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Beef Trade: A Decade of Perspective

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Nearly 11 years ago when I became the Chief Economist of the National Cattlemen's Beef Association, one of the greatest jobs any son of a Kansas farmer/rancher could have, I was told that unlike wheat, corn and soybeans, beef trade just didn't matter much. Early on during my tenure, it was the opinion of some that we needed to focus our efforts on keeping beef imports out and that beef exports would never be anything more than a niche business of little consequence to the bottom line of U.S. cattlemen.

I politely disagreed then and recall what I was thinking to myself at the time…you don't know what you've got until it is gone. Back in 2003 BCSC (Before the Cow that Stole Christmas), beef exports in 2003 were $3.86 billion with Japan leading the way at $1.4 billion – statistics I can still recall off the top of my head. Actually, beef exports already mattered a lot back in 2003. Back in the fall of that year, our export tonnage was hitting new monthly levels and the November 2003 value of beef exports was $150/head – a historic high. If hides and offal were added in the value of these exports came to just under $200/head.

Currently, export markets account for almost $300/head, which means that 17 percent of the value of a finished steer now comes from the international marketplace. Another way to look at it is that 17 percent of the money used as payment for the product we are producing comes in the form of Pesos, Yen, Won, Yuan, Euros, Rubles, Canadian or Taiwan dollars. The point here is that producers should not get caught up in the notion that per capita domestic beef consumption is declining. Think of the marketplace in terms of every consumer on the planet who buys their food from a supermarket, "wet market" butcher or restaurant. Also consider that one of the biggest economic changes of the past decade is the increased buying power of consumers in all corners of the globe for U.S. beef.

Understanding the importance and opportunity of beef exports to everyone in this industry's bottom line has been a difficult lesson during the past 10 years. Even today, it is difficult to fully appreciate our export potential since we still do not have 100% market access around the world. But a decade has now passed since we lost nearly everything making this a good time to again remind ourselves about the importance of beef exports and, more importantly, to ask what the next 10 years might look like. Let's take a quick tour of our non-U.S. customer base – past, present and future.

Japan

It took ten years of unbelievably difficult diplomacy and interaction between two of the world's largest trading partners but on February 1 of this year we were finally able to nearly normalize beef trade with Japan. We exported $1.4 billion of beef products to Japan in 2003 and it looks like we'll finally meet or exceed this level in 2013. Could we have done things differently and gotten there sooner? Possibly. In hindsight, we *may* have been able to hold out for something a little better than the "A40" maturity level that for many years limited the number of fed cattle that were eligible for the Japanese market. However, it could be countered that had it not been for this criteria we wouldn't have shipped anything to Japan, which would have allowed our competitors to completely take over the market. The demand for 20 month and under cattle also ushered in the "age and sourced" era that really jumpstarted our industry's ability to grasp the notion of traceability. It also led to market develop efforts that exposed Japanese importers and consumers to a wider variety of cuts from eligible carcasses, which in the future, may boost Japanese imports of U.S. beef. Nonetheless, over these ten years, the economic loss of U.S. beef exports to Japan alone approaches $10 billion.

This year's strong resurgence in exports clearly demonstrates that the relationship between Japanese consumers and U.S. beef is still very strong. In the future, the greatest challenge facing this relationship may be that consumers from other countries have the ability to outbid Japanese consumers for the same cut of U.S. beef. Japan's 38.5% applied tariff on all beef imports is now one of the highest that U.S. beef faces anywhere in the world. Without an opportunity to lower and eventually remove this tariff within the context of the Trans-Pacific Partnership (TPP) trade negotiations, Japanese consumers will be required to pay *more* than 38.5% more in order to bid the same cut of U.S. beef away from consumers in other countries with no import tariff.

South Korea

One of the basic tenets of negotiating tariff reductions with another country is that we want the tariff to go to zero for any product we're exporting. We only have one shot—EVER—at negotiating the deal and you want to, eventually, get to a point where your products have duty free access. The art of the negotiation is really only about how long it will take to get to that point. In agriculture, most of the agreements we have negotiated have maximum phase-in periods of 15 years although we were able to do a little bit better than that in the Australian deal (18 years) when we were playing defense. Thus, it was pretty easy to know what the final agreement with South Korea would look like – duty free access after 15 years. The difficult part was negotiating an agreement that didn't backload the tariff reductions into the last five years of the agreement like we did with our poultry meat access into Mexico as a part of NAFTA. This resulted in a fairly sizable increase in U.S. poultry exports to Mexico at the end of the implementation period of the tariff schedule. It inflicted enough strife on Mexico's domestic industry to cause the U.S. and Mexico to renegotiate the tariff schedule.

Fortunately, we were successful in negotiating a straight-line reduction in South Korea's 40% tariff on beef imports, which is 2.67% per year. Although it took ***way*** too long to get this agreement ratified by Congress – nearly five years due to the influence of labor unions on the Democratic Party – the agreement finally entered into force on March 15, 2012. This means that in 2014, we will be in the third year of implementation of the agreement, which will put the tariff on U.S. beef at 32% or eight percent less than everyone else exporting beef to South Korea. How big will this eight percent be?

Apparently big enough for Australia's beef export promotion arm, my good friends at Meat & Livestock Australia (MLA), to close their Korean office. South Korea is about the only place on the planet where U.S. and Australian beef goes head-to-head. MLA spent a small fortune in Korea during the period when we were locked out of that market in an effort to carve out a permanent market share upon our return. For the past several years, Australia has put an all-out effort into getting its own trade agreement with South Korea completed but, to date, it has not been successful. This could mean that in 2014, it is game over for the Australians in South Korea.

The expectation is that U.S. beef will soak up somewhere in the neighborhood of 70 percent of South Korea's beef imports. In the future, U.S. beef exports to South Korea will swing up and down due to domestic beef production changes and prices in competing meats but the leverage of continued tariff reductions via the US.-Korea Free Trade Agreement gives us the drop on the competition, plain and simple. So where are the Australians choosing to focus?

Greater China

This is where the story gets interesting. Back in 2003, China was barely a blip on the world beef trade radar screen with U.S. exports of only about $30 million before the market closed. Back then, Hong Kong was a $90 million market but it will be in the neighborhood of $700 million this year. Vietnam essentially imported no U.S. beef in the pre-BSE days of 2003 (a couple of hundred thousand dollars), but reached $160 million last year. Currently, the beef export business into this part of the world, at least for now, appears to be shifting to the port of Hong Kong, which is why analysts like to combine this trade data into a regional or "Greater China" discussion in order to fully grasp the incredible phenomenon that is beef and meat consumption in today's China.

Now for some statistics that will blow your mind:

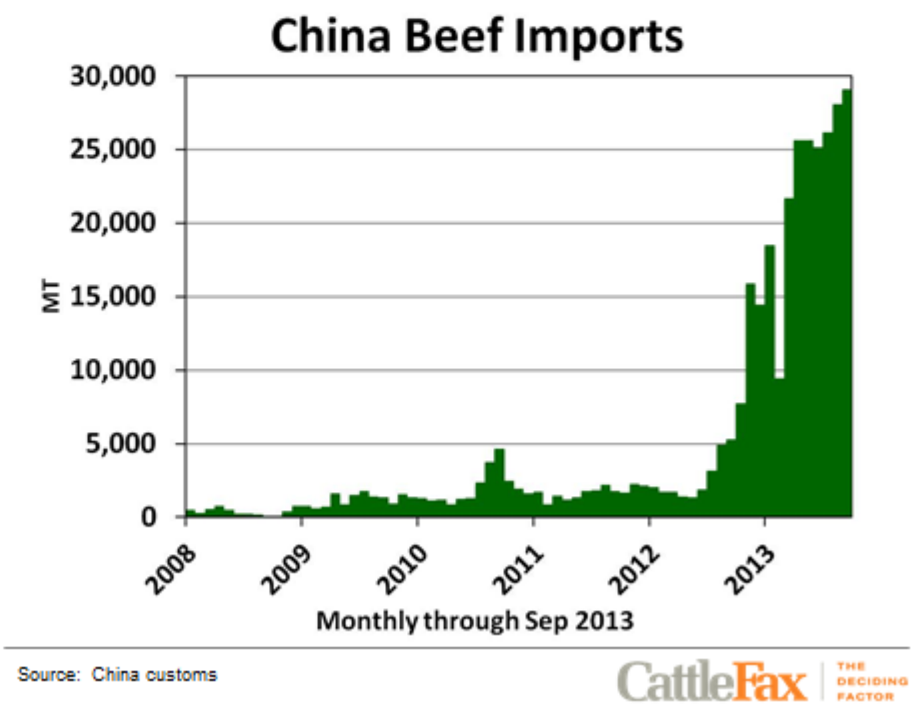
- 1.5 billion pounds more beef is going to China/Hong Kong this year versus last year. (To put this into perspective Wal-Mart's beef sales domestically are a little over two billion pounds and total U.S. beef imports are about 2.2 billion pounds.)

- During the past two years, beef prices in China have increased 83%. (Since January 2012, U.S. beef prices are up 16 %.)

- The retail price of beef in China is now **$4.80/lb**. Here in the U.S. it is currently $4.95/lb.

- The U.S. is no longer the world's largest beef importer. During the past five months, "Greater China" has been the world's largest beef importer with 80 percent of these imports coming from the southern hemisphere (Australia, Brazil, Argentina, Uruguay)

- "Greater China" bought 100,000 metric tons of beef per month this summer. A year ago it was 40,000 mt per month. In comparison, total U.S. beef exports to all countries are currently running about 70,000 mt per month.



When I first saw these statistics it immediately reminded me of the raging debate among market analysts back in 2002 about whether China would be an importer of 15, 18 or 20 million metric tons of soybeans that year and whether that country would be a consistent and reliable customer that we could rely on in the years to come. USDA currently projects that China will import 69 mmt of soybeans this year compared to a trite 59.5 mmt last year. USDA currently has U.S. soybean production pegged at 86 mmt.

Of course the soybean meal from these beans is going mostly to feed hogs – lots and lots of hogs. The entire U.S. pork industry is only about 9-10% the size of China's. China eats a LOT of pork – of course 1.35 billion people can do that. In just the first nine months of this year China has imported 1.5 mmt tons of pork from around the world worth $3 billion. But here's the kicker: that amounts to only 1.2% of their pork consumption!

Ten years ago, per-capita incomes in China relegated Chinese consumers to importing products like tendons, backstrap (ligaments), omasum, rectum, aorta and whatever else they could import at a price point of about $2.00 per pound. U.S. short ribs and chuck rolls, the staple in South Korea and Japan, were mostly out of reach for middle-class Chinese consumers who were dining out. The fact that this appears to no longer be the case has to be one of the biggest things to happen – possibly ever – to ranchers all around the world.

Now consider that we may be witnessing just the tip of the iceberg. There are currently about 300 million "middle class" consumers in China in terms of global per capita income. (Note: the U.S. population is currently 317 million.) By 2020 it is projected that China will be home to 600 million middle class consumers. That's the equivalent to another U.S. population with the ability to afford beef in a hot pot at the neighborhood restaurant. Even today, beef on the menu is the rule rather than the exception in Chinese restaurants. Typically it is brought to the table raw and is cooked in full view of the customer. This is important as it allows the customer to see whether the beef has yellow fat (grass fed) or white fat (U.S. grain fed) and it certainly comes as no surprise which color fat Chinese consumers prefer. Let's see… a million restaurants consuming just 20 pounds of beef per day multiplied by 365 days would be…the equivalent of about three times Wal-Mart's annual beef sales.

With Chinese incomes at roughly 1/6 of our income, $4.80/lb. roughly translates to $28-29/lb. in terms of a U.S. consumers' pocketbook. Yet even at this price, Greater China demand has pushed the wholesale price of U.S. short ribs $2/lb. or $20/head higher than it would be otherwise. This market is now thought to be worth $60/head for U.S. fed cattle prices. But the key take away here is that its value to U.S. beef producers may only be in its infancy.

One of the clear advantages of the port of Hong Kong is that Hong Kong's tariff on beef is zero compared to a 12% duty for beef imported into mainland China. In the future, the difference in tariff rates between Hong Kong (0%), South Korea (32% and falling for U.S. beef) and Japan (38.5%) gives Chinese consumers a considerable advantage in their ability to bid away a limited supply of chuck rolls and short ribs, even with their lower per-capita incomes. Imagine a future where domestic consumers of U.S. beef are outbid for the product we produce by non-U.S. consumers. It isn't so hard to imagine and, in fact, it already happens with several cuts today.

Taiwan

Next door in Taiwan, it appears that tastes and preferences are also changing in favor of U.S. beef. Back in 2003, U.S. beef exports to Taiwan were barely on the radar at $75 million. This year it certainly looks like we're going to set a new record with sales in the neighborhood of $250 million. Taiwan is still a place that likes America and its culture and a tariff of 15 cents per pound isn't much of a tax on consumption. In the past year we've made considerable progress on the ractopamine issue and it now seems like we've turned a corner in terms of consumer acceptance. In the future, this is but one of several markets where we must continue to work very hard to improve the dialogue regarding the use of science and technology in food production.

Mexico

During the past decade Mexico has been our most reliable trading partner. U.S. beef exports to Mexico have been a consistent $800 million to $1.2 billion and U.S. imports of Mexican feeder cattle during that period have averaged around one million head per year. I have spent a lot of time with our ranching friends south of the border during the past decade. During that time I've watched as the relationship between U.S. and Mexican ranchers has matured and grown stronger despite many ups and downs. It has also been a time of dramatic change and improvement in Mexico's processing industry leading to a not-insignificant level of Mexican beef exports around the world. The genetics of the Mexican herd, particularly along the Mexican states that border the U.S., have also made enormous strides. Red Angus cross cattle from these states are now quite desirable and Mexican feeder cattle now account for roughly 40 percent of the cattle on feed in Texas. This is now a mature market and a mature relationship and not even country-of-origin labeling (COOL) can mess it up.

Russia

In 2008 prior to the global financial meltdown, there was a period when Russian beef imports exceeded those of the United States. At major food shows like one I attended in Germany, the meat exhibit hall was consistently packed wall-to-wall with Russian importing interests. In those days Russia was a major importer of poultry, beef and pork with U.S. beef imports reaching a high point of about $300 million. But even since Putin's early days, Russia has been determined to build its own domestic meat production sector no matter how many non-tariff trade barriers they had to erect to get there.

Historically these shenanigans have kept the U.S. government up at night, such as to how to keep about $1 billion in poultry exports to Russia from backing up into the U.S. market. Next was pork, locked out via the ractopamine angle, but only in the past year or so has Russia started causing trouble on the beef side. U.S. beef access to Russia is now also hung up over the ractopamine issue but in reality it has a lot more (maybe everything) to do with supporting domestic interests than it does anything else.

In July 2012, and after 10 years of effort, the U.S. government was finally able to complete the process to obtain a CODEX or international maximum residue level for ractopamine (Optiflex). It was a major accomplishment and a major political blow to the European Union's long-standing ability to block the acceptance of the use of technology via the CODEX process. With Russia now a member of the WTO, this issue should have gone away. Russia's simple, but not so clever, explanation for its behavior was that although it is now a member of the WTO, it didn't vote for the ractopamine MRL in the CODEX so therefore it does not have to adhere to the new MRL. Perhaps Russia still has a little work to do when it comes to understanding how democracy works.

European Union

Of course we all know who wrote the book when it comes to using non-tariff trade barriers to block imports and protect domestic markets, but now the U.S. is actually selling in excess of a quarter of a billion dollars worth of beef to the EU. How did this happen? Well, it just so happens that 2003 was a watershed year for the EU and beef as this was the year it went from net beef exporter to importer. Isn't it interesting how attitudes change once you go from being a seller to a buyer of a product?

We also traded away our retaliation over the hormone case for something that we could actually use and that was duty free access for – hormone free – U.S. beef into the European market. Does this mean we've "settled" the hormone dispute? I honestly don't know. The answer to this is now tied to something the trade policy wonks call T-TIP or the Transatlantic Trade and Investment Partnership. What we're really talking about here is a U.S.-EU Free Trade Agreement. Well maybe.

The truth of the matter is that everyone outside of agriculture is chomping at the bit to cut a financial services or some other sort of sectoral trade deal with the Europeans and these domestic interests are worried sick that the whole process could easily get wrapped around the axle for years over agriculture. From the onset comments like, "the aggies are going to have to move off of traditional negotiating tactics for this one," were being whispered in the hallways up on Capitol Hill and around town.

There is no question that these issues have been seemingly intractable for decades. It should also be strongly emphasized that there is absolutely no guarantee that some or all of these issues will even be brought to the negotiating table unless agriculture interests slam their collective fists on the table with this Administration and force it to happen. What are the issues?

- "GMOs" – To label or not to label? (Keep in mind domestically we're now labeling bags of Halloween candy with labels like "free of major allergens")
- Beta-agonists
- Antibiotics
- Animal Welfare

The tariff discussion should be pretty easy. Are we prepared to walk away from the negotiating table if access is restricted via these other issues? We better be.

<u>Sanitary and Phytosanitary (SPS)</u>

Of course no legitimate discussion about agriculture trade is complete this day and age without a considerable amount of time spent describing the litany of sanitary and phytosanitary issues our products face around the globe. These issues are the new tariffs and the whack-a-mole process of dealing with them makes for good job security for agricultural trade policy wonks in our nation's Capitol. Here are a couple of points regarding this topic:

1. We are usually our own worst enemy.

In Mexico I was once told by one of their government officials that every tactic they use to keep our agricultural products out of Mexico they learned from us. Ironically, this U.S. trained lawyer is now on retainer by Mexican ranchers to sort out this COOL mess. I also recall when high level Chinese government officials lectured a previous USDA Undersecretary saying in so many words that every time you Americans come over here you lecture us about sound science and yet you turn around and do something completely to the contrary – as in Congresswoman Rosa DeLauro's infamous USDA appropriations rider that blocked USDA from working on the cooked poultry issue. It took USDA nearly 10 years to finally get this mess sorted out. This one continues to cost us dearly. I would also add COOL and the Brazil WTO Cotton case to this list for good measure. And don't even get me started about HSUS and eggs or these western state GMO referendums.

2. When it comes to science and technology these days, scaring people makes for good fundraising within the activist community. The same might also be said for animal welfare.

At present, we're dealing with beta-agonists and GMOs, but do not let your guard down about antibiotics and animal welfare. Our detractors are extremely well-funded, politically connected, media savvy and communicate with each other globally. U.S. beef producers must match them stride for stride now and into the future.

A critical step forward would be to develop a model amongst key trading partners to deal with these issues at the speed of commerce; before the activists can get to the politicians (here and elsewhere) and before the politicians say something stupid that they can't take back, which ends up stopping commerce.

SUMMARY

In the past ten years we've rebuilt the beef export engine nearly from scratch. The headline for the ten years ahead certainly appears to be China, where it is all starting to happen for beef. There are now several key U.S. beef export markets. Our non-U.S. customer base is now pretty well diversified and that is a good thing. These exports are not only important in terms of sources of new revenue to drive prices higher, they are also serving to provide a solid foundation for these current price levels. And I would note, we're talking about price levels that are almost double what they were 10-12 years ago.

Despite starting from nearly scratch in 2004, we'll have taken beef exports from $5.5 billion last year to $6 billion in 2013. Our ability to move to $8 or even $10 billion in the coming decade has much more to do with our ability to produce the beef than it does finding a plate to put it on.

One of my favorite things to do each year is the annual selection of our replacement heifers. When the day comes to do this on each of your operations, take a minute to think about all the places the beef from the offspring of those heifers you're retaining may go in the coming years. It is a pretty amazing list. My advice to each of you is simply: go forth and multiply…and retain those heifers.

Footnote: a huge thank you goes to Brett Stuart of Global AgriTrends (& Cattle-Fax) for help with these statistics. He's one of the best in the business.