APAC Agricultural Policy Analysis Center
The University of Tennessee

PolicyPennings by Dr. Daryll E. Ray

The hog industry: It wasn't supposed to happen this way!

The vertical integration of the hog industry was supposed to lead to a more efficient, rational use of resources at the integrator level and reduce the risks at the producer level through contracts. In late August 2009, the price for hogs in the Iowa-Southern Minnesota Direct hog trade was just over $45/cwt, compared to nearly $85/cwt a year earlier. Production costs have exceeded market costs in 20 of the last 22 months.

But it wasn't supposed to happen this way. With contracts, the integrators were supposed to have greater control over the hog cycle than when there were a large number of small producers.

But things don't always work out the way they were planned

In the mid-1990s, the North American Free Trade Agreement (NAFTA) set the framework for an integrated North American hog industry just at the time that the Canadians abolished their Crow Rate grain transportation subsidy for grain that reduced the transportation cost of getting Western Canadian grain to markets.

With the elimination of the subsidy, these Western Canadian farmers began to cast about for an alternate way to protect their income. With the encouragement of the provinces they went into hog production, adding value to their locally produced grain and oilseeds. Hog production increased, and the number of feeder pigs sold into the US increased from less than a million head in 1995 to over 6 million head in 2008.

This is the same period in which the US saw dramatic gains in production efficiency as the number of sows fell and production increased. The number of active producers also fell as many smaller operators got out of hog production and others grew in size.

This increase in production was needed to meet the growing export demand that zoomed from less than a billion pounds in 1995 to nearly 5 billion pounds in 2008. At the same time, US consumption continued to increase, although not as rapidly as export demand.

As long as demand was booming, the hog industry was in good condition. However, it only takes a small change at the margin to trigger dramatic results.

Some of the new markets like Russia then decided that they needed to develop their own domestic pork industry. They did not want to be at the mercy of foreign suppliers for a commodity as important as pork, so they began to find ways to restrict their imports of pork and provide incentives to domestic producers.

The financial crisis that began in 2008 started to put economic pressure on US households to reduce their total expenses, and the consumption of pork fell by 1.7 percent from 2007 to 2008.

And if economic pressures weren't enough, 2009 saw the outbreak of a novel strain of H1N1, referred to in the press as "swine flu." Despite the fact that humans cannot get the flu from eating pork, the sale of pork dropped off, and some importers used it as a reason to restrict the importation of pork products from the US.

In the past, losses in hog production resulted in farmers' hauling some of their sows to market and selling their grain instead of feeding it to their hogs. With the integration of the hog industry, some farmers got out of the meat business and concentrated on grain production. Similarly, other farmers focused their resources entirely on hog production. Those producers are now finding it difficult to reduce their production because they have no alternate source of income. As a result, the contraction of the hog industry is happening at a glacial pace. Many producers are waiting for the other person to blink first.

In all of this we have seen the development of a perfect storm that has driven hog prices sharply downward.

It wasn't supposed to happen this way. Ending transportation subsidies in Canada was supposed to eliminate distortions in the grain market. As a result, we ended up with increased hog production because Western Canadian farmers saw it as away to diversify their income sources and increase the value of their grains by feeding them to hogs.

Integration was designed to allow packers to more efficiently use the capacity of their plants by scheduling production to get away from the fall and winter surge in slaughter demand. Signing contracts was supposed to reduce the price risks in hog production.

NAFTA allowed for the development of a North American meat market in which each country would do what it does best-Canada produced feeder pigs, the US fed those pigs to market weight, and Mexico

Cont. on p. 2

The hog industry: It wasn't supposed to happen this way!

Cont. from p. 1

imported pork to feed its population. Exports were supposed to be the future of the pork industry, but along came a worldwide economic crisis, import restrictions, and something called swine flu.

Any one of these issues is enough to challenge the pork industry. Taken together, they call into question some of the assumptions upon which the industry is built.

And in some ways it is less resilient than it was when farmers could switch from grains to meats and back depending on the relative profitability of each item.

Daryll E. Ray holds the Blasingame Chair of Excellence in Agricultural Policy, Institute of Agriculture, University of Tennessee, and is the Director of UT's Agricultural Policy Analysis Center (APAC). (865) 974-7407; Fax: (865) 974-7298; dray@utk.edu; http://www.agpolicy.org. Daryll Ray's column is written with the research and assistance of Harwood D. Schaffer, Research Associate with APAC.