October 22, 2021

Critique of the U.S. Beef Supply Chain: Issues and Challenges. Proceedings of a Workshop on Cattle Markets (June 2021) Agricultural and Food Policy Center, Texas A&M University.

The above-named proceedings, authored by 17 economists, was obviously written to prevent the adoption of initiatives currently under consideration. Initiatives which many producers feel would improve the competitiveness and transparency of the fed cattle market. In the Proceedings first paper, by Dr. Derrel S. Peel, he starts by insulting cattle producers with the following quote from a 1999 paper by Dr. Wayne Purcell:

"The beef cattle industry is caught up in difficult times. As economic pressures intensify, reactions tend to move away from the objective and toward the emotional. Calls for solutions are becoming more strident and many are taking the form of proposed legislative remedies… The big danger is that all the attention on short-run and highly visible issues will block recognition of the problems that are long run and structural in nature and, in the process, prevent efforts to move to programs and policies that have a legitimate chance of helping." Then Dr. Peel goes on to write:

"*The issues facing the beef cattle industry today are not new; indeed, they have changed little in the past 30 years, and some have roots that extend back over a century. It is perhaps reassuring that the industry has, for the most part, avoided embarking on policies targeting issues "that are more nearly peripheral in nature and often deal with the symptoms of economic problems rather that the causes" (Purcell, 1999). Mandatory Country of Origin Labeling (mCOOL) is a notable exception, but the United States did back away from the detrimental policy. However, like many other issues, mCOOL has not gone away. Indeed, the emotions, anger and frustration accompanying recent events such as the Holcomb packing plant fire in 2019, the ongoing COVID-19 pandemic beginning in 2020, and the winter storm of February 2021 have fueled demands for an array of potential legislative actions that attempt to jump to a solution without addressing the complex structural and behavioral issues that brought the industry to the current situation. The risk is that these overly simplistic solutions will have long term detrimental impacts on cattle producers, the industry, and consumers, and jeopardize the ability of the industry to compete in dynamic global protein markets for a successful future.*

The more pressing need, as identified by Dr. Purcell, is to understand and address issues "that would help the long run and structural issues that are prompting the price pressures" (Purcell, 1999). There is critical need to understand why the industry has evolved to have the structure that exists today and to function the way that it does. "

The rest of the 183 pages proves beyond a shadow of the authors' doubt that supply and demand market forces explain all price discrepancies; that increased levels of "spot" market sales will result in lower cattle prices; that Alternative Marketing Agreements (AMA) are absolutely essential to the functioning of the cattle industry; and that it is only because of the economies of scale of the packers that cattle prices are as high as they currently are. The arguments on all of four of these core arguments are chock full of convenient omissions and inconsistencies.

Supply and Demand: In many places in these Proceedings it is asserted that supply and demand fully explains the discrepancies in market prices. There is not one reference to the many studies that show conclusively that with increase in captive supply (aka AMA) there is a decrease in price.

For instance, John Schroeter and Assedine Azzam, using market data from 1995/96, found that there was $1.13 per head decrease in price for each 1% rise in captive supply. That would mean that the difference in price for a 1300-pound steer where there was zero percent (0%) AMAs and sixty percent (60%), would be $67.86. I may not be an economist but that does not seem like peanuts to me. Incidentally, Ted Shroeder and Stephen Koontz, both of whom are authors in these Proceedings, also published a study that indicated a strong negative (and statistically significant) correlation between increased captive supply and decreased prices. Somehow, they fail to take their own research into account.

Spot Market: The initiative that these economists collectively most want to prevent is the 50/14 proposal introduced by Senators Grassely and Tester. This amendment to the Livestock Marketing Act would require that fifty percent of all fat cattle be purchased through the negotiated spot market. In Chapter 3, Bastian et. al, cites an experiment done by Menkhaus et.al, which found that negotiated sales when compared to auctions resulted in prices 10% lower than optimal.

It is this that Koontz in Chapter 5 extrapolates, claiming that by mandating that 50% of the cattle are sold on the spot market, it would cost producers $2.5 billion the first year and 16 billion over ten years. But if increased use of the spot market results in lower producer prices, then why does he not recommend the elimination of all negotiated spot market sales? That would be the logical course of action, if negotiated spot markets sales cause lower prices for producers.

However, Dr. Koontz does go on to explain that use of "…AMAs do not create market power as they do not change the supply and demand fundamentals, nor do they change control of the transaction process." If this is true, why then would increasing the numbers sold on the spot market decrease prices as he had just maintained. Would not the "supply and demand fundamentals" still be the same? Maybe it is just me, but there appears to be some confusion.

Intuitively, most of us would agree that when one of the 40,000 or so feedlot operators negotiates with one of the 4 packers, the feedlot owner is at a natural disadvantage. Whether this results in a negative 10 percent result or not, I am not sure, but a negotiation between parties where there is a major discrepancy of power will most often result in a disadvantage to the one in the weaker position.

On a personal level, I am not a fan of the 50/14 proposal but for very different reasons. First, no one has explained how the Livestock Marketing Act can be amended to mandate that cattle sales be conducted in a prescribed manner. Second, if 50% of cattle are required to be marketed through a negotiated spot market, this implies that the other 50% will then be legally marketed through captive supply. It is my reading of the Packers and Stockyards Act, that captive supplies should be declared illegal.

Alternative Marketing Agreements: Many of the words in these papers are devoted to telling us what fantastically beneficial things are these AMAs (aka Formula Contract and Captive Supply). Apparently, without AMAs, beef would be tough tasteless stuff. They go on to claim that only through the use of AMAs can feeders get paid the true value for their cattle, because when selling through the spot market, feeders only receive average prices.

I think that cattle buyers would be bemused by this notion. Every cattle buyer with a few years of experience under their hat that I ever met, always knew exactly what they were buying. Naturally, they would negotiate to pay the least possible, but if you had quality cattle to sell you would get paid for that quality. The reported negotiated spot market averages sales together, but those prices include high prices for quality cattle and lower prices for lessor quality. The notion that feeders can only be paid for their quality through AMAs is ludicrous. If this is case, how does one explain that the use of AMAs are highest in Texas which has the lowest quality cattle, and the least used in Nebraska which has the best.

The other questionable assertion is that it has been the use of AMAs that has driven the improvements in beef quality. It may be that these economists are in danger of confusing correlation with causation, a sin, economists in general, delight in accusing others. Seed stock producers would certainly make a strong argument that it has been the adoption of EPDs and embryo transfers that has resulted in a rapid and significant improvement in the quality and uniformity of the U.S. cattle herd.

Economies of Scale: Another claim by Koontz is that producers benefit from the economies of scale of the large packing plants. He shows that there is a $20 per head difference in efficiency between a plant that can slaughter 70,000 head per month versus one that processes 140,000. Apparently, the smaller of the large plants can kill for about $200 per head while the very largest for $180. Dr. Koontz's goes on to assert that producers are the financial beneficiaries of these economies of scale, and that this benefit outweighs whatever benefits might accrue from better market competition. He does not, however, explain why owning 10 or 20 of these large packing plants, as is the current practice with the dominate packers, is necessary. The economy of scales that he describes are only for operating a single plant.

Incidentally, my neighbor who operates a custom exempt slaughter facility, charges $120 for killing, chilling, and aging a steer. Chances are for another $60 I could talk him into cutting it into chunks and dropping it all into a box.

Addressing the Complex Structural and Behavioral Issues: The authors complain that cattle producers are not "…addressing the complex structural and behavioral issues…" and that "… overly simplistic solutions will have long term detrimental impacts on cattle producers…" However, in the entire 183page document there only three half-hearted attempts to identify and address what are, in their estimation, the "structural and behavioral" issues.

In Chapter 6, Maples and Burdine, question the need for maintaining the confidentiality of the packers in reporting sales, and makes a case for increased reporting. Maples and Burdine also like the idea of a published library of contracts. This would allow feeders to understand the deals

being offered to other feedlots. Senator Deb Fisher of Nebraska has introduced the Cattle Market Transparency Act which address both of these issues.

Bastian et. al. in Chapter 3 reminds Dr Peel that he had written in 2020 that "…adding a transparent electronic trading platform for spot market transactions could improve price discovery for fed cattle markets with even a small amount of transactions." Bastian et. al. goes on to say, "We extend that suggestion here as an alternative for consideration to policies focused on mandating increased negotiated cash trade. Research suggests that a double auction would likely be the best trading institution for such an endeavor (Menkhaus et. al., 2003). Price discovery will tend to be efficient in this institution provided a sufficient number of buyers and sellers participate."

What Bastian et. al. are proposing has already been proposed, and all of the other economists featured in these Proceedings should be well cognizant of this proposal. However, they somehow fail to mention it. In 1997, The Western Organization of Resource Councils (WORC) petitioned the Secretary of Agriculture for rulemaking that would require that all fed cattle transactions be transparent and competitively priced. In 2007, Senators Tester and Grassely, picked up the concept in their Captive Supply Reform Act.

This approach is similar to that of the original Consent Decree accompanying the passage of the Packers and Stockyards Act in 1921. At that time, the packer cartel owned the market place. As a result of the Consent Decree, they were required to purchase their cattle through a third-party marketing system. It worked. Competition was restored to the cattle market until the Reagan Administration stopped enforcement of the P&S Act.

We have a similar situation, today, because the packer cartel has de facto ownership of the fed cattle market platform. Therefore, the same solution should apply. Packers should be required to make their purchases through a third party operated market. The WORC/Captive Supply Rule would require that all AMA contracts have a base price set at the time of initiation which would be subject to a premium or discount when delivered. This approach maintains all of the benefits said to accrue to the use of AMAs while providing full transparency and optimum price discovery.

Country of Origin Labeling: Dr. Peel goes out of his way to disparage COOL and appears relieved that it was rescinded. However, he does not explain why he feels that it is beneficial to the U.S. cattle industry to have consumers believe that they are buying beef born, raised, and processed in the USA when it is in fact it comes from Brazil?

Final: Since these economists prefaced their papers by insulting cattle producers, perhaps it is only fair that a cattle producer concludes this review of their work with blunt candor. When Land Grant University economists come out from behind the security of their tenured publicly subsidized positions, such that their paychecks are subject to the uncertainties of supply and demand market forces, then they will earn the right to lecture those of us who do.

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The Way to Fix a Flawed Compromise is to De-couple “Negotiated” from “Spot”

Dear Editor,

Senate Bill 3229, is said to be a compromise merging the 50/14 concept proposed by Senators Grassely and Tester, with a bill that enhances mandatory price reporting advanced by Senator Fischer. The original version of the 50/14 proposal would require that half of the fed cattle be purchased on the “negotiated spot” market, and Senator Fischer’s contribution would require mandatory price reporting of all fed cattle sales, along with the publishing of a library of forward and formula contracts.

Because less than twenty percent of the fed cattle are sold on the “negotiated spot” market, which is then used to price the remaining eighty percent - this clearly results in inadequate “price discovery.” Absolutely! The number of “spot” market sales must be increased, and fifty percent is a good target. However, the flaw in this proposal is coupling “negotiated” with “spot.” A “spot” market is a “cash” market for immediate delivery. A “negotiated” market is one where the buyer and seller agree in private on the sale terms.

The problem in any “negotiated” market is that there is a built-in bias in favor of the buyer. This is because the seller has already invested their money in the cattle and have a lot to lose if the market goes down. Buyers, on the other hand, have time on their side and other cattle from which to choose. This dynamic results in a lower “negotiated” price than what “supply and demand” conditions would otherwise warrant. Economic research confirms this downward bias.

If half of the cattle are required to be sold on the “negotiated spot” market, this will result in lower overall cattle prices. The solution is to de-couple “negotiated” from “spot” and require instead the use of an electronic/video auction market mechanism for the “spot” marketing of fed cattle.

Here in cow/calf country there tends to be a distrust of auction markets. This is probably because most of us have been burned when a load of calves or culls were sold for less than they should have. As a result of these bad experiences, many ranchers prefer to market their calves by “negotiating” with a trusted buyer. The feeling is that not only is one avoiding the risk of a bad sale, you are also avoiding the four percent auction fee, along with the shrink when your calves wait three or four hours to be weighed after already being on a truck for two.

There is, therefore, a legitimate reason to prefer to “negotiate” rather than sending the calves to the auction barn. However, an electronic/video market overcomes many of those objections. And too, one does not really avoid the four percent marketing fee because the buyer with whom you “negotiate” also has costs that needs to be covered. The only reason that the “negotiated” market for feeder calves works as well as it does is because a significant number of calves are sold at the auction barns or through the electronic/video auctions. This provides an honest reference. Ultimately, the most efficient and most accurate way to arrive at optimum “price discovery” is through an auction. It may not be perfect, but auctions are, in the long run, better

than all of the alternatives. And as an added bonus, the prices derived at a public auction is open for all to see.

In the fed cattle market, there is no honest reference, because all "spot" market sales are "negotiated." We mitigate that to some degree by mandatory price reporting. A better solution would be to require that the "spot" market be conducted through an electronic/video auction where not only is "price discovery" more accurate, the market information is public.

Why stop there, why not require that all fed cattle be sold in an electronic/video auction. Just as in the case of the electronic/video sales for the future delivery of feeder calves, an electronic/video auction for future delivery of fed cattle would work very efficiently. As with feeder calves, where a base price is set at the time of the sale and adjusted at the time of delivery, appropriate terms can be incorporated in the contract.

We are told by the beef packers, their captive economists, and the NCBA that it is absolutely essential that most of the cattle be marketed through alternative marketing agreements (AMA) - better known as "captive supply." Otherwise, they contend the quality of the cattle will deteriorate and consumers will stop buying beef. Maybe or maybe not, but by employing an electronic/video market mechanism, operated by an independent marketing company, packers could enter into forward delivery contracts where the base price would be adjusted at the time of delivery to compensate for actual carcass quality.

Such a market would preserve all of the alleged benefits of the current "captive supply" system, except that the packers would not be able to manipulate cattle prices in their favor. If the "spot" market sales were also reached through an electronic/video auction, the entire market for fed cattle will be open and competitive. Optimum "price discovery" would result.

This in turn would allow the feeder calf market to be more competitive. Instead of the current situation where the continual losses by the feeders are passed down to the cow/calf producers, actual supply and demand conditions would prevail. In 1921 they solved the monopoly problem of their day by requiring that cattle be purchased in an open and competitive forum. This requirement allowed smaller packing firms the opportunity to compete in an honest market along with full transparency of the resulting sales. It worked then, and it will work now.