CAPI
THE CANADIAN AGRI-FOOD POLICY INSTITUTE

The State of Canada's Processed Food Sector: Trade Balance

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The Canadian Agri-Food Policy Institute (CAPI) is an independent, unbiased policy forum that is dedicated to the success of Canada's agriculture and agri-food sector. CAPI is a catalyst. It identifies emerging issues, promotes dialogue and advances alternative solutions to issues with stakeholders across diverse agri-food supply chains and among other food stakeholders. Based in Ottawa, CAPI was established as a not-for-profit corporation in 2004 by the federal government and is guided by a diverse Board of Directors and an Advisory Committee.

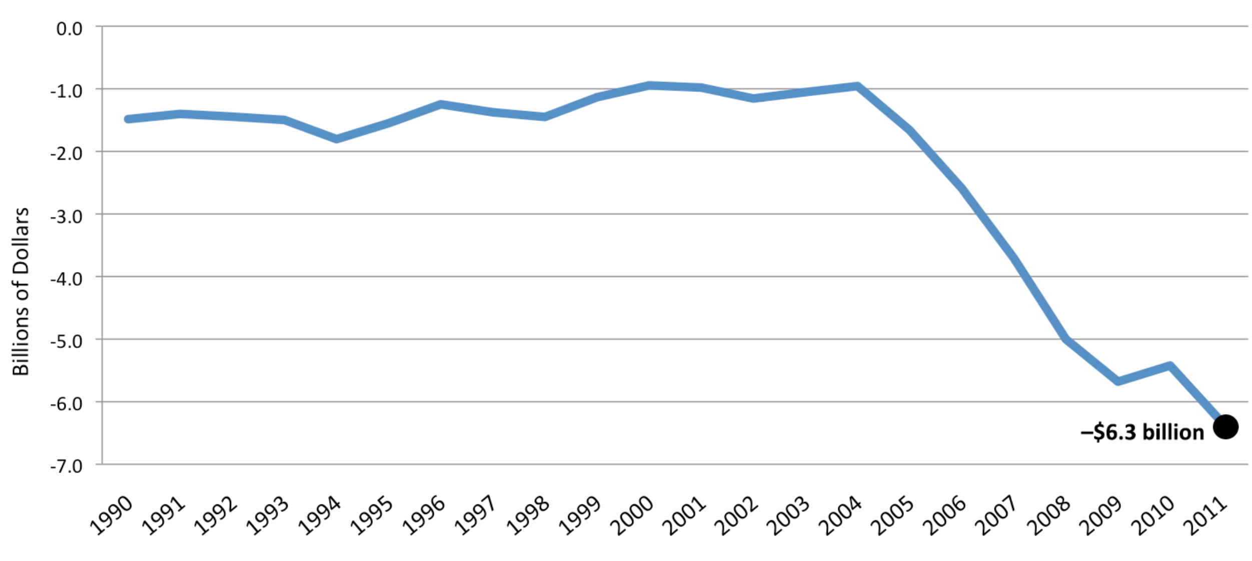
The State of Canada's Processed Food Sector: Trade Balance

For more than 20 years, Canada's processed food sector has experienced a trade deficit. Over the past decade, the deficit has worsened significantly. Meanwhile, the rest of the agriculture sector has enjoyed a positive trade balance. This paper explores trade trends in the processed food sector over the past two decades, with the objective of prompting a dialogue on the causes of this trend and its ramifications for the competitiveness of the sector and the country's agri-food sector as a whole.[1]

Highlights

- Canada's net trade in value-added processed food has deteriorated from a deficit of about $1 billion in 2004 to $6.3 billion in 2011.
- While Canadian processed food exports stalled over this period, imports rose steadily.
- Processed food is the only group in the entire food and agriculture sector with a net trade deficit. Overall, the commodity sector has a positive trade balance.
- Canada's net trade in processed food with the US and Mexico has been negative for the past four years, having fallen from a surplus of $2.2 billion in 2004 to a deficit of $1.3 billion in 2011. The trade situation with the rest of the world also deteriorated from a deficit of $3.2 billion in 2004 to a deficit of $5.0 billion in 2011.
- Of the $6.3-billion trade deficit in processed food in 2011, about 60% ($3.7 billion) is associated with "beverages, spirits and vinegar." "Food products" constitute the remaining 40% ($2.6 billion).

Canada's Trade Balance in Processed Food



Terminology

Most of the data for this paper are taken from the World Customs Organization's Harmonized Commodity Description and Coding System (HS) for trade statistics. Data used to describe activity across the agri-food sector (known as "Agricultural and Food Products") are grouped in four categories; three of these are commodities: live animals and animal products; vegetable products (which also includes grains, oilseeds and other crops); and fats, oils, and waxes.[2] The fourth category refers to processed food and includes food products, beverages, spirits, vinegar and tobacco products.[3] For purposes of this analysis, tobacco has been excluded.[4] This paper focuses on secondary (value-added) food processing only, not primary processing (activities such as the preparation of meat cuts after slaughter, canola crushing and initial vegetable processing).

Key questions (for further dialogue)

What is the explanation for the sustained trade deficits in processed food? To what extent is the lack of penetration of large growing markets part of the problem?

What are the implications for Canada's processed food industry and the agri-food sector as a whole, including primary production and processing?

How can industry players reverse current trends? What role should a focus on innovation play?

Introduction

For many years, Canada enjoyed a positive overall net trade for agriculture and processed food, with the sector contributing significantly to the nation's current account balances. There was a lengthy period of growth in the net trade throughout most of the 1990s. But during the last decade, the trends have been more variable and have not exhibited the growth of earlier years. Net trade in agriculture and food, excluding processed food, remained relatively constant from 1996 to 2006 at about $10 billion, increasing sharply in the last four years to the $14.7 to $18.5-billion range. For processed food, the net trade deficit grew from approximately $1 billion in 2004 to $6.3 billion in 2011 for beverages and food products combined.

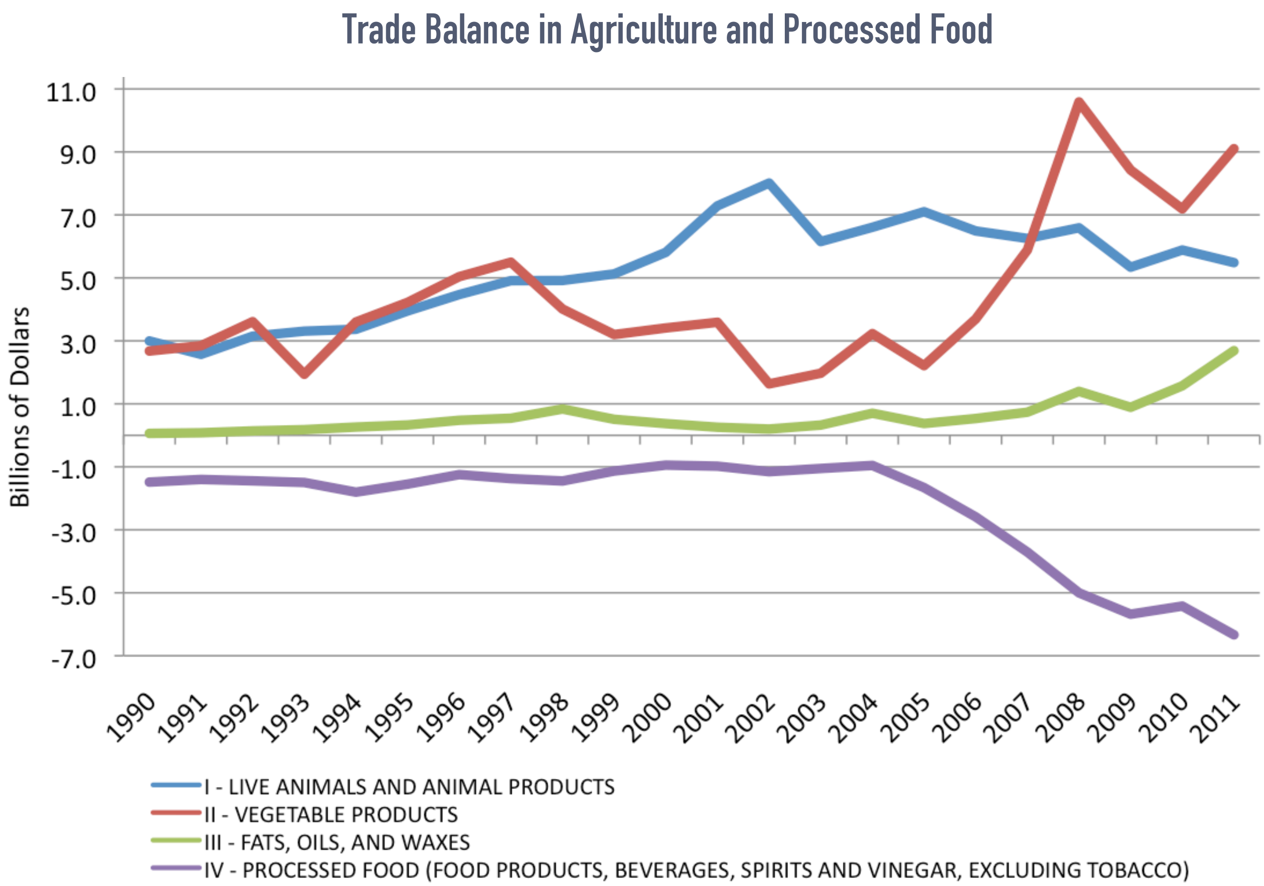
Performance of Agriculture and Processed Food

- Live Animals and Animal Products: For Live Animals and Animal Products (HS I), there were steady increases in exports and net trade from 1990 to 2002, with exports reaching nearly $12 billion and a net trade of $8 billion in 2002. Since that time, exports have fallen, but remained stable at about $10 billion annually, although the positive net trade has weakened to the $5-6 billion range in recent years.

- Vegetable Products: While this category (HS II) is dominated by grains and oilseeds, it includes all fresh fruit and vegetables. It saw strong growth in exports and the trade balance in the early 1990s, followed by a relatively stable period of exports at about $9-10 billion annually; net trade deteriorated from about $5 billion in 1997 to a low of $2 billion of 2002. The rapid increase in prices starting in 2007 for grains and oilseeds sharply increased export values to the $16-20 billion range, with net trade ranging from $7 billion to 10 billion. Nonetheless, imports continued to climb throughout the period 1990 to 2011, reaching over $10 billion by 2011.

- **Fats & Oils:** Fats, Oils, Their Cleavage Products and Waxes (HS III) is by far the smallest of the four categories. This group is dominated by the animal fats, and by oils from Canada's oilseeds, canola, soybeans, flax and others. There was a surge in exports to $3.7 billion in 2011 from the low levels of the early 1990s. Imports are currently about $1 billion, leaving a net trade of $2.7 billion in 2011.

- **Processed Food:** This category (HS IV) presents a significantly different picture from the other three. Net trade was negative in the early 1990s, with a deficit of $1.4 to $1.7 billion and improving slightly to approximately $1 billion early in the last decade. Since 2004, the net trade has worsened, with the deficit reaching $6.3 billion in 2011. This trend shows little sign of changing. Clearly, growth in the other three categories is being offset by the burgeoning deficit in the food products category.



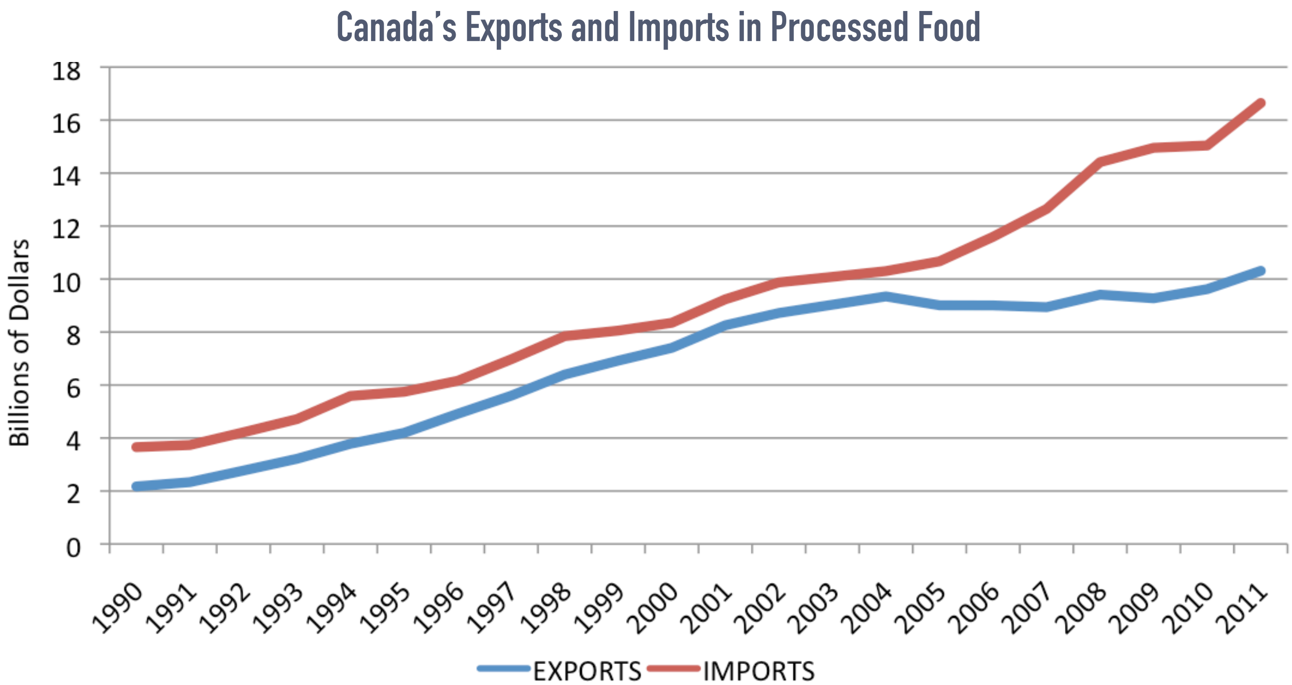
Purpose

This paper explores the trends in the net trade for processed food by breaking out the detail behind these changes. It examines the underlying trends in this category, identifies the specific sub-sectors contributing to this growing deficit, and identifies the analysis needed for understanding possible reasons for the change.

The objective of the Canadian Agri-Food Policy Institute (CAPI) is to present the evidence on these changes as a basis for engaging industry and governments in discussions on what can be done to halt and reverse the accelerating decline in the net trade in processed food. CAPI's mandate is to identify emerging issues, promote dialogue, and advance alternative solutions in order to help Canada's agri-food sector achieve greater success.

Trends in Canada's Processed Food Sector

To more fully explore the net trade deficit in processed food, more detailed trade data are needed. The "food products, beverages, spirits, vinegar and tobacco products" category is broken down to determine which of the sub-categories are responsible for the decline in net trade.



Rising imports; stalled exports: Imports have risen from $3.66 billion in 1990 to $16.65 billion in 2011. Exports, on the other hand, began the 1990s at $2.17 billion, rose to $7.55 billion by 2001, and have since stalled at $9-10 billion, reaching $10.31 billion in 2011. Although net trade was marginally negative for the category throughout the 1990s, the continued rise in imports and the stalled export levels have led to a steady growth in the negative net trade since 2005. The obvious question is: what changed a decade or more ago that led to this trade result?

Beverages: The largest component of the net trade deficit is in beverages, spirits and vinegar, representing $3.7 billion (60%) of the deficit in 2011. Exports and imports were largely in balance throughout the 1990s, but abruptly turned downward about 1999. Interestingly, every sub-category in Beverages at four-digit HS data shows a negative trade balance since 2007, although many showed a positive trade balance through the 1990s.

Food Products: Food products accounted for the remainder of the deficit, $2.6 billion or 40% of the total. However, the pattern of net trade differs sharply from the beverages group for the period 1990 to 2004. For much of the 1990s, the food group had a negative net trade of between $1.3 and $1.8 billion. In the following years, net trade rose sharply and was positive for the years 2003 to 2005. From this point forward, net trade fell steadily to a deficit of $2.6 billion in 2011 and there is no indication that the declining net trade is slowing down. This change in direction occurs at approximately the same time as the growing trade deficit in the beverages group. The same question can then be asked: what changed a decade or more ago that led to this trade result?

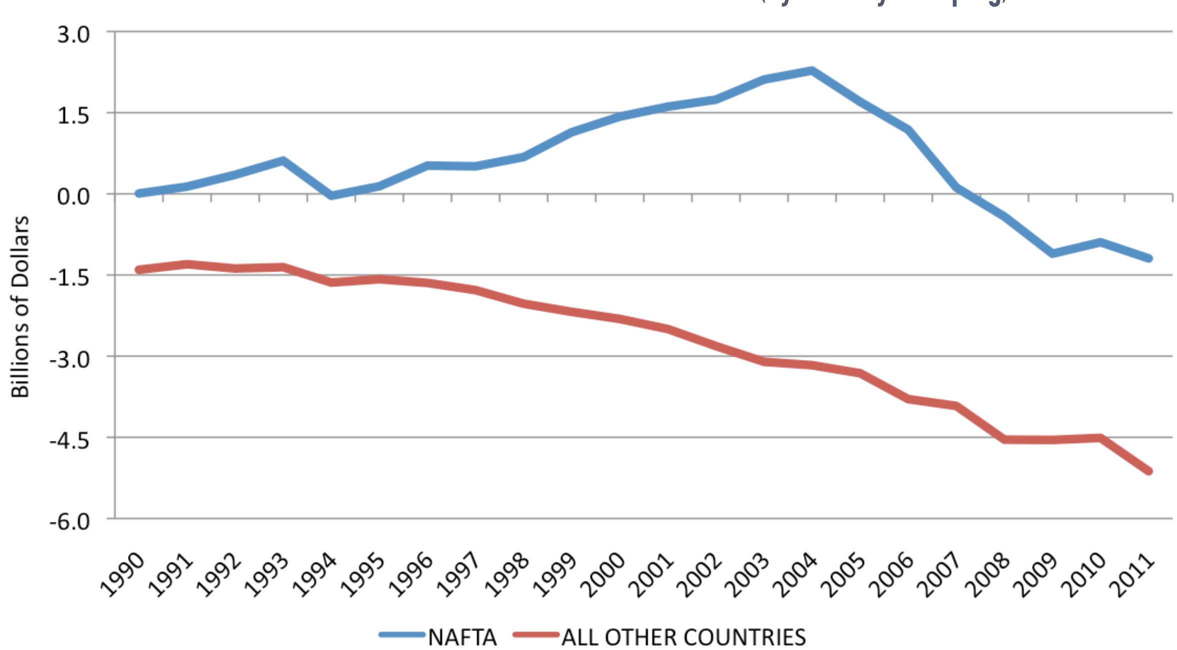
To further explore food products, data for the individual HS two-digit categories were examined. For the sub-categories in food products, roughly the same pattern is shown over 22 years for each of the sub-categories as was shown for the group as a whole. That is, they demonstrate the pattern of negative net trade in the early years, with several sub-categories turning positive in the middle of the period and all but one of the sub-categories (Preparations of Cereals, Flour, Starch or Milk (Including Bread and Pastry)) suffering an increasingly negative net trade over the past few years.

Returning to the beverages group, the four-digit HS categories for beverages need to be further examined. The most interesting feature is that the net trade pattern for Grape Wines and Grape Must (HS 2204) appears to differ substantially from the remainder of the beverages group. This sub-category had a negative net trade in 1990 of $343 million which gradually became even more negative, accelerating a decade or more ago to a negative net trade of $1.9 billion by 2011.

When considering the subset of potable beverages only,[5] the pattern of the trade balance differs only slightly from the net trade pattern shown by the food grouping. Net trade in almost all sub-categories was positive throughout the 1990s, but then net trade deteriorated steadily across all items, with all items negative from 2006 onward. Three areas represent $1.2 billion (32%) of the overall trade deficit in the Beverages category: Water and Non-alcoholic Beverages (HS 2202), Beer (HS 2203), and Spirits, Liqueurs, and Other Spirituous Beverages or Alcoholic Preparations (HS 2208).[6]

International perspective: Breaking out the trade balance within NAFTA and all other countries demonstrates that, for a number of years, Canada had a strong positive net trade within NAFTA. Nonetheless, the balance of trade began dropping in 2005 and went into a deficit in 2007, declining to a deficit of more than $1.3 billion by 2011. For trade with the rest of the world, Canada had a net deficit throughout the 1990s. In 2004, the trade deficit was $3.2 billion and grew to $5.0 billion by 2011. The basic question remains: what changed over the period, particularly during the years 1995-2005, that led to these changes in the food products trade deficit?

Canada's Trade Balance in Processed Food (by Country Grouping)

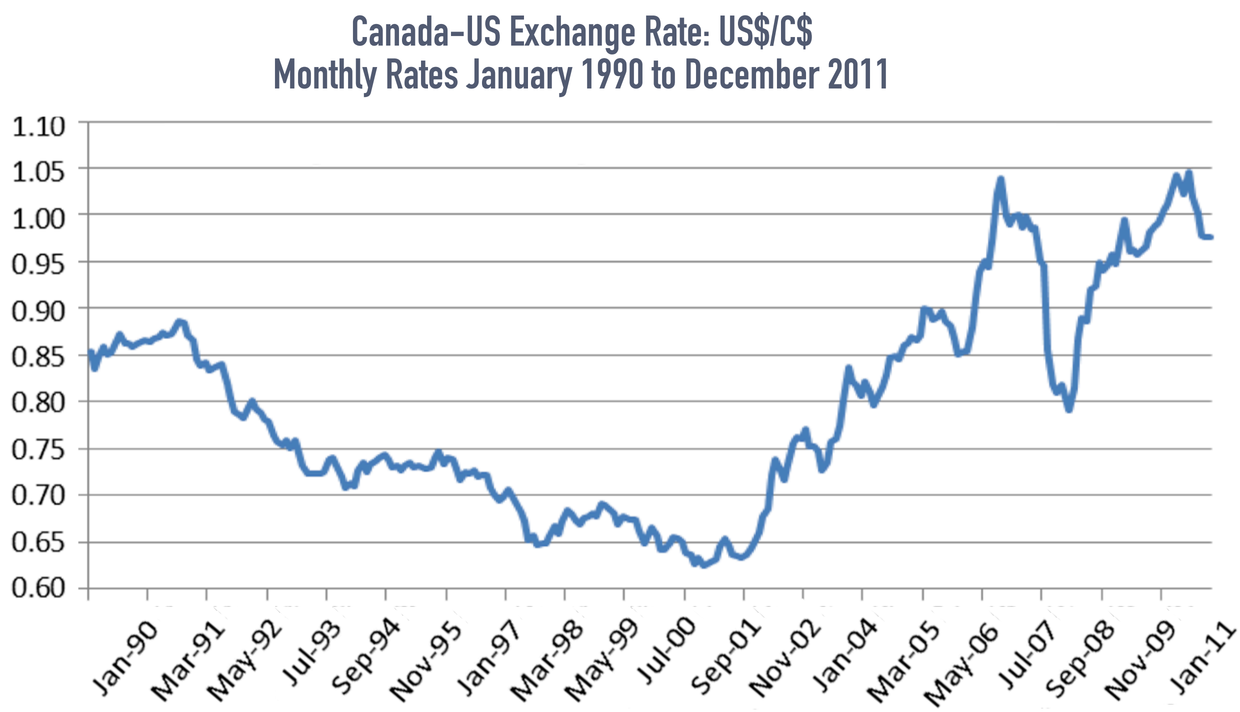


Possible Explanations

Below is a suggested set of analyses that need to be examined to fully understand the causes of the change in Canada's net trade performance in processed food. More study is required. The list is necessarily incomplete but offers an initial set of hypotheses for further study and discussion with industry. Agriculture and Agri-Food Canada (AAFC) has been working with the food processing industry to explore ways to strengthen this sector.[7]

1. Exchange Rate Impacts:

Is the Canada-US exchange rate an underlying cause of the changes shown above? The Canadian dollar in 1990 was worth US$0.85, fell steadily through 1990s to about US$0.64 by 2001, and then began a long period of appreciation to the current level, which is roughly on par with the US dollar. The turning point in the early 2000s and the appreciation in the following years are often cited as a problem for the Canadian food industry. This exchange-rate pattern mirrors to some degree the timing of changes in the processed food trade balance.



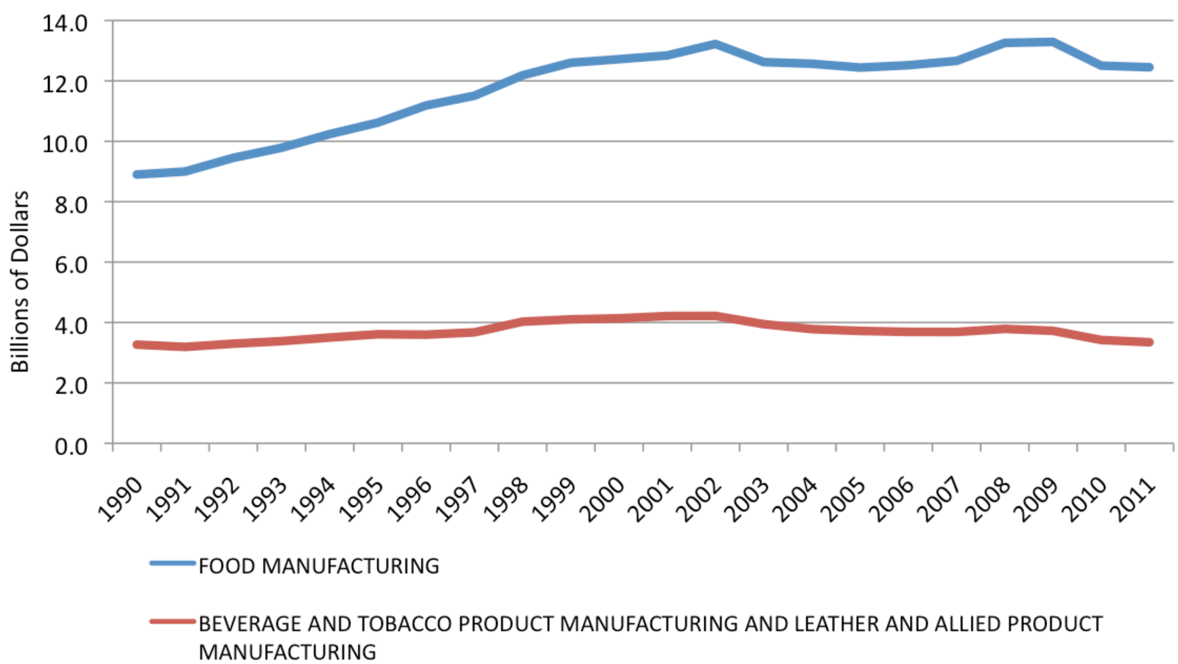
2. Regional Trade Agreements:

The Canada-US Free Trade Agreement (CUSTA) of 1988-89 offered considerably greater trade access for each other's markets for processed food products. This agreement was extended to include Mexico in 1992 through NAFTA. The WTO Agreement was signed in 1994 and came into effect in 1995, with implementation completed by 2002 for Canada. CUSTA/NAFTA represented a major change in Canada's trade arrangements, but the US has signed agreements with a number of other countries and regions since then, essentially offering many of the same advantages in access enjoyed by Canada under CUSTA/NAFTA. Canada has also made similar trade agreements with other nations. How have the benefits of Canada's relative access to NAFTA markets been eroded by the US regional trade agreements? Looking ahead, what are the implications of emerging trade deals for the sector (such as with the EU)?

3. Integrated North American Economy:

With the Canada-US trade agreements and the greater ease of product movement between the two countries, the North American market has become considerably more integrated over the past 20 years. Few large food processing and manufacturing firms are based in Canada, with much of Canada's capacity represented by branch plants of US and other foreign firms. Is Canada losing product mandates in processed food to other countries, particularly the US, because of the greater market access offered by the trade agreements?

Net Capital Stock in Canada[8]



4. Falling Capital Investment:

Has the capital stock of Canada's processed food industry kept pace with the integration of the North American market? Capital stock represents the net value of assets used in the processed food industry. The data show a steady increase in capital stock for food manufacturing, beverages and related industries from 1990 to 2002. Thereafter, capital stock declined from its peak of $17.4 billion to $15.8 billion in 2011. This implies a net disinvestment in the manufacturing sector for food and beverages over the last nine years. More analysis is needed to better identify why this is occurring.

5. Policy and Regulatory Changes:

The most difficult question is whether specific policy or regulatory changes have induced the changes in Canada's net trade in food and beverages. There is little literature available on this topic and considerable analysis and industry discussion are needed. Associations representing the sector focus on the regulatory burden. The George Morris Centre has explored the issue of regulatory issues, expressing concerns that Canada has not kept pace with other countries.[9] The Food Processing Industry Roundtable (referenced above) has addressed the issue. In addition, the Government of Canada has established the Regulatory Cooperation Council and a joint action plan with the US government in 2011 in part to facilitate cross-border regulatory issues.[10]

Summary

Canada's net trade performance in processed food has deteriorated sharply over the past seven years. This framing paper explores what changes have taken place over the past 22 years, and suggests a number of topics that need greater analysis and industry discussion to fully reveal the reasons for the change, their implications, and possible avenues for reversing the growing trade imbalance.

Endnotes

[1] See additional information on the data in "Appendix to the State of Canada's Processed Food Sector," found on CAPI's website.

[2] Animal and animal products (HS I) includes live animals and whole meat products, such as steaks, primal cuts and edible offals. It also includes fish and other sea products. Processed meats, such as sausages, are included in the food products group. Fats and oils include oils from oilseed crops, as well as animal fats and oils such as tallow and lard, and waxes derived from oils.

[3] For details of the two- and four-digit HS levels for agriculture and food, see the Appendix. All data for this report were supplied by Statistics Canada through Industry Canada's online trade data portal at http://www.ic.gc.ca/sc_mrkti/tdst/tdo/tdo.php.

[4] The Processed food category (HS IV – Food Products, Beverages, Spirits, Vinegar and Tobacco Products) group includes tobacco and tobacco products (HS 24), but these have been excluded from consideration in this paper to allow concentration on food products. In any event, this sub-category shows a very minor net trade balance, occasionally negative, occasionally positive, but negligible with respect to the rest of the category. As well, the processed food category is further broken down between "food products" (HS 16-21 and HS 23) and "beverages" (HS 22 — Beverages, Spirits and Vinegar). Throughout this document, the term "processed food " refers to all of the HS IV items except tobacco.

[5] To comment on potable beverages, this discussion removes HS 2207 (Ethyl Alcohol and Other Denatured Alcohol) and HS 2204 (Grape Wines and Grape Must) from the category of "beverages".

[6] For HS 2207 (Ethyl Alcohol and Other Denatured Alcohol), both imports and exports were negligible for most of the period, although imports have increased dramatically in the past few years, adding $588 million to the Food Products trade deficit in 2011.

[7] Food Processing Industry Roundtable report "Growing the Canadian Food Processing Sector: An Industry/Government Action Plan." See: http://www.ats-sea.agr.gc.ca/rt-tr/5708-eng.htm

[8] The capital stock information is taken from CANSIM Table 031-0002: Flows and stocks of fixed non-residential capital, by North American Industry Classification System (NAICS) and asset, Canada, provinces and territories, annual (dollars × 1,000,000), downloaded 7 August 2012.

[9] See: http://www.georgemorris.org/publications/file.aspx?id=51143a47-f294-42e4-82f4-0dd91a3c4aa3

[10] See for example: http://actionplan.gc.ca/en/page/rcc-ccr/regulatory-cooperation-council