

Trade Agreements and Canada as a Trader in Agri-Food

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Discussion Paper

October, 2015

Introduction

The purpose of this paper is to explore elements of Canadian agri-food trade and trade agreements. The paper was prepared as speaking notes for a panel discussion hosted by the Receivables Insurance Association of Canada on October 8, 2015 in Toronto. It starts with an overview of who Canada is with respect to trade in food and agricultural products, then into Canada in the Trans-Pacific Partnership, and concludes with some observations on the interaction between trade/foreign policy and domestic policy that exists with any significant trade agreement and how this impacts the ultimate value of trade agreements.

Canada as a Trading Nation

What frames Canada's interests in food and agricultural trade? Comparing Canada's resources and capacity for agricultural production with the domestic demand for food and farm products reveals a distinct juxtaposition. Canada has a land base and agricultural production capacity that extends well beyond the domestic demand for farm and food products. Drawing upon those resources produces surpluses versus our own needs, which makes us structurally export-oriented. At the same time, Canada has a tremendous diversity in terms of what types of farm and food products it produces, but most of these occur at modest scale. There are divergences of view regarding how we market farm products. And we have an abundance of land relative to the workforce needed to operate and process the products from it.

Table 1 below provides some context for Canada's agricultural resource base. It is illustrative to compare Canada with another OECD country with a contrasting resource base- Korea. Canada has about 42 times the arable land base per capita compared with Korea, about 14% of the fertilizer use and about 5% of the pesticide use, and uses only about 4% as much water in agriculture in proportion to annual availability. Compared with most countries, Canada has abundant land and water, avoiding many plant and livestock diseases that encumber other countries with higher density agriculture.

Based on this natural resource endowment, Canada operates at what could be considered a global scale- capable of anchoring state of the art supply chains- in a range of farm and food commodities. This includes canola; Canada is the largest single producer of canola in the world. Canada is a significant producer and among the largest exporters of wheat. The same is true of pulse crops- lentils, chick peas, field peas, and a variety of beans. Canada has been the largest exporter of pork and remains a significant producer. Canada is also a major supplier of grain-fed beef and potato products. These products are largely western Canadian-based, where the land base relative to local demand is especially large.

At the same time, Canada produces a tremendous variety of farm products- fruits, vegetables, dairy, poultry, and many other products. However these operate at a domestic or more modest scale. The dairy and poultry industries are essentially domestic in scale due to supply management programs, built out of past farm marketing struggles. The grain segment in eastern

Table 1 Agricultural Resource Benchmarks

	Arable Land Ha/capita	N fertilizer tonnes/km2	Pesticide Use tonnes/km2	Water Withdrawal % of gross annual availability
Australia	2.14	0.2	0.02	6.4
Canada	1.25	2.7	0.06	1.5
France	0.28	7.5	0.27	17.5
Germany	0.15	10.5	0.17	20.2
Japan	0.03	9	1.24	20.3
Korea	0.03	18.9	1.2	35.6
US	0.51	2.6	0.08	19.2

Source: OECD

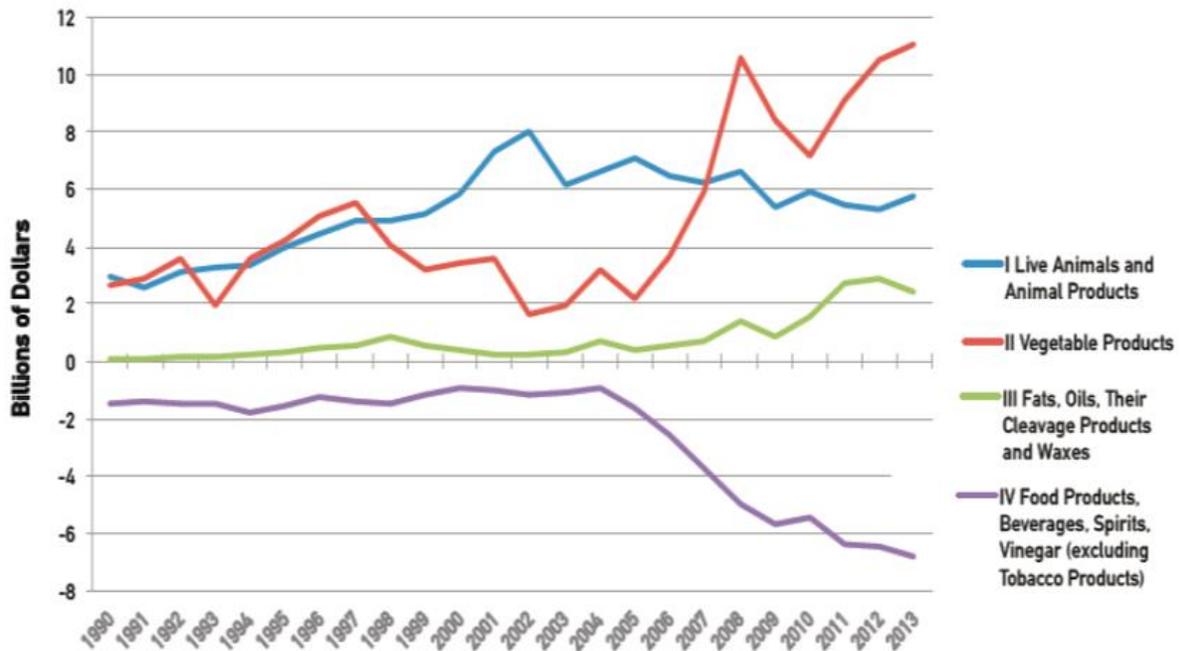
Canada, largely Ontario and Quebec, is based around corn, soybeans, and wheat. It has similarities with the US Midwest in farm products supplied but is much smaller in area and as such is essentially domestic in scale. Horticultural production and industries exist in selected regions where the climate and soils facilitate it- mainly in Southern Ontario, Lower Mainland of BC, Annapolis Valley, and parts of Southern Quebec. In these regions there is a large diversity of horticultural crops produced, as well as floriculture and nursery production. For example, the Ontario Fruit and Vegetable Growers Association claims that 144 horticultural crops are grown in Ontario. One industry that has emerged in scale is the greenhouse vegetable industry, especially in southern Ontario and the Lower Mainland of BC. However, most other horticultural industries support domestic or more modest scale supply chains.

Canadian Agri-Food Trade

The range of farm/food products in which Canada operates at a world-class scale, and others with a domestic or more modest scale, are borne out in international trade data. More than 90% of the canola is exported (as seed, oil, or meal), as well as about 75% of wheat, 65% of the malt, 60% of hogs/pork, and about 50% of the cattle. In approximate order of value for 2014, Canada's leading agri-food exports were wheat and wheat products, canola, pork, pulse crops (beans, peas and lentils), seafoods, and soybeans. What we import are the types of items that you would expect a developed, cosmopolitan northern country to import- wines and spirits, food preparations, and foods/beverages that are in demand but that we don't produce or produce only seasonally in small volumes- like coffee, sugar, chocolate, and fresh fruits and vegetables.

Figure 1 illustrates trends Canada’s net trade (exports-imports) according to grouped HS chapters. Our big ticket net export items are grains, oilseeds and products (included in “vegetable” products), livestock to the US and red meats, and animal fats and oils. Exports of crops and products have grown rapidly, consistent with the rally in grain prices 2007-13. An issue of trade deficit or net import for us is processed food and beverages, and as can be seen, net trade in processed food began a significant slide in the mid-2000’s and that has continued. This is consistent with ongoing concern regarding the productivity, scale, and export competitiveness of food processing in Canada.

Figure 1 Canadian Net Agri-Food Exports



Source: Canadian Agri-food Policy Institute, Industry Canada

An aspect that transcends the trade data and export orientation is domestic marketing policy. This is important, because Canada has developed a differential approaches to farm products marketing. As export intensity has increased, commodities with more of an export footing increasingly have increasing taken on a freer trade marketing policy orientation. For example, provincial hog marketing boards were once ubiquitous in Canada; today only Quebec has retained its hog marketing board. The Canadian Wheat Board had its single desk powers removed several years ago, and farm organizations in operation for canola and beef never have had marketing board authority.

The situation in other farm commodities is different, in part because the products are more domestically oriented. Dairy, chicken, turkey, eggs, and broiler hatching eggs are governed under supply management by provincial marketing boards that establish prices and product supply, with protection of tariffs and tariff rate quotas (TRQ's) administered by the federal government. The specific rationales for supply management systems are slightly different in each case, but generally relate to problems of chronically low farm prices, excess supplies, and market power of processors. In other cases, notably in horticulture, provincial marketing boards have the authority to negotiate and bind producers to contracts with food processors, and establish a range of product and production standards. There is a range of products in which marketing is regulated in this way, fragmented at the provincial level and across products. There are also many horticultural products without marketing boards and regulated markets.

Trade Agreements

Canada has a range of trade agreements, and more in negotiation. Canada is engaged in trade negotiations with India (Canada-India Economic Partnership Agreement), Caribbean countries (CARICOM), and with a group of Central American countries. This complements a range of existing trade agreements presented in the first column of Table 2 below. Into this mix, the Trans Pacific Partnership (TPP) was completed in early October, 2015 after about five years in negotiation.

Table 2 below presents Canada's existing trade agreements, the TPP members, the TPP with whom Canada has no existing trade agreements, and whether these countries are viewed as an opportunity or threat with respect to Canada's agri-food trading interest. The third column of the table lists the countries that are new to Canada as trade agreement partners. Of these, a number could be viewed as small in terms of agri-food. Brunei, Vietnam, and Malaysia would not be viewed as major expanding opportunities for Canadian agri-food. Singapore has been the focus of past trade negotiation effort on behalf of Canada, and is a regional hub of entry into adjacent markets. Japan is a major developed country market for agri-food products in which Canada

Table 2 Canada's Trade Agreements and the TPP

Existing FTA's	TPP Members	Who is new in TPP?	Opportunity/Threat
CETA-EU, Ukraine- pending	New Zealand	New Zealand	Threat
Korea	Australia	Australia	Threat
Central American	Japan	Brunei	Neutral
Israel	Brunei	Vietnam	Opportunity
Columbia	Vietnam	Singapore	Opportunity
EFTA countries	Singapore	Malaysia	Opportunity
Jordan	Malaysia	Japan	Opportunity
Chile	Chile		Neutral
Peru	Peru		Neutral
NAFTA	NAFTA countries		Threat

already has a significant presence, especially in pork, beef, canola, soybeans, and wheat. It is viewed as a large, premium market for agri-food products and a major opportunity.

Table 2 also lists countries that are seen as representing threats to Canada's agri-food trading interest. Chief among these are New Zealand and the US, for different reasons. In the case of New Zealand, increased dairy market access is among the highest of priorities in the TPP, and among Canada's greatest sensitivities. New Zealand made abundantly clear that increased access to the Canadian dairy market as an objective in TPP. Both New Zealand and Australia have similar export interests in beef and grains as Canada, making them competitors. In the case of the US, the threat is that of the US obtaining differential market access, especially between the US and Japan versus Canada and Japan, would break down the North American market in red meats and grains that has built up, with some irritants, since the Canada-US Trade Agreement and later NAFTA. The US has also pressured Canada on increased market access for dairy and poultry.

Trans Pacific Partnership

The completion of the TPP agreement was announced on October 5th, 2015. At this time, the information on the content of the agreement is still very general in nature. What is known is the following:

- Japan
 - On pork, gate price tariffs under the gate will be reduced from ¥482 to ¥50, phased-in over 10 years

- For beef tariffs will be reduced from 39-50% to 9% over 15 years
- On wheat, there will be TRQ of 40,000-53,00 tonnes phased in over 6 years
- For canola oil, tariffs will be phased out over 5 years
- US/Mexico
 - Equivalent access for Canada, US, and Mexico in red meats. Beef access equivalent to access obtained by Australia in Australia-Japan free trade agreement
- Canadian concessions
 - 3.25% market access in dairy based on expanded TRQ's
 - 2.1% market access in chicken based on expanded TRQ's
 - 2.0% market access in turkey based on expanded TRQ's
 - 2.3% market access in eggs based on expanded TRQ's
 - 1.5% market access in broiler hatching eggs based on expanded TRQ's
 - Canada secured compensation packages for supply managed commodities- \$2.4 billion for revenue losses, \$1.5 billion to secure farm quota values, \$450 million in processor modernization, and \$15 million in marketing assistance

In-depth analysis of these and other changes to market access will be forthcoming as more detail emerges. However, the increased access to the highly protected Japanese market is remarkable. It could be a game-changer in short order for canola, as the removal of canola oil tariffs will give the incentive to process canola in Canada and export canola oil to Japan, rather than have canola seed exported to Japan and processed at ports there. Similarly, under TPP changes will occur in Japan's notorious pork "gate price" scheme, which should generally expand the market for non-premium pork cuts, and generally allow for a more transparent importing system. Importantly, Canada will obtain the same access to Japan as the US in beef and pork.

With regard to Canadian trade concessions on supply managed products, these appear remarkably limited and backed by disproportionately large compensation measures. For example, the dairy industry was expecting market access under TPP of 5-10%, but was only subject to a 3.25% increase. Market access conceded in poultry is only in the range of 2%. However, more detail will be required to properly interpret these. In separate releases on October 8th, New Zealand, Australia, and the US all indicated that Canada agreed to eliminate tariffs on milk protein isolates, and the tariffs on dried whey would be phased out. It does not appear that this could have been included in the estimate of 3.25% dairy market access conceded, and the removal of these tariffs could have major effects.

On the surface, the Canadian dairy industry appears to have come through the TPP relatively unscathed and with major programming support to cushion a downturn- with the import caveat on tariff reductions noted about. This leaves the dairy industry to focus on other pressing issues. These include a move toward more competitive farm milk pricing that will allow competition with imports, especially imports of milk protein isolates and other products containing high

levels of non-fat milk solids that are in surplus in Canada. These imports have increased dramatically, and at the same time Canada is limited in its dairy export volumes by a past WTO decision. This makes the operation of milk supply management increasingly difficult, and is the focus of ongoing negotiations between dairy producers and processors on pricing and other aspects of the system.

Conclusion

With TPP now complete, the task now is to make the opportunities it presents real, as is the case with CETA. Member countries will need to communicate the prospective net benefits in a tangible manner in order for it to pass their respective legislatures and parliaments. There is a need to size up the nature of opportunity with available capacity. In areas where we lack capacity to effectively respond to opportunities, this capacity will need to be developed- with associated marketing, financing, human resources, risk mitigation, and policy to support it.

To illustrate, Figure 2 below presents the Canadian beef cow herd since 2000. The cow herd anchors the capacity of the Canadian beef industry, and has been in decline since the mid-2000's. Consistent with this, Canadian beef processors are currently focused on acquiring sufficient raw product volume to meet existing customer demand and capacity. The same is true, to a lesser degree, in pork. At the same time, Canada obtained new increases in market access for 50,000 tonnes of beef and just over 80,000 tonnes of pork in CETA, and now obtained greatly improved access to Japan for pork and beef under TPP. Clearly, this capacity will need to be developed, and it will take time.

Particular focus will need to fall on food processing. Numerous studies have found Canadian food processing to be lagging in labour productivity with the US and other exporting countries. Perhaps the best evidence is the data on net exports in food and beverage products, where Canada's trade deficit is increasing. One aspect of this is lagging investment in global scale, state of the art technology food manufacturing plants. New trade agreements can be the impetus for such investments, both to exploit opportunities and to defend existing market share- both at home and abroad.

TPP and CETA will usher forth important technical trade issues. Technical issues in agri-food products can be somewhat anticipated when trade occurs with developed countries, with exceptionally high levels of food standards, such as Japan and some EU countries. This relates to aspects such as standards for low level presence of contaminants or GMO seeds, and regulatory standards more generally.

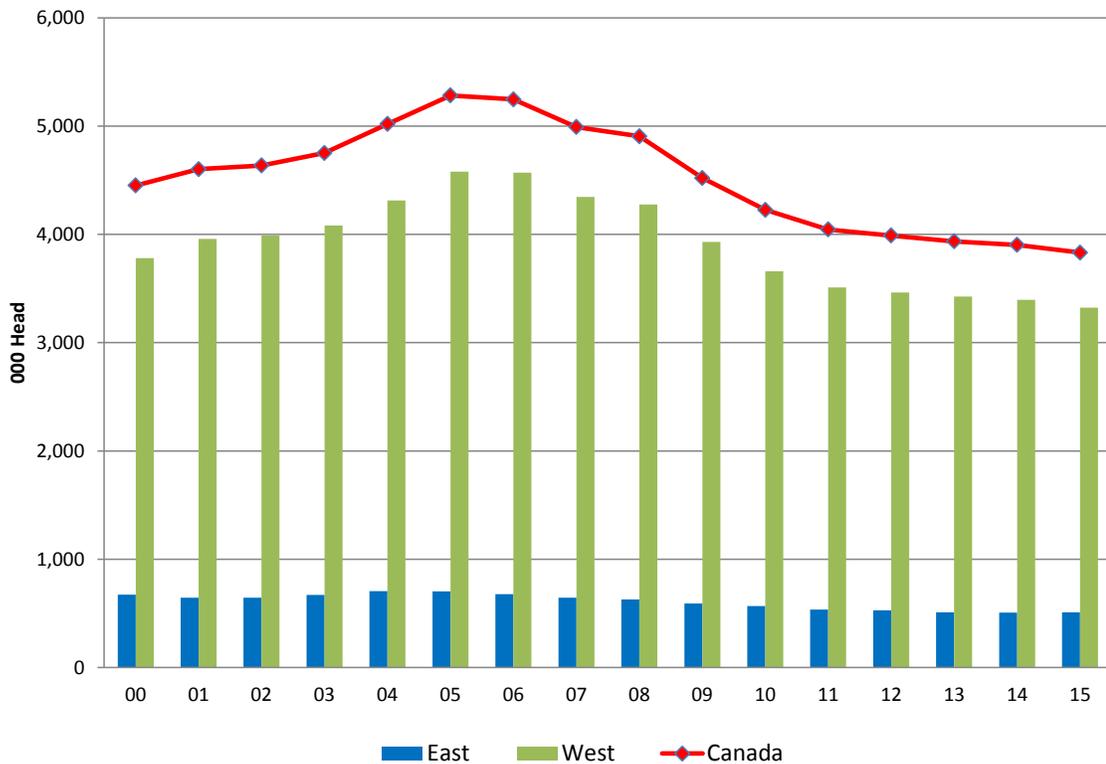
Product marketing represents another broad area that will need to be addressed. Canadian or North American brands do not necessarily have the same market traction in Japan or France as they do in Canada, and distribution networks for products will need to be secured. At the same time, both Europe and Japan have strong incumbent food companies with their own brands that

will not wish to yield market share, even if Canada has obtained the market access. Thus, resources will be required to compete within new markets secured.

Finally, there is a need to refine policy to assist those disadvantaged by trade agreements. This is an important aspect of credibility in policy. Canada has clearly advanced this in its dealings in TPP.

The above underscores the need for shifts in domestic policy and investment to accompany the important shifts in foreign policy to fully respond to important opportunities presented to Canadian agri-food in CETA and TPP.

Figure 2 Canadian Beef Cow Herd, 2000-2015



Source: Statistics Canada, January inventory