism conference planned for November, 2004, and the production of a Kansas-specific agritourism resource manual. In phase two, Product Development, Commerce will provide limited financial assistance and organizations consulting in line with current programming. In phase three, Marketing Experiences, the State of Kansas will market agritourism destinations to the public and to tour operation.

Ag Innovation Center:

Last fall, USDA announced that our division was the recipient of one of ten Ag Innovation Center Grants in the amount of $1,000,000. We are working with our partners, Kansas State University, Pittsburg State University, 21st Century Producers, and Advanced Manufacturing Institute to provide business development services for value added ventures, both new and existing, to help ensure their success and sustainability.

International Trade:

Our division has worked in partnership with the Trade Development Division on a number of initiatives, which include reconstruction efforts in Iraq, trade with Cuba, a joint Communiqué with Taiwan, and bolstering the confidence of Japan in the safety of our beef industry. We facilitate requests for information regarding trade regulations and shipping to export markets for small, mid-size, and large Kansas companies and assist food processors with introduction to export markets through tradeshow assistance programs within the Department and through MIATCO.

Economic Revitalization Plan:

Given recent and sustained droughts and periods of low commodity prices, farmers in Kansas have been forced to eat away at their personal equity to sustain their family farming operations, and hence, their liquidity has been lowered. This has resulted in difficulty raising investment capital for value added ventures of all types. Some of the tools proposed in the Economic Revitalization Plan may be helpful in dealing with this equity drain. New pools of capital, be they regional or "angel investor" based, will be useful for capitalization of new value added ventures and will help augment the equity capital currently lacking the production agriculture economy. Also, the transferability of tax credits potentially can bring in cash flow in the early years of new value added ventures, which may mean the difference between success and failure. Therefore, just because these tools do not specifically contain the word agriculture, they will nonetheless be advantageous to the agriculture business sector as new ventures arise.

FY 2004 Projects

Project #	Contract Name	Company	Funding
2004-01	KSU Meat Science	K-State	$13,310.00
2004-02	KSU Food Science	K-State	$50,000.00
2004-03	AgraMarke Equipment Phase II	AgraMarke, Inc.	$43,220.74
2004-04	AgraMarke Equity Drive	AgraMarke, Inc.	$6,779.26
2004-05	SEK Grain	SEK Grain, Inc.	$70,000.00
2004-06	Central Soyfoods, LLC	Central Soyfoods, LLC	$35,000.00
2004-08	KanSoy	KanSoy LLC	$10,000.00
		Total	$228,310.00

Kansas Department of Commerce
Ag Marketing Division
Statute Summary:

Objectives: "include, but not limited to"

- provide technical assistance to existing and potential value added facilities, including incubators
- develop a network for collecting and distributing information to individuals involved in value added processing
- initiate pilot plant facilities to act as research and development labs for existing and potential small scale value added processing endeavors
- provide technical assistance to new value added businesses
- develop and promote communication and cooperation among private businesses, state government agencies and institutions of higher ed
- establish R&D programs in technologies that have commercial potential for food and nonfood ag products to achieve substantial and sustainable continuing growth for the Kansas economy
- act as a catalyst for industrial agriculture
- establish an industrial ag industry in the state
- commercialize the industrial ag technologies in smaller communities and rural areas
- develop investment grade agriculture value added technologies and products
- develop a market referral program by matching distribution to buyers in coordination with other state agencies concerned with marketing Kansas products
- assist private entrepreneurs with facilities and markets for new value added ag endeavors
- introduce coordinated programs to develop marketing skills of existing value added processors

Acts to be performed for more advantageous marketing of ag products:

- study marketing of farm products
- promote sales and distribution
- furnish information and assistance
- study and recommend efficient and economical methods of marketing
- provide for market studies and research
- gather and diffuse market information
- conduct market development activities and develop new markets with exterior partners (commodity groups, trade and producer organizations, etc.)
- render assistance to above groups and development activities and make a reasonable service charge for those services
- accept other state and federal monies for research, investigation and/or market development

Trademark:

- promulgate policy on use
- print, reproduce or use trademark in educational and promotional materials
- fix, charge and collect fees for use of trademark

Reports:

- on or before February 1 of each year report to House and Senate Ag Committees regarding performance

Mission Statement

To enhance the value of agricultural products through new and existing markets and new uses in order to provide a greater return to producers, processors and rural communities.

Definition of "Value Added Agriculture"

Further processing and/or alternative marketing of agricultural products to capture more of the end consumer dollar at the producer level.

Fiscal Year 2003 Budget
$1,127,670 with $505,129 was dedicated to the AVAC Loan Fund

From the Land of Kansas Trademark Program

Mission Statement

To efficiently and effectively utilize the specialized state-registered trademark program to assist Kansas companies in the promotion of their products, enhance their sales and increase their profitability.

Initiatives for 2004:

- To ensure the trademark consistently signifies high quality value to the consumer in coordination with regulatory agencies and food processor inspection services.
- Update, with assistance from the Division's administrative assistant, the FLOK directory/database and develop an outcomes-based tracking system to track sales and return on investment from trade show participation, etc.
- Distribute inventory of FLOK indoor/outdoor banners and other collateral materials to better promote the Trademark and trademark program.
- Develop and maintain a database of qualified Kansas food companies for promotion to institutional food service (restaurants, hotels, convention facilities, etc.) and for use by state agencies, the administration and the legislature for state sponsored meals/meetings.
- To create greater loyalty of Kansas consumers to purchase Kansas products from Kansas companies through the efficient use of print, radio and television media.
- To enhance the profitability of Kansas food companies through direct marketing seminars and other marketing education efforts.
- To develop a strategic campaign to use National Ag Week/National Ag Day as a springboard for promotion of Kansas food producers and processors to Kansas consumers.
- To work with Travel & Tourism Division to highlight Kansas-made products in tourism efforts, and use those products as a doorway to agri-tourism experiences.

Report of the Kansas Dairy Marketing Advisory Board

Presented to the House Agriculture Committee of the 2003 Legislature

January 21, 2004

Christine Wilson, Kansas Dairy Association

The Kansas Legislature created a Dairy Marketing Advisory Board in 1994. This board reports annually to the Senate and House Agriculture Committees.

The board is made up of two representatives of dairy producers, one representative of dairy processors, one consumer, and the Secretary of Agriculture or his or her designee. Current members are Dennis Metz, producer from Wellington; Elaine Sauerwein, consumer representative from Newton; and Kansas Secretary of Agriculture Adrian Polansky. Two positions, one representing producers and one representing processors, are not filled.

This report has been prepared through the cooperation of the Dairy Marketing Advisory Board, the Kansas Dairy Association and the Kansas Department of Agriculture. Signed copies of the report will be filed with each committee when they are received.

The Kansas Dairy Industry

The Kansas dairy industry continues its pattern of change. As we have reported for the past few years, the state again has a lower number of dairies, fewer cows, but a higher milk production rate. Indeed, the increase in the rate of production is dramatic, with Kansas showing a 56.4 percent increase in total production in the five years between 1997 and 2002.

For benchmarking purposes, we can compare the early '80s dairy picture with the early 2000s. There were 1,327 Grade A dairies and 738 manufacturing grade operations in 1981. Those dairies were populated by 123,000 cows that produced nearly 1.4 million pounds of milk.

By 2002, Kansas was down by more than half, to 508 Grade A dairies. Only one manufacturing grade dairy remains. In 2002, 109,000 cows produced 2.01 million pounds of milk.

Changing National Picture

Nationwide, milk production during 2002 increased 2.6 percent compared with 2001, growing to a record 169.8 billion pounds. That total was 1.3 percent higher than the previous record of 167.6 billion pounds in 2000.

Kansas recorded the largest annual percentage gain among the states compared to 2001, producing 24.8 percent more than it had in 2001. Other states with gains in production higher than five percent were Alaska, Oregon, New Mexico, Arizona, Colorado, Idaho and California.

Per capita production of milk nationwide increased one percent between 1997 and 2002; of the 14 states which showed production gains, Kansas led the pack at a per capita production gain of 49.8 percent.

Also in 2002, Kansas ranked eighth in production per cow, and moved into the top 20 of milk producing states, coming in at number 12.

Milk Income Loss Contract Program

The Milk Income Loss Contract Program (MILC) began in 2002 and is to end Sept. 30, 2005. It financially compensates dairy producers when domestic milk prices fall below a specified level. The program was authorized by the 2002 Farm Bill and has no set funding level.

Under the program, payments are made on a monthly basis to producers when the Boston Class I milk price falls below $16.94 per hundredweight. It is our belief that the MILC payments have helped some of the state's smaller producers stay in business.

Regional Dairy Compacts

The Kansas Legislature acted in 1999 to allow the Kansas Secretary of Agriculture to enter into a Southern Interstate Dairy Compact if it was determined this would benefit Kansas producers. The Kansas Dairy Association supported this action. The goal of compacts was to stabilize prices received by farmers for fluid milk, thus reducing business uncertainties and stabilizing supply in a region. There has been no action on such a compact in the past year, and none is expected in the near future.

Milk Prices

Milk prices in November 2003 were somewhat improved over November 2002, from a statistical uniform price of 10.74 to 13.67; however, producers still are not feeling a great deal of relief after the long-time low prices.

In Conclusion

Change in the dairy industry is inevitable, but the Kansas industry is showing some positive changes. Increased production increases the state's chances of attracting a processing plant with jobs and economic benefits. Also, several smaller producers are developing ideas to produce cheese or bottled milk for niche markets. The Kansas Department of Commerce's agricultural marketing program and the Kansas Department of Agriculture's dairy inspection program are available to help producers with good ideas turn them into reality.

We thank the Kansas legislature for its interest and ask that it continue to monitor the impact of volatile prices on the Kansas Dairy Industry.

Sincerely Submitted,

Dennis Metz
Member, Kansas Dairy Marketing Advisory Board

Elaine Sauerwein
Member, Kansas Dairy Marketing Advisory Board

Adrian Polansky
Kansas Secretary of Agriculture
Member, Kansas Dairy Marketing Advisory Board

MPC Key Response Points

TALKING POINTS:

- We urge you to become a co-sponsor of S. 560 or HR 1160

- Dairy farmers are united on this endeavor. There is no regionalism or difference of opinion.

- We need this legislation to fix an unfair and poorly negotiated agreement. Of all OECD members, we are the only country with significant levels of casein and MPC imports. We support trade (for those legislators who are free traders or pro-trade), but it must be fair. This legislation will level the playing field with our trade partners and will even provide substantial leverage for current WTO negotiations.

- If a similar action was good for U.S. Tobacco, it must be good for Dairy. The U.S. renegotiated Tobacco's import duties in the WTO. Currently, the EU is considering to renegotiating their tariffs for grains, India is negotiating with the U.S. and others certain import duties and Chile has recently renegotiated their sugar tariffs too.

- Simply put it, this legislation is WTO consistent.

- Out of more than 11 tariff negotiations under Article 28, not once a country has retaliated. Even Amb. Zoellick has stated that he will prefer to renegotiate with Europe before retaliating

- This legislation will not create a shortage of any product in the United States. Most low and mid-protein MPC can be replaced with NFDM, while casein and high-protein MPC imports will remain about the same due to the compensation provision. In addition, the U.S. has begun the production of these products and is ready to expand production significantly if demand is there.

- The impact on the retail price of a processed cheese will be about one-tenth of one percent. In other words, almost non-existent.

Q. Why is this issue a priority?

A. Dairy farmers depend almost exclusively on the marketplace for their livelihoods. Government programs, even during recent periods of extremely low farm-level prices, represent only two percent of on-farm dairy income; the rest comes from consumer dollars. The Price support program is in jeopardy due to the massive amounts of milk proteins imported since 1996. Prices that farmers receive has been driven down by the surge of imported dairy proteins – primarily Milk Protein Concentrate (MPC) – that is displacing domestically-produced dairy products in a variety of end uses, such as cheese. If this issue is not corrected, U.S. producers will find themselves competing with increasing large quantities of subsidies milk proteins.

This low-cost competition is actually a circumvention of U.S. trade laws, and should be corrected through the passage of legislation by Congress.

Q. Why legislation? Why not Customs?

A. Unfortunately, only a portion of the growing volume of milk protein imports is in fact a mislabeling issue. Simply put it, a general review by Customs will not solve the problem that dairy producers' face with the growing imports of milk protein. Indeed, the only permanent and legal fix that will allow a fair and level playing field with our trade partners and even provide substantial leverage for future negotiations is to pass S. 560 and HR 1160.

In addition, it appears that Customs has been pressured by multinational Corporations to decline our request for reclassification, even though technical officials in a preliminary Customs ruling admitted that the current classification has been an error.

Q. Importers, processors and even the GAO have suggested that there is a real demand for these products. Our problem is that we don't produce this product in the United States and we need to import them.

A. Milk protein is milk protein. In the majority of cases, purchasers of MPC and casein are merely shifting from using traditional domestic milk protein sources to these imported versions because they are lower cost ingredients. There are some products that do require the particular functional characteristics of these milk protein products. That is why domestic production of MPC and casein have begun and can expand if the right conditions are in place. We can assert that in the absence of increasing levels of MPCs, U.S. food processors would use U.S. nonfat dry milk to manufacture similar end products.

We do not produce these products in the United States, because our possibilities have been dampened by subsidized imports of MPC and its ability to substitute skim milk powder. In addition, the U.S. price of SMP and the product yield of

SMP per hundredweight of milk, generate a higher economic return than drying ultra-filtered milk to turn it into MPC.

If these products are indeed needed by the marketplace, then appropriately priced imports are likely to continue to be purchased for those products that truly require them, or the price will rise to a level competitive enough to stimulate domestic production. What is clear is that imported milk protein products are displacing domestic milk proteins.

Both, NZ and EU are subsidizing and dumping this product into our market. We don't believe that a lower price support will prevent Europe and NZ from continuing to dump milk protein in our markets.

Q. Would new tariffs on MPC and casein create a major shortage of these products since we do not manufacture them in the United States?

In 1997, MPC imports amounted to approximately 17,000 metric tons. The legislation allows nearly 16,000 tons of the product to come into our market under the compensation clause. U.S. food manufacturers will therefore still have access to a significant supply of MPC, plus large quantities of domestically-produced skim milk powder.

Likewise, S. 560 and H .R. 1160 will allow substantial amounts of MPC and casein into the U.S. market. In fact, the legislation permits the free entry of casein for industrial purposes, while imposing tariffs only on casein for food manufacturing or animal feed. Further, potential compensation given to the main suppliers of these commodities under our WTO obligations could make available an even greater quantity that has been established in both the Senate and House bills.

Q. What impact will S. 560 and H.R. 1160 have on Consumer Prices?

A. The legislation will prevent import surges of MPC and casein. It will thus have an impact on prices only if imports rose significantly above current levels and filled the tariff-quotas negotiated under the legislation. At most, this may impact the price of MPC with 40 to 90 percent protein, which is used in manufacturing non-standardized cheeses, and caseinates, which are used to produce non-dairy creamers and similar products. Any price impact would occur, if at all, only in the last few months of each calendar year.

The legislation might increase the cost of MPC for making processed cheese by up to $10 million per year, which represents one-tenth of one percent of annual retail sales of processed cheese. It is highly unlikely that such a small ingredient cost increase would be passed on to consumers. The cost of caseinates for making non-dairy substitute products might increase by up to $5 million per year, which also represents a small fraction of annual product sales, also unlikely to be passed on to consumers.

The price of domestic milk ingredients would not be affected by the legislation.

Q. The U.S. agreed to bound its MPC and casein tariffs in the Uruguay Round. Although Article 28 of the WTO allows a binding to be broken, the compensation that must be paid has to be negotiated with the other countries. Is the dairy industry prepared to allow cheddar cheese, for example, to be the offset?

A. As noted before and admitted by USDA, any WTO Member has a right to invoke Article XXVIII to raise and rebind its tariffs. The dairy industry is certainly prepared to give our negotiators the necessary latitude to renegotiate our milk protein tariffs under the provisions of Article XXVIII of the WTO.

Q. What is the impact the legislation, if adopted, would have on the WTO obligations of the U.S.

A. If properly negotiated, NONE.

Q. What is the potential reaction of other countries should the MPC legislation be adopted? Congress does not want to take a step which could result in retaliation by other countries against other agricultural commodities.

A. It is important to recognize that although the exporting country might not like the fact that the importing country is invoking Article XXVIII in a manner that will adversely affect its imports, it cannot complain that doing so is unfair or a violation of international rules. In fact, the opposite is true – the importing country is clearly playing by the rules.

Why is retaliation unlikely? First, the GATT rules require compensation as the preferred remedy. Therefore, there is an expectation that fair compensation will be negotiated. Second, the exporting country's primary interest is to reserve as much of the market as it can. Third, although the exporting industry will be deprived of some potential trade volume, the value of its exports will likely not be adversely affected, for the simple reason that increased tariffs tend to raise the internal price of the product at issue. Thus, even if export volume is diminished, the value of a country's exports, on a per unit value basis, is likely to increase.

Fourth, any retaliation that the exporting country might invoke will have a detrimental impact on other important domestic constituents – *i.e.*, the domestic industries who import and use the products on which retaliatory duties would be placed. Those industries do not want to be caught in the trade crossfire and will lobby heavily against the use of retaliation.

Fifth, retaliation presents some very complex legal issues for the country considering it. Retaliation under Article XXVIII has been rarely invoked because of the danger of triggering a chain of withdrawals by third-party bystanders who are inadvertently "hit in the crossfire."

<u>Finally, simply put, the exporting industry from a specific country gains nothing from retaliation.</u>

There is no better example of the strong preference for compensation over retaliation than the 1994 Article XXVIII negotiation over the unbinding of the U.S. tariffs on certain tobacco products. In that case, the United States imports of tobacco had increased from an average of 142,792 MT during 1990-92 to 222,246 MT in 1993. In the negotiation, the U.S. initially offered a TRQ of only 130,000 MT, and eventually settled for 151,200. However, in the end, all countries with exporting rights settled for U.S. country-specific allocations of that TRQ amount. No country invoked retaliation.

CALL FOR ACTION FTA w/ Australia

Urge the U.S. Government to firmly reject the inclusion of dairy in the U.S.-Australia Free Trade Agreement.

- U.S. dairy will not support reduced tariffs or expanded TRQs in the Australia FTA. A bilateral FTA with Australia does not gain additional access for U.S. dairy in international markets and offers no benefits for U.S. dairy producers.
- The U.S. is currently one of the least restricted and largest dairy import markets in the world. Although the United States is the world's largest milk producer, dairy markets in other developed countries remain virtually closed to U.S. dairy products (EU, Japan, Canada, and Korea).
- The U.S. has already granted other countries large quantities of access through Tariff Rate Quotas including Australia at duties ranging from zero to extremely low. Our 45 percent tariff on cheese is the lowest among all developed countries, except for Australia and New Zealand.
- The U.S. market is the path of least resistance and Australia will always prefer to expand access to the U.S. dairy market rather than work to expand or develop alternative markets.
- A potential free trade agreement with Australia will certainly eliminate any hope to further discipline dairy trade within the World Trade Organization. By obtaining unlimited access to the vital United States dairy market, Australia and its partner New Zealand will simply forgo any efforts to open additional markets around the world, including the EU, Canada and Japan.
- Australia has a population of 19.4 million and New Zealand 3.9 million. Both are developed economies. Compare that to other countries in Latin America or South East Asia with a population over 350 million and more than 1 billion. Dairy demand increases as disposable incomes increases, as shown in Mexico, Korea and China. If the Administration plans to pursue further Bilateral agreements, Australia and New Zealand are obviously not the right candidates.
- Australia's credibility as a trade partner has been clearly brought into question as noted in the U.S. Government 2002 National Trade Estimate Report on Foreign Trade Barriers. Australia maintains a number of restrictions and prohibitions on imports of agricultural products through quarantine and health

measures. In addition, Australia maintains export monopolies and engages in proven price discriminatory actions against U.S. products. In fact, Australia's trade policy has been criticized as being overly protective in the World Trade Organization, to the point of protectionism.

- Eliminating U.S. dairy import tariff-rate quotas on imports from Australia, because of a U.S.-Australia Free Trade Agreement, would result in significant additional imports of butterfat, milk proteins, cheeses and dairy food preparations. The negative impact of these additional imports on the U.S. dairy industry would be substantial. U.S. dairy farmers' income would drop by more than $1 billion per year. In addition, hundreds of thousands of jobs in farming, manufacturing and other rural activities will be lost.

- Although bilateral free trade agreements may play a complementary role in advancing President's Bush overall trade objectives, we see little likelihood that the U.S.-Australia FTA could be concluded on a basis acceptable to the U.S. dairy industry. U.S.-Australian dairy (agriculture) trade is highly unbalanced in favor of Australia and involves a number of complex and sensitive commodity issues that can only be effectively addressed in the WTO negotiations.