

COOL is a Hot Problem

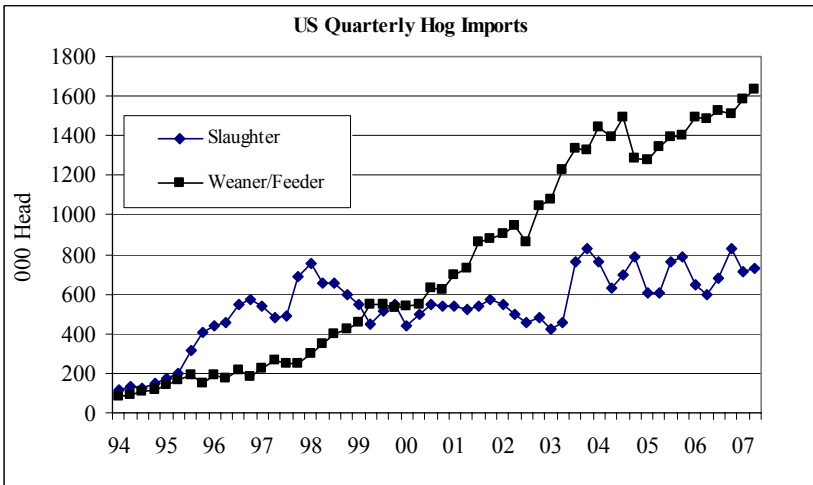
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Country of Origin Labeling (COOL) is to be put into practice in the United States by October 1, 2008. This is likely to have major negative ramifications for the Canadian cattle and hog industries.

Reminding the industry and its suppliers of the importance of trade to the industry may seem redundant, but the numbers are always interesting if not surprising nonetheless. Furthermore, assessing the importance of trade, particularly with the US, provides perspective on the significance of COOL. In that regard, it is noted that in 2006, the Canadian packing industry slaughtered about 21.6 million head. In addition to that, however, Canadian hog producers sold nearly 8.8 million live hogs to the US. **Figure 1** shows the trends in live exports from 1994 through the second quarter of 2007. In particular, the graph shows the quarterly exports of slaughter hogs and weaner/feeders. At six million head, the weaners and feeders were about double the slaughter hog exports in 2006.

Figure 1. Trends in Canadian Hog Exports to US – 1994 to 2007



Combining the Canadian slaughter with the US live shipments means that Canadian hog producers marketed about 30.4 million live hogs. Of those live marketings, 29% (8.8 million) went to the US. That 29% is not the full picture of the importance of the US to Canadian hog producers. In addition to those live exports, Canadian packers also sold 364 million kilograms of pork to the US. Using some creative arithmetic, those kilograms can be equated to 5.4 million live hogs. Therefore, the US was the destination for over 14 million Canadian hogs in either live or meat form. That in turn means that of the total Canadian marketings of 30.4 million head, 47% went to the US in one form or another. Of course different provinces have different shares of their production going to the US. In Manitoba for example, the share of hogs going to the US could be more like 70%.

That provides a solid perspective on just how important the US market is to the Canadian industry. The fact that the purpose of Country of Origin Labeling is to deter or reduce Canadian imports, helps to focus attention on the importance and threat of this legislation.

Essentially, under the original version of COOL that was proposed in 2002, the law required 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 would 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. The current effective date for implementation is October 2008. Opponents of COOL have included the American Meat Institute, the US National Pork Producers Council and the Food Marketing Institute, a retailer organization. Certain cattle producer groups were also in opposition. Those producers and

packers that were opposed were concerned about the cost of implementation and the resulting competitive repercussions. Both retailers and packers asserted that the legislation was burdensome and unnecessary as consumers were not demonstrating particular interest in the origin of their beef and pork. In that regard the potential consumer benefits of COOL are doubtful. As noted by the USDA in May of 2007:

Food manufacturers infrequently label food as 'Made in USA.' The absence of such voluntary labeling suggests that suppliers believe consumers either do not care where their food comes from or prefer the imported product. It is also possible that consumers prefer domestic products, but are unwilling to pay higher prices to cover labeling costs. Any of these explanations implies that suppliers believe it is generally not profitable to label.

Some consumers may actually prefer such labels, but this group may be too small for markets to satisfy their demands profitably. In this case, consumers who value the information may be better off with mandatory COOL, depending on how much they are willing to pay for label information and the cost of providing it. Even for these consumers, however, costs could exceed the benefits. For consumers who are indifferent to labels, the higher prices resulting from mandatory COOL would make them unequivocally worse off.

Source: www.ers.usda.gov/AmberWaves/May07SpecialIssue/Findings/Mandatory.htm

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 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. COOL would impede livestock imports. That, of course, is exactly what its proponents, mostly US cattle producers, intended when they pushed for the legislation. This view is supported by the American Meat Institute (AMI), which is a very strong opponent of mandatory Country of Origin Labeling. For example in May of 2004, the AMI made the following statement in a letter to the US Congress: "Unfortunately, some groups have public policy positions supporting mandatory county-of-origin labeling for red meat that are solely for the purpose of erecting trade barriers, especially directed at Canada and Mexico -- our two largest export markets for red meat. These groups have, for too long, been mischaracterizing the mandatory labeling requirements that currently exist in this country. And, now they are raising bogus and irresponsible food safety arguments to further their protectionist agenda."

This legislation in its original form 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. At the same time, however, the only reason more will be processed in Canada is due to problems in the livestock sector directly resulting from the implementation of COOL. If in fact COOL did result in lower pricing in Canada, the benefits to processors will only be short run until the livestock sector declines.

As noted earlier, 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 livestock for their packing plants, feedlots and finishing barns. In addition, the US benefits from livestock imports due to the fact that all the value-adding and jobs occur there, not in Canada.

As a result of this US producer opposition to COOL, there have been changes made in the proposed law. Unfortunately, at the time of this writing, the final version of the law has not yet been made clear. A version passed in the US House of Representatives during the summer of 2007 contained some important changes. As of October 2007, the US Senate has not made its contribution to the legislation. Nevertheless, the following are the key provisions or compromises that are being brought forward by Congress and industry as of October 2007:

The biggest value of the compromises to U.S. pork producers is that it limits the records that USDA can require for verification of origin to those records kept in the normal course of business. Further, it appears likely that producers will only have to provide their customers with a statement indicating: a) the origin of the pigs, and b) that the producer has records showing where he/she got the pigs. In other words, the trail of those records would lead back to the origin of the pigs.

In addition, the new language allows ground meat to be marked with a "may contain" label that lists all of the countries from which ingredients either actually came from or could reasonably come. That is not a big deal for pork, but it is huge for ground beef.

There is some disagreement about how the House bill will change the actual labels applied to pork other than the fact that there will be only three labels as opposed to the four or more presented in the original rules. Those rules required actual combinations of where animals were born, raised and slaughtered.

The law is clear -- imported meat is to be labeled as product of the source country. My reading of the law says that animals born, raised and slaughtered in the United States must be labeled "Product of the U.S." Animals born or raised in another country and slaughtered in the United States will be labeled "Product of Country X and the United States." Some observers believe that product from animals born, raised and slaughtered in the United States can be included in that latter label, basically lumping everything other than imported meat into one label. USDA will have to interpret the law during the rulemaking process.

Source: National Hog Farmer's North American Preview, August 3, 2007

As noted in Meatingplace.com, July 27, "the measure creates three categories of labeling: one that indicates product was born, raised and slaughtered in the United States; one that indicates product was not exclusively born, raised and slaughtered in the U.S.; and one that includes products entirely derived from foreign countries. Ground meat product can be labeled with a list of countries where product may have originated."

The compromise will not repair all shortcomings in the COOL law but it makes many improvements for the nation's cattlemen, says the National Cattlemen's

Beef Assn (NCBA). Cattle Buyer's Weekly says that the measure greatly eases cattlemen's concern that proving the origin of their cattle would require burdensome recordkeeping, it says. NCBA's top priority from the beginning has been that the benefits of COOL must outweigh the costs for producers, says vp of government affairs Jay Truitt. The amendment takes some major steps in that direction. But the latest version of COOL is far from perfect. Poultry is still completely exempt from all requirements imposed on beef, pork and lamb. This is a major disappointment for cattlemen because poultry is beef's primary protein competitor in the consumer marketplace, he says. Cattlemen's final objection to the COOL law is the misconception that it will address food safety issues. Labeling is not a solution to recent safety problems with imported foods, says NCBA president John Queen. (Source: Cattle Buyers Weekly, July 23, 2007)

More importantly, the change that involves "basically lumping everything other than imported meat into one label," has huge ramifications for Canadian livestock producers. What that means is that US packers may simply choose to use one label which would preclude the need for segregation and sorting. That in turn would mean that Canadian livestock would not cost more to handle than US livestock.

Again it needs to be emphasized that the compromise is not yet agreed to in law. Furthermore, it remains up to the USDA to write rules to apply the law. How the USDA interprets and writes the rules will have a major impact on how packers may deal with imported livestock. In addition, there remains a great deal of uncertainty as to how the US retailers are going to react. Key questions with regard to retailer behavior will include the following:

- Will retailers demand US product only?
- Will retailers pay more for US product?
- Will retailers discount non exclusive US product?

As of the fall of 2007, US packers are uncertain as to how they are going to react to the possible compromise version. Packers not only are uncertain if the compromise will be in the final version, but they also do not know how onerous the final rules will be once written by the USDA. Finally the packers are uncertain as to how their customers will react to the compromised version.

The bottom line is there are at least three basic directions that COOL can take. One scenario is that the legislation remains largely in its original 2004 form with regard to the requirement to identify Canadian livestock as the origin of the beef or pork. If this is the case, the law would have the very negative consequences noted earlier. That is, US packers would need to document and segregate Canadian livestock. They may respond by not purchasing the livestock at all in order to eliminate that cost or they may discount their bids on Canadian livestock by the amount of the added costs. This will have an

impact across the Canadian cattle and hog sectors and it will reduce overall pricing levels.

Another scenario is that the compromise version becomes law and that the rules are worded such that packers have a great deal of leeway in how product is labeled. That is, packers may just choose to have one label for pork that says product of the US and Canada. This label would be placed on all of their pork and as such, segregation and additional costs would not result from slaughtering Canadian hogs. If this in fact is the case, then COOL would be meaningless to Canadian livestock producers and it would be business as usual.

Another direction is some combination of the two noted above. That is, the compromise version becomes the final law but retailers and packers demand separate labels for the product of the US and the product that contains Canadian livestock. If that is the case, then a further one or two events could occur. The first is that it could cost more to prove US product and it therefore may cost more in the market. Alternatively, non-US product may need segregation and sorting and therefore something similar to the first scenario evolves.

As of the fall of 2007, the entire situation is unclear and confused. The positive point, however is that the compromise worked out in the House, does give hope that Canadian livestock will not be discounted. That hope was dim prior to the summer of 2007. Another hopeful point is that it appears that COOL is in direct contradiction to US trade agreements. These agreements state that any animal slaughtered in the US is product of the US. If that holds, then COOL's interference is not valid and could be over turned.

The bottom line is that COOL remains a source of uncertainty and risk for Canadian hog producers at a time of mounting uncertainty and risk in most other areas of their businesses.