EU Export Certification

Kevin Grier

Senior Market Analyst, George Morris Centre, 225-150 Research Lane, Guelph, ON N1G 4T2
Email: kevin@georgemorris.org

Introduction

At the European Union (EU)-Canada Summit on May 6, 2009 in Prague, government officials announced the launch of negotiations towards a Comprehensive Economic and Trade Agreement (CETA) between Canada and the EU. The negotiations are scheduled to be completed by the end of 2011.

The Canadian pork industry has urged Canada to negotiate for the free and unimpaired access for Canadian pork products. They have also advocated for the recognition of mutual veterinary standards and the Canadian meat inspection system. The purpose of this paper is to assess market opportunities and challenges for Alberta pork in the European market. In essence this report assesses and explains the market opportunities and constraints that the Alberta pork industry faces in the EU currently and potentially in a post trade deal environment.

Trade between Canada and the European Union

Canada and the European Union have a long standing trade partnership. EU-Canada bilateral trade and economic collaboration was formally established through the 1976 Framework Agreement for Commercial and Economic Cooperation. Many sectoral agreements have been concluded over time while others are still under negotiation. The European Union (EU-27) is an important trading partner for Canada. It is Canada’s 2nd largest export market after the United States, while Canada is the 11th most important trading partner for the European Union.

The Canada-EU Comprehensive Economic and Trade Agreement (CETA) is intended to be comprehensive in scope, with negotiators suggesting that there
is a potential to exceed the scope of the NAFTA. There are two broad fronts contemplated in this process: one relating to trade and the other to areas of greater cooperation. Both parties entered into the process with all trade related issues on the table and subject to negotiation.

Agriculture is only one small part on the negotiation table as the main exports from Canada to the European Union are in manufacturing. Canadian food and live animal exports have a share of 1.9% of Europe’s total imports.

The agreement is intended to be ambitious in its scope and in its goal of freer trade between Canada and the EU. The timelines are very short given that an agreement is to be concluded by the end of 2011. The pork industry sees its specific goals as being consistent with the broad framework. That is, the main objective for the pork industry is free and unimpaired access for Canadian pork products to the EU.

- Tariff Rate Quotas and Non-Tariff Restrictions

Canadian firms wishing to export pork to the European Union face trade requirements such as Tariff Rate Quotas (TRQ’s), import licenses, sanitary prohibitions and other special conditions.

The total quota size for fresh and frozen pork only represents less than one half of one percent of the total EU pork consumption of 21 million tonnes. Within that tariff and quota regime, in 2008, total EU imports were estimated to be around 40,000 tons pw. That is, while the quota is very small, actual imports were smaller.

For further perspective, while Canada is allotted a specific quota of over 4,600 tonnes, actual export shipments for 2007 and 2008 were less than 2,000 tonnes. The total in 2009 is estimated at just over 4,800 tonnes according to Statistics Canada. All of the pre-2009 shipments would have only entered European ports, not the EU market proper. That is because prior to 2009, no Canadian plant was EU approved. In 2009, Aliments Lucy Porc, of Yamachiche, Quebec, began to ship fresh and frozen pork to EU markets. Les Viandes Du Breton of Riviere-dy Loup, Quebec is also approved. The point of course is that the quota overstates what is actually imported by the EU.

Tariffs represent a significant burden for European importers and exporters to Europe. There is a range of possible tariffs on a Euros per tonne basis. The low stratum of the range at about 250€/tonne, is approximately C$360/tonne at a representative exchange rate of 1.45 Canadian dollars to the euro. That in turn is C$0.36/kilogram on pork products that typically sell for $1-3/kg at the
plant in Canada. For further reference, in 2009 Canada’s exports to the EU averaged C$1.87/kg in unit value. At the low end, the tariff represents nearly 20% of the Canadian unit export value. At the upper end, the 434€ tariff is roughly C$0.63/kg. That upper end represents 34% of the Canadian export unit value in 2009. According to George Morris Centre estimates of Canadian packing industry margins, total gross margins in the fresh pork sector are typically around 20%. As such, the tariffs on quota products are at least as wide as industry gross margins.

In addition to tariffs and quotas, the high cost of meeting EU technical and sanitary requirements has curbed the number of US and Canadian pork plants willing to become EU-approved. In addition to those factors, there is also the tendency of the EU market to only take specific cuts. This leaves slaughter plants to cover the increased production and processing costs on only the small EU exported part of the pig. The balance of cuts are sold domestically as “commodity” products, with little or no premium currently available.

The EU bans pork from pigs fed on feed containing hormones. In particular, the Beta-Agonist Paylean (Ractopamine) is banned in the EU. Any pork intended for export to the European Union must be produced under a documented control system that will provide assurances that Ractopamine has not been fed to the animal. The EU ban continues to act as a major impedance to imports of pork from countries such as the US and Canada where the Paylean product is commonplace in feed. It means that pork for the EU market must come from animals finished on farms that are part of a US or Canadian government approved list of “Hormone Free” facilities.

All these factors from the tariffs to the non-tariff restrictions combine to substantially decrease the profitability of the EU market to North American exporters. The tariffs, quotas, plant requirements, technical issues and sanitary restrictions collectively comprise a thorough and imposing barrier to Canadian imports.

- The EU Pork Market

There is a strong demand for pork in the EU. This is demonstrated through the performance of the per capita consumption trends and the overall total consumption in Europe. EU pork consumption is much greater than in Canada. In addition to higher consumption, perhaps most interestingly, prices in the EU are very high in comparison to pork prices in North America. The very large price gap is due to the protective barriers in place for the EU pork market. North American processors can expect to see EU prices often two times greater than domestic prices.
While imports are very small, there is a wide base of countries and companies that are importing pork. The processing companies that utilize imported and domestic pork products are also varied and diverse in size and location.

Within that context, given the exceptionally small volume of imports, their usage has been limited and strategic. The key users of imported pork are the EU’s further processing industry, on the basis of price. There is some tactical use of imported pork as a means to negotiate or leverage the price of meat bought on the domestic markets. In addition, prices of imported pork are lower than domestic product prices in the EU. This is due to its position in the market as an ‘anonymous’ ingredient for the processing industry which has some preference for local origin.

With that said, there is an increasing focus on quality and importers are showing increasing interest in foreign suppliers that can consistently supply high quality product.

**Marketing Considerations and Constraints for Canada**

At first glance, wholesale pork price differences between the EU and Canada make this an attractive market for Canadian pork exporters. As noted above, however, there are a number of obvious constraints that Alberta and Canadian producers and processors will need to consider. These are the tariff and non-tariff barriers discussed in section 2 (*Trade between Canada and the European Union*). They are summarized as follows:

- Firstly the ban on hormones and Paylean in feed will require a specific, certified production unit for pigs that are to be used to supply the EU. Cuts not suitable to the EU would need to be sold on the domestic market.
- EU in-quota tariffs are high enough to erode some of the favourable price differential between the 2 markets.
- EU plant requirements and protocols.

Of the three issues above, the biggest issue regarding moving larger volumes is Paylean or ractopamine. Even if packers are willing and able to address the plant challenges and even if price points are profitable after tariffs, the Paylean issue will keep volumes low. Large scale plants will not be able to efficiently segregate and sort Paylean/ractopamine free pork. Even if packers are able to overcome those challenges, the added costs through the feed and production chain combined with the fact that only certain cuts will move to the EU, make this the biggest impediment. At the very least, if there is progress...
involving non-ractopamine issues in the agreement, the industry needs to work with CFIA to make the certification process simpler.

In addition to those issues, there are also important market factors including the following:

- EU processors would rather use EU supply, but will buy small volumes from non-EU sources (if cheaper) as a negotiating tactic to influence prices.
- Some of the US companies having the most success in exporting are using European based subsidiaries or partners in the EU to supply pork. That is to suggest that the most effective exporters might be those that have investments or at least strong partnerships in Europe.

While price has traditionally been seen as the most important driver for European buyers, quality of imported product is growing as a driver. Canadian suppliers have potential to develop a positive image in Europe as a reliable high quality origin for a number of products. In addition it is largely not seen as tainted by the US reputation for big industrial farming. In addition, there is the perception that the US is not a consistent supplier in terms of quality. Initial US shipments are often of higher quality than follow-up business. Canadian suppliers can benefit from a more positive impression and also benefit from becoming known as consistent suppliers of high quality product. Canadian firms should be able to outperform US firms on quality.

While it is a price driven market, as most markets are, there is no question that the European processors are starting to look to Canada for a steady supply of higher quality product. In addition, market intelligence from many European companies suggests that there might be potential for branding products in the EU. The EU might be the most branded market in the world.

In order for Canadian pork to be competitive in the European market, it will have to take a number of marketing steps, after complying with EU standards.

- Packers should offer service on the cuts sent, in respect to finishing and packing, to suit their EU customers, and to out-perform the US packers.
- Exporters should market under the positive image of the Canadian origin which may have affirmative connotations for marketing in the EU compared to product of US origin.
- For the more difficult EU foodservice sector, a well-established EU importer with good wholesale connections and who already operates in this area of the market should be used to position the product, and service clients.
In the long run direct relationships with processors should be developed, with the understanding that volumes are likely to make up a small share of that processors requirement. In the short term this business would probably be developed via an import trader in Europe.

Working with experienced Canadian trading firms can prove helpful in exporting pork and in gaining experience in this complicated market.

While Western Canadian companies face a freight disadvantage compared to eastern Canadian processors, they appear prepared and ready to compete in Europe. Canadian companies are poised now to address the hurdles that they face in Europe.

## Conclusion

Looking forward, any reduction in the trade barriers resulting from the CETA would be beneficial to Canadian packers. With that said, for there to be a meaningful breakthrough for the pork industry, there needs to be significant progress made towards achieving the goals set out by the pork industry. These goals call for major increases in tariff free quotas as well as equality of production and processing standards. The entire array of tariff and non-tariff barriers needs to be addressed if there is to be serious increase in access volumes and revenues.

With that said, it is unlikely that the non-tariff barriers will be reduced enough in these negotiations to result in a serious increase in access. The EU is expected to be intransient in particular on the non-tariff barriers. If, however, these pork industry goals are met, it would make a major positive difference for the Canadian industries.