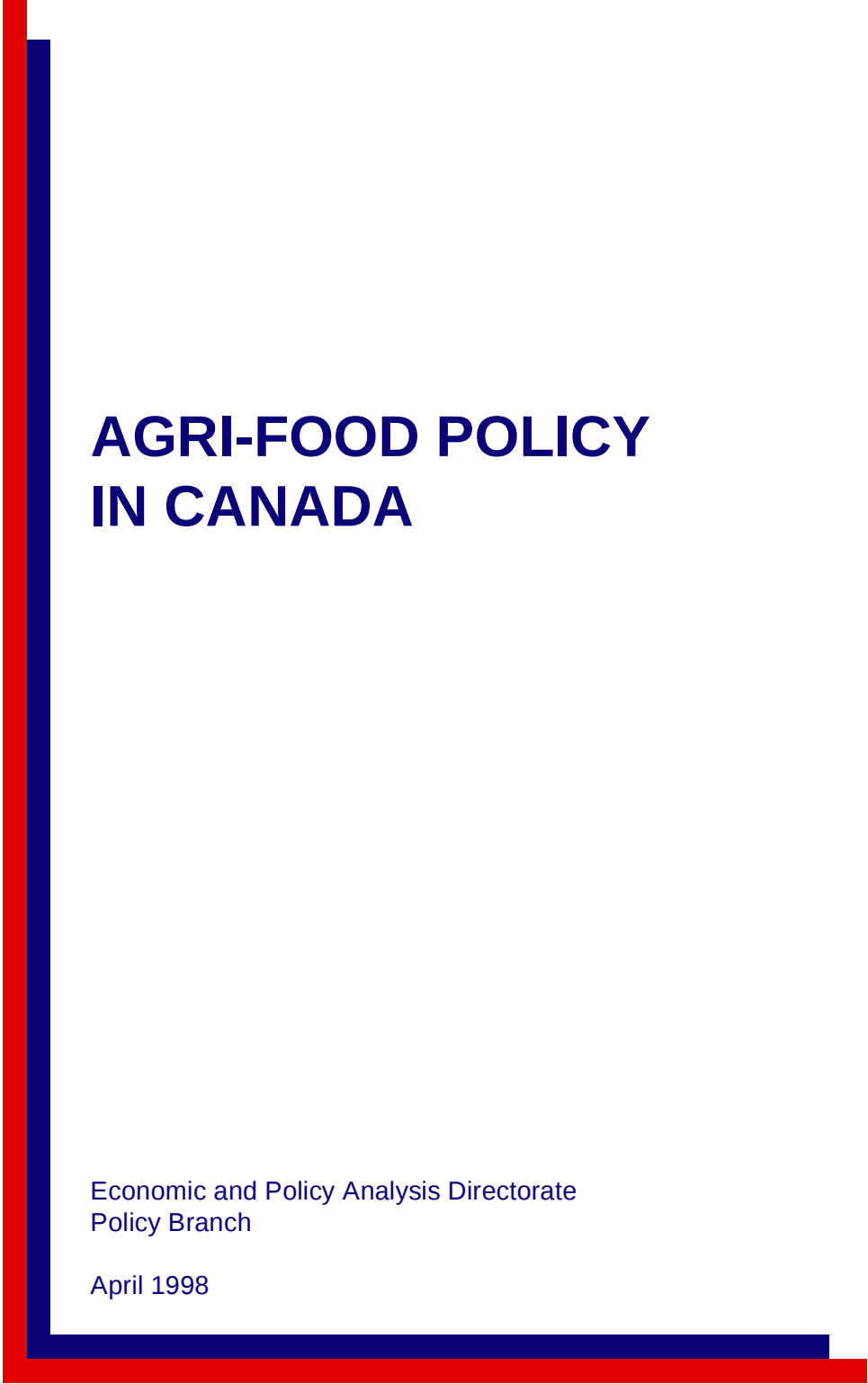




AGRI-FOOD POLICY IN CANADA

Economic and Policy Analysis Directorate
Policy Branch

April 1998



Agriculture and
Agri-Food Canada

Agriculture et
Agroalimentaire Canada

AGRI-FOOD POLICY IN CANADA

Economic and Policy Analysis Directorate
Policy Branch

April 1998

AGRI-FOOD POLICY IN CANADA

Ken Ash

Economic and Policy Analysis Directorate
Policy Branch

April 1998

Any policy views, whether explicitly stated, inferred or interpreted from the contents of this publication, should not be represented as reflecting the views of Agriculture and Agri-Food Canada.

To obtain additional copies, contact:

Information Production and Promotion Unit
Economic and Policy Analysis Directorate
Policy Branch
Agriculture and Agri-Food Canada
Ottawa, Ontario
K1A 0C5
Tel: (613) 759-7443
Fax: (613) 759-7034
E-mail: ipp@em.agr.ca

Electronic versions of EPAD publications are available on the Internet at www.agr.ca/policy/epad.

Publication 1982/E
ISBN 0-662-27209-9
Catalogue A22-179/1998E
Project 98040r

Aussi disponible en français sous le titre :
“Politique agroalimentaire au Canada”

Table of Contents

Executive Summary	i
Introduction	1
Chapter 1: The Canadian Agri-Food System	3
Chapter 2: Canadian Agri-Food Policies	9
Market Regulations	9
Income Stabilization Policy	11
Grain Transportation	12
Other Policy Initiatives	13
Overall Policy Support.....	14
Chapter 3: Looking Ahead — Market Prospects and Further Policy Reform	17
Conclusion	21

Executive Summary

The agri-food sector is an important part of the Canadian economy. Increasingly, the sector builds upon its primary production capabilities to satisfy global, as well as domestic, demand for high quality and often more highly value-added food products. Agri-food policies in Canada have changed in response to this evolving orientation. Overall support levels have been reduced substantially; on-going spending is shifting toward non trade-distorting measures; and greater emphasis is being placed on productive investments (i.e., in research and development and product safety) that both comply with international trade agreements and allow producers to respond to consumer expectations.

The degree of public intervention in the agri-food system remains high in many countries around the world. But the nature of that intervention is changing, and support levels are declining slowly. The specific timing of further policy reforms in Canada will be strongly influenced by domestic fiscal pressures, bilateral and multilateral trade agreements, economic developments, and important social and political considerations.

There is generally wide recognition that agri-food policy reforms to date have contributed substantially to improved industry efficiency, productivity and international competitiveness, as well as to improved consumer well-being. There is an equally wide understanding that much more remains to be done.

Improving commodity prices, better functioning markets, established trade rules and disciplines, a more stable macro-economic situation in many national economies, and rising growth prospects in many developing countries are all reasons for optimism. But there are risks and uncertainties that restrain such an optimistic outlook. Many long-standing production- and trade-distorting policy measures remain in

place and continue to make the future for world agri-food markets more uncertain than otherwise. Technical barriers to trade are emerging as an increasing source of tension. Public policy responses to environmental issues can sometimes significantly affect production and trade. Food security continues to represent a major concern in many countries, and resulting policy initiatives may have unintended and negative impacts.

An important lesson of the past ten years is that policy reforms have contributed to world agri-food markets that are more responsive to consumer needs, at prices that are more reflective generally of true production costs. Additional reforms promise further benefits. An ambitious start to, and a swift and successful conclusion of, the next WTO round of agriculture negotiations, beginning in 1999, will contribute to further realization of the benefits of increased trade in agriculture and food products.

Introduction

The paper begins with a brief overview of the agri-food system in Canada, and a discussion of Canadian agri-food policy follows. Particular consideration is given to recent policy changes. Perhaps most importantly, the third chapter offers views on the medium-term prospects for world agri-food markets, and on other factors expected to influence the nature of future agri-food policies.

In many countries, the degree of public intervention in the agri-food system remains high, relative to most other sectors. But the nature of that intervention is changing, and support levels are declining. A key conclusion of this paper is that agri-food policy reforms to date have contributed substantially to improved industry efficiency, productivity and consumer well-being.

A second key conclusion is that much more remains to be done. Despite the opportunities inherent in growing world agri-food markets, many long-standing production- and trade-distorting policy measures remain in place. Effectively addressing such impediments remains a challenge to policy makers. The industry wants to pursue its competitive advantages, in response to changing market demands. Toward this end, early and successful conclusion of the next round of negotiations will enable further progress in realizing the gains from increased, freer and fairer trade in agriculture and food products.

Chapter 1: The Canadian Agri-Food System

The agri-food system is a significant part of the Canadian economy, accounting for 8.4% of Gross Domestic Product (GDP) and 13.2% of total employment.

The food and beverage processing sector is the largest single component of the agri-food system in terms of GDP (contributing 2.5%), but primary agriculture employs about twice as many people. The distribution and food service sectors are larger, in terms of employment, and are growing faster. This continued growth in the relative size of the food service sector is consistent with growth trends in other service industries across the economy (Figures 1 and 2).

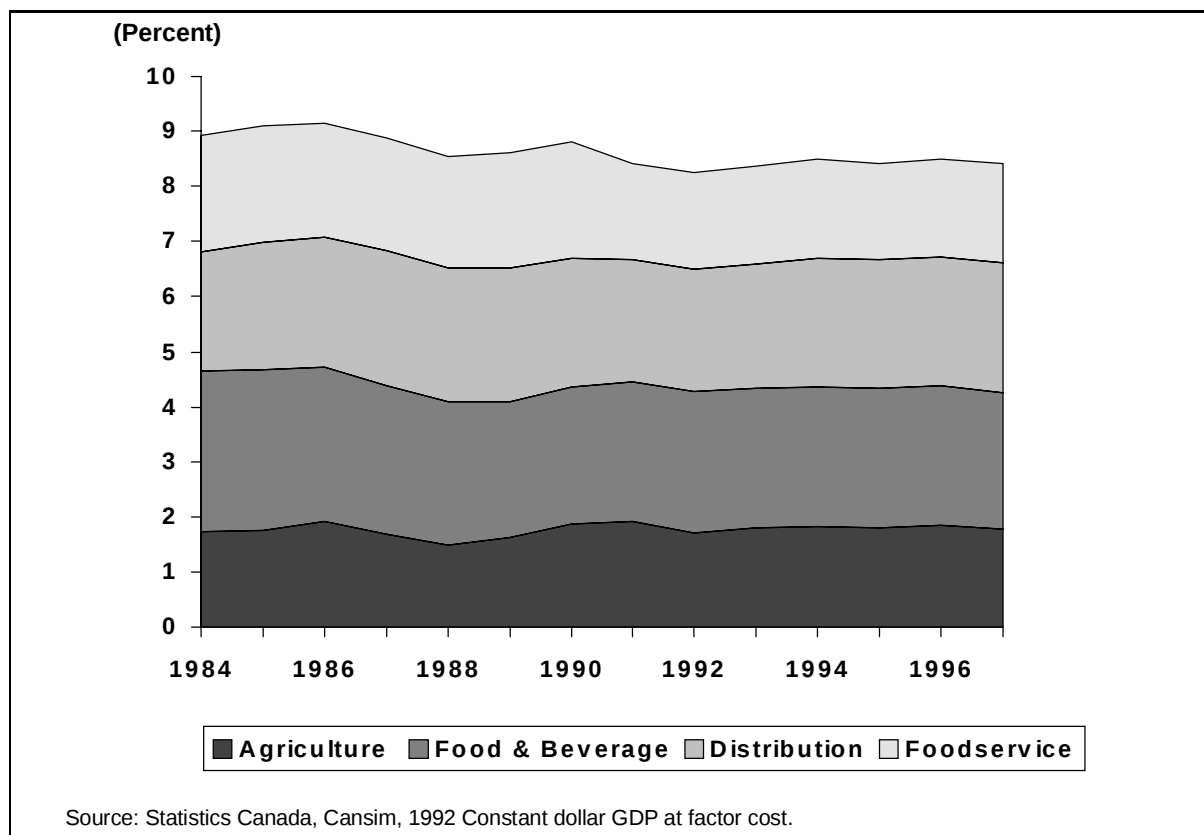


Figure 1: Agri-Food System Contribution to Economic Growth — GDP

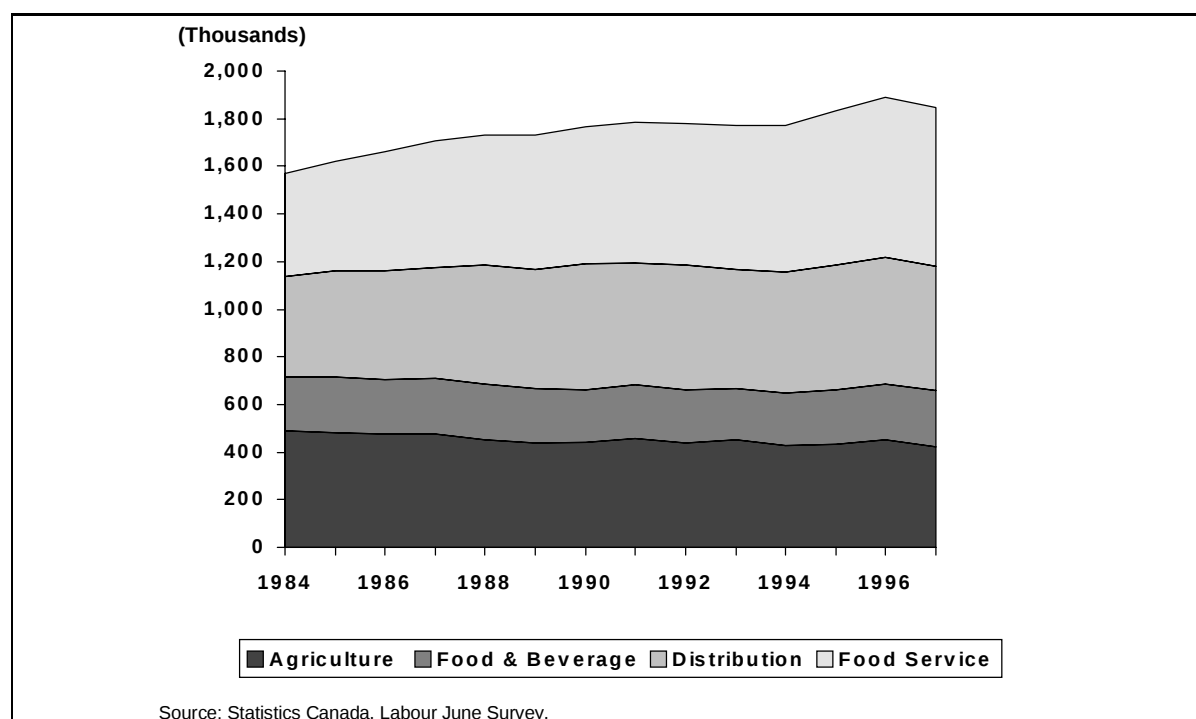


Figure 2: Agri-Food System Contribution to Economic Growth — Employment

At the retail distribution and food service levels, the value of domestic food transactions is approximately \$89 billion. However, agri-food exports are increasingly important and currently account for about 40% of market receipts of primary agriculture products and 18% of the value of shipments from the food and beverage processing sector (Figure 3).

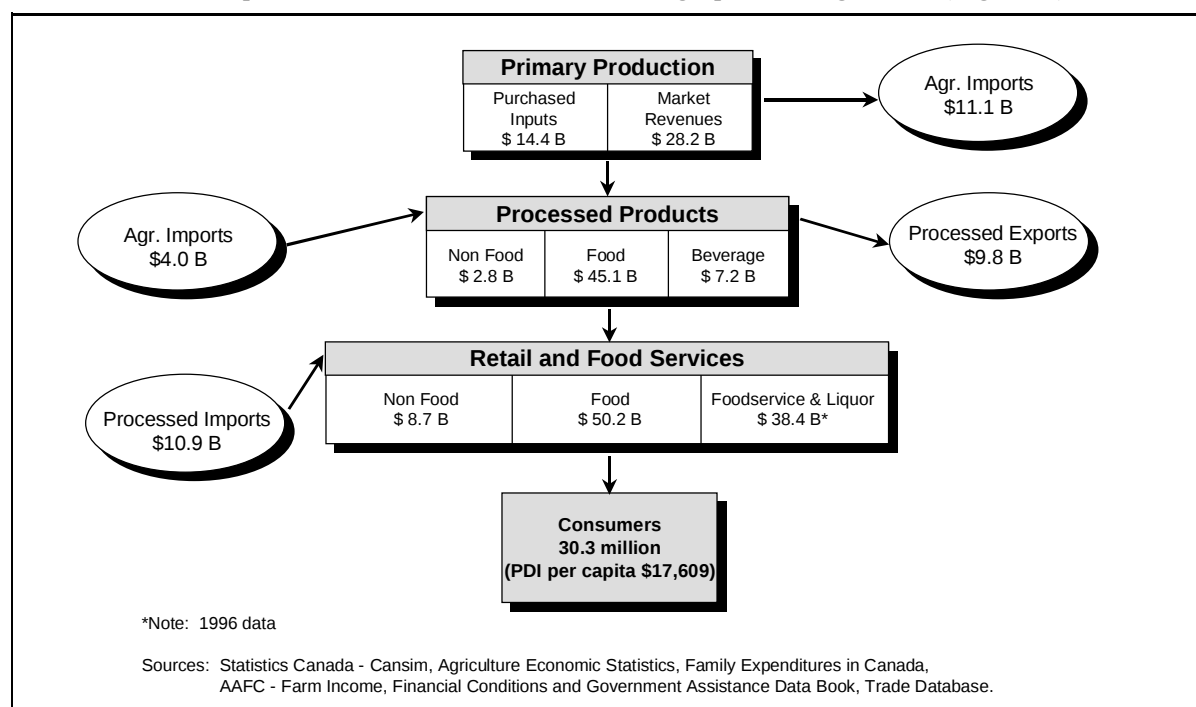


Figure 3: Agri-Food System Value of Gross Output, 1997

Canada's global trade has grown consistently over the 1990s as has net trade balance. The U.S. remains Canada's largest trading partner, accounting for over 50% of the value of both agri-food exports and imports. The trade balance with the U.S. was slightly negative in 1991 but has since been positive, and growing. Trade with the rest of the world has been somewhat more variable, with both imports and exports increasing substantially; the trade balance has remained positive (Figure 4).

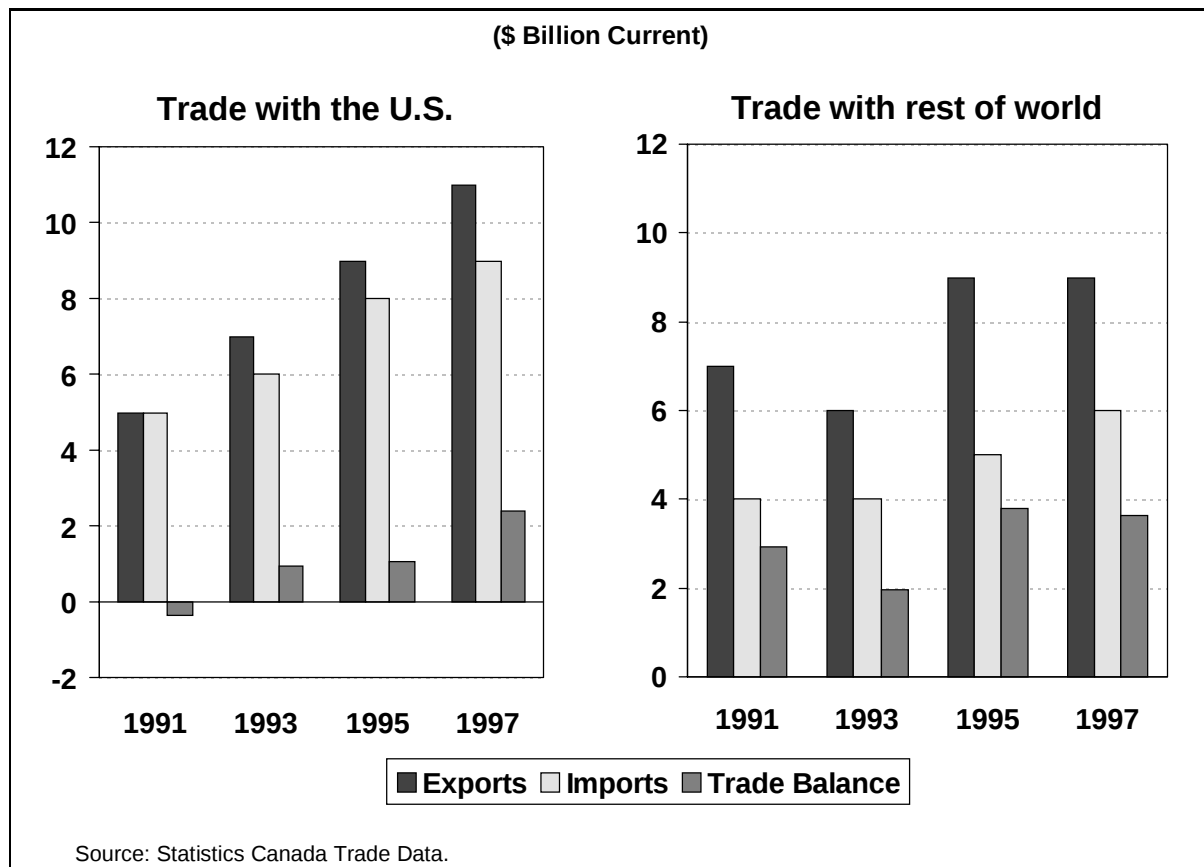


Figure 4: Value of Trade

Canada continues to export more bulk commodities and intermediate goods than consumer oriented products. Grains and oilseeds are the largest export commodities followed by live-stock and meat products. Imports are dominated by consumer products, including tropical fruits and vegetables, as well as coffee, tea and other products unavailable from domestic production. Canada has a positive trade balance in bulk commodities and intermediate products, with both showing steady recent growth. Consumer products have a persistent negative trade balance, with some recent improved performance (Figure 5).

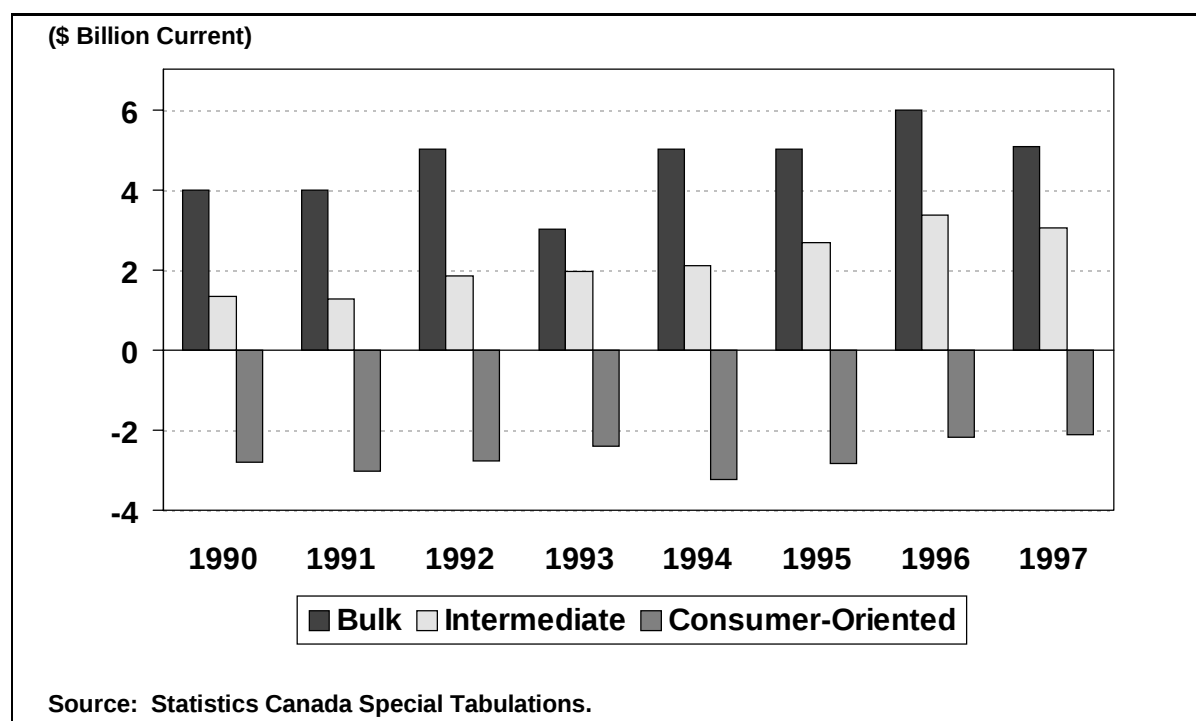


Figure 5: Trade Balance by Type of Product

The number of farms has been declining somewhat and farm size has been increasing, reflecting increased farm productivity. Total land on farms has remained relatively constant since 1971. Larger farms (i.e. those with more than \$100,000 annual gross sales) represent an increasing share of all farms, accounting for about 30% in 1996 (Figure 6).

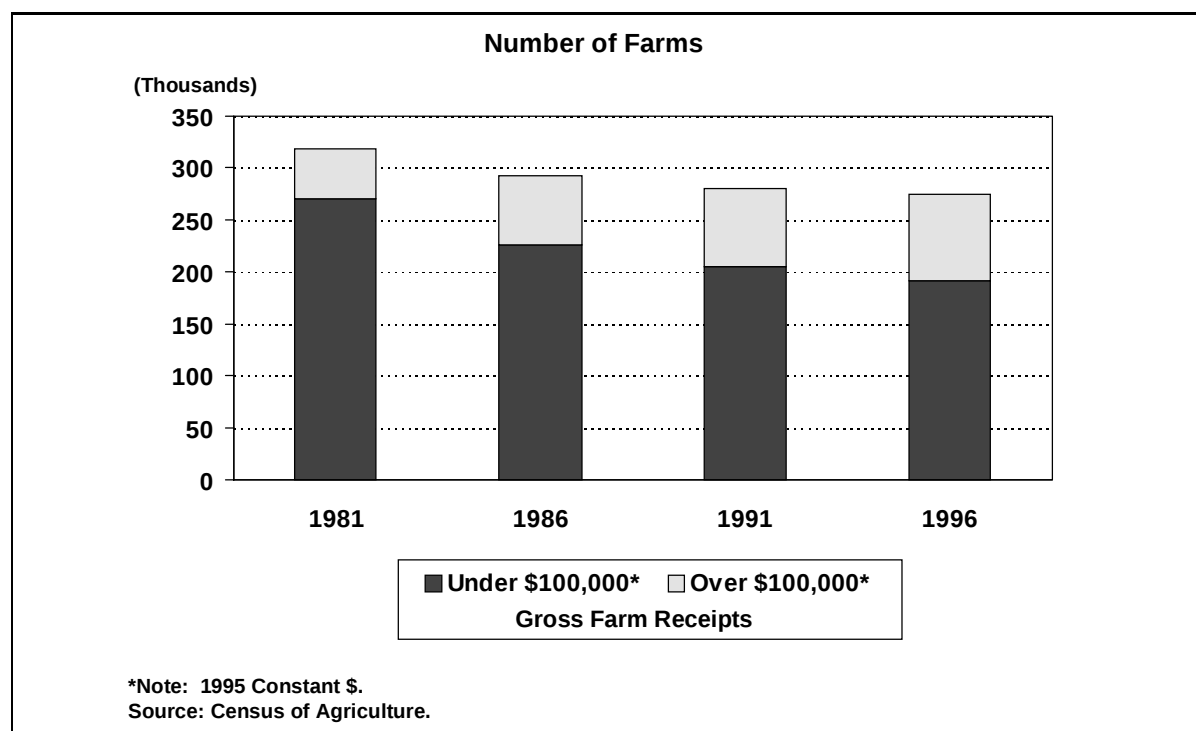


Figure 6: Number and Size of Farms

Net farm cash income has been relatively stable but with a slight upward trend since the early 1990s. At the same time, direct government payments have been reduced significantly. In other words, producers have been successfully earning more and more of their income from the market place (Figure 7)

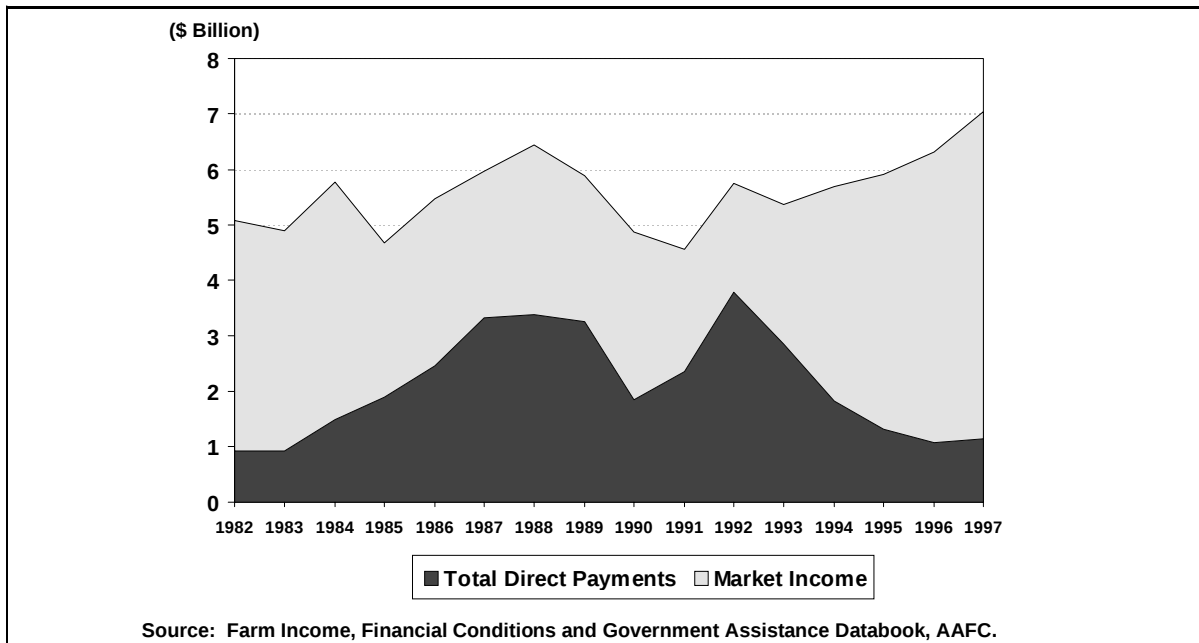


Figure 7: Net Farm Cash Incomes

Profit margins and rates of return in Canada's food processing industry have recently stabilized, following a period of decline. Investment has begun to increase, and this is a significant indicator of the relative attractiveness and future prospects of the sector (Figure 8).

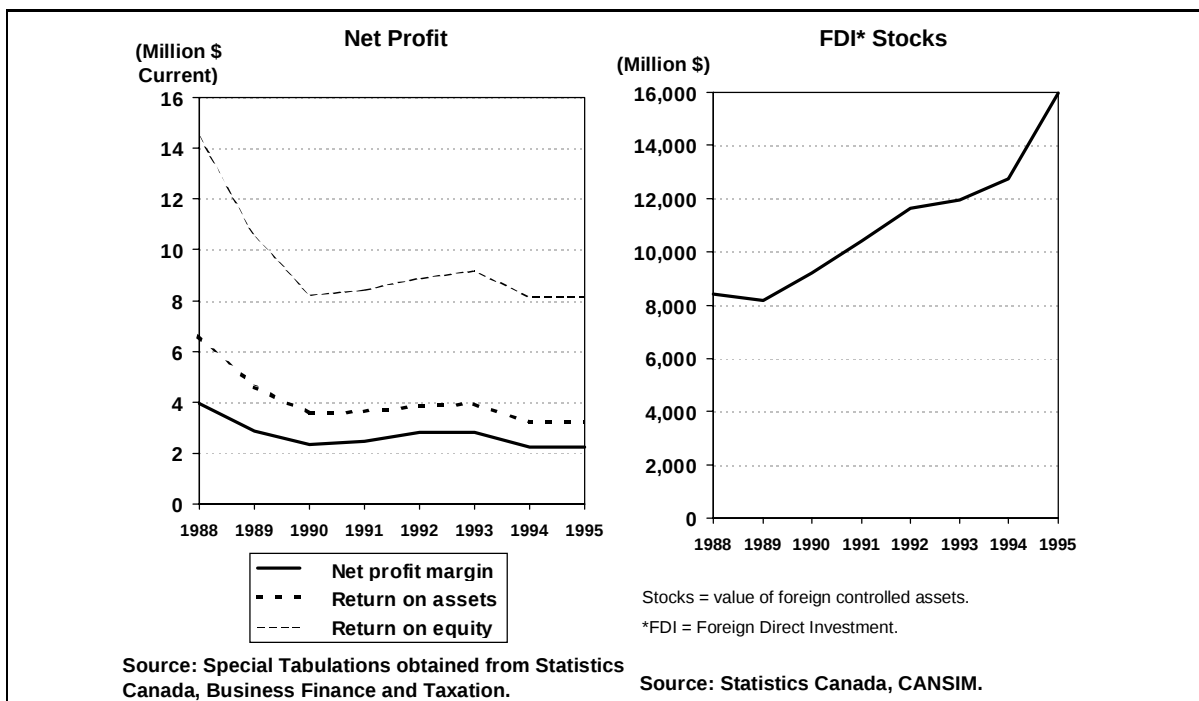


Figure 8: Performance of the Food and Beverage Sector

In terms of ownership in the processing sector, Canadian-controlled establishments continue to create relatively more jobs, while foreign-controlled establishments are generally characterized by larger plants, higher value-added, higher productivity levels and higher pay rates. About 20% of the food and beverage processing work force “turns-over” annually. Just over 10% of employment is created, and just under 10% is destroyed, annually. Modest net employment growth masks significant adjustments.

Chapter 2: Canadian Agri-Food Policies

Three major elements of Canadian farm policy represent the majority of government interventions in the sector: market regulations, income stabilization and grain transportation.

Market Regulations

One of the distinguishing features of Canadian agricultural policy is the development of marketing boards, beginning as early as the 1920s. The purpose of these boards is to ensure “orderly marketing” of certain agricultural commodities, which reflects the desire both to stabilize agriculture markets and to improve producer prices. The two most significant and perhaps controversial applications of marketing boards in Canada are the supply management system and the Canadian Wheat Board (CWB).

These major tools of public policy are virtually costless to governments, in a financial sense. In the case of supply management, the major benefits to producers are paid for by consumers, in the form of higher prices.

Supply Management

The supply management system covers dairy and poultry products, and is built on three elements:

- control of domestic production / marketing
- import controls / tariffs
- administered pricing

Domestic production/marketing controls are intended to achieve a balance in domestic supply and demand. Each year, demand is forecasted and production targets are allocated to each province, largely on the basis of historical shares. Individual farm production is controlled through a quota system administered by provincial agencies; while initially allocated at no cost, quotas can be bought and sold and have become quite a valuable asset.

Quantitative border restrictions were permitted under the GATT, but subsequent to the WTO Agreement on Agriculture, import quotas have been replaced with equivalent tariff protection. Initial tariffs for supply-managed commodities have been set quite high, and

market access under these tariffs is limited to between 5% and 8.5% of total domestic demand, depending on the product. Effectively, tariffs have maintained a protected domestic market.

Administered prices exist for industrial milk, fluid milk and poultry products. A target price for industrial milk is set annually by the federal Canadian Dairy Commission, based on cost of production surveys and other market considerations. Actual prices paid are determined by provincial agreements, with reference to this target price. A dairy subsidy is provided by the federal government, effectively reducing the price of milk paid by consumers. Fluid milk and poultry prices are determined on a provincial basis. Formerly, these prices were based exclusively on cost of production estimates. Currently, these prices are subject to adjustments negotiated between provincial marketing boards and processors to reflect market factors in addition to production costs.

The supply management system for dairy and poultry clearly remains a major element of Canadian agri-food policy. Changes to this system have been introduced to improve industry responsiveness to changing consumer demands.

- The introduction of special milk classes and a “Pooling Agreement” provides industrial milk at lower prices for use in competitive product markets, thus improving the cost competitiveness of Canadian food processors who use dairy ingredients. More recently, industrial and fluid milk reserves have been pooled across two regions, essentially an eastern Canada region and a western Canada region. This will provide more equitable distribution of milk revenues within these pooled regions. It also might represent a gradual move toward establishing national revenue-sharing for all fluid and industrial milk.
- As well, the \$110M dairy subsidy is being phased out over the period through to January 31, 2002.
- In the broiler chicken industry, the 1995 system of establishing national quotas, using the sum of the quantities contracted for by processors with each provincial board, has resolved the short supply difficulties experienced by further processors and the restaurant trade in earlier years.
- The federal Proclamations establishing the chicken, turkey and egg national agencies were amended in 1996 to provide agency membership to nominees of downstream stakeholders. This has provided downstream stakeholders with a direct voice in the management and program operations of these agencies.

The Canadian Wheat Board (CWB)

The CWB is a crown corporation established in 1935. The CWB acts as a single-desk seller for wheat and barley grown in Western Canada. Its three major objectives are:

- to maximize net producer returns from the marketing of wheat and barley grown within the CWB region;
- to equalize prices to producers at a given location, through a system of price pooling, for a given quality of grain, in each crop year; and

- to provide equitable access for farmers to the grain handling and transportation system.

To meet these objectives, the CWB has sole seller rights for sales to export and for domestic human consumption of all wheat and barley grown in the CWB area. The Board is obligated to accept all grain delivered as called for in delivery contracts it administers, but does not have control over supply. The Board is also obligated to make initial payments and give producers their share of pool returns. The CWB regulations ensure equitable access to the handling system for producers of wheat and barley, and afford the Board a role in allocating railway cars to transport grain to market.

The Board has been the subject of much scrutiny and discussion in recent years. Generally speaking, the Board is sometimes accused of not being sufficiently transparent in its marketing practices, particularly its price setting, and of restricting producers from pursuing niche-market opportunities directly. In this regard, the CWB is not very different from other single-desk sellers operating in other countries.

Amendments to the CWB Act have been approved by Parliament. Major elements include:

- introduction of operational flexibilities relating to grain purchases, such as authority to increase initial payments in response to market conditions;
- replacement of the appointed commissioners with a president and a (partially) producer-elected Board of Directors, thereby increasing responsiveness to producer concerns;
- introduction of a requirement to establish a contingency fund for potential losses associated with cash trading and adjusted payments (initial payments would continue to be guaranteed by the government).

Income Stabilization Policy

Another important feature of the policy landscape in Canada is safety net policy.

In 1991, an umbrella statute (Farm Income Protection Act) was introduced to provide a general framework for income stabilization programs. All programs under this framework are guided by the principles of:

- market neutrality
- equity among commodities and regions
- social, economic and environmental sustainability
- consistency with international obligations

The major elements of this safety net framework, developed to address the different needs of different sectors of the industry, are Crop Insurance, the Net Income Stabilization Account (NISA), and province-specific companion programs.

Crop Insurance provides protection against production risks, including drought, flood, hail, frost, excessive moisture and insects. Payments are triggered when a producer's yield falls below 70%–80% of that farm's average historical yield due to any of the risks listed. Premiums are charged so that the program is actuarially sound, with producers contributing 50% and the two levels of government contributing 25% each.

NISA assists farmers in stabilizing income, essentially by establishing a fund which receives contributions during good years in order to provide withdrawals during poor years.

Participating farmers may contribute up to 3% of eligible net sales (to a maximum of \$250,000). This basic 3% contribution is matched by a combined contribution from the federal and provincial governments. Producers may contribute an additional 20% of eligible net sales, but this is not matched by governments. Interest on funds is paid at market rates plus a 3% bonus. Withdrawals are allowed when the gross margin for the entire farm falls below the five-year average, or when income from all sources falls short of a defined minimum level. The uniqueness of the program is its whole farm approach, as opposed to the commodity-specific approach of previous stabilization programs. The NISA program is expected to be the core of our future safety net system.

Province-specific companion programs are intended to complement the programs described above, by addressing more specific provincial and regional concerns while maintaining market neutrality.

This evolution of safety net programs demonstrates the strong commitment to putting in place a system that stabilizes income fluctuations, without raising incomes to some artificially high level. The aim is to be compatible with the WTO Agreement on Agriculture and, most importantly, to avoid establishing a system that distorts producers' decisions. This goal is consistent with the desire of farmers to earn monies from the market place, not from the public purse.

Grain Transportation

The objective of the Western Grain Transportation Act (WGTA) was to subsidize the movement of western grain to export.

The size of this subsidy was among the largest of any single program in Canadian agriculture. From 1989 to 1992, for example, the cost to the federal government was about \$725 million per year, equivalent to about \$20 per tonne of grain shipped. This subsidy also had the unfortunate consequences of discouraging feeding grain to livestock and discouraging processing grain into higher value products, by effectively raising domestic prices by an amount equivalent to the value of the subsidy. After several years of reductions through the budgeting process, this program was eliminated in 1995.

A one-time \$1.6B capital payment was provided to landowners, and a \$300 million adaptation fund was established to facilitate adjustment to the new policy environment. A smaller, feed freight assistance program was also terminated, with compensation provided to affected producers. Remaining grain transportation issues include disposition of the 13,000 hopper cars owned by the government, and the scheduled 1999 review of the legislation that continues to regulate freight rates.

Other Policy Initiatives

Supply management, income stabilization and grain transportation are traditionally the most significant policy areas. In terms of size, they continue to be significant, but other important policy changes are also being made.

A new Canadian Food Inspection Agency has been established, integrating the *food safety and quality assurance* activities of several government departments into a new, independent agency. Its mandate includes recovering a portion of its costs from users of its services. Its aim is more efficient and more effective operations, and avoidance of unnecessary costs and activities.

Increasingly, public *research and development* efforts are being undertaken in close cooperation with industry. In particular, a recent initiative supports collaborative research by making departmental funds available to match private sector contributions to high priority R&D activities.

A number of additional specific and highly targeted initiatives are also in place or under development to pursue three key objectives:

- to improve and secure market access and enable the sector to capture economic opportunities in domestic and export markets, with a focus on higher value agri-food products (activities relate to trade negotiation, bilateral and multilateral, and dispute resolution; trade development services, including provision of market information; and investment promotion);
- to support sector efforts to develop and produce competitive products and processes in an environmentally sustainable manner (activities that are priorities, in addition to public-funded R&D services, include monitoring of environmental performance and integration of environmental considerations into public and industry decision making); and
- to enhance the sector's economic viability while strengthening opportunities for rural community economic development (activities include funding for adaptation/adjustment initiatives aimed at exploiting local opportunities, including provision of important infrastructure services, as well as coordinating government-wide services to better respond to local needs).

Overall Policy Support

Taken together, recent policy changes have been substantial. In terms of departmental spending, the AAFC annual budget has declined from an average of \$3.3B in the 1988–1992 period, to \$1.8B in 1997. The focus of this spending is shifting to non trade-distorting or “green” programs as defined by the WTO Agreement on Agriculture. In particular, there is greater relative emphasis on R&D and product safety, and less on commodity specific income stabilization initiatives. Within the allocation for income stabilization, there has been a major shift from commodity price support to whole farm income stabilization, consistent with WTO principles.

A similar trend is evident in some other countries, when considering total support levels as defined by OECD Producer Subsidy Equivalent (PSE) measures. Canada’s current level of support is less than half of that of just a few years ago (Figure 9).

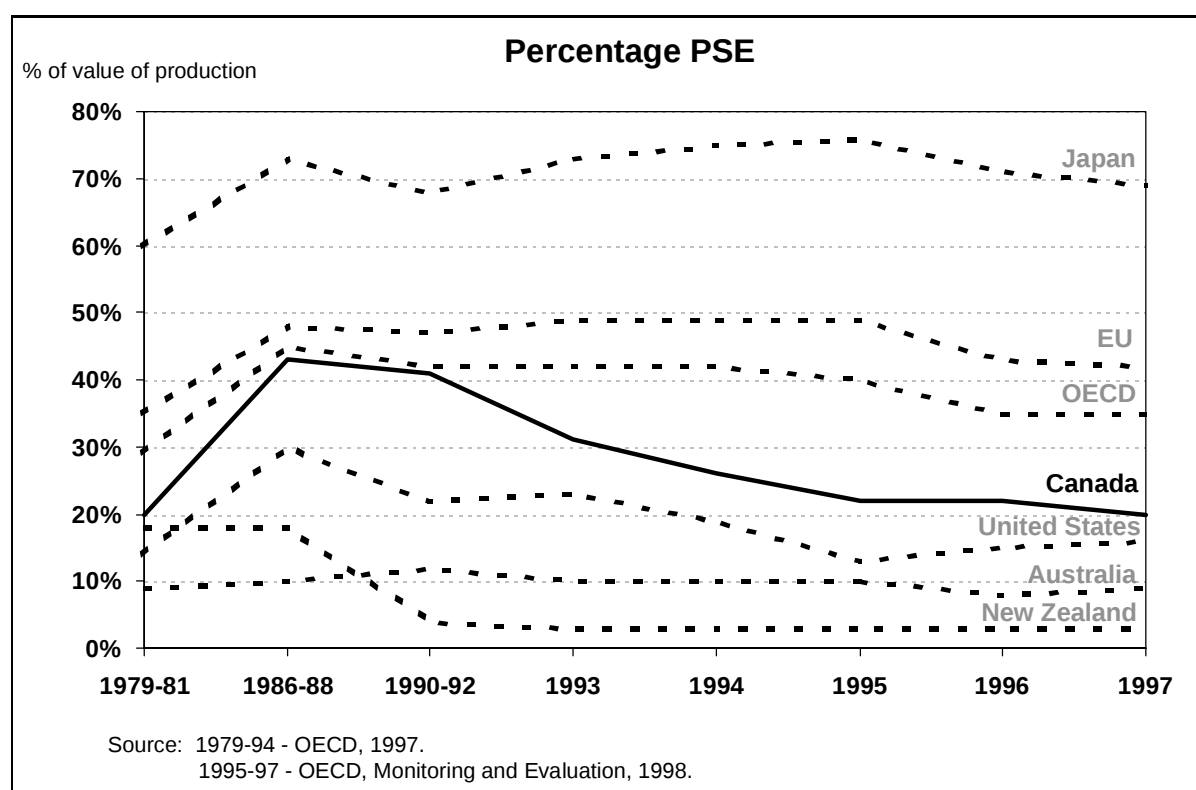


Figure 9: Government Support — International Comparisons

Relative to international trade commitments, Canada is nowhere near approaching the total Aggregate Measurement of Support (AMS) level permissible under the current WTO Agreement on Agriculture (Figure 10). Total current AMS is less than C\$1B, whereas the ceiling is over C\$5B. Canada, of course, is not unique amongst countries in making changes of this order of magnitude.

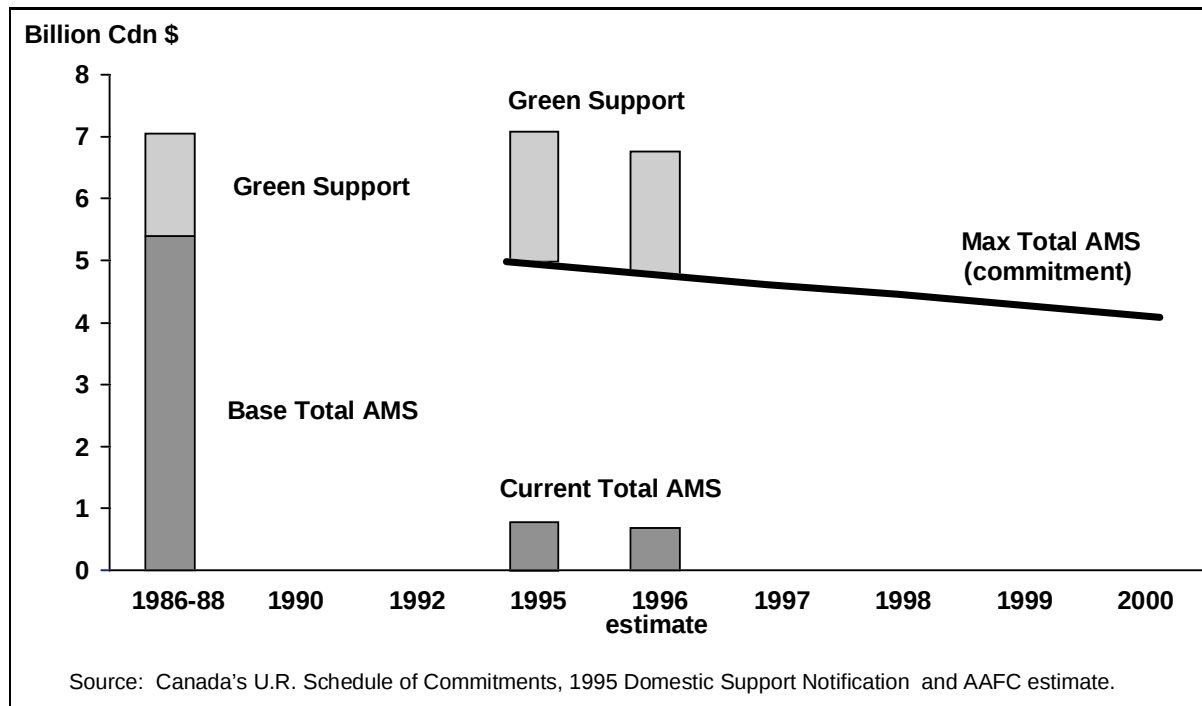


Figure 10: WTO Domestic Support — Canada

Canadian agri-food policy does not evolve and develop in isolation. Changes are publicly debated for many years, and industry is actively involved in the consideration of options and alternatives. While this is time consuming and complex for all of those involved, including those who prefer no change and those who prefer more change, it provides for informed decision-making.

Neither are policy changes affecting the sector taken in isolation of policy developments in other sectors of the Canadian economy. Many major decisions were made via the 1995 federal budget, which reduced economic spending and clarified economic priorities in all sectors. This economy-wide perspective is an important component of effective and sustainable policy reform. Of course, commitments made by all signatories to the WTO Agreement are a pre-requisite to ensuring that important policy reforms are implemented effectively.

Chapter 3: Looking Ahead — Market Prospects and Further Policy Reform

The nature and specific timing of further policy reforms in Canada will continue to be influenced strongly by domestic fiscal pressures, bilateral and multilateral trade agreements, economic (supply and demand) changes, and important social and political considerations.

A cautious optimism currently prevails in world agricultural markets. This optimism is not only about improved commodity prices, but also relates to better functioning and responsive markets, in which there is an improved sense of rules and disciplines. On one plane, optimism is an extension of an improved macroeconomic situation where modest, but stable growth prospects, price stability, and favourable investment conditions prevail in national economies. The duration and magnitude of the recent financial crisis in Asia is, of course, an important concern. But widely viewed, growth prospects in developing countries, particularly in Asia, Latin America, Africa, and the states of the Former Soviet Union and Eastern Europe, are fuelling a demand-driven growth for food.

But as importantly, optimism also concerns re-orientation of agricultural policies and less distortion in international markets. The result is an improvement in prices in international grain markets compared to the lows of the early 1990s. As an indicator, consider the export subsidy-adjusted price of wheat on international markets of \$US 80 per tonne in 1990–1991, compared with prices exceeding \$US 200 per tonne in 1995–1996, or even the more recent but lower levels of \$US 140 per tonne. As projected by the OECD, prices are expected to improve over the medium term, and remain well above levels experienced during the Uruguay Round negotiations. But aside from higher world commodity prices, international rules and disciplines now provide a better framework for domestic policy development and for trade. The future context is strikingly different than that during the so-called “grain-trade war” period.

This optimistic outlook is not without risks and uncertainties. Domestic and trade policies of one nation have as much implication for other nations as for domestic interests. Policy compatibility, convergence and harmonization pressures will eventually present themselves on broader fronts. Where the market fails to work, the need for common or coordinated policy will be increasingly on the table for discussion and resolution.

Arguably, reforms of the Uruguay Round have been relatively easier in many areas than ones which remain at centre stage. Many tariffs remain large; effective access remains low.

Future reforms may invite radically different trade patterns, and issues which accompany these. The future for agri-food markets will be very much affected by the pace and extent of domestic and trade policy reforms. In all countries, trade in goods and in investment capital are the driving forces for income and employment growth. Decreasing tariffs, increasing market access, reduction of export subsidies, and the use of de-coupled direct payments are directions which will continue. The proposed EU reforms of Agenda 2000 have the potential to enable the EU to export cereals without subsidy, and to align its domestic prices more with international markets. Expanding the EU will further enhance its presence in international markets. Future US farm legislation will likely continue to move its sector toward capturing the growth that increasingly global markets provide.

But as conventional production and trade distortions are reduced, technical barriers have emerged which may present other difficulties. For example, new approaches are needed to solve the tension between scientific standards and consumer standards and preferences as they relate to trade in goods. The issues not only concern production and processing but also technological matters, such as the use and acceptance of genetically enhanced products.

The movement of investment capital among nations is significant and growing rapidly. It requires appropriate frameworks, as international enterprises seeking the highest returns transfer their expertise and production processes, either to get around existing tariff and non-tariff barriers to trade, or to move production closer to consumption nodes.

Although world population growth is slowing, and is now below the rate of productivity growth generally in agriculture, food supply growth increasingly will lean on sustainable technologies, and also on new, controversial ones. International frameworks for the development and application of these technologies, as well as the consumption of goods from them, will determine the adequacy of the food supply to meet growing needs. The key to increasing the food supply rests in exploiting the comparative advantages of regions/countries, and in nurturing the growth and adoption of new technologies on a broad scale.

Warnings of chronic food supply shortages are not supported by facts; even at current technologies, ample supply potential exists to meet demands. Warnings of shortages fail to acknowledge that supply and demand are also functions of relative prices, and that market mechanisms help to equate the two. However, many cases are known where this price mechanism is, or will be, inadequate in the future. For example, climate change poses long term threats to the food supply, but price mechanisms may not be adequate to mitigate the threat. Such issues require coordinated policy approaches at an international level. The same is true of other environmental issues (e.g. manure disposal), and although these may be more sensitive to local needs, they may also affect production and trade.

Food security is increasingly a twofold problem of income and of distribution. Real prices of food, that is, costs of a nutritional food basket relative to general consumer prices, are likely to continue their long-term decline, even if slightly buoyed during the reform process. International markets can complement domestic supplies, but full use of that capacity requires specific disciplines in trade. Policy measures which limit distribution are being reduced, but they still significantly affect trade (tariffs, export subsidies/taxes). Issues of transportation and especially the internal functioning of markets in many countries prohibit effective food distribution and mask market signals which allocate products to markets. There remain

millions of people who do not have adequate access to a nutritional supply of food. The challenge of overcoming this is on-going, and will only be addressed effectively through a globally efficient market for food, and appropriate and targeted policies, such as those aimed at overcoming poverty and other causes of hunger.

With the decline of public stock-holding, concerns have been raised about the impact of the variability of crop yields, consequent supply shortages and price spikes. For this reason, it has been suggested that either domestic measures for food security are justified, or some form of an international stock-holding program be endorsed. On the contrary, evidence of past stock-holding does not assure that such activity has in fact stabilized markets. The best course appears to be more open markets, where the breadth of the market can be made larger relative to yield/supply shocks, in order for markets to allocate spatially and more efficiently, and hence stabilize prices across a greater number of consumers.

Conclusion

An important lesson of the past ten years is that policy reform has worked to improve efficiency and productivity. Agricultural markets are now more responsive and international prices are more reflective generally of true production costs. In this context, an ambitious start to, and a swift and successful completion of, the upcoming round of GATT/WTO negotiations beginning in 1999 will set the stage for continuing to reap the benefits of increased trade in agriculture and food commodities.

Canada is a small country (in terms of population) with a large and productive resource base. Economic growth possibilities, focused just on the needs of 30 million Canadians, are extremely limited. Capitalizing on international competitive advantages in sourcing certain agricultural and food products can only result from increased global trade. Increased global trade can only result from more open, transparent and fair trade rules.

Efforts to put the entire agri-food system in a better position for the freer trade environment of the future must be on-going. In domestic and foreign markets, however competitive the agri-food sector may be today, it will need to be more so tomorrow.