

# Shifting Geo-Politics and Trade Policy: Wither Canadian Agri-Food Policy?

Independent Agri-Food Policy Note

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## The Issue

Canadian agri-food finds itself in an ominous situation on multiple fronts in the fall of 2019. As harvests come off in Canada, it will become tangible to many the bitter economics facing segments of the crop sector- notably oilseeds. Livestock returns have waned when expectations existed for much better returns. Canada faces ongoing restrictions to market access in some foreign markets- notably China, India, Saudi Arabia and parts of the EU- and these create secondary risks out of fear that other products could be subject to exceptional inspection, delays, and costs. Various industry groups are surveying and estimating the economic damage done to date, and looking to governments for answers and compensation to control the damage. Canadian governments are left wondering how to assess the damage, and for a forward-looking strategy to deal with the global issues. Both governments and the agri-food industry are seeking a way forward that could help them frame and anticipate what is to come.

This situation has developed rapidly and presents a conceptual problem in terms of both the scope of factors and complexity of analysis. The post 1980's world facing Canadian agri-food has largely been one of market equilibrium adjustments, in which supply and demand fluctuated within the bounds of relatively known and stable trade rules and restraints on domestic agricultural support and export competition, which facilitated specialization and incremental adjustments that could be relied upon to produce a relatively stable equilibrium. Countries mostly acted on an understanding that shared economic growth within a rules-based trading system with supporting foreign policy was in the best interest of all. The emergence of stable domestic agricultural policy structures, notably common stabilization programs shared by federal, provincial and territorial

governments, was founded on the stable trade environment under WTO and NAFTA (as well as other trade arrangements in the 1990s).

Major elements of this order have now changed, and many of the assumptions based on past experience may no longer be accurate or reliable. The emerging evidence is that there is exceedingly little scope for returning in the coming years to the markets, domestic policy and trade relationships that has prevailed in the previous 20 -25 years. In this regard, Canada's strategy and policy structures for agri-food development will need to be re-thought and re-designed. But how to do so with the complexity of factors in flux, and how deeply and fundamental change in strategy should go, present a vexing conceptual problem. This policy note attempts to develop a framework within which to enumerate the major shifting policy factors, and to connect them in drawing implications.

## Historical Context

The western powers that were the victors of the Second World War established a broad range of institutions- economic, political, and military- that would safeguard the peace, contain the expansion of communism, and maintain the resulting world order. Canada was a great beneficiary of this; as a small country (along with Australia and New Zealand). This structure allowed Canada to pursue an open post-war economy, and generally evolve from the worries of mass unemployment and associated threat of political unrest following the end of the war, and ultimately move beyond Keynesian economics and toward a freer-trade posture. This in turn facilitated the full use of Canadian agricultural productive capacity, which required and benefitted from export markets and secure access to them. Over time it created the confidence to ratchet back the regulation of farm

products marketing, and facilitated a reduction in the need for agricultural support and stabilization.

This liberal world order that developed suited the victors of the Second World War, and also created benefits more broadly. Many of its institutions led to positive developments in economy and health in the developing world, especially in East Asia. It is now widely acknowledged that freer trade throughout the world, made possible by the WTO and regional trade agreements consistent with it, has lifted literally millions out of abject poverty. The hostility that existed between NATO countries and the Soviet Bloc was resolved and the Cold War ended without open conflict. Global institutions have adjusted to engage and facilitate change that can support post-Second World War order. For example, developing countries initially organized themselves in a trade dialogue under the United Nations Conference on Trade and Development (UNCTAD) apart from developed countries operating under General Agreement on Tariffs and Trade (GATT); this was engaged and led to the formation of the WTO. Rather than use leverage and influence for their own gain, large developed countries have been satisfied that all boats rise in the tide in this liberal world order.

Clear signs of shifts in the liberal world order began following the Arab Spring, beginning around 2011. As Tunisia, Egypt, Libya, Yemen, and others rose up against despotic leaders, it seemed that it would reinforce the trend toward secular liberal democracies. However, this mostly appears not to have occurred, and instead, new despotic governments have developed that seek tribal retribution against their predecessors, with increased conflict and instability. In the period since the Arab spring, there has been erosion in the democratic governance of a number of liberal democracies. As a recent article by Jones, Feltman, and Moreland published by Brookings observes<sup>1</sup>

*“Economic factors have fed a new, deeper American and British skepticism of multilateralism...Nor is this skepticism of the existing multilateral system confined to the United States and the United Kingdom; amidst rising nationalism and populism around the world, fewer actors are available to step into the breach left by Washington and London”*

The trade environment is challenged today with the increased economic and geo-political prominence of countries that do not fit with many of the assumptions of a liberal world order, and others in which portions of the population feel taken advantage of or otherwise left behind. As such, some of the assumptions of the liberal world order- price arbitrage and market clearing; competition driven by private profit incentives; preference for the certainty of rules-based commerce over power-based relations; redress from unfair trade and marketing actions of other countries- do not necessarily apply today.

This recent evolution in the global trade policy order cannot be in the interest of Canadian agri-food. Canada lacks the economic weight to maintain its current international economic status and levels of market access if trade relations are to be based on leverage and influence. Large parts of Canadian agri-food rely on secure export market access for markets to clear, and in turn to justify efficient levels of investment- particularly because the products are commodity resource leveraged and subject to arbitrage. Across an even broader swath of products, Canadian agri-food relies on the liquidity of US or global markets for price discovery and price reference- this assumes that market access is essentially equivalent across countries and markets participating in price discovery. The re-emergence of agricultural subsidies as a force in global agricultural markets cannot be a winner for Canada, as it lacks the treasury of larger countries to engage in this game- leaving aside the well-known distortions it creates in global agricultural markets. Concerns regarding

<sup>1</sup> Bruce Jones, Jeffrey Feltman, and Will Moreland. *Competitive Multilateralism: Adapting Institutions to Meet the*

*New Geopolitical Environment.* Brookings Institution (September 2019)

global debt levels and the prospect of even small increases in interest rates highlight a pending concern for Canadian agri-food. Ironically, in other quarters, the prospect of price deflation is a worry.

### Unpacking the Agri-Food Context

Reduction in domestic agricultural support formed a priority aspect of the WTO-Doha Round. As recently as the WTO Ministerial held in Buenos Aires in 2017, the aspiration existed that tighter limits on domestic support could be agreed to, consistent with proposals discussed and advanced in 2008. Agricultural support in major producing and exporting countries has generally declined; for example, between 2000 and 2018, agricultural support tracked by the OECD fell from about 32 percent of gross farm receipts to about 19 percent.<sup>2</sup> However, agreement on agricultural support did not occur in Buenos Aires, a portent for 2018-19.

Following increased tariffs initiated against China by the US in 2018, China introduced retaliatory tariffs against US soybeans, pork, and a range of other US farm and food products in July 2018. In turn, China intensified its soybean import purchasing from South American countries- notably Brazil and Argentina. This was consistent with extensive agri-food investments, in addition to infrastructure investments, in Brazil and Argentina by China.

At the same time, in August 2018, China notified the World Animal Health Organization of an outbreak of African Swine Fever (ASF). The attempts to control ASF in China essentially failed, and throughout the last half of 2018 and the first half of 2019 ASF spread throughout China and then into Vietnam, Laos, South Korea, Timor, and the Philippines. The staggering effects of ASF in China are still just coming to light. In its September 30, 2019 outlook, Rabobank forecasts that for 2019 the sow herd in China will be just under 20 million sows, down from over 40 million in 2018. This leaves a gap in the Chinese pork supply that

exceeds global pork trade, and pork prices in China are rapidly increasing. It also dramatically reduces the demand for feed, especially soymeal, which is generally made from imported soybeans crushed in China.

The effect on soybean markets has been profound. The new harvest of 2018 in the US met exceptionally soft demand due to the Chinese duties against the US, Chinese demand shifted to South American suppliers, and greatly reduced the demand for crusher soybeans in China. This has resulted in large US stocks, and a price discount in US soybeans versus South America. Chinese purchasing of Canadian soybeans was aggressive in the fall of 2018, but this appears to have evaporated coming into fall 2019.

The effect on pork and hog markets has been somewhat different. A series of US pork export sales to China created a brief sensation in April 2019, generating a major futures market rally. However, this abated as Chinese imports have been largely muted, as Chinese pork supplies were drawn from large regional storage stocks throughout the summer of 2019. At some point, presumably in the fall of 2019, the regional pork stocks held in China will run down, and Chinese demand for imported pork and meat will increase aggressively. Rabobank reports sharp increases in pork and live hog prices in China since July 2019. Canada is not subject to the duties on pork levied against the US by China, but instead has experienced technical issues on health certificates with exports to China that have temporarily eliminated both pork and beef exports.

Canola markets are heavily influenced by soybeans, and the sluggish soybean demand in China transfers to canola. In this environment, China suspended the import permits for two Canadian suppliers of canola, over an unspecified technical issue. Canada has attempted to engage China in the dispute, and recently initiated the matter for WTO dispute resolution.

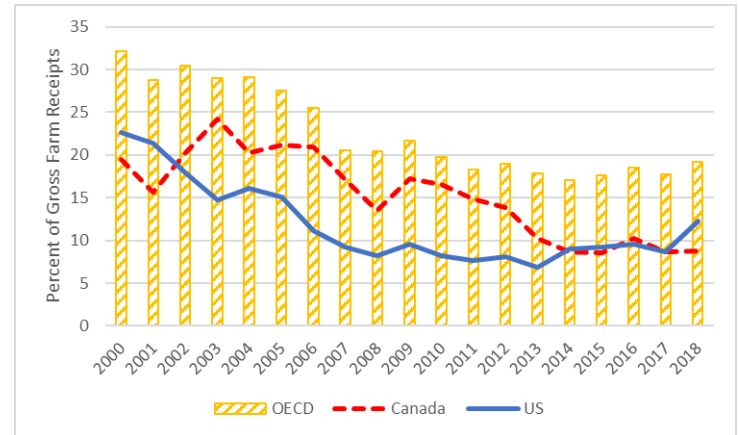
<sup>2</sup> <https://data.oecd.org/agrpolicy/agricultural-support.htm>

The turmoil in agricultural markets, especially against soybeans and pork produced in the US Midwest, prompted the US to introduce farm support payments under the Market Facilitation Program (MFP). US\$12 billion was announced in August 2018 targeted mostly to soybeans, and a further US\$16 billion based on a per acre payment fragmented by county. The US has not yet made clear how it intends to notify these payments relative to WTO disciplines<sup>3</sup> on agricultural support. Among the distortionary effects of domestic support is that it tends to hold acreage in existing cropping patterns- to the exclusion of market signals- as producers rationally expect that future payments may be based on past crop history and/or updated yields. This in turn will serve to depress prices and provides the basis for other countries to follow suit and increase support.

Figure 1 below provides some context, based on Producer Subsidy Equivalents percentages for OECD countries, along with the US and Canada. Since 2000, agricultural support as a share of farm cash receipts in OECD countries, as well as in Canada and the US has declined- to 2017 levels of just under 9 percent in both Canada and the US, and between 17-18 percent OECD average. With MFP payments in 2018, OECD estimates for the US are for a PSE percentage of 12 percent- an increase of almost 50 percent over 2017, and with 2019 MFP payments higher and US farm cash receipts likely to be lower, the US PSE percentage is likely to be higher again in 2019- a further break with a long standing trend.

Most Canadian farm commodity prices use as a starting reference US prices- typically a futures price, or sometimes cash- with a basis adjustment that reflects Canadian supply/demand conditions versus the US reference, along with freight cost and currency

**Figure 1 Producer Support Percentages, OECD Countries**



Source: OECD

conversion. This provides some capability to use US futures markets to lay off risk through hedging, provided that the variance in the basis is small relative to the variance in the underlying US reference price. However, as market access splinters off in different directions across countries, price arbitrage does not occur as readily, and support levels differ sharply, it can be anticipated that the volatility in basis could be much higher than it has been previously. This undermines the pricing model for some Canadian farm products.

The proliferation of domestic and international agri-food marketing/value chains that have been built over many years increases the significance of the threats now faced. The risk of breakdown in these chains in the face of market access uncertainty serves to undermine re-investment, urgently needed in some cases, to re-develop these structures to allow markets to clear. Consider as an example US breakfast cereal manufacturing based on imports of oats from Canada. US production of oats is limited as land capable of producing oats in the US is better suited for other crops. As a result, Canada has developed a

program details were still being developed deferred to its 2019 WTO notification

<sup>3</sup> In response to questions from a number of countries, including Canada and China at the late June 2019 meeting of the WTO Committee on Agriculture, the US responded that the

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comparative advantage in producing oats, Canadian oats are imported to the US to supply the breakfast cereal manufacturing industry, the US can supply domestic and export markets for breakfast cereal, and the US grows corn and other crops on land that would be underutilized growing oats.

### Broader Trade Context

Actions taken on soybeans, pork, and other farm products came about as a result of broader international trade tensions. These relate to established concerns on behalf of the US with Chinese domestic and trade policy, and with the WTO dispute settlement process, and more recent developments in trade relations among the US, EU, and India. Internal US concerns have also come to the fore regarding whether trade relations engaged by the US are “fair”, with new directions in US trade policy intended to correct past perceived inequities.

Concerns with domestic and trade policy in China on behalf of developed open economy countries (including Canada), led by the US, have existed for some time. These relate to the following. For the purposes of certain provisions of trade rules, China has status as a “developing country”; others view that China has long ago graduated from this status but still claims its benefits of protection. Significant elements of the Chinese economy operate under State-Owned Enterprises (SOE's). The concern exists that Chinese SOE's benefit from implicit subsidies and can exercise distortionary market power in global markets through their trading behaviour, undermining equal treatment of suppliers based on origin and/or implicit export subsidy. Issues of domestic agricultural support are an ongoing issue, and the US is in the midst of a WTO case against China on past support for wheat and rice. The fact that the WTO has consistently refused to consider upstream and downstream subsidies in countervail and antidumping cases when there are no direct subsidies

for the product in question exacerbates the situation. Another irritant is the intellectual property and how this is shared and used by Chinese affiliates of foreign companies operating in China. There are other issues, and the manner in which policy measures are designed in China appear to fall between the cracks of WTO disciplines- which generally assumes a market economy with policy interventions an exception, rather than the rule. This seems not to apply well to China.

While these are of long-standing concern to the US and others, the current US administration has escalated matters bilaterally (rather than multilaterally through the WTO) in the hopes of provoking a resolution. This began in 2018 with initial tariffs against China. Following successive rounds of US tariff escalation and retaliation by China, tensions appear to have been emboldened rather than resolved. China has revealed itself to be committed to its economic growth model, which is not overtly market-oriented despite Xi Jinping's earlier pronouncements to move in that direction. It appears also to be prepared to wait out the US pressure.

Another point of contention is the WTO and specific aspects of dispute resolution. For some time, the US has expressed concern that the appeals to WTO rulings draw upon uses of precedent from previous WTO cases that the US did not agree with, and that more generally WTO appellate panels have effectively created new policy through certain decisions, and overreached relative to interpreting existing rules. To leverage its views, the US has applied filibuster pressure by blocking appointments to WTO appeals panels. The effect of this has been reduced capacity for dispute resolution in the WTO, and an end to an effective dispute resolution mechanism by the end of 2019.

Bacchus and Lester (2019) explain the significance of this.<sup>4</sup> They observe

<sup>4</sup> <https://thehill.com/opinion/international/458264-the-crucial-role-of-a-wto-appeals-court#.XWaOCOhrCk.twitter>

*“Imagine there were no Supreme Court, and questions about fundamental issues such as free speech, religious freedom and equal protection were left up to various lower courts to decide. One court might rule one way; a different court might rule another way. There would be no certainty as to what the law meant and what policies were in place... In international law, there is no single high court and no law of precedent. Even so, there is an informal practice of taking into account past rulings to help ensure certainty and foreseeability for all those who may be affected by rulings, whether they are formal parties to them or not.”*

Without a WTO appellate body, we lack the means of interpreting and learning what agreed upon trade rules mean, and lack the protection of a binding decision. This surely heightens the risk and uncertainties of international trade- and especially for a small country like Canada lacking the weight to apply leverage in lieu of a rules-based system. In turn, it erodes the credibility of trade rules and the institution that facilitated their creation.

More generally, the appetite for multilateral trade institutions has been reduced in favour of a belief strictly in domestic institutions. One example was the US desire for NAFTA dispute cases to be heard in US courts. This was not implemented in USMCA/CUSMA; however, a willingness to circumvent elements of the core understandings of WTO remains. This is illustrated in the recently announced US-Japan agreement, that it appears will grant the US the same access to Japan for most agricultural products that it would have obtained under the original TPP. As observed by Lester (2019)<sup>5</sup>, a bilateral trade deal covering agricultural and a number of other products between the US and Japan that provides preferential tariffs contravenes the Most Favored Nation principle (GATT Article I). Conversely, it is hard to see how the

US-Japan deal covers a broad enough range of products to rise to the standard of “substantially all trade” required for a trade agreement to grant preferential access (GATT Article XXIV). Thus, US-Japan is likely illegal under WTO; but it is unclear who will challenge it, given the anticipated demise in the WTO Appellate Body at the end of this year. It also presents an example of the use of leverage in lieu of WTO rules, as the US held the threat of auto tariffs over Japan in reaching this agreement.<sup>6</sup>

Further conflict in trade can be expected. Irritants are brewing between the EU and the US, mostly relating to the role of subsidies in the EU. The opening rounds of trade tensions between the US and EU have related to subsidies for aircraft; this stands to expand.<sup>7</sup> India presents the challenge of a growing global power with an economic development model not based in markets in the manner of western countries. India makes extensive use of subsidy for a range of agricultural inputs that it claims as “green” under Annex II of the Agreement on Agriculture and outside of WTO discipline, has very large public stockholding programs for a range of crops, and makes liberal use of special safeguards as protective instruments; India is a developing country for the purposes of WTO rules. Canada and India have an ongoing dispute regarding access to India for Canadian exports of pulses.

### Geo-Political Context

The primary victors of the Second World War, and the framers of the world order since, were the US, the UK, the Soviet Union, France, and China. These countries are each permanent members of the United Nations Security Council. Their fates have fluctuated since the formation of the post-war order. UK and France are relatively weaker economically and militarily today,

<sup>5</sup> <https://ielp.worldtradelaw.net/2019/09/the-us-japan-deal-more-than-just-in-principle-now.html>

<sup>6</sup> The US and Japan have agreed to work toward a broader trade arrangement during 2020, with the intent of bringing a wider agreement into line with WTO rules.

<sup>7</sup> On October 2, 2019 the WTO panel ruled against the EU in a case relating to subsidies to Airbus. The US announced increased duties on EU aircraft, cheese, wine, and whisky <https://www.reuters.com/article/us-wto-aircraft-timing-idUSKBN1WH0SI>

and really large middle powers. The Soviet Union does not exist, replaced by Russia, and is still militarily powerful, but much less so. The US is the dominant superpower, but it has reigned in its past role and is no longer the default protector of the global order. China is a growing superpower, with economic and military weight that may have previously underwhelmed its status as a permanent member, but is growing rapidly both economically and militarily.

One aspect of China's growth could be viewed as neo-colonialism, through development assistance on an unprecedented scale. It has advanced its Belt and Road Initiative (BRI), a mega project that targets investments in transportation logistics, communications and infrastructure throughout Asia, and also throughout South America and Africa. Using this network of investments, China is building a network that it will use to access primary and intermediate goods for final use/consumption in China as well as to sell Chinese finished goods and technology. A second instrument of foreign influence employed by China is leadership in emerging technologies, such as artificial intelligence and 5G wireless technology, which will be distributed throughout countries aligned in the BRI and provide new relations with others

The implications are potentially profound. As an illustration, in November 2018 an investment in railways in Argentina under Chinese construction and funding was announced. The infrastructure created will allow soybeans to be moved more easily and much cheaper over the rail system and into export position. In the summer of 2019, China approved Argentinian soymeal plants for export to China; this is unusual, as China typically imports soybeans for crushing in its plants at Chinese ports to access soymeal. China purchased the majority of the Argentinian soybean crop in 2019, and in a stunning irony, Argentina ended up importing soybeans from

the US to maintain operation of its soy crushing plants.

What is remarkable is that China appears committed to a geo-political strategy in which, through transportation logistics, communications networks, and a range of other investments throughout Asia, Africa, and South America under the BRI, it will essentially align its supply chain. This lies in contrast to the recent situation in which firms in the US and elsewhere in the west have established outsource partners in China- either to serve the Chinese/Asian market, or to provide imported low-cost inputs. In this context, the US may have anticipated that by escalating tariffs it could isolate or contain China economically and provoke a settlement. However, an understanding of the BRI suggests China is playing a larger geo-political game ultimately designed to wall-off its market to the US and its allies.

Canada cannot escape the impacts of the deterioration of US access to Chinese agri-food markets. With an open Canada-US border, the price impacts felt by US producers will flow automatically into Canada, whether or not China blocks or limits Canadian access to China.

However, at the same time, China abolished the "Iron Rice Bowl" policy, essentially ending job and income security for life, more than 20 years ago. This presents two very difficult challenges for China, given the current context with ASF. With pork the source of around 80 percent of meat protein in China, the pork supply chain- farms, feed mills, packing plants, transportation, etc., is a major employer. With the dramatic decline in the sow herd and current (and forthcoming) declines in pork production, ASF could present a major unemployment and lost income problem in the Chinese workforce, especially regionally.<sup>8</sup> At the same time, increasing meat prices are fueling inflation. Rabobank is reporting sharply higher pork, beef, chicken, and sheep meat prices in

<sup>8</sup> The Economist May 25 2019 reports that ASF "has walloped the tens of millions of Chinese who depend on pig-rearing for

their livelihood.... Experts say that it may take years for China to control the disease"

China. The double whammy of significant increases in unemployment in some regions, coupled with meat price-led inflation pressures the Chinese government to be seen as having a solution to the pork supply in the immediate term long before the ASF crisis can be resolved.

Elsewhere, in a remarkable coincidence of awkward timing, just as the US is preparing to ratify USMCA, proceed toward conclusion of an agreement on trade with China, ratify the US-Japan trade agreement, negotiate with North Korea, and engage in potentially tense trade talks with the EU, India, and post-Brexit Britain, the US House of Representatives has initiated impeachment proceedings against President Trump. This could create numerous risks, regardless of the actual outcome of the process. Impeachment could take an extensive period of time, and tie up the congressional calendar such that other matters are derailed. One such issue is the ratification of USMCA, which could be delayed or even sidelined by impeachment. Secondly, the nature of the impeachment dialogue could dissipate any remaining bipartisan goodwill, and undermine the compromises necessary to pass USMCA, as well as other matters before Congress. Finally, impeachment proceedings could trigger counter measures by the administration designed to distract or pressure the proponents of impeachment. One example could be the President withdrawing the US from NAFTA as a means of creating an emergency distraction to impeachment, and/or to pressure expedient ratification of USMCA. Other events that could distract political attention, such as a crisis in the Middle East or North Korea, are also possible.

## Macroeconomic Context

As Michael O’Sullivan describes in his book *The Levelling*,<sup>9</sup> central banks in western countries have

recently assumed a much larger political-economic profile than they have historically. Indeed, central banks throughout western countries are increasingly relied upon as an ongoing source of economic stimulus, rather than as the guardian against spiraling inflation or public impetus to boost the economy at times of sputtering economic growth. Ten years in, quantitative easing looks almost permanent. Globally, interest rates are very low compared with history, and governments are loath to allow interest rates to rise due to the risk of economic slowdown- even though many economies with exceptionally low interest rates are only able to achieve anemic GDP growth (1-2 percent).

Conversely, the cheap money environment has created very high debt levels. This is illustrated in Figures 2 and 3. Based on IMF data, Japan’s public debt:GDP ratio is 244 percent; the US is at 109 percent; Canada is at 84 percent and China is at 54 percent.<sup>10</sup> Measured as a share of disposable income, private debt ranges just over 100 percent in Japan and the US, and close to 180 percent in Canada. Data for China are unavailable- however, it is widely reported that household debt in China is at record high levels- source of some concern.<sup>11</sup>

The problem this creates is that if interest rates were to be increased (say to combat a sudden rise in inflation or adjust international capital flow balances) it risks mass defaults of private and/or sovereign debt.

In the US, the Federal Reserve is under intense pressure to keep interest rates low to stimulate economic growth. At the same time, the largest foreign holders of US treasury bonds (sovereign debt) are China and Japan.<sup>12</sup> Recently, the US has discussed the possibility that it will order the delisting of Chinese companies from US stock exchanges as a

<sup>9</sup> Michael O’Sullivan. *The Levelling: What’s Next After Globalization*. New York: Public Affairs. 2019.

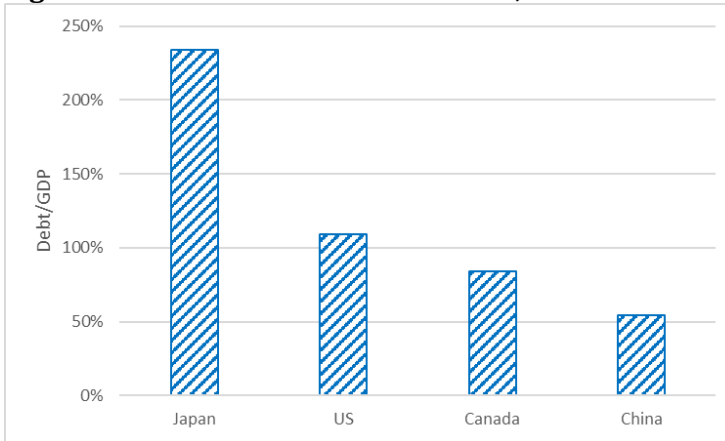
<sup>10</sup> <http://worldpopulationreview.com/countries/countries-by-national-debt/>

<sup>11</sup> <https://www.reuters.com/article/us-china-economy-debt/chinas-debt-level-set-to-rise-but-household-debt-risks-most-alarming-adviser-idUSKCN1ST1FN>

<sup>12</sup> See <https://ticdata.treasury.gov/Publish/mfh.txt>

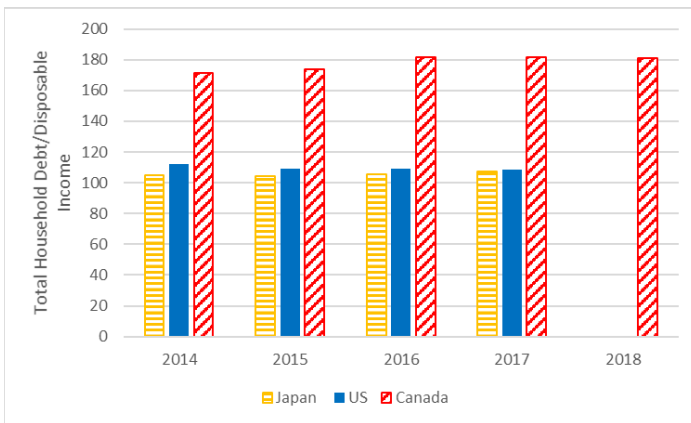


**Figure 2 Public Debt as a Share of GDP, 2019**



Source: IMF- sourced through World Population Review

**Figure 3 Household Debt/Disposable Income**



Source: OECD

matter of leverage against China in the trade war.<sup>13</sup> This move presumably will increase the cost of capital to some Chinese firms. As China already has its own high levels of debt, this may force some liquidation of US sovereign debt by China, with this capital redeployed to finance Chinese companies impacted by US stock exchange limits. In turn, the US treasuries

<sup>13</sup> Reuters estimates the value of equity investments in Chinese companies by major US investors at \$US 40 billion <https://www.reuters.com/article/us-usa-trade-china-stocks->

released will need to be bought up. This effect by itself will exert upward pressure on US interest rates and inflation, potentially triggering additional secondary increases in interest rates. Aligned with this is the US administration resurgent concern about currency manipulation by other countries, keeping the US dollar high, limiting its exports, and increasing imports. The difficulty is that the growing uncertainty in trade and limited economic growth, will push investors toward the safety of the US dollar, placing further upward pressure on the US dollar.

Ironically, a different threat is deflation- economy-wide price decreases in the face of structurally softening demand. This is a serious concern in Japan, and it could spread. The difficulty with deflation is the dearth of macroeconomic tools to stabilize the economy.

Whether either of these scenarios play out, the greater point is that with debt levels so high, and economic growth so sluggish, countries have become effectively addicted to low interest rates. In so doing, central banks have lost almost all of their effectiveness to provide stimulus in response to a serious recession, and conversely to reign in runaway growth and inflation. There is very little space to move on interest rates by central banks in either direction; conversely if interest rates were increased, mass debt defaults are a real possibility, which then cascades into falling GDP, and recession/depression. Trade and geo-political tensions will exacerbate the situation, with countries wanting to reduce foreign debt holdings and increase control over their capital markets and currency exchange rates.

## Implications

The conventional wisdom in Canadian agri-food is perhaps that the current situation and outlook, while serious and daunting, is not altogether unfamiliar.

[graphic/major-u-s-investors-have-billions-at-risk-in-chinese-stocks-idUSKBN1WG2S9](https://www.reuters.com/graphics/major-u-s-investors-have-billions-at-risk-in-chinese-stocks-idUSKBN1WG2S9)

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Fifteen years ago, crop prices were desperately low, and we were still in the midst of the BSE crisis. Industry adjustment, facilitated by BRM programming and *ad hoc* support carried the industry through, and by 2007 a more normal situation had returned, albeit with some significant adjustment. We have seen multiple reverberations since- such as 2009-10 in hogs. Making needed improvements in BRM programming and (if necessary) *ad hoc* assistance can secure the future.

But there is reason to believe that the situation looking forward is actually fundamentally different. We are not facing supply-demand misalignment in which, for example, low prices will eventually cure low prices. That is a situation in which markets are sufficiently stable and open that incremental market adjustments toward an equilibrium can bring balance, and buffer extreme outcomes. But because so many of the fundamentals taken for granted in the operation of farm product markets are shifting or under siege now (and looking forward), it is not clear that equilibrium adjustments (e.g., low prices curing low prices) will lead to an eventual recovery back to a normal or stable state. Rather, low prices could be an indicator that a market as we have known it is simply gone or badly impaired, with unknown points of traction and stability at much lower levels, yet to be discovered.

Consider soybeans. By all appearances, China has moved on from the US (and by extension, Canada) as a supplier of its soybean demand, in favour of an aligned system with South America and its BRI partners. That shift is fueled by Chinese investments abroad, retaliatory tariffs against the US, and (more ominously) discrimination among import suppliers by Chinese SOE importers. Imports of US soybeans in the future can be expected to be far lower, and probably erratic as China periodically imports some US soybeans just to keep the market on edge. With China by far the largest soybean importer, this should induce a decrease in US soybean acreage in the US, as profitable market is unlikely to exist for the typical US soybean crop of 70-75 million acres. However, with

the return of large support payments, this US adjustment is likely to be slow or muted. Low prices may not be effective in curing low prices, and countries like Canada that price off the US markets are collateral damage, as our pricing model does not reflect true value- and arbitrage really comes in only one direction. This dynamic could play out across farm commodities- grains, oilseeds, and livestock. Similarly, large *ad hoc* payments for agriculture in Canada will slow adjustment and retard consideration of the needed reconstruction and investment to deal with the emerging market uncertainty.

The key issues for Canadian agri-food out of this complex outlook are export market access and trade remedy. Agricultural markets are historically among the most distorted and protected, and the view forward from today is such that future market access will be much more uncertain for Canada, and its access to trade remedy much weaker. So the strategic question then is not how long, and how much assistance it could take to get back to the more “normal” situation of the last 25 years or so, the question rather is how we retain what we currently have as a Canadian agri-food sector. The matter is one of sector resilience- the ability to redefine and reorganize in the face of adversity, so that the sector can retain its capacity and essential functions through creativity and innovation.

There is also a different form of collateral damage risk faced by agri-food, including Canadian agri-food, that seems increasingly likely in this environment. Agri-food products are often employed as retaliation in trade disputes involving totally unrelated products. To illustrate, the two major concerns of the US with China were in regard to intellectual property and SOEs, along with the steel and aluminum tariffs. This provoked retaliation by China focused on the agri-food trade. That is, agricultural commodity trade bears an undue burden of retaliatory tariffs in nearly all recent cases. After the WTO Airbus decision (with no connection whatever to food and agriculture), the US appears likely to place tariffs on wine, cheese, Scotch, and other foodstuffs from EU countries as the

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primary means of redress. Clearly, agri-food is the “go to” weapon in trade retaliation.

Canada has limited power in geopolitical events of the current magnitude, but under the threat to rules-based trading, it will need to become much more familiar with it and develop a different strategy. Broadly speaking, Canada lacks leverage versus the large economies, a problem that the original WTO was designed to overcome. However, within this, Canada must seek out specific elements in which it has leverage that it can bear. Agri-food is one such area.

Food security is a matter of high importance for China, as it cannot feed itself.<sup>14</sup> Surely this is a key strategic motivation for the BRI. Food security is an important issue among other developed countries as well, such as Japan. The sheer magnitude of disruption due to ASF in China and throughout Southeast Asia overlaid on this creates an entirely unprecedented situation, only still developing and for some years ahead. Food price inflation is taking hold in China, and the effects will export meat price inflation globally, likely for some years.

In this context, it is not in the interest of China to limit its foreign meat suppliers. Some evidence that the Chinese government is aware of this is contained in recent announcements by China of blanket export approvals of meat plants in Brazil<sup>15</sup> and Argentina<sup>16</sup>. As a meat exporter, Canada has leverage in this regard, suggesting a way forward with China on trade issues regarding beef and pork that Canada can engage.

The US also has an interest in Canadian agri-food. Its food processing industry is vulnerable to the prospect of any change that would reduce or limit its access to

Canadian bulk or intermediate product imports and/or the Canadian consumer market for its outputs. The recent news on US manufacturing is bad, with manufacturing showing its worst results since the great recession- the apparent victim of the US trade war.<sup>17</sup> According to the US Bureau of Economic Analysis in 2015, Food, Beverage, and Tobacco Product manufacturing was 12% of US manufacturing GDP- falling only behind chemical products (17%) and computer and electronic manufacturing (13%). The US administration has demonstrated that its preferred (and perhaps only) negotiating tactic is escalation. With the developing risks of USMCA passage and prospect of US withdrawal from NAFTA, if threatened Canada can focus on agri-food as an important point of trade engagement with the US.

More generally, Canadian agri-food cannot stand still, uphold free market/WTO principles in isolation, nor “*ad hoc* support” its way out of this; the international environment has already changed too much. Among a range of its apparent options are:

- Pursue a revamp of WTO or a new trade policy alignment and rules with “willing countries”
- Food may be an entry point in discussions with China, not necessarily to settle current drivers in Canada’s tensions with China, but rather as a means to extend goodwill and willingness to engage
- Canada will need a new agreement with the UK post-Brexit. The apparent default is the CETA framework, but Canada could explore a further, more intimate commercial relationship in a Canada-UK trade agreement

<sup>14</sup> Less than a decade ago, China was a net exporter of agri-food products; in short order, this situation has reversed itself.

<sup>15</sup> <https://www.reuters.com/article/us-brazil-meat-china/china-clears-25-brazil-meat-plants-for-export-lifting-shares-idUSKCN1VU1IN>

<sup>16</sup>

<https://www.globalmeatnews.com/Article/2019/09/23/China-increases-number-of-approved-Argentine-meat-plants>

<sup>17</sup> <https://www.reuters.com/article/us-usa-economy/us-manufacturing-dives-to-10-year-low-as-trade-tensions-weigh-idUSKBN1WG47G>

- Finding, developing alternative crops to lower dependence on a few large ones and to offer flexibility in responding to market changes; Canada has excelled at this in the past
- Broaden Canada's diplomatic messages at UN and other fora to specifically include agri-food trade. Canada will not use food as a weapon in dealing with other countries; how can we assist other countries to join us in this commitment?
- Canada has a comparative advantage in sustainable natural capital to produce food. In some cases (e.g., GHG's) this can be measured and validated. Other food exporting countries lack Canada's natural resources or fail to manage them sustainably. To protect its resource base from imports that are not produced as sustainably and are thus underpriced, Canada may wish to consider a tax on agri-food imports,

A number of these options would have been seen as extreme, wrongheaded, or even absurd only just a short time ago, and some may be inclined to write them off as antithetical to Canadian agri-food's committed free and open trade posture. It is an indication of the seriousness and abrupt change in the situation that these now warrant some consideration.

Moreover, the negative tone may seem exaggerated or even dire. This serves to underline the point that no stabilization payment package, nor crop disaster or livestock disease emergency elsewhere that shocks supply and temporarily lifts Canadian farm prices can change the fact that the world is turning away from liberalized, rules-based trade. Canada needs to face and adjust to this reality.

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