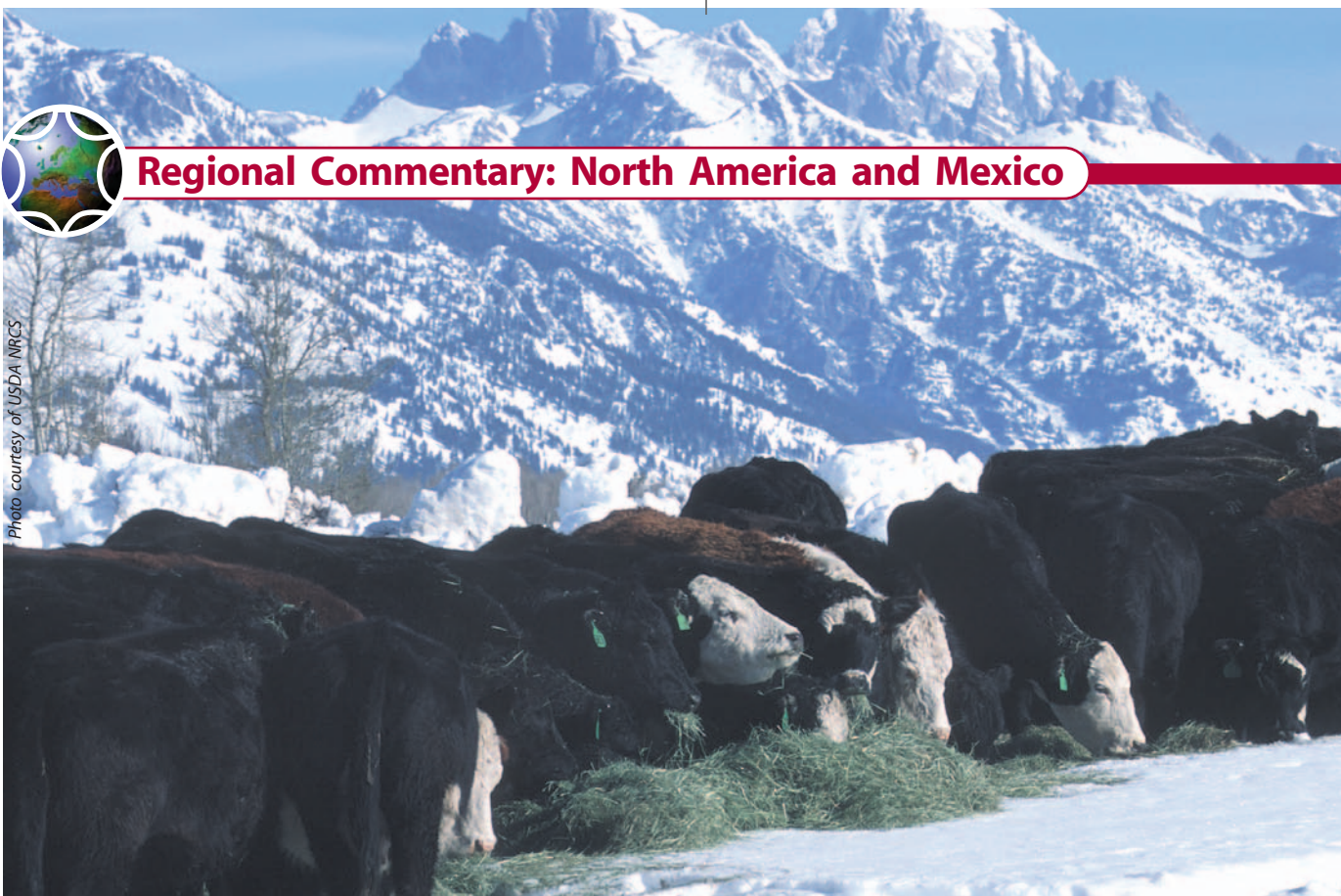




Regional Commentary: North America and Mexico

Photo courtesy of USDA NRCS



150 million cattle and the united states of NAFTA

Blizzards and storms have hit the plains of the USA this winter, leaving cattle stranded to the elements. Many have died and the hide markets have felt the force of the storms as the stressed cattle that survived have failed to gain weight, thus reducing the number of head that reach grade choice and therefore yielding less money for the cattle feeders. Furthermore, due to the current high cost of corn and the lack of pastureland available to graze on because of the storms, hay is running out in the west, especially in the Colorado area and feeders, which are losing in the region of \$100-125 per head are now facing a no-win situation—either sell their cattle and take a loss, or hope for better days later this winter and spring and continue to feed their livestock on expensive corn. However, in spite of the bad hand dealt to the industry by Mother Nature, the slaughter has continued to increase and it had already surpassed 2006 figures by the end of January, which bodes well for the continuation of the positive, although demand-driven, trend seen in the US hide market in recent times.

2006 appears to have been a good year for the US hide market, certainly compared with 2005, but will 2007 match it? China was the main buyer throughout last year, absorbing 111.98 million metric tonnes for its still burgeoning leather

manufacturing industry. The number of hides entering the US wet blue sector, however, was substantially down on the heydays of the 1990s.

In the past, commentators on the North American industry would have focused on the production of the giant, domestic tanneries but today the focus is more on the region as a supplier of raw material and an importer of finished consumer products. It still holds the strings, however, in terms of finance, design, R&D as well as dictating the finished material and product to be manufactured.

In 1993, *World Leather* previewed the arrival of NAFTA on January 1, 1994, and the effects the new trading bloc would have on the three countries involved. For the leather industry, the North American Free Trade Agreement was seen as the vehicle to provide interesting opportunities but it is unlikely that those who drew up the agreement could foresee how it would affect the hide and leather industry just ten years later and beyond.

Whilst much attention has been focused on the unification of relations in Europe in recent years, with the continued expansion of the EU and the introduction of the euro, the progression of trade ties in the North American Free Trade Area (NAFTA) has expanded significantly to form what could easily be viewed as a single market. The power that the USA wields over the global

economy is irrefutable, but many may not be fully aware of the importance of its collaboration with Canada and Mexico under NAFTA for the agricultural and leather sectors in all three nations.

In the first 12 years of NAFTA, trade between the three countries increased by a staggering 173% to reach approximately \$810 billion. And although the USA may have seen the largest benefits in terms of improved trade—recording a 133% increase in trade within the NAFTA region up to 2005—NAFTA is said to have had a positive effect on all three states in terms of overall Gross Domestic Product (GDP). Up to 2005, GDP in Mexico grew 40%, it improved 48% in the USA, and increased by an impressive 49% in Canada. But, as is the case with any collaboration of this type, although the overall picture may be a positive one, trade liberalisation can have marked effects on individual sectors—some of which can suffer for the 'greater good'. As the USA, Canada and Mexico increasingly trade as a single market, there are victors and victims in all three economies. And although trade between the three countries continues to improve, the agricultural landscape has changed significantly as a result of NAFTA—as well as through other factors such as BSE. So what has this meant for these sectors in each individual nation?

In terms of employment, NAFTA has

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US hide exports down but not out

With a high demand for red meat in the USA, the country still produces a significant number of hides and, as the domestic leather industry has slipped into decline, the USA has become a major exporter of hides around the globe. In fact, according to the US Hide, Leather and Skin Association (USHSLA) over 50% of the daily production of 135,000 hides produced—worth \$2.4 million—is now exported and accounts for 4.5% of total agricultural exports. The main export market is, of course, China, but the American industry is by no means putting all of its eggs in one basket. With the help of funding from the Foreign Agricultural Service (FAS), US hide producers are now looking to expand their export markets. With this in mind, USHSLA organised a trade mission to India in early February to assess the Indian market and to promote US hides. During the visit four-member delegation—which included John Reddington, president of USHSLA, C. Kelly Meine, president of Union Hide Company; David Seaver, director Hide Sales and Marketing at Swift & Company, and Jay Jensen, International sales director of Southwest Hide Co—led a seminar at the India International Leather Fair (IILF), offering an overview of the US hide industry and highlighting the stable supply and quality of US-sourced hides to prospective consumers in the expanding Indian leather sector.

Total accumulated exports of cattle hides by country ranked in descending order for marketing year 2006 (1,000 Metric Tons)

Country	2006		2005		2004		2003	
	Exports	Rank	Exports	Rank	Exports	Rank	Exports	Rank
China	11,195.8	1	9,037.2	1	7,387.5	1	6,549.3	2
Korean Republic	5,077.5	2	5,916.5	2	7,178.7	2	7,699.8	1
Taiwan	2,261.8	3	2,070.2	3	2,157.4	3	2,178.4	3
Mexico	1,453.5	4	1,411.3	4	1,380.4	6	1,512.7	6
Japan	1,218.1	5	964.0	6	1,530.0	5	1,614.4	5
Hong Kong	1,165.7	6	1,185.5	5	1,917.8	4	2,118.3	4
Thailand	651.5	7	725.9	7	764.2	7	776.3	8
Italy	338.4	8	406.5	8	433.4	8	938.9	7
Vietnam	220.4	9	218.9	9	122.1	10	16.5	15
Dom Republic	99.7	10	112.5	10	29.5	14	27.1	13
Canada	59.7	11	86.6	11	179.2	9	267.3	9
Total	2,3877.7		2,2325.9		2,3329.0		2,3961.9	

Source: FAS

thus far had a slightly positive effect in certain agricultural sectors in the USA where it maintains an advantage over the other two countries; however this is likely to alter significantly in the future as Mexico continues to expand its global presence in the more labour-intensive sectors of the agricultural market whilst the USA and Canada continue to focus more on capital-intensive businesses. It is true to say that these trends were already apparent before the NAFTA agreement was signed and they have been compounded, if not accelerated, since its implementation.

Beefing up the market

The outbreak of BSE in the USA in 2003, admittedly affecting very few cattle, had a devastating effect on the sector and it is fair to say that the NAFTA agreement aided the survival of the country's beef industry. Before the outbreak of BSE, its

primary beef export markets were Japan, Korea, and Mexico but, as both Japan and Korea implemented bans on US beef products following the confirmation of the disease, the USA had to look to its close allies. This explains why, in the post-BSE era, the large majority of the USA's exports generated by its national beef herd of approximately 97 million now go to Mexico and Canada. In 2004, following the outbreak, US beef exports to Mexico reached almost 107,000 metric tons, compared with 39,000 metric tons in 2003, despite an interruption in trade during the initial discovery of BSE. Even now that Japan and Korea are looking at fully reopening their borders, the USA is still struggling in its traditional markets due to competition from other exporters that were more than happy to fill the gap when US beef was off the menu.

But, despite this increased competition,

the US beef market continues to improve, as packers achieve better live cattle prices, and as a result of the USA's relationship with Canada and Mexico—although the cuts of beef consumed by its NAFTA neighbours are not as high quality as those previously sold to Korea and Japan. Whatever the reasons may be, the future for the market looks positive with US beef exports set to improve by 30% to reach 680,000 tons in 2007. This continued trade with its NAFTA partners is the result of harmonised sanitary standards which has meant that feedlots can now be found to house cattle that may have lived in any, or all, of the NAFTA countries.

This harmonisation has also assisted the Mexican livestock and beef industries and it is now a net exporter of cattle and its northern neighbour is now the main export market for Mexican beef and veal. Whilst Mexico played an important role in the survival of the US market it also profited from the situation, becoming a significant beef and veal exporter to the Asian countries that had restricted US beef. Until the outbreak of BSE, the USA had accounted for over 99% of Mexico's exports, but by 2005 Japan and South Korea accounted for 26% and 13% of beef and veal export trade respectively. Mexico's live cattle exports are also forecast to grow in 2007 and, whilst this may in part be a result of its close ties with the USA and Canada and the resulting improvement in quality and sanitary conditions, it is also attributable to the recovery of the national herd following a severe drought in the late 1990s that decimated the industry. Mexico's total cattle herd had recovered to 27 million head at the beginning of 2006—approximately 90% of which were beef cattle—and following the favourable weather conditions last year, Mexico's 2007 exports of live cattle are now predicted to reach 1.2 million head. ►

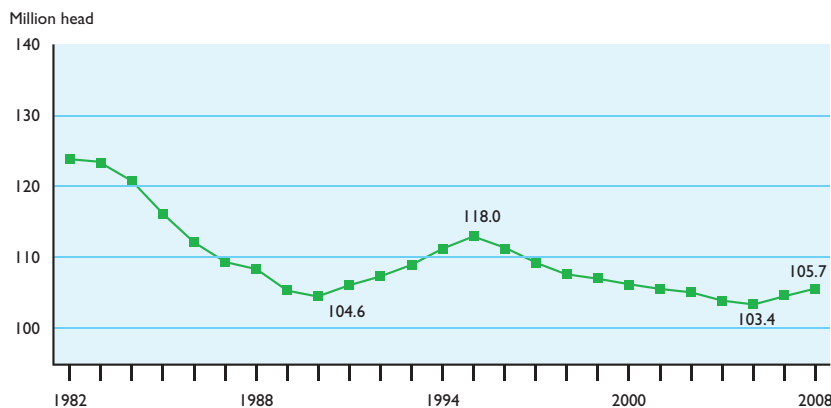




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United States cattle inventory

July 1, 1982-2006



Source: Agricultural Statistics Board, July 2006 3 NASS, USDA

While Mexico's beef and livestock industry has expanded, Canada's cattle and beef industries have been ravaged by BSE and it has relied heavily on its closest trade ally, the USA, for much of its business. Following the small outbreak, even Mexico was wary of Canadian produce and Canada's beef exports to its NAFTA partner declined by 38% in 2005, although it did remain the second largest market. Thanks to the close ties between the North American neighbours, Canadian exports to the USA increased 5%; however, levels are still far from those seen prior to the occurrence of BSE as annual beef and veal exports totalled only 458,377 tonnes in 2005, whilst imports from the USA doubled. The number of live cattle exported to the USA at the end of 2005 reached 558,235 head, which was 80% of Canada's total beef exports, but this was below the 1.7 million head exported to the USA in 2002—the last full year before the outbreak.

In fact Canada has remained the USA's

most important trade partner in total trade and agricultural trade and, whilst the USA and Canada may compete in the global beef market, the close proximity of the countries and the integration that exists, meant that it was in both countries' best interests to reclaim North America's market share. Before BSE, North America had accounted for nearly 25% of global beef exports and 50% of that trade was conducted between NAFTA countries; however, in 2005, following the outbreak, NAFTA's market share fell to 13% of global trade whilst trade between NAFTA members increased to 95%, thus illustrating the safety net that NAFTA provides to its member states. In fact, definitive steps have been taken to integrate the beef markets in the USA and Canada. At the end of 2005 the American Meat Institute (AMI) and the Canadian Meat Council (CMC) signed a memorandum of understanding to enhance co-operation between the two representative bodies under which they

now jointly co-ordinate animal welfare, worker safety, and promotional and public affairs strategies. Commenting on the agreement at the time, president of the AMI said, "For years, we have operated for all practical purposes as an integrated, North American market. It's time that our trade associations work together in a more formal way to reflect that integration," and added, "I am very optimistic that this memorandum of understanding will yield major benefits for the industry on both sides of the border."

Food for thought

Integration under NAFTA is not limited to agriculture alone as it follows the production chain up to meat packers and processors—a substantial sector.

The processed food industries are now interlinked, particularly between Canadian and US companies and this has led to the countries gaining a significant market share.

The USA boasts the largest meat processing companies in the world and collaboration in this sector has cemented its domination in this field. Arkansas-based Tyson Foods, Inc. is the world's largest processor of chicken, beef, and pork. It employs some 107,000 staff at its 200 facilities and offices around the globe and sells products in more than 80 countries. However, with sales remaining static in 2006, the company is looking for ways to reduce costs and increase revenue. This has led to a reduction in the workforce and the relocation of manufacturing facilities abroad. The company recently announced that it had entered into a joint beef processing venture in Argentina and it plans to seal two further deals in Brazil and China in 2007. On a more positive note, it also has plans to open a new R&D ➤



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centre that will be based in the USA.

Meanwhile, although Swift & Company—the world's second-largest processor of fresh beef and pork products—reported 6.9% higher sales of \$2.47 billion for its fiscal second quarter of 2007, it has also recently announced 'overhead reductions' to maintain its margins and secure its position in order to compete in the global market. This naturally involved job cuts in the USA. There has also been a great deal of consolidation within the Canadian meat industry as processors have merged to

improve competitiveness by reducing outgoings and increasing profitability.

This trend only reflects the global scenario in traditional manufacturing sectors which is moving more and more towards reducing costs and relocating production to lower cost countries. Whilst this has impacted the meat industry, it continues to profit, unlike other traditional manufacturing sectors such as the leather industry.

The end of an era

Due to high production costs and

Top 10 Beef slaughterers and estimated daily slaughter capacity, October 2006

Beef packers

Company	Daily capacity
1 Tyson Foods ¹	30,875
2 Cargill Meat Solutions	25,850
3 Swift & Co. ²	15,800
4 National Beef Packing Co. ³	13,000
5 Smithfield Foods	7,600
6 American Foods Group, LLC	5,200
7 Greater Omaha Packing Co.	2,600
8 Nebraska Beef, Inc.	3,000
9 Creekstone Farms	1,600
10 AB Foods (Washington Beef) ⁴	1,500
Total Daily	135,030

¹ Closed Boise - Oct 2006

² Sold cow plants to XL Foods, Calgary

³ Purchased Brawley Beef

⁴ Increased daily kill from 1,000 to 1,500

Source: Sterling Marketing, Inc.

XXIX IULTCS Congress and 103rd ALCA Annual Meeting June 20-24, 2007 JW Marriott Hotel Washington, DC, USA

Schedule
Wednesday, June 20
Registration, Welcome Reception

Thursday, June 21
*Heidemann Lecture to be given by Lorenz Siggel,
"Leather-Related Molecular Modelling of Collagen Fibers"*
*John Arthur Wilson Memorial Lecture to be given by Richard Daniels
"Tannery Effluent and Reedbeds: Working with Nature"*
Technical Sessions, Visual Displays, Fun Run

Friday, June 22
*Technical Sessions, Visual Displays,
Golf Tournament, Explore Washington*

Saturday, June 23
*Technical Sessions, Sports/Social Activities Luncheon,
Reception, Banquet, Closing Ceremony*

Additional Social Activities
*DC After Dark Bus Tour
Wine, Cocktails, and Hôrs d'oeuvres with 'George Washington'
at the Historic Willard Hotel.*

Guest Activities
*Lunch on the Potomac River
Arlington Cemetery and DC Monuments Bus Tour*

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environmental issues the tanning industry in the USA has been reduced to a shadow of the thriving industry it once was. In the modern day we tend to hear more about US lawsuits and settlements over environmental pollution from former tanneries and the archaeological discoveries of historic tanning sites rather than any increase in production.

Since the beginning of NAFTA, four US agriculture-related manufacturing sectors posted significant declines in employment. These are textile mill products, apparel and other finished textile products, paper and allied products, and leather and leather products. This may be the result, in part, to US tanneries relocating production to Mexico as its leather industry expands, but neither Mexico nor Canada's combined share of US leather product imports can account for the large fall in production and the significant rise in US imports. It is more likely a reflection of the general move towards lower cost developing countries such as those in the Far East.

The decline in leather tanning and finishing began in the 1980s, when the sector underwent a huge consolidation process as larger companies acquired smaller ones. The number of tanneries and finishing companies had already fallen to 328 by the late 1990s from the 342 registered in the early 1980s as a

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result of competition from foreign tanners in developing nations. And although tanneries still exist in the USA, this is often due to political decree rather than commercial savvy. For example, whilst Prime Tanning continues to thrive and produce leathers for the footwear, apparel and upholstery markets, it secures a significant amount of business as a result of the US legislation that demands that military footwear is produced and sourced from domestic companies. Other big names also continue to enjoy success, but whilst they may still be headquartered in the USA, the majority of production is carried out overseas as companies have established facilities in lower cost countries. An example of this is US-based supplier of high-end automotive leather Eagle Ottawa, LLC, which announced the closure of its manufacturing facilities in Michigan in 2006. The move was part of the company's strategy to focus manufacturing in lower cost countries such as Mexico, Eastern Europe and the Far East. Speaking to *World Leather*, Eagle Ottawa's vice president of Human Resources, Jim Wise, said that the closure was the result of changing customer demand and production cost considerations. He added that the company has to constantly assess its "global footprint" and had to be flexible, adjusting to the current market, thus prompting the decision to focus production in more viable geographical areas such as Mexico, South America, Eastern Europe and China, where the company had recently expanded its facilities.

This scenario is a common one in developed countries in the 21st century. The tanning industry in Canada has virtually disappeared albeit for small niche sectors such as processing seal pelts and this in itself is not an easy sector due to a certain amount of controversy. At the beginning of 2006 Greenland's state-owned tannery Great Greenland was banned from importing Canadian seal skins by the government due to worries over the manner in which they were killed. This was a huge blow to the industry, as well as for the tannery in Greenland that had imported 40,000 Canadian pelts in the first nine months of 2005. However, Canada has taken steps to protect the seal industry and improve revenue through selling added-value products. In mid-2006 Canada's Minister of Fisheries and Aquaculture for Newfoundland and Labrador, Tom Rideout, announced that as of April 1, 2008, the government will require that all seals landed in the area undergo full primary processing, to the

tanned stage in the province. Commenting on the legislation, Mr. Rideout said, "This new policy will create additional employment opportunities for residents of the province and have significant implications for our rural economy," adding that, "the new policy will require that seal pelts be processed to a final consumer stage before leaving the province." This was a significant step as more than 90% of the Canada's harp seal harvest takes place in Newfoundland and Labrador and the seal harvest is vibrant, posting a landed value of approximately

\$15.7 million and a market value approaching \$40 million in 2005. The industry in the province also employs between 400 and 500 individuals at its seal processing facilities and an estimated 5,000 to 6,000 sealers participate in the seal harvest each year.

As for Mexico the outlook for the tanning industry is far more positive. Just as Eagle Ottawa has moved a significant part of its production to the USA's southern NAFTA partner, others are following suit in order to benefit from free trade and to enjoy the lower ➤

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