



Policy Advisory Note:

If Canadian Food Companies are at Risk From US Tariffs, Canadian Agriculture is at Risk. We Need to Focus Support on Food Processors

Al Mussell, Douglas Hedley, and Ted Bilyea

February, 2025

As of mid-February, an expanding tariff and trade war initiated by the US against Canada and others appears imminent. US tariffs against a broad swath of countries, including Canada, have just been enacted on steel and aluminum. Canada has been given a reprieve on 25 percent uniform tariffs until early March, and what occurs after that is unknown- but it would be naïve to suppose that Canada could have anything approaching the secure trade environment that it has with the US going forward. Coupled with wrenching political changes in the US, and heightening geo-political tensions, the trade and foreign policy threat to Canada is certainly at the highest level since the end of the Cold War, and probably the highest since the Second World War.

Our existing agri-food policy structures are built on the footings of international rules-based trade, but this is rapidly eroding as the US adopts a growing list of exemptions to international obligations, including to Canada under CUSMA/USMCA. Government ministries of agriculture and agricultural industry associations in Canada are surely rushing to understand what their liability is or may become to this dramatic shift in US policy- in which US imports from Canada could face heavy tariffs, despite the US commitments under CUSMA/USMCA- and assessing what agri-food policy measures can and should be taken in response.

Canada's food manufacturers have been lower profile, at a distance in most agri-food policy discussions- especially those at the downstream end closest to the consumer. Indeed, most of the instruments of agri-food policy are targeted at the farm. But it is precisely the food companies that export foods and ingredients manufactured in Canada to the US, that stand to be the first casualties of US tariffs.

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Agri-Food Economic Systems 5225 7th Line RR#4 Rockwood, Ontario N0B 2K0 (519) 827-6239

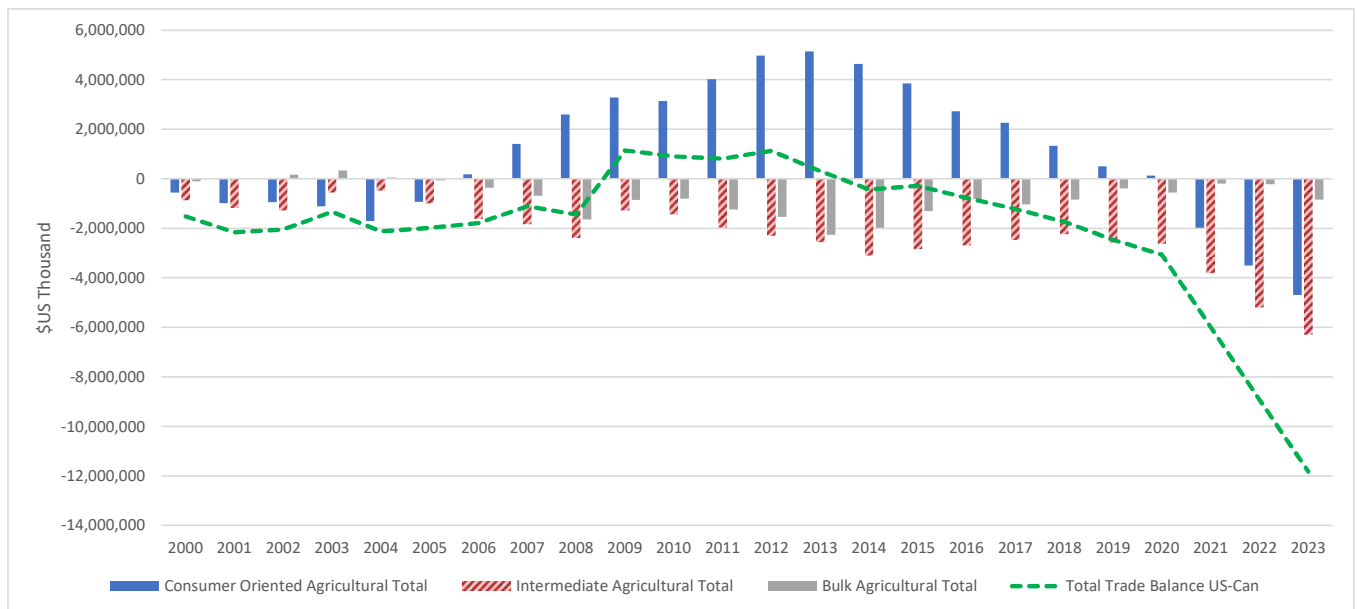
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This advisory note highlights the risk of US tariffs to Canadian food companies as exporters, connects this to the farm level and broader agricultural markets, and proposes some exceptional measures that may be required.

Canada is a Net Food Exporter to the US, and Suddenly That’s a Problem

Canada has emerged as a significant and growing net exporter of agri-food products to the US. Figure 1 below provides an overview since 2000, using the BICO aggregation and data obtained from the US exports to Canada minus US imports from Canada, in US dollars. On ready to eat foods, as represented by the consumer-oriented category, the US had a trade surplus with Canada that from the mid-2000’s to 2020; since then, the US has had a growing trade deficit with Canada in the consumer-oriented category, and a trade deficit with Canada in agri-food as a whole.

Figure 1 US-Canada Agri-Food Trade Balance



Source: USDA FAS-GATS

Figure 2 provides US imports of the major constituents of the consumer-oriented segment contained within the US trade deficit with Canada. The largest grouping of US imports from Canada, and the fastest growing, is bakery, cereal, and pasta manufacturing. US import values of beef have grown, along with fresh vegetables and processed vegetables and fruit. Food preparations are significant and growing; US pork imports from Canada are significant and steadier in nature.

Figure 2 US Leading Imports of Consumer Oriented Products from Canada, 2000-2023

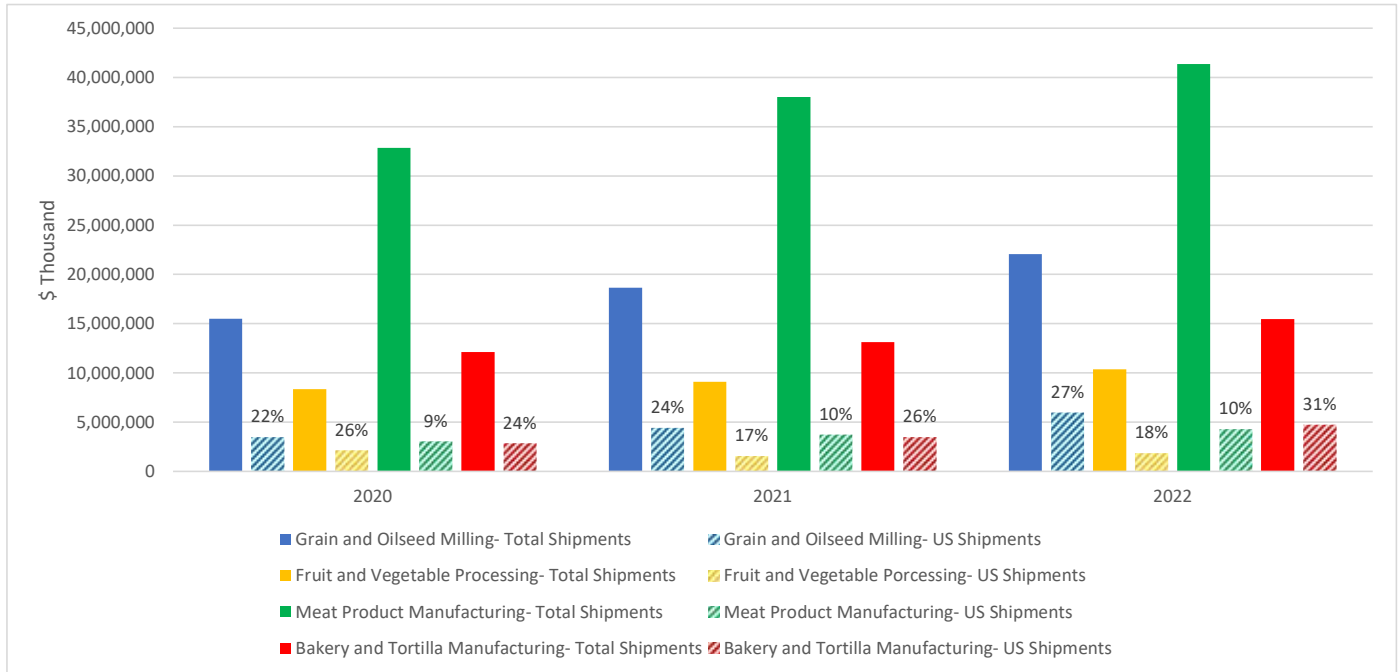


Source: USDA-FAS GATS

Some indication of this growth and significance in the value of processed food trade with the US is provided in Figure 3, which presents the total value of Canadian food processors shipments, and the value of shipments to the US, for selected NAICS food manufacturing categories in Canada. The total value of shipments by Canadian food processors increased in each year from 2020 to 2022 for all categories, and the value of Canadian shipments destined to the US increased as well, with the exception of fruit and vegetable processing. The percentages on the value of US shipments give the value of shipments destined for the US as a share of total shipments. The figure shows that for grain and oilseed milling and for bakery and tortilla manufacturing, the US share of the value has been increasing, most recently at 27 percent for grain and oilseed milling, and 31 percent for bakery and tortilla manufacturing. Meat manufacturing and processing is steady at 9-10 percent, but this will understate the situation for beef and pork processors, as the data includes poultry processing which is domestically-oriented. The share of US sales in fruit and vegetable processing declined from 2020 to 2022, and was most recently 18 percent of the value of shipments.

It is thus striking how exposed major segments of Canadian food manufacturing are to the vagaries of US trade policy- notably bakery/tortillas and grain and oilseed milling, each at close to 30 percent of sales.

Figure 3 Value of Total Shipments and US Shipments, Canadian Food Processing Segments, Selected NAICS Industry Groupings, 2020-22



Source: Statistics Canada. Table 36-10-0698-01 Origin and destination of manufacturing sales by industry, annual

Connecting Downstream Food Products with Farm Products

Farm products are exported from Canada to the US and to other markets around the world. For example, the US is a significant Canadian export market for wheat. In a 25 percent tariff situation, the effect would manifest itself quite directly on farm wheat prices- either in terms of an adjustment to volumes sold as the tariff must be added to Canadian product prices- but not on US or third country product in the US market; or conversely the tariff is sufficient to make Canadian wheat not price competitive versus US domestic product. It is a very tangible effect.

But other Canadian farm products also move from the farm through the Canadian handling system and into primary and further-processing into food products in Canada. As illustrated by the data above, some of the Canadian food companies involved have a significant US export business, and could be badly affected by US tariffs. But the effect is not immediately seen by the farmer- and presents negative impacts on Canadian agri-food that we may not otherwise see coming.

Figure 4 illustrates the essential economics for a generic processed food product. In the bottom panel is the market for the farm product where food processors purchase from farmers; the top panel illustrates the processed food market where the food processors sell to consumers or end-users. The volume is standardized for the yield of the farm product in generating the

manufactured food product. The demand for the farm product used in processing is derived from the supply of processed foods, tied together by a processing margin, which covers the processors costs and its expectations of operating profit. The farm supply has to do with the costs of producing the farm product and the profitability of alternatives that the farmer has. The demand from consumers is related to their preferences, their budget, and the price of alternatives. Initially this situation generates a marketed volume (Quantity), farm price, and food price as indicated in Figure 4.

Figure 5 explores what happens if the processor exports, and the exports become subject to a tariff. The tariffs are paid by consumers in the importing country; in order for the processors' product to be price competitive with like domestic and other product not subject to tariff, the processor must lower their price by the amount of the tariff. This causes the consumer demand facing the processor to shift to the left by the amount of the tariff. The reduced revenue causes the price realized by the processor to fall, and at this lower level of revenue the processor cuts back volume. Since nothing in the processor's cost structure has changed, the lower food price is simply transferred into a lower farm price, and concomitantly less farm product purchased.

It is reasonable to expect that most food manufacturers in Canada supply the domestic market, perhaps in addition to US or other export destinations, so the dynamic described above in response to a tariff applies only to a subset of the processors output. But as is evident above, some Canadian food processing categories have in the neighbourhood of 30 percent of sales as US exports, and as such could be severely impacted under a significant tariff. Moreover, the above assumes that the processor can simply pass through the effect of the tariff in a lower farm price- but if there is competition for the farm product with rival Canadian processors that are less exposed to the tariff, it may not be able to pass on the effect of the tariff and its margin becomes pinched, which ultimately undermines its economic viability. If that occurs, the local demand for the farm product disappears, and surely farm prices will fall. Alternatively, the processor may determine that the effect of the tariff is too much to bear by operating in Canada, and it will move operations to a location not subject to the tariff. This will also eliminate local demand for the farm product and weaken farm prices.

The situation is only slightly different if the farm product in Canada is priced based on US futures markets and a local spot market, adjusted with a price basis. In this case, the farm price can be relabeled "basis", and what happens due to the tariff is that it weakens the cash-futures price basis. If the processor ceases operations due to the tariff, the basis will weaken further.

There are some qualifications to this. If the exported food product is not generic, and instead is unique or a differentiated niche, the exporter may be able to pass through the effect of the tariff by the raising the price. In this case, there is a decrease in volume sold proportional to the price elasticity of demand, and a corresponding decrease in food and farm prices. This in turn will be a smaller adjustment than in the situation described above. For this reason, product differentiation can be a mitigation strategy. A similar situation plays out if there are no or

Figure 4

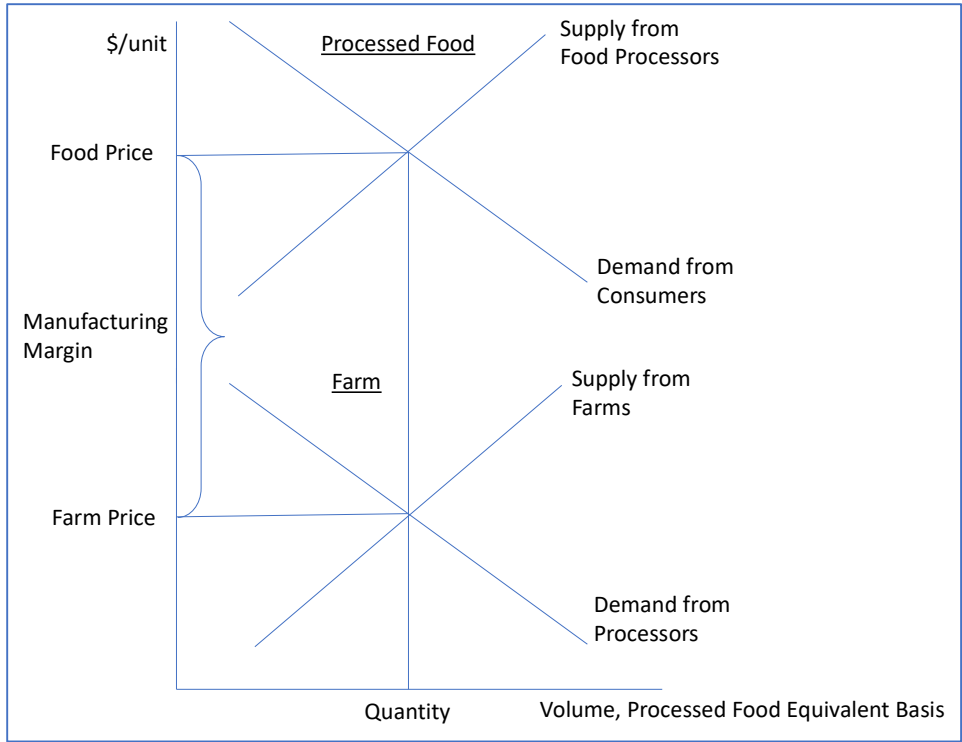
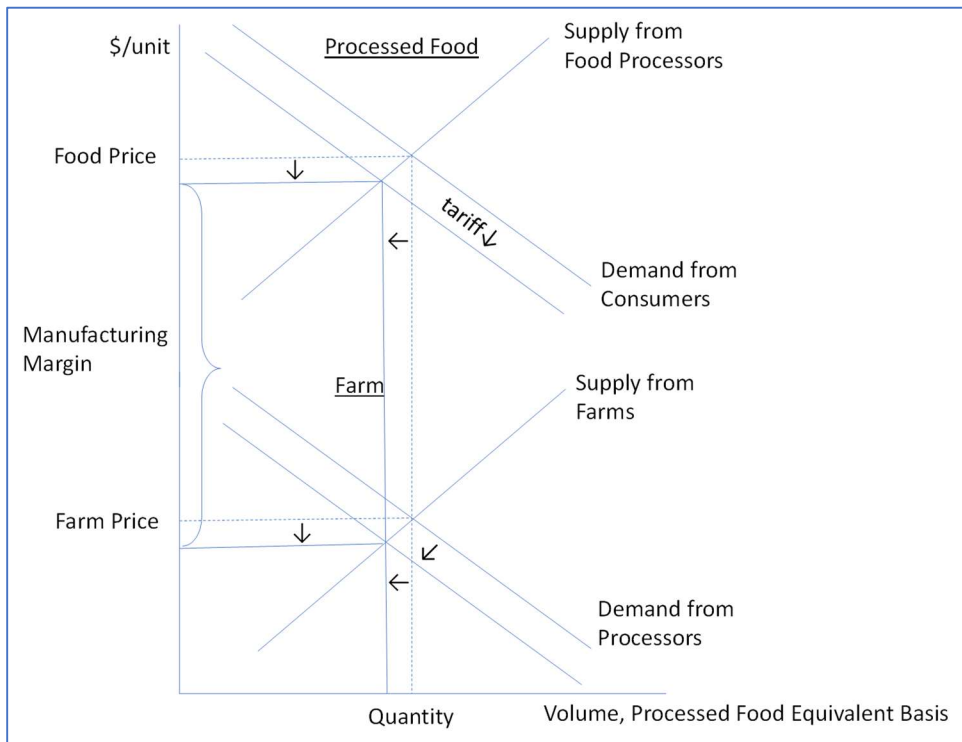


Figure 5



insufficient domestic substitutes for the product exported from Canada, or conversely if there is no or insufficient third-country supplies free of tariff available to substitute for the product exported from Canada.

There can also be indirect effects that blow back on Canada. As tariffs impact export sales, processors may pull some product back into the Canadian market, which then puts downward pressure on processed product prices, and thus competitors' prices and margins, which further reduces farm prices. The whole dynamic is playing out while the U.S. is a net importer of agri-food products in total, and as such it is difficult to imagine that U.S. tariffs on imported food will not trigger considerable inflation, and push up cost of production for processed foods in the U.S.

Policy Implications for a Tariff War Initiated by the US

Clearly, Canadian food manufacturing has been successful growing through exports to the US market, particularly in certain categories. But at this moment that success looks like a liability—some Canadian food processing categories are doing around 30 percent of sales as exports to the US. These are industry averages, so some Canadian food processors could be doing much more than 30 percent of their sales as exports to the US.

Surely many food processors are on edge and reviewing their options. Some may fear for their financial viability. Others are perhaps looking at relocation to the US due to the anticipated impact of US tariffs on their businesses. Still others are looking at doubling down on niche products in which they have few competitors, and could be capable of maintaining most of their sales despite the tariffs, or searching for other markets where they can redeploy their existing US volume.

There will also be knock-on effects that act across categories and commodities. For example, a hit taken by companies in the Canadian bakery sector obviously impacts grain milling and grain production; but it also impacts the supply chains and companies supplying other ingredients—such as eggs; dairy; vegetable oils; sugar; and others. Ironically, some of these ingredients may be imported by Canadian companies from US suppliers.

Moreover, there is a very direct connection between tariffs on food products exported to the US by Canadian processors and a reduction in farm prices, volumes of farm product sold, or both, going back up the supply chains. This will be missed by some, especially when there are direct exports to the US of bulk products like grain, and intermediate products like livestock and canola meal/oil which are more tangible. But the tariff effects on exports of manufactured foods effectively magnify the losses to farm products, and could come as a shock if not anticipated. And the data are telling us that we have a lot to lose in terms of processed food exports to the US.

Canada has had considerable success in penetrating the US market in the last few years and the US tariffs could not only halt the growth in exports but sharply reduce or eliminate recent gains, and undermine investments made by Canadian companies that underpin the export growth. With

major elements of Canadian food processing heavily leveraged into US export, it suggests the need to stabilize this segment against US tariffs to strengthen Canadian food processing companies' ability to operate in this environment, and to contain the hurt from being driven back up the supply chain and to Canadian farmers writ-large. The business risk management programs that farmers have for income stabilization are a blunt instrument with which to address this problem- that originates far distant from them with US tariffs on food products.

To forestall and contain the injury from the US tariffs, some selective government support may be needed to preserve the gains Canada has made in food exports. One option could be to develop a type of margin support program that can be offered to food processors that qualify based on their exposure to US sales. Such a program should be temporary in nature, and tailored according to the customer base and income statements of applying companies.

There may be more and possibly better ways of assisting/retaining US exports by Canadian food processors. For instance, perhaps government can compensate the amount of the tariff imposed to each company -for all of the tariff or a portion of it. If Canada in turn places tariffs on similar products coming in from the US, can our domestic industry have access to the resulting tariff revenues? Can we develop a policy mechanism to help facilitate exports and adapt our products to other markets? If Canadian exports are driven out of the US market, how can these displaced volumes that come back into the Canadian market be channeled to replace Canadian imports from the US- for agri-food products that Canada both exports to and imports from the US? There are many like products that move both directions between Canada and the US.

Equally, we will need a full court press for governments to prioritize trade agreements with large markets elsewhere, as well as making sure current agreements are working as they are supposed to for agri-food products. The ultimate goal of programming to assist food processors must be to improve competitiveness by enough to offset the effects of the tariff, and to diversify to other markets.

Another matter is timing. Do we assume that the tariffs will be in place for at least Trump's term in office? Or does one plan that the tariffs will disappear through some arrangement in under a year? Our strategies will need to take care of both of these scenarios. And the immediate response to urgently prevent permanent damage to the industry may need to change as time passes.

Canadian food manufacturers are competitive and accustomed to operating in a largely free enterprise environment, and some will not be pleased with the thought of support programming applied on a company basis. However, going out of business, shrinking, or picking up stakes and moving to the US could be the alternative for some Canadian food companies, which would shrink the Canadian agri-food sector as a whole. Canadian agriculture needs to find a way in which to stand behind its food processors, and in short order.

Canadian agriculture operates at a scale that exceeds the food demand of Canadians, so it must export. It needs food manufacturing to address perishability of farm products and to add value to farm product as well as to generate economic development through conversion to food products. It will need to have access to the US market, due to its market size and proximity. If US tariffs become a fixture of this, Canadian agriculture and food processing will need to adapt.