DOJ/USDA Competition Workshop: Effects of Antitrust Activities and Anticompetitive Practices on the U.S. Cattle Industry and Responses to False Claims Against the GIPSA Rule

PART I
Effects of Antitrust Activities and Anticompetitive Practices on the U.S. Cattle Industry

A. INTRODUCTION

The cattle industry is the largest segment in American agriculture and is the economic foundation for many, if not most, rural communities across America. The cattle industry holds the greatest potential to revitalize Rural America, provided competition is restored to the industry.

Beef packer concentration is constraining the U.S. cattle industry, causing it to shrink and preventing it from keeping pace with increased domestic beef consumption:

- U.S. cattle operations declined 40 percent since 1980, with over 500,000 operations exiting the industry since that time.
- The size of the U.S. cow herd is now the smallest since the 1950s.
- Contrary to claims that increased productivity offsets the need for more cattle operations and more cattle, U.S. beef production remained relatively stagnant during the past 14 years *even in the face of growth in U.S. beef consumption* (consumption outpaced production from 1996-2009).

B. UNPRECEDENTED CONCENTRATION

Concentration of the market outlets for fed cattle and boxed beef have surpassed levels known to elicit noncompetitive behavior and result in adverse economic performance:

- Four packers control over 80 percent of the fed cattle market, which is a radical increase from the 36 percent they controlled in 1980.
- Four packers control over 50 percent of the cow/bull market, which is a radical increase from the 10 percent they controlled in 1980.
- Four packers control over 84 percent of the boxed beef market, which is a radical increase from the 53 percent they controlled in 1980.

Concentration in the feeder cattle market is increasing and the exodus of independent feedlots already has reduced the number of competitive bidders for feeder cattle:

- Feedlots with capacities under 1,000 head have been reduced by 30,000 just since 1996.
- The four largest feedlot companies: JBS-owned Fiver Rivers Ranch Cattle Feeding, Cactus Feeders, Cargill-owned Cargill Cattle Feeders, and Friona Industries, market about 20 percent of all fed cattle, though the actual selling price and terms for these cattle is not definitively known.

The majority of U.S. hogs are now produced where the packers decided to locate and the feeding sector of the U.S. cattle industry is following the same path by concentrating in the High Plains, with only a few states outside this region continuing to receive cattle prices that are above the national average.

- About 42 percent of the nation's gross income from cattle sales is now generated in only three states: Nebraska, Texas and Kansas, up 12 percent since 1980.
- About 56 percent of the nation's gross income from hog sales is now generated in only three states: Iowa, Minnesota and North Carolina, also up 12 percent since 1980.

The three largest beef packers claim to have the same economic interests as cattle producers. Yet, each of these packers has a duty to their shareholders to maximize profits in their poultry and/or hog ventures, which prevents them from partnering with cattle producers to compete with the substitute proteins poultry and pork.

- Studies show the demand and price for cattle is influenced by the supply and price of competing proteins, which are now controlled by the major beef packers (Tyson is a major beef, pork and broiler packer; Cargill is a major beef and pork packer; JBS is a major beef and broiler packer).
- Contrary to industry claims, these three beef packers do not share the cattle producers' goal of maximizing beef's share of the protein market.

- It is anticompetitive for beef packers to also dominate markets for beef substitutes.

C. RESTRICTED MARKET ACCESS

Any distortion or manipulation of the price paid for fed cattle by the four largest beef packers reverberates throughout the entire cattle industry and harms each of the 753,000 cattle operations in the U.S., including seed stock producers, cow/calf producers, backgrounders, stockers and feeders.

- This is because the value of young cattle is based on the expected value of fed cattle.

With control over market outlets, beef packers created a new risk for cattle feeders known as market access risk – the risk that feeders may not have timely access to a market when their cattle are ready to sell.

- As gatekeepers, packers decide who does and who does not have timely access to a market.
- Packers use this new economic risk to entice cattle producers to enter captive supply contracts: they guarantee market access in return for the cattle feeder's willingness to enter a marketing contract.
- As more feeders enter marketing contracts, the cash market thins in terms of fewer sellers and fewer cattle. Thin cash markets are least able to establish competitive prices and are highly susceptible to manipulation.
- Packers then exploit the thinning cash market by designating it as the price discovery market, which establishes a base price for the cattle controlled under marketing contracts, and by avoiding the cash market when prices are high or rising, thus lowering the aggregate price for cattle.
- The volume of cattle sold to packers in the cash market in one of the three regional fed cattle markets (the TX-OK-NM market) fell from 55 percent to only 34 percent within just four years (2005-2009).
- Cattle feeders are caught in a catch-22 situation: they have no alternatives to avoid market access risk and the exploitation in the cash market other than to commit their cattle to captive supplies, even though their actions lower the aggregate price for cattle, making themselves worse off.
- This explains how packers recruit allies from among cattle feeders – cattle feeders involved in captive supply arrangements fear they will face market access risk and the exploitation in the cash market if captive supply arrangements are discontinued.
- The packers have used this strategy since 1980 to: 1) eliminate market opportunities for hogs raised by independent producers; 2) lower hog prices below the cost of production; 3) reduce the number of hog producers by over 90 percent; and, 4) capture near complete control over the live hog supply chain. They are now deploying this successful strategy in the U.S. cattle industry.

Studies show that price impacts from packer concentration are negative and that captive supplies increase the instability of prices for cattle producers and hold down prices. Yet, current research has failed to properly consider the unique characteristics of both cattle and the cattle market that make them vulnerable to exploitation, particularly to market access restrictions. These unique characteristics include:

- Cattle have the longest biological cycle of any farmed animal, making it impossible for cattle producers to respond quickly to changes in price and demand (this places cattle at a distinct disadvantage when compared to hogs and poultry).
- Slaughter-ready cattle are highly perishable.
- Transportation costs limit marketing options for cattle producers.
- Regional competition for raw products (such as cattle) is inherently less intense than is competition in processed food products.
- Cattle prices are sensitive to even slight changes in supply. The International Trade Commission found a 1 percent increase in fed cattle numbers would be expected to decrease fed cattle prices by 2 percent.
- Cattle prices are sensitive to the shifting of cattle from the cash market to alternative marketing arrangements. USDA's 2007 Livestock and Meat Marketing Study found a shift in the volume of cattle procured in the open market to any one of the alternative procurement methods is associated with a decrease in the cash market price.
- The demand for cattle is bounded on a weekly basis due to plant capacity limits.
- Price transparency is limited in the cattle market. The 2005 Government Accountability Office reported that a large percentage of cattle transaction data were being excluded from the Livestock Mandatory Reporting system.

- Beef packers have superior market information regarding future demand for cattle and future prices for beef, particularly those with captive supplies and long-term beef wholesale contracts with retailers.

D. MARKET FAILURE

Evidence that the market is not functioning properly (market failure) is pervasive in the U.S. cattle industry:

- The producers' share of the consumers' beef dollar for a standard animal, cut up in a standard way, and sold in standard form (meaning these data are not influenced by value-added products) has declined 20 cents since 1980, falling from 63 cents to 43 cents.
- Since 1980, the spread between cattle prices and retail beef prices has increased dramatically (this shows the marketplace is inefficient and that both producers and consumers are being exploited).
- The cattle cycle has been disrupted as evidenced by the unusual 8-year liquidation phase that began after 1982 (previous liquidation phases lasted only 3-4 years), and the unprecedented liquidation phase that began in 1996 is now in its 14th year (this demonstrates that competition-induced supply and demand signals that historically led to expectations about changes in cattle prices are no longer functioning properly).
- From 1994-2002, cattle prices remained depressed during the period when U.S. export volumes were reaching new record highs. But, after U.S. export volumes fell to a 19-year low in 2004, U.S. cattle prices jumped to the highest actual levels in history (which is exactly the opposite of how cattle prices should respond to changes in export volumes in a competitive marketplace).
- Cattle prices have become disassociated with beef demand as evidenced by the rising cattle prices that occurred during the periods 1985-1993 and 2004-2008, which were periods when beef demand was falling (suggesting that beef demand is not as accurate an indicator of cattle price movements as would be expected in a competitive market).
- The long-run losses experienced by cattle feeders from late 2006 through early 2010 while retail beef prices remained at or near record levels is evidence that retail beef prices are disassociated with cattle prices (the value of beef no longer reflects the value of cattle, a disassociation evident since 1985).
- The U.S. cattle industry is shrinking in the face of the economic opportunities associated with increased beef consumption and increased beef exports. Meanwhile, imports are capturing an ever-growing share of the United States' total available beef supply (Since 1985, the share of the United States' total available beef supply captured by imported beef and beef from imported cattle increased from 10 percent in 1985, to 13 percent in 1996, and to 17 percent in 2009).

E. EXAMPLES OF MARKET POWER ABUSE

The lack of enforcement of U.S. antitrust laws and the Packers and Stockyards Act have allowed packers to exercise abusive market power. The following are examples of known or suspected market power abuses:

- Packers have made coercive threats to cattle producers to advance the packers' political goals.
- Packers have imposed arbitrary production specifications that lead to producer discounts and facilitate preferential treatment.
- Packers' procurement practices result in pricing anomalies that benefit beef packers.
- Packers' procurement practices facilitate a division of the market that reduces/eliminates competition for certain types of cattle in certain regions.
- Packers have engaged in coordinated actions with the effect of lowering cattle prices.
- Packers' dual role as a feeder and a packer enables them to force smaller feeders out of business.
- Packers' dominance in the cash market is mirrored in the futures market, where they also can exercise market power.
- Packers are uniquely positioned to manipulate beef demand to prevent cattle prices from responding to tight domestic supplies.
- Packers have agreed to purchase market-ready cattle only if feeder are willing to keep the cattle for an additional week or longer, causing the feeder to incur additional feed costs during a period when animal feed efficiency is reduced.
- Packers have exacted discounts on cattle without providing adequate justification to the cattle feeder.
- Packers have paid higher prices for lesser quality cattle without providing reasons as to why the cattle feeder received a lower price for superior cattle.

F. THE SOLUTION

To restore competition to the U.S. cattle industry the U.S. Department of Justice (Justice Department) and USDA must immediately and vigorously enforce U.S. antitrust laws and the Packers and Stockyards Act of 1921 (PSA) to reverse the industry's monopolization and prohibit the ongoing anticompetitive practices in the U.S. protein market, the U.S. beef market, and in the live cattle supply chain. To achieve this necessary goal, the Justice Department and USDA must:

- Require the dominant beef packers to divest all of their substitute protein ventures.
- Require the dominant beef packers to divest stand-alone packing plants.
- Require the dominant beef packers to divest all of their packer-owned feedlots and cattle.
- Prohibit the dominant beef packers from engaging in practices that restrict an individual cattle feeder's timely access to the marketplace.
- Prohibit the dominant beef packers from manipulating the cash market, which continues to function as the price-discovery market.
- Prohibit the dominant beef packers from procuring cattle through contracts that do not contain at least a base price for the cattle.

The proposed rule issued by GIPSA is an essential first step in the process of restoring competition to the U.S. cattle industry. The proposed rule addresses four major affronts to competition:

- It addresses the lack of accountability on the part of the beef packers by clarifying that the PSA protects individual cattle sellers from any unfair, unjustly discriminatory, or deceptive practice by a packer regardless of whether such a practice causes an overall harm to competition.
- It addresses the lack of currently available documentation with which to determine if a packer's procurement transactions are in compliance with the PSA by requiring reasons and justifications for purchases involving differing prices, terms, premiums and discounts.
- It addresses the lack of transparency in the market by, again, requiring documentation regarding cattle procurement transactions and by requiring packers to provide sample contracts so cattle producers can make informed decisions regarding which packer is seeking the type and quality of cattle the producer is selling.
- It addresses the inattention to ongoing anticompetitive practices such as packer-to-packer sales of cattle that enable packers to acquire cattle from a seller with a disincentive to receive an above-average price (a packer has no incentive to sell cattle for a price above what the packer wants to pay when purchasing cattle for the packer's own plant) and the practice where two or more packers rely on a single buyer to purchase the supply needs of each plant – a practice that is known to have eliminated competition for cows and bulls procured by cow/bull packers.

PART II
Responses to False Claims Regarding the Proposed GIPSA Rule

- *False Claim: The proposed rule would put an end to alternative marketing arrangements.*

The proposed GIPSA rule (proposed rule) will *not* cause packers to abandon alternative marketing arrangements that enable them to vertically coordinate the supply chain to produce higher value beef. Packers claim these vertically coordinated programs are highly profitable, returning greater profits to them and to cattle feeders. It is incomprehensible that packers would give up these profitable programs simply because GIPSA will require them to maintain documentation to justify these programs. Packers already have this documentation – otherwise, they would not know if the programs are, in fact, returning profits to them.

- *False Claim: The proposed rule will result in disclosure of confidential information.*

The proposed rule will *not* result in the disclosure of confidential information contained in marketing arrangements as it only requires packers to provide GIPSA with *sample* contracts, not completed contracts.

- *False Claim: The proposed rule will open the door for frivolous lawsuits against packers.*

The proposed rule will *not* create a boon for trial lawyers *unless* the packers choose to engage in unlawful practices that are prohibited under the PSA and that harm U.S. cattle feeders, either collectively or individually. Litigation likely will be reduced due to the proposed rule's clarification of packer responsibilities.

The PSA would remain meaningless if individual producers could not stop a packer from engaging in an unlawful practice that could financially ruin the producer unless the producer could first prove the unlawful practice harmed the entire industry (harm to competition). For example, it would be impossible for a producer to show harm to competition if packers were to retaliate against him/her by refusing to buy his/her cattle or by unduly discounting the producer's cattle. Obviously this would be an isolated action targeted at only one producer and harm to competition could not me shown. The proposed rule ensures that individual producers can seek protection under the PSA if they are individually targeted by one or more packers. It is obvious why the packers do not want this provision.

- *False Claim: The proposed rule would make GIPSA the final decision-maker regarding the appropriate price for cattle.*

Neither the PSA nor the proposed rule authorizes GIPSA to establish cattle prices. Instead, GIPSA is authorized to determine if an unfair, unjustly discriminatory, or deceptive practice, or if an undue preference or advantage, was used to manipulate the price a producer receives below a competitive price. Thus, GIPSA is authorized to prevent anticompetitive behavior that adversely affects cattle prices. To determine if such behavior has occurred, GIPSA must have the documentation – the records, reasons and justifications – surrounding a cattle sales transaction. Without such documentation, there would be no way to determine whether the packer did or did not engage in unlawful behavior.

- *False Claim: The proposed rule would dictate how a cattle feeder markets his/her cattle.*

The proposed rule does not require, recommend, prohibit, or approve any particular marketing option for cattle producers. Instead, it requires packers to maintain documentation (justifications, reasons and records) to ensure that, in the event of a complaint, the price, terms, and conditions for the sale of cattle procured by the packer under *any* marketing option were not influenced by the unlawful behaviors enumerated in the PSA.

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- *False Claim: The proposed rule harms cow/calf producers because cattle feeders would not be able to pay a premium for superior genetic traits.*

Not only does the proposed rule not prohibit premiums for superior genetic traits (or discounts for inferior traits), it expressly recognizes the appropriateness of premiums and discounts with which to reward or penalize cattle producers. It requires packers to provide reasons and substantiate the revenue and cost justifications associated with premiums and discounts. Packers already do this. For example, when packers sell wholesale beef derived from cattle with premiums, the beef is differentiated – the higher quality wholesale beef commands a higher price and also may be labeled with a branded-program label. This is the type of reasons and justification that would be required. Without such reasons and justification, producers would be wholly dependent on the packers' word regarding the application of either premiums or discounts.

- *False Claim: The proposed rule hurts cow/calf producers by adding uncertainty to the market.*

Just the opposite will occur. The proposed rule provides clarity regarding packer responsibilities, resulting in more certainty regarding the rules packers must follow to comply with the PSA. In addition, the many independent cattle feeders that continue to sell cattle in the cash market and under contract will be better protected against unlawful behavior, and this likely will increase competition for feeder cattle.