New Factors Affecting Cattle Prices

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Introduction

The U.S. cattle industry is an important component of the agricultural industry with cash receipts in 1996 estimated at $35 billion by the U.S. International Trade Commission (Pub. 3048, July 1997). Ranchers and feeders have experienced lower returns over the last 4 years and several reasons have been forwarded for those lower returns. Classical economics con-siders supply and demand and looks for those factors that may be driving the market in one direction or another because of shifts in supply or demand.

Demand Factors

Demand has been blamed for some of the problems in the cattle industry because of increased competition from competing meats. Industry analysts point to increased demand for poultry products and the other white meat, pork. The beef industry has been aggressive in promoting products but questions still arise as to its ability to compete with consumer friendly poultry and pork products.

Another factor that has been blamed for lower prices in the cattle industry is the loss in comparative advantage relative to poultry and pork. Gains in efficiency by producers of competing meats allow those producers to receive lower prices for their products yet experience higher profits. Development of new technologies that lower the breakeven price of beef are needed according to those analysts, so that beef could compete with the lower prices of poultry and pork in producing meat for consumers.

Supply Factors

A third factor presented by some analysts as contributing to lower prices is the capacity utilization of the packinghouses. Packinghouses use a variety of methods for keeping their slaughter facilities operating at capacity. It is important for those packinghouses to operate at capacity in order to keep their average costs at the minimum of their long run average cost curve. Those facilities that are not able to operate efficiently can not compete in the markets as effectively as those who manage to operate at optimum capacity. Captive supplies have been one method used by packinghouses to tie up existing supplies before the animals are ready for slaughter. Forward contracting takes animals out of the cash market and assures packinghouses a steady supply of animals for slaughter. Captive supplies have been investigated rigorously within the U.S. cattle industry and been blamed by many producers for larger margins between grower and retail levels. Inasmuch as captive supplies lead to thin cash markets for live cattle, it could contribute to the increasing margins between grower and retail levels.

Another factor frequently presented as causing lower prices in the cattle market is the increasing weight of fat cattle for slaughter. Given that heavier weight animals increase the supply of beef in the market, there is some credibility to this argument. However, the cause of increasing weights must also be understood. Nobody likes to lose money. Farmers are notorious for accepting large amounts of risk. They produce billions of dollars worth of products not knowing the price they will receive until months later when the products are finally sold. Futures and options markets have been developed to help those growers manage risk, but farmers have been slow to adopting those risk management tools, partly because of a lack of confidence in using those tools and partly because risk creates excitement in the business of farming. Farmers are notorious for being optimistic. If prices are low today, an optimist's logic would be to hang on to the product longer and sell it for a higher price later. This is especially true when returns are below breakeven price. Nobody likes to be wrong and anytime we lose money it becomes hard evidence that we made a mistake. It is for these reasons that many cattle feeders hold on to fat cattle beyond the time when they should be sold. They continue feeding the animals hoping that prices will increase. The more prices decline, the larger the average weight of fat cattle for slaughter. More growers will hold on to the animals hoping for higher prices.

International Trade

A final argument that has received considerable attention over the last year is the effect of imports on returns to cattle producers. The U.S. cattle industry filed antidumping cases last year with the U.S. Department of Commerce and the U.S. International Trade Commission contending that unfairly traded imports of live cattle from Canada and Mexico were causing material injury to the U.S. cattle industry. A countervailing duty case was also brought against Canada contending that subsidies in violation of international trade laws were giving Canadian producers an unfair trade advantage in inter-national markets. The producers who filed those cases are seeking a resolution to those cases to allow U.S. producers to compete on a level playing field. In order for those cases to be ruled to the favor of U.S. producers, it must be proven that imports have caused (or are likely to cause) material injury to U.S. producers. In the anti-dumping case, it must also be proved that those imports entered U.S. markets because of unfair trade practices (i.e., sales below fair market value). The countervailing duty case requires that subsidies be identified that are not allowed by international trade law that give producers in Canada an unfair advantage in international markets.

The U.S. International Trade Commission (ITC) is responsible for determining whether imports have caused or are likely to cause material injury to the U.S. industry. After a lengthy and spirited campaign to gain the necessary support to have standing for the case against Mexico, a hearing was held in Washington in early December to give petitioners and respondents opportunities for presenting data relevant to the cases.

Studies have demonstrated the integration in the live cattle and beef industries of the United States and Canada. Most of the U.S. imports of live cattle from Canada are fed cattle for slaughter. Young and Marsh examined integration and interdependence in the U.S. and Canadian live cattle and beef sectors and concluded:

"Evidence indicates that the live cattle and beef industries of the United States and Canada are well integrated. Quotas and tariffs no longer restrict trade, and border sanitary restrictions are being reduced. Trade in both directions has increased since the implementation of the Canada-U.S. Free Trade Agreement. U.S. and Canadian slaughter cattle prices are closely related." (Linda Young and John Marsh, "Integration and Interdependence in the U.S. and Canadian Live Cattle and Beef Sectors", Montana State University Policy Issues Paper No. 5, July 1998: p. 13)

Imports of live cattle from Mexico are also important in the U.S. live cattle market. Most live cattle imports originating from Mexico are feeder cattle that are fed in the U.S. for slaughter (Jose' Garcia-Vega and Gary W. Williams, "The Mexican Livestock, Meat, and Feedgrain Industries: A Dynamic Analysis of U.S.-Mexico Economic Integration." TAMRC Int. Mar. Res. Rep. IM-3-96. College Station, TX. Aug. 1996). An analysis of trade in livestock demonstrated the importance of price in affecting trade in feeder cattle between the U.S. and Mexico.

The price of live cattle sold in U.S. markets is sensitive to changes in quantities of live cattle and beef sold. Several studies have been completed that examine the price elasticity of beef with respect to total supply. Purcell used retail beef price data to estimate the retail demand for beef and concluded that the price flexibility for beef consumption was –0.96, implying a 1 percent increase in the beef supply would decrease the price of beef at retail by 0.96 percent (Wayne Purcell. "Analysis of Demand for Beef, Pork, Lamb and Broilers: Implications for the Future." Virginia Tech Res. Bull. 1-89. July 1989). He also concluded that grower prices would be even more flexible than retail, indicating that the price flexibility of live cattle could be as high as –1.6.

The American Farm Bureau Federation (AFBF) provided testimony during the U.S. International Trade Commission Investigation "Cattle and Beef: Impact of the NAFTA and Uruguay Round Agreements on U.S. Trade" (Inv. 332-371) and concluded that the peso devaluation in Mexico, high feed grain prices and reconstruction of slaughter facilities in Canada were all having an effect on cattle and beef trade and cattle prices in the U.S. They noted the significant increases in imports of live cattle from Canada and Mexico. Peak imports from Mexico occurred in 1995 following a severe drought that affected Mexico and the southwestern U.S. Imports from Canada continued to climb through-out the period with imports reaching 1.475 million head in 1996, nearly 500% higher than the 247,000 head imported in 1986. They con-cluded that increased imports of fed cattle from Canada and feeder cattle from Mexico had caused fed cattle prices to be $1 to $2 per hundredweight lower and feeder cattle prices to be $2 to $4 per hundredweight lower. The American Farm Bureau estimated a loss to the cattle industry ranging from $500 million to $750 million in 1995 alone.

The Food & Agricultural Policy Research Institute (FAPRI) developed a modeling system that they use to generate a medium-term outlook for agricultural commodities in the U.S. and major trading countries. That model uses current policy provisions and incorporates both the North American Free Trade Agreement (NAFTA) and the General Agreement on Tariffs and Trade (GATT) to generate projections from 1997 through 2007 by simulating the market given basic assumptions of beef demand and supply. In their 1998 projections, FAPRI assumed an expansion of Canadian beef production and net exports of beef from Canada to grow at an average rate of 10 percent annually. The Mexican market was assumed to grow in their model and provide growth in beef exports for U.S. producers of 12.6 percent annually.

The impacts that imports have had on U.S. cattle feeders were estimated using the FAPRI modeling system of the U.S. cattle industry. The total potential impact to the U.S. industry from correcting the dumping and subsidy margins in Canada alone was estimated at $1.12 billion. The prices of fed cattle and feeder cattle are sensitive to changes in the quantity of live cattle imported from Mexico and Canada. Unfair trade practices resulting from dumping or from unfair subsidiza-tion of the cattle industry will have significant impacts on U.S. producers.

The ITC issued a preliminary ruling earlier this year indicating that imports from Canada were causing or were likely to cause material injury to the U.S. cattle industry. The ITC ruled in the negative on the case for live cattle from Mexico. The U.S. Department of Commerce (US DOC) followed these decisions by initiating an investigation of marketing practices of Canadian live cattle and a review of programs which subsidize Canadian cattle producers. The US DOC is collecting evidence that will be used to draw conclusions in these cases. A positive determination in those investigations could lead to the imposition of antidumping and or countervailing duties being collected on imports from Canada to remedy the unfair trade practices that have been used by Canadian producers.

Conclusions

The live cattle markets have suffered through depressed returns of the last several years. Several factors have been attributed to those lower returns. Demand considerations are important because of the competition beef producers face in the diet of the consumer. Supply factors are also important. Increased supplies from heavier weight cattle do lead to lower prices. The influence of packinghouses in the pricing of supplies is also important.

International trade in live cattle and beef has been important to the U.S. cattle industry. International trade relies on fair trading practices being followed within the community of nations so that efficiency and comparative advantage become the driving forces in determining who produces and sells products throughout the world. Trade has become one of the more important issues in determining industry profitability. The trade dispute with Canada and Mexico will be resolved following the investigations initiated by ITC and USDOC. Negotiations will be initiated in November, 1999 for the Millenium Round of GATT Negotiations. It is expected that these negotiations will move forward in eliminating more of the tariff and non-tariff barriers in agricultural trade. The importance of trade as a factor in industry profitability will grow. The assurance of fair trade will also be important to the live cattle industry.

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