



GEORGE MORRIS CENTRE

Canada's Independent Agri-Food Think Tank

Canadian Agri-Products Policy Project

Vision, Mission, Intents and Instruments

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PURPOSE

This purpose of this paper is to outline progress made to date in the development of a new Canadian Agri-Products Policy. The project and the process by which it is being conducted are explained on the George Morris Centre's website, <http://www.georgemorris.org/GMC/Events.aspx?IID=247>. The information in this report is presented in 3 stages:

- Summary of implications and conclusions from our analysis of the external and internal environments
- Proposed statements of vision and mission for the agri-products sector
- Clear statements of strategic intent within public policy that would assist the sector in achieving the vision and mission

ANALYSIS IMPLICATIONS

WHAT ARE THE OPPORTUNITIES?

The External and Internal Environment Facing the Canadian Agri- Products Sector

Examination of the factors affecting markets for Canadian products leads to the following conclusions:

Future Demand for Agricultural Products Will Have Four Major Components

- There is limited opportunity for growth in demand for traditional food products in developed countries.

High income countries around the world, including Canada, have aging populations whose fertility rates are below replacement rate. Therefore, any net growth in population is from immigration. At high income levels, food consumption is already high and these countries tend to have issues with obesity. Hence, there will be limited growth in the *tonnage* of food consumption.

- There is substantial opportunity for growth in demand in developing countries.

Many lower income countries in Asia, South America, and Africa are experiencing relatively rapid economic growth. Global history shows that when this occurs, demand for food is stimulated, especially for animal products and fats and oils, because people have relatively low levels of consumption. Moreover, populations in these countries are relatively young. Hence, relatively large portions of these populations are made up of people whose food consumption is still growing.

- Much opportunity exists in both developed and developing countries to increase demand for differentiated products.

There is no such thing as “the consumer” in the singular; rather there are many types of consumer segments. These segments are interested in buying specific attributes. These attributes may be associated with the physical product itself, the processes through which it is produced or processed, or the services associated with it. The concept is simple: some consumers are willing to pay a premium for specific attributes.

By providing those attributes, suppliers create value. If the value they create exceeds their costs, then differentiation from basic commodities can be profitable.

In particular, as the human population ages and as research shows more about the impacts of food on human health, people are increasingly interested in the links between food and health benefits. Understanding and exploiting these linkages will likely be a source of differentiation in the future.

- There may be considerable opportunity for growth in demand of traditional commodities used in nontraditional product markets.

The early example of this is using grain to produce ethanol as a substitute for gasoline. Considerable effort is currently being made to expand this to include production of bio-diesel and other bio-products, both of which are growing domestically and internationally. Many people expect the next round of development for these products to be in the form of industrial fibers made from plant material for biofuels.

While these products have captured the imagination and hopes of many in the agri-products sector, and are currently fueling resurgence in grain prices, they are not without risks. As with many things in agriculture, US and other developed countries are heavily subsidizing the ethanol and bio-diesel industries, both directly and through reduced taxes. In addition, yields of raw material in the US and other competing countries such as Brazil are higher than in Canada. These two factors combine to suggest that Canada may be less competitive unless Canadian governments are willing to match US subsidies. Moreover, ethanol production creates by-products that result in excellent feed for ruminant animals, but not for non-ruminants. The by-products are low in value and bulky to ship. Therefore, substantially expanded production of ethanol in the US could be a serious detriment to Canada's livestock industries.

Canada Must Have an Export Oriented Strategy

Canada's population is very low relative to its arable land base, and growth in traditional food demand, segmentation, and nontraditional product demand all have major international components. Therefore, it is mandatory that any strategy with a chance to create prosperity in the agri-products sector must have elements designed to expand Canada's international market share.

Canada has the world's second largest ratio of arable land per person, behind Australia. As a result, Canada is among the top seven exporters of a long list of products including livestock, meat, grains, oilseeds, pulses and frozen potato products. Major tracts of Canada's farmland would need to be removed from production if we only think about a policy of food self-sufficiency. Conversely, therefore, being able to generate more value from the land that is in production will need to include an export component.

To Be Successful, Innovation Is Needed

We define innovation in several ways:

- Breakthroughs in technology that increase productivity. This may include genetic engineering, biological, biochemical or other new applications of technology.
- Applying existing technology to new applications or by new firms. To illustrate the latter, colour sorting and quality control equipment that exists in Europe but not in Canada would be an innovation if Canadian fruit and vegetable processing firms invested in it.
- New and better inputs. While this may be part of the technological breakthroughs, it may also be accessing seed varieties, plant health products, animal health products, etc. that already exist but are not being used in Canada.

- New product development. This means providing products of value to consumers or customers in the supply chain. It may be done by changing or introducing new intrinsic or extrinsic traits to products, or by changing packaging or the service provided with the product.
- Transportation improvements.
- New ways to serve customers. This may mean reorganizing a supplier's organizational structure, moving to just-in-time shipping, improving order time or cycle time, etc.

Many of the people with whom we consulted during this project pointed out that the agri-products sector is generally characterized as a “first-mover world”. Whether one competes on the basis of low-cost or differentiation, the entrepreneur who takes a risk by introducing something intended to reduce cost or to differentiate will reap many of the economic benefits that are first mover in nature. This means the farmer or processor who invests in cost reducing and/or output increasing technology gets the early benefit because of lower costs. When others see the impact and copy the innovator, then output increases, price falls and the initial benefits are bid away. Similarly, the food supplier who comes up with a new niche product with a high margin will likely be copied by competitors.

Therefore, in this marketplace the only true source of sustainable competitive advantage is continuous learning and continuous innovation. There is every reason to believe that these competitive pressures will not ease in the future, rather that they will continue to press. Therefore, from a national and sector perspective, people need to be innovators and policies need to encourage innovation.

Managing Value Chains Will Be Increasingly Important

This conclusion follows from the foregoing. Whether the products created are commodities or differentiated, value chain management will become increasingly important. For differentiated products, it is important because managing the value chain ensures that suppliers in the chain understand what attributes customers and consumers want, and it is important in making sure products are delivered that consistently provide those attributes.

Whether value chains involve commodities or differentiated products, good value chain management is important in ensuring that transactions costs in the value chain are minimized. Traditionally, many in the sector have been concerned about minimizing their local costs; in the future there will be increasing emphasis on minimizing **system** costs.

Excellent Management Skills Will Be Required

All of the foregoing leads to the conclusion that those who will prosper in the future will need to be good managers. Long term commitment, dealing with complexity, and managing marketing, people, risk and finances are skills that will be required at both the farm and processing levels.

ANALYSIS CONCLUSIONS

HOW WELL ARE WE POSITIONED TO EXPLOIT THE OPPORTUNITIES?

All the points above are implications from the external environment. Below are the conclusions we draw from looking at the internal environment - i.e. how we stack up as competitors in the evolving marketplace.

Canada's Productivity Is Lagging

Our white paper shows clearly that productivity in food processing is lagging and presents evidence to suggest the same is so at the farm level. If our sector is to gain or even maintain market share in the emerging marketplace, then productivity will be fundamental in creating competitive advantage.

It is important to stress that, while our measures of productivity are portrayed as “labour productivity”, they really reflect capital. The issue that contributes most to Canada's declining productivity is lack of investment in capital - i.e. mechanization, and world scale plants. The issue is not confined to the agri-products sector. Research, including that from the OECD (2006), the Fraser Institute (Veldhuis and Clemens, 2006), the Institute for Competitiveness and Prosperity at the University of Toronto (2006), the C. D. Howe Institute (Chen and Mintz, 2003), Conference Board of Canada (Iqbal, 2003) and, most recently, the Canadian Manufacturers Coalition has, for years, pointed out that Canada's tax system is the worst in the developed world for encouraging investment.

Canada's Regulatory System Stifles Innovation

As with the tax system, the OECD and other economic researchers point to Canada's regulatory system as one that stifles innovation. Nowhere is this clearer than in agriculture, where a plethora of studies show that institutions responsible for registering animal and plant health products, as well as consumer products with health benefits have been less than efficient. Comparing Canada's performance in this area to a country like Australia, which developed a system that focuses on improving processes and practices, makes it clear that Canadian farmers and food companies face a substantial disadvantage that manifests itself in higher costs and constraints on innovation.

Regulatory issues are also increasing within the sector itself through conflicts between farmers or other suppliers in the chain and marketing boards and agencies. This is a dilemma within the sector. Boards and agencies were put in place during the middle decades of the 20th century for essentially two reasons: to increase the efficiency of marketing systems through collective actions and to provide bargaining power for farmers. While some farmers are now less concerned about bargaining power, many are not: there are compelling reasons to retain the ability of farmers to engage in collective marketing.

At the same time, many of the regulations put in place by marketing agencies were developed in an era characterized by commodities and markets that were primarily concerned with cost. They were put in place to encourage people to homogenize products and processes in the name of efficiency. The evolving market, as discussed above, has elements that want differentiation. It is not surprising that conflicts arise when entrepreneurs want to respond to market opportunities and regulations get in the way.

This issue needs to be addressed.

Canada Has Poor Value Chain Management

This issue follows from the last two paragraphs: real and perceived market power and abuses of power lead many farmers and processors to conclude that they have little bargaining power, that they need protection. The attitude is widespread. It does not just come from farmers. Many processors feel that they are at the mercy of highly concentrated retailers. In some markets, as was underlined in this project, people are afraid to speak out in the presence of powerful farm organizations due to a fear of being punished.

As a result, most attitudes are, at best, characterized by the scarcity paradigm - i.e. “the size of the pie is fixed so the only way I can get more is to take it away from you.” This means negotiations are generally win-lose or even lose-lose. The result is supply chains with extremely high transactions costs because few are interested in finding ways to reduce them. Conversely, the costs of risk, lack of trust and lack of vision are extremely high.

The Sector Is Hampered by Human Resource Issues

Now, more than at any time in the past several decades, the agri-products sector has issues with labour and management. Like much of the Canadian economy, we face a growing shortage of skilled labour. Moreover, there are indicators that management skills are lacking in the sector.

WHAT NEEDS TO CHANGE?

START WITH A COMMON VISION

The people who participated in this process from across the country are people trying to build the sector. They looked at the information provided and came to the conclusion that Canada can do far better. Many expressed their perception that Canada has an abundance of natural resources and people who can be global leaders in the agri-products sector. There is a hunger to excel, and there was no disagreement on the nature of our vision. As is normal, different people associated different connotations with various words, but there was overall agreement on the concept.

Our vision is:

Canada's agri-products sector prospers through leadership in commercial innovation for, and with, its global customers

There is much meaning in these few words. The following points are meant to enrich and clarify the meaning of the statement.

- *Prosper* means to sustain profitability. In turn, sustain simply means “over time”. So the first five words suggest that in our vision participants in Canada's sector are profitable over time.
- This prosperity results because we are, and are seen to be, global leaders in commercial innovation. Innovation is as characterized above, i.e. it refers to a wide array of breakthroughs that improve our performance as suppliers. It is through innovation that we achieve prosperity.
- *For and with its global customers* has a number of connotations.
 - “global” means that Canadians will be leaders in doing business in both the domestic and export markets.

- “for its customers” means we lead in customer service and market responsiveness, and this is the reason we innovate, i.e. to continuously serve our customers better.
- “with its customers” is meant to imply that we practice excellent supply chain management. Note that the word is “customers” not “consumers”. This is done purposely to emphasize the concept of value chain because most members are not selling to final consumers. Participants in one workshop suggested we use the term “co-management”, which means direct involvement in management by all members of a value chain. The suggestion came from a feeling of deep frustration among those in the group that they are relatively powerless in making decisions. And these were not farmers. This, again, underlines the issues we have in value chain management in Canada, and how far we are from our vision. The authors chose not to use the term co-management, even though we find it appealing because we think it is over prescriptive for all situations. We do agree that it describes a direction toward which the sector should be headed.

MISSION

As this project unfolded, it became clear that a mission also needed to be included. In the parlance of the George Morris Centre, “mission” is more immediate and defined than “vision”. Vision is a long-term position or state, usually not measurable, toward which one is striving. Mission is what we will focus on for the next three to five years as a first step toward achieving the vision.

The suggested statement of mission is:

Create a progressive business environment that fosters innovation

Again, it is useful to amplify the meaning of this statement. There are really two elements. One is fostering innovation in the sector. The second is creating a business environment that allows this to happen. The latter comes from the issues, discussed above, that hamper innovation and entrepreneurship in Canada. We cannot be leaders in innovation when we are blocked by public policies that stifle it.

One reason we felt the need to emphasize both elements was that, in the workshops for this project, the facilitator often asked for feedback on what focus publicly funded research should take. Surprisingly, there was little feedback. After probing, our conclusion was that innovation is so difficult in Canada many people haven't given much thought to what would help them do so. Therefore, part of the challenge in the next few years is to help people understand how to innovate while simultaneously changing to a progressive business environment that fosters innovation.

STRATEGIC INTENTS AND INSTRUMENTS OF PUBLIC POLICY REQUIRED TO ACHIEVE THE MISSION

So how can we accomplish this mission? It will require material changes in behaviour by those in the sector and changes in public policy that affects the sector. In this section, we suggest seven strategic intents for public policy affecting agri-products. In each case, we also put forward specific recommendations for policy instruments that can be used to accomplish the intents.

These strategic intents arose from the focus group feedback. They are presented in no particular order. There is general agreement among participants on the first five intents listed. They are all necessary: failure to enact any will render the rest less effective, therefore they are all priorities.

1. *Encourage Productivity and Innovation through New Investment*

In the past, Canada used grant programs to stimulate investment. Programs of this nature continue to this day. They have several shortcomings:

- They depend on arbitrary criteria established by bureaucrats for decisions about what will be invested in, not the market place. Sometimes they will be right, sometimes they will be embarrassingly wrong.
- Grants are inherently unfair and market distorting; they are only available to those who are chosen.
- They often lead to unfair competition; unsubsidized investors find themselves competing with the subsidized.

A much fairer and more efficient approach is to design business taxation so that it encourages potentially profitable investments. This would require a substantial revision of Canadian tax policy, as well as spending policy. In doing so, three tax instruments would be useful to attract investment:

- Increase CCA (capital cost allowance) for investment in plants and equipment. Reducing tax burdens in the early years of an investment often makes the difference between investing and not investing. Hence, being able to write investments down earlier can make a substantial difference in the level of investment. New investment generally enhances productivity.

It is tempting to argue that this and the capital gains recommendation below should be made available only to the agri-products sector. However, to do so would be merely self-serving because taxation issues are having a negative impact throughout the economy. If our argument is that leveling the tax burden allows the market to function more efficiently, then that argument applies across all sectors. Hence we concur with recommendations that have been made recently by the Canadian Manufacturers Association, the CD Howe Institute, the Fraser Institute, the Centre for Competitiveness and Prosperity and others that a tax strategy to enhance investment in capital be pursued.

- Reduce capital gains tax. For most businesses, the value of assets increases because of profitability in the business. Since business and labour income is already taxed, capital gains tax amounts to multiple taxation. Leaving greater possibility for owners/investors to gain on the value gives greater incentive for investment and, therefore, an increase in potential productivity.
- Remove capital taxes. An issue that is mentioned in almost all criticisms of Canadian tax policy is capital taxes that are levied by some provinces. Capital taxes levy taxes even on borrowed money; hence investors have to pay tax as well as interest.

Perhaps the most difficult aspect of these three taxes is that businesses often have the choice of investing in Canada or elsewhere. When all three of the major tax programs give a disadvantage to Canada, then Canada loses not only the investment, but also the jobs and added value that go with it.

There was considerable discussion about also developing new investment instruments for the sector to attract capital from investors outside it. Specific suggestions are to

- develop flow-through shares similar to those in the gas and oil market
- develop real estate income trusts for farm land, and specialized mutual funds for companies in the sector.

These likely involve actions by both the private sector to design them and legislative changes to enable them, especially the first two.

It is interesting to note that, in discussing these possibilities with people who know investors outside of the sector, the point was made that, even with better investment instruments, investors are often reluctant to invest in our sector because of the pervasive influence of government whose actions can quickly change the profitability of an investment. At the same time, some suggest that attracting capital from sophisticated capital markets is not something that people in our sector do frequently. Therefore, management training that includes work on valuation and attracting financing would be valuable. This should be done in conjunction with development of investment instruments.

2. *Encourage Productivity and Innovation by Reforming the Regulatory System*

Two things need to be said to introduce this recommendation. The first is that no amount of tax relief will encourage investment when the regulatory system offsets any tax advantages. This underlines the feeling of project participants that these recommendations are not items on a menu, from which to choose. Rather, they are key components of a single comprehensive commercial policy.

The second is that no one argues for low regulatory standards regarding health and safety. The overwhelming perception by most people in the agri-products sector is that high standards assist us in differentiation. However, with Canada's relatively small market, regulatory decisions that are slow and unwieldy have the following results:

- Companies are reluctant to register animal and plant health products in Canada because the cost is too high
- Farmers and food companies are unable to use inputs and/or develop final products which can be the basis for successful differentiation
- Companies are reluctant to undertake research and development in Canada because the lag times are too long for registration in a small market
- Farmers and others in the value chain do not have access to products that are environmentally superior
- Farmers and others in the value chain do not have access to drugs that assist in improving efficiency and lowering costs. Often, competitors in other countries do have access and their products can be sold in Canada without restriction.
- There is currently no regulatory framework for fortification of foods, health claims and novel foods

These regulatory issues facing the sector have the feel of a huge hidden tax. A slow and unwieldy system offsets the benefit of having high scientific standards, if the standards of delivery do not make products available so that the Canadian value chain can gain competitive advantage. The George Morris Centre has adopted the phrase, "**Tough but FAST**" as a description of the optimal system. This means that the regulatory system will use high scientific standards, will make decisions about registrations quickly and in a transparent manner, decisions will be made consistently and with predictability, and resources will be used efficiently, including resources of other countries whenever possible and appropriate.

A number of initiatives are under way in the regulatory agencies of Health Canada that are intended to improve the performance of the system. Some of them are internal and some are being undertaken as part of the NAFTA relationship or the Security and Prosperity Partnership (SPP). They fall generally into the category of continuous improvement, although it would appear that continuous improvement was not high on the agendas until the current generation of administrators was appointed. These are necessary components that will improve performance and they need to continue. The Centre has laid out more specific recommendations in two reports (Brethour *et al.* 2004; Brethour *et al.* 2005) on animal and plant health registrations processes.

However, the lasting and fundamental changes required to make Canada's regulatory system a source of pride and competitive advantage need to be made at a political level. This means that federal politicians will need to make this a substantive objective for reform, and that the optimum system for the 21st-century needs to be designed. It means changing the system to include a competitiveness objective as well as the protection objectives that are included in the current legislation. This requires close examination of systems in other countries, such as Australia, to find, understand and implement best practices. It also requires understanding how best to design Canada's domestic system to mesh with international health treaties, regional and multilateral trade treaties and emerging systems for scientific monitoring. It likely requires appointment of an independent commission, as Australia used several years ago to make it the best model in the world.

The second category of regulation is regulation by marketing boards and agencies. As discussed earlier, the issue is the clash between a system that provides bargaining power to farmers, often through regulations that were appropriate for markets characterized mainly as commodities, but which increasingly operate in an era of differentiation. Commodities need “sameness” to increase efficiency and reduce costs. Differentiation needs uniqueness to add value for specific market segments. In a market characterized by differentiation, a different set of innovations is needed and expected.

The policy question facing regulated marketing is how to get back to the idea of collective marketing under differentiation. How does one simultaneously represent the collective while encouraging what must often be individual innovation? This is not an easy question, and only a few agencies appear to be asking it. A good example is the Ontario Processing Vegetable Growers, who have shown considerable flexibility in negotiating contracts that are different for various end users of the same product, while clearly maintaining bargaining power for growers. There will be costly friction in our marketing systems until it is asked and answered. The friction will be over whether marketing systems should be voluntary or mandatory. Clearly, the trend is toward voluntary. This issue was only addressed tangentially in the workshops for this project, largely because the issue crystallized late in the process. Based on discussions that were held about it, three potential recommendations have come forward:

- Charge marketing agencies with the responsibility to develop and implement regulatory procedures that will encourage innovation in their industries.
- Charge supervisory boards with the responsibility to ensure that agencies develop and implement those regulatory procedures. The risk is that merely adding the responsibility for agencies does not guarantee implementation. In theory, supervisory boards have the responsibility to oversee actual operations of agencies to ensure they achieve federal or provincial policy objectives. Therefore, if encouraging innovation is to be a policy objective, it needs to be added to the responsibilities of the supervisory boards.
- Governments should appoint independent third parties with sunset clauses of no more than seven years to report on the progress of the agencies and the degree to which supervisory boards take responsibility. If we truly believe that innovation is a part of our vision then we need to instill processes within our institutions to encourage it. We suggest the sunset clause because we believe that organizations of this type should likely have a short period of time to bring about fundamental change.

3. Encourage Productivity and Innovation by Improving the Public Research Network

Much, but by no means all, innovation results from research. This means that Canada needs to foster and carry out substantial and strategically focused research. However, the benefits of research are notoriously difficult to retain internally, especially public research. And even when they are locally commercialized their

products can be globally available. Therefore, it is important for Canada to access research results from around the world and adapt them to Canadian conditions. A significant example of this is that leading edge work on colour sorting and process control engineering is being done in Europe. The result is equipment that is not manufactured in North America, but is available to be adapted to our conditions.

Interestingly, this issue was probably the least well defined by participants in the focus groups for the project. There was general agreement that, to have an innovative sector, there must be strong public research efforts. However, many participants were short on specific suggestions. Further work by some participant and the project team brought forth five specific recommendations:

- Make the Scientific Research and Experimental Development Tax Incentive Program more easily available. Canada has a well conceived tax incentive program for companies that conduct research and development. However, many small companies argue that it is difficult and costly to access. Others argue that the difficulties are generally self-inflicted because companies have attempted to claim the tax credit on activities that don't qualify. The complaint from small companies is widespread enough to be taken seriously. We recommend that all efforts be made to streamline and simplify the processes required for qualification.
- Research expenditure under SRED must include funds to fully explore research being conducted in other countries that could be adapted for the Canadian environment. This needs to include identifying latest innovations, leading trends, private sector developments and bringing this knowledge back to the Canadian agri-products sector.
- Increase the cap on the SRED tax program to \$10 mil. The current cap of \$2 mil was put in place almost 20 years ago. Since then inflation has clearly increased costs. More importantly, many experiments are much more complex and, therefore, costly.
- Develop specialized research centres following the Australian Rural Research and Development Corporations (RDC) model. With this model, specific RDCs¹ were created to undertake research and development for major commodities or commodity groups and are a cost-share partnership between the Australian government and the various fishery and food industries. The cost-share funding works as follows; for every dollar that the industry invests into research and development the Australian government will match those dollars up to 0.5% of that industry's gross value of production.

The RDC model was created to expand Australia's research and development effort in this sector and to improve the efficiency and effectiveness of investing in research and development in priority areas for various industries and then transferring the research results for improved competitiveness of the industry².

- For public expenditure on research, governments should develop a more transparent and objective manner to set priorities. Whether this is done in product centres, as discussed above, or with the current configuration of research facilities, many people perceive that agendas are established too much by the interests of researchers and too little by strategic need. The suggestion was made that research priorities be set in a process that is facilitated by third parties and includes people with strategic knowledge about what research would have the highest payoffs in the short and long-term.

¹ 15 Research and Development Corporations have been created focusing on eggs, pork, wool, cotton, dairy, fisheries, forest and wood products, grape and wine, land and water, meat and livestock, sugar, grains, horticulture, live exports and rural industries.

² For more information: <http://www.innovateaustralia.com/Default.aspx>

Particular interest was expressed in focusing on research necessary to grow Canada's capacity for non-traditional products such as bio-fuels and industrial fiber applications.

- One issue that arose across the country was the strong perception that most public investment in research is on discovery. Very little is on commercialization. As a result, the effectiveness of the public investment in discovery is often questioned because so little of the results is ever commercialized. Hence there is considerable interest in examining ways to facilitate the commercialization process. An example is the proposed International Food Processing & Innovation Centre in Toronto. It responds to the constant call for a focus on commercialization, especially for small and medium sized companies. It will help strengthen the link between rural and urban areas because it will provide more opportunities for sales of farm products into the local processing industry and will provide opportunities for differentiation and value chains because many of the smaller companies want attribute-specific raw products including those with potential health benefits. The food manufacturing industry in the greater Toronto area has over 400 companies, employs over 30,000 people and is the second largest manufacturing industry employer in the Greater Toronto Area (GTA). If successful, it is a model that can be used in other urban centres. Requested public investment in the Innovation Centre is quite modest, and could have a tremendous payoff. It should be supported.

4. *Develop Human Resources in the Sector*

Especially in the past three years during the most recent gas and oil boom, human resource availability has been an issue for the agri-products sector at the farm, processing and retail levels. But the problem is not just transitory and cyclical; it is structural and it will become more acute as the baby boomers age. The human resource issue actually has three components. Recommendations for each are presented below.

- The first is labour availability. There is a growing shortage of people to perform manual labour throughout the sector. This includes farms, manufacturing and retail industries. Traditionally, this has been a problem for horticultural producers. However, it is now much more widespread because of the demand for labour in the energy sector and because Canada's population is aging, with substantial growth in demand for skilled people.

The horticultural industry has developed extraordinary programs to hire seasonal non-resident labour. These programs provide compensation at or above Canadian minimum wages, as well as transportation costs, housing and health care. The labour issue is becoming so severe that it now appears to be time to expand these programs to other farming and processing industries. For many of these industries, the need is not seasonal but rather chronic. Therefore, programs will need to be structured to accommodate these needs – i.e. off-shore labour programs to meet year-round requirements.

Another aspect of enhancing availability is improved integration of permanent immigrant residents into the work force. The Canadian Chamber of Commerce has initiated pilot projects that provide both work skill and life skill training for permanent immigrants. These should be expanded and tailored to the needs of regional areas and to the agri-products sector.

- The second human resource issue is skills development. This goes hand in hand with investment in new capital. In most parts of the agri-products sector, new investment will be made in equipment that is complex and requires advanced engineering, biochemical, or computing skills to install,

operate, and maintain. The example above of colour sorting and process control equipment is a case in point; the equipment is developed in Europe, can make fundamental differences in what is possible, and no one in North America knows how to install, operate or repair it.

Many industries will need specialized training. This element of the human resource issue must be coordinated with the capital investment component discussed earlier: if tax reform will generate investment, then industries must be strategic enough to anticipate the skills that will be required. The federal government has programs in place through HRSDC to gauge skill and management requirements in an industry. These will need to expand in the future and provide industry and labour with increased flexibility in assessing and addressing skills needed.

- The third area is management training. The white paper provides considerable evidence that the sector needs better management skills. It points out that there are many sources of training available in Canada that are often unused by the sector. As well, the federal government and most provinces have programs in place to cost-share management training programs. This remains, however, an area characterized by a lack of appreciation for the benefit of certain skills when one doesn't have those skills. Therefore, the most important factor is a need to show people the advantages in improving their management skills.

5. *Help Improve Value Chain Management in the Sector*

Participants in this project believe that this is a very important area. They also believe that most of the things governments can do to assist it are indirect. They believe that changing the tax system to encourage investment, changing regulatory structures to give better access to products and markets, changing regulatory systems to encourage innovation, and supporting skills development are the major actions governments should take in this area. Establishing rewarding value chain relationships is inherently a management skill. As discussed above, training in business management and leadership need to be improved in this sector. Therefore, if there is an effort to improve management skills in the sector then there will likely be a spillover effect into the management of value chains.

There were strongly voiced opinions in several workshops that government's role otherwise is to move out of the way. Therefore, only two specific recommendations came to the fore. The first has essentially been covered by recommending that marketing agencies and supervisory boards be accountable for putting in place processes to encourage innovation. Innovation obviously includes those measures designed to improve performance of value chains.

When prompted to discuss the actual and potential contribution of the federal government's Value Chain Round Table initiative, the feedback was, at best, lukewarm. Several people commented on their perception that the agendas for round tables are often those of the civil servants in charge of them, not the industry. Moreover, some people perceive that by organizing around traditional commodity lines, the process "divides and conquers" because it does not allow for synergies across commodity lines. Some perceive that while there is value in having a place for industry participants to talk to each other, value chain management will be most successful when opportunities exist for proprietary arrangements to be made. Public fora do not lend themselves to such developments.

In some industries, a good example being the pulse industry, efforts have been made to bring together members of the supply chain with people who have knowledge about non-traditional technologies and potential markets. They point out that this is facilitated by relatively small investments from government agencies. It is recommended that these programs be formalized into programs that will provide financial assistance for learning in the quest to develop domestic and export markets.

6. *Optimizing Environmental Goods and Services for the Future*

This area has two components.

Compensation for Providing Environmental Goods and Services

The first – compensation for providing environmental goods and services (EGS) is one for which there was too little time and information to do justice in the project and, therefore, where there is little agreement. Interestingly, there was very little discussion in any of our workshops on the need for farm subsidy programs. There were strong statements across the country that Canada can be competitive without subsidies so long as trading rules are fair. The issue at hand is whether and how to compensate people who provide environmental goods and services for which there is no market.

What characterizes these issues is that society enjoys a perceived benefit from restricted land use but does not pay the cost. Suppliers of these goods and services, usually farmers, may or may not obtain benefit, but pay the direct or indirect costs embodied in the land-use restrictions. Therefore, the question is whether it is appropriate for society to compensate land owners for foregone rights based on an estimate of the value to society.

One aspect of this issue is that, since Canada does not have constitutional protection of property rights, property rights are not well defined. Therefore, a fundamental step is to define and give property rights to owners of property. Subsequently, where possible, market mechanisms should be developed to provide payment for environmental goods and services.

Where this is not possible, EGS compensation would imply the kind of “green” programs that many Canadians associate with the European Union. An argument for adopting them is that members of the sector often bear the largest burden of costs and providing services for which there is no market value. Therefore, society reaps value for which the suppliers pay the lion’s share. The Green Belt in Ontario, the Agricultural Land Reserve in British Columbia, or the provision of wetlands across the country are examples. Regulations are often put in place that amount to “sticks”, i.e. regulations that compel people to follow certain practices, incur private costs, or that deprive them of potentially profitable uses of their land. This amounts to confiscation of property rights of landowners. The alternative is to compensate people for the value created.

The other side of the argument is, “why should we pay people to do the right thing?” and “green programs may create misallocations of resources”. Both are right at some level, but both have flaws. Where there are no markets for environmental services, one can easily argue that the current system already mis-allocates resources: e.g. if there was a market for “wetland services”, then the supply might be much greater than it is because owners of land would be properly compensated for preserving wetlands. Hence, ***not*** attempting to compensate people may well have resulted in much ***worse misallocation***.

Moreover, when land-use opportunities are limited by regulation and, therefore, when owners cannot obtain the highest value for the land, the argument about doing the right thing has many holes. The “right thing” to do is very different with different incentives. This is an area that needs to be investigated much more fully and most likely incorporated into Canada’s policy. It is particularly important for Canada because we have one of the highest endowments of land and water compared to our population. In addition to their value in farming and other traditional commercial pursuits, land and water will have increasing value in tourism. Thinking about land, water and their use in long-run strategic terms needs to be included in Canada's policy.

Water Management

The second aspect of the natural environment is water. This was not discussed widely in our workshops, but it will be of growing importance and needs to be addressed. Water will be one of the scarce resources of this century even without global warming, in large part because urbanization and water use by humans continues to grow. Canada has a large endowment of it, as we do with land. The combination of land and water in this country is second to nowhere in the world. There is very little of more strategic importance for the long term future of the country than to maintain this resource and use it ever more wisely. Three objectives of water policy must be:

- Maintain sovereignty over Canada's water supply
- Invest in infrastructure to make water more available for farm production
- Invest in infrastructure to make water more potable and pure.

7. *Maximizing International Market Access*

Market access in this project focused mainly on government's role and position in gaining access to foreign markets through trade negotiations and pursuit of trade disputes.

There was some discussion about internal market access regarding inter-provincial trade barriers, and general approval of the recent agreement between the provinces of British Columbia and Alberta aimed at minimizing them.

But international market access was clearly the major issue and the most controversial one in the process. This follows from Canada's surplus of land and water in a market place where future growth in demand will come largely from export markets. What, then, is the appropriate role of government in gaining and maintaining foreign market access? The controversy naturally arose because of the conflicting interests of the roughly 80% (in gross farm revenue terms) of the agri-products sector that is subject to international market forces and the 20% that is supply managed and protected from international markets. This is not a new conflict in Canada, and is certainly not without emotion. In the current context, there are some relevant questions:

- Is Canada's position at the Doha Round of the WTO negotiations consistent with the vision for our sector?
- Does the position on protection of supply managed commodities result in economic harm for the non-supply managed industries?
- Is it possible that a strategy based on bi-lateral treaties can be as advantageous for Canada as multilaterals?

Deliberations at the workshops for this project concentrated on these issues. On the surface it would appear that a position that simultaneously asks for maximum access to markets in foreign countries, while giving up nothing for products Canada wants to protect, is inconsistent with the vision. But one can argue that all countries have things they want to gain and things they want to protect, so this is the type of starting point that we come to expect in negotiations. At the same time, it is clear that a number of other countries have offered to compromise on their positions, while Canada has not and has been chastised in the WTO for slowing progress.

For many, the first two questions are quite interrelated: if our market access position does no harm to the exporting industry, the first question is moot. However, many people perceive there is harm and cite as the lack of progress in the current Doha round "sensitive" products; the so-called "voluntary" caps on Canadian wheat exports to the US because of pressure from the US dairy lobby; and the fact that Canada was unable

to participate in the negotiations for tariff rate quotas for a number of products such as canola oil to Japan in the Uruguay Round, not to mention Canada's inability to access tariff rate quotas in other countries for dairy products. The latter issues are a result of Canada's position in the Uruguay Round.

Many people apparently believe that Canada would be well advised to develop a bilateral strategy for market access, although no one made the arguments in any of the workshops for this project. There was apparent general agreement that bi-laterals may work well as special agreements within the WTO framework, e.g. agreements like NAFTA in which selected trading partners go farther in terms of market access, dispute settlement, or harmonization of standards than does the general agreement. Bi-lateral agreements would be important in implementing strategic marketing plans for individual countries or regions. But to rely on bi-laterals as a potential source of advantage seems to be at odds with reality:

- The WTO gives smaller countries, such as Canada, much more legal clout against larger countries in both one-on-one and third party disputes because of its dispute settlement process. This is evidenced by the continuous erosion of US and EU policies through losses in trade disputes – e.g. US cotton, EU beef, the Byrd Amendment, US steel tariffs, etc.
- Canada has a relatively small human population that is geographically dispersed and costly to serve. It is not obvious that access to our market is as attractive to other countries as would be much larger and/or geographically concentrated countries. Hence, Canada's negotiating strength relative to others is questionable.
- Similarly, Canada can offer relatively little in economic and defense aid in negotiations. This again calls into question Canada's negotiating strength.
- There is an alarming lack of a plan for deciding what countries would be priorities for bi-lateral trade negotiations if this is the way to go, and other countries are far ahead in this regard.

There is no support among those we spoke with for a strategy based mainly on bi-laterals, since they would simply allow Canada to play into the hands of large countries who have advantages in size and market power, and who would use bi-laterals as sources of advantage over us. As suggested above, there *is support* for bilateral agreements as second level tools in developing and implementing strategic marketing plans for Canadian exports.

But there is also no unanimity on Canada's position on WTO. More than once we heard powerful and articulate arguments about the consequences of giving up the protection that Canada has for dairy and poultry. One dairy farmer summed up the argument well. The gist is that he has no doubt Canada can compete in a market that has fair competition. But he does not believe that the competition is fair or that it will become so because the US will not abide by the rules. This is a widely held point of view in our sector, and it will be difficult to change.

One of the most constructive suggestions in the project was made at two different workshops. It is a suggestion to develop contingency plans. This would occur in case it becomes clear that a substantial agreement is likely to be reached that would seriously erode protection for dairy and poultry. The contingency plans would be developed by the appropriate national boards and governments. They would contain transition plans for the industries, including how to adjust pricing mechanisms and quota allocations under more international competition. Hopefully, they would also be done in time to allow Canada to participate fully in any final negotiations on tariff rate quotas and other implementation issues so that neither the supply managed nor non-supply managed industries would be left out of these important processes again.

This is not a subject on which there will ever be agreement. Hence it falls to government to make the right decision for Canada. From the perspective of the Centre, the right decision is self-evident. For Canada not

to take a strong stand in favor of market access and reduction of trade distorting subsidies by major industrial countries is tantamount to economic suicide.

TYING IT TOGETHER

There is a strong belief among those who participated in this project that Canada's agri-products sector can prosper in a global marketplace that increasingly offers opportunities for bulk food, differentiated products and services, and an increasing range of nontraditional products. But to do so, two factors are fundamentally important.

First, Canadians must be innovators. To us, innovators are entrepreneurs: they take risks in devising and delivering new products, new services, new technologies, new applications of existing technologies, improved processes, supply chain efficiencies and a wealth of other things that entrepreneurs will think of.

Innovation is one-half of the mission identified herein for the agri-products sector. We simply have to be leaders in innovation. Experience tells us that Canadians **can** be innovators, but often are not. As the project unfolded and we heard from more and more people, it became apparent that much of what constrains Canadians' innovation and entrepreneurship is the business climate in which we must operate. From every group and every piece of research on Canada's economy, the evidence mounts that Canada's tax system, its regulatory system, and limitations on Canada's ability to gain international market access frustrate, constrain and limit our ability to act. In fact, the business climate often encourages people to continue to do what they have always done. And, in agriculture the system encourages innovation to be focused on maximizing the size of government cheques. Thus, developing an appropriate business climate is the second fundamental factor and the second part of the mission that must be accomplished if our vision is to have any hope of being fulfilled. To repeat, our mission is to:

***Create a progressive business environment
that fosters innovation***

Much of the time spent in the project workshops was invested in defining strategic intents and policy instruments. The concept of strategic intents is straightforward. The vision and mission discussed above describe what commercial participants in the agri-products sector want to create. In order to do so, they need government policy to achieve a number of goals. The goals are the strategic intents.

Policy instruments are then the things governments should do to achieve the strategic intents.

Two of the areas of strategic intent are focused on assisting with creating innovation. One of these is the human resource intent, especially the components dealing with management and technical training. The other is improving value chain management.

In both cases, there is a role for government and public policy, but we want to underline that the private sector also has responsibility. There is an even bigger role for members of the private sector to understand the importance of these two areas and to optimize opportunities. It is important for government to offer the opportunities for training. This will come to nothing, however, if managers do not recognize the need for it.

Similarly, we can talk until we are blue in the face about the need for better supply-chain management. But if managers in supply chains insist on thinking and acting in terms of traditional adversarial relationships, blue will be our only accomplishment. It is interesting that, in a comment from federal civil servants on an early draft of our white paper, surprise was expressed that we had elevated supply-chain/value chain

management to such an important level. Our reaction is that this expression of surprise simply underlines how far we are from understanding how much opportunity exists by improving supply-chain management.

The Centre is currently in the process of developing a training program on value chain management. To date, one major component is over 60 hours of interviews with people from around the world whose livelihoods have been enhanced by developing formal value chains and implementing them through concepts such as lean manufacturing, pricing mechanisms that focus on end user value, and finding ways to share information in the value chain on consumer wants and needs. Formalized or otherwise, until a significant portion of Canada's sector begins to understand the opportunities provided by this approach, we will not have accomplished our mission.

The remaining five intents are primarily aimed at improving the business climate in Canada so that entrepreneurs can innovate. They are about removing the barriers and providing appropriate incentives to do so. We start with improving a tax system that has been criticized by every economic research unit in Canada and, increasingly, around the world. There are enough studies that have shown the benefit of these kinds of changes in countries such as Ireland and Portugal that it may be time for Canada's governments to learn the lesson.

Similarly, 25 years of analysis show the extent to which Canada's regulatory systems, especially (in the case of our sector) those of Health Canada, impede our ability to innovate. There is *no disagreement* among those in our sector that highly scientific standards regarding safety of people, plants, animals and the environment are good for business and innovation. But there's also no disagreement that sloppy, slow, and inefficient administration of regulatory systems offset any advantage of high standards.

The George Morris Centre has worked with a number of administrators of regulatory programs over the past few years and it is clear from our experience that many of them understand the need for change. However, what is missing is the political will to develop clear policies that say regulatory systems should be administered in ways that simultaneously protect Canadians, plants and animals, and/or the environment while enhancing our competitiveness. A vision for this approach that should be adopted is to have a regulatory system that is "*Tough but FAST*". This vision should be used to make changes within existing regulatory systems and to change systems.

'Tough but
FLEXIBLE
ACCOUNTABLE
SENSIBLE
TRANSPARENT'

Similarly, regulatory systems within the agri-products sector need to be examined and, where appropriate, redesigned to simultaneously provide bargaining power for farmers and to encourage innovation in the supply-chain. In the evolving market place it is simply not acceptable to protect existing structures. They must evolve to encourage entrepreneurs to innovate either collectively or individually.

At the same time, there is a belief that the public sector has a responsibility to support innovation through research. This report contains some basic principles for improvements, but more input on what the key strategic areas of research are, and how best to implement them is required from entrepreneurs. A strong message from the project is to listen to the people who are trying to do business, not just to those in the

research community who often want to push their ideas whether there is a market or not. As with several other sets of recommendations, we suggest a strong third party intervention to accomplish this.

Two strategic intents do not have recommendations from the workshops that were quite so unequivocal because there was not complete agreement on them. One is the question of compensating farmers and others in the supply chain for providing “environmental goods and services”, EGS. The other is market access.

The EGS component in turn has two issues. The first is whether the value of the natural capital used to deliver environmental goods and services should be compensated via the kind of “green” programs that many Canadians associate with the European Union. The basic arguments pro and con are laid out above. We believe these arguments need to be fleshed out and long term strategic decisions made on land and water use policies to ensure that Canada obtains the most from the two resources with which we have been heavily endowed. They will be keys to our potential for innovation in the future.

The second and related issue is maintaining sovereignty over our water, and investing in infrastructure that optimizes its use and potability. These are further concepts to ensure that Canada has the ability to innovate.

The strategic intent regarding market access through trade negotiations has two sides based on vested interests. Approximately 80% of the industries in our sector must compete with international markets. Not surprisingly, given this and Canada's position and as a land-surplus country, the majority of those industries would like to see maximization of export market access. Moreover, many of them understand that multilateral forums such as the WTO provide optimum opportunity for smaller countries, such as Canada, to influence placing limits on the exercise of economic power by larger countries. The industries that make up the other 20% are protected by import tariffs and focus on the domestic market. Also, not surprisingly, the majority of them would like to see their industries remain protected. International trade agreements, if successful, do not result in both simultaneously.

Given the potential market growth in external markets, Canada's land and water endowments, and the power for policy reformulation that the WTO offers, the Centre must conclude that efforts to maximize market access through the WTO is fundamental to our vision of providing “leadership in commercial innovation for and with our global customers”.

We do believe that adoption of the strategic intents identified here will be a start toward bringing about the fundamental change needed in order for Canada to reach its potential and fulfill the vision. These must be done together. We can improve management all we want, but if the tax system, the regulatory system, and lack of market access impose limitations that no one can overcome, then it's a waste of time, effort and money. More importantly, a huge amount of human potential will have been lost.

Therefore, this must be thought of as a package, and the entire package needs to be implemented...Now.

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