Country of Origin Labeling…The Biggest Challenge

A Think Piece by Kevin Grier, Senior Market Analyst and Larry Martin, CEO
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Country of Origin Labeling (COOL) is to be put into practice in the United States by October 1, 2008. House Ag Committee chair Collin Peterson says that implementation is inevitable on or before that date. This is likely to have major negative ramifications for the Canadian cattle and hog industries.

Essentially, COOL requires that all fresh pork and beef sold at retail in the US be labeled as to the country of its origin. For a product to be labeled as product of the United States, it would need to be produced from an animal that was born, raised and processed in the United States. All other permutations and combinations would need to be put on the label. For example, if a pork chop came from a hog that was born in Canada, but finished and killed in the US, the label would need to say: born in Canada, raised and processed in the United States. An Eye of Round roast might have the following on the label: born and raised in Canada, processed in the United States. In that case, of course, the roast would have been from a steer or heifer born in Canada, fed in Canada but shipped south for slaughter. Don't even ask about hamburger. Needless to say this will involve multiple labels, which will increase costs through the chain. COOL for seafood is already in place in the US and it has proven to be far more costly for retailers than the original USDA estimates.

Fresh meat products from Canada sold in the US would simply need to be labeled as product of Canada. Processed products such as bacon or baloney are not included in COOL, nor are chicken or products sold at foodservice. There are fines ($10,000 per occurrence) included in the legislation for those who get caught with mislabeled product.

COOL was passed as part of the 2002 Farm Bill. Significant battles since that time have delayed the implementation of COOL for livestock and meat twice, with the current effective date being September 2008. There was some speculation that if the Republicans had held Congress in last November's elections, implementation could have been further delayed or even quashed. With the Democrats now in control of Congress, however, COOL is suddenly a big priority. COOL will be implemented. There aren't the votes in Congress to delay it another year or more. It is due to be implemented October 1, 2008. Nevertheless, the law might change before then as House Agriculture Committee chair Collin Peterson, D-Minn., wants both COOL and mandatory cattle identification. This is a clever move on his part. He and the industry might be able to work together to get some derogation on ground beef and Canadian/Mexican cattle that are substantially raised/processed in the U.S.

In 2003 and 2004, when COOL first raised its head, the George Morris Centre did a great deal of research on behalf of hog industry organizations, like Manitoba Pork, regarding the impacts of the legislation. The bottom line of the research was that US packers would need to segregate, sort, control and account for Canadian livestock that they purchase. They would also need to segregate and label the meat from these animals separately from other meats.

Needless to say, handling Canadian livestock would increase risks of mislabeling by US packers. More importantly, handling Canadian livestock would be more costly than running a plant without Canadian livestock. For example, the 2004 George Morris Centre research estimates indicated that handling Canadian hogs would cost packers an extra $5-10/head. Other estimates of extra Canadian cattle costs were much higher. These extra costs and risks mean one of two things: US packers won't bother buying Canadian livestock, or US packers will discount bids on Canadian livestock by the amount of the added costs and risks. Some packers simply said they could not take the risk or the added costs of buying Canadian cattle. Other packers said they would need to pay less for Canadian cattle due to higher costs. More than 160,000 hogs and 20,000 cattle cross the border each week. That amounts to about one third of total livestock marketings in Canada, which means that livestock prices in Canada will decline as soon as the legislation is enforced.

The George Morris Centre research concluded that COOL is nothing less than a non-tariff barrier to trade. That, of course, is exactly what its proponents, mostly US cattle producers, intended when they pushed for the legislation.

This legislation has the potential to exert a very damaging impact on the Canadian livestock industry. It will result in lower prices in Canada and will accelerate producer attrition and the decline in herd sizes for both cattle and hogs. Those who see the glass as half full will point to the fact that more livestock will be processed in Canada, which is true, but will only be due to problems in the livestock sector directly resulting from the implementation of COOL. The benefits to processors will be short run as the livestock sector declines.

Canadian livestock producers are not alone in facing negative consequences resulting from COOL. US cattle feeders, hog finishers, packers and retailers will all be worse off as a result of COOL. Not only will they face higher, non productive costs, but they depend on Canadian cattle. In addition, the US benefits from livestock imports due to the fact that all the value-adding and jobs occur there, not in Canada.

The Canadian livestock industry is facing many challenges now, perhaps no greater of which exists than COOL. The Canadian livestock and meat industries need to work together to fight against COOL in the international trade arena. There are some potential opportunities worthy of further investigation:

- COOL could offer an advantage to the Canadian packing industry: it will incur no new costs for products labeled Product of Canada. The problem lies in the traditional pricing mechanism: since the cost of procurement by US packers will rise for Canadian hogs and cattle, US packers will bid prices down to reflect that cost. In the normal competitive model, Canadian packers would also bid Canadian prices down to meet the competition. So, Canadian packers would have the same cost of their raw material and would not face the segregation and labeling costs of their US competitors. Moreover, the very fact that COOL will differentiate product of Canada gives the opportunity to build a brand reputation. This is further detailed below.

  However, this will eventually catch up to Canadian packers as some producers will find alternatives to raising hogs and reduce the supply to packers. This will result in higher costs of unused capacity for packers. An alternative is to find a way to share risk and benefit with others in the value chain by sharing gross returns on the basis of producers' and packers' contributions to final value over time. This will be more of a challenge for pork than for beef in the short term because Canada has excess slaughter capacity for cattle, but too little for hogs.

- A variation on the foregoing, with or without a value chain component, is for the industry to focus on branding. Never before has Canadian product been labeled conspicuously, and with a potential cost advantage over its US competitors. This yields the opportunity for Canadian companies to more easily establish brand value propositions. It may be a place for both public and private investment, especially if WTO clarifies what constitutes legitimate market development assistance and export subsidy.

- One supposes there may be an opportunity for a trade dispute with the US, either on the basis that COOL is in violation of the Sanitary and Phyto- sanitary provisions of the WTO, or that COOL is discriminatory against Canada because other exporters of pork to the US do not face the same restrictions.

This reasoning would seem to suggest, therefore, that Canada should take major steps to gain access to alternative markets through negotiations at the WTO.