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The Canadian Hog Trade Dispute

Geoffrey S. Becker
Specialist in Agricultural Policy
Resources, Science, and Industry Division

Summary

On April 6, 2005, the U.S. International Trade Commission (ITC) made a final determination that imports of live Canadian hogs are not materially injuring the U.S. hog industry. The ITC's negative determination culminates investigations requested in March 2004 by U.S. pork producers under U.S. antidumping (AD) and countervailing duty (CVD) laws, and means that no import duty order will be imposed. The ITC's decision came despite an earlier U.S. Department of Commerce (DOC) final determination that producers/exporters have sold live swine from Canada at less than fair value. DOC also earlier announced its final CVD determination that countervailable subsidies are not being provided to Canadian producer/exporters, ending the CVD investigation. This report will be updated if significant developments ensue.

The Complaint

The ITC and DOC had received AD and CVD petitions March 5, 2004, from the National Pork Producers Coalition (NPPC), a number of state pork associations, and more than 100 individual producers. The petitions allege that the industry is materially injured and threatened with material injury due to imports of live swine (both slaughter hogs and feeder pigs) from Canada, where farmers receive substantial subsidies under a variety of government programs. Petitioners allege that the subsidies have encouraged the Canadian industry to produce too many animals, which in turn are exported to the United States and sold at less than fair value. Pork and hogs for breeding are not covered by the action.[1]

Legislative Basis

U.S. trade law spells out the relatively complex process for filing and investigating an AD or CVD petition, which is filed simultaneously with both the ITC and Commerce. (As with this case, petitions can be filed requesting both AD and CVD relief involving the same imports.) The agencies then follow specified steps in investigating the petitions

[1] The ITC investigations were announced on March 16, 2004 (69 *Federal Register*, p. 12347), and the DOC investigations on April 14, 2004 (69 *Federal Register*, p. 19815 and p. 19818).

to determine whether the product has been subsidized or dumped, as the case may be, whether U.S. producers have been injured, and the level, if any, of duties that should be levied. The law authorizes *antidumping duties* on imported goods if Commerce (more specifically, the Import Administration of the International Trade Administration within Commerce) determines that an imported product is being sold at less than its fair value, and the ITC, an independent agency, determines that a U.S. producer is being materially injured or threatened with material injury as a result. Dumping is a form of price discrimination whereby goods are sold in one export market at prices lower than the prices of comparable goods in the home market or in other export markets.

The law also authorizes *countervailing duties* on imported goods if Commerce determines that a foreign government is providing a countervailable subsidy for the goods, and the ITC determines that the imports are causing or threatening to cause material injury to a U.S. industry. The purpose of the CVD law is to offset any unfair competitive advantage that a foreign producer or exporter might have over U.S. producers due to the subsidies. Any U.S. AD and CVD action must conform to the terms of World Trade Organization (WTO) agreements. In addition, the North American Free Trade Agreement (NAFTA) allows a final dumping, subsidy, or injury determination involving imports from NAFTA countries to be reviewed by a binational panel instead of by a court in the country issuing the determination.[2]

The Investigations

The ITC issued a preliminary determination on May 3, 2004, of material injury to the U.S. industry.[3] Commerce announced on August 16, 2004, a negative preliminary determination in the *CVD* case.[4] Commerce found that several of 22 Canadian programs it had examined appeared to be "countervailable," but the value of the subsidies provided were less than 1% *ad valorem*. Other programs were not countervailable, the DOC found. On the *AD* petition, Commerce did preliminarily determine on October 14, 2004, that Canadian swine are being, or are likely to be, sold in the United States at less than fair value. To determine preliminary dumping margins, the DOC compared an export price or constructed export price during calendar 2003 with a calculated "normal value" for the animals. The margins effectively became the provisional duties.[5]

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[2] The authority for CVD and AD actions is in Subtitle A, Title VII, of the Tariff Act of 1930, as amended (19 U.S.C. 1671 and 1673). For an explanation of this authority and CVD and AD procedures, see CRS Report RL31296, *Trade Remedies and Agriculture*.

[3] The ITC published its determination on May 14, 2004 (69 *Federal Register*, p. 26884), and detailed its views in *Live Swine From Canada: Investigations Nos. 701-TA-438 (Preliminary) and 731-TA-1076 (Preliminary)*, Publication 3693 (May 2004).

[4] Published August 23, 2004 (69 *Federal Register*, p. 51800). This preliminary negative determination by Commerce did not, however, terminate the CVD investigation.

[5] Under the so-called Byrd Amendment (Section 1003 of P.L. 106-387), final duties would have to be redistributed to the domestic industries claiming to be injured by the imports, in this case petitioning pork producers. A WTO dispute settlement panel has determined that the Byrd Amendment violates U.S. trade obligations.

On March 7, 2005, DOC announced a negative CVD determination, i.e., that countervailable subsidies are not being provided to Canadian producer/exporters, concluding the CVD case. However, DOC ruled affirmatively in the AD case, finding that producers/exporters have sold live swine from Canada in the U.S. market at less than fair value. It set dumping margins for individual firms ranging from 0.53% (*de minimis*) to18.87%.[6] In the final investigatory step, the ITC issued its final AD determination on April 6, 2005. Despite the earlier affirmative Commerce ruling in the AD case, the ITC found that a U.S. industry is not materially injured or threatened with material injury by reason of live swine imports. As a result, no AD order will be issued.[7]

The North American Pork Industry[8]

In the United States, approximately 74,000 producers held nearly 60 million hogs and pigs in 2003, but this aggregate number masks the industry's evolution and current structure. Production and inventories traditionally were located in Corn Belt states, with access to abundant feed grain and soybean meal supplies. Twenty-five years ago, tens of thousands of small, independent farms, many diversified crop-livestock operations, raised hogs from birth to slaughter weight.[9] These hogs were sold to dozens of small to medium, independently owned slaughter plants.

By 2003, the commercial U.S. pork industry had changed dramatically, due largely to the adoption of vertical production methods (i.e., contract production arrangements by a few large integrators who also own slaughter and processing plants). Six large producers — Smithfield, Premium Standard Farms, Seaboard, Prestage, Cargill, and Iowa Select — together accounted for nearly 30% of U.S. hog production in 2003. Informa Economics estimated that the hog production segment of the industry now has about 30 key firms, plus several hundred additional "significant" operators. In the packing (slaughter) sector, less than a dozen key firms predominate, Informa reported.[10] Another trend has been the expansion of production into other regions like the Southeast. Production improvements (lower costs of scale economies, improved genetics, and innovative management) have enabled the United States to raise more meat with fewer sows and to become, by 1995, a net exporter of pork products. It is now the third-largest exporter, after the European Union (EU-25) and Canada, respectively.

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[6] Published March 11, 2005 (70 *Federal Register*, pp. 12181-12188). *De minimis* means less than 1% and therefore is disregarded.

[7] "Live Swine From Canada Do Not Injure U.S. Industry, Says ITC," press release, April 6, 2005, accessed at the ITC website at [http://www.usitc.gov/]. The ITC said its final report with views and findings will be available after May 9, 2005.

[8] Sources for this section include the ITC's May 14, 2004 report; USDA, Economic Research Service (ERS), *Market Integration in the North American Hog Industries*, November 2004; and Informa Economics, *Special Report: The Changing U.S. Pork Industry*, November 1, 2004, at [http://www.informaecon.com/LVNov1.pdf]. Informa, is an economics consulting firm.

[9] Such farrow-to-finish operations keep hogs until slaughter weight of 240-270 pounds. The other specialized hog enterprises are feeder pig producers who raise them from birth to about 10-60 pounds and sell them for finishing; and finishers who buy feeder pigs and feed them to slaughter.

[10] The four largest firms accounted for 56% of all hog slaughter in 2002, compared with 33.6% in 1980. The eight largest firms accounted for 78.7% in 2002, compared with 50.9% in 1980. Source: USDA, *2002 Packers and Stockyards Statistical Report*, p. 48.

However, the United States is a net importer of live hogs, almost all from Canada. Imports have increased more than fivefold since 1989, to 7.4 million head in 2003, representing 7.3% of U.S. production. The 2003 imports were 30% higher than in 2002, and were expected to exceed 8 million in 2004. Two-thirds of the total imports are now feeder pigs, and most of the rest slaughter hogs. By contrast, the United States exported approximately 170,000 live hogs in 2003, many of them slaughter hogs to Mexico.

Canada's swine industry is about one-fourth the size of the U.S. industry. Canada relies heavily on the U.S. market, sending to the United States nearly 25% of the 29.9 million head it marketed (slaughter plus exports) in 2003. Cross-border trade reflects an increasingly integrated North American hog-pork complex, which has been facilitated in part by NAFTA. The agreement (and its predecessor, the U.S.-Canada Free Trade Agreement) reduced tariffs and other trade barriers and allowed competitive market forces to play a larger role in trade and industry trends, according to USDA.

The Canadian breeding herd expanded by 40% from 1994 to 2004, from about 1.11 million head to1.55 million. Over the same period, the U.S. breeding herd declined by about 17%, from 7.21 million to 6 million.[11] USDA analysts point to a number of factors spurring Canadians to produce and export feeder pigs to the United States. One was a Canadian government effort to curb subsidy expenditures in the 1990s, notably a grain-transport subsidy. Without it, grain stayed in the Western provinces to feed livestock. Also, lower Canadian subsidies had led to reductions in previous U.S. countervailing duties on Canadian hogs. And, an appreciating U.S. dollar against the Canadian dollar from November 1996 to January 2002 favored Canadian sellers. Starting in January 2002, a steady appreciation in the Canadian dollar then helped to slow, but as of late 2004 not yet to halt, the rate of Canadian breeding herd expansion, USDA said.

In the United States, available slaughter capacity and dependable feed supplies have been among the factors driving construction of hog-finishing facilities in Corn Belt states, which helped to spur demand for feeder pigs, according to USDA; Canada has been a willing provider. USDA and others also point out that Manitoba, with a cooler climate and vast open spaces (helping disease control), provides more attractive conditions for siting large-scale pig farrowing facilities than Iowa and Minnesota, the primary destinations of feeder pigs sold in the United States. NPPC has countered that numerous areas of the United States offer similar climatic and spatial conditions. NPPC asserts that the USDA study failed to recognize that substantial government subsidies were the prime contributor to Canadian expansion (see next section).

Arguments for and Against the AD/CVD Action

For. NPPC asserts that Canadian swine producers have received "substantial" subsidies from more than one dozen programs.[12] Iowa State University agricultural economist Dermott Hayes asserts that the Canadian Agricultural Stabilization Program provided Canadian swine producers with a total of $136.6 million, which translated into an actual "risk-reducing" benefit of as much as $4 to $6 per pig during 2000-2003. A Quebec-specific income stabilization program provided producers there with a benefit of

[11] Sources: Statistics Canada, and USDA's National Agricultural Statistics Service.

[12] These programs are described in 69 *Federal Register*, pp. 51800-51811.

as much as $15 per pig, Hayes adds. NPPC argues that the DOC's CVD investigation erred by preliminarily determining that the federal income subsidies were not specifically targeted at the Canadian hog industry; by finding that the benefits were "recurring" and thus not countervailable; and by failing to investigate the Quebec program.

NPPC contends that subsidies distort markets by protecting Canadian producers from normal economic risks. As a result, NPPC maintains, Canadian swine production has expanded even as net market returns are negative, disrupting the normal hog cycle. Most of this overproduction, NPPC argues, is exported to the United States, where it harms U.S. producers by depressing domestic prices, from which Canadian producers are "unfairly immunized." Iowa State's Hayes calculated that the additional pork produced due to the Quebec subsidies alone is equivalent to 30% of U.S. exports.[13]

Against. Opponents, including the Pork Trade Action Coalition, contend that trade remedy actions are unjustified because swine prices are set by the market, not Canadian exporters. Hundreds of U.S. farmers are buying the Canadian pigs and raising them in the United States, where they consume U.S.-grown feed, are slaughtered in U.S. plants, and are processed into high-value pork products to meet strong domestic and export demand, it is argued. The preliminary dumping duties are a "tax" that will make the pigs unaffordable to these farmers, many of them NPPC members, the coalition contends, calling the imports a "vital component in U.S. pork industry productivity and profits."[14]

Informa Economics reports that the western Corn Belt has excess packing capacity and surplus feedgrain production. To address this situation, the region imported about 20 million pigs in 2003, both from Canada and from other states. "If this flow were sharply curtailed for some reason, plant efficiency would immediately decline and permanent plant closures probably result," Informa observes (see footnote 8). Small producers have remained solvent by concentrating on finishing out feeder pigs, either under contract with an integrator, or by independently importing them from elsewhere, including Canada. A finishing barn involves less investment risk, labor, and management expertise, "making these operations a better fit for farms involved in grain production as well as livestock," according to the Informa report.

The Pork Trade Action Coalition contends that Canadian imports account for only 3.3% of the annual U.S. market. (This figure is the live weight of the hogs, or 27 billion pounds. USDA's 7.3% estimate of market share is based on the number of head.) The coalition also declares that U.S. producers currently are receiving record prices and profits. USDA analysts confirm that strong domestic and export demand for U.S. pork products, along with higher prices for competing beef, helped to push the average price of hogs to an estimated $53 per 100 pounds (cwt.) in 2004, the highest since 1990.

Additional Observations

Under the WTO agreement on agriculture, countries promised to classify their farm subsidies based on their potential to distort production and trade, and not to exceed

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[13] NPPC views and supporting materials are available through its website, [http://www.nppc.org].

[14] The coalition says it represents Midwestern producers who are purchasing the Canadian imports. Its website is at [http://www.porktradeaction.org].

specified, quantifiable limits for those deemed to be the most distorting.[15] In its last notification of domestic farm support to the WTO, which was for 1999, Canada reported that hog producers had received C$160 million in support (through provincial programs), or the equivalent of 6.2% of the value of production. Canada counted this spending as "amber box" — that is, defined under the WTO as potentially trade/production distorting.

Elsewhere, the Organization for Economic Cooperation and Development (OECD) has developed its own measure of major countries' domestic supports — both exempt and nonexempt — and publishes them annually. OECD said its "producer support estimate" (PSE) for Canadian pigmeat was 7% of the value of production during 2002-2002. Its comparable PSE for the United States was 4%.[16]

A 2004 USDA analysis concluded that any final AD and/or CVD penalty likely would result in a slowing of North American pork market integration, and a decline in U.S. imports of slaughter hogs as incentives increase to finish and slaughter them in Canada. U.S. hog prices would increase to the benefit of U.S. hog producers, but at the expense of U.S. hog buyers; Canadian domestic hog prices would decline.[17]

The NPPC materials further explain that Canada lacks enough capacity to feed to slaughter weight the feeder pigs it will produce over the next 6-12 months, so these would have continued to be exported to the United States in the short run, assuring U.S. feeders an adequate supply. NPPC argues that Canadian rather than U.S. producers would absorb most of the net lower price impact of a new duty, leading to reduced Canadian output.[18]

USDA and other analysts have noted another possible consequence if dumping penalties and slowing imports of Canadian swine had occurred: an increase in Canadian pork exports to the United States in 2005. USDA expects U.S. pork imports in 2005 to increase by nearly 10%, to about 1.2 billion pounds (December 2004 estimate). According to some analysts, Canadian pork imports would continue to trend higher over the long term if Canada were to add hog finishing and packing plant capacity, creating more competition for those segments of the U.S. industry.

In a statement on April 6, 2005, NPPC said it would monitor the situation, noting that "[t]he U.S. government plans to meet with the Canadian government to discuss the hog subsidies in the near future."

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[15] See CRS Report RL30612, *Farm Support Programs and World Trade Commitments*.

[16] *Agricultural Policies in OECD Countries: Monitoring and Evaluation*, 2003. The OECD data differ from that collected by the WTO for subsidy reporting purposes, and therefore are not directly comparable. See the above CRS report for clarification.

[17] ERS, *Market Integration in the North American Hog Industries*; and *Livestock, Dairy, & Poultry Outlook*, November 18, 2004.

[18] NPPC says that due to the duty, prices for feeder pigs will be higher in the United States (benefitting those selling U.S. feeder pigs) but lower in Canada. Though U.S. feeder pig buyers will have to pay more, anticipated higher prices for U.S. slaughter hogs should offset all or part of this cost, NPPC argues.