AMERICAN MEAT INSTITUTE

**QUESTIONNAIRE REGARDING LIVESTOCK MARKETING**
**HOUSE COMMITTEE ON AGRICULTURE**
**WASHINGTON, D.C.**

**American Meat Institute Response**

**1. Characterize the strengths and weaknesses that exist in the current marketing system for livestock. Please outline the nature and scope of the problems you observe. Finally, describe an appropriate governmental role in maintaining a viable livestock marketing system.**

The strength of the current livestock marketing system in the U.S. is the flexibility it provides to producers, packers/processors and retailers in responding to market signals, while maintaining a variety of choices for the producer through the consumer. Producers have a multitude of options in marketing their livestock: spot market transactions, cooperatives, bargaining associations and other programs that allow them to align themselves with packers through contractual arrangements to manage risk.

Programs that provide multiple risk management tools for producers through contractual arrangements with packers and other forms of vertical integration have helped to protect producers from uncertainty while providing consumers with the consistency and quality offered in branded products. Within the last decade, we have witnessed growth in both branded beef and pork products and at the same time increases in animal protein production and consumption.

The most appropriate government role in today's livestock marketing system is to enforce the existing laws and regulations that ensure fair and nondiscriminatory business practices among producers and packers, while allowing producers the freedom of choice on how best to market their livestock. The government should exercise its current and vast authority under the Sherman Act, the Clayton Act, the Robinson-Patman Act, the Packers and Stockyards Act and other state codes.

**2. The Grain Inspection, Packers & Stockyards Administration's (GIPSA) definition of "captive supply" differs from many in the livestock and meatpacking industry. Why? Given that GIPSA's definition differs from many in the regulated industries, should GIPSA modify its definition? As we have seen, different individuals have different notions about the term "captive supply", which often complicates discussions about livestock markets. Please define the term captive supply.**

GIPSA defines captive supplies as livestock that is owned or fed by a packer more than 14 days prior to slaughter; livestock that is procured by a packer through a contract or marketing agreement that has been in place for more than 14 days prior to slaughter; and livestock that is otherwise committed to a packer more than 14 days prior to slaughter.

GIPSA should modify its definition of captive supply to reflect and comport with industry practices. To define captive supply based on any other criteria serves only to create artificial data and can lead to a misunderstanding of what is transpiring in the market.

**3. Should captive supplies be reduced to 50%, 25%, 0%, or some other number? What criteria should a packer use to reduce captive supplies? Which current feeders will be eliminated from the captive supply chain? Who will make this decision? How will we measure the success of limiting or eliminating captive supplies?**

Captive supplies should not be limited by government fiat. To do so would seriously jeopardize the strength of our current livestock marketing system -- flexibility and choice. Such an arbitrary action would limit not only the choices producers have in marketing their animals, but the ability of packer/processors to create demand for a branded product market. In effect, such government interference would unnecessarily and inappropriately disrupt market forces.

In order to create the food products people want to buy, AMI's members have done many things. They have improved coordination with livestock producers so that the raw materials they purchase yield products consumers want to buy. Packers have enhanced their coordination with their retail and foodservice customers, sometimes changing management or operations in order to meet their customers' needs. This improved coordination has led to increased vertical integration, which can, in some circumstances, result in some packer ownership of livestock supply.

If captive supplies were artificially limited, many of these business arrangements and branded product programs would be seriously jeopardized. A captive supply rate reduced to zero percent or some other arbitrary percentage could preclude producers not currently involved in vertical coordination from participating in risk management contracts and/or require many of those arrangements to be terminated -- essentially firing a producer and requiring their participation in the spot market.

**4. Are you familiar with any empirical studies that have been conducted to determine what the current price of fed cattle would be if there were no captive supplies today? Will eliminating captive supplies put beef at a long-term disadvantage to pork and poultry in the development of new branded convenience products?**

In a report issued by Dr. Wayne Purcell, Alumni Distinguished Professor and Director, Research Institute on Livestock pricing at Virginia Tech, he concludes that "producers have to recognize that regulating the market place or controlling how packers can do business is not going to push calf prices up in any significant way. There is no huge pile of dollars down this path, no return to prices that will consistently cover producers' costs. The facts simply do not support claims that producers are being robbed by middlemen." Dr. Purcell further writes that, "Any increase in middlemen's spreads, even increases economically justified by rising costs, will push producers' prices down if retail prices are stagnant because of weak demand for beef. In expanding on this now obvious point, we come to a better understanding of where the needed dollars are: <u>They are in the pockets of the modern consumer</u>."

Consistent with Dr. Purcell's views, government mandates eliminating captive supplies or other forms of government intervention would increase producers' overall income. In fact, if branded products and certain vertically integrated relationships would be eliminated by such government intrusion, producers of both beef and pork would be at a competitive disadvantage with other forms of protein and receive less value.

**5. In lieu of current alliance systems, what type of production and marketing system will provide a quality and consistent product needed for branded meat products?**

The industry searches in the market for the answer to this question every day -- through competition. Although one might quite naturally look to the poultry model, being vertically integrated, as successful and a model to emulate -- one size does not necessarily fit all regarding other species. Nor does one size fit all for the particular markets in which individual producers or companies seek to do business.

If the increases we are witnessing in beef and pork production, consumption, exports and branded products is any indication it seems that the marketing system that is currently evolving is providing that system.

**6. Do contracts, alliances or other kinds of marketing agreements improve or harm marketing alternatives for all size producers? Since some lenders require price protection (hedges, forward contracts, etc) for cattle production loans, what alternatives will replace forward contracts?**

There are a variety of risk management tools available to virtually any producer regardless of size. This variety of tools serves producers well because it allows them to match their capabilities with their own financial risk needs -- thus maintaining flexibility and choice in making business decisions and marketing their livestock.

If forward contracts are effectively eliminated there is probably very little protection producers will have available to them other than to hedge their own risks. Although a choice available to producers today, it seems to be an option that does little to protect producers from unforeseen volatility in the markets and could leave them exposed if unaware of the complexities of such systems.

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**7. Should independent, producer-owned plants, feedlots, marketing cooperatives and other livestock businesses be subject to the same level and kinds of legal and regulatory restrictions as more traditional livestock operations are currently and in the future?**

Absolutely. In a free market economy, everyone should be subject to the same rules - restrictions and freedoms - to compete fairly on a level playing field. To do otherwise results in, picking winners and losers though a regulatory scheme rather than through the free market economy. Providing benefits for one over another through regulatory requirements also distorts capital investment.

**8. What role do purchasing arrangements by major retailers have on packer pricing, captive supplies and other marketing and production arrangements? What is the current farm-to-retail price spread? How has this changed over time? What role have captive supplies had in altering the spread? Will a further regulation of captive supplies or other governmental intervention in livestock markets impact the spread? How?**

Forward selling or purchasing arrangements between packers and retailers allow for optimization of packing plant capacity. The sole determinant for valuing livestock is supply and demand. However, these arrangements create an orderly marketing system that benefits both producers and processors.

The farm-to-retail price spread is monitored and reported by USDA annually. When reviewing the relationship between the prices paid to producers for their livestock and the prices received by packers for boxed beef or fresh pork over a 20 year period, the prices track closely. When the price received by producers trend downward, prices received by packers trend downward too and vice-a-versa. (See attached charts -- information provided by USDA).

Packers and producers are connected in the farm to wholesale price spread. Policy makers should recognize packers have nothing to do with the wholesale to retail pricing structure. The farm to retail price spread does not account for value addition throughout the chain. Therefore, it stands to reason that packers add value to a carcass – a value for which they should be paid.

As the USDA data show over the past 20 years, packers and producers have been connected in the farm to wholesale price spread - rising and falling in near tandem. USDA data also shows that captive supply ratios in the beef and pork sectors have fluctuated. However, we have not seen an advantage in price received between the producer or packer as those captive supply ratios have fluctuated.

Eliminating captive supplies or other forms of government intervention will not increase producers' overall income. In fact, if branded products and certain vertically integrated relationships were eliminated, producers of both cattle and hogs would be at a competitive disadvantage with other forms of protein and receive less value. Nor do we believe it would have a positive effect for producers on the farm to retail price spread.

**9. Numerous policy proposals have been discussed in Congress recently. For instance, a ban on packer ownership was debated during the farm bill and a packer requirement to purchase 25% of their daily slaughter from the cash market is being discussed now. Please highlight the economic effects of each of these on all of the participants in the livestock production sector in both the near and long term.**

AMI cannot see any positive impact from these types of policy recommendations. AMI is unaware of any evidence that any of these proposals would add to the producers' economic bottom line. The most obvious and immediate impact would be that it would make certain companies' entire business models illegal and force packers to terminate risk management programs with producers, particularly in the pork sector.

With the stroke of a pen many companies would experience an immediate devaluation of their assets, in effect a taking and devaluation by the federal government without compensation. AMI believes these proposals would hasten further consolidation in the packing industry and lead to an immediate reduction in packing capacity, particularly in the pork sector.

**10. Mandatory price reporting was advocated as necessary to improve market transparency and price discovery. Implicit in the arguments of individuals advocating mandatory price reporting was the idea that this improvement would lead to higher prices for producers. What has been the effect of mandatory price reporting on producer prices?**

AMI strongly opposed the mandatory price reporting legislation when Congress considered it, believing that problems associated with a producer's ability to understand price discovery was not caused by inadequate collection of pricing data by USDA. Rather, the problem was inadequate understanding of the data that government already published.

At the time mandatory price reporting legislation was under consideration and ultimately passed by Congress, AMI could see no evidence that producers would experience economic benefit from its passage. We still cannot see that benefit in its implementation.

**11. How does one reconcile the assertion that packers manipulate the market with the fact that prices move both up and down?**

There is no way to rationally reconcile such an assertion. As stated in the question, market prices move both up and down based on a variety of factors.

In addition, the business practices of meat packers and processors are governed under the Sherman Act, the Clayton Act, the Robinson-Patman Act, the Uniform Commercial Code as well as the Packers and Stockyards Act - a statute unique to our industry that prohibits packers from engaging in unfair or deceptive business practices that disadvantage livestock suppliers. Should such manipulation be under taken by a packer - the oversight is expansive and the penalties severe.

**12. What structural and/or economic transformations have occurred in the livestock, poultry, meat and retail industries in the past decade? To what extent have these transformations been caused or influenced by consumer demand or purchasing habits?**

Structurally, the livestock, retail, meat and poultry industries have moved in the same direction as many other industries over the same time frame. They have consolidated. Consolidation is driven largely by consumer demand for consistent product quality at the lowest possible price. The demand for low prices has led to fewer and larger retail chains in fields as diverse as home improvement products (Home Depot), video rentals (Blockbuster), food and consumer products (Wal-Mart) and fast food (McDonalds). In fact, these companies not only owe their success to these qualities and business practices, they advertise them to consumers. The consolidation at the retail level has driven consolidation at the manufacturing level - for tools, appliances, consumer goods and food products, among others. The demand for consistent product quality has led many firms to exert greater control over their supply chain. Just ask anyone who supplies products to Wal-Mart or McDonalds what that means: it means you must meet their standards or not selling to them. It often means subjecting your products and plants to periodic customer audits. This is the way business is done today -- and the meat industry should be, and is, no exception.

In fact, livestock producers have raised and spent hundreds of millions of dollars over the past decade through check off programs designed to build consumer demand for beef and pork. A large part of these efforts has been to send clear signals from the consuming public back to producers, so that producers can deliver the type of livestock that will yield the meat products most in demand. These efforts have had many benefits, including improved communications throughout the meat chain among retailers, packers and producers. This, too, has led to vertical integration.

To create the foods people want to buy, AMI's members have done many things. They have improved coordination with livestock producers so that the raw materials they purchase yield the foods consumers want to buy. Packers have improved or operations in order to meet their customers' needs. This increased coordination has led to increased vertical integration, which has sometimes included complete or partial ownership of some of each packer's livestock supply. Some positive outcomes of this increased coordination may be familiar:

**Leaner Beef and Pork for Consumers.** Retailers, meat packers and livestock producers heard loud and clear in the 1980s that consumers wanted leaner meats. Working together, these three sectors accomplished an average 27 percent fat reduction in a serving of beef and a 31 percent fat reduction in a serving of pork. Among the actions taken were: packers and retailers trimming fresh meats to ¼-inch of external fat; hog producers and pork packers working together to develop leaner hogs; cattlemen and meat packers petitioning USDA to create a new "Select" grade for leaner beef; and meat processors developing vast new offerings of low-fat hot dogs, luncheon meats, ham, sausage and bacon products.

**Improved Risk Management Options for Producers.** The volatility inherent in farming and ranching has been reduced for many livestock producers through the increased use of contracted sales and many other creative risk management plans in conjunction with meat packers. The benefits to farmers were perhaps most vivid during the hog market crash of 1998, when spot market prices for an unanticipated over-supply of hogs dropped to as low as $9 per cwt. Those hog farmers with contracts had locked into much higher prices for their hogs – generally $35 and more per cwt. – and were protected from the low market prices. Packers with contracts, on the other hand, were obviously paying far over the market value for hogs at the time. Both parties to the contract, however, benefited from the certainty provided by a steady, consistently priced, contracted supply of hogs.

**13. Has the merger and acquisition activity in these sectors been greater than similar activities in other segments of the U.S. economy such as other food or consumer product manufacturers or retailers? What factors have motivated mergers and acquisitions within these sectors?**

See response to question number 12.

**14. What factors have motivated vertical integration within these sectors? Are all vertical integration models the same? If not, describe various models and their benefits or detriments for consumers, retailers, manufacturers and producers.**

See response to questions number 12 and 13.

**15. During the past 10 years, which meat packers have increased packing capacity and/or built new packing facilities -- those who own or contract for some or all of their livestock, or those who do not?**

Over the past 10 years, many existing beef and pork slaughtering facilities have been renovated to enhance product safety, expand product variety, improve efficiency and increase capacity. In the pork sector, three slaughter facilities were newly constructed in North Carolina, Missouri and Oklahoma, each by vertically integrated businesses, which own and raise their own hogs. Significantly, two of the three companies were new entrants to the pork sector. In the beef sector, two new slaughtering facilities were recently completed, one producer-owned and both involving vertical alliances between cattle producers and the packinghouse. Virtually all of today's major beef and pork packers are involved in either contracting or ownership of livestock.

**16. Does the business structure of the current U.S. retail; meat and poultry processing; and livestock production sectors optimize productivity, quality and profitability for each sector? Why or why not?**

These sectors are striving to reach full optimization in productivity, quality and profitability but likely have not realized its full potential. Value chain alignment has not been fully realized. The beef industry is improving productivity and profitability for each segment of the rancher/feeder/packer chain, but the capital investment needed to achieve the level of integration realized in the poultry and pork sectors would be far too excessive to make it economically viable in beef. However, the beef, pork and poultry industries continue to make strides by improving the value chain alignment and through innovation in technology and the development of new food products.

In some instances, the government has stood in the way of this optimization. For instance, the mandatory price reporting law has been a hindrance to optimization. Furthermore, passage of the prescriptive, mandatory country-of-origin labeling law will be a hindrance, the effects of which are only just beginning to be realized.

**17. Based on a competitive analysis of these sectors, which are better positioned for business success or failure? Why?**

It would appear that the retail sector is in the best position for business success. Packers, feeders and ranchers are driven to capacity utilization and by their very nature lack the ability to adjust to monthly and even weekly changes in events in their part of the chain. A retailer can make adjustments in its their exposure by simply moving the lines in the meat case to feature more beef, pork or poultry if one or two of the proteins are not in their favor.

This may explain the wide discrepancy in the farm-to-retail price spread between packers and producers versus retailers.

**18. Would an analysis of farm, processing and retail margins for meat products over the past decade show that any one of these sectors has greater power or profitability than any other? Why?**

If such an analysis were to be comprehensive in scope and conducted by a recognized and highly respected institution with a background in business model evaluation, it may have merit.

**19. How do these production/processing/retailing sectors compare with similar chains in other consumer product manufacturing industries, such as the automotive, dairy or pharmaceutical industries? What lessons can be learned?**

See response to question number 12.

**20. What are the drivers of and barriers to profitability in today's livestock production, meat and poultry processing, and retail industries?**

There are many barriers to profitability, including but not limited to ill considered, government mandated farm and food safety policies, to international trade barriers, to terrorism and interruptions in the world markets.

**21. What effect do vertical integration, contracting and other supply-management strategies in the meat and poultry production/processing/retailing chain have on consumers? Retailers? Processors? Producers?**

Please see response to question number 12.

**22. Does the current Packers and Stockyards Act need to be modernized to respond to changing conditions in the livestock sector? If yes, please outline the specific changes and/or additions to current law and resources that would be necessary to accomplish this goal.**

AMI does not believe changes to the current Packers and Stockyards Act are necessary. Congress has approved a major reorganization within the past two years and has increased the agency's investigative ability enormously through increased staffing levels.

**23. Because the issue is so complex, it is impossible to cover the entire topic of livestock markets in one set of questions. This questionnaire, and the ongoing public policy debate, will inevitably require additional inquiry. Please take a moment to suggest additional questions you would like to see asked. These should not just be those you would like to answer but those you would like to see put to other actors in the livestock sector.**

The House Agriculture Committee should focus on issues and factors that will keep the meat and poultry industry competitive with other sources of protein domestically and abroad. We are grateful for the opportunity to participate in your current investigation and look forward to working with you on issues of importance to our nation as they arise.