



DE-TOXIFYING BEEF TRADE: SELF-HELP, COMMON SENSE

-- SPEAKING NOTES --

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**John R. Magnus
TRADEWINS LLC
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Me thinks I have no more wit than a Christian or an ordinary man has. But I am a great eater of beef, and I believe that does harm to my wit.

- Shakespeare, *Twelfth Night*, Act I, sc. iii

Thank you for attending this morning, and thanks especially to Judge for including me in this panel. I also want to recognize the ABA International Trade Committee, which is co-sponsoring this morning's event.

The quote above comes out of the mouth of Sir Andrew, asked by his friend Sir Toby to account for some less-than-deft behavior in an Illyrian bar. I include it, first, to show that irrational prejudice regarding beef has a long pedigree; and second, to tee up my function this morning, like that of Toby and Andrew in Shakespeare's classic, as comic relief.

I have a short presentation – first some scene-setting factual information, then some thoughts on overcoming BSE-based beef trade restrictions (my main focus today), and finally a few points on beef trade within the Western Hemisphere. As you will see, and as Judge grasped in putting this event together, it is a sector with no shortage of trade issues – some of them very technical and narrow, others tied directly to the broad themes of today's high-level trade policy debates.

I. Introduction - An Unhappy Status Quo

The current gloom and doom in respect of beef trade is, even for a veteran of steel and other trade horror stories, pretty extreme. Some basics:

- U.S. beef exports to Asia are mostly blocked.
- U.S. beef exports to the EU are mostly blocked.
- Roughly \$3 billion in annual export sales have disappeared, and what was until recently a trade surplus in fresh/chilled/frozen beef has turned into a deficit:

F/C/F BEEF	2003	2004	2005
Exports	\$3B	\$0.5B	\$0.8B
Imports	\$2.4B	\$3.3B	\$3.3B
Deficit	<i>surplus</i>	(\$2.8B)	(\$2.5B)

- Meanwhile, the sector has experienced employment *and* output declines.¹
- Foreign consumers' perception of the safety of U.S. beef is said to be very poor.
- The formal OIE² classification of the United States, with regard to BSE risk, has been slow in arriving and does not appear likely to have much rapid impact in restoring lost trade flows.
- The Korea-US Free Trade Agreement (KORUS FTA) talks are proceeding under a cloud because of BSE-based import restrictions.
- Trade liberalization in the sector generally is painful, thanks to the squeeze of declining output and difficulty exporting, and so is opposed by important players.
- Each bilateral trade arrangement (with countries in Latin America, with Vietnam, *etc.*) seems to attract a distinct, *ad hoc* resolution on BSE, with details on bones, slaughter age, and other particulars.
- The whole beef trade/BSE issue has become so politicized that every development, even routine ones like plant inspections and scientists' meetings, seems to prompt letters, accusations, recriminations, *etc.*
- *In sum, these are not the best of times. BSE-based closures of foreign markets are key.*

II. Self-Help and the BSE Problem

The BSE/beef trade story-line is a familiar one for people working in the trade field. Product standards bedevil trade in many sectors, and in the food sector concerns often arise about food-purity or sanitary/phytosanitary (SPS) rules that are said to be based on something other than "sound science."

But in one respect the beef tale is peculiar indeed. Normally when companies ask government officials for help in breaking down foreign market barriers, the first (and second, and third) response is in the form of a question: *what are you doing to help yourself?* Officials naturally want to know that they are not the first resort. So they ask questions like: what local resources have you deployed in the foreign capital to promote the result you seek? What have you done to make

¹ In many sectors characterized by trade friction, one sees employment declines coinciding with steady or rising output. It is hard to know how to react to such fact patterns, where the job losses may be productivity-driven and the sector considered "healthier" at higher output and lower employment. But fresh/chilled/frozen beef output reportedly fell by 6% from 2003-05.

² Office International des Epizooties, established 1924. The "OIE" acronym is still in use, even though the entity's name is now the "Organisation Mondiale de la Santé Animale" or "World Organization for Animal Health."

your product more acceptable to the pertinent regulators, or more attractive to foreign customers? Have you done everything possible, and is U.S. government pressure the only remaining option?

A Puzzling Anomaly

In this case there are U.S. producers doing exactly what trade orthodoxy says they are supposed to do: trying to help themselves, and make their product more acceptable, by testing their animals for BSE (using the best currently-available testing technology) at the time of slaughter. And the U.S. government, rather than encourage them, has threatened to impose stiff penalties. The matter is currently in litigation. (I have a very small involvement as a Washington consultant to the plaintiff in this litigation, Creekstone Farms.)

I became interested in this situation because of how anomalous it is in trade terms. Of course, large beef processors have a negative view of point-of-slaughter testing; any significant use of it could create a standard that they might feel pressured to meet, and doing so would be costly for them given the high-speed, high-volume nature of their facilities. But for the government to enforce that preference, industry-wide, through prohibitory regulation? A Republican government, no less -- supposedly solicitous of private property rights, reluctant to regulate business behavior (especially the innovative kind), and enamored of the process by which consumer demand sends signals in the marketplace that influence suppliers' behavior? And in flat contradiction to standard trade dogma? There had to be a *really* good reason. I investigated.

There is none.

The government contends that it is unreasonable for foreign regulators -- no matter what their consumers may be asking for -- to insist that U.S. beef be tested as a condition of entry, or to maintain any sort of preference for tested beef. Because of the U.S. ruminant-to-ruminant feed ban and the mandated removal of specified risk materials (SRMs) during processing, U.S. beef is safe whether or not it is tested at the time of slaughter, and foreign governments should let it all in. This is entirely correct -- and entirely irrelevant if there are U.S. producers who are nonetheless prepared to test voluntarily.

The government responds that if any tested U.S. products become available, that will give foreign governments an "excuse" to continue rejecting other (untested) U.S. beef products. The premise here -- the supposed linkage between foreign governments' behavior and the product offerings of private U.S. companies -- is debatable. The governments in question have an obligation to promptly extend full market access to all U.S. beef. But any reluctance to do so, including any limitation of imports (generally or in certain categories) to BSE-tested products, by definition reflects their policy interests. Private U.S. companies cannot alter those policy interests, be blamed for the resulting policies, or furnish an "excuse" for foreign governments to violate their trade obligations.

In any event, assuming the hypothesized linkage does exist, the answer is ... *so what?* To U.S. companies that want to offer tested beef, the U.S. government is saying, in effect, “by meeting their unreasonable standards, you may encourage foreign governments to do something they shouldn’t do -- something they have pledged in trade agreements *not* to do -- and so we will prevent you from offering products acceptable to them.” This is naked picking of winners and losers, of the type that normally makes conservative officials wince. To block innovators within a sector from introducing a more desirable product -- even if there is no good reason why consumers *should* regard it as more desirable -- is to play favorites.

And it has been taken to absurd lengths. When Korean inspectors recently examined 37 U.S. beef processing facilities and cleared 30 of them to resume export shipments -- the other 7 had not done enough to segregate Canadian-origin product regarded by Korea as presenting greater BSE risks -- the U.S. government said “thanks, but no thanks” and *prevented the successful facilities* from promptly resuming exports.

Food Safety Perspectives

The food safety arguments here are admittedly more complex. Some people think more testing would surface more cases of infected animals. Others disagree, or agree but consider the point wholly irrelevant in food safety terms. Some people think the sheer awfulness of CJD, the human version of BSE, justifies using every conceivable precaution, regardless of its expense. Others think the use of precautionary measures, both voluntary and mandated, should reflect a cost-benefit analysis, and consider that expanded testing could generate “false positives” that would lead to unjustified hysteria or otherwise interfere with the smooth flow of accurate food safety information.

I cannot help resolve these arguments. As a personal matter, I eat beef without pausing to wonder whether it was tested at slaughter. I trust the efficacy of the first-line BSE-safety measures (feed ban and SRM removal), and I wouldn’t pay extra for tested beef. But a lot of people -- especially in Japan and Korea but also here at home -- see things differently. A tested product is not transformed by the testing into a different product. But it does carry additional information that many consumers value. Some processors do not wish to respond to consumers’ signals with regard to BSE testing, and there is no reason why they should be obliged to do so. But there is equally no reason why processors that *do* wish to meet this element of consumer demand should be forbidden to do so. Private/voluntary testing represents an innovation, in responding to articulated consumer demand, that should not be squelched by the government ... *whether or not* it actually enhances food safety.

In any event, there is no need to agree on the food safety/science issues to see the government’s approach here as odd trade policy. At its most basic level, the dogma of trade is about enabling willing sellers and buyers to connect irrespective of borders. Here, there are U.S. producers ready to supply a tested product, and there seems to be little doubt that such a product would be well-received overseas. For example, in a December 2005 telephone poll by Kyodo

News Agency, over three quarters of Japanese respondents said they were unwilling to eat U.S.-origin beef, and over half agreed that the Japanese government should demand blanket BSE testing of all U.S. cattle processed for shipment to Japan. A December 2001 study found that Japanese consumers on average were willing to pay 50% more for beef from cattle tested for BSE.³ And while the U.S. government prevents American firms from responding to these preferences, market positions in Asia are being ever-more-securely occupied by beef from BSE-free Australia.

The legal assertions are odd as well. The government is relying on a hoary statute, the Virus-Serum-Toxins Act, enacted in 1913 to give USDA authority to regulate treatments and diagnostic tests used on *live* animals, as authority to control how firms may (and may not) examine tissues taken from *dead* animals. And note that the government is not regulating commercial claims made by processors selling tested beef; it is enforcing a *prior restraint on conducting* BSE tests. (The government of course does have authority to regulate any claims made by purveyors of tested beef on their packaging.)

[A Different Approach -- Worth Trying](#)

Voluntary testing is no panacea for the beef industry's trade problems. They are big problems, and point-of-slaughter testing for all or even most U.S. beef seems unrealistic. But the cloud over the KORUS FTA, and over Japan-US trade relations, could be smaller. With an enlightened approach to private/voluntary testing, trade could start flowing again more quickly, and access for the rest of the U.S. industry could (hopefully) be worked out in a less-charged atmosphere. And even if not -- is it fair to hold innovators hostage?

The current strategy -- insist that U.S. beef is safe regardless of testing, and demand full access -- does not seem to be working. Confirmation of the United States' "controlled BSE risk" status by the OIE may provide a boost for this strategy. Or, its results may disappoint. Whatever the true motivations of the foreign officials involved (probably some mix of rank protectionism and legitimate food safety concern), U.S. officials have been unable to convince large beef importing countries to accept U.S. beef with less stringent precautions than they apply to their domestic beef. (Routine, or at least much more frequent, BSE testing appears to be a norm outside North America.)

A useful analogy: the path back into key export markets runs through a door. Current U.S. strategy is based on the idea that the door is, or will be, wide enough for the whole U.S. industry to walk through side by side. As I read the available information, it is more realistic to think about reorienting the line so that producers can move through the door single-file or perhaps two-by-two. The "all together" approach may once have been worth trying, but should not be followed slavishly if it shows no hope of prompt success. If, as recent experience seems

³ Jill J. McCluskey, *et al.*, "Bovine Spongiform Encephalopathy in Japan: Consumers' Food Safety Perceptions and Willingness to Pay for Tested Beef," 49 *The Australian Journal of Agricultural and Resource Economics* 196 (2005).

to suggest, only premium processors can lead the way for U.S. beef back into key export markets, ... why not turn them loose and wish them well?

This does not of course mean the bigger problem will be or should be ignored. There is no contradiction in asserting one's rights, on one hand, and navigating around a trade barrier, on the other. A terrific example comes from the beef sector itself. The EU has an import restraint on hormone-fed beef. This restraint lacks a valid scientific justification, and the U.S. government has rightly challenged it under WTO rules on behalf of the entire U.S. beef industry. Retaliatory tariffs have been in place for years. But individual beef processors have certainly been (and remain) able, at their election, to seek to supply products that conform to the EU rules. No one would have thought to interfere with that. And no one should do so in the BSE context either.

Having focused extensively overseas, I will now take a very selective tour in our own hemisphere with stops in Canada and South America.

III. Canada

Trade with Canada in this sector is vexed as well. The partial reopening, and proposed complete opening, of the U.S. market to cattle and beef imports from Canada has triggered legal challenges and significant political push-back.

Specific issues in (or destined for) court litigation include: (1) the "BSE Minimal Risk Region" rule, already promulgated by USDA, which affects younger live animals and beef, and (2) the newly proposed, or re-proposed, "over thirty months" (OTM) rule for cattle in Canada that have reached that venerable age.

Over time affected U.S. interests have brought to bear a mix of trade tools (including petitions under Title VII of the Tariff Act of 1930 and threatened actions under Section 301 of the Trade Act of 1974) and other legal tools, with mixed results. It would be -- perhaps has been -- a terrific subject for study within the Political Economy program at one of our great universities. One interesting aspect is that those opposing greater imports from Canada have seemed to focus more on U.S. government rules and policies than on government measures or private practices in Canada.

Among the notable market conditions cited (and argued over) by those involved in this struggle are:

- high concentration in the processing part of the U.S. beef industry, with the four largest processors ("packers") accounting for 83% of shipments and assertedly enjoying, as a result, monopsony power with respect to the purchase of cattle for slaughter;
- inability of those processors to own cattle in the United States, coupled with ability to own cattle in Canada -- they are said to use Canadian herds as a

“strategic reserve” and bring animals into the United States opportunistically to head off hints of firming cattle prices; and

- atomized nature of the cattle producing part of the U.S. industry, increasing the inherent vulnerability arising from the perishable nature of their product (cattle must be promptly sold, at whatever price is obtainable, once fattened for slaughter).

As noted, these claims, and the policy implications, are disputed. The result might well be a stand-off -- leaving the default rule of free trade between Canada and the United States to govern in the beef and cattle sector as it does in most others -- but for Canada’s role (deserved or no) in the blockage of U.S. exports to Asia. Canada has a bigger BSE problem. That is to say, despite having similar first-line disease control measures (feed ban) and similar methods and intensity of testing for disease prevalence, Canada has documented many more BSE cases than has the United States (13 versus 3, and one of the U.S. cases was a Canadian animal in the State of Washington). And as noted already, one of the criteria applied by other importing countries considering how to treat U.S. beef is how carefully Canadian-origin product is segregated within U.S. processing facilities. Canadian beef is perceived as riskier, and that perception has operated as a drag on the restoration of U.S. export opportunities.

This gives rise to an interesting debate. Purely as a trade policy matter, should we limit what comes in from Canada, in order to enhance the perceived safety of our beef in the eyes of consumers and regulators in Asia and around the world? Or, if we do so, are we departing from the science-based and OIE-based standard we want other countries to follow, and thereby undermining our best chance to restore exports? The two sides in the debate summarized above give, as you might expect, different answers. The U.S. government has so far come down firmly on the side of “doing unto Canada as we would have other countries do unto us.” We believe we can persuade other trading partners not to hold an open Canada-U.S. border against us.

The wisdom of this approach depends largely on what results one thinks will follow (and how quickly) after the OIE confirms, as it is expected to do in May, its designation of both the United States and Canada as “controlled BSE risk” jurisdictions. How this much-anticipated step will affect the regulatory approaches of importing countries is hard to predict and thus (in my view) dangerous to rely upon. The “controlled risk” category is a broad one, as evidenced by (1) the fact that it has room for both the United States and Canada, with their differing recent histories of discovering infected animals, and (2) the fact that the only alternative designations are “negligible risk” and “indeterminate risk.” “Controlled risk” is much like when economists refer to the “middle class.” For example, even with the same OIE status, it will be surprising if U.S. and Canadian beef get identical treatment in key Asian markets any time soon.

The controlled risk designation is also insensitive to breaking BSE news. (Imagine another infected animal being discovered in the U.S. herd next week.

The OIE designation should be unaffected -- in fact, the science on which it is based assumes that more cases will surface -- but importing countries' posture would almost certainly be affected.) The OIE designation is probably best seen as a data point, a single, although hopefully influential, factor bearing on a complex political discussion occurring at the domestic and government-to-government levels.

Whether the United States should continue to put all its eggs in this particular basket is, at the least, a fair question deserving a carefully-considered and non-ideological response.

The United States and Canada have admirably remained in sync with each other, under trying conditions, on BSE policy. For the reasons stated above, I suspect that they may need to go beyond that -- *i.e.*, may need to consider unifying on a different policy -- in order for their cattle and beef sectors to thrive.

IV. South America

Beef trade with South America has its complexities and flash points as well. Individual South American exporting countries have, for example:

- shown an ability to ship a lot of beef to the United States over the hefty tariff that applies to quantities outside existing tariff-rate quotas (Uruguay);
- shown an ability to increase U.S.-bound beef shipments rapidly once declared free of foot-in-mouth disease (Chile); and
- implemented what appear to be some fairly substantial production and export subsidies (Brazil).

Another South American country currently in the U.S. trade spotlight, Colombia, is considered capable of shipping a lot of beef to the U.S. market if its processing sector develops through investment and foot-in-mouth disease is brought under control. Colombia has a cattle herd of some 25 million, managed to increase its exports 6-fold from 2003-2004, and is reported to utilize both export and domestic subsidies in this sector. U.S. cattle producers have also raised concerns about the rule under which slaughter confers "origin" for purposes of the draft Colombia-U.S. Trade Promotion Agreement. They have an eye on the 170 million herd in nearby Brazil, and are worried about the prospect of large-scale duty-free imports of beef obtained from Brazilian animals brought into Colombia for slaughter.

The United States has much to gain from reciprocal liberalization with South American countries in the beef sector. But the structure of the U.S. market, especially on the producer side (the unique relationship between cattle producers and beef processors), will significantly affect how the costs and benefits of that liberalization are experienced by different players.

And, as I noted at the outset, all beef trade liberalization, even reciprocal, will remain painful to some players (and thus a problem politically) so long as large export markets remain wholly or mostly closed to U.S.-origin beef.

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I am very grateful for your attention this morning, and look forward to your questions.