Fighting for the U.S. Cattle Producer!
R-CALF USA

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The Honorable Collin Peterson
Chairman
House Committee on Agriculture
1301 Longworth House Office Building
Washington, DC 20515

Dear Chairman Peterson,

On behalf of its thousands of U.S. cattle farmer and rancher members, R-CALF USA appreciates and supports your effort to fundamentally reform commodity futures markets through your proposed Derivatives Markets Transparency and Accountability Act of 2009 (Act).

Although our full membership is just now considering the complexities of this issue, and R-CALF USA may later propose additional recommendations, the R-CALF USA Marketing Committee understands the need to provide timely guidance and we encourage you to consider the following recommendations specific to the U.S. cattle industry during the ongoing development of your Act.

Background:

Though the U.S. live cattle industry is the largest single segment of U.S. agriculture,[1] it is unique in that it *under-produces* for the domestic beef market. For over 40 years, the U.S. cattle industry has not produced sufficient numbers of slaughter-ready cattle to satisfy domestic beef consumption.[2] In recent years, 2004–2007, the annual shortfall between domestic cattle production and domestic beef consumption has been greater than at any time in history.[3]

As a result of this unique production characteristic, the trade of live cattle in commodity futures markets does not require a significant level of additional liquidity, as might other commodities traded in commodity futures markets, in order for the cattle futures market to perform its proper function of providing price discovery and reducing price risk for physical cattle hedgers (i.e., the actual buyers and sellers of live cattle). Also, and for this same reason, the futures market

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[1] Cash receipts from the sale of cattle and calves were approximately $50 billion in 2007, far greater than any other agricultural commodity and more than three times the amount generated from hogs. *See* U.S. Farm Sector Cash Receipts from Sales of Agriculture Commodities, 2004-2008F, U.S. Department of Agriculture, Economic Research Service, available at http://www.ers.usda.gov/briefing/farmincome/data/cr_t3.htm.
[2] *See*, e.g., Beef and Veal Summary Selected Countries, Production, Supply, and Distribution Online, U.S. Department of Agriculture Foreign Agricultural Statistics Service, available at http://www.fas.usda.gov/psdonline/psdHome.aspx (R-CALF USA produced a domestic production vs. domestic consumption graph from archived FSA data for the period 1961-2007, available at http://www.r-calfusa.com/Trade/trade_home.htm, under R-CALF USA . . . Trade Presentation . . . Jan. 7, 2009, Slide No. 27.).
[3] *See id*.

for live cattle is highly susceptible to market distortion should additional liquidity be introduced in the form of excessive speculation.

In addition, the U.S. cattle industry sells cattle into one of the most highly concentrated marketing structures in the U.S. economy – one that has exceeded levels generally considered to elicit non-competitive behavior and adverse economic performance.[4] Today, the four largest U.S. beef packers purchase and slaughter over 85 percent of all slaughter-ready U.S. steers and heifers.[5] Inherent to this high level of market concentration is substantial disparity between the economic power of the hundreds of thousands of disaggregated U.S. cattle producers (i.e., cattle sellers)[6] and the economic power wielded by very few beef packers (i.e., the buyers for slaughter-ready cattle).

As a result of this significant economic disparity between cattle producer-sellers and buyers of slaughter-ready cattle, cattle producer-sellers, who use futures markets to offset price risk, are vulnerable to any market distortions caused by beef packers that may not only participate in the futures market as physical hedgers, but as significant speculators as well. For example, the cattle futures market is susceptible to downward price movements – in contradiction of supply/demand fundamentals, should beef packers, which may hold a physical hedging position in the market, also begin to engage in substantial speculative short selling of the market. The effect of the beef packers' speculative short selling is to lower not only the futures market price, but also the cash spot market price, which is intrinsically tied to the futures market. This action benefits the beef packers, which purportedly procure about half of their slaughter-ready cattle from the cash spot market,[7] by lowering the procurement price of cash spot market cattle. However, this action is severely detrimental to the financial interests of disaggregated cattle producer-sellers who must then sell about 50 percent of all slaughter-ready cattle in the now depressed cash spot market.

Finally, the remaining participants in the U.S. live cattle industry, whose numbers have already been reduced by an alarming 40 percent since 1980,[8] operate on slim margins and are highly susceptible to even small changes in cattle prices.[9] As a result, cattle producer-sellers are

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[4] *See* A Review of Causes for and Consequences of Economic Concentration in the U.S. Meatpacking Industry, Clement E. Ward, Current, Agriculture Food and Resource Issues, 2001, at 1.

[5] *See* United States of America et al. vs. JBS S.A. et al., Amended Complaint filed on Nov. 07, 2008, U.S. District Court, Northern District of Illinois, Eastern Division, Civil Action No. 08-CV-5992, (The U.S. Department of Justice alleged, "Defendants [JBS S.A. and National Beef Packing Company, LLC] plus Tyson and Cargill together purchased over 85% - nearly 24 million – of these [fed] cattle.") at 3.

[6] There were 967,000 U.S. cattle operations in the U.S. in 2007. *See* Farms, Land in Farms, and Livestock Operations, U.S. Department of Agriculture, National Agricultural Statistics Service, Sp Sy 4 (08) a, February 2008, at 14.

[7] *See* GIPSA Livestock and Meat Marketing Study, January 2007, Volume 3, at ES-4, available at http://archive.gipsa.usda.gov/psp/issues/livemarketstudy/LMMS_Vol_3.pdf (this study found that nearly 62 percent of fed cattle were procured through the open spot market); *see also* USDA Livestock and Grain Market News, Mandatory Price Reporting, St. Joseph Missouri (charts prepared by USDA for the state of Kansas, e.g., for the period 2005-2008 show that since 2006, less than 50 percent of fed cattle were procured from the open spot market).

[8] The size of the U.S. cattle industry, as measured by the number of cattle operations in the U.S., declined from 1.6 million in 1980 to 983,000 in 2005 (and, as stated *supra*, further declined to 967,400 in 2007). *See* Federal Register, Vol. 72, No. 152, Wednesday, August 8, 2007, at 44,681, col. 2.

[9] A Review of Causes for and Consequences of Economic Concentration in the U.S. Meatpacking Industry, Clement E. Ward, Current Agriculture Food and Resource Issues, 2001, at 2 ("[E]ven seemingly small impacts on a $/cwt. basis may make substantial difference to livestock producers and rival meatpacking firms operating at the margin of remaining viable or being forced to exit an industry.").

particularly vulnerable to financial failure caused by both market volatility and by market distortions that swing prices low, even for short periods, as they are operating in an industry already suffering from a long-run lack of profitability.

Recommendations:

Given the aforementioned susceptibilities and vulnerabilities, all of which may well be unique to U.S. live cattle when compared to other agricultural commodities, the Act must incorporate the following recommendations in order to ensure that cattle futures markets are free from manipulation and function in a manner beneficial to physical live cattle hedgers:

1. The Act must eliminate the particular device that concentrated beef packers use to artificially depress the open cash market, which is intrinsically tied to the cattle futures market. That device is speculative short selling (i.e., selling commodity contracts without either owning the commodity or purchasing commodity contracts), and **a prohibition against speculative short selling would end this market distorting practice.**
2. The Act must ensure that the live cattle futures market is heavily dominated by physical hedgers. This can be accomplished by **imposing aggregate speculative position limits across all markets**. Such speculative position limits must be imposed on all speculative activities, including, e.g., the portion of a beef packer's activity associated with speculation, while the portion of the beef packer's activity associated with physical hedging would remain exempt from position limits. Imposing such aggregate speculative position limits across all markets would also effectively curb the commodity indexing strategies of large institutional investors, whose strategies severely distort futures market price discovery.
3. The **speculative position limits to be set for the live cattle futures market must be established by physical hedgers**, representing both buyers and sellers, who are directly involved in the cattle and beef industries and who use the cattle futures market for its intended purpose. This will best ensure that the live cattle futures market will have adequate, but not excessive, speculative position limits for proper market performance.
4. The Act must minimize the excessive daily market volatility facilitated by the current $3.00 daily limit. This **excessive volatility can be effectively minimized by restoring the cattle futures markets' $1.50 daily limit**.
5. Finally, the Act must **reform the current practice of allowing cash settlements on futures contracts** in lieu of actual delivery of the commodity, which practice has the effect of artificially lowering the futures price on the day of contract expiration.

We believe the aforementioned recommendations are necessary to eliminate practices that cause artificial price distortions and have relegated the cattle futures market to an ineffective tool for price discovery and risk management for U.S. cattle producers. Please contact R-CALF USA CEO Bill Bullard at 406-670-8157 should you have questions about our recommendations.

Sincerely,

Dennis Thornsberry
R-CALF USA Marketing Committee Chair