



USDA Foreign Agricultural Service

GAIN Report

Global Agriculture Information Network

Template Version 2.08

Voluntary Report - public distribution

Date: 4/20/2007

GAIN Report Number: RS7036

Russian Federation

Livestock and Products

National Meat Association Head Comments on Pork Market

2007

Approved by:

Allan Mustard
American Embassy

Prepared by:

Allan Mustard

Report Highlights:

National Meat Association Head Sergey Yushin identifies several problems that have arisen due to the Russian National Priority Project for accelerated development of the livestock sector. They include expansion of production of low-quality pork that now is difficult to market, and difficulties in repaying loans taken out to expand pork production due to falling pork prices. This article is reprinted here in English translation with permission.

Includes PSD Changes: No
Includes Trade Matrix: No
Unscheduled Report
Moscow [RS1]
[RS]

Summary

Sergey Yushin, head of Russia's National Meat Association, published an analysis of the Russian pork market April 17, 2007, on the website of *Krestyanskiye vedomosti* newspaper (original Russian text can be found at <http://www.agronews.ru/newsshow.php?NId=35614>). Yushin correctly points out that globally, pork production is a high-risk, low-profit business, and that after briefly enjoying windfall profits due to imposition of tariff rate quotas on meat imports, Russian pork producers due to a confluence of changed market conditions now face lower prices and slackened demand. Yushin also points out that typical small-scale Russian producers do not produce live hogs of the quality demanded by meat packers, which results in downward price pressure. He points out that some smallholders who borrowed money to ramp up hog production are now having difficulty repaying loans, and suggests that farmer education (so they will be better able to read the market and to produce what their customers want) is key to successful development of Russia's livestock sector.

Given Yushin's authoritative position and keen market insights, we provide here with permission an English translation of his analysis, and offer our own commentary at the end of this report.

BEGIN TEXT:

Commentary. Pork's not priced right. Analytical overview.

For some months a tense price situation has prevailed on the Russian pork market, which for the first time in years showed growth in production. Since the middle of last year in the majority of provinces the price of pork has fallen on average by 30%. Hog production's profitability has dropped sharply.

Illusion of a Deficit

If you look at the world history of pork production, during most of the 20th century it was a high-risk but high-income business. In the last quarter of the last century the situation changed, and today under conditions of harsh competition in most countries pork production is a high-risk, but low-income, business.

In Russia thanks to introduction of tariff barriers to meat imports, after 2003 an attractive investment climate for development of pork production steadily formed. New projects for building swine complexes were carried out in various regions in 2004 and 2005. The second wave of investment came in 2006 when hundreds of companies and tens of thousands of private farmers decided to invest in raising hogs.

In the first half of 2006 unprecedentedly high prices for slaughter hogs appeared. At that time in Russia the price for a slaughter hog, live weight, was the highest in the world. Whereas European hog producers were getting from \$1.30 to \$1.60 per kilogram live weight, in Belgorod oblast a high-quality hog sold easily for \$2.10 to \$2.30 per kilogram. Learning about the profits of hog producers in our country, American farmers rolled their eyes with envy – efficient Russian producers had profits 5 to 6 times higher than American.

With this market analysis in the background, investors, farmers and common villagers eagerly responded to the call to participate actively in implementation of the national project in its portion devoted to accelerated development of the livestock sector.

Unnaturally high prices on our market were a result of the confluence of a whole series of circumstances. Among them were the temporary veterinary bans on import of pork from Brazil, which reduced the volume of red meat imports in the first six months of 2006, the

sharp growth of export prices for pork and beef, the limited delivery of hogs for slaughter from Poland, and relatively unexpressed presence on the market of Chinese contraband meat. But all these factors could not continue to affect the market and support prices at that level for long.

Pork became too expensive for consumers, who began more often to prefer cheaper poultry meat. In addition, during the second half of last year imports of red meat rose compared to the first part of the year. Imports of pork in 2006 exceeded those for 2005 by 13%. Russia broke the 2002 import record, and this in the face of tariff barriers and a 60% out-of-quota duty.

This is direct evidence that high-quality pork cuts ready for processing and retail in fact are in short supply here. However, there is a surplus of supply of live hogs, not of high quality, that meat packers are not hurrying to buy.

In Front of the Locomotive

National Meat Association analysts at that time warned a few provincial governors, where pork production was growing particularly quickly, that a price correction was unavoidable. You need to approach expansion of production in a more balanced and cautious manner, or else you can lose it, period, and in one stroke destroy peoples' faith in the national project.

As of the middle of last year NMA analysts created a database of planned investments, projected potential growth out production capacity, analyzed the status of primary processing and logistics in our country, studied world experience and production statistics and prices in various countries for the last 50 years. The final analysis was a three-year forecast of production growth, import volume trends, and prices on the Russian pork market. Today it is being fully confirmed. NMA monitoring is continuing, since the situation could change for the better or worse.

In the national project are laid out, as we see it, tried, cautious, and well founded rates of growth of meat production. All types of pork producers decided to jump ahead of the proposed trends and got an unavoidable result – a sharp price drop.

Increasing production, many forget that the pork market is inelastic, and therefore a one-time increase in supply of live hogs, even of a few percent, leads to an immediate cut in farmgate prices of 10-20%. This happens in all countries of the world, and it happened to us.

Why do pork supplies in Russian rise during Great Lent, when half of the population isn't eating meat in general? When from all sides we are reminded of the need to observe Lent strictly, should we be surprised that demand for pork, and the price of pork, fall?

Passions Glowing

The current price level is fully acceptable to large producers with established production. They are even making not a bad profit. But for tens of thousands of rural dwellers, who took out loans in the framework of the national project, for hundreds of legacy Soviet-era, aging complexes the situation is depressing. They cannot sell animals they've produced even for 35 rubles/kilogram live weight.

In 2006 Russian pork production was up by 9% or 176,000 tons. If you consider the plans of investors, in 2007 growth of production in live weight may reach no less than 400 thousand tons, and in 2008 we will add another 500-600 thousand tons. Our market is unlikely to be

able to absorb that even if imports are reduced, pork prices fall and unprofitable farms shut down. In part the market tension may be reduced if an unfavorable price situation causes some producers to hold back from ramping up production, and import of live hogs from the EU will not grow as it did in 2006, and unsurmountable obstacles to illegal trade in pork from China, Brazil and a few other countries will be put in place.

From Quantity to Quality

It's no secret that many producers, especially in private plots, as before know the market and its requirements only poorly, and some even think it unnecessary to produce in accord with consumer preferences. They say, whatever I produce, you can buy. You need to look truth in the eyes. In private plots with their primitive technology there is a historical conception that the hog should be fat. It's been that way a long time. But how does the peasant find out? Every farmer will not wander among the meat packers and stores to find out what kind of pork is needed, with what mix of cuts and hams, what thickness of backfat, and how demographic processes or regional cultural peculiarities affect change in consumer preferences. For this the producers have to found and fund their own associations.

Russia still produces large quantities of low-quality commodities. Research of the Gorbatov Meat Industry Institute showed that the share of muscle mass in commodity hogs in different regions of our country averages 35-38%. For comparison – the Danes achieve 62-64%. Here lies the secret of success for Russian hog producers. Improving the quality of animals raised and the final product, you can provide for significant growth in pork production, without increasing the national swine inventory.

Around the world, the live weight price depends on how much meat the live animal carries. And in Russia, the degree of leanness can affect farmgate prices for live hogs within a single province by up to 30%. Hog producers complain that meat packers are squeezing them on prices. But you see, meat packing is a business that seeks the best conditions. Plants can't function on raw material that makes the cost of production too high. And for high-quality raw material they pay well.

Harmful and Helpful Information

Unfortunately, instead of deep and unbiased economic analysis of the situation, some regional officials and representatives of agricultural science make loud declarations and accusations aimed at the government. Or they offer data not confirmed anywhere, and opinions, repeating various fabrications to the effect that our sausage is made from imported wool, horns and hooves. All this "information" is published nationwide. It's possible people want to feel for the peasants who are suffering hard times. But in fact this only harms them. If the consumer loses faith in meat products, the domestic meat packing industry will suffer, and then to whom will our Russian farmer sell hogs? Of course, you can appeal to the vanity of the producers, telling them their product is the best. It's just that this information doesn't help them, but the opposite; it impedes their finding the real reasons for problems that arise and solutions to them.

The short handbook of American pork producers, published with the support of several associations of producers, shippers and universities, includes over 1500 pages of useful information on genetics, selection, biosafety, marketing, and finances. Dancing around the campfire, chanting of mantras and casting spells don't help people who believed in the opportunity to develop the sector and who invested their hard labor and money into resurrecting domestic pork production. They need to be armed with modern knowledge, competent analysis and accessible forecasts; current, unbiased statistics, so they can make rational and balanced production decisions. You see, in pork production a decision not to

breed a sow at a given moment (for example, linkage to a seasonal demand factor when the offspring would reach a market weight of 100-115 kg) is also a competent marketing decision. That is, the producer should forecast the situation a minimum of 10 months in advance. This is where the national project funding should be directed.

The National Priority Project "Development of the Agroindustrial Complex" in the area of livestock gave hope for a technological breakthrough, a jump ahead by decades. This means the most modern science needs to be engaged.

Rapid growth of domestic production should not be the goal in and of itself. You can do that, but we won't get any profit – that's the issue. In the U.S. over the last 10 years prices for slaughter hogs ranged from \$0.18/kg to \$1.50/kg. There you have the effect of growth and decline of supply. And you see, the U.S. pork market has a century of history and, it would seem, they already know everything there is to know. But no. Sometimes factors affect price discovery that nobody had previously suspected. And here again you need associations and competent analysts working in them.

The Private Citizen at the Trough

In the current situation the most vulnerable category is the private plot. In cost of production, no private plot can compete with industrial, largescale commodity farms. At a modern swine complex the majority of processes are automated and computerized, rations are balanced, biosafety rules are strictly observed, and the genetic potential of the animals is noticeably higher. Volume purchasing of inputs for production garners significant discounts; stable production allows for long-term contracts. Thanks to all of this the enterprise attains low costs of production and competitiveness.

Attracting private citizens to the production process, the state resolves social problems of the rural population. Advocates of small-scale production point out that construction of modern swine complexes does not increase employment opportunities at the production site. That's true, but let's not forget that around the complexes a mass of other production facilities arises, including in the service sector, so that the benefit, including to society, from founding such large farms is easily perceived, and they are more stable, which means more social stability. If the state is interested in villagers producing hogs in their backyards, you have to comprehend that in a short time that number of people growing hogs in the backyards will create a huge environmental problem. Can backyard production dispose properly and safely of manure? People are forced to create next to their houses crucibles of ecological disaster, otherwise they can't raise the hog. And that's at the dawn of the 21st century.

Unbalanced rations, poor genetics, all this works against the private citizen hog producer. People are counting on getting some additional income. And the result is just additional problems.

Nobody to Slaughter

One more factor that led to the sharp drop in prices for live animals, and you have to recall that this is precisely what the commodity producers offer, is the absence in the majority of provinces of modern, high-technology slaughter and primary processing facilities, which would produce tens and hundreds of types of raw material for meat packing plants and meat for retail sale, which we are forced to buy from overseas. Why do many meat packing plants prefer imported raw material? Because it has already been maximally prepared for further processing into meat products. It's not a lack of patriotism. It is a usual and normal business decision, providing greater efficiency and profitability.

You see, nobody thinks to accuse Avtovaz when it assembles a car from parts and does not produce metal from ore itself, plastic from petroleum, and so on. Far from all meat processing enterprises need the whole carcass. Some need butt hams, some need necks, some need shoulders. Here is there is more room for development.

The market is also impeded by the lack of coordination of the actions of the agricultural officials themselves. In some regions we note a paradox. On the one hand local authorities do everything to urge peasants to get to work – raise hogs in their yards, and with the other, to limit the ability of meat plants to buy imported raw material, offering them the opportunity to build their own swine complexes. But if the meat combine builds its own hog farm, where will the villagers sell their hogs? You can't eat that much yourself.

The market is not elastic enough to double in size in a few years. Investors should do their homework and spend time and money on normal, unpredetermined analysis. In the figures buried in the national project is the answer to today's issues. Don't produce more than the market can consume. In America over 70 years pork production grew on average 1.5% per year. At the same time one observed a huge inflow of immigrants and planned growth in exports.

There is a Way Out

How do you get out of this situation? There's no need to panic and to bombard the Ministry of Agriculture and government with petitions every time the price falls a little. In the coming weeks we will see uneven growth of some pork cuts, and with the beginning of the shish kebab season, the end of Great Lent, and reduced shipments of meat from abroad.

The market has already moved upward. Price growth isn't noted across the whole spectrum of products, for it's there.

The government should think about raising tariffs on import of hogs for slaughter from 5% to 35%. Otherwise we will see further growth of this import, and specifically live hogs, and not deboned, frozen pork, are for now the direct competitor for our product.

We need to bolster border control. Why introduce tariff barriers for imports, if contraband is being sold nationwide?

And of course, you don't need to overpoliticize this business. Hog raising and pork production should be viewed as a business, and not an incidental side activity. Even if it performs a valuable societal function. it's not worth it to criticize and call on the carpet this or that producer for cutting production levels – maybe in a deficit market he'll sell his commodity for a better price and pay back his loans. Otherwise he, maybe, will report greater production but won't have anything to return to the bank.

Urging companies and private citizens to boost output, we should honestly warn them that they will sell more but cheaper. Otherwise the consumer himself will turn down expensive pork, and eat chicken. Let them decide what's cheapest. It's their money and their loans.

In leading pork-producing countries, prices for hogs are determined after they are cut up or strictly dependent on the category, and the leanness of meat is determined through ultrasound. The proportion of backfat, bone, neck and cuts determines the profit of the hog producer. Before assigning all blame to imported meat, wouldn't it be worth studying attentively its quality, and understanding where its advantages are, and learning to do it better?

And, finally, primary processing. Feet, tails, ears, hide and diaphragm are also commodities, which should produce income. Hides that are needed for sausage production are imported from abroad. Same as for pork bellies. Having so many hogs of fat breeds in our own country, the meat packers are forced to import pork bellies, since Russian product isn't good enough. Without innovative technologies and farmer education we will continue to scramble, like squirrels in a cage, filling holes first here, then there.

In every market situation you have to investigate separately and take long-term decisions that will support domestic production, without tossing overboard meat processing and simple consumers. The algorithm isn't complex:

1. Correct data and information.
2. Balanced, unpredetermined, unbiased and professional analysis.
3. Competent, unpoliticized conclusions.
4. Correct recommendations and decisions.

It seems simple, but it still isn't working...

END TEXT.

Comments

Yushin's analysis is on the mark, and correlates well with information from other sources. Difficulties reportedly already exist in repayment of loans taken out under the National Priority Project in order to expand and build new swine complexes. These difficulties will only deepen if prices, as Yushin predicts, remain low.

One root of the problem is that the National Priority Project represents an effort to resolve a multifaceted problem, a swine sector that was in decline, with a limited array of tools: additional credit and some amount of imported superior genetics. Modern livestock production, like all of modern agriculture, is a science-intensive and knowledge-based undertaking, and these are key inputs missing from the formula. Land, labor, and capital (in the form of money and genetics) are not enough. They need to be managed properly. In a country in which agricultural education is neglected, real-time market information is almost non-existent, and producers' comprehension of markets (especially, what the market really is asking for) is severely limited, proper asset management and market positioning are out of reach. Yushin's calls for better market information and farmer education as more proper targets for a national priority project are broad hints at what is lacking.

In the case of market information, in Russia real-time reporting on prices is spotty at best and utterly lacking for most markets. In addition, as Yushin points out, many producers do not understand what products are in demand in what markets. This comprehension is lacking not only among small-scale producers, but among Soviet-legacy managers of commercial hog operations, as well. While a case could be made for dissemination of timely, accurate and unbiased market information to be a proper role for producer associations, it is a government function in many developed countries, including the United States, but so far not in Russia.

Regarding farmer education, the continued travails of Russia's agricultural education establishment and its nearly total disconnection from relevant research offer little hope for improvement in this area any time soon. Over the past 15 years most competent young and middle-aged professors were recruited away from universities by private agricultural companies paying vastly greater salaries. The older professors remaining, educated in Marxian economics during the Soviet period, are unable to teach market-oriented courses to students being trained in production agriculture. With real (after inflation is discounted)

spending on agricultural education declining year on year, this situation is unlikely to change for the better in the foreseeable future.

Furthermore, most current managers of Soviet-legacy livestock operations were trained during the Soviet period. The majority of them, products of the Soviet-era deficit economy, do not choose to accept modern methods of farm management or a customer orientation. Thus, with little appreciation either on Soviet-legacy livestock farms or in agricultural colleges for the special nutritional, care, and herd management needs of elite brood stock, the impact of importing pedigree swine genetics is sharply reduced. With little appreciation for customer requirements and preferences, these older producers, conditioned in their youths to a non-market economy characterized by shortages, are prone (as Yushin points out) to produce whatever they want and to assume the market will take it off their hands.

Yushin alludes to another issue in his reference to the need for profitability. The National Priority Project for accelerated livestock development is about increasing output of livestock products and achieving some higher level of "food security", i.e., reduced dependence on imported meat. It is not about achieving income security for producers, and therein lies the rub. Merely boosting output is inadequate for sustained success of a subsector in a market economy. Output must be economically rational, price competitive, and in demand. Absent prolonged, extraordinary levels of market protection, that is a hard case to make for the Russian domestic pork sector.