# The New Economics of the Business

## The U.S. beef industry learns how new regulations will change the way it does business.

by **Troy Smith**

When a single case of bovine spongiform encephalopathy (BSE) was detected in Washington state, you could hear the collective groan from cattle country. U.S. beef producers swallowed hard and braced themselves for impact. Cattle prices dropped in anticipation of consumer reaction. It was no surprise when major export markets closed their doors to U.S product. However, confident American consumers did not shy away from beef, and cattle prices rebounded more quickly than expected.

Feeder cattle prices returned to levels near those seen prior to last December's BSE event, but calf sellers should not think they can escape the impact of BSE. Randy Blach, director of Cattle-Fax, a Colorado-based market analysis service, says the loss of export markets is a blow to the chin of the industry as a whole. BSE-inspired government regulations will change the way producers do business. Blach says BSE has altered the economics of the cattle industry, and all producers will be affected.

### Export dilemma

Without a doubt, the greatest negative impact has been the loss of important foreign markets, including Japan, South Korea and Mexico. In 2003 those three countries accounted for about 80% of all exported U.S. beef. Blach says many producers don't realize how important exports have become.

"In 1980 we exported about one-half of 1% of the beef we produced. In 2003 exports accounted for nearly 10% of production. That's 2.6 billion pounds (lb.) of beef, or the equivalent of 60,000 head of fed cattle," Blach explains.

With exports closed, net beef supplies are almost 1 million lb. larger. Blach estimates that every man, woman and child in this country would have to consume at least 2 lb. of additional beef during 2004 to offset the loss of export markets. And a considerable portion of exports includes variety meats and products for which there is little demand in the United States. Normally, from 60% to 70% of short ribs, tongues and short plates are exported. Now, most will end up in beef trim, with a significantly lower value.

PHOTO BY SHAUNA ROSE HERMEL

Randy Blach

Blach says the loss of beef muscle cut exports shaves $9.50-$10 per hundredweight (cwt.) from fed-cattle prices. Variety meat exports represent $3-$4, with byproduct and other export value accounting for another $0.50-$1 per cwt. Add it up, and the affect on fed-cattle prices is $13-$15 per cwt., or $165-$190 per head.

### New regulations

Also influencing the new economics of the cattle industry is the government's response to the BSE finding. New regulations have been issued as precautions against the spread of the disease and for added protection to public health. These come in addition to import controls initiated in 1989, a BSE surveillance program, and a 1997 ban on feeding most mammalian protein products (such as meat-and-bone meal) to cattle or other ruminant animals.

New since the BSE event is the Food and Drug Administration's (FDA's) prohibition of all mammalian blood and blood products as ingredients in ruminant feeds. Also banned is the feeding of poultry litter and restaurant plate waste (meat scraps). Since some of these protein materials may be used to manufacture nonruminant feeds, FDA now requires dedicated milling and rendering facilities or production lines to prevent cross-contamination of ruminant feeds.

Citing the need to exercise "an abundance of caution" the Food Safety Inspection Service (FSIS) took regulatory actions to prevent potentially BSE-infective bovine tissues from entering the human food supply. A particularly bold rule requires that all nonambulatory or "downer" animals presented for harvest be condemned. Even animals that are healthy, but have suffered injury making them unable to walk, would be subject to this rule and end up as rendered product.

According to Cattle-Fax estimates, this rule could increase annual condemnation totals by 145,000 head. Most of the animals are likely to be cows. Assuming an average weight of 1,020 lb., and using the 2001-2003 average Canner-cow price of $36.35 per cwt., Blach calculates the value per animal at $371. Applied to 145,000 animals, the "downer" rule could cost the industry more than $50 million.

Additional steps have been taken to eliminate from the human food supply tissues considered at high risk for carrying the infective BSE agent. Tonsils and small intestines from all cattle are designated as "specified risk materials" (SRMs) and inedible. The brain, skull, eyes, spinal cord, vertebral column, and certain tissues associated with the nervous and lymphatic systems of cattle 30 months (mo.) of age or older are also designated as SRMs.

The "30-month" rule stems from evidence that BSE infectivity is confined to animals beyond that threshold. If birth documentation is not available, the ultimate determinant of a harvest animal's age will be dentition — examination of the animal's teeth. The presence of at least one of the second set of permanent incisors is the determining factor, indicating the animal is at least 30 mo. old.

Blach says 0.4% of the 2003 fed-cattle harvest was considered "hard bone" C maturity and discounted for age. Dentition is currently identifying between 1% and 2% of fed-cattle harvested as 30 mo. of age or older. At the rate of 1%, an estimated 172,800 additional animals will be discounted in 2004. The "no roll" discount, Blach says, represents a loss of $13 per cwt., or somewhere near $100 per head.

There are costs associated with segregation of carcasses from 30-mo. and older animals — $30-$40 per head by Blach's estimate. The lost value of variety meats from those carcasses would range from $35 to $45 per head. He claims the tally could go higher if FSIS should decide to conduct BSE tests on all carcasses in the 30-mo. category. That would cost $12-$35 per head.

When you add it all together, new BSE-driven regulations could cost the industry about $200 million. More changes are likely to occur, so it's hard to tell what the total affect will be. The new rules, Blach warns, will affect producer programs, such as grids and formula marketing arrangements.

"Grid pricing variables will change," he explains. "Heiferette feeders could see significant discounts. Grazing programs may need to be modified to avoid cattle over 30 months."

The rules should result in a more consistent beef supply, which Blach calls positive for the long term. But BSE has given U.S. beef producers a costly education. There is no doubt, he says, it has increased the cost of doing business.

**Editor's Note:** *Secretary Javier Usabiaga of Mexico announced March 3 that Mexico will again accept U.S. beef imports. Resumption of trade will occur in phases, beginning with boneless beef and veal from animals less than 30 mo. of age. See "Beef Business," page 269.*