

The New Geo-Political Economy of Food

Independent Agri-Food Policy Note

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The Issue

The situation confronting Canada in terms of trade and trade policy for agri-food, and indeed foreign policy more generally, is very different in the spring of 2019 versus one year ago. The range and magnitude of changes in play today present a contextual problem, challenging analyses in taking stock of all relevant changes, effectively incorporating their sheer magnitudes, and determining their implications. What is becoming clear is that the situation faced by Canada is like none other in recent memory, with worries of the sudden decline in the rules-based international trading system, coupled with much larger countries dueling with one another in trade wars, and the menace of an historic animal disease outbreak.

Canada's agri-food policy has broadly evolved toward a greater market orientation and increased trade liberalization, and the prospect of increasing economic growth and income through export. This is consistent with high levels of capacity and productivity in the Canadian agri-food sector, well beyond the scale of the demands of the Canadian population. This is especially the case in the farm product supply chains in which Canada operates at global scale- notably canola, wheat, pork, beef, pulse crops, potatoes, and greenhouse vegetables, as well as some others. Agricultural policy in Canada is geared to growth of these products, largely through export. This broad approach has extended to other products as well, with tolerance for some trade liberalization in products in which the interest is domestically focused and primarily defensive with respect to trade- notably dairy, poultry, and eggs.

This evolution in Canadian agri-food policy dates from the chaotic period following the Second World War in which Canada (like other countries) built its

agri-food policy around the concern of chronic surpluses, low farm prices, and low returns to farmers, with agricultural trade policy almost entirely focused on Europe and east-bound exports. In Canada these concerns gave rise to a range of price stabilization programs, farm products marketing regulations and marketing boards, and a range of farm income supports. Other developed countries introduced similar policies and it was argued that the "special characteristics of agriculture" prevented it from being effectively covered under the newly formed General Agreement on Tariffs and Trade (GATT).

The resulting anarchy in agricultural trade reached a head in the 1980's when governments were grappling with farm product surpluses and the cost of surplus disposal. It was in this context that the US deliberately intensified an agricultural export subsidy war with Europe in order to put pressure on the GATT to finally bring agriculture under effective international disciplines. This pressure eventually led to the agreements comprising the WTO.

In the 25 years since the formation of the WTO, Canadian agri-food has evolved to the size structure we see today, with investments in scale, technology, processing, and human resources following this broad policy direction and its export orientation- now toward Pacific markets rather than Europe.

This policy direction and its commercial success depends critically upon a rules-based trade environment, rational actors, and a market orientation, broadly speaking. This largely goes without saying, and has long been accepted implicitly as a premise in Canadian agri-food policy. However, the sudden shift in the international trade and political environment facing Canada in 2018-19

reopens these assumptions and how Canada could, or should, proceed.

The purpose of this note is to set the context and begin the process of understanding and discussing the potential implications and ramifications of the current situation, with a focus on the international trade implications of US-China trade conflicts and developing agri-food supply disruptions, and what the implications may be for Canadian agri-food.

Global Food Situation

The global situation with regard to staple food products, notably meat and oilseeds, continues to deteriorate, for sharply different reasons. With regard to meat, the spread and implications of African Swine Fever (ASF)- a highly virulent, incurable disease in pigs (but not a human disease) affecting China only gets worse with updated reporting. Pork production in China will experience an immense decline in 2019/20 vs. 2018, and the spread of the disease is continuing; ASF has spread throughout China and into Vietnam and Cambodia¹. The New York Times recently reported that local notifications to Beijing of ASF outbreaks within China may be significantly understated.² The OIE notifications by China may well be understated because local authorities are under reporting it to Beijing. It may indeed continue to spread throughout Southeast Asia and perhaps elsewhere. Moreover, while multiple teams are working on an ASF vaccine, none currently

exists and the prospect of a workable vaccine seems far off.

This stands to open up unprecedented gaps in the global meat supply, with sharply increasing prices corresponding to the scarcity of meat. The effects are likely to last for years.

The ongoing trade tensions between the US and China (discussed below), combined with significantly reduced feed demand in China, have resulted in reduced demand for oilseeds. As the largest importer of soybeans, the pivot of China toward South America as its anchor supplier of imported soybeans- away from the US- has suppressed soybean prices in the US,³ and by extension canola in Canada. The prospect exists of acreage shifts away from soybeans in the US toward corn and wheat, reducing prices in the grain complex as well. Moreover, the most recent global crop conditions outlook is broadly positive, supporting the likelihood of large crops further dampening feed grain and oilseed prices.

A commonality between the pork and oilseed situation is that the most active market participants individually represent very large volumes. For example, Chinese importers of oilseeds and grain include COFCO and Sinograin (State-Owned Enterprises) and a range of companies in which the Chinese government owns a stake; other Chinese importers are privately owned⁴. An analogous structure exists among meat importers. Single orders

¹ A range of estimates of actual losses due to ASF in China exist. In a late April 2019 report, INTL FC Stone estimated that 40 percent of the Chinese pig feeding capacity has been destroyed due to ASF. The report observed, "When you take that much food out of the world's most populated country, you're going to change politics, you're going to change social behavior, and you're going to change economics," *Chinese Pig Epidemic Poised to Reshape Global Trade* INTL FC Stone. April, 2019

² A Vicious Untreatable Killer Leaves China Guessing *NY Times*, April 22, 2019
<https://www.nytimes.com/2019/04/22/business/china-pigs-african-swine-fever.html>

³ The March 2019 *USDA Agricultural Projections to 2028* makes a remarkable observation, "Rising trade tensions between the U.S. and China create two soybean prices in the world: the China-Brazil (higher) price, as China sources its soybeans from Brazil instead of the U.S., and the rest-of-the-world (lower) price."

⁴ On May 7, 2019 Bloomberg reported that the Chinese government was planning to merge COFCO and Sinograin, creating yet a larger state-owned agri-food trading entity
<https://www.bloomberg.com/news/articles/2019-05-07/china-is-said-to-plan-overhaul-of-state-agriculture-giants>

by these very large market actors can be sufficient in size to significantly influence world prices; conversely a Chinese government influenced decision undertaken by one of them not to purchase from a given country could be devastating for a heavily export oriented country. Moreover, the concentration of very large trading blocs can reduce international market liquidity and the usual price arbitrage across suppliers and buyers compared with past expectations.

US Situation

There appears to be a strongly held view in the current US Administration that the US is now at a competitive disadvantage vis a vis its principal trading partners because, in the past, its geopolitical concerns about the Soviet Union threat overshadowed its narrow commercial interests. This view suggests that the US must now somehow “rebalance” its trade relationships more toward its commercial interests.

It is evident that the US decision to deliberately create a trade crisis was taken by the current US Administration but it must be recognized that the underlying US concerns are long-standing and pre-date the Trump Administration. As a recent article by Chad Bown at the Peterson Institute for International Economic illustrates,⁵ trade actions initiated by the US to reign in trade irritants with China have an extended history going back at least to the accession of China to the WTO in 2001.

In the view of the US, existing actions under WTO have not been effective in disciplining Chinese exports it views as illegal, nor in curbing implicit subsidies resulting from Chinese state-owned enterprises, ubiquitous in China (and notably in agri-food). The US also has concerns regarding forced

partnerships/joint ventures between US and Chinese firms for US firms operating in China, with a resulting leakage of US intellectual property to Chinese firms. The US has also been thwarted at WTO panels in its endeavor to include upstream or downstream subsidies in calculating countervail duties, as well as denial of using its “zeroing” method in calculating dumping duties for a product.⁶

These are serious concerns. Past attempts by the US to reform WTO measures to engage China in this regard have been frustrated, leading the US to pursue filibuster tactics on the appointment of judges to WTO dispute panels as leverage. However, by escalating and taking these actions outside of the WTO, the US must be aware that it is contributing serious damage to the rules-based international trade environment; it can only be inferred that the US sees this as warranted from its perspective. However, the costs of this action reach far beyond the US.

It can be argued that there is a coherent rationale underlying the recent US trade actions. The measures enacted by the US against China in 2018, described below, go well beyond the bilateral trade actions previously taken by the US (dumping and/or countervail) under WTO rules. If one assumes fundamental change needs a crisis to precipitate reform, the US can be seen as deliberately creating an interlinked series of short-term trade crises in order to achieve its long-term goal of trade reform and a rebalancing of its trade relationships. The short-term pain created for US trade allies and its own economy, particularly for agriculture, by these aggressive trade actions are, in the US view, a price worth paying if it achieves a more effective and equitable global trading system in the longer term.

The US agri-food sector, anchored in the Midwest, sees itself as a primary casualty of US-China trade

⁵ <https://piie.com/publications/working-papers/2018-us-china-trade-conflict-after-40-years-special-protection>

⁶ Soumaya Keynes and Chad Bown, 2019. Zeroing: The Biggest WTO Threat You’ve Never Heard of. Trade Talks

Episode 80. <https://piie.com/experts/peterson-perspectives/trade-talks-episode-80-zeroing-biggest-wto-threat-youve-never-heard>

tensions, the target of a range of retaliatory duties enacted by China. This is especially the case for soybeans, the subject of retaliatory duties by China. The US is heavily dependent upon exports to China as a market for soybeans, and the Chinese soybean duties, combined with ASF-influenced reduction in Chinese demand has dampened US soybean prices. In response, the US introduced support programming totalling about \$US 12 billion to support producers affected by trade retaliation. The payments for soybeans are estimated at \$US 7.7 billion of the \$US 9.6 billion total in the Market Facilitation Program, the largest component of the support package.⁷

China Situation

Due to its population and economy, its dispute with the US threatening global trade institutions, and its dependence on pork threatened by ASF, the situation in China is pivotal at the moment. The Chinese economy has been growing rapidly for quite some time, and there appears also to be some sense of destiny, or a return of China to its rightful place as a global economic and cultural center. Among some, the history of past achievements and Chinese dominance are seen as a roadmap, or objectives for the future. This is rooted in an historical view (either implicit or explicit) of the transition of China that began to occur in the late 1980s (after the fall of the gang of four and Deng Xiaoping coming to power), gathering steam in the 1990s, then joining WTO in 2001.

China's record as WTO member seems to be mixed. On one hand it has "played fast and loose" with the rules and been found to be outside of its WTO

commitments- most recently in the case brought by the US on stockholding and support of Chinese wheat and rice, and on TRQ administrative measures for cereals. However, as pointed out in by Mazarr *et al*, China has a good record of compliance with WTO decisions, even when they are not in its favor, and there is no apparent incentive nor indication on behalf of China that it wishes to weaken WTO or the rules- based trading system.

A submission by China to the WTO General Council in early May 2019 generally supports this view of China as a willing and loyal participant in the WTO system, and also sets forth its priorities for WTO reform.⁸ In it, China describes the current situation as "unprecedented existential crisis of the WTO". China pledges its support for the WTO as a rules-based facilitator of trade. China's reform priorities include phasing-out developed country AMS entitlements and maintaining and even enhancing special and differential treatment for developing countries (China self-identifies as a developing country and has AMS entitlements). Additionally, China views existing WTO rules on subsidies and countervailing measures as discriminatory against WTO members with state-owned enterprises, and envisions reforms such that private and state-owned enterprises essentially receive like treatment.

China's accession to the WTO, and emergence as a partner in establishing and maintaining reasonable order in world trade and diplomacy coincided with the common (but erroneous) conclusion that the fall of the Berlin Wall signaled the steady and immutable move toward liberal democracy and a capitalist economy around the world, and led much of the

⁷ Farm Policy: USDA's Trade Aid Package. Congressional Research Service, February 2019

<https://fas.org/sgp/crs/misc/R45310.pdf>

⁸ China's Proposal on WTO Reform, May 13, 2019.

WT/GC/W/773

https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S006.aspx?MetaCollection=WTO&SymbolList=%22WT/GC/W/773%22+OR+%22WT/GC/W/773/*%22&Serial=&IssuingDateFrom=

https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S006.aspx?MetaCollection=WTO&SymbolList=%22WT/GC/W/773%22+OR+%22WT/GC/W/773/*%22&Serial=&IssuingDateFrom=

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world to see the emerging China in a strictly positive light.

But China takes a very long view of both history and culture. As it pertains to trade, China is trying to demonstrate that it has overcome the political humiliation endured for well over a century through the opium war and the forced opening of trade over 100 years ago.⁹ It is trying to rebuild China as the “middle kingdom”, described as culturally and economically somewhere between heaven and earth. The Belt and Road Initiative did not start under the current leadership in China; it has been in design and planning for over 20 years and probably longer.

However, food security may become a harsh reality confronting modern China and its bold vision. China has rapidly changed from a net exporter of food to a country heavily dependent upon imports from others to feed itself. This is dominated by imports of oilseeds (42% of agri-food import value [2017]), meats (9%), animal fats and oils (8%), cereals (6%) and dairy products (5%). The risk of this situation, currently being realized with ASF, is of significant inflation based on food and shortages, and perhaps actual protein reduction for many people. China is especially vulnerable to inflation driven by pork as it has been about 80 percent of total meat protein in the Chinese diet.¹⁰

This situation is consistent with rapid industrialization, urbanization and economic growth

⁹ As noted by Michael J. Mazarr, Timothy R. Heath, and Astrid Stuth Cevallos in *China and the International Order*, Rand Corp. (2018) President Xi has identified the purpose of foreign engagement as “the achievement of the Chinese Dream of the great rejuvenation of the Chinese nation”. This is consistent with its recent military buildup, especially sea power. For a recent discussion see Reuters The China Challenge <https://www.reuters.com/investigates/section/china-army/>

¹⁰ The INTL FC Stone report notes “...pork is far and away the dominant meat source in China. It makes up 3% of the country’s consumer price index and is the number one driver of food inflation. As the industry declines, it will have far reaching effects on the world’s second-largest economy”.

in China. As China has attempted to adjust by increasing its own agri-food production, it has generated major environmental problems and externalized costs.¹¹ These are water contamination, serious loss of productivity and resilience in soils, and livestock disease pathogens. As China continues in its attempts to increase domestic agri-food production and to begin the repopulation/recovery from ASF, it is engaging a broad demand for soil remediation and mitigation of agricultural pollution. Appropriately addressing these poses sobering challenges that will take years and consume extensive resources.

In apparent response to this dependence on imported foods, planning is occurring in China to increase agricultural production and food self-sufficiency. A March 2019 report by USDA-FAS describes the recent release of a Chinese government guidance document calling for self-sufficiency in rice and wheat (in lieu of corn) with production of soybeans and canola stimulated with support payments, structured to meet China’s WTO commitments.¹²

China has also moved heavily into investments in agri-food production assets elsewhere, notably in Central Asia, Eastern Europe, and Africa where it has made significant farm land purchases or leases. Better known are its investments in processing and logistics facilities for soybeans and grain in Argentina and Brazil, dairy and lamb processing investments in New Zealand, cattle and dairy in Australia, and acquisitions in meat processing, notably Smithfield in

¹¹ See for example, Cassou, Emilie, Steven M. Jaffee and Jiang Ru. (2018) *The Challenge of Agricultural Pollution: Evidence from China, Vietnam, and the Philippines*. World Bank. The authors note that agricultural intensification, as it has occurred in these countries has “led to serious pollution problems that have adversely affected human and ecosystem health, as well as the productivity of agriculture itself”.

¹² *China’s 2019 No. 1 Agricultural Document Doubles Down on Rural Reforms in the Face of External Pressure and a Slowing Economy* USDA GAIN report GAIN Report Number: CH19015. March 21, 2019.

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the US. The recent purchase of controlling interest in Hylife, an integrated pork processor in Manitoba, is by a Thai firm with the bulk of its operations and investments in China.

China is also pursuing development of new agri-food supplies through new investment and trade policy developments. China's Belt and Road Initiative (BRI), effectively a multi-lateral logistical capacity development and trade agreement led by China, appears in no small part premised on China accessing food and natural resources from countries located on or near the ancient Silk Road, and also far beyond. The recent guidance document referenced in the March, 2019 USDA GAIN report on China indicates that China "will specifically look to countries that participate in the BRI in an effort to diversify its suppliers."

US-China Trade Relations

The US is negotiating with China for a bilateral trade pact intended to resolve differences, beginning with US Section 232 tariffs on steel and aluminum, escalated by Section 301 duties levied against China on a repeated basis, with retaliatory duties enacted against the US by China. On May 10, 2019, the US further escalated tariffs across a range of products. China responded soon after with retaliatory action, announcing a range of new and increased tariffs on US products.

In the past, resolution of this situation would have been a positive for Canada, with the US standing up for international institutions (WTO among others), pushing to hold the Most Favored Nation (MFN) Foundation in the WTO, and bringing China into an arrangement that would be more satisfactory within the WTO rules. Under such an approach, Canada likely would have little to worry about, and the resumption of a more normal situation would remove trade and investment uncertainty.

The situation today is very different. The US quickly recognized after China joined the WTO in 2001 that

the multilateral trade rules were designed for market economies, and did not provide effective disciplines on a hybrid state/capitalist economy like China. In fact, state intervention increased rather than decreased after China joined the WTO, contrary to the earlier expectation of the US and others that China would become more market oriented once it joined the WTO. In its recent WTO submission, China has made clear that it sees state-owned enterprises as core to its economic development and will push reforms that treat them the same as private entities for the purposes of subsidy and countervail. This is likely to be held as completely unacceptable to western/developed countries, including the US and Canada.

Agricultural trade reform and creation of an effective dispute settlement system were the two crown jewels of the Uruguay Round which saw the GATT evolve into the WTO. However, the US appears to have become disillusioned with how the WTO operates. It has been highly critical of the appeal provisions of the dispute settlement system, arguing that the Appellate Body has, in effect, created trade law which had not been agreed by the Uruguay Round negotiators. The US concerns with the WTO have been intensified by the failure of the Doha Round of trade negotiations and its dissatisfaction with the long-standing practice of operating the trade body on the basis of consensus where one country can block an initiative.

The US decision to block new appointments to the Appellate Body, which will eventually result in the breakdown of the dispute settlement system, was an early signal of the emerging US view that "tough love" is sometimes a necessary condition for international reform. The underlying US concerns regarding China and the WTO appear to be increasingly shared by a number of US trade allies, as personified by the recent Canada/Japan initiative on WTO reform.

From a third-country perspective such as Canada's, a best-case trade policy outcome would be a China/US deal which, among other things, stimulated reform of the WTO by incorporating elements of the bilateral

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agreement into a plurilateral or multilateral framework (e.g. Tariff-Rate Quota (TRQ) administration, industrial and agricultural subsidies, improved Sanitary Phytosanitary (SPS) provisions, stronger intellectual property disciplines, forced technology transfer, currency manipulation). This would in effect result in the negotiation of a “WTO Plus”.

A worst-case scenario from a Canadian/third-country perspective would be a China/US agreement which was self-contained and entirely preferential. This indeed could signal the beginning of the end for the WTO. Such an outcome could be as bad as a breakdown of the bilateral negotiations and the development of an all-out trade war.

Even under a best-case scenario any US/China agreement would likely include a variety of China purchase commitments from the US (e.g. US soybeans) but this would be a price worth paying, provided the US and China recognize the benefits of multilateralizing some of their commitments into a revitalized WTO. Certainly, it would appear in China’s interest to treat any bilateral package as a one-off deal and to use a strengthened WTO as a shield against further one-on-one pressure negotiations with the US.

China has a good history of adopting WTO dispute settlement findings and this needs to be encouraged. (The recent WTO panel findings on TRQ administration and Chinese agricultural subsidies could well form part of US/China package which in turn could be reflected in revised WTO disciplines). It would also appear to be in the US interest to use a US/China agreement as a catalyst for fundamental WTO reform. US efforts to move beyond the existing WTO disciplines have so far been stymied and a reformed WTO which is more effective and fairer from a US perspective would help cement the argument that the short-term pain of trade policy by

crisis was well worth paying in order to achieve a rebalancing of the trade system, i.e. after the implementation of a US/China agreement and the negotiation of a “WTO-Plus”.

Canadian Situation

The key elements of the current situation relating to Canadian agri-food are canola and pork. China has also made reference to reduced purchases of Canadian wheat, peas, flax, and most recently cattle genetics.¹³ With regard to canola, the permits for export of Canadian canola to China have been revoked for two major grain handling firms, dating from early March 2019, based on concern vaguely stated as “pests”. Restrictions on Canadian pork exports to China relate to labeling issues and especially impact two Canadian pork processors.

The swift reaction to these events in Canada has been to link the Chinese moves on canola, pork, and other products to retaliation for the arrest of Meng Wanzhou. The current dynamic in China-Canada relations surely strains the environment in which the two countries might have otherwise informally worked through issues. It is an environment of heightened attention to Canadian product, and one in which Chinese regulatory and inspection officials are much less likely to be positively disposed toward Canada in exercising discretion.

Canada should also recognize that the issues raised by China may also be somewhat more complex than pettiness or retaliatory threat. The canola case could be instructive. Technical issues on canola with China are not new. China regards blackleg in canola as an SPS issue (and a pest), previously raised with Canada as an irritant to China. It is also the subject of a past arrangement between Canada and China in which Canada committed to conduct research and provide scientific information to China regarding blackleg, in return for retained market access. The Canada-China

¹³ “China hasn’t renewed export permits for 2 Canadian livestock genetics companies” iPolitics May 2, 2019

<https://ipolitics.ca/2019/05/02/china-hasnt-renewed-export-permits-for-2-canadian-livestock-genetics-companies/>

arrangement was agreed to in September, 2016 with a term running to 2020; at the time it was signed, the measure was seen as a means of retaining Canadian canola market access to China.¹⁴

The measure taken against Canadian canola in March, 2019 by China should not be considered exclusive of this arrangement. In particular, if China regards that scientific data it expected from Canada dealing with blackleg risk thus far has been insufficient, this action taken against Canadian exporters did not come entirely out of the blue- it is really China pushing forward the time frame of a known, existing arrangement with Canada. Clarity on the matter may come from Canada engaging China on the matter through the WTO.¹⁵

Under strained relations with China, greater vigilance is now required in all aspects of compliance and management of relationships with Chinese customers and government authorities. An error in a single character in printing a label, or (perhaps) a perceived gap in technical information is now enough to create a major trade disruption.

The risk of attributing any and all actions taken by China against Canada to retaliation and/or escalation relating to the Meng Wanzhou case, that it can deflect attention from this pronounced need for due diligence in dealing with China just now, increasing the risk of additional actions against Canada by China in the future.

Current Tension

In order to avoid having to deal with difficult internal issues, China will need to maintain its existing

economic growth trajectory or something approaching it. However, the prospect of significant food price inflation is a potent threat to Chinese economic growth, and by all appearances China is scrambling to mitigate this risk by acquiring or contracting food production assets globally to enable greater control over its food supply.

In turn, this presents new risks to other countries with well developed food production and trade systems, notably the US, EU, Japan, Australia, New Zealand, Canada, and others. There is an interest on behalf of these countries for continued economic growth in China, within the confines of their security interests and acknowledging concerns of an expansionist China.

The US has raised multiple challenges to China- regarding what it views as abuses of intellectual property, predatory macro-economic policy, violation of WTO obligations (notably on wheat and rice), and trading practices it regards as unfair and threatening to US national interests. The US has also insisted on Chinese participation on its containment policy of Iran; the source of a dispute with Huawei in which Canada has become involved, as well as current issues regarding restrictions on Iranian oil exports. Canada has also experienced a range of diplomatic difficulties engaging with China, relating to the Huawei case.

In this situation, food becomes an instrument in engaging China. In the immediate term, China will be looking to import meat to mitigate the effects of ASF, with purchases made by both private and state-owned importers at almost any price. This could leave open market exporting and importing countries

¹⁴ A Canola Council of Canada press release of September 27, 2016 notes, "A proposed measure that would have hampered trade and increased costs was set to be implemented on September 1st, though was stayed during Prime Minister Trudeau's visit to Beijing when officials were directed to achieve a science-based agreement."

[https://www.canolacouncil.org/news/stable-canola-access-to-](https://www.canolacouncil.org/news/stable-canola-access-to-china-welcomed/)

[china-welcomed/](https://www.cbc.ca/news/politics/canada-wto-canola-china-1.5126518?cmp=rss) In effect, Chinese market access for canola lost in 2019 was at high risk as early as 2016.

¹⁵ See *Canada calls on China at WTO council meeting to deliver evidence to back its canola ban* May 7, 2019

<https://www.cbc.ca/news/politics/canada-wto-canola-china-1.5126518?cmp=rss>

short and spread food price inflation globally¹⁶. In the immediate term it appears that Chinese demand for oilseeds and grain will decrease sharply with far fewer hogs to feed, but this is transitional as China intends to rebuild its pork production capacity while significantly increasing production of other meats, eggs and dairy.

Prior to the ASF outbreak China made the decision, at the highest levels, to devote less acreage to corn and more to oilseeds by restructuring its support payment scheme- both for economic and security reasons, as well as to improve soils. At the same time, they decided to move hog operations away from cities. These planned changes would have impacted the amount of imported oilseed required eventually but of course ASF is now driving the curtailment of the swine production. In the intervening period, the risk exists that Chinese state-owned enterprises may use the depressed oilseed and grain price environment as an opportunity for additional international acquisitions to secure more control over its food supply in the future.

This, in turn, leads to difficult decisions for the food industry in Canada. Investment for expansion to meet some of China's food demands bears the risk of being lost if Canada is shut out of some product markets. Not investing is equally risky; by missing an historic opportunity to respond to the apparent gaps in world supply Canadian firms could be simply overtaken by others.

The sheer magnitude of loss in the Chinese pork complex and resulting demand for imported meat will test logistical infrastructures, and create bottlenecks as the design of the system does not contemplate the demands that will be placed on it. The effect will not be limited to pork nor to meats, nor to exporting countries, as many products and countries share in the network of refrigerated containers and ships to

carry them. At various points in time, it may not be the supply shortfall that determines volumes exported to China so much as the availability of logistics infrastructure (cold storage warehousing, refrigerated containers, ships, ports, etc.) capable of handling the volume frozen or chilled exports.

Future food shortages could be thrust onto other countries, as China is protecting itself through its investments abroad. Moreover, as China acquires food production assets globally, other countries will lose leverage, given the damage that the trade conflict between China and the U.S. and (potentially) its resolution places on the rules-based trading system.

Conclusion

Canada could soon face multiple threats under this developing situation. Canada's essential problem is how to survive and prosper, given the emerging trends in trade and diplomacy without the umbrella of credible and effective international institutions and rules governing trade. The risk is that power relationships built on leverage are replacing the rules-based trading system. The US is provoking this change, and the ensuing crisis being fomented may result in both an agreement with China and initiatives triggering deeper WTO reforms that will address the concerns of the US (and others- including Canada).

It can be argued that the view that there is a coherent strategy behind the US induced crisis tactics is a charitable interpretation of recent trade policy events. In particular, the rigid and continuing statements from the US that it is only interested in bilateral trade arrangements, confirmed by its approaches to Japan, the EU and India in addition to China could suggest that it is not in fact thinking of the multilateral system in pressing bilateral arrangements.

¹⁶ To illustrate, as of early May 2019, New Zealand media are reporting an increase in pork prices of 25 percent, attributed to ASF in China

<https://www.stuff.co.nz/business/farming/112532717/nz-consumers-to-pay-25-per-cent-more-for-imported-pork-as-swine-fever-hits-china>

However, to think there is no strategy is to accept as inevitable that the multilateral trading system as we have known it is coming to an end and we are facing a future of preferential trading arrangements based on relative power. This would indeed represent a dramatic reversal in how the US sees its interest in foreign relations and trade.

The risk of a major weakening in global trade governance as this situation plays out is serious enough by itself. Yet, at the same time, we have the crisis presented by a deadly, incurable pig disease in ASF occurring at mass scale, and the critical need for trade to help close the global meat supply-demand gap. The ultimate magnitude of the ASF crisis is still developing, but the following appears clear- the multilateral system governing world trade is being hit with a severe stress test just as it is undergoing what could prove to be an existential crisis.

Canada, along with others, risks being collateral damage in this environment. The end of the Second World War ushered in a chaotic period in which recovering agricultural production capacity, technological improvements, along with food security concerns shaped protectionism in agri-food policy among developed countries, including Canada, for the ensuing 40 years. Geo-political shifts and the apparent victory of the market economy over the command-control economy, exemplified by the collapse of the Soviet Union and the end of the Cold War, and the crisis that developed over export subsidy wars in agriculture, facilitated the development of improved forms of credible international institutions to build rules-based trade.

But China did not lose the Cold War, nor was it a significant world player when the Berlin wall fell. It is essentially an authoritarian country with markets, but with state-owned enterprises accounting for about half of the economy- as market participants, but also with a role in directing trade. It views agri-food policy as central to geo-politics, and a critical element of its national aspirations.

Canada's agri-food policy- with investments and expectations by industry based on it- envisions economic growth and prosperity for the sector and regions dependent upon it, largely through export. It does not anticipate the emergence of a dominant importing economy that is not market-based, nor the decline in the rules-based trading system in an environment of large, sudden, and potentially sustained supply-demand gaps in products in which it is a global player.

One strategy for Canada immediately evident in mitigating this risk is to diversify its agri-food trade outside of the US and China. By matching the demand/scale of its customers to its scale of capacity, it could use a customer portfolio approach to reduce the type of risk currently being experienced with canola market access to China- in which, having grown into dependence upon a single, large customer market, its sudden loss or reduction is devastating, and lost volume not easily redistributed to other customers. This approach was probably always prudent in a rules-based trade environment; however, alternative approaches may be entirely necessary in a future environment of *ad hoc* leverage in bilaterally negotiated agreements.

Conversely, there are other countries that are at risk of collateral damage from this shifting environment with an agri-food importing interest. These include Japan, the UK under Brexit, South Korea, and Mexico. Each of these countries, to varying degrees, stand to be collateral damage from a decline in rules-based trading. and a US-China trade agreement if it is exclusionary. The scale of Canada's agri-food output may be better suited to these markets. Canada's attempts to revive and reinvigorate WTO are logical and progressive, but at some point, if these are not moving forward, it may be necessary to focus on enhancing existing pacts (or engaging new ones) among middle countries with a common interest in being shielded from the collateral damage of leverage-based trade agreements made by large countries.

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Japan would seem to be especially vulnerable in the current situation. The original Trans-Pacific Partnership (TPP), with the US participating, served as a mechanism through which to engage China as a single large bloc, and thereby protect Japan through a deepening economic relationship with the US (among others). With the US out of TPP, its successor CPTPP no longer serves this purpose. The US now seems interested in re-engaging Japan in a trade agreement¹⁷. However, it is unclear how this can happen under the terms of the original TPP to which the US and Japan initially agreed, given that President Trump campaigned so vehemently against it. A different (better) deal between Japan and the US would undermine the CPTPP and Canada's interests, especially in agri-food where CPTPP has been seen to be immediately beneficial. Alternatively, Japan may have no choice but to look for wider trade and diplomatic relationships than those contained in CPTPP and the US, such as China.

The Canadian problem boils down to this- how do we deepen relations with Japan in such a way that we can encourage it not to do deeper bilateral trade agreements with either the US or China that would disadvantage Canada?

Another strategy that could assist Canada in this situation is to shift to a more value-added agricultural economy, where we are decidedly less of a bulk exporter. This would help maintain the value of our exports in specific markets, potentially (for example) to Japan, and the U.K. It also deals with the co-product problem; canola represents an illustration.

The Chinese demand for canola is down, predicated on the decline in demand for canola meal from ASF; but the demand for canola oil fundamentally has not changed. Finally, as we go further down the value-added chain, marketing becomes much more sophisticated and the "like product" argument used to

protect domestic product from import competition becomes more difficult to make compared with bulk commodities. This could be viewed as always being a good idea (or motherhood), and where this hasn't happened, economics and the market should be telling us something. However, the prospect of departing the rules-based trade system alters this logic.

Some of the indications from Chinese agri-food investment behaviour cited above are that China is executing a very rational strategy for renewed economic growth, with a vision of global leadership or dominance. In the near term, as the fallout from ASF in China becomes evident, Canada and other countries could face very strong demand for meat. Literally any other major production disruptions in agriculture at this time due to drought, flood, pests, or disease could greatly exacerbate the issue. In this event, it will become evident that by investing in food production abroad, China is insulating itself and exporting its food security problems to others.

A vaccine for ASF, efficacious and readily available with widespread adoption, would be of critical value now. This is true not only to deal with the global meat supply-demand gap that is developing. It would reduce the stress on the world trade system to mitigate the shortfall, and create important space for the renewal of discussion on the benefits of, and improvements to, the governance of international trade. However, a vaccine for ASF is not available, and not expected any time soon.

For Canada, this places strong priority and reliance upon advanced and vigilant biosecurity, and working out rules to allow exports through zoning, regionalization, and compartmentalization, which will allow continued movement of pork in the event of an ASF outbreak. Biosecurity is really also the only

¹⁷ The attempts by the US to obtain a quick, narrow trade agreement with Japan on agriculture appear to have been rebuffed. See "Japan refuses to give greater access to US

farmers" *Financial Times* April 28, 2019
<https://www.ft.com/content/6ae28e80-698b-11e9-80c7-60ee53e6681d>

solution currently available to support global pork trade that can mitigate the global effects of ASF.

Meanwhile, it is increasingly clear that whether or not the US reaches a trade deal with China, the possibility of a rapid return to the range of global marketing and value chains in food and agriculture built over the past two or three decades under rules-based trade is increasingly remote.

The fallout is apt to manifest itself in food security concerns, well beyond those currently the subject of dialogue. In Canada, food security is mostly viewed as connected with poverty or northern and first-nations communities; this is consistent with a middle-class, food exporting country with extensive capacity. However, with the prospect of the disruptive effects of ASF lasting for years (due to recovery time in China or further spread of the disease) and the potential for the occurrence of other agricultural production disruptions, this assumption may require re-examination. Another major agricultural production shock at this time, say a drought in the Midwest US or South America, could drive major scarcity and fear of foreign ownership of agri-food assets in Canada.¹⁸

Under a rules-based international trade regime, domestic food security fears due to foreign ownership of Canadian agri-food assets would be exaggerated; under a power-based trading system, fears of foreign ownership impacting access to food in Canada become much more credible. Planning should be undertaken to respond to the full range of possible long-term outcomes. This includes renewed initiatives to design changes to WTO that could draw the US back into full support for the WTO, or creating new institutional structures among Canada and other countries to regain, or salvage, the principles upon which the WTO was created.

¹⁸ As of spring 2019, some concern exists regarding infestations of armyworm in rice in southern China; delayed corn planting in the US Midwest is also raising some concerns.

Finally, in addition to the US and China, third countries like Canada need to recognize that they cannot remain complacent and assume the multilateral trading system, which has served the world so well over the post-WWII period, can simply continue to exist on the basis of the status quo. It took a crisis to reform the GATT into the WTO. The challenge facing all trading nations will be to use the current set of crises to precipitate needed reform of the WTO into WTO-Plus.