GEORGE MORRIS CENTRE

The Ontario-Quebec Trade and Cooperation Agreement and the Agri-Products Joint Action Plan: Understanding the Potential

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June 2010

1. Introduction

The provinces of Ontario and Quebec recently unveiled a "joint action plan" on agriculture and food. This extends from the omnibus Ontario-Quebec Trade and Cooperation Agreement reached last fall. The scope of last fall's agreement, as it relates to agri-products, was a pledge to rationalize and resolve issues related to technical standards for food products, and to pledge mutual support for supply management.

The most recent announcement reaffirms the commitment of last fall's agreement, and "commits to collaboration on issues of common interest". On the surface, this may seem relatively inconsequential, which may indeed turn out to be the case. Indeed, the two governments have committed to very little other than meeting annually under this agreement.

However, it could also allow possibilities for policy coordination that governments have not previously signaled they were open to. If appropriately engaged, this could be important in addressing significant and evolving issues surrounding eastern Canadian agri-products. In the announcement, Ontario and Quebec ministers made explicit reference to the situation in hogs and chicken as just such common matters, in addition to compositional standards for yogurt.

1.1 Purpose and Objectives

The purpose of this paper is to provide an analysis of the potential benefits of the Ontario-Quebec announcement. The objectives are as follows:

- To provide an overview of the Ontario-Quebec Trade and Cooperation Agreement and the joint action plan
- To provide an overview and analysis of key issues that could be engaged under the joint action plan
- To provide some suggestion as to how these issues might be approached by industry

1.2 Organization of the Paper

Section 2 below provides an overview of the agri-products components of the Ontario-Quebec Trade and Cooperation Agreement as it exists within the Agreement on Internal Trade, as well as an overview of the joint action plan. Section 3 provides a description of some of the apparent issues that warrant discussion under the joint action plan, with further analysis on the hog segment. Section 4 concludes the paper.

2. Agri-products in the Ontario-Quebec Trade and Cooperation Agreement, and the *Joint Action Plan*

In November 2007, Ontario Premier Dalton McGuinty and Quebec Premier Jean Charest agreed to develop a "modern, comprehensive trade agreement that would further reduce barriers to trade and enhance Ontario and Quebec's economic relationship". This launched detailed discussions and negotiations between the two provinces, led by Chief Negotiators, Jim Prentice for Ontario and Michel Audet for Quebec, supported by government officials from each province.

Discussions were formally initiated in the winter of 2008 and led to agreement on a number of key chapters, building on past work under the Agreement on Internal Trade, and the Alberta-British Columbia trade agreement. A number of key areas for trade enhancement and future cooperation were identified, and a draft direction for the negotiations was approved, first by each Cabinet, then at a joint meeting of Ontario/Quebec Cabinets in Quebec City in June 2008. In that direction, the agri-food sector, as identified by the two Ministers responsible, was included among the potential chapters to be negotiated and approved.

Throughout the negotiations, the focus evolved toward improved economic cooperation and future activity on a number of chapters, and supporting key themes of both governments:

- enhancing economic cooperation
- harmonizing regulatory practices
- supporting green and efficient energy sectors
- protecting the environment
- promoting common regulatory practices
- establishing new trade disciplines
- improving access for new financial services
- harmonizing transportation regulations and standards
- providing for equal access to public procurement opportunities, and
- addressing common issues facing the agri-food industry.

On this last theme, the two provinces, through the Chief Negotiators and a separate negotiating table on agri-food issues, focused on existing trade barriers/issues between the two governments in this sector, and on future cooperation between the two governments over a range of agri-food issues. Both provinces discussed the overall Agreement strategy, ongoing trade, and policy issues with their own agri-food stakeholders, led by the departments of agriculture in each province

Negotiations and discussions were held among the governments and the key stakeholders, which for the most part were the respective farm commodity groups and the general farm organizations. This led to the Agri-Food chapter in the Agreement, which reflected more on future cooperation and direction, and a strong commitment to the existing regulated marketing systems in both provinces.

The Ontario-Quebec Trade and Economic Cooperation Agreement was signed by both Premiers and Ministers responsible for trade in September 2009. An overall commitment was made for responsible Ministers for each chapter to meet regularly - at least annually - and to develop a work program and move toward meeting the identified goals/directions in the respective chapters of the Cooperation Agreement. For the Ministers of Agriculture, that meeting occurred in spring 2010.

The Agri-Food chapter, as noted above, did not dwell on major changes to existing regulatory or policy instruments and directions. It confirmed directions already agreed upon and, through the strong direction of the Ontario/Quebec general farm organizations and supply-managed farm groups, re-emphasized a commitment to work within the existing frameworks for regulated marketing. The chapter did provide for discussions and identification of future issues and opportunities for improved cooperation or joint action on several issues, including animal health, food processing and food safety opportunities. As well, it included examining joint work on future standards for a number of agri-food subsectors.

It should be noted that the Chapter within the Agreement underlined the need for close consultation and discussion with industry stakeholder groups and, more importantly, implicitly sought industry direction on issues, timing and agreement on how best to move forward to resolution. The joint meeting in Spring 2010 between the Ontario Minister of Agriculture, Food and Rural Affairs and the Quebec Minister responsible for the Ministre de l'Agriculture, des Pêcheries et de l'Alimentation du Québec (MAPAQ) highlighted a number of points of discussion and a willingness to work together. It did not signal, however, any specific issues that would require urgent action to resolve, or any actions to move issues forward in the immediate term.

For major action or significant resolution of ongoing issues to occur, or for undertaking a new initiative, it was effectively left to the agri-food industries in each province to take the leadership in identifying issues, possible options, and practical and sustained solutions, in cooperation with the two Ministers and their respective departments. Indeed, this would be the case for almost all the Chapters within the Agreement.

3. Economic Context for the Ministers' Joint Action Plan

As highlighted in the agriculture ministers' Spring 2010 announcement, there are at least three significant issues that frame the joint agreement. First, Quebec has articulated a proposal for compositional standards in yogurt. Second, there are ongoing issues with trade flows of live chicken and eggs between Ontario and Quebec. Third, the hog segments in both Ontario and Quebec are moving through a period of rapid adjustment. These are discussed below.

3.1 Compositional Standards for Yogurt

In 2007, the Canadian International Trade Tribunal issued a ruling regarding imports of milk protein isolates (MPI's) that essentially allowed for imports on a tariff-free basis.

Following this ruling, the concern developed that increased utilization of MPI's would result in significant displacement of non-fat solids supplied by the Canadian dairy industry. Following consultations between dairy farmers and processors, the federal government introduced compositional standards for cheese that establish rules regarding the use of MPI products, applicable for cheeses manufactured in Canada and for imports.

However, the prospect also exists to use MPI products as a substitute for non-fat milk solids in manufacturing yogurt. In an attempt to control this substitution, the Quebec government has developed compositional standards for yogurt. The basis is that yogurt production in Canada is mostly concentrated in Quebec, and by implementing a provincial standard, the threat of further loss of market for non-fat milk solids is mitigated.

At the same time, there are distinct disadvantages to a provincial standard, even if Quebec represents a high proportion of yogurt production. First, since import standards and inspection occur at the federal level, yogurt imports cannot be bound by the Quebec standard. Second, it invites movement of yogurt production outside of Quebec if processors perceived the standards as onerous. Finally, and most importantly, the development of unilateral provincial standards does not address the issue of competitive pricing by milk class and component that leads processors naturally into compliance. This same issue dogs the compositional standards for cheese - the standards imply a significantly different production cost base using domestic milk solids versus imported MPI's. Industrial milk pricing issues cannot be resolved unilaterally by a province - they must devolve to regional pools and ultimately to the national level as they are impacted by support prices. Thus, substantive agreement on a yogurt standard is necessary to deal with yogurt issues as well as the pricing issues relating to both yogurt and cheese.

3.2 Interprovincial Trade Flows in Poultry and Eggs

Allocation of the national market across provinces in poultry and eggs has created tension in the operation of poultry supply management. While the details vary in terms of how supply management allocation works in chicken, turkey, eggs, and hatching eggs, the essential logic is as follows: a national allocation is determined, and then distributed across provinces based on historic weights. These provincial allocations typically relate to historical production levels, provincial consumption demographics, and other factors. The consequence of this system is that while the national market can grow, the national market share of one province relative to another may not. The potential for friction associated with this system is exacerbated by the move toward processing supply assurance in many provinces. Thus, a given plant is entitled to its historic share of provincial production.

As processors compete and differentiate, the above has made it difficult for one processor to grow relative to other processors in the province, without having to purchase plant supply assurance entitlement from rival processors. An alternative is to purchase farm product from an adjacent province for processing. This is especially significant in Quebec and Ontario, where there is a high density of processors and producers, and no major physical barriers to interprovincial transport. Marketing boards exercise only limited authority preventing interprovincial movement and, unlike dairy, the regulatory basis for interprovincial pooling does not exist. Moreover, the practice of cross-border procurement by one province from another almost invariably leads to a reciprocal response as the selling provincial market is shorted.

It becomes difficult for provincial supply management agencies to effectively regulate supplies, and marketing boards are reduced to blunt instruments in an attempt to control this behaviour. Marketing boards attempt to use moral persuasion with producers, regulate out of province supply agreements, and control quota transfers as a disincentive to "export enclaves" close to an importing province.

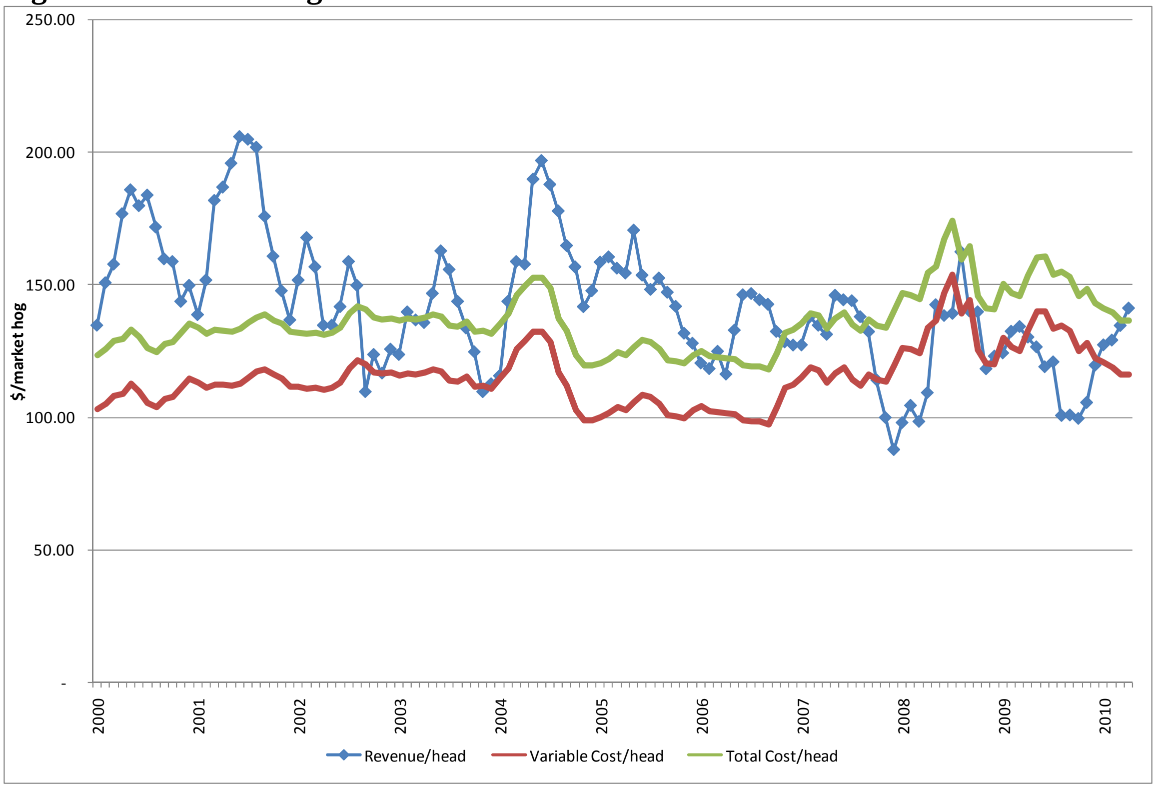
Fundamentally, these issues relate to provincial management of a national allocation. Engagement of these at the regional, rather than provincial, level could recast the discussion away from a reactive zero-sum game and toward a more collaborative resolution.

3.3 Adjustment in Eastern Canadian Hog Segments

Following significant expansion and profitability through much of the last decade, the eastern Canadian hog segment has experienced what could only be called crushing losses. Some evidence is presented in Figure 3.1 below using Ontario as an illustration, based on George Morris Centre estimates. The figure suggests that market hog revenues fell below total costs around mid-2007 and have only very recently recovered. In other words, sustained losses occurred for almost three consecutive years.

This has spawned policy responses relevant to the Ontario-Quebec context. First, two national programs were introduced to facilitate a cull of the sow herd. These appear to have been heavily subscribed in Ontario, and also in Quebec. Second, a hog loan program was introduced that appears to have had limited uptake by producers. Third, Quebec announced changes to the assurance stabilization revenue agricole (ASRA) program that will limit the quantity of production eligible for payment under the program.

Figure 3.1 Ontario Hog Production Costs and Returns

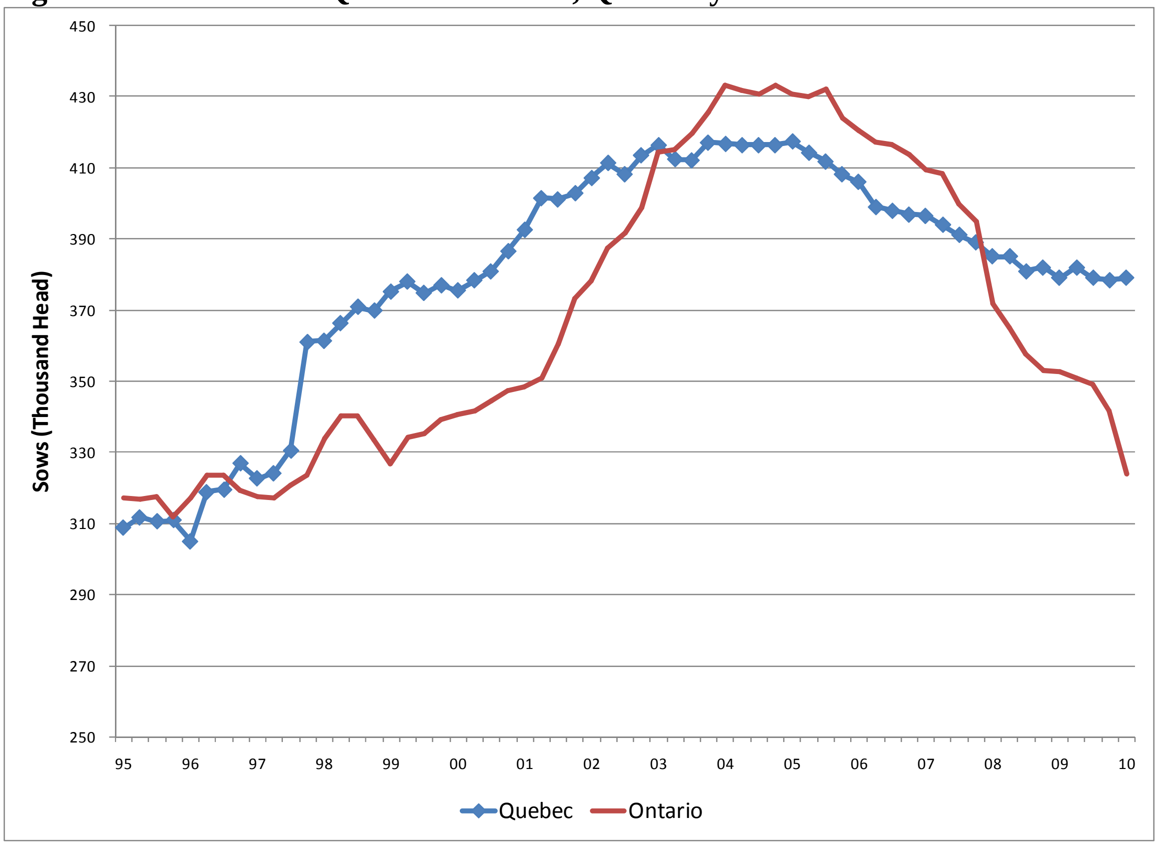


Source: George Morris Centre

In addition, the cost of production model used to generate support levels has been amended to effectively give a lower supported price under ASRA. Finally, Quebec introduced a new producer deposit-government matching safety net program called *Agri-Quebec*. Similar in nature to the former Net Income Stabilization Account (NISA), in principle this could act to mitigate the adjustment that might otherwise occur due to reductions in ASRA support. However, given that it is only valued at $70 million for all non-supply-managed products in Quebec, the ultimate ability for Agri-Quebec to forestall adjustments to ASRA is highly questionable. (ASRA payments were valued at well over $300 million in hogs alone in 2009).

The results of the above conditions are illustrated in part in Figure 3.2 and Table 3.1 below, which frame the change in the sow herd in Ontario and Quebec. Figure 3.2 shows that, compared with peak levels around 2003-2005, the Quebec sow herd has declined by around 40,000 sows, and the Ontario sow herd has declined by more than 100,000 sows compared with its peak. Using simple and conservative arithmetic of 20 pigs marketed per sow, this represents the loss in market hog production *potential* of about 2.8 million market hogs. However, a portion of sows in eastern Canada historically supplied feeder pigs for export to the US; reduction in the number sows supplying feeder pig exports does not diminish the capacity to supply market hogs. Table 3.1 presents the apparent export of feeder pigs from eastern Canada to the US, and the implied stock of sows supplying these pigs, assuming 20 feeder pigs marketed/sow/year. The table shows that, at its maximum, the equivalent of around 80,000 sows were engaged in supplying feeder exports. The implication is that if the Ontario-Quebec sow herd has decreased by about 140,000 sows from its peak, material capacity deployed in supplying market hogs has been lost from Ontario and Quebec.

Figure 3.2 Ontario and Quebec Sow Herd, Quarterly



Source: Statistics Canada

Table 3.1 Eastern Canadian Feeder Pig Exports*, and Implied Sow Herd (Head)

	Feeder Pig Exports	Implied Sows
2000	727,830	36,392
2001	1,210,346	60,517
2002	1,393,415	69,671
2003	1,589,065	79,453
2004	1,531,407	76,570
2005	1,165,553	58,278
2006	1,194,739	59,737
2007	1,069,332	53,467
2008	792,734	39,637
2009	722,762	36,138

*US imports entering into Michigan, New York, and Vermont.
Source: US Department of Agriculture, Animal and Plant Health Inspection Service

Meanwhile, there has not been a closure of a major hog processing facility in Ontario or Quebec in recent years. But clearly, processing must be in a precarious balance. The largest processor in Quebec operates multiple site facilities, none of which would be considered North American in scale, and has struggled to bring its labour costs under control. Three years ago, the largest processor in Ontario announced its intent to sell or close its facility, yet neither has occurred. A significant reduction in hog marketings can be expected to further imperil these processing operations as processing costs are known to be sensitive to hog procurement volumes. Competition among plants for scarce raw product supplies typically leads to temporary but unsustainable price premium competition, a portent that a plant will close or decrease capacity. This, in turn, will either restore balance in the regional hog market or create a hog surplus, driving further reductions in hog production.

Hogs move freely between Ontario and Quebec, with the dominant movement from Ontario into Quebec. Thus, matching processing capacity to hog production levels is a common interest. The prospect exists for a rationalized consolidation of hog and pork production without the sudden closure of a plant and the ripple effect of further downsizing of the production base. This demands a regional approach between provinces, and the joint action plan provides for just such a framework.

4. Conclusion: An Industry Agenda for the Ministers' Joint Action Plan

On the surface, the Ontario-Quebec Agreement and Joint Action Plan is little more than a vague resolution between agriculture ministries to talk once a year. The challenge to industries in the two provinces is to leverage the opportunity to initiate needed change that provincial or regional politics might otherwise render unattainable. Thus, it could be an important opening for industry segments to propel policy innovations.

As it stands, the issues within supply management are probably the most sensitive, since there is resistance to change built into the system. But, as the two largest quota holders in all supply-managed commodities, the Agreement and Joint Action Plan could be used to drive changes that act to strengthen the integrity of the system without the difficulties of multilateral negotiations among all provinces. The primary issues are the compositional standards for yogurt and cross-border movement of live poultry and eggs, but these could be usefully expanded into other aspects, such as the institutional mandate of regional milk pools and the stated desire to advance consolidation of milk marketing boards across provinces. Bilateral agreements between provinces could be developed to mitigate these issues; it is precisely these types of arrangement that the Ontario and Quebec governments have signaled they are open to.

The most urgent need, and thus opportunity, appears to be in pork. Based on the existing trends in Ontario and Quebec, one or more plants in the two provinces are poised to close as the regional hog supply shrinks. Without any further planning or coordination, this contraction in processing could be exceptionally disruptive, and indeed destructive.

For example, a closure of a major plant in Ontario would dramatically reduce the demand for and price of live hogs in Ontario; in the immediate term it would result in increased hog marketings from Ontario to Quebec and/or the US. This reduction in price would lead to a series of further decreases in Ontario hog marketings, and claims against safety net programming. If material exports to the US occurred coincidentally with safety net program payments, the prospect could exist for a US trade action, exacerbating the suffering in the Ontario hog segment. The analogy to a downward spiral is evident.

In the course of writing this paper, two important developments have occurred that clarify the uncertainty in the eastern Canadian pork segment, and sharpen the case made above. First, the Ontario Minister of Agriculture recently announced a decision regarding the marketing authority and mandate of Ontario Pork. The decision removes single desk hog marketing authority from Ontario Pork, and effectively allows for unlimited marketing of hogs outside of Ontario Pork. This removes a critical source of uncertainty with regard to the future Ontario hog marketing environment. Second, Maple Leaf Foods recently announced its intention to re-initiate the sale of its Burlington, Ontario hog processing facility. In 2009 Maple Leaf had announced that the sale of the facility would be delayed.

Thus, the logic exists for Ontario and Quebec pork industries to jointly ask the following questions:

- Given the apparent shrinkage in the sow herd and hog marketings, how much primary pork processing capacity is needed in Ontario and Quebec?
- How can Ontario and Quebec industries coordinate in this orderly consolidation of capacity?
- What new investments are required, and how can Ontario and Quebec governments act to facilitate these investments?

Engaging this issue in isolation would be dangerous for the two provinces. For example, if Quebec held fast to the notion that its pork processing capacity should match its historical hog marketings, and Ontario reciprocated, a plausible (or likely) result would be that on a combined basis the two provinces would renew their respective hog processing infrastructure, each with excess capacity. This would immediately threaten the financial viability of pork processing in *both* provinces.

Thus, governments have created a potential opening for industry to coordinate and bring forward solutions, which could address important issues. It is left to them to do so.