

## Why Can't We Do What our Great Granddads Did.

Last summer our son visited and brought his puppy which gave us endless amusement watching that dog chase her tail. That was fun, but I am getting sick and tired of watching cattle producers chase their tails on market reform ideas that go nowhere.

Most of us have known for a long time that the cattle market is dysfunctional, but there has not been much of a desire to do anything about it. Last year's fire in a Tyson packing plant and the market disruptions caused by the COVID - 19 epidemic hit a nerve and perhaps we have a consensus that something needs doing to restore competitive pricing in the fat cattle market. But what? That is the sticking point.

The 50/14 proposal, where half of the cattle would be sold on the spot market, is being advanced by a number of cattle organizations. However, they neglect to tell us just how this concept can be legal. No one has pointed to a statute that can compel a meat packer that they must purchase half of their needs in a government mandated manner?

Answer me that question and maybe I can take the 50/14 proposal seriously. And what about the cattle feeders? If packers are required to buy 50% of the fat cattle on the spot market, then feeders would also be required to sell 50% of their cattle that way. How can such a scheme be legal and how will it be policed? And then remember, if half the cattle are sold on the spot market, the other half continues to be unpriced captive supply. Does the 50/14 approach really fix anything? It looks to me to be like using a Band-Aid on a gaping wound.

Naturally the National Cattlemen's Beef Association (NCBA) cannot go along with something that any other organization proposed, so they have countered the 50/14 plan with some kind of incomprehensible "volunteer" 75% market proposal. NCBA did go one step further to put real teeth into their plan. They threatened that if the packers do not follow the 75% plan, NCBA would do **SOMETHING**. Do what they did not say. Perhaps hold their breath until they turn blue!

Some are saying that having a stronger spot market is one thing but what is really need are more negotiated sales for fat cattle. They argue that feeders should negotiate more vigorously for formula contracts. Yes, they undoubtedly should, but the reason that we have a situation where there is an almost nonexistent spot market while the bulk of the cattle are sold through unpriced captive supply arrangements, is because the packers have arranged things that way. Why would they haggle with feeders when they know that the cattle will come to them on the packer's terms anyway? That is why it is called captive supplies.

There seems to be a hope that if the Justice Department (DOJ) investigates that they would do something to hold the packers accountable for the market dysfunction. I hate being the "Debby Downer" but the Justice Department does not have jurisdiction over the Packer and Stockyards Act. That is the responsibility of the Department of Agriculture.

DOJ can investigate under the Sherman Antitrust Act which forbids market collusion. The trouble is that collusion is defined very narrowly. Corporate executives must be found to be sitting down together and actually negotiating prices and market share. The packers are smarter than that, besides they have whole buildings full of lawyers making sure that their executives do not directly collude. Indirect collusion, however, is perfectly legal.

There is a way to restore competition in the fat cattle market that is both legal and doable. All that needs to happen is to do what they did 100 years ago when the packing cartel of that era was required to divest of their proprietary market system and instead bid for cattle in a public competitive marketplace.

This approach solves both the captive supply and thin spot market problem. And it is both legal and has legal precedence. The Packers and Stockyards Act clearly states that the “effect” of having a dysfunctional market is sufficient grounds for the Secretary of Agriculture to take action. All that the Secretary needs to do is require that the packers bid in a public competitive market place.

The beauty of this approach is that there would be no new bureaucracy required to enforce it. The privately run market places will do so automatically because feeders would offer their cattle and packers would bid for their needs in open competition. If feeders and packers agree that they prefer to contract some of the cattle for future delivery, then there could be a public market for future contracts. We do that all the time with feeder calves through video/electronic markets that work very well.

There are some in this industry who are always telling us how important it is to be able to “sell on the grid.” Apparently, if feeders don’t “sell on the grid” all manner of terrible things would happen – quality would crash and consumers would stop buying. I don’t know about all that, but requiring that cattle be publicly priced does not hinder “selling on the grid” in any manner what-so-ever. All that needs to happen is that a base price is set and the terms of the grid published at the time the contract is made. It is just that simple.

Let’s stop chasing our tails and put our efforts to solving our market dysfunction once and for all. Our great granddads did it in 1921. Why can’t we do the same in 2021?

Gilles Stockton  
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January 10, 2021

April 28, 2020

Unintended Consequences.

The collapse of cattle prices following the outbreak of coronavirus has most certainly got our attention and has sparked an intense desire to do something about it. One idea that has gotten traction is to require that beef packers purchase more of their cattle in the spot market, which at best has been only 20% of the cattle and sometimes nearly none. Both the US Cattlemen's Association (USCA) and R-Calf have come up with competing versions of this idea. USCA wants 30% of total fat cattle sales to be made in a spot market while R-Calf ups the ante to 50%. My feeling is that we had best beware the law of unintended consequences.

More cattle purchased in the spot market would probably semi-solve a problem in pricing cattle sold under formula and basis arrangements (captive supply). But it is the unintentional flip side that is the problem. Requiring a certain level of spot market purchases, sanctions the captive supply practices which makes up the rest of the market - 70% captive supply in the case of the USCA's plan and 50% in that of R-Calf. This would not be good.

In looking to solve one problem, USCA's and R-Calf's proposals unintentionally concedes that packer monopoly and market dysfunction is inevitable. Passage will add to the economic forces pushing cattlemen to join the ranks of chicken and pork producers as vertically integrated cogs in a giant meat machine. An actual public competitive market for cattle will be a thing of the past as is already the case for chickens and pigs. I am sure that the proponents of enhanced spot market purchases do not desire this outcome.

Requiring packers to buy more fat cattle on the spot market will not increase competition or price discovery. The spot market is nothing more than a negotiated sale for near term delivery. Because of the Mandatory Price Reporting law, spot market sales must be reported, which at least is a positive thing. The spot market price, in turn, is used to settle the delivery price for the captive supply cattle.

It will still be the same four packers buying and each will still have their own territories, which effectively eliminates any chance for competition between them. And there would still be no opportunity for a small competitor to bid against the big boys. In short, requiring that packers buy more cattle for immediate delivery would shine a little light on cattle pricing practices, but not nearly enough.

The worst effect of this approach is that it would undermine the most important protection we have that is written into the Packers and Stockyards Act - the prohibition of undue preference or unreasonable prejudice:

It shall be unlawful with respect to livestock . . . for any packer . . . to:

- (a) Engage in or use any unfair, unjustly discriminatory, or deceptive practice or device;
- or

(b) Make or give any undue or unreasonable preference or advantage to any particular person or locality in any respect whatsoever, or subject any particular person or locality to any undue or unreasonable prejudice or disadvantage in any respect whatsoever; or . . .

The way that the market for fat cattle has evolved is plainly in violation of the P&S Act because it is based on secret arrangements which are predicated on undue preference and unreasonable prejudice. The reason that this happened is that beginning about 1980, the Justice Department made a policy decision to stop enforcing the antitrust laws.

Neo-Liberal economic theory coming out of the Chicago School of Economics, became the government's de-facto anti-trust policy. Under this economic theory, it is assumed that larger firms have natural economies of scale which in turn results in lower prices for consumers. The effect on the market for those of us who supply the dominant firms with raw materials is, under Neo-Liberal economic theory, irrelevant.

But the anti-trust laws are still on the books, and the Packers and Stockyards Act would no doubt be delighted if the Packers and Stockyards Act was weakened. All that I am writing here would be merely academic if there were no proposal out there that would actually fix the cattle market dysfunction - once and for all. Not only has one been proposed, it has been vetted from both a legal and economic perspective. In addition, in 1999, USDA actually held a hearing on this proposal with nationally recognized legal and economic experts debating the pros and cons.

Of all of the ideas that have been tossed around, only Captive Supply Reform actually solves our problem. It simply states that in order to be compliant with the P&S Act, 100% of the fat cattle must be purchased through a public market. This can be an exchange where the price and terms are publicly offered, or preferably a virtual auction, similar to the video market through which a large number of forward contracts for feeder calves are sold.

The actual wording is very simple. Captive Supply Reform only requires that a base price be set at the time the contract is agreed to. Instead of mandating that a set percentage of cattle be purchased on the spot market, feeders and packers would be free to enter into forward contracts for any length of time that is convenient for their purposes. Just as in feeder calf forward contracts, a base price would be set along with a list of conditions that will adjust the final settlement.

If packers desire to also be in the cattle feeding business, their cattle would have to be offered for sale in a public forum. If fat cattle are shipped in from Canada, these too would have to be priced through a public forum. The beauty of all this is that no regulatory agency would be needed to monitor the program, because all of the

prices and terms of sale would be publicly open. The other beauty of Captive Supply Reform is that, although it does not break up the packer cartel, it would allow, for the first time in half a century, true competition by start-up specialty packer firms.

I have been told that Captive Supply Reform is too ambitious, and that it would be better to tinker by fixing the cattle market in incremental steps. Besides, I have been informed, there is currently interest in Congress to require more cattle be sold on the spot market and we should take advantage of this interest. But have the allies in Congress actually held hearings and debated the pros and cons - and the alternatives? I don't think that this has happened.

This coronavirus pandemic has revealed how vulnerable our globalized economy actually is. Outsourcing of manufacturing, just in time delivery, dependency upon autocratic governments, control of important industries by criminal elements, the wholesale monopolization of key industries - Free Trade is revealed as a cynical lie. In agriculture, beef markets are undermined by imports while wheat, corn and soybean exports are vulnerable to every global hiccup.

It is clearly time to rethink the structure of our economy including a complete overhaul of farm and rural policy. Captive Supply Reform was proposed by a number of western state's senators back in 2007, but it was our organizations that failed to coalesce to push for its passage. Division, among like the minded cattle producer organizations, has failed us time and again. However, we now see how vulnerable our future as independent cattle producers has become, the time has come to unite and restore competition to the cattle market.

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#### USDA Enables Rustlers

We brand our calves to prevent theft and that works pretty good but as a result of Department of Agriculture Secretary Purdue withdrawing the GIPSA Rules, once those cattle reach a slaughter plant, rustling is condoned. Theft by packing plants may not be strictly legal but since there is nothing practical that a cattle owner can do about it, it comes to the same thing. Under President Obama, USDA went through the rule making process to clarify the Packers and Stockyards Act as to what kinds of actions by packing plants and poultry integrators is "undue and deceptive." Underpaying because of inaccurate weights and wrong grades was definitely considered "undue and deceptive" under the new GIPSA Rule.

The Trump Administration withdrew the GIPSA Rule as fast as they could and now that a Federal Judge has agreed with them, cattle producers again do not have the right to sue packers for under weighing and mis-grading carcasses. The National Cattlemen's Beef

Association (NCBA) apparently agrees with the withdrawal of the GIPSA Rule because according to them, if cattle feeders are allowed to sue beef packers for underpayment, the entire system of marketing fat cattle would fall apart.

The NCBA is right of course, if packers were required to bid on cattle and accurately pay for what they bought, the current system would fall apart. Captive supplies are what makes the current market for cattle work, and captive supply is designed to extract cattle from the people who raise and feed them as cheap as possible. It is perfectly true that this is what companies do, they strive to buy low and sell high. The problem is that when a segment of an industry becomes sufficiently concentrated, it no longer makes sense for them to actively compete against each other. Economic studies have clearly shown that the three dominate packing companies have every incentive to coordinate how they buy and sell their products - in this case fat cattle and beef.

The purpose of anti-trust laws is not to punish successful businesses but to insure competition. When an industry becomes too concentrated, competition is compromised which in turn distorts the market and the structure of that industry. We see that clearly in the drastic loss of smaller independent cattle feeders. This is important for cow/calf producers because with fewer independent feeders and the growth of larger feedlots that are vertically integrated with packing firms, there is less competitive bidding on feeder calves. Witness this past fall's feeder calf sales which were uniformly less than the cost of raising them.

USDA withdrew the GIPSA Rule in October of 2017. By December 2018 USDA announced that they were fining JBS USA for not accurately tracking, weighing, and grading dressed carcasses. This underpayment happened over a four-month period starting in December of 2017 through March of 2018. JBS was fined a whopping \$50,000. This is a fine example of our government looking after our interests and protecting our backs.

The Packers and Stockyards Act is a continual embarrassment to the packing concerns and their captive supply of cattlemen's associations, docile federal employees, bought and paid for politicians, and agricultural economists. The Act clearly states that packers should not be engaged in deceptive practices but because their business model is based on deceptive practices, they are in constant violation of the law. They get by year after year by conveniently ignoring this law, emasculating the regulators, and using litigation to block reforms to the cattle markets. It is interesting that the NCBA and the packers are in favor of litigation when it them doing the suing, but they oppose cattle producers being able to sue for accurate payments. Past statements by the packers and the NCBA are quite clear, should cattle feeders ever be allowed to sue beef packers the sky would fall.

We have a see saw situation going on. The Democrats, when they have power and after they have summon up a little bit of courage attempt to reform the cattle market. Over the last two decades Democrats looked at forbidding captive supplies, passed Country of Origin Labeling, and enacted the GIPSA Rule. The Republicans, on the hand, rescind these reforms as fast as they possibly could.

It is actually quite simple to restore function to this dysfunctional livestock market. All that is needed is to require that packers actually bid for their cattle supply. Individual cattle producers have a couple of choices about what to do about cleaning up the fraud in the cattle market. One of them is to continue to do what most cattlemen have been doing - which is not putting

up much of a fuss at all. On the other hand they can insist that Country of Origin Labeling is reinstated and follow that up with restoring competitive markets in fat cattle.

December 20, 2017

The Farmer Fair Practice Rule or Serfs on Our Own Land

According to the Merriam Webster Dictionary, *sophistry* "... is reasoning that seems plausible on a superficial level but is actually unsound, or is used to deceive." In other words, *sophistry* is a fancy word for a certain type of lying. Wes Ishmael, Contributing Editor of Beef Magazine, is engaged in *sophistry* in a December editorial, "Focus On Consumer-Based Value, Quality Differences."

What Mr. Ishmael is applauding in this editorial is the demise of the Farmer Fair Practice Rule at the hands of Secretary of Agriculture Sonny Purdue. According to Mr. Ishmael "...these rules would have eliminated the need for someone to prove competitive injury in order to win a GIPSA lawsuit. ... the rules could have unhinged the alternative marketing arrangements that enable producers to receive more than an average price for more than average value."

In this editorial Wes Ishmael is parroting the National Cattlemen's Beef Association (NCBA) attempting to link a rule that would have clarified the right of livestock producers to be treated fairly in the market place with the future of branded beef programs. Two things that have nearly nothing to do with each other. Mr. Ishmael and the NCBA apparently believe that livestock producers should NOT have the right to receive fair treatment from beef packers. To prove the case, he makes exaggerated claims about the benefits and virtues of branded beef programs. This is *sophistry*.

What he is conveniently glossing over, is that under the current Federal Court interpretation of the Packers and Stockyards Act (P&SA), a cattle producer who has been cheated on weights, grade, or price by one of the dominate beef packers must prove that not only was he cheated but that all other cattle producers were harmed by that action. I kid you not!

The P&SA was specifically passed to protect livestock producers from just these kinds of discriminatory practices and says so in very plain language: i.e. "*It shall be unlawful for any packer .... to engage in or use any unfair, unjustly discriminatory, or deceptive practice...*" It could take only a person meticulously trained in law, and apparently as in Mr. Ismael's case - economics, to conclude that in order for this law to be applied, one must prove that the harm you personally received at the hands of a meat packer, adversely affected the entire industry. Within Mr. Ishmael's nightmare scenario, should livestock producers be granted the right to sue packers for breach of contract, the packers would retaliate by no longer offering bonuses for quality. Just the fact that he feels that is plausible, reveals the very telling reality that packers are in a position to collude to set market prices. Mr. Ishmael is tacitly admitting that the market for fat cattle is not based on verifiable competitive price discovery. The packers strategic use of captive supplies has thinned the spot market to such a degree that it longer reflects the actual state of supply and demand.

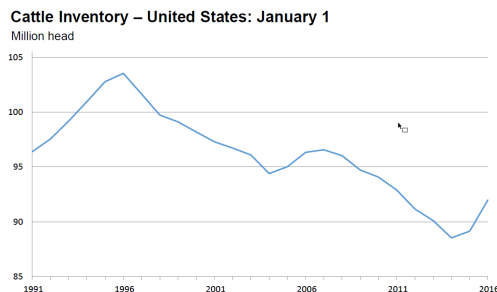
In his article, Ishmael places great importance on his assertion that marketing arrangements has resulted in higher quality beef and that bonuses for exceeding standards are an important incentive driving this trend. Maybe so, but even an economist should be able to understand that a bonus premised on a base price that is fundamentally fraudulent is also fraudulent.

Then too we must understand that the definition of quality is in the eye of the beholder. Certified Angus Beef (CAB) is perhaps the most successful of the Branded Beef marketing arrangements and it is based on black hided cattle that have a high potential to grade choice and prime. There are perhaps many who would assert that grass-fed beef is an inferior, less than average product. However, there are also many consumers who willingly pay a premium for a grass-fed beef steak.

Why should any of us begrudge a producer who has a grass-fed branded product and is able to profit from that. Of what earthly matter is it that the grass-fed cattle do not have the same percentage of prime as do the CAB cattle. As long as the grass-fed producers and the CAB producers are satisfying their respective customers, we should be grateful.

What should worry us more is how Branded Beef Marketing Arrangements are driving vertical integration of the beef industry. Market Arrangements based on non-competitive market pricing will ultimately result in contract serfdom. On the other hand, Market Arrangements based on public, open, and competitive markets will foster independence and insure the future vitality of the livestock industry.

The issue, therefore, is whether both the grass-fed and the CAB producers are receiving fair market value for their labor. If they are not, and by all indications they are not, then correcting that market dysfunction should be the primary concern of livestock economists, magazines like



BEEF, organizations like the National Cattlemen's Beef Association, and all conscientious cattle producers. The Farmer Fair Practice Rule was a good start in the difficult process of restoring integrity to the cattle market. We should not be celebrating its demise - we should be plotting its restoration.

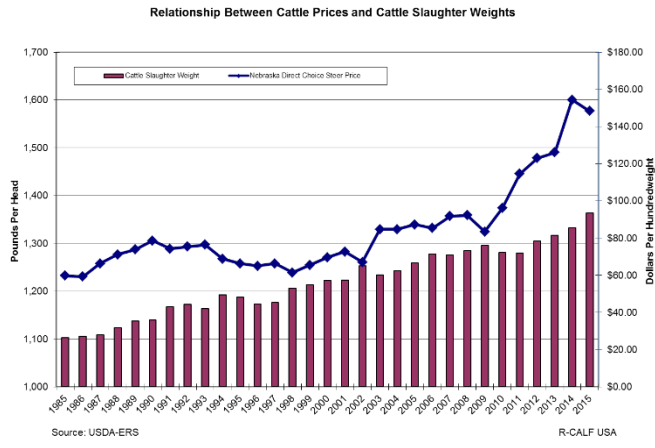
### **There is a Solution**

By now, the disaster that is the cattle market has been factored into the coming year's budget. For some it means the end of a dream to own a ranch, for the remaining it means a hard assessment about what will be affordable. The disaster is trickling down through the economy, to the businesses that supply goods and services to agriculture, and to the legislators and county commissioners, who are scrambling to fund schools, maintain roads, pay for social services, and law enforcement with less tax revenues. It is a depressing situation but there is a solution.

The solution, however, is only available if we focus clearly on what is wrong in the cattle market. First we must understand that a collapse of 45% to 50% in feeder calf prices cannot be justified by citing supply and demand. Healthy markets do not have these kinds of swings. After years of decline to the lowest inventory ever, US cattle numbers were up by a modest 3% in 2016. In addition, the cattle in the feed yards may have been kept a little longer, increasing carcass weights by about 2%. Although these percentages were calculated from USDA sources, it should be understood that 2016 numbers are projections, and we will not know actual statistics for a year or so. (see Figures 1 & 4)



We should also not forget that in 2015 Congress rescinded Country of Origin Labeling (COOL), an action which put negative pressure on Figure 1 the cattle market. There is every indication that COOL was working to promote USA produced beef, which explains the insistence by packers to have it overturned.



On the positive side, however, beef and cattle imports decreased by about 12 percent, and exports increased by 9 percent. This does not mean that the trend is permanent. 2015 had the highest level of imports and lowest level of exports in recent years. The 2016 projections could be just a readjustment to a more normal level of imports and exports, with the long-term trend going for more imports and lower exports. (see Figures 2 & 3)

Also on the positive side we saw lower corn and soybean prices in 2016. With the cost of gain for cattle on feed decreasing, this should have resulted in upward pressure on the feeder calf market.

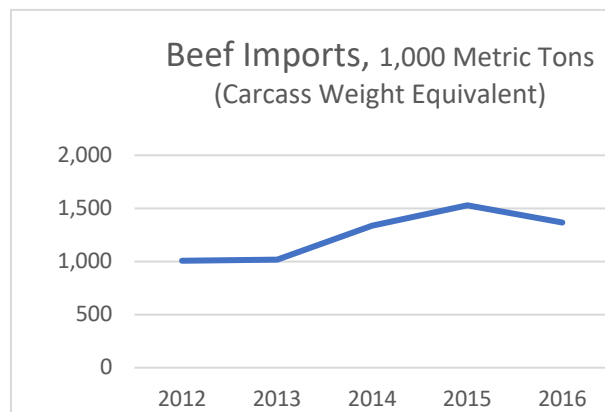
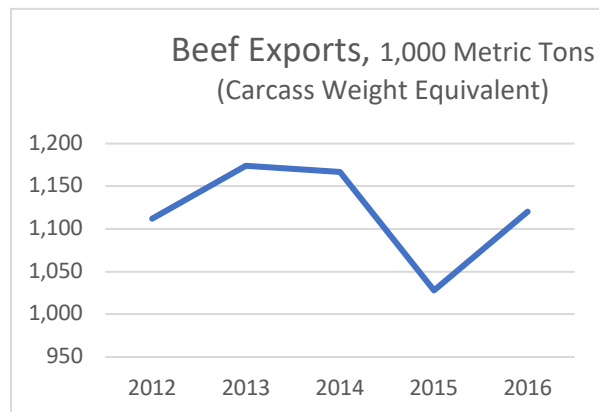
Yet instead of a modest re-adjustment of cattle prices, the market for cattle nosedived while at the retail level, consumers got only a minimum decrease in beef prices. An additional indicator that something is not as it should be is the Chicago Mercantile, which suspended trade in cattle futures because the spot market for fat cattle, a necessity to settle contracts, went up in smoke.

When the professional gamblers push away from the table, the cowboys should take notice that something is fundamentally wrong.

The disappearance of the spot market for fat cattle is the crux of the dysfunction in the cattle market. Unpriced captive supply contracts and arrangements now dominates the relationship between cattle feeders and packers. The solution is simple.

Competition must be restored in the cattle markets by requiring packers price their supply in a publicly traded market. Figure 4 that

This was first proposed in 1997 by the Western Organization of Resource Councils (WORC) in a petition for rulemaking to the Secretary of Agriculture. The entire legal and economical rationale



can be found in the Federal Record (Vol. 62, No. 9 Tuesday, Jan. 14, 1997, page 1845). USDA held a hearing on the concept, but administrations changed and the Bush Administration was not interested in pursuing the matter. The concepts first proposed by WORC, were picked up in 2007 by a handful of western Senators (both Republican and Democrat) and proposed as the Captive Supply Reform Act (110<sup>th</sup> Congress, 1<sup>st</sup> Session S. 1017). But because livestock producers did not demand passage of this act, it languished.

The arguments for restoring integrity and competition to the cattle markets by actually enforcing the Packers and Stockyards Act (P&S Act) are legally sound, economically elegant, and morally correct. The rule proposed by WORC in 1997 has two parts. The first is:

*No packer shall procure cattle for slaughter through the use of formula or basis price forward contracts. All forward contracts used by packers for purchase of cattle slaughter supplies shall contain a firm base price that can be equated to a specific dollar amount at the time the contract is entered into and be offered or bid in an open public manner.*

The second part:

*No packer shall own and feed cattle unless those cattle are sold for slaughter in an open public market.*

The rule is premised on requiring packers and feeders to switch from a secret negotiated price system, to a public bid market, presumably in an electronic format. Such an electronic market would function for both immediate delivery (spot market) and for delayed delivery (forward contracts). Electronic market auctions, such as commonly used for feeder calves, have proven to be highly efficient and a very cost effective method to clear a market. By using an electronic auction for fat cattle, everything would be above board, publicly open, and completely neutral as to the size of the sellers and buyers.

The second part of the rule proposed by WORC presumes that beef packers may, as they do in their hog and poultry subsidiaries, prefer to be in the cattle feeding business as well as slaughter. If that is the case, and in order to not be in violation of the Packer's and Stockyards Act, packers should be required to make the finished cattle available for purchase to all potential bidders through the same electronic market system. If it is a blind bid auction, they can buy their own livestock back without violating the Act.

Inexplicably the criticism of Captive Supply Reform was that this would be an interference in the "marketing preference" of livestock feeders. This is puzzling argument. A livestock feeder should either want to sell for immediate delivery or know in advance the terms, the price, and the date of delivery. What other kind of "marketing preference" is there unless a livestock feeder actually prefers to not have any say, what so ever, in determining delivery and price. Which is incidentally, the situation faced by contract poultry and hog growers.

An electronic market for forward contracts could accommodate all manner of flexible terms and incentives. If for instance feeders and packers would like to base the final price with a premium calculated from the market at the date of delivery, there is no reason that the forward contract could not accommodate that desire on the condition that a competitive spot market actually exists. The only requirement imposed by Captive Supply Reform is that a base price be set at the time the forward contract is entered into. Premiums for meeting certain goals could also be included in the contract. In addition, if the feeder's cattle were of a quality that fit a

Figure 5

special market brand, but the packer managing that branded beef program did not offer the highest bid, there is no reason that the feeder could not choose the

lower bid. It is unclear why they would do so, but they could. The only “market preference” that this rule does not accommodate is that of contract servitude.

LMR Purchase Type Breakdown by Region												
NATIONAL												
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Jan - Aug 2016
Cash	52.1%	49.4%	47.3%	42.6%	38.8%	37.4%	32.6%	26.0%	23.1%	23.1%	21.3%	25.4%
Formula	33.2%	34.3%	37.4%	39.1%	43.7%	43.1%	47.4%	54.8%	59.8%	56.8%	57.0%	57.1%
Forward Contract	4.8%	7.2%	6.8%	11.2%	9.5%	11.9%	13.2%	12.0%	10.8%	15.8%	17.5%	13.5%
Negotiated Grid	9.9%	9.0%	8.5%	7.1%	8.0%	7.6%	6.7%	7.2%	6.3%	4.3%	4.2%	4.0%

Source: USDA AMS Livestock, Poultry & Grain Market News

### History of attempts to reform the cattle market.

Winston Churchill is supposed to have said, except that it is apparently not true that he actually did: “Americans will always do the right thing, only after they have tried everything else.” The same can be said about the livestock industry which has tried every possible solution to fix the dysfunction in the market system except the one that will actually do the job.

The first attempt came from the National Cattlemen’s Beef Association (NCBA) when they backed mandatory price reporting of cattle sales. The NCBA’s probable motive was to prevent a more effective measure to enhance competition from being considered. Mandatory Reporting came to nothing since the four beef packers insisted that what they pay for cattle is proprietary information and that because there are only four packers controlling the market, their competitors could infer what each individual packer was paying and how many cattle they had committed. USDA immediately backed down and keeps the reported information confidential. Mandatory Reporting is a good idea that came to nothing because the cattle market is controlled by a cartel. It would not have, in any event, solved the dysfunction in the market because the problem with the market is that in fact, it is controlled by a cartel.

Next tried was Country of Origin Labeling (COOL) which was made law in 2002. The idea, from the respect of livestock producers is that consumers at retail would be able to distinguish between foreign and domestic product. The hope was that consumers would prefer to buy domestic beef which would give producers an opportunity to build a “Born, Raised, and Slaughtered in the USA” brand which in turn would support better prices. Consumers are more than ninety percent in favor of a country of origin label.

The packers went berserk. Every possible objection and delaying tactic was employed to prevent COOLs implementation. Following a World Trade Organization (WTO) objection filed by Canada and Mexico on behalf of the packers, COOL was not fully applied until 2013 when USDA published the final label requirements. This, however, was not the end because the governments of Canada and Mexico objected to the revised label requirements as well. Eventually a WTO tribunal ruled that COOL somehow violates our trade agreement with Canada and Mexico. The packers could not even wait for the WTO process to come to a final conclusion and in 2015 directed their captive supply Congresspersons to rescind COOL. COOL is a good and useful idea which helps to brand and market US produced beef. The indications are, that COOL was actually performing as cattlemen hoped, which is why the packers were so insistent on killing COOL. However, as good as COOL was, it did not get to the heart of the reason for the dysfunction of the livestock market.

In 2008, USDA, responding to a directive from Congress to address the problems faced by poultry growers in their business relationship with the poultry integrators, proposed the GIPSA

Rule (Grain Inspection, Packers and Stockyards Administration). This rule, "...would clarify when certain conduct in the livestock and poultry industries represents the making or giving of an undue or unreasonable preference or advantage or subjects a person or locality to an undue or unreasonable prejudice or disadvantage."

Section 202 of the Packers and Stockyards Act, states clearly that packers cannot give undue preference or prejudice in any transactions with buyers or sellers. The problem comes from Federal Judges who seemingly have trouble understanding what might be "undue" or "unreasonable" in a livestock market context. The GIPSA Rule supplied a "laundry list" of actions that constitute "undue or unreasonable preference or prejudice." These definitions addressed actual complaints made by contract poultry growers and pork producers. However, the beef industry is not structured the same as the poultry and hog industries and has not experienced the same level of vertical integration. For cattle producers, the GIPSA rules would not have been that useful in solving the market problems.

There was, however, one clause in the GIPSA Rule that was applicable to the cattle industry. The Federal Courts, in previous cases had come to the conclusion that a producer claiming discrimination by a packer had to show that this discriminatory action harmed the entire industry and not just that single producer. This is a ridiculously impossible standard and rendered the P&S Act essentially useless in protecting producers from harm in marketing and contracting. The GIPSA Rule stated that producers did not have to prove "harm to overall competition" when arguing that they had been subject to acts that were "deceptive," "unfair," "unjust," "undue" or "unreasonable."

The Republican dominated House of Representatives immediately declared that USDA had overstepped the Congressional directive and forbade the Secretary to use any authorized funds to implement the GIPSA Rule. Reform of the livestock market was essentially dead for the next six years, until the fall of 2016 when Secretary of Agriculture Vilsack proposed a new revised and pared down version of the GIPSA Rule. It did not take long for organizations such as the National Pork Producers Council (NPPC), The National Chicken Council (NCC), and National Cattlemen's Beef Association (NCBA) to attack the abridged version of the GIPSA Rule on the principal that it should continue to be legal for Packers to engage in deceptive, unfair, unjust, undue, and unreasonable practices. How the Trump Administration will deal with the abridged version of the GIPSA Rule is still an open question.

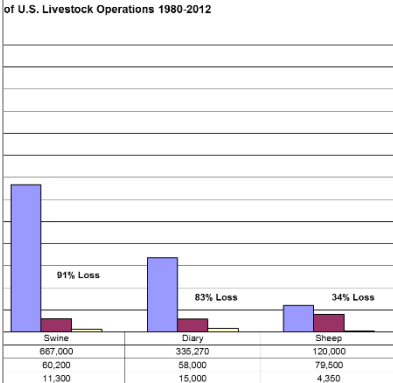
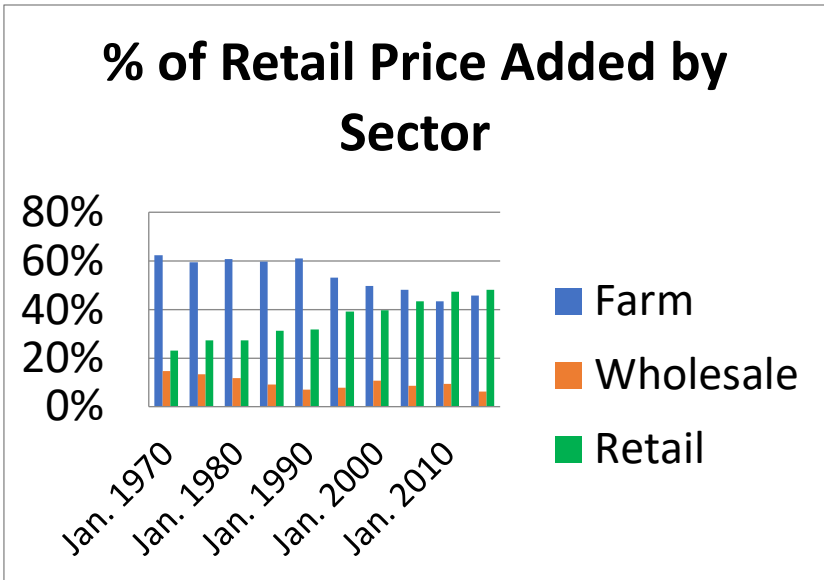
Figure 6

There was one additional effort to reform the dysfunctional livestock market, that was floated by hog producers who were facing the disintegration of the competitive hog market. They asked for a ban on the ownership of livestock by packers. This initiative did not consider that if packers could not own livestock during the fattening phase, they could still enter into unpriced captive supply contracts and arrangements with cattle and hog feeders. In any event this attempt did not reach the level of real consideration. Also, like Mandatory Reporting, COOL, and the GIPSA Rule, the ban on packer ownership did not get to the heart of vertical integration and market concentration.

### **Vertical Integration in the beef industry**

Because beef cattle are raised in two stages – cow/calf and then feeding – many cow/calf producers assume that they are immune to the kind of vertical integration experienced by poultry and hog producers. Hog producers probably felt that they

Figure 7

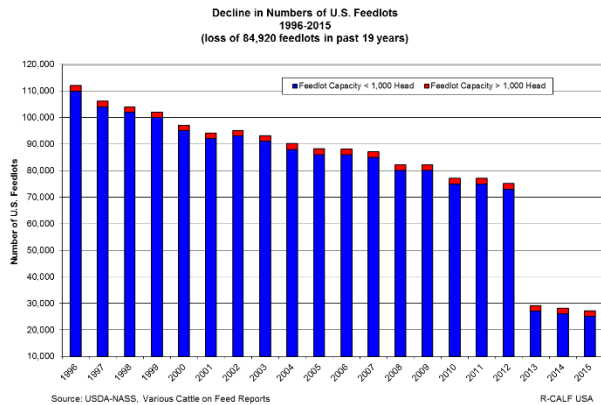


too were safe from vertical integration, but when the decision to integrate the hog industry was made in the

mid- 1990s, it did not take long to eliminate the independent hog producer. Today only 2.6% of hogs are sold in a public spot market. An independent pork producer can raise all of the pigs he wants to, it is selling them that is the problem.

(See Figure 6)

Cattlemen have been concerned about concentration in beef packing since the mid-1980's when it became apparent that a monopoly was forming. Although the numbers of cattle producers have steadily fallen over that thirty year period, cow/calf producers are still essentially independent and market many of their calves through auction yards or video/electronic market systems (See Figure 6). Cattle feeders, however, were



systematically vertically integrated into a captive supply procurement chain allied to one of the major packing firms. Independent feedlots have been eliminated, the spot market disappeared, and now a small number of large feeding firms control most of the fat cattle. The 2016 market season was pretty much the end for independent feeders. (See Figure 7)

Cow/calf producers clearly receive the residual prices after everyone else's margins and profits have been subtracted. Over the last 25 years the producers share of the retail beef dollar has fallen from more than 60% in 1990 to 45% in 2015 ( See Figure 8). We don't yet know the statistics for 2016, but the cow/calf operators share has most certainly plummeted over the past year. The packers over that same 25-year period have been able to hold on to their share of the consumer dollar but it is at the retail level where that 15% of the consumer dollar lost to the primary producer has been gathered. Retail dominate price setters. In order to maintain their down stream and pay less for fat cattle. Feeders in chains are clearly the profit margins, packers look turn squeeze the cow/calf

Figure 8

Chances are the packers do not want to own the land and the mother cow herd. It is more convenient and less risky for them, to leave the cow/calf sector independent as land owners but not necessarily independent as feeder calf suppliers. Control is exerted through low prices, fewer buyers, and imposed requirements such as source verification and pre-conditioning of calves.

We see the pattern. At first, pre-conditioning and source verification by placing RFID tags were options for which premiums were paid. Now both are required and there is no longer a premium. Although from a veterinary perspective, pre-conditioning, is a good idea, it can be a very expensive practice for ranches with remote pastures in mountainous or rough country. The source verification information now provided for free most certainly goes into a data base where producers are ranked and compared.

The imposed requirements can only increase. In the future, will pre-conditioning be sufficient, or will cow/calf producers be required to wean and hold the calves for a number of weeks before they can be shipped. Pre- approved genetics, and other types of required management practices, such as the use or non-use of growth promotors, are most certainly coming as cow/calf producers are herded into market chains. What is left of a competitive market for feeder calves will wither away and the cow/calf sector will be vertically integrated in practice if not in name. Unlike contract poultry and hog producers, they will not even have a contract. Cow/calf producers will just be captive suppliers.

#### **Why regulate packers but not the retail cartel.**

Some may question why focus this argument on reform at the packer level when it is retail that is controlling cattle prices. The reason is that the P&S Act only regulates packers. The growing, hegemony, of a small number of very large retail grocery chains (Walmart, Kroger, Safeway, and Publix) are regulated by other antitrust laws that do not have the same nondiscriminatory language. The retail grocery cartel deserves scrutiny by anti-trust officials, but that is an even more complex issue. The P&S Act is the legal tool available to cow/calf producers and the P&S Act clearly requires that packers not discriminate in buying cattle and in selling meat.

When packers negotiate exclusive supply contracts with a retail chain, this is just as much a violation of the P&S Act as when they have exclusive agreements with certain feedlots. The way for packers to avoid being in violation of the P&S Act is to sell meat through an electronic blind bid auction system.

#### **Would eliminating captive supply actually result in market relief.**

Breaking up the packers would, of course, be the most direct method to restore competition. Economic research has suggested that all economies of scale in meat packing are met in one of the large modern packing plants capable of slaughtering 2% to 3% of the national daily kill. This means that there could be 25 to 30 packing companies, all competing against each other without a diminution of production efficiency.

However, politically and legally, breaking up the packers would be a difficult and lengthy process tied up in years of litigation. It is not at all certain that breaking up the packer cartel would be successful. Going the route suggested by WORC and the Captive Supply Reform Act would not provide immediate relief from low cattle prices and in a sense, this is the strength of this approach. What Captive Supply Reform does is set up the conditions for the industry to change. It would be an evolutionary rather than revolutionary process.

Evolution was the approach taken in 1921 when the P&S Act was passed and a consent decree was entered into with the dominate packers of that era. In those days, producers sent their livestock by train to central packer owned stockyards in places like Chicago and Kansas City. The livestock were priced only after they arrived. The packers owned the boxcars in which the animals were shipped, they owned the yards, and they owned the buyers. The consent decree required the packers to divest of the stockyards and the railway cars.

This allowed for a competitive market to develop when new packers entered into the business and the industry evolved to one that was much less concentrated. After the passage of the P&S Act, public auction yards became the main system for pricing livestock. By 1975 the packing industry was at its least level of concentration.

Starting in 1980 USDA and the Justice Department essentially stopped anti-trust enforcement. As a result, thirty-five (35) years later, not only meat packing but just about every industry that you can think of is dominated by a handful of firms and many control their industry on a global basis. Ours is an era of extraordinary economic concentration and political power by trans-national corporations.

### **Opposition to competitive market reform**

There are two paths to relief. The rule as proposed by WORC, requires that the Secretary of Agriculture exercise his authority to interpret the Packers and Stockyards. The Captive Supply Reform Act instead, would be Congressional action that would direct the Secretary to restore competition through enforcement of the P&S Act. Both paths are valid and probably should be pursued simultaneously.

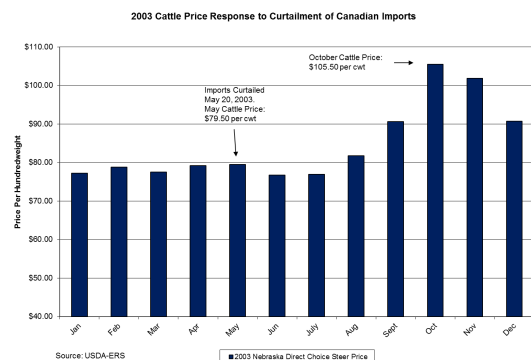
The opposition to reform will be intense and not in the least constrained by the truth. The same old tired, condescending, and hysterical arguments be will levelled by the NCC, NPPC and NCBA. For instance, this statement comes from Tracy Brunner of the NCBA opposing the currently considered abridged GIPSA Rule: "...this rulemaking will drastically limit the way our producers can market cattle and open the floodgates to baseless litigation. In a time of down cattle markets, the last thing USDA needs to do is limit opportunity. The fact of the matter is, we don't trust the government to meddle in the marketplace."

The NCBA's condescension towards producers struggling to be treated fairly in the market place is amazing. It is doubly so when one considers that were it not for a government program that showers the NCBA with government collected Beef Checkoff tax money, the NCBA would probably not exist as an organization. NCBA makes four points against the abridged GIPSA Rule, and will make the same four arguments opposing Captive Supply Reform because they have nothing else. We can, therefore, consider the validity of these arguments:

1. Limit the way producers can market cattle: The only limit Captive Supply Reform would make on the market, is on secret under-the-table agreements designed to manipulate prices for all of the rest of the producers. Forward contracting would be available to all of those who wish to market in that manner. There could, also, be a public market for long-term production contracts to accommodate the poultry and hog sectors which are fully transitioned to contract production. Raising livestock, or for that matter all manner of crops under contract is a perfectly legitimate mode for agriculture as long as the terms of the contract are fair. If the contracts are publicly available to all producers who meet the criteria or entered into through a public auction system, then competition is protected.

2. Open the floodgates to baseless litigation: Why would litigation following reform be baseless? Is it just when farmers and ranchers have legal complaints that the litigation is baseless because corporations are always suing each other and everyone else. Poultry contract growers have been subject to all manner of underhanded actions by the poultry integrators, such as not being allowed to witness their birds being weighed. Would it be a baseless lawsuit if a grower suspected that the birds he raised were being systematically under weighed. Ordinary people do not resort to a lawsuit against a gigantic corporate power unless they have a valid complaint. They only do so at a last resort and because they have nothing left to lose. NCBA's argument is just pure arrogance
  
3. In a down market, USDA should not limit market opportunity: The exact time to do something to restore competition in cattle markets is when prices are down. Cattle prices are down because the market is non-competitive. If not now, then when should competition be restored?
  
4. Do not trust the government to meddle in the market: Who does trust the government to meddle in the markets? After all it is the government that did not enforce the anti-trust laws for the past thirty-five (35) years allowing a livestock cattle market to develop that is clearly non-competitive and just as clearly dysfunctional. The government needs to step up and do the job that is required of them by the Constitution and by legally enacted law. Anti-trust laws were not enacted in order to punish corporations for doing well, instead anti-trust laws protect competition, not the individual competitors. It is through market competition that efficacy in production, and innovation are enhanced. An industry dominated by a small number of corporations will cease to be efficient and innovative. Their business model will shift to limiting competition by start-up companies, squeezing suppliers, and shortchanging customers.

The government's responsibility is to ensure the opportunity for competition because under conditions of actual market competition, an industry will evolve to a structure that is most efficient. Only through market competition can society determine what size and structure is truly most efficient. In cattle packing, it may be that having just four dominate packing companies (JBS, Tyson, Cargill, and National), is in fact the most efficient structure. If after restoring competitive pricing for fat cattle, and the same packers maintain their market dominance, then we will know that this is what the market decrees. If, however, smaller competitive packers come into existence, we will know that the beef cartel was not efficient. The P&S Act has one last unique provision not included in other anti-trust laws. It requires that packers not: "...engage in any course of business or do any act for the purpose or with the effect of manipulating or controlling prices, or of creating a monopoly in the acquisition of, buying, selling, or dealing in, any article, or of restraining commerce." The key word here is "effect." Other antitrust laws require proof that there was the intent to manipulate or control prices in order for the government to correct the market imbalance. The P&S Act, requires redress if the market is in fact being controlled. Economic research has shown





conclusively that with increased use of captive supply arrangements, cattle prices on the spot market decreases.

### **Imports role in lowering cattle prices and reducing competition**

In 2003 we experienced an interesting test of the integrity of the cattle market, when Canadian cattle imports were blocked because of the outbreak of BSE (Mad Cow Disease) in Canada. Feeder calf prices immediately jumped 25%, far more than what one would expect from the removal of that relatively small number of cattle from the US market. What this event revealed is that the Canadian Cattle were being strategically used by the packers as a “foreign based captive supply” for the purpose of controlling the market. (see Figure 8)

The realization that cattle and beef imports are being used to control prices in the US has since made beef imports a major concern for cattle producers. This is why producers are very skeptical of entering into additional trade agreements. The Captive Supply Reform effort would require that cattle and beef imports by a beef packer be publicly priced before being imported. This would prevent an international packer, such as JPS, from importing beef from their slaughter plants in Australia and South America in a manner that manipulates the domestic cattle market.

### **What is at stake and what it will take to**

Figure

**win.**

Over the past fifty years, the structure of agriculture in the US has changed dramatically. We were once a nation of independent small farmers, each selling into a competitive regional market system. Many farmers are no longer independent and agricultural markets are no longer regional nor competitive. Cow/calf producers are the only major commodity sector in which producers have maintained a measure of independence. There are a lot of benefits - on the personal level, for our families, for the communities in which we live, and for our nation - in maintaining a healthy independent farming structure. Our country may very well come to regret the demise of independent farming. It is not too late for the cow/calf sector to stop the slide to vertical integrated serfdom, but it is nearly too late. Captive Supply Reform is possible but will require an intense coordinated effort on the part of the organizations that represent us in Washington.

The concern is that we are divided, not only by organizations who make it their mission to lobby in favor of packer monopolization, but between the different independent organizations as well. Organizations representing independent livestock producers are struggling to maintain their memberships and are jealous of one another. Unless members insist that restoring competitive markets is the priority, these organizations will each go their separate ways pursuing their own priorities of policy reform, and our voices will be diluted. If that is the case, we will lose. There is a solution - but it is in our hands.

*(I would like to thank USDA, R-Calf-USA, US Cattlemen’s Association, The Organization for Competitive Markets (OCM), and the law firm of Stewart and Stewart for supplying graphs and statistics for this article)*

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