PROCEEDINGS

STRUCTURAL CHANGE IN LIVESTOCK: CAUSES, IMPLICATIONS, ALTERNATIVES

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PROCEEDINGS

STRUCTURAL CHANGE IN LIVESTOCK: CAUSES, IMPLICATIONS, ALTERNATIVES

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PREFACE

This *Proceedings* includes a summary of the major papers comprising the book **Structural Change in Livestock: Causes, Implications, Alternatives** , the reviews of the papers developed for the book, original presentations by the conference presentors whose contributions were not in the book, and the in-conference discussions. Copies are available at $5 each, $3.00 for orders of 10 or more, from the Research Institute on Livestock Pricing.

The book **Structural Change in Livestock: Causes, Implications, Alternatives** which was distributed at the conference includes reports on major research efforts on the structural change issue by Wayme Purcell, Clement Ward, and Michael Hudson and associates. The book also includes an extensive annotated bibliography on research in livestock pricing prepared by John Rowsell, an Associate with the Research Institute on Livestock Pricing. The section dealing with structural change has been updated and 30 articles and books are cited with a brief summary of the findings in each. The 212-page book is available at $10 per single copy, $8 per copy for requests of 2-5, and $6 per copy for requests of 6 or more from the Institute.

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SECTION 1

Keynote Address

by

Jo Ann Smith
Assistant Secretary
Marketing and Inspection Services, USDA

Most of you in this room are familiar with the agencies under my direction as USDA's Assistant Secretary for Marketing and Inspection Services and some of the emerging issues these agencies face. One example is the role of the Agricultural Marketing Service in relation to price reporting. In addition, there are many new and important issues. I can assure you that an issue comes before me and our people every day. We have to make sure we are reacting in the right way and we are making certain we have a contingency plan to help insure industries within the United States and around the world are safe and protected. I did not expect I would be dealing with ostrich chicks and llamas when, as a cattle rancher and former head of the National Cattlemen's Association, I accepted my current position.

You may have heard about the problem we had with tick-infested ostriches. When the ticks were found on the ostriches, the issue came to me. We tried to work our way through permits and applications for permits. The question became, "How do you make certain the ostriches that are coming through quarantine do not have ticks?" Until that point, I had never in my life thought I needed to think about how you dip an eighteen-foot ostrich. There were a lot of people who had never thought about that. Ostriches are very hard to dip, very hard to deal with, and they are very hard to scratch. Nonetheless, there are many people who want to bring them in. I want to help bring them in, just as long as they don't have ticks and they are not a threat to our domestic industries.

When we look at agencies within the USDA that are my responsibility, each of them will tell you that their agenda is changing versus the issues they used to address. They perform many tasks now that they did not do historically to make certain that our food supply is safe. With new technology we want to test for residues instantly as we go through a complex pattern of production and distribution. We have many challenges throughout our agencies because we are the ones within the department that have the responsibility for a new product, whether it's in fruits and vegetables, livestock or poultry. There will continue to be tremendous challenges and problems, domestically and internationally.

I would like to turn to the issue of structural change. I want to identify some key points, but I also want you to move with me from the 1980s to the 1990s. Let us remember what happened through the 1980s, but let's start looking more into the 1990s.

Let's talk about efficient supply. There was a time that the only questions were whether there would be adequate supplies and whether the agricultural sector would continue to expand. We saw a great American agriculture progress in the 1950s and 1960s. The trend continued into the 1970s with an emphasis on production and we saw structural changes in that decade.

There was typically some profit in every part of American agriculture. But the scene became very different as we changed from small channels, the typical mom and pop stores, to a large retail market. We grew from product production into food production. We are entering the 1990s (entered through the 1980s) with a different consumer than we saw in the 50s and the 60s. We see convenience being a very key item, and you see us now in the food business.

As I look around the room today, many of you are not in commodity production, rather you are in the food business. Your counterparts are also in the food business. The meat business has joined every other business as we have become a "merger nation". Every tenth product in the retail market today was not there 10 years ago. And what do you think is going to be there in the 1990s? You may find a still different scenario five years from now.

As we look at what is happening in the structure of the industry, we see organization, we see growth, we see plant size, and we see cost being a tremendous factor. Where is the packing industry going? A tremendous amount of capital is needed to support any endeavor today, whether it's cow-calf operations, whether it's a hog operation, or whether it's the packing industry. We see research being questioned, but we as commodity people are pleased with the amount of research that is being done today.

The beef industry, the pork industry, the cotton people, the egg people all have money to use for research through Research and Promotion programs. Some have had much more success in R&D and in advertising, particularly the cotton industry, the egg industry, and the dairy industry. All this structural change may mean different things to different people. Certainly we have to progress as we adopt structural change. Important issues are: (1) quality control; (2) a means of chemical examination; (3) our ability to test and make certain that a product is safe throughout production; (4) a system that will monitor critical points where something could happen; and (5) such a system must exist for all commodities.

As we look at structural changes, what kind of system has to be put into place for the end of the line? When that product comes to the consumer, whether it's in a fast food chain or a table-top restaurant or whether in the retail market to take home, how can we assure the consumer that the product is safe and that the product doesn't have any harmful residues?

That is the challenge I will put to you. In our production today, if you don't address that issue, you can be sure that your competitors will. The concerns we've talked about here are very legitimate concerns, and if you don't believe that, then you're wrong. We will talk a little more about that because I want to also make you very aware just how critical I think the issue of food safety is and how critical Secretary Yeutter thinks it is.

Vertical integration will continue to be the byword and there will be contracts because of a need for an adequate supply. We can't afford for plants to have downtime. They have to be efficient, economical, and cost conscious. Of course, most of you, and I am sitting in that same chair with you, question the reliability of data up until now. Will people always question it? I would prefer not to hear from the economists that, of course, the corrections in recent cattle on feed reports were a shock to them. It appears that the cattle in Iowa were seriously miscounted. All this shocked me.

Statisticians have one theory and cattlemen often have another. But after we look at it, reliability in the data is absolutely a key issue. You have some things that will happen. As we move from day to day, you folks are very key players in what we in government are going to do and what, more importantly, you are going to do. Certainly as Packers & Stockyards continues to monitor this industry, they will be very aware of the changing structure, changing practices, and of changing data needs.

The Packers and Stockyards Administration is proceeding very carefully to monitor the shift in livestock feeding now that 90 percent of steers and heifers are being marketed direct. So, we see things happening that you are aware of when we talk about structural changes. You are on top of that, I'm not saying anything that you are not aware of.

Being a new person in this administration, I believe it's very important that what we do as a department is become more accessible to you in the area of price reporting and in the area of research. I realize that we are a resource, or need to be a resource, that you can rely upon. We have to have a two-way communication process.

Cooperation between government and industry continues to be very important. We want to make sure, all of us, that there is competition in marketing and effective price discovery methods in the livestock and food industry. Certainly, the National Cattlemen Association's Task Force on

Concentration and Integration recommended that all firms continue to report transaction prices voluntarily. That will continue to be an issue. We need voluntary reporting. We will try to be alert to changes that will be detrimental to the industry. But, you are in the business every day. You are more aware of the structural changes than the rest of us. We will all need to focus in on price fixing and engaging in unfair price behavior.

Now, monitor the change in the direction of the industry. Channels of communication must be left open to assure that this administration will work very hard, 24 hours a day, to keep the free market system in place and make certain it works.

As we look at legislation, there are some key issues coming forth this year. Let's talk a little about what we want to watch for in the 1990s at USDA.

One of the areas that we feel very responsible for, to the producer and to the processor, is that the product that you deliver is the product the consumer wants. The market today can supply all the products the consumer wants. Listen to what the consumer wants. All industries have done a tremendous amount of research on what the consumer wants. Listen to that, respond to that. Genetically, you can do it. Certainly, after you look at and identify your market, here and internationally, produce for that market. Marketing will change and that issue will be discussed further on your agenda today.

Make sure that the checkoff dollars will pay. Do all you have to do as far as understanding the consumer. Lifestyles change. Those are going to be some things that I think you are going to see.

As we move into the 1990s, many factors are going to have a direct impact and should be a positive impact on the agricultural sector. You can control that impact. That is what I want to challenge you with today.

I am pleased to be in Washington at this time and have the opportunity to work with Secretary Clayton Yeutter and the President. As we have looked at and now have put together sixteen recommended changes in the Farm Bill, the first thing we identify is that we do not have the same scenario that we did in 1985 when we passed the previous Farm Bill. It is totally different in the 90s and less dominated by agricultural production. Producers are going to be faced with some problems they are not ready for. Certainly, if we are going to remain competitive in the world market, we must realize that we have to change our approach. What are we talking about? Issues right now at USDA are different than they were in 1985. In the 1990 Farm Bill, a key issue is that of the General Agreement on Tariffs and Trade (GATT). The GATT negotiation certainly will be important. Then, there are the issues of food safety, rural development, global warming, animal welfare, bio-technology and a national strategy.

I will not dwell on this, but bio-technology is a volatile area. Yesterday's Wall Street Journal carried a front page article about caterpillars being used in Columbia, South America to attack the cocoa plants. By 2:00 o'clock that afternoon, the department received 47 calls concerning using integrated pest management.

I had the opportunity of being with the Secretary when representatives of five nations, including Canada and Australia, discussed their agricultural industries. Four issues were addressed. We all were concerned with communication. We want to try to counter the emotionalism of food safety issues and be able to address them rationally. Commodity by commodity, we do have concerns such as alar on apples and on grapefruit.

What I'm saying is that whether it's the trade barrier issue or whether it's something else, other nations are concerned about food safety. Certainly if we look at the detail and the emotionalism that can be created, while we at USDA are trying hard, we have not been handling the issues very well. We are going to try to turn that around. We are all at a point such that if we don't deal with this issue correctly, it will get all of us. It is an issue that needs to be addressed with a Presidential initiative. As you know, President Bush appointed a Task Force. You have read very little about what a good job they've done.

Part of your responsibility in the industry is to talk about how good you are. Tell people what you're doing. Unless we have more private-sector efforts to monitor and to be able to certify what is going on, then it's going to be more difficult for us to stand up and say we know what is going on.

We need change. USDA doesn't have all of the issues under control, whether they deal with grain, meat, or potatoes. But, we are aware of that. We are working with the EPA, FDA, and a number of international agencies and organizations. We will try to improve our communication. A number one priority of this administration and the message we want to convey is that we are working to bring you the least expensive, best quality, and most of all, the safest food supply in the world. We don't do that by a lack of effort. It doesn't just happen. There has to be a story there in terms of what you have done. Find your story and tell it because it is so important that you do so.

An issue you will be hearing more about, and is very critical as we look at structural changes, is harmonization. Look at what happened with the ban on meat shipments to the European Economic Community. If we had accomplished harmonization, a total harmonized position of who, what, when, and where, this would have never happened. To achieve new markets or retain and expand existing markets, we need equitable trade policies and a coordinated effort to be successful. I think each of you in this room would say to me that the consumer, both here and internationally, should be assured of a safe food supply. Unless we have agreement on standards worldwide, it's going to very difficult to provide. Harmonization is going to be very difficult.

Canada has become the number one importer of U.S. products and by the same token, our sales have increased significantly. We definitely have a market there. We have been working with Mexico to try to enhance the opportunity for commerce across the border, not only as we look at cattle, but certainly as we look at lambs. Our problem is that we have to help these people bring their animal health standards up to ours. Our responsibility is to manage and protect our own animal health industry. We also intend to work with those who want to take this opportunity for international marketing. Concentration on this international dimension will be critical for the future, and if we don't make significant progress, we will be set back many years. The future of our agricultural sector rests largely on being able to put products into the international market.

In our Farm Bill, the number one objective of USDA is to help American agricultural products be competitive in a worldwide market. Unless the structure is there to trade, that goal is going to be difficult to achieve and you're going to run into more roadblocks. Also, in the Farm Bill, we will attempt to realign target prices that are now sending confusing market signals. We are supporting the establishment, on a long-range and uniform basis, of support for all crops. We believe that economists will be more effective in trying to reform profit-sharing, and the Farm Bill addresses that issue.

There is no doubt that one of the other issues that will affect the Farm Bill is environmental protection. It will affect the decisions that you and I make daily. Here again, a job that you have done very well, and about which you haven't communicated enough, is protecting the environment. I encourage you to make that your number two priority. Project or put the firm you've developed in a position of talking about how you do the work, and make sure that you do a good job.

Animal welfare will also be a very key issue. It is an emotional issue. It is an important issue. There are a lot of people involved. They have a lot of money to spend. How you handle the issues will determine whether or not we see this issue cause major problems.

Much of what is going to happen in this industry is going to be dictated by what happened in early decades, especially the 1980s. You must adapt to structural changes. USDA is not going to bring back that which was in the 70s or 80s. The world of agriculture is going to move on. That is the opportunity you have. The economy is changing; opportunity is there worldwide, so I say, take advantage of it. Make sure that you look at those changes that have been structural in nature, find your niche and move into it. Direct your eyes to the future.

SECTION 2

Session 1: Structural Change: A Research Base

by

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OPEN DISCUSSION

Summary of

Economics of Consolidation: Causes, Implications, Continuing Issues

Wayne D. Purcell

The purpose of the chapter was to offer broad coverage of the issues. Significant declines in demand for beef and pork, starting in the late 1970s, are identified as a primary catalyst for the consolidation of the 1980s. Consolidation is presented as a largely inevitable response to the economic pressures associated with the demand-side problems.

Declines in demand for beef and pork are demonstrated graphically and documented by econometric models. Attention is focused on the decline of over 30 percent in the inflation-adjusted Choice beef prices from 1979 through 1986 in the presence of essentially constant per capita supplies (per capita consumption) of beef. Less severe demand problems are documented for pork.

With consumers refusing to pay higher nominal prices and accepting constant or sometimes reduced supplies of beef and pork only at sharply lower inflation-adjusted prices, the producer and processor faced "capped" prices at the consumer level. With operating costs (labor, packaging, transportation, interest, etc.) tending to go up with overall price inflation, there was tremendous pressure for change in the beef and pork systems. If middlemen's margins had gone up with overall price inflation, the derived prices at the producer level would have been forced sharply lower. To offset those pressures and survive, producers and processors faced a need to get more efficient and reduce costs.

Efficiency gains at the producer level were impressive as cattle types were changed and less efficient producers were forced out of business. Beef production in 1989, from a herd of 99.5 million head, was comparable to production levels in the early 1980s when the total cattle inventory was in the 110-115 million head range. Comparable efficiency gains were accomplished in pork. Pork production in excess of 15.5 billion pounds was recorded in 1989 from a total inventory (December 1 of 1988) between 53 and 54 million head. In 1979, roughly the same production was available from an inventory of over 60 million head.

Efficiency gains were also recorded at the processing level, especially in beef. From 1979 through 1988, the inflation-adjusted farm to retail price spread for beef declined over 20 percent. Early in the period, the reductions were related primarily to changes in labor costs in union and non-union contracts, but the declines were sustained through 1988. If the farm-retail margin had increased with overall price inflation, cattle prices at the producer level would have been pushed still lower.

In the pork sector, gains at the processing level were less impressive. The inflation-adjusted farm to retail price spread declined approximately 20 percent from 1979 through 1984, and then turned higher again. In 1988, it was back at 1980 levels and trending higher.

The efficiency gains at the producer and processing level were not adequate to offset the impact of the decreases in demand, however. Inflation-adjusted prices of cattle (slaughter and feeder) and slaughter hogs moved lower through 1986, and hog prices dipped again in 1988. Lower inflation-adjusted prices mean the producer was not receiving prices adequate to cover inflated production costs and many producers were forced out of business.

> **Decreases in demand were a primary catalyst for forced change in the livestock sector in the 1980s. Cost-price squeezes became intense at the producer and processing levels and some type of adjustment to the economic pressures was inevitable.**

Consolidation via mergers and acquisitions is presented as the response to the economic pressure. Firms grew large seeking economies of size in individual plants and related multi-plant economics. Research results suggest a beefpacking plant killing 300 head per hour can operate $8-10 per head below the costs in a plant killing 100 head per hour. There are apparently comparable economies in the fabrication function and in multi-plant operations within a single firm.

Having presented the "why" of the observed consolidation, the chapter examines the pros and cons of what occurred and what was allowed to occur by the Justice Department and the courts. The issue is *economies of size* versus concerns about the *market power* that comes with large-size operations.

The "pro" arguments are based on the economies of size concept. Firms needed to get big, it was argued at the time, to reap the economies of size and to accumulate the financial prowess needed to do the risky market and product development work. It appears both the Justice Department and the courts agreed with the "efficiency" arguments. The last round of mergers/acquisitions in 1987 pushed the 4-firm concentration ratio in boxed beef to the 80 percent level -- a level double the measures in the

1979-80 period, and a level without precedent in the history of the industry.

The "con" arguments presented are based on the concerns that come with large size and the related market power. There were and are concerns that the large firms will move to control available supplies via integration or contracting and thereby eliminate a viable economic role for the smaller producer. Related, there are concerns that the base of visible prices for market reporting purposes will shrink to inadequate levels as the use of contracting isolates cattle or hogs from the open market mechanisms. The widely-used basis contracts in cattle, for example, tie the final price to the futures market and thus pass the job of price discovery to the futures market.

As the markets, nationally and regionally, become more concentrated, there is a related reduction in the number of buyers, outlets, and bids on cattle and hogs. The question of how many bids is needed to insure competition is not an easy question to answer, but there is a mounting concern that two, or even three or four, may not be enough. The concerns are greater for the smaller producer who may not have the quantity to attract the attention of fewer and larger buyers.

Questions are also raised about how the accumulated financial prowess will be used. Will the money be reinvested in the industry to help insure its economic viability? Will the market and product development work that is needed to help correct the demand-side problems be done? Critics are not sure that the large packers will be concerned about the industry in a long-run context, and may divert financing and capital into other areas of activity in the future.

> **In assessing the net impact of the consolidation to date, Purcell focuses on the advantages of economies of size in packing/processing versus the disadvantages that can be associated with market power. He notes that the benefits of the consolidation -- increased efficiency, reduced costs, retaining industry capacity -- have been achieved, but the issues surrounding the possible exercise of market power are still in the future. The research and policy agendas in the 1990s should revolve around the still unanswered questions as to how a highly consolidated beef industry will perform.**

The consolidation in the beef sector has occurred and is likely to be irreversible. Consolidation in pork has not developed to the same extent, and that possibility becomes an important issue that will be carried into the 1990s. Should consolidation in pork be allowed as it was in beef? Purcell indicates we need to know more about the implications of what has occurred in beef and offers a research agenda designed to answer questions and/or quantify the implications of the massive consolidation.

Research is needed to better estimate the economies of size in the slaughter and fabrication functions in the large packing plants. There is also a need to investigate the possible economies of multi-plant operations. Related, research is needed to estimate the marginal value product of an added head of livestock for various levels of operation relative to the desired or designed level of capacity. Such research would provide better estimates of the hypothesized benefits accruing from moving to a few, large firms.

With the consolidation in the beef sector has come different ways of coordinating inter-level activities. Packers have moved aggressively to secure "captive supplies" of cattle via vertical integration, contract feeding, contractual procurement, and business arrangements between packers and feedlots. Research is needed to quantify the benefits of more stable supplies of livestock moving into the packing plants.

Related, there is a pressing need to investigate the impact of captive supplies of cattle (or hogs) on the price discovery process and on the day-to-day activities in the market. Purcell suggests that access to captive supplies of cattle (such as contract cattle) may reduce the day-to-day demand for non-contracted cattle and/or make that demand more inelastic. The impact on demand is tied conceptually to the notion there is a "marginal value product" for cattle related strictly to the level of operating capacity. The capacity-related MVP of an added head of cattle may be lower if 80 percent of kill needs are already filled via contracts as compared to the MVP if the 80 percent guarantee of supply needs is not present.

There can be another side to the issue, however. If more stable supplies of cattle or hogs serve to reduce packers' cost over time, the general price level for cattle could be higher because of the reduced costs. Purcell suggests, therefore, that the issue is one of the net impact over time on the level and variability of price. Research is needed to measure that net impact.

Efforts are also needed to investigate the impact of consolidation on the effectiveness and efficiency of the price discovery process with special attention to the availability and adequacy of available prices for market-reporting purposes. A bit more abstract than some of the other possible implications, Purcell apparently feels this is one of the more important issues.

The potentially negative dimensions of consolidation and high levels of concentration are largely in the future. Research is needed on the impacts in such areas as price discovery, demand for livestock, and level of competition to guide discussion and any policy or legislative moves designed to "correct" any imbalances that emerge due to consolidation.

In a changed industry, there is much uncertainty about impact and implications of the consolidation and the chances for accentuated adversarial relationships are increased. Purcell closes the chapter with an expression of how important it is for all sectors of the industry to work together. He suggests that the beef sector, for example, has a chance to become a growth sector again if there is an industry-wide agenda and industry-wide planning. But that type of coordinated action is not likely in the current environment and some new and added steps will be needed. Purcell suggests some type of "coordinating council" should be established to provide an opportunity for industry-wide examination of issues, to provide continuity in industry programs and efforts over time, and to be prepared to address the "state of the industry" in an appropriate annual forum.

A coordinating council is needed to provide an infrastructure with continuity and breadth in perspective and to help guide continuing industry efforts to cope with change.

Summary of

Implications to Pricing and Competition: Feeder/Packer Subsector

Clement Ward

A review of developments during the 1970s and 1980s is provided. Ward documents the changes in the number of firms and the trends in percentage of business handled by the large packing firms. Looking beyond the traditional 4-firm concentration ratios, an increase in the number of large plants is documented for cattle, hogs, and sheep. The percentage of total volume handled by the large firms, such as plants killing 1 million or more hogs per year, increased steadily for all classes of livestock across the past 15 years. Ward notes that concern about concentration in the livestock sector is not new but suggests the increased activity in the late 1980s by private-sector groups (American Farm Bureau, National Cattlemen's Association) indicates that concern about consolidation, integration, and concentration is growing.

Results from a June 1989 study on procurement practices by packing plants in the cattle feeding sector are presented and contrasted to the results of a similar study conducted 10 years earlier. Ward notes response to surveys was strictly voluntary and cautions that the results of the study may not be strictly indicative of the entire industry. Responses were received from 152 of 223 feedlots surveyed in the Southern Plain (Texas, Colorado, Kansas) feeding area.

The results from the June 1989 survey, a study on contracting by Ward and Bliss, and a special survey by Packers and Stockyards Administration (PSA) are discussed and summarized. Roughly 30 percent of all slaughter lambs are fed by packers. Contract hog production is apparently around 10 percent of total production in the U.S. In the fed cattle sector, captive supplies (packer feeding, contract and/or marketing agreements) range up to a high of 39 percent in one month of 1988 in the High Plains and Colorado (Colorado, Texas north of Lubbock, and Kansas). Captive supplies were as low as 3 percent for the same month in the Nebraska-Iowa feeding area.

There is large variation within the year in both packer feeding and in contracting and the larger feedlots (20,000 head or more) do much of the contracting. Ward notes the time period for delivery of cattle bought in the cash market was much longer in June of 1989 than in the earlier July

1979 study. One-half of all lots were to be delivered six days or more after purchase in 1989 compared with five percent in 1979.

> **Available data indicate that the large packers are moving to increase "captive supplies" as a percentage of total cattle needs. This trend appears to support the inferences by Purcell and others who have suggested stability in flows of livestock are very important to cost-conscious packers.**

More detail on the results of the June 1989 study are provided. Survey responses show that the number of buyers, number of bids, and buyer activity in the feedlots have decreased sharply. Much of the buyer interest and activity is early in the week and the level of competition for cattle late in the week will often be minimal at best.

Across all the survey regions, 50.7 percent of the fed cattle were sold to the one firm extending a bid. In Northeast Colorado, that figure was 71.7 percent -- indicating nearly three-fourths of the lots of cattle sold were sold to the only packer who had bid on them.

> **The June 1989 survey results document the high levels of concentration at the packing level. Many feedlots have only limited or no alternative to the large packing plant in their area. Evidence that over 50 percent of the cattle across the entire region were sold with only one bid should provide impetus to further investigate the implications of consolidation to pricing and to competition.**

Ward reviews the available literature dealing with the impact of consolidation on price and on profits of meatpackers. The available literature gives mixed results on whether there is evidence of the existence of market power in livestock procurement or in the sales of meat products. Information on profits is sketchy, but Ward concludes there is no compelling evidence that large meatpackers are earning excessive profits. The continued presence of excess capacity at the packing level may be providing a "safety net" against the exercise of market power in livestock procurement. This is an hypothesis that Ward suggests needs investigation and testing.

In examining the possible implications of consolidation to price discovery processes, Ward again finds mixed results. Some studies show that price is positively related to the number of buyers/bids but other studies find no relationship or even a negative relationship. In his own examination of the detailed data collected during June of 1989, Ward could find no evidence that the large packers paid or bid a lower price for cattle.

By including a measure of "captive supplies" in regression models, an effort was made to quantify any relationship between the percent of cattle in the captive supply pool and prices for fed cattle. Statistical models showed no significant relationship but Ward would qualify that result by noting that (1) the time period of study was short (daily prices for one month), and (2) more research is needed over longer time periods and possibly wider market areas.

Policy alternatives are reviewed and Ward emphasizes that the importance of clearly-defined policies increases with the increasing concentration levels. A 5-point move on the 4-firm concentration ratio from 75 to 80 may not have the same implications as a 5-point move from 45 to 50.

Ward notes that almost all analyses of the situation to date favor voluntary actions. The NCA Task Force, for example, favors voluntary and industry-level actions in surveillance of contracting activity and in reporting prices to facilitate efforts of market news reporters. But those reports also tend to be opposed to still further concentration in the beef sector and those industry positions may influence actions of the Justice Department and Congress. Ward would like to see increased surveillance, a more active role for Packers and Stockyards Administration in decisions regarding mergers and acquisitions, and increased recognition of the need for voluntary actions by the large firms in a consolidated industry. If that does not occur, then required reporting, required disclosure of volume, etc. by congressional action is the probable alternative.

Three areas in which more research is needed are identified. The first is the continued study of the possible impacts of structural change to price, price discovery, and the overall viability of the industry. Ward notes that most producers and cattle feeders feel the consolidation, and its corollary move to captive supplies and contracting, is negative for the industry. More research is needed and better data bases on such "variables" as captive supplies are needed.

A second area deals with monitoring and surveillance activities of the regulatory agencies. Currently, the 4-firm concentration ratio and the Hirschman-Herfindahl indices are used by the Justice Department. Ward is critical of both measures because they fail to account for vertically-integrated activities which lead to captive supplies of livestock. He introduces a competition index defined as:

$$CI = \frac{\sum_{i=1}^{n}(MS_i^2)(CS_i)}{1{,}000}$$

where CI is the competition index, MS is the percentage market share of the i^{th} firm, and CS is the percentage of livestock needs that are captive supplies for the i^{th} firm. Ward believes the competition index is a more appropriate measure of concentration in today's industry in cattle and in the emerging industry for pork.

In concluding the chapter, Ward expresses a continuing concern for the lack of a solid research base for policy decisions. The massive consolidation in the beef sector is now history, but it was not until 1989 and early 1990 that an active dialogue about its impact began to develop. After the fact, structural change is largely irreversible, but most research is *ex post* in orientation.

> **Too little time, effort, and resource expenditure is going into forward-looking and creative research on the implications of consolidation in the livestock sector. A better information and intelligence base is needed before the policy decisions regarding mergers and acquisitions are made.**

Summary of

Implications to Pricing and Competition: Packer/Retailer Subsector

Michael A. Hudson, Bruce J. Sherrick, and Darin R. Gregg

Change has been the one constant in the beef sector across the past two decades. With the change has come an increasing dialogue, a dialogue that has not always been calm. Consumers have voiced their opinions by changing buying habits and the decreases in demand helped prompt a massive consolidation. The 4-firm concentration ratio in boxed beef moved up to 80 percent and new needs emerged. Large packers stressed the need for a consistent supply of high-quality livestock, but producers and industry analysts were unsure of how a changed and restructured industry would perform.

The authors suggest the structural change is bringing an increased need to understand how the various levels of the system, from producer to retailer, are interrelated. In the absence of understanding, adversarial posturing by participants at different levels of the system blocks progressive adjustments to change. The focus of the chapter is to facilitate understanding of how the various sectors fit together and why past, present, and future changes have occurred or will occur.

The authors suggest the NCA Concentration/Integration Task Force report and the report "Competitive Issues in the Beef Sector: Can Beef Compete in the 1990s?" (commissioned by the NCA) were limited in their contribution by a prior presumption that a limited number of "players" (such as packers) at one level of the system will possess enough power to exert influence over other players (such as cattle feeders) at some other level of the system.

> **Assuming a perfectly competitive market as the "norm" will limit analyses and lead to often predictable results. In particular, the authors argue, assuming a world in which there are a few market outlets and where captive supplies are prevalent is harmful to cattle producers is not an appropriate point of departure for examining the future of the industry.**

There was no grand plan employed by some groups to change the industry. Changes in consumer demand and changes in the structure of the food processing and distribution industries brought the industry consolidation. Part of the initiative comes from basic demographics. As the population of consumers ages, they demand different products, want different sources, and are willing to pay for convenience, even for delivery of food items. The food processing industry has either been forced to adjust or the more aggressive firms have seized the initiative and pushed value-added processing of the meats.

As these forces of change filter down through the system, still further change will be prompted at the processing and producing levels. In integrated structures and in structures where contract procurement is widely used, information flows (product descriptions, specifications, management directives) can effectively replace negotiated prices as coordinating mechanisms.

The authors contrast a "traditional" and an "emerging" perspective of the beef production-marketing system. In the traditional view, the slaughter function has been seen as the dividing line between a production orientation (producers, cattle feeders) and a processing orientation (packers, fabricators, retailers). From that perspective, the producer's "job" was finished once the slaughter animal was delivered to the packing plant. It was someone else's job to merchandise and worry about the consumer's needs and wishes.

Such a "farm gate" perspective of marketing was perhaps adequate until the demand problems emerged in the late 1970s and early 1980s. The red meat sectors were then no longer growth sectors and the dictates of an increasingly discriminating consumer became critically important. As the industry consolidated, especially at the packing level, a new perspective began to emerge.

The system is now much more focused on the consumer. As a result, the clear demarcation between production and marketing has disappeared. Value-added processors are emerging between the packers and the wholesale-retail complex. The new group of processors are more nearly food companies than beef or pork companies and they may or may not be involved in slaughter. An example is Sara Lee, one of the 5 largest distributors of meat products.

> **In the emerging systems, there is no sharp division into production and processing functions. All stages of activity are more nearly coordinated and dedicated to serving the needs of the final consumer.**

In the new beef and pork systems, the production decision and production activities will not be the center of attention. Production will be important as part of a broader systems effort that ranges from the producer to the consumer. Increasingly, the entire system will be coordinated and business investments will flow toward that part of the system that makes important contributions to the overall objective of meeting consumer demands and expanding consumer markets.

In the 1990s, the competition *for* livestock markets may be more important than the competition *within* the markets. If competition is in fact reduced in highly concentrated markets and packers are able to more consistently secure target per-head operating margins, that does not necessarily mean cattle feeders have been hurt. Competition *for* the fed cattle market as the large firms build and acquire capacity, invest in modern technology, and in other ways seek to protect their investment may more than offset any problems associated with reduction in number of bids and in market outlets.

The authors present a conceptualization of the beef system in the context of investment in various activities across some time interval. This approach, it is suggested, helps the observer to understand why price series at various levels of the system might not show a constant spread or difference. Different investment strategies are being employed as value-added processing functions are considered. The returns to the various strategies will vary over time and any premium return may be nothing more than a reward to the investor(s) who "complete" the market -- that is, the investor who offers the services needed to finalize the infrastructure connecting the consumer and all other system participants.

A summary of results from a study designed to identify and estimate the price linkages between various levels of the system is provided. The study shows price linkages, with time lags that run up to five days, between live cattle futures prices and various cash price series for fed cattle. Boxed beef value series reported by the USDA have a lagged influence of two to three days on primal and subprimal cutout series reported in the Meat Sheet, a private report of cash trade. The results, suggest the authors, support their contention that no one phase -- such as production -- can be treated in isolation.

> **During the 1990s, it is likely that the interstage linkages will be still tighter. The entire system will start to react to economic stimuli, such as changes in consumer buying patterns, without the time delays the industry has experienced historically.**

In assessing the changes which have occurred and which are occurring, the authors identify several implications to producers. The implications arise from the changing nature of the entire system and the increasing recognition that any operational separation of the production and processing functions is artificial and inappropriate. The implications listed include:

1. An increase in the demand for consistent quality and quantity in the supply of slaughter livestock.

2. As the value-added sector expands, new buyers will enter the market bringing competition for captive supplies of livestock and needs for specific livestock to fill a defined or "niche" market need.

3. Adversarial posturing will diminish or the entire production and marketing system will suffer in its competition for the consumer's dollar.

4. Consolidation will level off in beef and will be slowed in pork as regulatory attention increases and concentration becomes more difficult to measure as the value-added segment of the system expands.

5. Pricing systems for cattle and hogs will change so as to reflect the value of the animal in its final use but the changes may be confusing to the producer in the developmental stages.

The authors, in summarizing, restate their view that the beef sector is actually an interconnected system, driven by consumer demand, with the performance of the investment becoming increasingly important, and characterized by pricing systems that will have to change to reflect the final value of the product. In fostering better understanding of this type of system, the authors suggest more research is needed in:

1. Intradisciplinary efforts that bring new approaches to bear on old problems;

2. Research that is anticipatory versus reactionary and designed to assess total costs and benefits of change;

3. The behavioral dimensions of the system (consumer reactions, adversarial attitudes, etc.) that, while generating results more difficult for academicians to publish, may be far more important to the industry;

4. Increased use of case studies as a means of improving understanding of the sector; and

5. Simulations and controlled experimentation that generate, in a computer era, indicators of how decision makers and investors are likely to behave under selected sets of conditions.

In closing the authors offer the following:

> **In a changed and consolidated industry, the importance of the linkages between the packing-retailing subsector and the producer is likely to be**

magnified. It will be important that the producer understand that the traditional "middlemen" will place increasing demands on the production subsector to provide the specific quantities and qualities needed to meet the demands of value-added processing. Non-price means of coordination (contracting, integration, etc.) could become even more important in the 1990s. As those adjustments are working themselves out, it will be important that every industry participant avoid adversarial postures and that our research efforts do a better job of sorting out the costs and gains to various participants.

Review: Leo Vermedahl

I think a few important things have been said here today. The point about consumer demand and its effects on what has gone on in the industry, as far as structure is concerned, is the most significant. Because consumer demand has been capped by the refusal of the consumer to pay higher nominal prices, the beef industry would be smaller at all levels as we go into the decade of the 1990s if the efficiencies associated with consolidation had not been captured. In other words, if the packer consolidation and the resulting significant decrease in the packer-retail spread had not occurred, many of us that are still in the industry today would not be there. I think that is very significant. As we talk about the effect on me as a producer, the first and most obvious reaction is, "What does it mean in terms of selling cattle at the feedlot level?"

I was in the feedlot industry when American Beef went down. I was in the industry when Louis Heller took some people down as he went down. I've sold cattle to the same packers and they have to wire transfer funds before we put the cattle on the truck. When it comes to selling cattle, I would much rather sell cattle to three strong packers than I would to twenty weak ones.

I, as a feedlot operator, have a responsibility to the people who feed cattle in my feedlot. As I sell the cattle I have to assure them that when the packer delivers that check, the check is going to be good. That is an extremely important aspect of my job. Even though we're down to just three or four packers, the frustrations that go along with the fact that we sometimes only get one bid on a pen of cattle are things we have been willing to put up with in return for having strong bidders out there.

The second thing that comes to mind is price discovery. The definition that you see of price discovery, as you read the book prepared for this conference, is that it is a dynamic process whereby buyers and sellers analyze available information of supply and demand and seek that price level that will clear the quantity through the market.

As I think about the feedlot industry, even as I was back home observing my dad sell cattle, we used to trade cattle by what is called the cob-rolling method. To give you an explanation of that, the packer/buyer would come to the feedlot and we would have a showlist of the cattle we would want them to look at. I, as the manager or cattle salesman, would take that showlist and go with the packer/buyer into a pen of cattle and we would get out and walk that pen of cattle. The sparring process would then occur as we were walking the cattle. He would point out to me how poor the cattle were and I would point out to him how good the cattle were. That conversation would go on accordingly until we got back to the gate of the feedlot. Then the packer/buyer would ask how I had these cattle priced. I would reach down and find a cob and start rolling it around with the toe of my boot and say, these are pretty good cattle, give him all the attributes of the cattle, and price the cattle at $49.00. Of course, he would throw a fit and say that was not within his realm of possibilities at that time and I would ask, "If you can't give that, then what can you give?" He would pick out a cob and start rolling that cob and say, "I can only give $47." In the process of rolling those cobs and talking back and forth, we may actually arrive at what the value of that pen of cattle was in terms of me as the seller and he as the buyer. We would finally agree, and those cattle would be traded.

That may sound like a good process, but it was kind of inefficient from the standpoint of the time element involved. It did accomplish price discovery. It satisfied the seller that he was able to get what he perceived the cattle were worth and the buyer was satisfied as to what he thought they were worth. Now, the industry has changed. Some of these buyers are very sophisticated, have considerable knowledge, and know more about how the cattle perform than I ever hope to know. In an attempt to give these sellers better information, the industry developed market reporting techniques to inform the seller. One of the reasons Texas Cattle Feeder's was born back in 1967 was the development of a market department to keep the feedyard members informed about what cattle were bringing. I might say that they have done an extremely good job.

Today we have a system within our marketing department of the Texas Cattle Feeder's that is superior to anything in the country. Part of it involves what we call the MNET system. The MNET system is a series of computers in each feedlot manager's office that are linked via satellite to the mainframe at the Texas Cattle Feeder's office and to each other. The instant a set of cattle are traded at any one feedlot, information on the price, the kind, the buyer, and all particulars are put into the computer and it is immediately available to all the other feedlots. Before that buyer can get into his car and drive to another feedlot, that second feedlot already knows what has happened, what kind of money he's got, and what he paid for the cattle. But what has happened, in terms of price discovery, is that we no longer trade cattle by the cob-rolling method; we now trade cattle by the average. Look at what happened in the Texas Cattle Feeder area last week. Eighty percent of the cattle traded brought from $79 to $79.50. No matter how little you know about the livestock and the beef industry, do we really believe that all the cattle coming out of Texas feedlots are worth within 50 cents per hundredweight of each other? We've developed a price discovery process whereby somebody sells the first pen of cattle and then all anybody else wants to do is get that same price.

Last week we traded over 60,000 head of cattle, but like I said, most of them brought $79 to $79.50. One of the things that this has accomplished is that it has allowed the large concentrated packers to accumulate the numbers they need to run their plants. It's allowed them to do it with very few buyers, and I might say sometimes inexperienced buyers, to the extent that the main things many buyers ask for when they come to the feedlot are: (1) where the cattle are, (2) the weight of these cattle, and (3) how many days they have been on feed. They then go look at the cattle and see what color they are and make some estimation of grade and yield. This is largely determined, in their mind, by the number of days those cattle have been fed. So we're trading cattle, we are accomplishing a process of getting the cattle transferred, but we're not sending the proper signals. We talk about value-based marketing but then we look at the system whereby price discovery is operating today. This approach is not going to send the proper signal from the consumer back to the producer. I think that some changes have to be made in the area of price discovery. I don't have the answer; I have lots of questions.

I was a little dismayed as I heard that IBP was going to start using the average purchase price of cattle as a base for how they were going to sell their boxed beef. Having worked on the NCA Task Force with Sam Washburn, having adequate knowledge of how beef was traded from the standpoint of the boxed product was a starting point in price discovery. Now, there is a difference between price discovery and price reporting, I understand that, but price reporting is a place to start for information and having more thorough information on beef that's traded. They still have some work to do, but we know that they are doing an extremely good job of gathering information. There is still some reluctance involved in reporting some information from some of the packers that claim that they are doing a better job at cutting strip loins or a better job at preparing briskets than somebody else is doing. Until they overcome that attitude, they may have some problems.

The third area I get concerned about is the area of captive supplies. The concept that supplies isolated from the current cash trade doesn't affect price over time because the total volume of cattle traded remains the same is not a true perception of many cattle feeders. It may be okay to look at it in a broad sense over time and say that the captive supplies will not affect price, but let me take you back to some personal experiences to make some significant points. I'm presently general manager of a very small feedlot relative to the way feedlot sizes go. It's a 24,000 head feedlot in Summerville, Texas, a feedlot called Seven X Feedyard. Normally we will market from 5 to 6 percent of our cattle each week which in that size yard is around 1,200 cattle a week. Some of the cattle are contracted ahead of time, some are on feed for a packer, and those cattle are not on the showlist. A typical week is like last week where we had just a little under 1,000 cattle on the showlist. Two of the pens of cattle were pretty good cattle, extremely good cattle -- probable weight 1,175, grading 75 percent Choice -- the kind of cattle that without a doubt should have brought the practical top, whatever that was supposed to be. The other interesting point here is those two particular pens of cattle were hedged. So, as you're selling hedged cattle, you pay attention to where the futures market is trading because of the difference between where you sell the cattle and where you have to get out of that paper. This is called the basis and that is becoming extremely important.

Last Monday morning, the first buyer to drive into the yard was from IBP. I sit on the second floor and have a great picture of the feedlot so I can see what's going on. I watched the IBP driver go up and down the alleys, barely slowing down at a pen of cattle until he came to what I consider our best pen of cattle, pen 39, and he did stop there. He didn't get out and walk the cattle, but he did stop. He drove back to the office and the first question he asks, "How do you have pen 39 priced?", and I told him I had it priced at $79.50. He says, "I'll give you $78." He means $79 I thought, because generally these buyers don't try to insult you, they try to save a little. But it turns out his orders are to buy a pen of cattle, not over 200 head, and not pay over $78.

Why would a buyer have that attitude? Here we are 60 miles from Amarillo, and Amarillo has a plant that kills 27,000 cattle a week. Go back to a little over a year ago and that particular plant had eight buyers. Those eight buyers had to procure 27,000 head of cattle every week. They had to be extremely active every day, particularly Mondays and Tuesdays, even Wednesdays and Thursdays, to get their 27,000 together for next week's kill. Now, what's changed? That plant is supplied 60 percent of their needs by a marketing agreement with Cactus Feeders. Those 60 percent of the cattle are not traded under a cash basis, but they still have the same eight buyers now procuring 40 percent of the cattle which is approximately 11,000 per week. The interesting thing is that the price they pay for those 40 percent of the cattle is the base on which the 60 percent in the marketing agreement are priced. To the extent that this buyer, and the seven others like him on any one day, buys 200 head of cattle and pays from $1.00 to $1.50 under the market -- my perception of that is that it is good business for them, but not for the market.

That is the base by which they would lower the cost of the other 60 percent of the cattle. There was good reason for this buyer to be following the orders he was given. It's frustrating for me as a manager trying to sell cattle at what I perceive the market is, but you deal with that. I don't know if he found his 200 cattle that day or not. I haven't talked to him since.

The next buyer who tried was from Excel. We sit about 20 miles from the Excel plant and we have a good relationship with them. They have a good buyer and we like to see them come. The minute he came through the front door he says, "Don't bother to give me the showlists, I just want to drink a cup of coffee." He said, "We've got a pretty good supply of contract cattle this week and we also have some of our own cattle on feed." The point I'm trying to make here is leading up to the frustration that I, as a feedyard manager, have in this area of captive supplies. We did give him a cup of coffee because we want him back next week and I feed some cattle for Excel. I appreciate their business and don't want to upset these buyers. We want a good working relationship, but it gets frustrating.

The third buyer didn't come until the next day. He was from Monfort. He looked at the cattle and asked how we were pricing the pens of our better cattle. I'm pricing at $79.50 and he agrees that the cattle are probably worth it. He says that if those cattle were setting next door to his plant he would give $79.50. He said, "You recognize we're 125 miles from our plant, and I have a $.75 freight rate. I want to buy your cattle, but I can only give you $78.75." At the time the futures were trading at $79.30-40, bouncing up to $79.50, so you're looking at approximately a 60 to 75 cent basis. I wasn't ready to do that, but by that time I thought if I'm going to get out even I'm going to be lucky. This particular Tuesday and Wednesday nothing had happened and futures were still in the $79.30-50 area. By Thursday nothing happened and the futures were still trading at the $79.50 area. They're going to go off the board the following Tuesday, and they don't trade Monday. There are rumors that a particular outfit in Tennessee controls a major part of the long side of the futures and the open interest is considerably large. There could be some volatility there. What do you do? Talk about frustration. I learned to sell fat cattle from a guy sitting in this audience. He told me one time if you put cattle on the showlist on Monday morning do it because the cattle are ready and you better not own them Friday night. So come Thursday, we sell the cattle at $78.75 and get out of the futures.

My point of these three observations of what actually happened is to make a point of the frustration that the captive supplies can cause a feedlot manager. As we look at why packers contract cattle, why they tie up captive supplies, I think that's been alluded to here at various times during these presentations and I can't argue with them. Other than the fact that if you think the packers contract cattle so they can have their hands on a particular quality of cattle that fit their needs, that is good in theory. But in reality, that is not why they are contracting cattle. If their home office gives an order to go out and buy the better cattle for later delivery via contracts, they will buy more variance of quality at that price than they will on the date they are trying to buy cash cattle for immediate kill needs. They are willing to take lesser cattle at the same money when they're contracting three to four months before they need the cattle than when they are buying in the cash market. That throws cold water on the feeling that the only reason they are contracting is to tie up a certain quality of cattle. In theory that is a good statement and it may become true as we go farther along.

It is an interesting business. The changes occurring are occurring so fast that as I read the papers that were developed into the book you received and was looking at some of the suggestions for research, the thought came to mind of how valid is research based on what is happening today given what we may see tomorrow. I don't mean it shouldn't be done, but we're in a period when the structure of the industry is caught up in a fast-changing world. If you do research on an academic level on the bases of what you've seen happen recently, it makes you wonder how applicable this is to what is going to happen tomorrow. I wish I knew what was going to happen tomorrow. I hope that whatever it is I'm still in the industry. Even though I get frustrated, it is still fun. That's why I continue to do it.

Review: Jens Knutson

Wayne had asked me about a month or so ago to review the materials for the book and be on the program this morning to react to what has been said. I'm the only representative from the packing sector up here, so you will have to excuse me if my remarks seem a bit defensive at times. I've been doing a lot of reacting lately to what's being said about structural changes in the industry, defending if you will, explaining where I can. We have had the National Cattlemen's Association meet with us twice over this issue. We have had meetings with the American Farm Bureau, numerous interviews with the press, and have been contacted by representatives of the Government Accounting Office who are investigating structural change in the packing sector. There have been questions from people in the Economic Research Service of the USDA and talk about congressional hearings and Justice Department investigations.

As I said, I first read the original papers about a month ago before they were in book form. I didn't find too much to disagree with then, so I read them a second time. Not too many papers by economists get read twice -- and in some places, it is clear these were written by economists -- but I got more out of the papers the second time around. I would encourage you to read them too, at least once, because there is a lot of relevant information in them. After reading them a second time, however, I still couldn't find too much to disagree with, so I ended up reading them three times. And the third time through, I did find some things that caused me some concern. Now if you have been listening carefully, you just heard me tell you two things that should help put today's program and my remarks in perspective. First, you can read a set of three economic papers three times, get something valuable out of them, and live to tell about it; and, secondly, if you look hard enough, you can always find something to cause you concern.

I'll address Clem Ward's efforts first. Clem makes two points that bear repeating. First, there is no evidence of monoposony or monopoly power in the meatpacking industry. A lot of people have looked, but no clear evidence has been found of any undue market power on either the buying or selling side. Secondly, there is no evidence that fewer buyers cause prices to be lower. In our discussion about what change means, we cannot afford to forget either of these points. Yet, after making these points and several others in the same vein, Clem talks about the need to more strongly enforce antitrust legislation. Where is there an indication that something is wrong, that some law has been broken? Clem says that the consolidation "could" or "perhaps will" at "some unknown time" result "in an inevitable loss in pricing efficiency." This is heavy speculation, and that bothers me.

Michael Hudson references something very similar to my concerns. He suggests the type of attitude that I attributed to Ward reflects a bias in the research community that can impede an understanding of what is going on, what it means, and how the industry can adapt to the changes we are seeing take place.

Regarding Michael Hudson's presentation, I completely agree with him that analyzing structural changes in the context of a perfect competition model is inappropriate. Perfect competition exists only in textbooks. The emphasis should be on broad analysis to help the industry survive and compete in a changing environment. We have to have more of that kind of analytical orientation. I agree with his emphasis on the total system where we analyze the impact of change on the overall system as opposed to its separate components. I also think he made a valuable contribution when he presented models of the industry and identified the changing roles of the packer and processor in a changing industry. I think much of the ongoing research today fails to recognize and correctly account for these changing roles.

In terms of the changes that Hudson identifies, and especially the changing roles of the packer and processor, I think everyone in this room would agree that they require that we do things differently. We would all agree, for instance, that the demand for a consistent supply of livestock, consistent in terms of both quantity and quality, will increase in the future. But getting to that point will take discussion with producers and all parties involved and we will have to have less of the adversarial posturing that has characterized our industry in the past.

Turning to Wayne Purcell's efforts, Wayne did a good job documenting the problems on the demand side. We have to be more aware of that side of the equation because developments in demand define not only our problems but also our opportunities. We cannot afford to ignore it. He also did this group a service by referencing the fact that increased productivity and efficiency across the past 15 years have resulted in less downward bias on cattle prices than we would have seen had these changes and the consolidation not occurred. This is a message that I believe needs to be more widely understood.

Wayne hits on an issue here that all of us in this room, especially those of us at AMI and in the packing sector, have felt strongly about, but to date it has been primarily a "gut feeling." The issue has to do with the benefits of consolidation and can be identified by how much lower cattle prices would have been had the consolidations not occurred. We have trouble dealing with this issue intellectually because we all bring to it a different orientation and perspective. Related to this, there is also the question of how much more would the consumer be paying for beef at the retail counter if the changes had not occurred. Or how much more would beef's market share have declined if the industry had not adjusted to the need for increased efficiency and reduced costs? Or how many more producers would be out of business, and how many fewer packers would we have today if there had not been change? Wayne says that the beef industry would be smaller at all levels if the efficiencies associated with consolidation had not been captured. I agree with that statement completely, but am afraid it is not widely perceived within the industry.

Wayne says it is easier to document the "pros" of consolidation than the "cons." Easier maybe, but still not easy. Everyone in the industry -- producers, packers, consumers -- needs and deserves an answer to the question of how much these changes have benefited the industry at large. We at AMI are working on that answer, trying to document those benefits and put a number on that "gut feeling" we have; a number in dollars per head, cents per retail pound. This is the type of information that just has to be made available. We are trying to do it via margin analysis and I don't have to tell you folks that it is not the easiest thing to do. We had hoped to have some numbers for you today but we have not reached that point just yet. Those of you in the audience who are researchers or those who read the Proceedings from this conference are encouraged to come forward if you have techniques and procedures that will document these benefits we have been discussing. There is definitely a market for it at AMI.

The focus to date, and this gets back to my concerns, has been on the harm caused by the changes and the consolidation. Wayne says that because the pros are easier to document than the cons, that is a good reason for putting more research into the "con" side of the issue, into documenting the downside that to date has not been found, only speculated on. He does address the need for research to estimate and document the benefits, but the reference to more work needed to identify the cons -- that is what bothers me. As an industry, what does that say about our bias? And what does that bias tell us about ourselves and our ability to deal with change and to respond to challenges?

That concludes my remarks on the papers themselves. Again, I would note they are all quality efforts and I had to look very hard to find very little to criticize. They have provided a service to the industry.

There is one area associated with the changing structure, however, that I anticipated would be dealt with more strongly. Wayne referenced it several times in his paper. It deals with the area of product development and R&D, and suggestions that packers have been remiss in this area. Have we been remiss in product development, in R&D? In each of the last three years, we have seen in excess of 500 new processed meat products come to market. And in each of the last three years, over 600 new entree items have been introduced, many if not most of which are red-meat based. These are significantly big numbers. I am told the average supermarket only carries 1,700 items of all kinds, yet in the meat and frozen entree cases, packers and processors have introduced over 1,100 new products in each of the past three years.

To my way of thinking, product development and R&D is receiving an outstanding emphasis in the industry. IBP has a new R&D function called Design Products that did not exist before August 1989 and is a major commitment of resources and money. Excel, of course, has targeted literally ten's of millions of dollars to new product development and a potentially revolutionary marketing concept. Monfort has budgeted $10 million to R&D this year. Morrell has just spent $5 million on a new research center. And the list goes on.

So the emphasis is there, but we have to be sure we understand just what role the packer plays in the product development process. Every one of our companies would love to develop a "chicken McNuggett." I use the chicken McNuggett example because when we talk to producers and some packers about new products, we sense that in the back of their minds they are talking about something like the McNuggett -- something that will completely revolutionize the industry, create its own demand and earn something like a 20 percent share of the meat market overnight. I don't want to disappoint you, but realistically speaking, a product like that is not going to be developed by packers. I hope I'm wrong, but I don't think it is going to happen.

To understand why, you have to understand the packing business and its role in the changing structure of the overall meat business. Meatpacking is unlike other sectors of the meat business. One, it is larger than the other sectors and two, it earns a lower relative rate of return on dollar volume generated. Sometimes we forget that. The magnitude of this business and the magnitude of the risk to profits from throwing out new products are such that our packers need almost a guarantee of success before they will commit to a new product line. We have to have some assurance that the product is going to sell because the risk is so large.

That being said, Excel nevertheless has rolled out a branded beef product line and tried something new. And before that Monfort spent $16 million on pre-cooked beef, only to see it not sell. It did not even get off the ground. In light of all this, however, I can still say to you that we anticipate developments from a number of firms that will start to revolutionize the way beef is presented to the consumer. Not necessarily new products in any conventional sense, but new marketing concepts, new ways in which products are presented.

Beyond this need for some assurance of success, you also have to understand that most of the R&D expenditures in the meatpacking business are not targeted to the development of new products, but instead to the production process. We are all aware of what bad publicity associated with an isolated incident that hits national television can do. Packers target major expenditures to the process by which meat products are produced and offered, expenditures designed to ensure product wholesomeness and consumer satisfaction. ConAgra's Healthy Choice line of entrees is a good example of this emphasis on the process as well as the changing role of the packer. ConAgra Chairman Mike Harper appears in advertisements that stress the healthfulness of his Healthy Choice product line. This is a product designed for that portion of the market where health concerns are the top priority. The last thing he wants is for a consumer to get sick from his product. And the first thing his subsidiary Monfort has to be concerned with is that consumers not get sick from the beef they supply to Harper for his Healthy Choice products.

We also talk about the need to expand world trade. Here again the packer's emphasis is on the process required to service that market. Domestically the red-meat sector is seen as a mature industry; there will not be much growth domestically even if we turn the demand picture around. So, if growth in the industry is to occur, it is going to have to come in the world market. It is said that with communications technologies advancing like they are, the world gets smaller every day. But if you are moving meat to overseas markets it is still a big world and meat distribution on an international level is markedly different from distribution within this country. A worst-case scenario in international distribution involves the need for shelf life of up to 100 days to reach some markets. A 100-day shelf life on fresh product is not something that just happens. We have to work on the production "process" to achieve that goal and to reach these markets that offer our industry growth potential. Is work in that area product development? Some would say no, at least not in any conventional sense. I disagree, and would argue that it is.

I recognize that many feel more activity in product development is needed. Maybe packers will do it, maybe they won't. I do know that somebody will. If packers do not get heavily involved in value-added, further processing, we'll have other sectors of the industry perform that function. Packers will still be contributing by making major commitments to the process that ensure safe, high-quality meat products. Michael Hudson did a good job outlining the changing roles of the various sectors within the industry. You have packers and you have processors, commodity operators and value-added marketers. This segmentation is in place and will stay that way and the differentiated functions performed by each segment will continue developing and become more pronounced in the future.

In closing, then, if you want to understand the role of R&D in the red-meat business and you think the packers are coming up short, keep in mind that it is a segmented industry. Each segment has a different emphasis. The packer emphasis in many cases, and rightly so, is on process development and not necessarily product development.

Review: Gary Walters

Business today is made up of a tremendous segmentation. There are people who grow cattle, people who give birth to cattle, people who kill cattle, people who process cattle, and people who sell the beef, pork, and chicken. What this segmentation does is make it extremely important to understand how the entire chain works.

Our communication is very simple and basic in terms of the consumer. In the business I'm in, we take consumer research on a daily basis. We turn off our cash registers, we walk around our operation at 12:00 at night and you have consumer research because when we're closed, we find out what product they wanted. We find out which product they didn't buy. You think to yourself, "That product is selling, I have to order some more. That product isn't and is taking up too much room." So, you start making adjustments. That is how our business is basically run. That sounds extremely simplistic but it is not. The era of computers alone has made our business unbelievably complicated. We could probably fill this room with reports that give unbelievable detail on price and on product movement.

An opportunity has thus presented itself. You use that kind of data and feed it back through the chain to the processors. The consumers are the people that present the opportunity to affect our business. This "affect" is becoming increasingly important.

In my short tenure at our general office, I've tried to take advantage of the opportunities. Participating in conferences such as this and also discussions with other players in the meat business allows this needed communication.

To further highlight or clarify our position and to be able to discuss issues with you, let me take you around one of our local grocery stores. When you walk in the front door you see the floral shop. Consumers are bombarded with it. There are flowers from around the world.

You walk to the produce department and we have keewee fruit from New Zealand and strawberries in the middle of January from Chili. We are operating probably one of the finest imported melon displays in this department. As the shopper walks through, she is making buying decisions.

Then she goes to the dairy. In the dairy we offer a yogurt display that's about 16-feet long, with a variety of flavors and brands. She goes past the cheese display, in the same dairy case, and they are offering 30 varieties. She turns a little bit to her left and then she sees the canned grocery display, pork and beans, green beans, all of those good products. There are products that come from Europe, Asia, international foods and products that are processed not only in the United States but around the world. She wanders down this aisle and picks up a few items and she turns around and goes to the frozen food department. You remember the frozen food departments? They used to be coffin cases, now they are upright glass door cases, holding 10 times the variety. Things have really changed!

Do you remember Jens Knutson talking about the processors offering 600 new, meat-based products each of the last three years? Where are they going? They're going into those frozen food cases, meaning more buyer decisions. The space for frozen food in our stores is almost five times what it used to be. The entrees served today have no comparison to the past, except that they are frozen.

The shopper now walks into the specialty meat department. The display case is loaded with quality. There is the fresh seafood department, fish from around the world. Very little on the display is frozen. In fact, almost 90 percent of the display is fresh and has never been frozen. From points like Alaska, an airplane brings salmon in, fresh shrimp from Taiwan, other fresh products. Once again, a buying decision. The product is represented in as many as 30 or 40 different varieties.

Then she enters the meat department. What she sees are traditional products that she is used to looking at. Our case display is basically a plain paper wrap with price and weight. In about 25 percent of our stores, she sees Excel beef. She sees the service meat department. We offer in the city of Cincinnati, which is our area headquarters, approximately 300 recipes of what we call value-added base products. The product is sold to the customer, she takes it home and puts it into the oven, cooks it, and eats it. Cooking tips and recipes enhance her satisfaction. Meat products range in price from $4.98/lb. to $22.98/lb. The concept of in-store, value-added services is growing.

This is the competition that the meat industry faces. That lady only has so many dollars to spend when she comes through our front door. Grocery lists are smaller than ever before and the reason for this is that people can't make up their minds because they don't know what we are offering. You walk past the melon display that smells like the middle of June in January, and you buy regardless of whether the item is on a "list."

In the presence of all this competition, what do we need from the beef, pork, and lamb people? We need products that are value-added. We need beef products that come to us with a quarter-inch trim, that are as easy to slice as a loaf of bread. We need the same style product for lamb and pork, and we need those products not because we are having trouble with the labor issues, which we are. Labor today is still a major issue and a determinant of where certain services are performed.

We don't need them just because of the labor issue, we need them because we need those employees out in front of our meat cases talking to those customers, patting the little boy on his head, and selling products. It is one of the ways, that employee-based arena, that I feel the meats can compete in the overwhelming volume of variety we offer. It will allow us to better compete for the consumer's food dollar in a competitive environment. We also need more processors to choose from. Mr. Hudson put up a slide that showed value-added processing and suggested we will see more food companies move into this area. We hope so, because we need more suppliers.

We have employees that are in the store for an eight-hour shift, they work for six of those eight hours preparing a meat product and the employee sells it all in two hours. How much could we sell if the employee had eight hours to sell? We need those value-added products as ingredients to the value-based product. There is a tremendous opportunity there. We need to get those employees involved in the selling of the product. We wish there was another retailer in the United States and another supplier in the United States for case-ready beef such as Excel's product. We don't mean that we would like to withdraw. We would like for somebody to come out with the same concept. The things that we've heard in the last three years where Excel beef is concerned suggests we are trying to educate the American public that quality can be consistent and can be worth looking for when we shop.

The Kroger store in Blacksburg, Virginia sells Excel beef and John Rowsell mentioned to me that he is a loyal Excel beef buyer because of the consistency of the product. That is the success story around Excel. Last year we sold a little bit better than seven million dollars of Excel beef. We need more players, we need more retailers and processors because we need to teach the American public what Excel beef is. What kind of steps do we have to take in order to make this happen? I understand the consequence of developing and trying new products. It is a bit like Las Vegas; put your money down and try your best to do well. But we need those new products. We are doing well with beef, and we will continue to work hard in this area. But we need those new products that are appealing to a modern and changing consumer.

Look at what has happened in poultry. In the early 1970s, we had chill-pack, whole birds and separate packages of legs, thighs, etc. In all, there were about eight product offerings. In the same store that we operate to-day, there are 32 varieties of chicken -- from 8 to 32. There are 11 varie-ties in fresh turkey, never frozen. This is all caused by packaging, by marketing, by advertising, and by branding, and a dedication to providing value-added products.

The consumer wants a fresh product, one that is easy to prepare. The retailing food industry is probably one of the most dynamic areas in the retail sector because there is so much we can do and so much we can offer that industry. With some of the things we have talked about here today, we could make a hell of an impact on the industry. We need to have na-tional and regional campaigns that will have an impact upon these areas. The campaign needs to be oriented to the particular region because what works in Texas will not necessarily work in New York.

Regionalize, take that opportunity, follow that through to the store and develop a message. Let the consumer see what you are doing. Tell her she is important and that you have her in mind. All these messages need to also be provided by the employees in a Kroger store.

We have to understand each other's needs. Without that we face some serious problems all over the United States. Interacting with you is an opportunity, one that we welcome because it gives us the opportunity to learn things that we need to know. It gives us the opportunity to meet people and to have an impact on something that drives our lives. We don't think we have enough information to make these kind of judge-ments. We don't know if the producer is doing well selling cattle today. We can tell you that last year we sold our fair share of meat. We sold 3 percent more beef last year than the year before. In chicken, 7 percent ahead of the year before. Ground beef, 8 percent ahead of a year ago. Fresh pork, 2 percent ahead. Lamb and veal, we about broke even. We're doing our best, better than national trends on the same commod-ities.

It's an opportunity to talk about a fresh product that is protein-based and can be the center of any meal in any home in the United States. We have an outstanding opportunity. Kroger had an outstanding year in beef. As a result of that we had an outstanding year as a corporation. Beef is extremely important to us. We are always looking for ways to help move the industry forward to the benefit of everyone, from producer to con-sumer.

Session 1: Open Discussion

QUESTION - For Gary Walters - In terms of sales of Excel beef, at the end of the week how much does that increase your store volume?

ANSWER - Gary Walters - That is very difficult to determine. It is a part of the 3 percent increase in beef sales during last year. We have Excel beef at some of our stores and the opportunity with Excel beef is in trying to get a consumer to try it once. For a new product it very rapidly develops a tremendous following because of the fact that it is aged slightly relative to other fresh products. It is an extremely consistent product. The packaging is superior. The color of the product hurts it a bit. It adds sales to the total department because of the recent employee charge to do something. Management is working in the area and has done very well in growth of value-added products. I think the answer to the question is more nearly not how much is done in force of Excel beef sales, but in force of total beef sales.

QUESTION - For Gary Walters - How do you handle the record keeping for a case-ready product such as the Excel product, and how do your prices and returns compare to your other fresh meat products?

ANSWER - Gary Walters - Obviously we pay more per pound than we do for a beef product that is not processed to the same extent because a lot of the trim loss is taken by Excel. You also add cost. Advertising the product costs. You need a different style of accounting if you're going to price Excel products. You cannot make as much money in terms of top line, gross profit with an Excel package as you think you can, compared to the product that is processed in-store. When you price an Excel product, you have to eliminate a number of factors. First, you eliminate labor in processing the product. You eliminate the cost of tray, which may not sound like a lot to you. You have to eliminate the storage of the product. We sell Excel beef at or below the price of the product processed in the store because we think we have identified those individual costs associated with trimming, packaging, etc. We have a spreadsheet that works with the price of the product and takes it from what we receive at the distribution center to the final case-ready product and you put all those costs together. Most of the time Excel beef is at or below cost of the in-store processed product.

QUESTION - For Jens Knutson - Some of these new product initiatives that we've heard comments about, is AMI addressing the desires on the part of retailers such as Kroger for new types of products?

ANSWER - Jens Knutson - Yes, but packers have to balance that part of their business that centers on commodities with that part that centers on service. I've said that offering a new product or a new service with no assurance of success is a risky business. It is a hard sell to retailers. It takes time to get it introduced. If a value-added feature catches on with the consumer, then Gary Walters is right. As acceptance grows, it is a good deal for packers and retailers and we could all make a bit more money. But, it is the retailer that has the direct contact with the consumer and the packers are having to work through the retailer/customer relationship to develop new ideas for different products in the fresh-meat case.

QUESTION - For Leo Vermedahl - How can packers, as you suggest, always buy or price the cattle on contracts at prices below the going market rate?

ANSWER - Leo Vermedahl - I didn't say that they price them lower, I said they price them at what they are able to buy the remaining part of the open-market trade. The formula in the contract may, in fact, give the seller of that captive supply more money. There's got to be some incentive in there. We have to recognize that trading cattle from one party to the second party by that cob-rolling method costs both parties money. If they are able to eliminate that trading process through some arrangement, they can both share in the money saved. In that situation, where IBP has made an arrangement with Cactus to buy their cattle, the arrangement is based on the remainder of the buy but it probably also has a premium. If it didn't, Cactus would not be selling their cattle to IBP. I didn't mean to infer that all the cattle purchased are purchased at a cheaper price. If they are able to pull down the costs of the remaining 40 percent, it does hold down the 60 percent in the marketing agreement also. It still could be a pretty good price to the seller.

QUESTION - For Leo Vermedahl - Are you confident that the differences in price are based on real and legitimate differences in cost of procuring these cattle and only on those legitimate differences?

ANSWER - Leo Vermedahl - I don't know what they are based on. I do know that not knowing everything costs money and if you're dealing with the known, there is less gambling and there is more money to be shared. I think it naive to say it is all based on knowing differences in the costs of procuring cattle. With the NCA Task Force, everybody we talked to in the beef-processing business, and more particularly in the poultry business, talked about wanting to be the low-cost producer to the extent they can. It helps if you become a more low-cost producer. If they eliminate some people, then it is identifiable that they are saving some costs, but to eliminate unknowns also reduces the cost. It is good for the industry. I don't mean to insinuate these arrangements tying up packer-controlled inventory are bad for the industry. It is frustrating for me compared to the way I used to do business and you have to understand if you're going to be in this business, you're never going to go back to doing it the way you did yesterday. We had an occasion to have a group meet with us at the NCA convention. Their goal was to back this industry up the way it was 10 years ago. It isn't going to happen and anyone who believes that is going to happen is not going to be here tomorrow.

QUESTION - For Jens Knutson - Would you react to what Leo perceived would be a problem or some frustration on a daily basis in getting his cattle sold?

ANSWER - Jens Knutson - I can appreciate his concern. Beyond that, I am not sure what can be changed to resolve his concerns. We have heard today that some reaction to major economic shocks had to occur and the result is fewer buyers for cattle feeders. But we need to keep in mind that those large firms are competing vigorously for cattle and Leo Vermedahl's prices, even with fewer bids, may be higher because of what has happened.

QUESTION - For Gary Walters - How important to Kroger's meat merchandising is the USDA quality and yield grading?

ANSWER - Gary Walters - We feel that government inspection and quality grade are certainly important. Consistency of quality to us comes up first and foremost, and the Choice grade helps. We also like to work with yield grading because of the obvious advantage to us in less fat cover and less trim from the better yield grade cattle. They are very, very important.

QUESTION - For Leo Vermedahl - Why don't you get more information and sell on a grade and yield basis where you can get the value for that carcass?

ANSWER - Leo Vermedahl - The problem is, historically, those that sell on the grade and yield basis are not paid for value. If they had been, the term "grade and steal" would never have been developed. For example, today it is difficult if you send cattle grade and yield to a packer without a pre-arranged situation. They will pay on the basis of the sheet, the Yellow Sheet plus two or three dollars. In reality, their buyers are working with what would be the carcass price plus $12 or plus $10. Carcass today is $1.13 for Choice beef and the boxed price is at $1.21. These buyers are probably carrying a $1.24-1.25 "hot card." That is what the buyers have to work with. Where is the difference made up -- drop credit. Drop credit is $80-90 a head. Traditionally, unless there is a pre-arranged arrangement, the packer has not been willing to pay a price that really reflects full value for the cattle. Change will come, through cooperation -- and that was emphasized here -- there needs to be cooperation to the different facets. If we are going to move toward value-based marketing, there will have to be a lot more trust between the cattle seller and the packer. Through the short 18 years I've had in the feedlot industry, it has always been an adversarial relationship.

QUESTION - For Clem Ward - This conference is about structure and structural-related issues. How does that fit within the context of what we've heard today of the possible foreign ownership of one of the major players and does this mean that we really should quit worrying so much about the domestic supply and demand and turn attention to the international arena?

ANSWER - Clem Ward - I'm not really sure why companies of foreign owners have bought the companies they have but I assume that they have some marketing plan in mind and expect a return on their investments. So, yes, they have a reason and I can't help but think that part of it has to do with tapping the international market.

QUESTION - For Wayne Purcell - What will happen to the marketing price mechanisms if we get involved in a very tight supply of cattle across the next few years?

ANSWER - Wayne Purcell - The need for numbers is going to be so great in the next few years that we effectively are not going to have discriminating pricing mechanisms for live cattle. I think some of the discrimination we will see is in terms of trying to generate better communication down through the system, and that is what we need. It has gone ways other than price, via supply arrangements, via contracts, etc. Your implication is that the cattle are in limited supply and that anything that walks is going to be in demand and I will agree with you. I believe it is a very difficult time to have an increasingly discriminatory pricing mechanism that truly prices to the value of what has been produced. There has been a lot of talk here today that in effect says that open-market price mechanisms historically have not brought the inter-level coordination that is needed. One of the reasons we have gone to coordinated/integrated structures, it has been implied, is because that inter-level coordination never has been achieved. I think that is true. With separate, independent ownership at every level in the system, prices are even less likely to effect the needed coordination given the tight supplies of cattle we will see the next 2-3 years. I think we are replacing the open-market pricing mechanism. The coordinating role is going to management control via integrated structures and contractual mechanisms and away from the price mechanism.

QUESTION - For Gary Walters - Can we increase the consumption for beef by creating more value-added products?

ANSWER - Gary Walters - Yes.

QUESTION - For Michael Hudson - How can we go about reducing that adversarial relationship that is in the system?

ANSWER - Michael Hudson - I think that everyone has talked about communication. I think the first step is communication. In the research community part of the need is to start working in the case study types of things and find out what the behavior is and what is actually happening out there. I think events like this help when I look at the mix of people in this room. There are people, hopefully, that are going to be talking today and tomorrow who don't normally talk. Communication is step one.

QUESTION - For Gary Walters - You said you liked to buy pretrimmed beef. Do you see that happening in the near future?

ANSWER - Gary Walters - Pre-trimmed beef is in our future. We feel pre-trimmed, pre-cut, pre-packaged beef, not necessarily case-ready, is in our future. We will see something that is tray-ready, a product that doesn't have to be cut in-store but is cut at some other point. The need is to get the beef in the case quickly and effectively, and we do see case-ready beef in the future for Kroger.

QUESTION - For Leo Vermedahl - If the packers would be interested in buying cattle with less fat, would you be interested in producing cattle with less fat? Further, is it not the case that we now see price being determined in terms of dressing percent, which may encourage production of fat?

ANSWER - Leo Vermedahl - The answer is dollars. When the proper signal comes through economic return, each segment of the industry would do what was best for them in terms of dollars. As long as the retailer is willing to accept a yield grade 3.9 Choice carcass and pay as much for it as they would for a yield grade 3.0, the proper signal is not being sent. At some point the packer may be willing to sell yield grade 2s consistently. If that is what the retailer wants and will pay more for it, the packer ends up making more net. If he turns around and wants to buy them from me and pay what the additional value would be or some part of that, then yes I'll produce them. I will then send a signal back to the cow-calf man and he will breed them. Until the economic signal is sent, it won't be done.

QUESTION - For Leo Vermedahl - During your comments earlier, I believe you were saying that the economic signal was even weaker on forward transactions than it is on spot transactions. In fact, you said that packers will actually pay $79 for a larger range of quality if it is 3-4 months in advance than it is the case of a same-day sale. Is that what you were saying? If so, why does that happen?

ANSWER - Leo Vermedahl - I'm not sure why it happens, but it happens. Generally, people that I deal with, as they set out to contract cattle for future delivery, are for the most part contracting on a basis contract. Their buyers are sent out to contract cattle for a particular month and until they get some percent of the cattle they want to contract, their basis offer is pretty good. If they have a lot of takers, they reduce the basis. My observation has been that when they come with that offer, they are willing to accept a wider range of cattle than they would if they had a particular price for the cattle that are ready. Part of it is they can't tell as much when you have cattle that are four months away from being ready for slaughter. You can't tell what the true value of those cattle is going to be in terms of cutability, in terms of grade, or in terms of particularly yield -- and here I am talking dressing percentage. They play the averages more at that end. The packers are willing to play the averages. We as sellers all sell most of our cattle within a $.50 range and we don't like that. But that fits the pattern very well because the packer is dealing in averages too. The packer is willing to work on averages and we are willing to sell on averages, but it doesn't send the proper signals.

COMMENT - Michael Hudson - There is an issue of risk here. Granted, four months out you have less idea what they are going to look like, but you're deciding now what you are going to pay for future supplies. You can use the financial markets to transfer the risk. It may look very realistic when you see it as a business decision or an investment in inputs for a future time period.

QUESTION - For Michael Hudson - Do you have an opinion on where in the food channel is a responsibility and a need for acting on the food safety issue rests?

ANSWER - Michael Hudson - It is the responsibility of the entire system. There is a major education need on this issue. Society has to decide how much risk it is willing to take and every level of the food system needs to understand it is their concern. A "scare" may appear to be hurting only the producer of apples or the importer of grapes from Chile, but it actually is hitting at the economic future of every member of the system. We need education and guidelines.

QUESTION - For Michael Hudson - Do we talk with the USDA since they oversee everything and then do they talk back to the industry?

ANSWER - Michael Hudson - I think that right now, we're playing volleyball. We don't know what the real issue is and we are not yet doing a good job of coordinating a plan of action.

SECTION 3

Session 2: Outlook in the Legislative and Legal Arenas

by

Congressman Dan Glickman
Member, House Agriculture and Judiciary Committees, Washington

Sanford Litvack
Attorney, Dewey, Ballantine, Bushby, Palmer, and Wood, New York

REVIEWS: Anthony Nanni
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Calvin Watkins
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OPEN DISCUSSION

Session 2: Legislative and Judicial Overview

Congressman Dan Glickman

I came into Congress the same year as David Stockman. He worked for President Reagan. He told me that the first time he ever went home to his district he addressed his local Rotary Club in Benton Harbor, Michigan and he was introduced the following way: "And now folks, let's hear the latest dope from Washington." So, that's what you have today. I know there are a lot of folks in this room who are much more expert than I am in the intricacies of the marketplace and of the livestock industry, whether it's beef or poultry.

I'm reminded of the story of the two dairy cows that were standing along the country road talking to each other and grazing. All of a sudden, as they were sitting there relaxing and grazing, a milk truck drives by. On this milk truck in big red letters written on the side of the truck were these words: Standardize, Homogenize, Vitamin Enrich, Good For You. And one dairy cow looks at the other dairy cow as the truck rolls by and says, "Well, kind of makes you feel inadequate, doesn't it?" You all certainly have more expertise than I do. From the standpoint of my interest, as Wayne said, not only am I an active member of the Agriculture Committee, but I am also a member of the Antitrust Subcommittee of the Judiciary Committee, the only member to serve in both capacities. I'm going to talk a little about foreign policy at the end of this because I think it has some relation to some of the more mundane but serious antitrust issues.

I have an interest in this issue. I spoke to this issue when I was at the American Meat Institute meeting a couple of years ago. What I basically said there was that the levels of concentration may not be per se bad, but they are causing us to sit up and take notice of what is happening, not only in the meat industry but in the food industry generally. My own state of Kansas is the leading state in the country in beef processing and packing. We have overtaken Texas, we have overtaken Iowa, we are number one in beef and therefore we have seen a lot of this concentration take place in our own state. In addition to and because of that, I have talked to farmers and ranchers over time. I am aware of the National Cattlemen's Association efforts. I've seen the Task Force report and their interest in this issue has raised it's visibility. If producers of agriculture, farmers and ranchers, are upset about this issue, there will be a legislative interest in it. We don't really get interested in it from an abstract point of view, but we get interested in it from the point that our constituents care.

The first constituents who would care would be cow-calf operators, ranchers who might see themselves victimized by a marketplace where there are fewer avenues for them to sell their livelihood. We've heard a little more of that recently. I must say that there is not a flood of concern or crying, but there is more concern than there was five to ten years ago about the ability the cow-calf operator, or the ability of your typical farmer with cattle, hogs, or poultry, to have a fair process at which to sell his product in the marketplace. So, those things are a political fact of life.

Yesterday there was talk about the statistics, about the variety offered by the packing industry, and about the beef production industry that is controlled by a smaller number of firms. I think it is worthwhile talking about it, not only in the livestock sector, but in the food sector generally. It is obvious that the livestock sector has 70 percent of fed steer and heifer slaughter controlled by four firms compared to around 30 percent 10 years ago. When you consider that we have the consent decree just 50 to 60 years ago where we had more firms controlling even a smaller percentage of the markets, these numbers are rather significant. Seventy-seven percent of the sheep and lamb industry is controlled by four firms, and we've heard it was 56 percent 10 years ago. Seventy-five percent of the boxed-beef industry is controlled by four firms and we've heard it was 50 percent 10 years ago.

In addition to horizontal integration, there is growing vertical integration in the industry. Packing firms are going to forward contracting with producers and beginning to move into branded products. In short, the boundaries of the beef industry, and the food industry to some extent, are moving in both directions, both horizontally and vertically. Now the food industry is also involved. Even though the focus of this conference is livestock and meat, the real issue is the food industry, especially when one considers that the four largest firms in meat are also in other foods.

Concentration in the food industry is growing as evidenced by the following four-firm concentration percentages. In broilers, it was 40 percent in 1988 compared to 22 percent in 1979. Turkey was 30 percent in 1988, but I don't have numbers back 10 years before. Flour millin was 53 percent in 1987 compared to 38 percent in 1977. Soybean processing was 72 percent in 1989 compared to 54 percent in 1977. Corn milling was 74 percent in 1982 (most recent numbers) compared to 63 percent in 1977. Now statistics alone may not reflect exactly what is happening out there in the country, but these are extraordinarily interesting. The level of concentration generally in the food industry, particularly on the raw side of the picture, is a market fact in this country's economic cycle that we are in. Talking about the food industry generally, since 1981 there have been 160 mergers and acquisitions in the food industry. The trends are there, and I guess that one of the questions is, "Should we be concerned?" Is this a natural phenomenon that is occurring that deals with the realities of the world when we are in a world market and we have to deal with government?

The trends in the livestock and the food industry, however, track general merger and acquisition trends in the economy in general. We have to view this in the context that it's happening everywhere in our society, and those trends have caused very large corporate debt loads, leaving companies able to only service that debt and not expand into research. It caused short-term corporate planning to meet debt requirements, not long-term strategic investments largely for fear of being taken over by somebody else. I think the trends here caused an increased concentration of economic power. Some say, however, that the U.S. industry, the food industry, has to streamline to be competitive in the world market. I also know that the weak demand for red meat in the 1970s led to dislocations in supply, causing some of these mergers to take place. Companies couldn't survive with that lower demand without somehow combining.

There are understandable reasons why it's happened and we also have very low historic profit margins in the food industry. These very low historic profit margins caused people, when there are changes in the world and dislocations, to merge. When you're making a 1 percent or half percent or one-tenth percent of gross sales, anything can dislocate your business, and there are reasons why the consolidation occurred. What should the government do? Nothing? Should we step up with very, very active antitrust enforcement? Well, I think there are some historical things to look at here for a minute.

In 1988, the Subcommittee on Judiciary held a hearing on the whole issue of mergers and concentration of the food industry. As you can imagine, there were diverse opinions. Some of the statistics were interesting. During the period 1981 to 1984, only 6 percent of large food manufacturing acquisitions were challenged by the Justice Department even though concentration in food manufacturing was increasing. During the 1960s and 1970s, Professor Willard Mueller of the University of Wisconsin calculated that the Department of Justice and Federal Trade Commission challenged roughly 24 percent of all large food manufacturing acquisitions. One out of four acquisitions was challenged, not that it was stopped. It was reviewed and challenged in a much more poignant way than what happened certainly in the 1980s. Professor Mueller also documents, and this again is from the records of the subcommittee hearing, a corresponding increase in profitability in the food industry. Right or wrong, his testimony says that in the year 1987, consumers paid between 26 and 29 billion dollars in overcharges because of the lack of competitiveness of the food manufacturing industries. I don't know if Professor Mueller is right, but that kind of testimony of nearly 30 billion dollars of overcharges to the consumers caused the Congress to sit up and take notice.

Is there a problem? If there is, let's take a look at it. There is no question that the philosophy of antitrust enforcement during the Reagan years was very lax and I think I'm being charitable when I use the word "lax." There was a focus on criminal activity. That is, they would go out and bring criminal cases against two companies who Justice or FTC could prove, through pretty well documented evidence, had engaged in a price conspiracy. Most of these were small cases where the Sherman Act could actually prove, without a doubt, that two companies or industries got together and actually set prices. They had merger guidelines and they believed that the merger guidelines had wide influences and that was basically enough for them. All this was accompanied by a general philosophy permissive of business expansion and consolidation. The general feeling, I think, underlined by the "Chicago School of Economics," was basically survival of the fittest. If the company could grow big and merge with other companies and be more efficient, then the marketplace should work to let that company become more efficient even if it meant less competition.

Efficiency became the guideword for mergers, not competition. And that presented, in my judgement, a change from what we had seen particularly under the Ford years and under the Nixon years which were a more aggressive period in terms of antitrust enforcement than were the Reagan years. Now, what is the Bush administration likely to do? I have a speech Jim Rill, who is the Assistant Attorney General for the Antitrust Division, made back in November. He talks about some of their goals. On paper, at least, it does not appear they are going to make a significant change, although he talks about the department's commitment to criminal enforcement will continue to be a top priority. He does say no industry should be exempt from criminal enforcement. You may see the Justice Department taking more aggressive action on the criminal side of the picture. He does say that the Department will undertake an equal commitment to merger analyses. Implicit in his statement is that enforcement of antitrust statutes is going to be tougher than it was during the Reagan years.

There is thus not a lot of difference from the Reagan years in terms of their public position. But I think you will see the Justice Department much more aggressive in the merger area than you saw during the Reagan years. It's difficult to know what it will mean specifically, but I think that these folks are much more sensitive to what people are saying out in the countryside. You know people in the countryside are saying that this merger is staggering competition and you better look at it. I think the Bush Justice Department will be much more prone to look at it than was the Reagan administration.

Now what about Congress, what are we likely to do? Well, we have a new Chairman of the House Judiciary Committee, Jack Brooks, from this great state of Texas. He is a mean chairman. When it comes to antitrust policy, he is one tough cookie. Our previous chairman Steven Robino was a very nice man, made his fame during the Watergate era, but quite frankly he was not as assertive a chairman in terms of making policy. Brooks will be more assertive. That may make Congress more prone to getting involved and push the Justice Department in some of these cases. On the Senate side, Senator Biden, Senator Messenbaum - there is an aggressive streak over there as well. I suspect you will see Congress at least more interested in antitrust issues and more interested in what the Justice Department does on antitrust issues than we have seen before.

At this stage, I don't see us making any substantive changes right now as I speak today in the Clayton or the Sherman Acts to make a fundamental difference in the ability of the Justice Department to move ahead on some of these cases. That doesn't mean it won't happen, but I frankly think the general feeling is the laws on the book are still fairly adequate. The question is whether there is commitment of the administration to look at these mergers and determine if they are in the national interest and whether competition is fostered. I do think, however, that we will press the administration more and more on the basic theme: Is competition fostered by this merger, rather than looking at the efficiency gains of the 1980s? I actually can't ignore both, but I tend to think that what is happening is there has been a tendency to not consider the two together, to think that one is mutually exclusive of the other. That is just not the case at all.

In terms of what we will do, the best answer is "we're going to monitor mergers." We're going to see how the Justice Department does in enforcing the Clayton and Sherman Acts and the other antitrust statutes. We will reserve judgement on whether we need additional legislative action. I still suspect that these laws are adequate on their own and we probably don't need any fundamental change in antitrust laws. We may need to look at the securities laws to see whether they are compatible with the antitrust laws.

I go back to a couple of things. We will probably do a lot more oversight work into issues. For example, are our cow-calf operators being given adequate access and good reasonable pricing decisions to sell the product? Are we developing an American kind of feudal system of owning and marketing livestock and having to belong to an organization vertically all the way to the top in order to really have access to sell your livestock in the marketplace? In terms of the retail side of the picture, we are going to continue to look at the whole issue of pricing and competition to see that it is working. I think the key will be oversight and the key will be watching both the industry and the administration to make sure that they are complying with the law and that they are actively enforcing the law. That is about all I can tell you right now. I don't see us in the game at this stage of making major modifications in antitrust laws that would affect the subject matter that we are talking about today.

There is a growing feeling in this country that some of the industries that have been fully de-regulated and have been made separate, apart from the operation of a variety of laws, including antitrust laws. Well, we may have gone too far. Whether it's the airlines, other transportation industries, or financial services -- banking, savings and loans, credit unions, or securities markets -- it could be that we went too far in our zeal to "get the government off their backs." The public interest may have not been protected in that process. So, I don't think you can view this issue as a separate issue apart from the larger issue of what the role of government is to protect the consumer from things that they cannot protect themselves from. Whether it's in the health and safety areas, or the kinds of things you all face every time you fly, I think that these issues have to be viewed in a larger context.

Let me talk for a moment about the 1990 Farm Bill and how it relates to all of what we are talking about here. I think it is going to have some significance to some of the issues you are dealing with. A lot of you folks are big in the food business and you will be very much affected by this Bill. I don't think, in terms of the basic thrust of the Farm Bill as it relates to the world and relates to how you compete with the Europeans, the Canadians, and others, that there will be a fundamental change in 1990 in terms of agricultural policy. I think we understand where the goal must be now, that we cannot have a farm policy that removes us from the world market. We must do our best to have a free flow of goods between countries and among nations of this world.

The fundamental push of the 1985 Farm Bill was to make us competitive in the world. I suspect that we will continue that push. We will not have any mandatory supply management programs and for the most part we will continue with what we've had. However, saying that, I think you have to recognize a couple of things. Since 1900 but more recently since 1950, we have seen a rapid depopulation of rural America. Rapid. To give you one example, in 1940, my state had 8 members in the United States Congress. Kansas will have 4 in 1990 because of reorganization. That is happening all over. I think North Dakota has fewer people now than they had during the depression, the only state in the country where that is the case. You're seeing members of the Congress lost in rural areas. Iowa is going to lose a Congressman, Illinois is going to lose one or two. There are other reasons for that, but part of this is rural population loss.

One of the things that has struck me as we debate this 1990 Farm Bill: Can we do something in this Bill that tries to allocate or target what farm relief we provide to those people who are what I call, mid-sized, family-sized producers, without interfering in the international marketplace, so as to try to move into rural America and stop this trend toward larger and larger operators? This is a real trap. You talk about it, you look at it, and you see what is happening out there. We do have what's called a $50,000 payment limit in the law now when it comes to the farm commodity program. If you're a cotton, wheat, or corn producer the maximum dollars you can get in terms of a check from the government, a subsidy check, is $50,000. You can get loans -- commodity loans -- in amounts greater than that, but the actual subsidy you can get is $50,000. There was an attempt by Congress a few years back to try to make sure the large operators didn't get it. The farmers and ranchers and people in agriculture in certain parts of this country, not all but certain parts, really began the process of reorganizing their farms to get around the $50,000 payment. You have this reorganization that occurred largely in rice and cotton country, but it occurred all over this country where a farmer would sub-divide his farm into farm a, b, c, or d in order to get $50,000 for each farm. This was referred to as the Mississippi Christmas Tree because it was done in Mississippi first, quite successfully in cotton country. It was done in a lot of places in the south, in California, and in the Plains area.

What we found out, with that and with everything else, is that we are still allocating a very large percentage of our resources in agriculture to a very small percentage of producers. That has, I think, encouraged the trend for more and more consolidation in agriculture. One of the things that we are going to talk about is to try to see if, without trying to change the loan rates dramatically, or without affecting the world market, try to take the dollars that we have and allocate them to the producers who fit that mid-sized category. By that I mean a farm that has gross sales between

$100,000 and $500,000 a year. That doesn't mean that the people above it wouldn't get help or people below it, but allocate much of it to that mid-sized group.

There are several ways you can do that. You can basically have a dollar sales test. That is not one of the most popular things in Congress, but that is one possibility. Another possibility would be allocate a higher target price on the first bushels of production so that the more you produce, the lower your target price, and your subsidy payment would be on per bushel basis until you reached the $50,000. The goal is to try to figure out a way we can send a signal out there that is a matter of social policy. We would like to re-populate rural America and the best way to do it is to make it more productive for the farmers that stay involved in agriculture. I admit to you it is a little bit of social engineering, but that is what farm policy has been about for many, many years. There's no reason not to be honest about it.

In my state we go from county to county and they can't keep a hospital alive, schools are closing, and you have people that are without services. That's not the way we want this country to be. I think a good strong rural America is important for the political and moral future of this country. Our farm policy should be geared as much as we can so it will not mess up the rural marketplace. There is always a tendency for policy makers to do that. I don't want to do that. There should be a way to do this, to try to help these folks in rural parts of the country. I think that is going to be a theme, trying to target payments to mid-sized, family-sized producers, however you define it. It is also a theme that speaks of a larger issue which is the general feeling that maybe we have gone too far with the whole issue of concentration, of economic forces in this country, of mergers and leveraged buyouts and the dollars flowing just to make fees on deals put together without serving necessarily any economic purpose. We have to say "whoa" to that. We have to slow down. What's the best way we can restore competition to this country?

I will close by saying this: I believe very strongly again in the wisdom of the economic marketplace as I watch these people in Poland and in Czechoslovakia come down and talk to a joint meeting of Congress. The President of Czechoslovakia on October 22, 1989, was in a prison in Prague. On December 22, 1989, he's President of the country. Imagine this kind of thing. The messages you see coming out of there, in addition to basic issues of freedom, is how competition works. Competition for ideas and competition in the economic marketplaces does work. It may not produce the most efficient operators in the short-term, but in the long-term it usually does. I guess my message today is: As we approach some of these issues, we have to preserve the American model of competition. It works, it's what has made this country economically vibrant. I hope that we will use our antitrust policies to, in fact, reinforce that.

Open Discussion
Questions to Congressman Glickman

QUESTION - Should Congress take a closer look at the area of vertical pricing and other related areas?

I do think we should take a closer look, I just don't have a legislative solution right now in what we should do. We did pass a bill in the House to basically enforce laws dealing with resale price maintenance which basically makes it unlawful for a manufacturer to set prices on what consumers will have to pay. They can discriminate against other retailers who do not honor that suggested price. Quite frankly, we had some opposition from the Justice Department because they thought the "rule of reason" should be applied and there shouldn't be a violation. I just don't know specifically in this area what precise changes in the statutes we should make. Maybe what we should do is have some suggestions and put a little uncertainty out there in the marketplace so the people would then know if you're not careful we might prosecute more vigorously certain kinds of things. But I just don't have any precise language.

QUESTION - Do you anticipate Congress holding hearings on this issue of structural change in the livestock sector this term?

I don't know on the hearings. We had one in 1986. There has been a tendency for people in the agricultural sector to not want to raise this issue. The National Cattlemen's Association did raise it. In the issue of livestock pricing, unless somehow you get consumers' welfare actively involved, it is difficult for me seeing this issue raised right now to the point where we would actively be seeking legislation. I don't think that is going to happen. I am, however, going to encourage the Chairman of the Judiciary Committee to hold oversight hearings, not only as to the operation of the Justice Department's antitrust division, but to continue to look at various industries in America. Airlines, for example, should be the focus of continuing antitrust investigation. You talk about transport concentration and for example, reservation systems, that is one of the big issues. Who runs these reservation systems? It doesn't matter if you have 22 airlines if you have one reservation system that has 90 percent of the marketplace. They are going to guide you into the areas where reservation systems point you. I think we should look at the airlines, we should look at the food industry, and continue to look at it in terms of antitrust policy and from the oversight point of view of economics of concentration in the food industry. I think we probably should look at the financial services industry as well, and finally at health care. I think we should look at it, but at this stage I don't see a legislative initiative on the horizon. I don't think it's going to happen.

QUESTION - What are your views on the conservation reserve?

Does everyone here know what that is, the conservation reserve? I'm supportive of the reserve. I think it has been a profound effort to try to protect the soil and water of this country. I think in certain parts of the country we have removed so much of the land from production that we have had an economic impact. I think that when we rewrite this Farm Bill, what we probably will do is take a look again to "limit" the amount of land that can be taken out of production in the reserve program in various regions, or counties of this country, and deal with this issue of what land is in reserve and how it comes out of the reserve. That has not been dealt with very precisely and we're going to have to deal with that because of fundamental issues of supply and demand in this country.

Session 2: The Legal Perspective: Prospects for the 1990s

Sanford Litvack

Most of my talk will be a review of where we are in the antitrust area and some thoughts on where we likely are going. Nine years ago in 1981, I was lucky to be able to guess, with some degree of accuracy, what the antitrust trend would be in the 1980s. Trying to guess what that trend will be over the next 10 years is a much more difficult task.

At the outset, it is well to remember that antitrust attitudes like so many other things are, in truth and in fact, a reaction to the general political and economic environment in the country. Antitrust law and the antitrust statutes are, when all is said and done, really a compromise between, on the one hand, a total laissez-faire policy that would permit competition on the basis of survival of the fittest and, on the other hand, an economy strictly regulated by the government. The antitrust laws represent an intent to legislatively balance those two. Having attempted that, if you look at the framework of legislation, it is interesting how it has developed.

Take a moment and consider the evolution of the antitrust laws. The Sherman Act goes back to 1890. It will be celebrating its 100th birthday this July. The economic backdrop to its adoption is instructive. It was an era of big business cartels, the Carnegies, the Rockefellers, and others. So, what do we do? We passed legislation -- the Sherman Act -- which makes it a crime for anyone to enter into any contract, combination or conspiracy which will restrain trade and commerce among the states or in foreign commerce. The whole notion was that business had gone too far; cartels had grown and it was important to impose laws restricting them.

A few years later in 1914, along came the Clayton Act. The notion again was: "Strengthen the antitrust laws. Business must be regulated further, we have got to make certain we are controlling it more." The next major piece of legislation, passed in 1936 when the U.S. was in a major depression, was the Robinson-Patman Act. This legislation said something very, very different. It said: "We now are concerned because small businesses are being hurt. Big businesses are being able to obtain price concessions from suppliers. Let's make sure that they can't do that anymore. We'll pass the Robinson-Patman Act." With many exceptions, the Robinson-Patman Act in essence says, "Thou shalt not sell to competing purchasers at different prices -- where the effect of the discrimination would be substantially to lessen competition." This was a very different approach from the Sherman Act.

As we moved into the 1970s, we had Watergate and the reaction again was concern about business and a move to increase the penalties under the antitrust laws, increase the enforcement, do away with certain exemptions. As we hit the 1980s, the mood again changed and, as Congressman Glickman put it, the goal was "getting government off the people's back." That slogan helped elect Ronald Reagan twice with increasing margins. What does the slogan mean? It means -- take a step back, it means less intrusion, it means more laissez faire -- and that is what we have had.

Let's talk about that movement as it affected this industry, the kinds of decisions that were made, and the kinds likely to be made. Before turning to that, I'd like to make two comments. First, I have known Tony Nanni for about 20 years and I told him I obviously would be taking a swipe, as I have many times, at the Antitrust Division's performance from 1981 to 1988. That is not directed at Tony. Rather, it is a philosophical disagreement with certain former heads of the Division. Second, I am sorry the Congressman had to leave for a moment, but I'm always somewhat amused -- and Congressman Glickman is one of our best Congressmen -- when I hear a Congressman say in a response to a question of what should we do that "We should look at it." We've been looking and we keep looking. Congress has looked the last eight years and I suspect they will look for the next eight years. I just wish they would raise their hands when they see.

Having said that, let's talk about what has happened in antitrust in the 1980s. We can start with mergers and look at how we got where we are, what we're concerned about, and why we care. Why does anybody care? The truth is there is a lot of dispute as to why we care, whether we should care, and how much we should care.

The merger laws, as we know them, are relatively recent. They came about in the 1950s as a result of the passing of the Cellar-Kefauver Act. So we are talking about legislation, as we currently know it, that is just about 40 years old. Up till then, if you wanted to challenge a merger, you had to do so under Section I of the Sherman Act.

The Sherman Act, as you recall, basically prohibits contracts which unreasonably restrain trade and commerce. Congress was concerned that the standard, which required showing an actual unreasonable restraint on interstate trade and commerce, was too difficult and too many mergers could slip by. As a result, Congress amended Section 7 of the Clayton Act to provide, in essence, that any merger which has a tendency to substantially lessen competition or create a monopoly in any line of commerce shall be unlawful.

When they passed the legislation, Congress made it quite clear that their view and purpose was to pass a statute, which as they put it, was an insipiency statute; i.e., let's nip potentially anti-competitive mergers in the bud. The goal was to prevent mergers which were likely to substantially reduce competition before they happen.

After the law was passed, it took a number of years -- about 11 years -- until the Supreme Court had an occasion to consider what it meant. In a landmark decision in 1961, the Supreme Court set forth some guidelines. They tried to define a "line of commerce," and they gave guidelines as to what it meant by "likely to substantially reduce commerce." In so doing, the court focused on concentration and Congress' intent when amending Section 7. In substance, the Court said the following: Congress was concerned with the trend toward concentration for a variety of reasons and it, therefore, adopted a statute which was designed again to look forward, not wait for a result, but be able to anticipate one. Concentration became the buzz word and the test became trying to figure out if there was going to be undue concentration as a result of a proposed merger.

The first question is: Why do we care about concentration and what difference does it make? The answers are as varied as the people who have looked at the issue. During the 1980s, certainly during the past 8 years, the answer has been a very narrow and focused one. We care about concentration only, when, and if, it will either (1) materially facilitate collusion (in other words, there will be so few people that they can collude to fix prices more easily among each other), or (2) firms will have aggregated so much market power that we should be concerned. Until we reach those levels, the view recently has been that we are not concerned about concentration.

At the other end of the spectrum, looking back into the 1960s, the courts were concerned with concentration because, they believed, there was benefit to having a multiplicity of firms -- competitors -- in the market. Hence, lower levels of concentration were a concern. Current thinking, during the Reagan years, has been that there is no inherent benefit in having a multiplicity of firms and the only goal of the antitrust laws, as Congressman Glickman said, was efficiency. As long as it is efficient, it is good. Other people have suggested that is not so, arguing that there are an array of goals: innovation, competition broadly defined, etc. This kind of debate has been an ongoing debate over the years.

In the 1960s and into the 1970s, the government brought a series of cases designed to "nip," at the outset, mergers which they perceived to have potentially anti-competitive effects. The government's track record was phenomenal. The record was indeed so phenomenal that one Supreme Court Justice said the only consistency he could see in the Court's decisions was that the government always won.

In 1968, as we neared the end of the Johnson administration, the Antitrust Division published its 1968 Merger Guidelines. During the Johnson administration, business firms had complained that there were no concrete guidelines, and, hence, the administration charged the Division with the responsibility of developing guidelines. The Merger Guidelines were the result. The Guidelines identified three kinds of mergers of concern: (1) horizontal mergers, i.e. mergers between competitors, (2) vertical mergers, those in a vertical chain, and (3) conglomerate mergers, those between companies who are not in the same lines of business. We had experienced a wave of conglomerate acquisitions in the late 1960s and, hence, these kinds of mergers were part of the Guidelines.

The Guidelines, following the Supreme Court cases, basically focused first on concentration. Is the industry concentrated, or is it not? If it is already concentrated, then we are much more concerned about further concentration. If it is not concentrated, then we are less concerned. To determine whether a market was concentrated, two different standards were applied: the so-called 4-firm and 8-firm concentration ratios. The issue was the percentage of sales controlled by the top 4 firms and the percentage held by the top 8 firms. The Guidelines established levels for both of these ratios and, depending upon whether the result yielded a "concentrated" industry or not, it established market share levels which would lead to an attack. By way of illustration, in a concentrated market, a merger between companies each of whom had 5 percent of the market would, under the Guidelines, be challenged. Just think of what that means. No one would even suggest that today. Remember one other thing that often gets lost: these Guidelines, whatever they may mean to the Department of Justice at any given point in time, are at most standards by which the Department of Justice has said it will assess whether or not it will challenge an acquisition. I emphasize that because it is a far cry from saying a merger is illegal. The fact that the Department of Justice or the Federal Trade Commission challenges a merger means one thing, and one thing only, that they *think* the merger is illegal. The courts may have a different view and, in fact, from 1974 until the early 1980s, the government lost most of their cases. Why? Because the courts did not accept a lot of the government's arguments. Remember, when we talk about guidelines, we are talking enforcement policy, we are not talking legality. They do not have the force of law. A court can adopt them or reject them. The court must apply standards consistent with the case law and, hence, the Guidelines are often ignored.

The 1968 Guidelines were thus reacted to differently by different groups, but in general, they were widely accepted. They did have an impact because business firms did not want to be challenged by Justice or the FTC.

In the 1980s, we had a political and economic revolution in this country and antitrust was one part of it. We had a change in philosophy. The philosophy became one of extreme laissez faire -- let's leave business alone. The premise behind that concept -- and it is an economist's premise -- is that if you just leave it alone, everything will be okay, and the reason everything will be okay is because businesses will always act rationally -- at least as the economists saw it. In 1981, the so-called "Chicago School" economists took over the Department of Justice and Assistant Attorney General Bill Baxter, who was clearly of the Chicago school economists, decided to redo the Guidelines and come out with new ones.

You heard Congressman Glickman say that the Administration believes that the 1982 Guidelines themselves have inhibited a lot of mergers, but I believe that those who have advised clients, such as Assistant Attorney General Rill, know better. The fact is, the Guidelines were designed to be permissive. While they did not permit all mergers, they were designed to deliver the message that the government was taking a step back and would be more permissive and less intrusive.

The antitrust message for the 1990s with the appointment of Jim Rill is, I believe, very different. It says we are going to change the rhetoric. We are not going to simply continue the last eight years, we are going to make some changes from the prior Administration's view that the marketplace can and will work without vigorous merger enforcement and that the antitrust laws are, in the merger area, mostly an impediment.

During the past eight to nine years, antitrust was not alone in terms of placing enforcement on the back burner. Congressman Glickman referred to the SEC. They took a large step back and seemed to operate on the notion that what's good for Drexel-Burnham was good for the country. One has to wonder.

Returning to the 1982 Guidelines, they are relatively simple and there really aren't a lot of differences between the levels in these Guidelines and those in the 1968 Guidelines. The 1982 Guidelines use words like the

Herfindahl Index, the HHI, instead of concentration ratios, but if you look at the measures they are not materially different. So, too, when you look at the various tests to be applied, they are not materially different from the 1968 Guidelines. But, the key issue is how they are implemented.

What has happened? What has happened is an unparallel wave of mergers during the 1980s. Not all the mergers had antitrust implications, of course. Indeed, the biggest ones, the LBO's that we have all been scratching our heads about and saying that maybe we went too far, generally had no antitrust consequence one way or the other. They were driven by different kinds of motives, largely the notion that there was more money to be made.

What was antitrust doing all this time? The answer has to be "very little." This livestock/meat industry is one of the examples of where "very little" was done by Justice. In 1987, I believe it was, I found that the Department of Justice brought only six merger cases. Since it is hard to believe that there were only six cases that merited action, the question arises as to why there has been no enforcement.

To answer that question, let's look first at the Guidelines themselves. The Herfindahl, or HHI index, is used to start the process. If the HHI is under 1,000, then the industry is considered a very unconcentrated industry. If the HHI is between 1,000-1,800, it is considered a moderately concentrated industry. Finally, if it is above 1,800, it is considered a highly concentrated industry. This is the objective standard that is applied. The Guidelines then tell you that in order to determine how much more concentration there will be after the merger than there was before, you take the market share of each of the companies involved in the merger, multiply them by each other, and multiply the result by 2 -- and you get the increase in the HHI. What the Guidelines tell us is that if that difference is under 100 and the HHI is between 1,000-1,800, it is unlikely that the Department of Justice is going to challenge the merger; if the HHI is over 1,800, and the difference is at least 100 -- and in some cases 50 -- it is likely that they will challenge it. That's what the Guidelines tell us.

The Guidelines, however, inject two other factors that are very important because if you apply just those numerical criteria, you would expect more than six cases to have been challenged in 1987. There are two other factors, "fudge factors," and they are: (1) how you define the market, and (2) ease of entry. How you define the market is pivotal because, for instance, if you define beef as a separate and identifiable market, you would yield one level of concentration. If you define the market as everything you eat, and beef is just a part of that, then there would not be a very high level of concentration from that merger of two beef firms.

Apart from market definition, you must consider ease of entry. If anybody can enter the business relatively easy, then it is argued that we do not have to be worried about concentration because people will come flowing in if the existing competitors raise prices. Those are the two biggest loopholes, escape valves, through which most mergers go. If a merger is not challenged, you may be reasonably assured that it is one of those two factors -- market definition or ease of entry -- that is the reason.

One brief word about market definition which, I suspect, is of critical interest to you as you reflect on what has happened in the beef industry. The Guidelines provide that markets are defined by picking products, aggregating them together, and saying: "If I had a 5 percent price increase that lasted a year, what other products would people turn to?" If they would turn to other substitutes, then those products to which they turn would become part of the relevant market and the market must be expanded. Remember, the test is a hypothetical 5 percent increase over a year, and the question of what products people will shift to.

In looking ahead, it is clear that the direction of the Department of Justice is related to the posture of the current administration and the appointees that will direct Justice into the 1990s. What will largely impel antitrust enforcement in the 1990s is really the economic climate. While no one knows, I suspect in the next 2-3 years we will see two phenomena: (1) there will be a reduction in the amount of mergers that are occurring for simple economic reasons, and (2) if the economy continues to have its problems and if the financial institutions are as hard pressed as they seem to be, then there will in all likelihood be a popular backlash with a call for invigorated antitrust enforcement.

The finger-pointing that will follow will, I believe, be in the direction of big business, mergers that have occurred, alleged price fixing, restricted practices in vertical distribution, and a whole host of things. Therefore, expect that you are going to see a period of marked antitrust enforcement starting in the next couple of years.

Review: Anthony Nanni

In evaluating a merger, the threshold question is whether concentration within the industry will or will not be increased substantially. Our concern increases as concentration levels increase, as measured by the Herfindahl index. There is no magic in the Herfindahl index -- you can use any index. The Herfindahl index totals the square of each firm's share. You see greater effects when, as the market share goes up, the square goes up. The use of "squaring" really shows big effects when there are few sellers in the market. It is theoretically more accurate than just taking a straight share index but it doesn't matter what index you use. It's the level of concentration that I think justifiably causes concern. High concentration levels cause concern of purchasers and they cause concern in the antitrust field, because concentrated markets, as a general proposition, are not competitive markets. We like competition, we are competition advocates.

The concentration level is only the beginning point in merger analysis. There is just as much debate after concentration levels are calculated as there is before. What does a given level of concentration mean in an industry? There are several issues that emerge, and the barriers to entry question that Sandy Litvack mentioned is one. Clearly, if you have easy entry competition can be intense even with higher concentrations. The debate is whether there is easy entry. Lawyers are very creative on making arguments about entry to us. We have enjoyed dealing with Sandy, both inside and outside the antitrust division, because he is a wonderful advocate. We try to get the best information we can to make the best judgements on every issue. As a theoretical matter, if entry is very easy then if sellers try to raise the prices above competitive levels, new firms would come in. There is usually a debate whether entry is really easy or not and that is a subject for another day. Nevertheless, the entry question should be asked. It is a question that must be answered as part of a rational, working enforcement policy. Obviously the entry question is a legitimate one. It's a difficult one. It is very fact intensive and it isn't based only upon economic models.

My sharpest point of disagreement with Sandy would be this: He suggested that the most important people that come to see us are the economists, second to the lawyers. I say no. Certainly, lawyers are the least important because I know what lawyers arguments are like, I like to make them. I don't really care much about what the lawyers say. I also care more what the economists say only to the extent to which economists may use more facts in their arguments than do lawyers. I think the most important people to come in before any agency are the business people involved who tell us what the industry is about. Obviously, business people are advocates too. They may have not gone to law school but some of it comes naturally. Certainly salesmen know how to sell and if they don't know how before they come in, the lawyers will coach them on how to advocate their positions. Businessmen tend to answer questions more directly than lawyers. They know their industries and they supply facts. When businessmen come in and we ask them a question, we get a factual answer. We get to explore their reasoning and explore the facts upon which conclusions are based.

It is a wonderful process and I thoroughly enjoy it, not that I am always free from confusion when the process ends. I love asking businessmen to tell me how their business works. Why do you do this, or that? Some businessmen know most of the answers and others try to come in and flim-flam but that becomes apparent. It is apparent with a businessman because he should know his business. He should know the answers, he may be right or wrong, but his answers have to be factually based and not argumentative. That is what we try to do, to see through the advocacy and try to fit the facts within our analytical framework. That is where the crystal ball comes in. Even after you gather all the facts, there commonly is debate about the right approach. If you listen to the speakers here and you read the efforts of Professors Purcell and Ward in particular, you see a good example of the kind of debate that occurs. Is market power the reason for the increased concentration in the beefpacking industry or is the search for efficiency that is the major factor?

Congressman Glickman waved the efficiencies wand and said antitrust enforcement has become lax during the Reagan era because the search for efficiency is the beginning and the ending of the analysis. That is only partly true. Efficiencies are important but I think efficiencies are overrated. I don't really like efficiencies arguments because most efficiencies arguments to me are a lot of fluff. The one kind of efficiency argument that always gets my attention, however, is economies of scale, because you can't fool with economies of scale. That is an objective fact. That is also the issue that is central in this business of meatpacking.

If packers have to get bigger to be more efficient because of economies of scale, and if those economies of scale are real and significant and are documented, then why shouldn't we take that into account in analyzing whether a merger that is increasing concentration is good or bad? Clearly, more efficient slaughterers and fabricators of beef are better for the industry. Certainly the consumer is better off. If you will look at the data of Professors Purcell and Ward, which I think is excellent work, you see that over the past several years spreads between prices at the farm level and prices at the retail level have declined in real dollar terms. That is, the slaughterers and fabricators are taking less money out of the flow. That has to help consumers and it has to help the producers because if prices are relatively lower to the consumer, more people are going to buy beef. Everybody benefits, and the system is more efficient. Now, what is wrong with that?

I must come back to the antitrust analysis. I found it to be a very telling statistic because when we looked at ConAgra-Swift, for example, we didn't know what the outcome would be. We were guessing. We did know that economies of scale were very significant and we did take them into account. It is not the beginning of the analysis, it's not the end of the analysis, but it is correctly a factor. That kind of efficiency is important. If everybody benefits, then the objections to our enforcement policies are not well-founded. You really can't stop efficiency. I think General Motors knows that now. I think the Japanese have beaten the hell out of them because the Japanese are more efficient. If you really want to have a strong economy, it has to be an efficient economy. You can have regulated economies and you can stop the efficiency, but we all know what happened in Eastern Europe and in the Soviet Union. I'm not a follower of the Chicago-school of economics, but I do believe in economic efficiency. I believe it is a very important issue in merger enforcement policy.

Some of the efficiencies gained by large beef processors must have been passed on because the farm-retail spread has narrowed in real dollar terms. Beef prices are lower than they would have been and that is important. We don't always have that kind of data when we're doing merger analysis, and I'm trying to emphasize that today because I find it fascinating. This is one example which tends to show that the increase in concentration has not had adverse effects. It seems that if prices haven't gone up and if that is the object of our analysis and if everybody is better off, the enforcement policy has been correct. If the objective is to make things better and then things are in fact better, then we did the right thing. It's always nice to look back. We could debate my conclusion here today, but I will make that observation.

There are one or two other points that I would like to emphasize. There is movement in antitrust merger enforcement policy just like there are changes in the length of skirts. They go up, they go down a half an inch, and antitrust has that kind of movement. Antitrust policy has to change and adapt over time. I have been involved in that process over the last 20 years and I've enjoyed the process. I think it is an exhilarating process to see antitrust theory change. I think Sandy was quite right, the 1980s brought a revolution in thinking and that translated, I think, partly fairly, but mostly unfairly, into the notion that laissez faire was the answer. I don't think that was really true. Nobody really knows what the right thing is. To some extent you can get over-zealous and believe that you have the sole right approach.

I also agree with Sandy that the merger guidelines are there and that while the analysis is the same, they will now be interpreted a little more tightly. But that is mostly in the margin. If a merger is clearly bad, we'll bring a case. We always would. It is those cases in the margin where real debate is. I should say that probably no case is free from any doubts. I never had a problem if I thought the merger was bad. I'd recommend that a case be brought in, and I really have never been turned down even by the most conservative, free-market-type thinkers in the antitrust division. I just want to assure you that the process is trying to arrive at a reasonable approach. There is a political overtone. You may think it is 90 percent politics and 10 percent analysis, but I would suggest to you that the reverse is true.

The suggestion was made yesterday by Professor Ward that Packers and Stockyards Administration be included in the merger enforcement process. I want to say I agree and I disagree. I think that Packers and Stockyards has always been part of the process. They are a source of expertise, because we are always trying to get the facts for a decision. Nevertheless, someone has to make the decision on when to contest a merger in the courts. I think that should be the Department of Justice. If PSA can provide more input concerning industry conditions, that would be a positive step. I approve of that. Ultimately, however, the decision must be left with the Attorney General and his Assistant Attorney General in charge of antitrust enforcement.

Finally, I don't want anything I've said here today to be taken as a prediction of where antitrust enforcement is going in the meatpacking business. While I've said some things about ConAgra-Swift, I don't know if that applies to the next merger request. Each merger is distinct. As concentration levels rise we become more and more concerned. Although I have suggested that it looks like we did the right thing in ConAgra-Swift, there are many factors involved. The same may not be true with the next merger. Indeed since concentrations have risen with that acquisition, I don't think anyone can predict what action will be taken on the next one. We will look at all mergers very carefully that influence concentration, and to make a prediction on our reaction to the next proposed merger or acquisition is very dangerous. We will do the same analysis the next time that we did the last time, but obviously concentrations are higher and the questions may have strikingly different answers. I know less about the pork industry than I do about beef, but I believe predicting developments in pork based upon the beef industry is also dangerous. I wouldn't want to predict what the outcome will be if we were considering a merger among pork packers or processors.

Review: Calvin Watkins

I find myself in some ways in a rather unique position this morning, following on the heels of two attorneys. It's not often or common for me that I find myself as an administrator of a regulatory agency and an investigator in the company of attorneys, both attorneys for government and attorneys for the respondents. So often in a trial situation, to the investigator it sometimes seems that he is the one being prosecuted. I don't think that is going to occur today.

We at PSA have a unique role. I thought at first I might come down here and just react to some of the things that were said. But visiting with the PSA staff, they encouraged me not to do that. I have some prepared remarks which I am going to give. They told me they thought it would be better to have some prepared remarks and use those rather than to say I don't recall or I don't remember. I may still do that some, but we'll get into this issue together.

I think some of the things I'm going to say will give you an idea of how we approach things. We have a new administrator that came on board Tuesday of this week, Virgil Rosendale, so the things I say may or may not be used against me.

During the time that I have been with Packers & Stockyards Administration, there have been a lot of changes and we have discussed a number of those the last couple of days. There have been many changes. Our role has changed. The P&S Act dates back to the turn of the century. The critics believe that the law as it is cannot effectively address problems in the industry today. I disagree. I believe the basic premise of the Act is still sound and still valid. Basically, it says one shall not engage in any unfair or deceptive practices or engage in any anti-competitive practices. When you take the basic premise of the law, I think it is probably as good today as it was when the Act was enacted in 1921. I think that what we find is something that has been referred to by speakers here earlier, that the law as it is written word-for-word today is not the same law, in application, as it was when it was written at the turn of the century. It's not the same law yesterday as it is today, nor will it be the same law as it is applied tomorrow. I think one of our challenges is to be able to bring all those forces together that we have spoken about -- the philosophical differences, the industry changes, the attitudinal differences -- and then apply those to the law as it is written and make the determination as to how it applies in today's environment.

Those of us in administrative agencies are faced with the issue that we also have our attitudes toward the law. Our attitudes in the course of making an investigation and applying the law to the industry are something that we try to protect. We must come to the attorneys and say, "This is what we believe, this is what we think is going on out there." In doing that, we are only one voice. Your voices also must be heard as to how you are concerned about the industry and industry changes. I commend Wayne Purcell for this conference because it keeps a discussion and a debate going about the industry changes that have occurred, especially since 1987.

Quite often we come to the table with our attorneys with the impression that we are using the approach that was implied earlier this morning. We are saying to the attorneys, "Why shouldn't we?" and they are saying "Why should we?" The difference is in approaches. The attorneys, not only in the Justice Department but also in the USDA, have a responsibility entirely different from ours. They have to get beyond those attitudinal implications of any information or case or suggestions that we bring to them and know what might be able to play when we get to the courts. I don't think anyone has spoken directly to that issue, but as the years change, not only does the administration change, but the attitudes in the courts change. Attorney Litvack spoke of the changes in the Justice Department in terms of the leadership there and suggested that there might very well be an attitudinal change. I don't think anyone has addressed the question that it may take a little longer than that to address attitudinal changes of the court. How that is going to be translated in the immediate future, I think, is going to be a real question as to the enforcement philosophy of antitrust laws.

I might jump from that to discuss the question of our being involved in the decision-making process of mergers and acquisitions in the industry, particularly where we have some jurisdiction and authority. That has been a topic of discussion for some time. I would hasten to tell you that we are a participant in that process. Sometimes from our vantage point and from our viewpoint -- and I'm speaking personally as well as expressing an agency philosophy -- I come to the table with the attorney, as I suggested earlier, and say, "Why shouldn't we?" and the attorney is saying "Why should we?" I respect that opinion, and respect that their role is entirely different from ours, but I do think that the process is good. Whether or not we get more involved with the decision-making process in some kind of formal way, we have been and will continue to be involved in that process. A more formal process may cause a recognition on everyone's part that we are a player in the game. There is a question right now as to whether the Department of Agriculture and the industry has had any input. I will agree, however, with Tony Nanni that in the end, there is going to have to be one place that the decision is made. We can make our viewpoints and attitudes known, we can do our best to educate the attorneys with the Justice Department on the way the industry operates, but in the end the Attorney General is going to be held responsible for carrying the case and making that decision unless there is new legislation and the law is changed.

There could be an argument made that given the administrative law we have under PSA, we might very well challenge a merger today under administrative law. I think the argument could be made because Section 202 of the P&S Act does in fact have a non-competitive provision in it. We have used this over the years in what is called the incipiency theory in prosecuting cases under the P&S Act, but they did not deal with antitrust implications. That is not too strong an argument because, ultimately, the administrative decision that is made is subject to review. Eventually, the Justice Department is going to be reviewing that position and deciding whether or not to try it in the courts.

Concentration ratios are a big topic of discussion and earlier the Congressman talked about 70 percent of cattle being slaughtered by the top 4 firms. I'm sure, during your course of discussions yesterday, that you know 70 percent is a figure that applies to fed steers and heifers. There are those saying these concentration ratios are as significant now as they were in the 1920s when the P&S Act was born. Related to those situations that created the reasons that the P&S Act was enacted, there are several differences. Back then, packers not only had the concentration ratios, but they controlled the marketing channels as well. They controlled the stockyards, transportation, owned their own stockyard facilities, and it was truly a vertically-integrated operation at that time. The P&S Act was passed to deal with some of those problems. Although there are some similarities in the conditions today, there are also some differences. Sometimes we might miss those differences.

As we talk about the concentration issue, a reference was made to the pork industry and their concerns. I think Wayne Purcell's belief was that the pork industry, although the 4-firm concentration ratio right now is 34 percent, it is going to change, and I agree. It's going to change because of expansions of some of the firms that are in the business more so than due to mergers and acquisitions that may take place in the pork industry. Plant size and plant capacity lead to many other concerns. Clem Ward has addressed those in a number of his papers. Tight supplies have led to a certain kind of vertical integration, forward contracting, and controlling livestock before slaughter. As the industry becomes concerned, we as regulators and also as Congressman Glickman indicated, Congress begins to get concerned and so does the administration whether you're talking about the Justice Department or the Department of Agriculture.

As you're concerned about these issues, so are we. In 1988, with the issue of packer-fed livestock and forward contracting, we recognized that as far as our agency was concerned we didn't have any reliable data. We went out with a special report to get that and I think all of you have talked about that. At that point in time, we were being asked to be concerned about something that we didn't know what the real figures were and we did go out and get it. That information has been distributed to you. We are bringing that information up-to-date this year, so at least when we get that information we can look at it on a comparative basis and will be able to see the short-term trend. We will get that information out to you this year as we work to serve the needs of the industry.

Open Discussion

QUESTION - For Anthony Nanni - In the merger decisions in 1987, it was suggested that these mergers allowed companies to take considerable advantage of economies of scale. Now evidence has been presented here that economies of scale, plant by plant, are quite substantial. But even the largest of the meatpacking plants and fabricating plants can't account for more than about 3-4 percent of national sales. How does economies of scale clearly justify these mergers? Are there any multi-plant economies of scale?

ANSWER - Anthony Nanni - I think economies of scale of all kinds are important. The point I want to emphasize is we try to consider all of those factors. The ultimate question for us to decide is whether there will be an exercise of market power through a non-competitive rise in price. The thing that I found to be quite telling in Professor Purcell's analysis of the farm-to-retail margins was that the "price" for slaughter and for fabrication has gone down while the concentrations have increased. So, it's not just that there are theoretical efficiencies, but there actually was a lower price being charged in a more concentrated industry. Not only were there theoretical efficiencies, but they were being shared with consumers and with producers. Our concern from a merger analysis would be that high concentration would permit processors to take a greater spread, take a greater share of the wealth. The data are showing exactly the opposite. I would have been distressed if I had seen the opposite.

COMMENT - John Connor - I agree that it is comforting that the price of beef has declined in real terms. However, the real question is whether it has declined relative to what it could have been under competition. As far as I can tell there is no evidence that has been presented that its decline has surpassed what we would have expected in a highly-competitive situation. So, your logic is partially correct in that it is in the right direction.

COMMENT - Wayne Purcell - Toni Nanni is talking about the price the middleman is charging for his services, reflected as a spread, that I and other people have presented. John, I think what you're saying is we don't know whether that would have moved any differently than it did if we had a more competitive and less concentrated industry. That decline in the real price spread that we talked about, we don't know whether that is due to reduced cost or less profits being taken. It could have been an even more impressive picture in terms of declining price spreads had it been more competitive.

COMMENT - Anthony Nanni - It is certainly possible. I will take solace and comfort in your impressions that price has moved in the right direction because when we do merger analysis, nobody can fully explain what has happened and we certainly couldn't predict what the future might bring. I think "solace and comfort" are the right words. I would point out that Professor Purcell's own piece seems to suggest rather strongly that the reason why you could have slaughterers taking a smaller piece of the pie by lowering their actual charge for services is because they are more efficient. If those efficiencies come about as a result of mergers, it certainly is less anti-competitive than the same merger when there are no efficiencies. The point is still the same: the efficiencies are not the beginning of the analysis or the end of the analysis, but they are a proper factor for consideration. I do think there is merit to the position that the spread was indeed narrowed because of all the efficiencies.

QUESTION - For Anthony Nanni - The biggest variable cost in the packing operation is the cost of procuring fed cattle. Is it not possible that the concentration has led to administered pricing on the procurement side in the packer sector?

ANSWER - Anthony Nanni - I don't know whether the spread would include those costs or not. I'm not sure that I have enough depth of knowledge to be able to answer your question fully.

QUESTION - For Wayne Purcell - Has market power been used on the procurement side to effectively reduce the price that could otherwise been paid for fed cattle?

ANSWER - Wayne Purcell - If I had the answer to that question, I probably wouldn't be at this conference. Clem Ward made some reference yesterday to what studies are finding. Certainly there are people in this audience who have been involved in those studies. I think most of them would agree with me that if there are concerns to be raised about already having seen the exercise of marketing power, it is more likely to be on the procurement side of livestock than it is on the selling side. That doesn't bring a lot of specificity to the answer but I think all the research efforts that have found any evidence of a problem have been on the buying side.

QUESTION - For Anthony Nanni - To this point in time, we could have a positive impact from the consolidation economies that you refer to. But, down the road when cattle supplies are more abundant and the safety net that has been referred to due to tight cattle supplies disappears, what is going to happen then in a short-run and long-run context?

ANSWER - Anthony Nanni - To the extent which a merger truly enhances real efficiencies, that is a positive factor, not a negative factor. Here, we have at least over the past several years proven that those efficiencies have in part been passed on to the consumer. We have some data to suggest that the margins of packers are not increasing. Are we, just as Congressman Glickman suggested, looking at efficiencies and saying, "Okay, here are efficiencies." But are they the only things considered in merger analysis? No, they aren't. We try to weigh efficiencies in with the concentration levels and all the other factors. To some extent, we are making a predication as to whether prices in the market will be less competitive with a merger than they otherwise would have been. That's the test. Will the merger substantially tend to lessen competition? We don't always have answers for the very hardest questions. Here, I look at the post-acquisition situation to see if it suggests that the consolidation has had some benefits. I still go back to the proposition that if the industry is more efficient, and those efficiency gains have been shared in these times, then it certainly isn't going to hurt at other times even if only part of those gains are captured.

COMMENT - Sanford Litvack - You're talking about weighing possibilities, likelihoods, probabilities, etc. You are saying that if you knew that in a year the market was going to change, that this was going to be the picture, and that the result will be this kind of power aggregated into the hands of a few people who will then be in a position to reduce competition. If you knew that, I think that would be a very important factor in the merger analysis. On the other hand, if it is certainly a mere possibility that some day that could happen, again that would not be enough. What you are doing when you analyze the merger, what Tony Nanni does and what everyone does, is try to gather the information and weigh the short-term, medium-term, and long-term to the extent you can forsee in giving, as it were, weights to the short-term against long-term, one being more readily identifiable than the other. What is going to happen to this one that is substantially less in competition? Tony listed one and said it has reduced the middlemen's cost and therefore been a plus. The question that you pose is slightly different, "Yes, but what about the following?" The answer to that really has to be that if that were reasonably likely at the time of the merger, that would/should be part of the analysis and would have to be weighed against these so-called benefits. On the other hand, that it could happen at some time in the future, it seems to me that it is not something which carries a great weight and can't get considered too much.

COMMENT - Calvin Watkins - Under the P&S Act, we look at and address those situations in the short-run. Our concern is whether they perform. I believe we can address those in the short-run if and when we are able to pinpoint a situation and say that at the present time this market power is being used and does affect prices in this way.

QUESTION - For Anthony Nanni - You have focused on the efficiencies of economies of size or scale and the ease of entry as two reasons to justify mergers and acquisitions. Isn't it possible that there is a trade-off here such that the greater the economies of size, the less likely there will be effective ease of entry?

ANSWER - Anthony Nanni - That is an excellent question and the answer is, "Yes, it is certainly possible." Part of the analysis of entry deals with the existence of plant efficiencies and not only that, it's not just in creating economies but in the capital investment required to be effective and to gain a certain size to be competitive. The evaluation of the entry question would change as the economies of scale change in an industry. You are absolutely right.

QUESTION - For Anthony Nanni - In an area in which we have packer contracting in a very major way, and you apparently choose not to participate as a feedlot in that type of function, I was faced during the last two April's with a situation where I couldn't get any bids. If that's not market power or harm associated with concentration, what does it take for someone to recognize it as power or harm?

ANSWER - Anthony Nanni - I don't have an answer for that question. I don't have enough facts to know why this situation occurred. Clearly, changes of market structure change procedure. It's not clear to me what caused these problems -- an exercise of market power or just a reaction to market conditions.

COMMENT - Wayne Purcell - I don't see any obvious entry into the loop to get that type of abberation or disequilibrium or whatever it is into the process that goes on in the regulatory agencies. It may be that we will get caught with crisis management, that we have to have a major crisis before we do anything.

QUESTION - For Anthony Nanni - I would like to follow-up on an earlier question. If the Justice Department in fact has a concern about the problems the cattle feeder was discussing earlier in integrated activities, then I would like to pose a question. If someone else were to get into that loop and try to create competition in the form of an alternative cash contract, then potential boycotting on the part of the packers should be a concern of the Justice Department. The packers are certainly not going to be excited or thrilled about an alternative contract, but what would be the probability of boycotting and in what role do you see the Justice Department?

ANSWER - Anthony Nanni - Certainly the Department would always be interested in trying to avoid a boycott by anyone. To the extent that individual buyers or sellers make decisions on their own, it would be of less concern. If we see behavior that is evidence of market power or behavior in the market that suggests that the market is not behaving competitively, then you have to ask the question why. If it's collusive behavior we are concerned immediately. If it's non-coordinated behavior, then we certainly like to know about that, and the next time a merger comes out we would consider whether the market is already too concentrated and causing disruptions that are not competitive. We would have to consider that in analyzing whether a merger should be challenged.

QUESTION - For Anthony Nanni - Taken the circumstances that he has quoted, how would you come to know about that and be able to take any action in the courts?

ANSWER - Anthony Nanni - Somebody sending me a letter or calling me on the phone and complaining. Then the immediate question would be to determine whether it is collusive behavior. Everybody believes we're strong criminal enforcers, and I can assure you that that is true. We have a disagreement about merger enforcement, but we are very happy to conduct a criminal investigation against coordinated and collusive behavior. If it is not coordinated behavior, it is brought to our attention to file that away for the future for the next merger that comes down.

COMMENT - Wayne Purcell - Justices' role is not to be out there looking for atypical or unacceptable behavior. Somebody, somewhere has to call their attention to it.

COMMENT - Anthony Nanni - I think Sandy Litvack put it best when he said we are not a regulatory agency. We cannot go in and say we don't like this going on so we are going to pass a rule and say you can't do it. That's not our role.

QUESTION - For Anthony Nanni - What I hear you say though, is that there has to be coordination. But what about the threat in the area where we have one packer? If they don't show up and offer a bid, that is not a problem for you. That would not be coordination.

ANSWER - Anthony Nanni - That would not be coordination, but it would be helpful to know about those incidents because it is relevant to merger analysis. When we're trying to determine what the effects of high concentrations are, that's a possible effect.

QUESTION - For Anthony Nanni - The frustration of the cattle feeder segment is that they are blocked out. Some of this isn't because of a merger, it's a practice. My question revolves around captive supplies and the possibility that an individual feeder may actually be effectively locked out of the market where it is a month or two months before effective buying power emerges. What concerns does the Justice have about that and what posture does Justice have on that type of practice that looks potentially negative?

ANSWER - Anthony Nanni - I think you have to understand the limit of antitrust in smoothing out this type of situation in any market. Certainly, if we analyze the merger and predict this kind of anti-competitive situation, then we would take that into account. However, let's assume, hypothetically, that your situation resulted because someone that grew big in your area, internal growth, better efficiency, whatever, no mergers involved. He may have a local monopoly, but that local monopoly is not necessarily illegal. He has a right to it unless he's done some bad acts along the way. We are limited in what we can do. We have a role to stop anti-competitive mergers and to bust up illegal monopolies, but he will have to have done something bad. Merely the fact that he has that power and is functioning as a regional monopoly does not mean that we have any right to go in and rectify the situation.

QUESTION - For Calvin Watkins - Does PSA have a role to play in protecting this alleged or apparent anti-competitive activity on the buying end where the market is concerned?

ANSWER - Calvin Watkins - Yes, we do. Most likely in situations like this we would be the ones. How we proceed from there and whether or not we've got sufficient cause or evidence that would cause the Justice Department to act on it would be an entirely different story. That has to be taken into consideration in the process.

QUESTION - For Sanford Litvack - We've seen a number of perfect or imperfect substitutes for an ownership-type integration occur in the meatpacking sector. Contracting and other methods are being used to control the supplies to some extent. Is this a factor in considering mergers of vertical impact when a merger occurs in the meatpacking industry? How much of the supply has to be under control before it becomes a danger point?

ANSWER - Sanford Litvack - I can tell you that vertical mergers or the enforcing of Section 7 with respect to vertical acquisitions has declined materially over the years. That is not a phenomenon that arose in 1981. Really we haven't had a lot of vertical merger enforcement by the government. There has been very little enforcement and the reason is the notion that there are so many different ways to accomplish the same thing that the vertical mergers as such usually don't hurt much because the parties can integrate up or down, as the case may be, by a series of other events. I think the answer to your question is that there would have to be a very high level of vertical restraint before anyone would become concerned. In that regard I should refer to something else, which I think is largely discredited but nonetheless still exists, called the Vertical-Restraint Guidelines. These Guidelines were something adopted in 1984 or 1985 by the Department and they basically purported to set forth the context in which the Department would attack vertical restraints. What they said was that unless 30 percent of the market was being affected, the Antitrust Division does not have a problem. Therefore, what the Vertical-Restraint Guidelines really say is that we, the Department of Justice, don't intend to bring any cases in the vertical area. Since 1985, everybody has walked a little bit away from that Guideline.

QUESTION - For Calvin Watkins - In an era in which we only have one, two, or at most, three buyers calling on a feedyard, it may be that Buyer A might come on Monday and Buyer B on Tuesday, etc. and they may implicitly just agree to do it that way and divide up the cattle and divide up the market. Is this collusion? If it isn't, why not? If it is, how do you measure it?

ANSWER - Calvin Watkins - The essence of collusion is the intent, but you have to have communication to really have intent. If someone makes an independent decision with full knowledge of what the other fellow's practice is, there is not any reason to claim intent. They just may know that he's coming on a Monday, so I'm going to go on Wednesday. He likes it that way and it works for him so long as he has not communicated. That's fine, it may not be the most competitive situation, but there is a difference between what is illegal and what is convenient. If it's totally independent, then it's not collusion.

COMMENT - Dan Glickman - You can agree without sitting down in a room and signing a contract. You can have an agreement in lots of informal ways, but at the end of the day it must be an understanding of some sort. Mere parallelism of conduct, if that's all you have, you don't have enough particularly when the conduct is independently in each one's self interest. If we do have conduct that is not independent and in my own interests, then you're starting down a road and at the end you would have something more than conduct, you don't need an agreement. It is a question of whether or not it is an agreement. It is a question for the judge or a jury to decide. They look over all the facts you put together.

COMMENT - Clem Ward - I might mention something today that I didn't mention yesterday. On the data I collected last summer from the feedlots, almost every day there was one buyer that bought significantly more than anyone else. But there was no apparent pattern. If there was somebody that decided on that given day that he was going to drop by, I suspect all of you who work with feedlots or are in that industry see that. One of the underlying features of a merger guideline is to try to avoid situations where collusion may be more likely.

QUESTION - For Anthony Nanni - You and Mr. Litvack have talked about the benefits that might go to the consumer or the implications to consumers as a factor in the decisions. For example, you said that beef prices have not increased and so that is positive, that is a positive result. Is the Justice Department or the courts looking more at the consumer-related issues here compared to the needs and interests of the supplier and producer?

ANSWER - Anthony Nanni - We look at both. When we look at meatpacking specifically, as I suggested, we've got to look at both sides. You've got the bottom side where you've got beef concentration, and beefpacking has suppressed price, and then on the selling side the concentration in the meatpacking industry might serve to raise the price to the customers. We look at both. The spread is important because it can either come from lower prices on the buying side or higher prices on the selling side.

COMMENT - Dan Glickman - I think it is a fact that they can, at the end, focus on the consumer side. Clearly, during the last eight years, the whole notion has been more consumer welfare. While Tony says that he looks at the supplier side and looks at the impact in terms of a merger, that is true, but the ultimate question is how does this impact on the consumer. There are loads of cases which say that the antitrust laws are concerned with competition, not competitors, and that little catchy phrase that you see repeated over and over again really does drive the process.

QUESTION - For Anthony Nanni - The reference to the declining price spreads in real terms does not in any way imply or prove anything about the absence of monopoly or market power. You cannot state that there is no market power being exercised out there just because of a decline in real margins. Would you react?

ANSWER - Anthony Nanni - I think that comes as the same question as the very first question that was asked. We are dealing with probability. I just find it reassuring and comforting to know that the spreads are not increasing. If you did have a real exercise in market power, in that the efficiencies were not being passed on to the consumer, you would at least expect the spread to stay constant or perhaps be increasing. That is a probability, there is no certainty that the evidence surrounding the spreads proves anything. You're absolutely right and it may well be the spread will be constant or declining if we had not seen a merger. I can't control that.

SECTION 4

Session 3: Price, Price Discovery, and Market Information Issues

by

Sam Washburn
Chairman, NCA Task Force, Concentration/Integration

Paul Fuller
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OPEN DISCUSSION

Session 3: Current and Pending Pricing Issues

Sam Washburn

When Wayne called me and asked me to participate in this discussion with all of you I was delighted. I wanted to be able to bring to you the feelings of the National Cattlemen's Task Force, but equally important, to release some of my frustrations. I'm not in any way undermining the effects of the Task Force report: I felt that it was significant to me that we could agree. We came up with a unanimous report, we came up with a group that said, "This is the way we look at the industry." However, in spite of that, I had some personal concerns that we didn't go far enough. As I think about the Task Force and think about what happened, a number of people said to me at the time that I had accepted to be the Chairman, "I thought you were smarter than to take that job." As I look at it in retrospect, the only thing that scares me is how close I came to saying no. It has been the greatest learning experience that I have ever had. I thought that I understood the cattle industry, but I didn't.

Today, after the 15 members of that Task Force had worked together for 13 months representing geographical differences and age spreads, types of business, and types of experience, the report is out. This was a cohesive group that covered all of the industry. I will defend our efforts as far as understanding the beef industry, the make-up of it, and how it works because we had the opportunity to talk with the major players in every sector of the business and they talked with us openly. The CEO of the group or the owner or director told us what they did and why they did it. We did not ask proprietary questions, they gave us simple proprietary answers that we would not have asked them. I can quote one of those, and you all know him. He gave us voluntary information we did not expect, volunteering "answers." I said, "Kenny, why did you give those answers?" He said, "Because you didn't ask those questions, if you had, I would have said none of your business, but you were very careful not to ask those questions and not be proprietary in questions. So, I think you're entitled to an answer." That is the kind of openness we had with many people we talked to.

What we wanted to do is bring to you what we found. As we started in the Task Force activities, we had very different backgrounds, different experiences in appreciation and in understanding. We had some people in the industry that wanted to do something. They were walking around with a club on their shoulder: we're going to get someone. I had a number of people calling me and asking how I perceived the question or the problem of the industry. I naively almost made a comment or two before

I caught myself and I asked them what they perceived the problem in the industry to be. I could just hear the silence on the other end of the phone, and knew they were wondering what kind of dummy Dale Humphrey appointed to chair the Task Force that doesn't even understand the problem. If you think about it, the problem in such a dynamic industry is totally reflective of where you are in the industry. If you're out in public-land states and selling calves in the fall, if you only have two buyers compared to having had five, you look at the industry very differently than if you are in Garden City with a 20,000-head feedlot and looking at 60 and 80 or 100-thousand head feedlots somewhere else. It is relative to where you are and what you see. It is also a change. I am very bullish on the cattle industry. I think we have an outstanding decade ahead of us. We will have as many or more profits in the next 10 years; however, fewer people will share them.

If you think the golden years of the past are what you want to emulate in your business, from what I see, the future is not going to be that way. If you want to be an innovator and change, and adjust, and meet the competition, you have a bright future. If you don't want to change and want to dwell on how things used to be and do everything in your power to get back to those times, you probably don't have a future in the industry.

My assignment today is not to talk about the Task Force per se, but talk about some of the things that we found and review price discovery. I've been widely quoted by some of you here in the room that price discovery is the key, price discovery is so important, and I feel it is. I want to talk about price reporting versus price discovery. I use as an example of price reporting and price discovery someone wanting to travel to Australia or New Zealand, as if they were one place. We talk about price reporting and price discovery as if it is one phenomenon. That couldn't be farther from the truth. I don't want to belabor a point if it is obvious to you, but if it is obvious to everyone in this group, you are by far the most perceptive group that has ever assembled anywhere because we have different feelings.

Price reporting is history. Price discovery is market dynamics of how we arrive at a price. I will use price discovery and price determination interchangeable. Price discovery is what I will be talking about and that equals price determination. Price reporting is very different. It is what has happened, it's done, it's finished. I am assuming that it has happened. I'll also assume that an ideal market is an open market. Cattle markets used to be open markets. The broiler market today is a classic example of a closed market. I evaluate market systems on criteria of (1) accessibility, (2) freedom to sell anything at anytime, and (3) potential to sell to any buyer, no restrictions. I then evaluate the cost of operating the system. This is how I evaluate a market system.

Market systems and open markets are declining in all agriculture today. The old terminal livestock market was an example of an open market. I'm not going to say it was a good example of one, but it was about as good example as we had. It served as a price discovery arena for cattle. The way I look at price as a cattle feeder and a cattleman are: (1) as a negotiated private treaty; (2) the auction market; (3) the bid/offer/acceptance; (4) a type of administered pricing; (5) true formula pricing; and (6) futures market pricing. My basis for evaluating a market system or price discovery merits would include the relative openness, reliable information, and adequate competition. There are traditional terminal markets and many auction markets that some of these criteria fit fairly well, but they don't fit them all. More importantly in cattlemen's perceptions, they didn't confirm that they fit the open-market criterion.

The cattlemen perceived collusion in the old terminal market. I can remember going to the terminal in Chicago as a young boy. We saw how the cattle sold and my dad was always talking about the old open market, the open-terminal market. The cattlemen questioned the competition, felt it was too expensive, really thought there was tremendous cost involved, and were absolutely sure that they had no control over what was happening. My father was rather close, he was the son of a Scottish immigrant, my brother's name is Angus, and so probably any cost in that market would have been exorbitant. As we rode back from Chicago he would explain all these things we've heard about. We were only there twice a year so when it came to selling cattle they always traded off of our cattle, and we talked about the cost as we were trying to sell them.

Every group came in doing their thing: get the cattle up, stir them around, look at every one of them six or seven times, and then go to the next pen. The buyer then claimed that wasn't what he wanted. Well, if he wanted red cattle, I would have thought that he could have known those were black cattle before he got in there. I understand that it was not just perceived. I already knew when I went home that this was not a cost-efficient marketing system. I can say and I think you can appreciate that the prices for live cattle through the systems that we had, systems we called open markets, were never fair or accurate as perceived by cattlemen. In other words, the pricing system didn't work or was perceived as not working. What happened? We moved toward direct selling and contracting because it eliminated uncertainty and left the cattlemen in control. He felt he was in control of his destiny. He'd been had, but he knew it. If you're going to let them do it to you in Chicago why not let them do it to you with home-folk? That is about what it had come to. I did send one load of cattle to Chicago because I was in charge of running my business and I wanted to see what it was like, but the only difference between myself and my father is that I found out in one trip.

The marketing changes happen. The wide diversities of information and ability between the buyer and seller are there, but human nature might explain that if we could be there one-on-one with someone we've seen before there would be someone in charge. It was a little like the buyers were saying let's get up a basketball game, and on the buying team we had the big leagues and on the selling team we had a pee wee team. That is about the only thing we could say was even, that we used the same ball. That's what was happening. There were a lot of demands for improving price reporting and the effort to improve price reporting was perceived as the solution to the problem. If we just knew what the prices were, we probably would not have been taken advantage of. I don't think that is true. The problem was in price discovery, not in price reporting. As we evaluate price discovery, one of the components for good price discovery I think is an open market: lots of competition; 100 percent of the cattle are available; we have good information of grades, descriptions, quality, yields, etc. Anything less than that impairs price discovery.

I listened to Jens Knutson and heard that the enthusiastic competition between three packers with 80 percent of the cattle free and 20 percent captive was somewhat better than if all the cattle were free. If that is true, if we only had 60 percent free cattle and 40 percent captive, it would just be absolutely exciting. I won't accept that Jens, and you can tell your bosses that I don't accept it, but I don't think it would be of any surprise. I think that for price discovery, if we had them all out there, we can't get better than having them all. What we need to know is that once they are all out there, how we are going to trade on them without having 17,000 little deals going on at one time that are less than efficient? Essentially this is where the Task Force ended up. Nationally, we have 20 percent captive supplies, 80 percent free cattle. That may be okay for price discovery, certainly better than 60/40 or 40/60, but it would be ideal if we had 100 percent cattle free meeting the criteria I outlined for good price discovery. So, in talking about captive supplies, the significance in having captive supplies simply means that we don't care. How they're isolated from the market, whether they are packer owned, whether they are contracted, or whether they are forward priced. They are somewhere out there and the residual cattle are what priced them as well as everything else. I think that is descriptive of where we are and how we are trading. It's just that they aren't available to the open market for purchase or sale. Probably 80 percent free cattle can price all the cattle. I think that we are at the point, and if we do not deteriorate from this point, that there is still some competition in efforts to pricing all the cattle.

Now the Task Force looked at this and didn't know what to do. As the Task Force, we didn't do anything. I guess the only good thing to say about that is we didn't do anything wrong. There is no price or price discovery system for broilers. We asked the broiler producers in the Atlanta area if they were concerned about not having a price discovery mechanism that worked. Apparently they were not upset because they weren't even upset that they didn't have a price. The system to them just seemed to work. We asked them about price and price discovery and they said, "Well, what we end up getting, is just what we get." We, as cattlemen, were not willing to accept this as the way our product was priced. Just because the broiler people aren't concerned doesn't mean I'm not concerned and I think all of us, as producers, in this room should be concerned.

I think there is an alternative for price discovery. The assumption is that Sam Washburn wants to maintain an open market for live cattle, therefore there must be an effective and efficient method of price discovery if we are going to have that kind of a market. Some feel better reporting will help, others promote mandatory reporting as the solution. That isn't price discovery, that is simply recording. If that satisfies you then that will mean price reporting and price discovery are the same. If that doesn't satisfy you, we must look at the situation in the industry that's a large and quite diverse industry, very dynamic, and probably some mix of methods will constitute price discovery.

I think a market that is open and free needs to have some kind of a multi-contract available. This would be typical of a private-treaty market or a negotiated live cattle market. The CME futures market is open and accessible to anyone. There needs to be some kind of a retail base on boxed-beef index developed. I'm not talking about in-company or in-house, but something across-the-board for all boxed beef. It probably would need to be some kind of a formula base including byproducts, other wholesale prices, and drop credits. We need to have expanded and accurate (verified) reporting. All this is necessary to negotiate live cattle prices. As we look at open markets, the nearby futures for grain has pretty much been accepted as the price base for the cash market. We take the December option less the basis, less the margin and transportation, and this is the price to the farmer. I think there is some real opportunity there. I don't know if this is the most efficient system in the world, but it is totally accepted in the grain business.

If we're thinking about some things that might be -- let me think out loud for a minute. Some of it may be a bit theoretical and most of it a little wishful, but with several methods of price discovery at work in limited ways, I think ideally there needs to be a national, open-public market. That sounds wishful and somewhat naive, but I think if we had this kind of a market for all cattle and beef accessible to everyone, available at one time, and at a reasonable cost, it would fit my criteria for price discovery. Possibly it is naive and it may sound theoretical, but I think it could be available and it could become the ultimate for marketing and price discovery at the same time.

Modern communications have improved specifications which I think make this possible today. There are video auction markets for feeder cattle being used in a number of areas. What about a national slaughter cattle market, open and accessible, offered and sold by specification? I'm not sure this is so far out for communications where they are today. We need to price the cattle some way in the meat and not on the hoof. We need to, in my opinion, fix our pricing system and fix our marketing system before we try to fix or get some kind of a price discovery system. We can't talk about price discovery in a meaningful way because the marketing or pricing system is so screwed-up that we don't know what we're comparing. I know this is not going to be widely accepted because when we start talking about it -- remember my baseball game -- there is no reason for everyone to accept this because there are more people that are more adept at buying than some of us are at selling.

I think that if we have an open, cost-effective national market, it becomes the ultimate price discovery system. The Task Force did not address price discovery: we did not know what to do. We wrote to a number of outside analysts to ask about what they would suggest on price discovery and they didn't do anything with it. We had two or three opinions in our reports, talking about price discovery, but they didn't really address price discovery. I haven't found many people who really wanted to talk about price discovery. I invited some market analysts and some economists to help me today in preparing a background for price discovery and I got very little material. I don't want to say it wasn't helpful, but what I used it for was just the right size booster chair for my granddaughter's birthday party. There wasn't anything I could build on. Wayne did not have a long list of economists volunteering to address and discuss price discovery. I asked him about coming and addressing price discovery to you, I asked him if he were looking for someone that might say something outrageous and he said he was looking for someone who just might say *something*.

I think as we look at price discovery, we have to realize that this is an area that we start by explaining the difference between reporting and price discovery. Because the Task Force couldn't decide or agree on anything in price discovery, we avoided it. So have many, if not most and probably all economists, because we can't fix price discovery when we're attempting to discover price in such an antiquated and unrealistic arena. I am being critical of economists, but few economists have said anything that has been very much help to producers over the last few years.

My conclusion is that price discovery will come from several sources: private treaty sales, live auctions, futures markets, a boxed-beef index if we could get it, but we must make some real effort to fix up pricing and marketing systems. We can't expect modern price discovery to work from an antiquated marketing and pricing system. The old Model-T can't be expected to run 200 miles per hour. We really haven't changed pricing and marketing since the time I rode back in the truck with my father. We need to fix the pricing system. You heard Leo Vermedahl talking about guessing at the live cattle value, putting them within 50 cents per hundred as far as the overall. I believe he was talking about a difference between $79 and $78.50. That particular day, he said most of the cattle sold to the Texas Cattle Feeders fell in that range of just a half a dollar a hundred. You can't tell me that that is all the variation in those cattle. This is not meant to be just an endorsement of value-based marketing, but we certainly need to look and know precisely what we're selling and not just accept the averages. We look at live cattle and guess at them. We sell on the average and never really confirm, after the fact, what they were objectively. The only cattle that we hear about it are the ones that didn't work. How many packers have called up and said, "Gosh, they were good, they didn't work out at $79, they worked at $83."

Let's remember and think. If we do price discovery, let's do it based on an objective and fair proposal, where we are determining price and the market dynamics on a basis that is fair to the buyer and seller alike. I think that if we look at price discovery it will become improved because of information. How well informed sellers are is improving rapidly. It is time to move our marketing system into the 21st century. We could do that with the technology and the opportunities that we have today if we just insisted on putting them to work. So, let's move our marketing system into the 21st century. That is very important if we want to be around to see it and know it could work. I think the opportunity is there.

Session 3: Current and Pending Informational Issues

Paul Fuller

The mission of the Market News Service is to improve the efficiency of the nation's agricultural marketing system by insuring timely dissemination of unbiased information to all buyers and sellers in the marketing system. The value of a market reporting service depends on the perceived impartiality, accuracy, and completeness of the reported information. The data must not be -- or appear to be -- controlled by either the buying or selling side of the trade. The marketing system will operate at maximum efficiency only when both buyers and sellers have adequate and accurate information for making decisions and have confidence in the source of the information.

USDA's market news is responsible for providing this unbiased and factual information. Price discovery, on the other hand, is the process of buyers and sellers utilizing all available information -- including market reports, plus data giving cattle on feed, supply, market projections, estimates of demand, etc. -- to arrive at a market price, which in time becomes information for market reports.

Much discussion and considerable concern in recent years have focused on the process of price discovery and the impact on this process of the decline in available market information. For example, concentration in both the feeding and processing sectors has reduced the number of sources from which market information can be obtained. We are facing the same result from industry consolidations and contracting. These kinds of changes in the marketing system for livestock and meat contribute to our concerns since both producers and processors must utilize different types of market information as well as different reference points.

Keeping Pace with Industry Changes

We in USDA have sought to keep pace with industry changes by adapting our market news reports to the evolving marketing system. Today, we place less emphasis on terminal markets than we did 10-15 years ago, and instead we focus on the direct trade and new methods of marketing such as video auctions. Currently, over 80 percent of the cattle, 88 percent of the hogs, and 81 percent of the sheep are sold direct. Terminal markets no longer play a major role in livestock marketing. We work closely with the states in covering local livestock auctions, which mainly market feeder cattle and slaughter cows.

Meat reporting is handled from our Des Moines office, except for lamb and the west coast meat trade report released from Bell, California. All prices reported from Des Moines are brought back to an Omaha-based average by the average freight rates that we periodically update by checking with the industry. The Des Moines office currently reports the beef carcass trade -- which I will discuss later -- fabricated beef cuts, and the market for pork cuts and byproducts. We also compute the beef and pork cutout value.

As you can see, we are diligently seeking to improve the price discovery process by providing current and accurate information on what is happening in today's market. Our policy is now and always has been to report what has actually occurred and not what some buyer or seller would like the market to be. For example, if a pen of slaughter steers estimated to grade 70 percent Choice is sold at $79.00 with 20 percent discounted $10 per hundredweight, we will not quote the pen as selling at $79.00. As another example, the over-supply of heavy, fat lambs in this country has placed the lamb trade under severe pressure. This is not something we can change, we merely reflect the market situations in our reports.

Of course, we use some judgement in releasing information. For example, if a trade appears to be too high or too low in relation to other trades during the day, we will try to discover the reason. It could be because of muddy cattle, a long haul, or in the case of meat, a closer trim, special selection, extra handling, or a distressed (old) product. There can also be a situation where two or more cuts of meat are delivered on the same load and only one cut is traded at the market price and the other is sold at a price not representative of the current market conditions. These types of trades will not be used unless the condition of the sale or explanation can be given.

It is a well-established fact that over time commodities will seek a given price level depending on supply and demand, regardless of how accurately they are reported. However, on a short-term basis, inaccurate or incomplete reports will influence the price, possibly to someone's disadvantage. In one case, attempts were made to influence the price of a certain commodity by consistently reporting "formula" prices higher than the actual selling price. The net result was that since prices were being quoted artificially high, most buyers and sellers were in the dark about what the actual trading price was. Such a situation is confusing.

Voluntary Reporting of Information

It has always been our policy to support voluntary price reporting. We will continue to support a voluntary system as long as we are confident that the information given to us adequately represents the trading level for a given commodity. However, under a voluntary system, we must accept the fact that there will be a degree of selective reporting to the various reporting services. This has always been the case. The impact of this selectivity on our being able to report complete and accurate information increases in inverse proportion to the number of participants in the marketplace. As the number of participants declines, the adverse impact of selective reporting increases. Unless we can overcome some of the "selectivity" problems we are currently facing, we may need to re-evaluate the soundness of a voluntary system. For a free market system -- which we all support -- to operate efficiently, information must be available to both buyers and sellers.

Reporting Values vs. Actual Prices

Currently, our reports primarily consist of prices that are actually paid for a product. However, for several years, we have computed a carcass value for both beef and pork from wholesale cuts. The value is calculated by using the average individual yields of the cuts and the average price paid. Although not an actual price quote for a trade, this computation is a reliable guide to carcass value and a worthwhile tool in the process of price discovery for both producers and processors. Because of declining trades on a cash basis for both livestock and wholesale meat, we may want to look at the feasibility of computing a carcass and/or live value from the price of retail cuts.

Contracting and Forward Pricing

We are concerned to see a trend emerging in the live trade which has long been practiced in the meat trade -- formula pricing and contracting without a specific reportable live price. It is not the method of trading which concerns us but rather the lack of information available for the industry to use as a basis for making decisions, or in other words, for price discovery. For example, our reporter in Moses Lake, Washington, tells me that 80-90 percent of the trades on slaughter steers and heifers in the northwest area are made either on a contract or formula basis. In the Texas-Oklahoma Panhandle area, about a third are traded this way in some weeks. Nationwide, we estimate about 25-30 percent of all steers and heifers are marketed other than on a cash basis.

At some point in the future, we could have the same situation in the live trade which we now have in the carcass market -- meaning a very small percentage of the supply having a major influence on setting the market. We have followed this situation very closely and last year started reporting the number of cattle moving under contract or formula trade plus as many of the sales conditions as we can obtain. In the absence of a reportable cash price, numbers under contract (or captive supply) become more important. However, we have not been as successful as we would like in obtaining full cooperation from buyers/sellers who could furnish this information. We estimate that our reports represent 25-30 percent of the current week's cattle contracted for future delivery. However, 50-75 percent of the numbers contracted, when they move out of the feedlots, are captured in our reports.

Weighted Average Reporting

In September 1988, we initiated a "weighted average" price and weight report on slaughter cattle for Kansas. Since that time, we started similar reports for each of the major direct areas -- Texas and Oklahoma Panhandles, Kansas, Colorado, eastern Nebraska, and Iowa and southern Minnesota. Last year we started combining this information into a national summary. We also have "weighted average" price reports on most meat quotations. In some cases this provides the user with a more meaningful price than the price ranges from a number of small markets or trades. However, "weighted average" reports could be a drawback if they are used as a basis for formula pricing and reduce the volume of cash trades. One major packer has started using the weighted average price on slaughter steers to price his boxed carcass units. Another major packer has indicated his firm will use the computed cutout value, which I would like to discuss now.

Meat Reporting

On January 2, after more than a year's evaluation, we started publishing a revised boxed beef cutout value. The revision incorporates the latest cutting methods at the processing level by including 35-40 cuts, compared with only 12 that were utilized in the previous calculation. Using this revised method raises the Choice cutout about 50 cents to $1.00 and Select $1.00 to $3.00 per hundredweight.

The individual fabricated cuts that make up the four major carcass components -- round, chuck, loin, and rib -- are used in calculating the value of these four primals. The average industry yields and "weighted average" prices are used to arrive at the value. The next step in the calculation consists of computing the carcass value from the four primals and the credits (flank, brisket, plate, trimmings, etc.). The value is computed from a 2-day average, the current day as well as the previous day. This tends to level out wide swings in the value. However, the volume shown as being traded in our reports reflects only the current day's trading, and that averages between 150-200 loads per day or about a third of the boxed trade.

The report is now released twice a day -- noon and late afternoon -- compared with only the late afternoon release before January of this year. To obtain the information, we contact 12 packer-processors, 31 processors and distributors, 10 brokers, and 56 chains that operate 16,000-20,000 stores.

Currently, the number of trades covered in our carcass beef reports represents only about 1 percent of the total steer and heifer slaughter. Trading is negotiated on about 95 percent of the fabricated beef cuts, compared with only 5 percent of the carcasses. We are very concerned that this small volume of reported carcass trades may not be a true representation of the market, and we expect to discontinue this report later this year. However, we will give the industry adequate notice so that any necessary adjustments can be made.

We estimate that around 20-25 percent of the carcass lamb trades are negotiated, while 95 percent or more of the pork cuts are formula traded. We feel reasonably comfortable with our quotations on pork because of the large number of buyers and sellers whom we contact for information.

Although we use "weighted average" prices in our meat reports, we also show the price range for the full day's trading. We don't feel it is practical to release a closing price. Trading is taking place throughout the day, and it is impossible to talk to all of our contacts shortly before releasing the final report of the day.

Dissemination

Efficient dissemination of market news reports is one of our top priorities. USDA, like other segments of our society, has been caught up in the rush of new technology, which is changing the way we live and work. We are adapting to these changes to provide more accurate and timely market information.

Just last year, the Agricultural Marketing Service installed a new communications system for disseminating market reports. This new system, which utilizes the latest in satellite technology, gives us a faster, more reliable, and more cost-effective dissemination method than ever before. Virtually all the major wire services are connected to the system, including UPI, AP, Reuters, and the Commodity News Service. In addition, our reporters voice about 4,000 market reports each week over 1,200 radio and television stations. We have 105 answering devices throughout the country, which receive about 21,000 calls per week, and we mailed 2.2 million printed reports last year.

Another important tool, the market news data base, is in the developmental stage. When this system is operational, current information as well as historical data can be accessed by computer. We are also utilizing FAX machines to communicate with the industry and will probably expand their use in the future, perhaps even to disseminate market reports.

Meeting the Challenge of Change

In conclusion, the livestock and meat industry obviously is not static. Changes are continually taking place in marketing practices. Our challenges in USDA are to be aware of these changes and to be prepared to modify our services to help ensure an efficient and effective marketing system from the producer to the consumer. Our willingness to change with today's industry has been demonstrated by our shift in focus in collecting information to accommodate new marketing practices and our utilization of the latest communications technology to speed delivery of market reports to the user.

You may be certain that we will continue to watch changing marketing patterns to keep pace with industry needs. When industry works with us in a spirit of cooperation, our joint success is assured.

Open Discussion

QUESTION - For Sam Washburn - Our Texas Cattle Feeder's Association had a great idea not too many years ago, I think it came out "Texas Lean." Texas A&M did some cutting tests and our Texas Lean was supposed to be worth $6-7 a hundred more but it was just what we call U.S. Select today. We could never sell it, of course the packer said he could never sell it, and the retailer kept quiet. How will we get to value-based marketing in this type of environment? What will it take?

ANSWER - Sam Washburn - As I mentioned to you, I can work with a lot of rules as long as I know them ahead of time. I don't want to get my cattle up to the day I want to sell them and the packer says, "Oh, gosh, that's not what I want." I want to know ahead of time, when I start, that this is the set of rules I'm going to be working with. If I have so much lean, I'll get a premium, or if I have so much fat I'll get a discount. Whatever the set of rules, then I will produce towards those but I want to be paid proportionate to my ability to meet or exceed those specifications. If I can't meet or exceed it, or don't, I expect to be penalized. I don't want to meet the specifications or exceed them and get there and get the average.

COMMENT - Paul Fuller - I'm sure there is much debate over what the definition of a value-based market system is. I think it's a matter of how you get to there from where we are that is the big question.

QUESTION - For Sam Washburn - What constitutes an efficient market and, if it's open and accessible to everyone, do you have a great imbalance in terms of concentration, numbers of people on the buying and selling side? Does the industry need to be worrying about things that would facilitate or change the negotiation process such as something like a bargaining association that would have impact on the negotiations?

ANSWER - Sam Washburn - I was wanting to agree with you up to the point of the bargaining association. I'm not sure that I want to do that. Negotiations tend to get into something like that. My point is in agreement with you that we look at the idea of negotiating for value. I feel that it is time for new tools -- electronic marketing or something like that or some variation. More significant is the fact that the time is right to do it because for producers to get in the position of marketing in somewhat of a different way, about the only time we would have the leverage, the tactical advantage, is when there aren't enough cattle to go around. I guarantee you if there are extra cattle and there is an excess or we are in a liquidation phase, there isn't any way that this would have a chance of even being discussed.

QUESTION - For Sam Washburn - When you have to go to value based, you really need to tie it to something such as the retail level because the adequacy of the short-months supply of cattle, the uneven bargaining power between buyer and seller, could destroy all that if you tie it to something down in the system. Is that true?

ANSWER - Sam Washburn - I agree absolutely with that. I think that we are beginning, as an industry, to recognize that some of the values that we want to pay a premium for are different than they were a few years ago. A few years ago the only value that you had added was dressing percentage and it was all higher. It made no sense to me at all to pay more for fat cattle. But I think we're getting past that and if we haven't gotten past it, then we're at the point that we all know we're doing something wrong. So I think that as we look at value-based, let's tie up the subject that receives a premium or a desirable effect in this current environment. I agree we need to tie to final values.

COMMENT - Paul Fuller - That gets back to what I said, it's not the objective of value-based marketing, but we know that the value-based marketing system is based on the premise that you're going to get paid the value of the retail yield. How you get to that system is where the big difference of opinion is.

QUESTION - For Sam Washburn - The cattle feeder, for example, has a choice as to whether or not he forward contracts. If he chooses not to participate in forward contracting, then if he doesn't have a buyer for his cattle for a month, he really is responsible for that. Do you agree?

ANSWER - Sam Washburn - I do agree with that. We are free enterprises and we make a decision. If we make a decision that proves to be a bad decision, there's no one to blame but ourselves. That's part of it, and maybe not one of the desirable parts of the system. Increasing forward contracting is valuable to you but it might not be valuable to you later.

COMMENT - Wayne Purcell - We've talked a lot about the fact that this industry may be moving toward a position where there is a "loop" of really high volume, commercial-type activity, and I think at least everyone has to figure out what that loop is going to look like and what you have to do to play in it and participate in it. If you choose not to be in that loop, then that is your choice. I think everybody would agree with that. Maybe one thing we can at least do to facilitate this process over time is have a little bit more dialogue about what the loop is like. We are going to concentrated activity probably deeper down in the system, and we're going to contracting activities for lots of reasons that have been discussed here.

QUESTION - For Sam Washburn - Sam, in this loop we're talking about and all this discussion about what can we do in the ideal, etc., what is the catalyst that gets something to happen? Is it associations such as the NCA, cattle feeder groups, or is it a large private entity coming in and stepping into that loop that says I'll do it, I'll contract from him, or do you see anything on the horizon? I don't think we're talking about 20 years from now, we're talking about in the near future that provides that glue that will cause some of this to happen.

ANSWER - Sam Washburn - There isn't any one catalyst. As large and dynamic as the American beef industry is, there are a number of things going on at any one time. There are a number of groups, associations, and companies that are involved with the process and they would all have something to contribute. I think fortunately that is one of our real strengths, that we're large and diverse and competitive. But as we think about something like what we're thinking about today and realize that there are some things we might do, there are a number of ways we can head that way. The NCA, Texas Cattle Feeders, and some private firms can do some things. If we're heading in one direction, I think we want to have the really objective thoughts that this is the way we want to go. And this is the type of forum that we answer that question. If we leave here and collectively say this is just dandy what we're doing, let's do it. Let's do it faster and more of it, but if we ask some questions in broader scope that head in a slightly different direction, then now is the time.

QUESTION - For Sam Washburn - Can it therefore follow that behind closed doors there are a lot more ideas, a lot more information, etc. than there are in public forums?

ANSWER - Sam Washburn - I think that is a fair thing to say because remember I mentioned that there was a very short list of people who wanted to come out here and make any kind of statement in front of all of you. And, for whatever reasons, Wayne was successful in finding me to make some of these statements to get you all excited. We're coming up here with some thought. I hope some of the things that I have suggested will make a lot of you think. I think that this is the kind of industry that has so many ideas out there. We wouldn't have advanced to the point we are now and have the kinds of very solid firms we have, if we didn't have a lot of real innovators that could put things together. I just appreciate all of you and the fact that we can have this type of discussion. We're lucky to have this kind of an opportunity.

QUESTION - For Sam Washburn - Since we have more regional disparities in price and probably coming from an industry that is not as concentrated as cattle at a national level, but it may be even worse in hogs than in cattle at the regional level, do we need to be looking at electronic marketing or some way to get beyond the bounds of those regions and allow other buyers in?

ANSWER - Sam Washburn - It would seem likely to me but I have no experience in producing and marketing hogs.

COMMENT - Wayne Purcell - I think your question is pertinent. We both come from the southeastern part of the country and can easily document the cash markets in southeast Virginia, where the fourth largest killer in the nation resides, in 1977-78 went from about $3.00 under midwestern terminal markets to $8.00 under midwestern points when a plant in Georgia closed. Producers suggest how fragile those hog markets can be out there sometimes when you have no alternative buyer within any reasonable distance. I said already I think one really important underlying agenda to all this is that consolidation is going to happen in hogs in the 1990s.

QUESTION - For Sam Washburn - Do captive supplies include packer-owned cattle?

ANSWER - Sam Washburn - Yes, by the way I describe it, captive supplies are any cattle that for whatever reason are insulated from the open market in the pricing system.

SECTION 5

Wrap-Up and Future Directions

by

Fred Knop
Editor
Drover's Journal

Wayne, I would like to ask the group to recognize your efforts in organizing this magnificent conference and giving us a wealth of good thoughts to take home. I would like to thank you for asking me to do this. As a journalist, we don't get invited to do things as prestigious as this very often and it makes me feel good about livestock journalism. In a sense I accept this also on behalf of some of my colleagues who are here. I believe livestock journalism is climbing the ladder to heights where we can participate in a leadership way and in what's going on in improving the level of business planning and management in the cattle industry.

I have to confess that I feel a little like Anthony Nanni when he said this morning that he was beginning his presentation not sure that he was free from confusion. To start with, let me make a point that as things have turned out, perhaps the title of this conference should have been different. The scope of the program I have here specifies a "structural change in livestock, its implications and alternatives." Seems to me that we have spent the better part of two days focusing on a different title, something like structural changes in the meatpacking industry, it's causes, implications and alternatives. Perhaps that is all right, but I don't think that it would be right for us to go home with tunnel vision, with packer tunnel vision. Structural change is occurring throughout the livestock industry. It is occurring as we speak and will continue to occur from here on out.

You said at the start of your presentation, giving me a reason for why structural changes are occurring, that at the root of it is a demand problem for red meat. If we look back over what has happened in the last 15 years back to 1975, of the market for beef, poultry, and seafood, beef had a 41 percent market share. By 1985 that share had shrunk to 33 percent and last year, to the best of my knowledge, it stood at about 29 percent. Last summer, at the annual meetings of the Livestock Publications Council, we had a panel on market share. Representatives of the beef industry, pork industry, and poultry industry were on hand. The poultry industry people came prepared with a very good set of numbers. If what they forecast comes true, chicken will exceed beef's share of the market by 1995. That is 29 percent. Beef will be down to 26 percent and pork will have about 25.5 percent of the market share. That is a rather sobering set of numbers to me particularly from the standpoint of my cattle orientation.

Underlying this problem that you described, Wayne, is the diet and health problem that we cannot overlook in assessing this matter of structural change in what has occurred. Also, there has been the food safety issue which has cost us a lot in terms of people deserting the product of beef for poultry, and to some degree, for pork. I think that we would be remiss if we didn't accept that there is another thing, while we're holding this conference on restructuring of the industry and we've touched on this in many ways, and that is the competition problem. I characterize what's going on out in the livestock as a war. Red meats against poultry and other protein sources. It's important that we recognize that the red meat industry, particularly the cattle industry, is fighting under the weight of several handicaps. One is their price handicap. If we can use Paul Fuller's table on the broiler market and the beef market, beef is selling at about a 3 to 1 price ratio to poultry right now. There is about a $2.00 per pound spread between broiler prices and average beef prices. That is an awful lot. There are products, many examples of products, that carry a big price premium.

We have a cost handicap. It costs over a $1.00 a pound to raise a steer calf and costs about $.70 a pound to put weight on him in the feedlot. That is about double what it is for pork and triple what it is for poultry. It takes a hell of a product to persist in the face of that kind of cost differential.

I am here to relate the things that have been discussed today to the economic health and future of the industries at their very base and production level. It again is awfully easy for me to do this in a beef context, and I will do so. A very big question in my mind is whether it is possible to have a discussion of industry structure without focusing on that denominator of cost that is so discriminating. As the cattle industry engages in competition for major market share in the 1990s and beyond, the cost of production at the industry's foundation -- out in the pasture, in the cow-calf operations -- is where that war will be won or lost. Notice I said cost, not profits. In my view, the thing that this conference has failed to address is the relevancy of the issues discussed to the industry's economic health. As the beef industry wages it's battle for share of the market, cost efficiency has got to be the objective of every sector. We cannot assume that loosely-controlled price and cost anywhere in the sector can be passed upwards. Beef sells at a premium to other meats, but like any product, this has its limits. The NCA Task Force said in its report: The basic economic principle lives; in the long term consumers will adapt tastes and preferences to accommodate lower price alternatives.

For many years beef production grew and grew and grew. With the exception of just a few years, the industry marketed more cattle every year for 27 straight years between 1950 and 1976. Slaughter numbers grew from 18.6 million to 42.6 million head. According to USDA January reports, the total herd grew from about 80 million to 132 million. Let's take a look at what was also happening at that time. According to the U.S.

Census, there were about 1.4 million cattle herds in this country in 1964. In 1982 that number had shrunk to 960,000 and in the 1987 census, for which we are now getting good data, that number is down to about 840,000. Something happened to the profitablity of cattle production during those years. Forty percent of the operators became dropouts. We can take some consolation that while the national herd dropped from 132 million to about 99 million, beef production dropped only about 2 percent. During that period, there was a 25 percent reduction in the number of cows and only a 2 percent reduction in the amount of beef that was produced. That's got to say something about the efficiency of the cow-calf producer.

I will hasten to add that there is a trap there and you have to be careful. As we look ahead to the 1990s, we must be careful not to expect this to continue. We've gotten about all we can out of the new breed, the new-breed phenomenon. I'm talking about the infusion of the European-Continental breeds into the U.S. breeding herd. It was pretty much English breeding when it all started. The cattle size has moderated the proportion size which is found among consumers. The cattle industry is promoting beef in 3-ounce segments in the paper ads. Steers and breeding cattle of extreme size no longer bring the championships in the show ring. Emphasis has shifted to carcass composition and genetic merit. We will never raise a better cattle, never succeed in cattle with beef production on a plateau that it has now reached, if we're not careful with our attitudes at the cattle-feeding and the beefpacking areas. We have a problem with the cattle-feeding industry. Back in 1950 we moved away from the independent feeder using the lures of the tax laws to build giant cattle hotels which we then turned to investments. Along with this concept came the relationship between feeders and producers. Whereas the cattle feeder once saw an opportunity to buy certain cattle for his feeding program, because they were the best bets, the modern cattle feeder has gotten happy to take his chances on the market.

This has contributed to my realization of the American cattle herder, the concept of buying and feeding and selling on the averages. Today we have a concentrated feeding industry. A very limited number of feedyards feed the vast majority of the cattle and at last a few people are sending most of the signals down to the production sector and these signals are not providing stimulation to change that cattle profile. I'm not here to knock the cattle-feeding industry. We have concentrated and there is a lot of good in that. We have a cattle-feeding industry that has a cost basis that is lower than it would have been under the old concept. We have to ask ourselves if the cowman is making any money. I'm sure it's true of some. If we look at the data being collected by the USDA, as late as

1988, the cowman was still writing with red ink. Now we're in a situation where the consumer economy is beginning to soften. We have to assume that somewhere along the line retail prices will soften as well.

Let's take a look for a minute at the packing industry. Here too we have a sector that plays a dangerous game. The packing industry really hasn't done much to make the cowman feel a part of a real team. I don't believe that even the most vocal packer basher really wants to place the industry's future back in the hands of the high-cost packers. But I think the packing industry, especially the Big 3, needs to understand that only the level-headed policymakers and the National Cattlemen's Association may be standing between them and some real heat on the concentration issue. I really believe that a situation exists today that there is a very strong undercurrent of resentment out in the country where concentration is concerned. Packers, I say, are fighting producers too hard and they'll fight back. That could be a force even greater than the NCA could moderate.

Somehow it is almost a matter of social responsibility. We need to make sure that all producers get a fair and timely bid on their cattle and that probably can be best facilitated through the value-based procurement system backed by a sound, price-discovery system. Based on this belief, the packing industry will get out front on the issue and will stop encouraging the production of unnecessary fat. We heard Gary Walters from Kroger say yesterday that he's ready to buy beef that is trimmed by the packers. I am sure the Excel trim program is able to do that. I don't know of another packer who is offering that kind of a deal, and one of the things that retailers tell me is that most of their business situations is a one-source market. To get another player involved, I'm not sure we will see it by accelerating trimming at the packer level and branded beef coming from the packers. I think we need a packing industry that will work proactively with the feeding industry to ensure that it does nothing to choke off the industry as a whole at its roots. This is why I think we're really here.

Consciously or subconsciously, I think that we have to be concerned about what actions at the feeder level have to do at the production level. Chances are very real that we can do something that would equate with the sheep industry, where I'm pretty sure numbers have fallen and fallen and fallen. The share of the market there has fallen to the point where they are not much of a player and that would be a shame to see it happen in the beef industry. What needs to be done and we should do it, by that I'm saying everyone involved with the beef industry, the cow-calf operator up to the retailer, the restaurateur, needs to get involved: Everyone has a role to play in 'getting quality up and cost down. I believe that the decade of the 90s, and the years beyond, will require strong action on the part of our national organizations -- National Cattlemen's Association, American Meat Institute, American Food Marketing Institute. There needs to be a strategic plan from each of these sectors within those organizations and to which producers and their other members can talk. I'm certain they will get the dedication and involvement of Wayne Purcell and the Research Institute on Livestock Pricing, and many other public and private economist, and specialists that allow us to resolve our problems.

I think that one of the most high-potential ideas advanced at this meeting was when we said that perhaps we need one more entity: a continuing group that can look at what's being accomplished by the various sectors of the industry, then sit down once a year and pull together a state-of-the-industry kind of report. We need to get everybody excited again and producing results on a consolidated basis.

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Serving the Needs of the Livestock Industry