

“THE IMPACT OF SHUANGHUI INTERNATIONAL GROUP’S ACQUISITION OF
SMITHFIELD FOODS”

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BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY

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Chairwomen Stabenow, Ranking Member Cochran, and members of the Committee, thank you for the opportunity to appear today to discuss the proposed acquisition of Smithfield Foods by China’s Shuanghui International Holdings, Ltd. The US-China Economic and Security Review Commission (the “Commission”), on which I serve, has not taken a position on this proposed transaction and has not made any public statements on it. I will share the commission’s recommendation regarding foreign investment in the United States with you, however, the views I present today are entirely my own.

OVERVIEW

Shuanghui’s purchase of Smithfield will have major implications for the US and the global economy. The transaction is worth \$ 7.1 billion dollars and represents the largest purchase of a US firm by a Chinese company. Globally, Chinese agribusinesses have so far invested little in meat processing, focusing instead on crops, dairy and agrochemicals. That shows just how important the meat industry has become for China. Shuanghui is not investing in just any US meat company – Smithfield is a vertically integrated, multinational enterprise that leads the US pork market in hogs and slaughtering capacity. Smithfield has 25 US plants, and 7 more in Mexico, Romania and Poland. They employ 46,000 workers and control 26% of the US pork market and 28% of the domestic sows.

Smithfield owns 460 farms and has contracts with 2,100 farmers in 12 states.

Shuanghui is a Chinese state-controlled¹ company that owns the majority of the shares of Henan Shuanghui. Shuanghui sells 13.3% of the pork sold in China under

¹ For China, the question of state ownership or control can be particularly complicated, because the government’s role is not always straightforward or disclosed. Despite economic reforms and moves toward privatization, much of the Chinese economy remains under the ownership or control of various parts of the Chinese government. In addition to outright ownership or direct control, the government or the Communist Party can also exert control by deciding the composition of corporate boards and the corporation’s management team. China’s state-owned banks may use below-market rate loans or loan forgiveness as a

the Shineway brand. It operates 20 processing plants, slaughters 15 million hogs a year, employs 60,000 workers and is investing \$800 million to build 4 more plants. In 2012, Shuanghui sold \$6.2 billion worth of pork and had assets of \$1.6 billion.

A central issue implied in this transaction is China's rising outbound investments. Beijing has issued a directive to their state-owned and state-controlled entities to "Go Abroad." I recognize that, as China's economy matures, its companies will seek to acquire assets and enter new markets overseas, a process that can aid China's transition to a new growth model. I remain concerned about how China is making these investments. Many of the largest Chinese enterprises, including Shuanghui, maintain strategic ties to the Chinese Government, whether through direct ownership or control, preferential access to massive government subsidies, and personal links to the Chinese Communist Party. These companies are also tapping into the huge foreign exchange reserves that the central bank has accumulated through currency manipulation and capital controls.

I am also concerned that China's outbound investment is part of a concerted effort to acquire strategic assets, either downstream in intellectual property and brands, or upstream in natural resources. China has built its economic success on labor-intensive manufacturing, backed by state control over their economy. A big reason why China's companies are "going abroad" is to compensate for the deficiencies in this growth model. The trouble is that Chinese companies often have perverse incentives to use resources inefficiently and constantly disregard intellectual property rights.

Since China joined to the WTO in 2001, agriculture has been one of the few sectors in which the United States has enjoyed a trade surplus. For the past three years, China has become the number one destination for US food and agriculture exports.

But in many ways, our food and agriculture trade with China has not met expectations. About seventy (70%) of what the United States exports to China today is soybeans and other bulk commodities. Conversely, in consumer foods, we have run a cumulative trade deficit with China of nearly \$5 billion from 2008 to 2012. According to the US Trade Representative, China has erected unfair trade barriers that violate its WTO commitments. Some of the most egregious barriers are based on unscientific food safety concerns and have little to do with China's legitimate consumer protection and a lot to do with its industrial policy and its agricultural policy of self-sufficiency.

tool to dictate to the management of corporations. The government favors certain sectors of the economy, such as high technology manufacturers, with extensive subsidies, including tax abatements, and may prohibit participation or investment by foreigners. Chinese companies seeking to invest abroad must first receive government approval. In these and other ways, the government directs the activities of companies that may be listed as private on the three Chinese stock exchanges but are in fact government owned or controlled.

With these issues in mind, I would like to turn to three areas of discussion: First, an examination of why China wants Smithfield. Second the potential impact of the acquisition on our economy. And, finally, a recommendation offered by the Commission in its 2012 annual report for your consideration.

WHY SMITHFIELD?

To understand why China has focused on Smithfield, it is important to understand the changes that are occurring in China today, specifically their diet and the growing demand for meat and meat protein.

Over the last few decades, China has brought 300 million people from abject poverty into the Chinese middle class. These people are demanding western diets, especially meat and meat protein. Over the next ten years, based on their rate of growth, the CIA predicts they will add 500 million more, including 240 million migrant workers.

With 21% of the world's population, China has only 7% of the productive farmland. The country suffers from severe water shortages in its northern half and extensive surface water and air pollution. When you couple this with the growing demand for meat, you can begin to understand the enormous challenges faced by China's leadership and its agro industry.

China does not have sufficient farmland to grow the feedstock required to produce the amount of meat and dairy demanded by its citizens.

Despite China's very strong preference for self-sufficiency in meat, especially pork, the people face periodic shortages and large price increases. The country consumes 50% of all pork globally and the rising demand for pork is pushing the system beyond its limits.

Consequently, China is scouring the planet for agricultural assets that can be utilized by the world's most populous nation.

China is on track this year to spend a record amount on the purchase of food assets and farms. Their drive for agricultural assets in South America, Australia, Africa, and other locations has ignited concerns from lawmakers around the world.

In my view, the purchase of Smithfield by China is the first of what I expect will be many forays into rural America.

China's purchase of Smithfield is driven by several considerations:

1. The Chinese want some control over the international price of pork. With Smithfield's commanding domination of the US pork industry, they can have some impact on pricing. At peak times, the Chinese demand for pork is so great that they do not want to be at the mercy of the commodities market. During China's explosive growth they were exposed to the coal and iron ore markets and paid a

very high price. They have learned it's in their best interest to purchase the mines rather than buying the raw materials.

2. The Chinese want Smithfield's very valuable technology and hog genetics. Smithfield has developed high-value hog genetic strains that it contends are "the leanest hogs commercially available." Smithfield also has some of the most advanced meat processing technology and manure management techniques that helped foster industrial-scale hog production. It's interesting to note that US taxpayers help finance much of Smithfield's growth. The USDA awarded close to 200 research grants related to swine genetics between 2000 and 2012. The 2,100 contract farms that produce hogs for Smithfield are dependent on USDA-backed operating and land loans to finance their operations. Their world-class manure management techniques were developed with the support of USDA grants. I should also point out that Smithfield paid \$15 million dollars to North Carolina State University to develop "environmentally superior technologies" for waste management.

The Chinese Government is seeking better technologies to increase productivity of its livestock. According to Delta Farm Press, a leading agriculture publication in the US, China is now capitalizing on decades of cutting-edge US agricultural research. In particular, Chinese producers are looking to forge more uniform herds based on the most efficient breeds, like Duroc, Yorkshire and Landrace.

3. In order to become a leading multinational company in their industry, the Chinese need Smithfield's advanced management, marketing and operating expertise, especially as it applies to industrial hog production and food safety.

4. Smithfield's brand name and reputation is enormously valuable in China. Due to the poor food safety record of Chinese companies, including Shuanghui, many Chinese consumers do not trust Chinese brands. They prefer the safety of foreign brands, especially US companies.

5. Finally, Smithfield allows China to enjoy the profits of a value added processor, as opposed to just importing hogs or pork products.

When you consider the above benefits, it's easy to see why the Chinese have offered to pay a 31% premium for Smithfield.

NOW I WOULD LIKE TO TURN TO THE POTENTIAL IMPACT THIS PURCHASE MAY HAVE ON OUR ECONOMY.

1. Shuanghui's takeover of Smithfield will exacerbate a pattern in US-China trade relations that have taken hold over the past ten years, whereby value added production is shifted to China, to the detriment of US workers and businesses. It raises the question of whether this transaction is in the best interest of the US.

If this deal is approved, it will open the door for other purchases of US food companies by Chinese firms or investors. Our agriculture and food sector is unusually concentrated, with just a few companies dominating the market in each link of our food chain. In most sectors of the US economy, the four largest firms control between 40% to 45% of the market and many economists maintain that higher levels of concentration can start to erode competitiveness. According to data compiled by the University of Missouri in 2012, in the agriculture and food sector, the four largest companies control 82% of the beef packing industry, 85% of soybean processing, 63% of pork packing and 53% of broiler chicken processing. These national concentration measurements can conceal even higher levels of concentration at the regional or local levels.

Agribusiness consolidation contributes to the decline in independent, medium and small livestock producers that can drain the economic vitality of rural communities.

2. Another risk is that this deal will do little to improve overall market access for US pork. China is unlikely to abandon its policy of self-sufficient meat production. A more likely result is a closed market of intra-company trade between Shuanghui and Smithfield. Given Smithfield's massive output, it alone might suffice to satisfy China's limited "quota" for US pork. Smithfield has developed a special relationship with Shuanghui over several years. At its plant in North Carolina, the largest of its kind in the world, it is already producing ractopamine-free pork at Shuanghui's request. Other pork processing plants in the US could still find it hard to export to China, either because the cost of complying with ractopamine restrictions are too high, or because they do not enjoy the special privileges of a firm directly owned by a Chinese parent company.

Even if China does import more US pork, US pork processors could lose out. Under China's 12th Five Year plan (2011-2015), China has begun to consolidate and industrialize operations. It is shutting down backyard pig farms in favor of large, vertically integrated operations. Shuanghui is one of 6 companies designated by the government to carry out the policy. Shuanghui has invested huge sums in building large industrial facilities to slaughter and process pork, but lacks the hogs to fill them. Lacking control over hog farms, it sources meat from smaller producers, which leads to erratic quality and output. Until they are able to fully increase hog production, importing pig carcasses from Smithfield appears to be a more expedient solution.

In keeping with China's industrial policy, some of this processed pork could even be exported to the world market.

3. This deal has been promoted as a way to facilitate US pork exports to China, but ultimately Shuanghui could export pork back to us. A significant portion of US pork exports are half-hog carcasses where they are processed into value-added pork cuts by firms like Shuanghui. The adoption of Smithfield hog genetics and processing technologies will dramatically improve hog production in China and could allow Shuanghui to reverse the global flow of pork products and begin the export of

Chinese pork products to the US. Currently, the United States does not permit imported pork from China, but that could change. I would expect Shuanghui to apply for approval to re-export pork products processed from imported US hogs and may even apply to ship pork from hogs raised in China. All of these products could bear labels from the familiar Smithfield brands. Because processed pork products, like ham, bacon and sausage are exempt from mandatory country of labeling requirements, American consumers would be unaware that these products were imported from China.

4. Providing foreign competitors access to Smithfield's technology and intellectual property could disadvantage our domestic hog industry, both here and globally. Shuanghui is expected to adopt Smithfield's hog genetic lines that could weaken the US pork export opportunities. Shuanghui has an extensive supply chain and distribution system in China and throughout Asia, with operations in Japan, and South Korea. The merger would improve the position of Shuanghui's Mainland China processing plants by sharing US technology and expertise and potentially allow Shuanghui to undercut US pork exports to the Pacific Rim.

CONCLUSION

I think it is reasonable for you to expect a wave of Chinese investments into our food and agriculture industry and this potential purchase is not a one off. Today it's Smithfield, but tomorrow it could be Consolidated Grain, ConAgra or Tyson Foods. With that in mind, the Commission, in its report to Congress last year, made the following recommendation:

“CONGRESS EXAMINE FOREIGN DIRECT INVESTMENT FROM CHINA TO THE UNITED STATES AND ASSESS WHETHER THERE IS A NEED TO AMEND THE CFIUS STATUTE TO: 1. REQUIRE A MANDATORY REVIEW OF ALL CONTROLLING TRANSACTIONS BY CHINESE STATE OWNED OR STATE CONTROLLED COMPANIES INVESTING IN THE UNITED STATES; 2. ADD A NEW ECONOMIC BENEFITS TEST TO THE EXISTING NATIONAL SECURITY TEST THAT CFIUS ADMINISTERS; AND 3. PROHIBIT AN INVESTMENT IN A US INDUSTRY BY A FOREIGN COMPANY WHOSE GOVERNMENT PROHIBITS FOREIGN INVESTMENT IN THAT SAME INDUSTRY.

Chairman Stabenow and ranking member Cochran, thank you for allowing me to appear before you today. I appreciate the Committee's focus on this important issue and I look forward to your questions.