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Canadian Tariffs on U.S. Food Imports

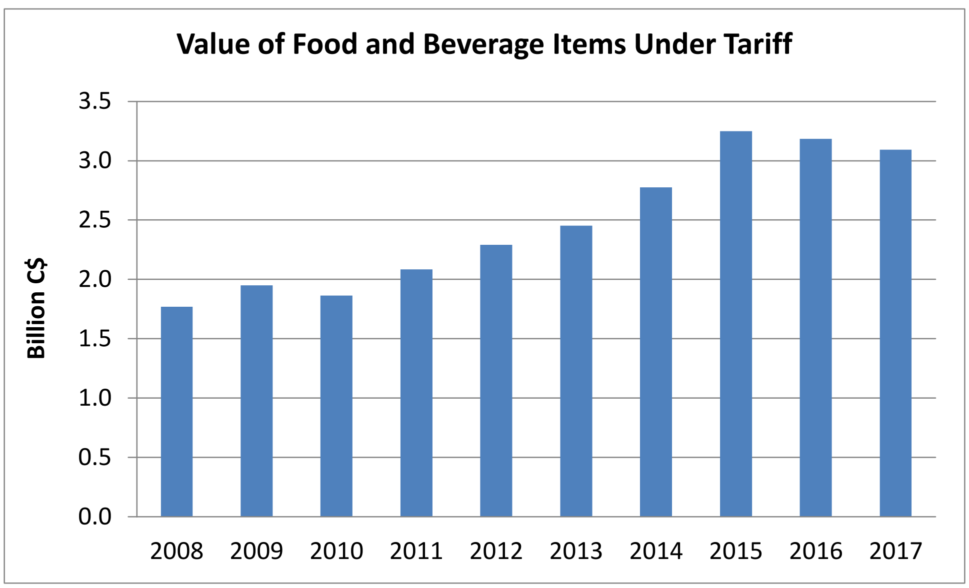
Kevin Grier, July 2018

Canada's retaliatory tariffs on imports of food products from the United States is a major development with important ramifications for the Canadian grocery trade.

On May 31, 2018, the United States announced the imposition of tariffs on imports of certain steel and aluminum products from Canada (at the rates of 25% and 10%, respectively).

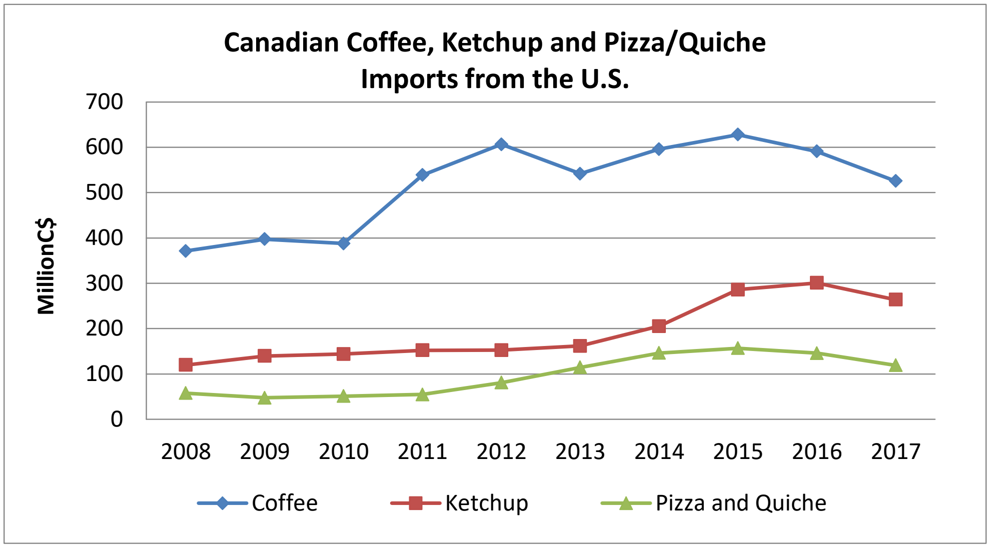
In response to U.S. tariffs on steel and aluminum, Canada imposed surtaxes or similar trade-restrictive countermeasures against up to C$16.6 billion in imports of steel, aluminum, and other products from the U.S., representing the value of 2017 Canadian exports affected by the U.S. measures. The Canadian counter tariffs took effect on July 1. The steel items are hit with a 20% tariffs while aluminum and other products face a 10% tariff.

Included in the "other products" are about 45 packaged food product categories that now have a 10% tariff applied. Importers will pay an added 10% duty on top of the purchase price. The impacted imports of food products are valued at C$3.1 billion in 2017.



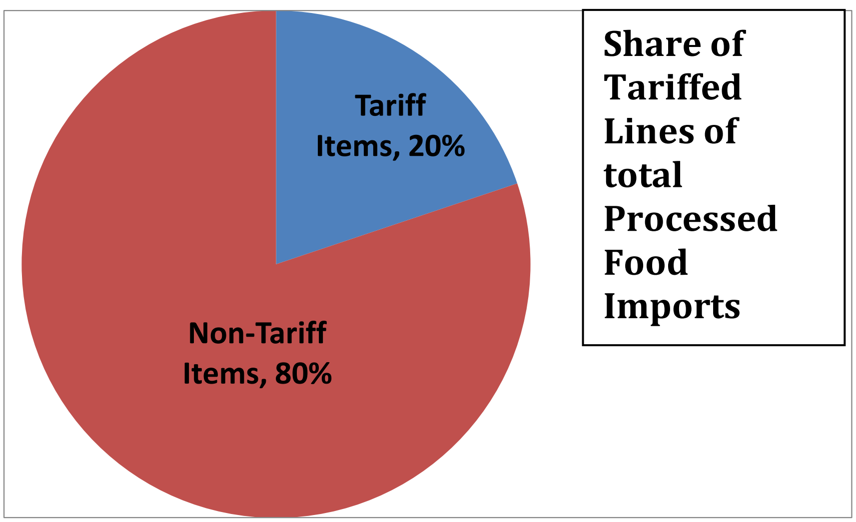
The 2017 import value of these categories ranges widely from the $600 million roasted coffee line to the $800,000 worth of almond paste and butter. The roasted coffee includes familiar name brands. Other big items include processed beef, pizza and quiche, orange juice and ketchup. Ketchup amounts to about $300 million per year in import value. In addition there are a variety of candy, chocolate and confectionery products that have been hit as well. Those sweet-tooth items amount to an import value of about $520 million last year including $25 million worth of marshmallows. There are also tariffs on $35 million of liquorish and toffee.

Mustard made the proposed list of retaliatory tariffs on U.S. goods, but the federal government dropped it just before the tariffs took effect July 1. CBC.ca, July 10, says that the reason was to cut Canadian mustard seed farmers a break. Several industry groups petitioned Ottawa to get certain items taken off its hit list. And while boats, dishwashers and ketchup imported from the U.S. still face a 10 per cent tariff, the cries of Canada's mustard lobby were apparently heard. The government wouldn't comment on the specifics of its decision, says CBC.ca.



Huge Share of Canadian Processed Food

For perspective, U.S. processed food exports to Canada amounted to about C$15.6 billion in 2017. For additional perspective, the value of processed packaged food products consumed in Canada at the manufacturer level is about C$25-26 billion. As such the products now under tariff that were imported into Canada amount to about 20% of the value of U.S. processed food exports to Canada. The tariffed items also amount to about 5-10% of the processed food sold in Canada.



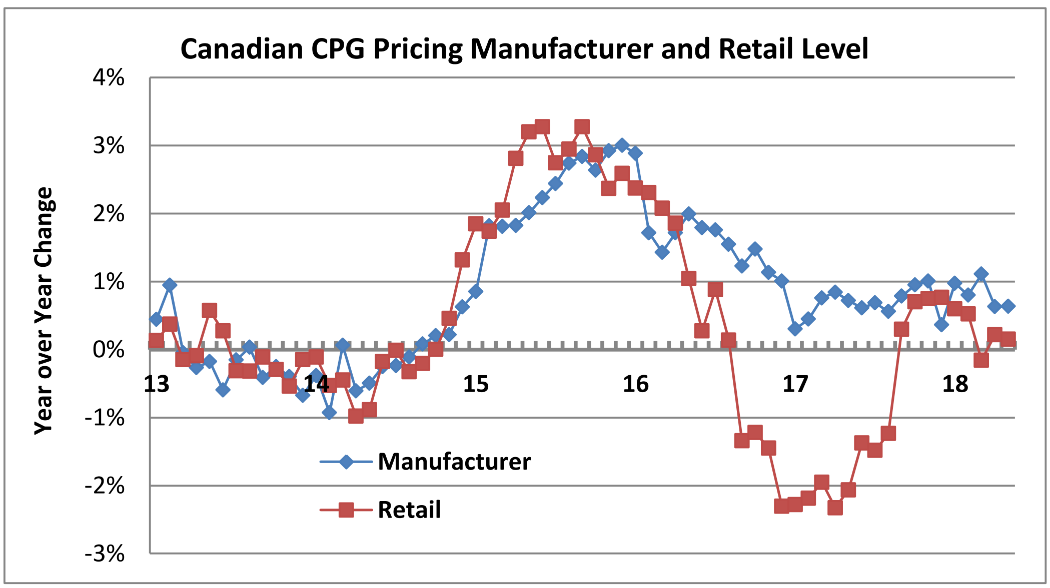
If the liquorish tariffs are not bad enough, also included is about C$250 million worth of toilet paper. Canada is the largest toilet paper export market and the biggest state exporting is Ohio.

Part of the reason, if not the whole reason behind the items chosen, is the probability of inflicting maximum political fallout in key congressional regions of the United States such as Ohio, a swing voting state. Much of the ketchup and candy come from Heinz and Hershey in Pennsylvania. Pennsylvania is another critical swing state. It also hurts because Canada is by far and away the largest export market for ketchup as well as toilet paper, as noted above.

Awkward and Frustrating

With the rationale noted, the bottom line though is that the tariffs are a major development for the Canadian food industry. The tariffs will have serious economic and marketing ramifications for the Canadian food industry. Canadian importers, which include distributors, grocers, brokers and manufacturers are all now dealing with the fallout.

The grocery trade is extraordinarily resistant to price increases at any time. During the last two years, grocers have seen consumer packaged goods prices decline on a year over year basis at the consumer level. At the same time, consumer packaged goods prices have seen modest increases in prices at the manufacturer level. In other words, the grocery margin performance of the consumer packaged goods is probably not where they would like it to be. Hence they are very resistant to packaged goods price increases for that and other reasons.



Grocer resistance to cost increases is axiomatic and this issue of tariffs does not seem to be changing their attitudes or willingness in that regard. In other words this tariff issue is no exception. Grocers do not appear to be taking or entertaining price increases associated with this as of early July. Some grocers that are considering increases are simply treating this situation as a normal request for a price increase. That is, they are not treating these tariffs as a significant, unforeseen development. As such some are saying that the increase can only take effect in 90 days. That might be considered a normal increase lag. On the other hand, however, most suppliers are going to have only a month or so of supplies. They will either have to absorb the increase or stop supplying the product. They don't have a ten percent wiggle room. Shelves won't be empty in the tariffed categories, but they will be squeezed smaller or the impacted lines will be eliminated.

Of course the grocers and distributors that are the importer of record for private label or other products will be paying the duty right away. As such if they are the importer they will pay the duty, even if they won't all allow domestic suppliers the increase. Frustration is running high.

Another sensitive issue is the magnitude of the increase itself. The ten percent tariff is on the imported cost. It comes before margins, fees, allowances and promotion. For multinational manufacturers this tariff would be applied to the internal transfer price between the Canadian and U.S. unit. For other importers it is their invoice cost and the U.S. suppliers price. That cost is a closely guarded transaction for any Canadian grocery supplier. Grocers will want to know how the increase is applied. That is going to be awkward.

Furthermore, as shown on the graph above, packaged goods cost increases tend to be small in scale. As seen above, a 3% increase in packaged goods costing is a relatively big increase. In fact since 2011 the biggest increase in costs grocers faced was 6% in 2011. A ten percent increase is off the charts huge. That will be very hard for them to swallow.

As a result of the tariffs, there is probably and eventually going to be price increases on significant shares of the Canadian processed food market. This could give competing Canadian manufacturer suppliers a competitive advantage. It could also provide them with leverage to increase their prices as well. Of course there is ample potential that this results in significant financial losses for the business that market the impacted products.

Why it Matters
This is a major development in the Canadian food market. A significant share of the processed industry is facing a 10% increase in costs. In the normally sedate world of Canadian food pricing, this will likely cause significant changes. Products could be taken off the shelf; Canadian food prices could rise significantly and businesses could be financially damaged.

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A version of this report first appeared in the June 2018 edition of Grocery Trade Report. If you are interested in a free two month trial subscription to that report, email Kevin@kevingrier.com.