R-CALF USA Briefing Paper: The Proposed GIPSA Competition Rule (August 16, 2010, Version II)

Background:

Until now, the U.S. Department of Agriculture Grain Inspection, Packers and Stockyards Administration (GIPSA) made no effort to promulgate regulations to implement provisions in the Packers and Stockyards Act (PSA) that prohibit packers from engaging in unfair, unjustly discriminatory, or deceptive practices and granting undue preference or advantage. As a result, such anticompetitive practices are not only widespread in U.S. livestock markets, but also, they have become institutionalized and are now viewed by many as normal business practices. Many people erroneously believe the effects of these anticompetitive practices result from natural market forces.

What has happened to the U.S. hog industry, however, provides a blueprint for U.S. cattle producers to predict the future of their U.S. cattle industry if fundamental changes are not made. The hog industry's experience shows that the 30-year exodus of 90 percent of U.S. hog producers was not the result of natural market forces. Instead, it resulted from a well-orchestrated plan carried out by dominant packers during a period when U.S. antitrust laws and the PSA were both unenforced and ignored. It is important to review the highly successful, five-step plan the packers used to capture control of the hog supply chain, which enabled the packers to control the entire hog/pork industry from birth-to-plate. This five-step plan is well underway in the U.S. cattle industry.

The Packers' Winning Strategy for Controlling Livestock Supply Chains

Step 1: Packers created an economic risk for feeders called 'market access risk.' Market access risk is the risk that feeders will not have timely access to a market outlet when their livestock are ready for slaughter. Packers created market access risk through consolidations that put control over market outlets into the hands of only a few. In effect, packers have become gatekeepers, deciding who does and who does not have timely access to the market.

Step 2: Packers offered to solve the market access risk problem by guaranteeing timely market access in return for producers' willingness to sign marketing contracts that promise delivery of livestock at some future point in time.

This would appear to be a win-win situation – producers secure timely market access and packers are better able to schedule their procurement needs. But, this is the beginning and end of the mutually beneficial aspect of the plan.

Step 3: When livestock volumes shift from the cash market to the contract market, packers continue using the cash market to discover the base price for *all* contracts. Thus, price discovery for the entire industry continues to take place in the market where market access risk abounds. As the price discovery market becomes thinner, less competitive, and more susceptible to manipulation, the packers' pricing strategy lowers the aggregate price for all livestock, including the price for cattle involved in branded programs and other alternative marketing programs.

Step 4: Packers exploit the ever-thinning cash market, which they can do because they are so few in number, simply by shunning the cash market for extended periods of time, say a week or longer, which is sufficient to lower livestock prices. The effect of market access risk and the attendant pricing strategy is an eventual lowering of the price of all livestock below the feeders' cost of production, resulting in the mass exodus of livestock producers.

Step 5: Packers lead the few remaining feeders to believe the cash market is an outdated, antiquated market and they actually convince feeders to berate the cash market in favor of alternative contracting methods. This effectively distracts attention from the packers' anticompetitive pricing strategies and it encourage producers to seek a new so-called solution to the new problem associated with the mass exodus of feeders: Packers begin offering livestock producers not just a marketing contract, but a full-fledged production contract where the packer, and not the livestock producer, determines the terms of production and terms of marketing; and, because competition is severely reduced, the packer gains even more control over the pricing of all livestock.

This simple, five-step plan is not conjecture. This is the highly effective strategy packers used to reduce the number of hog producers from 667,000 in 1980 to fewer than 65,000 today. The cattle industry is now in the fourth-step of this five-step process. In just the past four years, the volume of cattle sold in the cash market was reduced 20 percent. Today, fewer than 40 percent of the cattle set the base price for all the cattle sold to packers, including the 60 percent sold under alternative marketing agreements. The warning sirens could not be sounding any louder!

How the GIPSA Competition Rule Disrupts the Packers' Plan to Control the Cattle Supply Chain:

The cattle industry is now caught in a classic, catch-22 situation. It would be disastrous to limit cattle producers' access to alternative marketing arrangements while packers continue to control timely access to the market. This is why the GIPSA Competition Rule "does not restrict limit or prohibit marketing agreements, the use of premiums, or other value-added activities." (*See* USDA letter at: http://archive.gipsa.usda.gov/psp/avalosstatements.pdf.) *It is, however, clearly obvious to critical thinkers why the packers and industry trade associations that have packers seated on their governing boards are doing everything in their power to mislead cattle producers into believing the GIPSA Competition Rule (GIPSA Rule) will limit or prohibit such marketing methods.*

The GIPSA Rule disrupts the packers' five-step strategy by prohibiting them from exercising their power to limit access to the marketplace. It accomplishes this by: 1) requiring packers to justify the offering of different prices and different terms (including the timing of market access) to feeders who sell similar quality cattle and market similar volumes of cattle; 2) requiring packers to maintain documentation regarding the reasons premiums and/or discounts are granted to some feeders but not to others; 3) requiring packers to provide justification for giving certain feeders price and/or market access preference or advantages while denying such treatment to others; 4) requiring packers to submit *sample* contracts so feeders will know the specifications and pricing variations offered by the remaining packers; and, 5) clarifying that packers cannot avoid the PSA's prohibitions against engaging in anticompetitive practices by claiming their actions only harmed an individual producer and not the competitiveness of the entire industry. It accomplishes this by clarifying that a producer need not prove harm to the entire industry (harm to competition) in order to stop a packer from engaging in an anticompetitive practice that is targeted at him/herself.

The GIPSA Rule also puts an end to practices known to reduce competition. It prohibits a packer that needs additional cattle to fill weekly supply needs from purchasing such residual cattle from a competing packer, which would enable the packer to avoid making bids in the competitive cash market. It accomplishes this by prohibiting packer-to-packer cattle sales. It also preserves competition by requiring that each packer use its own buyer to purchase cattle. This provision addresses the problem discovered in U.S. auction yards where three cow/bull packers joined together to hire a single cow/bull buyer. Though this was great for the three packers – their shared buyer was able to purchase all the cows and bulls the packers needed for the price the packers wanted to pay, it harmed cow/bull sellers because where once there were three bidders for their cattle, suddenly there was only one.

Summary:

The GIPSA Competition Rule is necessary to prevent packers from exploiting their dominant market positions that already enable them to create market access risk for cattle feeders, entice cattle feeders to abandon the competitive cash market to avoid market access risk, and establish pricing strategies that effectively lower the aggregate price for all cattle. It accomplishes this by addressing four factors that are known to reduce, if not eliminate, competition: First, it addresses the lack of packer accountability by clarifying that packers are prohibited from engaging in unfair, unjustly discriminatory, and deceptive practices against cattle feeders even if such practices are directed at a single cattle feeder. Second, it addresses the lack of documentation needed to evaluate disparities in prices and terms offered for cattle of similar quality. Third, it addresses the lack of transparency in the marketplace by requiring packers to submit sample contracts for cattle feeders to review. And, fourth, it prohibits known practices that, by their nature, are anticompetitive: packer-to-packer sales and multiple packers colluding to use a single cattle buyer. In short, the GIPSA Competition Rule is the first comprehensive effort in nearly 90 years to both protect and preserve an open, fair, and transparent competitive marketplace for independent U.S. cattle producers.

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