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CONCENTRATION IN THE LIVESTOCK SECTOR  
A PRODUCER'S PERSPECTIVE

by

John Hardin, Jr.  
Member USDA Advisory Committee  
on Agricultural Concentration

*The participants in every link of the beef, pork, and poultry chains are becoming fewer and larger. The economic forces driving these changes are similar to those that are bringing about increased concentration in the rest of our economy. The USDA Advisory Committee on Agricultural Concentration (the Committee) was assembled to review the impact of increasing concentration on U.S. agriculture, and to recommend new public policy in areas where the Committee felt change was needed.*

*The membership of the Committee included agricultural economists and representatives from the production, marketing, processing, and transportation sectors of the industries that were to be reviewed. Their political philosophies covered the entire spectrum of the agricultural policy rainbow. In spite of the diversity of the group, the committee did reach consensus on a number of broad policy recommendations and unanimously endorsed a policy to support and improve market information as a vital component of a competitive marketplace. The committee made a number of recommendations for the livestock industry in four areas; antitrust and regulation, a new disclosure policy, vertical linkages, and cooperatives/producer bargaining.*

*The committee found that major differences exist between the beef, pork, lamb, and poultry industries. The industries differ significantly with respect to their structure, marketing and pricing systems, biological capabilities and limitations, business practices, and current levels of industry cooperation, concentration, and coordination. There was recognition that blanket recommendations for one species could have serious, unintended consequences if applied to the entire meat industry.*

*U.S. agriculture is clearly in the midst of evolutionary change. Vertical integration is the predominate structure in some industries, and nearly all of the rest of agriculture is moving to much greater coordination throughout the production and marketing chain. The reasons for these changes are numerous. Two of them are: targeted production gives better quality control and greater responsiveness to consumer demands; and vertical coordination often results in lower costs and improved efficiency throughout the chain.*

*As the world economy becomes increasingly interdependent, large multinational companies have a significant competitive advantage in opening and expanding export markets. An increasing share of U.S. exports are value added commodities. In meat exports, our initial penetration into a commercial export market is often with our very highest quality meat products. The large meat packing firms have a choice: (1.) do they obtain the needed top quality cuts by sorting from the general production run; or (2.) do they ally themselves with producers that will provide animals that will meet the product quality and production standards their import customers demand. It is my contention that a growing number of meat exporters will choose the second option.*

*Some of the producers who testified before the committee felt that these trends were threatening their way of life, and that public policies should be developed to stop or reverse the momentum of change. I do not believe this is a likely outcome. My belief is that we should focus on the new reality of coordinated production and the issues that must be addressed if farmers and ranchers are to become partners rather than pawns in the U.S. food system.*

*The poultry industry is the most integrated in the meat sector. The committee heard divergent testimony as to the viability and fairness of grower contracts. In areas of the country where multiple processors were competing for contract growers there seemed to be satisfaction with economic returns to growers and the relationships between the integrators and the contract growers. In areas where a single processor was the only integrator available to growers, there tended to be much greater dissatisfaction on the part of the contract growers. Competition matters and a means to insure a balance of economic power is essential in areas where competitive forces are not in balance.*

*Producers should be able to bargain with first handlers as a group without fear of recrimination. At the same time, the processor or integrator should retain the right to deal individually with a grower who does not meet the performance standards of the production contract. The right of producers to organize under the Capper-Volstead Act must be preserved. The committee recommended that the Agricultural Fair Practices Act of 1967 be*



*amended to require handlers to engage in good faith negotiation with producer cooperatives and networks, and to purchase products from these entities without discrimination. As a growing share of agricultural production is controlled by production contracts, a proactive public policy in this area is vital to maintain the opportunity for good economic returns to the production sector.*

*While the pork industry is not as integrated as poultry, it appears to be following a similar path. Many producers hope that a model of networks and coordinated production will prove to be competitive with players in the industry that attempt full vertical integration. An important ingredient for individual producers will be transparency regarding marketing arrangement qualifications. Producers will need to know what they must do to qualify for participation in future marketing arrangements.*

*The capital requirements for the live animal production necessary to supply a modern pork slaughterhouse are very large compared to the poultry industry and will be an impediment to full integration. The challenge for independent growers will be to remain cost competitive and to provide large numbers of animals that produce cuts that are consistent in size and high quality. In addition a system to insure that the quality of the products offered to the consumer is constantly being upgraded will be a vital ingredient in competing with fully integrated producers.*

*The latest data I have from Grimes and Rhodes is that 71 percent of the hogs sold in 1994 were purchased on a carcass merit basis. Thirty-eight percent of all hogs purchased that year were through some form of formula pricing. Local data bases I have seen in my home state would indicate that producers combining carcass merit with formula pricing are receiving higher returns than other producers. Packers obviously have an interest in, and are willing to pay for uniform lots of high quality animals that are available for processing on a predictable schedule.*

*At some point in the future as the cash market for live hogs becomes thinner, formulas may be based upon downstream markets, thereby making accurate, timely data on wholesale and retail prices more critical to the farm pricing decision. Research describing the transition from spot markets to other pricing arrangements in other commodities may help target issues the pork industry should address. In addition, USDA/industry efforts to improve price reporting systems on the wholesale, sub-wholesale, and retail sectors will be vital to the transition to a new price discovery process.*

*The majority of the public testimony the committee heard covered concentration issues in the beef industry. Eighty-two percent of fed cattle are slaughtered by the four largest beef packing firms. The three hundred*

*largest feed lots account for fifty-seven percent of the fed cattle sold. There was widespread distrust of the price discovery process. It was asserted that there have been times when most of a week's fed cattle trade happened in a thirty minute window. Many producers were concerned about captive supplies of packer controlled slaughter ready cattle. Many felt that packer ownership and the use of marketing agreements and forward contracts allowed beef packers to depress the prices offered for open market cattle. Other producers gave testimony that marketing agreements allowed them to enhance their selling price and that they used forward contracts to manage risk.*

*The intensity and emotion of some who presented testimony was a reflection of the reality that fed cattle prices were at a ten year cycle low and feed grain prices were soaring to all time highs. These two events dealt a double blow to feeder calf prices. Many who testified came from ranches that had few economic alternatives other than converting grass into meat protein. Cow-calf operators and the rural communities that depended on them were in a genuine crisis.*

*The committee made a number of recommendations that would increase the amount of market information available to the beef industry. Some of the proposals were:*

*1. Contract or formula pricing premiums and discounts, based on carcass merit should be captured and reported.*

*2. Require timely, accurate price reporting of all packer livestock transactions, including data on captive supply.*

*3. The development of a value matrix for cattle similar to the "Lean Value Direct Hog Trade" that AMS Market News makes available to the pork industry.*

*4. USDA should develop a standardized list premium or discount categories for carcass merit purchasing.*

*5. The committee asked for considerable increase in volume and specificity of market information available on the wholesale beef trade.*

*6. USDA should encourage the development of a close trimmed boxed beef futures contract as an additional means of price discovery.*

*The committee heard from some players in the industry who felt that the additional market information requested was excessive. I believe the requests are a reflection of industry concentration and the relatively low levels of coordination in the beef industry.*

*Information the committee received indicated that small price differentials are paid for quality differences in slaughter cattle. Beef representatives on the committee informed us that some custom feedlot operators attempt to negotiate the same selling price for all cattle sold from their feed yards to a packer in a given week. I believe that if these practices are widespread,*

*they are detrimental to the long term interests of the beef industry. In our economy change happens through incentive, and steps need to be taken so that each sector of the beef industry has a clear economic incentive to improve quality.*

*It should be noted that the beef industry concentration and price determination studies furnished to the committee showed that cattle prices were within predictable ranges. The recent decision by Tyson Foods to exit beef and pork processing is instructive. According to published reports, the management of the company felt that it could get higher returns for its capital and management by focusing on poultry. This is evidence to me that these sectors of the beef and pork industries are competitive.*

*On the other hand, the recent price fixing convictions in the feed ingredient industry remind us of the need to be vigilant. The committee made a number of recommendations that advocated increased monitoring and enforcement of antitrust and regulatory policy. However, there was a recognition that in the current environment, antitrust actions have become much more complex and difficult.*

*Daniel I. Padburg, Ph.D., who served as chairman of the committee, suggested that we consider a "market based disclosure policy" as an alternative to the traditional methods of antitrust enforcement. The committee supported inclusion of this proposal in the report. Many of the committee recommendations for more detailed market information would facilitate such a policy.*

*I quote from the report, "We conclude that antitrust policy would be more positively and effectively enforced if anticompetitive practices and behavior were more transparent and visible. Scarce resources and opportunities for productive government-business relationships would not be wasted in investigations that eventually wither for lack of evidence--or worse, because they were unjustifiable in origin... A disclosure policy can provide a basis for harmonious and productive interactions between the food industry and farmers as well as consumers... Finally, and importantly, disclosure makes the unfair use of market power against farmers more visible, easier to observe, and therefore, more effectively and quickly corrected."*

*I hope this portion of the committee report is given serious discussion. There is a strong sense that the old ways of regulating business practices are incompatible with responsible oversight of the new food system in the United States.*