

**Competition Reform Q&A  
for 2007 Farm Bill Discussion**

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**Question #1: No one forces cattle producers to enter into contracts with packers, and these alternative marketing arrangements (AMAs) can provide important benefits to the producer as well as the packer. Why eliminate the option for producers to enter into voluntary contracts with packers?**

The Captive Supply Reform Act (S. 1017) does not eliminate the option for producers to enter into contracts with packers. Instead, the legislation regulates the terms of those contracts to ensure that they guarantee fair and open competition. The Act requires such contracts to contain a firm base price that can be equated to a fixed dollar amount when the contract is entered into, and the Act prohibits contracts with a formula price based on prices that will not be established until after the contract is signed. The Act also requires contracts to be offered for bid in an open market and limits the total amount of livestock that can be traded under one contract.

Some producers currently opt to enter into contracts that do not meet these criteria. That is because those producers have few other attractive contracting choices in an industry where only four packers control 80 percent of the market, where there is asymmetrical access to information, and where ranchers are selling a highly perishable commodity with a limited marketing period. Furthermore, while a formula contract based on future spot market prices may appear attractive to an individual producer at a given point in time, the collective impact of these contracting practices on the market as a whole does not benefit the producer segment of the industry. Producers acting individually are not in the position to change these dynamics of the market, and thus legislation is required. Similar distortions have necessitated legislation to create functioning markets in securities trade, commodities futures markets, and many other areas. The Captive Supply Reform Act would serve a similar function in the livestock industry by reintroducing balance into the marketplace so producers and packers can freely negotiate contract terms that meet their needs and that reflect market fundamentals.

**Question #2: The recently-released RTI study commissioned by USDA found that AMAs lower price risk for producers, improve beef quality, and help with herd management. Would these positive benefits for producers be lost if captive supply contracts are prohibited?**

No. As explained above, the Captive Supply Reform Act does not eliminate contracting – it simply regulates contracting practices to ensure that contract terms reflect a free and open negotiation between producers and packers. Many of the positive aspects of some AMAs can be preserved in contracts that comply with the Captive Supply Reform Act, while the Act would regulate the more harmful features of these contracting practices.

For example, a significant portion of cash transactions employ a negotiated grid with premiums and discounts based on grade and quality. These provisions create the same kinds of quality incentives and herd management benefits as captive supply contracts, without the formula prices. There is no reason that such desirable provisions cannot be part of more sales transactions if packers and producers negotiate with one another and agree to incorporate them.

In addition, there is no reason that price risk cannot be hedged through price terms based on futures markets rather than through formula prices based on cash market prices that are as yet undetermined at

the time of signing the contract. In fact, the Captive Supply Reform Act explicitly states that contracts that include quality and grade adjustments and contracts that rely on futures market prices are not prohibited under the Act.

Finally, it is important to note that the RTI report's finding that variances in prices were lower under AMAs than in the cash market is disputed by other studies on the subject. In addition, the RTI report found that an increase in the use of AMAs was associated with lower prices on the cash market, as other studies have concluded.

**Question #3: The RTI study commissioned by USDA found that eliminating AMAs would reduce cattle producers' surplus while also harming packers and beef consumers. Why do producers support prohibiting these practices if doing so will harm them economically?**

Unfortunately, it was not within the scope of the study commissioned by USDA to consider the costs and benefits of limiting some of the market-distorting features of captive supply contracts while preserving some of the benefits found to accrue from AMAs. The cost estimates in the study are thus based on the false premise that all AMAs would be eliminated outright. The Captive Supply Reform Act does not, however, propose throwing out the baby with the bathwater. The Act would not eliminate all forms of contracting and would certainly not prevent producers and packers from entering into sales transactions that allow for efficient and predictable procurement of high-quality cattle. Therefore, the estimates provided in the study simply do not provide useful guidance regarding the economic impact of regulating contracting practices to restore balance within livestock markets.

**Question #4: Contractual agreements between packers and producers, such as alliances and joint ventures and including arrangements where producers and packers cooperate to produce high-value branded products, are viewed as beneficial in that they help producers secure financing and they facilitate market efficiency and competition. Will a ban on packer ownership end these mutually beneficial arrangements?**

No. The ban on packer ownership currently contained in bipartisan Senate bill S.305 would only prohibit (1) direct ownership of livestock by the dominant packers and (2) marketing arrangements in which the packer assumes management authority over the production of livestock, though nominal title remains with the producer, to the extent that the producer is no longer materially participating in the management of the livestock. The legislation would not affect contractual arrangements such as alliances and joint ventures and other arrangements in which the producer retains title and materially participates in the production of the livestock.

**Question #5: Some ranchers own their own packing plants to process their cattle. Would a ban on packer ownership of cattle drive these small packers out of business and reduce competition?**

No. The ban on packer ownership currently contained in bipartisan Senate bill S. 305 explicitly exempts from the ban those small packers that are excluded from Livestock Mandatory Price Reporting, packers that only own one processing plant, and producer-owned cooperatives that also slaughter livestock. These provisions will ensure that small packing operations and producer-owned packing operations can continue to function and compete in the open market, while eliminating ownership of cattle by larger packers for more than seven days before slaughter. Thus, the Act would restore transparency to the market by eliminating ownership of cattle by the larger packers, while protecting small packers and producer-owned packing establishments and enhancing competition in the market overall.