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Robert Sturm, Chief Clerk
Committee on Agriculture, Nutrition and Forestry
SR-328A Russell Senate Office Building
United States Senate
Washington, DC 20510

Re: Post-Hearing Response to Question by R-CALF USA

Dear Mr. Sturm,

Thank you for the opportunity to respond to the post-hearing question directed to R-CALF USA following my testimony to the U.S. Senate Committee on Agriculture, Nutrition and Forestry on April 18, 2007. The supplemental question was: "If a regional market has one packer, isn't competition gone, and prices go down as a matter of both theory and fact? (American West in Cattle, Southeast U.S. for Smithfield in hogs, etc)."

R-CALF USA's answer to this question is yes, absolutely. If there is only one packer in a region, that packer is able to exercise considerable monopsony power within the regional marketplace. This monopsony power would allow the single packer to control access to the market, leverage lower prices, control entry and exit of feeders, and distort the quality-based grid. This is true because sellers in a given region are essentially captured by the economic constraint associated with the cost of transporting live cattle or other livestock to another region.

A single packer in a given region can readily control access to the market by capitalizing on the perishable nature of finished cattle, by engaging in anti-competitive cattle procurement practices (formula pricing and packer ownership), and by spreading the higher costs of procuring its residual needs over the lower costs of procuring the majority of its needs. For example, if in a region where there is only one packer and that packer's capacity is 100,000 head per week, a buyer can offer a non-negotiable price comparable to the reported market price in another region less transportation costs. Given the perishable nature of finished cattle, which are subject to quality degradation when overfed, many of the captured sellers within the region will capitulate and sell at the non-negotiated price to avoid the risk of overfeeding. If the packer procures 80,000 cattle using this non-negotiable price it has more than one option with which to fill its weekly capacity without increasing its non-negotiable price offering: 1) it could slaughter its own cattle if the packer is engaged in the practice of owning and feeding packer-owned cattle; 2) it could slaughter cattle committed under formula contracts where the base price is not established until after the cattle are killed and the weekly demand is satisfied; 3) it could purchase livestock from another region and although such procurement costs may be higher than would be realized by increasing the bid for cattle in that region, the increased costs associated with purchasing 20,000 cattle from another region would neither elevate the region's cash market (to which all the formula-priced cattle would be tied) nor would it offset the economic benefit of being able to procure 80 percent of its capacity at the lower, non-negotiable price initially established by the packer.

Similarly, a single packer in a given region can readily leverage lower cattle prices in the entire region by virtue of having no competition for which to challenge the packer's initial price offering. Moreover, the lower prices resulting from the lack of competition for finished cattle adversely affect the prices for all classes of cattle in the region. For example, cow/calf producers are indirectly impacted as the reduced prices for finished cattle are partially transferred back to feeder cattle and to cow/calf producers. In this situation, the region with only one packer is likely the region to set the market floor as, by its very structure, it becomes a buyers market. The buyer, again capitalizing on the perishable nature of finished cattle, is able to convert otherwise ordinary sellers into distressed sellers simply by refusing to increase the bid offering when finished cattle have reached their optimal selling weight. And, indeed, the packer doesn't have to increase its bid offering if there are no other buyers to challenge the initial offering and the packer has alternative options with which to procure its weekly needs as was discussed above.

It is important to note that a single packer in a region can also subtly control the entry and exit of cattle feeders in a region. This can be accomplished by offering preferential marketing arrangements to some feeders and not others. Eventually, those feeders without preferential marketing arrangements would exit the business. Similarly, these same subtle, preferential marketing arrangements could be used to both attract and encourage select, new feeders to enter the region, thus adding to potential regional supplies regardless of whether such additional supplies are justified by competitive market forces. This would not be a competitive market.

Finally, not only can the exercise of monopsony power by a single packer in a region lower the base price of cattle in that region, but also, such power can distort quality-based grid pricing. Because a single packer can establish the baseline for grid pricing, particularly the center from which premiums and discounts are calculated, a single packer in a region that, for example, exclusively markets lower quality, i.e., select quality beef, to a retailer, could establish a grid to reward such lower quality cattle and penalize producers of higher quality cattle.

In summary, a geographical region both defined and constrained by transportation costs and in which there is only one packer, hence one buyer, is void of competition. The result is lower prices to all farmers and ranchers who sell livestock, regardless of the class of cattle offered for sale or the method of marketing used to consummate the sale.

Again, I appreciate the opportunity to respond to the post-hearing questions. Please contact me if I can be of further assistance.

Sincerely,

Eric J. Nelson

Eric Nelson
R-CALF USA