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NEW DEVELOPMENTS IN CONTRACT RELATIONSHIPS IN THE SWINE INDUSTRY

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Contracts at the Production and Marketing Phase are Evolving

Coordination of the Chain Continues

Forces Encouraging Coordination

- **Branding of Various Kinds to Capture Consumer Surplus and Overcome Destructive Cost Competition as Only Viable Strategy**
- **Traceability as a both a Legal and Branding Requirement**
- **Critical Mass for Up-Chain Negotiation**
- **Food Safety/Bio-Terrorism Issues**
- **Emerging Animal Welfare Issues**
- **Co-Permitting Threats**

Production Contracts

- Building Costs Rising Dramatically
  - China and India Factor
  - Dollar Value
  - Housing Market
  - Hurricanes
- Interest and Permitting Costs Rising
  - Economy Growing Rapidly
  - Inflation Worries Encourage Incremental Increases in Rates
  - Terms Extending to 12-15 Years from 10
- Energy Costs Rising
  - Real Costs Expected to Stabilize and Move Downward
  - Propane price (a by-product) is highly volatile
- Contract Terms
  - Changing to Match Extended Financing
- Satisfaction by Growers High (4.9 on 6.0 Scale)
  - 2003 Univ of MO et al Study
- Procedures Changing to Accommodate New Demands by Government and Market Branding Requirement

Marketing Contracts

- **10% Sold on Negotiated Market (likely long-term equilibrium)**
- **Contract Terms Differentiated on Packer Strategy (Meat vs. Food)**
- **Moving to a Whole Chain Pricing Formula to Establish a Rational Investment Environment for the Chain (Paradigm Change: From Pigs to Meat to Food)**
- **New Demands by Customers and Government(s) Making Their Way into Contract Terms—Traceability, Animal Welfare, Food Safety, Environmental Assurance**

U.S. Hog Marketing Contract Study*

Table 1
Percent of U.S. Hogs Sold Through Various Pricing Arrangements,
January 1999-2006*

	1999	2000	2001	2002	2003	2004	2005	2006
Hog or meat market formula	44.2	47.2	54.0	44.5	41.4	41.4	39.9	41.8
Other market formula	3.4	8.5	5.7	11.8	5.7	7.2	10.3	8.8
Other purchase arrangement	14.4	16.9	22.8	8.6	19.2	20.6	15.4	16.6
Packer-sold				2.1	2.2	2.1	2.4	2.6
Packer-owned				16.4	18.1	17.1	21.4	20.1
Negotiated - spot	35.8	25.7	17.3	16.7	13.5	11.6	10.6	10.2

*2006 data were reported to USDA voluntarily; 2002 through 2005 data are based on USDA Mandatory Reports; 1999-2001 are based on industry surveys by the University of Missouri.

Non-negotiated or non-spot purchases in January 2006 accounted for 89.8% of the purchases of market hogs included in the price reporting data. The 2005 study showed 89.4%; the 2004 study showed 88.4%; the 2003 study showed 86.5%; the 2002 study showed 83.3%; the 2001 study showed 82.7%; the 2000 study showed 74.3%; the 1999 study showed 64.2%; and the 1997 study showed 56.6% were non-negotiated transactions.

* Grimes and Plain, University of Missouri Dept of Agricultural Economics Working Paper No. AEWP 2006-01

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