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Ag economists: Farm bill amendment raises red flags

WEST LAFAYETTE, Ind. – Farm legislation passed by the U.S. Senate contains an amendment designed to slow the trend toward corporate farming. While intended to protect family farms, the proposal could mean less competition within agriculture and fewer choices for consumers, say Purdue University agricultural economists Ken Foster and Allan Gray.

The amendment within the Senate's 2002 farm bill would prohibit meat packing companies from owning the livestock they process. That provision, and other parts of farm bills approved by the Senate and U.S. House of Representatives, will be considered in a Senate-House conference committee in the coming weeks. The committee is charged with drafting a compromise bill.

"This amendment is driven by the concern of the farm community about the lack of independence of producers in owning the livestock and controlling the management decisions," Foster said. "It goes back to the consolidation of the farming enterprise into larger farms, fewer farms, farms that are more aligned with agribusinesses, and the fear that those agribusinesses are taking advantage of those farms."

The Senate legislation would nationalize a policy that already exists in a handful of Midwest states, Indiana excluded, Gray said. States such as Iowa and Minnesota have adopted anti-corporate farming laws, which ban meat packers from owning livestock.

As written, the Senate amendment breaks up the control some large packers have over nearly the entire livestock production process – known within the industry as "vertical integration." Within the hog, cattle and poultry industries packers often control animal genetics, livestock feeding, transportation, packing plants and product labels. Packers contract with livestock farmers to supply animals raised to the packer's specifications.

The poultry industry is more than 90 percent vertically integrated. About 7 percent of the beef industry and 25 percent of the hog industry is vertically integrated, although a majority of pigs and many cattle are marketed through some form of coordination between the producer and packer.

"We have an industry now where the top four firms in the packing industry slaughter 70 percent or more of the hogs," Foster said. "A big part of this amendment is about access to markets, and the hope that somehow by removing the animals from the ownership of the packers, those packers now will have to bid for those animals on the open market, giving farmers more alternatives and places to sell their animals."

In spite of criticism by some family farm advocates, vertical integration has been good for many livestock producers, Gray said. Farmers are assured more stable prices from packers, regardless of price swings in live animal markets.

"One of the key benefits of vertical integration for a producer is the reduction of risk," Gray said. "A producer doesn't face 9-cent-per-pound hogs like they do in the open marketplace, but he also doesn't get to face 55-cent-per-pound hogs, either. He faces something in the 28- to 30-cent range for the hogs he produces.

"That can be a huge benefit to many producers. Many would prefer a situation where they don't have the large risks they face in the open market system. That set of producers would no longer have that option available to them under this amendment."

Competition is likely to suffer should the packer amendment become law, Foster and Gray said. The poultry industry is exempted under the legislation's terms, leaving the hog and beef industries to operate under a more stringent set of rules.

A less competitive livestock industry could lead to fewer choices for consumers and, subsequently, higher prices.

"Pork and beef will be at a disadvantage competitively in the domestic market relative to poultry," Foster said. "The bottom line is, in an unconstrained industry the system that evolves will be the one that delivers to consumers what they want at the lowest cost. If we ban a particular form of market coordination, then we're probably going to a second-best solution to provide the food that consumers want. It may not provide it as quickly, it may be at a higher cost, or both."

Packers may find a way to circumvent the law even if their ownership of livestock is made illegal. Firms could set up a contract/subcontract purchasing system that operates much like a vertical integration arrangement, while still complying with the letter of the law, Gray said.

"We think a logical reaction from the packers might be to select what we call 'preferred suppliers,' which would be a few very large producers of hogs or cattle," Gray said. "These producers would have a very close relationship with the packer to deliver exactly what the packer was having delivered by his own company. This very large producer would then contract with a group of smaller producers under production-type contracts – similar to the way that it's done now – to assist the larger producer in raising animals to the specifications needed for the plant.

"So what we envision is an industry that looks similar to the way it is now in terms of vertical integration and some of the ownership, except that the packer no longer owns the animals. He simply has a contract with two or three or four major, large suppliers of hogs."

An alternative scenario could develop in which vertically integrated packers would sell the packing plant, with the understanding it would continue to slaughter the firm's animals at a break-even fee, Foster said. Packers with retail brands would continue to market their branded products and treat the packing plant as a fixed-cost intermediary.

Foster and Gray said the Senate amendment could pose other problems, as well, including:

• Interpretation of the word "control" – The legislation uses the word to describe the packer-dominated production system. Because "control" is vaguely defined, it may be left up to a court to decide, Foster said.

• Tracking contaminated meat – With vertical integration severed in the pork and beef industries, it may be more difficult to trace the origin of tainted products back from the grocery store through the production chain, Gray said. Under a packer-owned livestock system, it is easier to determine where and how animals were raised and slaughtered.

• Loss of exports – As the U.S. livestock industry restructures to comply with the new law, other nations with less regulated livestock industries could try stealing market share. Latin American countries and Australia might make some inroads, with Canada the biggest threat, Foster said.

"That could easily backfire," he said. "If we get our act together in a year or two the window of opportunity for these other nations is going to be closed. Then there's going to be a lot of pork and beef on the market, and prices are going to be really lousy for everybody."

• Shift of livestock production away from regions with limited production to areas with large production – Minus an ownership stake in a portion of the livestock production, packers in regions with limited supplies of live animals may no longer have an economically viable plant, eliminating packing capacity in that region.

"This bill might favor the regions where production is most concentrated, at the expense of less concentrated areas of production," Gray said.

Neither Foster nor Gray believes the Senate proposal would spell the end of the U.S. livestock industry. But it could make life tougher for the very farmers it is supposed to help.

"The major concern that I have is that the implications of a law like this are not clear for anybody, particularly the independent livestock farmer," Gray said.

Gray, Foster and Purdue agricultural economist Michael Boehlje have written an analysis of the Senate amendment. The paper, "Implications of Banning Packer Ownership of Livestock," will appear in an upcoming issue of the Purdue Agricultural Economics Report.

Writer: Steve Leer, (765) 494-8415; sleer@aes.purdue.edu

Sources: Ken Foster, (765) 494-1116; kfoster@purdue.edu

Allan Gray, (765) 494-4323; gray@purdue.edu

Michael Boehlje, (765) 494-4222; boehljem@purdue.edu

Ag Communications: (765) 494-2722; Beth Forbes, bforbes@aes.purdue.edu; http://www.agriculture.purdue.edu/AgComm/public/agnews/

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