



U.S. Department of Agriculture
Foreign Agricultural Service
May 2000

Permanent Normal Trade Relations With China
What's at Stake for Dairy?

China's successful entry into the World Trade Organization (WTO) will dramatically cut import barriers currently imposed on American agricultural products, including dairy foods. The bilateral accession agreement China signed with the United States locks in lower tariffs, allows U.S. companies to more freely market and distribute products, and commits China to use sound scientific measures for sanitary import regulations. These, and other, concessions will expand our access to a market of over one billion people. China's economy is already among the world's largest and over the past 20 years has expanded at a phenomenal rate of nearly 10 percent per year. Incomes among many segments of the population are increasing rapidly, raising demand for high-quality imports of processed dairy products including cheese, ice cream, yogurt, whey and lactose products, and dry milk, among others.

Congress must grant China permanent normal trading relations (PNTR) status in order to guarantee that American agriculture benefits from the concessions the U.S. negotiated bilaterally under the WTO. Even if Congress fails to approve PNTR, China will likely become a member of the WTO. Failure to grant China PNTR would mean that our Asian, European, and Latin American competitors would enjoy these benefits while American agriculture would lose out.

The Market

Although China's dairy industry is expanding rapidly, production is still small compared with the size of the market. For example, China's population is four times that of the United States, but Chinese milk production is only one-tenth of U.S. output. China's production of dairy products such as yogurt and ice cream is growing rapidly but quality is a problem throughout much of the dairy industry. In addition, cold storage and distribution facilities are limited, particularly outside major cities.

Demand for high-quality imports is rising quickly and will accelerate after China accedes to the WTO. China's dairy product imports were about \$170 million in 1999, up 60 percent from just two years ago, according to China's official statistics. U.S. statistics show that in 1999, the United States only exported about \$17 million in dairy products directly to China, but \$60 million to China and Hong Kong combined. A significant portion of U.S. exports to Hong Kong are transhipped to China. China/Hong Kong is the fourth largest market for U.S. dairy products, but market liberalization through China's implementation of its WTO commitments for lower tariffs and fewer sanitary and technical barriers (such as labeling) can substantially increase U.S. sales.

China has one-fifth of the world's population and its economy has grown an average 10 percent annually since 1980 and is expected to grow 7 percent annually until 2010. As per capita income

rises, demand for high-quality dairy products available from the United States will grow.

The Opportunities

- China's current dairy imports consist primarily of whey powder and nonfat dry milk. China is not scheduled to lower the import tariffs for these two products, but America's comparative advantage in efficient processing, coupled with China's market liberalization as it implements its WTO commitments, in particular the end to strong regulation of distribution services, will create market niches for high-quality, competitively priced U.S. dairy products. U.S. whey is very competitive overseas and prospects for export growth to China are bright as food processing expands.
- Besides whey, China's food industry is very interested in other low-cost, high-quality food ingredients available from dairy processing. The already-low tariff on whey products, plus the scheduled reductions for lactose (35 to 15 percent) and dairy-based food preparations (25 to 10 percent), should result in a big boost in U.S. exports once China accedes to the WTO.
- Many other dairy products will benefit from lower tariffs. U.S. cheese exports are likely to experience the greatest boost, as the tariff is expected to drop from 50 percent to 12 percent. China's cheese consumption is extremely low on a per-capita basis, so lower prices should boost consumption dramatically. But, the number of fast-food and pizza restaurants is growing rapidly in China, creating new markets for cheese.
- Although ice cream consumption is growing rapidly in large cities, it is marginal in rural areas. Expanding markets are expected to create demand for both imports of ice cream and ice cream ingredients. As a result of China's WTO accession, the tariff for ice cream will drop from 45 to 19 percent; and the tariff for yogurt will drop from 45 to 10 percent.
- U.S. companies will be able to more freely market, distribute, and provide sales services through China's liberalized distribution system, a primary commitment sought by U.S. agricultural exporters. China now generally prohibits companies from distributing imported products, an obstacle that will remain in place without PNTR. China's distribution commitment, phased in over three years, is comprehensive, covering commission agents services, wholesaling, retailing, franchising, sales away from a fixed location, as well as related subordinate activities such as inventory management.
- Dairy product exports will face fewer trade restrictions once China is a WTO member, and technical sanitary import measures must be based on sound scientific principles. Any future disagreements can be settled through the dispute resolution mechanism.

The Bottom Line for the U.S. Dairy Industry

- Without PNTR and China's WTO membership, U.S. dairy industry sales to China will

continue to face high tariffs, regulation of distribution services, and potential unscientific sanitary barriers to imports.

- Dairy competitor New Zealand has already completed its WTO bilateral agreement with China. Another competitor, the European Union, hopes to end its bilateral WTO talks soon. U.S. producers would suffer a major disadvantage if China accedes to the WTO and Congress does not grant PNTR.
- In 1998, U.S. dairy product exports of \$850 million supported nearly \$2.2 billion of total economic activity in agriculture and related industries. These exports contributed 12,100 jobs to the nation. California, Wisconsin, New York, and Pennsylvania are the leading dairy-producing states. The rest of the economy gains from dairy product exports through supplying inputs, export services, storage, transportation, insurance, finance, and other related services.