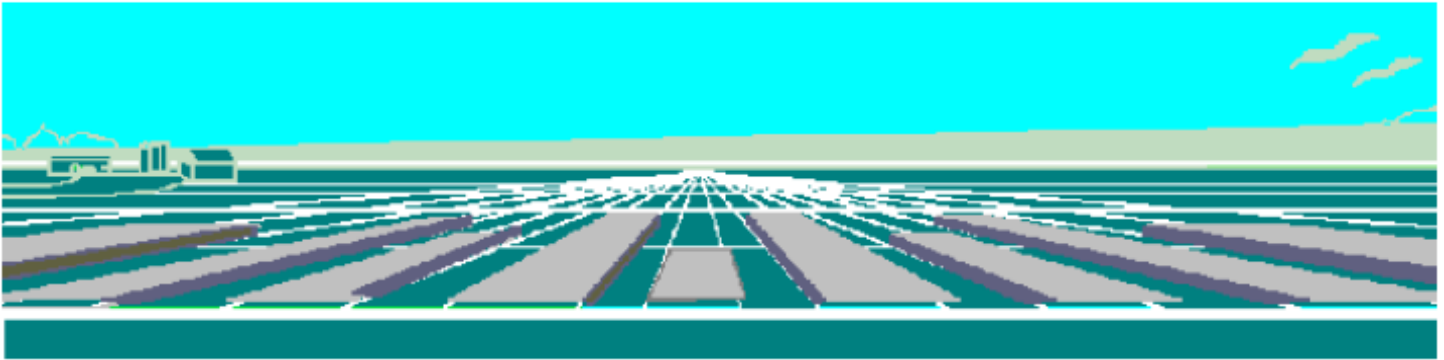


Iowa Farm Outlook



March 15, 2007

Ames, Iowa

Econ. Info. 1954

USDA Releases Livestock and Meat Marketing Study

The USDA Grain Inspection Packers and Stockyards Administration (GIPSA) released a report of livestock and meat marketing practices and their impact on producers, consumers and prices. In 2003, Congress allocated funds to GIPSA to conduct a broad study of the effects of alternative marketing arrangements in the livestock and meat industries. GIPSA developed the specific scope and objectives of the study, and RTI International was awarded a contract to conduct the Livestock and Meat Marketing Study following a competitive bidding process. RTI then worked with agricultural economists and business school faculty to complete the work.

Research on the pork volume was led by faculty at North Carolina State University. The beef volume research was largely conducted by faculty from Colorado State University and Wharton School of Business. I was involved in the final 18 months of the study and worked primarily on the beef and meat processor volumes. I also consulted and reviewed the pork volume.

An interim report was released in July 2005 that summarized the literature review and initial findings of the study. The interim and final reports can be viewed and downloaded at <http://www.gipsa.usda.gov/GIPSA/webapp?area=home&subject=imp&topic=ir-mms>. Each section has an executive summary that is relatively brief and that summarizes the findings of the study.

The final report, released February 23 was over 1200 pages and included the analysis of surveys and interviews with producers, packers, meat processors and retailers. It also includes economic analysis procurement and sales transactions data from the largest meat packers and processors and downstream market participants (wholesalers, exporters, retailers, and food service operators) for the 2.5-year period from October 6, 2002, through March 31, 2005. Additionally, weekly profit and loss (P&L) statements were collected from meat packers and processors for the same time period.

This final report focuses on determining the extent of use of alternative marketing arrangements (AMAs), analyzing price differences and price effects associated with AMAs, measuring the costs and benefits associated with using AMAs, and assessing the broad range of implications of AMAs. In this report, AMAs refer to all possible alternatives to the cash or spot market. AMAs include arrangements such as forward contracts, marketing agreements, procurement or marketing contracts, production contracts, packer ownership, custom feeding, and custom slaughter. Cash or spot market transactions refer to transactions that occur immediately, or "on the spot." These include auction barn sales; video or electronic auction sales; sales through order buyers, dealers, and brokers; and direct trades.

It is important to note that the data collection period for the study, October 2002 through March 2005, was an unusual time for the U.S. meat industry. The beef industry experienced a turbulent market because of the discovery of BSE in North America. The initial BSE case in Canada in May 2003 stopped imports of live cattle to the United States. The first U.S. case of BSE in December 2003 blocked U.S. beef exports until July 2005.

Cattle prices set annual record highs in 2003, 2004, and 2005. Packers experienced significant losses because of tight cattle supplies and continued imports of Canadian boxed beef. While hog prices were not at record highs, hog producer returns, which were negative during 2002 and much of 2003, turned positive from February 2004 through the end of 2006. The higher hog prices in 2004 and 2005 came at a time of record production, while demand for pork improved. Lamb prices increased sharply—setting record highs in the first quarter and second quarters of 2005—while the supply of lambs declined.

Within the context of these market conditions, the general conclusions of the study are as follows:

- Use of AMAs during the October 2002 through March 2005 period, including packer ownership, is estimated at 38% of the fed beef cattle volume, 89% of the finish hog volume, and 44% of the fed lamb volume sold to packers.
- Packer-owned livestock accounted for a small percentage of transactions for beef and lamb (5% or less), even when the small percentage of partial ownership arrangements is included, but accounted for a large percentage of transactions for pork (20% to 30% depending on assumptions).
- Given the current environment and recent trends, we expect moderate increases in use of AMAs in the lamb industry, but little or no increase in the beef and pork industries.
- Cash market transactions serve an important purpose in the industry, particularly for small producers and small packers. In addition, reported cash prices are frequently used as the base for formula pricing for cash market and AMA purchases of livestock and meat.
- The use of AMAs is associated with lower cash market prices, with a much larger effect occurring for finished hogs than for fed cattle. Many meat packers and livestock producers obtain benefits through the use of AMAs, including management of costs, management of risk (market access and price risk), and assurance of quality and consistency of quality.
- In aggregate, restrictions on the use of AMAs for sale of livestock to meat packers would have negative economic effects on livestock producers, meat packers, and consumers.

In addition to these general conclusions, there were more detail findings in each of the sections. The report found that some packers and producers benefit from the uses of AMAs, but that not all packer and/or producers use AMAs. It also found that AMAs were associated with lower prices in the cash market. The size of the impact differs with the type of AMA and whether it is pork, beef, or lamb. Given this finding, how can the final bullet point be true, that restrictions on AMAs would have a negative economic effect on producers, packers, and consumers?

It is confusing, but it has to do with the cost savings in operational efficiency of the packing plant with AMAs and improved consumer demand due to quality associated with AMAs. Thus, if restricted “middle-man” costs would increase causing higher consumer and/or lower producer prices. The reduced demand and higher consumer prices leading to less quantity demanded would result in a smaller industry. Thus, even if producer prices increased (which they did not in the simulation), there would be less total beef and pork produced requiring fewer producers.

It is anticipated that there will be congressional hearings and further debate about the findings of this study. Whether you agree with the conclusions of the report or not, it does provide new information and should make for a better informed debate as the next farm bill is being shaped.

John Lawrence

USDA Supply-Demand Updates Neutral to Slightly Negative for Corn

USDA's latest U.S. supply-demand projections, released March 9, contained almost no changes from the previous month. The only exceptions were (1) a very minor increase in the rice imports and supply, (2) narrowing the projected season average soybean price range for the current marketing year to \$6.10-\$6.50 from \$5.90-\$6.50 last month, (3) slightly reducing the amount of projected soybean oil imports and carryover stocks, and (4) slightly narrowing the projected price range for soybean meal.

South American Crop Projections Increase

Although domestic numbers were market neutral, USDA increased its production projections for this season's Brazilian and Argentine corn harvests. The Argentine corn crop is now projected to be about 20 million bushels larger than last month and 36% larger than last year's weather-reduced harvest. Brazil's crop is projected to be 80 million bushels larger than indicated last month and 15 percent larger than last year. Increases for these two countries were partially offset by a reduced projection for the South African crop. Its production was lowered about 60 million bushels from last month and now is projected to be 8% above last spring's weather-reduced level. ***Together, these three countries are expected to produce about 495 million bushels more corn than last year. Their combined exports are projected to increase by about 250 million bushels, with the rest of the increased production being used to expand domestic feeding and rebuild depleted carryover stocks.*** The projected increase in Southern Hemisphere corn exports is equivalent to 11% of this season's projected U.S. corn exports. At recent corn prices, modestly larger corn exports from Brazil than currently projected cannot be ruled out.

USDA increased its projection of this spring's Brazilian soybean crop by about 37 million bushels from last month, but left the Argentine bean crop projection unchanged from last month. ***The two countries together are projected to produce about 200 million bushels more soybeans than last year. Most of the increase is likely to be exported, either as soybeans or processed products. The projected increase in production is equivalent to 18% of this season's U.S. unprocessed soybean exports.***

Soybean Crushings

Census crush data for January indicated the crush was about 3.6% above a year earlier. Soybean oil stocks at processing plants at the end of January were about 2.6% higher than a year earlier and meal stocks were up 33%. February crushings data should be out soon. NOPA soybean crush data for January indicate oil yields per bushel were 3% lower than a year earlier, but meal yields were 0.8% higher. ***Soybean gross crushing margins reported for central Illinois by USDA for mid-March were 35% less than a year earlier.***

Acreage Prospects for 2007 and Corn Feed Demand

About half a dozen private reports in the last two weeks have placed potential 2007 U.S. corn plantings at approximately 10 million acres larger than last year. All of these projections were based on much smaller and less scientific surveys than the USDA Prospective Plantings report that will be released March 30. The USDA planting intentions and the stocks report, also to be released on March 30, will be extremely important market indicators for corn, wheat, and soybean prices this spring. The stocks report will allow analysts to estimate corn feed usage during the winter quarter. Feed usage is still the largest source of demand for the corn crop, despite projections by USDA's Chief Economist for a 50% increase in corn processing for ethanol in the 2007-08 marketing year that starts on September 1, 2007. For the current marketing year, corn processing for ethanol is projected to be 34% larger than a year earlier.

Where Could Additional Corn Acres Come From?

A widely respected forecasting firm released its expected 2007 acreage numbers to the public on March 16. Their report showed U.S. corn acreage increasing 9.5 million acres from last year. That pushed total projected corn plantings to 87.8 million acres. Its U.S. soybean acreage projection was 70.4 million acres, down 5.1 million acres from 2006. Its spring wheat projected plantings were down 0.9 million acres.

Reports from the South suggest that around 1.6 million of last year's unusually large 15.3 million acres of cotton may shift to corn this spring. Last year, 2.6 million of the U.S. cotton acres were not harvested. Normally, 0.5 to 0.6 million planted cotton acres are not harvested.

If all of the reduction in spring wheat acres is shifted to corn (which is unlikely), and the anticipated declines in soybean and cotton plantings are shifted to corn, these changes would boost corn plantings by 7.3 million acres. About 3.8 million acres of last year's U.S. soybean crop were double-cropped. Increased double-cropping after wheat could account for some of the difference between private and USDA soybean acreage changes and the increased corn plantings that are anticipated. Possibly another million acres might be shifted from CRP to corn, although CRP acres usually do better in beans the first year.

The private projections appear to imply that a sizeable amount of hay and pasture acreage may be shifted to corn this year.

Acres shifting from cotton and spring wheat to corn almost certainly will have substantially lower yields than those in the Midwest. The three-year simple average corn yield for Louisiana, Mississippi, and Texas is 129 bushels per acre. For North Dakota, it is 115 bushels per acre. The three-year simple average yield for Iowa, Nebraska, Minnesota, Illinois, and Indiana is 163.4 bushels per acre. For corn planted after corn, agronomic research indicates at least a 9 to 12 percent yield reduction should be expected when compared to corn following soybeans.

Robert Wisner