Rabobank, Mexico

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INTRODUCTION: SOME CONCEPTUAL OBSERVATIONS

In the various discussions, market power was often defined primarily in terms of concentration. This definition may be acceptable for a single country economy. Within the context of ever increasing trade, the concept of market power should be revisited.

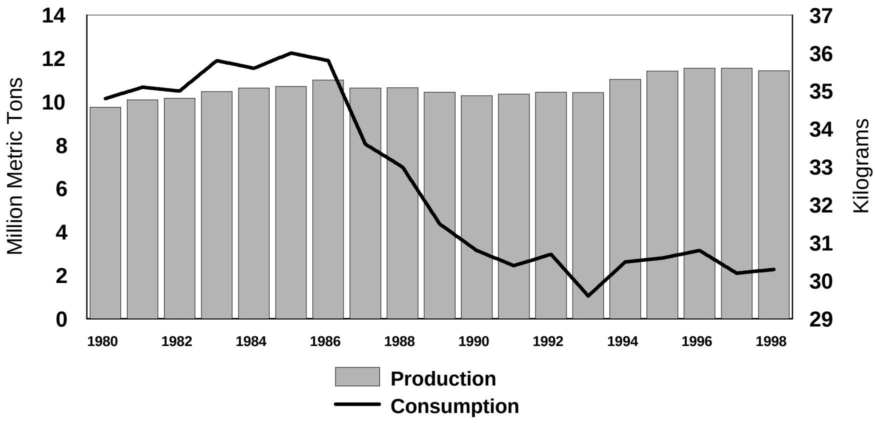
One alternative would be to combine absolute size with concentration ratios. For example, in the U.S. beef industry, the leading packers control over 80 percent of the market. In Mexico the leading four companies control about 12 percent of the market (based on slaughter). The size of the cattle herd in the United States is about three times that of Mexico. While it is not unusual to state that the market power of the U.S. industry within a trading context is higher than that of the Mexican industry, the combination of concentration and size puts that relationship in a new context. More work should be done to develop indicators that capture these cross-border differences.

Most of the discussions have tended to focus on one part of the industry, with a bias towards primary production. New business models are emerging which are both the result and catalyst of structural change in the food business. Trade disputes should be analyzed within a framework that takes into consideration chain management based on a series of strategic alliances built around strong food industry players. The remarks that follow will attempt to focus on some of the differences in the two business models, which tend to accentuate trade disputes.

The U.S. Beef Sector: An Industry In Crisis

In contrast with other speakers, I view the U.S. industry as facing a serious crisis. Production has grown while per capita consumption, in spite of a recent increase, is significantly below the levels of the early 1980s (Figure 1).

Figure 1: Beef Production and Per Capita Consumption in the United States, 1980-1998.



Source: National Cattlemen's Beef Assocation (USA)

The industry has attempted a number of measures to reactivate beef consumption in the United States but, in the final analysis, the alternative for the survival of the cattle/beef industry as it exists today is the export market. There is some question as to how much more meat can be consumed in the United States. If the beef industry is successful in expanding per capita consumption, that will mean that either poultry or pork producers will have to increase their dependence on the international market[1] .

For the U.S. beef industry, Mexico represents a natural market for exports. Not only is it a reflection of location, but the growing economy and population suggests that meat demand will continue to grow. Furthermore, the structure of demand means that cuts with minimum market potential in the United States are widely consumed in Mexico. Added to this is the price structure in the Mexican market in which "popular" cuts are relatively more expensive compared to premium cuts than in the United States (Figure 2). This means that for U.S. companies, profits can be enhanced through selective exports to the Mexican market.

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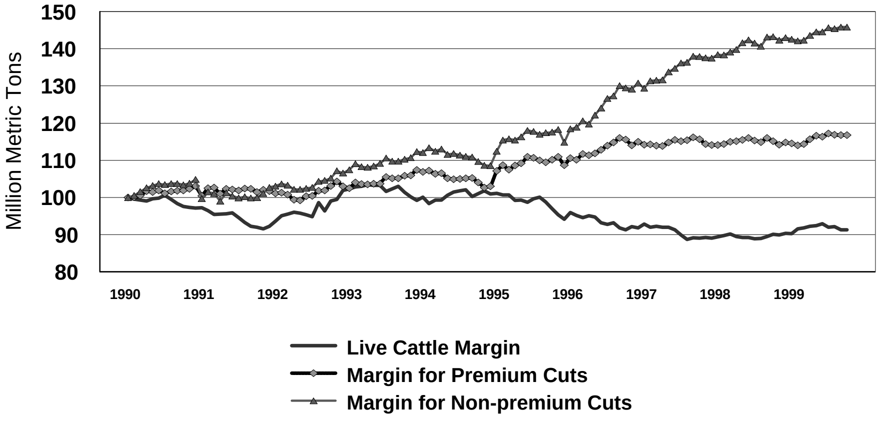
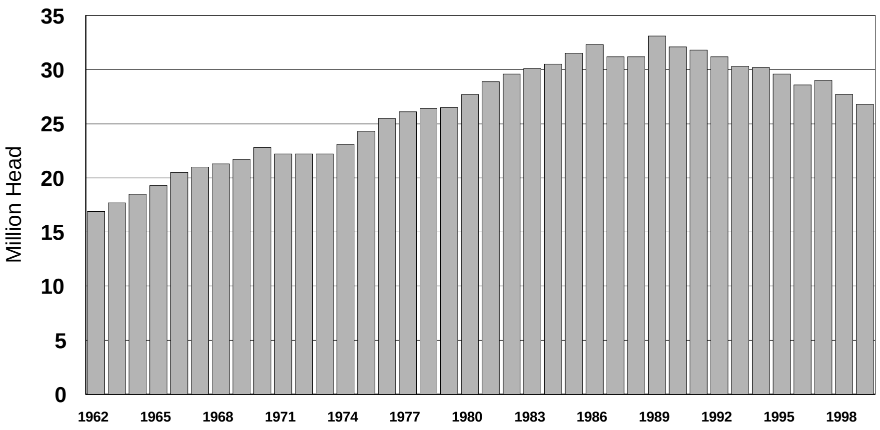
[1] The center of the plate business model that is emerging in the United States is an example of a strategic response to this situation. Research should be carried out in relation to this business model and its impact on trade and investment.

Figure 2: Margins in the Beef Marketing Chain in Mexico, 1990-1999.



Source: Banco de México

Figure 3: Cattle Population in Mexico, 1961-1999.

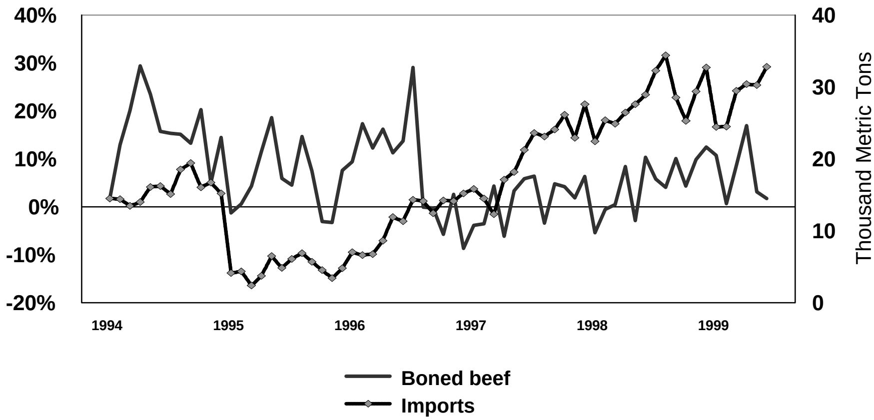


Source: FAO

The Mexican Beef Cattle Industry: On-Going Trade Disputes

The number of cattle in Mexico grew continuously up though the end of the 1980s (Figure 3). Recurrent economic crises, reduction in official support to agriculture, contraction of credit combined with high interest rates are

Figure 4: Margins of Producers of Mexican Boned Beef and Imports of Beef, 1994-1999.



Source: Rabobank International from INEGI and SHCP Data

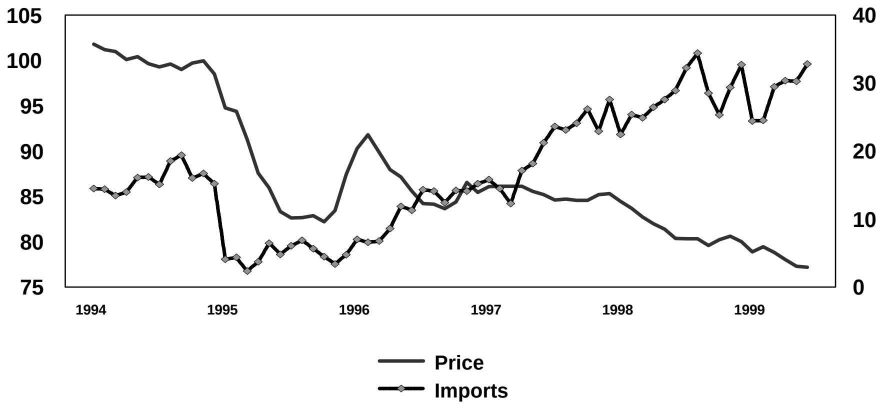
some of the reasons that explain the downturn in cattle numbers. Another important reason has to do with the increase in imports of beef. Accompanying the economic shock program that the government initiated in the late 1980s was a decision to open the border to imports of agricultural products, including beef.

As imports grew, cattle numbers declined. The imports put pressure on prices and margins in the industry (Figures 4-5). Yet, at the same time, consumption of beef grew reflecting the growing importance of imported meat. The pressure from imports, which in part results from the pressure coming from the United States to export, erupted in trade disputes. The first, brought by the National Cattlemen's Confederation (CNG), was settled through negotiations between the U.S. and Mexican cattle producer organizations and governments. In the late 1990s, the Mexican cattle feeder association (AMEG) initiated a dumping action against the U.S. industry. This action is now in the process of going to a dispute resolution panel.

The Structure Of The Mexican Beef Industry: A Study Of Contrasts

The previous discussions, while looking at certain segments of the industry, focused on primary production. It is considered that they could have

Figure 5: Real Prices of Beef* and Imports, 1994-1999.

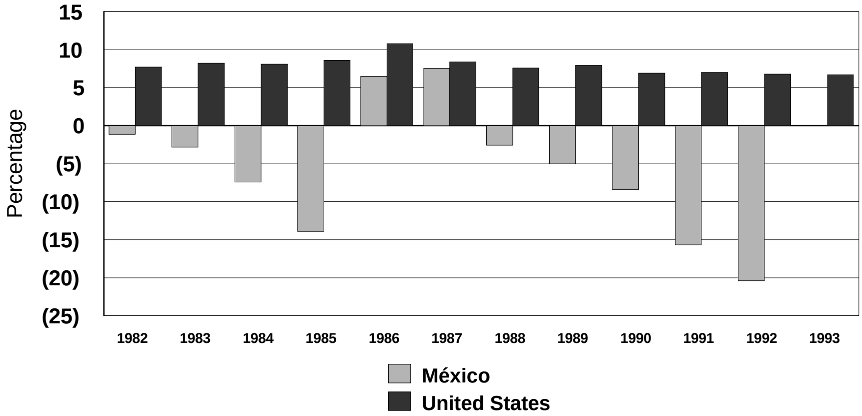


Source: INEGI y AMEG
* Deflated using producer price index

emphasized more structural differences and changes taking place throughout the beef marketing system. At the farm level, the Mexican beef sector encompasses a range of producers running from internationally efficient feedlots to small-scale dual-purpose operations, with a wide assortment of technologies and breeds. The diversity in production makes averages practically meaningless. While feedlot operations are becoming more important, it is still too early to say that they will become the dominant model for the industry.

At the same time, diversity that is found in production is also seen in the marketing of meat. The small butcher shop still predominates. Often they are located in public markets, with a number of shops clustered in one specific area. Supermarkets are becoming an increasingly more important source for retail sales of beef. In major urban centers and among the higher income groups supermarkets take on a more prominent role for food distribution. Growth in retail sales has been concentrated in supermarkets more than in the public markets. For 2001, the supermarket association projects growth in sales at 7.3 percent, more than twice the expected GDP growth.

Figure 6: Cattle Industry Producer Subsidy Equivalents, 1982-1993.



Source: United States Department of Agriculture

As supermarkets become an increasingly important channel, meat marketing will also change. Foreign investment is strong in the supermarket sector with the presence of Wal-Mart, Carrefour, Safeway and HEB, among others. These retailers will bring about changes in marketing and supply relationships that will impact the beef industry. There are already attempts, albeit limited, to develop branded fresh beef. At the same time, value-added packaged products are also beginning to be offered to consumers. The most common of these is a seasoned arrachera, which is a strip steak-like cut. Case-ready products are also making their appearance in Mexican markets.

If there is a strong presence in direct foreign investment at the retail end of the chain, at the production level there is little foreign investment. There are examples of U.S. investment funds as well as U.S. companies directly involved in cattle production, but these are still the exceptions.

Public policy is also an area of important differences. In the area of subsidies, U.S. producers benefit from extensive support programs (Figure 6). In Mexico, the emphasis in agricultural support programs tends to concentrate on grain producers. In spite of changes and attempts to bring a more market focus to policy, the inconsistencies impact negatively on price and assured supply.

Information, or rather the lack of it, represents another important structural difference. Cattle numbers, for example, vary from source to source. Market data are difficult to obtain, and when available, are often out dated.

The Future: More Disputes As The Market Changes

Most of the speakers have focused on Mexico as a destination for U.S. exports. While this is valid at present, it is not unreasonable to see Mexico as an exporter of beef, as well as other meat products. Concerns about food safety in the United States are leading to a multi-plant model for meat companies. The expected growth in branding and new packaging technologies in the United States will facilitate long distance packer operations. These factors, along with the cost of labor in the U.S. market suggests that production of packaged cuts of beef can be highly competitive in Mexico. Nor is it unreasonable to think that live cattle from the U.S. would be shipped over long distances to take advantage of market and or labor conditions. For example, cattle are already shipped from Canada to packers in the United States.

What this implies is an integration of the Mexican and U.S. industries driven by cost considerations and the changing nature of competition at the retail end of the distribution chain. As this scenario develops, in the short run, the reaction to the structural change raises the spectrum of more trade disputes, this time initiated by U.S. cattle producers.