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True North in Canadian public policy

Commentary

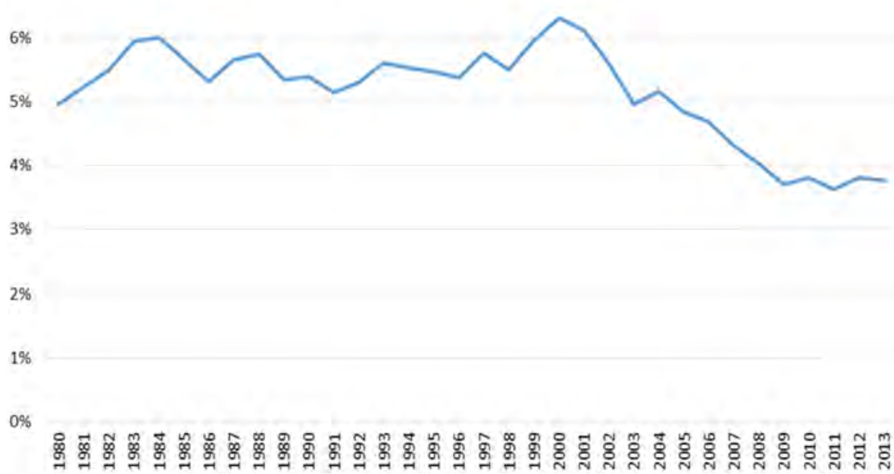
June 2016

Does Canada Really Want New Agriculture Export Markets?*

Brian Lee Crowley

The Canadian Animal Health Institute kindly invited me to come and talk about market opportunities, specifically, where Canadian agri-food should be looking to find new markets for its products. The last time I spoke to the CAHI was about four years ago, and in that talk I blamed a number of factors for Canada's declining share of world agri-food markets despite our many competitive advantages and despite rising world demand for food.

Canada as a % of Total World Trade in Agricultural Products



Source: WTO

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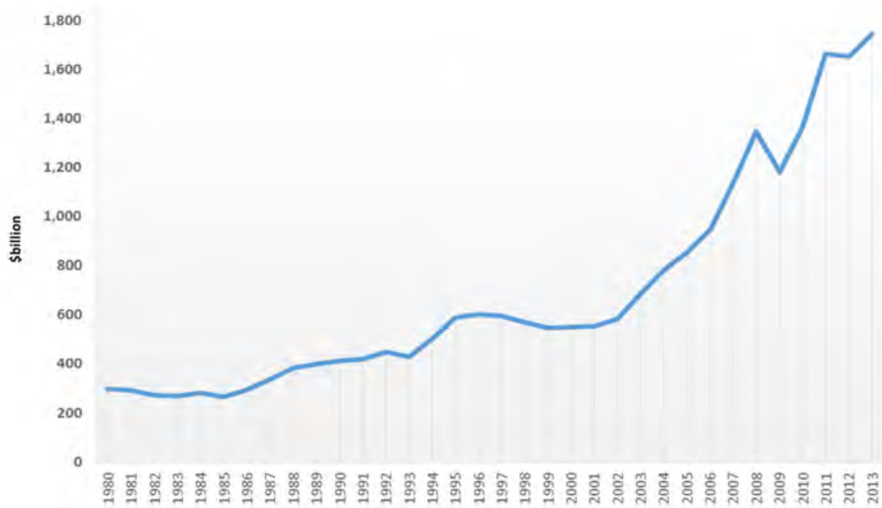
* This article is based on a speech given at the annual general meeting of the Canadian Animal Health Institute on June 6, 2016.

World Trade in Agricultural Products

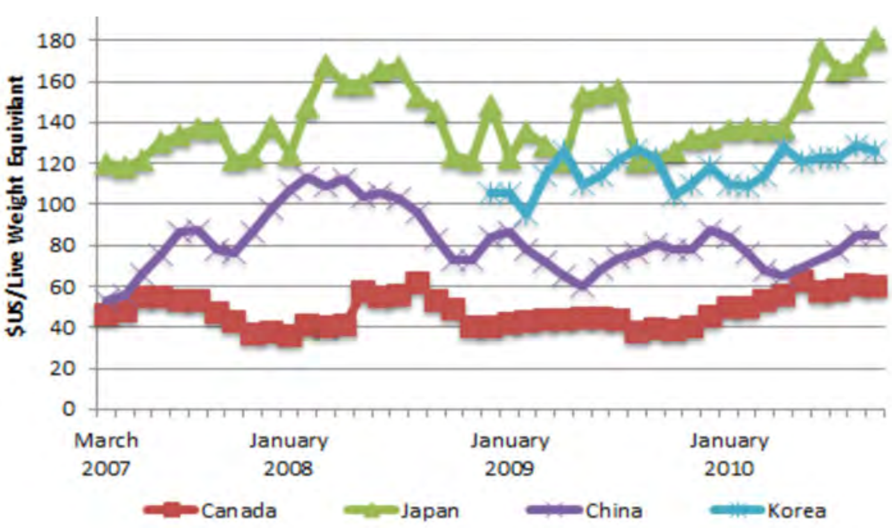


At that time I mentioned factors such as protectionism in potential markets like Asia, our dogged insistence on protecting supply management at the cost of international market access, our slowness in reforming supports to the agri-food industry, a cumbersome and contrary regulatory system, and political resistance to the emergence of enterprises with the scale needed to compete internationally.

I pointed out at that time that depreciation in agri-food capital investment exceeded new investment, meaning that far from increasing our capacity to serve new markets, we were pulling our capital out.

I am sorry to say that most of these obstacles remain intact – and in fact have become worse, while new obstacles have been added. So the question we really need to be asking is whether Canadians in fact want to get into new markets. I have to tell you that the evidence is pretty overwhelming, to me at any rate, that they don't, despite the obvious market opportunities. I have picked just one example of such an opportunity: live hogs. I have documented how Canada's price for live hogs is considerably lower than it is in Japan, one of the major new markets to which we would gain access under the Trans-Pacific Partnership (TPP).

Live Hog Prices, Select Countries



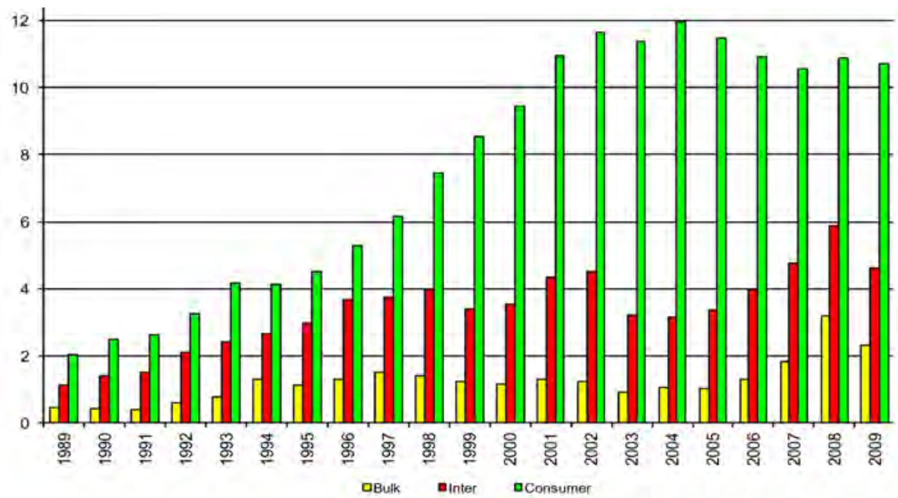
Source:USDA, Agriculture Canada, MAFF

Canada's export markets

It may be worthwhile to step back for a moment and take a broader view in order to get a sense of the opportunities that may exist, because I don't want to leave anyone with the impression that I don't think Canada could do extremely well by expanding its presence in export markets. On the contrary, as the paper for my institute a few years ago put it, we believe that Canada has everything it needs to be a world food superpower.[1]

So first, let's look at how we do in terms of our favourite export market, the one to which we have pretty well assured access thanks to free trade agreements: the United States.

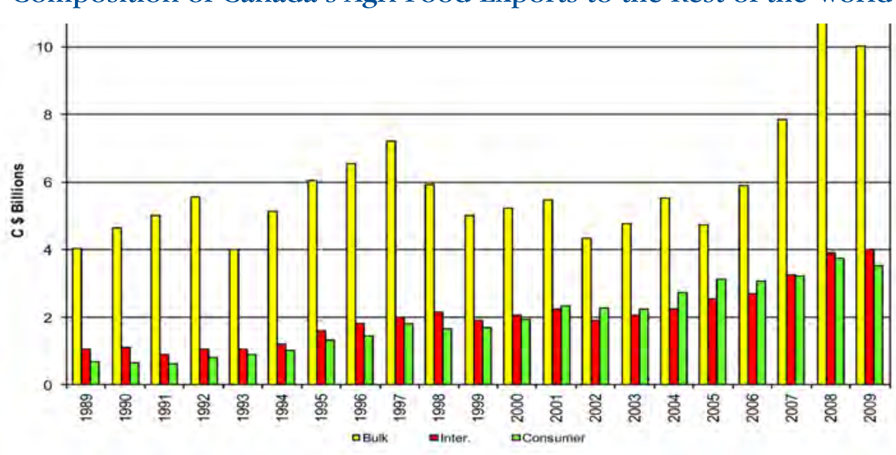
Composition of Canada's Agri-Food Exports to the United States



I have broken Canada's exports to the US into three categories: bulk, intermediate, and final consumer products. The good news is that we do pretty well in terms of the higher value-added products. Less encouragingly, that part of the market has levelled off, and has even been declining in recent years, whereas the bulk and intermediate exports have been stable or growing.

Now let's compare our agri-food trade with the US to that with other countries, which is presumably where we think Canada's market is for increased exports. The pattern is almost the reverse of our trade with US: bulk exports predominate, accompanied by a slow, steady increase of intermediate and consumer products growing from a relatively small base. This suggests lots of room for growth, not only in total exports but in the composition of those exports. This is especially so given that the markets new trade agreements are opening tend to be ones with higher incomes and more sophisticated consumers, such as the European Union.

Composition of Canada's Agri-Food Exports to the Rest of the World



Here is how I see things four years on from our last conversation. There is good news and bad news.

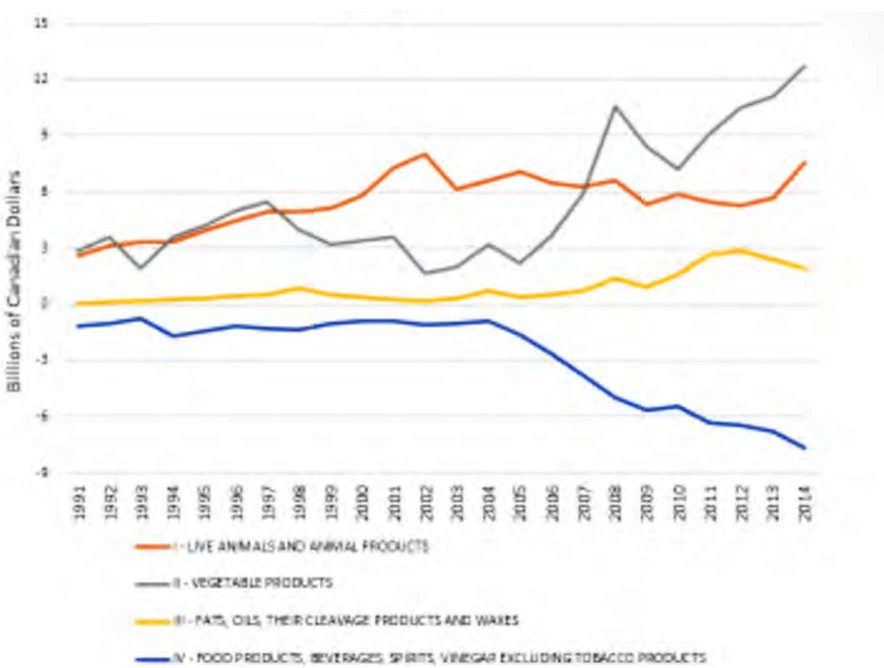
The current situation

It's hard to continue to blame the lack of competitiveness in the food processing industry on Canada's protection of supply management. In both the Comprehensive Economic and Trade Agreement (CETA) and the Trans-Pacific Partnership, the meat industry, as well as grains and oilseeds, have gained considerable market access, and the dairy and poultry industries have lost some protection. That means that theoretically, the agri-food business in Canada should be looking to Asia and Europe as obvious newly-opening markets. These are also markets where a number of Canadian products enjoy cost and quality advantages. The fact that Canadian trade negotiators signed onto these agreements indicates that the previous negotiating stance – that supply management was untouchable – is being diluted. Add to that Lino Saputo's recent declaration that he would rather be working in a market-driven context than under supply management, and the ground is shifting rapidly.

Obviously, since the TPP and CETA aren't yet in place, we don't know exactly what impact they'll have. I have to say that I am hearing worrying things about the eventual adoption of TPP in particular, so the market opening it promises may not even materialise. The commitment of Canada's new federal government to TPP is weak, in my view, and meanwhile, Japan is facing some difficulties getting TPP adopted and the political ground is shifting rapidly against free trade in Washington. CETA is on safer ground, although even there resistance is growing in Germany, without whose support passage is far from assured.

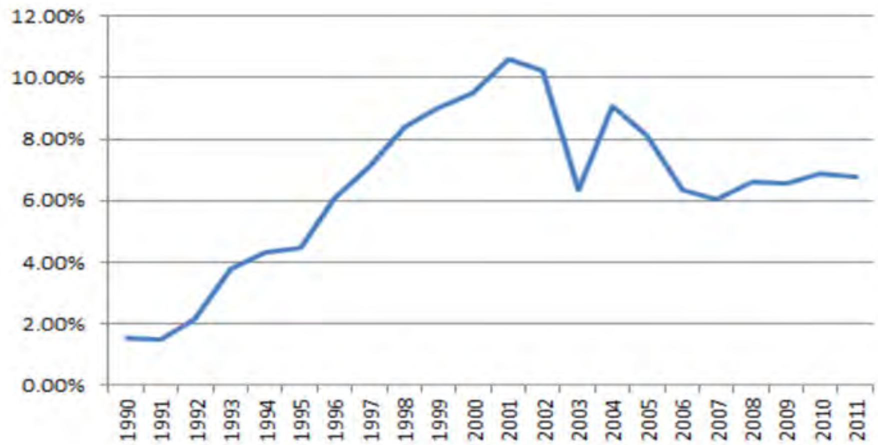
But a look at the evolution of Canada's export performance in the agri-food sector over the last few years shows why I think supply management, currency fluctuations, and lack of market access can no longer be blamed as the chief culprits in Canada's poor export performance. Of the four groups of agricultural and food products, the value of exports of two groups is essentially flat and one is in serious decline. The only one that grew is grains and oilseeds (vegetable products), and that is only because of commodity price increases internationally, not because export volumes increased (except in pulses – chickpeas and lentils). This is at a time when barriers to trade in these commodities have been stable or declining.

Canada's Net Trade Balances: Trade Balances for Major Agricultural and Food Products



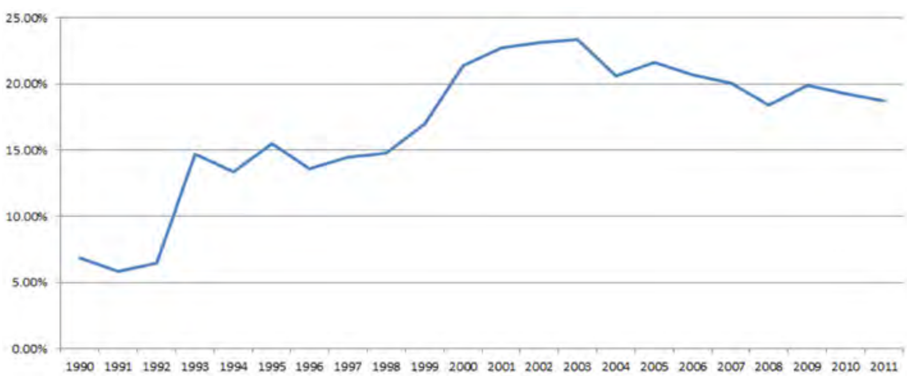
Four accompanying slides show details of Canada's export performance in beef, pork, rapeseed, and wheat.

Canada's Export Market Share in Beef



Source: FAOSTAT, 2010

Canada's Export Market Share in Pork

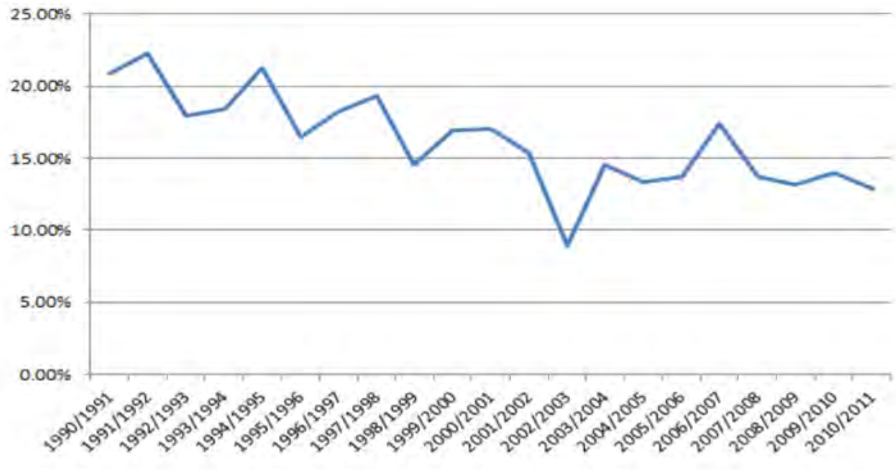


Source: FAOSTAT, 2010

Canada's Export Market Share in Rapeseed

Source: FAOSTAT, 2011

Canada's Export Market Share in Wheat



Source: USDA – Foreign Agriculture Service, Production, Supply and Distribution Online

Reasons behind the drop in processed food trade

The net trade in processed food has dropped straight downward to reach a negative $9 billion annually. All of this is consistent with the fact that there is a net negative investment in food processing (i.e., annual depreciation exceeds new investment), especially in greenfield-type investments as opposed to the refurbishment of ageing existing capacity.

There are several reasons for this.

First, after the North American Free Trade Agreement (NAFTA) there was no serious intention to gain market access through expanded trade agreements until CETA and TPP. A quarter of a century passed between the adoption of NAFTA and the negotiation of these two new agreements. As in so many other fields, Canada was content to gain access to American markets and became increasingly complacent, despite the fact that the Americans have been signalling to us over and over again, through Keystone XL, softwood lumber, the third crossing at Detroit, and country-of-origin labelling, to pick just a few examples, that Canada was ill-advised to put all its eggs in the US free trade basket.

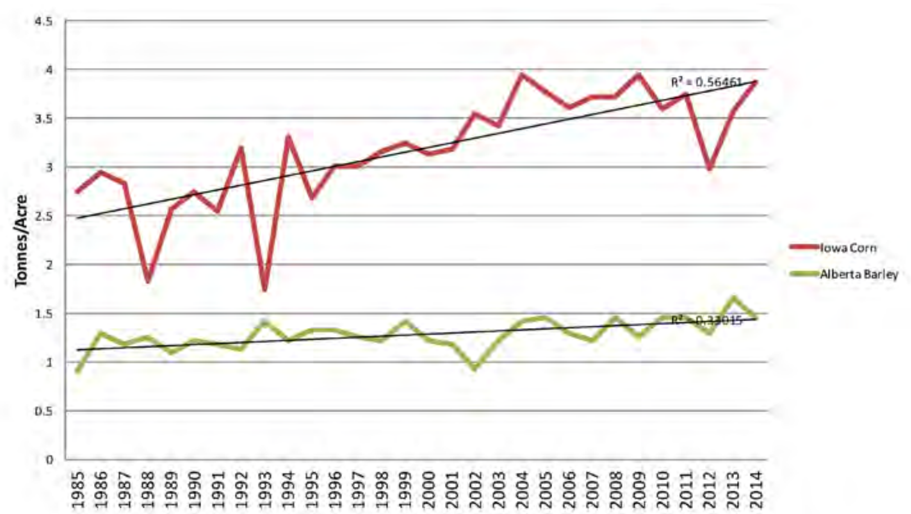
A second reason for our poor performance is the nature of Canada: its size and the distribution of its relatively small population mean that transportation costs are high and it is difficult to achieve economies of scale. But that is a problem to be surmounted, not a disadvantage to be accepted. If Canada wants to be internationally competitive and break into new markets, or even just keep the international market share it has had, it is imperative that we raise our productivity.

Productivity is highly linked with capital investment: labour productivity rises when workers have access to automation and when they work in plants that have economies of scale. In the food manufacturing industry over the past decade and more, there has been less new investment than capital depreciation. We are not merely not investing; we are pulling our money out. It is therefore not surprising that there have been few gains in productivity.

It is in the nature of industry and productivity that technological development makes it possible to cut costs, but to do so you have to increase production. If you are losing market share, it is hard to invest to increase production, and this becomes a vicious circle. We are now talking about access to new foreign markets because that will help to give us the scale to justify investments, but we haven't even been keeping up with the capital investment needed to serve the markets to which we already have access. Compared to our peers in the United States, Australia, and New Zealand in particular, our record is pitiful.

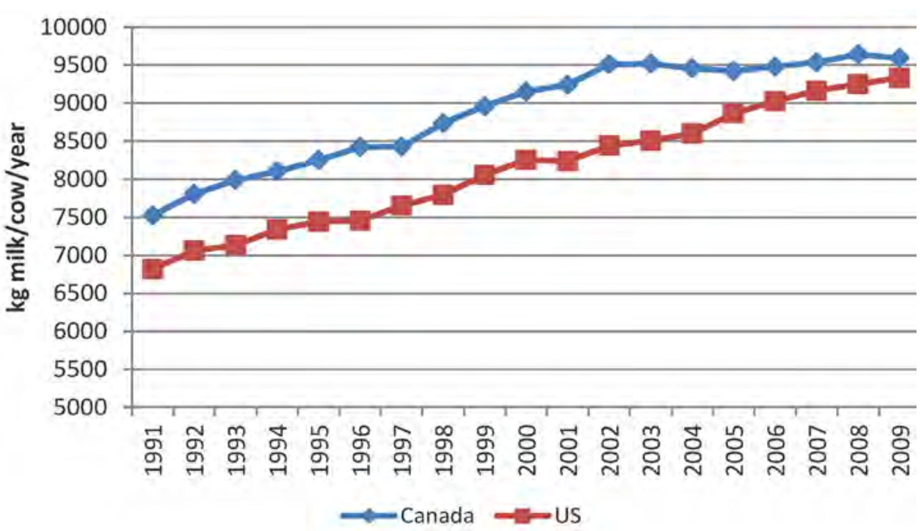
Let's compare our productivity performance, the key to winning international market share, with that of the United States. Five accompanying slides tell the story.

Feedgrain Yields: Iowa Corn and Alberta Barley Yields, 1985-2014



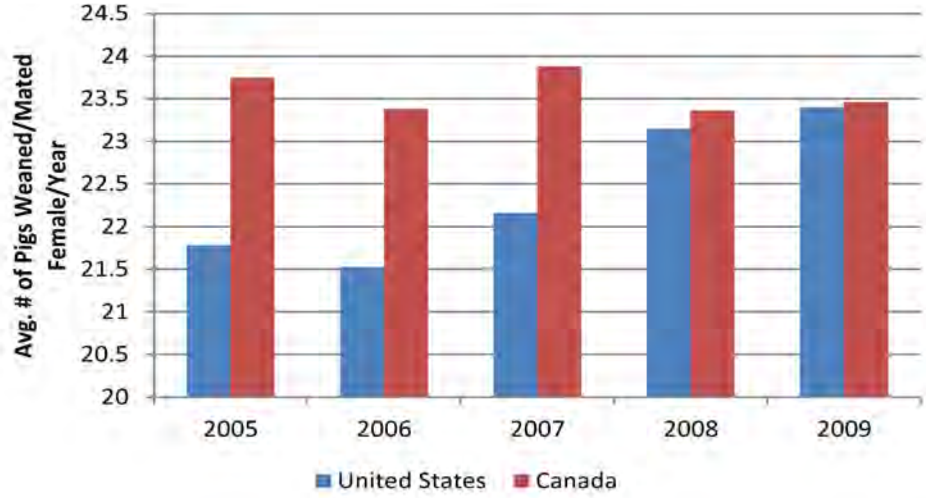
Source: USDA and Statscan

Dairy Productivity



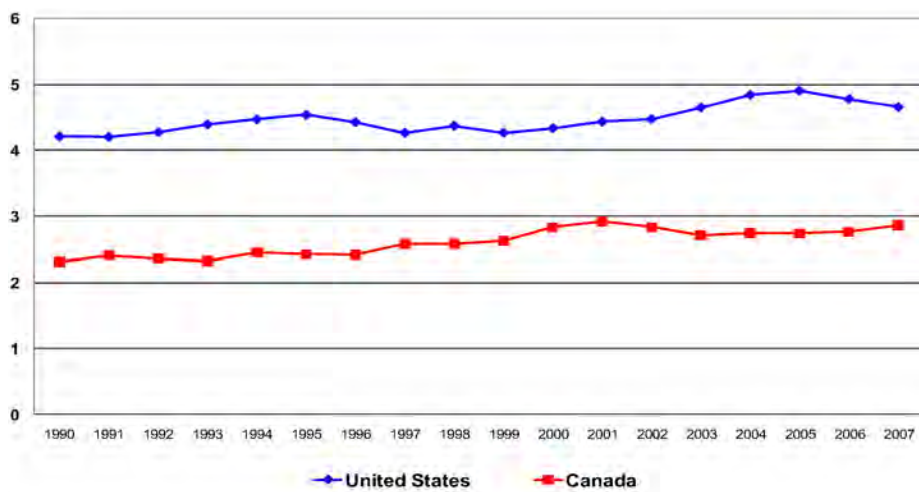
Source: AAFC, USDA

Hog Productivity

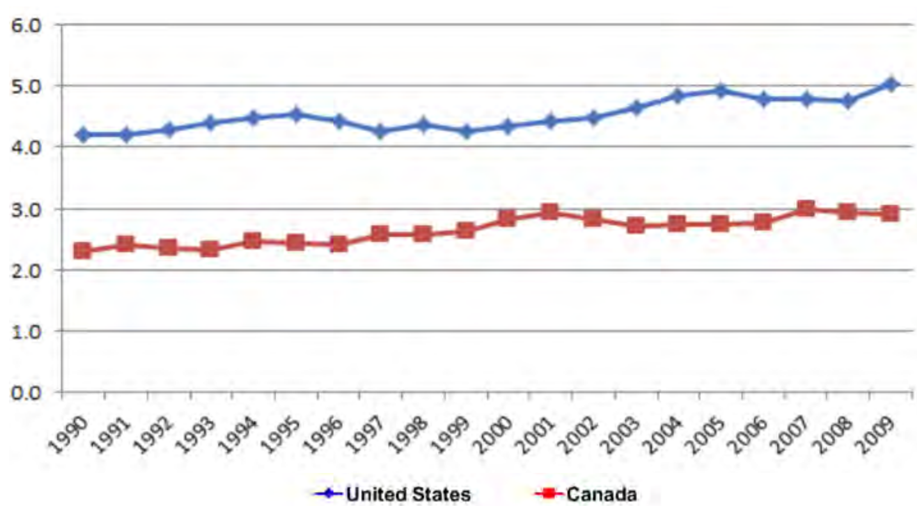


Source: PigChamp, 2010 http://www.pigchamp.com/benchmarking_summaries.html

Food Processing Productivity: Value Added per $ of Wages and Salaries



Total Food Manufacturing (311): Value Added/Labour Cost



The comparisons with our competitor countries show us that there is no reason to think that western industrial countries such as Canada cannot compete internationally in agri-food. But to do so they need to get everything right. Canada has not.

Where are we going wrong?

Look at Canada's regulatory environment:

- Health Canada,
- CFIA [the food inspection agency],
- interprovincial barriers,
- provincial and local health inspections;

These regulations are a huge, burdensome tax on investment in this industry because they are applied inconsistently and, to quote my good friend Larry Martin, former head of the George Morris Centre, an agri-food think tank, policies in this area are apparently applied mainly by sociopaths who think their job is to harass Canadian agri-food investors. Everywhere Larry goes, he hears stories about how regulators are holding up even the simplest expansions and investments for months and even years.

I remember one example of my own from when I lived in Nova Scotia. A Greek gentleman married a Nova Scotia woman and they set up a very successful feta cheese operation on their farm in the Annapolis Valley. They kept expanding and expanding and were supplying markets as far away as Toronto. But they reached a size where the local department of agriculture determined that they were no longer a farm operation but an "industry," and the department said that if they wanted to expand any further, they would need to abandon their farm-based operation and move to an industrial park. Given the cost and regulatory burden they simply decided to stay put and stop investing in expansion.

So Canada's regulatory system is slow, cumbersome, and inefficient. It discourages the adoption of new technologies at the farm level and in food processing. It discourages food companies from developing new products that can provide health and other benefits to consumers. As a result, it removes the opportunity for farmers and food companies to differentiate their products. It is, in a word, an oppressive blanket on innovation in the food sector that not only discourages investment, but drives it out of the country and removes any opportunity for Canada to be an early adopter of technology in any area. It should be the subject for immediate and substantial reform aimed at simultaneously providing healthy products to Canadians and encouraging innovation and efficiency in the food supply system.[2]

Agricultural policy

Canadian governments spend the lion's share of their agriculture budgets on farm income support, although the total is falling. When one adds in the economic benefit to the dairy and poultry industries resulting from supply management, price and income support represents roughly 90 percent of total government agricultural and food policy. In total, according to the OECD, Canada's market support for agriculture remains between 20 and 25 percent of gross farm income on average, year in and year out. Other countries have transformed their policies, either to reduce market support below 10 percent, as in Australia and New Zealand, or have begun to replace market support with policies aimed at improving productivity and the environment.

Canada's agri-food policy, like that of most other developed countries, is a product of six decades of food surpluses when productivity didn't matter, or was to be actively discouraged because it drove people off the land and was politically unpopular. If food scarcity is the more likely prospect in the future, then it is well past time to rethink our policy. This is especially the case for a country whose agriculture and food sector relies heavily on export markets and would benefit from an orderly expansion of export markets.

Preoccupation with small operations

Many programs, sometimes with direct government investment, aim to increase the number of small agricultural operations. This preoccupation reduces our competitive advantage and directly and indirectly reduces the amount of capital available for investment.[3] In fact, it flies directly in the face of the imperative of increasing the industry's productivity.

Then there are the problems associated with the difficult balance to be struck between democracy, science, and the imperatives of feeding the world's teeming billions.

The politicians responsible for agricultural and food policy are highly motivated by political concerns – particularly the desire to be re-elected. Accordingly, they are vulnerable to pressure from special interest groups that do not necessarily have the interests of the food industry at heart, including some conservationists, environmental groups, animal rights activists, and recreation and tourism interests. Indeed, such groups may be actively hostile to agriculture, and the campaigns they wage against it have a deleterious effect on agricultural policy. As I have often said, if farming didn't already exist, it is not at all clear to me that we would be allowed to invent it today.

Other pressures on the agri-food industry

In addition to the regulatory burdens mentioned earlier, Canada has among the highest and most continuously increasing minimum wages. As well, in some provinces, notably Ontario, the out-of-control increases in energy costs have literally put many in the agri-food industry out of business and certainly don't encourage them to invest, especially with the government making it clear that the era of rapidly rising energy costs is far from over.

Another factor holding us back is the food industry's continued dominance by multinationals with no interest in developing export capabilities. Far too often they see Canadian production as either serving the Canadian market or as inputs for the US agri-food industry. Again this limits the potential investment base. Many of the Canadian companies are SMEs for whom the leap to international competitiveness is daunting. How many SMEs are seriously going to try to break into markets in Japan or Germany when they already have their hands full dealing with the obstacles to operating in markets they know well in Canada and the United States?

Ironically, one of the Canadian companies that has achieved the kind of scale necessary to be a successful international competitor, Saputo, has achieved this dominance in the context of supply management, which hinders their forays into international markets where they feel confident they could compete quite successfully.

Another factor that receives for too little attention is the inclination of federal and provincial governments to believe they are sufficiently well-informed to be able to invest directly in individual companies; this is a significant constraint on investment, and not just in agri-food.

If my competitor gets a couple of million dollars free, or at a very low cost, to invest in something substantial, that automatically reduces the payoff for me if I am considering risking my own money in a similar investment. The availability of government investment encourages me to go after what the government wants to fund, even though that may have nothing to do with what will make me more competitive in my market. Governments show little awareness of how their seemingly generous policies warp decision-making and undercut private investment driven by the business case.

Finally, and this links back to my comments about the Canadian-owned part of the industry being largely in the SME sector, observers note that the industry in general seems to have very little interest in improving their management knowledge. Managers have little or no time, opportunity, or encouragement to upgrade their skills or to get away from day-to-day pressures to think strategically. There is substantial pressure to regard businesses as being what they are instead of what they can be, despite so much evidence that things have never changed so fast.

There is no will on the part of government or industry to develop any type of strategy that will improve competitiveness across all these issues. But only such a strategy will earn us the productivity increases which are the indispensable condition of winning the international market share that our agri-food capacity warrants.

Brian Lee Crowley is Managing Director of the Macdonald-Laurier Institute.

Endnotes

1 *Canadian agriculture and food: A growing hunger for change* (Oct. 2011) by Larry Martin and Kate Stiefelmeyer. http://www.macdonaldlaurier.ca/files/pdf/Canadian-Agriculture-and-Food-A-Growing-Hunger-for-Change-October-2011.pdf

2 An example comes from Agriculture Canada and/or CFIA, which recently tried to improve the regulatory system. One suggestion made by many people is that Canada stop requiring "proof of efficacy" as part of the process in getting regulatory approval for new products. Almost no other country in the world requires this. It increases the cost and the time required to get a new input or final product registered. However, the suggestion for its cancellation was met with a huge wall of resistance, most likely led by the National Farmers Union. The whole argument for maintaining efficacy is that farmers are too stupid to be able to figure out whether a product that is being offered to them works or not. It seems to me if I'm buying a product, it is incumbent upon me to require the seller to prove to me that it works. If I don't require that proof, then the responsibility is mine, not government's. That one change would make a huge difference in the regulatory system and its cost in Canada. This is a case of industry shooting itself in the foot.

3 For example, there were 100,000 farms in Canada (2004–2008) with sales of less than $100,000 per year. They represented 55 percent of the total number of farms, generated only 5.7 percent of net operating farm income, but collected 16.2 percent of support payments from government. These farms also had about $4.2 billion in income from other sources (non-farm). While a few of these operations may be legitimate farms, very few of them contribute much to the economy.

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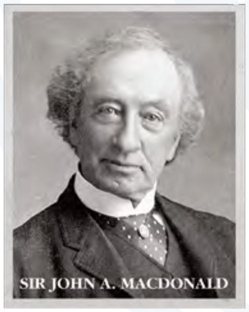
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True North in
Canadian public policy

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