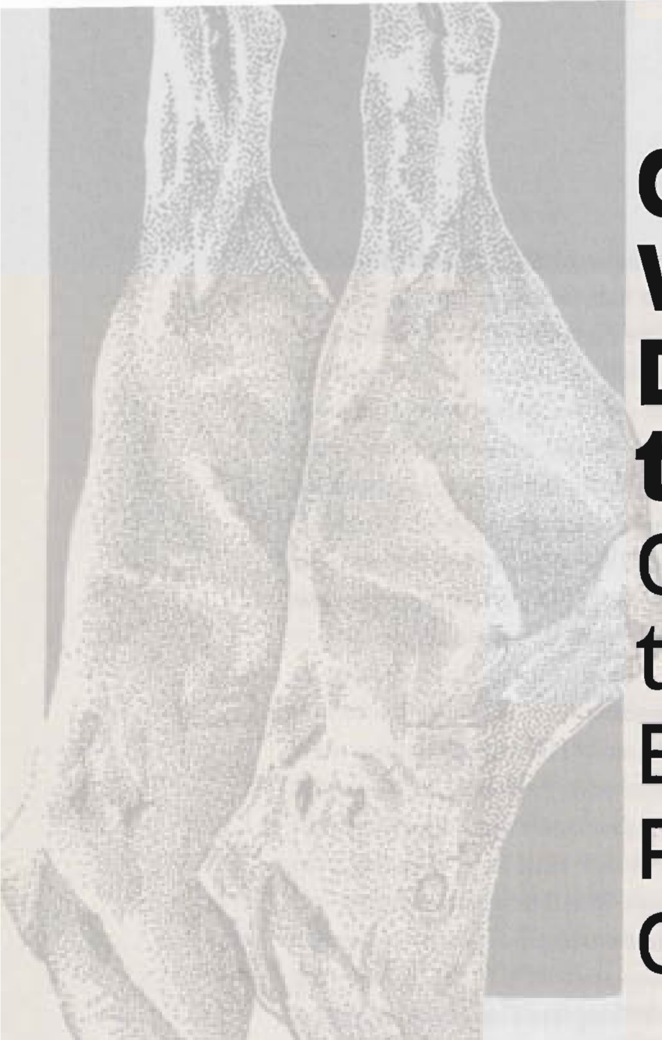
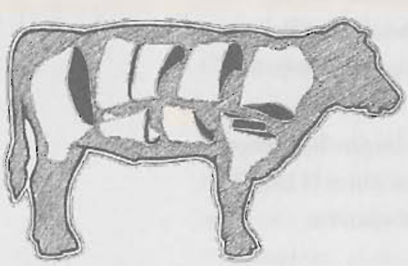
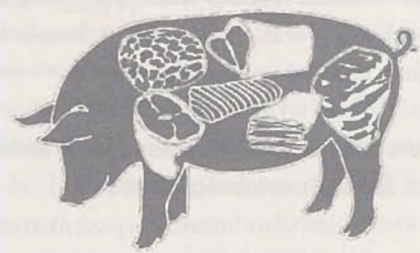


Cutting Verticals Down to Size: Congress, the Farm Bill, and Packer Control

The proposed amendment to the 2002 Farm Bill would have prohibited packer control of supply in the beef and pork industries. It offers an interesting study of the role agricultural economists can play in shaping and influencing policy debates. In the aftermath of the debate, the question is: **Can the profession do better?**





BY MARVIN L. HAYENGA

In December 2001, a bipartisan group of U.S. Senators put forward a suggested change in the proposed 2002 Farm Bill that was moving through the House and Senate. The proposed section 1043 would prohibit meat packers from owning, feeding, or controlling livestock for more than 14 days prior to slaughter. The Senate narrowly approved this proposed section, along with a subsequent amendment. The earlier Farm Bill, passed by the House of Representatives, had no provision dealing with captive supplies, and the Senate-House conference committee excluded this section from the final 2002 Farm Bill.

Captive supply was a divisive issue in the livestock and meat industry, in many farm organizations, and in Congress. The key arguments expressed by members of Congress, and the key points made by academic and industry economists and lawyers are outlined below.

The Initial Proposal

A diverse group of farm organizations expressed concerns about increased industry concentration, vertical integration, and contracting by meat packers. In response, the Senate proposed to amend the Packers and Stockyards Act by making it unlawful for any meat packer or live poultry dealer to own, feed, or control directly or indirectly livestock intended for slaughter for more than 14 days prior to slaughter.

All art courtesy of Art Today.

Leading Arguments in the Senate

Cattle producers and their advocates argued for this legislation because of the possibility that increased concentration and market power would bring possible market manipulation by packers. Slightly different concerns were expressed by some hog producer groups who felt that increased concentration and large-scale producers with packer contracts would restrict independent producers' access to markets.

The Senators sponsoring this legislation held the same views. Senator Tim Johnson (D-SD) said that the proposed legislation would

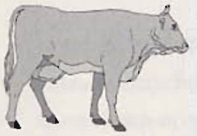
strengthen existing law to restore free enterprise, competition, and access to livestock markets. Further, he argued that packers were trying to kill the proposed amendment in order to give preference to their own livestock, so they would not have to pay farmers and ranchers a fair price. Senator Chuck Grassley (R-IA) claimed that the proposed amendment would protect the ability of farmers to enter into forward contracting and other voluntary marketing agreements, and promote greater access, transparency, competition, and fairness.

Economists and Lawyers and Legislators

Agricultural economists in universities, consulting firms, farm organizations, and the USDA contributed to the debate. Eight university economists who specialize in livestock industry problems (Feuz, et al.) expressed concern that prohibition of "control" of livestock by packers might invalidate most of the mutually beneficial producer-packer marketing contracts widely used in the beef and pork industries. They argued that prohibiting such linkages would:

- reverse the trend toward improved food quality and safety,
- reduce the ability of producers and packers to capture added value from their output, and
- increase risks and decrease coordination, efficiency, and global competitiveness of these industries.

A second group of livestock economists (Meyer, et al.) echoed some of the first group's discussion, pointing out that prohibiting packer ownership would raise packer costs. As a result, plants in remote production



areas might close. The prohibition might also slow product innovation and beef demand improvements linked to stronger packer-producer relationships.

Agricultural lawyers then contended that the economists' concerns about "control" were a legal error and that similar state legislation had not been construed to prohibit marketing contracts, because contracts do not give the packer operational and managerial control over the livestock producer's production activities. The lawyers also concluded that cooperatives having alliances with packers would not be prohibited.

Later, Conner et al. countered Feuz et al.'s economic analysis by contending that increased industry consolidation, vertical integration, joint ventures and alliances, and contracting trends have led to serious imbalances of market power between meat packers and independent producers. They concluded that increased beef packer margins in the last few years had stemmed from oligopsony power among packers. A significant statistical relationship between higher captive supply and lower cattle prices appears frequently in the literature. Connor et al. argued that the usual interpretations by researchers — correlation, not causation — were not credible interpretations. They offered evidence of packer market power and concluded that the claimed harms from the proposed legislation were not credible and were less significant than the perceived benefits.

An Amendment to the (Proposed) Amendment

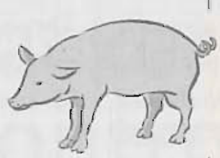
Initially, Senator Johnson responded to concerns about the term "control" by saying that the word was to be interpreted in the context of ownership. He indicated that the amendment was not designed to prohibit contracts for future delivery of livestock. Instead, it was designed to prevent packers from owning cattle outright, through a subsidiary, or through any other arrangements that give them operational control over livestock except during the last two weeks before slaughter.

The concerns that "control" would invalidate marketing contracts in these industries were dealt with by amending the original proposal to read (Sec. 1072): "Packers could not own or feed livestock directly or indirectly, nor have operational, managerial, or supervisory control over the livestock, or over the farming operation that produces the livestock, to such an extent that the producer is no longer materially participating in the management of the operation with respect to the production of the livestock."

More Economists Join the Fray

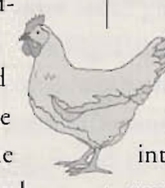
In March 2002, economists at Purdue University offered a separate assessment of the implications of this section of the proposal. They concluded that the market power of packers was unlikely to be significantly affected by the amendment, and that the drive toward closer vertical linkages with packers would continue. They concluded that some plants and production units in fringe production areas would likely close if this amendment became law. If so, large producers would become the favored contract partners of packers, but smaller producers would not be helped by the legislation.

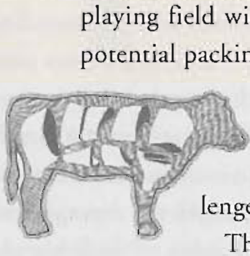
In March 2002, Sparks Companies, Inc., a Memphis-based consulting firm specializing in agricultural problems, prepared an analysis of the proposed legislation. National beef and pork producer organizations funded their work. They estimated losses for beef and pork producers of over $4 and $3 billion, respectively, resulting from the proposed legislation. They concluded that packers would lose efficiency, and have a competitive disadvantage with poultry and international competitors. They expected reduced investment in quality and market development in the beef and pork industries, and increased vulnerability of producers outside major production areas.



Interest Groups Weigh In

State and national groups in the same industry took opposing sides. While some state pork producer organizations (such as in Iowa) favored the amendment, the National Pork Producers Council opposed the legislation as originally proposed because it did not apply to poultry, and because it increased the risks of forward contracting. The group argued that the proposal would give the poultry industry a competitive advantage, establish an unfair playing field with international competitors, and risk potential packing plant closures. The National Cattlemen's Beef Association also opposed the amendment, indicating that it would not contribute to fixing current challenges facing the beef industry.





The American Meat Institute, a packer trade association, said the proposed Senate amendment would force massive asset divestitures, flooding the market and forcing prices lower. Thousands of packer contracts with large and small producers would be jeopardized. They argued that the massive and unprecedented government intrusion on private industry — barring one sector from utilizing vertical and horizontal integration as a means of survival while striving for excellence — was unfair and punitive. AMI also argued that disagreements among economists about the implications of this amendment suggested that it had not been well researched, thoroughly studied, and discussed.

The Bush Administration

The Bush administration did not take an official position on the amendment. In public forums, USDA officials expressed concerns about the effects of the proposal and the ability to implement and enforce it, especially uncertainty regarding the definition of "meaningful participation." They cited a high probability of litigation, and the possibility that the amendment could prohibit many existing contracts between producers and packers. Given the wide range of opinions regarding likely consequences of the legislation, the USDA recommended a study to resolve uncertainties regarding likely consequences.

The Conference Committee

The House of Representatives did not have a similar section in its version of the 2002 Farm Bill (H.R.2646), so the differences prompted substantial debate among Farm Bill conferees from the Senate and the House. Congressional staff involved in the conference committee sessions report that the leading arguments against this section of the Farm Bill were the absence of evidence that it would directly benefit producers, especially by increasing prices paid to producers. It was perceived as a blunt instrument intended to solve packer concentration problems, and a punitive measure against packers by producer advocates. The significant disruption of the pork industry producer-packer relationships — built up over many years in North Carolina and other states — was another negative influence in the political benefit-cost analysis. The prevailing argument by House members was that the legislation would damage a large number of industry participants, and benefit few.

In May 2002, the conference committee dropped the packer ownership and control section from the final version of the Farm Bill, and both the House and Senate adopted the conference report.

Disagreement on packer ownership and control was not the most critical issue to be resolved by Farm Bill conferees. Significant differences in spending on major crop support levels and payment limitations clearly were the major economic differences between the two bills that had both large budget and political implications.

Aftermath: A Role for Ag Economists

This proposed legislation brought forth more public debate involving academicians and industry analysts than almost any agricultural policy debate in recent years, and the proposal was divisive within and among some farm organizations. There were clearly differences in perceptions of problems, and over the appropriate level of government intervention in these industries by economists as well as policy-makers participating in the policy process. Why?

There are no definitive experiments to show the direct and indirect consequences of major changes in industry structure and coordination systems, so differences are understandable. Yet, one wonders how economists applying sound economic logic and in-depth industry knowledge would come to such divergent views on policy implications. Can our profession do a better job demonstrating the negative and positive effects of contracting and vertical integration, and the implications of policy prescriptions that may emerge?

New policy prescriptions on these issues (and others like them) will continue to surface in both state and national policy arenas. Should we embark on a more extensive dialogue among ourselves, so that we may move economists closer to consensus on some elements of this and other highly charged policy issues?

We need sound analysis and improved dialogue between economists and policy makers in order to contribute more effectively to the next series of policy debates. There may be an important role for AAEA, perhaps in conjunction with C-FARE and USDA, in facilitating this dialogue. Such a forum, jointly organized and funded, could play a vital "quick-response" educational role when issues like this one spring to the fore. Having a more "public" venue, in which competing views may contend — and in the process, help shape and influence the broader policy debate among all stakeholders — could enhance the value agricultural economists bring to the agricultural/agribusiness/policy community.

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