AGRICULTURAL EXTENSION SERVICE · UNIVERSITY OF MINNESOTA

Swine Update

VOLUME 3, NO. 5 JUNE, 1985

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CONTRACT FEEDING

Custom contract feeding of hogs increased rapidly in the corn belt during the past year. Some call this "vertical integration" and say it is "bad" for the industry. Others see it as a way of getting credit at reduced risk during the current financial crisis and so call it "good". This article lists the major advantages and disadvantages of contract feeding. It also reviews the reasons for its recent growth and offers some observations as to its future.

Why The Fast Growth?

Consumers are shifting from pork to poultry. The strong U.S. dollar and foreign price support policies gave rise to sharply higher hog imports in 1984. Expansion of hog production after the record high hog profits in 1978 leaves the industry with an overcapacity of some 10 percent in the face of the current weak demand for hogs.

On the cost side, interest costs are sharply higher, feed costs have been very volatile, and other costs have continued to rise. The combination of weak demand and higher nonfeed costs has resulted in losses to hog producers about half of the time since 1978. These low (and variable) returns when coupled with sharply declining asset values have put many hog producers and their creditors in a high risk financial position. Some are insolvent already--others could also find their debts greater than their assets if their hog enterprise loses money another year or two. Consequently, contract feeding, with its promise of positive cash flows without the need for operating credit for pigs and feed, holds a real attraction to a growing number of producers.

Advantages Of Contract Feeding

- It greatly reduces the risks involved in hog feeding. (Only two of the last six years, 1982 and 1984, have been profitable for hog finishers.)

- It removes the need for operating credit for the hog finishing enterprise. (Most programs supply both the pigs and the feed.)

- It accelerates cash flows by allowing the hog finisher to sell his home produced feed earlier. The complete hog producer can also accelerate cash from the enterprise by selling his pigs to the contractor--but keeping them on the farm under the custom feeding program.

- It provides the marketing service--both buying the feeder pigs and selling the market hogs. (If these tasks are done by specialists, a larger gross margin is likely over time.)

- It can provide a start-up opportunity for the beginner who is short on capital.

- It can increase profits from the hog enterprise. (Some have criticized the current average payment of about $8 per hog fed to cover labor and facilities as being below cost. But this about equals the average returns to labor and facilities observed on record keeping hog finishing farms the past 5 years.)

Disadvantages Of Contract Feeding

- Facilities may not be fully utilized. (The farmer may want some written assurance that pigs will be provided on a regular basis.)

- The contract may require more time and management input--for example, more detailed records may be required.

- The operator will need to cooperate with the fieldman for the contractor. (Will the fieldman be a consultant or a boss?)

- Participation in a contract program may, at present, have a "poor image" as being suggestive of financial trouble. (This image is likely to change as it has in cattle feeding when one must be a "good manager" to attract customers--and the value of custom feeding as a risk management strategy is recognized.)

- The industry-wide impact will--if average production costs are reduced--tend to increase supplies and lower prices.

What Does The Future Hold?

Will contracting fade away if and when the agricultural income situation improves? This will depend, in part, on how good a job of management the contractors do in the next few years. Many will likely fail to deliver the full potential as outlined in the advantage list above. But, if a significant number can deliver--while minimizing the potential disadvantages listed--contracting will become firmly established as an acceptable form of specialization that reduces credit needs and risk exposure while providing an acceptable return to labor and facilities. To attract and hold good managers with superior facilities may require the payment of performance related bonuses.

Estimates are that some 5 percent of the hogs now on feed are under contract. The advantages offered by contracts under current conditions will encourage the expansion in the next few years. If contractors effectively utilize specialized talent to increase returns for their farmer cooperators as well as for themselves, expansion will continue. In fact, this alternative might keep more small hog producers in the business who otherwise would not be competitive with the large specialized units that already utilize specialists in nutrition, breeding, health and marketing.

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U.S. HOG AND PORK IMPORTS

Buoyed by Canadian government subsidies that result in increasing pork production above domestic needs in Canada and by the relative strength of the U.S. dollar, sharp increases in U.S. hog and pork imports occurred over the past four years. Import rates continued to increase during the first three months of 1985. Recently released figures for April showed reductions from a year ago. This decline was likely due, in part, to the imposition of a duty on pork imports from Canada.

The Changing Level of Live Hog and Pork Imports

Information in table 1 indicates that sharp increases have occurred since 1982 in both live hog and pork imports in fresh, frozen or prepared form. Live hog imports into the U.S. increased 352 percent from 1982 to 1984. Nearly all of the live hog imports each year came from Canada. The small remainder came from Latin American countries.

Table 1. U.S. Hog and Pork Imports, Total World and Canada, 1982-1984

	Calendar Year			Percent Change
	1982	1983	1984	1982 to 1984
Live Hogs (Head)				
World	294,937	447,465	1,332,015	+352%
Canada	294,933	447,391	1,328,750	+352%
Pork (000 lbs. Carcass)				
World	619,598	706,882	953,919	+54%
Canada	280,972	276,556	356,056	+27%

Source: Livestock and Meat Branch, National Economics Division, ERS-USDA.

Fresh, frozen and prepared pork imports into the U.S. have also increased sharply from Canada and other world markets. Most of the pork from Canada is fresh and frozen. Conversely, most of the pork from other countries, such as Denmark, Netherlands, Poland, and Great Britian, is in processed form.

Two major factors contributed to the increase in hog and pork imports from Canada and Europe:

1. Canadian hog production has been increasing in recent years as a result of a Canadian government production subsidy of approximately $3.75 per cwt. This program increased supplies and effectively lowered domestic Canadian hog prices.

2. The rise in the value of the U.S. dollar against the Canadian dollar and European currencies has significantly cheapened Canadian hogs and European pork products for U.S. packers and meat distributors. For example, it took only 70 cents to buy a Canadian dollar in March 1985, whereas in 1981 it took 90 cents. Also, in March 1985 it took only 7 cents to buy a Danish Krona; in 1981 it took 17 cents.

Imports Expressed in Live Hog Equivalents

Information in table 2 is the result of translating the amount of pork imports into live hog equivalents. When these numbers are added to the hog imports, a clearer picture of the magnitude of total hog and pork imports is developed. For example in 1984, in addition to the 1,328,750 live hogs imported from Canada, another 2,150,096 head came in to the U.S. in the form of pork. Imports from all world sources totaled the equivalent of some over 7 million hogs, roughly 75 percent more than in 1982. Live hog equivalents from Canada were up about 60 percent.

Table 2. Total Live Hog Equivalent of U.S. Hog and Pork Imports From All Sources and Canada, 1982-1984

	1982	1983	1984
Live Hogs (World)	294,937	447,465	1,332,015
Pork (Head Equiv.)*			
World	3,741,533	4,268,611	5,760,380
Canada	1,696,691	1,670,024	2,150,096
Total (Head Equiv.)			
World	4,036,470	4,716,076	7,092,395
Canada	1,991,628	2,117,415	3,478,846

* Calculation: [pounds of carcass weight pork from table 1 ÷ average live to carcass yield (.72)] ÷ 230 pound hog = number of live hog equivalents.

Relative Contribution of Imports to U.S. Supply

Information in table 3 indicates the magnitude of these live hog equivalent imports relative to the total U.S. supply of hogs which includes both domestic commercial slaughter and live equivalent pork imports. Imports over the time period have made up an increasing portion of total U.S. supply. By 1984, world imports contributed nearly 8 percent of U.S. hog supplies and Canadian imports almost 4 percent. The contribution of imports to U.S. hog supplies over the first three months of 1985 was the highest on record, nearly 11 percent for the world and nearly 6 percent for Canada.

Table 3. Live Hog Equivalent Imports as Percent of Total U.S. Hog Supply*

	1982	1983	1984	1985**
World	4.6	5.4	7.8	10.6
Canada	2.4	2.4	3.9	5.6

* Commercial domestic slaughter plus live equivalents from pork imports.
** First three months.

Level and/or Rate of Imports Down in April 1985

Monthly 1985 first quarter imports were high for hogs and pork products, both from Canada and other exporting countries (table 4). However, April showed declines for both hog and pork products from Canada. This was largely the result of the imposition on March 27, 1985, by the U.S. Commerce Department of a temporary countervailing duty on all live and pork product imports originating from Canada. The duty amounted to $5.30 per cwt. (Canadian) live basis for pork products and live hogs. Given the exchange rate at that time, this was equal to approximately $3.90 per cwt. in U.S. dollars. On June 10, the Commerce Department upheld its decision to impose countervailing duties and suggested permanent duty levels of $4.39 per cwt. (Canadian; approximately $3.29 U.S.) for hogs and $5.53 per cwt. (Canadian; approximately $4.00 U.S.) of carcass for pork products. This ruling now goes to the International Trade Commission which has until July 25 to determine if countervailing duties at these levels should become permanent. The ruling is expected to be in the affirmative.

Some midwestern states also banned imports of hogs from Canada in late April because the drug chloramphenicol is used in hog feeding in Canada. This drug is banned from use in the U.S. On May 7, 1985, the Canadian government began hearings to determine if it should be banned from use in Canada. These hearings will remain open until July 7, when a decision will be made. Manitoba has already banned its use. Minnesota now requires a seven day quarantine on imported Canadian hogs. As a result of these restrictions, both May and June live import figures are likely to be below a year ago. However, assuming a ban by Canada of the chloramphenicol drug, increases will likely show up again in summer and fall import figures.

Despite these restrictive measure, most analyist expect total 1985 imports from Canada to only be down slightly from 1984 unless the U.S. dollar loses value.

Table 4. U.S. Hog and Pork Imports, Canada and Other Countries, January-April, 1984-85

	Hogs (head)			Pork (million lbs.)		
	1984	1985	Percent Change	1984	1985	Percent Change
			Canada			
January	92,407	184,294	+99%	26	30	+15%
February	87,962	142,330	+62	29	36	+24
March	94,035	214,490	+128	29	46	+58
April	114,760	89,183	-23	30	27	-10
			Other Countries			
January				42	67	+59
February	(Negligible)			36	53	+47
March				41	81	+97
April				60	66	+11

Source: Livestock and Meat Branch, National Economics Division, ERS-USDA.

Impact of Imports on U.S. Prices

Live hog and pork imports at the levels of recent years have impacted on U.S. hog prices. If one assumes that hog prices respond by about 1.8 percent for each 1 percent change in hog supplies, some rough calculations of price impacts of imports can be made. These are shown below under varying assumptions.

Price impacts on 1984 U.S. hog \$48.90 cwt. average price assuming:	Price effect of imports per cwt.
1. Zero change in world imports from 1983: (2.4 x 1.8) x \$48.90 =	\$+2.12 cwt.
2. Zero change in Canadian imports from 1982: (1.5 x 1.8) x \$48.90 =	+1.32 cwt.
3. Zero imports from Canada: (3.9 x 1.8) x \$48.90 cwt. =	+3.43 cwt.
4. Zero imports from any sources: (7.8% x 1.8) x \$48.90 cwt. =	+6.86 cwt.

Given the above analysis, there is little doubt that the results of the significant rise in hog and pork industry since the early 1980s has had a negative impact on the U.S. hog industry.

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