IMPLICATIONS OF THE NAFTA FOR THE NORTH AMERICAN FOOD INDUSTRY

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This paper provides comments on the implications of the North American Free Trade Agreement (NAFTA) on the North American food industry. The workshop is billed as a "Report Card on Agriculture under the NAFTA", but agriculture and food are intimately connected, partially as a result of the NAFTA. The agri-food industry is, today, an integrated supply chain that is driven by consumer demand for food products. It includes production, processing, wholesale, retail distribution and finally the food service sector, the latter two being where most consumers are making their food choices. Producing and selling commodities without an awareness of the North American consumer marketplace is not a realistic option today. Those companies in the food supply chain who do not adjust (i.e., adopt a market orientation) are facing serious difficulties.

As indicated in the background material for this workshop, the NAFTA had six objectives, two of which will be discussed here:

- elimination of barriers to trade and facilitation of cross-border movement of goods and services; and
- increasing investment opportunities in the NAFTA territories.

With respect to the North American food industry, both of these NAFTA objectives have been realized. Total NAFTA agri-food trade has increased substantially, and investment decisions in the agri-food industry are being made now on a North American (or global) basis, through the guarantee of market access and the removal of investment restrictions within the NAFTA countries. Agri-food industry integration is increasing in most sectors, and industry confidence is increasing in all three national jurisdictions. In the case of Canada, adjustments have occurred in an industry that was stumbling badly ten years ago.

TRADE FLOWS AND INDUSTRY ADJUSTMENT

From the wider food industry perspective, trade flow statistics can be misleading or problematic when attempting to determine industry adjustment patterns. There are three major reasons for this problem:

- first, companies may choose to invest in a country rather than trade with it. Consequently, investment data may be just as important as trade flows in understanding industry adjustment.
- second, export trade categories can mask major industry or market shifts. For example, including beverages within the broad “high value processed product” category masks significant intra-category shifts.
- third, export trade category titles may (falsely) imply that the adding of value to commodities is limited to certain categories. For example, the “bulk commodities” category suggests no adding of value by industry, when in fact grading or other value-added processes may be part of the sectoral marketing strategy.

The NAFTA trade data were grouped into five major categories for purposes of this conference. Below is a listing of some subcategories in each of the five categories, and a brief commentary related to industry adjustment strategies.

1. **High Value Processed Products (HVPP)**
   - Red meat and Poultry meat.
   - Dairy products, Milk and Eggs.
   - Processed Fruit and Vegetables.
   - Sugar products.
   - Imitation Dairy products.
   - Packaged and Branded food products.
   - Beverages [Juices, Water, Beer, Wine].

The HVPP category typically attracts the attention of policy analysts and industry specialists. Today, the common wisdom suggests that countries exporting HVPPs have made the adjustment to the globally competitive agri-food industry. Although all products in this category have had value added, there is a considerable range of value-added, and the mere presence of value-added does not guarantee the product has a sustainable or profitable market in North America.

The red meat, poultry, dairy and egg industries have all experienced significant restructuring and rationalization over the past ten years in Canada and the United States. The result has been large regional processing facilities that depend upon high throughput to ensure low per unit costs. Smaller facilities have closed or shifted to producing niche products that can sustain higher-cost facilities. Dairy and sugar products have both experienced regulatory and restricted market access issues that has limited industry adjustment to some degree.

Beverages are a unique product area that requires separate consideration. The wine and beer industries have undergone substantial adjustment to meet the challenge and opportunity of increased market access under NAFTA. In Canada, the wine industry has moved towards a quality model to capture a domestic niche when protection was removed, In Mexico, beer products and exports have increased dramatically as United States and Canadian consumers were able to access the Mexican product more readily.

2. Processed Intermediates

- Live Animals and Birds.
- Flour and Starch.
- Feeds of all types.
- Oils and Fats.
- Hides and Fur.
- Wool and Hair.
- Soya products – vegetarian products.
- Ginseng Root – functional foods.
- Enzymes – products of biotechnology.
- Extracts/Oils – nutraceuticals.

Some of these sectors have low value-added (e.g., livestock), while others are extremely high value (e.g., enzymes). Many of these products are inputs to higher value products that may be manufactured by another NAFTA partner. Feed is a large, yet often forgotten, industry that can help intensive livestock operators remain profitable in light of tightening margins and reduced protection at the border. Livestock and poultry producers in both Canada and the United States now own and operate their own feed mills, using vertical integration as an adjustment strategy.

Soya, ginseng, enzymes and extracts are emerging and growing industries resulting from increased consumer demand. These products more properly belong under the HVPP category.

3. Produce and Horticulture

- Fruits.
- Vegetables and Potatoes.
- Flowers and Plants.
- Nuts and Spices.
- Mushrooms.

Fresh fruits and vegetables, fresh mushrooms, and floriculture and nursery products are all "commodity-like" products, but with significant added value that makes the horticulture industry one of the most profitable and dynamic in the agri-food industry. Adjustment to the NAFTA has been dramatic in this sector. Both increased market access through lowered tariffs and improved sanitary and phytosanitary rules have encouraged sectoral growth. For example, the greenhouse vegetables industry, including tomatoes, bell peppers and cucumbers in both Canada and the United States have:

- added stickers to the produce;
- guaranteed quality;
- developed strategic partnerships with competitors; and
- undertaken cooperative seasonal marketing.

This is a dramatic development over the past 10 years and at least partially reflects the fact that NAFTA reduced border protection against Mexican horticultural products.

4. Bulk Commodities

- Grains.
- Oilseeds.
- Cotton and Jute.
- Coffee Beans.

Bulk commodity trade is the traditional mainstay of agricultural trade. Needless to say, bulk commodity trade is a much reduced percentage of total agri-food exports in all the NAFTA countries. However, value can be added to these commodities. Examples include:

- organic bulk commodities
- quality grading systems, such as the one for Canadian grains; and
- speciality marketing of commodities with unique markets, such as "fairly traded" coffee beans.

5. Related Agriculture

- Fish and Shellfish.
- Lumber and Wood products.
- Spirits.
- Cigarettes and Cigars.
- Wool and Cotton Yarns.

For the United States and Mexico, related agriculture is less than 10 percent of their export shares. However, for Canadian exports to the United States, the figure is almost 60 percent. This is caused by Canada's large forestry and fish exports to the United States. It may be useful to remove this category from the trade analysis and consider the adjusted results.

FOOD INDUSTRY ADJUSTMENT TO NAFTA

There have been at least four areas of adjustment in the North American food industry:

- moving to a consumer focus;
- developing supply chain relationships;
- undertaking appropriate marketing strategies; and
- organizing into globally competitive operations.

The bottom line for the agri-food industry is that *demand, not supply, now drives the industry.* Strategic planning starts with the consumer, not the producer, the processor, or the retailer. The "consumer" is a spatial entity with dynamic tastes. Firms in the food industry ignore this reality at their peril.

Consumer Focus

A consumer focus requires that industry understand what the consumer wants. The considerations that must be made include price, quality, variety, safety and health, and nutrition of the products presented . Remember that old marketing saying, "There are three considerations in any purchasing decision – price; quality; and timeliness, and you can have any two"? Today's food consumer says: "No, I'll have all three!".

Today's consumer is also wealthier. As a proportion of 1998 disposable income, Canadians consumers spent 9.8 percent on food, the United States spent 10.9 percent, Mexicans 33.2 percent, the Japanese 17.8 percent and Australians 14.6 percent. For Canada and the United States, these percentages are at historical lows. However, North American consumers will resist any price increases.

As for variety and availability consumers want fresh produce such as apples, banana, mango, corn-on-the-cob, available every day; they want access to *any* product discovered in travel or from their home country; and they want products that are inputs to recipes available on demand such as shellfish, lemon grass, etc. Retailers will ensure these products will be available. They have access to imports and if the local source is short, product will be imported.

Food Safety and quality are also important. Historically, most agri-food products were grown, raised, processed or manufactured and consumed locally. Processors, retailers, restaurants and food service buyers largely purchased locally. Consumers did not question the food chain on safety, and food safety problems were "localized" or, in the case of imports, isolated at the border. This is no longer true today. Consumers now are educated, aware, and understand how to get attention, if they are concerned about food safety. The food industry is aware of this and has responded by demanding all food chain participants adapt food quality programs.

Food Supply Value Chain

Major players in the food supply value chain include consumers, retailers and food service outlets, wholesale/distribution firms, processors and producers of the primary product. A food value chain or supply chain is essential in the future. Margins are thin, so a supply chain offers great advantages to all participants. For example, in a supply chain arrangement, there is little chance that burdensome inventories will accumulate at any level on this chain.

Marketing Strategies

There are many marketing strategies, but the key is "adding value" to a commodity or product. Examples include the following:

- New food products such as nutraceuticals;
- Certified Products
    - Organics
    - "Angus" beef, speciality eggs;
- Quality Assurance such as "VQA" for wine;
- Farm processing/direct farm sales;
- Complementary marketing of products; and
- Regional marketing which might include
    - Local identification programs
    - Psychographic profiling.

Globally Competitive Operations

Today, competitive firms in the food industry:

- source product/inputs globally;
- provide quantity and quality based upon a national or continental market;
- invest in other North American markets; and
- protect domestic market through marketing strategies, not protectionism.

CONCLUSION

The agri-food industry continues to have difficulties adjusting to NAFTA in those sectors where government has guaranteed conditions for one or more industry stakeholder (e.g., income; price; stability; market share), or where government continues to regulate a sector (e.g., dairy; sugar). Where the agri-food industry has been allowed to adjust, the adjustment has moved the industry towards the market and the consumer.