SENATE SÉNAT

CANADA

CATTLE SLAUGHTER CAPACITY IN CANADA

Interim Report of the Standing Senate Committee
on Agriculture and Forestry

Chair
The Honourable Joyce Fairbairn, P.C.

Vice-Chair
The Honourable Leonard J. Gustafson

May 2005

MEMBERSHIP

The Honourable Joyce Fairbairn, P.C., *Chair*

The Honourable Leonard J. Gustafson, *Vice-Chair*

And

The Honourable Senators:

*Jack Austin, P.C. (or William Rompkey, P.C.)
Catherine Callbeck
Aurélien Gill
Elizabeth Hubley
James F. Kelleher, P.C.
*Noël A. Kinsella (or Terrance Stratton)
Terry Mercer
Donald H. Oliver
Robert W. Peterson
David Tkachuk

*Ex-officio members

In addition, the Honourable Senators Percy E. Downe, Rose-Marie Losier-Cool, Frank W. Mahovlich, Elaine McCoy, Grant Mitchell, Pierrette Ringuette, Herbert O. Sparrow and Marilyn Trenholme Counsell were members of the Committee at various times during this study or participated in its work.

Staff from the Parliamentary Information and Research Service of the Library of Parliament:
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Line Gravel
Clerk of the Committee

ORDER OF REFERENCE

<u>Extract from the *Journals of the Senate*, Thursday, October 19, 2004:</u>

The Honourable Senator Fairbairn, P.C. moved, seconded by the Honourable Senator Pépin:

That the Standing Senate Committee on Agriculture and Forestry be authorized to hear from time to time witnesses, including both individuals and representatives from organizations, on the present state and the future of agriculture and forestry in Canada.

That the papers and evidence received and taken on the subject during the Third Session of the Thirty-seventh Parliament be referred to the Committee;

That the Committee submits its final report to the Senate no later than December 23, 2005, and that the Committee retain until January 31, 2006 all powers necessary to publicize its findings.

The question being put on the motion, it was adopted.

Paul Bélisle
Clerk of the Senate

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CHAIR'S FOREWORD

While some agricultural sectors, such as the grain and oilseeds industry, seem to face chronic unfavourable conditions, the Canadian cattle industry has always been very successful at taking advantage of market opportunities. Trade liberalization with the United States has been the driving force of the growth of that industry in the last two decades. The integrated North American cattle market has however proven to be operating on a fragile equilibrium: one single case of BSE resulted in an immediate shut down of Canada's foreign markets, including the most important one south of the border.

The fall-out from the discovery of Bovine Spongiform Encephalopathy (BSE) in Canada in May 2003 will have lasting effects on the Canadian cattle industry. The negative impact of the border closure is still being felt across the country. Canadian ranchers have always been fierce promoters of the independence of their industry from government intervention. However, because the BSE crisis is beyond the control of the industry, a new form of cooperation between farmers, ranchers, processors and governments is required to find solutions to the crisis. Members of the Senate Committee recognize the tremendous cooperation among all stakeholders.

This is a follow-up to another report entitled, *The BSE Crisis – Lessons for the Future*, tabled in April 2004. At that time, the Committee, under the Chairmanship of Senator Donald Oliver, felt there was an urgent need to study the implications of this situation and explore potential solutions, with the aim of preventing the recurrence of such a disaster. The Committee then recommended shifting the industry from being "live animal oriented" to "meat and processed products oriented" and increasing the meat processing capacity in Canada. It was also the Committee's view that Canada, the United States and Mexico must find a way to use tools within the North American Free Trade Agreement in a manner that would preclude instant closing of borders in the face of any similar occurrence in future trade difficulties.

Over the past 6 months, the Committee heard from government ministers and officials, farm groups, bankers, processing industry groups and a number of farmers who are trying to expand Canada's beef packing capacity. The committee also travelled to Washington, D.C., in March 2004 to strengthen connections with representatives in both Houses of Congress as well as key national farm organizations and think tanks located in the U.S. capital.

This report offers an overview of the efforts that have been made and provides directions to improve the current measures developed to reach the goal of facilitating increased domestic slaughter capacity. This report is the result of an extraordinary series of meetings. The Committee wants to thank all the witnesses for their time, frankness and clarity of their presentation, which have been the basis for our recommendations.

Joyce Fairbairn
Chair

CATTLE SLAUGHTER CAPACITY IN CANADA

I. INTRODUCTION

Since 20 May 2003, the work of the Standing Senate Committee on Agriculture and Forestry has focused on the fallout from the first discovery in Canada's domestic cattle herd of Bovine Spongiform Encephalopathy (BSE), commonly known as "Mad Cow Disease." Following that discovery, the United States quickly closed its borders to our cattle, as did several other nations. These events had a profound impact on our cattle industry and on related industries, processors, truckers and the marketplace itself.

In April 2004, the Committee tabled an interim report, *The BSE Crisis – Lessons for the Future*, that focused particularly on the need to increase meat processing capacity in Canada. Prior to the border closure, Canadian ranchers had access to packing plants not only in Canada but also in the United States. They were thus able to benefit from keen competition between packers when they wanted to sell their livestock. However, the extent of Canada's dependence on our neighbour's infrastructure to process our animals proved to be a weakness once the U.S. border was closed to all live cattle. The closure has also done great harm to the U.S. processing industry, which relied on the supply of Canadian cattle. It has become clear to the Committee that one lesson learned from the current BSE crisis is that Canada must restructure its packing industry. That view is shared by the government, which on 10 September 2004, announced a **strategy to reposition the Canadian livestock industry**.[1] The four elements of the strategy are:

- reopening the U.S. border;
- facilitating increased domestic slaughter capacity;
- sustaining the industry until capacity is increased; and
- increasing the international market share of Canadian beef.

[1] Federal funding for the strategy was initially budgeted at $488 million, including $66.2 million to increase ruminant slaughter capacity and $384.7 million for industry support.

In recent months, the Senate Committee on Agriculture and Forestry has heard from government ministers and officials, farm groups, bankers, processing industry groups and a number of farmers who are trying to expand Canada's beef packing capacity. The committee also travelled to Washington, D.C., in March 2004 to strengthen connections with representatives in both Houses of Congress as well as key national farm organizations and think-tanks located in the U.S. capital. Anticipating that the border would open on 7 March 2005, BSE issues were at the top of each agenda. The new Secretary of the U.S. Department of Agriculture (USDA), Mike Johanns, told the U.S. House Agriculture Committee he was looking forward to reopening the border.

Regrettably, hopes collapsed on 3 March 2005, when a federal judge in Montana issued a preliminary injunction to stop the border opening. Although the border issue is still in the hands of the U.S. judicial system, the Committee believes that Canada must continue its pressure on the United States and continue to assist its own processing capacity to be ready to face tougher competition when the border reopens. We must not underestimate that challenge, and the Canadian cattle industry must make hard choices to continue to grow. The Committee firmly believes that the necessary evolution of the industry will reinforce Canada's reputation as a reliable source of safe, high-quality beef. The industry, with governments' support, must make the Canadian packing industry stronger so it can benefit all cattle producers and Canadians across the country.

This report outlines the recent evolution of the North American packing industry, and then focuses on some key elements of the government's strategy that are designed to help build new packing capacity. The remainder of the report highlights witnesses' concerns with respect to a number of issues including a national domestic standard, food and feed safety regulations, traceability, BSE testing, export markets and the beef import policy.

II. THE CHANGING SITUATION OF THE NORTH AMERICAN PACKING INDUSTRY

A. May 2003: Canadian Dependence on U.S. Facilities

Prior to the discovery of BSE in May 2003, trade of live cattle and beef products occurred on a North American basis. In 2002, almost half of the cattle sold in Canada were exported as either live animals or meat. Of this amount, over 70% of Canada's exports of beef products and virtually all of our exports of live cattle were destined for the United States. Canada typically exported approximately 1.1 million head of cattle to the United States each year.[2]

The cattle industry on both sides of the border became increasingly vulnerable as the packing industry developed into an integrated North American trade. While, due to a number of production factors, the size of the U.S. cattle herd declined by 8% over the past nine years, a growing supply of Canadian cattle allowed U.S. slaughter plants to continue operating at capacity. By the same token, under-capacity for slaughtering in Canada made Canadian beef producers increasingly dependent on American slaughterhouses.

Table 1: Canadian and U.S. Annual Cattle Slaughter Rates (Million head)

	2004	2003	2002	2001
Canadian Slaughter Rates[3]	**3.9**	3.16	3.46	3.37
U.S. Slaughter Rates[4]	**32.7**	35.4	35.7	35.3

[2] Competition Bureau, "The Competition Bureau's Examination Into Cattle And Beef Pricing," News release, 29 April 2005.
[3] CanFax, *2004 Annual Report*.
[4] U.S. Department of Agriculture National Agricultural Statistics Service, *Livestock Slaughter: Annual Summary*, 2004, 2003, 2002, 2001.

B. The BSE Crisis: Building Canadian Capacity and Reducing U.S. Capacity

The border closure resulted in an immediate and substantial decline in the available supply of cattle for U.S. packers and an oversupply in Canada where cattle production greatly exceeded existing slaughter and processing capacity.

In Canada, the packing industry responded to the new market conditions, principally by building domestic slaughter capacity. In 2004, capacity growth was driven in part by expansion of existing operations through the addition of extra shifts, Saturday kills, or routine overtime. In addition, Gencor Foods Inc. in Ontario, and Blue Mountain Packers in British Columbia reopened slaughter plants. New packers entered the market. Notably, Atlantic Beef Products Inc., a new plant located in Prince Edward Island, commenced operations in December 2004.

At the end of 2004, Canada's federally inspected slaughter capacity was approximately 81,000 head per week.[5] Provincially inspected slaughter added another 4,500 head per week, providing a total Canadian slaughter capacity of 85,500 per week or approximately 4.3 million head annually. The Canadian slaughter rate in both federally and provincially inspected facilities was just over 3.9 million head in 2004; this was the highest rate since 1978, when 4 million head were processed.

Slaughter capacity continued to grow during the first half of 2005 as the newly opened firms completed their set-up phase and kills expanded to maximum plant capacity. In addition, Tyson Foods and Cargill Limited both announced significant expansions. Depending on utilization rates within the plants, slaughter in 2005 is projected to range between 4.2 and 4.6 million head, an increase of between 21 and 33% compared to pre-BSE levels (2002). Other proposals currently under discussion could result in additional capacity over the next two years, facilitating an annual slaughter target of 5 million animals by 2006. This would represent an increase of over 40% compared to the 2002 level.

[5] Cull animals (typically those older than 30 months from dairy and breeding herds) made up approximately 10,500 head of this total; fed cattle comprised the remaining 70,500 head per week.

In the United States, the impact of border restrictions was greater in regions where packing plants relied heavily upon Canadian cattle imports for capacity utilization. Canadian imports represented 30% of cattle slaughter in Utah, 19% in Washington and 10% or more in Minnesota, Michigan and New Jersey. As a result, many U.S. slaughter plants are facing financial difficulties, and have stopped production and laid off workers:

- Several plants have closed, including the Iowa Quality Beef plant (Tampa, Iowa) in August 2004, the Simplot Meat Products plant (Nampa, Idaho) in September 2003, and the Ferry Brothers plant (Ferndale, Washington);
- Two Swift and Co. plants cancelled shifts, including the plant in Greeley (Colorado) where only about 3-5% of cattle slaughtered had come from Canada; and
- More recently, Tyson Foods suspended slaughtering operations in its plants in Denison (Iowa), Norfolk and West Point (Nebraska), Boise (Idaho) and Pasco (Washington), affecting 2,100 workers over six weeks (January and February 2005). These plants had been running at less than 75% of capacity, 10-15% below historical levels, because of the lack of cattle to process.

C. And Now? Sustainability of the Packing Industry in Canada

The U.S. border remains closed to all live cattle and meat from animals older than 30 months. Nevertheless, this situation will not last indefinitely. For many witnesses, confronting U.S. competition when the border fully reopens has become the next major challenge for the industry. At that time, it is expected that U.S. packers will try to regain their lost share of the Canadian cattle supply by offering more competitive prices to producers, thus making it less profitable to process cattle in Canadian plants. Many witnesses agreed that returning to the same dependence on exports of live cattle is not an option for the long-term sustainability of the beef industry, and they suggested options for sustaining the recent increased capacity in Canada.

Over the years, the meat packing business has been characterized by low margins which have led to the consolidation of the industry. Even today in Canada, four facilities are responsible for processing close to 80% of the Canadian production of fed cattle, and two facilities process 90% of cull animals. According to the Canadian Meat Council, this consolidation, by allowing processors to increase efficiency and ultimately profitability, has enabled the Canadian industry to compete internationally.

It is precisely the increase in profitability, particularly following May 2003, that raised some Parliamentarians' concerns when significant decline in prices paid to Canadian cattle producers did not equal similar decline in retail prices for beef. In response to these concerns, the Competition Bureau began an examination on February 2004 with the mandate to determine if "there were agreements among beef packers to lower prices paid to cattle producers or among grocers to raise or maintain retail prices for beef. The Bureau also examined whether pricing patterns were the result of one or more dominant firms engaging in a practice of anti-competitive acts that restricted competition."

The Bureau found no evidence of collusion or abuse of dominance by beef packers or grocers. It concluded that beef prices are set in a North American basis because of the reopening of the U.S. border to boneless beef exports from cattle UTM, and cattle prices dropped because producers have no other choices than selling to Canadian slaughterhouses, resulting in a massive oversupply. Cattle prices tend to be volatile since they are normally set in auction markets, and lower cattle prices do not necessarily lead to lower consumer prices for beef because the latter includes a number of other fixed costs such as labour and transportation. Finally, the Bureau concluded that the size of a business, even one that dominates a particular market, does not itself raise an issue under the *Competition Act* unless the business engages in conduct to restrict competition.

Consolidation in the packing industry, however, has long been a concern for cattle producers in North America. When a small number of large firms dominate, they can exert significant control over purchasing prices. That concentration of market power enables these firms to generate higher profits, especially when conducting business with much smaller and less organized participants, like farmers. Accordingly, some observers have expressed concern over an April 2005 proposal by the American giant Cargill Foods Ltd to take over the third-largest meat packing plant in Canada, Better Beef Ltd., located in Guelph, Ontario. If the takeover receives the Competition Bureau's approval, Cargill will control over 50% of the federally inspected fed cattle slaughter in Canada. The proposal was nevertheless well received by the cattle industry because of the potential to enhance export opportunities.

Canada is taking advantage of the opportunity offered by the current crisis to restructure its packing industry and reduce its dependence on exports, particularly of live animals. Market forces, on the other hand, appear to be dictating a trend toward concentration for the North American packing industry if it is to remain competitive on the world market.

One of the lessons learned from the BSE crisis, however, is that concentration and increased competition from the United States need not inevitably lead to the pre-BSE trend of fewer packing plants in Canada. The Canadian beef industry must continue its current effort to become more "meat and processed products oriented" rather than "live animal oriented," as the Committee indicated in its April 2004 report, *The BSE Crisis – Lessons for the Future*. The industry has come to realize that some risks inherent in the beef industry are more manageable with processed products than with live animals.

In order to both capture value-added benefits and ensure the long-term viability of the industry, one strategy of the Canadian packing industry must be to secure the supply of Canadian cattle. This strategy has been successfully pursued by the larger international conglomerates. More vertical integration in the packing industry will be made possible through a strong partnership between cattle producers and the packing plants, such as farmer-owned plants (co-operative or majority shareholders), and strategic alliances with retailers or secondary processors. Many groups of farmers are currently involved in projects to start up new packing plants, recognizing that by acquiring plants, they can become less vulnerable to other crises. The Committee notably commends the Fédération des producteurs de bovins du Québec on its effort to buy two packing plants in order to move up the value chain and retain a larger share of the profits. Such arrangements can also allow a fully traceable system from the calf to the meat, a feature that may appeal to some customers.

Another strategy being pursued mainly by smaller processors is the development of differentiated products. Smaller packers are becoming increasingly successful at targeting their products regionally and developing niche markets that may not be attractive to larger producers. Smaller firms are also becoming more knowledgeable about related concepts such as branding and marketing, and can adapt more quickly to emerging consumer preferences. New plants such as Atlantic Beef Products Inc. are currently pursuing that strategy for long-term sustainability. Another strategy that benefits large and small producers alike is the industry’s efforts, with government assistance, to diversify its world customer base in order to reduce future dependence on the U.S. market.

There was broad agreement that adequate start-up capital is vital to ensure the long-term competitiveness of new facilities. Given the cattle industry’s difficult financial situation, however, governments need to provide financial support for the transition to a new domestic marketplace that will give producers the option of investing in value-added products and processes, and create the appropriate domestic competitive tension with the large commodity-based processors. The Committee notes that many of these concepts have been incorporated in the government’s current strategy to assist Canada's livestock industry in repositioning itself to ensure its long-term viability. The strategy announced in September 2004 includes continuing efforts to reopen the U.S. border, taking steps to increasing ruminant slaughter in Canada, introducing measures to sustain the cattle industry until capacity comes on line, and expanding access to export markets for both livestock and beef products.

The Committee strongly believes, however, that we must not create an overcapacity to the detriment of long-term viability. Many slaughterhouse proposals and initiatives are being discussed, and the risk of overcapacity may be a factor in some financial institutions' reluctance to invest in these ventures. The Canadian Co-operative Association indicated to the Committee that it encourages the federal government to work with the beef industry to explore ways to coordinate the development of new slaughter facilities and the marketing of beef.

In summary, while consolidation is driven by market forces and appears inevitable to compete on the North American and world markets, there is room for smaller packing plants if they can secure their supply of cattle, raise adequate start-up capital and possibly target niche markets. In facilitating the emergence of these smaller-scale plants, the government could give more power to producers: it would increase the options available when they market their livestock, and/or producers would go up the value chain. The following two sections will provide recommendations to give impetus to restructure a packing industry where smaller-scale packing plants thrive alongside consolidated commodity-based processors to the benefit of cattle producers.

III. BUILDING ADDITIONAL CAPACITY

A. Financing New Plants

As part of the strategy to reposition the livestock industry, the government introduced a ruminant Loan Loss Reserve Program (LLRP) to support loans for the expansion and establishment of small and medium-sized slaughter facilities. In addition to the initial \$37.5-million reserve initially made available under the program, a further \$17.1 million was committed to the program in the 2005 Budget. The objective of the program is to reduce the risk to private lenders, facilitating financing for viable business proposals.

To date, two formal agreements have been signed with financial institutions to deliver the program (Farm Credit Canada and the Alberta Treasury Branches). The Minister of Agriculture and Agri-Food informed Committee members that negotiations were progressing with six chartered banks to conclude agreements with them. As of 30 April

2005, no loans had been finalized under the LLRP, although several applications were under consideration.

Along with members of the industry, financial institutions noted the importance of ensuring the long-term viability of new projects. A key principle of the program is that loans are to be made on commercial terms, with lending decisions made by participating financial institutions based on a business plan. While the reserve program mitigates some of the risks associated with new projects, lenders noted that it does not replace the need for a viable long-term plan that takes into account the reopening of the U.S. border to live cattle. Moreover, some witnesses noted that protection offered under the LLRP may be inadequate to convince lenders to support new projects.

Industry representatives suggested several revisions to the existing program that would better meet the needs of producers and others interested in setting up new facilities, as well as the lending institutions. There was broad agreement that adequate start-up capital is vital to ensure the long-term competitiveness of new facilities, as well as to secure bank financing – an element that is absent from the current program. The Committee heard several recommendations on this subject.

The Fédération des producteurs de bovins du Québec noted its support of an earlier recommendation made by the Canadian Cattlemen's Association (CCA) to replace the current program with a matching capital program. The Federation also supports new tax incentives for investment in slaughter facilities put forward by the CCA, including investment tax credits and accelerated amortization. Alternatively, the Canadian Co-operative Association suggested replacing the current program with a loan guarantee program. The Canadian Co-operative Association also advocates tax measures aimed at facilitating the provision of equity. It suggests implementing a cooperative investment plan that would provide a tax credit for individuals investing in agriculture cooperatives, including slaughterhouses. The program would assist new cooperatives in raising the initial capital required before seeking financing.

The Committee will monitor closely how the LLRP is meeting industry's needs as the situation evolves. Nevertheless, considering that the LLRP does not address the need for adequate start-up capital, a crucial element to ensure the long term viability of new projects,

Recommendation 1: the Committee recommends that the government complement the existing Loan Loss Reserve program with a capital matching program thereby addressing the need for adequate start-up capital to help ensure the long-term viability of new projects.

And

Recommendation 2: the Committee recommends that the government develop new tax incentives for investment in slaughter facilities including a cooperative investment plan that would provide a tax credit for individuals investing in agriculture cooperatives.

The Fédération des producteurs de bovins du Québec also recommended modifying the program to improve accessibility. Firstly, the program should be made available to all producers wishing to acquire slaughterhouse facilities, even if the acquisition does not immediately result in an increase in capacity. Moreover, the Federation notes that the program should not impose a ceiling on the sales of the eligible businesses. The Committee believes that farmers' investment in packing plants is a good way to secure the supply of Canadian cattle in slaughterhouses and make cattle producers less vulnerable to other crises, therefore

Recommendation 3: the Committee recommends that the government expand the eligibility of existing programs to producers or producer groups wishing to acquire slaughterhouse facilities.

Sound business plans are crucial to the sustainability of new packing capacity. Farm groups, however, do not have all the expertise for business planning in the value-added industry. Furthermore, the cooperative business model is one of the options available for farmers, who want to invest in slaughterhouses, therefore

Recommendation 4: the Committee recommends that the government reallocate funds from the strategy to reposition the Canadian livestock industry to enable farm groups interested in building slaughterhouses, including co-operatives, to undertake business planning and obtain expert assistance.

And

Recommendation 5: the Committee recommends that the federal government reallocate funds from the strategy to reposition the Canadian livestock industry to provide additional funding for the Advisory Services component of the Co-operative Development Initiative to enable regional co-op groups to provide expertise on the co-operative business model.

B. Approval of New Plants and Inspection Needs

Part of the funding promised under the Canadian livestock industry repositioning strategy is currently going to the Canadian Food Inspection Agency (CFIA) to streamline processes for the approval of new slaughterhouses under the *Meat Inspection Act*. In order to register a slaughter plant under the meat inspection regulations, an application must be submitted to the CFIA, along with detailed plans, blueprints and specifications of the establishment. The submission is reviewed by the agency and is conditionally approved if it meets the requirements prescribed in the regulations. Once the facility is built, the agency inspects it to ensure that it was built according to the approved submission. If the inspection is satisfactory, the building is registered and a registration number is issued.

Since the repositioning strategy was announced on 10 September 2004, the CFIA has received several requests for registration, including the following:

- Seven companies requested new plant registration, including the two establishments that started their operations at the end of 2004 (Blue Mountain Packers in British Columbia and Atlantic Beef Products Inc in Prince Edward Island). The CFIA anticipates that the remaining five establishments will be operational in approximately 6 to 12 months.

- Two existing federally registered plants passed final inspection by the CFIA and are approved to expand their slaughter capability to beef.
- Three federally registered beef establishments have requested approval to expand.

The Committee, however, heard concerns about the approval process. It took almost 5 months for the Blue Mountain Packers plant in British Columbia to be federally registered by CFIA, although the establishment was already an approved plant before it was bought by the current operators. The representative from Gencor Foods Inc. in Ontario, whose plant was approved in 2004, also mentioned that the blueprint approval process was not user-friendly. In his opinion, a process that should take 6 weeks can take 6 months.

Since then, however, the CFIA has implemented changes to its blueprint review. The blueprint approval has been decentralized and is now done in the area where the plant is located. The CFIA has also established a team of experts to expedite the review of new establishments for registration and licensing approvals. Nevertheless, it is still too early to tell whether these changes will be effective, and the Committee will monitor this issue very closely.

Increased packing capacity also means that more inspectors will be needed in the various establishments to inspect the meat. The federal model of inspection oversight requires that veterinarians and inspectors be in the plant throughout the time when animals are slaughtered. They provide oversight from a food safety perspective and an expert market standard perspective.

The CFIA has requested and received new resources to be able to keep pace with the industry as new plants come on-line and existing plants expand their capacity. The CFIA is monitoring the registration approval process, and, as new establishments approach the date when they are due to become operational, the Agency is proceeding with some anticipatory hiring and training of veterinarians and inspectors, so that they can be in place the moment these plants begin operations. As of 3 May 2005, the CFIA had hired an additional 10 veterinarians and inspectors to meet expansion plans, and the Agency anticipates that significantly more personnel will be hired over the course of 2005. The CFIA has also received some limited resources for use in assisting provinces in the inspection of provincial abattoirs, specifically for the purpose of ensuring that specified risk materials are properly removed.

IV. OPERATING ENVIRONMENT

In addition to facilitating the creation of new plants or the expansion of existing ones, the government can act in a number of areas to create a better operating environment for the packing industry. The two major areas of potential action are in food safety standards and international trade.

A. Food Safety Regulations

1. A National Domestic Standard

Slaughterhouses that sell their products solely in the province where they are established come under the responsibility of their provincial government. To be able to sell in another province, a slaughterhouse must be registered with the CFIA and comply with federal *Meat Inspection Act* requirements. The standard for interprovincial trade is therefore the same as for the foreign export trade.

Provincial packing capacity is relatively small (4,500 head a week), but it offers a window of opportunity that, if fully used, can address some regional problems. For example, the Fédération des producteurs de bovins du Québec mentioned that producers in Abitibi-Témiscamingue (Quebec) are located close to an Ontario provincial slaughterhouse but have to ship their cattle to Montréal for slaughtering. Many witnesses suggested the development of a national domestic standard that would allow interprovincial trade without authorizing foreign export trade. Witnesses also felt that, in order to be effective and credible to our trading partners, that standard should be under the responsibility of the federal government.

As mentioned above, the current standard for interprovincial trade is the same as for foreign export trade. According to the CFIA, certain terms and conditions in the federal standard that are demanded by our foreign trade partners could be removed from a purely domestic national standard, which would make interprovincial trade possible without authorizing foreign exports. CFIA officials indicated to the Committee that there is now an agreed-upon "meat code," which reflects an agreement between the provincial and federal governments with regard to basic minimum food safety standards for meat processing plants. For the new meat code to be operational, it would have to be enshrined in provincial regulations. Since the federal government has jurisdiction over interprovincial trade, the *Meat Inspection Act* would also have to be amended to either:

- allow interprovincial trade of meat produced in plants that are not necessarily approved by the federal government; or
- create another level of federally registered plants different than those allowed to export.

There are other implications since, in accordance with WTO obligations, the standard for interprovincial trade would then become the standard that Canada would request of foreign countries shipping meat to Canada. Since some imported meat products would meet the domestic standard, they could not necessarily be processed and re-exported. A thorough traceability system would then be needed to segregate products meeting the domestic standard and those meeting the export standard.

In its December 2004 report *Value-Added Agriculture in Canada*, the Senate Committee expressed its concern that interprovincial agricultural trade issues and barriers continue to exist and called on the federal and provincial governments to act on their Agreement of

Internal Trade promise to review agricultural trade in Canada. It is the Committee's view that interprovincial trade is too often a hurdle to the sustainability of the agriculture industry. Therefore,

Recommendation 6: The Committee recommends that the Canadian Food Inspection Agency immediately undertake a legislative review, in consultation with the industry and the provinces, and with due consideration of all trade implications, to propose changes to the relevant acts and regulations in order to implement a domestic standard allowing establishments that comply with this standard to trade with other provinces without being fully registered to trade on the international market.

2. New Food and Feed Safety Requirements

As scientific information surrounding health issues evolves very quickly, the meat packing industry must constantly adapt to new requirements dealing with food safety, and commit significant amounts of money and resources to ensure their products meet the highest standard possible. The government has recently proposed or introduced new health and safety requirements for the meat industry, including the mandatory implementation of Hazard Analysis Critical Control Point (HACCP) programs and the removal of bovine specified risk materials (SRM)[6] from the feed chain.

By the end of 2005, the implementation of an HACCP program will become mandatory in all federally registered meat and poultry establishments. As of December 2004, 86% of federally registered meat and poultry establishments had an HACCP program. Some of the new packing plants that testified before the Committee, however, mentioned it will be hard for them to meet the end-of-year deadline. In *Value-Added Agriculture in Canada*, the Senate Committee recommended that the federal government enhance funding to help small-scale food producers and processors achieve HACCP standards or other similar food safety and monitoring standards. Evidence provided during our

[6] SRM are cattle tissues that may contain the agent that causes BSE (brain tissue, bone marrow, etc.).

hearings on the packing capacity in Canada gives the Committee additional reasons to reiterate this recommendation.

Another new food safety requirement that affects the meat packing industry is the removal of SRM from all animal feed. SRM are now removed from the food system but can still end up in animal feed for non-ruminants such as hogs and poultry that are not susceptible to BSE. On 10 December 2004, the CFIA proposed a regulation that would require removing SRM from all animal feed, pet food and fertilizers. CFIA officials indicated that the proposed regulatory amendments will strengthen the feed ban and will serve to mitigate the effect of BSE in Canada more rapidly. Preventing SRM from entering the feed production chain enhances the existing feed ban by diminishing the effects of potential cross-contamination of animal feeds that could occur as feed is produced and distributed, as well as any inappropriate on-farm use. CFIA officials mentioned that the regulations could enter into force in the spring or early summer of 2005, following the end of the comment period and the publication of the regulations in the *Canada Gazette*, Part II.

In July 2004, the U.S. Food and Drug Administration also requested comments on the removal of SRM from all animal feed. In Washington, the Committee heard that the U.S. industry is opposed to this measure. Although teams of international animal health experts that reviewed the Canadian and U.S. responses to the discovery of BSE cases recommended this measure, the National Cattlemen’s Beef Association believes it is not supported by science, since there is already a high compliance rate with current ruminant-to-ruminant feed bans in Canada and the United States.

Although the ruminant-to-ruminant feed ban is effective, the removal of SRM from all animal feed will accelerate the eradication of BSE in Canada. The Committee believes our trading partners around the world must see Canada as doing everything to eradicate BSE from the national herd as quickly as possible. The Committee therefore supports this initiative.

Witnesses, however, expressed concerns on the costs for the industry of such a measure as well as the potential environmental impact. One witness indicated that 375,000 pounds of SRM per week will have to be disposed of in Ontario only, and estimated the Canadian production of SRM at 2 million tonnes per week. If the regulatory proposal comes into force, the disposal of SRM will have to be addressed. The generally accepted method is rendering and the rendered SRM can be buried in landfills or incinerated.

The proposed regulations do not deal with the issue of SRM disposal but Agriculture and Agri-Food Canada (AAFC) is leading consultations with all stakeholders, including the provinces, which have primary responsibility for waste disposal. AAFC tries to identify the best options for SRM disposal in each province because the environmental conditions vary from one area to another. The most significant challenge remains the transportation of the material, given that in most instances the density of animal population is not very high.

3. Traceability

Many foresee that traceability, the ability to track a food product from the farm of origin to the plate, will become something that will be required more and more in markets around the world. It is very important that Canada support any initiative to explore traceability from the first identification of animals through to the abattoir and onward into the market chain, so that if any problems arise it is possible to track the source of the food product.

Canada has already set up an animal identification system that puts our country many steps ahead of our trade competitors, including the U.S. CFIA officials indicated that the next objective is to register each animal’s date of birth in the data bank, as well as movements between farms. In Quebec, the provincial government has already the legislative framework in place to gather this type of information.

Through program requirements or regulations, the CFIA is creating, expectations for industry in terms of traceability on an establishment or on a product basis. Generally, the industry is required to be able to trace forward one step and trace back one step. In other words, it must be able to identify where the product is coming from and where it is going to. If an issue is identified with respect to food safety, the Agency wants to be able to follow that product throughout its life cycle. Through Can-Trace, an industry-led initiative, Canada is also trying to develop voluntary minimum requirements for national whole-chain tracking and tracing standards.

Atlantic Beef Products Inc. recently obtained funds from the Atlantic Canada Opportunities Agency (ACOA) and AAFC in order to implement a full traceability system for its products. In addition to food safety advantages, the technology that this plant wishes to implement would be able to virtually re-create a carcass and the cuts of each particular animal, and give the actual value per animal. Atlantic Beef Products has entered into an agreement with the federal government whereby it will test the technology and the equipment. Based on this traceability enhancement pilot project in Prince Edward Island, AAFC may decide that there is merit in expanding the system across Canada.

A full traceability system would have many similarities with HACCP programs, notably in terms of technical capabilities and record-keeping procedures. For many years, the CFIA had a voluntary program, the Food Safety Enhancement Program (FSEP), to help packing plants develop HACCP programs. The Committee believes the Canadian packing industry must stay ahead of its competitors and explore the possibility of being able to fully trace products. Therefore,

Recommendation 7: The Committee recommends that the Canadian Food Inspection Agency develop a program similar to the Food Safety Enhancement Program (FSEP) to help develop traceability systems in meat processing plants. Such a program should be funded to allow the meat industry to have such systems in place by 2010.

4. BSE Testing

When the world closed its doors to Canadian cattle and beef in May 2003, many options were discussed to try reopening foreign markets to Canadian meat. Since Japan, our third-largest export market for beef products before 2003 (after the U.S. and Mexico), tests all slaughtered animals for BSE, some suggested Canada should do the same to regain access to Asian markets.

The World Animal Health Organization (OIE) does not recommend testing all slaughtered animals as a measure to protect consumers from BSE. The removal of SRM is currently the best method to ensure the safety of meat. Given the long incubation period of the disease, young animals do not necessarily react to the test and it may create a false sense of security. Furthermore, if Canada were to test all animals for BSE, all carcasses or portions derived from a carcass would have to be detained until the results were known. This would require logistical changes in the plants (to provide extra storage, for example) and add significant further costs to the actual cost of the test.

Japanese authorities have commissioned scientific reviews to explore the idea of moving away from testing all animals. The Committee understands that Japan has already made a decision to move away from 100% testing and is going through a very elaborate process to implement a new system that is based on age verification. With the advice of their scientific community, Japanese authorities are considering establishing an age limit under which it will be deemed safe not to test for BSE. Only animals over that age would be tested. This would be more in line with practices in the European Union, where countries do not generally test animals less than 30 months old.

There have been proposals in Canada, however, to test all animals for "branding" purposes. Industry associations appreciate that there will be markets that will demand testing, and have suggested a pragmatic approach that provides for additional testing for meat destined for specific countries and markets that require 100% testing.

Nothing currently prevents a meat packing plant from hiring a private laboratory to do the testing, but there seems to be an interest in involving the federal government. For example, the Canadian Co-operative Association recommended that the federal government consider providing 100% testing of meat being exported to specific markets that demand it. CFIA officials indicated that the Agency is willing to discuss private-sector proposals to access specific niche markets that demand 100% testing, or any other type of testing that foreign markets might require related to residues of hormones, drugs, etc.

The Committee believes it is important that the federal government facilitate the work of meat packing plants that want to access specific niche markets. The government must provide quick and easy access to technologies such as test kits, or new processing methods such as hot boning, to maintain the Canadian beef industry's competitiveness.

The Committee believes it is important that the federal government facilitate the work of meat packing plants that want to access specific niche markets. In that context, the government has the responsibility to provide quick and easy access to technologies such as test kits, or new processing methods such as hot boning, to maintain the Canadian beef industry's competitiveness. The government must therefore give priority to the necessary research that would allow the industry to have access to such tools aimed at providing a competitive edge to the industry.

B. International Trade

1. Export Markets

Increasing the meat packing capacity in Canada is a strategic move by the beef industry to become less vulnerable and less dependent on the export of live cattle. It does not, however, change the industry's dependence on export markets. According to the

Fédération des producteurs de bovins du Québec, 60% of Canadian cattle production is exported either live or in beef products. It is therefore useless to increase the packing capacity if Canada does not have the opportunity to market the meat internationally. At the same time as the industry increases its capacity to produce beef products, Canada must work to reopen markets to Canadian beef and cattle around the world.

Canada has had some success in reopening certain markets to Canadian beef products, including the partial reopening of the U.S. and Mexican borders to some categories of beef products in August 2003. On 30 November 2004, Hong Kong agreed to resume imports of Canadian boneless beef from animals under 30 month (UTM) with all SRM removed. Cuba also reopened its border to a wide range of beef and beef products from Canadian cattle of any age. Cuba went further in March 2005 and agreed to conditions for imports of Canadian cattle, sheep and goats, bovine semen and embryos.

In March 2005, the United States completed a rule-making process to provide the necessary authority to reopen the border to certain classes of live ruminants and a broader range of ruminant products. This so-called U.S. "BSE minimal risk rule" amends the requirements regulating the importation of animals and animal products, and creates a new category for regions in which BSE has been detected in the national herd but in which precautionary measures have been taken that reduce the risk of BSE being exported to the United States. The rule, which was scheduled to take effect on 7 March 2005, adds Canada to this new category. In February 2005, U.S. Agriculture Secretary Johanns announced that the USDA would delay the effective date for allowing imports of beef from animals over 30 months (OTM), but the rest of the rule – notably the provisions allowing the importation of live UTM cattle for slaughter – would be implemented as scheduled. The rule does not include either OTM cattle or breeding cattle and replacement dairy heifers. A separate rule-making process addresses these classes of animals.

Anticipating that the U.S. border would reopen on 7 March, the Committee went to Washington to strengthen connections with representatives in both Houses of Congress as well as the U.S. Administration and key national farm organizations. On 3 March 2005, the Senate passed a resolution of disapproval of the rule.[7] In order to keep the rule from going into effect, this resolution would have to be passed by the House of representatives and signed by President Bush. In various meetings, the Committee was told the resolution is unlikely to be supported by a majority of representatives. Furthermore, the White House issued a press release on 3 March 2005 stressing its support for an open border, praising the work of Canada's scientists and government, and making it quite clear that President Bush, for the first time, would exercise his veto power should Congress demand a closed border.

Independently of the congressional review, on 2 March 2005, a federal judge in Montana ordered a preliminary injunction to halt the implementation of the rule until the Court has the opportunity to review it. This preliminary injunction was obtained following a lawsuit filed by the Ranchers Cattlemen Action Legal Fund United Stockgrowers of America (R-CALF USA). USDA appealed the preliminary injunction decision. This appeal, which will be heard in the U.S. Ninth Circuit Court of Appeals in San Francisco, and the Court case in Montana regarding the implementation of the rule, are expected to be dealt with this summer.

USDA officials indicated to the Committee that the U.S. Administration is hopeful that the case will be judged on its merits, because the merit is there; the USDA was very cautious in writing the rule and is prepared to reopen the border. USDA officials also mentioned that the rule providing for the reopening of the border to OTM cattle is in the process and the USDA wants to expedite it.

The Committee recommended in its previous report that one issue for which Canada should continue to fight is trade based on rules and scientific standards. Resuming normal trade for all types of beef products with the United Stated and Mexico, including meat from OTM animals, will send a strong signal to other trading partners in the world.

([7]) Fifty two senators voted in favor of the resolution of disapproval (including 13 republicans) and 46 against (including 4 democrats)

In our meetings in Washington, many shared the Committee's view that we cannot expect our export markets, notably Japan, to follow a science-based approach if North American countries do not themselves follow such an approach.

As part of that process, the CFIA has already changed its regulations to further align Canada's BSE-specific policy for imports from the United Stated with science-based international guidelines for safe trade, which are designed to protect public and animal health. The import regulations to allow for a range of U.S. commodities that have been prohibited since a case of BSE was detected in Washington State in December 2003 came into force on 29 March 2005.[8] This was an important step towards a harmonized North American import standard for BSE.

In its April 2004 report, *The BSE Crisis – Lessons for the future*, the Committee recommended to enhance the harmonization of sanitary and phytosanitary standards with Canada's NAFTA partners and set up a permanent NAFTA agricultural secretariat with the mandate to use these standards and generate reports including recommendations for actions by NAFTA partners to regulate the trade flow when a sanitary or phytosanitary issue occurs.

In addition to BSE, there are still some issues between the United States and Canada on import requirements related to bluetongue and anasplasmosis.[9] Canada removed the requirements for feeder cattle imported from the United States. However, the restrictions to import breeding animals remain and are still an irritant, especially in the Northern Tier States where cow/calf operators are very dependant on selling their breeding cattle. These two diseases do not incur an economic loss of production and Canada's environment kills the insects responsible for the diseases. Minister Mitchell indicated that Canada's regulations on these two diseases will be reviewed.

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[8] Under the new import regulations, some of the commodities now allowed include feeder cattle less than 30 months of age and goats and sheep less than 12 months of age for feeding or immediate slaughter, and bulls destined for animal semen production centres. Bone-in sheep and goat meat from animals under 12 months of age is also now permitted.

[9] Bluetongue and anaplasmosis are livestock diseases found in the United States, but not in Canada.

While the fate of the Canadian beef industry lies to some extent in the hands of the U.S. judicial system, we cannot forget that Canada's best insurance is **to maintain the best possible animal health standards in our country** and encourage the North American market to do the same.

As markets gradually reopen to Canadian beef products, it will be important to regain market shares that are now filled by other international competitors. On 10 March 2005, the government announced a $50-million federal contribution to the Canadian Cattlemen's Association's Legacy Fund to launch an aggressive marketing campaign to reclaim and expand markets for Canadian beef. This money will help to develop new international markets for Canadian meat products, and to regain our market share once some now closed markets such as the Japanese market reopens. The Committee fully supports this initiative and sees the expansion of markets for Canadian beef as an important part of the sustainability of Canada's increased packing capacity.

2. Canadian Beef Import Policy

Canada offers two levels of access to beef imports from around the world. For its North American Free Trade Agreement (NAFTA) partners, there are no quantitative limitations – under normal conditions – on how much beef Canada can import from the United States and Mexico. In addition, all beef trade in North America is tariff-free. Canada and Chile have a similar agreement in place.

The import of beef from all other WTO countries is limited by a Tariff Rate Quota (TRQ). In accordance with its WTO commitments, Canada is required to provide tariff-free access to up to 76,409 tonnes of fresh, chilled and frozen beef and veal annually. Normally, any amount above that total is subject to a 26.5% import duty. Two countries are guaranteed a specific portion of the TRQ amount. Because of historic Commonwealth ties, Australia and New Zealand are entitled to 35,000 tonnes and 29,600 tonnes of the TRQ, respectively. The remaining 11,809 tonnes is open to imports from any country certified by the CFIA, including Australia and New Zealand.

In special cases, authorization may be granted to waive the tariffs on amounts exceeding the TRQ threshold. If a company cannot find a Canadian supplier that can offer an equivalent product at an equivalent price, that company may apply to the Minister of International Trade for a supplemental import permit. For example, in 2002 – the most recent year unaffected by the BSE crisis – Canada authorized supplementary imports of about 65,082 tonnes over and above the 76,409-tonne TRQ threshold.

The companies that typically apply for supplemental import permits are those that do value-added processing on the basic meat cuts available from slaughterhouses. Such business primarily supplies the convenience food market. The companies require a stable, reliable supply of very specific cuts of beef from meat packing plants that they then further process to meet the needs of their customers, such as delicatessens and fast-food companies. These meat purveyors have generally found that the products they require are readily available from slaughterhouses in Australia and New Zealand at very competitive prices.

By contrast, cattle processing capacity in Canada is limited. Prior to the discovery of BSE, about half of Canada’s beef and cattle exports to the United Stated consisted of live animals destined for meat packing plants in that country. In the case of those that were processed domestically, companies found it more lucrative to export different cuts of meat to the U.S. market than to supply the specific needs of the specialty meat purveyors.

When the world closed its doors to Canadian cattle and beef in May 2003, the federal government took several steps to help the domestic industry. Among these was a move to restrict imports of foreign beef in the hope that local supply could be used to meet the demand. Canada’s commitments under the WTO and NAFTA prevented it from arbitrarily closing its border, but Canada could limit supplemental tariff-free imports over the TRQ threshold.

On 4 June 2003, Canada tightened its supplemental import policy; a month later, it effectively cancelled the policy altogether. However, the United States partially reopened its borders shortly thereafter. Canadian exports of certain cuts of meat from animals under 30 months old were permitted, but the border remained closed to meat from older animals and to live cattle.

The partial border opening did nothing to relieve the glut of cattle in Canada. Domestic processing capacity was limited; with partial access regained, Canadian meat packers once again began to export to the U.S. market. The end result was that specialty meat purveyors were unable to secure a reliable supply in Canada, but were not granted supplemental import permits to acquire the product abroad.

Finally, in April 2004, the Canadian government reinstated the supplemental import tariff exemptions, and companies were once again able to import products tariff-free above the TRQ. As a result, Canada finds itself in the position of having an excess supply of cattle but still importing specific cuts of beef over and above its minimum WTO obligations.

Some small packers suggested to the Committee that any shipment of meat above the 76,409-tonne TRQ should attract the tariff, and that Canada should again cancel its supplemental import tariff exemptions. Nevertheless, according to the Canadian Meat Council, importers have to contact several suppliers in Canada before the supplementary import quota, or permit, is issued. Suppliers are given 48 hours to respond as to whether or not they can provide this product. If Canadian suppliers cannot provide the product, then it is actually beneficial for the Canadian market to import it; otherwise, the market for beef could be lost to some other source of protein. Moreover, International Trade Canada statistics show that in 2004 virtually no supplementary import quotas were issued (457 kg), and a little less than two-third of the tariff-free quota of 76,409 tonnes was actually imported (49,400 tonnes).

V. CONCLUSION

Canada has a low incidence of BSE and the Committee is satisfied that the proper measures are in place to protect consumer and animal health. Canada is certainly taking steps to be prepared for the next crisis. As Dr. Gravel of the CFIA indicated:

> "In a way we are like firefighters. You cannot staff for the major fire that is happening all the time. You have to find a medium between having a certain percentage of your troops as a reserve and not wasting taxpayers' dollars […] waiting for the emergency to happen. That is the major challenge. To what extent do we have the capacity inside to deal with a crisis and also when we get to a bigger crisis, have access to additional funding or partners that will help us manage that crisis. Whether these partners would be provinces or industry or others, and that is what we have been trying to do."[10]

The Committee believes that preparing for future crises entails looking at where our industry is vulnerable and taking steps to reduce this vulnerability. Farmers need reassurance that another crisis will not have such lasting consequences, and having a stronger packing capacity will be a part of that process.

Although the Canadian cattle and beef industry has benefited from integrated North American trade, the BSE crisis has shown that borders still exist and can profoundly affect our agricultural industries. By increasing its packing capacity, the industry will become stronger and more sustainable whether or not the U.S. border reopens. The implementation of programs to reduce the industry's vulnerability is certainly a necessary precondition to a more sustainable future; but Canada's demonstration that it is monitoring and managing this crisis is, in the Committee's view, an equally important element of a strategy for the industry's recovery.

[10] Dr. André Gravel, Canadian Food Inspection Agency, Standing Senate Committee on Agriculture and Forestry, Issue No X, 1st Session, 38th Parliament, Ottawa, 3 March 2005.

APPENDIX : **WITNESSES**

First Session, Thirty-eight Parliament

November 16, 2004 *Agriculture and Agri-food Canada:*
The Honourable Andrew Mitchell, P.C., M.P., Minister
Leonard Edwards, Deputy Minister

Canadian Food Inspection Agency:
Richard Fadden, President

December 2, 2004 *Agriculture and Agri-food Canada:*
Gilles Lavoie, Sr Director General, Operations

Canadian Food Inspection Agency:
Krista Mountjoy, Executive Director, Coordination of Operations
Cameron Prince, Executive Director, Animal Products Directorate
Bill Anderson, A/Director, Food of Animal Origin Division

Canadian Cattlemen's Association:
Stan Eby, President
Ann Duford, Market Analyst

December 7, 2004 *Canadian Bankers Association:*
Terry Campbell, Vice-President, Policy

Scotiabank:
Bob Funk, Vice-President, Agriculture

RBC Royal Bank:
Brian Little, National Manager, Agriculture and Agri Business

TD Bank Financial Group:
Dave Marr, Senior Advisor, Community, Rural and Agriculture Issues, Government and Community Relations

February 10, 2005 *Rancher's Choice Beef Co-Op Ltd:*
David Reykdal, President

BC Blue Mountain Packers:
Robert Kuziw, President of Rangeland Beef Processors Inc.

February 15, 2005	*Atlantic Beef Producers Co-operative:* Dean Baglole, Chairman
	Gencor Foods Inc: Mark Ishoy, General Manager
March 22, 2005	*Canadian Meat Council:* Arie Nuys, President Jim Laws, Executive Director
April 14, 2005	*Fédération des producteurs de bovins du Québec :* Michel Dessureault, President Gib Drury, Member of the Board of Directors Gaëtan Bélanger, Secretary Treasurer
April 19, 2005	*Agriculture and Agri-food Canada:* The Honourable Andrew Mitchell, P.C., M.P., Minister Leonard Edwards, Deputy Minister
	Canadian Food Inspection Agency: Richard Fadden, President
April 21, 2005	*Canadian Co-operative Association:* Claude Gauthier, Director Bill Dobson, Vice President
May 3rd, 2005	*Canadian Food Inspection Agency:* André Gravel, Executive Vice President Krista Mountjoy, Vice-President, Operations Bill Anderson, A/Director, Food of Animal Origin.